

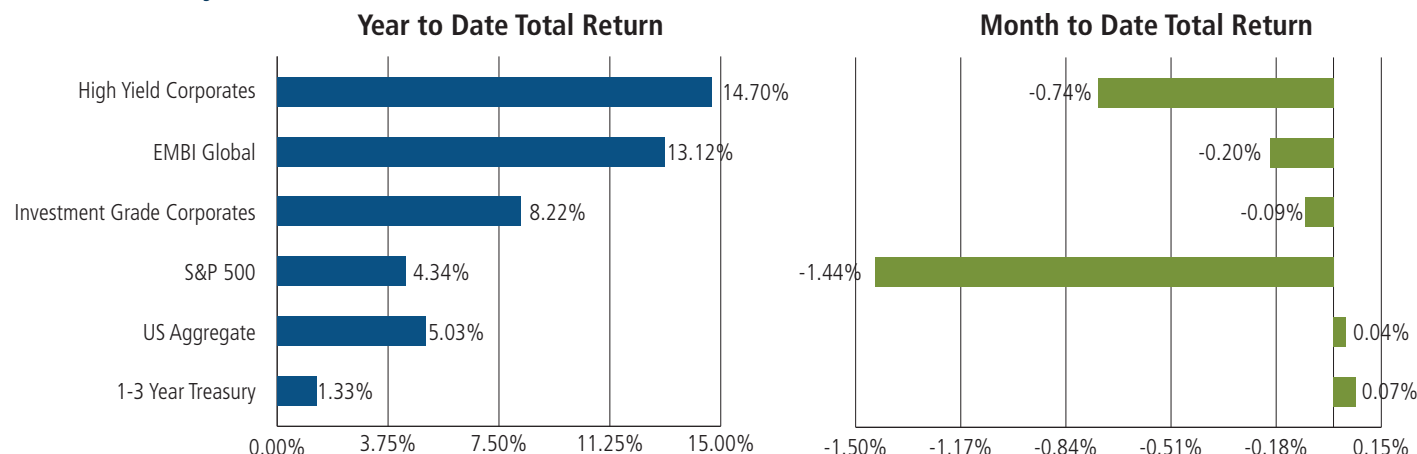
Week Ending November 4, 2016

As the Economic Tide Turns, Will Markets Follow?

Economic Overview:

Distracted by central bank meetings and the impending US elections, many investors have lost sight of trends in global economic activity. In particular, the JPMorgan Global Manufacturing Purchasing Managers' Index (PMI) jumped to 52 in October, the highest reading in exactly two years (>50 = expansion; <50 = contraction). The indicator suggests global manufacturing activity is heating up after several years of cooling. Indeed, the global PMI touched 50 in February 2016—convincing many that a global recession loomed just around the corner (see chart). And with good reason: the oil price shock of 2014-2015 took a bite out of global activity. Not only that, the global slowdown cast shadows over corporate earnings, dragged down inflation and weighed on global interest rates. As the tide turns, will markets follow?

Total Returns by Asset Class



Highlights of the Week:

- **Equities:** Election-induced negative market sentiment drove the S&P 500 index to its longest daily losing streak (8 days) since the financial crisis. Investors have been risk averse in light of the macro uncertainties, ignoring the first positive quarterly earnings growth in seven quarters.
- **Corporates:** Corporate fund flows had a \$2 billion outflow from mutual funds and ETFs while spreads widened 3 basis points on the week to an OAS of +135. The pharmaceutical sector widened the most after news came out of a criminal investigation into suspected price collusion, spreads were 20-30 wider.
- **Securitized Product:** Agency mortgages lagged US Treasuries on an uptick in volatility as the market grappled with a ho-hum employment report, shifting monetary policy signals, and Presidential election jitters. In other structured product markets, the highlight of the week's deal flow was the \$1 billion refinance of the Cosmopolitan Hotel in Las Vegas by Blackstone Real Estate Partners (the AAA-rated bonds cleared at 1-month LIBOR + 140 basis points with strong demand).
- **High Yield:** As the probability of a Trump presidency has increased, risk market volatility has increased as well. In high yield, spreads have widened and outflows have accelerated. However, despite short-term volatility, the economic fundamentals that drive capital markets' performance remain solid.
- **Emerging Markets:** Egyptian authorities announced that they would let the Egyptian pound float and simultaneously tightened their monetary policy rate by three hundred basis points. The move was followed by a ~45% depreciation of the currency. With this move, Egypt joins a handful of emerging market central banks in countries such as Argentina, Azerbaijan, and Kazakhstan that have moved away from defending overvalued exchange rates in the last two years.
- **Municipals:** Municipal issuance in October totaled approximately \$53 billion, the largest total in 30 years and up 57% year-over-year. Despite elevated supply and yields drifting higher across the curve, demand remained robust and municipal funds received approximately \$1.7 billion of inflows during the month. VRDN inventories remained at depressed levels despite another aggressive decline in the SIFMA index, with the benchmark rate down another 7 basis points week-over-week to 0.56%.
- **Currencies:** A combination of factors helped lift the sterling off its multi-year lows and gain 2.3% this week. First came the decision of the High Court that the UK Government cannot start the process to leave the EU without the prior approval of Parliament, followed by the unanimous decision of the Bank of England to keep interest rates unchanged and, to top it all, a record upward revision to the growth forecast for 2017.