Payden&Rygel Investment Management

WEEKLY MARKET UPDATE

August 5, 2016

MARKET LEVELS

	Friday*	Last week	Dec. 31, 2015	One year ago
Dow Jones Industrial Avg	18,489	18,432	17,425	17,420
S&P 500	2,179	2,174	2,044	2,084
NASDAQ	5,217	5,162	5,007	5,056
Russell 2000	1,227	1,220	1,136	1,216
DJ STOXX Europe 600 (€)	341	342	366	401
Nikkei Index (¥)	16,254	16,569	19,034	20,664
MSCI EM Index	444	443	411	436
Fed Funds Target	0.25%-0.50%	0.25%-0.50%	0.25%-0.50%	0.00%-0.25%
2-Year Treasury Yield	0.71%	0.66%	1.05%	0.70%
10-Year Treasury Yield	1.56%	1.45%	2.27%	2.22%
U.S. $ / Euro	1.11	1.12	1.09	1.09
U.S. $ / British Pound	1.31	1.32	1.47	1.55
Yen / U.S. $	101.85	102.06	120.22	124.74
Gold ($/oz)	$1,339.13	$1,351.00	$1,061.42	$1,089.55
Oil	$41.83	$41.60	$37.04	$44.66

**Levels reported as of 7:35 a.m. PDT*

MARKET RETURNS

Year-to-date (12/31/15 – 08/05/16)*		Year-to-date (12/31/15 – 08/04/16)	
Dow Jones Indus Avg.	7.75%	**90 Day T-Bill**	0.19%
S&P 500	8.00%	**2-Year Treasury**	1.29%
NASDAQ	5.04%	**10-Year Treasury**	8.02%
Russell 2000	8.98%	**ML High Yield Index**	12.19%
MSCI World Index	2.70%	**JPM EMBI Global Diversified**	12.67%
DJ STOXX Europe 600	-4.03%	**JPM Global Hedged**	6.97%
MSCI EM Index	7.95%		

**Returns reported as of 7:35 a.m. PDT*

RECAP OF THE WEEK'S ECONOMIC RELEASES

Date	Report	Survey	Actual	Prior	Details
08/02	(US) PCE Core YoY	1.60%	1.60%	1.60%	US Core PCE inflation came in at 1.6% for the 6th month in a row.
08/04	(UK) Bank of England Bank Rate	0.25%	0.25%	0.50%	The Bank of England cut its policy rate to the lowest level since it was founded.
08/05	(US) Change in Nonfarm Payrolls	180k	255k	287k	Monthly US job growth beat expectations for the second month in a row.

ECONOMIC OVERVIEW

Prompted by fears of a Brexit-related slowdown in economic growth, the Old Lady of Threadneedle Street announced a slew of policy measures. The policy rate was cut to its lowest level since the Bank was founded in 1694, asset purchases were expanded (both in scope—to include corporates—and scale), and a new version of cheap bank funding for productive lending made a debut. Issuance of new bank reserves will be used to finance the stimulus measures, which means the BoE joins the ranks of other global central banks that are expanding their balance sheets. But will balance sheet bloat prevail against the BoE's concerns? Recent history of central bank balance sheet expansion suggests otherwise. Central banks have affected bond yields by removing high-grade bonds from circulation but have had little impact on macroeconomic goals. We have little faith the BoE's efforts will be any different.

US MARKETS:

TREASURIES

- The Treasury market has been in flux the past few weeks with conflicting signals from abroad and the domestic economy. The weak Q2 GDP last Friday got the Treasury rally started and picked up steam on strong month-end buying from overseas. To start the week, Japanese Government Bond yields spiked on a disappointing outcome from the Bank of Japan stimulus plan which was the worst 3-session selloff since 2003.

- This moved Treasury yields higher and the curve steeper as there has been motivated sellers in the long-end as positioning remained stretched to the long side. The almost $20 billion Microsoft deal with large back-end tranches hit the market lower and steeper as it felt like investors were full on duration after month-end. The Bank of England over delivered using more bullets than the market had expected which had Gilts surging and taking German bunds and Treasuries along for the ride but was short lived as payrolls in the US were much stronger than forecasted. Despite the cheapening of the front end of the curve, there was better buying reported out the curve. It seems almost too common that a strong non-farm payroll number is quickly dismissed and any weakness is quickly bought. Historic global central bank policy will dominate macro markets more than the domestic economy for the foreseeable future.

LARGE-CAP EQUITIES

- The U.S. Equity Market rallied into the end of the week, posting its fifth weekly gain in the last six weeks. Broad equities (S&P 500) had largely traded sideways over the last 10 trading sessions due to seasonal low market attendance and investors' lack of a directional bias.

- However, the strong U.S. jobs report provided the market with a much needed spark, which helped the S&P 500 break out of its narrow price range and make a new record high. The S&P 500 and Dow Jones Industrial Average indices both ended the week up approximately +0.4%, while the NASDAQ Composite jumped

+1.2%. The higher beta small-cap stocks outperformed large-cap stocks. In terms of style, large-cap growth stocks outperformed large-cap value stocks. The best performing sectors were info tech and financials, while the worst performing sectors were utilities and telecom.

CORPORATE BONDS

- August opened with a significant new issue calendar - notable for a summer month - with just over $42 billion as of Friday. This surpassed expectations of $30-$35 billion for the week. The bulk of issuance was brought on Monday by Microsoft, funding their acquisition of LinkedIn. The AAA rated company issued nearly $20 billion in new bonds, ranging from 3 to 40 year maturities. One interesting note was the pricing of the deal versus other new issues during the week. The Microsoft 10-year bond priced at a spread of 90 basis points above Treasuries; in comparison, Google's 10-year issue the next day priced at 68 basis points despite being a slightly lower rated company (Aa2/AA).

- In corporate news, European banks started the month of August back in a quagmire of woes and were weighed down by negative interest rates, non-performing loans in the Italian banking system, and poor results out of one of Germany's biggest banks. Earnings season is drawing to a close, with nearly 80% of S&P results reported as of Wednesday. The Corporate Index Option-Adjusted Spread (OAS) finished the week at +146, three wider on the week. Overall metals/mining were three tighter and energy was 18 wider as oil prices fell below $40 per barrel midweek. Senior financials were three wider and subordinated financials were six wider. Industrials were six wider and utilities were wider by three.

MORTGAGE-BACKED SECURITIES

- The Agency mortgage market had a nice summer week. The sector outperformed equivalent Treasuries as interest rates rose due to a robust labor market report that increases the likelihood of the Fed raising rates, maybe as early as September.

- The particular strength in the mortgage sector has to do with the current level of mortgage rates which currently sits at about 3.5% for 30-year fixed rates. If mortgage rates were to continue lower an onslaught of supply could come into the marketplace as borrowers seeks to refinance mortgages made at higher rates over the last 1 to 2 years. The strong labor report pushes mortgage rates higher and relieves the anxiety over future supply fears. Within the mortgage sector, 15-year mortgages and higher coupon 30-year mortgages outperformed lower coupons which is not surprising given the move to higher interest rates. In other news, mortgage prepayment data was released to little fanfare. The report reflected slightly slower prepayments, which was good, but mostly due to the number of days in the reporting period rather than any other influences. Next month's prepayment data is the one to watch as prepayments are expected to increase substantially.

ASSET-BACKED SECURITIES

- The yield grab continues as the third heavy week of new issuance was easily absorbed by the marketplace. Commentary from Wells Fargo's ABS desk said, "Spreads in our market continue to rally as investors snap up paper across the board, with significant strength in benchmark auto and card names." This is not an isolated event as the BAML ABS index posted very similar returns to the BAML 1-3 year corporate AAA-A index for July.

- CLOs had an even more impressive July led from the bottom of the credit stack. The JP Morgan CLOIE BB index returned a blistering 10.61% for July. BBBs were impressive at 4.59%, while AAAs were a more modest 0.72%. Speaking with Deutsche Bank's CLO analyst this week, we agree that the AA/A segment of the CLO market are the richest part of the credit stack in CLOs.

MUNICIPAL BONDS

- The market has absorbed much of the heavy $12.5 billion calendar, though we've seen rates and spreads pressured modestly wider. We've seen front end rates perform well on a relative basis though SIFMA remains higher on supply pressures. Despite continued demand from both mutual funds and crossover buyers in long maturities, we've seen the 30-year ratio inch higher over that last few weeks closer to what we consider fair value.

- The market continues to be supported by strong technicals as demand remains strong and both primary and secondary supply remains manageable. Per Bloomberg's MBWDPAR index, which measures the total par amount of bonds out for the bid on the MBWD system, we saw just $382 million par amount out for the bid last week. Up until the end of June, the 20-day average was in the mid-to-upper $500 million range. We expect demand to remain strong enough to withstand heavy supply weeks such as these and continue to keep relative value ratios range bound.

HIGH-YIELD BONDS

- The BofA Merrill Lynch BB/B cash pay constrained index was up +0.22% this week as spreads widened by two basis points to an option-adjusted-spread of +447 basis points. The BofA Merrill Lynch BB/B index that excludes utilities and energy was up +0.23% for an OAS of +424 as the spread of that index also widened by two basis points. The BofA Merrill Lynch Euro BB/B constrained index was up +0.16% and the spread of that index tightened by four basis points this week, resulting in an OAS of +377.

- The price of crude oil fell below $40 week before recovering to around ~$41.50 on Friday, about where it traded at the end of last week. Spreads of high yield Energy bonds are slightly wider, but prices have traded down at a much slower rate than earlier this year. Nonetheless, Energy companies like California Resources, Diamond Offshore, and Murphy Oil are among the worst performers this week. The Healthcare sector has shown signs of weakness as well as Valeant Pharmaceuticals' securities remain volatile and Health Facilities have generally reported disappointing earnings this quarter.

- Outflows for the week are an estimated $2.5 billion as fund flows have begun to unwind the massive inflows (+$6.3 billion) into bond funds in July. Secondary volumes were generally in line with the YTD average yesterday as $12.6 billion traded on Thursday versus a year-to-date average of $12.7 billion. Secondary activity this week was generally higher which can in part be attributed to the increase in new issue activity.

- $6.4 billion across ten issues has priced so far this week. Eight out of ten of this week's issuers are accessing the market to refinance outstanding debt as companies take advantage of solid technicals amid strong demand for new issue, even from lower quality issuers. Foundation Building Materials, a split-rated Caa1/B+ issuer, priced $575 million of 8.25% coupon bonds on Tuesday that traded well on the break; the bonds tightened 100 basis and are now offered at a 7.2% yield.

INTERNATIONAL MARKETS:

GLOBAL BONDS AND CURRENCIES

- Global market sentiment was mostly cautious in the beginning of this week as investors digested the results of the European banking sector stress test, a renewed weakness in oil prices and the general uncertainty about the outlook for monetary policy globally. Concerns about the health of the financial institutions in select European countries weighed on risk appetite but this trend was partially offset later in the week by some better than anticipated earnings results in the sector. The week concluded with a stronger than expected US jobs report on Friday, which resulted in most core government bonds selling off across the board.

- In Europe, German bund yields followed the US Treasury market closely and finished the week 3 basis points wider on the back of the improvement in risk appetite towards the end of the week. UK Gilt markets outperformed after the Bank of England cut interest rates by 25 basis points to 0.25% on Thursday. Additionally, the central bank pledged £70 billion in monetary stimulus as part of a new bond-buying program which would include both government and corporate bonds. The UK Gilt curve flattened as a result, particularly in the longer end, and the benchmark 10-year Gilt yield was 6 basis points lower on the week. Japanese government bonds, on the other hand, sold off after the uncertainty around the Bank of Japan’s stance on further monetary easing led many to believe that the central bank may soon end its negative interest rate policy.

- In the currency markets, sterling sold off notably against most major currencies after Thursday's easing move by the Bank of England. The US dollar bounced back from its previous lows against the euro supported by the better than expected non-farm payroll report on Friday. The Japanese yen managed to rise against the greenback this week supported by rising real yields in Japan. The Australian dollar was firmer against the US Dollar despite the RBA cutting interest rates to a record low of 1.5% on Monday.

EMERGING-MARKET BONDS

- Emerging market (EM) dollar-pay spreads narrowed four basis points (bps) to 361 bps over US Treasuries, while local debt yields declined by four bps to 6.24%. EM currencies broadly appreciated against the US dollar, led by the South African rand (3.2%), Brazilian real (+3.1%) and Polish zloty (+2.2%).

- Purchasing Managers Index (PMI) data for July was released in several countries. The closely watched manufacturing PMI in China showed mixed results, with official statistics showing a slight decline to 49.9, while the Caixin print improved to 50.6. Other manufacturing PMI readings softened, including in Mexico, Russia, Poland and Indonesia. However, several PMI readings that incorporate non-manufacturing sectors showed improvement, including in Brazil and India.

- India's upper house of parliament passed the long-awaited Goods and Services Tax (GST) Amendment Bill. Approval of the GST legislation has been watched by markets as a signal of President Modi's ongoing structural reform efforts. The bill seeks to unify India's fragmented tax structure, with the goal of lowering costs and improving tax efficiency.

- In Poland, a closely watched plan to convert mortgages originally taken out in Swiss francs back to Polish zloty was announced. The proposal appeared that it would create less of a burden for the banking sector than markets expected, supporting Polish assets early in the week.

- Indonesia reported second quarter GDP growth of 5.2% year-over-year (y/y), beating expectations and up from 4.9% y/y in the first quarter. Solid private consumption and rising government spending drove the improvement.

- Monetary authorities in Thailand held the policy rate at 1.5%, but stated their concern that the strength of the Thai baht was creating a growth headwind. The National Bank of Romania maintained the key rate at an historic low of 1.75%, noting that the path of inflation was undershooting prior expectations.

HIGHLIGHTS OF NEXT WEEK'S ECONOMIC RELEASES

Date	Report	Consensus	Last
08/08	(GE) Industrial Production WDA YoY	0.50%	-0.40%
	(JN) Money Stock M3 YoY	2.90%	2.90%
08/09	(UK) Industrial Production YoY	1.60%	1.40%
	(UK) Manufacturing Production YoY	1.30%	1.70%
	(US) NFIB Small Business Optimism	94.5	94.5
	(CA) Housing Starts	195.0k	218.3k
	(US) Nonfarm Productivity	0.50%	-0.60%
	(US) Wholesale Inventories MoM	0.00%	0.10%
08/10	(US) JOLTS Job Openings	--	5500
08/11	(CA) New Housing Price Index YoY	--	2.70%

08/12	(EC) Industrial Production WDA YoY	0.70%	0.50%
	(EC) GDP SA QoQ	0.30%	0.30%
	(EC) GDP SA YoY	1.60%	1.60%
	(US) Retail Sales Advance MoM	0.40%	0.60%
	(US) PPI Final Demand MoM	0.10%	0.50%
	(US) PPI Ex Food and Energy MoM	0.20%	0.40%
	(US) U. of Mich. Sentiment	91.5	90