Payden&Rygel Investment Management WEEKLY MARKET UPDATE

August 19, 2016

MARKET LEVELS

	Friday*	Last week	Dec. 31, 2015	One year ago
Dow Jones Industrial Avg	18,564	18,576	17,425	16,991
S&P 500	2,178	2,184	2,044	2,036
NASDAQ	5,243	5,233	5,007	4,877
Russell 2000	1,234	1,230	1,136	1,173
DJ STOXX Europe 600 (€)	339	346	366	373
Nikkei Index (¥)	16,546	16,920	19,034	20,034
MSCI EM Index	460	457	411	415
Fed Funds Target	0.25%-0.50%	0.25%-0.50%	0.25%-0.50%	0.00%-0.25%
2-Year Treasury Yield	0.74%	0.71%	1.05%	0.66%
10-Year Treasury Yield	1.58%	1.51%	2.27%	2.07%
U.S. $ / Euro	1.13	1.12	1.09	1.12
U.S. $ / British Pound	1.31	1.29	1.47	1.57
Yen / U.S. $	100.28	101.30	120.22	123.40
Gold ($/oz)	$1,345.52	$1,335.85	$1,061.42	$1,152.18
Oil	$48.44	$44.49	$37.04	$41.14

**Levels reported as of 7:32 a.m. PDT*

MARKET RETURNS

Year-to-date (12/31/15 – 08/19/16)*		Year-to-date (12/31/15 – 08/18/16)	
Dow Jones Indus Avg.	8.52%	90 Day T-Bill	0.20%
S&P 500	8.08%	2-Year Treasury	1.20%
NASDAQ	5.65%	10-Year Treasury	7.62%
Russell 2000	9.66%	ML High Yield Index	14.04%
MSCI World Index	4.45%	JPM EMBI Global Diversified	13.37%
DJ STOXX Europe 600	-4.41%	JPM Global Hedged	7.11%
MSCI EM Index	11.95%		

**Returns reported as of 7:32 a.m. PDT*

RECAP OF THE WEEK'S ECONOMIC RELEASES

Date	Report	Survey	Actual	Prior	Details
08/16	(UK) CPI Core YoY	1.40%	1.30%	1.40%	UK core inflation inched lower and has been below the 2% target since June 2014.
	(US) CPI Ex Food and Energy YoY	2.30%	2.20%	2.30%	US core inflation was above 2% for the 8th consecutive month.

ECONOMIC OVERVIEW

From mid-2014 until a few weeks ago, falling oil prices loomed over the economy and markets. Everything from corporate earnings to retail sales to inflation and industrial production have been affected by the continuous decline in the price of crude oil. For the first time in two years, in August, the year-over-year percentage change in oil prices turned positive. What will the implications be? We expect a reversal in some of the weakness in the inflation and production data will follow as the second half of the year unfolds.

US MARKETS:

TREASURIES

- Despite strong non-farm payrolls, soft retail sales and CPI, and exceptional quantitative easing overseas, the 10-year Treasury yield stayed in a 1.50% handle the entire month of August (daily close). The July FOMC minutes out this week were less hawkish than the market expected especially after the comments from the Fed's Dudley that a September rate hike is a real possibility.

- The market doesn't seem to believe the Fed "crying wolf" narrative as the dollar took a hit and the front-end of the curve was bought after the minutes were released. Meanwhile the implied probability of a 2016 rate hike is no better than a coin flip. The TIPS market recovered late in the week after a soft July CPI print as the 5-year auction stopped 1.1 basis points through on the strength in crude oil. Conviction remains low and moves within the range feel futures led as flows in cash Treasuries remain suppressed.

LARGE-CAP EQUITIES

- The U.S. Equity Market ended unchanged in another quiet summer week. The path of least resistance appears to be higher as broad equities made a new record high on Monday. However, the price action was muted as hawkish comments from Fed members, which brought some profit-taking leading up to the Fed minutes, were offset with the lower-for-longer tone in the Fed's minutes.

- All major U.S. equity indices (S&P 500, Dow Jones Industrial Average, NASDAQ Composite) finished the week little changed. The higher-beta small-cap stocks outperformed large-cap stocks. In terms of style, large-cap value stocks outperformed large-cap growth stocks. The best performing sectors were energy and materials, which was supported by the further bounce in oil prices, while the worst performing sectors were telecom and utilities.

CORPORATE BONDS

- The third week of August finally slowed after a busy start to the month, with just $7.4 billion in issuance versus an expected $5-$10 billion. Already, this month has topped every August looking over a 15 year period with $85 billion total issued. One notable deal was issued by Standard Chartered PLC on Tuesday. They issued a three tranche $3 billion deal, which was more than seven times subscribed in the 10-year tier 2 tranche. Despite the heavy demand, the 10 year was the only tranche to not tighten on the break.

- Although the market was generally quiet, a few corporate events stood out. One was in health insurance, when Aetna stepped out of several states' healthcare exchanges. This makes it the third large insurance company to do so. Cisco also made headlines for cutting 5,500 jobs, although it was less than rumored just prior to the announcement. The Corporate Index Option-Adjusted Spread (OAS) finished the week at +138, five tighter on the week. Overall metals/mining were eight tighter and energy was six tighter. Senior financials were four tighter and subordinated financials were six tighter. Industrials were three tighter and utilities were tighter by four.

MORTGAGE-BACKED SECURITIES

- Slow and steady win the race as agency mortgages outperformed US Treasuries on a little rate movement. The micro trading range held with pass-through spreads compressing by one-to-three basis points on very low volume. Demand from Asian accounts was just enough to trump mortgage origination.

- Despite refinance activity drifting lower, prepayment risk remains on investor minds as next month's release will represent the peak experience for the cycle. With the market calm, investors are looking under rocks for value by finding specified pool stories, low loan balance and New York originated loans that should mitigate the refinance response. Within the market, higher coupons bested lower coupons on a duration-adjusted basis. Higher coupons were undervalued after lagging the rest of the coupon stack in June and July. Japanese buying of Ginnie Maes offered support for that product relative to conventionals. In other markets, commercial MBS spreads held steady with no new supply. The benchmark AAA non-agency CMBS trades at 90 basis points over the 10-year US Treasury.

- For the week, the 30-year current coupon versus the 10-year US Treasury held steady at 80 basis points. According to Freddie Mac, the 30-year mortgage rate edged lower to 3.43%.

ASSET-BACKED SECURITIES

- The S&P/Experian consumer default index was released this week and it continues to show lower overall defaults on a year-over-year basis. First lien mortgages are leading the way, but the best of times are likely in the rear view mirror for auto loans and credit cards as 2016 defaults are now slightly higher on a year-over-year basis compared to the 2015 lows.

- The new issue market was very quiet in ABS with Capital One being the lone issuer. The CLO market was more active with GSO/Blackstone bringing and upsizing their Jay Park CLO. Carlyle did a reset of their CGMS 2012-3 CLO. Back in 2012, the CLO market was just starting to recover from the crisis, and the reset margins were quite steep. The AA-rated class for example, carried a 3-month LIBOR+225 reset margin. After this reset, the same class will carry a 3-month LIBOR+185 reset margin. Resetting is a popular option since calling a deal and remarketing a new one can be economically costly and time consuming.

MUNICIPAL BONDS

- This week we saw another paltry week of issuance of $5 billion; well below the weekly average of $8.5 billion for the year. The light calendar combined with a likely 45th consecutive week of inflows for municipal bond funds provided a strong technical backdrop to support the market. The largest deal for the week was the Baa3 rated $480 million Brooklyn Arena (Barclays Center) refunding deal that was extremely well received as investors continue to reach for yield in lower rated issuers. The deal tightened dramatically in the secondary following the issuance.

- True to its general nature, municipal volatility remains low as Treasury rates continue to bounce around in a stable range. Modest underperformance for municipal bonds when Treasuries rally turns to modest outperformance as Treasuries reverse course. "Steady as she goes" seems like an appropriate characterization of the market as we continue to grind along in a narrow range. With demand emerging from non-traditional buyers, we don't anticipate this to change in the near term.

HIGH-YIELD BONDS

- The BofA Merrill Lynch BB/B cash pay constrained index was up +0.45% this week as spreads tightened by 14 basis points to an option-adjusted-spread of +405 basis points. The BofA Merrill Lynch BB/B index that excludes utilities and energy was up +0.38% for an OAS of +386 as the spread of that index tightened by 12 basis points. The BofA Merrill Lynch Euro BB/B constrained index was up +0.17% as the spread of that index tightened by six basis points for an OAS of +354.

- High-yield credit was firm this week as the market easily absorbed the relatively heavy new issue calendar for the month of August thus far. Fund flows were positive again this week as $889 million came into the asset class which follows an inflow of $1.65 billion last week. The fresh cash fueled the need for accounts to spend down growing cash balances and helped stoke demand for new issuance. Expectations are for the pace of issuance to slow dramatically as the traditional end of summer slowdown begins to take hold next week and activity will be muted until after the Labor Day weekend.

- Almost $19 billion has priced so far this month as compared to full month's totals of $10.8 billion in August 2015 and $4.9 billion in August 2014. The majority of the deals saw the usual dynamics of a strong credit markets with orders books being multiple-times over-subscribed and final pricing at or through the tight end of original price guidance. The bulk of this week's new issue activity took place in the early part of the week as the expected slowdown in issuance began to take effect.

- Over $5.5 billion in new issue priced this week across a dozen tranches with the largest single tranche being issued by Novelis Corp. The subsidiary of India-based Hindalco Industries LTD which manufactures aluminum sheet and foil products brought an upsized $1.15 billion B2/B rated eight-year note at a spread of 479 basis points over treasuries to yield 6.25%. The final order book was well over $6 billion and final pricing was 50 basis points tighter than the wide range of initial price talk. The new notes rallied over two points when freed to trade and tightened by forty basis points for a yield for a yield of 5.85%

INTERNATIONAL MARKETS:

GLOBAL BONDS AND CURRENCIES

- In another week that was light on data and policy announcements, markets continued to focus on the potential timing of the next hike in US interest rates. Market sentiment was generally mixed, with some investors pushing back their expectations on the back of the dovish tone of the latest policy meeting minutes, while others focused on the more bullish comments of various Federal Reserve officials. Oil prices fluctuated with the movements in the US dollar and eventually global government bonds finished the week with very little change.

- In Europe, 10-year German bund yields moved largely in line with the US Treasury market and finished the week a mere basis point higher as investors struggled to identify a clear trend. In the UK, a string of stronger than expected economic data, including retail sales and employment numbers, undermined demand for safe-haven assets. As a result, Gilts sold off with the yield on the 10-year benchmark note rising by 6 basis points, while longer-dated Gilts also came under pressure. In Europe's periphery, Portuguese government bonds sold off noticeably amid speculation about a potential credit rating downgrade; the yield on the 10-year note climbed by 36 basis points by Friday.

- In the currency markets, the euro continued to rise against the greenback, supported by the dovish tone of the latest Fed minutes. The Japanese yen also benefitted from the recent US dollar weakness and firmed up on the week. The positive economic data in the UK provided some relief for the UK pound, which gained some ground against the US dollar.

EMERGING-MARKET BONDS

- Emerging market (EM) dollar-pay spreads tightened five basis points (bps) to 335 bps over US Treasuries, while local debt yields declined by two bps to 6.14%. EM currencies were mixed on the week, with the Colombian peso (+2.7%) and the Russian ruble (1.4%) exhibiting the strongest performance. The Chilean peso (-1.7%) and the Argentine peso (-1.3%) underperformed.

- In Zambia, the results of the closely-contested presidential elections were released, with incumbent, President Lungu, winning a second term. In light of Lungu's narrow margin of victory and opposition challenges, the results are being reviewed by Zambia's constitutional court. Separately, in the Dominican Republic, President Medina was inaugurated to a second term. Medina won reelection in a landslide election (62% of the vote) in May 2016 and has stated that he plans to deepen electricity and fiscal reforms.

- Emerging markets continued to release second quarter GDP data. In the Philippines, economic activity expanded by a robust 7% y/y, driven by a strong outturn in services (+8.4% y/y). Elsewhere in Asia, Thailand’s Q2-16 growth (+3.5% y/y) came in slightly better than expectations. In Israel, Q2-16 growth surprised to the upside, accelerating to 2.6% y/y. Economic activity was supported by buoyant private consumption (+6.7% y/y). Last, in Chile, Q2-16 GDP came in above consensus but remained tepid. Growth increased by 1.5% y/y but posted a modest contraction on a sequential basis (-1.4 quarter-over-quarter saar). The manufacturing and mining sectors lagged over the period.

- Turing to monetary policy, Bank Indonesia (BOI) altered its monetary policy framework. It is now using the seven day reverse repo rate, at 5.25%, as its policy rate. BOI also reduced its interest rate corridor to 75 bps above and below its policy rate, from 175 bps above and 75 bps below. The Bank of Mongolia raised its policy rate 450 bps, to 15%, in a bid to defend the currency after concerns about the country’s external liquidity position triggered outflows.

- In ratings news, Moody’s downgraded Mongolia from ‘B1’ to ‘B2.’ It left the sovereign on negative outlook in the context of poor external liquidity, aggressive fiscal expenditure, and loose monetary policy. El Salvador was also downgraded by Moody's to 'B1' from 'Ba3,' and remained on negative outlook. Moody's cited a deterioration in the country's debt profile along with liquidity concerns linked to the government's inability to reach an agreement with Congress allowing for international issuance.

HIGHLIGHTS OF NEXT WEEK'S ECONOMIC RELEASES

Date	Report	Consensus	Last
08/23	(US) Markit US Manufacturing PMI	52.6	52.9
	(EC) Consumer Confidence	-7.7	-7.9
	(US) New Home Sales	580k	592k
08/24	(GE) Exports QoQ	0.70%	1.00%
	(US) Existing Home Sales	5.53m	5.57m
08/25	(US) Durable Goods Orders	3.50%	-3.90%
	(US) Initial Jobless Claims	265k	262k
	(US) Markit US Composite PMI	--	51.8
	(US) Kansas City Fed Manf. Activity	-2	-6
	(JN) Natl CPI YoY	-0.40%	-0.40%
	(CA) CFIB Business Barometer	--	57.6
08/26	(JN) Natl CPI Ex Fresh Food, Energy YoY	0.60%	0.70%
	(EC) M3 Money Supply YoY	5.00%	5.00%
	(UK) GDP QoQ	0.60%	0.60%

	(UK) GDP YoY	2.20%	2.20%
	(US) Personal Consumption	4.20%	4.20%
	(US) GDP Price Index	2.20%	2.20%
	(US) U. of Mich. Sentiment	90.6	90.4