

August 26, 2016

MARKET LEVELS

	Friday*	Last week	Dec. 31, 2015	One year ago
Dow Jones Industrial Avg	18,541	18,553	17,425	16,655
S&P 500	2,184	2,184	2,044	1,988
NASDAQ	5,244	5,238	5,007	4,813
Russell 2000	1,247	1,237	1,136	1,154
DJ STOXX Europe 600 (€)	344	340	366	362
Nikkei Index (¥)	16,361	16,546	19,034	18,574
MSCI EM Index	456	459	411	408
Fed Funds Target	0.25%-0.50%	0.25%-0.50%	0.25%-0.50%	0.00%-0.25%
2-Year Treasury Yield	0.79%	0.75%	1.05%	0.69%
10-Year Treasury Yield	1.54%	1.58%	2.27%	2.19%
U.S. \$ / Euro	1.13	1.13	1.09	1.12
U.S. \$ / British Pound	1.32	1.31	1.47	1.54
Yen / U.S. \$	100.45	100.22	120.22	121.03
Gold (\$/oz)	\$1,333.89	\$1,341.26	\$1,061.42	\$1,124.84
Oil	\$47.44	\$48.52	\$37.04	\$42.56

**Levels reported as of 7:59 a.m. PDT*

MARKET RETURNS

Year-to-date (12/31/15 – 08/26/16)*

Dow Jones Indus Avg.	8.39%
S&P 500	8.41%
NASDAQ	5.69%
Russell 2000	10.83%
MSCI World Index	3.88%
DJ STOXX Europe 600	-3.15%
MSCI EM Index	10.83%

Year-to-date (12/31/15 – 08/25/16)

90 Day T-Bill	0.20%
2-Year Treasury	1.07%
10-Year Treasury	7.29%
ML High Yield Index	14.29%
JPM EMBI Global Diversified	13.37%
JPM Global Hedged	7.08%

**Returns reported as of 7:59 a.m. PDT*

RECAP OF THE WEEK'S ECONOMIC RELEASES

Date	Report	Survey	Actual	Prior	Details
08/26	(UK) GDP YoY	2.20%	2.20%	2.20%	UK Q2 GDP came in strong despite Brexit with household spending providing the largest boost.
	(US) GDP Annualized QoQ	1.10%	1.10%	1.20%	US Q2 GDP was revised down from its previous estimate with low corporate profits but robust consumer spending.

ECONOMIC OVERVIEW

US Federal Reserve Chair, Janet Yellen, kicked off the gathering of central bankers, macroeconomists and academics in Jackson Hole with a wakeup call for the markets. According to Yellen, “continued solid performance” in the labor market and a positive outlook for economic activity and inflation meant that “the case for an increase in the federal funds rate has strengthened in recent months.” Her assessment of the labor market is correct, especially after a stellar July jobs report. If the FOMC does increase the target federal funds rate in September, traders and investors will remember this line from her speech. The rest of the speech focused on the Fed’s tool kit. Yellen reiterated that the tools at the Fed’s disposal (interest on excess reserves, asset purchases and forward guidance) were sufficient to help the economy if we were to face another recession in the near term.

US MARKETS:

TREASURIES

- The Treasury market pretty much ran in place ahead of the Fed Chair’s speech at the Jackson Hole conference. The past 30 days have been the least volatile of any 30 day period in the last 30 years and the 10-year Treasury traded twelve sessions in a row to the 1.56% level.
- This week, supply across 2-year, 5-year and 7-year came and went with little market impact, showing investors had little concern about Yellen on Friday. Friday proved to be a choppy trading session first rallying on a statement that the real neutral rate could be close to zero followed by power flattening of the yield curve on Vice Chair Fischer’s comments about nearing full employment. The market implied probability of a September rate hike ticked up to 38% but remains far from the 60-75% priced in the Fed will most likely need to avoid short term market turmoil. The 3-year Treasury yield moved back to pre-Brexit levels to finish the week but the back end of the curve has a long way to go.

LARGE-CAP EQUITIES

- The U.S. Equity Market ended the week unchanged in another quiet summer week. Trading activity remained light and price volatility was non-existent. In fact, the broad equity market (S&P 500) has not posted a 1% daily price change in the last 35 trading days.
- Generally positive economic data releases and Fed President Yellen’s comments of a strengthening economy at the Jackson Hole symposium provided a boost to stock prices, but the upside was limited. The S&P 500 and Dow Jones Industrial Average indices both closed the week little changed, while the tech-focused NASDAQ Composite added +0.2%. The higher beta small-cap stocks outperformed large-cap stocks. In terms of style, large-cap value stocks outperformed large-growth stocks. The best performing sectors were materials and financials, while the worst performing sectors were health care and consumer staples.

CORPORATE BONDS

- The fourth week of August was slow with just \$6 billion in primary issuance, albeit in line with expectations of \$3-\$8 billion. Already, this month has topped every August looking over a 15-year period with \$92 billion total issued. One notable deal was issued by Bank of Montreal on Wednesday. They issued the biggest deal of the week, with \$3.5 billion across three tranches. Despite the recent dearth of issuance, demand was two times the deal size. Based on this, the bonds priced 10-15 basis points inside of initial price talk, on the low end of average.
- Generally speaking, the market was very quiet. Pfizer made headlines when it bought Medivation for \$14 billion on Monday, and made further acquisitions of a portion of AstraZeneca's drug unit on Wednesday. The Corporate Index Option-Adjusted Spread (OAS) finished the week at +136, three tighter on the week. Overall metals/mining were one tighter and energy was four tighter. Senior financials were four tighter and subordinated financials were six tighter. Industrials were two tighter and utilities were tighter by one.

MORTGAGE-BACKED SECURITIES

- The dog days of summer treated the mortgage market well over the past week. Mortgages typically do well in trading environments where there's not much going on and that characterizes this past week's activity.
- Lower coupon mortgages outperformed higher coupons and GNMA narrowly beat out FN/FH as buying support from overseas continues to support GN's vs FN/FH. 30-year mortgage rates remained steady at 3.5%. In mortgage policy news, the FHFA extended the high LTV refinance policy program, commonly known as HARP. The program was set to expire this December and has been extended to September of 2017. In addition, the FHFA created a new program to take its place in October of 2017. The new program will have little impact on overall mortgage market valuations, however, it provides a loss mitigation outlet for the agencies in the event of a future housing downturn as well as support for borrowers if housing price drop substantially.

ASSET-BACKED SECURITIES

- Put me in Coach, I'm ready to play, today. Look at me, I gotta be center field – John Fogerty – and the dog days of summer are officially here. New issuance is dead and I'm guessing a quarter of market participants are on vacation. Throw in month end, Labor Day, and the ABS East conference September 18-20 and issuance will be choppy at best in the near future. After that, it will be a mad rush to front run year end and regulatory requirements that kick in November.
- It has been a little over a month since the inaugural Verizon smartphone deal priced at swaps+55, and market support continues to be strong. Being 12 times oversubscribed, the deal certainly had investor interest, and secondary trading has brought spreads into the current swaps+36/34 market. Recently speaking with Fitch, the Verizon presale report was the most downloaded in history, and the requests came from 12 different countries. Fortunately for issuers and unfortunately for investors, the new collateral type concession has largely disappeared. After one issuance, smartphones are trading very near to traditional credit cards and autos.

MUNICIPAL BONDS

- Municipal issuance for the week picked up slightly, as close to \$8.5 billion was priced in the market. The calendar was dominated by a large \$1.5 billion State of Massachusetts Revenue Anticipation Note issue. With pricing broken into three competitive \$500 million tranches, the deal initially struggled a bit to find footing before successfully being placed away.
- The poor initial reception reinforces the struggles that ultra-short dated municipals have had as money market reform has driven outflows and SIFMA has inched higher in recent months. The weekly SIFMA index was adjusted another 7 basis points higher this week, to 0.56 from 0.49 the prior week. The recent increase in the SIFMA index has also caused the front end of the municipal yield curve to invert slightly, as bonds in the

1 to 2-year maturity range have traded in-line to slightly below the SIFMA weekly rate. We expect that this inversion could last until tax-exempt money market funds begin to regain traction and rebalance the supply-demand of the "money market" range. We see this as an opportunity to improve structure while enhancing portfolio liquidity and yield through the use of VRDNs.

HIGH-YIELD BONDS

- The BofA Merrill Lynch BB/B cash pay constrained index was up +0.15% this week as spreads ticked tighter by one basis point to an option-adjusted-spread of +399 basis points. The BofA Merrill Lynch BB/B index that excludes utilities and energy was up +0.17% for an OAS of +379 as the spread of that index also tightened by one basis point. The BofA Merrill Lynch Euro BB/B constrained index was up +0.27% as the spread of that index tightened by six basis points for an OAS of +347.
- High-yield credit firmed slightly this week and overall activity was muted as the end of summer slowdown was in full effect. There was no new issuance and secondary trading volumes were lower than average as the pace of inflows waned.
- The new issue forward calendar is currently bare and there are no expectations for any new issuance until after the Labor Day weekend. This month has been relatively robust in terms of new issue volumes with almost \$21 billion pricing. Despite the "Closed for the summer" signs being hung at capital markets departments all along Wall Street, this August has already priced double the full month of August's total in 2015 and four-times the total for August 2014. New issue is still playing catch up after a slow start to this year as just \$198 billion has priced year-to-date versus \$230 billion at this time last year. Total new issue for this year is not expected to reach the \$293 billion total that was achieved in 2015.
- The pace of fund flows has slowed, but remain positive as \$162 million came into the asset class for the reporting week that ended Wednesday. This follows two weeks of inflows that totaled \$2.55 billion. YTD inflows total \$10 billion as compared to an outflow of \$4.2 billion at this point in 2015.

INTERNATIONAL MARKETS:

GLOBAL BONDS AND CURRENCIES

- Global equity and bond markets traded cautiously in seasonally thin markets, as investors waited to see if a highly-anticipated speech from Federal Reserve Chair Janet Yellen at the annual central banker symposium in Jackson Hole contained further clues about the trajectory of US monetary policy. Ms Yellen acknowledged that while growth had not been rapid, it had been "sufficient to generate further improvement in the labor market," where jobs have been added at an average monthly pace of 190,000 over the past three months.
- The data out of Europe was mixed, with European purchasing managers' index (PMI) data improving slightly for the month of August, while the German Ifo business climate index fell. Nevertheless, bond markets saw very little change, and 10-year German bund yields ended almost flat on the week, in line with the US Treasury market. In the UK, despite rising UK consumer confidence, the yield on the 10-year benchmark note declined by about 2 basis points. Peripheral European government bond spreads over Bunds also remained stable on the week.
- In the currency markets, the US dollar had a mixed performance versus most of the major crosses, as Yellen's speech was not hawkish enough to support the currency. The Euro finished the week lower against the greenback, while sterling was supported by signs the British economy is proving resilient in the wake of the Brexit vote. The Japanese yen lost some ground on the week as weaker inflation data underscored the challenges facing the Bank of Japan as it uses unprecedented monetary stimulus to try and revive the economy and generate inflation.

EMERGING-MARKET BONDS

- Emerging market (EM) dollar-pay spreads widened two basis points (bps) to 337 bps over US Treasuries, while local debt yields increased by ten bps to 6.25%. EM currencies were largely weaker against the dollar, led by a sharp depreciation in the South African rand (-3.7%). The Argentine peso (+0.4%) and the South Korean won (+0.4%), were the strongest performers on the week.
- In politics, South African Finance Minister, Pravin Gordham, is being investigated for actions he took when he was head of the country's tax agency. South African assets have sold off, with investors fearing that this is an attempt by President Zuma to sideline Minister Gordham due to political differences. In Colombia, the government and the FARC, a separatist group, announced that they reached a peace agreement. The accord could potentially end a civil conflict that has lasted over 50 years. It is due to be voted upon in a plebiscite on October 2nd.
- In Mexico, second quarter GDP was released, pointing to an expansion of 2.5% y/y. However, on a sequential basis, growth was slightly negative. The supply-side breakdown suggests that growth was concentrated in the tertiary sector (services) while the industrial sector continued to struggle. In Peru, second quarter GDP expanded by 3.7% y/y, supported by strong performance in the mining sector. In the Dominican Republic, the central bank reported that the economy expanded by a robust 8.7% y/y in Q2-16, a pick up from the Q1-16 expansion of 6.1% y/y.
- The Reserve Bank of India (RBI) named a successor, Urijt Patel, to replace outgoing governor Raghuram Rajan. Patel is believed to be a strong replacement, quieting some concerns following Rajan's unexpected decision to step down in September 2016. In Turkey, the central bank kept its benchmark rate unchanged at 7.5% but reduced the ceiling of its interest rate corridor by 25 bps to 8.5%. Elsewhere, the Hungarian central bank maintained its benchmark rate steady at 0.9%, a decision that was in line with expectations.
- Turning to ratings news, S&P changed its outlook on Mexico's 'BBB+' credit rating to 'negative'. S&P underscored that Mexico's structural reform agenda had failed to deliver higher growth which had, in turn, weighed on the country's fiscal outlook. Last Friday, Fitch affirmed Turkey's LT foreign debt currency rating at 'BBB-' but changed its outlook to 'negative.' In its press release, the rating agency highlighted elevated political risks in the wake of a recent coup attempt. Similarly, in Ecuador, Fitch affirmed the sovereign's 'B' rating but changed the outlook to 'negative,' pointing to a deteriorating growth and fiscal outlook.

HIGHLIGHTS OF NEXT WEEK'S ECONOMIC RELEASES

Date	Report	Consensus	Last
08/29	(US) PCE Core MoM	0.10%	0.10%
	(US) PCE Core YoY	1.50%	1.60%
08/30	(EC) Consumer Confidence	-8.5	-8.5
	(CA) Industrial Product Price MoM	-0.50%	0.60%
	(US) S&P CoreLogic CS 20-City YoY NSA	5.10%	5.24%
	(US) Consumer Confidence Index	97	97.3
	(JN) Industrial Production YoY	-3.00%	-1.50%
08/31	(GE) Unemployment Claims Rate SA	6.10%	6.10%
	(EC) Unemployment Rate	10.00%	10.10%
	(IT) CPI EU Harmonized MoM	-0.10%	-1.80%
	(US) ADP Employment Change	175k	179k
	(CA) Quarterly GDP Annualized	-1.50%	2.40%
09/01	(US) Nonfarm Productivity	-0.60%	-0.50%

	(CA) RBC Canadian Manufacturing PMI	--	51.9
	(US) Markit US Manufacturing PMI	52.1	52.1
	(US) ISM Manufacturing	52	52.6
	(US) ISM New Orders	--	56.9
	(US) Wards Total Vehicle Sales	17.23m	17.77m
09/02	(JN) Consumer Confidence Index	41.5	41.3
	(EC) PPI YoY	-2.90%	-3.10%
	(US) Change in Nonfarm Payrolls	180k	255k
	(US) Unemployment Rate	4.80%	4.90%
	(US) Average Hourly Earnings YoY	2.50%	2.60%
	(US) Labor Force Participation Rate	--	62.80%
	(US) Underemployment Rate	--	9.70%
	(US) Factory Orders Ex Trans	--	0.40%
	(US) Durable Goods Orders	--	4.40%