

**September 2, 2016**

**MARKET LEVELS**

	<b>Friday*</b>	<b>Last week</b>	<b>Dec. 31, 2015</b>	<b>One year ago</b>
<b>Dow Jones Industrial Avg</b>	18,509	18,395	17,425	16,375
<b>S&amp;P 500</b>	2,181	2,169	2,044	1,951
<b>NASDAQ</b>	5,256	5,219	5,007	4,733
<b>Russell 2000</b>	1,249	1,238	1,136	1,145
<b>DJ STOXX Europe 600 (€)</b>	349	344	366	362
<b>Nikkei Index (¥)</b>	16,926	16,361	19,034	18,182
<b>MSCI EM Index</b>	455	456	411	406
<b>Fed Funds Target</b>	0.25%-0.50%	0.25%-0.50%	0.25%-0.50%	0.00%-0.25%
<b>2-Year Treasury Yield</b>	0.80%	0.84%	1.05%	0.69%
<b>10-Year Treasury Yield</b>	1.62%	1.63%	2.27%	2.16%
<b>U.S. \$ / Euro</b>	1.12	1.12	1.09	1.11
<b>U.S. \$ / British Pound</b>	1.33	1.31	1.47	1.53
<b>Yen / U.S. \$</b>	104.19	101.84	120.22	120.07
<b>Gold (\$/oz)</b>	\$1,317.77	\$1,321.22	\$1,061.42	\$1,125.47
<b>Oil</b>	\$44.26	\$47.64	\$37.04	\$46.75

*\*Levels reported as of 7:48 a.m. PDT*

**MARKET RETURNS**

**Year-to-date (12/31/15 – 09/02/16)\***

<b>Dow Jones Indus Avg.</b>	8.29%
<b>S&amp;P 500</b>	8.34%
<b>NASDAQ</b>	5.96%
<b>Russell 2000</b>	11.06%
<b>MSCI World Index</b>	3.65%
<b>DJ STOXX Europe 600</b>	-1.63%
<b>MSCI EM Index</b>	10.71%

**Year-to-date (12/31/15 – 09/01/16)**

<b>90 Day T-Bill</b>	0.21%
<b>2-Year Treasury</b>	1.08%
<b>10-Year Treasury</b>	7.37%
<b>ML High Yield Index</b>	14.39%
<b>JPM EMBI Global Diversified</b>	13.37%
<b>JPM Global Hedged</b>	6.81%

*\*Returns reported as of 7:48 a.m. PDT*

## RECAP OF THE WEEK'S ECONOMIC RELEASES

Date	Report	Survey	Actual	Prior	Details
08/29	(US) PCE Core YoY	1.50%	1.60%	1.60%	US core PCE inflation has accelerated since the start of the year but still remains below 2%.
08/31	(EC) Unemployment Rate	10.00%	10.10%	10.10%	Eurozone unemployment stayed at 10.1%. It has been at this level since April.
09/01	(US) ISM Manufacturing	52	49.4	52.6	After being above 50 for 5 months, US ISM manufacturing index dropped back below 50, indicating a contraction.

## ECONOMIC OVERVIEW

May was a blip. Or so policymakers might have sighed upon seeing Friday's jobs report. According to data released by the Bureau of Labor Statistics, the US economy added 151,000 jobs and the unemployment rate held steady at 4.9% during the month of August. Combined with upward revisions, the three-month moving average of nonfarm payrolls hit 232,000—the best reading in six months, and a far cry from the 24,000 May number which had many worried. Will the resilience on display in August's report be enough to compel the Fed to hike in September? One clue comes from Janet Yellen's speech last week at Jackson Hole. Speaking before she knew of today's strong number, Fed Chair Yellen remarked, "I believe the case for an increase in the federal funds rate has strengthened in recent months." The case must be stronger now. With the labor market at or near full employment—the three-month moving average of wage growth was the second highest reading in the last five years—and inflation beginning to perk, we think the odds are still on at least one rate hike this year.

## US MARKETS:

### TREASURIES

- Range trading remains the name of the game for Treasuries as the 10-year yield has touched 1.56% for 25 of the last 30 trading sessions. The Fed's Vice Chair Fischer did not walk back his comments from last Friday nor did he say anything particularly hawkish either and such, the market breathed a sigh of relief and the curve steepened on a series of block 5-year Treasury futures trades.
- The larger than average month end index extension came and went as the market chopped around the magic 1.56% level and dealers reported better selling into the close possibly ahead of an expected record supply in investment grade bond issuance.
- The August payrolls number came in slightly weaker than expected and the curve steepened as one would expect but the long end traded heavy again on supply concerns. The 10-year note started heating up in the repo market and now sits at negative 175 basis points which could be the sign of a short base into September. The market is back from summer vacation Tuesday and hopefully will trade with a purpose again.

### LARGE-CAP EQUITIES

- The U.S. Equity Market rallied for the week as Friday's disappointing jobs report dampened expectations of the Fed hiking rates later this month. Despite oil prices falling and generally weaker economic data released this week, broad equities (S&P 500 index) climbed back to the top of the summer's narrow price range.
- Corporate headlines were light with the exception of the European Commission's ruling of Apple's special tax treatment in Ireland. The S&P 500 and NASDAQ Composite both climbed approximately +0.5% for the week, while the Dow Jones Industrial Average added +0.6%. The higher beta small-cap stocks outperformed

large-cap stocks. In terms of style, large-value stocks outperformed large-cap growth stocks. The best performing sectors were financials and consumer staples, while the worst performing sectors were health care and energy.

## **CORPORATE BONDS**

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- August ended quietly in contrast to the rush of issuance early in the month. The last week of the month hit \$12 billion in primary issuance versus \$3-\$8 billion expected, surpassing expectations. Overall, this August outranks all previous Augusts in terms of supply. One notable deal was issued by the Commonwealth Bank of Australia, totaling \$3.3 billion. Bonds priced just five basis points inside of initial price talk on two times demand; bonds were mostly unchanged on the break.
- Generally speaking, the market was very quiet. The main news of the week surrounded the EU seeking retroactive taxes from Apple after Apple funneled profits earned in the EU through Ireland. This could have tax implications of as much as \$14.5 billion. The Corporate Index Option-Adjusted Spread (OAS) finished the week at +136, flat on the week. Overall metals/mining were one wider and energy was three tighter. Senior financials were one tighter and subordinated financials were two tighter. Industrials were one tighter and utilities were tighter by two.

## **MORTGAGE-BACKED SECURITIES**

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- The summer doldrums for one more week? Trading volume was very light ahead of Labor Day weekend. The primary event, the August employment report, was slightly below expectations but strong enough to keep the Federal Reserve in play for September. Bonds reacted by selling off but equities enjoyed the goldilocks number. Agency mortgages performed well versus US Treasuries as volatility was in check with rates failing to move out of the recent micro range.
- Mortgage supply was non-existent but so was demand as foreign investors stepped back. Money managers were the activity engine fine-tuning ahead of major events in late September. Pass-through spreads closed unchanged for most active mortgage coupons (3s through 4s). In the agency programs, Ginnie Mae trading was uneventful but a smidge cheaper to conventionals. 30-year's outperformed 15-year's. It was quiet in the credit mortgage products of commercial, non-agency, and single family rental.
- For the week, the 30-year current coupon versus the 10-year US Treasury narrowed by one basis point to 79 basis points. According to Freddie Mac, the 30-year mortgage rate edged higher to 3.46%.

## **ASSET-BACKED SECURITIES**

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- According to S&P, year-to-date new issue ABS supply stands at \$130 billion at the end of August. This is versus the \$146 billion pace set in 2015, and \$183 billion total issuance last year. The target for 2016 is still \$190 billion, but we may fall short. In CLO space, year-to-date issuance stands at \$38 billion versus \$73 billion at the same time last year. Total estimated CLO issuance for 2016 remains \$50-60 billion.
- On the performance side, the BAML ABS index returned 0.01% on the month and 2.12% year-to-date. For comparison, the BAML 1-3 year Treasury index returned -0.17% and 1.21% respectively. Additionally, the BAML 1-3 year AAA-A rated corporate index returned -0.04% in August and 2.05% for the year. I often group these three indices together since they carry very similar duration profiles, and ABS and short IG corporates tend to have very similar return profiles historically.

## **MUNICIPAL BONDS**

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- Municipal issuance was below trend this week at \$6.3 billion as the market approached the upcoming holiday weekend. New issuance was dominated by a \$2.8 billion State of California G.O. issue led by JP Morgan. Spreads were priced wider than secondary trades from the last few weeks, but the pricing was well received with maturities 15 years and longer trading up 3-5 basis points once free to trade in the secondary. Spread

tightness was notable on the longest-dated 5% coupon bonds. The short end of the curve continued to struggle, with MMD off 10 to 11 basis points this week from 3 years and shorter.

- The weekly SIFMA floating index was adjusted another 7 basis points higher this week, after an upwards adjustment of 7 basis points last week as well - the rate now stands at 0.63. This anomaly continues to persist and even became more pronounced, as SIFMA now exceeds 1-week LIBOR by 19 basis points. The front end of the municipal yield curve remained inverted slightly, as bonds in the 1-2 year maturity range continue to trade 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 continue to view this as an opportunity to mitigate price risk on the front end of the curve, as odds for another Fed rate hike in 2016 increase, while also enhancing portfolio liquidity and yield through the use of VRDNs and short term note issues.

## HIGH-YIELD BONDS ---

- The BofA Merrill Lynch BB/B cash pay constrained index was down -0.10% this week as spreads widened by 11 basis points to an option-adjusted-spread of +401 basis points. The BofA Merrill Lynch BB/B index that excludes utilities and energy was down -0.01% for an OAS of +382 as the spread of that index widened by 12 basis points. The BofA Merrill Lynch Euro BB/B constrained index was up +0.31% as the spread of that index tightened by five basis points for an OAS of +341.
- High-yield was steady this week in trading that decelerated into the long Labor Day weekend. Secondary volumes were 50-75% of average as trading desks were thinly staffed and there was no new issue or idiosyncratic credit news to spur more activity. Fund flows were negative (-\$387 million) for the first time in four weeks, although month-to-date inflows remained relatively heavy at \$2.3 billion.
- Secondary trading volumes for Thursday were \$7.3 billion as compared to a YTD daily average of \$12.4 billion. New issue continued its late summer slumber and there has been no new issuance in high-yield since August 18th. Estimates for new issue for the month of September are roughly \$25 billion which is approximately the new issuance volumes seen in September of 2015 and 2014.
- Fund flows in high-yield are tracking towards an estimated outflow of -\$387 million for the month which follows an inflow of \$162 million last week and a combined \$2.54 billion during the first two week of August.

## INTERNATIONAL MARKETS:

### GLOBAL BONDS AND CURRENCIES ---

- Non-US sovereign bond markets came under pressure during the past week, as bond yields increased on improved risk appetite. Equity and commodity markets rose and bonds sold off despite US employers adding fewer workers in August than expected by economists. Risk appetite improved following positive economic data out of the UK and China.
- In Europe, markets shrugged off a weaker Eurozone manufacturing survey and 10-year German bund yields were up by about 4 basis points on the week, in line with the US Treasury market. In the UK, Gilts underperformed following a strong manufacturing report for August, as the weaker currency helped to drive up export orders. The yield on the 10-year benchmark note rose by 16 basis points on the week. Peripheral European government bond spreads over Bunds were stable to wider on the week.
- In the currency markets, the US dollar had a mixed performance versus the other major crosses, as it recovered from its earlier losses despite the US jobs data being worse than expected. The Euro finished the week lower against the greenback, while sterling was supported by further signs the British economy is proving resilient in the wake of the Brexit vote. The Japanese yen lost some ground on the week, while the Australian dollar ended slightly lower despite the better than expected Chinese economic data.

## EMERGING-MARKET BONDS

- Emerging market (EM) dollar-pay spreads widened by five basis points (bps) to 342 bps over US Treasuries, while local debt yields increased by three bps to 6.28%. EM currencies were mixed against the US dollar, with the Malaysian ringgit (-1.7%) and the Colombian peso (-1.6%) depreciating most. The Argentine peso (+1.2%) and Brazilian real (+1%) outperformed on the week.
- In Brazil, the impeachment trial of Dilma Rousseff officially came to a close with the senate voting her guilty of budget violations by a margin of 61 to 20. Michel Temer, who was Rousseff's Vice President, will serve out the remainder of her term. The next election is in 2018. Temer is expected to continue working to correct Brazil's fiscal imbalances, though he faces a challenging political environment. Brazil also reported second quarter GDP growth of -3.8% year-over-year (y/y), an improvement from -5.4% y/y in the first quarter. Following several quarters of contraction, investment turned positive on a sequential basis, while consumption remained weak. Finally, Brazil's central bank maintained the Selic rate at 14.25% but made changes to the accompanying policy statement that suggested it was open to beginning an easing cycle.
- Second quarter growth figures for India, Colombia, and Nigeria came below consensus forecasts. India reported a 7.1% y/y expansion, lower than estimates of 7.6%, with softer performance in agriculture and mining offset by strong growth in services and manufacturing. Colombia's 2.0% y/y growth was below the 2.3% estimate; the mining, utilities and transport sectors were the weakest during the period. Nigeria's economy moved into a recession with its second consecutive quarter of GDP contraction; economic activity contracted by 2.1% y/y after -0.4% y/y in the prior quarter.
- In August, Emerging market manufacturing PMI numbers slipped modestly, to 50.1 from 50.4 in July. In China, the Caixan manufacturing PMI declined to 50, from 50.6 in July. Additionally, negative prints were notable in South Africa (-4.7 pts) and Turkey (-0.6 pts). The bright spot was in Asia, with Indonesia's PMI increasing 2 pts (to 50.4) and India's up by 0.8 pts to 52.6.
- Colombia's central bank held its policy rate at 7.75%, pausing after a cumulative 325 bps of rate hikes that have been enacted over the past year in response to high inflation and current account deterioration.
- Gabon held presidential elections over the weekend, with results showing that the incumbent, Ali Bongo, had defeated opposition candidate Jean Ping by a slim margin of 49.85% to 48.16%. However, Ping disputed the vote tally as independent observers reported a lack of transparency in the polling. In Venezuela, thousands of people marched demanding that President Maduro allow a recall referendum on his presidency. Against a backdrop of hyperinflation, severe recession, insecurity, and far reaching goods shortages, Maduro's government is deeply unpopular. To date, his administration has used administrative measures to stall the recall referendum process.

## HIGHLIGHTS OF NEXT WEEK'S ECONOMIC RELEASES

Date	Report	Consensus	Last
09/04	(JN) Real Cash Earnings YoY	0.70%	1.80%
09/05	(EC) Sentix Investor Confidence	5	4.2
	(EC) Retail Sales YoY	1.80%	1.60%
	(RU) CPI YoY	6.90%	7.20%
09/06	(EC) GDP SA QoQ	0.30%	0.30%
	(EC) GDP SA YoY	1.60%	1.60%
	(US) Markit US Composite PMI	--	51.5
	(US) Labor Market Conditions Index Change	--	1

	(US) ISM Non-Manf. Composite	55	55.5
09/07	(GE) Industrial Production WDA YoY	0.20%	0.50%
	(UK) Industrial Production YoY	1.90%	1.60%
	(UK) Manufacturing Production YoY	1.70%	0.90%
	(CA) Bank of Canada Rate Decision	0.50%	0.50%
	(US) JOLTS Job Openings	--	5624
	(JN) GDP SA QoQ	0.00%	0.00%
	(JN) GDP Annualized SA QoQ	0.20%	0.20%
09/08	(EC) ECB Main Refinancing Rate	0.00%	0.00%
	(EC) ECB Deposit Facility Rate	-0.40%	-0.40%
	(CA) New Housing Price Index YoY	--	2.50%
	(JN) Money Stock M3 YoY	2.90%	2.90%
09/09	(CA) Housing Starts	190.0k	198.4k
	(CA) Unemployment Rate	7.00%	6.90%
	(US) Wholesale Inventories MoM	0.00%	0.00%