

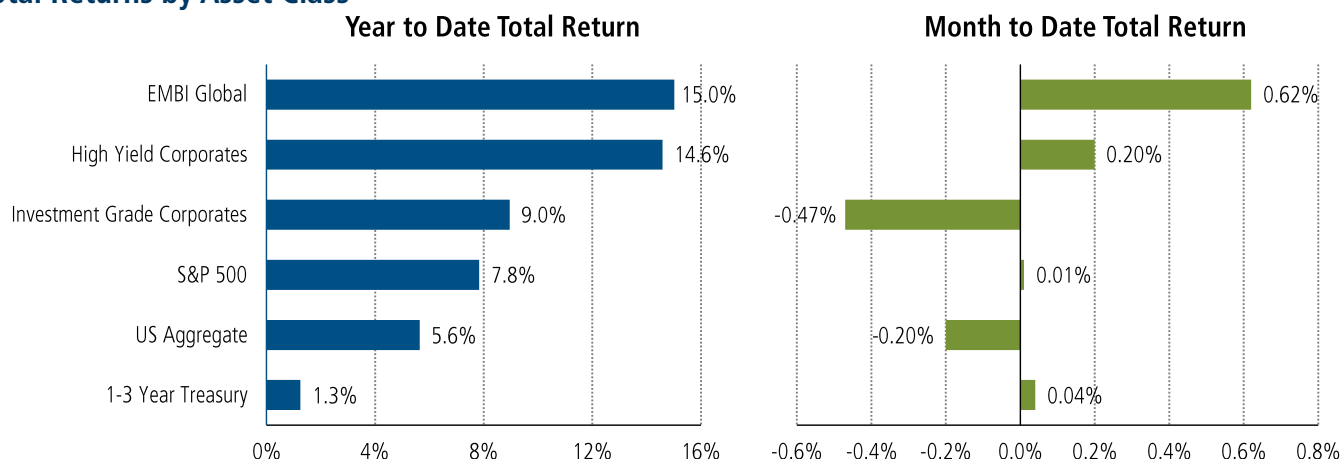
Week Ending September 23, 2016

Risk On As Central Banks Stay Easy

Economic Overview:

If a central bank expands its balance sheet to \$4.5 trillion and still fails to meet its policy objectives, what are policymakers to do? That's the quandary the Bank of Japan (BoJ) found itself in at its September 21st policy meeting. Inflation in Japan is still nowhere near the BoJ's 2% objective. As a result, the central bank decided to target a 0% interest rate on 10-year government bonds, while pledging to allow inflation to exceed 2% (to "overshoot"). Regardless of what we think about the policy's prospects (we don't think it will work), bloated balance sheets are likely to be a permanent feature of 21st century central bank operational frameworks—in Japan, the US, and elsewhere. Targeting an overnight interest rate to achieve an inflation rate is the strategy of yore. Using a large balance sheet to target macroeconomic objectives and interest rates across the yield curve is the new regime.

Total Returns by Asset Class



Highlights of the Week:

- **Treasuries:** The BoJ and the Fed ended up more dovish than the market had anticipated and long end yields went lower.
- **Equities:** The interest rate sensitive Real Estate and Utility sectors benefited the most from the no rate hike after finishing the week as the top performing sectors. Corporate news flow was abundant with FedEx boosting market sentiment after reporting strong 1st quarter earnings results, while Wells Fargo continues to face backlash, this week from the Senate, after disclosing sales practices that resulted in millions of phony customer accounts.
- **Corporates:** Mylan's EpiPen saga continued this week as the CEO pled her case before congress after the price of the drug outraged consumers. According to her, just \$100 of the \$609 price was kept as profit. The company plans to sell a half-priced generic version soon to placate the public.
- **Securitized:** The ABS East Conference had notably low attendance because of the Zika scare in Miami. But talk during the conference revealed that cash, like ABS industry members, is sitting on the sidelines as tight spreads make investors apathetic.
- **High Yield:** High-yield was firmer this week as investor's appetite for risk returned and fresh cash flowed into the asset class. New issue was once again the main focus of the week as almost \$5.5 billion was priced bringing the post-Labor Day total issuance to over \$25 billion as issuers continue to take advantage of strong demand and historically low borrowing costs.
- **Emerging Markets:** S&P upgraded Hungary to 'BBB-', citing an improvement in the country's fiscal discipline, better growth prospects, and a stronger external position. The move follows Fitch's upgrade to 'BBB-' in May 2016 and marks a turnaround after the country lost its investment grade rating in 2011.
- **Municipals:** Lipper reported a 51st consecutive week of inflows to municipal bond funds, which has helped fuel the rally in 10-year yields down to 1.51% from 2.23% a year ago. Tax-exempt municipals remain very attractive relative to Treasuries, with 10-year muni ratios at 95.15% and 30-year ratios at 98.34%.
- **Currencies:** The US dollar lost ground against most major currencies this week following the Federal Reserve's decision on Wednesday to leave interest rates unchanged. The Japanese yen managed to finish the week higher against the greenback after a volatile trading session following the Bank of Japan's announcement of changes to its monetary policy.

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