Payden&Rygel
Investment Management

WEEKLY MARKET UPDATE

June 17, 2016

MARKET LEVELS

	Friday*	Last week	Dec. 31, 2015	One year ago
Dow Jones Industrial Avg	17,695	17,865	17,425	18,116
S&P 500	2,074	2,096	2,044	2,121
NASDAQ	4,812	4,895	5,007	5,133
Russell 2000	1,150	1,164	1,136	1,285
DJ STOXX Europe 600 (€)	326	333	366	384
Nikkei Index (¥)	15,600	16,601	19,034	19,991
MSCI EM Index	413	421	411	459
Fed Funds Target	0.25%-0.50%	0.25%-0.50%	0.25%-0.50%	0.00%-0.25%
2-Year Treasury Yield	0.70%	0.73%	1.05%	0.64%
10-Year Treasury Yield	1.61%	1.64%	2.27%	2.34%
U.S. $ / Euro	1.13	1.13	1.09	1.14
U.S. $ / British Pound	1.43	1.43	1.47	1.59
Yen / U.S. $	104.25	106.97	120.22	122.96
Gold ($/oz)	$1,296.06	$1,273.92	$1,061.42	$1,201.92
Oil	$47.19	$49.07	$37.04	$60.45

**Levels reported as of 7:26 a.m. PDT*

MARKET RETURNS

Year-to-date (12/31/15 – 06/17/16)*

Dow Jones Indus Avg.	2.94%
S&P 500	2.58%
NASDAQ	-3.24%
Russell 2000	1.91%
MSCI World Index	-2.09%
DJ STOXX Europe 600	-8.54%
MSCI EM Index	0.42%

**Returns reported as of 7:26 a.m. PDT*

Year-to-date (12/31/15 – 06/16/16)

90 Day T-Bill	0.15%
2-Year Treasury	1.11%
10-Year Treasury	7.21%
ML High Yield Index	7.90%
JPM EMBI Global Diversified	7.89%
JPM Global Hedged	5.92%

RECAP OF THE WEEK'S ECONOMIC RELEASES

Date	Report	Survey	Actual	Prior	Details
06/14	(UK) CPI Core YoY	1.30%	1.20%	1.20%	UK inflation remained steady as increasing services prices were offset by goods prices, much like the US.
06/16	(US) CPI Ex Food and Energy YoY	2.20%	2.20%	2.10%	US core CPI inflation rate moved up on the back of service prices.
06/17	(CA) CPI YoY	1.60%	1.50%	1.70%	Canadian headline CPI dropped due to low food prices while core CPI stayed above 2%.

ECONOMIC OVERVIEW

The Federal Open Market Committee (FOMC) met this week and decided to leave its policy rate, the federal funds rate, unchanged at 0.25-0.50%. In their accompanying statement, policymakers repeated the phrase that “inflation has continued to run below the Committee's 2 percent longer-run objective.” While true for the core PCE (a measure of inflation culled from spending data that excludes food and energy), a wide array of other measures of inflation point toward 2% or higher inflation already. What’s more, core PCE tends to follow the trend set by the other indicators we follow. Finally, a 2% rate on core PCE is a bit of mythical entity. Nearly 80% of the months over the last 20 years featured a rate of core PCE below 2%. So, inflation is not that low and low inflation is not that uncommon. Why fret?

US MARKETS:

TREASURIES

- Brexit fears have become the primary driver of market moves as referendum polls show the remain vote losing more ground to those who wish to leave the EU. The risks seem to be much higher to the downside in yield on a leave outcome, as 10-year Treasury yields closed Thursday at the lowest levels since 2012.

- Unlike the move in February where yields quickly gapped, this march lower has been orderly and more concerning. The FOMC meeting revealed members had lowered their 2017, 2018 and long run policy rate projections which bull steepened the curve as the implied probability of a July rate hike moved from 53% to start the month to just 6% as of this Friday. The hurdle for the Fed to hike at all this year hinges on a stay vote out of the UK followed up with a June payrolls report well above 100k with revisions to May. TIPS breakevens significantly underperformed other asset classes this week with the 10-year flatter by 15 basis point since last Wednesday.

- Focus now shifts to front end supply next week which will be crammed in to accommodate the UK Referendum vote on the 23rd. The 7-year should be especially challenging given the proximity to the vote in addition to the 30-year TIPS reopen at the same time.

LARGE-CAP EQUITIES

- The U.S. Equity Market fell for the week as a risk-off sentiment drove equity prices lower. Investors’ uneasiness surrounding the so called “Brexit” vote and the loss of confidence in central bank policies was most pronounced this week as market volatility spiked to 4-month highs. However, some of that volatility can be attributed to Friday’s expiration of equity stock and index futures and options, which typically increases overall trading activity. The S&P 500 index declined approximately 1% for the week, its third consecutive weekly loss. The Dow Jones Industrial Average also fell 1%, while the tech-focused dropped -

1.8%. Large-cap stocks outperformed the higher beta small-cap stocks. In terms of style, large-cap value stocks outperformed large-cap growth stocks. The best performing sectors were the defensively viewed telecom and utilities, while the worst performing sectors were financials and info tech.

- In fund flow news, domestic equity mutual funds continued to face redemptions as Lipper reported investors redeemed $3.0 billion for the week. Domestic equities have been out of favor this year as this marked the nineteenth consecutive week of redemptions. International equity mutual funds also saw redemptions with investors redeeming $1.4 billion for the week.

CORPORATE BONDS

- The third week of June was very quiet in the new issue market, awaiting the FOMC decision on Wednesday. Compared to $10-$15 billion in anticipated issuance, only $2.5 billion came to the market this week, far underperforming expectations. As Brexit fears mounted, spreads widened several basis points in the first few days of the week, finally breaking out of the very thin trading margin that bonds have been in since early May. Duke Energy brought a five tranche deal on Tuesday totaling just $1.3 billion thanks to very small tranche sizes. It is rare to see tranches of less than $250 million (which are not index eligible), but two of the tranches were less than $250 million. The deal priced about 10 basis points inside of initial price talk.

- In corporate news, the rumors of a UK company purchasing Perrigo surfaced on Tuesday afternoon, pushing the stock up by 10%. Bond spreads tightened 40 basis points; this rumor is yet unconfirmed. The Corporate Index Option-Adjusted Spread (OAS) finished the week at +156, six wider on the week. Overall metals/mining were 10 wider; energy was four wider. Senior financials were seven wider and subordinated were 15 wider. Industrials were six wider and utilities were wider by two.

MORTGAGE-BACKED SECURITIES

- Mortgages failed to keep pace with US Treasuries as dovish outlook by Federal Reserve policy makers sent bond yields to their lowest since 2012. Pass-through spreads widened by three-to-five basis points across the coupon stack. The movement was surprisingly tame considering the building refinance risk of the entire mortgage complex.

- Primary mortgage rates have been sticky on the way down but the major banks may be forced to lower the offering rates if the non-bank players continue to steal market share. According to Freddie Mac the conforming 30-year fixed rate stands at 3.5% with more room to run. Within the products, as expected, 30-year lower coupons bested higher coupons on an absolute basis but lagged on relative to their duration hedges. In a surprise, Ginnie Mae mortgages held up well as foreign banks bucked the recent trend (on the sidelines) by investing at lower yield levels. As for 15-year mortgages, they struggled to move up in price as the yield curve flattened. In other markets, commercial MBS and non-agency bonds widen a few basis points from a lack of activity. The credit picture, however, looks brighter with a dovish Fed and a lower rate projection providing borrowers cheaper financing alternatives.

- For the week, the 30-year current coupon mortgage versus the 10-year Treasury spread closed four-basis points wider to 85 bps.

ASSET-BACKED SECURITIES

- The highlight of the week was talking to clients about Verizon's upcoming smartphone ABS deal scheduled for sometime this fall. Since this will be a new collateral type, some account guidelines may need modifications. The eventual market size is anticipated to be close to that of the credit card market, so it is significant and a natural fit for many short duration accounts. There are plenty of additional details so please contact your designated portfolio manager for further information.

- Continuing with the theme of something new, there will be a first time deep subprime auto ABS issuer next week. The parent company is a market place lender who in turn is funded via private equity. SoFi will also be issuing their inaugural unsecured consumer loan ABS. It is just a matter of time before SoFi brings their first residential mortgage deal too.

MUNICIPAL BONDS

- Municipal yields held steady this week, along with treasuries as the market expected little from the Fed on a June hike and Janet Yellen's statements. Overall yields marched lower on treasuries and munis resulting in lower, flatter yield curves than in week prior. 10-year benchmark municipal yields tightened by almost 10 basis points and registered at 1.47%. Same trend observed for the 30-year maturity, which registered at 2.17% this week. With the short end of the yield curve remaining anchored, the curve flattened to a multi-year record of only 151 basis points of "term premium" that an investor gets for investing in 30 year bonds vs. 2 year bonds. Naturally, we conclude that there is little added benefit and compensation for taking on more risk and going further out in maturity and duration on the yield curve past the intermediate range.

- The week was rich in credit related headlines for municipal "bad actors" like Illinois and Puerto Rico with each reaching their own "special" milestones of distress. Illinois got a fresh multi-agency downgrade to mid-BBB levels as punishment for the culture of mismanagement and political gridlock that has gripped the state for over a year now preventing it from passing a budget and achieving necessary long term reforms. Puerto Rico got one step closer to a "plan to have a plan" with a Supreme Court rejection of a local restructuring law. This cleared the way for a Congressional legislative solution called PROMESA to install an oversight board to restructure its debt and finances and help set the territory on a path to fiscal solvency and budget sustainability.

HIGH-YIELD BONDS

- The BofA Merrill Lynch BB/B cash pay constrained index was down -0.95% this week as spreads widened by 32 basis points to an option-adjusted-spread of +506 basis points. The BofA Merrill Lynch BB/B index that excludes utilities and energy was down -0.82% for an OAS of +489 as the spread of that index also widened by 31 basis points. The BofA Merrill Lynch Euro BB/B constrained index was down -1.07% as the spread of that index widened by 39 basis points for an OAS of +421.

- High-yield moved lower this week as Brexit fears weighed on risk markets. High-yield saw better selling starting Thursday afternoon of last week and it continued until Tuesday afternoon of this week. Wednesday morning saw a respite in the selling pressure as polls indicated a slight increase in sentiment favoring remaining in the EU. Trading activity was muted overall as attention shifted to the mid-day FOMC rate decision announcement and a press conference by Fed Chair Janet Yellen.

- Thursday saw risk markets lower and high-yield ETF's were active with bid-wanted-in-competition lists as they sought to sell bonds into a soft and somnolent secondary market. High-yield firmed along with equities later in the day and finished Thursday's trading sessions at the highs for the day. Trading volumes tapered off as the week wore on and the lack of new issue calendar lessened the need of accounts to trade in the secondary. $10.9 billion in high-yield bonds trade on Wednesday versus $13.9 billion on Tuesday with the month-to-date average daily trading volume for June standing at $13.3 billion.

- Funds flows turned negative for high-yield mutual funds this week as Lipper reported an outflow of $1.8 billion with ETF's accounting for 87% of the total outflow. This is the largest weekly redemption in five weeks and reverses two weeks of inflows that totaled $892 million.

- High-yield new issue was busy for the first two days of the week as $5.2 billion was priced and was no new issue for the balance of the week. The market appeared to be taking a breather after the busy week in new issue last week which saw $15.2 billion price and was the biggest week for issuance since July of 2015. New issuance for June so far is $23.2 billion and follows a steadily increasing monthly total for 2016 after market conditions early this year caused a very slow start for new issue.

INTERNATIONAL MARKETS:

GLOBAL BONDS AND CURRENCIES

- The non-US government bond markets had a mixed performance during an eventful week, after a trio of opinion polls raised the prospect of a vote by the UK to leave the EU next week. Sovereign bond yields were at record low levels after simmering anxiety over the outlook for the global economy drove investors into the safest and most liquid sovereign bond markets, despite the vanishing returns they offer. Expectations that the Federal Reserve would abstain from raising interest rates on June 15 given weak May non-farm payrolls data and rising volatility in global markets had driven investors into the relative safety of government debt. Central banks remained one of the main talking points this week with The Fed, the Bank of England and the Bank of Japan all keeping policy on hold.

- In Europe, the 10-year German Bund yield went negative for the first time and hovered around zero. Nevertheless, it finished the week almost flat, while peripheral sovereign bond spreads widened. In the UK, Gilts outperformed with 10-year yield falling by 6 basis points on the week as the growing possibility of a UK exit from the EU continued to support these assets.

- In the currency markets, the US dollar came under pressure after a dovish policy statement from the Fed and finished the week lower against the other major crosses. Sterling ended almost flat against the US dollar despite the threat of Brexit weighing heavily on the currency. The Japanese yen recovered following the Bank of Japan's decision to refrain from easing monetary policy further.

EMERGING-MARKET BONDS

- Emerging market (EM) dollar-pay spreads widened 24 basis points (bps) to 411 bps over US Treasuries, while local debt yields increased 10 bps to 6.54%. EM currencies were weaker against the US dollar, led by the Mexican peso (-3.7%), South African rand (-3.5%) and Polish zloty (-2.9%).

- Against expectations it would remain on hold, Bank Indonesia eased its new policy rate (the 7 day reverse repo rate) by 25 bps to 5.25%. Officials have expressed a desire to support lending and growth, which they feel face downside risks this year. Chile's central bank held the policy rate steady at 3.5%, matching consensus, balancing still-elevated inflation with the lower global interest rate environment. The Central Bank of Egypt chose to hike its deposit and lending rates by 100 bps each, to 11.75% and 12.75%, respectively, as inflation has spiked amid challenging supply-side conditions.

- China's economic activity data for May was generally weaker than expected, particularly fixed asset investment, which grew 9.6% year-to-date, year-over-year (y/y), down from 10.5% in April. Retail sales expanded 10.0% y/y, slightly below consensus, while industrial production matched expectations at 6.0% y/y.

- Nigeria's central bank announced that it would move to a floating exchange rate regime effective June 20. Officials had kept the exchange rate pegged since early 2015, even as lower oil prices and oil production shocks severely restricted domestic US dollar liquidity, leading to sharply slower growth. Forward markets suggest that the naira may devalue by 25% or more when interbank trading is allowed next week.

HIGHLIGHTS OF NEXT WEEK'S ECONOMIC RELEASES

Date	Report	Consensus	Last
06/22	(CA) Retail Sales MoM	0.90%	-1.00%
	(EC) Consumer Confidence	-7	-7

	(US) Existing Home Sales	5.55m	5.45m
06/23	(US) Initial Jobless Claims	270k	277k
	(US) Markit US Manufacturing PMI	50.7	50.7
	(US) New Home Sales	560k	619k
	(US) Leading Index	0.20%	0.60%
06/24	(US) Durable Goods Orders	-0.40%	3.40%
	(US) U. of Mich. Sentiment	94.2	94.3