

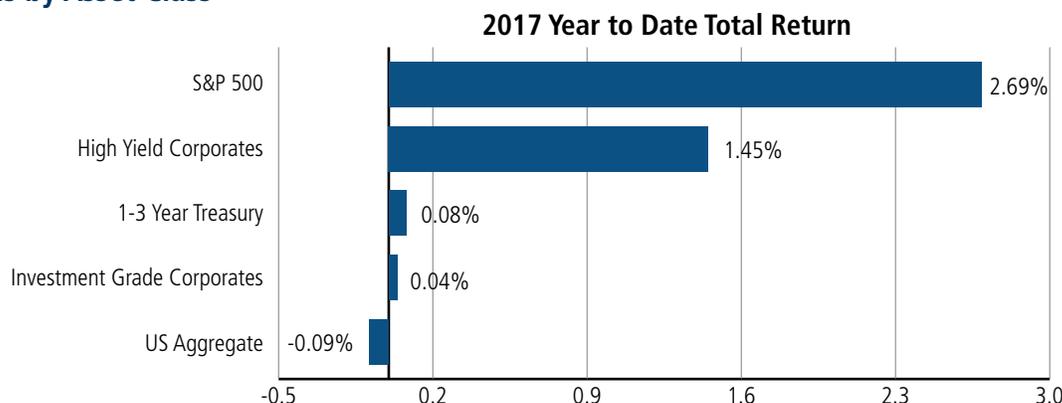
Week Ending January 27, 2017

Is The Honeymoon Over?

Economic Overview:

Despite the many "For Sale" signs you might see posted in front yards in your neighborhood, the inventory of existing homes in the United States is at its [lowest level in over 15 years](#). This measure, which excludes the inventory of newly built homes, suggests two related things. First, after years of sluggish new home construction, would-be buyers today have little choice but to pick through the few existing properties that are on the market. Second, even as new home construction has rebounded from its nadir, the supply/demand imbalance depicted above suggests that the recent price gains in the U.S. single-family housing market may continue for some time.

Total Returns by Asset Class



Highlights of the Week:

- **Treasuries:** Treasuries traded with much uncertainty and caution in President Trump's first week in office, maintaining recent ranges but ending the week closer to the higher end in yields. The market probability for a rate hike at next week's Fed meeting hovered at 22%.
- **Equities:** The Dow Jones Industrial Average Index closed above 20,000 for the first time ever this week. It took the nearly 90-year old stock index, and arguably the most well-known in the world, more than 70 years to surpass the first 10,000. However, "the Dow" managed to double from that level in less than 20 years, overcoming the housing/financial crisis.
- **Corporates:** Amid scrutiny and a shifting environment, attempts to consolidate the healthcare industry have been rapid but not assured. This week Johnson & Johnson reached an agreement to buy pharmaceutical company Actelion for \$30 billion; this is awaiting shareholder and regulatory approval. Meanwhile, health insurance companies Aetna and Humana were rejected from merging by the Department of Justice. They will likely appeal and restructure to try to keep the deal together.
- **Securitized Products:** "Ford is the canary in the coal mine," said Maryann Keller, an auto industry consultant citing the wave of used vehicles rolling off-lease that is expected to continue into 2018. Ford and the rest of the auto industry are reacting with heavier incentives and extended warranties to try to bolster prices, but it is happening selectively. If you are looking for a vehicle this weekend, think fuel-efficient cars, and not gas-guzzling trucks and SUVs.
- **High Yield:** This week saw reports that the CEOs of Verizon Communications and Liberty Media have discussed a combination of Verizon with Charter Communications. Given expectations for a more forgiving regulatory environment under the new Presidential administration, we expect to see more high yield issuers like Charter targeted for M&A this year, a dynamic that will serve as a tailwind for the asset class.
- **Emerging Markets:** Turkish monetary policy has been closely watched in light of the rapid depreciation of the lira. This week, Turkey's central bank chose to tighten liquidity via the overnight lending rate (raising it 75 bps to 9.25%) and the late liquidity window (hiking the rate 100 bps to 11%), while leaving the benchmark rate unchanged at 8%. The move highlighted the bank's desire to use unconventional monetary policy to combat currency weakness, in particular given a softer domestic growth environment.
- **Currencies:** The two Antipodean currencies usually move in tandem; however, this week saw a divergence in their trajectory against the US dollar. The New Zealand dollar rose on Wednesday after better than anticipated CPI data boosted the expectations of a rate hike by the RBNZ. The Australian dollar, on the other hand, slumped against most counterparts despite some strong export price data. Many attributed the Aussie dollar's softness to a combination of weak domestic inflation figures and low December industrial numbers in China. If the trend persists, this is likely to be the Aussie's first weekly loss in 2017.
- **Municipals:** Municipal funds realized a third consecutive week of inflows, drawing a modest \$6.98mm over the past week. Performance continued to be resilient, with municipals outperforming a Treasury market drifting higher in yield.