Market Overview

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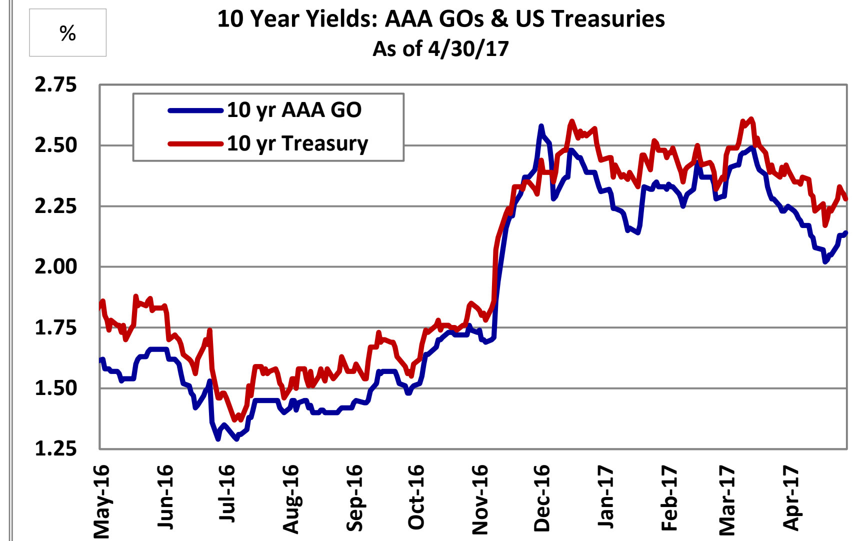
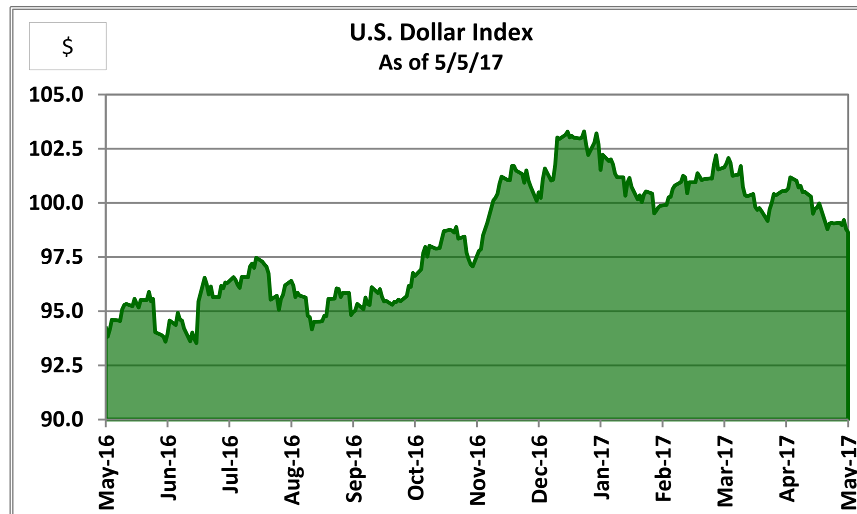
Yields across US rate markets continued to decline modestly as bond investor fears of fiscal stimulus and a more aggressive Federal Reserve were tempered by slow progress on the legislative front. But in a surprise development, the House narrowly passed the American Health Care Act (AHCA) 5 weeks after failing to garner enough momentum to schedule a vote. The effort to get the legislation to the finish line was accompanied by virtually no debate on the House floor, and importantly included no scoring from the Congressional Budget Office regarding its cost or the number of people who would be left uninsured in its wake. There was limited market reaction to the news which was likely reflective of the uphill sledding the bill faces in the Senate. Early indications are that the Senate will start work on a separate bill rather than use the AHCA as a starting point for its efforts. Market participants will be keen to observe whether the House passage presages renewed legislative momentum or augurs for an even slower track for Tax Policy and Infrastructure initiatives as the Senate takes up Health Policy.

Since the start of the year, rate and currency markets have been correcting some of the excesses that were priced in following the November election. The Dollar, which rallied more than 5% after the election, has corrected by 3% to the downside through April of this year, and 10-year Treasury yields have fallen by 30 basis points from their high-water mark reached in mid-March. Equity investors, however, remain the most optimistic with broad market indices holding gains of nearly 15% from the November lows. Across domestic fixed income markets, 'reach-for-yield' behavior continues to predominate as yields grind lower and quality spreads shrink further. The need to replace lost income continues to exert a stronger influence on fixed income investors than the fear of higher rates. We believe this balance will ultimately shift and behavior will change, but for the time being low nominal rates and tighter spreads remain the order of the day.

- Treasury yields worked lower during the month as rate markets continue to consolidate in quiet trade.
- Corporate issuance year-to-date continued at a record clip, extending the trend of 5 consecutive years of expanding new issue volume.
- Municipal yields declined modestly with the strongest performance in the intermediate portion of the yield curve.
- Municipal New Issue Volume decelerated from last year's record pace as Refunding Issuance declined sharply.
- Quality spreads continued to compress across domestic markets as 'reach-for-yield' behavior proved the path of least resistance for fixed-income investors.

France says Non! The populist tide that swept Britain to vote to leave the European Union received a crushing defeat in the French Presidential Election. The pro-EU, centrist newcomer, Emmanuel Macron, was elected in a landslide helping to ease market fears of a continued march toward schism and potential breakup of the Eurozone itself. Anti-EU candidates have successively failed in Austria, the Netherlands and now France. With the hurdle of the French Presidential election now passed and parliamentary balloting set to take place in early June, Macron will be hoping to attract candidates to affiliate with his newly formed La Republique En Marche (Republic on the Move) party which favors strengthening EU integration. The failure of the anti-globalists in France is a significant event and may mark a turning point in the weakening of the West and the fracturing of its global alliance. Chancellor Merkel's party also performed well in state elections this month, providing a boost as she prepares for Federal elections in the Fall.





Source: Bloomberg; Municipal Market Data.
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Fixed Income Market Commentary ✧ May 2017

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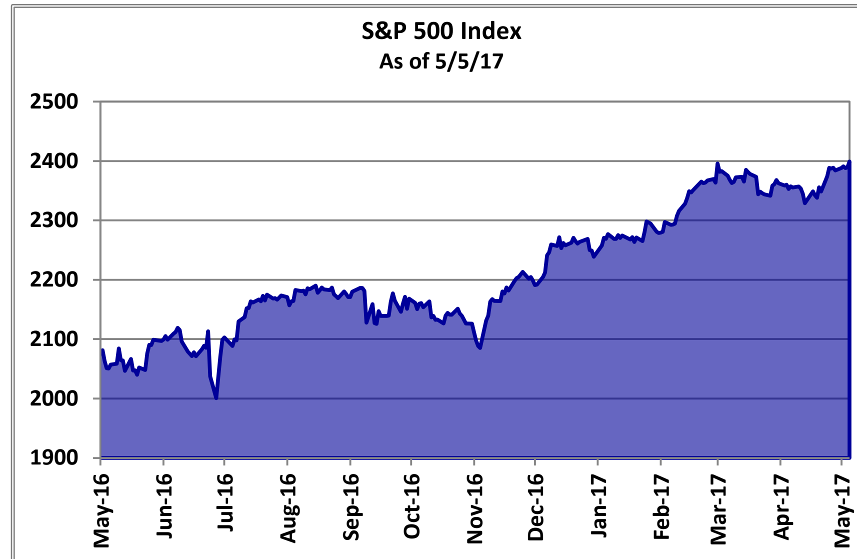
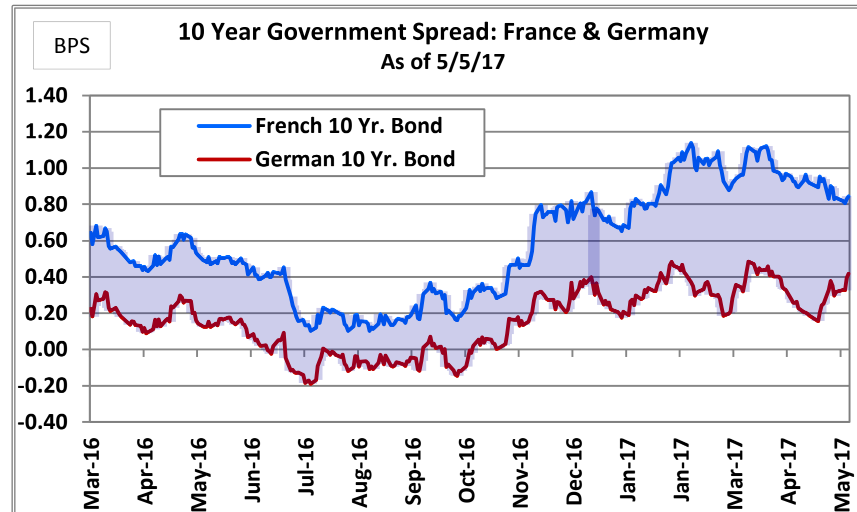
The stage has now been set for the Commonwealth of Puerto Rico to begin the path toward a ‘bankruptcy-like’ process to work out from under its mountain of debt ($73B) and massive unfunded pension liability ($46B). The Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) was passed by Congress and signed into law in June of 2016. The legislation was designed to provide the Commonwealth with temporary relief from creditor litigation while efforts were made to spur bondholders and other stakeholders to more aggressively pursue accommodation during negotiations. The act provided for the installation of a 7-member Board to steer negotiations, oversee the budgetary process, and included authorization to enter into a bankruptcy-like process in the event that negotiations failed to reach sustainable resolution. The process has now begun and will be overseen by a Federal Judge who is expected to preside over hearings in San Juan. The Commonwealth’s fiscal crisis has been ongoing for many years, and the degree of economic and fiscal strain is severe. We expect the resolution of the crisis to take considerable time and extract significant costs from stakeholders. Ultimately, we believe a liability rebalancing which restores conditions that foster economic growth and opportunity for the citizens of the Commonwealth is the only viable road to a sustainable economic future.

As we approach mid-year, we expect the economy to continue to travel along the moderate path of 2% growth and near 2% inflation. Despite the ebullience reflected in US equity markets of late, we believe the fundamentals are indicative of an economy which is at or near full employment, experiencing weak productivity growth, and continuing to encounter relatively weak aggregate demand globally. While the global growth prospects appear to have brightened somewhat recently, we view the improvement as a cyclical upswing rather than a fundamental turn of trend. Inflation has turned higher, but the recovery back to target is mostly a reflection of a rebound in oil prices from the severely depressed levels that occurred at the start of last year. The housing and medical components of inflation are trending higher but the broader outlook for prices appears more benign. As such, solid growth in the 2% range combined with non-accelerating inflation and a Federal Reserve that is removing accommodation at a gradual pace, come together to foster conditions which provide a relatively benign backdrop for fixed-income investors. We expect the Fed will continue its attempt to ‘normalize’ short-term interest policy but remain more circumspect about the effect monetary policy will have on the longer-end of the yield curve. Political and geopolitical risks remain elevated and are of concern over the medium-term.





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