

Fixed Income Weekly

FOR PROFESSIONAL INVESTORS

Dodging a Bullet and a Missile

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Key takeaways

- US yields moved higher as concerns over Hurricane Irma and potential conflict with North Korea faded
- The Federal Open Market Committee is on track to begin balance sheet normalization
- US Inflation data a little firmer so we may see one more fed funds rate hike in 2017

Full commentary

Florida dodged a bullet as the worst fears over Hurricane Irma were fortunately not realized. The dangerous storm came ashore as a category 4 hurricane in the Florida Keys. On the heels of last month's Hurricane Harvey this marked the first time ever that two Category 4 Atlantic storms made landfall in the US in the same year. Hurricane Irma stayed away from Miami and Tampa, instead moving up the central area of the state. The storm lost strength along the way and for the most part avoided major population centers. While Hurricane Irma undoubtedly caused a substantial amount of destruction, the damage in Florida was far less than anticipated allowing financial markets to breathe a sigh of relief this week. Spreads on fixed income risk assets, which had moved sharply wider the previous week as Irma approached Florida, snapped in on Monday last week. US equity markets also moved higher closing the week at or near all-time highs.

Geo-political events were also highlighted as the UN Security Council voted to impose additional economic sanctions on North Korea. Financial markets were somewhat calmed by a watered down version of the resolution which passed unanimously. North Korea responded with another intermediate missile launch over Japan on Friday. Markets largely shrugged off the missile launch, appearing to have grown immune to escalating tensions with North Korea. Likewise, a terror attack on the London subway system on Friday had little to no impact on financial markets, solidifying the notion that investors have grown numb to these types of events.

Hurricane worries and geo-political concerns had the US 10-year yields close to a new low for the year on Friday, September 8 at 2.06% after touching 2.01% earlier in the day. However the flight to quality rally was quickly unwound last week as the market perceived diminishing tensions with North Korea and saw far less damage from Hurricane Irma than anticipated. The 10-year yields finished the week at 2.20%. Risk assets performed well on the week with US high yield credit posting a 64 basis points positive excess return and the S&P 500 Index touching 2,500 for the first time, closing at a new all-time high at 2,497.

The market's attention now turns to the Federal Open Market Committee (FOMC) meeting next Wednesday. The Federal Reserve (Fed) is widely anticipated to announce an October commencement of the tapering of their mortgage-backed securities (MBS) and US Treasury re-investments, and a gradual normalization of their balance sheet. US economic data has been positive with an upward revision from 2.6% to 3.0% to the second quarter's gross domestic product (GDP) and a solid September payroll report. Thursday's Consumer Price Index (CPI) release ended 5 consecutive misses to the downside of expectations. Core CPI was up 0.2% m.o.m. largely driven by an increase in the lodging component.

Near term trends suggest that US inflation is firming, which lends support to the Fed's consensus projection for one additional hike to the fed funds rate in 2017, which would likely come at the December FOMC meeting. Current pricing of fed funds futures show market participants split about 50/50 over a December hike. Recent weakness in the US dollar, coupled with continued labor market strength, suggests that the Fed's view regarding inflation moving towards its 2% target may in fact finally be right. That would come as a surprise to bond markets and it could induce US yields higher. So too would any more hawkish language from the Fed statement next week.



Last week's market developments

Monday, September 11

- No data to report

Tuesday, September 12

- UK CPI increased to 0.6% m.o.m. n.s.a. for August
- UK Producer Price Index for manufactured products increased to 0.4% for August m.o.m.
- Japan Producer Price Index increased to 2.9% for August y.o.y.

Wednesday, September 13

- Germany CPI (final estimate) remained at 0.1% m.o.m. for August
- US Producer Price Final Demand Index increased to 0.2% m.o.m. for August

Thursday, September 14

- US CPI increased to 0.4% m.o.m. s.a. for August

Friday, September 15

- US Empire Manufacturing Index decreased to 24.4 s.a. for September
- US Retail Sales Advance Change Index decreased to -0.2% m.o.m. for August
- US industrial production growth decreased to -0.9% m.o.m. for August
- US University of Michigan Consumer Sentiment Index (preliminary estimate) decreased to 95.3 for September

Source: Bloomberg, data as of September 18, 2017

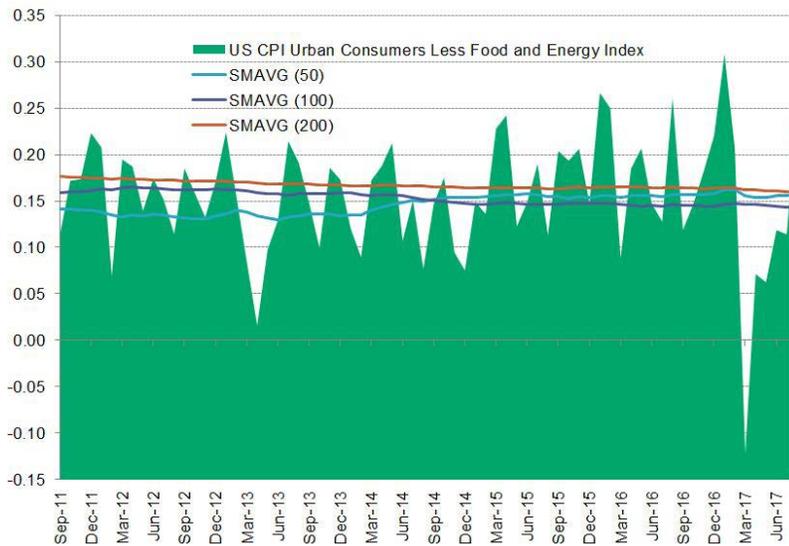


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Chart of the Week
Core CPI Change



Source: Bloomberg; data as of September 18, 2017



This week's market developments

Monday, September 18

- Eurozone CPI is expected to increase to 0.3% m.o.m. for August

Tuesday, September 19

- Germany ZEW Expectations of Economic Growth Survey Index is expected to increase to 12.0 for September
- US Housing Starts Index is expected to increase to 1,174k for August

Wednesday, September 20

- US existing home sales are expected to increase to 5.46m s.a.a.r. for August
- UK retail sales ex-auto fuel growth is expected to decrease to 0.1% m.o.m. for August

Thursday, September 21

- Japan All Industry Activity Index is expected to decrease to -0.1% for July m.o.m.
- US Philadelphia Fed Business Outlook Index is expected to decrease to 17.1 for September
- Europe Consumer Confidence Indicator is expected to remain at -1.5 for September
- US Conference Board Leading Index is expected to remain at 0.3% m.o.m. for August

Friday, September 22

- Markit Eurozone Manufacturing PMI is expected to decrease to 57.2 s.a. for September (preliminary estimate)
- Markit US Manufacturing PMI is expected to increase to 53.0 s.a. for September (preliminary estimate)
- Markit US Services PMI is expected to decrease to 55.7 s.a. for September (preliminary estimate)

Source: Bloomberg, data as of September 18, 2017



Central Bank Watch

	Last move	Date of move	Current policy rate	Implied 3-Month Rate on September 2017 Interest Rate Futures Contract	Next meeting
Fed	+25 basis points	June 14, 2017	1.00% - 1.25%	1.15%	September 20
ECB	-5 basis points	March 10, 2016	0.00%	-0.36%	October 26
BoJ	-20 basis points	February 16, 2016	-0.10% - 0.00%	0.06%	September 21
BoE	-25 basis points	August 4, 2016	0.25%	0.34%	November 2

Source: Bloomberg; data as of September 18, 2017

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