Fixed Income Weekly
FOR PROFESSIONAL INVESTORS

If Only President Trump Would…

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Key takeaways

- Geopolitical concerns and turmoil in Washington are creating uncertainties in risk markets.
- Overall second quarter results show continued earnings strength, but the much anticipated pickup in capital expenditures is not materializing and outlook for 2018 is also being lowered.
- Strong July retail sales set the third quarter economic growth on solid footing; however, the US political situation could raise uncertainties in the second half of the year.

Full commentary

The much anticipated, late-August calm in financial markets has taken a backseat amidst rising geopolitical concerns, increased uneasiness in response to the rhetoric from Washington and a few weaker-than-expected earnings releases this past week. After a strong first quarter earnings season, overall results for the second quarter, so far, is also better-than-expected, with mid-single digit top line growth and earnings growth almost doubling that of revenue. We are seeing margin expansion in the most cyclical companies and as long as revenue growth continues and wage pressures remain muted, profit and profit margin expansion should persist in the near term. As global growth increases, companies with larger international exposure are increasing earnings at a faster pace than their domestic only peers. The European region is seeing stronger economic growth than many anticipated heading into the year, and the Japanese economy expanded its growth streak during the second quarter, while the picture in Latin America remains mixed. We expect earnings to benefit from currency translation gains in the second half of 2017. Leverage for US corporate remains elevated and the much anticipated pickup in capital expenditures is not materializing. Based on a recent Standard & Poor's survey of corporate issuers, North American companies are expected to increase 2017 capital expenditures by 3.5% over 2016. While the trend is better than recent years, it is underwhelming, and with the expectation for meaningful tax reform fading, along with reduced outlook for energy prices, 2018 capital expenditure budgets may be lowered as well.

Absent any major shocks, many economists expect the US economic expansion to continue for the next 12-18 months, the longest on record. However, events over the past couple of weeks have created some angst in markets, especially for the riskiest segment. Equities and high yields saw outflows over the past week, as investors flooded to traditional safe havens. Market moves were further accentuated by the terrorist attack in Spain (see VIX Index chart of the week). Deteriorating support for our President is coming from all directions, domestically and internationally, and we remain concerned that the political turmoil in Washington is contributing to a loss of confidence.

Economic data released this past week, while mixed, is largely supportive of continued growth in early third quarter. The 0.6% gain in retail sales in July and upward revisions in May and June, showed an accelerating consumer demand in the third quarter 2017. The strength in retail was broad based, with even the department stores, in secular decline, posting growth. Total business inventories increased by 0.5% in June, also signaling a slight upward revision to second quarter GDP data. US Industrial Production and Capacity Utilization data came in positive during July, with Industrial Production up 0.2% and Capacity Utilization up 0.1% sequentially. Homebuilding data was mixed. Housing starts and building permits were below expectations, while homebuilder confidence increased, ahead of expectations, and may be indicative of the difficulties that builders face in finding suitable land.

This week's market developments

Monday, August 14
- Eurozone industrial production growth decrease to -0.6% for June

Tuesday, August 15
- Germany second quarter GDP growth (prelim estimate) remained at 0.7% q.o.q.
- UK CPI growth decreased to -0.1% m.o.m. for July
- UK PPI output growth increased to 0.1% m.o.m. for July
- US retail sales advance growth increased to 0.6% m.om. for July

Wednesday, August 16
- Eurozone second quarter GDP growth (prelim estimate) remained at 0.6% q.o.q.
- US housing starts decreased to 1,155,000 for July

Thursday, August 17
- Eurozone CPI growth decreased to -0.5% m.o.m. for July
- UK retail sales ex auto & fuel decreased to 0.5% m.o.m. for July
- US industrial production growth decreased to 0.2% m.o.m. for July
- US Leading Index growth decreased to 0.3% m.o.m. for July

Friday, August 18
- University of Michigan Sentiment Index (prelim estimate) increase to 97.6 for August

Source: Bloomberg, as of August 21, 2017

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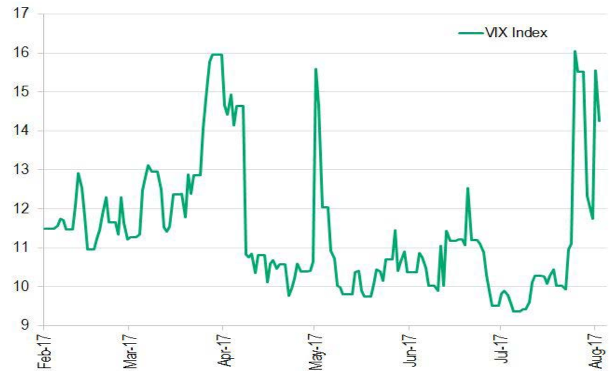
From a fundamental perspective, the current cyclical backdrop remains supportive for U.S. earnings growth in the second half of 2017, and consumption data started off the third quarter on a strong footing. With a strong job market and household wealth at record levels, the favorable consumer indicators remain supportive to the U.S. economic growth narrative. However, a deteriorating political situation could raise uncertainties in the second half of 2017.

Chart of the Week

Chicago Board Options Exchange SPX Volatility Index



Source: Bloomberg; data as of August 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%	1.16%	September 20
ECB	-5 basis points	March 10, 2016	0.00%	-0.18%	September 7
BoJ	-20 basis points	February 16, 2016	-0.10% - 0.00%	0.06%	September 21
BoE	-25 basis points	August 4, 2016	0.25%	0.29%	September 14

Source: Bloomberg, August 21, 2017

Next week's market developments

Monday, August 21
- Japan All Industry Activity Index growth is expected to increase to 0.4% m.o.m. for June

Tuesday, August 22
- US FHFA House Price Index growth is expected to increase to 0.5% m.o.m. for June

Wednesday, August 23
- Germany Markit Manufacturing PMI growth (prelim estimate) is expected to decrease to 57.6 for August
- Germany Markit Services PMI growth (prelim estimate) is expected to increase to 53.3 for August
- Markit Eurozone Manufacturing PMI growth (prelim estimate) is expected to decrease to 56.3 for August
- Markit Eurozone Services PMI growth (prelim estimate) is expected to remain at 55.4 for August
- Markit US Manufacturing PMI growth (prelim estimate) is expected to increase to 53.5 for August
- Markit US Services PMI growth (prelim estimate) is expected to increase to 54.9 for August
- US new home sales are expected to remain at 610,000 for July

Thursday, August 24
- UK second quarter GDP growth (prelim estimate) is expected to remain at 0.3% q.o.q.
- US existing home sales growth is expected to increase to 5,550,000 for July

Friday, August 25
- Germany second quarter GDP growth (final estimate) is expected to remain at 0.6% q.o.q

Source: Bloomberg, as of August 21, 2017