Fixed income weekly

FOR PROFESSIONAL INVESTORS

Disconcerted complacency

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Key takeaways

- While the catalyst for a sustained change in sentiment can be difficult to predict, several risk factors may disrupt markets during the remainder of this year.
- The global economy appears to have entered a synchronized expansion.
- Despite rising exogenous risks, markets appear to be prodding along on a steady upward trajectory.

Full commentary

Doldrums have arrived as we enter the final weeks of summer. However, those that followed the old seasonal adage of "sell in May and go away…" may have missed an atypical seasonal rally in risky assets. Have we become too complacent? Are we missing something? What challenges are looming around the corner? While the catalyst for a sustained change in sentiment can be difficult to predict, several risk factors may disrupt markets during the remainder of this year. These risks can be broadly categorized in three groups: politics, geopolitics and economic.

Chaos in Trump administration continues to drive headlines and this week was no exception. The reshuffling of cabinet positions has led to another dismissal in the oval office. White House communications director Anthony Scaramucci was fired after just ten days in the role in response to inappropriate comments made which exceeded the boundaries of social decorum. Distractions within the administration continue to severely limit the potential for legislative success. With congress departing for August recess, healthcare reform has been put on hold for the foreseeable future. The next item on the triage list is an increase in the debt ceiling which will dominate the agenda in September. With just a few weeks before the mid-term elections, political gerrymandering will be prominently displayed in the media. Admittedly, the risk of a government shutdown should be taken seriously, but as in previous iterations, a "save the day" agreement is likely to be made at the eleventh hour.

New developments in the geopolitical environment are far more concerning. The diplomatic discourse with North Korea was taken to a new level this week as the US military proudly displayed their intercontinental ballistic missile capabilities with a test launch across the Pacific Ocean. Not to be left out, Congress passed a new sanctions bill on Russia largely in response to suspected election meddling which was subsequently signed into law by President Trump later in the week. The bill, which included additional sanctions on both Iran and North Korea, related to the nuclear ambitions of both countries, served to disrupt any hope of improving US-Russian relations, another strike to the Trump platform. The deterioration of international relations has been a troubling theme for the last year and may pose increased risk to markets in the coming year.

In contrast to politics, economic conditions are less dire with low perceived risk of a near term US recession. The global economy appears to have entered a synchronized expansion with several economies in the mid to late cycle stages. We are comforted by the fact that weak growth generally leads to long cycles and that, with inflation remaining below target, monetary policy makers are unlikely to remove stimulus very quickly. Current economic conditions continue to support corporate profit growth lifting both revenues and earnings across the globe. The

This week's market developments

Tuesday, August 1

- Markit Eurozone Manufacturing PMI growth (final estimate) decreased to 56.6 for July
- Eurozone 2nd quarter GDP growth (advance estimate) remained at 0.6% q.o.q.
- US Personal Income growth decreased to 0.0% for June
- US ISM Manufacturing Index decreased to 56.3 for July
- US Construction Spending decreased to -1.3% m.o.m. for June

Wednesday, August 2

- US ADP National Employment Report increased to 178,000 s.a. for July
- UK Markit/CIPS Construction PMI decreased to 51.9 s.a. for July

Thursday, August 3

- US factory orders growth increased to 3.0% m.o.m. for June
- US durable goods orders growth (final estimate) decreased to 6.4% m.o.m. for June

Friday, August 4

- Germany factory orders growth increased to 1.0% m.o.m. for June
- US change in non-farm payrolls increased to 209,000 m.o.m. for July
- US unemployment rate decreased to 4.3% s.a. for July

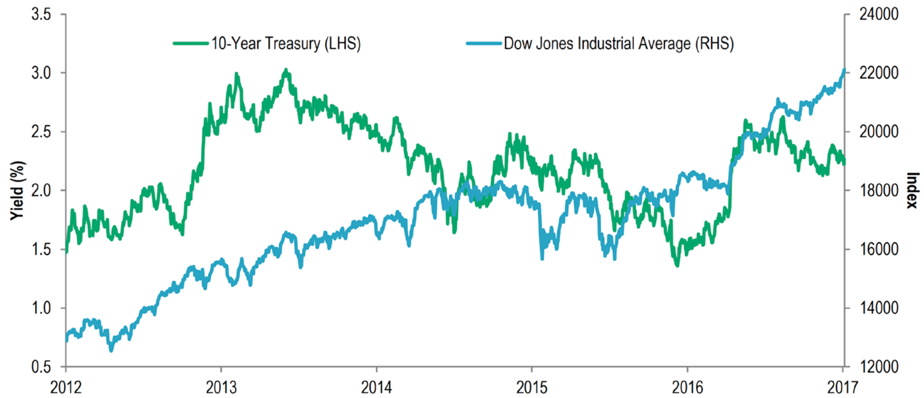
Source: Bloomberg, as of August 4, 2017

US consumer has benefitted from a steadily improving labor market which has the potential to drive spending patterns in the coming year. Nonetheless, the combination of a maturing economic cycle and a shift to tighter monetary policy may introduce more volatility in markets going forward.

Despite rising exogenous risks, markets appear to be prodding along on a steady upward trajectory. The Dow Jones Industrials breached 22,000 on Friday, after the Bureau of Labor Statistics reported an increase of 200,000+ jobs and a corresponding decrease in the US unemployment rate to 4.3%. The modest increase in wages should support improvements in consumer spending patterns though are unlikely to drive inflation appreciably higher in the near term. While current conditions should restrain monetary policy makers, the source of market risk may lie elsewhere

Chart of the week

US equities surge; US Treasury yields range trade



Source: Bloomberg as of August 4, 2017

Next week's market developments

Monday, August 7

- Germany industrial production growth is expected to decrease to 0.2% m.o.m. for June

Tuesday, August 8

- US NFIB Small Business Optimism is expected to decrease to 103.5 for July

Wednesday, August 9

- US Wholesale Inventories growth is expected to remain at 0.6% for June
- Japan Machine Orders growth is expected to increase to 3.6% m.om. for June
- Japan PPI is expected to increase to 2.3% y.o.y. for July

Thursday, August 10

- Japan Tertiary Industry Index growth is expected to increase to 0.2% m.om. for June
- UK Industrial Production growth is expected to increase to 0.1% m.o.m. for June
- UK Manufacturing Production growth is expected to increase to 0.0% m.om. for June
- US PPI Final Demand growth is expected to remain at 0.1% m.om. for July

Friday, August 11

- Germany CPI growth (final estimate) is expected to remain at 0.4% m.o.m. for July
- US CPI growth is expected to increase to 0.2% m.om. for July

Source: Bloomberg, as of August 4, 2017

Central Bank watch

	Last move	Date of move	Current policy rate	Implied 3m rate on September 2017 interest rates futures contract	Next meeting
Fed	+25 basis points	June 14, 2017	1.00 % - 1.25 %	1.16 %	September 20, 2017
ECB	-5 basis points	March 10, 2016	0.00 %	-0.18 %	September 7, 2017
BoJ	-20 basis points	February 16, 2016	-0.10 % - 0.00%	0.07 %	September 21, 2017
BoE	-25 basis points	August 4, 2016	0.25 %	0.30 %	September 14, 2017

Source: Bloomberg