Payden&Rygel Investment Management

WEEKLY MARKET UPDATE

March 11, 2016

MARKET LEVELS

	Friday*	Last week	Dec. 31, 2015	One year ago
Dow Jones Industrial Avg	17,206	17,007	17,425	17,895
S&P 500	2,016	2,000	2,044	2,066
NASDAQ	4,729	4,717	5,007	4,893
Russell 2000	1,081	1,082	1,136	1,237
DJ STOXX Europe 600 (€)	342	342	366	395
Nikkei Index (¥)	16,939	17,015	19,034	18,991
MSCI EM Index	409	409	411	448
Fed Funds Target	0.25%-0.50%	0.25%-0.50%	0.25%-0.50%	0%-0.25%
2-Year Treasury Yield	0.96%	0.86%	1.05%	0.67%
10-Year Treasury Yield	1.98%	1.88%	2.27%	2.12%
U.S. $ / Euro	1.12	1.10	1.09	1.06
U.S. $ / British Pound	1.44	1.42	1.47	1.49
Yen / U.S. $	113.74	113.92	120.22	121.37
Gold ($/oz)	$1,259.08	$1,259.25	$1,061.42	$1,153.68
Oil	$38.56	$35.92	$37.04	$47.05

**Levels reported as of 8:40 a.m. PDT*

MARKET RETURNS

Year-to-date (12/31/15 – 03/11/16)*

Dow Jones Indus Avg.	-0.57%
S&P 500	-0.85%
NASDAQ	-5.27%
Russell 2000	-4.55%
MSCI World Index	-3.95%
DJ STOXX Europe 600	-5.91%
MSCI EM Index	-0.60%

**Returns reported as of 8:40 a.m. PDT*

Year-to-date (12/31/15 – 03/10/16)

90 Day T-Bill	0.05%
2-Year Treasury	0.40%
10-Year Treasury	3.31%
ML High Yield Index	1.75%
JPM EMBI Global Diversified	3.06%
JPM Global Hedged	2.77%

RECAP OF THE WEEK'S ECONOMIC RELEASES

Date	Report	Survey	Actual	Prior	Details
03/08	(EC) GDP SA YoY	1.50%	1.60%	1.50%	Euro-Area Q4 2015 growth marked the 11th consecutive quarter of positive growth.
03/09	(UK) Industrial Production YoY	0.00%	0.20%	-0.40%	UK industrial production rebounded due to manufacturing and energy production.
03/10	(US) Initial Jobless Claims	275k	259k	278k	Last week's jobless claims marked the 52nd consecutive week of claims below 300k.

ECONOMIC OVERVIEW

Several thoughtful critics of our view that the US economy will avoid a recession in 2016 have pointed to earnings growth as a bad omen. A contraction in corporate earnings usually signals a recession, they say. Is it true? Should we heed the clarion call of earnings and abandon our upbeat view on the economic outlook?

To help answer that question we looked at monthly earnings data, maintained by economist Robert Shiller, going back to 1871. Since 1871, of the 32 times monthly earnings growth went negative on a year-over-year basis, 11 times a recession followed within 12 months. That is, 34% of the time, an "earnings recession" meant a real recession within 12 months. However, 66% of the time earnings growth served as a "false positive," predicting a recession when one did not follow. Further, even when earnings growth turned negative before those recessions, it was not alone in its foresight. Other leading economic indicators, such as initial claims for unemployment, the yield curve, housing activity and even the unemployment rate were flashing red in the year leading up to the start of each recession.

So we offer two conclusions. First, it would not be a shock to see a period of negative earnings growth without a recession following. Second, and most significantly, when earnings growth does signal a recession, a host of other leading indicators tend to corroborate the forecast—something we do not see in the economic data today. As forecasters, we never rely on a single indicator but consult a wide array of factors to make our best predictions about the future.

In short, we acknowledge the risks presented by the contraction in corporate earnings but we still aren't betting on a recession.

US MARKETS:

TREASURIES

- Treasuries finally succumbed to pressure from $45 billion of corporate supply and $56 billion of government supply this week. Yields moved higher across the curve with the short end moving the most. The curve continued to flatten with 5/30's down 10 basis points to 122. Economic data was second tier and scarce with no real surprises.

- With 10-year and 30-year repo rates at fail levels due to lack of supply and large demand for "on the run" issues, the market was setting up for strong auctions. The 3-year and 10-year were weak and tailed while the 30-year came through. All of these moves coming on lighter volumes with the markets waiting for the ECB on March 10.

- Mario came through on all measures and then some: three different interest rate cuts (marginal, main and deposit), monthly purchases increased, investment grade non-bank corporate bonds included in purchases and four new longer term refinance operations (TLTRO II). The Q&A offered surprises as well with Draghi saying he "expected no further rate cuts". The Euro currency and equity markets quickly reversed the positive effects of the plan.

- On Friday, with the markets getting another day to digest the details of the policy changes all was right with the world and equities and financials in Europe rallied and the euro sold off the highs. The risk on sentiment carried through to the US with equities rallying and yields moving higher. The 10-year yield broke through the 50 day average of 1.93%. Asia continued the volatility and uncertainty this week with Chinese exports lowest since 2009 and JGB auction well oversubscribed causing 30-year JGB yields to fall 22 basis points in one day only to reverse 24 basis points higher the next day.

LARGE-CAP EQUITIES

- The U.S. Equity Market rallied for the fourth consecutive week as the ECB announced a series of additional easing measures and commodity prices continued to recover. The improved market sentiment was apparent as recent laggards and the riskiest of sectors surged higher on the back of lower volatility. The S&P 500 index closed the week up approximately 0.7%, posting gains in eight out of the last nine trading sessions. The Dow Jones Industrial Average index surged 1.1% higher, while the tech focused NASDAQ Composite lagged other major indices after ending the week up only 0.2%. Large-cap stocks outperformed small-cap stocks. In terms of style, large-cap value stocks outperformed large-cap growth stocks. The best performing sectors were utilities and materials, while the worst performing sectors were financials and industrials.

- In fund flow news, redemptions out of domestic mutual funds slowed for the week as Lipper reported investors redeemed a mere $163 million for the week, the fifth consecutive week of redemptions. Conversely, investors continued to add international equities as Lipper reported that non-domestic equity mutual funds took in $416 million for the week, its sixth consecutive week of subscriptions.

CORPORATE BONDS

- Primary activity has been busy in March, with several large deals coming in the last few days. Expectations for the week were around $30 billion and as of Friday issuance hit $25 billion, just slightly under estimates. The biggest deal of the week was $9 billion issued on Tuesday by AA rated company Berkshire Hathaway (BRK). One interesting note on the deal was that the bonds only extended to a 10 year maturity, whereas most similarly large deals have a 2-30 year maturity range. Only one of the three floating rate tranches was dropped. The dropped tranche was a 5 year floater; the longer floating tranches like this one have been the most frequently dropped so far this year. The deal was 4.1x subscribed and tightened 25-30 basis points from initial price talk to final pricing, a new phenomenon of significant price tightening that has sprung up in the new month. The bonds tightened another 5-10 basis points on the break.

- In corporate news, BBB bonds have been outperforming higher quality investment grade paper as the risk-off sentiment has retreated somewhat in recent days. Similarly, energy bonds have gotten a significant boost as oil is over $38 again. The Corporate Index Option-Adjusted Spread (OAS) finished the week at +180, 13 tighter on the week. Overall Metals/Mining were 35 tighter; energy was 46 tighter. Senior financials were 10 tighter and subordinated were 15 tighter, outperforming industrials for the first week in about a month. Industrials were eight tighter and utilities were tighter by two.

MORTGAGE-BACKED SECURITIES

- Agency mortgages benefited from higher interest rates, a flatter yield curve, and an unwind to flight-to-quality positions. Stronger-than-expected economic reports and expansion of the ECB's quantitative easing campaign lifted credit and equity markets. Mortgage pass-through (MBS) spreads compressed across the curve by 5-7 basis points.

- The release of prepayments for February showed a modest increase but was still in-line with dealer forecasts. The market is expecting a jump in prepayments in the next two reports to account for dip in primary mortgage rates in January/February. On a relative basis, the twist in the yield curve favoring longer-term assets led to relative outperformance for lower coupons and 30-year mortgage bonds versus higher coupons and 15-year bonds. In the programs, Ginnie Mae MBS continued their ascent over Fannie Mae/Freddie Mac from steady buying from Japan. This has been a trend that we have witnessed since mid-February as foreign buyers have specific yield entry points. In other markets, commercial MBS failed to rally with corporate credit and equities with spreads unchanged for the week. No new conduit deals priced but secondary positions on long-cash flow 10-year AAA bonds traded in the mid-150s versus US Treasuries.

- For the week, the 30-year current coupon spread versus the 10-year Treasury tightened by two basis points to 73 basis points. According to Freddie Mac, the average primary 30-year mortgage rate offered to borrowers edged higher to 3.68%.

ASSET-BACKED SECURITIES

- The CLO market has finally followed the rest of the credit market tighter. A couple of successful BB-rated sell lists on Tuesday, followed by some BBB-rated selling on Thursday were the catalyst to send spreads tighter for the first time this year. BBB spreads are 30 tighter on the week, and BB spreads are 80 tighter according to Citibank.

- On-the-run new issue ABS continues to be popular with investors like the Mercedes lease deal this week. Subordinated classes of near-prime and subprime auto loan deals are just the opposite. Both the Ally and California Republic deals had to widen their BBB-rated classes to clear the marketplace with all in yields in the +4% area. Next week should be interesting with a wide variety of collateral types anticipated to come to market. There will be tiers, but the real question will be how much?

MUNICIPAL BONDS

- The municipal market traded to slightly higher yields this week with a steepening bias against a backdrop of stronger energy prices. At mid-week, the 10-year AAA benchmark municipal yield registered in at 1.88% and nearly 99% of its Treasury counterpart. The municipal to Treasury yield is more attractive farther out the yield curve on a relative value basis as 30-year municipal yields are 108% of their Treasury counterpart.

- New issue supply decreased to $8.5 billion this week. The 2015 weekly average was about $8.0 billion. The largest deals this week included $2 billion State of California and $1.4 billion New York City UDC Personal income Tax bonds. New issue supply is lower so far this year due to reduced refunding volume. Most new issues priced at historically traditional spreads due to the excess calls and redemptions generating cash aided by positive mutual fund flows. The calendar next week is about $6 billion led by $780 million Vanderbilt University Medical Center and $750 million New York City Transitional Finance Authority.

- Competitive deals saw meandering demand while most negotiated new issues were priced attractively in order to garner buyer's attention amidst a low interest rate environment. The secondary market experienced reasonable bidding with most trading in-line with the overall markets' weaker tone. Dealer's bids are spotty under current market conditions. The 30 day visible supply is $10.0 billion, somewhat larger to averages for the year. Longer term, municipal bonds should outperform other fixed markets as relationships are reasonable relative to Treasuries.

HIGH-YIELD BONDS

- The BofA Merrill Lynch BB/B cash pay constrained index was up +0.19% this week as spreads tightened by two basis points to an option-adjusted-spread of +538 basis points. The BofA Merrill Lynch BB/B index that excludes utilities and energy ticked up +0.06% for an OAS of +490 as the spread of that index remained unchanged for the week. The BofA Merrill Lynch Euro BB/B constrained index was up +0.75% as the spread of that index tightened by 26 basis points for an OAS of +499.

- High-yield was slightly softer early in the week as the rally of the past three weeks paused amid profit-taking and waning inflows. The breather was short-lived; the ECB's massive stimulus announcement on Thursday sent risk assets soaring higher.

- Inflows into high-yield funds totaled +$1.9 billion this week on the heels of the record inflow of +$5 billion last week. The inflows for the past three week's total +$9.5 billion and are also the largest on record for that time period. Year-to-date high-yield inflows for 2016 now total +$4.75 billion versus an inflow of +$11.4 billion year-to-date in 2015.

- Secondary trading activity has also slowed down from last week's blistering average volume of $17.8 billion per day, but the pace of trading remains elevated. The daily average secondary trading volume for the week so far is $15.2 billion versus a year-to-date average of $13.2 billion.

- Dealer inventories were already being reported towards the lower end of the historic range prior to the rally of the past three weeks, and recent investor demand reduced it even further. The New York Fed report of dealer holdings of non-investment grade corporate bonds for the week of 2/24 was $1.4 billion. This was a decrease of $509 million from the prior week, with a range of $308 million to $8.4 billion since April 2013.

- Market conditions continue to improve for high-yield and the new-issue market is starting to show signs of life. Three issues have price so far this week for total proceeds of $2.025 billion. The largest deal of the week so far was a $900 million add-on to the existing 5.00% secured notes maturing on 1/15/24 issued by First Data Corporation. The add-on increases the total issue size of the B1/BB rated notes to $1.9 billion and was priced at 99.50 to yield 5.08% at a spread of 355 basis points over treasuries. The commerce technology solutions provider is using the proceeds of the new notes to pay down term loans that mature in 2018.

INTERNATIONAL MARKETS:

GLOBAL BONDS AND CURRENCIES

- Sentiment in the markets this week was largely driven by the European Central Bank's (ECB) policy meeting on Thursday. The week started on a more cautious tone as investors anticipated President Draghi's speech in the middle of the week and some earlier soft economic data from China weighed on risk appetite. However, this sentiment was reversed on Thursday after the ECB announced that it will cut deposit rates by 10 basis points to -0.40%, increase the size of its quantitative easing program by €20 billion per month and expand it to include corporate bonds.

- This announcement exceeded investors' expectations and yields on benchmark European sovereign bonds initially fell as the prospect of further buying supported European government bonds across the board. However, the reaction was short-lived as comments by Mr Draghi following the announcement suggested that he did not anticipate any further interest rate cuts. As a result, the yield on the 10-year German Bund finished the week 5 basis points higher, while peripheral European spreads to German Bunds tightened. UK Gilts underperformed their German counterparts and the 10-year Gilt yield rose by 9 basis points on the week.

- In the currency markets, the euro experienced a very volatile trading session on Thursday. The common currency saw swings in the 4% range as comments by Mario Draghi at the press conference on Thursday largely reversed the effect of the accommodative policy announcements made earlier. The US dollar finished the week lower versus the euro, sterling and Japanese yen, while the euro rose against most major currencies. The Canadian dollar rose on the back of the central bank's decision to leave interest rates unchanged, while the New Zealand dollar sold off after the Reserve Bank unexpectedly cut interest rates by 25 basis points.

EMERGING-MARKET BONDS

- Emerging market (EM) dollar-pay spreads tightened 15 basis points (bps) to 419 bps over US Treasuries, while local debt yields fell 14 bps to 6.63%. EM currencies generally appreciated against the US dollar, led by the Brazilian real (+4.7%), Russian ruble (+2.4%) and Polish zloty (+2.1%).

- China's Premier Li released statements about economic policy to mark the opening of the National People's Congress. The 2016 growth target was revised modestly lower to 6.5-7% (originally 7%), while the government signaled a more expansionary fiscal policy, targeting a 3% budget deficit (2.4% in 2015). The announcement also indicated that monetary policy would remain flexible, while authorities committed to infrastructure investment, supply-side reforms and ongoing reform of state-owned enterprises. In terms of data releases, China's foreign exchange reserves fell by a smaller than expected $28.5 billion, and trade data showed continued weakness, with exports declining 25.4% year-over-year (y/y) and imports falling 13.8% y/y. Although China's headline inflation came significantly above expectations at 2.3% y/y, the reading was largely influenced by food prices; core inflation decelerated to 1.3% y/y.

- Bank Negara Malaysia left its policy rate unchanged at 3.25% in Governor Zeti Aziz's final monetary policy decision. Governor Zeti, who has led the central bank since 1998, is set to step down at the end of her term in April, though no replacement has been appointed. The National Bank of Poland maintained its base rate at 1.5% following the recent replacement of several Monetary Policy Council members. Countering consensus expectations of a hike, Peru's central bank chose to hold rates at 4.25%; officials are pausing to assess the impact of four recent hikes.

- Colombia's fourth quarter 2015 GDP came at 3.3% y/y, ahead of estimates and higher than the 3.2% y/y rate in the third quarter. Agriculture, manufacturing and services were among stronger performing sectors. Nigeria's GDP growth release showed a deceleration in the fourth quarter to 2.1% y/y, led by an 8.3% y/y contraction in the oil and gas sector. The release confirmed full year growth at 2.8%, the slowest pace since 1999.

HIGHLIGHTS OF NEXT WEEK'S ECONOMIC RELEASES

Date	Report	Consensus	Last
03/14	(EC) Industrial Production WDA YoY	1.60%	-1.30%
03/15	(JN) Industrial Production YoY	--	-3.80%
	(EC) Employment YoY	--	1.10%
	(US) Retail Sales Advance MoM	-0.10%	0.20%
	(US) PPI Final Demand MoM	-0.20%	0.10%
	(US) NAHB Housing Market Index	59	58
03/16	(UK) ILO Unemployment Rate 3Mths	5.10%	5.10%
	(US) Housing Starts	1150k	1099k
	(US) Housing Starts MoM	4.60%	-3.80%
	(US) Building Permits	1201k	1202k
	(US) CPI YoY	0.90%	1.40%
	(US) CPI Ex Food and Energy YoY	2.20%	2.20%
	(US) Real Avg Weekly Earnings YoY	--	1.20%
	(US) Industrial Production MoM	-0.20%	0.90%
	(US) FOMC Rate Decision (Lower Bound)	0.25%	0.25%

	(US) FOMC Rate Decision (Upper Bound)	0.50%	0.50%
	(RU) Industrial Production YoY	-2.10%	-2.70%
03/17	(EC) CPI YoY	-0.20%	-0.20%
	(UK) Bank of England Bank Rate	0.50%	0.50%
	(US) Philadelphia Fed Business Outlook	-1.4	-2.8
	(US) JOLTS Job Openings	5550	5607
	(US) Leading Index	0.20%	-0.20%
03/18	(CA) Retail Sales MoM	0.80%	-2.20%
	(CA) CPI YoY	1.40%	2.00%
	(CA) CPI Core YoY	1.90%	2.00%
	(US) U. of Mich. Sentiment	92.2	91.7