William Blair

February 10, 2016

Weekly Market Update

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The role of manufacturing relative to the total U.S. economy continued its decline in 2016. The U.S. economy reported a $502 billion trade deficit, the largest deficit since 2012 and the 41st consecutive since 1975. In stark contrast, the U.S. services sector reported a $247 billion trade surplus over the same period. With manufacturing jobs down from 17 million in 2000 to 12.3 million currently, President Trump hopes to reclaim lost manufacturing employment by renegotiating long-standing trade arrangements such as NAFTA (and recently the Trans-Pacific Partnership) individually with each U.S. trading partner.

President Trump's support of "One China" is expected to smooth trading relationships. The reported phone conversation in which President Trump reassured Chinese President Xi Jinping that the United States will not diplomatically recognize Taiwan as an independent nation is hoped to set a baseline of goodwill between the United States and its largest trading partner. While equity markets took some relief from President Trump's overture (significant headwinds could accrue to both economies should tariffs escalate purportedly as high as 45% from their current average of 3%), considerable uncertainty remains about each country's willingness to embrace needed concessions. Noting that China and Hong Kong are large foreign holders of Treasury securities and consistent supporters of Treasury auctions, the move also helped mollify President Trump's recent assertions of China engaging in currency manipulation to its trading advantage.

U.S. consumer economic growth expectations dropped for the first time since October. While the University of Michigan Survey reading of 95.7 was notably lower than 98.0 expected (and just under a 10-year peak at 98.5 in January), equity markets still view the index as signifying that consumer confidence remains quite favorable. Consumers' expectations fell along party lines, with Republicans' expectations near a record high and Democrats' expectations near a record low. Consumers also expressed an expectation of increased inflation over the next year, albeit leveling off over the longer term.

Oil prices were spurred by a record 90% production compliance among OPEC member nations. Led by Saudi Arabia, Angola, and Qatar cutting more than initially promised, the decreased collective outputs of approximately 1 million BPD (relative to October 2016) are the deepest cuts in OPEC's history, according to the International Energy Agency (IEA). West Texas Intermediate crude increased by 1.6%, to $53.86, and Brent crude increased by 1.8%, to $56.39. Experts expect the rising oil market to support 198 additional U.S. rigs in 2017, with 51 new rigs already online year-to-date. The IEA estimates call for global demand to grow by 1.4 million BPD in 2017.

The British Parliament nears its formal exit from the EU, to be effective in early 2019. The House of Commons voted 494 to 122, leaving the completing step for Article 50 to a vote by the unelected House of Lords on February 20. Italy's anti-establishment Five Star Movement and other mainstream parties are seeking EU exit referenda as early as June, well ahead of the 2018 election cycle. Further, should the Five Star Movement be voted into power, the referenda may also include exiting the euro currency, a precarious move for the country's fragile banking system and the EU. France's front-running far right National Front candidate, Marie Le Pen, with two rounds of the presidential election to come on April 23 and May 7, has also promised more independence from the EU with respect to the national currency, immigration policy, and defense.

Equity markets reached new record highs; municipal markets remained subdued. Strong economic data, rising oil, constructive meetings with airline executives, easing fears of retaliatory postures in trade renegotiations, and a financial service sector in anticipation of a Dodd–Frank review, in combination, edged equity markets to new record highs. Low municipal new-issue supply allowed for a tentative outperformance versus Treasuries early to mid-week. Municipal market tone then

acquiesced to a slightly weaker holding pattern ahead of Fed testimony to Congress, and a soon-to-be-unveiled tax policy that might notably include nondeductibility of interest for corporate borrowers. Awaiting a better sense of direction, municipals have become lag-response to Treasuries, but with a duration preference toward the shorter end of the yield curve. Low weekly average new-issue supply ($6.7 billion versus $8 billion in 2016) has been a boon for competitive sales as well as a buffer to volatility from uncertainty.

The 10- and 30-year Treasuries closed the week at 2.41% and 3.01%, respectively, down from a respective 2.49% and 3.11% last Friday. The 10- and 30-year AAA MMD closed at 2.30% and 3.07%, respectively, down from a respective 2.33% and 3.09% last Friday. SIFMA reset on Wednesday at 0.65%, unchanged from the prior week.

The *Bond Buyer* 30-day visible supply is at $9.4 billion, with $5.7 billion ($4.2 billion negotiated) expected to come during the week. There are seven Fed speakers during the week, with Chair Yellen speaking before Senate and House panels. Data for the week include PPI, CPI, NFIB Small Business Optimism, retail sales, and leading indicators.

2/10/2017	**Change***	
SIFMA	0.65%	0
LIBOR	0.77%	-1
AAA Municipal Market Data Rates		
5-Yr.	1.53%	-7
10-Yr.	2.30%	-3
20-Yr.	2.97%	-2
30-Yr.	3.07%	-2
U.S. Treasury Rates		
10-Yr.	2.41%	-8
30-Yr.	3.01%	-10
Municipal to Treasury Yield Ratios		
10-Yr.	95.4%	1.9
30-Yr.	102.0%	2.6
Dow Jones	20,269	198
S&P 500	2,316	19

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