General Market

Financial markets were whipsawed on Wednesday by news reports indicating President Trump was going to fire Fed Chair Powell. Within an hour, the President refuted the report but left open the possibility. Given a new appointment would likely steer the FOMC to begin cutting rates immediately, the UST yield curve continued to steepen in anticipation. These reports were weighed against a softer inflation reading and University of MI's survey showing consumers forward expectations of inflation also dropped. Retail Sales were stronger than expected, Jobless Claims declined for the 5th straight week, and bank earnings calls all painted a picture of a stable, albeit cautious consumer. While Powell seems intent on waiting for more clarity on how the upcoming tariffs may flow through to the economy, several Fed members including Governor Waller indicated the economy isn't doing as well as some think and that the time is now to begin cutting rates. By the close of the week, the front end fell 2bps while the long bond rose 4bps.

IG Munis

Despite treasuries having a relatively tame week, the mood across the muni market was bleak. The benchmark AAA MMD curve underperformed across all tenors but suffered its heaviest losses the further out the curve one looked as the 30y rose by 22bps. As July reinvestment capital had mostly been spent, the market was hit with a deluge of new issuance after the primary calendar topped out at more than $16bn in deals. This supply came just as duration-induced losses caused fund flows to begin to turn negative. Lipper reported $225mm of outflows this week, though they were entirely from IG funds which lost $259mm. This led to an uptick in BWICs, with JPM reporting +18% relative to recent averages, which proved difficult for the market to absorb. In many cases, bonds were trading 10-20bps behind evals. The primary market saw decent subscriptions, such as the Aa2/AA+ UT Trans deal that was 3-5x oversubscribed across most maturities, but the entire primary calendar came at healthy concessions to where evals had been marked on existing bonds. By the end of the week, we noted several inquiries emerging as ultra-high grade 5% coupon bonds broke past par. For example, a NY Income Tax competitive deal was bought using 5s at 5.10% in 30y. While munis will remain at the whim of the rate market, we suspect high grades behind a 5% will prove to be an attractive entry point and will provide somewhat of a natural floor on how far prices can fall.

HY Munis

The HY muni market underperformed for the 2nd week in a row as ever higher yields in the IG space make riskier bonds less and less attractive. Benchmark names like Buckeye Tobacco saw yields come close to touching all-time highs, off ~30bps on the week. While sellers were still trying to get more opportunistic levels in the beginning of the week, the tone soured as the week wore on. This led to an uptick in secondary trading and BWICs, but there also appeared to be healthy demand from buyers at levels generally down 10-15bps. Lipper reported HY fund flows at a modest +$34mm but we heard reports of several accounts looking to lighten up risk in fears of coming outflows. In the primary market, the largest deal of the week, a $1.3bn transaction for JFK New Terminal One was well received with most of the longer maturities bumped 2-3bps. Away from the Brightline news mentioned last week, it appears most of the weakness is rate related due to the HY market's long duration rather than credit fears beginning to percolate. Regardless, we believe caution is warranted as credit spreads are still not properly compensating investors for the risks relative to higher quality parts of the market.

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<u>Market Commentary</u>

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