Weekly Market Overview

September 17, 2018

Comerica Wealth Management

Peter Sorrentino, Chief Investment Officer, Comerica Asset Management

Global equity prices were broadly positive last week, as all major indices finished in positive territory. In the domestic market, the energy sector continued to recover, posting a 2% increase, followed by almost a tie for second between industrials and technology, which posted gains of 1.9% and 1.85%, respectively. The sole declining sector was financials, which slipped 0.35%. Gains in the asset management group, notably the 5.49% gain registered by Franklin Resources, were not enough to overcome weakness among the regional banks, led lower by Sun Trust's loss of 7.57%. The catalyst for the decline was the continued flattening of the yield curve, which investors fear will pressure banks' net interest margin. The recovery in the developed markets produced a strong 1.76% gain for the MSCI EAFE® index and modest 0.54% gain for the MSCI Emerging Markets last week. Apart from the continued recovery in wheat prices, up another 5% last week, commodity prices were stable. With this week's release of inflation and retail data, the long end of the U.S. yield curve remains firmly anchored, while the short end continues to climb. The interest rate differential between the two-year and ten-year U.S. Treasury notes continues to narrow as recent inflation data was below expectations. This is serving to subdue investor inflation expectations, thus holding long-term Treasury yields in check.

To follow on that last point, it appears that bond investors are not terribly concerned with prospects of inflation eroding the value of their principal. That addresses one of the risks factors facing bond investors, so if we understand what the expectations of inflation risk are, we can turn to credit risk. Bloomberg reported, back in July, that the U.S. corporate bond market is currently $7.5 trillion in size, of which $1.2 trillion is comprised of leveraged loans. These are borrowers who are so weak, they cannot issue traditional high yield bonds. The true investment grade segment of the market is now just $1.21 trillion. The grey area in between is comprised of traditional high yield debt and a burgeoning BBB-rated group that now totals $2.56 trillion. The reason this is important is the implication for investors who have, in their search for yield, ventured into holdings that will respond poorly in the event of even a modest market pullback. In Exhibit 1, I have plotted the term structure for rates on U.S. BBB and BB corporate bonds. As you can see, just that one rating grade costs issuers roughly 50% more in interest, or for a holder of paper downgraded from BBB to BB, it could be as much as a quarter of your market value. Oh, and bond downgrades are like roaches in a dorm room – there is rarely just one. The point of this is to stress how important it is not to be complacent; you need to know what you own and understand the risks.

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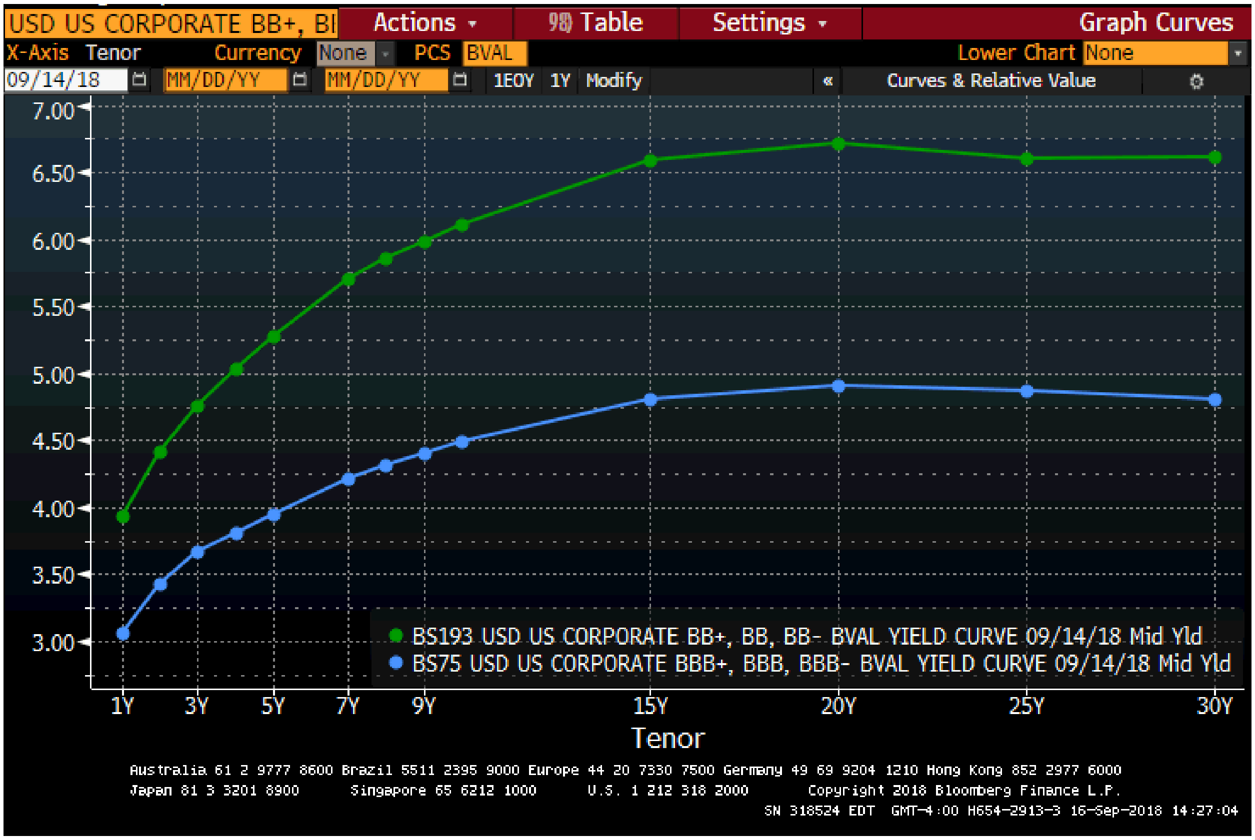

Exhibit 1 (Source: Bloomberg)

EQUITIES						S&P 500® SECTORS		
DOMESTIC			**INTERNATIONAL**				**YTD**	**12MTH**
	LEVEL	**YTD**		**LEVEL**	**YTD**	Energy	4.58%	15.19%
DJIA	26154.67	5.81%	FTSE 100	7304.04	-8.11%	Material	-0.55%	7.81%
S&P 500®	2904.98	8.65%	HANG SEN	27286.41	-9.19%	Cons Disc	19.37%	31.77%
S&P 400	2046.56	7.68%	MSCI EAFE®	1939.02	-2.95%	Cons Stpl	-2.52%	1.47%
S&P 600	1086.35	16.03%	MSCI EMG	1028.53	-9.30%	Health Care	14.22%	14.77%
						Financials	1.97%	15.42%
COMMODITIES			**CURRENCIES**			Technology	19.68%	30.89%
	LEVEL	**YTD**		**LEVEL**	**YTD**	Industrial	5.25%	14.06%
Gold	1194.85	-8.29%	MXN/DLR	18.8888	4.08%	Utilities	4.97%	1.92%
Silver	14.06	-16.98%	DLR/EUR	1.1625	-3.17%	**KEY INTEREST RATES**		
WTI	68.99	14.18%	DLR/GB	1.3068	-3.29%	LIBOR OVERNIGHT		1.9151%
Nat Gas	2.77	-6.30%	CDN/DLR	1.3036	-3.57%	LIBOR 3 MONTH		2.3371%

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