After Fed Hike, Markets Temper Anticipation of More in 2017

- Last week, the FOMC raised the Federal Funds rate to 1-1.25%, as expected. The reaction was limited as the market was already digesting the CPI release earlier in the day. For May, CPI dropped 0.1%, which was below expectations and marked the third consecutive below-consensus CPI release. The miss was led by a 2.7% drop in energy costs.
- While the Fed maintained its forecast for another hike in 2017, the CPI data suggests that another hike is not warranted. Currently, the market probability of another rate hike is low for the remainder of the year. The Fed announced a formal balance sheet reduction plan which will allow bonds to mature at a pace of $10 billion per month between Treasuries and Mortgage backed securities.

Tax Revenues Continue to Soften

- The Rockefeller Institute confirmed that state and local tax revenue growth ended 2016 on a softer note, with 2.3% growth in the fourth quarter. Dragged down by state tax revenues that increased by only 1.4%, local government tax revenues grew at a healthier 3.5%, but are also showing signs of deceleration.
- Preliminary data for the first quarter of 2017 indicates improvement, but anecdotally, a number states announced very weak collections of personal income taxes in April.
- Highlighting the trend of weaker tax collections, the National Association of State Budget Officers released its spring survey which indicated that current fiscal year growth is expected to be only 2.4%. Notably, 33 states have experienced below-budget collections, the highest tally of underperformance since 2010 when states were still struggling with recessionary pressures.
- As many states approach the beginning of their fiscal year on July 1st, we expect budget conditions to remain tight as rising costs for healthcare and retirement benefits contend with modest revenue growth and uncertainty over federal funding.

Illinois Lawmakers to Reconvene

- Governor Bruce Rauner called for a special legislative session from June 21st through June 30th as lawmakers attempt to achieve a budget compromise before Illinois' fiscal year begins.
- Following failure to pass a budget before the regular legislative session ending on May 31st, both S&P and Moody's downgraded the State's General Obligation rating to within one notch from "junk" status. Lawmakers are on a tight timeline, as S&P has clearly stated that it will hit Illinois' rating once more should no budget be in place by July 1st.
- There appears to be a greater sense of urgency to compromise on a spending plan, but the political divide remains among the Republican governor and Democrat-led legislature.

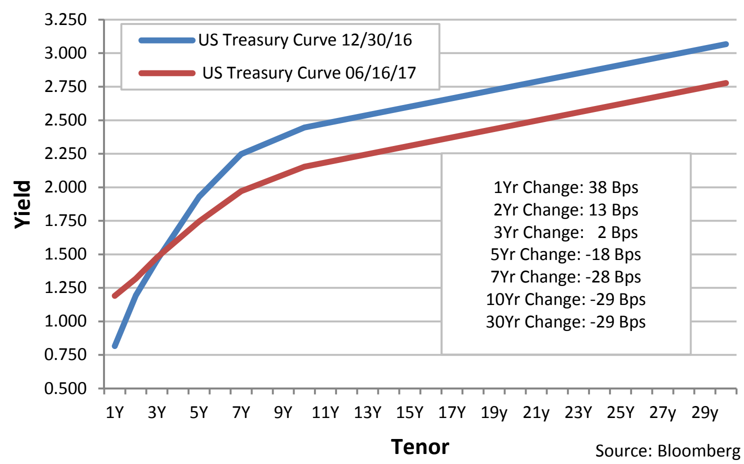
Muni Market Overview

- The muni curve saw another flattening this week with the 2Yr up 6bps to 0.96% and the 10Yr down 1bp to 1.86%. The spread on 2Yrs to 10Yrs is now down to 90bps, which is the lowest we have seen this year and down about 50bps from the high.
- New issue supply this week is relatively robust at about $12 billion, and 30-day visible supply increased to $16 billion. The largest deal of the week is $850 million NY City Transitional Finance Authority (Aa1/AAA/AAA), which is followed by the City of Chicago O'Hare Airport (NR/A/A) with $825 million.
- Although Muni Mutual Fund flows were muted at $138 million, they continued the trend for the 10th consecutive week of inflows, bringing the year-to-date total inflows to $5,704 million.

Corporate Market Overview

- Investment grade corporate issuance disappointed yet again last week, with another sub $20 billion week at $16.59 billion of new debt. That was to be expected with the Fed meeting looming on Wednesday. One of the most notable deals of the week was the $3 billion brought by Brighthouse Financial (BHF Baa3/BBB+/BBB). Whisper pricing on the $1.5 billion 10Yr tranche was +180, but with demand very high, final pricing whipped in 25 basis points to +155. Prospects for this week's IG pipeline is expected to be much better than the last two with consensus for over $25 billion.

YEAR TO DATE U.S. TREASURY CURVE - Bear Flattener



Source: Bloomberg

FIXED INCOME INDEX RETURNS AS OF 06/16/2017

	MTD	YTD
Barclays 3Yr	-0.08	2.04
Barclays 5Yr	-0.06	3.56
Barclays 7Yr	0.05	4.44
Barclays MM Short 1-5Yr	-0.08	2.27
Barclays MM 1-10Yr	0.03	3.82
ML US Gov/Corp 1-10 Yr	0.11	1.72

Source: Interactive Data

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