APPLETON PARTNERS, INC.

This Week in the Bond Market 6/27/16

Headline News

Brexit Leading to Uncertainty

- Justifiably, investors spent much of the weekend discussing Thursday night's surprise Brexit vote and the short and long term ramifications. The lack of a clear blueprint for the process of leaving the European Union is leading to market volatility that has continued into this week's trading session. Among the many unknowns that Appleton will be monitoring are:
  - When will the U.K. invoke Article 50 of the Treaty of Lisbon? Prime Minister Cameron has stated that he wants to leave the task of starting the Brexit to his successor. This gives some hope to the Remain camp who are frantically trying to petition the government to redo the referendum. The petition has been signed by nearly 4 million U.K. citizens, meaning Parliament must at least consider debating it.
  - How strict will the E.U. be with the U.K. during negotiations over the next two years? This is an important question because if the E.U. is not strict enough, it might coax other member countries to hold their own referendum on leaving the Union. Too strict and they risk harming the economies of both the U.K. and the E.U.
  - Will other countries press to leave the E.U? This is most likely the most important question investors have because it threatens the viability of the E.U. going forward. Given the fallout post-vote, and the fact the nearly 4 million U.K. citizens have signed a petition asking for a re-referendum, we believe other Europeans would rather avoid buyer's remorse.

Brexit Drops Yields Across the Curve

- In a flight to safety, bond yields dropped across the curve following the Brexit vote. The U.S. 10Yr Treasury closed at 1.74% Thursday afternoon and had dropped to 1.46% as of Monday afternoon. Many developed nations saw their sovereign debt trade to record or near-record low yields. For corporates, the risk-off trade hit spreads, particularly in the financial sector and in the high yield market. Domestic Municipal bonds held their ground given how much more insulated they are from Brexit concerns. The uncertainty in the aftermath of the Brexit vote is surely to keep the FOMC on hold in their effort to normalize rates. The implied odds of a hike by February '17 have fallen to less than 10%.
- The team at Appleton is confident that our focus on high quality, conservatively structured Municipal and Domestic Corporate Fixed Income instruments will help to weather the uncertainty and volatility that the Brexit vote has brought to the global capital markets. It is possible that the "Leave" decision could further weaken economic prospects domestically and globally, as GDP growth expectations will be adjusted downwards. We will continue to monitor the subsequent impacts to the marketplace and evaluate opportunities as we find them.

Meeting	Probability of Hike	Probability of Cut
7/27/2016	0.00%	8.0%
9/21/2016	0.00%	22.7%
11/2/2016	0.0%	22.7%
12/14/2016	9.3%	20.0%
2/1/2017	9.3%	20.0%

Source: Bloomberg

Market Update

Muni Market Overview

- The "flight to quality" trade after the Brexit vote pushed munis to record low yields along with U.S. Treasuries. The 10Yr Muni is hovering around 1.30%, putting the 10Yr Muni/Treasury ratio at about 90%.
- Further challenging the Muni market is the continued supply and demand imbalance. Another week of muni fund inflows, about $1.5 billion this week, brings the year to date total to $32.3 billion. The new issue calendar is expected to be about $10 billion this week, which is essentially the entire 30-day visible supply as the next week, a holiday shortened week, will be slower again.

Corporate Market Overview

- Last Thursday's Brexit vote caught investors off guard with a massive "flight to quality" trade. U.S. Treasuries rallied to an inter-day low of 1.40% and settled down to end the week at 1.55% - a drop of 20 basis points from Thursday night's close. Agency securities were able to keep pace and only widened a basis point or two while investment grade corporate bonds also caught a bid, but could not keep up with Treasuries resulting in a slight widening of spreads.
- Ahead of the Brexit vote last week, new issue volumes were almost non-existent with only a handful of issuers participating. Now that Brexit is behind us, we anticipate that corporations will take advantage of the new rate environment, although Molson Coors (TAP) Baa3,BBB- is the only corporation to announce a deal so far.

FIXED INCOME INDEX RETURNS AS OF 6/24/2016

	MTD	YTD
Barclays 3Yr	0.50	1.44
Barclays 5Yr	0.95	2.39
Barclays 7Yr	1.22	3.29
Barclays MM Short 1-5Yr	0.59	1.50
Barclays MM 1-10Yr	1.15	2.93
ML US Gov/Corp 1-10 Yr	1.06	3.38

Source: Interactive Data

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