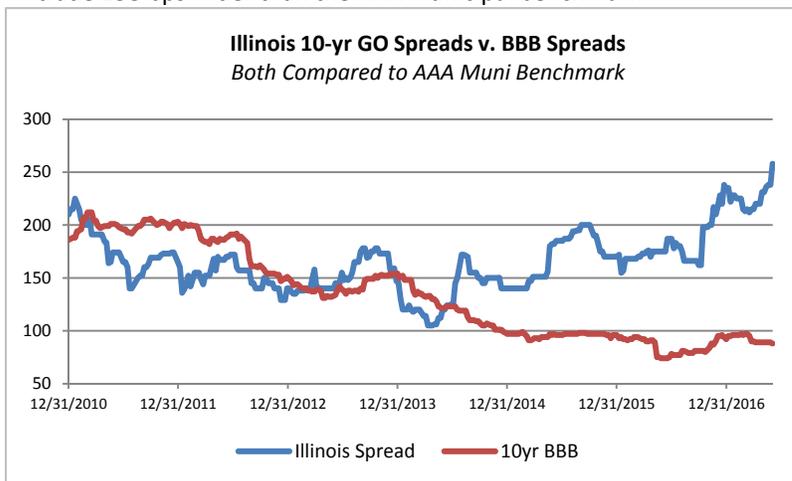


Market Still Expecting June Rate Hike Despite Employment Data

- On Friday, May Nonfarm payrolls were disappointing at 138k versus the expected 182k. Additionally, the 2-month revision was net downward of 66k for March and April. The 3-month average rate of job growth was low at 121k. Average Hourly earnings for May was as expected at 0.2%, but April was revised up a tenth to 0.3%. The decline in the unemployment rate to 4.3% was due to the decrease in labor force participation. The market is still pricing in a rate hike at the June meeting (6/14/17) with 89.7% probability.

Illinois is Downgraded One Notch Above Junk

- Both S&P and Moody's downgraded the State of Illinois' General Obligation rating to one notch above junk at BBB- and Baa3, respectively. The negative rating action stemmed from the passing of a May 31st deadline to come to an agreement on a fiscal 2018 spending plan. Although the fiscal year begins July 1, Illinois law stipulates that a budget passed after May 31st requires a two-thirds majority vote as opposed to a simple majority approval beforehand. Given the increasingly partisan political environment in the state, the rating agencies clearly voiced their lack of optimism that the Illinois legislature can come to an agreement in a timely manner. We agree with this opinion, and even if a plan is approved by July 1st, we doubt it will include materially improvements to the State's fiscal profile.
- With July 1st fast approaching, it is likely that Illinois will head into the third consecutive fiscal year without a formal spending plan in place. Both S&P and Moody's have acknowledged that the political gridlock has reached a tipping point, and a failure to come to a meaningful resolution in the near-term could result in Illinois being downgraded to sub-investment grade.
- A move to sub-investment grade would be historical. Considering data back to 1970, neither S&P nor Moody's have rated a state below investment grade. It remains uncertain whether this threat of "junk" status is enough to motivate politicians to break the multi-year stalemate.
- The market responded to the rating actions with intermediate Illinois spreads widening 26 basis points. 10-year GO bonds now trade 258 bps wider than the AAA municipal benchmark.


Muni Market Overview

- The muni curve moved lower and flatter after the disappointing jobs report on Friday. 5Yr was down 6bps to 1.21%, and 7Yr was down 9bps to 1.44%. 2Yr to 10Yr muni spread has dropped to 98bps.
- Supply is up this week with about \$9 billion on the calendar, which is above the YTD average of \$7.5 billion. 30-day visible supply is not much higher at \$12.1 billion, so the increased calendar may be the a catch-up effect after the Memorial Day shortened week. For the month of May, issuance was \$35.5 billion, 16.9% below the previous year.
- Muni fund flows were marginally positive bringing the YTD total inflows to \$4.1 billion.

Corporate Market Overview

- The focus of the short week was certainly the jobs report that came out on Friday. The US Treasury market was trading in a very narrow band heading into the number, but quickly dropped on the news that there were not as many jobs created as originally anticipated. From Monday through Thursday's close, the 10Yr remained steady at 2.21%. After Friday's disappointing Jobs report the 10Yr hit an intraday low of 2.14%, but ended the day at 2.16%. The curve continues to flatten.
- The \$30 billion of new investment grade debt issue on the week was a surprise to the upside, as expectations for the week were on the lower end. The majority of that issuance was done on Thursday when \$17.1 billion hit the tape. That was led by the \$5.2 billion brought by Cardinal Health Inc (CAH Baa2/A-) over 6 tranches. The deal attracted many and became more expensive as demand compressed spreads by 25 – 30bps.

FIXED INCOME INDEX RETURNS AS OF 06/02/2017

	MTD	YTD
Barclays 3Yr	0.02	2.14
Barclays 5Yr	0.06	3.68
Barclays 7Yr	0.10	4.49
Barclays MM Short 1-5Yr	0.04	2.39
Barclays MM 1-10Yr	0.12	3.91
ML US Gov/Corp 1-10 Yr	0.11	1.72

Source: Interactive Data

Source: Thomson Reuters