Interest Rate Market Insight

July 14, 2014

• A number of factors pushed markets into negative mode last week along with the start of Q2 earnings season, with impactful tidbits coming from the Federal Reserve FOMC minutes, some reinvigorated banking troubles in Portugal that crushed peripheral European debt markets, and additional violence in the Middle East. Equities sold off roughly 1% on the week and the back half of the Treasury yield curve fell about 10 bps WoW. The VIX volatility index for S&P 500 futures rose nearly 20% from an all-time low level as a result. The minutes from the latest FOMC meeting were interpreted as hawkish perhaps even though nothing monumentally shifted, as governors saw the Taper ending in October if the economy's trajectory was steady, a possible balance sheet reduction occurring with the non-reinvestment of portfolio principal after the target rate gets pushed higher, and potential management of the unwind of stimulus using the deposit and overnight repo rates. While an uptick in overall inflation was noted, wage pressure was seen as limited despite stronger demand and supply in the labor market of late. Jobless claims fell again and beat consensus at 304,000, and consumer spending improved based on chain store sales and credit growth.

• The rest of the data were light, befitting a post-holiday summer week, and trading almost felt vacuum sealed as a result. As the markets became more comfortable with the oil-related impacts of ISIS in Iraq, the price of the hydrocarbon fell for 10 days in a row, which should also aid the lower-end consumer in the summer driving season. After Germany took the World Cup for the first time in 24 years and for the fourth time overall, it is interesting to note that the spread between 10-year paper in the US and Germany has not been this wide in favor of the Germans (2.52% - 1.20% = 132 bps) since the late 1980s. With so much relative weakness in the rest of Europe and the decent strength in the Euro, it is not difficult to understand why this is occurring. Today's yield curve vs. a year ago is surprisingly similar, but the slight flattening trend is obvious. Watch for markets to get ahead of this with bearishness towards risk assets if the trend continues, as many recessions are preceded by flat or inverted yield curves and many consider this bull market aged. A $60 billion budget surplus for June allowed the Treasury Department to reduce its deficit forecast to $583 billion, which while staggeringly high, would still represent a 17% improvement YoY.

• More data will be absorbed this week, with headliners including retail sales, which should rise 0.6% MoM and 0.5% ex autos and gas, Empire State and Philly Fed surveys that should dip slightly but stay positive, and housing starts and homebuilder sentiment which should both improve. Leading indicators are expected to advance 0.5% MoM as well. Producer prices for final demand are expected to rise 0.3% (0.2% ex food and energy), but as we mentioned, the Fed is taking the inflation gains in stride. We also get reports on business inventories, industrial production (+0.4% expected), and Treasury international capital flows (TIC) that will show domestic and international money flows.

Index Rates	Last	Week Ago	Month Ago	Year Ago
1-month LIBOR	0.15%	0.16%	0.15%	0.19%
3-month LIBOR	0.23%	0.23%	0.23%	0.27%
6-month LIBOR	0.33%	0.33%	0.32%	0.41%
12-month LIBOR	0.55%	0.55%	0.54%	0.69%
Fed Funds Target	0.25%	0.25%	0.25%	0.25%
Prime Rate	3.25%	3.25%	3.25%	3.25%
SIFMA Muni Swap Index	Call	0.04%	0.06%	0.05%

Treasury Rates	Last	Week Ago	Month Ago	Year Ago
2-yr Treasury	0.46%	0.51%	0.44%	0.35%
3-yr Treasury	0.94%	0.96%	0.89%	0.69%
5-yr Treasury	1.65%	1.74%	1.71%	1.46%
7-yr Treasury	2.14%	2.24%	2.24%	2.06%
10-yr Treasury	2.54%	2.64%	2.65%	2.63%
30-yr Treasury	3.37%	3.47%	3.48%	3.65%
2s-10s Spread	2.08%	2.13%	2.20%	2.27%

Taxable Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr LIBOR Swap	Call	0.63%	0.57%	0.50%
3-yr LIBOR Swap	Call	1.06%	1.00%	0.81%
5-yr LIBOR Swap	Call	1.77%	1.74%	1.58%
7-yr LIBOR Swap	Call	2.23%	2.24%	2.20%
10-yr LIBOR Swap	Call	2.66%	2.68%	2.75%

Tax-Exempt Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr SIFMA Swap	Call	0.36%	0.33%	0.33%
3-yr SIFMA Swap	Call	0.68%	0.62%	0.55%
5-yr SIFMA Swap	Call	1.32%	1.29%	1.18%
7-yr SIFMA Swap	Call	1.77%	1.77%	1.76%
10-yr SIFMA Swap	Call	2.22%	2.22%	2.29%

All else equal, amortizing swaps and caps will have lower rates and costs, respectively. Please call for specific structure pricing requests.

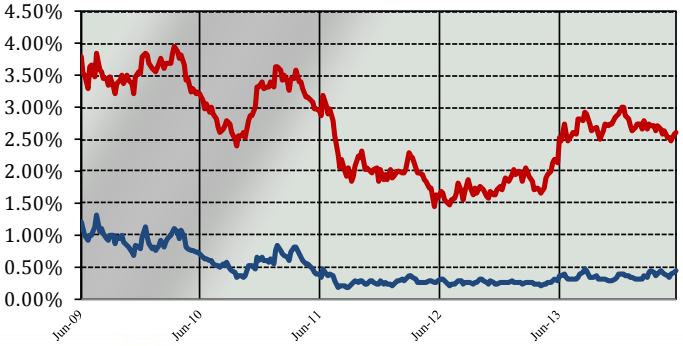
Agency Rate Caps (in bps)	LIBOR = 3%	LIBOR = 4%	LIBOR = 5%	LIBOR = 6%
3-yr LIBOR Cap	32	18	12	9
4-yr LIBOR Cap	94	61	32	21
5-yr LIBOR Cap	176	101	60	37
7-yr LIBOR Cap	389	252	143	90

Fwd Implied 3mL Rate	Last
Dec. 14	0.27%
Dec. 15	0.99%
Dec. 16	2.02%
Dec. 17	2.76%

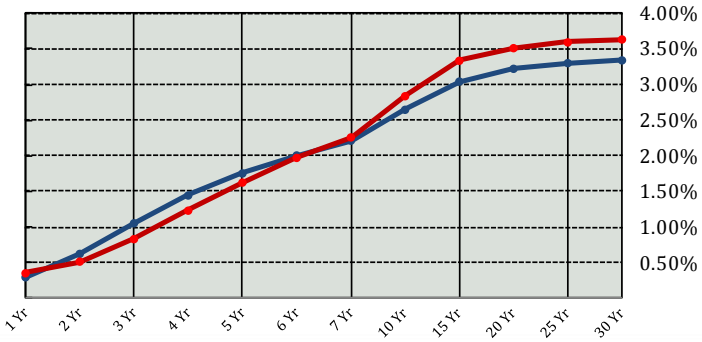
Conventions

Source: Bloomberg. LIBOR swaps use 1-month LIBOR, monthly payments, act/360 for both legs. SIFMA swaps reset weekly and pay monthly, act/act. For %of LIBOR swaps, multiply the %used by the taxable swap rate. No amortization.

2 Yr (Blue) & 10 Yr (Red) US Treasury Yield (last 5 yrs)



LIBOR Swap Curve - Current (Blue) vs. Year Ago (Red)



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