Interest Rate Market Insight

October 20, 2014

• The weekly closing levels do little justice in revealing quite how rampant the volatility got last week, despite a deliberate fall in rates, equities, and oil. At its most feverish moment on Wednesday morning, the yield curve had fallen roughly 30 basis points, pushing the 10-year yield to 1.86% and the 5-year all the way to 1.10%. The rest of the day and week basically saw the entire move down in rates dissolve, leaving the curve roughly 10 bps lower in the longer dated notes. The move was accompanied by a nearly 3% drop in global equities and oil falling to $80/bbl, but the steepness and brevity of the drop points to massive forced liquidations. Why did this happen? The most unexpected part of the recent downdraft has been oil price declines, a product whose trading is often levered on both speculative and production sides, increasing volatility and affecting other markets with spread trades. While Ebola is certainly an unpredictable negative force for markets, it is actually pretty hard to get, so the threat of recession in Europe is probably the relevant problem we face globally, and also an excellent reason for the rush into risk-free US government debt. Many will embrace this market 'breather' as a healthy correction that many had been calling for all year. Half of the 50% hike in equity volatility (up to 24% annualized from 15% a month ago) has already been retraced as we start the new week, and endless discussion of bottoms can be expected. • The data front actually left a fair bit to be desired last week. Retail sales fell by -0.3% and -0.2% MoM for headline and ex-autos, respectively, both missing consensus and worse than just falling gasoline prices would dictate. Producer prices fell 0.1% MoM and were flat excluding food and energy, lagging expectations and favoring Fed Governor Bullard's comments that we are importing deflation from Europe. While he is a hawk and a non-voter, and he was a primary architect of the QE programs, he indicated that it might make sense to keep QE going for longer than this month, when tapering is expected to run its course at the next FOMC meeting. With Empire State missing widely and the Philly Fed survey remaining strong, industrial production rebounding and slower inventory builds, housing starts beating estimates and homebuilder confidence dropping MoM, consider the waters officially muddied. Oh, and jobless claims fell 23k to a 14-year low of 264k WoW and consumer sentiment rose to a 7-year high, so maybe everyone ignoring capital markets is hanging in there.

• Few, but interesting data reports will be mixed into the roiling market waves this week. In housing news, existing home sales are expected to bounce and new home sales to dip for September readings, while the FHFA House Price Index should rise 0.3% MoM. Flash PMI manufacturing should stay in positive growth mode around 57, and leading indicators are expected to rise 0.6% MoM after a sluggish August print. The consumer price index (CPI) is expected to remain flat MoM and rise 0.1% excluding food and energy, which will leave inflation below 2% again for September. Jobless claims are expected to bounce back up near the 4-week average to 285k this week.

Index Rates	Last	Week Ago	Month Ago	Year Ago
1-month LIBOR	0.16%	0.15%	0.15%	0.17%
3-month LIBOR	0.23%	0.23%	0.23%	0.24%
6-month LIBOR	0.32%	0.32%	0.33%	0.36%
12-month LIBOR	0.55%	0.55%	0.58%	0.62%
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%	0.04%	0.09%

Treasury Rates	Last	Week Ago	Month Ago	Year Ago
2-yr Treasury	0.37%	0.43%	0.57%	0.31%
3-yr Treasury	0.79%	0.88%	1.10%	0.61%
5-yr Treasury	1.42%	1.53%	1.83%	1.33%
7-yr Treasury	1.86%	1.97%	2.30%	1.97%
10-yr Treasury	2.19%	2.28%	2.62%	2.59%
30-yr Treasury	2.97%	3.01%	3.37%	3.66%
2s-10s Spread	1.82%	1.86%	2.05%	2.28%

Taxable Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr LIBOR Swap	Call	0.67%	0.78%	0.43%
3-yr LIBOR Swap	Call	1.09%	1.26%	0.71%
5-yr LIBOR Swap	Call	1.66%	1.94%	1.45%
7-yr LIBOR Swap	Call	2.01%	2.33%	2.06%
10-yr LIBOR Swap	Call	2.35%	2.68%	2.65%

Tax-Exempt Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr SIFMA Swap	Call	0.39%	0.45%	0.29%
3-yr SIFMA Swap	Call	0.70%	0.80%	0.50%
5-yr SIFMA Swap	Call	1.21%	1.41%	1.14%
7-yr SIFMA Swap	Call	1.58%	1.82%	1.71%
10-yr SIFMA Swap	Call	1.95%	2.21%	2.30%

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

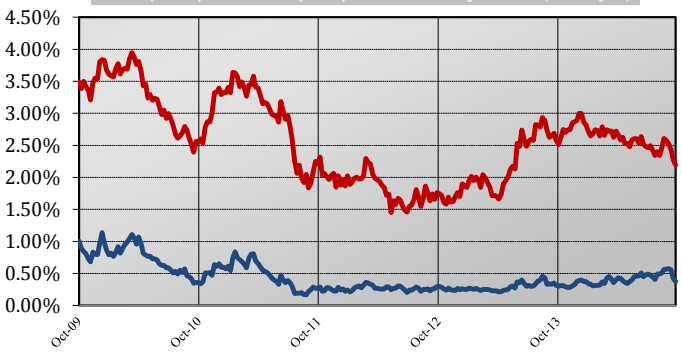
Agency Rate Caps (in bps)	LIBOR = 3%	LIBOR = 4%	LIBOR = 5%	LIBOR = 6%
3-yr LIBOR Cap	27	15	10	15
4-yr LIBOR Cap	76	41	24	31
5-yr LIBOR Cap	148	79	46	29
7-yr LIBOR Cap	318	202	114	72

Fwd Implied 3mL Rate	Last
Dec. 14	0.25%
Dec. 15	0.77%
Dec. 16	1.67%
Dec. 17	2.34%

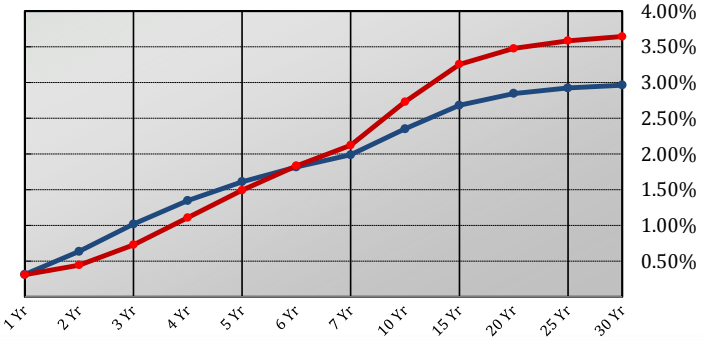
Conventions

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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