MERGANSER
CAPITAL MANAGEMENT

THE MERGANSER FLASH

FIXED INCOME INSIGHTS

AS OF OCTOBER 31, 2014

Market Commentary

THE ECONOMY

- The focus recently shifted to worries of disinflation from the modest pace of economic growth, as the strengthening of the US dollar combined with a worldwide glut of oil & gas is bringing downward price pressure to the US. Consumer prices index and producer prices index are hovering around nil (0.1% and -0.1% MoM respectively in September) while import prices are clearly declining (-0.5% MoM in September).
- An uptick in capacity utilization (79.3% in September) and a firm job market (continuing claims declined to 2.3 million mid-October) underpinned GDP growth of 3.5% (QoQ) for the third quarter and expectations around 3% for the fourth quarter.

STRUCTURED MARKETS

- Spreads in the asset backed sector widened modestly 2-5 basis points (bps) during the month in response to a heavy new issuance calendar and a flurry of large bid lists. Despite a stabilization in spreads late in the month (albeit at wider levels), secondary trading remained choppy as dealers seemed less willing to position bonds and buy side investors remained on the sidelines.
- Year-to-date issuance was $166 billion, which was ahead of 2013 issuance year-to-date and is on track to reach $200 billion. Given the heavy supply, new issue deals are generally pricing at the wider end of initial guidance.

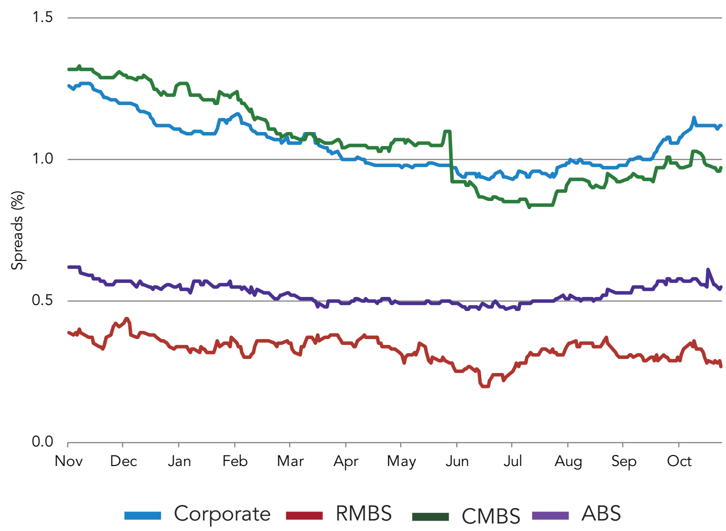
CORPORATE CREDIT MARKET

- Volatility struck fixed income markets in October and corporate spreads continued to move wider in fits and starts. Corporate spreads were six bps wider and about 20 bps wider from the summer tights seen in June. Technology issuers were the weakest this month, moving out 10 bps due to heightened event risk (Hewlett-Packard, eBay and Symantec) and weak earnings from IBM. Insurance spreads also moved meaningfully wider due mostly to negative market sentiment for insurers during equity market selloffs.
- Third-quarter earnings are thus far largely in line with expectations, though there have been pockets of softness among telcos (AT&T reduced revenue forecasts) and utilities. Financial results, however, exceeded expectations and reflected broad based balance sheet improvement. Banks and finance companies held in much better than the corporate sector as a whole, only leaking a couple basis points wider.

GOVERNMENT MARKET

- A combination of fears of deflation, weaker than expected data and new Ebola victims in the US, among other drivers, caused significant market volatility and large swings across the Treasury curve intra-month. One particularly volatile day, 10s fell 35 bps, getting as low as 1.86% intra-day before recovering some to end 11 bps down on the day. Similarly, 30s climbed 6 points in price before settling in just 12 ticks higher. As fears subsided and the FOMC released more hawkish than expected meeting minutes indicating increased confidence in the labor market, rates rose and the curve steepened a bit with 10s and 30s down ~15 bps and ~13 bps MoM.

SPREADS TO TREASURIES



BARCLAYS BENCHMARK DATA

	Total Return MTD
1-3 Gov/Credit	0.28%
Int. Gov/Credit	0.70%
Aggregate	0.98%
1-3 Yr US Treasury	0.29%
3-5 Yr US Treasury	0.85%
5-10 Yr US Treasury	1.34%
10-20 Yr US Treasury	1.87%
20+ Yr US Treasury	2.93%

SECTOR DATA FROM BARCLAYS AGGREGATE

	Total Return MTD	Excess Return* MTD	Current YTM
Corporates	1.02%	-0.25%	3.04%
Financials	0.97%	-0.07%	2.73%
Industrials	0.99%	-0.38%	3.18%
Utilities	1.53%	-0.13%	3.29%
RMBS	0.97%	0.03%	2.72%
CMBS	0.92%	0.16%	2.25%
ABS	0.51%	0.10%	1.32%
Agencies	0.69%	-0.05%	1.67%

*Month-to-date performance of spread bearing bonds versus duration-matched Treasuries