MERGANSER
CAPITAL MANAGEMENT

# THE MERGANSER FLASH

## FIXED INCOME INSIGHTS

AS OF NOVEMBER 30, 2014

## Market Commentary

### THE ECONOMY

- The US economy is humming along, as evidenced by the 3.9% GDP expansion in Q3 (QoQ). After a 4.6% increase in Q2, it marks the biggest back-to-back advance since late 2003. Cheaper gasoline is supporting higher consumer spending, which grew at 2.2% during that period, and is likely to bolster holiday season spending.
- However, we are far from a global economic recovery with the euro zone stuck in low-growth mode (0.2% GDP growth in Q3), Japan back in recession (0.4% GDP contraction during the same period) and China resorting to financial stimulus to maintain its target of 7.5% annualized GDP growth.

### STRUCTURED MARKETS

- Despite November's heavy new-issue pipeline, concentrated mostly in single borrower and floating rate issuance, cash spreads held their ground. Legacy vintages outperformed recently issued names, as the bid for short paper is still very strong. Further fueling legacy outperformance is the continued deterioration of new issue underwriting, which is driving market loss expectations on legacy loans lower (i.e., availability of more aggressive financing terms helps loans that weren't expected to pay off do so at par).
- We expect liquidity to diminish going into year-end as dealers close up balance sheets and the holidays approach. However, we will look for tightening at the onset of 2015 with legacy maturities outpacing new issue causing negative net supply.

### CORPORATE CREDIT MARKET

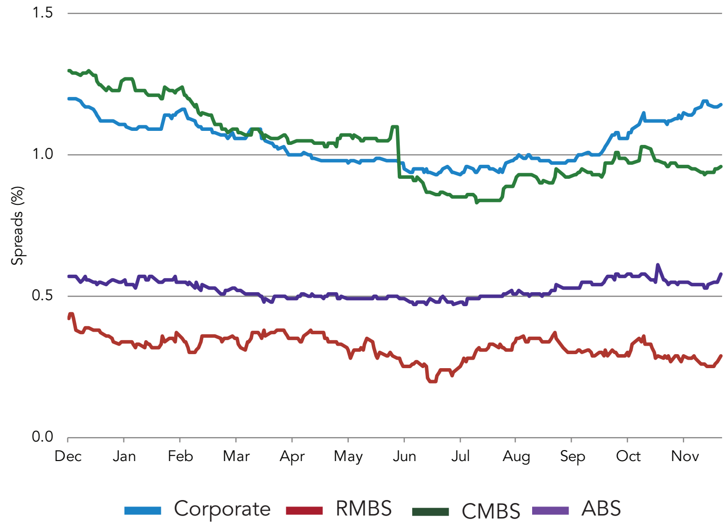
- Corporate spreads continued to move wider in November due to several factors, including heavy primary issuance (~$116B mtd), shrinking balance sheets at banks, credit concerns regarding event risk and the impact of falling oil prices. Corporate spreads are seven basis points (bps) wider month-to-date and about 25 bps wider from this year's tights seen in June. New-issue concessions have pushed spreads wider, though appetite for new corporate paper remains insatiable. The energy sector has seen the greatest push wider, as oil prices have dropped more than 35% from the year-to-date highs recorded during the summer, while basic industries have been weak due mostly to concerns over a slowdown in the Chinese economy.
- With third-quarter earnings season completed, the results were somewhat better than expected for both revenue and net earnings. The impact of falling oil has not yet hit that sector's bottom line meaningfully and there were small pockets of weakness in other sectors, including telecom.

### GOVERNMENT MARKET

- Treasury rates bounced around a narrow range after leaking higher on economic growth optimism, and then falling from the release of mildly dovish FOMC minutes and collapsing oil prices. The curve flattened with the very front of the curve selling off slightly, while the long end rallied. One-year bonds were up 2.5 bps in yield, while 10s and 30s were down 17 bps and 18 bps, respectively.



### SPREADS TO TREASURIES




### BARCLAYS BENCHMARK DATA

| | Total Return MTD |
|---|---|
| **1-3 Gov/Credit** | 0.15% |
| **Int. Gov/Credit** | 0.50% |
| **Aggregate** | 0.70% |
| **1-3 Yr US Treasury** | 0.15% |
| **3-5 Yr US Treasury** | 0.58% |
| **5-10 Yr US Treasury** | 1.08% |
| **10-20 Yr US Treasury** | 1.85% |
| **20+ Yr US Treasury** | 2.95% |

### SECTOR DATA FROM BARCLAYS AGGREGATE

| | Total Return MTD | Excess Return* MTD | Current YTM |
|---|---|---|---|
| **Corporates** | 0.63% | -0.51% | 3.01% |
| **Financials** | 0.79% | -0.10% | 2.64% |
| **Industrials** | 0.65% | -0.58% | 3.16% |
| **Utilities** | -0.19% | -1.76% | 3.37% |
| **RMBS** | 0.65% | -0.09% | 2.60% |
| **CMBS** | 0.67% | 0.06% | 2.18% |
| **ABS** | 0.25% | -0.02% | 1.30% |
| **Agencies** | 0.39% | -0.19% | 1.65% |

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