THE MERGANSER FLASH

FIXED INCOME INSIGHTS

AS OF JANUARY 31, 2015

MERGANSER CAPITAL MANAGEMENT

Market Commentary

THE ECONOMY

- Consumer confidence, which drives consumer spending (70% of the US GDP), continues to be stimulated by lower gasoline prices and a positive job market. Oil remained below $50 a barrel for most of the month while the unemployment rate declined to 5.6% in December. First estimates of GDP were below expectations (2.6%) but a still strong domestic market is buffering the US against global weakness as Federal Reserve policymakers prepare to meet to discuss if and when to raise interest rates.
- Worried about deflation and the outcome of the Greek elections (which gave a strong mandate to the anti-austerity Syriza party), the European Central Bank (ECB) launched its long-awaited Quantitative Easing (QE) plan. The markets reacted positively to the ECB's announced plan to purchase Eu60 billion in bonds monthly until at least September 2016.

STRUCTURED MARKETS

- ABS issuance came out of the gates strongly in January with close to $19 billion of new supply. Given heavy supply in 2014, demand for new deals was somewhat tepid, signaled by some deals pricing wide to initial guidance and at least one deal where the issuer had to retain the lowest-rated subordinated tranches. Notably, the esoteric space was fairly active with securitizations collateralized by railcars, containers, timeshares and a $2.5 billion private placement whole business deal securitization from Dunkin Donuts.
- We remain constructive on asset backed sector fundamentals and will continue to look for attractive relative value opportunities in the secondary and new-issue markets. Looking ahead, we expect spreads to remain range-bound to slightly wider as new issuance ramps up, particularly from subprime and more off-the-run issuers.

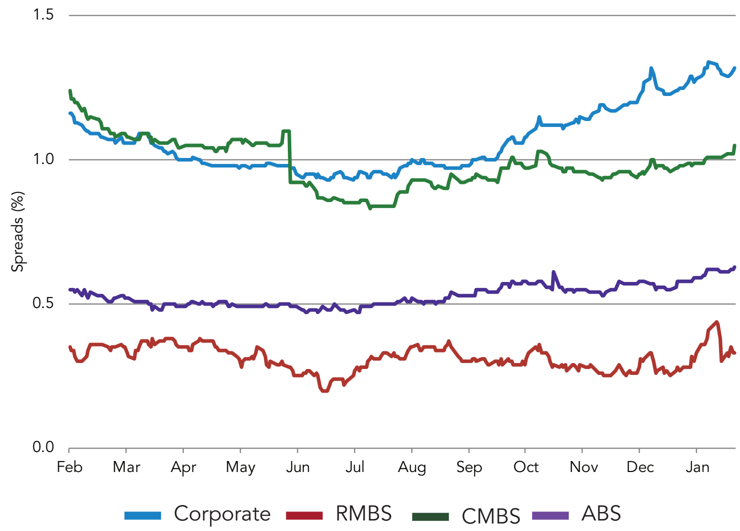
CORPORATE CREDIT MARKET

- Corporate spreads started out poorly in early January, as oil prices continued to slide, stocks sold off and news of the terrorist attacks in Paris drove a flight to quality in fixed income. Spreads widened nearly ten basis points (bps) over the first two weeks of the month but recovered nearly half of that in the back half of the month. Economic news and corporate earnings have been mixed, however, so corporate spread moves appear to be driven by macro themes. Corporate supply, which is forecast to fall short of the 2014 total but still exceed $1T, has begun in earnest with $91B of new issuance. Demand for the new supply has been strong, though a handful of issuers have had to offer meaningful concessions in order to attract sufficient interest.
- At current levels, corporate spreads appear to offer attractive relative value and we are seeking to increase our allocation for most portfolios.

GOVERNMENT MARKET

- The Treasury curve rallied dramatically in January with yields on the 10- and 30-year each down 53 bps. This move was predominantly driven by the ECB's decision to initiate QE and surprise rate cuts by three other central banks (Canada, India and Denmark). Many anticipate the Fed will delay its decision to raise rates given downward pressure of lower global rates on US rates and the persistently low inflation environment.

SPREADS TO TREASURIES



BARCLAYS BENCHMARK DATA

	Total Return MTD
1-3 Gov/Credit	0.52%
Int. Gov/Credit	1.66%
Aggregate	2.10%
1-3 Yr US Treasury	0.53%
3-5 Yr US Treasury	1.81%
5-10 Yr US Treasury	3.32%
10-20 Yr US Treasury	4.38%
20+ Yr US Treasury	9.29%

SECTOR DATA FROM BARCLAYS AGGREGATE

	Total Return MTD	Excess Return* MTD	Current YTM
Corporates	3.03%	-0.34%	2.79%
Financials	2.39%	-0.20%	2.47%
Industrials	3.18%	-0.45%	2.95%
Utilities	4.59%	-0.06%	2.91%
RMBS	0.85%	-1.04%	2.28%
CMBS	1.78%	-0.08%	2.05%
ABS	0.87%	-0.01%	1.25%
Agencies	1.34%	-0.41%	1.59%

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