THE MERGANSER FLASH

FIXED INCOME INSIGHTS

AS OF FEBRUARY 28, 2015

MERGANSER
CAPITAL MANAGEMENT

Market Commentary

THE ECONOMY

- Stronger European activity, coupled with some soft spots in US data, suggests that the stark Atlantic growth divide may be narrowing. The euro zone flash PMIs for February (composite at 53.5) added to the earlier upside surprises in the euro area Q4 GDP (+0.9% YoY), whereas recent US housing data (decline in housing starts, building permits and existing home sales in January) and parts of the US flash PMI series were disappointing. While the US economy undoubtedly retains the strongest growth outlook, the shrinking divergence could signal a pickup in other regions or fatigue in the US.
- The slowly unfolding Greek tragedy seems to have had little repercussion on the remainder of the euro zone, with banks and market participants significantly reducing their exposure since the previous Greek crisis. Ukraine and Russia also continue to make the headlines daily, but with very little impact on economic output or policy.

STRUCTURED MARKETS

- Spreads in the commercial mortgage backed securities sector have been range bound in 2015, as macro-economic headwinds (mainly oil) have had a muted effect on spreads and commercial real estate fundamentals remain strong. New issue dupers moved 7 basis points (bps) wider in January and ~8 bps tighter in February.
- 2015 issuance at $8.5 billion is outpacing issuance this time last year. Despite a year-over-year increase in supply, we anticipate negative net issuance for 2015 as paydowns continue to be greater than new supply. This will be a positive technical for spreads.

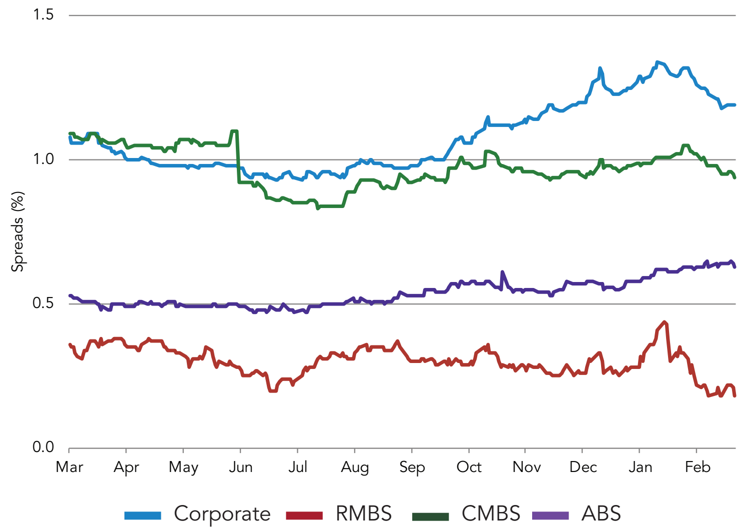
CORPORATE CREDIT MARKET

- Corporate spreads compressed 13 bps in February, more than any month since July 2013, as oil price stabilization, higher all in yields and insatiable demand for dollar denominated fixed income assets brought spreads back to levels similar to November. February supply was below forecast for the first 3 weeks as many of the issuers that were expected in the market chose instead to utilize cheaper financing in Swiss Francs, Euro and Sterling, as well as bank financing (such as AT&T and Verizon). However by month end, supply reached $112 billion, a new February record driven by greater than expected issuance by banks to bolster capital and others looking to issue ahead of significant M&A driven financing. Even with the record issuance level, the market continues to feel undersupplied, resulting in a strong technical backdrop.
- Despite the tightening over the course of the month, corporate spreads appear to offer attractive relative value at current levels and we are seeking to opportunistically increase our allocation for most portfolios.

GOVERNMENT MARKET

- Outside of the US, a combination of low inflation prints, subdued growth and preferences for a weak currency continued to tilt central banks towards additional easing. This has caused volatility in the US Treasury market as opposing forces, a strengthening US economy and a growing likelihood of a Fed ready to lift rates, are causing rates to rise. In February, rates retraced their dramatic rally in January. The 10 and 30 year Treasuries rose 35 bps and 37 bps respectively.

SPREADS TO TREASURIES



BARCLAYS BENCHMARK DATA

	Total Return MTD
1-3 Gov/Credit	-0.16%
Int. Gov/Credit	-0.70%
Aggregate	-0.94%
1-3 Yr US Treasury	-0.23%
3-5 Yr US Treasury	-0.97%
5-10 Yr US Treasury	-1.87%
10-20 Yr US Treasury	-2.61%
20+ Yr US Treasury	-5.80%

SECTOR DATA FROM BARCLAYS AGGREGATE

	Total Return MTD	Excess Return* MTD	Current YTM
Corporates	-1.01%	1.01%	2.94%
Financials	-0.82%	0.72%	2.63%
Industrials	-0.99%	1.18%	3.09%
Utilities	-1.98%	0.89%	3.11%
RMBS	-0.16%	0.60%	2.46%
CMBS	-0.64%	0.38%	2.21%
ABS	-0.38%	0.05%	1.44%
Agencies	-0.62%	0.35%	1.75%

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