MERGANSER
CAPITAL MANAGEMENT

THE MERGANSER FLASH

FIXED INCOME INSIGHTS

AS OF SEPTEMBER 30, 2015

Market Commentary

THE ECONOMY

- The first Fed meeting with a meaningful discussion of raising interest rates since 2006 came and went with the policy rate unchanged. Chair Janet Yellen cited global macro concerns and lack of a positive inflation trajectory as the cause of inaction. Despite these concerns, the Fed remains constructive on the US economy as employment data remains expansionary, consumers continue to spend and second quarter GDP growth was revised up to 3.9%. Looking forward, the base case remains a rate hike during 2015. We remain cautious that the economic recovery lingers on unstable ground and is increasingly vulnerable to exogenous shocks.
- Emerging markets and commodities remained highly volatile, causing numerous reverberations throughout the capital markets. EM currencies remain under considerable pressure, with Brazil's economic woes driving 8% devaluation in September alone. We continue to have a cautious stance on global growth as central banks abroad begin to run out of policy tools just as the Fed is poised to raise interest rates.

STRUCTURED MARKETS

- The ABS market lacked conviction during the month, with spreads moving modestly wider across the main consumer segments.
- Over 4,000 industry participants gathered for the annual ABS East conference to discuss market trends, emerging collateral types and regulation, among other things. The meeting had a defensive tone as investors ponder the implications of the first Fed rate hike, changing liquidity dynamics and impending REG AB II reporting requirements.
- The Volkswagen news added to the defensive tone in ABS. The specter of vehicle recalls and heavy fines caused modest widening on Volkswagen ABS loans and leases and a greater selloff in floorplans. With respect to loans and leases, we feel the selling is overdone given the minimal expected impact to cashflows and look for the market to normalize in the weeks ahead.

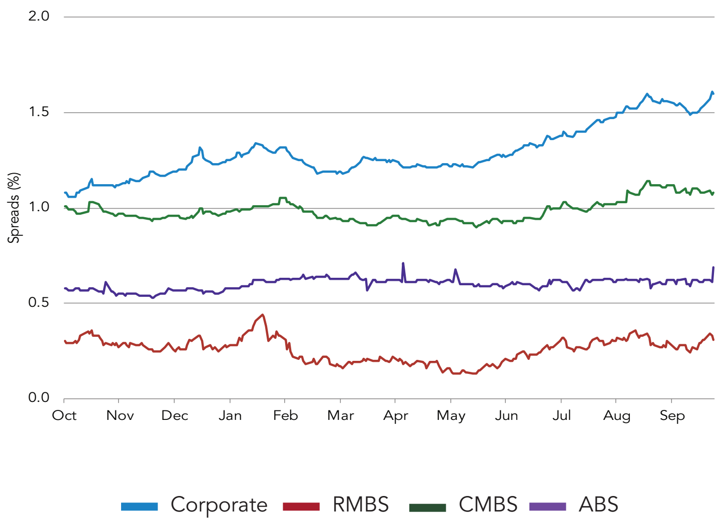
CORPORATE CREDIT MARKET

- Away from the Fed, corporate spreads ground tighter during most of September, only to push wider in the last week due to broad based investor concern surrounding commodity related issuers and negative headlines from the automotive sector (Volkswagen's emission scandal). Ultimately, corporate spreads ended September 6 basis points (bps) wider and now stand at their year-to-date high.
- New issuance was dominated by two large deals: $10B from Gilead in early September and $14.6B from Hewlett Packard Enterprise Co., which pushed total supply over $100B for the month. With more than $1T of IG corporate issuance in 2015, supply is up approximately 18% year over year.

GOVERNMENT MARKET

- US Treasury yields moved lower for the month of September. The 5-yr and 10-yr yields fell19 bps and 18 bps respectively. The 30-yr and the 2-yr both fell 11 bps during the period.

SPREADS TO TREASURIES



BARCLAYS BENCHMARK DATA

	Total Return MTD
1-3 Gov/Credit	0.30%
Int. Gov/Credit	0.67%
Aggregate	0.68%
1-3 Yr US Treasury	0.30%
3-5 Yr US Treasury	0.86%
5-10 Yr US Treasury	1.35%
10-20 Yr US Treasury	1.72%
20+ Yr US Treasury	1.52%

SECTOR DATA FROM BARCLAYS AGGREGATE

	Total Return MTD	Excess Return* MTD	Current YTM
Corporates	0.75%	-0.31%	3.40%
Financials	0.91%	-0.03%	2.94%
Industrials	0.60%	-0.50%	3.63%
Utilities	1.21%	-0.01%	3.61%
RMBS	0.58%	-0.20%	2.61%
CMBS	1.22%	0.28%	2.43%
ABS	0.45%	0.02%	1.45%
Agencies	-0.23%	-0.83%	1.99%

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