MERGANSER
CAPITAL MANAGEMENT

THE MERGANSER FLASH

FIXED INCOME INSIGHTS

AS OF DECEMBER 31, 2015

Market Commentary

THE ECONOMY

- After seven years of a zero interest rate policy, the Federal Reserve raised the fed funds rate from near zero to between 0.25% and 0.50%, while emphasizing a gradual liftoff over the next three years. Fed Chairwoman Janet Yellen cited the "substantial improvement in labor market conditions" as a fundamental driver, and expressed belief that that the economy "is on a path of sustainable improvement" despite volatility across industries and regions.
- The hike will likely create ripple effects since a stronger dollar may exacerbate anemic growth in emerging markets. All eyes will be on a potential UK rate hike given its economic recovery. Conversely, prolonged weakness in the Eurozone may mean an expansion in loose monetary policy via additional QE.

STRUCTURED MARKETS

- Despite the first FOMC rate increase in 10 years and volatility in other financial markets, ABS spreads were well behaved during December. In fact, the subprime auto sector tightened approximately 10 basis points (bps) since November 30th. From our standpoint, secondary market trading activity appeared orderly during the final weeks of 2015, with a slight uptick in the demand for floating rate paper.
- Full year ABS issuance reached $177 billion, a 7% decrease compared to the same period last year. We anticipate activity to pick up markedly in the first few weeks of 2016 as issuers map out their funding needs for the year.

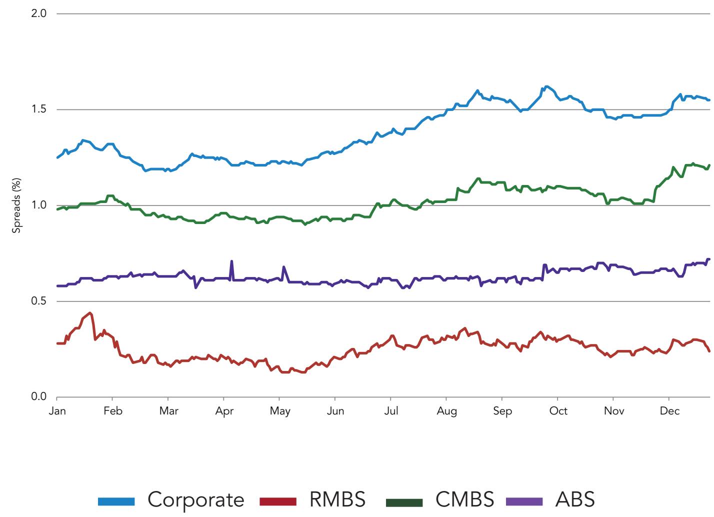
CORPORATE CREDIT MARKET

- Corporate spreads widened 11 bps through December, with energy out 57 bps due to mild winter weather and OPEC's decision to maintain output. Financials widened 6 bps on selling pressures post S&P's ratings action related to the removal of implied government support for bank holding companies. Away from energy and financials, Third Avenue's shuttering of a high yield fund had spillover effects on IG corporates due to mounting concerns of illiquidity in the credit markets.
- While December was a choppy month, it was not all lumps of coal since investment grade corporates closed out a banner year in issuance with $1.33 trillion in supply (17% higher than 2014 volumes). We believe that the technicals relating to year-end tax loss harvesting should be constructive for spreads as we head into 2016.

GOVERNMENT MARKET

- The yield curve continued to flatten in December as rates on the 2-yr and 5-yr both climbed 12 bps for the period. The yield on the 10-yr rose 6 bps during the month, while the 30-yr rose 4 bps.

SPREADS TO TREASURIES



BARCLAYS BENCHMARK DATA

	Total Return MTD
1-3 Gov/Credit	-0.13%
Int. Gov/Credit	-0.33%
Aggregate	-0.32%
1-3 Yr US Treasury	-0.09%
3-5 Yr US Treasury	-0.22%
5-10 Yr US Treasury	-0.29%
10-20 Yr US Treasury	-0.20%
20+ Yr US Treasury	0.01%

SECTOR DATA FROM BARCLAYS AGGREGATE

	Total Return MTD	Excess Return* MTD	Current YTM
Corporates	-0.78%	-0.58%	3.67%
Financials	-0.25%	-0.08%	3.16%
Industrials	-1.11%	-0.88%	3.92%
Utilities	-0.42%	-0.29%	3.86%
RMBS	-0.03%	0.09%	2.77%
CMBS	-0.89%	-0.68%	2.96%
ABS	-0.19%	-0.11%	1.87%
Agencies	-0.58%	-0.44%	2.03%

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