THE MERGANSER FLASH

FIXED INCOME INSIGHTS

AS OF MAY 31, 2017

MERGANSER CAPITAL MANAGEMENT

Market Commentary

THE ECONOMY

- The Fed is expected to raise rates in June, the second time this year, as economic indicators remain within the Fed's expectations. While headline inflation returned to positive territory in April, Core PCE posted another modest sequential decline, stoking concerns of weakening inflation. Consumer spending continues to underwhelm but the labor market remains robust with unemployment at 4.4%. Looking forward, as growth has begun to increase in Germany, the topic of reducing quantitative easing in Europe is likely to be a major topic for markets in the second half of the year.

STRUCTURED MARKETS

- CMBS continues to weather the retail headlines rather well, with the exception of credit derivative indexes tied to seasoned portfolios. The near daily news of struggling department and apparel stores and resulting bankruptcies and store closings has not materially affected cash spreads.
- New issue dynamics have shifted with a wave of non-agency supply that has depressed secondary trading. Q2 supply will likely eclipse last year after a disappointing Q1. Spreads at the top of the stack may widen given supply, but we expect the small amount of credit bonds available will continue to be well received, absent a macro risk-off move. At the same time, agency supply has slowed down supporting spreads.

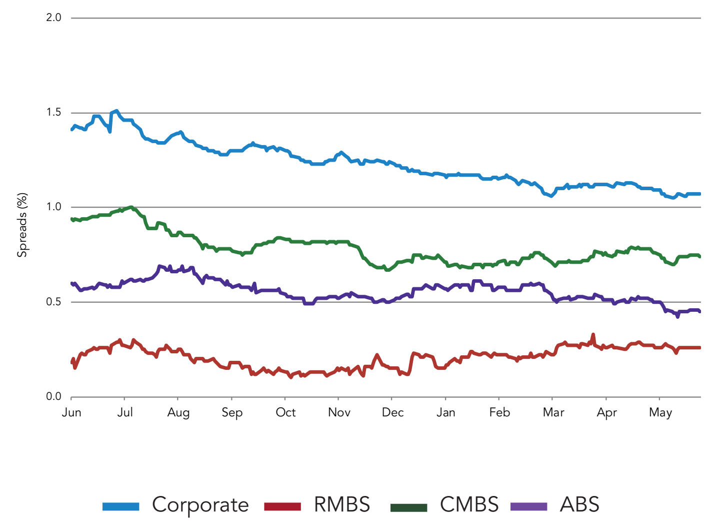
CORPORATE CREDIT MARKET

- Corporate spreads resumed their rally in late April and once again touched multi-year tights in mid-May. The US Corporate index matched the YTD low of 111 basis points (bps) on May 15th, but weakened slightly as equity markets saw a moderate sell off due to lower confidence in the US administration's ability to implement meaningful tax reform. Investment-grade spread reaction was relatively muted, however, and primary issuance has continued unabated. There was $162B in supply through May despite low all-in yields and minimal new issue concessions. The favorable market tone was supported, in large part, to record fund flows into USD investment-grade credit.

GOVERNMENT MARKET

- The 2-yr yield increased about 2 bps for the month of May, while the 5-yr, 10-yr and 30-yr decreased 6 bps, 8 bps and 9 bps respectively.

SPREADS TO TREASURIES



BARCLAYS BENCHMARK DATA

	Total Return MTD
1-3 Gov/Credit	0.17%
Int. Gov/Credit	0.50%
Aggregate	0.77%
1-3 Yr US Treasury	0.13%
3-5 Yr US Treasury	0.37%
5-10 Yr US Treasury	0.76%
10-20 Yr US Treasury	1.03%
20+ Yr US Treasury	2.08%

SECTOR DATA FROM BARCLAYS AGGREGATE

	Total Return MTD	Excess Return* MTD	Current YTM
Corporates	1.15%	0.37%	3.15%
Financials	0.99%	0.38%	2.94%
Industrials	1.21%	0.37%	3.23%
Utilities	1.36%	0.34%	3.35%
RMBS	0.62%	0.14%	2.73%
CMBS	0.86%	0.29%	2.60%
ABS	0.35%	0.19%	1.79%
Agencies	0.53%	0.12%	2.10%

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