THE MERGANSER FLASH

FIXED INCOME INSIGHTS

AS OF NOVEMBER 30, 2016

MERGANSER CAPITAL MANAGEMENT

Market Commentary

THE ECONOMY

- Risk assets rallied following the surprise election of Donald Trump. Fear of uncertainty was overwhelmed by an expectation for significant government spending, resulting in higher inflation. Abroad, central banks continue to provide market support, with Japan expanding the scope of its government bond purchase plan. 3Q GDP was ahead of expectation at 3.2%, a significant rebound from the first half of the year. OPEC reached a production cut agreement that, if properly implemented and monitored, will bring better balance to the energy market. With higher inflation seen more likely under the new administration and signs of inflation further supported by the rise in energy prices, the market-implied probability of a rate hike in December has reached 100%.

STRUCTURED MARKETS

- CMBS supply continues to be well absorbed, aided by higher US Treasury rates post-election. The market priced two more risk-retention compliant transactions ahead of the December 24th regulatory date. Tiered pricing versus other deals was less significant than the first deal in August as underwriting standards converge.
- YTD supply in non-agency CMBS is $62B (vs $95B in 2015), while agency CMBS continues to grow at $109B versus $96B in 2015. Heavy pay-downs in earlier vintage non-agency deals has driven negative net supply for several years now, but will accelerate. Considering expectations of fresh allocations at banks and insurance companies heading in 2017 and stronger credit profiles from risk-retention requirements, spreads should be stable in the near term.

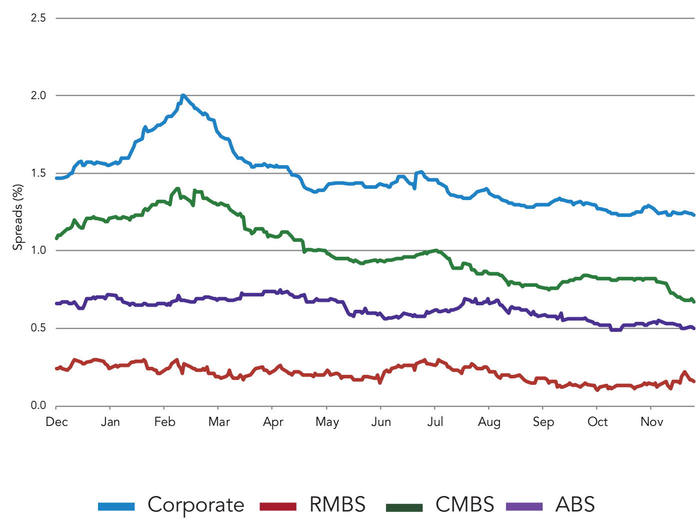
CORPORATE CREDIT MARKET

- As with most US risk assets, the IG Corporate Index tightened 5 basis points (bps) in November. The selloff in Treasuries and light dealer inventory provided for a favorable technical backdrop as investors redeployed cash in anticipation of the President-elect's pro-growth platform. Front-end credit curves also experienced somewhat of a recovery from the malaise associated with money market reforms in prior months. Primary issuance was $75B in November with the balance of the year expected to be roughly $30B.

GOVERNMENT MARKET

- Yields have increased across the curve in November. The 2-yr, 5-yr, 10-yr and 30-yr yields increased by 27 bps, 54 bps, 56 bps and 46 bps respectively.

SPREADS TO TREASURIES



BARCLAYS BENCHMARK DATA

	Total Return MTD
1-3 Gov/Credit	-0.41%
Int. Gov/Credit	-1.73%
Aggregate	-2.37%
1-3 Yr US Treasury	-0.41%
3-5 Yr US Treasury	-1.67%
5-10 Yr US Treasury	-3.39%
10-20 Yr US Treasury	-4.94%
20+ Yr US Treasury	-7.71%

SECTOR DATA FROM BARCLAYS AGGREGATE

	Total Return MTD	Excess Return* MTD	Current YTM
Corporates	-2.68%	0.52%	3.36%
Financials	-1.98%	0.53%	3.13%
Industrials	-2.92%	0.50%	3.46%
Utilities	-3.60%	0.61%	3.54%
RMBS	-1.71%	-0.48%	2.80%
CMBS	-1.86%	0.73%	2.64%
ABS	-0.52%	0.10%	1.70%
Agencies	-1.86%	-0.19%	2.11%

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