INCOME RESEARCH + MANAGEMENT

IR+M CLIENT UPDATE
December 2016

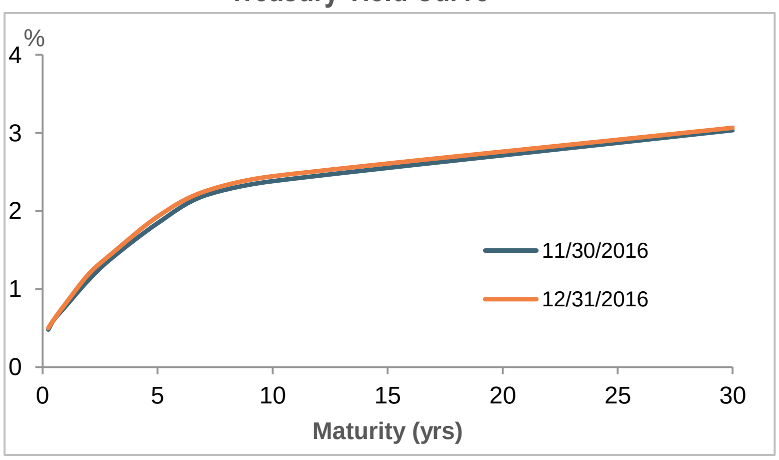
January 3, 2017

MARKET NEWS

- The Federal Reserve (Fed) raised the federal funds rate target to 0.50-0.75% at the Committee's final meeting of the year[1]
    - Markets have shifted focus to the Fed's rate plans for 2017, and the market-implied probability for a hike at the next meeting in early February is 12%
- Investors anticipated the policy change in December, but Treasury rates still sold off and continued to gradually rise over the course of the month[1]
    - The biggest moves occurred in the short and intermediate parts of the curve with the 2-year and 5-year Treasury yields increasing 8bps and 9bps, respectively
- US economic reports indicated improving business activity and healthy employment conditions, which drove positive market sentiment heading into 2017[1]
    - Third quarter GDP was revised upward from 3.2% to 3.5%, and initial jobless claims fell for 3 consecutive weeks to 265,000 – claims are trending well below 300,000, which is considered typical for a strong labor market
- Corporate supply was front-loaded in December and totaled roughly $35 billion, reaching $1.2 trillion for the year[2]
    - Following 2 years of record issuance, early 2017 estimates are projecting a modest annual decline
- Muted market volatility, strong US economic data, and higher oil prices drove corporate spreads tighter to 123bps[2]
    - The market's anticipation of the 2017 OPEC production cuts supported oil prices, which gained almost 10% in December and over 40% in 2016
- Commercial mortgage-backed securities (CMBS) weakened ahead the new risk-retention requirements that went into effect at the end of December[1]
    - While the increased regulation could continue to weigh on the sector, lower 2017 supply predictions could support technicals and mitigate some of the spread widening[3]
- The municipal market benefitted from light supply and fairly stable Treasury rates, and the 10-year municipal/Treasury ratio fell 12% on the month to 96%[1]
    - Despite some recent strength, investors remain concerned about future tax policy implications, which continues to drive outflows post-election

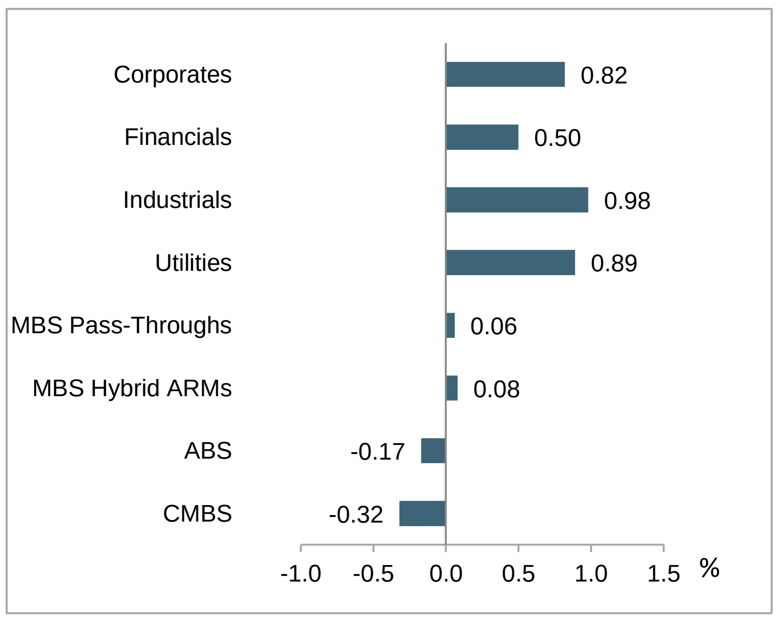
MARKET STATISTICS

Treasury Yield Curve[1]



Maturity	2-year	5-year	10-year	30-year
12/31/2016	1.19	1.93	2.45	3.07
MTD Change	0.08	0.09	0.06	0.03

December Excess Returns[1*]



As Of: 12/31/16. Sources: 1. Bloomberg Barclays 2. Citigroup 3. BofA Merrill Lynch

*Excess returns are the curve-adjusted excess return of a given index relative to a term structure-matched position in Treasuries.