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\(^6\)
  - 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\(^1\)**

<table>
<thead>
<tr>
<th>Maturity</th>
<th>2-year</th>
<th>5-year</th>
<th>10-year</th>
<th>30-year</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/2016</td>
<td>1.19</td>
<td>1.93</td>
<td>2.45</td>
<td>3.07</td>
</tr>
<tr>
<td>MTD Change</td>
<td>0.08</td>
<td>0.09</td>
<td>0.06</td>
<td>0.03</td>
</tr>
</tbody>
</table>

**December Excess Returns\(^*\)**

- Corporates: 0.82
- Financials: 0.50
- Industrials: 0.98
- Utilities: 0.89
- MBS Pass-Throughs: 0.06
- MBS Hybrid ARMs: 0.08
- ABS: -0.17
- CMBS: -0.32


\*Excess returns are the curve-adjusted excess return of a given index relative to a term structure-matched position in Treasuries. The views contained in this report are those of IR+M and are based on information obtained by IR+M from sources that are believed to be reliable. This report is for informational purposes only and is not intended to provide specific advice, recommendations, or projected returns for any particular IR+M product. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission from Income Research + Management.