Interest Rate Risk Management Weekly Update

January 4, 2016

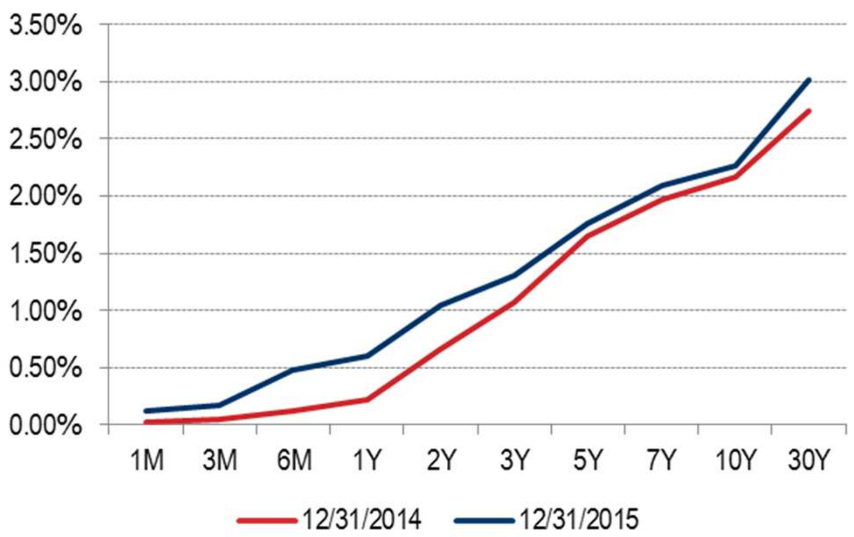
Current Rate Environment

Short Term Rates	Thursday	Prior Week	Change	
1-Month LIBOR	0.43%	0.42%	0.01%	↑
3-Month LIBOR	0.61%	0.60%	0.01%	↑
Fed Funds	0.50%	0.50%	0.00%	○
Fed Discount	0.75%	0.75%	0.00%	○
Prime	3.50%	3.50%	0.00%	○
US Treasury Yields				
2-year Treasury	1.05%	1.00%	0.05%	↑
5-year Treasury	1.76%	1.71%	0.05%	↑
10-year Treasury	2.27%	2.24%	0.03%	↑
Swaps vs. 3M LIBOR				
2-year	1.23%	1.18%	0.05%	↑
5-year	1.79%	1.74%	0.05%	↑
10-year	2.24%	2.22%	0.02%	↑

Fedspeak & Economic News:

- Market participants dealt with a host of macro-economic issues last year, including, weakness in the commodity complex, further divergence in global economies and central banks' monetary policies, and rising concerns about terrorism. Two-, five- and 10-year US Treasury yields finished ~38, 15, and 16 basis points higher, respectively; in other words, the US Treasury curve flattened, which was largely attributable to the Federal Reserve's decision to hike short-term interest rates.
- Many of the market drivers that dominated 2015 will continue to do so in 2016. The Fed's pace of tightening will play a central role while the European Central Bank's response to the region's economic headwinds will also play a vital part. Market participants will also keep a watchful eye on commodity prices and Asian economies: Will the Japanese economy gain some traction? Will China be able to stymie its economic slowdown?
- The main driver of domestic price action will be the timing of the next FOMC rate hike. We will see the first labor report of the year on Friday, however, it is likely the headline nonfarm payrolls figure will play less of a role than it has in the past. Investors will pay more attention than they have to indicators that suggest wage growth is on the move, since the Fed has communicated that a tighter labor market will lift core inflation over time, which would be accompanied by consumer-driven growth and the need to hike rates further. A handsome report would serve as a catalyst for a more serious conversation about the prospect of another hike at the mid-March FOMC meeting. The next Fed meeting is a little over three weeks away and will conclude January 27.
- Markets have begun the new year with a sharp risk-off move, as global equity markets drag lower and bring bond yields down with them. A couple of items are to blame: the release of weaker-than-expected manufacturing data and a falling currency triggered a massive selloff in Chinese equities and the news of strained relations between Saudi Arabia and Iran. The deteriorating diplomatic ties are affecting markets to a lesser degree than the poor economic news out of China, however, the international community is on high alert for a further breakdown as other countries in the region begin to take sides.

The US Treasury Curve Flattened in 2015



In 2015, numerous factors contributed to a flattening of the yield curve, with the difference between 2- and 10-year US Treasury yields reaching its narrowest level since the crisis in early 2008 (currently 122 bps). While the lift in short-term rates is the direct result of the Fed hike last month, long-term rates appear relatively anchored. Market participants are usually uneasy about a flat yield curve, yet they remain sanguine for a few reasons, one of which being signs of modest inflationary pressure.

Sources: Bloomberg

The Week Ahead

- We will see the release of the final employment report for 2015. With the next possible interest rate hike at least two months away, the report will be considered influential to the medium-term outlook.

Date	Indicator	For	Forecast	Last
4-Jan	ISM Manufacturing	Dec	49.0	48.6
4-Jan	Markit US Manufacturing PMI	Dec F	51.1	51.3
6-Jan	Durable Goods Orders	Nov F	-	0.0%
6-Jan	Factory Orders	Nov F	(0.2%)	1.5%
6-Jan	Trade Balance	Nov	-$44.10b	-$43.89b
6-Jan	ADP Employment Change	Dec	191k	217k
8-Jan	Change in Nonfarm Payrolls	Dec	200k	211k
8-Jan	Unemployment Rate	Dec	5.0%	5.0%
8-Jan	Wholesale Inventories MoM	Nov	(0.1%)	(0.1%)

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