

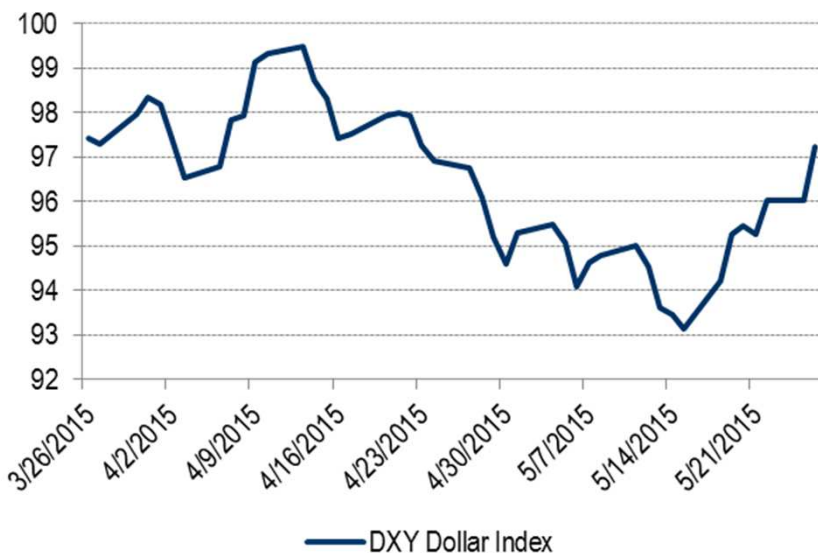
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.18%	0.19%	(0.01%) ↓
3-Month LIBOR	0.28%	0.28%	0.00% ○
Fed Funds	0.25%	0.25%	0.00% ○
Fed Discount	0.75%	0.75%	0.00% ○
Prime	3.25%	3.25%	0.00% ○
US Treasury Yields			
2-year Treasury	0.62%	0.54%	0.08% ↑
5-year Treasury	1.56%	1.46%	0.10% ↑
10-year Treasury	2.21%	2.14%	0.07% ↑
Swaps vs. 3M LIBOR			
2-year	0.93%	0.85%	0.08% ↑
5-year	1.75%	1.66%	0.09% ↑
10-year	2.33%	2.25%	0.08% ↑

Fed Speak & Economic News:

- The Treasury curve ended up flatter by the end of the week, with shorter-dated yields moving higher than later-dated yields, in an environment characterized by lower-than-usual trading volume given the Memorial Day weekend. The release of the April FOMC minutes on Wednesday was the showcase event of the week.
- The minutes were in line with expectations, with perhaps a dovish tint to them. FOMC officials acknowledged that a rate hike in June would be unlikely, but they did not provide further guidance on the subject. However, it is important to understand that the timing of the first hike since the Great Recession will be determined on a meeting-by-meeting basis and depends on the evolution of economic data. Committee members reiterated that the weakness in first quarter growth reflected transitory factors, citing their concerns about weaker consumer spending, softer exports, and the underperformance of the energy sector. The minutes and recent Fed rhetoric suggest that policymakers have not shied away from the intent to increase short-term interest rates this year, even if they are not exactly sure when.
- Fed Chair Janet Yellen spoke on Friday, which was quite interesting since it was about an hour before markets closed, leaving little time for market participants to reposition themselves in case she unveiled any market-moving news. However, in the end, there were no major headlines that impacted markets, but overall, the tone of her speech was upbeat. Regarding inflation, she argued that with oil prices no longer falling and expected inflation levels having stabilized, she expects inflation to move up to two percent over time. On employment, she acknowledged that slack remains but that the economy is "approaching" full employment. If the economy improves as she expects it to, she thinks it would be prudent to take the initial step to raise the fed funds target rate and begin interest rate normalization this year. There was nothing out of the ordinary in the speech, except her comments sounding upbeat about the economy, which was in contrast to her recent speeches.
- As we approach the end of the month, we will see the largest duration Treasury Index extension for May since 2009 (0.13 year extension), so expect additional support for Treasuries this week.

Higher Interest Rates: A Double-Edged Sword



The prospect of an interest rate hike has had the dollar rallying sharply. The graph to left represents the value of the US dollar compared to other major world currencies. The most recent uptick is due in part to Chair Yellen's comments on Friday. It is somewhat surprising that the collective response was this bullish given that the market had already priced in a rate hike for this year, with September being the most likely candidate. However, it is a double-edged sword; as interest rates rise, the US dollar rallies, which has negative implications on the economy and could affect the timing of interest rate normalization.

The Week Ahead

- A slew of economic data will be released this week, including US durable goods, consumer confidence, sales of new US homes, jobless claims, and another look at 1Q GDP.
- We will also see a decent amount of Fedspeak including speeches from Richmond President Jeffrey Lacker, San Francisco President John Williams, and Minneapolis President Narayana Kocherlakota.

Date	Indicator	For	Forecast	Last
26-May	Consumer Confidence Index	May	95.0	95.2
26-May	Durable Goods Orders	Apr	(0.5%)	4.7%
26-May	New Home Sales	Apr	508K	481K
27-May	MBA Mortgage Applications	22-May	-	(1.5%)
28-May	Initial Jobless Claims	23-May	271K	274K
29-May	GDP Annualized QoQ	1Q S	(0.9%)	0.2%
29-May	U. of Mich. Sentiment	May F	90.0	88.6
29-May	Chicago Purchasing Manager	May	53.0	52.3

Sources: Bloomberg



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