Interest Rate Risk Management Weekly Update

August 4, 2014

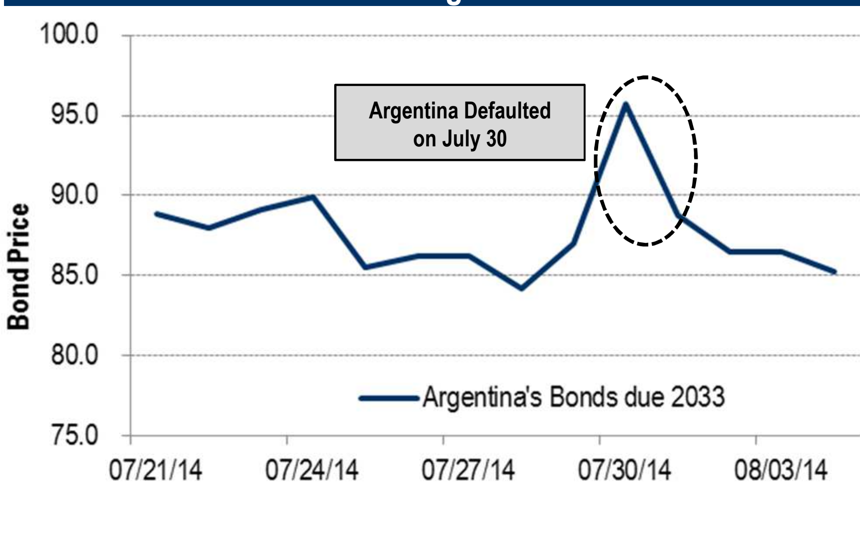
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.16%	0.16%	0.00%
3-Month LIBOR	0.24%	0.23%	0.01%
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	0.47%	0.49%	(0.02%)
5-year Treasury	1.66%	1.67%	(0.01%)
10-year Treasury	2.49%	2.47%	0.02%
Swaps vs. 3M LIBOR			
2-year	0.73%	0.74%	(0.01%)
5-year	1.86%	1.85%	0.01%
10-year	2.68%	2.64%	0.04%

Fed Speak & Economic News:

- If you had taken a look at the Treasury curve at the beginning of the week and then again at the end, you probably would have thought that the week was relatively non-eventful. However, the truth is that it was saturated with consequential economic releases, meetings, and geopolitical events that led to an increase in interest-rate volatility. By Friday, the Treasury curve had a slight steepening bias, but for the most part, yields ended up where they had started.
- The week kicked off on a promising tone, with the release of a handsome second quarter US GDP figure. Thereafter, economic data were encouraging: consumer confidence, ISM manufacturing, and core PCE all surprised to the upside. The FOMC's July meeting concluded on Wednesday, but while a portion of the language was modified, the outcome of the meeting was as expected, including a further taper of monthly asset purchases to $25 billion per month. However, on Friday, the yield reversal began, with July payrolls showing a disappointing 209,000 gain. The below-forecast jobs report may be the reason we witnessed a slight steepening bias in the curve by the end of the week. It appears market participants have delayed their rate-hike timelines and priced in a faster hiking pace. In addition to the myriad of economic data, there was a host of geopolitical concerns.
- Tensions between Russia and the United States and Europe escalated, with the European Union imposing a fresh round of sanctions aimed at crippling Russia's arms trade and access to capital markets. But perhaps the most galvanizing event was the proliferation of violence in the Gaza Strip, where a 72-hour cease-fire had been broken before it began. What is strange is that despite the unsettling geopolitics of the world and the selloff witnessed in equities, later-dated yields finished the week slightly higher. Hence, we are seeing that the front- and back-end of the curve are responding to different drivers. Yields in the front-end continue to be driven by economic data, which in turn are driving the decision-making process at the Fed. Essentially it is an educated guessing game, with market participants trying to time the Fed's first rate hike. Meanwhile, yields in the back-end are being driven by the confluence of geopolitical concerns in the Middle East and eastern Europe. As a result, if we see geopolitical tensions alleviate, we could see yields the back-end of the curve increase further.

Argentina's Selective Default



Source: Bloomberg

In a curious manner, Argentina selectively defaulted on its debt last week, marking the eighth time the country has defaulted in the past 200 years. What was different this time around was that the default was not the result of Argentina's inability to make its bond payments, but rather because a US judged decided it would also have to pay the bondholders of its debt it had defaulted on in 2001. The decision marked a turn of events in which creditors were given favorability over debtors, which is a change from debt negotiations we saw in Europe.

U.S. Economic Data

- Nonfarm payrolls in July increased by 209k versus 230k expected
- The unemployment rate ticked up from 6.1% to 6.2%
- GDP annualized QoQ surprised to upside, registering a 4.0% gain versus 3.0% expected.
- Consumer confidence printed at 90.9 versus 85.4 expected
- ADP payrolls increased by 218k in July, below the 230k expected
- Markit US Manufacturing PMI printed at 55.8 versus 56.5 expected

Date	Indicator	For	Forecast	Last
5-Aug	Factory Orders	Jun	0.6%	(0.5%)
5-Aug	ISM Non-Manf. Composite	Jul	56.5	56.0
5-Aug	Markit US Services PMI	Jul F	60.8	61.0
6-Aug	MBA Mortgage Applications	1-Aug	-	(2.2%)
6-Aug	Trade Balance	Jun	-$44.9B	-$44.4B
7-Aug	Initial Jobless Claims	2-Aug	304K	302K
8-Aug	Wholesale Inventories MoM	Jun	0.7%	0.5%

Group Head
Matt Milcetich 216-689-3141

Cleveland, OH
David Bowen 216-689-3925
Mary Coe 216-689-4606
Dusko Djukic 216-689-4224
Sam Donzelli 216-689-3635
Anand Gomes 216-689-4932
Frank Kuriakuz 216-689-4071

Seattle, WA
Vani Rao 206-689-2972
Greg Dawli 206-689-2971

Documentation
Ramona Berce 413-567-6758
Linda Maraldo 216-689-0516
Marybeth Simon 216-689-0897

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