

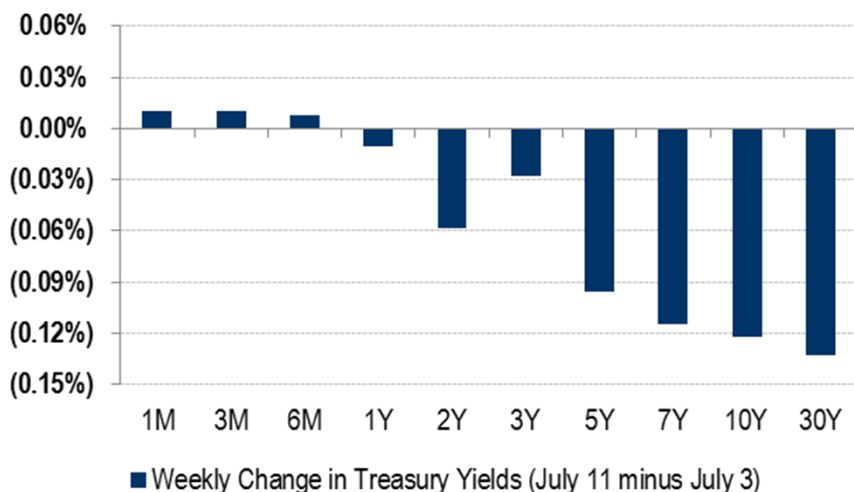
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.15%	0.16%	(0.01%) ↓
3-Month LIBOR	0.23%	0.23%	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	0.45%	0.51%	(0.06%) ↓
5-year Treasury	1.64%	1.74%	(0.10%) ↓
10-year Treasury	2.52%	2.64%	(0.12%) ↓
Swaps vs. 3M LIBOR			
2-year	0.67%	0.69%	(0.02%) ↓
5-year	1.79%	1.84%	(0.05%) ↓
10-year	2.68%	2.77%	(0.09%) ↓

Fed Speak & Economic News:

- Two things are clear from last week: the Middle East solidified itself as an arc of instability; and the fault lines in the euro zone resurfaced. Both of these factors had considerable influence on the Treasury curve, sending rates across the term structure lower. At home, the Fed released the June FOMC meeting minutes, which were perceived as dovish by market participants.
- The conflict in the Gaza Bank weighed on the long-end of the term structure and will continue to do so if tensions remain heightened. Hamas and other militant factions in the area clashed with Israeli defenses despite international pleas for a cease-fire. To the west, one of Portugal's banks, Banco Espirito Santo, sparked liquidity concerns by missing a debt payment, exacerbating the underperformance of risk assets. However, despite the market's jitters, core European government bond spreads demonstrated some resilience. Easing the collective minds of market participants might be the fact that European banks' nonperforming loan balances have trended lower and core capital ratios are at their highest levels in recent memory, exceeding 10 percent. But despite this, the ramifications spilled over into peripheral markets, evident by market participants' suppressed appetite for risk (e.g., some equity indices were down up to five percent). With the Treasury's most recent supply behind us, it is hard to imagine that if instability in the Middle East and credit concerns in the euro zone persist, the back-end will not remain well bid.
- At home, the curve influences were different than those of Europe. While the economic docket was light, economic data releases showed a further acceleration in the job market; initial claims fell more than anticipated and JOLTS data (a Yellen-preferred measure) showed an increase in job openings. In addition, the Fed released the minutes of its June FOMC meeting. The minutes were perceived as dovish and disclosed the Fed's intent to end its monthly bond purchases in October. In addition, the Fed divulged why its year-end 2016 Fed Funds median forecast remained so low, a view that is increasingly divergent from that of market participants. The rhetoric has not changed: inflation remains low and slack remains in the job market. Some FOMC committee members noted their intentions to raise rates gradually, citing low equilibrium rates (i.e., rates consistent with the eventual full utilization of resources). The Fed remains focused on wage growth relative to productivity, which is not there yet in the Fed's eyes.

Treasuries Rally Amid a Spike in Risk-Aversion



Risk-aversion has the back-end of the Treasury curve well supported despite improving economic fundamentals in the United States. It is likely that the June FOMC meeting minutes weighed on the shorter-end of the structure, where policy expectations exert their greatest influence. We could see the curve flatten further, as the hiking cycle draws closer due to the improving economy (higher short-end rates) and as the Middle East remains a cradle of instability (lower long-end rates).

U.S. Economic Data

- Initial jobless claims printed at 304k vs 315k expected.
- Small business confidence dipped in June (95.0 vs 96.6 prior) but still remains at a comfortable range.
- The NFIB hiring plans index climbed 2 points
- Job openings per JOLTS report showed highest level since mid-2007

Date	Indicator	For	Forecast	Last
15-Jul	Retail Sales Advance MoM	Jun	0.6%	0.3%
15-Jul	Empire Manufacturing	Jul P	17.00	19.28
16-Jul	Industrial Production MoM	Jun	0.3%	0.6%
16-Jul	PPI Final Demand MoM	Jun	0.2%	(0.2%)
17-Jul	Univ. of Michigan Confidence	Jul P	83.0	82.5
17-Jul	Housing Starts	Jun	1025K	1001K
18-Jul	Leading Index	Jun	0.5%	0.5%

Source: Bloomberg

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