

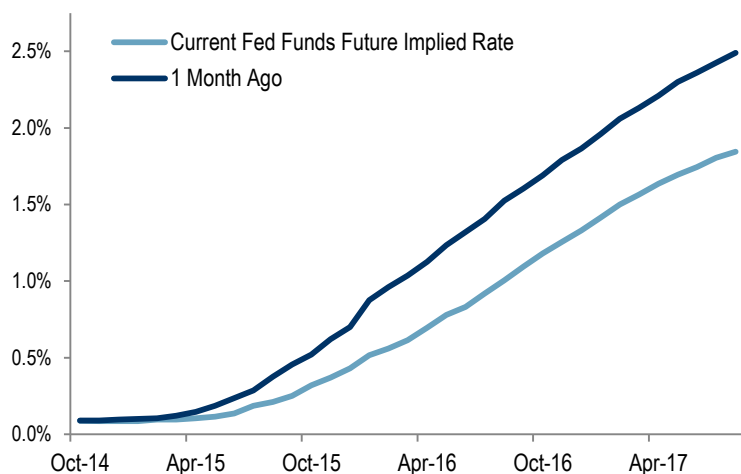
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.16%	0.15%	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	0.36%	0.43%	(0.07%) ▼
5-year Treasury	1.41%	1.53%	(0.12%) ▼
10-year Treasury	2.19%	2.28%	(0.09%) ▼
Swaps vs. 3M LIBOR			
2-year	0.68%	0.74%	(0.06%) ▼
5-year	1.64%	1.76%	(0.12%) ▼
10-year	2.39%	2.47%	(0.08%) ▼

Fed Speak & Economic News:

- Underlying last week's major market movement was serious concern of global disinflation or even a deflationary spiral and its possible spread to the US. Sparking the rapid sell off in equities and its reciprocal Treasury rally starting on Wednesday was poorer than expected retail sales data in the US, fueling fear of a zero inflation environment. All asset classes were affected by high volatility for the rest of the week, with the 10yr Treasury yield moving as much as 40bps down in one day and the S&P 500 down nearly 3%.
- Pressure for action from the ECB has risen dramatically as market fundamentals continue to deteriorate in the Eurozone. Equity markets in Europe were hit hard across the board on continually uninspiring economic reports and worsening inflation expectations. Based on a speech in April 2014 by Mario Draghi outlining the criteria that would prompt action, notably a "broad based weakening of aggregate demand" and "substantial positive supply shock that loosens anchoring of medium-term inflation expectations", action should be immanent as these conditions have arguably been met. Market participants are coming to expect a large scale asset purchase and, should Draghi fail to deliver, could risk losing credibility in the ECB's ability to reach its mandate of "price stability".
- Fed Speak this past week was as confusing as ever, leaving much doubt to what action will be taken at the next FOMC meeting on October 28-29. Barring last week, the Fed almost assuredly would fully wind down their asset purchases, with the final \$15B in MBS and Treasuries coming to an end with the meeting's conclusion. Uncertainty now looms as to whether that will be the case, with some Fed officials such as St. Louis's Bullard hinting that inflation targets must be met, even if that means delaying QE, and others such as Philadelphia's Plosser urging an earlier rate hike than mid 2015. Conflicting messages come as the US economy, ex September's retail sales, continues its positive drive, with initial jobless claims (264k vs. expected 290k) consistent with a strong economy. In addition, non-farm payrolls have averaged an increase of 212k since the start of the year, also consistent with a robust economy. Manufacturing in the US sees positive momentum as industrial production and capacity utilization both surprised to the upside compared to expectations. Lastly, housing seems to have taken a positive turn as housing starts rebounded to a + 1MM annualized rate.

Volatility Encourages Fed Futures Movement



Last week's rollercoaster ended with the conclusion that the market thinks the Fed will push back rate hikes by another six months from the previously estimated hike of mid 2015. At the peak of market instability, the first hike was priced as far back as mid 2016. To give a sense of volatility late last week, the Dec 10yr Treasury futures traded at four times the average daily volume of the year and a record high. Eurodollar contracts also traded an incredible amount of volume, 11 million contracts, compared to the former record of 6.9 million. Volatility is likely to persist through the remainder of the year.

U.S. Economic Data

- Industrial Production MoM exceeded expectations at 1.0% compared to consensus of 0.4%.
- Capacity Utilization printed higher at 79.3% compared to consensus of 79.0%
- Housing starts for September were also higher than anticipated, at 1.017MM compared to forecast of 1.008MM.
- University of Michigan Confidence rating for October was higher than expected at 86.4 vs survey of 84.0.

Date	Indicator	For	Forecast	Last
22-Oct	MBA Mortgage Applications	Oct	-	5.6%
22-Oct	CPI MoM	Sep	1.6%	1.7%
23-Oct	FHFA House Price Index MoM	Aug	0.30%	0.10%
23-Oct	Markit US Manufacturing PMI	Oct P	57.0	57.5
24-Oct	New Home Sales	Sep	470k	504k

Source: Bloomberg

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