Interest Rate Risk Management Weekly Update

June 30, 2014

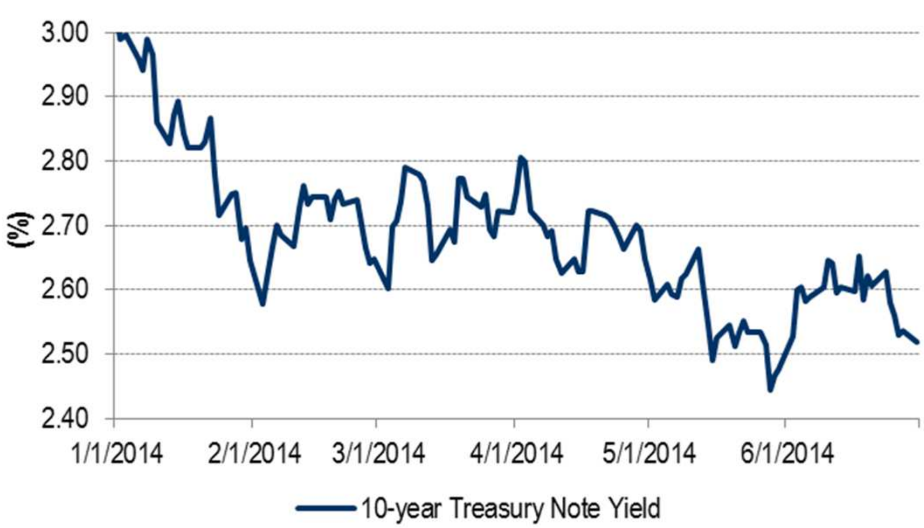
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.15%	0.15%	0.00%
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	0.46%	0.46%	0.00%
5-year Treasury	1.64%	1.68%	(0.04%)
10-year Treasury	2.54%	2.61%	(0.07%)
Swaps vs. 3M LIBOR			
2-year	0.64%	0.66%	(0.02%)
5-year	1.76%	1.82%	(0.06%)
10-year	2.69%	2.75%	(0.06%)

Fed Speak & Economic News:

- In terms of global economic development, the first half of the year was disappointing to say the least. At the end of 2013, the yield on the 10-year Treasury note hovered around three percent; today, it sits nearly 50 basis points lower at two and a half percent. Recurring themes throughout the first two quarters quickly come to mind when one reminisces: low economic growth and volatility, sluggish inflationary pressures (most so in Europe), and unified dovishness by central banks around the globe. In the United States, the labor market improved and inflationary pressures began to mount. Conversely, we saw the ECB unveil a bold easing package in early June to help catalyze inflationary pressures as the economic dynamics of the eurozone have diverged from those of the United States and the rest of the developed world. In addition, just as inflation in the eurozone fell, Japan looked as if it was waking up out of its economic slumber. However, the year hasn't been without its turns and twists; despite the yield curve being lower, we have seen how quickly rate expectations – especially in the belly of the curve – can change as market participants quickly disseminate economic news and interpret central banks' messages. Finally, this year is not without its geopolitical upheaval, with the Ukraine-Crimea crisis and the insurgency in Iraq. The good news is that the second half of the year looks more promising than the first.
- One of the main themes in the second half of the year is likely to be the diverging paths of central banks. As the Fed steps closer to normalizing rate policy, the ECB is destined to become more accommodative, likely unveiling further easing packages in the coming months, should deflationary concerns remain. The recent pickup of inflation in the United States will force the Fed to maintain its credibility, and hence, communication at future meetings is likely to acknowledge the uptick in inflationary pressures. On the other hand, the Bank of Japan is likely to take a path between that of the ECB and Fed, with a bias towards remaining accommodative. Japan's economy has weathered the increase in the consumption tax well, and Shinzo's 'Third Arrow', a series of reforms, will likely bolster growth by addressing areas of the economy that demand change. The low-volatility environment witnessed earlier this year is unlikely to persist at historic lows as we approach the cusp of rate normalization. In short, we are likely to see materialization in global economic growth and inflation, and continuation of easy monetary policy in sluggish economies.

The 10-Year Treasury Note Lower – Looking for a Rebound



Source: Bloomberg

The 10-year Treasury note started the year off yielding three percent but has surprised most market participants and made its way lower. US economic growth in the first quarter was basically a write-off amid harsh weather. Given the recent build in inflation, higher growth prospects, and the Fed winding down asset purchases, many expect to see the 10-year yield trend higher.

U.S. Economic Data

- First quarter GDP showed the economy contracted 2.9%; exports decreased 8.9% and imports increased 1.8% while business inventories decreased. These factors are interrelated with the harsh winter weather.
- Consumer spending registered at 0.2% vs 0.4% expected despite personal income registering at consensus at 0.4%.
- Durable Goods Orders decreased in May by 1.0%.

Date	Indicator	For	Forecast	Last
1-Jul	ISM Manufacturing	Jun	55.9	55.4
1-Jul	Markit US Manufacturing PMI	Jun F	57.5	57.5
2-Jul	Factory Orders	May	-0.30%	0.70%
2-Jul	ADP Employment Change	Jun	205K	179K
3-Jul	Change in Nonfarm Payrolls	Jun	215K	217K
3-Jul	Unemployment Rate	Jun	6.3%	6.3%
3-Jul	Trade Balance	May	-$45.0B	-$47.2B

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