INTEREST RATE MARKET INSIGHT

FEBRUARY 2, 2015

• A supremely volatile January for equity and rate markets has drawn to a close, with the damage consisting of about a 3% decline for broad indices and a 50 basis point decline in long term yields. One might easily trade the former for the latter, particularly when adding on another 10% decline for crude oil below $50 a barrel. The Dow moved 1%+ up or down the last four days of the month. The Federal Reserve's FOMC meeting last week resulted in much of the same, however with the "solid" economy and "labor market conditions [that] have improved further," the Fed could remove its rate policy accommodation sooner "if incoming information indicates faster progress toward the Committee's employment and inflation objectives." The newly comprised Committee had zero dissents, and the market consensus centers around a September hike presently. The next moment comes on Friday, when the Nonfarm Payrolls report is expected to show a 230,000 job gain for January and a flat 5.6% unemployment rate. The other driving release of the week was the preliminary Q4 2014 GDP, which rose only 2.6% QoQ amid consensus at 3% and the strong 5% from the third quarter. Ahead of Friday's jobs report, initial jobless claims plummeted to 265k, a 15-year low.

• We will be fortunate if the jobs data shows what is expected to be a 0.3% MoM gain in wages after the worst-ever decline of 0.2% MoM in December. Prices were flat QoQ (+0.7% QoQ core) in the GDP report, with expectations of a 1% annualized advance, another deflationary sign for the Federal Reserve to interpret. Durable goods orders slipped -3.4% MoM (-0.8% ex transportation), well below modestly positive forecasts. The employment cost index rose 0.6% QoQ and remained 2.2% higher on an annual basis, a solid print for wage earners. New home sales (481k annualized) and December S&P Case-Shiller home prices rose 0.7% MoM, however the pending home sale index slipped. Chicago PMI rose to 59.4, revealing expansionary growth for the Midwest region. Consumer confidence and sentiment reports showed persistent recovery high readings. Demand from buy-and-hold accounts was fierce in the Treasury auctions last week, leaving dealers with only 30% of the offerings for 2-, 5-, and 7-year notes. The flash services PMI rose to 54, up modestly MoM for the largest component of the US economy. The new Greek government seems close to receiving concessions from the EU on their austerity package, which could mean a debt holder haircut.

• Before the jobs report, traders will focus on ISM surveys for services (56.5 expected) and manufacturing (54.5 consensus), as well as the precursory ADP private payrolls report that should show 220,000 net new payrolls ex government. The international trade report should show a compressing deficit of only -$37.9 billion for December, while a 2.2% MoM decline for factory orders and a 0.6% advance in construction spending are expected. This morning, personal income rose 0.3% while spending slipped 0.3% MoM, and the core YoY PCE deflator inflation gauge remained at 1.3%. Fed Governors are out in force speaking this week to help markets further digest the FOMC policy statement.

Index Rates	Last	Week Ago	Month Ago	Year Ago
1-month LIBOR	0.17%	0.17%	0.17%	0.16%
3-month LIBOR	0.25%	0.26%	0.26%	0.24%
6-month LIBOR	0.36%	0.35%	0.36%	0.34%
12-month LIBOR	0.62%	0.62%	0.63%	0.57%
Fed Funds Target	0.25%	0.25%	0.25%	0.25%
Prime Rate	3.25%	3.25%	3.25%	3.25%
SIFMA Muni Swap Index	Call	0.02%	0.03%	0.04%

Treasury Rates	Last	Week Ago	Month Ago	Year Ago
2-yr Treasury	0.45%	0.49%	0.69%	0.35%
3-yr Treasury	0.74%	0.85%	1.10%	0.70%
5-yr Treasury	1.16%	1.31%	1.68%	1.51%
7-yr Treasury	1.46%	1.60%	1.99%	2.15%
10-yr Treasury	1.64%	1.80%	2.19%	2.70%
30-yr Treasury	2.22%	2.37%	2.76%	3.64%
2s-10s Spread	1.19%	1.31%	1.50%	2.35%

Taxable Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr LIBOR Swap	Call	0.73%	0.87%	0.46%
3-yr LIBOR Swap	Call	1.04%	1.26%	0.81%
5-yr LIBOR Swap	Call	1.43%	1.74%	1.60%
7-yr LIBOR Swap	Call	1.67%	2.00%	2.20%
10-yr LIBOR Swap	Call	1.89%	2.23%	2.75%

Tax-Exempt Swap Rates	Last	Week Ago	Month Ago	Year Ago
2-yr SIFMA Swap	Call	0.38%	0.50%	0.28%
3-yr SIFMA Swap	Call	0.63%	0.79%	0.54%
5-yr SIFMA Swap	Call	1.03%	1.25%	1.22%
7-yr SIFMA Swap	Call	1.30%	1.56%	1.80%
10-yr SIFMA Swap	Call	1.55%	1.85%	2.35%

All else equal, amortizing swaps and caps will have lower rates and costs, respectively. Please call for specific structure pricing requests.

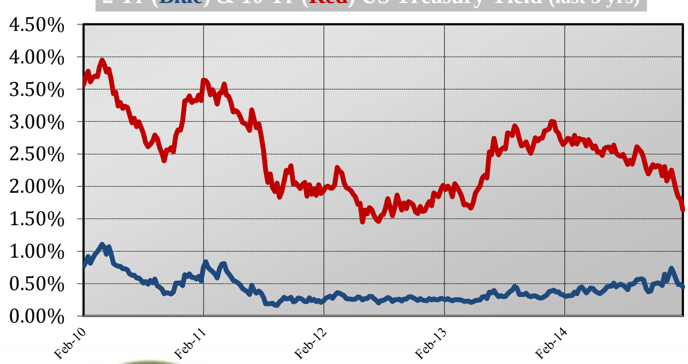
Agency Rate Caps (in bps)	LIBOR = 3%	LIBOR = 4%	LIBOR = 5%	LIBOR = 6%
3-yr LIBOR Cap	24	14	14	11
4-yr LIBOR Cap	59	33	36	30
5-yr LIBOR Cap	105	59	36	51
7-yr LIBOR Cap	251	175	133	107

Fwd Implied 3mL Rate	Last
Dec. 15	0.67%
Dec. 16	1.35%
Dec. 17	1.78%
Dec. 18	2.05%

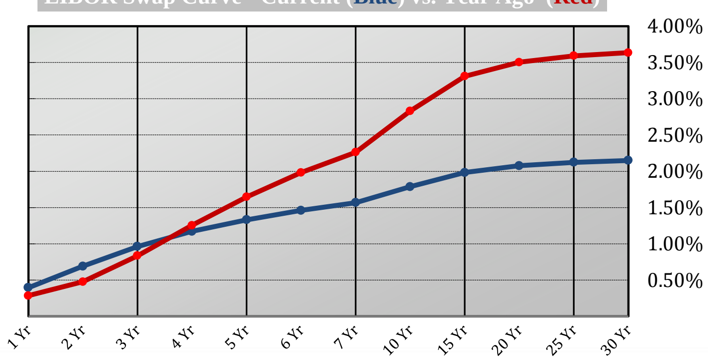
Conventions

Source: Bloomberg. LIBOR swaps use 1-month LIBOR, monthly payments, act/360 for both legs. SIFMA swaps reset weekly and pay monthly, act/act. For %of LIBOR swaps, multiply the %used by the taxable swap rate. No amortization.

2 Yr (Blue) & 10 Yr (Red) US Treasury Yield (last 5 yrs)



LIBOR Swap Curve - Current (Blue) vs. Year Ago (Red)



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