THE MERGANSER FLASH

FIXED INCOME INSIGHTS

AS OF JANUARY 31, 2019

MERGANSER CAPITAL MANAGEMENT

Market Commentary

THE ECONOMY

- Widespread concerns surrounding a global economic slowdown that erupted late last year seem to have quieted, or at least pushed to the side, illustrated by rallies across equities, high grade fixed income, high yield and emerging markets. One factor underpinning that optimism is the market's view that the Fed will keep interest rates relatively low for the foreseeable future (Fed Funds futures point firmly to no hikes at all in 2019). US economic data are mixed, with employment continuing to be strong, while housing starts and home appreciation are slowing. The impacts of the US government shutdown are difficult to quantify but will certainly detract from early 2019 GDP growth. Global questions remain, with no definitive progress toward a US-China trade resolution or an agreeable Brexit plan. Valuations appeared attractive following the late-2018 sell off but the quick recovery seems unsustainable given the context of broad economic uncertainty.

STRUCTURED MARKETS

- CMBS supply began the year with multiple Agency and SA/SB deals. Two non-agency conduit deals are lined up to price, but none priced in January, a result of slower deal volumes as volatility increased in Q4. Spreads have lagged the recovery seen in other markets. New issue 10-year AAA non-agency spreads are currently being marketed at +96, the average for Q4. The credit curve has steepened with new issue BBB-spreads over +400 again, vs +350 average in Q4. A strong domestic labor market suggests fundamentals are stable, and relatively low supply should be a tailwind to spread tightening absent an exogenous shock in the macro picture.

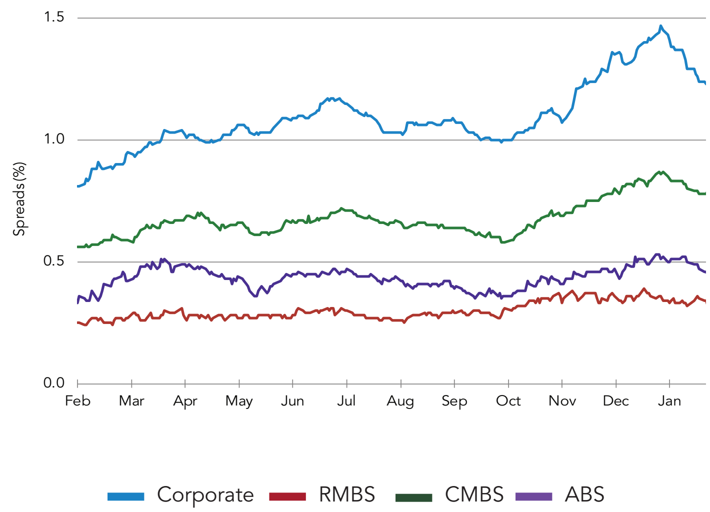
CORPORATE CREDIT MARKET

- Despite a momentary widening to start the month, corporate spreads and most risk assets rallied significantly in January. The Bloomberg Barclays Corporate Index tightened 25 basis points (bps) to end the month at 128 bps. The confluence of Fed commentary to assuage market jitters, excess liquidity and overseas demand were additive to the risk rally. MTD supply of $115bn was 15% lower than January 2018 issuance of $135bn. First movers on new issues paid heavily with concessions in excess of 50 bps at the beginning of the month, however, the basis between primaries and secondaries eventually compressed to near zero on heavy demand.

GOVERNMENT MARKET

- The 2-yr and 5-yr yields decreased by 2 bps and 6 bps, respectively, for the month of January. The 10-yr yield decreased by 5 bps, while the 30-yr yield decreased by 2 bps for the month of January.

SPREADS TO TREASURIES



BLOOMBERG BARCLAYS BENCHMARK DATA

	Total Return MTD
1-3 Gov/Credit	0.39%
Int. Gov/Credit	0.87%
Aggregate	1.06%
1-3 Yr US Treasury	0.27%
3-5 Yr US Treasury	0.41%
5-10 Yr US Treasury	0.67%
10-20 Yr US Treasury	0.77%
20+ Yr US Treasury	0.66%

SECTOR DATA FROM BLOOMBERG BARCLAYS AGGREGATE

	Total Return MTD	Excess Return* MTD	Current YTM
Corporates	2.35%	1.83%	3.88%
Financials	2.33%	1.84%	3.74%
Industrials	2.53%	1.99%	3.97%
Utilities	0.97%	0.38%	3.85%
RMBS	0.79%	0.32%	3.28%
CMBS	1.05%	0.51%	3.30%
ABS	0.47%	0.16%	2.94%
Agencies	0.74%	0.31%	3.15%

*Month-to-date performance of spread bearing bonds versus duration-matched Treasuries