THIS WEEK IN THE BOND MARKET 01/26/2015

HEADLINE NEWS

Demand For Bond Insurance Remains Weak

Bond insurance in the primary municipal market continues to slowly increase, with $18.6 billion insured in 2014 compared to $11.5 billion in 2013. Insurance penetration reached 5.6% from below 4.0% the past two years, but remains well below the 57% reached in 2005. Assured Guaranty and Build America Mutual led with the way with a combined 93.9% of market share. The value proposition of bond insurance continues to be difficult to sell in a market with low nominal yields and tight spreads.

Lower Gas Prices Spur Tax Hike Debate

Proponents of increasing the federal gas tax, which is currently 18.4 cents per gallon for gasoline, argue that the recent drop in pump prices opens the door for an increase, something that has not happened since 1993. While an increase in the federal gas tax would improve the federal program that funds transportation infrastructure, its likely that the political will necessary to approve a hike will continue to be fleeting. That leaves states with the burden to increase current revenue sources or develop new ones to help repair aging roads and bridges. Many have already increased sales and gas taxes, and states such as Iowa, Michigan, and Utah are in the midst of developing dedicated revenue streams to help finance transportation projects.

S&P Downgrades Russian Sovereign Debt

Earlier today, Russia's credit rating was lowered to junk status, the first time the country has been rated below investment grade in a decade. Russia's economy has been under pressure from all sides, with oil prices at their lowest levels since 2009 and U.S. and European allies imposing economic and financial sanctions over the crisis in Ukraine. The deteriorating situation in Russia has curbed investor appetite for the ruble, as well as Russian stocks and bonds. The Russian stock market is down more than 40% in the last twelve months. As risk continues to leave the Russian financial markets and the EU implements quantitative easing measures, it is very possible that more capital will flow into the U.S. fixed income markets, keeping a lid on yields here.

We at Appleton Partners would like to extend our best wishes to our colleagues in the Northeast as the coast braces for tonight and tomorrow's historic blizzard – may you and your loved ones remain safe as we prepare for potentially record-setting snowfall.

MARKET UPDATE

Municipal Issuance Exceeds Expectations

The municipal market has seen higher than expected supply for the first part of the year. For the first three weeks of the year, issuance has been $23.2 billion, made up of 53% new money and 47% refunding. If rates stay in this range, many market participants will have to adjust their issuance expectations up due to increased refundings. Last week, the market digested the supply, but with some volatility. Inside of 5 years, the AAA curve tightened slightly. Beyond 6 years, yields are moderately higher with the 7yr 2bps higher at 1.40% and the 10Yr 6bps cheaper at 1.81%. This week's calendar is expected to be about $6.5 billion with the largest deal being a $1 billion Commonwealth of Pennsylvania GO (Aa3/AA/AA-) competitive deal.

Oil Decline Fails to Dampen Energy Issuance

The short week did not affect issuance in the Investment Grade credit space, as it reached $28.2 billion last week, bringing YTD volume to $113.8 billion. The highlight of the week was on Tuesday as Southwestern Energy Company (SWN, Baa3/BBB-/BBB-) issued $2.2 billion over three tranches. Given the recent selloff in oil and the general pressures in the energy markets it was unclear where this deal would come to market. Surprisingly, the deal was well subscribed, and pricing changed several times before being released. Since the release, the 10yr maturity of the deal has tightened in about 20 bps from its original +318 bps over the 10yr. Meanwhile, the US Treasury curve continued its bearish trend as the curve continued to flatten. The 3yr benchmark UST maturity rose 3 bps to .85% on the week, and in opposition the long bond decreased 8 bps to end the week at 2.374%.

FIXED INCOME INDEX RETURNS

	MTD 1/23/15	YTD 1/23/15
Barclays 3Yr	0.56	0.56
Barclays 5Yr	1.30	1.30
Barclays 7Yr	1.52	1.52
Barclays MM Short 1-5Yr	0.76	0.76
Barclays MM 1-10Yr	1.41	1.41
ML US Gov/Corp 1-10 Yr	1.19	1.19

Source: Interactive Data

APPLETON PARTNERS, INC. ONE POST OFFICE SQ. BOSTON, MA 02109 TEL. 617.338.0700 WWW.APPLETONPARTNERS.COM