

HEADLINE NEWS
Puerto Rico Default

- On January 4th, Puerto Rico defaulted on \$37.3 million of debt service payments out of a total of almost \$1 billion in aggregate payments due, or less than 4% of their total debt service obligations. The Commonwealth will make the full payment on its General Obligation debt, only possible due to clawing back of revenues dedicated to other bonds. They are defaulting on \$36 million in Puerto Rico Infrastructure Finance Authority bonds backed by the island's rum tax revenues, and \$1.4 million Puerto Rico Public Finance Corporation bonds.
- The diverting of dedicated revenues away from their implied uses has already sparked a lawsuit from Ambac and FGIC, two of the creditors on the defaulted debt, with further litigation expected. In addition to the diverted revenues, money was also tapped out of reserve funds to make the debt service payments, further straining the liquidity position of the Commonwealth. Puerto Rico's next debt service payment on February 1st totals almost \$420 million.

Macro in Focus this Week

- A number of macroeconomic data points will be in focus during this first week of trading in the New Year. Kicking off the week, Monday's U.S. manufacturing ISM fell below expectations (48.2 vs 49), but investors are more likely to focus on Wednesday's release of the minutes from the December FOMC meeting and Friday's jobs report. Consensus estimates call for an addition of 200K nonfarm payrolls and an unemployment rate of 5.0%.

FIXED INCOME INDEX RETURNS AS OF 12/31/15

| | MTD | YTD |
|-------------------------|-------|------|
| Barclays 3Yr | -0.06 | 1.18 |
| Barclays 5Yr | 0.20 | 2.43 |
| Barclays 7Yr | 0.51 | 3.26 |
| Barclays MM Short 1-5Yr | -0.03 | 1.36 |
| Barclays MM 1-10Yr | 0.36 | 2.78 |
| ML US Gov/Corp 1-10 Yr | -0.22 | 1.35 |

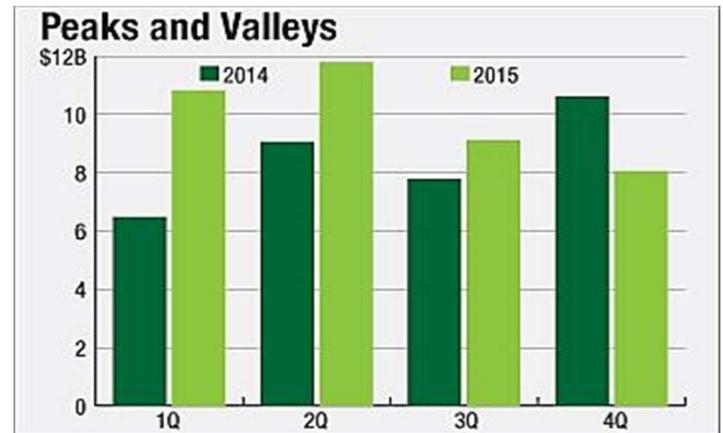
Source: Interactive Data

MARKET UPDATE & YEAR END REVIEW
Muni Market Overview

- The Municipal market was very quiet last week given the holidays and yields were about a basis point lower in the 6-10 year part of the curve. The supply is still very low, with \$3.3 billion expected for the week and 30-day visible supply remains low at \$7.5 billion.
- Looking at the year in review, the municipal yield curve flattened with the most dramatic move in the 6-10 year part of the curve. From 12/31/14 to 12/31/15, the 8 year was lower by 17bps, with 13bps of the change coming in the 4th Quarter.
- On the issuance side, 2015 brought \$397.7 billion, which is the highest it has been since 2010 (\$433.27 billion), but still short of the anticipated \$400 billion marker, with the month of December contributing to the miss. As shown in the graph to the right, 4th quarter issuance for 2015 was significantly off levels seen in the 4th quarter of the prior year.

Corporate Market Overview

- Last week was slow on all fronts as most participants were enjoying the holidays with their families. According to the BAML IG Corporate Master OAS Index, Investment Grade credit spreads were 34 bps wider on the year. The credit curve was also steeper in 2015 and there were negative excess returns in IG for the second straight year. The record \$1.5 trillion of IG New Issuance was one of the bigger stories in 2015, as low rates made it attractive for companies to borrow as well as the significant increase in M&A activity. Next year's issuance could be substantial, as well.



Source: The Bond Buyer

- The ends of the US Treasury yield curve had the biggest move in 2015. The benchmark 1 & 2Yr bond increased by 38 bps and ended the year at .60% and 1.05%, respectively. In 5 & 10 years yields rose roughly 10bps each to 1.76% and 2.27%. The long bond rose 26bps to end the year at 3.02%. Questions still remain on the timing of the continued rise in rates by the FED and most of the effects will continue to be felt in the short end of the yield curve. Volatility and global uncertainty will continue to play a big part of what happens in 2016.