

HEADLINE NEWS

Puerto Rico Offers Bondholders Cumulative 45% Haircut

- Puerto Rico released a debt exchange proposal last Monday under which all bondholders, including those owning constitutionally-protected General Obligation bonds, would be asked to take a haircut on par owed.
- The proposal contemplates a voluntary debt exchange with bondholders receiving two new securities: a fixed rate “Base Bond” that would delay payment for a number of years and a “Growth Bond” that is more akin to a contingent value right and would only be paid if Puerto Rico’s economy experiences strong growth.
- We note that the proposal seems low and that many participants may hold out in the hope that recovery would be higher via a court restructuring. GO bondholders who enjoy a constitutionally-protected clawback on revenues of other issuers would receive a 30% impairment based on par exchanged that in reality would be closer to a 40-50% haircut based on current market yields for Puerto Rico paper.

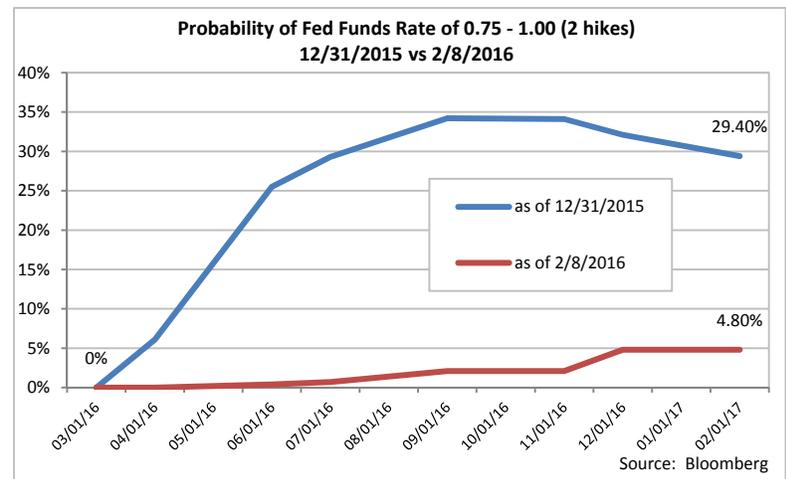
Mixed Economic Data Drives Market Expectations Down

- January nonfarm payrolls reported a 151,000 increase versus an expected 190,000, and the December number was revised down by 30,000 jobs to 262,000. Contradictory to the jobs report, the unemployment rate went down to 4.9% from 5% and average hourly earnings increased to 0.5%, higher than the expected 0.3% MoM.
- After the releases on Friday, the market implied probabilities of Fed Funds rates increasing to a range of 0.75% - 1% are further reduced. For the June 2016 meeting, the likelihood is 0.4% and only gets to 4.9% by the February 2017 FOMC meeting. As of the

end of 2015, the implied probability that the Fed Funds rate would be raised to the 0.75-1% range by the June 2016 meeting was 25.5%

Chicago Public Schools Gets Deal Done... At a Price

- After delaying the deal two weeks ago, Chicago Public Schools was required to increase the offered yields and trim the par issued to successfully sell \$775 million of general obligation bonds. Bonds with maturities in 2044 priced at an 8.5% yield or more than 550 basis points above the AAA municipal benchmark.
- Tantamount to deficit financing, the proceeds will help the school district make a debt service deposit in February. Battling increasing pension contributions, unstable labor relations, and a lack of support from the State, this deal may help CPS’ short-term liquidity but does little to fix the underlying structural problems.



MARKET UPDATE

Muni Market Overview

- The municipal yield curve was lower over the week by as much as 12 basis points between 3yrs-5yrs and 8bps in 7Yrs to 1.21% with the Treasury rally. Municipals are further supported by continued bond fund inflows of \$765 million for the week (ending 2/3/16) bringing the YTD total to \$5.77 billion.
- Supply picks up this week to almost \$9 billion, which is above the 3 year average for this week of \$5.7 billion. Leading the issuance is \$1.2 billion FL State Board of Administration Finance Corp (Formerly, Florida Hurricane Catastrophe Fund) rated Aa3/AA/AA.

Corporate Market Overview

- Last week’s \$12.23 billion in investment grade corporate issuance left market participants feeling discontent and low volumes in secondary trading didn’t provide any relief. The largest single deal of the week was Home Depot’s (HD A2/A/A) \$4.25 billion issued across 3 tranches. The \$1.30 billion HD 3.0% 04/01/26 (10Yr) was issued at +120, but it later traded in the greys market 8-9 bps tighter, signaling a healthy appetite for investment grade bonds.

- US Treasuries continue to rally, the curve continues to flatten, and it continues to be the best performing asset class so far this year. The 10Yr bond dropped an additional 9 bps last week to 1.87%, bringing the year-to-date decrease in yield to 43 bps.

FIXED INCOME INDEX RETURNS AS OF 2/5/2016		
	MTD	YTD
Barclays 3Yr	0.27	0.91
Barclays 5Yr	0.45	1.60
Barclays 7Yr	0.41	1.84
Barclays MM Short 1-5Yr	0.30	1.06
Barclays MM 1-10Yr	0.43	1.74
ML US Gov/Corp 1-10 Yr	0.26	1.66

Source: Interactive Data



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