THIS WEEK IN THE BOND MARKET 6/13/16

HEADLINE NEWS

Illinois' Ratings Fall Again

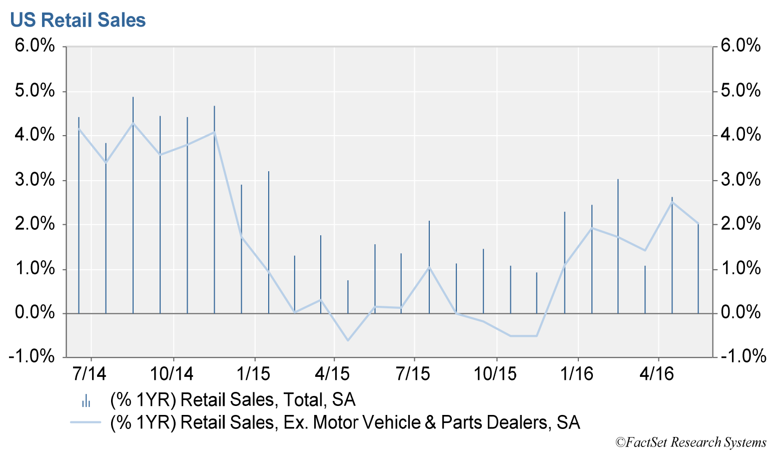
- Ahead of a $550 million General Obligation deal to be sold competitively on June 16th, both Moody's and S&P downgraded the State of Illinois to Baa2 and BBB+, respectively. The rating action reflects the high likelihood that Illinois will end its fiscal year on June 30th having never passed a budget and the possibility that the State begins next fiscal year without a budget as well.
- A contentious political environment between the Republican governor, Bruce Rauner, and Democrat-controlled legislature has led to an inability to address gaps between expenditures and recurring revenues. More importantly, lawmakers' ongoing budget discussions have distracted them from tackling Illinois' most pressing fiscal challenge: a large and growing pension liability. Illinois is the only state with ratings in the "BBB" category.

New Jersey Dodges Pension Bullet

- New Jersey's Supreme Court ruled in favor of the State this past week, validating New Jersey's freeze on cost-of-living-adjustments to retiree benefits since 2011. The State had incorporated the provision as part of broad-based pension reform, resulting in an estimated savings of $11.5 billion over the last five years.
- The ruling essentially maintains the status quo for the State as reported pension liabilities and annual pension contributions had been calculated assuming the adjustment freeze was legal. If the ruling went against New Jersey, unfunded pension liabilities would have increased by an approximate $30 billion and may have led to rating downgrades.
- While the ruling removes an overhang for New Jersey, long-term challenges remain.

Busy Macro Week Highlighted by FOMC on Wednesday

- The macroeconomic calendar is full this week with a number of important items we will be watching. Tuesday's retail sales report came in at 0.5%, above the expected 0.3%. We will also be watching the PPI and CPI reports for any signs of inflation.
- The highlight will be Wednesday afternoon's FOMC policy announcement followed by a Janet Yellen press conference. We do not believe that the Fed will raise rates at this meeting, but will be monitoring for any mention of July as a "live" meeting.



MARKET UPDATE

Muni Market Overview

- The Municipal yield curve flattened over the week with the 3Yr down 5bps, the 7Yr down 7bps, and the 10Yr down 10 bps. In the 10Yr spot, the Muni/Treasury ratio declined to 92.7% to end the week from the previous Friday of almost 95%.
- Mutual fund flows were very strong last week at $2.8 billion (week ending 6/8/16) bringing the year to date total up to $29.6 billion and reversing the recent trend of lower inflows.
- On the supply side, this week's new issuance is expected around $6 billion following last week's large $14.2 billion. With the continued supply and demand imbalance, the deals will likely be well received by the market.

Corporate Market Overview

- The Primary market in the Investment grade credit space was somewhat subdued last week, especially when compared to the past 5 weeks of issuance which averaged over $50 billion per week. The $33.625 billion received the usual warm welcome, as investor demand remains steady and rates drift lower.
- It wasn't the largest deal of the week, but Under Armour (UA Baa2/BBB-) dipped its toes in the debt market for the first time on Wednesday. Initial price talk on the $500 million, 10Yr bullet was in the +200 bps area; however, a decent amount of interest drove pricing to +160 bps and the deal was upsized to $600 million. The proceeds, not surprisingly, will be used to repay outstanding debt revolver. Overall, Investment Grade spreads remain steady and have slowed from 2016 tights back in the beginning of May.
- The Treasury curve bull flattening trend that we have seen over the course of this year continues as intermediate yields fall dramatically. The chance of a rate increase for June and July followed suit and any consensus for an increase was erased. The 5Yr & the 30Yr UST were both down 6bps on the week to 1.17% and 2.45%.

FIXED INCOME INDEX RETURNS AS OF 6/10/2016

	MTD	YTD
Barclays 3Yr	0.20	1.13
Barclays 5Yr	0.38	1.82
Barclays 7Yr	0.51	2.57
Barclays MM Short 1-5Yr	0.23	1.14
Barclays MM 1-10Yr	0.48	2.25
ML US Gov/Corp 1-10 Yr	0.72	3.03

Source: Interactive Data

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