

HEADLINE NEWS: NO SURPRISES FROM THE FED

- As the FOMC meeting adjourns this week, the markets should be given everything they expect: an additional \$10 billion/month reduction in purchases (lowering the monthly asset purchases to \$35 billion/month) and little or no change on the timing of the initial rate hikes (mid-2015). However, the number of future meetings that will continue to run on “auto-pilot” are diminishing, as signs of economic health continue to grow and the discussion begins to focus on the exit strategy. The labor market appears to be in recovery mode, housing is tentative, and the geo-political picture is in uncertain territory. Chairwoman Yellen will try not to rock the markets in her Wednesday afternoon press conference.
- Global corporations continue to take advantage of investors' willingness to accept duration risk for incremental yield. The Financial Times has reported that global issuance of corporate bonds maturing in 50Yrs or longer has reached a record of \$33.5 billion. This new record comes on the heels of 2013's 84% increase in 50Yr+ issuance. There appears to be plenty of demand to soak up record-level issuance as long-term corporate bonds have outperformed maturities of 10Yrs or less by close to 6% this year. In another sign that investors are seeking riskier securities in exchange for higher yields, last week GM priced the largest bond backed by subprime auto loans since 2007. Furthermore, the \$1.4 billion asset-backed bond offering was priced at the lowest yields that GM has come to the market with in more than a year.
- A California judge ruled last week that the state's teacher tenure laws are unconstitutional and protect poorly performing teachers to the detriment of students' education. While the ruling will most likely be appealed by teachers' unions, a change in tenure laws may provide California school districts with more leverage to adjust salary and benefit costs, providing improved financial flexibility. California's teacher tenure laws are viewed as some of the strongest in the country, so the ultimate ruling may not have widespread effects, but could encourage more challenges in other states with historically strong educational labor protections.

MARKET UPDATE: GEO-POLITICS DRIVES STRONG DEMAND FOR CORPORATES

- Municipals widened for the week with 5Yrs ending at 1.30% and 10Yrs at 2.33%, as the market digested the relatively large primary market calendar. This week, the calendar drops slightly to \$6 billion. The two largest deals, both with the highest credit ratings, are \$978 million Georgia GO (Aaa/AAA/AAA) and \$900 million Texas Transportation Commission (Aaa/AAA/AAA). According to the Fed Flow of Funds data, the Municipal market, at \$3.66 trillion, is 1.8% lower than the market at end of 1Q13 and 3% lower than the market peak size in 4Q10.
- Intermediate-term US Treasuries began the week in sell-off mode, but regained composure to end the week unchanged. There was a slight lift in the short-end of the curve with the 2Yr and 3Yr climbing 3–7bps. However, the curve continues to be very steep as the spread between the 2Yr and 10Yr is 215bps. This past week was the sixth largest week this year in Investment Grade corporate issuance with \$44.5 billion coming to market. New issuance continues to be buoyed by strong demand. The political unrest in the Ukraine and violence in Iraq could move some to implement a “risk off” mentality, sending demand for High Grade corporates higher and spreads tighter.

**FED'S MOST RECENT ECONOMIC PROJECTIONS - 2014
GDP MAY BE REVISED LOWER AT THE JUNE MEETING**

	2014	2015	2016
<i>Change in Real GDP</i>	2.8%-3.0%	3.0%-3.2%	2.5%-3.0%
<i>Unemployment Rate</i>	6.1%-6.3%	5.6%-5.9%	5.2%-5.6%
<i>Core PCE Inflation</i>	1.4%-1.6%	1.7%-2.0%	1.8%-2.0%

Source: Federal Reserve, March 2014

FIXED INCOME INDEX RETURNS

	MTD 6/13/14	YTD 6/13/14
Barclays 3Yr	-0.08	0.85
Barclays 5Yr	-0.39	1.84
Barclays 7Yr	-0.52	3.66
Barclays MM Short 1-5Yr	-0.17	0.71
Barclays MM 1-10Yr	-0.50	2.46
ML US Gov/Corp 1-10 Yr	-0.47	1.64

Source: IDC

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