

HEADLINE NEWS: CHINA INCREASES TREASURY HOLDINGS

- There have been many theories as to why the 10Yr yield has been range-bound despite the Fed continuing to taper its purchases. Theories include a global flight to quality, attractive relative yields to global benchmarks, and large buying from other sovereign nations (i.e. China). The latter theory was confirmed last week when U.S. Treasury data showed that China had upped its holdings of U.S. Treasuries by \$107 billion in the first five months of the year. China's Treasury holdings as of May now total \$1.27 trillion, or 11% of all outstanding Treasury debt.



Source: FactSet

- On July 3rd, the Illinois Supreme Court ruled that retiree health care subsidies should be afforded the same state constitutional protections that have historically applied to pensions within the state. The Supreme Court overturned a lower court's ruling from March 2013 and legislation that was passed in 2012 that eliminated the state's responsibility to pay for a portion of retiree health insurance premiums. The immediate ramification will be increased expenses for Illinois, but it also signals a stronger possibility that the State Supreme Court could overturn recent state pension reforms. It does not bode well for recent pension reform efforts by the City of Chicago and Cook County. State pension reform passed in December 2013 had been viewed as a positive step in stabilizing Illinois' credit profile. However, the recent court ruling undermines that stability and subsequent trading resulted in the spread on 10Yr Illinois GO bonds widening out approximately 25bps to 150bps above the MMD AAA scale.

MARKET UPDATE: GEOPOLITICAL EVENTS DRIVE TREASURY TRADING

- The Intermediate part of the Municipal yield curve rallied over the week, with the 5Yr coming in by 5bps to 1.25% and the 10Yr coming in by 11bps to 2.24%. Longer maturities also rallied, with 30Yrs tightening 8bps to 3.31%. Demand for Municipals firmed up over the week, partially due to increased flows into Municipal bond funds from \$145 million in outflows the previous week to \$184 million of inflows last week. This week's calendar totals about \$5.5 billion, which is slightly smaller than last week's new issuance. The largest deal of the week is \$779 million Maryland GOs (Aaa/AAA/AAA) coming competitive on Wednesday in two tranches. The state also offered \$100 million in a negotiated deal on Monday. Levels on these deals will be an important factor in determining the AAA benchmark curves this week.
- The political pot continues to boil over north of the Black Sea, as the tension escalates between the Ukraine and Russia. This uncertainty and the tragic events of last Thursday triggered the "risk-off" trade and U.S. Treasuries rallied across the curve. By week's end, U.S. Treasuries backed off slightly and the curve flattened. The 2Yr Treasury rose 3bps to 0.48%, the 10Yr dropped 4bps to 2.48%, and the 30Yr note ended the week lower by 5bps to 3.29%.
- The Investment Grade Corporate bond market continues to be driven by new issuance. However, this past week was significantly slower with only \$14.4 billion being priced by the end of the week. A lot of factors were at play here, including a large focus on earnings season, summer vacations, and the uncertainty noted above. The largest deal to come last week, and for the first time, was Bed Bath & Beyond (BBBY Baa1/A-/BB+), which came to market with \$1.5 billion in three tranches: 10yr @+120bps, 20Yr @+155bps, and 30Yr @+180bps.

FIXED INCOME INDEX RETURNS

	MTD 7/18/14	YTD 7/18/14
Barclays 3Yr	-0.01	1.02
Barclays 5Yr	-0.06	2.23
Barclays 7Yr	0.05	4.28
Barclays MM Short 1-5Yr	-0.01	0.93
Barclays MM 1-10Yr	0.07	3.01
ML US Gov/Corp 1-10 Yr	-0.04	1.98

Source: IDC

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

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