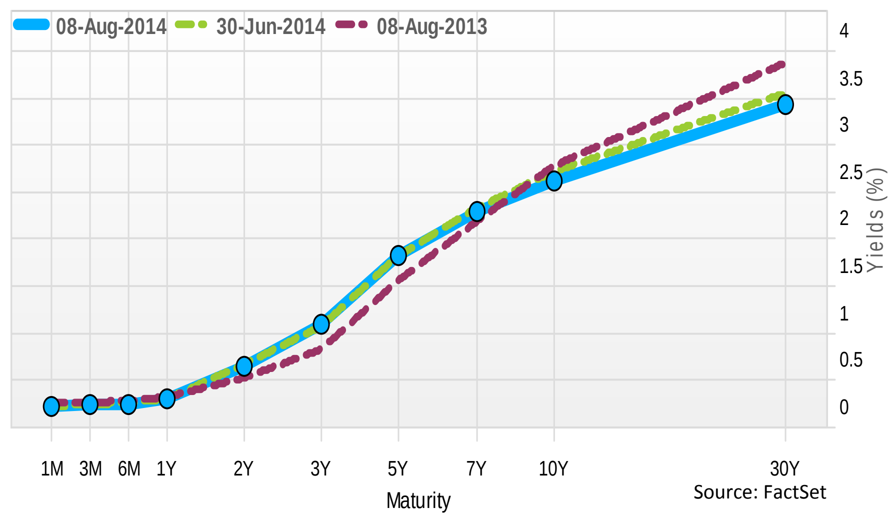
APPLETON PARTNERS, INC.

THIS WEEK IN THE BOND MARKET 8/11/2014

HEADLINE NEWS: GEOPOLITICAL UNCERTAINTY DRIVES A FLIGHT TO QUALITY

- While stocks managed to eke out gains on Friday, bond yields on both sides of the Atlantic fell to their lowest levels this year as the US carried out airstrikes on militants in Iraq. In the US, the 10Yr Treasury yield fell to an intraday low of 2.35%, a level which has not been seen since June of last year. Meanwhile, the 10Yr German bund closed at 1.054%, the lowest historical yield on record. French and U.K. 10Yr benchmark yields also dipped to 1-year lows. While the action in the US benchmark likely reflects a general flight to quality, tightening yields in the EU may be signaling that the entire region will follow Italy back into a recession.
- Thursday, August 14th looms as an important date for the Puerto Rico Electric Power Authority (RPEPA) and the Commonwealth itself, as payment on a twice extended line of credit will come due. Given significant liquidity issues, PREPA appears to be the leading candidate to exercise its newly granted rights under Puerto Rico's Recovery Act to restructure its debt. Based on trades at distressed levels, the market is anticipating a restructuring. Although Puerto Rico's troubles are idiosyncratic, we believe a default by PREPA may cause temporary concern throughout the entire market, and potentially providing an opportunity for astute investors.

12-MONTH TREASURY YIELD CURVE MOVEMENT



Source: FactSet

- High-Yield bonds have been the darlings of the bond market throughout the recovery, as the low-rate environment has pushed investors into higher-risk assets chasing the yield advantage. But geopolitical risk, equity uncertainty, and historically tight spreads have put investors on alert. For the period ending August 6th, Lipper reported a record $5.8 billion in taxable high-yield mutual fund outflows, marking the fourth consecutive week of billion dollar plus outflows. Concurrently, Investment Grade funds have seen average weekly inflows of almost $1.0 billion for the past 4 weeks.

MARKET UPDATE: POSITIVE FIXED INCOME FUND FLOWS GENERATES STRONG PRIMARY DEMAND

- The municipal market continues to experience positive technicals, with positive fund flows, bond calls, and maturities all appearing to generate strong demand for a continued light calendar. Citibank estimates that gross supply for the year will total $280 billion, with a "negative net issuance" of $43 billion. Municipal investors seem to be scrambling to reinvest maturities and call proceeds. Not surprisingly, Municipals outperformed similar maturity Treasuries this week in the 5, 10, and 30Yr spots by roughly 5bps. California paper appears in particularly strong demand, with quality names trading on or below the AAA scale and limited on the horizon.

FIXED INCOME INDEX RETURNS

	MTD 8/8/14	YTD 8/8/14
Barclays 3Yr	0.06	1.19
Barclays 5Yr	0.26	2.69
Barclays 7Yr	0.46	4.87
Barclays MM Short 1-5Yr	0.12	1.17
Barclays MM 1-10Yr	0.39	3.54
ML US Gov/Corp 1-10 Yr	0.49	2.27

Source: IDC

- With earnings season concluding, the Investment Grade primary market returned from its short hiatus. Last week's issuance totaled $24.98 billion across nineteen issuers, totaling three times the previous week's volume. Triple B credits led the week accounting for 67% of the total issuance. Tyson Foods Inc. (TSN Baa3/BBB/BBB) issued the largest deal of the week with 5/10/20/30Yr tranches at +100/+150/+190/+160bps, respectively. Outside of the primary issuance market, the secondary market appeared softer and spreads were generally wider due to global unrest and volatility.
- The US Treasury market posted a strong rally last week as geopolitical concerns appeared to push investors to less risky assets. The 10Yr benchmark Treasury began 2014 at 3.03% and has yet to come close to that mark. In fact, the yearly average stands at 2.65%. August 7th marked the low on the year for the 10Yr, as the bond fell to 2.35% in premarket trading. However, it ended the day and the week at 2.41% at 2.42%, respectively.

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