

## Trading Desk Commentary

As investors tried to put together a little momentum in the “risk on” trade early this week, it seemed like European Central Bank President Mario Draghi was constantly there to throw cold water on the optimism. His comment that the strengthening euro currency may be counterproductive to the ECB’s recovery efforts gave rise to new speculation that the central bank may need to loosen its current monetary stance. Draghi’s words fueled a demand for safety and US Treasury yields fell further from their 2013 highs touched late last week. Europe has laid relatively low over the past few months, assisted in part by the global spotlight-stealing show put on by US Congress at the turn of the year. However, EU leaders’ two-day budget session in Brussels this week brought the ECB and EU’s challenges back to the fore. On the brighter side, the EU had agreed upon its first budget in its five-decade history that required spending cuts, an initiative driven primarily by the U.K. Prime Minister, David Cameron. The agreement permitted the Dow to retrace some of its losses and US Treasuries stabilized at the end of a bumpy week. Munis, on the other hand, entered the week in cruise control and never really changed gears. Very manageable current supply levels (~\$4.5bln), a moderate Bond Buyer 30-day visible supply calendar (<\$6bln) and steady tax-exempt demand allowed Munis to ignore the noise from their taxable counterparts and maintain their firm foundation. A few of the intermediate maturities improved modestly on the week, according to Municipal Market Data.

Following the past couple of weeks of suppressed supply yet resilient Municipal demand, tax-exempt participants find themselves in a difficult environment. The demand for Munis marches on, illustrated by the Lipper Muni bond fund flows that persisted again this week and totaled over \$5bln YTD. It is worth noting that this week’s inflow resulted in \$109mln in new assets, a steep decline from the average totals we have observed since early January. 2013 YTD equity returns are bound to be drawing some of the “faster” money toward the asset class (the Dow is now up over 800 points since the start of the year but the week’s EU events appear to have tempered at least some of the equity market’s enthusiasm). Still, the Muni market feels relatively stable, if a bit quiet due to the lack of supply. Which brings us to the biggest challenge: new supply. The recent menu of issuers bringing new debt has been noticeably limited. The effect of low supply has been (at least) two-fold. First, getting money to work following year-end maturities has been a grind. Secondly, a subdued primary market has forced investors to heavily rely on secondary market purchases to get invested. In the secondary, participants are still yield-starved, favoring those issuers or sectors that can provide a boost to their income stream. As a result, the usual yield suspects in the hospital, power, housing, and education sectors are trading at extremely tight spreads to the MMD AAA benchmark scale. In other words, overwhelming demand has driven down the amount of extra yield (and prices upward) these types of bonds offer versus a AAA GO-type issuer. While we have had some success in sourcing larger blocks of bonds at attractive levels, we remain committed to our emphasis on executing smaller trades at a higher frequency. This continues to be an effective strategy of purchasing names that we like at more reasonable prices. Without an uptick to more robust supply thresholds, we suspect the secondary market will remain the focus of our efforts.

Muni Rates	Current Wk	Yld Change	Prior Wk	Muni to UST
2 Year	0.34	0.00	0.34	136%
5 Year	0.80	0.01	0.79	99%
10 Year	1.80	-0.02	1.82	92%
30 Year	2.86	0.00	2.86	91%
UST Rates				
2 Year	0.25	-0.01	0.26	
5 Year	0.81	-0.08	0.89	
10 Year	1.95	-0.08	2.03	
30 Year	3.16	-0.06	3.22	

	Current Wk	Prior Wk
<b>Weekly Municipal Supply (\$ Bln)</b>		
Negotiated	\$2.40	\$2.50
Competitive	\$2.42	\$1.79
<b>TOTAL</b>	<b>\$4.82</b>	<b>\$4.29</b>

<b>Municipal 30 Day Visible Supply (\$ Bln)</b>	<b>\$5.73</b>	<b>\$7.22</b>
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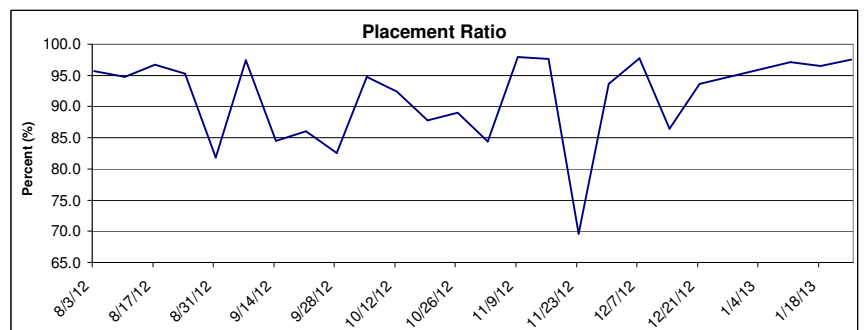
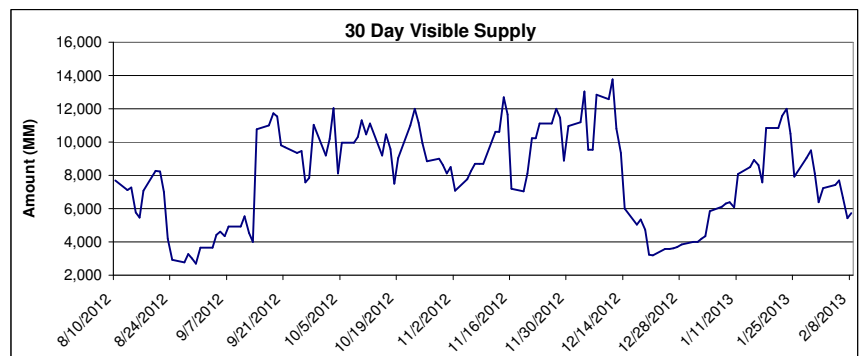
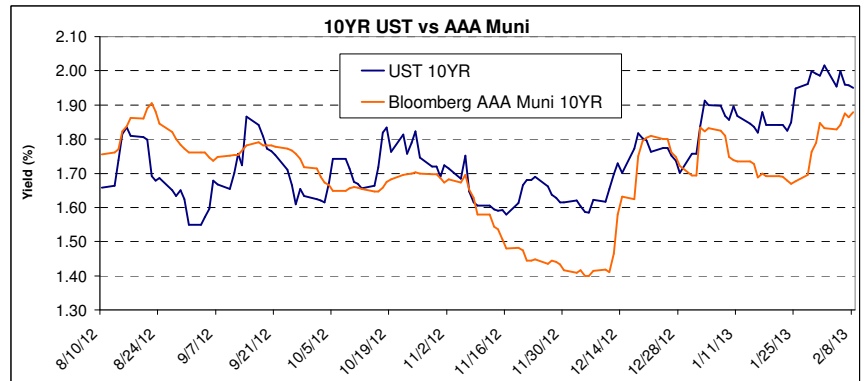
<b>Bloomberg Muni PICK Offerings (\$ Bln)</b>	<b>\$13.38</b>	<b>\$13.20</b>
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<b>Muni Placement Ratio (New Issues)</b>	<b>n/a</b>	<b>n/a</b>
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<b>Bond Buyer 20 Municipal G.O. Index</b>	<b>3.68%</b>	<b>3.67%</b>
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### Select Economic Releases

Date	Event	Period	Survey	Prior
2/13	MBA Mortgage Applications	8-Feb	--	3.4%
2/13	Import Price Index (MoM)	Jan	0.8%	-0.1%
2/13	Advance Retail Sales	Jan	0.1%	0.5%
2/14	Initial Jobless Claims	9-Feb	360K	366K
2/14	Continuing Claims	2-Feb	3205K	3224K
2/15	Empire Manufacturing	Feb	-2.00	-7.78
2/15	Industrial Production	Jan	0.2%	0.3%
2/15	Capacity Utilization	Jan	78.9%	78.8%
2/15	U. of Michigan Confidence	Feb P	74.8	73.8



#### **Explanation of Key Measures :**

**Weekly Municipal Supply** - The total dollar volume of municipal securities expected to be offered during the upcoming week, broken down by deal type. This helps gauge near term supply and momentum along with the 30 day visible figure.

**30 Day Visible Supply** - The total dollar volume of municipal securities expected to be offered over the next 30 days. The visible supply, which is compiled and published by The Bond Buyer, indicates the near-term activity in the municipal market.

**Bloomberg PICK Offerings** - The total dollar amount of offerings listed on Bloomberg's dealer offerings system. The figure helps gauge secondary supply in the market.

**Placement Ratio** - The amount of bonds sold by underwriting syndicates each week as a percentage of the amount issued that week by issuers selling \$1,000,000 par value or more of securities. The ratio published by The Bond Buyer, helps gauge the demand for municipal bonds in the marketplace.

**Bond Buyer 20 G.O. Index** - Index published weekly representing the average yield of 20 G.O. bonds with 20 year maturities, rated AA2 by Moody's.

**Sources:** Weekly municipal supply figures, and municipal rates are produced by Thompson Reuter (Municipal Market Data). 30 day visible figures, and the placement ratio are obtained through The MuniCenter, and produced by The Bond Buyer. The 20 G.O. index yield is obtained through Bloomberg, and produced by The Bond Buyer. Pick offerings par value, UST supply, economic releases, and UST rates are obtained through Bloomberg Professional Service. Information obtained from these sources is believed to be reliable but is not guaranteed.

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