@ Caprin_Asset

CAPRIN
knowledge preserves wealth

Weekly Trading Desk Update

Peyton Studebaker Chip Hughey
Media contact: Adam Plotkin aplotkin@caprinbonds.com

October 31, 2014

Trading Desk Commentary

The US continues to set the pace in the field of global economic recoveries. Yesterday, the first glimpse of US Q3 GDP got out of the gate strongly. The +3.5% annualized rate beat expectations by +0.5% and puts the US on track for about +2.0% growth in 2014. That +2.0% number is roughly in line with the expansion we have seen in recent years. Put Q2 and Q3 GDP together and we are in the midst of a solid 6-month stretch of US activity. The most recent print also helps alleviate concerns from early 2014 when the economy was shrinking and recessionary fears re-emerged. The +3.5% release is undeniably positive but the underlying make-up of the number does raise a few eyebrows. A big part of the surge was due to substantial increases in government spending (particularly defense spending) and a spike in US exports. The higher defense spending is probably not sustainable and the powerful strengthening of the US dollar in the current quarter will likely result in a meaningful drop in US exports. Furthermore, most of the major economies that boosted Q3 trade are struggling more and more, particularly in Europe. Economists speculate that US consumers could swoop in and save the day when Q4 GDP is released. Lower gas prices and the holiday season may fuel improved spending and offset some of the drag that reduced government spending and exports would cause. Time will tell that tale. At present, most of the world's economies have less to be optimistic about. The Bank of Japan unexpectedly announced an increase to its stimulus program today in an effort to stave off deflation. The Eurozone is flirting with a recession while the European Central Bank can't find an effective weapon to deploy against the slowdown. Global interest rates are still near all-time lows as their own investors demand safety assets. This phenomenon should continue to bolster US debt prices. The US offers some of the most attractive absolute yields available. This, coupled with the US's better-than-average growth prospects, is attracting a great deal of foreign dollars into US Treasuries. This should continue to weigh down US yields (i.e. drive up prices) that might other wise rise based on our brighter domestic prospects. 2.35% is an important threshold for the 10-Year US Treasury. We traded right up to it when the FOMC announced this week that the Fed's bond purchases were over and then added some hawkish language to their statement. Yields failed to break through the 2.35% barrier but they are still sitting within a few basis points of it today. Should US yields muster the strength to break through, we would expect to be within a 2.35-2.65% trading range for some time. More likely we will continue our sideways momentum for the near-term barring a major geopolitical event.

Munis paid a small price for the weaker US Treasury backdrop. Trading activity felt fairly sluggish and dealers were willing to hit down-bids for their inventory items. Part of the reason could be the increase in The Bond Buyer 30-day visible supply which is now over $12bln. Such a robust calendar with a negative bias in debt prices could be giving buyers some pause. Lipper reported new inflows into Muni bond funds this week but the +$37mln is a far cry from the enthusiastic flows we were seeing earlier in the year. Our base case scenario expects range-bound tax-exempt yields in the near-term. If that holds true, next week's $8.26bln could test Muni buyers' appetite. We are already seeing signs of yield fatigue and while this week's sell-off could help reduce that, we are still near recent lows in Muni yields. The low absolute levels should support those deals that offer some spread over the AAA Muni scale, like next week's $355mln (Aa3/AA-) Missouri Health & Ed Mercy Health revenue deal. Buyers are looking lower on the credit spectrum in search of more attractive yields. Credit spreads are tightening as a result, but some sectors are still offering relative value. We are still emphasizing housing, education, power and hospital bonds to combat the low rate environment. However, doing so requires a high level of selectivity to ensure we are appropriately compensated for the risk those sectors tend to offer. Despite the suppressed supply, we are still locating value in both the new issue and secondary markets – but the search is as arduous as ever.

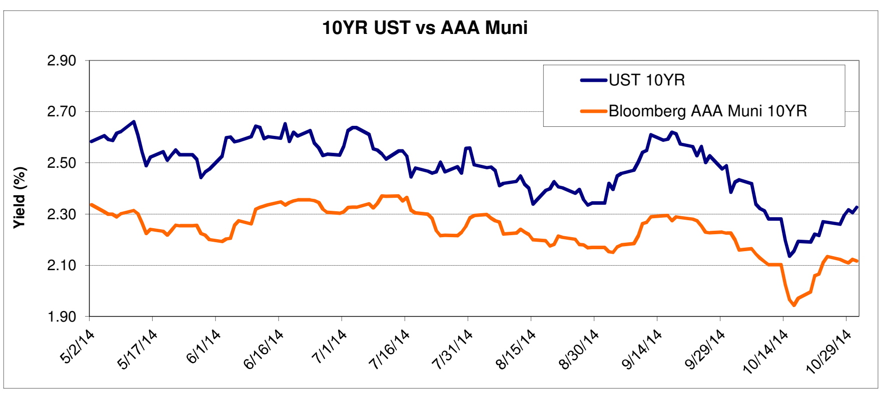
Caprin Strategy Summary

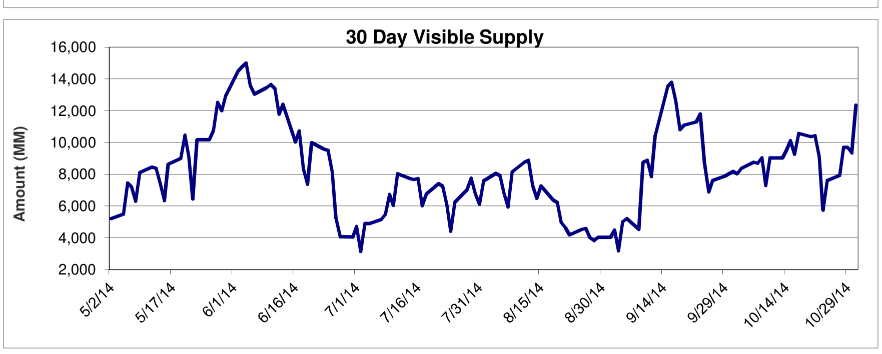
Name	Target Duration Position	Target Maturity Range	Highlights
Short Maturity Muni	Min – Max	0 YRS – 5 YRS	Prefer Hlth, Hsg, Pwr to G.O.'s for Yield
Low Duration Taxable	Min – Max	0 YRS – 5 YRS	Prefer Corporates and Taxable Munis
Intermediate Muni	Min – Max	0 YRS – 17 YRS	Prefer Hlth, Hsg, Pwr to G.O.'s for Yield
Intermediate Taxable	Min – Max	0 YRS – 12 YRS	Prefer Corporates and Taxable Munis
Tactical Muni ETF	Min – Max		Overweight to CA
Core Plus ETF	Min – Max		Slight Overweight to Corporates
Tactical Opportunity ETF	Min – Max		Slight Overweight Munis to Taxables

Market Overview

Muni Rates	Current Wk	Yld Change	Prior Wk	Muni to UST
2 Year	0.36	0.02	0.34	75%
5 Year	1.10	0.02	1.08	68%
10 Year	2.04	0.02	2.02	88%
30 Year	2.98	0.01	2.97	98%
UST Rates				
2 Year	0.48	0.06	0.42	
5 Year	1.61	0.10	1.51	
10 Year	2.32	0.06	2.26	
30 Year	3.05	0.00	3.05	

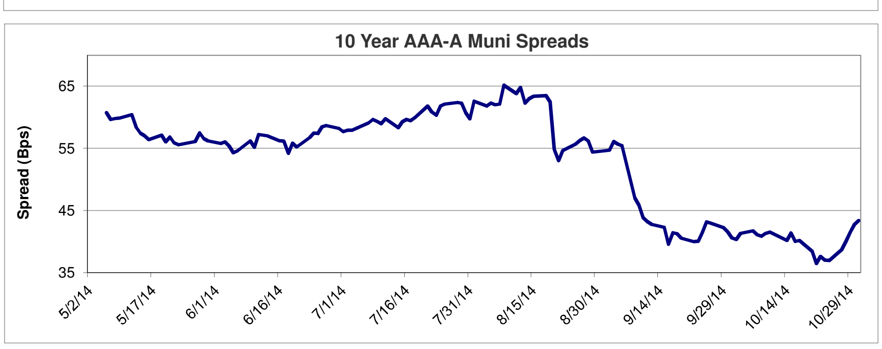
	Current Wk	Prior Wk
Weekly Municipal Supply ($ Bln)		
Negotiated	$5.52	$4.58
Competitive	$2.74	$0.69
TOTAL	**$8.26**	**$5.27**
Municipal 30 Day Visible Supply ($ Bln)	**$12.35**	**$7.61**
Bloomberg Muni PICK Offerings ($ Bln)	**$15.07**	**$13.76**
Bond Buyer 20 Municipal G.O. Index	**3.90%**	**3.90%**





Select Economic Releases

Date	Event	Period	Survey	Prior
11/3	Markit US Manufacturing PMI	Oct F	56.20	56.20
11/3	ISM Manufacturing	Oct	56.20	56.60
11/4	Trade Balance	Sep	-$40.0B	-$40.1B
11/4	Factory Orders	Sep	-0.50%	-10.10%
11/5	MBA Mortgage Applications	31-Oct	--	-6.60%
11/5	ADP Employment Change	Oct	220K	213K
11/6	Initial Jobless Claims	1-Nov	285K	287K
11/7	Change in Nonfarm Payrolls	Oct	234K	248K
11/7	Unemployment Rate	Oct	5.90%	5.90%



Please refer to the second page for explanations of key measures, sources, and disclosure information.

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.

AAA-A Muni Spreads - The difference in yield, as expressed in basis points (.01%), between the Bloomberg BVAL AAA 10 Year Benchmark Muni Index and the BVAL A Revenue 10 Year Muni Index.

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 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.