

## Trading Desk Commentary

The much-anticipated Federal Reserve meeting concluded Wednesday, and, as expected, the central bank increased the lower band of the Federal Funds rate by 25 basis points. The move was so well telegraphed by Fed officials that markets largely dismissed the news and instead focused on the release of the updated dot plots, which reflect the Fed's view of future rate increases. The muted reaction to the hike itself is exactly what the Fed had been hoping for since deciding against hiking at their September meeting. Front-end rates sold off post-meeting but not as drastically as some expected, confirming the move had been previously priced into the market. The 2-year Treasury rose 4 basis points and closed at 1.00% (ytd high) after Wednesday's meeting only to rally on Thursday and Friday back to 0.96%. 10's and 30's rose 2 basis points on Wednesday and also reversed course Thursday and Friday, rallying as much as 10 basis points each. The rally was led in part by a perceived dovish tone in the official statement and Yellen's press conference, in which she stressed gradual rate increases going forward and admitted the economy and inflation still have a ways to go before reaching desired targets. So why hike now? In the Fed's defense, jobs are stronger as evidenced by Nonfarm payroll growth, low unemployment, and certain sectors (i.e. housing) continuing to show growth, albeit slow. However, one has to wonder if this hike was more centered on saving credibility after the Fed took a noticeable hawkish stance post-September meeting. Fed rhetoric aside, the numbers just aren't that impressive, and headwinds abound. Inflationary pressures remain subdued as the price of crude has fallen 42% since its year-to-date high of \$61/barrel in June. The current \$34/barrel price is approaching 10-year lows, and the world supply/demand gap is at its highest level since 1998. The price of Industrial metals continues to decline due to the economic slowdown in China and emerging markets; the Bloomberg Industrial Metals Index, which is composed of futures contracts on aluminum, copper, nickel and zinc, is down another 30% this year and is trading at prices lower than levels seen post-crash 2008. Factor in volatility surrounding the high yield, junk bond market, as we discussed last week, and the opportunity for a wide variance in economic data and the probability of persistent slow growth here at home is high.

Back to the dot plots: median Fed Funds rate forecasts were largely unchanged with a slight median downward revision of 0.25% and 0.125% in 2017 and 2018, respectively. These projections suggest a 2.375% Fed Funds rate in 2017 and 3.25% in 2018. To reach 2.375% in 2017, the Fed would need eight 0.25% increases over the next 24 months. In our view that trajectory doesn't necessarily connote "gradual" when factoring in transitory headwinds, low inflation, global economic malaise, and a Fed that sat on 0% for over 7 years. In fact, the OIS curve expects considerably lower rates over the forecasted period – 1.30% in 2017 and 1.61% in 2018. Could this hike have been executed, at least in part, to give the Fed the ability to cut rates should their targets remain elusive and transitory factors linger longer? Or, are they strategically getting in front of future sustained growth in our economy? Only time will tell, but rest assured data dependency will be a theme throughout 2016.

It was an overall quiet week in the municipal space as only \$2.2 billion came to market. Muni rates were somewhat insulated from the more pronounced swings in the Treasury market, rising only 1 to 2 basis points across the curve over the course of the week. Secondary market activity was also subdued as buyers adjusted year-end strategy and dealers adjusted inventory around the rate hike. It seems that most dealers have their books buttoned up for the year and are reluctant to move bonds at concessions. Next week will be equally quiet as only one negotiated transaction (\$38 million Bucks County, PA W&S) will come to market. On the credit front, Puerto Rico was back in the news on Friday as the island's electric utility (PREPA) reached a tentative agreement with MBIA, Assured Guaranty and some additional larger bondholders to restructure over \$8 billion of outstanding debt. The "preliminary" agreement would prevent a default on a \$196 million interest payment due January 1, 2016, however a similar agreement was further along in negotiations this year before it was struck down prior to PREPA's board signing off on the proposal. We hope everyone is enjoying the holiday season as we wind down 2015.

## Caprin Strategy Summary

| Name                     | Target Duration Position | Target Maturity Range | Highlights                                    |
|--------------------------|--------------------------|-----------------------|---|
| Short Maturity Muni      |                          | 0 YRS - 5 YRS         | Prefer Hlth, Hsg, Pwr to G.O.'s for Yield     |
| Low Duration Taxable     |                          | 0 YRS - 5 YRS         | Slightly Shorter Positioning Given Volatility |
| Intermediate Muni        |                          | 0 YRS - 17 YRS        | Neutral Positioning Given Global Weakness     |
| Intermediate Taxable     |                          | 0 YRS - 12 YRS        | Neutral Positioning Given Global Weakness     |
| Tactical Muni ETF        |                          |                       | Neutral Duration, Overweight to CA            |
| Core Plus ETF            |                          |                       | Neutral Duration, Overweight to Treasuries    |
| Tactical Opportunity ETF |                          |                       | Neutral Duration, Overweight Munis            |

## Market Overview

| Muni Rates | Current Wk | Yld Change | Prior Wk | Muni to UST |
|------------|------------|------------|----------|-------------|
| 2 Year     | 0.77       | 0.02       | 0.75     | 81%         |
| 5 Year     | 1.26       | 0.02       | 1.24     | 75%         |
| 10 Year    | 1.93       | 0.01       | 1.92     | 88%         |
| 30 Year    | 2.81       | 0.01       | 2.80     | 96%         |

| UST Rates | Current Wk | Prior Wk |
|-----------|------------|----------|
| 2 Year    | 0.95       | 0.88     |
| 5 Year    | 1.68       | 1.55     |
| 10 Year   | 2.20       | 2.13     |
| 30 Year   | 2.92       | 2.87     |

|   | Current Wk    | Prior Wk      |
|---|---------------|---------------|
| <b>Weekly Municipal Supply (\$ Bln)</b> |               |               |
| Negotiated                              | \$0.64        | \$1.60        |
| Competitive                             | \$0.00        | \$0.62        |
| <b>TOTAL</b>                            | <b>\$0.64</b> | <b>\$2.22</b> |

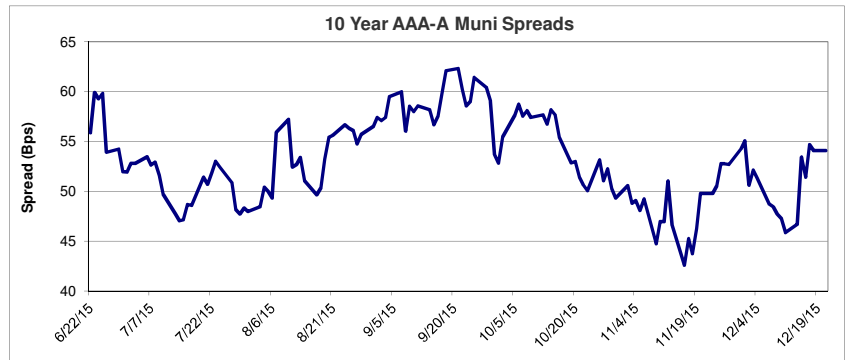
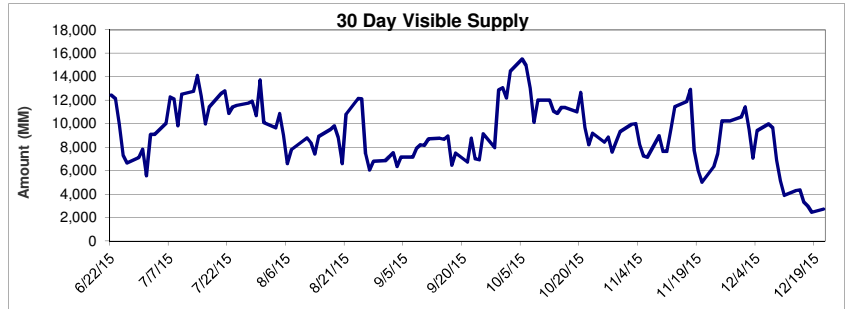
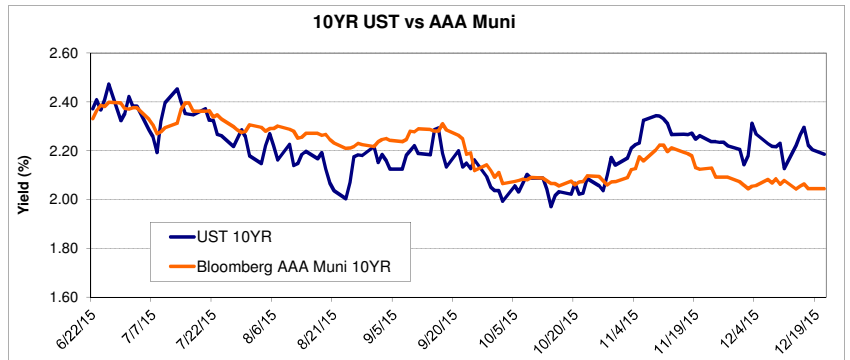
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|---|---------------|---------------|
| <b>Municipal 30 Day Visible Supply (\$ Bln)</b> | <b>\$2.46</b> | <b>\$3.85</b> |
|---|---------------|---------------|

|   |                |                |
|---|----------------|----------------|
| <b>Bloomberg Muni PICK Offerings (\$ Bln)</b> | <b>\$14.22</b> | <b>\$14.69</b> |
|---|----------------|----------------|

|   |              |              |
|---|--------------|--------------|
| <b>Bond Buyer 20 Municipal G.O. Index</b> | <b>3.57%</b> | <b>3.57%</b> |
|---|--------------|--------------|

### Select Economic Releases

| Date  | Event                      | Period | Survey | Prior  |
|-------|----------------------------|--------|--------|--------|
| 12/22 | GDP Annualized QoQ         | 3Q T   | 1.90%  | 2.10%  |
| 12/22 | Existing Home Sales        | Nov    | 5.34m  | 5.36m  |
| 12/22 | GDP Price Index            | 3Q T   | 1.30%  | 1.30%  |
| 12/23 | U. of Mich. Sentiment      | Dec F  | 92.00  | 91.80  |
| 12/23 | Durable Goods Orders       | Nov P  | -0.70% | 2.90%  |
| 12/23 | MBA Mortgage Applications  | 18-Dec | --     | -1.10% |
| 12/23 | New Home Sales             | Nov    | 505k   | 495k   |
| 12/23 | Personal Spending          | Nov    | 0.30%  | 0.10%  |
| 12/23 | Personal Income            | Nov    | 0.20%  | 0.40%  |
| 12/23 | Durables Ex Transportation | Nov P  | 0.00%  | 0.50%  |
| 12/24 | Initial Jobless Claims     | 19-Dec | 270k   | 271k   |



**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.

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