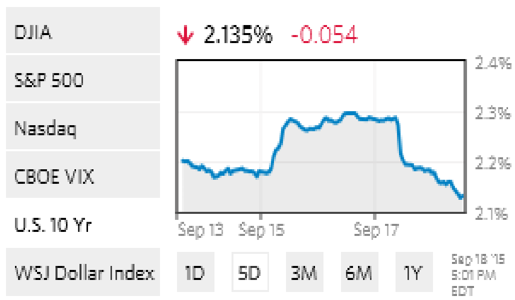
Special Edition – Fiscal Agent Market Update "Lower for Longer"

September 21, 2015

The defensive trades in front of last week's FOMC meeting proved unnecessary as global concerns outdid the modestly improved domestic indicators, leaving interest rate policy unchanged. This weekly chart of the ten-year treasury note (CT-10), our pricing benchmark for 20-year debentures, shows its rate moving higher into Thursday's announcement only to rally at week's end, closing 7.5 bps lower than when we last priced on September 10th.



What does the decision mean?

The wording of the announcement identified global concerns (read China) and its impact on emerging markets as a consideration for not changing policy. The Fed has focused on full employment as the engine to drive higher interest rates, but has now introduced an international perspective for its consideration, and that further clouds the transparency for Fed policy. Chairwoman Yellen was candid about emerging market weakness and cautioned about the risk of an abrupt slowdown in China. Whether an abrupt slowdown or just gradual weakening of Chinese GDP, the impact is widely felt since they are the biggest trading partner for emerging market economies. Its reduced demand for raw materials impacts commodity prices and foreign exchange rates resulting in weaker global growth.

Speaking of lower community prices, they are impacting domestic Gas and Oil businesses which are filing for bankruptcy at a rate of 4.8%, the sector's highest level since 1999 and double the rate of businesses in general. The volume of defaulted bonds YTD stands at $10.4 billion and yields in this sector of the junk bond market are as high as 11%.

CT-10's closing rate of 2.135% is its 200-day Moving Average and represents a rate the market has frequently settled at in weakness and strength going back four months. Indications are that we will remain with this low rate sentiment as the Fed exercises increased patience before normalizing monetary policy.

Even their modest projections seem inflated as officials still maintain a 2015 rate hike is probable. Here is the schedule of *projected* federal funds rates:

2015	.375%
2016	1.4%
2017	2.6%
2018	3.4%
Long-run	3.5%

The .375% projection for 2015 assumes a 25 bps increase in the next three months and then little else if the Fed is to maintain the gradual path they have advertised.

20-year Debenture rates and spreads
If we are going to see this 2.135% Treasury rate serve as a magnet until the Fed is confident of the global market’s tolerance for higher rates we might see our debenture rate hold near its two most recent levels of 2.82%, compared to our twelve-month average rate of 2.73%. The challenge will be to maintain historical pricing spreads, because that is where investors will demand more for their participation. The absence of clarity will encourage investors to remain neutral as they sift through endless commentary about economic growth, commodity prices, and global concerns.