Market Overview

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The on-again off-again fixation surrounding if and when the Fed will reach 'lift-off' decidedly tilted in favor of a December hike following the release of the October Employment report. After finishing the 3rd quarter on a tepid note, employment roared back with non-farm payrolls registering a monthly gain of 271,000 and the Unemployment Rate dipping to 5.0%, its lowest rate since February of 2008. Wage growth finally showed its hand with average hourly earnings advancing by a respectable 2.5%, YOY. The Fed, for its measure, has repeatedly indicated its preference for moving off the zero lower bound Funds Rate before the end of the year. It delayed moving in September and October in light of unstable market conditions and a surging dollar, but the glide path now appears set for action following the Fed's mid-December meeting, barring untoward developments. A move in December will also serve to clear the decks for subsequent adjustments in 2016 with limited concerns that the FOMC was potentially interfering with the presidential election cycle, which will be coming into sharper focus in upcoming months.

In other economic news, growth is estimated to have slowed rather substantially following the second quarter surge. In the advance estimate of Q3 GDP, the Commerce Department indicated it expects growth to have dropped to 1.5% from the 3.9% pace registered in Q2. It now appears likely that growth for the full year will fall somewhere shy of last year's 2.4% pace. Nevertheless, economic conditions remain relatively healthy on the US domestic front while growth abroad continues to slow. It is worth noting that Consumption remains a bright spot with consumer confidence buoyed by lower gas prices. Over on the inflation front, headline price pressures continue to flat-line on the back of weak energy markets while core price pressures remain uncomfortably below the Fed's preferred 2% target rate.

In the wake of a steep selloff at the end of the third quarter, capital markets entered corrective mode with risk assets recovering ground while Treasuries and other high quality domestic fixed-income assets chopped sideways during October. Equity markets surged with the S&P 500 regaining all of its 10% correction in a steady 4-week advance. On the credit front, spread markets demonstrated a tendency toward tightening on the back of higher equity prices. Most spread sectors generated positive excess returns versus Treasuries with lower quality assets generally producing the strongest relative returns. The municipal market also outperformed Treasuries, as prices were little changed despite a bounce higher in Treasury yields. A second consecutive month of reduced issuance, relative to last year's pace, helped cushion volatility, and demand has remained strong throughout most of the year. Despite the recent slower pace, total issuance year-to-date has already exceeded last year's 12-month total, and volume for the full year should approach $400B, which would be the strongest issuance year since the surge of Build America Bond issuance in 2010.

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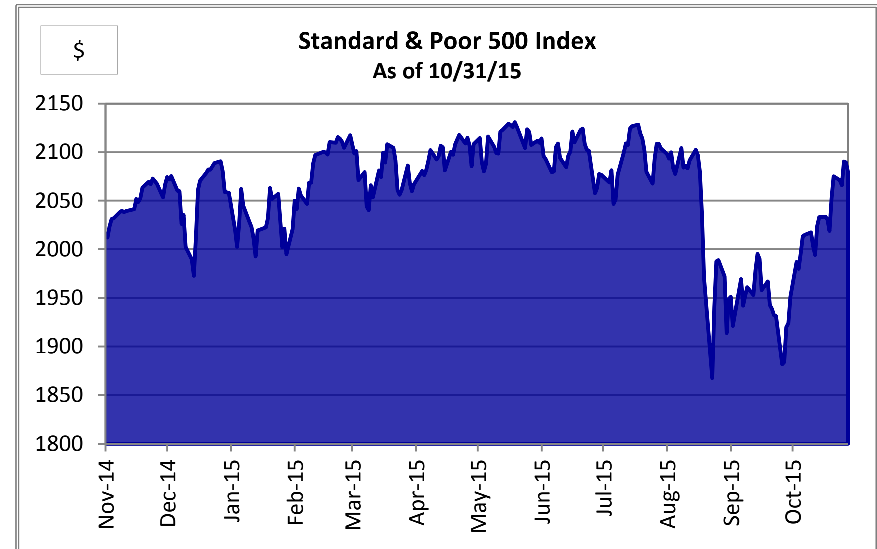

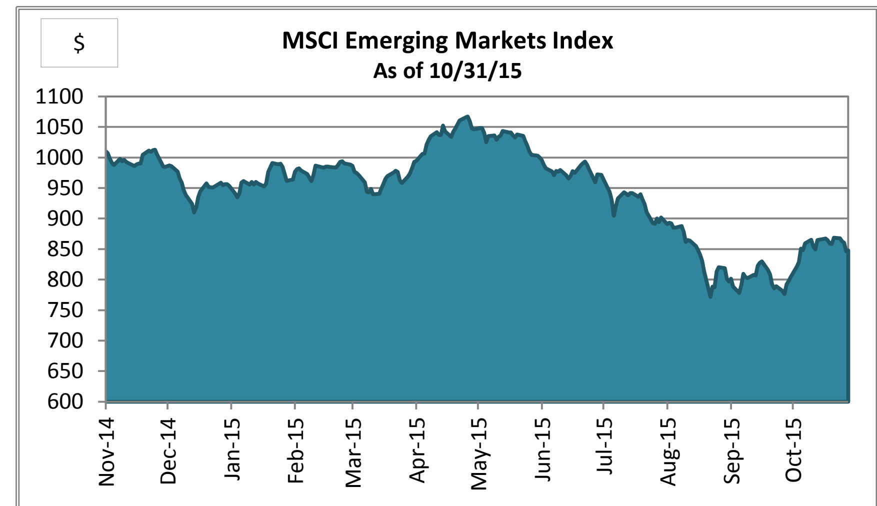

Source: Bloomberg
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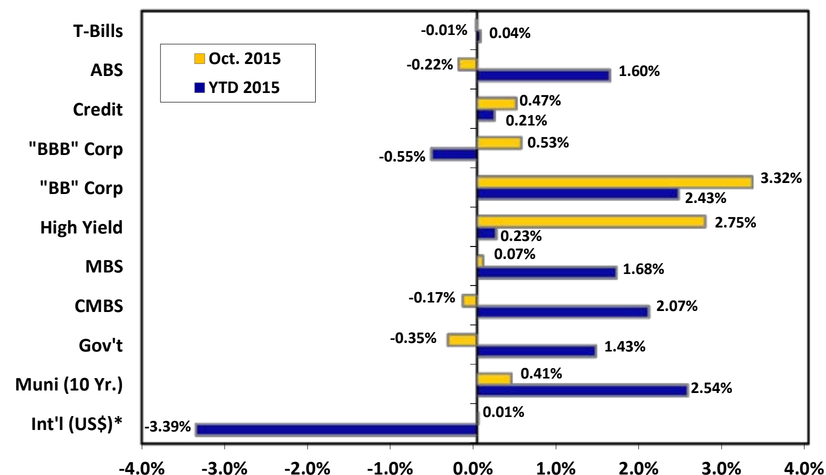
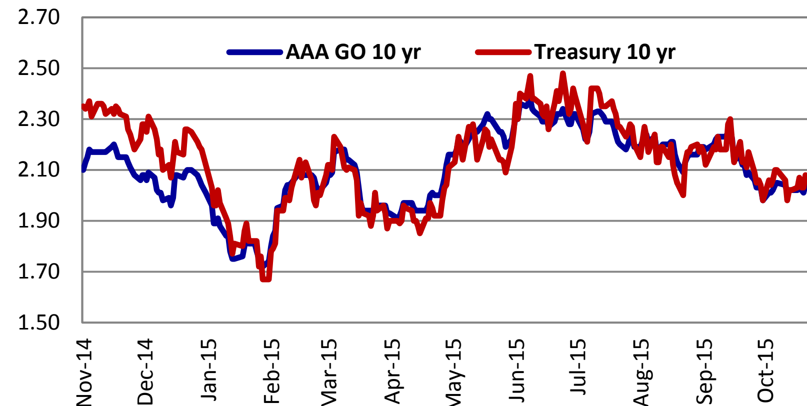
Fixed Income Market Commentary ✧ November 2015

- Risk markets generally recovered following their Q3 plunge.
- Emerging market currencies and equities temporarily stabilized as the prospect of a September Fed tightening was averted.
- Spread sector assets produced positive relative returns across most credit-related categories, with lower quality assets generating the strongest returns.
- Consensus expectations for a December rate hike firmed in the wake of a strong October Employment Release.

We continue to maintain that Fed rate action is likely to be deliberate, data-dependent, gradual and much shallower than recent historical rate cycles have proven. While a December rate hike now appears quite probable, it is critical to assess what is likely to occur next. It is important to assess conditions relative to the Fed's dual-mandate; and while the labor market appears healthy enough to sustain a modest move higher in rates, the Fed's goal of 2% inflation appears more suspect. Recent modest wage gains aside, headline inflation remains flat while core price pressures have shown little inclination to move higher and remain uncomfortably below the Fed's preferred objective. While domestic conditions now appear more favorable from a sustainability standpoint for labor markets, global conditions appear malign relative to Fed intentions and may play a larger factor as developments move forward.

Reaching conditions that will accommodate a rate rise may prove easier than sustaining conditions that will tolerate a rate rise and allow for potential further adjustments going forward. Critical to the expected path will be developments in emerging market economies and, importantly, the valuation of the dollar in light of diverging economic fundamentals and central bank policies. While the expected Fed rate rise has been thoroughly telegraphed, it will nevertheless be critical to assess currency market reaction if and when it becomes a reality. Should dollar strength renew in earnest, it will serve to make the Fed's dual mandate significantly more problematic to achieve than it currently appears.





Sources: Municipal Market Data; Federal Reserve Bank; Bloomberg.
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