



Bond Market Weekly

Week of December 29, 2008

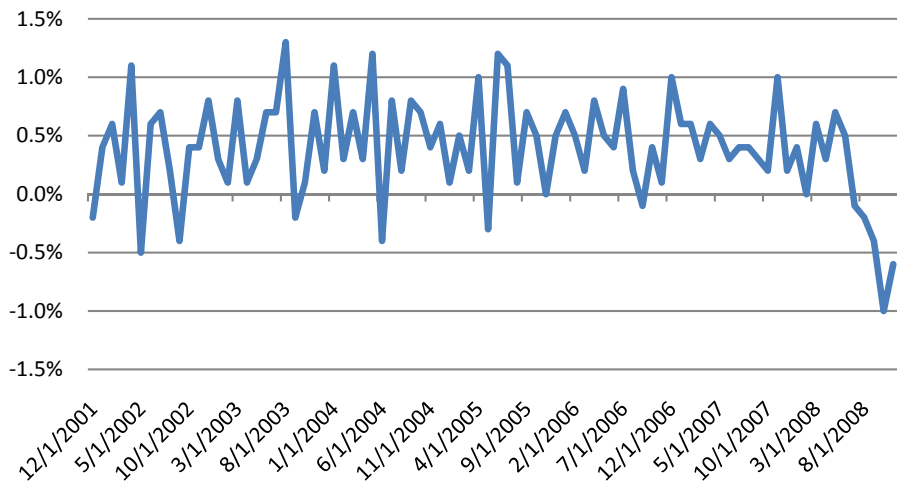
Municipal and Corporate Review

Page 1 of 2

Market Overview

US Personal Consumption Expenditures Index (MoM)

12/31/2001-11/30/2008; Source: Bloomberg



- ❑ The spillover from the FOMC's public acknowledgement of a zero interest rate policy and its explicit statement that they were considering purchases of longer dated Treasuries to lower interest rates, continued in the holiday shortened trading week. US Treasury yields increased slightly with the worst performance in the shorter end of the curve (2-5 years), as the flight to quality continued to unwind.
- ❑ The FOMC spillover and the unwinding of flight to quality trade continued to provide support to most fixed income markets as spreads tightened in Agency, Municipal, and Corporate markets during thin holiday trading. Investors continue to gravitate towards sectors that have high credit quality and offer higher returns than US Treasuries following the strong run-up in US Treasury prices.
- ❑ Economic data released during the week continued to reflect more of the same. Economic output remains muted as the final release of 3Q GDP remained steady at -0.5%, personal consumption was slightly worse at -3.7%, new and existing home sales continued their weakness, and durable goods orders were - 1.0%. On the bright side, durable goods orders ex-transportation were up 1.2%. Inflationary pressures continue to subside as final 3Q Core PCE slightly increased to 2.4%, and November's Core PCE was unchanged month-over-month. Personal income (-0.2%) and spending (-0.6%) both fell in November as consumer buying habits remained very selective. No major economic releases are scheduled for the last week of the year; we expect that most investors will continue to gravitate towards high quality, non-US Treasury markets. Close attention will be paid to the holiday sales figures (by all indications they appear to be weak) and to ongoing developments in the Middle East.

Tax Exempt Markets

- ❑ Municipal bonds rallied for another week with 10-year yields falling 12 bps to 3.93% on the back of continued demand ahead of January and the lack of new issues sold.
- ❑ Volume was light as the market focused on the holiday and many firms, for all intents and purposes, were finished trading for the year.



Bond Market Weekly

Week of December 29, 2008 | Municipal and Corporate Review

Page 2 of 2

Tax Exempt Markets

- ❑ The forward calendar is still respectably large with the Bond Buyer 30-Day Visible Supply Index at \$12.1 billion.
- ❑ It is unlikely that large new deals will be priced this week due to the holiday and only two full trading days left in the year. We expect the new issue market to pick up next week and it will likely pick up full steam in the second half of January.
- ❑ Congress is considering exempting the interest on private activity bonds from the AMT. This would potentially allow much lower borrowing rates on many infrastructure projects such as airports, sewage treatment plants and housing issues. As an increasing number of individuals have become subject to, or potentially subject to the AMT, the spread between AMT and non-AMT bonds has widened to +100 bps, according to sources quoted on Bloomberg.
- ❑ In addition, as part of a fiscal stimulus package, Congress is also looking at allowing banks to purchase a larger portion of the municipal bond market in order to stimulate demand. While we do not know which of the bills being considered in Congress will ultimately pass, it is apparent the Congressional Democrats are looking to not only stimulate the economy in general, but specifically the municipal market.
- ❑ Our trading was muted last week with the holiday shortened week; however, we continued to raise cash for clients' year-end needs. Likewise, we expect this week to be quiet with little trading.

Taxable Markets

- ❑ Taxable markets were relatively quiet as accounts and dealers alike concentrated on year-end cleanup items. In general, spread product continued to be well bid, especially recent corporate new issues.
- ❑ Finalization of the auto bailout legislation did little to support the bonds or equity of the Detroit Three. GM and Chrysler bonds were trading near their lows as the Government plan indicated little value for shareholders and probably a significant haircut for bondholders. One bright spot was the Christmas Eve decision to grant GMAC bank holding company status, which should give them access to Troubled Assets Relief Program (TARP) and the Temporary Liquidity Guarantee Program (TLGP). These actions are designed to provide car buyers with better access to credit.
- ❑ Mortgage and Government Agency bonds continue to do better as short and intermediate term quality instruments continued to be in high demand. Bonds issued by banks and finance companies under the TLGP (guaranteed by the FDIC) traded tighter as the acceptance of these instruments by customers continues to climb. However, this market will be tested as issuance in this sector is expected to be heavy in the upcoming weeks.
- ❑ Corporate bonds continued to tighten over the week as accounts stretch for yield in this market. There was little new issuance due to the holidays, which forced accounts to concentrate on secondary offerings. At these absolute yield levels, issuance should remain brisk after the New Year break.
- ❑ The taxable municipal market remains a two tiered market. Credits with strong underlying ratings remain well bid, while bonds with no underlying ratings or poor quality enjoy less liquidity and trade at correspondingly cheap prices. New issuance early next year should help with the price discovery process in the secondary market and liquidity is expected to improve as customers see the values in secondary market bonds.