



Bond Market Weekly

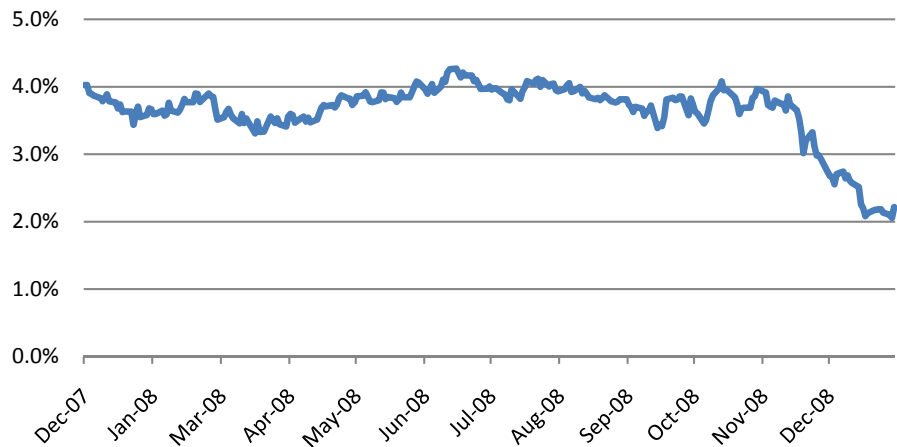
Week of January 5, 2009 | Municipal and Corporate Review

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Market Overview

- ❑ A sluggish and thinly traded holiday week ended with substantial weakness in US Treasuries. The benchmark 10-year Treasury yield rose 24 bps to finish the year at 2.37%. With short maturities holding steady, a reversal of the recent flattening trend took hold. Spreads between 2- and 10-year Treasuries rose 30 bps to +155, while 2- to 30-year spreads rose 25 bps to +197.

10-Year U.S. Treasury
12/31/07-12/31/08; Source: Bloomberg



- ❑ TIPS relative performance were mixed on the week with the current 5-year horizon inflation expectations rising 4 bps to -12 bps and the 5-year forward measure unchanged. Once quantitative easing induced inflation fears take hold, these measures will remain near their lowest levels and quite subdued as we begin 2009.
- ❑ ISM Manufacturing was the only top tier economic data released last week and it was severely depressed. At 32.4, the survey has reached depths only seen in the recessions of the early eighties, mid-seventies and late forties. The data are indeed as dismal as the headlines state and the US has much fiscal and monetary work to do in the year ahead.
- ❑ Additional negative data is likely as the unsatisfactory chain store sales and employment report will be digested during the first week of trading. November sales were down 2.7% and retail anecdotes paint an even gloomier picture for December. Bloomberg survey of economists show a likely 7% unemployment rate during the month when job losses near 500,000. Bad data and poor corporate profits appear to be current hurdles for markets as Obama's fiscal stimulus will not grab headlines until later in the year.

Tax Exempt Markets

- ❑ Municipal bonds rallied into the last week of the year in wake of virtually nonexistent new issues and strong demand by dealers and customers seeking to position themselves for what hopes to be a typical January rally. For the week, the 10-year municipal bonds fell 9 bps to 3.91%.
- ❑ What started out as another bad month for municipal bonds turned out to be quite strong with the Barclays Municipal Bond Index up 1.46% during December. As represented by the accompanying chart, the long bonds rally was minimal as most of the performance was observed in bonds maturing in less than 15 years.



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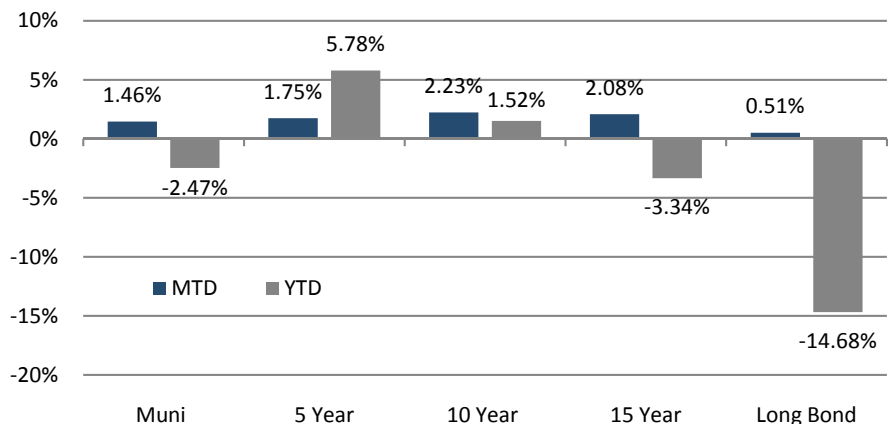
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Tax Exempt Markets

- ❑ Municipal bonds had a tough year with the failure of the auction rate market, downgrades of virtually all of the bond insurers and general credit fears. Returns varied (see accompanying chart) with the short end of the curve far surpassing longer term bonds which felt the pain of forced redemptions and the unwinding of TOB funds.
- ❑ Looking forward, January's fresh start in the new issue calendar will bring close to \$15 billion in 30-day supply. These new issues coupled with January historically being the fourth highest month for maturities and redemptions should provide plenty of fuel for a market rally. While we would hope that many of the woes felt in the municipal market last year are behind us, we would be wary of getting caught up in a January rally. For example, last January saw a 1.26% gain in the Barclays Municipal Bond Index only to be followed by a 4.58% loss in February.
- ❑ We were generally quiet last week with a few year-end cash needs being met and buying to invest the remaining cash in client portfolios. We expect to become much more active in the New Year with new issues coming to market.

Barclays Municipal Bond Index

1/1/2008-12/31/2008; Source: Barclays/Lehman Live



Taxable Markets

- ❑ 2008 closed the year with the Barclays Intermediate Government/Credit Index posting a 5.08% total return on the strength of the Treasury and agencies markets. Within the Index, Agencies had a 9.26% total return for the year while corporates posted a -4.94% total return. The MBS market ended with a 8.34% total return for the year.
- ❑ Last week was another quiet, holiday-shortened week as participants had largely finished end of year trades earlier in the month. Corporate spreads in the Barclays U.S. Corporate Investment Grade Index tightened 14 bps to +555 OAS (option-adjusted spread) on light volume. Volume should pick up significantly this week, especially under the TLGP (FDIC-backed debt) as more bank holding companies come into the fold such as CIT and GMAC.
- ❑ Mortgage markets outperformed Treasuries last week. The Barclays U.S. MBS Index tightened 15 bps to +147 OAS. The Fed is said to be preparing to commence purchasing \$500 billion in MBS through the first half of 2009. Mortgage refinancing should gain momentum as FHLMC 30-year mortgages ended the year at a low 5.10%.
- ❑ Agencies also outperformed Treasuries on the week as the Barclays U.S. Aggregate Agencies Index ended the week at +93 OAS from +102 OAS the prior week. So far \$15 billion of the planned \$100 billion has been completed by the Fed.