



Bond Market Weekly

Week of January 12, 2009 | Municipal and Corporate Review

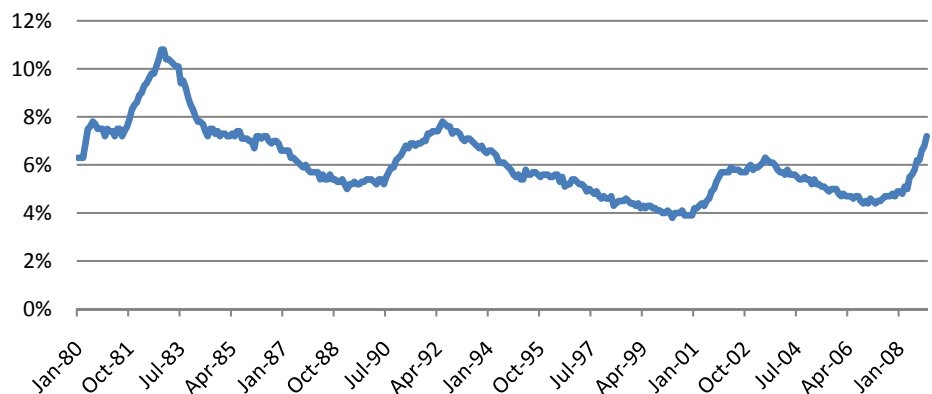
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Market Overview

- ❑ A volatile week of trading began with a bearish chatter following Barron's article depicting a Treasury bubble. Ultimately the week closed with little change for the benchmark 10-year note with yields rising just 2 bps to 2.39%. Supply concerns rattled the yield curve throughout the week with late week buying of short maturities driving spreads between 2- and 10-year 9 bps higher to +164 and 2- to 30-year spreads 34 bps higher to +231.

US Unemployment Rate Total in Labor Force

1/1/1980-1/12/2009; Source: Bloomberg



- ❑ TIPS showed signs of life as the yield on the 5-year maturity fell 14 bps and pushed the current 5-year horizon of breakeven inflation back to zero from -12 bps. The longer 5-year forward breakeven measure made a considerable move of 75 bps to 1.27%. The TIPS market could come into further focus in 2009 as the Treasury may decide to fund more fiscal stimulus packages where investors can find safety from credit risk while hedging against inflation fears that may be brought on by the actions of the Treasury and the Fed.
- ❑ Economic data has a hard time surprising many these days as an unusual consensus view is merely confirmed in recent releases. The data is simply terrible, as is the wide-held expectation of them. Employment garnered the anticipation similar to an approaching car wreck with the consensus of 524k job losses and 7.2% unemployment rate, the report was not as bad as feared. Time and execution of monetary and fiscal rescue plans will likely trump economic data as market drivers for some period to come.

Tax Exempt Markets

- ❑ Municipal bonds rallied sharply in the first full week of trading in the New Year with 10-year bond yields falling 25 bps to 3.66%. Demand has been strong across all sectors as January 1st maturities/calls including cash received from ARS settlements have fueled a wave of buying.
- ❑ Short-term yields have also fallen with cash sitting in many accounts, the current AAA 7-Day Reset Index stands at only 0.52%.
- ❑ New deals are beginning to fill the calendar with the Bond Buyer 30-Day Visible Supply Index at just under \$17 billion. This week will see moderate issuance with roughly \$4 billion in new deals expected to be priced. Among these new deals are \$121 million for the Jacksonville Electric Authority and \$300 million for the New York Transitional Finance Authority.



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Tax Exempt Markets

- ❑ In news significant to the municipal market, Citigroup has potentially decided to form a joint venture with their Smith Barney brokerage unit and Morgan Stanley's brokerage operations. This could further reduce the number of active dealers in the municipal market and could further weaken liquidity in the markets going forward.
- ❑ It looks increasingly likely that the Federal government will provide some sort of assistance to the municipal market. The form of assistance is still to be decided. Among the possibilities include the outright purchase of municipal bonds, forming some sort of federal guarantee for new deals, funding the states with capital to start their own bond insurers and raising the issue size eligible for banks to purchase municipals. All of these could have a profound long-term effect on the municipal market and we will be watching these events closely.
- ❑ A federal investigation has commenced in the municipal market on a number of fronts related to potential bid rigging, tax evasion and other corruption occurring in the municipal bond business. These investigations center on whether banks and other companies submitted false bids to get bond issuance, fraud related to derivatives deals, and whether municipal bonds are properly certified for tax-exempt treatment. The results of these investigations could ripple through the market and force major changes in the way business is transacted. It reminds us of the days of the "yield burning" cases in the 1990's where hundreds of millions of dollars in settlements were agreed to by many brokerage houses. Whether these investigations will force more transparency on the opaque municipal market remains to be seen.
- ❑ We purchased bonds mostly inside 10-years while shied away from pre-refunded bonds as they have tightened dramatically and traded on top of Treasuries, roughly 100 bps tighter than AA and AAA municipals.

Taxable Markets

- ❑ The tone of the credit markets has definitely shown improvement since the end of 2008. In the investment grade corporate sector, spreads on A and BBB rated bonds have tightened by 35 bps and 45 bps, respectively, since 12/31/08. However, higher rated credits have not benefited as much from the rally. AAA rated corporates have actually widened by 8 bps since the start of the year, ending last Friday at +337 bps over benchmark Treasuries.
- ❑ In a positive sign, sales of new corporate debt hit an 8 month high last week as \$41 billion of issuance came to market. Anheuser-Busch InBev NV sold \$5 billion in the week's largest non-financial new issue. GE Capital Corp. became the first financial credit since November to issue 30-year debt without the backing of the US federal government after its \$4 billion sale of 30-year bonds last week. However, their deal did come on the heels of a separate GECC \$10 billion issue that was backed by the government liquidity program.
- ❑ The new issue pipeline continues to look robust. Nike Inc. is planning to issue approximately \$760 million in new debt this week which would be the company's first sale in about five years. Thompson Reuters has indicated that it will be looking to sell up to \$3 billion in unsecured debt, while Boeing and Colgate-Palmolive have filed registrations to issue to \$5 billion and \$1.5 billion, respectively, in new bonds. Charles Schwab and Microsoft also filed shelf registrations pointing to upcoming new issues in the pipeline.