



# Bond Market Weekly

Week of January 20, 2009 | Municipal and Corporate Review

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## Market Overview

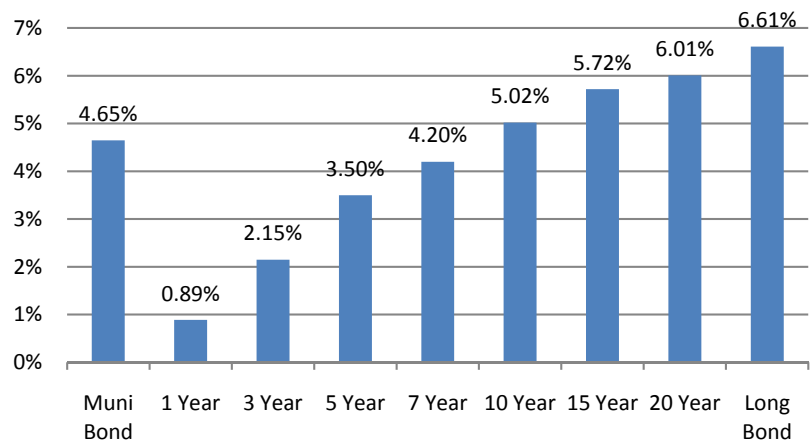
- More banking troubles, a weak retail sales report and evaporating inflation brought buyers back to the safety of US Treasuries last week and pushed the benchmark 10-year yield 7 bps lower to 2.32%. The yield curve resumed its recent flattening bias with 2- to 10-year spreads narrowing 4 bps to +160, while the 2- to 30-year spread tightened by 16 bps to +215.
- Breakeven inflation in the TIPS market was somewhat mixed but generally lower across the board. The current 5-year horizon rate did tick up 7 bps from zero, while the 5-year forward moved 5 bps lower to 1.22%. The producer price report showed year-over-year prices moving into deflationary territory at -0.9% last week. Consumer prices are not far behind as the year-over-year measure fell to +0.1%. Core CPI settled in at a 1.8% increase year-over-year in December. These measures along with the employment data are likely to become front and center of attention as 2009 moves along and the assessment of monetary and fiscal stimulus takes hold.
- Housing and jobless claim data highlighted a quiet economic week. Both are forecast to continue in their current trend (initial claims estimate 545k vs. 524 last week). January employment surveys are likely to have a major influence on the nonfarm payroll estimates in coming weeks. In addition, Treasury is set to announce details of auctions set for the final week of January. 20-year TIPS, 2-year notes and 5-year notes are expected.

## Tax Exempt Markets

- The massive rally in the municipal market continued last week despite strong issuance and an early close on Friday. 10-year bond yields fell 27 bps to 3.38%. According to Municipal Market Advisors, benchmark yields inside of 10-years closed at their lowest levels in over twenty years.
- Investor demand continued with mutual fund inflows at \$737 million last week, according to AMG Data Services, the largest weekly inflow since last May.
- Issuer supply continues to be strong this week. Over \$3.7 billion in new supply is expected. The state of Connecticut will be issuing \$420 million in debt along with \$320 million from the District of Columbia.

### Municipal Bond Index MTD Total Returns

1/1/2009-1/20/2009; Source: Barclays Capital





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### Tax Exempt Markets

- ❑ Healthcare and other weaker issuers are still having financing issues. Royal Oak Hospital in Michigan, rated A1/A, sold \$393 million in bonds last week with yields ranging from 6.4% to 8.65% on the long end. This compares to AAA state of Delaware GOs which sold at 4.50% last week for their longest maturities.
- ❑ With the new President coming into office today and Congress's desire to get a fiscal stimulus bill passed as soon as possible, it looks as though municipalities will receive some help from the Federal government. However, how much, and in what form, remains to be seen.
- ❑ California's fiscal woes and government gridlock continued last week as they stopped tax refund payments for the month to conserve cash. Per state law, funds must be applied to education and debt payments before any other expenditures can be made. This legal provision keeps the likelihood of an actual default extraordinarily remote.
- ❑ We purchased bonds mostly inside of 10-years last week and are buying high coupon callable bonds to hedge against the possibility that rates may cheapen in the coming months.

### Taxable Markets

- ❑ It was a mixed week for the taxable markets as corporate spreads improved while agency and MBS markets experienced spread widening.
- ❑ The corporate market improved 6 bps to an option-adjusted spread (OAS) of +515. The Industrials and Utilities sectors within the Barclays Capital U.S. Corporate Investment Grade Index performed well with a spread tightening of 6 bps and 7 bps to +454 OAS and +489 OAS, respectively. However, Financials were 6 bps weaker to +602 OAS as Bank of America and Citigroup released disappointing Q4 2008 numbers.
- ❑ New issuance of investment-grade corporate was \$26.8 billion for the week as investor appetite continued to be strong. Higher rated credits did especially well. For example, Campbell Soup Co. (A2/A/A) came with a \$300 million deal and was massively oversubscribed with orders for \$6 billion. It was priced at a spread of 237.5 bps and has since tightened to a bid of 220 bps.
- ❑ Both MBS and agencies were weaker. The Barclays Capital U.S. MBS Index widened 30 bps to +103 OAS despite heavy buying of MBS by the Fed. There has been significant selling by banks and money managers taking advantage of gains since November (OAS was 172 on Nov. 21). The Barclays Capital U.S. Aggregate Agencies Index was 5 bps wider on the week to +94 OAS.