



## Bond Market Weekly

Week of January 26, 2009 | Municipal and Corporate Review

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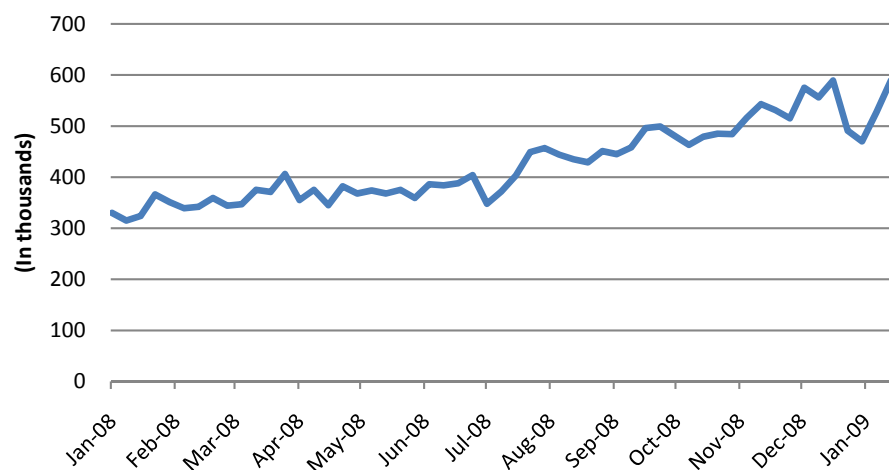
### Market Overview

□ An overall quiet economic calendar last week and decidedly negative performance in financial stocks did not help the recent tone in the Treasury market. The benchmark 10-year yield rose 30 bps on the week to 2.62% as the market positions itself for new supply over the next few weeks. Weakness was most evident on the long-end as the yield curve steepened by 21 bps to +181 from 2- to 10-year, while 2- to 30-year spreads rose 36 bps to +251.

- TIPS performed slightly better than nominal Treasuries which raised the current 5-year horizon breakeven rate to +19 bps, or 12 bps higher than the previous week. The change in the 5-year forward horizon rise was more pronounced at +30 bps to finish the week at +1.52%, roughly a full percentage point higher than at the end of 2008.
- Housing permits continued their plunge, coming in at 549,000 in January vs. 600,000 in December. Housing starts were also lower at 549,000 in January vs. 605,000 in December. Initial jobless claims of 589,000 seemed to clear the seasonal distortion period and moved back in-line with a worsening employment trend.
- The week ahead picks up notably with the January FOMC meeting concluding Wednesday and the much anticipated Q4 GDP report (consensus -5.5%) on Friday. In addition, various Fed surveys along with durable goods orders and corporate earnings reports point to a volatile week ahead.

### US Initial Jobless Claims

1/1/2008-1/26/2009; Source: Bloomberg



### Tax Exempt Markets

- The year-to-date rally in the municipal bond market reversed itself last week with bonds selling off rather sharply across the curve. 5-year yields rose by 11 bps, 10-year yields 13 bps and the long bond was higher by 22 bps.
- It seems retail demand slowed appreciably last week with profit taking reported from bank TOB funds. Whether follow-up selling will continue this week remains to be seen. Mutual fund inflows were again positive last week with \$461 million inflows according to Municipal Market Advisors. It seems that retail's apparent unwillingness to buy was felt mostly in separate accounts as opposed to the mutual fund channel.



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### Tax Exempt Markets

- ❑ This week should bring a relatively moderate calendar, with only \$2.3 billion of expected new issue volume according to I-Deal. Notable issues include \$300 million for the DC Water and Sewer system, as well as \$259 million for the Yankee Stadium project, the latter of which will have a Baa3/BBB- underlying rating and be wrapped by Assured Guaranty.
- ❑ Assured Guaranty and CIFG closed their reinsurance deal whereby Assured Guaranty will reinsure substantially all of CIFG's outstanding municipal book. The novation would provide a boost for bondholders due to Assured's rating of Aa2/AAA.
- ❑ Many new deals last week were repriced cheaper as demand began to wane in the latter part of the week. We saw a few new issues depreciate by 20 bps from their initial levels as buyers balked at the historical low yields available inside of ten years.
- ❑ We participated heavily in both the primary and secondary markets, focusing mostly on bonds with maturities of 15-years and less. Despite a strong rally this year, the fundamentals remain sound for municipals going forward, especially in relation to U.S. Treasuries. We expect to see continued volatility throughout 2009 but are confident in the long term value that municipal bonds currently exhibit.

### Taxable Markets

- ❑ With the exception of the financial sector, corporate bonds showed steady improvement last week. Overall, corporate spreads tightened by 5 bps versus Treasuries to +510 OAS (option-adjusted spread) in the Barclay Capital U.S. Investment Grade Index. The industrial sector saw significant improvement with a 17 bps tightening move to +437 OAS, while the utilities sector improved 9 bps to +480 OAS. Financials widened 11 bps, however, to close at a +613 OAS, as 4<sup>th</sup> quarter earnings from several banks still managed to disappoint despite the market's already low expectations.
- ❑ Risk tolerance seems to be creeping back to the market as sales of high-yield bonds jumped to its biggest weekly total since July of 2008. Companies took advantage of investor interest by issuing a total of \$1.8 billion in below investment-grade debt.
- ❑ On the other end of the credit spectrum, Citigroup came with the largest offering yet of notes guaranteed by the FDIC under the TLGP program. They sold \$12 billion of the Aaa/AAA notes among 4 different series.
- ❑ The MBS and Agencies markets showed modest improvement for the week. The Barclay Capital U.S. MBS Index tightened 4 bps, to +99 OAS, and the Barclay Capital U.S. Aggregate Agencies Index tightened 9 bps to +85 OAS. The Fed has purchased \$52.6 billion of agency MBS so far which appears to be on target for their \$500 billion goal by mid-year.