



Bond Market Weekly

Week of February 9, 2009 | Municipal and Corporate Review

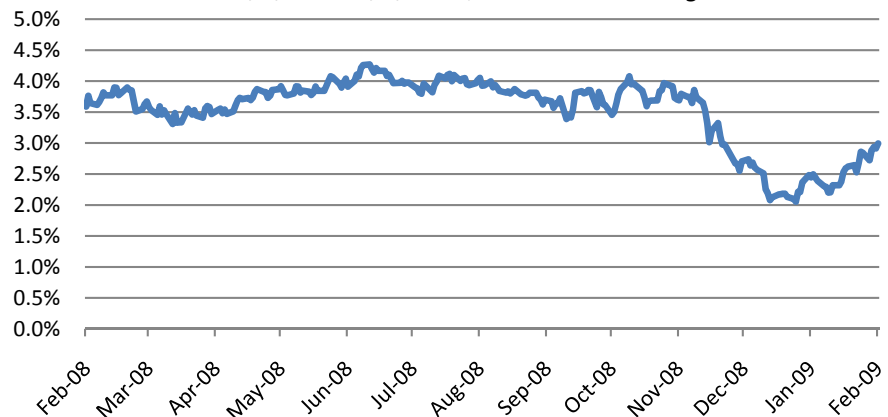
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Market Overview

- Supply driven momentum to higher yields continued in the Treasury market last week as the benchmark 10-year note rose 15 bps to yield 2.99%. The one silver lining for the week was less volatility than in the prior weeks. The yield curve did continue a steepening trend with 2- to 10-year spreads rising 10 bps to +199, while 2- to 30-years spreads rose 5 bps to +270.

10-Year US Treasury Yield

2/6/2008-2/6/2009; Source: Bloomberg



- Inflation expectations priced in the TIPS market continued volatile shifts with the current 5-year horizon rate rising 30 bps to 0.78%. Another silver lining was seen here as the 5-year, 5-year forward measure fell 6 bps to 1.93%. Less deflation in the immediate years along with less inflation over the horizon is exactly what Fed officials are hoping for as monetary and fiscal stimulus are enacted. Indeed, the movements in the TIPS market last week were consistent with both.
- Treasury supply is on the forefront of interest rate trader's mind these days and thus far it looks to be a \$1.8 billion concern. The fiscal 2009 supply of \$1.8 trillion is \$800 million more than observed in 2008. The immediate concern for the market is this week's supply which consists of \$32 billion in 3-year notes on Tuesday, \$21 billion in 10-year notes on Wednesday and \$14 billion in 30-year notes on Thursday. How these auctions perform will go a long way to determining if the bleed in the Treasury market continues. Currently, the market is divorced from horrendous economic data and focused on short-term supply.
- The employment report on Friday was indeed terrifying as the unemployment rate shot up to 7.6% and nonfarm payrolls shed 598,000 jobs in January. At 7.6%, the unemployment rate is just below the peak of 7.8% hit after the 90-91 recession. Poor trends in the details of the report such as temporary hiring (-76,000) signaled the trend here is likely to continue for some time.

Tax Exempt Markets

- February began where January left off – very strong. Municipal bonds continued to rally as 10-year bond yields fell 7 bps and 30-year bond yields fell 24 bps, according to Municipal Market Data.
- Market participants easily absorbed the \$4.8 billion in new issue supply during the week as offerings rose to a 3-week high. Georgia and Los Angeles Unified School District were the most notable names in the market during the week.



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Tax Exempt Markets

- ❑ Net cash inflows into municipal bond mutual funds were \$758mm during the week ending February 4th, according to AMG Data Services. Ongoing fund inflows were one of the primary market drivers early in the year.
- ❑ The calendar continues to be robust as municipalities seek to capitalize on increased demand. The Bond Buyer 30-Day Visible Supply grew \$800 million week-over-week to end at \$11.6 billion. Texas A&M University and North Carolina are two of the more notable names on the docket this week.
- ❑ We continue to primarily focus on new issues as we participated in the Alaska Eastern Power, Pleasant Prairie TX, Greater Arizona Development Authority and Blue Springs IA deals last week.
- ❑ The most recent update from Washington D.C reported \$40 billion in state aid being cut in the current Senate bill. Municipal investors will keep a close eye on negotiations as they weigh the impact the stimulus package will have on state budget gaps. Additionally, Rep. Barney Frank discussed the creation of a government backed municipal bond insurer. As with many new ideas out of Washington, the proposal lacked specific detail and generated more questions than answers.

Taxable Markets

- ❑ Corporates were relatively stable for the week with modest spread improvements in the Industrial and Utilities sectors offset by weakness in the Finance sector. The Barclays Capital U.S. Corporate Investment Grade Index OAS (option-adjusted spread) was 3 bps wider to +484. Industrials tightened 3 bps to +399 OAS, Utilities improved by 8 bps to +422 OAS, and Financials widened by 18 bps to +621 OAS. Investors continue to display demand for non-financials.
- ❑ Corporate new issuance continued to be well received, especially for quality names. According to Bloomberg, investment-grade bonds sales were \$21.9 billion down from \$44.4 billion the previous week. Novartis (Aa2/AA-) was among the strong credits that priced new deals with \$5 billion between 5-and 10-year maturities. Pricing was +225 for each issue and spreads tightened immediately afterward to +203.
- ❑ The MBS market showed signs of strain as cramdown legislation led to uncertainty. Also, an amendment to the stimulus package to lower mortgage rates to 4.0% – 4.5% was defeated. FHLMC 30-year fixed rate mortgages averaged 5.25% last week, up 15 bps from the prior week. The Barclays Capital U.S. MBS Index widened 18 bps to +125 OAS. On a related note, the Commercial MBS market was hit negatively with news of Moody's putting the entire market on review for possible downgrade. AAA rated CMBS traded near their all time wides of +667 bps (worst close was +848 bps on 11/29/2008).
- ❑ Agencies had a strong week as news hit Friday that the Obama administration may move FNMA and FHLMC onto the federal budget, solidifying explicit U.S. support of these issuers. The Barclays Capital U.S. Aggregate Agencies Index tightened 12 bps to +78 OAS.