WASMER, SCHROEDER & COMPANY, INC.
Investment Advisors
600 5th Avenue South, Suite 210
Naples, Florida 34102
wasmerschroeder.com
T 239.263.6877
F 239.263.8146

Bond Market Weekly

Week of February 17, 2009 | Municipal and Corporate Review

Market Overview

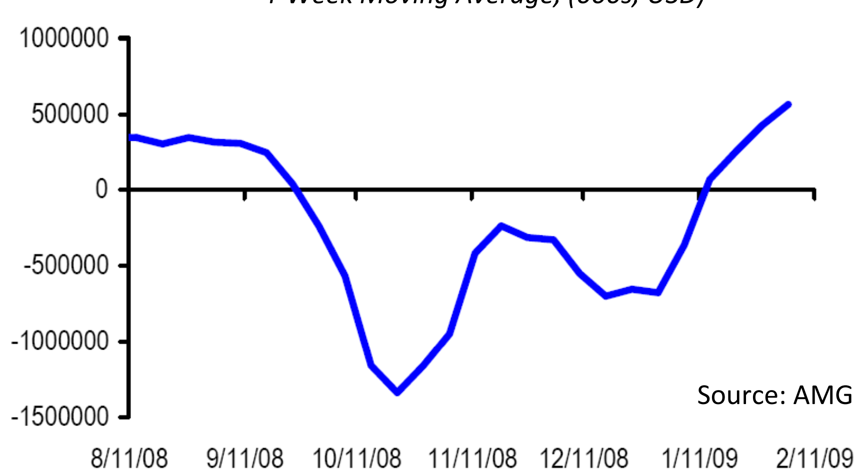
- The progress in passing the $787 billion stimulus package in Washington had little benefit for risk markets last week and was met with decent buying in the safe-haven of US Treasuries. The benchmark 10-year yield fell 10 bps to 2.89% during the week as disappointment over Treasury Secretary Giethner's lack of details on TARP reform and well digested supply supported prices. In addition, the stimulus package is doing little to calm fears of demand depression as the independent Congressional Budget Office suggests only a marginal impact will be felt from this legislation until 2010.
- The yield curve flattened from 2- to 10-years, but lackluster demand at the 30-year auctions earlier in the week led the long bond to lag the rest of the market. Spreads from 2- to 10-years narrowed 7 bps to +192, while 2- to 30-year spreads rose 1 bp to +271.
- Inflation expectations measured in the TIPS market continued to move in the direction the Fed hoped. The breakeven inflation rate increased 3 bps over the immediate 5-year horizon to +0.81%. The 5-year, 5-year forward horizon measure fell 5 bps to 1.78%. Recall, the latter had a dramatic move off its low 0.41% reading at year-end only to climb to 2.02% by late January. The recent movements are indeed more calming.
- Economic data was on the back burner last week yet still noteworthy. The biggest surprise came via a 1% increase in January retail sales versus the expected loss of 0.8%. It appears some shoppers held out for after holiday sales; however, many economists dismiss the data as distorted due to seasonal trends. More components of the final Q4 GDP number came to light via a -1.4% drop in December wholesale inventories. Morgan Stanley estimates dramatic contractions as the Q4 number will be revised to -5.4% (advanced -3.8%) while Q1 is expected to be -5.2%.

Tax Exempt Markets

- Municipal bonds continued their rally last week on the back of continued strong retail demand and mutual fund inflows. The curve steepened with 5, 10 and 30-year bond yields falling 6, 3, and 1 bp, respectively.
- Mutual funds continued to post impressive inflows with $711 million in new money for the week ending February 11th, according to AMG Data. Interestingly, California focused

Municipal Bond Fund Asset Flows

4-Week Moving Average, (000s, USD)



Source: AMG

WASMER, SCHROEDER & COMPANY, INC.
Investment Advisors
600 5th Avenue South, Suite 210
Naples, Florida 34102
wasmerschroeder.com
T 239.263.6877
F 239.263.8146

Tax Exempt Markets

funds continue to see net withdrawals, largely due to worries about the state's fiscal issues. Also, New York focused funds have seen no growth at all, possibly also due to investors' desires for more geographic diversification regardless of pure tax exemption.

- The municipal bond market continued to outperform Treasuries this year with municipal yields falling and Treasury yields rising. According to Municipal Market Advisors since December 30th the muni-to-Treasury ratio has fallen from 191% to 113%.
- New issue supply continues to be stable with the Bond Buyer 30-Day Visible Supply Index at $11.1 billion. New deals this week include $600 million for the GA State Road and Tollway Authority, $525 in Massachusetts GO's and $275 million for the Jacksonville Electric Authority.
- The government's new stimulus package will likely have a significantly positive effect on state and, potentially, local budgets. The largest states will receive substantial grants towards new projects with up to $80 billion in direct stimulus over the next two years. This could potentially reduce new issuance as municipalities will not need to issue bonds for new projects as they would have without direct access to the grant money.
- We bought across the curve last week with focus on a number of new deals including Paulding, GA Water and Sewer and Texas A&M University.

Taxable Markets

- There was a positive tone to most asset classes within the taxable universe and spreads tightened across the corporate and MBS markets.
- Corporate spreads continued to tighten both in secondary trading and new issuance. The option-adjusted spread of corporates tightened 13 bps to +471 OAS in the Barclays Capital U.S. Corporate Investment Grade Index. Each sector within the Index performed well as the Financials sector led the way with a 22 bps spread improvement to +599 OAS.
- Investment-grade new issuance was down a bit for the week with $11.8 billion compared to $27.4 billion for the week ended 2/6/09. However, a total of $38.4 billion has been issued for the month, about $6 billion ahead of the pace set last year. One of the deals we were selectively involved with was from Marathon Oil that priced $1.5 billion between 5- and 10-year issues at +487.5 bps to the respective Treasuries. The bonds have since rallied to +445 (as of Friday).
- The Fed's MBS purchase program continued to drive the mortgage market with $23.2 billion of buying reported last week. The decline of refinancing volume and lower costs of hedging the origination pipeline also contributed to better levels in MBS. Spreads tightened 9 bps to +116 OAS for the week in the Barclays Capital U.S. MBS Index. The agency market was fairly quiet with spreads in the Barclays Capital U.S. Aggregate Agencies Index closing at +82 OAS, 4 bps wider than the previous week.