



Bond Market Weekly

Week of March 2, 2009 | Municipal and Corporate Review

Page 1 of 2

Market Overview

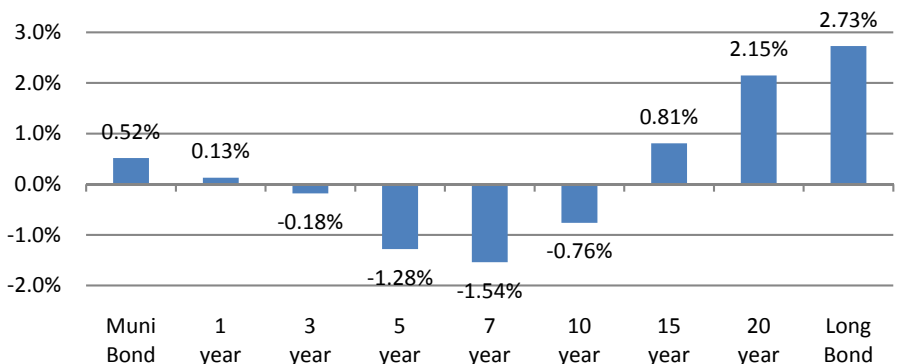
- ❑ The combination of poor economic data and deterioration in the credit markets proved no match for the heavy dose of supply in government bonds last week as the benchmark 10-year Treasury yield jumped 23 bps to 3.02%. The most pronounced weakness was felt in the belly of the Treasury yield curve as flight to quality buying emerged in short maturities. The curve steepened 19 bps to +204 from 2 to 10-years while 2 to 30-year spreads increased 12 bps to +273.
- ❑ Breakeven inflation in the TIPS market moved again in a Fed friendly direction with the current 5-year horizon rising just 2 bps to +0.70% and the 5-year, 5-year forward measure falling a whopping 34 bps to +1.38%. While the Fed may like the direction of the forward expectations, the absolute level does remain significantly below the stated goal of 2% inflation.
- ❑ Gloomy economic data (Durable Goods Orders -5.2% Jan, GDP -6.2% Q4), along with Treasury's Citi deal and the announcement of a "Capital Assistance Program", contributed to the downbeat backdrop for trading last week. The schedule this week includes the typical slew of month releases such as the ISM and employment data. ISM Manufacturing expectations remain severely depressed at 33.8 (50 breakeven) and estimates for nonfarm payroll losses are -650,000 jobs in January.
- ❑ On the Treasury supply front, announcements are expected this week regarding the size of next week's 3, 10 and 30-year auctions. Thus far higher yields in advance of supply have helped the market digest new issuance resulting in decent auction performances. Each recurring auction will be closely watched for this ongoing success is extremely important to future supply. This is also the subject of great political focus as President Obama ramps up an aggressive spending budget.

Tax Exempt Markets

- ❑ Municipals weakened again last week, although mostly inside of ten years, with 5, 10, and 30 year maturities rising 8, 11, and 7 bps, respectively.
- ❑ Weekly issuance has stayed relatively steady with \$3.98 billion issued last week, according to the Bond Buyer, and an estimated \$4.4 billion to be issued this week. The forward calendar has begun to creep up with the Bond Buyer 30-day visible supply index at \$13.7 billion.

Performance of Barclays Capital Indices

February 2009; Source: Barclays Capital



- ❑ There are a number of noteworthy deals this week including, \$450 million for the Trustees of the California State University System, \$435 million for the University of Pittsburgh, and \$430 million in GOs for the state of Utah.
- ❑ February ended with shorter maturities underperforming longer ones, much like January. However, 3 to 10-year bonds had price declines for the month as evidenced by the chart above.
- ❑ With worries about March's typically weak performance, investors are closely watching both new issuance and fund flows. Municipal bond mutual funds had another strong week of inflows adding \$470 million, according to AMG Data Services.



Bond Market Weekly

Week of March 2, 2009 | Municipal and Corporate Review

Page 2 of 2

Tax Exempt Markets

- ❑ One question on the minds of many investors is whether March and April of this year will see the large amount of selling that typically accompanies April 15th tax payments. With so many investors incurring losses during 2008, the degree of selling could be more muted than levels seen in previous years.
- ❑ We made the majority of our purchases in the second half of the week as bonds became progressively cheaper and relative values improved. We purchased a new A+ rated deal in Missouri, as well as large blocks in North Carolina, Florida, and Illinois.

Taxable Markets

- ❑ Financials dominated the news last week as various measures were introduced to support the banking system. On Wednesday, the government released details of the previously announced Capital Assistance Program (CAP) which utilizes a stress test of banking institutions to determine whether certain financials would be required to raise capital. The program requires a mandatory assessment of bank holding companies with assets above \$100 billion and a voluntary assessment for companies under that level. If it is determined that the bank requires more capital under two stress test scenarios, the government specified how the capital raise would be structured.
- ❑ Citigroup announced that it will exchange equity for existing preferred stock owned by the U.S. government which could result in the government owning 36% of the company's stock. These actions caused corporate spreads to widen by 12 bps to +505 OAS in the Barclays U.S. Corporate Investment Grade Index. Financials contributed with a 41 bps widening while Industrials and Utilities had respectable showings with spreads tightening 2 bps and 8 bps, respectively. The corporate total return for February was -1.97%. Stronger industrial credits continue to be well bid.
- ❑ Agencies continued their rally last week as the Office of Management and Budget indicated that it is considering fully incorporating Fannie Mae and Freddie Mac into the federal budget. This action would completely remove any doubts about explicit support of the agencies by the U.S. government. The Barclays U.S. Aggregate Agencies Index tightened 8 bps to +70 OAS. For February, the index had a 0.38% total return.
- ❑ MBS also reacted positively to the OMB statement regarding the agencies. The Barclays U.S. MBS Index finished at +108 OAS from +119 OAS the prior week. The total return for this sector for February was 0.58%.