



Bond Market Weekly

Week of March 9, 2009 | Municipal and Corporate Review

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Market Overview

- A brief respite from new supply along with Bank of England's (BOE) plans to purchase GILTS, led US Treasury yields lower last week with the benchmark 10-year finishing 15 bps lower at 2.87%. Speculation that the BOE purchases will pave the way for similar transactions in the US had a pronounced effect on long yields, flattening the curve by 12 bps from 2- to 10-years (+192) and 14 bps from 2- to 30-years (+260).
- TIPS lagged the move in nominal Treasuries as breakeven inflation dropped 19 bps to 0.51% over the current 5-year horizon. Meanwhile the 5-year, 5-year forward horizon fell 10 bps to 1.28%. Despite audible fears of "explosive inflation" arising from current policies, the TIPS market continues to price in sanguine expectations under 1.50% even over the longest of horizons.
- The Bank of England's announcement Thursday of a 75 billion pound buyback (\$106 billion USD) on Thursday started a 58 bp rally in the 10-year Gilt and sent global yields lower. The plan is initially to be executed over 3-months but a longer period of monetization of debt is possible.
- With fiscal and monetary news dominating the landscape, economic data has been largely ignored. The exception has been employment data which came largely as expected with February job losses at 651,000 and jump in unemployment to 8.1%. However, other details during the week revealed a silver lining on the consumer front with personal income and spending (+.4% and +.6% respectively in Jan) and chain store sales (-.1% Feb) showing some life in consumers, however fleeting it may be. Economists such as Ian Shepherdson of High Frequency Economics surmise that incomes are holding up so far since those who are still employed did have success in extracting wage gains last year in response to food and energy costs. Again, this is likely to be fleeting.

Tax Exempt Markets

- Municipals weakened again last week with most of the strain being felt in the intermediate portion of the yield curve. Yields on 5, 10 and 30-year maturities rose roughly 14, 20 and 1 bps respectively. This brings benchmark AAA yields on 5, 10 and 30-year maturities to 2.3%, 3.3% and 4.13% respectively.
- New issues continued to see solid sponsorship last week with both New York State and Massachusetts State Water coming to market with large deals in the primary market. New York State came to market with \$455 million GO bonds rated Aa3/AA while Massachusetts State Water Pollution Abatement Trust issued \$408 million of bonds rated A1/AA-.
- The forward calendar continues to expand with the Bond Buyer 30-day visible supply up to \$13.457 billion, up from \$11.989 billion the week prior.
- While the new issue market remains active, volume is down significantly in the secondary market. Bid-offer spreads are wide with sellers opting to wait for better exit points rather than sell to bids well behind pricing. Unlike the bout of illiquidity we experienced late last year sellers aren't forced to sell into this market. This is due in large part to stable, positive mutual fund flows.
- Municipal bond fund flows remain positive. According to AMG Data Services, the 4 week moving average inflow for the "All Muni Fund" category is hovering around \$1.1 to 1.2 billion. At this pace, municipal funds are set to recapture the \$11.3 billion they lost during 4Q08 and 1Q09.



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Tax Exempt Markets

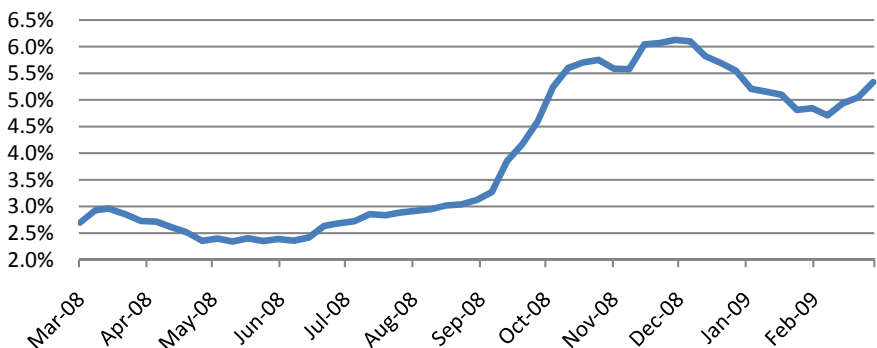
- Moody's dealt a blow to Ambac, placing them on review for downgrade following a poor earnings release. Moody's indicated that their review of Ambac's Baa1 rating could result in a multiple notch downgrade, suggesting a below investment grade rating as a possible outcome.
- Credit spreads remain inverted with the spread between AAA and BBB yields higher in the short and intermediate areas of the curve than on the long end.

Taxable Markets

Barclays Capital U.S. Corp Investment Grade Index OAS

3/7/2008 - 3/6/2009; Source: Barclays Capital

- The credit market underperformance versus Treasuries last week was driven by significant weakness in the financial sector of the corporate market. Negative headlines surrounding GE Capital and AIG raised concerns with financial credit investors and contributed to the option-adjusted-spread (OAS) of the Barclays U.S. Corporate Investment Grade Index widening 28 basis points to +533 OAS. The Financial sector ended 64 bps weaker while Industrials and Utilities were 15 bps and 13 bps wider, respectively.



- Stronger credits that came to market during the week were met with vigorous investor demand. \$21.6 billion in new investment-grade debt was issued for the week. Among the issuers were BP, Eli Lilly, and Coca-Cola, and Pitney Bowes. Year-to-date, corporations have sold \$273 billion of debt. This is above the \$207 billion seen during the same period of 2007, which ended up being a record year for bond issuance.
- Mortgages underperformed moderately for the week as details from the Obama mortgage plan were released. The plan lends itself to less expensive and more convenient refinancing scenarios for borrowers. While this is good for homeowners, premium MBS issues were hit as a result of the expectations of faster prepayment rates. Overall, the Barclays U.S. MBS Index was 7 bps wider on the week to +115 OAS.
- Agencies underperformed Treasuries for the week as the Barclays U.S. Aggregate Agencies Index widened 6 bps to +89 OAS. While FNMA and FHLMC have access to both capital and the secured funding facility of the Treasury, only FHLB has access to the secured funding facility. Stress from the credit markets resulted in underperformance of FHLB issues relative to FNMA and FHLMC.