



Bond Market Weekly

Week of March 16, 2009 | Municipal and Corporate Review

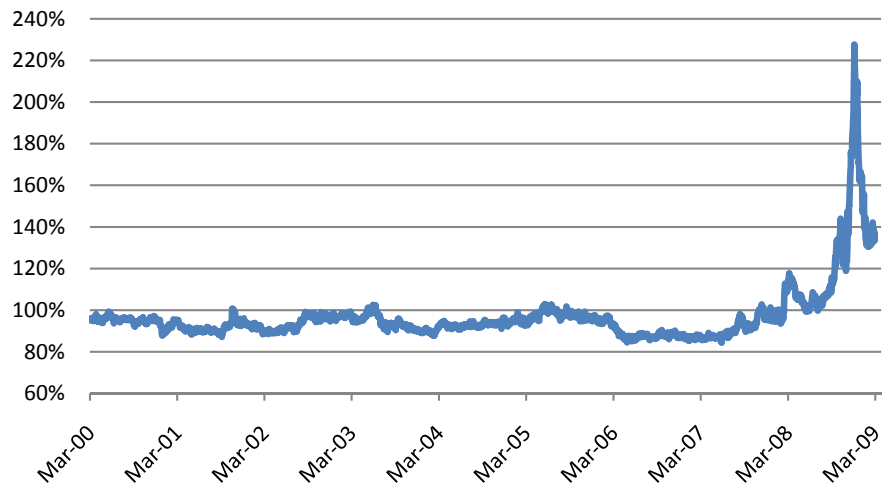
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Market Overview

- A slight easing in the dour economic outlook along with heavy Treasury supply provided a headwind for the benchmark 10-year note last week. The benchmark 10-year yield rose 2 bps to 2.89%. A steepening bias was in place over the week as spreads from 2- to 10-years rose just 1 bp to +193, while 2- to 30-year spreads jumped 11 bps to +271. All in all not a terrible week for Treasuries given the supply digestion and improved economic outlook.
- With better equity and retail sales data (ex. autos +0.7% vs. -0.1% exp Feb) and mortgage default markets performing well, TIPS outperformed the nominal Treasury market and moved breakeven inflation measures higher. The current 5-year horizon measure rose 8 bps to +0.59% while the 5-year, 5-year forward shot 34 bps higher to +1.62% (recent high 2.03% in early Feb).
- The week ahead could shape up as an historic one with the FOMC expected to further discuss Treasury purchases. Successful implementation of the “quantitative easing” measure at the Bank of England has US market participants increasing expectations of that eventuality here. Morgan Stanley pointed to strength in the 7-year area of the Treasury yield curve last week as an effect of expectations that purchases will come eventually, if not this week, in the “belly” of the curve in order to target lower mortgage rates more effectively.
- Beyond a possible historic Fed bid for Treasuries, a busy week of economic data is highlighted by February’s CPI data release on Wednesday. The year-over-year headline increase is expected to be 0% for the first time since 1954. However, the year-over-year core measure is expected to fall to +1.7%, while still significantly above multi-decade low set in 2003 at +1.1%.

30-Year AAA Municipal to 30-Year Treasury Yield Ratio

3/16/2000-3/16/2009; Source: Bloomberg L.P.



Tax Exempt Markets

- Municipal bonds were quiet, although slightly weaker, along the curve last week. 10-year yields rose 4 bps to 3.55%.
- The market continues to worry about not only primary supply but also secondary pressure with the April 15th tax deadline fast approaching. So far the secondary pressure has not materialized and primary supply has stayed in a relatively tight range which has not overwhelmed the market.



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Tax Exempt Markets

- ❑ The Bond Buyer 30-Day Visible Supply Index has climbed to just under \$14 billion with over \$5 billion in new issues expected this week. The market will see \$480 million from the Houston Utility System as well as \$200 million for George Washington University and \$450 million for the Los Angeles Community College System which will be comprised of both tax exempt and taxable bonds.
- ❑ In legislative news last week, Congress is beginning to preliminarily look at a number of measures to help the municipal market. While none of the measures are final, the initial steps show the willingness of Congress to help state and local municipalities. These potential measures include the creation of a Federal guaranty for GO's, the reinsuring of the monoline insurers' public finance books, and the support of banks that give LOC to variable rate debt.
- ❑ In credit news the city of Atlanta was downgraded to A from AA- and the State of Illinois to AA- from AA by Standard and Poor's.
- ❑ We bought a large number of bonds last week with much of the issues coming from new deals. We purchased a Lubbock, Texas GO deal as well as a New York Dorm Authority Issue. Most of our buying was in the 5-10 year area of the curve.

Taxable Markets

- ❑ The corporate bond market suffered early last week on comments by a member of the House Financial Services Committee suggesting that debtholders of financials had not shared enough pain in the financial crisis. Although these comments were not consistent with the Obama administration, it nevertheless caused weakness in the financial sector. The financial sector of the Barclays Capital U.S. Corporate Investment Grade Index widened 44 bps to an option-adjusted spread of +792. While the industrial and utilities sectors were only 1 bp and 8 bps wider, respectively, financials pushed the overall corporate index out 16 bps to +549 OAS.
- ❑ New issue corporate debt with strong credit ratings continued to be met with robust investor appetite. \$42.8 billion of new debt was priced last week bringing the total year-to-date volume to \$316.7 billion compared to \$192.4 billion for the same period of 2008.
- ❑ Debt issuance under the FDIC's Temporary Liquidity Guarantee Program jumped last week after the FDIC announced they would be charging more for the debt guarantees. Companies took advantage of the window of opportunity to issue \$29.8 billion last week making it the second busiest week of issuance since the program began last November. Among the larger issuers last week were GE, Goldman Sachs, and Bank of America.
- ❑ The mortgage market was a bit stronger last week on further MBS purchases by the Treasury. Since the beginning of the year the Fed and Treasury has accumulated \$252 billion in MBS debt. Agency MBS clearly appears to be central to government policy and its efforts to stimulate the economy. The Barclays Capital U.S. MBS Index tightened 8 bps to +107OAS last week.