



Bond Market Weekly

Week of March 23, 2009 | Municipal and Corporate Review

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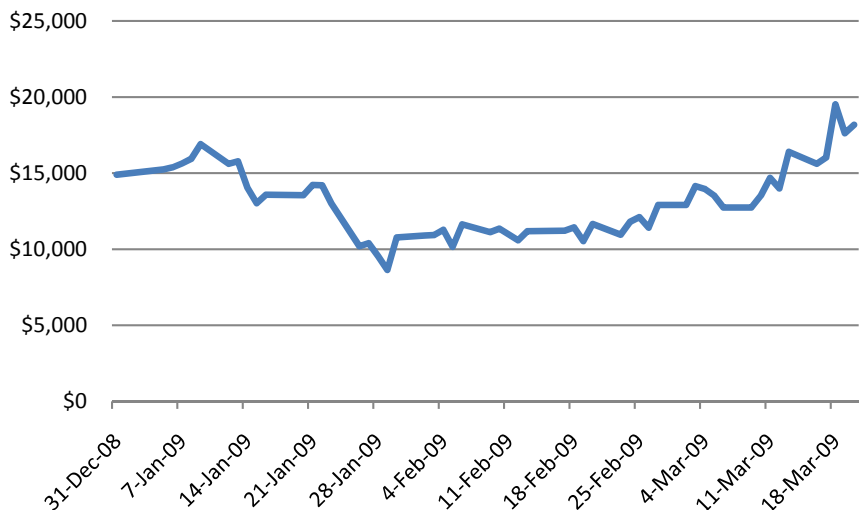
Market Overview

- ❑ In a historic move, the Fed announced plans to purchase \$300 billion in US Treasuries which led to a major rally in government bonds. The benchmark 10-year note fell to 2.63%, or 25 bps lower than the prior week close. The Fed's desire to focus much of their buying in the 2- to 10-year portion of the yield curve led to a 16 bps flattening of 2- to 10-year spreads to +177, while 2- to 30-year spreads rose 8 bps to +279. Indications are that purchase will include TIPS and maturities elsewhere along the curve, but that the "belly" is the priority.
- ❑ The inflationary or reflationary impact of further quantitative easing led TIPS to outperform on the week and breakevens to rise. The current 5-year horizon breakeven rose 8 bps to a still paltry 0.67% while the 5-year, 5-year forward measure jumped 33 bps to 1.95% - just below the recent high set in early February.
- ❑ The FOMC vote on the Treasury purchases, along with additional \$750 billion in agency MBS and \$100 billion in agency debt, was unanimous and noteworthy. The surprising timing (sooner than most observers expected) and their ability to bring Jeffery Lacker into agreement after previous reservations signals a dire mood within the committee despite Chairman Bernanke's "green shoots" comments on 60 Minutes.
- ❑ Early Monday morning news of Treasury's Public-Private Investment Program to remove toxic assets from bank balance sheets appeared well received initially. With much of the Treasury yield curve capped through Fed purchases, it is difficult to know how the anticipated improvement in riskier asset liquidity will ultimately impact safe-havens. The question of what price these assets are removed from the banks looks open for debate and critical in its effectiveness, but for now markets are relieved to see a plan.

Tax Exempt Markets

- ❑ Municipal bonds began the week poorly, however, rallied significantly after the Fed's announcement of its plan to buy Treasuries, agencies, and mortgage backed securities. The week ended with 10-year municipal yields falling 7 bps to 3.48%.
- ❑ Selling pressure may re-emerge this week with the much anticipated \$4 billion California State GO deal. The bonds are rated A2/A and are preliminarily priced at 4.90% in 2019 and 6% in 2038. New issue supply is still of primary concern this week as the 30-Day Visible Supply calendar has ballooned to over \$18 billion.

30-Day Visible Supply Index
12/31/2008-3/20/2009; Source: Bloomberg





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Tax Exempt Markets

- ❑ The U.S. Congress continues to look for ways to prop up the municipal market. It looks as if Rep. Connolly will sponsor a bill to provide a Federal liquidity backstop for the VRDO market. This could significantly mitigate the problems of many municipalities in finding new LOCs for their short term financing needs.
- ❑ According to Municipal Market Advisors as investors became inundated with supply, fears of longer term inflation are surfacing on the long end of the municipal market (which looks cheap on a relative basis with the 2s/30s spread at 370 bps. This may provide a large degree of value for those investors looking to maximize their tax free income).
- ❑ Budget woes continue throughout the country with the state of Illinois looking to raise income taxes, motor fuel fees and driver's license fees. Also, Hillsborough County, FL School Sales Tax bonds were cut to A- on declining sales tax revenues and thinner coverage for bonds. While the district has strong reserve levels the weakness in sales tax revenue is a concern for budgeting in the future.
- ❑ We participated in a number of new deals last week including a Parker, TX GO issue and the new \$1.5 billion State of Wisconsin annual appropriation issue.

Taxable Markets

- ❑ The focus of the corporate market was again new issuance as sales of investment-grade debt set a weekly record of \$25.7 billion, according to Bloomberg. The bulk of the issuance was from Pfizer which sold \$13.5 billion of notes to finance its purchase of Wyeth. They sold 3-, 6-, 10-, and 30-year notes ranging from +305 to +345 bps to comparable Treasuries. Even with the large size, the deal was oversubscribed nearly 2 times.
- ❑ Financials in the corporate market rallied 27 bps to +769 OAS in part from progress reported at the FASB on changes to mark-to-market accounting rules. The changes from distressed sale pricing to a more orderly pricing and the guidelines for other-than-temporary impairments being implemented for the Q109 reporting period gave a boost to banks. With the improvement in financials offsetting some weakness in the industrial and utilities sectors (6 bps and 12 bps wider, respectively), the Barclays Capital U.S. Investment Corporate Grade Index tightened 3 bps to +546 OAS.
- ❑ The mortgage-backed securities market performed fairly well last week relative to Treasuries after the FOMC statement to dramatically increase purchases of MBS, Agency, and Treasury debt. As noted, Treasuries rallied strongly but MBS held in firm (normally strong Treasury rallies cause pricing pressures on MBS securities on prepayment concerns). The Barclays Capital U.S. MBS Index widened only 1 bp to end the week at +108 OAS.
- ❑ Agencies were 2 bps tighter on the week to +78 OAS in the Barclays Capital Aggregate Agencies Index. Technical factors continue to bode well for this sector as the Fed purchased \$32 billion of agencies in YTD through February with net issuance during this time of -\$12 billion, resulting in \$44 billion being taken out of the market during this period.