



Bond Market Weekly

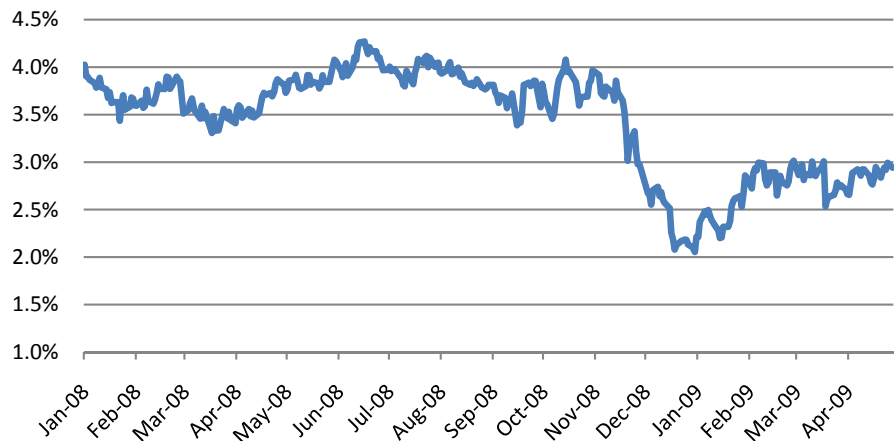
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Market Overview

- ❑ After a sizable early week rally, US Treasuries largely faded throughout the rest of the week leaving the benchmark 10-year note 4 bps higher to close Friday at 2.99%. Also reversing course was the shape of the yield curve, which moved steeper by 6 bps to +204 from 2- to 10-year, while the spread from 2- to 30-year rose 9 bps higher to +292.
- ❑ TIPS relative performance to nominal Treasuries was mixed with the current 5-year horizon breakeven inflation dropping 7 bps to 0.73%, while the 5-year, 5-year forward horizon rose significantly by 53 bps to 2.47%.
- ❑ The week's economic data calendar was generally light and offered a mixed assessment of current conditions. After a few weeks of Easter distortions, Initial Jobless Claims jumped back to 640,000 and pointed to a continuing deterioration in the employment picture. Home sales data were mixed with February gains giving way to March declines (March -3% Existing, -0.6% New) but anecdotes beyond foreclosure filings seem to be pointing to at least a bottoming process.
- ❑ Much of the focus across fixed income markets hovered around Build America Bonds and the banking "stress tests". The week ahead likely will carry the same themes but the calendar does include noteworthy items. A terrible Q1 GDP advance estimate is due out Wednesday with consensus around -4.7%. Also, the Wednesday FOMC meeting appears to be less newsworthy with Bernanke's transparency changes.
- ❑ Manufacturing surveys are back in focus as consensus moves to improving conditions. Friday marks the release of the April ISM Manufacturing survey which is expected to improve again to 38.3.
- ❑ Bond traders will be watching the success of \$101 billion in 2-, 5- and 10-year Treasury Notes. Thus far, the sizable auctions have largely been well received with market positioning and pressure occurring in advance. Note 10-year notes are now near the top of recent yield ranges and positioned well in advance.

10-Year Treasury Yield
1/1/08-4/27/09; Source: Bloomberg



Tax Exempt Markets

- ❑ Municipal bonds continued to rally last week with yields on 10-year bonds falling by approximately 2 bps to 3.22% as of Friday's close.
- ❑ New issuance was relatively slow while retail demand remained strong. Many issuers brought Build America Bonds to market, with 35% of coupon payments being rebated by the Treasury. This program was well received by the market with many of the new deals tightening significantly off the break.



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Tax Exempt Markets

- ❑ Tax exempt municipal fund flows remained strong last week with net inflows tripling from the week prior. This represented the largest weekly inflow since May 2008.
- ❑ The forward calendar remains somewhat muted with the Bond Buyer 30-Day Visible Supply Index at \$13.7 billion.
- ❑ Last week was highlighted by the aforementioned Build America Bonds, a program which allows issuers to sell taxable municipal bonds for new infrastructure projects and provides the issuers with a rebate for 35% of the coupon from the U.S. Treasury. California and the New York MTA both brought deals last week that were very well received by the market. The benchmark California 30-year bonds came at +360 bps to the 30-year Treasury and tightened to +330 bps. We expect issuers to use this option more regularly in the future, although there is an annual issuance cap of \$50 billion for each of the two years authorized by the program (2009/2010).
- ❑ Build America Bonds have alleviated a glut of supply in the tax exempt market which has added fuel to the tax exempt rally. During last week alone, \$7.4 billion in Build America Bonds were brought to market. Considering tax exempt issuance was a little over \$5 billion, this represented a significant sum.
- ❑ We purchased a number of new deals last week, including a Miami-Dade International Airport issue. The bonds are back by airport revenues and insured by Assured Guaranty. As we mentioned last week in the case of California, investors have shied away from credits in Florida which presents compelling relative value opportunities.

Taxable Markets

- ❑ Spreads in the corporate market improved 10 bps on the week to +473 OAS (measured by the Barclays Capital U.S. Corporate Investment Grade Index) as earnings season continues to exceed expectations in the aggregate. Approximately 26% of the S&P 500 companies have reported Q1 earnings and about 67% of those companies have exceeded expectations, while 26% have missed. One could argue that companies have been revising estimates lower in recent weeks which would tend to result in the earnings story somewhat mixed so far. Companies headlining the positive surprises included Bank of America, American Express, Wells Fargo, IBM, and AT&T. Disappointments have been reported by Morgan Stanley, Caterpillar, and UPS.
- ❑ Investment-grade new issuance was light on the week at \$10.1 billion due in part to earnings – related blackouts. Toledo Edison, an operating company of FirstEnergy, was active though with the pricing of 11-year first-mortgage bonds at +437.5 bps.
- ❑ The MBS market continued to improve with a 12 bps spread tightening in the Barclays Capital U.S. MBS Index. The Index ended the week at +66 OAS on news that key senators are in the process of revising cram down legislation that in part would prohibit judges from forgiving mortgage loan principal. Also, the Treasury announced they had purchased \$17.4 billion of agency MBS in March. Government purchases also continued to lift the agencies markets pushing that market 5 bps tighter to +62 OAS.