



## Bond Market Weekly

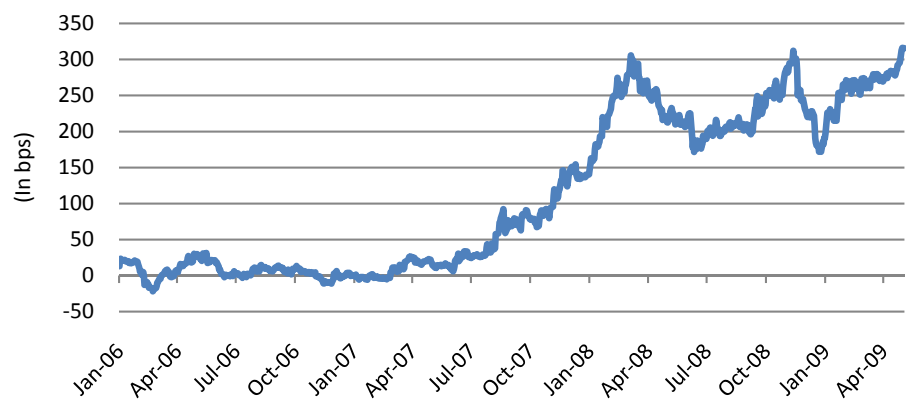
Week of May 4, 2009 | Municipal and Corporate Review

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### Market Overview

- ❑ US Treasuries fell last week as an economic theme of “recovery” gained momentum for some market participants. The benchmark 10-year note rose 20 bps in yield to 3.19% Friday afternoon after penetrating support levels around 3% that have held since January. The yield curve steepened 24 bps from 2- to 10-years to +227 during the week while rising 26 bps to +318 from 2- to 30-years.
- ❑ The FOMC statement, while mostly unchanged from the previous meeting, did little to support Treasuries as previously announced Fed purchases were left unchanged. It is widely expected that the Fed will not welcome a substantial rise in rates and increase its support for longer dated maturities before a sustainable recovery is in sight. Furthermore, the upcoming month of June has marked the annual peak in 10-year US Treasury yields for the past 3 years.
- ❑ Breakeven inflation in the TIPS market jumped 18 bps across the current 5-year horizon by midweek but faded back to 6 bps by Friday to end at 0.82%. Perhaps in anticipation of a quicker recovery and sooner reversal of Fed stimulus, the longer-term 5-year, 5-year forward measure fell a sizable 39 bps to 2.18%. However, it is worth noting that the Fed is now involved in these markets and true market feedback is blurred.
- ❑ Confidence surveys and regional manufacturing data continued to improve throughout the week. Besides better Dallas (-31.6 vs -49), Richmond (-9 vs -20), and Chicago (40.1 vs 31.4) numbers, ISM Manufacturing clawed its way back to 40.1 in April (low -32.9 Dec.) with all components better except inventories.
- ❑ However a combination of unsustainable economic free-fall post Lehman and contrarian impatience with a consistent negative theme may be offering false hopes. Q1 GDP advanced estimate showed a -6.1% decline in GDP while personal income and spending slumped back into negative territory in March. Continuing jobless claims also continued their rapid ascent (4/17 - 6.27 million or 40% higher than 1/2/09 claims). All the while, Chrysler’s bankruptcy and plant shutdown has been estimated to shave 0.2% off of GDP per month alone this summer. Are markets ahead of themselves?

**2- to 30-year Treasury Spread**  
12/31/2005-5/4/2009; Source: Bloomberg L.P.



### Tax Exempt Markets

- ❑ Municipals weakened last week with 10-year yields rising 8 basis points to 3.28%. Many felt that the strong rally from the prior week was overdone on the back of the flurry of Build America Bonds (BABs) issuance. This week saw a much slower issuance pace coupled with weakness in Treasuries.
- ❑ With April behind us investors are looking to May and June as seasonally high months for maturities and calls. This could offset some of the recent weakness felt in the municipal market.



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### Tax Exempt Markets

- Performance for April was the best for this month since 1989, according to Merrill Lynch's Municipal Master Index, which returned 2.5% last month. Heavy mutual fund inflows of over \$1 billion for the week ending April 22nd contributed to the strong municipal performance.
- Cash in tax exempt money market funds has fallen below \$470 billion; its lowest level since 2007. While the seasonal factors will probably add to this total, a strong stock market and low absolute yields could potentially inhibit a continued rally going forward.
- New issues of note in the coming week include \$300 million in Georgia State GOs, \$155 million for the Ohio Turnpike and \$163 million for the state of Texas. 30-day visible has been stable around \$13 billion and there seems to be enough demand for the new deals coming to market with few having large balances.
- After the flurry of large BABs deals two weeks ago, last week saw smaller and shorter BABs deals sold into the market. The taxable market's appetite for this sort of structure could easily be overwhelmed if too many issuers end up trying to bring deals to market.
- We were generally quiet this week although we were large participants in the Florida Citizens Property new issue which offered attractive yields on the front end of the curve. We have been following this credit for years and believe that it represents great value relative to its trading levels in what is otherwise a largely yield compressed environment.

### Taxable Markets

- The US Treasury curve had a mixed week as the short end improved slightly while the long end suffered from a triple whammy of large auctions, the announcement of more supply during the May refunding, and a continuation of gradually improving economic statistics. The spread between 2- and 10-year note yields steepened rather dramatically, increasing 24 basis points to +227.
- Corporate bond spreads continued to move tighter, improving another eye-catching 34 basis points on the week to close at +439 OAS. This finished a month in which the US Corporate Investment Grade component of the Barclays Capital Aggregate Index posted a total return of 3.47%. New issuance of corporate debt remained strong and was led by \$1 billion-plus new issues from the likes of Goldman Sachs, Credit Suisse, Nokia, ITT Corporation and British Petroleum. These new deals continued their recent trend of good secondary performance. For example, the Goldman deal priced at 410 basis points over the 5-year note on Wednesday, and ended the week in the 375 off range. The health of the market was also highlighted by three new high yield deals, for Starwood Hotels, supermarket chain Supervalu, and Ryland Homes, which were priced and also traded well in the secondary market.
- Agency debt also continued to perform well even during a week in which issuance of new debentures was heavy. Each of the agencies continued the process of calling older higher coupon issues and replacing them with new debt both in bullet and callable forms. Market participants noted that, despite tighter and tighter new issue spreads on each new deal, investor demand remained strong throughout the week. Agency MBS held their ground despite ever higher dollar prices, finishing the week virtually unchanged in OAS (+67 vs. +66 last week). Both sectors were buoyed by further purchases by the Treasury Department.
- Several new Build America Bond issues were priced although the week's issues were generally much smaller than those brought to market last week. The large benchmark deals done last week, such as those from the State of California and the New York MTA, continued to tighten significantly in secondary trading.