



Bond Market Weekly

Week of May 18, 2009 | Municipal and Corporate Review

Page 1 of 2

Market Overview

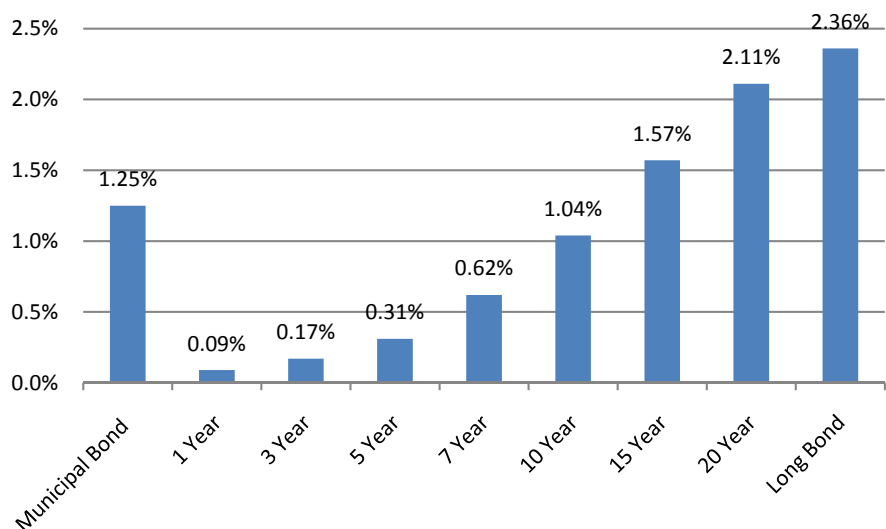
- ❑ A supply respite along with a reality check via retail sales and jobless claim data halted the recovery theme across markets last week and helped the benchmark 10-year Treasury rally 15 bps to 3.14% Friday afternoon. Treasury market support was a bit stronger in long maturities which helped a minor flattening of the yield curve. Spreads from 2- to 10-years fell 1 bp to +229, while 2- to 30-years spreads fell 5 bps to +324.
- ❑ Breakeven inflation as measured in the TIPS market retreated as well, with the current 5-year horizon falling 6 bps to 0.99% while the 5-year, 5-year forward period slipped 10 bps to 2.16%. The April CPI release Friday showed the current year-over-year rate at -0.70%. Core inflation continues its stubborn fight, rising +1.9% year-over-year after bottoming out +1.7% in January.
- ❑ Beyond CPI, market participants looked closely at April retail sales and weekly jobless claims reports last week which dampened recovery enthusiasm. April sales fell -0.4%, the data was worse than expected while March was revised lower to -1.3%. For the moment, it appears January's 1.7% and February's 0.4% rise was a special government payment induced head-fake after 6 previous months of declines.
- ❑ Another glimmer of hope dashed last week was the jobless claims data. Initial claims jumped back above 637,000 after a two-week dip to 605,000. Continuing claims jumped 202,000 to 6.56 million and a whopping 45% higher than at year-end. The deteriorating employment picture appears to have a long way to go, especially with auto related losses just beginning in earnest.

Tax Exempt Markets

- ❑ Municipal bonds continue to grind higher with 10-year bond yields falling 7 bps to 3.21%. Longer maturities continue to perform well this month, as evidenced by the accompanying chart.
- ❑ Market demand remained healthy with reasonable supply and an abundance of cash looking to be put to work. Municipal bond mutual fund inflows were \$1.73 billion for the week ending May 6th, according to the Investment Company Institute, the highest weekly inflow this year.

Municipal Bond Index MTD Total Return

Source: Barclays Capital





Bond Market Weekly

Week of May 18, 2009 | Municipal and Corporate Review

Page 2 of 2

Tax Exempt Markets

- ❑ Forward supply continues to be manageable with the Bond Buyer 30-Day Visible Supply Index at only \$11.1 billion. The market is preparing for large cash inflows in June and July with over \$100 billion expected. To put it in perspective, year-to-date through May has only seen approximately \$130 billion in coupon payments and redemptions. Therefore, the effect on demand without an increase in supply could be noted.
- ❑ Tax exempt supply continues to be constrained by the issuance of Build America Bonds (BABs) which have had a significant impact on the long end of the municipal market. How much demand will exist for this structure remains to be seen, but it may continue to impact the levels and structure of the tax exempt market.
- ❑ This week new deals include \$188 million for the city of Baltimore, \$300 million for the state of Massachusetts and \$790 million for New York City.
- ❑ More details have come out about Congressional legislation regarding the municipal market. One bill will create an Office of Public Finance which will reinsure new issues through existing public finance only bond insurers. Whether this will be typical reinsurance or cut-through reinsurance where policy holders will go direct to the government if desired remains to be seen. Additionally, Congress would authorize the Fed to set up a special purpose vehicle to provide standby purchase agreements for VRDNs, significantly helping the short-term financing market.
- ❑ We generally bought in the secondary market last week as new issues were in high demand and largely expensive. We focused on the 5 to 15 year area of the curve and bought both callable and non-callable bonds mostly in the AA category.

Taxable Markets

- ❑ The corporate market took a breather from its recent rally with spreads widening just 1 bp. The Barclays Capital U.S. Corporate Investment Grade Index finished the week at +408 OAS as the industrial and utility sectors were each 10 bps wider. However, financials continued to tighten on the heels of last week's bank stress test results by the Treasury with another 17 bps of compression to Treasuries closing at a +553 OAS.
- ❑ Corporate new issuance picked up volume following the market's improved tone to prior weeks. Microsoft was the highlight of the week with their first ever debt issue. The company received a Aaa/AAA rating and issued \$3.75 billion among 5-, 10-, and 30-year bonds that were priced at a spread of +95 bps for the 5-year and +105 for both the 10- and 30-year issues. Wal-Mart (Aa2/AA) was also a dominant participant with a 5-year \$1 billion issue priced at +125 bps. In aggregate, investment-grade borrowers sold \$28.2 billion of new debt.
- ❑ The mortgage-backed securities market had a very positive week. Spreads were 16 bps better to end the week at +48 OAS in the Barclays Capital U.S. MBS Index with higher coupon performance leading the strength. The Mortgage Bankers Association weekly survey showed an 11% decline in refinancing applications. Origination activity continues to be lower than market expectations resulting in greater interest in up-in-coupon trades. Also buyer appetite continued from the Fed as it purchased \$27 billion for the week ending May 13th while banks quarterly data showed the top 50 banks added \$42 billion in the first quarter of 2009.