



Bond Market Weekly

Week of May 26, 2009 | Municipal and Corporate Review

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Market Overview

- ❑ Fed purchases of Treasuries came to a close on Thursday while \$101 billion of new supply was announced for the 2, 5 and 7-year maturities. The backdrop of a possible UK debt downgrade added to the market drag and created substantial losses on the week. The benchmark 10-year rose 31 bps to close at 3.45%. The sell-off was again most pronounced in longer-dated maturities which steepened the yield curve from 2- to 10-years by 28 bps to +256, while pushing the 2- to 30-year spread 27 bps higher to +350.
- ❑ The likelihood of a US AAA downgrade remains very remote, recall that the rating agencies get their oxygen from the US SEC's NRSRO status, but the headlines certainly cast a cloud over the current fiscal plan of borrowing our way back to economic growth while fueling the sensational political outrage against Obamanomics.
- ❑ Nonetheless, fears of a US downgrade punished the dollar while simultaneously increasing inflation expectations. Breakeven inflation over the current 5-year horizon jumped 20 bps to 1.2% while the 5-year, 5-year forward horizon spiked 33 bps to 2.56%. Note the Fed's updated central tendency for PCE (Personal Consumption Index) inflation over the next few years ranges from as low as 0.6% in 2009 to as high as 1.9% in 2011.
- ❑ The economic data calendar was light last week with mixed results. Initial jobless claims (631k vs. 625k exp) and continuing claims (6,662k vs. 6,650k exp.) continued to push higher and are showing no signs of relief. April leading indicators, mostly comprised of already published data, rose 1% reflecting the earlier trend of improving data over the course of April. A setback of sorts came via the May Philly Fed survey which held solidly in the negative 20s (-22.60 vs. -18 exp.) and barely improving from April. The economic calendar will pick up in the week ahead, however top tier data will not be released until the first week of June.

Tax Exempt Markets

- ❑ Municipal bonds continued their upward price path this week but without the same momentum we have seen in previous weeks. The higher yielding A and BBB issues traded much tighter than they have in months despite 10-year yields falling 3 bps to 3.18%.
- ❑ The new issue calendar has remained relatively steady with the Bond Buyer 30-Day Visible Supply Index at \$11.58 billion. Demand for new issues has remained strong as investors are getting ready for the June 1st flood of maturities, calls, and coupon income.
- ❑ New deals this week include \$160 million for Jefferson Parish, LA, \$283 million for the government of Guam, a B+ rated credit, and \$310 million for the Washington Metropolitan Transportation District. The Guam deal will be instructive in determining the actual strength and depth of the high yield market.
- ❑ The municipal market closely followed the hearings on the many bills being proposed regarding municipal bonds. It is still difficult to predict what the final outcome will be, but definite opposition exists with respect to the Federal government taking any role in the municipal market.



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Tax Exempt Markets

- California was again in the news due to the rejection of virtually all of the budgetary propositions that were voted on last week. This puts the state in a precarious position to contend with a projected \$23 billion budget deficit. Governor Schwarzenegger now is asking the Federal government to help support the state in its upcoming issuance of up to \$13 billion in short-term notes.
- WSC was active last week looking for new deals to invest June 1st maturities that are on the horizon. WSC purchased new deals in West Mission Valley Community College District, CA, University of Pittsburgh Medical Center, and a large block of Chicago, IL GO's in the secondary market.

Taxable Markets

- The corporate, MBS, and agency debt markets outperformed the Treasury market last week. Minutes of the Fed's April meeting revealed last Wednesday show that the Fed is open to increasing the size of its MBS purchasing program beyond the committed \$1.75 trillion level. This news helped push the overall MBS market still tighter to Treasury yields. The Barclays Capital U.S. MBS Index ended the week 18 bps tighter to Treasury yields. The average rate for Freddie Mac 30-year mortgage loans posted on Thursday finished at 4.82% (4 bps better on the week) but considering the back-up in Treasury yields last week, it is likely that near term, mortgage rates will creep higher.
- Corporates continued outpacing Treasuries as well. Spreads compressed another 26 bps last week to end at +382 OAS in the Barclays Capital U.S. Corporate Investment Grade Index. Risk appetite has been increasing ever since the results of the Treasury's bank stress tests helping to compress spreads in the Financial sector another 45 bps last week.
- Investment-grade borrowers sold \$32.7 billion for the week, up \$2.3 billion from the prior week. A new issue from Hewlett-Packard illustrates the strength of the corporate markets lately. The company raised \$2 billion last week in part to refinance commercial paper issued for their purchase of EDS last August. Their newest 3-year issue was priced last week at +160 bps to Treasuries compared to their 3-year priced in February at +295 bps to Treasuries.

U.S. Corporate Investment Grade Spreads (OAS)

5/22/2008-5/22/2009; Source: Barclays Capital

