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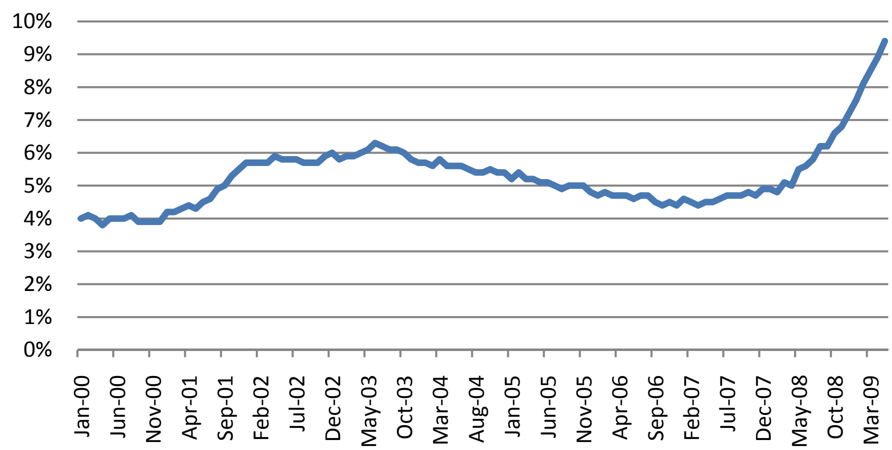
Bond Market Weekly

Week of June 8, 2009 | Municipal and Corporate Review

Market Overview

US Unemployment Rate Total MoM

1/31/2000-5/31/2009; Source: Bloomberg



- The supply respite was no match for Treasury bears, mortgage hedging sellers and knee-jerk reaction to somewhat better than expected jobs report. Benchmark 10-year yields jumped 37 bps higher to finish at 3.83% after peaking around 3.87% early Friday.
- A notable positive, yet brief, reaction to Chairman Bernanke's comments in Washington signaling that the Fed "will not monetize the debt". 10-year Treasury yields dipped lower on Wednesday to 3.54% due to maneuvering by the Fed to tamp down recent spikes in inflation expectations with hawkish rhetoric. Stay tuned for the outcome of the June 24 meeting.
- The jump in 10-year rates did not come with the usual yield curve steepening seen of late. The spread from 2- to 10-years rose 4 bps to +258, while 2- to 30-year spreads fell 5 bps to +337. The weakness on the short end even included a move in Fed Funds Futures to a 70% chance of a hike by November. The markets are clearly pricing in an aggressive recovery.
- The TIPS market continued a trend toward higher short-term inflation and long-term disinflation. The current 5-year horizon moved a considerable 36 bp higher to 1.77% while the 5-year, 5-year forward horizon fell 3 bps to 2.40%.
- The economic data calendar was loaded last week and produced compelling arguments for both bulls and bears. The recovery theme was supported by another jump in ISM Manufacturing to 42.8 or a level consistent with positive GDP growth. Also, continuing jobless claims leveled off at 6,735k while nonfarm payrolls shed a better than expected 345k jobs.
- Bears found solace in the details of the employment report, where a surprise jump of 0.5% to a 9.4% unemployment rate (just 0.6% below the "stress test" level) along with a continued deterioration in the hours worked and earnings showed little signs of improvement.
- Late Friday, consumer credit was reported to have contracted by $15.7 billion from April 2008. The pace of decline has now reached -7.4%. Revolving credit is contracting at a -11% pace.

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Tax Exempt Markets

- Municipal yields rose last week in sympathy with US Treasuries and in anticipation of increased supply. According to Municipal Market Data, 10-year AAA municipal bond yields closed at 3.01% on the week.
- 30-Day Visible Supply increased by $3.8 billion to $18.7 billion with as much as $11.5 billion expected to price this week. If the full $11.5 billion makes it to market, it will be the largest weekly volume so far this year. While we expect the market may get a bit sloppy before it is all said and done, the new supply should be absorbed with relative ease given the significant demand we've seen as of late.
- Larger issues expected into the market this week include Hawaii, San Diego Gas & Electric, Texas, Washington, Puerto Rico, and the New Jersey Healthcare Facility Authority. The State of Ohio is expected to price a Build America Bonds (BABs) deal which will likely get plenty of attention.
- We participated in the State of Texas issue this past week. The 8-year serial priced at 3.11%, which was approximately 92% of US Treasuries on a nominal basis for a strong AA/Aa1 credit.
- Balance sheet liquidity for the larger, well funded issuers remains very strong and this has been reflected in their solid trading levels. In addition, we have seen increasing retail interest in lower rated obligors and some of the less liquid sectors of the credit markets as buyers resume their hunt for additional yield.

Taxable Markets

- Risk appetite continued to improve last week as evidenced by the steady demand felt in the corporate bond market. New issuance was strong and overall spreads further compressed relative to Treasuries.
- Investment-grade new issuance was $32 billion last week with a noticeable increase in the number of Baa-rated issuers coming to market versus previous weeks. Vodaphone (Baa1/A-) and Express Scripts (Baa3/BBB) were two of the larger issuers, each printing a total of $2.5 billion among varied maturities. GMAC also made news with its maiden issue of $4.5 billion of 3-year FDIC-backed debt (under the TLGP). In unrelated news, the company's former parent, GM, made the inevitable official last Monday when it filed for chapter 11 protection under the bankruptcy code.
- Corporate spreads were 27 bps tighter to Treasuries last week with the final reading in the Barclays Capital U.S. Corporate Investment Grade Index of +325 OAS. The strength was felt across each broad sector as Industrials, Utilities, and Financials were 27, 21, and 28, bps tighter respectively.
- MBS was largely unchanged after the roller-coaster ride investors felt from the prior week. The Barclays Capital U.S. MBS Index ended at +35 OAS, 4 bps tighter/wider for the week. Overall, lower coupon MBS lagged as higher coupon MBS improved with the perception that the refinancing wave may take a breather because of higher mortgage rates. The FHLMC survey showed the average 30-year mortgage rate at 5.29% as of June 4th, 38 bps higher than the previous week.