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Bond Market Weekly

Week of June 15, 2009 | Municipal and Corporate Review

Market Overview

- Treasuries posted a positive week of performance on words of support from Japan and strong demand trends in recent auctions. The benchmark 10-year yield dropped 4 bps to 3.79%, while the 2- to 10-year spread dropped 2 bps to +251. Despite a very well received auction of the bond, 30-year yields rose 1 bp on the week leaving the 2- to 30-year spread 3 bps higher at +334.
- The run up in the TIPS market stalled last week as current 5-year inflation breakevens experienced a marginal 2 bps increase to +1.74%. The 5-year, 5-year forward measure pared some of its most recent moves and shed 8 bps to +1.93%.
- Are TIPS an effective inflation hedge? This is a complex issue. Since 3/2/09, the CRB Index has risen 31% while price performance in 10-year TIPS is a measly 66 bps.
- The story of the week for Treasuries was the auctions and their level of support. High demand was present for all three auctions with bid-to-cover ratios 2.82, 2.62 and 2.68 on the 3-, 10- and 30-year, respectively. Each was well above prior auction levels, while indirect bidders (non-dealers) took down an unusually strong 55% of the issuance illustrating significant demand at the higher yields.
- The Fed Beige Book, retail sales and jobless claims highlighted a quiet economic calendar and largely were inconsequential. The Beige Book echoed recent data suggesting the post Lehman economic collapse has receded, however growth remains elusive. Retail sales, beyond autos and gasoline (headline +0.5% in May) remain stagnant (+0.1%). Initial jobless claims eased again to 601,000 while continuing claims continue to gap higher (+59,000) at 6.816 million. The insured unemployment rate hit 5.1% or the highest since 1982.

Tax Exempt Markets

- Municipal bonds sold off for another week, although Friday saw new signs of strength as the market slightly improved. 10-year municipal yields rose 18 bps to 3.49% for the week. The market sell-off was not attributable to a large number of sellers, but more so reflected an overall lack of demand amidst a large new issue calendar.
- The coming week will bring a large number of new deals with at least $8 billion scheduled to come to market. The Bond Buyer 30-Day Visible Supply Index stands at a healthy $12.1 billion which could keep pressure on municipal yields for the time being.
- New deals this week include $600 million for the Atlanta Wastewater Authority, $1 billion in debt for the Dallas Area Rapid Transit Authority which will be a mix of tax exempts and Build America Bonds (BABs), and also $600 million for the Port Authority of New York and New Jersey.
- Mutual fund inflows continue to be extremely strong with $1.3 billion of inflows into tax exempt mutual funds for the week ending Jun 3rd, according to the Investment Company Institute.
- The U.S. Treasury announced the availability of $25 billion in bonding authority for "Recovery Zone Bonds" which would be issued to help revitalize areas and promote job growth. These would be issued as both taxable and tax exempt series. The taxable bonds would receive a 45% credit back from the U.S. government, much like the BABs issues but with a higher payout rate to issuers. This could be another strong source of supply for the market going forward.

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Tax Exempt Markets

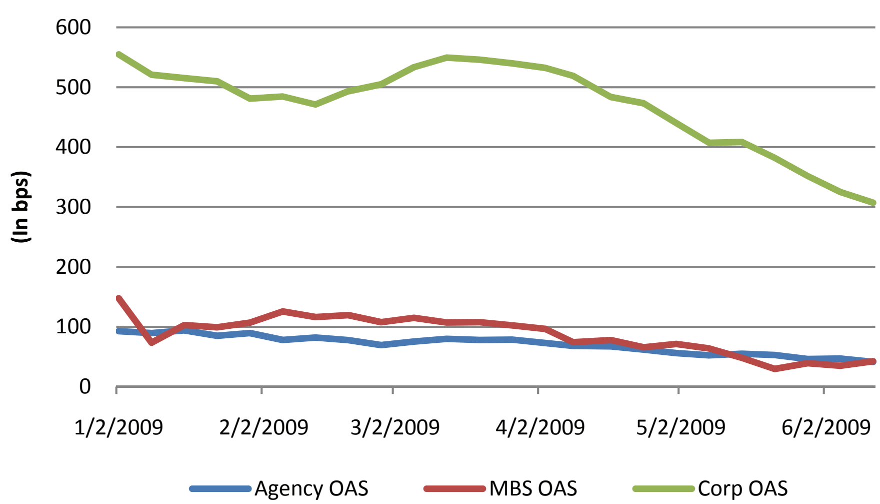
- Much of our buying was muted this week as we are largely fully invested and were content to allow yields to rise to a more comfortable level to buy. We bought specialty state paper to fill some outstanding inquiries including a new issue in Maryland.

Taxable Markets

- Spread compression continued in the corporate market last week, albeit at a subdued pace. Corporates were 18 bps tighter to Treasuries pushing the Barclays Capital U.S. Corporate Investment Grade Index to +307 OAS. Lower quality credits outpaced the higher quality names as investor risk appetite improved. Within the Index, Aa rated credits tightened 14 bps while Baa rated credits tightened 89 bps. Financials benefitted from the announcement that 10 firms would be repaying their TARP funding. This sector tightened 17 bps on the week.

Taxable Market Spreads (OAS)

1/2/2009-6/12/2009; Source: Barclays Capital



- Corporate new issuance slowed as Treasury rates increased for much of the week. With the 10-year briefly touching above 4.00%, issuers desire to borrow money was restrained. According to Bloomberg, investment-grade new issuance was $16.2 billion for the week, roughly half of the level from the prior week. Lower-rated credit issuance continued to be met with strong demand last week. Anadarko Petroleum sold $900 million of bonds within 3 different maturities that were well oversubscribed. Its largest issue was a $325mm, 30-year priced at +335 to the long bond benchmark Treasury.
- Agencies debt continued to grind tighter with spreads in another 6 bps to end the week at +41 OAS in the Barclays Capital U.S. Aggregate Agencies Index.
- MBS was a different story, spreads widened 7 bps as this market experienced a recent shift in sentiment with metric valuations such as duration and convexity reasserting itself relative to the bid from Fed and Treasury purchase programs. Current MBS coupon moved to 6 month highs Wednesday, but ended the week a bit stronger. The FHLMC survey for 30-year fixed mortgage rates ended the week 30 bps higher to 5.59%.