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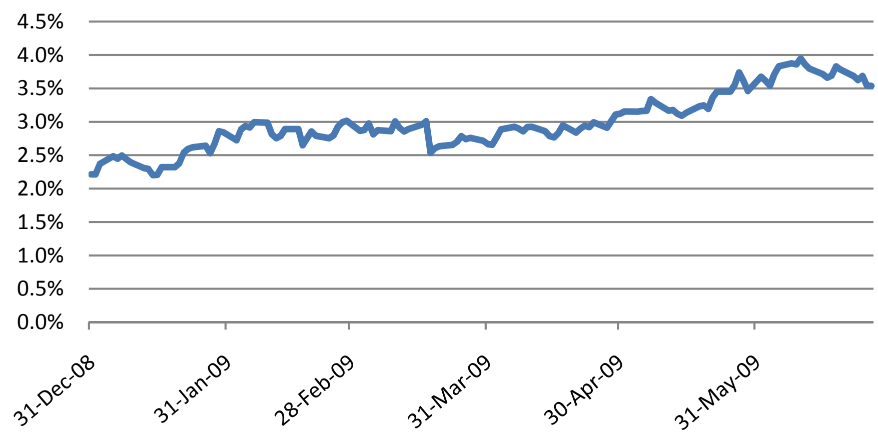
Bond Market Weekly

Week of June 29, 2009 | Municipal and Corporate Review

Market Overview

10-Year US Treasury Yield

12/31/2008-6/26/2009; Source: Bloomberg



- Treasuries have found a solid footing. Last week the benchmark 10-year Treasury note shrugged off huge supply and a strong durable goods orders report to finish the week 28 bps lower in yield at 3.50%. Strength was observed across the yield curve; however, long maturities won the week with yields flattening 17 bps to +240 from 2- to 10-year spread, while 2- to 30-year spread fell 10 bps to +320.
- The tiring of the "green shoots" theme pushed TIPS to underperform nominal Treasuries, significantly adjusting the breakeven inflation rate. The current 5-year horizon breakeven measure plummeted 32 bps to 1.25%, 61 bps or 33% lower than the June 10th close. The 5-year, 5-year forward horizon dropped 13 bps to 2.31%, after the recent peak of 2.60% in late May.
- The June FOMC statement turned out to be largely a non-event for the market as minor adjustments were made without additions to the stimulus exit strategy. This briefly weakened the Treasury market but was quickly forgotten as the rally resumed. The FOMC remains focused on deflation, holding rates steady indefinitely and not planning an increase in mortgage or Treasury purchases.
- Economic data was mixed. Pointing to stabilization in capital spending, durable goods orders rose 1.1% ex. transportation in May while the closely watched nondefense ex aircraft measure surged 4.8%. Initial and continuing jobless claims reversed their turned for the better trend rising to 627,000 and 6,738,000, respectively.
- The jobless claim retracement of the recent improvement along with a scaled down expectation of payroll losses in May could be setting the markets up for an easy disappointment this week. Friday's report consensus estimates June's nonfarm payroll change at -350,000. Recall May's estimate of -520,000 which was initially reported at -345,000, the bar is set considerably lower this month.

Tax Exempt Markets

- Municipal bonds rallied on the back of Treasuries with 10-year yields falling 6 bps to 3.39%.
- Investor demand remained strong despite over $8 billion in new deals last week. New issues did well, according to Bank of America, spreads between AAA and A rated bonds were 184 bps, their highest level since April 6th. Both Puerto Rico and Virgin Islands sold bonds last week with low BBB ratings and yields approaching 7% on the long end of the curve.

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Tax Exempt Markets

- This week will see a small new issue calendar of roughly $3 billion due to the holiday shortened week. The Bond Buyer 30-Day Visible Supply Index stands at only $10.35 billion. Deals expected this week include $440 million bonds for Miami-Dade County for refunding and the new Marlins stadium, $237 million for the John Wayne Airport in Orange County, California and $768 million in Washington State GOs.
- Tax exempt mutual funds continue to see significant inflows with $1 billion deposited for the week ending June 17th, according to Investment Company Institute.
- The state of New Jersey finally passed a budget, largely along party lines. Taxes were increased on cigarettes, liquor and upper income earners while spending was cut across a wide swath of government agencies. According to Assemblyman Declan O' Scanlon, many of the revenue increases were a one time fix and unless the economy rebounds significantly the state will face a $9.2 billion deficit in 2011.
- We purchased a number of new issues this week including Kentucky State Property Corp, Utah Housing, and New York State Housing. In addition, we were active in the secondary market with most purchases inside the 10-year maturities utilizing both callable and non-callable structures.

Taxable Markets

- It was a relatively quiet week in the corporate markets. Spreads were 4 bps wider in the Barclays Capital U.S. Corporate Investment Grade Index ending the week at +311 OAS. Year-to-date corporate spreads tightened 244 bps with a total return of 8.12% compared to a -4.25% total return for the Treasury Index.
- The highlight of corporate new issuance was a $4.25 billion deal by Merck (AA3/AA-) to help finance its purchase of Schering-Plough. It came in 4 parts, expressed in spreads relative to comparable Treasuries: a 2-year at +75 bps, a 6-year at +137.5 bps, a 10-year at +140 bps and a 30-year at +145 bps. Campbell Soup (A2/A) came to market with a 5-year issue which was quickly priced and sold at +87.5 bps. The $300 million deal sold within 10 minutes and was 6 times oversubscribed.
- As we close the first half of 2009, it should be noted that investment-grade issuance was $469 billion as lower absolute yields and recent spread tightening have attracted issuers some of which were first time borrowers like Microsoft
- Agencies and MBS markets received supportive news during the week as the Fed left its securities purchase programs intact for these asset classes. The Fed has capacity to buy up to another $104 billion of agency debt and another $650 billion of agency-backed MBS by year-end. For the week, agencies were 1 bp tighter to +43 OAS and MBS was 1 bp wider to +36 OAS in each respective Barclays Capital Indices. Year-to-date total returns have been 2.97% for MBS and -0.23% for agencies.