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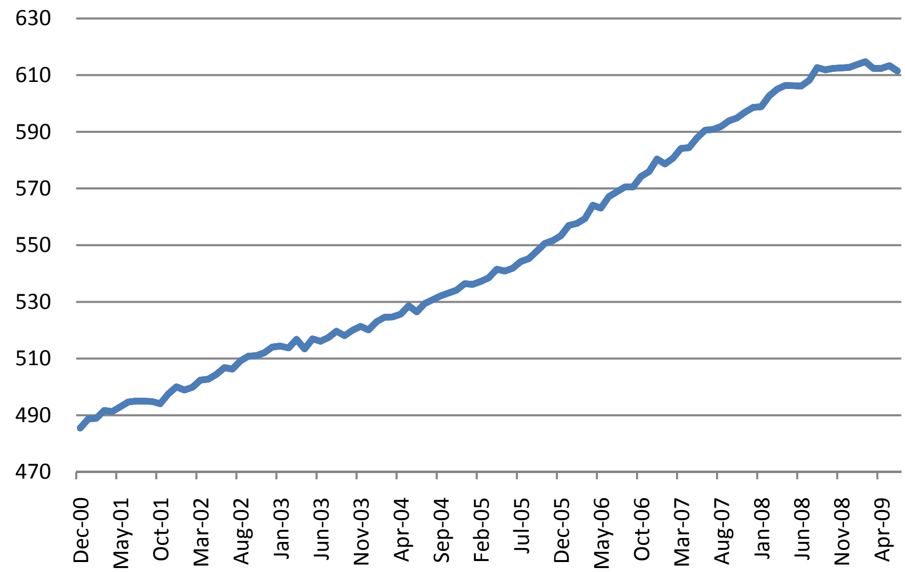
Bond Market Weekly

Week of July 6, 2009 | Municipal and Corporate Review

Market Overview

Average Weekly Earnings

12/31/2000-6/30/2009; Source: Bloomberg L.P.



- Benchmark 10-year US Treasuries posted their 4th consecutive week of positive price performance as yields fell by 5 bps to close at 3.50%. The holiday shorten week included continued momentum from impressive supply digestion and boosts from a surprising relapse in consumer confidence and the employment picture. Treasuries found solid support in the combination of a surprising relapse in consumer confidence and a worsening employment picture. Fed chatter of a prolonged, "near-zero" target Funds Rate drove the shortest maturities to outperformance and led to a steepening of the yield curve. The spread from 2- to 10-years rose 8 bps to +251 while 2- to 30-year maturities jumped 11 bps to +333.
- A strengthening bid for short term TIPS pushed the current 5-year horizon breakeven inflation estimate higher by 6 bps to 1.31%. However, the 5-year, 5-years forward measure shaved another 13 bps to 2.17%. Convergence of these two measures points to a near miss on deflation but a prolonged period of price containment as well.
- ISM Manufacturing and the Nonfarm Payroll Survey were the most highly anticipated economic releases headed into the week, but a surprising relapse in Consumer Confidence also had a forceful impact. June confidence fell to 49.3, down from 54.8 in May, as consumers appear to be refocusing on rising foreclosures, higher unemployment and slowing wages rather than the spring gains in the equity markets. This caught the markets by surprise given the 55.3 expected reading while casting a negative tone across equities and providing a tail wind for Treasuries.
- June's ISM Manufacturing survey was released at 44.9 and confirmed the "less bad" tone the manufacturing sector has been showing of late. The market's reaction was muted, however, as an improvement to truly healthy readings (at least upper 40s) seems needed for a positive catalyst at this point.
- The real sentiment downer came via the employment data on Thursday. May's improvement to just 345,000 job losses gave way to a spike back to 467,000 jobs being shed again in June. The unemployment rate did report below expectations at 9.5% but still above May's reading. In addition, more focus is being paid to the earnings data that accompany such reports. Hourly earnings were unchanged over the month and up only 2.7% year over year. Meanwhile, weekly hours worked are down to 33. Prominent economists worry that this combination is seriously risking deflation.

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Tax Exempt Markets

- Municipal bonds rallied on the back of Treasuries with 10-year yields falling 4 bps to 3.35% last week. A light new issue calendar and July reinvestment aided in the positive tone.
- The Municipal Securities Rulemaking Board (MSRB) rolled out its Electronic Municipal Market Access system (EMMA) last week. This electronic repository centralizes the formerly fragmented structure of multiple repositories for identical disclosure. MSRB'S EMMA will enable all investors to access the same information free of cost over the internet at emma.msrb.org.
- This week will see a small new issue calendar of roughly $3.3 billion. The Bond Buyer 30-Day Visible Supply Index stands at only $10.35 billion. Deals expected this week include Pennsylvania Turnpike Commission and Anne Arundel County, MD.
- California announced Friday that it will be issuing IOUs to vendors and other third parties (not employees or bond holders). The IOUs will bear interest at a rate of 3.75%. Both Bank of America and Wells Fargo have announced they will be accepting them from their customers, but only though July 10. S&P affirmed the State of California's rating at 'A' with a negative outlook on Wednesday. For more about California, please see our State of California credit update and advisor talking points, available upon request.
- S&P affirmed Assured Guaranty's 'AAA' financial strength rating last Thursday but revised their outlook to negative on worries about the competitive dynamics of the industry. WSC continues to evaluate credits based on their underlying ratings.
- We purchased bonds from a New Mexico Mortgage Financial Authority deal last week. The bonds are backed by a pool of mortgages insured by Ginnie Mae, Fannie Mae and Freddie Mac which earned the issue a 'AAA' from S&P. The bonds were roughly 80 bps cheaper compared to consensus AAA scale on the 5 year portion of the deal.

Taxable Markets

- It was a quiet week in the corporate market as investors prepared for quarter-end and the July 4th holiday weekend. Spreads in the Barclays Capital U.S. Corporate Investment Grade Index were 6 bps tighter to +311 OAS. Industrial credits continued to grind tighter by 3bps to +244 OAS. Bank and finance spreads on the run issues were wider on the week; however, subordinated bank paper performed as the relationship between them and senior paper narrowed significantly. Financial spreads were 13 bps tighter as a group to +411 OAS.
- The highlight of corporate new issuance was a $4.5 billion deal brought by Oracle (A2/A) to partially fund the acquisition of Sun Microsystems. The deal came in 3 parts, expressed in spreads to comparable treasuries: a 5-year at +120bps, a 10-yr at +155 bps, and a 30-year at +185bps. The deal was upsized, significantly oversubscribed and performed well in the secondary market, which has been the pattern for new issue corporate bonds over the past couple of months.
- MBS underperformed for the first time in a while this week as spreads widened marginally. The Fed purchased less MBS this week than many investors had anticipated. Agencies were marginally tighter on the week. The Refi index continues to plummet as higher mortgage rates decrease the ability of homeowners to re-finance their mortgages. Relative to their respective Barclays Capital indices, agencies were 2 bps tighter to +41 OAS and MBS were 9 bps wider to +45 OAS for the week.