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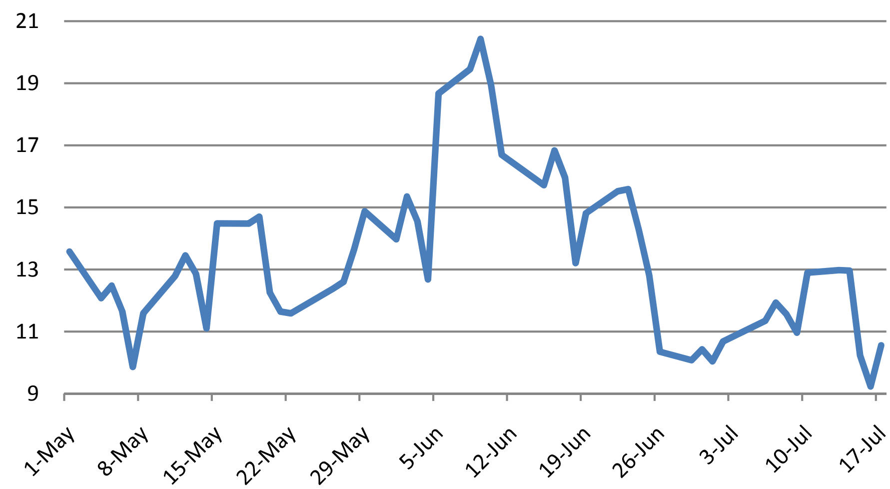
Bond Market Weekly

Week of July 20, 2009 | Municipal and Corporate Review

Market Overview

Bond Buyer 30 Day Visible Supply

5/1/2009-7/17/2009; Source: Bloomberg L.P.



- The benchmark 10-year Treasury note rose 34 bps in yield to 3.65% as the economic tone shifted back to optimism last week. Better than expected economic data and corporate earnings pushed concerns surrounding a potential CIT Group bankruptcy aside as the yield curve steepened by 24 bps from 2- to 10-years (+264) and by 21 bps from 2- to 30-years.
- The sharp rise in nominal Treasury yields shot inflation breakevens higher across all TIPS maturities. The current 5-year horizon breakeven rose 31 bps to 1.41% while the longer term 5-year, 5-forward period jumped 36 bps to 2.47%.
- Inflation of course is the media and bond market's focus of late. Both producer and consumer prices failed to ebb significantly during June which represented core impediments to further Treasury gains over the week. Core producer prices jumped to a +3.3% Year-over-year trend while CPI fell to a +1.7% (from +1.8% May) year-over-year pace. Spikes in energy and recreation costs held back a bigger move toward disinflation.
- Retail sales offered reason for hope in a June due to a spike in auto purchases (headline +0.6% vs. +0.4% May) however core readings (+0.3% vs. +0.4% May) did not exhibit signs of a significant consumer rebound outside the iPhone-led electronics component.
- Fed minutes from the June meeting went quietly and without any major surprise. While the decision was made to hold mortgage and Treasury purchases at previously targeted levels, the minutes show a potential for further upsizing should a relapse in sentiment and liquidity occur.
- Fed Governors and Presidents also updated their forecasts for GDP, Unemployment and PCE Price Indices. Reflecting an improving second half sentiment, 2009 GDP estimates moved to a range of -1.5% to -1.0% from -2% to -1.3% in April. 2010 and 2011 estimates moved to an aggressive +2.1% to +3.3% and +3.8% to +4.6%, respectively. Unemployment is expected top out around 10% and fall to below 8.8% in 2011. The PCE Price Index expectation jumped significantly for 2009 to a range of 1.0% to 1.4% - some 40 bps above April expectations.

Tax Exempt Markets

- Municipals significantly outperformed Treasuries last week with 10-year yields actually falling one basis point to 3.20%; however, 30-year bond yields rose two basis points to 5.04%.

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Tax Exempt Markets

- Upcoming municipal supply remains rather light with the Bond Buyer 30-day Visible Supply Index at $10.55 billion, considerably lower than the more than $20 billion in forward supply seen at the beginning of June. This shift somewhat tempered the desire to sell in the face of a weaker Treasury market.
- Retail inflows continue to be extremely strong with just over $1 billion in net assets added to tax exempt bond funds during the week ending July 8th, according to ICI.
- On the economic front, fifteen states have now reported unemployment rates above 10% in June with Michigan topping the list at 15%. Georgia, Nevada, Rhode Island, South Carolina, Florida, and Delaware posted their highest jobless rates since 1976. According to Steven Cochrane of Moody's Investors Services the unemployment rate will not begin to level off until mid-2010. If this is the case, unemployment will continue to put pressure on state budgets, especially those with a high reliance on personal income taxes.
- In ratings news, California general obligation bonds were cut by Moody's to Baa1 in a widely anticipated move. Interestingly, California's GOs have rallied significantly since the end of June and their BABs have rallied between five and seven points just over the last few weeks. On a more positive note, the state of Florida's Aa1 rating was taken off negative watch by Moody's last week after the passage of a budget which closed their deficit by raising revenue and cutting expenses.
- We were highly active in both the primary and secondary markets this past week with new issues being purchased for Iowa State Special Obligations and also the Georgia Tech University Foundation. Most of our buying was inside of five years.

Taxable Markets

- Corporate Spreads were tighter during the course of the last week. The Barclays U.S. Corporate Investment Grade Index closed 8 bps tighter on the week at +297 OAS. Earnings season continues to bring positive surprises as Goldman Sachs, IBM, and JP Morgan all reported earnings that were much better than expected. Financial Institutions were 6 bps tighter on the week due to the strength in second quarter results.
- The new issue calendar remained quiet with Goldman Sachs 3-year being the only new deal that came of any significance. The deal performed very well in the secondary market. There continues to be strong demand for quality corporate credits in the short end of the curve.
- There was much attention paid during the week to the issues surrounding CIT Group. Although CIT had received approval as a bank holding company, they had not been approved for the TLGP Program. Due to the rapidly rising possibility of a bankruptcy filing, CIT was forced to seek out sources for a potential out of court restructuring. The situation remains in considerable flux and is of particular importance due to the company's role as a significant provider of small business lending.
- Agencies showed a 2 bps spread improvement for the week with the Barclays U.S. Aggregate Agencies Index ending at +37 OAS. They were tighter to swaps but wider to US Treasuries.
- The Barclays U.S. MBS Index strengthened 6 Bps to +33 OAS. Callable agencies and MBS suffered from increased volatility and widened nominally during the course of the week, but outperformed on an option adjusted basis.