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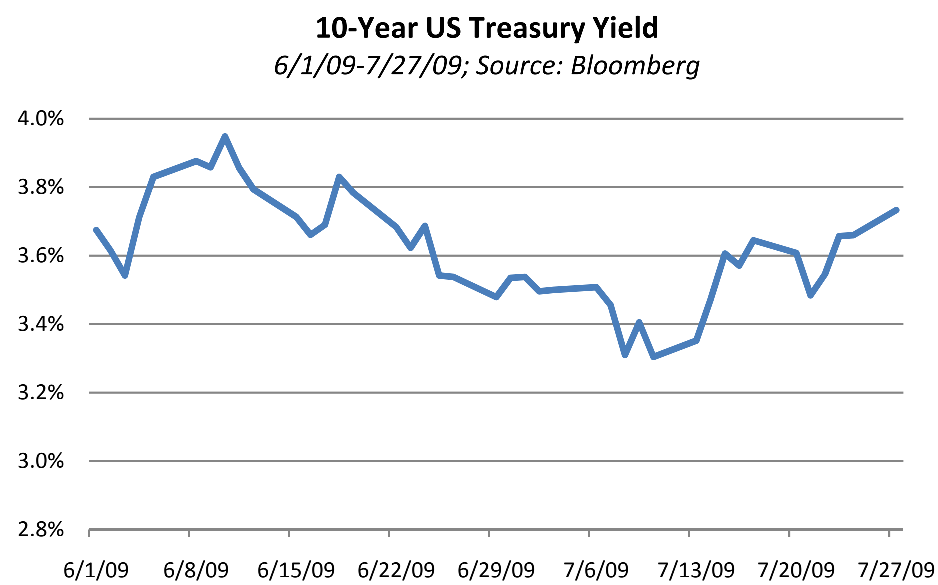
Bond Market Weekly

Week of July 27, 2009 | Municipal and Corporate Review

Market Overview

- For lack of a better analogy, the bond markets took a well deserved summer vacation this past week. New issues were few, trading volumes reported in most sectors were light, and price action was much more muted, especially intra-day, than has been the case recently. Treasury 2- and 10-year note yields finished the week within 1 bp of where they began, as some strength early in the week was met with an equal amount of selling, owing in no small part to the Treasury's announcement of another $115 billion of notes to be sold this coming week.



- The action was clearly in the equity markets, as buying started early in the week, strengthened mid-week following very solid earnings announcements from the likes of Apple, McDonald's, 3M and several large banks, following through Friday even after somewhat disappointing results from Microsoft and American Express. As discussed further below, spreads on risk assets shared in the enthusiasm of the stock market which ended the week higher by approximately 4%.
- Part of the reason for the bond market's inactivity was a dearth of economic data; only a stronger than expected reading on Leading Economic Indicators seemed to move prices at all, as weekly jobless claims and University of Michigan Consumer Confidence numbers were in line with expectations. Next week's calendar doesn't offer much more hope for action, only new home sales and durable goods orders appear to have chance of propelling the market, and participants will have to wait for the employment report in two weeks for the next real read on the economy and its nascent recovery.
- Politics continued to be center stage in the markets. Treasury Secretary Geithner, Fed Chairman Bernanke and FDIC Chairman Bair all took their turns before various Congressional Committees, though with only muted reaction. Riveting to the markets was the ongoing debate over health care reform, this was exhibited best by the rally in stocks that immediately followed Senator Reid's announcement that the Senate would not take up the issue in earnest until at least September.

Tax Exempt Markets

- Municipal bonds were relatively unchanged last week with yields on 10-year bonds falling 1 bp to 3.19%, despite rising yields on U.S. Treasuries.
- Demand continues to remain strong from retail investors despite continued low yields. Tax exempt mutual fund inflows of $1.46 billion for the week ending July 15th, according to Investment Company Institute.

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Tax Exempt Markets

- Forward supply continues to be manageable with the Bond Buyer 30-Day Visible Supply Index at $10.9 billion. The continued use of the Build America Bonds (BABs) structure has limited the supply of tax exempt bonds in the market, further exacerbating the supply/demand imbalance.
- This week will see new issues from the Houston Airport for $420 million, the City of Philadelphia for $240 million and $331 million for the Southern California Metro Water District.
- As of Friday evening it appeared the Senate was close to balancing and approving their budget which then goes to the House. Hopefully, this will bring an end to their fiscal issues. However, many provisions within the budget could potentially become problematic in the next few years.
- Moody's released their upgrade to downgrade ratio for the 2Q09 which was 0.7:1, respectively, which further highlights the continued weak economic environment around the country. The largest downgrades included the State of Ohio, Cook County, Illinois and the State of California.
- We were active last week with most of our purchasing inside of five years. We bought new issues for Las Vegas Valley Water and Conroe, Texas School District as well as Houston, Texas GOs, Tennessee State GOs and Virginia Transportation bonds in the secondary market.

Taxable Markets

- The corporate market continued its rally on the positive tone of 2Q09 earnings announcements. Within the S&P 500, 190 companies reported late last week that 57% beat expectations, 25% were below expectations, and 18% were in-line with expectations sentiment in the equity and corporate bond markets which gained a boost. Investment grade spreads tightened 19 bps to +272 OAS in the Barclays U.S. Corporate Investment Grade Index.
- According to Bloomberg, new issuance picked up considerably as investment-grade companies sold $20.3 billion of debt last week up from $9.6 billion. Issuers that dominated the flow were Boeing, Bank of America, and Citigroup. Boeing (A2/A+) sold $1.95 billion between 5.5-year, 10.5-year, and 30.5-year issues at +110, +130, and +145, to respective Treasuries. Bank of America (A2/A) did a $2.5 billion 7-year deal at +330 and Citigroup (A3/A) did a 30-year deal at +380.
- The MBS market inched 3 bps tighter overall on the week. 15-year collateral showed strength on stronger CMO deal demand. Also, the FHFA Housing Price Index released data for May which showed a seasonally adjusted 0.9% MoM increase and a 5.6% YoY decline, the smallest decline in 10 months of data. The Fed also announced it purchased $21.1 billion of agency MBS for the week bringing the cumulative total to $681.9 billion. The Barclays U.S. MBS Index ended the week at +28 OAS.
- Agencies ended the week 2 bps tighter to finish at +36 OAS led by strength in the 5-year part of the curve. The highlight of the week was a new $4 billion 3-year issuance by the FHLB.