



## Bond Market Weekly

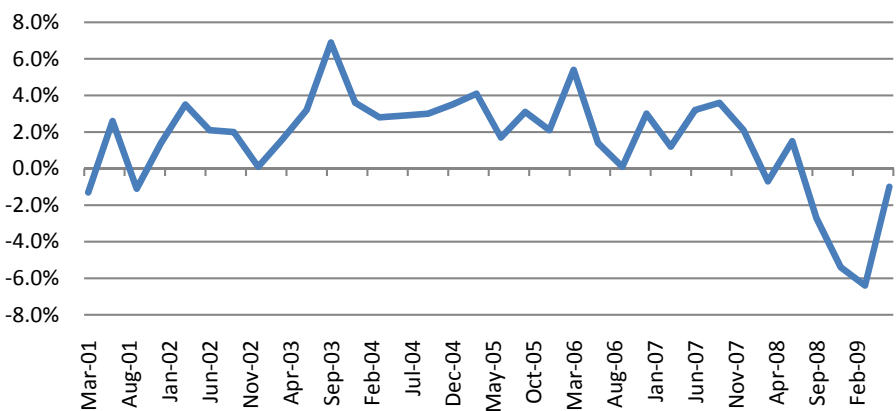
Week of August 3, 2009 | Municipal and Corporate Review

Page 1 of 2

### Market Overview

- ❑ Poorly received 2- and 5-year Treasury auctions set a soft tone for trading early last week; however, Thursday's solid demand for the 7-year Treasury auction reversed the market's course. The benchmark 10-year managed to rally a solid 16 bps to 3.50% Friday afternoon, after early week rumblings of a Chinese auction boycott.
- ❑ Anticipation of a diminishing period of emergency level short rates may be pushing buyers toward a flatter yield curve and reducing concerns over the US growth picture; however, advancing headwinds for inflation. The spread from 2- to 10-years narrowed by 27 bps to +239 while 2- to 30-year spreads slipped 35 bps to +319.
- ❑ Along with better performance in longer nominal Treasuries, the breakeven inflation measure trended lower over the week. While the current 5-year measure dropped just 1 bp to 1.39%, the longer-term 5-year, 5-year forward period fell 8 bps to 2.46%. At 200 bps higher than the early year level for the latter, the picture of an inflation sentiment shift is clear.
- ❑ Advanced estimates for Q2 GDP released Friday showed a better than expected drop of 1%. However, revisions to -6.4% from -5.5% in Q1 data and a poor mix of -1.2% growth (-0.5% exp.) in personal consumptions cast a pall over the data. A strong rebound in personal consumption in Q1 (-3.1% Q4 to 0.6% Q1) from government payments failed to sustain itself. This data provides little support for the notion that a consumer recovery is near.
- ❑ Wednesday's Fed Beige Book reported a moderating contraction across most districts. Concerns from the post Lehman collapse of economic activity and markets has abated. Now that most are in agreement that depression risk has been removed, markets must decide if rebounded valuations are aligned with the likely pace forward.

US GDP QoQ (Seasonally Adjusted)  
3/31/2001-6/30/2009; Source: Bloomberg



### Tax Exempt Markets

- ❑ Municipal bonds were slightly better on the week with 10-year yields falling 1 bp to 3.18% on the back of strong Treasuries and healthy demand from retail.
- ❑ Mutual fund inflows continue at a torrential pace with \$1.7 billion of inflows into tax exempt mutual funds for the week ending July 22<sup>nd</sup>. Year-to-date inflows have now reached \$33.7 billion, according to the Investment Company Institute. Combined with the increasing issuance of Build America Bonds, these inflows have created a strong technical underpinning to the municipal market.



## Bond Market Weekly

Week of August 3, 2009 | Municipal and Corporate Review

Page 2 of 2

### Tax Exempt Markets

- ❑ Largely due to the abysmally low yields of money market funds, tax exempt money market fund assets continue to drop with roughly \$45 billion currently in funds (down from over \$520 billion last fall).
- ❑ New issue supply is still moderate with the Bond Buyer 30-Day Visible Supply Index at only \$10.97 billion.
- ❑ New issues coming this week include \$485 million for the state of Maryland, \$250 million for the MARTA in Atlanta, and \$825 million for the Metro DC Airport Authority.
- ❑ Much of our buying was on the front end of the curve in short highly liquid names such as the states of Tennessee and Minnesota as well as GOs for Houston, Texas and Phoenix, Arizona. We also purchased a new deal for the Houston, Texas Airport, rated Aa3/AA-.

### Taxable Markets

- ❑ Last week's corporate activity could be summed up as a demand outstripping supply. New issuance was relatively light with most investment-grade activity occurring last Monday and Friday. Monday's activity was highlighted with Northrop Grumman (Baa2/BBB) pricing a 5-year at +115 and a 10-year at +135 for a total of \$750 million. Friday's activity occurred with well oversubscribed deals from Colgate-Palmolive (Aa3/AA-) and Safeway (Baa2/BBB). Colgate priced their \$300 million 6-year at +67 that was sold out within 10 minutes and Safeway priced their \$500 million 10-year at +158 in a very short period also.
- ❑ Corporate spreads continued tightening in part, because of the dearth of supply and increased demand. The Barclays U.S. Corporate investment Grade Index ended July at +247 OAS, which was tighter by 25 bps, 59 bps, and 308 bps for the week, month, and year-to-date, respectively. The total return for the Index year-to-date has been 12.99%.
- ❑ With about 2/3<sup>rd</sup> of the S&P 500 companies having reported Q2 earnings, 74% have beat expectations while 17% have missed, leading to optimism in the corporate sector.
- ❑ Agencies and MBS spreads tightened for the week. Agency activity seemed to rally on the strength of the corporate market as sector news was very light. The Barclays U.S. Aggregate Agencies Index rallied 4 bps to end at +32 OAS which is 61 bps tighter year-to-date, 9 bps tighter for the month of July, and 4 bps tighter for the week. MBS ended 5 bps tighter for the week putting the Barclays U.S. MBS Index at +23 OAS. This Index was 13 bps better for the month of July and improved 122 bps year-to-date through 7/31/09.