WASMER, SCHROEDER & COMPANY, INC.
Investment Advisors
600 5th Avenue South, Suite 210
Naples, Florida 34102
wasmerschroeder.com
T 239.263.6877
F 239.263.8146

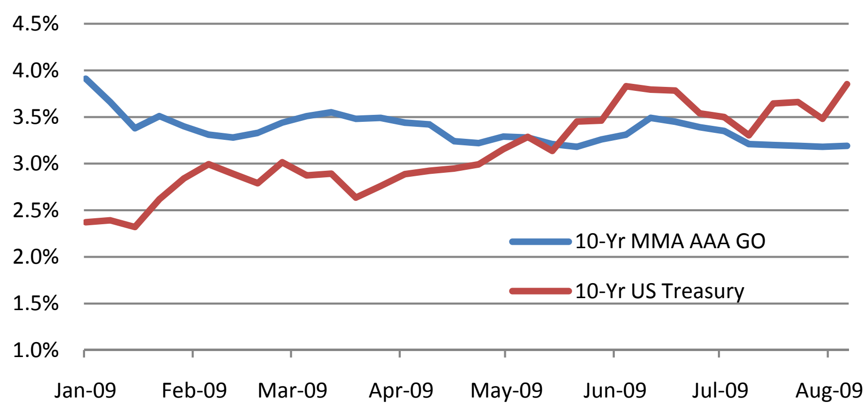
Bond Market Weekly

Week of August 10, 2009 | Municipal and Corporate Review

Market Overview

10-Year MMA AAA GO vs. 10-Year US Treasury

12/31/08-8/7/09; Source: Bloomberg



- The benchmark 10-year Treasury note spiked 38 bps in yield to 3.86% last week. Better than expected economic data and equity market sentiment moved firmly into recovery territory.
- With short rates anchored by emergency Fed Funds levels (-0.25%), the yield curve steepened 29 bps from 2-to 10-years (+256) and 14 bps from 2- to 30-years (+332).
- TIPS fared better than nominal Treasuries on the recovery theme and pushed the current 5-year breakeven inflation up 15 bps to 1.50% while the longer-term 5-year, 5-year forward measured jumped 35 bps to 2.73%. The latter represents the highest weekly close since September 2008 and pre-Lehman's collapse.
- During the week, economic data held a consistent recent theme of a gloomy consumer spending outlook but markedly improved production beyond. ISM Manufacturing started the week with strong July 48.9 reading which is near the breakeven 50 level consistent with moderate growth. Better than expected auto sales and factory orders further cemented sentiment which rocketed higher Friday with July employment shedding 247,000 jobs and the unemployment rate dipping to 9.4%
- Bond bulls could find solace in some data, however, as the PCE Core Price Index took a surprise dip to 1.5% year-over-year in June.
- Given the recent performance of risky assets and latest economic data, the Fed appears back in play as a significant driver of further market movement. Conveniently, next week holds the next FOMC meeting where new action is less likely but statement language becomes critical. The impression of a flat-footed Fed in the face of euphoric risk markets is a rising risk for Treasury yields to break out above recent ranges.

Tax Exempt Markets

- Municipal bonds were slightly weaker for the week. 10-year yields rose 1 bp to 3.19%, although, on a relative basis municipals significantly outperformed U.S. Treasuries.
- Retail demand continued unabated with the 30th straight week of inflows into tax exempt mutual funds with $1.3 billion for the week ending August 5th, according to the AMG Data. With the likelihood of Federal tax rates rising and many state tax rates already rising, the taxable equivalent yields of municipal bonds continue to look enticing to many investors.

WASMER, SCHROEDER & COMPANY, INC.
Investment Advisors
600 5th Avenue South, Suite 210
Naples, Florida 34102
wasmerschroeder.com
T 239.263.6877
F 239.263.8146

Tax Exempt Markets

- Forward supply remains tame with the Bond Buyer 30-Day Visible Supply Index at a meager $11.7 billion, well below this year's $13.2 billion average.
- New deals this week include $490 million in Houston, Texas GOs, $305 million for the Cleveland Clinic in Ohio and $770 million for the Bay Area Toll Authority in California.
- Both MBIA and Ambac reported earnings this week with Ambac's results weaker than expected. Interestingly, MBIA has identified over $1 billion worth of ineligible mortgages in deals they wrapped and are trying to negotiate and/or litigate the swapping of these for conforming mortgages. If this is successful, it could significantly reduce MBIA's payments on the wrapped structured securities.
- We were busy in the secondary market last week, focusing on 3-to 10-year bonds mostly in the AA and AAA ratings categories.

Taxable Markets

- $21.7 billion of investment-grade corporate debt came to market compared to $7.8 billion the prior week. The supply was met with very strong demand. Four different companies came with issues of $2.0 billion or more. BP Capital (Aa1/AA) priced a 2- and 5-year at +40 and +75, respectively. Citigroup (A3/A) priced a 5-year at +380. Dow Chemical (Baa3/BBB-) did a 3 part deal: a 2-year at +225 to LIBOR floater, a 3-year at +312.5, and a 5.5-year at +325. GE Capital (Aa2/AA+) did a 10-year at +235. With the exception of BP, each of these large issues tightened considerably by the end of the week.
- Overall corporate spreads were better on the week as the Barclays U.S. Corporate Grade Index ended 10 bps tighter to +237 OAS. The Financial sector got a boost on the successful underwritings of Citigroup and GE Capital which contributed to a 17 bps tightening in the sector.
- In agencies, Q2 earnings were reported by Freddie Mac (gain) and Fannie Mae (loss). Fannie also reported a need for further capital injection of $10.7 billion. 3-year agencies underperformed Treasuries mostly from a $4.5 billion Freddie reference note priced. Longer dated paper outperformed Treasuries leading to a 1 bp widening in the overall Barclays U.S. Aggregate Agencies Index to +37 OAS.
- The MBS market sold off a bit as some investors concluded this market may be too rich. Current coupon collateral is around -15 OAS which prompted some selling. The Barclays U.S. MBS Index ended the week 3 bps wider at +26 OAS.