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Bond Market Weekly

Week of September 8, 2009 | Municipal and Corporate Review

Market Overview

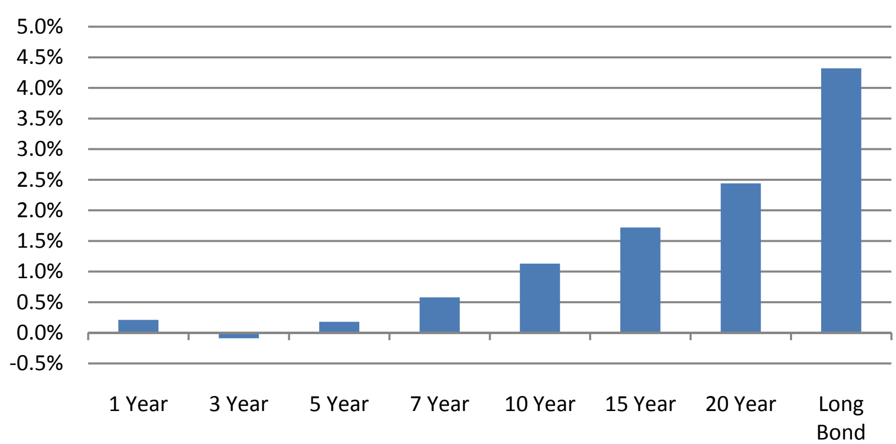
- The benchmark 10-year note dropped 2 bps in yield to 3.43% last week as positive momentum carried over from the week prior. Late week positioning for the coming round of supply in 3-, 10- and 30-year notes (set for this week), however, erased 14 bps in gain for the 10-year on Thursday and Friday.
- The yield curve shifted back steeper on the week to +250, up 7 bps from 2- to 10-years while the 2- to 30-year spread popped 15 bps higher to +218. Strength in shorter duration maturities netted a move back to 2-year yields at 0.93% not seen since early July.
- TIPS have seen significant strength over the last few trading sessions, outperforming nominal Treasuries and leading breakeven inflation measures higher. The current 5-year horizon jumped 9 bps to 1.3% while the 5-year, 5-year forward inched up 1 bp to 2.47%.
- A busy week for economic data had a muted impact on the bond market as positive early week data on growth (Chicago PMI 50 vs. 48 exp, ISM Manufacturing 52.9 vs. 50.5 exp.) shadowed a move to lower yields while Friday's disappointing employment data (Unemployment 9.7% vs. 9.5% exp.) preceded an 8 bps jump in yield.
- Having recovered a significant portion of a spring sell-off, the Treasury market is now positioned at lower yields, conceding near-term growth led by the inventory restocking phase of the downturn, but skeptical on a return of end consumer demand and expecting further ebb in core inflation. Current ranges thus appear in place until conviction is found in the next phase of this cycle.

Tax Exempt Markets

- Municipal bonds continued their long march upward in price with 10-year yields falling 6 bps to 3.09% and 30-year bond yields falling an impressive 8 bps to 4.94%.
- To recap last month's performance, the long end of the market rallied significantly (see chart at right) while shorter maturities underperformed, and as exhibited by the 3-year portion of the Index, actually delivered a negative total return.

MTD Total Return

8/1/09-8/31/09; Source: Barclays Capital



- Retail demand remains unabated with flows into mutual funds at $2.3 billion for the week ending August 26th, according to the Investment Company Institute.

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Tax Exempt Markets

- Investor demand coupled with the continued low supply and the increasing use of Build America Bonds (BABs) has continued to put downward pressure on tax exempt yields. The Bond Buyer 30-Day Visible Supply Index stands at a measly $5.7 billion and during August BABs issuance was 31% of total municipal volume.
- This week will see new issues from North Carolina Eastern Muni Power as well as the Ohio Water Authority. Large BABs deals will be sold for the Chicago Board of Education and the University of Texas.
- In positive ratings news, North Carolina Eastern Muni Power was upgraded from BBB+ to A- by Standard & Poor's and their Catawba Project from A- to A. The ratings upgrade was based upon their expected new deal which will terminate their swap agreements and refill their debt service reserve funds with cash instead of a surety bond. This stability will limit the likelihood for rate increases in the future.
- We were involved across the curve last week with purchases from 1- to 15-years, spending upon client needs. In the primary market we purchased bonds for the Maryland Department of Housing, rated Aa2/AA.

Taxable Markets

- Summer doldrums had a grip on the corporate bond market. $6.0 billion of new debt was priced compared to an already slow $8.6 billion the week ended August 28, 2009. Weaker investment-grade issuers took advantage of lower absolute yields to refinance and extend existing debt. Plains All American Pipeline LP (Baa3/BBB-) sold $500 million of an 11-year priced at +245 to Treasuries. Republic Services Inc. (Baa3/BBB) issued $650mm of a 10-year at +220. In higher grade names, US Bank (Aa3/A+) issued a modestly-sized $350 million 3 ½ -year at +85.
- Corporate spreads were relatively flat for the week ending 1 bp better at +232 OAS in the Barclays U.S. Corporate Investment Index. For the month of August, the total return for the Index was 1.83% and 15.06% YTD through August 31, 2009. The Industrial and Financials sectors each matched the improvement seen in the overall Index while Utilities were 5 bps tighter.
- MBS showed a slight improvement last week after 2 prior weeks of widening. The Barclays U.S. MBS Index ended the week at +29 OAS, a 3 bps improvement. The Fed bought $25.7 billion of MBS outright last week bringing the total purchases up to $816 billion of their stated $1.25 trillion target.