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# Bond Market Weekly

## Week of September 14, 2009 | Municipal and Corporate Review



## Market Overview

- The first, shortened week of the back-to-school (and back-from-vacation) season was characterized by a sluggish start and, ultimately, higher prices across virtually all fixed income sectors. Fears of large auctions of Government Bonds, which led to slightly higher yields through mid-week, were quickly brushed aside as each auction seemingly went better than the one before it. The benchmark 10-year note, despite being reopened during the auction process, dropped another 10 bps in yield to close the week at 3.34%. Other maturities followed suit, although the Treasury yield curve did flatten slightly.
- Breakeven inflation measures were virtually unchanged in the long end, but did increase in shorter-dated maturities. It appears that some market participants seem to be contemplating 'stagflation' in the near to intermediate term.
- Taking a cue from stock markets, which enjoyed their best week in a couple of months, spreads on risk assets tightened further. New issuance volume was moderate; most newly priced issues followed their secondary counterparts to higher prices and tighter spreads. Corporate issuers included insurers Prudential and MetLife and utilities National Rural and Spain's Iberdrola; heavy Build America Bonds issuance was highlighted by large issues from the University of Texas System and the Chicago Board of Education.
- A dearth of economic data released during the week was highlighted on Tuesday afternoon by the Fed's announcement that consumer credit contracted by a record $21.6 billion during July, far outpacing most economist projections. No doubt this was brought about by a combination of fears of card-issuing financial institutions and retail consumers who are still dealing with the effects of the events of the past 18 months. Interestingly and in some contrast, especially noting last week's employment report, the University of Michigan's Consumer Confidence survey actually increased for the first two weeks of September against this backdrop.
- It appears that, at the moment, there continues to be an imbalance between the demand for most fixed income products and the tradable supply of paper. This phenomenon is being exacerbated by light volumes in most sectors, and notably, seems to now have bled over to the US Treasury market.

## Tax Exempt Markets

- Municipal bonds charged forward for another week despite only four days of trading. 10-year municipal yields fell 4 bps to 3.05% which is the lowest the Municipal Market Advisors (MMA) 10-year has been since 2003 when fears of deflation were rampant. 30-year bond yields fell by an additional 7 bps to close at 4.87%.
- Retail demand was unabated despite falling yields. Tax exempt mutual funds reported inflows of $2.39 billion for the week ending September 2nd, according to the Investment Company Institute. Until retail demand slows or tax exempt supply picks up considerably, it will be difficult for municipal prices to fall without a substantial sell-off in U.S. Treasuries.
- Forward supply has begun to build again to $12.1 billion, according to the Bond Buyer 30-Day Visible Supply Index. However, if Build America Bonds continue to make up a significant portion of this issuance, the actual tax exempt issuance will be quite low. For example, next week State of Utah is issuing over $1 billion in bonds but only $311 million will be tax exempt.

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## Tax Exempt Markets

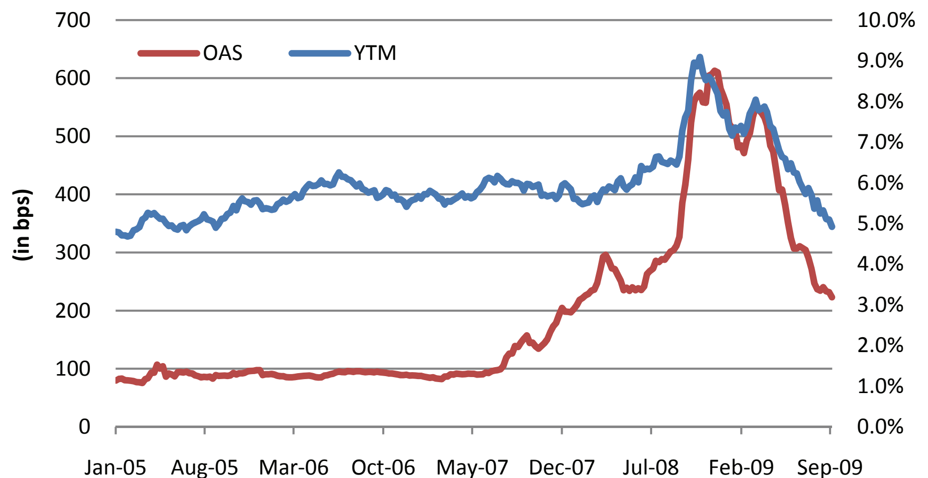
- In ratings news, Standard and Poor's downgraded about $1 billion in tobacco settlement payment bonds to below investment grade on concerns that the Federal government's new tobacco taxes will further dampen demand and the rate of smoking in the United States.
- Despite the lack of supply, we were especially busy in the secondary market in the 7- to 15-year area of the curve. High coupon callable bonds are beginning to show significant value as investors are flocking to non-callable structures because of fears of continued falling rates. Cushion bonds not only provide extra yield to both maturity and call but can be an effective hedge against rising rates.

## Taxable Markets

- Despite a holiday-shortened week, corporate bond issuance increased four-fold from the previous week to $24.1 billion of newly priced investment-grade debt. The headline issuers were Prudential Financial (Baa2/A), CVS Caremark (Baa2/BBB+), and a unit of Met Life (Aa2/AA-). Prudential sold a total of $1.5 billion between a 3-year priced at +225 and a 6-year at +250 to Treasuries. CVS brought $1.5 billion of a 30-year at +187.5. Met Life priced $1 billion of a 3-year at +160. Overall, supply was priced at the tight end of initial indication ranges, a positive sign for demand.

**Corporate Yields and Spreads**

*1/7/2009-9/11/2009; Source: Barclays*




- Corporate spreads tightened to Treasuries on positive macro news of consumer sentiment improvement and a better-than-expected continuing claims number. The Barclays U.S. Corporate Investment Grade Index improved 9 bps for the week to finish at +223 OAS (option-adjusted spread). Financials did particularly well compared to Industrials and Utilities as each tightened 18 bps, 5 bps, and 1 bp, respectively. Other significant news came from the FDIC which stated it will extend the TLGP program beyond the 10/31/09 expiration date on a case-by-case basis. Since June, GE and Citigroup are the only issuers to tap the TLGP program. On an absolute yield basis, investment-grade corporates are now (4.92% YTM) at their lowest weekly levels since June 2005.
- MBS spreads compressed 4 bps to +25 OAS as measured by the Barclays U.S. MBS Index. The FHLMC survey of 30-year fixed rate mortgages showed rates are now at 5.07%. With the holiday-shortened week, the Fed slowed their recent pace of $25 billion of MBS purchases last week with $18.8 billion bringing the total purchases in the program to $836.5 billion.