



MARKET OVERVIEW

- Benchmark 10-year Treasury yields rose 11 bps last week to 3.50%. A Friday Treasury rally prevented the 10-year from having five consecutive days of lower prices.
- The short end of the yield curve drastically outperformed the long end with the 2- to 30-year spread finishing the week 21 bps steeper at +354 bps. The 2- to 10-year spread was 15 bps steeper on the week at +265 bps. These levels are approaching those of late May. Based on the long end supply due next week, we may see a test of some historic levels.
- The stock market was the place to be last week with the Dow Jones Industrial Average rallying more than 250 points while the Standard & Poor's rallied 16 points during the course of the week. Both Indices posted gains every day throughout the week.
- Gold spiked to record prices this week on the back of Indian purchases of the precious metal. Its rise continues to defy skeptics.
- The Fed left the target interest rate unchanged at 0.25% on Wednesday. The key points in the statement were that they expect to leave interest rates low for an extended period of time. However, the Fed did make comments noting the increase in economic activity. While there was little surprise to the statement, it underlines the Fed's committed to supporting the economy with low rates and their willingness to err on the side of caution by being behind the curve when it comes to inflation.
- The economic calendar was very full last week and the data pointed towards an economy that is beginning its recovery. The ISM Manufacturing and Construction Spending numbers were both stronger than expected. In addition, Initial Jobless Claims were lower than expected. However, Friday's employment numbers were somewhat disappointing and there is little doubt that the rate, now at 10.2%, will be the subject of newspaper headlines.
- This week's light economic calendar will focus on the Treasury auctions of 10-year and 30-year bonds. This will be a good test of market demand in light of recent economic statistics.

TAX EXEMPT MARKETS

- Municipal bonds were largely unchanged last week with 10-year bonds flat at 3.17% and 30-year yields rising 1 bp to 5.03%.
- Despite the large amount of issuance last week the market remained steady. The California Education Records Bureau (ERB) deal from the prior week continued to trade up versus new issue levels through Friday.
- Retail demand looks to have picked up again after slowing down in the beginning of October. According to the Investment Company Institute, tax exempt mutual funds saw \$1.31 billion for the week ending October 28th. This was a significant jump from the prior two weeks where inflows were well below the \$1 billion mark.
- Coming up supply still remains reasonably strong with the Bond Buyer 30-Day Visible Supply Index at \$10.6 billion. This week will see large new issues from the State of Connecticut (\$600mm), Hawaii (\$523mm), and Gwinnett County GA School District (\$355mm).
- Issuers only have a few weeks left before markets will begin slowing down for the holidays. Municipal Market Advisors noted this week that while retail demand has been rising in past weeks, as measured by Municipal Securities Rulemaking Board (MSRB) trade volume, dealer volume has stayed relatively flat. We have heard many anecdotal reports that dealers are disinclined to take on large positions or risk before year-end to not jeopardize their profits thus far this year. This lack of demand from broker/dealers may hurt the market if the accounts begin selling for year-end cash needs.
- Standard & Poor's issued a report last week on the third quarter municipal market. The upgrade/downgrade ratio was 14:1, highlighting the resilience of municipal bonds despite the difficult economic environment. Healthcare and housing were the only sectors with more downgrades than upgrades and these tend to traditionally be the riskiest sectors of the market.



TAX EXEMPT MARKETS (CONT.)

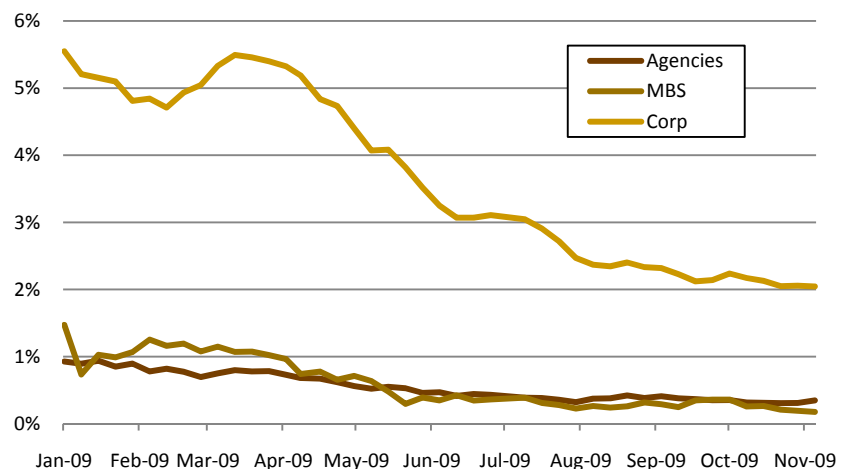
- Much of our buying last week was in the 7- to 12-year portion of the yield curve. We bought a new issue for the Commerce, GA School District as well as added to our position in the new California ERB deal that sold two weeks ago.
- In ratings news, the State of Nevada was cut from AA+ to AA by Fitch due to the degree of economic stress the State is facing in the current environment.
- We were busy last week along the curve and purchased a large chunk of the new California ERB deal for many accounts. This A1/A+ credit is backed by a quarter cent sales tax and the State's GO pledge.

TAXABLE MARKETS

- With October behind us, we see the corporate bond market has had a relatively modest return for the month. The Barclays US Corporate Investment Grade Index returned 0.7% for October and 17.93% YTD. Spreads for last week were up 1 bp to end at +206 OAS (option-adjusted spread) which improved 12 bps for the month and 337 bps YTD.
- Interim reporting on Q309 corporate earnings so far show that, of the first 295 S&P 500 companies announcing earnings, 81% have beat expectations. Technical factors continue to hold corporate spreads tighter. Taxable bond funds posted \$4.9 billion of inflows for the week while equity funds saw outflows of \$1.8 billion. Corporate new issuance was \$15.9 billion last week, a 27% increase from the prior week.
- Last week the Fed completed its \$300 billion Treasury purchase program, unless of course it gets re-opened. During the life of this program from March 18th to October 29th, the 10-year Treasury yield never rose above 4%.
- The Fed continued its pace of MBS purchases with \$18 billion of agency-backed MBS bought outright which brings the program total to \$977.1 billion. The MBS Purchase Application Index decreased 5.2% from the prior week and the FHLMC survey of 30-year fixed mortgages showed an average rate of 5.03%, up 3 bps on the week. MBS spreads were another 2 bps tighter in the Barclays US MBS Index to end at +19 OAS. YTD, the Index recorded a 6.04% total return.
- Agencies spreads were unchanged, ending the week at +31 OAS. Only one benchmark deal was priced: FFCB issued a \$1.5 billion 3-year issue.

Weekly OAS for YTD 2009

Source: Barclays



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