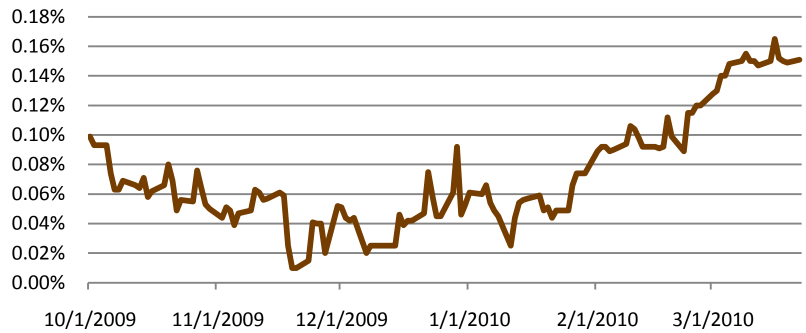
WASMER, SCHROEDER & COMPANY
INVESTMENT ADVISORS

BOND MARKET WEEKLY | WEEK OF MARCH 22, 2010

MARKET OVERVIEW

3-Month Treasury Bill
10/1/2009-3/22/2010; Source: Bloomberg



- Another quiet week for U.S. Treasuries ended with the yield on the benchmark 10-year note dipping 1 bp to 3.69% at Friday's close.
- A decline in short maturities drove the yield curve flatter with 2- to 10-year spreads easing 5 bps to +268 and 2- to 30-year spreads falling 8 bps to +359.
- The FOMC continued to signal an "extended period" of a low Fed funds rate, but tightening is occurring in the short-term funding markets as the Fed revives its Supplemental Financing Program (SFP). This initial effort to drain liquidity from the banking system pushed 3-month bills to 16 bps last week, significantly higher than the recent low of 1 bp in November.
- Inflation breakevens in the TIPS market fell 9 bps to 2.10% over the current 5-year horizon while the longer term 5-year, 5-year forward fell 4 bps to 2.51%. Producer and consumer prices continued to ease in February with the latter dipping to 2.1% year-over-year and 1.3% year-over-year on core goods. The last 4 months have produced 0.0%, 0.1%, -0.1% and 0.1% increases in core prices month-over-month with medical costs the only upside outlier. A continuing trend of those readings could raise great concerns at the Fed, especially with emergency programs such as mortgage purchases coming to an end.
- Beyond the tame inflation data, the improving manufacturing story continued last week with another solid Empire manufacturing survey (22.86), Philly Fed (18.9) and a tick up in capacity utilization (72.7%). The Leading Indicators saw a more modest result with just a 0.1% improvement. Meanwhile, improvement on the housing and jobs front seems to have stalled with the NAHB survey dipping again to a very weak 15 reading. Initial jobless claims remain stuck with a 457k reading while continuing claims edged higher again at 4,579K.

TAX EXEMPT MARKETS

- Municipal bonds were essentially unchanged on the week with a flat 10-year at 3.00% and 30-year bonds falling 1 bp to 4.44%. Despite strong new issue supply, deals were well received with most oversubscribed and few balances in the aftermarket.
- Despite the impending tax season there seems to be no slowdown in mutual fund inflows with the Investment Company Institute reporting $1.22 billion of inflows for the week ending March 10th. Anecdotally, so far this year we have seen few requests for cash from clients and the requests have been smaller than in most years.
- New issue volume this week will be reasonably high with estimates of over $10 billion, about a quarter of which will be taxable. The highlighted deal for the week is the $2 billion Citizens Property Insurance Corporation issue which started selling retail last Friday with yields about 200 bps higher than MMD. We have been long-time fans of this credit and are looking at the new deal as an opportunity to add to our position.
- Moody's announced they will be recalibrating their municipal ratings to the "global" scale. Corporate bonds with similar default characteristics have historically been rated higher than equivalent municipal credits; this action will seek to level the playing field. As a result, most tax backed investment grade municipal credits will see a 1 to 2 notch move upward (NOT an upgrade). Moody's action will allow easier comparison to taxable credits but will diminish the granularity municipal ratings once had.

TAX EXEMPT MARKETS (CONT.)

- Last week at the National Municipal Bond Summit in Miami, Ben Watkins, Director of the Division of Bond Finance for the State of Florida, said Florida will halt Build America Bond sales while they seek more information regarding "offsets" on interest rebates. Earlier this month, Watkins had expressed caution following a conference call with the IRS who said they may offset money owed to the Federal Government by the states for expenses, such as Medicare, thereby negating the interest cost savings of the subsidy.

- Much of our buying last week was in the secondary market with most purchases filling specific needs of clients as opposed to large scale buying. We did, however, buy the new California State University deal which we believe was attractively priced in the 10-year area. It was heavily oversubscribed.

TAXABLE MARKETS

- It was another strong week in the corporate market. Spreads were 5 bps tighter in the Barclays U.S. Corporate Investment Grade Index, to end the week at +155 OAS (option-adjusted spread). Financials led the way with a 10 bps tightening in the sector. Worries regarding Greece's sovereign debt crisis seemed to have abated based on credit-default-swaps. Greece 5-year CDs traded at 322 bps on Friday compared to the peak of 428 bps on Feb 4th and a pre-crisis level (at least in the financial press) of 325 bps on Jan 26th. However, new concerns this morning were driving up pricing, indicating this story has not fully played out.

- Senator Dodd's financial regulatory reform bill was released on March 15th. The bill did not contain any significant surprises, which came as relief to the corporate market.

- Some large issues dominated corporate underwritings, but total issuance was less robust than the previous week. A unit of Royal Dutch Shell issued (Aa1/AA) $4.25 billion of 3-, 10-, and 30-year bonds priced at +42, +77, and +95 to those respective Treasuries. Credit Suisse NY (Aa1/A) priced a 5-year at +112.5 bps. Total investment-grade corporate issuance was $18.2 billion compared to $28.4 billion the prior week.

- Fed minutes confirmed that they will end their buy program of agency MBS debt. The Fed bought $10 billion of agency MBS last week which leaves only $15 billion remaining of their $1.25 trillion target. The weekly Freddie Mac survey showed the average 30-year mortgage rate was 4.96%, up 1 bp from the previous week. The Barclays U.S. MBS Index ended the week at +11 OAS, down 1 bp from the previous week.

About the Firm: Wasmer, Schroeder & Company, Inc. (WSC) is a privately owned Florida S-Corp incorporated in 1987 and registered in 1988 with the U.S. Securities and Exchange Commission as an investment advisor. WSC is independent and employee-owned with corporate headquarters and tax exempt portfolio management in Naples, Florida; our taxable portfolio management team in Cleveland, Ohio; and a client service office in Philadelphia, Pennsylvania. Specializing in fixed income separate account portfolio management for high net worth individuals, wealth management groups and institutions, including foundations, endowments and retirement plans, WSC has over $3.3 billion in assets under management, as of 12/31/09. The Firm works with clients and their advisors to construct taxable and tax exempt fixed income portfolios tailored to their preferences and constraints and typically include a mix of cash and fixed income securities.