BOND MARKET WEEKLY | WEEK OF MARCH 29, 2010

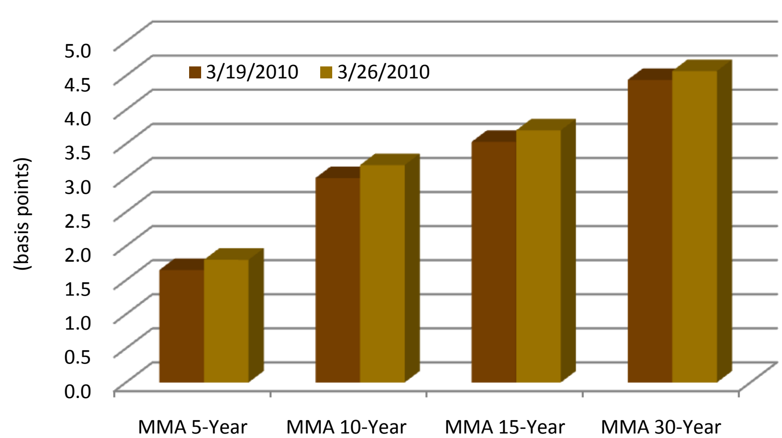
MARKET OVERVIEW

- The relative quiet in the Treasury market ended last week as the benchmark 10-year note rose 17 bps to close at 3.86%. Impacting Treasuries were poorly received 2-, 5- and 7-year auctions amid growing concern of weakness in sovereign debt assets and slightly better economic data, muted slightly by news of a potential naval conflict between the two Koreas.
- Potentially impacting yields were the Dow Jones Industrial Average's flirtation with 11,000 during the week and continued strength in the dollar. The dollar has climbed from a low of 1.51 € late in 4Q09 to open this week at 1.34 €.
- While short maturities continued their recent sell-off, long dated maturities were even weaker. The yield curve steepened 10 bps to +280 from 2- to 10-years while the 2- to 30-year spread jumped 11 bps to +370.
- Sovereign risk concerns stemming from outsized deficit and debt levels were a key theme driving real interest rates higher. TIPS participated in much of the sell-off but did manage to push breakeven inflation 7 bps higher over the current 5-year period to 2.17%. However, the longer-term period 5-year, 5-year forward saw just a 2 bps rise to 2.53%.
- Chairman Bernanke reiterated the Fed's intention to keep the Fed funds rate at "exceptionally low levels…for an extended period." In addition, the Chairman stated their intent to "get back to an all-Treasury portfolio within a reasonable amount of time."
- The economic data calendar was light last week ahead of top tier measures this week. Of note were durable goods orders, which grew slightly below expectations at 0.6% in February but better than expected ex. transportation at 0.9%. Another bright spot was a deceleration in initial jobless claims to 442,000. Q4 GDP was revised down slightly to a still solid +5.6% with personal consumption a bit weaker at +1.6% in the quarter.

TAX EXEMPT MARKETS

- Municipal bonds faced their first material sell-off of the year with 10-year bond yields rising 19 bps to 3.19% and 30-year yields rising to 4.57%. Most of the sell-off was concentrated inside 10-years as the continued use of BABs saps tax exempt supply at the longer end of the curve.
- A swathe of new deals were sold last week and the market had difficulty digesting most of them. Despite this, the Citizens Property Insurance Corporation new issue was actually tightened from the initial price talk. In a positive for the market, visible supply has dropped precipitously with the Bond Buyer 30-Day Visible Supply Index at a low $6.64 billion.

MMA Indices Yield Change



- Investor demand remains strong with tax exempt bond funds reporting $1.1 billion of inflows for the week ending March 17th, according to the Investment Company Institute.
- In ratings news, Fitch announced they will also be recalibrating their municipal bond ratings to be in-line with their corporate ratings. This change in rating will go into effect at the end of April and will mean upgrades across many municipal sectors.

TAX EXEMPT MARKETS (CONT.)

- The Port Authority of New York and New Jersey was upgraded to Aa2 by Moody's last week due to near monopoly status, essential nature, improving financial results and large reserves. On the flip side, the State of Illinois was put on negative watch by Standard and Poor's due to their continued large budget gap.

- The City of Vallejo, which is still in bankruptcy, reached an agreement with their firefighter's union. This will significantly reduce short- and long-term costs and move the city closer to emergence from bankruptcy and put the bondholders in a better position going forward.

- Much of our focus last week was on the Citizens Property Insurance Corporation new issue, which we bought for 2017 maturity at 4.43%. As mentioned previously, we continue to like this credit, especially at what we consider to be attractive relative spreads.

TAXABLE MARKETS

- Corporate spreads tightened slightly. Despite some disappointing macro economic data, the market seemed to respond with relief that the uncertainty of healthcare legislation is behind us now (even with several large companies taking large charges because of previously recorded deferred tax assets that will lose employee drug benefit deductibility going forward). The Barclays U.S. Corporate Investment Grade Index finished the week at +152 OAS (option-adjusted spread), 3 bps better than the previous week.

- New issue volume of investment-grade corporates increased to $26.3 billion for the week, up 45% from the prior week. Wells Fargo & Co. (A1/AA-) issued a $1.25 billion 5-year at +123 to Treasuries. Wal-Mart (Aa2/AA) issued $2 billion between a 5-year at +45 and a 30-year at +95. Anheuser-Busch InBev (Baa2/BBB+) came with $3.25 billion in a 4-part deal, the largest of which were a 3-year at +87.5bps and a 10-year at +123.

- As the Fed winds down its agency-MBS purchase program, Chairman Bernanke's testimony to the House Financial Services Committee (HFSC) made news with his comment that selling of these securities may take a more prominent role for exiting their monetary stimulus actions. Although he did not specify when the selling would begin, he provided more clarity to investors as to potential withdrawal methods. Spreads were unchanged at +11 OAS in the Barclays U.S. MBS Index.

- The agency debt market improved 2 bps due in part to testimony by Treasury Secretary Geithner to the HFSC where he reiterated the Government is committed to ensuring the GSEs have sufficient capital to honor guarantees now and in the future. The Barclays U.S. Aggregate Agencies Index ended the week at +22 OAS.