WASMER, SCHROEDER & COMPANY

INVESTMENT ADVISORS

BOND MARKET WEEKLY | WEEK OF APRIL 5, 2010

MARKET OVERVIEW

- Coming off disappointing auctions, a sour Treasury market tone continued during the holiday shortened week as improving economic data affirmed the current trend toward higher rates. As a result, the benchmark 10-year Treasury yield rose 10 bps to 3.95%.
- Most of the recent moves in the Treasury market have been parallel across maturities and similar in affect on TIPS. The yield curve slope was unchanged from 2- to 30-years (+370) last week and only managed a 3 bps rise from 2- to 10-years (+284).
- Breakeven inflation in the TIPS market edged higher by 5 bps over the current 5-year horizon to 2.21%, but the longer term 5-year, 5-year forward period was unchanged at 2.54%.
- Economic data did little to shake the negative tone in Treasuries last week as the manufacturing sector of the economy continues a v-shaped, solid recovery. The Chicago PMI (58.8) and ISM Manufacturing (59.6) survey for March confirmed the domestic and global health in manufacturing.
- Perhaps old habits die hard or "recession fatigue" has set in, but the consumer savings rate has fallen again as February spending increased 0.3% while income was unchanged. After a decent job of improving balance sheets in 2008 and early 2009, spending has resumed eclipsing income 8 of the last 9 months.
- The bullish argument for bonds largely centers on the inflation trend which got a boost via the February PCE Core measure which was unchanged and edging lower to +1.3% year-over-year. Those inside the Fed arguing for continued rock bottom rates are acutely aware of this trend.
- The market's favorite indicator (payrolls) released on Good Friday showed an improving gain of 162,000 jobs in March. Despite missing the overall consensus estimate of +200,000, upward revisions to January and February cast an overall positive tone to the economic outlook. Those mere skeptical of the positive spin noted a steady unemployment rate at 9.7%, an upward tick in the broader unemployed measure (U-6 16.9%), and a decrease in hourly earnings (-0.1%). Indeed, there is something for every analyst in this complex "recovery".

TAX EXEMPT MARKETS

- Municipal bonds were generally unchanged last week with 10-year bond yields rising 4 bps to 3.23% and 30-year yields rising 2 bps to 4.59%.
- Last week marked the slowest week of the year in the primary market since the holiday muted week of December 25, 2009 with just $4.4 billion in new issuance. The holiday calendar had an effect on the market as participants paused late in the week to observe Good Friday.
- Visible supply remains low with the Bond Buyer 30-Day Visible Supply Index at just $7.415 billion, up only slightly from the previous week. The back up in yields coupled with the holiday left issuers without an impetus to rush to market. However, higher absolute yields will likely coax retail participation back to the market.
- Despite new issue volume being off last week, first quarter volume was up 17% year-over-year. State and local governments issued just shy of $100 billion in debt in the first quarter of 2010 compared to only $85 billion for the same period in 2009.
- Notable deals in the primary market this week include $341 million of water and wastewater bonds for Philadelphia, Pennsylvania.

TAX EXEMPT MARKETS (CONT.)

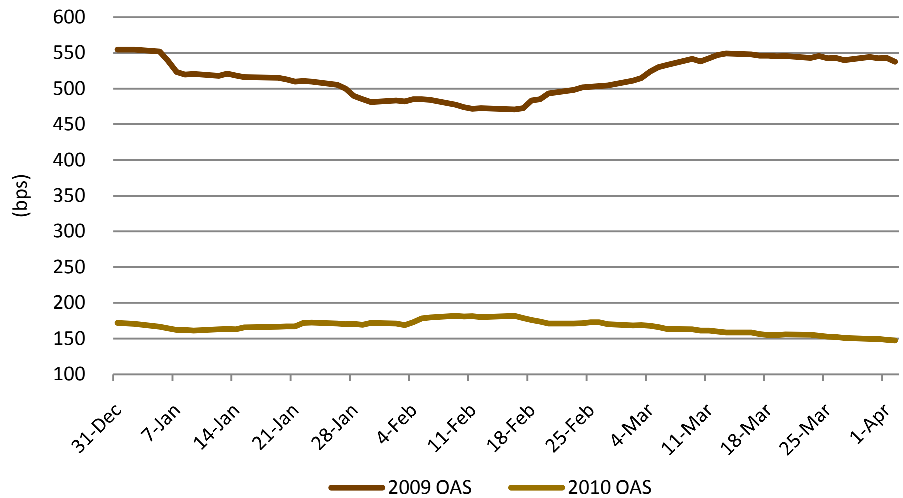
- The sell-off over the last two weeks pushed the benchmark 5-year yield to highs for the year. 5-year AAA municipals currently yield 1.85%, according to Municipal Market Advisors. However, the sell-off seemed to be confined to the higher grade quality with A rated credit spreads essentially improving.

TAXABLE MARKETS

- Last week saw the first quarter of 2010 come to a close with a total of $250.85 billion of new investment-grade corporate issuance. It was not as robust as first quarter of 2009, but that period had significant issuance under the TLGP (FDIC-backed) program as the Fed and Treasury Department tried to revive the capital markets. For the week, issuance was $6.7 billion reflective of a slowdown prior to the Good Friday holiday. Barclays Bank Plc (Aa3/AA-) brought the biggest issue with a 5-year note priced at +130 to Treasuries.

INVESTMENT GRADE CORPORATES OAS

YTD 2009 vs. 2010; Source: Barclays Capital



- Corporate spreads were 4 bps tighter for the week. The quarter ended with corporate spreads 22 bps tighter to finish at +148 OAS (option-adjusted spread) in the Barclays U.S. Corporate Investment Grade Index. The Financial sector had the largest input to overall gain with a 40 bps compression to Treasuries.

- Agencies drifted 3 bps wider as the Fed concluded its buy program of agency debt and agency-backed MBS debt. Although the size of Fed buying of agency debt (ending at $172 billion) was much smaller than that of MBS (ending at $1.25 trillion), it appears the absence of the Fed as a buyer seems to have caused spreads to widen. The Barclays U.S. Aggregate Agencies Index ended at +25 OAS.

- As mentioned above, the end of the Fed's agency-MBS buying caused spreads to widen a significant 13 bps (Barclays U.S. MBS Index), to finish at +24 OAS.

- The week marked the 1-year anniversary of the Build America Bonds (BABs) Program. Since inception, over $90 billion in par amount of BABs have been issued in what has become a popular and growing segment of the taxable fixed income market.