



BOND MARKET WEEKLY

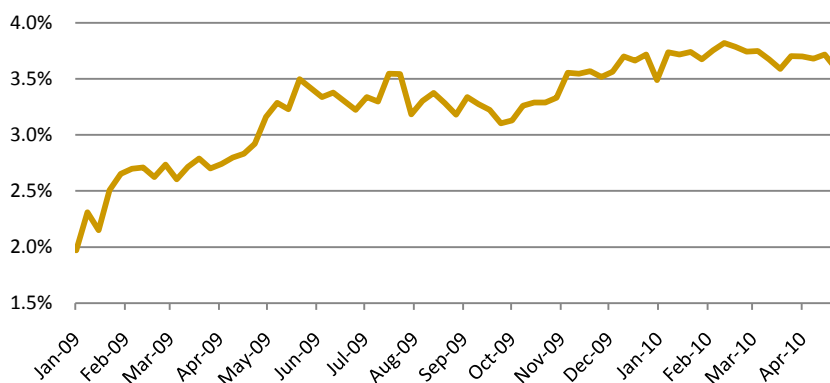
WEEK OF APRIL 26, 2010

MARKET OVERVIEW

- A quiet week on the US economic data front provided little catalyst for bonds which drifted higher as the Goldman fraud angst abated. The benchmark 10-year note ultimately opened on Monday morning at 3.79% as Greece officially asked for EU and IMF aid at the end of last week and risk aversion fell across the globe.
- A bias toward a flattening yield curve appeared early in the week and ultimately held as the 2- to 10-year spread narrowed 7 bps to +274 and 13 bps from 2- to 30-year to +359. Most of the strength in 2-year notes post the Goldman-SEC announcement evaporated by week's end as the Greek move, solid durable goods orders (March +2.8% ex transportation) and new homes sales data (March +26.9%) repriced the bid for safety.
- Inflation breakevens measured in the TIPS market edged higher by 4 bps across the current 5-year horizon to 2.29% while the longer term 5-year, 5-year forward pushed just 1 bp higher to 2.67%. The former has traded in a narrow range around 2.20% since early January after jumping from approximately 1.50% in the 3Q of 2009.
- Next week's calendar includes the April FOMC meeting and will be watched closely for indications of the beginning of an asset sale program and the potential removal of the "indefinite" reference to the low fed funds rate.
- Also closely watched will be Friday's GDP report with consensus expectations at +3.4%. Personal consumption is expected to be a large driver in 1Q's growth with consensus of 3.1% versus 4Q 2009's more muted 1.6%. The report is also expected to confirm the continuing downshift in inflation to just 0.9% annualized in the GDP deflator and 0.5% in the quarter-over-quarter Core PCE measure.

2- to 30-Year U.S. Treasury Spread

1/1/2009 - 4/23/2010; Source: Bloomberg



TAX EXEMPT MARKETS

- Municipal bonds rallied again last week with 10-year yields falling 3 bps to 3.22% and 30-year yields falling 2 bps to 4.58%.
- This drop came despite the fact that the Investment Company Institute reported outflows of \$251 million from municipal bond funds for the week ended April 14th. This may be solely due to the April 15th tax date but if flows into mutual funds subside or diminish significantly, one of the strongest forces behind the municipal bond rally could disappear.
- Supply remains constrained and the Bond Buyer 30-Day Visible Supply Index stands at only \$5.4 billion. When combined with the upcoming May 1st maturity and coupon date this is a relatively small amount of issuance for likely market needs.
- This week will see a \$650 million new issue from the DC Airport Authority, which will consist of taxable and tax exempt bonds. Also, the North Texas Tollway Authority will issue \$400 million in subordinate lien bonds rated "Baa3" by Moody's. It will be interesting to see how the market reacts to supply in the low investment grade area.
- Moody's rating recalibration continues with the following states recalibrated on April 26th: FL, IA, KY, MA, MI, NJ, OH, PA, TX, and WA. From what we have seen so far, the yields on newly recalibrated bonds seem to be tightening closer to existing credits with the same rating. This should be a boon for holders of "BBB" and "A" rated bonds in essential service sectors as these bonds' spreads and liquidity will likely improve over the coming months.



TAX EXEMPT MARKETS (CONT.)

- In positive economic news, New York City reported that the economy expanded in the 4Q for the first time in almost two years. Real gross city product was up 0.9% for the quarter, according to Comptroller John Liu. The Financial sector's strong rebound certainly helped New York City and it remains to be seen whether the rest of the country improves so quickly.
- In ratings agency news, a Senate panel has concluded that Moody's and S&P were influenced by Wall Street, had insufficient resources and used outdated models when rating mortgage securities. "Credit rating agencies allowed Wall Street to impact their analysis, their independence, and their reputation for reliability," said Senator Carl Levin (D-MI). While ratings reports are an important tool in analysis, we have, and always will, believe in the importance of in-house research in any fixed income asset class.
- Our purchases were mostly in the secondary market last week, although we did purchase one new deal for Citrus County School District in Florida. Although we have been shying away from the five year area, these credits were extremely attractive at 2.79% YTM or 112% of Treasuries.

TAXABLE MARKETS

- The 1Q 2010 earnings reporting season has so far been positive overall. Late last week with 157 of the S&P 500 companies reporting, earnings were 17.7% ahead of expectations on a dollar-weighted basis. Financials thus far have beat expectations by 70%. Another positive sign is that 87% of the companies have exceeded or met revenue expectations. Corporate spreads were unchanged for the week despite wider spreads in the financial sector (spreads were 5 bps wider on the week). It seems that despite good earnings reports within this sector, spillover from the Goldman Sachs civil case and looming regulatory reform has pushed spreads wider.
- Investment grade new issuance declined in corporates, in part, because we are now in the heart of earnings reporting which precludes companies from issuing (blackout period). Issuance was \$14 billion for the week, down 19% from the previous week. The largest deals once again were Yankee issues of foreign banks. A new domestic name that did get attention was Thermo Fisher Scientific (Baa1/A-) which came with \$300 million of a 5-year at +75 and \$450 million of a 10-year at +90. The combined \$750 million issuance was met with reports of \$6 billion in orders.
- MBS spreads had been unchanged through Thursday but tightened 3 bps on Friday to finish the week at +25 OAS (option-adjusted spread) in the Barclays U.S. MBS Index. The most significant news was the much better than expected 26.9% month-over-month increase in new home sales for March (on top of the larger than expected 6.8% increase in existing home sales for March reported on Thursday) as buyers pushed to beat the tax credit deadline.

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