



**BOND MARKET WEEKLY**

**WEEK OF MAY 3, 2010**

**MARKET OVERVIEW**

■ The backdrop of EU turmoil and a populist legislative push to corral “Wall Street” provided solid support to the safe-haven of U.S. Treasuries last week and ultimately pushed the benchmark yield 13 bps lower to open the week at 3.69%. A generally parallel move across the yield curve pushed 2- to 10-year spreads slightly lower to +270, while 2- to 30-year spreads also held near +357.

■ The TIPS market saw a mixed execution of a new 5-year note which found strong demand but mostly from the dealer community rather than end buyers. The new on the run TIP finished the week yielding 0.40% or a breakeven of 2.02% inflation versus the nominal 5-year maturity.

■ In addition to 5-year TIPS, auctions this week of 2- and 7-year maturities found solid demand amidst the global elevation of fear and equity market volatility.

■ April’s FOMC meeting faded to the background as Greece, Goldman and financial regulation were the focus for the week. None the less, the Fed held firm on rates noting that “inflation is likely to be subdued for sometime” due to “substantial resource slack.” The Fed also noted that “information suggests that economic activity has continued to strengthen and that the labor market is beginning to improve.”

■ Economic data supported thoughts of an improving economy with firm regional Fed survey’s (Dallas, Richmond, Chicago and Milwaukee) and Q1 GDP registering growth of 3.3%.

■ GDP details show inventories accounting for more than half of the growth with final demand up just 1.6%, consistent with the 1.5% to 1.7% tepid rebound seen over the last 3 “recovery” quarters. Also of note, government contribution has turned negative with state and local contraction more than fully offsetting the fading 1.7% federal boost.

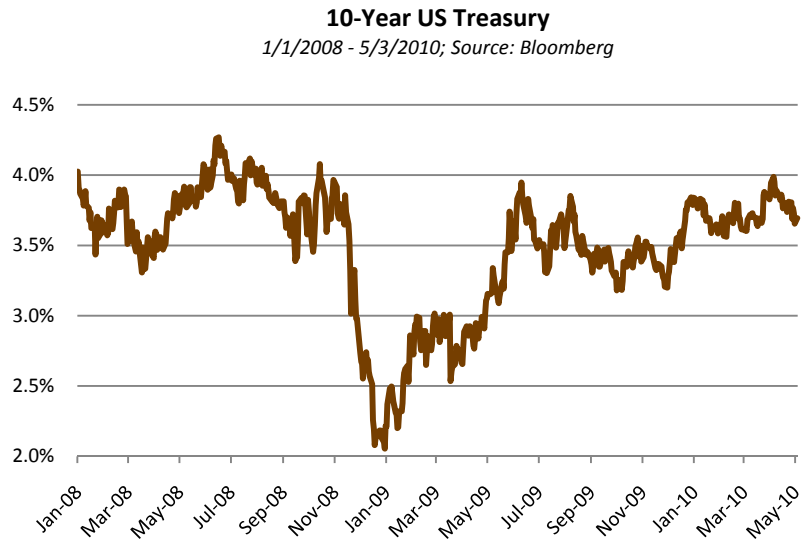
■ The consumer saving rate dipped lower to 3.1% in the quarter and offset tepid income growth to support broader growth. Strategic default cash? Frugal fatigue? Is it enough to carry the torch as the inventory cycle inevitably turns?

**TAX EXEMPT MARKETS**

■ Municipal bond yields continued to fall last week with 10-year yields declining 2 bps to 3.20% and 30-year yields 5 bps to 4.53%.

■ Mutual fund demand has started to return with the Investment Company Institute reporting \$710 million in inflows to Municipal Bond Mutual Funds for the week ending April 21<sup>st</sup>. Renewed investor demand coupled with large amounts of calls and maturities over the next 60 days could be setting the stage for another rally in the municipal market.

■ Future supply also remains muted with the Bond Buyer 30-Day Visible Supply Index at only \$9.09 billion. While higher than last week, it is below the \$10.7 billion average of the past 12 months, further reducing the likelihood of a sell-off in the tax exempt market.





## TAX EXEMPT MARKETS (CONT.)

- New issues this week include \$2 billion for the California Department of Water, \$410 million for the Long Island Power Authority in New York, and \$229 million for Michigan State University.
- With many proposals being talked about in the financial services regulation that is slowly proceeding through Congress, one in particular could have a large effect on the municipal market. One of the amendments proposed would force any swap provider to municipal issuers to act as a fiduciary when dealing with the municipality. This, according to some market experts, may shut down the municipal swap market completely, a possibility we do not necessarily have a problem with.
- Our buying this week was minimal with a small amount of swaps and cash being raised for clients. With the light calendar we have focused primarily on the secondary market as the best value has been found outside of new issues.

## TAXABLE MARKETS

- Investors had plenty of news from which to choose, some good, some bad. Good news was seen in earnings announcements. 318 of the S&P 500 companies have reported earnings so far, meeting or exceeding expectations 79% of the time. Bad news was seen in the continuing saga with European sovereign risk and hearings on financial reform. Downgrades of Greece and Portugal debt took place Tuesday, followed by Spain on Wednesday which heightened contagion fears that have existed for much of this year. Corporate spreads in the Barclays U.S. Corporate Investment Grade Index ended at +143 OAS (option-adjusted spread), 4 bps wider for the week. However, during the month of April spreads actually tightened 7 bps.
- Corporate new issuance was very light last week. NBC Universal (Baa2/BBB+) dominated the volume with \$4 billion of a 3-part deal. Their 5-year was priced at +128 to Treasuries while the 10-year and 30-year issues were priced at +148 and +183, to the respective Treasuries. For the week \$8.6 billion was priced, 62% below the prior week. Total issuance for April was \$51.9 billion, roughly half the \$100.2 billion in March.
- Agencies were 3 bps wider for the week, seemingly correlated to the European headlines. New supply was light. FNMA priced \$ 1 billion of a reopening of its 2-year note. Spreads ended the week at +26 OAS in the Barclays U.S. Aggregate Agencies Index.
- MBS was also 3 bps wider last week. As expected with the conclusion of the Fed's MBS buying program on 3/31/10, spreads have drifted since then. For the month of April, the Barclays U.S. MBS Index was 8 bps wider to +28 OAS.

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