



## MARKET OVERVIEW

- Despite a deluge of economic data, the U.S. bond market spent the week focused on the broader impacts of the Greek sovereign debt crisis. A global flight to quality reaffirmed the U.S. dollar and U.S. Treasuries as THE safe haven with the European banking system becoming increasingly at risk of sovereign default. U.S. exports may face a stiff headwind from a rapidly rising dollar. The benchmark 10-year Treasury note ended the week 24 bps lower in yield at 3.48% and 50 bps lower than its recent high on April 5<sup>th</sup>.
- Long Treasury maturities outperformed the short end on prospects of a longer term global slowdown. Spreads from 2- to 10-year maturities fell 8 bps to +260 while the 2- to 30-year measure declined 9 bps to +346.
- TIPS did not attract the same level of interest as nominal Treasuries and, as a result, breakeven inflation measures plummeted. The current 5-year horizon sank 25 bps to 1.77% while the 5-year, 5-year forward period dropped 23 bps to 2.85%. Beyond the general deflationary effects of another potential sovereign credit crisis, crude oil's \$11 per barrel drop on the week weighed heavily on this market.
- At least the coincident economic data released during the week was largely on the bright side. Personal income (Mar. +0.3%), spending (Mar. +0.6%), ISM Manufacturing (April 60.4), jobless claims (444k) and payrolls (April +290k) all pleased growth bulls.
- The ultimate path the EU takes in handling the sovereign debt struggles of the "PIIGS" countries will likely impact U.S. Treasury yields over the short- and medium-term, however the more tangible U.S. inflation story continues to be bullish for the market. Unit labor costs fell again in Q1 (-1.6%) and hourly earnings data in April exhibited no change month-over-month, resulting in a meager +1.6% growth rate for the year-over-year period. Combined with a 9.9% unemployment rate and continued abundant capacity slack across U.S. sectors, the pre-Greece U.S. "recovery" remains a distant threat to U.S. bonds via inflation.

## TAX EXEMPT MARKETS

- Despite the volatility in global equities and government bond markets, municipals yields were mostly range bound with 10-year bonds tightening 3 bps to 3.17% and 30-year bonds unchanged at 4.53%.
- Tax exempt mutual funds continued to see inflows, albeit at a slower rate than the previous week. The Investment Company Institute reported \$392 million in inflows for the week ending April 28th.
- Forward supply continues to be moderate with the Bond Buyer 30-Day Visible Supply Index at \$9.8 billion, with roughly \$2.5 billion of that expected to be in taxable BABs.
- New deals this week included \$245 million for the State of Oregon, \$810 million for the Seattle Municipal Light Authority and \$144 million for the Pennsylvania State University.
- With much of the focus last week on the Greek sovereign debt crisis, we find it illuminating to compare some of its debt and income ratios to one of the more "challenged" states, California. These numbers are rough estimates and while there is some debate over each entities' actual level of debt, it quickly becomes clear that California is lightly levered compared to Greece.
  - Population
    - Greece - 11 million
    - California - 37 million
  - Debt
    - Greece - \$236 billion (some estimates are closer to \$400 billion+)
    - California - \$70 billion



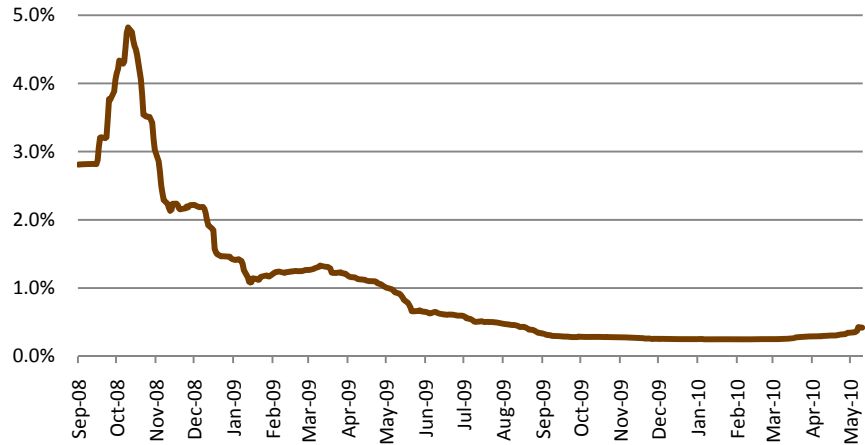
## TAX EXEMPT MARKETS (CONT.)

- Debt per capita
    - Greece - \$21,254
    - California - \$1,892
  - GDP per capita
    - Greece - \$29,635
    - California - \$49,024
- Much of our buying was in the secondary market, although we bought a new issue for the Massachusetts State Housing Authority. We continue to focus on 7- to 10-year bonds as the steepness of the curve in that area makes it the most attractive in our opinion.

## TAXABLE MARKETS

### 3-Month LIBOR Index - U.S. Dollar

9/1/2008-5/10/2010; Source: Bloomberg



- Last week we saw some disturbing patterns from the 2008 credit crisis start to emerge which unnerved the credit markets. As investors grew more cautious with the events unfolding in Europe, costs for interbank lending (via LIBOR) jumped which pressured corporate spreads of financials and banks. Last week, 3-month LIBOR jumped 8 bps to 0.43% as European banks seemed to have created a liquidity demand in short-dated funding. While nothing like the 4.82% level we saw in October 2008, the bump did re-kindle some of that fear.
- Corporates took a beating with spreads widening 26 bps to finish the week at +169 OAS (option-adjusted spread) in the Barclays U.S. Corporate Investment Grade Index. The financial sector was the biggest driver of the weakness with spreads widening 36 bps for the week.
- Over the weekend, EU finance ministers put together a EUR 750 billion (\$955 billion) loan package to defend the Euro. Early market indicators show this move is being well received.
- Agencies also saw spread widening from the flight to quality and higher risk aversion on display last week. The Barclays U.S. Aggregate Agencies Index ended the week 6 bps wider at +32 OAS. Also of note, Freddie Mac released its 1Q10 earnings with a reported \$6.7 billion loss and a net worth deficit of \$10.5 billion.
- The MBS market fared relatively well last week, despite nominal yields moving wider to Treasuries. On an OAS basis, this widening was countered by the rise in interest rate volatility which resulted in the Barclays U.S. MBS Index to end the week unchanged at +28 OAS.

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