



MARKET OVERVIEW

■ Last week delivered oscillating levels of Euro-zone concerns, and after a historic weekend rescue plan, ended with the benchmark 10-year Treasury yield just 2 bps higher at 3.46%. Short Treasury yields benefitted most from a renewed global flight to quality on Friday after a report suggested France's Sarkozy threatened a Euro pullout in order to arm-twist Germany into the measures. That led to a steeper yield curve as spreads from 2- to 10-years rose 5 bps to +267 and 2- to 30-year spreads were 9 bps higher at +355.

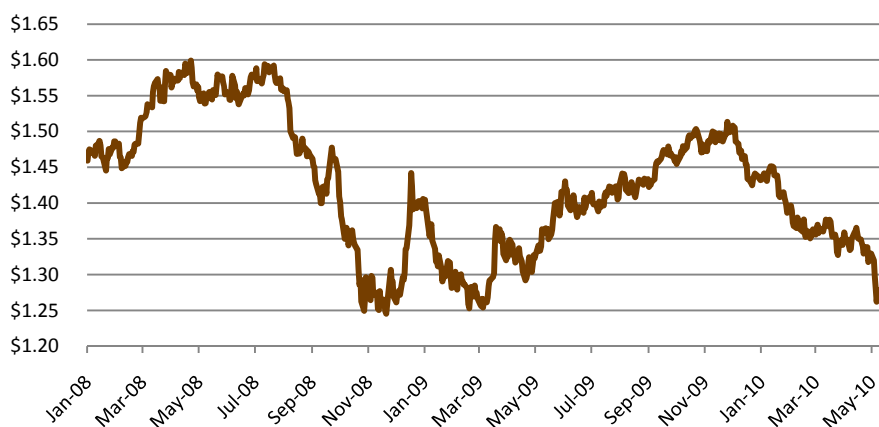
- The TIPS market also posted results on the week with the current 5-year horizon breakeven giving up 9 bps to end the week at 1.86%. Further out, the 5-year, 5-year forward period saw breakevens drop again, this time by 6 bps to 2.79%.
- After an initial sigh of relief over Europe's plan to halt the sovereign credit contagion, lingering doubts remained in the markets throughout the week and supported a 4 cent move lower in the Euro, and a tailwind for U.S. Treasuries. By week's-end, U.S. equities faltered on global slowdown concerns and solidified a well bid U.S. Treasury market. Additionally, no obvious cause or errors were discovered to explain the prior Thursday's Greece-led stock market plunge, which contributed to ongoing market unease regarding equities.
- Incoming economic data was largely ignored given the potential game changing nature of Europe's sovereign issues, but the story remains the same. Small businesses remain depressed with a slightly better but weak 90.6 NFIB optimism survey in April. Initial jobless claims continued a slow ebb to 440k last week but remain hardly meaningful for inflation and reducing the excess capacity of idle U.S. labor. Retail sales for April had a modest gain of 0.4% after showing significant improvement during March (2.1%), likely the result of an early Easter shopping period. Meanwhile, industrial production improved again in April with a gain of 0.8% after a small 0.2% lift in March. Huge slack, however, remains with capacity utilization of just 73.8%.

TAX EXEMPT MARKETS

- Municipal bonds rallied this week on the back of Treasuries with AAA rated 10-year yields falling 3 bps to 3.14% and 30-year bonds 2 bps to 4.52%.
- Despite uncertainty around the globe, demand for municipal bonds remains strong. The Investment Company Institute reported \$808 million in tax exempt bond fund inflows for the week ending May 5th. Additionally, there have been some reports that demand from TOB funds is on the rise again. Municipal Market Advisors noted Friday that TOB funds have been exhibiting strong demand in the 25 years and out portion of the curve.
- Forward supply remains manageable with the Bond Buyer 30-Day Visible Supply Index at \$9.34 billion. In the secondary market, the number of items out for the bid is higher than it has been in recent weeks and has been running about 12% higher than the average for 2010.
- New deals this week include \$894 million for the Massachusetts DOT, \$971 million for the New York City Transitional Finance Authority and \$145 million for North Carolina Municipal Power Agency.

Price of 1 Euro in US Dollar

1/1/2008 - 5/17/2010; Source: Bloomberg





TAX EXEMPT MARKETS (CONT.)

- The State of New York's fiscal woes have gotten much press in the past week with Governor Paterson planning to furlough 100,000 state workers for one day a week in order to save \$30 million per week. A federal court temporarily blocked this action with a hearing set for May 25th. The State may also delay \$1.5 billion of school aid until the State's June 15th income tax payments are received. While obviously a stressed State, Paterson has been aggressive in opposing the unions and making the necessary cuts in order to pay the bills and bond holders.
- Much of our buying was in the secondary market last week although we purchased new issues for the Massachusetts State Housing Authority as well as Blue Springs, MO GO's.

TAXABLE MARKETS

- Corporate bond spreads rebounded nicely last week after the prior week's selloff. The week started out strongly after the bailout package was presented to stop European sovereign risk fears but as the week progressed trading became bumpier. Stronger economic news (i.e. industrial production) and improving corporate fundamentals (so far, earnings have been 12.7% ahead of expectations for the S&P 500 companies on a dollar-weighted basis) seemed to have guided spreads tighter. The Barclay's U.S. Corporate Investment Grade Index finished the week 3 bps tighter at +166 OAS (option-adjusted spread). Industrials were especially strong, tightening 8 bps.
- New life was seen in corporate new issuance from a near flat-line condition the previous week. Total investment-grade underwritings were \$10.5 billion led by Morgan Stanley (A2/A) and Citigroup (A3/A). Morgan Stanley priced \$1.75 billion of a 3-year quarterly-pay note at Libor +2.50%. Citigroup followed with a \$1.5 billion 5-year fixed note priced at +260 to Treasuries.
- The MBS market rallied also. Spreads were 8 bps tighter as measured by the OAS of the Barclays U.S. MBS Index to finish at +20 OAS. Nominal spreads to Treasuries showed a more robust rally, but since the OAS measurement incorporates implied volatility, this rally was more subdued. Newsworthy items for the week were the Freddie Mac survey which showed the average 30-year mortgage rate fell 7 bps to 4.93%, a level not seen since February 18th, and the MBA Weekly data that posted a 14.8% rise in the Refinancing Index.

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