



BOND MARKET WEEKLY

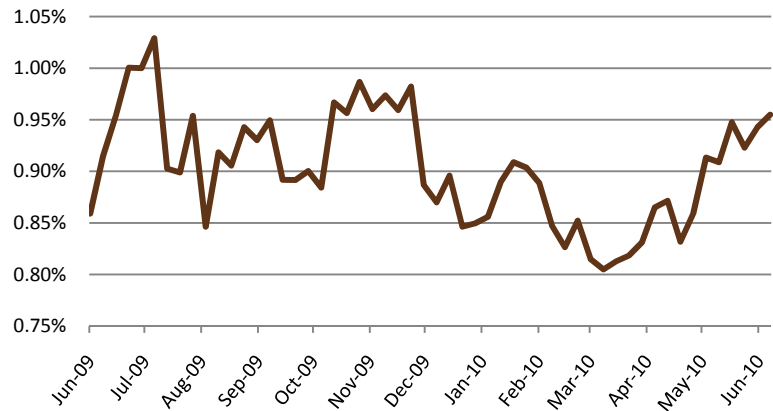
WEEK OF JUNE 14, 2010

MARKET OVERVIEW

- US Treasury yields were higher across the curve this week with the yield on the benchmark 10 year increasing by 3 bps from 3.20% to 3.23%. The Treasury curve steepened 3 bps from 2-10 years to +250 bps and the 2-30 year spread was 2 bps steeper to +342 bps.
- The stock market recovered from a tough early part of the week to finish up. The Dow Jones Industrial Avg. was down -115 points on Monday but managed to finish the week up +280 points to close above 10,000 at 10,211.
- Nominal yields on TIPS were higher on the week and outperformed US Treasuries slightly as the breakeven dropped 3 bps.
- This week was fairly light in terms of economic data. Initial jobless claims came in at 450k, 6k less than expected, however the prior number was revised upward and the continuing claims came in higher than expected at 4,640k. Despite this data, the long-term trend in continuing claims seems to be lower.
- Advanced retail sales were among the final economic numbers of the week and they disappointed at -1.2%, significantly below the consensus forecast of +2.0%. This was the first negative month-over-month number since September 2009, which was concerning to those still looking for a V-shaped recovery. However, later in the day, the University of Michigan Consumer Confidence number came out at 75.5, higher than expectations and the highest level since early 2008.
- Significant attention was paid to the continued problems between BP and the Government over the cleanup of the oil spill in the Gulf of Mexico. Both BP's stock and bond prices were very volatile this month as concerns over legal claims and cleanup costs weighed heavily on the market.

10 Yr Muni to Treasury Ratio

6/1/2009-6/11/2010; Source: Bloomberg



TAX EXEMPT MARKETS

- The municipal market followed Treasuries lower this week, with both selling off on Thursday. The retail market's aversion to low absolute yields and an equity market rally pushed yields higher across the curve. The yield on 10 year 'AAA' rated municipals ended the week at 3.15%, 3 bps higher than the week prior. The yield on 30-year 'AAA' rated municipals rose 4 bps to 4.52%.
- Forward supply fell slightly last week with The Bond Buyer's 30-day visible supply index falling \$11 million to \$8.9 billion. Issuers came to market with \$9.2 billion last week and these new deals did well in the primary market demonstrating the market's continued resiliency.
- Late Friday afternoon, Fitch downgraded the State of Illinois' general obligation rating from 'A+' to 'A'. Fitch noted the state government's unwillingness to take decisive action to remedy budget deficits and the state's high debt burden as reasons for the downgrade. The state also faces a looming unfunded pension liability, but has managed to pass modest bipartisan pension reform. Fitch's action followed Moody's downgrade of the State earlier this month to 'A1' from 'Aa3'.



TAX EXEMPT MARKETS (CONT.)

- The State of Arizona came to market last week with \$300 million certificates of participation backed by mortgages on state buildings. The bonds carried underlying ratings of 'Aa3' from Moody's and 'A+' by S&P. Investor interest was high despite the state's financial condition.
- As for mutual fund flows, the Investment Company reported weekly inflows for the week ending June 4th of \$896 million. Higher nominal yields after last week's sell off will likely lure "yield shocked" investors back into the market.

TAXABLE MARKETS

- The focus of the corporate market seemed to shift squarely on the oil spill crisis in the Gulf of Mexico last week with much less concern on Europe. In fact, new debt offerings were successfully priced by Portugal, Spain, and Italy. Comments from Washington had a gnawing effect on the broader market as the implications of higher energy costs and unclear direction regarding future regulation as a result of the spill was a hot topic among traders and investors last week. The Barclays U.S. Corporate Investment Grade Investment Grade Index ended the week 6 bps wider to finish at +197 OAS (option-adjust-spread).
- It was another slow week for corporate new issuance with just \$7.8 billion of investment grade paper priced for last week. Of note was Citigroup ('A3'/'A') that did a 3 ½-year \$1.9 billion deal at +425 bps to Treasuries and US Bancorp ('Aa3'/'A+') with a \$1 billion 3-year deal at +85 bps to Treasuries. Also of note, although not included in the Bloomberg weekly total figure above, Microsoft ('Aaa'/'AAA') came to market with a \$1.15 billion 0% at a 33% convertible premium.
- The average 30-year mortgage rate last week reported by the FHLMC was at 4.72%, just 1 bp from the record low. However, the most recent report by the Mortgage Bankers Association (week ended June 4th) showed a -12.2% decline in the overall number of applications and a -14.3% decline in the refinancing component of the index. This decline broke a string of 4 consecutive weekly increases. Mortgages still did well on the week, to finish at +13 OAS in the Barclays U.S. MBS Index.

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