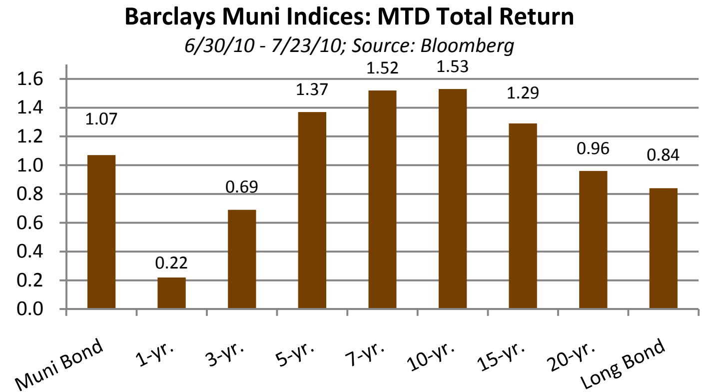
WASMER, SCHROEDER & COMPANY

INVESTMENT ADVISORS

# BOND MARKET WEEKLY | WEEK OF JULY 26, 2010

## MARKET OVERVIEW




- US Treasuries retreated slightly last week following their recent strength as strong corporate earnings propelled US equities higher. Buyers kept US Treasuries well bid earlier in the week as investors awaited the outcome of bank stress tests in Europe. The initial take from analysts was that the results were better than expected, and US Treasuries faded and US equities rallied. The benchmark 10-year Treasury closed 5 bps higher on the week at 2.99%.
- The yield curve steepened on the week as short maturities remained well bid and intermediate and longer rates backed up 5-7 bps. Spreads from 2- to 10- years widened 6 bps to +240 and 2- to 30- yr spreads widened 8 bps to +343. The steepening on the week, while considerable, still leaves us with a curve considerably flatter than earlier in the year.
- Last week saw a relatively light economic calendar released. Early in the week Housing Starts at 549k fell short of the forecasted 577k, while Building Permits at 586k bested the forecast of 575k. Additionally, we saw existing home sales fall 5.1% MOM, while the Housing Price Index rose 0.5% MOM. What we appear to be witnessing is a housing market that is very much in flux as it looks for a bottom. Additionally, Initial Jobless Claims rose 35k to 464k, while Continuing Claims fell 223k to 4,487k.
- The economic calendar is heavier this week as we get New Home Sales (312k survey) today, Consumer Confidence (51.0 survey), Durable Goods (1.0% survey) on Wednesday, and 2Q GDP (2.5% survey) to complete the week. Investors continue to pour through economic releases trying to gauge the veracity of the economic recovery; this week will be no different.

## TAX EXEMPT MARKETS

- Municipals improved again last week with both 10- and 30- year bonds rallying two basis points to 2.86% and 4.40%. According to MMA's indices on Bloomberg 10- year yields are the lowest they have been since at least 2001 and close to the 30- year lows of 4.29% from November 2006.
- Municipal flows into mutual funds continue to be strong with the Investment Company Institute reporting $415 million in inflows for the week ending 7/14/10. With August 1st quickly approaching (meaning more coupon and maturity payments), there will likely be plenty of cash in buyers' hands despite record low yields.
- Forward supply appears to be picking up with the Bond Buyer 30-day Visible Supply Index rising to a respectable $11.04 billion, which will potentially cap some of the rally we have seen so far this month. This week will see new issues from Columbus, Ohio ($430 million), New York City ($800 million) and the Texas Transportation Commission ($1.5 billion).
- While we do not typically comment on short term performance trends, this month's rally has been notably strong in municipal bonds, particularly in the belly of the curve. Approximately one quarter of this year's returns have come in the last three weeks. Despite recent press reports suggesting the demise of municipal credit, the end buyers of municipal securities have not been deterred from buying bonds at a furious pace.
- With many investors favoring convexity in the face of this month's rally, bonds with short calls appear cheap from a relative basis and much of our focus was in this area last week. Additionally, due to the significant liquidity in the secondary market, we continue to lighten up on A rated holdings in favor of AA and AAA credits.

## TAXABLE MARKETS

- Corporates had plenty of data to digest as we are now near the apex of Q2 earnings reporting season. With 157 of the S&P 500 companies (representing 46% of the market by value) having reported through Friday, the results look very good. Reported earnings are 13.5% higher than expectations (on a dollar-weighted basis) from strength in revenues and margins. The Barclays U.S. Corporate Investment Grade Index finished 4 bps tighter for the week to end at +178 OAS (option-adjusted-spread).
- The results of the stress tests for European banks revealed that only 7 banks failed to preserve at least a 6% Tier 1 ratio under 3 stress scenarios: 5 Spanish savings banks, a German bank and a Greek bank. None of these banks were major players.
- Investment-grade new issue volume declined to $17.7 billion according to Bloomberg. Large issues were brought by Goldman Sachs (A1/A) and Morgan Stanley (A2/A), each coming with $3 billion between 5- and 10-year notes.
- Financial regulatory reform, otherwise known as the “Dodd-Frank Act”, became law last week. While we know the rules have changed, the details are unclear and need to be defined. One provision that has had an immediate consequence was the rating agencies’ forbidding the use of their ratings in the filing of SEC documents for fear of potential legal liability. This halted asset-backed issuance to $0 last week compared to the prior week’s $3 billion.
- The MBS market was rather quiet. The MBA Mortgage Application Index posted a 7.6% increase last week: up 3.4% from purchases and up 8.6% from refinancings. Freddie Mac’s national survey showed 30-year mortgage rates were 1 bp cheaper averaging 4.56%. The yield-to-worst in the broadly measured Barclay’s U.S. MBS Index finished the week at 2.91%.

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**About the Firm:** Wasmer, Schroeder & Company, Inc. (WSC) is an independent and employee-owned owned Florida S-Corp. WSC was incorporated in 1987 and registered as an investment advisor in 1988 with the U.S. Securities and Exchange Commission. The Firm’s corporate headquarters are in Naples, Florida, where the tax exempt Portfolio Management team, Client Services, Operations, IT, Accounting, Compliance, Marketing and Administration reside; our taxable Portfolio Management team is located in Cleveland, Ohio; and Client Relationship offices in Philadelphia, Pennsylvania and Portland, Oregon. Specializing in fixed income separate account portfolio management for high net worth individuals, wealth management groups and institutions, including foundations, endowments and retirement plans, WSC has over $3.57 billion in assets under management, as of 6/30/10. The Firm works with clients and their advisors to construct taxable and tax exempt fixed income portfolios tailored to their preferences and constraints and typically include a mix of cash and fixed income securities.