

# DAILY MARKET VIEW

PORTFOLIO ADVISORY GROUP — U.S. FIXED INCOME STRATEGIES



RBC Wealth Management

Wednesday, February 22, 2012

Market Snapshot	7:30am CST	Prior
30-year UST	3.20%	3.16%
10-year UST	2.055%	2.02%
5-year UST	0.90%	0.88%
2-year UST	0.30%	0.29%
6-Mo UST	0.13%	0.12%
3-Mo UST	0.08%	0.08%
10-year TIPs	-0.24%	-0.25%
10-year Corp	3.10%	3.06%
10-yr AAA Muni	1.95%	1.89%
3M LIBOR	0.49%	0.49%
Fed Funds	0.25%	0.25%
Prime Rate	3.25%	3.25%
CPI (Y-O-Y)	2.90%	2.90%
NASDAQ*	2,934.07	2,952
DJIA*	12,965.69	12,950
S&P 500*	1,362.21	1,361
Oil	106.04	104.65
Gold	1754.60	1737.50
Copper	381.70	379.05
Yen / US Dollar	80.24	79.68
US Dollar / Euro	1.324	1.322
*Previous Day		

## At the Open

U.S. Treasuries are rebounding from yesterday's sell-off as Purchasing Manager's Indexes in Europe and Asia were mixed with most reports lower than the forecasts. China's PMI improved to 49.7 from 48.8, but still below the critical 50 level. The Eurozone reported a level of 49.7 versus the estimate of 50.5 and Germany's came in at 50.1 versus the consensus of 51.5. France reported a 50.2 as compared to the estimates of 49. Also supporting the stability in the Treasury market was a downgrade of Greece's long-term debt rating to C from CCC by Fitch. The short term rating was affirmed at C. The yield on Greece's ten year security rose over 60 basis points to 34.05% during the morning trading hours.

The two-year note is unchanged at a 0.295% yield and the five-year note has improved by 1/32 resulting in a 0.905%. The ten-year note has increased 2/32 for a 2.055% yield while the price of the benchmark thirty-year bond has risen 7/32 for a 3.20% yield.

Here are the four things to watch today –

**First, Existing Home Sales** are expected to show a modest up-tick. Amid recent signs of possible stabilization in housing, sales data will be watched closely.

**Second, the Treasury auctions** \$35 billion five-year notes; the issue is currently WTI trading to yield 0.92%.

**Third, despite the approval** of its second bailout package in three years, markets have not ruled out the possibility of default. Issues in Greece specifically and Europe in general will continue to cast a long shadow.

**Four, oil prices** continue to push higher as the Iranian situation deteriorates. The impact of higher oil prices on consumer activity is a concern.

## Today's Highlights

Economics		The Fed		Treasury Auctions			
Time CST	Period	Survey		Date	Total		
6:00am	MBA Mortgage Applications	17-Feb	--	There are no officials listed on the speaking calendar.	5 Year T-Note	02/22/2012	\$35B
9:00am	Existing Home Sales	JAN	4.65M		7 Year T-Note	02/23/2012	\$29B
9:00am	Existing Home Sales MoM	JAN	0.90%				

## Previous Day's Bond Market Recap

It was a choppy session with prices biased to the downside on Tuesday as market participants digested the details of the Greece bailout package. While seen as a band-aid which removes the imminent threat of default in March, market consensus seems to be that many issues still exist that will keep the threat of default alive going forward. Rising oil prices due to heightened tensions with Iran are garnering headlines and concern is growing that if the trend persists, it will have a negative impact on U.S. economic

growth.

- European finance ministers approved a second bailout package allowing them to avoid a March bankruptcy. The reforms and austerity measures are designed to allow Greece to slash its debt to GDP ratio to 120% (from 160% currently) by 2020. Markets continue to feel that a default can't be ruled out
- Euro-area central banks will follow the ECB in swapping the Greek bonds in their portfolios for similar securities to avoid enforced losses during a debt restructuring.
- Oil prices rose to a nine-month high near \$106 a barrel after Iran said it stopped selling to Britain and France.
- The Treasury auctioned \$35 billion two-year notes with a 0.25% coupon to yield 0.301%, the highest since 0.417% at the July 2011 auction. The bid-to-cover ratio fell to 3.54 from 3.75 at the January auction and indirect bidders bought 35.8% of the issue, up slightly from January.
- The 2yr T-note closed to yield .299%, the 5yr T-note fell 8/32 to yield .909%, the 10yr T-note dropped 16/32 to yield 2.059%, and the 30yr T-bond finished lower by 1 point and 7/32 to yield 3.211%.

## Strategy and Economics

### **Previous Day's Highlights:**

- The Chicago Fed National Activity Index came in at 0.22, which was below last month's revised reading of 0.54. Since 2006, the index has ranged from a low of -4.468 on 1/31/2009 to a high of 0.911 on 12/31/2006. The index provides current state of economic activity and inflationary pressures that includes data from output and income; employment and unemployment; personal consumption; housing starts and sales; manufacturing and trade sales; as well as inventory orders.

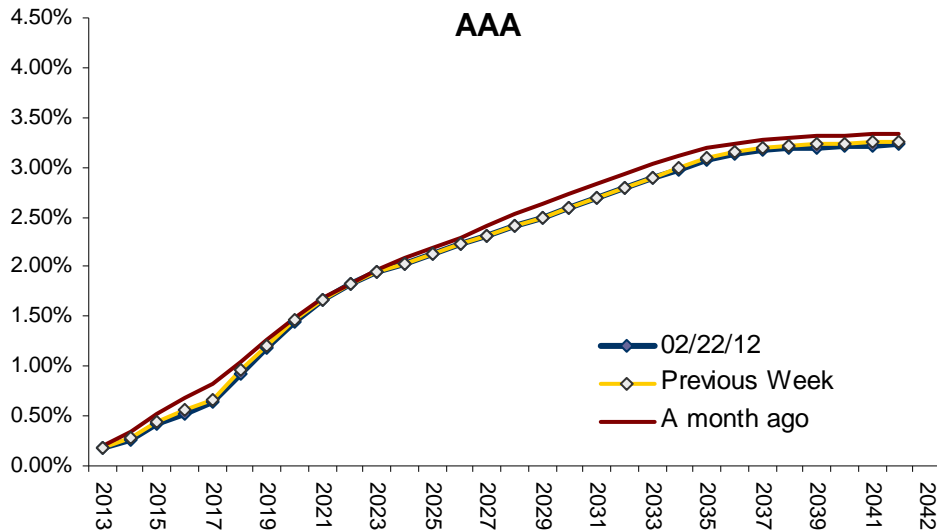
### **Today's Highlights:**

- The **MBA Mortgage Applications** report showed a decrease of 4.5% following a decline of 1.5% last week. The MBA also reported that refinancing activity fell 4.8% and purchase applications dropped 2.9% from the previous week. The average rate on a 30-year fixed rate mortgage increased one basis point to 4.09% while the 15-year fixed rate increased five basis points to 3.38% from 3.33%.
- Existing Home Sales is forecasted to increase 1.1% to 4.66 million units on a seasonally annual adjusted basis. Last month the increase was 5.0%

### **Municipal Market Comments – By Phil Lankford, Sr. Municipal Portfolio Strategist**

- A few large deals accounted for most of last week's new issuance, but overall supply remains light.
- Lower investment grade rated borrowers are benefitting from this lack of supply in the face of continued strong demand. Puerto Rico Aqueduct and Sewer Revenue rated BBB- by S&P issued \$1.8 billion, there were orders for \$5.6 billion, at levels 68 basis points lower than back in 2008.
- The Bond Buyer 20 Bond Index fell another 5 basis points last week to yield 3.65%.
- The Investment Company Institute reported its 24<sup>th</sup> consecutive week of inflows which totaled \$1.74 billion for the week of February 8<sup>th</sup>. In January the inflows represented more the 40% of the new issue market.
- In this short week, supply will be minimal again and we believe rates will be largely based on what happens in the Treasury market.

## MMD Curves AAA



Source: MMD - Chart by U. S. Fixed Income Strategies RBC Wealth

### RBCCM U.S. Market Economics: The Daily Deck – Tom Porcelli

- The Daily Deck discusses how the very mild January weather (4th warmest on record) could give existing home sales an outsized seasonal boost. RBCCM believe should this thesis play out, the seasonal quirk would be a short-lived phenomenon as the recent decline in pending home sales augurs for a pullback here.

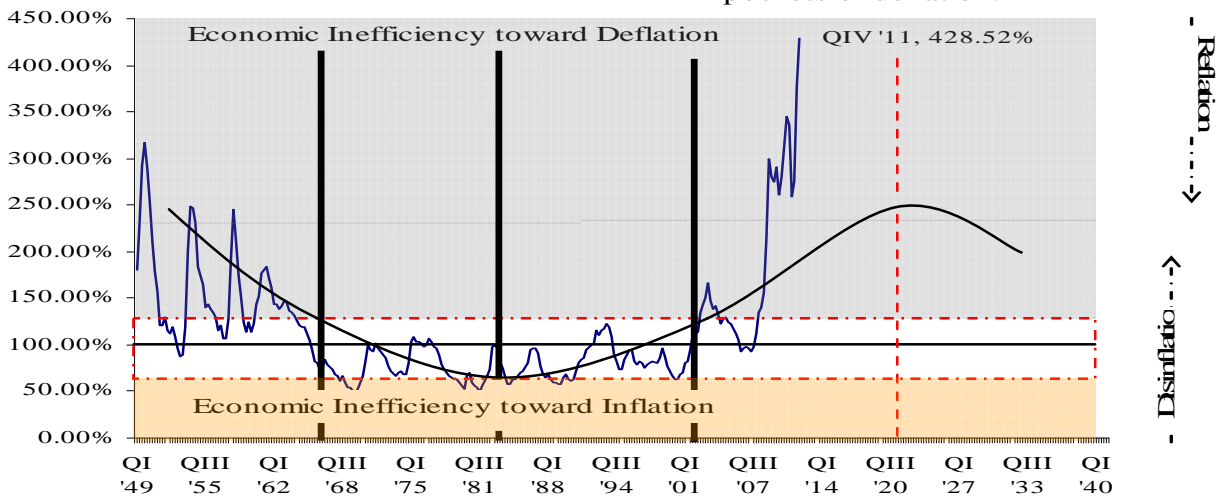
### Featured Commentary

#### **Focus on Stability** - By Paul Winghart, Sr. Taxable Portfolio Strategist

During periods of surplus productivity, it is not uncommon to see wage growth suppressed significantly on an aggregate basis as the realization of productivity gains makes labor cheap relative to its potential. In addition, and most importantly, surplus productivity tends to cause the output gap to widen which eventually leads to further pockets of deflation and illiquidity as well as increased price volatility.

Unemployment/ Long-Term Interest Rate Ratio  
1949 - present

The ratio clearly highlights the increasing potential for more pockets of deflation.



Data source: Bloomberg L.P. Chart by the Fixed Income Strategist Group RBC Wealth Management

In order to protect themselves as much as possible from these periods of volatility, fixed income investors need to remain especially attuned to the general strategy of stability with respect to their portfolios. In this case, that means the appropriate amount of maturity diversification with very highly rated issuers that have as many "knowns" - fixed coupons, stated final maturities, limited to no call exposure - as possible.

## Economic Releases

Date	Time CDT	Release	Period	Survey*	Actual	Prior	Revision of Prior
<b>Tuesday</b>							
2/21	7:30am	Chicago Fed Nat Activity Index	JAN	0.21	0.22	0.17	0.54
<b>Wednesday</b>							
2/22	6:00am	MBA Mortgage Applications	17-Feb	--	-4.50%	-1.00%	--
2/22	9:00am	Existing Home Sales	JAN	4.65M	--	4.61M	--
2/22	9:00am	Existing Home Sales MoM	JAN	0.90%	--	5.00%	--
<b>Thursday</b>							
2/23	7:30am	Initial Jobless Claims	18-Feb	355K	--	--	--
2/23	7:30am	Continuing Claims	11-Feb	3430K	--	--	--
2/23	8:45am	Bloomberg Consumer Comfort	19-Feb	--	--	-39.8	--
2/23	9:00am	House Price Index MoM	DEC	0.40%	--	1.00%	--
2/23	9:00am	House Price Purchase Index QoQ	4Q	--	--	0.20%	--
2/23	10:00am	Kansas City Fed Manf. Activity	FEB	9	--	7	--
<b>Friday</b>							
2/24	8:55am	U. of Michigan Confidence	FEB F	72.9	--	72.5	--
2/24	9:00am	New Home Sales	JAN	315K	--	307K	--
2/24	9:00am	New Home Sales MoM	JAN	2.60%	--	-2.20%	--

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