

Weekly Market Summary

September 7, 2010

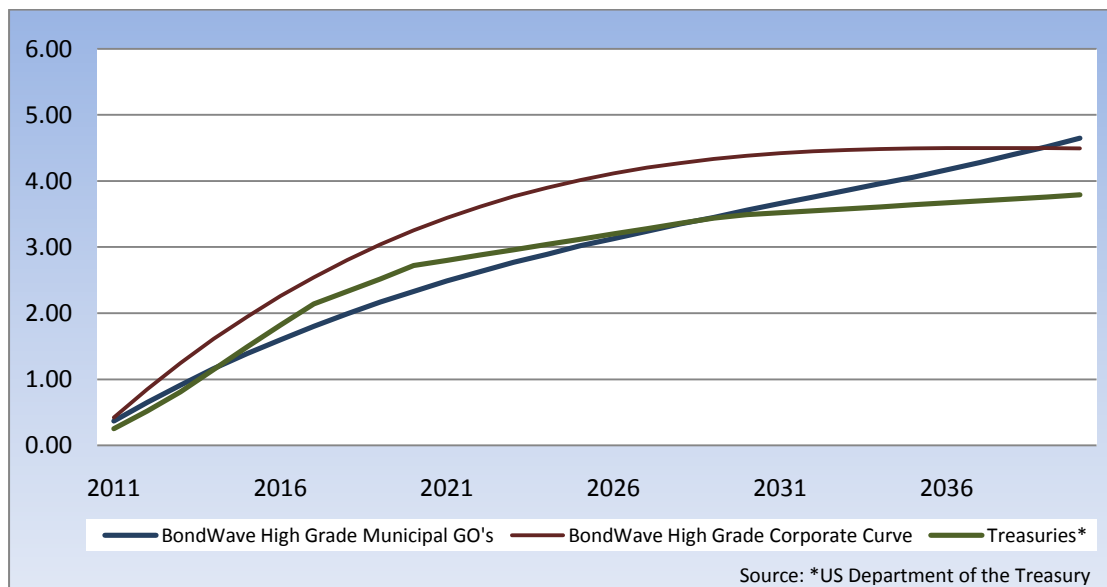
BONDWAVE
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The Markets

	3-Sep	27-Aug	Weekly Change	
Dow Jones Industrial Average*	10447.90	10150.70	2.93%	+297.20
S&P 500*	1104.51	1064.59	3.75%	+39.92
Nasdaq*	2233.75	2153.63	3.72%	+80.12
10 yr. Municipal [†]	2.33	2.33	0	bp
10 yr. Treasury**	2.72	2.66	6	bp
Dollar Index*	82.02	82.92	-1.09%	-0.91
Gold*	1246.75	1238.10	0.70%	+8.65
Oil*	74.60	75.17	-0.76%	-0.57

Sources: *Bloomberg.com, **US Department of the Treasury, [†]BondWave High Grade GO Curve

Bond Yields



Commentary

What a Difference a Month Makes

As investors flipped the page from August to September there seemed to be a change in the air besides the change in calendar month. August was certainly a month that equity investors would like to forget. Weaker manufacturing numbers on August 30th and 31st from Dallas, Chicago, and Milwaukee kept equities on the defensive at the beginning of the week, feeding into the pessimistic attitude that has characterized investors lately.

The DJIA, S&P 500, and Nasdaq Composite completed August with monthly losses of 4.31%, 4.74%, and 6.24% respectively.

September, however, seemed to bring fresh data and a fresh attitude. On Wednesday (Sept 1), national manufacturing activity, as measured by the Institute of Supply Management, continued to pick up. This was unexpected as economists had anticipated a decline.

The manufacturing report was followed by Friday's (Sept 3) employment report by the Bureau of Labor Statistics (BLS). The BLS report showed that the economy added more than expected private sector jobs in August (67,000 vs. 40,000 expected) as well as July (revised higher by 36,000 to 107,000).

The brighter data made an impact. Stocks rallied throughout the remainder of the week, with all three major US stock indices finishing sharply higher for the week. Treasuries, whose yields had been dropping at the end of August, saw a reversal. Yields on 10-yr and 30-yr Treasuries rose by 25 and 27 basis points respectively during the first three days of September to finish higher on the week.

With an extremely light economic calendar this week, traders coming back from vacation will be left time to digest the immense amount of economic data reported last week. Investors may look for weekly jobless claims to fall for a third consecutive week, supporting the positive outlook provided by last week's BLS report.

Economic Calendar (8/30/10 – 9/10/10)

Last Week

Date	Time (EST)	Economic Data	Consensus	Actual	Previous	Revised
30-Aug	8:30 AM	Personal Income (July)	0.3%	0.2%	0.0%	
	8:30 AM	Personal Spending (July)	0.3%	0.4%	0.0%	
	10:30 AM	Dallas Fed Manufacturing Activity (Aug.)	-10.0	-13.5	-21.0	
31-Aug	9:00 AM	S&P Case Schiller Home Price Index (June)	--	147.97	146.43	146.47
	9:45 AM	Chicago Purchasing Manager (Aug.)	57.0	56.7	62.3	
	10:00 AM	Consumer Confidence (Aug.)	50.7	53.5	50.4	51.0
	10:00 AM	NAPM Milwaukee (Aug.)	60.3	59.0	66.0	
	2:00 PM	FOMC Meeting Minutes (Aug 10)				
1-Sep	8:15 AM	ADP Employment Change (July)	15K	-10K	42K	37K
	10:00 AM	ISM Manufacturing (July)	52.8	56.3	55.5	
2-Sep	8:30 AM	Nonfarm Productivity (2Q Final)	-1.9%	-1.8%	-0.9%	
	8:30 AM	Initial Jobless Claims	475K	472K	473K	478K
	8:30 AM	Continuing Claims	4450K	4456K	4456K	4479K
	10:00 AM	Factory Orders (July)	0.2%	0.1%	-1.2%	-0.6%
	10:00 AM	Pending Home Sales (July Month to Month)	-0.1%	5.2%	-2.6%	-2.8%
3-Sep	8:30 AM	Unemployment (Aug.)	9.6%	9.6%	9.5%	
	8:30 AM	Change in Nonfarm Payrolls (Aug.)	-105K	-54K	-131K	-54K
	8:30 AM	Change in Manufacturing Payrolls (Aug.)	10K	-27K	36K	34K
	10:00 AM	ISM Non-Manufacturing (Aug.)	53.2	51.5	54.3	

This Week

Date	Time (EST)	Economic Data	Consensus	Actual	Previous	Revised
8-Sep	2:00 PM	Fed Beige Book				
9-Sep	8:30 AM	Initial Jobless Claims	470K		472K	
	8:30 AM	Continuing Claims	4445K		4456K	

Source: Bloomberg

Economic Indicators

Last week was an important glimpse into the employment picture. On Wednesday (Sept 1), ADP reported that private sector employment fell by 10,000 jobs, breaking a string of six months of positive growth. Service-providing firms added 30,000 jobs while goods-producing firms shed 40,000 jobs.

Friday's report (Sept 3) of the employment situation by the Bureau of Labor Statistics was encouraging. Expectations were for net job losses of over 100,000 due to continued Census layoffs. Net job losses only amounted to 54,000 in August, with the economy adding 67,000 private sector jobs, exceeding expectations. Additionally, July numbers were revised upwardly with private payroll gains adjusted from 71,000 to 107,000 jobs.

A few manufacturing indicators early in the week painted a picture of moderating activity. The Chicago Purchasing Managers Index slipped for the fourth time in the past six months, slipping slightly more than expected to 56.7 in August (from 62.3 in July). Six of the seven components slipped yet six remained above 50 and in expansionary territory.

Manufacturing in Texas, as measured by the Dallas Fed District, continued to contract for the third consecutive month. 12 of the 15 components showed declines from July, with employment and production leading the decliners. NAPM Milwaukee slipped more than expected, falling to 59.0 in August from 66.0 in July. The components were mixed with 5 higher and 4 lower. All components remained above the breakeven mark of 50 except for lead times.

A more robust picture was painted on Wednesday (Sept 1). Despite expectations of a decline, ISM Manufacturing rose in August. As in July, 9 of the 10 components were above the breakeven mark of 50. 6 of the 10 components rose, including production and employment.

After a rash of bad home sales figures the week ending 8/27, the housing market got some good housing news. On Tuesday (Aug 31) home prices rose by more than expected in June, according to the S&P/Case Shiller home price index. Home prices were unchanged or higher in 19 of the 20 reported metropolitan areas between May and June. Home prices are up 3.6% nationally over the last year. The report did warn that although prices have rebounded, continuing foreclosures and the end of tax incentives continue to create "ominous" conditions. Thursday (Sept 2) saw pending home sales unexpectedly rise 5.2%.

The economic calendar takes a break this week, with very little in the way of headline economic numbers. Wednesday (Sept 8) the Fed releases the Beige Book, an anecdotal summary of economic conditions across the country. Thursday's weekly jobless claims numbers have taken on more significance recently and may again this week given the dearth of economic data.

	Year	Yield	Weekly Change (bps)
1	2011	0.25	-2
2	2012	0.52	-4
3	2013	0.81	-2
4	2014	1.15	-1
5	2015	1.49	0
6	2016	1.82	3
7	2017	2.14	5
8	2018	2.33	5
9	2019	2.52	5
10	2020	2.72	6
11	2021	2.80	6
12	2022	2.88	6
13	2023	2.96	6
14	2024	3.04	6
15	2025	3.12	6
16	2026	3.20	6
17	2027	3.28	6
18	2028	3.36	6
19	2029	3.44	6
20	2030	3.49	8
21	2031	3.52	8
22	2032	3.55	8
23	2033	3.58	8
24	2034	3.61	8
25	2035	3.64	8
26	2036	3.67	8
27	2037	3.70	8
28	2038	3.73	8
29	2039	3.76	8
30	2040	3.79	10

Source: US Department of the Treasury for 1,2,3,5,7,10,20, and 30-year securities. All other yields are interpolated by BondWave Advisors.

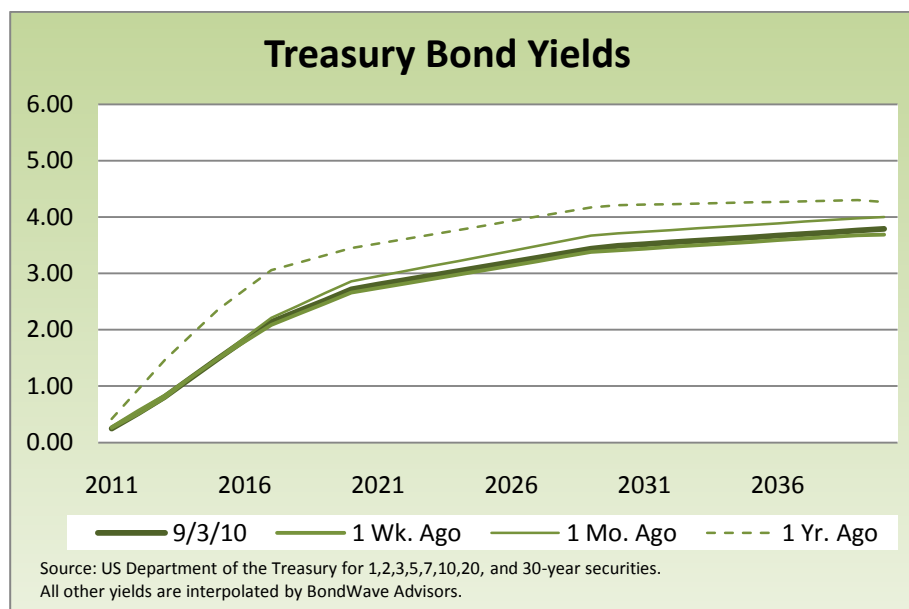
US Treasury Market

Treasury yields increased last week in a curve steeping bias amidst an unexpectedly strong ISM manufacturing index, a rise in pending home sales, a less than expected drop in nonfarm payrolls, and the FOMC minutes. Upon the announcement of the FOMC minutes last Tuesday, Treasuries recouped losses experienced the Friday prior. According to the minutes, some of the Fed officials expressed a negative outlook on the economic recovery. The 10-year Treasury rallied the most on this news. Prices stayed up Tuesday owing to the month-end purchases of Treasuries, as investors lengthened the duration of their portfolios in order to match respective benchmarks. Treasuries sold off Friday after the release of the stronger than expected employment report.

Last month ended positively for bonds while equities showed monthly losses. In light of subdued inflation expectations and concerns about economic recovery, investors continued to favor intermediate to longer-dated bonds. The 10-year Treasury yields decreased by as much as 47 bps and 30-year yields fell 46 bps over the month of August. The yield curve experienced significant flattening as the 2-year yields decreased by merely 8 bps over the same time period. Overall, Treasuries returned 2.01% in August according to Barclays Capital Indices. The 20+ year portion of the curve led the way, returning 8.08%.

The US government is benefiting the most with short term yields anchored at ultralow levels. Most of the US Treasury debt outstanding is short term in nature. The interest cost for the US Treasury debt outstanding fell by 22% in 2009 and 17% so far this year, according to Bloomberg data. After successfully issuing the 2-year, 5-year and 7-year notes at their lowest ever yields in the week prior, the US Department of the Treasury sold \$10 billion in 10-year TIPS last Thursday (Sept. 2). The bid-to-cover ratio at the auction was better than average at 2.80 but this was a decline from the prior two auctions. The yield was higher than expected at 1.019%.

During this holiday-shortened week with a light economic calendar, new debt sales will take the center stage. The Treasury will sell \$33 billion in 3-year notes (Sept. 7), \$21 billion in 10-year notes (Sept. 8) and \$13 billion in 30-year bonds (Sept. 9).



Yield Curve Slope (1 yr - 30 yr) in bps	
9/3/10	354
1 Wk. Ago	342
1 Mo. Ago	375
1 Yr. Ago	385

Yield Curve Slope (5 yr - 30 yr) in bps	
9/3/10	230
1 Wk. Ago	220
1 Mo. Ago	249
1 Yr. Ago	191

	Year	Yield	Weekly Change (bps)
1	2011	0.42	2
2	2012	0.85	2
3	2013	1.25	3
4	2014	1.61	3
5	2015	1.95	4
6	2016	2.26	5
7	2017	2.54	6
8	2018	2.80	7
9	2019	3.04	9
10	2020	3.25	10
11	2021	3.44	12
12	2022	3.61	13
13	2023	3.77	16
14	2024	3.90	17
15	2025	4.02	18
16	2026	4.12	19
17	2027	4.20	20
18	2028	4.27	21
19	2029	4.33	21
20	2030	4.38	22
21	2031	4.42	22
22	2032	4.45	21
23	2033	4.47	21
24	2034	4.49	20
25	2035	4.49	18
26	2036	4.50	16
27	2037	4.50	13
28	2038	4.50	10
29	2039	4.50	7
30	2040	4.50	3

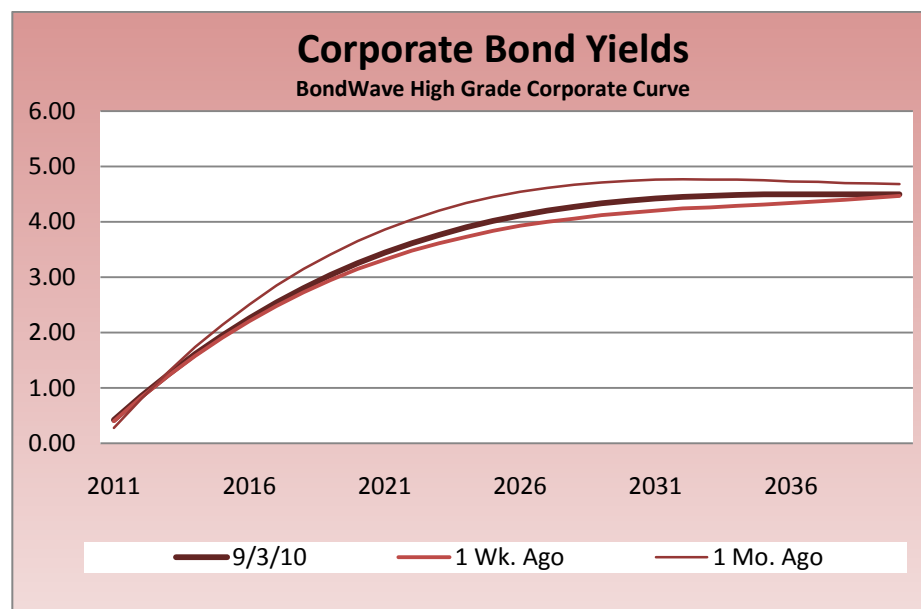
Source: BondWave High Grade Corporate Curve

Corporate Bond Market

The Markit Investment Grade CDX index tightened over the week as the effect of disappointing economic numbers was neutralized by the other good numbers. Disappointing Dallas Fed Manufacturing numbers on Monday and Chicago Purchasing Manager on Tuesday caused the index to widen 3.5bps over the period. Better than expected ISM manufacturing on Wednesday and jobless claims on Thursday helped the index tighten 3bps. The index welcomed the better than expected Nonfarm Payroll numbers on Friday en route to 3bps of tightening. The Markit Investment Grade CDX index ended the week at 103.39, 7.6 bps tighter for the week. Investor aversion to high yield bonds continued to plague the Markit High Yield CDX index but favorable economic numbers helped it end higher for the week. The Markit High Yield CDX index ended the week at \$97.81, up \$1.33 for the week.

Corporate debt sales last week came in at \$7 billion, with a majority of the issuance by foreign companies. Investment grade issuers accounted for 95% of the volume. Among the investment grade issuers were Germany's state owned development bank, Kreditanstalt Fuer Wiederaufbau, which sold \$4 billion of 10-year dollar-denominated debt and Sara Lee with \$800 million evenly split between the 5 and 10 year maturities. China shopping mall developer, Renhe Commercial Holdings, ended the high yield dearth by issuing \$300 million in 6-year notes.

August was a record setting month for high yield issuance as \$23 billion was issued, despite no activity the last 10 days of the month; it was the seventh largest monthly volume according to Dealogic. High yield issuance may continue to lull in September as investors look for signs of growth in the economy before investing in these riskier securities. Despite this, Bank of America Merrill Lynch raised its high yield issuance forecast from \$210 billion to \$240 billion for 2010, sighting a backlog of offerings. \$176 billion has been issued year-to-date. High grade issuers have fared better as investors have clamored for their bonds as they expect these issuers to weather the slowing economy better than their high yield counterparts. \$73 billion of investment grade debt was issued for the month of August. September is expected to be a high issuance month for investment grade debt as vacations begin to wind down and activity resumes on the issuance desks.



Yield Curve Slope (1yr - 30yr) in bps	
9/3/10	407
1 Wk. Ago	407
1 Mo. Ago	440

Yield Curve Slope (5yr - 30yr) in bps	
9/3/10	255
1 Wk. Ago	256
1 Mo. Ago	254

	Year	Yield	Weekly Change (bps)
1	2011	0.37	2
2	2012	0.65	5
3	2013	0.91	6
4	2014	1.16	8
5	2015	1.39	8
6	2016	1.60	7
7	2017	1.80	6
8	2018	1.99	4
9	2019	2.17	3
10	2020	2.33	0
11	2021	2.49	-2
12	2022	2.63	-5
13	2023	2.77	-7
14	2024	2.89	-10
15	2025	3.02	-11
16	2026	3.13	-13
17	2027	3.24	-14
18	2028	3.35	-14
19	2029	3.45	-14
20	2030	3.56	-12
21	2031	3.66	-9
22	2032	3.76	-6
23	2033	3.86	-1
24	2034	3.96	5
25	2035	4.06	12
26	2036	4.17	22
27	2037	4.28	32
28	2038	4.40	46
29	2039	4.52	60
30	2040	4.65	77

Source: BondWave High Grade GO Curve

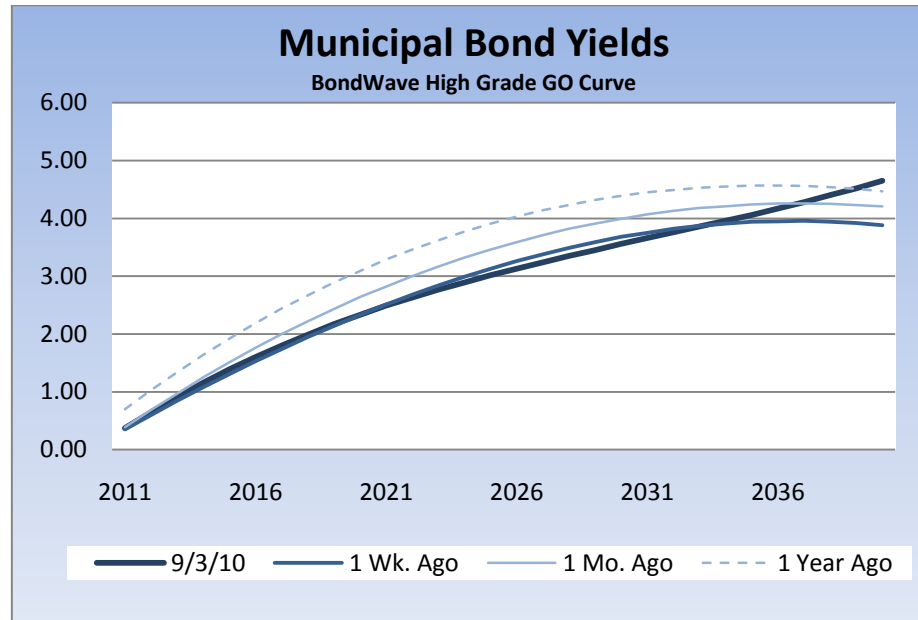
Municipal Bond Market

Municipal bond prices were buoyed Monday (8/30) and Tuesday (8/31) as a result of month-end buying. Economic news in the latter half of the week had munis pausing as treasuries sold off. Trading was light as is typical in advance of a shortened holiday week. New issue supply has been light for many weeks and reached a 6-month low of \$27.2 billion in August, according to Thomson Reuters. This represents a decline of 25% compared to the same period in 2009. Taxable issuance declined even more, at 31% less than the year prior. This includes BAB issuance which was the lowest in 13 months.

Despite ultra low yields and a barrage of bad press for municipals, the month of August proved very positive for municipals, both taxable and tax exempt. Municipal bonds are less sensitive to economic activity than Treasury bonds and corporate bonds, and August was a volatile month for economic activity. The Barclay's Build America Bond index had a total return for the month of August of 5.33%. The index has had a positive return for each of the eight months in 2010, which cannot be said for tax-exempts, corporates, or treasuries.

Last week the Assistant Treasury Secretary for Economic Policy addressed states' concerns regarding the IRS offsetting BAB subsidies for other monies owed, and called the concerns overblown in a speech to the National Association of State Treasurers. He stated only seven subsidy payments to issuers have been withheld of 278. He affirmed the fact that other tax credits or federal payments to the states would be offset if BABs were not issued.

New issuance remains light this week with total municipal issuance scheduled for a mere \$3 billion, according to Thomson Reuters. Roughly \$2.5 billion will come as tax-exempt while \$500 million will be issued as BABs or other taxables. We could see BAB issuance pick up due to issuers rushing to receive the federal subsidy if Congress does not extend the expiration. For example, last week the Pennsylvania Turnpike Commission issued \$600 million in BABs to cover two years of financing locking in the 35% federal subsidy on interest payments whereas it typically issues debt for only one year of financing at a time.



Yield Curve Slope (1 yr - 30 yr) in bps	
9/3/10	428
1 Wk. Ago	353
1 Mo. Ago	382
1 Year Ago	377

Yield Curve Slope (5 yr - 30 yr) in bps	
9/3/10	326
1 Wk. Ago	257
1 Mo. Ago	270
1 Year Ago	255

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