



FIXED INCOME NEWS

Fixed Income Strategies Group

Tuesday, April 27, 2010

Economic Commentary

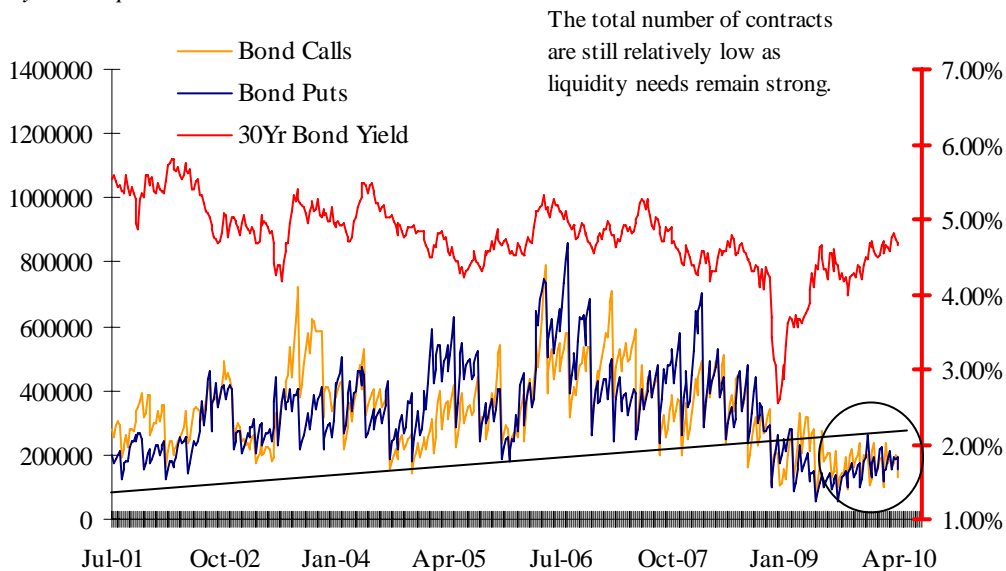
by Paul Winghart

Rebounding from yesterday's lull, action in the Treasury market is relatively sharp this morning with the benchmark 10yr note up a half of a point in price to yield **3.74 percent**. The entire curve is enjoying a spate of increased demand this morning resulting in a parallel shift of the yield curve. While the abrupt nature of today's rally may be attributed to a number of causes, more than anything else demand is being exaggerated (either way) by speculation stemming from further Treasury auctions as well as the Fed's forthcoming FOMC meeting.

The Treasury Department is set to auction \$44.0 billion in new 2yr notes this afternoon after coming to the market with \$11.0 billion in 5yr TIPS yesterday. The 2yr note has found itself in a rather peculiar place as of late, in the crossroads between longer-term economic fundamentals and near-term trends in monetary policy. As a result, the yield on the 2yr note has fallen as low as 0.77 percent and risen as high as 1.18 percent since the beginning of the year (a relatively large spread given the nominal level of its coupon). The results of today's auction may provide some insight into the market's general perception of tomorrow's FOMC meeting. Currently, the W-I yield on the 2yr note is trading around 1.05 percent, the lowest level it has traded at since being announced last week.

Bond Open Interest Option Contracts

July 2001 - present



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

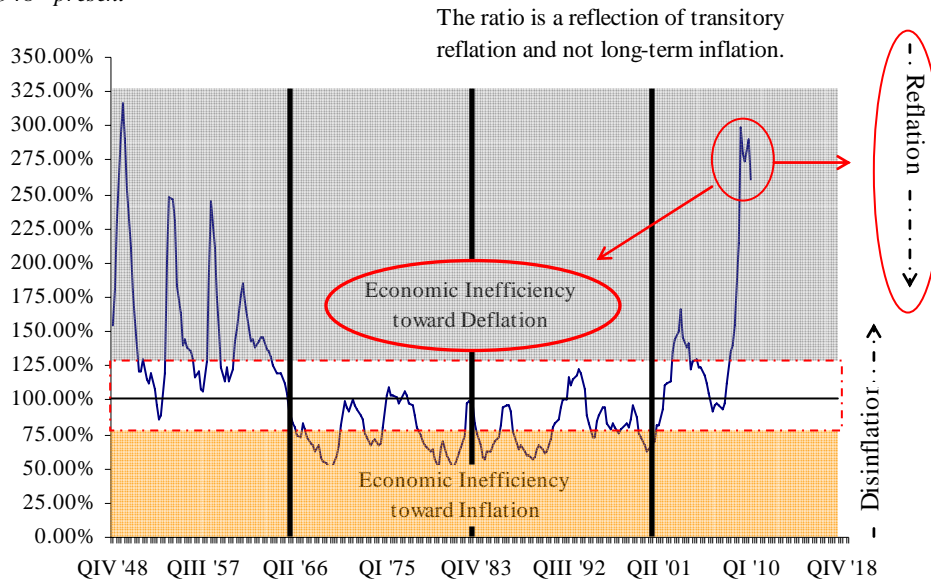
The short-end is especially suspect to an increase in speculation in the current economic environment as the longer-end is slowly supplanting it as a source of liquidity. The overall volume of bond open interest option contracts, both calls and puts, remains extremely low overall. Indicating a relative unwillingness to "play with" monies on the longer end, these maturities are now serving their more economical function of providing investors a source of liquidity that is more reliable and time-tested than shorter maturities. At the same time, the increasing lack of confidence that the Fed will be able to effectively manage monetary policy going forward increases the probability that a tremendous amount of volatility may surface without warning.

Although every situation is unique, the state of monetary policy today is reflecting a similar position to 2004. That year, it was a March employment report that put the market on notice that the Fed was ready to begin tightening policy, and this was ultimately set forth in the following May FOMC meeting. Currently the data doesn't appear to "be there" yet, but the

Fed does not need specific nominal levels of unemployment or payrolls to rationalize a change in monetary policy.

Sacrificing its dual mandates in order to provide a more direct support to the financial sector, policymakers are at risk of compromising an inordinate amount of current price stability the longer they wait. The erosion of price stability, consequently, would be seen as a tremendous failure on the Fed's part which may have a dramatic affect on the behavior of short-term interest rates for a long time. With broad ramification for the economy overall especially one that is dominated by the service sector, a loss of price stability, which is extremely hard to recover, could dominate trends in monetary policy for years to come.

Unemployment/ Long-Term Interest Rate Ratio
1948 - present



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

Economic Calendar

Date	Time CDT	Release	Period	Survey*	Actual	Prior	Revision of Prior
Monday							
04/26	9:30am	Dallas Fed Manf. Activity	APR	9.80%	21.10%	7.20%	--
Tuesday							
04/27	9:00 am	Richmond Fed Manufact. Index	APR	10.0	30.0	6.0	--
04/27	9:00 am	Consumer Confidence	APR	53.5	57.9	52.5	52.3
04/27	4:00 pm	ABC Consumer Confidence	25-Apr	-48	--	-50	--
Wednesday							
04/28	6:00 am	MBA Mortgage Applications	23-Apr	--	--	13.60%	--
04/28	1:15 pm	FOMC Rate Decision	28-Apr	0.25%	--	0.25%	--
Thursday							
04/29	7:30 am	Chicago Fed Nat Activity Index	MAR	-0.2	--	-0.64	--
04/29	7:30 am	Initial Jobless Claims	24-Apr	445K	--	456K	--
04/29	7:30 am	Continuing Claims	17-Apr	4613K	--	4646K	--
Friday							
04/30	7:30 am	GDP QoQ (Annualized)	1Q A	3.40%	--	5.60%	--
04/30	7:30 am	Personal Consumption	1Q A	3.10%	--	1.60%	--
04/30	7:30 am	GDP Price Index	1Q A	0.90%	--	0.50%	--
04/30	7:30 am	Core PCE QoQ	1Q A	0.50%	--	1.80%	--
04/30	8:45 am	Chicago Purchasing Manager	APR	60	--	58.8	--
04/30	8:55 am	U. of Michigan Confidence	APR F	71	--	69.5	--

Market Data

Note: low yield = high price

Source: Bloomberg

Tuesday, April 27, 2010

7:30 AM Central

12 Month

Intra-Day Highs

Intra-Day Lows

30-year Treasury

4.62%

4.84%

04/05/10

3.96%

10/01/09

10-year Treasury	3.76%	3.99%	04/05/10	2.91%	04/27/09
5-year Treasury	2.51%	2.92%	06/08/09	1.85%	04/27/09
2-year Treasury	1.02%	1.40%	06/08/09	0.67%	11/30/09
6-Mo Treasury	0.24%	0.35%	06/29/09	0.13%	11/19/09
3-Mo Treasury	0.15%	0.20%	06/23/09	0.01%	11/19/09
10-year TIPs	1.40%	1.92%	06/18/09	1.08%	11/30/09
10-year Corporate	4.65%	5.61%	06/10/09	4.16%	10/01/09
10-year AAA Municipal	2.94%	3.61%	06/12/09	2.62%	10/02/09
10-year TEY*	4.52%	5.55%	06/12/09	4.03%	10/02/09
3M LIBOR	0.33%	1.05%	04/27/09	0.25%	02/04/10
Fed Funds Target Rate	0.25%	0.25%	04/27/09	0.25%	04/27/09
Prime Rate	3.25%	3.25%	04/27/09	0.00%	01/00/00
CPI (Y-O-Y)	2.30%	2.70%	12/31/09	-2.10%	07/31/09
NASDAQ (Prior Day's Close)	2,523	2,530	04/23/10	1,664	05/13/09
DJIA (Prior Day's Close)	11,205	11,204	04/23/10	8,017	04/28/09
S&P 500	1,212	1,217	04/23/10	855	04/28/09
Oil	83.36	86.84	04/06/10	49.92	04/28/09
Gold	1149.10	1,217.40	12/03/09	888.20	05/01/09
Copper	352.70	362.60	04/05/10	191.40	04/28/09
U.S. Dollar / Yen	93.56	99.12	05/07/09	86.41	11/30/09
Euro / U.S. Dollar	1.329	1.513	11/25/09	1.304	04/27/09
*TEY (35% Federal Tax Bracket)					

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