U.S. Daily Directions: March 3, 2008, NY Edition

Today: **ISM, construction spending, vehicle sales, FedSpeak.** The Feb ISM mfg index is expected to fall into contractionary territory (from 50.7 to 48.4), consistent with declines in several of the regional activity surveys. Jan January Construction Spending is expected to have fallen 0.7%m/m, consistent with the weak durable goods orders for the month. Feb vehicle car sales are expected to rise modestly from 15.3mm to 15.5mm. FedSpeak includes Plosser (hawk, voter) regarding monetary policy and Krozner (voter) regarding risk management.

Overnight: **Ip on stagflation, CMBS, Countrywide blindsided, Auction rate woes.** Greg Ip has an article pointing out that 1970's-style of stagflation is unlikely to recur, a notion with which we agree. Nonetheless, we do believe that the Fed's focus on easing at a time when inflation pressures remain supports our curve steepening both at the short and long ends of the curve. The US AID food program is scaling back its distribution of food due to the 41% rise in the cost of wheat, corn, rice and other cereals over the last six months. The WSJ is highlighting the potential for commercial real estate to precipitate another round of large bank writedowns in coming quarters, a warning our own bank analyst, Gerard Cassidy, has been making in recent months. The Office of the Comptroller of the Currency has warned that commercial real estate exposure will likely lead to bank insolvencies in coming quarters. Countrywide's annual SEC filing shows deepening woes. The most troublesome development is that the company was blindsided by the lack of reimbursement from home equity trusts because the losses on the loans triggered non-reimbursement clauses. The company recorded a $704 million loss to cover the estimated costs of its obligations on the lines of credit but noted that further losses may lie ahead and that the company could not actually "define" the "maximum obligation". Auction rate woes are mounting, with Municipality ratings getting downgraded, student lenders ceasing operations, and auction rate investors incurring losses. Additionally, the auction failures are causing municipalities to shift to alternative financing, causing a glut of muni bond supply. Gold advanced to a record $984.95, and silver jumped to $20.19, the highest in 27 years as the dollar fell to a record against a basket of six major currencies.

Asset Commentary/Assessment:

Eurodollars: **Overnight, yields mixed, curve flatter.** Yields on contracts out to Sep'08 rose 0.5-2bp, and further out they mostly fell 0.5-2.5bp. The strip now suggests a trough in the fed funds rate below 2.25% in Sep'08. We retain our view that the Fed will cut the overnight rate to 2.00% by Q2'08. As to the March Fed meeting, the futures price in not only a 50bp cut, as we expect, but also a 28% chance of a 75bp cut.

Treasuries: **Overnight, yields unch to higher, curve steeper.** Yields moved lower early in Asia, stabilized, and then rose throughout most of the European morning. The 2yr yield is stable at 1.61%, although it traded as low as 1.56%, a new low since Apr'04. The 10yr yield is up 2.6bp to 3.54%. Our 2s30s steepener at (entry 268bp, stop-loss at 255bp, initial target of 300bp) rose 3.7bp to 282bp.

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