U.S. Daily Directions: March 5, 2008, NY Edition

Today: **Services ISM, ADP employment, Beige Book, Challenger job cuts.** The services ISM for Feb is expected to rebound to 47.3 from 44.6, the record low in data back to 1997. ADP employment for Feb is expected to print an anemic 18K gain. The Beige Book will be useful in providing color on the trade-offs for the Fed between the risks to growth from real economic slowing and tightening credit on the one side, and the risks to inflation on the other. Jan factory orders are expected to have fallen 2.5%, a correction from four consecutive gains. Challenger job cuts are not forecast, but have failed to do more than hint at rising job losses.

Overnight: US equity futures are up on expectations of an Ambac bailout plan, as CNBC reported "progress" on that front late yesterday. The question is how permanent such a plan will prove in light of the expected further deterioration in housing, which will put further pressure not only on Ambac's structured finance business, but also the strength of the banks being counted on for the bailout. As evidence of this strain, the WSJ is running an article today highlighting the hesitance of foreign investors to plough even more money into Citi group. Bonds have faded the Ambac bailout news, and the 2yr yield has fallen 4.85bp and the 10yr yield is down 3.6bp. The failure rate for auction-rate bond failures is approaching 70%, with no sign of recovery. Borrowing rates for municipalities have risen to an average of 6.52% as of Feb 28 from 3.63% in Jan, and rising funding costs will, dampen economic activity at the local level. Bernanke's testimony is increasingly being viewed as "out-easing" the Treasury, and on the negative side, it could very well lead to accelerated bank and MBS losses, but on the positive side, it could short-circuit derivative losses due to CDO downgrades. ABC consumer confidence rebounded to -34 from -37, which had been the low since 1993.

Asset Commentary/Assessment:

Eurodollars: **Overnight, yields higher, curve mixed.** Yields rose to varying degrees along the entire curve. The Jun'08 yield rose the most (4.0bp), but some yields rose as little as 1.0bp. The strip now suggests a trough in the fed funds rate between 2.00% and 2.25% in Sep-Dec'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, despite the rebound in yields, the futures price in not only a 50bp cut, as we expect, but also a 68% chance of a 75bp cut.

Treasuries: **Overnight, yields lower, curve steepens.** Yields fell in Asia and most of the European morning before partially rebounding coming into the US session. The 2yr yield is down 5.6bp at 1.60%, while the 10yr yield is down 4.0bp to 3.58%, and this yield appears to have found good support at 3.50%. Our 2s30s steepener (entry 268bp, stop-loss at 255bp, initial target of 300bp) rose 3.3bp to 288bp.

Swaps: **Yesterday, swap spreads blew out** as the de-leveraging in the market continues. 2-year spreads relative to the rate (spread divided by the all-in rate) have reached record extremes. To put things into perspective, late last year 2 year swap spreads were a little above 100 and 3 month Libor was higher then 5%. Now 2 year spreads are right around 100 (granted we have had rolls, etc) and 3 month Libor is over 200bp lower. This is about de-leveraging across multiple asset classes and not about the Fed right now. If anything we have been pricing for a more aggressive Fed and spreads have done nothing but widen.

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