

April 4, 2008

U.S. Directions

Fixed Income Strategy

Trade Recommendations 2

Sell UST 4.375% 2038 vs Canada 5% 2037

Sell UST 10s vs Australia 10s ** Trade to consider **

Macro: Policymakers grim, data flirtatious, markets guarded 3

Week Ahead: Light data week, FOMC minutes..... 4

Treasuries: Yield curve at critical level..... 4

Eurodollars: Market hedging bets 4

Swaps: Late to the tightening party 5

MBS: Spread still too wide 5

Calendar and Economic Forecasts 6

Keys to the week

- * FOMC minutes
- * Pending home sales
- * Trade balance, import prices
- * U. Mich. Confidence
- * FedSpeak

Sector	View	Specific Comments
Notes/bond yields	* Value in 2yr at 2.0% * Long-end leaking wider	After breaking to a new high since February, the 2yr yield has stabilized below 2.00%, which our trading desk sees as presenting good value. Further upside could come from more supply, while economic and financial crisis considerations suggest the 2yr should remain capped. The 10yr yield appears to be forming an uptrending channel off the Mar low, although it has been soundly rejected at 3.60%, at least for the short-term.
Curve	* At critical level	Hedge fund liquidation, short-end supply, and massive liquidity provisions continue to cause curve flattening. From a fundamental perspective, we retain a steepening bias, but the technical factors are in control of the situation.
Eurodollars	* Bullish	Eurodollars are pricing in a trough in the Fed Funds between 1.75% and 2.00%. We believe the Fed will cut to 1.50% by mid-year due to ongoing large bank losses, rising losses at regional banks, hedge funds and real money accounts, and continued deterioration in the economy. Additionally, the market is pricing the chance of tightening as early as Dec'08 (we do not forecast tightening until H2'09).
Swaps	* Expect tighter	Swap spreads should benefit generally due to having lagged the generalized tightening move and should corporate issuance begin to pick up as volatility declines.
Mortgages	* Look to buy basis * 15yr vs 30yr	Basis still looks cheap, but has come too far to fast. Look to re-enter tightening positions on pullbacks. We also believe 15yr paper is attractive relative to 30 yr paper.

Trade Recommendations

Note all costs of carry are calculated over 3-months at inception unless otherwise stated

Profit/losses are calculated relative to the last edition of U.S. Directions, Trades priced at noon EST

Sell US 30s vs Canada 30s

Entry (Mar 19)	Close (Apr 4)	Target	Stop-loss	Carry	Weekly P&L	Cumulative P&L
-30bp	-26.5	-50bp	-20bp	-	-11.4bp	+7.9bp

This trade has been hammered by curve flattening in the US. Nevertheless, the fundamental backdrop remains in place, and we will ride the position through this downdraft.

This trade seeks to capitalize upon Canada's superior inflationary backdrop – the BoC being the only central bank we cover that is not concerned on the prices front while the Fed cuts rates aggressively in the face of lingering inflation concerns. The supply-side backdrop is also conducive for this trade with Canada likely posting healthy surpluses while the US budgetary shortfall looks set for a marked deterioration as the government pushes out a stimulus package worth close to 1.0% of GDP.

Trade: SellT4.375% 2038 vs CAN5% 2037

Trade Under Consideration

Sell US 10s vs. AU 10s After widening for the last two years, the benchmark 10 year AU-US spread appears to have stabilized in a 240-280bp range in the last 2 months. This is around the widest level since 1995 and largely reflects the divergence in the economies and monetary policy, especially over the last year. However, with early indications that domestic demand is finally starting to moderate in AU suggesting that cash rates have peaked at 7.25% while the Fed inches closer to the end of its easing cycle, relative value is emerging. While we do not expect any notable outperformance of AU against the US in the coming months, the odds favor a narrowing in the 10 year AU-US spread over the longer term (6-12 months). Accordingly, we are monitoring opportunities to begin building a small long position preferably around the top of the recent range (275bp).

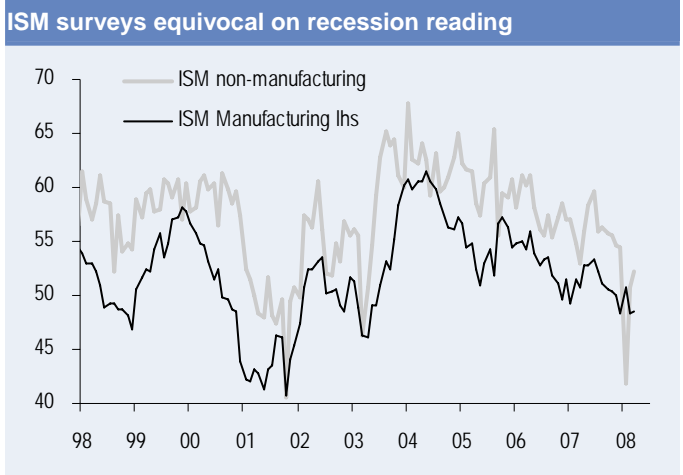
Policymakers are grim, data flirtatious, and markets guarded

Policymakers focus on grim state

Markets received two days of testimony from key financial crisis players and policymakers, and the testimony reflected a dire financial market situation and a heightened potential for a recession during H1'08. Geithner described the situation as a “self-reinforcing downward spiral” involving “higher volatility and still lower prices”. He also indicated that the Fed’s actions in facilitating JP Morgan’s buyout of Bear Stearns, policymakers sought to halt a crisis that would have caused “protracted” economic damage. Further, he avoided expressing any confidence that the recent policy actions had curtailed the risk of other banks running into similar problems as Bear Stearns had. Geithner characterized capital markets as still “substantially impaired”. For his part, Fed Chair Bernanke finally let slip the “R” word, conceding that a “recession is possible”, but doggedly observing that at the “moment”, the economy is still “slightly growing”. Bernanke held to the view that the economy would rebound in the second half of 2008, buoyed by both lower interest rates and the tax rebate stimulus package. However, he admitted that “in light of the recent turbulence in financial markets, the uncertainty attending this forecast is quite high and the risks remain to the downside.”

Data reflect growth’s flirtation with recession

The data this week largely reflected recession-like activity and sentiment. All of the PMI-type survey headlines, despite uniformly surprising to the upside, remain in contractionary territory. The manufacturing ISM unexpectedly ticked higher to 48.2, consistent with moderations in growth rather than full-fledged recessions. The services PMI also unexpectedly ticked higher to 49.3, although a reading between 45 and 50 is consistent with the readings during the 2001 recession. The dichotomy in the extent to which the manufacturing and services ISM’s suggest recession reflects the boost in manufacturing, which is more easily exportable, from the weak US dollar, whereas the services survey fully reflects the slowdown from the housing recession. Construction spending continued to fall (5th consecutive month),

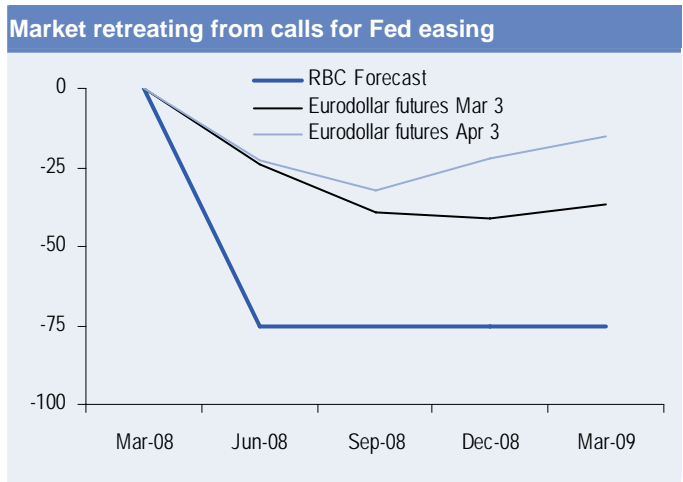


Source: ISM, Bloomberg

slipping 0.3%/m during February, but the decline was not as bad as feared (-1.0 expected). Factory orders fell 1.3%/m in Feb, the 2nd consecutive decline, and the prior reading was revised lower. The labor data was mixed, but looks increasingly recessionary. The March ADP report showed a surprise 8k gain in private payrolls. However, initial claims rose to 407K, continuing claims jumped to 2937K, and non-farm payrolls fell 80K, all levels consistent with the 2001 recession.

The markets remain guarded

Despite the passage of quarter-end, the TED-spread (3-mo LIBOR less 3-mo. T-bill) has risen - from 132bp on Mar31 to 139bp. Longer-term spreads remain elevated, if down from the peaks at the height of the Bear Stearns crisis. The 10-yr agency less Treasury yield is down to 76bp, well below the March 17 peak of 101bp, but still above the wide of the crisis last August. The mortgage spread is down to 219bp, significantly below the 293bp peak on March 6, but still above the long-term average (since 2000) of 154bp. The 2yr swap spread is settling into an 80-85bp range below the recent high of 113bp on March 7, but still near the highs of last August. As to expectations for the Fed, the market has paired back on its view that the Fed will have to continue easing aggressively. A week ago, the futures market priced in a 42% chance of a 50bp cut on April 30th, but now prices in only a 22% of a 50bp cut. Additionally, the market prices a higher trough in the Fed Funds rate. A week ago, 1.75% appeared to very likely during H2'08, with significant odds of cuts to 1.25%. However, currently, the market is focusing more on a trough of only 2.00% not so dovish as our base case of 1.50%. The retreat in view reflects the cross-winds presented by the massive non-interest rate measures taken to inject liquidity into the financial markets, the fiscal stimulus scheduled to boost consumption, which we expect will happen primarily in Q3, the dissent of two FOMC members against the magnitude of the March 18 ease, and ongoing reports of global inflation pressures.



Source: Bloomberg, RBC Capital Markets

Week Ahead: Light data week, FOMC minutes

Data risk drops to a relatively low level this week. The FOMC minutes will shed light on the trade-offs the Fed considered between economic growth, inflation concerns, and the financial crisis. Also of note will be how the dissents by Fisher and Plosser were considered. The condition of housing will be evidenced by pending home sales for Feb, which are expected to have fallen 0.8%/m/m, continuing the downtrend in this time series. The condition of the consumer will be ascertained by the consumer credit, chain store sales, ABC consumer, IBD/TIPP and U. Mich confidence surveys. Consumer credit for Feb is expected to have fallen to \$5.5bn, leaving a sharp downtrend from mid-2007 in place and suggesting weaker personal consumption. Chain store sales are not forecast, but have deteriorated since mid-'06 to 1.9%/y in February, with recent readings as weak as those during the recessions of 1990-1 and

2001. The U. Mich is forecast is for a decline to 69.0, yet another low since 1992. The ABC index (most recent reading of -33) is stabilizing around lows since 1993, while the IBD index has recently registered 42.5, a low since Hurricane Katrina.

Other data includes import prices, the budget and trade balance. Import prices for Mar are expected to have risen 2.0%/m/m, the 4th highest spike since 1990. The budget statement is expected to show an 81.0bn deficit, as revenues continue to trend lower even as expenses rise. The trade deficit is expected to moderate to \$57.8bn, and this measure has been consolidating since mid-2006. Auction activity will include a \$6.0bn 10yr TIPS. Additionally, Fannie will announce the float of a 2y, 3yr, 5yr or 10yr note worth a potential \$3.0bln.

Treasuries: Yield curve at critical levels

The yield curve continued to flatten in recent sessions, with the 2s30s down almost 20bp in recent sessions to 248bp, well off the Mar6 high of 306bp, and at the flattest level since early February. From a technical analysis perspective, the price action has not only broken a head and shoulders pattern established since February, but also psychological support at 250bp and 248bp support (Feb 20 [post-SocGeg] low). The breach of these levels suggests further flattening, with support at 2.20% (high from Jan), 2.07% (Jan29 low) and then 2.94% (target of breach of head and shoulders pattern). Support for such price action could derive from further Fed sales of Treasuries to offset liquidity provisions being implemented. Additionally, the curve could be weighed by position unwinds as hedge funds come under pressure from margin calls and/or investor redemptions. The deteriorating economic situation continues to support steepening positions, but non-fundamental considerations are dictating price action currently.



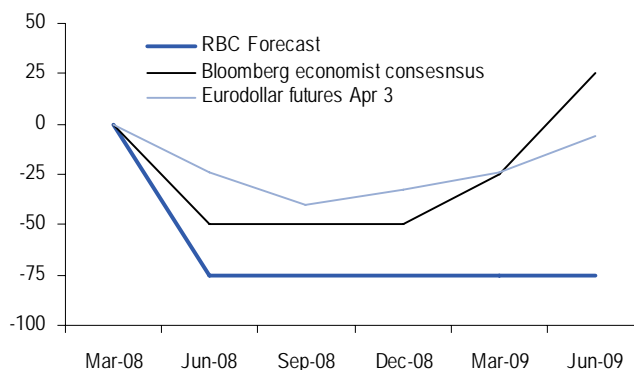
Source: Bloomberg

Eurodollars: Market hedging its bets

The Eurodollars curve has pared back on its bets that the Fed will cut the overnight rate 50bp from 48% last week to only 36%. Furthermore, the expected trough for the Fed Funds rate has moved higher. A week ago, the market was comfortable with 1.75% as a trough in H2, with the potential for more easing. Now, the market appears conflicted as to whether the Fed cuts to a trough in Q3 of 2.00% or 1.75%, with some believing a cut to 1.50% is possible. Further, the market is pricing in the chance for tightening as earlier as December. Economists share a similar view. The Bloomberg consensus expects the Fed to cut to a trough of 1.75% by mid-year, and then to begin hiking during Q1'09.

We retain the view that the Fed will cut to 1.50% by mid-year due to ongoing financial market dislocations and further economic deterioration as the housing and financial market crises weigh further on consumers. Further, we share the Fed's concern that risks to growth are greater than those to inflation, and so have no tightening in our forecast until H2'09.

RBC forecasts more and more prolonged Fed easing

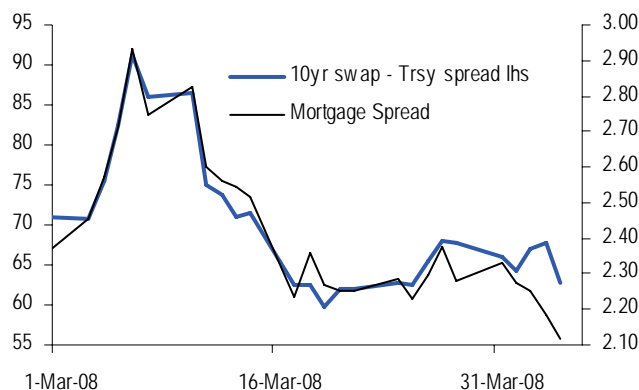


Source: Bloomberg, RBC Capital Markets

Swaps: Late to the tightening party

After leaking wider despite in recent sessions despite dramatic tightening in other spread products (Agencies, Mtges, IG index) and vol dropping off, swap spreads finally tightening sharply in the wake of non-farm payrolls. Likely, the reason for the disconnect was that given the rally in cash spread product, hedging was taking place ahead of payrolls in the form of paying in swaps. Nonetheless, the sentiment in general is somewhat better on the credit side, and this could precipitate more issuance in the next 2 weeks, which should lend itself to more spread tightening on a short term basis. Relative to other products, swap spreads still look wide, especially further in the curve. Also, given the impressive performance of these other asset classes versus swaps, we may see profit taking, which should also lend itself to swaps tightening. One last separate issue is the recent pressure in Libor going into and through quarter-end. Today's 3 month setting came in at 2.7275 and we are trading tomorrow's set at 2.69 for Monday. The pressure will be something to keep an eye on, although price action today suggests Libor should go lower heading into next week.

Swap spread lagging MBS spread in tightening



Source: Bloomberg

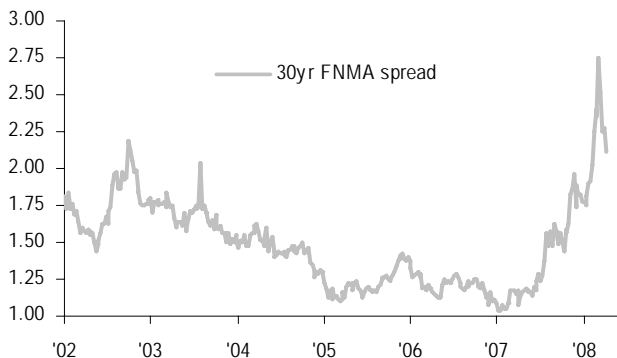
MBS: Spreads still too wide

MBS remain cheap on an OAS basis and against agencies. Although the basis has tightened over 80bp to 211bp since reaching 293bp early in March, it remains wide on a historical basis, as since 2003, it has averaged 142bp, and relative to nominal Treasury yields, which would suggest the spread should contract further towards 180bp.

Nevertheless, our trading desk took profit on a long position, as the basis had come "too far, too fast". The pace of the recent move have traders wondering who the next buyer could be. More nimble accounts should look to reestablish long basis trades on any widenings.

We are seeing increasing demand for specified paper, as the convexity over TBA's remains cheap. Additionally, we believe 15yr paper offers value relative to 30yr paper. For example, we would recommend buying Dwarf 4.5s vs FNMA 5.0s.

MBS spread remains historically wide



Source: Bloomberg

Data / Event Risk Calendar

Day/date	Time (EDT)	Release/Event	Market	Prior	Comment
Mon / Apr 7	15:00	Consumer credit (Feb)	\$5.5bn	\$6.9bn	Decline suggests weak personal consumption
	16:00	Paulson at Inter-American development meeting in Miami			
	17:30	Fed's Yellen – opening remarks			
	17:30	Fed's Kohn – dedication of new building			
Tue / Apr 8	10:00	Pending home sales m/m (Feb)	-0.8%	0.0%	Return to m/m declines leaves downtrend from 2004 in place
	10:00	IBD/TIPP economic optimism (Apr)	-	42.5	Low since Hurricane Katrina in 2005
	14:00	FOMC minutes from Mar 18	-	-	Balancing of financial crisis vs. real economy growth vs. inflation
	17:00	ABC consumer confidence (Apr6)	-	-33	Remains depressed near levels last seen in 1993
Wed / Apr 9	07:00	MBA mortgage applications (Apr 4)	-	-28.7%	Very volatile in light of changing underwriting and interest rates
	10:00	Wholesale inventories (Feb)	0.5%	0.8%	Not seeing inventory drawdowns yet
	13:30	Fed's Fisher – U.S. economy			He's a voter. He dissented from the most recent rate cut
Thu / Apr 10	08:30	Trade balance (Feb)	-\$57.8bn	-\$58.2bn	Continues to stabilize in range in place since late-'06
	08:30	Initial jobless claims (Apr 5)	-	407K	At levels similar to 2001 recession
	08:30	Continuing claims (Mar29)	-	2937K	At levels similar to 2001 recession
	13:30	ICSC chain store sales y/y (Mar)	-	1.9%	In sharp downtrend since mid-2006
	14:00	Budget statement (Mar)	-\$81.0bn	-\$96.3bn	Revenues are deteriorating as expenses continue to rise
Fri / Apr 11	08:30	Import price index m/m (Mar)	2.0%	0.2%	Price pressures remain worrisome
	08:30	U. Mich. confidence (Apr P)	69.0	69.5	A new low since 1992
	09:00	Fed's Fish – welcome remarks			

Economic and Financial Market Forecasts

	Quarterly												Annual		
	Q107	Q207	Q307	Q407	Q108	Q208	Q308	Q408	Q109	Q209	Q309	Q409	2007	2008	2009
Real GDP q/q saar	0.6	3.8	4.9	0.6	0.0	-1.0	3.9	1.7	1.9	2.9	3.0	3.0	2.2	1.4	2.3
Consumer Prices y/y	2.4	2.7	2.3	4.0	3.6	2.2	2.5	2.5	2.4	2.4	2.5	2.3	2.9	2.7	2.4
Core CPI y/y	2.6	2.3	2.1	2.3	2.1	1.9	2.0	2.2	2.1	2.2	2.3	2.3	2.3	2.1	2.2
Fed Funds Rate (e.o.p.)	5.25	5.25	4.75	4.25	2.25	1.50	1.50	1.50	1.50	1.50	2.00	2.50	4.25	1.50	2.50
2-year yields (e.o.p.)	4.60	4.93	3.94	3.08	1.50	1.60	1.80	1.95	2.10	2.45	2.75	3.25	3.08	1.95	3.25
10-year yields (e.o.p.)	4.65	5.03	4.53	4.03	3.45	3.60	3.75	3.90	4.00	4.25	4.50	4.75	4.03	3.90	4.75

TJ Marta (New York)
+1 212 858 6077
tj.marta@rbccm.com

All of the views expressed in this report accurately reflect the personal views of the responsible analyst(s) about any and all of the subject securities or issuers. No part of the compensation of the responsible analyst(s) named herein is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the responsible analyst(s) in this report.

The information contained in this report has been compiled by RBC Capital Markets ("RBC CM") from sources believed to be reliable, but no representation or warranty, express or implied, is made by Royal Bank of Canada, RBC CM, its affiliates or any other person as to its accuracy, completeness or correctness. RBC Capital Markets is a business name used by subsidiaries of the Royal Bank of Canada including RBC Dominion Securities Inc., RBC Dominion Securities Corp., RBC Dain Rauscher Inc., Royal Bank of Canada Europe Limited and Royal Bank of Canada – Sydney Branch. All opinions and estimates contained in this report constitute RBC CM's judgement as of the date of this report, are subject to change without notice and are provided in good faith but without legal responsibility. This report is not an offer to sell or a solicitation of an offer to buy any securities. RBC CM and its affiliates may have an investment banking or other relationship with some or all of the issuers mentioned herein and may trade in any of the securities mentioned herein either for their own account or the accounts of their customers. Accordingly, the entities constituting RBC CM or their affiliates may at any time have a long or short position in any such security or option thereon. Every province in Canada, state in the U.S., and most countries throughout the world have their own laws regulating the types of securities and other investment products which may be offered to their residents, as well as the process for doing so. As a result, the securities discussed in this report may not be eligible for sale in some jurisdictions. This report is not, and under no circumstances should be construed as, a solicitation to act as securities broker or dealer in any jurisdiction by any person or company that is not legally permitted to carry on the business of a securities broker or dealer in that jurisdiction. This material is prepared for general circulation to clients and does not have regard to the particular circumstances or needs of any specific person who may read it. To the full extent permitted by law neither RBC CM or any of its affiliates, nor any other person, accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. No matter contained in this document may be reproduced or copied by any means without the prior consent of RBC CM. The entities comprising RBC Capital Markets are wholly owned subsidiaries of the Royal Bank of Canada and are members of the RBC Financial Group. **Additional information is available on request.**

To U.S. Residents:

This publication has been approved by RBC Dominion Securities Corp. ("RBCDS Corp.") and RBC Dain Rauscher Inc. ("RBC DRI"), both of which are U.S. registered broker-dealers, which accept responsibility for this report and its dissemination in the United States. Any U.S. recipient of this report that is not a registered broker-dealer or a bank acting in a broker or dealer capacity and that wishes further information regarding, or to effect any transaction in, any of the securities discussed in this report, should contact and place orders with RBCDS Corp. or RBC DRI.

To Canadian Residents:

This publication has been approved by RBC Dominion Securities Inc. Any Canadian recipient of this report that is not a Designated Institution in Ontario, an Accredited Investor in British Columbia or Alberta or a Sophisticated Purchaser in Quebec (or similar permitted purchaser in any other province) and that wishes further information regarding, or to effect any transaction in, any of the securities discussed in this report should contact and place orders with RBC Dominion Securities Inc., which, without in any way limiting the foregoing, accepts responsibility for this report and its dissemination in Canada.

To U.K. Residents:

This publication has been approved by Royal Bank of Canada Europe Limited ("RBCCEL") which is regulated by Financial Services Authority ("FSA"), in connection with its distribution in the United Kingdom. This material is not for distribution in the United Kingdom to private customers, as defined under the rules of the FSA. RBCCEL accepts responsibility for this report and its dissemination in the United Kingdom.

To Persons Receiving This Advice In Australia:

This material has been distributed in Australia by Royal Bank of Canada -Sydney Branch (ABN 86 076 940 880). This material has been prepared for general circulation and does not take into account the objectives, financial situation or needs of any recipient. Accordingly, any recipient should, before acting on this material, consider the appropriateness of this material having regard to their objectives, financial situation and needs. If this material relates to the acquisition or possible acquisition of a particular financial product, a recipient in Australia should obtain any relevant disclosure document prepared in respect of that product and consider that document before making any decision about whether to acquire the product.

Copyright © RBC Dain Rauscher Inc. 2003
Copyright © RBC Dominion Securities Inc. 2003
Copyright © RBC Dominion Securities Corp. 2003
Copyright © Royal Bank of Canada Europe Limited 2003
All rights reserved. Member CIPF