U.S. Daily Directions: April 18, 2008, NY Edition

Day ahead: **No data, Fed's Lacker, Rosengren.** The Fed's Lacker and Rosengren will speak regarding liquidity and credit risk.

Overnight: **LIBOR sets higher, end of the major bank crisis? more rice panic.** 3-month LIBOR set 9bp higher to 2.91%, a high since before the Bear Stearns crisis. The 1-month LIBOR over OIS spread jumped 6bp to 84.5bp, a high since mid-Dec when the Fed first introduced the TAF program. During the Aug'07 CP crisis, the spread reached 95bp, and during the Dec'07 yearend credit crunch crisis, the spread reached 110bp. In the 3yrs prior to the Aug'07 meltdown, the spread median registered 6.5bp. Markets reacted to the worse-than-expected earnings report of a major US bank quite positively; apparently, the sentiment is that the worst of the credit crunch is over. Rice traded to a new record high of $24.26/100lb, with analysts suggesting that governments have resorted to attempting to hoard the grain.

Asset Commentary/Assessment:

Eurodollars: **Overnight, yields higher.** Yields rose 3-10.5bp with the largest rises in Dec'08-Jun'09 range. The odds of a 50bp cut on Apr30, fell further to 12%. However, to the extent rising LIBOR negatively impacts financing costs and the real economy, as indicated by Donald Kohn, it might actually push the Fed into more aggressive easing later on. The expected trough for the Fed Funds has risen to 2.00%, with the Fed expected on hold throughout H2'08.

Treasuries: **Overnight, even more bear flattening.** The 2yr yield rose another 8bp to 2.18%, and it is now outpacing the uptrending channel and testing the double top high of 2.20% during March. The 10yr is up 4bp to 3.76%, is well above the uptrending channel in place since Mid-Mar. The 76.4% retracement of the Feb-Mar decline lies at 3.80%. The 2s30s curve collapsed 6bp flatter to 236bp. The next support is 220bp, the high of mid-Feb.

MBS: **Yesterday, roller coaster for spreads.** Most of the excitement was saved till the end as MBS spent most of the day wider to the curve despite strong overseas buying again in 5.5's and 6's. Yesterday's convexity hangover continued, with 5.5's lagging on better servicer related selling most of the morning. After swaps made a remarkable reversal in the afternoon from their widening trend, mortgages followed tightening in ~16/32nds from the wides. 5.5's and 6's led the stack into the close, ~8bps tighter to the treasury curve and ~5bps tighter to swaps; the tights of the session. CC MBS have moved over 2 handles in less than a week and up in coupon seems a little over done and we like moving from 5.5's to 5's. Rolls continue to remain well bid as Libor continues to reset higher, and they are currently implying ~50bps through the 1m Libor rate. This is a very strong sign for MBS and the basis could find more strength into higher dollars as convexity unwinds pause.

Swaps: **Yesterday, volatile day in the swap market.** After gapping wider this morning, spreads reversed sharply in the afternoon and managed to finish tighter by a couple across the board. The buzz around the swap market remains the Libor reset situation. There are lots of cross currents in the market right now, and they generally continue to involve de-leveraging. The market will present/offer value at some point, but for now the reality remains (curve/outright) a disconnect between price action and data. Our flows in general were light, although we did see receiving interest this morning off the back of the initial widening.

T.J. Marta
+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 ("RBCEL") 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. RBCEL 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.