

## U.S. Daily Directions: June 16, 2008, NY Edition

Investment Recommendation	Recommendation Date	Theme
MBS: long seasoned 15-yr	Jun 5	Best short duration mortgage alternative to mitigate extension risk
MBS: long '05 vintage 30yr 5.5s	Jun 5	30yr, 5.5s from '05 have been prepaying faster than '03, '04 vintages
MBS: buy GEO / High-LTV	May 5	Prepayment speeds slowing in Florida
MBS: High LTV 30yr 6%	May 8	Lower speed multipliers = better convexity

**Overnight: Inflation.** The G8 finance ministers identified spiking commodity prices as the most serious policy challenge, and the causes of the price rises appear to be many. In the US, the worst flooding since at least 1993 has caused the price of corn to reach a new record high. But the price spikes are not just about flooding. The Chairman of Nestle has declared that high food prices "are here to stay" as governments divert resources to make biofuels, amass stockpiles and limit exports. Another source of rising food prices has been rising energy prices, and the UN and over 30 nations have appealed to Saudi Arabia for that country to increase its output of oil. Some indication has been given that the Saudi's might increase production. However, the Saudis and many analysts believe the prices of commodities have been pushed well above supply/demand relationships by excess liquidity searching for "alpha". EU inflation accelerated to 3.7%/y, the highest rate since June 1992.

**Day ahead: Empire manufacturing, homebuilders' index, FedSpeak.** The Empire manufacturing survey is expected to have increased in June from -3.2 to -1.5, suggesting that the NY region manufacturing is stabilizing at a soft, but not recessionary, pace. The homebuilders' index for Jun is expected to have remained stable at 19, near the all-time low of 18 set in Dec'07. FedSpeak includes Bernanke (Health Summit) and Lacker (economic outlook). Other important data include PPI, housing starts, building permits, industrial production, and the Philly Fed.

### Asset Commentary/Assessment:

**Eurodollars: Overnight, mostly lower.** Yields fell 2.0-3.5bp along most of the curve (Dec'08 and further out). The Jun08 contract yield slipped 0.75bp. The market has now priced an 26% chance of a 25bp hike by the Fed on Jun25 as well as a 95.2% chance of some hike (centered on 50bp to 2.75%) by yearend.

**Treasuries: Overnight, modest bull flattening.** Yields started lower in Asia and started even lower in European trading. The 2yr yield is down 2.5bp to 3.01%. The 10yr yield is down 3.7bp to 4.22%. Technical resistance lies at 4.29-30%, the low of Sep'07 and the high from Dec'07. The 2s30s curve flattened 1.6bp to 174bp, leaving the flattening trend in place since March.

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