

U.S. Daily Directions: August 7, 2008, NY Edition

Recommendation	Date	Theme
MBS: Buy 100% FI premium	Aug 5	Florida 6% slower prepay with less pay-ups
Agencies: Buy long lockout, intermed. mat.	Aug 5	Strong relative value
MBS: Buy low MLB, HLB, low FICO 20yr 6%	Jul 7	Historically low value allows capture of "free convexity"
UST: 2s30s steepener	Jul 2	Market's focus is shifting to growth concerns
Agcy: Buy 3nc6m 1x	Jul 1	Cheapest value in the callable agency market
Euro\$: Aug 97.00/97.25 euro\$ call spread	Jun 19	Market will abandon view that Fed hikes by Sep
MBS: GNMA LLB vs conventional LLB	Jun 10	Better convexity at lower price

Overnight: RBC CASH Index rebounds, 2007 mortgages suffer rise in delinquencies. The RBC CASH index for Aug rebounded moderately, from 14.6 to 33.8 due to falling energy prices and rising equity prices, although the level remains low and the headwinds facing consumers argue against declaring the start of any uptrend. The WSJ is reporting an FDIC analysis that shows that 0.91% of 2007-vintage mortgages were seriously delinquent after 12 months, almost 3 times the 0.33% for 2006-vintage mortgages. This news suggests the housing downturn could last longer than previously feared.

Day ahead: Jobless claims, pending home sales, chain store sales, consumer credit, 30yr bond auction. Initial jobless claims for the week ended Aug 2 are expected to have remained elevated at 425K, clearly consistent with non-farm payrolls losses. Continuing claims for the week ended Jul 26 are expected to have slipped to 3255K, still a rate surpassed only in the wake of prior recessions. Pending home sales for Jun are expected to have dropped 1%, suggesting a continued downturn in the housing market. The market expects that ICSC chain store sales during Jul moderated to 4.0%, suggesting that the tax rebate checks had their maximum impact in June. Finally, consumer credit for June is expected to have fallen to \$6.3bn, a low since Dec and suggestive of a slowdown in personal consumption. The Treasury will auction \$10bn of 30yr bonds at 1pm.

Asset Commentary/Assessment:

Eurodollars: Overnight yields lower. Yields fell along the curve, at much as 4.0bp for the Jun'09-Mar'10 contracts. The market increased the odds of no Fed move in Sep from 52% yesterday to 56%, and increased the odds the Fed will be on hold through yearend from 39.9% yesterday to 45.2%. We retain the view that the Fed will not hike rates by yearend, and our long eurodollar position - a 97.00/97.25 call spread on the Aug options contracts - stands at 16.5bp (entry at 6.5bp).

Treasuries: Overnight, bull steepening. Treasuries rallied as equity futures sank and the price of oil rose. The 2yr yield is down 5.7bp at 2.51%. The 10yr is down 2.5bp at 4.02%. Our 2s30s steepening position steepened 4.1bp to 216.3bp, extending the uptrend in place since mid-June (support off the lows lies at 202). Our trading desk strongly believes that the curve is set to flatten in the wake of the 1pm 30yr auction, but the strategy team will ride out such a downdraft, as our perception of the longer-term fundamentals remain that the Fed being pinned down will keep the short end anchored, while inflation pressures will buoy the long end.

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