U.S. Daily Directions: July 25, 2007, NY Edition

Day ahead: Data risk today included existing home sales, which the market expects dropped in June to .586mm, a new low since 2003. The Fed's Beige Book will not likely move markets; look for evidence of a slowing consumer, bleed through from the housing sector, and the health of business investment. Late in the session, Geithner speaks about global integration.

Friday: Overnight, the Fed's Poole stated that the real economy continues to do quite well, that the housing correction was likely to remain contained because of the relatively low exposure of banks, that consumption could be adversely impacted, and that inflation, while having moderated "a bit" remained the number one concern. The key international mover overnight was AU bonds, which weakened by 6-12bp across the curve, led by the short end as CPI printed strong across the board. Headline CPI rose by 1.2% (Consensus +1.0%) with the key core measures jumping +0.9% in Q2 (Consensus +0.7%). We have brought forward our expectations for a Q4 hike to Q3, and specifically August.

***Asset Assessment*:**

Eurodollars: **Curve: inverted.** The Dec'07/Dec'08 curve inverted overnight by 1.5bp to -20.0bp. We advocate positions taking the view that this curve could trade as low as -39bp as the market anticipates Fed easing due the effects of the CDO crisis, ARMs resets, and higher borrowing costs generally as credit spreads widen.

Treasuries: **Notes/Bonds: increasing pressure for lower yields.** The 10yr yield inched 1.5bp higher overnight after testing 4.89% support (downtrending channel and former resistance in January). The 2yr yield is trading similarly, rising 0.8bp to 4.74% overnight after testing support at 4.73% (downtrend channel).
Curve: steeper. The 5s30s continued to steepen yesterday, reaching 24.7bp, a high since May. The next resistance is 27bp (May high).

Mortgages: **Sell basis on strength.** The basis widened again yesterday. Countrywide earnings, more concerns over subprime, ABX selloff, another mortgages bank fallout, and a 200 point drop in the stock market all led spreads in credit,swaps and MBS wider on the day.

Swaps: **Range trade.** The swap market reflects the widening credit crunch in the US debt markets. Something has to give here, either equities have to give it up or credit is going to implode. The cancellation of high yield deals and the inability of the large banks to syndicate their leveraged loans is causing the credit markets to shut down. The widening of spreads is reflecting this risk as players attempt to hedge themselves in illiquid markets. The markets are finally attempting to re-price the easy credit terms that allowed players to binge themselves on leverage.

Agencies: **Bullets:** Yesterday, spreads widened, yields fell and the curve steepened. Agency Bullets widened 2bps once again on minimal volume. 10yr paper is now 5.5bps wider from Friday morning, while 2yr paper is outperforming the rest of the agency curve and is currently 2.5bps wider. Spreads vs Treasuries are multi yr wides but could easily gap wider on further credit/sub-prime concerns. We are flat the product and will wait and watch for stability in swap spreads.

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