U.S. Daily Directions: September 26, 2007, NY Edition

Day ahead: **Durable goods highlights.** Durable goods orders for August are expected to have retraced (-4.0% overall and -1.0% ex-trans) after strong prints in July (6.0% overall and 3.8% ex-trans). Also pay attention to non-defense, ex-air orders, which have sunk y/y into negative territory for much of 2007. The Fed's Poole speaks to small business owners on Wednesday.

Overnight: **Plosser sounds inflation warning.** The Fed's Plosser spoke last night and expressed the first Fed warning that the recent rate cuts might cause inflation to accelerate precipitate a reversal of the action. He also indicated while he expected weaker data (we concur, and especially look to downward benchmark revisions to next week's payrolls), he did not expect further rate cuts unless data became "much weaker". US stock futures rose overnight after news that GM and the UAW had reached a contract agreement and that the strike had ended. 1-month Libor has held steady at 5.12875% for three consecutive days. The spread over the Fed Funds target rate stands at 37.875bp, significantly above the 7bp it registered prior to the August crisis. MBA mortgage applications fell 2.8%w/w for the week ended Sep21, although refinancings continue to rise (3.3%), gaining for four consecutive weeks.

Asset Commentary/Assessment:

Treasuries: Yields rose overnight, and the 2s10s curve flattened 1bp. Today's supply in 2yrs could lead to further yield gains. The curve should continue to push wider as it seems as if a flattening would be welcome or an opportunity to get back in the curve at a more comfortable level.

Swaps: Swap spreads widened yesterday, particularly at the front end of the curve. Libor remains elevated relative to the Fed Funds target, indicative of continuing problems at the front end of the curve. Spread price action was choppy, as flows were mixed, with receivers in the belly of the back of asset swap unwinds. Our trading desks likes paying 10yr spreads on dips.

MBS: Mortgages widened yesterday vs both treasuries and swaps. Lack of overseas buying and some servicer selling caused the basis to hover around ~2 to 3/32nds wider for the greater part of the trading session. Buyers showed up in the afternoon, which helped bring in the basis by ~1/32nd. 30yrs closed ~2/32nds wider vs the curve and unched vs their 10yr HRs. Specifieds were a little more active today as accounts took advantage of the softer rolls and cheap pay-up levels across the specified market. 10/20 and 40yr 6's have seen broader participation over the last couple weeks and pay-(up)s are close to 8/32nds off their lows. 15yrs have yet to fully participate with the steeper and look very cheap on the model vs their 30yr counterparts. With a negative bias on the 30yr basis we like adding 15yrs vs 30yrs particularly the low swap (dwf5/fn5.5).

Comm Ppr: Yesterday, flows increased yesterday as there are pockets of money to be had from investors. Conditions started off unchanged as fed funds opened again at 4 3/4% and LIBOR was unchanged in 1-3 months. 1-month flows transacted at L+15 to L+20 from various investors. Some flow was transacted in 3 months at L+12. O/N's continue to offer liquidity and with many investors keeping cash available for possible redemptions at quarter end, this will allow issuers the opportunity to keep term issuances from widening out any further. Supply should not be a strain on the market for the rest of the week as normal amounts are expected.

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.