

U.S. Daily Directions: September 27, 2007, NY Edition

Day ahead: **New home sales, jobless claims, final Q2 GDP.** New home sales for Aug are expected to have collapsed 5.2% m/m, taking the rate to 825K, a new low since 2000. Jobless claims are expected to have remained benign at 316K (week ended Sep 22), indicating that the jobs market has not yet begun to significantly shed jobs. The final Q2 GDP print is expected to be revised down from 4.0% to 3.8%. Fed speak includes Rosengren, Evans and Bernanke providing welcoming remarks at different conferences, as well as Mishkin speaking about globalization.

Overnight: **Yields, equities higher, Libor lower.** Yields and equities rose, partly on news that Bear Stearns was attracting investors that included not only Warren Buffet, but also Chinese banks. An additional sign that global liquidity might be sufficient enough that the sub-prime crisis might abate without a complete collapse of the financial system was news that Yale University's investment returns soared 28% due to holdings that include hedge and buyout funds. In contrast to the snub treatment the BoE's auction of loans received yesterday, the ECB made emergency loans totaling EUR3.9bn, the most since Oct'04 – the bad news is the loans are needed, but the good news is firms are coming forward. 1-month Libor slipped to 5.12750%.

Asset Commentary/Assessment:

Treasuries: **Yesterday, yields fell slightly and the 2s10s curve steepened** 1bp to 65bp, a high since Apr'05. Yields had risen during European trading and into the North American morning, only to completely retrace during the afternoon session as the 2-yr auction was well-received and then headlines regarding potential Merrill losses circulated. The 10yr yield continues to consolidate the 37bp rise since Sep10, while the 2yr yield has given up part of its smaller 25bp rise, capped by expectation of further Fed easing. The futures currently price only a 4% chance the Fed remains on hold through year end, but a 32% chance of another 25bp cut and a 64% chance of another 50bp of easing.

Swaps: **Trading was lackluster yesterday** with yields close to unchanged and spreads moving tighter by 1.5bps on issuance and an increased appetite for risky assets. The Merrill news put a bid to spreads with 10s closing at 64.75, almost 2bps wider from the lows of the day. However, rumors of Warren Buffet negotiating to buy a 20% stake in Bear Stearns did bring in some receiving interest causing spreads to stabilize. The market will continue to gyrate around the most timely economic data to determine how much more work is needed to be done by the Fed. Steepeners are attractive but are clearly a populated trade and as such should be entered into opportunistically on back-ups.

MBS: **Better overseas buying yesterday** in the morning out of Asia lent a bid for the 6% coupon early on as investors added for month-end in G2 6's, Gold 6s and 10/20 IO 6's. In terms of domestic flows, there was some servicer related selling in discounts and well as up-in-coupon flows and modest fast-money buyers of 15/30yr swaps. Flows were pretty even with >1bb in originator selling, and the basis hovered around unched to 1/32 wider vs treasuries for most of the trading day with discounts lagging the stack. 5.5's and 6's ended ~1 to +/32 wider respectively vs the treasury curve. Despite the drop in vol, mortgages underperformance was more pronounced vs swaps as 30yrs lagged the swap curve by ~3/32nds. Rolls softened up in the premium coupons by ~.125/32 and trending lower into October. Specifieds continue to see more demand and pay-ups have been increasing across the gamut of specified collateral. Soft rolls provide attractive arbitrage opportunities for those with balance sheet and pay-ups continue to trade at the lower end of fair value.

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 ("RBCCEL") 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. RBCCEL 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.