# U.S. Daily Directions: September 28, 2007, NY Edition

**Day ahead:** **Heavy data/Fedspeak day.** The key risk derives from the Aug core PCE deflator report, which the market expects will show a tick lower to 1.8%y/y. Personal income and spending are expected to remain in a moderating trend (consensus for both is 0.4%m/m). The Chicago PMI is expected to slip from 53.8 to 53.0, a low since April, and construction spending is expected to have fallen 0.3%m/m in August, a second consecutive decline and consistent with the renewed deterioration observed in housing starts and building permits. Fedspeak includes Yellen (behavioral economics and policy), Lockhart (economic outlook), Mishkin (globalization and systemic risk), and Poole (thinking like a central banker).

**Overnight:** **Yields fell globally** along with most equity markets last night on continued financial and economic concerns emanating from sub-prime fallout. S&P500 earnings may decline to 3.2% during Q3, which would represent the 1st quarter in 20 that earnings registered below 10%. German retail sales fell 1.4% in August. The UK's Northern Rock borrowed another GBP5bn from the BoE. Germany's IKB, after delaying reporting 6 weeks, reported that its quarterly profit fell 67% to EUR11.7bn, and it further warned that the impact of the crisis was only partially reflected in the quarter being reported. The weak US dollar is also having an impact, as the UK's Tate & Lyle (sugar producer) warned the FX rate would reduce earnings. The iTraxx Crossover index rose 5bp, indicating a rising perception of credit worries for European companies.

**Asset Commentary/Assessment:**

***Treasuries:*** Yields initially jumped Thursday on the better-than-expected initial jobless claims, but almost completely retraced due to the poor new home sales report. The 5yr auction was strongly received, with the auction stopping more than a bp through the 1pm bid side, the highest bid/cover since Aug'06, and 16.7% indirect bid (above the year's average of 10.9%). The curve flattened as yields fell, dropping the 2s10s by 2bp to 62bp.

**Swaps:** Spreads tightened 1.5-2.7bp along the curve Thursday. The 2yr spread, which had risen to 70bp, appears to have failed on looks as if it could tighten back towards 60bp. The 10yr spread has similarly failed to widen (peaked at 66bp two days ago) and looks set to test tighter, also towards 60bp.

**MBS:** Yesterday, mortgages strengthened into the general bond rally, with discounts leading stack. 5's and 5.5's tightened ~5 vs Treasuries and 1+ to 2bp vs swaps. 6's tightened 3+ vs Treasuries and 1+ vs swaps. Additionally, rumored strong buying ahead of the 5yr auction helped bring MBS spreads in vs the curve.

**CP** Outstanding ABCP declined another $17 billion this past week, an unsurprising development as much of the paper placed prior to the disruption is now being repaid by bank facilities. Such prepayments are occurring largely for CDOs financed by super-senior ABCP tranches, SIVs and other programs that are having difficulty generating liquidity. Although these structures no longer have liquidity, the assets are still high in quality and can be financed by other conduit structures. Multi-seller conduits and other viable structures will eventually start financing these assets and will therefore begin to prop up the ABCP market. This will happen as conduit managers become more secure with their market capacity.

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