U.S. Daily Directions: October 1, 2007, NY Edition

Day ahead: The key risk Monday will be the manufacturing ISM. The market expects it will slip from 52.9 to 52.5, but after upside surprises on the Chicago PMI, Philly Fed, Milwaukee NAPM, and Richmond Fed surveys, the risk seems to be to the upside. The other key report this week will be the Sep non-farm payrolls report, which the market expects to show a rebound from -4K to +110K. However, market reaction will also depend on the revision to the Aug report, which will likely result in a jobs gain that month, as well as the benchmark revision, which is expected to result in a downward revision of 200K-400K. Preceding the non-farms report will be the Challenger jobs cuts and ADP employment change. The non-manufacturing ISM is expected to fall from 55.8 to 55.0. Pending home sales are expected to fall 2.1%m/m. Consumer credit for Aug is expected to have risen to $9.5bn. Fedspeak includes Fisher (Technology) and Mishkin (science of monetary policy).

Overnight: More evidence of global growth independent of the US consumer, which should support US growth. China's Sep PMI Rose, signaling output growth will quicken, and India's Sep manufacturing growth accelerated as rising consumer incomes domestic spending. The weak US dollar and strong global growth should partially offset housing weakness fallout as US companies remain supported. However, the subprime “tape bombs” will likely continue to weigh on perceptions regarding the economy. Citigroup is warning of substantial, 60%, decline in Q3 earnings. UBS reported an unexpected Q3 loss (CHF600-800m, consensus 3.3bn profit).

Asset Commentary/Assessment:

Treasuries: Treasury's closed lower Friday, as positions for month-end were caught up in a liquidation trade brought on by a late day slide in the dollar. With the month-end extension past, we are entering a seasonal negative time frame for bonds. There is increasing talk of estimates for next week’s payrolls being revised upward. All of these factors will keep pressure on prices coming into this week.

Swaps: Friday proved a choppy and volatile session, with the market initially trading well on anticipated month-end demand and strong technicals. However, significant selling in the afternoon forced out lazy long positions. Spreads moved wider as the market traded down with 10s last at 62.5. The U.S. dollar closed at an all-time low and will likely turn out to be a major discussion point. The implications for the curve and spreads are not that clear but it is probably not healthy for the long-end.

MBS: Mortgages opened Friday a couple better vs the curve on continued overseas buying in 6's. This was short lived as MM and HF's came in to sell the strength and pushed mtge's a couple wider. Continued selling, the lack of a month end indexer bid, and the Asian golden week continued to weigh on the basis as mtge's go out 4 ticks wider vs the curve. Rolls improved ~ 1/8 across the board except in 6.5s were the roll improved 1/4 on better up in coupon buying out of the servicer community. In specifieds, non deliverable paper got a boost today as 10/20's and 40yr paper are trading a couple ticks better than where they were offered at the beginning of the week.

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