

## U.S. Daily Directions: October 5, 2007, NY Edition

**Today:** **Treacherous payrolls.** The payrolls report presents a particularly treacherous release for short-term traders: the Sep figure, the July-Aug revision, and the benchmark revision. The overall, longer-term theme will be more clearly discernible: softer. Economists expect the Sep figure to show a rebound to 100K and that the negative Aug report will be revised higher. However, the benchmark revision is expected to be downward with estimates ranging from -200K - -400K. The report will cause short-term volatility due to the complexity of the release and represents a threatening environment for traders. The longer-term picture will likely be that the employment situation has been softer than originally thought. This will undoubtedly stoke fears about the downside risks to growth, although we highlight the difference between weaker job creation and actual job destruction, which we have yet to see on an aggregate basis. Just as important to the Fed's dual mandate will be that the weaker job creation will ease Fed concerns regarding the inflationary impact of capacity constraints. That said, average hourly earnings are expected to remain elevated at 3.9%.

**Overnight:** **Quiet ahead of payrolls. CASH index rebounds.** RBC's Consumer Attitude and Spending by Household (CASH) index for October showed a largely rebounded from the September collapse, rising from 71.1 to 80.6. The rebound indicates the severe impact of the liquidity crunch and the calming effect of the Fed's ease. However, the lack of a complete rebound also evidences a remaining wariness about the financial situation.

### Asset Commentary/Assessment:

**Treasuries:** The market will be going into NFP at recent flats on the curve. There was an attempt at steepening Thursday, but more pension-related buying of the long end and dollar for dollar extensions kept a bid in long end.

**Swaps:** Spreads moved slightly wider and the spread curve steepened marginally. Activity in the swap market was muted with flows consisting of participants cleaning up positions ahead of NFP tomorrow. Spreads should trade directionally after NFP.

**Agencies:** Light customer flows allowed bullets to wider slightly across the curve. Bullets in the 10yr sector traded at attractive spreads to on the runs. In callables, there were good 2 way flow across the curve, and spreads were constant with vol slightly lower. On the new issue front, the GSE's continue to experience rich funding levels, which creates relatively strong demand for secondary paper, especially when combined with the enormous amount of redemptions that are occurring.

**MBS:** Mortgages finished Thursday ~ 1tick tighter vs the curve and 1+ tighter vs the swaps curve. This marks the 4th consecutive day they have closed tighter to the curve. Up-in-coupon led the stack, closing 1+ tighter. The 6.5 roll continues to be a source of frustration trading ~ 3/32nds through carry. ~1.5bb in origination contributed to wider spreads throughout most of the trading day, but post-3:00 spreads resumed their tightening course into the non-farm report. The stronger rolls have kept a strong bid for MBS alive and the market is trading like the worst is behind us. Specifieds seeing pay-ups rise in all vintage, loan balance, 10/20 and 40yr collateral.

T.J. Marta  
+1.212.858.6077  
[Tj.marta@rbccm.com](mailto:Tj.marta@rbccm.com)

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