

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

- Today:** Countrywide, which was reported earlier in the week to be under new pressure from its activities in option (potentially negative amortization) ARMs, reports earnings. The week closes on a light data note, with the 2nd U Mich confidence report for Oct expected to remain stable at a weak 82.0. The Fed's Mishkin speaks after the market close regarding financial instability.
- Overnight:** Crude oil passed \$92/bl and the euro reached a new record high versus the US dollar in European trading as the import of the US Treasury's sanctions against doing business with certain Iranian entities sunk in. The moves include freezing assets of the Iranian entities in US jurisdiction, imposing sanctions on US companies that conduct business with the Iranian entities and considering sanctions against non-US companies conducting such business. The dollar was likely also weighed by international reaction to the gloominess of market sentiment in the US yesterday. Deutsche Bank has announced it is considering participation in the \$80bn MLEC concept floated by Citigroup, JPMorgan and BoA; the one tangible benefit of this "super-SIV" would be to forestall depreciated SIV assets from ending up on bank balance sheets.

Asset Commentary/Assessment:

- Eurodollars:** The eurodollars futures market sold off 2-5bp overnight, with the biggest selling out in the 2010 contracts. The contract strip implies an expectation that the Fed Funds rate will bottom at or below 4.00% in Dec'08. As of last night, the odds of an Oct 31 easing remained steady: 25bp fully priced and a 14% chance of a 50bp ease.
- Treasuries:** Overnight, the 2-yr yield rose one bp and the curve flattened 1bp. Yesterday, yields started the day falling, almost completely undoing the rise during European trading on the weak durable goods headline number and higher-than-expected initial jobless claims report. However, they rebounded to the top of the overnight range following the housing data. Into the afternoon, yields settled back down to the bottom of the range as remittance reports weighed on the ABX indexes and rumors regarding credit problems, but as at least one of the rumors was denied, yields rallied to close near their highs. The 5yr auction came at 3.993, with a light indirect bid of 21.3%.
- Swaps:** Thursday, trade focused on the equity market and the yield curve. Equities gyrated around off the back of rumors regarding AIG's potential CDO exposure, which was later denied according to CNBC. Stocks traded down 100 DJIA points in the middle of the day the market attempted to make new low yields. Swap spreads were mixed on the day with front end spreads tighter and the back end slightly wider.
- MBS:** Yesterday, mortgages traded very sticky and to shorter hedge ratios throughout the day. Into higher dollars mortgages were unched to a touch weaker and on sell-offs MBS tightened vs the curve. Asia started off the day a buyer of the 6% coupon which brought spreads in ~2+/32nds during early morning hours. They were adding in conventionals, g2's and 10/20 IO collateral, all 6% coupons. As equities faded on rumors of more write downs and treasuries caught a bid, MBS went from 2 tighter to ~+ wider. However, that was short lived and by the end of the afternoon, equities recovered and treasuries faded, which brought MBS back to ~1+ tighter vs the curve at the close.

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