U.S. Daily Directions: October 29, 2007, NY Edition

Today: The week starts slowly with no data risk, but the other four days are packed. The market expects 25bp of easing by the FOMC, and in light of the moderating economy, fragile financial markets, and lack of Fed rhetoric to dispel the market of its easing notion, the Fed will likely ease 25bp. No change would incite a financial riot as markets repriced, while a 50bp cut could be perceived as the Fed knowing something bad that the markets do not know about. Non-farm payrolls are reported Friday, and the market expects a 90K gain - still indicative of a reasonably stable labor market. The ISM manufacturing index is expected to moderate to a marginally expansionary 51.5. Other data out include the S&P/CS house price index, construction spending, Q3 advance GDP, core PCE deflator, personal income/spending, Challenger job cuts, ADP employment, consumer confidence, and the Chicago and Milwaukee PMI's. Earnings announcements are due from UBS (Oct 30), DB (Oct 31) and Credit Suisse (Nov 1). UBS has already confirmed that its Q3 loss will register approximately US$516-688mm and warned that Q4 results could deteriorate from the initial positive readings.

Overnight: Bonds fell generally, and equities rallied, with the Hang Sang surging 3.9%. Oil reached nominal and inflation-adjusted records, as it traded above $93/bl and exceeded the inflation-adjusted record of 1981, when Iran cut exports. The recent spike stems from Mexico cutting production due to storms, a weakening US dollar, continued tensions in the Middle East, and ongoing global demand. Gold rallied to $794.7/oz a high since January 1980 on the crude oil rally and as the dollar slumped to an all-time low against the euro. The Greenback dropped against all major currencies but the yen, as carry trades moved forward overnight.

Asset Commentary/Assessment:

Eurodollars: Overnight, futures sold off 2-3bp, mostly in the ’08 contracts. The contract strip implies an expectation that the Fed Funds rate will bottom around 4.00% in H2’08. The amount of easing priced for Oct 31 moderated: 25bp fully priced and an 8% chance of a 50bp ease. We believe the Fed cuts 25bp this week.

Treasuries: Overnight, the 2-yr yield rose 2bp, causing the curve to flatten. Friday, yields seesawed, rising when the Countrywide earnings were not so disastrous as feared, falling after the downside surprise from the U. Mich consumer confidence and a sell-off in equities, but then recovering as equities rebounded. This week, yields are likely to remain near their recent lows (3.69% for the 2yr, and 4.31% for the 10yr), and the curve will likely remain near its recent high (63bp on 2s10s) until the FOMC. Assuming an as-expected 25bp ease, the tone of the statement will provide the key for yields and the curve. A dovish slant will allow yields to break out lower and the curve to steepen beyond the September highs, while a benign or hawkish statement will allow yields to rebound and the curve to flatten back.

Swaps: Overnight, spreads tightened, more so at the front end (2yr -1.3bp, 10yr -0.4bp). For the week, spreads will likely chop around in a tight range until the FOMC and then tighten once the uncertainty of Fed action has passed. Risk emanates from the many data points, especially the ISM and payrolls reports, which occur after the FOMC announcement. Additionally, spreads could be impacted by earnings announcements. Longer-term, we believe that as the financial uncertainties moderate gradually, the 2yr swap spread in particular will tighten significantly. Consequently, we are contemplating 2yr receiver positions.

MBS: MBS opened Friday roughly 2 wider vs the curve and stayed there for most of the day. Good overseas buying in 6's kept them bid initially this morning. However, they widened out another 2 ticks to finish the day roughly 4 wider vs the curve, led by discounts which underperformed by 1+ vs premiums. In specifieds, vintage and 10/20 IO paper traded very well today. Payups on seasoned discounts increased by nearly a tick, and 10/20 6%s tightened in almost two ticks.

RBC Capital Markets

RATES STRATEGY | **RESEARCH**

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 ("RBCEL") 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. RBCEL 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.