U.S. Daily Directions: November 6, 2007, NY Edition

Today: Very light data risk, with only the weekly same-store figures on the schedule. The pace of sales has downshifted in recent months but remains stable at a modest rate. Bernanke speaks about microfinance.

Overnight: The US dollar continues to collapse on US banking concerns, losing ground against all major currencies but the yen, and gold is making new highs above $820/oz. Crude oil, which fell late yesterday, is again testing new highs near $96/bl. The TIPs market is registering the inflation implication, with the 5yr, 5yr forward rising to 2.52%, a high since Oct 11. Equity markets are stabilizing, with most indexes up modestly overnight. Global yields are generally higher. 3-mo Libor rose more than 2bp to 4.8975%, a one-week high, but the issue appears to be related to the year-end turn rather than a renewed short-term funding crisis, as the 1-mo Libor fell to 4.66688%, a low since Mar'06.

Asset Commentary/Assessment:

Eurodollars: Overnight, yields continued higher, rising 3-6bp along most of the curve. The strip now suggests a trough in the Fed Funds rate around 4.00% in H2'08. Yesterday, yields rebounded 3-6bp along much of the curve. The futures market reduced the odds for a 25bp ease in Dec from 68% Friday to 62%, and it prices the odds of a move to 4% or lower by Mar'08 at 52%.

Treasuries: Yields rose modestly overnight, mostly in Europe. Monday, yields opened lower on credit concerns, but pulled back to Friday's closing levels by mid-day, helped by the stronger-than-expected ISM report. The Morgan Stanley news capped yields for a time. However, the late-session in equities caused yields to rally to the highs of the session before retracing slightly on the Citigroup downgrade. The treasury curve gave back all overnight gains. The intermediate sector coming under pressure in the afternoon session, giving up 2-3bpts, and we look for continued weakness in 5's and 10's vs the curve. The 3.65% 2yr level is likely to prove tough support where reluctance of fresh longs will occur and serve as short term resistance. There's no data for the market to focus on tomorrow so rumors of further write downs and stock market gyrations will dictate price action.

Swaps: Overnight, spreads tightened, particularly in Europe, and managed to retrace a significant portion of yesterday's widening. Monday, after opening wider on concerns regarding Citigroup's losses, spreads stabilized temporarily but then widened into the close. The 2yr spread spiked 5.4bp to 77.1bp today, has spiked 13.5bp in the last 3 sessions, and is approaching the 82.25 high from Aug 21. The 10yr spread rose 3.25bp today, and is up 8.5bp in the past three sessions, but remains considerably below the 83.75 high from Aug 16.

Agencies: Yesterday, **callables** leaked wider with swaps and bullets. Spreads, on an OAS basis, widened ~5 in spite of the sell off in treasuries. We expect spreads to hold these levels in future sessions, a significant amount of redemption money continues to flow back into the market. **Bullets** cheapened 1.5 to 2.5bps across the curve in light screen volume. Tomorrow Freddie Mac will announce 3-4 Billion of a new 2yr or 3yr. Both areas of the curve should be met with strong investor demand (swap spreads have widened 7bps over the last few days & agencies have outperformed swaps during the latest rally).

MBS: Mortgages traded back at the wides of the session by mid-afternoon. 30yr MBS widened ~8 to 7/32nds (5.5's and 6's respectively) to Treasuries and ~6 to 5/32 to the swap curve. Rolls have collapsed further today which is pressuring MBS spreads. Roll implied funding is 5.00% and possibly moving higher as we approach roll day on Thursday. Dealer year ends and balance sheet constraints are keeping rolls soft.

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.