

U.S. Daily Directions: November 8, 2007, NY Edition

Today: **Bernanke testifies** before Congress regarding the economic outlook. This testimony is not the regular twice-yearly report, but rather was scheduled in the last several days. Initial **jobless claims** are expected to remain benign 325K. ICSC **chain store sales** for Oct are expected to have risen 2.0%/y/y, up from 1.7% in Sep, but still only just at “stall speed”.

Overnight: **Globalization of credit fears.** Stocks retreated in Europe and Asia, led by financial companies. Morgan Stanley reported losses and stated that the credit outlook had worsened. European credit default swaps have surged 13.5bp to 375.5, a high since the August crisis. Furthermore, S&P reported overnight that Asian credit markets would suffer during the next years as credit conditions tightened. Last night, after the NY close, AIG reported worse than expected losses (\$1.35/sh vs expectations of \$1.62).

Asset Commentary/Assessment:

Eurodollars: **Overnight, yields fell** 2-4bp along much of the curve. The strip now suggests a trough in the Fed Funds rate below 4.00% in H2'08. As of yesterday's close, the futures market had increased the odds for a 25bp ease in Dec to 70% from 62% Tuesday, and increased the odds of a move to 4% or lower by Mar'08 from 53% to 64%.

Treasuries: **Profit taken on 5s30s steepener.** The 5s30s curve steepened to as high as 80bp in Asia overnight, and we took profit on the position. We still like the steepening play, however, and will look to re-enter a steepening position. Overnight, yields fell in Asia before rebounding in Europe. The 2yr yield pushed through 3.50% before rebounding to 3.58%. Technical support lies at 3.46% (low just before collapse in the wake of 9/11 attacks) and 3.41% (low from Jun'05). The 10yr yield traded as low as 4.277% before retracing to 4.318%, and it continues to consolidate near multi-year lows.

Swaps: Overnight, spreads tightened in European trading about 1bp along much of the curve. Yesterday, spreads spiked wider off the back of continued negative news from the Financials (WAMU, Monolines, GSE's, etc.) and another poor stock market session. The swap spread curve continues to flatten as the flight to quality trade steepens out the Treasury curve. Concerns regarding the monolines are hanging over the Muni market and pressuring spreads. Financial duress appears likely to persist through the yearend, which should reward buying spread wideners on dips.

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