U.S. Daily Directions: November 27, 2007, NY Edition

Today: **House prices, consumer confidence, Richmond Fed index, Fedspeak.** The S&P/CaseShiller index for Sep is expected to show a record (data back only to 2001) 5.0%y/y decline. The Richmond Fed manufacturing index for Nov is expected to improve from -5 to -2, better than H1 activity, but otherwise among the lows since H2'04. The Nov consumer confidence measure is expected to have fallen to a post-Hurricane Katrina low of 91.0. The Fed's Plosser (alternate voter) and Evans (voter) both speak regarding the economic outlook. Plosser has indicated that even growth as low as 1% would not spur him to favor a rate cut. Evans has advocated a risk management approach to policy, suggesting the Fed needs to weigh high cost, though low probability, events stemming from the financial conditions.

Overnight: **Abu Dhabi's Citigroup infusion – no "silver bullet".** The government of Abu Dhabi agreed to infuse Citigroup with $7.5bn of cash, which will help replace some of the losses flowing from the beleaguered bank. That announcement caused Treasuries to sell off in Asia, but the price action stabilized and then mostly reversed in European trading. The move represents part of the solution – applying excess global liquidity to buy depressed and/or illiquid assets – although it does not represent a silver bullet for Citi, let alone the heavily damaged financial intermediation pipeline for US housing (i.e. monolines, real money investors, money market funds, municipal bond funds, municipalities). Libor fixings rose again, with the 1mo up 0.875bp to 4.80875% and the 3mo up almost 1bp to 5.06188%, a high since Oct 24.

Asset Commentary/Assessment:

Eurodollars: **Yesterday, yields collapsed upwards of 25bp in further out contracts.** The largest declines were in the '09-'10 contracts, and the strip suggests a trough in the Fed Funds rate near 3.25% by Dec'08. Despite the price action, the futures market downgraded its odds for a 25bp ease in Dec from 96% to 82%, but the odds of a move to 4% or lower by Mar'08 rose from 95% to 99%.

Treasuries: **Yesterday, yields collapsed, curve steepened.** The 2yr yield collapsed 19bp to 2.885%, crashing through 3.00% support; the next support lies at 2.93%, the June'04 high. The 10yr yield collapsed 16bp, crashing through 4.00% support to 3.839%; the next technical support lies at 3.803%, the Jun'05 low. The 2s10s curve steepened only 2bp to 95bp, below the recent multi-year high of 101bp, while our 5s30s position (target 130bp) steepened 6bp to 108bp, back near the multi-year high of 111bp.

Swaps: **Yesterday, tighter, short-term vol higher.** After last week watching swap spreads blow wider with the rally in the bond market, yesterday the action completely reversed as convexity kicked in on a huge scale. Once 10yr notes broke through 3.96%, the market exploded as treasuries rallied and spreads collapsed. Back end spreads led the way as receivers required the duration of the longer maturities, 30 yr spreads were 5.75 bps tighter on the day. The market continues to be marked by a definite lack of liquidity. We warned earlier in the month that another August-like liquidity freeze going into the Nov 30 yearend could cause short-term vol to spike relative to longer-term vol. The spread of the 6mo into 2yr bp vol to the 2yr into 10yr bp vol has risen from 18.4 to 25.6, a high since early Sep.

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