The Afternoon Email

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Any stories from wire services are EST.
Otherwise, times are CST.

All times Eastern

15:18 08/27 **US TSYS/RECAP**: Tsys gained amid 1) German Bund improvement as ECB's Trichet said ECB Aug. 2 statement written "before mkt turbulence"; (suggests ECB less firm on rate tighten view); 2) safe-haven bid and short-covering this afternoon; 3) high July inventories of existing homes, up 5.1% to 4.592M or a 9.6-month supply; 4) morning fast money accounts buyers in US 2Ys, intermediates; 5) financial institutions doing 2Y/10Y flatteners earlier, and 6) also fast money doing 2Y/10Y steepeners. There has been 7) early a.m. brisk foreign selling in cash 5Ys, and also was chunky cash 5y seller at 101 even level. 8) Swap-tied flows in NY relatively muted and two-way. 9) Hedges vs corporate supply continued in morning amid heavy selling in 2s from real money accts after interest to put 2s/10s steepeners back on by same accts, after curve flattening last wk. 10) Eurodlrs saw a.m. sellers of 2Y bundles & Red packs (Sep 2008-Jun 2009), balanced by buyers of 1Y & Sep 2008 2Y bundles. Strong US$43B 3M, 6M Tbill sale (despite most sold since 1990).

15:11 08/27 **EURODLR FUTURES:** Eurodlr futures finished near session highs, curve unwinding a fraction of last week's 25 bps flattening, the Red/Gold pack spd (Sep08-Jun09) vs (Sep11-Jun12), steepened 3.5 bps. In the Fronts (Sep07-Jun08), the Sep07 were 0.75 bps higher at 94-67 on combined Globex and pit volume of 181,000, the Dec07 higher 6.0 bps at 95-09 on volume of 198,000, the Mar08 8.0 bps lower at 95-34 on volume of 242,000, while the Jun08 were 7.5 bps higher at 95-38.5 on volume of 205,000. The Red pack (Sep08-Jun09) a 2yr proxy, settled 3.5 to 4.0 bps higher across the pack with 515,000 contracts traded.

15:01 08/27 **US SWAPS**: On the heels of receiving-tied flow in 10s during Asian sess., NY swap flow was relatively muted and two-way, similar to lighter flow in agencies/MBS. Hedges vs corp supply continue, sources reported heavy selling in 2s from real money accts followed by interest to put 2s/10s steepeners back on by same, this after last week's sharp flattening. Eurodollar sources reported sellers of 2yr bundles and Red packs (Sep08-Jun09), balanced by buyers of 1yr and Sep08 2-year bundles. Spds off early session tights as Tsys firmed post housing data, summer illiquidity issues a contributing to swap vol. According to GovPX:

Time (ET)	2Y Swap/Mid	5Y Swap/Mid	10Y Swap/Mid	30Y Swap/Mid
Mon 3:00	-3.25/66.50	+0.00/66.25	+0.00/66.25	+0.00/61.00
1:30	-3.25/66.50	-0.50/65.75	+0.00/66.25	+0.00/61.00
11:10	-2.75/67.00	-0.75/65.50	-0.25/66.00	-0.25/60.75
10:00	-3.50/66.25	-0.75/65.50	-0.50/65.75	-0.50/60.50
Mon Open	-4.00/65.75	-2.00/64.25	-2.00/64.25	-1.75/59.25
Fri 3:05	-6.25/69.75	-5.25/66.25	-4.25/66.25	-2.50/61.00

(continued)

15:12 08/27 **US TSY FUTURES**: Tsy futures finished near session highs, the Sep T-bonds
settled 15/32 higher at 111-10, the Sep 10yr notes higher 6/32 at 108-27, the Sep 5yr note 6.5/32 higher at 106-10.5, while the Sep 2yr note settled 2.25/32 higher at 102-27.

15:17 08/27 **US AGENCIES:** Better buying heard. Included was foreign and domestic accounts and dealers on the screens as well according to a trader. Swaps and GSEs tighten but agencies have the day. Indications as follows - Freddie June'09 +46.5 according to
TradeWeb and other screen (vs Friday's 3PM mark of +50); Fannie July'09 +47.5 (+52); Fannie Mar'10 +48 (51.5); Freddie Aug'10 +52.5 (+57.5); Fannie May'12 +48 (+51); Freddie Aug'12 +49 (+51.5); Fannie June'17 +56 (+59); Freddie Aug'17 +56 (+58); Fannie Nov 2030 +52.5 (+54); Freddie Jul'32 +53 (+52). Supply just a week away now. "Way to soon to even think about," said a dealer. "Too many wild cards to let that enter the equation just
yet."

MarketNews international

News: Snapshots throughout the day

Stone & McCarthy RESEARCH ASSOCIATES

09:28 08/27 **US VIEW**: Robert Blake of BOA offers insight into last week's Fed custody holdings, where US Tsy and agency securities in custody fell for the 4th consecutive week, the largest consecutive declines (total holdings) since April 2001. The bulk of the decline was in US Tsy Securities (down $14.2 bn after cumulative $30bn decline in prior 2 weeks), and this was the largest 3-week decline since 1989, he says. <u>The "outsized" decline in custody holdings reflects "the record paydown of debt by the US Tsy August 15" and reduced dollar purchases in FX markets by foreign central banks due to recent weakness in emerging market currencies.</u> "As underscored by the US dollar's recent resiliency, the reduced inflows do not appear to represent a sudden shift in foreign demand away from US assets, but rather a byproduct of recent currency market volatility and some heightened preference for liquidity on the part of foreign official accounts," Blake says.
[my emphasis]

10:11 08/27 **FED:** Street making much of Fed's legal letters to Citi and BAC allowing securities financing transactions between the banks and their mortgage affiliates, presumably with the aim of increasing the flow of financing.
11:31 08/27 **FED:** We hear those waiting for illumination of recent mkt events in the Aug 7 FOMC minutes are likely to be disappointed. These minutes are due Tues and cover all the events THROUGH Aug 7 -- which is just prior to the mkt's liquidity crisis. Any special Fed meetings after Aug 7 will be discussed in the Sept 18 FOMC minutes, which will be released Oct 9.
13:24 08/27 US MKTS: **Fed securities lending** totaled $2.984b today, with $1.8b of that amount in 3 bill issues.

1:43 08/27 **CHINA:** After news Friday that two Chinese banks had subprime exposure (Industrial Bank of China $1.23bn and Bank of China $9.6bn), Hong Kong-listed China Construction Bank, one of the mainland's "big four" state-owned commercial banks, announced also that it has invested some $1.06 bn in US subprime mortgages. CCB has set aside Cny139 mn ($18 mn) as a provision for any investment that sours. The Shanghai Composite index closed at a record high of 5,150.12, which put the index up 92.5% y-t-d. Earlier, the index posted a new life high of 5,192.06. CCB said its net profit in the first-half to June rose 47% year-on-year to Yuan34.22 bn ($4.5 bn) from Yuan23.22 bn on the back of a 37% increase in net interest income and a 102% surge in net fee and commission income.

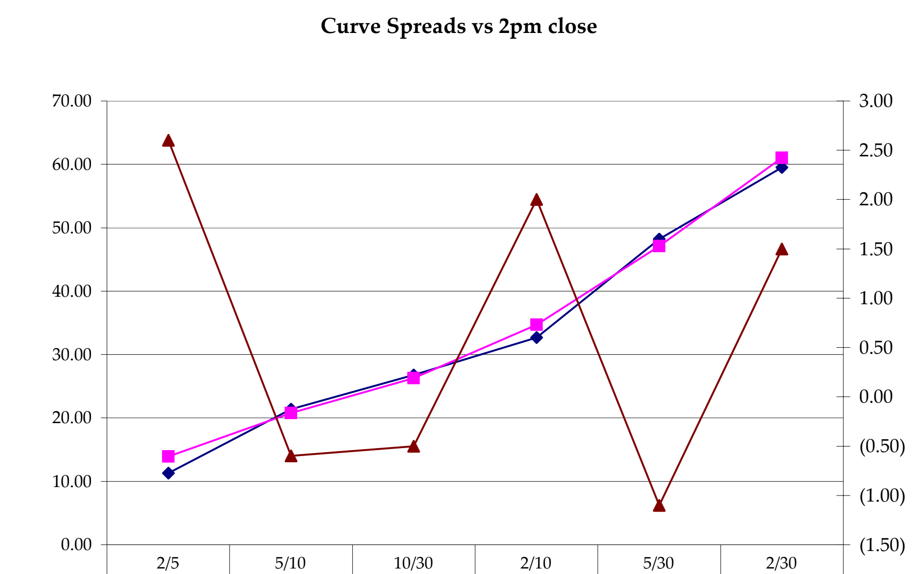
12:12 08/27 **JAPAN/YEN**: Using data from the Tokyo Futures Exchange, analysts note that Japanese retail investors are clearly feeling "gun shy" and cut positions in half last week. Greg Gibbs of ABN AMRO notes that these investors "rarely conduct stop loss trading" and typically "buy dips and sell rallies" (dollar-yen, euro-yen etc...). This "sudden and rare" risk aversion on the part of Japanese retail investors contributed to the hefty declines in Aussie, Kiwi and dollar-yen last week, Gibbs says. JPMorgan Chase analysts noted that their estimates of Japanese retail FX margin positions in the high yielders show Y388bn($3.3bn) in yen sales/FX buying on the week, which suggests carry is still popular. With aggregate yen shorts still at $33bn, there is risk of a "decent yen rally if credit concerns force another round of deleveraging in coming weeks," JPMC says.

13:47 08/27 **US TSYS**: Analyst Tony Crescenzi of Miller, Tabak says today's $43b T-bill sale was the most sold since 1990, "and the results... were very strong. The results look good at face value and even stronger when adjusted for the large auction sizes." Cover at 3.14 for the 3m, for example, is above avg and means the "total amount of bids submitted in today's 3-month T-bill auction was about $73 billion, much more than" the $44b average. He says these strong results may mean there is still a 'fear trade' in the mkts.

14:03 08/27 **US TSYS/FED/ABCP**: As markets appear to steady a bit, Tsys traders eye the stocks, which still remain lower in languid fashion. And some traders eyed the Fed's notice last Friday that a bank can pledge asset-backed commercial paper at the discount window for which it provides the backup liquidity and most applauded the move. One traders noted that it will "speed up normalization" of the financial system, while another noted that the discount window move last Friday "was perceived to be helpful." And a third trader noted that Fed officials "are really pushing hard for this method of liquidity" but "only time will tell" about the outcome.

Curve Spreads

	Yield Curve Spreads		
	TC	PDC	Diff
2/5	11.30	13.90	2.60
5/10	21.40	20.80	(0.60)
10/30	26.80	26.30	(0.50)
2/10	32.70	34.70	2.00
5/30	48.20	47.10	(1.10)
2/30	59.50	61.00	1.50



	2/5	5/10	10/30	2/10	5/30	2/30
Last	11.30	21.40	26.80	32.70	48.20	59.50
PDC	13.90	20.80	26.30	34.70	47.10	61.00
Diff	2.60	(0.60)	(0.50)	2.00	(1.10)	1.50

Notes:

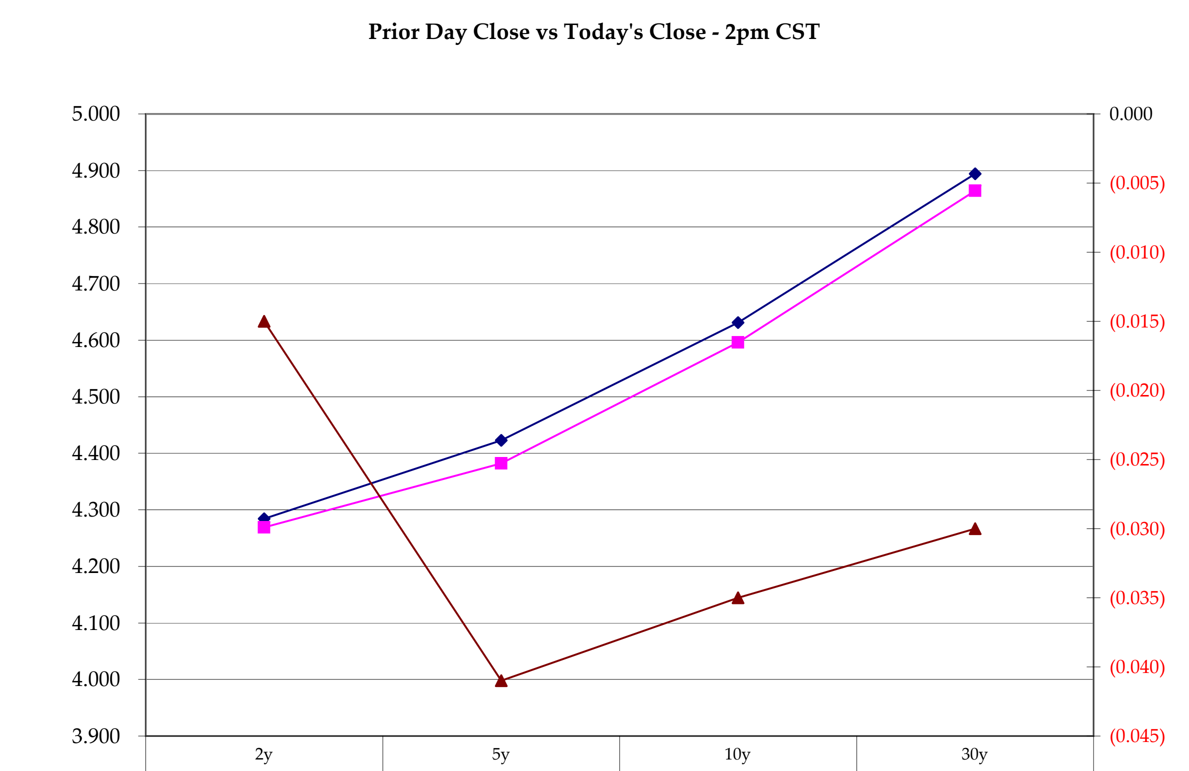
TC = Today's Close at 2pm

PDC = Prior Day's Close at 2pm

Prior Day Close vs Today's Close - 2pm CST

	Cpn	Mty	PDC 32	PDC	TC	Diff	Basis PDC	Basis TC
2y	4.625	7/31/09	100.1900	4.284	4.269	(0.015)		
5y	4.625	7/31/09	100.2775	4.423	4.382	(0.041)	25.32	24.67
10y	4.750	8/15/17	100.300	4.631	4.596	(0.035)	70.80	73.85
30y	5.000	5/15/37	101.21	4.894	4.864	(0.030)	193.21	195.64

	PDC 32	TC
ZF	106.040	106.110
ZN	108.210	108.270
ZB	110.27	111.090



	2y	5y	10y	30y
2pm Cls	4.284	4.423	4.631	4.894
Last	4.269	4.382	4.596	4.864
Diff	(0.015)	(0.041)	(0.035)	(0.030)

Notes:
Basis = (Cash Decimal - (Futures Decimal * CF))*32
32 = price is quoted in 32nds
TC = Today's Close at 2pm
PDC = Prior Day's Close at 2pm

Eurodollar Packs

Eurodollar Packs	Last Yield	Net Yield	Last Price
Q.ED.White	5.008	5.438	9512.125
Q.ED.Red	4.847	7.375	9527.625
Q.ED.Green	5.050	5.625	9508.000
Q.ED.Blue	5.240	4.250	9489.750
Q.ED.Gold	5.426	3.875	9471.875
Q.ED.Purple	5.426	3.875	9471.875

Fed Funds Daily Effective Rate

Minus US Treasury Yields

Spread Name	Diff bps	Net Chng	08/14/2007
Fed Funds - 2yr yield	84.1	23.5	44.6
Fed Funds - 5yr yield	72.8	25.3	31.5
Fed Funds - 10yr yield	51.4	24.4	8.2
Fed Funds - 30yr yield	24.6	25.1	-17.7
GFER	**5.11**	23.0	

GFER = Fed Funds Daily Effective Rate

Why 8/14/2007?

Pre-CPI (& Post PPI) is a good benchmark when the FED is focused on inflation.