



The Morning Email: Treasuries

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Stone & McCarthy
RESEARCH ASSOCIATES

[Highlights from Dr. McCarthy's thoughts on the FOMC minutes. They're brilliant.]

FOMC Minutes...What A Difference A Few Days Makes! by Ward McCarthy, PhD

"From the Fed's standpoint, policy options are not as obvious as it might appear to be on the surface. The Fed is NOT in the business of bailing out investors who have made bad investment decisions, and to do so invites moral hazard; encouraging financial market participants to take excessive risks due to the belief that government action will save them from their own imprudent actions.

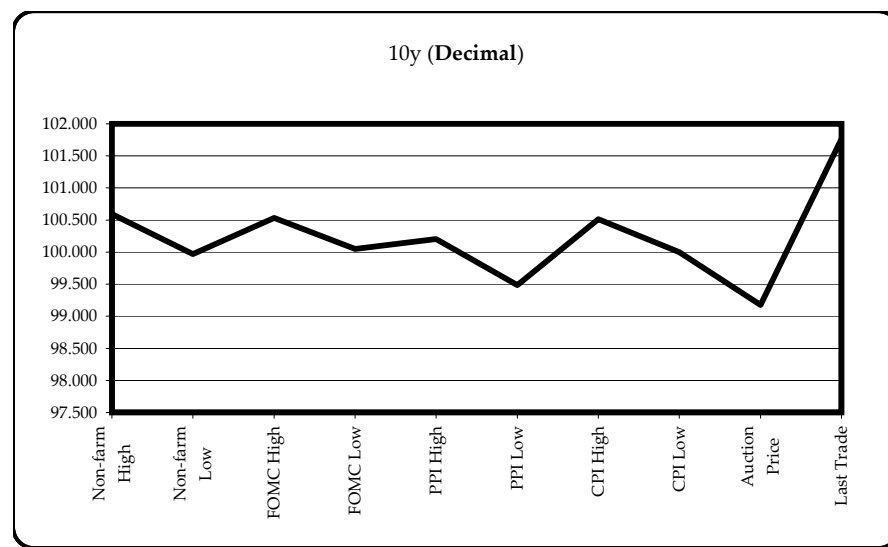
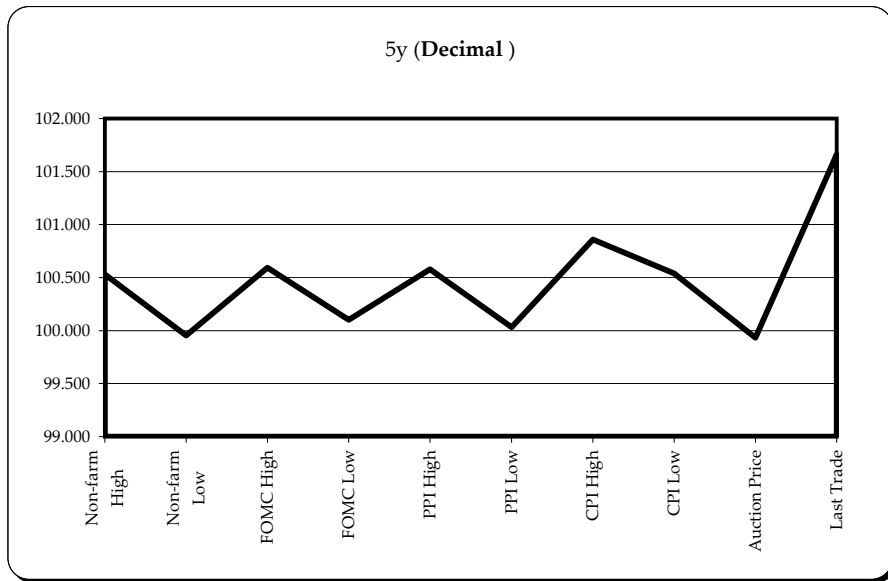
"The Fed IS in the business of ensuring that there is sufficient liquidity available to allow markets to function, and the Fed has addressed that responsibility aggressively. The Fed IS also in the business of anticipating when major financial market disruptions portend risk to economic activity and, therefore, require a policy response. The distinctions between bailing out investors who have made bad investment decisions easing when major financial market disruptions portend risk to economic activity are not always clear, however, or at least require time to differentiate."

Want something added? Let me know: jgoulding@ghco.com

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Economic Releases - 32nds					
	5y	10y	ZNU7	ZBU7	Date
Non-farm High	100.1700	100.190	107.300	110.23	8/3/2007
Non-farm Low	99.3050	99.310	107.115	109.30	8/3/2007
FOMC High	100.1900	100.170	107.300	110.18	8/7/2007
FOMC Low	100.0325	100.015	107.140	110.02	8/7/2007
PPI High	100.1850	100.065	107.295	109.30	8/14/2007
PPI Low	100.0100	99.155	107.070	109.01	8/14/2007
CPI High	100.2750	100.165	108.090	110.00	8/15/2007
CPI Low	100.1725	100.000	107.245	109.11	8/15/2007
Auction Price	99.2988	99.056			
Last Trade	101.2120	101.245	109.170	111.21	8/29/2007 5:47

Auctions - 32nds				
	2 y	5y	10y	30y
Auction Price	99.254	99.299	99.056	99.026
Auction Yield Stop	4.735	4.64	4.855	5.059
Actual Auction Date	7/25/2007	7/26/2007	8/8/2007	8/9/2007



Notes: Cash and futures are adjusted for roll.
 Release times are from release to 2pm cdt
 (Jun07 to Sep07 Futures roll: ZN & ZB even) (ZF = +3tics)
 r = reopen

Quotes

32 nds							
	Last	Net	High	Low	Open	Volume	SYM NAME
TUAU7	103.042	9.2	103.047	102.290	102.307	572,152	2y Fut
FVAU7	106.295	19.5	106.305	106.145	106.170	1,359,181	5y Fut
TYAU7	109.170	22.5	109.175	108.305	109.015	1,903,544	10y Fut
USAU7	111.210	10	111.270	111.090	111.140	630,286	30y Fut
	Last	Net	High	Low	Open	Volume	SYM NAME
BUS02P	100.297	6.2	100.300	100.227	100.237	na	2y Cash
BUS05P	101.210	12.0	101.217	101.062	101.080	na	5y Cash
BUS10P	101.245	10.0	101.260	101.095	101.130	na	10y Cash
BUS30P	102.080	1	102.195	102.000	102.010	na	30y Cash
	Last	Net	High	Low	Open	Volume	SYM NAME
BUS02Y	4.116	(9.80)	4.243	4.103	4.226	na	2y Yield
BUS05Y	4.246	(8.30)	4.379	4.239	4.35	na	5y Yield
BUS10Y	4.526	(3.90)	4.59	4.518	4.57	na	10y Yield
BUS30Y	4.855	0.00	4.875	4.831	4.857	na	30y Yield

Notes: SYM = Symbol

**All times Eastern****Yesterday:**

15:24 08/28 **US TSYS/RECAP:** (Tsys rallied Tue on 1) safe-haven buying/ ABCP jitters, 2) weak stks aid Tsys; DJIA -1.45%; 3) foreign central bank buying in T-bills, 3Y, 5Ys; 4) major de-leveraging by hedge funds, who exited yen carry trades (sold risky debt/bought Tsys); 5) FOMC mins say mkts underestimated Fed inflation concern in Jun FOMC statemnt, which hurts stocks. 6) real money asset-allocation (sell US stocks/buy US Tsys) 7) Earlier had been bank profit-taking in long end, buy-and-hold selling in 10s; 8) fast money buying in 2Ys, 5Y/10Y flatteners; 9) mo-end/qtr-end illiquidity eyed; 10) short-coverg on weak Aug. Conf Bd Cons Conf 11) 2-way flows earlier: Street selling in 2Ys, fast money buying in 5Ys, international institution buying intermediates, swap-tied buying out curve. 12) Bank buying in 5s, bills, 10s. 13) Rolling in 5Y, 10Y, 30Y futures, hundreds of thousands of contracts. 14) Fed funds futures: odds 75 bps of ease by end-Dec. 15) Front end vols off after FOMC min tho swap spreads blowout. 16) 10am ET Fri Bernanke Jackson Hole.

15:30 08/28 **EURODLR FUTURES:** EuroDlr futures finished at session highs, curve continuing to unwind last week's 25 bps flattening, the Red/Gold pack spd (Sep08-Jun09) vs (Sep11-Jun12), steepened 7.25 bps, out 10.75 on the week. In the Fronts (Sep07-Jun08), the Sep07 were 0.50 bps higher at 94-68 on combined Globex and pit volume of 197,000, the Dec07 higher 9.5 bps at 95-18.5 on volume of 262,000, the Mar08 10.0 bps higher at 95-44 on volume of 333,000, while the Jun08 were 10.0 bps higher at 95-48.5 on volume of 309,000. The Red pack (Sep08-Jun09) a 2yr proxy, settled 10.5 to 11.0 bps higher across the pack with 709,000 contracts traded.

15:16 08/28 **US SWAPS: US SWAPS:** Front end spds at session wides in 2s by bell, though still off 7yr wides of week ago, with a few minutes to go on the session. Apparently still enthralled w/credit crunch anxieties after early morning ABCP-tied news. Flow turned light after early receiver-tied interest in long end. According to GovPX:

Time (ET) 2Y Swap/Mid 5Y Swap/Mid 10Y Swap/Mid 30Y Swap/Mid

Tue 3:15 +6.25/72.75 +5.75/71.75 +4.25/70.75 +1.75/63.50

2:55 +6.25/72.75 +6.25/72.25 +4.75/71.25 +2.50/63.50

2:10 +5.00/71.50 +4.75/70.75 +3.50/70.00 +2.00/63.00

11:30 +3.50/70.00 +3.25/69.25 +1.75/68.25 +0.25/61.25

9:10 +2.25/68.25 +2.00/68.00 +1.25/67.75 +0.50/61.50

Tue Open +3.00/69.00 +2.00/68.00 +1.25/67.75 +0.75/61.75

Mon 3:00 -3.25/66.50 -0.25/66.00 +0.25/66.50 +0.00/61.00

Contributing to the firmer price action early, sources reported modest receiver related support in front end Eurodollars as well as intermediate to long end Treasuries.

(continued)**Overnight:**

05:21 08/29 **TSYS:(1)** Treasuries are trading higher across the curve in London Weds, as renewed concerns over the health of the global credit markets. However, traders noted a slight difference in recent safe haven trends, as the two-year note didn't lead the way higher. With the Nikkei 225 sharply lower and JGBs ending higher, Treasuries rallied from the getgo in Tokyo trade, as the credit market jitters underpinned. However, the front of the curve lagged, with the 2-year note running into hedge selling ahead of the \$18 billion auction due later in the day. Japanese life and pension funds were also buyers of the longer-end of the curve, fulfilling month-end duration weighed demand. London saw Treasuries continue to push higher, with the yield on the 10-year dipping below the 4.50% levels. However, as European bourses contained losses, profit-taking capped the upside in the Treasury market.

05:21 08/29 **TSYS:(2)** Real money accounts were buyers of the belly of the curve, with leveraged names seen selling 10-year paper. However, leveraged names were sellers of the two-year note ahead of the auction, helping the curve flatten modestly. The Bund/T-note was unchanged on Monday's levels, with the spread standing at 39 bps. Ahead of the U.S. session, the 2-yr note was 1/64 higher, trading at 101 1/32 to yield 4.06%. The 10-yr note was 5/32 higher at 102 2/32 (4.49%), with the Bond 5/32 higher at 102 20/32 (4.83%). The 2-yr/5-yr yield curve was 2 bps flatter on Tuesday's levels, trading at +13 bps. The 2-/10-yr curve was also flatter by 1 bps, trading at +43 bps, while the 2-yr/30-yr curve was unchanged, standing at +77 bps.

MarketNews
international

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13:29 08/28 **US BONDS:** While people are on pins and needles waiting for other shoes to drop, there are some signs of stabilization/recovery out there:

- 1) Some originators willing to make jumbo prime mortgages (around 8%) and hold on books;
- 2) FF back to 5.25%-5 3/8% level for two days;
- 3) While ABCP deemed heart of problem, amt outstanding dwindling - and market got over the hurdle of largest amts maturing - so in a sense problem getting smaller -- providing one can get funding elsewhere. Part of Macy's \$350M 5.5Y bond issue Tue was to repay CP. AT&T upped 30Y from \$1B to \$2B and might be partially CP related too;
- 4) Money again coming into money market mutual funds;
- 5) Recent large amts of debt issuance from investment banks might be way of doing their part to signal all is going to be okay. But, surely the demand is there too and that signals people okay with credit;
- 6) Hearing some money managers finding value in select ABCP around 6%.
- 7) Fed is targetting areas where it can do real help and buying time to assess where economy is on Sept 18. The financial markets like action and answers but for now the markets and the Fed must just sit and wait for new data to shed light on how the financial crisis has affected the general economy...

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RESEARCH ASSOCIATES

Our view of the underlying difficulties facing the U.S. housing sector (and by extension the U.S. economy and financial markets) will not be alleviated by the corrective actions undertaken by the Federal Reserve. We expect the Federal Reserve to decide to reduce its target for the federal funds rate by 25 basis points to 5 percent at the September 18, 2007 FOMC meeting. We expect additional rate reductions at subsequent FOMC meetings to come.

14:00 08/28 **US DATA/FED:** Aug 7 FOMC minutes give only a slim hint about the mkt crisis to come, saying Fed was watching the mtg market: "a further deterioration in financial conditions could not be ruled out and, to the extent such a development could have an adverse effect on growth prospects, might require a policy response." There's no hint at what the response might be, and FOMC ultimately decided to keep its inflation bias and keep the 5.25% funds target in place. FOMC staff lowered its econ projections in Aug but participants still saw moderate expansion likely, saying rising employment and exports were expected. Hsg to remain a drag, and subprime to recover over time; hsg credit remained generally available. Core inflation readings were favorable, but participants wanted evidence that improvement would be sustained.

14:01 08/28 **US DATA/FED: Take-2:** FOMC was fighting a battle in rear view mirror, as minutes say that mkt underestimated FOMC's infl concern in the June minutes. That's prob why the inflation bias was kept so prominently on Aug 7 although the FOMC was aware of brewig subprime problems.

FROM HOWARD [re minutes]:

- MARKETS UNDERESTIMATED INFLATION CONCERN IN JUNE FOMC STATEMENT
- BERNANKE MONETARY POLICY TESTIMONY CAUGHT MARKETS UNAWARE
- MULLED POSSIBLE POLICY RESPONSE TO FUTURE MARKET TROUBLE
- CREDIT CONDITIONS SUGGEST MORE DOWNSIDE GROWTH RISKS
- NO EVIDENCE RECENT CORE INFLATION TRENDS TO BE SUSTAINED
- MEDIAN LONG TERM INFLATION EXPECTATIONS 'TICKED UP'
- FOMC LOWERED 07 AND 08 GDP FORECAST FOR MEETING
- HOUSING TO REMAIN A DRAG ON GROWTH
- 'SOME MEASURES' SHOWING DECLINES IN HOUSE VALUES
- HIGHER RATES, TIGHTER CREDIT SLOWING HOUSING DEMAND
- HOME PRICE APPRECIATION CONTINUING TO SLOW
- INFLATION RECEDED IN JUNE DUE TO ENERGY PRICE DECLINES
- EMPLOYMENT ATILL INCREASING AT 'HEALTHY PACE'
- TRADE DEFICIT WIDENED, OIL IMPORTS ROSE SHARPLY
- SECURITIES BACKED BY SUBPRIME MOERTGAGES EXPECTED TO RECOVER

	M Duration	DV01 32	DV01 \$	DV01 Box	CF
30y	15.58	5.11	\$1,596	10.21	n/a
10y	7.88	2.57	\$803	5.14	n/a
5y	4.35	1.42	\$444	5.68	n/a
2y	1.81	0.59	\$184	2.35	n/a
ZB	9.61	3.49	\$109	3.49	0.8625
ZN	5.64	2.01	\$63	4.02	0.9086
ZF	3.80	1.32	\$41	2.63	0.9430
ZT	1.73	1.15	\$36	4.59	0.9764

	Yield Curve Spreads		Diff
	Last	2pm close	
2/5	13.00	14.80	1.80
5/10	28.00	29.00	1.00
10/30	32.90	33.20	0.30
2/10	41.00	43.80	2.80
5/30	60.90	62.20	1.30
2/30	73.90	77.00	3.10

DV01 32 said differently is how many TICS is in a basis point. Example, If ZN moves 1-basis point, it's moved 1.94 tics.

Since it trades in half tics 4 boxes = 1 basis point in ZN.

Notes

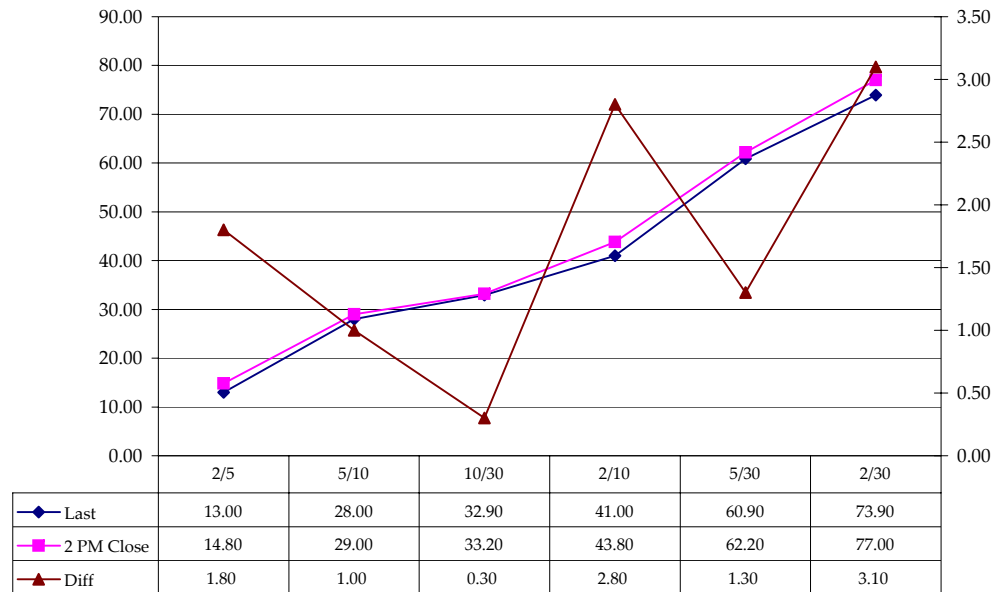
CF = Conversion Factor

MDuration = Modified Macaulay Duration

MDuration & DV01s for Futures are based on proxy issue (CTD)

DV01 Box = Dollar Value of 1 basis point move per Box

Curve Spreads vs 2pm close



US Financial Futures / Eurex Bond

	ZB	ZN	ZF	ZT
Bund (U)	1.000	1.800	2.700	3.000
Bobl (U)	0.560	0.970	1.470	1.664
Shatz (U)	0.220	0.382	0.578	0.653

US Financial Futures

	ZB	ZN	ZF	ZT
ZB		1.740	2.656	3.046
ZN	0.575		1.527	1.750
ZF	0.376	0.655		1.147
ZT	0.328	0.571	0.872	

Eurex Bonds

	Bund (U)	Bobl (U)	Shatz (U)
Bund (U)	1.0	1.9	4.7
Bobl (U)	0.6	1.0	2.4
Shatz (U)	0.2	0.4	1.0

US Treasuries v US Financial Futures

	2y	5y	10y	30y
ZB	1.61	4.07	7.35	14.62
ZN	2.80	7.08	12.80	25.43
ZF	4.28	10.80	19.54	38.83
ZT	4.91	12.39	22.40	44.52

US Treasuries v Eurex Bonds

	2y	5y	10y	30y
Bund (U)	1.7	4.0	7.1	13.9
Bobl (U)	3.1	7.3	13.1	25.5
Shatz (U)	7.8	18.6	33.3	65.0

US Treasuries

	2y	5y	10y	30y
2y		2.524	4.418	8.745
5y	0.396		1.750	3.465
10y	0.219	0.553		1.916
30y	0.110	0.278	0.487	

Note: Any ratio with the Bund, Bobl, or Shatz is from Bloomberg. Bloomberg hedge ratio's are static. Meaning, I only update them once a week and on rolls. My hedge ratio's are live, meaning, they're updated in real-time. I've managed to get the Eurex to Eurex ratio's updating live as of 07/05/2007. I'll be working on Eurex to the USA ratio's soon.

Current Positions										
Small Spec			Large Spec			Commercials (Hedgers)				
	Long	Short	Net	Long	Short	Net	Long	Short	Net	
ZF	273,882	242,698	31,184	234,376	299,416	(65,040)	1,273,631	1,239,774	33,857	ZF
ZN	353,577	398,651	(45,074)	831,112	301,625	529,487	2,015,695	2,500,107	(484,412)	ZN
ZB	148,817	166,569	(17,752)	138,355	212,222	(73,867)	785,697	694,078	91,619	ZB

WoW^ Position Change				
	Sml Spec	Lrg Spec	Comm	
	Net	Net	Net	
ZF	15,514	(1,971)	(13,542)	As of 8/21/2007
ZN	40,273	(128,543)	88,271	
ZB	(4,871)	46,783	(41,912)	

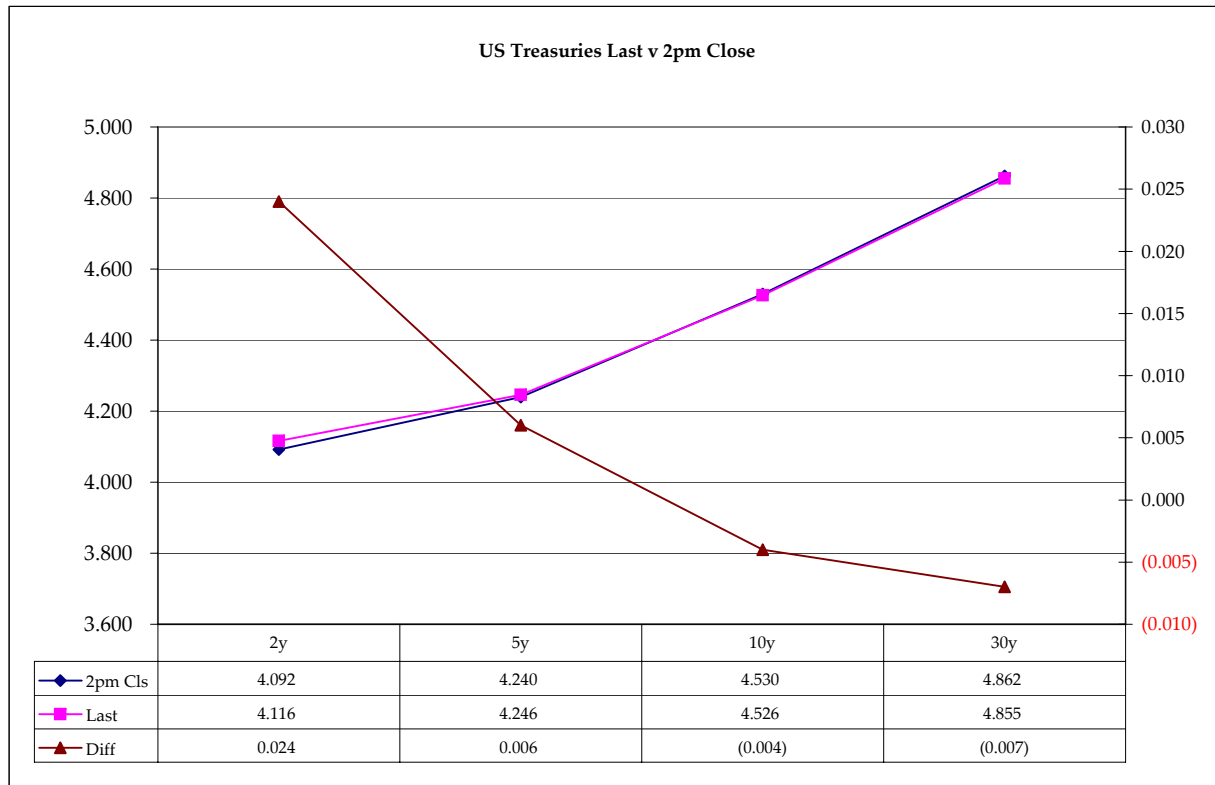
^WoW = Week over week

Closes: 2pm CST vs this Morning

	Cpn	Mty	Close 32	Close	Last	Diff	Basis		Roll
							Close	Last	
2y	4.625	7/31/09	100.2975	4.092	4.116	0.024			-1.50 / +1.75
5y	4.625	7/31/09	101.2150	4.240	4.246	0.006	27.03	26.73	-.50 / +.75
10y	4.750	8/15/17	101.240	4.530	4.526	(0.004)	72.27	71.86	
30y	5.000	5/15/37	102.05	4.862	4.855	(0.007)	188.15	189.79	

	Close 32	Last
ZF	106.295	106.295
ZN	109.160	109.170
ZB	111.20	111.210

Curve Spreads		
	Close bps	Last bps
2/5	14.8	13.0
5/10	29.0	28.0
10/30	33.2	32.9
2/10	43.8	41.0
5/30	62.2	60.9
2/30	77.0	73.9



Notes:
 Basis = (Cash Decimal - (Futures Decimal * CF))*32
 MDuration for Curve Spreads:
 Longer duration minus shorter duration
 32 = price is quoted in 32nds

Hey! Where are the Correlations? The R-Squared?

All correlations have been moved to a new morning email called.....The Morning Email: Correlations & R-Squared.

Thanks,
Jim

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Cash Duration Matrix

Cash Duration Matrix				
	2	5	10	30
2	100%			
5	44%	100%		
10	24%	55%	100%	
30	12%	28%	50%	140%
Cash Matrix [DV01 x Duration]				
	2	5	10	30
2	\$184			
5	\$196	\$444		
10	\$196	\$444	\$803	
30	\$189	\$429	\$776	\$1,538
Cash Matrix [DV01 over / (under) valued]				
	2	5	10	30
2				
5	(\$12)			
10	(\$12)	\$0		
30	(\$5)	\$15	\$27	
Cash Matrix [DV01 over / (under) as %]				
	2	5	10	30
2				
5	-6.23%			
10	-6.16%	0.07%		
30	-2.85%	3.60%	3.52%	

What is this? (1):
 2yr cash has X% duration of 5yr cash .

What is this? (2):
 -2yr cash has DV01 of \$202
 -Multiply the 2yr DV01 by the percent duration to come up with what the 2yrs DV01 SHOULD be compared to the 5yr.

What is this? (3):
 -Now you can see the over/under value, based on the DV01, from contract to contract. In this example we are looking at the 2yr compared to the 5yr.

Or you can look at the over/under value as a percentage instead of dollar terms.

Tic for Tic Matrix				
	2y	5y	10y	30y
ZT	1.03	2.48	4.48	8.58
ZF	0.45	1.08	1.95	3.74
ZN	0.29	0.71	1.28	2.45
ZB	0.17	0.41	0.74	1.41

Box for Box Matrix				
	2y	5y	10y	30y
ZT	1.03	2.48	8.96	17.17
ZF	0.45	2.16	3.91	7.49
ZN	0.59	1.42	1.28	2.45
ZB	0.67	1.63	1.47	2.82

	2y	5y	10y	30y
2y	1.00	2.42	4.37	8.37
5y	0.41	1.00	1.81	3.46
10y	0.23	0.55	1.00	1.92
30y	0.12	0.29	0.52	1.00

	2y	5y	10y	30y
2y		2.42	2.18	4.18
5y	0.41		0.45	1.73
10y	0.46	2.21		1.92
30y	0.24	0.58	0.52	

	ZT	ZF	ZN	ZB
ZT	1.00	2.29	3.50	6.09
ZF	0.44	1.00	1.53	2.66
ZN	0.29	0.66	1.00	1.74
ZB	0.16	0.38	0.57	1.00

	2y	5y	10y	30y
ZT		2.29	7.00	24.37
ZF	0.44		1.53	5.31
ZN	0.14	0.66		3.48
ZB	0.04	0.19	0.29	

Sept		450	475	500	525	550
8/23/2007		18.4%	30.3%	28.5%	22.8%	0.0%
8/24/2007		24.4%	22.9%	24.3%	28.4%	0.0%

I'm switching to this type of view instead of the other one. I think this is better because we have a day to day comparison that we can see instantly.

October		450	475	500	525	550	575
8/23/2007		63.1%	0.0%	13.8%	19.6%	3.5%	0.0%
8/24/2007		53.0%	4.7%	19.3%	19.7%	3.3%	0.0%

December		375	400	425	450	475	500	525	550
8/23/2007		17.1%	16.5%	0.0%	7.2%	22.3%	18.3%	18.0%	0.0%
8/24/2007		23.3%	0.1%	0.0%	7.8%	26.1%	19.4%	20.1%	2.9%

These probabilities take options into account and are much better at forecasting the FOMC intentions than the 'day-count' equation most analysts on the street use.

Notes:

All probabilities are taken from The Cleveland Federal Reserve

