

The Afternoon Email

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

**All times Eastern**

15:15 10/18 US TSYS/RECAP: Tsys gained Thu amid 1) short-covering after +28K rise in US wkly jobless claims, weaker 6.8 Oct Phila Fed (vs. 10.9 Sep); 2) safe-haven buying amid SIV/ABCP/credit/funding jitters after sweeping downgrades Wed; 3) morning repo collateral squeeze, many issues on special, then eased; 4) fears of more SIV/hedge fund problem; 5) p.m. real money buying in front end, 5Ys, bank 5Y/10Y flatteners; 5) ongoing a.m. hedge fund buying and swap receivers; 5) heavy securities lending to dealers from Fed esp. 3Y, 10Y; 6) rate-lock unwinds vs. US\$3B FHLB 10Ys; 7) Wed rally forced Street, hedge funds to cover deep shorts, still there were shorts to cover Thu; 8) But into Tsys strength, levered money this morning sold both 2- and 5-years, although buy-and-hold accts bought there. 9) Options flows included buyers of volatility, put buying from mortgage servicers and 2-way flows in calls. 10) Also heavy front-end receiver flows in 2Y. 11) Levered accounts bought Dec 10Y, 30Y futures prior to claims. 12) Some sold Tsys to go to German Bunds, Schatz.

15:10 10/18 US EURODLR FUTURES: Eurodlr futures finished off session highs, curve bull steepening again as the front end outperforms, the Red/Gold pack spd 2.0 bps steeper at 81.125 by the bell--nearly 12 bps steeper for the week. In the Fronts (Dec07-Sep08), the Dec07 was 6.5 bps higher at 95-19 on combined Globex and pit volume of 291,000, the Mar08 5.5 bps higher at 95-48 on volume of 294,000, the Jun08 5.5 bps higher at 95-64 on volume of 301,000, while the Sep08 contract was 6.0 bps higher at 95-71.5 on volume of 327,000. The 2yr proxy Red pack (Dec08-Sep09), settled 4.5 to 6.0 bps higher across the pack with 682,000 contracts traded.

15:01 10/18 US SWAPS: Spds ended session well off highs as FI mkts gradually gave back early gains. On heels of good-sized Asian swap receiving in belly & follow-through buying by U.S., Japanese and Asian real money in Tokyo, sources reported healthy swap-tied buying in fronts to intermediates early in NY. Coinciding with the moment 2yr spds tightened off wides, Eurodlr sources reported a Chicago FCM and a NY dealer +2.3k 2yr bundles while Tsy sources reported ongoing receiver interest in belly.

According to GovPX:

Time (ET)	2Y Swap/Mid	5Y Swap/Mid	10Y Swap/Mid	30Y Swap/Mid
Thu 3:00	+0.00/68.75	+0.75/67.25	+0.75/64.50	+0.00/61.25
12:00	+0.50/69.25	+1.25/67.75	+0.75/64.50	+0.50/61.75
10:05	+1.00/69.75	+1.25/67.75	+0.75/64.50	+0.25/61.50
9:35	+0.50/69.25	+1.25/67.75	+0.75/64.50	+0.25/61.50
9:05	+1.50/70.25	+1.50/68.00	+0.75/64.50	+0.00/61.25
Thu Open	+1.25/70.00	+1.50/68.00	+1.50/65.25	+0.25/61.50
Wed 3:00	+4.50/68.75	+2.25/66.50	+0.75/63.75	+0.00/61.25

(cont)

15:05 10/18 US SWAPTION VOLS: At-the-money straddle swaption premiums ended session firmer, off session highs, however, as FI mkts gave back early gains as equities recovered late in the session. While OTC flows were fairly light, steepeners still favored by those present, sources continued to point to increased odds of near term Fed rate cuts for rise in vols. Despite the rally, sources noted a conspicuous absence of servicers hedging convexity risk on the session, even though Tsys have rallied about 32 bps since Mon, 10s some 18 bps. According to GovPX:

Time (ET)	GAMMA, 3M/2Y	INTERMEDIATE, 2Y/10Y	VEGA, 5Y/5Y
Wed 3:00	76.6 bps	700.2 bps	547.2 bps
12:15	77.0 bps	698.7 bps	547.7 bps
11:05	77.2 bps	697.2 bps	547.2 bps
10:00	77.2 bps	701.4 bps	548.4 bps
9:15	78.6 bps	706.4 bps	548.6 bps
Thu Open	75.4 bps	697.6 bps	545.4 bps
Wed 3:00	75.4 bps	690.8 bps	544.2 bps

12:33 10/18 **US MBS/SubPrime**: The fall out is continuing from yesterday's announcement by S&P on downgrading a massive 1,713 tranches of 1H 2007 vintage subprime first-lien, Alt-A and second-lien RMBS, many which were originated as recently as 1H'07. According to 1 market source: 1) the downgrades are particularly important since they affect deals first issued only a few months ago (Jan-June '07), 2) For CDOs and SIVs which hold some of this paper, credit protection triggers might get hit and covenants breached, 3) bid lists are now in circulation with asset sales across the board - particularly hybrid ARMS and mortgage-linked ABS.

12:42 10/18 **US RMBS**: In addition to S&P RMBS downgrades, Moody's downgraded SLNs/Extended Notes of Ottimo Funding Ltd to Not Prime from Prime-1 on Wed. Moody's said, "Ottimo uses the proceeds from the issuance of the notes to invest in a portfolio of Aaa-rated residential mortgage-backed securities. All assets in the portfolio are currently rated Aaa. Following the extension of SLNs during the first week of August, the conduit's overcollateralization fell below the required amount as a result of market value deterioration of the assets in the portfolio. The program sponsor and administrator Aladdin Capital Management LLC and its investors have since agreed to postpone the liquidation of the securities as required by the program documents. However, they have not been able to reach an agreement regarding a long-term extension of the notes or restructuring of the conduit. Some of the extended notes have reached their legal final maturity. Moody's rating action reflects the current market value of the assets held by the program relative to the required enhancement and likely continued price volatility."

US RMBS: More on 12:42 bullet. Market sources say S&P downgrades of 1,713 classes of RMBS issued Jan to June 2007 and Moody's Ottimo Funding downgrade on Wednesday have really shaken the market as models are now ruined and all funds have various bucket requirements -- this means there could be other victims, they say. Today are reports of more Hybrid ARM and ABS HEQ bidlists. Market sources say the execution of the public sale of \$2.8B in AAA Alt-A paper from Ottimo Funding between 10/29 and 11/1 will be interesting and very important. "That list will be the beginning of meaningful, public price discovery," one mortgage veteran said. Several traders say this is a necessary step. "People haven't been selling any of this paper because they say the bidside is too cheap compared to valuations," one trader said. "People can wish and hope all they want, but at times like this, the bidside is all that matters." Market sources also suspect that as painful as this process might be, setting some public price levels and perhaps getting new investors involved could be very healthy for the markets.

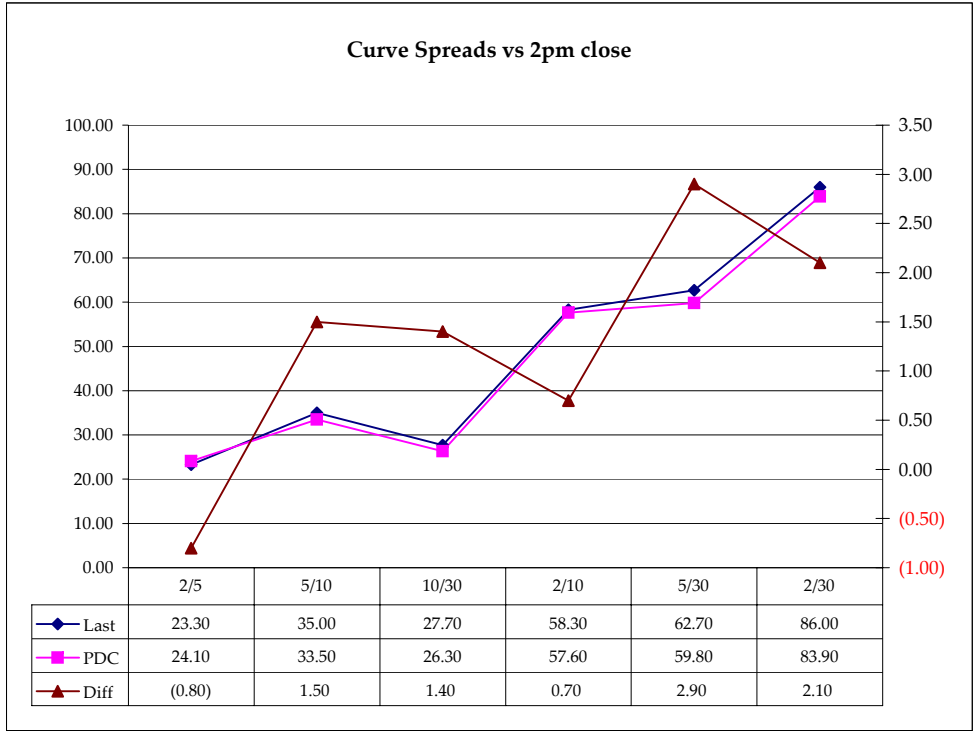
At this juncture, a rough estimate for the October ISM index is 51-52, which compares with 52.0 in September. The October ISM report is scheduled for release on Thursday, November 1 at 10AM ET. [Stone & McCarthy]

13:19 10/18 **US DATA REACT**: JPM says after the Phila and NY mfg data, their prelim est for mfg ISM is 51. [Source: MNI]

13:50 10/18 **US OUTLOOK**: RBSGC looks for mfg ISM to print 52.5 in Oct, up from 52 in Sept. On an ISM basis, Philly Fed index fell to 50.5 in October and the Empire State survey strengthened to 59.7, RBSGC says, suggesting improvement across the nation. [Source: MNI]

[Note from Jim: Why is this so important? Because when ISM heads under 50 the fed cuts rates.]

Yield Curve Spreads			
	TC	PDC	Diff
2/5	23.30	24.10	(0.80)
5/10	35.00	33.50	1.50
10/30	27.70	26.30	1.40
2/10	58.30	57.60	0.70
5/30	62.70	59.80	2.90
2/30	86.00	83.90	2.10

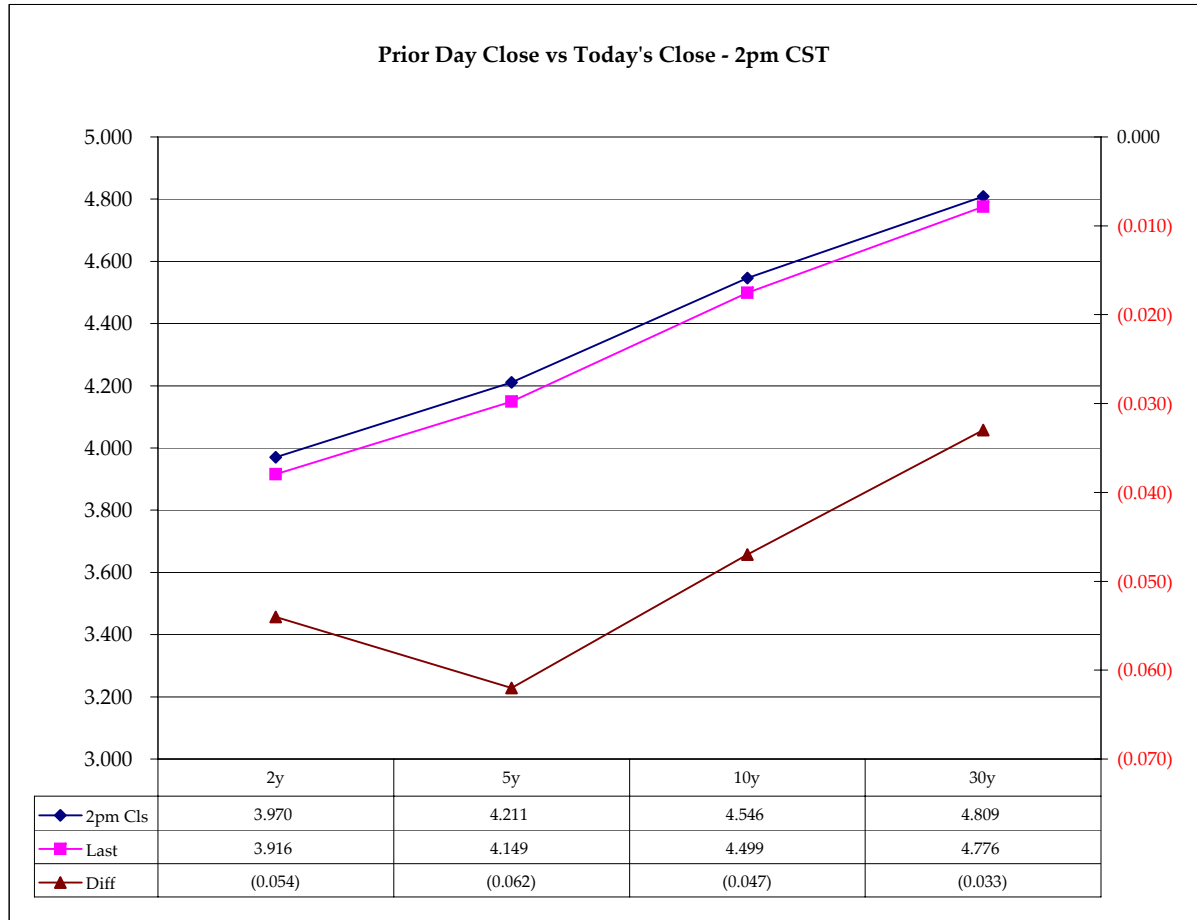


Notes:
 TC = Today's Close at 2pm
 PDC = Prior Day's Close at 2pm

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

	Cpn	Mty	PDC 32	PDC	TC	Diff	Basis	
							PDC	TC
2y	4.000	9/30/09	100.0175	3.970	3.916	(0.054)		
5y	4.125	8/31/12	100.0550	4.211	4.149	(0.062)	21.67	23.37
10y	4.750	8/15/17	101.190	4.546	4.499	(0.047)	71.41	73.34
30y	5.000	5/15/37	103.00	4.809	4.776	(0.033)	-672.21	-671.76

	PDC 32	TC
ZF	107.050	107.120
ZN	109.180	109.280
ZB	111.22	112.040



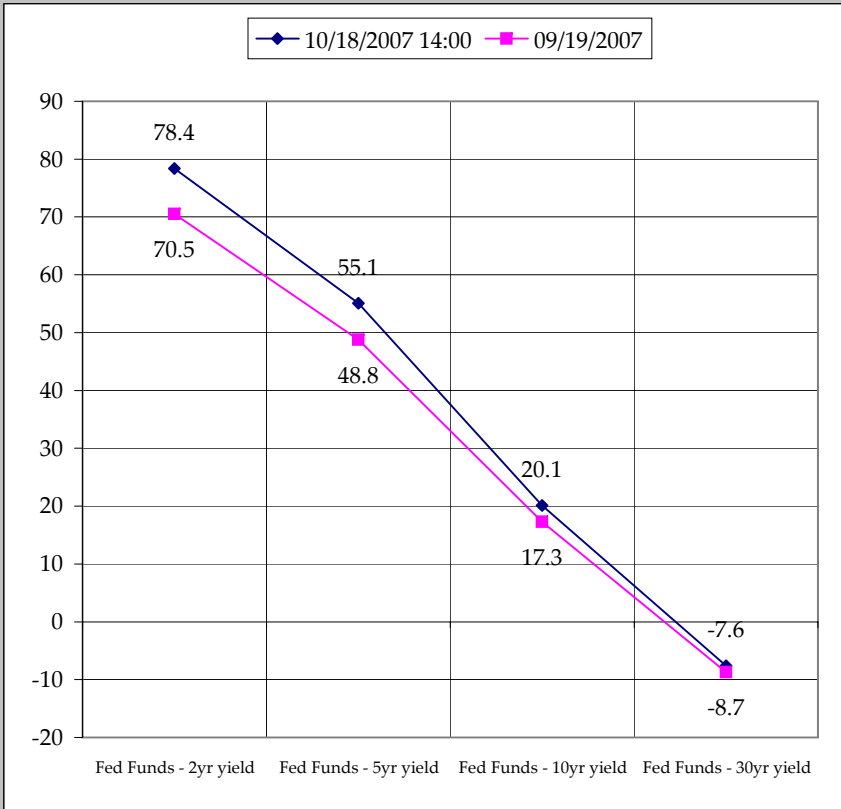
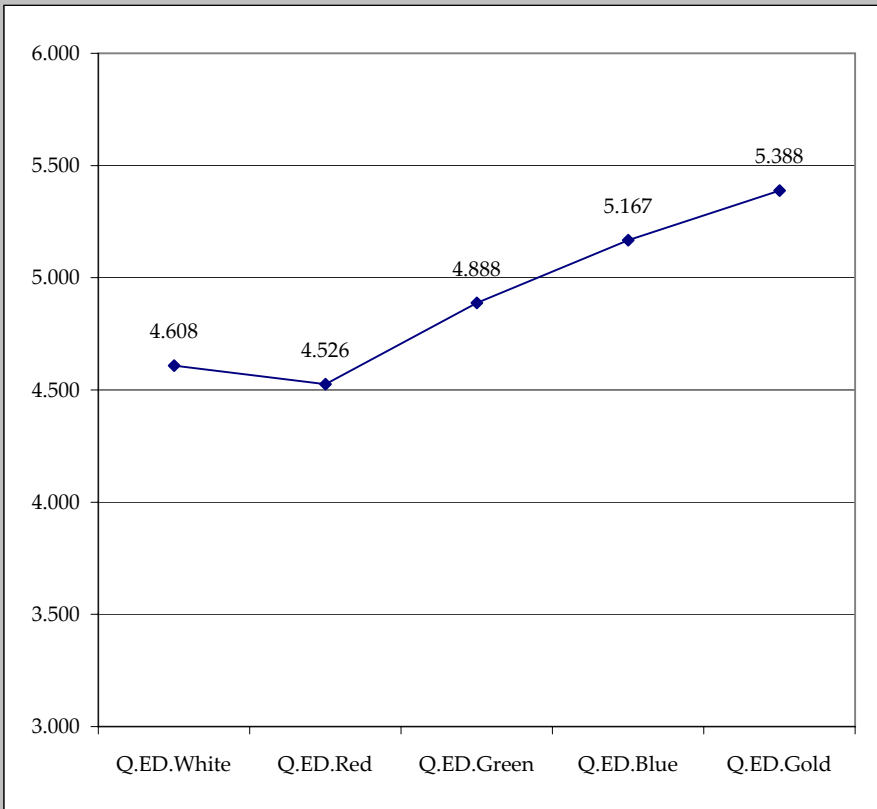
Notes:
 Basis = (Cash Decimal - (Futures Decimal * CF))*32
 32 = price is quoted in 32nds
 TC = Today's Close at 2pm
 PDC = Prior Day's Close at 2pm

Eurodollar Packs			
	Last Yield	Net Yield	Last Price
Q.ED.White	4.608	5.875	9550.625
Q.ED.Red	4.526	5.500	9558.500
Q.ED.Green	4.888	4.500	9523.625
Q.ED.Blue	5.167	2.500	9496.750
Q.ED.Gold	5.388	1.750	9475.500

Fed Funds Daily Effective Rate Minus US Treasury Yields			
Spread Name	Diff bps	Net Chng	09/19/2007
Fed Funds - 2yr yield	78.4	8.3	70.5
Fed Funds - 5yr yield	55.1	8.2	48.8
Fed Funds - 10yr yield	20.1	7.3	17.3
Fed Funds - 30yr yield	-7.6	6.6	-8.7
GFER	4.70	2.0	

GFER = Fed Funds Daily Effective Rate

Why 9/19/2007?
 The morning after the last FOMC meeting is a good benchmark. I marked at 7:00am CT. (Before CPI release).



Month	Fed Funds (FF)			ED	ED - FF
	Last	Net	Implied	Implied	bps
Oct-07	95.265	0.050	4.735	0.000	0.0
Nov-07	95.425	0.400	4.575	4.970	39.5
Dec-07	95.550	0.600	4.450	4.815	36.5
Jan-08	95.615	0.600	4.385	4.690	30.5
Feb-08	95.720	0.750	4.280	0.000	0.0
Mar-08	95.745	0.750	4.255	4.520	26.5
Apr-08	95.760	0.600	4.240	0.000	0.0
May-08	95.830	0.850	4.170	0.000	0.0
Jun-08	95.820	0.750	4.180	4.360	18.0
Jul-08	#VALUE!	#VALUE!	#VALUE!	0.000	0.0
Aug-08	95.910	0.900	4.090	0.000	0.0

