# The Afternoon Email

**Table of Contents**



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

**All times Eastern**

15:15 09/14 **US TSYS/RECAP:** Tsys ended higher vs 3pm Thu after wild Fri: early
rally on weak US 0.3% Aug retail sales, weak US stocks, UK's N. Rock bank woes, but then Tsys plunged as US stocks cut losses, then had choppiness later. Yahoo stock up 4% at one pt amid merger talk rumor. Tsys traders trim size of Tues rate cut hope to 25 bps from 50 bps, and 2Y yield rejected going below 4%. Some eyed Univ Mich 5-Yr inflation expectations at 3% Sept prelim vs. 2.9% Aug. Earlier, hedge funds, end-users, leveraged accounts, U.S. banks bought intermediates, while some buy-and-hold accounts take profits in 10Y to go into spread product. There was Asian T-bill bid this morning in NY, also central bank selling in T-bills, also light reinvestment T-bill bid. Foreign central banks bought intermediates, including 5s. There were earlier 3Y/5Y steepeners in cash, swaps; 2Y/10 real money steepeners. There also was outright Japanese buying in 10Y futures. Fund mgrs bought US 7s. US intermediates had MBS-tied sales, Mideast selling (some move to UK Gilts)

15:23 09/14 **US SWAPS**: Sources reported mainly curve plays with real money doing 2/10Y and 3/5Y steepeners as well as some switching from 10Y tighteners to 2Y tighteners. Some swap hedging reported vs custy selling of MBS structured product. Also, sources said short gamma players paid in 10Y to 20Y either outright or vs 5Y swaps, which kept the back end under pressure and underpinned volatility on the swaps curve. According to GovPX:

| Time (ET) | 2Y Swap/Mid | 5Y Swap/Mid | 10Y Swap/Mid | 30Y Swap/Mid |
|---|---|---|---|---|
| Fri Close | -2.75/69.75 | -0.50/67.50 | +0.75/67.25 | +2.25/65.00 |
| 11:56 | -3.00/69.50 | -0.75/67.25 | +0.00/66.50 | +1.25/64.00 |
| 10:00 | -1.75/71.25 | -0.25/67.75 | -0.50/66.00 | -0.25/62.50 |
| 9:30 | -1.50/71.50 | -0.25/67.75 | -0.50/66.00 | -0.50/62.25 |
| 9:00 | -1.00/71.50 | -0.25/67.75 | -0.50/66.00 | -0.50/62.25 |
| Fri Open | -1.50/71.00 | -0.50/67.50 | -0.75/65.75 | -0.50/62.25 |
| Fri 8:00 | -1.75/70.75 | -0.75/67.25 | -0.75/65.75 | -0.50/62.25 |
| Thu 3:00 | -4.75/72.50 | -0.50/68.00 | +1.50/66.50 | +1.75/62.75 |

**(continued)**

15:15 09/14 **SWAPTION VOLS:** Sources said while the swaps curve remains whippy, swaption flows have been light at some shops. While late last week and earlier this week the rally brought in significant flows including dealer short covering and mtg buying of receivers, that flow has ebbed and today's flows were lackluster. There has been some dealer vol desks selling Dec 10Y vol today though for light size and some typical receiver servicer action. Unless, the mkt rallies back to the yld lows, sources say flows should stay quiet ahead of the Fed. However, short gamma players have been payers in 10Y and 30Y swaps either outright or vs 5Y, source say. According to GovPx:

| Time (ET) | GAMMA, 3M/2Y | INTERMEDIATE, 2Y/10Y | VEGA, 5Y/5Y |
|---|---|---|---|
| Fri Close | 95.5 bps | 722.2 bps | 563.6 bps |
| Fri 1:40 | 95.4 bps | 723.0 bps | 564.2 bps |
| Fri Open | 97.6 bps | 730.4 bps | 564.4 bps |
| Thu 3:00 | 97.4 bps | 730.4 bps | 567.6 bps |

15:22 09/14 **US TSY FUTURES:** Tsys closed higher on the day with the Dec T-bond ended up 5/32 at 112-31 with 347K traded while the Dec 10-yr settled better by 5.5/32 at 109-26.5 with 1.28M traded. The Dec 5-yr notes settled up 3.5/32 at 107-04 with 605K traded while the Dec 2-yr closed better by 2.25/32 at 103-12.75 with 214K changing hands.

14:47 09/14 **US BONDS/LOANS/RISK**: US Tsys see some late short-covering as stocks still mildly weaker. ABCP seems calm but a few things ahead next week:
- Mon 9/17: Launch of large First Data financing package, US$5B LBO loan, at a discount of 96c on the dollar, said Reuters LPC. First Data overall LBO term loan size has been reduced to US$13B from US$14 prior, it said; financing package is litmus test of risk;
- Monday/Tuesday: 9/17-9/18: there is US$113B euro commercial paper due by Tue, with the heaviest ECP maturity day Mon.
- Tuesday: 9/18 The FOMC meeting and Lehman Bros. quarterly earnings.
- Wednesday, 9/19: Morgan Stanley quarterly earnings.
- Thursday: 9/20: Goldman Sachs, Bear Stearns report earnings; all the big bank earnings will be key to how much housing/credit crises have affected big houses both here and abroad to date. Needless to say, other Q3 earnings follow in mid-Oct, each will be closely eyed.
- Thursday: 9/20: Fed Chairman Bernanke speaks on Capital Hill.

MarketNews international

Stone & McCarthy RESEARCH ASSOCIATES

**US TSYS/RESEARCH:** Bank of America bond strategists noted that "in last week's Global Rates Focus, we discussed the dramatic operational strains on the Federal Reserve that would occur if discount window borrowing surged (it could trigger the largest balance sheet overhaul by a central bank since the BOJ started quantitative easing). This week, we look at those strains in more detail, and the likely market implications. Investors who believe that discount window borrowing will rise sharply after the FOMC meeting should look to buy Fed funds contracts, sell Tsy GC, sell TBills, and buy 2yrs versus off-the-run 2s."

12:05 09/14 **CARRY TRADES**: While sterling specifically remains under pressure versus the dollar and on the crosses, other carry trades are holding up quitewell, especially yen carry trades. Euro-yen holds at Y159.78, on the high side of a Y158.80 to Y160.24 range, while sterling-yen holds atY231.48, in the middle of a Y230.21 to Y233.30 range. Market players are being selective in the currencies they want to hold and not hold.Emerging market currencies as well as sterling are being weighed by weekend profit-taking, while the Canadian and Aussie dollars continue to see solid demand. The yen remains week vs the dollar and on the crosses.

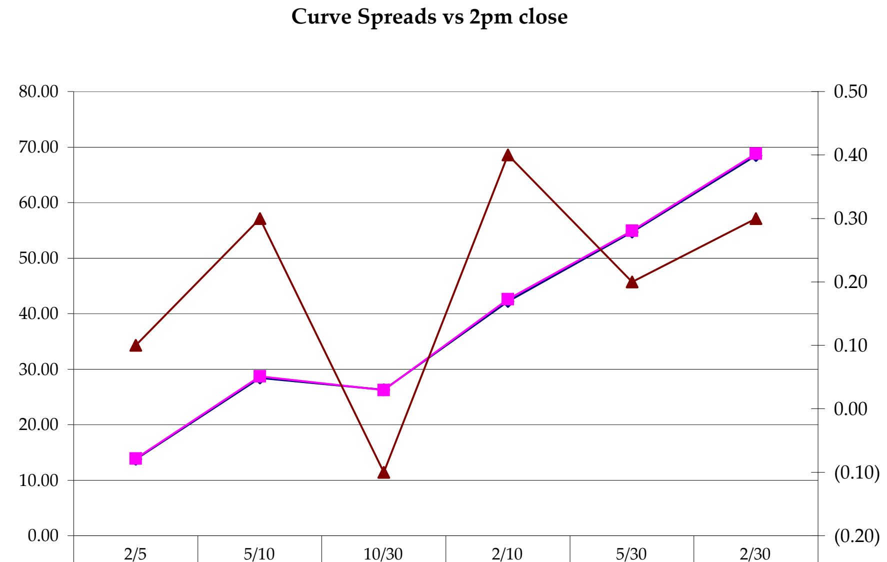
**Discount borrowing** under the Fed's primary credit program for banks surged to more than $7.1 billion outstanding as of Wednesday, up from about $1 billion a week earlier, the central bank said yesterday. It was the highest level since the day after the Sept. 11, 2001, terrorist attacks.--SOURCE WSJ

**Merrill Lynch** said it has lowered the value of securities backed by subprime mortgages and other assets amid roiling credit markets, signaling a possible drag on earnings.--SOURCE WSJ

# Curve Spreads



| | Yield Curve Spreads | | |
|---|---|---|---|
| | TC | PDC | Diff |
| 2/5 | 13.80 | 13.90 | 0.10 |
| 5/10 | 28.40 | 28.70 | 0.30 |
| 10/30 | 26.30 | 26.20 | (0.10) |
| 2/10 | 42.20 | 42.60 | 0.40 |
| 5/30 | 54.70 | 54.90 | 0.20 |
| 2/30 | 68.50 | 68.80 | 0.30 |




| | 2/5 | 5/10 | 10/30 | 2/10 | 5/30 | 2/30 |
|---|---|---|---|---|---|---|
| Last | 13.80 | 28.40 | 26.30 | 42.20 | 54.70 | 68.50 |
| PDC | 13.90 | 28.70 | 26.20 | 42.60 | 54.90 | 68.80 |
| Diff | 0.10 | 0.30 | (0.10) | 0.40 | 0.20 | 0.30 |

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

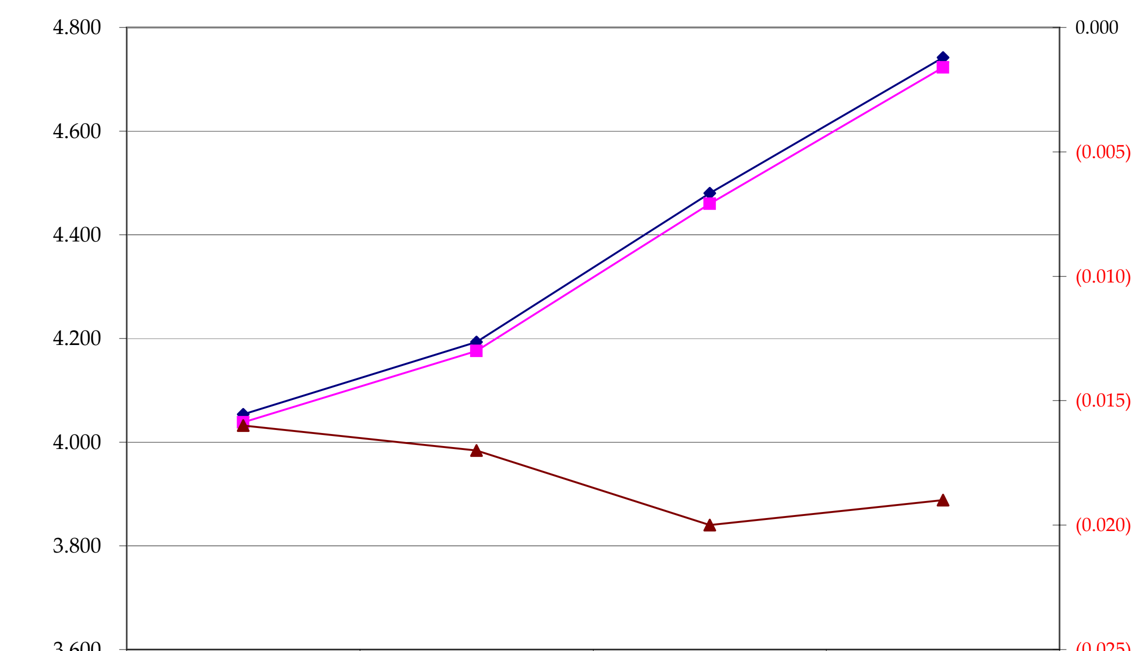
9/14/2007 14:00

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



| | Cpn | Mty | PDC 32 | PDC | TC | Diff | Basis PDC | Basis TC |
|---|---|---|---|---|---|---|---|---|
| 2y | 4.000 | 8/31/09 | 99.2750 | 4.054 | 4.038 | (0.016) | | |
| 5y | 4.125 | 7/31/09 | 99.2225 | 4.193 | 4.176 | (0.017) | 23.96 | 22.71 |
| 10y | 4.750 | 8/15/17 | 102.045 | 4.480 | 4.460 | (0.020) | 86.19 | 85.70 |
| 30y | 5.000 | 5/15/37 | 104.03 | 4.742 | 4.723 | (0.019) | -672.13 | -668.79 |

| | PDC 32 | TC |
|---|---|---|
| ZF | 107.005 | 107.045 |
| ZN | 109.210 | 109.265 |
| ZB | 112.21 | 112.270 |




| | 2y | 5y | 10y | 30y |
|---|---|---|---|---|
| 2pm Cls | 4.054 | 4.193 | 4.480 | 4.742 |
| Last | 4.038 | 4.176 | 4.460 | 4.723 |
| Diff | (0.016) | (0.017) | (0.020) | (0.019) |

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 & Fed Funds - Treasuries



| | Eurodollar Packs | | |
|---|---|---|---|
| | Last Yield | Net Yield | Last Price |
| Q.ED.White | 4.976 | 3.875 | 9515.188 |
| Q.ED.Red | 4.534 | 3.625 | 9557.750 |
| Q.ED.Green | 4.802 | 2.125 | 9531.875 |
| Q.ED.Blue | 5.044 | 0.625 | 9508.625 |
| Q.ED.Gold | 5.277 | 0.000 | 9486.250 |
| Q.ED.Purple | 5.277 | 0.000 | 9486.250 |

**Fed Funds Daily Effective Rate**

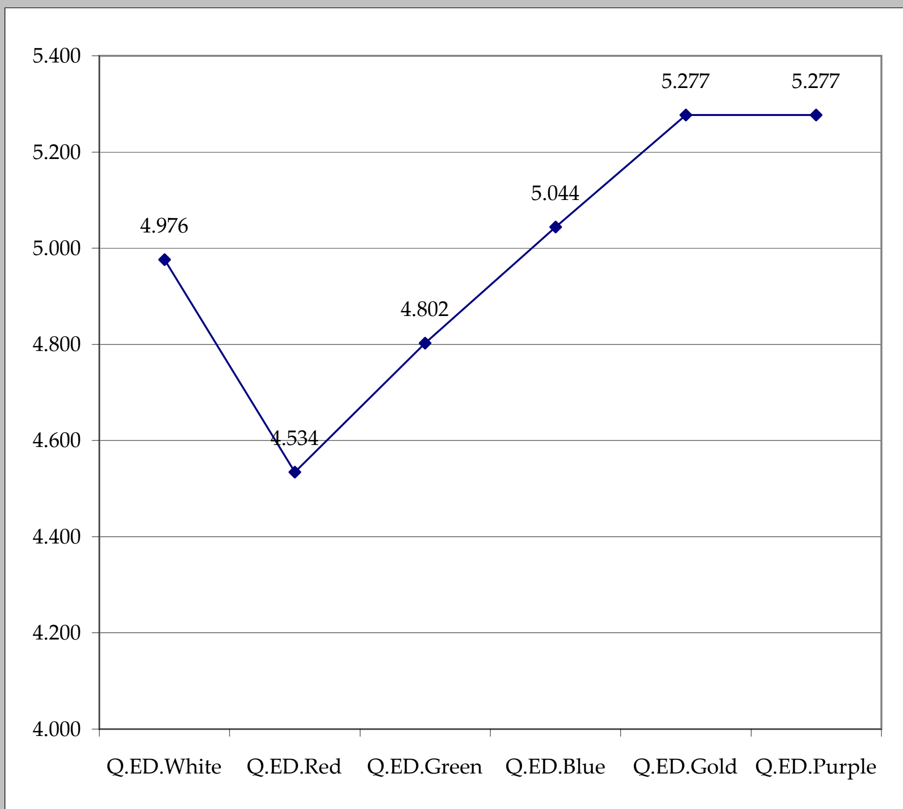
**Minus US Treasury Yields**

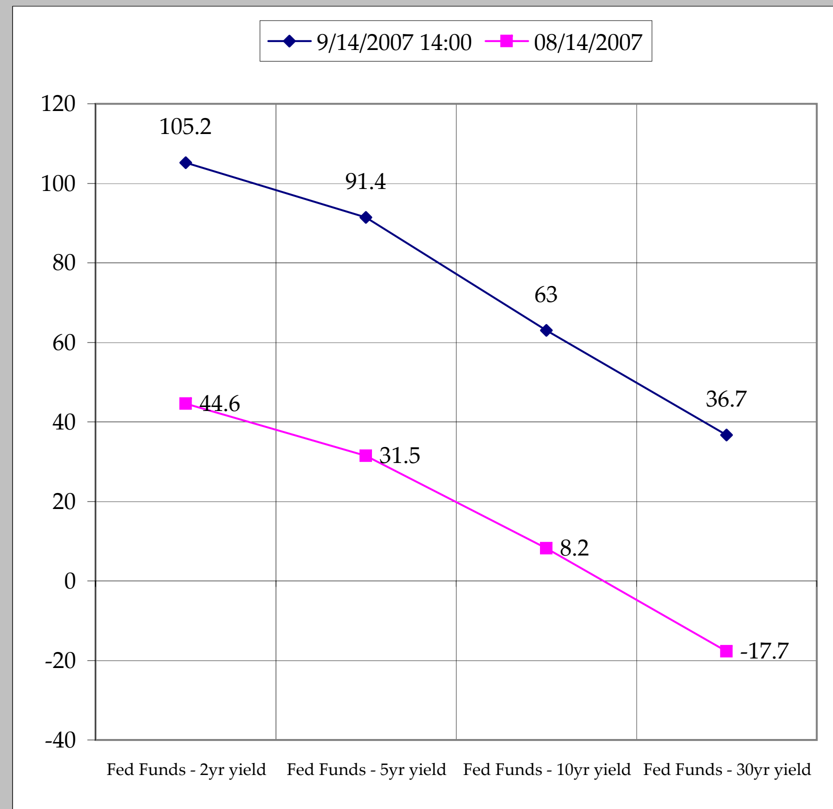
| Spread Name | Diff bps | Net Chng | 08/14/2007 |
|---|---|---|---|
| Fed Funds - 2yr yield | 105.2 | -10.7 | 44.6 |
| Fed Funds - 5yr yield | 91.4 | -9.2 | 31.5 |
| Fed Funds - 10yr yield | 63 | -8.8 | 8.2 |
| Fed Funds - 30yr yield | 36.7 | -8.6 | -17.7 |
| GFER | **5.19** | -9.0 | |

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.



## Fed Funds - Eurodollars



| | Fed Funds (FF) | | | ED | ED - FF |
|---|---|---|---|---|---|
| Month | Last | Net | Implied | Implied | bps |
| Sep-07 | 95.030 | -0.250 | 4.970 | 5.593 | 62.3 |
| Oct-07 | 95.150 | 0.050 | 4.850 | 0.000 | 0.0 |
| Nov-07 | 95.310 | -0.200 | 4.690 | 0.000 | 0.0 |
| Dec-07 | 95.400 | -0.250 | 4.600 | 4.885 | 28.5 |
| Jan-08 | 95.450 | -0.250 | 4.550 | 0.000 | 0.0 |
| Feb-08 | 95.545 | -0.250 | 4.455 | 0.000 | 0.0 |
| Mar-08 | 95.575 | -0.400 | 4.425 | 4.515 | 9.0 |
| Apr-08 | 95.705 | 0.200 | 4.295 | 0.000 | 0.0 |
| May-08 | #VALUE! | #VALUE! | #VALUE! | 0.000 | 0.0 |
| Jun-08 | 95.705 | -0.300 | 4.295 | 4.400 | 10.5 |
| Jul-08 | #VALUE! | #VALUE! | #VALUE! | 0.000 | 0.0 |
| | | | | | |
| | | | | | |