



Economic and Fixed Income Market - Weekly Update

February 8, 2010

- >The manufacturing ISM purchasing managers' survey rose to 58.4 in January from 54.9 in December, marking the sixth straight month of expansion in the nation's manufacturing sector. The survey jumped in January to its highest level since 2004 and the details of the report showed the rise in the overall index was broad based. The production index rose to 66.2 from 59.7 in December and the new orders index -- the most forward looking component -- rose to 65.9, the highest since April 2004, from 64.8 in December.
- >On another positive note for future production, 32% of manufacturing respondents reported customer inventories were "too low," -- the lowest reading since the inception of this index in January 1997 -- and marked ten consecutive months that inventories were too lean following the massive inventory liquidation that took place in the second half of 2008 and during 2009. The resulting pickup in orders and production necessary to rebuild depleted stockpiles is providing a modest boost to the jobs market. The employment index rose to 53.3 in January, the third reading above 50 in the past four months.
- >The nonmanufacturing ISM purchasing managers' survey pointed to growth in the service sector for the first time since October, rising to 50.5 in January from 49.8 in December. The survey's employment index showed job losses moderating, as the employment index improved to 44.6 from 43.6 in December. However, that is still a weak employment index and marked the 25th straight month of job losses.
- >The other details of the report were mixed. New orders, an indication of future business activity, rose to 54.7 in January from 52.0, the fifth consecutive monthly reading above 50, which is consistent with a growing order book. While business activity showed growth at a reading of 52.2, that was slower than the 53.2 reading in December and of the 18 industries the ISM surveyed, only four grew, while three were unchanged and eleven industries were still shrinking.
- >Nonfarm payroll employment fell 20,000 in January after losing 150,000 jobs in December. November was revived to a gain of 64,000, which represented the first monthly gain in employment in 23 months. The annual benchmark revisions to the payrolls data showed the economy lost an astonishing 8.4 million jobs since the start of the recession in December 2007, compared to the 7.2 million previously reported -- still an awful number. The economy has given back all of the jobs created during the last decade, as payroll employment is back to a level first attained in September 1999.
- >The unemployment rate dropped to 9.7% in January from 10.0%, a better than expected outcome. The unemployment rate is calculated from the household survey, which reported a 784,000 gain in employment. The household survey typically leads an improvement in the payroll survey as it more effectively captures employment gains arising from small business formations. The leading indicators in the payroll report continue to point to positive readings on payrolls over the next couple months. Average hourly earnings rose 0.2% m/m, the workweek rose 0.1 hours to 33.9 hours, and temporary employment rose by 52,000 in January, compared to the 4Q 2009 monthly average of 65,000, -11,000 in 3Q 2009, -38,000 in 2Q 2009, and -52,000 in 1Q 2009.

Economic Forecasts - Percent Change

	2009				2010				Annual Changes		
	1QA	2QA	3QA	4QA	1QE	2QE	3QE	4QE	2008A	2009A	2010E
Real GDP	-6.4	-0.7	2.2	5.7	3.5	2.5	2.5	2.5	0.4	-2.4	3.0
Unemployment Rate	8.1	9.3	9.6	10.0	9.8	9.6	9.7	9.9	5.8	9.3	9.8
Housing Starts (mil)	0.53	0.54	0.59	0.55	0.60	0.65	0.65	0.70	0.90	0.55	0.65
GDP Price Index	1.9	0.0	0.4	0.6	1.0	1.0	1.0	1.0	2.1	1.2	1.0
CPI	-2.4	1.3	3.6	3.4	1.5	1.2	1.2	1.5	3.8	-0.3	1.4
Core CPI	1.5	2.4	1.5	1.5	1.0	1.0	1.0	1.0	2.3	1.7	1.0

Interest Rates - Percent (End of Period Yields)

	2009				2010				End of Year		
	1QE	2QA	3QA	4QA	1QE	2QE	3QE	4QE	2008A	2009E	2010E
Federal Funds Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.25	0.25	0.50
3-Month T-Bills	0.2	0.2	0.1	0.1	0.3	0.3	0.5	0.5	0.1	0.1	0.5
2-Year T-Notes	0.8	1.1	0.9	1.1	1.1	1.2	1.2	1.3	0.8	1.1	1.3
10-Year T-Notes	2.7	3.5	3.3	3.8	3.7	3.8	3.8	4.0	2.2	3.8	4.0

Bond Market Commentary

> Credit spreads widened 26 basis points on investment grade corporate bonds over the past four weeks. There could be additional spread widening due to the ongoing stock market decline which is having an adverse effect on investors' appetite for risk. Corporate bond valuations appeared fairly rich at the end of 2009 following the incredible rally that began in the 2nd quarter and persisted for the duration of the year. This recent back-up in credit spreads represents a modestly attractive window for investors to add corporate sector exposure.

> The yield on the 10-year Treasury note closed Friday at 3.57%, which is 27 basis points lower than the 3.84% closing yield on 12/31/09. Yields on municipal bonds with similar maturities, however, are nearly unchanged for the same time period. Because of this, we find muni yields compelling, especially when we consider the pending legislation for higher income tax rates proposed for high income earners, who are likely to demand more tax-exempt securities as a result. We attribute the stagnate muni yields not to a lack of investor interest, but to the huge success and acceptance of "Build America Back" bonds, which have accounted for nearly half of newly issued municipal issues this year.

	2/8/10 (Percent)	
	Treasury Yields	Agency Yields
2 year	0.76	0.88
3 year	1.26	1.55
5 year	2.23	2.58
7 year	3.00	3.34
10 year	3.57	3.84
30 year	4.52	4.91

Joseph T. Keating
Chief Investment Officer

B. Todd Golden, CFA
Chief Fixed Income Officer

Matthew H. Foster
Portfolio Manager