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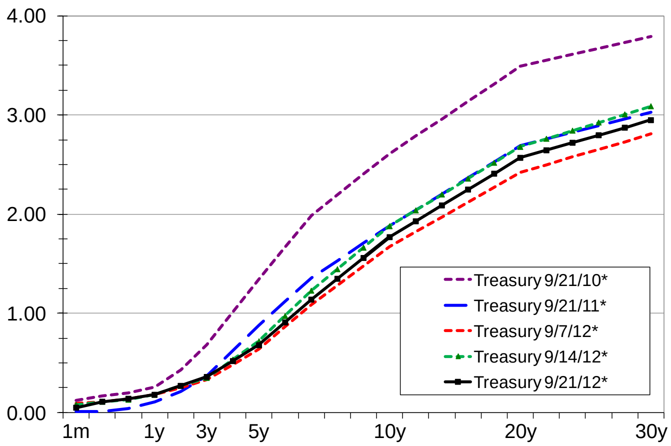
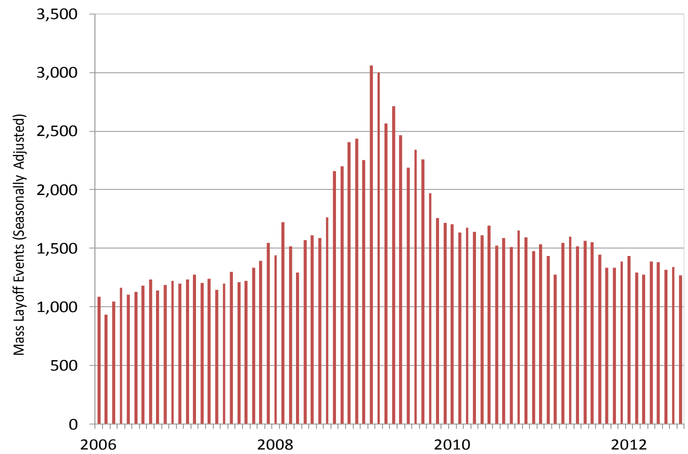
Weekly Economic Newsletter for Treasury and Finance — *September 24, 2012*

The Big Picture: Yield Curve & Mass Layoffs



U.S. Treasury Yield Curve—Source: [U.S. Department of the Treasury]



Mass Layoffs—Source: [Bureau of Labor Statistics]

Measure	Numerical Trend	Current Trend	Analysis
Existing Home Sales August 2012 *Source: National Association of Realtors*	*Millions* *Seasonally Adjusted* *Annualized Rate* Aug 12: 4.82 Jul 12: 4.47 Aug 11: 4.41	↑	Sales of previously owned homes accelerated 7.8% in August to the fastest pace in over 2 years. Gains were consistent on a regional basis with sales rising in the Northeast (+8.6%), West (+8.3%), Midwest (+7.7%) and South (+7.3%). Sales of single-family homes increased 8.0% while condo sales were up 6.1%. Inventories of unsold homes grew by 2.9% to 2.47 million units, representing a 6.1 month market supply. Even with the increase, this was 18.2% below levels of a year earlier. The median existing home sales price of $187,400 was up 9.5% from August 2011, the largest 12 month gain since January 2006.
Housing Starts August 2012 *Source: Census Bureau*	*Thousands* *Seasonally Adjusted* *Annualized Rate* Aug 12: 750 Jul 12: 733 Aug 11: 581	↑	This was the 2nd fastest pace of housing starts in 2012 (behind only that of June) even as starts declined in both the Northeast (-12.6%) and West (-4.3%). Starts increased in the Midwest (+20.7%) and South (+3.7%). Single-family unit starts increased 5.5% to an annualized rate of 535,000 in August—an increase of 26.8% from a year earlier. Multi-family construction slowed 4.9% to 215,000 unit sales. Due to a decline in multi-family permitting activity (-3.0%), the pace of permit issuance slowed 1.0% to 803,000 (SAAR). Completions increased 0.7% to 689,000 units (SAAR), up 11.7% from a year ago.

Mass Layoffs August 2012 *Source:* *Bureau of Labor Statistics*	*# of Layoff Events Affecting >50 Workers Seasonally Adjusted* Aug 12: 1,267 Jul 12: 1,340 Aug 11: 1,551	↓	A seasonally adjusted 127,454 people lost their jobs from a layoff event that affected at least 50 workers at a single employer. This was down 7.3% from July and 22.4% from a year ago. The manufacturing sector was responsible for 24.7% of mass layoff events (314) and 30.3% of the 1st time claims for jobless benefits resulting from them (38,667). This was a drop from July, which had 364 manufacturing mass layoff events.
Treasury International Capital Flows July 2012 *Source:* *Department of Treasury*	*Net Long-Term Securities Transactions Billions* Jul 12: +$67.0 Jun 12: +$9.3 Jul 11: +$2.0	↑	Net TIC flows of +$73.7 billion resulted from +$59.0 billion in foreign private (investor) net inflows and +$14.7 billion in foreign official (institution) net inflows. Foreign investors added $50.0 billion in Treasury securities to their portfolio. Foreign investors also added $6.4 billion in U.S. equities and $4.5 billion in agency bonds to their portfolios but shed $0.6 billion in corporate bonds.
Leading Indicators August 2012 *Source:* *The Conference Board*	*Index (2004 =100) Seasonally Adjusted* Aug 12: 95.7 Jul 12: 95.8 Aug 11: 93.7	↓	The leading index continued its recent trend of oscillating within a tight range, as just 4 of 10 index components recorded gains during the month. The largest positive contributor to the index was the interest rate spread while the largest negative contributor was the ISM new order index. The coincident index ticked up 1/10th of a point to 104.7 while the lagging index added 2/10ths of a point to 116.5.
NAHB Housing Market Index September 2012 *Source:* *National Association of Home Builders*	*Index (>50 = "Good") Seasonally Adjusted* Sept 12: 40 Aug 12: 37 Sept 11: 14	↑	Builder confidence soared to its highest level in more than 6 years after a 5th straight monthly increase. Confidence improved across all 4 Census regions: the Northeast (+9 to 32), West (+5 to 45), Midwest (+4 to 45) and South (+4 to 39). Sales expectations for the next 6 months jumped 8 points and pushed through the good/poor threshold of 50 (to 51). The current sales index added 4 points to 42 while the prospective buyers index was up a point to 31.
Jobless Claims Week ending September 15, 2012 *Source:* *Department of Labor*	*First-Time Claims Seasonally Adjusted Thousands* Sept 15 12: 382 Sept 8 12: 385 Sept 10 11: 417	↓	The 4-week moving average for initial filings increased 2,000 from the previous week to 377,750. This was 9.6% below the 4-week moving average of a year earlier (414,000). The seasonally adjusted insured unemployment figure for the week ending September 8 was 3.272 million. The 4-week moving average fell 12,000 to 3.310 million, down 11.1% from a year ago (3.724 million).
Current Account Second Quarter 2012 *Source:* *Bureau of Economic Analysis*	*Balance in Billions Seasonally Adjusted* Q2 12: -$117.4 Q1 12: -$133.6 Q2 11: -$119.1	↑	This was the fastest quarterly contraction in the current account deficit in 3 years. The deficit on goods and services shrank by $9.1 billion to -$139.3 billion, with the goods deficit shrinking $8.5 billion to -$185.8 billion and the services surplus growing $1.4 billion to +$46.5 billion. The income surplus jumped $8.1 billion to +$55.5 billion while net transfer payments to foreigners totaled $33.6 billion.

Economic Commentary edited by Kevin Roth

Last week featured three reports showing the housing sector remained a bright spot for the U.S. economy during August. First, the National Association of Realtors estimates August existing home sales were at a seasonally adjusted annualized rate of 4.82 million units, up 7.8 percent from July and 9.3 percent from August 2011. Sales grew in all four Census regions on a month-to-month basis and in three of four regions on a year-to-year basis (sales were flat in the West).

Since 80 percent or more of home sales are typically of previously owned properties, the existing home sales figures often sets the overall tone for the sector. But the bigger story is the recent rebound in prices—the median sales price of previous homes sold during August was $187,400, up 9.5 percent from a year earlier (the biggest 12-month comparable in 6.5 years). NAR's press release tied the strong report to "excellent affordability conditions" and to what it termed the "broadly balanced" inventories of available homes (although there were shortages in both the West and in Florida). The 2.47 million unsold homes at the end of August (up 2.9 percent from July but down 18.2 percent from a year earlier) was equivalent to a 6.1 month supply.

Even if the inventory of unsold homes was "broadly balanced," the fact that fewer homes were on the market has led to increased interest in newly constructed homes. A second major housing report released last week, by the U.S. Census Bureau, indicated housing starts were up by just 2.3 percent during August. But the seasonally adjusted annualized rate of 750,000 units was up 29.1 percent from a year earlier. The SAAR rate of housing starts has been above 700,000 units for eight of the past nine months. The Census Bureau also estimates the number of permits issued during the month fell 1.0 percent to 803,000 units (SAAR), but was nevertheless still 24.5 percent above year ago levels.

In this environment, the nation's homebuilders have been growing increasingly confident about business prospects. A third housing report last week featured a key measure of sentiment hitting a six-year high. The Housing Market Index from the National Association of Home Builders gained three points in September to a seasonally adjusted reading of 40. This was the index's best reading since June 2006. The recent rise in the index has been impressive—over the past year, the index has surged by 26 points. But even with the recent gains, the index has not been above a reading of 50—the threshold between a "good" and "poor" market-since April 2006. The NAHB, in its press release, noted that the housing market was "moving in a positive direction" but still faced a number of obstacles like "unnecessarily tight credit conditions," a lack of housing lots and growing prices for building materials.

But if the housing sector is enjoying some positive momentum, manufacturing does not appear to be doing the same (at least in parts of the Northeast):

- The general business conditions index from the Empire State Manufacturing Survey (by the Federal Reserve Bank of New York) lost another 4.6 points to a negative seasonally adjusted reading of -10.4 in September. This was the second straight month in which the index indiciated a contracting manufacturing sector in the New York district. The index for new orders lost 8.5 points to -14.0 while the unfilled orders index shed 4.3 points to -14.9. While staying positive (and hence suggesting growth), the employment index nevertheless plummeted by 12.2 points to +4.3 (its lowest reading since last December).
- The story was a bit better from the Federal Reserve Bank of Philadelphia's September 2012 Business Outlook Survey. While the general business conditions diffusion index reading of -1.9 was the fifth straight month in which it indicated a slowdown in manufacturing activity, it was an improvement from both the -7.1 reading in August and the recent low of -16.6 back in June. The new orders index was positive for the first time since April (+1.0) while indices for unfilled orders (-8.2) and employment (-7.3) improved even if they remained in negative territory.

On the positive side, the number of mass layoffs slowed in the manufacturing sector during August following a big jump the previous month. The Bureau of Labor Statistics estimates that the sector was subject to a seasonally adjusted 314 mass layoff events—defined as a layoff event affecting at least 50 workers per establishment. This was down from 364 events in July and 382 events during August 2011. Mass layoff events in manufacturing were responsible for 38,667 first-time claims for unemployment insurance benefits, an improvement from 44,920 in July and 49,194 a year earlier. The improvement in the manufacturing sector was a significant contributor to the overall reduction in mass layoff events. The seasonally adjusted count of 1,267 mass layoff events was the fewest since September 2007. The key takeaway: the uneven picture from the labor market is more the result of slow hiring than layoffs.

A few weeks ago, we learned that the U.S. economy created a mere 96,000 jobs during August. On Friday, the BLS reported that payrolls grew in 28 states during the month, with the largest increases in Texas (+38,000 workers), Florida (+23,200) and Missouri (+17,900). Payrolls contracted in another 21 states and the District of Columbia, with the largest declines in Virginia (-12,400), the District of Columbia (-11,200) and Washington (-8,800). Payrolls were above year ago levels in 42 states and the District of Columbia, with the largest percentage increases in North Dakota (+6.7 percent), Oklahoma (+2.9 percent) and Texas (+2.5 percent).

If all of this paints a picture of a middling economy, the most recent reading of The Conference Board's Leading Indicators suggests that more is in the offing. The leading indicators index lost 1/10th of a point to a seasonally adjusted 95.7 (2004 = 100), but has traded within a tight range for all of 2012. Just four of ten index components made a positive contribution to the index: the interest rate spread, stock prices, new orders for non-defense capital goods and a credit index. The Conference Board's press release stated that the group does not expect much improvement in the economy as it "continues to be buffeted by strong headwinds domestically and internationally."

The Week in Corporate Finance edited by Brian Kalish

Just like the Washington Redskins, the markets cooled off a bit this past week. While there is still plenty of optimism to go around and the future is looking brighter, it is just a bit more tempered. Now that we are fewer than seven weeks to go before the U.S. elections, there is a general feeling the markets may be stuck in a bit of a holding pattern until November 7th. Of course, plenty of surprises may still await us over the next month and a half, so we will have to see what unfolds.

After quite a back-up over the past two weeks, buyers saw a bit of an opportunity to jump back into U.S. Treasuries. For the week, the U.S. 2-year Treasury note yield was up 1bp to 26bps; the 5-year note was down 4bps to 67bps; the 10-year note was down 11bps to 1.75 percent (still up +20bps over the past three weeks); and the 30-year bond was down 15bps to 2.94 percent (still up +27bps over the past three weeks). The 2-year/30-year curve flattened by 16bps to stand at +268bps (still wider by +23bps over the past three weeks).

On the mortgage front, both the 30 and 15-year fixed-rate product fell to all-time historic lows. The average 30-year mortgage touched 3.49 percent and the 15-year mortgage dropped to 2.77 percent. The Fed's recent announcement of QE III, provided quite a bit of support to the mortgage market with the Mortgage/Treasury spread falling to its tightest level ever at +61bps (a drop of 34bps from last week).

It was a similar story in Germany this week. The 30-year Bund yield was -11bps lower at 2.43 percent; the 10-year Bund fell 11bps to 1.60 percent; and the 2-year Bund dropped 6bps to 3.6bps. It was a very quiet week in France, as the 10-year Oat was up 2bps to 2.28 percent.

It was an uneventful week in Spain as the 10-year note yield was lower by 3bps to finish the week at 5.76 percent. The Spanish 10-year has now fallen by 199bps since late July. The Italian 10-year note ended the week 3bps higher to close at 5.05 percent. During the week, the note was as low as 4.92 percent.

The situation in Greece continues to improve. Their 10-year note yield continued its recent trend lower, falling by another 86bps to drop back into the teens at 19.93 percent. We are now back to yields last seen in late March. Reversing its recent trend, the Portuguese 10-year note moved back up 49bps to settle at 8.58 percent. The yield on this note was higher by 300bps (11.58 percent) as recently as late July.

Corporate bond issuance continues unabated. Both absolute and relative yields continue be at or near all-time lows. Novartis led the way this week with a $2 billion two-tranche transaction comprised of $1.5 billion of a 10-year note and $500 million of a 30-year bond. In this low interest rate environment, it makes perfect sense that we continue to see borrowers issuing debt on the longer-end of the maturity curve. Vodafone was active with its own $2 billion two-tier deal consisting of $1 billion each of a 5-year and 10-year piece. Ford was also in the market with $1 billion of a 10-year note.

As we come into quarter-end, we may see a bit of window-dressing as investment managers adjust their portfolios. Then it is off to the beginning of the fourth quarter, which could end up being quite exciting for both the economic as well as political markets.

What to watch over the next week:

Monday, September 24, 2012

- Chicago Fed National Activity Index (August 2012)

Tuesday, September 25, 2012

- The Conference Board Consumer Confidence (September 2012)
- S&P Case-Shiller Home Price Index (July 2012)

Wednesday, September 26, 2012

- New Home Sales (August 2012)

Thursday, September 27, 2012

- GDP (Q2 2012 – 3rd Estimate)
- Durable Goods (August 2012)
- Pending Home Sales (August 2012)

Friday, September 28, 2012

- Personal Income (August 2012)
- University of Michigan Consumer Sentiment (September 2012)

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