

## Centerpoint Advisors Fixed Income Second Quarter 2009 Overview

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### Overview

Had you been marooned on a desert island for the last year and unaware of all the gyrations that have occurred in the markets you would be unimpressed by the level of liquidity that has found its way back into the bond market. Corporate spreads have come back with a vengeance. As an example, AT&T 5.50% due 2/1/18 trade at approximately +174 bps over 10yr treasuries as of 6/30/09 in from +180 bps over 10yr treasuries as of 6/30/08 (the same bonds traded at a approximately +536bps over 10yr treasuries on 11/21/08). In addition, State Level General Obligation municipal bonds that traded at 99% of Treasury yields in 10yrs back on 6/30/08 now trade at 98% as of 6/30/09 (keep in mind this debt traded at 121% of 10yr treasury yields in mid October 2008). The question is: Have we come to far too fast? What is different now versus June 2008 is the overall state of the economy. One only has to pick up the paper to realize that the factors that are impacting our economy and markets - joblessness, deficit spending, the housing market, consumer debt, etc., are not going away anytime soon. While it is encouraging to see an improvement in credit conditions, the environment in which we now find ourselves is concerning.

### Taxable Market

Treasury yields were on a roller coaster ride for much of the quarter. The benchmark 10 year treasury started the quarter at 2.65%, touched 3.95% briefly on June 10th, then rallied back to 3.54% to end the quarter. The sell off occurred as investors became more comfortable with risk assets. The rally back to the 3.54% area occurred mostly as a result of the flight to safety as stocks have sold off. As noted above, corporate investment grade debt continued to tighten during the quarter. The tightening coupled with low treasury rates allowed treasurers to sell a total of \$293.3 billion in investment grade corporate debt (domestic) at attractive levels to the issuers. While issuance for the quarter was down from the \$330.2 billion issued during Q2 2008, part of the difference was made up by the issuance of Build America Bonds, a new type of

debt created by the Obama administration's stimulus package. Build America Bonds (BAB's) let states and cities sell taxable debt and receive a subsidy from the Federal Government equal to 35% of the interest cost of that debt. The program, introduced in late 2008, began to pick up steam in early 2009 and continues to be an important issuance mechanism for states and cities. One of the major advantages to issuers, aside from interest cost savings, is the ability to attract a large class of taxable buyers to their debt (pension plans, life insurers etc). The advantage to the buyer, aside from the yield, is the ability to invest with a new taxable issuer. While yields in general have come down for corporate bonds, they still offer a substantial pick up versus money market alternatives (See Diagram 1).

**Diagram 1: Selected Key Rates**

Treasury Yields		Yield to Maturity
2yr - 1.125% coupon due 6/30/11		0.95%
5yr - 2.625% coupon due 6/30/14		2.39%
10yr - 3.125% coupon due 5/15/19		2.84%
30yr - 4.25% coupon due 5/15/39		3.70%
Corporate Issuer	Rating Moody's/S&P	Approximate Offer YTM
Goldman Sachs 5.125% coupon due 1/15/15	A1/A	4.83%
JPMorgan Chase 4.65% coupon due 6/1/14	Aa3/A+	4.40%
Hewlett-Packard Co. 4.75% coupon due 6/2/14	A2/A	3.50%
General Electric Co. 5.00% coupon due 2/1/13	Aa2/AA+	3.39%
Pepsi Bottling Group 4.625% coupon due 11/15/12	Aa2/A+	2.34%
Money Market Fund Yields		7-Day Current Yield
Fidelity Cash Reserves Fund (FDRXX)		0.48%

All yields as of July 7, 2009 and sourced from Bloomberg.

### Municipal Market

Municipal yields continued to grind tighter during the quarter relative to treasuries. As noted in Diagram 2 the spread relative to treasuries for 10yr State Level General Obligation paper has compressed back to June 2008

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### Municipal Market Continued

levels. Part of the tightening relates to the overall improvement in the bond market but part of it also can be attributed to a lack of overall supply. As noted above, issuers that may have typically issued tax exempt debt to the market are now finding it more cost efficient to issue Build America Bonds in taxable form. The result of the lack of issuance in tax exempts has created, to some extent, a scarcity value in these bonds.

**Diagram 2: Selected Municipal Key Rates**

Generic State General Obligation Municipal Bonds AAA Rated	Yield to Maturity as of		AAA Municipal as % of Current US Gov't Securities	
	6/30/2009	6/30/2008	6/30/2009	6/30/2008
2yr General Obligation due 2010	0.97%	2.57%	90.86%	100.74%
5yr General Obligation due 2013	2.18%	3.37%	85.67%	101.63%
10yr General Obligation due 2018	3.52%	4.00%	98.36%	99.51%

All yields sourced from Bloomberg.

### Our Portfolios

On the taxable side, we maintain our focus on high quality names. Names we have been active in include Pepsi Bottling Group, Cisco, Pfizer, IBM, Emerson Electric to name a few. Overall our taxable portfolio consist of certificates of deposit (mainly for short term needs), agencies and high grade corporates. On the municipal side, we continue to compare municipal yields (primarily on the shorter end) with their fully taxable (corporate) counterparts to determine the highest taxable equivalent yield for the client. As of right now I am sure of three things: death, taxes, and our government's need to issue a substantial amount of debt over the next few years. We feel interest rates will move higher as a result of supply and continue to keep our portfolios short.

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