INSIDE DEBT

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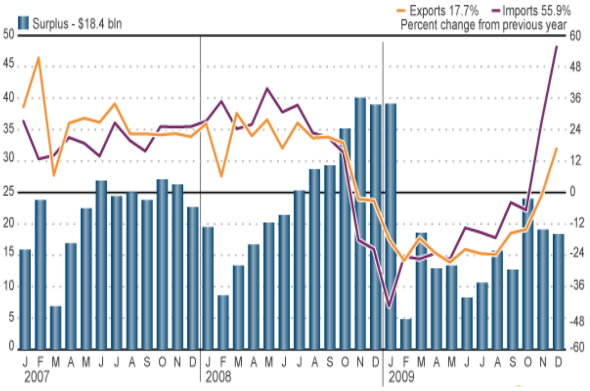
Monday, January 11, 2010

CHART OF THE DAY

China December trade



Growth in China's exports and imports last month blew past expectations, providing fresh evidence of the vigor of the economy and strengthening the case for Beijing to let the yuan start climbing again.

TODAY'S TOP NEWS

- Obama, Cuomo target Wall Street bonuses
- U.S. deficit may pose risk to AAA rtg in 3-5yrs-Fitch
- China lending reportedly jumps, feeding hot economy
- U.S. job mkt gauge highest since Jan 2009-Conf Board
- U.S. 10-year TIPS auction met with solid demand
- New York Fed releases new primary dealer rules
- White House mulls bank fee in budget -reports
- Junk bond default rate slips to 12.5 pct in Q4-Moody's
- BIS-Trichet says global economy in recovery mode
- Emerging sovereigns eye $7 bln in new bonds

ECON WATCH

FOR TUESDAY JANUARY 12

ET		Indicators	Unit	Reuters	Prior
04:30	GB	Trade Balance	bln	-7.00	-7.108
04:30	GB	Trade Balance, Non-EU	bln	-3.40	-3.533
08:30	US	International trade	bln	-34.8	-32.94
08:30	CA	Merch Trade - surplus	bln	0.60	0.43
08:30	CA	Merch Trade - exports	bln	31.6	31.13
08:30	CA	Merch Trade - imports	bln	30.93	30.71
08:30	CA	New housing PI	%	0.3	0.3
10:00	US	IBD economic optimism	ind	-	46.8
23:30	JP	Bankruptcies m/m	%	-	-10.2
23:30	JP	Bankruptcies y/y	%	-	-11.4

MARKETS TODAY

TODAY'S TOP STORY: The White House and a top U.S. regulator attacked excessive Wall Street bonuses, as the nation's biggest banks prepare to hand out awards that critics say were made possible only by taxpayer bailouts. **For more please click here**

TREASURIES: U.S. Treasuries traded mostly higher, as investors nibbled at low-risk assets due to weaker stock prices and solid demand at a $10 billion auction of government inflation-protected bonds.

- 10-yr Treasury prices rose 2/32 for a yield of 3.83 pct from 3.84 pct.
- 30-yr bonds fell 11/32 in price to yield 4.74 pct from 4.72 pct.
- 10-year TIPS due January 2020 cleared at a high yield of 1.430 pct, below traders expectation of 1.48 pct.
- The spread between two- and 10-year yields widened to a record 289 bps, from 285 bps on Friday.
- 2-yr notes rose 2/32 to yield 0.94 pct from 0.98 pct.

FOREX: The U.S. dollar fell across the board with Friday's disappointing U.S. jobs data continuing to weigh on sentiment while comments from a Fed official that U.S. interest rates are likely to stay low for quite some time further eroded dollar support.

- The dollar fell 0.5 pct to 92.08 yen.
- Euro rose 0.61 pct to $1.4518, having hit its highest level in more than three weeks at $1.4557.
- Australian dollar rose 0.27 pct to $0.9317. Earlier, it struck a five-week high versus the U.S. dollar at $0.9296.

CORPORATES: U.S. corporate bond spreads were mixed as the new issue market once again was the dominant driving force and overshadowed the secondary market, stealing thunder from what has been an ongoing active trade.

- The CDX.IG-13 index tightened by 2 bps to 76 bps, its lowest level since Dec 2007.
- PepsiCo Inc launched $4.0 bln of debt in a four-part sale.

STOCKS: The Dow and the S&P 500 closed at fresh 15-month highs as shares of big manufacturers advanced on strong Chinese economic data, but the Nasdaq fell as tech shares like Apple Inc succumbed to profit-taking.

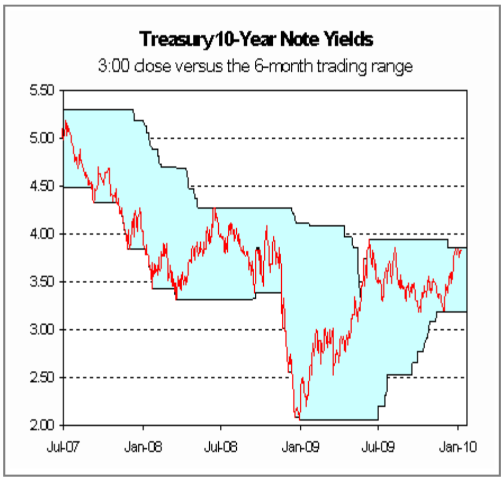
- Dow rose 0.43 pct to 10,663.99, S&P was up 0.17 pct to 1,146.98 and Nasdaq shed 0.21 pct to 2,312.41.
- Caterpillar Inc jumped 6.28 pct to $64.13, its largest daily advance in nearly three months. Alcoa Inc rose 2.53 pct to $17.45.
- Tech hardware makers dragged on the Nasdaq with Apple Inc down 0.88 pct to $210.11 and Hewlett-Packard Co. fell 0.3 pct at $52.43
- S&P financials index rose 0.04 pct, S&P technology index fell 0.67 pct.

C & E: Oil prices fell after early rising to a fresh 15-month high, as the promise of milder weather in the U.S. took some steam out of the market.

- U.S. crude prices fell 0.60 pct to $82.25 per barrel, off an earlier peak of $83.95, the highest price since October 2008.
- Gold was up 1.20 pct to $1,151.6 an ounce.
- Reuters-Jefferies index shed 0.47 pct to 289.39.

- For MARKET SNAPSHOT click here
- For NEXT UP click here
- For DEEP DIVE click here

MARKET SNAPSHOT as of 3:00 pm EST



REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.130	O/N	0.130
2-Week	0.150	2-Week	0.180
1-Month	0.180	1-Month	0.190
3-Month	0.200	3-Month	0.210
AGENCY REPOS		i-REPO℠ INDEX	
O/N	0.130	10:00 AM	0.050
2-Week	0.170	3:00 PM	0.047
1-Month	0.170		
3-Month	0.190		

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.110	0.130	-	-
1-Month	0.220	0.300	0.122	0.132
3-Month	0.240	0.450	0.138	0.148
6-Month	0.300	0.650	0.179	0.189
12-Month	0.850	1.250	0.366	0.376

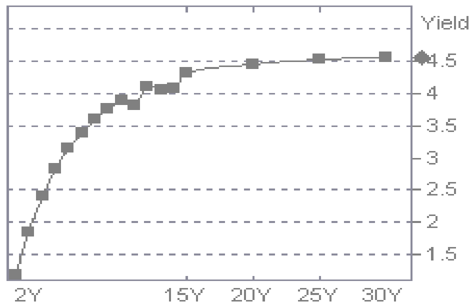
TREASURIES <5> <500>

	BID	ASK	YIELD	CHANGE
1-Mo Bill	0.035	0.005	0.035	0.001
3-Mo Bill	0.030	0.020	0.030	-0.018
6-Mo Bill	0.130	0.125	0.132	-0.019
1-Year	0.305	0.280	0.310	-0.030
2-Year	100.117	100.148	0.940	0.086
3-Year	98.914	98.945	1.507	0.121
5-Year	100.320	100.367	2.556	0.195
7-Year	99.641	99.688	3.308	0.195
10-Year	96.359	96.406	3.822	0.133
30-Year	94.328	94.391	4.731	-0.203

IR SWAPS <19901>

	SPREAD		RATE	
2-Year	24.75	28.75	1.18	1.20
3-Year	35.00	39.00	1.84	1.86
5-Year	27.25	31.25	2.82	2.83
7-Year	10.50	14.50	3.41	3.40
10-Year	7.75	11.75	3.89	3.88
30-Year	-17.50	-13.50	4.55	4.53

U.S. Interest rate swap—yield curve



EQUITIES

	INDEX	CHANGE
DJIA	10645.93	27.74
NASDAQ	2306.07	-11.11
S&P 500	1144.93	-0.22

OIL

	PRICE	CHANGE
NYMEX	82.3	-0.5
BRENT	81.6	-0.7

EURODOLLAR FUTURES

	CLOSE	CHANGE
Jan-10	99.748	0.000
Mar-10	99.710	0.005
Jun-10	99.530	0.015
Sep-10	99.220	0.035

FUTURES

	PRICE	CHANGE
CBOT 5 yr	115.04	0.03
CBOT 10 yr	116.00	-0.03
CBOT 30 yr	115.19	-0.28

CURRENCIES

	BID	ASK
Euro	1.4522	1.4524
Sterling	1.6104	1.6106
JP Yen	92.05	92.08
Swiss Franc	1.0155	1.0158
Can Dollar	1.0328	1.0332
Mexico	12.7661	12.7754

FED FUNDS		NYFR℠ - 10AM	
Open	0.1100	1m	0.2190
High	0.1200	3m	0.2540
Low	0.0700		

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	0.875	12/01/2012	14	13	1.08
3-Year	1.75	10/08/2012	2	-7	1.53
5-Year	2.875	09/02/2015	29	28	2.86
7-Year	5.125	18/10/2016	17	0	3.49
10-Year	-	-	-	-	-
30-Year	6.625	15/11/2030	33	32.25	5.06

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	15/12/2011	8.5	7.5	1.04
3-Year	1.375	09/01/2013	25	24	1.76
5-Year	2.625	20/11/2014	20	19	2.77
7-Year	5.25	15/09/2016	15.25	14.75	3.46
10-Year	3.75	27/03/2019	17	0	4
30-Year	6.25	15/07/2032	31.25	30.75	5.04

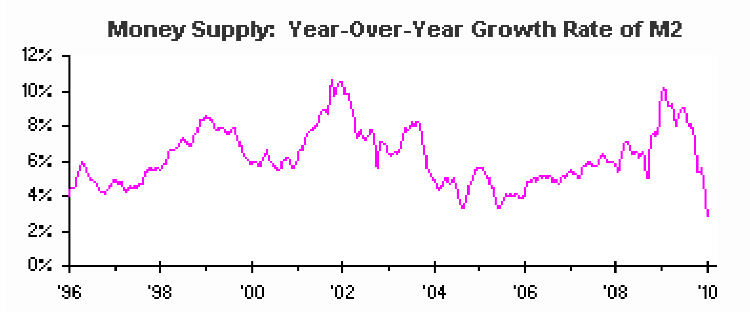
Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	5.0	105.0260	105.0460	2.772
FHLMC	5.0	105.0160	105.0360	2.784

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	5.5	105.0360	105.0560	3.151
FHLMC	5.5	105.0770	105.0970	3.052
GNMA	5.5	105.0500	105.0700	3.728

Wrightson ICAP℠ Chart of the Day



TODAY'S TOP NEWS

Obama, Cuomo target Wall Street bonuses

The White House and a top U.S. regulator attacked excessive Wall Street bonuses, as the nation's biggest banks prepare to hand out awards that critics say were made possible only by taxpayer bailouts.
Amid reports of payouts that could average hundreds of thousands of dollars each at some banks, White House spokesman Robert Gibbs said some Wall Street executives "continue not to get it" when it comes to big bonuses at bailed-out companies.
Meanwhile New York Attorney General Andrew Cuomo asked the first eight banks to receive bailout money under the government's much-maligned TARP to turn over data on expected bonus payouts in 2009.
These banks are Bank of America Corp, Bank of New York Mellon Corp, Citigroup Inc, Goldman Sachs Group Inc, JPMorgan Chase & Co, Morgan Stanley, State Street Corp and Wells Fargo & Co.
In letters to the eight banks, Cuomo requested details by Feb. 8 about whether cash or stock is being used in awards, how banks tie pay to performance, how TARP money affected payouts, and whether any awards can be recouped if bank fortunes sour.
Gibbs said the president wants in his next budget proposal to include a provision to ensure that taxpayers are repaid in full for financial bailout funds.

China lending reportedly jumps, feeding hot economy

Chinese bank lending surged in the first week of 2010, industry sources said, adding to the concerns fuelled by blockbuster trade data for December that the world's third-largest economy is overheating.
Despite the indications of gathering economic momentum, Finance Minister Xie Xuren said China would stick to its pro-growth fiscal stance, warning that withdrawing stimulus spending too early could damage the economy.
China, long known as the factory floor of the world, also beefed up domestic consumption last year and became the world's largest auto market. Passenger car sales rose 52.9 percent to 10.3 million units in 2009, with sales surging 88.7 percent in December from a year earlier, the China Association of Automobile Manufacturers said.
Policymakers have been trying to remove excess cash and stamp out speculation in the property market, but have been wary of removing government support at the current stage of the economic recovery.

U.S. 10-year TIPS auction met with solid demand

The U.S. government sold $10 billion worth of 10-year Treasury inflation-protected securities in an auction that attracted solid demand to kick off this week's round of government debt sales.
Yields in the auction were below expectations indicating investors were keen to pay up for the debt.
Overall demand was strong, with investors submitting bids worth 2.65 times the amount on offer, above the average of 2.50 in last year's two auctions of new 10-year TIPS.
In one sign of weakness however, foreign and large institutional investors showed below-average appetite for the debt on offer, based on the indirect bidding category, which accounted for 40 percent of the sale. That was below the average of about 49 percent in the two new 10-year TIPS auctions last year. Financial markets have watched recent bond auctions amid a burgeoning U.S. budget deficit, which was brought on by a costly financial sector bailout and efforts to stimulate the economy.

U.S. deficit may pose risk to AAA rtg in 3-5yrs-Fitch

The near-term risk to the United States' top AAA credit rating is 'minimal,' but its expanding debt levels could have a negative impact in three to five years, Fitch Ratings said.
Fitch affirmed the United States' top AAA credit ratings, with a stable outlook, meaning it is unlikely to downgrade the rating at any point in the next 18 months.
"The near-term risk to the United States' 'AAA' status is minimal given its exceptional financing and economic flexibility and the US dollar's role as the world's predominant reserve currency," said Fitch analyst Brian Coulton in a release.
However, "in the absence of measures to reduce the budget deficit over the next three-to-five years, government indebtedness will approach levels by the latter half of the decade that will bring pressure to bear on the (United States') 'AAA' status," he said.
Fitch said that the U.S. government's heavy reliance on foreign investors to buy its debt is another risk.
The agency forecasts public debt on a general government basis, consolidating federal, state and local debt, to increase to 89 percent of GDP in 2010 from 79 percent in 2009.

U.S. job mkt gauge highest since Jan 2009-Conf Board

The U.S. job market continued to improve in December to levels seen almost one year ago, dictating that, despite recent bleak government data showing deeper-than-expected job cuts, employment is approaching a smooth recovery in the near term, a research group said.
The Conference Board said its Employment Trends Index climbed to 91.8 in December from a downwardly revised 90.3 in November, which was originally reported as 90.8.
It was the highest index level reading since January 2009, when it stood at 93.7
The index is still down 5.2 percent from one year ago, according to the group, after being down 13.2 percent on the year in October.
Separately, President Barack Obama plans more economic stimulus measures to bring down the high U.S. unemployment rate, while cutting the bulging budget is a longer-term challenge, a top White House economic aide said on Sunday.

New York Fed releases new primary dealer rules

The Federal Reserve Bank of New York announced a new set of standards it will use in its dealings with banks and securities firms known as primary dealers.
The rules contain tighter requirements, including a higher minimum net capital level and a year's worth of operating experience for new applicants for primary dealer status.
Currently 18 banks are authorized to deal directly with the Fed, the U.S. central bank. They are required to bid on Treasury securities auctions and help the Fed implement monetary policy.
Existing primary dealers are likely to find they already meet the requirements.
The New York Fed will now require primary dealers to hold at least $150 million in net capital, up from $50 million.
The rules also touched upon possible actions the New York Fed could take against firms that do not continue to meet primary dealership standards, including suspension or withdrawal of the status.
Primary dealer status has been viewed among banks and their clients as a stamp of government approval, but there has been little public information about the process by which the New York Fed evaluates applicants.

TODAY'S TOP NEWS

White House mulls bank fee in budget -reports

The Obama administration is considering imposing a fee on banks to help recover some of taxpayers' costs of bailing banks out from the financial crisis, according to multiple reports.
The White House said President Barack Obama wants to ensure that taxpayers are paid in full.
Such a fee, which would likely be highly popular with taxpayers still angry at bankers who are preparing to reap huge bonuses, could be part of next month's budget. Exactly what form such a fee might take will be hotly discussed but it is unlikely to be a broad-based fee on transactions.
A fee on financial transactions was suggested by British officials at a meeting of G7 finance ministers last fall, but was opposed by U.S. Treasury Secretary Timothy Geithner.
An official from the White House's Office of Management and Budget, asked if a bank fee was being mulled, did not reject it out of hand but would not confirm it either.
Separately, President Barack Obama on Saturday renewed his pitch for final congressional passage of a U.S. healthcare overhaul and promised Americans they will begin reaping the benefits soon after he signs a bill into law.

Junk bond default rate slips to 12.5 pct in Q4-Moody's

The global junk bond default rate fell in the fourth quarter for the first time in nearly two years, credit rating agency Moody's Investors Service said.
The quarter-over-quarter decline adds to evidence that after the global financial crisis and following the most severe economic downturn in decades, credit conditions are easing enough to take some pressure off companies.
The trailing 12-month global speculative-grade default rate finished at 12.5 percent in the fourth quarter of 2009, down slightly from 12.6 percent in the previous quarter, Moody's said.
The rating agency now predicts the global speculative-grade default rate will fall sharply to 3.3 percent by the end of the fourth quarter of 2010. A total of 32 Moody's-rated corporate debt issuers defaulted in the fourth quarter, sending the 2009 default count to a record high of 266.

BIS-Trichet says global economy in recovery mode

The global economy continues to recover from the worst recession in 70 years with "dynamic" emerging markets leading the way, top policymakers said.
ECB President Jean-Claude Trichet said fiscal consolidation was essential for a sustainable recovery and for economic confidence.
Ewald Nowotny said growth was expected to be slow this year and that the ECB's December forecasts were still valid.
"It will be positive growth in 2010 but it will be still a rather sluggish recovery. So it means that one has to be still rather cautious with regards to the economic development," he told reporters on the sidelines of the meeting.
Mario Draghi, who also heads the Italian central bank, said financial markets were in much better shape than could have been expected a year ago, but much of the improvement was due to extraordinary monetary and fiscal measures.
Trichet said at the meeting that governments had to be fiscally responsible.

Emerging sovereigns eye $7 bln in new bonds

Emerging sovereign borrowers took advantage of favorable debt markets to launch new bonds, with around $7 billion seen in new issuance in two days, 15 percent of expected emerging debt issuance for the quarter.
Three sovereigns launched bonds with long or ultra-long maturities, reflecting renewed investor confidence in emerging markets.
Poland sold 3 billion euros ($4.36 billion) in 15-year bonds, far higher than plans for a 1 billion euro bond initially mooted.
Indonesia set price guidance for a 10- and 30-year dollar bond which investors say will total at least $2 billion, while Mexico is planning a 10-year dollar bond of benchmark size -- at least $500 million.
Emerging sovereign debt spreads on JPMorgan's benchmark EMBI+ index are trading at 260 basis points over U.S. Treasuries, around their tightest levels since May 2008.

NEXT UP

U.S. crisis panel will scratch but not maul bankers

The U.S. commission examining the financial meltdown is expected to take Wall Street bankers to task this week for a return to extravagant bonuses, but the spectacle should fall short of the political theater that marked a similar investigation of the Great Depression.
The 10-member, bipartisan Financial Crisis Inquiry Commission will hear from the executives just as public outcry is again reaching a fever pitch over the multimillion-dollar bonuses the banks are poised to award after hurrying to repay billions of dollars of taxpayer bailouts.
The panel is modeled after the Pecora Commission, which investigated the Wall Street crash of 1929. That commission was beset with political turmoil and sideshow moments including a dwarf who jumped on the lap of banker J.P. Morgan Jr. during his testimony.
The new commission on Wednesday will hear from top executives of Goldman Sachs, JPMorgan Chase, Bank of America and Morgan Stanley.
Those executives are prime targets for public anger, not only for the lavish bonuses, but also because they remain tight-fisted with credit to consumers and small businesses.
The tone of the hearings may be less than bombastic, however, since no commission members are currently politicians seeking to show voters a good public drubbing of the bankers.
The panel members were politically appointed but have said they do not want to politicize their mission of finding out the how and why behind the most severe financial crisis since the 1930s.
The panel is chaired by Phil Angelides, a Democrat and former California state treasurer. Its vice chairman is Bill Thomas, a Republican and former head of the House Ways and Means Committee.
Other notable members include Brooksley Born, a Democrat and former head of the Commodities Futures Trading Commission, who issued early warnings about risks in the financial system.

DEEP DIVE Commentary and Analysis

Compound option can exploit U.S. mid-term FX effect

By Neal Kimberley and Marco Garavello

Old hands will remember the Super Bowl effect, which argued that U.S. economic weakness followed an AFC victory while a winner from the NFC presaged growth.

Today's currency traders might like to note what could be termed "the Mid-Term effect".

Substituting the euro for the German mark where needed (using the conversion rate of 1.95583 at the euro's 1999 birth), Reuters graphic data shows the dollar has weakened against the euro in every year of a U.S. mid-term election since 1990.

Investors who believe the trend will be maintained might consider a compound option on euro/dollar, which is cheaper and more flexible than taking a long position or a vanilla option.

Whether a Republican or Democrat is in the White House, the result is the same.

In 1990, under Republican George Bush, the (synthetic) euro opened the year at $1.18, edged up to $1.21 in June before rising to $1.37 at the November elections before closing the year at $1.36.

In 1994, where Democrat Bill Clinton saw his party lose heavily in the mid-terms, the (synthetic) euro began the year at $1.11 rising to $1.16 in June. It then appreciated to $1.27 for the November elections before closing the year at $1.22.

The story was the same in Clinton's second term. The (synthetic) euro opened at $1.09 in January 1998, hit $1.10 in June but then rose to $1.19 when the polls opened in November. The year-end close was at $1.17.

The same correlation continues into the two terms of Republican George W. Bush. In 2002, the euro opened the year at $0.89 before edging up to $0.93 in June. By the November elections, the euro had reached parity. The euro closed on New Year's Eve at $1.05.

In the most recent mid-term election year, 2006, the euro opened January at $1.18. By June it had risen to $1.27, before rising to a high above $1.29 in November. The move continued into year end with a closing rate of $1.3150.

Mid-term elections in the United States are a chance for voters to protest and the market seems to reflect the heightened political uncertainty.

In the last five mid term election years, regardless of the party in the White House, regardless of the results at the Congressional elections, the dollar has weakened against the euro over the year, with the bulk of the dollar depreciation occurring in the second half.

A compound option may be the ideal strategy for an investor who expects the dollar to suffer from the Mid Term effect in 2010.

A compound option is essentially an option on an option, and in this context it would offer the buyer the right to purchase at the end of May a year-end call option in euro/dollar at a pre-defined premium.

Any option offers investors greater flexibility than a forward position as, by definition, the maximum liability is known in advance and equal to be premium spent.

Moreover, the holder of an option does not run the risk of being stopped out as may often happen with cash positions.

And, compared to a vanilla, a compound option offers additional flexibility as it gives the holder the right but not the obligation to enter the underlying vanilla option at a certain date in the future.

The holder may decide not to enter into the vanilla should his or her view have changed in the meantime.

This feature is particularly valuable in this case because, at the end of May, the holder may realize that new factors have emerged to affect the performance of the dollar in the second half of the year, and that the Mid Term effect may break down.

If that is the case, the holder may just not exercise the right. Another reason to let the option lapse would be if euro/dollar spot had not risen enough by the end of May to justify the exercise at the pre-defined premium.

In both cases, the holder's only cost is the upfront premium on the compound.

These are the details of the structure:

Spot reference: $1.4520 Underlying option:

Expiry = Dec. 31, 2010

Euro call dollar put strike = $1.55 Compound option:

Expiry = May, 31 2010

Buy call option on the underlying option strike = 2.00 percent dollar notional

Premium upfront = 0.80 percent dollar notional

The upfront premium for this strategy is limited to 0.80 percent of the dollar notional.

On May 31, the holder can decide whether to spend an additional 2.00 percent dollar notional to enter into a year-end $1.55 euro call, or else to let the option lapse.

At current levels of volatilities, euro/dollar spot would need to be trading at least as high as $1.50 to make the exercise worthwhile. At that level, the underlying vanilla would cost more than 2 percent and hence it would be worth exercising the compound.

Given that in previous mid-election years the dollar had already weakened by end-May, such a scenario seems plausible.

-- Neal Kimberley and Marco Garavello are FX market analysts for Reuters. The opinions expressed are their own --

U.S. retailers face tough road to recovery in '10

By Martinne Geller

U.S. retailers made big strides in profitability during the 2009 holiday season even if consumers warmed up only slightly to spending, but the sector's key test in 2010 will be to keep margin growth up if shoppers retreat.

Last week, U.S. chain stores posted a larger-than-expected rise in same-store sales for December, the fourth straight gain after a year of monthly declines in the wake of the downturn. Chains such as Macy's Inc, Nordstrom Inc, TJX Cos and Aeropostale Inc increased their profit forecasts, as a strategy of lowering inventory levels in 2009 that helped them avoid deep discounts.

Industry experts say monthly sales data should continue to show improvement off year-ago declines for much of 2010, but that shoppers will not spend freely again until unemployment and home values recover. With no real bump in consumer demand, they see margin growth constrained by the fact that most stores already tightened their belts as much as they can.

"At some point your margins won't expand anymore, and if the top line doesn't pop back, you're probably going to be in a holding pattern," said Doug Conn, a managing director at investment bank Hexagon Securities.

"That's probably the big thing to watch for in 2010 -- if that does happen, and there is no top-line growth, we may see a little bit of flatlining," he added.

The National Retail Federation (NRF) is hosting its annual expo in New York this week, gathering thousands of retailers as well as vendors of services like staffing and consulting.

If attendance at the industry's biggest trade show were a proxy of its health, NRF spokesman Scott Krugman said things are looking up, with retailer attendance 27 percent higher than last year. Attendance overall, he said, is tracking at January 2008 levels.

DEEP DIVE Commentary and Analysis

"We feel they're doing this because they see a bounce-back is about to happen and it's about positioning themselves for that," Krugman said about the return to pre-recession levels. "It's going to be the year of the retail recovery ... a very fragile recovery."

But not everyone shares Krugman's optimism.

Eric Beder, an analyst at Brean Murray, Carret & Co, said retailers may have trouble growing their bottom lines in the first half of 2010, since they will begin cycling cost-cutting measures taken in the wake of the financial crisis -- from cutting inventories and marketing budgets to closing stores and laying off workers.

But the biggest impact may be seen mid-year, when year-over-year sales comparisons get more difficult, he said.

"The second half is going to be the true, true test here," Beder said.

2010: THE YEAR OF RETAIL RECOVERY?

Same-store sales, as tracked by Thomson Reuters Data, fell every month from September 2008 through August 2009, meaning that retailers should have relatively easy comparisons on this closely watched metric until September 2010.

With the exact timing of an economic recovery unclear, analysts are recommending stocks of retailers that are less dependent on a rebound -- such as those with room left to increase their store bases or margins, or those that offer special value or products.

Thomson Reuters director of consumer research Jharonne Martis said stores may see a near-term sales bump from holiday gift-card redemptions, but offered a tepid view on the year.

"It's going to be hard to keep up this momentum because the (high) unemployment rate continues to be the No. 1 hindrance to consumer spending," she said. "For the rest of 2010 I wouldn't be so optimistic; not until the unemployment number starts to heal."

RBC Capital Markets analyst Howard Tubin said the next few months may be particularly tough on clothing chains, as there is no compelling reason to shop between now and the end of March, when Easter and spring break arrive.

Furthermore, splurging on holiday gifts can limit people's ability to spend in the early spring, said Al Ferrara, a partner in BDO Seidman's retail and consumer product practice.

"The pre-Easter and Easter seasons are going to be very telling as to whether or not we really have a sustainable turnaround," Ferrara said.

Edward Jones analyst Matt Arnold said there are signs that consumers are a little more willing to spend, but he does not expect the type of broad-based retail rebound seen after prior downturns. Stores will have to battle harder for market share, rather than look for a rising tide to lift all boats.

STOCK PICKING AT LOW TIDE

For 2010, Barclays Capital analyst Jeff Black likes companies that rely less on revenue growth for earnings, such as those with room to cut costs, over companies already at peak margin levels. On Friday, he raised his rating on Limited Brands Inc and downgraded shares of TJX.

"The consumer has shown a definite willingness to come out and shop, although you still need some level of enticement in the form of markdowns," Black said.

RBC's Tubin sees success for retailers that either offer the best value or the most unique merchandise. His picks include Aeropostale for value and UGG boot maker Deckers Outdoor Corp for merchandise.

Meanwhile Oppenheimer analyst Robert Samuels recommends investors stick with turnaround names such as Foot Locker Inc or those with capacity to open more stores, such as Gymboree Corp.

Other good picks, according to Lazard Capital's Todd Slater, are names with international exposure that could benefit from the weak U.S. dollar, such as Wal-Mart Stores Inc and Warnaco Group Inc.

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