

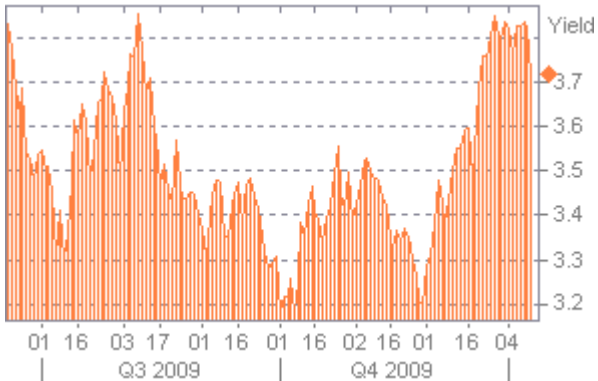
INSIDE DEBT

PRODUCED BY REUTERS IN PARTNERSHIP WITH ICAP

Wednesday, January 13, 2010

CHART OF THE DAY

10-yr treasury yield



In the open market, the price on the reopened benchmark 10-year note issue was down 18/32 at 96-20/32. Its yield was 3.78 percent, up from 3.72 percent late on Tuesday.

TODAY'S TOP NEWS

- Wall St execs under fire before U.S. crisis panel
- U.S. SEC proposes "effective" ban on naked access
- U.S. reopened 10-year notes sale has solid demand
- Fed says U.S. economy weak but mending as 2010 began
- U.S., Google and China square off over Internet
- Fed's Evans-tight credit restraining recovery
- Obama to announce TARP fee on banks on Thursday
- U.S. budget gap widens in December from year ago
- Europe recovery may have lost impetus in late 2009

ECON WATCH

FOR THURSDAY JANUARY 14

ET	Indicators	Unit	Reuters	Prior
02:00	DE CPI final mm	%	0.7	-0.1
02:00	DE CPI final yy	%	0.8	0.4
02:00	DE HICP final mm	%	0.9	-0.2
02:00	DE HICP final yy	%	0.8	0.3
05:00	EZ Industrial production mm	%	0.5	-0.6
05:00	EZ Industrial production yy	%	-8.5	-11.1
07:45	EZ ECB rate decision	%	1.00	1.00
08:30	US Import prices mm	%	0.0	1.7
08:30	US Export prices mm	%	0.3	0.8
08:30	US Retail sales mm	%	0.5	1.3
08:30	US Retail sales ex-autos mm	%	0.3	1.2
08:30	US Initial Claims	k	437	434
08:30	US Jobless contin claims	mln	4.77	4.802
10:00	US Business Inventories mm	%	0.2	0.2

MARKETS TODAY

TODAY'S TOP STORY: Top executives of Wall Street's biggest banks acknowledged broad failures as they testified to a U.S. commission looking into the financial crisis, while the White House said an industry apology was in order. **For more please click here**

TREASURIES: U.S. Treasury prices fell as renewed appetite for stocks and other risky assets pared demand for government bonds even after a solid auction of 10-year notes.

- 30-yr Treasury bonds were down 38/32 to yield 4.7 pct, up 8 bps from Tuesday.
- The second reopening of an older 10-year note due Nov 2019, cleared at a high yield of 3.754 pct.
- 2-yr Treasury notes was down 3/32 for a yield of 0.96 pct.
- 2-10's part of the yield curve steepened to 283 bps from 281 bps.

FOREX: High-yielding currencies rallied, reversing losses in the prior session, as investors concluded China's unexpected monetary tightening would not derail the world's third largest economy.

- The dollar rose 0.49 pct to 91.44 yen, after falling to 90.73 yen on Tuesday. Euro jumped 0.65 pct to 132.67 yen.
- The euro rose 0.16 pct at \$1.4505. Earlier it hit \$1.4582, its highest since Dec. 16.
- Dollar index fell 0.13 pct to 76.856 after dropping to its lowest since mid-December earlier in the session.

CORPORATES: U.S. corporate bond prices edged lower under the weight of recent issuance and amid caution about company earnings.

- The CDX.IG-13 index widened by 1 bps to 80 bps.
- In a spectacular year-long rally, corporate bond yield spreads over Treasuries had narrowed to 176 bps as of Tuesday according to Bank of America Merrill Lynch.

STOCKS: U.S. stocks ended higher, pushing the Dow average to a fresh 15-month closing high, as investors bought financial and technology shares, and Merck & Co benefited from a brokerage upgrade.

- Dow rose 0.5 pct to 10,680.92, S&P was up 0.83 pct to 1,145.68 and Nasdaq gained 1.12 pct to 2,307.90.
- Merck shares were up 3.68 pct to \$38.93.
- JPMorgan shares rose 1.75 pct to \$44.25, while Advance Micro Devices jumped 5.78 pct to \$9.15 after falling five straight sessions.
- Kraft raised its 2009 earnings outlook, sending shares shed 0.2 pct to \$29.23.
- S&P financials index rose 1.18 pct, S&P technology index rose 0.94 pct.
- KBW bank index rose 1.56 pct.

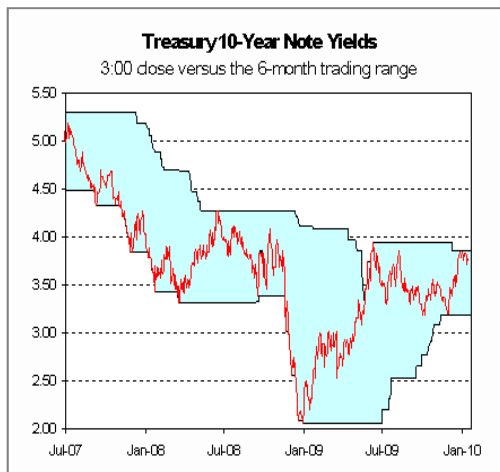
C & E: Oil prices fell below \$80 a barrel pressured by a U.S. inventory report showing rises in crude and distillate fuel stocks despite severe winter weather.

- U.S. crude prices fell 1.42 pct to \$79.64 per barrel. Earlier it fell to \$78.37, the lowest since Dec. 29.
- Gold rose 0.86 pct to \$1,137.65 an ounce.
- Reuters-Jefferies index was up 0.22 pct to 285.14.

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



MARKET SNAPSHOT as of 3:00 pm EST



TREASURIES <5> <500>

	BID	ASK	YIELD	CHANGE
1-Mo Bill	0.015	-0.015	0.015	0.018
3-Mo Bill	0.055	0.045	0.056	0.006
6-Mo Bill	0.145	0.135	0.147	0.006
1-Year	0.360	0.350	0.366	0.020
2-Year	100.078	100.109	0.960	-0.086
3-Year	99.500	99.531	1.547	-0.117
5-Year	100.422	100.469	2.534	-0.250
7-Year	99.891	99.938	3.268	-0.344
10-Year	96.672	96.734	3.783	-0.531
30-Year	94.781	94.844	4.702	-1.258

EQUITIES

	INDEX	CHANGE
DJIA	10679.26	52.00
NASDAQ	2306.83	24.53
S&P 500	1145.14	8.92

OIL

	PRICE	CHANGE
NYMEX	79.8	-1.0
BRENT	77.5	-1.8

EURODOLLAR FUTURES

	CLOSE	CHANGE
Jan-10	99.745	-0.003
Mar-10	99.700	-0.010
Jun-10	99.520	-0.030
Sep-10	99.210	-0.040

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.110	O/N	0.130
2-Week	0.150	2-Week	0.170
1-Month	0.170	1-Month	0.180
3-Month	0.200	3-Month	0.210
AGENCY REPOS		i-REPO SM INDEX	
O/N	0.130	10:00 AM	0.060
2-Week	0.150	3:00 PM	0.060
1-Month	0.170		
3-Month	0.230		

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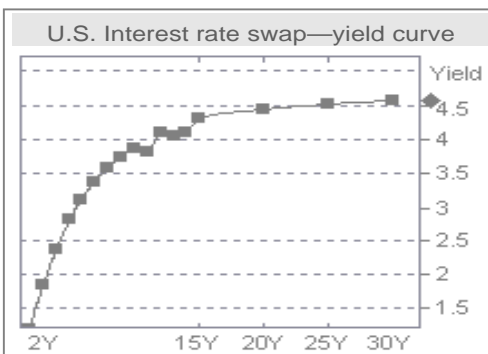
	SPREAD		RATE	
2-Year	24.50	28.50	1.20	1.22
3-Year	30.00	34.00	1.84	1.86
5-Year	26.50	30.50	2.79	2.80
7-Year	11.25	15.25	3.38	3.37
10-Year	8.25	12.25	3.86	3.84
30-Year	-15.25	-11.25	4.55	4.52

FUTURES

	PRICE	CHANGE
CBOT 5 yr	115.38	-0.23
CBOT 10 yr	116.66	-0.09
CBOT 30 yr	116.59	-0.22

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	0.139	0.149
6-Month	0.300	0.650	0.179	0.189
12-Month	0.850	1.250	0.379	0.389



CURRENCIES

	BID	ASK
Euro	1.4508	1.4510
Sterling	1.6279	1.6284
JP Yen	91.43	91.46
Swiss Franc	1.0182	1.0184
Can Dollar	1.0306	1.0312
Mexico	12.7159	12.7220

FED FUNDS NYFRSM - 10AM

Open	0.1100	1m	0.2219
High	0.1100	3m	0.2537
Low	0.0700		

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	0.875	12/01/2012	13	12.5	1.09
3-Year	1.75	10/08/2012	-6	-8	1.48
5-Year	2.875	09/02/2015	29.5	29	2.81
7-Year	5.125	18/10/2016	19	0	3.43
10-Year	-	-	-	-	-
30-Year	6.625	15/11/2030	38	0	5.05

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	15/12/2011	10	8.5	1.03
3-Year	1.375	09/01/2013	21.5	21	1.75
5-Year	2.625	20/11/2014	20	19	2.74
7-Year	5.25	15/09/2016	16.75	16	3.44
10-Year	3.75	27/03/2019	16	14	3.95
30-Year	6.25	15/07/2032	34.75	34	5.05

Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	5.0	105.0970	105.1170	2.683
FHLMC	5.0	105.0870	105.1070	2.696

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	5.5	105.0100	105.0300	3.170
FHLMC	5.5	105.0450	105.0650	3.078
GNMA	5.5	105.0830	105.1030	3.700

Wrightson ICAPSM Chart of the Day



TODAY'S TOP NEWS

Wall St execs under fire before U.S. crisis panel

Top executives of Wall Street's biggest banks acknowledged broad failures as they testified to a U.S. commission looking into the financial crisis, while the White House said an industry apology was in order.

With U.S. unemployment near a 26-year-high after the worst recession in decades, public fury is growing over the cost of taxpayer bailouts and huge bonuses for bankers, now that the industry has rebounded from the 2008 meltdown.

The top executives acknowledged mistakes in managing risk but defended their pay packages and called for modest regulatory changes.

Goldman Sachs CEO Lloyd Blankfein was compelled to defend his firm's role in creating subprime mortgage-backed securities at the center of the financial crisis, while at the same time shorting them, or betting they would lose value.

The hearing took place as President Barack Obama prepared to unveil a plan to recoup \$120 billion in bailout funds through a fee on banks.

White House spokesman Robert Gibbs told reporters that an apology from Wall Street leaders "would be the least of what anybody might expect."

U.S. reopened 10-year notes sale has solid demand

A U.S. government sale of \$21 billion worth of reopened 10-year Treasury notes was met with solid demand, alleviating some analysts' fears of a waning appetite for longer-dated debt.

Yields in the auction were above expectations, based on trade in the when-issued market just before the sale, indicating investors were keen to pay up for the debt.

Overall demand was strong, with investors submitting bids worth 3.00 times the amount on offer, above the average of 2.70 in the seven reopened 10-year note auctions last year.

The level of buying by indirect bidders, including foreign and large institutional investors, was below average however, as it was in the previous two debt auctions so far this week.

Indirect bidding accounted for about 29 percent of the sale, which was below the average of about 44 percent in all 10-year note auctions since June 2009, when the rules of who is considered an indirect bidder were changed.

The reopened 10-year sale was the third in a total of \$84 billion of auctions this week.

U.S., Google and China square off over Internet

Google's threat to quit China over censorship and hacking intensified Sino-U.S. frictions as Washington said it had serious concerns and demanded an explanation from Beijing.

China has not made any significant comment since Google said it will not abide by censorship and may shut its Chinese-language google.cn website because of attacks from China on human rights activists using its Gmail service and on dozens of companies, including Adobe Systems.

Friction over the Internet appears likely to stoke tensions between the United States and China.

President Barack Obama's administration has angered China by approving arms sales to Taiwan and by slapping tariffs on Chinese tires and steel products.

Writing before the Google decision, The Eurasia Group consultancy, pointing mainly to economic disputes, identified U.S.-China relations as the top global risk of 2010. With China the largest lender to the United States, Internet tensions will make steering this vast, fast-evolving relationship all the more tricky, especially with the U.S. Congress in an election year.

U.S. SEC proposes "effective" ban on naked access

U.S. securities regulators proposed rules that would require more supervision of unlicensed high-frequency traders who gain unfettered, or "naked," access to public markets.

The SEC voted for a proposal that would require brokerages that rent out their access to the markets to have rules in place to protect against potential mishaps from unlicensed traders.

The practice, known as "sponsored" access, is when brokerages that have been approved to trade on an exchange rent their access to traders who are then able to shave milliseconds from the time it takes to access the markets.

"Naked sponsored access", also called "unfiltered" access, is when the brokers do not screen orders en route to markets, making electronic trading even faster.

The proposal is open for a 60-day comment period and will require another commission vote to adopt the rule.

The proposal would require broker dealers to implement risk controls and supervisory procedures to manage various risks such as faulty orders.

Fed says U.S. economy weak but mending as 2010 began

U.S. economic activity remained at a low level as 2010 began but was improving modestly and beginning to broaden out to include wider swaths of the country, the Federal Reserve said on Wednesday.

"Reports from the 12 Federal Reserve districts indicated that while economic activity remains at a low level, conditions have improved modestly further, and those improvements are broader geographically than in the last report," according to the periodic Beige Book report compiled this time by the Philadelphia regional Fed bank.

Based on conditions on or before Jan. 4, it said shoppers in the 2009 holiday season spent slightly more freely than in 2008 but at a rate still far below 2007 levels, when the economy was just on the verge of slipping into serious financial crisis.

Fed's Evans-tight credit restraining recovery

A senior U.S. Federal Reserve official said that tight credit and cautious businesses and households will restrain the economic recovery and keep the jobless rate at high levels in 2010, but the return to health could be surprisingly robust.

"I expect these headwinds to abate as we move through 2010," Chicago Federal Reserve Bank President Charles Evans said in remarks prepared for delivery to a business group.

"Of course the recovery could exceed these expectations," he said. "Some of the recent data have been a good deal better than expected."

Evans said he sees inflation staying relatively stable, with unemployment keeping it low this year and next, followed by a slight pickup in 2012. He is not a voter on the Fed's policy-setting panel this year.

Evans, who is seen as falling in the middle ground of the U.S. central bank's anti-inflation hawks versus pro-growth doves, said the Fed's massive supply of money to the economy during the recent financial crisis was not now causing inflation pressures.

"Currently, most of the increase in the monetary base is sitting idly in bank reserves, and because banks are not lending the reserves, they are not generating spending pressure," he said.

The Fed's next policy meeting is Jan. 26-27, and it is not expected to make changes to rates or its promise to keep borrowing costs at rock-bottom levels for a while.



TODAY'S TOP NEWS

Obama to announce TARP fee on banks on Thursday

President Barack Obama will announce plans to raise up to \$120 billion from major U.S. financial firms to cover expected losses from a taxpayer-funded bank bailout, a senior administration official said.

Obama's announcement will come as U.S. unemployment is stuck in double digits and public anger is growing over big bonuses that some financial firms are poised to resume paying, barely a year after the height of the global financial crisis that made the bailout necessary. The Obama administration official said the amount of money raised from the fees would not exceed \$120 billion since this was the higher end of conservative estimates of the cost of the TARP.

U.S. Treasury officials expect TARP losses to be much lower than that sum, and over the course of years the fee will pay back any costs of the \$700 billion taxpayer bailout, the administration official said. A source said government officials are discussing exempting automakers and insurer AIG from the fee, even though these companies are expected to represent a large chunk of the bailout losses.

U.S. budget gap widens in December from year ago

The United States racked up a \$91.85 billion budget deficit in December, a record for the month, marking a record 15th straight month of government red ink, the U.S. Treasury Department said.

The monthly budget gap, up from a \$51.75 billion deficit in December 2008, pushed the budget shortfall for the first quarter of fiscal 2010 to \$388.51 billion deficit. That compares to a \$332.49 billion deficit for the same period a year ago.

The December deficit was in line with Wall Street and Congressional Budget Office estimates for a \$92 billion gap.

In December, government spending came in at \$310.77 billion, up from \$289.54 billion in December 2008. It was the largest on record for a December.

Receipts totaled \$218.92 billion, the lowest for the month of December since 2004, the department said. Receipts in December 2008 stood at \$237.79 billion.

Europe recovery may have lost impetus in late 2009

Europe's largest economies issued reports that suggested growth slowed sharply during the last few months of 2009 after a spurt which lifted much of the region out of recession in the third quarter.

A German statistics office official said growth there may have been zero in the fourth quarter of last year and industrial output figures in Britain and Italy for November served only to reinforce concerns about the strength of recovery.

Germany's statistics office announced that overall economic output fell an estimated five percent in 2009, when most of the damage was concentrated in the early part of the year.

The more surprising news came from a statistics office official who said GDP may have stagnated over the last three months of 2009, after two quarters of expansion, the last of which saw GDP rise 0.7 percent in July-September over the previous three-month period.

Industrial output data for the euro zone as a whole is due to be published on Thursday and economists polled by Reuters are on average expecting a 0.5 percent monthly increase after a surprisingly poor October, when output slid 0.6 percent.

U.S. mortgage applications rise in 1st week of 2010

U.S. mortgage applications rose in the first week of 2010, reflecting surging demand for home refinancing loans as interest rates dropped, industry data showed.

The MBA said its seasonally adjusted index of mortgage applications, including both purchase and refinance loans, rose 14.3 percent to 528.1 for the week of Jan. 8. The four-week moving average was down 6.4 percent. The MBA said borrowing costs on 30-year fixed-rate mortgages averaged 5.13 percent, down 0.05 percentage point from the previous week.

The MBA's seasonally adjusted purchase index rose 0.8 percent to 213.7. The index of refinancing applications increased 21.8 percent to 2,407.2. The refinance share of mortgage activity increased to 71.5 percent of total applications from 68.2 percent.

The MBA said fixed 15-year mortgage rates averaged 4.45 percent, down from 4.62 percent the previous week.

NEXT UP

PREVIEW-U.S. retail sales seen up 0.5 pct in December

The median forecast for retail sales is for rise of 0.5 percent after an increase of 1.3 percent. Forecasts range from flat to a rise of 1.4 percent.

The median forecast for sales excluding autos is for a gain of 0.3 percent following an increase of 1.2 percent in November. Forecasts ranged from a 0.1 percent fall to a rise of 1.2 percent.

December retail sales could help to restore some confidence in the durability of the economy's recovery, which was shaken by a surprise drop in nonfarm payrolls last month. Major U.S. retailers have reported stronger-than-expected sales for December and motor vehicle purchases have also shown strength.

Core retail sales are expected to have recorded their fifth straight month of gains in December.

Strong retail sales could see traders bringing forward their expectations of a Federal Reserve interest rate increase, boosting the U.S. dollar and weighing on government debt prices. Prospects of tighter monetary policy could lift the U.S. dollar against the yen as investors increasingly use the Japanese currency to fund carry trades.

PREVIEW-ECB to start new year with rates firmly on hold

The ECB is set to start 2010 by flagging that interest rates will remain at a record low of 1.0 percent for some time, casting the bank's view on Greece's current debt troubles into the spotlight. All 80 economists in a recent Reuters poll see the ECB keeping rates on hold, with all but a handful seeing the central bank keeping them there well into the second half of the year as it waits for the economy's recovery to firm up.

ECB watchers also expect the central bank's President Jean-Claude Trichet to give little new information on its plan to wean the banking sector off its support measures, although it may keep the process inching forward with a decision on whether or not to keep up dollar and Swiss franc lending operations.

But Trichet is likely to be quizzed on Greece's ongoing financial troubles and whether reform plans go far enough.

Despite a mixed run of euro zone data over recent weeks, Trichet is expected to stick to his cautiously optimistic view on the region's recovery.



DEEP DIVE Commentary and Analysis

Bond yield flip hints at U.S. government debt worry

By John Parry

Bond investors are willing to lend more cheaply to big companies than to the U.S. Treasury, in a market twist that hints at ebbing confidence in the government's ability to manage its ballooning debt burden.

Debt issued by Procter & Gamble and Microsoft has traded at a premium to government bonds, with yields, which move inversely to prices, dipping below those of Treasuries in recent days. One AT&T issue yielded almost the same as Treasuries.

Traditionally, investors demand higher yields for corporate bonds to compensate for the greater chance a company will default than a government.

So the market anomaly is capturing attention.

"At face value, the yields tell us that people believe there is a greater risk to holding a Treasury bond than holding a very high grade U.S. corporate bond of a similar maturity," said David Levy, chairman of the Jerome Levy Forecasting Center in Mount Kisco, New York.

However, Levy and others say the phenomenon may be more a matter of supply and demand as markets adjust to the aftermath of the global financial crisis.

One factor distorting yields is an unprecedented flood of government issuance as Washington deals with the aftermath of the financial crisis and recession. And there is a host of other factors impacting Treasuries and corporate bonds amid these unusual conditions.

There is strong demand for the dwindling number of triple-A rated U.S. corporate bonds, especially from mutual funds with a mandate to buy a certain proportion of the highest quality credits, analysts point out.

And the rise of shorter maturity Treasury yields above those of some corporates may also signal that bond investors anticipate Federal Reserve interest rate hikes sooner than many analysts expect, said William Larkin, portfolio manager with Cabot Money Management in Boston.

"The indication here is that short term rates should be higher. The Fed usually follows the market up," Larkin said.

The two-year Treasury note yield, which is highly sensitive to expected rate moves, has jumped to about 0.92 percent now from 0.62 percent in late November.

In recent weeks, Treasury yields in general have risen on worries about issuance while shorter-maturity government yields -- a classic harbinger of Fed rate expectations -- have jumped. Meanwhile, corporate yields have fallen, flipping the yield relationship between the two.

Among highly rated, shorter-dated company debt, Procter & Gamble notes maturing in August 2011 were yielding about 6 basis points below equivalent Treasuries on Tuesday, according to MarketAxess. Microsoft notes maturing in June 2014 briefly traded at 10 basis points below Treasuries on Tuesday.

RICH COMPANY, POOR GOVERNMENT

Microsoft Corp. is a striking example of a cash-rich company with an exceptionally low level of debt, analysts said. That contrasts sharply with the U.S. government, whose debt burden is growing.

The Treasury sold \$1.7 trillion of new debt last fiscal year and plans to add another \$1.4 trillion this fiscal year. That will increase Treasury debt outstanding to near \$9 trillion, up from about \$5 trillion before the global financial crisis started in 2007. Because U.S. debt is denominated in dollars, the world's leading reserve currency, it's all but impossible for the government to actually default. Even so, a potential spike higher in yields and deep dollar depreciation remain serious potential threats to gov-

ernment bond prices.

"Clearly this (yield move) speaks to the fact that the government is issuing so much paper that you have supply and demand characteristics that are unattractive," said Haag Sherman, co-founder and managing director of Salient Partners, a Houston-based investment firm.

The shift also reflects strong demand for the diminishing number of corporate issuers who carry the top triple-A rating from credit agencies.

Some exchange traded funds and mutual funds are mandated to buy a certain amount of triple-A rated corporate debt, which has pushed down yields.

"You have investors that are snapping up high grade corporates regardless of yield just to get the appropriate weighting," Sherman said. This, together, with the rising flood of Treasuries that's pushing government bond yields up "is causing some anomalies," he said.

U.S. private mortgage bond buzz portends deal revival

By Al Yoon

U.S. mortgage bonds at the heart of the financial crisis may be revived by Wall Street as soon as this quarter, in what could be the most significant step yet toward repairing the credit and housing markets.

Rumblings have increased in recent weeks of the first new residential mortgage-backed securities (RMBS) packaged by private investment banks with traditional bond ratings since the mortgage crisis deepened in mid-2008, according to analysts, investors and a firm that assesses loan quality.

New issues would likely be first backed by conservative, "jumbo" mortgages above \$417,000, sources said, a corner of the market that has seen limited access to funding. Restarting the RMBS market would give banks a chance to sell loans they originate instead of holding them on their balance sheets -- expanding the ability to boost lending crucial to the U.S. housing recovery.

"We will have a (mortgage) securitization within the next two months," predicted Sue Allon, chief executive of Denver-based Allonhill, which is talking with dealers to provide independent reviews on loans, in addition to the designations of traditional bond rating companies.

"Everyone has a goal of trying to see if they can get one out this quarter," she said, adding that the issues will initially be "small and very clean."

Trade groups, regulators and lawmakers have long urged the return of private sources of housing credit to build on what government programs offer. But colossal failures of subprime and other private mortgage bonds have tainted the market, and a recovery is partly based on issuers' abilities to provide increased transparency and accountability.

REGULATORY CLOUDS

Complicating the process are proposed rules from the Federal Deposit Insurance Corp, which include a requirement for banks to hold loans for up to a year before selling them. The FDIC also wants banks to retain some ownership interest as a way to ensure quality originations.

But critics say the need for housing credit exceeds that available from bank balance sheets or government programs.

Demand for Fannie Mae, Freddie Mac and Federal Housing Administration funding has soared since the private markets dried up in 2008. During the housing boom, high volumes from private issuers reduced FHA loans to a trickle and eroded Fannie Mae and Freddie Mac market share so much that the two companies began expanding into purchases of riskier mort-



DEEP DIVE Commentary and Analysis

gages.

"The private market could help diversify mortgage risk that the government is taking on," said Alex Wei, head of structured credit at Delaware Investments in Philadelphia.

Fresh issuance may be possible because investors are clamoring for the higher yield of existing mortgage securities, even those backed by loans defaulting at alarming rates. The demand is lowering yields that investors will accept to close to levels that make it profitable for dealers to buy the loans and resell them as securities, said Scott Buchta, a strategist at Guggenheim Capital Markets in Chicago.

PENT-UP DEMAND

Bonds backed by prime, 30-year fixed-rate jumbo mortgages traded in the mid-\$80s in December, recovering from \$55 at the depths of the credit crisis in March, according to Amherst Securities Group.

Some bonds with top-quality jumbo loans originated in 2004, before home prices peaked, are already trading above the \$100 face value, Buchta said.

Yields on bonds backed by prime jumbo mortgages range from 6.5 percent to 9.5 percent.

"Demand for high-quality assets is out there," Buchta said. "So it's a matter of time before the economics of the deal make sense as yields continue to come in."

Delaware's Wei and Chris Sullivan, chief investment officer at United Nations Federal Credit Union, said they would consider a new prime RMBS, depending on the structure.

Dealers may be able to garner higher prices for new bonds with high-quality loans created under today's more stringent terms, Wei said. Strong demand for top-quality assets recently helped sell a handful of commercial mortgage bonds after a long silence there, he added.

Sadie Gurley, a managing director at Marathon Asset Management in New York, said hedge funds that need to buy the riskier parts of mortgage bonds are not yet enticed by yields generated in a new securitization, she said.

"The arbitrage isn't there yet," said Gurley, who has discussed possible structures with dealers. "By the first half of the year we will have one, but not in the next six weeks."

INSIDE DEBT is produced by Reuters in partnership with ICAP.

(Compiled by Anil Kumar and Rahul Karunakar in Bangalore)

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