

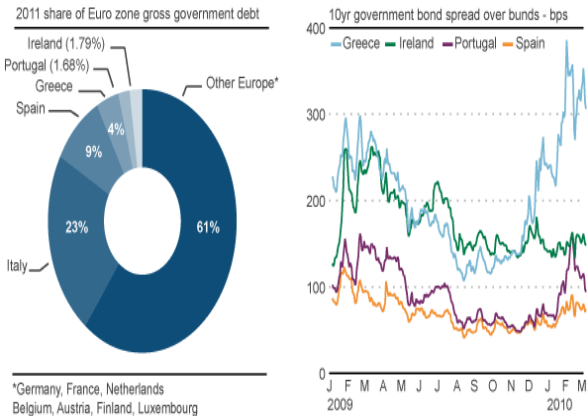
INSIDE DEBT

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Wednesday, March 3, 2010

CHART OF THE DAY

Euro zone government debt & bond spreads



Greek government bond yields fell, outperforming German Bunds, after Greece won tentative support from markets and the European Union with deficit-reducing austerity measures worth 4.8 billion euros.

TODAY'S TOP NEWS

- Data suggests a recovering U.S. job market
- Greece piles on austerity, seeks EU safety net
- Obama lays out Volcker rule specifics for Congress
- Fed's Fisher: Must break up banks that are too big
- Obama seeks to push healthcare to final vote
- CFTC, House chairman aim to fix U.S. swap reform law
- U.S. mortgage rate drop below 5 pct stirs demand
- EU unveils 10-year plan to boost growth and jobs

ECON WATCH

FOR THURSDAY MARCH 4

ET	Indicators	Unit	Reuters	Prior
05:00	EZ GDP revised qq Q4	%	0.1	0.4
05:00	EZ GDP revised yy Q4	%	-2.1	-4.0
07:00	GB BoE rate decision	%	0.50	0.50
07:45	EZ ECB rate decision	%	1.00	1.00
08:30	US Initial Claims	k	470	496
08:30	US Jobless contin claims	mln	4.60	4.617
08:30	US Productivity, revised Q4	%	6.3	6.2
08:30	US Labor costs, Rev Q4	%	-4.4	-4.4
08:30	CA Building permits mm	%	0.9	2.4
10:00	US Factory orders mm	%	1.8	1.0
10:00	US Durable goods, R mm	%	-	3.0
10:00	US Durable Gds ex-trns mm	%	-	-0.6
10:00	US Durables ex-def mm	%	-	1.6
10:00	US Nondef cap ex-air R mm	%	-	-2.9
10:00	US Pending sales chg mm	%	1.0	1.0
10:00	CA Ivey PMI	ind	57.0	50.8

MARKETS TODAY

TODAY'S TOP STORY: U.S. private employers eliminated fewer jobs last month, suggesting the job market may be on the mend, while the U.S. services sector grew at its fastest pace since the recession began.

For more please click here

TREASURIES: U.S. Treasury prices eased for a second day after data showed private sector job losses slowed last month, raising hopes the economy's recovery was becoming more pronounced and tarnishing the safe-haven appeal of government debt.

- 30-yr bond prices shed 9/32 to yield 4.59 pct.
- 10-yr Treasury prices were down 4/32 to yield 3.62 pct.
- 5-yr and 2-yr Treasury notes fell 1/32 to yield 2.27 pct and 0.81 pct.
- 2-10's part of the yield curve flattened by about 1 bps to 281 bps.

FOREX: The euro rose after Greece announced plans for a further \$6.5 billion in pay cuts and tax hikes to reduce its deficit, easing worries about the country's debt crisis.

- Euro was up 0.6 pct to \$1.3697. Earlier, it rose to \$1.3736, its strongest since Feb. 17, before easing to \$1.3720.
- The euro rose 0.14 pct to 121.06 yen.
- Sterling rose 0.87 pct to \$1.5099 after hitting a 10-month low on Monday.
- Dollar fell 0.47 pct to 88.38 yen, above an 88.33 yen session low, the lowest since December.
- Dollar index shed 0.66 pct to 79.987.

CORPORATES: U.S. corporate bond yield spreads tightened after encouraging economic data and more signs that the Greek debt crisis is on the mend sparked renewed demand for corporate debt.

- The CDX.IG-13 index tightened by about 1 bps to 88 bps.
- Time Warner Inc launched its \$2 bln two-part debt sale.

STOCKS: Wall Street ended little changed as worries about bank regulation and a setback for drug company Pfizer offset signs of improvement in the labor market and services sector.

- Pfizer shares fell 1.59 pct to \$17.32.
- Dow fell 0.09 pct to 10,396.61, S&P was up 0.04 pct to 1,118.78 and Nasdaq remained unchanged at 2,280.68.
- Merck fell 0.48 pct to \$37.21.
- Costco edged 1.14 pct lower to \$60.68 and BJ's fell 5.1 pct to \$34.61 after the warehouse club operators reported quarterly earnings that missed expectations.
- S&P financial index was up 0.05 pct, S&P energy index rose 0.19 pct.
- Goldman Sachs fell 0.65 pct to \$157.72.

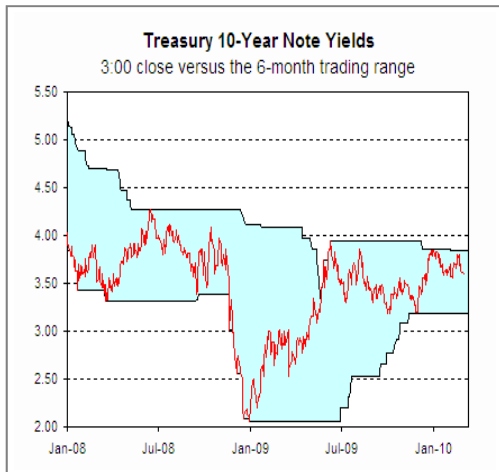
C & E: Oil rose toward \$81 a barrel as a weaker dollar and rising equity markets outweighed a U.S. government report showing a large rise in crude inventories.

- U.S. crude prices was up 1.56 pct to \$80.92 per barrel.
- Gold rose 0.42 pct to \$1,139.25 an ounce.
- Reuters-Jefferies index gained 0.94 pct at 277.71.

- 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	0.100	0.070	0.101	0.008
3-Mo Bill	0.140	0.130	0.142	0.007
6-Mo Bill	0.185	0.180	0.188	0.001
1-Year	0.295	0.290	0.300	0.004
2-Year	100.125	100.156	0.812	-0.031
3-Year	100.141	100.172	1.327	-0.043
5-Year	100.484	100.523	2.272	-0.012
7-Year	99.734	99.781	3.042	-0.031
10-Year	100.000	100.063	3.625	-0.125
30-Year	100.656	100.734	4.584	-0.227

EQUITIES

	INDEX	CHANGE
DJIA	10392.22	-16.25
NASDAQ	2276.49	-4.52
S&P 500	1117.93	-0.44

OIL

	PRICE	CHANGE
NYMEX	80.8	1.1
BRENT	79.2	1.0

EURODOLLAR FUTURES

	CLOSE	CHANGE
Mar-10	99.743	0.003
Jun-10	99.665	0.000
Sep-10	99.495	-0.010
Dec-10	99.210	-0.010

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.230	O/N	0.230
2-Week	0.220	2-Week	0.220
1-Month	0.220	1-Month	0.220
3-Month	0.240	3-Month	0.250
AGENCY REPOS		i-REPO SM INDEX	
O/N	0.220	10:00 AM	0.170
2-Week	0.220	3:00 PM	0.169
1-Month	0.230		
3-Month	0.240		

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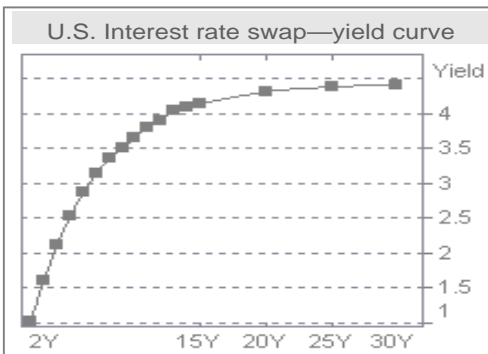
	SPREAD		RATE	
2-Year	21.00	25.00	1.01	1.04
3-Year	28.75	32.75	1.61	1.63
5-Year	26.00	30.00	2.53	2.53
7-Year	8.75	12.75	3.13	3.12
10-Year	2.50	6.50	3.65	3.63
30-Year	-18.00	-14.00	4.40	4.38

FUTURES

	PRICE	CHANGE
CBOT 5 yr	117.11	0.02
CBOT 10 yr	118.91	0.02
CBOT 30 yr	118.78	-0.06

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.150	0.170	-	-
1-Month	0.200	0.280	0.142	0.152
3-Month	0.220	0.400	0.153	0.163
6-Month	0.250	0.450	0.172	0.182
12-Month	0.600	1.000	0.295	0.305



CURRENCIES

	BID	ASK
Euro	1.3701	1.3704
Sterling	1.5096	1.5100
JP Yen	88.38	88.42
Swiss Franc	1.0675	1.0678
Can Dollar	1.0311	1.0316
Mexico	12.7032	12.7088

FED FUNDS NYFRSM - 10AM

Open	0.1500	1m	0.2138
High	0.1700	3m	0.2544
Low	0.0800		

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1	04/04/2012	22	20	1.04
3-Year	1.375	09/01/2013	17	16	1.51
5-Year	2.875	09/02/2015	30	29	2.59
7-Year	5.125	18/10/2016	17	16.5	3.21
10-Year	-	-	-	-	-
30-Year	6.625	15/11/2030	37	33	4.96

ACTIVE FREDDIE MAC AGENCIES

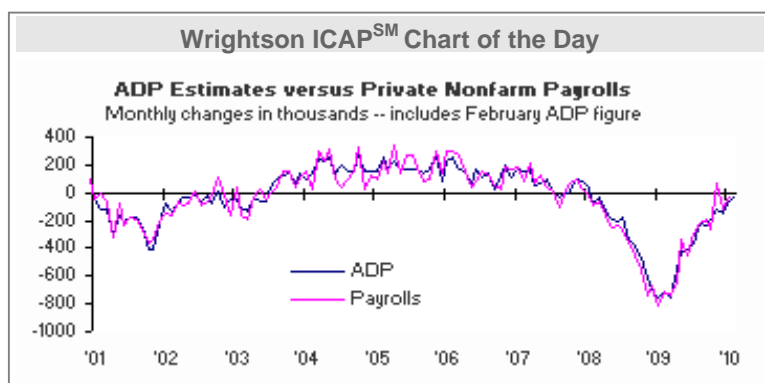
TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	15/12/2011	-5.25	-6	0.76
3-Year	1.75	22/02/2013	22.5	22	1.57
5-Year	2.625	20/11/2014	0	16	-
7-Year	5.25	15/09/2016	13.75	13.25	3.18
10-Year	3.75	27/03/2019	0	19	-
30-Year	6.25	15/07/2032	33.75	33.25	4.92

Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	5.0	105.2210	105.2410	2.502
FHLMC	5.0	105.2310	105.2510	2.490

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	5.5	105.2910	105.3110	2.787
FHLMC	5.5	105.2810	105.3010	2.751
GNMA	5.5	105.3030	106.0030	3.452



TODAY'S TOP NEWS

Data suggests a recovering U.S. job market

U.S. private employers eliminated fewer jobs last month, suggesting the job market may be on the mend, while the U.S. services sector grew at its fastest pace since the recession began. Private employers cut 20,000 jobs in February, compared with 60,000 job losses in January, the report by ADP, a payroll processor, showed. The February number was in line with the median estimate.

Separately, the ISM said its services index rose to 53.0 from 50.5 in January. The reading was the highest since December 2007 and well above the 51.0 median forecast of 71 economists surveyed by Reuters. Also, data showed the number of planned layoffs at U.S. firms fell to its lowest since July 2006, according to the report from global outplacement consultancy Challenger. Separately, economic activity strengthened modestly across most of the 12 Federal Reserve districts during February and likely would have done better if not for heavy snowstorms that battered many areas. The pace of layoffs slowed but hiring plans were "generally soft," according to Beige Book summary prepared by the Kansas City Fed, which also said wage and price pressures were muted except for commodities such as lumber and raw materials that were moving up.

Obama lays out Volcker rule specifics for Congress

U.S. banks would be banned from proprietary trading and other large financial firms would face quantitative limits on such activity, according to draft language on the so-called "Volcker rule" from the Obama administration.

The language maintains the toughest components of the proposal first floated in January, despite skepticism from lawmakers and the industry that such restrictions would do little to prevent another financial meltdown like the one that seized markets in 2008. Banks would also be banned from investing in or sponsoring hedge funds and private equity funds, according to a draft version of the legislative language obtained by Reuters.

The proposal would prevent a financial firm from acquiring another company if the resulting firm would have more than 10 percent of the liabilities of the financial system.

Separately, the U.S. Fed proposed another new rule to strengthen consumer protections against abusive practices by credit card issuers, including limiting penalty fees and requiring them to reconsider past interest rate hikes.

The proposed rule would prohibit card issuers from charging late payment fees or other penalty charges that exceed the amount of a consumer's excess of the account terms.

Obama seeks to push healthcare to final vote

President Barack Obama said it is time to pass his sweeping healthcare overhaul using only a slim Democratic majority in Congress if necessary, saying the issue is too important to be delayed by politics after a year of debate.

Obama said his plan included ideas from both his fellow Democrats and rival Republicans, who staunchly oppose the idea of a sweeping overhaul of the \$2.5 trillion healthcare industry that accounts for one-sixth of the U.S. economy.

Obama said he opposed the Republican call to throw out broad bills passed by the House of Representatives and Senate last year and begin again with a more step-by-step approach.

With more than one third of the Senate and all seats in the House up for grabs in November elections, his fellow Democrats want to move past healthcare to focus on job creation and the economy. Using reconciliation to pass the final healthcare bill would be a two-step process.

Greece piles on austerity, seeks EU safety net

Greece targeted civil servants, the rich and the church in a sweeping new 4.8 billion euro (\$6.5 billion) austerity program designed to secure European help to tackle its crippling debt burden.

The government said the public sector pay cuts, pensions freeze and tax increases would save the equivalent of 2 percent of GDP on top of existing plans to reduce this year's budget deficit to 8.7 percent of GDP from 12.7 percent in 2009.

Finance Minister George Papaconstantinou said Greece had reached the limits of austerity and could not rule out going to the IMF if EU help was not forthcoming.

The IMF welcomed the fiscal plan as "substantial".

The measures include raising VAT by 2 percentage points to 21 percent, cutting public sector salary bonuses by 30 percent and freezing state pensions. There will also be higher rates of tax for those earning over 100,000 euros (\$136,500) a year, for owners of big properties such as the church and for those splashing out on yachts, expensive cars and jewels.

Moody's Investors Service said Greece's new austerity measures are consistent with its current A2 rating and negative outlook.

Fed's Fisher: Must break up banks that are too big

Banks that are seen as too large to fail should be broken up in order to make the financial system more stable, Dallas Fed President Richard Fisher said.

In his most explicit call yet for reshaping the financial industry, Fisher said markets could only function properly if institutions that take big risks are allowed to go under.

His comments come as Washington debates financial regulatory reform, which some analysts worry has become too watered down to prevent another financial crisis. Fisher called for an international agreement to break up oversized firms.

Fisher, like colleagues at the Fed, argued that supervisory authority is key to the adequate conduct of monetary policy, since it gives policy makers a bird's eye view of financial markets.

In a separate statement, he said that the U.S. Federal Reserve will not print money to monetize the government deficit.

Separately, Atlanta Fed President Dennis Lockhart said, the end of Fed Reserve purchases of mortgage-backed securities has been well-anticipated and should not cause major disruptions in the housing market.

CFTC, House chairman aim to fix U.S. swap reform law

A central Congressional player in financial reform legislation said he is willing to close a potential loophole that might allow big derivatives traders to avoid public scrutiny of their deals.

It brought his position closer to that of CFTC Chairman Gary Gensler, who has pushed lawmakers to weave a tighter regulatory net around the unregulated over-the-counter U.S. derivatives market that he has estimated at \$300 trillion.

Gensler said the House financial reform bill is strong, but might still let some large institutional traders escape a requirement to trade standardized derivatives on exchanges and clear those trades.

The CFTC also stepped up efforts to convince Congress to include in its overall reform package tougher securities-style firewalls and insider trading bans for commodity and energy markets.

The House bill included new requirements for firewalls within commodity trading firms, similar to those in place for securities dealers, Gensler said in written testimony.



TODAY'S TOP NEWS

U.S. mortgage rate drop below 5 pct stirs demand

U.S. mortgage rates retreated below 5 percent last week, proping up demand for home loans after purchase applications sank to a nearly 13-year low in the prior week, the Mortgage Bankers Association said.

February's volatile swings in housing demand came on the heels of a steep January sales slump, blamed mainly on unusually harsh winter weather.

The industry group's market index rose by a seasonally adjusted 14.6 percent in the week ended Feb. 26 to the highest level since mid-December. Purchase applications increased 9 percent while refinancing requests jumped 17.2 percent last week, as average 30-year mortgage rates fell 0.08 percentage point to 4.95 percent. Refinancing loans represented about 69 percent of all applications last week.

The 30-year mortgage rate is seen headed as high as 6 percent after the Fed ends its \$1.25 trillion in mortgage bond purchases on March 31.

EU unveils 10-year plan to boost growth and jobs

The EU unveiled its flagship 10-year economic program, aiming to boost growth and jobs while fighting climate change, but critics say the plan is unrealistic and fear it is doomed to fail.

Presenting the Europe 2020 strategy, European Commission President Jose Manuel Barroso said the bloc's 27 governments needed to coordinate policy far better if they were to ward off future crises and prevent their economies drifting apart.

A 10-year plan put forward in 2000 that has widely been shown to have failed, focuses on innovation, research and development, education, clean energy and more flexible labor markets.

The program, which will be discussed by EU leaders at a summit on March 25-26 before its planned approval in June, aims to prevent the bloc of 500 million people slipping behind economic and political rivals on the world stage.

Separately, Officials working for EU financial markets chief Michel Barnier will meet industry experts and supervisors on Friday to discuss debt speculators amid concerns traders are worsening Greece's borrowing problems.

U.S., China economic talks to be held in May

U.S. and Chinese officials will meet in Beijing in May for their next round of talks on trade and foreign exchange issues to try to keep economic disputes smoothed out.

The S&ED was established last year superseding the former Strategic Economic Dialogue that had been set up during the Bush administration.

U.S. Trade Representative Ron Kirk said the Obama administration was working across agencies to try to develop a "holistic approach" toward dealing with several China trade concerns. Issues range from China's industrial policies to export tax rebates to "unreasonable restraints" on U.S. industry, he said. Kirk said officials from the National Economic Council as well as the National Security Council were working together to shape a broader approach to trade relations with China and enhance chances for making progress. The U.S. Treasury has declined to name China a currency manipulator and is generally considered unlikely to do so in the upcoming report.

Euro zone services PMI dips but divergence remains

The euro zone's services sector expanded slower in February than previously expected as the divergence among the big four economies in the euro area persisted, a survey showed.

The data showed a further disparity in growth rates with Spain's services sector contracting at a faster pace last month while services in Germany, France and Italy continued to expand.

Markit said its final Eurozone Services PMIs' Index fell to 51.8 in February from 52.5 in January, revised down from a flash estimate released two weeks ago of 52.0.

At this time last year the index was languishing at an 11-1/2 year survey low of 39.2 in the worst recession since the Second World War.

Data from Spain showed its services PMI fell to 47.1 from 48.8 in January. Germany's index dipped to 51.9 from 52.2, while France's service PMI dropped to 54.6 from 56.3. The Italy PMI nudged down to 50.8 from 50.9. In contrast, the British services sector bounced back faster than expected last month to record its fastest expansion in more than three years.

NEXT UP

Yen seen falling close to 100 vs dollar in a year

The Japanese yen is set to weaken to just shy of 100 yen to the dollar in a year thanks to prolonged deflation and a return to widespread use of the yen as a funding currency, the latest Reuters poll showed.

Consensus forecasts from a poll of over 60 strategists were little changed over the past month, pegging the yen at 90 to the dollar in a month, 95 in six months and 99 in a year from now, compared with 91, 95 and 100 expected in the February poll.

Thirty-two of 63 strategists, surveyed March 1-3, saw the dollar at or above 100 yen anytime over the forecast horizon, compared with 33 of 61 in the February poll.

Against the euro, cross rates calculated by Reuters show the euro/yen pair at 122 in one month, 128 in six months and 135 in a year, compared with 128, 133 and 138 in the February poll.

ECB to unveil next small steps in stimulus withdrawal

The ECB is set to hold interest rates at a record low level of 1.0 percent and detail the next steps in its gradual withdrawal from emergency lending measures at its monthly meeting tomorrow.

The 87 economists polled by Reuters were unanimous in pre-

dicting no change in rates this month and on average expected the first rise only in the fourth quarter.

Thursday's focus instead will be on what changes it plans to make to the extra liquidity it has provided for the banking system since the worst days of the financial crisis in 2008, with markets primed for some minimal tightening of conditions -- most likely in access to 3- and 6-month money. The ECB could switch back to auctions for its 3-month operations, shortening outstanding maturities.

BoE to hold policy steady until economic fog clears

The Bank of England is likely to make no change to monetary policy this week as it pauses to assess the impact of the 200 billion pounds of asset purchases it has already made.

All but one of 62 economists polled by Reuters reckon the central bank will not extend its quantitative easing program on Thursday, despite policymakers' insistence they are ready to resume asset purchases if the economy deteriorates.

Most economists do not expect interest rates to rise until the second half of this year at the earliest, and a growing number believe they could stay on hold until 2011.



DEEP DIVE Commentary and Analysis

ANALYSIS-Austerity steps to ease, not end Greek crisis

By Andrew Torchia

Austerity steps announced by Greece on Wednesday may pave the way for European Union government aid, easing fears that Greece could lose its ability to borrow from debt markets at affordable rates.

But market worries about Greece are likely to remain acute for the foreseeable future, and doubts will remain over its ability to hit fiscal targets amid a deep recession.

Confidence in the euro currency and euro zone assets in general will probably not revive fully. Any EU aid to Greece would not resolve big divergences in the performances of euro zone economies, and could create a precedent for the zone's rich states to bail out the profligate spending of poor ones.

PROSPECTS FOR EU AID

Greece's announcement may be a key step towards an informal aid-for-austerity exchange deal with EU governments.

All parties are under growing time pressure to reach a deal on easing the crisis because Greece needs to refinance about 20 billion euros of debt maturing in April and May.

Greek Prime Minister George Papandreou will meet German Chancellor Angela Merkel in Berlin on Friday, and visit French President Nicolas Sarkozy in Paris on Sunday.

A German government spokesman said on Wednesday that Berlin would not offer any assistance to Greece on Friday, and German public opinion has strongly opposed aid to Greece.

But editorials in some major German newspapers this week suggested key opinion-makers were shifting towards granting aid in order to avert damage to the euro zone as a whole. Merkel appeared to encourage this shift by saying the euro faced the most difficult time in its 11-year history.

Papandreou has another bargaining chip with the EU: he told his cabinet on Wednesday that he might turn to the International Monetary Fund if the EU did not give support, a government source said. For the EU, this would be an embarrassing admission that the bloc could not solve its own problems.

SHAPE OF ANY EU AID

Although the EU treaty seeks to prevent bailouts of member states, legal issues could be overcome with enough political will. EU governments could offer many forms of aid, from speeding disbursement of structural economic aid to giving debt guarantees or creating a bailout fund.

Because aid would have to be justified to taxpayers in rich EU states, it is unlikely to involve government-to-government transfers of cash. Instead, it would probably be indirect and designed to help Greece continue to borrow in debt markets.

Sources familiar with governments' deliberations have said, for example, that state-run banks such as Germany's KfW and France's Caisse des Depots might buy Greek bonds or extend guarantees for other banks to do so.

German and French media reports have said governments in the 16-country euro zone might offer aid worth a total of 20 to 25 billion euros (\$27 billion to \$34 billion). Officials have declined to comment on the size of any aid plan.

GREECE'S ABILITY TO IMPLEMENT AUSTERITY

Papandreou seems to face no serious political challenge in pushing through austerity steps; his socialist party has 160 seats in the 300-member parliament and the main conservative opposition has committed itself to austerity in principle. No general election is due until late 2013.

Despite a series of one-day strikes by unions, public opinion polls show strong support for austerity in principle if the pain is

distributed equitably. A poll last month showed 76 percent of Greeks thought there should be no strike action until the crisis had passed.

But a crumbling of the austerity consensus and the launch of protracted industrial action cannot be ruled out late this year if the economy does not start recovering in the second half as the government has predicted.

The Markit Manufacturing Purchasing Managers' Index for Greece, released this week, suggested the economy was continuing to worsen; the February index hit a 10-month

GREECE'S ABILITY TO HIT FISCAL TARGETS

By hurting tax revenues and shrinking gross domestic product, the recession may make it even harder for Greece to hit its ambitious fiscal targets - and any EU aid is expected to be conditional on these targets being met.

Athens aims to slash its budget deficit-to-GDP ratio from 12.7 percent last year to 8.7 percent this year, to 5.6 percent in 2011 and below the EU limit of 3 percent in 2012.

Even in good economic times, such a fast reduction would be very difficult and has rarely been achieved by other countries, as the Czech finance minister observed last week.

MARKET REACTION

Investors have begun to anticipate a Greek austerity announcement and an EU aid package in recent days, so given the continued scepticism over Greece's ability to hit its targets, markets may not rally much further even if EU aid is confirmed.

The spread of the 10-year Greek bond yield over German Bunds has narrowed sharply to 291 basis points from 370 last week, but is unlikely to approach the levels of healthier euro zone states below 100 bps.

Greek bank shares have rebounded 18 percent since early February but remain about 45 percent below a peak hit in October before the country's crisis erupted. They fell on Wednesday.

EU aid would cut the risk of a run on Greek banks triggered by Athens losing access to the debt markets, but the austerity steps will mean the banks facing a tougher operating environment.

Debt rating agencies are unlikely to rush to upgrade Greece. Pierre Cailleteau, head of global sovereign ratings at Moody's Investors Service, said last month that if in the next couple of months Moody's saw Athens was on track to hit fiscal targets, it might change the negative outlook for Greece's A2 rating to neutral.

Twenty-seven of 47 economists in a Reuters poll early this week predicted the crisis would continue in a "slow burn" mode, with Greece avoiding default but making only limited progress towards its fiscal targets.

OUTLOOK FOR EURO ZONE

Should the EU does come to the aid of Greece this year, German taxpayers may become unwilling to provide support over the long term if structural economic weakness keeps Athens dependent on EU aid for years.

And the EU has shown little sign of reforming the way the bloc works to prevent such debt crises occurring with other members in future.

It has said it will tighten monitoring of members, but it still has no guarantee that countries will maintain fiscal discipline or that their economies will be able to work well inside the euro zone's monetary straightjacket.

For these reasons the euro, which has been weak against the dollar since early December partly as a result of the Greek crisis, may not stage a substantial rebound any time soon, and investors may attach a risk premium to it over the long term.



DEEP DIVE Commentary and Analysis

The euro firmed only marginally on Wednesday and remained near nine-month lows.

ANALYSIS-Hedge funds get smart to avoid bonus barriers

By Laurence Fletcher

Hedge fund investors could be left out of pocket as managers conjure up shortcuts to earn once again the lucrative bonuses based on performance fees that were a feature of the industry before the credit crisis.

Despite 20 percent returns last year, big losses in 2008 mean that between a half and two-thirds of hedge funds are below high-water marks -- performance levels they must hit before claiming a 20-percent fee on a fund's profits.

This could persuade more managers to move to new firms where they can start earning these bumper fees straight away, forcing clients to decide whether the quality of the managers justifies the additional cost and disruption needed to follow them. "If certain funds don't reach their high-water marks, not the founders but the number 2s or numbers 3s in a hedge fund firm could start looking at other roles," said one prime broker who declined to be named.

Managers staying put might be tempted to take greater risks to hit high-water marks, or could close a fund to new investors, only to launch a new and similar fund where clients committing new money will pay fees on performance straight away.

Like a mark on a riverbank showing how high past floods have reached, high-water marks are the top net asset value hit by a fund in its lifetime, and below these levels, a manager can't get performance fees even if the fund makes money.

The intention is to stop managers taking fees, beyond standard management charges, simply for making back money lost in previous years.

FRUSTRATION

Firms such as Man Group, Brevan Howard and GLG have launched versions of their hedge funds as Ucits III funds, a more regulated structure that allows them to be sold across Europe, hence opening up the strategy to a wider pool of investors.

Such funds can often earn performance fees straight away, even if the funds they mirror are still 'under water'.

"One attraction of launching a new fund is that managers can immediately begin to earn performance fees on the new vehicle," said Kate Hollis, lead analyst at S&P Fund Services.

INSIDE DEBT is produced by Reuters in partnership with ICAP.

(Compiled by Anil Kumar and Pronita Naidu in Bangalore)

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With the average fund down 2.7 percent over the past two years, frustration is growing as managers find themselves some way off earning the fees to which they have become accustomed.

"It will create some changes -- new openings or some (funds) closing," said Patrick Fenal, chief executive of Unigestion, which runs \$3.1 billion in funds of hedge funds.

Moreover, managers who are above their high water marks may be unhappy sharing their bonuses with less successful managers and could leave for a rival.

"The incentive for someone who's performed very, very well to stay in a shop where de facto bonuses will be less than elsewhere (is less). They could create their own fund or go and work for someone else," said Unigestion's Fenal.

GLG star Greg Coffey's departure in 2008 was linked by some commentators to the firm's funds being below high-water marks. A source close to Coffey said on Tuesday: "This is nonsense and it never had anything to do with high-water marks".

GLG declined to comment.

Data from Hedge Fund Research shows just 31 percent of hedge funds hit high-water marks during the fourth quarter last year, and barely half hit it during the whole of 2009.

TAKING RISKS

Regulators' concerns lie elsewhere, and fears have been raised that managers some way off high-water marks may be encouraged to take riskier bets with investors' money.

"There may be incentives to take greater risk," Britain's Financial Services Authority said in a survey of 50 firms, released last week, which showed about half of hedge funds' main share classes were below their high-water mark.

Unigestion's Fenal said checks on such funds were vital.

"Most good managers are above historical high-water marks. All the ones below are more questionable. You have to question in your due diligence your motivation to keep them, to be sure they won't have (risky) behavioural patterns to reach the desired level (to earn fees)," he said.

However, some doubt whether moves such as setting up new funds will really get past investors' watchful eyes.

"Do I think some people are going to do it? Yes, of course some people are going to do it," said David Aldrich, head of securities industry banking at Bank of New York Mellon. "But ... I think investors will see through that very quickly."

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