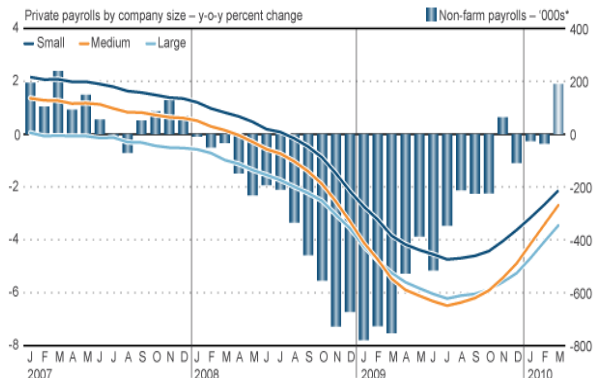


CHART OF THE DAY

U.S. private employment



U.S. private employers shed 23,000 jobs in March, missing expectations for an increase although fewer than the adjusted 24,000 jobs lost in February.

TODAY'S TOP NEWS

- U.S. private sector sheds jobs in March
- Moody's downgrades five Greek banks
- Fed's Lockhart: Unemployment "most vexing" problem
- U.S. loan issuance jumps 36 pct in Q1-LPC
- U.S. dollar share of Q4 global FX reserves rises - IMF
- U.S. to pay Morgan Stanley mlns to sell its Citi shrs
- EZ inflation jumps, unemployment hits 10 pct

ECON WATCH

FOR THURSDAY APRIL 1

ET	Indicators	Unit	Reuters	Prior
03:43	IT Markit/ADACI Mfg PMI	ind	52.6	51.6
03:48	FR Markit/CDAF Mfg PMI	ind	56.3	54.9
03:53	DE Markit/BME Mfg PMI	ind	59.6	57.2
03:58	EZ Markit Mfg PMI	ind	56.3	54.2
04:28	GB CIPS/Markit Mfg PMI	ind	56.8	56.6
08:30	US Initial Claims	k	440	442
08:30	US Continuing claims	mln	4.61	4.648
10:00	US Construction spending	%	-1.0	-0.6
10:00	US ISM Manufacturing PMI	ind	57.0	56.5
10:00	US ISM Prices Paid	ind	67.0	67.0
-	US Domestic car sales	mln	4.10	-
-	US Domestic truck sales	mln	4.50	-
-	US Total Vehicle Sales	mln	12.0	10.3

FACTBOX-Fed's exit strategy toolkit

The U.S. Federal Reserve formally ends on Wednesday its program of buying around \$1.4 trillion of mortgage-related debt. **For more please click here**

MARKETS TODAY

TODAY'S TOP STORY: U.S. private employers unexpectedly shed more jobs in March, dampening hopes for job growth ahead of Friday's key employment report. **For more please click here**

TREASURIES: U.S. government debt prices rose after data showed an unexpected decline in private payrolls in March, reducing bets on the strength of the economy to produce a high number of jobs.

- 30-yr bonds rose 17/32 to yield 4.71 pct, down from 4.75 pct.
- 10-yr Treasury notes were up 7/32 to yield 3.83 pct, while 2-yr notes gained 3/32 to yield 1.02 pct.
- 5-yr Treasury notes rose 6/32 to yield 2.56 pct.
- 2-10's part of the yield curve steepened by 1 bps to 281 bps.

FOREX: The dollar hit a three-month high against the yen and although it slipped against the euro, the greenback remained on track for its best quarterly performance in 12 months on the view that the U.S. economy continues to improve.

- Dollar rose 0.71 pct to 93.48 yen, near a session peak, after dipping to 92.76 yen. It rose as high as 93.63 yen overnight, its highest level since early January.
- Euro rose 0.71 pct to \$1.3509 and gained 1.42 pct against the yen at 126.31 yen.
- Dollar fell 1.15 pct to 1.0540 Swiss francs. Earlier the euro fell to a fresh record low of 1.4210 Swiss francs.

CORPORATES: U.S. corporate bond spreads edged wider after weaker-than-expected labor market data made investors slightly wary of holding riskier assets.

- The CDX.IG-14 index widened by about 2 bps to 88 bps.
- U.S. high-grade corporate bond sales rose in the first quarter to \$216 bln from \$207 bln in the same period a year earlier, according to Thomson Reuters data.
- Bank of Nova Scotia sold \$1.75 bln of senior unsecured notes in a re-opening of an existing two-part deal.

STOCKS: U.S. stocks fell as a report showing a surprising drop in private-sector employment stoked concerns about the health of the labor market two days before the government's key payrolls data.

- Dow fell 0.47 pct to 10,856.63, S&P was down 0.33 pct to 1,169.44 and Nasdaq fell 0.53 pct to 2,397.96.
- Chevron shares rose 0.70 pct to \$75.83.
- Honeywell International rose 0.71 pct to \$45.27 a day after raising its first-quarter profit outlook. RIM fell 1.26 pct to \$73.97.
- S&P financial index was up 0.17 pct, S&P energy index rose 0.39 pct. KBW bank index rose 0.48 pct.

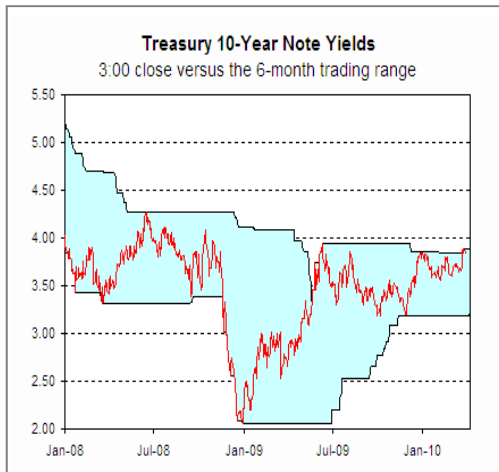
C & E: U.S. crude oil futures ended at their highest level this year and posted loftiest settlement for a front-month crude contract in almost 1.5 years, as a weakening of the dollar attracted buying.

- U.S. crude oil rose 1.02 pct to \$83.21 per barrel.
- Gold gained 0.94 pct to \$1,112.85 an ounce.
- Reuters-Jefferies index shed 0.14 pct to 273.34.

- 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	0.165	0.13	0.167	0.028
3-Mo Bill	0.160	0.150	0.162	0.007
6-Mo Bill	0.235	0.230	0.239	0.002
1-Year	0.383	0.375	0.389	-0.008
2-Year	99.938	99.969	1.032	0.074
3-Year	99.391	99.422	1.587	0.125
5-Year	99.703	99.742	2.564	0.195
7-Year	99.797	99.844	3.283	0.211
10-Year	98.266	98.313	3.837	0.195
30-Year	98.516	98.578	4.718	0.484

EQUITIES

	INDEX	CHANGE
DJIA	10860.56	-46.86
NASDAQ	2404.54	-6.15
S&P 500	1170.48	-2.79

OIL

	PRICE	CHANGE
NYMEX	83.5	1.1
BRENT	81.0	-0.2

EURODOLLAR FUTURES

	CLOSE	CHANGE
Apr-10	99.693	0.008
Jun-10	99.635	0.015
Sep-10	99.470	0.040
Dec-10	99.170	0.045

FUTURES

	PRICE	CHANGE
CBOT 5 yr	115.67	-0.13
CBOT 10 yr	115.73	-0.20
CBOT 30 yr	115.28	-0.22

CURRENCIES

	BID	ASK
Euro	1.3505	1.3508
Sterling	1.5175	1.5180
JP Yen	93.43	93.46
Swiss Franc	1.0539	1.0542
Can Dollar	1.0147	1.0154
Mexico	12.3540	12.3572

FED FUNDS NYFRSM - 10AM

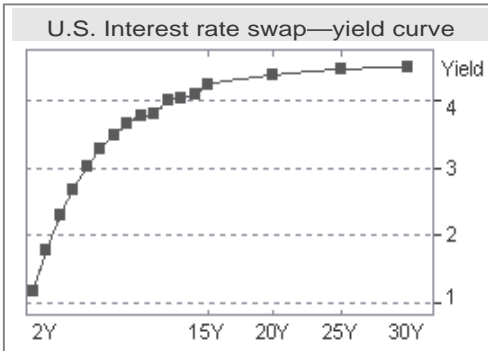
Open	0.1200	1m	0.2311
High	0.1300	3m	0.2881
Low	0.0200		

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.120	O/N	0.200
2-Week	0.250	2-Week	0.250
1-Month	0.270	1-Month	0.260
3-Month	0.270	3-Month	0.270
AGENCY REPOS		i-REPO SM INDEX	
O/N	0.200	10:00 AM	0.030
2-Week	0.240	3:00 PM	0.037
1-Month	0.260		
3-Month	0.300		

IR SWAPS <19901>

	SPREAD		RATE	
2-Year	15.00	19.00	1.17	1.20
3-Year	20.00	24.00	1.78	1.79
5-Year	15.00	19.00	2.71	2.71
7-Year	1.75	5.75	3.30	3.29
10-Year	-3.75	0.25	3.80	3.78
30-Year	-22.50	-18.50	4.49	4.47



EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.100	0.150	-	-
1-Month	0.220	0.300	0.187	0.197
3-Month	0.240	0.400	0.197	0.207
6-Month	0.350	0.450	0.228	0.238
12-Month	0.700	1.050	0.394	0.404

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1	12/04/2012	14.5	13	1.18
3-Year	1.625	15/04/2013	23	0	1.81
5-Year	2.875	09/02/2015	19.5	18	2.76
7-Year	5.125	18/10/2016	15.25	12.25	3.44
10-Year	-	-	-	-	-
30-Year	6.625	15/11/2030	37.5	35.5	5.1

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	15/12/2011	-3.5	-4	1.01
3-Year	1.75	07/05/2013	24.5	23.5	1.83
5-Year	2.625	20/11/2014	9.5	0	2.65
7-Year	5.25	15/09/2016	12	9	3.4
10-Year	3.75	27/03/2019	25	24	4.09
30-Year	6.25	15/07/2032	0	34.5	-

Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	4.0	101.1110	101.1150	3.610
FHLMC	4.0	101.1070	101.1130	3.611

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	4.5	100.0360	100.0420	4.454
FHLMC	4.5	100.0420	100.0460	4.454
GNMA	4.5	101.0220	101.0260	4.264

Wrightson ICAPSM Chart of the Day



TODAY'S TOP NEWS

U.S. private sector sheds jobs in March

U.S. private employers unexpectedly shed more jobs in March, dampening hopes for job growth ahead of Friday's key employment report.

U.S. private employers cut 23,000 jobs in March, missing expectations for an increase in jobs although fewer than the adjusted 24,000 jobs lost in February, according to the data by a private employment service. The median of estimates from 35 economists surveyed by Reuters for the ADP Employer Services report was for a rise of 40,000 private-sector jobs this month.

The ISM Chicago business barometer slipped to 58.8 in March from 62.6 in February. Economists forecast the index at 61.

Meanwhile, the ISM New York's seasonally adjusted index of current business conditions fell to 60.6 in March from a revised 78.1 in February.

In a slightly more upbeat report, the Commerce Department said orders for manufactured goods increased 0.6 percent after an upwardly revised 2.5 percent jump in January, initially reported as a 1.7 percent advance. Economists polled by Reuters had forecast factory orders rising 0.5 percent last month.

Fed's Lockhart: Unemployment "most vexing" problem

Unemployment is the "most vexing current problem" for the U.S. economy, which, combined with subdued inflation, means the Federal Reserve's accommodative policy is appropriate now, a top Fed official said.

Dennis Lockhart, president of the Atlanta Fed, said the U.S. economy remains in a transitional phase from growth relying on government support to growth based on private spending.

But Lockhart said it is possible the U.S. economic recovery could gather steam and put tighter policy on the table before there is a significant reduction in the unemployment rate.

Meanwhile, a top U.S. Federal Reserve official expressed guarded confidence that banks would step up lending as the economy improves. Duke said declines in loans outstanding are of "great concern" to the central bank and urged bankers to work with bank supervisors to reverse that trend.

Separately, the U.S. economic recovery is gathering speed as business activity picks up pace, despite lingering weakness in employment, Dallas Fed President Richard Fisher said.

U.S. dollar share of Q4 global FX reserves rises -IMF

The U.S. dollar's share of global currency reserves rose to 62.1 percent in the fourth quarter of 2009 as total holdings climbed to a record of more than \$8 trillion, IMF data showed.

The IMF data showed the dollar's share of the roughly \$4.6 trillion allocated reserves rose to \$2.8 trillion.

The greenback in the third quarter of 2009 had a share of 61.5 percent. In the second quarter of 2001, the dollar share was 73 percent.

The IMF estimates that at the end of 2009, global reserves stood at \$8.1 trillion, up from \$7.9 trillion in the previous quarter. Of the allocated reserves, the euro's share slipped to 27.4 percent from the third quarter's 27.8 percent share.

The yen's share slipped to 3.0 percent from 3.2 percent in the previous period while sterling's share was steady at 3.2 percent. Meanwhile, unallocated reserves, in which China accounts for the bulk, rose to \$3.5 trillion in the fourth quarter from \$3.4 trillion previously.

While China is said to be diversifying away from U.S. assets, the country reportedly holds 65 percent to 75 percent of its reserves in U.S. dollars. Emerging market holdings increased to \$5.4 trillion from \$5.2 trillion in the third quarter.

Moody's downgrades five Greek banks

Moody's Investors Service downgraded its rating on five Greek banks, highlighting the pressures they face given the country's weak economic outlook.

The downgrades added to gloomy sentiment on heavily-indebted Greece, which has had to impose tough austerity measures to try to reduce its ballooning budget deficit. Moody's said its ratings downgrades on the banks were prompted by Greece's macroeconomic outlook and its likely impact on the asset quality and earnings potential of the banks. Moody's downgraded National Bank of Greece to A2 from A1, EFG Eurobank, Alpha Bank and Emporiki to A3/Prime-2 from A2/Prime-1, and Piraeus Bank to Baa1-Prime-2 from A2/Prime-1.

Separately, Greece will issue a global U.S. dollar denominated bond in late April or early May, the head of the country's debt agency said. Greece faces a refunding hump in April and May as it rolls over maturing bonds, T-bills and pay coupons coming due. Rated A2 by Moody's and BBB+ by Fitch and Standard & Poor's, the over borrowed country has about 23 billion euros of debt maturing between now and the end of May.

U.S. loan issuance jumps 36 pct in Q1-LPC

U.S. loan issuance in the first quarter rose to \$159 billion, up 36 percent from \$117 billion in the first quarter of 2009, as lender and investor appetite for senior debt improved, according to data from Thomson Reuters Loan Pricing Corp.

Leveraged loan issuance jumped 118 percent to \$71 billion in the quarter, up from \$33 billion in the same period a year ago, while investment-grade loans fell to \$56 billion, down 15 percent from \$65 billion in the first quarter of 2009, LPC reported.

Nearly \$26 billion in loans were extended in the first quarter, following \$62 billion in maturity extensions in 2009, LPC said.

Separately, U.S. mortgage-backed securities issuance jumped to \$118.4 billion in the first quarter of 2010, up sharply from \$33.5 billion in the same period a year earlier.

Meanwhile, U.S. mortgage applications rose for the first time in three weeks as demand for home purchase loans reached the highest level since October, data from an industry group showed. The MBA said its seasonally adjusted index of mortgage applications, increased 1.3 percent for the week ended March 26. The four-week moving average of mortgage applications was up 2.2 percent.

U.S. junk bond sales hit a record this quarter, data showed, as investor demand for riskier assets continued to recover in the aftermath of the global financial meltdown. U.S. first-quarter junk bond sales soared to \$61 billion, the biggest-ever quarter since records began in 1980, and up from \$11 billion in the same period a year ago, according to Thomson Reuters data.

U.S. to pay Morgan Stanley mlns to sell its Citi shrs

The U.S. Treasury will pay Morgan Stanley between \$23.577 million and about \$134 million for selling taxpayers' 7.7 billion shares of Citigroup Inc, according to a contract released.

Treasury will pay Morgan Stanley \$0.003 for each Citi share sold electronically and \$0.0175 for each share sold otherwise.

The contract is part of a pre-set trading plan for the Treasury to unload its 27 percent equity stake in Citigroup acquired through \$45 billion in taxpayer-funded bailouts in 2008 and 2009.

Under the terms posted on the Treasury's website, the plan also includes a \$500,000 administration fee paid by the Treasury to Morgan Stanley, bringing the "obligated value" of the advisory contract to \$23.577 million. The contract term is for 18 months, ending Sept. 29, 2011, with an option for extension.



TODAY'S TOP NEWS

Euro zone inflation jumps, unemployment hits 10 pct

Euro zone inflation rose much more than expected this month and the unemployment rate reached 10 percent in February, data showed, highlighting the fragility of economic recovery. Inflation was 1.5 percent year-on-year, the highest since December 2008 and up from 0.9 percent in February, the EU statistics office said. But economists played down any impact from faster price growth on the ECB's monetary policy, saying the increase resulted mainly from energy costs and should be temporary.

Separately, signs euro zone banks may be feeling confident enough to wean themselves off excess central bank liquidity may lead to upward pressure on short-term lending rates in the second half of the year.

Analysts had expected demand of around 70 billion euros at the ECB's final tender of six-month funds, at which banks were guaranteed all the money they wanted. But only 17.9 billion euros were allotted.

Germany, France boost chance of global bank levy deal

Germany and France said bank levies should be imposed internationally to ensure a level playing field and called for national bank restructuring rules to be embedded in a European framework. France is the latest country to seek a levy on bank balance sheets to fund bank bailouts, after Germany earlier this month announced plans to introduce such a charge.

The move raises the chances of the G20 group of countries agreeing to a bank levy at their summit in June.

Separately, German unemployment fell unexpectedly in March, posting its biggest drop since June 2008 and adding to evidence that Europe's largest economy is perking up after growth stalled over the winter.

Federal Labour Office figures released showed the jobless total fell by 31,000 in March from the previous month to a seasonally adjusted 3.382 million.

Meanwhile, Germany's total public sector budget deficit hit a record 105.5 billion euros last year, the Federal Statistics Office said.

China c.banker warns of bubble risks in emerging mkts

Emerging markets face the risk of asset bubbles that could burst dangerously once the United States raises interest rates, a vice governor of China's central bank said, while also stressing the risks of an unsteady dollar.

Zhu Min, a vice governor of the People's Bank of China, made the warning in a speech reported in the Chinese-language Financial News.

He did not refer to China's own economy but dwelt on broader worries about the threats to global economic recovery.

Beijing faces mounting pressure from Washington to let its exchange rate rise, lifting the value of the yuan, which has been effectively pegged near 6.83 to the dollar since mid-2008, helping Chinese exporters ride out the financial crisis.

China keeps much stricter controls on capital flows than many other emerging markets. But its property market has gone through heady price rises that have led to warnings of a real estate bubble, especially in the big cities.

Japan new export orders hit 6-year high

New export orders won by Japanese firms jumped to the highest in almost six years in March in a sign the manufacturing sector will likely keep recovering on demand in emerging markets such as China, a survey showed.

But as companies struggled to cope with stagnant domestic demand, earnings of Japanese workers fell for the 21st straight month in February and winter bonuses showed a record drop, government data showed.

The Nomura/JMMA Japan Manufacturing PMI fell to a seasonally adjusted 52.4 in March from 52.5 in February. The index for new export orders rose to 55.7 from 55.2 in the previous month, hitting the highest level since May 2004. Housing starts fell 9.3 percent in February from a year earlier, much more than the median estimate for a 0.8 percent annual decline.

Separately, Japanese government bond futures fell to a 4-1/2 month low in late trading on speculation Japan Post Bank may buy less government debt in the new fiscal year starting on April 1, market players said.

NEXT UP

U.S. investors ease back on stocks in favor of bonds

U.S. fund managers slightly decreased their high exposure to equities in March and raised their bond allocations on signs the economic recovery continues to be slow-moving, a Reuters poll showed. Based on 12 U.S.-based fund management firms surveyed Mar. 16-30, the poll found they held an average of 64.6 percent of assets in equities, compared with 66.2 percent a month earlier, which was a post-crisis high. The equities allocation had been 65.0 percent in December. Money managers in the Reuters poll have loaded up on equities over the past several months and reaped big returns. Now, poll participants are taking some profits while fixed-income markets have become the beneficiaries of new cash. Rising Treasury yields are enticing value investors, but unsettling equity managers. But Treasury yields have recently been rising on investors' lack of enthusiasm for new government sales. The poll showed managers raised fixed-income holdings to an average of 30.0 percent, from a 29.1 percent average in February. The average cash allocations remained the same for both February and March at 1.7 percent, while alternative assets rose to 2.4 percent in March, from 1.7 percent the previous month.

Improvement seen in U.S. manufacturing, services

The U.S. manufacturing sector is expected to have expanded in March for an eighth straight month, and the vast services sector likely also grew, suggesting ongoing improvement in the U.S. economy.

The median Reuters forecast for the ISM's manufacturing index is 57.0, while the median forecast for the non-manufacturing ISM is 53.5. The manufacturing sector has been growing steadily since August, 2009, though momentum did slow slightly in February, when the index came in at 56.5. A steady improvement was expected for March, partly due to more clement weather. The services sector has been slower to move back into expansionary territory, the result of a weak labor market that has caused consumers to be a bit more cautious with their credit cards. The highest forecast for manufacturing ISM was 59.0 and the lowest was 54.0 among the 63 analysts polled. For the services ISM, the highest forecast was 55.0 and the lowest was 51.0. Investors will likely focus on the employment component of the two indexes as they try to assess the strength of underlying employment trends ahead of March's payrolls report due out at the end of the week.



DEEP DIVE Commentary and Analysis

FACTBOX-Fed's exit strategy toolkit

The U.S. Federal Reserve formally ends on Wednesday its program of buying around \$1.4 trillion of mortgage-related debt. Officials have signaled that if the recovery continues, their next steps will be to withdraw its unprecedented levels of support for the economy.

Below are tools the Fed could use when it decides the time has come to tighten policy.

PAYING INTEREST ON EXCESS RESERVES

The interest rate the Fed pays on excess reserves will be the one to watch once the central bank begins to raise borrowing costs.

By raising the rate it pays on bank reserves, the Fed creates a magnet for banks to keep those reserves with the Fed rather than lend them out.

"By increasing the interest rate on reserves, the Federal Reserve will be able to put significant upward pressure on all short-term interest rates, as banks will not supply short-term funds to the money markets at rates significantly below what they can earn by holding reserves at the Federal Reserve Banks," Ben Bernanke, the U.S. central bank chairman, said in testimony to lawmakers on March 25.

A number of central banks around the world have effectively used similar tools.

LARGE-SCALE REVERSE REPURCHASE AGREEMENTS

The Fed could arrange large-scale reverse repurchase agreements (reverse repos), with financial market participants. They would temporarily drain reserves from the banking system and reduce excess liquidity at other institutions.

Reverse repos involve the sale by the Fed of securities from its portfolio with an agreement to buy them back at a slightly higher price at a later date.

The New York Fed's open market desk last year tested its ability to conduct term reverse repos with primary dealers -- its usual dealing partners -- using agency debt and Treasuries.

Minutes from the Fed's January policy meeting showed Fed staff expect the central bank will be able to conduct reverse repos using mortgage-backed securities as collateral "early this spring."

Bernanke has said the Fed has been working to expand its range of counterparties for reverse repos beyond primary dealers.

TERM DEPOSIT FACILITY

The Fed has proposed creating a new "term deposit facility" for banks, similar to certificates of deposit that banks offer retail customers. Like the reverse repos, this would reduce the supply of funds banks have available to lend to each other.

While the Fed already pays interest on reserves held overnight, a term deposit facility would lock up funds for longer. In its proposed rulemaking, the Fed said deposits would not exceed one year and would likely have maturities ranging between one and six months.

"The Federal Reserve would likely auction large blocks of such deposits, thus converting a portion of depository institutions' reserve balances into deposits that could not be used to meet their very short-term liquidity needs and could not be counted as reserves," Bernanke said on Feb. 10.

He said March 25 the Fed expects to conduct tests on the term deposit facility in the spring and to have the facility up and running if necessary afterward.

The minutes of the January meeting showed that staff expect the facility to be operational as soon as May.

ASSET SALES

The Fed could sell a portion of its securities holdings into the open market.

"The redemption or sale of securities holdings would have the effect of reducing the size of the Federal Reserve's balance sheet as well as further reducing the quantity of reserves in the banking system," Bernanke said on March 25.

He said in February he did not anticipate the Fed will sell any of its security holdings in the near term, at least until after policy tightening has gotten under way and the economy is clearly in a sustainable recovery.

However, he omitted that language last week, leading some to conclude he may be more open to asset sales.

Other Fed policymakers hold a more favorable view of sales. Several think it is important to begin sales in the near future to ensure the Fed's balance sheet shrinks more quickly than if it relied on prepayments and redemptions of maturing securities.

DISCOUNT RATE INCREASE

The Fed in February raised the discount rate -- the rate it charges banks for emergency loans -- to 0.75 percent from 0.5 percent. It stressed this move reflects healing financial markets and was not a step to tighten lending conditions.

The Fed has said it is studying whether further increases in the spread between the discount rate and the fed funds rate would be appropriate.

Agency MBS buffered by loan buyouts after Fed exit

By Julie Haviv

Goodbye, Federal Reserve. Hello Fannie and Freddie.

With the U.S. Federal Reserve ending its 15-month \$1.25 trillion mortgage bond buying binge on Wednesday, delinquent loan buyouts by Fannie Mae and Freddie Mac could serve as the saving grace for the \$5 trillion agency mortgage-backed securities market.

The paydowns from these buyouts will put billions into the hands of mortgage investors for reinvestment and significantly reduce supply, mitigating the massive void the central bank will leave behind and helping keep yield spreads near record tight.

That is good news for the U.S. housing market since it should keep mortgage rates, which are linked to yields on Treasuries and yields on mortgage-backed securities, at historically low levels.

The timing is everything as the housing market enters its most important period -- the spring selling season -- and struggles to regain its old self as data shows growth has been anything but resurgent.

The delinquent loan buyouts of \$200 billion by Fannie Mae and Freddie Mac, first announced in February, will put about \$140 billion of cash into private investors' hands, according to Matthew Jozoff, managing director and head of mortgage strategy at JPMorgan in New York.

At the same time, these buyouts will remove about \$200 billion of net supply from the market, his team said.

"This 'double-whammy' is powerful, and effectively extends the Fed involvement several months from their official end date," they said.

LESS SUPPLY, LOW RATES

The Federal Reserve has plowed billions per week into the agency MBS market since early 2009 in an effort to bring down mortgage rates and to stimulate the battered housing sector and the overall economy.

"The (Fannie and Freddie) buyouts should help take supply out of the marketplace, so in our view, the technicals have lined up



DEEP DIVE Commentary and Analysis

to make the Fed exit go smoother than otherwise would have been expected," said Joe Ramos, lead portfolio manager on the U.S. fixed income team at Lazard Asset Management in New York.

"While reinvestments from paydowns will not be big enough to fully offset the buying by the Fed, it should help keep prices firm," he said.

Mortgage rates play a crucial role in housing affordability. February home sales data points to a sector that has hit a lull after showing signs of a recovery late last year. New home sales fell for a fourth straight month, reaching a record low, while existing home sales fell for a third straight month.

Interest rates on 30-year fixed-rate mortgages, currently around 5 percent, will probably drift higher throughout 2010, ending the year at over 5.5 percent, according to Mark Zandi, chief economist at Moody's Economy.com, in West Chester, Pennsylvania.

"The current 5 percent fixed rate has been key to keeping the housing market together as well as it has been kept together," he said. "That the housing market is so weak despite the low rates suggests how strong the headwinds are to the housing market, including the tough job market, tougher underwriting standards, and the ongoing foreclosure crisis."

Mortgage rates will likely be buffered over the next few months

as the majority of the paydowns get reinvested, but investors will also likely keep some cash as well, according to Janaki Rao, vice president of mortgage research at Morgan Stanley in New York.

"The initial reaction to the buyout news indicated a rush towards the lower coupons as investors rushed to safeguard against faster prepaids," he said.

While reinvestments are certainly a strong positive for agency MBS, a confluence of other factors should keep agency MBS firm as well. A buildup of cash, solid deposits and weak loan growth should foster strong bank demand for agency MBS going forward.

Furthermore, many money managers who were underweighted the sector for much of the past year amid lofty valuations are expected to buy on even modest cheapening. That, coupled with low supply, will offset the Federal Reserve's absence from the agency MBS market.

"We do not see things changing in a major way, perhaps 10 to 20 basis points of widening without demand from the Fed," Lazard's Ramos said.

"Demand from asset managers will likely have the largest impact on prices after the Fed exit," he said.

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