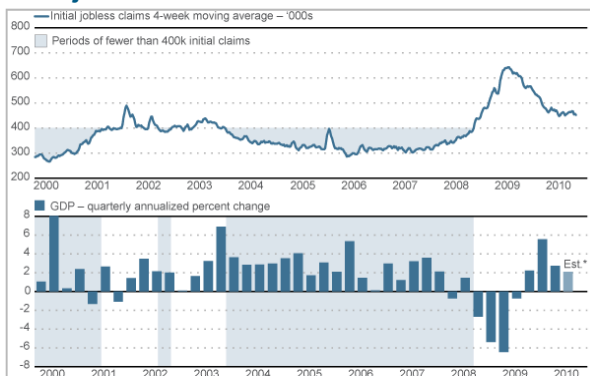


CHART OF THE DAY

U.S. jobless claims



Initial claims fell last week 11,000 to 457,000 but remain above the 400k level which economists associate with a recovering economy. The economy has been growing but at a slower pace.

TODAY'S TOP NEWS

- Fed's Bullard-buy more Treasuries if prices dip
- U.S. unemployment claims fall, but still elevated
- Republicans block small business plan in Senate
- Moody's says U.S. needs debt plan to keep rating-DJ
- U.S. 7-year debt auction attracts weak demand
- Euro zone economic sentiment rises to 28-month high
- China eyes gradual fiscal exit, no rate rise -IMF
- BP pushes on with asset sales in Asia, Latam

ECON WATCH

FOR FRIDAY JULY 30

ET	Indicators	Unit	Reuters	Prior
02:00	DE Retail Sales-real mm	%	-0.2	3.0
02:00	DE Retail Sales-real yy	%	1.9	-0.7
05:00	EZ Inflation, flash yy	%	1.7	1.4
05:00	EZ Unemployment rate	%	10.0	10.0
05:00	IT CPI prelim mm	%	0.2	0.0
05:00	IT HICP prelim mm	%	-0.9	0.1
08:30	CA GDP by industry mm	%	0.1	0.0
08:30	US Real GDP qq	%	2.5	2.7
08:30	US Implicit Deflator	%	1.0	1.1
08:30	US Final Sales	%	1.8	0.8
08:30	US Core PCE Prices	%	1.0	0.7
08:30	US PCE Price index	%	0.3	1.6
08:30	US Employment Costs	%	0.5	0.6
09:55	US Reuters/UMich Sent	ind	67.0	66.5
09:55	US Current Conditions	ind	76.0	75.5
09:55	US Expectations	ind	61.3	60.6

MARKETS TODAY

TODAY'S TOP STORY: The U.S. Federal Reserve should consider buying more Treasury securities, instead of promising an extended period of low rates to support recovery, should inflation drift lower, a top Fed official said. **For more please click here**

TREASURIES: Longer-dated U.S. Treasury prices fell, while debt in the middle of the yield curve rose, following a wobbly auction of seven-year notes.

- The 7-year sale attracted bids worth 2.78 times the amount on offer. That was below their six-month average of 2.86 and lowest since 2.61 in March.
- 30-year bonds lost 3/32 yielding 4.08 pct.
- 10-year and 2-year notes rose 2/32 to yield 2.99 pct and 0.59 pct respectively.
- 2-10's part of the yield curve steepened by about 1 bps to 240 bps.

FOREX: The euro broke above \$1.3100 to a 12-week high against a broadly weaker dollar as supportive European data prompted investors to bet the European economy is on a better track compared with the U.S.

- Euro rose 0.69 pct to \$1.3076, earlier it reached a level strongest since May 4.
- Dollar fell 0.62 pct against the yen to 86.8 yen while euro gained 0.08 pct to 113.52 yen.
- New Zealand dollar gained 0.49 pct to \$0.7239. Australian dollar climbed 1.03 pct to \$0.8999. Sterling advanced 0.13 pct to \$1.5609.

CORPORATES: U.S. corporate bond spreads were broadly steady after the previous session's profit-taking, as investors took a measured view of corporate earnings and the economy.

- U.S. corporate bond spreads tightened by about 1 bps to 104 bps.
- McDonald's paid just 3.5 pct to sell 10-yr notes yesterday, the lowest coupon ever for a 10-yr corporate bond. Kimberly-Clark, Duke Energy Indiana, Target and Oracle also sold debt this month with coupons under 4 pct.

STOCKS: U.S. stocks sagged in volatile trading after weak outlooks from technology companies and downbeat comments from a Federal Reserve official gave investors little reason to buy.

- Dow shed 0.3 pct to 10,466.85, S&P was down 0.42 pct at 1,101.50 and Nasdaq lost 0.67 pct to 2,251.69.
- Nvidia was down 9.87 pct and Symantec shed 11.18 pct.
- Exxon Mobil fell 0.95 pct, while Kellogg shed 6.87 pct.
- The PHLX semiconductor index fell as much as 2.8 pct, its largest percentage decline in nearly two weeks, taking the index near its 200-day moving average. The index last traded down 1.93 pct.

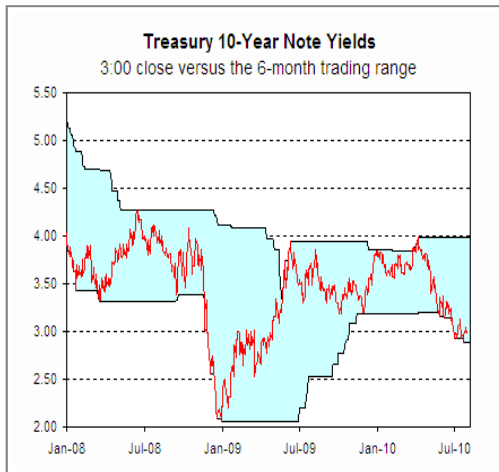
C & E: Oil prices rose as the dollar weakened to a 12-week low against the euro, boosting demand for oil priced in dollars, and after European data showed eurozone economic sentiment has improved.

- U.S. crude oil rose 1.68 pct to \$78.28 per barrel.
- Gold rose 0.47 pct to \$1,168.05 an ounce.
- Reuters-Jefferies index gained 1.52 pct to 270.2.

- 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	0.150	0.12	0.152	-0.011
3-Mo Bill	0.150	0.140	0.152	0.003
6-Mo Bill	0.200	0.195	0.203	0.002
1-Year	0.290	0.280	0.295	0.000
2-Year	100.031	100.063	0.610	0.023
3-Year	100.258	100.289	0.912	0.090
5-Year	100.203	100.250	1.708	0.133
7-Year	100.672	100.719	2.394	0.070
10-Year	104.156	104.219	3.007	-0.141
30-Year	104.969	105.047	4.085	-0.313

EQUITIES

	INDEX	CHANGE
DJIA	10494.78	-3.10
NASDAQ	2263.10	-1.49
S&P 500	1104.55	-1.58

OIL

	PRICE	CHANGE
NYMEX	78.4	1.4
BRENT	76.4	1.1

EURODOLLAR FUTURES

	CLOSE	CHANGE
Aug-10	99.578	0.018
Sep-10	99.585	0.010
Dec-10	99.540	0.015
Mar-11	99.460	0.015

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.290	O/N	0.300
2-Week	0.280	2-Week	0.300
1-Month	0.290	1-Month	0.290
3-Month	0.310	3-Month	0.310
AGENCY REPOS		i-REPO SM INDEX	
O/N	0.290	10:00 AM	0.220
2-Week	0.290	3:00 PM	0.208
1-Month	0.290		
3-Month	0.300		

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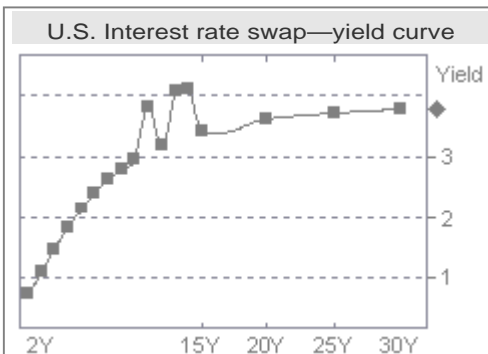
	SPREAD		RATE	
2-Year	15.00	19.00	0.75	0.78
3-Year	19.25	23.25	1.10	1.12
5-Year	13.75	17.75	1.84	1.85
7-Year	3.50	7.50	2.43	2.43
10-Year	-5.00	-1.00	2.96	2.96
30-Year	-33.00	-29.00	3.75	3.74

FUTURES

	PRICE	CHANGE
CBOT 5 yr	119.12	0.23
CBOT 10 yr	123.23	0.03
CBOT 30 yr	128.00	-0.13

EURODOLLAR DEPOSITS & OIS STRIPS (ASKED)

	BID	ASK	BID	ASK
O/N	0.200	0.240	-	-
1-Month	0.300	0.400	0.190	0.200
3-Month	0.400	0.600	0.190	0.200
6-Month	0.550	0.700	0.189	0.199
12-Month	0.900	1.200	0.245	0.255



CURRENCIES

	BID	ASK
Euro	1.3076	1.3078
Sterling	1.5614	1.5618
JP Yen	86.91	86.94
Swiss Franc	1.0419	1.0422
Can Dollar	1.0353	1.0356
Mexico	12.6973	12.7034

FED FUNDS NYFRSM - 10AM

Open	0.2000	1m	0.3124
High	0.2000	3m	0.4729
Low	0.1400		

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	1.125	30/07/2012	9 8	0.69
3-Year	1.625	15/04/2013	3.5 2.5	0.94
5-Year	2.375	28/07/2015	17.5 16.5	1.88
7-Year	5.125	18/10/2016	4 -	2.43
10-Year	-	-	- -	4.59
30-Year	6.625	15/11/2030	29 27	4.37

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD	YIELD
2-Year	1.125	27/07/2012	10 9	0.7
3-Year	1.25	20/08/2013	17.5 17	1.08
5-Year	2.875	09/02/2015	2 -	1.72
7-Year	5.25	15/09/2016	1 -	2.4
10-Year	3.75	27/03/2019	7 -	3.07
30-Year	6.25	15/07/2032	31.5 28.5	4.4

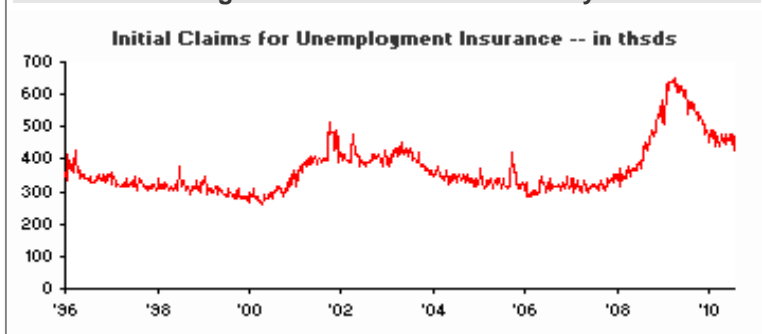
Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	4.0	104.1060	104.1120	2.709
FHLMC	4.0	104.1060	104.1120	2.688

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	4.5	104.0860	104.0920	2.936
FHLMC	4.5	104.0660	104.0720	2.914
GNMA	4.5	105.0660	105.0720	3.267

Wrightson ICAPSM Chart of the Day



TODAY'S TOP NEWS

Fed's Bullard-buy more Treasuries if prices dip

The U.S. Federal Reserve should consider buying more Treasury securities, instead of promising an extended period of low rates to support recovery, should inflation drift lower, a top Fed official said.

St. Louis Federal Reserve Bank President James Bullard said he is worried about the risks the United States could fall into a Japan-style quagmire of falling prices and investment that is hard to get out of.

"The FOMC's extended period language may be increasing the probability of a Japanese-style outcome for the U.S., and on balance, the U.S. quantitative easing program offers the best tool to avoid such an outcome," he wrote in a research paper, referring to the central bank's policy setting group, the FOMC.

The Fed's long-running promise to hold benchmark rates exceptionally low for an extended period -- which is aimed at spurring growth -- could lead businesses and consumers to anticipate slight deflation ahead, the St. Louis Fed chief said.

Bullard said he continues to view the most likely course for the U.S. economy as a gradual recovery and that more easing of financial conditions will not be necessary. But he said the Fed should be prepared for further actions if unexpected shocks materialize.

U.S. Republicans block small business plan in Senate

U.S. Senate Republicans blocked a \$30-billion plan to help community banks boost lending to small businesses, dealing a blow to President Barack Obama's election-year battle to reduce unemployment.

Temper ran high as Democratic leaders failed to muster the 60 votes needed to advance the measure over Republican objections. Republicans were upset that Democrats shut them out from amending the package that also includes about \$12 billion in tax breaks for small businesses.

Obama twice this week called for the Senate to pass the bill. He wants to show Americans he is focused on job creation. An earlier Democratic effort to pass a jobs package that included money for cash-strapped states and extended some expired individual and tax breaks was also blocked in the Senate by Republicans who argued that the extra spending should be covered by cuts elsewhere in the budget.

Obama has been pushing for passage of the lending measure arguing that getting more capital into the hands of independent community bankers would lead to more small business loans.

U.S. 7-year debt auction attracts weak demand

The U.S. government sold \$29 billion worth of seven-year debt in a poorly bid auction as unattractively low yields produced the weakest demand for this maturity since March.

The seven-year sale, the final of this week's three bond offerings totaling \$104 billion, attracted bids worth 2.78 times the amount on offer. That was below their six-month average of 2.86 and lowest since 2.61 in March.

Primary dealers took almost half of the sale, compared to their six-month average of around 39 percent. Foreign central bank and large institutional investor demand appeared soft compared to recent offerings, based on the indirect bidder category which accounted for 42 percent of the sale. This was well below the average of almost 55 percent in the auctions since June 2009, which has become a benchmark for comparisons because of changes in calculations that affected this category.

The recently growing direct bid accounted for about nine percent of the sale, below the six-month average of nearly 12 percent.

U.S. unemployment claims fall, but still elevated

New U.S. claims for unemployment benefits slipped last week, but stayed at a stubbornly high level that underscored the labor market recovery was having trouble gaining traction.

Initial claims for state unemployment aid dropped 11,000 to 457,000, the Labor Department said, a touch more than the fall to 459,000 that financial markets had forecast.

Sluggish jobs growth, marked by a 9.5 percent unemployment rate is a recovery that has shown signs of wilting in the last couple of months. A U.S. government report tomorrow is expected to show growth slowed to a 2.5 percent annual rate in the second quarter from a 2.7 percent pace in the first three months of the year. In the week ended July 17, 4.57 million people were still receiving jobless benefits after an initial week of aid, up 81,000 from the prior week. Meanwhile, Fixed U.S. mortgage rates set record lows last week for the sixth straight week, keeping affordability high for borrowers who can get loans, home funding company Freddie Mac said. Refinancing has picked up steam but the pace remains well below last year's peaks when rates were similarly low.

Moody's says U.S. needs debt plan to keep rating-DJ

The U.S. government needs to elaborate a credible plan to address its soaring debt in order to maintain its Aaa credit rating, Moody's Investors Service's told Dow Jones newswire.

If U.S. government budget projections for debt as a percentage of national output and interest payments as a percentage of revenue are realized in coming years, the country's Aaa rating would come under scrutiny, Steve Hess, a senior credit officer in the sovereign risk group at Moody's told Dow Jones Newswires in an interview. Such a scenario, however, wouldn't lead to an automatic downgrade, Hess said. The U.S. rating remains on a stable outlook at Moody's.

Separately, uncertainty over tax policy and new regulations is hindering U.S. businesses, making any potential further monetary accommodation by the Fed likely ineffective, a top Federal Reserve official said. Calling price stability the Fed's "ultimate goal," Richard Fisher said the U.S. central bank will not tolerate either inflation or deflation.

Euro zone economic sentiment rises to 28-month high

Euro zone economic sentiment rose strongly in July, buoyed by figures from Germany that point to a recovery as the currency area overcomes the sovereign debt crisis, though the outlook remains uncertain.

The European Commission said its economic sentiment indicator for euro zone currency area rose to 101.3 in July, a 28-month high, from an upwardly revised 99.0 in June.

The Commission said economic sentiment improved thanks to an increase in the index for the export-driven industrial sector to -4 from -6 and improvement in services to 6 from 4. Morale of consumers rose to -14 from -17.

The Commission's separate business climate indicator for the euro zone increased more than expected, rising to 0.66 in July from 0.40 in June. It was the highest reading since March, 2008. Separately, German unemployment fell by a seasonally adjusted 20,000 month-on-month in July to 3.211 million, its lowest level since November 2008, declining for the 13th consecutive month. Business sentiment in Italy's manufacturing sector rose in July to 98.3 from an upwardly revised 96.3 in June, its highest level in two years.

[Click here](#) for an interactive graphic on key global economic and cyclical indicators.

TODAY'S TOP NEWS

China eyes gradual fiscal exit, no rate rise -IMF

Subdued inflation is reducing the need for higher interest rates in China, which intends to withdraw its fiscal stimulus gradually, IMF said.

Chinese policymakers said that debt strains in Europe had increased their worries about the global economic recovery, making them more cautious about unwinding anti-crisis measures.

For the most part, the report is glowing. China, it said, "is contributing greatly toward ensuring strong, sustained, and balanced global growth". Central bank officials, responding to the IMF's call for less reliance on credit quotas, indicated they were fully committed to a greater use of indirect monetary policy instruments. On fiscal policy, officials told the fund that they had yet to decide their stance in 2011. Any eventual withdrawal of stimulus would be "measured and gradual", but over the longer term they wanted to return to a balanced budget.

BP pushes on with asset sales in Asia, Latam

BP pushed ahead with plans to sell assets in Vietnam, Colombia and Venezuela, as it scrambles to hive off \$30 billion of assets to pay to clean up the worst oil spill in U.S. history.

The planned sales also aim to create a leaner company with the potential for higher growth.

BP has hired advisers to sell its stakes in oil fields and gas projects in Colombia and Vietnam, according to separate sources familiar with the matter. And Russia's TNK-BP said it was considering buying BP's Venezuelan interests, which analysts value at \$850 million to \$1 billion. BP has hired Barclays Capital to sell its Colombian assets, according to two people familiar with the matter. Analysts value that business, based around the Cusiana and Cupiagua fields, at \$1.5 to \$2 billion.

In Moscow, a TNK-BP spokesman told Reuters it was "actively evaluating the opportunity to participate in the assets," and said a deal "would be beneficial for both companies and would foster further development of Venezuela's oil sector".

Three other people familiar with the situation said the British oil giant recently tapped HSBC to sell its stake in the Nam Con Son gas project in Vietnam.

Hungary bond auction strong as investor view improves

Hungary drew better demand than expected at bond auctions, less than two weeks after halting talks with the IMF and EU, and traders said the markets took the view that Hungary's finances still looked good despite the policy uncertainty.

Hungary's government cut its 3-year bond offer by 5 billion forints but raised its longer, 5-year and 15-year bond offers by a combined 12.5 billion forints.

At a non-competitive top-up auction the government sold further 8 billion forints worth of five-year bonds and 2.6 billion forints worth of 15-year bonds.

The average yield on the 5-year 2016/C bond fell to 7.14 percent from 7.22 at an auction two weeks ago and the 15-year yield dropped to 7.09 percent from 7.10 at the last auction of this instrument in early May.

The 3-year 2014/C paper was sold at 7.13 percent. Separately, Euro zone peripheral bellwether Italy drew solid demand as it sold nearly 9.5 billion euros of fixed and floating rate bonds, nudging down yields in another sign that appetite for peripheral bonds is returning.

Soft UK mortgage data point to housing market weakness

British mortgage approvals fell more than expected in June and lending came in weaker than forecast, BoE figures showed, suggesting the housing market will continue to soften.

The central bank said mortgage approvals numbered 47,643 in June, falling from a downwardly revised 49,461 in May and below forecasts for a reading of 49,000.

Net mortgage lending growth eased to 665 million pounds (\$1.04 billion) in June from 838 million pounds in May, below forecasts for 1.0 billion pounds.

And consumers unexpectedly repaid 98 million pounds of unsecured credit.

Separate figures showed the BoE's preferred money supply gauge slowed markedly in June, rising by just 0.2 percent on the month, the lowest since January.

On a three-month annualized basis, lending on this measure eased to 6.0 percent in June from 8.9 percent in May.

NEXT UP

Cautious funds grab corp debt for yield-Reuters poll

Caution remained the watchword for leading investors in July although a search for yield drove many into top quality corporate debt, Reuters asset allocation polls showed.

U.S. fund managers lifted their exposure to equities and corporate bonds slightly in July. The poll of 12 U.S.-based fund management firms found they held an average of 65.0 percent of their assets in equities, compared with 64.8 percent a month earlier. Bond exposure rose to 29.8 percent from 29.5 percent. Cash dropped to 2.0 percent from 2.2 percent.

Japanese fund managers cut their weightings for equities to the lowest in more than 11 years and moved into cash.

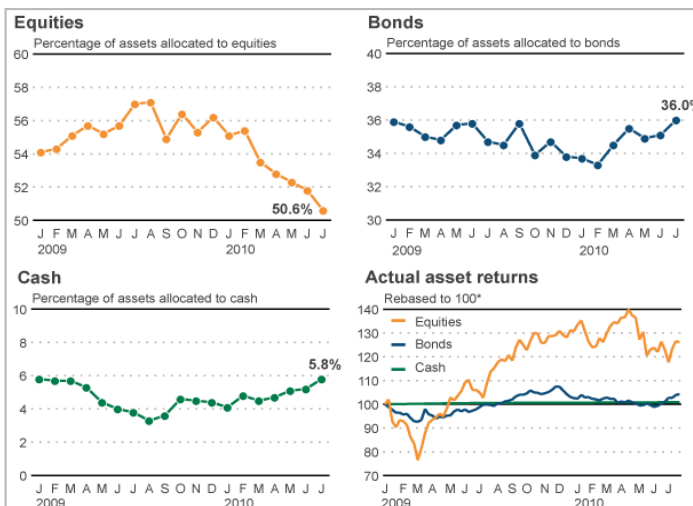
The Reuters poll of 13 fund managers showed an average weighting for equities at 44.2 percent. The bond weighting fell to 48.2 percent in July and cash positions jumped to 4.7 percent.

The poll of 15 Europe ex UK asset management firms showed a typical mixed portfolio holding 40.6 percent in bonds this month. The allocation to equities stood at 46.8 percent.

British fund managers continued to seek out the security of cash and bonds while equities remained relatively out of favor.

The survey of 11 fund managers showed exposure to cash,

bonds and property increased since the previous month. Equity holdings were 46.4 percent compared with 49.2 percent, bonds rose to 25.5 percent from 24.5 percent and cash also rose, to 9.6 percent from 8.7 percent.



DEEP DIVE Commentary and Analysis

FACTBOX

Obama pushes for small business lending plan

President Barack Obama is urging the Senate to pass a proposal that would provide \$30 billion in capital the government could invest in independent community banks to increase lending to small businesses.

The House of Representatives last month passed its version of the bill, which provides for federal investments in independent banks with assets less than \$10 billion. Supporters say the lending fund would support as much as \$300 billion in new loans to small businesses, which account for a large portion of job creation in the U.S. economy.

Small businesses have been struggling to get loans since the financial crisis dried up credit availability.

Critics call the plan another government bailout for businesses similar to the \$700 billion Troubled Asset Relief Program, which was used to prop up Wall Street firms during the 2008-2009 financial crisis.

Here are the details of the proposed bill:

SMALL BUSINESS LENDING FUND

The Senate bill, like the version passed by the House, would establish a \$30 billion fund to provide capital to small community banks to prompt small business lending. Only banks with less than \$10 billion in assets will be eligible. More than 90 percent of eligible banks have less than \$1 billion in assets. Banks would pay a 5 percent dividend on the government capital investments. But dividend payments would decrease to as low as 1 percent as banks increase small business lending relative to a 2009 base level. Banks that do not increase their small business lending in the first two years after receiving the capital are to pay a 7 percent dividend.

OTHER PROVISIONS IN THE PROPOSED SENATE BILL

The Senate bill provides \$1.5 billion to support existing state small business credit initiatives. An earlier version provided \$900 million. The House bill provides as much as \$2 billion to help state initiatives.

Small Business Administration loan limits would be increased in the Senate bill to \$5 million from \$2 million. SBA limits for its 504 lending program for commercial real estate projects would be increased to \$5.5 million from \$1.5 million. Loan limits for microloans would rise to \$50,000 from \$35,000.

To encourage investments in small businesses, the bill would exclude some small business stock sales from capital gains taxes. The stock must be held for more than five years.

Small business deductibles for start-up costs would be doubled to \$10,000.

Small businesses would be able to immediately expense up to \$250,000 in capital spending. The bill also extends through 2010 tax provisions that allow all businesses to more quickly write off purchases of new equipment and other depreciable property.

The bill frees up capital by allowing small businesses to carry back general business tax credits to offset taxes paid over the previous five years, instead of the current one year carry back. Anything left over can be carried forward for 20 years.

The cost of the lending provisions and the roughly \$12 billion in business tax breaks are to be offset by a number of revenue-raising provisions aimed at clarifying and tightening tax rules.

The bill also includes a provision that would eliminate advance payments for people eligible for the earned income tax credit.

The bill would tighten eligibility rules on the cellulosic biofuel producer tax credit to exclude highly corrosive fuels such as crude tall oil which is a by-product of paper manufacturing.

A provision was added to provide about \$1.5 billion in assistance to farmers for crop losses in 2009.

Banks rethink may prompt investor return from junk

By Natsuko Waki

Investors wary of investment grade corporate bonds because of a heavy presence of banks in them may have a rethink thanks to greater clarity surrounding European banks, prompting a switch back from high-yield debt.

High-yield bonds -- typically riskier paper rated below investment grade -- have been a hot credit asset over the past year as it was an "ex-banks" trade for those who were worried about the fallout from Europe's sovereign debt crisis.

This resulted in a rush of funds into the so-called junk space, with fund tracker EPFR estimating nearly \$6 billion had flown into a broader high-yield bond universe since January.

However, the tide may be turning in favor of higher-quality investment grade after last week's European bank stress tests were conducted without incident and banking regulators scaled back proposals to beef up global bank capital and liquidity rules.

"High yield has outperformed basically because it was not banks. That was pretty much the best thing you could say about the asset class," said Christian Dinesen, head of international corporate credit research at Bank of America Merrill Lynch.

"But for the rest of the year, senior financials should, particularly after this benign result of the stress test, have a pretty good run. High-yield is okay but ... risk-return wise investment grade is probably better."

A Reuters poll of global asset managers published on Thursday showed exposure to investment grade bonds rose to 22.6 percent in July from 19.7 percent in June. High yield debt was less popular.

Until now, investment grade bonds have struggled this year, especially in Europe, where more than one in two issues come from banks.

European high-grade corporate issues, which have sovereign-like ratings in the investment grade space, returned 0.7 percent less than benchmark governments this year, BofA Merrill estimated.

In contrast, junk debt gave an excess return over government bonds of 0.94 percent in the same period.

Based on prices, global junk debt rose 22.7 percent over the past year while top-rated corporates gained 7.3 percent.

BofA Merrill forecasts spreads of high grade European debt to tighten 27 basis points from current levels to 202 bps towards the year end, giving an excess return over government bonds of 1.5 percent.

Goldman Sachs expects spreads of triple-B issues -- the riskiest segment within the investment grade space -- to hit 175 bps this year, their lowest since late 2007.

The positive performance outlook comes against a backdrop of falling default rates. According to Standard & Poor's, the 12-month rolling default rate for global investment grade paper stands at just 0.21 percent, down from 0.41 percent in 2008.

"We remain confident in investment grade, this is one of our clear risk trades. The risk rewards are clearly tilted towards the positive side. On HY, valuation is a little bit too stressed," said Franz Wenzel, senior strategist at AXA Investment Partners in Paris.

A Fitch survey of 85 asset management houses showed investment grade financials moved to the top slot for most favored credit investment choice, with 21 percent of investors picking them, versus 14 percent for emerging market firms.



DEEP DIVE Commentary and Analysis

HIGH YIELD RISKS

High-yield debt by definition gives a higher return than investment grade bonds, but it carries a bigger risk of default and loss on principal and interest.

Furthermore, supply risk appears to be higher in the junk universe. Citi expects high yield to be the only key market where issuance is likely to be higher than 2009 and to be one of the highest in the past 10 years, at over \$200 billion.

Investment grade bonds can also be appealing when compared with equities, especially for those who are looking to increase exposure in the banking sector. Apart from its intrinsic structure that is safer than equity, valuation is one reason.

Generally speaking, investment grade credit has lagged equities in recovering from a May sell-off.

The credit derivatives swap index for most-liquid investment grade issues in Europe, measured by the iTraxx, fell 26.4 per cent since its May risk aversion peak. The VIX that measures equity option volatility more than halved.

"When you're investing in credit, all you care about is to get your money paid back," Dinesen said.

"When it comes to comparing banks in terms of equity and credit, in a scenario like this, you're likely to get the performance first in credit, then in equities."

INSIDE DEBT is produced by Reuters in partnership with ICAP.

(Compiled by Anil Kumar, Pronita Naidu and Mowna Ravikumar in Bangalore)

For questions or comments about this report, email us at: inside.debt@thomsonreuters.com or contact Chandra Ramarathnam on +91 80 4135 5899

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