

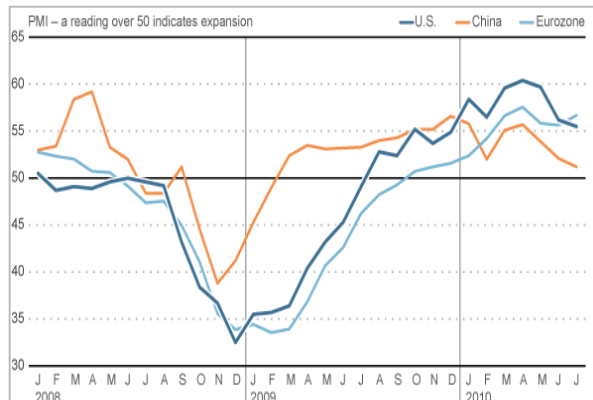
INSIDE DEBT

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Monday, August 2, 2010

CHART OF THE DAY

Global manufacturing



In July, U.S. and China manufacturing expanded at a slower pace than in June, but euro zone expansion accelerated.

TODAY'S TOP NEWS

- U.S. manufacturing slows in July for 3rd month
- Economy still short of full recovery-Bernanke
- Geithner aims to calm Wall Street on rules
- U.S. Treasury to borrow \$350 bln in July-Sept qtr
- U.S. Democrats' small business bill may pass-senator
- ECB continues to slow government bond buying
- HSBC, BNP profits beat view after bad debts tumble
- Output grows in U.S., Euro zone; China slows
- SEC probes BP as it poised to "kill" Gulf well

ECON WATCH

FOR TUESDAY AUGUST 3

ET	Indicators	Unit	Reuters	Prior
5:00	EZ Producer prices mm	%	0.4	0.3
5:00	EZ Producer prices yy	%	3.1	3.1
8:30	US Personal income	%	0.2	0.4
8:30	US Personal cons	%	0.1	0.6
8:30	US PCE price index	%	-	0.0
8:30	US Core PCE price ind	%	0.1	0.2
10:00	US Factory orders mm	%	0.7	-1.4
10:00	US Durable goods	%	-	-1.0
10:00	US Ex-transportation	%	-	-0.6
10:00	US Ex-defense	%	-	-0.7
10:00	US Nondefense ex-air	%	-	0.6
10:00	US Pending homes sales	%	0.6	-30.0
-	US Domestic car sls	mln	3.88	3.767
-	US Domestic truck sls	mln	4.88	4.745
-	US Total vehicle sls	mln	11.50	11.1

MARKETS TODAY

TODAY'S TOP STORY: U.S. manufacturing growth slowed in July to its weakest rate this year, with measures of new orders and production also slowing. **For more please click here**

TREASURIES: U.S. Treasury prices slumped as upbeat earnings and better-than-expected factory data reduced fears of a double-dip recession, stoking a stock market rally and a sell-off in government bonds.

- 30-year bonds fell 1-13/32 to yield 4.07 pct from 3.99 pct.
- 10-year notes declined 16/32 yielding 2.96 pct from 2.91 pct, while 2-year notes were down 1/32 to yield 0.56 pct.
- 2-10's part of the yield curve steepened by 5 bps to 240 bps, while 2-30's part of curve steepened by 7 bps to 351 bps.

FOREX: The dollar fell to a three-month low against a basket of currencies on fears the U.S. recovery is faltering.

- Euro climbed 0.83 pct to \$1.3169.
- Sterling was up 1.01 pct at \$1.5884. Earlier it hit a six-month high.
- Australian dollar climbed 0.75 pct to \$0.9125, earlier hitting a three-month peak at \$0.9147.
- Against the yen, dollar rose 0.06 pct to 86.42 yen and euro advanced 0.89 pct to 113.82 yen.
- Dollar index fell 0.74 pct to 80.935, nearing its 200-day moving average.

CORPORATES: U.S. corporate bond spreads tightened, extending a four-week improving trend as strong bank earnings lifted sentiment and low interest rates prompted investors to reach for yield in corporate debt.

- U.S. corporate bond spreads tightened by 5 bps to 99 bps.
- Ford Motor rose after its rating was upgraded two notches to B-plus by S&P's. Ford's 7.45 pct bonds rose to 98 cents on the dollar.
- Nearly \$59 bln of investment-grade bonds were sold in July, up from \$44 bln in July 2009.
- More supply hit, including ArcelorMittal's \$2.5 bln deal, \$2 bln from Credit Suisse NY, \$1.5 bln from IBM and \$1 bln from Omnicom Group.

STOCKS: U.S. stocks closed at their highest in 10 weeks and the S&P 500 pierced key technical levels as a weaker U.S. dollar lifted energy and raw material shares.

- Dow gained 1.99 pct to 10,674.38, S&P rose 2.20 pct to 1,125.84 and Nasdaq added 1.80 pct to 2,295.36.
- Transocean was up 9.67 pct and Anadarko Petroleum rose 8.36 pct.
- The Philadelphia exchange oil services sector index rose 4.49 pct.
- Alcoa rose 4.83 pct to \$11.71 and Humana rose 3.51 pct to \$48.67.
- S&P auto index jumped 3.12 pct, S&P energy index rose 3.55 pct while S&P material index rose 2.65 pct. KBW bank index rose 3.15 pct.

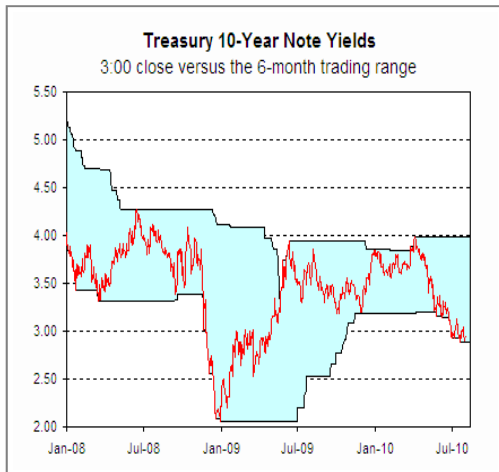
C & E: Oil rose 3 percent to break above \$80 a barrel, its highest price in nearly three months, as equity markets rose on positive economic sentiment and the dollar weakened.

- U.S. crude oil rose 3.15 pct to \$81.44 per barrel.
- Gold fell 0.03 pct to \$1,181.1 an ounce.
- Reuters-Jefferies index gained 0.91 pct to 276.85.

- 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	0.002
3-Mo Bill	0.145	0.135	0.147	0.001
6-Mo Bill	0.190	0.185	0.193	-0.003
1-Year	0.275	0.270	0.279	0.001
2-Year	100.109	100.133	0.570	-0.027
3-Year	100.445	100.477	0.847	-0.055
5-Year	100.523	100.570	1.641	-0.184
7-Year	100.156	100.203	2.351	-0.242
10-Year	104.531	104.594	2.963	-0.453
30-Year	105.328	105.391	4.065	-1.313

EQUITIES

	INDEX	CHANGE
DJIA	10678.77	212.83
NASDAQ	2297.38	42.68
S&P 500	1126.18	24.35

OIL

	PRICE	CHANGE
NYMEX	81.5	2.5
BRENT	76.4	1.1

EURODOLLAR FUTURES

	CLOSE	CHANGE
Aug-10	99.595	0.005
Sep-10	99.600	0.010
Dec-10	99.565	0.010
Mar-11	99.495	0.005

REPURCHASE AGREEMENTS

G/C		MORTGAGE REPOS	
O/N	0.330	O/N	0.330
2-Week	0.290	2-Week	0.310
1-Month	0.300	1-Month	0.310
3-Month	0.310	3-Month	0.310
AGENCY REPOS		i-REPO SM INDEX	
O/N	0.310	10:00 AM	0.270
2-Week	0.300	3:00 PM	0.272
1-Month	0.300		
3-Month	0.310		

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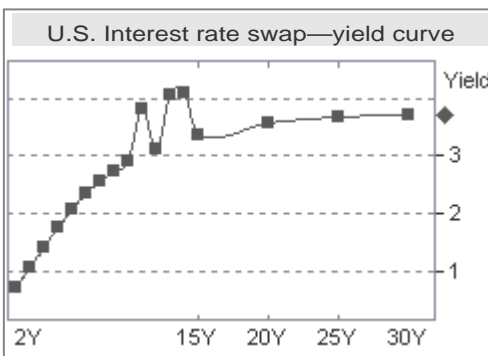
	SPREAD		RATE	
2-Year	15.25	19.25	0.72	0.75
3-Year	21.00	25.00	1.05	1.08
5-Year	13.50	17.50	1.77	1.79
7-Year	1.25	5.25	2.36	2.37
10-Year	-5.50	-1.50	2.91	2.91
30-Year	-32.75	-28.75	3.74	3.72

FUTURES

	PRICE	CHANGE
CBOT 5 yr	119.62	-0.21
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	0.210	0.240	-	-
1-Month	0.300	0.400	0.180	0.190
3-Month	0.400	0.600	0.177	0.187
6-Month	0.550	0.700	0.179	0.189
12-Month	0.900	1.200	0.227	0.237



CURRENCIES

	BID	ASK
Euro	1.3172	1.3174
Sterling	1.5884	1.5890
JP Yen	86.50	86.52
Swiss Franc	1.0395	1.0398
Can Dollar	1.0237	1.0242
Mexico	12.5758	12.5818

FED FUNDS NYFRSM - 10AM

Open	0.2300	1m	0.2931
High	0.1400	3m	0.4500
Low	0.2300		

ACTIVE FANNIE MAE AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	30/07/2012	12	11.5	0.68
3-Year	1.625	15/04/2013	6	3.5	0.9
5-Year	2.375	28/07/2015	19	18.5	1.83
7-Year	5.125	18/10/2016	-0.5	-	2.34
10-Year	-	-	-	-	4.57
30-Year	6.625	15/11/2030	29.25	26.25	4.36

ACTIVE FREDDIE MAC AGENCIES

TERM	COUPN	MATURITY	YIELD-SPREAD		YIELD
2-Year	1.125	27/07/2012	-	-	0.69
3-Year	1.25	20/08/2013	18.5	18	1.03
5-Year	2.875	09/02/2015	3	1.5	1.67
7-Year	5.25	15/09/2016	-2	-5	2.33
10-Year	3.75	27/03/2019	8	-	3.04
30-Year	6.25	15/07/2032	35	32	4.41

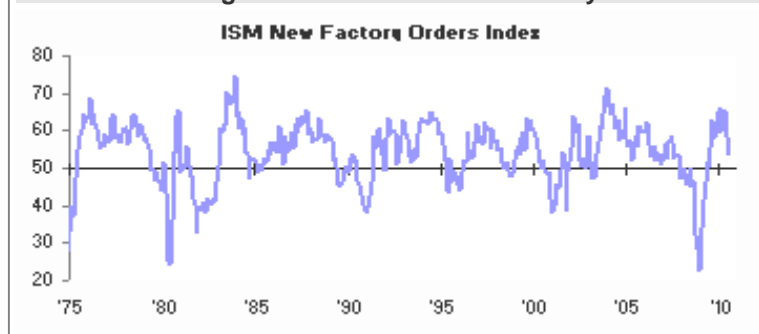
Active MBS 15YR

	CPN	BID	ASK	YIELD
FNMA	4.0	104.1560	104.1620	2.465
FHLMC	4.0	104.1520	104.1560	2.426

Active MBS 30YR

	CPN	BID	ASK	YIELD
FNMA	4.5	104.0860	104.0920	2.763
FHLMC	4.5	104.0560	104.0620	2.722
GNMA	4.5	105.0860	105.0920	3.035

Wrightson ICAPSM Chart of the Day



TODAY'S TOP NEWS

U.S. manufacturing slows in July for 3rd month

U.S. manufacturing growth slowed in July to its weakest rate this year, with measures of new orders and production also slowing. The ISM said its index of national factory activity fell to 55.5 in July from 56.2 in June, the third consecutive monthly decline. Also, the new orders index dropped to 53.5 in July from 58.5 in June to its lowest level since June 2009, while production declined to 57.0 from 61.4.

Manufacturing has been leading the recovery, which started in the second half of 2009. But economic data in recent months has signaled the pace of the recovery is slowing.

An employment component in today's ISM report rose, however, providing a positive sign ahead of last week's monthly jobs report from the U.S. government. Job growth has been the biggest hurdle for improving the economy.

Another report showed U.S. construction spending unexpectedly rose 0.1 percent in June as increased investment in public projects offset the 15th straight monthly decline in private nonresidential construction.

Because of concerns about the economic outlook, many strategists see the Fed keeping overnight interest rates near zero until the second half of next year. The U.S. central bank has said it stands ready to ease monetary policy further if the recovery withers.

Geithner aims to calm Wall Street on rules

U.S. Treasury Secretary Timothy Geithner promised not to swamp Wall Street with red tape and vowed to move quickly to put in place new rules for the financial marketplace to dispel uncertainty.

In return, he urged big banks to step up and make loans more readily available to businesses. He said the administration would seek to streamline regulation and not simply "layer new rules on top of old". But Geithner said financial firms have a responsibility too. Treasury is on a drive this week to sell the financial reform package, sending out top officials to beat the drum for the benefits that heightened consumer protection will bring. Geithner said Treasury will try to speed up the rule-making process. That would reduce the period of uncertainty for banks and other businesses but it would also mean lobbyists for the financial industry would have less time to influence the rules. Geithner said the financial overhaul was necessary.

He suggested there could be benefits for business by eliminating some old rules, though he didn't publicly specify which ones

U.S. Democrats' small business bill may pass-senator

Democrats have a chance to pass their \$30 billion bill aimed at boosting lending to small business in time for the November mid-term election, U.S. Senate Republican Leader Mitch McConnell said in an interview with Reuters.

Senate Republicans up to now have blocked the plan to authorize funds to invest in banks with assets of less than \$10 billion, to spur investment in small businesses, dealing a blow to President Obama's effort to reduce unemployment in a congressional election year. But McConnell said it still has a chance to pass once the full Congress returns from its summer recess in September. Obama has called several times for the Senate to pass the bill. He wants to show Americans he is focused on job creation, mindful that voter anxiety over the lackluster economy and the near 10 percent unemployment rate could lead to big losses for his Democratic Party at the polls.

The Congressional Budget Office estimates the bill would cost a net \$3.3 billion over 10 years.

Economy still short of full recovery-Bernanke

The U.S. economy is improving but has yet to recover fully, with high unemployment and a weak housing market leaving consumers unsettled, Fed Chairman Ben Bernanke said.

This means U.S. monetary policy must remain accommodative until the economic recovery is on a sustainable path and job creation picks up, he said. His remarks come as manufacturing data showed the sector's expansion moderating to its slowest pace since December, and ahead of a July employment report expected to show a second month of net job losses.

In a speech to state legislators that focused heavily on the problems faced by budget-strained state and municipal governments, Bernanke said constraints at the local level were also hindering the national rebound.

Bernanke said consumer spending should pick up in coming quarters, as income rises and credit conditions improve.

Inflation will remain subdued over the next couple of years, he added, citing stability in measures of inflation expectations.

With regards to banks, Bernanke said loan loss rates appeared to have peaked, but many bank balance sheets remained riddled with troubled loans. Fears about sovereign debt burdens in Europe also have contributed to financial market strains, although the public disclosure of bank stress tests appeared to have quelled anxiety, Bernanke said.

U.S. Treasury to borrow \$350 bln in July-Sept qtr

The U.S. Treasury Department said it plans to borrow \$350 billion in the July-September quarter by issuing new government bonds.

That was up modestly from the April-June period, when the Treasury issued \$344 billion in "marketable" securities, meaning those that can be resold in financial markets.

During the October-December quarter, Treasury said it expects to issue \$380 billion.

The estimates assume an end-of quarter cash balance of \$270 billion, which includes \$200 billion allocated for the Supplementary Financing Program established to help the Federal Reserve manage monetary policy.

The report comes amid a tug-of-war in Washington between Democrats, who would like to boost spending in the near-term to support a fragile economic recovery, and Republicans, who have made spending cuts a mid-term election issue.

A Treasury official said U.S. primary dealers on average expect the U.S. budget deficit to hit \$1.35 trillion for fiscal 2010, which ends on Sept. 30.

ECB continues to slow government bond buying

The ECB bought and settled just 81 million euros worth of government bonds last week it said, keeping its controversial purchase program alive, but only just.

The ECB has now spent just over 60.5 billion euros since it started buying government bonds back in early May in response to the euro zone debt crisis.

As in previous weeks, the ECB said it would offer commercial banks up to 1 percent in interest to park an equal amount of their own funds in its vaults for the next week, a move that is designed to prevent the bond purchases kicking up inflation. As usual it also said it would repeat the so-called 'sterilization' operation next week.

The ECB's weekly purchases have been dropping steadily since it launched the program. The 81 million euros spent last week compares to 176 million the week before, and is just a fraction of the 16.5 billion it spent the first week.

TODAY'S TOP NEWS

HSBC, BNP profits beat view after bad debts tumble

HSBC and BNP Paribas trumped earnings forecasts after bad debts fell sharply, more than offsetting slowing investment banking growth and lifting both shares.

The two banks showed a dip in investment banking income in the latest quarter, but more than made up for that with lower losses on personal and corporate loans as broad economic conditions improved. Half-year profits for HSBC hit \$11.1 billion, more than double the \$5 billion of a year ago. Loan impairment charges and other credit risk provisions fell to \$7.5 billion, down \$6.4 billion from a year ago to the lowest level since the start of the financial crisis. France's BNP Paribas said net profit rose 31 percent to 2.1 billion euros (\$2.7 billion) in the second quarter. For the first half, profit rose 39 percent to 4.4 billion euros.

The rise was also thanks to lower loan provisions and strong retail banking, offsetting volatile financial market conditions that hit investment banking. Its second-quarter provisions halved to 1.1 billion euros, the lowest in two years.

Output grows in U.S., Euro zone; China slows

Global manufacturing showed little risk of a double-dip recession as output in July grew in the United States and Europe and a rare contraction in China suggested Beijing was successfully reining in its hot economy.

The ISM's index of factory activity fell to 55.5 in July from 56.2 in June. Credit Suisse said the 55.5 headline index was consistent with 3.75 percent economic growth.

In Europe, production continued to grow after concerns about public debt levels and the health of the region's banks in recent months. The euro zone's manufacturing PMI rose further above the 50 mark that separates growth from contraction, to 56.7 in July from 55.6 in June, led by Germany and Italy. But French manufacturing growth slowed to its weakest in 10 months.

Meanwhile, production fell in China as the government successfully pulled back on the growth throttle.

HSBC's PMI of Chinese companies showed government steps to slow bank lending and fight property speculation hit home as the headline index dipped below the 50 mark for the first time since the global downturn.

SEC probes BP as it poised to "kill" Gulf well

U.S. regulators were investigating BP for possible insider trading related to its oil spill, dealing a potential blow to the energy giant's efforts to restore investor confidence.

Two sources familiar with the preliminary SEC investigation said the alleged insider trading took place after the start of the BP oil spill on April 20.

The SEC is also investigating whether the British company properly disclosed information on risks related to its deepwater oil operations in the Gulf, one of the sources said. BP was preparing to deliver the first of what it hopes will be two knockout blows to "kill" its Gulf well.

The White House said it was "cautiously monitoring" the situation as BP engineers, mindful of previous setbacks to permanently seal the well, conducted final tests. The tests will show whether BP can move ahead with its planned "static kill".

Japan PM wants BOJ help but not rigid price target

Japanese Prime Minister Naoto Kan called on the BOJ to help beat deflation and curb job losses but rebuffed calls from his own party members to impose an inflation target on the central bank.

Japan is slowly recovering from the global downturn, but the economy is mired in deflation and the strength of the yen is adding to the price pressures and could threaten exports.

Yoshihiko Noda highlighted the economic risks of a high yen, stepping up his warnings against big foreign exchange moves as the dollar hovered near an eight-month low against the Japanese currency.

Some lawmakers say an inflation target would give the government a clear measure to use to push the central bank into loosening policy further to support the economy and create jobs.

Kan said he saw no need to make the BOJ responsible for maintaining full employment. But he called on the central bank to do what it can under the current policy framework to help the government curb job losses.

Separately, Noda stepped up his warnings on big currency moves as the dollar hovered near an eight-month low versus the yen due to growing signs that the U.S. economy is slowing.

NEXT UP

Australia central bank seen holding rates steady for 3rd month

Australia's central bank is all but certain to leave interest rates unchanged tomorrow as benign domestic price pressures give it room to pause policy for the third month in a row.

A Reuters poll of 20 economists showed they all thought the RBA would hold rates at 4.5 percent. The market was just as confident the RBA would stay on the sidelines.

The RBA has said explicitly the crucial question for its August rate decision was whether the latest inflation data materially changes its medium-term outlook for price pressures. The RBA expected inflation to cool, and the data showed just that. With markets still worried about a slowdown in the global economic recovery, the RBA should have no qualms taking a wait-and-see approach.

The RBA may choose to focus on the main risks to economic growth abroad and at home. It could signal that a hazy economic outlook means there is no need to hike over the next few months. But given Australia's labor market has proven to be surprisingly resilient so far, the RBA may not want to limit its future policy options by striking a dovish chord now.

German industry orders seen growing again in June

Manufacturing and Services PMIs seen stable at 61.2 and 57.3 respectively.

Orders seen growing again by 1.5 percent m/m after a 0.5 percent contraction in May.

Industrial output growth seen slowing to 0.7 percent month on month from 2.6 percent in May.

Germany has its exports to thank for recovering from its deepest post-war recession but recent indicators have boosted hopes that the consumer sector may also pick up.

Industrial orders and output data next week will give further clues on the business outlook for the months ahead, especially as doubts over what lies ahead still linger in the light of the euro zone debt crisis.

The Reuters consensus forecast is for orders to have grown again in June, by 1.5 percent, after a 0.5 percent contraction in May.

On the business side, sentiment leapt by a record margin in July to reach its highest level in three years, fuelled by a World Cup buzz that boosted consumer spending, the Ifo business climate index showed last week.



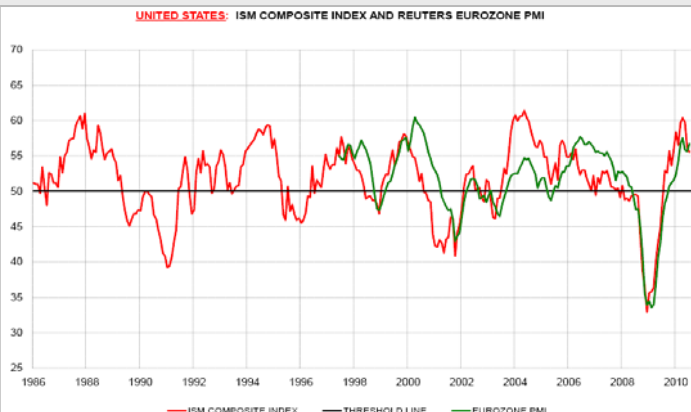
DEEP DIVE Commentary and Analysis

COLUMN-ISM shows U.S. recovery running out of steam

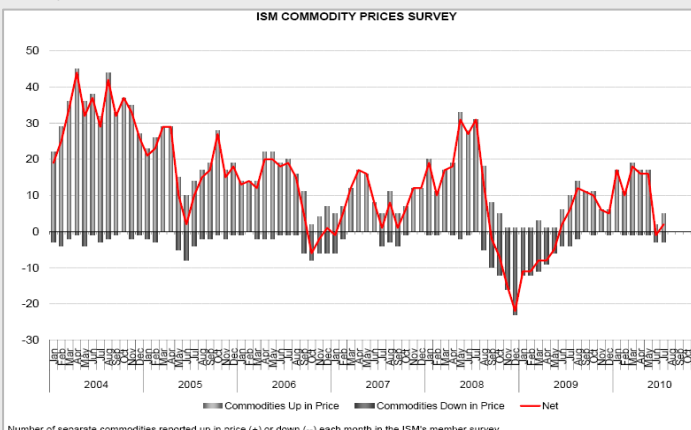
By John Kemp

U.S. manufacturing reported a further moderation in the rate of growth last month as the expansion becomes more mature and loses some of its early momentum.

For the third month running, the Institute of Supply Management's composite activity indicator pulled back to 55.5, its lowest level since December 2009, though still well above the 50-point threshold which divides expanding activity from a contraction.



The report was better than expected (the median forecast was 54.1) but that only shows how pessimistic the market had already become.



There are marked signs of a deceleration in growth. The percentage of firms reporting a month-on-month increase in new orders has halved from a recent peak of 52 percent in April to just 27 percent in July.

The percentage of firms reporting increases in production is down from 49 percent in May to just 31 percent last month.

But the figures that will alarm policymakers already worried about the state of the recovery are the number of firms reporting that conditions actually worsened.

The percentage of firms reporting new orders were worse jumped from 14 percent to 20 percent, the highest level since November 2009.

The percentage of firms reporting production was lower jumped from 13 percent to 19 percent, the highest for 13 months.

ISM survey data needs to be interpreted with special care.

All expansions tend to slow as they mature, as the initial burst of growth associated with the shift in the inventory cycle from liquidation to rebuilding gives way to increases in underlying demand.

Moreover, the ISM measures are diffusion measures. They provide an indication of how many firms report gains or losses in

output, orders, inventories, production and prices are, but contain no information about how big those gains or losses might be.

Finally, as the expansion matures, the baseline for month-on-month improvements becomes increasingly challenging to beat, so diffusion indices naturally tend to tail off.

The moderation in the composite activity index and its key production and new orders components therefore comes as no surprise. But policymakers will be concerned by how early in the current recovery the activity indicators are starting to turn down. After such a deep and prolonged recession, the economy ought to have managed a much bigger growth spurt.

Lacklustre data from the ISM survey is consistent with other signs of stalling growth, including weak payroll numbers and the very small increase in final demand reported during Q2 in last week's GDP numbers.

Senior policymakers on the interest-rate setting Federal Open Market Committee will have to decide whether the recovery has enough momentum to maintain its current "exit trajectory" from recession unaided, or whether it needs additional stimulus to avoid falling back into recession.

Meanwhile weakening growth will ensure oil demand continues to recover only modestly in H2 2010 and inventories will remain comfortable going into the northern hemisphere winter.

The fact oil prices have continued to rally confirms the market's fundamentally bullish bias at present (with bullish news and sentiment having a bigger impact on prices than bearish news-flow).

There is currently a critical mass of investors and speculators who believe prices should and will press on higher, who are willing to "look through" short-term noise created by the news-flow.

-- John Kemp is a Reuters market analyst. The views expressed are his own --

ANALYSIS-Waning inflation view redraws bond market bets

By John Parry

As the U.S. economy has lost some momentum, markets have swung from fretting about inflation to bracing for a brush with deflation, triggering some major bond market shifts.

Rather than fearing they need to buy protection against inflation, investors earning near zero in cash are prioritizing the hunt for yield.

With inflation running at a low of about 1 percent, some fund managers have upped their purchases of longer maturity corporate bonds in preference to safe-haven government bonds. Longer-dated bonds are the biggest gainers when inflation is tame.

Those still nervous about stocks but unimpressed by very low Treasury yields have sought high-yield corporate bonds that tend to be less volatile than equities.

"When you look at the 8 or 9 percent you can earn, you really have to believe economic growth will deteriorate rapidly to make that (investment) a problem," said Dan Peirce, a portfolio manager responsible for global asset allocation at State Street Global Advisors.

Most economists do not expect severe deflation or a depression, which could cause a surge in corporate defaults and losses for junk bond holders.

Instead, the consensus view is for muted inflation. Economists' latest forecast for core U.S. consumer prices is a 0.8 percent rise in the third and fourth quarters and for a 1.1 percent reading in the first quarter 2011.

A deceleration of the economy's growth pace has pushed the

DEEP DIVE Commentary and Analysis

benchmark 10-year Treasury note's yield below 3 percent from as high as 4 percent in April as investors have flocked to this traditional safer-haven. Yet that drop in yield has dimmed government bonds' appeal, some say.

"Treasury bonds look pretty expensive" after their rally year-to-date, said Peirce. "We have been more than happy just to own corporate bonds instead and that has worked out fine."

Although corporate bond yields are at historic lows in some cases, they still offer nearly 200 basis points more than Treasuries, an incentive for those who expect the economy to grow feebly but to escape a recession that would spawn high numbers of corporate defaults.

"We have been seeing some good buying in investment-grade and high-yield securities because of this scenario," said Kevin Flanagan, chief fixed-income strategist with Morgan Stanley Smith Barney in Purchase, New York.

The buying has given a stellar corporate bond market rally a second wind. The rebound started in the depths of the credit crisis in December 2008, when U.S. investment-grade yield spreads hit record wides above 650 basis points.

This rally stalled in April as concerns about the global impact of Europe's sovereign debt crisis and the possibility of a "double-dip" U.S. recession began to stalk markets. But in recent weeks, fears about both factors have abated somewhat, allowing corporate bond yields to resume a tightening trend.

U.S. investment grade corporate bonds have returned 8.3 percent year-to-date and junk bonds have returned 8.4 percent, according to Bank of America Merrill Lynch data.

TIPS' STAR WANES

With no inflation on the near horizon, Treasury Inflation Protected Securities have fallen out of favor as a wager on the shorter-term economy and interest rate outlook.

William Bellamy, director of fixed income with Thompson, Siegel & Walmsley in Richmond, Virginia, sold his holdings of inflation-indexed securities during the global financial crisis in 2008. He has not bought any since, expecting downward price pressures in the economy to persist.

"I have been a deflation guy for two years and will be until I see the signposts change in the economy," he said.

Yet some fund managers have hung onto longer maturity inflation-indexed bonds and other fixed-income securities that would do well once rates start to rise.

Although TIPS are not widely sought now, says Peirce, they also haven't generated big price losses for holders and are a useful bet on longer-term inflation expectations.

Some fund managers are buying step-up bonds, whose coupons automatically reset higher at regular intervals, as a bet that the trillions of dollars of debt the government issued during the financial crisis may eventually ignite inflation.

For example, in June, William Larkin, portfolio manager with Cabot Money Management in Salem, Massachusetts, bought a Morgan Stanley step-up bond due in July 2025. The 5 percent coupon on this bond will rise to 6 percent in July 2013 and 8 percent in July 2016. That's a good hedge against inflation if inflation and interest rates start to rise, provided the issuer has not called or redeemed the security by then.

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

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