General Commentary

The treasury market kicked off the week on a solid footing, continuing to fall after last Friday's unexpectedly weak payrolls report. Despite revisions being revealed on Tuesday showing US payrolls were marked down by a record 911,000 jobs in the year through March vs what was originally reported, treasuries gave back Monday's gains that day. Wednesday and Thursday saw a continuation of the rally after the PPI report showed wholesale inflation declined in August for the first time in four months, Core CPI came in as expected, and initial jobless claims unexpectedly rose. However, gains were again reversed on Friday on little relevant news, though the University of MI survey showed long-term inflation expectations rose. It seems some traders were taking profits after a strong rally over the past few weeks and ahead of next week's FOMC meeting. Taken together, the curve flattened on the week with the front end rising by 4bps while the long end fell by 8bps.

IG Munis

Despite choppy treasury action, the muni market continued the strong tone seen last Friday post-payrolls, with desks reporting trade volumes that were near YTD highs all week. The benchmark AAA MMD curve was bumped 11bps up front and 19-20bps in the 10-30y range, outperforming treasuries by ~15-20bps across the entire curve. Investors poured cash into mutual funds, with Lipper reporting +$2.18bn of inflows, which was the 2nd highest inflow of the year and trailing only the $2.3bn seen just 3 weeks ago. On the flip side, supply was light as the $10.5bn primary calendar was mostly devoid of clean high-grade new issues and instead littered with large deals in spreadier and lower rated sectors like airports, healthcare, and housing. With funds flush with cash and few good options in the new issue market, secondary volumes surged. JPM reported BWICs rose 9%, but this was entirely driven by ultra short paper and short-call bonds with little duration, while longer maturity bonds saw volumes decline 13-18%. On the other hand, customer purchases rose 16%, with the largest uptick in 20y+ paper at +31%.

One dealer commented that this rally felt different from others this year and that the seemingly all-clear signal from the Fed to begin cutting rates has emboldened accounts who had been hesitant to take on risk. Instead of watching from the sidelines at any side of rate weakness, he felt customers were going to step in and buy the dip. The structures that had been hit the hardest in the sell-off were the biggest beneficiaries of this new attitude as inquiries jumped for short-call paper and long duration high-grade 4% coupon bonds that are still comfortably at a discount. Even with the outperformance, most trades we tracked printed at least 10bps better than the MMD curve implied. For example, AA/AA+ rated MA School Building Authority Sales Tax 5.25s of 2050 traded away to a customer at 4.31% on Thursday after a 4.62% away print last Friday. Similarly, a Aa1/NR/AA+ NY Personal Income

Tax bond discussed last week as having been one of the last opportunities to purchase ultra-high grades near 5% when it sold via new issue at 4.93%, traded up 30bps on the week to 4.50%. New issues unsurprisingly saw a surge in demand as well. AAA rated Austin TX GOs, one of the only sizable ultra high-grades to price at $682mm, saw oversubscriptions as high as 17x in its longest 20y tenor, with the underwriter repricing 16bps tighter. While a sustained treasury sell-off could certainly sap the momentum, participants are betting that the about-face in performance will lead to stronger inflows which should boost demand above what's expected to be a relatively tame supply picture over the coming weeks.

HY Munis

The HY market turned in a similarly strong performance this week, with each successive trade better than the last until Thursday afternoon when buyers pulled back on the aggressiveness after a very fast rally that saw the index turn positive for the year. Dealers scrambled to keep pace with the inventory turnover, bidding ever higher to satisfy the surge in customer demand. Higher quality names led the march higher, with some bonds trading up 30bps+ and outperforming MMD while other riskier and wider spread names mostly traded in line with the curve. Baa3 rated GA SR400 Express Lane 5.75s of 2060 closed the week trading 5.39->5.37, off 5bps from Thursdays highs, after a 5.72% dealer buy last Friday. On the other side of the spectrum, a recently issued nonrated solid waste disposal deal for Noble Environmental traded 19bps better to 6.77% on Thursday. Large, heavily owned benchmark names traded similarly, with Cofina 5s of 2058 away at 5.12%, or 20bps stronger than last Friday and Buckeye Tobacco 5s of 2055 purchased 21bps stronger than last week. Fund flows were robust, with HY mutual funds taking in $1.06bn of the $2.18bn weekly total. With the influx of cash and new yield levels that can be achieved, we suspect underwriters will crank up the new issue machine as at least a dozen speculative deals that have been attempted over the past few months have been sitting on day-to-day status waiting for a market environment like this.

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Market Commentary

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