

The details from the FOMC meeting on November 4<sup>th</sup> found the committee reiterating the plan to complete the Fed's shift to drain the market liquidity created over the past year and to outline its economic forecast. This revised forecast contains a positive GDP growth in the fourth quarter of 2009 and a growth range of 2.5% to 3.5% in 2010 (2010 GDP; 2.6% median of 63 economists surveyed by Bloomberg). The unemployment rate is still expected to remain high through 2010. Inflation is expected to be contained and remain low. The minutes of the meeting also covered how the Fed plans to drain excess reserves using the introduction of large scale reverse repurchases (the Fed sells securities for a set period, temporarily lowering the amount of money available in the system and in a tri-party repo a third party functions as the agent for the transaction and holds the security as collateral), and term deposit agreements with banks. With these vehicles the Fed's assets (\$1.25 trillion of MBS, \$175 billion agency debt and \$300 billion of Treasury securities) will run off over time as they mature or are prepaid. There was also a discussion at the meeting concerning the risks arising from keeping the Fed funds rate near zero for an extended period of time. The interesting feature here is that the discussion was included in the meeting's minutes which might point to the fact that this concern is becoming more widely held by the committee members.

Potentially the lines are being drawn for the continuing battle between concerns about economic weakness (Bernanke) versus the dollar (Japan, China, etc) or the risks of higher inflation. In general every news wire/market analyst does not expect Mr. Bernanke to raise rates before mid-2010. So in light of this the fixed income market is faced with unemployment above 10% and housing potentially taking another downturn, the year end flows into short term U.S. government issues for little or no return (for the first time in seven decades, Treasury bills are paying no interest) to ensure capital preservation is accruing. On the other hand, stock investors, are investing as if the worst is over and that low borrowing costs mixed with almost \$12 trillion of stimulus will bolster earnings into 2010. Compounding this divergence in financial markets, the demand for bills has also been driven by banks adding the safest securities to improve their balance sheets at year-end, and a drop in issuance as the Treasury lessens its dependence on short term financing and fewer alternatives as companies cut back on sales of commercial paper. The supply of bills will decline approximately 10% from September through February as the Treasury cuts its Supplementary Financing Program for the Fed to \$15 billion from \$200 billion.

In November, for the first time in nine months, the high yield market didn't outperform the investment grade corporate market. Prior to this, high yield bonds outperformed the investment grade market by 30 percentage points. This reversal comes from a combination of very heavy new issuance and even some investor resistance to the relatively rich pricing of the sector after what has been an explosive rally all year. Investment grade corporates outperformed Treasuries again, but by the narrowest margin since February. As in October, the "BBB" rated corporate credits outperformed by a relatively narrow margin. The Treasury curve also steepened further in November, with the yield on the long bond little changed while the two-year yield fell almost 25 basis points (bps) to near the lows of the year. Even before the Dubai scare (Dubai World {state run} seeks to defer est. \$60bb in debt payments for 6 months), yields on bills and shorter Treasury notes had moved back to levels seen last December when the flight-to-safety bid dominated flows. The yield curve that measures the gap in rates between 2 and 10-year Treasury notes expanded to 2.66% points this month, the widest since July.

The mortgage market (Agency Pass Thru's, MBS) recorded their best monthly return since March and the second best in 2009, as MBS spreads narrowed almost 25bps in November. At less than 75bps, these spreads are close to the narrowest in modern times. The Fed purchases (800 lbs gorilla) of almost all new issues (new production 4,4.5 and 5% coupons) have drained the agency pass-through market of product, forcing investments in MBS that normally wouldn't be accepted. The Fed has focused on purchasing issues near the current coupon, buying close to all the outstanding production in 4's and 4.5 coupons.

In summary, the uneven nature of the economic data this month probably reinforced the chairman's concerns about the economy. Inflation indices continue to suggest that price pressures are not building. However, this balance could be the result of the polarized extremes that exist in the TIPS market. The employment data is also extremely important to the Fed. While expressing some concern about dollar weakness (the dollar index has fallen 15.5% since March 5<sup>th</sup>, a steeper drop than in any eight month period in 23 years) and exuberant financial markets (bubbles), Fed officials have emphasized that the weak economy is job number one. Best wishes for the holidays.

Yield and Total Returns									
Ryan Labs Indexes	YTW	QTD	YTD	12M <sup>1</sup>	Ryan Labs Indexes	YTW	QTD	YTD	12 M <sup>1</sup>
<b>RL 2 Year Indexes</b>					<b>RL 10 Year Indexes</b>				
TIPS	-0.12	2.49	10.55	12.78	TIPS	1.37	4.69	11.08	20.08
Treasury	0.69	0.64	2.26	3.12	Treasury	3.22	1.49	-5.93	0.18
FHLMC	1.10	0.38	2.76	5.35	FHLMC	3.53	2.04	0.21	8.62
FNMA	0.92	-0.34	1.81	4.18	FNMA	3.14	2.36	2.90	11.12
AAA Corporate	1.41	1.54	4.62	6.82	AAA Corporate	4.16	2.73	-0.30	7.40
AA Corporate	2.06	2.00	7.78	10.42	AA Corporate	4.81	2.70	13.32	23.28
A Corporate	2.37	2.00	15.57	18.82	A Corporate	5.03	2.53	15.63	23.26
BBB Corporate	3.52	2.17	18.84	20.53	BBB Corporate	5.60	3.34	30.29	36.02
<b>RL 5 Year Indexes</b>					<b>RL 30 Year Indexes</b>				
TIPS	0.52	3.95	13.61	18.06	TIPS	1.79	4.64	9.20	22.13
Treasury	2.05	1.89	0.52	2.86	Treasury	4.20	-1.55	-20.36	-8.05
FHLMC	2.10	0.44	1.39	4.48	FHLMC	4.69	-1.66	-9.51	5.27
FNMA	2.63	-3.31	0.71	3.62	FNMA	4.69	-1.58	-7.62	5.87
AAA Corporate	2.52	2.54	6.08	8.79	AAA Corporate	4.96	0.59	-10.11	6.22
AA Corporate	3.15	2.65	10.77	15.34	AA Corporate	5.74	0.65	11.91	30.00
A Corporate	3.71	2.78	18.55	23.99	A Corporate	5.90	0.46	16.28	33.95
BBB Corporate	4.53	3.20	27.78	30.29	BBB Corporate	6.35	1.58	31.14	46.27

1) Last 12 Months Return

The material presented and calculated here is based on information considered reliable. Ryan Labs does not represent that it is accurate or complete.

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Ryan Labs TIPS				
	Yield To Worst (%)	MDuration (Years)	Year To Date Returns (%)	Last 12 Month Returns (%)
2 Year TIPS	-0.12	2.59	10.55	12.78
5 Year TIPS	0.52	4.93	13.61	18.06
10 Year TIPS	1.37	10.65	11.08	20.08
30 Year TIPS	1.79	14.78	9.20	22.13
RL TIPS Index	0.85	7.74	11.42	18.05

Market Implied Breakeven Inflation Expectation				
	Yield To Worst (%)		Inflation (%)	
	Nominals <sup>1</sup>	TIPS	BEI <sup>2</sup>	Current <sup>3</sup>
CPI (1 Month Lag)				-0.20
2 Year	0.69	-0.12	0.81	
5 Year	2.05	0.52	1.53	
10 Year	3.22	1.37	1.85	
30 Year	4.20	1.79	2.41	

- 1) Nominals represent conventional U.S. Treasury Bonds and Notes.
- 2) BEI = Breakeven Inflation Rate (Nominal yields minus TIPS yields). Widening BEI indicates that TIPS are outperforming nominal bonds. When realized inflation is greater than implied inflation, TIPS also outperform.
- 3) Current Inflation = Bureau of Labor Statistics, Year over Year Consumer Price Index (non-seasonally adjusted, all items, 1 month lag)