

The month of December brings the year of 2009 to a quiet close as the fixed income market continues to focus on the transition from recovery to stabilization, and potentially expansion. The Treasury in the final weeks of the year provided a combined \$29.26 billion in capital to ten small banks across the country. Not a large sum in light of everything that has been thrown around this fiscal year but the Treasury did say that these banks would be the last to receive capital under the initiative called the Capital Purchase Program. Through this program, launched in October 2008, the Treasury has provided 707 U.S. banks with \$204.9 billion (bn) in capital. At the Federal Reserve, Ben Bernanke is trying to withdraw unprecedented stimulus and emergency lending programs without impeding efforts to sustain a recovery and reduce unemployment, which is now close to a 26-year high. The FOMC released, in the mid-month statement, a unanimous decision, to leave its target for the benchmark interest rate unchanged in a range of zero to 0.25 percent.

The Fed policy makers next meet January 26-27th, 2010. Then, over the Christmas holiday, the Treasury made a surprising announcement to bolster the government's support of Fannie Mae and Freddie Mac, the beleaguered mortgage giants. Rather than beginning to extricate itself from these two companies, as it is with other bailed-out businesses, the government stated that they would remove the \$200bn (each) credit line and guarantee those unlimited funds for the next three years. In addition to this, the portfolio cap will be lifted to \$900bn and the 10% reductions (previously agreed to) will not begin at the end of 2010. These two organizations stumbled badly in the financial crisis after backing too many troubled loans. Late last year, the government put them into conservatorship, and they have provided most of the liquidity in the mortgage market. These two agencies (GSE) have already used \$112bn of the \$400bn pledge from the Treasury to stay afloat. This news is particularly interesting in light of the fact that the Fed has said that it will be scaling back on its quantitative easing. By the end of the first quarter, the Fed will have closed most of the special lending facilities and the MBS purchase program. There are some investors who feel that there is a risk that the end of Fed purchases and the Federal Homebuyer tax credits may crush any improvements in the housing market.

The topsy-turvy state of the fixed income markets is best demonstrated when the total returns for individual sectors are compared with the results generated just last year. While the annual (2008, 2009) total returns for the broad market indexes were fairly similar, the distribution across sectors was not. For example, the weakest performers in 2008 were the best performers in 2009, and vice versa. Remember long treasuries excelled in 2008 but then a year later they were the worst in 2009. The high yield market had its worst year ever in 2008 and its best year ever in 2009. This shift was true for the ABS market (TALF program). Even in the municipal market, although less dramatic, the recovery was pretty powerful. And the mortgage market retained its status as a source of relatively stable returns, recording positive returns in 2008/09. In the U.S. Treasury sector, just like in January this year, December's returns (10yr; -4.85% and 30yr; -6.73%) were especially bad for monthly returns. The big negative returns in December were a surprise considering that this is usually a seasonally strong period for Treasuries. In the investment grade corporate market, the December total monthly issuance of \$56.6bn was in line with the \$55bn average since 2000.

The 2009's total issuance volume was a record of \$1.24 trillion as borrowers took advantage of low interest rates to refinance debt after locked out of the bond market during last year's financial crisis. The previous record was \$1.17 trillion in 2007. While the 2009 absolute return for the investment grade index was not a record, the excess return versus Treasuries was the greatest ever.

In an effort not to be too simplistic, the story of 2009 (and the month of December) was about the narrowing of spreads. By year-end, the Agency Pass-through's spreads were 75 basis points or less, the smallest differentials on record. Also, total returns in the credit markets were dominated by capital gains, which is typical for the late-recession/ beginning the recovery stage of the cycle. And let's not forget the banner year in stocks, highlighted by the biggest annual percentage gain in the Dow Jones Industrial Average in six years. What a difference a year makes.



Yield and Total Returns

Ryan Labs Indexes	YTW	QTD	YTD	12M ¹	Ryan Labs Indexes	YTW	QTD	YTD	12 M ¹
RL 2 Year Indexes					RL 10 Year Indexes				
TIPS	0.13	1.96	9.98	9.98	TIPS	1.67	1.70	7.91	7.91
Treasury	1.27	-0.18	1.42	1.42	Treasury	3.85	-3.41	-10.46	-10.46
FHLMC	1.09	0.47	2.86	2.86	FHLMC	4.00	-1.28	-3.04	-3.04
FNMA	1.23	-1.14	1.00	1.00	FNMA	3.72	-0.95	-0.43	-0.43
AAA Corporate	1.95	0.41	3.45	3.45	AAA Corporate	4.67	-1.25	-4.17	-4.17
AA Corporate	2.49	1.29	7.03	7.03	AA Corporate	5.17	0.54	10.94	10.94
A Corporate	2.74	1.37	14.85	14.85	A Corporate	5.35	0.71	13.58	13.58
BBB Corporate	3.73	1.89	18.52	18.52	BBB Corporate	5.81	2.26	28.93	28.93
RL 5 Year Indexes					RL 30 Year Indexes				
TIPS	0.81	2.60	12.14	12.14	TIPS	2.07	0.75	5.14	5.14
Treasury	2.74	-0.92	-2.25	-2.25	Treasury	4.66	-8.42	-25.91	-25.91
FHLMC	2.09	0.66	1.61	1.61	FHLMC	5.00	-5.11	-12.68	-12.68
FNMA	2.53	-2.65	1.40	1.40	FNMA	5.01	-4.93	-10.76	-10.76
AAA Corporate	3.27	0.16	3.61	3.61	AAA Corporate	5.30	-3.81	-14.04	-14.04
AA Corporate	3.60	1.16	9.16	9.16	AA Corporate	5.95	-1.52	9.50	9.50
A Corporate	4.11	1.46	17.03	17.03	A Corporate	6.15	-1.97	13.46	13.46
BBB Corporate	4.88	2.30	26.67	26.67	BBB Corporate	6.49	0.44	29.67	29.67

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.

REGISTERED INVESTMENT ADVISOR

Ryan Labs TIPS				
	Yield To Worst (%)	MDuration (Years)	Year To Date Returns (%)	Last 12 Month Returns (%)
2 Year TIPS	0.13	2.51	9.98	9.98
5 Year TIPS	0.81	4.83	12.14	12.14
10 Year TIPS	1.67	10.5	7.91	7.91
30 Year TIPS	2.07	14.58	5.14	5.14
RL TIPS Index	1.14	7.55	9.18	9.18

Market Implied Breakeven Inflation Expectation				
	Yield To Worst (%)		Inflation (%)	
	Nominals ¹	TIPS	BEI ²	Current ³
CPI (1 Month Lag)				1.80
2 Year	1.27	0.13	1.14	
5 Year	2.74	0.81	1.93	
10 Year	3.85	1.67	2.18	
30 Year	4.66	2.07	2.59	

- 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)