

The first month of the New Year started off with enough market activity, news developments and questions to keep investors' focus even after a quiet holiday season. The U.S. economy expanded in the 4th quarter of 2009 at the fastest pace in six years as factories pumped up assembly lines and the quarter saw a swing from steep to modest inventory liquidation. The 5.7 percent annualized increase in gross domestic product (GDP) reported near the end of January exceeded the 4.8 percent median forecast of economists surveyed by Bloomberg news. Separate data releases reported that consumer spending, which comprises about 70 percent of the domestic economy, rose to a 2 percent pace following a 2.8 percent increase in the previous three months. However, for all of 2009, the economy shrank 2.4 percent, the worst single-year performance since 1946. Also, household purchases dropped 0.6 percent for all of last year, the biggest decrease since 1974.

The Federal Reserve panel (FOMC) in charge of interest rates declared at its January meeting that for the first time the domestic economy is in "recovery" and reaffirmed it will end liquidity backstops and a \$1.25 trillion program to buy agency mortgage-backed bonds (Pass Through's). The central bankers repeated their pledge to keep the benchmark lending rate in a range of zero to 0.25% for "an extended period," while noting the economy "continued to strengthen." It should be noted that Kansas City Federal Reserve Bank President Thomas Hoenig dissented, favoring a quicker adjustment to the rate outlook. Some market observers are starting to wonder if policymakers are concerned as to why banks are not lending more aggressively given the accommodative stance of policy. Meanwhile, Mr. Bernanke's reconfirmation made it through the Senate vote. One of the question marks for the market-place was answered. Now the mortgage market gets to focus on the question; what happens when the Fed leaves the mortgage pass through market?

The old rule of thumb for the bond market to rally into the year end, only to perform poorly in January, has failed to occur for the second year in a row. The Treasury market, which sold off a lot in December, recovered partially in January. The never-ending government bond supply pressures that are a natural symptom of the increasing federal deficit have created solid support for note and bond yields that are higher than the lows reached in late November. The closing January yields on the longer maturities were generally 40 basis points above the lows set at the end of November. The mortgage market underperformed Treasuries in January because MBS spreads to Treasuries were the narrowest in recent history in December. These incredibly narrow spreads leave the mortgage market susceptible to any increase in Treasury yields and to the termination of the Fed's purchase program at the end of March.

On the other hand, investment grade corporates outperformed Treasuries in January but high yield did not. In 2009, the high yield market outperformed Treasuries by an average of approximately 500 basis points per month. The BBB investment grade issues returned 2.4% versus 1.4% for the AA credits. The point here is that the demand from last year for riskier corporate credit has not stopped in January. Although towards the end of the month credit performance began to weaken. The equity markets had negative returns in January, which makes the positive return for high yield even more impressive. Flight from the sovereign debt of Greece and the other "PIIGS" (Portugal, Italy, Ireland, Greece and Spain) helped the U.S. Treasury performance, especially when the monthly economic data would normally have sent yields higher. The negative bill rates posted this month seem to be a product of this foreign flight to safety, not a flight of assets out of bank deposits as was true last fall.

Yield and Total Returns

Ryan Labs Indexes	YTW	QTD	YTD	12M ¹	Ryan Labs Indexes	YTW	QTD	YTD	12M ¹
RL 2 Year Indexes					RL 10 Year Indexes				
TIPS	-0.22	1.29	1.29	9.19	TIPS	1.53	2.18	2.18	10.73
Treasury	0.84	0.89	0.89	2.80	Treasury	3.61	2.30	2.30	-3.86
FHLMC	1.09	0.09	0.09	3.18	FHLMC	3.87	1.36	1.36	2.80
FNMA	0.95	0.64	0.64	1.88	FNMA	3.47	1.87	1.87	5.84
AAA Corporate	1.58	1.17	1.17	4.37	AAA Corporate	4.46	2.93	2.93	4.81
AA Corporate	2.12	1.08	1.08	6.86	AA Corporate	4.86	1.83	1.83	16.12
A Corporate	2.27	1.36	1.36	14.20	A Corporate	5.12	1.97	1.97	17.56
BBB Corporate	2.90	1.57	1.57	16.71	BBB Corporate	5.52	2.34	2.34	29.72
RL 5 Year Indexes					RL 30 Year Indexes				
TIPS	0.63	1.66	1.66	10.94	TIPS	1.95	2.11	2.11	11.92
Treasury	2.39	2.08	2.08	0.80	Treasury	4.53	2.54	2.54	-11.18
FHLMC	2.65	-4.29	-4.29	-2.50	FHLMC	4.91	1.56	1.56	-1.53
FNMA	2.53	0.21	0.21	2.71	FNMA	4.90	1.70	1.70	-0.28
AAA Corporate	2.95	1.81	1.81	6.13	AAA Corporate	5.14	2.70	2.70	1.95
AA Corporate	3.25	1.59	1.59	10.85	AA Corporate	5.90	0.84	0.84	17.53
A Corporate	3.75	1.99	1.99	17.58	A Corporate	6.02	1.85	1.85	21.39
BBB Corporate	4.38	2.31	2.31	25.21	BBB Corporate	6.36	1.87	1.87	34.35
Bcap. Indexes					Bcap. Indexes				
Barclays Agg	3.37	1.53	1.53	8.51	ABS	2.43	1.68	1.68	19.07
CMBS	6.24	4.52	4.52	39.39	MBS	3.86	1.33	1.33	7.09

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	-0.22	2.68	1.29	9.19
5 Year TIPS	0.63	5.17	1.66	10.94
10 Year TIPS	1.53	10.89	2.18	10.73
30 Year TIPS	1.95	14.59	2.11	11.92
RL TIPS Index	0.90	7.77	1.79	10.63

Market Implied Breakeven Inflation Expectation				
	Yield To Worst (%)		Inflation (%)	
	Nominals ¹	TIPS	BEI ²	Current ³
CPI (1 Month Lag)				2.7
2 Year	0.84	-0.22	1.06	
5 Year	2.39	0.63	1.76	
10 Year	3.61	1.53	2.08	
30 Year	4.53	1.95	2.58	

- 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)