



WEEK ENDING
07 OCT
 2 0 1 1

Global Market Review
Liquidity

US Taxable

On the economic front, the September employment report headlined the week. Nonfarm payrolls rose a stronger-than-expected 103,000, with substantial upward revisions to the prior months. Average weekly hours worked increased to 34.3 from 34.2. Elsewhere, manufacturing data continued to show modest growth. The Institute for Supply Management's (ISM) manufacturing index unexpectedly rose in September, climbing to 51.6 from 50.6 in the prior month. Of note was the improvement in the employment component, to 53.8 from 51.8. The September ISM non-manufacturing report, covering US service industries, declined modestly to 53 from 53.3 over the same period. The drop in the employment component, to 48.7 from 51.6, was the first contraction since August 2010.

There were no major surprises in US Federal Reserve (Fed) Chairman Ben Bernanke's testimony before the Joint Economic Committee of the US Congress. Bernanke reiterated that the recovery has clearly not been as strong as the Fed would have liked. Furthermore, the Fed remains prepared to take additional action, if warranted, he said. Prudent fiscal decisions were also needed to ultimately aid growth and job creation.

The European sovereign debt situation continued to weigh on global markets. EU officials' comments that additional measures will be needed to restore confidence in the region's banking system were well received. Later in the week, both the European Central Bank (ECB) and the Bank of England (BOE) announced programs that called for additional asset purchases.

LIBOR levels continued their modest ascent. Three- and six-month LIBOR each climbed 2 basis points (bps), to 0.39% and 0.58%, respectively. Money market investor activity was more robust, with activity concentrated on fixed-rate product in the three- and six-month part of the curve. This week, the Fed began its operation of selling short-term US Treasury holdings and replacing them with longer dated Treasury obligations in an attempt to reduce borrowing costs. Bernanke expected the program

to reduce long-term rates by approximately 20 bps.

US Tax Exempt

Tax-exempt money fund assets fell again this week, by \$773.1 million, bringing the total assets to \$288.52 billion. The Securities Industry and Financial Markets Association (SIFMA) Index reset 2 basis points (bps) lower to 0.14%, as dealers anticipated that money funds will have cash from October coupon payments to invest in variable-rate demand notes (VRDNs). On Friday, S&P downgraded Dexia's core banks to A-/A-2, citing the bank's limited access to funding markets and the potential increase of collateral requirements on hedges. While many money funds have already reduced considerably their exposures to European banks, the downgrade on the short-term rating to second-tier A-2 reduces Dexia Bank's viability as a liquidity provider for VRDNs going forward. There was a smaller new-issue calendar this week, with just over \$300 million in short-term notes for sale. Santa Clara CA sold \$125 million of tax- and revenue-anticipation notes (TRANS), due June 2012 and priced to yield 0.20%. The Municipal Market Data AAA One-Year Index was unchanged at 0.25%. While we saw some activity on high-grade municipals, the overall market tone still felt less strong this week. Investors are certainly being more cautious, as the uncertain economic tone both here and in Europe has market participants on edge and led to increased selectiveness amongst trust account buyers.

Eurozone

Eurozone		Change (bps)	07 Oct 11	30 Sep 11
LIBOR:	1 Month	0	1.30	1.30
	3 Month	1	1.50	1.50
	12 Month	1	2.06	2.04
	Slope (1-12 Month)	1	75	74
OIS/LIBOR Spread:	3 Month	-9	66	75
Swap Spread:	2 Year	2	96	94
	5 Year	1	81	79
Govt Bonds:	2 Year	8	0.63	0.55
	10 Year	10	1.99	1.89
	Slope (2-10 Year)	2	136	134

Current Market Pricing for Key Policy Rate: Market consensus rate increase in 4Q11

Source: Bloomberg

The European Central Bank (ECB) Governing Council

met on October 6 and left the official interest rate unchanged at 1.5%. At his final press conference, ECB President Jean-Claude Trichet announced additional liquidity measures to support the European banking sector by conducting further refinancing operations and launching a new, €40 billion covered-bond purchase program. In another main takeaway from the introductory statement, Trichet said that the choice to keep the official interest rate unchanged reflected a consensus decision made after an extensive discussion about whether to lower rates or keep them unchanged.

Turning to economic data, the eurozone final purchasing managers index (PMI) composite for September was revised downward to 49.1 from the flash estimate of 49.2. The final services PMI was revised downward to 48.8 from the flash estimate of 49.1, while the final manufacturing PMI was revised upward to 48.5 from the flash estimate of 48.4. Retail sales data for August revealed a 0.3% month-over-month (MoM) decline following a 0.2% MoM increase in July. Moody's rating agency announced its decision to downgrade Italy's sovereign rating by three notches to A2 from Aa2, citing concerns about rising downside risks to economic growth and the government's overall ability to meet its fiscal targets.

UK

United Kingdom		Change (bps)	07 Oct 11	30 Sep 11
LIBOR:	1 Month	0	0.69	0.69
	3 Month	1	0.96	0.95
	12 Month	1	1.73	1.72
	Slope (1-12 Month)	1	103	102
OIS/LIBOR Spread:	3 Month	0	43	43
Swap Spread:	2 Year	7	77	70
	5 Year	10	51	41
Govt Bonds:	2 Year	4	0.62	0.58
	10 Year	4	2.47	2.43
	Slope (2-10 Year)	-1	185	185
Current Market Pricing for Key Policy Rate:		Market consensus rate increase in 4Q12		

Source: Bloomberg

© Western Asset Management Company 2011. This publication is the property of Western Asset Management Company and is intended for the sole use of its clients, consultants, and other intended recipients. It should not be forwarded to any other person. Contents herein should be treated as confidential and proprietary information. This material may not be reproduced or used in any form or medium without express written permission. Past results are not indicative of future investment results. This publication is for informational purposes only and reflects the current opinions of Western Asset Management. Information contained herein is believed to be accurate, but cannot be guaranteed. Opinions represented are not intended as an offer or solicitation with respect to the purchase or sale of any security and are subject to change without notice. Statements in this material should not be considered investment advice. Employees and/or clients of Western Asset Management may have a position in the securities mentioned. This publication has been prepared without taking into account your objectives, financial situation or needs. Before acting on this information, you should consider its appropriateness having regard to your objectives, financial situation or needs. It is your responsibility to be aware of and observe the applicable laws and regulations of your country of residence. Western Asset Management Company Distribuidora de Títulos e Valores Limitada is authorized and regulated by Comissão de Valores Mobiliários and Banco Central do Brasil. Western Asset Management Company Pty Ltd ABN 41 117 767 923 is the holder of the Australian Financial Services Licence 303160. Western Asset Management Company Pte. Ltd. Co. Reg. No. 200007692R is a holder of a Capital Markets Services Licence for fund management and regulated by the Monetary Authority of Singapore. Western Asset Management Company Ltd is a registered financial instruments dealer whose business is investment advisory or agency business, investment management, and Type II Financial Instruments Dealing business with the registration number KLFB (FID) No. 427, and a member of JSIAA (membership number 011-01319). Western Asset Management Company Limited ("WAMCL") is authorised and regulated by the Financial Services Authority ("FSA"). In the UK this communication is a financial promotion solely intended for professional clients as defined in the FSA Handbook and has been approved by WAMCL.

The Bank of England (BoE) Monetary Policy Committee (MPC) surprised the market by announcing a £75 billion expansion of its asset purchase program (commonly known as quantitative easing, or QE)—taking the overall program to £275 billion. The consensus expectation was that the MPC would expand the current program in November. Also, the MPC left the base rate unchanged at 0.5%.

Second-quarter GDP was finalised at 0.1% quarter-over-quarter (QoQ) from the initial estimate of 0.2% QoQ. On an annualised basis, GDP for 2Q11 stood at 0.6% year-over-year (YoY) from 1.6% YoY in 1Q11. Looking at the underlying details, private consumption and net trade declined over the quarter. Also worth noting is that the Office for National Statistics has implemented some changes, switching to CPI-based deflators from a Retail Price Index-based approach; this explains the changes in the historical GDP. The UK manufacturing PMI rose more than expected to 51.1 in September from 49.4 (revised) in August due to an increase in output and domestic orders. Services PMI also surprised to the upside by rising to 52.9 from 51.1 over the same period due to an increase in new business and employment. However, construction PMI disappointed by falling to 50.1 from 52.6 over the same period. The latest producer price index (PPI) figure rose more than the market had expected, highlighting further price pressures. PPI input rose by 1.7% MoM in September after declining 1.8% MoM in August. PPI output climbed to 0.3% MoM from 0.0% MoM over the same period.

For more information on Western Asset visit our website at www.westernasset.com.