WESTERN ASSET

WEEK ENDING
05 AUG
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Global Market Review

Liquidity

US Taxable

It was a turbulent week once again driven by both political and global financial concerns. Ongoing concerns surrounding the European financial system have once again come to the forefront of the marketplace. Economic data in the U.S. was generally disappointing, though Friday's employment report helped to allay fears that the economy was slipping back into recession. Non-farm payrolls for July rose a stronger than forecasted 117k (est. +85k), with net revisions, to prior months, of 56k. The unemployment rate fell 0.1% to 9.1%, but that was a result of a decline in the labor force participation rate. Elsewhere, both the ISM manufacturing and non-manufacturing reports for July were weaker than expected, signaling the recovery has lost some momentum.

Over the week we saw short-term risk measures move higher. The TED spread widened from 16 bps, to 27 bps as US Treasury bills rallied sharply; partly the result of one custodial bank announcing the implementation of a fee for clients holding excessive cash deposits. LIBOR levels again moved marginally higher over the week. Three and six-month LIBOR rose 1 basis point each, to .27% and .44% respectively.

US Tax Exempt

Tax-exempt money fund assets were lower by $1.23 billion, bringing the total assets close to the $3 billion dollar mark, at $299.95 billion. The Securities Industry and Financial Markets Association (SIFMA) Index reset 10 basis points (bps) higher this week to 0.18%, as a result of the many crossover buyers who began dumping their holdings of variable-rate demand notes (VRDNs) and redeploying their cash into the Treasury market, where yields on T-Bills had risen dramatically in the face of a possible downgrade due to the stalemate occurring in Washington over raising the debt ceiling. Although the near-term crisis over the rescue package proposed for Greece has been averted, volatility still reins supreme in the European banking sector, as many market pundits feel that additional solutions to the debt crisis overseas still need to be found. Hence, many money funds continue to be very cautious about adding more exposure to European banks. The new-issue note calendar this week saw approximately $500 million in loans. In the week's largest deal, Oyster Bay NY (SP-1+) sold $135 million in notes maturing August 2012 priced to yield 0.26%. Participation by money funds was limited, as some chose to stay away from notes temporarily, preferring to be invested in VRDNs until the market landscape improves. The Municipal Market Data AAA One-Year Index remained at 0.20%, with retail and trust-account investors continuing to be the buyers of high-grade municipals for both their attractive relative value and as an alternative to parking cash in money funds.

Eurozone

Eurozone		Change (bps)	05 Aug 11	29 Jul 11
LIBOR:	1 Month	-3	1.35	1.38
	3 Month	-4	1.52	1.56
	12 Month	-7	2.10	2.17
	Slope (1-12 Month)	-4	75	79
OIS/LIBOR Spread:	3 Month	19	50	31
Swap Spread:	2 Year	3	77	75
	5 Year	2	78	77
Govt Bonds:	2 Year	-31	0.85	1.16
	10 Year	-17	2.37	2.54
	Slope (2-10 Year)	14	152	138
Current Market Pricing for Key Policy Rate:		Market consensus rate increase in 4Q11		

Source: Bloomberg

The European Central Bank (ECB) Governing Council at its August 4 meeting decided to leave the key interest rate unchanged at 1.5%. Following the meeting, the introductory statement delivered at the press conference announced new, extraordinary liquidity providing operations and indicated that the Securities Market Program had been reactivated. The statement also highlighted that the Governing Council took a unanimous decision to keep the interest rate on hold and provided a cautious outlook concerning the risks to economic activity.

The eurozone purchasing managers index (PMI) composite for July fell to 51.1 from 53.3, with both underlying components reporting a decline. The flash PMI manufacturing fell to 50.4 from 52.0, while PMI services fell to 51.6 from 53.7 over the same period. Retail sales data were better than expected, as sales rose by 0.9%

month-over-month (MoM) in June following a 1.3% MoM decline in May. The eurozone Eurostat unemployment rate was reported unchanged at 9.9% in June. In Germany, factory orders continued to climb at a healthy pace, increasing by 1.8% MoM in June following a 1.5% MoM jump in May. In contrast, German industrial production (IP) for June declined by 1.1% MoM after increasing by 0.9% MoM in May.

UK

United Kingdom		Change (bps)	05 Aug 11	29 Jul 11
LIBOR:	1 Month	1	0.64	0.63
	3 Month	0	0.83	0.83
	12 Month	0	1.59	1.59
	Slope (1-12 Month)	0	95	96
OIS/LIBOR Spread:	3 Month	2	33	31
Swap Spread:	2 Year	-2	65	67
	5 Year	-4	48	52
Govt Bonds:	2 Year	-5	0.58	0.63
	10 Year	-13	2.73	2.86
	Slope (2-10 Year)	-7	215	223
Current Market Pricing for Key Policy Rate:		Market consensus rate increase in 1Q12		

Source: Bloomberg

Manufacturing PMI contracted for the first time in two years as a slowdown in output growth, weaker domestic market conditions and job losses caused the index to fall to 49.1 from 51.4. Construction PMI reported strong growth of new orders and overall confidence regarding future business prospects, with the index posting 53.5 in July, a small drop from 53.6 in June. Services PMI rose higher than expected to 55.4 from 53.9 due to an uptick in new business activity and expectations.

The latest PPI was broadly in line with consensus. PPI output increased by 0.2% MoM, while PPI input increased by 0.6% MoM. As a result, PPI output price inflation rose to 5.9% year-over-year (YoY) and PPI input price inflation rose to 18.5% YoY—the highest level since 2008. The Halifax House Price Index in July increased by 0.3% MoM following a 1.5% MoM increase in June. Also, the Bank of England Monetary Policy Committee met on August 4 and left the key base rate unchanged at 0.5% and the asset purchase target unaltered at £200 billion.

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