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Money Markets: Market Events May Pressure Short-term Rates

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In September, the Federal Reserve (Fed) took another significant step in its attempt to stimulate the stagnant U.S. labor market. While many market participants were expecting a third round of quantitative easing (QE), the Federal Open Market Committee (FOMC) exceeded expectations with an open-ended asset purchase program. Under the program, the Fed will purchase $40 billion in agency mortgage-backed securities each month until targeted economic improvements are achieved, contingent upon inflation remaining within the central bank's comfort range. The FOMC statement indicated that, if warranted, the Fed could purchase additional Treasury securities and enact more policy tools. If such steps were taken, they would likely take place in 2013.

> The expiration of Operation Twist at the end of 2012 may place downward pressure on short-term rates due to a lower supply of short-dated Treasuries.

The Fed also extended its guidance to maintain the federal funds target rate at its current level through at least mid-2015. Furthermore, the FOMC statement referenced the likelihood of loose monetary policy "for a considerable time" beyond a sustained economic recovery. With these measures, the Fed is essentially attempting to avoid past central bank mishaps, when the premature

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removal of monetary stimulus contributed to prolonged periods of economic malaise—the Great Depression and Japan's "lost decade."

Post Operation twist, additional stimulus likely to drive short-term rates lower

Operation Twist—the simultaneous sales of short-dated Treasuries and purchases of long-dated Treasuries in an effort to lower long-term bond yields—has provided some relief to money market investors during a time when the amount of commercial paper outstanding is at a decade low[1] and the supply of agency discount notes continues to decline. The Fed's injection of short-term Treasury securities into the market may have contributed to yields on Treasury bills and repurchase agreements (repos) remaining relatively elevated (see Exhibit 1, below). However, Operation Twist sales will be completed at year-end, reducing the available supply of short-term Treasury securities, potentially putting downward pressure on short-term rates.

The Fed's $40 billion monthly purchases of agency mortgage-backed securities may also weigh on money market rates as asset purchases reduce the supply of available collateral for repurchase agreements. In addition, improved liquidity conditions and market perception in the eurozone has caused LIBOR to fall, further reducing yields on high-quality commercial paper and certificates of deposit.

Potential for money market fund inflows if FDIC Transaction Account Guarantee expires

Money market yields could fall further if the FDIC Transaction Account Guarantee (TAG) program expires. The TAG program, implemented in December 2010 as part of the Dodd-Frank Act, has resulted in significant inflows to bank deposit accounts as institutional clients have been able to receive FDIC insurance on non-interest-bearing deposits with balances exceeding $250,000.[2] Since the TAG program was initiated, $570 billion has been deposited into these FDIC-insured accounts, bringing the current total of TAG-insured deposits to approximately $1.6 trillion.[3] TAG balances increased by $400 billion[4] during the second half of 2011 alone, when financial markets experienced significant volatility stemming from the U.S. debt ceiling show-down, the U.S. sovereign downgrade, and the eurozone debt crisis. In contrast, during the same period institutional general purpose money market fund assets declined by $125 billion.[5] These flows indicate that approximately 30% of TAG bank account deposit growth during this period may have come from money market funds. The expiration of the TAG program could result in a portion of these dollars returning to money market funds or into instruments purchased

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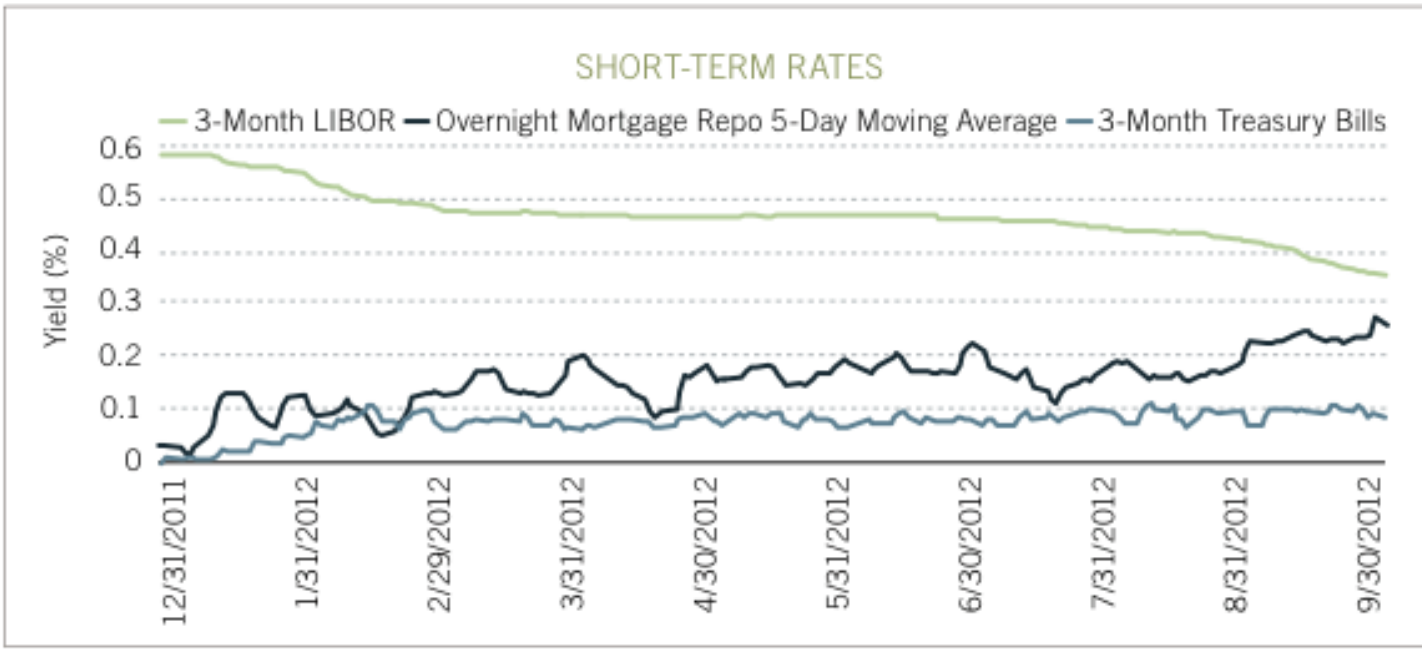
EXHIBIT 1: Operation Twist may have contributed to relatively elevated T-bill and repo yields.



LIBOR is the London Interbank Offered Rate. Source: FMR, Bloomberg, as of Oct. 1, 2012.

by money market funds, including repos, Treasuries, agency securities, commercial paper, and so on. In any case, expiration of the program could result in lower rates. Congress went into recess without placing a TAG extension into a bill, increasing the probability that the program will expire at year end. A TAG extension could still occur, but would need to be passed during Congress's lame duck session.

Fund strategy

Fidelity's taxable money market mutual funds maintained bar-belled strategies, with increased holdings in overnight repos and longer-dated Treasury securities, which resulted in longer average maturities relative to peers. This portfolio positioning contributed positively to fund performance in September because overnight repo rates increased and LIBOR levels declined. Our general purpose funds maintained a moderate allocation to longer-dated Treasury and agency securities and maintained exposure to high- quality short-dated financials. We purchased a modest amount of unsecured short-term securities from select eurozone banks after updating our comprehensive analysis and further stress-testing. While the situation in the eurozone has improved due in part to greater support from the European Central Bank, weak credit fundamentals could reemerge as the region is expected to remain in recession. Therefore, we remain cautious regarding the eurozone banks, investing in the highest-quality, short-maturity instruments in this sector.

> The Federal Reserve's third round of quantitative easing may contribute to lower short-term rates due to a lower supply of collateral for repurchase agreements.

Endnotes

1 Federal Reserve as of September 2012.

2 Through December 31, 2012, unless otherwise extended, all commercial non-interest bearing transaction accounts are afforded unlimited FDIC insurance coverage. After December 31, 2012, the standard $250,000 insurance coverage will apply. Source: Federal Deposit Insurance Corporation. www.fdic.gov.

3 Wrightson ICaP as of Sep. 2012.

4 Barclays Capital as of Sep. 2012.

5 iMoneyNet.

As the availability of bonds issued from Fannie Mae and Freddie Mac decreases over time, it is clear that portfolio managers will need to find other investment alternatives that balance the need for safety of principal, liquidity, and income.

Covered Bonds— An Introduction

Investments To Balance the Need for Safety of Principal, Liquidity and Portfolio Income

TODD CUPPIA, *VICE PRESIDENT, Fixed Income Strategist*
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For years, government investment officers have favored GSE debt as a nearly inexhaustible source of high quality and liquid assets to manage anticipated cash flow needs, while earning a reasonable spread above Treasury securities. However, with the accelerated wind-down of both Fannie Mae and Freddie Mac, the availability of bonds in this sector will necessarily fall, leaving the Federal Home Loan Bank as the largest issuer of GSE paper. Recall that on August 17, 2012, the Treasury Department announced a modification of its Preferred Stock Purchase Agreements (PSPAs) with the entities. The new agreements stipulate that the investment portfolios of Fannie Mae and Freddie Mac will now be required to shrink to $250 billion at a 15% annual rate, from the previous 10% annual decline.1 Specifically, beginning on December 31, 2012, the firms must maintain mortgage assets of less than $650 billion. At the end of 2013, and every following year, the firms must reduce the aggregate amount of mortgage assets owned to 85% of what was allowed for the previous year. Against this backdrop, the global appetite for the highest quality USD denominated assets has only risen as a consequence of sovereign debt concerns and a global economic slowdown. As the availability of bonds issued from Fannie Mae and Freddie Mac decreases over time, it is clear that portfolio managers will need to find other investment alternatives that balance the need for safety of principal, liquidity, and income. Covered bonds (CBs) strike an attractive balance of these important considerations due to their investor friendly structural protections, active primary and secondary markets, and attractive yield spreads.

In terms of size, the covered bond market was nearly $3.2 trillion at the end of 2011 at prevailing exchange rates, and a great many of the bonds receive AAA ratings from Moody's, S&P, and Fitch. From a liquidity perspective, bid/ask spreads for covered bonds are somewhat wider than GSE paper. The typical bid/ask spread for GSE debt is around 0.5-1 basis point on large liquid issues, where bid/ask spreads on covered bonds are typically between 5-10 basis points, in line with most corporate bonds.

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What is a Covered Bond?

While there is no formal definition of what constitutes a covered bond, they can be described as corporate bonds issued by financial institutions that are "Secured by a cover pool of mortgage loans or public sector debt to which investors hold a preferential claim in the event of default."2 While there can be notable differences in the nature of this preferential claim and the regulations under which the bonds are issued, they have one important characteristic in common: the dual recourse nature of the obligation. Dual recourse refers to the fact that, like other corporate bonds, investors in covered bonds have a claim on the assets and earnings of the issuing institution. Importantly, investors in covered bonds also hold a preferential claim to a dedicated pool of collateral, typically held on the balance sheet of the issuing institution that can only be used to satisfy obligations to the investors in the covered bonds. This pool of assets is generally referred to as a "cover pool." The collateral characteristics of the cover pool are transparent, with monthly reports typically made available through investor relations departments. Covered Bonds represent just one of the many tools utilized by financial institutions to fund their balance sheets. The bonds can provide issuers with an attractive longer term funding vehicle at pricing that is lower than other unsecured alternatives. The issuing institution receives a lower cost of funds due to the extra credit protection that is provided by the cover pool.

> Covered bonds (CBs) strike an attractive balance of these important considerations due to their investor friendly structural protections, active primary and secondary markets, and attractive yield spreads.

Are all Covered Bonds Programs the Same?

There are a number of important differences in covered bond programs due to the fact that they are issued by financial institutions under a number of different regulatory frameworks in many countries around the world. However, the similarities of the securities are much greater than their differences. The most important similarity is the fact that in the event of issuer insolvency, the dedicated cover pool can only be used to satisfy the claims of CB investors. If there are remaining obligations to investors after the liquidation of the cover pool, the CB investor generally ranks pari-passu to other senior unsecured obligations. To the extent that the issuer remains a "going concern," covered bonds are functionally equivalent to senior unsecured obligations of the same issuer. The CB investors have recourse to the issuer first and to the cover pool second in the event that the issuer is unable to meet its financial obligations.

How Are Covered Bonds Different from Standard Corporate Bonds or Mortgage Securitizations?

Another important structural protection common to most covered bond programs is the legal and contractual obligations the issuing institutions have with respect to maintaining the quality and over-collateralization of the cover pool. The market value of the cover pool, including the overcollateralization, must be maintained by replacing any matured loans and any non-performing loans with acceptable collateral. What this reveals is how CBs differ from the unsecured debt issued from financial firms and traditional mortgage securitizations. For example, the principal payment of the covered bond will not accelerate due to mortgage prepayments or defaults in the cover pool (unlike a MBS pass-through.) It is the obligation of the issuer to replenish the pool with performing assets. Due to this enhanced structural protection, covered bonds tend to yield less than unsecured debt of the same issuer, but will typically carry a higher rating from the rating agencies (generally AAA).

Additionally, in contrast to traditional mortgage securitizations, the relevant assets remain on the balance sheet of the issuing institution. As long as the issuing institution remains solvent the cover pool will be dynamic, as the issuer replaces nonperforming and maturing assets with acceptable collateral. However, if the issuing institution becomes insolvent, the pool becomes static with no new assets added to the cover pool. Mortgage securities typically consist of a static pool of assets with credit enhancement provided by loss absorbing junior and equity tranches. Also unlike traditional mortgage securities, CBs typically have a fixed-rate coupon and

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a hard final bullet maturity. This highlights the important role that the asset/liability management of the cover pool plays in the overall credit risk to the CB investor. For example, the loans collateralizing the cover pool have the potential to amortize or default more quickly than the funding vehicle supporting the assets (the CBs). If the assets that are used to replace the amortizing loans are lower yielding than the assets they are replacing, it could cause the asset yield of the cover pool to fall below the funding cost of the CB. The recourse that CB investors have to the issuing institutions serves to mitigate this risk.

The level of the over-collateralization (OC) of the cover pool also mitigates that risk, as some deals have over 10%+ OC. Importantly, the level of OC required by the ratings agencies to support a AAA rating is in many cases higher than the subordination beneath the senior most tranches of RMBS securitizations. On the other side of the coin, the benefit that investors in CBs receive from the dual recourse nature of their obligation actually works to the detriment of unsecured creditors. As a firm's CB funding increases as a percentage of total liabilities, the debt recovery value of unsecured creditors will necessarily fall.

Are all Covered Bonds Issued Under Rule 144A?

Until recently all covered bonds were issued under rule 144A. However, the Royal Bank of Canada issued the first ever SEC registered covered bond on September 19th 2012, the RY 1.2% due 9/19/2017. With the success of this issue, we would expect a growing number of financial issuers to fund their balance sheets through registered covered bond issuance.

Prepare for the inevitable.

As the funding needs of the two largest GSEs, Fannie Mae and Freddie Mac, decline we expect that a portion of investment allocations will gravitate towards the covered bond markets for their high credit quality, excellent liquidity, and attractive yield spreads above Treasuries. Investors that take the time to familiarize themselves with this market segment will be better prepared for the future.

1 http://www.treasury.gov/press-center/press-releases/Pages/tg1684.aspx

2 European Covered Bond Council

GIOA Officers

FUN FACT$

- If you start saving just $286.45 per month and can average an 8 percent annual rate of return, you will have $1 million in a mere 40 years.
- Did you know that money has a short life span? On average a $1 bill lasts only 18 months, a $5 bill will last two years, and a $10 bill will last three years. This is why the U.S. Bureau of Engraving & Printing has to reprint $541 million worth of currency each year.

WHO KNEW?

Key Details Behind the World Bank's Triple-A Credit

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Against the backdrop of today's volatile financial landscape where the US's credit rating was downgraded to AA- by S&P and GSEs like Fannie May and Freddie Mac are issuing less debt, US government investors are turning to the supranational sector as high quality investment alternatives. As interest has grown, in-depth questions on the credit of supranationals are being asked. The World Bank's credit story could be a good starting point for US government investors as they continue to navigate the diverse set of issuers within the supranational universe, and in the following text we attempt to provide the basics behind the World Bank's triple-A credit rating.

The Basics

The World Bank was established in 1945 and is essentially a development cooperative whereby many of its borrowers, along with richer countries, are also its shareholders. The World Bank provides project and development policy loans to its member governments as part of its goals to promote sustainable economic development and reduce poverty in the developing world. To fund these loans, the World Bank has been issuing bonds in the capital markets since 1947 and has maintained its triple-A credit rating for over 50 years. The World Bank's financial strength is backed by the following key drivers:

- **Asset Quality** based on the quality of its loan and investment portfolios
- **Equity Capital** which is made up of paid-in capital and reserves
- **Prudent Risk Management** to mitigate the World Bank's credit and market risks
- **Government Backing** from its 188 member governments

Asset Quality

The World Bank's track record for consistent loan repayment and its high quality liquid investments make up the institution's asset quality.

The World Bank's loan portfolio quality is reflected in the record

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of its member country borrowers meeting their debt service obligations to the World Bank, even in times of financial distress. Prioritizing the World Bank as almost "super-senior" status in this way is also known by rating agencies as a "preferred creditor status" and can be attributed not only to the institution's cooperative nature in which countries realize the importance of their role in maintaining the institution's financial stability, but also to the specific policies that provide actual and tangible incentives for borrowers to honor their debt obligations. These incentives include the availability of low cost funds with long maturities at below market rates, equal pricing for IBRD loans to all eligible borrowers regardless of their credit rating, and continued access to fresh funds once repayment begins within 30 days of the loan's due date. In the case a borrower fails to make payment on any principal, interest, or other charges, the World Bank suspends disbursements immediately on all loans. The result is that the World Bank has never rescheduled or written off a loan, nor has it ever had a default in loan repayment from its member countries.

The quality of its investment portfolio also helps determine the World Bank's asset quality. According to its liquidity guidelines, aggregate liquid asset holdings are to be kept at or above a specified "prudential minimum" in order to safeguard against any potential cash flow interruptions, and so that it can meet its financial commitments as well as retain flexibility in timings of market borrowings. The World Bank manages its portfolio against strict guidelines and conservative benchmarks in order to meet its prudential minimum target. Eligible high grade investments include fixed income securities issued by government or agencies rated AA- or higher and corporate and asset-backed securities rated AAA. As of FY12, the credit quality of the World Bank's portfolio was concentrated in the upper end of the credit spectrum, with 90% of the portfolio rated AA or above. This reflects its continued preference for highly rated securities and counterparties across all categories of investments.

A key feature behind the World Bank's financial strength is its ability to withstand potential unexpected losses.

Equity Capital

A key feature behind the World Bank's financial strength is its ability to withstand potential unexpected losses. This ability to absorb risk while continuing to support normal lending activities is based on the World Bank's equity base which is made up of paid-in capital and retained earnings.

The World Bank's adherence to its conservative financial policies enabled it to build significant reserves that support lending while also protecting the World Bank's credit. In addition to these reserves, the decline in outstanding World Bank loans just before the financial crisis helped the World Bank build additional capital to support the increased demand for new loans when the crisis set in.

Also in response to the financial crisis was the decision by the World Bank board to increase its capital by US$86.2 billion, of which US$5.1 billion will be paid in over a 5-year period. This capital increase – the first of its kind since 1988 – further enhances the World Bank's equity base so that it may resume its normal lending activities despite the global financial volatility facing its borrowing member countries.

Prudent Risk Management

The World Bank's ability to mitigate credit risk as it continues to lend, and various market risks associated with its borrowing activities, are also key to the World Bank's financial strength.

To mitigate its credit risk, the World Bank can never lend more than its subscribed capital, reserves, and surplus. Specifically, as described in the IBRD Articles of Agreement that first established the World Bank, the total amount outstanding of loans made by the World Bank, including participation in loans and callable guarantees, may not exceed the statutory lending limit. As of June 30, 2012, outstanding loans and guarantees were $136 billion, which is equal to 59% of the statutory

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lending limit of $232,209 billion. The World Bank also uses key risk management indicators, such as the equity-to-loans ratio, to ensure that over the medium term the volume of loans supported by equity does not exceed the prudential level. The World Bank's policy is to not drop below 23% (26.98% as of June 30, 2012.)

Because of the strong surge in the World Bank's lending activity due to the financial crisis, the FY11 capital increase package mentioned earlier in this article was also designed to keep the equity-to-loans ratio within the 23 to 27% target range.

The World Bank also manages its country credit risk – specifically a portfolio concentration risk, which arises when a small group of borrowers account for a large share of loans outstanding – by setting concentration limits for individual countries determined by their ability to repay debt. The Single Borrower Limit for FY 2013 is set at $16.5 billion for all qualifying borrowers (except India whose limit is set at US$17.5 billion).

In the context of its funding program, the World Bank uses derivatives in the form of swaps to manage its interest rate and currency risk exposure. World Bank loans are disbursed in USD floating rate and are managed on a USD Libor basis. For this reason, each bond transaction is then swapped to mitigate the risk of interest rate or currency mismatches between asset and liabilities. The World Bank also manages exchange rate risks by matching its liabilities in various currencies with assets in those same currencies and by matching the currency composition of its equity to that of its outstanding loans.

For derivative products, the World Bank uses the estimated replacement cost of the derivative as the measure of credit risk exposure. While the contractual principal amount of derivatives is the most commonly used volume measure in derivative markets, it is not a measure of credit or market risk. So, for all securities, the World Bank limits trading to a list of authorized dealers and counterparties. Credit risk is controlled through application of eligibility criteria, volume limits for transactions with individual counterparties, and through the use of mark-to-market collateral arrangements for swap transactions. As a result of these mark-to-market collateral arrangements, the World Bank's residual commercial credit risk is concentrated in investments in debt instruments issued by sovereign governments, agencies, time deposits, and corporate entities.

Diversified Shareholder Base

Support for the World Bank is reflected in the capital backing it has received from its members and in the record of its member country borrowers in meeting their debt service obligations to the Word Bank, as mentioned earlier. All of its 188 shareholders are represented on the World Bank's Board of Directors, which is responsible for approving each loan, policy, and other proposed changes. Of this large shareholder body, the US is the largest with 16.5% ownership and sole veto power on any changes made to the World Bank's Articles of Agreements.

As US government investors continue to learn more about the supranational sector, the due diligence they undertake likewise helps issuers like the World Bank tailor their educational outreach so they can continue to support those who are still considering what their investment alternatives could be.

Please call or email us if you wish further information at (202) 477-2860 / debtsecurities@worldbank.org.

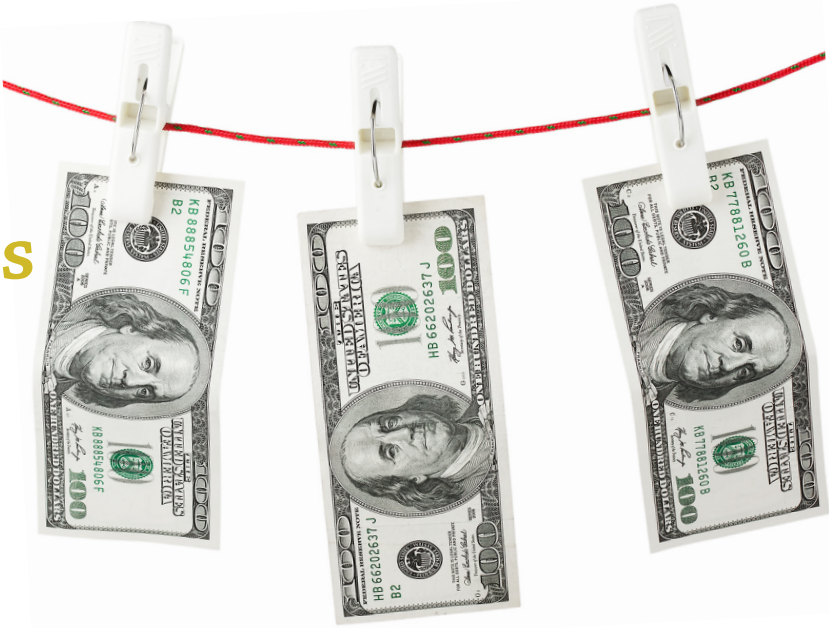
FUN FACT$

- The first person to collect Social Security Retirement benefits was a high school classmate of President Calvin Coolidge. She lived to be 100, thus collecting hundreds of times what she paid into the system. It didn't matter as there were 40+ workers paying in for every one that was getting benefits. Now there are less than THREE paying in for every one receiving.

WHO KNEW?

Three Current Themes In Agency Callables

BY HAMPTON SMITH, CFA,
MANAGING DIRECTOR, BNP PARIBAS



Senior Unsecured Callable Agency Notes have attracted quite a bit of attention in recent months, much of it for good reason. As the Federal Reserve has shifted into a third round of quantitative easing, and provided guidance for very low interest rates through 2015, investor's demand for yield pick-up has only increased.

Many investors are limited to highly rated, relatively safe investment classes which include: US Treasuries, Agencies, MBS, and secured lending transactions (reverse repo). In this environment, investors should examine the risk/reward characteristics of agency callable notes as part of their investing strategy.

There are three major themes currently developing among the above-mentioned highly rated asset classes – each of which involves callable notes issued by the three residential housing and the agricultural finance government sponsored enterprises (GSEs). We will discuss the relative value among:

- Agency callables vs. agency MBS.
- Step-up agency callables vs. agency bullets.
- Short-lockout/short maturity agency callables vs. short term reverse repo.

In two of the three comparisons, agency callable structures can appear compelling, while in one, the alternative is more attractive.

Theme #1: Agency Callables vs. Agency MBS:

Much ado has recently been made concerning the recent "callables for mortgages" trade. Indeed, with the Fed focusing its QE efforts on the new origination mortgage market, the mortgage basis quickly traded to all time tights.

Investors quickly took notice of the dislocation this created: Recent production agency MBS with empirical durations of 2 to 4 years appeared rich to similar WAL agency callable notes when considered on an option-adjusted spread basis. Consider the following recent matched duration valuation metric: [1]

Agency MBS (TBA)	OAD	OAS	Empirical Yield
FNCL 4.0%	1.49	-17	1.12%
FNCL 3.5%	2.27	-31	1.27%
FNCL 3.0%	3.84	-31	1.64%

Agency Callable	WAL	OAS	Indicated Yield
3NC6m Bermuda	1.56	-9	0.50%
5NC6m Bermuda	2.23	-8	1.00%
7NC1y Bermuda	3.64	-10	1.51%

Relative value investors, particularly those already long premium MBS, would be inclined to sell those holdings in favor of new issue par priced agency callables with a similar duration, and indeed that trade did happen in the marketplace. However, hold-to-maturity, yield-oriented investors would not be so inclined due to the remaining residual yield difference. For a short period of time, longer maturity, longer lock-out callables appeared compelling on both an OAS and yield basis to low coupon TBA (FNCL 2.5%), however these opportunities were only available to the most nimble of investors.

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Theme #2: Step-up Coupon Agency Callables vs. Agency Bullets:
Despite guidance from the Fed that rates are expected to remain low well into 2015, many institutional investors have expressed concern about duration risk and are choosing to underweight duration relative to their benchmark index. With the front end of the yield curve very steep, underweighting duration comes at a cost in yield.

Short maturity agency bullets do not provide much in the way of yield, often only a few basis points higher than comparable US Treasury yields. A structure that can potentially offer incremental yield to a similar duration bullet instrument, but still offers a reasonably high likelihood of being redeemed at par on the first call date is a step-up agency callable note.

Consider the following comparison among similar duration instruments (Fannie Mae as issuer):[2]

Structure	WAL/Duration	Yr1 coupon	Yr2-5 coupon
5NC1y step-up berm	1.5y	0.50%	1.45%
18 month bullet	1.45y	0.30%	0.30% (6 mos.)

For the first year, the step-up callable yields 20bps above the comparable duration bullet yield. If not called at the end of the first year, the coupon steps up by 95 additional basis points to 1.45% until the next potential call date in 3 months, an amount well above FOMC guidance and, at the time of this analysis, approximately equivalent to the 4y swap rate 1y forward when adjusting for the issuer funding spread.

The step-up coupon feature provides a higher likelihood of the note being redeemed at the first call date than a standard level-coupon Bermudan callable and therefore contributes to a lower WAL.

Naturally, if rates rise dramatically over the next 18 months in excess of current expectations, then the bullet is the safer investment option given its positively convex nature. However, for investors comfortable with potentially extending at a somewhat protected higher coupon, then the incremental return garnered today is worth noting.

Theme #3: Short Lockout/Short Maturity Agency Callables vs. Short Term Repo:
Finally, it appears that the once robust short lockout/short final callable market is not currently compelling relative to alternative short term investments. Many 2A7 types of investors relied on the extra yield that short term callables like 1yrNC3mo structures provided over

FUN FACT$

- The largest bill ever printed by the Bureau of Engraving and Printing was the $100,000 gold certificate.

WHO KNEW?

non-callable alternatives, however that market is not capable of producing compelling coupons at present. There are two main reasons for this recent development:

- GSE issuers have cheaper funding alternatives available in Discount Notes, and have consequently richened the funding level at which they will issue short dated callables.
- Additionally, the value of the call option embedded in the note has diminished significantly as FOMC guidance has essentially pegged short term rates between 0% and 0.25% for several quarters into the future.

As an alternative, and with the additional benefit of being secured and potentially overcollateralized, many short term investors are currently turning to the reverse-repo market instead where overnight and term GC rates can exceed 0.20% (see chart).

In conclusion, it should be apparent that investing in agency callable notes requires attention to structure and to the opportunities available in similar credit and duration asset classes. The astute rates product investor will always consider the balance between risk and reward when considering agency callable notes versus the alternatives.

Sources:

1 BNP Paribas non-objective research publication "US: The case for callable agencies vs. other products"; October 12, 2012. www.GlobalMarkets.com

2 BNP Paribas trading desk calculations, issuer funding grids, week of October 29 to November 2, 2012.