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Fixed Income Commentary

Monthly Update: REITs, Utilities Lead Corporates in April

Corporate bonds had a decent month in April, though financials underperformed as a result of the SEC suit against Goldman Sachs. Financials posted an excess return of 28 basis points (bps) versus Treasuries compared to industrials at 63 bps and utilities at 78 bps. Within financials, banks posted flat excess returns with the regional banks outperforming the money center banks. Of the money centers, Citigroup was the outperformer with its 30-year senior bonds tightening 10 bps month-over-month compared to Bank of America (BAC), J.P. Morgan Chase (JPM), Goldman, and Morgan Stanley which were all 25 to 40 bps wider. Somewhat surprising, floating rate trust preferred securities (TRUPS) held up very well, ending the month up two to three points (BAC, JPM) despite their fixed rate counterparts being 15 to 20 bps wider during the same period. GECC bonds were flat in April with 30-year issues wrapped around +155 bps to the 30-year Treasury. REITs had another blockbuster month, outperforming Treasuries by 175 bps. Year-to-date, REITs are the best performing sector within corporates with a 5.53% excess return—and that's after being the best performer in 2009. The biggest contributor to the REIT outperformance last month was Simon Property Group, with its 10 year 60 bps tighter, after its bid for General Growth Properties was rejected.

Utilities were the best performing broad sector in the corporate index with 78 bps of excess returns. The option adjusted spread of the utility sector is now 137 bps over Treasuries. Within utilities, pipelines outperformed again by roughly 25 bps as the convergence continued. We've seen a ratings convergence between electric utilities and pipelines as several large electric utilities have been downgraded over the last few months on a tougher regulatory environment. Second, regulated pipelines were trading too cheap on a relative basis, with 30% more spread (40 bps wider) at year end vs. similarly rated electric utilities.

Refiners were the best performing sub-sector in the Barclays Capital U.S. Corporate Index with 263 bps of excess returns. Valero has the largest weighting in the sector and rallied 40 bps last month. As crack spreads and light-heavy differentials have remediated, the outlook for refining margins has improved.

Build America Bonds (BAB) fall under the foreign/local government category within the Barclays Capital U.S. Credit Index. Excess returns were 107 bps in April, the best non-corporate performing sector in the credit index. California general obligation bonds, tightened 25 bps last month (the 30-year trades at spreads of 220/210 bps currently) and are the best performing municipal issuer (and also still the state GO with the widest spread). We think a couple of technicals are helping the performance. One, BAB supply thus far this year has been a lot lower than anticipated (which means the second half of 2010 should be heavy), and two, demand from overseas investors has developed. According to Citigroup, 20% of the last California BAB deal was taken down by foreign investors, which is a huge uptick from 2009.

	Monthly Excess Return	YTD Excess Return	YTD Total Return	OAS
Corporate Index	0.52%	1.69%	4.16%	143
Industrials	0.63%	1.45%	4.01%	119
Financials	0.28%	2.01%	4.28%	180
Banks	0.04%	1.17%	3.41%	179
REITs	1.75%	5.53%	7.84%	218
Utilities	0.78%	1.75%	4.47%	137

Source: Barclays Capital

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