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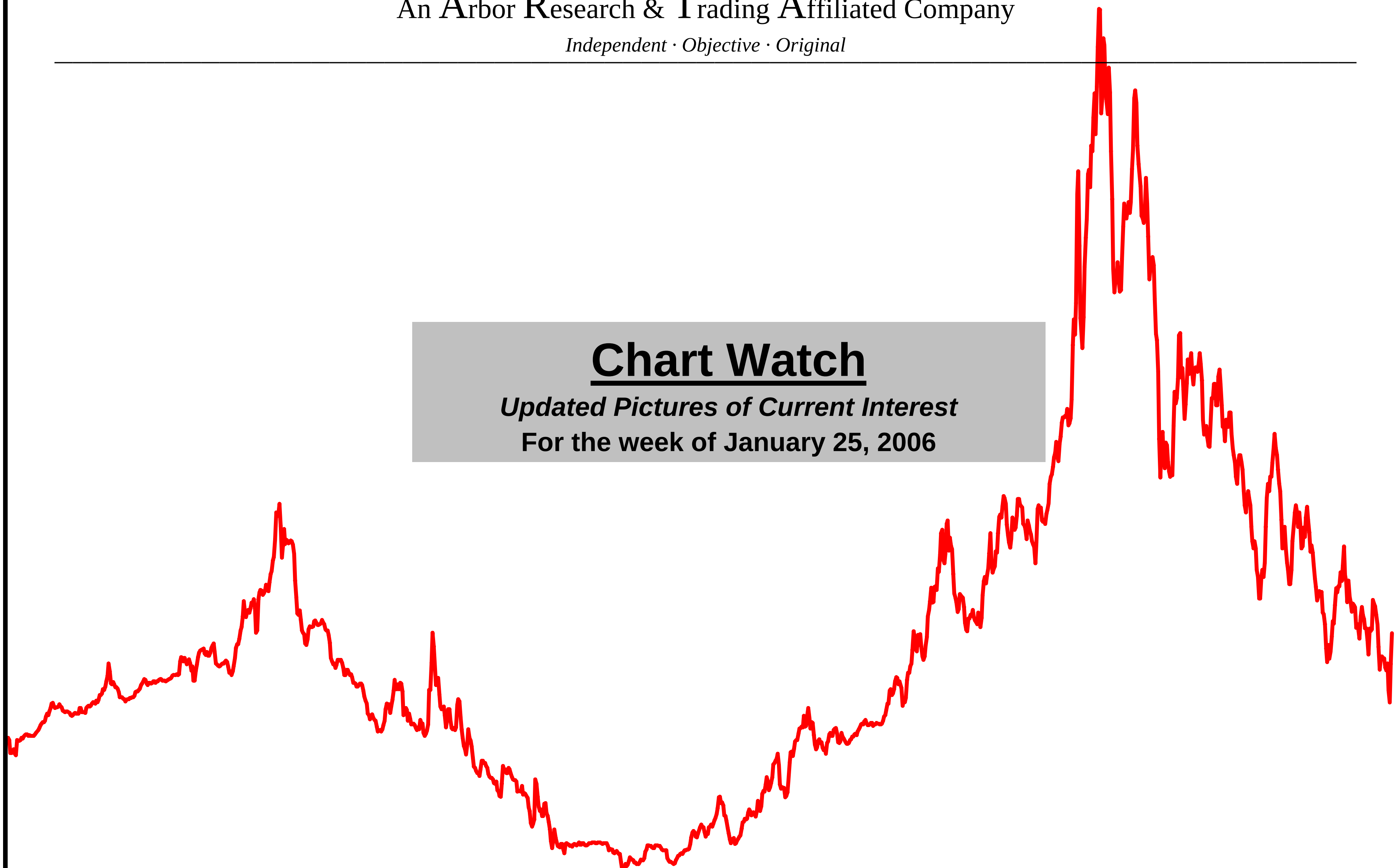
Chart Watch

Updated Pictures of Current Interest

For the week of January 25, 2006



Long-Term Interest Rates - 1900 to 2004

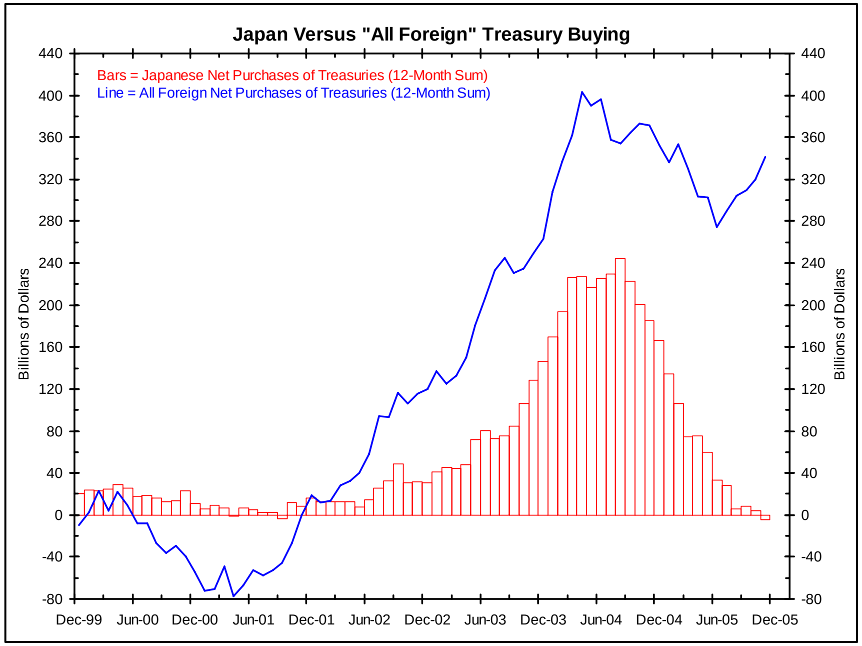
Official Institutions Buy Fewer Treasuries

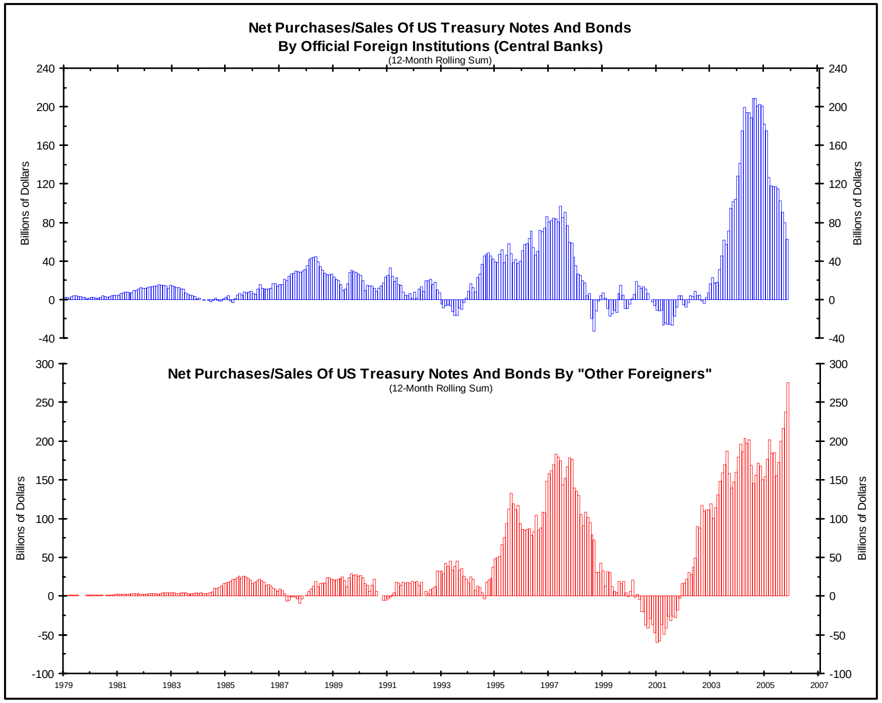
Latest Update From [The U.S. Treasury International Capital Statistics Report]

Notice that, as Japan's net purchases began to decrease (red bars left chart), so did the net purchases of Official Foreign Institutions (top panel right chart). This suggests Japan's net purchases consist almost entirely of Central Bank transactions and make up a large part of world central bank activity (and despite media reports to the contrary, Chinese flows are still a small fraction of this total). That said, these decreases are currently being more than offset by "Other Foreign" net purchases. The end result is the upswing seen in net purchases by All Foreigners (left chart blue line).

Why are "other foreigners" buying so many Treasuries? We have argued before that foreign activity in treasuries, taken in mass, is an exercise in following the momentum of the dollar. The exception is the Bank of Japan.

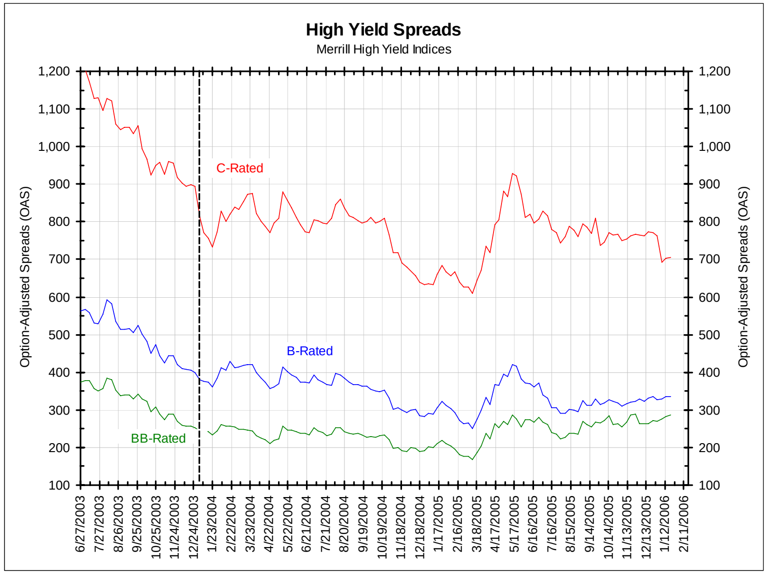
So, when the dollar is weak, "Other (private) Foreigners" shun investments in a weak currency. In this case other foreign flows stall or decline. When the dollar is strong, other foreign flows rise as these investors chase the momentum of a strong currency.



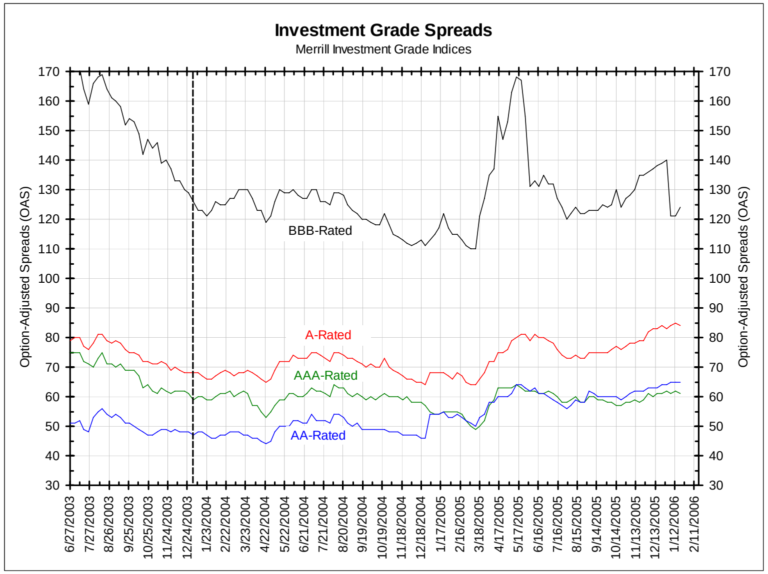


Flight From Quality In The Corporate World?

While credit spreads for BB and B-rated bonds have risen of late, the spreads for C-rated bonds have narrowed.



While credit spreads for A-rated bonds expanded, those for BBB fell in December and early January.



Bond Returns Changed After Bernanke Appointment

From Our Latest Performance Watch

The table below shows the relative performance of the U.S. bond market did change in late October. During the Greenspan period, U.S. bonds were among the worst performers, ranking 24th best of the 26 largest bond markets. In the Bernanke period they jumped to 7th best of 26. Furthermore, of the six markets ahead of the U.S., the only one of significant size is the U.K.

Looking at the U.S. bond market in detail, the returns between the Greenspan and Bernanke periods changed significantly. During the Greenspan era, the safety of three-month bills was the best performer, with the 25-year Treasury strips the worst. The opposite is the case during the Bernanke period. Many have suggested that with Bernanke as Federal Reserve chairman, the long predicted “pause” was finally here. This pause, it has been said, would be bullish for long-duration assets.

World Fixed Income Returns
Ranked by Bernanke Period
Benchmarks in Bold

Rank			Return's Current Through	Percent Change		
Greenspan 7/20/2005 Through 10/24/2005	Bernanke 9/2/2003 Through 1/20/2006	Entire Period 7/20/2005 Through 1/20/2006	January 20, 2006 Name	Greenspan 7/20/2005 Through 10/24/2005	Bernanke 9/2/2003 Through 1/20/2006	Entire Period 7/20/2005 Through 1/20/2006
EFFA/Gov't Bond Markets -- Greater than 1 year in USD Terms (Total Returns)						
1	1	1	South Africa	1.56%	5.99%	7.64%
3	2	2	United Kingdom	1.36%	4.38%	5.81%
13	3	3	New Zealand	0.96%	2.03%	3.01%
25	4	10	Hungary	-0.79%	2.02%	1.21%
15	5	4	Australia	0.94%	1.98%	2.94%
22	6	6	Czech	0.42%	1.47%	1.90%
24	**7**	**17**	**United States**	**-0.52%**	**1.45%**	**0.92%**
19	8	7	Canada	0.60%	1.29%	1.90%
4	9	5	Poland	1.27%	1.13%	2.42%
21	10	11	Norway	0.53%	0.59%	1.12%
26	11	26	Japan	-0.97%	0.43%	-0.54%
11	12	8	Ireland	1.02%	0.27%	1.29%
8	13	12	Spain	1.09%	-0.02%	1.08%
12	14	16	Netherlands	0.97%	-0.04%	0.94%
10	15	14	France	1.03%	-0.04%	0.99%
14	16	18	Germany	0.95%	-0.09%	0.86%
9	17	15	Euro	1.09%	-0.11%	0.98%
5	18	13	Austria	1.13%	-0.13%	1.00%
16	19	19	Belgium	0.92%	-0.14%	0.78%
2	20	9	Italy	1.40%	-0.15%	1.25%
6	21	20	Greece	1.11%	-0.34%	0.76%
20	22	24	Finland	0.56%	-0.35%	0.21%
23	23	25	Sweden	0.20%	-0.36%	-0.17%
18	24	22	Portugal	0.86%	-0.37%	0.49%
17	25	23	Denmark	0.89%	-0.41%	0.48%
7	26	21	Switzerland	1.10%	-0.52%	0.57%

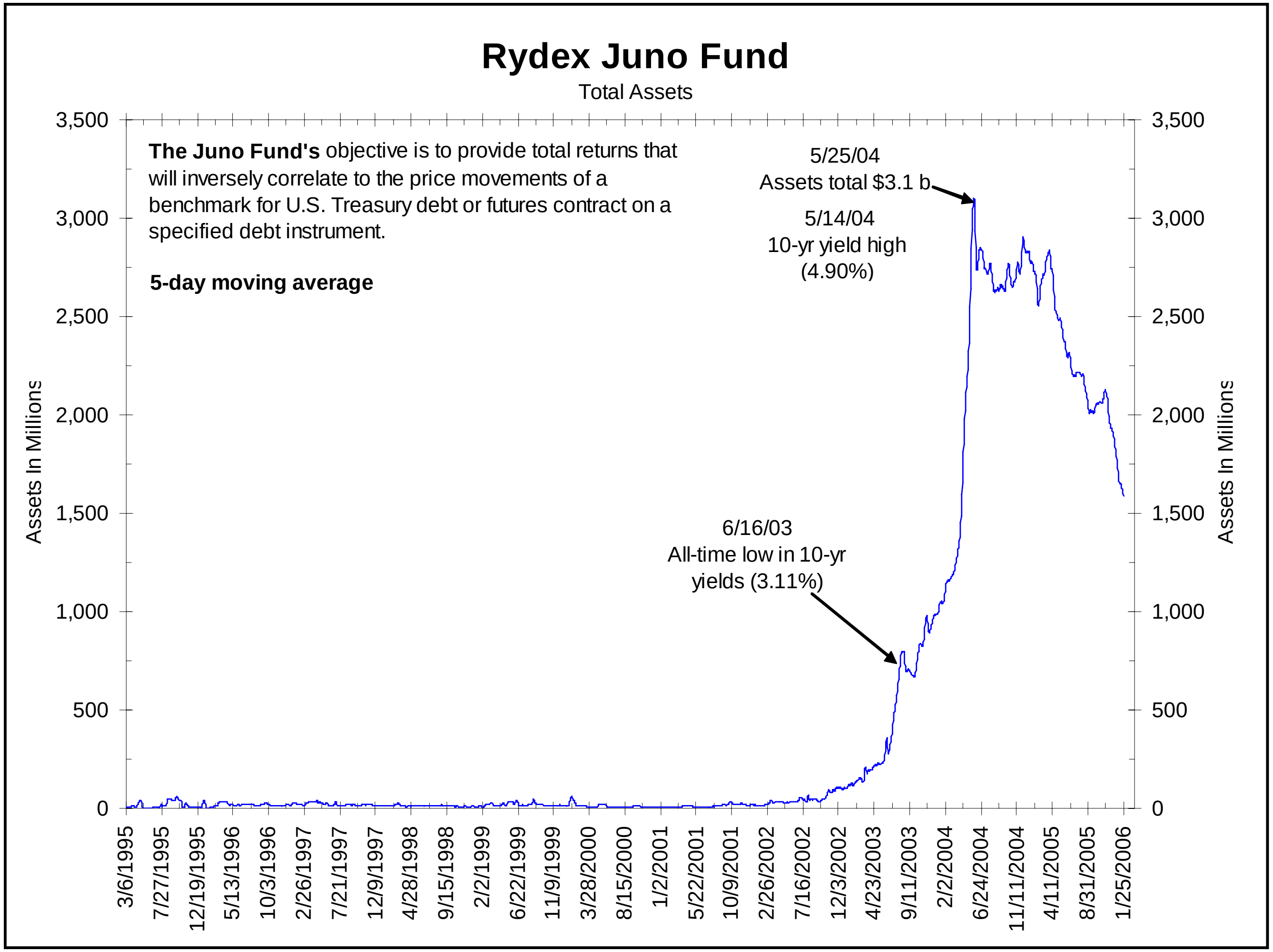
Major U.S. Fixed Income Returns
Ranked by "Bernanke" Period
Benchmarks in Bold

Rank			Returns Current Through		Percent Change		
Greenspan 7/20/2005 Through 10/24/2005	Bernanke 10/24/2005 Through 1/20/2006	Entire Period 7/20/2005 Through 1/20/2006	January 20, 2006 Name	% of Domestic Master Index	Greenspan 7/20/2005 Through 10/24/2005	Bernanke 10/24/2005 Through 1/20/2006	Entire Period 7/20/2005 Through 1/20/2006
Ryan Labs Treasury Indices (Total Returns)							
8	1	5	Ryan 30-Year Index		-2.65%	3.43%	0.69%
9	2	9	Ryan 15-Year Strip Index		-2.87%	2.91%	-0.04%
10	3	10	Ryan 20-Year Strip Index		-3.85%	2.71%	-1.24%
11	4	11	Ryan 25-Year Strip Index		-5.09%	2.42%	-2.80%
7	5	7	Ryan 10-Year Strip Index		-1.55%	2.11%	0.53%
6	**6**	4	**Ryan 10-Year Index**		**-1.27%**	**1.99%**	**0.69%**
2	7	1	Ryan 6-Month Index		0.76%	1.10%	1.87%
4	8	6	Ryan 5-Year Index		-0.37%	1.03%	0.65%
1	9	2	Ryan 3-Month Index		0.88%	0.94%	1.83%
3	10	3	Ryan 2-Year Index		0.33%	0.85%	1.18%
5	11	8	Ryan 5-Year Strip Index		-0.50%	0.72%	0.22%
Merrill U.S. Domestic Master Fixed Income Indices (Total Returns)							
1	1	1	"TIPS"[1]	4.14%	0.88%	1.83%	2.73%
5	2	4	High Yield 2[1]	7.62%	-0.25%	1.71%	1.46%
4	3	3	Mortgage	33.19%	-0.15%	1.66%	1.51%
6	**4**	**5**	**Domestic**	**100.00%**	**-0.37%**	**1.47%**	**1.10%**
8	5	8	Treasury	28.99%	-0.51%	1.45%	0.93%
7	6	7	Government	40.11%	-0.41%	1.36%	0.94%
9	7	9	Corporate	22.36%	-0.69%	1.34%	0.64%
3	8	6	Agency	11.13%	-0.14%	1.15%	1.00%
2	9	2	Asset Backed	2.75%	0.50%	1.03%	1.53%

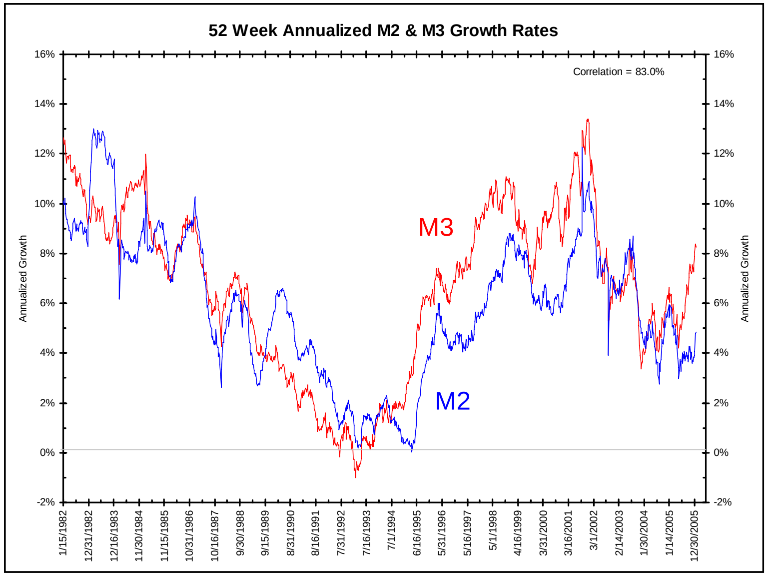
[1] Not Part of the Merrill Domestic Master Index

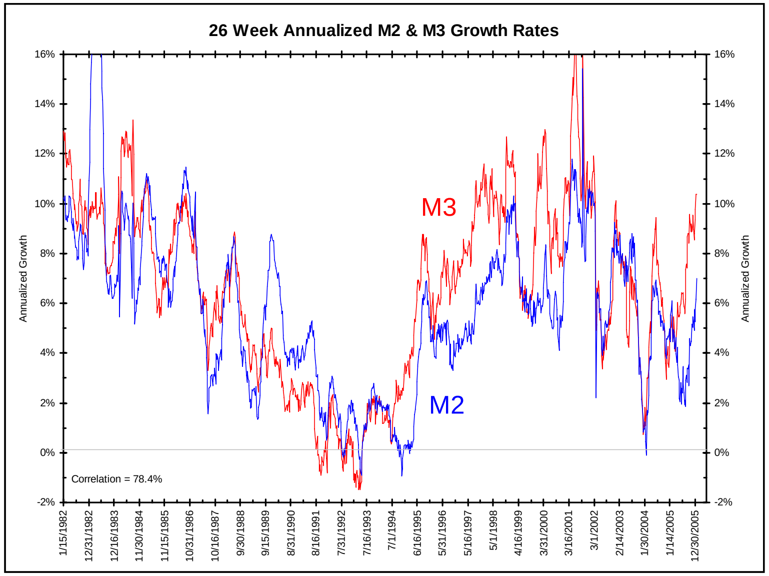
Bond Doubters Worn Out

Is a bearish bond fund "suitable," in the SEC sense of the word, for retail bond traders? How many of these investors were aware they not only had to be right on the trend of interest rates, but they had to pay the net carry of bonds as well? Buying this fund may have seemed a good idea in anticipation of higher short-term interest rates, but the flattening of the yield curve made it an unprofitable one. The old adage that bull markets either "wear 'em out or scare 'em out" seems to be finding a resolution in the former.



Dial M2 For Money. M3 Is No Longer In Service





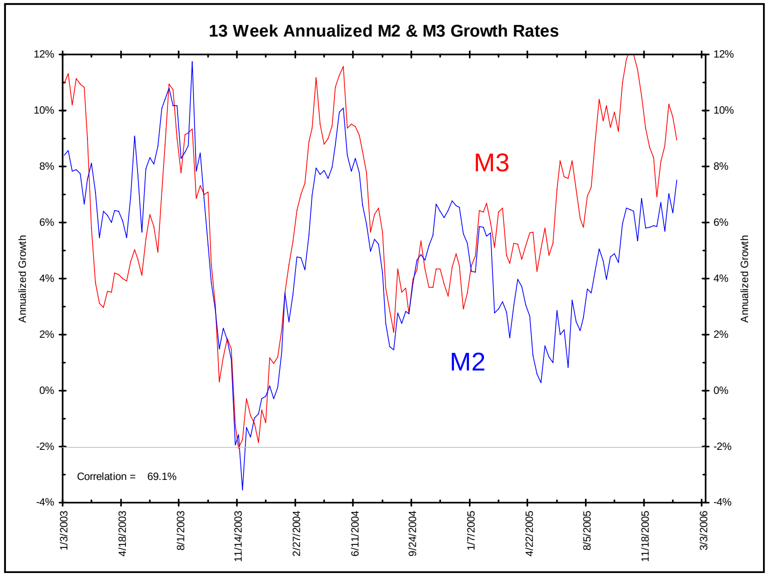
From Our Collection Of Money Supply Charts

M3 has grown strongly in recent months, but so has M2. The difference between the two is not material. In recent years, the Ms have not correlated very well to either economic activity or the financial markets as non-bank sources of credit have risen in importance.

The Fed is dropping M3 at the end of March. While we find the stated reason, to save $500,000 in production costs, a little weak, we did not rely on M3 for any exclusive insights. At best, it was one more economic datum.

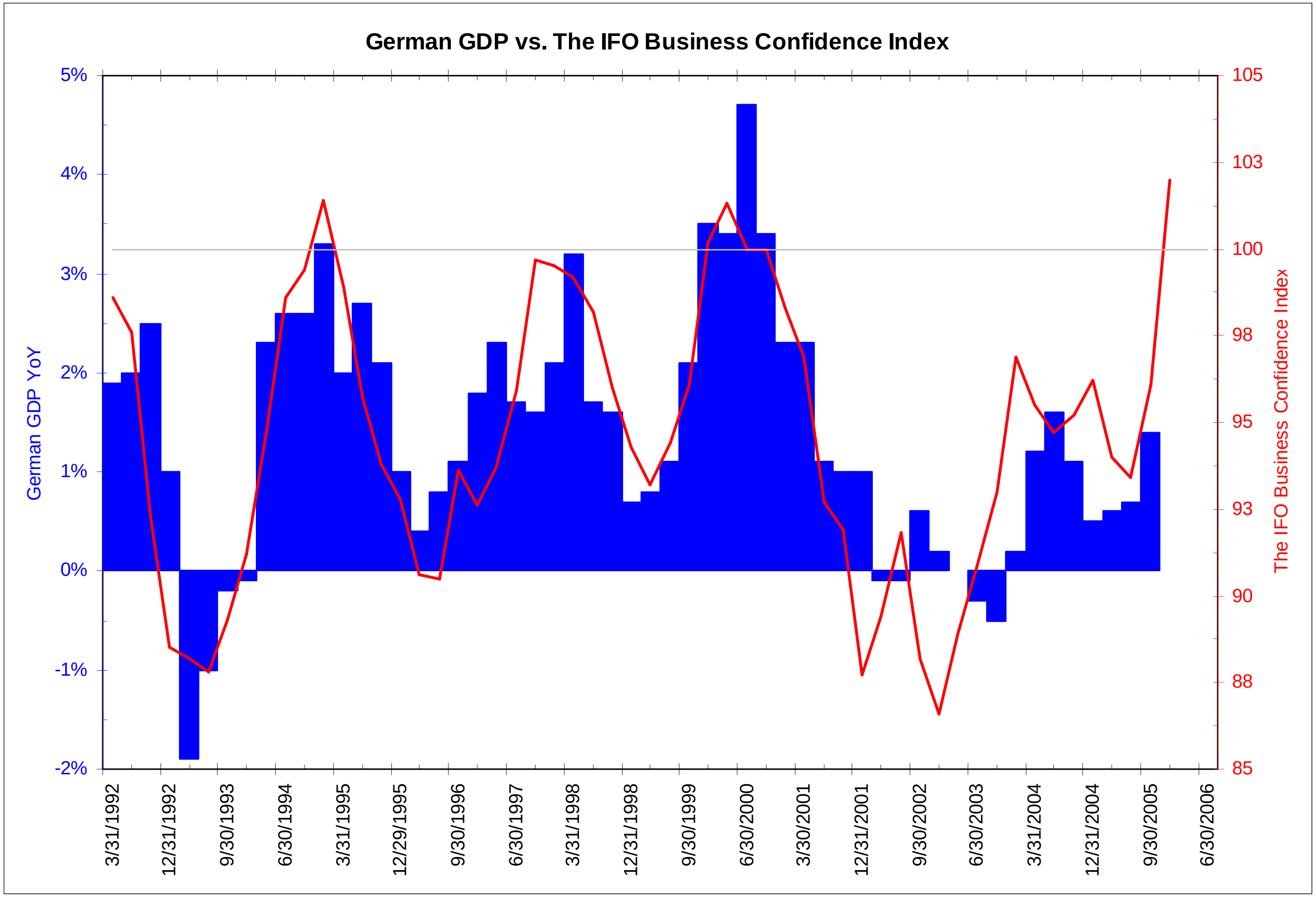
M3 is M2 plus repo transactions and Eurodollar deposits. These are repo transactions between banks, not the financing of securities. Many of these transactions represent dollar-denominated transactions between non-American parties, which explains why they are not a robust descriptor of U.S. economic activity and of financial markets.

We do not agree with those who find darker meaning in the Federal Reserve's decision to abandon the reporting of M3.



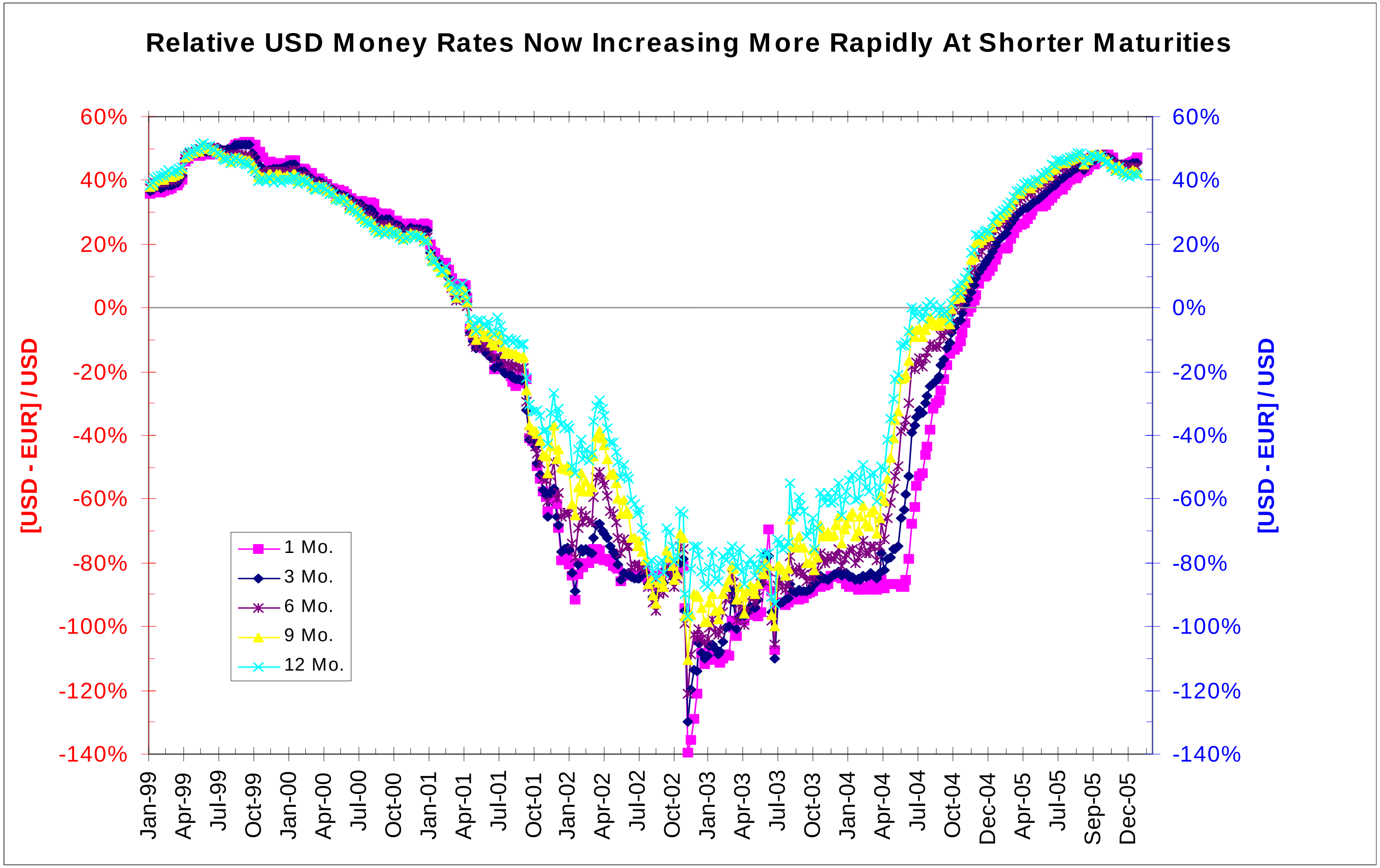
Germans Replace *Angst* With *Konfidenz*

The IFO business confidence survey has proven a good short-term leading indicator of economic activity in Germany. This is consistent with our view, expressed in a Commentary, the interest rate gap between the U.S. and the Eurozone will narrow and support the Euro.



U.S. – Europe Money Market Rate Spreads

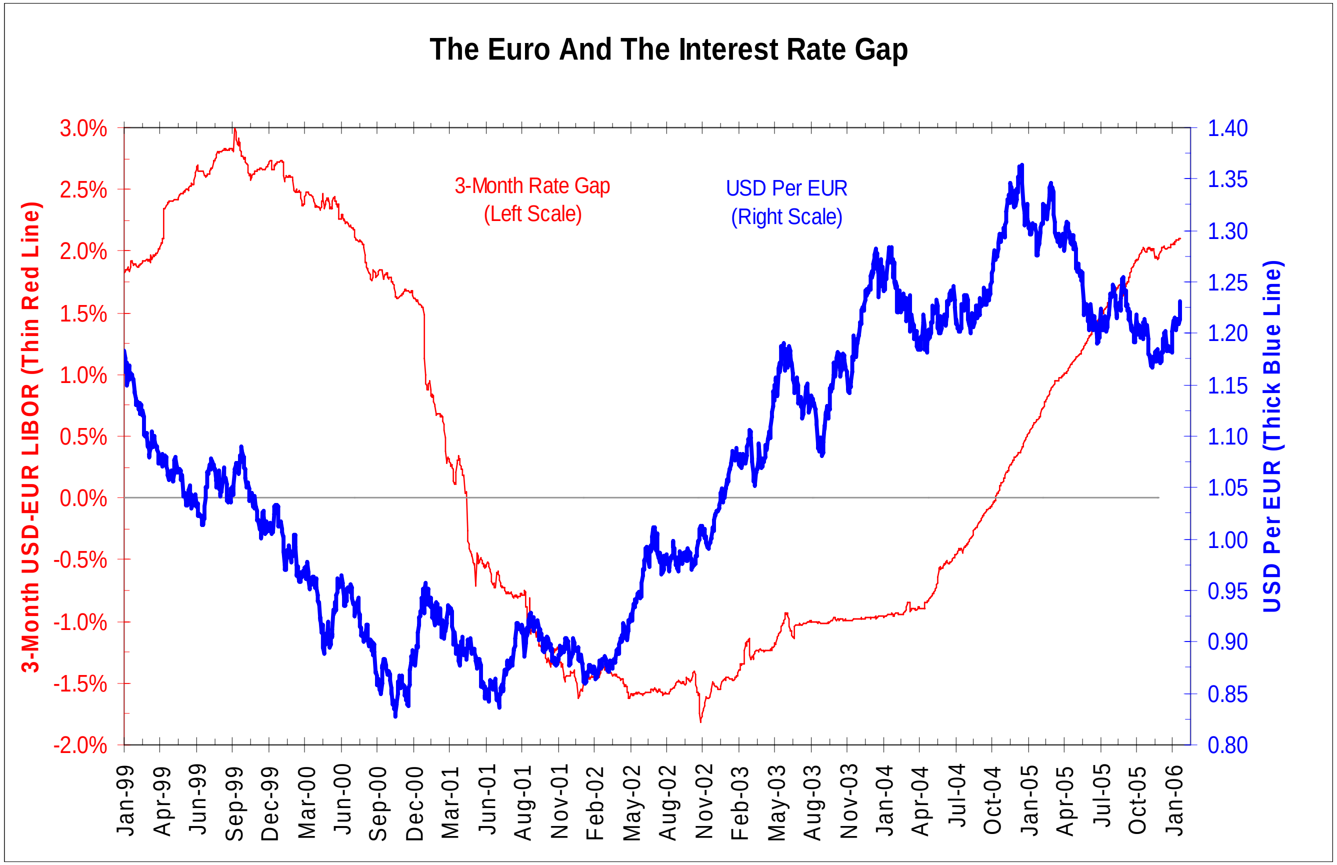
While the rate gap between the U.S. and the Eurozone has ceased growing at all money-market maturities, the rate of cessation is time-dependent. The 12-month maturities (turquoise) are showing the most rapidly narrowing gap, while the one-month maturities (magenta) are showing a stable rate gap



The Euro And The Three-Month Rate Gap

From A Recent Commentary

As most currency transactions take place at short-term horizons in the form of three-month non-deliverable forwards and related options, we should expect the rate gap at the three-month horizon to be the strongest determinant of the exchange rate. In practice, the absolute rate gap (thin red line, following page) follows the exchange rate (thick blue line) more than it leads it. If this pattern holds, we should see the rate gap between the U.S. and the Eurozone narrow in the coming months.

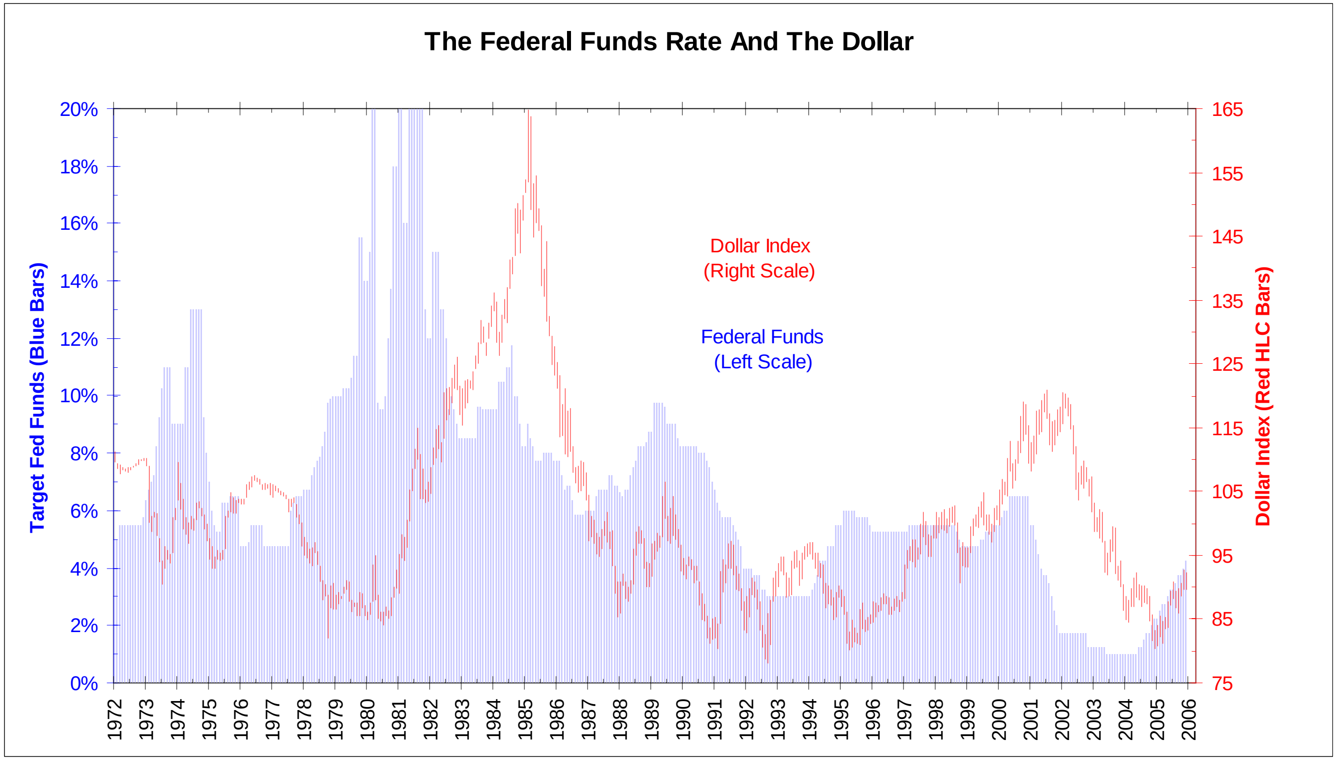


Monetary Policy And The Dollar

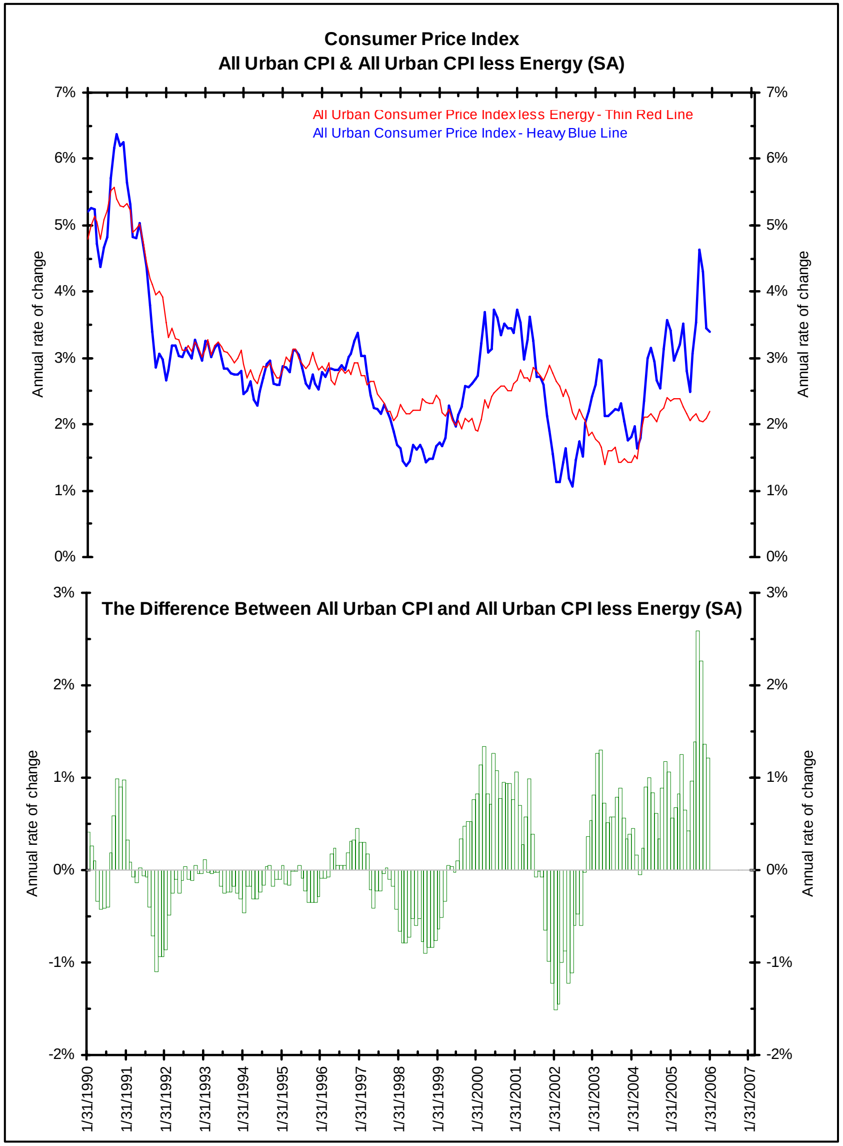
From A Recent Commentary

The long-term history of U.S. monetary policy and the dollar suggests, unsurprisingly, that a higher nominal federal funds rate (blue columns) does in fact lead to a stronger dollar (red high-low-close lines). While reasonable people certainly can disagree as to when the present rate-hike cycle will end in the U.S., the consensus and market behavior indicate we are far closer to the end than to the beginning.

Does the chart below suggest the federal funds rate has risen high enough and long enough to propel the dollar higher? Unless we are willing to believe Benjamin S. Bernanke is Paul Volcker's spiritual successor, willing to raise the federal funds rate aggressively and be given the political blessing to do so, the answer must be a decided, "No."



The Impact of Energy on Inflation



From Our Latest [Inflation Watch Update]

Energy contributed a large amount to the All Urban CPI headline number for December. As the chart on the following page illustrates, the annual rate of change of All Urban CPI was 3.40% (thick blue line top panel) while All Urban CPI less Energy was only up 2.19% (thin red line top panel). Thus, energy contributed 1.21% to the overall annual CPI number (green bars bottom panel).

Using crude oil and gasoline prices as our proxies, energy prices are up almost 8% and 3% respectively since the end of the year. Barring any plunge in prices, energy should contribute an even larger amount to the headline All Urban CPI number in January. If all else holds equal, higher energy prices could easily push headline CPI above 4% in the month of January.

Ten-Year / Two-Year Note Yield Curve Spread

From Our Weekly Spread Model Update

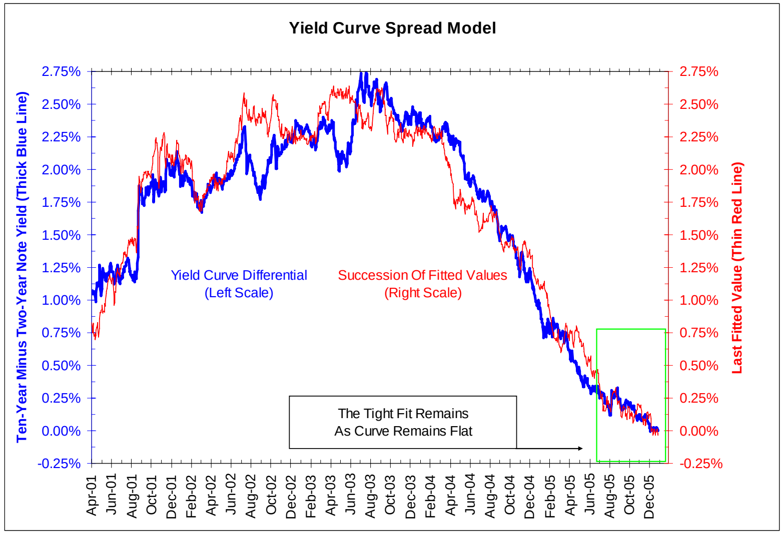
Contribution Of Inputs Over Past Week				
Factor	Coefficient	Factor's Beta To Yield Curve	Factor Movement	Contribution To Signal
Two-Year Note Yields:	Negative	0.683	Falling	Widening
Crude Oil:	Negative	0.267	Rising	Narrowing
Ten-Year Note Volatility:	Positive	0.250	Falling	Narrowing

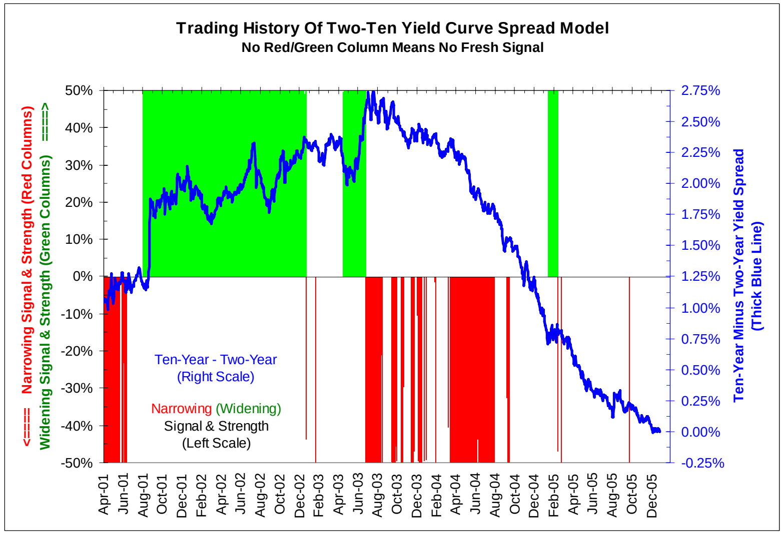
- The 2-10 yield curve spread's (blue line, top chart) hesitation at staying inverted remains well-handled by the model's dynamics (red line, top chart)
- The operating signal, a narrowing initiated on March 9th, (red columns, lower chart) has been reinforced by successive signals, most recently on October 17th
- Two of the three variables in the model (top table) worked toward narrowing over the past week. Lower two-year note yields remain the likeliest cause of a widening

Summary Historic Statistics

From April 23, 2001

Historic		Current	
Total Signals:	7	Current Position:	Narrowing
Correct Signals:	6	Entry Date:	09-Mar-05
Percent Correct:	85.7%	Entry Price, BP:	86.4
Average P/L:	55	Current Price, BP:	0.9
Total P/L:	383	Current Open P/L:	85.5



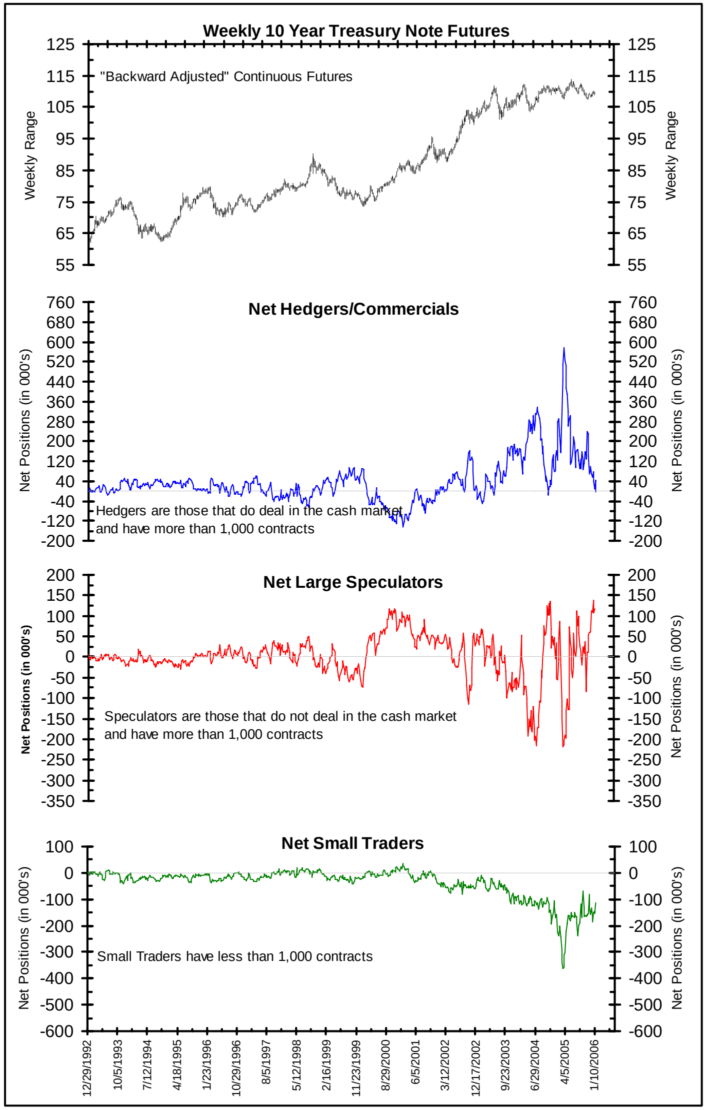


10-Year Note Futures: Hedgers Go Net Short

From Our Latest
Commitment Of Traders Update

Friday's Commitments of Traders data for 10-year futures showed Hedgers were net short 4,074 contracts on January 17. At the same time, Friday's report showed the Large Speculators were net long 117,996 contracts on January 17.

Prolonged trading ranges encourage short-term trading behavior, and this seems to be the case here. Neither side can claim success. We can note, however, how both the Large Speculators and the Small Traders are increasingly willing to trade the market from the long side, which should be viewed as a negative for price. They are by definition weak longs at this stage.



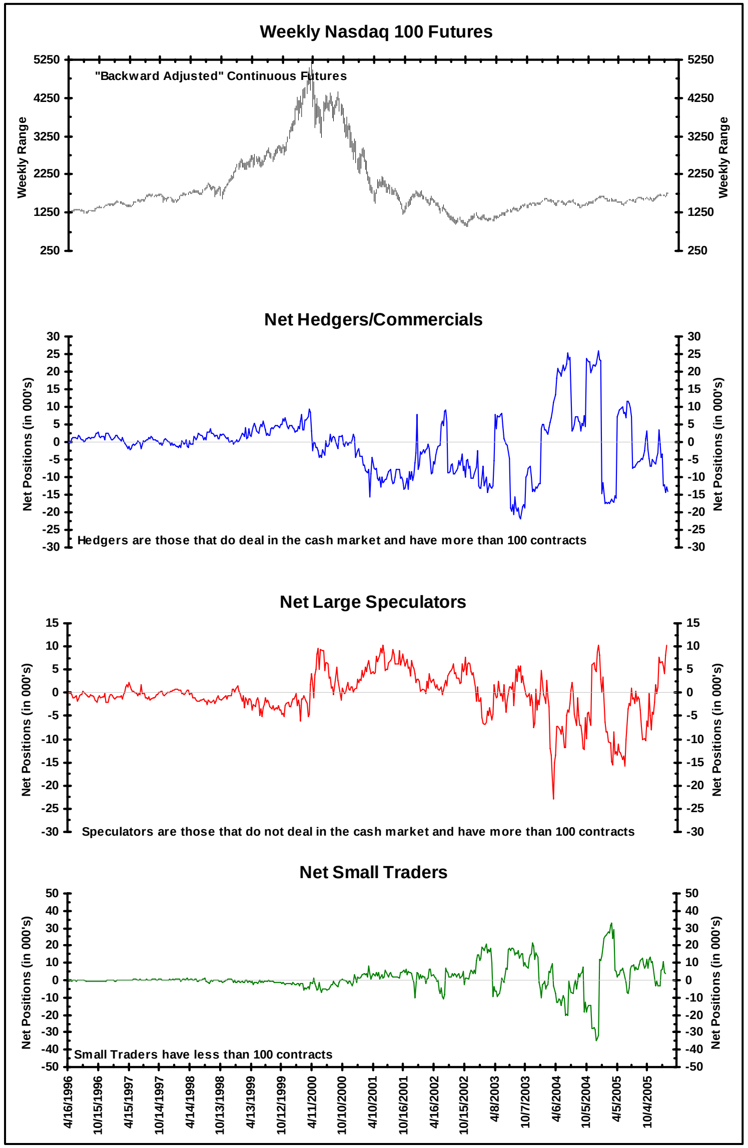
NASDAQ Futures: Hedgers Remain Short

From Our Latest

Commitment Of Traders Update

Friday's Commitments of Traders data for Nasdaq futures showed Hedgers were net short 14,195 contracts on January 17. At the same time, Friday's report showed the Large Speculators were net long 10,302 contracts on January 17.

The Small Traders have kept their net longs small, while the Large Speculators were willing to press the long side against the Hedgers. This so far looks like a losing bet for the Large Speculators; we will have to wait to see how much of the end-of-week selling came from the Large Speculators liquidating positions.

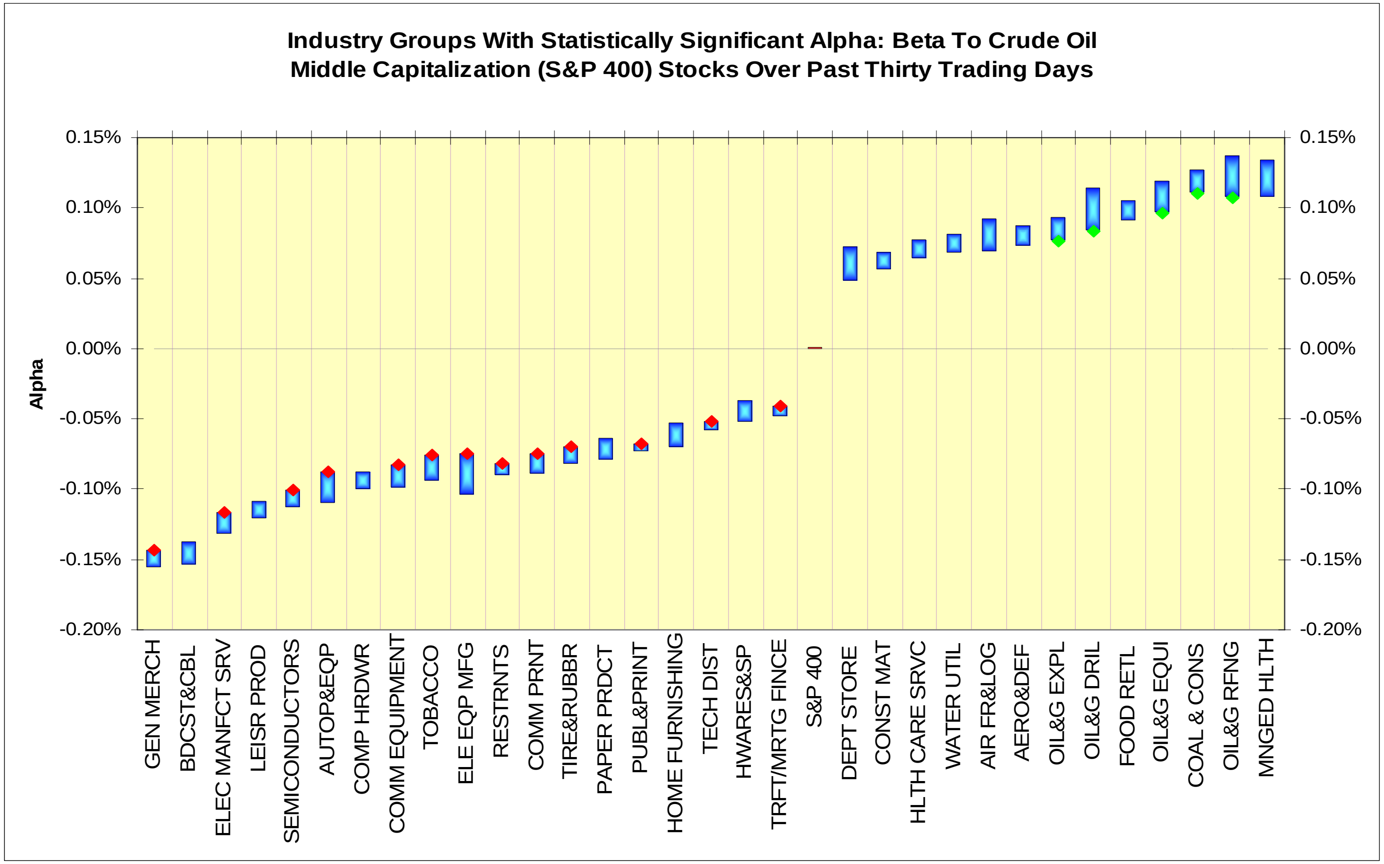


Higher Crude Oil Prices Depress Mid-Cap Laggards

From A Recent Equity Sector And Group Analysis

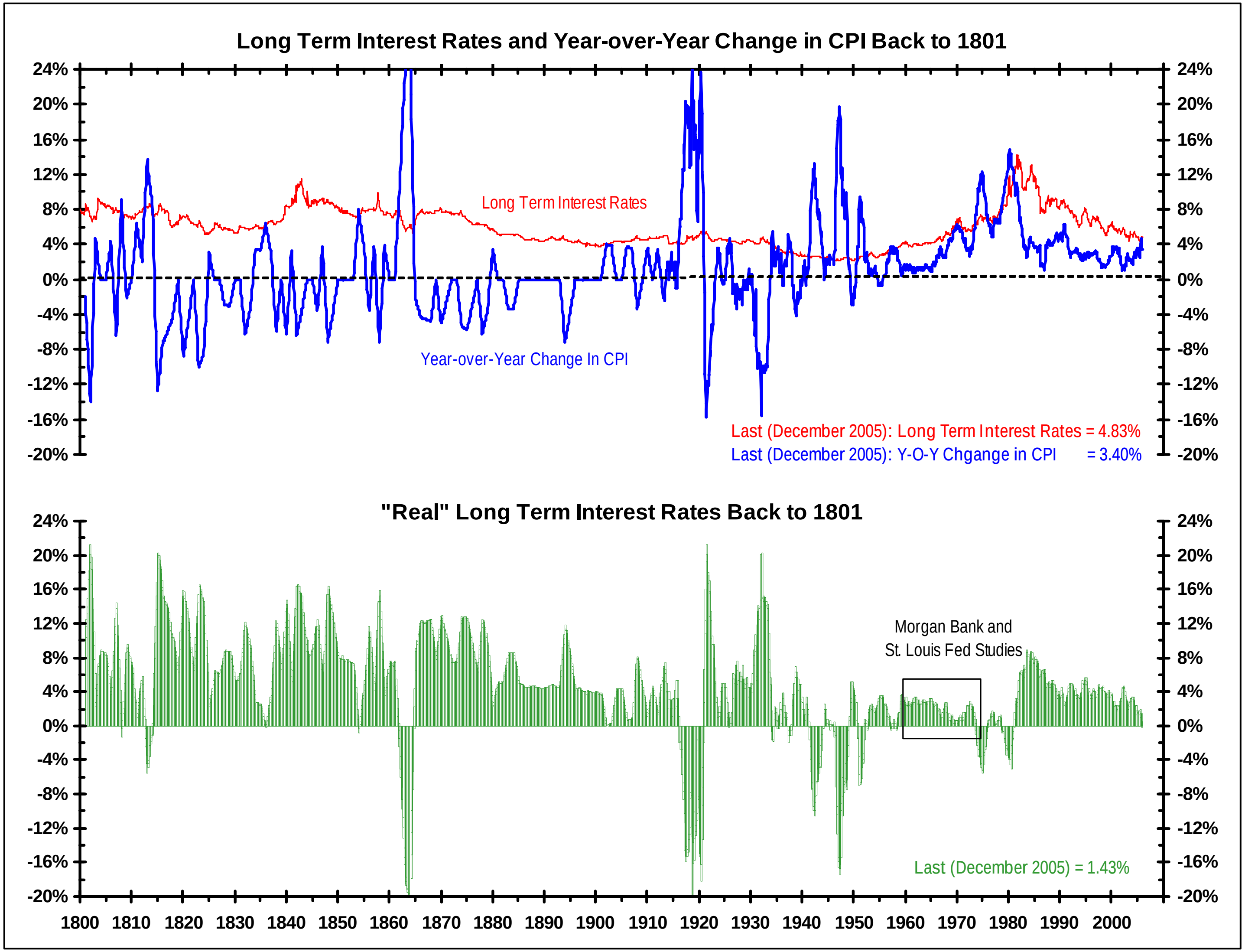
- A downturn in crude oil prices would boost for General Merchandisers, Electrical Manufacturing Services, Semiconductors, Auto Parts & Equipment, Communication Equipment, Electrical Equipment Manufacturing, Tobacco, Restaurants, Commercial Printing, Tires & Rubber, Publishing & Printing, Technology Distributors and Thrifts & Mortgages

- Only Coal and the oil-related groups are hurt by lower crude oil prices



Long-Term Look: 205 Years Of Real Long-Term Interest Rates

From Our Collection of Long-Term Charts



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