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Sung Nam

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Weekly Fixed Income Update

Commentary - Economics enraptures the entire financial, business system and a recent read helped to nail this home for us. The writer hit on the following points below. Economists analyze countries, while analysts analyze companies. Hurricane Sandy, weak Christmas season, Fiscal cliff on the radar, but no mention of the still unfolding European crisis, which seems like a deliberate censoring, rather than an observation of an actual defusing situation. China's recent indicator hinting of improvement easing concerns of a hard landing. What has happened in the past month to fix these previously abhorrent, looming financial crisis i.e. hard landing, European crisis? Central bank interventions? Currency dumping? Do these monetary policies fix the underlying, core issues? We think not. Don't write off the crisis so easily. It has yet to rear its' ugly head.

GDP – Strengthening economy (3.1% vs. 2.7%). Fiscal cliff has been avoided for now, but kicked the can down the road. Weak Christmas season offsets the slight improvement to investor sentiment. May see a weakening in Q2, when the budgetary issues need to be addressed.

Employment – Strengthening as well; rate at 7.7%. In particular, California and New Jersey.

Business Activity – Stronger durable goods activity. Machinery sales slowed, as companies are hesitant to invest in capital goods at this juncture. When this data point strengthens, recovery is firmly in place. Increased business activity with the current machinery, but zero future investment, can't translate into future growth. Business activity is the key driver for growth, not consumer, nor construction. Surely, the actual manufacturing could take place outside the border. So we must check Chinese machinery orders, since they will purchase them and Japanese/German exports, since they manufacture a majority of the machines.

Construction Activity – Single family prices are raising steadily, on back of low rates and prices. Inventory of homes around 5 months.

Consumer Activity – tax withholdings related litigation will have a large impact on consumer spending habits. Christmas season was weak and will stay pat until employment figures improve. Pundits raise concerns over inflation stimulated by the QE activity, which will dampen spending in the mid-term. Also, read supply concerns over commodities will also pressure prices.

Interest Rates – rates at lows ranging from 0.7% to 3%. German/Treasury spread at 0.3% for 10 year as German bund rallying, not over safety haven but increased liquidity. Tax exempt bonds on the board for review under the fiscal cliff related legislation. Yields were lower relative to taxable, but now even, implying probability of losing benefit of full tax exemption for interest payments to the top tax bracket. Greek/Portuguese yields at teens.

There are a few more points we did not include in our update, primarily due to food coma, but bond investors aggregate all these data points and make a conclusion of how interest rates will move, which affects the bond price (duration, convexity).