Payden&Rygel Weekly Market Update

For the week ending July 16, 2010

MARKET LEVELS

	Friday*	Last week	Dec. 31, 2009	One year ago
Dow Jones Industrial Avg	10,142	10,198	10,428	8,712
S&P 500	1,071	1,078	1,115	941
NASDAQ	2,195	2,196	2,269	1,885
Russell 2000	617	629	625	522
DJ STOXX Europe 600 (€)	248	250	254	210
Nikkei Index (¥)	9,408	9,585	10,546	9,344
Fed Funds Target	0%-0.25%	0%-0.25%	0%-0.25%	0%-0.25%
2-Year Treasury Yield	0.59%	0.63%	1.14%	0.98%
10-Year Treasury Yield	2.94%	3.05%	3.84%	3.57%
U.S. $ / Euro	1.29	1.26	1.43	1.41
U.S. $ / British Pound	1.53	1.51	1.62	1.64
Yen / U.S. $	86.63	88.50	93.02	93.61
Gold ($/oz)	$1,190.18	$1,211.60	$1,096.95	$937.34
Oil	$76.01	$76.09	$79.36	$62.02

**Levels reported as of 9:15 a.m. Pacific Standard Time*

MARKET RETURNS

Year-to-date (1/1/10-07/16/10)*		Year-to-date (1/1/10-07/15/10)	
Dow Jones Indus Avg.	-2.74%	**90 Day T-Bill**	0.06%
S&P 500	-3.97%	**2-Year Treasury**	1.37%
NASDAQ	-3.28%	**10-Year Treasury**	7.20%
Russell 2000	-1.41%	**ML High Yield Index**	2.07%
MSCI World Index	-4.74%	**JPM EMBI Global Diversified**	7.59%
DJ STOXX Europe 600	-2.28%	**JP Morgan Global Hedged**	4.37%

**Returns reported as of 9:15 a.m. Pacific Standard Time*

RECAP OF THE WEEK'S ECONOMIC RELEASES

July 13 — *Balance of Payments for Goods and Services* – The trade deficit widened unexpectedly to reach -42.3% in May, an increase from -40.3% in April.

July 14 — *Retail Sales* – Sales at retailers and food service locations fell by -0.5% in May. However, the decline was driven by falls in building materials, gardenware and home furnishings, implicating the expiration of the homebuyer tax credit.

	Business Inventories – Total business inventories rose by 0.1% in May, slower than April's increase of 0.4% but in line with expectations.
July 15	*Producer Price Index* – Producer prices fell by -0.5% in June, following May's decline of -0.3%. However, much of the slide came from food prices, which fell by -2.2%; core PPI rose 0.1%.
	Initial Claims – Initial unemployment claims fell to 429,000 from 458,000 in the prior week, but the four-week moving average fell only slightly.
	Capacity Utilization – Industrial capacity utilization remained unchanged in June at 74.1% after rising steadily for the past year.
	Industrial Production – Industrial production increased by just 0.1% in June, significantly less than April's increase of 1.3%, and propped up entirely by rising utility usage from hot weather.
July 16	*Consumer Price Index* – Consumer prices fell by -0.1% in June, marking the third straight month of decline. However, core CPI, which excludes food and energy costs, rose by 0.2%.
	Michigan Consumer Sentiment Preliminary – Consumer sentiment has fallen sharply to 66.4 in July, down from 76.0 in June, according to preliminary readings of the University of Michigan's index.

ECONOMIC OVERVIEW

The many economic releases this week were not especially encouraging, but they looked worse than they were. Consumer prices fell by -0.1% as expected, driven primarily by another steep fall in energy prices. However core CPI, which excludes food and energy, rose by 0.2%, the largest increase since October 2009 and the latest in a long series of small but positive readings. The slow but broad-based acceleration in core prices suggests that fears of deflation may be overblown.

Consumer sentiment disappointed, falling sharply to 66.4 in July from 76.0 in June. This marks the eighth-largest fall in the 60-year history of the University of Michigan's survey, and brings the index down to September 2009 levels. However, sentiment has not historically been a strong indicator of consumer spending. Indeed, although retail sales fell by -0.5% in May, the decline was driven by prices of building materials, gardenware and home furnishings, suggesting that the expiration of the homebuyer tax credit is to blame. Given the scorching 10.9% annual rate in the first three months of the year (the largest since 2003), the recent retail sales figure may simply represent a slowdown from an unsustainable pace.

Finally, initial jobless claims fell to 429,000 from 458,000, but these numbers must be interpreted with caution because delays in the timing of summer manufacturing layoffs have wreaked havoc on seasonal adjustments. Jobless claims tend to be a noisy indicator in the summer months; a better metric is the four-week moving average, which has fallen only slightly. On the whole, the data points to slower economic growth in the second half of this year. However, there is little evidence for a double-dip recession.

US MARKETS:

TREASURIES

- Treasury yields rallied this week, recapturing momentum after a slight reprieve last week. With moderations in growth expectations, inflation expectations and sovereign risk premiums, investors are increasingly comfortable buying Treasuries. Producer prices dropped and retail sales data disappointed, signaling a lower trajectory of economic activity. Agency spreads were docile this week, while Treasury Inflation Protected Securities underperformed nominals by a handful of basis points.

LARGE-CAP EQUITIES

- The stock market fell on disappointing economic data but was tempered by increased mergers and acquisitions and better-than-expected corporate earnings. The S&P 500 and Dow Jones Industrial

Average both fell approximately -0.5%, and large-cap stocks outperformed small-cap stocks. In terms of style, large-cap growth stocks outperformed large-cap value stocks. The best performing sector was information technology and the worst performing sector was financials. Earnings season kicked off this week with Alcoa, Intel, JPMorgan Chase, Bank of America, Citigroup, and General Electric all beating analysts' estimates, while Google trailed estimates. In the headlines, Goldman Sachs agreed to pay $550 million to clear themselves of fraud charges as part of a settlement with the Securities and Exchange Commission. The company's shares rallied over 4% on the news. In other news, BP was successful in their latest attempt to cap the oil well: oil flow was halted for the first time since the spill began in April. Shares of BP jumped over 7% on the welcome news.

CORPORATE BONDS

- Investment grade primary activity came out with a bang as issuers raced to close deals before the blackout period for 2nd quarter earnings begins. This week saw strong earnings for those companies that have reported. However, investors and analysts will also be looking for future guideline revisions. Notable deals included Qatari Diar Finance ($3.5bln) and Oracle Corp ($3.25bln). There remains a strong demand for new issuance, as evidenced by deals that continue to be severely oversubscribed and tightening on the break.

- Investment grade corporates tightened yet again this week, led by the financial sector. Financials have been feeling the brunt of Goldman's SEC investigation, financial reform and the state of affairs in overseas markets. With new issuance lower-than-expected, investors continued to look for places to park their money. With most of the street either flat or short, the market is technically in good shape for those who don't have to buy. The Barclays Credit Index Option-Adjusted Spread (OAS) finished the week at +168, tighter by 10 basis points. Financials tightened by 18 basis point (banks -20, insurance -11); industrials tightened by six, (basic materials -11, capital goods -3, telecom -6, consumer cyclical -3, consumer non-cyclical -2, energy -13); and utilities tightened by six basis points.

MORTGAGE-BACKED SECURITIES

- The agency mortgage market continued to defy logic by outperforming Treasuries in the bond market rally. Economic reports suggested a disinflationary environment and a slowdown in economic activity. The shift in bias, by market participants, on the direction of interest rates has caused a yield grab as the Federal Reserve is likely to stay on hold until 2011. As an alternative 'safe haven' product, agency mortgage securities have benefited from an allocation out of equities into bonds. With mortgage rates at all-time lows, investors should be concerned about refinance risk. Tight credit conditions and many borrowers underwater on their homes have supported current mortgage prices at record levels. Like last week, the best performing securities have been lower coupon 30-year mortgages. Higher coupons have stalled but still have posted positive excess returns relative to comparable Treasuries. The 30-year current coupon mortgage versus the 10-year Treasury spread is at 61 basis points. As reported by Freddie Mac, the 30-year primary mortgage rate stands at an all-time low of 4.57%.

MUNICIPAL BONDS

- Yields on tax-exempt municipal bonds fell near record lows across the yield curve this week amid strong demand from retail accounts and a scarcity of bonds in the primary and secondary markets. Yields on AAA-rated state government obligation bonds (GOs) maturing in 2 years reached 0.45% -- a new record low. Yields on 5-year GOs hit 1.40%, just off a record of 1.39% reached in December 2009. Finally, 10-year AAA-rated state GOs are now at 2.62%, just 5 basis points off the low yield hit in September 2009. Supply in the secondary market is constrained and bidding for high-grade bonds in the short and intermediate range of the market has been heated. Large chunks of new supply continue to come to market in the taxable Build America Bonds (BABs) market rather than the tax-exempt space. Fund flow data for the first week of July show retail money flooding out of equities and into bonds. Municipals continue to benefit from this, but the real question is: how long this will continue based on the low level of yields offered? The consolation is that inflation is nonexistent and trending lower, meaning "real" (inflation-adjusted) income for income-oriented investors is actually improving. The monthly headline

CPI print has now been negative for 3 consecutive months. The last time we saw 4 consecutive monthly negative CPI prints was during the 1930s deflationary period.

- One large deal of note this week was the $900 million Illinois GO BABs deal. The 7.1% coupon bonds maturing in 2035 sold at +325 basis points to Treasuries, or a 7.35% yield. The deal was well received by the market despite the headline risk the State of Illinois poses with its ongoing fiscal imbalance. In Friday morning trading the market for the 2035s was quoted at +313/+321 in spread terms.

HIGH-YIELD BONDS

- The high-yield market has exhibited strong momentum in the first half of July, as worries about the economic situation in Europe and fears of a double-dip recession in the US have abated somewhat. The Merrill Lynch high-yield BB/B index is up 1.6% in July to-date as investors have bid bonds up on expectations of declining risk aversion and renewed potential for global economic growth. The rebound in the equity markets has also helped to lift market spirits, with major indices up 6-8% since the end of June 2010. The new issue market continues to grow, with almost $1.5 billion of high yield rated deals pricing this week. The Dutch semi-conductor company, NXP, priced a $1 billion offering with a coupon of 9.75% and Cedars Fair, a large amusement park company, priced a $405 million offering with a 9.125% coupon. Both deals were well received and traded up in the secondary market. In a sign of declining risk aversion, high yield mutual funds reported a heavy $1.3 billion of inflows. This is the second largest weekly inflow in 2010 and bodes well for market liquidity and a pick-up in the pace of new issue deals.

INTERNATIONAL MARKETS:

EASTERN EUROPEAN EQUITIES

- The CECE index of equities traded in Central Europe (Czech Republic, Hungary, and Poland) gained +2.5% over the past week, while the Russian stock index RTS went up by +2.2%.

- Ukraine abandoned plans to sell its first Eurobond since 2007 as investors demanded higher yields than the government was willing to pay after successfully striking a second loan agreement with the International Monetary Fund (IMF). With investors seeking a yield of more than 9%, the administration "decided not to proceed with a new transaction, given other immediate sources of financing and its liquidity position." Meanwhile, Ukraine is starting to follow through on some of its promises to the IMF in order to secure the first tranche of the US$14.9 billion stand-by agreement. The government is also planning to raise household utility prices by 50% in order to limit the deficit of state-owned Naftogaz (which is still expected to be UAH 10 billion in 2010). The government is providing UAH 5.4 billion in subsidies to the poorest Ukrainians in order to soften the blow.

GLOBAL BONDS AND CURRENCIES

- The past week's focus on the potential for a double-dip recession in the US was sufficient to ensure that all major government bond markets closed the week little changed or slightly firmer. In Europe, bond market sentiment was also supported by strong demand for a series of bond issues by the governments of Greece, Portugal and Spain. Japanese government bonds were supported by a rise in the yen, which was seen as dampening earnings prospects for Japanese exporters.

- In currency markets, concerns about US growth weighed on the US dollar, which finished lower against the yen, euro and sterling. The sterling received a lift from better-than-expected UK labor market figures. Commodity-linked currencies were set back by concerns about a slowdown in Chinese demand for raw materials, while expectations of an imminent announcement on the general election in Australia had little adverse impact on the Australian dollar.

EMERGING-MARKET BONDS

- Emerging market dollar-pay debt spreads widened marginally as weaker-than-expected consumer confidence late in the week reduced investor risk appetite.

- The central bank in Mexico kept its benchmark interest rate unchanged at 4.5%, in line with expectations. In a statement following the announcement, they noted that there has been a “favorable shift in trend” for domestic consumption and investment. Local bonds were stronger this week.

- In Turkey, the central bank kept its benchmark interest rate unchanged at 7%, in line with expectations. In a more dovish statement, the Central Bank pointed towards weaker external demand, reiterating that “it may be necessary to maintain policy rates at current levels for a prolonged period.”

NEXT WEEK'S ECONOMIC RELEASES

July 19	*NAHB Housing Market Index*
July 20	*Housing Starts, Building Permits*
July 22	*Initial Claims, State Benefits, Existing Home Sale, US Leading Indicator Index*