FLORIDA PRIME

Weekly Commentary

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A week of Greek drama that went down to the wire may soon be replaced by another thriller, this time involving neighboring Italy. It appears as if Greece was able to save its much debated European Union bailout last week, but only after Prime Minister George Papandreou agreed to step down and make way for a unity government. This came at the end of a week that first saw Papandreou shock the world, and his own ministers, by announcing he would put the deal that included unpopular austerity measures to a referendum. He backed off that pledge on Friday, holding a confidence vote that he barely survived only by promising to form a new government headed by someone else.

This led the markets to shift focus to Italy, where 10-year government bond yields hit a euro-era high last week on concerns about the ability of Prime Minister Silvio Berlusconi's government to address its debt ills. And overshadowing all this uncertainty were growing signs that the EU economy may be headed for recession. The European Central Bank unexpectedly cut its benchmark funds rate a quarter point to try and forestall a downturn. Meanwhile, European banks rattled by the unsettledness continued to park cash in the ECB, where overnight deposits hit a record high on the year. As has been the case since the EU sovereign-debt crisis first emerged as an issue in 2010, Federated's conservative stance on managing and monitoring every security within its money market portfolio has resulted in extensive and continuous review of our portfolio's exposures to European senior bank debt, prompting portfolio management to shorten maturities, downgrade certain names and to eliminate others from its list of investable securities.

Back at home, events were far less dramatic. October nonfarm payrolls rose slightly less than expected—80,000 vs. 95,000 consensus—but the two previous months were revised up sharply, marking the fifth straight report in which private payrolls were revised higher. The headline on October's manufacturing ISM disappointed, but it still had its 27th straight month of expansion and, more significantly, the weakness was driven by a significant decline in inventories that businesses admitted were too low relative to sales activity, indicating an inventory build is likely this quarter. Elsewhere, September factory orders unexpectedly rose and, in a sign of stronger future demand, unfilled capital expenditure orders were revised up. On the monetary policy front, the Federal Open Market Committee didn't do anything, but the Fed did revise down its longer-term outlook on GDP and inflation, even as it raised its near-term view on the economy. Its post-meeting statement, as well as comments from Chairman Ben Bernanke, indicated the Fed at this point is disinclined to raise its benchmark funds rate well beyond the mid-2013 date that it continues to cite.

On the week, credit rates continued to inch up, with three-month and six-month London interbank offered rates (Libor) rising a basis point each to new 52-week highs of 0.44% and 0.63%, respectively. One-year Libor also hit a new 52-week high of 0.95%, up two basis points. There was little change on the government front, save 13-week Treasury bills, which slipped a tick to 0.01%.

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Views are as of November 7, 2011, and are subject to change based on market conditions and other factors.