FLORIDA PRIME

Weekly Commentary

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Concerns about Greece quickly shifted to Italy last week, with yields on the country's 10-year note briefly breaching the 7% level—a funding level that forced Greece, Ireland and Portugal to accept bailouts. The sell-off came after Italian Prime Minister Silvio Berlusconi seemed to balk at the need for his country to take action during the prior weekend's G20 meeting, a stance that ultimately ended the political career of the flamboyant Berlusconi, who by week's end agreed to step down as part of deal clearing the way for Italy's Parliament to approve a package of austerity measures sought by the European Union. Italy worries the EU because it accounts for 17% of European GDP and a quarter of euro-area government bonds outstanding (it's the world's third-largest bond market), effectively making it too big for the EU to simply bail out.

While Italy's action helped calm the markets, the affair highlighted the ongoing struggles the EU faces as debt-laden members work to bring fiscal policies more in balance. The broader issue is the impact all of this is having on the European economy and European banks, particularly French banks, which hold a large share of the most troubled countries' sovereign debt. Just how on edge the markets are was evident Thursday, when Standard & Poor's erroneously said France's AAA credit rating had been downgraded, causing yields to spike again before S&P stepped in a few hours later and said it had all been a mistake. As has been the case since we first identified the potential severity of the euro crisis in early 2010, Federated continuously reviews all of our money market portfolios' exposure to European senior bank debt and, in accordance with our conservative principles, acts to shorten maturities, downgrade certain names and eliminate others from our list of investable securities as appropriate.

Across the shores, events in the United States have been far less dramatic—although that could change as the congressional super committee charged with coming up with at least $1.2 trillion in longer-term budget savings wraps up its work over the next week and a half. The market doesn't seem to be expecting much, but doing nothing likely would be an unwelcome outcome. On the economic front, sentiment appears to be improving, with the NFIB small business optimism index edging higher a second straight month and the University of Michigan's initial take on November sentiment rising to a nine-month high. The improving sentiment comes amid signs that consumers are more willing to spend as the holidays arrive. September consumer credit rose above expectations; October consumer goods import prices rose the most since 1992 on growing demand; and MasterCard said the four-quarter total of U.S. purchase volume rose 9% to $876 billion in Q3, surpassing its previous peak.

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Continuing improvement in the job market could add to the spending mood—the number of unemployed per job opening fell to its lowest level since December 2008, mass layoffs in the private sector hit a four-year low and continuing jobless claims fell to their lowest since September 2008. Also, September's trade deficit fell more than expected as exports grew more than imports, which rose for the first time in four months on consumer demand. But any potential boost to GDP when the first revision to the Q3 estimate comes out next week likely will be offset by the unexpected drop in September wholesale inventories, where businesses are playing it tight for fear of overstocking.

On the week, credit rates continued to inch up, with the three-month London interbank offered rate (Libor) rising two basis points to a new 52-week high of 0.46% and both six-month and one-year Libor rising three basis points each to 0.66% and 0.98%, respectively, also new 52-week highs. There was little change on the government front, where yields continued to hover near historic lows.

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