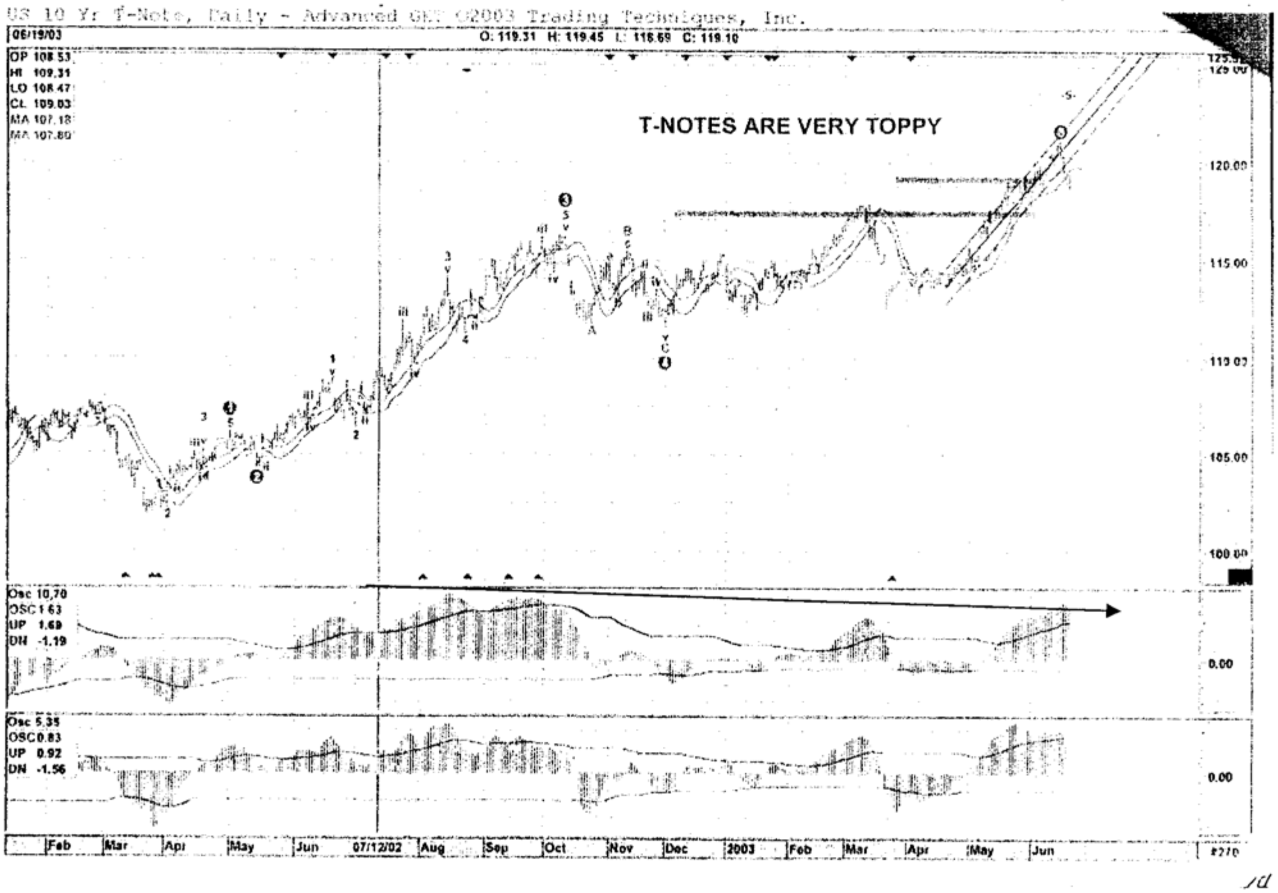
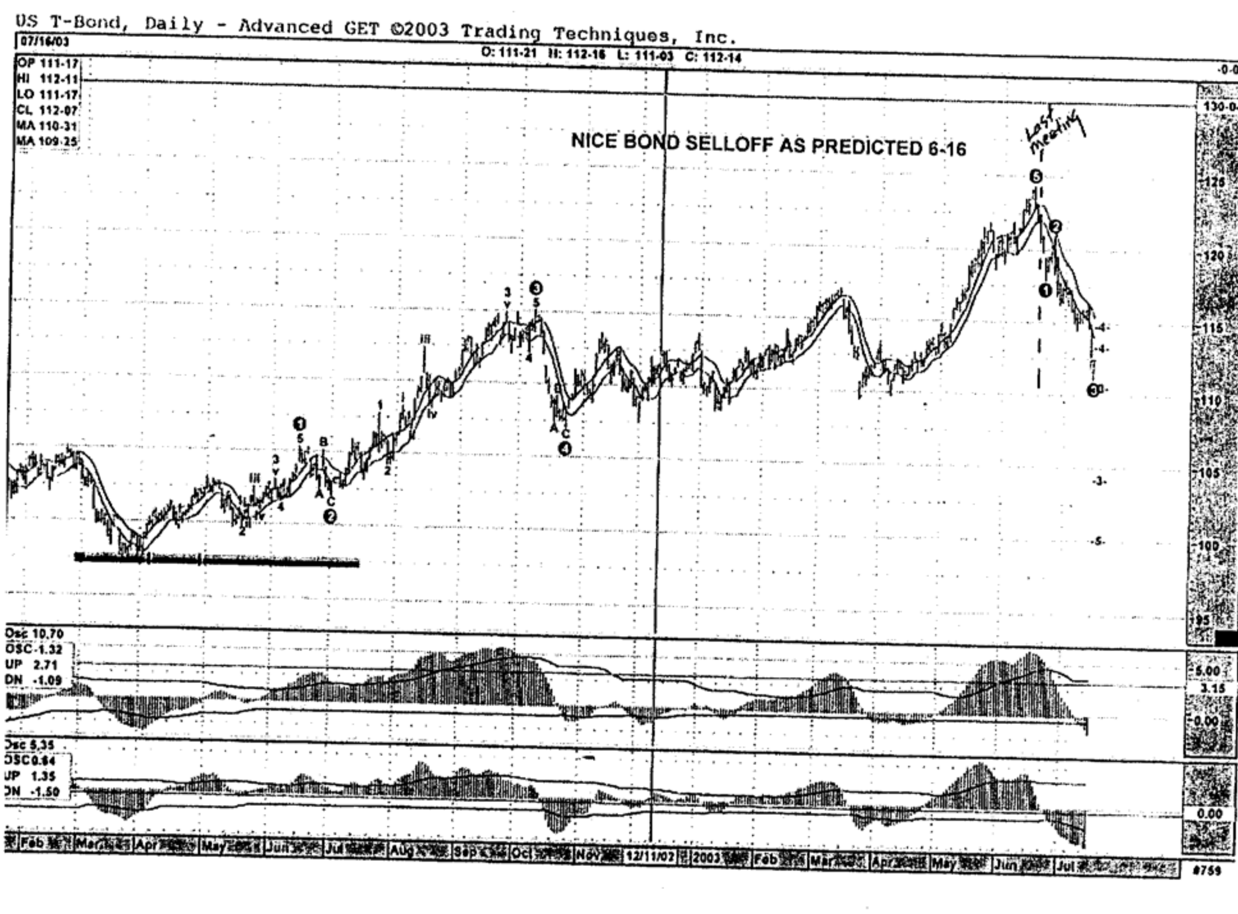
6-19-03: CALLING A MAJOR TOP IN BONDS



7-16-03: DRAMATIC BOND SELLOFF CONTINUES



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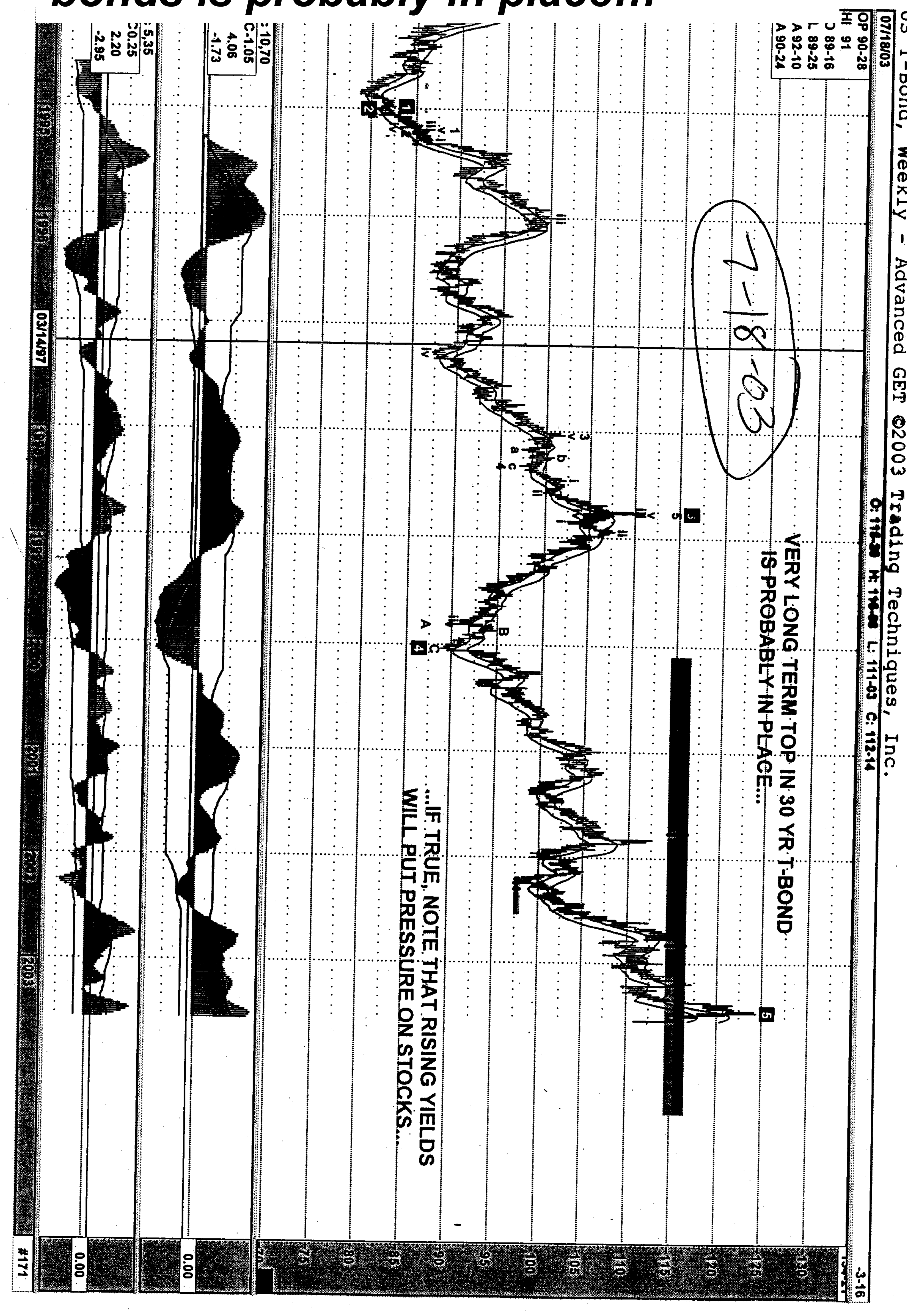
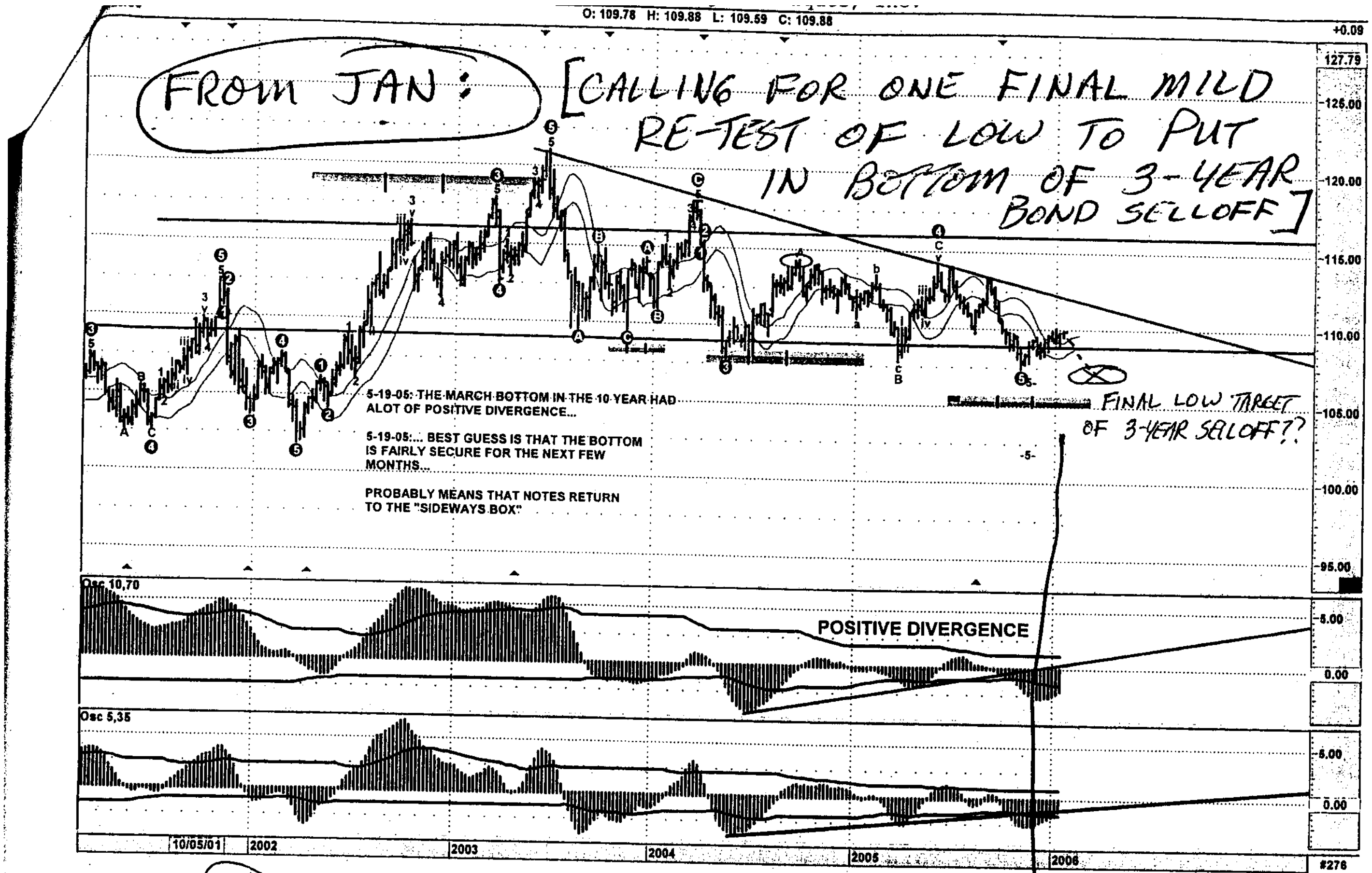
7-18-03 "… a very long term top in bonds is probably in place…"



Jan/Feb ’06: 3-year bond selloff nears a bottom



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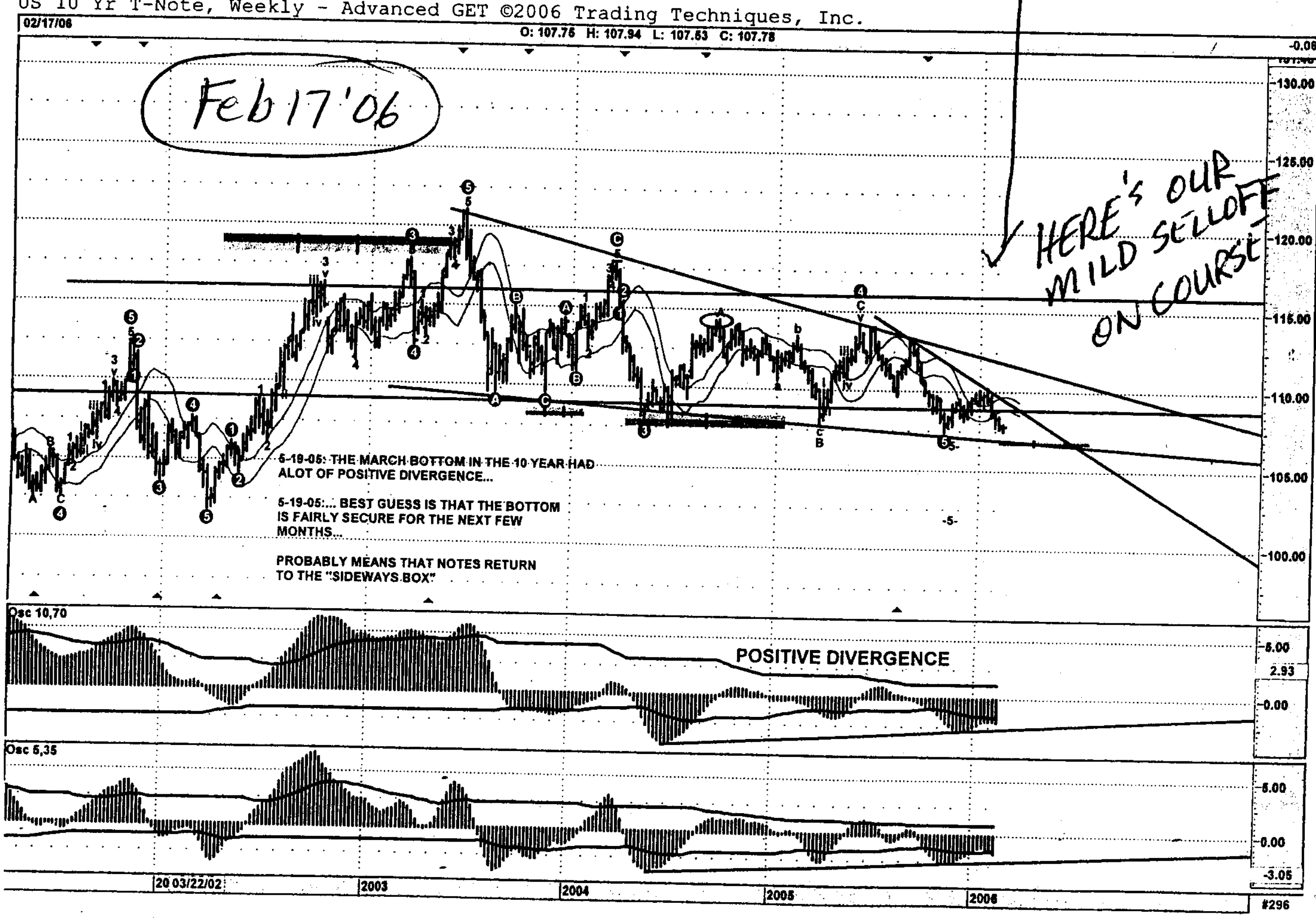
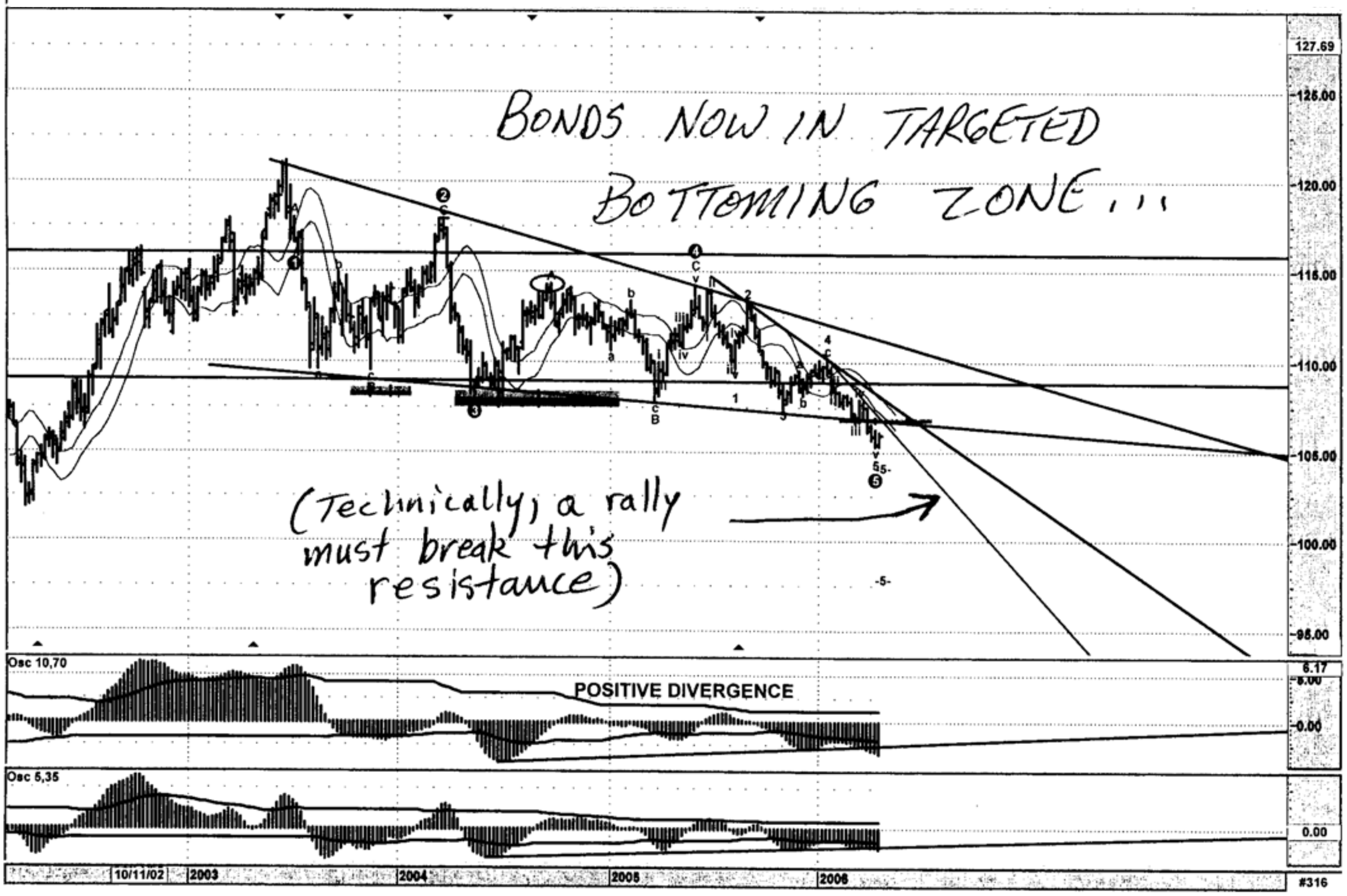


E19

April '06: Bonds reach our bottoming targets



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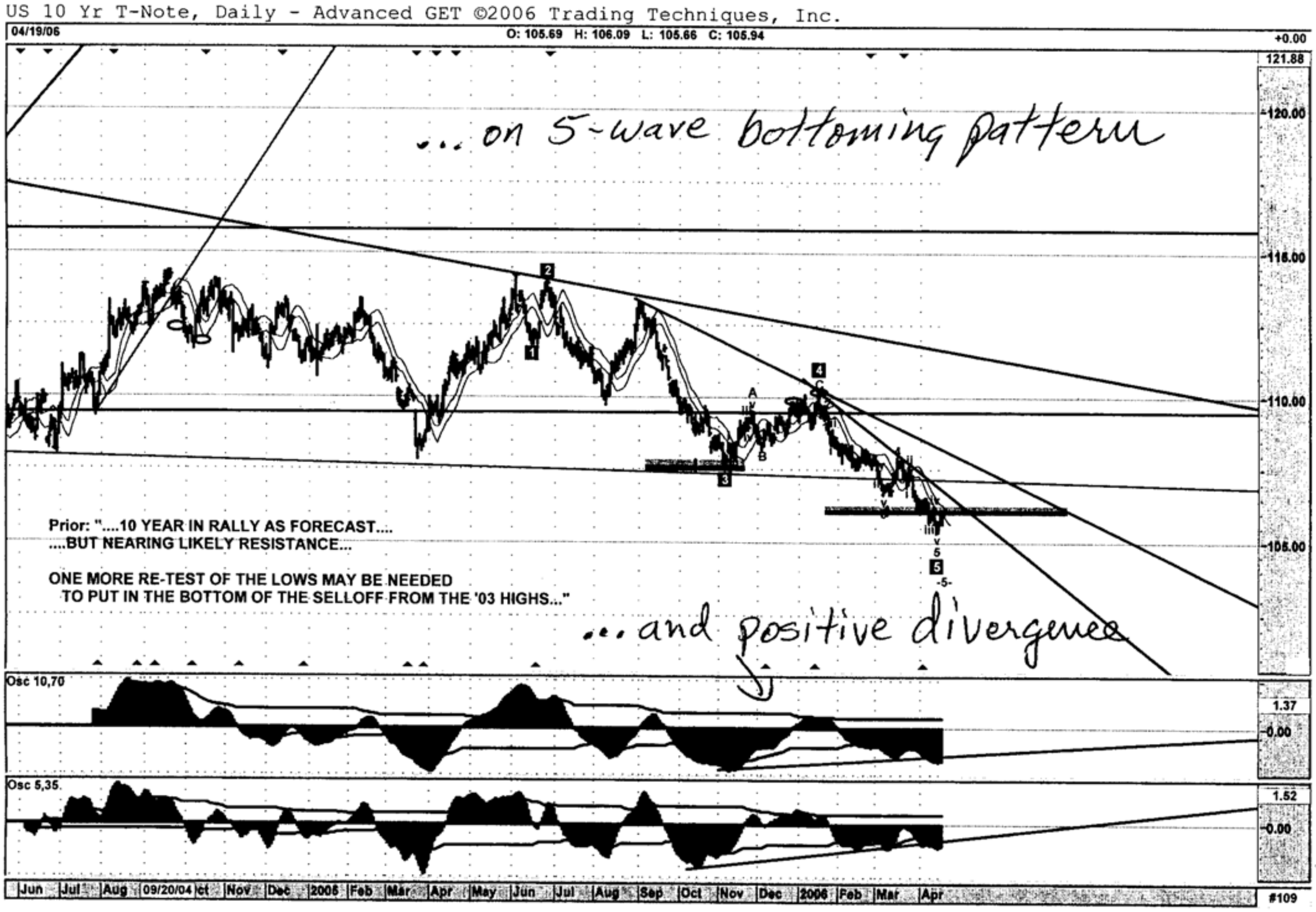
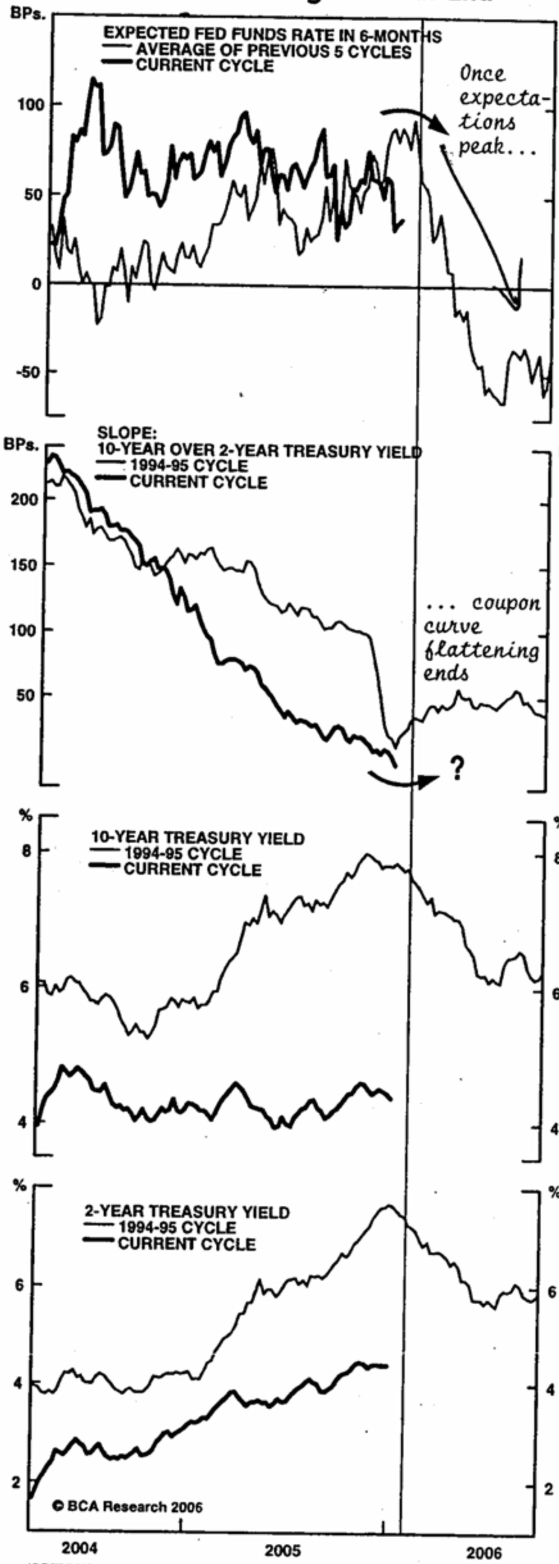


Historically, bonds have bottomed after yield curve inversions.

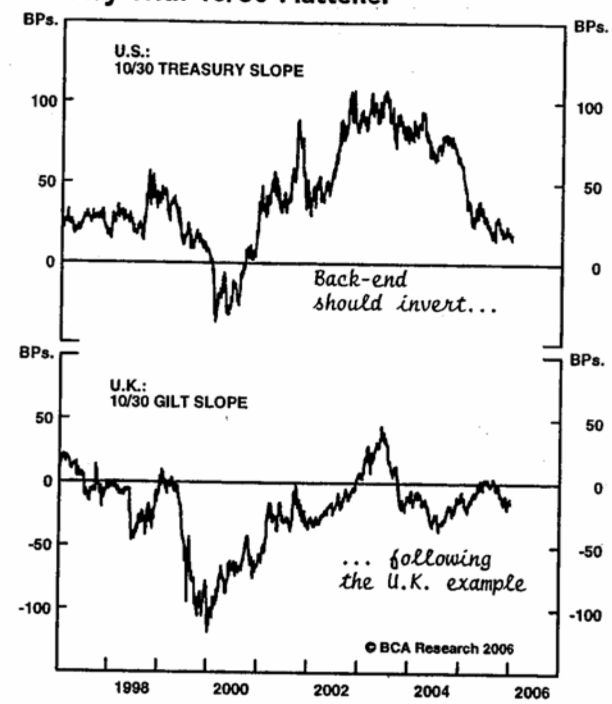
RATES OF AFTER FLATTENING

CHART 8
U.S. Curve Flattening Near An End



*PREVIOUS CYCLES ALIGNED TO LAST FED RATE HIKE, EXPECTED TO BE 31 JANUARY 2006 DENOTED BY VERTICAL LINE

CHART 9
Stay With 10/30 Flattener



In contrast, investors should retain 10/30 U.S. Treasury flattening positions (implemented using the May 2030 over the August 2015). The back end of the curve is still too steep given the low inflation backdrop and the prospect of heavy pension fund demand for long duration assets (notwithstanding the looming resumption of the 30-year auction). The U.K. 10/30 curve has been inverted for much of the time since 1997 (**Chart 9**). We think the U.S. curve will also be flat-to-slightly inverted.

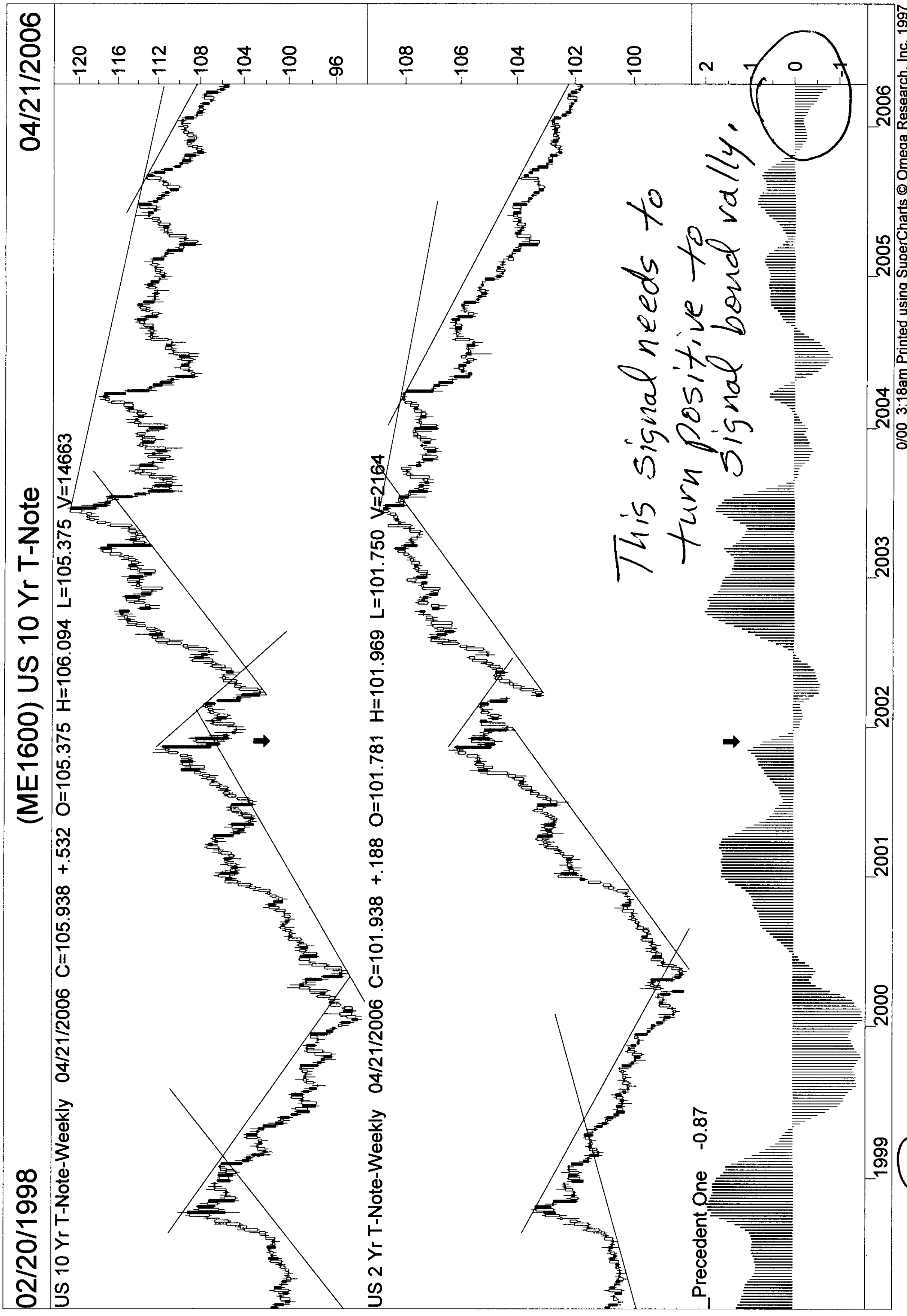
Bottom Line: Take profits on the 2/5/10 curve flattening trade, but stay in the back-end flattening trade.

ECONOMY AND INFLATION

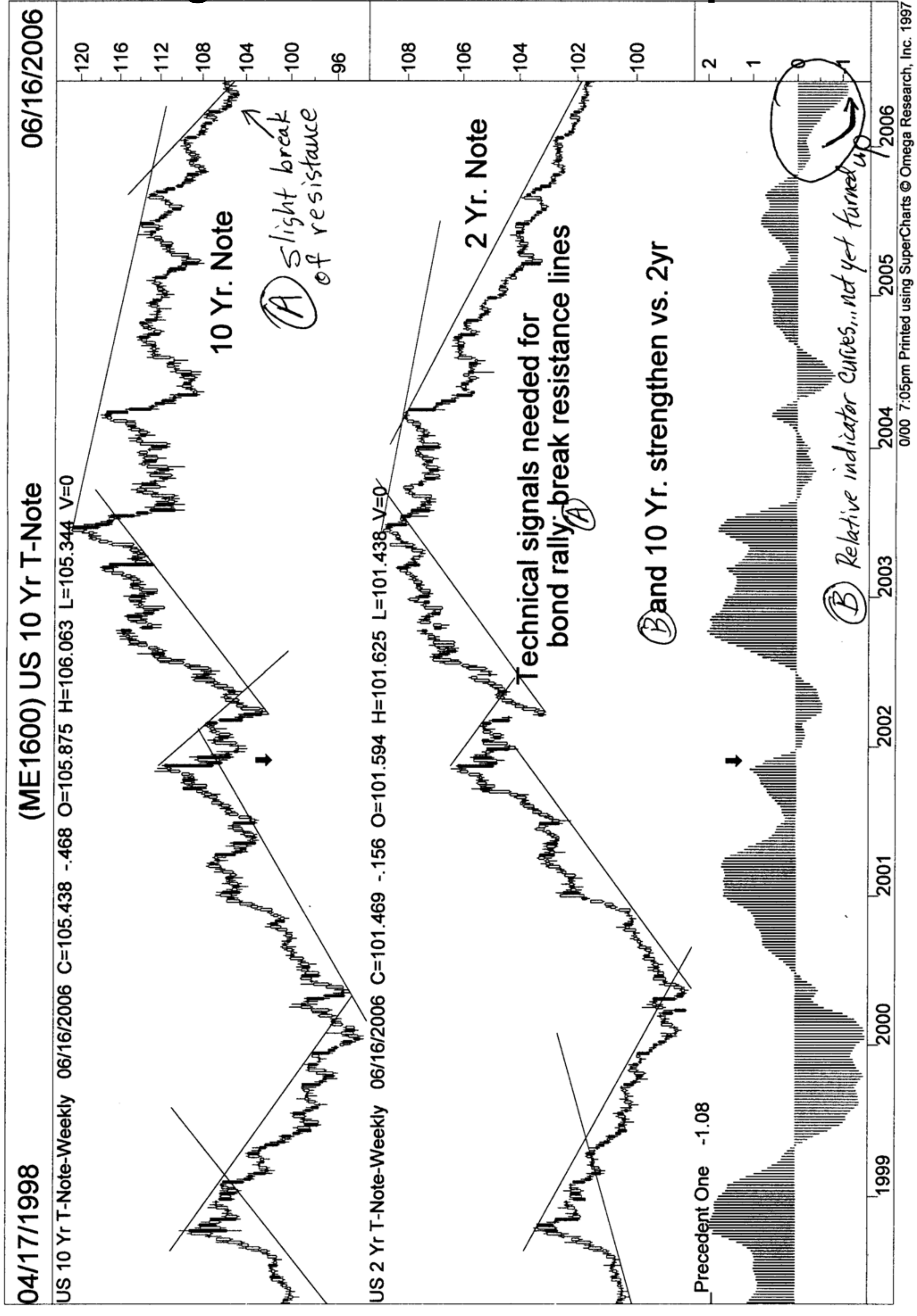
The ISM surveys showed some loss of momentum compared with earlier in 2005, but activity was still expanding at a decent pace at yearend (**Chart 10**). However, the deceleration in consumption and profit growth warn that weaker

8

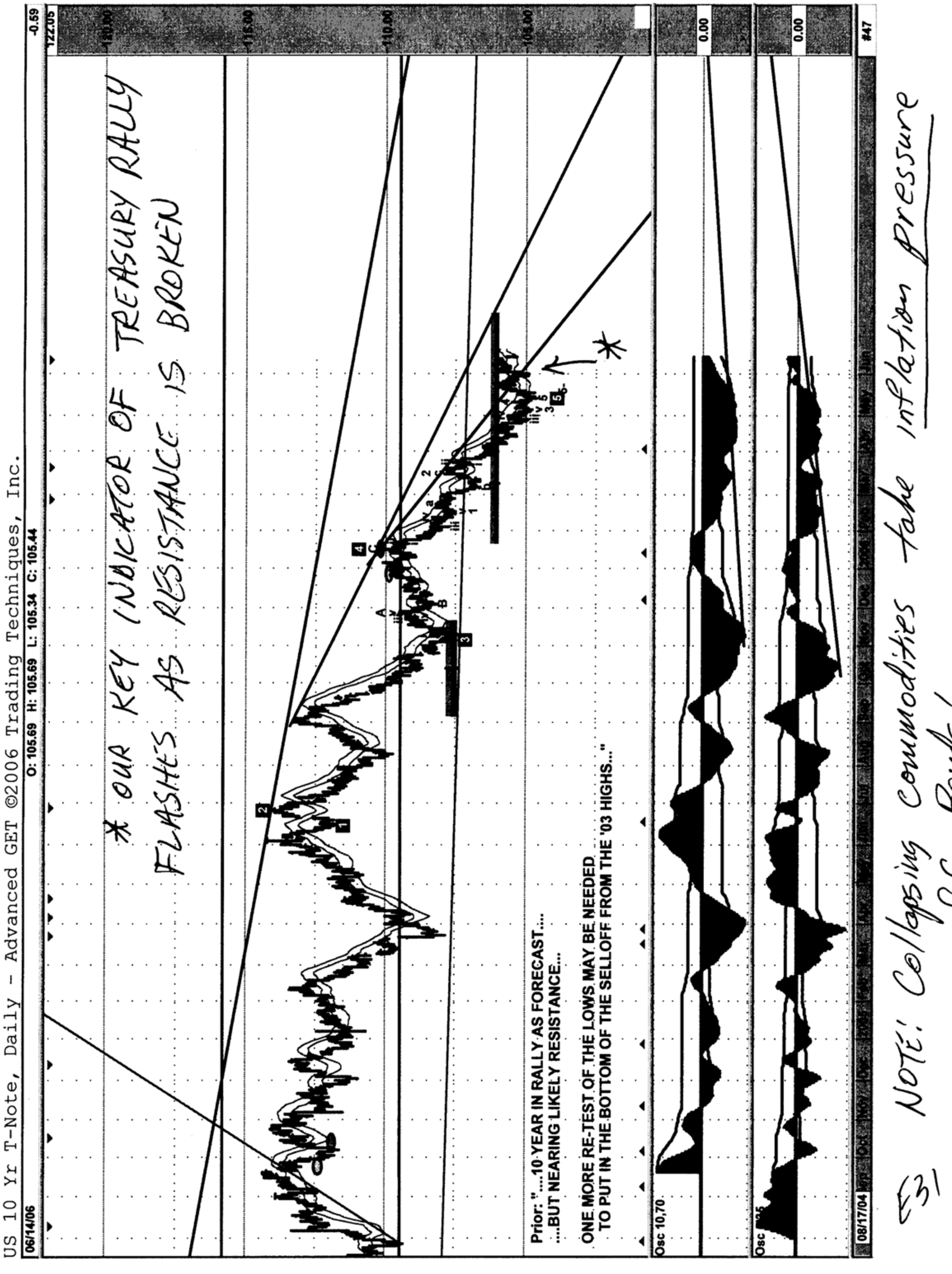
4-21-06: Awaiting bull signals: 1) Resistance line break and 2) 10 yr turns relatively stronger than 2 yr



6-16-06: 10 Yr Bond resistance slightly broken as Relative strength indicator curves to upside…



June ’06: Resistance line break signals bond rally..



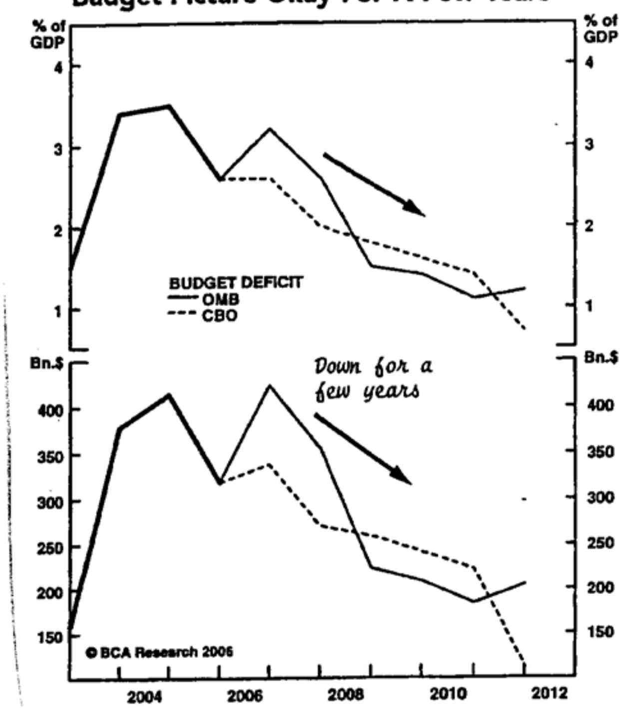
In the short run, falling government deficits will reduce the need to borrow and should be a support to bonds.

Longer-term, Deficits are likely to explode if Baby-Boom Retirement issues Are not addressed.

U.S. BOND STRATEGY - SPECIAL REPORT MARCH 1, 2006 4

WILL TAKE PRESSURE OFF RATES,

CHART 4
Budget Picture Okay For A Few Years



Bush May Meet Vow To Halve The Deficit — Three Years Early

'06 Tax Receipts Up 12.9%

Revenue from rich, firms swell at far-faster pace, but boomer bust nearing

BY JED GRAHAM
INVESTOR'S BUSINESS DAILY

Aided by surging tax receipts, President Bush may make good on his pledge to cut the deficit in half in 2006 — three years early.

Tax revenues are running $176 billion, or 12.9%, over last year, the Treasury Department said Monday. The Congressional Budget Office said receipts have risen faster over the first eight months of fiscal '06 than in any other such period over the past 25 years — except for last year's 15.5% jump.

The 2006 deficit through May was $227 billion, down from $273 billion at this time last year. Spending is up $130 billion, or 7.9%.

The CBO forecast in May that the 2006 deficit could fall as low as $300 billion. Michael Englund, chief economist of Action Economics, has long expected a deficit of about $270 billion this year. Now he thinks there's a chance the "remarkable strength in receipts" will push the deficit even lower.

With the economy topping $13 trillion this year, a $270 billion deficit would equal less than 2.1% of GDP, easily beating the president's 2.25% goal. Bush made his vow when the White House had a dour 2004 deficit forecast of 4.5% of GDP, or $521 billion. The actual '04 deficit came in at $412 billion, or 3.5% of GDP, before falling to $318 billion, or 2.6% of GDP, in 2005.

A CBO analysis last week noted that withheld individual income and payroll taxes are up 7.6% from a year ago, with the gains picking up in recent months.

"Those gains suggest solid growth in wages and salaries in the national economy," CBO said.

While gains are broad, those at higher-income levels are enjoying bigger salary hikes. Because they

Rove recently said. That's up from 40.5% — despite Bush's tax cuts.

Nonwithheld income tax receipts are up about 20% vs. a year ago. That may reflect year-end bonuses and capital gains.

Corporate income taxes are up about 30% from last year's pace.

While economic growth is producing impressive tax revenue gains, budget experts say they won't be enough to wipe out deficits, especially as baby boomers retire. Englund thinks the deficit could hit $150 billion if the expansion lasts two or three more years. "When we go into a downturn, the numbers reverse," he said.

Money Rolling In
Tax receipts, fiscal 2006 to date through May, in billions

	YTD 2006	YTD 2005	% change
Individual income	$687	$605	13.6%
Corporate income	184	141	30.5
Social insurance	563	525	7.2
Other	111	98	13.3
Total tax receipts	1,545	1,369	12.9
Total spending	1,772	1,642	7.9
Deficit	227	273	-16.8

Source: Treasury Dept.

Long-term growth in Social Security, Medicare and Medicaid "threaten to force either European-style tax increases, unprecedented spending cuts or unprecedented debt," said Heritage Foundation budget expert Brian Riedl. "There's no growing out of the long-term budget problems."

Heritage sees an $800 billion deficit in 2016, assuming tax cuts are extended and spending stays on its present course. If the economy and tax receipts continue to outperform, the deficit would still be at least $600 billion, Riedl said.

He noted Congress has been more disciplined about discretionary spending lately. But that saves a mere $10 billion a year, he said.

Late last week, House and Senate negotiators reached a deal to hold a supplemental spending bill

E 33

More fuel for bond rally: Commodities exit.

GOVERNMENT BONDS

6-14-06

Safe haven buying provides fillip

TREASURIES RALLY

By Jennifer Hughes in New York, Joanna Chung in London and David Turner in Tokyo

US Treasuries were higher and yields lower yesterday as any weakening from higher-than-expected inflation data seemed to be outweighed by reports of safe-haven buying as global equities tumbled.

Bond moves largely tracked US stocks as indices wavered between gains and losses before heading definitively lower. But by the close they were off their worst levels again, having led bonds through a see-saw session.

Producer prices rose by less than forecast in May, but the core rate, at 0.3 per cent, was above expectations. Reactions were, however, muted as the market focused more on the equity sell-off and waited for the consumer price index today, typically a bigger event than the wholesale price numbers.

Core CPI is forecast to have risen 0.2 per cent in May, although investors fear the rate could be higher after the two most recent readings of 0.3 per cent.

By late trade in New York, yields on two-year notes were 0.4 basis points lower at 5.018 per cent and 10-year yields were down 1.6bp at 4.967 per cent.

Yesterday, 30-year yields briefly joined the yield curve inversion between two and 10-year yields, but at 5.019 per cent, had just nudged back into positive territory.

Eurozone government bonds also rallied as stocks slid.

As prices rose in late trading, the yield on the two-year Schatz fell 1.6bp to 3.313 per cent and the 10-year Bund yield lost 4bp to 3.862 per cent.

"European bonds continue to take their cue from weak stock markets, which are having another attack of the jitters as risk aversion continues to take a toll," said David Brown, chief European economist at Bear Stearns.

"Stocks remain under the weather as investors continue to fret about the risk of slower growth momentum ahead, especially set against the backdrop of implied tougher rate policy coming out of the US and Europe."

Equity weakness propped up **gilts** despite a pick-up in headline inflation. The yield on the two-year gilt edged down 0.7bp to 4.649 per cent while the 10-year gilt yield fell 2.8bp to 4.516 per cent.

The yield on the benchmark 10-year **Japanese government bond** dropped 5bp to a three-month low of 1.775 per cent, as doubts increased about whether the Bank of Japan will feel able to end its zero interest rate policy tomorrow.

COMMODITIES

Severe declines from record highs continue

... AS COMMODITIES SELLOFF

By Kevin Morrison

Energy and metal prices fell sharply yesterday as commodity markets continued to endure a sharp correction from the record prices of barely a month ago.

The broad-based price declines reflected investor selling, with some momentum investors such as Commodity Trading Advisors (CTAs) selling down their exposure to the sector and accelerating the sell-off.

The sharpest falls were in the metals sector, which also suffered the biggest price rises from the start of the year to their peak in May.

Gold dropped more than 6 per cent or $37 to $569 a troy ounce as it fell through the $600 level for the first time since early April. Bullion has fallen 22 per cent from its 25-year peak of $730 touched a little more than a month ago.

Silver was the biggest faller in the precious metal complex, down about 10 per cent to $9.92 a troy ounce. It was the first time the metal has fallen below $10 since March 13.

Silver has lost more than a third of its value after reaching a 25-year peak of $15.17 last month. If it falls by another $1, all of the gains it has made this year will be wiped out. Silver had recorded a gain of more than 70 per cent on the year at its peak on May 11.

Base metals also fell below key support levels, and now look vulnerable to further declines.

Copper prices fell almost 7 per cent to $6,580 a tonne in late trade on the London Metal Exchange, its lowest level in almost two months and about 25 per cent below its record high struck last month. Traders said that if copper fell below $6,500 the next support level is about $6,000.

The three-month LME **zinc** price dropped below $3,000 a tonne for the first time in two months, trading at $2,965 a tonne in late London trade, down 25 per cent from last month's record peak. **Nickel** dropped more than 8 per cent to $17,550 a tonne.

"It was inevitable that a steep price decline was going to happen, after the sharp price rises we saw earlier in the year," said Robin Bhar, base metals strategy at UBS.

Crude oil prices were lower after a bearish report from the International Energy Agency, which warned that high oil prices were affecting demand growth.

IPE Brent for July delivery fell to a two-month low when it dropped $2.01 to close at $66.92 a barrel in London trade, extending the $1.55 decline from the previous session.

July West Texas Intermediate eased $1.80 to settle at $68.56 a barrel in New York trade, a level it last visited three weeks ago, as investors were reluctant to sell US crude futures due to potential supply disruption during the current Atlantic hurricane season, which has just started.

COMMODITY PRICES

		Change
Alum HG (cash, t)	$2413-13.5	-67.0
Alum Alloy (cash, t)	$2340-50	-35.0
Copper Gr A (cash, t)	$6880.5-81	-349
Lead (cash, t)	$968-9	-44.0
Nickel (cash, t)	$18595-600	-2252
Tin 99.85% (cash, t)	$7750-75	-110
Zinc SHG (cash, t)	$3085-90	-250
Gold close (troy oz)	$576.00-577.00	-32.9
Gold am fix (troy oz)	$590.75	-17.0
Gold pm fix (troy oz)	$586.50	-22.7
Gold - GOFO, 3mth	5.21	nc
Silver fix (troy oz)	1047.0c	-55.0
Platinum (troy oz)	$1135.0	-42.0
Palladium (troy oz)	$282.0	-36.0
Oil- Brent blend (Jul)	$68.41-8.47	-2.4
Unleaded Gas (95R)	$717-719	-24
Gas Oil (German Htg)	$619.5-21.5	-25
Heavy Fuel Oil	$290-292	-10
Naphtha	$586-588	-20
Jet fuel	$689-691	-22.5
Diesel (French)	$642-644	-19.5
NBP Gas (Jul)	37.35-37.55	-1.2
Euro Gas (Zeebrugge)	38.00-38.30	-1.2
APX Spot Index £/Mwh	46.27	+17.4
Conti Power Index €/Mwh	40.7129	nc
globalCOAL RB Index™ †	$51.50	nc
Barley	75.0	nc
Maize (No3 Yellow) ♠	61.3	nc
Wheat (US Dark Nth)	111.1	nc
Rubber (KL RSS no1, c/kg)	897.0m	+16.5
Palm Oil (Malay) ‡	430.0	nc
Soyabeans (US)	161.0	+1.0
Cotlook A Index Φ	56.35c	+0.2
Wooltops (Super, p/kg)	398.0	nc
Coffee fut (Jul)	$1123	-10
Cocoa fut (Jul)	884	+3
Sugar fut (white, Aug)	$443.4	-2.4

Sources: LME/Amalgamated Metal Trading, lbma.org., Petroleum Argus, HGCA, APX UK power exchange, Platts, Global Coal, Reuters and Euronext.liffe. † US $ per metric tonne, week to date. ‡ CIF Rotterdam. ♠ CIF UK. t per tonne. Φ (Far East per lb)

INDICES

■ **Reuters** (Base: 18/9/31 = 100)

Jun 13	Jun 12	month ago	year ago
1989.02	2010.37	2024.52	1645.26

■ **DBLCI-MR Total Return** (Base: 1/12/88 = 100)

Jun 12	Jun 9	month ago	year ago
975.51	966.44	1027.36	835.17

■ **CRB Futures** (Base: 1967 = 100)

338.39	340.09	352.06	304.28

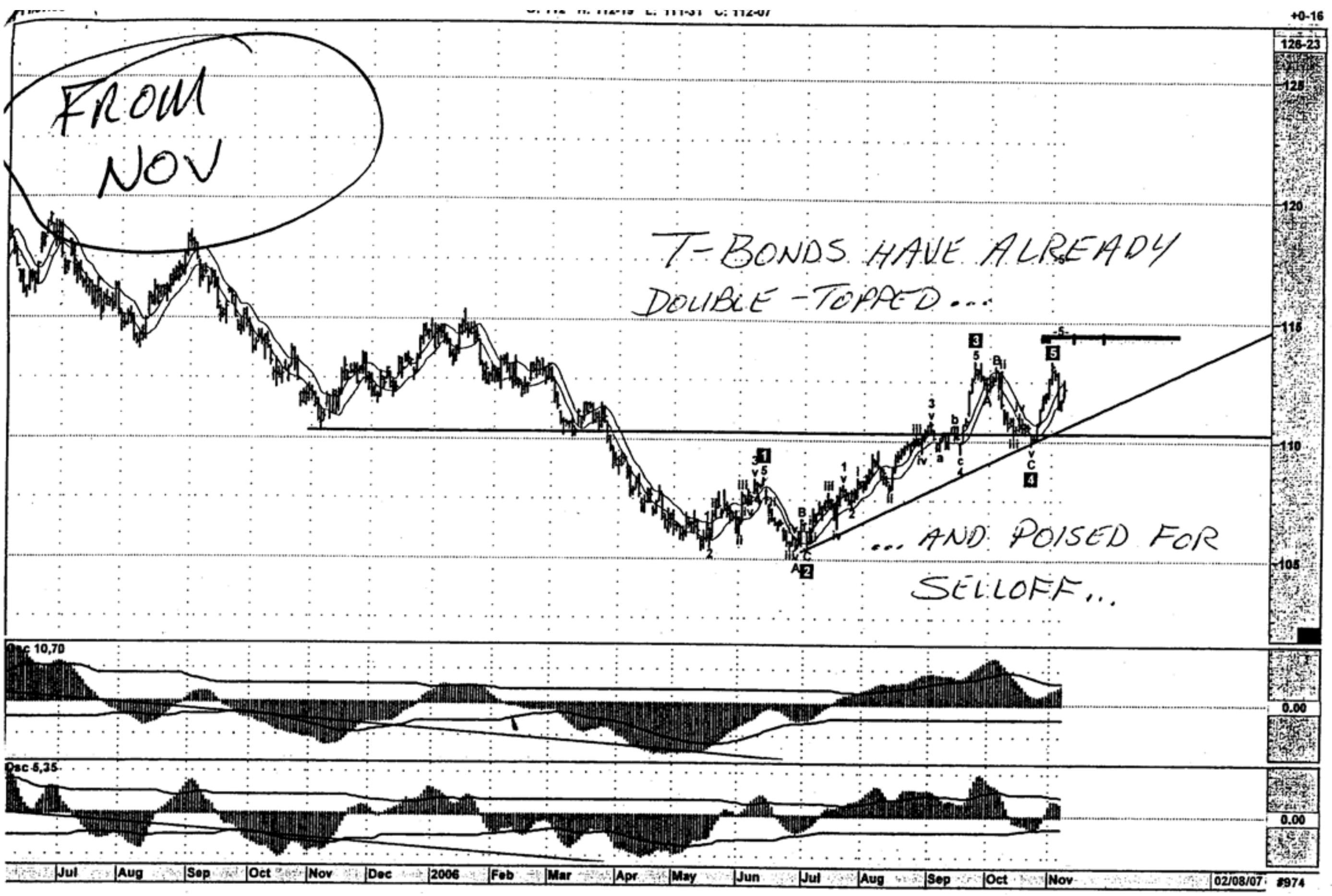
■ **GSCI Total Return** (Base: 1970 = 100)

6782.77	6864.10	6888.54	6194.22

E 32

Insert Sep/Oct Bond charts here “more Upside”

Nov. 10: Both Bonds & Notes poised for correction



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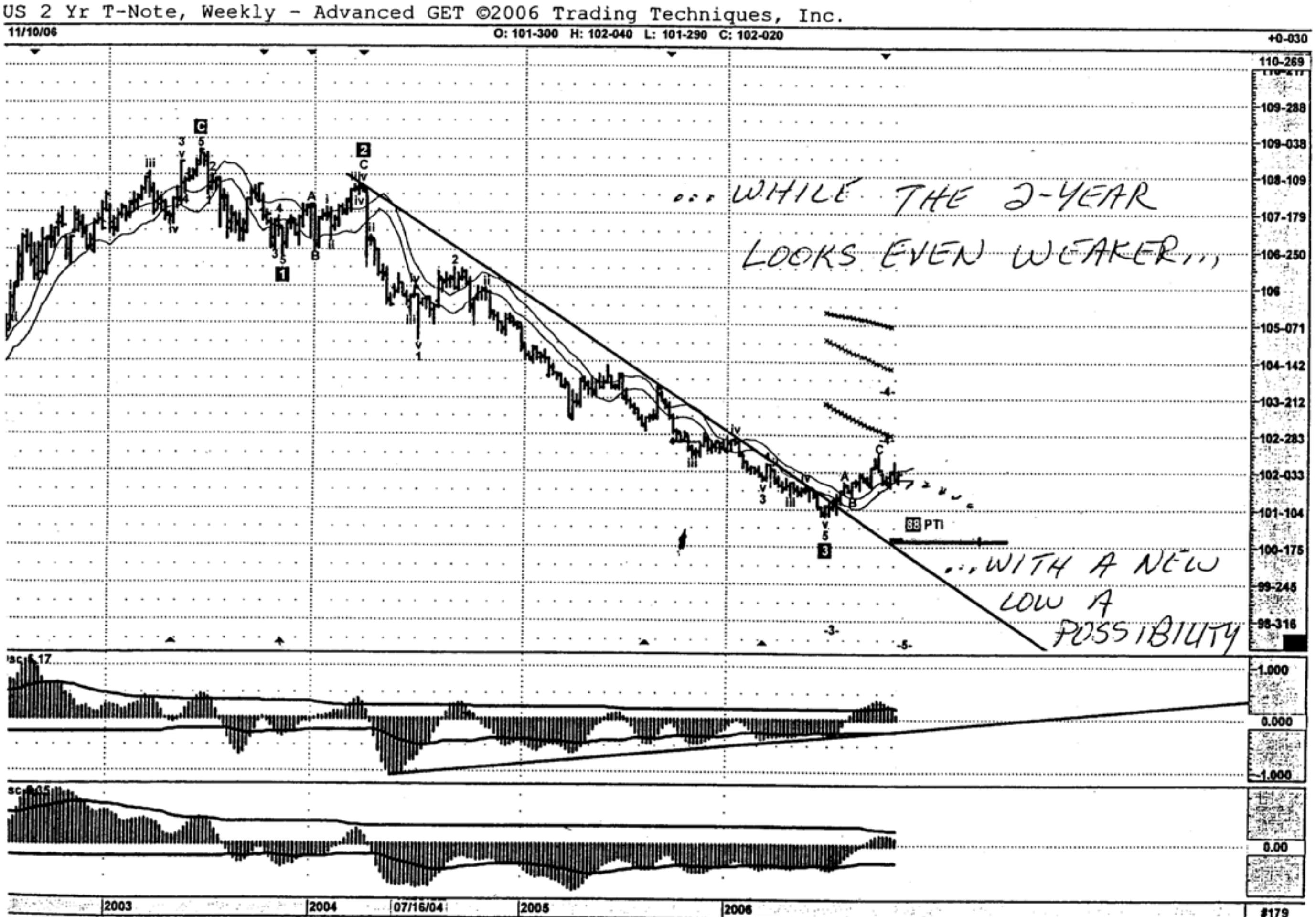

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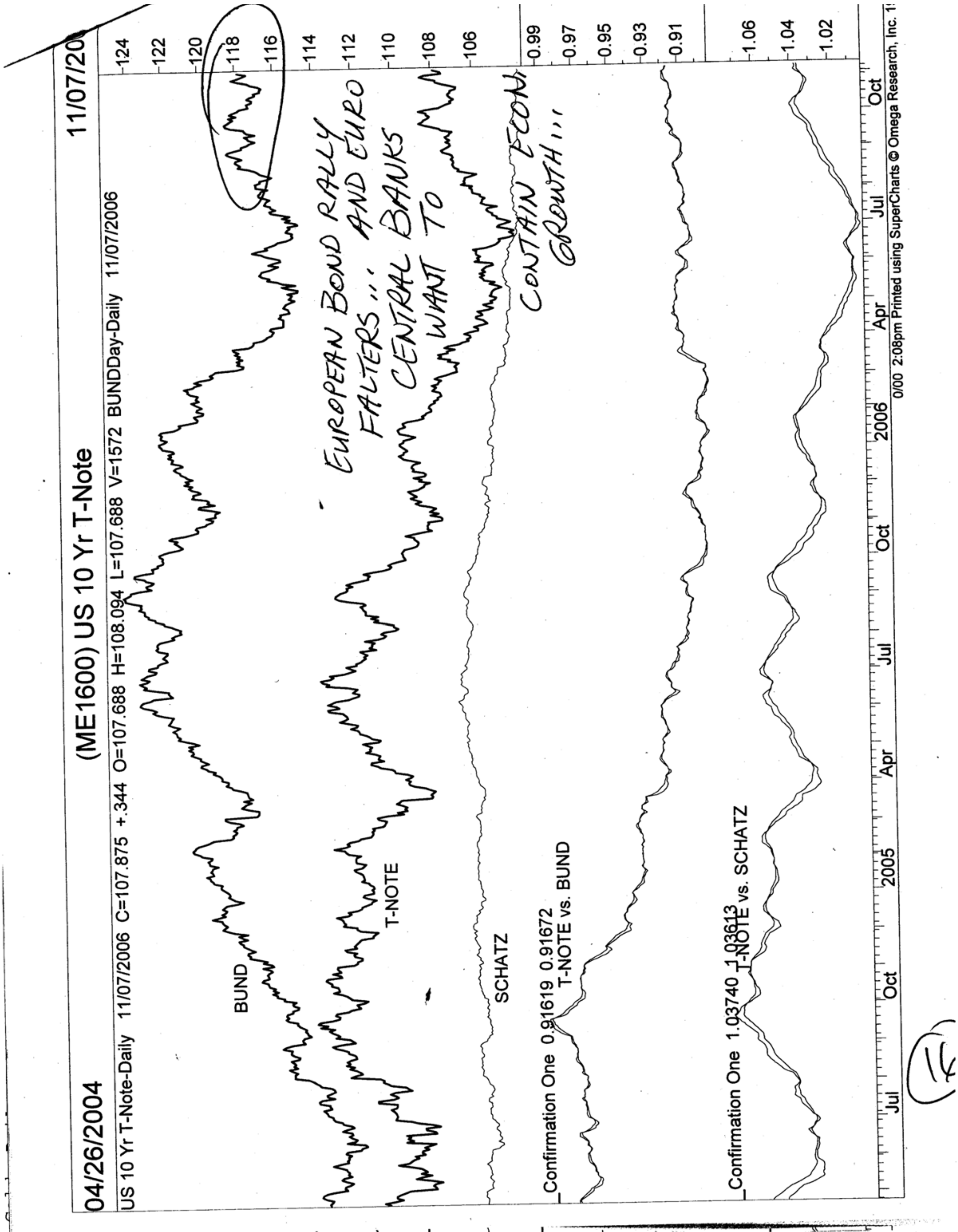
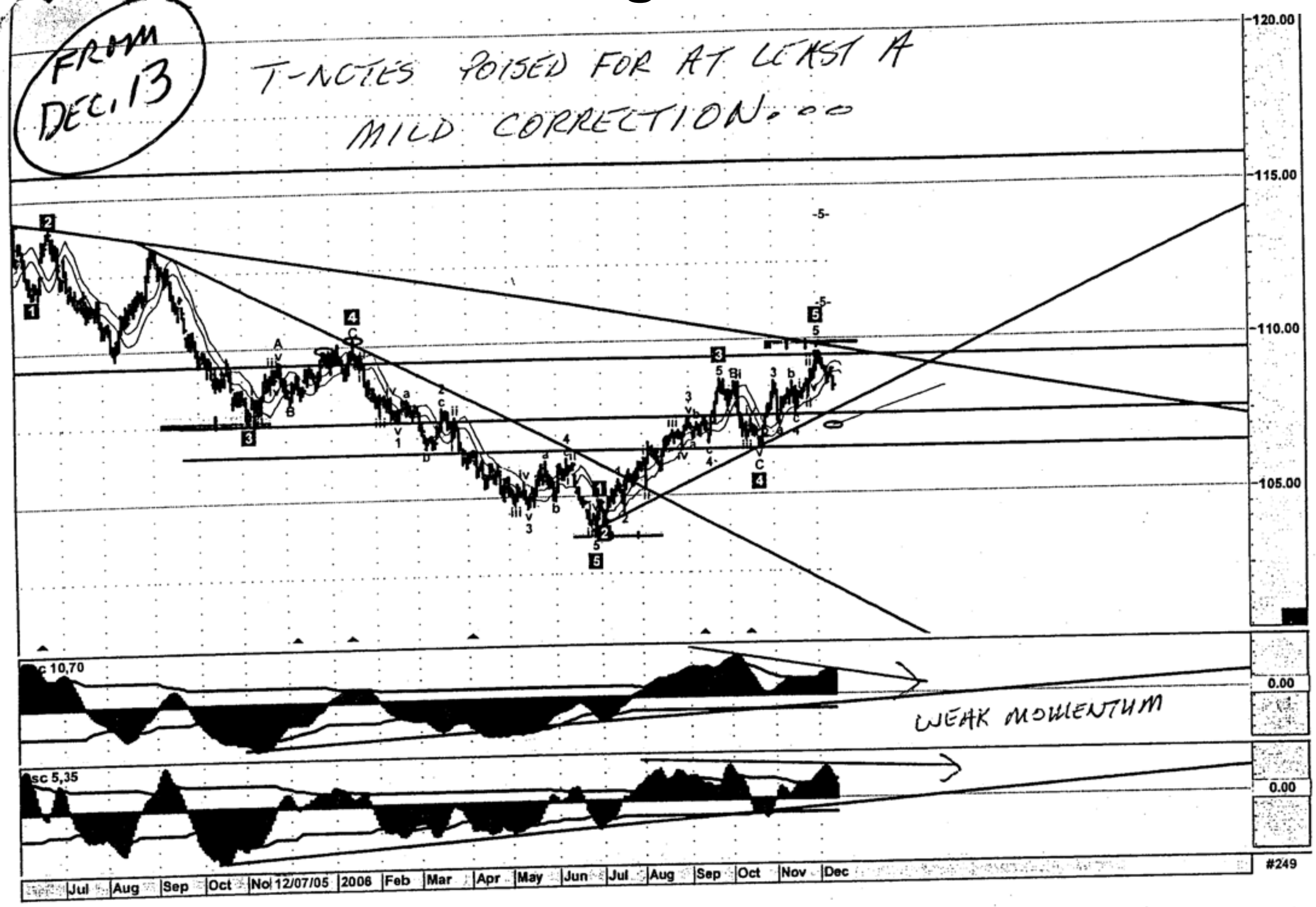
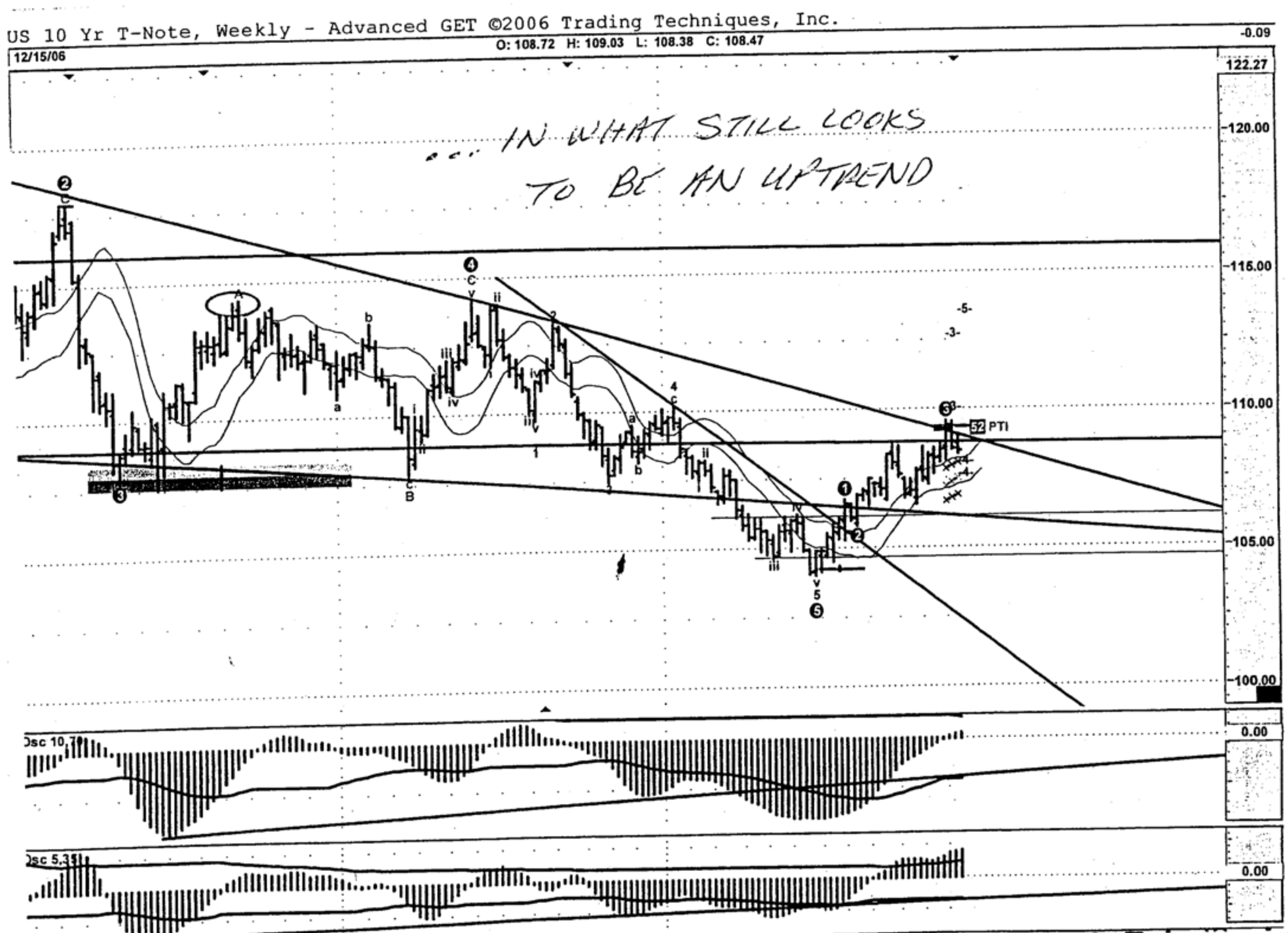
Toppy Global Indicator: U.S. rallies but Euro bonds falter



Dec 13: Calling Short-Term Bond Selloff





Dec/Jan Bonds “Poised for Correction, here it is