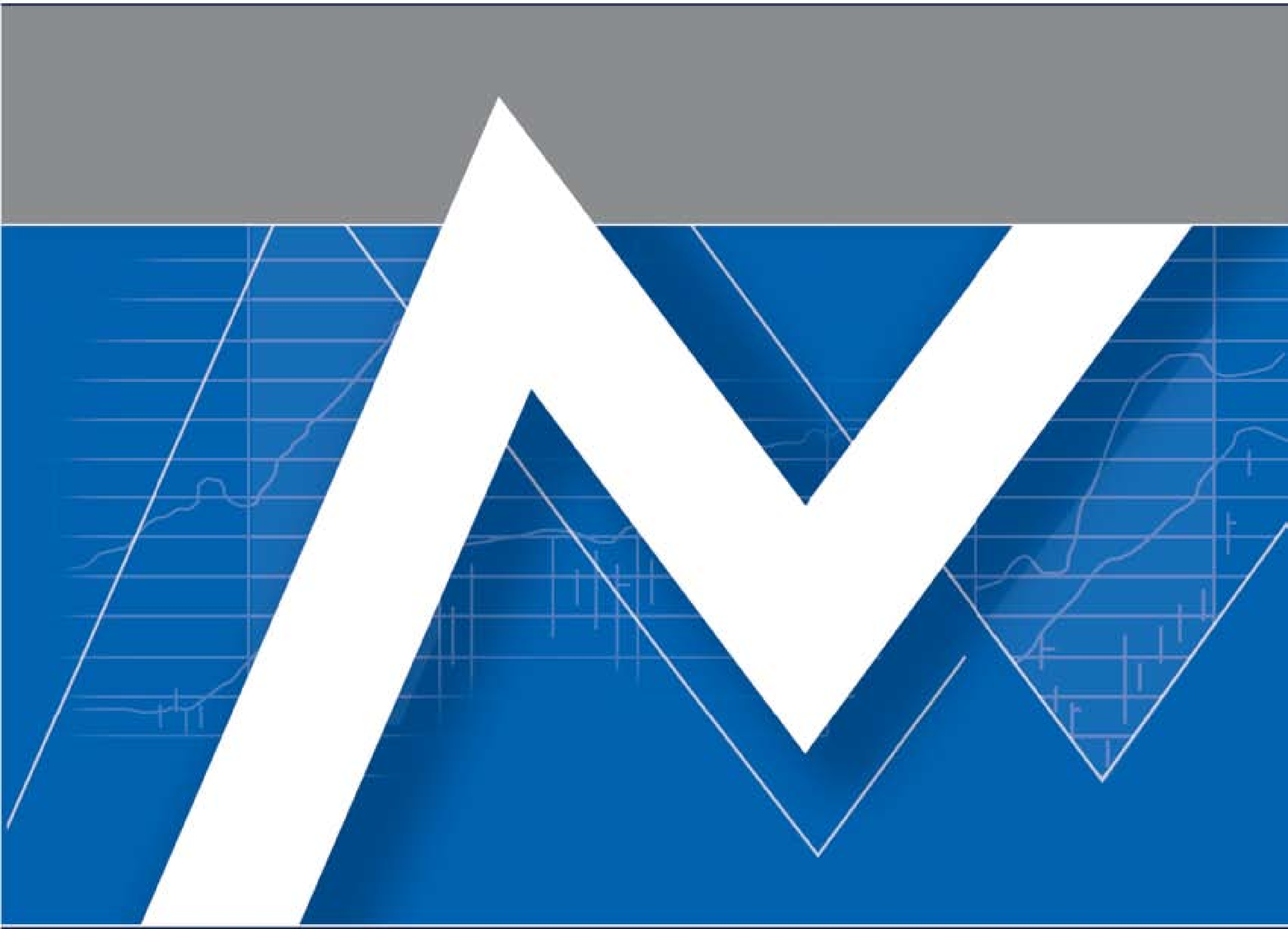
SIFMA®

Securities Industry and Financial Markets Association

RESEARCH REPORT

FEBRUARY 2008



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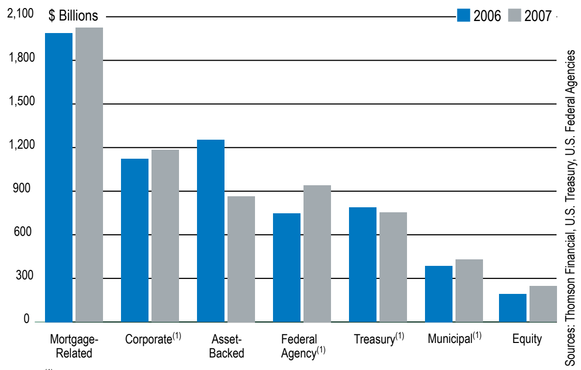
Securities Issuance Maintains Pace at $6.44 Trillion for 2007 Despite Second-Half Market Volatility

Securities issuance in the fourth quarter was $1.36 trillion, virtually unchanged from the third quarter. Full-year 2007 issuance of $6.44 trillion was also virtually unchanged from the $6.47 trillion in 2006. The effect of the credit market turbulence becomes more apparent when comparing first-half issuance volume of $3.72 trillion to the $2.72 trillion issued in the second half, a 27 percent decline. Municipal bond issuance set a record in 2007 based on strong refunding volumes. Corporate bond issuance also reached record territory on a strong first half before diminished liquidity and risk repricing slowed the sector in the second half of the year. Agency debt and mortgage-backed securities (MBS) issuance rose during 2007, reflecting the substantial funding cost difference between agency securities and the weakened non-agency, or private-label, mortgage market. Private-label mortgage and asset-backed securities volumes fell, especially home equity and subprime mortgage, reflecting non-agency MBS market conditions. Global collateralized debt obligations (CDO) issuance volumes also dropped, affected by weakened collateral performance, the deleveraging trend and illiquidity. Treasury issuance declined on a reduced federal budget deficit in fiscal year (FY) 07. Equity underwriting increased in 2007 compared to the previous year, although market indices slipped after setting records in October.

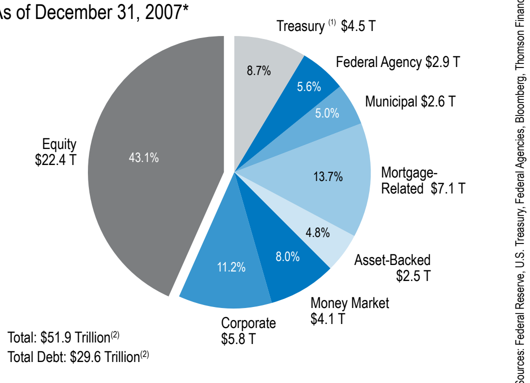
Credit market conditions continue to be the dominant theme across all asset classes. The consensus outlook is for economic growth to remain at a below-trend pace in the first half of 2008, with an increased probability of a more pronounced slowdown, before picking up in the second half of the year. Despite widening and volatile credit spreads, the accumulation of cash during the period of earnings growth has left nonfinancial corporate balance sheets stronger. The key drivers for the 2008 market outlook are the length and severity of mortgage market and housing weakness; the capacity for capital replenishment; the success of initiatives to free up credit markets and the degree to which "bad news" has already been reflected in financial market pricing.

Issuance in the U.S. Capital Markets
2006 vs 2007



(1) Includes long-term issuance only

U.S. Capital Markets Outstanding
As of December 31, 2007*



(1) Includes marketable public debt
(2) Figures may not add due to rounding
*SIFMA estimates

Issuance Highlights

$ Billions	2006:Q4	2007:Q4	YTD 2006	YTD 2007	% Change*
Municipal	120.7	104.1	386.5	428.8	10.9%
Treasury	188.9	208.3	788.5	752.3	-4.6%
Federal Agency	200.0	255.4	747.3	940.7	25.9%
Mortgage-Related	493.8	384.7	1,987.9	2,026.9	2.0%
Asset-Backed	335.3	94.7	1,253.1	865.0	-31.0%
Global CDO	180.1	29.9	551.7	485.7	-12.0%
Corporate	313.9	240.3	1,121.7	1,182.8	5.4%
Equity	34.5	71.3	190.5	246.0	29.1%

* Percent change between YTD 2006 and YTD 2007

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Municipal Volume Sets Record; Monoline Situation Changes Market Dynamics

Short- and long-term municipal securities issuance totaled a record $486.6 billion in 2007, 13.1 percent higher than the $430.5 billion issued in 2006 and 6.1 percent higher than the previous record of $458.7 billion set in 2005. With credit conditions in the municipal market remaining strong and relatively stable and benchmark yields historically low, issuers continued to access the bond market to finance new projects and refund existing debt. Slower economic growth and the weakened housing sector will affect state and local tax bases and demand for local government-supported projects, adding to the demand for debt financing. Long-term municipal volume was a record $428.8 billion in 2007, 10.9 percent higher than in 2006. Long-term issuance peaked in the second quarter at $123.8 billion, slowing in the second half amid the broader credit market turmoil, with issuance falling to $93.4 billion in the third quarter but rebounding to $104.1 billion in the fourth quarter.

Yields Fall; Insurer Vulnerability Introduces Complexity

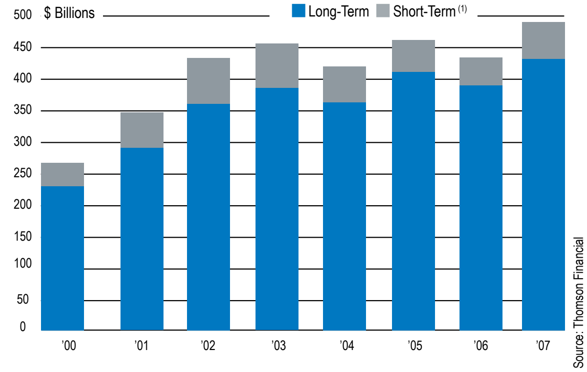
The municipal market remained relatively stable in 2007, taking into account the housing market downturn and credit market turbulence, but not entirely unscathed. Heightened investor risk aversion, combined with monoline insurer vulnerability that is reaching crisis proportions, triggered a rise in the ratio of the 10-year AAA-rated general obligation municipal yield to yields of Treasury securities of similar maturity to 93 percent at year-end, higher than the 84 percent recorded at the end of the third quarter, but less than the near 100 percent ratios in mid-August and during periods in the fourth quarter. Municipal prices weakened relative to Treasuries as concerns have mounted about some monoline insurers' ratings and capital situation. Historically, bond insurance has enhanced issuer liquidity and lowered issuer funding costs. Should the monoline stress persist, the likely scenario would be a reduction in the percentage of municipal bonds carrying insurance and more issuers relying on their underlying ratings and the sector's strong credit quality and low-default track record. While it is premature to predict an outcome, there are indications of potential new entrants into the monoline market as well as restructuring or recapitalization efforts that could help resuscitate those insurers experiencing stress. Historically, at least half of municipal new issues have been insured, with this percentage falling in recent months. Despite challenges faced by third-party credit enhancers, there has been no deterioration in the fundamentals of issuers' underlying credit conditions, and state and local bond issuers continue to be perceived as strong and stable credits. However, the situation is having an adverse affect on issuer funding costs.

The yield on 10-year AAA-rated general obligation notes ended the year at 3.74 percent, lower than the 3.85 percent of September 30. The yield on shorter maturity 2-year AAA-rated general obligation bonds was 3.05 percent as of the end of the year, a decline from 3.48 percent as of the end of the third quarter. Following the FOMC's combined 125 basis point cuts in January that lowered the target Fed funds rate to 3.00 percent, the municipal curve steepened as 2-year and 10-year AAA-rated general obligation yields fell further.

Low Rates Spur Refunding Volume; Education Tops Sectors

New money issuance in 2007 totaled $276.1 billion, 7.9 percent higher than in 2006. Refunding volume reached $152.7 billion, well above the $130.5 billion in 2006. Total long-term issuance in the general government sector, the largest issuing sector, totaled $111.2 billion in 2007, with $39.1 billion to refund outstanding debt and $72.1 billion in new capital.

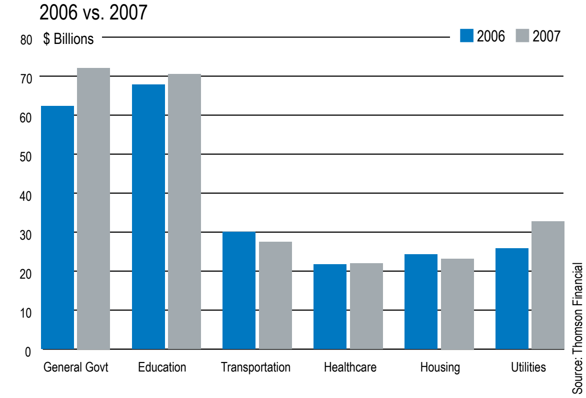
Short- and Long-Term Municipal Issuance
2000–2007



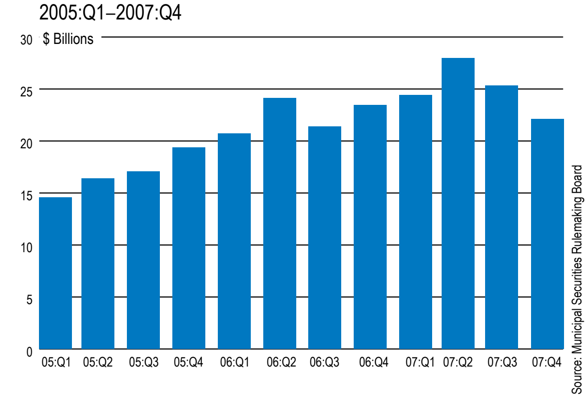
(1) Includes maturities of 13 months or less

Municipal GO AAA and 10-Yr Treasury Ratio
Jan. 2001–Dec. 2007

Municipal New Capital: Use of Proceeds
2006 vs. 2007



Average Daily Trading Volume of Municipal Securities*
2005:Q1–2007:Q4



* Includes both dealer-to-dealer and customer-to-dealer transactions

Net Treasury Issuance Slightly Higher; "Flight-to-Quality" Spurs Trading, Price Rally

Total net issuance of U.S. Treasury securities, including bills and coupons, was $179.4 billion in the 2007 calendar year, compared to $152.0 billion in 2006. Net coupon issuance declined to $119.6 billion in 2007 from $172.5 billion in 2006, reflecting higher-than-expected tax revenue growth that reduced the federal deficit and lowered the government's funding requirements. Consistent with the results of SIFMA's recent Government Forecast, total net issuance is expected to be higher in the first quarter of 2008. Treasury expects to issue $156 billion of net marketable debt in the first quarter of calendar year 2008. The White House Office of Management and Budget projects a federal budget deficit of $410 billion for FY 2008, an increase from FY 2007. The $163 billion FY 2007 budget deficit was the lowest full-year deficit in five years. Through the first three months of the fiscal year, the FY 2008 deficit was approximately $106 billion compared to $81 billion over the same period in FY 2007.

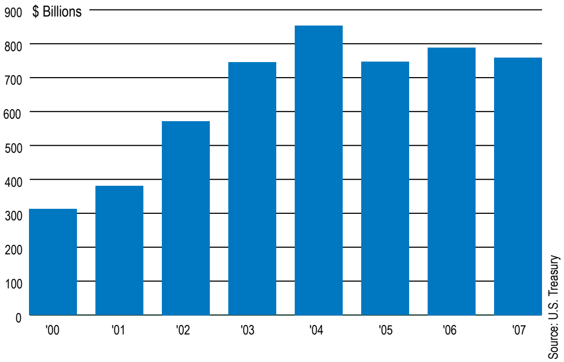
Gross coupon issuance volume declined 4.6 percent during 2007 to $752.3 billion, down from $788.5 billion the previous year. Fourth-quarter gross coupon issuance volume was 5.8 percent higher than in the same period of 2006. Gross bill issuance was $3.74 trillion in 2007, slightly above the $3.63 trillion issued in the previous year. Gross issuance is affected by expected refundings of maturing and callable debt as well as Treasury's new cash needs.

Total marketable Treasury debt outstanding reached $4.52 trillion as of December 31, 2007, a 2.0 percent increase from the end of the third quarter. Daily trading volume of Treasury securities by primary dealers averaged $556.3 billion in the fourth quarter and $561.8 billion for full-year 2007. The outstanding volume of Treasury Inflation-Protected Securities increased to $471.4 billion as of the end of the fourth quarter, up from the $456.8 billion outstanding at the end of the third quarter.

As a reaction to credit market turmoil, investors became more risk averse and sought the stability, safety and liquidity of the Treasury market during the second half of 2007. The result has been a rally in Treasury security prices, declining yields and a steeper yield curve during the second half of the year. The 2-year Treasury yield was 3.05 percent at year-end compared to 3.98 percent at the end of September and 4.81 percent at the end of 2006. The 10-year Treasury yield followed a similar pattern, falling to 4.02 percent by year-end, down from 4.59 percent at the end of the third quarter and 4.70 percent at the end of 2006. The 2-year to 10-year spread steepened from 60 basis points at the end of the third quarter to 98 basis points at the end of the year. As of January 18, the 2-year yield was 2.36 percent and the 10-year was 3.66 percent, with the yield curve steeper at 130 basis points. The SIFMA 2008 U.S. Market Outlook predicts GDP growth to increase in the second half of the year from the current below-trend level, enabling benchmark yields to rise later in the year.

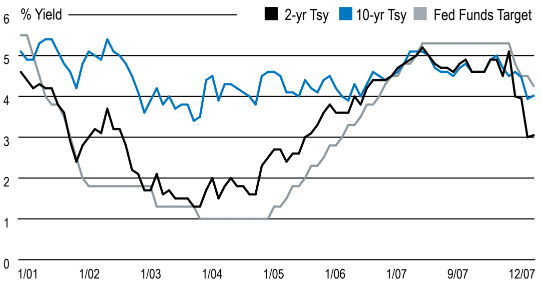
The Fed has expanded its set of tools to respond to credit market conditions. Based on below-trend economic growth, the severity of the housing correction and credit market uncertainty, the Federal Open Market Committee (FOMC) cut the target Fed funds rate by a cumulative 100 basis points over the last four months of 2007 and an additional 125 basis points in January to 3.00 percent. In addition, in order to provide banks with additional liquidity in the environment of a constrained money market, the Federal Reserve introduced the Term Auction Facility in December 2007. Consequently, the 3-month London Inter-Bank Borrowed Rate declined to 4.51 percent as of January 9, or by 60 basis points over the prior month.

Issuance of the U.S. Treasury Securities*
2000–2007

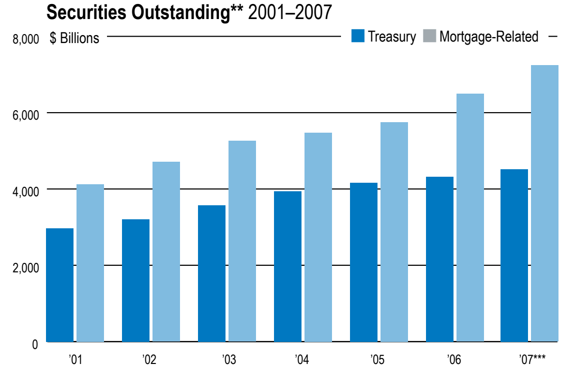


*Includes only marketable coupon securities

Treasury Yields and Fed Fund Rate
Jan. 2001–Dec. 2007

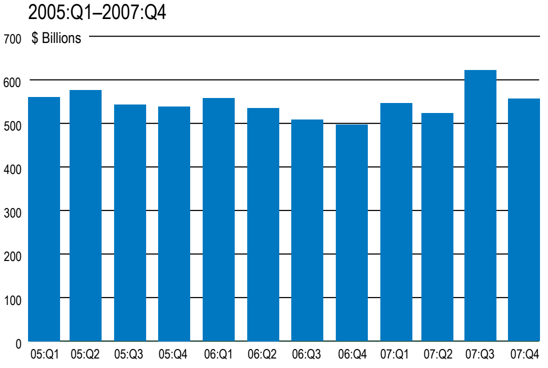


U.S. Treasury Securities Outstanding* vs. Mortgage-Related Securities Outstanding** 2001–2007



* Includes Marketable Public Debt
** Includes Agency MBS, Agency CMO and Private-Label MBS
***SIFMA estimates

Average Daily Trading Volume of Treasury Securities*
2005:Q1–2007:Q4



* Primary dealer activity

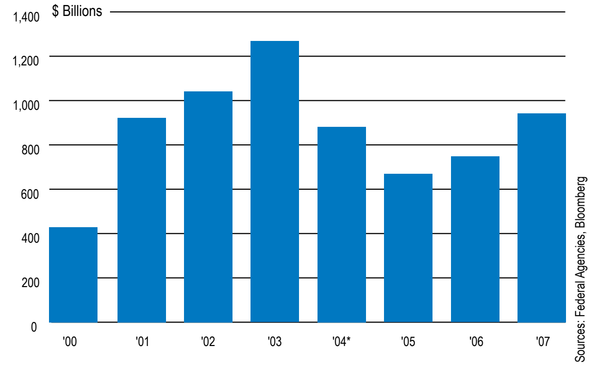
Issuance Increases in Tight Mortgage Credit Environment

Issuance of federal agency long-term debt totaled $940.7 billion in 2007, 26.0 percent higher than the $747.3 billion issued in 2006. Fourth-quarter federal agency issuance rose to $256.4 billion compared to $200.0 billion in the fourth quarter of 2006. The year-over-year volume growth is the result of the demand for conventional mortgage financing as the non-agency mortgage-backed securities (MBS) market dried up. Agency issuance rose in the fourth quarter by 38.0 percent on a linked-quarter basis and by 28.2 percent over the fourth quarter of 2006. SIFMA's recent Government Forecast anticipates a slight decline in issuance in the first quarter of 2008. The projected lower debt issuance for the quarter indicates that the continuing housing sector deterioration will cut into mortgage origination volumes. The relatively modest magnitude of the decline reflects the increased agency financing cost advantage, especially relative to non-agency MBS.

With diminished liquidity and historically high funding costs in the interbank funding market, the Federal Home Loan Banks (FHLB) became an important and relatively low-cost source of liquidity during the second half of 2007. With the rise in demand for FHLB funding from member financial institutions, FHLB issuance reached $495.2 billion in 2007, a 53.6 percent increase from 2006. Fourth-quarter 2007 saw the highest level of FHLB issuance at $152.6 billion compared to an average of about $114 billion for the first three quarters of the year.

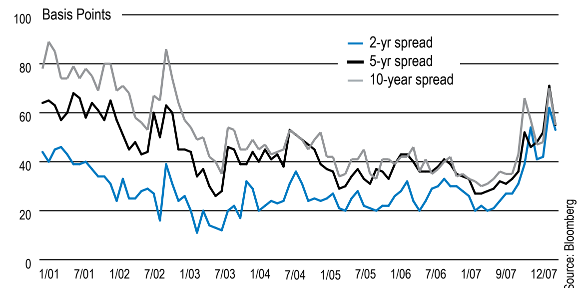
Freddie Mac's debt issuance decreased slightly to $190.0 billion in 2007 from $192.9 billion in 2006. Fannie Mae issuance increased 3.4 percent to $190.8 billion in 2007. Long-term issuance by the Farm Credit System increased to $64.6 billion in 2007, up from $46.2 billion in 2006. The Tennessee Valley Authority's issuance was $1.1 billion in 2007, virtually unchanged from 2006.

Long-Term Federal Agency Debt Issuance[(1)]
2000–2007

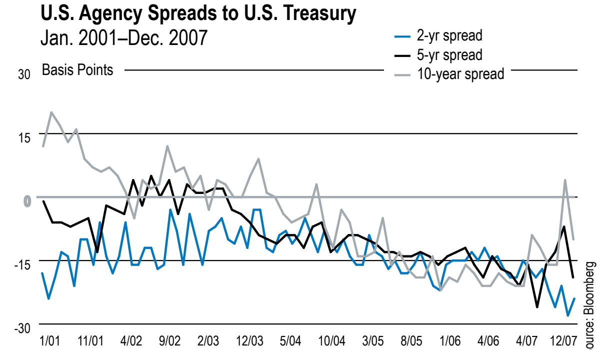


(1) Excludes maturities of one year or less
* Beginning with 2004, Sallie Mae has been excluded due to privatization

U.S. Agency Spreads to U.S. Treasury
Jan. 2001–Dec. 2007



U.S. Agency Spreads to U.S. Treasury
Jan. 2001–Dec. 2007



Long-Term Federal Agency Debt Issuance

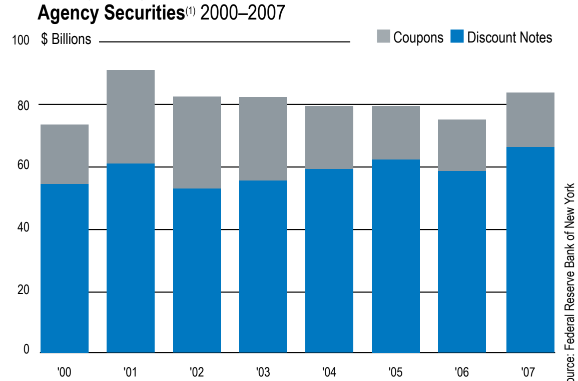
$ Billions	2007:Q4	2006	2007	% Change*	$ Change*
FHLB[1]	152.6	322.5	495.2	53.6%	172.7
Freddie Mac	35.2	192.9	190.0	-1.5%	(2.9)
Fannie Mae	42.7	184.6	190.8	3.4%	6.2
FCS[2]	25.9	46.2	64.6	39.8%	18.4
TVA[3]	0.0	1.1	1.1	0.0%	0.0
Totals	256.4	747.3	941.7	26.0%	194.4

*Percent and amount change between 2006 and 2007

Source: Bloomberg and Federal Agencies

[1] Federal Home Loan Bank System
[2] Farm Credit System
[3] Tennessee Valley Authority

Average Daily Trading Volume of Federal Agency Securities[(1)] 2000–2007



(1) Primary dealer activity

MBS Volume Higher for the Year; as Agency MBS Issuance Rises, Private-Label Issuance Falls; Mortgage Market Weakness Lowers Fourth-Quarter Issuance

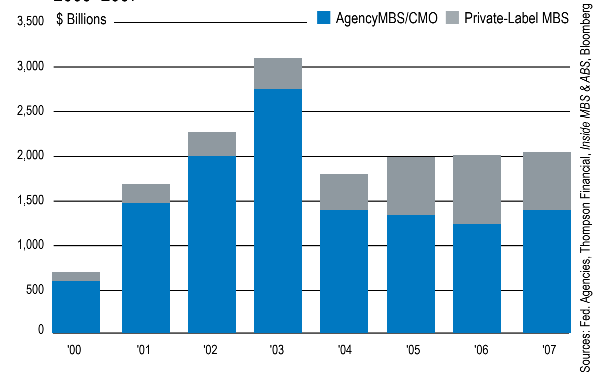
Issuance of mortgage-related securities, including agency and non-agency pass-throughs and collateralized mortgage obligations (CMO), totaled $2.04 trillion in 2007, compared to $1.99 trillion in 2006. Fourth-quarter mortgage-related securities issuance dropped sharply to $384.7 billion from $483.4 billion in the third quarter and $493.8 billion in the fourth quarter of 2006. Issuance peaked in the second quarter at $618.5 billion, with the volume in the second half of the year 25.1 percent lower than in the first half. The weakened housing market, declines in home prices, tighter underwriting and virtual disappearance of subprime origination, combined with credit market turmoil and diminished liquidity, led to the lower mortgage-related issuance activity in the second half of 2007. The widely followed S&P Case-Schiller Home Price Index fell by a record annual rate of 4.5 percent as of the third quarter. The consensus view is that the housing correction will run through most of 2008. The Mortgage Bankers Association expects mortgage originations to slow by 14 percent in 2008 to $1.96 trillion with the expectation of a roughly 50/50 mix between new purchases and refinancings.

Issuance of agency mortgage-backed pass-throughs totaled $1.15 trillion in 2007, an increase of 25.6 percent over 2006. Agency CMO issuance decreased to $222.3 billion in 2007, down 25.9 percent from the $300.2 billion issued in 2006. Agency MBS was the dominant source of issuance, especially in the latter half of the year, reflecting the historically wide pricing differentials between agency and non-agency securities in late 2007. SIFMA's U.S. Market Outlook projected the agency market share of total residential mortgage-backed securities (including agency and non-agency prime and subprime MBS) to increase to 80 percent in 2008, well above the 2006 and 2007 market shares.

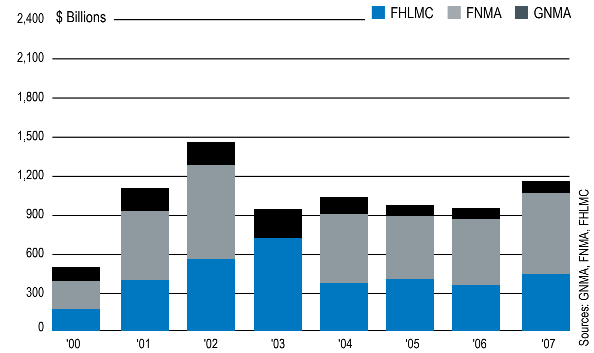
Private-label, or non-agency, residential mortgage-backed securities (RMBS) issuance is defined to include jumbo mortgages that exceed conforming loan size limits and higher-credit-quality MBS with a FICO score of 675 and above that do not meet agency underwriting guidelines. RMBS issuance decreased in 2007 to $440.8 billion, down 25.4 percent. Fourth-quarter issuance fell to $30.4 billion, from $89.6 billion in the third quarter, and was lower than the $142.4 billion issued in the fourth quarter of 2006, reflecting the pricing differential and credit quality weakening. Standard & Poor's reported that 87 percent of the RMBS ratings were affirmed in 2007, with 12 percent downgraded and 1 percent upgraded. The majority, or 79 percent, of the downgrades were for subprime RMBS, with most being from the 2006 vintage. As highlighted in a recent Lehman Brothers analysis, several factors play into current difficulties: non-agency MBS conditions; liquidity; credit quality expectations; financing costs; leverage (increased required subordination levels); and related structured credit valuation uncertainties. The initial resets of adjustable rate mortgages (ARMs) are due to peak in 2008 and 2009, increasing mortgage market risk exposure and borrower stress. This has led to widely publicized loan modification initiatives.

Commercial mortgage-backed securities (CMBS) issuance rose to $214.8 billion in 2007, an increase from the $181.9 billion issued the previous year. First-half issuance was $139.2 billion compared to the second half of $75.6 billion. CMBS metrics have been solid compared to RMBS, with upgrades well in excess of downgrades in 2007, according to Deutsche Bank data. As fourth-quarter issuance levels suggest, the commercial real estate sector is susceptible to below-trend economic growth.

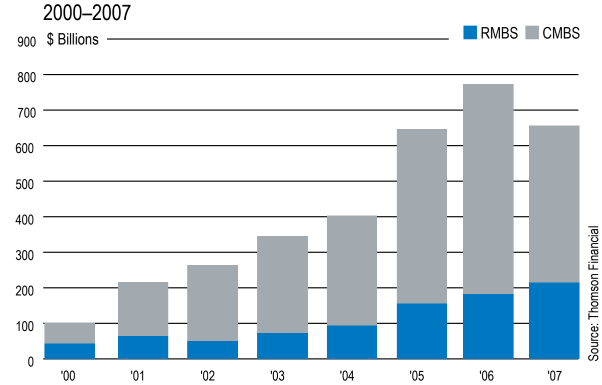
Issuance of Mortgage-Related Securities
2000–2007



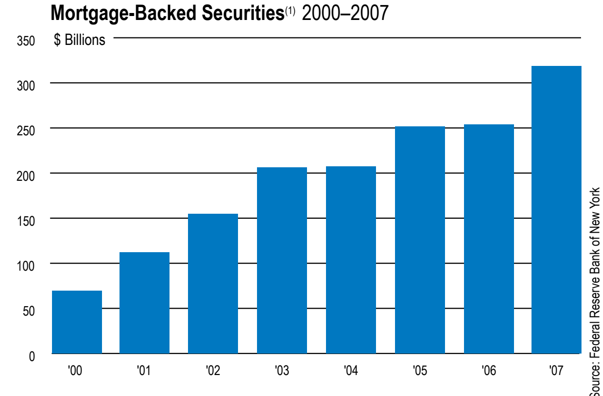
Issuance of Agency Mortgage-Backed Securities
2000–2007



Issuance of Non-Agency Mortgage-Backed Securities
2000–2007



Average Daily Trading Volume of Agency Mortgage-Backed Securities[1] 2000–2007



(1) Primary dealer activity

ABS Issuance Falls on Continued Mortgage Market Weakness

Asset-backed securities (ABS) issuance declined by 31.0 percent to $865.2 billion in 2007, the lowest volume since 2004, and down sharply from the record $1,253.1 billion issued in 2006. Fourth-quarter issuance of $94.7 billion was a 71.8 percent decline from the fourth quarter of 2006 and 29.0 percent below that in the third quarter of 2007. The reduced volume is directly attributable to conditions in the subprime mortgage and home equity loan (HEL) sectors. As with spread products generally, ABS credit spreads widened dramatically in the second half as a result of credit risk repricing, the spillover from the mortgage sectors and diminished liquidity. Subprime and HEL products experienced the most pronounced credit spread widening due to collateral credit quality deterioration and rating downgrades. The wider non-HEL consumer ABS credit spreads reflected reduced market liquidity and weakened investor demand and general credit risk repricing, exacerbated by disruptions in the money markets. The underlying collateral performance remained stable in other consumer sectors, especially in the case of prime auto and credit cards. Consumers' financial strength is a justifiable concern for 2008 based on anticipated slower economic and employment growth in the first half of the year, housing weakness, reduced credit availability, and higher energy and food prices. ABS issuance volumes are expected to remain subdued in 2008.

Leading ABS Sectors

Credit card ABS was the largest issuing ABS sector at $23.6 billion in the fourth quarter, unchanged from the third quarter. Credit card issuance increased by 42.6 percent in full-year 2007 to a record volume of $95.4 billion. As mortgage equity withdrawal receded, consumers have turned to credit cards. Credit card ABS issuance will be affected by the recent uptick in delinquencies and anticipated slower employment and income growth.

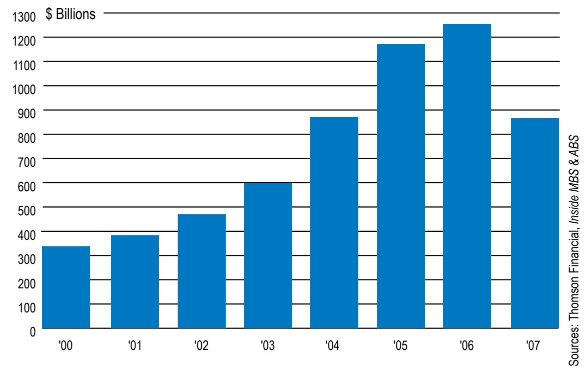
Auto loan ABS fourth-quarter issuance was $18.1 billion, a 27.5 percent increase over the third quarter, while full-year 2007 issuance was $67.9 billion, a 16.9 percent decline from 2006. Areas of concern for 2008 include rising subprime auto loan delinquencies and lower U.S auto sales, which fell 2.5 percent in 2007.

HEL ABS was the third leading issuance sector in the fourth quarter, at $17.9 billion, marginally higher than the third quarter but 83.3 percent lower than the fourth quarter a year ago. HEL ABS full-year volume decreased by 53.9 percent to $223.0 billion in 2007. As an indication of recent issuance trends, Markit Group, Ltd. announced that the launch of the newest HEL ABX derivative index, the ABX.HE series has been postponed due to the lack of qualified deals issued in the second half of 2007 compared to 2006. Lower HEL issuance is the result of weak pricing, lower housing prices and tighter underwriting standards.

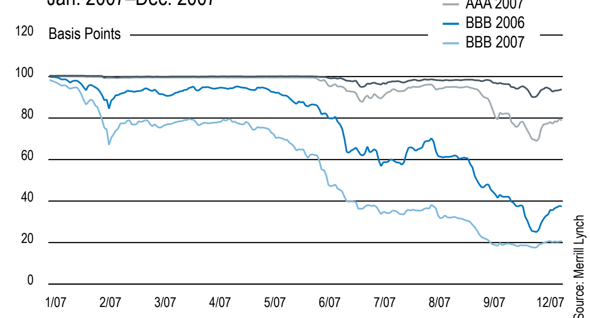
Mortgage ABS, including non-jumbo transactions comprising first-lien mortgage loans with weighted average FICO credit scores of less than 674 and subprime mortgages, was $85.9 billion in 2007, down 34.9 percent from 2006. The mortgage ABS market was virtually closed in the fourth quarter with quarterly issuance only $0.1 billion. (Separately, Inside Mortgage Finance reported fourth-quarter subprime mortgage MBS at $11.9 billion, 61.1 percent lower than the fourth quarter of last year, and full-year 2007 issuance of $219.4 billion, a 54.6 percent decline.)

Student loan ABS issuance totaled $61.4 billion in 2007, down 7.9 percent from 2006. Issuance of $12.4 billion in fourth quarter 2007 was 6.0 percent higher than in the third quarter but 14.5 percent lower than in the fourth quarter a year ago.

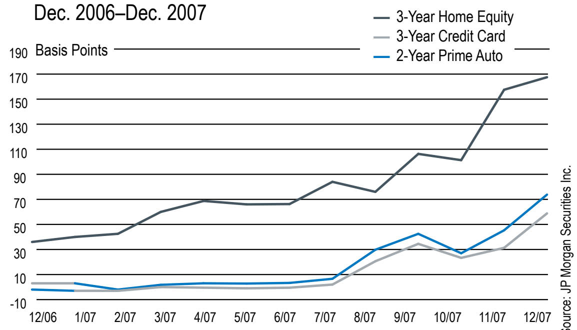
Issuance of Asset-Backed Securities
2000–2007



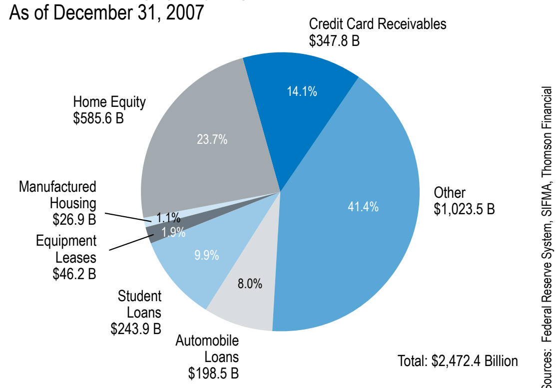
ABX.HE Credit Spreads
Jan. 2007–Dec. 2007



Asset Backed Swap Spreads
Dec. 2006–Dec. 2007



ABS Outstanding by Major Types of Credit*
As of December 31, 2007



*Percentages may not add due to rounding.

CDO Issuance Falls on Diminished Liquidity, Weakened Mortgage Credit Quality

Global collateralized debt obligation (CDO) issuance dropped in the second half of the year on credit market uncertainty, deleveraging, subprime mortgage deterioration and valuation concerns. After a strong first half, second-half global CDO issuance volume was 62.0 percent below that in the second half of 2006. Funded CDO volume declined to $485.7 billion for full-year 2007, down 12.0 percent from 2006, and fourth-quarter volume declined by 67.3 percent on a linked-quarter basis to $29.9 billion. Cash flow and hybrid CDO volume was $347.4 billion in 2007, down 16.2 percent from 2006, and declined to $21.9 billion in the fourth quarter, down 59.9 percent on a linked-quarter basis. Synthetic funded CDO volume was $51.5 billion in full-year 2007, compared to $89.0 billion in 2006, while market value CDO volume rose to $86.8 billion in 2007 from $47.9 billion in 2006 on a strong first half of the year. The synthetic funded CDO sector accounted for $3.9 billion in fourth-quarter 2007, compared to $25.3 billion in the fourth quarter of 2006, and market value CDO issuance was $4.1 billion, compared to $23.3 billion during the same period in 2006. Based on CDO purpose segmentation, arbitrage CDOs represented 86.5 percent of global volume for 2007, with volume declining by 11.0 percent to $420.2 billion for the full year.

Collateral and Currency Sectors

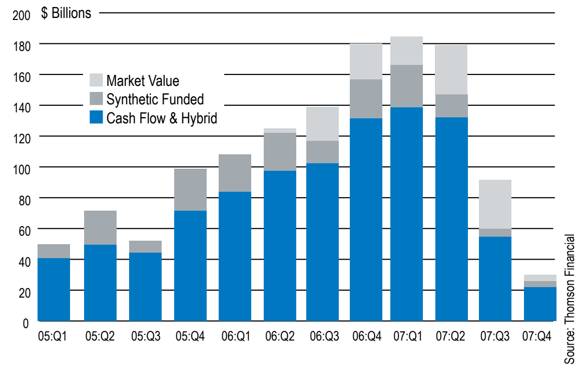
Although the structured finance (SF) collateral group encompasses a wide range of collateral types, it is dominated by mortgage-related (largely subprime) and home equity collateral. Credit quality deterioration, diminished liquidity and weak housing market trends along with a shutdown of subprime origination, slowed SF CDO issuance. SF CDO volume fell to $12.9 billion in the fourth quarter, down 67.0 percent from the third quarter, and full-year issuance dropped to $254.8 million, a decline of 18.9 percent from 2006. CDOs backed by high-yield loans, or collateralized loan obligations (CLO), replaced SF CDO as the largest collateral class at $12.9 billion in the fourth quarter, despite a 58.4 percent fourth-quarter volume decline on a linked-quarter basis. According to Deutsche Bank, $161 billion of CDOs were downgraded in 2007, most of which were SF CDOs, with only $23 billion in upgrades. As CLO collateral quality held up well through 2007, diminished liquidity and increased investor risk aversion were important reasons for the lower volumes.

Dollar-denominated CDO issuance accounted for 68.9 percent of global issuance in 2007, or $334.7 billion for the year, 20.6 percent lower than in 2006. Euro-denominated CDO volume ranked second in fourth-quarter 2007 at $9.0 billion, down 73.8 percent from the third quarter. Euro-denominated volume of $131.8 billion in 2007 surpassed 2006 based on a strong first three quarters of the year.

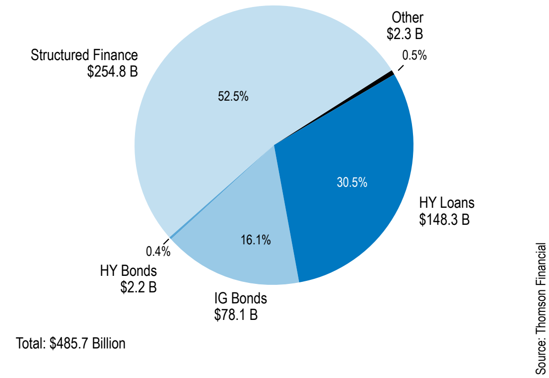
Credit Spreads Much Wider in Second Half, Liquidity Weakens

Based on Merrill Lynch data, CDO credit spreads widened significantly in the third quarter, but secondary market trading diminished so much that indicative spreads were not provided in the fourth quarter. High-investment-grade-rated (“AAA”) cash SF CDO spreads were 125 basis points, widening by 45 basis points in the third quarter. Similarly, “BBB” high-grade and mezzanine SF CDO credit spreads were 800 and 1,000 basis points, respectively, having widened by 200 basis points in the third quarter. CLO “AA”-rated tranches were 110 basis points, after widening by 58 basis points in the third quarter, and “BBB” spreads were at 350 basis points, having widened by 150 basis points in the third quarter.

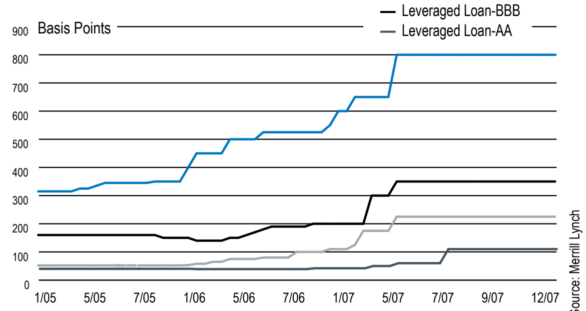
Global CDO Issuance by Transaction Structure
2005:Q1–2007:Q4



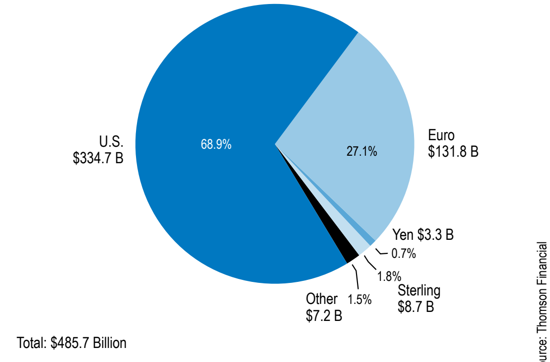
Global CDO Issuance by Underlying Collateral
2007



Asset Backed Swap Spreads
Jan. 2005–Dec. 2007



Global CDO Issuance by Currency
2007



Repo Average Daily Amount Outstanding Increases Slightly Through the First Quarter

The average daily volume of total outstanding repurchase (repo) and reverse repo agreement contacts was $6.31 trillion in 2007, a 12.5 percent increase over the $5.61 trillion average outstanding during the same period in 2006. Daily outstanding repo agreements averaged $3.86 trillion in 2007, a 13.8 percent increase compared to the $3.39 trillion outstanding at the same time a year ago, while average daily outstanding reverse repos increased to $2.46 trillion, a 10.5 percent increase from the $2.23 trillion average in 2006. The data represent financing activities of the primary dealers reporting to the Federal Reserve Bank of New York and include repurchase and reverse repurchase agreements involving U.S. government, federal agency, agency mortgage-backed and corporate securities.

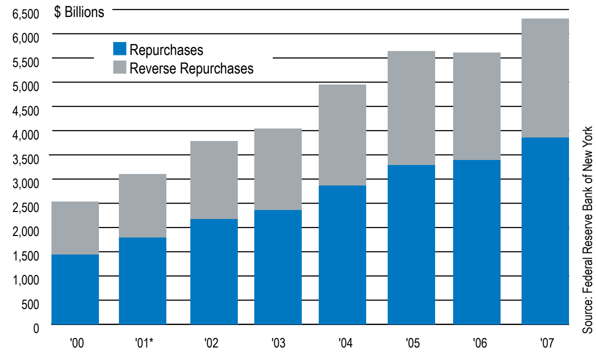
The Fixed Income Clearing Corporation's Government Securities Division (GSD), an SEC-registered clearing agency, facilitates orderly settlements in the U.S. government securities market and tracks repo trades settled through its system by product type. Over $514.3 trillion in repo trades were submitted by GSD participants in 2007, with an average daily volume of approximately $2.1 trillion. Transactions involving Treasury notes accounted for the largest share of GSD's repo activity, representing $361.8 trillion, or 70.3 percent of total volume. Repos involving Treasury bonds accounted for an estimated $45.6 trillion, or 8.9 percent of the total, while Treasury bills accounted for $31.3 trillion of the activity for the period. Transactions involving federal agency non-mortgage securities accounted for $46.1 trillion, or 9.0 percent of volume in 2007.

CP Outstanding Declines; Money Market Outstanding Rises Slightly to $4.03 Trillion

The outstanding volume of all money market instruments, including commercial paper (CP) and large time deposits, totaled more than $4.14 trillion at the end of December 2007, a 2.7 percent increase from the end of the third quarter. CP outstanding declined to $1.79 trillion at the end of December, a 3.7 percent decrease compared to the end of the third quarter in 2007.

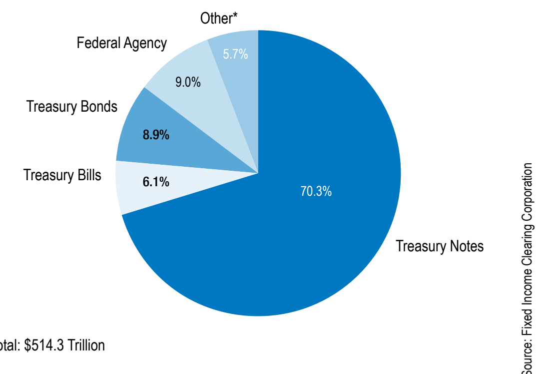
Financial CP outstanding increased to $804.3 billion as of the end of 2007, a 4.8 percent rise from the $767.3 billion outstanding at the end of September 2007. Non-financial CP outstanding stood at $166.2 billion at the end of the 2007, a 1.5 percent increase from $163.7 billion at the end of the third quarter. However, non-financial CP outstanding fell significantly in December, declining more than 12.9 percent in one month as money market disruptions continued, affected by deterioration in the mortgage market, deleveraging and money market investor risk sensitivity. Slower economic growth and reduced demand for debt-funded acquisition bridge financing has also lowered issuer demand. Asset-backed CP (ABCP) outstanding declined by 11.8 percent in the fourth quarter to $816.3 billion, and by about 36 percent from its peak earlier in 2007, due in large part to the market disruptions. Diminished liquidity remained a persistent problem in the ABCP market, with spreads at historically high levels. The Fed's introduction of the Term Auction Facility in December 2007 eased pressure on the commercial paper market, reducing ABCP spreads by 50 basis points in January 2008 to 43 basis points as of January 24. SIFMA's U.S. Market Outlook forecasts financial ABCP to decline in 2008 to $705 billion and for total CP (including ABCP) to total $1.76 trillion, down slightly from 2007 as conventional CP programs are expected to grow.

Financing by U.S. Government Securities Dealers
Average Daily Amount Outstanding 2000–2007



* Beginning July 2001, corporate securities are included

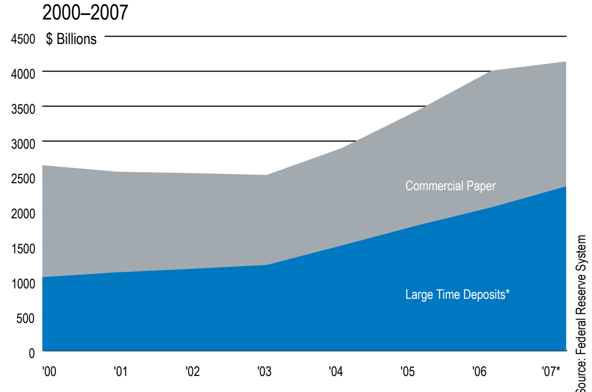
Repo Trades Submitted to the FICC
2007



Total: $514.3 Trillion

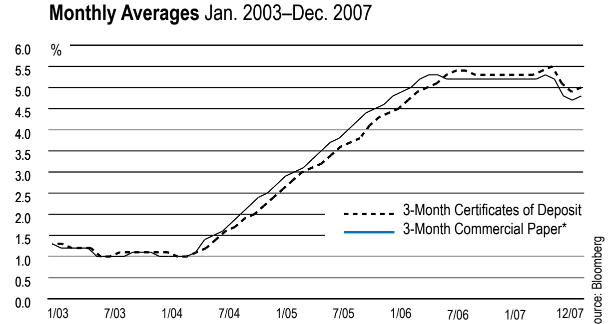
* Includes Discount Agency, Forward Starting Generic Repo Trades, STRIPs, TIPS Bonds, TIPS Notes

Outstanding Money Market Instruments
2000–2007



* SIFMA estimates

Domestic Money Markets Interest Rates
Monthly Averages Jan. 2003–Dec. 2007



*Discount basis

Corporate Bond Issuance Sets Record on Strong First Half; Sector Stalls Amid Second-Half Credit Market Turbulence

Corporate bond issuance reached a record volume in 2007 as a result of a strong first half, sustained by investor risk appetite, ample liquidity, and issuer and sponsor demand for corporate acquisition financing. These benign market conditions abruptly changed during the second half when heightened investor risk sensitivity, credit repricing, diminished liquidity and emerging credit quality concerns began to dominate the market. Despite the more difficult credit market conditions later in the year, total corporate bond issuance volume grew to $1.11 trillion, a 4.5 percent increase over issuance in 2006. On a linked-quarter basis, fourth-quarter issuance declined by 2.5 percent to $222.6 billion, 23.7 percent lower than in the fourth quarter of 2006. Second-half 2007 issuance dropped to $450.8 billion, from $655.6 billion in the first half of the year. Issuance in 2008 is expected to be lower than in 2007 but should remain at historically elevated levels. The key variable is the extent to which reduced market liquidity and investor risk aversion raise barriers to borrowing in the financial markets.

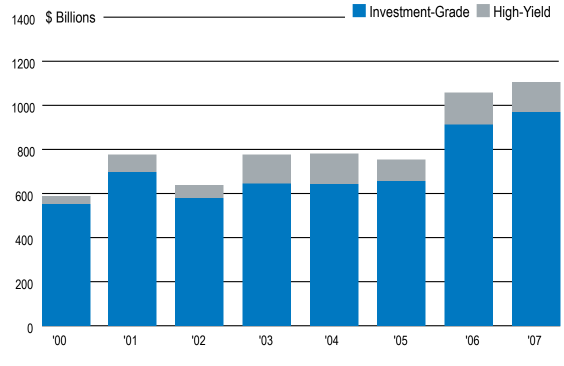
Spreads Blow Out Late in 2007; Credit Quality Concerns Ascending Despite Low Default Rates

Unlike the mortgage-related sectors, the underlying credit quality of corporate bonds held up quite well through year-end, with the exception of a few sectors. Corporate balance sheets, particularly for nonfinancial companies, are stronger following an extended period of double-digit profit growth. Corporate bond credit quality concerns have increased, however, based on the interaction of slower profit growth with increased leverage following the recent surge in shareholder-friendly actions including share buybacks and debt-financed corporate acquisitions.

It is widely believed that default rates are likely rise, especially in the second half of this year, based on slower economic growth and tighter financing conditions. S&P Global Fixed Income Research is forecasting a downward ratings trend and rising global corporate bond default rates during 2008 and into 2009, from a historically low 0.86 percent (0.97 percent in the U.S.) at the end of 2007 to 4.6 percent a year from now, but still below the long-term average.

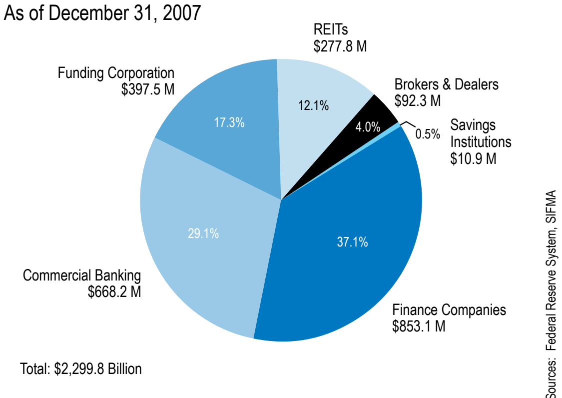
Corporate bond credit spreads, investment-grade and high-yield, widened to the highest levels in nearly five years during the second half of 2007. The Merrill Lynch high-yield index spread stood at 703 basis points on January 28, 180 basis points wider than at the end of the third quarter and 122 basis points wider than at year-end. Furthermore, the percentage of high-yield bonds trading at spreads over 1,000 basis points (distressed debt) nearly doubled during December and now exceeds 10 percent. The risk premium being exacted by the market is also reflected in derivatives prices, as CDX. HY spreads widened to 493 basis points as of December 31, from 337 basis points at mid-year and stood at 603 basis points at January 28. Affected by the significant presence of financials in the investment-grade universe, the J.P. Morgan Investment-Grade Index stood at 213 basis points on January 16, having widened by 77 basis points since mid-October. Opinions vary on the direction of spreads. Optimists point to a weak dollar and global growth benefiting earnings; easing of short-term interbank funding and money market strains; a responsive Federal Reserve; reduced event risk pressures as LBO volume slows; financial companies replenishing their capital; and "bad news" already incorporated in the spread widening in late 2007. Pessimists point to further financial industry write-downs; persistent weaker liquidity; rising financial sector funding costs passed on to

Corporate Bond Issuance*
2000– 2007



* Includes all nonconvertable debt, MTNs and Yankee bonds, but excludes all issues with maturities of one year or less, CDs, and federal agency debt

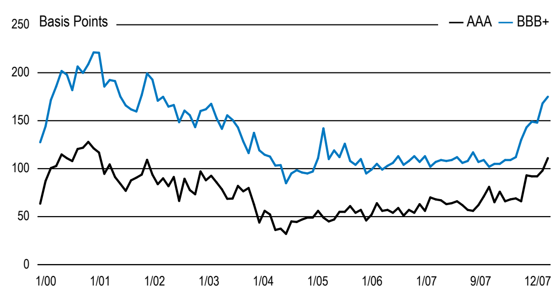
Corporate Debt Outstanding — Financial Sectors*
As of December 31, 2007



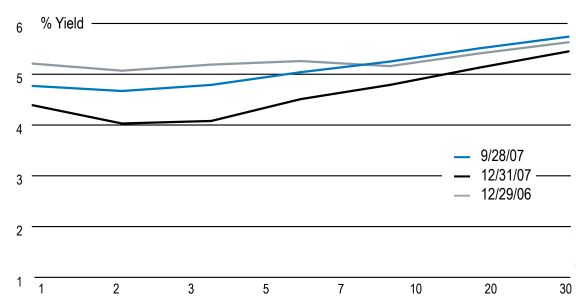
Total: $2,299.8 Billion

*SIFMA estimates

U.S. Corporate Spreads to U.S. Treasury — 10-Year
Jan. 2000–Dec. 2007



U.S. Corporate: AAA Industrial — Yield Curves



corporate borrowers; negative earnings "surprises"; and housing sector and energy strains on the economy and the consumer.

Investment-Grade Volume Sets Record but Drops in Fourth Quarter

Non-convertible investment-grade issuance increased 6.4 percent, to a record $970.4 billion in 2007, moderately higher than the $912.3 billion issued during the same period a year ago. On a linked-quarter basis, issuance fell to $191.0 billion, down from $219.1 billion in the third quarter and $234.3 billion in the fourth quarter of 2006.

Financials remain the dominant investment-grade issuing sector, with commercial banks, investment banks and other credit institutions comprising more than 43 percent of investment-grade issuance volume in 2007. Investment-grade issuance will benefit from financial sector capital needs, with borrowing at still relatively attractive all-in levels while benchmark yields are at historic lows, and higher financing needs are brought about by slower cash-flow generation. The volume of redemptions is seen increasing in 2008, with the largest share issued by financial companies, further adding to issuer demand.

High-Yield Issuance Falls Sharply in Second Half; Modest Decline for the Year

Non-convertible high-yield debt issuance declined to $136.0 billion in 2007, 7.2 percent lower than the 2006 volume of $146.6 billion.[1] Issuance fell nearly 60 percent in the second half of the year to $40.7 billion, compared to $95.3 billion in the first half. The manufacturing sector continues to be the leading high-yield issuing industry, accounting for 26.7 percent of total high-yield issuance in 2007. The tighter financing environment will slow new LBO deal volume after working through the existing calendar. Higher funding costs, less borrower-friendly credit conditions and a more risk-conscious investor universe could also lead to some pullback from other shareholder-friendly initiatives.

Medium-Term Note Issuance Declined in Second Half; Convertible Issuance Higher

Medium-term note issuance declined during the second half of 2007, reflecting of the volatile money and credit market conditions. Issuance totaled $329.7 billion in full-year 2007, a 6.1 percent decline from 2006. Issuance volume fell sharply in the second half to $123.6 billion, a 40.0 percent decline from the $206.1 billion issued in the first half of the year.

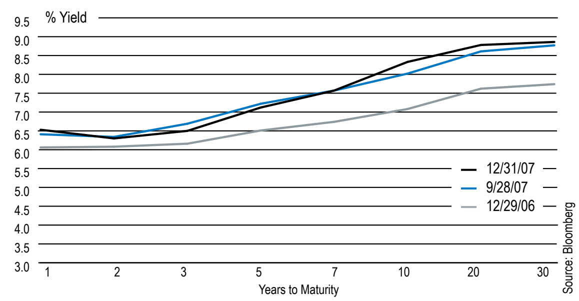
Convertible issuance (including investment-grade and high-yield issues) increased to $76.4 billion in 2007, up 21.7 percent from 2006. On a linked-quarter basis, fourth-quarter issuance more than doubled to $17.7 billion, but declined 19.5 percent from the fourth quarter of 2006. The growth of convertible bond issuance was reflective of investor demand for the hybrid characteristics of convertibles, which offer the benefit of equity price appreciation potential and the downside protection of fixed income.

Trading Volumes Decreases in the Fourth Quarter

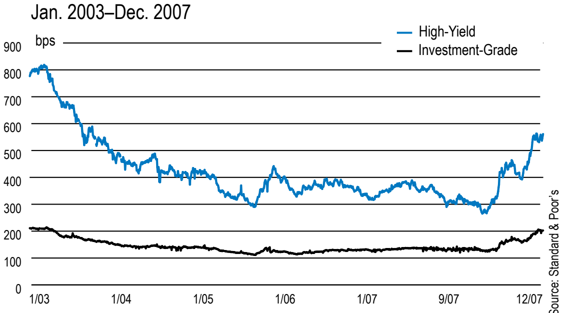
Reduced market liquidity during the latter part of 2007 led to lower trading volumes, which particularly affected the high-yield and least liquid issues. According to the FINRA's TRACE system, total estimated investment-grade average daily trading volume decreased in the fourth quarter to $6.8 billion, 12.9 percent lower than in the third quarter and lower than the $9.1 billion daily average traded during the fourth quarter of 2006. High-yield average daily trading volume decreased to $3.7 billion in the fourth quarter, down from $4.1 billion in the third quarter and down $4.4 billion in the same year-earlier period.

[1] High-yield corporate issuance now includes Euro/144A transactions sold in the U.S. under Rule 144A.

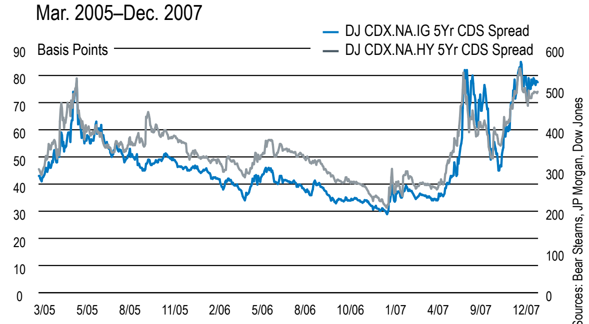
U.S. Corporate: BB Industrial — Yield Curves



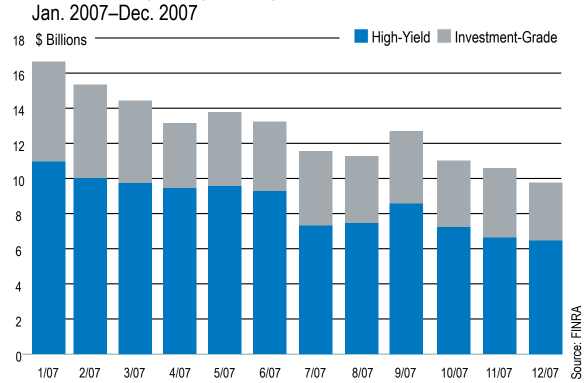
S&P Corporate Composite Spreads
Jan. 2003–Dec. 2007



Credit Default Swap Spread
Mar. 2005–Dec. 2007



TRACE Average Daily Trading Volume
Jan. 2007–Dec. 2007



Credit Market-Driven Equity Decline Leads Federal Reserve to Lower Target Rate a Combined 125 Basis Points in January; Share and Trading Volumes Hit Record Highs in 2007

Renewed credit market stress, along with the weakened housing market, drove stock markets lower in the fourth quarter of 2007 and into 2008. The Federal Reserve responded to these conditions by cutting the target Fed funds rate by a total of 100 basis points in the second half of 2007 and an additional 125 basis points in January. Equity prices increased following the Federal Reserve's cut in the federal funds rate on September 19, but the market response was more tepid and short-lived following the latter two cuts on October 31 and on December 11. The sharper sell-off in early 2008 led to the 75 basis point target fed funds rate cut to 3.50 percent on January 22, followed by a 50 basis point reduction at the scheduled January 30 FOMC meeting.

For the fourth quarter of 2007, the Dow Jones Industrial Average (DJIA) declined by 4.5 percent, the S&P 500 declined 1.6 percent and the NASDAQ fell 1.8 percent. For full-year 2007, the DJIA rose 6.4 percent S&P 500 3.5 percent and the NASDAQ 9.8 percent. All three indices reached record highs in 2007, with the S&P 500 peaking at 1,565.15 on October 9 and the NASDAQ at 2,859.12 on October 31. The DJIA closed the year at 13,264.82, the S&P 500 closed at 1,468.36, and NASDAQ closed at 2,652.28.

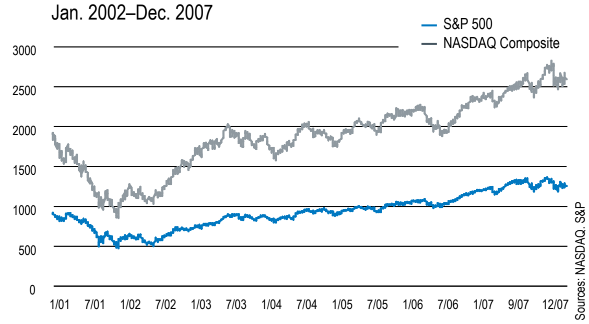
As noted above, the equity market decline accelerated in early 2008 as part of a global equity sell-off. As of January 22, the DJIA stood at 11,971.19, S&P 500 at 1,310.50 and NASDAQ at 2,292.27. A recovery will be dependent on improvement in credit market conditions. In early December, the SIFMA Economic Advisory Roundtable forecast an S&P 500 of 1,600 at the end of 2008. The forecast is predicated on lower benchmark yields, while also taking into account the effect of below-trend economic growth on earnings. The market's price-to-earnings (P/E) ratio is well within historical rangse. If profits exceed expectations, there is room for equity market appreciation through multiple expansion as well as earnings growth.

Full-Year 2007 Share Trading Volume Higher; Fourth Quarter Lower

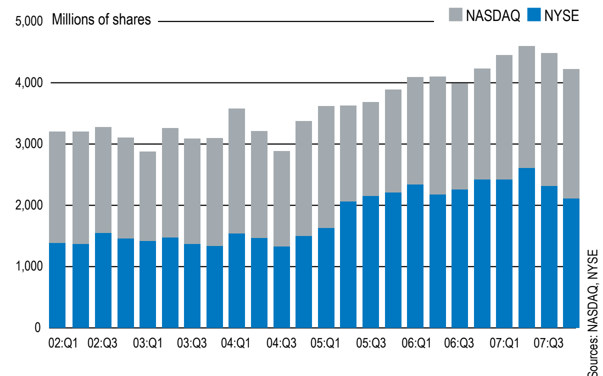
Both the New York Stock Exchange (NYSE) and NASDAQ recorded their highest daily average trading volumes in 2007, rising to 2,110.9 billion shares and 2,132.0 billion shares, up 15.6 percent and 6.5 percent, respectively, compared to 2006. The average daily share volume on the NYSE and the NASDAQ decreased in the fourth quarter on a linked-quarter basis, by 8.6 percent and 3.0 percent, respectively. Average daily share volume on the NYSE slowed to an average of 2,110.1 billion shares in the fourth quarter, despite a 24.2 percent increase in November. NASDAQ share trading volume dropped to an average of 2,108.3 billion shares in the fourth quarter.

The NYSE's average daily dollar trading value set a new record in full-year 2007 of $86.8 billion. The NYSE average daily dollar trading value in the fourth quarter declined to $87.1 billion, or by 8.7 percent, from the third quarter. The NYSE recorded its second highest monthly average daily dollar volume of $100.9 billion in November. The average daily dollar trading value on the NASDAQ also established a new record during the fourth quarter at $68.6 billion, up 10.9 percent from the third quarter. Both the NYSE and the NASDAQ volumes in the fourth quarter were substantially above the levels in the fourth quarter of 2006, increasing by 27.2 percent and 46.8 percent, respectively.

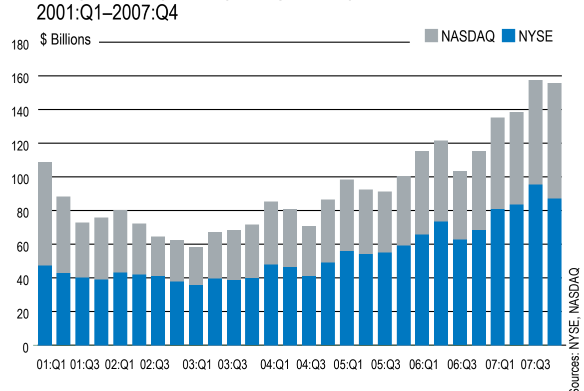
Daily Closing Stock Prices
Jan. 2002–Dec. 2007



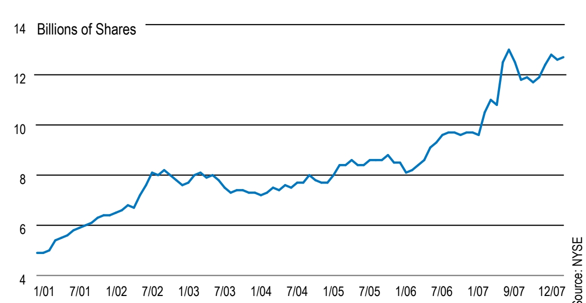
NYSE and NASDAQ Average Daily Share Volume
2002:Q1–2007:Q4



Equity Quarterly Average Daily Trading Volume
2001:Q1–2007:Q4



NYSE Short Interest
Jan. 2001–Dec. 2007



Short Interest Rises Sharply to Near Record Levels

NYSE short interest climbed to 12.74 trillion shares for the December 31 reporting period, increasing by 95 billion shares, or 0.8 percent, compared to December 14. Short-selling activity remained above the 10 trillion-share level for the fourteenth consecutive reporting period. The December 31 short interest represented 3.4 percent of the total shares outstanding on the NYSE. The short ratio, or number of days' average volume represented by the short positions outstanding on the NYSE, rose to 10.3 on December 31 from 9.1 on December 14.

Total Corporate Underwriting Reduced by Credit Market Turbulence

Fourth-quarter equity underwriting volume was $42.5 billion on 200 deals, compared to $28.6 billion on 115 deals in the third quarter. Second-half 2007 underwriting volume was $71.1 billion, compared to $114.9 billion in the first half, affected by the deterioration in credit market conditions. Based on the strong first half, full-year 2007 dollar volume was $186.0 billion, 18.3 percent higher than in 2006.

Closed-end funds had a record year in 2007, raising $38.9 billion on 96 deals, compared to $11.8 billion on 39 deals in 2006. Closed-end funds raised $4.6 billion in the fourth quarter, compared to $3.6 billion in the third quarter. Preferred stock issuance volume was also higher, raising $28.8 billion on 20 deals in the fourth quarter, an increase of 151.0 percent on a linked-quarter basis. Full-year preferred stock issuance of $60.0 billion was 79.8 percent higher than in 2006.

The securities industry raised $461.9 billion in capital in the fourth quarter through total corporate debt (straight bonds and securitizations) and equity underwriting, a decline of 16.6 percent from the previous quarter and 49.5 percent below that raised in the fourth quarter of 2006. The decline was directly attributable to lower mortgage ABS and non-agency MBS issuance, down 29.0 percent and 61.1 percent year-over-year, respectively.

Total Initial Public Offerings (IPOs); Higher in Fourth Quarter, Lower for the Year

U.S. initial public offerings (IPOs) raised $19.1 billion in the fourth quarter, a 34.1 percent increase over the previous quarter. "True" IPOs, which exclude closed-end fund IPOs, were $14.5 billion, 36.5 percent higher than the $10.6 billion raised in the third quarter of 2007 but 25.2 percent lower than in the fourth quarter of 2006. Full-year total IPO issuance volume was $89.6 billion, an increase of 54.9 percent from 2006, while "true" IPO volume was $50.7 billion, a 9.9 percent increase. Furthermore, the December backlog of filed U.S. IPOs increased for the fifth straight month to $33.3 billion on 122 deals in the largest IPO calendar in over three years.

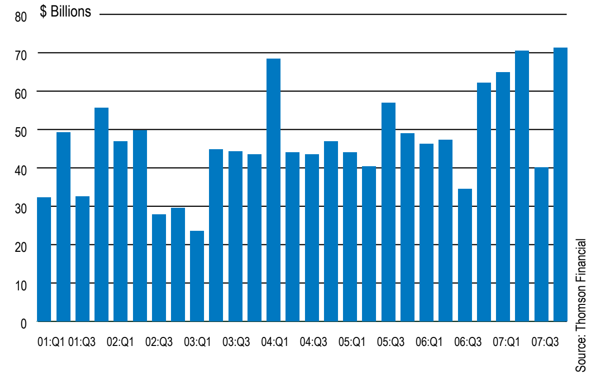
Introducing Venture Capital/Private Equity

Beginning with this issue, Research Quarterly will provide private equity and venture capital data. Capital disbursements rose 10.8 percent in 2007 to $29.4 billion, the second-highest total since 2001. Fourth-quarter volume declined, however, affected by the higher cost and reduced availability of credit to finance deals, to $7.0 billion, down 7.8 percent from the previous quarter.

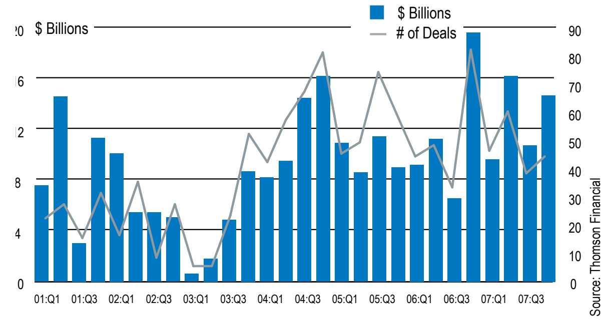
Fourth-Quarter Secondary Offerings Increase but 2007 Volume Lower

The total value of secondary equity offerings in the fourth quarter was $23.3 billion on 112 deals, a 62.4 percent increase from the third-quarter level of $14.4 billion and 17.4 percent lower than the fourth quarter a year ago. Full-year 2007 issuance volume was $96.4 billion, 3.0 percent lower than in 2006.

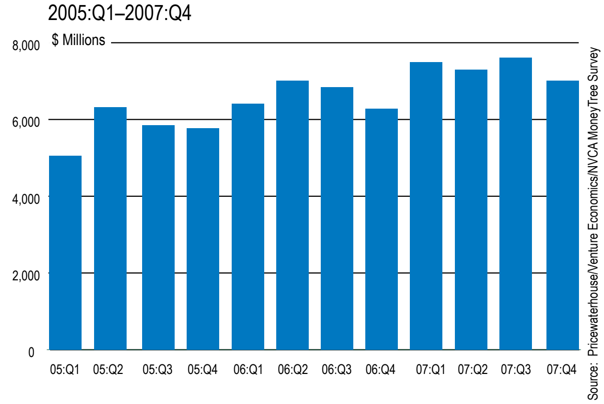
Total Equity Underwriting
2001:Q1–2007:Q4



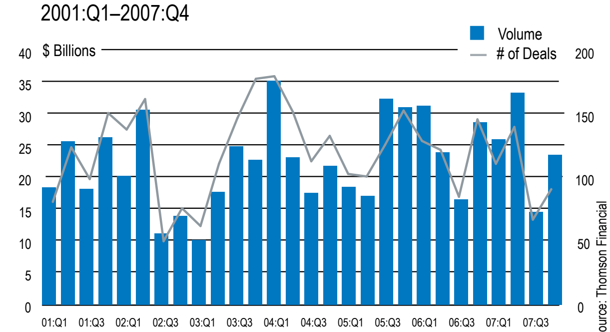
Quarterly "True" IPO - Excluding Closed-End Funds
2001:Q1–2007:Q4



Venture Capital Investment in U.S. Companies
2005:Q1–2007:Q4



Quarterly Secondary Stock Offerings
2001:Q1–2007:Q4



U.S. M&A Deal Flow Lower on Reduced Credit Availability

Mergers and acquisitions (M&A) volume grew at a record pace in the first half of 2007 but fell in the second half as credit market uncertainty reduced the availability of debt to finance corporate acquisitions. First-half 2007 announced deal volume was $1,021.1 billion, compared to $600.1 billion in the second half. Fourth-quarter deal volume of $291.5 billion represented a 5.5 percent decline from the third quarter, and was 39.7 percent less than a year ago. Nevertheless, total M&A volume in 2007 was the third-highest recorded with $1.6 billion, a 9.9 percent increase over that in 2006, but 6.9 percent below the record $1.7 billion in 2000. The number of M&A announced deals in 2007 was the second-highest level recorded at 11,296 deals. Average deal size is likely to be smaller in the coming year.

Although the M&A outlook for the coming year is uncertain, several considerations point to M&A growth over the next several years. More restrictive financing conditions in the bond and leveraged loan markets are certainly slowing LBOs and, to some degree, financial buyer motivated M&A in general. The below-trend economic environment has a mixed effect on M&A activity. Slower economic and profit growth tends to serve as a disincentive for corporations to take on the incremental risk of an acquisition. On the other hand, as opportunities for organic growth diminish in a below-trend economic environment, corporate buyers may turn to strategic M&A. Also, financial buyers, including private equity and hedge funds, have cash available for investment following an extended period of capital raising. Finally, the demand for capital in financial and housing-related industries provides another impetus for deal making.

CBOE Volatility Index (VIX) Above Long-Term Averages in the Quarter

Equity market performance was affected by higher volatility in the fourth quarter of 2007 and into 2008. The Chicago Board Options Exchange Volatility Index, or VIX, ended the year at 22.50. The October and November 2007 month-end VIX levels were 18.53 and 22.83, respectively, peaking at a 31.09 on November 9, compared to the five-year monthly average and 10-year monthly average of 16.24 and 20.66, respectively. The VIX remained elevated in early 2008, ending the week of January 18 at 27.18.

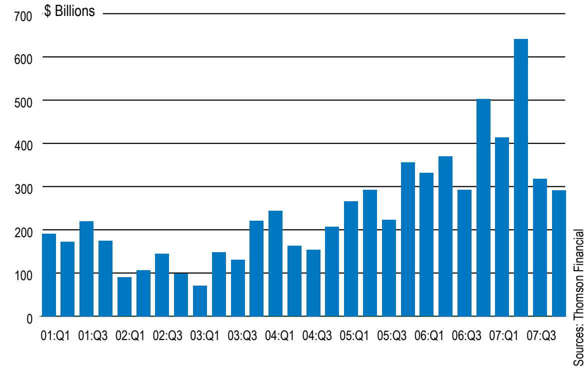
Share Buyback Growth Continues on the NYSE and NASDAQ

Share buybacks continue to be an integral part of corporate shareholder and equity price enhancement strategies. Corporate share repurchases in the fourth quarter and for the year indicate a continuation of the buyback trend. Fourth-quarter buyback dollar volume did decline on the NYSE by 30.3 percent but increased on the NASDAQ by 60.8 percent. The quarterly announced dollar volume on the NYSE was $104.8 billion on 82 deals, while the NASDAQ reported $23.4 billion on 26 programs. For the year, the NYSE had $455.2 billion in buybacks on 261 deals, and the NASDAQ reported $54.7 billion on 98 programs, an increase of 72.0 percent and 17.3 percent, respectively, on a dollar volume basis.

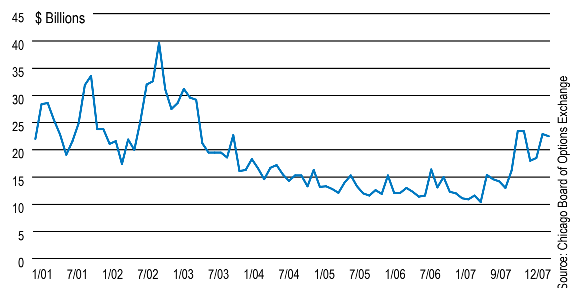
P/E Valuations Remain in Moderate Range

The P/E ratio of the S&P 500 stood at 18.64 at the end of December, below the 10-year average. The moderate P/E level provides a cushion against slower earnings growth and an opportunity for price appreciation should earnings "surprise" on the upside. S&P is projecting higher profit levels in most industry sectors for 2008.

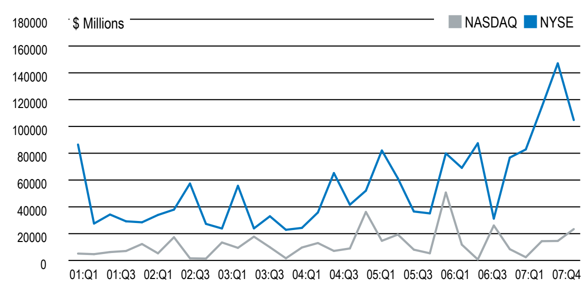
U.S. Mergers and Acquisitions Announced Deals
2001:Q1–2007:Q4



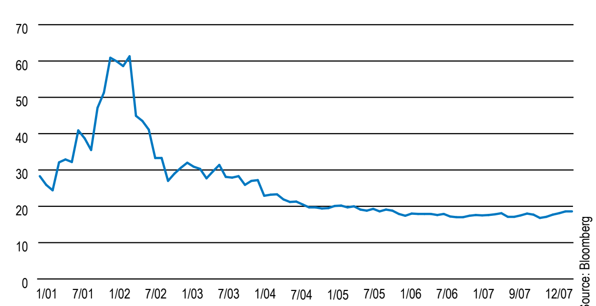
SPX Volatility Index (VIX) Close
Jan. 2001–Dec. 2007



NASDAQ and NYSE Share Buybacks
2001:Q1–2007:Q4



S&P P/E Ratio
Jan. 2001–Dec. 2007



2007 Review of the Secondary Loan Market

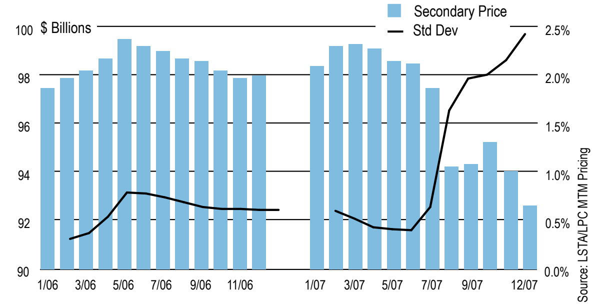
The year 2007 will be remembered for the subprime mortgage meltdown that fueled the credit crunch of the second half. Subprime contagion spread across all structured finance sectors during the second half, and hit the CLO sector, which had long been a dominant funder of leveraged loans, hard. The effects of the contagion, including the reassessment and repricing of credit risk, triggered a virtual shutdown of CLO issuance. CLO managers and issuers were left to grapple with the liability side of the equation in this difficult environment. The primary market quickly became crippled, while the newly created loan derivative LCDX index led secondary prices lower on higher volatility. By mid July, bids began to drop in the secondary market, which then revealed characteristics of a less liquid but much more volatile market. The higher level of price volatility during the second half was reflected in the rising standard deviation of the LSTA market dataset's month-end prices. The 2007 annual standard deviation of 1.19 percent was double that of 2006.

As was the story across all credit markets, the leveraged loan market was a tale of two halves. During the first half of the year, primary issuance was poised to obliterate 2006's record levels. According to Reuters Loan Pricing Corporation, first-half leveraged issuance totaled $431.5 billion, while the overwhelming majority of loans traded at a premium to par in the secondary market. CLO demand for loan assets continued to ascend to record levels. According the S&P LCD (Leveraged Loan Commentary and Data), first-half CLO issuance totaled $57.6 billion, with a record second quarter of $32.8 billion. New-issue supply changed accordingly–deals became larger and coupons trended lower. Loan structures loosened as covenants were relaxed, and, in some cases, removed entirely. To that point, S&P's LCD reported first-half covenant-lite volume of $104 billion, compared to $24 billion for full-year 2006, while second-lien volume reached an unprecedented $25 billion during the first half. Even though default rates stood at an all-time low of 0.29 percent and core corporate earnings were strong, trouble was on the horizon.

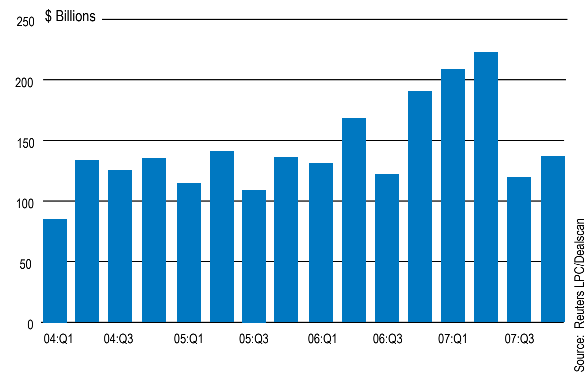
The performance of the secondary market during June began to reveal signs of what was to come, but could have certainly been viewed as an expected and natural pullback from the spectacular first quarter. According to the LSTA/LPC Mark-to-Market (MTM) Pricing Service (which supplies market participants with indicative secondary market prices), the LSTA market dataset (comprising U.S. term loans priced by 3 or more trading desks) reported an average secondary price of 98.76 at the end of the second quarter, 84 basis points shy of the first quarter's record high of 99.6. The bid-ask spread remained virtually unchanged through the first six months, fluctuating between 60 and 66 basis points–levels which supported a liquid secondary market. The percentage of the dataset priced above 100, or at a premium to par, was reported at 73 percent–a percentage which indicated a very strong level of demand, even though the percentage had slipped from the unprecedented 82 percent recorded at the end of the first quarter.

In this "perfect storm," the primary loan market was set to unleash record levels of new paper into the market. The rapid deterioration of CLO demand coincided with the massive volume of new-issue supply. Combined with an economy which slowed in the second half, secondary market prices were poised to plummet. During July, the secondary market entered into a period of unprecedented volatility, where prices deteriorated rapidly and bid-ask spreads widened to historically high levels. Ninety-six percent of the market dataset recorded MTM losses, with an advancer/decliner ratio

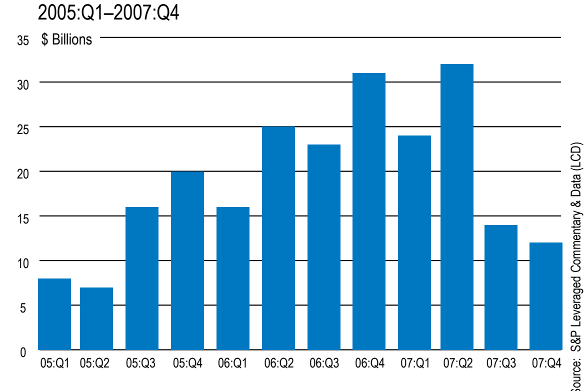
The Standard Deviation of Monthly Secondary Prices
Jan. 2006–Dec. 2007



Leveraged Loan Issuance
2004:Q1–2007:Q4



CLO Issuance
2005:Q1–2007:Q4



[2] The author of the Leveraged Loan discussion is Ted Basta, Loan Syndication and Trading Association (LSTA), Vice-President of Market Data & Analysis

 continued from page 14

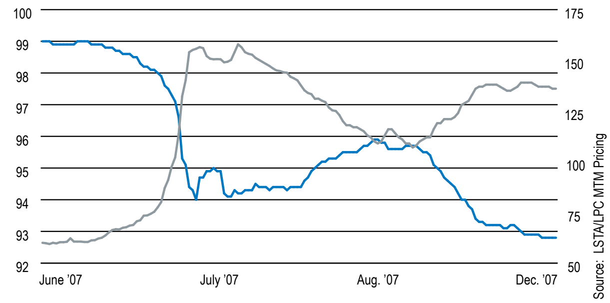
of 1:65. The dataset's price fell 363 basis points to 95.06, while the bid-ask spread widened to 140 basis points from 66 basis points. This abrupt correction sent the percentage of loans priced above 100 plunging to a previously unfathomable 5 percent of the market dataset, from 73 percent just four weeks earlier. Prices continued to fall precipitously through the first trading week of August. From month-end July to August 3, the market dataset's price fell an additional 100 basis points to 94.04 and its bid-ask spread widened to 156 basis points. The ensuing process of price discovery through September lifted secondary prices off their August lows. However, despite September's rally, third-quarter performance remained weak. The market dataset tallied a 344 basis point decrease in price, ending the quarter at the 95.32 level, while the bid-ask spread widened 59 basis points to 125 basis points over the three-month period. According to the LSTA Trade Data Study, secondary trading volume for the quarter was at a record $146 billion, following the previous record highs of the first quarter ($101.9 billion) and second quarter ($142.7 billion).

Credit market turmoil dominated the headlines during the fourth quarter. The prospect of rising mortgage default rates and rating agency downgrades on structured assets heightened concerns regarding credit market stability, and, as a result, new-loan supply slowed to a trickle. A number of leveraged deals were either postponed or downsized due to their inability to clear market. On the demand side, new CLO issuance remained mostly scarce, with non-traditional lenders filling the vacated space in search of the lucrative yields available in both the primary and secondary loan markets. According to S&P LCD, the CLO market share of primary issuance had fallen to less than 25 percent from roughly 60 percent since the beginning of the third quarter. Conversely, the combined market share of hedge, high-yield, and distressed funds in the primary market has more than doubled to roughly 60 percent from less than 25 percent. The timely arrival of these non-traditional lenders provided much-needed liquidity to the market, but could prove to be potentially short-lived. While this additional liquidity alleviated some of the downward price pressure in the secondary market, the rally was brief. Reversing a two-month trend of rising prices and tighter bid-ask spreads, the secondary market recorded its second-worst month of the year in November. Prices continued to retreat lower during December. By the end of the quarter, the market dataset was lower by 255 basis points while bid-ask spreads expanded by an additional 11 basis points, and 89 percent of loans recorded MTM losses and 78 percent of these fourth-quarter price changes were lower than -0.5 percent, with 56 percent recording declines between -1 percent and -5 percent, and an additional 12 percent at more than -5 percent.

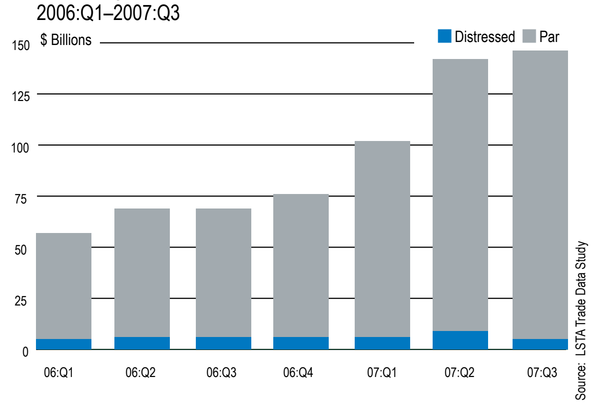
By the end of 2007, loan market supply and demand in both the primary and secondary markets entered an uncertain period as issuers and lenders pondered the future. Necessary changes occurred in how loans were structured, priced and subsequently traded in the secondary market, while the investor base was no longer dominated by the prominent CLO community. New deals were downsized and once again included more aggressive covenant packages and higher coupons. Despite rising coupon levels, yields were still not high enough to bring lenders back to the table. New deals were sold at deep discounts to par (original issue discounts or OID) in order to clear the substantial new-issue overhang.

Within the secondary market, liquidity suffered as prices declined and volatility increased to historic highs. The LSTA market dataset was down 594 basis points (6 percent) and ended the year at 92.77. At year-end, bid-ask spreads, commonly used as a measure of liquidity, widened 71 basis points to 136 basis points from January 2007, but were 22 basis points tighter than the 158 basis points recorded in August. Ninety-five percent of the dataset

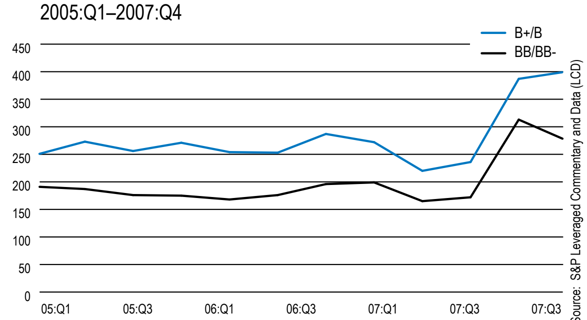
Secondary Price Performance
Jun. 2007–Dec. 2007



Secondary Trade Volume
2006:Q1–2007:Q3



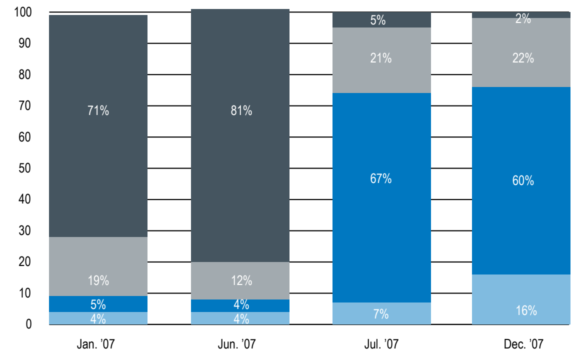
New Issue Spreads
2005:Q1–2007:Q4



recorded MTM price declines since the beginning of the year, 62 percent of which between -1 percent and -5 percent, with an additional 29 percent at more than -5 percent. This dramatic fall in prices changed the face of the secondary market landscape. Over the course of the last six months of the year, the secondary trading market morphed from a par-plus to a mid-'90s market. At the beginning of June, the percentage of loans priced above 100 was 81 percent, by the end of June 73 percent and by the end of July at an inexplicable 5 percent. With the percentage of loans priced above 100 diminishing throughout the year, the percentage of loans priced between 90 to 98 swelled. The 90 to 98 range ballooned from its first-half average of 4 percent to 63 percent of the market dataset by the end of July. Since July, it has fallen back to 60 percent, as several loans have fallen to below 90 or into the distressed range, which has risen to 16 percent, from 7 percent, of the market dataset.

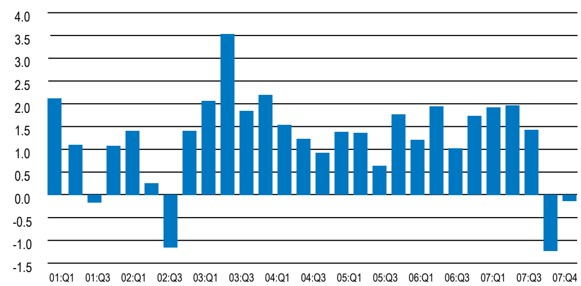
The performance of the S&P/LSTA Leveraged Loan Index (LLI), the leading benchmarking tool of the industry, further illustrates the trials and tribulations of 2007. The LLI posted a diminished 2.02 percent return on the year, down substantially from 6.77 percent in 2006. While returns on the Index fell sharply, volatility rose dramatically. The standard deviation of monthly returns rose to 1.34 percent in 2007, from 0.16 percent in 2006, according to S&P LCD. Loan prices are now said to be closely correlated to, and no longer shielded from, the daily price fluctuations of other asset classes. While the risk-adjusted returns of leveraged loans are still relatively attractive, today's returns come with higher volatility and an expectation of rising default rates. Should defaults begin to rise, a new and more challenging period of credit assessment and re-pricing will begin.

Secondary Price Distribution
Jan. 2007–Dec. 2007



Source: LSTA/LPC MTM Pricing

S&P/LSTA Leveraged Loan Index Quarterly Returns
2001:Q1–2007:Q4



Source: S&P Leveraged Commentary & Data (LCD)

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