

US – End of Credit Crunch?


Amid the collapse of US mortgage markets, financial companies around the world recorded more than \$500 billion in writedowns and credit losses this year, and were forced to raise more than \$360 billion in capital. On July 15, the Standard & Poor's 500 Index reached the lowest since 2005 after investors lost confidence in a government plan to rescue mortgage companies Fannie Mae and Freddie Mac. Last Sunday, the government seized the two companies finally. Investors and policy makers expressed relief Monday, according to IHT. In fact, the move have ended a period of extended uncertainty about the two companies - giant mortgage buyers that play a critical role in the American financial structure - and markets in Asia and Europe responded with their biggest rally in months. The move will protect central banks in Asia from taking big losses in the hundreds of billions of dollars of Fannie Mae and

Freddie Mac bonds they have amassed. China and Japan, the biggest buyers of Freddie Mac and Fannie Mae bonds, praised Washington for the rescue. Spreads between the company's debt and equivalent Treasury securities fell sharply, meaning that investors now see far less risk on investing in Fannie and Freddie debt than they did last week. The immediate reaction to the US government's commitment of up to \$200 billion to support the two giant mortgage lenders, which together back about half the country's \$12 trillion in mortgages, was positive. However, there are still myriad hurdles facing the US economy, and the housing market has not yet begun to recover from the sharp decline of the past several years. And many analysts were still trying to sort out all the implications of the government's actions over the weekend, which could

become one of the most expensive financial rescues in US history. The bailout of the country's two biggest mortgage finance companies, which may prove the costliest ever, was a still a symptom of the dismal state of capital markets more than a year into the crisis. On the other hand, bank and savings and loan insiders spent more money buying shares of their companies for May-July than in any previous three months in at least two decades, betting that financial institutions are bouncing back from the credit-market crunch. Insiders including bank directors and executives bought \$296.2 million of their own stock in the period, according to the Washington Service. That's the most since the research firm began tracking the data in November 1986. 



Microscope

The government is taking an increasing role in financial markets, after the Fed six months ago provided \$29 billion of financing to prevent Bear Stearns & Cos.'s collapse. US Treasury Secretary announced that the two companies, Fannie Mae and Freddie Mac, would be in a government operated conservatorship, ousting their chief executives and eliminating their dividends. The Treasury may purchase up to \$200 billion of stock in the firms to keep them solvent. The takeovers bring Fannie, formed after the Great Depression and spun off in 1968, and Freddie, created in 1970, back under the government's fold. It's the biggest step yet in officials' efforts to grapple with a yearlong credit crisis that has caused more than \$500 billion of losses and writedowns. Under the plan, the Treasury will receive \$1 billion of senior preferred stock in coming days, with warrants representing ownership stakes of 79.9% of Fannie and Freddie. The government will receive annual interest of 10% on its stake. As a condition for the assistance, Fannie and Freddie eventually will have to reduce their holdings of mortgages and securities backed by home loans. 

MARKET BRIEFING

YTD % (local curr)


US DJ
11,220 (-15.4%)
Nasdaq
2,255 (-14.9%)
Euro Stoxx 50
3,185 (-27.6%)
HSI
19,933 (-28.3%)
Japan NK225
12,212 (-20.2%)
China Shanghai Composite
2,202 (-58.1%)
Singapore
2,574 (-25.7%)
India BSE30
14,483 (-28.6%)
Brazil BOVESPA
51,939 (-18.7%)
Aus All Ord
4,949 (-22.9%)
US-10yr Bond
Yield 3.7%

As at 05/09/08


Insight: "Asset-Backed Securities"

The term asset-backed security (ABS) is defined a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the security holders. In the US, securities collateralized by home equity loans (HELs) are currently the largest asset class within the ABS market. Investors typically refer to HELs as any nonagency loans that do not fit into either the jumbo or alt-A loan categories. While early HELs

were mostly second lien subprime mortgages, first-lien loans now make up the majority of issuance. Subprime mortgage borrowers have a less than perfect credit history and are required to pay interest

rates higher than what would be available to a typical agency borrower. In addition to first and second-lien loans and other HE loans can consist of high loan to value (LTV) loans. In addition, securities can also be backed by credit card receivables. Credit card holders may borrow funds on a revolving basis up to an assigned credit limit. The borrowers then pay principal and interest as desired, along with the required minimum monthly payments. Because principal repayment is not scheduled, credit card debt does not have an actual maturity date and is considered a nonamortizing loan. 

A-Z Financial Tools

Accumulators are financial derivative products sold by an issuer to investors that require the issuer to sell shares of some underlying security at a predetermined strike price, settled periodically. This allows the investor to accumulate holdings in the underlying security over the term of the contract. The buyer speculates a company will trade between a certain price range within the contract period. 



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