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### Preview: Bernanke Testimony

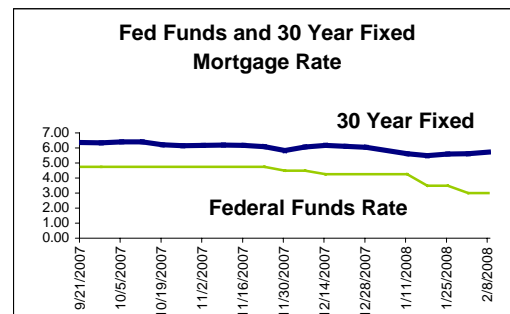
Fed Chairman Ben Bernanke is scheduled to appear before a Senate Banking Committee 14 February at 1000 EST/1500 GMT. Mr. Bernanke along with US Treasury Secretary Henry Paulson and Securities and Exchange Commission will present their outlook on the US economy and financial markets.

We expect that the substance of Mr. Bernanke's remarks will provide a bittersweet valentine for both the markets and the Congress. The prepared remarks can be expected to note the considerable strains that remain in financial markets in light of the very aggressive Fed action over the past few months. The Fed Chair can be expected to note both the 225bps of cuts and the recent passing of the stimulus package by the Congress as positive action that will mitigate the multiyear correction in the housing sector and the deceleration of consumption over the past month. While, the Mr. Bernanke will note the risks to inflation, he will reiterate that the FOMC's expectation that the pricing picture will moderate in coming quarters.

However, it is in the question and answer period that we anticipate that the Fed Chair will move into "Gentle

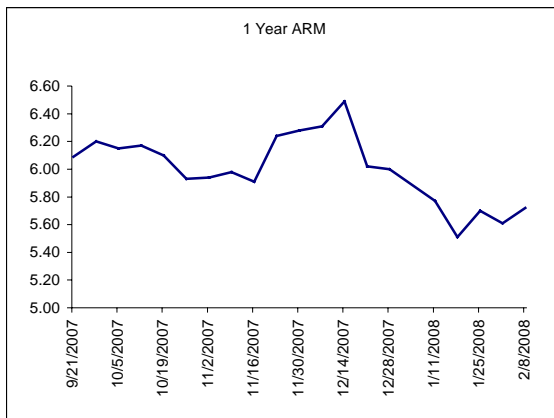
Ben" mode and communicate to the committee that the Fed stands ready to act in a timely manner should the economy continue to sputter in the first half of the year.

Given the increasing displeasure with the Fed in the capital markets, we do expect to see some aggressive questioning out of the committee that will provide the more interesting moments during the session.



First and foremost, from the committee will be a focus on the shape, efficacy and intent of Fed action to alleviate the collapse of the housing sector and the accompanying stress in the credit markets. In light of the 225bps cut in the federal funds rate over the past six months, the market for mortgages has become bifurcated. While, the short term and conforming markets have seen a general improvement in rates, the 30-year

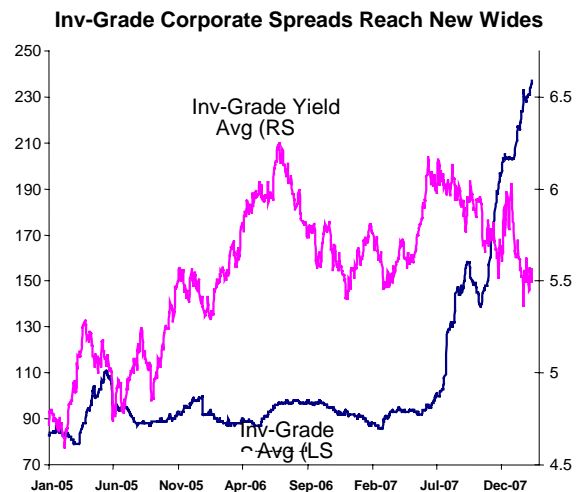
fixed conforming and non-conforming jumbo market and have actually seen rates increases over the past month the past month. Given the relative political importance of those consumers to the election prospects of committee members, the market should expect a sharp focus on the efficacy of Fed action and a healthy skepticism of whether the Fed stands ready to take further action to unlock the mortal coil at the upper end of the mortgage market.



Second, banks and investors remain skittish and are requiring greater compensation in return for credit in light of the ongoing problems caused by the collapse of the sub prime market. With the problems of monoline insurers providing a ongoing deadweight on the credit market Mr. Bernanke is going to have to go to some lengths to reassure the market that the Fed actually has a plausible response should MBIA or Ambac collapse.

The plain truth is that over the past month since the Fed engaged in an emergency 75bps cut, that credit spreads have continued to widen and both consumer and market confidence is on the wane. We do not expect that consumer confidence and a willingness of market participants to ease credit conditions until the efficacy of Fed action can be demonstrated.

Our outlook is predicated on the expectation that the fed will continue to cut rates with the FOMC reducing the policy rate when it meets on March 18. As long as the Fed



observes a concomitant softness in aggregate demand and further deterioration in the credit markets, the Fed should continue to cut the policy rate until the real federal funds rate moves into negative terrain.