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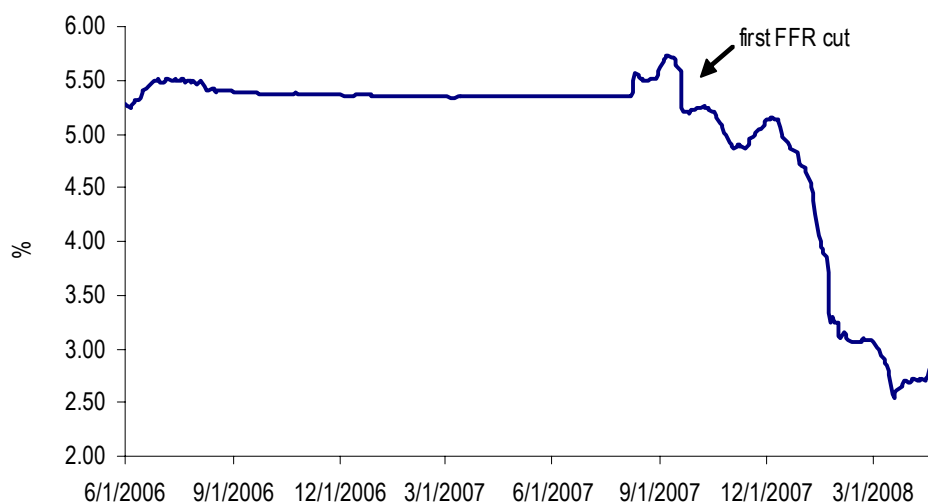
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Credit Markets Improving

We think the recent narrowing of credit spreads provides key confirmation in the recovery process. It outweighs the continuing turmoil in short-term LIBOR spreads in the U.S. and Europe.

- Credit spreads have generally narrowed since the middle of March in response to aggressive Fed action and the liberalization of Fannie Mae and Freddie Mac limitations.
- Short-term funding markets are functioning less well as spreads between interbank interest rates and central bank policy interest rates have widened substantially. On April 21, the Bank of England announced an important new 50 billion pound swap facility, which should help some with the wide sterling-LIBOR rate (graphed later in this piece).
- From a U.S. GDP standpoint, we think the decline in the LIBOR rate outweighs the wider LIBOR spread. The rate itself is used to price many variable-rate corporate and mortgage loans, while the spread is important in the profitability of certain types of lending.

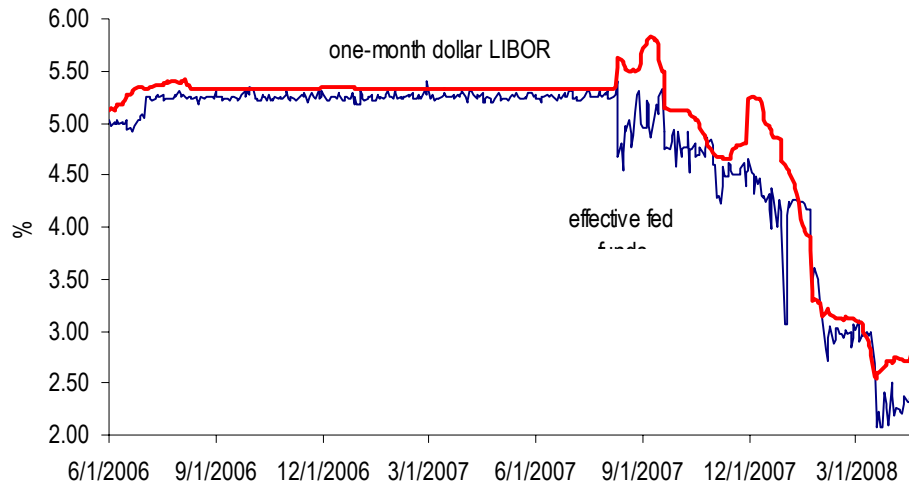
Three-month U.S. Dollar LIBOR (last obs. April 17, 2008)

Source: Haver; Bear, Stearns & Co. Inc.

Problems in Short-Term Interbank Markets

After having improved significantly following the advent of the Term Auction Facility (TAF), one-month LIBOR has again diverged from the Fed funds rate, reflecting problems in the functioning of short-term interbank lending markets.

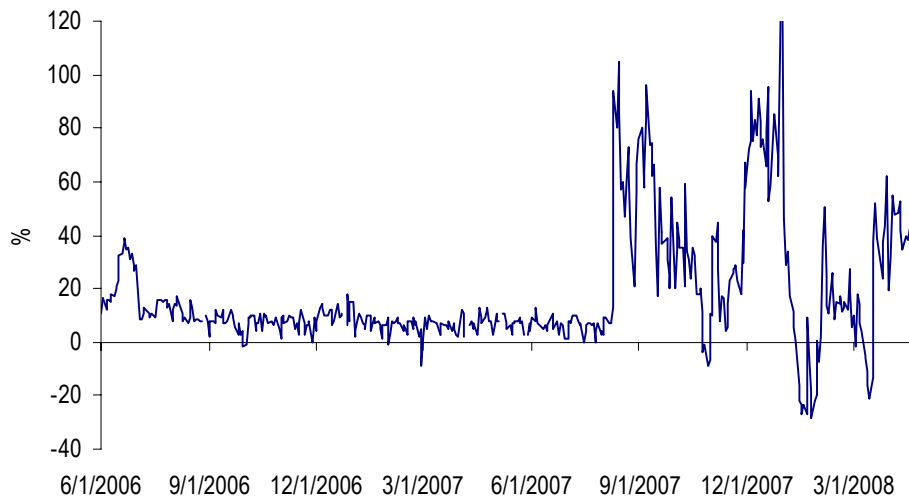
1-month U.S. LIBOR and Fed Funds Rate (last obs. April 17, 2008)



Source: Haver; Bear, Stearns & Co. Inc.

- The spread between one-month LIBOR and the fed funds rate has rebounded.

1-month U.S. LIBOR minus Fed Funds Rate (last obs. April 17, 2008)



Source: Haver; Bear, Stearns & Co. Inc.

- Similarly, the TED spread (euro-dollar yield minus treasury yield) remains somewhat elevated. It reflects an intense preference for Treasury securities, as well as continued concerns about the short-term health of banks.

TED spread (last obs. April 17, 2008)



Source: Haver; Bear, Stearns & Co. Inc.

- The funding of SIVs (structured investment vehicles) has also deteriorated some over the past month, though the current stress remains modest in comparison with that last September and December. The spread between the yield on one-month asset-backed commercial paper and the yield on non-financial commercial paper has risen to more than 90 bps recently, though well below the 194 bp peak in mid-December and 131 bps in mid-September.

Yield on One-month Asset-Backed Commercial Paper minus Non-financial Commercial Paper (last obs. April 17, 2008)



Source: Haver; Bear, Stearns & Co. Inc.

- The 10-year swap spread, one of the most consistent indicators of the severity of risk aversion, has widened recently after having narrowed in late March. Like the wider spreads in the short-term funding markets, it reflects concerns about bank risk.

10-year swap spread (last obs. April 17, 2008)

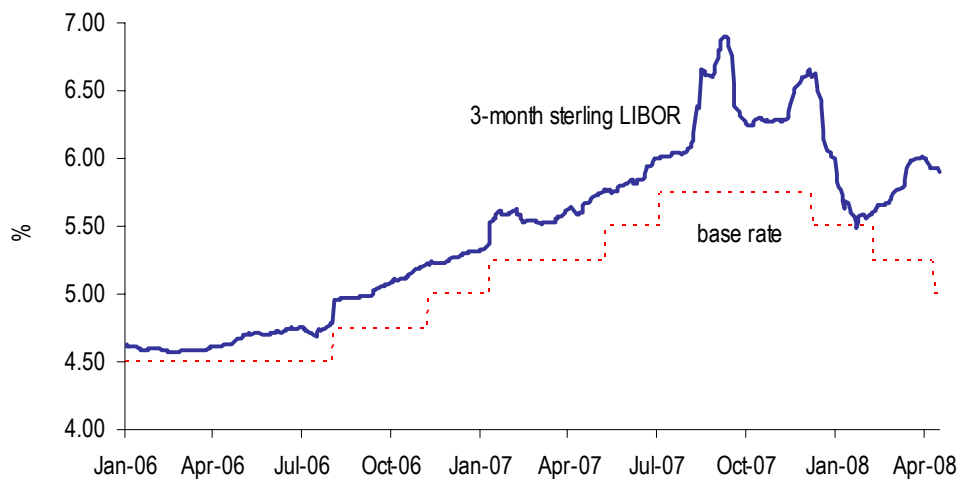


Source: Bloomberg; Bear, Stearns & Co. Inc.

Looking abroad, on April 10, the Bank of England (BOE) cut its base rate 25 bps to 5.0%, while the ECB left its key repo rate unchanged at 4.0%. While the BOE has responded to the credit crisis with interest rate cuts (and a new swap facility on April 21), its actions have been measured. In its view, it is performing a fine balancing act between promoting economic growth and containing inflation. The ECB is more concerned by the inflation outlook than the growth outlook, and may not cut rates for quite a while if at all.

- Sterling LIBOR has widened its spread to the base rate to more than 90 bps from 40 bps two months ago. The increase in short-term funding rates is therefore exerting renewed drag on the UK's overall activity.

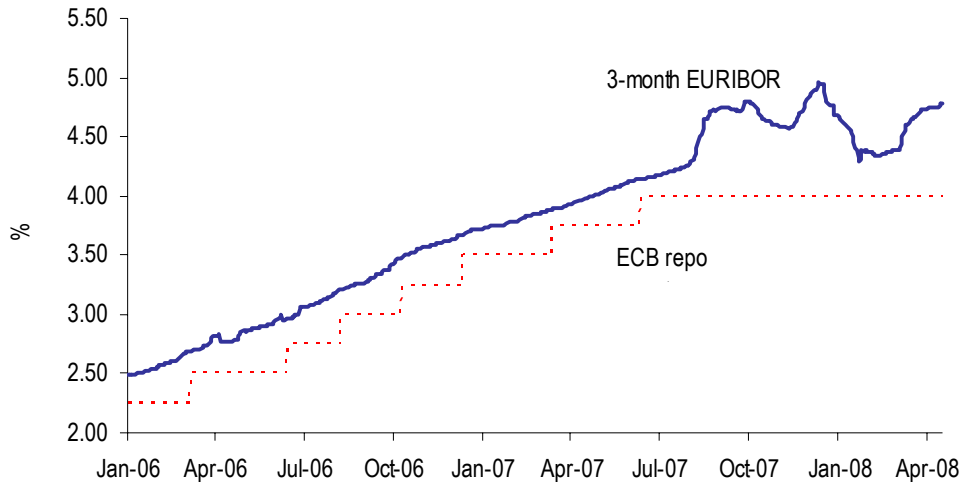
Three-month Sterling LIBOR vs. UK Base Rate (last obs. April 17, 2008)



Source: Haver; Bear, Stearns & Co. Inc.

- The ECB has left its repo rate unchanged at 4% since the financial-market turbulence began last summer. With inflation uncomfortably high (3.6% y/y at the last reading), it has been unwilling to offset the higher short-term interbank rate generated by the persistently wider gap between 3-month EURIBOR and the repo rate. This spread has widened to more than 75 bps and is back to levels experienced in September and late-December, weighing on the Eurozone economy.

Three-month EURIBOR vs. ECB repo rate (last obs. April 17, 2008)



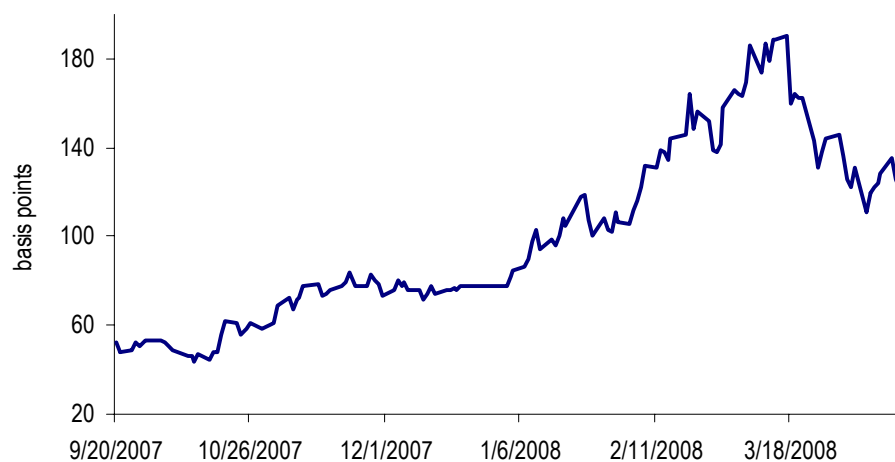
Source: Haver; Bear, Stearns & Co. Inc.

Progress in Credit Markets

In contrast with the continued tension in interbank markets, credit spreads have generally narrowed since mid-March. In the end, we think these and actual LIBOR rates will be better measures of the growth outlook, while interbank spreads point to continued concerns about bank balance sheets.

- The investment grade credit default swap spread, a measure of the speculation that corporate bonds might default, has narrowed significantly from its mid-March peak.

5-year CDS spread (investment grade IG9, last obs. April 17, 2008)



Source: Bear, Stearns & Co. Inc.

- While it remains quite wide relative to the record narrow readings reported last summer, the spread between high yield corporate debt and U.S. Treasury debt, at 756 bps, is well off its March 17 high of 899 bps—the highest reading on this measure since February 2003. Some activity that was previously funded by credit will no longer be—this is the nature of tighter credit and continues to weigh on the outlook.

**Yield on High-Yield Corporate Bond Index (BSC's)
minus U.S. Treasury Yield (last obs. April 17, 2008)**



Source: Haver; Bear, Stearns & Co. Inc.

- Risk appetite in Europe has also stabilized over the past two weeks, but at a very wide spread to government yields. Recent gaps between investment grade corporate yields and government security yields have narrowed slightly over the past few weeks, but from their widest on record (since the introduction of the euro on January 1, 1999).

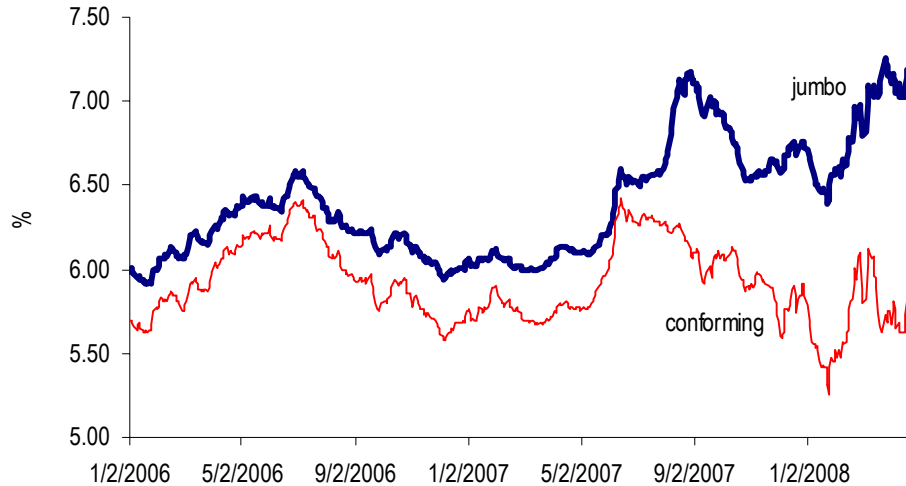
**Eurozone Credit Spread (Yield on investment grade corporate bonds minus yield
on government bonds, last obs. April 17, 2008)**



Source: DataStream; Bear, Stearns & Co. Inc.

- Notwithstanding a small backup recently, conforming mortgage interest rates have generally fallen over the past month, but the move down in jumbo rates has been delayed and more measured. We think declines in these rates, especially the conforming rate, will be key triggers for an improvement in the housing market.

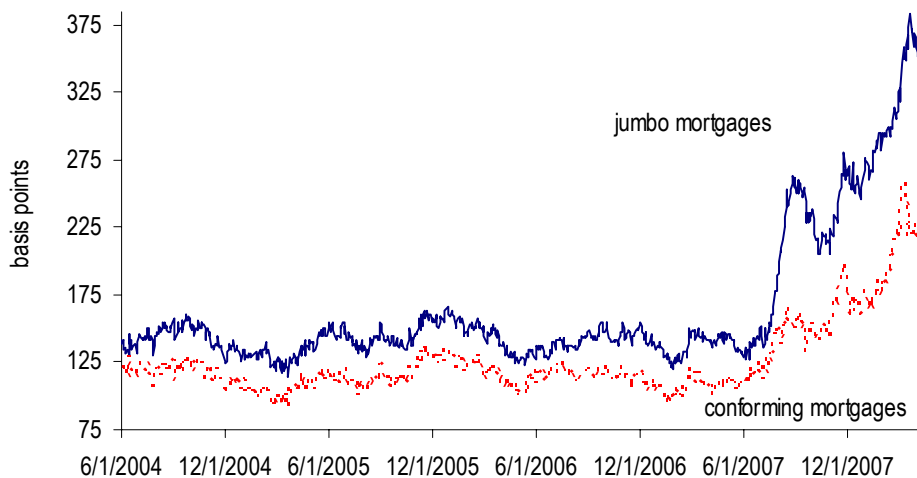
Jumbo and Conforming Mortgage Interest Rates (last obs. April 17, 2008)



Source: Haver; Bear, Stearns & Co. Inc.

- The spread between both conforming and jumbo rates and Treasury yields continues to narrow from highs in mid-March.

Spreads between Mortgage Interest Rates and 10-year Treasury Yields (last obs. April 17, 2008)



Source: Haver; Bear, Stearns & Co. Inc.

ADDENDUM

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