DerivativeFitch

CDOpinions

A global biweekly credit derivatives and CDO update

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In This Issue

New York
April Kabahar
Director
212-908-0245
april.kabahar@derivativefitch.com

London
Shaun Baddeley
Senior Director
+44 207 417 4396
shaun.baddeley@derivativefitch.com

Hong Kong
Rachel Hardee
Senior Director
+852 2263 9918
rachel.hardee@derivativefitch.com

CREDIT TRENDS AND NEWS

Fitch Sheds Light on First Generation CPDOs

Constant proportion debt obligations (CPDOs) are one of the latest innovations to enter the structured credit markets. Derivative Fitch has been asked to rate several first generation CPDOs, which utilize fifteen times leverage and reference "on-the-run" investment grade CDS indices for a ten-year period. Fitch expresses caution in rating these transactions and believes that the first generation CPDOs do not merit high investment grade ratings in the 'AA' or 'AAA' range.

The agency recognizes the concept behind CPDOs and agrees that they can be successful investment vehicles. However, CPDOs' dependency on the future development of its key performance parameters combined with a very short historical data available, which often reflects only a fraction of the risk horizon of the products to be rated, stresses the modeling risks associated in rating these transactions. The key performance parameters for these first generation CPDOs include spread volatility, roll-down benefit, bid/offer levels and, to a lesser degree, default risk. These parameters are discussed at length in a recent case study of first generation CPDOs which the rating agency released last week. The study found that the performance and ratings of this first wave of CPDOs are sensitive to even a minor amendment of the key parameters. The sensitivity of a CPDO rating towards any change in assumptions increases with high rating levels and easily leads to rating changes of several categories. The current leverage used in these structures also contributes to sensitivity to key performance parameters and potential ratings instability. Furthermore, scenario analysis using historical back testing showed that many of the more common CPDO structures would not have been able to withstand high investment grade stresses.

Fitch is actively monitoring the changes in this market and is reviewing proposals on a case-by-case basis. It is currently looking into several proposals for second generation CPDOs which seek to address the shortcomings of its predecessor. This new batch of CPDOs mitigate the risks of the earlier versions through some combination of features such as the removal of credits from the portfolio if the ratings drop below a (higher) pre-established threshold; the limitation of a leverage maximum; the introduction of a retained asset manager to manage the reference portfolio credit, among others. To view the results of this comprehensive study, please click on this link:
http://www.fitchratings.com/corporate/reports/report_frame.cfm?rpt_id=322962&sector_flag=4&marketsector=2&detail=2.

FX-Linked Credit Obligations Emerge

Collateralized foreign exchange obligations (CFXO) have generated increasing interest lately as the trend towards repackaging market price risk into credit-like synthetic collateralized securitization structures gains traction. CFXOs use a structure that is similar to synthetic collateralized debt obligations (SCDOs) and they also share similarities to commodities-linked credit obligations (CCOs). CFXOs are designed to provide investors with a return that is linked to the performance of a portfolio of foreign exchange (FX) rates. The portfolio FX risk is referenced via a series of swaps on appreciation or depreciation of FX rates. The FX risk is then repacked into a securitization format, utilizing a standard SCDO structure.

Fitch has analyzed CFXOs linked to appreciation and/or depreciation of currencies over a term of up to five years. Fitch has the ability to analyze portfolios of pure FX rates as well as hybrid portfolios, which combine FX and credit default swaps. To learn more about the structural and modeling considerations of these investment vehicles please go to**:** http://www.fitchratings.com/corporate/reports/report_frame.cfm?rpt_id=323476&sector_flag=4&marketsector=2&detail=2.

Analyzing Tranche ABX.HE Indices

Tranche ABX.HE (TABX.HE) index has ignited much discussion since its debut last February. Market participants have been discussing its potential uses and its role in providing more transparency and liquidity in the historically opaque asset-backed securities (ABS) market. Derivative Fitch has received numerous queries about its approach in analyzing the creditworthiness of the index. The rating agency draws upon the analytical expertise and credit models of both its CDO and residential mortgage-backed securities (RMBS) teams to study the risks associated with this latest innovation. Fitch believes that there is a need to customize its approach in analyzing TABX.HE to take into account the unique characteristics of the index vis-à-vis other structured finance (SF) portfolios. The main areas that Fitch has incorporated in its analysis include asset exposure size and credit quality, amortization profiles, recovery rates, and correlation and servicer concentration adjustments.

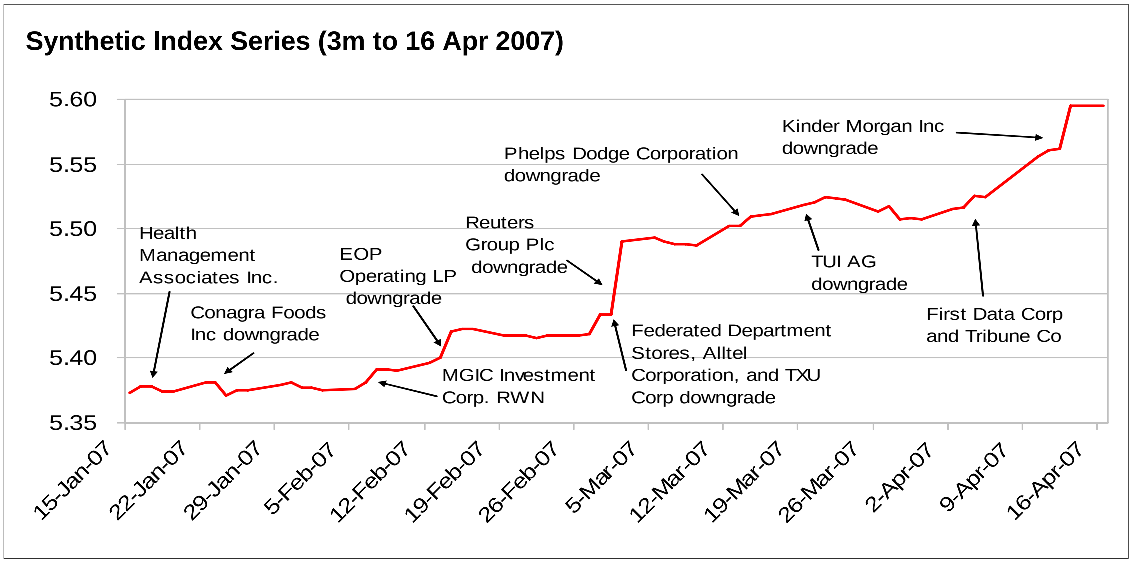
TABX.HE portfolios are less diversified than traditional SF CDOs and reference only 40 RMBS names from similar rating categories. The index is sensitive to systematic industry issues because it references the two previous ABX.HE portfolios and is concentrated by vintage mortgage originations from the previous 12 months. In addition, TABX.HE's concentrated nature makes its weighted average life (WAL) more sensitive to underlying mortgage prepayment and RMBS stepdown assumptions. For more details on Fitch's analysis, please check out the latest special report entitled Considerations for Rating Tranche ABX.HE Indices at**:** http://www.fitchratings.com/corporate/reports/report_frame.cfm?rpt_id=322936&sector_flag=4&marketsector=2&detail=2.

Gauging Global Synthetic CDOs' Exposure to U.S. Subprime RMBS

Derivative Fitch has conducted a study that measures the extent global synthetic CDOs are exposed to the beleaguered U.S. subprime mortgage sector. Fitch found 203 tranches from 72 global synthetic CDOs with exposure to U.S. subprime RMBS. Approximately, nine percent of Fitch-rated synthetic CDOs are exposed to U.S. subprime reference entities. European synthetic CDOs have an average of 27% exposure to the sector, while U.S. transactions have a 55% average exposure. A single synthetic CDO transaction issued in Asia had a limited exposure to subprime RMBS but all of the referenced assets are highly rated. The total exposure for European synthetic CDOs amounts approximately to USD27.5 billion, ranging between USD15 million and USD1.69 billion per individual transaction. The average exposure is approximately USD610 million. For U.S. synthetic CDOs, the total exposure is approximately USD10.3 billion, with a range of USD20.9 million to USD1.2 billion per deal, and an average of USD396 million. Globally, managed synthetic CDOs represent 72% of the exposed transactions and static deals accounted for the remainder.

Additionally, Fitch's global CDO surveillance analysts also stress-tested the exposed transactions with an instantaneous three-notch downgrade of all U.S. subprime entities. Fitch would expect to downgrade approximately 27% of the tranches of exposed synthetic CDOs, with the indication being a downgrade of between one and three notches in most cases, with an average of 2.4 notches. The extent of any actual tranche downgrades would depend on the actual credit migration of the U.S. subprime assets and the size of the exposure to U.S. subprime RMBS within the portfolios. Asset managers' ability to improve the credit quality of the portfolios is also an important factor. The complete results of the study can be accessed: at: http://www.fitchratings.com/corporate/reports/report_frame.cfm?rpt_id=322662&sector_flag=4&marketsector=2&detail=2.

Fitch Synthetic Index Continues Downward Trend



SOURCE: Derivative Fitch

Derivative Fitch's Synthetic Index continues to follow the trend of the previous three months with slight but constant credit deterioration. The synthetic index is a tool used to monitor the performance of static synthetic CDOs that reference corporate entities. The index's weighted average rating factor (WARF) deteriorated by 4.13% during the quarter beginning on January 15th to April 16th 2007. The month from February 15th to March 15th was the most volatile (1.63% WARF deterioration) of the set. The period from March 16th to April 16th has also seen a 1.52% deterioration in the index's WARF. This can be attributed to some large downgrades occurring in April which have affected a relatively large number of static synthetic CDOs. First Data Corp. and Kinder Morgan Inc., which represented 0.11% and 0.23% of the index respectively, were downgraded by four notches, each causing an increase in the index's WARF. The single largest mover during the whole quarter was Health Management Associates, Inc., a U.S.-based healthcare & pharmaceuticals company, which moved to 'BB–' (minus) from 'BBB' on January 17th, following a downgrade by Fitch. The company represented 0.06% of the total Index.

For the index universe as a whole, downgrades have outweighed upgrades by a ratio of 1.14 downgrades for every upgrade during the quarter. As a percentage of the index notional balance, 7.00% were subject to a rating downgrade versus 5.06% of index entities that were subject to a rating upgrade. Likewise, the severity of the downgrades with (-129) notches of downgrades exceeded the magnitude of upgrades with a notch movement of 102. However, within the Top 10 names (each representing between 0.52% and 0.40% of the index) ratings have remained stable with the exception of Federated Department Stores (0.50% of the index), which was downgraded by one notch, and MGIC Investment Corp. (0.46% of the index) which was put on negative rating watch. More details on the index methodology and the latest report are available at www.derivativefitch.com.

VALUSPREAD

This table illustrates the two-week movement of the Dow Jones CDX & iTraxx Europe indices.

Index Name	2007-04-06 Mean*	2007-04-20 Mean*	Percentage Change
iTRAXX Europe - 125 Series 6 (ex 12/2011)	23.02	21.1712	-8.73262
iTRAXX Europe - Crossover Price Index Series 6 (ex 12/2011)	197.75	172.178	-14.8522
iTRAXX Europe - Senior Financials Price Index Series 6 (ex 12/2011)	7.5	7.2615	-3.28444
iTRAXX Europe - Sub-Financials Price Index Series 6 (ex 12/2011)	13.875	12.7315	-8.98166
iTRAXX Europe - HiVol Price Index Series 6 (ex 12/2011)	42.3767	36.7312	-15.3695

**Data is calculated by Derivative Fitch based on actual contributions received from market participants. For more data analysis contact the Valuspread team at www.valuspread.com.*

COLLATERAL TALK

Fitch Affirms Kodiak CDO I Ratings

Fitch has affirmed the ratings it assigned to Kodiak CDO I Ltd. /Inc. (Kodiak CDO I); a CDO backed primarily by trust preferred securities (TruPS) and unsecured subordinated debt issued by real estate investment trusts (REITs) and homebuilders. Kodiak CDO I is managed by Kodiak Capital Management Company (Kodiak Capital Management). The ratings affirmation follows several material events which coincided with the completion of Kodiak CDO I's ramp-up period on April 19th last week. The transaction closed on Sept. 19, 2006, followed by a six month ramp-up period during which time Kodiak Capital Management identified an additional $172 million of eligible collateral to bring the total collateral balance to $735 million. During the ramp-up period, however, Kodiak CDO I experienced material negative credit migration with respect to three underlying trust preferred securities issued by subprime residential mortgage REITs. These three REIT securities were shadow rated by Fitch at the time of initial purchase, and subsequently came under increased pressure as a result of the downturn in the subprime mortgage sector. The notional amount of each of the three exposures was $28.1 million, which in total represented $84.4 million or 11.48% of the portfolio balance.

Without mitigating circumstances, the magnitude of the credit deterioration of these three securities would likely have negatively impacted the ratings assigned to one or more classes of liabilities issued by Kodiak CDO I. Positively, however, the credit profile of two of the three affected securities subsequently improved as a result of additional financing obtained by the REITs issuing such trust preferred securities. The third affected security was sold, at a loss, by Kodiak CDO I. While the sale of this security at a loss reduced the amount of subordination available to the rated notes, the magnitude of loss did not a warrant rating action at this time. Further credit deterioration could adversely impact the rated notes, and in particular, the most junior classes. As of the effective date, the transaction was passing all of its performance covenants.

CRE CDOs Feel Slight Pinch from Subprime RMBS Woes

Commercial real estate (CRE) CDOs with exposure to U.S. mezzanine subprime RMBS could be potentially downgraded towards the end of this year and into early 2008. However, the exposure is minimal, according to Derivative Fitch's CRE CDO team. The early vintage deals are static pools and therefore no rating changes are anticipated due to the seasoning of the underlying subprime bonds and the low overall exposure. Additionally, recent issues of CRE CDOs have rarely included any subprime RMBS as investors have expressed a preference for CDOs that do not mix asset types.

Thirteen of the 106 Fitch-rated CRE CDOs have exposure to U.S. subprime RMBS. All were issued between 2000 and 2006. Out of the three deals issued prior to ‘03, the average exposure to subprime RMBS is only 2.6%. For the ten issued in ‘03 or after, the exposure to subprime RMBS ranges from 15.5% to 60.7%. As these are managed transactions, the vintage composition of the subprime RMBS now also includes recently issued deals. While nine of these transactions are primarily composed of rated bond collateral, Newcastle REL CDO VIII, issued in December last year, is a managed CRE loan deal that has a maximum 10% bucket for ABS, of which 6.8% is currently invested in 'BB+' and 'BBB–' rated subprime RMBS.

The greatest downgrade risk in RMBS subprime assets are in the subordinate (‘A’ or lower) part of the capital structure within the ‘03 and ‘04 vintages in the near term. These RMBS assets are most at risk for default or downgrade due to their position in the capital structure. An increase in expected future pool losses coupled with slowing prepayment speeds is now more likely to breach the thinned credit enhancement levels of these vintages. In addition, subprime RMBS mezzanine assets of the late ‘05 and ‘06 vintages are at risk of downgrade as well. However, Fitch's subprime RMBS group does not expect material negative rating actions for ‘05 and ‘06 subprime RMBS bonds to come until the second half of ‘07. The underlying subprime deals of ‘05 and ‘06 already experienced higher delinquencies than ’04 and prior vintage subprime deals of the same seasoning. These trends are expected to result in a more severe rating deterioration for late ‘05 and ‘06 subprime RMBS over the next few years.

The two CRE CDOs with the largest exposure to subprime RMBS are G-Star 2004-4 (60.7%) and G-Star 2005-5 (55.7%). Both are managed transactions and as such have some exposure to the ‘06 vintage. Their current exposure to ‘03 and ‘04 vintages is 50.4% and 34.7%, respectively. More than 80% of the RMBS exposure is to bonds in the mezzanine part of the RMBS capital structure. But they have little to no exposure to 'BBB–' and below. Fitch is closely monitoring these transactions. All ten CRE CDOs issued in ‘03 and after have exposure to mezzanine subprime RMBS bonds. Other than the three deals discussed, four CRE CDOs have exposure to 'BBB–' and below. One CRE CDO has 14.9% exposure to this rating category; all others have less than 4% exposure to 'BBB–' and below. Five CRE CDOs, excluding the three specifically discussed above, have exposure to the 2006 vintage subprime RMBS. Although the performance of this vintage is expected to be very poor, the maximum exposure in any one of these CRE CDOs is 2.7%. Additionally, all 2006 subprime RMBS bonds in CRE CDOs are of investment grade quality. Fitch will continue to monitor the performance of these CDOs closely and take rating actions when necessary.

HY Default Rates Stay Low in U.S. and Europe

The default rates in the corporate high yield markets in the U.S. and Europe have remained low during the first quarter of 2007. In the U.S., funding conditions for corporate borrowers remained strong despite concerns that investor sentiment would shift following the sell-off in the equity markets in February and the continued weakness in the housing market, according to Fitch’s credit market research group. The trailing 12-month high yield default rates contracted further to 0.4% to date from 0.8% for the full year 2006. It is far lower than the long-term average annual default rate of 5.0%. The default rate has reached new lows despite the large concentration of bonds rated ‘CCC’ or lower. While the U.S. is experiencing a benign credit environment, it is important to note that the number of issues at greatest risk for default will likely be substantial should credit and economic conditions sour. It is likely that future defaults may be higher than in any other time in the past 20 years because the pool of these low-rated bonds is already large and is likely to grow larger going forward as economic growth eases. U.S. default volume totaled USD256 million in the first quarter versus USD3.1 billion in the same period last year. In Europe, the start of ’07 marked the fourth year of low default rates for the high yield market in the region. The trailing 12-month default rate for the European high yield market has risen to only 0.9% from 0.6% at the end of ’06. The market also experienced a record first quarter issuance totaling approximately EUR10.2 billion.

Innovations

CCO Criteria Launches

Derivative Fitch has formally rolled out its rating criteria for commodities-linked credit obligations (CCOs) which explains the main risks associated with these structures. CCOs consist of commodity risk repackaged in a credit securitization format and utilize structural features that are common to synthetic CDOs and other structured credit vehicles. CCOs are designed to provide investors with a return linked to the performance of an underlying commodities portfolio. The VECTOR CCO model, which is based on Monte-Carlo simulation, is used as the main quantitative tool for assessing the risks of the portfolio. The model will replace the beta version that was first released in January. The critical areas that Fitch has considered and incorporated in its CCO analysis include asset, structural and counterparty risks, charged asset arrangements, hybrid portfolios and management arrangements. The criteria report can be accessed at:
http://www.fitchratings.com/corporate/reports/report_frame.cfm?rpt_id=322804&sector_flag=4&marketsector=2&detail=2.

For a copy of the model, please e-mail vector.cco@derivativefitch.com.

FitchCDx.com – Global Industry Sector Price Movements*

Fitch Industry	Week of 20-Apr-2007	Week of 13-Apr-2007	Spread Change	% Change	# Assets
Insurance	11	10	0	3.8 %	23
Aerospace & Defense	14	14	0	1.7 %	5
Banking & Finance	38	38	1	1.4 %	131
Telecommunication	96	96	1	0.6 %	30
Energy	65	66	0	(0.7) %	11
Textiles & Furniture	76	76	(1)	(0.7) %	8
Real Estate	105	107	(2)	(2.1) %	8
Healthcare & Pharmaceutical	47	48	(1)	(2.7) %	8
Computers & Electronics	81	83	(3)	(3.1) %	13
Automotive	143	148	(5)	(3.4) %	24
Utilities	64	66	(2)	(3.4) %	26
Miscellaneous	84	87	(3)	(3.4) %	24
Building & Materials	46	48	(2)	(3.5) %	17
Industrial/Manufacturing	106	110	(4)	(3.5) %	17
Food, Beverage & Tobacco	42	44	(2)	(3.5) %	18
Consumer Products	59	62	(2)	(3.6) %	9
Paper & Forest Products	87	91	(4)	(4.0) %	12
Gaming, Lodging & Restaurant	101	106	(4)	(4.1) %	9
Sovereign	88	92	(5)	(5.1) %	15
Broadcasting & Media	111	118	(6)	(5.3) %	25
Retail	112	119	(7)	(5.6) %	17
Chemical	91	98	(6)	(6.3) %	19
Transportation	72	77	(5)	(6.7) %	16
Metals & Mining	35	38	(3)	(7.6) %	11
Leisure & Entertainment	190	206	(16)	(8.0) %	5
Supermarkets & Drugstores	66	72	(6)	(8.9)%	12

*Weekly credit default prices sourced from GFI Group Inc. (*www.GFIgroup.com*). Visit *www.fitchcdx.com* for advanced analysis and data for the credit derivatives market.

Mark Your Calendar

April 24 & 25

Derivative Fitch's Annual Global Structured Credit Conference

One Great George Street
Westminster, London

This two-day event will feature more than a dozen CDO managers, leading investors and Derivative Fitch's most seasoned analytical team discussing the latest structural and performance trends in the credit derivatives and CDO market.

If you are interested in attending this London event, please register online at www.fitchratings.com by clicking on the event link on the right hand side of the web page. You can also get more information or request a registration form by contacting Fitch's Events Team at ecpm@fitchratings.com or at +44 20 7862 4051.

New York	London	Hong Kong
April Kabahar	Shaun Baddeley	Rachel Hardee
Director	Managing Director	Senior Director
212-908-0245	+44 207 417 4396	+852 2263 9918

If you would like to respond to this e-mail, please write directly to april.kabahar@derivativefitch.com.

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