

CDO/CDS Update 09/06/06

I. Commentary

With Labor Day now behind us, vacationers were welcomed back to the office with a surprising announcement out of Ford Motor Co. The company made a bold change as CEO Bill Ford stepped down and Boeing Co. executive Alan Mulally was named the company's new president and CEO. Bill Ford will remain an executive chairman for the company. The management shake-up boosted the company's share price over 5% in after hours trading and helped tighten bond spreads. However, many questions still remain, including how this will affect the ongoing restructuring, possible alliances, and the FMCC sale. As of yesterday's close, FMCC 5-year CDS stood at 302 bps, 22 bps tighter week-over-week. This was despite the fact that weakened truck demand led to the seventh consecutive monthly drop in U.S. unit sales. Ford's August sales figures showed a 12% decline year-over-year. GM was able to post its first positive year-over-year monthly gain since January, as August sales came in 3.8% higher. However, the company cut its production schedule by 12% in anticipation of lessened demand going forward. Week-over-week, GMAC 5-year CDS tightened 7 bps to 184 bps.

It was a strong week for the credit indices as tightening was witnessed in North America and Europe. The CDX.NA.IG series 6 index tightened 1.5 bps to close yesterday at 37 bps. The North American high volatility and crossover indices were tighter by 2.8 and 8.6 bps, respectively. The best performer in North America was the high yield index which tightened over 13 bps to 325 bps. Across the Atlantic, the iTraxx Europe index closed at 26.8 bps, 1.3 bps tighter week-over-week. The iTraxx high volatility index was tighter by 3.8 bps to 48.1 bps. iTraxx crossover spreads performed well with compression of almost 18 bps to close at 235 bps. The ABX.HE index was fairly stable for the week with the most movement occurring in the BBB tranche that widened just over 1.5 bps. The CMBX.NA index was also flat week-over-week, as individual tranche spreads traded within 1 bp for the week.

U.S. CDO rating actions show improvement for 1H2006. According to Moody's, the number of CDO tranches downgraded in the first six months of 2006 was down nearly 30% (from 74 to 52) compared to the same period in 2005.¹ About 80% of the downgrades were fairly evenly distributed between arbitrage cash flow CBOs, synthetic arbitrage CDOs, and resecuritizations. This differs from mid-2005 when a majority of CDO downgrades were linked to resecuritizations of 2000 and 2001 vintage transactions. The resecuritization CDO sector saw its downgrade rate fall from 7% to 0.9% in the six month year-over-year comparison. The upgrade-to-downgrade ratio for U.S. rated CDOs was just under 1 to 1 at the end of June, slightly lower than the 1.24 to 1 ratio for 2005. However, the historic CDO upgrade-to-downgrade ratio is significantly below 1 to 1, residing at 0.17 and 0.064 to 1 in 2004 and 2003, respectively. There were no downgrades in the emerging market, balance sheet synthetic, distressed debt, TRUPS, and SME CDO sectors in 1H2006. The rating agency also noted

¹ Nazarian, D., M. Miagkova, and C. Li, *Rating Actions in the U.S. CDO Market: Year-to-Date Review – June 2006*, Moody's special report (August 2006)

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that CDOs backed by corporate credit continue to perform well as low defaults and high recovery rates contribute to the stable performance of the sector.

Moody's published methodology for LGDAs and PDRs. Moody's has released its final methodology for loss-given default assumptions (LGDAs) and probability-of-default- ratings (PDRs) for non-financial high yield companies.² Moody's current expected loss rating combines the likelihood of default with expected loss. The new assessment aims to supplement the current process for rating speculative grade companies by separating ratings into a LGDA and a PDR. PDRs will retain the standard Moody's alpha-numeric scale and will be assigned broadly to issuers, not specific debt issues. LGDAs will be provided for individual rated instruments such as bonds, loans and preferred stock. The scale for LGDAs will represent the expected accrued interest and percent of principal returned following a default and will range from LGD1 (loss of 0-9%) to LGD6 (loss of 90-100%).

As of September 6, all new U.S. high yield deals will be rated using the new methodology. On September 18, Moody's will begin rolling out its new ratings on an industry by industry basis in the U.S. The change in methodology is expected to result in higher ratings on a significant number of corporate loans. Moody's Western European ratings process is expected to begin using the new ratings system by early 2007.

2Q2006 Corporate Bond Market Review. FitchRatings released its review of the corporate bond market for the second quarter of 2006.³ The rating agency observed a dramatic increase in the par value of high grade bonds upgraded, \$111.9 billion in 2Q2006 from just \$10.2 billion in the 1Q2006. However, \$106.4 billion of the upgrades occurred within the banking and finance sector. When examining the investment grade industrial sector, the upgrade percentage was just 0.5% or \$5.5 billion of total outstanding rated volume, while downgrades totaled \$14.7 billion. We believe this supports our view that credit quality has already peaked and will begin trending weaker, yet will remain relatively healthy as we enter 2007. In speculative grade rating changes, upgrades outpaced downgrades \$30.8 billion to \$16.5 billion. Combined the corporate bond market witnessed \$142.7 billion in upgrades and \$34.5 billion in downgrades, for a ratio of 4.14 to 1.

As a result of the large par value of upgrades in the banking and finance sector, 8.4% of "A"-rated bonds witnessed ratings improvement. The only other rating category to see improvement was the "CCC-C" –rating level with \$10.8 billion in upgrades or 12% of outstanding rated bonds. Downgrades were mostly concentrated at the "BB" rating level, which impacted \$11.5 billion or 4.2% of the rating category's volume. Comparing results across sectors and adjusting for size, 24.1% of supermarkets and drug store volume, 17.0% of automotive bonds, and 3.7% of media sector volume were impacted by downgrades in the quarter.

² Rowan, M., P. Stumpp, R. Cantor, R. Solomon, and K. Emery, *Probability of Default Ratings and Loss Given Default Assessments for Non-Financial Speculative-Grade Corporate Obligor in the US and Canada*, Moody's rating methodology (August 2006)

³ Mancuso, P., and M. Verde, *U.S. Corporate Bond Market: Second Quarter 2006 Review*, FitchRatings Corporate Finance (August 25, 2006)

II. Recent Pricing & Pipeline

Issue	Date	Size (mm)	Collateral Manager	Assets	Lead	Class	Rating (M/S/F)	WAL	Spread
Attentus CDO II	8/31	\$512.00	Attentus	REIT/CMBS	JPM				
		235.00				A-1	Aaa/AAA/AAA	8.8	+24/L
		60.00				A-2	Aaa/AAA/AAA	10.0	+42/L
		55.00				A-3A	Aaa/AAA/AAA	10.0	+50/L
		5.00				A-3B	Aaa/AAA/AAA	10.0	-
		20.00				B	Aa2/AA/AA	10.0	+70/L
		32.00				C	A2/A/A	10.0	+140/L
		29.00				D	A3/A-/A-	10.0	+160/L
		16.00				E-1	-/BBB/BBB	7.6	+310/L
		2.00				E-2	-/BBB/BBB	7.6	-
		13.00				F-1	-BB/BB	7.6	+500/L
		5.00				F-2	-/BB/BB	7.6	-
		40.00				Sub	-/-/-	-	-
Kimberlite CDO I**	8/31	\$750.00	Blackrock	CMBS	WS				
		500.00				A-1	Aaa/AAA/-	8.74	-
		79.375				A-2	Aaa/AAA/-	9.43	+35/L
		40.125				B	Aa2/AA/-	9.60	+45/L
		45.75				C	A1/A+/-	9.81	+60/L
		10.125				D	A2/A/-	10.10	+65/L
		9.750				E	A3/A/-	10.10	+75/L
		11.625				F	Baa1/BBB+/-	10.10	+115/L
		12.00				G	Baa3/BBB/-	10.10	+175/L
		22.50				H	Ba2/BB/-	10.10	+400/L
18.75	PS	-/-/-	-	-					
Jersey Street CLO	8/30	\$308.76	MFS Inv Mgmt	Loans	WS				
		236.00				A	Aaa/AAA/-	8.3	+25/3ML
		14.00				B	Aa2/AA/-	10.3	+45/3ML
		20.25				C	A2/A/-	10.3	+75/3ML
		11.25				D	Baa2/BBB/-	10.6	+155/3ML
27.26	IN	-/-/-	-	-					
KKR Financial 2006-1	8/30	\$1,017.00	KKR Fin	Loans	MS				
		334.00				A1	Aaa/AAA/-	7.7	+28/3ML
		207.00				A2A	Aaa/AAA/-	7.3	+24/3ML
		69.00				A2B	Aa1/AAA/-	8.8	+40/3ML
		43.00				B	Aa2/AA/-	9.4	+50/3ML
		87.00				C	A2/A/-	9.7	+95/3ML
		67.00				D	Baa2/BBB/-	10.3	+200/3ML
		48.00				E	Ba2/BB/-	10.8	Pre-placed
		18.00				F	B2/B/-	11.1	Pre-placed
		48.00				G	-/-/-	-	Pre-placed
		48.00				H	-/-/-	-	Pre-placed
48.00	Inc	-/-/-	-	-					
Cairn HG ABS CDO II	8/28	\$1,000.07			RBC				
		820.00				A1	-/-/-		
		70.00				A2	Aaa/AAA/-	7.2	+38/3ML
		48.00				B	Aaa/AAA/-	7.2	+40/3ML
		36.00				C	Aa2/AA/-	7.2	+48/3ML
		9.00				D	A2/A/-	7.2	+120/3ML
		9.00				Sub	Baa2/BBB/-	7.2	+300/3ML
15.25		-/-/-	-	-					
Broderick CDO 2	8/25	\$1,600.00	Seneca Capital Mgmt.	HG ABS	ML				
		500.00				A1-AT	Aaa/AAA/-	5.1	+24.75/1ML
		876.00				A1-AD	Aaa/AAA/-	5.1	+24.75/1ML
		42.00				A1-B	Aaa/AAA/-	5.4	+39/3ML
		70.00				A2	Aaa/AAA/-	5.4	+44/3ML
		67.60				B	Aa2/AA/-	5.4	+50/3ML
		23.50				C	A2/A/-	5.4	+130/3ML
		8.00				D	Baa2/BBB/-	5.3	+310/3ML
		4.90				E	Ba1/BB+	5.3	+600/3ML
		8.00				P/S	-/-/-	-	-

Issue	Date	Size (mm)	Collateral Manager	Assets	Lead	Class	Rating (M/S/F)	WAL	Spread
OFSI Fund III	8/25	\$519.10	OFSAM	MM Loans	ML				
		200.00				A-1	Aaa/AAA/-	7.2	+29/3ML
		140.625				A-2	Aaa/AAA/-	7.2	+30/3ML
		39.50				B	Aa2/AA/-	8.9	+45/3ML
		36.50				C	A2/A/-	9.4	+85/3ML
		28.75				D	Baa2/BBB/-	10.1	+175/3ML
		11.50				E-1	Ba2/BB/-	10.6	+475/Sw
		9.125				E-2	Ba2/BB/-	10.6	+475/3ML
		53.125				Pref	-/-	-	-
Commodore -V	8/25	\$506.00	FFT&W	MZ ABS	ML				
		75.00				A1A	Aaa/AAA/-	3.8	+13/1ML
		225.00				A1B	Aaa/AAA/-	5.0	+33/1ML
		50.00				A2	Aaa/AAA/-	5.1	+35/1ML
		25.00				A3	Aaa/AAA/-	5.1	+40/1ML
		70.00				B	Aa2/AA/-	5.1	+50/1ML
		13.25				C	A2/A/-	5.1	+125/1ML
		24.00				D	Baa2/BBB/-	5.1	+325/1ML
		8.50				E	Ba1/BB+/-	4.8	+625/1ML
		15.42				PS	-/-	-	-
Kodiak CDO I	8/23	\$750.00	Kodiak	REITs	Bar Cap				
		338.50				A-1	Aaa/AAA/AAA	8.1	+36/3ML
		103.50				A-2	Aaa/AAA/AAA	9.9	+48/3ML
		83.00				B	Aa1/AA/AA	9.9	+65/3ML
		30.00				C	Aa3/AA/AA	9.9	+90/3ML
		13.00				D-1	-/AA-/AA-	9.9	Fx 6.549
		17.00				D-2	-/AA-/AA-	9.9	Fx 6.425
		17.00				D-3	-/AA-/AA-	9.9	+120/3ML
		14.00				E-1	-/A/A	9.9	Fx 6.721
		20.00				E-2	-/A/A	9.9	+150/3ML
		7.0				F	-/BBB+/BBB+	9.9	+220/3ML
		50.00				G	-/BBB/BBB	9.9	+350/3ML
		27.00				H	-/BB+/BB+	9.9	+500/3ML
Northwoods Capital VII	8/22	\$500.00	Angelo, Gordon & Co.	Loans	LB				
		137.50				A1	AaaAAA/-	9.9	+26/3ML
		75.00				A2	AaaAAA/-	9.9	+26/3ML
		100.00				A3	AaaAAA/-	9.8	+24/3ML
		25.00				A4	AaaAAA/-	10	+34/3ML
		30.00				B	Aa2/AA/-	10	+38/3ML
		37.50				C	A2/A/-	10	+68/3ML
		32.50				D	Baa2/BBB/-	10	+155/3ML
		10.00				E	Ba2/BB/-	10	+350/3ML
		52.50				Subs	-/-	-	-
Four Corners CLO III	8/22	\$300.00	Four Corners Cap	Loans	UBS				
		230.40				A	Aaa/AAA/-	8.0	+25/3ML
		9.00				B	Aa2/AA/-	9.3	+42/3ML
		18.00				C	A2/A/-	9.5	+68/3ML
		9.00				D	Baa2/BBB/-	9.6	+150/3ML
		9.60				E	Ba2/BB/-	9.8	+365/3ML
24.00	N	-/-	-	-					
Halcyon Long/Short CLO 2006-1	8/21	\$400.00	Halcyon Strct. AM	Loans	DB				
		261.60				A	Aaa/AAA/-	7.0	+19/3ML
		28.00				B	Aa2/AA/-	10.0	+44/3ML
		22.00				C	A2/A/-	10.0	+72/3ML
		28.00				D	Baa2/BBB/-	10.0	+159/3ML
		16.00				E	Ba2/BB/-	10.0	+365/3ML
44.40	Equity	-/-	-	-					

Issue	Date	Size (mm)	Collateral Manager	Assets	Lead	Class	Rating (M/S/F)	WAL	Spread
Octans CDO - I	8/18	\$1,500.00	Harding Advisory	MZ ABS	ML				
		975.00				A1	Aaa/AAA/-	5.7	Not Offered
		82.50				A2A	Aaa/AAA/-	5.1	+40/1ML
		67.50				A2B	Aaa/AAA/-	7.0	+48/1ML
		60.00				B	Aa2/AA/-	6.0	+51/1ML
		80.00				C	Aa3/AA/-	6.0	+61/1ML
		15.00				D	A2/A/-	6.0	+145/1ML
		60.00				E	A3/A/-	6.0	+165/1ML
		31.00				F	Baa2/BBB/-	5.2	+315/1ML
		39.00				G	Baa3/BBB/-	5.2	+385/1ML
		94.00				P/S	-/-	-	-
Jackson 2006-1	8/16	\$1,500.00	(static)	MZ ABS	CITG				
		1,161.75				SS	Aaa/AAA/-	-	Not Offered
		101.25				A	Aaa/AAA/-	-	+53/3ML
		65.25				B	Aa2/AA/-	-	+60/3ML
		12.75				C	Aa3/AA/-	-	+70/3ML
		34.50				D	A1/A/-	-	+75/3ML
		17.25				E	A3/BBB/-	-	+350/3ML
		72.75				Inc Note	-/-	-	-
Hamilton Gardens CDO**	8/16	\$500.00	Rabobank	RMBS	DBS				
		315.00				A-1	Aaa/AAA/-	6.5	Not Offered
		54.25				A-2	Aaa/AAA/-	6.6	+38/3ML
		56.50				B	Aa2/AA/-	6.6	+51/3ML
		25.00				C	A2/A/-	6.6	+140/3ML
		27.50				D	Baa3/BBB/-	6.6	+375/3ML
		21.75				Equity	-/-	-	-
Madison Park Funding - 3	8/15	\$650.00	CSFB Alt. Capital	Loans	CITG				
		381.50				A-1	Aaa/AAA/-	-	+24/3ML
		100.00				A-2a	Aaa/AAA/-	-	+23/3ML
		11.00				A-2b	Aa1/AAA/-	-	+32/3ML
		33.00				A-3	Aa2/AA/-	-	+37/3ML
		40.00				B	A2/A/-	-	+68/3ML
		24.50				C	Baa2/BBB/-	-	+142/3ML
		22.00				D	Ba2/BB/-	-	+345/3ML
		53.50				Inc Notes	-/-	-	-
Kingsland III	8/14	\$425.00	Kingsland	Loans	JPM				
		240.00				A1	Aaa/AAA/-	8.5	+21.5/3ML
		75.575				A2	Aa2/AAA/-	9.9	+36/3ML
		12.75				A3	Aa2/AA/-	10.0	+40/3ML
		29.75				B	A2/A/-	10.0	+65/3ML
		11.55				C1	Baa3/BBB/-	10.0	+160/3ML
		11.80				C2	Baa3/BBB/-	10.0	Fx 7.151%
		5.45				D1	Ba2/BB/-	10.0	+360/3ML
		2.00				D2	Ba2/BB/-	10.0	Fx 9.151%
		36.125				Sub Notes	-/-	-	-

New Pipeline	Size (mm)	Collateral Man.	Assets	Lead
Gannett peak CLO	\$607	McDonnell Investment Mngr	Loans	DBS
Arca Funding 2006 - I*	\$710	(static)	RMBS/ABS CDOs	MS
Callidus Debt Partners CLO Fund V	\$400	Callidus Capital Mgmt	Loans	CITG
Altius – III CDO	\$2,000	Aladdin Capital Mgmt.	MZ ABS	GS
Emerson Place CLO	\$350	Feingold O’Keeffe Capital	Loans	MS
Buchanan 2006-1	\$1,000	Bear Stearns AM	RE ABS	UBS
Calculus 2006-SCRE CDO*	\$800	(static)	CMBS	ML
Halyard - I	\$750	Solent Capital	MZ ABS	CS
Taberna Preferred Funding VII	\$700	Cohen	-	BS
Kefton CDO I**	\$500	Terwin Money Mgmt.	RMBS/ABS	MS
Pampelonne CDO I*	\$1,250	Vertical Capital	HG ABS	BarCap
HELD 2006-1**	\$2,000	(static)	RMBS	DBS
Halcyon ABS CDO**	\$400	Halcyon Sec. Prod. Inv.	MZ ABS	DBS
Altius – III CDO	\$2,000	Aladdin Capital Mgmt	ABS	GS
Halcyon Loan Inv CLO – I	\$650	Halcyon Loan Inv	Loans	CITG
Lochsong, Ltd.	\$1,200	Winchester Capital Principal	-	GS
Fort Duquesne CDO 2006-1	\$1,000	Federated Investors	RMBS	BAS
Scorpius CDO*	\$1,504	Strategos Cap Mgmt	RMBS	ML

* denotes synthetic; ** denotes hybrid deals.

Source: MCM, IFR, Bloomberg

III. Spreads

Index Constituent	5-Sep	Week Ago	Moody's Rating	S&P's Rating
Fannie Mae	7	7	Aaa	AAA
Boeing	13	13	A2	A
IBM	18	18	A1	A+
Deere & Co	20	21	A3	A-
GE Capital	12	13	Aaa	AAA
AIG	11	11	Aa2	AA
Dow Chemical	21	22	A3	A-
Alcoa	19	20	A2	A-
CIT Group	25	25	A2	A
Duke Energy	24	25	A3	BBB
McDonalds	14	14	A2	A
Walt Disney	18	19	A3	A-
Viacom	61	61	Baa3	BBB
Time Warner	44	50	Baa2	BBB+ /*-
Computer Associates	120	123	Ba1	BB
Altria Group	33	33	Baa2 /*+	BBB
Tyson Foods	103	111	Ba1	BBB-
Ford Motor Credit	302	324	B2 /*-	B+ /*-
GMAC	184	191	Ba1 /*-	BB /*
Carrefour	14	15	A2	A
AXA	13	16	A2	A
AKZO Nobel N V	25	26	A3	A-
Suez	14	15	A2 /*+	A- /*+
GUS PLC	35	34	Baa1 /*-	BBB+ /*-
Cadbury Schweppes PLC	35	35	Baa2	BBB
Renault	37	38	Baa1	BBB+
Brit Telecom PLC	41	41	Baa1	BBB+
Lafarge	36	38	Baa2	BBB
Deutsche Telekom AG	39	41	A3	A-
METRO AG	31	32	Baa2	BBB
France Telecom	33	34	A3	A-
Telecom Italia SpA	49	53	Baa2	BBB+
Volkswagen AG	22	24	A3	A-
DaimlerChrysler AG	49	49	A3	BBB
VNU	460	463	Caa1	CCC+
Koninklijke Ahold N V	138	144	Ba1	BB

5Y CDS Index	5-Sep	Week Ago	Change
CDX.NA.IG 6	37.00	38.50	-1.50
CDX.NA.IG 6 HVOL	73.84	76.62	-2.78
CDX.NA.IG XOVER	180.12	188.67	-8.55
CDX.NA.HY 6	324.49	337.55	-13.06
CDX.EM 5	125.79	136.61	-10.82
iTraxx Europe 5	26.75	28.00	-1.25
iTraxx Europe HVOL	48.06	51.81	-3.75
iTraxx Europe X-over	235.12	253.00	-17.88
iTraxx CJ Japan 5	24.69	27.00	-2.31
iTraxx Asia ex-Japan	51.40	53.25	-1.85
iTraxx Australia	30.00	31.20	-1.20
iTraxx SDI-75 2	34.40	35.48	-1.08
CDX Widest	5-Sep		
SUPERVALU INC	194		
RadioShack Corp	127		
Tribune Co	126		
Wendys Intl Inc	114		
Toll Bros Inc	113		
CDX Tightest	5-Sep		
Fed Natl Mtg Assn	7		
Wells Fargo & Co	8		
Wal Mart Stores Inc	11		
Amern Intl Gp Inc	11		
Gen Elec Cap Corp	12		
iTraxx Widest	5-Sep		
Portugal Telecom	169		
ITV Plc	94		
Degussa AG	89		
Valeo	88		
Glencore Intl AG	85		
iTraxx Tightest	5-Sep		
Nestle S A	5		
Royal Bk Scotland plc	6		
ABN AMRO Bk N V	6		
Barclays Bk plc	7		
SAN PAOLO IMI S p A	8		

Single-name CDS spreads are on a "XR" basis (without restructuring) for North America.

Source: Markit and Bloomberg

ABX.HE Index (as of September 1, 2006)				
	Price	Weekly change (bps)	Spread* (bps)	Coupon (bps)
ABX.HE.AAA.06-2	100.09	+ 0.27	8.92	11
ABX.HE.AA.06-2	100.10	- 0.02	14.26	17
ABX.HE.A.06-2	100.11	- 0.01	40.74	44
ABX.HE.BBB.06-2	100.41	+ 1.54	120.24	133
ABX.HE.BBB-.06-2	100.47	+ 0.93	226.94	242
CMBX.NA Index (as of September 1, 2006)				
	Spread	Weekly change (bps)	Coupon (bps)	
CMBX.NA.AAA.06-1	6.55	- 0.33	10	
CMBX.NA.AA.06-1	17.53	+ 0.03	25	
CMBX.NA.A.06-1	27.14	+ 0.45	35	
CMBX.NA.BBB.06-1	62.00	+ 0.12	76	
CMBX.NA.BBB-.06-1	105.29	- 0.83	134	

Source: Markit * assuming 35% CPR.

Source: Nomura Securities International

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