09 September 2008

Global SF markets – an update

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Global Structured Finance:

Moving from a Two-Speed to a Three-Speed Market

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Global Structured Finance Markets:

the Three-Speed Credit Crunch

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Credit crunch: a three-speed process

- The two-speed process of credit crunch proliferation
  - Developed economies
    - Feeling the real economy effects of the credit crunch
    - Significant decline in new issuance volume
    - Significant decline in mortgage and consumer loan origination
    - Distressed and quasi-distressed opportunities
  - Emerging markets – embarking on their own version of credit tightening, but with wide differences among countries
    - Pronounced slow-down and near closure of structured finance markets in more countries
    - Buoyant structure finance markets in fewer countries
    - Cross-border financing availability – significantly-reduced to non-existent
    - More or less pronounced slow-down in mortgage and consumer loan origination

Developed SF markets: US, Western Europe, Australia

- SF markets remain nearly closed – overall issuance activity YTD has experienced a significant drop compared to the same period of last year
    - GSEs dominate US mortgage markets
    - CB repo facilities support European and Australian issuance
    - Cross-border for European and Australian issuers - closed
- Underlying loan origination has been seriously curtailed:
    - decline in resi mortgage and consumer finance; significant reduction in refinancing availability
    - CRE loan origination – banks replacing conduits
- The real economic effects of reduced mortgage and consumer lending and low mortgage refinancing availability are being felt in consumer loan pool performance deterioration against the background of a general economic slow-down
    - House price declines; CRE price corrections
    - Rising delinquencies and foreclosures
    - Limited refinancing availability under tighter underwriting guidelines

Developed SF markets (2)

- Government steps to support mortgage and housing markets adopted in the US, UK, Italy and more to come
- Regulatory proposals by BIS (changes in BIS2) and EU Commission (proposed 10% rule) create uncertainty in the market
- Many structured finance instruments, esp. mortgages, trade at distressed or quasi-distressed levels – opportunities abound
  - Markets at historically widest spread levels and prices at all time lows across asset classes
  - Most sector spreads look attractive on a buy-and-hold basis
  - Investor concerns about MtM risk and diverging pricing assumptions, refi risk in 2009 and bond extension
  - Alternative credit funds and distressed funds increase in numbers but yet to enter the frey

Developed SF markets (3)

- Covered bonds
  - Market remains open and active despite decline in volume; activity differs by country and spread differentiation by country at all times high
  - Secondary trading and market making issues – liquidity remains relatively low
  - New national laws and legal changes suggest differentiation by products type and enhance tiering – covered bond risk assessment becoming more challenging
  - Covered bonds go beyond Europe as interest and activities increase in the US, Korea, Japan, Mexico, Hungary, etc.
- Property derivatives
  - Increasing market activities
  - Widening pricing of derivative contracts suggest deterioration in sentiment
  - Derivatives suggest further declines in residential and commercial real estate prices in the major economies

Developed SF Markets: Global CLOs

- Tightening lending criteria and lower liquidity is feeding into higher defaults
- Overhang slowly sorting out, but dragging prices lower – slower issuance, but stronger credit quality
- Gradually deteriorating performance
  - Defaults creeping up (mean-reversion so far)
  - Well-reasoned expectations for lower than historical recoveries
  - Loan repayment rates down to a 6-year low
- CLOs – adverse loan performance and pressure on spreads …
- … but senior tranches well protected

Developed SF markets: Japan

- Japanese market – less affected by the global credit crunch
- Tighter regulatory risk monitoring damps demand
- Decline in issuance and spread widening
  - Market volumes sustained by government-related securitisations
  - Slow down in residential mortgage origination (securitisation less economically efficient
  - Commercial real estate – challenges in refinancing and asset sales, but selective investor interest remains
  - Spreads at historical wides, but volatility contain
- Performance in consumer related assets remains stable, but macro effects are yet to be seen – some deterioration in consumer loan performance due to change sin the Money Lending industry
- Investment opportunities exist, provided investors are less concerned about MtM and fully aware of rating agency assumptions/ pool performance

Developing securitisation markets: Brazil, China, India, Korea, Peru - UP

- Domestic securitisation markets remain open and active, volume is up yoy
  - Predominantly consumer related credits
  - Government role in China – pilot projects
- Spreads - widening regardless of credit quality or deal types
- Consumer lending is growing rapidly in Korea, China, India, Brazil, HK – is this expansive growth sustainable in the medium term?
- Pool performance is improving or holding up – HK, China and Korea, but initial stresses appearing in unsecured consumer credit in India and auto / credito consignado credits in Brazil
- Property markets are cooling down in China, Korea, India
- Cross-border activity limited to Korea from foreign conduits and Brazil with DPRs deals
- Risks stem from rapid credit expansion in recent years, anti-inflationary actions by government, limited credit experience

Developing securitisation markets: Mexico, Colombia, Malaysia - DOWN

- Malaysia has experiences significant decline in issuance due to the absence of Cagamas and in less need of liquidity given manageable consumer and mortgage lending growth in past years; banking system liquidity high
- Colombian RMBS volumes have slumped due to lower investor appetite and pricing pressures
- Mexico
  - a full pipeline of RMBS deals but also a significant difference b/n bid and offer preventing deals form coming to market;
  - questions arise about available liquidity – role of SHF
  - Sharp deceleration in new credit origination in 1H08, esp. to low –income sector
  - uptick in delinquencies – more serious in consumer, credit card loans
- Risks associated with interest rises to combat inflation

Islamic Finance: from sukuks to loans

- YoY decline by almost half in sukuk issuance (still dominated by Malaysia, KSA and UAE) and spreads wider 2-3 times due to credit crunch contagion, new shariah compliance ruling on asset buy-backs and risk to currency peg in GCC
- Sukuk decline offset by shariah-compliant syndicated lending
- Rapid growth in consumer lending, esp. unsecured – questions about deposit availability to sustain lending
- Real estate expansion may be slowing down – financing and supply bottlenecks
- Residential housing – discrepancy between high-end availability and low-income needs, between demand for and availability of housing credit
- Clear need for securitisation, but challenges remain

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USA

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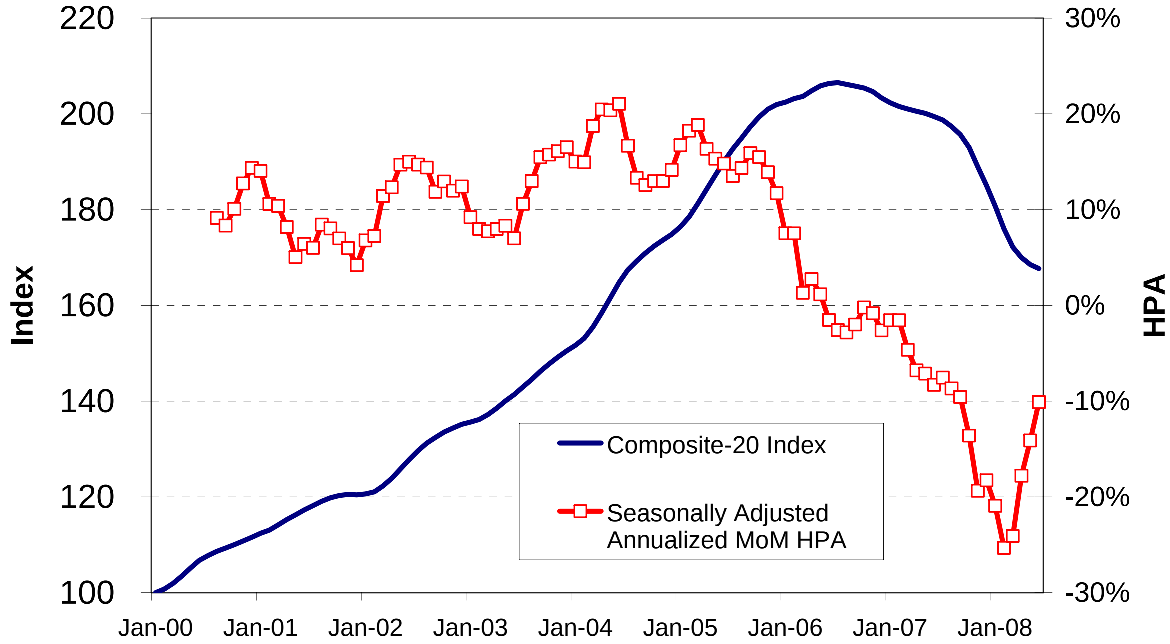
US RMBS

Continued Downward Trend in Housing

- Most recent data shows -10% annualized depreciation rate in housing.
- Rate of decline has decelerated considerably, after annualized declines exceeding 25% per year.
- But *seasonality must be considered.* August (and autumn) data will shed light.

Case-Shiller Home Price Series through June 2008



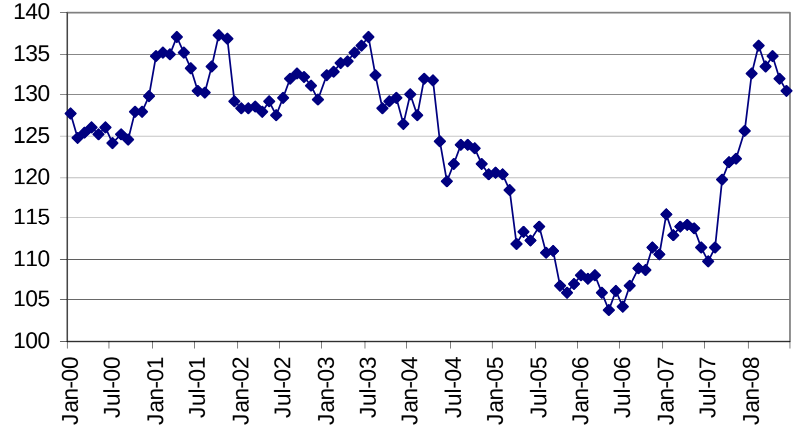
Source: Case Shiller, ML

See our publication "June Home Price Data: Reason for Hope?"

The Housing Market

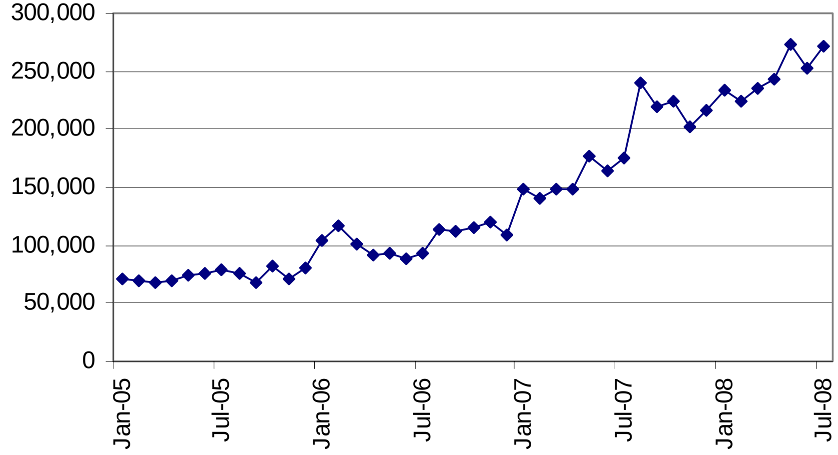
- Houses have become affordable again on the level of 1992-2004…

ML Housing Affordability (Seasonally Adjusted)



- But delinquencies and foreclosures continue to rise.

US Home Foreclosure Filings per month



Source: ML, NAR, RealtyTrac

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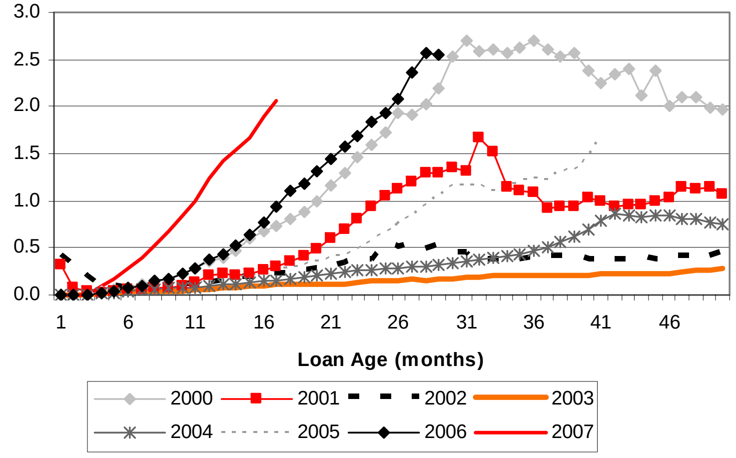
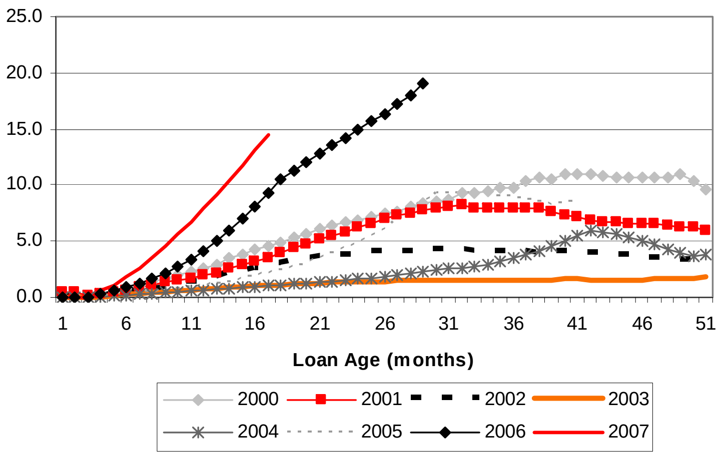
Delinquencies Still on the Rise

- 60+ delinquency populations are still rising
- Also on the rise: transitions rates from being current on loan payments to becoming seriously delinquent – prime loans starting to pick up here.

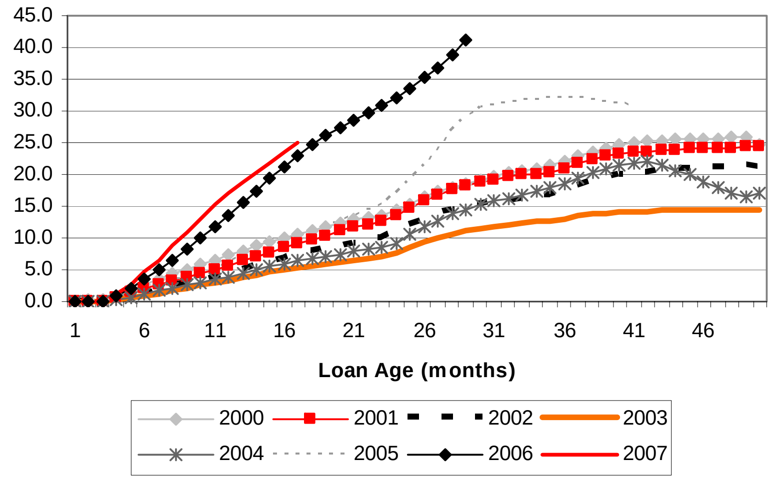
60+ DQ - Prime



60+ DQ – Alt-A



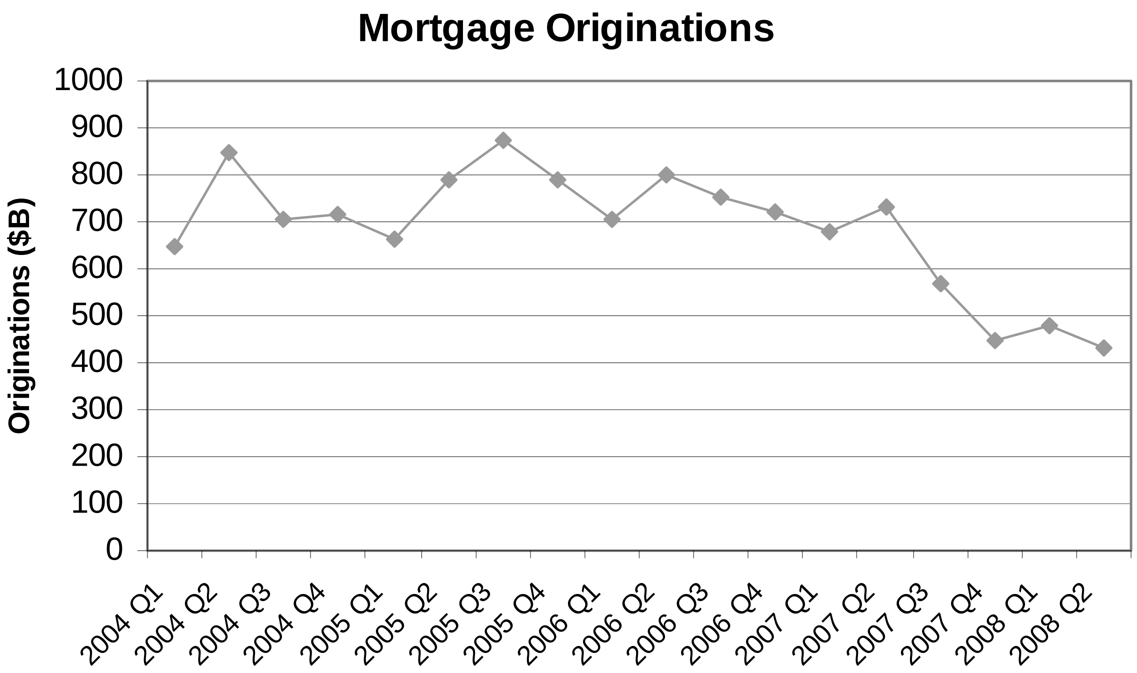
60+ DQ - Subprime



Source: ML

Mortgage Origination Trends

- Mortgage originations have declined overall with the onset of the credit crunch.



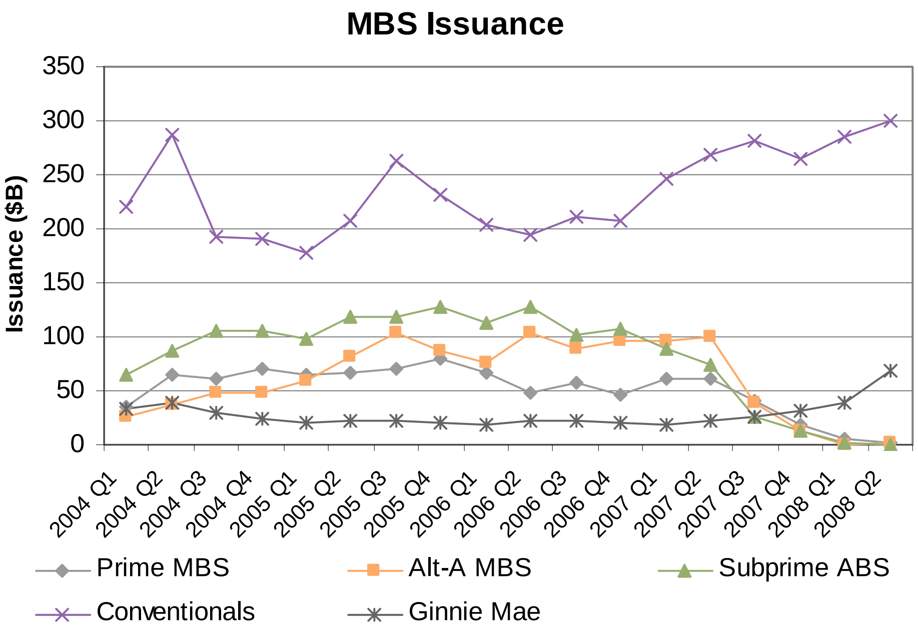
2007 Q1-Q2: $1,410 B

2008 Q1-Q2: $910B

Source: Inside Mortgage Finance

MBS Issuance Trends

- Nonagency MBS Issuance has declined markedly with the onset of the credit crunch.
- Agency MBS issuance has increased as a result.

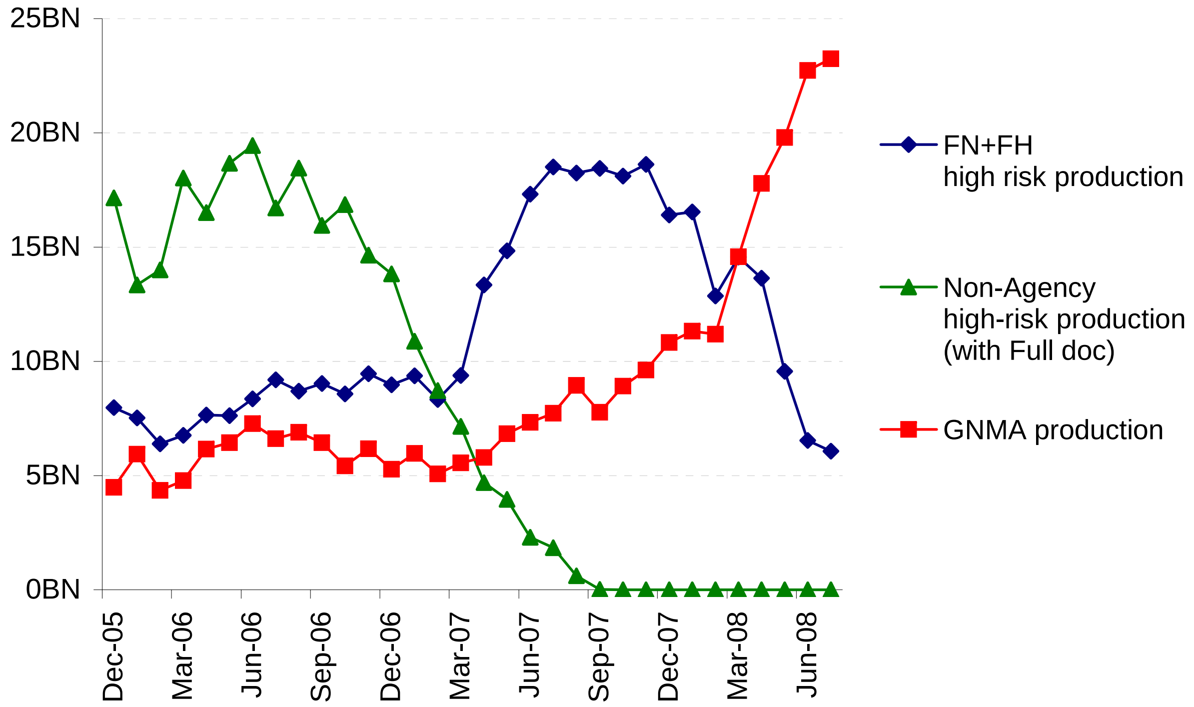


Issuance in $B	2007 Q1-Q2	2008 Q1-Q2
Conventional MBS	515	585
Ginnie Mae	40	107
Prime	121	6.7
Alt-A	198	1.9
Subprime	163	2.3

Source: Inside MBS & ABS

MBS High-Risk Issuance Trends

- The landscape of MBS issuance to high-risk borrowers has changed with the onset of credit concerns.
- The best execution for high risk borrowers has moved from the Non-Agency market, to Fannie/Freddie, and now to Ginnie.



Source: Inside MBS & ABS, GSEs, ML

Recent Legislation

- The Housing Economic and Recovery Act of 2008
  - The legislation gives the Treasury permission to purchase both debt and equity securities of the GSEs without an explicit limit.
  - The loan limits for a conforming loan are permanently raised in high cost areas, though not as much as the temporary provision, which expires at the end of this year.
    - Separately SIFMA decided that starting January 2009, TBA deliverable pools will be allowed to have up to 10% inclusion of Agency Jumbo loans. While this will slightly decrease the value of TBA mortgages, we believe the overall impact will be manageable.
  - Perhaps most importantly, a significant fraction of both Alt-A and subprime loans now qualifies for the Hope for Homeowners Act which establishes an FHA refinancing plan for up to $300 billion in mortgages accompanied by voluntary writedowns of outstanding balances of underwater loans.
  - This would create a new type of FHA mortgage, which could increase overall GNMA supply. On the other side, the bill also prohibits seller funded down payment assistance, which could reduce standard GNMA supply.

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State of Fannie/Freddie/Ginnie

- Fannie/Freddie
  - GSE placed into conservatorship:
  - US Treasury will ensure that the GSEs maintain a positive net worth by injecting capital as needed
  - US Treasury to establish a liquidity facility allowing GSEs to borrow money via collaterlised loans
  - GSE will be allowed to increase their portfolios through the end of 2009 up to a maximum of $850bn each
  - Us Treasury will buy MBS through the end of 2009 as long as spreads remain wide
  - Fannie and Freddie will re-address their current risk based pricing and will focus on affordability.
- Ginnie:
  - Without a functioning non-Agency market and with Fannie and Freddie tightening lending standards, marginal borrowers (low FICO and high LTV) have no choice, but to take out GNMA loans.
  - GNMA issuance is now up to 40% of total Agency issuance.

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Agency MBS spreads remain near their all-time wides

History of Current Coupon OAS

Event	OAS Wide
1998 LTCM Collapse	+37bp
2001 WTC/Enron	+17bp
2002 Corporate Scandals	+17bp
2003 Convexity whipsaw	+27bp
2007/8 Subprime Credit Crunch	+77bp

OAS on Sept 3rd
+60bp

Source: ML

With supply down, a buyers strike has kept spreads wide.

- Higher levels of rates has taken new supply of Agency MBS back down to +30BN per month. We are expecting new supply to remain around 35BN per month due since Agencies are only outlet for mortgage securitization.

	Jan	Feb	Mar	Apr	May	Jun	Jul
Monthly New Supply	45BN	72BN	29BN	46BN	61BN	55BN	32BN

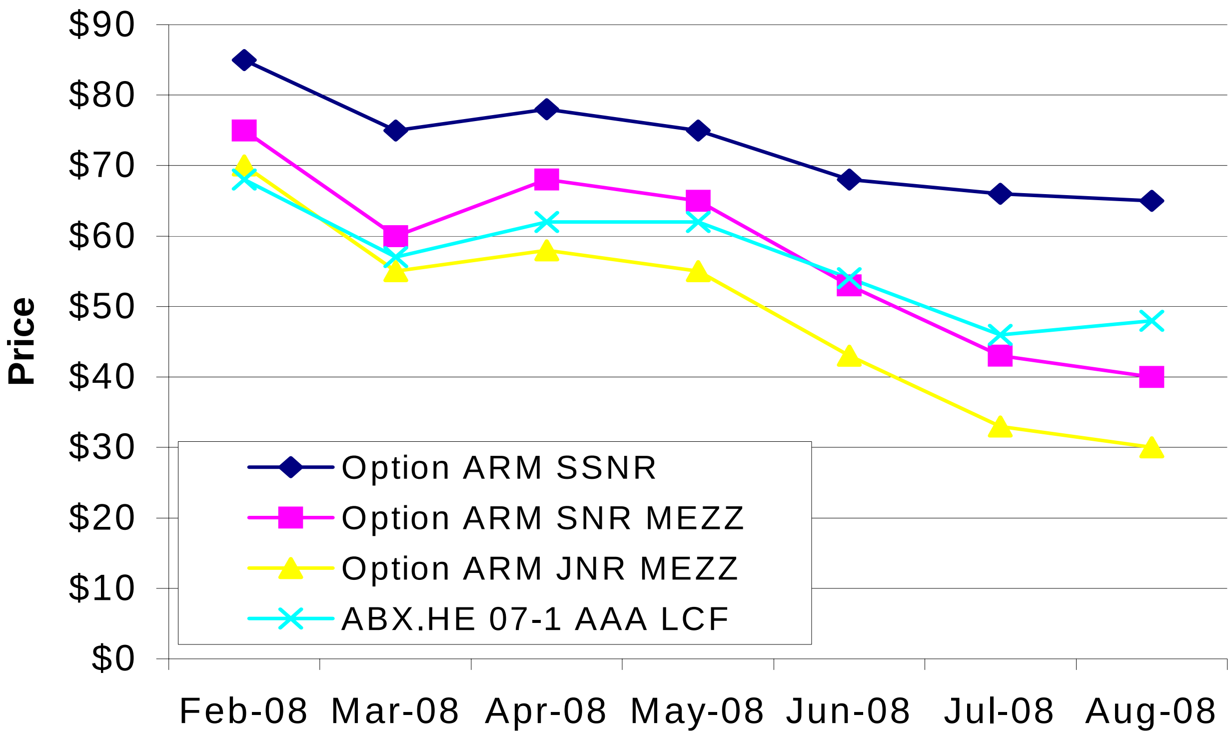
- Demand has been extremely tepid in July in August. The Agencies and Banks are capital constrained, Asia is on a buyers strike, and bond managers are already overweight mortgages. That being said, mortgage spreads do look attractive and supply has dropped.

	Jan	Feb	Mar	Apr	May	Jun	Jul
Commercial Bank PT	-3 BN	14 BN	27 BN	9 BN	2 BN	17 BN	9 BN
Commercial Bank CMO	10 BN	5 BN	7 BN	-4 BN	1 BN	-1 BN	-5 BN
Freddie	-1 BN	-7 BN	4 BN	**29 BN**	**35 BN**	**23 BN**	7 BN
Fannie	-3 BN	-3 BN	-3 BN	**5 BN**	**8 BN**	**10 BN**	7 BN
Foreign	9 BN	22 BN	4 BN	2 BN	10 BN	12 BN	*NA*
FHLB	5 BN	5 BN	5 BN	**5 BN**	**5 BN**	**5 BN**	*NA*

Source: ML, FED, Treasury, FHLB, Fannie, Freddie

Nonagency Prices at or Near All Time Lows

- After rebounding slightly in April non-agency securitized prices have fallen considerably in some sectors.
- The subprime and option ARM sectors are by far the most distressed.



Source: ML

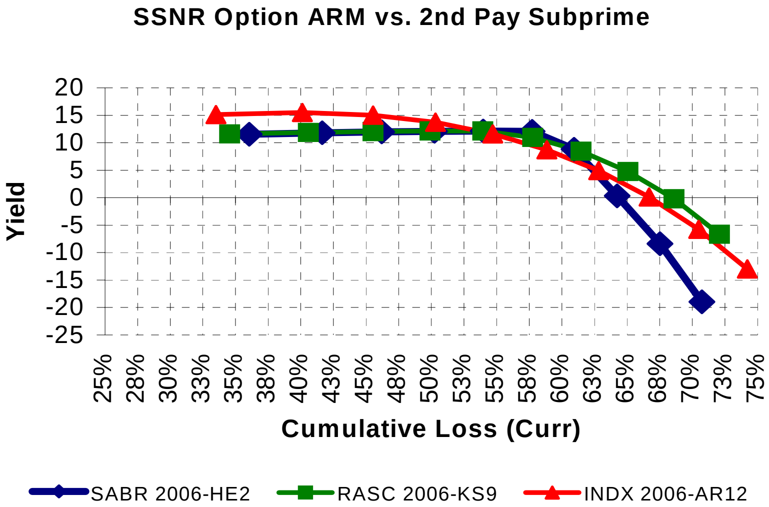
Relative Values/Trading Ideas

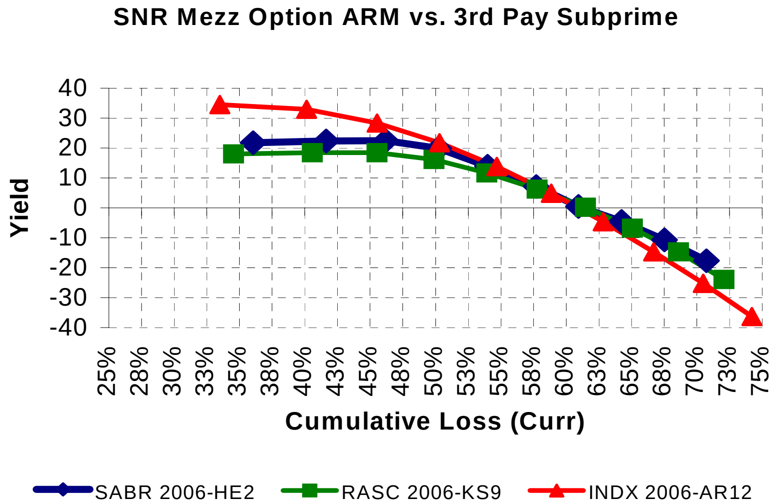
- Nonagency MBS is trading at distressed levels
- Many bonds are priced to double-digit yields, providing opportunity and low risk (even despite the health of the overall sector)
- Mezzanine AAA option ARMs offer great upside potential for investors looking to capitalize on a potential turnaround.
- Subprime first pay AAA offer relatively stable and attractive yields, with less risk but limited upside.
- AAA sector remains the most active sector

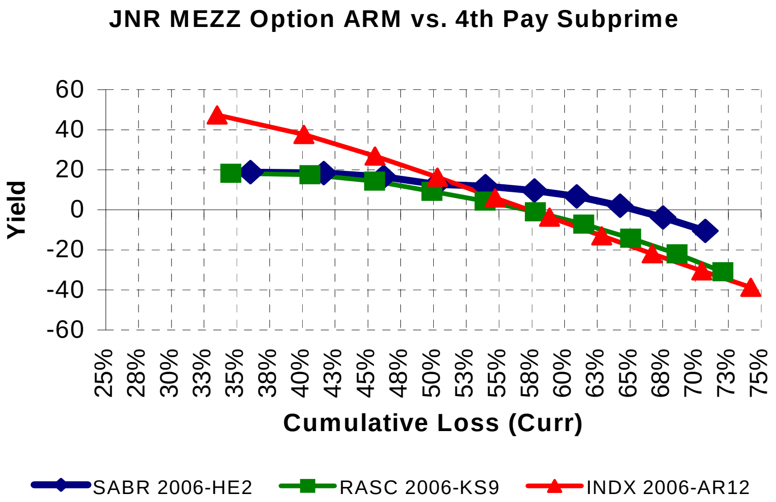
See our publication
"Distressed MBS: Priced to Yield but Technically Challenged"

Prices at or Near All Time Lows

- Distressed sectors offer attractive yields even under somewhat onerous scenarios, though technical risks still exist.







Source: ML

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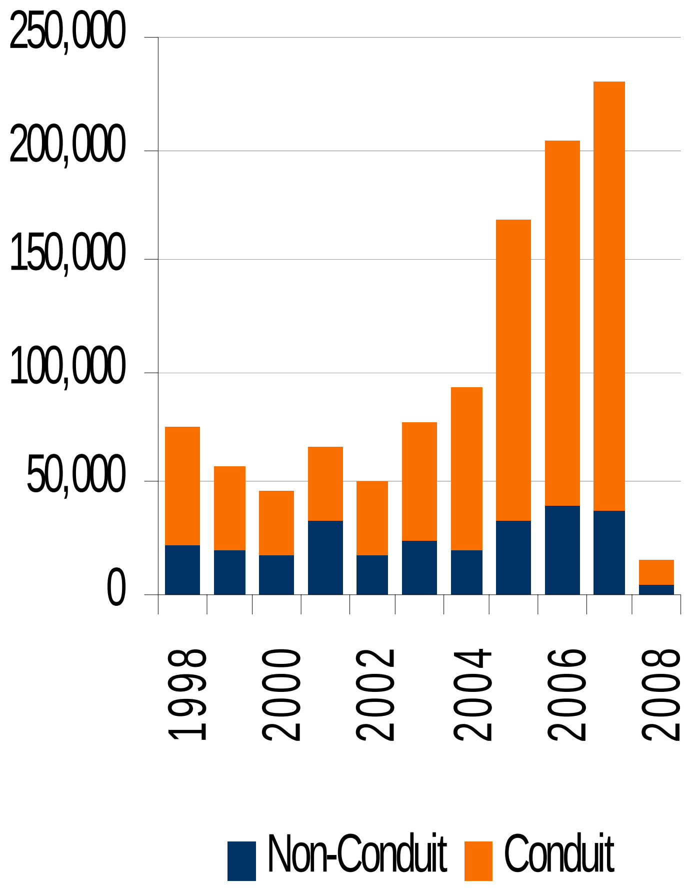
US CMBS

US CMBS Issuance



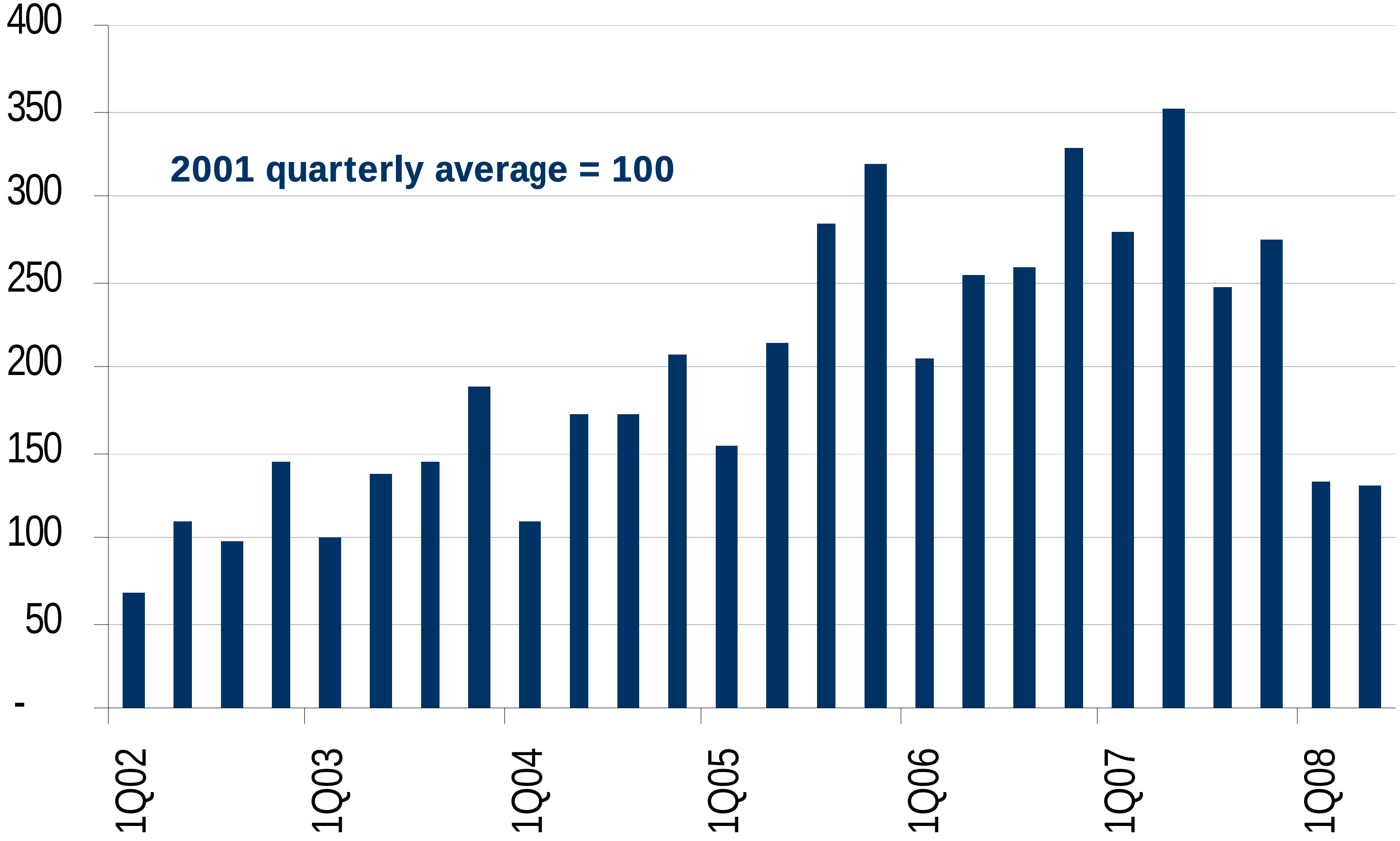
Source: Commercial Mortgage Alert, Merrill Lynch ($ Million)

- Only 8 conduit and 2 non-conduit deals priced YTD totaling $16.1 billion
- The last deal was priced on June 19 (BACM 2008-1)
- This compares to $137 billion of issuance for the 1H 2007 (including $117 billion in conduits), representing an 88% drop
- Given that the conduit origination programs are virtually closed, and the pipelines of previously originated loans are already exhausted, we do not expect any significant additional CMBS issuance until the year end
- On the fixed rate front, it is possible that another 2-3 conduit transactions will be brought to the market in the next 3-4 months
- In the floating rate segment, since the investor base for the floating rate paper is very limited, we do not expect that any of the formerly expected large floating rate loans (Hilton et al) will be actually securitized in 2008 - beginning 2009
- Absent any significant development, the issuance in 2008 is likely to be the lowest in decade.

Underlying Asset Lending

- In 2008 commercial banks became the most significant source of lending for CRE borrowers
- Insurance companies are still lending, but on a very selective basis (lower leverage, clean properties, etc.), some of the insurance companies are also experiencing capacity issues
- Approximately $6.2 billion of commitments were made by life companies in Q2 2008, this is down 36% from last quarter's total and down 39% from the same period last year; the spread on loan commitments by insurance companies continued to increase (~300 in Q2'08 compared to ~124 in Q2'07)
- The GSEs continue their lending program for multifamily CRE borrowers, however, their share in overall origination is somewhat limited given that they specialize only in one CRE property type, and exercise a very selective approach to the potential borrowers
- Despite a number of media reports that private funds are becoming more active in the CRE lending arena, we believe only a few deals were funded by the private lenders so far
- Lenders that securitize have not been active originators of CRE loans for the past year, and are not likely to resume their CMBS origination business anytime soon (spread volatility makes origination for securitization difficult).

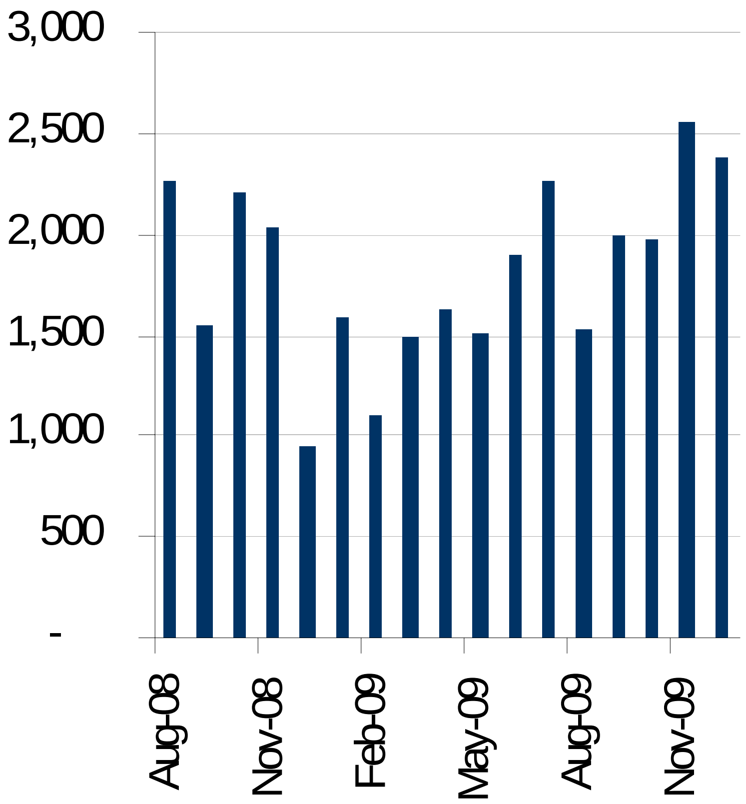
Commercial/Multifamily Mortgage Bankers Originations Index



Source: MBA, Multifamily Quarterly Survey of Commercial/ Multifamily Mortgage Bankers Originations, Q2 2008

Demand for Financing & Sufficiency of Funding Sources

Conduit Loans Expected to Mature
(2008-2009, monthly)

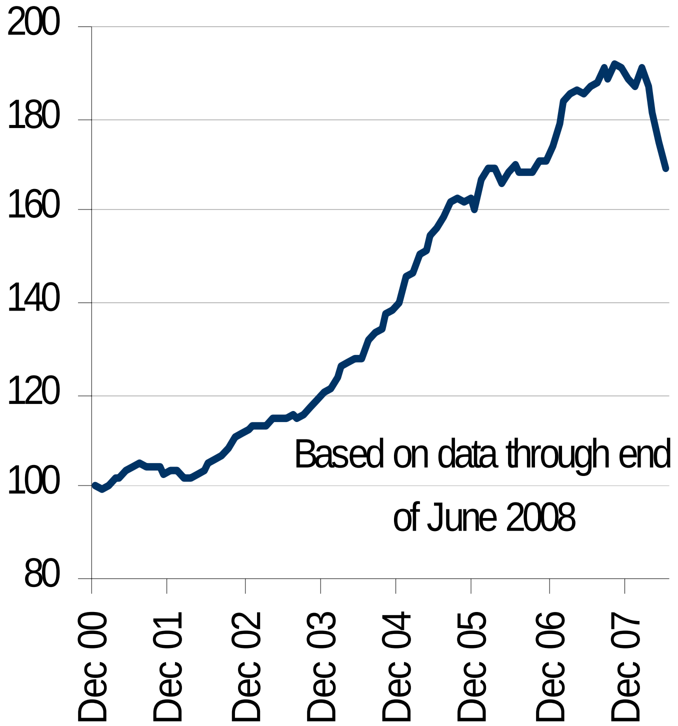


Source: Intex, Merrill Lynch ($ million), as of July 2008 remittance

- Between now and the end of the year we estimate there is approximately $9 billion fixed rate conduit loans that will reach their maturity and will need refinancing
- Although this is a sizeable amount given the current state of the CMBS market, we believe this total is manageable from the refinancing prospective (most of these loans will be able to refinance using commercial banks' and insurance companies' lending programs)
- However, in 2009, a total of $22 billion of CMBS conduit loans is expected to mature; unless the lending environment improves, we believe this might result in substantial extension pressures on maturing loans in the coming next year
- Approximately 15% of all conduit loans that matured during the past 6 months, extended for at least 1 month, and we believe this ratio might increase in 2009.

CRE Prices: Moody's CPPI

Moody's/REAL Commercial Property Price Index (CPPI) National

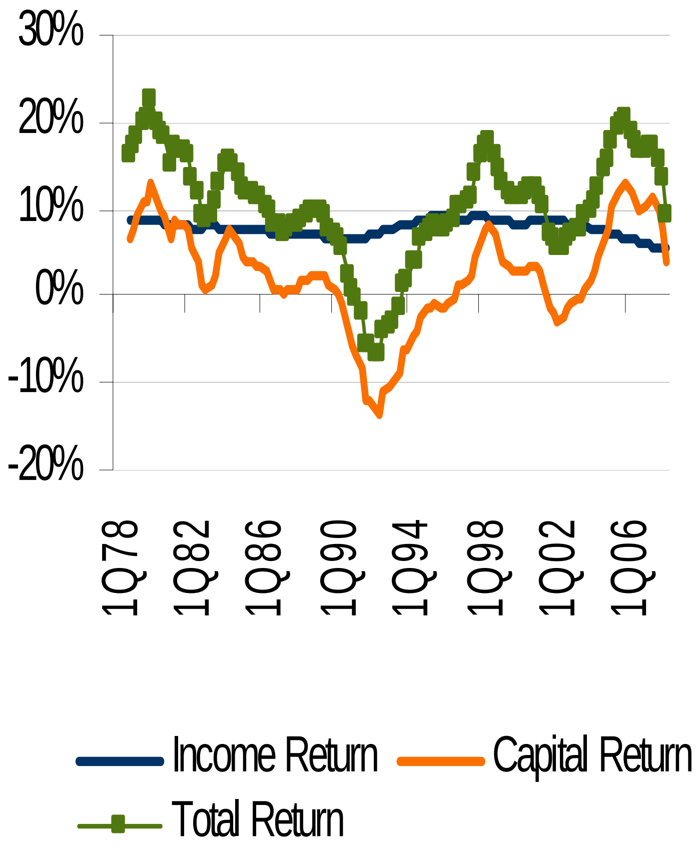


Source: Moody's, December 2000=100, aggregate for all property types

- Reduced availability of financing and reduced leverage will continue to put downward pressure on commercial real estate prices
- At the start of the year, we were in-line with the consensus view of calling for a 15-20% drop in CRE prices
- Our view remains that the drop in price does not automatically trigger a default, but rather increases its likelihood and the loss severity associated with it
- There is a broad array of indices and price points that are helpful in tracking CRE prices and returns, however none of them could be identified as a single and undisputed market standard
- Among the indicators we track, Moody's CPPI and NCREIF indices are the most popular
- The latest report from Moody's (June 2008) shows the index fell 3.3% in June (4th straight month of negative returns)
- The overall decline from the index peak in October 2007, is nearly 12%.

CRE Returns: NCREIF

NCREIF Returns, Annualized



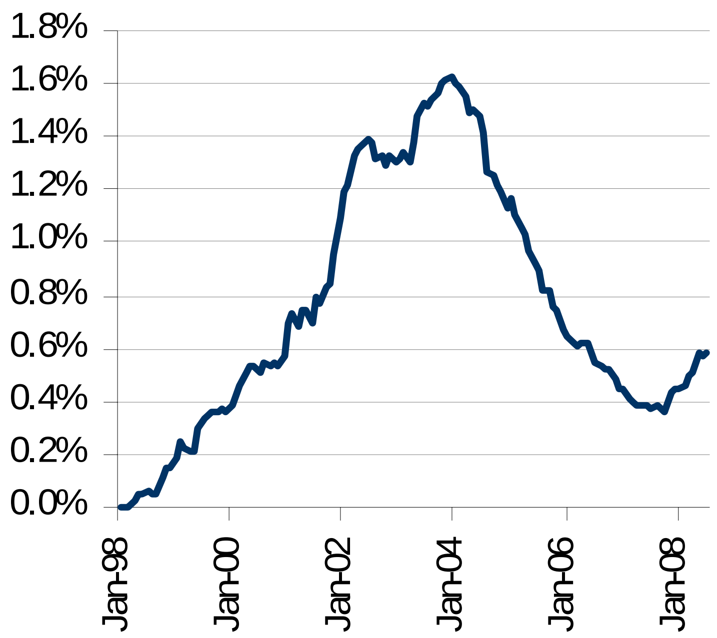
- NCREIF measures the income and capital return on a quarterly basis
- Quarterly capital return was negative in Q2 '08; first time since 1Q 2003
- Annualized total return dropped 4.4% Q-over-Q (from 13.6% to 9.2%) - biggest quarterly drop ever
- Mid-market projections for the 2008 FY TR are ~3% (implying a 5.11% price drop for the last 2 quarters); and 2009 FY TR is -2%

Source: NCREIF, Merrill Lynch

Collateral Performance

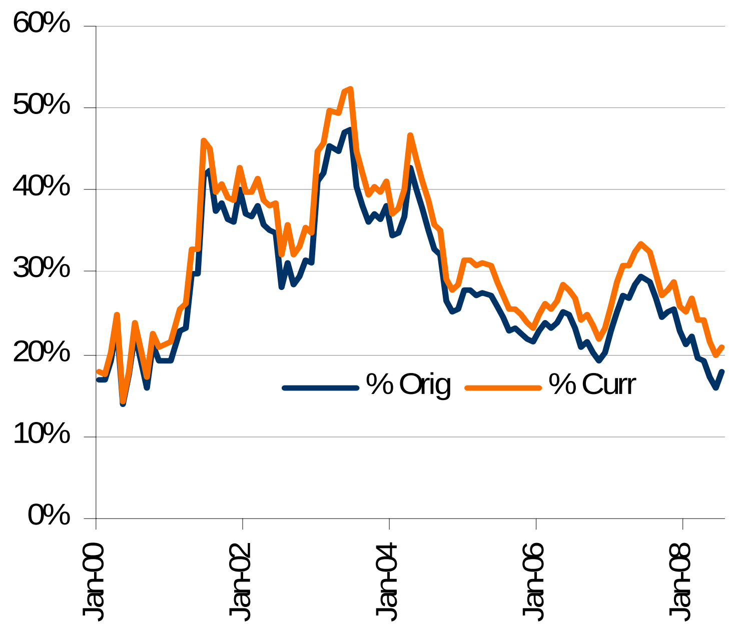
- CMBS delinquencies are on the rise, but from a very low base, currently standing at less than 0.6% for the pre-06 conduit universe
- Delinquency rates are up 63% in the past 3 quarters
- The loss severities, contrary to popular belief, remain well below historical 35% average

CMBS Delinquencies (% Current)



Source: Trepp, Merrill Lynch

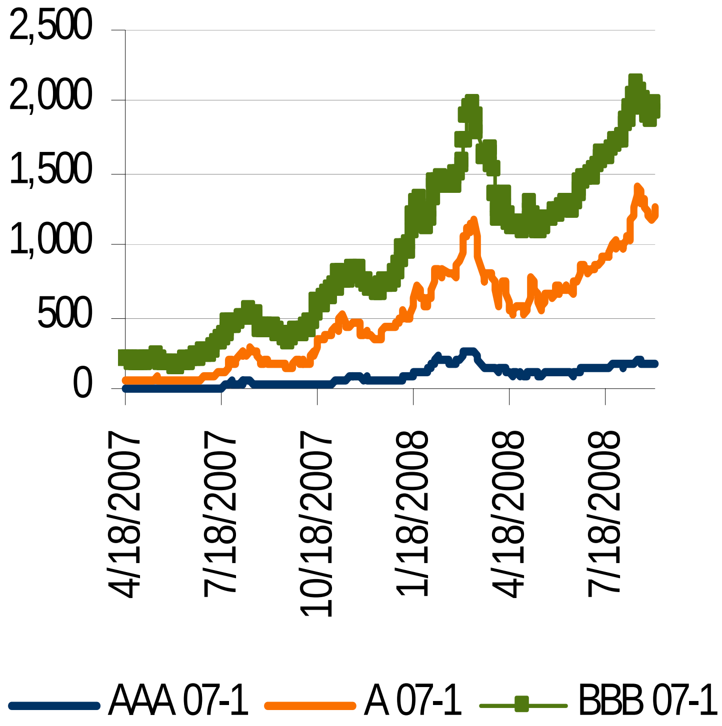
CMBS Loss Severities



Source: Intex, Merrill Lynch

Secondary Market Technicals & Spreads

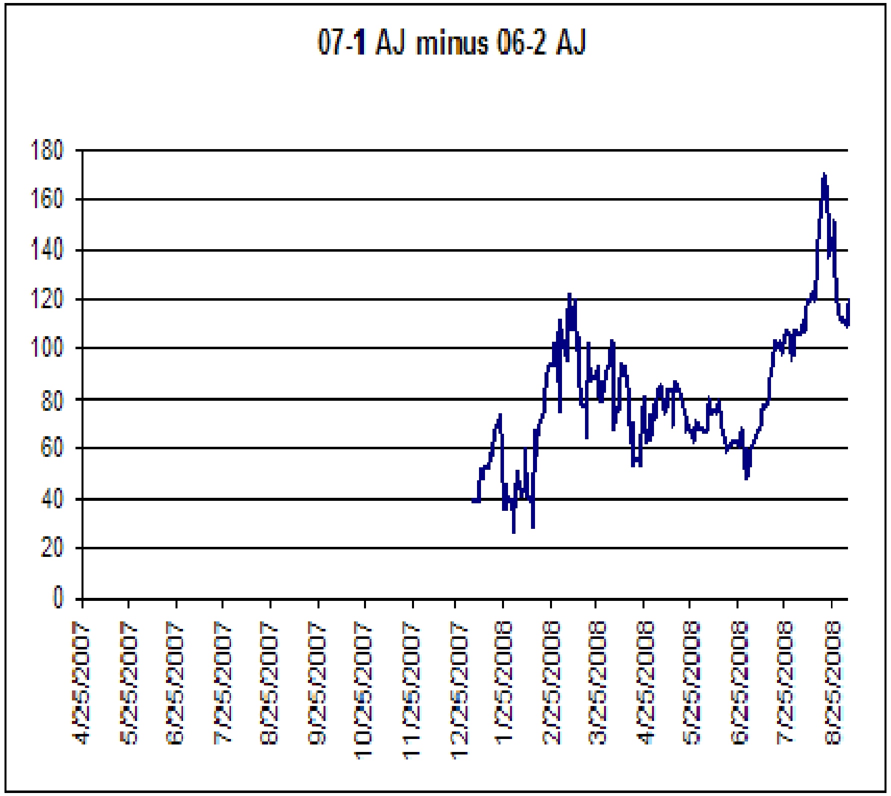
CMBX Spreads



- Growing investor concern about credit, especially in the late vintage conduit deals, has lead to reduced demand for 2007 AAA paper, and, more generally, less demand down in credit
- This results in interest in the more seasoned conduits (2004-2005 paper) and non-generic deals
- Some market players are attempting to capitalize on weak fundamentals, using the synthetic CMBX market
- Reduced appetite for risk-taking (by both dealers and investors) was among the factors that lead to spread widening

Source: Markit, Merrill Lynch

Investment Opportunities



Source: Markit, Merrill Lynch

Investment opportunities in the cash CMBS sector for the broader investor base are currently centered in:

- Off the run paper (single borrower deals)
- Seasoned conduit transactions (2004-2005 vintages)
- Newer vintages up in credit.

Opportunistic value exists in CMBX trading:

- The differential in CMBX 2/3 AJs represents a good example of such volatility
- After the news that one large loan securitized in a CMBX 3 transaction (Riverton) could potentially default, the differential widened to +165 bps (due to CMBX3 widening)
- As the story unfolded and more information became available, the relationship tightened ~50 bps.

Investor Base & Key Valuation Issues

- Investor Base
  - With no primary issuance expected, trading activity is naturally centered around the secondary cash trading and the CMBX synthetic market
  - The client base is thinning out in both cash and synthetic markets
  - In cash - most of trading activity now is generated by traditional investors (insurance companies, real estate focused shops, etc.); this has led to concentrated trading in single borrower deals, requiring certain expertise for its credit assessment, rather than generic conduits
  - In synthetics - CMBX is still dominated by the fast money (prop desks and hedge funds), with up to 70% of the flows being street driven
  - Recently a few of the real money accounts became active in CMBX, using it mostly for hedging purposes or negative basis trades, focusing almost exclusively in super-senior space
- Key Valuation Issues
  - concerns about concentration issue (top 10 loans in conduits deals)
  - estimation of cumulative losses and their timing
  - relative value between the products (we believe there is still value in super-senior tranches versus other sister products).

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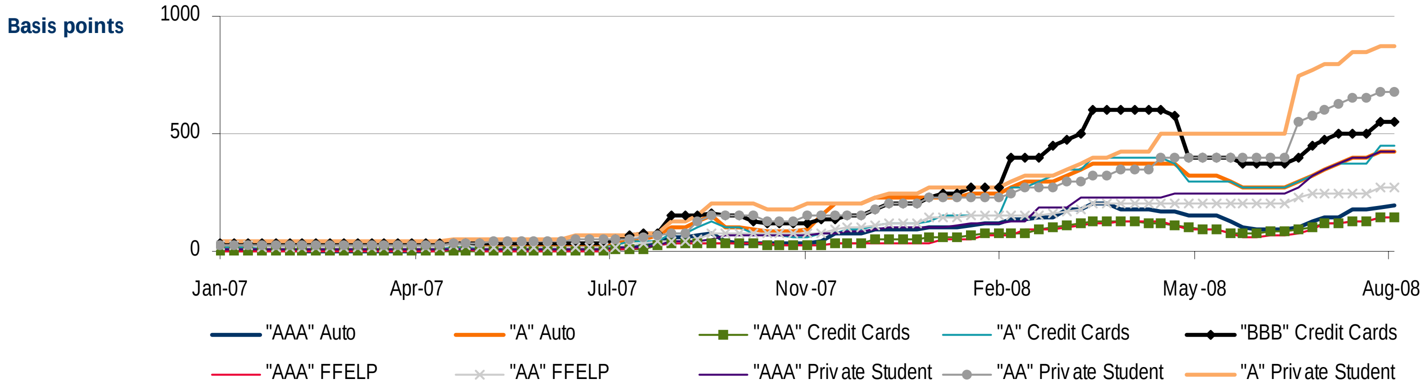
US Consumer & Commercial ABS Sectors

Consumer & Commercial ABS Sectors – Primary and Secondary Markets

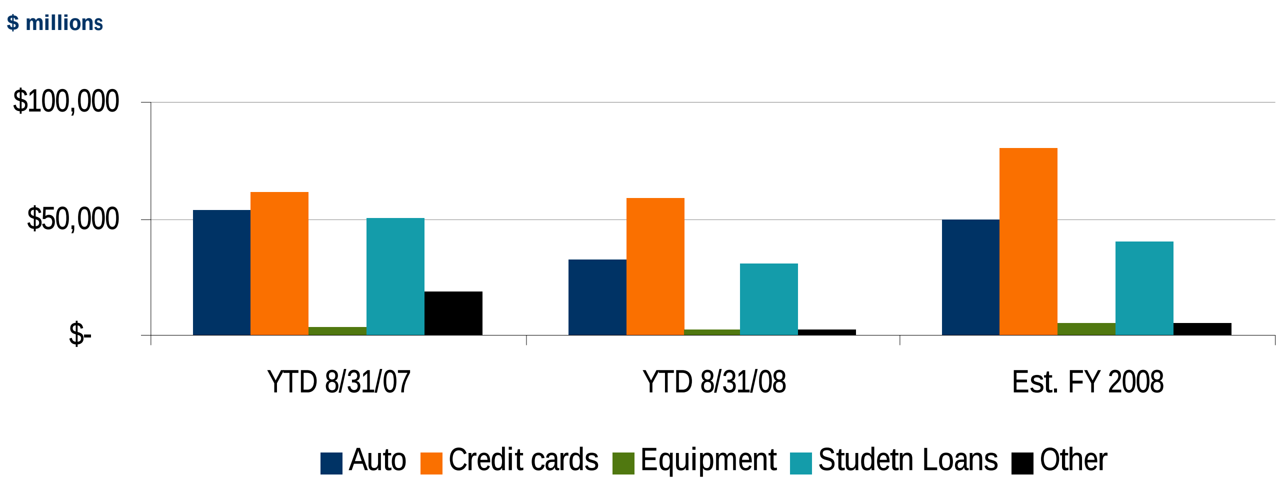
- Since the end of the second quarter, the consumer and commercial ABS sectors have seen spreads move out to historically wide levels.
- Market participants have reacted to the volatility proceeding the rescue of the GSE, the risks associated with of 2Q08 earnings, economic and collateral weakness and ratings actions, and the markets' assessment of relative value in competing products.
- We expect spread movement in consumer and commercial sectors to lag other structured products, which has been the case for most of this year.
- Tiering among sectors (e.g., auto, credit cards and student loans), sub-sectors (e.g., prime and sub-prime) and issuers remain pronounced.
- The secondary market continues to under-perform the new issue market, which is primarily driven by reverse inquiries.
- We believe the government student loan sector offers the most value given the US Government's 97%-98% explicit guarantee and the prospect of lower issuance volume.
- We believe most classes of top tier auto loan, credit card and equipment deals offer value.
- Several issuers have provided incremental support to their deals.



Source: Merrill Lynch

Consumer & Commercial ABS Sectors – Actual and Expected Issuance Volume

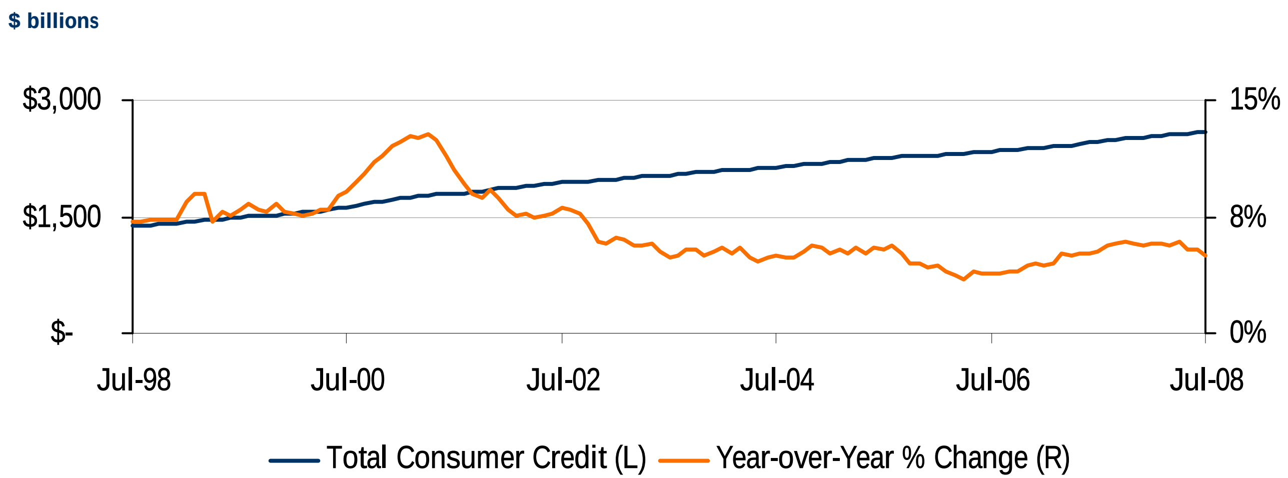
- Lower vehicle sales, credit concerns in the sub-prime auto loan sector and headline risk related to the domestic captives have placed downward pressure on volume in the auto ABS sectors. Banks and non-domestic captive have access to alternative funding sources, including cash, deposits (banks) and unsecured debt. Specialty finance companies and domestic captives have reduced origination volume.
- Refinancing activity, modest receivable growth and reasonable levels of liquidity have contributed to stable volume in the credit card ABS sector. Banks have access to alternative funding sources.
- Lower origination volumes and headline risk related to private student loans have placed downward pressure on volume in the student loan ABS sector. The launch of the Department of Education's financing/purchase program has provided an alternative source of funding.
- Weaker construction market and challenging funding environment have reduced volume in the equipment ABS sector. Issuers have access to alternative funding sources.



Source: IFR Markets, Bloomberg, Merrill Lynch

Consumer & Commercial ABS Sectors – Collateral Origination Volumes

- Lower vehicle sales, increased credit concerns resulting from higher defaults and lower used vehicle valuations, and a challenging funding environment have led to lower volume in the auto lending
- Lower levels of spending and increased credit concerns have led to modest receivable growth in credit card lending
- Reduced subsidy payments for government loans, credit concerns regarding private loans, fewer lenders, and a challenging funding environment have led to reduced volume in student loan lending



Source: FRB, Merrill Lynch

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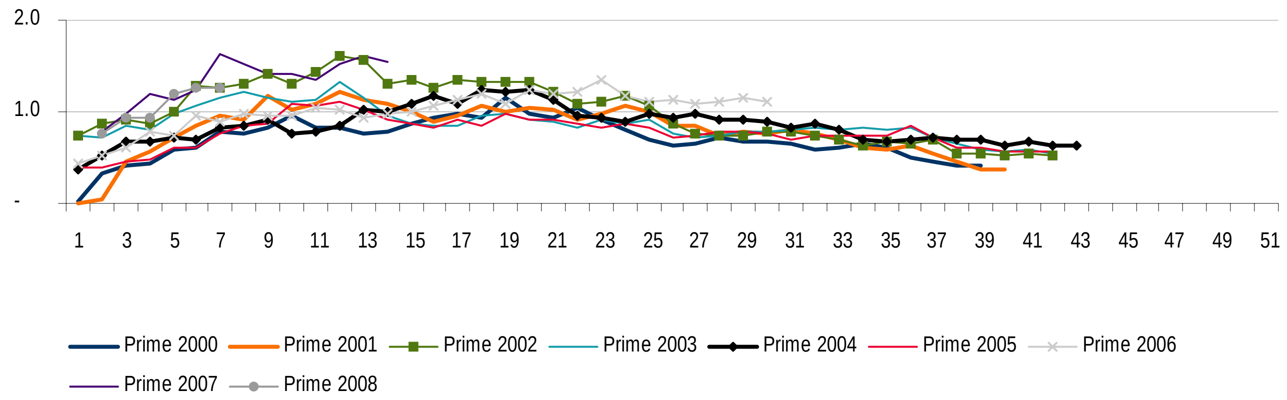
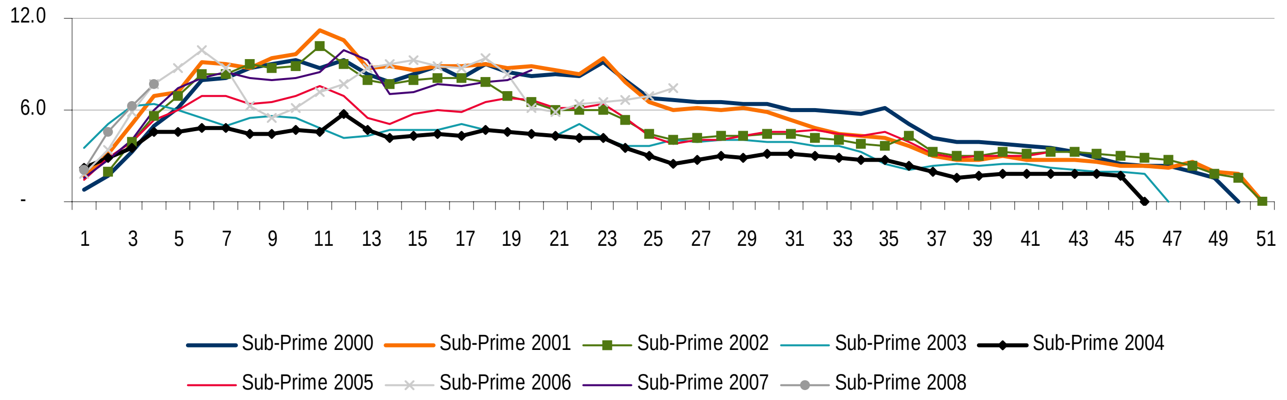
Consumer & Commercial ABS Sectors – Auto Loan Collateral Performance

- A weaker economy and lower used vehicle values have impacted performance of recent vintages. Performance varies among issuers.

Delinquencies as a % of Original Pool Balance



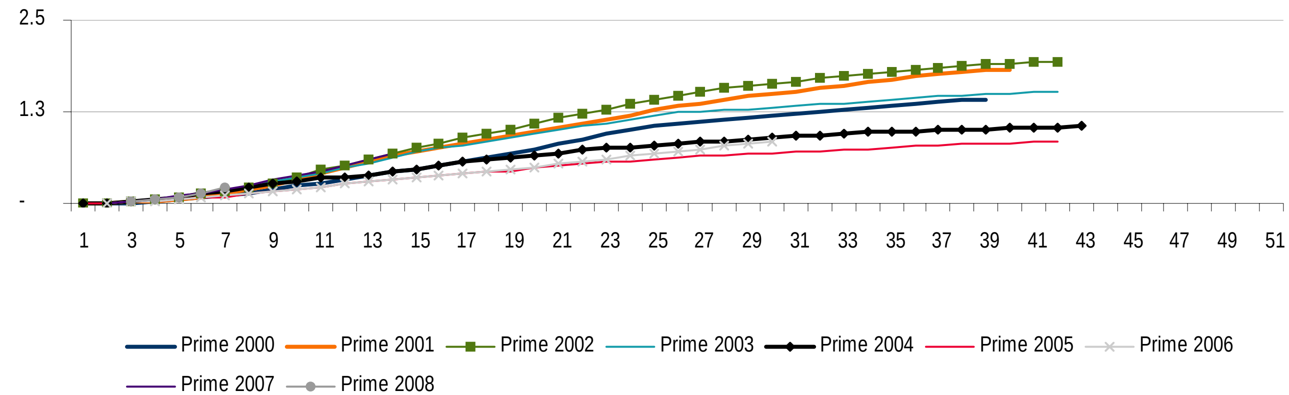


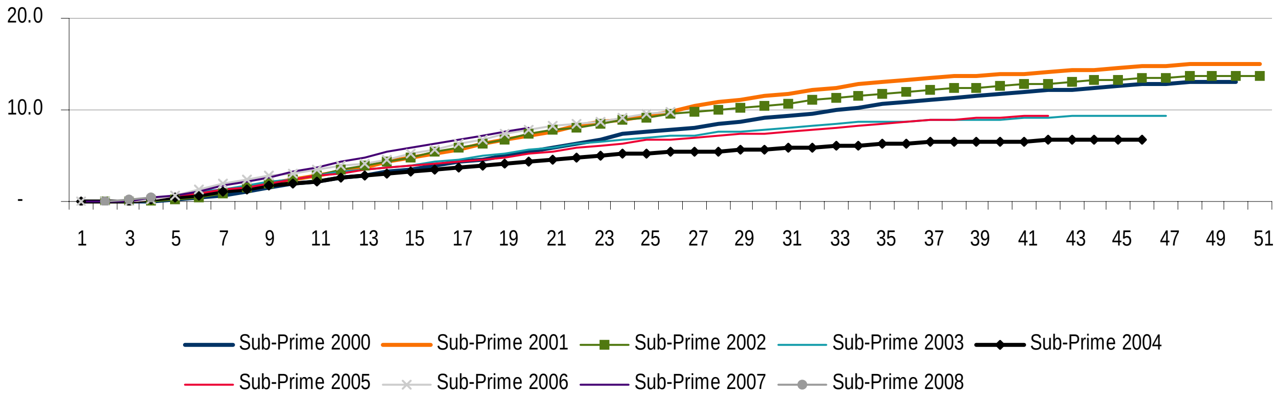
Source: Moody's, Merrill Lynch

Consumer & Commercial ABS Sectors - Auto Loan Collateral Performance

- A weaker economy and lower used vehicle values have impacted performance of recent vintages. Performance varies among issuers.

Cumulative Net Losses as a % of Original Pool Balance





Source: Moody's, Merrill Lynch

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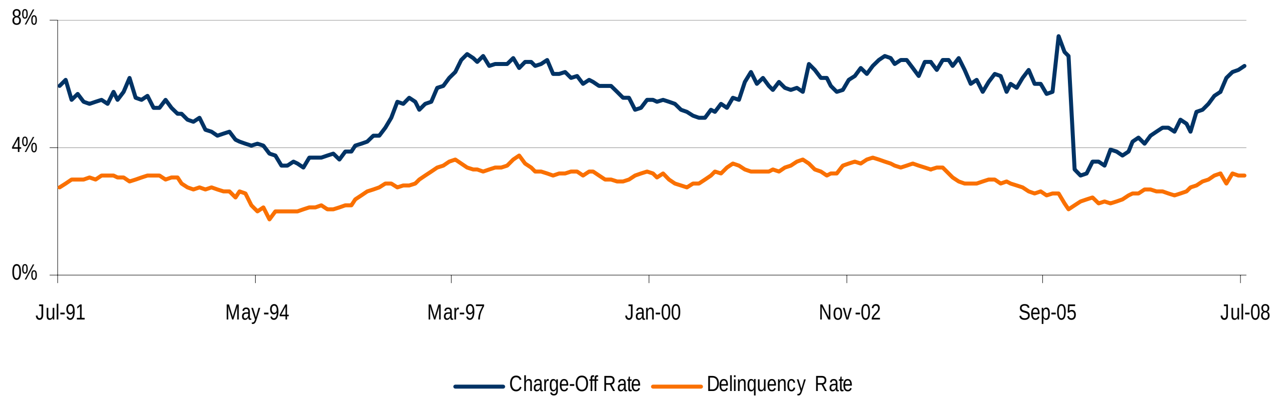
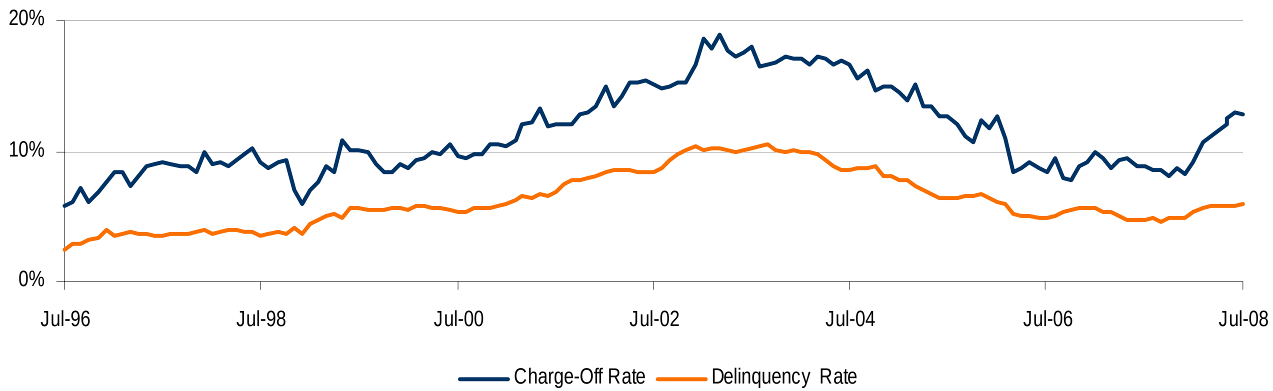
Consumer & Commercial ABS Sectors – Credit Card Collateral Performance

- A weaker economy has impacted performance. Excess spread for most trusts remains above trigger level for reserve account funding. Proposed regulations/legislation may limit issuers' ability to re-price portfolios.

Prime Credit Card ABS



Sub-Prime Credit Card ABS



Source: Fitch, Merrill Lynch

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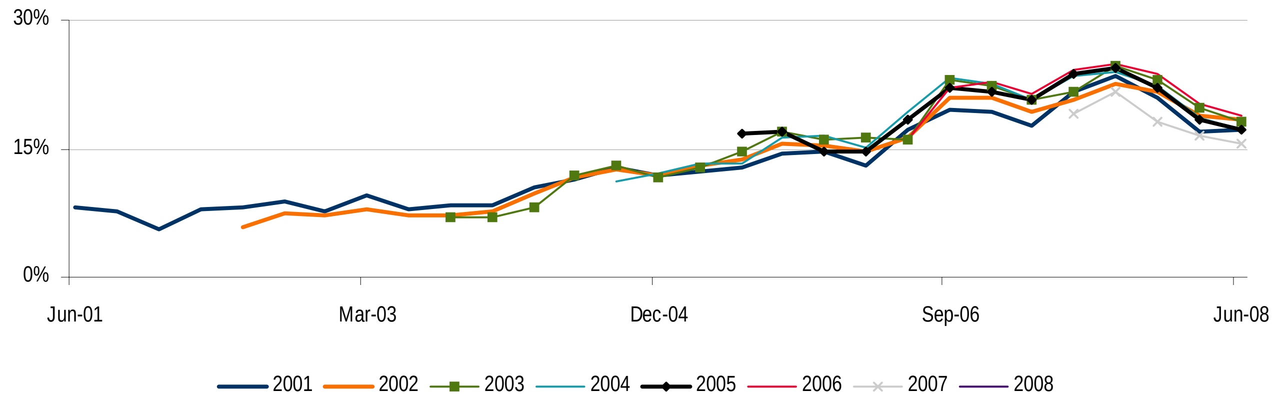
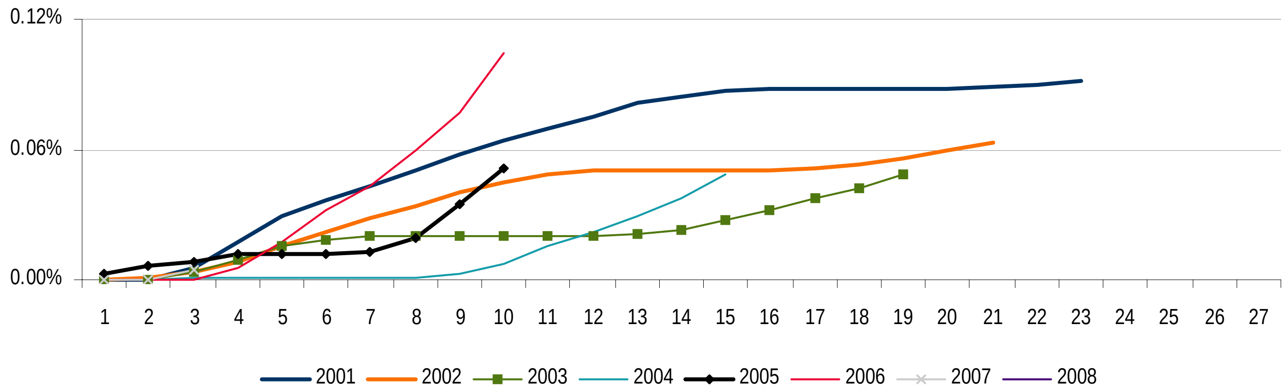
Consumer & Commercial ABS Sectors – Student Loan Collateral Performance

- The impact of a weaker economy is less evident in the government loan sector

Stafford/PLUS 90+ days delinquencies



Stafford/PLUS risk sharing (based upon original amount & deal seasoning)



Source: SLMA trusts certificates, Merrill Lynch

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Europe

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European RMBS

Regulatory confusion

- EU Commission, in its first consultation paper on potential changes to the CRD, proposed that originators hold regulatory capital for no less than 15% of the non-securitised exposures.
- The stated goal of that measure is to re-align the incentives of originators with those of securitisation investors, in hope that it will help maintaining sound lending practices.
- Given the critical response to this proposal, EU issued a second draft, with the focus now on investing banks, rather than originating ones. The new proposal requires banks to only invest in CRT (credit risk transfer) products is the originator retains no less than 10% of the non-securitised risk ("‘an explicit commitment to maintain on an ongoing basis, a net economic interest of in sum at least 10% in positions having the same risk profile as the one the credit institution is exposed to"). This applies whether the originator is a EU or non-EU institution.
- The Commission may also consider similar requirements for other institutional investors, such as UCITS schemes, insurance, etc.

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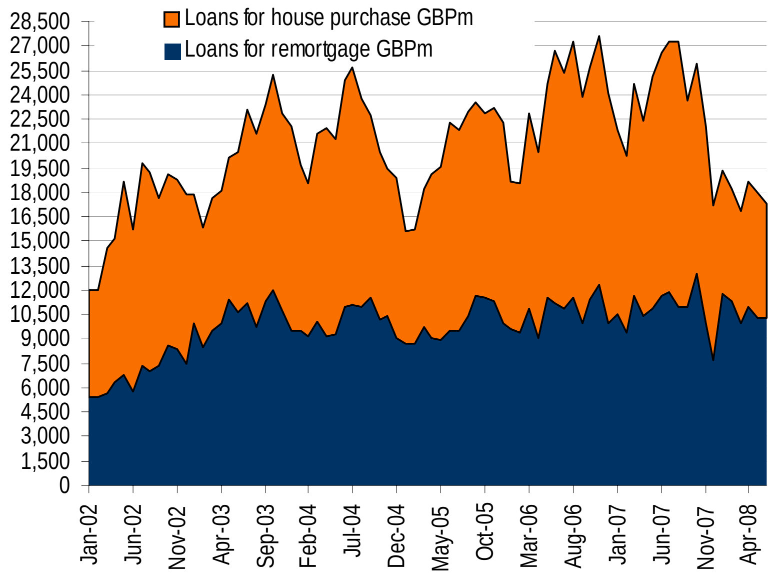
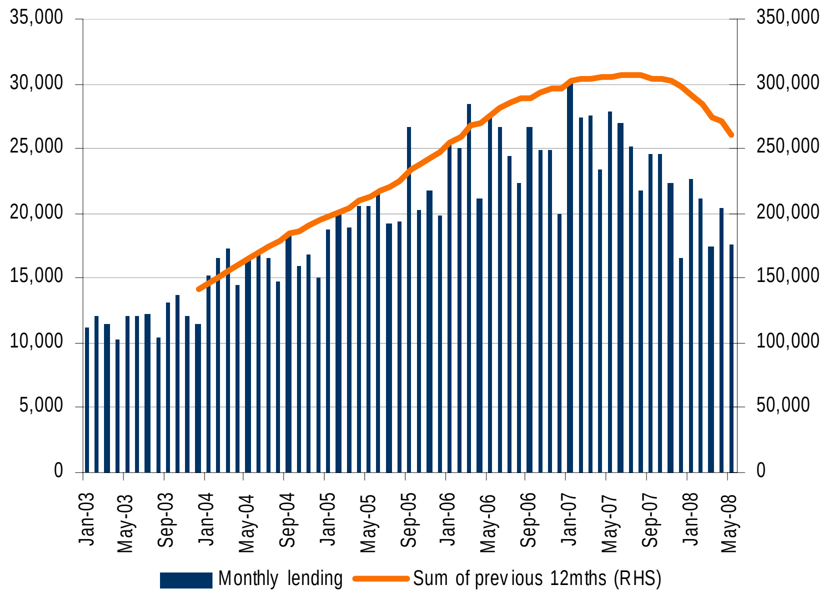
Mortgage lending stopped in its tracks

UK mortgage lending by type (GBPmn)



Source: CML

Spanish mortgage lending (EURmn)



Source: INE

- UK and Spanish mortgage lending for house purchase slowed dramatically since July 2007; lenders reacted to higher risks and more expensive funding by tightening criteria.
- Other main RMBS jurisdictions have not been as severely affected although there has been a general softening of lending growth across most economies.

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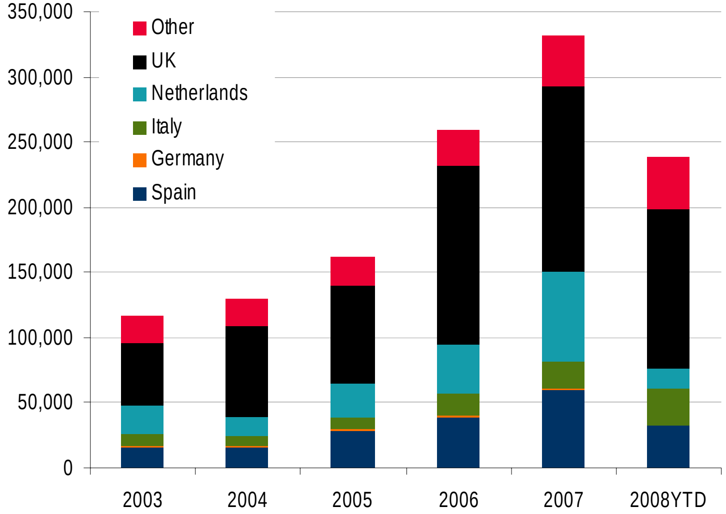
RMBS issuance mostly retained

European RMBS issuance by country, EURmn



Source: Merrill Lynch

- RMBS issuance YTD reached EUR239bn, 15% up on last year YTD but…
- …almost all issuance has been retained/privately placed/repoed

- The ECB changed its haircut criteria for ABS. Asset-backed securities are now to be included in the newly set up Category 5, subject to an haircut of 12%. The increased haircut is due to concerns about the quality of the collateral. The impact on issuance volumes is not clear yet:
  - We may see no or little change on the current environment as RMBS/ABS for repo can be customised to fit rating or subordination requirements relatively easily.
  - Some lenders may see their access to this type of cheap funding restricted and would therefore have to reduce lending and issuance, even if retained.
  - Many hope that an adjustment of the repo criteria by the ECB would spur the issuance of more publicly sold deals, leading to the setting of a benchmark spread level and eventually to the comeback of a functioning primary market. Given the current market conditions, this is however unlikely to happen.

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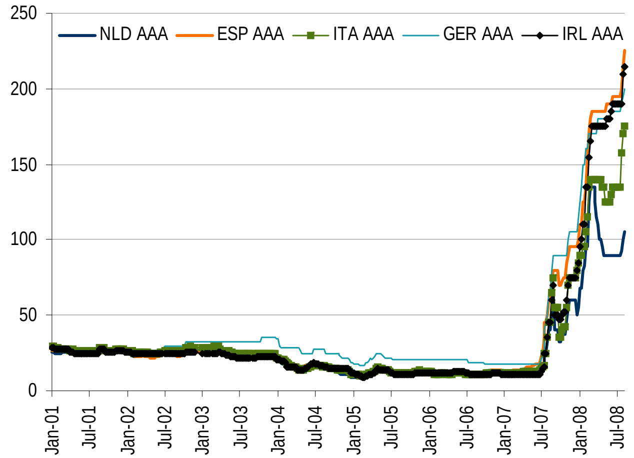
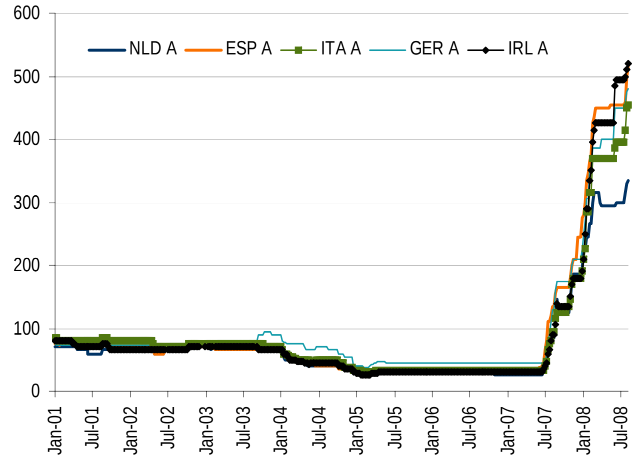
European RMBS spreads continue their climb

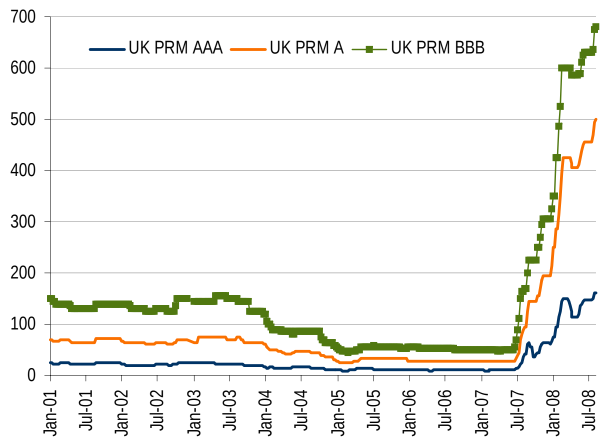
European AAA RMBS secondary spreads



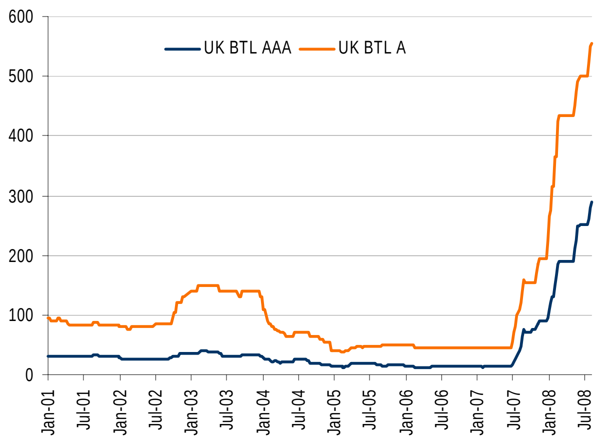
European A RMBS secondary spreads



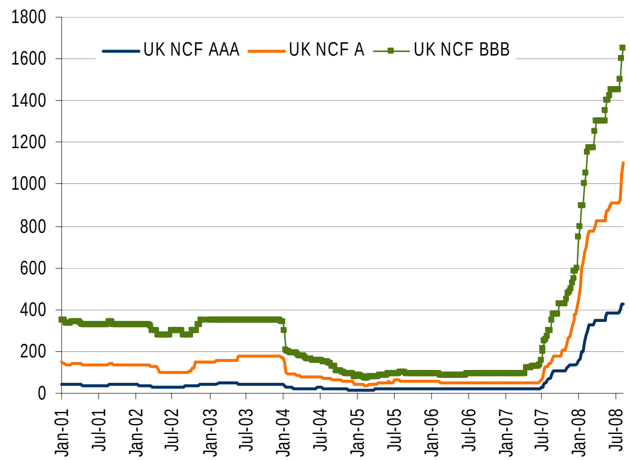
UK Prime RMBS secondary spreads



UK Buy-to-let RMBS secondary spreads



UK NCF RMBS secondary spreads



Source: Merrill Lynch

Technicals still drive spreads wider but fundamentals begin to matter

- RMBS cash spreads have now reached and passed the March highs for most jurisdictions.
- As usual, lack of demand (especially during the summer) and protection buying are amongst the main reasons for such further widening but…
- …what started as a financial crisis 12 months ago is now feeding through to the real economy: performance of Spanish and UK assets has clearly taken a sharp turn in the wrong direction and small signs of stress appear elsewhere.
- Therefore, we do not see cash spreads tightening in the near future and believe they will continue to be subject to high volatility.
- The synthetic space remains the most active at the moment, although most of the action is skewed towards protection buying; Spanish RMBS and in particular high LTV deals from recent vintages have increasingly been targeted by protection buyers.

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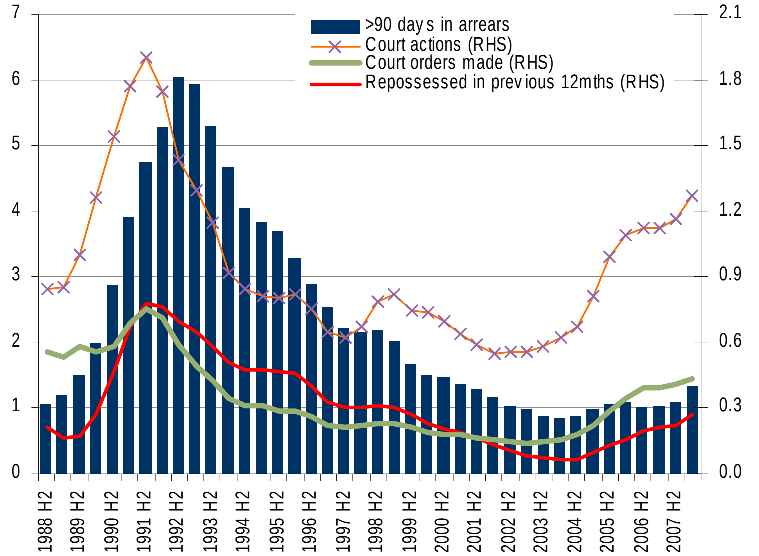
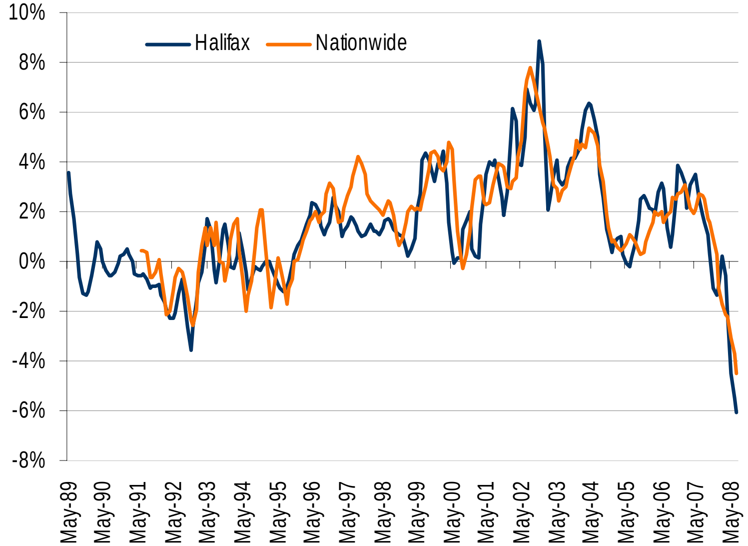
UK housing market – the perfect storm

Indicators of UK borrower performance



Source: Merrill Lynch, CML, Ministry of Justice

Leading house price indices: 3mth/3mth growth, %



Source: Halifax, Nationwide

- Arrears and forced sales rising but still low on a historical basis (1/5 and 1/3 of historical peak respectively), but…
- …court actions entered and repossession orders made (the steps prior to forced sale) are now at 2/3 and 3/5 of their historical peak → forced sales likely to increase now that private sale and refinancing options are not always viable.
- Mortgage approvals and lending for house purchase continue to fall while unsold property stocks and expected time to sale rise.
- Combined effect of weaker economy, higher forced sales, tighter lending and illiquid housing market are likely to depress house prices further: prices have so far fallen 11% from peak; we expect peak-to-trough decline of 25%

UK Prime RMBS offer value to buy-and-hold investors

- Despite currently being a hunting ground for CDS investors and subject to spread volatility, the prime sector offers value to buy-and-hold investor with a longer-term view:
  - Prime 90+ arrears have been increasing for the past 9 months (partly due to seasoning effect), while repossessions and losses remain stable and low. CPR also remains stable, although a slowdown is expected;
  - The UK economy is clearly getting weaker, but a repeat of the 90s severe recession is at the moment not expected; furthermore, prime borrowers should be able to weather the storm relatively unscathed;
  - We do not believe that, under the current forecast economic environment, cumulative defaults will exceed those recorded in the worst decade historically…
  - …hence, even though we expect house price decline to be 25% peak to trough, current excess spread of prime trusts should be enough to absorb any realised losses as they surface.
  - For these reasons, we believe that credit risk currently does not justify secondary spreads of 163/500/680bp at the AAA/A/BBB for UK prime RMBS, which offer good value for buy-and-hold investors

UK NCF RMBS – younger vintages likely to suffer losses and downgrades

- Limited or no refinancing opportunities, tougher economic environment and lower credit quality are likely to continue pushing arrears and repossessions up and prepayments down.
- Higher LTVs in recent vintages and low seasoning will exacerbate loss severity.
- We believe that, depending on pool quality, structural features and current level of their reserve funds, in a relatively conservative scenario:
  - 2006 vintage deals may on average experience severe principal losses at the BB and potentially at the BBB level
  - 2007 vintage deals may on average experience losses up to the BBB level and in some cases marginal ones at the A level.
- Furthermore, for most deals there is an increasingly concrete risk of downgrade even at the senior level.

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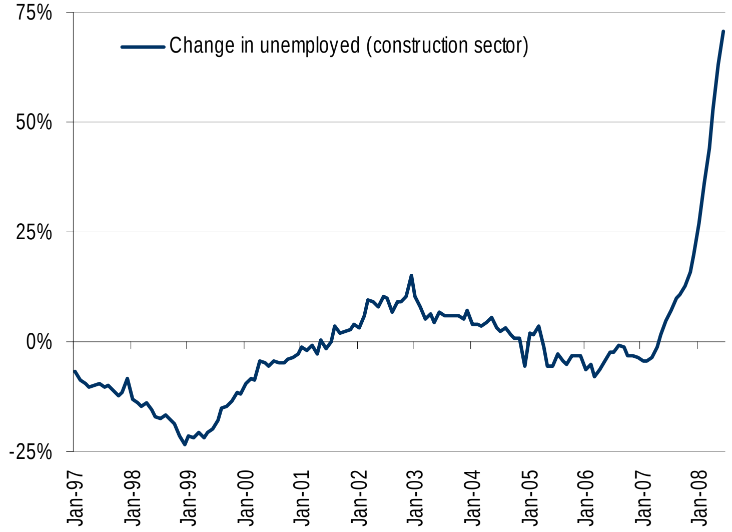
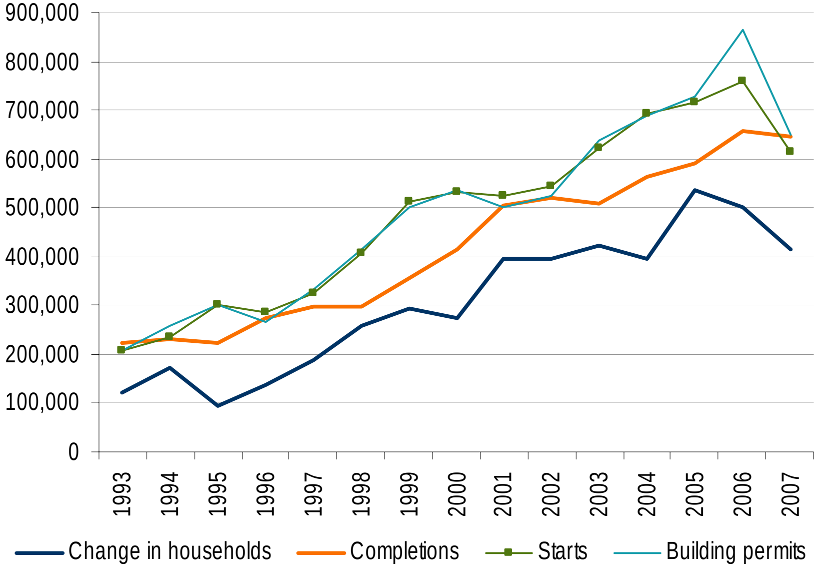
Spanish housing market – the *fiesta* is over

Annual change in unemployment in the construction sector (%), 1997-June 2008



Source: INE

New household formation, completions, starts and building permits 1993-2007



Source: INE, Ministerio de Vivienda

- For many years the constructions sector has fuelled Spain's economic growth: now that the tank is empty, the economy is heading for a downturn.
- Now that the credit crunch obliterated foreign demand and rising interest rates and a pessimistic economic outlook have severely dented the domestic one, the oversupply problem is become a daunting one.
- While official indices continue to show slightly positive, albeit slowing, house price growth, it is now inevitable that this will head south in the near future and will take a few years to recover.

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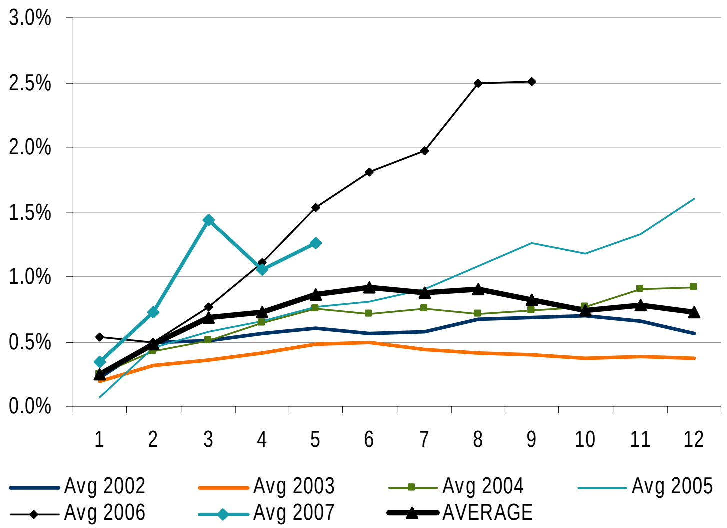
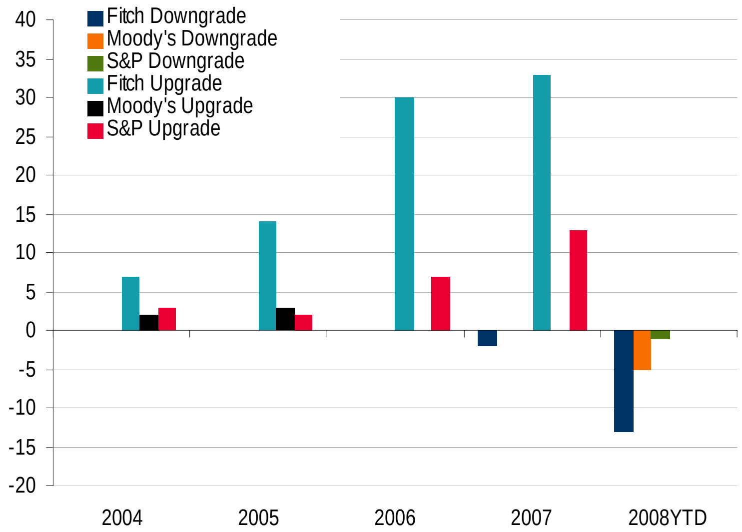
Spanish RMBS – downgrades materialise as performance weakens

Spanish RMBS 60+ arrears by vintage, quarters since launch



Source: ABSxchange, Fitch Ratings, Moody's, Merrill Lynch

Spanish RMBS tranches upgraded/downgraded, 2004-2008YTD



Source: Fitch Ratings, Standard and Poor's, Moody's, Merrill Lynch

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Spanish RMBS - recent vintages to bear the brunt

- The number of downgrades targeting Spanish RMBS deals belonging to recent vintages has picked up due to:
  - Weaker collateral performance;
  - Structural triggers protecting senior notes to the expense of junior ones and leading to reserve fund draws;
  - Rating methodology changes, penalising high LTV pools such as those of 2006-07 vintage deals.
- We also caution against deals with high exposure to coastal areas, more likely to have been affected by oversupply.
- We believe that performance will continue to weaken across the board and a number of 2007 deals may experience further downgrades throughout the capital structure and losses of principal at the junior level.
- Furthermore, CPR is slowing considerably compared to the prepayment speed assumed at pricing, which may lead to extension risk on the notes.
- Earlier vintages should not on average experience losses, thanks to de-levering and long seasoning of underlying pools. While 2006 deals should on average be relatively protected against losses, downgrade risk remains.
- Spreads are likely to remain volatile, but for buy-and-hold investors we reiterate gaining exposure to good quality, de-levered, seasoned deals at current spread levels, especially at AAA level.

Other European RMBS – bending but not breaking (1)

- In general, performance is showing some signs of stress but is not expected to collapse.

Dutch RMBS:

  - The economy is expected to cope with the downturn better than other European jurisdictions;
  - HPA is slowing but not expected to crash; furthermore, the Dutch housing market has proved to be more resilient than others: during the previous severe downturn in 1978-1982, when house prices fell 40%, cumulative losses for the period amounted to just 1-1.4%.
  - Despite the high average LTVs and pockets of weak affordability, a lender-friendly legal framework, a benign economic outlook and RMBS structures generally benefiting from guaranteed excess spread, should help keep losses limited.
  - Limited downgrade risk due to counterparty risk (EMAC-NL deals).
  - While offering great value across the capital structure to buy-and-hold investors, Dutch RMBS is perhaps a little expensive if compared to UK prime paper.

- **German RMBS:**
  - While arrears remain stable, losses for some of the worst deals in the market continue to rise at a rapid pace.
  - Frequent use of regulatory (Basel 2) calls may offer opportunities to those able to sell protection on good quality names.

Other European RMBS – bending but not breaking (2)

- **Italian RMBS:**
  - The economy has long been underperforming compared to the EU average and is expected to continue doing so, but…
  - …Italy did not experience the credit craze of some of its European counterparties → despite decade of healthy HPA, prices are not extremely overvalued and severe correction is not expected
  - Performance is somewhat stable but weaker than average; the long seasoning and low LTV of the pools should provide a buffer against losses but the extremely complex and inefficient foreclosure process (up to 6-7 years) means that often recoveries are very low.
  - Beware of regulatory changes: depending on rating agencies approach and decision of SPVs and lenders, the outcome may range from a higher risk profile of existing RMBS pools to higher prepayment speed.
  - Thin liquidity and generally weaker than average performance lead us to be comfortable at the mezzanine and senior level; however, depending on one's risk appetite, picking top performers should provide value also at the junior level. CDS activity is very limited.
- **Portuguese RMBS:**
  - Performance deteriorating as rising interest rates put pressure on a mostly floating rate market.
  - Some downgrade risk.

Consumer ABS

- **Auto loan ABS**:
  - European collateral performance shows some slight deterioration, especially Spanish deals, which have been affected by negative rating actions.
  - Auto industry outlook not positive, so issuance likely to decline in second half of the year, after a strong first quarter.
  - Short dated, good quality paper from experienced originators provides great value.
- **UK credit card ABS:**
  - Despite concerns about the performance of the UK consumer, performance of UK credit card ABS seems to be holding up for now.
  - Senior pieces of credit card ABS look attractive for buy-and-hold investors, although some downgrade risk exists.
  - Compared to UK prime RMBS, credit card ABS looks expensive given:
    - The current negative outlook for the UK consumer economy, with likely reduced spending and increasing cost of living;
    - The current record high level of arrears and charge-offs in the credit card market, compared to relatively low repossessions levels in the mortgage market from historical point of view;
    - The lower liquidity of credit card ABS compared to UK prime RMBS.

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Covered Bonds

Market remains soft

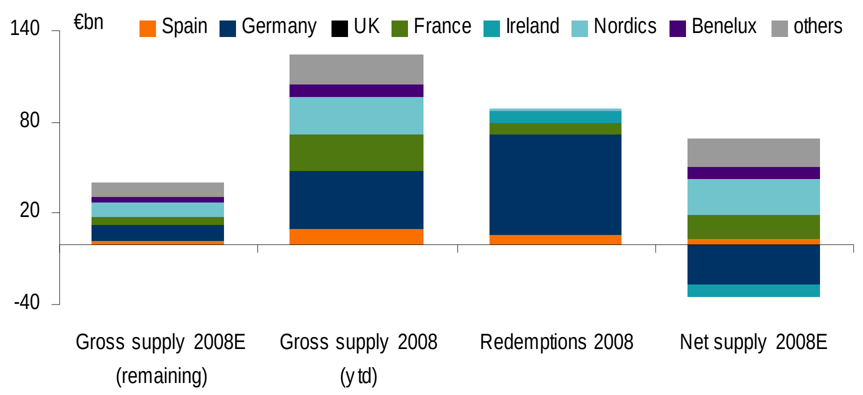
- Jumbo market until the end of August 2008 compared to the same period of 2007

- gross supply:	€84bn versus €112bn
- number of Jumbos issued:	62 versus 75
- number of Jumbo issuers:	44 versus 49
- share of debut issuers:	36% versus 20%

- Jumbo issue pipeline remains well stocked with 21 names; over 30% of the mandated Jumbos may not be launched and priced this year
- Jumbo market in the remainder of 2008 is tilted towards supply; issuers are gearing up to take advantage of any window of opportunity for Jumbo covered bond issues
- Shorter-term issues are more popular than longer-term issues
- Soft-sounding, private placements, and ‘smaller-sized’ Jumbos are in vogue
- Some existing players in the Jumbo market are carrying out ‘legislation arbitrage’
- New players joined or getting ready to join the party in search of attractive funding
- Investors’ appetite for mortgage and structured covered bonds is suppressed

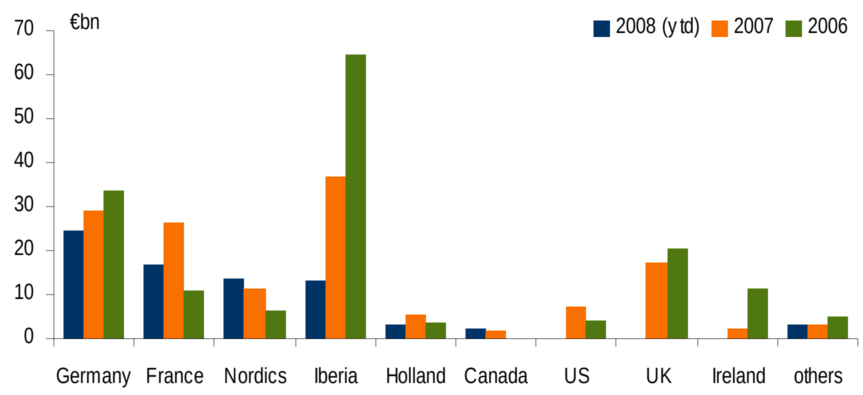
Supply challenges

Gross supply versus redemption of Jumbos in 2008E



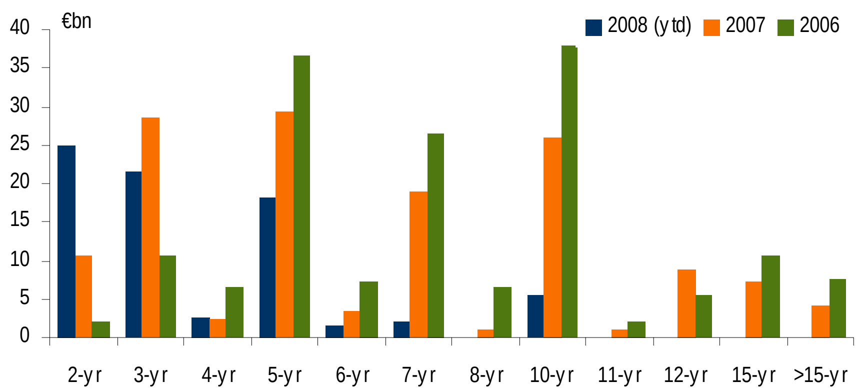
Source: Merrill Lynch

Germany dominates the 2008 Jumbo primary market



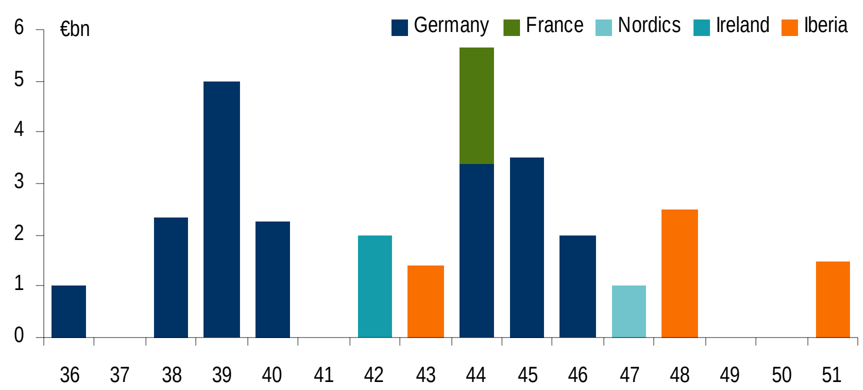
Source: Merrill Lynch

Jumbo issuers' focus on up to 5-year issues



Source: Merrill Lynch

Timing new Jumbo issues around Jumbo maturities



Source: Merrill Lynch

Secondary trading: new standards

- Spread development differs across markets and issuers
  - 5-year €-Jumbo spread widening from end 2007 until end-August 2008:*
    Germany: +10bp, Spain: +55bp, France: +15bp, Ireland: +30bp, UK: +80bp, and US: +200bp
- Spread differentiation between countries has reached all-time wides
- Risk assessment of covered bonds has become increasingly challenging
  - Certain covered bonds increasingly perceived as credit products rather than rates products
  - Crucial to know a product's structural features, its legal foundation, strength of specific law
  - Credit quality of the issuer and soundness of its business strategy became more important
  - Risks related to housing markets and economies, in which bank operates must not be ignored
- Liquidity in the Jumbo market remains relatively low
  - Prices shown on public domains continue to deviate from those quoted by market makers
  - Market started re-pricing outstanding Jumbos on recent new Jumbo issue levels
  - Revised market-making standards for German Jumbo Pfandbriefe
  - Technical changes to EuroCredit MTS to rejuvenate e-trading volumes
- Spreads may widen again if issuers try to exploit the same 'opportunity window'

*** Our spread calculations are based on Reuters' prices. The spreads are generic spreads of 5-year €-denominated Jumbos issued out of the specific jurisdictions. Consider that the calculations for France only consider *obligations foncières* while those for Ireland and Germany consider mortgage and public covered bonds.**

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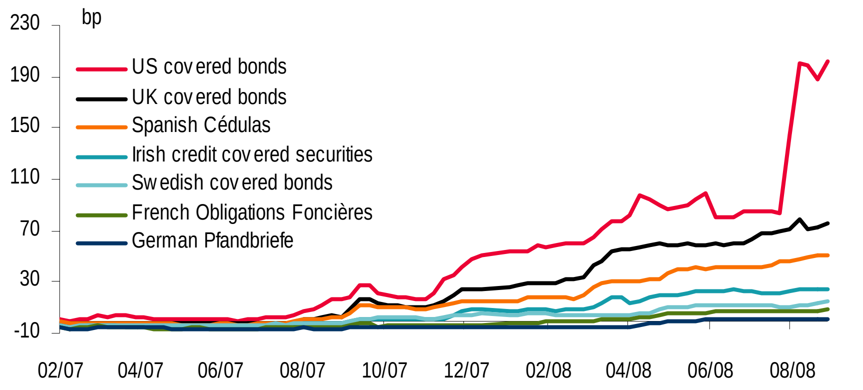
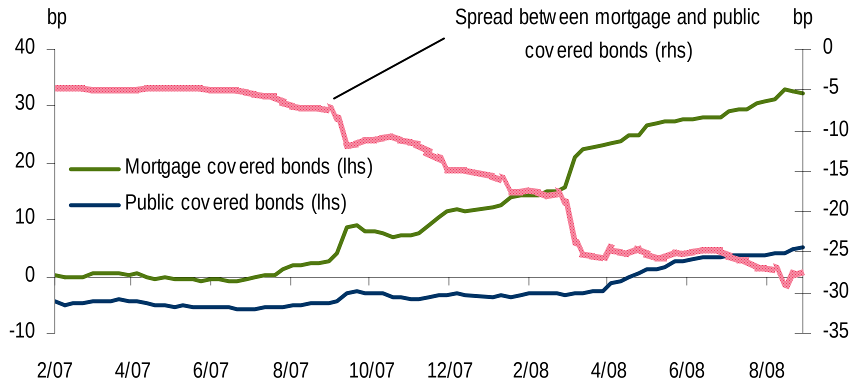
Wider spreads, bigger differentials

Secondary spreads of 5-year €-denominated Jumbos



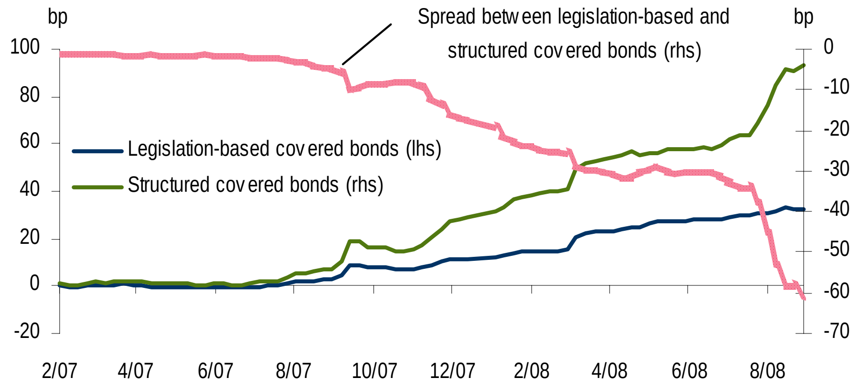
Source: Merrill Lynch

Spread b/w public and mortgage covered bonds



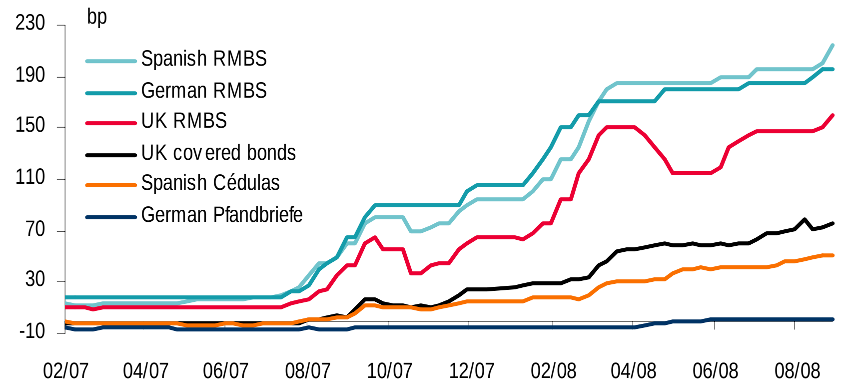
Source: Merrill Lynch

Spread b/w common and structured covered bonds



Source: Merrill Lynch

Spreads of 5-year triple-A rated RMBS and Jumbos



Source: Merrill Lynch

Regulatory changes

- Luxembourg: a closer look is advisable
  - Potential concerns in the market about relatively broad eligibility criteria
- Canada: no specific law but market remains in its infancy
  - OSFI monitors the market and evaluates potential benefits of and/or need for covered bond law
- US: early stages of what could be a promising path
  - US authorities suggest that covered bonds represent a potential additional source of financing
- UK: regulated covered bonds to be launched
  - UK regulator levelled the playing field for UK banks to compete with their European peers
- The Netherlands: no fuss about new covered bond legislation
  - Shortcomings in the new legislation should affect negatively the product’s marketability
- South Korea: creative, but complex
  - Time will tell whether investors decide to take up the innovative South Korean covered bonds
- Japan: covered bond with RMBS features
  - Proposed product is a ‘hybrid’ as it holds features of both RMBS and covered bonds

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CMBS & Corporate Securitisation

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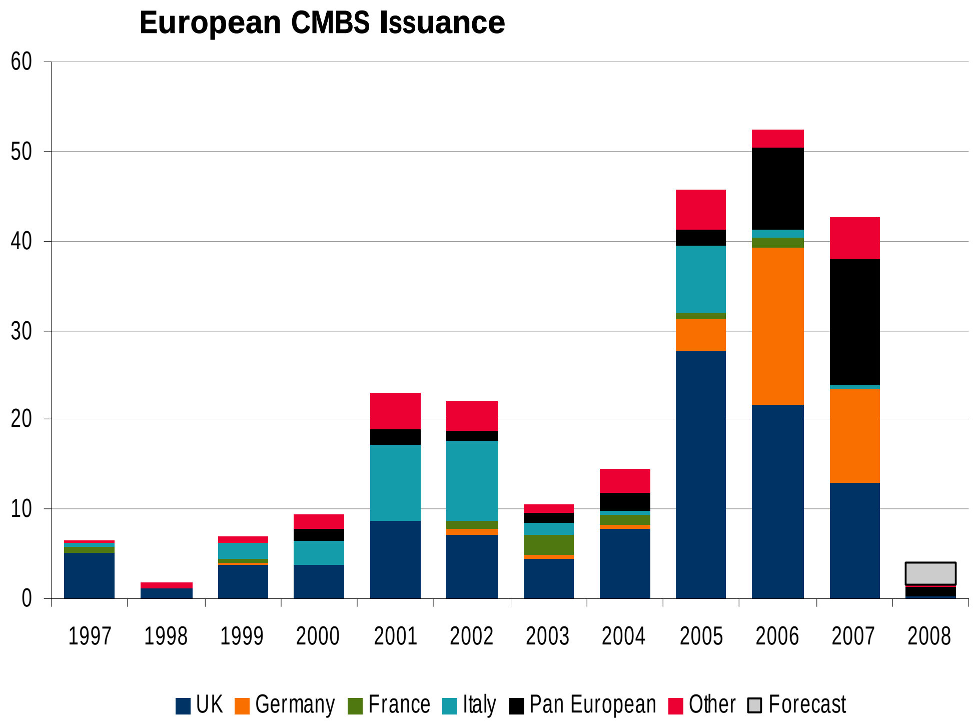
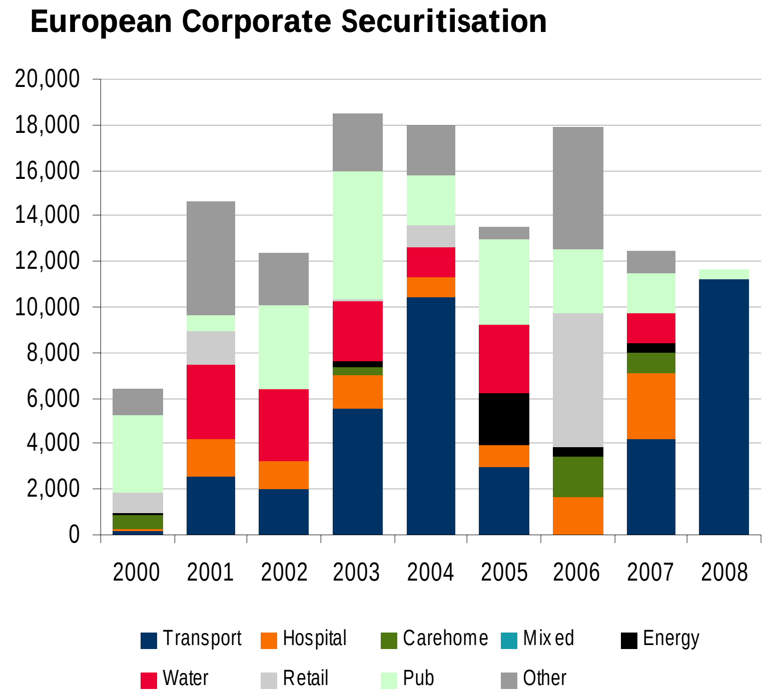
CMBS & Corporate Securitisation Issuance



Source: Merrill Lynch

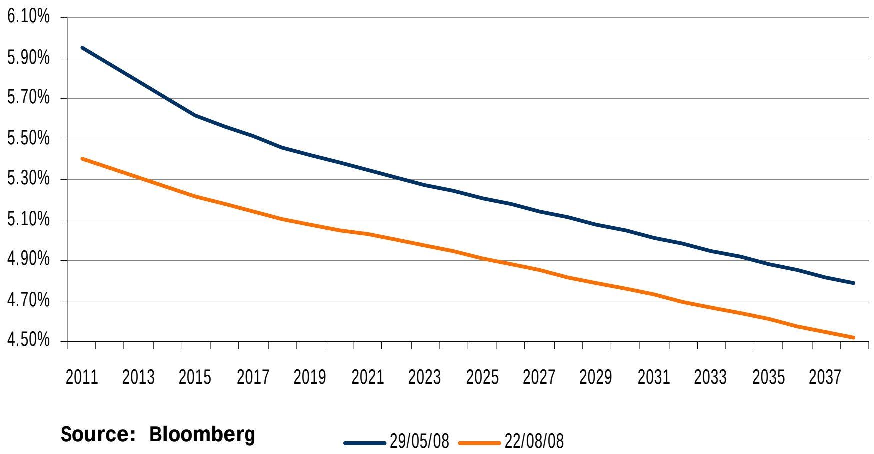


Source: Merrill Lynch

- Most of the minimal CMBS issuance in 2008 has been done for repo purposes.
- The corporate securitisation market was dominated by the €11.2bn BAA refinance…there was no new issuance in this deal just a refinance of existing debt.

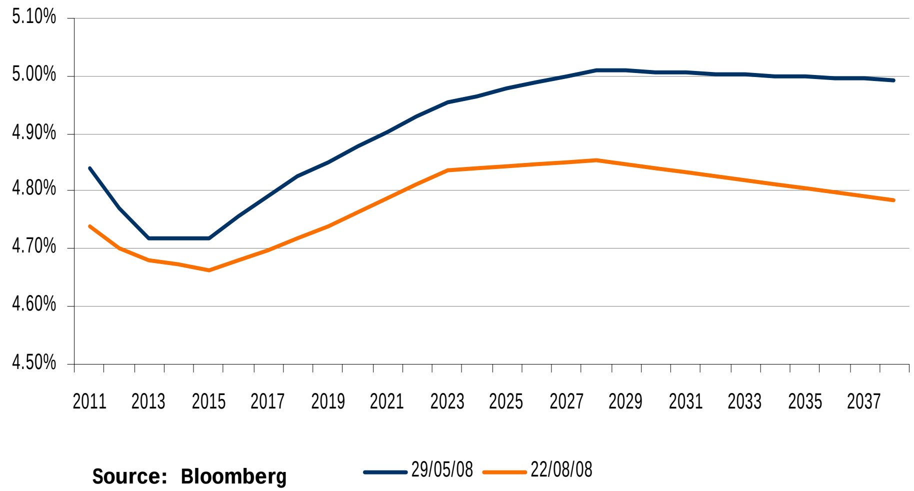
Swap rates: getting over inflation but leverage not available

UK Libor Swap Rate Curve



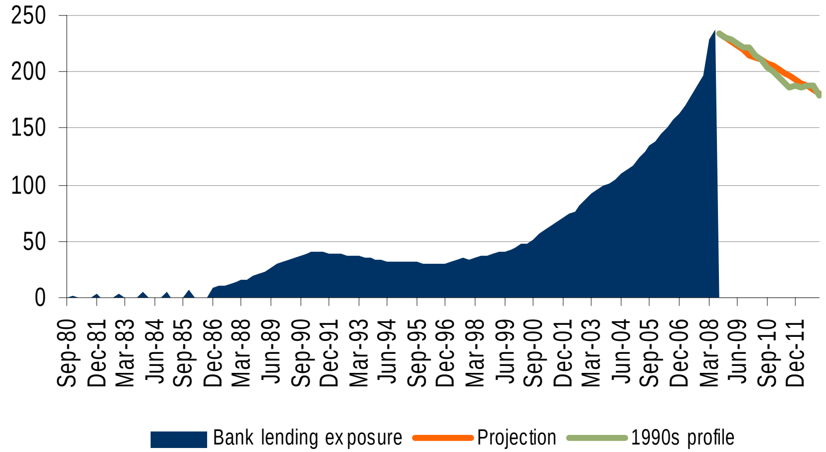
Source: Bloomberg

Euribor Swap Rate Curve



Source: Bloomberg

UK CRE Bank Lending



Source: Bank of England, Merrill Lynch Research

Euro area lending to CRE

	Q4 07 %	Q4 07 €bn
Euro GDP		2,261
European bank lending as % of GDP	272%	6,150
Target level of European lending	210%	4,749
Contraction in lending		(1,402)
% of lending that's CRE	8%	
Contraction in euro area CRE lending		**(112)**

Source: ECB, Merrill Lynch

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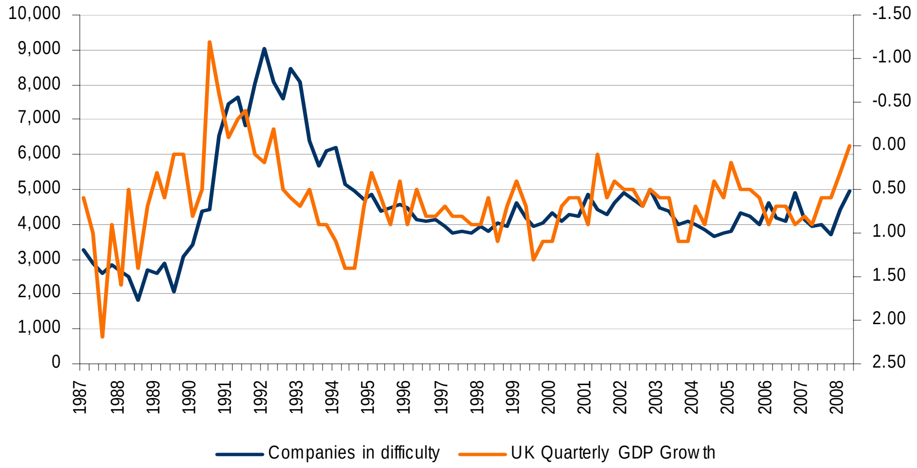
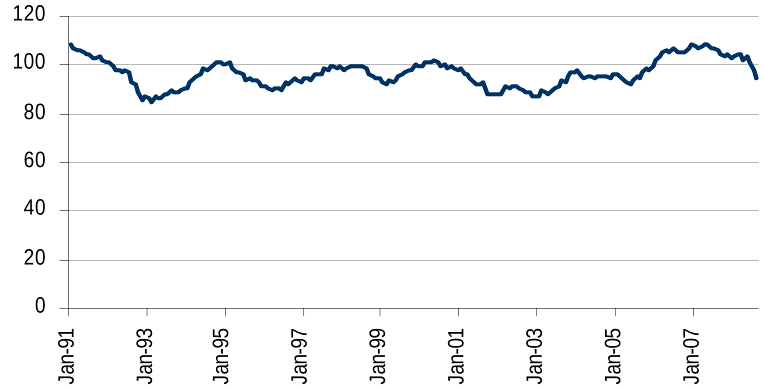
European fundamentals – generally bleak

Companies in difficulty versus UK QoQ GDP

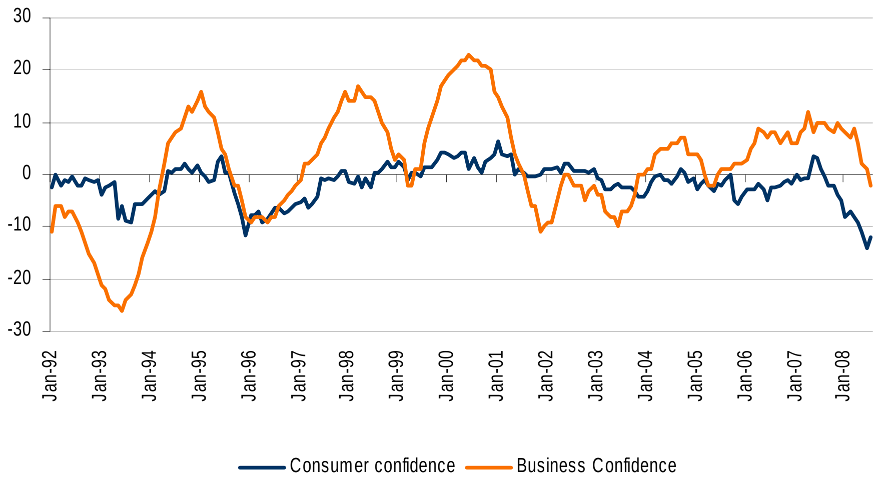


German IFO Business Climate Index



Source: IFO Institute

Diminishing French Consumer & Business Confidence



Source: European Commission, Insee

Spanish Retail Sales

Source: Datastream, Merrill Lynch

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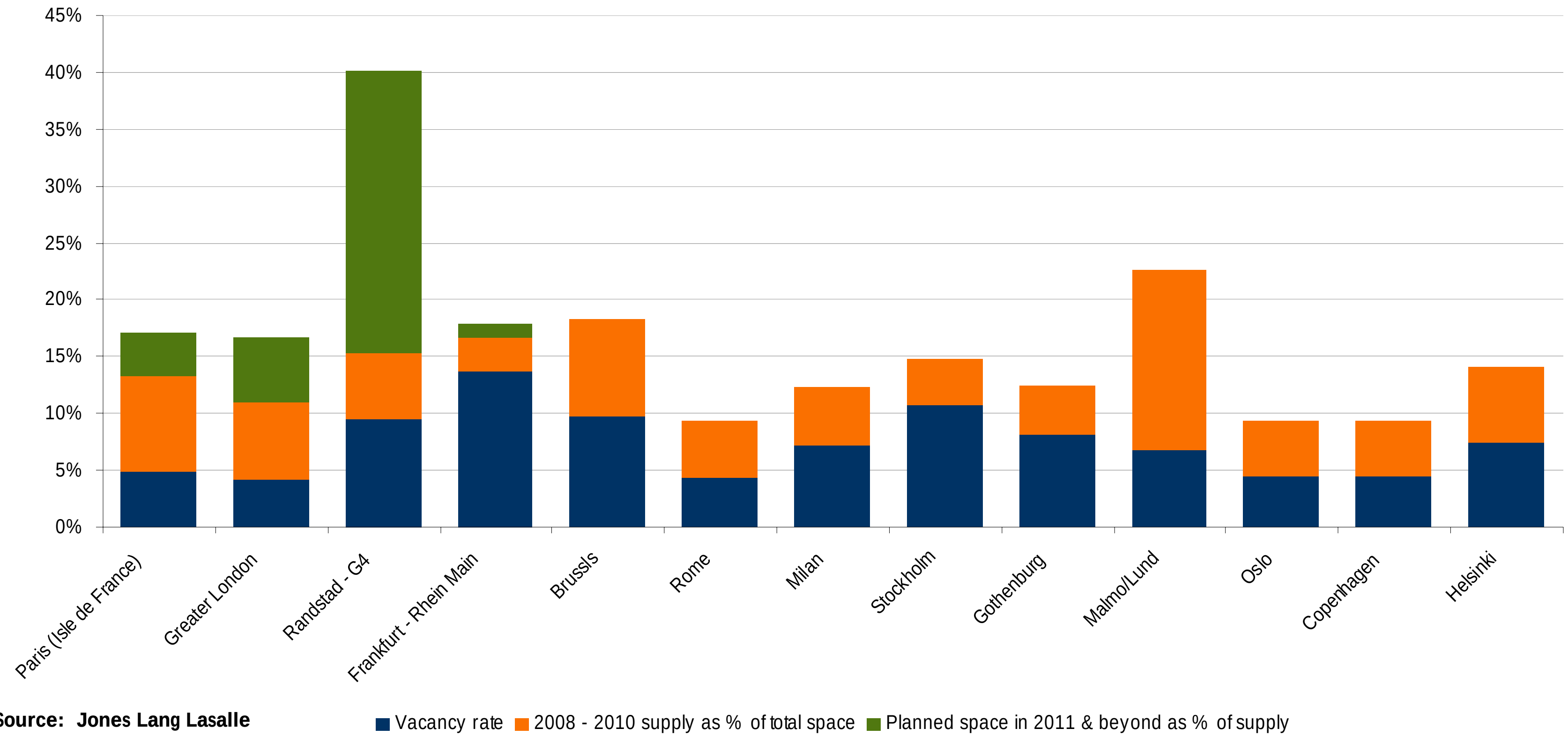
European office vacancy rates with forthcoming supply



Source: Jones Lang Lasalle

- Randstad has a substantial amount of planned space which is unlikely to be built
- Isle de France office market has a greater amount of supply in the pipeline than London
- Frankfurt has relatively limited supply coming but it is still shaking off its ECB hangover
- Brussels has the largest space due by 2010, historically corporates have taken 70% of space not public institutions
- Malmo / Lund looks like it might struggle
- Oslo, Rome and Copenhagen may be the potential safe havens

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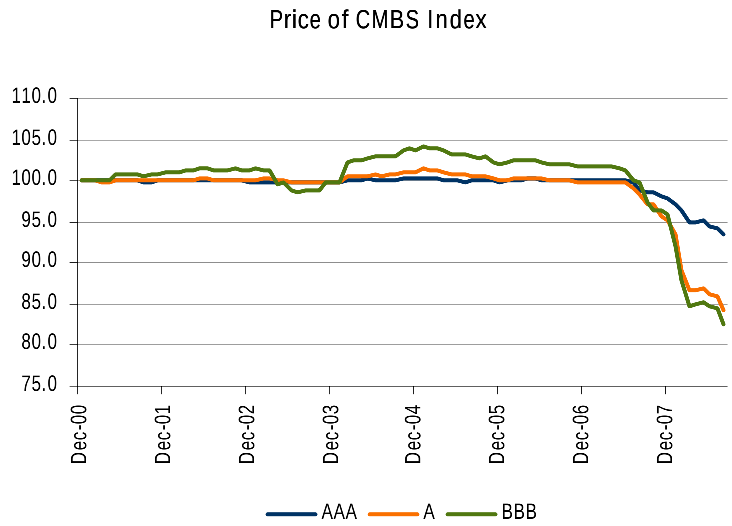
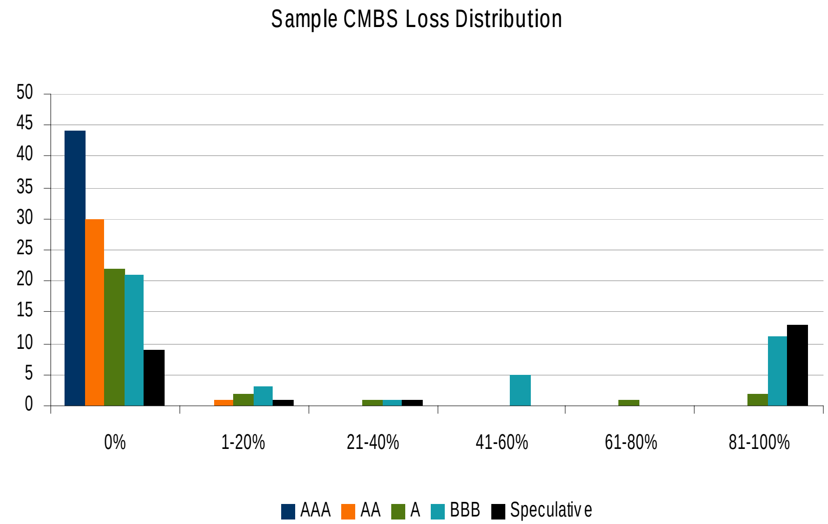
European CMBS - potential value lower down the capital structure





- Expected loss distribution indicates value for some juniors given our BBB CMBS price index value of 82, subject to the usual concerns.
- More deals entering either special servicing or the watch-list as c. 4.5% of loans on watch list
- Issues with enforcing the security to become clearer as we expect some to test the courts
- Forced sales could drive values lower, spreads wider and result in loan losses. Even portfolios with long term leases to good quality tenants may find themselves on the receiving end of forced sales & losses

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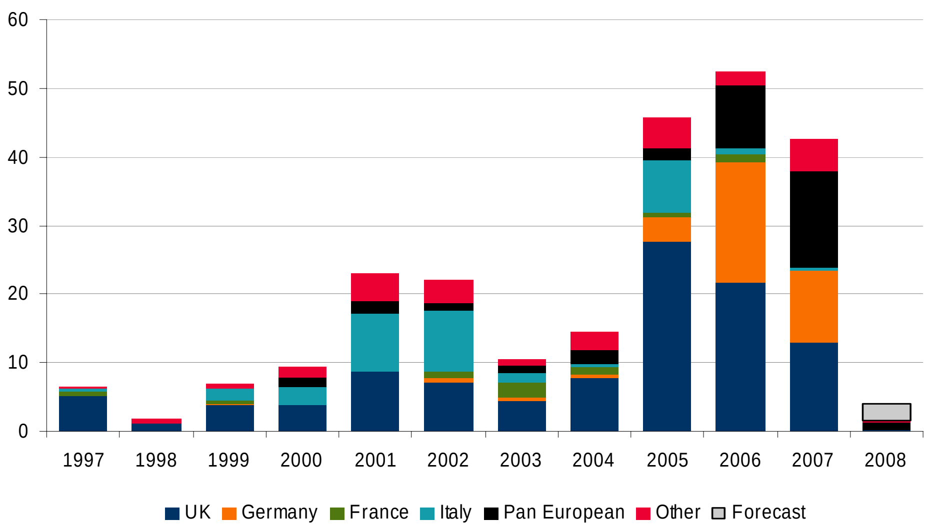
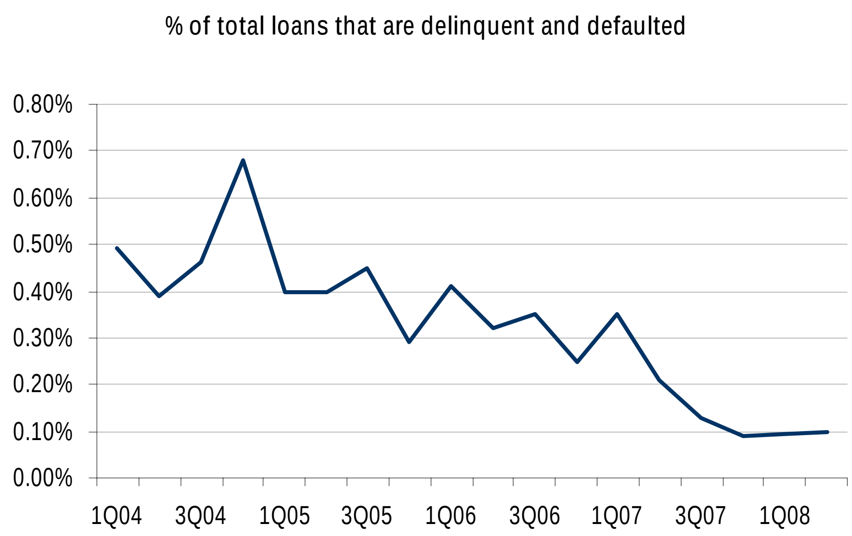
European CMBS - Issuance



Source: Merrill Lynch



Source: Standard & Poors

- Issuance so far is €1.5bn in 2008 which is down from €40bn over the same period in 2007
- Delinquencies on CMBS loans continue to be low, but increasing number of loans now in special servicing suggests its only a matter of time before delinquencies increase markedly

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Secondary market limited, but could begin to open up

- Secondary trading could be kick-started by further distress:
  - The expected increase in downgrades may result in forced sellers with rating restrictions in place
  - The risk return profile has shifted away from investment grade bond prospects to equity lower down the capital structure – real money accounts are not the natural players in this market.
  - Leaving the market to hedge funds, investment bank prop desks and others of a similar ilk
- We continue to expect spreads to widen across the capital structure as the negative newsflow continues
- Pools of liquidity are developing in corporate backed paper
- Investment banks looking to offload their assets
- The CDS market continues to be more liquid
- Expect real money accounts to only consider investing in new primary, which is unlikely to occur until H2 2009

Long trades

- Early prepayment from change of control such as Talisman Priory provides high return over shorter period of time
- Prepayment from enforced sale of assets following covenant breach, LTV breach is the most likely at the moment but insolvency of the borrower is starting to cause more events of default
- CMBS transactions with loans maturing in 2008/09 that are almost certain to pay: Titan 2007-2 (2 loans maturing before Apr 09 represent 52% of the pool with LTV's of 44.1% and 67.4%). Sell protection / long cash
- Quality names with experienced sponsors: Opera Metro and Opera Lakeside
- Transactions with low LTV's and tight covenants: Real Estate Capital Foundation 44% Advance rate to AA with LTV covenant of 55%
- Current EPRA index levels indicate a dividend yield of c4.75%. Whilst A and BBB returns are 11% to 15% respectively.
- Prepayment adds significantly to return expectations.
- Spread tiering to emerge potentially in corporate/ single borrower CMBS

Corporate Securitisations

- Long Mitchell & Butler, Marstons and Greene King bonds: quality estate with spreads of 250bps+ at BBB. Free-cashflow decline of circa 45% required before deal misses interest and principal payments
- Switch from Punch Taverns Finance class B1 and B2 to Unique class M. Both rated BBB+ but the class M notes in Unique need consent for new leverage
- Spirit issuer BBB at 500bps +. Rating recently reduced from BBB+ which prevents ability to tap.
- Uk Care No. 1 (Merrill Lynch transaction) closed in 1998 and very underlevered. Not possible to raise further leverage without prepaying the existing bonds
- CPUK Mortgage Finance…LTV of 55% at BBB+ level, legal final maturity of Oct 2018 and no ability to raise debt which ranks senior or pari passu to the noteholders.
- Arsenal Stadium Financing: no new debt that ranks senior or pari passu, potential issues with the monoline as controlling creditor
- Following the partial refinance of BAA: bonds could tighten in from 300bps over gilts to 200bps and still have a premium over water. Regulatory risk on water is ramping up…possible switch trade from water to BAA

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Global CDO

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CLOs

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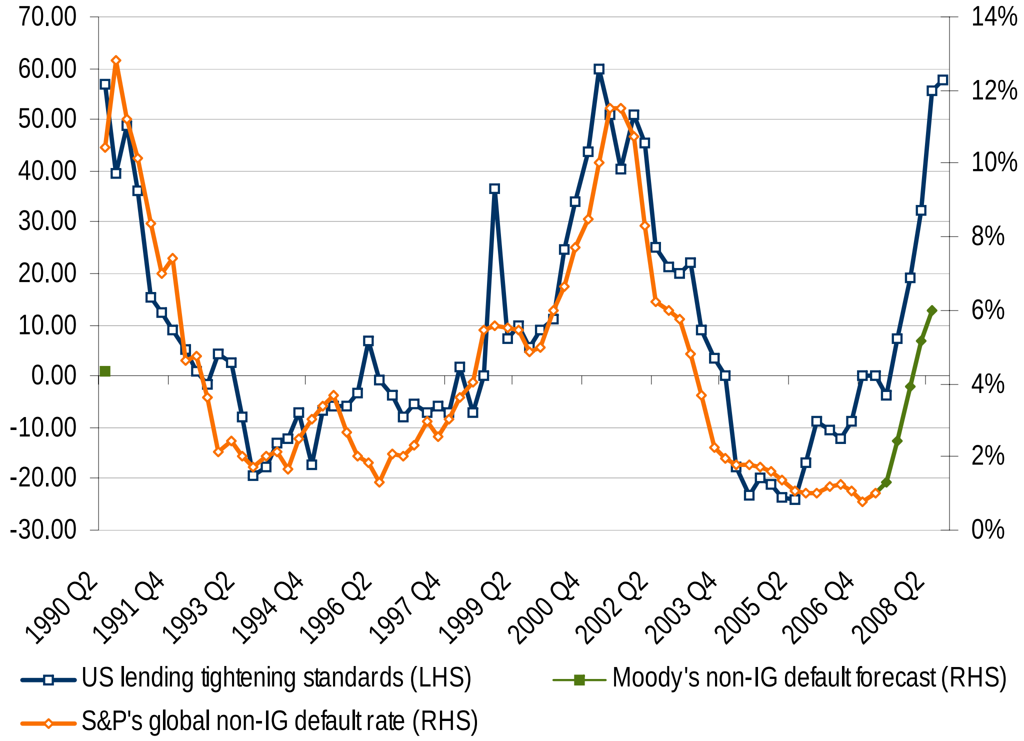
Corporates: liquidity issues morph into credit problems

- Lending criteria continue to tighten from their already narrow base …
- … this is starting to feed through to corporate defaults - and will likely continue to do so



Source: Federal Reserve, Moody's, S&P

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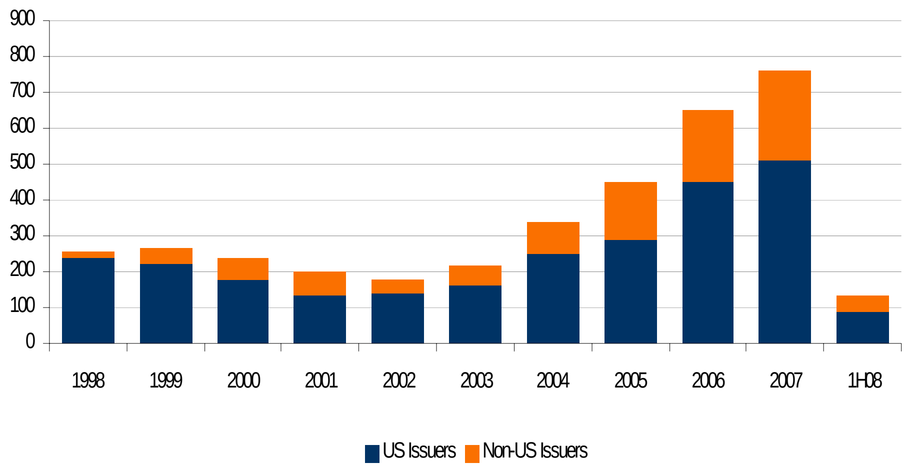
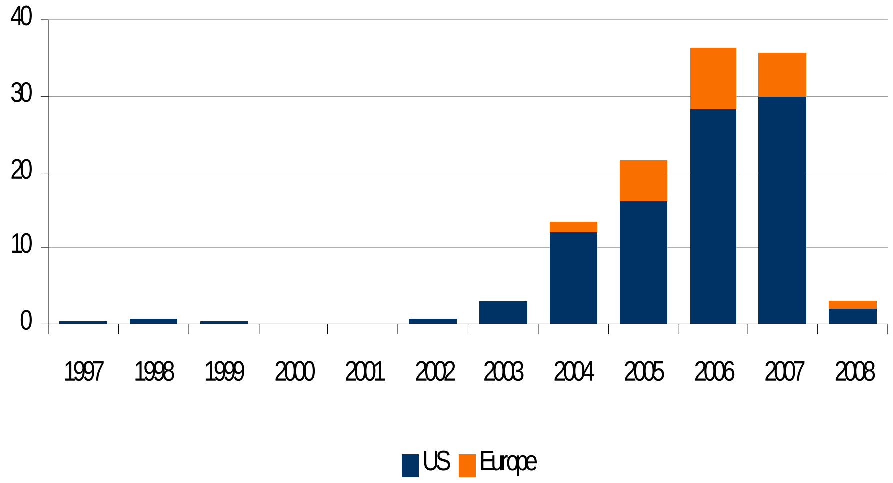
Leveraged loan market reversion - slow issuance, but safer credit terms

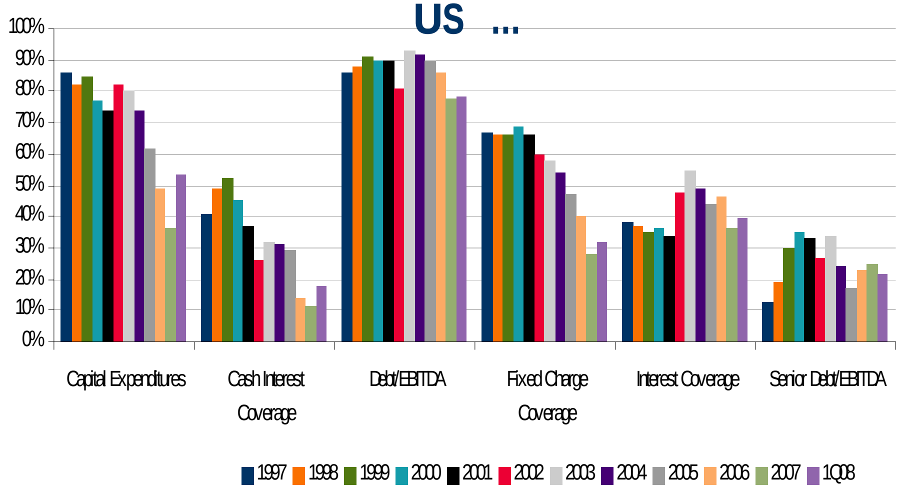
Senior loan issuance



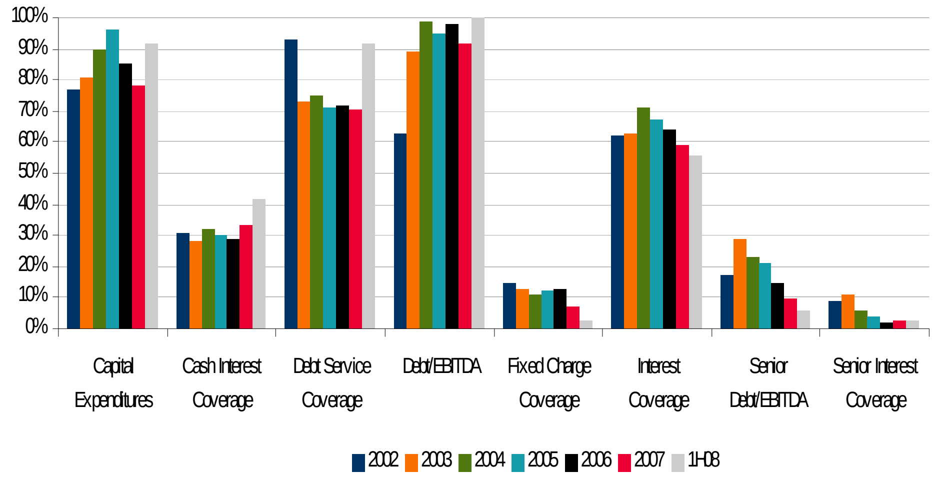
2nd-lien loan issuance



Covenants use increase across the board in US …



… as well as in Europe



Source: S&P LCD

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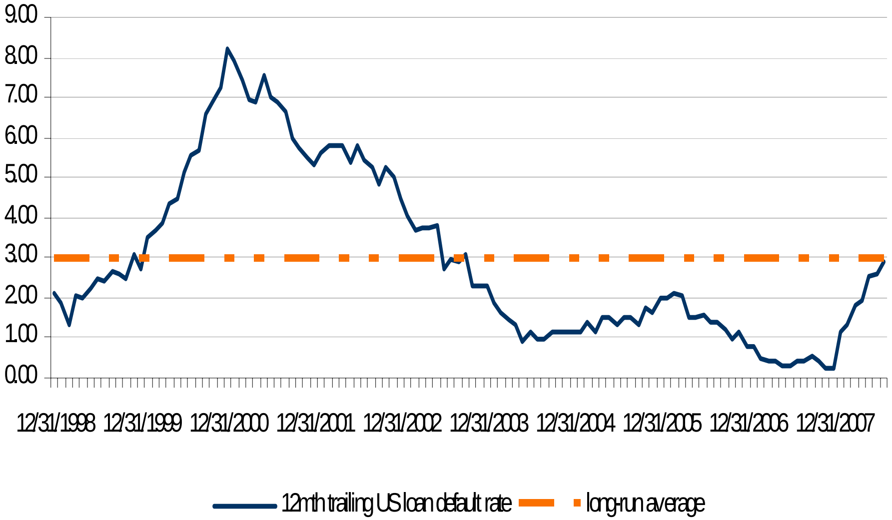
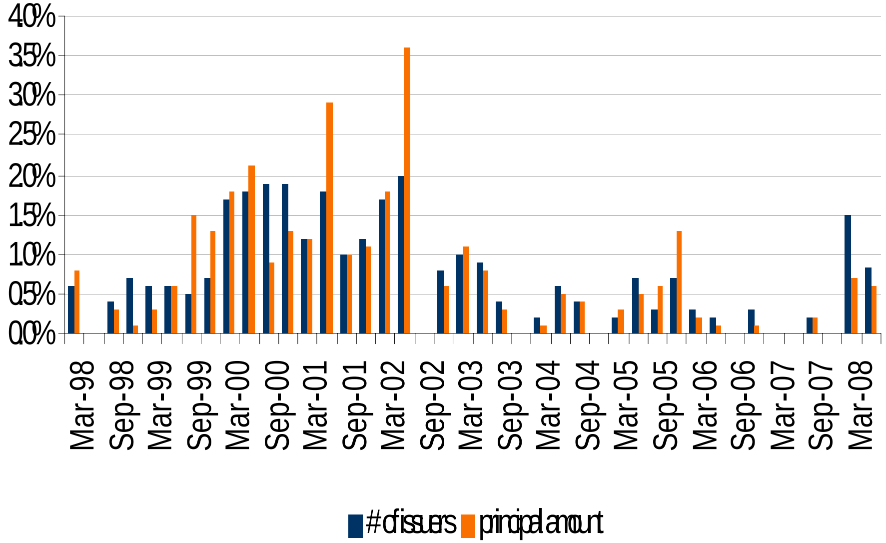
Loan defaults creeping up

- Loan defaults reverting to their long-term mean
- The rise is more pronounced in issuer-based default rate, indicating smaller borrowers struggle more

12 month trailing US loan default rate



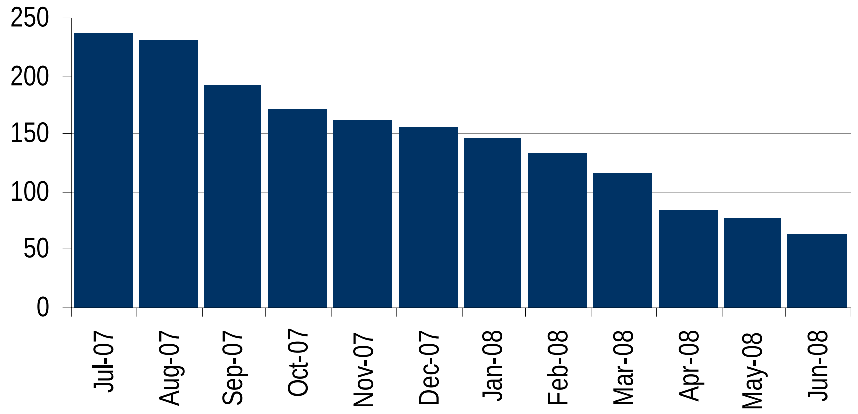
Quarterly US loan default rate



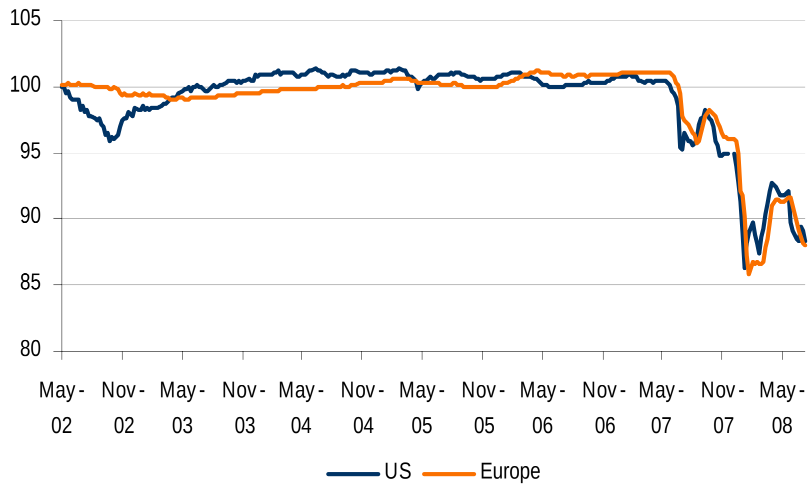
Source: S&P LCD

2007 overhang slowly sorting out, but dragging prices lower

US loan overhang



US and Europe flow name prices



Source: S&P LCD

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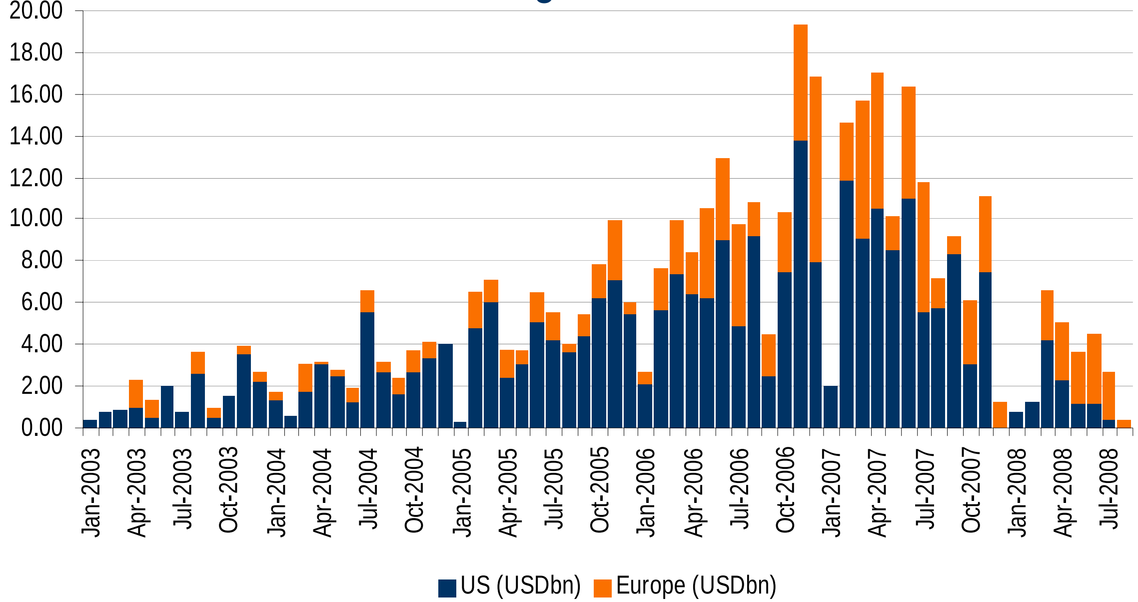
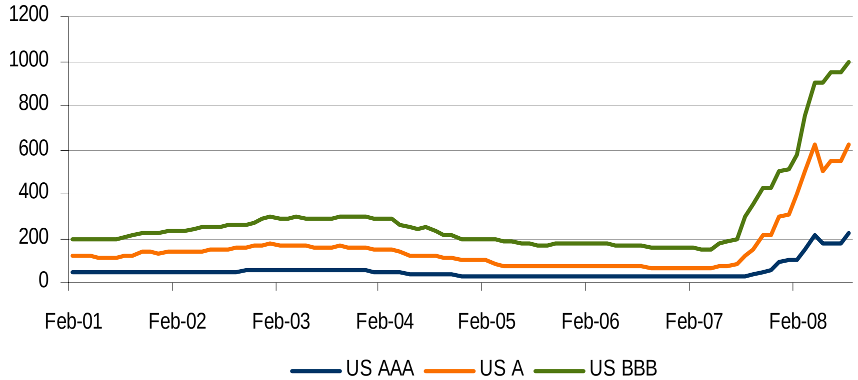
Leveraged loan CLOs: issuance at 4yr low, spreads at historical wides

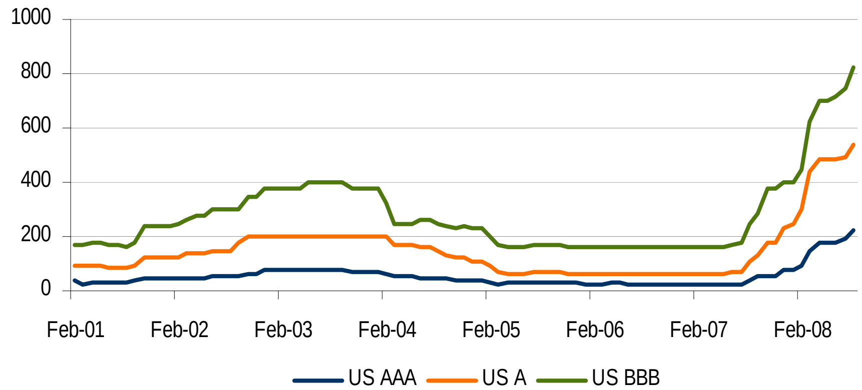
Global leveraged loan CLO issuance



US CLO secondary spreads



European CLO secondary spreads

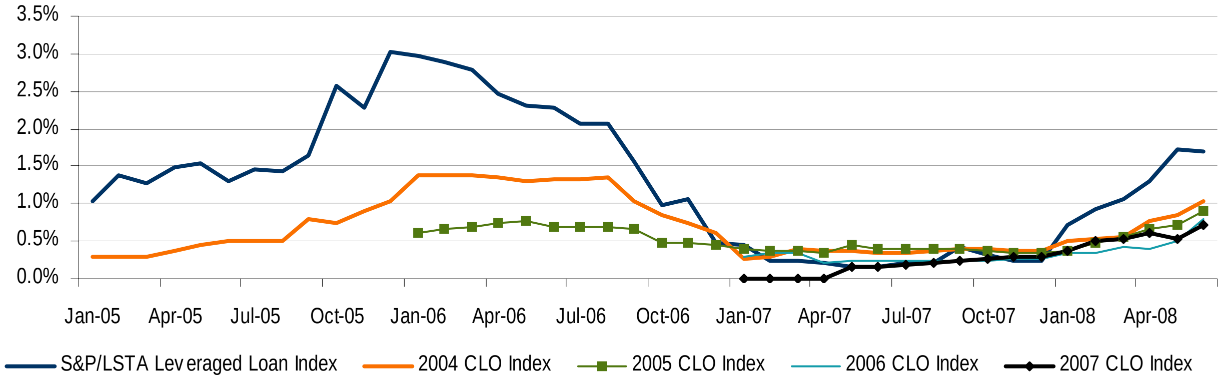


Source: Merrill Lynch

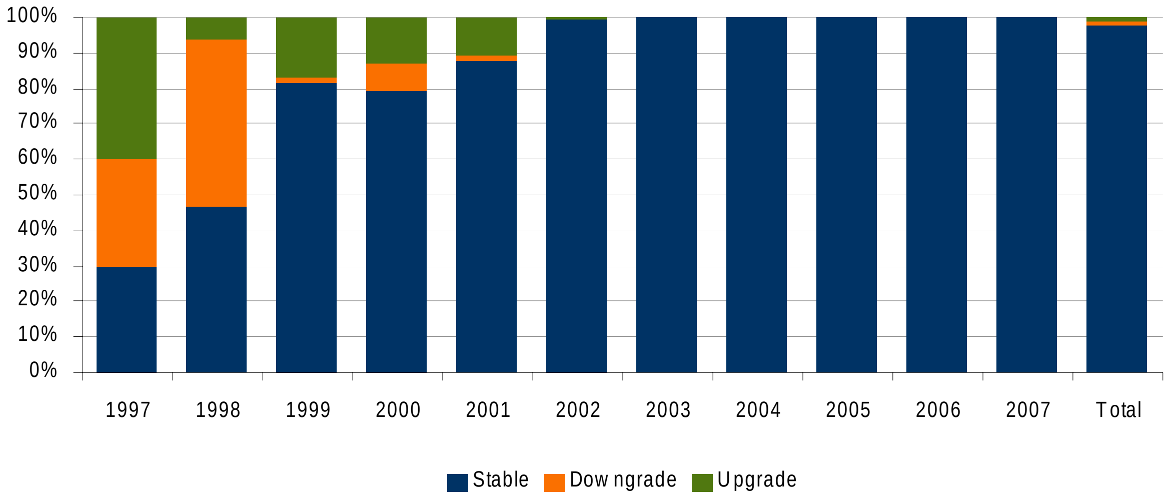
Leveraged loan CLO performance good but no longer perfect

- Leveraged loan CLO defaults increase, but outperform the broad market so far
- Rating stability remains excellent, but the first cracks (rating watch, some downgrades) are starting to appear for junior notes in US CLO

US CLO default rate versus S&P/LSTA index



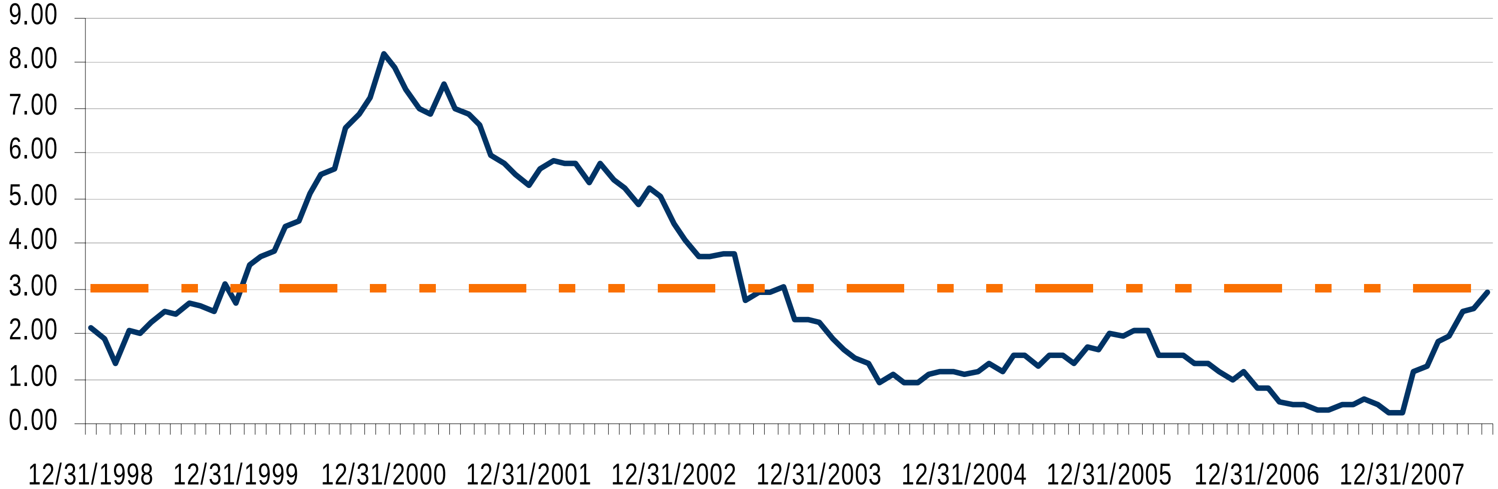
Historical rating stability performance



CLO: adverse loan performance, pressure on spreads, but senior debt well protected

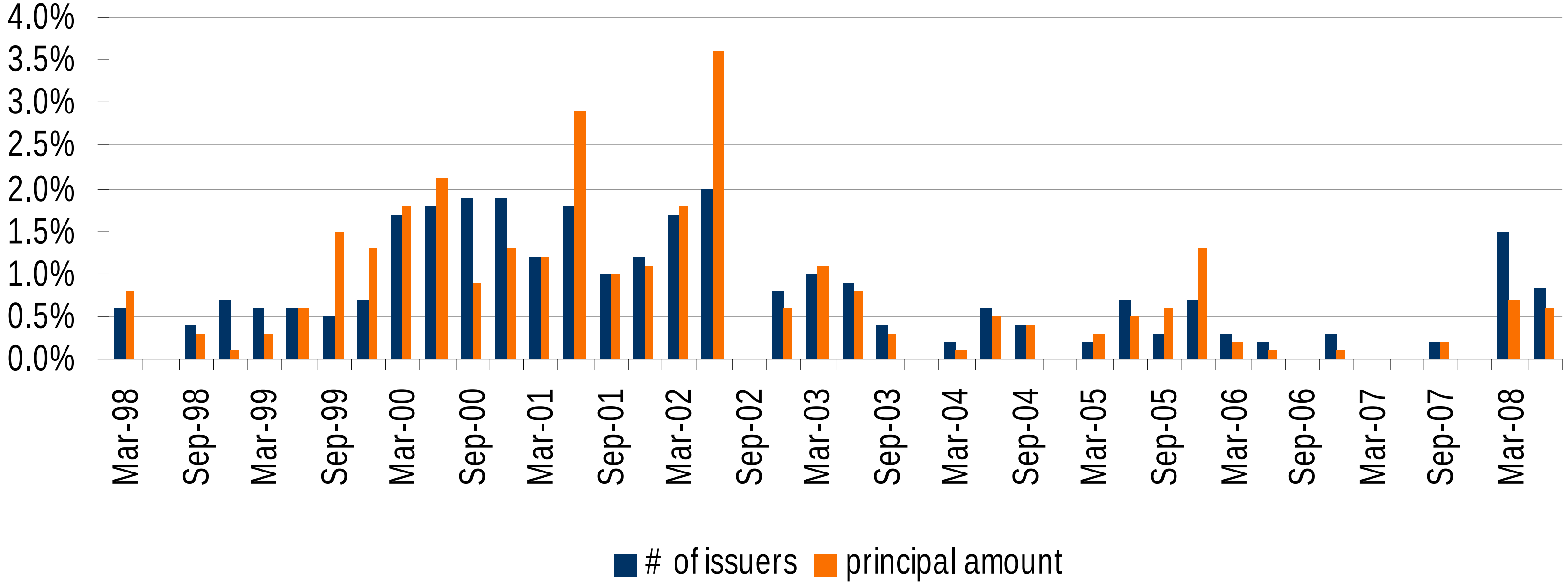
- Adverse loan performance is likely to affect CLO credit quality going forward
  - Higher defaults
  - Lower recoveries (resulting from looser covenants)
  - Slower prepayments (resulting from tighter credit, poor liquidity)
- But senior CLO notes are well protected
  - Sequential payment structure
  - AAA enhancement consistent with entire pool defaulting (recovery 70%, waterfall notwithstanding)
  - Cash-flow diversion upon coverage test failures

US 12mth trailing default rate reverting to long-run averages



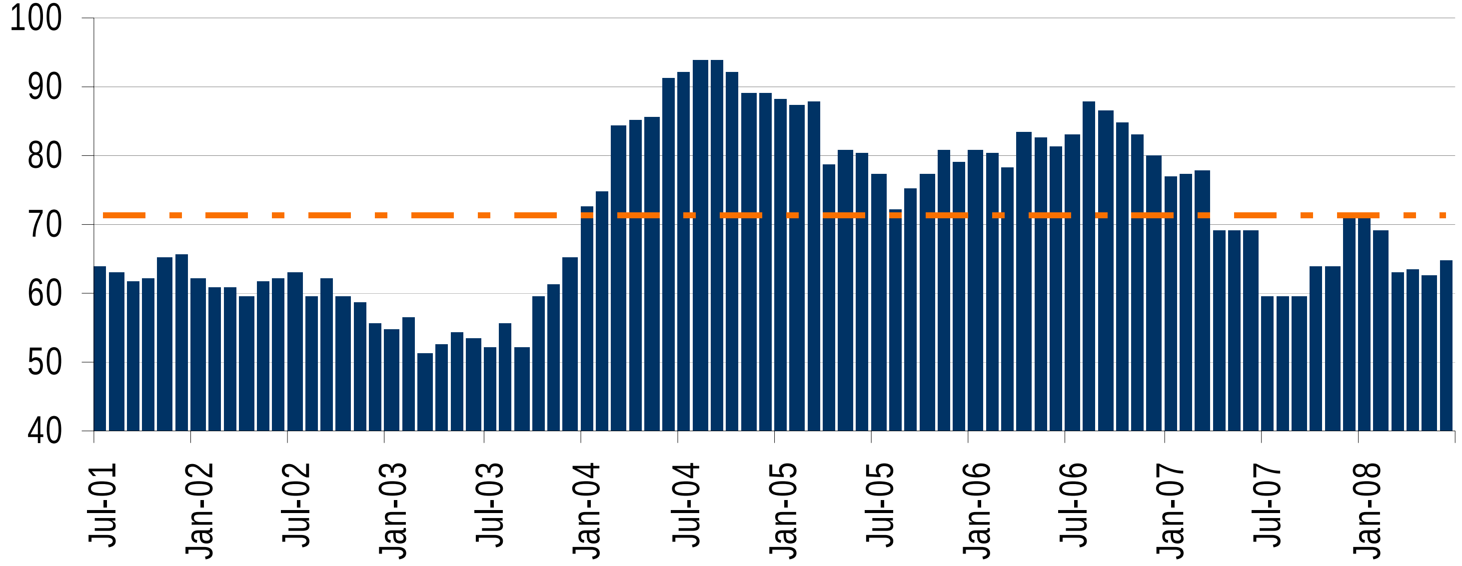
Source: S&P

US leveraged loans quarterly default rate – back to '03 run-rate



S&P LCD

12-Month Trailing Defaulted Bond Prices



Source: Moody's

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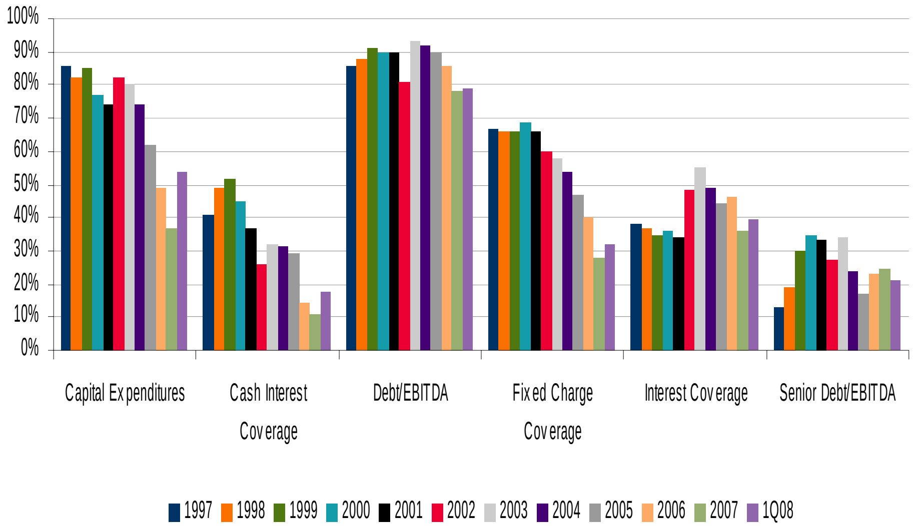
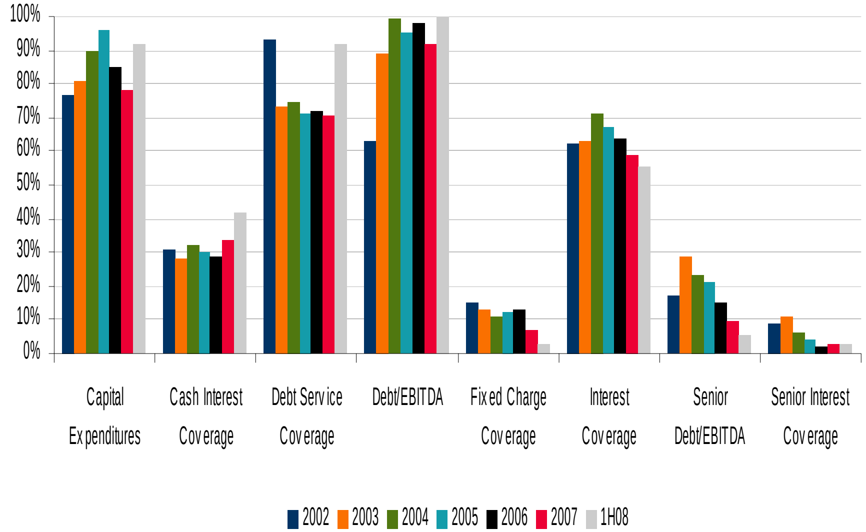
Key drivers of lower recoveries: looser covenants will delay defaults

Key covenants use in US first-lien leveraged loans*



Key covenants use in European 1st-lien leveraged loans*



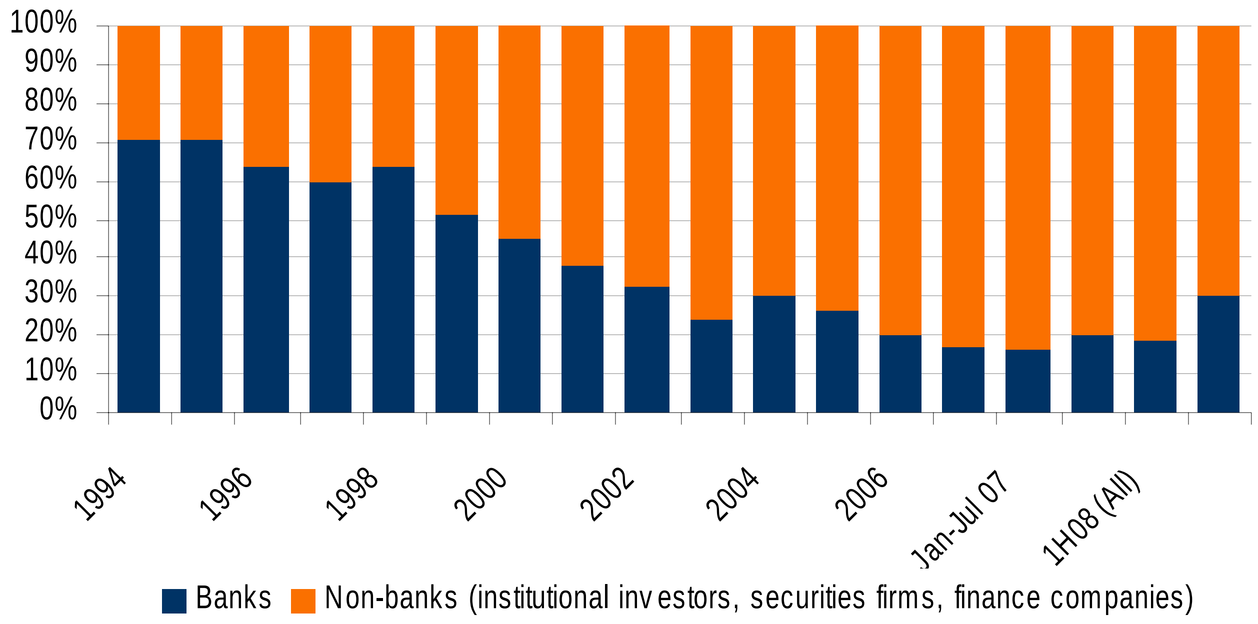
Source: S&P LCD

* ex cov-lites

Key drivers of lower recoveries (2): switch in loan investor base

- Institutional investors have gradually overcome banks as the largest loan investors
- This different investor base may have a lesser ability (and willingness) to cure troubled loans

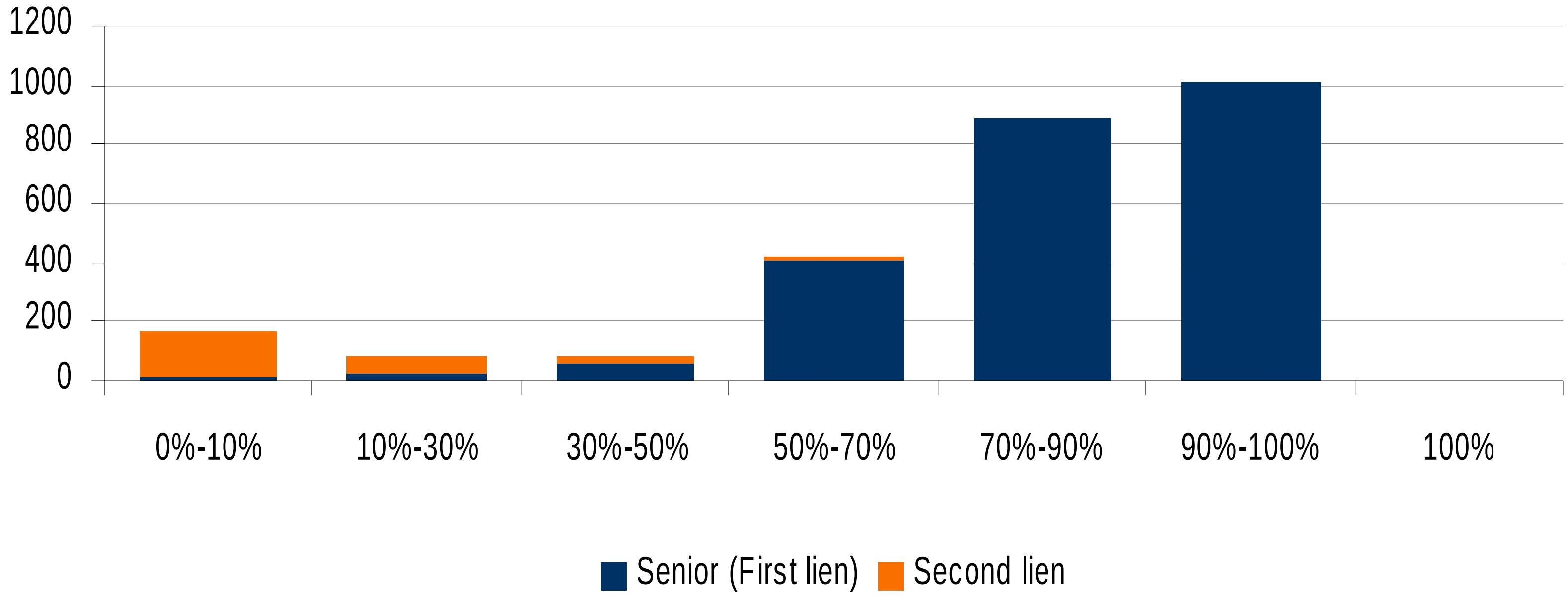
Banks vs. non-banks loan market share



Source: ML

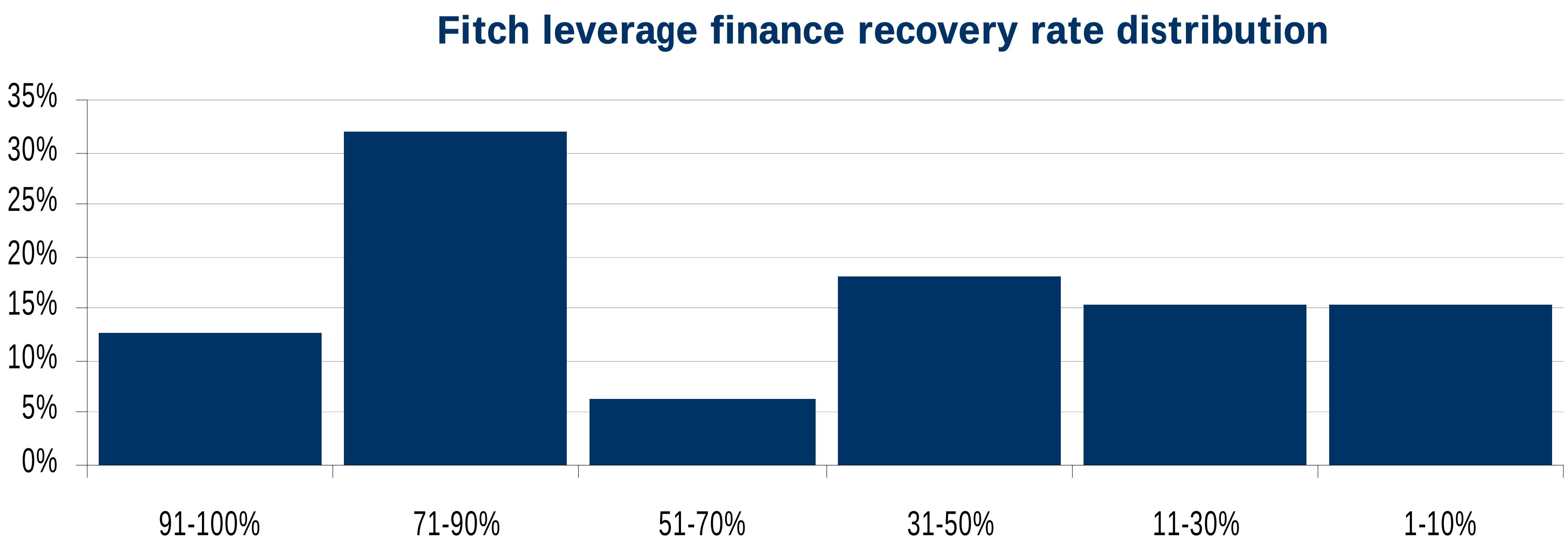
Key drivers of lower recoveries (3):
2nd lien / mezz record issuance of past years

Expected recovery on secured exposures to speculative grade borrowers



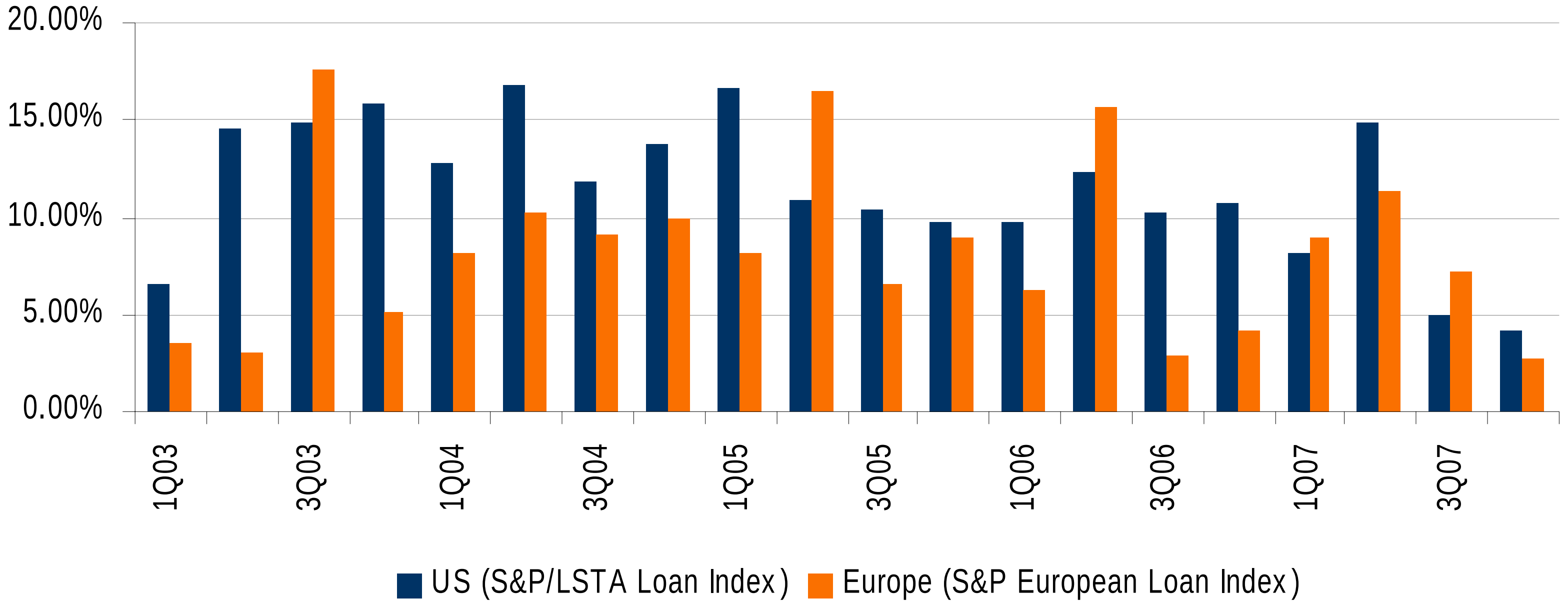
Source: S&P, data as of October 2007

Recoveries likely to come lower on average, with deep outliers



Source: Fitch

Loan repayment rates down to a 6-year low



Source: S&P LCD

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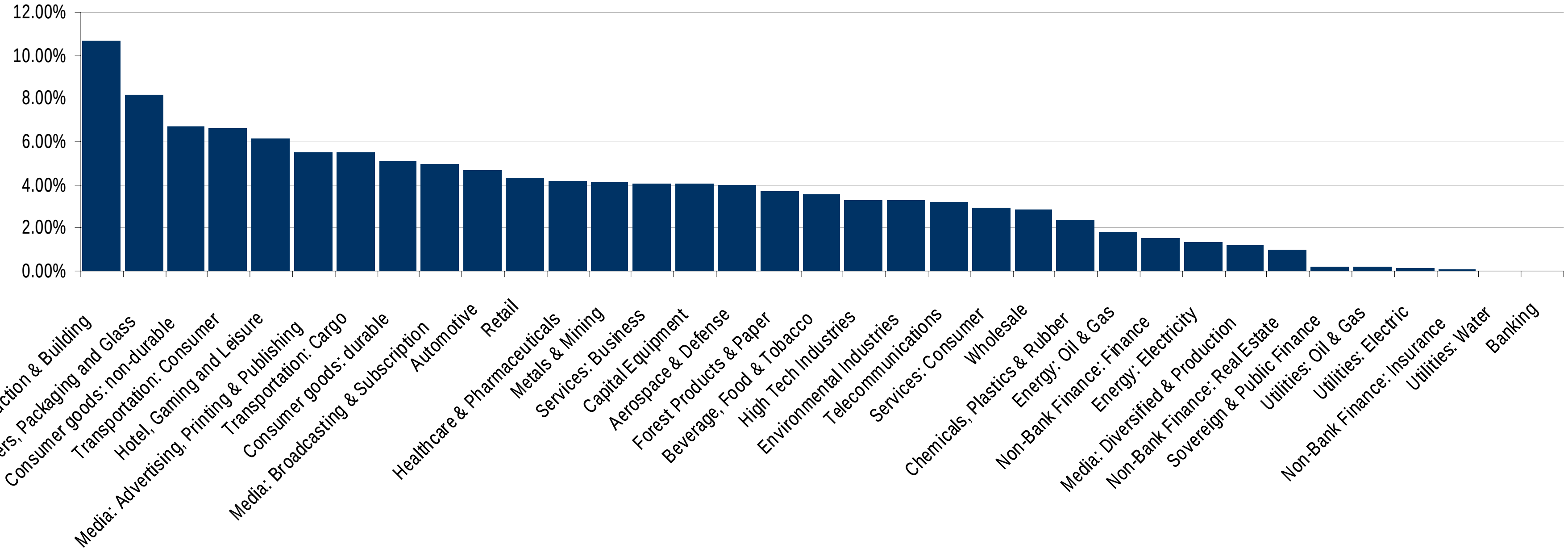
Industry view - US

Moody's 1YR default forecast per industry - US



Source: Moody's

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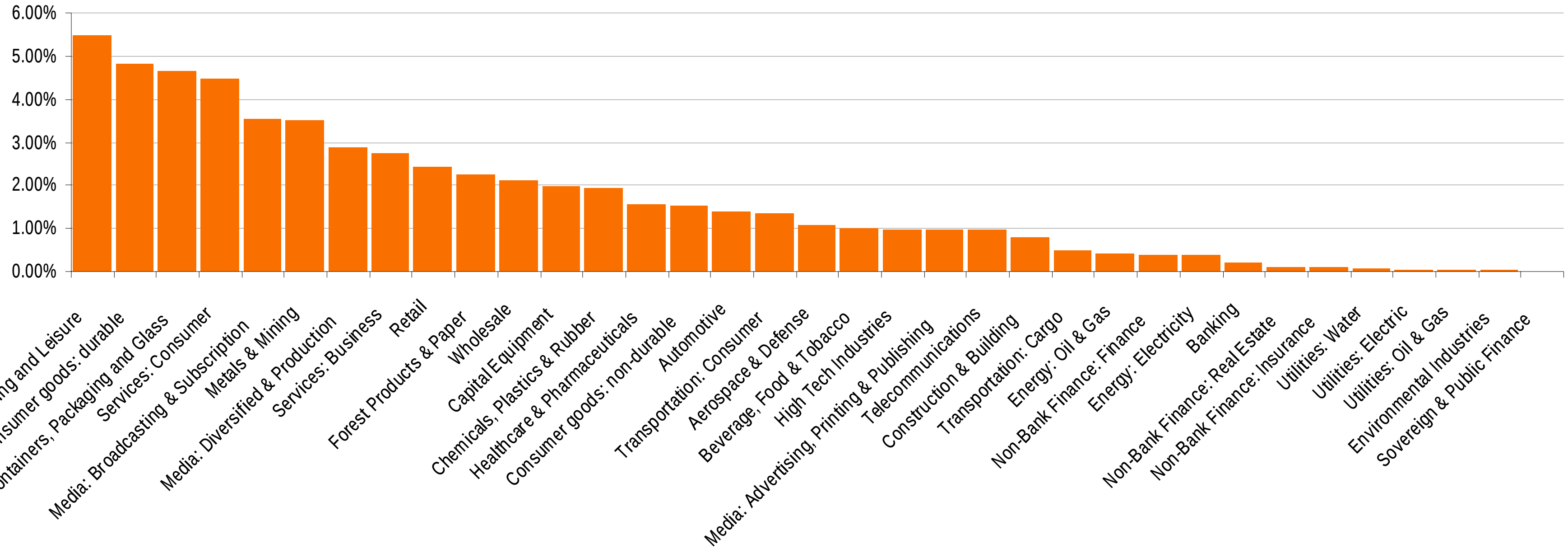
Industry view - Europe

Moody's 1YR default forecast per industry - Europe



Source: Moody's

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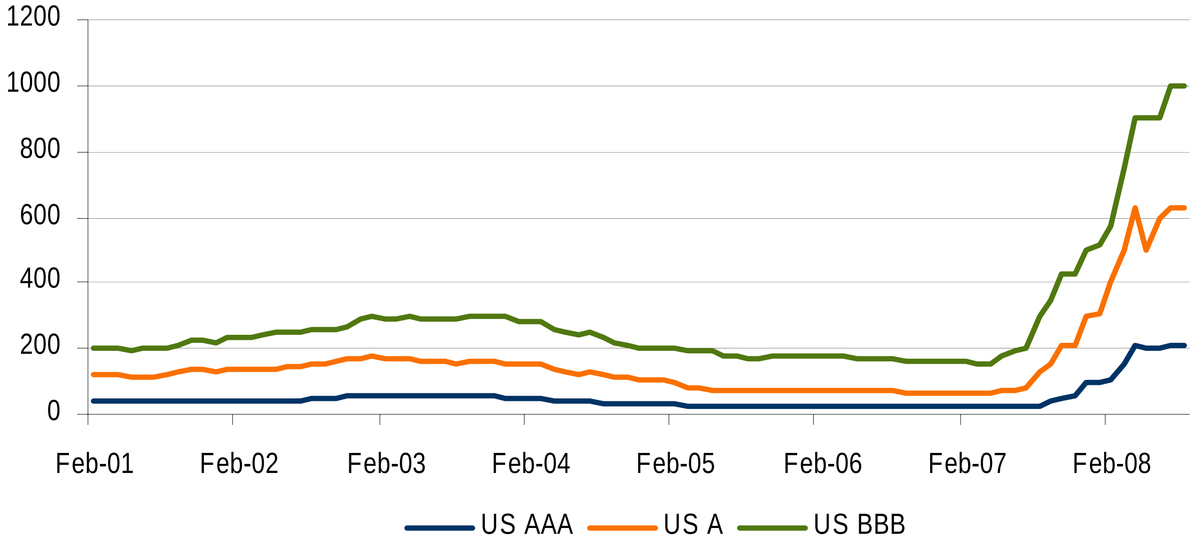
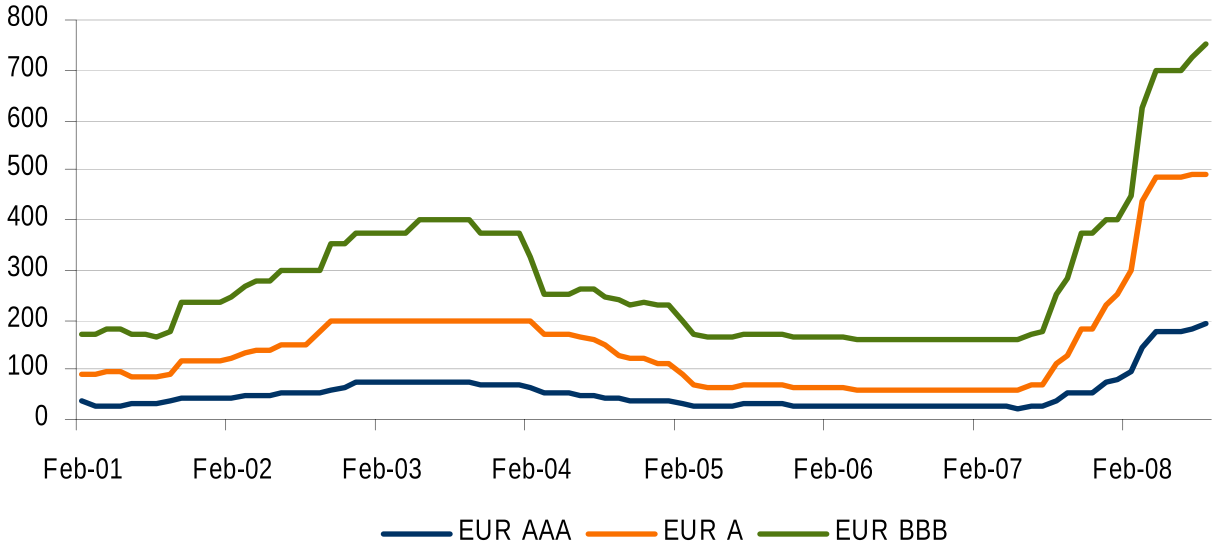
CLO debt spreads keep drifting wider

US



Europe



Source: ML

Outlook

- Cumulative loan defaults to match previous cycle – circa 30% over 5YR
  - Due to longer time to covenant breaches, peak annual default may be lower than 00-03
  - But lags likely to bring longer tails to the default cycle
- Same default rate, lower recoveries: higher losses
  - Weak lending standards, overcrowded claim on assets, and a growing non-bank investor base all contribute to much lower recovery prospects
  - Mid-50% average recovery expected, with much lower prospects for non 1st lien
- Key mitigants
  - CLO collateral default rate may overperform broad loan market (ability of the manager to go underweight key sectors, names)
- Key risks
  - Aggressive pool composition in certain deals: high 2nd lien / mezz, high cov lites exposures, names overlap acorss deals
  - Low prepayments reduce CLO managers' reinvestment opportunities

Despite poor collateral outlook, CLO senior debt remains well protected

Breakeven default rates for lev loan CLO (under 50% recovery assumption)

Tranche	CADR to first $ of loss	CADR to interest deferral
AAA	14%	17% (YR 8)
AA	12%	12% (YR 11)
A	10%	9% (YR 5)
BBB	8%	7% (YR 6)
BB	6%	5% (YR 4)

- CADR to first dollar of loss remains very elevated for AAA to A tranches
- Under our current collateral assumptions, BB / equity appear at risk – especially the temporary interruption of coupon payment upon coverage tests breaches
- BBB appears sound, but a more stressed loan outlook could change that view
- Default timing is key
  - All other things being equal, front loaded defaults favour senior tranches, as tests are breached early, and excess spread is kept in the structure
  - Conversely, back loaded defaults favour junior debt and equity, as they keep receiving coupons and excess spread, thus improving return profiles

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Synthetic CDOs

IG corporate credit rally peters out …

- The Q2 rally in corporate credit ran out of steam
- Levels are now significantly wider than April/May local bottom, albeit not at March levels yet

European CDS indices

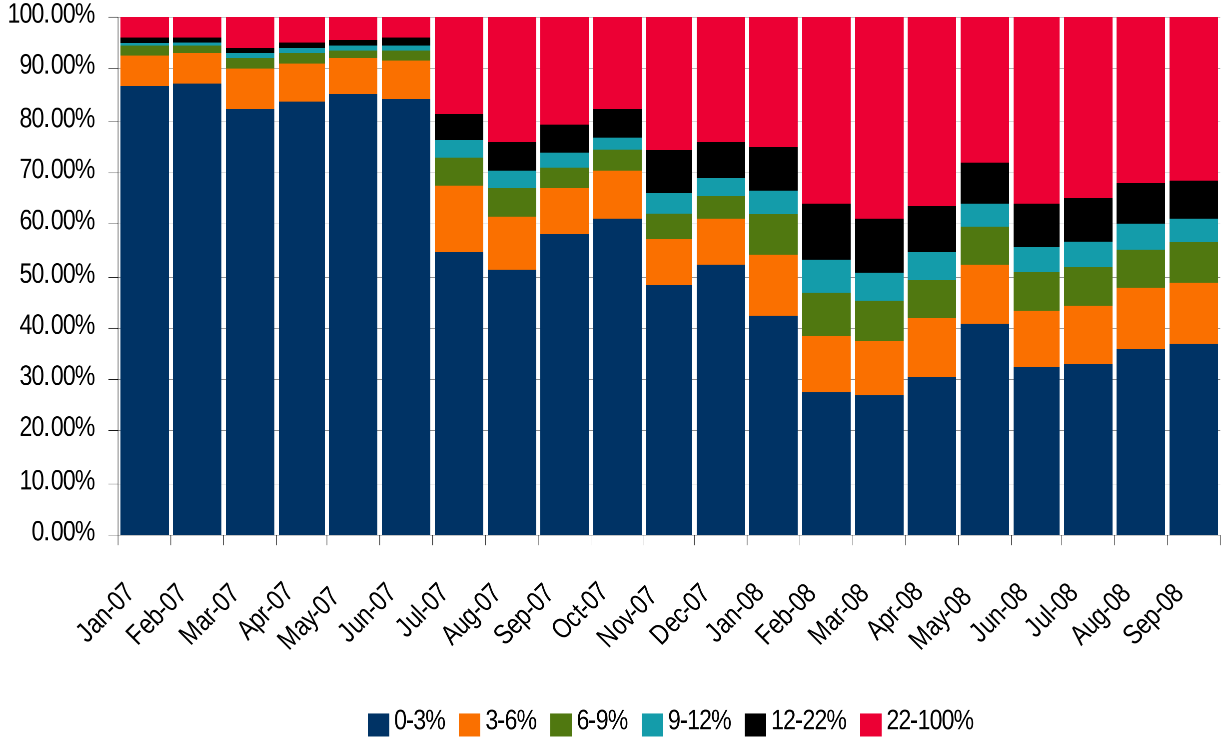
European CDS mezz tranches

Source: Merrill Lynch

... and correlations remain sticky

- No tangible signs of systemic relief yet
- Value remains in senior debt

European relative loss allocation in standardised tranches

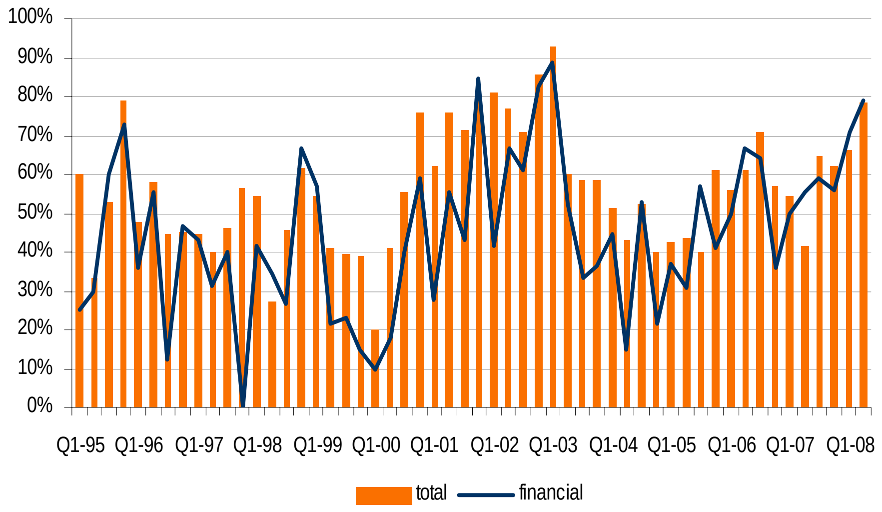


Source: Merrill Lynch Credit Derivatives Strategy

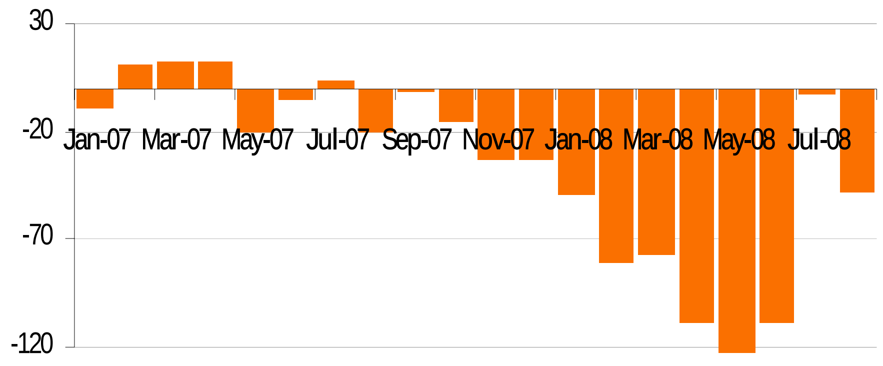
CSO downgrade risk decelerates, not out of the woods yet

- CSO from recent years were tightly structured to compensate for tight spreads
  - Not much subordination cushion to offset credit deterioration
- CSO are heavily exposed to those sectors and names most likely to underperform
  - Banks, monolines, homebuilders, …

Negative rating actions as a percentage of total rating actions



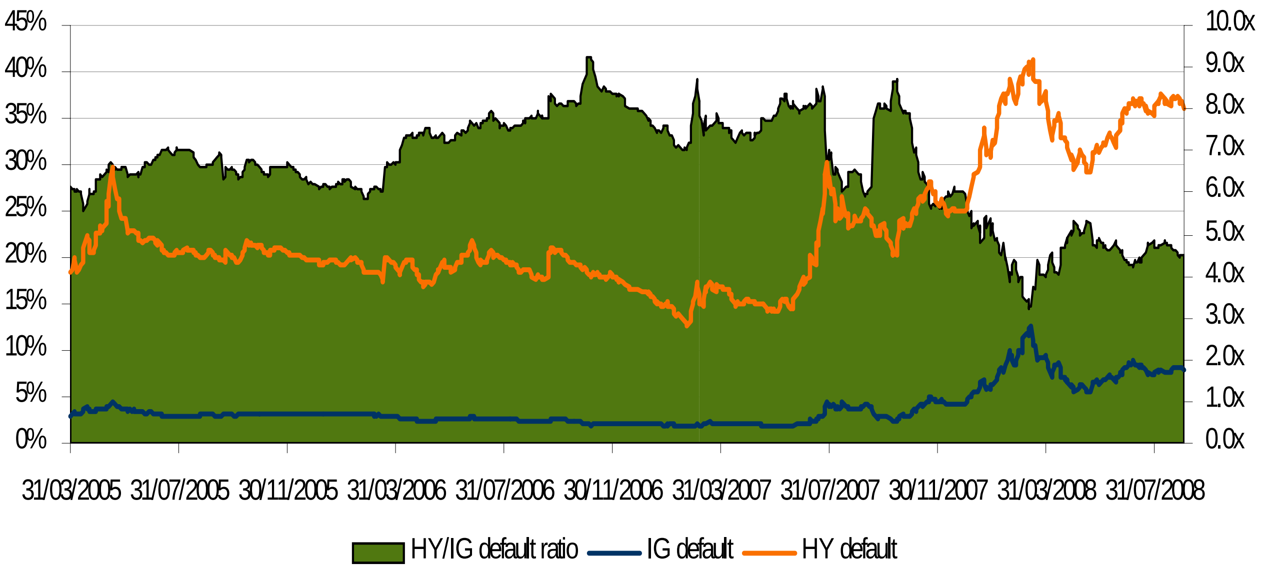
S&P net CSO rating migration



Source: Moody's, S&P

Corporate synthetics: look for the ‘cheap’ short

- HY remains at the same low multiple of IG in implied defaults HY
- Indices imply a ratio of HY to IG defaults of 5: 2x smaller than at the onset of the crisis
  - 1920-2007 average (A/BBB to BB/B defaults) is 12
  - Ratio typically increases in an economic downturn
- Different factors justify this (technicals, underperformance in financials) …
- … But reversion is likely



Source: Merrill Lynch

Corporate synthetics: shorter, higher, thicker

Given the corporate backdrop, we continue to argue that restructurings of existing deals could help investors restore either one of MtM or credit quality (i.e. restoring the eroded support)

- Flatter curves allow investors to move down the maturity curve
  - Shortening the exposure is cost efficient
- Elevated correlations allow to move up the seniority curve
  - Increasing subordination is cost efficient
- Moving up the capital structure is our favourite pick:
  - Increase cushions → prevent downgrade risk, methodology instability
  - Increase tranche size → reduce leverage
- Including HY shorts is another option, but basis risk has to be considered
- Funding the restructuring can typically be done:
  - Upfront
  - Through income reduction, either by slashing the coupon or foregoing payment dates
  - Confidence in the realisation of the restructured coupons will drive the choice

Global default rates per region (%)

Default rates per region (%)

		Global	U.S.	Europe	Emerging markets
investment grade	12-month rolling	0.06	0.13	0	0
	2007	0	0	0	0
	2006	0	0	0	0
	2005	0.03	0.06	0	0
speculative grade	12-month rolling	1.44	1.92	0	0.17
	2007	0.86	0.97	0.98	0.18
	2006	1.14	1.33	1.81	0.39
	2005	1.41	1.97	0.47	0.22
All	12-month rolling	0.64	1.04	0	0.1
	2007	0.36	0.48	0.18	0.1
	2006	0.46	0.63	0.37	0.23
	2005	0.57	0.93	0.09	0.13

Source: S&P

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Global Property Derivatives

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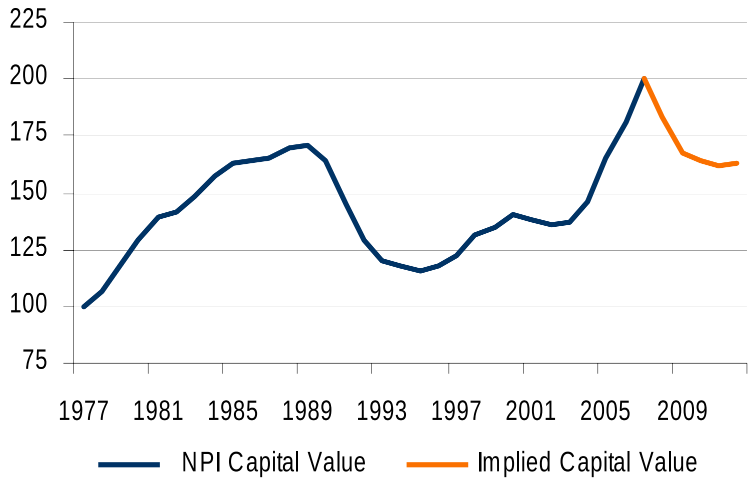
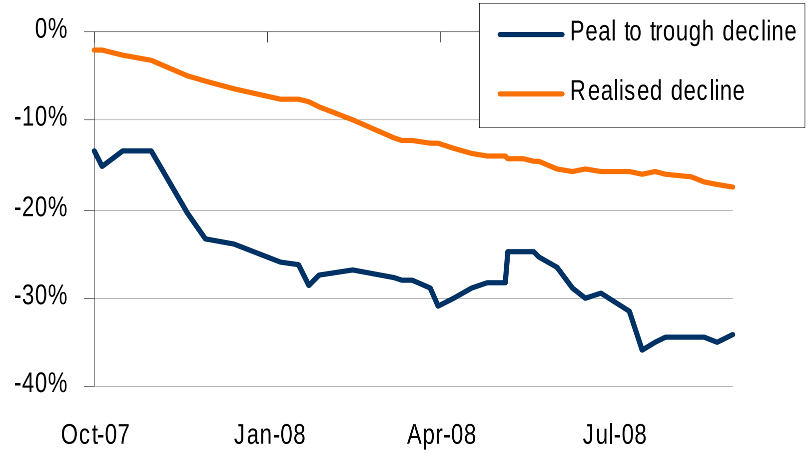
Property Derivatives - US

US NPI - historic and implied



US HP realised and implied decline



Source : Merrill Lynch Research, NCREIF

- **US Commercial Real Estate:** Capital values only started declining (according to NPI index) in Q2 2008. 18% peak to trough decline implied over next 3 yrs
- **US House Prices:** House prices down 17% from peak; total decline of 34% implied from peak through to trough at end 2009

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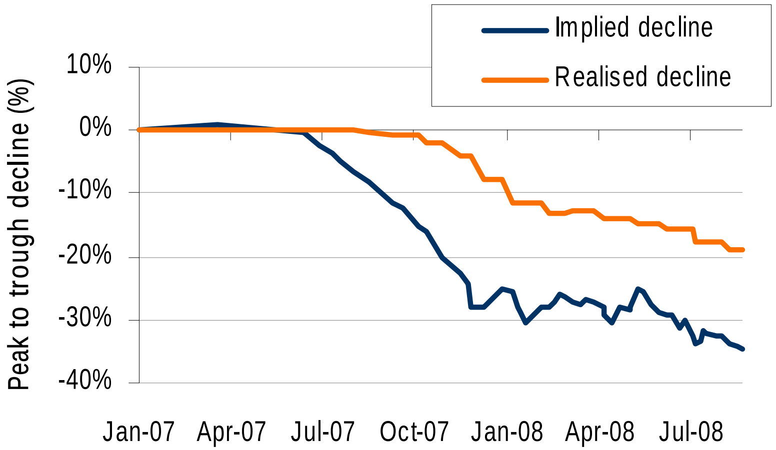
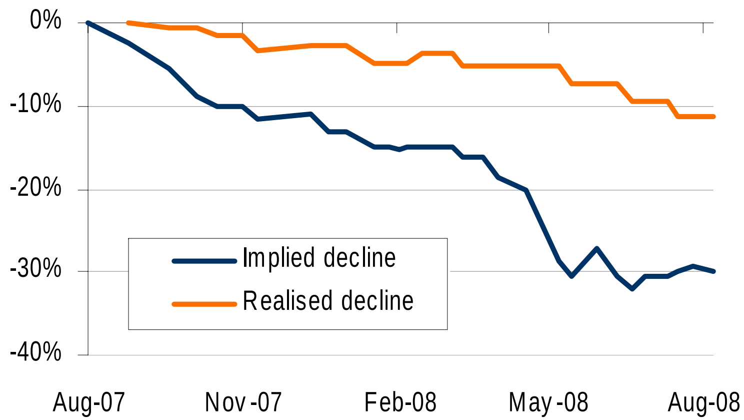
Property Derivatives - UK

UK IPD realised and implied decline



UK HP realised and implied decline



Source : Merrill Lynch Research

- **UK Commercial Real Estate:** Capital values already down 19% from peak, a further decline of 19% is implied (total decline 34% or 2.5% yield shift)
- **UK House Prices:** House prices down 11% from peak; total decline of 30% implied from peak through to trough July 2010, no recovery priced in

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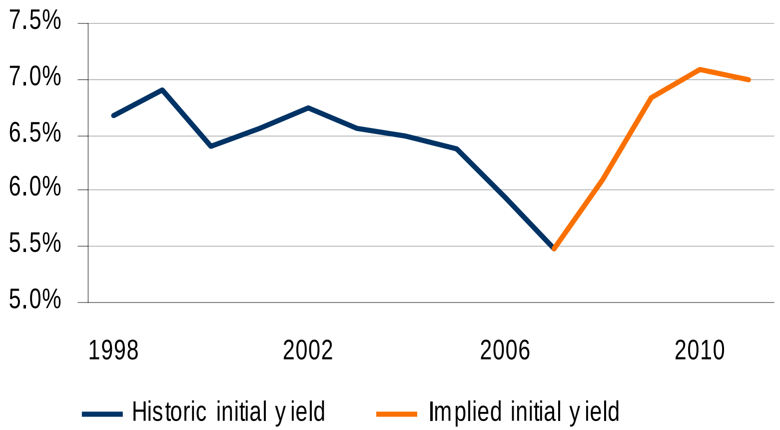
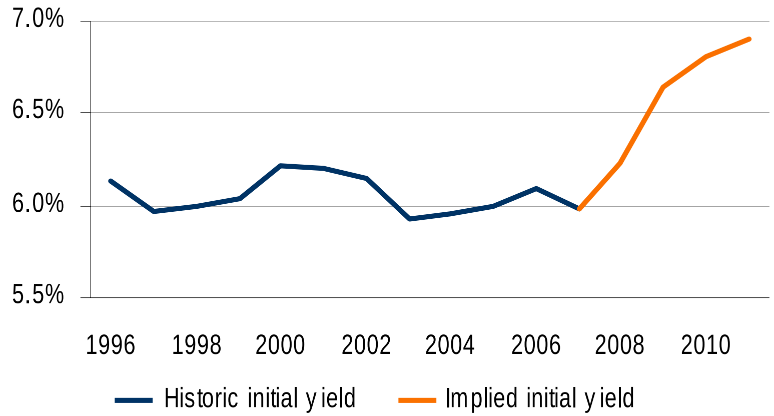
Property Derivatives - Europe

French Office IPD yields



German All Property IPD yields



Source : Merrill Lynch Research, IPD

- **French Office:** Capital values expected to decline 23% from peak at end 2007 to trough in 2010. Outward shift in yields of 1.6%
- **German All Property:** Further 13% decline in capital values implied from end 2007. Outward shift in yields of 0.9%.

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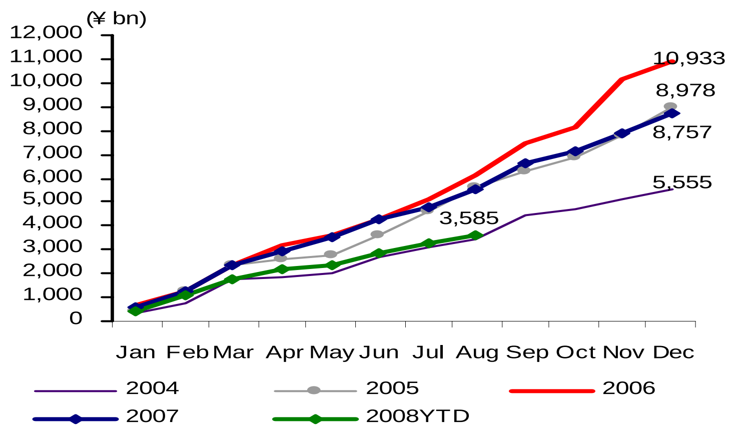
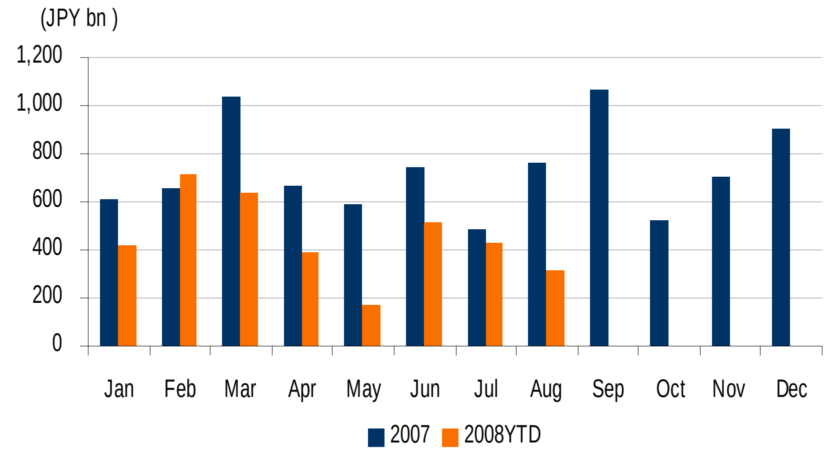
Japan

Year 2008 supply at 2004 levels

Japanese ABS monthly cumulative issuance (as of end of August 2008)



New issuance by month (as of end of August 2008)

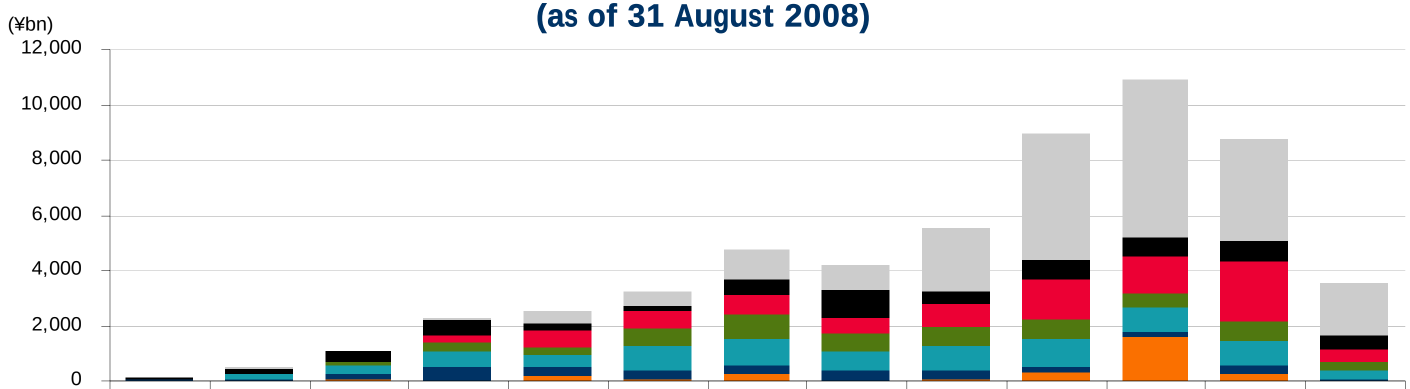


Note: Data includes all term ABS that are known to Merrill Lynch through information sources including rating agency releases, and distributed to investors in the form of securities or trust certificates. Transactions in the form of loans (non-recourse loans/ ABLs) are also included. As a general rule, ABCPs, unfunded portions of synthetic transactions, unrated tranches and transactions lacking details such as asset type, issuance date and issuance amount are not included. CMBS includes non-performing/ sub-performing loan ABS.
Source: Merrill Lynch

- Cumulative issuance back to year 2004 levels
  - Issuance as of end-August 2008 was Y3.6tn (US$34bn), down 35% YoY
  - Issuance in the months of June, July and August were down 31%, 12% and 59%, respectively
  - At this pace, primary issuance should end up at around Y5tn for the full year, or roughly half of that of the previous year

Primary issuance falling yoy in almost all sectors

Japan new issuance by asset type (as of 31 August 2008)



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008YTD
RMBS		32		50	435	484	1,028	927	2,307	4,612	5,713	3,695	1,943
CDO	28	218	377	572	231	207	613	978	441	674	720	753	475
CMBS		20		247	668	634	652	612	850	1,480	1,353	2,122	459
Consumer Credit ABS		8	109	335	220	644	901	647	705	687	506	746	311
Equipment Lease ABS	10	144	346	562	485	863	985	683	885	1,012	853	883	308
Auto Loan ABS	80	78	193	474	294	335	303	349	277	220	174	319	69
Other ABS		3	38	25	198	71	254	17	90	292	1,613	238	20

Note: Data includes all term ABS that are known to Merrill Lynch through information sources including rating agency releases, and distributed to investors in the form of securities or trust certificates. Transactions in the form of loans (non-recourse loans/ ABLs) are also included. As a general rule, ABCPs, unfunded portions of synthetic transactions, unrated tranches and transactions lacking details such as asset type, issuance date and issuance amount are not included. CMBS includes non-performing/ sub-performing loan ABS.
Source: Merrill Lynch

- Direct impact of the global credit crisis on the issuance market has been muted, with the exception of real estate-related sectors
  - CMBS sector most affected; RMBS origination also affected by the reversal of the real estate market conditions after summer 2007
  - Traditional ABS and cash CDO sector slow-down primarily due to industry environment, Japan-specific regulatory/ accounting changes and events

Sector developments post summer 2007: RMBS

- RMBS: issuance down 26% yoy
  - Lower mortgage origination due to sluggish housing sales
    - Sentiment in the real estate market has changed (indirect effect of the subprime issue); the revision of the building standards in June 2007 has also had a negative effect but this is starting to be resolved
    - Economic downturn and increase in building costs could place further pressure on housing supply and demand
  - Significant drop (67% yoy) in issuance from the private-sector banks/ non-banks
    - Repeat bank issuance falling due to lower mortgage origination volumes and less incentive to securitize given securitization costs/ regulatory environment
    - Slowdown of non-bank mortgage business in light of the high cost of securitization, low demand and difficult distribution of RMBS backed by “non-prime” assets
  - Discussions on structured covered bonds
    - Potentially a viable (cost-effective) funding source for issuers with relatively low credit rating; however, Shinsei Bank put off their potential deal twice, given market volatility
    - Application of the covered bond structure to public-sector exposure also being discussed

Sector developments post summer 2007: CMBS

- CMBS: issuance down 45% yoy
  - Bullish real estate securitization market has turned after the subprime fallout
    - Up to summer 2007, robust asset sales and refinancing activity as a result of the bullish real estate market resulted in heavy new issuance volumes; the positive spiral has clearly reversed since summer 2007
    - Major foreign banks have closed business and foreign investors have less appetite given issues back home, affecting origination of non-recourse loans and CMBS
  - First downgrades of conduit CMBS
    - Reason for downgrades/ negative review: asset sale falling behind rating agency assumptions/ sponsor plans; asset price falling below target levels; triggers being breached
    - Represents the challenges in refinancing/ asset sales under current market situation
    - Four listed real estate company failures in the last six months brings focus to quality of sponsors/ asset managers/ servicers and impact on loan/ CMBS performance
  - Market is open but investors are increasingly selective
    - Market is not closed; domestic and foreign investors who have capacity are seeking buying opportunities, but on a selective basis
    - Regulators have required domestic financial institutions to monitor real estate and securitization exposures closely; preference is for prime assets in prime locations; single-asset deals preferred over large “diverse” portfolios

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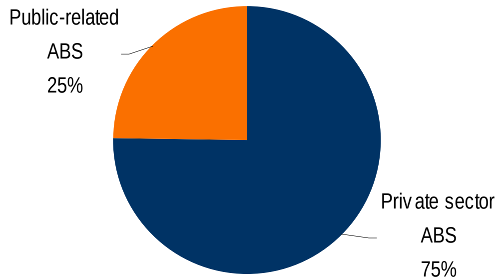
Sector developments post summer 2007: CDOs and ABS

- CDO: issuance up 7% yoy
  - Sector issuance is up, but only thanks to the new Zaito CLO programme
  - Zaito CLOs are backed by loans to government agencies; two issuances of Y100bn each represents roughly half of 2008ytd CDO issuance
  - SME CLOs seen at fiscal year-end but none since; the negative outlook on SME performance and the severe downgrade event on one transaction has resulted in investors disliking this sector
  - Two BS CLOs backed by large companies was originated by a major bank; No arbitrage CDOs have been publicly rated in 2008 - only CLNs and first-to-defaults
- ABS: issuance down 57% yoy
  - Consumer credit ABS: down 58% yoy
    - Cheap funding available; cost-effectiveness of securitization has diminished
    - Consumer lending volumes have dropped due to the New Money Lending Law that came into effect end-2007, as well as on-going industry consolidation and less consumer spending
    - Auto loans have fallen due to sluggish auto sales
  - Lease ABS: down 48% yoy
    - Primarily due to the new lease accounting standards that came into effect starting fiscal year 2008, as well as the availability of cheap bank funding; only a few independent leasing companies remain active as originators

Government initiatives supporting securitization supply

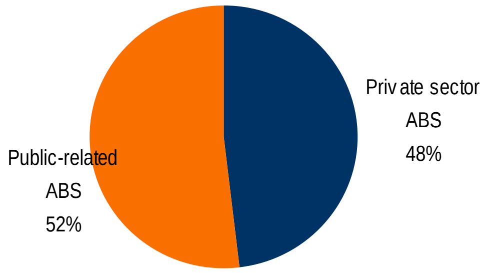
- Government-related deals have increased in share in the primary market
- Volume-wise, the Japanese market is relying heavily on public-related securitizations, representing more than half of primary issuance in 2008ytd
  - JHF MBS (Y1.5tn issued up to Aug) and JHF-guaranteed MBS (Y110bn as of Aug) : JHF MBS represents 75% of RMBS issuance in 2008ytd versus 47% in 2007, 81% including the guarantee-scheme MBS (issued by private banks but guaranteed by JHF)
  - Zaito CLOs issued in February and August (Y200bn in total)
  - SME CLOs initiated by local governments and JASME (Y75.4bn in total)

Japan public-related ABS vs. private sector ABS in 2007



Note: public-related ABS include JASME related CDOs (including JASME guaranteed CDOs), local government initiated CDOs, JHF MBS, JHF guaranteed MBS and a CLO initiated by Federation of National Public Service Personnel Mutual Aid Associations.
Source: Merrill Lynch

Japan public-related ABS vs. private sector ABS in 2008 (as of end Aug)



Note: public-related ABS include zaito CLOs, JASME related CDOs, local government initiated CDOs, JHF MBS, JHF guaranteed MBS and a RMBS deal originated by Mutual Aid Associations for Agricultural, Forestry and Fishery Organization Personnel.
Source: Merrill Lynch

Tighter risk monitoring affecting demand for structured product

- Tightening of regulatory reporting/ monitoring in response to the subprime crisis is affecting all securitization sectors, regardless of asset type, location and structure:
  - March 2008: JICPA published a statement for accountants and auditors on audit points in valuing securitization products - notes that “fair value” is the transaction price, and that it should reflect liquidity risk
  - April 2008: FSA revised the Guidelines for Financial Instruments Business Supervision; in response, JSDA established a working group to discuss the “traceablity” of securitized products
  - August 2008: FSA revised the regulatory guidelines for major banks and regional financial institutions, which focuses on enhancement of credit and market risk management for securitized products
  - In addition, FSA has required banks and other financial institutions to disclose their securitization exposure based on the FSF-suggested format for each financial reporting term
- Demand for structured products in general has dropped in response to the stringent monitoring and reporting requirements enforced by the regulators

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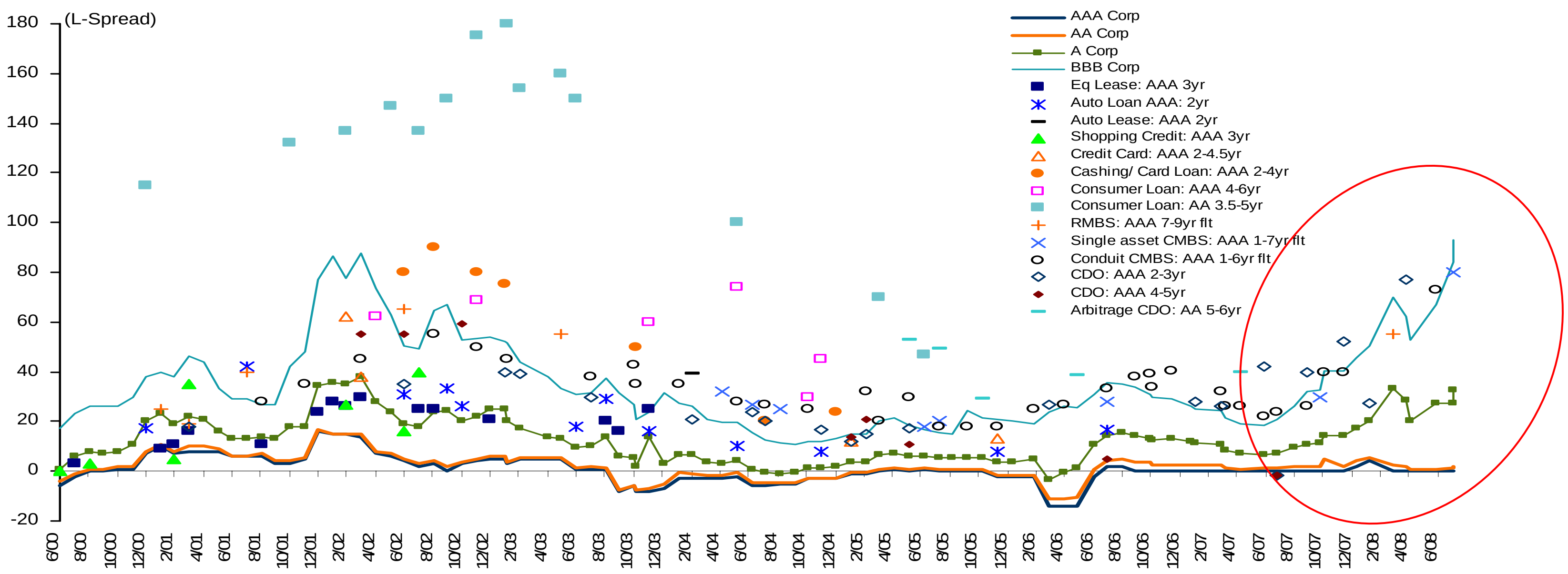
Spreads at historical wides, but volatility contained vs global markets

Japan primary ABS spreads by asset type

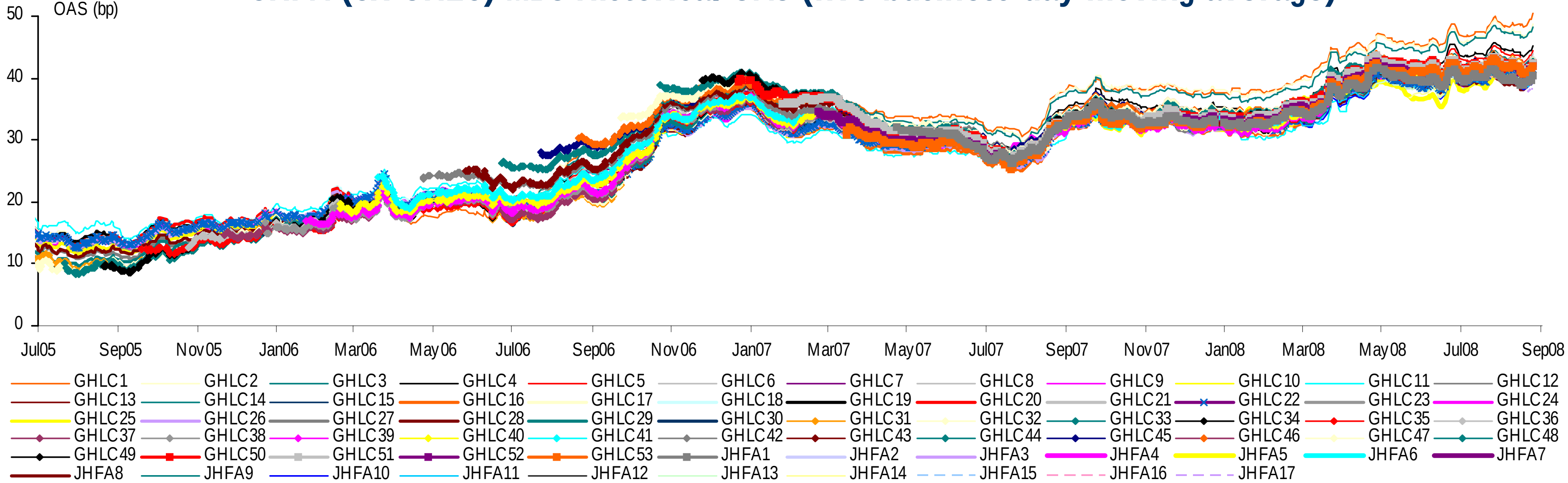


Note: Corporate spreads are average 5yr indications by rating based on Merrill Lynch indications for 120 corporate (mid-price, temporarily deducted NIS Group from 27 September 2007).
Source: Merrill Lynch from various sources

- Spread widening due to indirect impact of subprime/ credit crisis
  - Corporate sector volatility: Japanese ABS launch spreads track BBB-rated corporates
  - Change supply-demand balance
    - Investors gaining control over pricing and demanding wider spreads
    - Investors avoiding "securitization" in general, given management decisions and regulatory scrutiny
  - Concerns regarding underlying asset performance and downgrade pressure

JHFA MBS spreads creep up, but market stays stable

JHFA (ex-GHLC) MBS Historical OAS (five-business-day moving average)

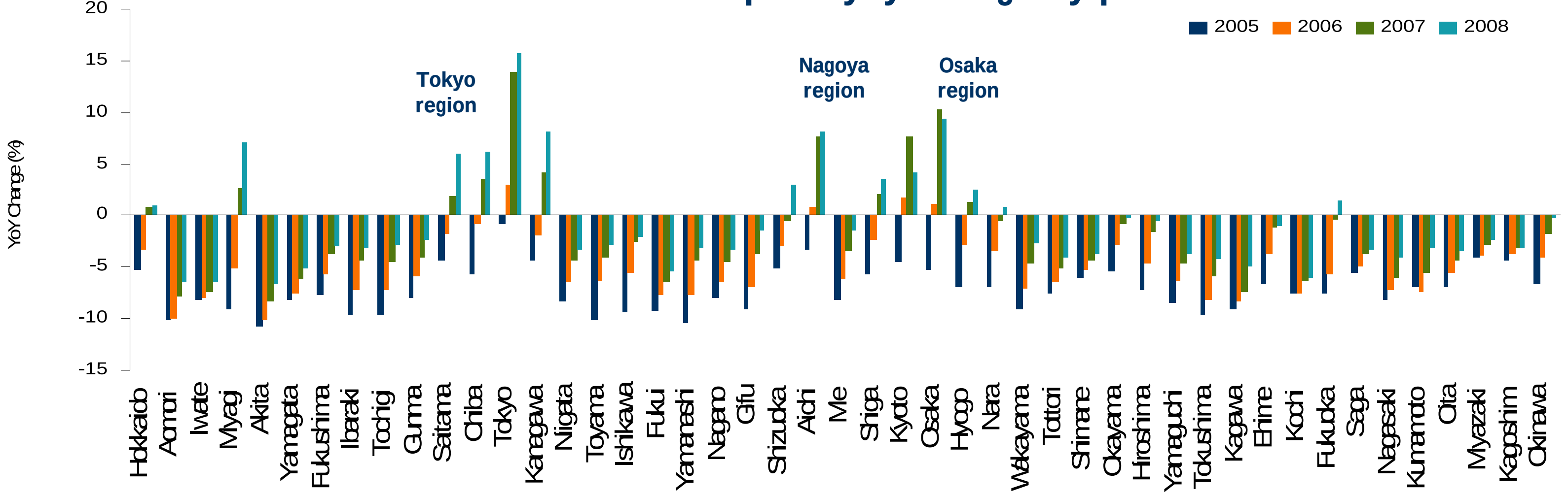


Source: Merrill Lynch

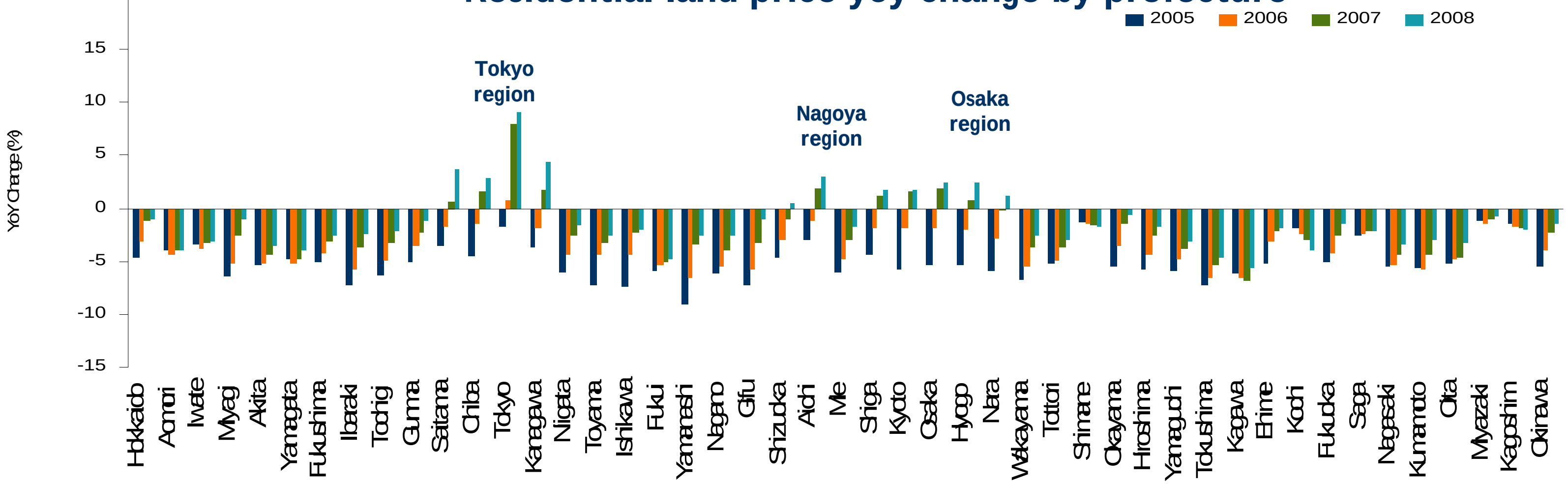
- A slight spread rise since summer 2007, but the market keeps calm in general.
  - JHFA MBS spreads have widened gradually as they tend to track Japanese agency bond sector.
  - Spreads rallied in Jul-Sep 2007 given weakened capacity of brokers to support the secondary market.
  - Demand remains robust given that investors constantly buy a certain amount of JHFA MBS; JHFA MBS is considered a safe investment.
  - Spreads have been almost flat since Apr 2008; launch OAS refers to that of prior months and interest rate risk of the fixed-rate bond is considered neutral, while pricing prior to summer 2007 was based on investors sensitivity to interest rate risk
- Investors’ primary concern at present is slowing prepayment speeds.

Real estate: recovery in metropolitan land price as per annual survey...

Commercial land price yoy change by prefecture



Residential land price yoy change by prefecture



Note: Koji chika as of 1 January each year
Source: MLIT

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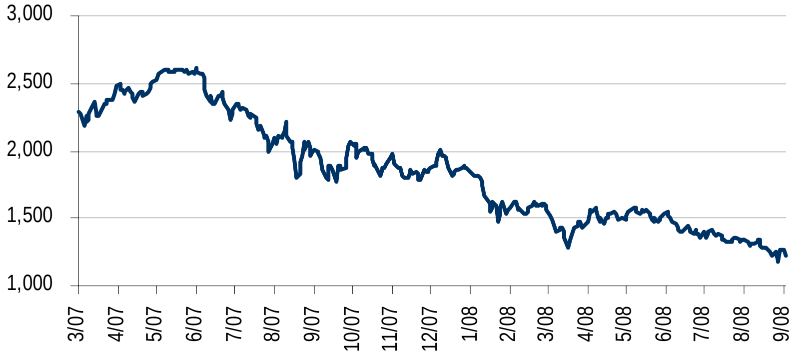
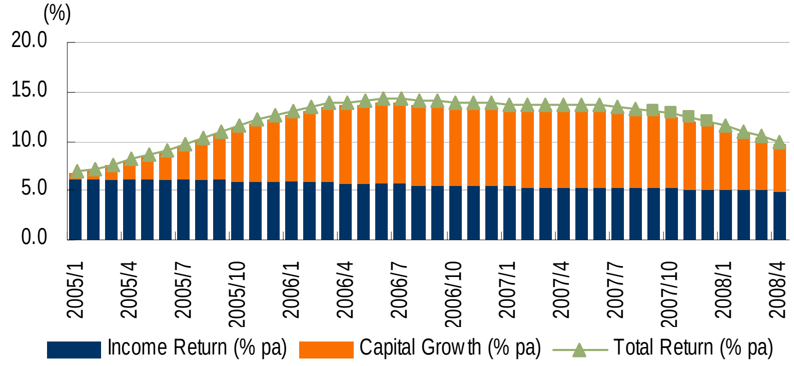
... but more recent indicators reveal slowdown in real estate investments

TSE J-REIT Index



Source: Bloomberg

IPD Japan Monthly Indicator returns

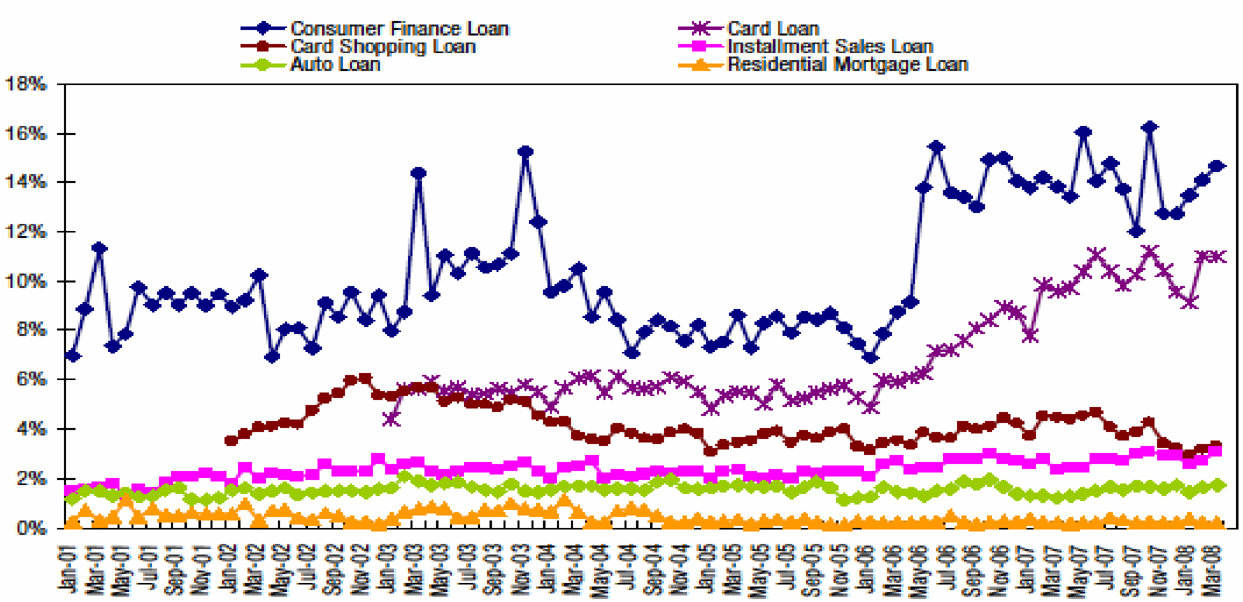


Note: Jan-Apr 2008 figures based on provisional values
Source: IPD

- J-REIT index reached its turning point in summer 2007: trend began by foreign investor selling, current market suffering from sell-off by domestic banks
- IPD monthly indicator (based on J-REITs portfolios) shows that capital returns have dropped since summer 2007 from 8.0% to 4.7%; income returns have seen less of a decline (5.3% to 4.9%)
- MLIT's recent quarterly real estate price survey to land appraisers regarding 100 major locations indicated that in the three months up to July 1, property prices dropped in 38 locations vs. 9 reported for the previous quarter; survey indicates that commercial properties in prime locations are favoured over those in the suburbs

Consumer asset performance stable, but macro effects yet to be seen

Moody's index: default rate by consumer asset sector (dynamic)

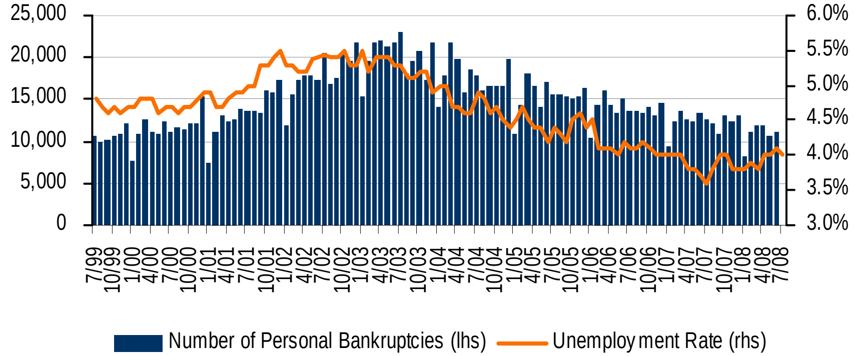


Source: Moody's

- Prime assets presenting stable performance to-date - default rates at near 0% for residential mortgages, thanks to the healthy macro economy in the recent years, borrowers' willingness to repay debt and generally tight underwriting standards; some uncertainties going forward in light of the concerns regarding outlook on macro economy and the relaxing of mortgage underwriting standards in certain cases
- Consumer loan/ card loan performance has deteriorated - not necessarily due to the subprime issue or deteriorating consumer credit, but rather due to the pressure on the money-lending industry as a result of the regulatory changes in 2007; this is proven by the relatively stable performance observed in the shopping, installment sales and auto loan sectors (which do not fall under the money-lending framework)

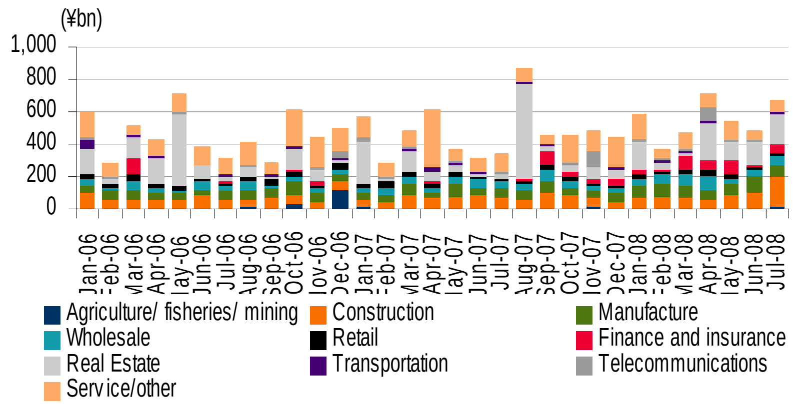
Macro environment: unemployment and corp. defaults rising moderately

Personal bankruptcy filings and unemployment rate



Source: Supreme Court, Ministry of Public Management, Home Affairs, Posts and Telecommunication

Corporate bankruptcies by industry sector (debt amount)



Note: Includes all legal and voluntary bankruptcies of total debt of Y10mn or more.
Source: Tokyo Shoko Research

- Unemployment rate is still low, but has risen moderately after bottoming out in summer 2007; personal bankruptcies tend to track unemployment with some delay
- Corporate bankruptcies also appear to be increasing gradually; the construction and real estate sectors are of particular note

Investment considerations

- Asset performance has been stable for the most part, but sector-specific issues and the impact of the slowdown of the macro economy need consideration
  - RMBS: Slowdown in prepayments observed in fixed-rate mortgage loans of recent vintage; the longer-term impact of looser underwriting standards in some deals require caution
  - CMBS: challenging refinancing environment to continue in the short to medium term; less aggressive lenders, selective investors and pressure on real estate prices
  - CDOs: SME credit is weakening amidst the current economic environment; however regulators are trying to promote SMEs lending
  - Consumer ABS: uncertainties remain regarding the money-lending industry as a whole and the impact of originator events, though the rate of deterioration appears to have slowed; longer-term concerns on moderately rising unemployment rate

Investment considerations

- Wider spreads due to supply-demand technicals provide for opportunities
  - Historically wide spreads allow investors to go up in the capital structure and to select better-quality assets
  - Market volatility remains a concern for MtM investors, but volatility has been contained as compared to corporate credit and other global securitization sectors
  - Assessment of rating agency assumptions are key; recent downgrade events are primarily a result of deals performing worse than initial expectations

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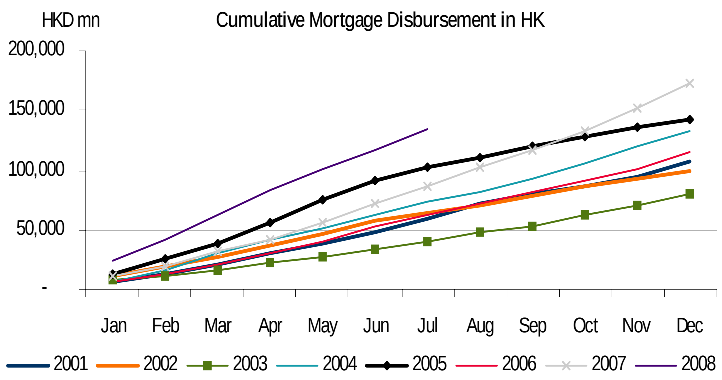
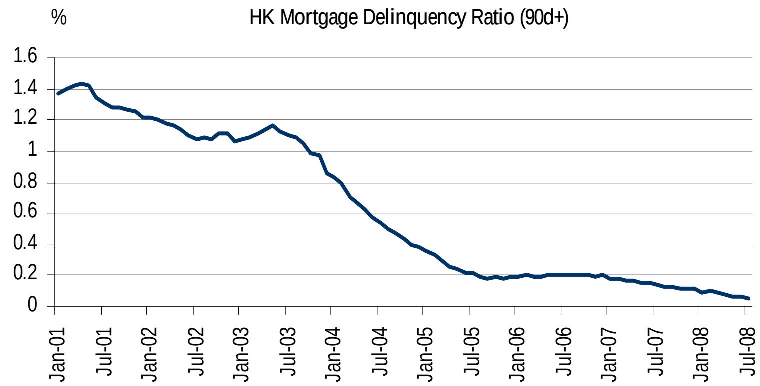
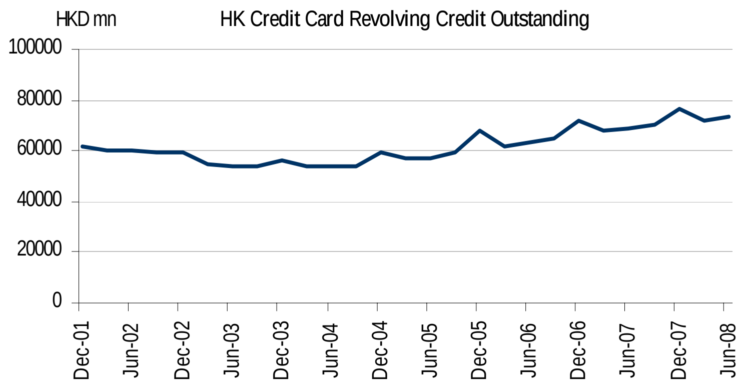
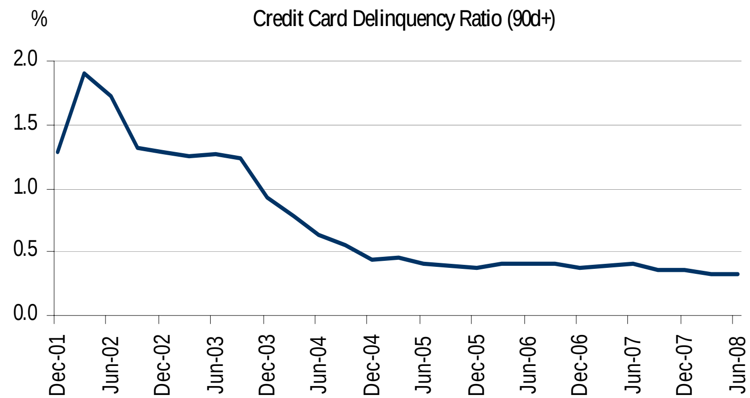
Asia ex-Japan

Consumer Lending: Hong Kong



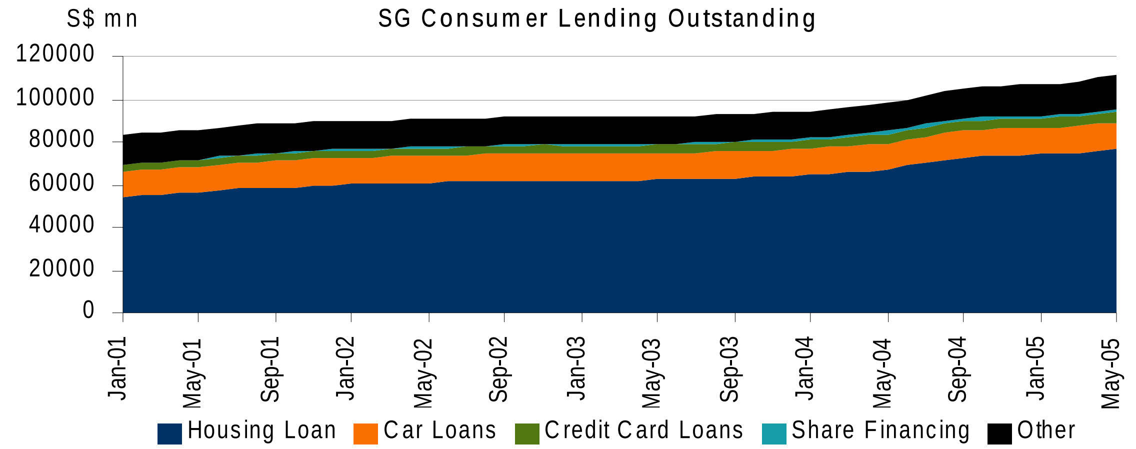




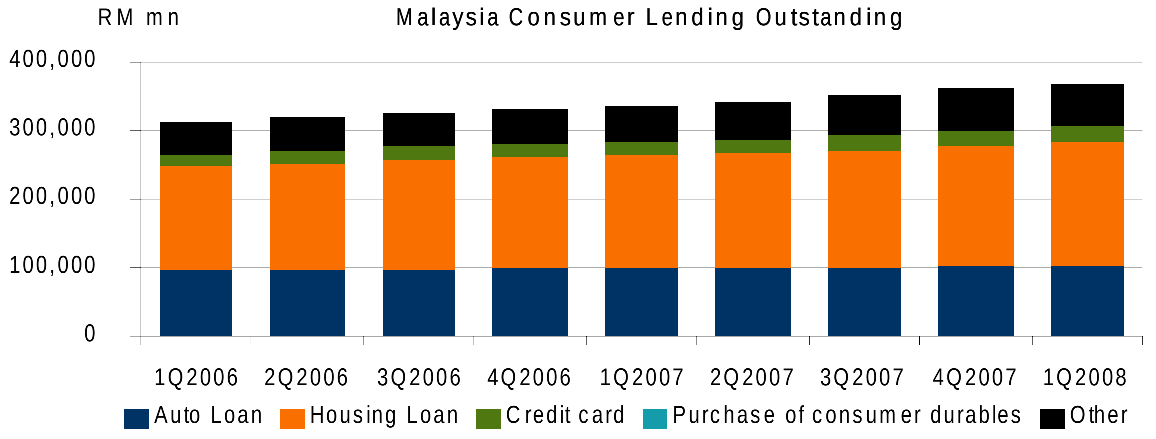


Source: CEIC

Consumer Lending: Singapore and Malaysia

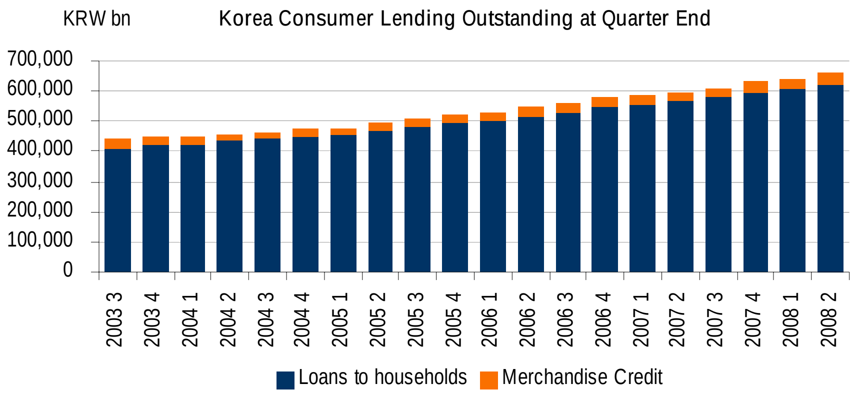


Source: Monetary Authority of Singapore

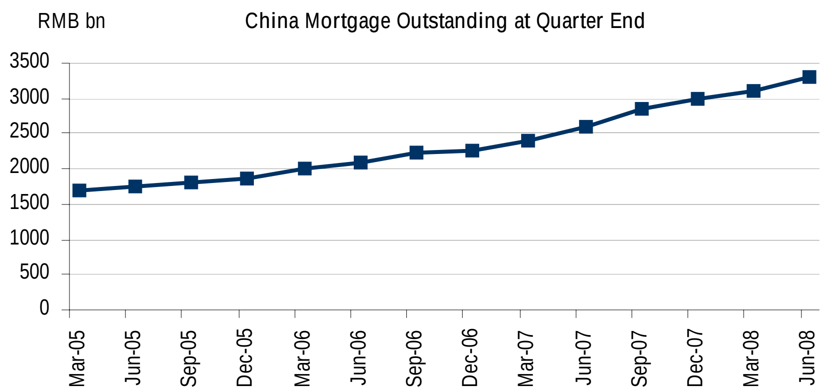


Source: Bank Negara

Consumer Lending: Korea and China

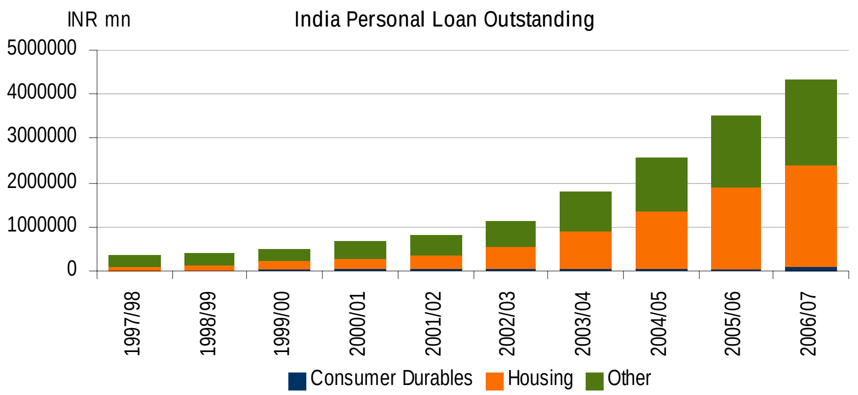


Source: Bank of Korea



Source: CEIC

Consumer Lending: India

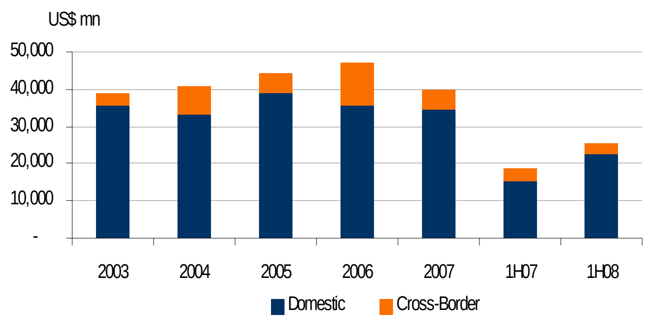


Source: Reserve Bank of India

Asia ex-Japan

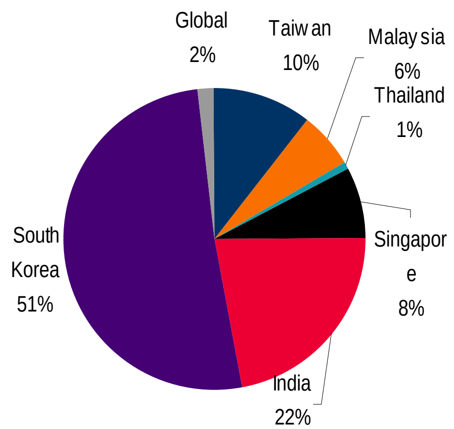
- SF issuance in 1H08 reached US$26bn, up by 36% from a year ago
- Domestic issuance still dominates the market
  - Domestic issuance accounts for 87% of the total, and up by 48% compared with 1H07
  - Cross-border issuance is US$1.9, down by 14% from 1H07
- By country - Increasing significance of India and China in the AXJ SF market

AXJ SF Issuance: Domestic vs. Cross-Border

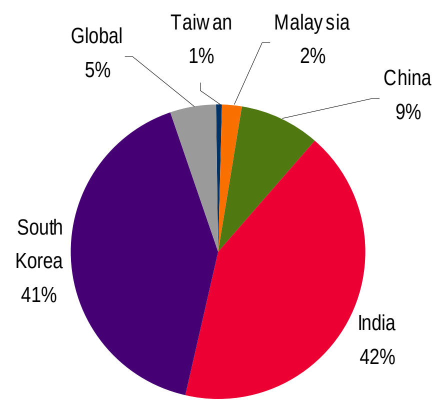


Source: Merrill Lynch

1H07 AXJ SF Issuance by Country



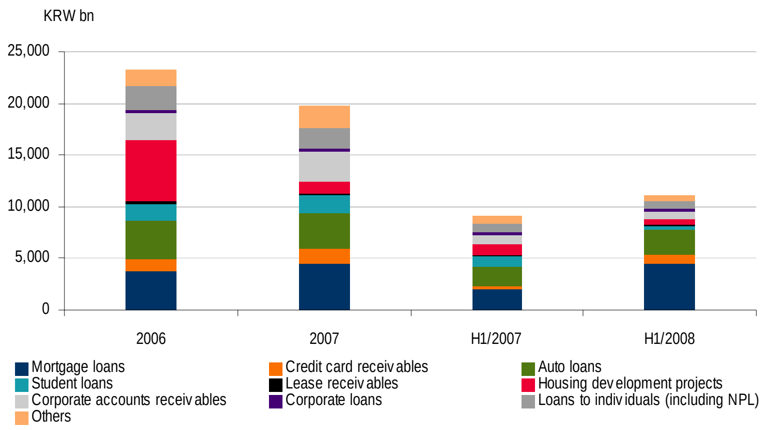
1H08 AXJ SF Issuance by Country



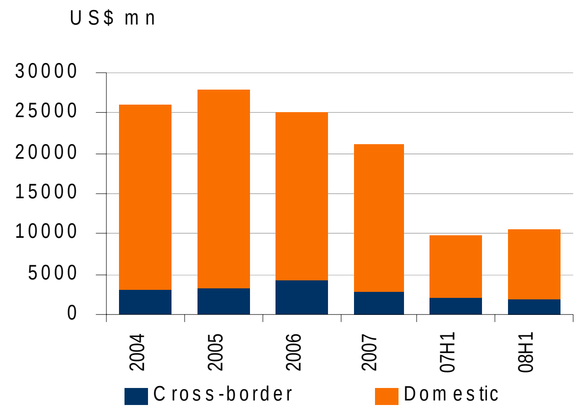
South Korea (1)

- SF issuance in 1H08 reached KRW11tn (US$10.6bn), up 23% from 1H07
  - Domestic issuance accounts for 92% of the total with the balance from cross-border issuance
  - Issuance backed by consumer lending (including mortgages, auto loans, credit card, student loans and leases) dominates, while issuance backed by housing development projects continues to decrease reflecting the cooling down of the property market
- More companies are accessing cross-border market for funding due to the attractive swap pricing
  - # of cross-border transactions in 1H08 is much higher than in 1H07 (6 vs. 3), though volume is similar
  - Emergence of first time issuer, like Citibank Korea, Kookmin Bank, Lotte Card and Shinhan Card

SF Issuance in South Korea by Asset Class



SF Issuance in South Korea: Domestic vs. Cross-Border



Source: Merrill Lynch

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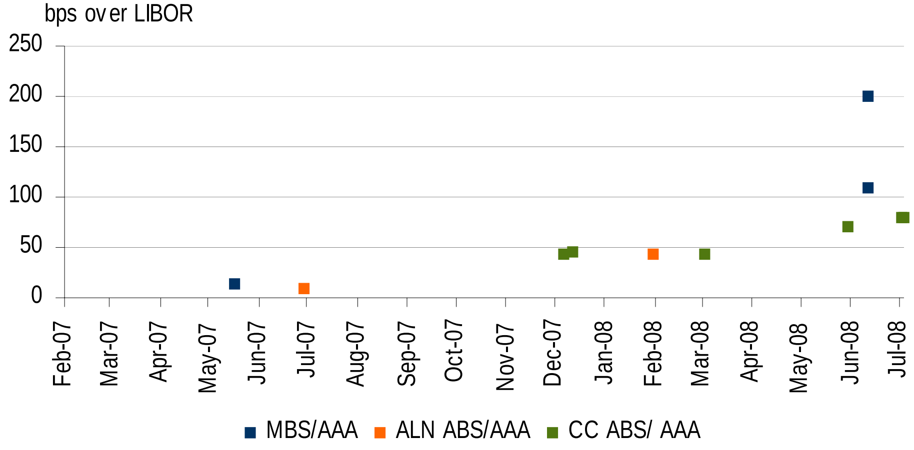
South Korea (2)

- Pricing has gone up despite strong performance
  - Cross-border triple-A primary spread level has widened from 15~16bps in 1H07 to 40~50bps in Jan 08 and further to 70~80bps in Jun 08, though
  - Extent of spread widening is much smaller compared to US and European market
  - Divergence in pricing between conduits and market investors, a case in point is
    - Korea ACE Mortgage Company, which is a RMBS transaction from first time issuer and also the only transaction placed with market investors, was priced at 200bps for triple-A, while at the same time
    - KB Mortgage Loan No.1, which is also a RMBS transaction from first time issuer but believed to be a conduit deal, was priced at 110bps for triple-A

AAA primary spread level for Korean Cross-Border Transaction

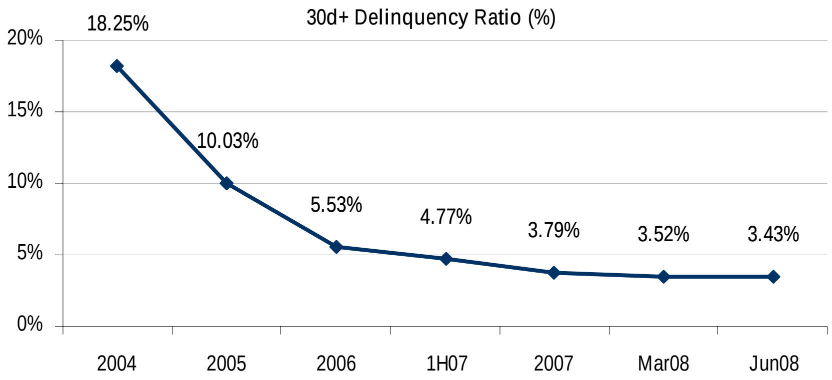


Source: Merrill Lynch

South Korea (3)

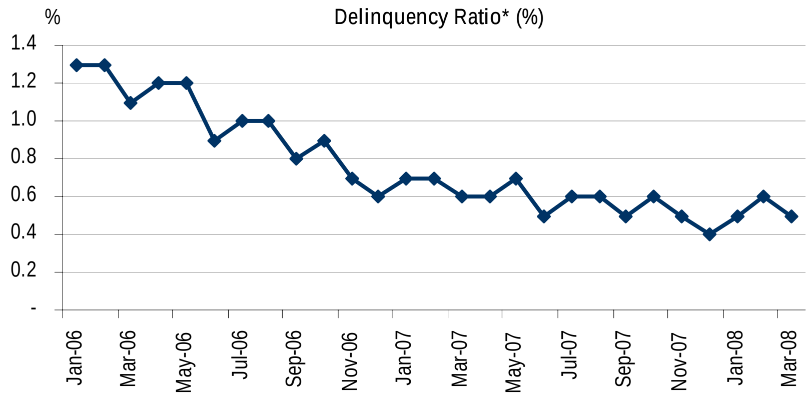
- Performance of consumer lending is holding up strong
  - Performance of credit card receivables originated by credit card companies (the main originators of cross-border transactions) has improved significantly since the credit card crisis in 2004
    - 30+d delinquency ratio has come down from 18.25% in 2004 to 3.79% in 2007 and stabilized at the level of 3.5%
  - Performance of mortgages originated by banks has also improved
    - Delinquency ratio* has come down gradually from 1.3% in Jan 2004 to 0.5% in mid-2007 and stabilized at that level since then

Credit Card Performance of Credit Card Companies in South Korea



Source: FSS

Mortgage Performance of Credit Card Companies in South Korea



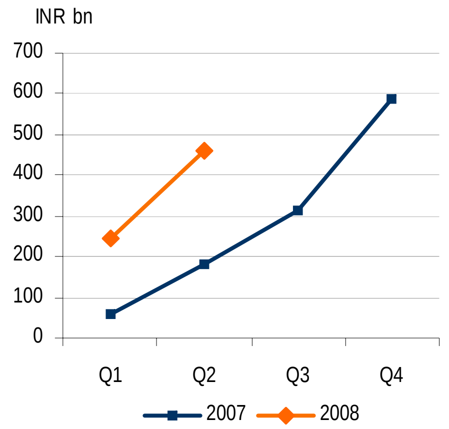
Source: KHFC

* Delinquency is defined as late principal repayment of more than 1 day

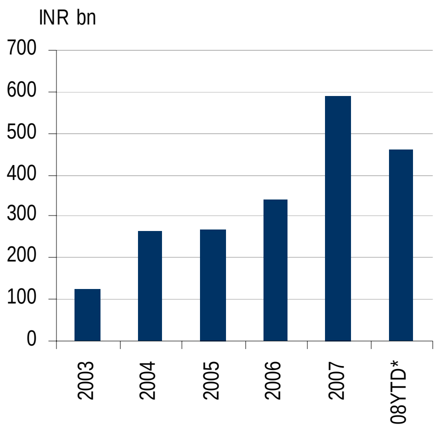
India (1)

- SF issuance in 1H08 reached INR460bn (US$11bn), up 53% from 1H07
  - All issuance are domestic
  - The increase in issuance reflects the rapid expansion of the consumer lending sector and the pent-up funding needs from banks and NBFC[2]
  - Consumer ABS and CDO[1] (also known as LSO) continues to dominate issuance
  - Issuance of consumer ABS dropped significantly in 2Q (almost 80% were issued in 1Q) due to increasing concerns on performance

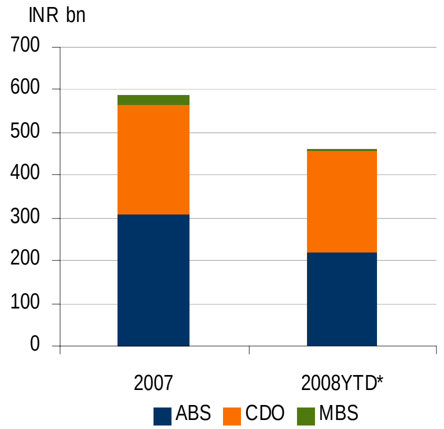
Cumulative SF Issuance in India



SF Issuance in India



SF Issuance in India by Asset Class



Source: Crisil; * As of end-Jun 2008

Footnote: 1. Also known as LSO, single Loan Sell Off; 2. Non-bank financial companies

India (2)

- Concerns on performance of unsecured personal lending
  - Pressure from media coverage on brutal collection methods used by some collection agents, has led to easing collection efforts by lenders and new regulation from government on selection of collection agents and collection methods to be used
  - Direct consequence is increase in delinquencies and also increase in CE levels of some recent ABS transactions
  - Other concerns include weaker economic outlook and increasing inflation
- Regulatory update: PTC are recognized as securities and are eligible to be listed
  - Positive for market transparency since extra disclosure is required for listing
  - However, PTC has always been a buy-and-hold market
  - Liquidity is unlikely to increase by just allowing the PTC to be listed

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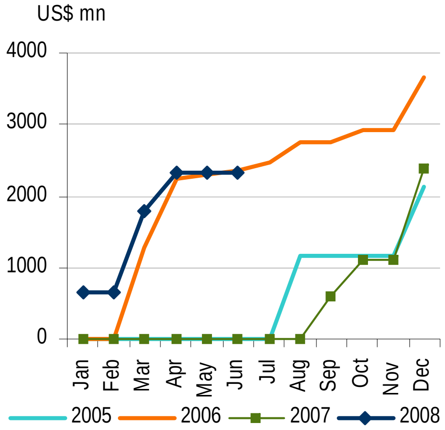
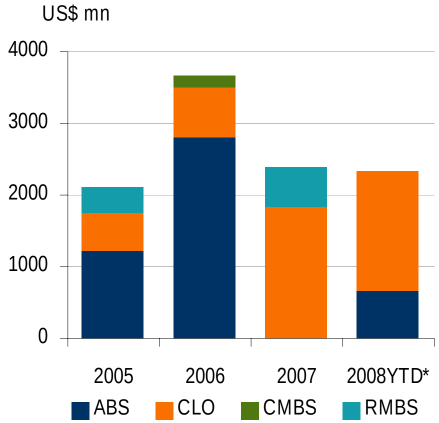
China

- SF issuance in 1H2008 reached US$2.3bn, almost on par with the total issuance in 2007
  - All denominated in RMB and issued under the Pilot Project program, supervised jointly by CBRC[1] and PBOC[2]
  - Issuance continues to be dominated by B/S CLO, accounting for 72% of the total
  - 1st Auto ABS (US$657mn) was launched by GMAC-SAIC
- Pipeline for 2H2008 is busy, but issuance is subject to approval of CBRC

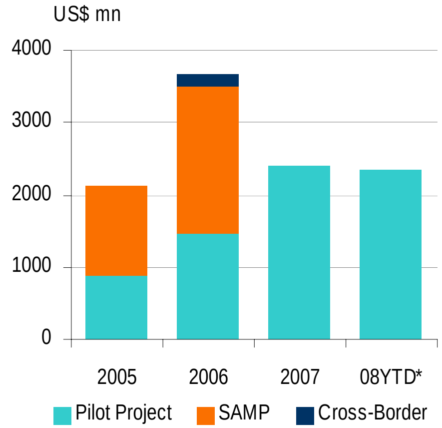
Cumulative SF Issuance in China



SF Issuance in China by Asset Class



SF Issuance in China: Domestic vs. Cross-Border

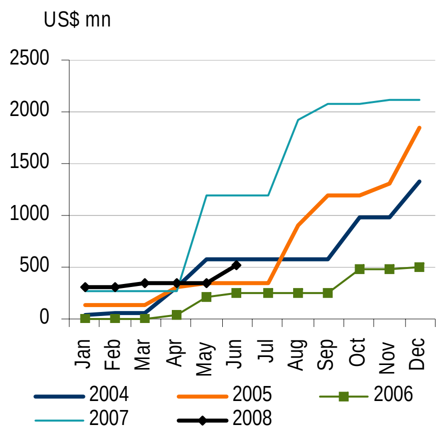


Source: Merrill Lynch; * As of end-Jun 2008

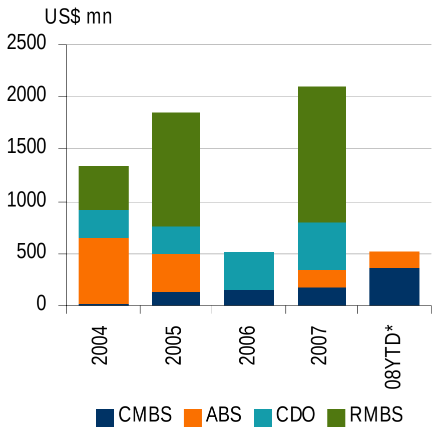
Footnote: 1. China Banking Regulatory Commission; 2. People's Bank of China

Malaysia

Cumulative SF Issuance in Malaysia



SF Issuance in Malaysia by Asset Class



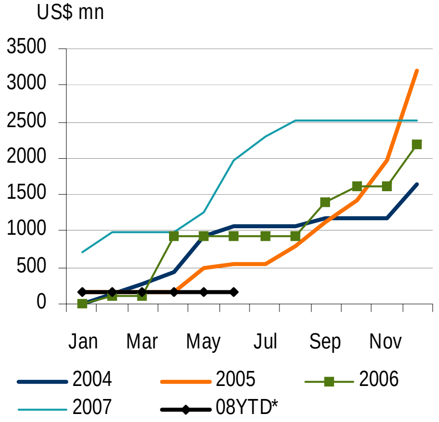
Source: Merrill Lynch; * As of end-Jun 2008

- SF issuance in 1H08 was US$523mn, down by 56% from 1H07 in the absence of Cagamas issuance and primary CLO issuance
  - Cagamas is the largest SF issuer in Malaysia. Its RMBS issuance accounts for 62% of the total issuance in 2007
  - Primary CLO has been one of the active asset classes in Malaysian SF market. Loans backing primary CLO are originated for the purpose of being securitized later on.
- Pricing
  - Not transparent: mostly sold at a discount
  - Anecdotally, pricing has gone up due to internal inflation pressure

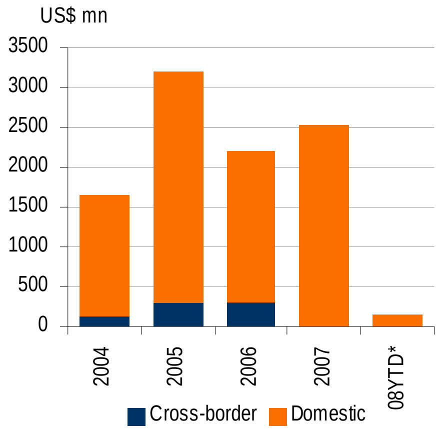
Taiwan

- SF issuance in 1H08 was only US$162mn, representing less than 10% of the issuance in 1H07
  - Taiwan CBO, which repackages the TWD-denominated structured bonds with USD-denominated assets, accounts for the majority of the SF issuance in Taiwan
  - As most of the TWD-denominated structured bonds has paid off or are approaching its maturity, there are less available to be securitized
- Performance concerns for Taiwan CBO
  - Due to the performance deterioration of the USD-denominated assets underlying those transactions
  - Performance of CLOs backed by loans originated in Taiwan remains strong

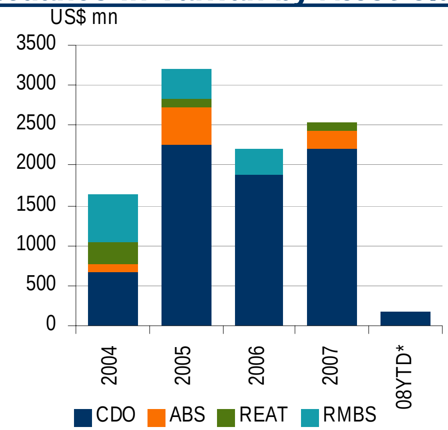
Cumulative SF Issuance in Taiwan



SF Issuance in Taiwan: Domestic vs. Cross-Border



SF Issuance in Taiwan by Asset Class



Source: Merrill Lynch; * As of end-Jun 2008

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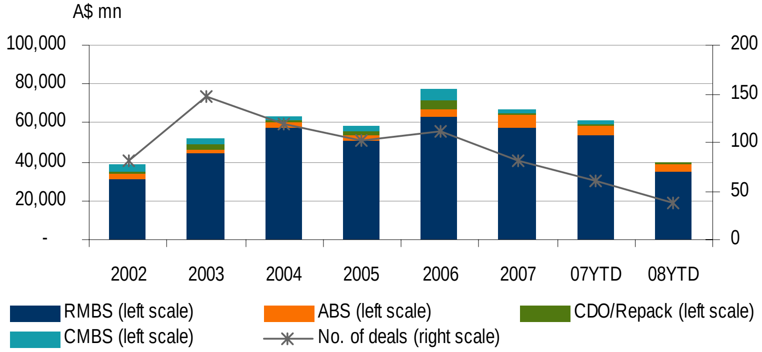
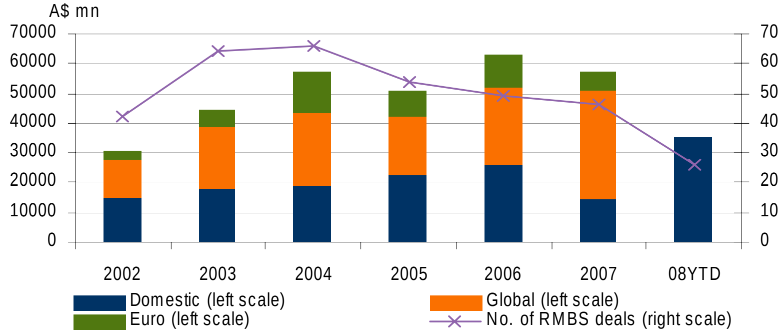
Australia (1)

- SF issuance in 08YTD* reached A$39bn, down by 36% down from same period last year
- RMBS continues to dominate the market with a total issuance of A$35bn from 26 transactions
  - RMBS issuance is down 19% from same period last year
  - 7 out of the 26 deals (with a total size of A$28.5bn) are retained by banks for the repo purpose with Reserve Bank of Australia
  - All MBS transactions are domestic transactions, as opposed to the 26% last year: partly reflecting the diminishing interest from oversea investors

SF Issuance in Australia by Asset Class



RMBS Issuance in Australia: Domestic vs. Cross-Border



Source: S&P; * As of end-Aug 2008

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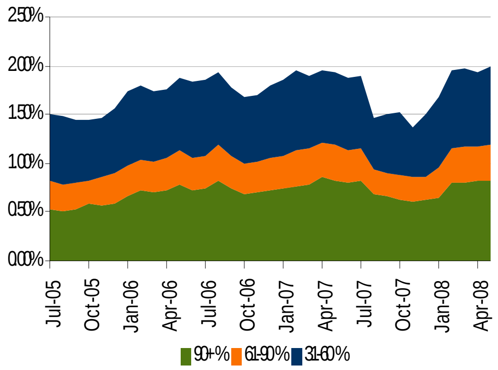
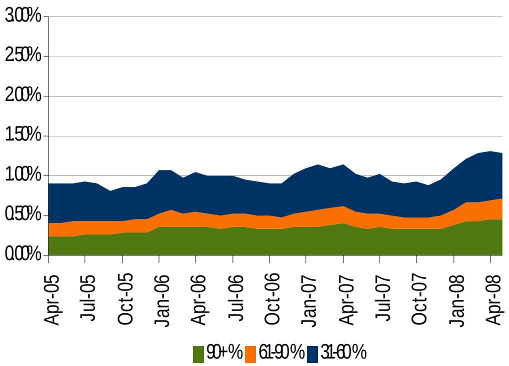
Australia (2)

- Rating dependency of subordinate RMBS tranches on LMI*
  - LMI has long been the main form of credit enhancement for Australian RMBS
    - Some recent RMBS transactions were structured such that the senior AAA tranche is independent of the LMI rating
  - This rating dependency was highlighted by some recent rating actions due to the rating actions on two main LMI providers
    - Rating actions on Genworth Australia and PMI Australia were due to the deteriorating performance of their parent companies in US
- Underlying mortgage performance deteriorating, but unlikely to affect RMBS rating
  - 90+ delinquency ratio for prime mortgage has reached a record high level of 0.55%
  - Given the weaker economic outlook and trend of higher interest rate, it is likely the delinquency will trend up further

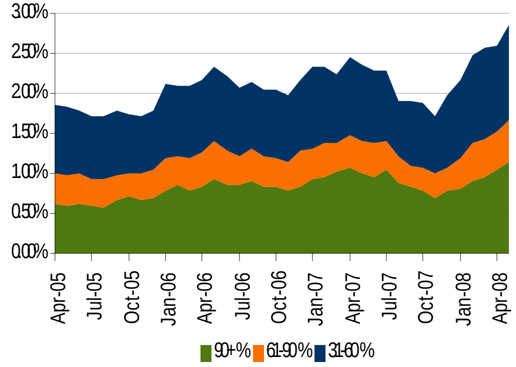
Prime Mortgage Performance



Prime Full-Doc Mortgage Performance



Prime Low-Doc Mortgage Performance



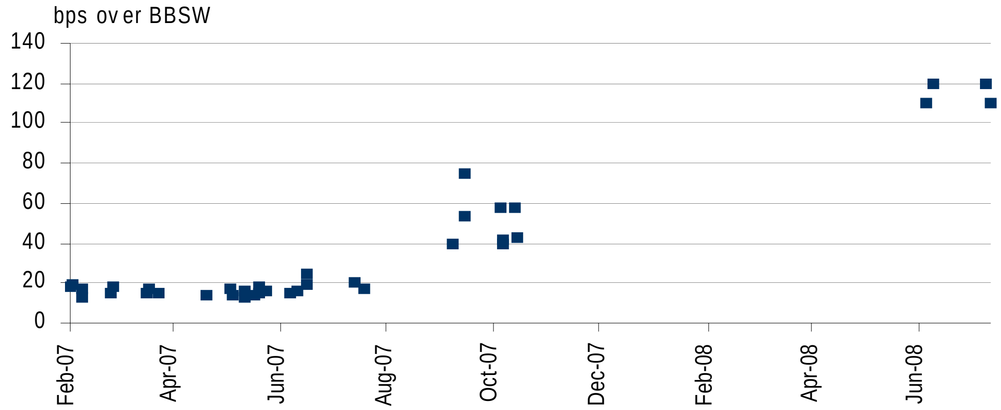
Source: S&P SPIN

* Lenders' Mortgage Insurance

Australia (3)

- Pricing has widened substantially since 1H07
  - Looking at triple-A primary spread for prime RMBS, spread has moved from around 20bps throughout 1H07 to 60~80bps in 2H07, then widened further to 110~120bps in July08
  - Reflecting concerns about
    - Impact of the global credit crisis
    - Rating dependence on LMI rating
    - Underlying mortgage performance

AAA primary spread for prime Aussie RMBS (denominated in A$)



Source: Merrill Lynch

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Latin America

Analyst

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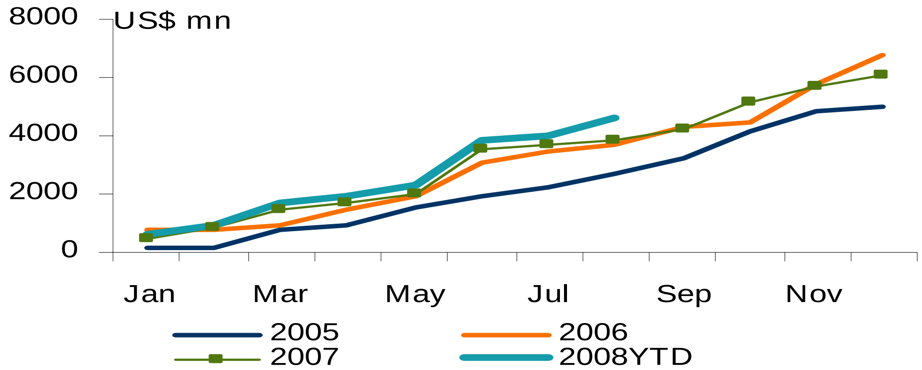
Brazil's securitization market: primary issuance

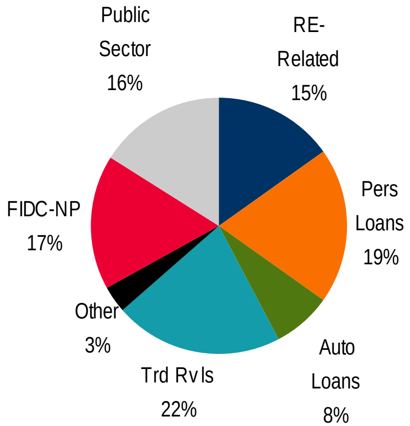
Annual issuance volumes to end-August 2008 (US mn)



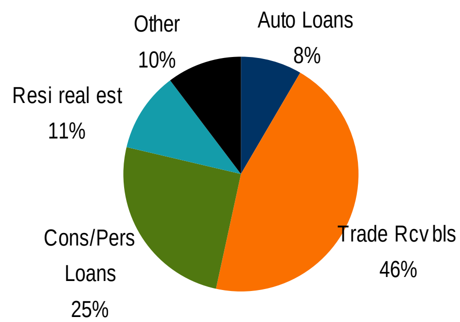
- Annual primary issuance volumes in 2008 likely to exceed historical records, despite a sluggish start to issuance in the first part of the year
- Expect 3Q and 4Q issuance volumes to outpace previous years, with several new transactions in the pipeline
- Surge in cross-border market issuance by local banks (mostly DPR transactions)

Brazil's securitization market: primary issuance

Securitization: asset mix, 2007



Securitization: asset mix, to end-August 2008



Source: Merrill Lynch estimates

- Share of domestic ABS market backed by consumer credit receivables has historically been smaller in Brazil than in other LatAm markets, but consumer credit ABS representing a larger portion of locally securitized assets each year
  - Trade receivables, usually the largest single category of securitized assets, are still dominant securitized asset
  - *Creditos consignados*, personal/consumer loans and auto loans together represent about a third of all securitization

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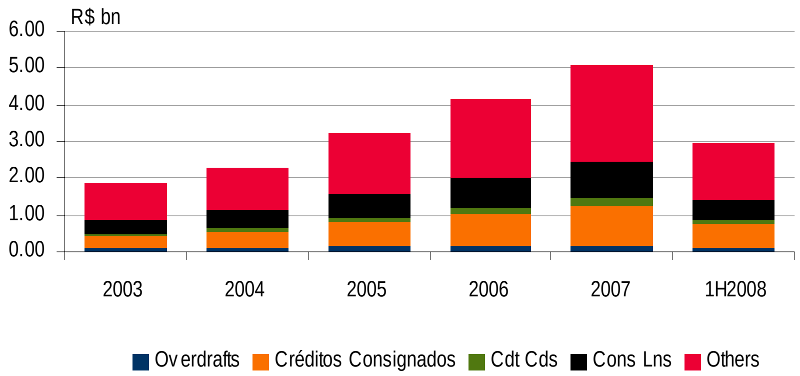
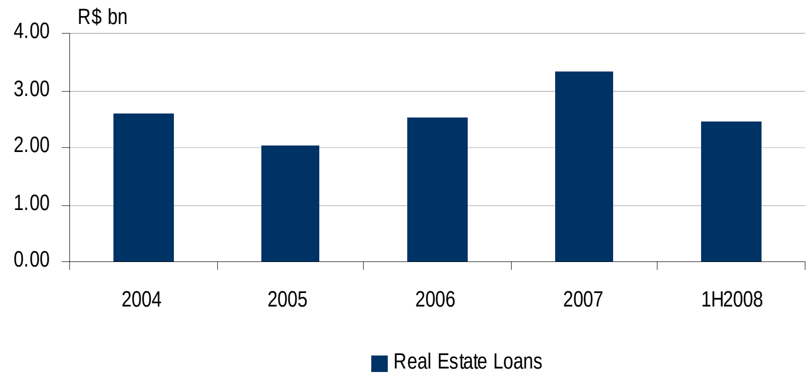
Brazil: consumer vs. corporate credit growth trends

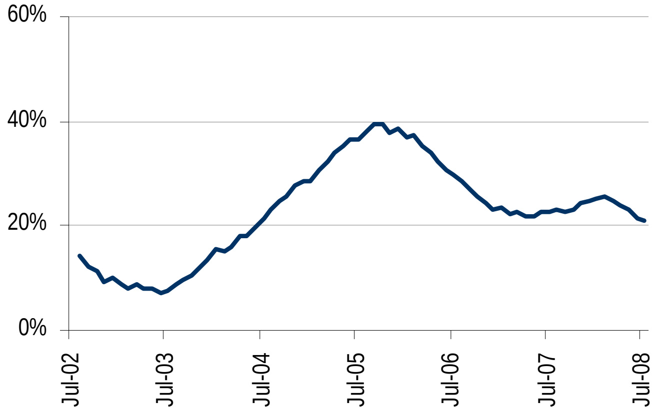
Retail/consumer lending: origination volumes (R$bn)



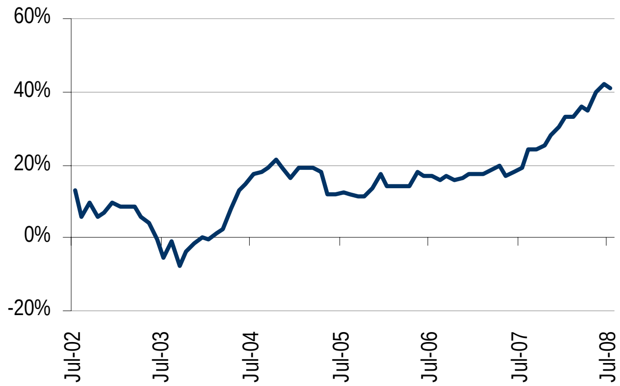
Real estate financing (mortgages/developers loans): origination volumes (R$bn)



12-month retail credit growth, July 2008



12-month corporate credit growth, July 2008

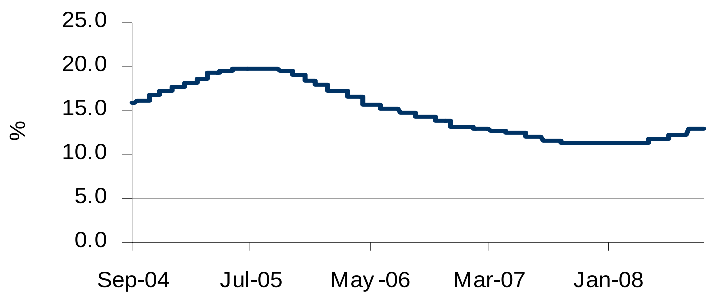


Source: Brazilian Central Bank

Brazil: trends in consumer credit

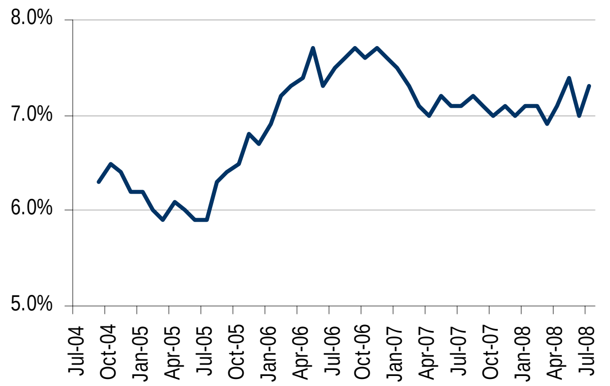
- An explosion in the availability of consumer credit, particularly visible in auto lending and paycheck deductible loans, characterized the Brazilian credit landscape for much of 2006 and 2007.
- However, this trend is moderating in 2008, with lenders tightening origination standards and average retail coupons trending upward based on recent hikes in the benchmark SELIC rate.
  - Efforts to curb domestic demand and combat Brazil's widening inflation rate has prompted the Central Bank to raise rates 3x times since April 2008
  - Average interest rates banks charge on consumer credit rose 4.4% in July to 51.4% from a year earlier
- Delinquency and default rates are trending modestly upward across most consumer credit asset classes; average default rate (>60 days), increased to 4.2% from 4% in June and declined from 4.7% in July 2007.

Brazil's benchmark SELIC rate



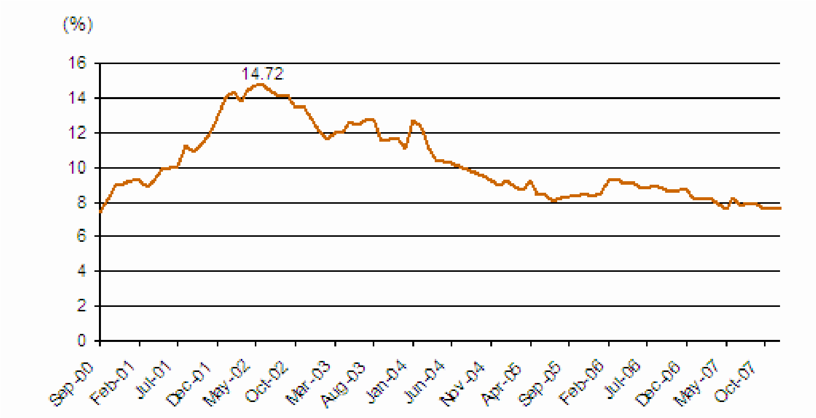
Source: Bloomberg, Central Bank of Brazil

90-day retail delinquency rates, July 2008

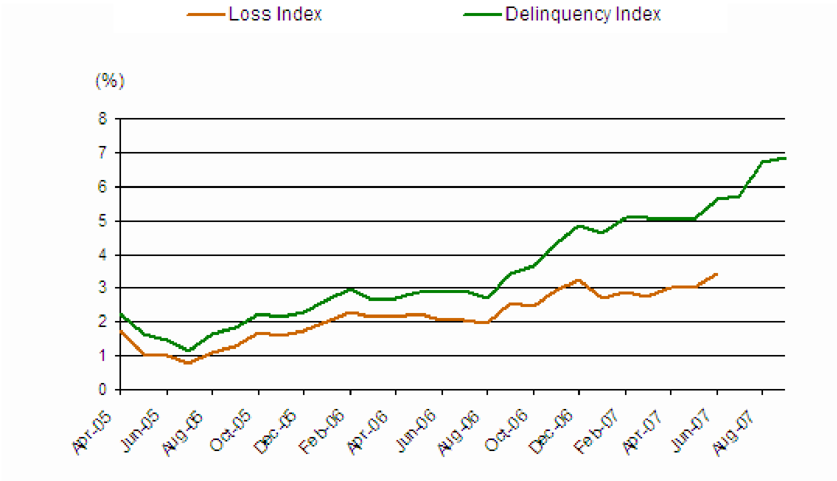


Brazil: performance of securitized portfolios

Securitized pools of personal loans (*consignados*): 90+ day delinquencies, 1Q08



Securitized portfolios: delinquency and loss indices for personal loans (*consignados*), 1Q08

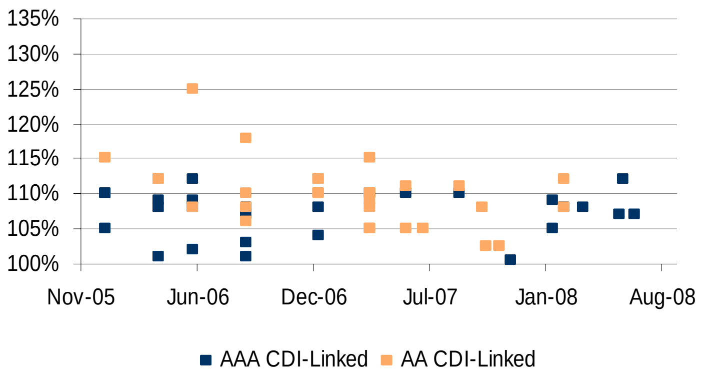


Source: Standard & Poor's

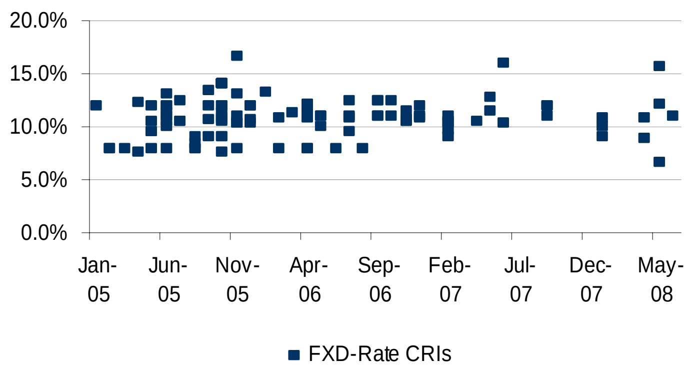
- Performance indices maintained by S&P indicate an upward trend in delinquency and loss rates for transactions backed by *creditos consignados,* but to date, no major issues reported in the performance of transactions backed by consumer credit receivables
- Majority of highly-rated, locally issued ABS is sold to local market investors—investor base not expected to alter much in 2008
  - A 15% withholding tax levied on foreign investors keeps these buyers at bay, with no signs that the government is looking to lift this tax

Brazil: spread developments

Launch coupons for CDI-linked FIDCs



Launch coupons for CDI-linked CRIs



Source: Merrill Lynch estimates

- Wider spread levels across most asset classes since 2H07 have persisted throughout the first 8 months of 2008
  - Expectation for widened spreads to persist through end of year
  - Competition between corporate and local commercial banks have forced spreads to widen across all local debt issuers
- Most larger bank originators continue to rely on deposits for the majority of their funding needs
  - Opportunistic tapping of international capital markets for additional funding, but has proven unreliable and/or expensive in past year

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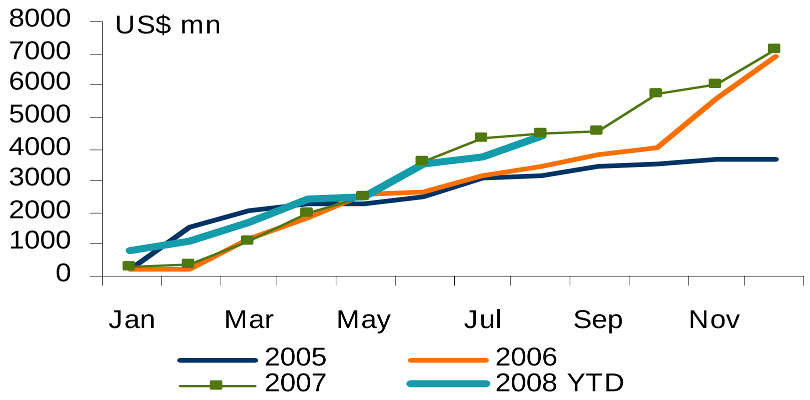
Investment opportunities

- Consumer sector still buoyant in Brazil, though we expect to see continued weakening in performance throughout the rest of 2008 - transactions backed by consumer assets should continue to perform positively in most cases
- Local economy aided by high commodity prices, strong currency
- Greatest medium-term risk is inflation (across the region) and credit overextension by local banks, but central bank appears to be taking steps to prevent a disruption resulting from the consumer credit boom
- Do not expect to see structured product activity in infrastructure space for balance of the year
  - No major transactions in the pipeline, despite the fact that Brazil's multi-year plan calls for US$450 bn in infrastructure spending from 2008-2011 (only 3.3% of the total earmarked for 2008 expenditure had been dispersed by August 7 of this year)
  - BNDES will continue to play a dominant role in this space

Mexico's securitization market: primary issuance

Annual issuance volumes to end-August 2008 (US mn)

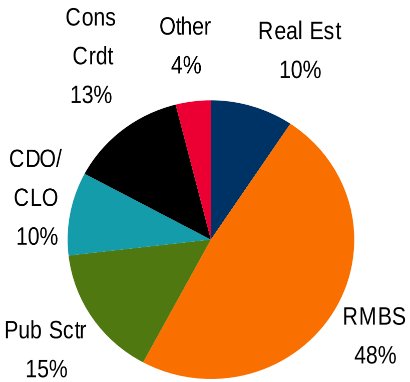


Source: Merrill Lynch estimates

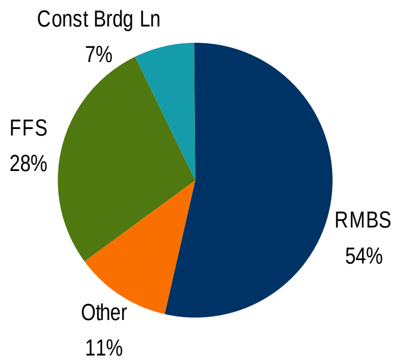
- Despite the existence of a large pipeline of originators waiting to issue, the summer months have seen diminished issuance activity
  - Majority of deals in pipeline are RMBS, which still dominates issuance in this market (some MXN$18bn worth of RMBS transactions are estimated to be currently in the pipeline)
  - A major infrastructure transaction has been waiting in the wings since early August but has found market conditions to continue to be too choppy
- Local investors frustrated by lack of issuer willingness to concede to demands for higher spreads

Mexico's primary securitization market

Securitization: asset mix, 2007



Securitization: asset mix, end-August 2008

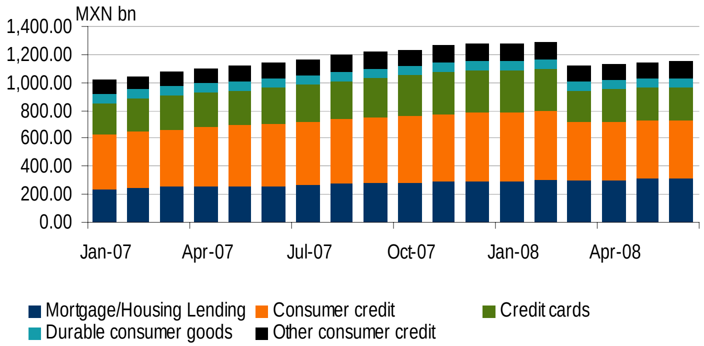


Source: Merrill Lynch estimates

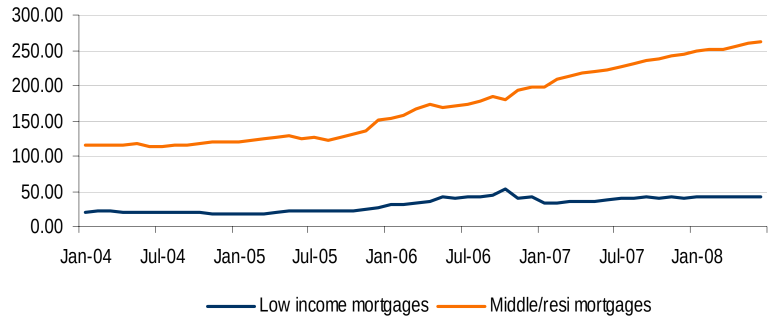
- RMBS continues to dominate issuance in this market, while a handful of very large public sector and future flow (toll revenue) transactions have maintained overall issuance volumes in line with previous years, even as total number of transactions has diminished
- In both 1Q and 2Q, a rash of transactions come to market in the last few weeks of the quarter; likely to see a similar phenomenon at end of 3Q
- 3Q and 4Q should see a number of transactions come to market, as funding needs dictate, but demand stained and difficult to predict

Mexico: consumer credit growth trends

Retail and mortgage lending: origination volumes (MXN bn)



Commercial bank mortgage lending (MXN bn)



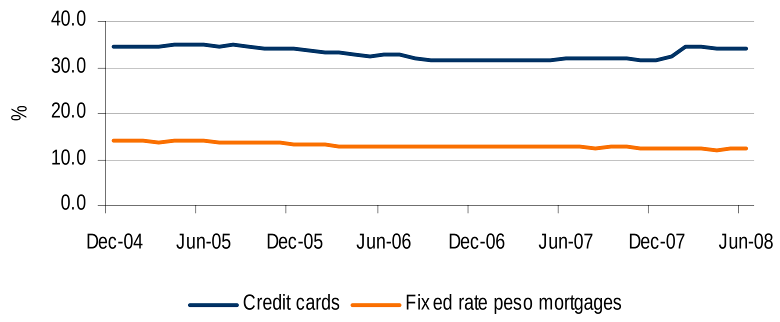
Source: Banxico

- Sharp deceleration in new credit origination in 1H08
- Mortgage lending from commercial banks is flat for low-income origination while middle/residential lending is still experiencing some growth—albeit sluggish

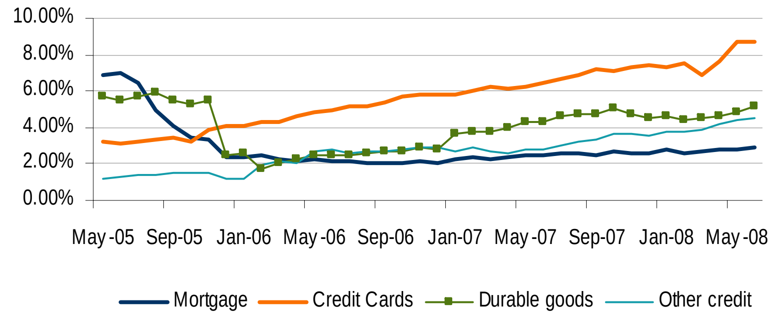
Mexico: credit trends and performance

- Average annual interest rates for consumer credit products have stabilized above recent lows, while mortgages have stabilized at around 12%
- Total volume of delinquent consumer credit portfolio has been steadily increasing at commercial banks
  - Credit cards historically worst performers
  - Only slight uptick in mortgage delinquencies

Average annual interest rates, credit cards and peso mortgages



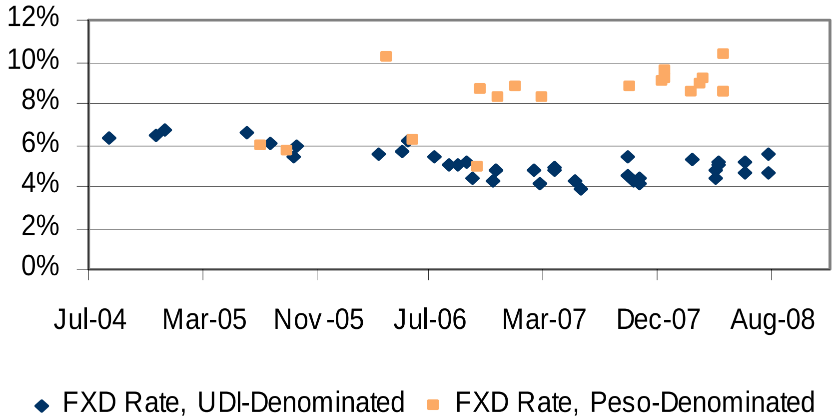
Delinquent portfolio as % of outstanding loans, commercial banks



Source: Banxico

Mexico: spread developments

Issuance coupons on AAA RMBS (at par)



Source: Merrill Lynch estimates

- Contagion from US crisis has also resulted in spread widening for Mexican issuers
  - Secondary spreads averaging 60bps wider than historical lows over the corresponding government benchmark for peso-denominated loans to up to 80bps for UDI-denominated bonds
- Deals have proven more difficult to place, despite conservative structuring and quality collateral
  - Some local institutional investors contend that launch spreads sought by issuers are still not adequately reflecting the market's new reality
  - Nonetheless, a record-breaking RMBS tsxn issued by BBVA Bancomer in early August may be a proof that appetite still exists in market for the strongest issuers

Investment opportunities

- Consumer credit sector has unequivocally begun to cool in Mexico, with credit origination shrinking and average coupons inching upward as funding has become more expensive for originators
  - Performance in loan portfolios also weakening somewhat as Mexican economy slows in step with US' underperformance
  - Thus far, stable collateral performance observed for securitized portfolios of Mexican mortgages and consumer credit-backed ABS, though a up-tick in defaults for later vintage securitizations (2006-2007)
- Hawkish stance by Banxico appears to have gone much of the way towards curbing inflationary pressures, a concern during 1H08
  - Inflation-linked currency (UDI) provides some protection, as majority of local ABS issuance is denominated in the UDI
- Securitization in infrastructure space expected to pick up in 4Q or early 2009
  - FARAC I package currently in the works, following on Carlos Slim's IDEAL MXN$7bn peso securitization of toll road revenues in June
  - Local market appears capable of absorbing large issuance volumes and interested in taking on infrastructure sector risk

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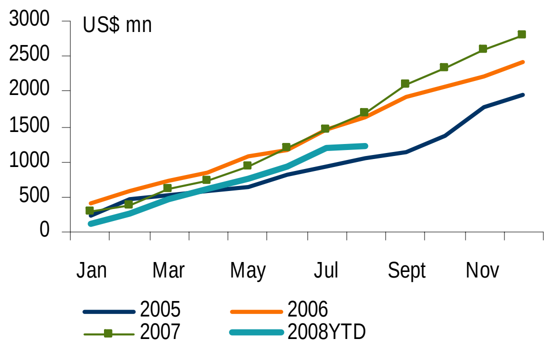
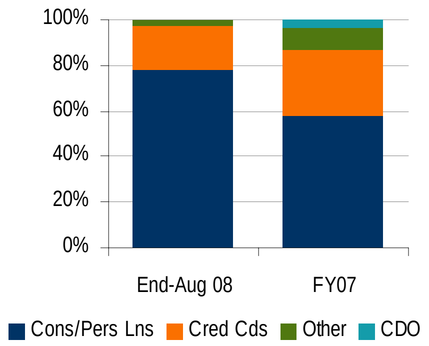
Argentina's primary securitization

Issuance volume to end-August 2008

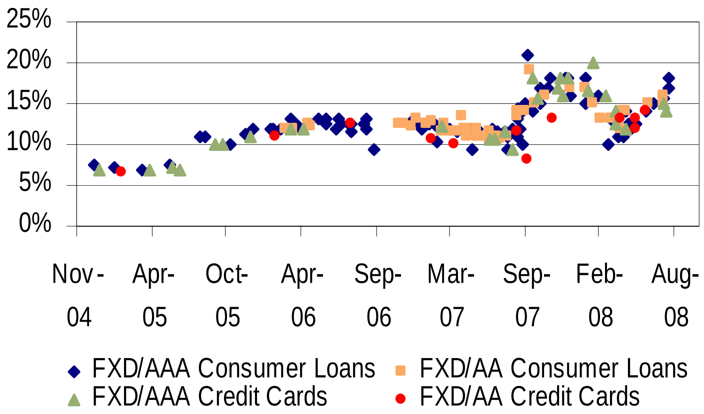


Source: Merrill Lynch estimates

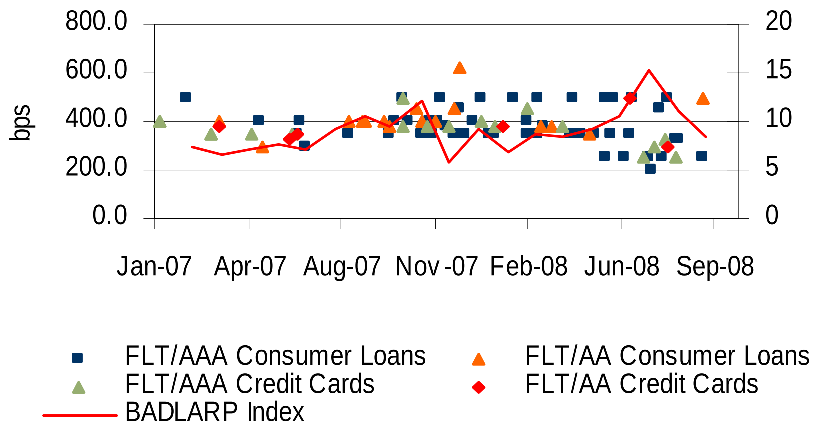
Securitized asset mix: 2007 vs. end-August 2008



Issuance coupons for fixed rate consumer credit ABS (at par)



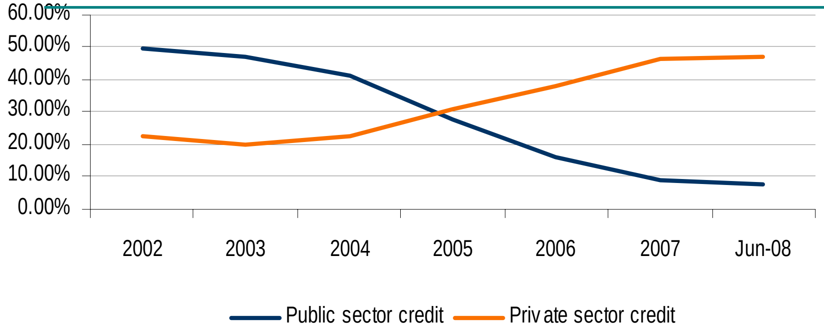
Launch spreads for floating rate consumer credit ABS



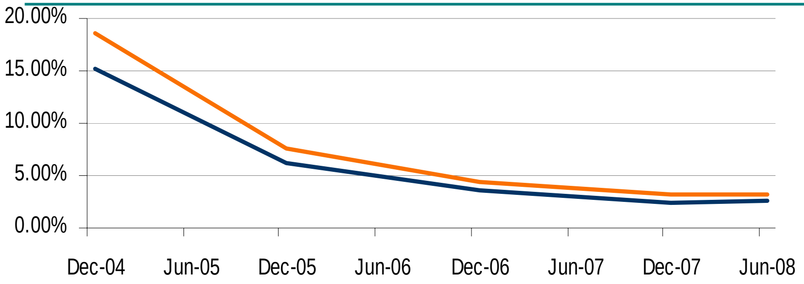
Source: Merrill Lynch

Argentina: consumer credit performance and growth trends

% of financial system portfolio exposure to public v. private sector credit



Portfolio delinquency rates, loans to non-financial private sector

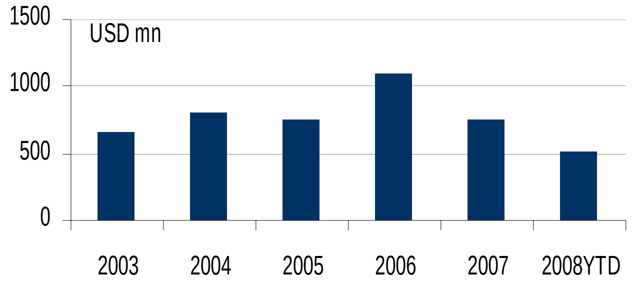


Source: Central Bank of Argentina

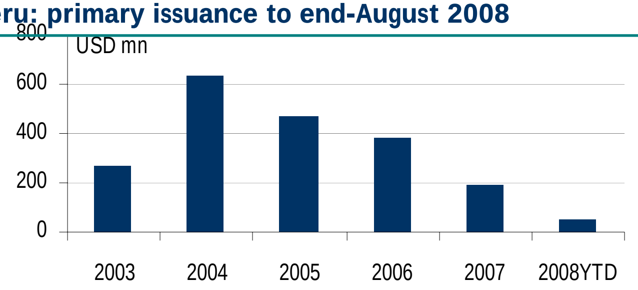
- Loans to the private sector have grown dramatically in past three years, but show some signs of cooling in the 1H08
- Central bank data points to only a modest up-tick in loan delinquencies in past year
- Greatest threat to Argentinean local market performance is persistent inflationary pressure, which is estimated to be currently above 25% (though official figures are much lower)

Other markets: primary issuance trends

Colombia: primary issuance to end-August 2008



Peru: primary issuance to end-August 2008

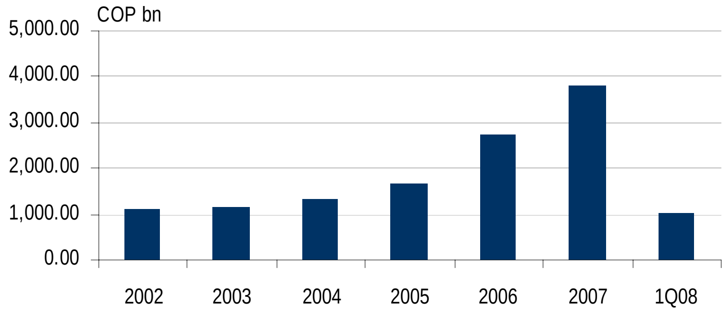


Source: Merrill Lynch and Fitch Ratings

- Primary issuance in smaller markets has been subdued in 2008 on back of US crisis
  - Colombian market still dominated by RMBS issuance from *Titularizadora Colombiana*
  - A small number of municipal transactions in Peru, despite recent establishment of *Titularizadora Peruana* (spin-off of Colombian entity) expected to further develop local RMBS market in 1H2009

Colombia: consumer credit market trends

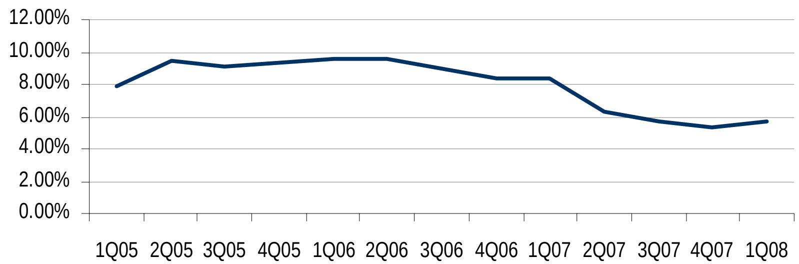
Colombian mortgage origination (COP bn)



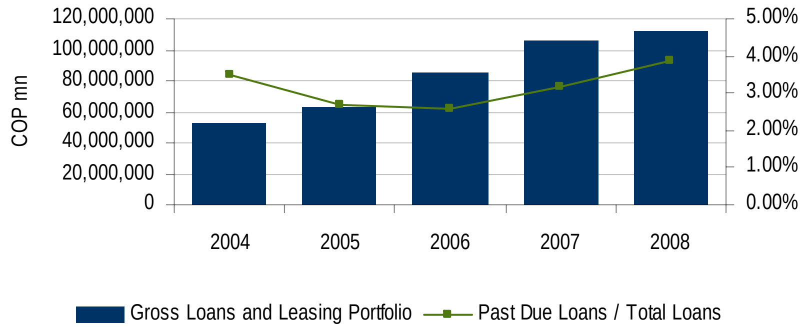
Source: DANE, Merrill Lynch

- Colombia's mortgage market still exhibiting positive growth trends and stable performance
- Retail loan delinquency rates, however, trending upward

30+ day delinquency as % of total mortgage portfolio



Delinquencies of retail loan portfolios at Colombian banks



Source: Superintendencia Bancaria de Colombia

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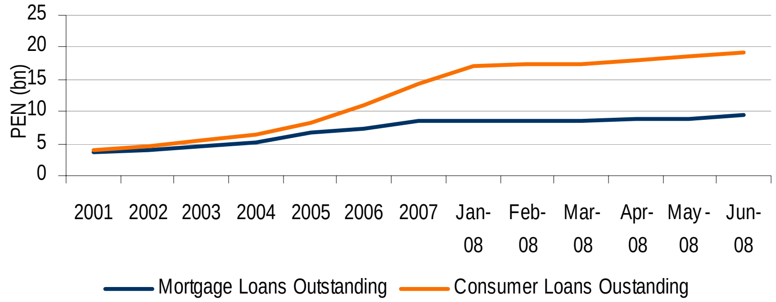
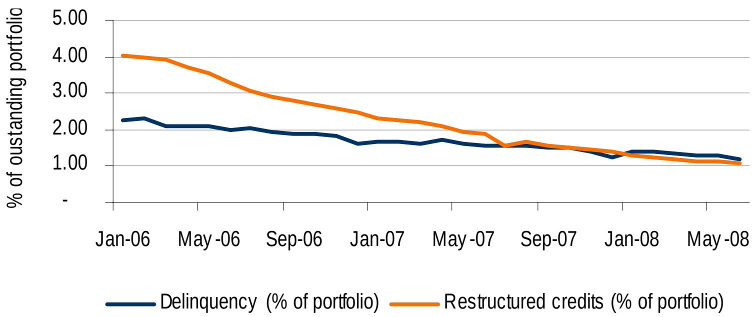
Peruvian mortgage and consumer credit markets

- Peruvian consumer and mortgage lending still growing at a healthy clip
- Performance of loan portfolios (all consumer credit loan types, including mortgages) at commercial banks have improved markedly in the past two years

Mortgage and consumer loans outstanding (PEN bn)



Delinquency and restructured credits, as % of commercial banks' portfolios



Source: Superintendencia de Bancos, Seguros y AFP

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Islamic finance

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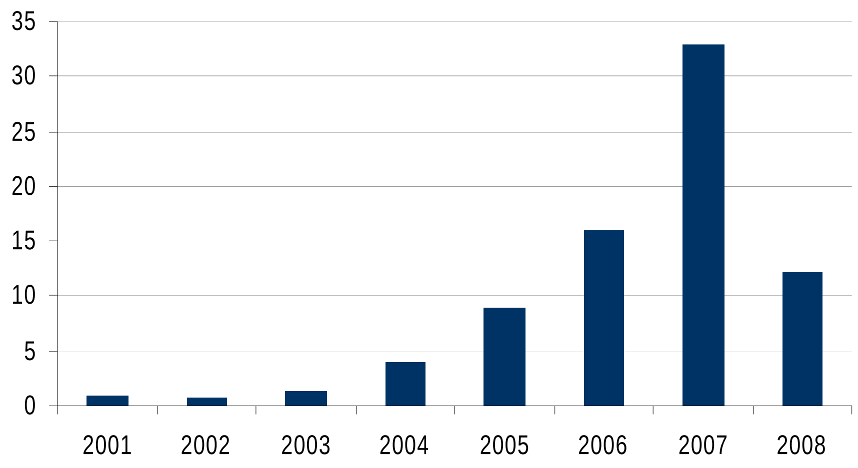
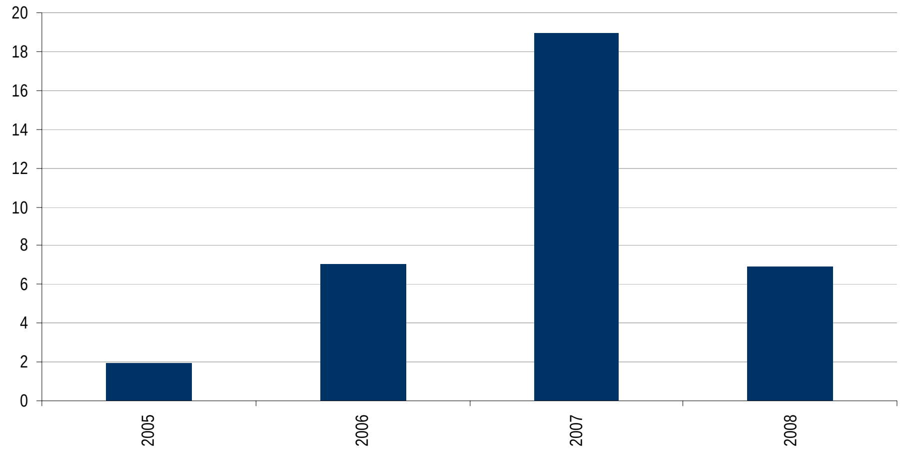
Sukuk market: lower issuance, wider spreads

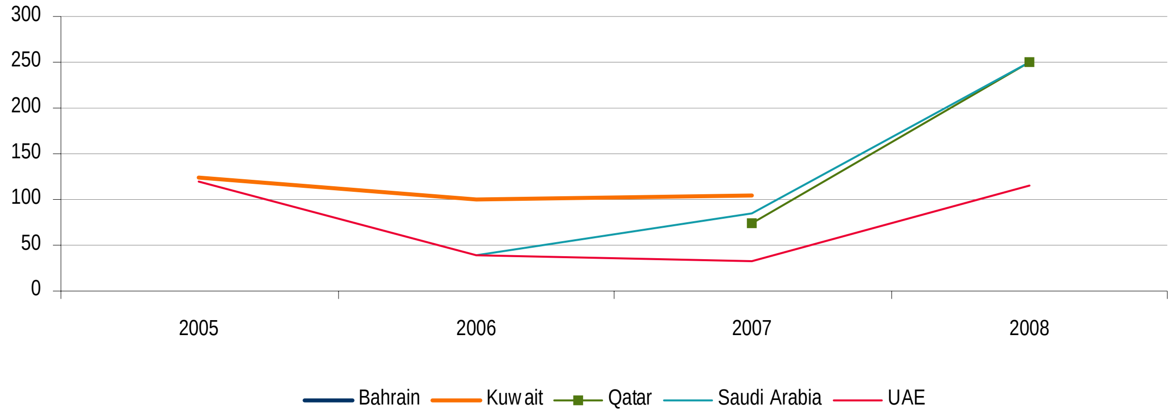
Global Sukuk issuance (US$bn)



GCC Sukuk issuance (US$bn)



5yr FLT, Corporate Sukuk spreads (bps)



Source: ML

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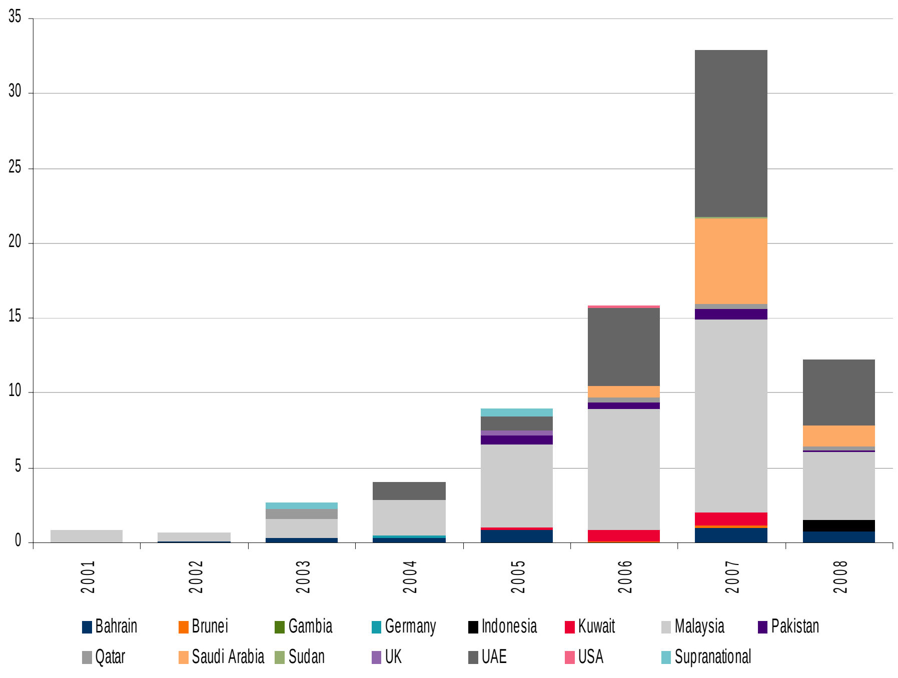
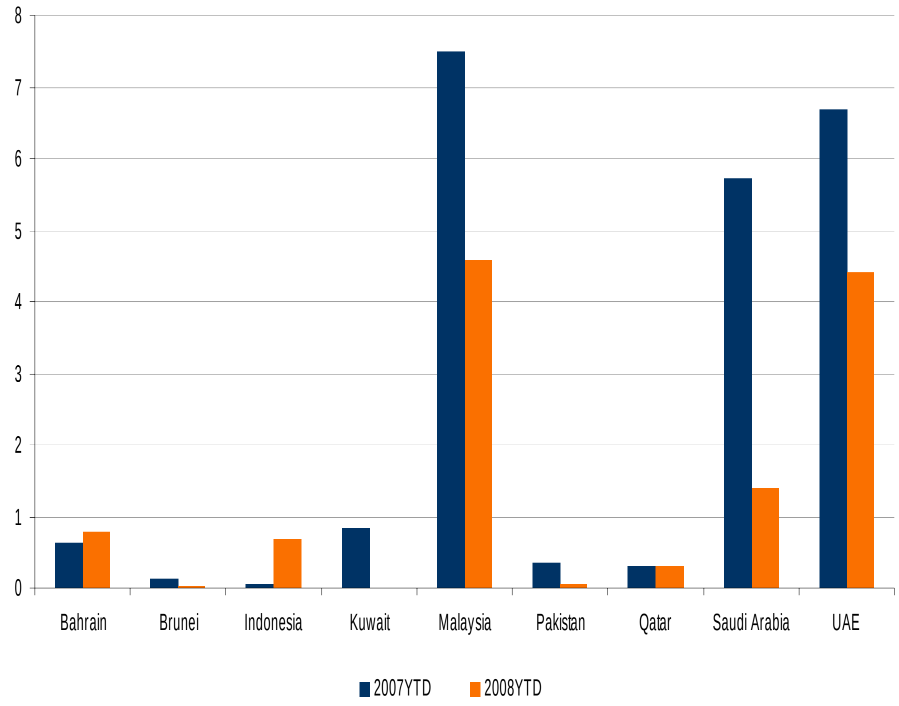
Sukuk market still driven by Malaysia, Saudi and UAE

Sukuk issuance by country (US$bn)



2007ytd vs 2008ytd Sukuk issuance (US$bn)



Source: Zawya, Merrill Lynch, IFIS

Sukuk spreads widened and issuance declined

- Sukuk spreads widened 2-3 times;
  - Corporate sukuk priced in the range of 115 – 275bps
  - Widening attributed to shariah ruling on asset buy-back in sukuks, contagion from the global economic slow down and uncertainty regarding the GCC dollar peg
- Ytd issuance declined 44% y-o-y; only Bahraini market surpassed last year's numbers – local money market instruments in demand
- Malaysian local currency sukuk dominated the market with US$4.6bn issuance
- Middle eastern issuance predominantly in local currency – peg issue
- Shariah-compliant syndicated lending continues as an alternate debt supplier

Islamic Securitisation

- First land securitization in Abu Dhabi and the UAE: Sun Finance Limited
  - First 100% local currency ABS; true sale with title transfer for asset isolation
  - Rated Aa3/A3/Baa3 and priced at 200/250/350bps over EIBOR
  - Low WA LTV (49%), 42% over-collateralisation, short WA life (21 months) & pre-funded reserve accounts
  - Strong state participation in Abu Dhabi's development, registered land ownership & high-rated backup servicer, positive real estate outlook in Abu Dhabi for short-medium term

Class	Rating	Amount (AEDmn)	Certificate %	Maturity	Coupon
A	Aa3	2,761	55	Jan-15	1 mth EIBOR + 200
B	A3	251	5	Jan-15	1 mth EIBOR + 250
C	Baa3	1,004	20	Feb-15	1 mth EIBOR + 350
Subordinated	NR	1,004	20		
Total		5,020	100		

Source: Moody's

GCC Securitisation: any chance?

- **Fundamentals:** Economic fundamentals supported by oil price
- **Credit growth: c**redit growing rapidly, bank lending growth (banks' loan-to-deposit 100% in Qatar, 65% KSA), over-exposure to the real estate sector – need to offload in the capital market
- **Collateral performance:** low non-performing loan ratio supported by economic growth in GCC; consumer loans exposed to local stock markets (esp. KSA) and real estate
- **Demand:** local investors and banks; shariah-compliant securitisation to attract Islamic banks
- **Legal issues:** untested and evolving legal system; two-tier SPV used so far; free-zones more reliable, replicate English law
- **Expectations:** GCC securitisation to continue; UAE the most developed markets in the GCC; Qatar and Saudi are showing signs of interest

MENA CRE: A snapshot

- Abu Dhabi
  - Office: limited supply resulting in a ‘hold-on’ mentality; likely delays in the forthcoming supply – support for rent and capital appreciation, but dependangt on macroeconomy
  - Retail: GLA per capita to increase by 53% in 2010; 19% y-o-y sales growth needed to sustain; mega malls with integrated leisure facilities to fare better
  - Hotel: 78.5% occupancy (83% for 5*); avg room rents grew 40% y-o-y; 75% demand from corporate tourism; sector relying on govt’s ability to attract tourists
- Dubai
  - Office: Supply to increase by 60% in 2009; over-supply concerns if timely delivery of projects; 28% y-o-y rental increase in Q1’08
  - Retail: Significant market share in GCC retail industry; space expected to double in the next 2-3 yrs; tourism figures are likely to have a direct impact
  - Hotel: Europe accounts for 36% of visitors; 84% room occupancy in 07; 89% 5* room occupancy; early indication of low occupancy rates in 08 - lead indicator for problems in Dubai’s CRE mkt?
- Qatar
  - Office: Rent to construction yield of 50%; supply to increase 150% in 2-3yrs; demand growing on Qatar’s expansion but is it sustainable?; government control essential
  - Retail: Space per capita to increase to 2-3 x Europe’s levels; trend of larger malls; mega malls – further development of mega malls a risk!
  - Hotel: 10% growth in rents; supply to triple vs. 150% tourism increase – risk to rents

MENA CRE: A snapshot (contd.)

- Damascus (Morocco)
  - Office: Shortage of Grade A properties; market fragmented into residential buildings; increasing demand and now supply driving rents and capital values up; initial yields around 8–11%
  - Retail: Country's largest employer; strong demand for 'family outing' type retail malls; new developments focussed on mega malls; initial yields in the range of 5-14%
  - Hotel: Increased tourism; supply constraints in the 4* & 5* segment; occupancy rising above 80% in some cases
- Amman (Jordan)
  - Office: Shortage of high quality space in the CBD; market fragmented into residential villas; occupancy rates 95%+; corporate tenants occupy 50% more space than that in the UAE; prime space yields of about 12%; for secondary space - 14%
  - Retail: Malls, a new concept; lack of international standard shopping space – considerable premium expected in this space; rents in the range of US$120 - 320 sqm/pa
  - Hotel: Occupancy rates improved since 2006; revenue per avg room improved with 5* commanding US$142; occupancy rates increased to 60% in 07

Source: Colliers, CBRE

MENA Residential

- Abu Dhabi
  - 98% occupancy rate; 100,000 units needed by 2010; 140,000 units expected to be delivered by 2013; sale price growth of 53% in 2007-08; 22% rental y-o-y growth; development delays likely; initial yields of 8%;
- Dubai
  - Rental growth slowed to 10%; 30,000 – 40,000 units of supply expected; delays experienced in supply; middle and low income housing is scarce
- Qatar
  - Upcoming supply enough to meet demand for 1.4% population growth vs. expected 7%; rents grew three times over the past 2 years; demand mainly from expatriates
- Damasacus (Morocco)
  - Significant speculative activity; Price fixing by govt bodies – 20% sale price growth, 30-40% rental growth; 7000 units of supply by 2013; private sector participation growing; initial yields of 5-7%
- Amman (Jordan)
  - Low-income demand being met through off-plan mortgages; affordable housing; 7000 units expected in 2007; high-end sector maybe over-supplied; initial yields of 8-10%

Source: Colliers, CBRE

Consumer & mortgage lending

- **Total loans (% of GDP):** UAE (103%), Qatar (69%), Bahrain (64%), KSA (42%), Egypt (48%)

Consumer

- **Deposits (% of GDP):** UAE (103%) and Bahrain (96%) leading, position boosted by offshore financial centres
- **Retails loans:** Highest retail loans in Qatar and Bahrain, UAE lagging (6% of GDP)
- Private consumption rising; credit card market growing – UAE accounts for 50%

Mortgage

- Mortgage penetration low across the board; UAE (8%) and Kuwait (10%) top the list
- Increasing housing costs to support mortgage growth
- Legal infrastructure needs clarity

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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