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FIXED INCOME ADVISERS

Top Ten Reasons for the Financial Crisis

May 4, 2009

Pennsylvania Association of
Public Employee Retirement
Systems (PAPERS)

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Information contained herein should be used for one-on-one
presentations only and should be accompanied by this disclosure.



Investment Forum 2009



“How could a few million problem U.S. mortgages bring down the global financial system?”

TOP TEN

REASONS FOR
THE FINANCIAL CRISIS

**TOP
TEN**

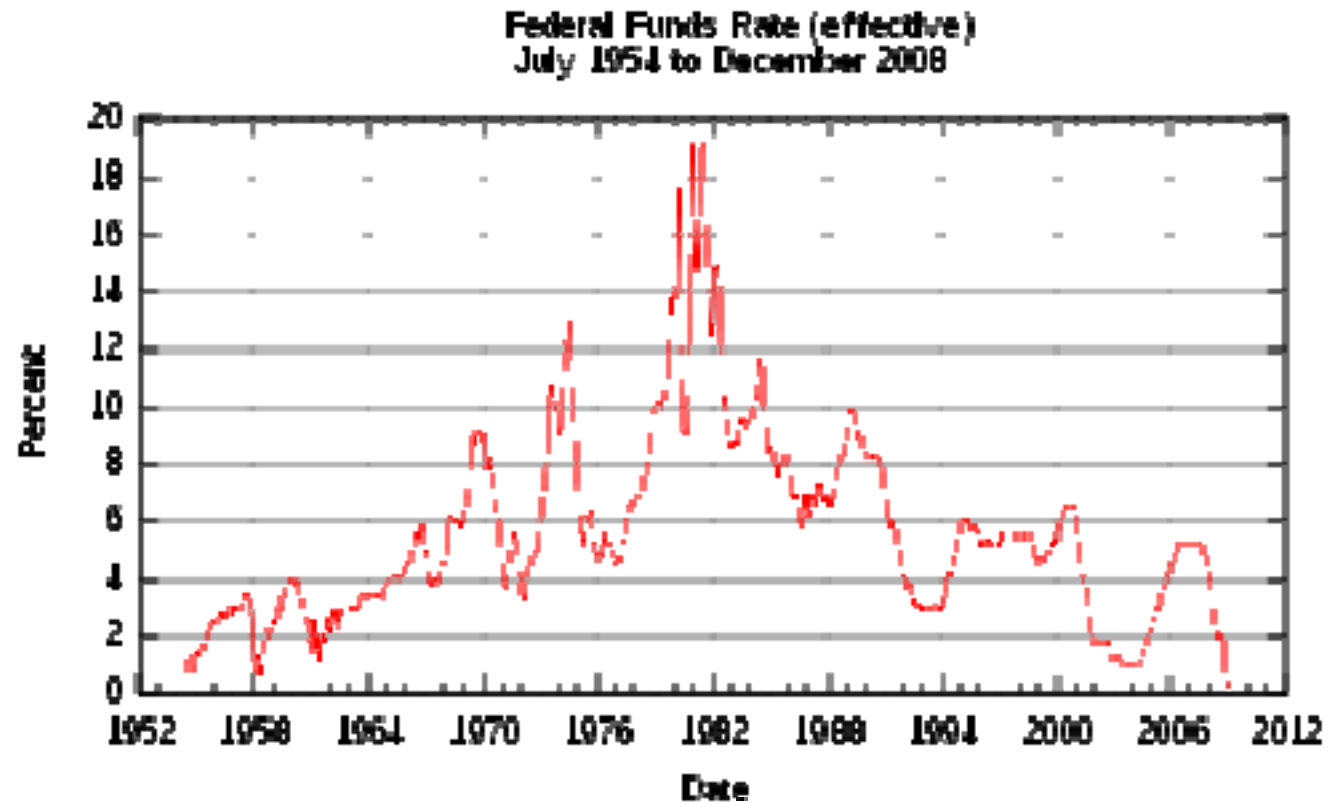
**REASONS FOR
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**TOP
TEN**

**REASONS FOR
THE FINANCIAL CRISIS**

10. POST WWII FED POLICY, MONETARY ACTIVISM

Federal Funds Rate 1954-2008



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Federal Funds Rate 1971-2009



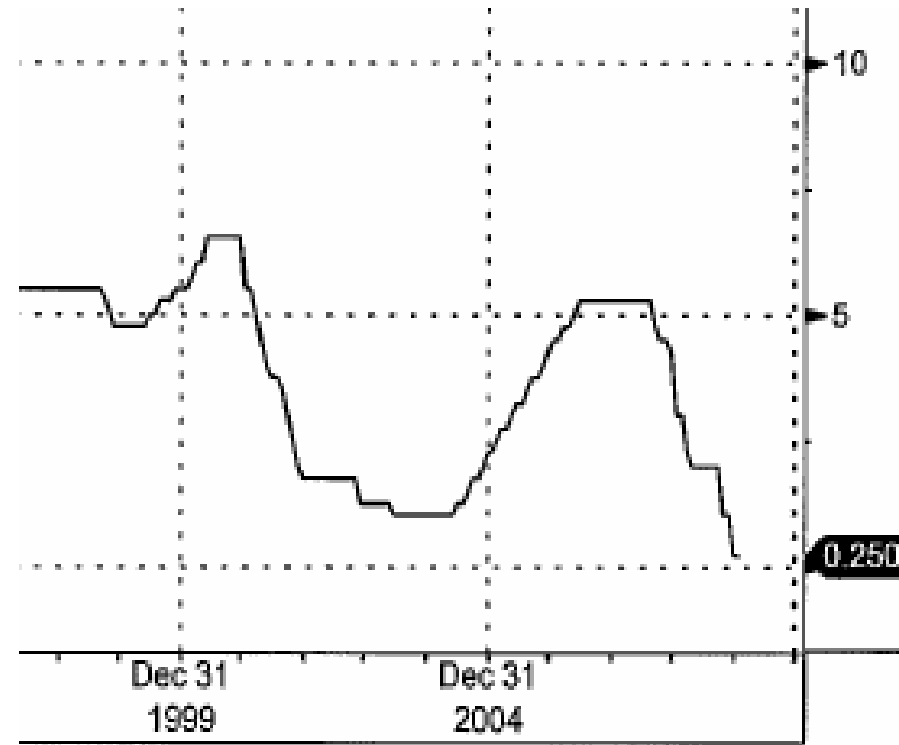
FDTR Last 0.25% JAN 28 Next 03/17/09 14:15 Surv -- Index **GP**
 Federal Funds Target Rate US

FDTR INDEX Hide GP - Line Chart Page 1/14
 Range 01/29/71 - 01/30/09 Upper Revised Line Mov. Avgs Currency USD
 Period Monthly Lower None Mov. Avg Events



Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000
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Federal Funds Rate 1999-2009



49 69 9204 1210 Hong Kong 852 2977 6000
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REASONS FOR THE FINANCIAL CRISIS

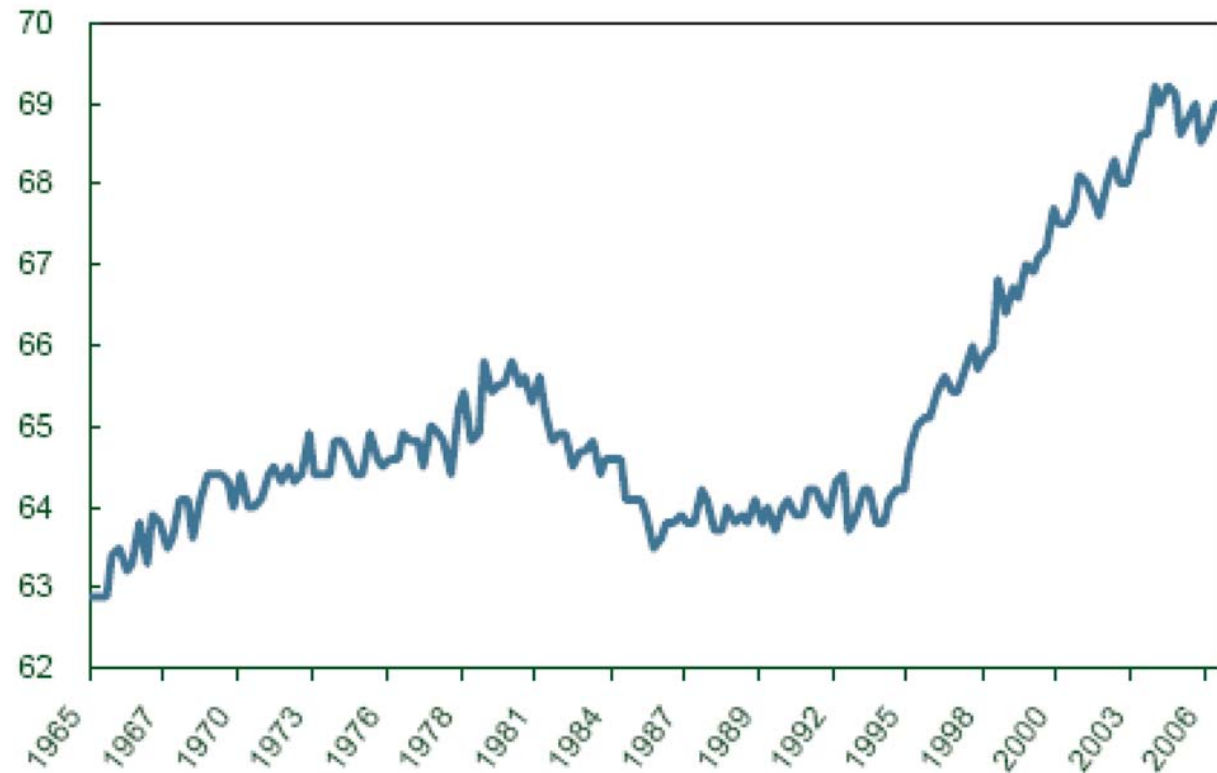
9. DECOUPLING OF THE LENDER/BORROWER RELATIONSHIP
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REASONS FOR THE FINANCIAL CRISIS

8. PUBLIC POLICY HOUSING INITIATIVES, AN OVERBUILT/
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U.S. Home Ownership Rate (%)

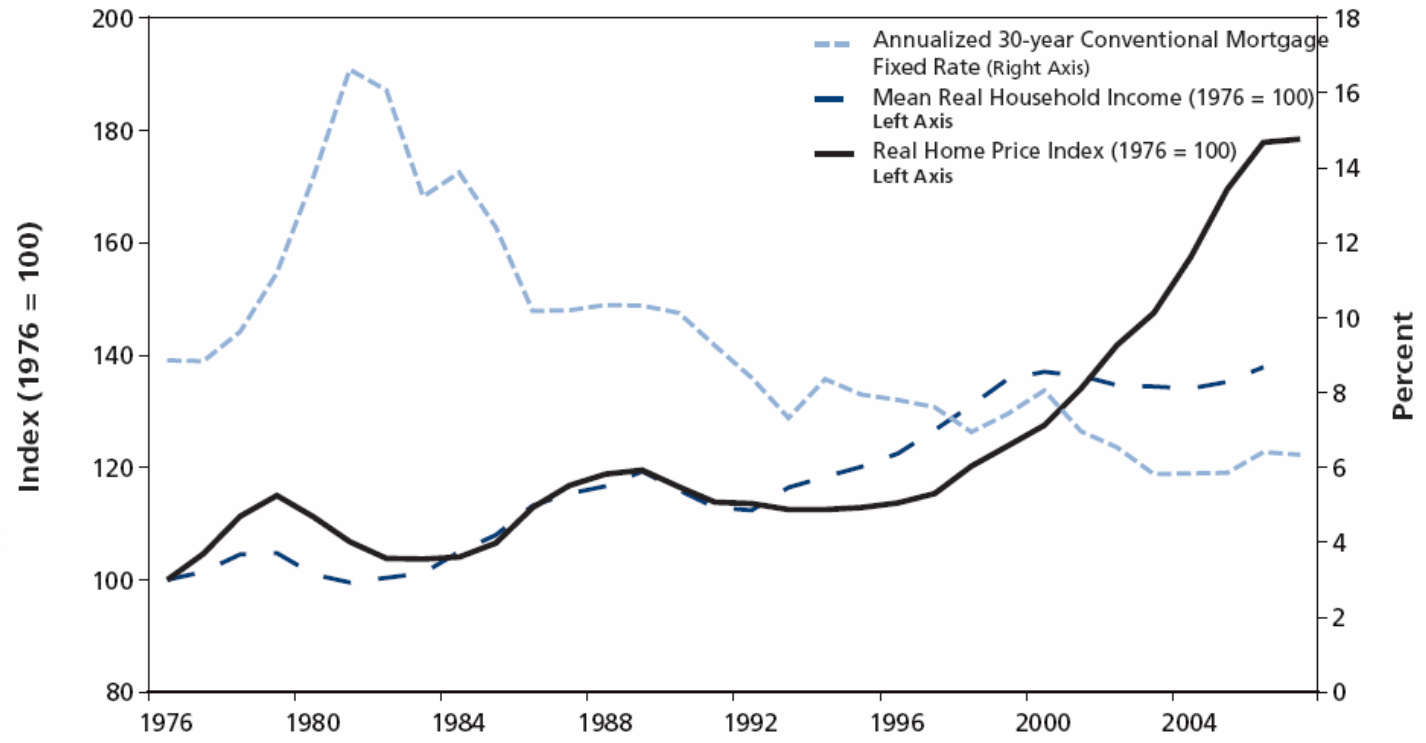


Source: U.S. Census



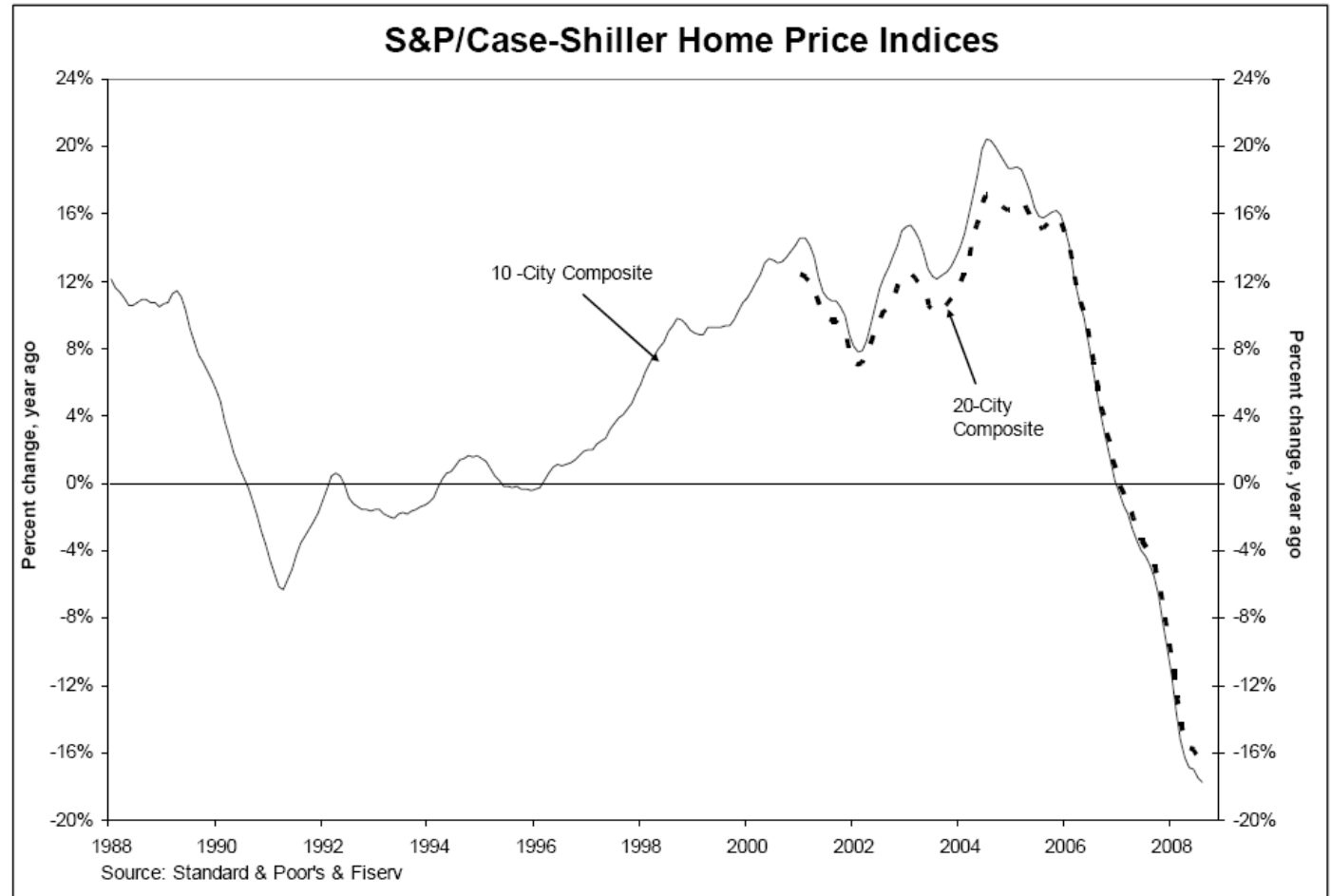
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Real Home Prices and Real Household Income (1976=100) 30-year Conventional Mortgage Rate



Source: OHFEO; Federal Reserve; Bureau of the Census. Home Prices and Income are deflated by CPI less Shelter

Home Price Index



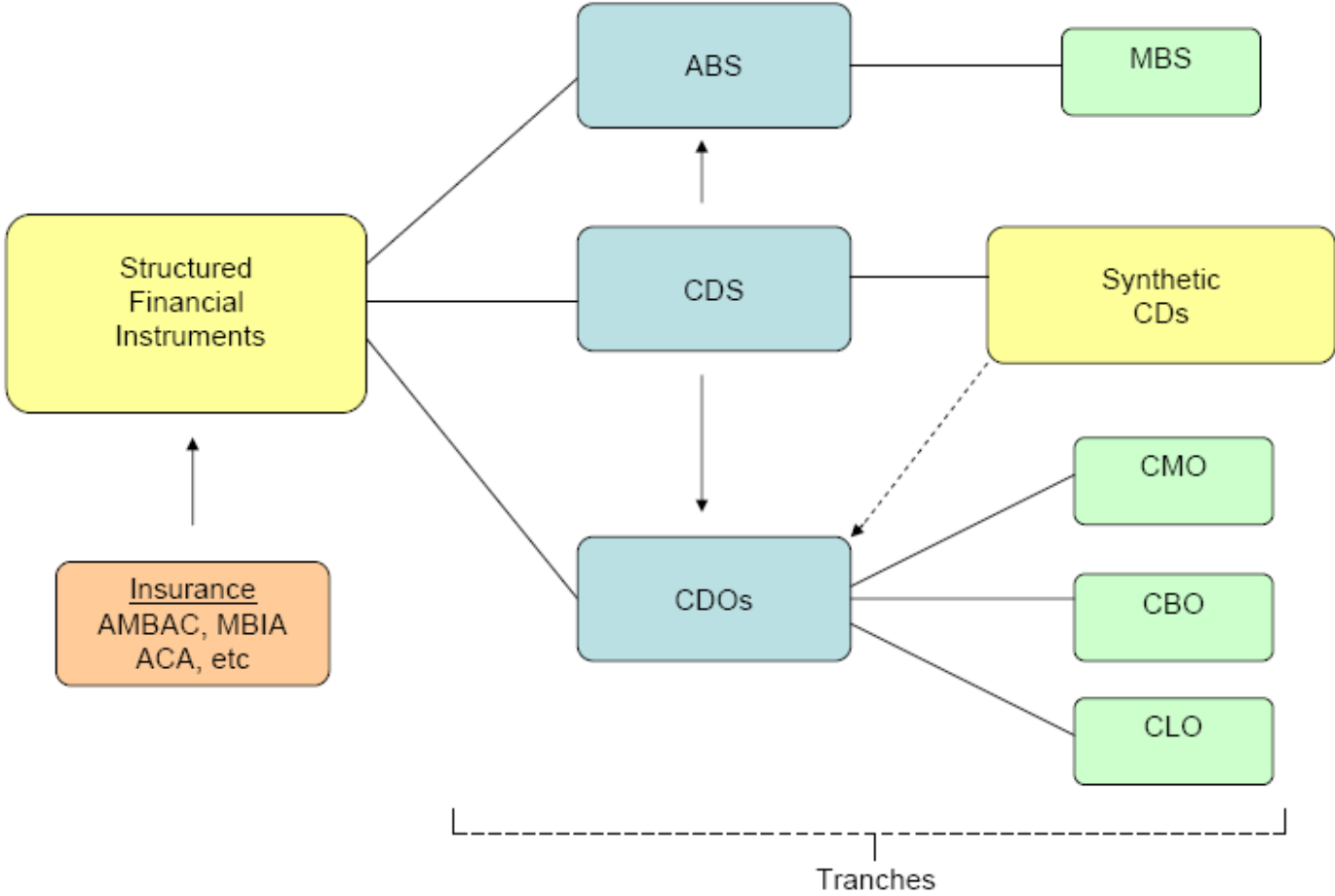
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REASONS FOR THE FINANCIAL CRISIS

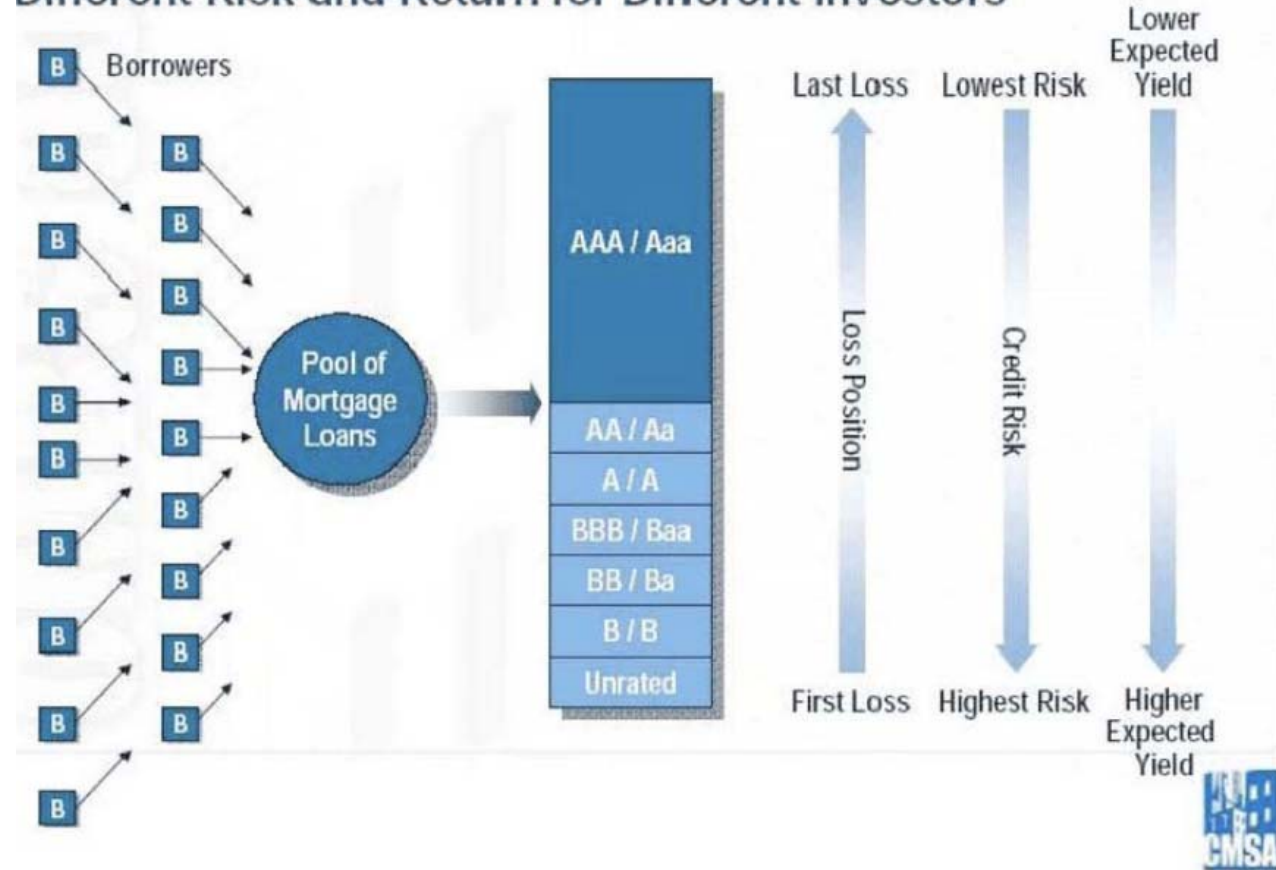
7. **FINANCIAL ENGINEERING AND SECURITIZATION, INVESTOR DEMAND FOR EXCESS RETURN**
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Evolution of Financial Engineering 1980-2008



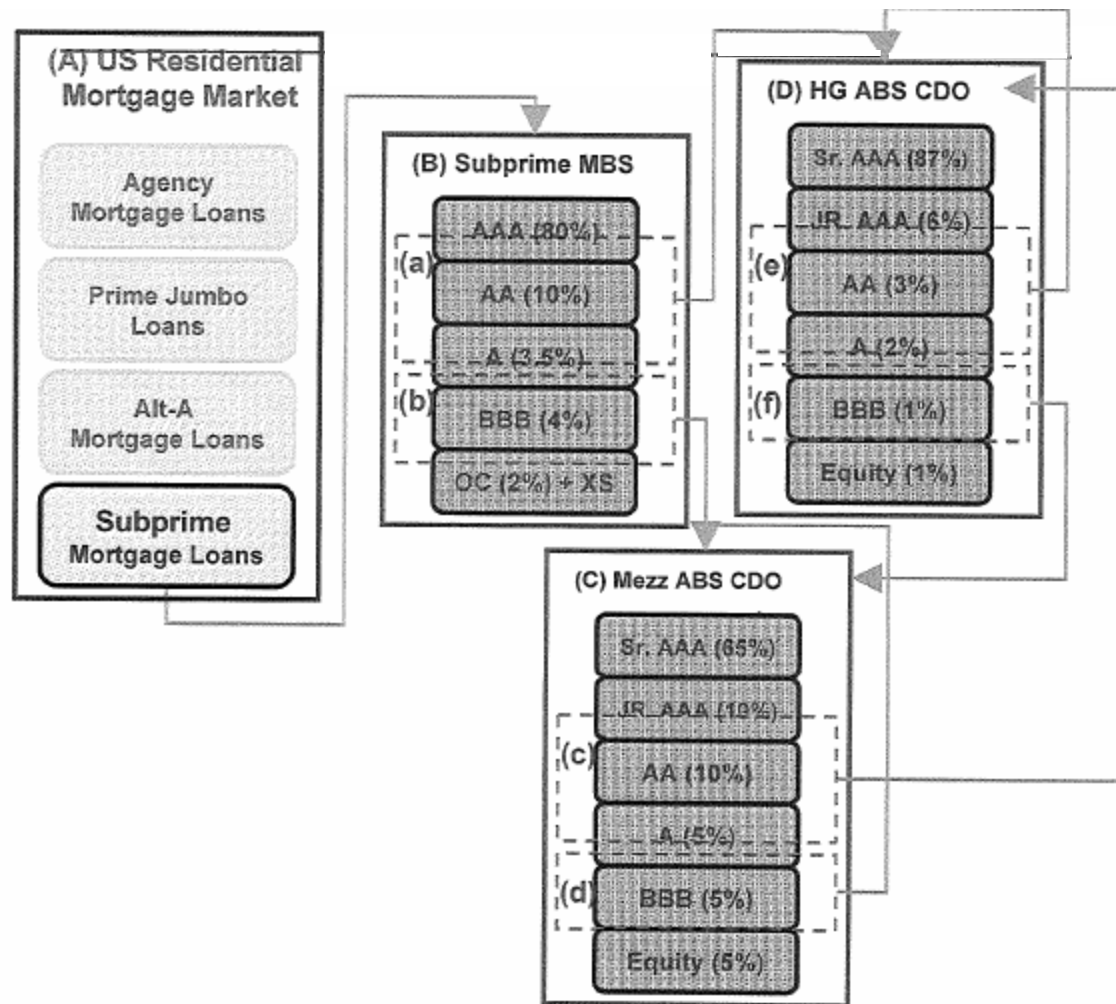
Asset Backed Securities (MBS)

Different Risk and Return for Different Investors



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CDO With Subprime Tranches



Credit Default Swaps (CDS)

A Common Credit Default Swap Transaction

Protection Seller

Does not usually own underlying credit asset

Selling Credit Protection

Long Credit Exposure

Payment Only if Credit Event Occurs

Credit Default Swap Premium Paid Periodically

Protection Buyer

Tends to own underlying credit asset

Purchasing Credit Protection

Short Credit Exposure

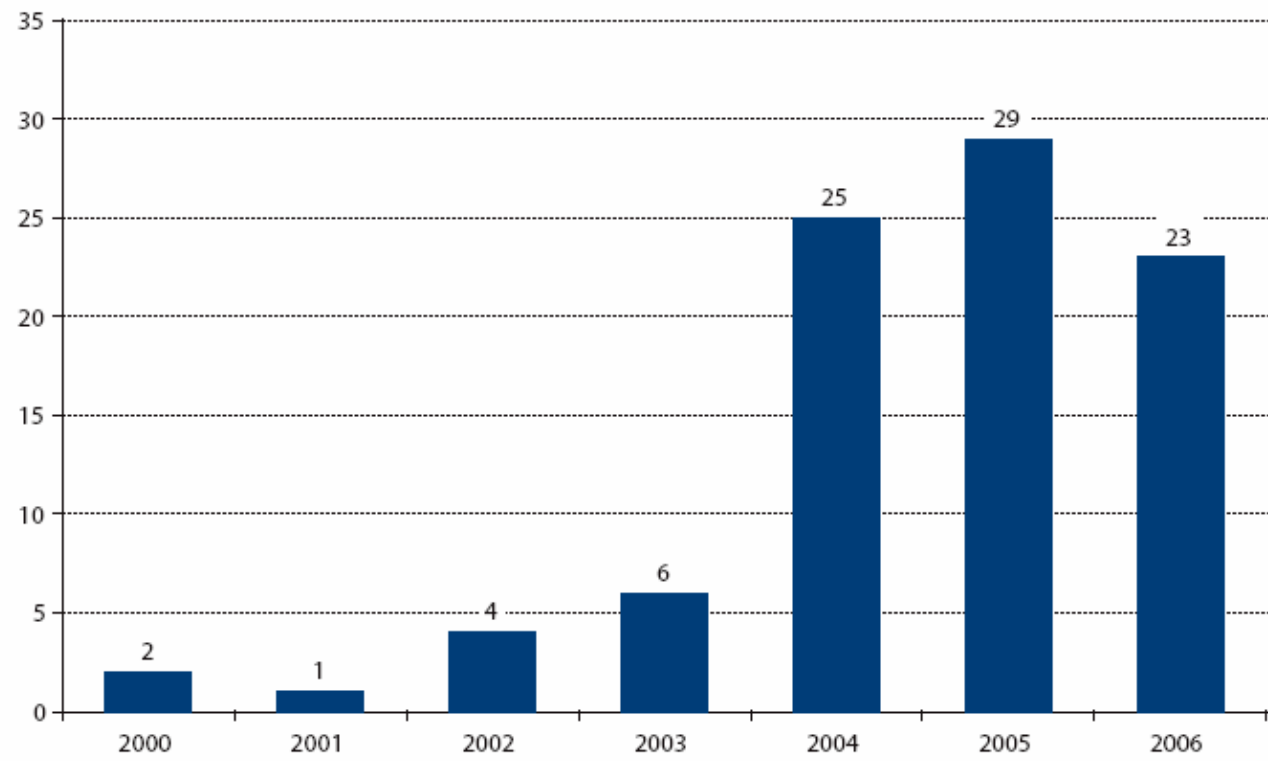


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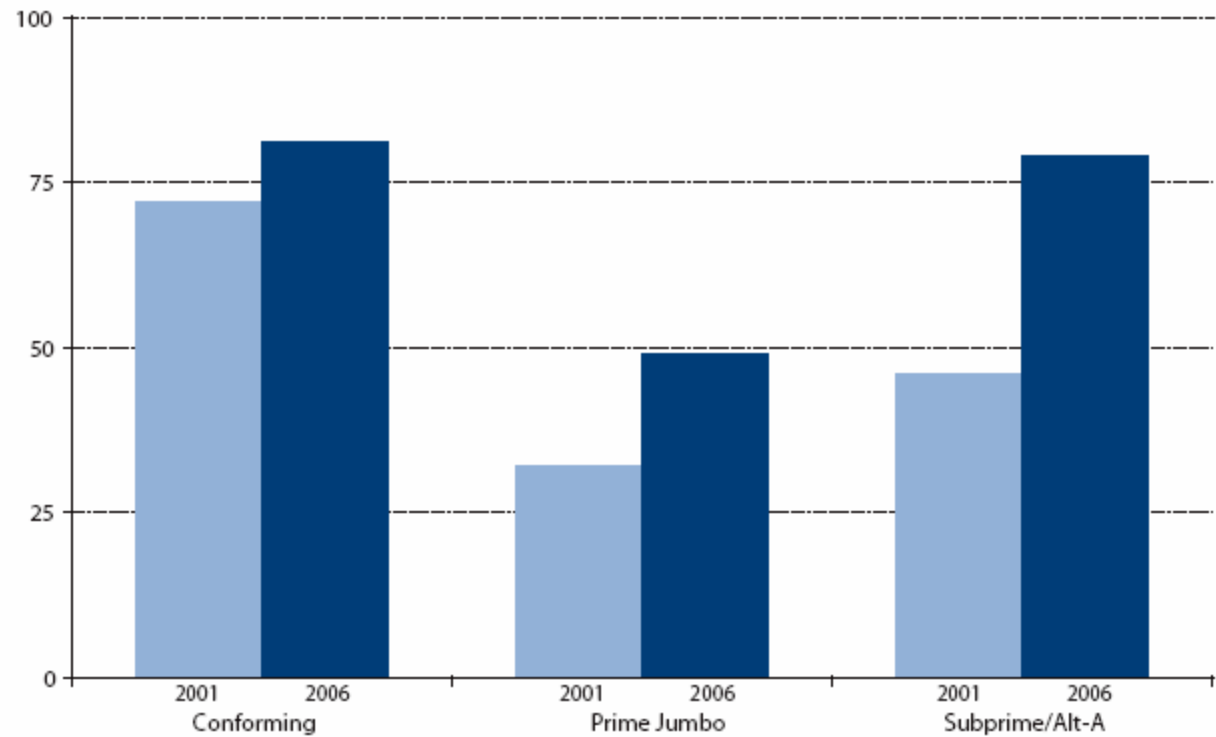
6. 1999:
 - a. CANUTE THE GREAT AND THE BUSINESS CYCLE
 - b. THE MONICA LEWINSKY EFFECT
 - c. RAINES DRINKS THE KOOL-AID
 - d. CDS REGULATION AND WASHINGTON'S PROCLIVITIES
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Interest-Only and Negative Amortization Loans, Share of Total Mortgage Originations Used to Purchase a home (excludes refis): 2000-2006; percent



Source: Credit Suisse (2007), LoanPerformance

Securitization Rates by Type of Mortgage, 2001 and 2006; percent



Source: *Inside Mortgage Finance*



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TOP TEN

REASONS FOR THE FINANCIAL CRISIS

5. **REGULATORY AND POLICY MISCALCULATION**
 - a. **FAS 157**
 - b. **REPEAL OF THE UPTICK RULE**
 - c. **DECIMALIZATION**
 - d. **NO CENTRAL CDS CLEARING MECHANISM**
 - e. **LACK OF TRANSPARENCY**
 - f. **CAPRICIOUS GOVERNMENTAL RESPONSE TO THE CRISIS**
 - g. **FAILURE OF THE RATING AGENCIES**

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REASONS FOR THE FINANCIAL CRISIS

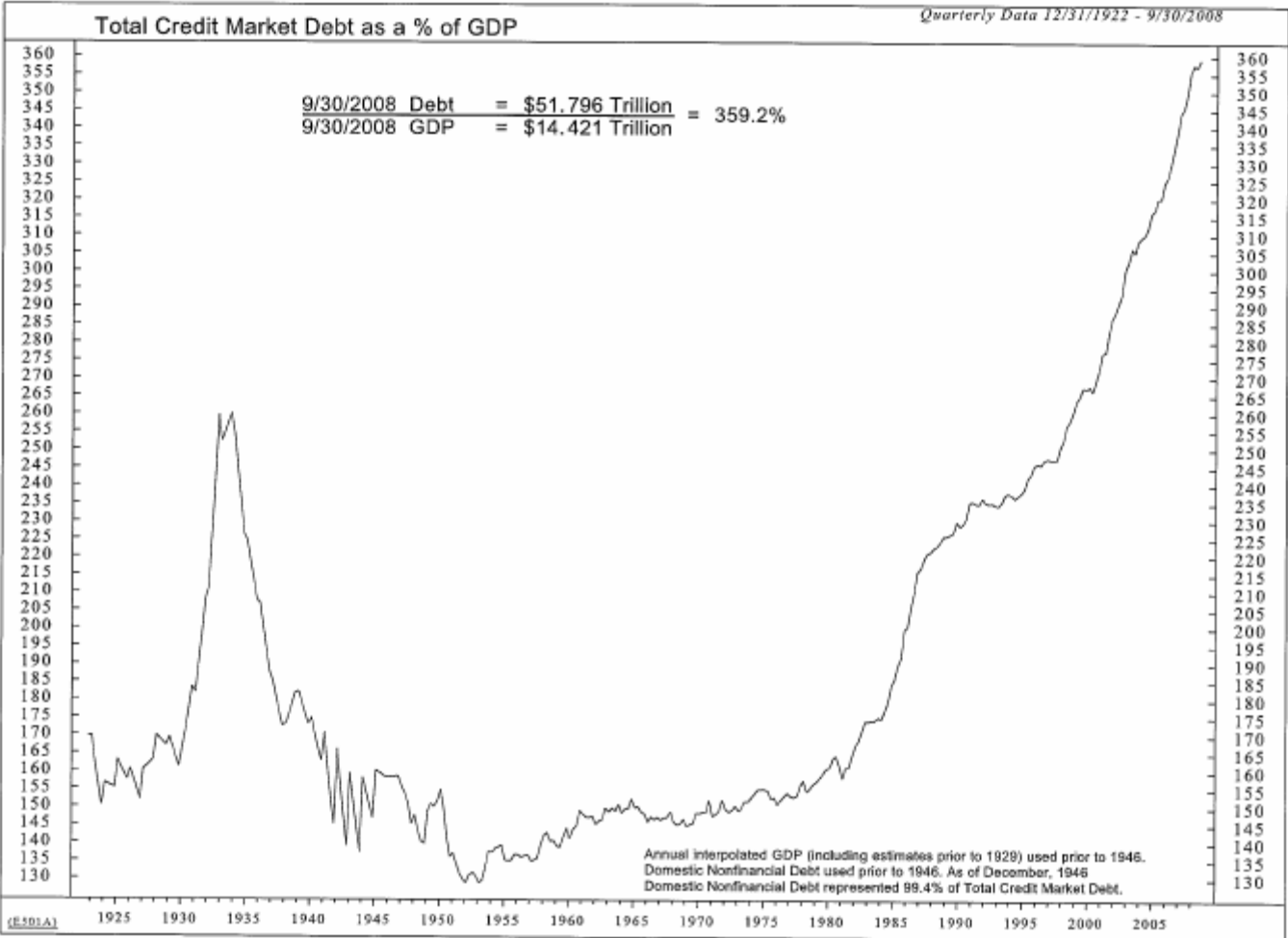
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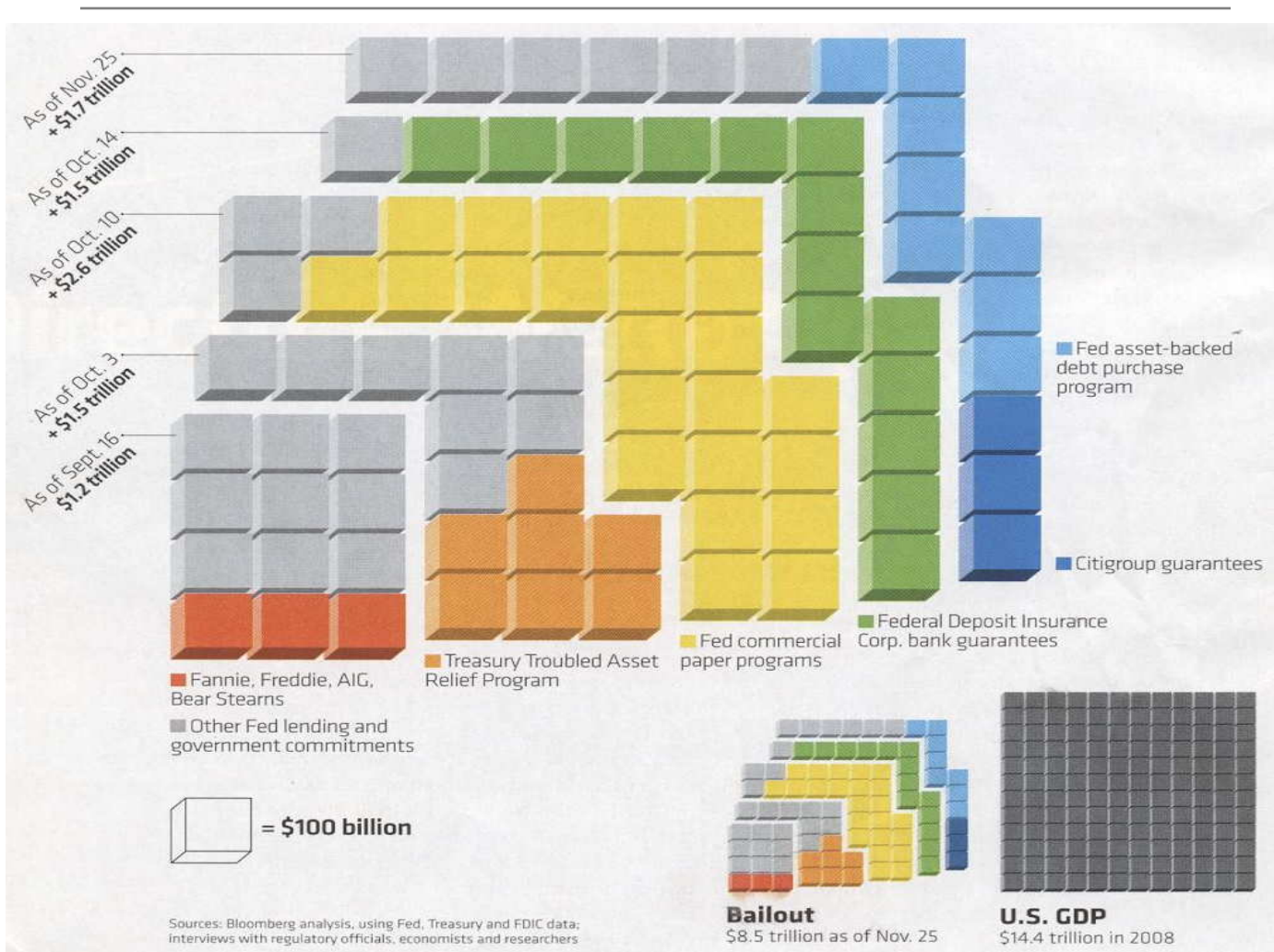
Total Credit Market Debt as a % of GDP



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Treasury & Fed Actions



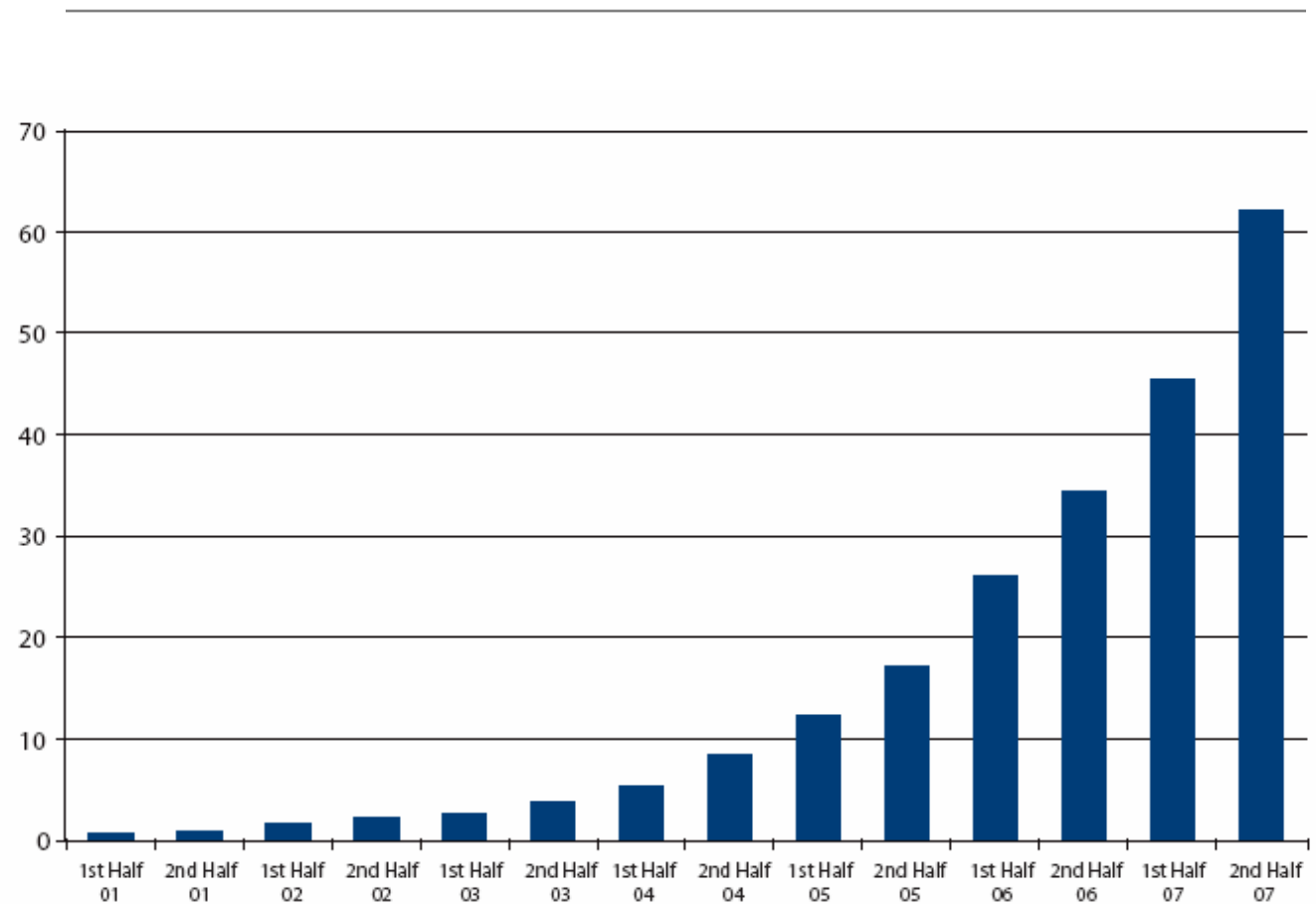
Source: Bloomberg

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REASONS FOR THE FINANCIAL CRISIS

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Value of Credit Default Swaps Outstanding; in trillions



Source: International Securities and Derivatives Association



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TOP TEN

REASONS FOR THE FINANCIAL CRISIS

1. **GREED AND THE MADNESS OF CROWDS**
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THE ORIGINAL HORROR SHOW!

FRANKENSTEIN

THE MAN WHO MADE A MONSTER



with COLIN CLIVE • MAE CLARKE
JOHN BOLES • BORIS KARLOFF
DWIGHT FRYE • EDWARD VAN SLOAN • FREDERIC KERR

Based upon the story by MARY SHELLEY
Adapted by JAMES W. WELLS
Directed by JAMES WELLS



A UNIVERSAL RE-RELEASE



WARNING!
THE MONSTER
IS LOOSE!

FRANKENSTEIN



The result :

SYSTEMATIC COLLAPSE OF
COUNTERPARTY TRUST