SVB Financial Group | SVB Asset Management

Observation Deck

March 2009

We are Not Alone: The Global Response to the Credit Crunch and Economic Slowdown

Debi Hanson, *Portfolio Manager*

We in the U.S. finally got our stimulus package passed. That should do it, shouldn't it? We are on our way to recovery, right? Well, unfortunately we are a far cry away from the end of the credit crunch and the prolonged recession we are currently experiencing. As we try to deal with our issues, so are many countries abroad. The global credit crunch and recession have spread and governments around the world are trying to come up with plans to save their own economies.

Over the past several months more than 33 countries have announced plans to stimulate their economies. The total dollars to date are in excess of $2.25 trillion, or about 2.8 percent of the global GDP. That is a lot of money, yet there are some experts who say it is not enough.

While much of the West is in a recession, for other countries the fear is that their growth is being dragged down by the lack of consumption, in part, by the West. China, for example announced a stimulus package worth $586 billion, more than 6 percent of its GDP. China's package primarily invests in infrastructure and spurring consumer spending. It gives tax breaks and discounts to boost internal spending, including halving the sales tax and waiving taxes on home sales. China's long-term goal is not to be so heavily dependent on exports for growth.

Markets

Treasury Rates	
3-Month	0.25%
6-Month	0.44%
1-Year	0.68%
2-Year	0.97%
3-Year	1.37%
5-Year	1.98%
10-Year	3.10%
February Total Returns	
ML 3-Month Treasury	0.02%
ML 6-Month Treasury	0.01%
ML 12-Month Treasury	-0.15%
S&P 500	-10.61%
Nasdaq	-6.49%

Source: Bloomberg, as of 02/28/09

France has taken an interesting approach to its €26 billion package. While France is including some infrastructure spending (including the repair of the ceiling at Notre Dame) it is also heavily investing in industry, with the two big winners being Airbus and Areva. In the package, whatever the government invests in an industry must be matched by that industry.

Germany's recession is deepening and it has put forth a total package of €80.3 billion. Much of this will be invested in schools and roads. Germany is lowering health insurance payments and giving families €100 per child. This is the most borrowing on the part of the government since World War II.

The Eastern Bloc is also looking to the International Monetary Fund or the European Bank for Reconstruction or Development to help its countries. Croatia will be receiving up to €300 million from the EBRD to help prop up its financial system. Slovak lawmakers back cutting taxes to boost spending. Romania is scrapping a 16 percent tax on reinvested profits. The Czech government approved a "crisis package of measures" totaling $1.8 billion aimed at reviving its economy.

Even South America is not immune to the pain being felt around the world. Peru's economy is slumping as a direct result of the depressed demand and prices for their metal exports. And, while Peru's growth last year was 9.8 percent, it is dropping quickly and is expected to fall under 5 percent this year. The government is responding quickly with its own $3 billion plan.

The Asian countries are all in the midst of putting together plans to aid their economies. Thailand is expected to announce a 117 billion baht (approximately $3.3 billion) plan. Malaysia said it needs a large, comprehensive $9 billion package. Hong Kong will announce its plan this week.

With countries around the world acting quickly and working together to reverse this global slowdown, hope arises. This will not be a quick turnaround, but should help to stem the downward spiral. We are confident that after going through this prolonged recession, and a change in business practices, our country and those abroad will recover and confidence will be restored.

Economic Vista

Minh Trang, *CFA, Portfolio Manager*

Another month has passed and most indicators show that the overall economy continues to languish. The revision on the fourth quarter 2008 GDP showed a contraction of -6.2 percent, which is steeper than the initial estimate of -3.8 percent. The economic slowdown was led by a drop in consumer spending, which fell 3.5 percent in fourth quarter 2008 after falling 3.8 percent the previous quarter. In addition, business investments and home construction slumped significantly over the same period.

The labor sector continues to face downward pressure as 13 consecutive months of negative non-farm payrolls have added up to almost 3.6 million in job losses. Correspondingly, the unemployment rate edged up to 7.6 percent, and is expected to move higher in the coming months as companies continue to announce layoffs.

For now, the expectation is that the $787 billion stimulus bill that was signed in mid-February will help provide some relief to both taxpayers and small businesses, and help stabilize the job market. Hopefully, the bill will offer not just financial assistance, but will also stimulate greater confidence among the investing public.

Credit Vista

Melina Hadiwono, *CFA, Head of Credit Research*

The Obama administration recently unveiled the "Homeowner Affordability and Stability Plan" authorized under the Housing and Economic Recovery Act. The plan reflects an important policy statement in bringing government sponsored enterprises (GSEs) to the forefront of ongoing government efforts and provides heightened support for the GSEs to ensure their ability to continue supporting the U.S. mortgage market. Through this plan designed to strengthen confidence in Fannie Mae and Freddie Mac, the Treasury doubled its preferred stock purchase agreements with Fannie Mae and Freddie Mac to $200 billion each (from $100 billion each). In addition, the Treasury department stated that it will continue to purchase Fannie Mae and Freddie Mac mortgage-backed securities to promote stability and liquidity in the marketplace.

To ensure that Fannie Mae and Freddie Mac can continue to provide assistance in addressing problems in the housing market, the Treasury raised the retained portfolio caps for each GSE by $50 billion to $900 billion along with the corresponding increases in the allowable debt outstanding. The Treasury affirmed the continued importance of the GSEs and stressed that they remain critical to the functioning of the housing finance system, highlighting that about three-fourths of new home loans written in 2008 were either financed or guaranteed by Fannie/Freddie.

As of December 2008, the combined debt outstanding and guaranteed mortgage-backed securities (MBS) for the housing GSEs was $6.7 trillion. Despite the very rapid growth in Treasury issuance, housing GSEs still exceed the publicly held debt of the United States by $300 billion. We note that former Treasury Secretary Paulson's conservatorship plan called for the GSEs to begin downsizing their retained portfolios in 2010 by about 10 percent annually until reaching $250 billion. However, the GSEs remain key players for the U.S. consumer's ability to obtain mortgage credit, and currently the GSEs are the only conduits for mortgage securitization. Hence, while important questions remain regarding the ultimate design and role of the GSEs over the long term, we can expect that in the near to intermediate term, the GSEs' role will be even more crucial as they become inextricably linked with the government's longer-term efforts to stabilize the mortgage markets.

Trading Vista

Hiro Ikemoto, *Money Market Trader*

There have been a couple of encouraging signs that liquidity is slowly coming back to the credit market. First, corporate bonds in the U.S. traded an average of $17.1 billion a day in February, following $17.7 billion in January. The trade volume is much stronger than last year's low of $9.4 billion in August and reached its highest level since February 2007, according to the Financial Industry Regulatory Authority (FINRA). Second, U.S. corporations issued $227 billion in bonds so far this year, an increase of 61 percent from the same period in 2008.

Looking at month-end yields, in the one-year maturity range, high-grade industrial bonds were yielding in the range of 1.5 percent, and Treasuries were at 0.68 percent, while agencies were at 1.05 percent. In the 90-day maturity range, commercial paper yields were 0.80, Treasury bills were at 0.25, and agency discount notes at 0.35.

With trade volume picking up and more new bonds being offered, along with the news that prime money market funds are taking in more assets, we hope to see the credit markets thaw out even further. However, this will depend on how many more negative headlines hit and how positively the market accepts the various government programs.

SVB Asset Management

185 Berry Street, Suite 3000
San Francisco, California 94107
Phone 1.866.719.9117
service@svbassetmanagement.com