Observation Deck

Scouting the Rapids

Paula Solanes, *Portfolio Manager*

As a fixed income investment management firm that specializes in investing for many startups, SVB Asset Management watches public offerings carefully. In addition, we also pay close attention to the Fed and Mr. Bernanke's monetary policy. It is interesting to note that throughout the economic recovery the Fed has been on call to step in if equities appear to be stumbling and to step in if the markets need some reinforcement. Before starting a journey down a river with rapids you scout the rapids; IPOs do something similar with the capital markets.

In the startup ecosystem, there are three ways investors (VCs and limited partners) exit startup companies: IPOs, M&A, and the unfortunate wind-down. Big exits can come through either of the first two and many factors are important — including the "vintage" year. (Much like fine wine, vintages are important not only to wines but also to startups). Choosing the right companies and then working to manage them for a successful exit is instrumental. But timing can affect the exit markets critically as we've seen over the last decade. Many times, an IPO brings maximum value, especially if the market is feeling a bit bubbly.

So, what is a successful IPO and what factors impact an IPO's success? There are many factors (see our recently published "Exit Interview" with Will Bowmer of Barclays Capital) and it is not usually until months after a company has gone public that one can gauge the success of a public offering. Market levels and *expected volatility* of future market levels are important in terms of timing.

Regardless of how "hot" the company going public is, there is no escaping market conditions. One indicator that seems to be a driver of IPO performance is the VIX Index. The VIX, referred to by many as the "fear index," is a measure of the implied volatility of S&P 500 Index options. The VIX projects the market's expectation of stock market volatility over the next 30-day period. In the last 20 years the VIX has peaked during significant economic turmoil with the recent peak during the 2009 liquidity crunch at 80.58. Since then, volatile news of global economic slowdown coupled with the EU debt crisis — at times offset by various "stimulus" actions — has impacted the VIX with the peak at 46.02. A tempered VIX is in the 15-20 range, and ideally that is the range most amenable to successful IPOs.

So far in 2012 there have been 274 announced IPOs vs 397 a year ago. Year-to-date there have been 207 IPOs, a 46 percent increase year over year, totaling about $35.89 billion. The sectors that have experienced the biggest increases year-over-year include consumer goods, industrials, basic materials and technology.

As the last two weeks have shown, the VIX reading has been one of the factors providing an optimal environment for companies scouting the river.

Markets

Treasury Rates

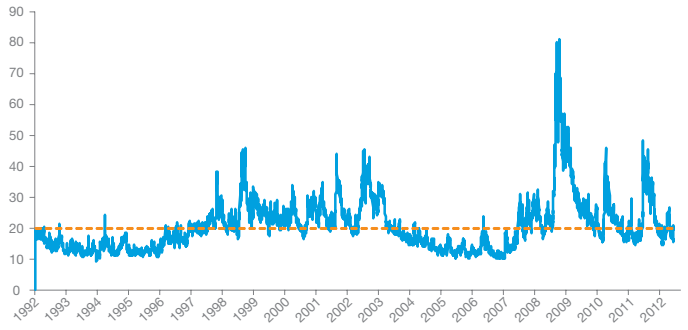
3-Month	0.10%
6-Month	0.13%
1-Year	0.16%
2-Year	0.21%
3-Year	0.28%
5-Year	0.59%
7-Year	0.97%
10-Year	0.15%

July Total Returns

ML 3-Month Treasury	0.01%
ML 6-Month Treasury	0.02%
ML 12-Month Treasury	0.08%
S&P 500	1.39%
Nasdaq	0.20%

Source: Bloomberg, as of 07/31/2012

VIX Index



Source: SVB Asset Management, Bloomberg

Economic Vista

Renuka Kumar, *Portfolio Manager*

Last month we saw a continuation of weak economic data which provides more evidence that the economy remains vulnerable. The advanced estimate of second quarter GDP came in at only 1.5 percent annualized. This follows a revised 2 percent growth in the first quarter and 4.1 percent growth in the fourth quarter. Slowing demand from the consumer was largely to blame with personal consumption expenditures down from the prior quarter.

The consumer showed further weakness in terms of spending with retail sales falling 0.5 percent in June. Excluding autos and gasoline, this was the third straight month of falling sales. Consumer credit rose by $17.1 billion in May, the largest increase for the year, which may provide some support to spending but will not bode well for consumers' balance sheets. Consumer sentiment, as shown by the University of Michigan index, fell to the lowest level this year at 72.3. Sentiment on current conditions increased possibly due to lower gasoline prices; however, the expectations component showed some deterioration in outlook due to concerns over higher food prices, the fiscal cliff, a weakening labor market and the potential impact of the European debt crisis.

Despite a struggling labor market with the unemployment rate holding at 8.2 percent, we have seen some improvement in home values. The FHFA home price index rose 0.8 percent in May, making it the fourth straight month of increases. Additionally, the NAHB Housing Market Index rose to 35 in July, the highest level since 2007. We did see some retrenchment of new and existing home sales in June, but this may have been driven by bad weather in some regions. Relatively speaking, the housing market has faired rather well in recent months.

Credit Vista

Sook Kuan Loh, *CFA, Sr. Credit Risk & Research Officer*

Mid-July marks the beginning of the earnings reporting season for most U.S. and European entities. The market entered the earnings season with much apprehension as the economic numbers have failed to excite in recent months.

Despite market challenges, the banking sector proved impervious to the headwinds as most of the U.S. banks so far had earnings surpassing analysts' estimates. The main source of earnings boost came from the mortgage banking business as refinancing activity mitigated the lower capital markets revenue.

The Industrial sectors faced mixed results as forex issues, the slow U.S. and global economic environment and euro overhang impacted earnings for the quarter. Forex issues were the mainstay of many earnings reports as USD continued to appreciate against other major currencies. However, some companies such as Caterpillar and IBM managed to churn out sufficient earnings growth to ease the impact of negative foreign currency movements.

The earnings outlook for the remainder of the year is subdued. Forex impacts remain a significant issue as analysts are uncertain of the direction of the USD/EUR trade and companies may find it difficult to effectively hedge their exposures.

S&P 500 companies continued to retain large amounts of cash on their balance sheets, at approximately 9.8 percent of total assets as of June 2012 compared to pre-crisis level of 5.9 percent as of June 2008. Companies continue to keep cash instead of investing, due to a myriad of reasons including economy and regulatory environment uncertainties.

Despite the headwinds, companies on SVB Asset Management's Approved List remain resilient. The overall credit impact should be muted as strong management steers the companies through the challenging environment.

Trading Vista

Hiroshi Ikemoto, *Money Market Trader*

The European "country of the month" for July was Spain. As many investors watched the Spanish five-year note go from 5.56 percent at the start of the month to 7.59 percent, U.S. Treasuries rallied on the flight-to-quality trade. The benchmark two's tightened from 30 basis points on July 2 to 20 basis points on July 20. The Treasury curve has bull-flattened with the difference between a one-year Treasury bill and a three-year Treasury note just 16 basis points. With credit spreads remaining flat, there is almost no pick-up extending duration.

The 2a-7 sector has also tightened as one-year EDSF was at 0.40 percent most of the month, the lowest that I can recall. With corporate bonds being priced off this benchmark, absolute yields for industrial issues were in the 20 to 35 basis points range, while financial names provided a yield of about 50 basis points for one-year maturities.

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