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Bear Stearns Asset Management Transcript of Conference Call

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[START 01 Conference ID 1072990]

OPERATOR: Good day, ladies and gentlemen and welcome to the High Grade Structured Credit Strategies conference call. At this time, all participants are in a listen-only mode, and later, we will conduct a question and answer session with instructions following at that time. If anyone requires assistance during the conference, please press star, then zero on your touchtone telephone. And as a reminder, this conference is being recorded. And now, ladies and gentlemen, your host for the day's conference: Mr. Ralph Cioffi. Mr. Cioffi, you may begin.

MR. CIOFFI: Thank you, operator. Before we begin the, uh, the presentation, I have to read a, uh, statement and that is: The following conference call is strictly for current investors in the fund. If you are not a current investor who is specifically invited to attend this conference call by a Bear Stearns representative, you have to disconnect now and call either Heather Malloy or Ken Mak at 800-436-4148, if you are- if you require additional information on any of the funds that, uh, we're

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discussing today.
Okay, let me talk, uh, firstly about our first quarter returns for both the High Grade Strategies and the Enhanced High Grade Fund.
Um, quarter to date through March 31st, High Grade has a cumulative return of -0.34, 34 basis points. And that was, um, ah, -- January's number was approximately 125 positive. February was approximately 150. Uh, March was down about 3, should-should come in at down 3 and a quarter, and then there's about a 50 or 60 basis point positive adjustment. Um, we're not sure if it's going to be in February's mark or March's mark. Um, the Enhanced--High Grade Enhanced Leverage, uh, has a quarter-to-date return of -4.74. Um, that's comprised of a January number, which was positive .67; a February number, which was about -0.5; and a March number that's going to come in around -5, 5 and a half. And there's about a 60 basis point positive adjustment in Enhanced Leverage that will either show up in the February number, ah, making February positive, or in the March number, reducing the-uh-the negative.
Um, at this point in time, um, the fund has, uh, significant

amounts of-of-of liquidity. Um, we have, um, as you know, one of st-our main strategy over the last several years has been to put in place significant amounts of-of-of non-recourse term funding, whether they be through our CDO structures or through structured repo. And the reason we-we-we-we did that, uh, is so that we would, we'd not be faced, or at-the-uh, or we would mitigate, uh-um, being a forced seller due to margin calls or, um, you know, having repo lines removed or terminated.
Um, first-firstly, the repo market has been very solid and very liquid. We've had no-no increase in haircuts, no -- actually, no increase in repo rates either. We've had margin calls that we've easily met. We've not had to force sell any assets, and what's-what's in--the reason we focus on that is, that if-if one believes that their assets are good and they're going to pay off at maturity, the-um-the market volatility that creates mark-to-market losses are only realized if-if-if one-if one has to sell because they lose their financing. So we've been very careful, very cautious, and very-very diligent on that front.
The um,—and-and, it's a good segue into the biggest financing transaction that, uh, we're-we're now engaged

in, which should be done, um, this month and will close in May. And that was the large financing transaction that we mentioned in February that we're doing with Bank of America. That trade has been upsized to $5 billion, and that is a significant, uh, transaction to get done: number one, in this marketplace, it'll be the largest CDO of-of the year so far, I believe. And that has significant benefits for us on a number of fronts. One is, we'd be mov-we'll be moving approximately 2.6 billion of assets out of-out of Enhanced and, um, 1.4 out of High Grade, and we'll be funding them in this facility that we've set up with BofA. The facility is-is-is essentially a Klio-like facility in that the majority of the financing is commercial paper. We'll be -- like Klio -- we'll be taking back equity in some of the rated-rated notes. And like Klio, that vehicle is-is term funding, it's non-recourse and the funding is not dependent upon any sort of a mark to market. It's purely a cash-flow structure. That transaction, um, adds significant liquidity to both funds. Post the-uh-the-the transaction, uh, we'll have an excess of 200 million of-of liquidity, cash and liquidity available in Enhanced, and I believe, uh, 125 million, um, maybe slightly more, uh-in-uh-in High Grade. And that's-that's post reinvesting cash, ca-uh, capital that we free up through that transaction, um, and, um, uh, investing about 100 million dollars--

MR. CIOFFI [aside]: Both in Enhanced and High Grade?

UNIDENTIFIED SPEAKER: Ah, yeah.

MR. CIOFFI: --uh, investing $100 million, uh, out of Enhanced and out of High Grade into new assets that we're in the process of identifying now in, uh, in the CDO space and structured credit space. And post those investments, we're pro-formaing a, uh, a carry in, um, in Enhanced of approximately 13--

UNIDENTIFIED SPEAKER: 80.

MR. CIOFFI: 80? Call it fourt-14% carry on an annualized basis, and um, about 11% in, um, in High Grade on an annualized basis. The, um, th-those returns -- and again, in-in the investments will not be done immediately -- it will take us, uh, a few months to, uh, deploy that capital, probably at most. Additionally, the funding vehicle has a billion dollars of additional capacity that we can use to buy assets. And, um, uh, that, you know, that we'll be doing simultaneous to buying assets for the-for the hedge fund. And then the other big benefit, obviously--

UNIDENTIFIED SPEAKER: Fire drill.

MR. CIOFFI: --the other big benefit is by moving 2.6 billion of assets out of Enhanced and a billion four out of High Grade, we're reducing our repo, uh, commitments, we're reducing our repo lines by that amount. I mean, we still have the repo lines open, but we'll be paying repo down by that amount, over 4 billion in, uh, about 4 billion between the two funds. Um, on top of the um, the increase in carry for both funds, we've also identified some significant relative-value trades that we're-we're going to be putting in place, leveraging our-our credit models that we've built over the last year that are very subprime and CDO specific. And with the advent of the ABS CDO/CDS market, and the subprime CDS market, we're going to be able to target some very attractive relative-value trades going both long and short -- assets we-uh-we like and dislike. We are targeting right now, um, call it a $500- to $750-million program, and on a proforma basis we think we can generate about a 15% gross return. The-the attractive aspect of those trades is that because you're long short -- and we're going to attempt to do

them with the same dealer when, if they have the executions - uh, the capital requirements are-are-are de minimis, maybe 5% total initial capital on those trades. So we're excited about that.
It's an opportunity the market's giving us right now.
With all the disarray and turmoil on the market, there's some-some significant, uh, trade opportunities out there for us to, uh, uh, put on. So we'll be add-we'll be adding carry, uh, and we'll be doing some, uh, total-rate-of-return, relative-value, long-short trades in-in-in that space.
Um, the-um-the big, you know, well obviously the-the-the questions that we've been getting from a number of investors are, how do we look on a-on a redemption/subscription basis? Um, the-um-the next big redemption date or-would be June 30th, and as of now, I believe we only have a couple million of redemptions for the June 30 date. So far, we've gotten, um, reasonable amounts of subscriptions in-into Enhanced and into High Grade. I believe we have about 45 million in subscriptions, and 25 of that is from Bear Stearns, and those will be for, um, I believe those are all for May 1st.
The, um, the-you know obviously I, now I want to spend

some time about what-what went on in March and why, and-and how we're doing in-in April. The majority if not all of the negative return in March for both funds was a result of the ABX hedge -- which we've been short -- rallying significantly, and some of the single-name credit shorts that we've had on, rallying. A lot of that rally was a-was a technical rally. There was significant short interest in the ABX indices, and, even though it was small, there was a-a moderation in the delinquency rate in all three indices in February and March. And then there was significant rhetoric around certain types of bailout programs and financing, and refinancing facilities that various banks were-were uh implementing. So that-that the market kind of bid based upon some of that stuff, and I think 450 basis points of the negative return, uh, in Enhanced was the ABX rallying and single names rallying and, um, about 250, or, uh, about 250 basis points I believe in High Grade was-was the same phenomenon. CDO spreads and CDO prices have not come back. They've stabilized for sure. Um, the-um-the market is cleaning up its inventory, stuff is trading,

and there's a-there's a definite bifurcation in-in-in the market. Not every AAA CDO is going to be downgraded. Not every AAA CDO is trading at a-a LIBOR spread of 200. There's definitely a market rationalization; deals that are managed by good managers, deals that have good collateral, specifically, those that are more seasoned and-and are not heavily concentrated in the 2006 subprime vintage, which is where the majority of the problems lie.
So there's clearly a bifurcated market, and there's still illiquidity, but I would say the market's significantly better than it was at the end of February and the end of March. So there's-there's some light at the end of the tunnel there, I believe. And-and a lot of it has to do with dealers being able to-eh sell out of inventory. There are several new-issue CDOs in the market, those seem to be getting done at a reasonable clip. And in fact there's a deal being priced this week for a very seasoned, good manager. The portfolio has been well selected and the AAA mezz bonds on that deal are getting done at LIBOR + 65. And, um, that deal is-is-is-is being, I-I-I believe is essentially placed --

I know the AAAs are. The AAs are getting done at 100. So not everything is in, uh, complete disarray. The, um, uh, the estimated returns for April are, um, -0.6 basis points for, um, High Grade and-and -0.7 for Enhanced. Now, from Fri-just from Friday alone, as the, uh, ABX has widened and gone down in price on, again, some more, you know, bad fundamental news, um, we've-we've gotten quite a nice mark-to-market benefit from that move.
Now we will be changing our hedges somewhat over the next several months, probably reducing some, but we're still not -- we're still using our credit models to-to buy protection on names that we don't like and stay short segments of the subprime and CDO market that we don't like. So, um, the, uh, the-the carry- the estimated carry numbers that I'd given before of approximately 14 for Enhanced and 11 for High Grade include the hedges that we currently have in place. (Pause)
Matt or Ray, anything to-to add before we go on to uh--
MR. TANNIN: W-w-yeah, and let me again, I've had a number of calls, again, as many of you know as investors. And-and the key, the key sort of big picture point for us at this point is our

confidence that the structured credit market, and the subprime market in particular, has not systemically broken down. The-the dislocation that we saw in February and March is simply one where the early high delinquency numbers in many of the subprime deals, um, has spooked the market into, uh, a position where people are simply afraid that all of the historical data that the rating agencies, and the structurers, and the investors have been using to assess the relative ratings volatility of these sorts of structures, right, that the people are scared that the -- what has been will not be the case in the next few years. While the information that people are looking at is real, right -- there clearly are higher delinquencies in the 2006 vintage -- from our-our assessment and the-the analysts that we talk to, and the servicers that we're talking to, there's no concern among these people that, um, that-that-that there's going to be a performance that is-that is not historically rational. So, while it's true that the early defaults or the early delinquencies are higher than they've been, the explanation for that is that homeowners who had been refinancing out of

their mortgages, um, in 2003, 2004, and 2005, who
normally, under normal situations, would have
been counted among delinquencies and defaults,
because of the rising home prices and the
availability of, um, refinancing opportunities,
weaker borrowers were carried through. So
when home price appreciation stopped, those
weak people were already sort of on the edge,
and those weak people are the ones who have
gone into delinquencies on their mortgages.
So, there's a rational explanation for why the
delinquencies are high at this point in-in-in these
deal lives, right? It's an early- it's an early phenomenon,
and we believe that overall these portfolios
are not going to be, um, that far away from
historical numbers that we've seen over the
last, you know, 10 or 12 years.
So what's happened is, people have stepped
away from the market. Um, there's a fear that-that
AAAs are actually going to be single A in
quality, which is -- that's-what that's what represents the
spread widening. We believe that that is
simply not true, that while there will be weak
deals, and that while attention to structure
and to collateral is even more critical now

than it was before, that this is not a
systemic breakdown in the entire structured
finance market. And because we believe that,
we are using our liquidity and we're using our
credit models to do, essentially, exactly what
we've done before with the-the-the financing
opportunities, particularly with Bank of
America -- and there are a number of additional
ones that we have, sort of, um, in the construction
phase. So we will be able to use the same
credit models that we've been using up until
now to give us a clear sense of which
collateral is good and which collateral isn't
good. We will be able to buy these assets at
spreads that are not rational. The carry in
the portfolio will go up and, as we move
forward in time, and the bifurcation that
Ralph spoke about in terms of deals that are
performing fine and deals that are not
performing fine, that will begin to be
represented in the price, so that the
mark-to-market loss that we've suffered, as
everyone has downgraded or-or priced down
everything, right, that-those-those price appreciations
will come over time as the data, um, materializes.

So, from a structural point of view, from an
asset point of view, from a surveillance point
of view, we're very comfortable with exactly,
you know, where we are. This has always been
a-a possibility; a dislocation is something
that, again, it was the thing that Ralph and I
spent the first four months of-of-um-of working with
Bear Stearns' credit and all the different, um,
people at Bear Stearns to get a sense of --
what could possibly happen that would cause
you to be a forced seller, right? We all knew
that something like this could happen, and the
way we structured the fund was (a) to limit
the downside, so it wouldn't be, again, the
number that we-we'd always spoken about was a 10%
draw down. And, more importantly, was that we
not be forced sellers. So, the structure of
the funds has performed exactly the way it was
designed to perform. We now have liquidity in-the-t-in-in-
in the form of both cash and in the form of
non-recourse vehicles to take advantage of the
opportunities that-that we see are there. And in
addition, right, in addition to just the-the-the-the
credit leverage carry, there are now
opportunities to-to do the relative-value kinds

of trades that Ralph was speaking about, where again, the credit models that we have can be exploited where there are opportunities for real price dislocation.
So, um, again, it's frustrating to have had, um, a negative month. Um, it's frustrating to be in an-a-in an industry where, um, people are writing all articles daily about how the world is coming to an end.
But our historical experience, having been through these sorts of things before, lead us to be comfortable in our credit models and not in the sort of headlines that, um, appear now and then about the subprime market being completely misguided. So, um, again, we-we're doing -- we feel that we're in a-in a position to do exactly what we've done all along, and that the opportunities now, I mean, we were, again, quite cautious in 2006, and even 2005, because on a risk-adjusted basis, it was not time to-to-to really take on, um, significant amounts of risk.
N-now is the time to do it, so the fact that we've been so cautious in-in-in the prior period, means that we have the capital and the flexibility to take advantage of spreads that are simply irrational. So, um, from the portfolio

construction, and from a market view, um, we're quite comfortable with where we sit.

MR. CIOFFI: You know, I want to expand on two points Matt made. One, this notion that the CDO model and the rating agency model is broken. Um, as Matt said, we don't believe that. It's purely a function of-of there are-there are good deals and there are bad deals. There's deals out there with too much leverage, there's deals out there with poorly selected portfolios, and deals that have been done by managers that-that shouldn't have done deals. You know, I refer to the transaction that just, that's pricing now in this market where the AAA bonds are pricing at LIBOR +65. That-that's only about 10 basis points wider than where AAA mezzes were being priced in ABS CDOs in December of '06. So the market to market is-is-is-signifi-is bifurcated. The other point to make on this '06 origination in the subprime space -- granted, the cum losses are going to be significantly higher than-than-than earlier vintages. Um, estimated cum losses on '06 are-are in excess of what occurred in 2000, which was the last really bad vintage subprime, and that was-that was punished by the fact that significant amounts of subprime securitizations were actually manufactured housing securitizations. And I believe the cum losses on the 2000 paper ended up being about 6 or 7%. What's interesting to note is the delinquency rates in 2000, the first year that delinquencies really picked up on that paper, are only about, uh, I believe 25% lower than, uh, the delinquency rates that we're seeing on '06. The thing that's interesting about '06 securitizations is the rating agency changed their subordination levels. They signific-they increased it significantly. I believe that BBB- in '06 had as much as 12% subordination -- might be double what-what-what some of the '05 subor-, uh, securitizations, uh, uh, had. Now, the m-the two most recent rating agency research pieces that were-were-were, uh, published, they're projecting 8%, about 8 % cum losses on 0-'06 originations. And, um, I believe S&P stated that in almost every one of their rated securitizations, 8% cum losses would not touch BBB and above. And I believe Moody's, which might have had slightly lower weighted average subordination levels, I think they stated that, uh, ev-everything single A above-and above would be, um, would

not be touched from a- from an actual dollar writedown perspective.
Alright well we-we want to save some time for, um, for questions, but I-I want to just give a, uh, a conclu- a concluding statement here. Um, we uh, we're, uh, we're executing the BofA transaction. Uh, that increases liquidity in both funds significantly. It, uh, it gives us additional capacity to buy assets in that vehicle to the tune of a billion dollars.
We'll be spending about a hundred million in each fund to increase our-our-our-c-our carry, approximately four-14% in Enhanced and 11% in High Grade. We'll be implementing some relative-value trades, long short, that we think could generate about a 15% gross return with very little capital usage. We are cautiously optimistic that the CDO market has found its footing and will trade on a going-forward basis based upon actual credit fundamentals. And there will be AAAs that are downgraded. There will be AAAs that trade at LIBOR +200. And there will be AAs that are downgraded. We have a handle on those deals. Where we have those risks in our portfolio, we feel comfortable that we've-we've significantly hedged them and we, um, um, we have been

hedging them. Um, the, um the market will stabilize, and the good news is that, from all indications, the 2007 originations that will be occurring in the subprime market will be significantly better from an underwriting perspective. There will be CDO deals done off of those transactions. Unfortunately the spreads won't be as wide as we can get in the-in the, uh, in the market now, but that'll be a big benefit to the overall CDO market. That'll generate more liquidity and I think get secondary trading to pick up. So we are-we are cautiously optimistic. We have a plan in place that'll get the funds back on track to generate positive return. And, um, most importantly, we have financing, and we have-we have significant amounts of liquidity. One last point on Enhanced High Grade: we-we-we've, we have significant liquidity in the Barclays line that we've yet to even draw down. We've drawn down some, but we have, we have the ability to draw down more. Um, so we-we're-we're-we're not really even using our full capacity there. Um, we probably will over time, but, uh, there's no need to at this point. Okay, um, w-w-w-well now I guess is a good time, we'll-we'll open it up to questions. And-and the other thing-we Matt mentioned we've done, sig-we've had a number of one-one-on-, dozens of one-on-ones -- conference calls as well as face-to-face meetings. We welcome that, we encourage it. We invite everyone on this call, if you want to have one-on-ones or conference calls with us individually, we're happy to do it. Sometimes easier for people to ask questions in that format as opposed to on a conference call. Um, and, so just, uh, feel, you know, feel free to call us and let us know. We'll respond immediately. Okay, operator, if you could open up the line for questions.

OPERATOR: Thank you, sir. Ladies and gentlemen, if you have a question or comment at this time, please press the number one key on your touchtone telephone. If your question has been answered and you wish to remove yourself from the queue, you can do so by pressing the pound key. Again, if you have a question or comment at this time, please press the number one key on your touchtone telephone. Our first question is from Jason Bunin of Bear Stearns. Your line is open, sir.

MR. BERGMAN: Ralph, it's actually Shelley.
MR. CIOFFI: Hi Shelley.
MR. BERGMAN: Um, on your staff currently, you've got a bunch of guys you hired from S&P and Moodys.
MR. CIOFFI: Yup.
MR. BERGMAN: And they were talented people over there, and you have them basically sifting through and ripping apart the-the-the components of each of the CDOs you have.
MR. CIOFFI: Right.
MR. BERGMAN: They're finding, as we discussed privately, and I'd like to, you know, just recap this. They're finding, uh, mispriced merchandise out there, um, on a daily basis.
MR. CIOFFI: Right.
MR. BERGMAN: Both on the upside and on the downside.
MR. CIOFFI: Right.
MR. BERGMAN: Uh, do they think, number one, um, uh, the rating agencies have it wrong? And number two, on some of the mispriced merchandise that they're finding, are they finding it 70 cents on the dollar, 80 cents on the dollar, 90 cents on dollar? Because most of your stuff matures anywhere from, uh, one to four years.
MR. CIOFFI: Right.

MR. BERGMAN: So are they finding stuff - uh, and what everybody is, you know, probably asking on the phone is, how are we going to make up the negative 3 to 5%, uh, and get back to, you know, the expectations that we laid out? So, I'd like to hear what they're finding. Are you guys taking advantage of it and going into the market and buying because, after all, you were waiting for some type of dislocation, perfect storm weakness.

MR. CIOFFI: Yeah, we--

MR. BERGMAN: Now we've got it, what are we doing about it?

MR. CIOFFI: Right, good point. I mean, we were-we were waiting, um, and our hedges did-did work, our liquidity is there. Um, we are going to start buying, uh, this market. We are seeing opportunities, the market-the market's efficient enough that in general if something's trading at 60 or 70, it may be undervalued, it may be-may be properly priced. Our credit models are helping us identify those opportunities. I'd give you one-one example of a transaction we did this week. It was a AA CDO; our credit models show that it takes no writedowns, the transaction is-is money good. It's an-eh ABS CDO. Uh, we were able to, uh, buy that at a-at a-a DM of LIBOR + 250, and we found a-a-a great short candidate, another ABS CDO, same vintage. Our credit models show that that takes a 100% writedown to the AA tranche. We're actually able to short that at a-at a spread of 200. So there's-there's those types of opportunities. There are AAAs out there. Uh, we're buying one AAA, um, at a discount margin, I think, of around LIBOR + 75. That shows no writedowns at all to the AAA tranche. There's significant subordinations - sig-there's significant subordination in that deal, that it's doubtful it would even-even be down, you know, have any-any ratings migration risk. So there are opportunities, and what we-what we try to map out here is our plan to earn back that -4.5% in Enhanced and, you know, to get positive return in High Grade through reinvesting the-the freed-up capital, as well as the excess capital we currently have in both funds, bringing up on a running basis our carry to about 14% in-in, uh, Enhanced and 11% in High Grade. And then these total-rate-total-rate-of-return trades that we're going to implement will generate, we think over the next couple of years, 15% gross return. And then there are-there are going to be, we will get mark-to-market benefits on some of the CDOs that have been marked down. For example, we have one AAA CDO that is essentially all '03 and '04 vintage subprime collateral. Now it's a AAA tranche that's-that's highly levered. But we think it's money good, we like it. Um, we don't see any writedowns in the underlying collateral pool, um, I think until '09. There's 30, I think we have 38% subordination to the, um, to the tranche in question. And that thing's been marked all the way down to 75, I think. So there's an example of an asset that, as-as credit performance flows through that structure, it's got to be marked back up and/or just accretes back towards par -- it's probably a 5-and-a-half- or, probably a 5-and-a-half-year average life piece of papy-paper, maybe, maybe less.

Um,we did-we did, in many respects, have the perfect storm on the asset side. The interesting thing was that the-that the liq-the funding markets were -- there-there wasn't even a blip in the repo world. Which-which we, I mean, we were very happy about. Um, so, we will be buying assets, we are going back into the market. And with the liquidity and the term funding that the BofA facility gives us, we've got a lot of- we got a lot of buying power, which, by the way, give us an awful lot of leverage with the dealers to get out of some paper we don't want to-we don't want to own. We have, let-let's call it, between the CDO and the hedge funds, we're going to have $2.5 to $3 billion dollars worth of paper to buy over the next three months, give or take. It'll be very easy to sell a couple hundred million of stuff we don't want to own, and-and-and probably sell it at a-at a pretty good price. So we've got a plan to make back money and we anticipate being profitable and ending the year, uh, in both funds, uh, on the upswing.

MR. TANNIN: Actually, let me just-let me just address exactly the question you raised with regards to the rating agencies. Um, again, Andrew, Stu, Dhruv, I mean, they're all, they've all seen collateral performance like this before. The rating agencies have seen collateral performance like this before. So, when the rating agencies rate a bond, whether it's a AAA, AA or A, they're not-they're not telling anybody that

there are not going to be defaults, that-that
there's not going to be delinquencies and and--
MR. CIOFFI: And downgrades.
MR. TANNIN: --or even downgrades, right. It's a, its a probability assessment that-that-that, given what the collateral is, and given how this collateral performs on a historical basis, and given the subordination and the structure, the probability of having a default is, you know, you know--
MR. CIOFFI: BBB
MR. TANNIN: --whatever-whatever the level would be for the particular structure that they rated. And it is simply impossible to extrapolate from two or three months of early delinquency data and make any-any-any logical assessment whatsoever about how the ultimate historical cumulative loss of that portfolio is going to perform.
So, um, you know, five years from now, one may-one may-one may-may be able to say, 'well, the rating agencies did this', or 'the rating agencies did this', and-and-and perhaps that the-the-the historical information and the-and teh subordination that they've-they've used for the last 15 years needs to be changed. But it is simply impossible, and-and-and-and has no basis whatsoever, to look at very short-term

collateral performance and make sort of sweeping statements about the rating agencies or the ultimate meaningfulness of ratings on structured finance.

MR. CIOFFI: You know, one thing, um, with regards to delinquencies. I'd mention the February and the March remittance reports. The, um, the April remits reports are coming out now, as we speak, and we have some color on those that I'll give you in a second. But for those of you that don't know what a remittance report is, it's basically the servicer report on 30-, 60-, and 90-day delinquencies, as well as foreclosure and-and REO, Real Estate Owned, data. So, up until February, those 30-, 60-, and 90-day delinquency buckets, as they're called, were increasing and they were increasing at an accelerating rate, as were the foreclosure and REO buckets. Well, the February remittance report and the March remittance report, and I believe -- well we don't have all the data yet, we-we probably have about a third to a half of it out so far -- you're seeing a continuation in the February and March trend, which was a flattening out of the-the-the delinquency, the-the acceleration or the increase in those delinquency buckets. They're still high by historical standards for the '07-1, which is probably the worst-selected vintage of subprime. The '06-2 would be the second worst and the '06-1, actually, performs pretty damn well. Our credit models show that even down to the BBB-, which we're actually long, take no credit writedowns. And those delinquency, um, buckets, and the rate at which those buckets have been increasing, has been flattening out since February. The rationale for that -- if you speak to subprime analysts or you speak to the, um um-uh the rating agencies -- the rationale for that is that these, um, fraud, um, fraud, uh,-underwritings and bad underwritings that occurred, they flow through the pipeline very quickly. If someone lied on their application and there was a, you know a fraudulent appraisal, they d- they're delinquent almost immediately; they go through the system, the servicer knows what's going on, they go into foreclosure and REO very quickly. Once they're through the pipeline, they're gone, they don't re- they don’t re-occur. Same thing with bad underwriting. So you’re-you’re-you're seeing those-those, the bad underwriting and-and-and the fraudulently, uh, obtained mortgages being flushed through the system. That's why these delinquency rates are-are flattening out and declining. No one's predicting that its go- '06 is going to be a great year, it won't be. Um, but, you know, some people are talking about 20 and 30% cum losses. I-I-I-I think that's a- that's an extreme, extreme overstatement. And-and right now it'd be hard, even given this horrible data, it's hard to, uh, see 20, even 20% cum losses. So think, the-the moderation that we're seeing is con-seems to have continued in April. '07, as I said, is the worst vintage; '07-1, which is mid- and late-uh, '06 originations is-will definitely go down in history as the-as the worst-originated, uh, subprime collateral.

MR. BERGMAN: Ralph, one other question. Can you hear me?

MR. CIOFFI: Yes.

MR. BERGMAN: You've been doing this a long time and you ran a lot of money for, uh, the principal desk here at Bear in the structured area. How bad was this in terms of, I mean, you said to me when we started this fund, you know, you've got to worry about geo-political risk, um, you got to worry about certain things and that's where you're going to get your dislocation. Was is this in your mind the perfect storm that has not occurred in 10 to 20 years?

MR. CIOFFI: In my mind, on the asset side, yes. And it was exacerbated by something Matt mentioned, which was all of a sudden everyone woke up one day and said, 'Hey, you know what, the rating agency models are broken, they don't work. The securitization business is over, the CDO business is over.' I mean, the CDO market last year was eight or - I-I guess- I-I think between subprime securitization and CDOs - h-had to be over a trillion dollar market, I would suspect. Um, so you had-you had a confluence of events in a matter of one - uh, uh, it was building, but it all came, kind of came to the forefront in-in-in almost, call it a one to three week period. Um, and then of course you had the big technical factor that we discussed. Everyone was using ABX as their hedge, and the street and-and many accounts were effectively just long the AAA and super senior component of the capital structure because up until that point that was a safe, that was a safe-really the safe have-haven. So, in my mind, yes, some people would debate that-that-that they've seen worse markets, but I-I think it was the six-sigma event everyone is worried about, um, from a market volatility perspective. What we'll see going forward now is-is price movement based upon actual credit performance. And that's where we think we’ve got a- we’ve got a-we've got an edge, and-and-and we've got a model that we like and is efficient, and that'll keep us ahead of that curve.

MR. BERGMAN: Okay, thanks.

MR. CIOFFI: Yeah.

OPERATOR: Thank you, our next question is from Joel Dryer of IO Partners, your line is open.

MR. DRYER: Hi Ralph.

MR. CIOFFI: Hey Joel.

MR. DRYER: Based on what I think I just heard you say, I-would you-do you think there's any credibility to, uh, Bethany's article in Fortune on April 2nd?

MR. CIOFFI: I didn't read the article. What-what was it?

MR. DRYER: Uh, it's entitled "Dropping the Ball."

MR. CIOFFI: Oh, about the rating agencies?

MR. DRYER: Yeah.

MR. CIOFFI: Um, well, I didn't read the article, but I-I-I-I can tell you what we-what we think. It'll probably look like they dropped the ball on

CDOs that have heavy '06 subprime originations. Um, but they probably dropped the ball on the subprime subordination levels. Now, what happened there is that got compounded in-in some of the CDOs, because if the subordination levels were too low on the '06 vintage paper, and if that '06 paper got into the CDOs, the subordination levels on the '06-originated CDOs were based upon a, let's call it a weighted-average rating of Baa2 or Baa1, they have historical ratings transition as well as cum loss data on those rated, on that rated collateral, um, so those CDOs are going to underperform. So from that perspective, yeah, they dropped the ball. They used-they used historical data that was skewed by the easy money that Matt referred to, that allo-a lot- that allowed, um, significant number of borrowers that would've ultimately ended up in the delinquency buckets in-in the the re-fi bucket. And actually, Bear Stearns' head of research, Gyan Sinha, had-had written about that I think in, uh, in '05. Now, the rating agencies did increase their subordination levels on '06, as I mentioned before. It's-it's going to be several years before you know whether or not the subordination levels were-are-are going to be sufficient. For example, if you take that '07 origination, that '07-1 index, which is the worst originated collateral, you still don't see any writedowns that begin in, I think, until 2009 or 2010. Now, a lot can happen in two or three years -- the Fed could lower rates 200 basis points, the housing market could turn around. Um, there's you know, there's a lot that can happen in two years, good and bad. Um, so, it's hard to say, Joel, uh, we'll-we'll know-we'll know-we'll know in 12 to 18 months, I would suspect.

MR. TANNIN: And, uh, again, Joel, uh, again, the point is, again, I think it's very hard at this point in time to say that the rating agencies dropped the ball. But, what it's not hard to say is, 'Did your portfolio manager,' right? We don't just look at the ratings--

MR. CIOFFI: Yes.

MR. TANNIN: --and buy stuff, so, were we concerned about lending standards? Yes we were. Were we concerned about the-the-um, the tight spreads of '06, uh,-originated collateral, given what we saw as, um, inevitable rising delinquencies? Yes we were. Were we concerned about IO loans and-and-and sort of, uh, um, barbell-shaped FICO scores in various different kinds of deals? Yes we were. So, we didn't buy those deals, even though-even though on day one they're rated the same. So, the rating, it's-it's important to put the responsibility in the proper place.

MR. CIOFFI: Right.

MR. TANNIN: We are responsible for making good credit decisions, and the credit decisions that we make are far in excess of just making sure that the rating agencies sign the rating letters, right? We don't, uh, again, we don't do that, and the-the people that we know in the market don't do that. We're looking at, I mean-I mean, again, we think we have the most sophisticated surveillance system, but our colleagues have sophisticated ways of looking at things as well. So, it's just simply not true that the rating is something that we just say, 'Okay, we've got 50% of the AAAs, our bucket's full, let's move on to some--'

MR. CIOFFI: Yeah, the only-the only-the only meaningful, uh, aspect of the rating is it-is it dictates our repo haircut and rate. But it-it doesn't matter -- look, there's BBBs, I've said this before, there's BBBs we buy and AAAs we won't buy, so the ratings to us are more of an academic point. Um, and I'll go over a statistic I gave in-in, uh January. We didn't-we didn't buy a direct -- we didn't make one direct investment in 2006-originated subprime. We did buy a significant amount of AA, AAA, and super senior CDOs. There was about a billion and a quarter, maybe a billion and a half, I forget the exact number, of '06-, late '05-, mid-to-late '06-vintage subprime in those CDOs. The majority of what we bought on the CDO front, 84% was AA, or yeah, I think 84% was AA or higher, and of that about 90% was AAA or higher. Um, we are short on-on a-a notional basis far more '06-vintage paper than we are long. Um, and that short, by the way, give-gives you an idea how crazy the markets are, that short in '06 vintage paper -- which the majority was an '07-1, which as I said is the-the-the, will-will go down in history we think as the worst underwritten vintage of-of any asset class -- was what was up the most in March. Um, so yeah, Matt-Matt-Matt makes the-the-the-s-the good point. The ratings are-are important as it relates to our repo and financing rates. They're not important as it relates to what we buy or sell.

MR. DRYER: Okay, uh, if-if I'm understanding correctly, in terms of our portfolio, um, the CDOs are the-uh tranches, or the pack-the repackaging of the ABSs?

MR. CIOFFI: Right.

MR. DRYER: And where are we in terms of ABS asset holdings and CDO asset holdings? So--

MR. CIOFFI: Well, A direct ABS, virtually -- when you talk about ABS you mean subprime. Is that -- direct subprime holdings in-in either the High Grade or the Enhanced Fund are virtually nil, and-and if we have them they're very seasoned vintage paper, or they're going to be very highly rated.

MR. DRYER: You-you get a CDO by slicing off the bottom of an ABS.

MR. CIOFFI: Well, you know what, Joel, why don't you -- if we're going to talk about CDO 101, why don't you call Matt or I direct and we'll have that discussion. I-I'd rather spend the time, um, talking, you know, going through that exercise--

MR. DRYER: That wasn't my-that wasn't my question. My question was purely -- and thanks for the 101 lesson, okay - uh, purely, what percent was the Fund in CDOs versus the, uh, the ABS. That was it. I really don't need an education, okay?

MR. CIOFFI: Okay. The majority of what we bought in-in-in '06, between the two funds, which was 7, call it 7 billion of ABS CDOs, um, the majority of which was AA and AAA, we had exposure to this '06 vintage that is creating the, really the problem in the market, uh, of between a billion and a quarter to a billion and a half is the underlying collateral. Um, and the, we-we have shorts in place that are far in excess of that number. Not-Not to mention that by buying the AA and AAA paper, there's significant layers of subordination that are beneath our AA and AAA. So that billion and a quarter, even if it weren't credit hedged, if we didn't have, uh, uh, you know, off-setting shorts, in theory that billion and a quarter could be written down to zero. And I can't think of a CDO that would have a writedown up to the AAA. Now there are some deals out there that are overly levered to only '06, so, uh, the ABS CDO on a percentage basis, let me see, you have--

MR. TANNIN: On a net-on a net long basis, it's-it's roughly 50%. So 23% of the portfolio, ultimately at the bottom, has corporate-related risk, whether that's secured high-yield loans or, um, investment-grade bonds.
MR. CIOFFI: And subprime, direct subprime is 7.2%.
MR. TANNIN: Right. So again, in-in-in easy numbers, right, its let's just say 25% is corporate, 50% is ABS of one form or another, which I can break down in-in more in one second, so that's 75%. And the other 75% is mostly one variation or another of, um, near-prime, uh, straight RMBS where we own the AAA. Of-of the- the CDOs, of the ABS CDOs, that 50%, most of those bonds are, that we own, are AA and AAA bonds where the collateral of that deal are single A CDOs, and of those single A CDOs, the collateral there, that's where you have BBB, um, uh, RMBS exposure. So while it's true that if the subprime market in '06, um, and even more than that, turns out to be one complete, absolute, unmitigated disaster across the board, completely systemically, right? Then the prices that everyone is marking the portfolios at right now are right. If the BBBs underlying these

deals end up performing, right, in a more credit-specific way, then the subordination that we have to the single As, which are the collateral for the AAA and AAs that we own, will not have a systemic writedown, and the AAAs that we own will not have systemic downgrades. So, again, it-it-it-it really is a matter of whether one believes that careful credit analysis makes a difference, or whether you think that this is just one big disaster. And if-and there's no basis for thinking that it's one big disaster.

MR. CIOFFI: And-and-and again--

MR. DRYER: I understand, and the point has been made twice now on two different conversations. And further to that point, I don't-I don't think implied was you're looking at what the rating agency says and saying, 'Oh great, that's what we're going to buy.' I mean, come on guys, give me a break, uh, everybody's got their money with you guys because we think you're smart, not because you look at the rating agencies.

MR. CIOFFI: Right.

MR. DRYER: I don't know where your

defensiveness has come from that, I don't know if other people kind of in-intimated that, but that to me sounds just absolutely silly. Why-why-why would a group of smart people just look at what the rating agencies say?

MR. CIOFFI: Right, we're not-we're not- we're not an index.

MR. DRYER: My question was, you know, my question was, what were your thoughts on what the rating agencies were doing? You know, have the rating agencies really scrubbed everything? Do you think they're done scrubbing? Do you think they've done a good job of scrubbing? I mean, that was really the heart of my question. I and, again, I-I don't understand where this defensiveness comes from.

MR. CIOFFI: You know, Joel, I think what the rating agencies relied on was somewhat of a black box. It hadn't been calibrated for the, um, the in-completely calibrated for the increased delinquency that-that '06 saw. And if you think of what happened to the originators, the New Centuries and the Lends and the NovaStars and all these folks that have had difficulties, some of whom are no longer with us. They filed because of the early payment defaults.

None of their credit models projected the-the-thae rate at which they'd have EPDs, Early Payment Defaults, within the first six months of origination. And when the originator originates a-a-a loan and sells it to a securitization, they have a-they're obligated for the first six months to buy it back if it goes 30 days delinquent. So all the-all the lax underwriting standards and rush to keep their stock prices up and earnings high, you know, they-they-they made loans that they never should've. So--

MR. DRYER: That came back to bite them quickly.

MR. CIOFFI: It did, and they, you know what, they didn't have the liquidity, um, to buy paper back. And most of their-most of their credit models were geared towards, you know, an underwriting standard that was based upon a longer term credit profile and they, I mean, they missed-they missed-they missed the-they missed the problem they were creating for themselves. So, the rating agency model's a black box, and they-they didn't recalibrate some of their, you know, some of their bells and whistles within that black box.

They're certainly doing it now, and-and that was -- I mean, they did start in '06, and they did increase their subordination levels, and-and I'm sure -- well actually, the '07 originations that are coming out now, we're seeing better-better subordination levels; in fact in some cases they're not even issuing BBB-. Um, so, I think-I think you're-you're going to see '06 -- the disaster. Paper prior to that is going to perform based upon more historical standards. And then, uh, '07, we hope, beginning mid-'07, um, we'll see better underwriting and-and-and much tighter rating agency, um, uh, standards.

MR. MCGARRIGAL: The other thing, Joel, is worth noting in '07, which we're starting to see, is investor push back on the purchases of those CMOs, so investors don't necessarily, you know, completely trust the rating agencies to the degree they used to. So now, you can, to some extent, dictate the absolute level of subordination and the triggers in the CMOs that you're willing to accept at a spread that you want to buy at. That's where '07 origination starts to become attractive to us on a direct-exposure basis. And there are, there have been a few transactions where we've been able to negotiate those terms to our liking. Um, the rating agencies' excuse in the past was, 'The underwriters wouldn't let us,' and the underwriters wouldn't let them because the investors didn't force them. If the investors can force the change, and right now we think we're in a position to do that, then you get better, uh, underwritten CMOs with the correct subordination, with the correct triggers in place to protect your investment, um, at spreads that we think are attractive. So that's where part of the opportunity this year, we think, comes from.

MR. DRYER: Thanks guys.

MR. CIOFFI: Okay, Joel.

OPERATOR: Thank you. And our next question is from Michael Ezra from Pentagon. Your line is open.

MR. EZRA: Hi, good-good-good afternoon, guys. Quick question: there's a large part of your portfolio, if I recall correctly, that's actually not marked to market. Now I know it's not necessarily an easy type of calculation, but have you any idea, if you sort of did theoretically mark to market all of the bonds that-that aren't marked to market--

MR. CIOFFI: Yeah, no, every security we own is marked to market. What isn't, when we say no

mark to market, we mean there's no margin calls. Those structured finance trades that we talk about, the funding is permanent. So any asset we own that represents ownership in those vehicles is marked to market. But the assets in the vehicle are not mark to market for purposes of financing. So I-I use no mark to market, I should use no margin call-mark to market. But no, every asset is marked to market.
MR. EZRA: No, but on those-on those particular assets where you just have, effectively, you've created some type of structure, you put a whole bunch of your own AAAs in it, and, uh, and then sold off various debt and created a sort of re-REMIC if you like--
MR. CIOFFI: Yeah.
MR. EZRA: That underlying sort of equity tranche, if you like, that you have left of that, uh, I presume you've left it because you've got long-term financing. Have you left it at par--
MR. CIOFFI: No, no--
MR. EZRA: Or have uh, uh you, you know, downgraded based on the value of everything else? This is the question.
MR. CIOFFI: Yeah, no, all those equity pieces

are marked to market monthly. They go up and down with the-with the, um, not with the price of the securities, but with the projected cash-flows that those securities generate. So we-we do mark them to market, and--

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MR. EZRA: Is…, is-is-is that done, because I, I -- in other words, the underlying spreads just widen out? Does that mean that you're not necessarily marking the things down if you just don't think there's going to be any defaults? So if you've taken the view that - it doesn't matter that spreads have widened out substantially because you think that the underlying credit's good, uh, good, you haven't necessarily, uh, uh, changed any cash flow assumptions and therefore you've not marked any price down.

MR. CIOFFI: No, no, well, no not at all. What we do, everything's basically a discounted cash flow method. So we had, we project -- every month we project the cash flows of the portfolio at that time, and there's default and recovery assumptions that we use. Now if we think the default recovery assumption

should be changed, we will, and that'll change the projected cash flows, and then we discount those cash flows at a, you know, an equity-like rate. And then we get an NPV, and that NPV goes up and down as those cash flows change. But we don't look at the price of the bonds. We, we, we; each one of the underlying bonds in those securitizations generates a cash flow and then that cash flow's impacted by default and recovery rate. And then we dis-discount all those cash flows at an equity IRR and we get an NPV. So there's some bonds, so there's some equity we purchased at-at, we'll call it par, that's been -- that has an NPV now of maybe 75. So, whatever we do, whatever we own, whatever we have in the portfolio has to be marked. There's nothing we carry at book.
MR. TANNIN: Michael, just to answer, uh, your question exactly, right, the, the-the price change, the price move between the collateral and the residual that we own, right, the residual moves in price based both upon the projected cash flows and what the market says is the correct PV.
MR. CIOFFI: Yeah, the right equity yields.
MR. TANNIN: So equity yields have gone up

when, as people are more worried about the cash flow. So as you PV those-those cash flows at the market higher yield that investors demand, that's where that price is reflected.

Mr. MCGARRIGAL: And, that-that, that is specific to certain types of equity. So, for example, CLO equity has actually tightened a touch. High-grade CDO equity is relatively unchanged. And CDO equity backed by these mezz tranches off of, uh, subprime, have widened. So it's collateral specific and dependent, depending upon how that equity should be valued in the market today.

MR. EZRA: Okay, I'll-I'll leave it there at the moment. I'll come back and have a private discourse if I need anything further. Thank you

MR. CIOFFI: Yeah, but bottom line is mark, we mark everything to market. Nothing, nothing is at book.

MR. EZRA: Okay.

OPERATOR: Thank you sir. Our next question is from Scott Hirsch of Seabrook Capital. Your line's open.

MR. HIRSCH: Ralph, if I -uh-uh have understood you correctly, um, in March the losses in effect were due to the short, particularly the ABX short, and a couple of other individual shorts you said. So it's sort of ironic that the-the hedges actually caused the losses. In other words, I guess, if I'm understanding this correctly, um-you, you put on the shorts too late or didn't take them off soon enough--

MR. CIOFFI: No, no, no, no, no. We've had the shorts on, the reason February was not down 8 or 9%--

MR. HIRSCH: Yeah.

MR. CIOFFI: --is because the hedges work--

MR. HIRSCH: Okay.

MR. CIOFFI: --we've been hedging since '06. And, one of the things that we used to get, you know, that people used to complain about in '05 and '06 is, 'well, your-your-your-your returns aren't high enough, you're paying too much for your hedges.' We've been short '06-1 -- well, '06-1 we're no longer short -- but '06-2, '07-1 since they came out.

MR. HIRSCH: Mm-hm.

MR. CIOFFI: We've been short those for months and months and months. And they really didn't start going down -uh- in price and adding to the return, pretty much until January. February they were down big, and then March they-they rallied. But no, we didn't put them on at the bottom of the market.

MR. HIRSCH: Okay, well, that-that-that was going to be my follow-up question. How much-how much of January and February's good returns came from the hedges?

MR. CIOFFI: Uh-We beat--we would've been 8 or 9% negative numbers in-in February. January, de minimis because we started seeing some CDO spread widening, the ABX did trade down. Um-I can give you the exact numbers, Scott, but February the hedges made an awful lot of money for us. Now, from the low point in February to the February 28th -uh- close, they rallied from the lows--

MR. HIRSCH: Mm-hm.

MR. CIOFFI: --Um--and then through the entire month of March, the ABX did rally.

MR. HIRSCH: Did you, I mean, were you giving some thought to, to covering, or did you just know it was just too early?

MR. CIOFFI: Oh we did, we monetized, we monetized a lot. We started covering at 60 on the '07-1 BBB-. Um—And—Um-- we monetized, I mean, again, we'll give you exact numbers, but I think in Enhanced we monetized maybe $40 or $50 million, and in

High Grade we probably monetized 30 million.

MR. HIRSCH: Mm-hm.

MR. CIOFFI: So yeah, we did cover. But keep in mind, they're not really trading - we-we-we do trade them, and we-we we're cognizant of-of-of valuations, but those '07- and '06-1 indices are long a lot of, I mean, they're long the '06 vintage; the '06 vintage stinks. Our credit models show significant writedowns in that '06-2 and '07-1 index.

MR. HIRSCH: Mm-hm.

MR. CIOFFI: Um-It's a large liquid market that allows us to express a short position that's good both from, you know, hedging mar-market volatility but also credit hedges because some of the CDOs we have, have exposure to that vintage.

MR. HIRSCH: Okay. And the-the, I think you said, if I heard you correctly, the, for High Grade at least, the, uh, month to date through mid-month in April was down about 70 basis points, is that about right?

MR. CIOFFI: High Grade through April, right. Through-uh- April 24th, I guess.

MR. HIRSCH: Okay, and the -- is that just a continuation of the rallying as you gradually cover up?

MR. CIOFFI: No, no. The-no. The-the-um, through, through April, the ABX continued to rally.

MR. HIRSCH: Right.

MR. CIOFFI: So, for example, on Friday of, of this month, um-Enhanced was down almost 3 and High Grade was down, call it, 2. Since Friday the ABX has come off significantly. So if I-if I were to, again, mark to market with the caveat of not having marked all my assets yet, but we don't think there's -- we don't believe there's going to be significant asset mark to market. The ABX has traded down since Friday, so we've gained back, um-you know, a significant amount of that-that underperformance. So we're -- Enhanced, as I said, is uh, about negative 70 and High Grade is about negative 65 roughly. And that's because ABX has-has traded down from Friday.

MR. HIRSCH: Okay, and just-um, justto sort of drill down a little bit more on this-this analogy of the perfect storm that you talked about earlier. Two sort of questions related to that: if, you know, given-given what you've been through, do you, uh, do you feel that what ended up happening sort of in March and so forth is, is about as well as you could've kind of hedged this in this perfect storm?

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MR. CIOFFI: Well--

MR. HIRSCH: I mean now, in retrospect, as you look back?

MR. CIOFFI: In retrospect, if we look back, yes. However, I mean, it would be nice, it would've been nice to have covered more of the ABX, um, you know, on February 24th, or whenever it was when it was just, the day the stock market crashed. Ah, we, Again, we did try to cover, but so did everyone else in the world. And that, and that, uh, in '07-1, the minuses, I think we started covering that at 61 and we're, we covered that in its entire -- the BBB minuses -- we covered that in its entirety I think at around 66. It got as high as 70. Now we converted some of that short into the BBB flat, which reduced the costs of the short. And we felt, our credit models show very little credit difference between the BBB and the BBB flat. Um, So we thought the BBB flat was a better short, we rolled into that. Um, But I think, I think -- look, we made two mistakes, and we discussed it in February: one is we were ramping up the Enhanced portfolio, um, to get its carry up. And, um, so, you know -- and we-we-we-we didn't, we didn't ramp up I mean as much as the Barclays facility would've allowed us to; we were, we were very diligent and being cautious. But we're you know, we're buying assets in December and January, but I think the performance - I-I-I think we performed very well, the hedges did work and they did help us, our term funding and our, uh, our-our term repos helped us.

MR. HIRSCH: What was the second mistake? I missed the February call, by the way.

MR. CIOFFI: Oh, just, you know, buying-buying some assets in January and, uh, you know?

MR. HIRSH: Yeah, yeah.

MR. CIOFFI: But, I mean, Enhanced is supposed to be more levered than High Grade, so—um,

MR. HIRSCH: And just in terms of this whole perfect storm thing, I mean, one thing that strikes me, as you said at the outset of this call, is you know the repo market remained fairly liquid, um, so did not create a forced-selling situation. And so, I mean, in that sense, it really wasn't the perfect storm.

MR. CIOFFI: Well no, I said, there-there, it would've been the perfect storm if the, if the repo liquidity dried up and dealers said, 'You know what, we're not going to repo your assets anymore.' Now that may have happened to some players, I don't know. I mean, we have a big footprint. Um, investors have a lot of confidence that we're part of the BSAM platform.

MR. HIRSCH: Mm-hm.

MR. CIOFFI: They have a lot of confidence, I mean, they know -- you know, we're very open with our repo counterparties, we send them a monthly repo report, they know all our positions, they know our liquidity. They ask for margin, we post it. We don't screw around. Um, We just moved about, almost 600 million of assets off of repo in Febr--March, I think, and moved them to Bear Stearns, just to pay some people down. We're taking 4 billion down, we're taking our repo down by 4 billion for the BofA trade. So we have seven--I think, seven-seventeen people we do repo with.

MR. TANNIN: Although, ironically, had we gotten more margin calls, had there been more of a problem in the repo market, the whole point of the hedge was it's there if we needed it, it's a very, compared to selling a AAA, right, in a market where everyone's freaking out, the-the whole point of the hedge was, if we

actually needed to-to monetize that, to-to have cash to make a margin call, it was there to do that. So, it's hard to know what would've happened, obviously. But-but you know in some peculiar way, it would've forced us actually to monetize more of the hedge at the lows. So, while it's true that--
MR. HIRSCH: Right.
MR: TANNIN: --you never want to be in a true -- you never want to be a forced seller, or you never want to be anywhere where people are freaking out, so it's always better--
MR. HIRSCH: Right.
MR. TANNIN: --that they weren't freaking out. However, the-the ultimate goal of the hedge is-is really to have that liquidity there if you need it. So, it was there, and we didn't need it.
MR. CIOFFI: So, for example on the hedges we have in place right now, we-we have I think 75 million of-of-of margin against each one of those hedges that we're not really, you know, we don't really count towards our liquidity, but it's liquidity.
MR. HIRSCH: Thanks, and just last thing is, would you guys hazard a, um, a guess at this point,

or an estimate at this point, of what this
year might look like? '07, in terms of how
you'll end up? Both sort of a cautious guess
and more maybe a more optimistic guess? In
other words, two, two ranges of where you may end
up for the year, given where we are now.
MR. CIOFFI: Right. Well, on a cautious
guess, I would say let's annualize our, the
carry numbers that we, um discussed before. And
that assumes that our relative-value trades do
nothing for us, and that the, um, the price discrepancy
that's occurred, i.e. the hedges rallying, the
assets going down, let's assume none of that
changes. Um, So after -- post BofA, and let's say
we ramp that additional capital up within two
months - um, we're running at a 14--we'd be
running at a 14 annualized level for High
Grade--for Enhanced, and 11 for uh, for High Grade.
So, I guess that'd be the cautious guess. Um, You
know, optimistic for us is, we think, the
relative-value trades will work out, we think
the market is rational, and CDOs that have
been marked down will start getting marked
back up. We believe in our credit models; we
think our shorts in '07-1 are good shorts to

have in place, our single-name shorts are good shorts to have in place. We think those will generate return for us. Um, You know, could we finish the year, let me see—Uh,

MR. TANNIN: Well conservatively that would mean flat for High Grade and up a little bit, up 2 for--

MR. CIOFFI: Well no, not flat for High Grade. Yeah, we're flat. Uh, yeah, we're flat. We're basically flat, we'll call it -- let's say April ends up down 6. So, January, February, March, April, so for the first 4 months, High Grade would be, would be down 1. Um, And then, if we're annualizing out at 1% a month, we have eight months to go, so you'd be up 8. And actually this is one of the, uh, one of the drills we did early on: we'd tell people, 'alright look, if you assume you have this major market move and it's over with and it doesn't come back, well we're reinvesting at wider spreads so our carry will go up. So we'll earn back just on carry.' And if you look at every market since, you know, the last 30 years let's say, after every major dislocation, the markets ultimately do come back. So, um, so let's say 8 on High Grade, if we just take carry and assume the dislocations stay, um, and then Enhanced is, uh, would be about a 1-1.2, so that'd be 8, that'd be 9. Well Enhanced, let's say, could be 6, um, assuming no, no benefit for um, relative values, relative-value trading, no benefit for the uh, uh-shorts we have in place, and no market rationality as it relates to, you know, CDO pricing -- things just stay where they are.

MR. HIRSCH: What kind of, what kind of pop could you get from some good relative trades, I mean, over the next eight months?

MR. CIOFFI: Well, a lot of these relative trades are more of a, maybe a 12-month, 24-month play out, but--

MR. HIRSCH: Gotcha.

MR. CIOFFI: But, um, you know, we looked at, you know, we're looking at some trades right now. Let me give you one example. We're long '06-1 BBB-, our model shows that fair market value on those is 84-85, they're trading at 86. '07-1 BBB flats, which we're short -- fair market value under our credit model is 28. Those are trading at 78. Now, does that, does that manifest itself over time as credit losses come in? Um, Or does it ultimately manifest itself much quicker? Remains to be seen. Um, We have a lot of CDOs where we're long AAAs, and we're short significant amounts of BBB collateral that's in those CDOs, as well as BBB collateral and single A collateral that we don't have exposure to. If there's significant writedown or downgrade on those BBBs and single As, there's significant mark-to-market benefit there that we'll experience. And again, there's significant layers of subordination between those losses and AAA, AA CDOs. Um, You know, if the equity markets participate, we still have our Rampart IPO that we're, we're hoping for in-in-in late summer, early uh fall. That could be a-a-a nice winner for us. Um, We, um -- so we have some, we have some interesting things that, um, to think, to look forward to. And you know, the one-the one-the one thing to think about, I don't know how long, Scott, you've been with the fund, but if you look at our returns since inception--

MR. HIRSCH: Yeah, we've been there about 3 years.

MR. CIOFFI: Okay, so if you look at the returns since inception, you know, up through, let's call it up through February, um, you know, cumulative returns for those in High Grade only and for those that went from High Grade to Enhanced I think is north of 40% or 45%. In my mind, at least on the asset side--

MR. CIOFFI [aside]: You have both sheets.

UNIDENTIFIED SPEAKER: Okay.

MR. CIOFFI: --at least on the asset side, we had a perfect storm, um, and um, and we've lived through it. We have plenty of liquidity. We're as well positioned as anybody out there to take the opportunities. Um, And, you know, it's interesting um, to note that there are a number of CDO and subprime opportunity funds that are now popping up. Um, Well, I mean, you-you could think of us as the ultimate CDO and subprime opportunity fund, and that we're established, uh, you know us, you've seen our track record. We have liquidity. We have a phenomenal partner in Bear Stearns. We have a great platform. Um, We have, um, we have- we have a tremendous, uh, you know, working relationship with all of our broker-dealer counterparties. Um, We have 40 people on my staff, uh, surveillance systems, credit models. So, we've weathered the storm. We're at spreads that are wider than where we--when we started the fund in many cases, and um, we know - we know how to take advantage of the opportunities, and we're going to. You know, we- some might argue we should've been more aggressive in, uh, in March. But one of the things we wanted to do is we wanted to make certain that-that we had significant amounts of liquidity and all of our repo people, all of our repo-counterparties were calm, uh, were with us, that if we had redemptions we had -we had and have plenty of liquidity. Once we do the BofA trade, I feel a lot more comfortable, and we will start deploying capital. So, we're -we're optimistic, we're getting subscriptions in, as I said, you know, part of our subscriptions for May will be Bear um, for 25 millionand I haven't checked, maybe we have other subscriptions as well but--

MR. TANNIN: We do.

MR. CIOFFI: We do? Matt's telling me we do.

MR. HIRSCH: Thanks a lot guys.

MR. CIOFFI: And, and, we, I mean, you've got a very devoted [laughs], dedicated asset management team here. Our-our money is in all three of these, in these funds. Um, I mean, we're-we're we're 24/7 on the job and um, you know we want to make our LPs' money

back, we want to make our money back, and
we're, we are focused. We are very focused.
OPERATOR: Thank you, again, ladies and gentlemen. If you have a question, please press the number one key on your touchtone telephone. And we have a follow up from Joel Dryer. Your line is open.
MR. DRYER: Yeah, so, I think, if I heard you correctly, all things being equal net-net, uh, December 31st, the two funds might get to 6 and 9%, did I hear you right?
MR. CIOFFI: Yeah. If we just take, if we just take--
MR. DRYER: No, it's fine. I understood it. I'm just looking at the number, thanks.
MR. CIOFFI: Yeah.
OPERATOR: Our next question is from Brant Behr of Concord. Your line is open.
MR. BEHR: Just um, one quick question on-on clarification, when you went through the ,um, asset class, uh, breakdown. The 50% that is ABS, that's basically consisting of AA and AAA bonds where the collateral is A and the collateral of A is basically BB subprime.
MR. CIOFFI: No, no, no, no, no. Um, The-the ABS CDO that we own is-is-is predominantly, well it's

predominantly AAA and super senior, but say of the-of the-of the ABS CDOs that we own, [clears throat] 84% or more is AA or higher, and then the rest would be single A. The underlying is predominantly going to be Baa1, Baa2, some Baa3 subprime. But, the most important distinction is, is, of the '06 vintage, which is creating the problem, um, only 28% of-of the underlying collateral -- you know, give or take, I-I don't have the exact number in front of me -- but call it 30% is exposed to that '06 vintage that we're, that is creating all the-all the havoc. And then we have hedges in place whereby we're-we're short an-an-an amount that's significantly greater than that billion and a quarter, billion and a half of that subprime paper -- so through a combination of CDO shorts, single-name subprime shorts, and then the index shorts. So, if um that '06 continues to deteriorate significantly, those hedges we have will start paying off very, very nicely, either-either because there's defaults and we get paid or because you get more, we get some price appreciation on those hedges. And the point is, because we're at the AA or AAA level, defaults within -- the reason there's subordination and the reason we're at that level is, if there are defaults, they've got to eat through a lot of subordination before your-your-your triples or doubles take a writedown, but we're getting paid on the hedges as-as the losses occur. Um, so, one simplistic way to think about it: let's say we had a $100 million AAA, and we had $100 million -- we had a hundred-name portfolio, and we think that the risk is in 30 of those names, and we short, um, 30 of those names. And let's say the AAA—uh, wait, let me start over. Let's say we have a AAA bond that's 50 million. And-and there's-and there’s a, um, $100 million collateral pool -- a hundred names, 1% per name. And we think 30-30 of those names represent all the risk. And we-we short those-those names. And let's say-let’s say the entire collateral pool - uh, let's take an extreme case -- let's say the entire collateral pool defaults, which is-which isn't going to happen, but we'd make 30 on our hedge, we'd obviously lose 50 on our AAA, but that's the extreme case. The more likely case is, if our credit models are right, we're doing our homework, we're going to make money on that, some portion of that 30 million, which gives us additional cushion against other losses. But the-the probability of getting up to that, you know, 50% cum loss rate in that deal is pretty slim. So those hedges will pay off before-before a AAA or AA gets hit. That's kind of the concept of the-of the strategy here. We're not, you know, you know, it's not to be net long anything, per se, we're-we're on a notional basis long, but we, um, we think we've got our real credit risks very well outlined, and very well, very well covered.

MR. BEHR: So just to clarify, for that 50% ABS, when you keep on drilling through to get to the underlying collateral, how much is subprime and how much is the o, you know, um '06 vintage?

MR. CIOFFI: Well, it's-its-its all -- well, I can't say, I'd have to see if it's all subprime, I guarantee it's not all subprime. But let's-let's-let's say that it's 75% subprime, but only about 25% is '06--

MR. BEHR: Okay.

MR. CIOFFI: --or the '06 we don't like, let's call it. But we have more than that amount hedged, you know, short. So on a net-net basis, you-you could say we're not long it. But if you-if you don't want to, if you want to disregard the shorts, then we're long it through the-through the

CDO. Is that clear?

MR. BEHR: Yup, thanks.

MR. CIOFFI: And again, we-we-we-we're-we're planning on meeting with you again, but I mean we can-we can-we can go through it in more detail in person.

MR. BEHR: Great.

OPERATOR: Thank you, sir. Uh, there are no further questions in the queue, sir.

MR. CIOFFI: Okay, again, I want to reiterate one-on-ones, conference calls, we encourage that, um, and, um, we're-we're here for all of our investors. If you need us, feel free to call. Thank you very much.

OPERATOR: Ladies and gentlemen, thank you for your participation in today's conference, this does conclude the program. You may now disconnect, and everyone have a wonderful day.

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