

Market Factor Implications

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Market Factor Implications

Case Study: Fannie Mae / Freddie Mac

- Who is Fannie Mae / Freddie Mac?
 - Fannie and Freddie, which together own or guarantee about \$5 trillion in home loans, about half the nation's total, have lost \$14 billion in the last year and are likely to pile up billions more in losses until the housing market begins to recover.
- What happened?
 - Officials announced Sunday, September 7, 2008, that both Fannie Mae and Freddie Mac were being placed in a government conservatorship, a move that could end up costing taxpayers billions of dollars. The conservatorship will be run by the Federal Housing Finance Agency, the new agency created by Congress this summer to regulate Fannie and Freddie.
 - The Treasury Department said it was prepared to put up as much as \$100 billion over time in each of the companies if needed to keep them from going broke, in exchange for senior preferred stock. Treasury will immediately be issued \$1 billion of such stock from each company, which will pay 10 percent interest. Further purchases of preferred stock will be triggered if quarterly audits find that the companies' capital cushion is below prudent standards.
 - The government, which will receive warrants representing ownership stakes of 79.9 percent in each company, is hoping that its moves will reassure nervous investors that they can continue to buy the debt of the two companies
 - Mark Zandi, chief economist at Moody's Economy.com predicted that 30-year mortgage rates, currently averaging 6.35 percent nationwide, could dip to close to 5.5 percent. That's because investors will be more willing to buy the debt issued by Fannie and Freddie -- and at lower rates -- since the federal government is now explicitly standing behind that debt.

Market Factor Implications

Case Study: Lehman Brothers

- Who is Lehman Brothers?
 - Lehman Brothers Holdings Inc. is a global financial-services firm. The firm does business in investment banking, equity and fixed-income sales, research and trading, investment management, private equity, and private banking.
- What happened?
 - On September 13, 2008, Timothy F. Geithner, the president of the Federal Reserve Bank of New York called a meeting on the future of Lehman, which included the possibility of an emergency liquidation of its assets.
 - Lehman reported that it had been in talks with Bank of America and Barclays for the company's possible sale.
 - The New York Times reported on September 14, 2008, that Barclays had ended its bid to purchase all or part of Lehman and a deal to rescue the bank from liquidation collapsed.
 - Leaders of major Wall Street banks continued to meet late that day to prevent the bank's rapid failure. Bank of America's rumored involvement also appeared to end as federal regulators resisted its request for government involvement in Lehman's sale.
 - On September 15, 2008, it filed for Chapter 11 bankruptcy protection; the filing marks the largest bankruptcy in U.S. history. The following day, Barclays plc announced its agreement to purchase, subject to regulatory approval, Lehman's investment-banking and trading divisions along with its New York headquarters building.

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Case Study: Merrill Lynch

- Who is Merrill Lynch?
 - Merrill Lynch & Co., Inc. is a global financial services firm. Through its subsidiaries and affiliates, the company provides capital markets services, investment banking and advisory services, wealth management, asset management, insurance, banking and related financial services worldwide.
- What happened?
 - On September 5, 2008 Goldman Sachs downgraded Merrill Lynch's stock to "conviction sell" and warned of further losses from the company. Bloomberg reported in September 2008 that Merrill Lynch had lost \$51.8 billion in mortgage-backed securities as part of the subprime mortgage crisis.
 - On September 14, 2008, Bank of America announced it was in talks to purchase Merrill Lynch for \$38.25 billion in stock. *The Wall Street Journal* reported later that day that Merrill Lynch was sold to Bank of America for 0.8595 shares of Bank of America common stock for each Merrill Lynch common share, or about US\$50 billion or \$29 per share. This price represented a 70.1% premium over the September 12 closing price or a 38% premium over Merrill's book value of \$21 a share, but that also meant a discount of 61% from September 2007.