0001 - 0:00

[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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0002 - 1:10

1 discussing today.
2 Okay, let me talk, uh, firstly about our first
3 quarter returns for both the High Grade
4 Strategies and the Enhanced High Grade Fund.
5 Um, quarter to date through March 31st, High Grade
6 has a cumulative return of -0.34, 34 basis
7 points. And that was, um, ah, -- January's number was
8 approximately 125 positive. February was
9 approximately 150. Uh, March was down about 3,
10 should-should come in at down 3 and a quarter, and
11 then there's about a 50 or 60 basis point
12 positive adjustment. Um, we're not sure if it's
13 going to be in February's mark or March's
14 mark. Um, the Enhanced--High Grade Enhanced
15 Leverage, uh, has a quarter-to-date return of
16 -4.74. Um, that's comprised of a January number,
17 which was positive .67; a February number,
18 which was about -0.5; and a March number
19 that's going to come in around -5, 5 and a
20 half. And there's about a 60 basis point
21 positive adjustment in Enhanced Leverage that
22 will either show up in the February number, ah,
23 making February positive, or in the March
24 number, reducing the-uh-the negative.
25 Um, at this point in time, um, the fund has, uh, significant

0003 - 2:50

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

1 in, which should be done, um, this month and will
2 close in May. And that was the large
3 financing transaction that we mentioned in
4 February that we're doing with Bank of
5 America. That trade has been upsized to $5
6 billion, and that is a significant, uh, transaction
7 to get done: number one, in this marketplace,
8 it'll be the largest CDO of-of the year so far, I
9 believe. And that has significant benefits
10 for us on a number of fronts. One is, we'd be mov-we'll
11 be moving approximately 2.6 billion of assets
12 out of-out of Enhanced and, um, 1.4 out of High Grade, and
13 we'll be funding them in this facility that
14 we've set up with BofA. The facility is-is-is
15 essentially a Klio-like facility in that the
16 majority of the financing is commercial paper.
17 We'll be -- like Klio -- we'll be taking back
18 equity in some of the rated-rated notes. And like
19 Klio, that vehicle is-is term funding, it's
20 non-recourse and the funding is not dependent
21 upon any sort of a mark to market. It's
22 purely a cash-flow structure. That
23 transaction, um, adds significant liquidity to both
24 funds. Post the-uh-the-the transaction, uh, we'll have an
25 excess of 200 million of-of liquidity, cash and

1 liquidity available in Enhanced, and I believe, uh,
2 125 million, um, maybe slightly more, uh-in-uh-in High
3 Grade. And that's-that's post reinvesting cash, ca-uh,
4 capital that we free up through that transaction,
5 um, and, um, uh, investing about 100 million dollars--
6 MR. CIOFFI [aside]: Both in Enhanced and High Grade?
7 UNIDENTIFIED SPEAKER: Ah, yeah.
8 MR. CIOFFI: --uh, investing $100 million, uh, out of
9 Enhanced and out of High Grade into new assets
10 that we're in the process of identifying now
11 in, uh, in the CDO space and structured credit space.
12 And post those investments, we're pro-formaing
13 a, uh, a carry in, um, in Enhanced of approximately 13--
14 UNIDENTIFIED SPEAKER: 80.
15 MR. CIOFFI: 80? Call it fourt-14% carry on an
16 annualized basis, and um, about 11% in, um, in High Grade
17 on an annualized basis. The, um, th-those returns -- and
18 again, in-in the investments will not be done
19 immediately -- it will take us, uh, a few months to, uh,
20 deploy that capital, probably at most.
21 Additionally, the funding vehicle has a
22 billion dollars of additional capacity that we can use
23 to buy assets. And, um, uh, that, you know, that we'll be
24 doing simultaneous to buying assets for the-for the
25 hedge fund. And then the other big benefit, obviously--

0006 - 7:50

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

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

1 some time about what-what went on in March and why,
2 and-and how we're doing in-in April. The majority if
3 not all of the negative return in March for
4 both funds was a result of the ABX hedge --
5 which we've been short -- rallying
6 significantly, and some of the single-name
7 credit shorts that we've had on, rallying. A
8 lot of that rally was a-was a technical rally.
9 There was significant short interest in the
10 ABX indices, and, even though it was small,
11 there was a-a moderation in the delinquency rate
12 in all three indices in February and March.
13 And then there was significant rhetoric around
14 certain types of bailout programs and
15 financing, and refinancing facilities that
16 various banks were-were uh implementing. So that-that the
17 market kind of bid based upon some of that
18 stuff, and I think 450 basis points of the
19 negative return, uh, in Enhanced was the ABX
20 rallying and single names rallying and, um, about
21 250, or, uh, about 250 basis points I believe in High Grade
22 was-was the same phenomenon.
23 CDO spreads and CDO prices have not come back.
24 They've stabilized for sure. Um, the-um-the market is
25 cleaning up its inventory, stuff is trading,

0009 - 12:32

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

0010 - 14:00

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

0011 - 15:50

1 confidence that the structured credit market,
2 and the subprime market in particular, has not
3 systemically broken down. The-the dislocation
4 that we saw in February and March is simply
5 one where the early high delinquency numbers
6 in many of the subprime deals, um, has spooked the
7 market into, uh, a position where people are simply
8 afraid that all of the historical data that
9 the rating agencies, and the structurers, and
10 the investors have been using to assess the
11 relative ratings volatility of these sorts of
12 structures, right, that the people are scared
13 that the -- what has been will not be the case
14 in the next few years. While the information
15 that people are looking at is real, right --
16 there clearly are higher delinquencies in the
17 2006 vintage -- from our-our assessment and the-the
18 analysts that we talk to, and the servicers
19 that we're talking to, there's no concern
20 among these people that, um, that-that-that there's going to
21 be a performance that is-that is not historically rational.
22 So, while it's true that the early defaults or
23 the early delinquencies are higher than
24 they've been, the explanation for that is that
25 homeowners who had been refinancing out of

0012 - 17:23

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

0013 - 18:49

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

0014 - 20:01

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

0015 - 21:13

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

1 construction, and from a market view, um, we're
2 quite comfortable with where we sit.
3 MR. CIOFFI: You know, I want to expand on two
4 points Matt made. One, this notion that the
5 CDO model and the rating agency model is
6 broken. Um, as Matt said, we don't believe that.
7 It's purely a function of-of there are-there are good deals
8 and there are bad deals. There's deals out
9 there with too much leverage, there's deals
10 out there with poorly selected portfolios, and
11 deals that have been done by managers that-that
12 shouldn't have done deals. You know, I refer
13 to the transaction that just, that's pricing
14 now in this market where the AAA bonds are
15 pricing at LIBOR +65. That-that's only about 10
16 basis points wider than where AAA mezzes were
17 being priced in ABS CDOs in December of '06.
18 So the market to market is-is-is-signifi-is bifurcated.
19 The other point to make on this '06
20 origination in the subprime space -- granted,
21 the cum losses are going to be significantly
22 higher than-than-than earlier vintages. Um, estimated cum
23 losses on '06 are-are in excess of what occurred
24 in 2000, which was the last really bad vintage
25 subprime, and that was-that was punished by the fact

0017 - 23:54

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

0018 - 25:29

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

0019 - 26:54

1 hedging them. Um, the, um the market will stabilize, and
2 the good news is that, from all indications,
3 the 2007 originations that will be occurring
4 in the subprime market will be significantly
5 better from an underwriting perspective.
6 There will be CDO deals done off of those
7 transactions. Unfortunately the spreads won't
8 be as wide as we can get in the-in the, uh, in the market
9 now, but that'll be a big benefit to the overall
10 CDO market. That'll generate more liquidity
11 and I think get secondary trading to pick up.
12 So we are-we are cautiously optimistic. We have a
13 plan in place that'll get the funds back on
14 track to generate positive return. And, um, most
15 importantly, we have financing, and we have-we have
16 significant amounts of liquidity.
17 One last point on Enhanced High Grade: we-we-we've,
18 we have significant liquidity in the Barclays
19 line that we've yet to even draw down. We've
20 drawn down some, but we have, we have the
21 ability to draw down more. Um, so we-we're-we're-we're not
22 really even using our full capacity there. Um, we
23 probably will over time, but, uh, there's no need
24 to at this point.
25 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.

0021 - 29:27

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

0022 - 30:19

1 MR. BERGMAN: So are they finding stuff - uh, and
2 what everybody is, you know, probably asking
3 on the phone is, how are we going to make up
4 the negative 3 to 5%, uh, and get back to, you
5 know, the expectations that we laid out? So,
6 I'd like to hear what they're finding. Are
7 you guys taking advantage of it and going into
8 the market and buying because, after all, you
9 were waiting for some type of dislocation,
10 perfect storm weakness.
11 MR. CIOFFI: Yeah, we--
12 MR. BERGMAN: Now we've got it, what are we
13 doing about it?
14 MR. CIOFFI: Right, good point. I mean, we
15 were-we were waiting, um, and our hedges did-did work, our
16 liquidity is there. Um, we are going to start
17 buying, uh, this market. We are seeing
18 opportunities, the market-the market's efficient enough
19 that in general if something's trading at 60
20 or 70, it may be undervalued, it may be-may be
21 properly priced. Our credit models are
22 helping us identify those opportunities. I'd
23 give you one-one example of a transaction we did
24 this week. It was a AA CDO; our credit models
25 show that it takes no writedowns, the

1 transaction is-is money good. It's an-eh ABS CDO.
2 Uh, we were able to, uh, buy that at a-at a-a DM of LIBOR +
3 250, and we found a-a-a great short candidate,
4 another ABS CDO, same vintage. Our credit
5 models show that that takes a 100% writedown
6 to the AA tranche. We're actually able to
7 short that at a-at a spread of 200. So there's-there's
8 those types of opportunities. There are AAAs
9 out there. Uh, we're buying one AAA, um, at a discount
10 margin, I think, of around LIBOR + 75. That
11 shows no writedowns at all to the AAA tranche.
12 There's significant subordinations - sig-there's
13 significant subordination in that deal, that
14 it's doubtful it would even-even be down, you know,
15 have any-any ratings migration risk. So there are
16 opportunities, and what we-what we try to map out here
17 is our plan to earn back that -4.5% in
18 Enhanced and, you know, to get positive return
19 in High Grade through reinvesting the-the freed-up
20 capital, as well as the excess capital we
21 currently have in both funds, bringing up on a
22 running basis our carry to about 14% in-in, uh,
23 Enhanced and 11% in High Grade. And then
24 these total-rate-total-rate-of-return trades that we're
25 going to implement will generate, we think

0024 - 33:01

1 over the next couple of years, 15% gross
2 return. And then there are-there are going to be, we
3 will get mark-to-market benefits on some of
4 the CDOs that have been marked down. For
5 example, we have one AAA CDO that is
6 essentially all '03 and '04 vintage subprime
7 collateral. Now it's a AAA tranche that's-that's
8 highly levered. But we think it's money good,
9 we like it. Um, we don't see any writedowns in
10 the underlying collateral pool, um, I think until
11 '09. There's 30, I think we have 38%
12 subordination to the, um, to the tranche in question. And
13 that thing's been marked all the way down to
14 75, I think. So there's an example of an
15 asset that, as-as credit performance flows
16 through that structure, it's got to be marked
17 back up and/or just accretes back towards par
18 -- it's probably a 5-and-a-half- or, probably a
19 5-and-a-half-year average life piece of papy-paper,
20 maybe, maybe less.
21 Um,we did-we did, in many respects, have the perfect
22 storm on the asset side. The interesting
23 thing was that the-that the liq-the funding markets were --
24 there-there wasn't even a blip in the repo world.
25 Which-which we, I mean, we were very happy about. Um, so,

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1 we will be buying assets, we are going back
2 into the market. And with the liquidity and
3 the term funding that the BofA facility gives us,
4 we've got a lot of- we got a lot of buying power, which, by
5 the way, give us an awful lot of leverage with
6 the dealers to get out of some paper we don't want to-we
7 don't want to own. We have, let-let's call it, between
8 the CDO and the hedge funds, we're going to
9 have $2.5 to $3 billion dollars worth of paper
10 to buy over the next three months, give or
11 take. It'll be very easy to sell a couple
12 hundred million of stuff we don't want to own,
13 and-and-and probably sell it at a-at a pretty good price.
14 So we've got a plan to make back money and we
15 anticipate being profitable and ending the
16 year, uh, in both funds, uh, on the upswing.
17 MR. TANNIN: Actually, let me just-let me just address
18 exactly the question you raised with regards
19 to the rating agencies. Um, again, Andrew, Stu,
20 Dhruv, I mean, they're all, they've all seen
21 collateral performance like this before. The
22 rating agencies have seen collateral
23 performance like this before. So, when the
24 rating agencies rate a bond, whether it's a
25 AAA, AA or A, they're not-they're not telling anybody that

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

1 collateral performance and make sort of
2 sweeping statements about the rating agencies
3 or the ultimate meaningfulness of ratings on
4 structured finance.
5 MR. CIOFFI: You know, one thing, um, with regards
6 to delinquencies. I'd mention the February
7 and the March remittance reports. The, um, the April
8 remits reports are coming out now, as we
9 speak, and we have some color on those that
10 I'll give you in a second. But for those of
11 you that don't know what a remittance report
12 is, it's basically the servicer report on 30-,
13 60-, and 90-day delinquencies, as well as
14 foreclosure and-and REO, Real Estate Owned, data.
15 So, up until February, those 30-, 60-, and
16 90-day delinquency buckets, as they're called,
17 were increasing and they were increasing at an
18 accelerating rate, as were the foreclosure and
19 REO buckets. Well, the February remittance
20 report and the March remittance report, and I
21 believe -- well we don't have all the data yet,
22 we-we probably have about a third to a half of it
23 out so far -- you're seeing a continuation in
24 the February and March trend, which was a
25 flattening out of the-the-the delinquency, the-the

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1 acceleration or the increase in those
2 delinquency buckets. They're still high by
3 historical standards for the '07-1, which is
4 probably the worst-selected vintage of
5 subprime. The '06-2 would be the second worst
6 and the '06-1, actually, performs pretty damn
7 well. Our credit models show that even down
8 to the BBB-, which we're actually long, take
9 no credit writedowns. And those delinquency, um,
10 buckets, and the rate at which those buckets
11 have been increasing, has been flattening out
12 since February. The rationale for that -- if
13 you speak to subprime analysts or you speak to
14 the, um um-uh the rating agencies -- the rationale for that
15 is that these, um, fraud, um, fraud, uh,-underwritings and
16 bad underwritings that occurred, they flow through
17 the pipeline very quickly. If someone lied on
18 their application and there was a, you know a fraudulent
19 appraisal, they d- they're delinquent almost
20 immediately; they go through the system, the
21 servicer knows what's going on, they go into
22 foreclosure and REO very quickly. Once
23 they're through the pipeline, they're gone, they don't re-
24 they don't re-occur. Same thing with bad underwriting.
25 So you're-you're-you're seeing those-those, the bad

1 underwriting and-and-and the fraudulently, uh, obtained
2 mortgages being flushed through the system.
3 That's why these delinquency rates are-are
4 flattening out and declining. No one's
5 predicting that its go- '06 is going to be a great
6 year, it won't be. Um, but, you know, some people
7 are talking about 20 and 30% cum losses. I-I-I-I
8 think that's a- that's an extreme, extreme
9 overstatement. And-and right now it'd be hard,
10 even given this horrible data, it's hard to, uh,
11 see 20, even 20% cum losses. So think, the-the
12 moderation that we're seeing is con-seems to have
13 continued in April. '07, as I said, is the
14 worst vintage; '07-1, which is mid- and late-uh,
15 '06 originations is-will definitely go down in history
16 as the-as the worst-originated, uh, subprime collateral.
17 MR. BERGMAN: Ralph, one other question. Can
18 you hear me?
19 MR. CIOFFI: Yes.
20 MR. BERGMAN: You've been doing this a long
21 time and you ran a lot of money for, uh, the
22 principal desk here at Bear in the structured
23 area. How bad was this in terms of, I mean,
24 you said to me when we started this fund, you
25 know, you've got to worry about geo-political

1 risk, um, you got to worry about certain things
2 and that's where you're going to get your
3 dislocation. Was is this in your mind the perfect
4 storm that has not occurred in 10 to 20 years?
5 MR. CIOFFI: In my mind, on the asset side,
6 yes. And it was exacerbated by something Matt
7 mentioned, which was all of a sudden everyone
8 woke up one day and said, 'Hey, you know what,
9 the rating agency models are broken, they
10 don't work. The securitization business is
11 over, the CDO business is over.' I mean, the
12 CDO market last year was eight or - I-I guess- I-I think
13 between subprime securitization and CDOs - h-had
14 to be over a trillion dollar market, I would
15 suspect. Um, so you had-you had a confluence of events in
16 a matter of one - uh, uh, it was building, but it all
17 came, kind of came to the forefront in-in-in almost,
18 call it a one to three week period. Um, and then
19 of course you had the big technical factor
20 that we discussed. Everyone was using ABX as
21 their hedge, and the street and-and many accounts
22 were effectively just long the AAA and super
23 senior component of the capital structure
24 because up until that point that was a safe,
25 that was a safe-really the safe have-haven. So, in my

1 mind, yes, some people would debate that-that-that
2 they've seen worse markets, but I-I think it was
3 the six-sigma event everyone is worried about, um,
4 from a market volatility perspective. What
5 we'll see going forward now is-is price movement
6 based upon actual credit performance. And that's where
7 we think we've got a- we've got a-we've got an edge, and-
8 and-and we've got a model that we like and is
9 efficient, and that'll keep us ahead of that curve.
10 MR. BERGMAN: Okay, thanks.
11 MR. CIOFFI: Yeah.
12 OPERATOR: Thank you, our next question is
13 from Joel Dryer of IO Partners, your line is open.
14 MR. DRYER: Hi Ralph.
15 MR. CIOFFI: Hey Joel.
16 MR. DRYER: Based on what I think I just heard
17 you say, I-would you-do you think there's any credibility
18 to, uh, Bethany's article in Fortune on April 2nd?
19 MR. CIOFFI: I didn't read the article. What-what was it?
20 MR. DRYER: Uh, it's entitled "Dropping the Ball."
21 MR. CIOFFI: Oh, about the rating agencies?
22 MR. DRYER: Yeah.
23 MR. CIOFFI: Um, well, I didn't read the article,
24 but I-I-I-I can tell you what we-what we think. It'll
25 probably look like they dropped the ball on

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1 CDOs that have heavy '06 subprime
2 originations. Um, but they probably dropped the
3 ball on the subprime subordination levels.
4 Now, what happened there is that got
5 compounded in-in some of the CDOs, because if the
6 subordination levels were too low on the '06
7 vintage paper, and if that '06 paper got into
8 the CDOs, the subordination levels on the
9 '06-originated CDOs were based upon a, let's
10 call it a weighted-average rating of Baa2 or
11 Baa1, they have historical ratings transition
12 as well as cum loss data on those rated, on
13 that rated collateral, um, so those CDOs are going
14 to underperform. So from that perspective,
15 yeah, they dropped the ball. They used-they used
16 historical data that was skewed by the easy
17 money that Matt referred to, that allo-a lot- that allowed,
18 um, significant number of borrowers that would've
19 ultimately ended up in the delinquency buckets
20 in-in the the re-fi bucket. And actually, Bear
21 Stearns' head of research, Gyan Sinha, had-had
22 written about that I think in, uh, in '05. Now, the
23 rating agencies did increase their
24 subordination levels on '06, as I mentioned
25 before. It's-it's going to be several years before

1 you know whether or not the subordination
2 levels were-are-are going to be sufficient. For
3 example, if you take that '07 origination,
4 that '07-1 index, which is the worst
5 originated collateral, you still don't see any
6 writedowns that begin in, I think, until 2009
7 or 2010. Now, a lot can happen in two or
8 three years -- the Fed could lower rates 200
9 basis points, the housing market could turn
10 around. Um, there's you know, there's a lot that can
11 happen in two years, good and bad. Um, so, it's
12 hard to say, Joel, uh, we'll-we'll know-we'll know-we'll
13 know in 12 to 18 months, I would suspect.
14 MR. TANNIN: And, uh, again, Joel, uh, again, the point
15 is, again, I think it's very hard at this
16 point in time to say that the rating agencies
17 dropped the ball. But, what it's not hard to
18 say is, 'Did your portfolio manager,' right?
19 We don't just look at the ratings--
20 MR. CIOFFI: Yes.
21 MR. TANNIN: --and buy stuff, so, were we
22 concerned about lending standards? Yes we
23 were. Were we concerned about the-the-um, the tight
24 spreads of '06, uh,-originated collateral, given
25 what we saw as, um, inevitable rising

1 delinquencies? Yes we were. Were we
2 concerned about IO loans and-and-and sort of, uh, um,
3 barbell-shaped FICO scores in various
4 different kinds of deals? Yes we were. So,
5 we didn't buy those deals, even though-even though on day
6 one they're rated the same. So, the rating,
7 it's-it's important to put the responsibility in
8 the proper place.
9 MR. CIOFFI: Right.
10 MR. TANNIN: We are responsible for making
11 good credit decisions, and the credit
12 decisions that we make are far in excess of
13 just making sure that the rating agencies sign
14 the rating letters, right? We don't, uh, again,
15 we don't do that, and the-the people that we know
16 in the market don't do that. We're looking
17 at, I mean-I mean, again, we think we have the most
18 sophisticated surveillance system, but our
19 colleagues have sophisticated ways of looking
20 at things as well. So, it's just simply not
21 true that the rating is something that we just
22 say, 'Okay, we've got 50% of the AAAs, our
23 bucket's full, let's move on to some--'
24 MR. CIOFFI: Yeah, the only-the only-the only meaningful,
25 uh, aspect of the rating is it-is it dictates our repo

1 haircut and rate. But it-it doesn't matter -- look,
2 there's BBBs, I've said this before, there's
3 BBBs we buy and AAAs we won't buy, so the
4 ratings to us are more of an academic point.
5 Um, and I'll go over a statistic I gave in-in, uh
6 January. We didn't-we didn't buy a direct -- we didn't
7 make one direct investment in 2006-originated
8 subprime. We did buy a significant amount of
9 AA, AAA, and super senior CDOs. There was
10 about a billion and a quarter, maybe a billion
11 and a half, I forget the exact number, of
12 '06-, late '05-, mid-to-late '06-vintage
13 subprime in those CDOs. The majority of what
14 we bought on the CDO front, 84% was AA, or yeah,
15 I think 84% was AA or higher, and of that
16 about 90% was AAA or higher. Um, we are short on-on a-
17 a notional basis far more '06-vintage paper
18 than we are long. Um, and that short, by the way,
19 give-gives you an idea how crazy the markets are,
20 that short in '06 vintage paper -- which the
21 majority was an '07-1, which as I said is the-the-the,
22 will-will go down in history we think as the worst
23 underwritten vintage of-of any asset class -- was
24 what was up the most in March. Um, so yeah, Matt-Matt-Matt
25 makes the-the-the-s-the good point. The ratings are-are

1 important as it relates to our repo and
2 financing rates. They're not important as it
3 relates to what we buy or sell.
4 MR. DRYER: Okay, uh, if-if I'm understanding
5 correctly, in terms of our portfolio, um, the CDOs are
6 the-uh tranches, or the pack-the repackaging of the ABSs?
7 MR. CIOFFI: Right.
8 MR. DRYER: And where are we in terms of ABS asset
9 holdings and CDO asset holdings? So--
10 MR. CIOFFI: Well, A direct ABS, virtually -- when you
11 talk about ABS you mean subprime. Is that --
12 direct subprime holdings in-in either the High
13 Grade or the Enhanced Fund are virtually nil,
14 and-and if we have them they're very seasoned
15 vintage paper, or they're going to be very
16 highly rated.
17 MR. DRYER: You-you get a CDO by slicing off the
18 bottom of an ABS.
19 MR. CIOFFI: Well, you know what, Joel, why
20 don't you -- if we're going to talk about CDO
21 101, why don't you call Matt or I direct and
22 we'll have that discussion. I-I'd rather spend
23 the time, um, talking, you know, going through that
24 exercise--
25 MR. DRYER: That wasn't my-that wasn't my question. My

1 question was purely -- and thanks for the 101
2 lesson, okay - uh, purely, what percent was the
3 Fund in CDOs versus the, uh, the ABS. That was it. I
4 really don't need an education, okay?
5 MR. CIOFFI: Okay. The majority of what we
6 bought in-in-in '06, between the two funds, which
7 was 7, call it 7 billion of ABS CDOs, um, the
8 majority of which was AA and AAA, we had
9 exposure to this '06 vintage that is creating
10 the, really the problem in the market, uh, of
11 between a billion and a quarter to a billion
12 and a half is the underlying collateral. Um, and
13 the, we-we have shorts in place that are far in
14 excess of that number. Not-Not to mention that by
15 buying the AA and AAA paper, there's
16 significant layers of subordination that are
17 beneath our AA and AAA. So that billion and a
18 quarter, even if it weren't credit hedged, if
19 we didn't have, uh, uh, you know, off-setting shorts,
20 in theory that billion and a quarter could be
21 written down to zero. And I can't think of a
22 CDO that would have a writedown up to the AAA.
23 Now there are some deals out there that are
24 overly levered to only '06, so, uh, the ABS CDO on
25 a percentage basis, let me see, you have--

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1 MR. TANNIN: On a net-on a net long basis, it's-it's roughly
2 50%. So 23% of the portfolio, ultimately at
3 the bottom, has corporate-related risk,
4 whether that's secured high-yield loans or, um,
5 investment-grade bonds.
6 MR. CIOFFI: And subprime, direct subprime is 7.2%.
7 MR. TANNIN: Right. So again, in-in-in easy
8 numbers, right, its let's just say 25% is corporate, 50%
9 is ABS of one form or another, which I can
10 break down in-in more in one second, so that's 75%.
11 And the other 75% is mostly one variation or
12 another of, um, near-prime, uh, straight RMBS where we
13 own the AAA. Of-of the- the CDOs, of the ABS CDOs,
14 that 50%, most of those bonds are, that we
15 own, are AA and AAA bonds where the collateral
16 of that deal are single A CDOs, and of those
17 single A CDOs, the collateral there, that's
18 where you have BBB, um, uh, RMBS exposure.
19 So while it's true that if the subprime market
20 in '06, um, and even more than that, turns out to
21 be one complete, absolute, unmitigated
22 disaster across the board, completely
23 systemically, right? Then the prices that
24 everyone is marking the portfolios at right
25 now are right. If the BBBs underlying these

1 deals end up performing, right, in a more
2 credit-specific way, then the subordination
3 that we have to the single As, which are the
4 collateral for the AAA and AAs that we own,
5 will not have a systemic writedown, and the
6 AAAs that we own will not have systemic
7 downgrades. So, again, it-it-it-it really is a matter
8 of whether one believes that careful credit
9 analysis makes a difference, or whether you
10 think that this is just one big disaster. And if-and
11 there's no basis for thinking that it's one
12 big disaster.
13 MR. CIOFFI: And-and-and again--
14 MR. DRYER: I understand, and the point has
15 been made twice now on two different
16 conversations. And further to that point, I
17 don't-I don't think implied was you're looking at what
18 the rating agency says and saying, 'Oh great,
19 that's what we're going to buy.' I mean, come
20 on guys, give me a break, uh, everybody's got
21 their money with you guys because we think
22 you're smart, not because you look at the
23 rating agencies.
24 MR. CIOFFI: Right.
25 MR. DRYER: I don't know where your

1 defensiveness has come from that, I don't know
2 if other people kind of in-intimated that, but
3 that to me sounds just absolutely silly. Why-why-why
4 would a group of smart people just look at
5 what the rating agencies say?
6 MR. CIOFFI: Right, we're not-we're not- we're not an index.
7 MR. DRYER: My question was, you know, my
8 question was, what were your thoughts on what
9 the rating agencies were doing? You know, have the
10 rating agencies really scrubbed everything?
11 Do you think they're done scrubbing? Do you
12 think they've done a good job of scrubbing? I
13 mean, that was really the heart of my
14 question. I and, again, I-I don't understand
15 where this defensiveness comes from.
16 MR. CIOFFI: You know, Joel, I think what the
17 rating agencies relied on was somewhat of a
18 black box. It hadn't been calibrated for the, um, the in-
19 completely calibrated for the increased
20 delinquency that-that '06 saw. And if you think of
21 what happened to the originators, the New
22 Centuries and the Lends and the NovaStars and
23 all these folks that have had difficulties,
24 some of whom are no longer with us. They
25 filed because of the early payment defaults.

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1 None of their credit models projected the-the-thae rate
2 at which they'd have EPDs, Early Payment
3 Defaults, within the first six months of
4 origination. And when the originator
5 originates a-a-a loan and sells it to a
6 securitization, they have a-they're obligated for the
7 first six months to buy it back if it goes 30
8 days delinquent. So all the-all the lax underwriting
9 standards and rush to keep their stock prices
10 up and earnings high, you know, they-they-they made
11 loans that they never should've. So--
12 MR. DRYER: That came back to bite them quickly.
13 MR. CIOFFI: It did, and they, you know what,
14 they didn't have the liquidity, um, to buy paper
15 back. And most of their-most of their credit models were
16 geared towards, you know, an underwriting
17 standard that was based upon a longer term credit profile
18 and they, I mean, they missed-they missed-they missed the-
19 they missed the problem they were creating for themselves.
20 So, the rating agency model's a black box,
21 and they-they didn't recalibrate some of their, you
22 know, some of their bells and whistles within
23 that black box.
24 They're certainly doing it now, and-and that was --
25 I mean, they did start in '06, and they did

1 increase their subordination levels, and-and I'm
2 sure -- well actually, the '07 originations
3 that are coming out now, we're seeing better-better
4 subordination levels; in fact in some cases
5 they're not even issuing BBB-. Um, so, I think-I think
6 you're-you're going to see '06 -- the disaster. Paper
7 prior to that is going to perform based upon
8 more historical standards. And then, uh, '07, we
9 hope, beginning mid-'07, um, we'll see better underwriting
10 and-and-and much tighter rating agency, um, uh, standards.
11 MR. MCGARRIGAL: The other thing, Joel, is
12 worth noting in '07, which we're starting to
13 see, is investor push back on the purchases of
14 those CMOs, so investors don't necessarily,
15 you know, completely trust the rating agencies
16 to the degree they used to. So now, you can,
17 to some extent, dictate the absolute level of
18 subordination and the triggers in the CMOs
19 that you're willing to accept at a spread that
20 you want to buy at. That's where '07
21 origination starts to become attractive to us
22 on a direct-exposure basis. And there are,
23 there have been a few transactions where we've
24 been able to negotiate those terms to our
25 liking. Um, the rating agencies' excuse in the

1 past was, 'The underwriters wouldn't let us,'
2 and the underwriters wouldn't let them because
3 the investors didn't force them. If the
4 investors can force the change, and right now
5 we think we're in a position to do that, then
6 you get better, uh, underwritten CMOs with the
7 correct subordination, with the correct
8 triggers in place to protect your investment, um,
9 at spreads that we think are attractive. So
10 that's where part of the opportunity this
11 year, we think, comes from.
12 MR. DRYER: Thanks guys.
13 MR. CIOFFI: Okay, Joel.
14 OPERATOR: Thank you. And our next question
15 is from Michael Ezra from Pentagon. Your line is open.
16 MR. EZRA: Hi, good-good-good afternoon, guys. Quick
17 question: there's a large part of your
18 portfolio, if I recall correctly, that's
19 actually not marked to market. Now I know
20 it's not necessarily an easy type of
21 calculation, but have you any idea, if you
22 sort of did theoretically mark to market all
23 of the bonds that-that aren't marked to market--
24 MR. CIOFFI: Yeah, no, every security we own is
25 marked to market. What isn't, when we say no

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

1 are marked to market monthly. They go up and
2 down with the-with the, um, not with the price of the
3 securities, but with the projected cash-flows
4 that those securities generate. So we-we do mark
5 them to market, and--
6 [END 01 Conference ID 1072990, START 02
7 Conference ID 1072990]
8 MR. EZRA: Is…, is-is-is that done, because I, I -- in other
9 words, the underlying spreads just widen out?
10 Does that mean that you're not necessarily
11 marking the things down if you just don't
12 think there's going to be any defaults? So if
13 you've taken the view that - it doesn't matter
14 that spreads have widened out substantially
15 because you think that the underlying credit's
16 good, uh, good, you haven't necessarily, uh, uh, changed any
17 cash flow assumptions and therefore you've not
18 marked any price down.
19 MR. CIOFFI: No, no, well, no not at all. What we
20 do, everything's basically a discounted cash
21 flow method. So we had, we project -- every
22 month we project the cash flows of the
23 portfolio at that time, and there's default
24 and recovery assumptions that we use. Now if
25 we think the default recovery assumption

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

1 when, as people are more worried about the
2 cash flow. So as you PV those-those cash flows at
3 the market higher yield that investors demand,
4 that's where that price is reflected.
5 Mr. MCGARRIGAL: And, that-that, that is specific to
6 certain types of equity. So, for example, CLO
7 equity has actually tightened a touch.
8 High-grade CDO equity is relatively unchanged.
9 And CDO equity backed by these mezz tranches
10 off of, uh, subprime, have widened. So it's
11 collateral specific and dependent, depending
12 upon how that equity should be valued in the
13 market today.
14 MR. EZRA: Okay, I'll-I'll leave it there at the
15 moment. I'll come back and have a private
16 discourse if I need anything further. Thank you
17 MR. CIOFFI: Yeah, but bottom line is mark, we mark
18 everything to market. Nothing, nothing is at book.
19 MR. EZRA: Okay.
20 OPERATOR: Thank you sir. Our next question
21 is from Scott Hirsch of Seabrook Capital.
22 Your line's open.
23 MR. HIRSCH: Ralph, if I -uh-uh have understood you
24 correctly, um, in March the losses in effect were
25 due to the short, particularly the ABX short,

1 and a couple of other individual shorts you
2 said. So it's sort of ironic that the-the hedges
3 actually caused the losses. In other words, I
4 guess, if I'm understanding this correctly,
5 um-you, you put on the shorts too late or didn't take
6 them off soon enough--
7 MR. CIOFFI: No, no, no, no, no. We've had the
8 shorts on, the reason February was not down 8 or 9%--
9 MR. HIRSCH: Yeah.
10 MR. CIOFFI: --is because the hedges work--
11 MR. HIRSCH: Okay.
12 MR. CIOFFI: --we've been hedging since '06.
13 And, one of the things that we used to get, you
14 know, that people used to complain about in
15 '05 and '06 is, 'well, your-your-your-your returns aren't
16 high enough, you're paying too much for your
17 hedges.' We've been short '06-1 -- well, '06-1
18 we're no longer short -- but '06-2, '07-1 since
19 they came out.
20 MR. HIRSCH: Mm-hm.
21 MR. CIOFFI: We've been short those for months
22 and months and months. And they really didn't
23 start going down -uh- in price and adding to the
24 return, pretty much until January. February
25 they were down big, and then March they-they

1 rallied. But no, we didn't put them on at the
2 bottom of the market.
3 MR. HIRSCH: Okay, well, that-that-that was going to be
4 my follow-up question. How much-how much of January
5 and February's good returns came from the hedges?
6 MR. CIOFFI: Uh-We beat--we would've been 8 or
7 9% negative numbers in-in February. January, de
8 minimis because we started seeing some CDO
9 spread widening, the ABX did trade down. Um-I
10 can give you the exact numbers, Scott, but
11 February the hedges made an awful lot of money
12 for us. Now, from the low point in February
13 to the February 28th -uh- close, they rallied from
14 the lows--
15 MR. HIRSCH: Mm-hm.
16 MR. CIOFFI: --Um--and then through the entire
17 month of March, the ABX did rally.
18 MR. HIRSCH: Did you, I mean, were you giving
19 some thought to, to covering, or did you just know
20 it was just too early?
21 MR. CIOFFI: Oh we did, we monetized, we monetized a lot.
22 We started covering at 60 on the '07-1 BBB-.
23 Um—And—Um-- we monetized, I mean, again, we'll give
24 you exact numbers, but I think in Enhanced we
25 monetized maybe $40 or $50 million, and in

1 High Grade we probably monetized 30 million.
2 MR. HIRSCH: Mm-hm.
3 MR. CIOFFI: So yeah, we did cover. But keep
4 in mind, they're not really trading - we-we-we do
5 trade them, and we-we we're cognizant of-of-of valuations,
6 but those '07- and '06-1 indices are long a
7 lot of, I mean, they're long the '06 vintage;
8 the '06 vintage stinks. Our credit models
9 show significant writedowns in that '06-2 and
10 '07-1 index.
11 MR. HIRSCH: Mm-hm.
12 MR. CIOFFI: Um-It's a large liquid market that
13 allows us to express a short position that's
14 good both from, you know, hedging mar-market
15 volatility but also credit hedges because some
16 of the CDOs we have, have exposure to that vintage.
17 MR. HIRSCH: Okay. And the-the, I think you said,
18 if I heard you correctly, the, for High Grade
19 at least, the, uh, month to date through mid-month
20 in April was down about 70 basis points, is
21 that about right?
22 MR. CIOFFI: High Grade through April, right.
23 Through-uh- April 24th, I guess.
24 MR. HIRSCH: Okay, and the -- is that just a
25 continuation of the rallying as you gradually cover up?

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1 MR. CIOFFI: No, no. The-no. The-the-um, through, through
2 April, the ABX continued to rally.
3 MR. HIRSCH: Right.
4 MR. CIOFFI: So, for example, on Friday of, of
5 this month, um-Enhanced was down almost 3 and
6 High Grade was down, call it, 2. Since Friday
7 the ABX has come off significantly. So if I-if I
8 were to, again, mark to market with the caveat
9 of not having marked all my assets yet, but we
10 don't think there's -- we don't believe there's
11 going to be significant asset mark to market.
12 The ABX has traded down since Friday, so we've
13 gained back, um-you know, a significant amount of
14 that-that underperformance. So we're -- Enhanced,
15 as I said, is uh, about negative 70 and High Grade
16 is about negative 65 roughly. And that's
17 because ABX has-has traded down from Friday.
18 MR. HIRSCH: Okay, and just-um, justto sort of drill
19 down a little bit more on this-this analogy of the
20 perfect storm that you talked about earlier.
21 Two sort of questions related to that: if, you
22 know, given-given what you've been through, do you, uh, do
23 you feel that what ended up happening sort of in
24 March and so forth is, is about as well as you
25 could've kind of hedged this in this perfect storm?

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1 MR. CIOFFI: Well--

2 MR. HIRSCH: I mean now, in retrospect, as you

3 look back?

4 MR. CIOFFI: In retrospect, if we look back, yes. However,

5 I mean, it would be nice, it would've been nice to have

6 covered more of the ABX, um, you know, on February

7 24th, or whenever it was when it was just, the

8 day the stock market crashed. Ah, we, Again, we did

9 try to cover, but so did everyone else in the

10 world. And that, and that, uh, in '07-1, the minuses, I

11 think we started covering that at 61 and

12 we're, we covered that in its entire -- the BBB

13 minuses -- we covered that in its entirety I

14 think at around 66. It got as high as 70.

15 Now we converted some of that short into the

16 BBB flat, which reduced the costs of the short.

17 And we felt, our credit models show very

18 little credit difference between the BBB and

19 the BBB flat. Um, So we thought the BBB flat was

20 a better short, we rolled into that.

21 Um, But I think, I think -- look, we made two mistakes, and

22 we discussed it in February: one is we were

23 ramping up the Enhanced portfolio, um, to get its

24 carry up. And, um, so, you know -- and we-we-we-we didn't,

25 we didn't ramp up I mean as much as the Barclays

1 facility would've allowed us to; we were, we were very
2 diligent and being cautious. But we're you
3 know, we're buying assets in December and
4 January, but I think the performance - I-I-I think
5 we performed very well, the hedges did work
6 and they did help us, our term funding and our, uh, our-our
7 term repos helped us.
8 MR. HIRSCH: What was the second mistake? I
9 missed the February call, by the way.
10 MR. CIOFFI: Oh, just, you know, buying-buying some
11 assets in January and, uh, you know?
12 MR. HIRSH: Yeah, yeah.
13 MR. CIOFFI: But, I mean, Enhanced is supposed
14 to be more levered than High Grade, so—um,
15 MR. HIRSCH: And just in terms of this whole
16 perfect storm thing, I mean, one thing that
17 strikes me, as you said at the outset of this
18 call, is you know the repo market remained
19 fairly liquid, um, so did not create a
20 forced-selling situation. And so, I mean, in
21 that sense, it really wasn't the perfect storm.
22 MR. CIOFFI: Well no, I said, there-there, it would've been
23 the perfect storm if the, if the repo liquidity dried
24 up and dealers said, 'You know what, we're not
25 going to repo your assets anymore.' Now that

1 may have happened to some players, I don't
2 know. I mean, we have a big footprint.
3 Um, investors have a lot of confidence that we're
4 part of the BSAM platform.
5 MR. HIRSCH: Mm-hm.
6 MR. CIOFFI: They have a lot of confidence, I
7 mean, they know -- you know, we're very open
8 with our repo counterparties, we send them a
9 monthly repo report, they know all our
10 positions, they know our liquidity. They ask
11 for margin, we post it. We don't screw
12 around. Um, We just moved about, almost 600
13 million of assets off of repo in Febr--March,
14 I think, and moved them to Bear Stearns, just
15 to pay some people down. We're taking 4
16 billion down, we're taking our repo down by 4
17 billion for the BofA trade. So we have
18 seven--I think, seven-seventeen people we do repo with.
19 MR. TANNIN: Although, ironically, had we
20 gotten more margin calls, had there been more
21 of a problem in the repo market, the whole
22 point of the hedge was it's there if we needed
23 it, it's a very, compared to selling a AAA,
24 right, in a market where everyone's freaking
25 out, the-the whole point of the hedge was, if we

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

1 or an estimate at this point, of what this
2 year might look like? '07, in terms of how
3 you'll end up? Both sort of a cautious guess
4 and more maybe a more optimistic guess? In
5 other words, two, two ranges of where you may end
6 up for the year, given where we are now.
7 MR. CIOFFI: Right. Well, on a cautious
8 guess, I would say let's annualize our, the
9 carry numbers that we, um discussed before. And
10 that assumes that our relative-value trades do
11 nothing for us, and that the, um, the price discrepancy
12 that's occurred, i.e. the hedges rallying, the
13 assets going down, let's assume none of that
14 changes. Um, So after -- post BofA, and let's say
15 we ramp that additional capital up within two
16 months - um, we're running at a 14--we'd be
17 running at a 14 annualized level for High
18 Grade--for Enhanced, and 11 for uh, for High Grade.
19 So, I guess that'd be the cautious guess. Um, You
20 know, optimistic for us is, we think, the
21 relative-value trades will work out, we think
22 the market is rational, and CDOs that have
23 been marked down will start getting marked
24 back up. We believe in our credit models; we
25 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

1 stay, um, and then Enhanced is, uh, would be about a
2 1-1.2, so that'd be 8, that'd be 9. Well
3 Enhanced, let's say, could be 6, um, assuming no, no
4 benefit for um, relative values, relative-value
5 trading, no benefit for the uh, uh-shorts we have in
6 place, and no market rationality as it relates
7 to, you know, CDO pricing -- things just stay
8 where they are.
9 MR. HIRSCH: What kind of, what kind of pop could you get
10 from some good relative trades, I mean, over
11 the next eight months?
12 MR. CIOFFI: Well, a lot of these relative
13 trades are more of a, maybe a 12-month,
14 24-month play out, but--
15 MR. HIRSCH: Gotcha.
16 MR. CIOFFI: But, um, you know, we looked at, you
17 know, we're looking at some trades right now.
18 Let me give you one example. We're long '06-1
19 BBB-, our model shows that fair market value
20 on those is 84-85, they're trading at 86.
21 '07-1 BBB flats, which we're short -- fair
22 market value under our credit model is 28.
23 Those are trading at 78. Now, does that, does that
24 manifest itself over time as credit losses
25 come in? Um, Or does it ultimately manifest

1 itself much quicker? Remains to be seen. Um, We
2 have a lot of CDOs where we're long AAAs, and
3 we're short significant amounts of BBB
4 collateral that's in those CDOs, as well as
5 BBB collateral and single A collateral that we
6 don't have exposure to. If there's
7 significant writedown or downgrade on those
8 BBBs and single As, there's significant
9 mark-to-market benefit there that we'll
10 experience. And again, there's significant
11 layers of subordination between those losses
12 and AAA, AA CDOs. Um, You know, if the equity
13 markets participate, we still have our Rampart
14 IPO that we're, we're hoping for in-in-in late summer,
15 early uh fall. That could be a-a-a nice winner for us. Um,
16 We, um -- so we have some, we have some interesting things
17 that, um, to think, to look forward to. And you
18 know, the one-the one-the one thing to think about, I don't
19 know how long, Scott, you've been with the
20 fund, but if you look at our returns since inception--
21 MR. HIRSCH: Yeah, we've been there about 3 years.
22 MR. CIOFFI: Okay, so if you look at the
23 returns since inception, you know, up through,
24 let's call it up through February, um, you know,
25 cumulative returns for those in High Grade

1 only and for those that went from High Grade
2 to Enhanced I think is north of 40% or 45%.
3 In my mind, at least on the asset side--
4 MR. CIOFFI [aside]: You have both sheets.
5 UNIDENTIFIED SPEAKER: Okay.
6 MR. CIOFFI: --at least on the asset side, we
7 had a perfect storm, um, and um, and we've lived through
8 it. We have plenty of liquidity. We're as
9 well positioned as anybody out there to take
10 the opportunities. Um, And, you know, it's
11 interesting um, to note that there are a number of
12 CDO and subprime opportunity funds that are
13 now popping up. Um, Well, I mean, you-you could think
14 of us as the ultimate CDO and subprime
15 opportunity fund, and that we're established,
16 uh, you know us, you've seen our track record. We
17 have liquidity. We have a phenomenal partner
18 in Bear Stearns. We have a great platform. Um, We have,
19 um, we have- we have a tremendous, uh, you know, working
20 relationship with all of our broker-dealer
21 counterparties. Um, We have 40 people on my
22 staff, uh, surveillance systems, credit models.
23 So, we've weathered the storm. We're at
24 spreads that are wider than where we--when we
25 started the fund in many cases, and um, we know - we know

1 how to take advantage of the opportunities,
2 and we're going to. You know, we- some might
3 argue we should've been more aggressive in, uh, in
4 March. But one of the things we wanted to do
5 is we wanted to make certain that-that we had
6 significant amounts of liquidity and all of
7 our repo people, all of our
8 repo-counterparties were calm, uh, were with us,
9 that if we had redemptions we had -we had and have
10 plenty of liquidity. Once we do the BofA
11 trade, I feel a lot more comfortable, and we
12 will start deploying capital. So, we're -we're
13 optimistic, we're getting subscriptions in, as
14 I said, you know, part of our subscriptions
15 for May will be Bear um, for 25 millionand I
16 haven't checked, maybe we have other
17 subscriptions as well but--
18 MR. TANNIN: We do.
19 MR. CIOFFI: We do? Matt's telling me we do.
20 MR. HIRSCH: Thanks a lot guys.
21 MR. CIOFFI: And, and, we, I mean, you've got a
22 very devoted [laughs], dedicated asset management team
23 here. Our-our money is in all three of these, in
24 these funds. Um, I mean, we're-we're we're 24/7 on the job
25 and um, you know we want to make our LPs' money

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

1 predominantly AAA and super senior, but say of
2 the-of the-of the ABS CDOs that we own, [clears throat] 84%
3 or more is AA or higher, and then the rest would be single
4 A. The underlying is predominantly going to be
5 Baa1, Baa2, some Baa3 subprime. But, the most
6 important distinction is, is, of the '06 vintage,
7 which is creating the problem, um, only 28% of-of the
8 underlying collateral -- you know, give or
9 take, I-I don't have the exact number in front
10 of me -- but call it 30% is exposed to that '06
11 vintage that we're, that is creating all the-all the
12 havoc. And then we have hedges in place
13 whereby we're-we're short an-an-an amount that's
14 significantly greater than that billion and a
15 quarter, billion and a half of that subprime
16 paper -- so through a combination of CDO
17 shorts, single-name subprime shorts, and then
18 the index shorts. So, if um that '06 continues
19 to deteriorate significantly, those hedges we
20 have will start paying off very, very nicely,
21 either-either because there's defaults and we get
22 paid or because you get more, we get some
23 price appreciation on those hedges. And the
24 point is, because we're at the AA or AAA
25 level, defaults within -- the reason there's

1 subordination and the reason we're at that
2 level is, if there are defaults, they've got
3 to eat through a lot of subordination before
4 your-your-your triples or doubles take a writedown, but
5 we're getting paid on the hedges as-as the losses
6 occur. Um, so, one simplistic way to think about
7 it: let's say we had a $100 million AAA, and
8 we had $100 million -- we had a hundred-name
9 portfolio, and we think that the risk is in 30
10 of those names, and we short, um, 30 of those
11 names. And let's say the AAA—uh, wait, let me
12 start over. Let's say we have a AAA bond that's
13 50 million. And-and there's-and there's a, um, $100 million
14 collateral pool -- a hundred names, 1% per
15 name. And we think 30-30 of those names represent
16 all the risk. And we-we short those-those names. And
17 let's say-let's say the entire collateral pool - uh, let's
18 take an extreme case -- let's say the entire
19 collateral pool defaults, which is-which isn't going to
20 happen, but we'd make 30 on our hedge, we'd
21 obviously lose 50 on our AAA, but that's the
22 extreme case. The more likely case is, if our
23 credit models are right, we're doing our
24 homework, we're going to make money on that,
25 some portion of that 30 million, which gives

1 us additional cushion against other losses.
2 But the-the probability of getting up to that, you
3 know, 50% cum loss rate in that deal is pretty
4 slim. So those hedges will pay off before-before a
5 AAA or AA gets hit. That's kind of the
6 concept of the-of the strategy here. We're not, you
7 know, you know, it's not to be net long anything, per
8 se, we're-we're on a notional basis long, but we, um, we
9 think we've got our real credit risks very
10 well outlined, and very well, very well covered.
11 MR. BEHR: So just to clarify, for that 50%
12 ABS, when you keep on drilling through to get
13 to the underlying collateral, how much is
14 subprime and how much is the o, you know, um '06 vintage?
15 MR. CIOFFI: Well, it's-its-its all -- well, I can't
16 say, I'd have to see if it's all subprime, I
17 guarantee it's not all subprime. But let's-let's-let's say
18 that it's 75% subprime, but only about 25% is '06--
19 MR. BEHR: Okay.
20 MR. CIOFFI: --or the '06 we don't like, let's
21 call it. But we have more than that amount
22 hedged, you know, short. So on a net-net
23 basis, you-you could say we're not long it. But
24 if you-if you don't want to, if you want to disregard
25 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.

[END 02 Conference ID 1072990]