

{TALF: Term Asset-Backed Securities Loan Facility}

The Fed's announcement of a \$200 billion (potential to grow to \$1 Trillion) loan program meant to jumpstart the asset backed securities market has piqued the curiosity of investors. Many view this non-recourse loan program as a tremendous opportunity to produce outsized investment returns with limited downside risk. Investors are clamoring to know how best they might access this opportunity. First, let us discuss how the program works and some of the assumptions associated with it. Next we will address the opportunity to participate as an investor.

The TALF is a program that allows investors in newly issued (post January 1, 2009) asset backed securities of the highest quality to post those securities as collateral for a non-recourse loan from the Federal Reserve. To be clear, the dollars loaned by the Federal Reserve are to purchase the ABS securities, this is not unencumbered cash that can be used to buy other types of securities. The goal of the program is to reinvigorate the consumer lending for autos, credit cards, small business and student loans (may later be expanded to mortgage backed securities), which has dried up in the past year as lending institutions and ultimately the purchasers of securitized assets have been reticent to put dollars to work. The lending facility will be available on a first-come-first-served basis and will generally provide \$8-\$9 worth of financing for each \$1 of collateral. Loan terms will range from one year to three years and will charge a rate of LIBOR +100bps. The loans are available to individuals and institutions, including money managers that are domiciled in the U.S., and require a minimum TALF subscription of \$10 million. The TALF is scheduled to start making its initial loans this month and is slated to stop making new loans as of December 31, 2009.

Given current yield spreads, the expectation is that on a levered basis, these investments could generate mid-teen or better returns. That, we expect, will attract a number of participants including hedge funds, traditional investment managers as well as even pensions and other larger institutions. The return expectations will therefore be impacted significantly by the supply and demand factors for asset backed securities. At current two and five year AAA ABS debt (Credit Card and Auto Loans) are priced at spreads of 275 to 375bps over Treasuries. The ABS market virtually ground to a halt in October 2008, with less than \$15 Billion in new issuance since then. The first three quarters of 2008 saw \$87 billion in new issuance and Calendar year 2007 witnessed over \$370 Billion in new issuance. The TALF should be all that is needed to get issuance back on track, though it may take a while to ramp up to the \$200 billion currently being allotted for this program. The real question is, who will participate and how quickly will spreads be driven lower?

The initial indications seem to be that a lot of managers are interested in taking advantage of this opportunity, though many admit they aren't 100% clear on all the details of the program, many of which are still being worked out. One real challenge is going to be the available supply of qualifying ABS and whether the demand for those assets outweighs the supply. If that is the case, it is feasible to think that certain buyers may be at a disadvantage in acquiring the securities as the biggest, most well-connected managers may get first shot at snapping them up from the private dealers that create them. The structure of the TALF is sure to attract many interested parties, many of which could end up left on the sidelines. As of now, we are not aware of any managers that have started dedicated portfolios that will specifically target this opportunity. Therefore, we expect in most instances, managers will implement this strategy in existing multi-strategy portfolios.

In the coming days we expect to have more detail on specific managers that are planning to participate in the program and also get a sense for whether investors can participate directly in these opportunities or whether exposure via existing diversified funds will be the only option.

Disclosure:

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