From: [redacted]
Sent: Wednesday, December 10, 2008 2:10 AM
To: Jeffery Epstein
Subject: Fw: Bond Fund analysis

Here u go.

----- Original Message -----
From: Doug Wurth
Sent: 12/09/2008 08:19 PM EST
To: Jes Staley
Cc: Brian Carlin
Subject: Bond Fund analysis

Lots of context below, but the sensitivity box at the beginning of the email below gets to the punch line. It rests on a set of assumptions described in more detail below, and highlights that unlevered returns look sufficiently attractive (up 26% to down 10%) , but that 1X leverage does add significant return enhancement without commensurate downside risk (up 48% to down -22%).

Of course, its all about the assumptions. Our bear case assumes that spreads blow out to 900 (from 600) and UST's at 1-2% are unchanged. Reasonable for a bear case, but these are strange times as you know.

Let us know if we can help further.
----- Forwarded by Doug Wurth/JPMCHASE on 12/09/2008 08:07 PM -----

Brian J Carlin/JPMCHASE

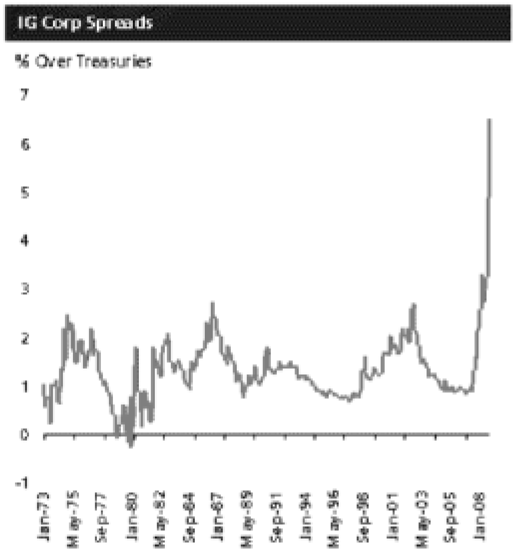
12/09/2008 08:07 PM

To Doug Wurth/JPMCHASE@JPMCHASE
cc
Subject printable version

Executive Summary: It would seem that either unlevered or 1 times levered offers the most interesting risk return skew as outline in the table below:

	Unlevered	1 X Lev	2 X Lev
Bull case	*26%*	*48%*	*71%*
Moderate	*14%*	*25%*	*36%*
Bear Case	*-10%*	*-22%*	*-35%*

Back drop: The 2 charts below look at the 35 year history of investment grade corporate spreads (about 5 yr duration) and the similar treasury yields. As you can see below, current levels of 600 over are unprecedented over the past 4 decades. However, a similar thing can be said of the current lows seen in 5 year duration US treasuries, leaving IG all-in yields elevated, but not unheard of.



Source: Lehman Live

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The buying if intermediate IG bonds at current yields of 8%+ seems attractive and we have recently added 3% to our non-tax paying client portfolios. Adding leverage to the mix has the potential to further increase the upside of the return, but depending upon the economic outcome and level of leverage used can also be fairly bad as well. There are 2 issues we have with leveraging fixed rate IG bonds- first is what happens to spreads, then where do treasuries go.

Bear case: Spread blows out to 900 (from 600) and UST's at 1-2% cant rally anymore and are unchanged. Unlevered downside risk is fair, with a negative total return of 10% in one year. However, even moderate 2 or 3 times leverage quickly turns -10% to -25%-35%. While I admit spreads have never been 900, up to this quarter they had never been 600 either, so I am hesitant to put a cap on where they can go.

Assumptions	
Libor	2.0%
5 Year Treasuries	1.5%
Leverage cost	L+1%
Time Horizon	1 year

Bear Case: (assume spreads widen another 300 bps, 5 yr. treasuries unchanged)

	Unlevered	Levered 2:1	Levered 3:1
Current Spread	600	600	600
Future Spread	900	900	900
Current Treasuries	1.5%	1.5%	1.5%
Future Treasuries	1.5%	1.5%	1.5%
Duration	5	5	5
Current Price	85	85	85
Future Price	70	70	70
1 Year Price Return	-18%	-35%	-53%
1 Year Yield	8%	13%	18%
Total Return	-10%	-22%	-35%

Bull case: Spread return to 300, high historically but reasonable as economic outlook is still mixed. UST still 1-2% as fed has done quantitative easing, buying longer term UST's to keep term structure of government rates low. Unlevered returns of 25% and 2-3 times leverage quickly gets to 50-70%.

Bull Case (assume spreads tighten back to 300 bps, 5 yr. treasuries unchanged)

	Unlevered	Levered 2:1	Levered 3:1
Current Spread	600	600	600
Future Spread	300	300	300
Current Treasuries	1.5%	1.5%	1.5%
Future Treasuries	1.5%	1.5%	1.5%
Duration	5	5	5
Current Price	85	85	85
Future Price	100	100	100
1 Year Price Return	18%	35%	53%
1 Year Yield	8%	13%	18%
Total Return	26%	48%	71%

Moderate case: Spread rally back by 200bps to a still high 400 over, but US treasuries also give up some of their current "flight to quality bid" and return to 2.5% levels from 1.5% current levels. Assuming we did not have any duration hedge here, we lose part of the spread rally from the higher risk free rates. Still a positive story overall, 14% unlevered, 25-35%

levered returns.

Moderate Case (assume spreads tighten back to 400 bps, 5 yr treasuries back to 2.50%)

	Unlevered	Levered 2:1	Levered 3:1
Current Spread	600	600	600
Future Spread	400	400	400
Current Treasuries	1.5%	1.5%	1.5%
Future Treasuries	2.5%	2.5%	2.5%
Duration	5	5	5
Current Price	85	85	85
Future Price	90	90	90
1 Year Price Return	6%	12%	18%
1 Year Yield	8%	13%	18%
Total Return	14%	25%	36%