



Making Money out of the Credit Crunch

Garrett Walsh
Head of Credit Research
Europe & Asia





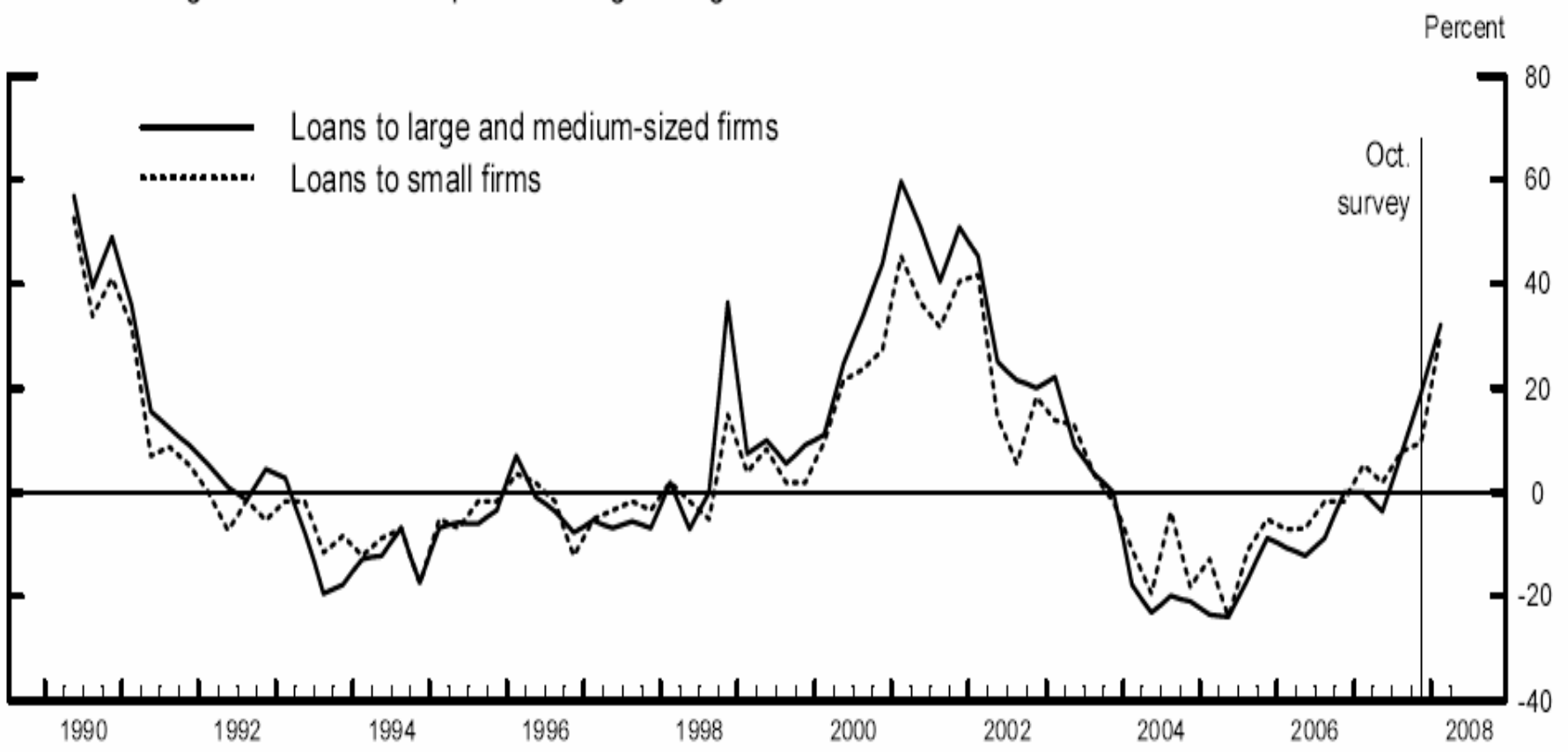
The Story So Far.....

- **Sub-prime losses...**
- **Structured credit losses**
- **Very poor liquidity**
- **Tighter lending standards**



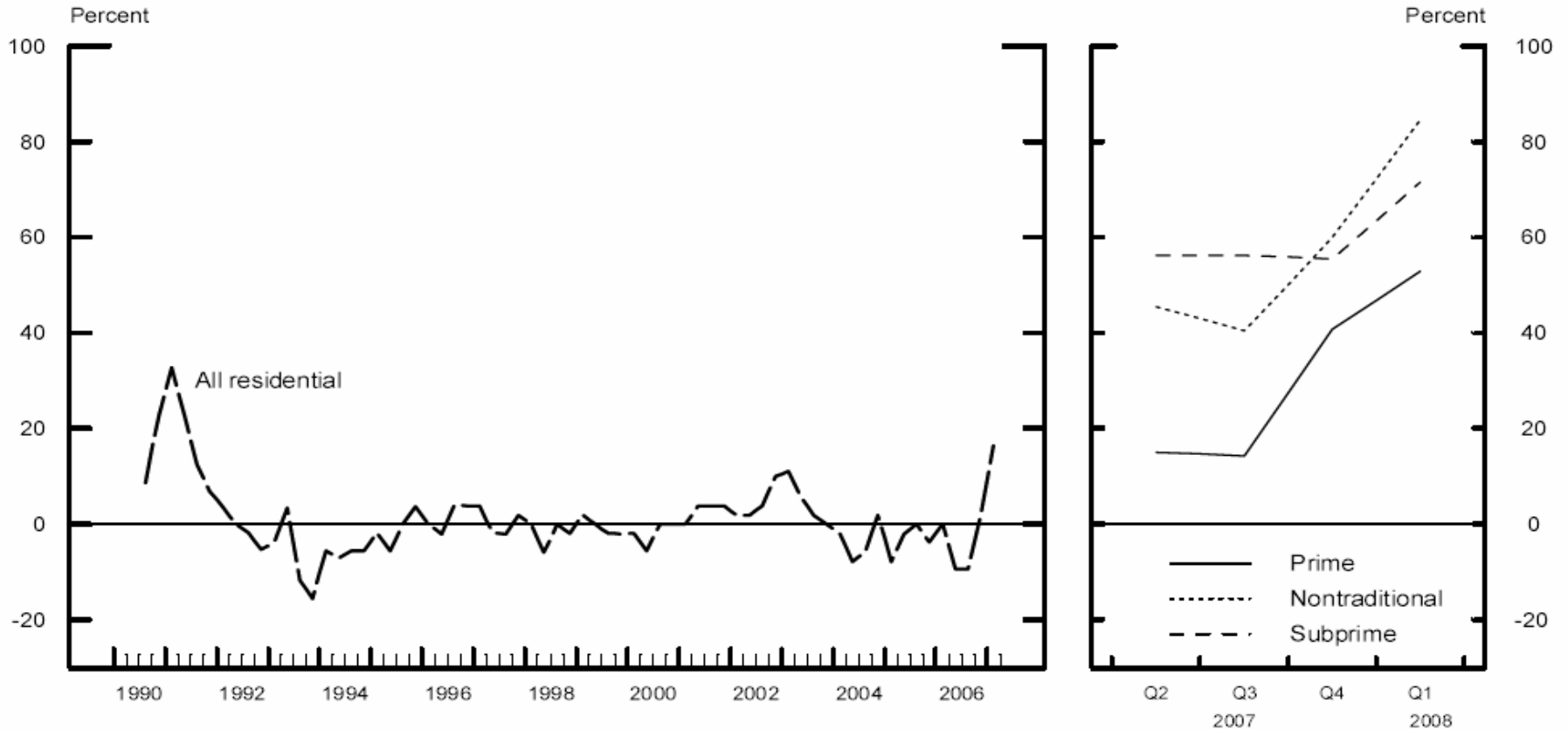
US Senior Loan Officer Survey

Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



US Senior Loan Officer Survey

Net Percentage of Domestic Respondents Tightening Standards for Residential Mortgage Loans

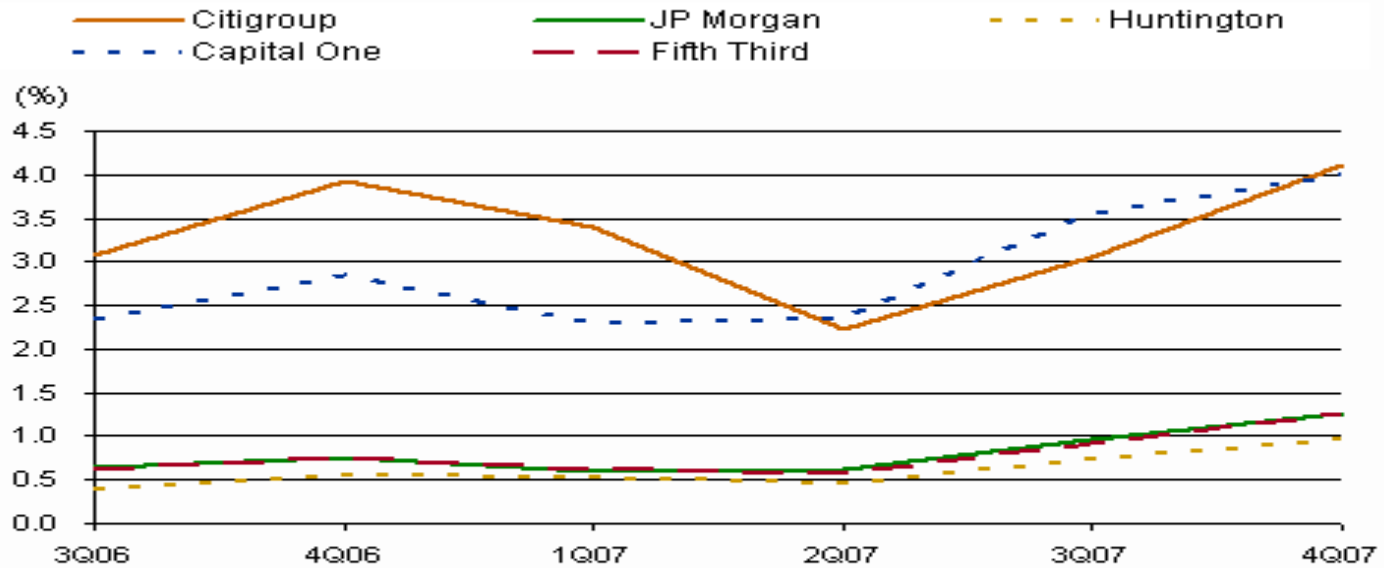


Note. For data starting in 2007:Q2, changes in standards for prime, nontraditional, and subprime mortgage loans are reported separately.



Autos

Auto Net Charge-Offs



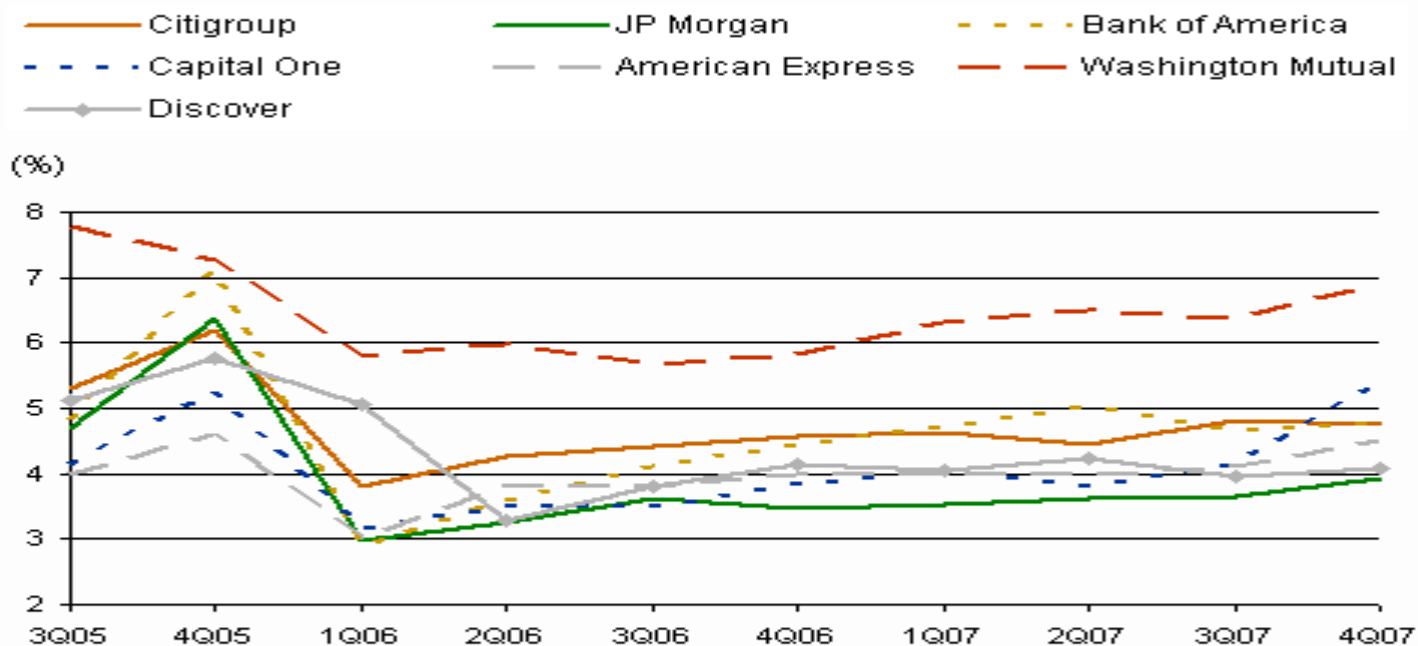
Annualized fourth-quarter data. Source: Company reports, Standard & Poor's.

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Credit Cards....

Managed Credit Card Net Charge-Offs



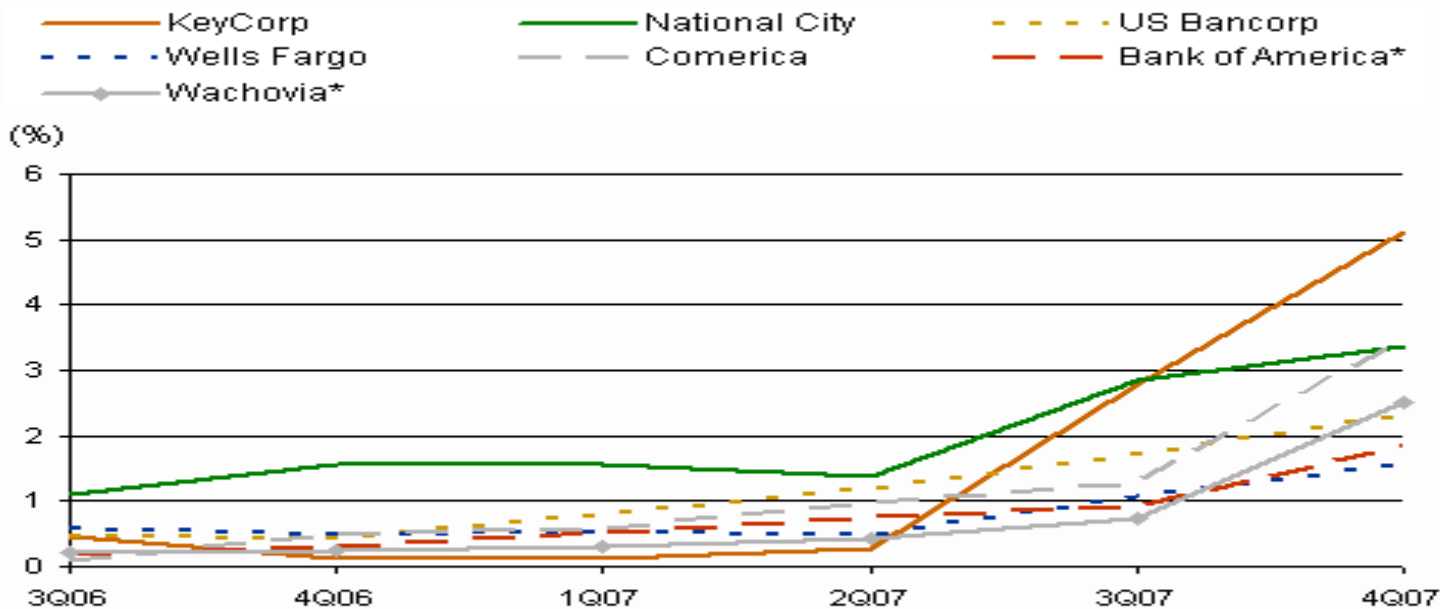
Annualized fourth-quarter data. Source: Company reports, Standard & Poor's.

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Construction

Unfavorable Trend In Construction Nonperforming Loans



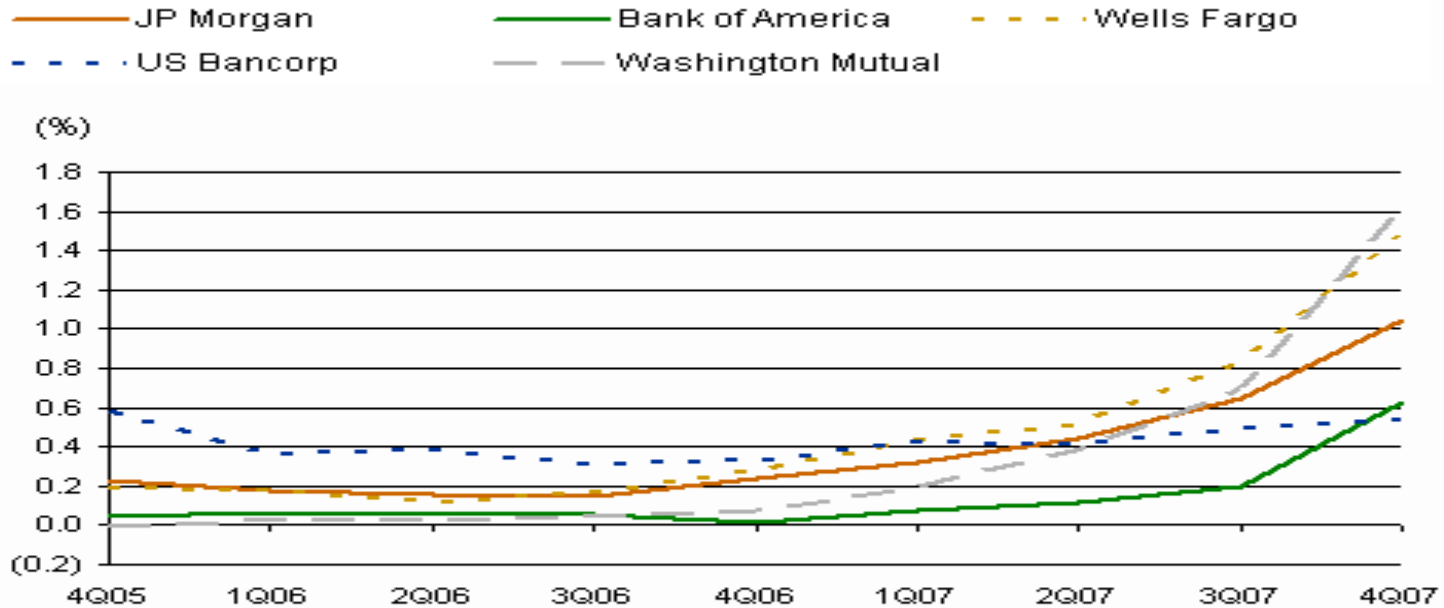
*Includes commercial and mortgage loans. Source: Company reports, Standard & Poor's.
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Home Equity Loans

Home Equity Net Charge-Offs Head Higher



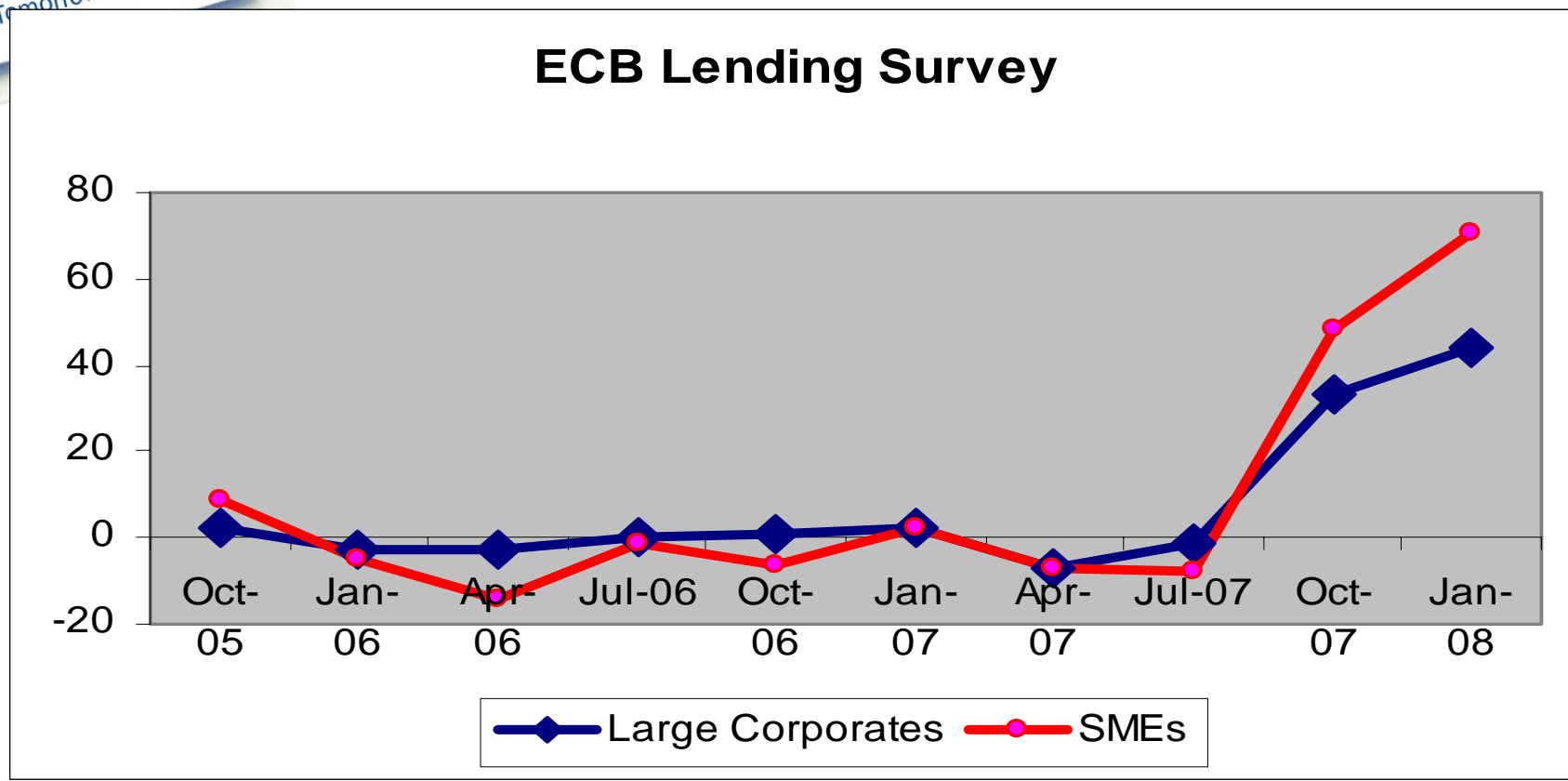
Annualized fourth-quarter net charge-offs. Source: Company reports, Standard & Poor's.





ECB - Credit Standards for Non Financial Corporates

ECB Lending Survey





Still As Many Questions As Answers...

- **Further losses in HELOCs / CRE / Cards?**
- **The flow of credit?**
- **Bank solvency..**
- **The great structured credit unwind?**
- **Hedge Funds?**
- **Corporate default rates will rise – but by how much?**
- **A US recession – ‘V’ or ‘L’ shaped? And Europe?**



Bank spreads significantly under-perform corporates



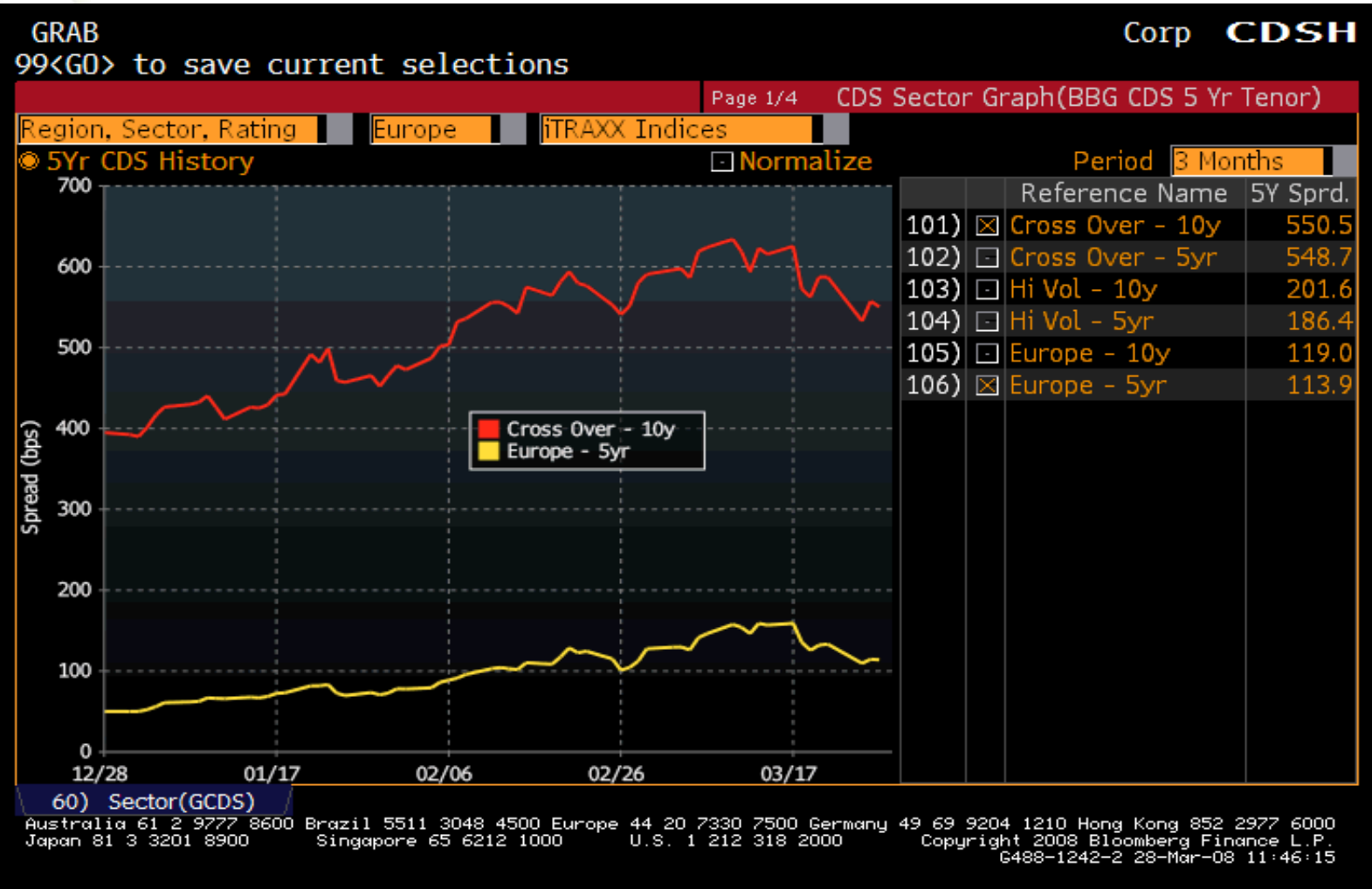
----- [Sector ASM] i Boxx Euro Corporate /Corporate: Financials/Financials/Banks/LT2
----- [Sector ASM] i Boxx Euro Corporate /Corporate: Non-Financials/Industrials/A

QAD: Credit Explorer





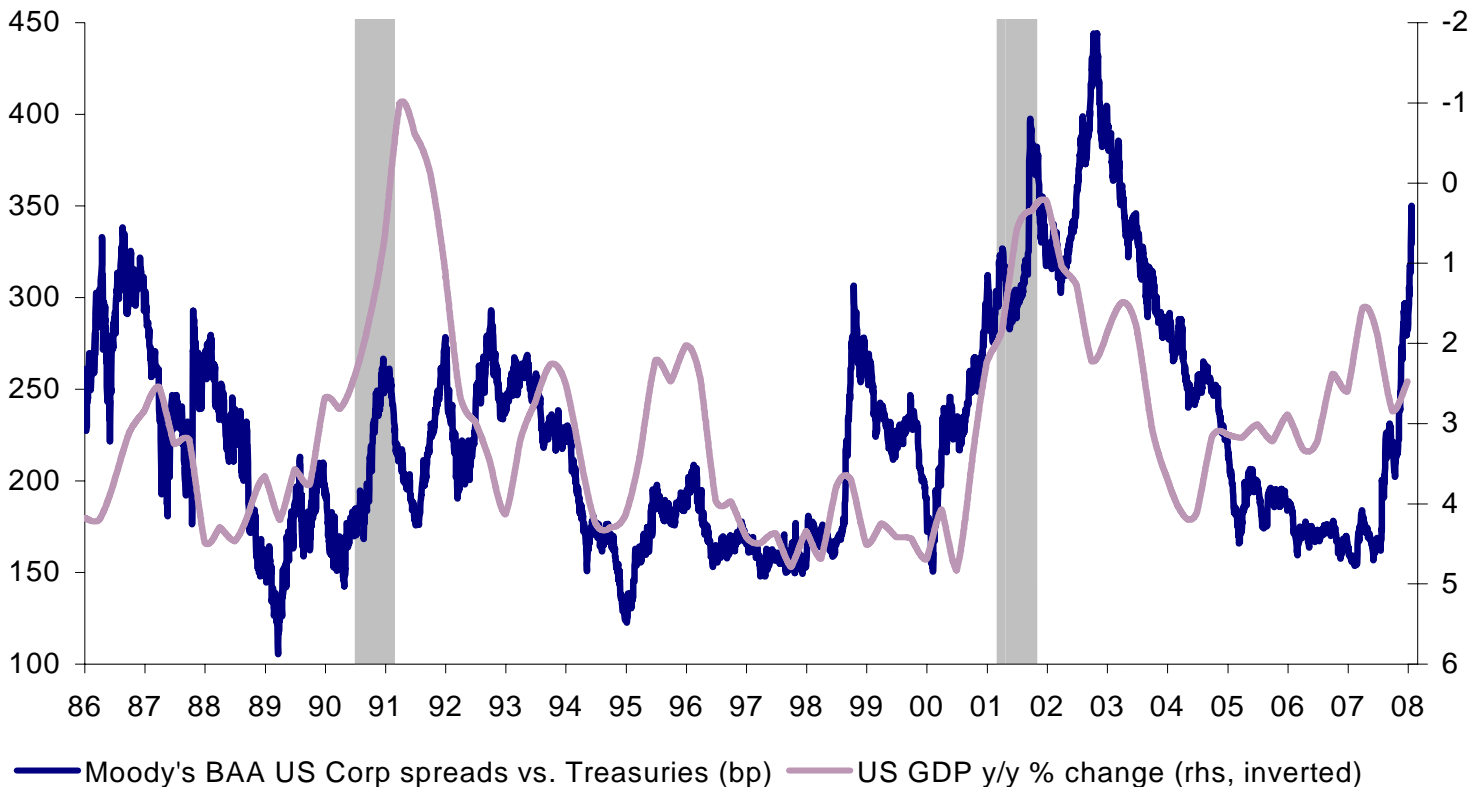
European CDS Index Spreads (S8)...





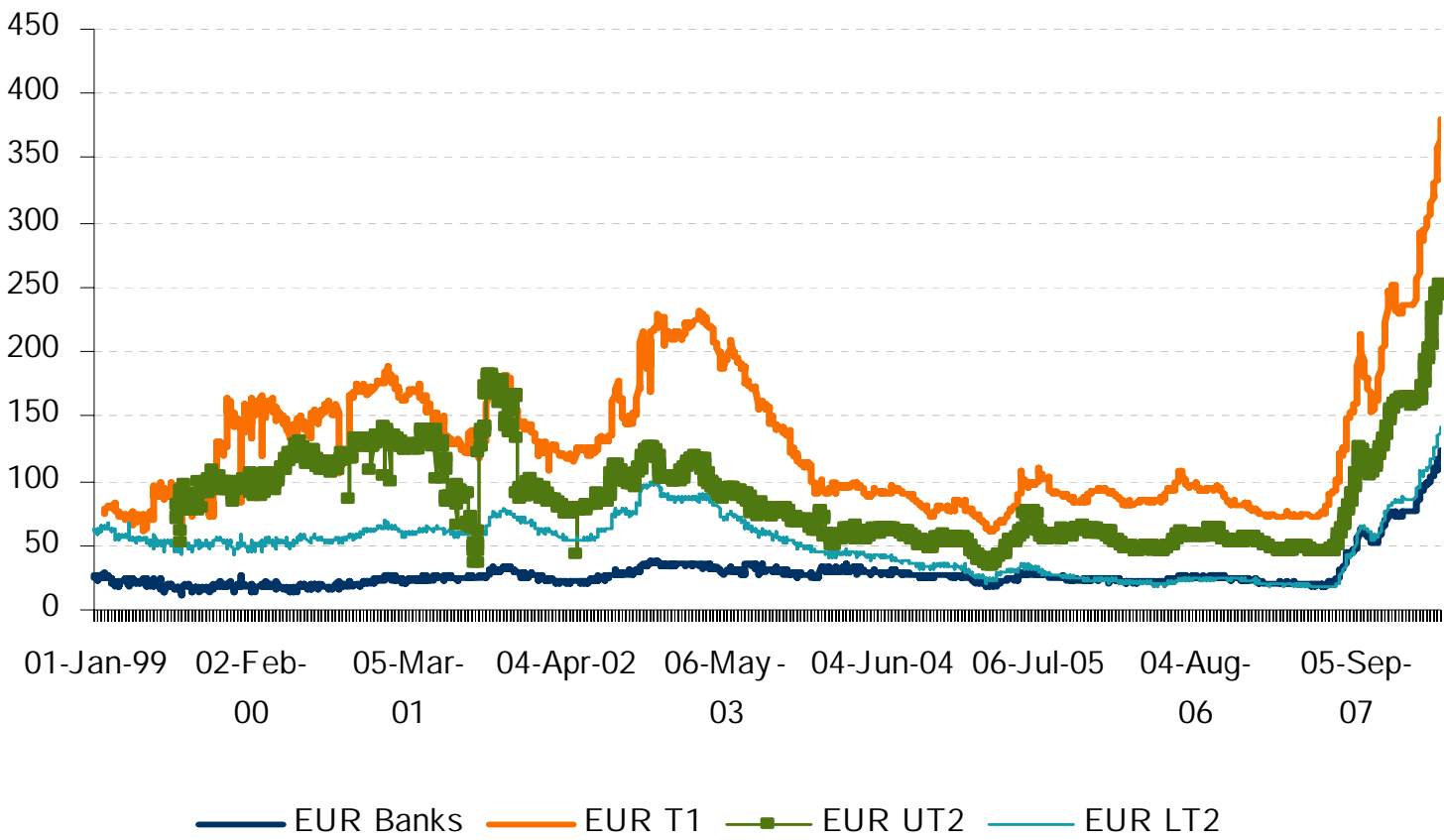
Credit; Recession Is Already Largely Priced In.....

Growth versus Credit Spreads (Cash)



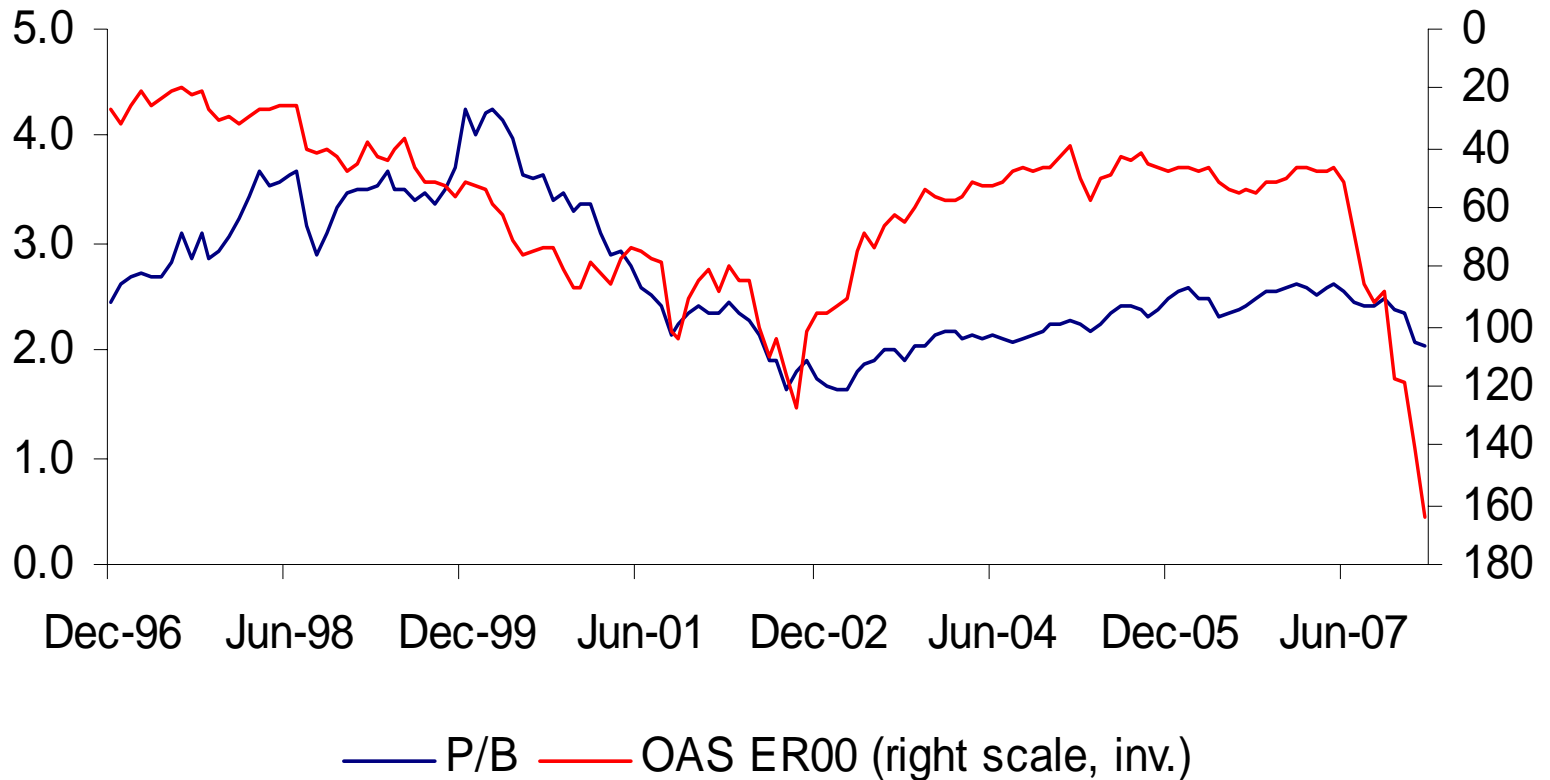


Banks Spreads Are Pricing *A lot Of* Bad News





Credit Currently Pricing In More Bad News Than Equity..

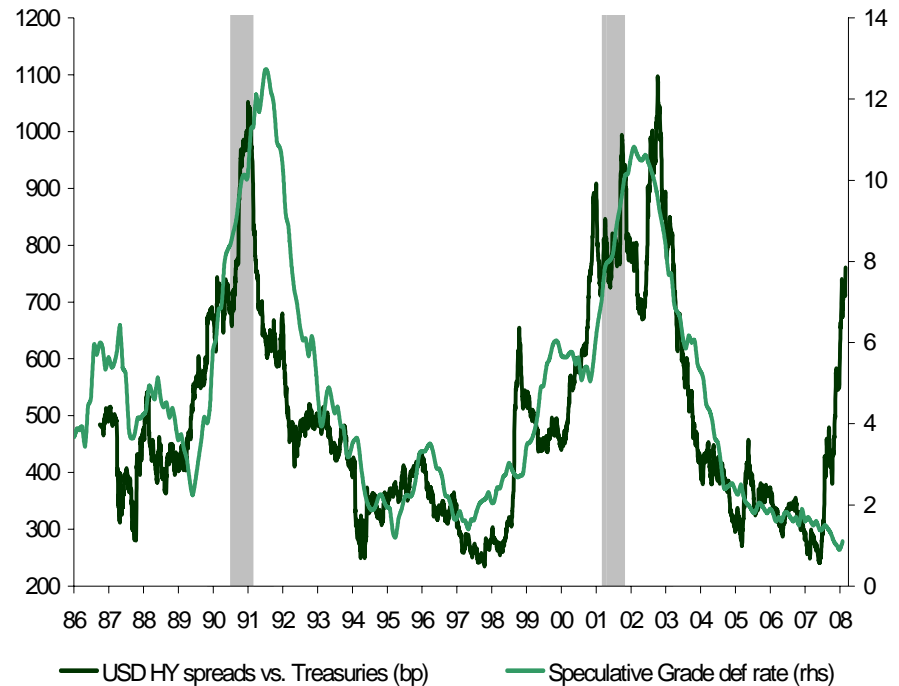




Default Rates v Credit Spreads

- **Default rates remain low**
 - c. 1% currently but expected to increase to near 5% by the end of the year.
 - Number of downgrades now exceeding upgrades
 - Number of names of CW or neg review greater than those with positive outlooks/ review
- Record number of companies trading at distressed levels
- Speculation that banks are cutting credit lines to distressed companies.

Low Default rates and high spreads





But the Technical / Trading Picture Remains Challenging In Credit..

- **Still Forced Sellers**
- **A Smaller & More Cautious Buyer Base**
- **Poor 'Street' Liquidity**
- **Redemptions**
- **A Queue of Issuers**



Short-term Tactical Opportunities

Use Derivatives!!!

- **Pair Trades**
- **CDS indices – to take directional bets**
- **Curve Trades – flatteners + steepeners**
- **Sell short-dated protection**



Medium-Long Term Opportunities

- **Buy Outright – ideally via the primary market or from forced sellers**
- **IG v HY?**
- **Bank Capital?**
- **Consider Basis Packages**



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- References – Slides 3+4 (US Federal Reserve) Slides 5-8 (S&P), Slide 9 (ECB Lending Survey), Slide 11 (iBoxx), Slide 12 (BBG), Slide 13 (Moody's), Slide 14 (ML Index), Slide 15 MSCI/ML Index), Slide 16 (Moody's).
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Questions & Answers

