

HOW DID WE GET HERE?

WHERE ARE WE GOING?

Prepared For:

**The Southern Conference on Teacher Retirement
Annual Meeting, Hilton Head, South Carolina**

Loomis Sayles & Company, L.P.

April 20, 2009

BANKS IN DISTRESS:

HOW BAD IS IT?

START WITH GOOD BANK, WELL-CAPITALIZED

\$85 Good Securities

\$15 Questionable
Securities

\$100 Total Assets

\$80 Deposits

\$10 Debt

\$90 Liabilities
\$10 Equity

Capital Ratio: $\text{Equity} / \text{Assets} = 10\%$

QUESTIONABLE'S MARKET VALUE FALLS TO \$5

\$85 Good Securities

\$5 Questionable
Securities

\$90 Total Assets

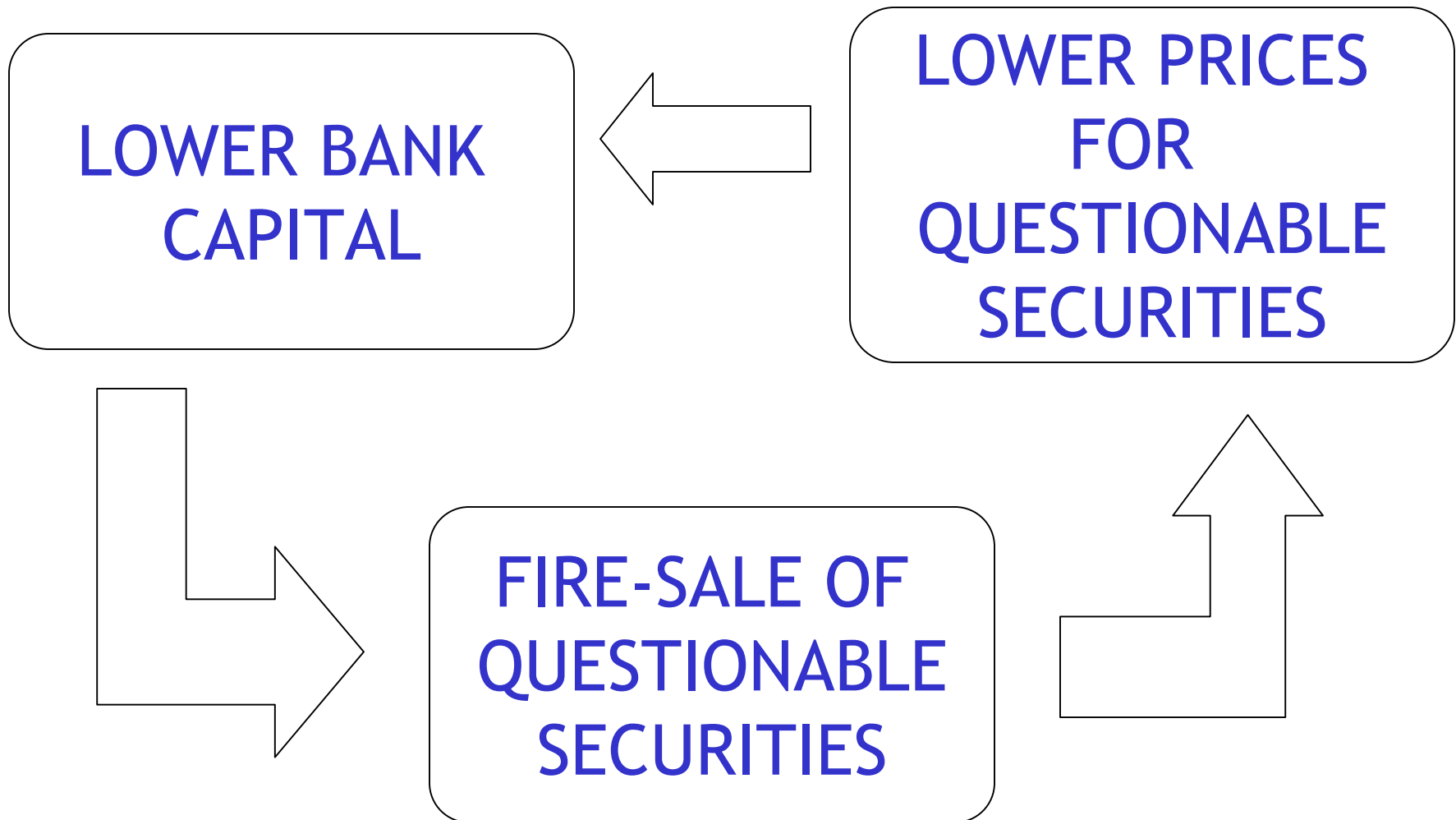
\$80 Deposits

\$10 Debt

\$90 Liabilities
\$0 Equity

Capital Ratio: $\text{Equity} / \text{Assets} = \text{Zero}$, Insolvent!

THE VICIOUS CYCLE OF REBUILDING BANK CAPITAL



TARP:
**“TROUBLED ASSET
RELIEF PROGRAM”**

TARP: REPLACE QUESTIONABLE ASSETS WITH
TREASURIES AT MARKET PRICE

\$85 Good Securities

\$5 Treasuries

\$90 Total Assets

\$80 Deposits

\$10 Debt

\$90 Liabilities

\$0 Equity

Capital Ratio: $\text{Equity} / \text{Assets} = \text{Still Zero! Insolvency!}$

TARP: OVERPAY FOR QUESTIONABLE ASSETS WITH TREASURIES

\$85 Good Securities

\$10 Treasuries

\$95 Total Assets

\$80 Deposits

\$10 Debt

\$90 Liabilities

\$5 Equity

Capital Ratio: $\text{Equity} / \text{Assets} = 5.3\%$ Low, But Solvent

A THEORY OF TARP

- (1) SUPPOSE PAR VALUE OF QUESTIONABLES IS \$15
- (2) “FIRE SALE” PRICE IS \$5
- (3) FUNDAMENTAL LONG-RUN PRICE IS \$12
- (4) TARP BORROWS FROM PUBLIC, BUYS ASSETS AT \$10
- (5) EVENTUALLY SELLS AT \$12
- (6) BANKS SAVE CAPITAL & AVOID FIRE-SALE PRICES...
- (7) TAXPAYERS MAKE MONEY IN LONG-RUN!

TARP

- \$700 Bil. Authorized By Congress
- \$667.4 Bil. Committed
- \$303.4 Bil. Actually Spent
- None of TARP Funds Used For Original Purpose
- Biggest Block of Funds Used For “CPP”
- \$200 Bil. Committed To “TALF” and “PPIP”

GAO SURVEY OF “TROUBLED ASSET RELIEF PROGRAM” (TARP)

Status of TARP Funds as of March 27, 2009 (dollars in billions)			
Program	Maximum announced program funding level^a	Projected use of funds	Disbursed
Capital Purchase Program	\$250.0	\$218.0	\$198.8
Systemically Significant Failing Institutions	70.0	70.0	40.0
Targeted Investment Program	40.0	40.0	40.0
Automotive Industry Financing Program	24.9	24.9	24.5
Citigroup Asset Guarantee	5.0	5.0	0.0
Bank of America Asset Guarantee	7.5	7.5	0.0
Homeowner Affordability & Stability Plan	50.0	50.0	0.0
Term Asset-Backed Securities Loan Facility (TALF) ^b	100.0	55.0	0.1
Unlocking Credit for Small Business	15.0	15.0	0.0
Auto Supplier Support Program	5.0	5.0	0.0
Public Private Investment Program	100.0	100.0	0.0
Capital Assistance Program	TBD ^c	TBD	0.0
Total	\$667.4	\$590.4	\$303.4

Source: Treasury OFS, unaudited.

^aSome of Treasury’s announced transactions are not yet legal obligations and actual amounts will depend on participation.

^bTreasury considers this program part of its Consumer & Business Lending initiative.

^cTreasury has announced the Capital Assistance Program, but has not yet announced the funding level for that program.

WHERE DID THE MONEY GO?

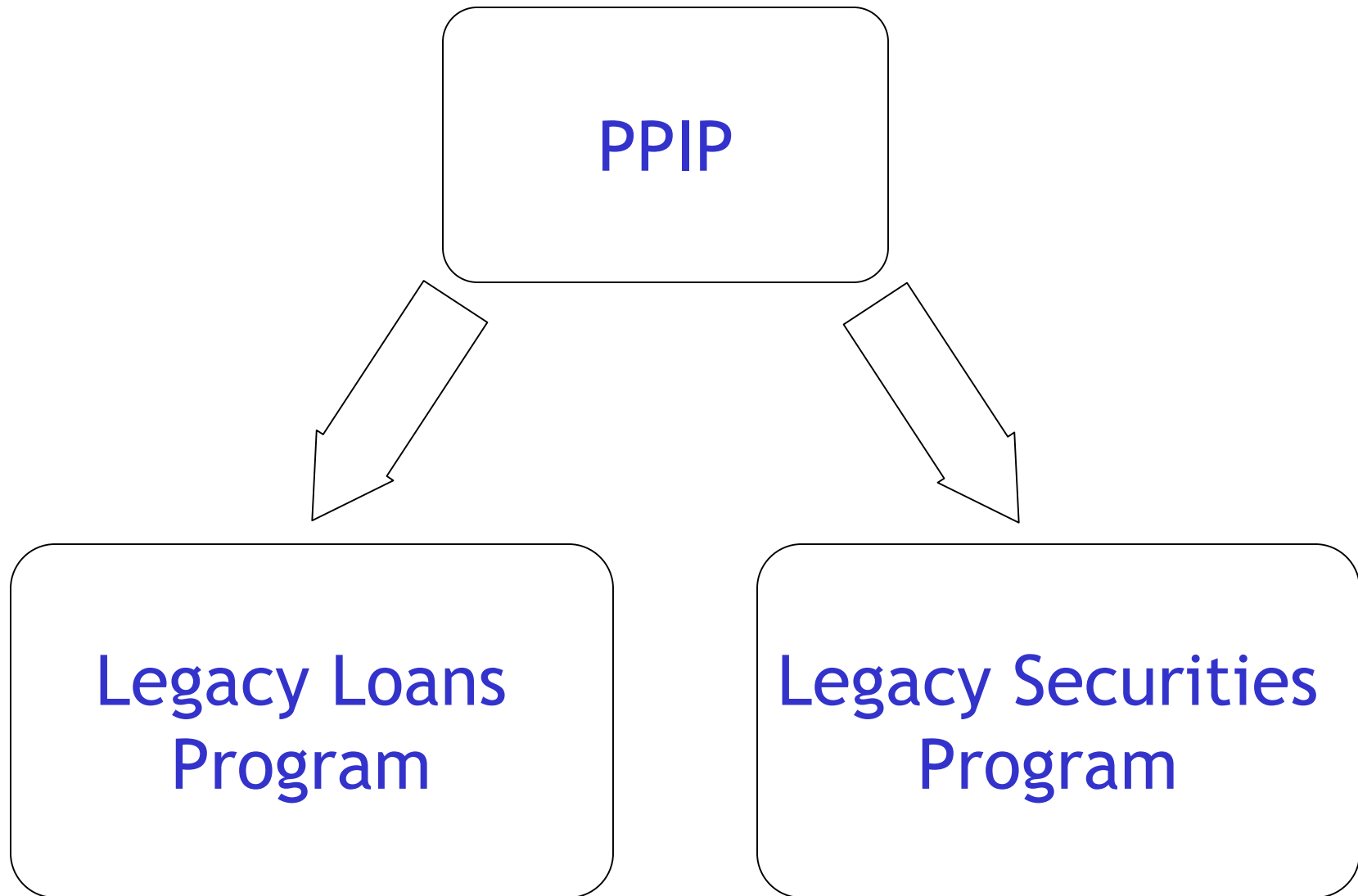
- CPP: Capital Injections Into Banks
- \$70 Bil. In A.I.G.
- \$40 Bil. To Citibank and Bank of America
- \$30 Bil. To Auto Sector
- \$50 Bil. To Foreclosure Relief
- Stress Testing Banks Wrapping Up; “Capital Assistance Program” For Those Too Stressed

PPIP and TALP

PPIP & TALF

- TARP Never Bought “Troubled Assets”
- Treasury Secretary Geithner Tried TARP Version 2
- Treasury & FDIC & Fed Launch PPIP
- Fed Launched & Expanded TALF
- Gigantic Amounts of Money In Play!

TREASURY'S "PUBLIC-PRIVATE INVESTMENT PROGRAM"



LEGACY LOANS PROGRAM

- Public-Private Investment Fund (PPIF) Buys “Toxic” Bank Assets In Auction For Less Than Par Value
- Treasury’s TARP & Private Investors Make Equal Equity Investments (\$50 and \$50)
- FDIC Guarantees Debt For PPIF, 6-1 Debt-Equity Ratio (\$600 of Debt); Non-Recourse Loan
- Later, “Toxic” Assets Sold, Debt Repaid, Treasury & Private Investors Share Profit
- But If Assets Deteriorate, Treasury & FDIC Lose Big Time

LEGACY SECURITIES PROGRAM

- Public-Private Investment Fund (PPIF) Set Up By Experienced Asset Managers
- Treasury's TARP & Asset Managers Make Equal Equity Investments (\$50 and \$50)
- Treasury Matches Its Equity With Equal Amount of Debt (\$50); Non-Recourse Loan
- Managers Hold Assets To Maturity, Debt Repaid, Treasury & Private Investors Share Profit
- Again, If Assets Deteriorate, Treasury Loses

FED'S TERM ASSET-BACKED SECURITIES LOAN PROGRAM

- FED Makes Collateralized Loans To Private Sector
- Unusual Collateral For Fed: New or Legacy Asset-Backed Securities (ABS)
- Eligible ABS: Credit Cards, Small Business Loans, Student Loans, RMBS, CMBS
- Up To \$1 Trillion In Loans, Financed By Creating Money Out of Thin Air; “Quantitative Easing”
- \$100 Billion Back-Stop From Treasury-TARP To Cover Potential Losses

PPIP & TALF

- \$100 Billion In TARP Funds For Equity For PPIP
- \$100 Billion In TARP Funds To Back-Stop TALF
- Over \$500 Billion In PPIF Asset Purchases
- Up To \$1 Trillion In TALF Loans From Fed
- Danger of Large Losses To Taxpayer, Depending On Asset Prices

FDIC

“TEMPORARY LIQUIDITY GUARANTEE PROGRAM (TLGP)”

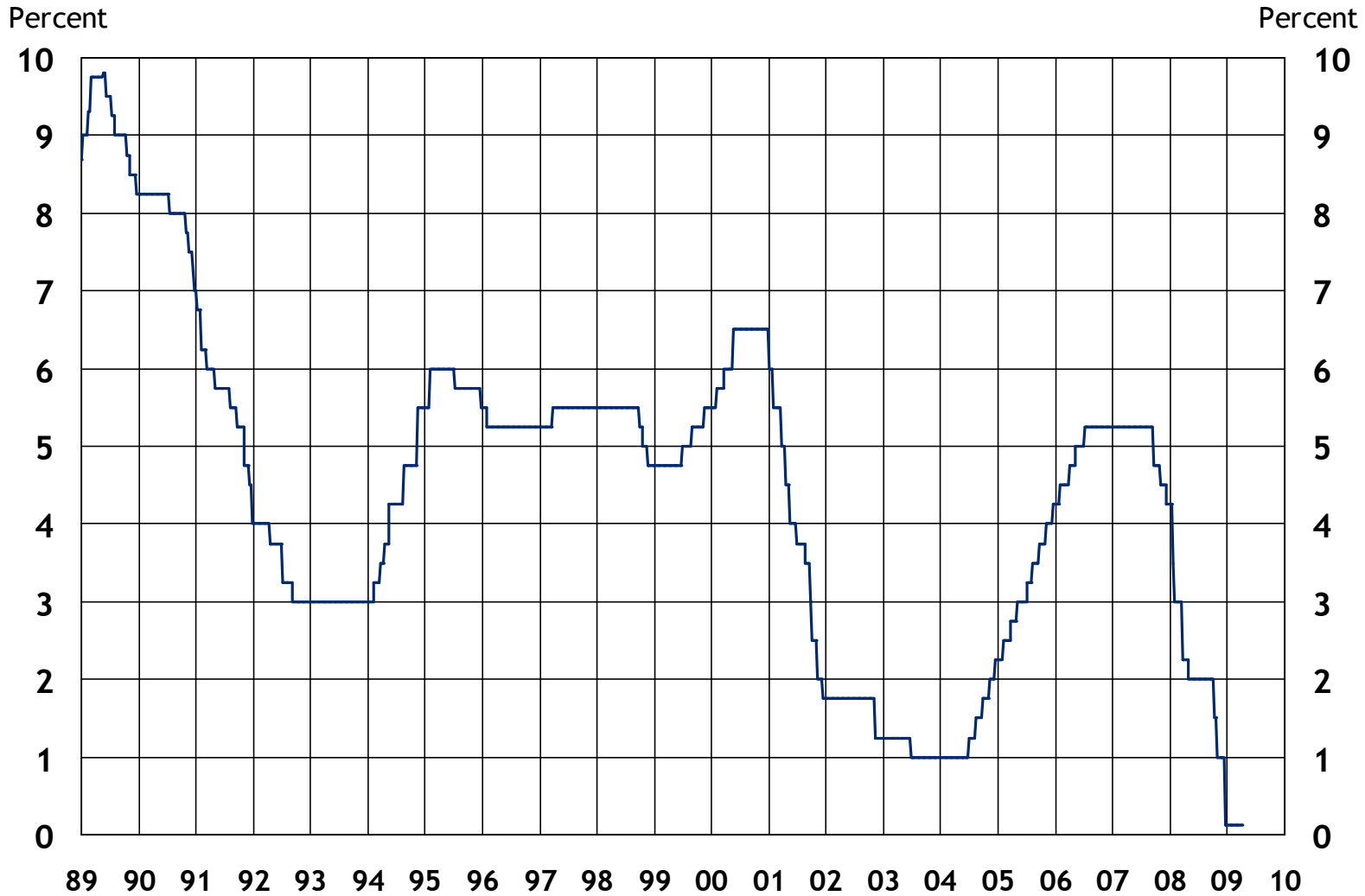
- “Transaction Account Guarantee Program” -- Deposit Insurance For All Checking Accounts
- “Debt Guarantee Program” -- Guarantees Newly-Issued Senior Unsecured Debt
- Up To \$1.4 Trillion For TLGP
- Up To \$500 Billion For PPIP

THE FED JOINS

THE FIGHT

GONE TO “ZIRP”! LOWEST RATES SINCE 1941.

FEDERAL FUNDS TARGET RATE



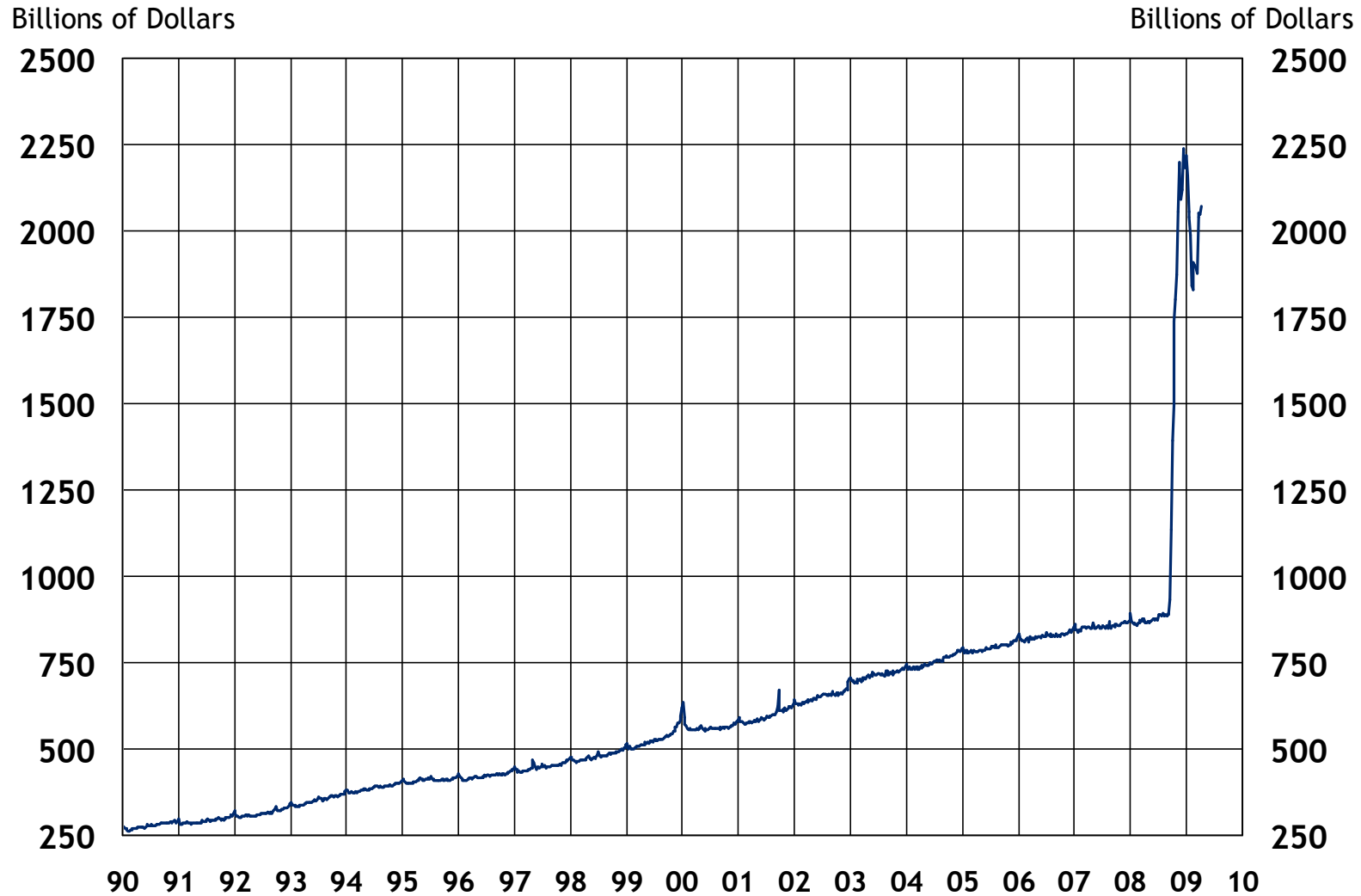
Weekly Data

Source: Federal Reserve; History Through April 8, 2009

12W-06

“QE,” TOO. QUANTATIVE EASING MASSIVELY.

RESERVE BANK CREDIT OUTSTANDING



Weekly Data

Source: Federal Reserve; History Through April 8, 2009

08W-10

FED COMMITMENTS

- Up To \$1.0 Trillion For Agency MBS
- Up To \$600 Billion For Agency Debt
- Up To \$1.0 Trillion For TALF
- Up To \$300 Billion To Buy Treasury Bonds
- Up To \$900 Billion For Term Auction Facility
- Unlimited Commitment To Central Bank Swaps

HOUSING GONE WILD:

LOTS OF BLAME TO GO AROUND

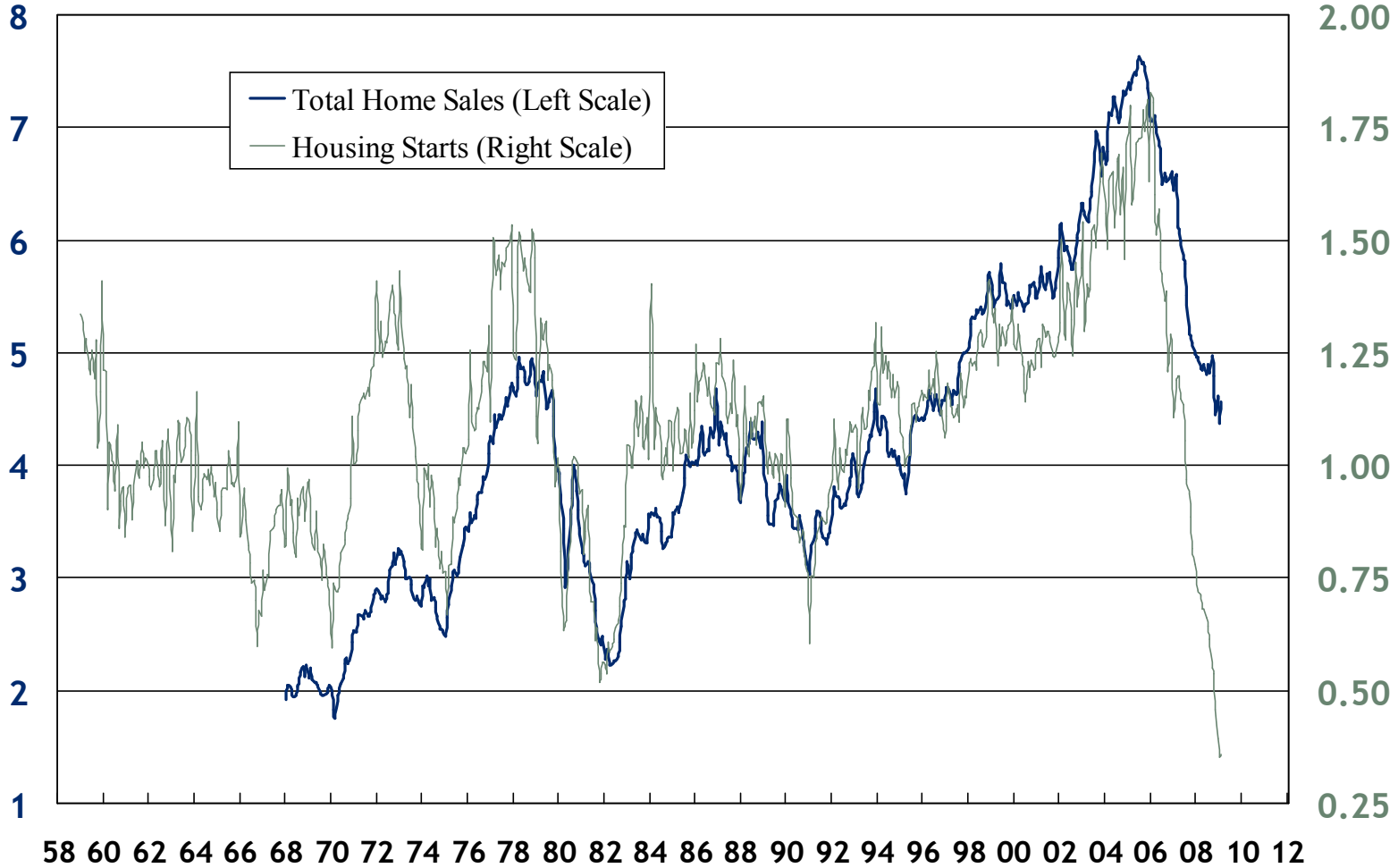
STARTS & SALES BOOMED, THEN COLLAPSED.

SINGLE-FAMILY HOUSING: SALES* Vs. STARTS

*New + Existing Homes

Millions of Units

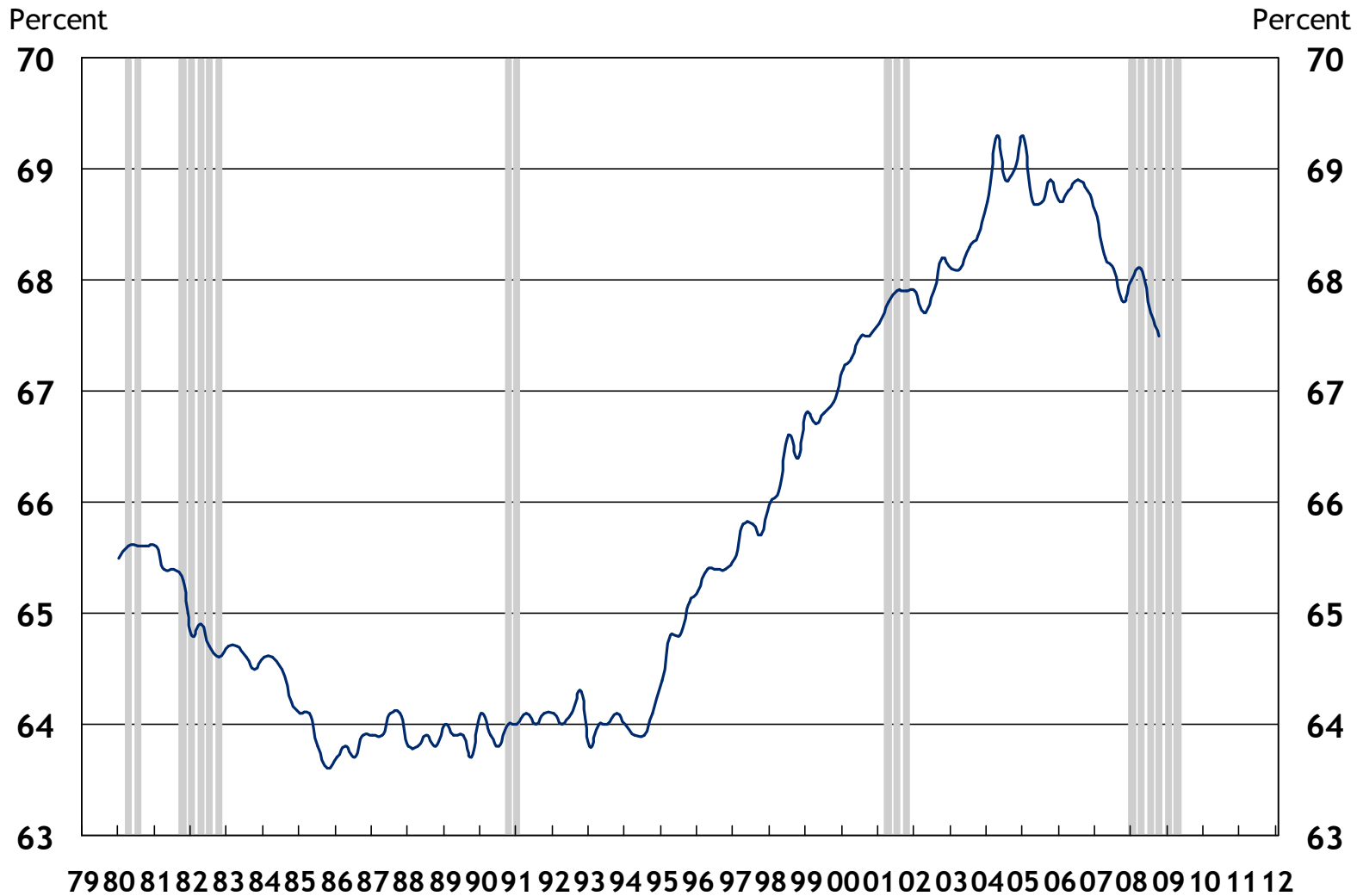
Millions of Units



Seasonally Adjusted & Annualized; Monthly Data; Shaded Areas Denote NBER-Designated Recessions
 Source: Commerce Department; History Through Feb-2009(Starts), Feb-2009(New + Existing Sales)

HOMEOWNERSHIP RATE: RECORD, THEN SHARP FALL.

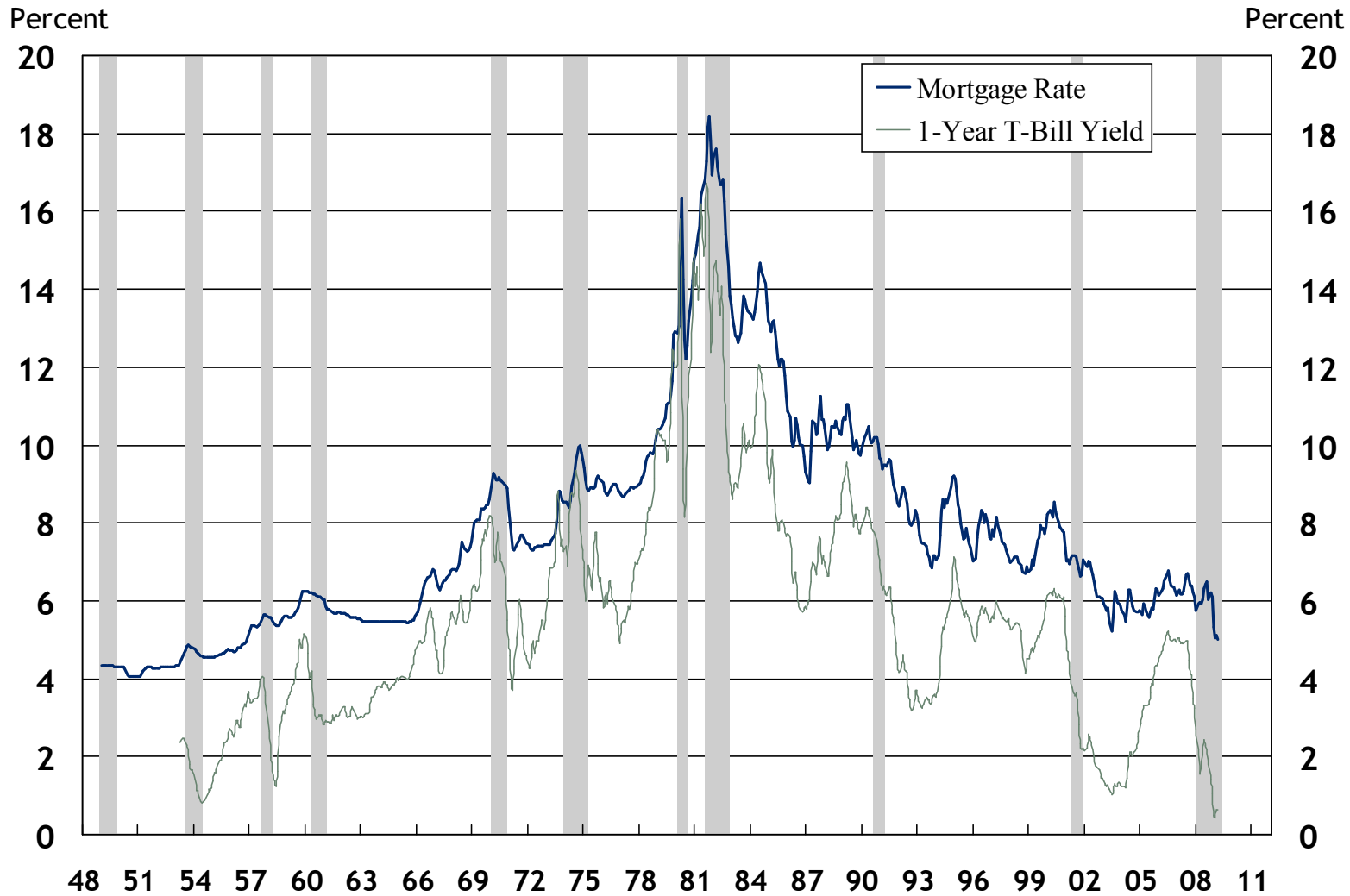
HOMEOWNERSHIP RATE



Seasonally Adjusted; Quarterly Data; Shaded Areas Denote NBER-Designated Recessions
Source: Census Bureau; History Through Q4:2008

BORROWING COSTS PLAYED A ROLE IN BOOM & BUST.

MORTGAGE RATE VS. 1-YEAR TREASURY BILL YIELD



Monthly Data; Shaded Areas Denote NBER-Designated Recessions

Source: FHA prior to 71:04; FHLMC as of 71:04; History Through Mar-2009(Mortgage), Mar-2009(T-Note)

18M-10

WHY STARTS and SALES BOOMED

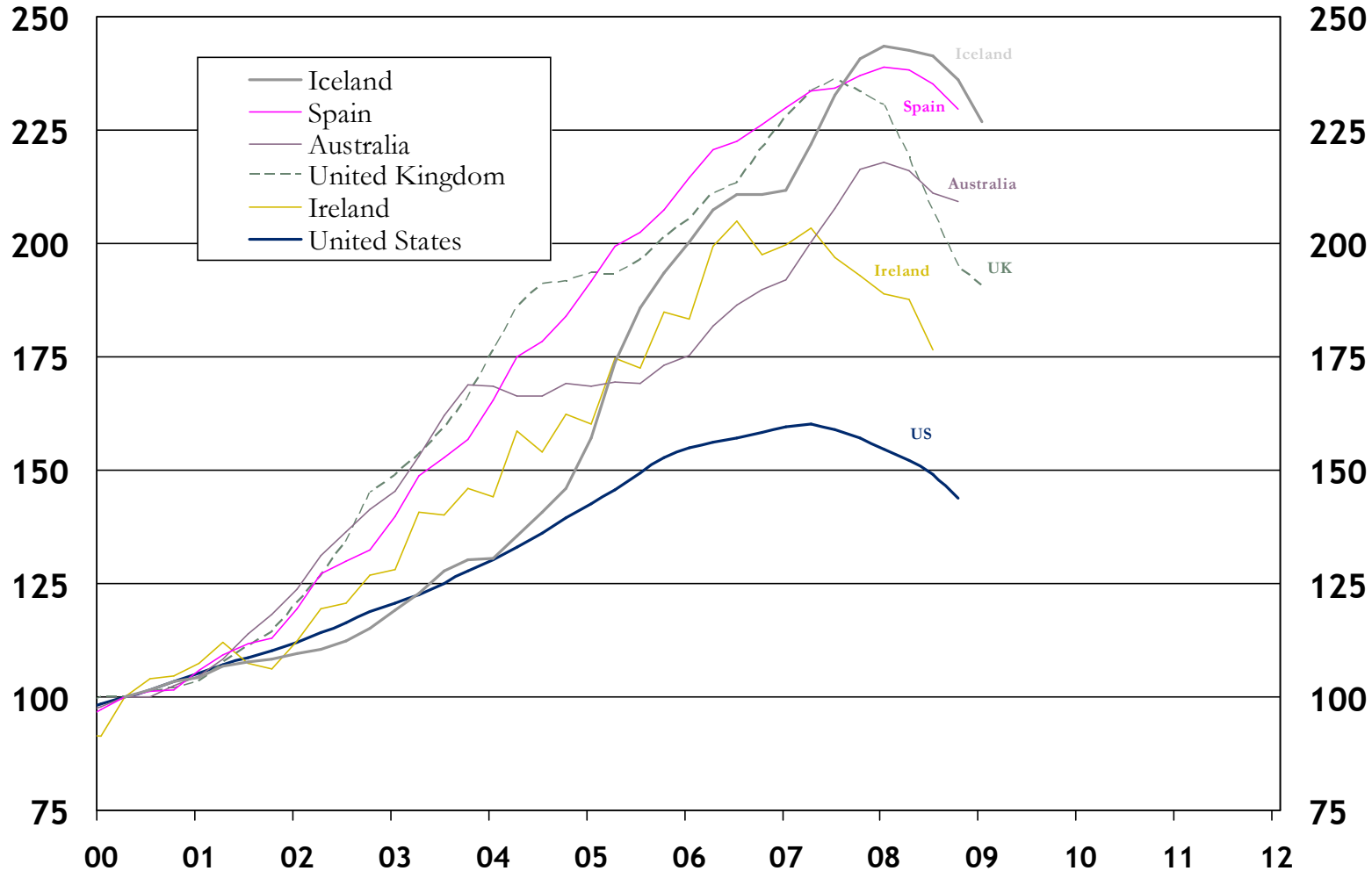
- Aging of Baby-Boomers
- Immigration Boost
- Rising Jobs, Population, & Wealth
- Lower Mortgage Rates
- Readily Available Credit

GLOBAL HOUSING BOOM, GLOBAL BUST & RECESSION.

GLOBAL HOUSE PRICE INDEXES

Index; Q2:2000 = 100

Index; Q2:2000 = 100



Quarterly Data; Source: Statistics Iceland; Ministerio de Vivienda; Australian Bureau of Statistics; Halifax Bank of Scotland; Department of the Environment; OFHEO History Through Q1:2009 (Iceland); Q4:2008 (Spain); Q4:2008 (Australia); Q1:2009 (UK); Q3:2008 (Ireland); Q4:2008 (US)

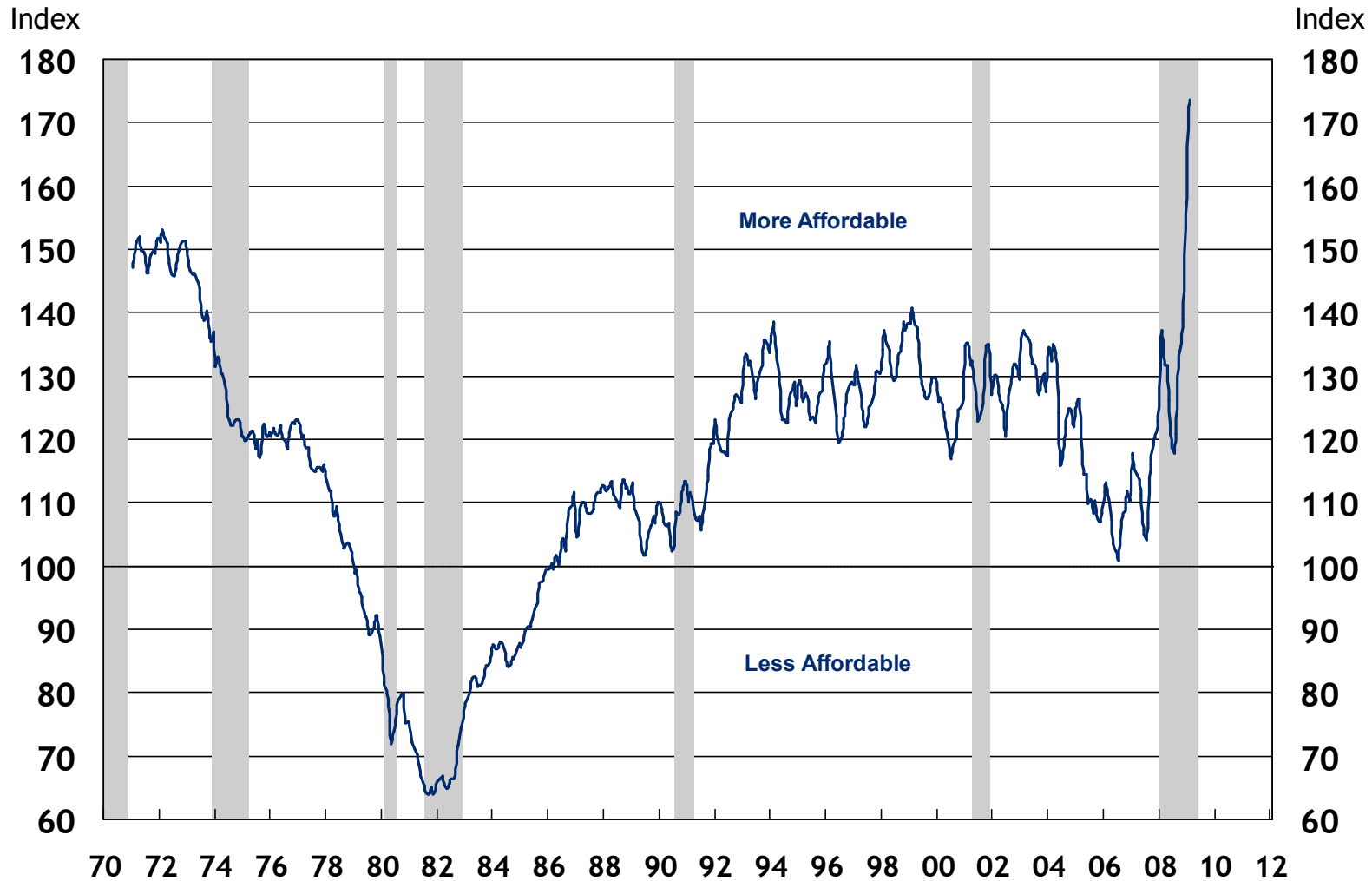
WHY HOUSE PRICES BOOMED

- Demand Soared...
- Supply Restricted In Coastal Regions
- Concentrated Jobs, Population, & Wealth
- Aggressive Zoning & Environmental Controls
- Questionable Lending Practices (NINJA Loans)
- LEVERAGE
- Bubble Mentality: “House Prices Will Always Rise”

HOUSING AFFORDABILITY RECORD HIGH.

HOUSING AFFORDABILITY INDEX*

* Index = 100 When Median Family Income Equals Qualifying Income

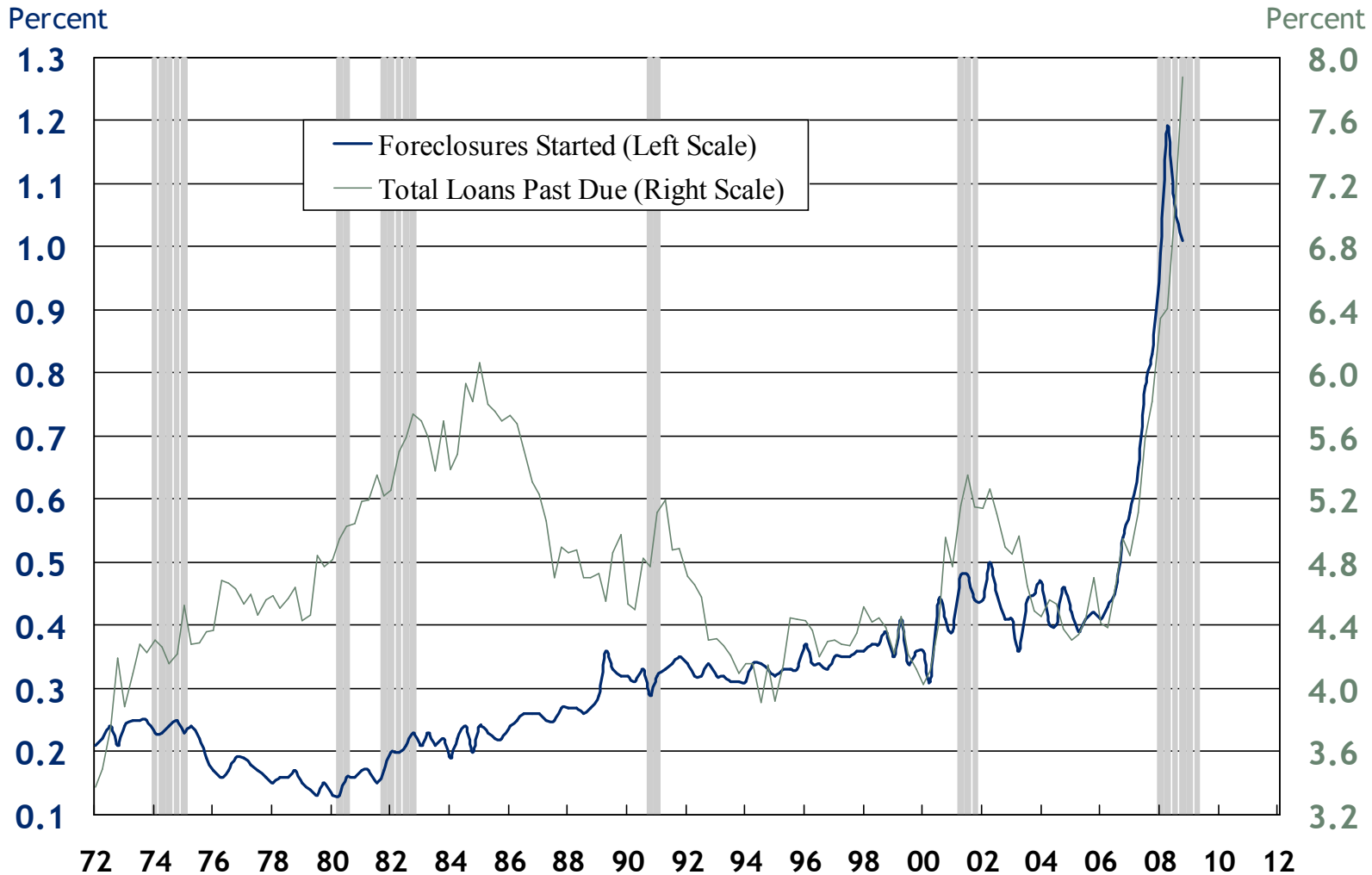


Monthly Data; Shaded Areas Denote NBER-Designated Recessions
 Source: National Association of Realtors; History Through Feb-2009

DELINQUENCY & FORECLOSURE RATES AT RECORD HIGHS.

ALL MORTGAGES: FORECLOSURES Vs. PAST DUE

Measured as a Percent of Total Number of Mortgages Outstanding



Seasonally Adjusted; Quarterly Data; Shaded Areas Denote NBER-Designated Recessions

Source: Mortgage Bankers Association; History Through Q4:2008

18Q-20

MORTGAGES GET SECURITIZED AND SOLD TO EVERYONE.

IT HAS CONSEQUENCES FOR BANKS.



WHY HOUSE PRICES WILL STABILIZE

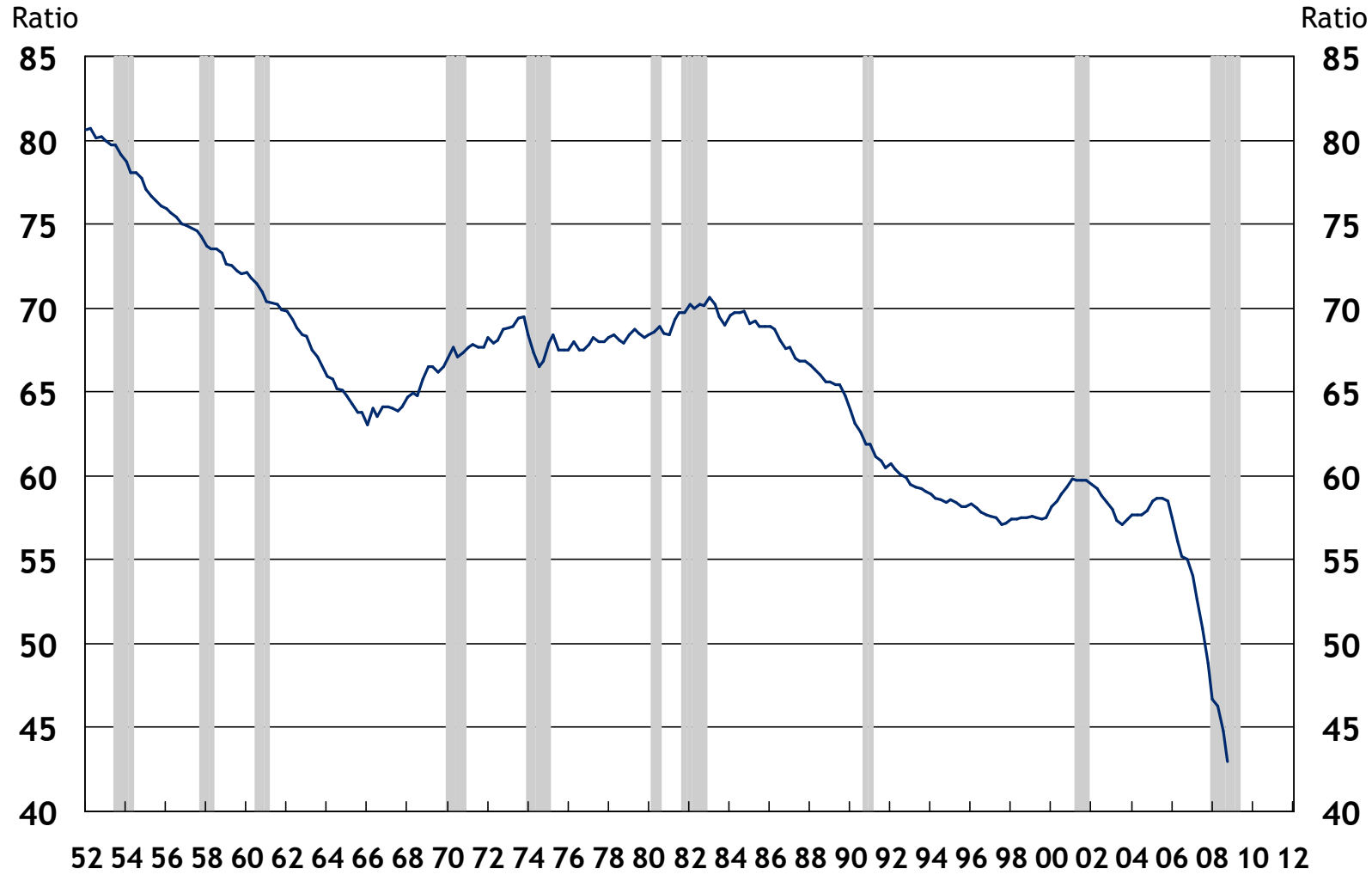
- Inventories Fall As Construction Collapses
- Population Rising 1% Per Year
- Prices Normalizing Relative To Income
- Mortgage Rates At 50-Year Lows
- Fed & Treasury & Fannie/Freddie Adding Credit
- Programs To Limit Foreclosures

**CONSUMERS GET
CRUNCHED**

LEVERAGE TO THE MAX! CORRECTION NOT YET STARTED.

RATIO OF OWNERS' EQUITY TO HOUSEHOLD REAL ESTATE

Includes Farm Households



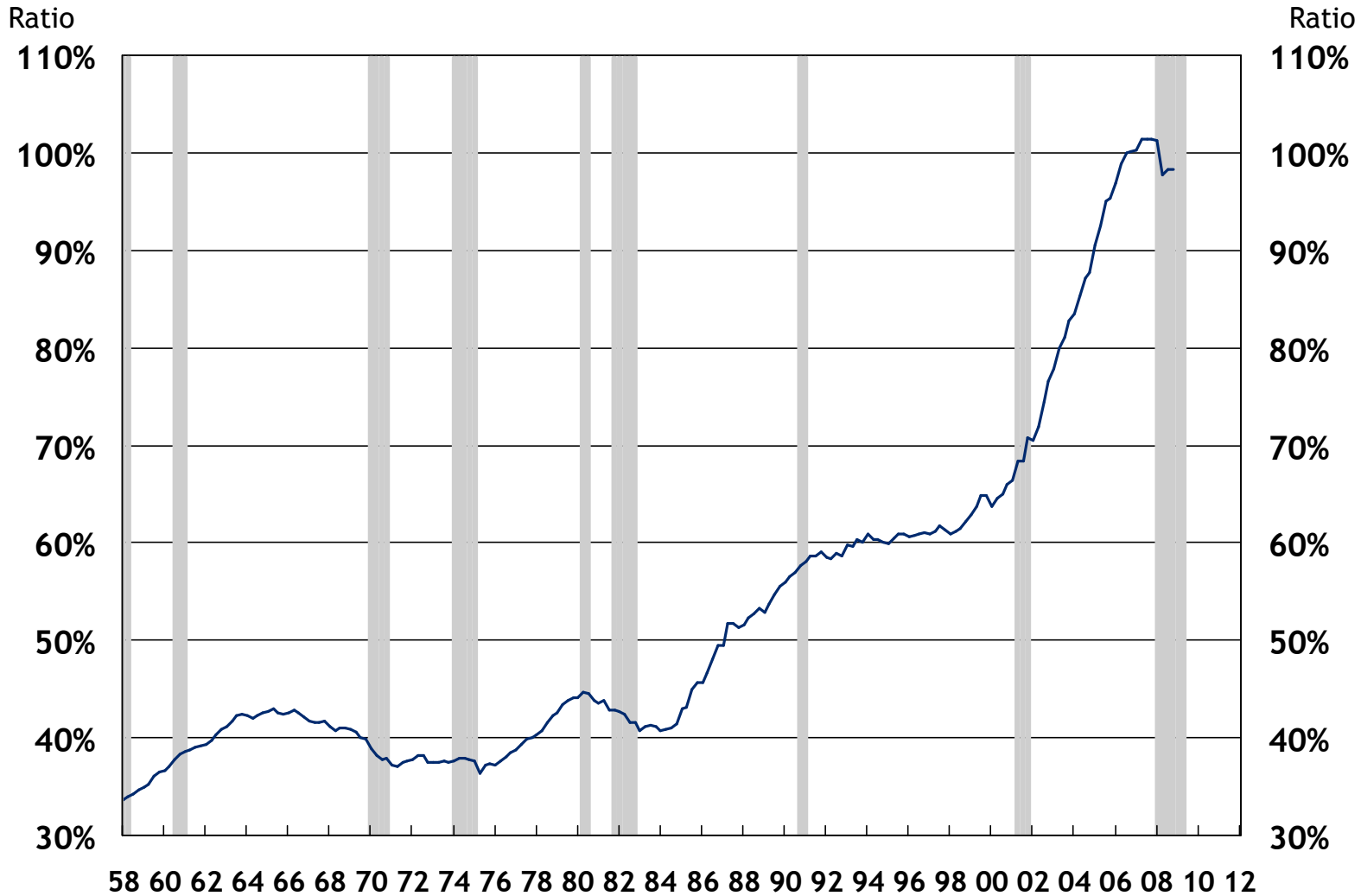
Seasonally Adjusted Quarterly Data (Flow of Funds Accounts); Shaded Areas Denote NBER-Designated Recessions

Source: Bureau of Economic Analysis; Federal Reserve; History Through Q4:2008

14Q-40

HOUSEHOLD DEBT: NOT CREDIT CARDS BUT MORTGAGES.

RATIO: HOUSEHOLD REAL ESTATE DEBT to DISPOSABLE PERSONAL INCOME



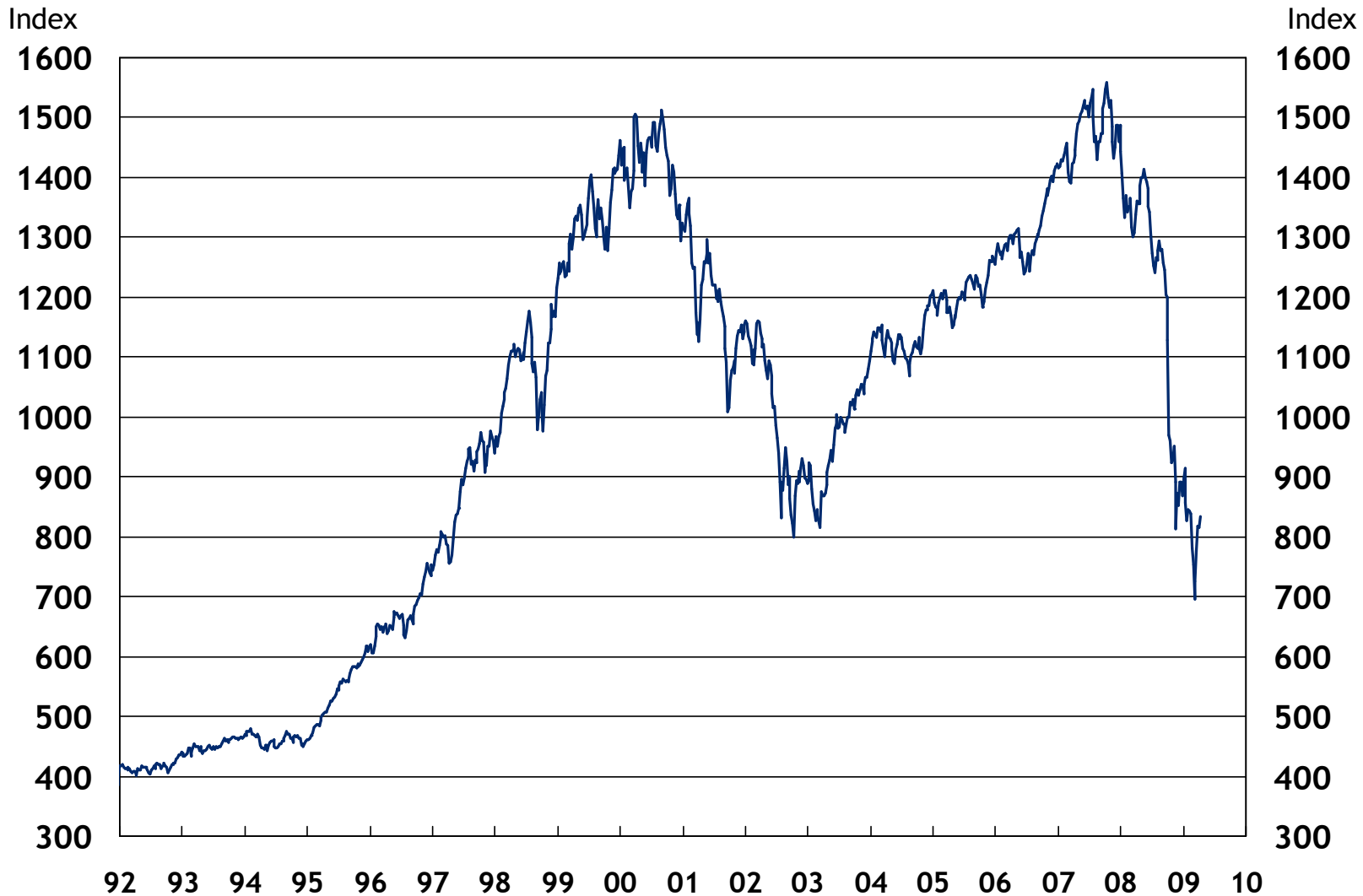
Seasonally Adjusted Quarterly Data (Flow of Funds Accounts); Shaded Areas Denote NBER-Designated Recessions

Source: Federal Reserve; History Through Q4:2008

14Q-35

WORST BEAR MARKET SINCE 1930's. \$11 TRILLION GONE.

S&P 500 COMPOSITE INDEX



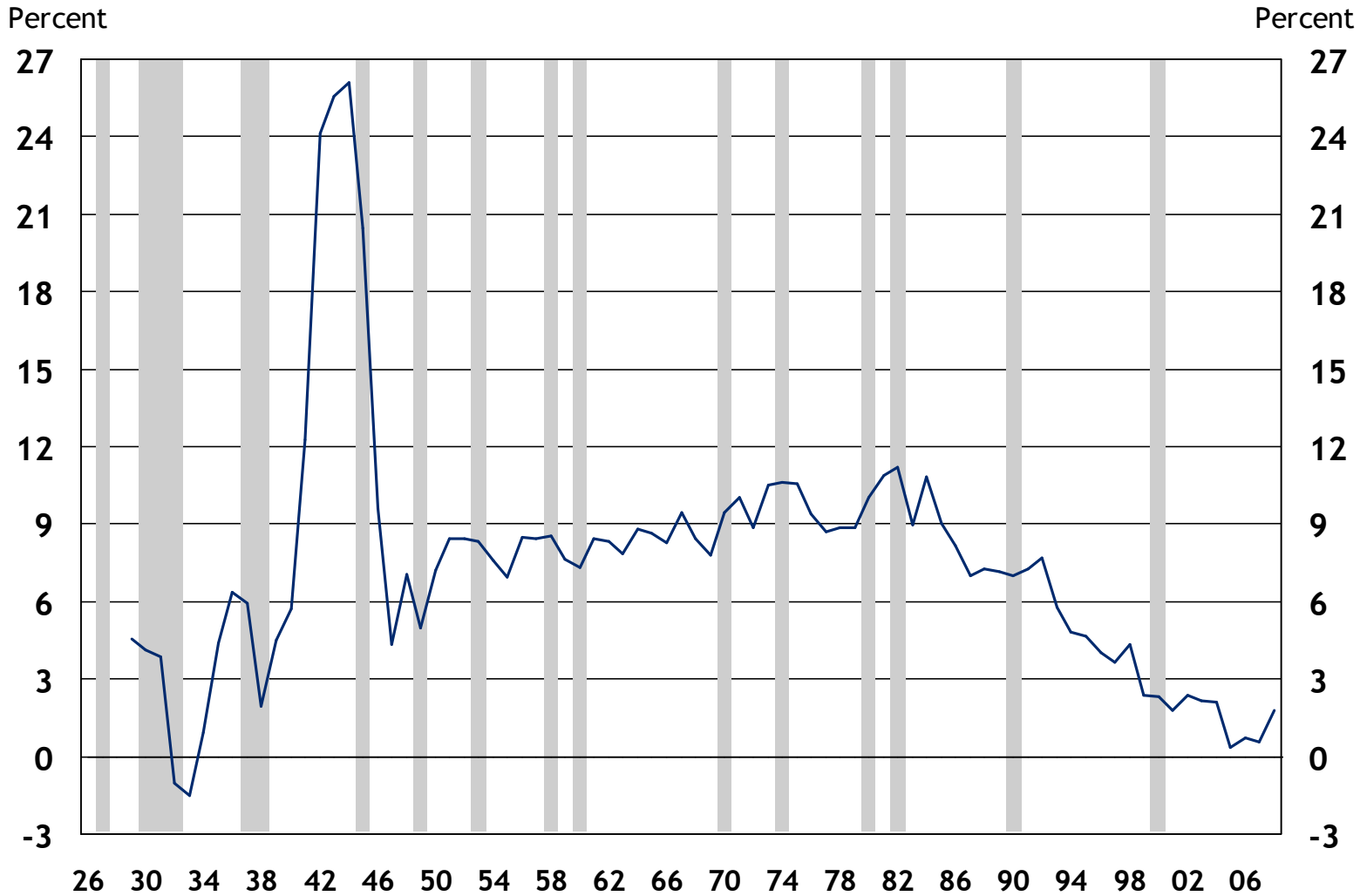
Weekly Data

Source: Standard & Poor's; History Through April 10, 2009

9W-02

THRIFT DISAPPEARED DURING STOCK MARKET & HOUSING BOOMS. IT WILL RETURN.

PERSONAL SAVINGS as SHARE of DISPOSABLE PERSONAL INCOME

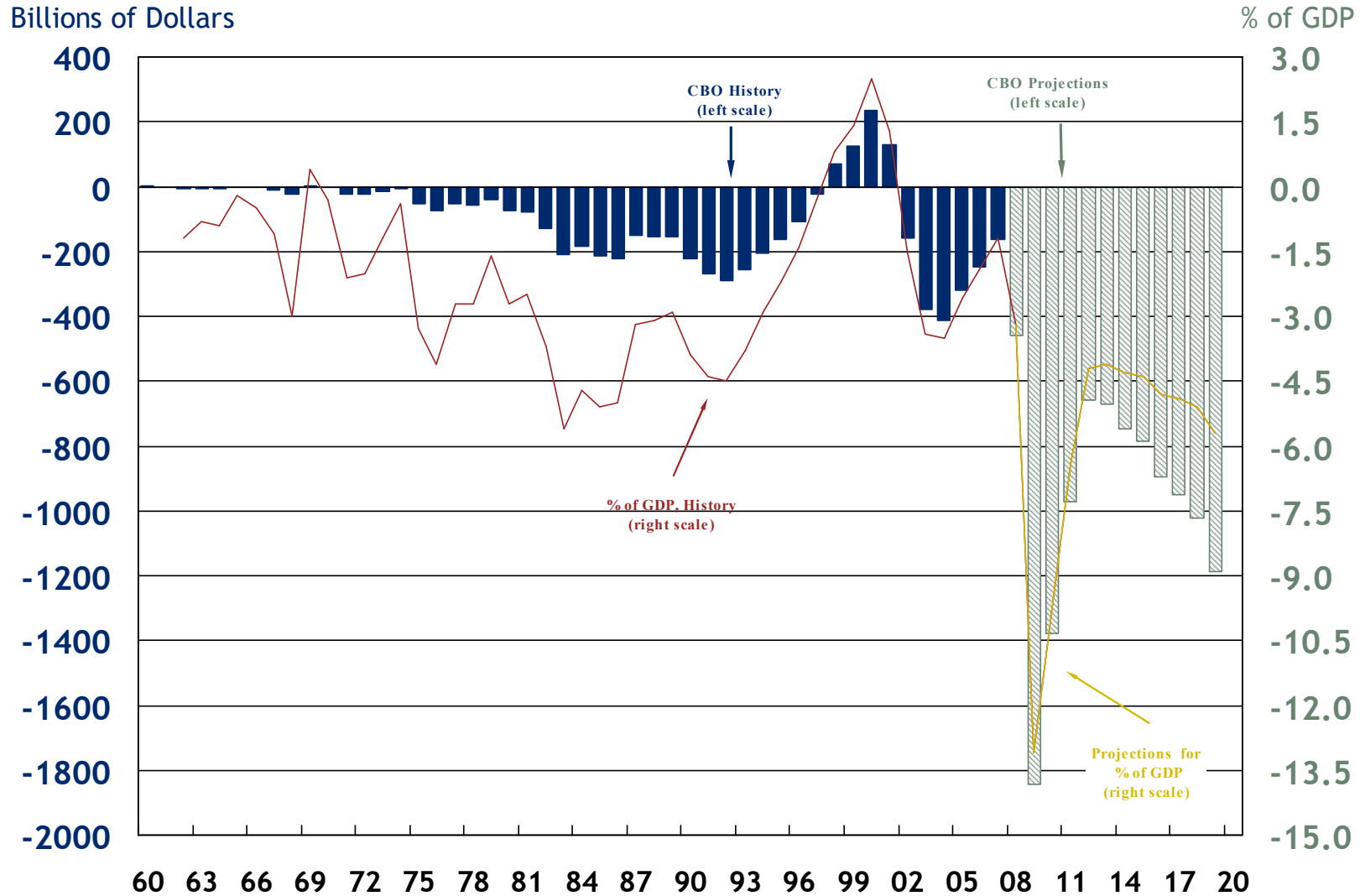


Annual Data; Shaded Areas Denote NBER-Designated Recessions
 Source: Labor Department; Loomis Sayles Estimates; History Through 2008

THE FEDERAL BUDGET MELTS DOWN

GIANT BUDGET DEFICITS, NOW AND TO COME.

FEDERAL GOVERNMENT SURPLUS/DEFICIT



Unified Budget Basis; Fiscal Years; Annual Data

Source: Congressional Budget Office Budget and Economic Outlook; Fiscal Years 2008-2018; Commerce Department; Annual History/Forecast Through FY 2019

06.4.03

HOW DID THE DEFICIT GET SO BIG?

- \$700 Bil. For TARP
- \$168 Bil. For Bush Fiscal Stimulus In 2008
- \$787 Bil. For Obama Fiscal Stimulus In 2009
- Tax Revenues Plunge With Recession & Bear Market
- \$200 Bil. To \$400 Bil. For Fannie and Freddie
- \$500 Bil. Line of Credit For FDIC
- \$300 Bil. Treasury Purchase of Agency MBS

HOW DOES IT

ALL END?

WHAT HAPPENS NEXT?

- We Are Probably In the Worst Recession In 70 Years
- Recapitalizing the Banking System Will Be Expensive
- House Prices Likely To Stabilize By Year-End
- Consumers Rediscover the Virtues of Thrift...
- ...But the Federal Government Does Not
- Much Higher Taxes Are Coming
- Housing Finance Needs To Be Rebuilt

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