

A Midsummer Comment

The prices of corporate bonds and loans have come down recently. This weakness has largely been triggered by concerns related to the sub-prime mortgage market and structured transactions, such as CDO's, that included sub-prime mortgages as part of their underlying investments.

Highly leveraged transactions in the sub-prime mortgage market were an accident waiting to happen. Now that this accident has happened, investors began to examine possible causes for future such accidents. They suddenly became aware that they may have generally overstretched themselves in extending debt in too liberal a fashion. Not surprisingly they realized, for example, that some private equity transactions had too much leverage attached to them. This has led to a more sober, and less giddy, assessment of risk.

Holders of subprime mortgage paper tried to lower their exposure to the asset class. Unfortunately there were few buyers at prices acceptable to the sellers. But the sellers needed to raise cash and were, therefore, forced to sell paper that was liquid and for which there were buyers. This brought some pricing pressure on our bonds and bank loans.

As we have said previously, we do not believe that we are at the beginning of a major down trend in corporate credit. Default rates are below 2% and the world's economies and companies' financial conditions are simply too strong to warrant a pessimistic outlook.

None of the companies in our portfolios suffered any credit deterioration in the last few weeks of market weakness. Their securities, however, have been repriced at more attractive levels which we believe offers an interesting buying opportunity. We are currently purchasing dollar denominated bonds at yields in excess of 8% and Euro denominated bonds at yields in excess of 7%. We are currently purchasing bank loans at spreads in excess of 225 basis points above Libor or Euribor. These are attractive levels. We would encourage taking advantage of current prices to initiate purchase programs.