

Recent Developments Fannie Mae and Freddie Mac

For Participants
July 16, 2008

The recent news regarding the financial health of Fannie Mae and Freddie Mac are grabbing many headlines, and unnerving many investors. We, at Advised Assets Group, LLC (AAG), have prepared the following questions and answers to address some of the questions being asked regarding the Federal Agencies.

Q. Why has the stock of Fannie Mae and Freddie Mac declined so much?

Investors are concerned that the Federal Government may have to take over the organizations should fears regarding the organization's potential losses due to exposure to the U.S. Housing market materialize. Should a Federal takeover occur, it's unclear what the value, if any, the stock of Fannie Mae and Freddie Mac might be worth.

Q. What would a Federal takeover mean to the debt and the Mortgage Backed Securities guaranteed by Fannie Mae and Freddie Mac?

We are not at that point as yet and, in fact, many analysts and the organizations themselves believe that there is no need for a Government takeover and that the firms are more than adequately capitalized. Further, Treasury Secretary Paulson is quoted as supporting the current form of the organizations as independent entities. The Treasury moves to date have all been to help Fannie Mae and Freddie Mac to continue to operate in their current form. With that said, any Government rescue plan would strengthen the ability of the Agencies to pay on their debt and other obligations.

Q. Does the Government currently guarantee the debt and other obligations of Fannie Mae and Freddie Mac?

Historically and currently, any obligations of the two agencies are the responsibility of the two organizations. However, the Bond market has long considered that, due to the size and importance of Fannie Mae and Freddie Mac, if the companies ever got into financial distress the Federal Government would step in and support them. Essentially, the Bond markets felt that there was an implicit guarantee of Federal Government support of the two organizations.

Q. What are the ratings of the debt and Mortgage Backed Securities guaranteed by Fannie Mae and Freddie Mac?

The obligations of the two organizations continue to be rated AAA.

Q. How has the Bond market reacted to any potential rescue plans for the two Agencies?

As opposed to stock holders, Bond investors seem to be very comfortable with greater Federal Government involvement with the Agencies. In fact, interest rate spreads over treasuries (a good proxy for risk) has generally reduced the last few weeks meaning that the Bond market thinks there is actually less risk to these securities now compared to what it was prior to the most recent concerns that have triggered the drop in the stock of the two organizations. In essence, Bond investors seem to think that greater Federal Government involvement would enhance the implicit guarantee of the Government and could potentially substitute it with an explicit guarantee.

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