Stephen P. Feltz
Treasurer and Controller
Tel: 503.220.2345
Fax: 503.220.2584
Toll Free: 1.800.422.4012
email: spf@nwnatural.com

February 26, 2008

VIA ELECTRONIC FILING

Public Utility Commission of Oregon
550 Capitol Street NW, Suite 215
PO Box 2148
Salem, OR 97308-2148

Attention: Filing Center

RE: Replacement Filing--Docket UF 4235

Pursuant to the Commission's Order No. 07-032, in Docket No. UF 4235, authorizing Northwest Natural Gas Company (the "Company") to enter into interest rate swaps, caps, floors, collars and other derivative products with financial institutions to manage exposure to interest rate fluctuation, we enclose herewith the initial and final documentation of the forward starting swap entered into by the Company on October 24, 2007 along with documentation demonstrating the that hedge transaction was prudent.

This filing replaces Northwest Natural Gas Company's filing dated 2/20/08 (OPUC filing number 6491) in the entirety. Pursuant to ORS 191.501 and 191.502, Exhibits B, C, D, E and F are marked confidential and are not included in this electronic filing, but will be submitted on a CD and mailed with the hard copy.

Sincerely,

/s/ Stephen P. Feltz

Stephen P. Feltz

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

In the Matter of the Application of NORTHWEST NATURAL GAS COMPANY for an Order Authorizing Various Arrangements with Financial Institutions to Manage Exposure to Interest Rate Fluctuations	)	Docket No. UF 4235 Report of Hedge Transaction and Documentation Supporting Prudency of Transaction

This report is filed pursuant to the Commission's Order No. 07-032 dated January 29, 2007, in which Northwest Natural Gas Company (the "Company") was authorized to enter into interest rate swaps, caps, floors, collars and other derivative products with financial institutions to manage exposure to interest rate fluctuations. The products are hereinafter referred to as "Interest Rate Hedge Products." The notional principal amount outstanding of Interest Rate Hedge Products entered into pursuant to such authorization does not and will not exceed $200,000,000 or more than 30 percent of the total debt outstanding, whichever is less. The authority will remain effective so long as the Company's senior secured debt has investment grade ratings from two nationally recognized rating agencies. The Company' current senior secured debt currently has investment grade ratings from two nationally recognized rating agencies.

1. Initial and final documents signed by NW Natural and any other party in the matter (including counterparty and agent) clearly providing information on the nature of the product, its maturity, all rates involved, and other pertinent terms and conditions.

On October 24, 2007, the Company entered into a Forward Starting Interest Rate Swap (the "Forward Swap"), as approved in Order No. 07-032 in Docket UF 4235. The Forward Swap was executed between UBS Securities LLC ("UBS") and the Company. The terms of the Forward Swap consist of a notional amount of $50,000,000, an effective date of September 30, 2008 and a maturity date of September 30, 2018. The Company will pay UBS a fixed annual rate of 5.083 percent based on a semi-annual and unadjusted interest period (30/360), and UBS will pay the Company a 3-month LIBOR rate (London Inter-Bank Offered Rate) based on a quarterly interest period (actual/360). The Forward Swap includes a mandatory cash settlement clause with the effective date of September 30, 2008. However, the Company intends for the actual settlement date to coincide with an issuance of at least $50,000,000 of senior secured notes within two months before or after the stated effective date. The terms of the Forward Swap are set forth in the Confirmation attached hereto as Exhibit A.

Fees for services, if any, are negotiated on a case-by-case basis at the time the Company enters into an Interest Rate Hedge Product. There were no additional fees or expenses related to the Forward Swap.

2. Demonstration that the Forward Swap was prudent, providing market data and correspondence with agents and counterparties as well as risk analysis, in support of that demonstration.

In the Company's 2007 financing strategy, the Company determined that it would need to issue debt out of our Medium Term Note ("MTN") program sometime around September 2008. The proceeds of this MTN issuance will be used to fund the acquisition and construction of property, the improvement or maintenance of service or the refinancing of maturing short-term and long-term debt. The Company was concerned about the current volatility of US interest rates and financial markets, as housing and, more recently, liquidity concerns roiled the credit markets. In September and October 2007, daily Treasury moves of 10+ bps had become increasingly common, and the Company was concerned that rising interest rates would negatively impact the Company's cost of capital for the identified debt issuance. At the same time, from early September to late September, 10-year Treasury rates had risen by 20 bps; then from late September to late October, 10-year US Treasury rates declined nearly 40 bps, constituting the lows for 2007 and dropping to levels not seen since 2005. The Company had identified both a need for issuing debt as well as for managing interest rate exposure due to market volatility. To assist the Company in obtaining protection against material adverse market events and provide opportunities to take advantage of favorable market conditions, the Company engaged in discussions with a number of potential counterparties.

We had been having discussions with UBS, Wachovia Bank, Wells Fargo Bank, JPMorgan, Bank of America, and Merrill Lynch (collectively the "Participant Banks") since early in 2007 about opportunities for hedging interest rate risks. During the month of September, Participant Banks indicated that, given the Company's need to issue long-term debt within the next year, the Company should mitigate the risk to rising treasury yields by using an interest rate hedge. The Participant Banks also indicated that based on the relative flatness of the yield curve, the historically low forward premiums to lock-in rates for up to 12 months, and the favorable market conditions for higher rated credits, this was one of the best market environments for pre-hedging new issuances. As a result, the banks recommended that the Company hedge to the most likely debt issuance date with sufficient flexibility around the desired hedge settlement date.

After discussions with the Participant Banks and due consideration, it was determined that the most beneficial interest rate hedging instrument for the Company's purposes at this time was a forward starting interest rate swap, which hedges both the benchmark treasury rate as well as the credit spread. A Forward Swap provides a number of advantages over pure Treasury locks, including: partial credit spread protection, to the extent that Company credit spreads are correlated with "AA" swap spreads; greater

pricing transparency and more efficient execution than Treasury locks for longer forward periods (i.e. longer than 3 or 6 months, Treasury locks involve rollover risk); simplification of accounting considerations that may arise with Treasury locks; and a lower forward premium than the cost associated with Treasury locks. Presentation materials making recommendations regarding the various interest rate hedging products from Wells Fargo, Merrill Lynch, UBS, Wachovia and JPMorgan are attached hereto as Exhibit B, Exhibit C, Exhibit D, Exhibit E and Exhibit F, respectively.

Once the desire for a forward swap product was identified, the Company began closely monitoring the 10-year swap rates in late September and early October. Exhibit G contains a number of e-mails from various banks keeping the Company apprised of the then-current forward swap rates. In late October, the Company determined that the market conditions were favorable for a forward swap transaction.

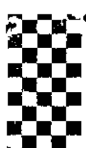
On October 24, 2007, the Company notified the Participant Banks by e-mail that it desired to enter into a forward-starting fixed-rate swap. The e-mail outlined the terms for the forward-starting fixed-rate swap along with the competitive bid process for the Participant Banks to submit their bids. This e-mail is attached hereto as Exhibit H. Participant Banks were asked to submit an all-in price quote on a 10-year fixed rate forward-starting swap, including forward premiums to September 30, 2008.

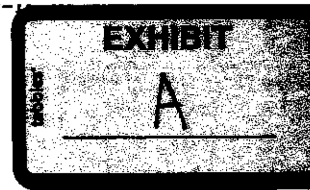
The bid process began at approximately 10:30 am Eastern Time (7:30 am Pacific Time) on October 24, 2007. A group of six Company representatives gathered in a conference room with six telephones. Each Company representative called one of the Participant Banks and asked them to hold on the line until all of the Participants Banks were on the telephone. Then, simultaneously, each of the Participants were asked to submit their bids, which were written down on bid sheets. The bid sheets for each of the six Participant Banks are attached hereto as Exhibit I. The lowest bidder was UBS, with an all-in price of 5.083%. Later that day, the Confirmation was executed by both the Company and UBS.

We believe the close monitoring of the market conditions by a number of national banks, assimilation of the advice received from the various national banks and, in particular, the competitive nature of the bid process, demonstrates that the Forward Swap was prudent and competitive based on market conditions on the date on which it was entered. Further, we believe that the competitive bid process used by the Company supports the notion that the Forward Swap rate is consistent with yields on first mortgage bonds for gas utilities with ratings similar to those of the Company. (See the attached Exhibit J for a summary of interest rates on new issues in the utility sector.) With respect to the Company's own debt cost history, the Forward Swap rate is expected to achieve a lower interest rate than the Company's most recent 10-year debt issuance, which was 5.15%, and it is expected to be lower than the interest rates on all but one of the Company's 10-year debt issuances since 1991. Finally, a retrospective analysis of the surrounding period indicates that the Company purchased the forward-starting fixed rate swap when the market conditions were quite favorable, at either the lowest, or nearly

lowest price during the period. This retrospective analysis is graphically depicted in the 15-Day CurncyCIP Grab sheet attached hereto as Exhibit K.

In short, given the market volatility and the Company's identified need for debt within the next year, the Forward Swap reduces the Company's risk with respect to cost of capital by protecting against increasing interest rates between now and then, avoiding any carrying costs for monies borrowed in advance of when the funds would be needed, and preventing the deterioration of certain debt to capital ratios that could adversely affect the Company's credit ratings. The number of Participant Banks involved and the bid process used provided the Company with a Forward Swap that was competitive based on market conditions and that was one of the lowest costs for medium-term debt issuances by the Company in a significant number of years.





Date:	✓24 October 2007
To:	✓Northwest Natural Gas Company ✓("Counterparty")
Attn:	JERRY FULPS
Fax No:	0015032734824
From:	UBS AG, LONDON BRANCH ("UBS AG")
Subject:	✓Cancellable Swap Transaction **UBS AG Ref: 37856990 (the "Transaction")** **Counterparty Ref: Please Advise**

Dear Sirs,

The purpose of this communication is to confirm the terms and conditions of the Transaction entered into between us on the Trade Date specified below. This Confirmation constitutes a "Confirmation" as referred to in the Master Agreement or Agreement specified below.

The definitions and provisions contained in the 2006 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc., are incorporated into this Confirmation. In the event of any inconsistency between those definitions and provisions and this Confirmation, this Confirmation will govern.

This Confirmation supplements, forms part of, and is subject to, the ISDA Master Agreement dated as of 15 April 2006 as amended and supplemented from time to time (the "Agreement"), between Counterparty and UBS AG. All provisions contained in the Agreement govern this Confirmation except as expressly modified below.

The terms of the particular Rate Swap Transaction to which this Confirmation relates are as follows:

General Terms

Trade Date:	✓24 October 2007 (time of execution available upon request)
Effective Date:	✓30 September 2008
Termination Date:	✓30 September 2018, subject to adjustment in accordance with the Modified Following Business Day Convention.
Calculation Agent:	✓UBS AG, unless otherwise stated in the Schedule to the Master Agreement
Broker:	✓None

Fixed Amounts

Fixed Rate Payer:	✓Counterparty
Fixed Rate Payer Calculation Amount:	✓USD 50,000,000.00
Fixed Rate:	✓5.083 percent per annum

Fixed Rate Day Count Fraction:	30/360
Fixed Rate Payer Payment Dates:	30 March and 30 September in each year, from and including 30 March 2009, up to and including the Termination Date, subject to adjustment in accordance with the Business Day Convention specified immediately below , and there will be no adjustment to the Calculation Period.
Business Day Convention:	Modified Following
Business Days:	New York and London

Floating Amounts

Floating Rate Payer:	UBS AG
Floating Rate Payer Calculation Amount:	USD 50,000,000.00
Floating Rate Option:	USD-LIBOR-BBA
Designated Maturity:	3 months
Floating Rate Day Count Fraction:	Actual/360
Spread:	None
Floating Rate Payer Payment Dates:	30 March , 30 June , 30 September and 30 December in each year , from and including 30 December 2008, up to and including the Termination Date , subject to adjustment in accordance with the Business Day Convention specified immediately below
Business Day Convention:	Modified Following
Reset Dates:	First day of each Calculation Period
Compounding:	Inapplicable
Business Days:	New York and London

Early Termination

Mandatory Early Termination:	Applicable

Settlement Terms

Mandatory Early Termination Date	30 September 2008
Cash Settlement	Applicable
Cash Settlement Valuation Time:	11:00 am, New York

Valuation Business Days:	New York and London
Business Day Convention for Cash Settlement Payment Date:	Following
Cash Settlement Method:	Cash Price
Cash Settlement Currency	USD
Settlement Rate:	Inapplicable
Quotation Rate:	mid

Relationship Between Parties

Each party will be deemed to represent to the other party on the date on which it enters into this Transaction that (in the absence of a written agreement between the parties which expressly imposes affirmative obligations to the contrary for this Transaction):-

(a) Non-Reliance. Each party is acting for its own account, and has made its own independent decisions to enter into this Transaction and this Transaction is appropriate or proper for it based upon its own judgement and upon advice from such advisers as it has deemed necessary. Each party is not relying on any communication (written or oral) of the other party as investment advice or as a recommendation to enter into this Transaction; it being understood that information and explanation relating to the terms and conditions of this Transaction shall not be considered investment advice or a recommendation to enter into this Transaction. No communication (written or oral) received from the other party shall be deemed to be an assurance or guarantee as to the expected results of this Transaction.

(b) Assessment and Understanding. Each party is capable of assessing the merits of and understands (on its own behalf or through independent professional advice), and accepts, the terms, conditions and risks of this Transaction. Each party is also capable of assuming, and assumes, the risks of this Transaction.

(c) Status of the Parties. Neither party is acting as a fiduciary for or as an adviser to the other in respect of this Transaction.

References in this clause to "a party" shall, in the case of UBS AG, London Branch and where the context so allows, include references to any affiliate of UBS AG, London Branch.

Account Details:

Currency:	USD
Favour:	UBS AG, Stamford Branch
Swift Address:	UBSWUS33XXX
Further Credit To:	UBS AG, London Branch
Swift Address:	UBSWGB2LXXX
Account No:	101-WA-140007-000

Offices

(a) The office of UBS AG for the Cancellable Swap Transaction is LONDON and
(b) The office of the Counterparty for the Swap Transaction is PORTLAND, OR.

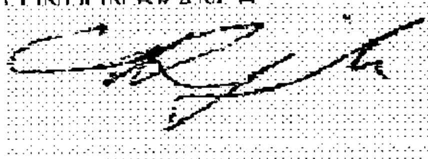
Contact Names at UBS AG

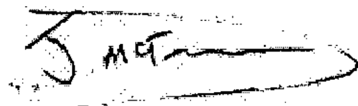
Pre Value Payments:	Pre Value Payment Investigations:	(44) 20 7568 2665
Post Value Payments:	Post Value Payment Investigations:	(44) 20 7567 8999
Confirmation Queries:	Confirmation Control:	(44) 20 7568 0211 (Management Escalation Only)
ISDA Documentation:	Credit Risk Management:	(44) 20 7567 4557
Swift:	UBSWGB2L	
Fax:	(44) 20 7567 2685 or 2990	
Address:	100 Liverpool Street, London, EC2M 2RH UBS AG	

Please confirm that the foregoing correctly sets forth the terms and conditions of our agreement by executing a copy of this Confirmation and returning it to us or by sending to us a letter or facsimile substantially similar to this letter, which letter or facsimile sets forth the material terms of the Transaction to which this Confirmation relates and indicates your agreement to those terms or by sending to us a return letter or facsimile in the form attached.

Yours Faithfully
For and on behalf of

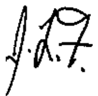
UBS AG LONDON BRANCH

By: 

By: 

Name: Christopher Dingle
Title: Director

Name: Jonathan McTernan
Title: Director



Acknowledged and agreed by Northwest Natural Gas Company as of the Trade Date specified above:

By:
Name: STEPHEN P. FELTZ
Title: TREASURER & CONTROLLER

By:
Name:
Title:

UBS AG London Branch, 1 Finsbury Avenue, London EC2M 2PP
UBS AG is a member of the London Stock Exchange and is authorised and regulated in the UK by the Financial Services Authority
Representatives of UBS Limited introduce trades to UBS AG via UBS Limited

Feltz, Stephen

From: Mau, Jacky (GMI - CAPMKTS) [Jacky_Mau@ml.com]
Sent: Monday, October 01, 2007 1:29 PM
To: Feltz, Stephen
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve - just a quick post. ISM retreated to the lowest level since March and 10y Treasuries are 3 bps lower on the day. The front-end of the curve also sold-off 4-5 bps. With a flatter curve, the drop on a forward-starting swap has decreased to ~9.25 bps for September 2008.

We'll keep you updated.

Regards,
Jacky

From: Feltz, Stephen [mailto:spf@nwnatural.com]
Sent: Friday, September 28, 2007 2:53 PM
To: Mau, Jacky (GMI - CAPMKTS)
Subject: Re: Hedging / Market Update

Thank you. I will follow up next week.

Sent from my BlackBerry Wireless Handheld

----- Original Message -----
From: Mau, Jacky (GMI - CAPMKTS) <Jacky_Mau@ml.com>
To: Feltz, Stephen
Cc: Schlopy, Karl (IBK-HOU) <karl_schlopy@ml.com>; Trachsel, Scott (GMIT - CAPMTS) <scott_trachsel@ml.com>; Ginfrida, Christine (GMI CAPMKTS) <Christine_Ginfrida@ml.com>
Sent: Thu Sep 27 13:06:44 2007
Subject: Hedging / Market Update

Steve,

Thought a quick update would be helpful given today was one of the heavier economic data days. Interest rates were pretty volatile -- selling-off 3-5 bps following GDP figures this morning, but have since rallied 5-7 bps following New Home Sales data.

Q2 GDP was reported at 3.8% -- lower than the preliminary read of 4.0%, but in-line with the consensus. Core PCE came in at 1.4%, slightly above the preliminary read of 1.3%. More importantly, New Home Sales tumbled 8.3% to an annual sales rate of just 795k units in August, from a downwardly revised 867k in July. This is the slowest sales rate since June 2000, and came in a month when median new home prices fell 8.3% M/M. The capitulation from builders on the pricing front did nothing to stimulate new home sales. Thus, it seems that prices will have to drop much further before we see any real pick-up in demand.

The 2s-10s curve is almost 2 bps flatter on the day and thus forward premiums have come down a bit. Below are updated 10y forward drops:

Aug. 31, 2008: 9 bps
Sept. 30, 2008: 11 bps
Oct. 31, 2008: 12 bps
Nov. 30, 2008: 14 bps

Spot 10y swap rate currently trading around 5.19%, over 15 bps lower than a week ago.

+ .10
5.29%

Regards,

Feltz, Stephen

From: robin.bauer@jpmorgan.com
Sent: Monday, October 01, 2007 1:58 PM
To: Feltz, Stephen
Cc: robert.bussa@jpmorgan.com; jennifer.m.saltarelli@jpmorgan.com
Subject: NWN Market Update

Hi Steve,

Amid mixed and conflicting data, uncertainty about the U.S. economic outlook remains high. Last week's report that August new home sales plunged 8.3%, to the lowest level since January 2000, suggests continued declines in building activity and home prices. Meanwhile, August real consumer spending rebounded sharply from a spring pause caused by higher gas prices. Since the start of the housing downturn, the quarterly growth rate of consumer spending has held steady at 3.0%, contradicting concerns about consumer retrenchment in the face of a decline in mortgage equity withdrawal and tighter mortgage credit. Tight labor markets and steady income growth have propelled spending.

This week's focus will be the Labor Department's September employment report, due on Friday. A month ago, the markets were stunned by the announcement that 4,000 net jobs were lost in August. Since then, jobless claims have moved lower and regional surveys suggest continued solid growth in manufacturing. Therefore, the consensus expects a sharp rebound in September payrolls, with 100,000 new jobs.

How will the Fed react to the disparate data trends? Last week, as credit markets continued to recover and liquidity in interbank money markets improved, various Fed officials suggested additional interest rate cuts are not a foregone conclusion. In fact, Philadelphia Fed President Charles Plosser warned the recent Fed rate cut risks accelerating inflation.
JPMorgan forecasts the Fed will need just one additional 25 bps rate cut, on October 30, to forestall a widening economic slowdown. Meanwhile, market rates have traded to reflect the expectation of at least two more Fed rate cuts (25 bps, each) by early 2008.

Below are up-to-date indications for the hedge strategies we have been discussing. You will see forward premia have compressed a bit as the curve has flattened from last week's extreme differential of 65 bps between 2Y and 10Y UST yields.

	T-Lock (THOR 10Y UST)	Swap Rate Lock (10Y Swap Rate)
Locked until	15-Sept-08	15-Sept-08
Spot	4.546%	5.182%
Fwd Premium	0.12	0.09
All-In Rate	4.666%	5.272%

Please let us know if we can provide anything further at this time.

Thanks + best regards,

Robin

Robin Bauer | Rate Risk Management | JPMorgan Chase Bank, N.A. | 21 S. Clark, 5th Floor | Chicago, IL 60670
' 312.732.5605 x 6 312.732.5645 x Mobile 312.485.5605 | + robin.bauer@jpmorgan.com

This communication is for informational purposes only. It is not intended as an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. All market prices, data and other information are not warranted as to completeness or accuracy and are subject to change without notice. Any comments or statements made herein do not necessarily reflect those of JPMorgan Chase &

Feltz, Stephen

From: edward.j.suvada@jpmorgan.com
Sent: Tuesday, October 02, 2007 7:31 AM
To: Peter.Madonia@jpmorgan.com; ANISHA.MEHRA@jpmorgan.com; Heather.Towner@jpmorgan.com; stephen.e.leamer@jpmorgan.com
Subject: JPMorgan Utility & Pipeline Weekly Update
Attachments: JPMorgan Utility & Pipeline update 09-28-07.pdf

Attached please find the JPMorgan Utility and Pipeline Weekly Update. Please let us know if you have any questions.

State of the markets

- While 3Q07 investment grade issuance was not as robust as 1H07, the slowdown in investment grade issuance was not as drastic as compared to other asset classes. Issuance for this quarter was only slightly lower than 3Q06 and 2007 year-to-date issuance remains on track to exceed 2006's record breaking totals
- New issuance volume totaled approximately $31 billion last week, with 4 utility and pipeline issuers pricing close to $2.5Bn of supply
  - **Exelon Generation** (A3/BBB+) announced $500mm 10yr unsecured notes with JPMorgan as Joint Bookrunner. The orderbook was multiple times oversubscribed, enabling the offering to be upsized to $700mm and priced at +165 bps, the tight end of +165-170 bps guidance
  - **PacifiCorp** (A3/A-) announced $500mm 30yr first mortgage bonds with JPMorgan as Joint Bookrunner. Strong demand allowed the offering to be upsized to $600mm and priced at +140 bps probably all-in cost in 6.20% range.
  - **Oneok Partners** (Baa2/BBB) priced $600mm 30yr unsecured bonds at +198 bps
  - **Enbridge Energy Partners** priced $400mm hybrid securities with a step-up after year 10. The notes included a 60 year final maturity, with the ability to extend to 70 years (one 10yr extension), and a 30 year scheduled maturity, with the ability to extend to 50 years (two 10yr extensions). The offering priced at +345 bps
  - *Utility and pipeline sector issuance surpassed $10Bn in September, making it the heaviest month in recent memory*
  - The FRN market is rebounding following the drop in issuance/demand for the product in 3Q07 - FRN supply comprised just 31% of overall supply in 3Q07, compared with 58% in 1H07
    - **American General Finance** (A1/A+) priced $750mm 2yr FRNs at L+35 bps with JPMorgan as Joint Bookrunner
    - High grade corporate bond spreads tightened slightly last week as trading volume picked up early in the week
      - Despite the recent re-pricing of credit spreads, BBB-rated credits have generally performed in-line with A-rated paper
      - While credit spreads appear posed to trend tighter, JPMorgan remains neutral on spreads over the near term given downside risks to the economy
      - CDS indices have outperformed cash bonds with the current differential standing at its widest level in three years
        - The underperformance in cash has been driven by large investment grade volumes and expectations of a heavy high yield calendar
        - A convergence between cash bonds and CDS is more likely to be the result of CDS widening than cash spreads tightening

Economic / Treasury market overview

- Last week's economic data provided a mixed outlook for the US economy with weaker consumer sentiment driven by the housing market
  - New home sales plunged 8.3% (-21.2%oya) in August, the lowest reading since June 2000, and existing home sales dropped 4.3% (-12.8%oya)
  - Up until August, the US consumer appears to have been doing surprisingly well, driven by solid income growth - consumer spending increased 0.6% in August and real

spending for the quarter–to-date is running at 3.4%, above the 2.8% forecast

- In contrast, looking at the most recent durable goods orders report (dropped 4.9% in August), the corporate sector has showed signs of retrenchment in August. These signs, coupled with the recent re-acceleration of energy prices, create downside risks for US consumer spending in coming months
- The JPMorgan forecast looks for slowing in real GDP growth from 3.0% growth in 3Q07 to an average of 1.75% over the next two quarters
  - This week the ISM data and Friday's employment report will help to provide a clearer understanding on the economic outlook
  - JPMorgan continues to forecast a 25bp Fed Funds rate cut in October and then expects the Fed to go on hold into 3Q08
  - Treasuries rallied last week with 5-, 10-, and 30-yr benchmark yields each falling 7 bps respectively

---

Ed Suvada
Debt Capital Markets
270 Park Avenue, Floor 8
New York, NY 10017
edward.j.suvada@jpmorgan.com
p: (212) 834-3311
f: (212) 834-6170

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Feltz, Stephen

From: Stefan.Clyne@ubs.com
Sent: Tuesday, October 02, 2007 10:11 AM
To: Feltz, Stephen
Cc: James.Gerhart@ubs.com; Ryan.Donovan@ubs.com
Subject: Fwd Starting Swap Quotes
Attachments: Legal Disclaimer

Steve,

This morning we've seen a rally in Treasuries as housing data continues its week trend - with August Pending Home Sales down 6.5% on the prior month. This was a continuation of the negative trend seen last month (-10.7%), and was the second lowest print in nearly 20 years.

The 10Y UST is hovering around the 4.50% area (currently 4.506%), and swap spreads are slightly tighter, with the 10Y Swap rate currently 5.13%.

Indicative Pre-hedge pricing:Forward Starting Swaps
Spot 10Y: 5.130%

1m: 5.137%
3m: 5.139%
6m: 5.155%
9m: 5.182%
12m: 5.215%

improving yields since last week

If you would like to discuss further, please let us know.

Regards

Stefan

Stefan Clyne
UBS AG
Fixed Income Derivatives
Tel. +1-203-719-8184
stefan.clyne@ubs.com

From: Gerhart, James+
Sent: Tuesday, October 02, 2007 12:48 PM
To: Clyne, Stefan+
Subject: FW: Fwd Starting Swap Quotes

with the 10Y at 450, can you shoot steve an update email?

From: Feltz, Stephen [mailto:spf@nwnatural.com]
Sent: Friday, September 28, 2007 1:11 PM
To: Clyne, Stefan+; Gerhart, James+
Cc: Donovan, Ryan+
Subject: Re: Fwd Starting Swap Quotes

Thanks for update. We will be following up early next week after qtr end.

Sent from my BlackBerry Wireless Handheld

----- Original Message -----
From: Stefan.Clyne@ubs.com <Stefan.Clyne@ubs.com>
To: Feltz, Stephen; James.Gerhart@ubs.com <James.Gerhart@ubs.com>
Cc: Ryan.Donovan@ubs.com <Ryan.Donovan@ubs.com>
Sent: Fri Sep 28 07:23:42 2007
Subject: RE: Fwd Starting Swap Quotes

Steve,

This morning rates have declined by 3bps in the 10Y UST (currently 4.533%), while swap spreads have tightened by nearly a basis point, resulting in a spot 10Y swap rate of 5.158%. Economic data this morning was mixed; PCE Core for August was 0.1% (in line with consensus and the previous month), Construction Spending was stronger than expected (0.2% compared with -0.3% consensus), and the U of Michigan Consensus was slightly below expectations at 83.4.

Indicative Pre-hedge pricing:Forward Starting Swaps
Spot 10Y: 5.155%

1m: 5.155%
3m: 5.161%
6m: 5.181%
9m: 5.210%
12m: 5.248%

Regards

Stefan
Stefan Clyne
UBS AG
Fixed Income Derivatives
Tel. +1-203-719-8184
stefan.clyne@ubs.com

From: Feltz, Stephen [mailto:spf@nwnatural.com]
Sent: Tuesday, September 11, 2007 2:14 PM
To: Gerhart, James+
Cc: Donovan, Ryan+; Clyne, Stefan+
Subject: RE: Fwd Starting Swap Quotes

Thank you.

From: James.Gerhart@ubs.com [mailto:James.Gerhart@ubs.com]
Sent: Tuesday, September 11, 2007 9:46 AM
To: James.Gerhart@ubs.com; Feltz, Stephen
Cc: Ryan.Donovan@ubs.com; Stefan.Clyne@ubs.com
Subject: RE: Fwd Starting Swap Quotes

Steve -

Please find below updated indicative pricing for a 10Y forward starting swap:

Spot 10Y: 4.990%

1m: 4.984%
3m: 4.975%
6m: 4.985%
9m: 5.011%
12m: 5.043%

The curve is flatter today so the forward premium has dropped.

James

From: Gerhart, James+
Sent: Friday, September 07, 2007 3:32 PM
To: Feltz, Stephen
Cc: Donovan, Ryan+; Clyne, Stefan+; Gerhart, James+
Subject: Fwd Starting Swap Quotes

Steve -

Please find below forward starting swap quotes for 10Y swaps from each respective forward date. I also put the spot 10Y swap rate for your reference. The yield curve is kinked in the front end which creates the somewhat counter-intuitive forward rate schedule.

Spot 10Y: 5.028%

1m: 5.027%
3m: 5.018%
6m: 5.038%
9m: 5.099%

As Ryan shared with you earlier, the best way to get a competitive quote is to get a couple banks on the phone at the same time and have them both bid their rate live. Lowest rate wins. These markets are fairly volatile as of late and with the slim margins banks have in their quotes, we are only able to hold a price for the few seconds after we give them. For this reason you want to have two phone lines open dealing with both counterparties in real time. You will get very sloppy execution if you try to get a quote from one bank, hang up and call another, then call back the first etc.

Ahead of that call its best to share with the banks a term sheet to be sure everyone is bidding on the same swap. Below would be a sample term sheet for a 6m forward starting swap:

Notional: $50 mm
Effective Date: March 11, 2008
Maturity Date: March 11, 2018
Fixed Rate Payer: Northwest Natural
Fixed Rate: [tbd], semi-annual, 30/360, unadjusted
Floating Rate Payer: Financial Institution
Floating Rate: 3M LIBOR, quarterly, ACT/360

I am happy to walk through any of the above in more detail if you would like -- just give me a call.

James Gerhart
Fixed Income Derivatives
UBS Investment Bank
(203) 719-8184
james.gerhart@ubs.com

Feltz, Stephen

From: Ginfrida, Christine (GMI CAPMKTS) [Christine_Ginfrida@ml.com]
Sent: Tuesday, October 02, 2007 10:52 AM
To: Feltz, Stephen
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Mau, Jacky (GMI - CAPMKTS)
Subject: RE: Hedging / Market Update

Steve,

Good afternoon. Today we are seeing a rally across the swap curve, with intermediate and long tenors 3-4 bps tighter on the day. The spot 10 year swap rate is around a 5.145%, which is the lowest rate we've seen since immediately following the Fed's rate cut on September 18th and is 23 bps lower than the highest rate during that same period.

The continued flattening in the curve continues to grind away at the forward drop. As of right now we see the following forward premia:

To August 31, 2008: 6.75 bps
To September 30, 2008: 9.0 bps
To October 31, 2008: 10.3 bps
To November 30, 2008: 11.5 bps

Please let Jacky or me know if you have any questions.

Regards,
Christine

From: Mau, Jacky (GMI - CAPMKTS)
Sent: Monday, October 01, 2007 4:29 PM
To: Steve Feltz (spf@nwnatural.com)
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve - just a quick post. ISM retreated to the lowest level since March and 10y Treasuries are 3 bps lower on the day. The front-end of the curve also sold-off 4-5 bps. With a flatter curve, the drop on a forward-starting swap has decreased to ~9.25 bps for September 2008.

We'll keep you updated.

Regards,
Jacky

From: Feltz, Stephen [mailto:spf@nwnatural.com]
Sent: Friday, September 28, 2007 2:53 PM
To: Mau, Jacky (GMI - CAPMKTS)
Subject: Re: Hedging / Market Update

Thank you. I will follow up next week.

Sent from my BlackBerry Wireless Handheld

----- Original Message -----
From: Mau, Jacky (GMI - CAPMKTS) <Jacky_Mau@ml.com>
To: Feltz, Stephen

Cc: Schlopy, Karl (IBK-HOU) <karl_schlopy@ml.com>; Trachsel, Scott (GMIT - CAPMTS) <scott_trachsel@ml.com>; Ginfrida, Christine (GMI CAPMKTS) <Christine_Ginfrida@ml.com>
Sent: Thu Sep 27 13:06:44 2007
Subject: Hedging / Market Update

Steve,

Thought a quick update would be helpful given today was one of the heavier economic data days. Interest rates were pretty volatile -- selling-off 3-5 bps following GDP figures this morning, but have since rallied 5-7 bps following New Home Sales data.

Q2 GDP was reported at 3.8% -- lower than the preliminary read of 4.0%, but in-line with the consensus. Core PCE came in at 1.4%, slightly above the preliminary read of 1.3%. More importantly, New Home Sales tumbled 8.3% to an annual sales rate of just 795k units in August, from a downwardly revised 867k in July. This is the slowest sales rate since June 2000, and came in a month when median new home prices fell 8.3% M/M. The capitulation from builders on the pricing front did nothing to stimulate new home sales. Thus, it seems that prices will have to drop much further before we see any real pick-up in demand.

The 2s-10s curve is almost 2 bps flatter on the day and thus forward premiums have come down a bit. Below are updated 10y forward drops:

Aug. 31, 2008: 9 bps
Sept. 30, 2008: 11 bps
Oct. 31, 2008: 12 bps
Nov. 30, 2008: 14 bps

Spot 10y swap rate currently trading around 5.19%, over 15 bps lower than a week ago.

Regards,
Jacky

Jacky Mau | Derivative Solutions | Merrill Lynch & Co. | Office: 212 449 7018 | Fax: 212 449 5057 | jacky_mau@ml.com

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Feltz, Stephen

From: Stefan.Clyne@ubs.com
Sent: Wednesday, October 03, 2007 11:40 AM
To: Stefan.Clyne@ubs.com; James.Gerhart@ubs.com
Subject: UBS Interest Rate Risk Management - October 2007
Attachments: UBS Interest Rate Risk Managment_Oct 2007.pdf; Legal Disclaimer

Please find attached our Interest Rate Risk Management Strategy analysis for October 2007.

This month we look back on the developments in the interest rate market following the cut in the Fed Funds rate by 50bps on September 18th. The Fed deemed a 50 bp cut necessary "to help forestall some of the adverse effects on the broader economy" from a "correction" in the housing market and a tightening of the credit conditions. As in late 2000, the Fed completely reversed its policy outlook in less than six weeks.

Now with the Fed decision a couple of weeks behind us, the market is presently torn by the twin threats of recession and inflation. In contrast to the beginning of past easing cycles, since the Fed meeting 10-year and 30-year US Treasuries are up 9 and 10 bps, respectively, while 2-year yields are nearly unchanged at cyclical lows. Many argue this steepening of the yield curve is evidence of a market concerned about growth in the short term and inflation in the long term.

For our trade idea, we revisit swapping fixed rate debt to floating - looking at historical data to determine the NPV benefits from swapping immediately following the beginning of a Fed easing cycle. We recommend a target level of 5.25% to receive fixed on 5+ year swaps in order capture the full benefit of the Fed easing cycle. At current LIBOR levels, these swaps will offer modest initial positive carry which will improve with each future cut by the Fed.

Please see attached for our full analysis.

Regards

James Gerhart & Stefan Clyne

<<UBS Interest Rate Risk Managment_Oct 2007.pdf>>

Stefan Clyne
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stefan.clyne@ubs.com

Global Fixed Income Derivatives

Interest Rate Risk Management Strategy October 2007

Over the past year we at UBS have held firmly to our conviction that the effects of a weakening housing market would ultimately spillover into the broader economy and force the Fed into an interest rate easing cycle. While the Fed's recent decision at the September 18th meeting to lower the Fed Funds rate by 50 bps is a partial validation of that forecast, it would be less than honest to assert we foresaw the exact events that led the Committee to its decision. Instead of lowering the Funds rate in response to the weakening of traditional economic barometers such as GDP or the unemployment rate, the Fed acted in September mostly to restore confidence and liquidity to a market that spent most of the warm summer months frozen in its tracks.

One thing, however, we can take credit for is our warning of how quickly the economic outlook can change. In the April update entitled "We might not ever see it coming (and neither will the Fed)" we made the argument that Fed policy in 2007 may end up looking very similar to late 2000. In November 2000, the Fed met and decided to leave the Funds rate unchanged at 6.00% and reiterated an inflation-fighting bias in its statement accompanying the rate decision. A month later, at the next scheduled meeting, the Committee shifted its balance of risks towards weaker growth, but again voted to leave the Funds rate unchanged. Only fifteen days later though, in the face of a quickly deteriorating economic outlook, the Fed eased 50 bps at an emergency meeting. This pattern is eerily similar to the Fed's actions beginning with the August 7, 2007 meeting when the Funds rate was left unchanged and the Committee stated its primary concern remained the risk that inflation would fail to moderate. This was followed by the September 18th meeting when the Fed deemed a 50 bp cut necessary "to help forestall some of the adverse effects on the broader economy" from a "correction" in the housing market and a tightening of the credit conditions. In both instances, the Fed completely reversed its policy outlook in less than six weeks.

Now with the Fed decision a couple of weeks behind us, the market is presently torn by the twin threats of recession and inflation. The combination of a pullback of liquidity and the housing downturn are certainly having a negative effect on economic growth, but will it be enough to bring the economy into recession? The last three times the Fed commenced a rate cut cycle, a recession followed two of them — 11 months later in 1990 and 2 months later in 2001. In 1996, however, a timely rate cut perhaps averted an economic contraction. Those less concerned with the prospects for growth point to skyrocketing commodity prices and a falling US Dollar to remind us that inflation should remain the primary focus of the Fed and the market.

The recent performance of the UST market underscores these risks. In contrast to the beginning of past easing cycles, since the Fed meeting 10-year and 30-year US Treasuries are up 9 and 10 bps, respectively, while 2-year yields are nearly unchanged at cyclical lows. Many argue this steepening of the yield curve is evidence of a market concerned about growth in the short term and inflation in the long term. As our strategist points out, 2-year UST yields "bask in the glow of the newly minted 4.75% Fed Funds rate, while the long end is left to flap in the hurricane left by a plunging dollar and soaring headline commodity prices."

In our view, rising commodity prices have been mostly the result of robust global demand and a continued housing driven slowdown in the US economy and potentially beyond will likely be a headwind for further price gains. Second, even if prices don't subside, the last couple years of falling inflation rates and rising commodity prices show that the pass through to consumer prices is not automatic. UBS forecasts the Fed will have the cover to ease at least another 50 bps in the coming year to bring the Fed Funds rate down to 4.25%. If the housing recession has a more severe impact, or lasts longer than currently anticipated, there is the potential for even more aggressive easing. As long as the dollar remains weak and commodity prices continue to make headlines, the inflation "story" is likely to persist in the market. We believe this presents the opportunity to receive fixed swap rates today that are likely to be in excess of Libor levels for years to come.

Trade Idea Revisited: Swap to Float

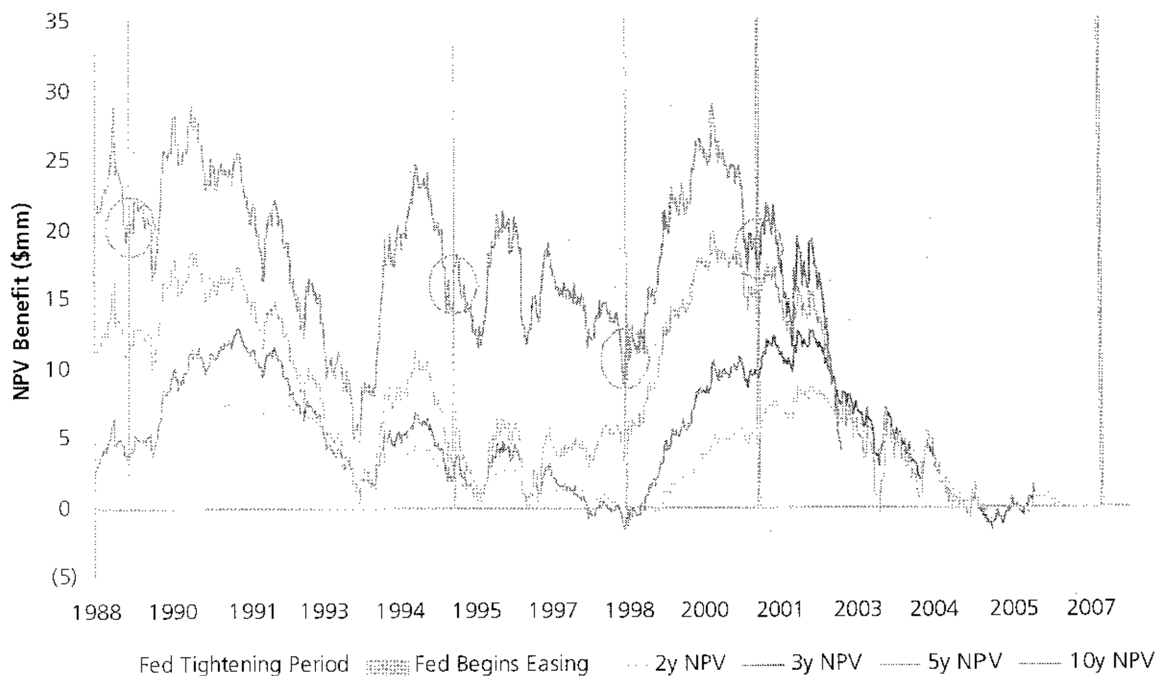
This month we revisit a topic that we have previously presented on a number of occasions: swapping fixed rate debt to floating. As was appropriate at the time, we recommended swapping from fixed-to-floating immediately following the end of the Fed tightening cycle – a strategy that historically maximized the NPV gains over the life of the swap.

With a 50bp rate cut behind us, we take another look at swapping fixed rate debt to floating to determine if, in a historic context, the market still presents an attractive environment to do so. As the graph below illustrates, the cyclical peak in NPV savings of swapping fixed rate debt occurs at / near the end of Fed tightening cycles. In most instances the NPV savings subsequently declined as long term rates fell with the market's anticipation of the beginning of an easing cycle. Once the Fed easing began, generally the decline in NPV savings continued but was interrupted by opportunities to capture the benefit of curve steepening (higher long term rates) within the context of declining short rates (Fed Funds / LIBOR). These periods of curve steepening were often the result of pre-mature market optimism ("just a couple cuts by the Fed and we'll be out of the woods") or overblown inflation fears. The current environment presents such an opportunity in that long term rates have actually risen since the Fed cut despite a market expectation of further Fed easing.

However, for shorter tenor swaps, the market has been fairly efficient in pricing ahead of time the full extent of the easing cycle (NPV savings at the start of the easing cycle are mostly near break-even). The historic benefit from swapping to float following the beginning of a Fed easing cycle is captured for longer tenor swaps (5+ years) which have tended historically to dramatically understate the magnitude of the Fed easing cycle.

We recommend a target level of 5.25% to receive fixed on 5+ year swaps in order capture the full benefit of the Fed easing cycle. At current LIBOR levels, these swaps will offer modest initial positive carry which will improve with each future cut by the Fed. Eventually this rate cut cycle will end, and the Fed will begin to hike rates again, but with a target 5.25% fixed rate, the recommended swap strategy will continue to accrue positive carry and decrease interest expense until Fed Funds / LIBOR reaches or exceeds the peak of the 2003 through 2006 tightening cycle.

NPV Benefit of Swapping $100mm from Fixed to Floating Rate



Source: UBS analysis, Bloomberg

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Global Disclaimer

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Feltz, Stephen

From: Mau, Jacky (GMI - CAPMKTS) [Jacky_Mau@ml.com]
Sent: Wednesday, October 03, 2007 3:02 PM
To: Feltz, Stephen
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve,

Rates sold-off 3-5 bps across the curve today for a few reasons. A consensus ADP number (58k vs. 60k survey) raised expectations that Friday's payroll will either fail to surprise, leading to a muted rate market response, or will be strong and result in a sell-off and more widespread sentiment that the economy is in OK shape. Today's slightly stronger-than-expected ISM (54.8 vs. 54.6 survey) supported this view and the idea that the economy will gradually shake off weakness. Finally, sentiment in equities and rates seems to have been somewhat dislocated over the past few days and there was a slight correction in both markets today.

The curve is flatter still and grinds away at the forward drop:
to 08/31/08: 6.75 bps
to 09/30/08: 8.6 bps
to 10/31/08: 9.4 bps
to 11/30/08: 11 bps

Barring any major surprises tomorrow, the market will be focused on Friday's payroll data.

Regards,
Jacky

From: Ginfrida, Christine (GMI CAPMKTS)
Sent: Tuesday, October 02, 2007 1:52 PM
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jacky_mau@ml.com

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Feltz, Stephen

From: James.Gerhart@ubs.com
Sent: Thursday, October 04, 2007 11:52 AM
To: Feltz, Stephen
Cc: Ryan.Donovan@ubs.com; Stefan.Clyne@ubs.com
Subject: RE: Fwd Starting Swap Quotes
Attachments: Legal Disclaimer

Steve -

We wanted to pass along a quick interest rate market update ahead of tomorrow's payroll report. 10Y yields are down 3 bps today in light volume as the market waits on the 8:30 am release tomorrow morning. With 10Y UST rates trading near 4.50%, a stronger than expected payroll report could spark a substantial sell-off in the bond market. The consensus estimate is for a +100k print but UBS economists are calling for +140k. While no one knows exactly where the number will come in, given the attractive overall level of rates at the moment, it may be worthwhile taking some risk off the table ahead of the release. Below are indicative 10Y forward starting swap quotes:

Spot 10Y: 5.149%

1m: 5.150%
3m: 5.151%
6m: 5.169%
9m: 5.193%
12m: 5.225%

Please be in touch if you would like to discuss further.

James

From: Feltz, Stephen [mailto:spf@nwnatural.com]
Sent: Friday, September 28, 2007 1:11 PM
To: Clyne, Stefan+; Gerhart, James+
Cc: Donovan, Ryan+
Subject: Re: Fwd Starting Swap Quotes

Thanks for update. We will be following up early next week after qtr end.

Sent from my BlackBerry Wireless Handheld

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To: Feltz, Stephen; James.Gerhart@ubs.com <James.Gerhart@ubs.com>
Cc: Ryan.Donovan@ubs.com <Ryan.Donovan@ubs.com>
Sent: Fri Sep 28 07:23:42 2007
Subject: RE: Fwd Starting Swap Quotes

Steve,

This morning rates have declined by 3bps in the 10Y UST (currently 4.533%), while swap spreads have tightened by nearly a basis point, resulting in a spot 10Y swap rate of 5.158%. Economic data this morning was mixed; PCE Core for August was 0.1% (in line with consensus and the previous month), Construction Spending was stronger than expected (0.2% compared with -0.3% consensus), and the U of Michigan Consensus was slightly below expectations at 83.4.

Indicative Pre-hedge pricing:Forward Starting Swaps
Spot 10Y: 5.155%

1m: 5.155%
3m: 5.161%
6m: 5.181%
9m: 5.210%
12m: 5.248%

Regards

Stefan
Stefan Clyne
UBS AG
Fixed Income Derivatives
Tel. +1-203-719-8184
stefan.clyne@ubs.com

From: Feltz, Stephen [mailto:spf@nwnatural.com]
Sent: Tuesday, September 11, 2007 2:14 PM
To: Gerhart, James+
Cc: Donovan, Ryan+; Clyne, Stefan+
Subject: RE: Fwd Starting Swap Quotes

Thank you.

From: James.Gerhart@ubs.com [mailto:James.Gerhart@ubs.com]
Sent: Tuesday, September 11, 2007 9:46 AM
To: James.Gerhart@ubs.com; Feltz, Stephen
Cc: Ryan.Donovan@ubs.com; Stefan.Clyne@ubs.com
Subject: RE: Fwd Starting Swap Quotes

Steve -

Please find below updated indicative pricing for a 10Y forward starting swap:

Spot 10Y: 4.990%

1m: 4.984%
3m: 4.975%
6m: 4.985%
9m: 5.011%
12m: 5.043%

The curve is flatter today so the forward premium has dropped.

James

From: Gerhart, James+
Sent: Friday, September 07, 2007 3:32 PM
To: Feltz, Stephen
Cc: Donovan, Ryan+; Clyne, Stefan+; Gerhart, James+
Subject: Fwd Starting Swap Quotes

Steve -

Please find below forward starting swap quotes for 10Y swaps from each respective forward date. I also put the spot 10Y swap rate for your

reference. The yield curve is kinked in the front end which creates the somewhat counter-intuitive forward rate schedule.

Spot 10Y: 5.028%

1m: 5.027%
3m: 5.018%
6m: 5.038%
9m: 5.099%

As Ryan shared with you earlier, the best way to get a competitive quote is to get a couple banks on the phone at the same time and have them both bid their rate live. Lowest rate wins. These markets are fairly volatile as of late and with the slim margins banks have in their quotes, we are only able to hold a price for the few seconds after we give them. For this reason you want to have two phone lines open dealing with both counterparties in real time. You will get very sloppy execution if you try to get a quote from one bank, hang up and call another, then call back the first etc.

Ahead of that call its best to share with the banks a term sheet to be sure everyone is bidding on the same swap. Below would be a sample term sheet for a 6m forward starting swap:

Notional: $50 mm
Effective Date: March 11, 2008
Maturity Date: March 11, 2018
Fixed Rate Payer: Northwest Natural
Fixed Rate: [tbd], semi-annual, 30/360, unadjusted
Floating Rate Payer: Financial Institution
Floating Rate: 3M LIBOR, quarterly, ACT/360

I am happy to walk through any of the above in more detail if you would like -- just give me a call.

James Gerhart
Fixed Income Derivatives
UBS Investment Bank
(203) 719-8184
james.gerhart@ubs.com

Feltz, Stephen

From: Mau, Jacky (GMI - CAPMKTS) [Jacky_Mau@ml.com]
Sent: Friday, October 05, 2007 8:29 AM
To: Feltz, Stephen
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve,

With the volatile trading we've seen in the market this morning, we thought it might be helpful to dive a bit into the details of today's economic releases - highlighted by the change in nonfarm payrolls.

Nonfarm payrolls came in line with consensus for September, although upward revisions to August made today's release on balance a stronger report. Payrolls increased by 110k in September, while August was revised upwards to 89k, from -4k reported the last month. This was tempered by news that the unemployment rate ticked up to 4.7% from 4.6%, now 0.3% higher than the cycle low hit last March.

Moreover, most of the job creation continues to be centered in government and other non cyclical portions of the economy. Government payrolls increased 37k in September and were up 57k in August (originally reported as -28k). Education and healthcare also increased 44k in September continuing a string of similar elevated reads that stretches back to 2004.

The economy exhibited a resilient jobs report in September, one that could possibly sideline the Fed on Oct. 31st, but the evidence remains that the y/y growth rate in jobs are generally decelerating. While this may push the Fed out of the picture at its next meeting, it certainly keeps them in play for meetings past that date. Near term volatility may subsist, but we see today's report as actually producing more long term uncertainty, as the Fed will continue to steer the economy through divergent economic data.

As the market continues to digest this morning's report, we also bring into focus next week's Fed minutes (to be released on Tuesday). The commentary may be especially important, and there were no dissenters for September's 50 bps rate cut. Since that cut, we have heard Fed Governors (Kohn & Poole) state that the Fed is not committed to ease, and will continue to watch the market's evolution. As it has in the past, the Fed's decisions will likely be led by its ability to successfully manage a "soft-economic landing," with moderating core inflation and private sector job growth.

Three hours after this morning's releases, the market is trading 9-11 bps higher, with the 10y UST retreating to a 4.63% level. Fed easing expectations have also been pushed out, with the market now pricing only a 50% probability that the Fed eases by 25 bps at its October meeting, down from last night's 70% implied levels.

Regards,
Jacky

From: Mau, Jacky (GMI - CAPMKTS)
Sent: Wednesday, October 03, 2007 6:02 PM
To: 'Steve Feltz (spf@nwnatural.com)'
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve,

Rates sold-off 3-5 bps across the curve today for a few reasons. A consensus ADP number (58k vs. 60k survey) raised expectations that Friday's payroll will either fail to surprise, leading to a muted rate market response, or will be strong and result in a sell-off and more widespread sentiment that the economy is in OK shape. Today's slightly stronger-than-expected ISM (54.8 vs. 54.6 survey) supported this view and the idea that the economy will gradually shake off weakness. Finally, sentiment in equities and rates seems to have been somewhat dislocated over the past few days and there was a slight correction in both markets today.

The curve is flatter still and grinds away at the forward drop:

to 08/31/08: 6.75 bps
to 09/30/08: 8.6 bps
to 10/31/08: 9.4 bps
to 11/30/08: 11 bps

Barring any major surprises tomorrow, the market will be focused on Friday's payroll data.

Regards,
Jacky

From: Ginfrida, Christine (GMI CAPMKTS)
Sent: Tuesday, October 02, 2007 1:52 PM
To: 'Steve Feltz (spf@nwnatural.com)'
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Mau, Jacky (GMI - CAPMKTS)
Subject: RE: Hedging / Market Update

Steve,

Good afternoon. Today we are seeing a rally across the swap curve, with intermediate and long tenors 3-4 bps tighter on the day. The spot 10 year swap rate is around a 5.145%, which is the lowest rate we've seen since immediately following the Fed's rate cut on September 18th and is 23 bps lower than the highest rate during that same period.

The continued flattening in the curve continues to grind away at the forward drop. As of right now we see the following forward premia:

To August 31, 2008: 6.75 bps
To September 30, 2008: 9.0 bps
To October 31, 2008: 10.3 bps
To November 30, 2008: 11.5 bps

Please let Jacky or me know if you have any questions.

Regards,
Christine

From: Mau, Jacky (GMI - CAPMKTS)
Sent: Monday, October 01, 2007 4:29 PM
To: Steve Feltz (spf@nwnatural.com)
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve - just a quick post. ISM retreated to the lowest level since March and 10y Treasuries are 3 bps lower on the day. The front-end of the curve also sold-off 4-5 bps. With a flatter curve, the drop on a forward-starting swap has decreased to ~9.25 bps for September 2008.

We'll keep you updated.

Regards,
Jacky

From: Feltz, Stephen [mailto:spf@nwnatural.com]
Sent: Friday, September 28, 2007 2:53 PM
To: Mau, Jacky (GMI - CAPMKTS)
Subject: Re: Hedging / Market Update

Thank you. I will follow up next week.

Sent from my BlackBerry Wireless Handheld

----- Original Message -----
From: Mau, Jacky (GMI - CAPMKTS) <Jacky_Mau@ml.com>
To: Feltz, Stephen
Cc: Schlopy, Karl (IBK-HOU) <karl_schlopy@ml.com>; Trachsel, Scott (GMIT - CAPMTS) <scott_trachsel@ml.com>; Ginfrida, Christine (GMI CAPMKTS) <Christine_Ginfrida@ml.com>
Sent: Thu Sep 27 13:06:44 2007
Subject: Hedging / Market Update

Steve,

Thought a quick update would be helpful given today was one of the heavier economic data days. Interest rates were pretty volatile -- selling-off 3-5 bps following GDP figures this morning, but have since rallied 5-7 bps following New Home Sales data.

Q2 GDP was reported at 3.8% -- lower than the preliminary read of 4.0%, but in-line with the consensus. Core PCE came in at 1.4%, slightly above the preliminary read of 1.3%. More importantly, New Home Sales tumbled 8.3% to an annual sales rate of just 795k units in August, from a downwardly revised 867k in July. This is the slowest sales rate since June 2000, and came in a month when median new home prices fell 8.3% M/M. The capitulation from builders on the pricing front did nothing to stimulate new home sales. Thus, it seems that prices will have to drop much further before we see any real pick-up in demand.

The 2s-10s curve is almost 2 bps flatter on the day and thus forward premiums have come down a bit. Below are updated 10y forward drops:

Aug. 31, 2008: 9 bps
Sept. 30, 2008: 11 bps
Oct. 31, 2008: 12 bps
Nov. 30, 2008: 14 bps

Spot 10y swap rate currently trading around 5.19%, over 15 bps lower than a week ago.

Regards,
Jacky

Jacky Mau | Derivative Solutions | Merrill Lynch & Co. | Office: 212 449 7018 | Fax: 212 449 5057 | jacky_mau@ml.com

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Feltz, Stephen

From: robin.bauer@jpmorgan.com
Sent: Friday, October 05, 2007 10:11 AM
To: Feltz, Stephen
Cc: robert.bussa@jpmorgan.com; jennifer.m.saltarelli@jpmorgan.com
Subject: NWN Market Update

Hi Steve,

The monthly employment report surprised markets again today, this time with significant upward revisions to August's disappointing results. While September job growth printed modestly above expectations (+110k actual versus +100k anticipated), August figures were revised much higher (+89k revised versus -4k original). Errant reporting of government positions was the largest contributor to the change, as the difference between the original and revised numbers in that sector alone totaled +85k.

Today's net upward revision to job growth reverses the troubling anomaly in last month's data and removes fears of spreading economic weakness.
Despite continued declines in construction and some manufacturing jobs, employment in service industries remains healthy. Overall, labor income is solid and supportive of consumer spending. Since the start of the housing downturn, quarterly growth in real consumer spending has held steady at 3.0%, contradicting concerns about consumer retrenchment in the face of declining mortgage equity withdrawal and tighter credit.

Today's data re-framed the debate about the extent of potential Fed rate cuts. The Fed's Sept 18th 50 basis point rate cut came just 11 days after the bleak August jobs report. Since then, credit markets have begun to revive and liquidity in money markets has improved. Notably, the September FOMC announcement omitted an explicit easing bias and reiterated inflation concerns. After today's news, market focus has shifted from debating the magnitude of an October 31st Fed rate cut to discussing whether the FOMC will be compelled to ease at all.

In general, rates are higher by 10 basis points across the curve today with the short end leading the way. Today's session will be abbreviated given the early market close ahead of Monday's Columbus Day holiday. Looking ahead, market participants will scrutinize September's FOMC minutes (due next Tuesday) to further refine their outlook for future policy.

Detailed market changes since last month's payroll report are as follows:

	9/7/07	Current
2Y UST	3.90%	4.07%
3Y UST	3.92%	4.10%
5Y UST	4.04%	4.31%
10Y UST	4.38%	4.61%

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Below are up-to-date indications for the hedge strategies we have been discussing.

	T-Lock (THOR 10Y UST)	Swap Rate Lock (10Y Swap Rate)
Locked until	15-Sept-08	15-Sept-08
Spot	4.64%	5.275%
Fwd Premium	0.115	0.086
All-In Rate	4.755%	5.361%

Please let us know if we can provide anything further at this time.

Thanks + have a great weekend!

Robin

Robin Bauer | Rate Risk Management | JPMorgan Chase Bank, N.A. | 21 S. Clark, 5th Floor | Chicago, IL 60670
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Feltz, Stephen

From: ryan.donovan@ubs.com
Sent: Friday, October 05, 2007 8:53 AM
To: undisclosed-recipients
Subject: UBS - End of Week Credit Market Update
Attachments: Legal Disclaimer

Post-payrolls and heading into a three-day weekend, the credit markets continue to rally. Here is a brief update:

Credit Market Recap
Over the past few weeks, credit markets have improved significantly, with corporate spreads tightening in from their wides, new deals tightening post-pricing and new issue premiums fading. At the same time, UST yields remain low, with 10-years oscillating between 4.50%-4.70% (currently 4.64%).

UBS' corporate strategists believe we may be in the midst of a "V-shaped" recovery that has caught all the bears by surprise. In less than two months, we have transitioned from headlines like "credit crunch" and "liquidity crisis" to "Dow 14,000". Market participants that were thought to be cash-strapped are now suddenly flushed with capital waiting to be deployed. Investors' willingness to look beyond the negative headlines (e.g. substantial bank write-offs, large drops in home sales) has sent stocks higher and credit spreads tighter. Today's employment number was close enough to consensus to give the market confidence to hold its recent gains and potentially rally further from here.

At the same time, the new issue market is healthy, with deals this week across the credit spectrum and also including a few hybrid issues, which indicate investor confidence is increasing. For example, this week Schwab issued $300 million of a 60 NC10 hybrid (rated A3/BBB, UBS joint bookrunner and sole structuring advisor). Pre-FOMC, there simply was no investor interest in hybrids. This week, we were able to attract significant reverse inquiry and get the transaction executed.

Outlook
We remain optimistic on the credit markets for the foreseeable future. In our view, the combination of tighter secondary spreads, fading new issue premiums and relatively low US Treasury yields is delivering attractive funding opportunities for borrowers. The new issue calendar will slow next week given earnings blackouts but pick up in the latter part of October and into November.

Ryan Donovan
UBS - Debt Capital Markets
Office: (203) 719-8495
ryan.donovan@ubs.com

Feltz, Stephen

From: Mau, Jacky (GMI - CAPMKTS) [Jacky_Mau@ml.com]
Sent: Tuesday, October 09, 2007 3:18 PM
To: Glickman, Greg (GMI - CAPMKTS); Ginfrida, Christine (GMI CAPMKTS)
Cc: Sconzo, Jack (CAPMKTS); Trachsel, Scott (GMIT - CAPMTS); Timmeny, Sean (GMI NY - DCM)
Subject: FOMC Minutes -- More Relaxed on Inflation, Some Data Dependence

Good Afternoon,

With release of the September 18 FOMC Meeting Minutes, Merrill Lynch economists believe the door is wide open to further rate cuts:

- The Fed cut rates by 50 bps to offset "some" of the negative impact of tighter financial conditions on the economy
- Staffers "marked down the fourth quarter forecast, reflecting a judgment that the recent financial turbulence would impose restraint on economic activity in coming months, particularly in the housing sector," and "the staff also trimmed its forecast of real GDP growth in 2008 and anticipated a modest increase in unemployment"
- Fed officials doubted that the employment picture was as weak as the original -4k print for August payrolls suggested, but they still unanimously voted for a 50 bps rate cut and saw much more downside risk for the economy going forward
- They noted that consumer spending had so far remained sturdy, but were worried that tighter lending standards for mortgages, the negative housing wealth effect, and a modest rise in unemployment would restrain consumer spending in 2008
- Inflation expectations remain well contained, although some Fed officials were still worried about underlying inflation pressures

Since the September meeting though, recent stronger economic releases may have caused the Fed to revise their view -- does the upwardly revised August payroll preclude the Fed from cutting rates again at the end of this month? According to the Fed Funds futures, the market has marked down the probability of a 25 bps ease from near certainty in mid-September to 36% currently.

We've included the complete text of the Minutes below.

Let us know if you have any questions.
Regards,
Jacky

Jacky Mau | Derivative Solutions | Merrill Lynch & Co. | Office: 212 449 7018 | Fax: 212 449 5057 | jacky_mau@ml.com

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Minutes of the Federal Open Market Committee
September 18, 2007
A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, September 18, 2007 at 8:30 a.m.

Present:
Mr. Bernanke, Chairman
Mr. Geithner, Vice Chairman
Mr. Evans
Mr. Hoenig
Mr. Kohn
Mr. Kroszner

Mr. Mishkin
Mr. Poole
Mr. Rosengren
Mr. Warsh

Mr. Fisher, Ms. Pianalto, and Messrs. Plosser and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Lacker and Lockhart, and Ms. Yellen, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Mr. Madigan, Secretary and Economist
Ms. Danker, Deputy Secretary
Ms. Smith, Assistant Secretary
Mr. Skidmore, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter, Deputy General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Messrs. Clouse, Connors, Fuhrer, Kamin, Rasche, Slifman, and Wilcox, Associate Economists

Mr. Dudley, Manager, System Open Market Account

Ms. J. Johnson, 1 Secretary, Office of the Secretary, Board of Governors

Mr. Frierson, 1 Deputy Secretary, Office of the Secretary, Board of Governors

Ms. Bailey 1 and Mr. Roberts, 1 Deputy Directors, Division of Banking Supervision and Regulation, Board of Governors

Mr. English, Senior Associate Director, Division of Monetary Affairs, Board of Governors

Ms. Liang and Mr. Reifschneider, Associate Directors, Division of Research and Statistics, Board of Governors

Mr. Wright, Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Mr. G. Evans, 1 Assistant Director, Division of Reserve Bank Operations and Payment Systems, Board of Governors

Mr. Blanchard, Assistant to the Board, Office of Board Members, Board of Governors

Mr. Oliner, Senior Adviser, Division of Research and Statistics, Board of Governors

Mr. Meyer, Visiting Reserve Bank Officer, Division of Monetary Affairs, Board of Governors

Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors

Mr. Natalucci, Senior Economist, Division of Monetary Affairs, Board of Governors

Mr. Luecke, Senior Financial Analyst, Division of Monetary Affairs, Board of Governors

Ms. Beattie, 1 Assistant to the Secretary, Office of the Secretary, Board of Governors

Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors

Ms. Holcomb, First Vice President, Federal Reserve Bank of Dallas

Messrs. Judd, Rosenblum, and Sniderman, Executive Vice Presidents, Federal Reserve Banks of San Francisco, Dallas, and Cleveland, respectively

Messrs. Dzina and Hakkio, Mses. Krieger 1 and Mester, and Messrs. Rolnick and Weinberg, Senior Vice Presidents, Federal Reserve Banks of New York, Kansas City, New York, Philadelphia, Minneapolis, and Richmond, respectively

Messrs. Krane, Peach, and Robertson, Vice Presidents, Federal Reserve Banks of Chicago, New York, and Atlanta, respectively

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1. Attended portion of the meeting relating to the discussion of approaches to stabilizing money markets. Return to text

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In the agenda for this meeting, it was reported that advices of the election of Charles L. Evans as a member of the Federal Open Market Committee had been received and that he had executed his oath of office.

By unanimous vote, the Federal Open Market Committee selected James A. Clouse and Daniel G. Sullivan to serve as Associate Economists until the selection of their successors at the first regularly scheduled meeting of the Committee in 2008.

The Manager of the System Open Market Account (SOMA) reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting. The Manager also reported on developments in domestic financial markets and on System open market operations in government securities and federal agency obligations during the period since the previous meeting. By unanimous vote, the Committee ratified these transactions.

The information reviewed at the September meeting suggested that economic activity advanced at a moderate rate early in the third quarter. After expanding at a robust pace in July, retail sales rose at a somewhat slower rate in August. Orders and shipments of capital goods posted solid gains in July. However, residential investment weakened further, even before the recent disruptions in mortgage markets. In addition, private payrolls posted only a small gain in August, and manufacturing production decreased after gains in the previous two months. Meanwhile, core inflation rose a bit from the low rates observed in the spring but remained moderate through July.

Private nonfarm payroll employment rose only modestly in August, and the levels of employment in June and July were revised down. The weakness in employment was spread fairly widely across industries. Residential construction and manufacturing posted noticeable declines in jobs, employment in wholesale trade and transportation was little changed, and hiring at business services was well below recent trends. Both the average workweek and aggregate hours were unchanged in August. The unemployment rate held steady at 4.6 percent, 0.1 percentage point above its second-quarter level and equal to its 2006 average.

After posting solid gains in June and July, total industrial production edged up only a bit in August. This increase was attributable to a surge in electricity generation, as temperatures swung from mild in July to very warm in August. After large gains in the preceding two months, manufacturing output declined in August, held down by a decrease in the production of motor vehicles and parts. High-tech output rose only modestly in August, but production gains in June and July were revised up considerably.

Consumer spending appeared to have strengthened early in the summer from its subdued second-quarter pace. Although auto sales were weak in July, real outlays for other goods rose briskly. At the same time, spending on services was up moderately despite a drop in outlays for energy associated with relatively cool weather in the eastern part of the United States. In August, consumption appeared to have posted another solid gain. Although nominal retail sales outside the motor vehicle sector were about flat (abstracting from a drop in nominal sales at gasoline stations associated with falling gas prices), vehicle sales stepped up and warmer weather likely caused an increase in energy usage. Real disposable income rose further in July, as wages and salaries posted a strong gain and energy prices came down. However, household wealth likely was providing a diminishing impetus to the pace of spending, reflecting recent declines in stock market wealth and an apparent further deceleration in house prices. Readings on consumer sentiment turned down in August after having risen in July, and the Reuters/Michigan index remained near its relatively low August level in early September.

The housing sector remained exceptionally weak. Home sales had dropped considerably this year: Sales of new and existing single-family homes in July were down substantially from their averages over the second half of last year. Demand was restrained

by deteriorating conditions in the subprime mortgage market and by an increase in rates for thirty-year fixed-rate conforming mortgages. In the nonconforming mortgage market, the availability of financing to borrowers recently appeared to have been crimped even further. Most forward-looking indicators of housing demand, including an index of pending home sales, pointed to a further deterioration in sales in the near term. Single-family starts slid in July to their lowest reading since 1996, and adjusted permit issuance continued on a downward trajectory. Although single-family housing starts had come down substantially from their peak, the drop had lagged the decline in demand, and as a result, inventories of new homes had risen considerably. In the multifamily sector, starts in July were in line with readings thus far this year and at the low end of the fairly narrow range seen since 1997. Meanwhile, house prices generally continued to decelerate.

Orders and shipments of capital goods posted a strong gain early in the third quarter. In particular, orders and shipments of equipment outside the high-tech and transportation sector registered a robust increase in July, and data on computer production and shipments of high-tech goods pointed to solid increases in business demand for high-tech. In contrast, indicators of spending for transportation equipment were mixed. Aircraft shipments in July and public information on Boeing's deliveries suggested that domestic spending on aircraft was retreating somewhat in the current quarter. While fleet sales of light vehicles appeared to have moved up in July and August, sales of medium and heavy trucks remained below the second-quarter average. More generally, surveys of business conditions suggested that increases in business activity were somewhat slower in August than in the second quarter.

Book-value data for the manufacturing and trade sectors excluding motor vehicles and parts suggested that inventory accumulation stepped down noticeably in July from the second-quarter pace. Inventories of light motor vehicles rose again in July and August. The number of manufacturing purchasing managers who viewed their customers' inventory levels as too low in August slightly exceeded the number who saw them as too high.

The U.S. international trade deficit narrowed slightly in July, as exports increased more than imports. Sharp increases in exports of both aircraft and automobiles contributed importantly to the overall gain. Exports of agricultural products and consumer goods were also strong. In contrast, exports of industrial supplies and semiconductors exhibited declines. The value of imported goods and services was boosted by a large increase in imports of automotive products. Higher imports of capital goods excluding aircraft, computers, and semiconductors and of oil also contributed to the overall gain in imports.

Economic growth slowed in the second quarter in most advanced foreign economies, except the United Kingdom. The step-down was most pronounced in Japan, where GDP contracted, but was also substantial in the euro area, where total domestic demand rose only slightly. Although growth remained robust in Canada, data late in the quarter, including retail sales, indicated a more significant weakening in activity. This softness appeared to have continued into the third quarter in some economies. In July, indicators for Europe generally moderated, on balance, from their second-quarter levels; those for Canada and Japan, however, slowed more notably. Most of the readings available on economic developments after August 9, when financial turmoil intensified, were measures of confidence. They dropped, on average, but otherwise were consistent with the indicators reported for July.

Data through July suggested that economic activity in emerging-market countries remained robust. Output in the Asian economies soared in the second quarter, and several countries posted growth at or near double-digit rates. In Latin America, output in Mexico and Venezuela rebounded sharply from earlier weakness. Indicators for China in July pointed to only a modest slowing of output growth from its torrid pace in the first half of the year. The scant data for August received thus far provided little indication that the turmoil in financial markets had a significant negative impact on real economic activity in emerging-market economies.

After rapid price increases earlier this year, U.S. headline consumer price inflation was moderate in both June and July. Although food prices continued their string of sizable increases, energy prices fell in June and July and gasoline prices appear to have dropped further in August. Core PCE prices rose 0.2 percent in June and 0.1 percent in July. On a twelve-month-change basis, core PCE inflation in July was below the comparable rate twelve months earlier. Step-downs in price inflation for prescription drugs, motor vehicles, and nonmarket services accounted for nearly all of the deceleration in core PCE prices. Although owners' equivalent rent decelerated over the past year, this change was largely offset by an acceleration in tenants' rent and lodging away from home. Household surveys indicated that the median expectation for year-ahead inflation declined in August and edged down further in early September to a level only slightly above the reading at the turn of the year; the median expectation of longer-term inflation in early September remained in the range seen over the past couple of years. The producer price index for core intermediate materials rose only modestly in July. Compensation per hour decelerated in the second quarter. Nonetheless, the increase over the four quarters ending in the second quarter was noticeably above the increase in the preceding four quarters and well above the rise in the employment cost index over the same period.

At its August meeting, the FOMC decided to maintain its target for the federal funds rate at 5-1/4 percent. In the statement, the Committee acknowledged that financial markets had been volatile in recent weeks, credit conditions had become tighter for some households and businesses, and the housing correction was ongoing. The Committee reiterated its view that the economy seemed likely to continue to expand at a moderate pace over coming quarters, supported by solid growth in employment and incomes and a robust global economy. Readings on core inflation had improved modestly in recent months. However, a sustained moderation in inflation pressures had yet to be convincingly demonstrated. Moreover, the high level of resource utilization had the potential to sustain these pressures. Although the downside risks to growth had increased somewhat, the Committee repeated

that its predominant policy concern remained the risk that inflation would fail to moderate as expected. Future policy adjustments would depend on the outlook for both inflation and economic growth, as implied by incoming information. The FOMC's policy decision and the accompanying statement were about in line with market expectations, and reactions in financial markets were muted.

In the days after the August FOMC meeting, financial market participants appeared to become more concerned about liquidity and counterparty credit risk. Unsecured bank funding markets showed signs of stress, including volatility in overnight lending rates, elevated term rates, and illiquidity in term funding markets. On August 10, the Federal Reserve issued a statement announcing that it was providing liquidity to facilitate the orderly functioning of financial markets. The Federal Reserve indicated that it would provide reserves as necessary through open market operations to promote trading in the federal funds market at rates close to the target rate of 5-1/4 percent. The Federal Reserve also noted that the discount window was available as a source of funding.

On August 17, the FOMC issued a statement noting that financial market conditions had deteriorated and that tighter credit conditions and increased uncertainty had the potential to restrain economic growth going forward. The FOMC judged that the downside risks to growth had increased appreciably, indicated that it was monitoring the situation, and stated that it was prepared to act as needed to mitigate the adverse effects on the economy arising from the disruptions in financial markets. Simultaneously, the Federal Reserve Board announced that, to promote the restoration of orderly conditions in financial markets, it had approved a 50 basis point reduction in the primary credit rate to 5-3/4 percent. The Board also announced a change to the Reserve Banks' usual practices to allow the provision of term financing for as long as thirty days, renewable by the borrower. In addition, the Board noted that the Federal Reserve would continue to accept a broad range of collateral for discount window loans, including home mortgages and related assets, while maintaining existing collateral margins. On August 21, the Federal Reserve Bank of New York announced some temporary changes to the terms and conditions of the SOMA securities lending program, including a reduction in the minimum fee. The effective federal funds rate was somewhat below the target rate for a time over the intermeeting period, as efforts to keep the funds rate near the target were hampered by technical factors and financial market volatility. In the days leading up to the FOMC meeting, however, the funds rate traded closer to the target.

Short-term financial markets came under pressure over the intermeeting period amid heightened investor unease about exposures to subprime mortgages and to structured credit products more generally. Rates on asset-backed commercial paper and on low-rated unsecured commercial paper soared, and some issuers, particularly asset-backed commercial paper programs with investments in subprime mortgages, found it difficult to roll over maturing paper. These developments led several programs to draw on backup lines, exercise options to extend the maturity of outstanding paper, or even default. As a result, asset-backed commercial paper outstanding contracted substantially. Investors sought the safety and liquidity of Treasury securities, and yields on Treasury bills dropped sharply for a period; trading conditions in the bill market were impaired at times. Meanwhile, banks took measures to conserve their liquidity and were cautious about counterparties' exposures to asset-backed commercial paper. Term interbank funding markets were significantly impaired, with rates rising well above expected future overnight rates and traders reporting a substantial drop in the availability of term funding. Pressures eased a bit in mid-September, but short-term financial markets remained strained.

Conditions in corporate credit markets were mixed. Investment- and speculative-grade corporate bond spreads edged up; they were near their highest levels in four years, although they remained far below the peaks seen in mid-2002. Investment-grade bond issuance was strong in August as yields declined, but issuance of speculative-grade bonds was scant. Speculative-grade bond deals and leveraged loans slated to finance leveraged buyouts continued to be delayed or restructured. Bank lending to businesses surged in August, apparently because some banks funded leveraged loans that they had intended to syndicate to institutional investors and perhaps because some firms substituted bank credit for commercial paper. Although markets for nonconforming mortgages were impaired over the intermeeting period, the supply of conforming mortgages seemed to have been largely unaffected by recent developments. Broad stock price indexes were volatile but about unchanged, on net, over the intermeeting period. The foreign exchange value of the dollar against other major currencies fell, on balance.

Investors appeared to mark down significantly their expected path for the federal funds rate during the intermeeting period, evidently in response to the strains in money and credit markets and a few key data releases, including weaker-than-expected reports on housing activity and employment. Yields on nominal Treasury securities fell appreciably across the term structure. TIPS-based inflation compensation at the five-year horizon was about unchanged, while inflation compensation at longer horizons crept higher.

Growth of nonfinancial domestic debt was estimated to have slowed a little in the third quarter from the average pace in the first half of the year. The deceleration in total nonfinancial debt reflected a projected slowdown in borrowing across all major sectors of the economy excluding the federal government. Although it decelerated in the third quarter, business-sector debt continued to advance at a solid pace, boosted by a surge in business loans. In the household sector, mortgage borrowing was estimated to have slowed notably, as mortgage interest rates moved up, nonconforming mortgages became harder to obtain, and as home sales slowed and house prices decelerated. M2 increased at a brisk pace in August. The rise was led by a surge in liquid deposits and in retail money funds as investors adjusted their portfolios in response to the turmoil in financial markets.

In preparation for this meeting, the staff continued to estimate that real GDP increased at a moderate rate in the third quarter.

However, the staff marked down the fourth-quarter forecast, reflecting a judgment that the recent financial turbulence would impose restraint on economic activity in coming months, particularly in the housing sector. The staff also trimmed its forecast of real GDP growth in 2008 and anticipated a modest increase in unemployment. Softer demand for homes amid a reduction in the availability of mortgage credit would likely curtail construction activity through the middle of next year. Moreover, lower housing wealth, slower gains in employment and income, and reduced confidence seemed likely to restrain consumer spending in 2008. Despite the recent difficulties in some corporate credit markets, financial conditions confronting most nonfinancial businesses did not appear to have tightened appreciably to date. But going forward, the staff anticipated that businesses would scale back their capital spending a touch in response to financing conditions that were likely to become a little less accommodative and to more modest gains in sales. With credit markets expected to largely recover over coming quarters, growth of real GDP was projected to firm in 2009 to a pace a bit above the rate of growth of its potential. Incoming data on consumer price inflation that were slightly to the low side of the previous forecast, in combination with the easing of pressures on resource utilization in the current forecast, led the staff to trim slightly its forecast for core PCE inflation. Headline PCE inflation, which was boosted by sizable increases in energy and food prices earlier in the year, was expected to slow in 2008 and 2009.

In their discussion of the economic situation and outlook, meeting participants focused on the potential for recent credit market developments to restrain aggregate demand in coming quarters. The disruptions to the market for nonconforming mortgages were likely to reduce further the demand for housing, and recent financial developments could well lead to a more general tightening of credit availability. Moreover, some recent data and anecdotal information pointed to a possible nascent slowdown in the pace of expansion. Given the unusual nature of the current financial shock, participants regarded the outlook for economic activity as characterized by particularly high uncertainty, with the risks to growth skewed to the downside. Some participants cited concerns that a weaker economy could lead to a further tightening of financial conditions, which in turn could reinforce the economic slowdown. But participants also noted that the resilience of the economy in the face of a number of previous periods of financial market disruptions left open the possibility that the macroeconomic effects of the financial market turbulence would prove limited.

Although financial markets were expected to stabilize over time, participants judged that credit markets were likely to restrain economic growth in the period ahead. Given existing commitments to customers and the increased resistance of investors to purchasing some securitized products, banks might need to take a large volume of assets onto their balance sheets over coming weeks, including leveraged loans, asset-backed commercial paper, and some types of mortgages. Banks' concerns about the implications of rapid growth in their balance sheets for their capital ratios and for their liquidity, as well as the recent deterioration in various term funding markets, might well lead banks to tighten the availability of credit to households and firms. Tighter credit conditions were likely to weigh particularly on residential investment and to a lesser extent on other components of aggregate demand in coming quarters. Meeting participants also noted that financial market conditions, while seeming to have improved somewhat in the most recent days, were still fragile and that further adverse credit market developments could well increase the downside risks to the economy. Even after market volatility subsided and the recent strains eased, risk spreads probably would be wider and credit terms tighter than they had been a few months ago. Although these developments would likely be consistent with longer-term financial stability, they were likely to exert some restraint on aggregate demand.

In their discussion of individual sectors of the economy, participants noted that recent data suggested greater weakness in the housing market than had previously been expected. Furthermore, recent financial developments had the potential to deepen further and prolong the downturn in the housing market, as subprime mortgages remained essentially unavailable, little activity was evident in the markets for other nonprime mortgages, and prime jumbo mortgage borrowers faced higher rates and tighter lending standards. The faster pace of foreclosures as subprime mortgage rates reset was also seen as posing a downside risk to the housing market. Nonetheless, participants observed that conforming mortgages remained readily available to creditworthy borrowers and that rates on these mortgages had declined in recent weeks. Moreover, conditions in the jumbo mortgage market were expected to improve gradually over time.

Although employment probably was not as weak as the most recent monthly data had suggested, trend growth in jobs had fallen off even prior to the recent financial market strains, and participants judged that some further slowing of employment growth was likely. Indeed, financial services firms had already announced layoffs, largely reflecting mortgage market developments, the demand for temporary workers appeared to have softened, and the most recent weakening in construction employment was likely to continue for a while. Moreover, if declines in house prices were to damp consumption, that could feed back on employment and income, exerting additional restraint on the demand for housing. Nonetheless, to date, initial claims for unemployment insurance did not indicate a substantial and widespread weakening in labor demand, and labor markets across the country generally remained fairly tight, with several participants citing continued reports of shortages of labor from their contacts in some sectors.

Participants thought that the most likely prospect was for consumer expenditures to continue to expand at a moderate pace on average over coming quarters, supported by growth in employment and income. However, some participants saw indications of a possible weakening of consumer spending. Sales of automobiles and building materials had flagged of late, and survey measures suggested that consumer confidence had been adversely affected by the recent financial market developments. Also, a further tightening of terms for home equity lines of credit and second mortgages seemed possible, which could weigh on consumer spending, especially for consumer durables.

Participants reported that recent financial market developments generally appeared to have had limited effects to date on

business capital spending plans and expected that business investment was likely to remain healthy in coming quarters. The access of investment-grade corporate borrowers to credit so far remained unimpeded, and rates on investment-grade bonds had declined in recent weeks. Moreover, participants noted that many capital expenditures were internally financed, making them less sensitive to credit market conditions. Nonetheless, the pace of financing for lower-rated firms--including issuance of both speculative-grade bonds and leveraged loans--had slowed sharply over the summer. Participants also noted that standards and terms for commercial real estate credit reportedly had tightened, and that credit availability for homebuilders could be trimmed going forward. In addition, contacts indicated that business executives in parts of the country had apparently become somewhat more cautious and that some were delaying investment outlays in view of heightened economic and financial uncertainty.

Some participants noted that foreign demand remained robust and net exports appeared strong. Port utilization rates reportedly remained high. Participants discussed the turbulence in foreign financial markets and noted that unusually high precautionary demand for dollar-denominated term funding in Europe had added to strains in U.S. interbank markets and contributed to a wide spread between libor and federal funds rates.

Participants made only modest revisions to their outlook for inflation in the period since the Committee's last regular meeting. Still, they recognized that incoming data on core inflation continued to be favorable, and they generally were a little more confident that the decline in inflation earlier this year would be sustained. Inflation expectations seemed to be contained, and the less robust economic outlook implied somewhat less pressure on resources going forward. Participants nonetheless remained concerned about possible upside risks to inflation. Higher benefit costs, rising unit labor costs more generally, reduced markups, and levels of resource utilization both in the United States and abroad that remained relatively high were all cited as factors that could contribute to inflationary pressures. Inflation risks could be heightened if the dollar were to continue to depreciate significantly.

In the Committee's discussion of policy for the intermeeting period, all members favored an easing of the stance of monetary policy. Members emphasized that because of the recent sharp change in credit market conditions, the incoming data in many cases were of limited value in assessing the likely evolution of economic activity and prices, on which the Committee's policy decision must be based. Members judged that a lowering of the target funds rate was appropriate to help offset the effects of tighter financial conditions on the economic outlook. Without such policy action, members saw a risk that tightening credit conditions and an intensifying housing correction would lead to significant broader weakness in output and employment. Similarly, the impaired functioning of financial markets might persist for some time or possibly worsen, with negative implications for economic activity. In order to help forestall some of the adverse effects on the economy that might otherwise arise, all members agreed that a rate cut of 50 basis points at this meeting was the most prudent course of action. Such a measure should not interfere with an adjustment to more realistic pricing of risk or with the gains and losses that implied for participants in financial markets. With economic growth likely to run below its potential for a while and with incoming inflation data to the favorable side, the easing of policy seemed unlikely to affect adversely the outlook for inflation.

The Committee agreed that the statement to be released after the meeting should indicate that the outlook for economic growth had shifted appreciably since the Committee's last regular meeting but that the 50 basis point easing in policy should help to promote moderate growth over time. They also agreed that the inflation situation seemed to have improved slightly and judged that it was no longer appropriate to indicate that a sustained moderation in inflation pressures had yet to be shown. Nonetheless, all agreed that some inflation risks remained and that the statement should indicate that the Committee would continue to monitor inflation developments carefully. Given the heightened uncertainty about the economic outlook, the Committee decided to refrain from providing an explicit assessment of the balance of risks, as such a characterization could give the mistaken impression that the Committee was more certain about the economic outlook than was in fact the case. Future actions would depend on how economic prospects were affected by evolving market developments and by other factors.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

"The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with reducing the federal funds rate to an average of around 4-3/4 percent."

The vote encompassed approval of the text below for inclusion in the statement to be released at 2:15 p.m.:

"Developments in financial markets since the Committee's last regular meeting have increased the uncertainty surrounding the economic outlook. The Committee will continue to assess the effects of these and other developments on economic prospects and will act as needed to foster price stability and sustainable economic growth."

Votes for this action: Messrs. Bernanke, Geithner, Evans, Hoenig, Kohn, Kroszner, Mishkin, Poole, Rosengren, and Warsh.

Votes against this action: None.

The Committee then resumed its discussion of monetary policy communication issues. Subsequently, in a joint session of the Federal Open Market Committee and the Board of Governors, Board members and Reserve Bank presidents discussed additional policy options to address strains in money markets. No decisions were made in this session, but it was agreed that policymakers should continue to consider such options carefully.

It was agreed that the next meeting of the Committee would be held on Tuesday-Wednesday, October 30-31, 2007.

The meeting adjourned at 3:55 p.m.

Notation Vote

By notation vote completed on August 27, 2007, the Committee unanimously approved the minutes of the FOMC meeting held on August 7, 2007.

Conference Calls

On August 10, 2007, the Committee reviewed developments in money and credit markets, where strains had worsened in the days since its last meeting. Participants discussed the condition of domestic and foreign financial markets, the Open Market Desk's approach to open market operations, possible adjustments to the discount rate, and the statement to be issued immediately after the conference call.

On August 16, 2007, the Committee again met by conference call. With financial market conditions having deteriorated further, meeting participants discussed the potential usefulness of various policy responses. The discussion focused primarily on changes associated with the discount window that would be directed at improving the functioning of the money markets. Most participants expressed strong support for taking such steps, although some concern was noted about the likely effectiveness of these measures and one participant also questioned their appropriateness. In light of the risks posed to the economic outlook by the tighter credit conditions and the increased uncertainty in financial markets, the Committee felt that the downside risks to growth had increased appreciably, but that a change in the federal funds rate target was not yet warranted. However, the situation bore close watching.

At the conclusion of the discussion, the Committee voted to approve the text below to be released the following morning:

"Financial market conditions have deteriorated, and tighter credit conditions and increased uncertainty have the potential to restrain economic growth going forward. In these circumstances, although recent data suggest that the economy has continued to expand at a moderate pace, the Federal Open Market Committee judges that the downside risks to growth have increased appreciably. The Committee is monitoring the situation and is prepared to act as needed to mitigate the adverse effects on the economy arising from the disruptions in financial markets."

Votes for: Messrs. Bernanke, Geithner, Fisher, Hoenig, Kohn, Kroszner, Mishkin, Moskow, Rosengren, and Warsh.

Votes against: None.

Mr. Fisher voted as alternate member.

Brian F. Madigan
Secretary

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Feltz, Stephen

From: Feltz, Stephen
Sent: Thursday, October 11, 2007 11:06 PM
To: 'Christine_Ginfrida@ml.com'
Subject: Re: Hedging / Market Update

We are monitoring rates and still planning to execute a hedge but timing right now is uncertain. I will stay in touch, and I appreciate the updates.

Sent from my BlackBerry Wireless Handheld

----- Original Message -----
From: Ginfrida, Christine (GMI CAPMKTS) <Christine_Ginfrida@ml.com>
To: Mau, Jacky (GMI - CAPMKTS) <Jacky_Mau@ml.com>; Feltz, Stephen
Cc: Schlopy, Karl (IBK-HOU) <karl_schlopy@ml.com>; Trachsel, Scott (GMIT - CAPMTS) <scott_trachsel@ml.com>
Sent: Wed Oct 10 06:56:57 2007
Subject: RE: Hedging / Market Update

Steve -

Good morning. As Jacky noted yesterday, the implied probability of a Fed ease at the Oct. 31st meeting continues to decline on robust economic data. As of this morning, the Fed Funds options market is implying a 66% chance that the Fed leaves rates unchanged at the next meeting - this is a nearly complete reversal from late last week, where the market was implying a nearly 70% likelihood that the Fed would ease by 25 bps.

This change in market sentiment has caused rates to sell off 3-4 bps at the long end since last Friday. However, the short end remains largely unchanged, resulting in slightly lower forward drops:

to 08/31/08: 6.5 bps
to 09/30/08: 8.25 bps
to 10/31/08: 9.00 bps
to 11/30/08: 10.5 bps

These are .25 - .50 bps lower than our last indications.

Have you made a decision on how you want to proceed with this? Please let us know if we can provide additional information to assist you with your decision.

Regards,
Christine and Jacky

Christine Ginfrida | Director, Merrill Lynch & Co | Phone: 212-449-2657 | Mobile: 917-494-9592 | christine_ginfrida@ml.com

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Feltz, Stephen

From: Stefan.Clyne@ubs.com
Sent: Friday, October 12, 2007 12:39 PM
To: Stefan.Clyne@ubs.com
Subject: UBS IR Market Update - October 12th
Attachments: Legal Disclaimer

Market Update

Today we've seen a relatively large sell off in the short end of the Treasury curve, with the 2Y UST yield up 10bps to 4.217% with the curve flattening by 5bps, as the 10Y UST yield has risen 5bps to 4.685%. Swap spreads have widened by slightly more than a bp across most of the curve, and the 10Y swap rate is currently 5.31% - above our previously suggested target for swapping to float of 5.25%.

The September Retail Sales data released this morning was stronger than expected - up 0.6% (consensus 0.2%) and Sales excluding autos were up 0.4% (consensus 0.3%, UBSe: 0.1%). PPI rose 1.1% in September (consensus: 0.5%) boosted by energy prices (+4.1%m/m) and food prices (+1.5%m/m). The core PPI was up 0.1% (cons: 0.2%), but included a sharp decline in motor vehicle prices. The University of Michigan consumer sentiment index fell to 82.0 in early October (cons: 84.0) reflecting weaker consumer expectations.

Based on the stronger than expected retail sales data today and foreign trade yesterday, our economists have raised our estimate for Q3 real GDP growth to 2.5% from 1.7%. This data, combined with some signs of stabilization in the financial markets, suggests reduced pressure on Fed officials to follow up their September 18 ease with another move on October 31. Our rates strategists still expect two more 25bp easings in the fed funds rate but now expect them on December 11 and January 30 instead of October 31 and December 11.

Stefan Clyne
UBS AG
Fixed Income Derivatives
Tel. +1-203-719-8184
stefan.clyne@ubs.com

Feltz, Stephen

From: Mau, Jacky (GMI - CAPMKTS) [Jacky_Mau@ml.com]
Sent: Monday, October 15, 2007 7:45 AM
To: Glickman, Greg (GMI - CAPMKTS); Ginfrida, Christine (GMI CAPMKTS)
Cc: Sconzo, Jack (CAPMKTS); Trachsel, Scott (GMIT - CAPMTS); Timmeny, Sean (GMI NY - DCM)
Subject: Merrill Lynch Week in Review -- 10/12/07
Attachments: Market Economist 101207.pdf

Good Morning,

Interest rates sold-off 4-15 bps over the course of last week, led by the front-end of the curve. Tuesday's Fed Minutes showed that at the emergency August 17 meeting and September 18 meeting, the Fed became increasingly concerned about the financial markets, noting "the impaired functioning of financial markets might persist for some time or possibly worsen, with negative implications for economic activity". The Minutes suggested the Fed saw greater weakness in the housing market than previously anticipated, and cut its GDP and PCE inflation forecasts for the fourth quarter and for 2008. While there was reduced concern about inflation as a result of the less robust economic data, some risks remain and could intensify if the dollar continues to depreciate.

According to Fed Fund Futures, the market is now pricing in only a 32% probability that the Fed eases 25 bps at the October 31 meeting, down from 48% the previous week. The data calendar for this week is moderately busy with consumer prices, industrial production, housing starts, and regional manufacturing surveys being the highlights. The Fed-speak calendar is busy with four officials on tap -- the highlight is Fed Chairman Bernanke speaking on the economic outlook on Monday night.

The 5, 10, and 30-year Treasury closed at 4.41%, 4.68%, and 4.90%, respectively.

Starting on page 18 of the attached, the report details this week's economic data releases as well as Merrill Lynch's forecast.

<<Market Economist 101207.pdf>>

Regards,
Greg / Christine / Jacky

Jacky Mau | Derivative Solutions | Merrill Lynch & Co. | Office: 212 449 7018 | Fax: 212 449 5057 | jacky_mau@ml.com

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Feltz, Stephen

From: Mau, Jacky (GMI - CAPMKTS) [Jacky_Mau@ml.com]
Sent: Tuesday, October 16, 2007 7:12 AM
To: Glickman, Greg (GMI - CAPMKTS); Ginfrida, Christine (GMI CAPMKTS)
Cc: Sconzo, Jack (CAPMKTS); Trachsel, Scott (GMIT - CAPMTS); Timmeny, Sean (GMI NY - DCM)
Subject: Bernanke "Dovish" Last Night

Good Morning,

In Chairman Bernanke's speech at the Economic Club last night, he stressed the downside risks to growth from this expected next large leg down in the housing sector. He seemed pretty relaxed about the inflation landscape even with the weaker dollar. The worry is that the housing and financial backdrop, and Bernanke was careful to say that many aspects of the credit and mortgage market are still not functioning properly, will spill over into business investment decisions and consumer spending. There was no mention of Q3 growth at all, which suggests the Fed is treating the latest data flow as old news -- the concentration is really on Q4 and Q1 next year.

Overnight, interest rates rallied 6 bps in the front-end and 2 bps in the back-end. The 2y UST is currently trading around 4.14% and the 10y UST around 4.66%.

The full text of the speech is attached below.

Regards,
Jacky

Jacky Mau | Derivative Solutions | Merrill Lynch & Co. | Office: 212 449 7018 | Fax: 212 449 5057 | jacky_mau@ml.com

Chairman Ben S. Bernanke
At the Economic Club of New York, New York, New York
October 15, 2007

The Recent Financial Turmoil and its Economic and Policy Consequences

The past several months have been an eventful period for the U.S. economy. In financial markets, sharpened concerns about credit quality induced a retrenchment by investors, leading in some cases to significant deterioration in market functioning. For some households and firms, credit became harder to obtain and, for those who could obtain it, more costly. Tightening credit conditions in turn threatened to intensify the ongoing correction in the housing market and to restrain economic growth. In response to these developments, the Federal Reserve has taken a number of measures to help ensure the normal functioning of financial markets and to promote sustainable economic growth and price stability. In my remarks this evening I will review recent events, discuss the Federal Reserve's responses to those events, and conclude with some comments on the economic outlook in light of recent developments. Although financial markets around the world have come under pressure in the past few months, I will focus my comments primarily on the United States. I will also have little to say this evening about the serious implications of rising rates of mortgage delinquency and foreclosure for troubled borrowers and their communities or about the Federal Reserve's responses to these important problems; I have discussed these issues several times in the past and will return to them in the future.

The Origins and Evolution of the Financial Turmoil

Overall, U.S. economic performance so far this year has been reasonably good. The rate of economic expansion slowed somewhat in late 2006 and early 2007, but growth in the second quarter was solid and some of that momentum appears to have carried over into the third quarter. The pace of private-sector job creation has slowed this year, but the unemployment rate has moved up only a little from its recent lows. And, although energy prices have been volatile, indicators of the underlying inflation trend, such as core inflation, have moderated since the middle of last year.

Moderate growth in overall economic activity has continued despite a notable contraction in the housing sector that began in the second half of 2005. The housing correction has intensified this year as demand has declined further, inventories of unsold new homes have climbed relative to sales, and house prices have decelerated, with some areas of the country experiencing outright

declines in home values. In response to weak demand and bloated inventories, homebuilders have sharply curtailed new construction. The decline in residential investment directly subtracted about 3/4 percentage point from the average pace of U.S. economic growth over the past year and a half. In its regular reports to Congress, most recently in July, the Federal Reserve Board has highlighted as a downside risk the possibility that housing weakness might spill over to other parts of the economy--for example, by acting as a restraint on consumer spending. Thus far, however, direct evidence of such spillovers onto the broader economy has been limited.

The housing correction has taken a more visible toll on the financial markets. In particular, since early this year, investors have become increasingly concerned about the credit quality of mortgages, especially subprime mortgages. The rate of serious delinquencies has risen notably for subprime mortgages with adjustable rates, reaching nearly 16 percent in August, roughly triple the recent low in mid-2005.1 Subprime mortgages originated in late 2005 and 2006 have performed especially poorly, in part because of a deterioration in underwriting standards. Moreover, many recent-vintage subprime loans will experience their first interest-rate resets in coming quarters. With the softness in house prices likely to make refinancing more difficult, delinquencies on these mortgages are expected to rise further.

At one time, most mortgages were originated by depository institutions and held on their balance sheets. Today, however, mortgages are often bundled together into mortgage-backed securities or structured credit products, rated by credit rating agencies, and then sold to investors. As mortgage losses have mounted, investors have questioned the reliability of the credit ratings, especially those of structured products. Since many investors had not performed independent evaluations of these often-complex instruments, the loss of confidence in the credit ratings led to a sharp decline in the willingness of investors to purchase these products. Liquidity dried up, prices fell, and spreads widened. Since July, few securities backed by subprime mortgages have been issued.

Investors' reluctance to buy has not been confined to securities related to subprime mortgages. Notably, the secondary market for private-label securities backed by prime jumbo mortgages has also contracted, and issuance of such securities has dwindled.2 Even though default rates on such mortgages have remained very low, the experience with subprime mortgages has evidently made investors more sensitive to the risks associated with other housing-related assets as well.

The problems in the mortgage-related sector reverberated throughout the financial system and particularly in the market for asset-backed commercial paper (ABCP). In this market, various institutions have established special-purpose vehicles to issue commercial paper to help fund a variety of assets, including some private-label mortgage-backed securities, mortgages warehoused for securitization, and other long-maturity assets. Investors had typically viewed the commercial paper backed by these assets as quite safe and liquid, because of the quality of the collateral and because the paper is often supported by banks' commitments to provide lines of credit or to assume some credit risk. But the concerns about mortgage-backed securities and structured credit products (even those unrelated to mortgages) greatly reduced the willingness of investors to roll over ABCP, particularly at maturities of more than a few days. The problems intensified in the second week of August after the announcement by a large overseas bank that it could not value the ABCP held by some of its money funds and was, as a result, suspending redemptions from those funds. Some commercial paper issuers invoked their right to extend the maturity of their paper, and a few issuers defaulted. In response to the heightening of perceived risks, investors fled to the safety and liquidity of Treasury bills, sparking a plunge in bill rates and a sharp widening in spreads on ABCP.

The retreat by investors from structured investment products also affected business finance. In particular, issuance of collateralized loan obligations (CLOs) and collateralized debt obligations (CDOs), which in turn had been major buyers of leveraged syndicated loans, fell off significantly during the summer. Demand for leveraged loans slowed sharply, reducing credit access for private equity firms and other borrowers seeking to finance leveraged buyouts (LBOs).

Concerns about liquidity and credit risk surfaced even in markets in which securitization plays a much smaller role. For example, spreads on lower-tier unsecured commercial paper jumped and issuance was limited to very short maturities. In corporate bond markets, issuance of speculative-grade bonds dropped off sharply as risk spreads widened. And although equity prices have moved up on balance since late spring, swings in prices have been large; indeed, the expected stock-price volatilities implicit in options prices roughly doubled during the summer before falling back more recently.

As the strains in financial markets intensified, many of the largest banks became concerned about the possibility that they might face large draws on their liquidity and difficult-to-forecast expansions of their balance sheets. They recognized that they might have to provide backup funding to programs that were no longer able to issue ABCP. Moreover, in the absence of an active syndication market for the leveraged loans they had committed to underwrite and without a well-functioning securitization market for the nonconforming mortgages they had issued, many large banks might be forced to hold those assets on their books rather than sell them to investors as planned. In these circumstances of heightened volatility and diminished market functioning, banks also became more concerned about the possible risk exposures of their counterparties and other potential contingent liabilities.

These concerns prompted banks to become protective of their liquidity and balance sheet capacity and thus to become markedly less willing to provide funding to others, including other banks. As a result, both overnight and term interbank funding markets came under considerable pressure. Interbank lending rates rose notably, and the liquidity in these markets diminished. A number

of the U.S. ABCP programs that had difficulty rolling over paper were sponsored by or had backup funding arrangements with European banks. As a result, some of these banks faced potentially large needs for dollar funding, and their efforts to manage their liquidity likely contributed to the pressures in global money and foreign exchange swap markets.

The U.S. subprime mortgage market is small relative to the enormous scale of global financial markets. So why was the impact of subprime developments on the markets apparently so large? To some extent, the outsized effects of the subprime mortgage problems on financial markets may have reflected broader concerns that problems in the U.S. housing market might restrain overall economic growth. But the developments in subprime were perhaps more a trigger than a fundamental cause of the financial turmoil. The episode led investors to become more uncertain about valuations of a range of complex or opaque structured credit products, not just those backed by subprime mortgages. They also reacted to market developments by increasing their assessment of the risks associated with a number of assets and, to some degree, by reducing their willingness to take on risk more generally. To be sure, these developments may well lead to a healthier financial system in the medium to long term: Increased investor scrutiny of structured credit products is likely to lead to greater transparency in these products and more rigor in the credit-rating process. And greater caution on the part of investors seems appropriate given the very narrow spreads and the loosening in some underwriting standards seen before the recent episode began. In the shorter term, however, these developments do imply a greater measure of financial restraint on economic growth as credit becomes more expensive and difficult to obtain.

The Federal Reserve's Response to the Financial Turmoil

Fortunately, the financial system entered the episode of the past few months with strong capital positions and a robust infrastructure. The banking system is healthy. Despite a few notable failures, hedge funds overall seem to have held up well, and their counterparties have not sustained material losses. The clearing and settlement infrastructure generally worked well despite trading volumes that were extremely high in some cases. Nevertheless, the market strains were serious, as I have discussed, and they posed risks to the broader economy. The Federal Reserve accordingly took a number of steps to help markets return to more orderly functioning.

The Federal Reserve's initial action was to increase liquidity in short-term money markets through larger open market operations--the standard means by which it seeks to ensure that the federal funds rate stays at or near the target rate set by the Federal Open Market Committee (FOMC). A number of other central banks took similar steps. One source of pressure in the overnight market was the demand for dollar funding by European banks to which I alluded earlier. As Europe is in the latter part of its trading day when U.S. markets open, this extra demand for dollars at times led the federal funds rate to open well above the target. The extra provision of liquidity by the Fed helped counter the resulting pressure on the funds rate early in the day; it also eased banks' concerns about the availability of funding and thus assisted the functioning of the interbank market. To be clear, an open market operation can provide market participants with increased liquidity; but the intervention does not directly increase participants' capital or allow them to shed risk. In essence, these operations are short-term loans collateralized by government securities.

The vigorous provision of funds through open market operations succeeded in damping pressures in overnight funding markets. Yet markets for term funding, including commercial paper markets as well as the interbank markets, remained strained, and signs of broader financial stress persisted. On August 17, the Fed took further action when the Federal Reserve Board cut the discount rate--the rate at which it lends directly to banks--by 50 basis points, or 1/2 percentage point. The Fed also adjusted its usual practices to facilitate the provision of financing for as long as thirty days, renewable at the request of the borrower.

Loans through the discount window differ from open market operations in that they can be made directly to specific banks with strong demands for liquidity. (In contrast, open market operations are arranged with a limited set of dealers of government securities.) In addition, whereas open market operations typically involve lending against government securities, loans through the discount window can be made against a much wider range of collateral, including mortgages and mortgage-backed securities. As with open market operations, however, Fed lending through the discount window provides banks with liquidity, not risk capital. In particular, the strong collateralization accompanying discount window credit eliminates essentially all risk for the Federal Reserve System and the taxpayer. Nonetheless, the availability of the discount window is potentially significant for banks, as it gives them greater confidence that they can obtain additional liquidity as necessary. Access to a backstop source of liquidity in turn reduces the incentives of banks to limit the credit they provide to their customers and counterparties. The Federal Reserve also took some other steps in response to strains in financial markets, including reducing the fee that it charges for lending Treasury securities from its portfolio, thus helping to meet the heavy demands in the market for those securities.

The Federal Reserve's actions to ease the liquidity strains in financial markets were similar to actions that central banks have taken many times in the past. Promoting financial stability and the orderly functioning of financial markets is a key function of central banks. Indeed, a principal motivation for the founding of the Federal Reserve nearly a century ago was the expectation that it would reduce the incidence of financial crises by providing liquidity as needed.

In its supervisory role, the Federal Reserve--like other bank regulators--attempts to ensure that individual banks maintain adequate liquidity on hand and make provision to raise additional funds quickly when the need arises. We must be wary of a subtle fallacy of composition, however. Even if each market participant holds a significant reserve of what--in normal times, at least--would be considered highly liquid assets, for the system as a whole the only truly liquid assets are cash and its equivalents.

The quantity of cash assets in the system at a point in time is, in turn, essentially fixed, being determined directly or indirectly by the central bank. Thus, whenever an investor sells less liquid assets to raise cash, the cash holdings of other market participants are reduced by an equal amount. Consequently, in highly stressed financial conditions, when the marketwide demand for liquidity rises sharply, one of two things must happen: Either the central bank provides the liquidity demanded by lending against good collateral, or forced sales of illiquid assets will drive the prices of those assets well below their longer-term fundamental values, raising the risk of widespread insolvency and intensifying the crisis. If the crisis becomes sufficiently severe, history suggests that damage to the broader economy is likely to follow.

In his classic 1873 treatise, Lombard Street, Walter Bagehot famously articulated the need for central banks to be prepared to lend freely against good collateral (what he called "good banking security") but at a penalty rate.3 A panic, said Bagehot, is a "species of neuralgia" and as such must not be starved (p. 25). Of course, judgment is required to assess whether a particular set of market conditions is severe enough to warrant extraordinary injections of liquidity by the central bank; a too-aggressive intervention could unduly reduce the incentives of market participants to insure against more-normal liquidity risks. In the steps it took, the Federal Reserve strove to reach a middle ground, signaling its willingness and ability to provide liquidity to markets as needed without significantly distorting the incentives of individual banks and other market participants to manage their liquidity prudently.

The Federal Reserve's efforts to provide liquidity appear to have been helpful on the whole. To be sure, the volume of loans to banks made through the discount window, though it increased for a time, has been modest. However, collateral placed by banks at the discount window in anticipation of possible borrowing rose sharply during August and September, suggesting that some banks viewed the discount window as a potentially valuable option. On the other hand, no amount of liquidity provision by the central bank can be expected to solve the problems regarding the valuation of complex securitized assets or to reverse the credit losses on subprime mortgages. These underlying difficulties will be resolved only over time by financial markets.

Since mid-August the functioning of financial markets has improved to some degree, supported not only by liquidity provision but also by the monetary policy action taken in September, to which I will return in a moment. Interest rate spreads on ABCP have fallen by more than half from their recent peaks, and overall commercial paper outstanding has edged up this month after declining sharply over August and September. Interbank term funding markets have improved modestly, though spreads there remain unusually wide. Some progress has been made in bringing pending LBO-related loans to market, albeit at discounts and with tightened terms. Risk spreads in corporate bond markets have narrowed somewhat, the issuance of speculative-grade bonds has restarted, and investment-grade issuance has been strong. Volatility in many asset markets has declined toward more-normal levels. Perhaps most important, in many markets investors are showing an increased capacity and willingness to differentiate among assets of varying quality.

In contrast, despite a few encouraging signs, conditions in mortgage markets remain difficult. The markets for securitized nonprime (that is, subprime and so-called alt-A) loans are showing little activity, securitizations of prime jumbo mortgages reportedly have increased only slightly from low levels, and the spread between the interest rates on nonconforming and conforming mortgages remains elevated. These continued problems suggest that investors will need more time to gather information and reevaluate risks before they are willing to reenter these markets.

Monetary Policy and the Economic Outlook

The Federal Reserve's efforts to support the normal functioning of financial markets have as their ultimate objective the stability and efficiency of the broader economy. In addition, of course, the Federal Reserve can adjust the stance of monetary policy by changing its target for the federal funds rate. The FOMC manages monetary policy to further its dual mandate to promote maximum sustainable employment and price stability.

The turmoil in financial markets significantly affected the Committee's outlook for the broader economy. Indeed, in a statement issued simultaneously with the Federal Reserve Board's August 17 announcement of the cut in the discount rate, the FOMC noted that the downside risks to growth had increased appreciably. However, to allow time to gather and evaluate incoming information, possible policy action was deferred until the Committee's next regularly scheduled meeting on September 18.

A key issue at that meeting was the extent to which the market disturbances had affected the outlook for the housing sector. Financial markets overall had improved somewhat, but tighter terms and standards in the mortgage market--particularly in the nonprime and jumbo segments--appeared likely to intensify the correction in housing significantly, with adverse implications for construction activity and house prices. Indeed, incoming housing data had continued to soften even before the advent of the stress in financial markets. A further sharp contraction in residential construction seemed likely to hold down overall economic growth in the fourth quarter and in early 2008.

As they had at earlier meetings, the participants in the September meeting evaluated the potential effects of housing-market developments on other parts of the economy. They agreed that significant spillovers to household and business spending were not yet evident. For example, auto sales had picked up in August from the low levels of earlier in the summer; and business investment did not appear to have been seriously affected by financial market developments, as highly rated firms continued to

enjoy good access to credit. Strong growth abroad was also viewed as supporting U.S. exports and domestic production. And as I have noted, the available evidence suggested that overall economic growth in the third quarter remained moderate.

However, downside risks to both household and business spending had clearly increased over the period since the Committee's previous meeting. Notably, the weak housing market, somewhat downbeat consumer sentiment, and slower growth in private-sector employment increased the likelihood that consumption spending would slow in coming quarters. Participants at the September meeting also reported somewhat greater caution in the outlooks of their business contacts. Financial market conditions were expected to improve slowly at best; and even if conditions began to normalize, credit would likely remain noticeably tighter for many borrowers than had been the case during the summer. Furthermore, any weakening in the economy could itself have a negative effect on still-fragile credit markets, possibly leading credit conditions to tighten further.

Regarding the other half of its mandate, to promote price stability, the Committee noted some improvement over the past year in measures of the trend component of inflation, such as core inflation. Moreover, slower growth in aggregate demand would help to ease pressure on resources. But inflation risks remained, including still-high levels of resource utilization and elevated prices for oil and other commodities. The Committee agreed that continued close attention to inflation developments was warranted. Overall, given the great difficulty of knowing how financial conditions would evolve or the extent of their effect on the economy, Committee members judged the level of uncertainty in the outlook to be unusually high.

As you know, the Committee chose to cut its target for the federal funds rate by 50 basis points at the September meeting. This action was intended to help offset the tightening of credit conditions resulting from the financial turmoil. Risk-management considerations also played a role in the decision, given the possibility that the housing correction and tighter credit could presage a broader weakening in economic conditions that would be difficult to arrest. By doing more sooner, policy might be able to forestall some part of the potential adverse effects of the disruptions in financial markets. As most of the meeting participants saw growth likely to run below trend for a while and with the incoming inflation data on the favorable side, the risks to inflation from this action seemed acceptable, especially as the Committee was prepared to reverse the policy easing if inflation pressures proved stronger than expected.

Since the September meeting, the incoming data have borne out the Committee's expectations of further weakening in the housing market, as sales have fallen further and new residential construction has continued to decline rapidly. The further contraction in housing is likely to be a significant drag on growth in the current quarter and through early next year. However, it remains too early to assess the extent to which household and business spending will be affected by the weakness in housing and the tightening in credit conditions. We will be following indicators of household and business spending closely as we update our outlook for near-term growth. The evolution of employment and labor income also will bear watching, as gains in real income support consumer spending even if the weakness in house prices adversely affects homeowners' equity. The labor market has shown some signs of cooling, but these are quite tentative so far, and real income is still growing at a solid pace.

On the inflation side, prices of crude oil and other commodities have increased somewhat in recent weeks, and the foreign exchange value of the dollar has weakened. However, overall, the limited data that we have received since the September FOMC meeting are consistent with continued moderate increases in consumer prices. As the Committee noted in its post-meeting statement, we will continue to monitor inflation developments carefully.

It does seem that, together with our earlier actions to enhance liquidity, the September policy action has served to reduce some of the pressure in financial markets, although considerable strains remain. From the perspective of the near-term economic outlook, the improved functioning of financial markets is a positive development in that it increases the likelihood of achieving moderate growth with price stability. However, in such situations, one must also take seriously the possibility that policy actions that have the effect of reducing stress in financial markets may also promote excessive risk-taking and thus increase the probability of future crises. As I indicated in earlier remarks, it is not the responsibility of the Federal Reserve--nor would it be appropriate--to protect lenders and investors from the consequences of their financial decisions. But developments in financial markets can have broad economic effects felt by many outside the markets, and the Federal Reserve must take those effects into account when determining policy. In particular, as I have emphasized, the Federal Reserve has a mandate from the Congress to promote maximum employment and stable prices, and its monetary policy actions will be chosen so as to best meet that mandate.

Indeed, although the Federal Reserve can seek to provide a more stable economic background that will benefit both investors and non-investors, the truth is that it can hardly insulate investors from risk, even if it wished to do so. Developments over the past few months reinforce this point. Those who made bad investment decisions lost money. In particular, investors in subprime mortgages have sustained significant losses, and many of the mortgage companies that made those loans have failed. Moreover, market participants are learning and adjusting--for example, by insisting on better mortgage underwriting and by performing better due diligence on structured credit products. Rather than becoming more crisis-prone, the financial system is likely to emerge from this episode healthier and more stable than before.

Conclusion
I have sought this evening to put recent financial market developments in context and to explain the thinking behind the steps

taken by the Federal Reserve. This has been a challenging period. Conditions in financial markets have shown some improvement since the worst of the storm in mid-August, but a full recovery of market functioning is likely to take time, and we may well see some setbacks. In particular, investors are continuing to reassess the risks they face and have not yet fully regained confidence in their ability to accurately price certain types of securities. The ultimate implications of financial developments for the cost and availability of credit, and thus for the broader economy, remain uncertain.

In coming months, the Federal Reserve, together with other agencies both here and abroad, will perform comprehensive reviews of recent events to better understand the episode and to draw lessons for the future. For now, the Federal Reserve will continue to watch the situation closely and will act as needed to support efficient market functioning and to foster sustainable economic growth and price stability.

Footnotes

1. Estimates of delinquencies are based on data from First American LoanPerformance.

2. Jumbo mortgages are those mortgages for which the principal value does not conform to the limit set annually by Fannie Mae and Freddie Mac for loans they will purchase; the amount for 2007 is $417,000. Jumbo loans are thus a type of "nonconforming" loan. Prime loans are those made to borrowers with good credit records.

3. Walter Bagehot (1962 reprint), Lombard Street (Westport, Conn.: Hyperion Press).

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Feltz, Stephen

From: James.Gerhart@ubs.com
Sent: Wednesday, October 17, 2007 11:22 AM
To: Feltz, Stephen
Cc: Ryan.Donovan@ubs.com; Ryan.Fleming@ubs.com; Stefan.Clyne@ubs.com
Subject: RE: Fwd Starting Swap Quotes
Attachments: Legal Disclaimer

Steve -

10Y US swap yields have dropped 10 bps today and are now trading near levels prior to the September payroll report (released Oct 5th). 10Y swaps closed at 5.14% the day prior to the report's release and rose following the stronger than expected report to trade as high as 5.31% earlier this week. As of this afternoon, the 10Y swap is trading around 5.18% with the 10Y UST at 4.54%. Many of our corporate clients find a sub-4.50% UST as an attractive entry point for hedges against higher rates. Just wanted to keep you updated as we approach these attractive levels.

	10/17	9/25	9/20	9/4	9/7
Spot 10Y:	5.180%	5.22	5.35	4.99	5.03
1m:	5.184%				
3m:	5.187%				
6m:	5.214%				
9m:	5.240%	5.28	5.40	5.01	5.10
12m:	5.276%	5.32	5.43	5.04	

Please feel free to be in touch if you would like to discuss further.

James

From: Clyne, Stefan+
Sent: Tuesday, September 25, 2007 9:52 AM
To: 'Feltz, Stephen'; Gerhart, James+
Cc: Donovan, Ryan+; Fleming, Ryan+
Subject: RE: Fwd Starting Swap Quotes

Steve,

This morning we've seen a rally in Treasuries as the market sees signs that the worst of the housing slump is not yet over. This morning Lennar Corp, the largest US homebuilder, reported its largest ever quarterly loss of $514mm. At 10am ET today the Existing Home Sales for August will be released, with consensus of 5.48mm down 4.6% from the prior period, and would be the lowest level since August 2002.

Currently the 2Y UST has rallied 9bps to 3.95%, the 5Y is down 8.5bps to 4.22% and the 10Y is down 6bps to 4.57%.

Since we last updated you, the 10Y swap rate has declined by approximately 12bps. Please find below updated indicative pricing for a 10Y forward starting swap:

Spot 10Y: 5.22%

1m: 5.224%
3m: 5.229%
6m: 5.249%
9m: 5.283%
12m: 5.321%

If you have any questions, or would like to discuss further, please let us know.

Regards

Stefan

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stefan.clyne@ubs.com

From: Clyne, Stefan+
Sent: Thursday, September 20, 2007 4:21 PM
To: Feltz, Stephen; Gerhart, James+
Cc: Donovan, Ryan+; Fleming, Ryan+
Subject: RE: Fwd Starting Swap Quotes

Hi Steve,

I heard from Ryan that you'd called and were enquiring as to where the forward points on forward starting swaps were.

As you may have noticed, post the Fed meeting the curve has steepened, while rates in the long end have risen. The unexpectedly strong reaction by the Fed to the recent financial market and housing issues has prompted concerns about inflation, resulting in a rise in US Treasury yields in the long end of the curve. Oil has risen to a record $83.90, which is also impacting inflation concerns, and the DJIA is currently up 360 points so far this week.

Please find below updated indicative pricing for a 10Y forward starting swap:

Spot 10Y: 5.347%

1m: 5.349%
3m: 5.348%
6m: 5.373%
9m: 5.399%
12m: 5.426%

If you have any questions, or would like to discuss further, please let us know.

Regards

Stefan

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stefan.clyne@ubs.com

From: Feltz, Stephen [mailto:spf@nwnatural.com]
Sent: Tuesday, September 11, 2007 2:14 PM
To: Gerhart, James+
Cc: Donovan, Ryan+; Clyne, Stefan+

Subject: RE: Fwd Starting Swap Quotes

Thank you.

From: James.Gerhart@ubs.com [mailto:James.Gerhart@ubs.com]
Sent: Tuesday, September 11, 2007 9:46 AM
To: James.Gerhart@ubs.com; Feltz, Stephen
Cc: Ryan.Donovan@ubs.com; Stefan.Clyne@ubs.com
Subject: RE: Fwd Starting Swap Quotes

Steve -

Please find below updated indicative pricing for a 10Y forward starting swap:

Spot 10Y: 4.990%

1m: 4.984%
3m: 4.975%
6m: 4.985%
9m: 5.011%
12m: 5.043%

The curve is flatter today so the forward premium has dropped.

James

From: Gerhart, James+
Sent: Friday, September 07, 2007 3:32 PM
To: Feltz, Stephen
Cc: Donovan, Ryan+; Clyne, Stefan+; Gerhart, James+
Subject: Fwd Starting Swap Quotes

Steve -

Please find below forward starting swap quotes for 10Y swaps from each respective forward date. I also put the spot 10Y swap rate for your reference. The yield curve is kinked in the front end which creates the somewhat counter-intuitive forward rate schedule.

Spot 10Y: 5.028%

1m: 5.027%
3m: 5.018%
6m: 5.038%
9m: 5.099%

As Ryan shared with you earlier, the best way to get a competitive quote is to get a couple banks on the phone at the same time and have them both bid their rate live. Lowest rate wins. These markets are fairly volatile as of late and with the slim margins banks have in their quotes, we are only able to hold a price for the few seconds after we give them. For this reason you want to have two phone lines open dealing with both counterparties in real time. You will get very sloppy execution if you try to get a quote from one bank, hang up and call another, then call back the first etc.

Ahead of that call its best to share with the banks a term sheet to be sure everyone is bidding on the same swap. Below would be a sample term sheet for a 6m forward starting swap:

Notional: $50 mm
Effective Date: March 11, 2008
Maturity Date: March 11, 2018
Fixed Rate Payer: Northwest Natural
Fixed Rate: [tbd], semi-annual, 30/360, unadjusted
Floating Rate Payer: Financial Institution
Floating Rate: 3M LIBOR, quarterly, ACT/360

I am happy to walk through any of the above in more detail if you would like -- just give me a call.

James Gerhart
Fixed Income Derivatives
UBS Investment Bank
(203) 719-8184
james.gerhart@ubs.com

Feltz, Stephen

From: Mau, Jacky (GMI - CAPMKTS) [Jacky_Mau@ml.com]
Sent: Wednesday, October 17, 2007 11:22 AM
To: Feltz, Stephen
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve - we're seeing a massive rally this afternoon. The 10y UST is over 12 bps lower on the day and nearly 20 bps lower than last week's highs.. The stock market is lower for the third consecutive day as housing starts fell to 1.191 million, the lowest since March 1993. Core CPI was reported in-line with expectations at 0.2% and 1.7% for m/m and y/y, respectively. This suggests a core PCE print of 0.2% m/m and 1.7% y/y, in-line with the Fed's implicit target. While these figures seem to give the Fed both reason to reduce rates at the next FOMC Meeting and the room to do so on the inflation side, it remains a close call given the divergent opinions on the FOMC about the downside risks to the economy.

Below are updated forward drops:
to 08/31/08: 7.75 bps
to 09/30/08: 9.70 bps
to 10/31/08: 10.5 bps

} Fwd drops are widening only a bit

While the drops are slightly higher from a steeper curve, interest rates are now below this year's average.

Let us know if this seems attractive to you.

Regards,
Jacky

From: Ginfrida, Christine (GMI CAPMKTS)
Sent: Wednesday, October 10, 2007 9:57 AM
To: Mau, Jacky (GMI - CAPMKTS); 'Steve Feltz (spf@nwnatural.com)'
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS)
Subject: RE: Hedging / Market Update

Steve -

Good morning. As Jacky noted yesterday, the implied probability of a Fed ease at the Oct. 31st meeting continues to decline on robust economic data. As of this morning, the Fed Funds options market is implying a 66% chance that the Fed leaves rates unchanged at the next meeting - this is a nearly complete reversal from late last week, where the market was implying a nearly 70% likelihood that the Fed would ease by 25 bps.

This change in market sentiment has caused rates to sell off 3-4 bps at the long end since last Friday. However, the short end remains largely unchanged, resulting in slightly lower forward drops:

to 08/31/08: 6.5 bps
to 09/30/08: 8.25 bps
to 10/31/08: 9.00 bps
to 11/30/08: 10.5 bps

These are .25 - .50 bps lower than our last indications.

Have you made a decision on how you want to proceed with this? Please let us know if we can provide additional information to assist you with your decision.

Regards,
Christine and Jacky

Christine Ginfrida | Director, Merrill Lynch & Co | Phone: 212-449-2657 | Mobile: 917-494-9592 | christine_ginfrida@ml.com

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Feltz, Stephen

From: Stefan.Clyne@ubs.com
Sent: Wednesday, October 17, 2007 12:39 PM
To: Stefan.Clyne@ubs.com
Subject: UBS Market Update - October 17th
Attachments: Legal Disclaimer

Market Update

We've seen a steady and sustained rally in Treasuries today, with the 2Y UST down 16bps to 3.97%, the 5Y down 13bps to 4.20% and 10Y UST down 11bps to 4.54%. Swap spreads have widened - the 2Y swap spread is 3.5bps wide to 68bps, while the 10Y is only 0.5bps wider at 63.7bps.

Today was a fairly busy day for economic releases, including CPI, Housing Starts and the Beige Book released. Most data were close to or at consensus, and the bond rally seems to have been based on investor concerns regarding the broader economic impact from the housing slump. Housing Starts have certainly shown no sign of recovery yet - for September, Housing Starts were 1191k - the lowest level since mid 1997. CPI ex Food and Energy printed at consensus at 0.2% (MoM), and 2.1% year-on-year. The Fed's Beige Book was released at 2pm today, with anecdotal reports suggesting that "while economic activity continued to expand ... the pace of growth decelerated since August".

In summary, with the housing data and Beige Book both supporting the view of a weakening economic environment, and inflation at a moderate level, we believe the Fed has room to cut rates should it see fit.

Fed Funds Futures are currently implying a 65% probability that the Fed will leave the Fed Funds rate unchanged at 4.75%, and a 32.4% chance of a cut by 25bps to 4.50%, whereas two weeks ago the implied probability of a cut was 50%. As mentioned in our update on Friday, UBS' view is that the Fed will keep the Fed Funds rate on hold on October 31, with a 25bp cut on December 11th and a further 25bp cut in January.

Stefan Clyne
UBS AG
Fixed Income Derivatives
Tel. +1-203-719-8184
stefan.clyne@ubs.com

Feltz, Stephen

From: Mau, Jacky (GMI - CAPMKTS) [Jacky_Mau@ml.com]
Sent: Thursday, October 18, 2007 5:28 AM
To: Feltz, Stephen
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve - we saw good follow-through buying from Asia and Europe overnight. Interest rates have rallied another 6-8 bps in the front-end and 2-4 bps in the back-end. The 10y UST is currently trading around 4.50%, last seen during the first week of September (right before the dip below 4.40% and subsequent bounce-back).

We're awaiting the Jobless Claims data to be released in a few minutes. We'll let you know how the market reacts.

Regards,
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Subject: RE: Hedging / Market Update

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Yes, this is more attractive and close to opportunity we were looking for.

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to 08/31/08: 7.75 bps
to 09/30/08: 9.70 bps
to 10/31/08: 10.5 bps

While the drops are slightly higher from a steeper curve, interest rates are now below this year's average.

Let us know if this seems attractive to you.

Regards,
Jacky

From: Ginfrida, Christine (GMI CAPMKTS)
Sent: Wednesday, October 10, 2007 9:57 AM
To: Mau, Jacky (GMI - CAPMKTS); 'Steve Feltz (spf@nwnatural.com)'
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS)
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Have you made a decision on how you want to proceed with this? Please let us know if we can provide additional information to assist you with your decision.

Regards,
Christine and Jacky

Christine Ginfrida | Director, Merrill Lynch & Co | Phone: 212-449-2657 | Mobile: 917-494-9592 | christine_ginfrida@ml.com

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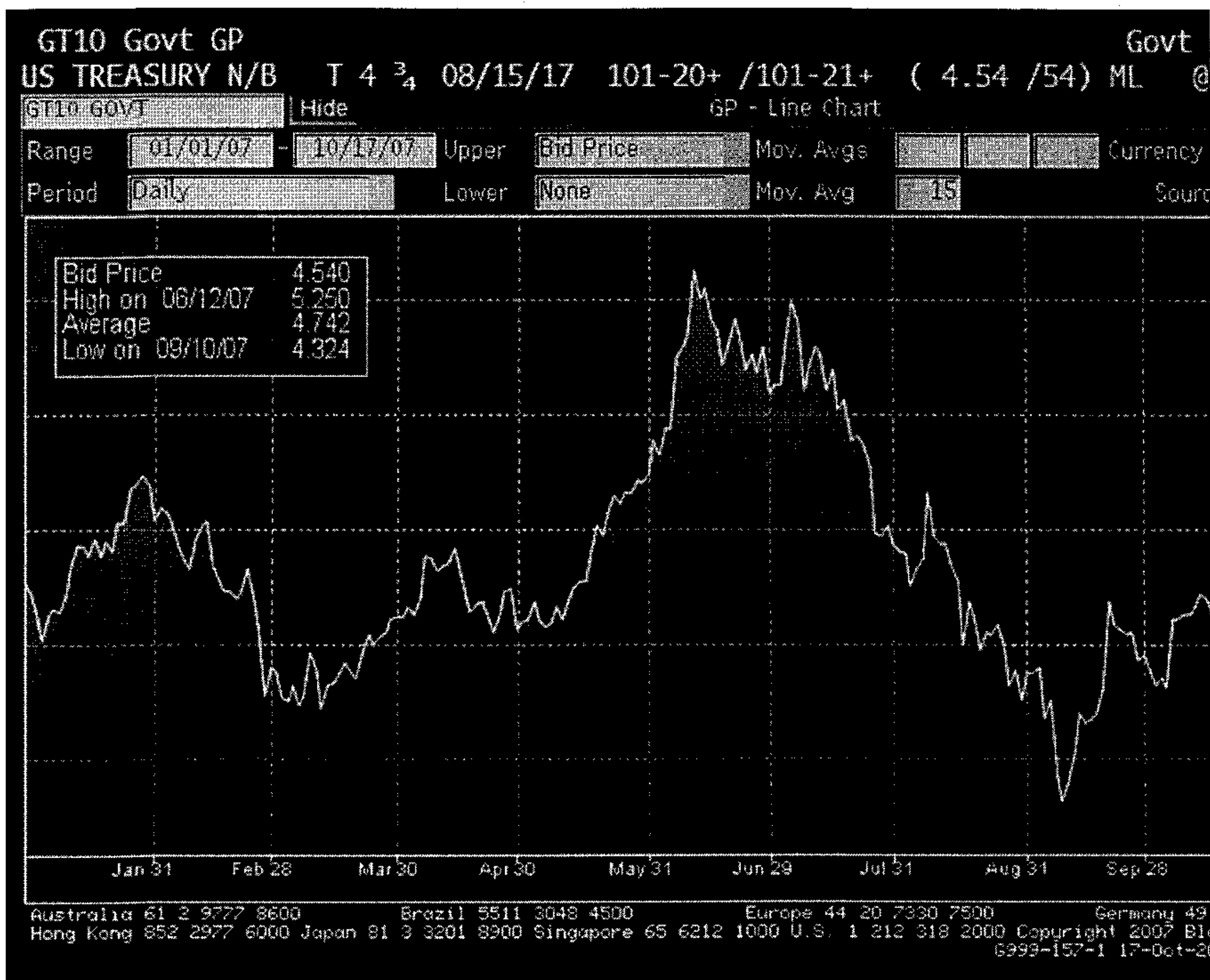

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Feltz, Stephen

From: James.Gerhart@ubs.com
Sent: Friday, October 19, 2007 6:58 AM
To: Feltz, Stephen
Cc: Ryan.Donovan@ubs.com; Ryan.Fleming@ubs.com; Stefan.Clyne@ubs.com
Subject: RE: Fwd Starting Swap Quotes
Attachments: Legal Disclaimer

Steve -

Swap rates have continued to grind slowly lower since Wednesday's update. As of the market open this morning, the 10Y UST is now trading sub-4.50% at 4.466% with the 10Y swap trading at 5.10%. With rates at current levels, we recommend legging into a forward starting swap to hedge against higher rates. Entering into a swap on half the notional of any expected issuance would allow you to hedge at historically attractive levels while still maintaining some upside if rates continue to fall further.

Spot 10Y: 5.100%

1m: 5.103%
3m: 5.105%
6m: 5.135%
9m: 5.160%
12m: 5.197%

James

From: Feltz, Stephen [mailto:spf@nwnatural.com]
Sent: Wednesday, October 17, 2007 3:02 PM
To: Gerhart, James+
Cc: Donovan, Ryan+; Fleming, Ryan+; Clyne, Stefan+
Subject: RE: Fwd Starting Swap Quotes

James,

Excellent. We are in that camp of clients waiting for attractive entry point, and I think we are very close.

From: James.Gerhart@ubs.com [mailto:James.Gerhart@ubs.com]
Sent: Wednesday, October 17, 2007 11:22 AM
To: Feltz, Stephen
Cc: Ryan.Donovan@ubs.com; Ryan.Fleming@ubs.com; Stefan.Clyne@ubs.com
Subject: RE: Fwd Starting Swap Quotes

Steve -

10Y US swap yields have dropped 10 bps today and are now trading near levels prior to the September payroll report (released Oct 5th). 10Y swaps closed at 5.14% the day prior to the report's release and rose following the stronger than expected report to trade as high as 5.31% earlier this week. As of this afternoon, the 10Y swap is trading around 5.18% with the 10Y UST at 4.54%. Many of our corporate clients find a sub-4.50% UST as an attractive entry point for hedges against higher rates. Just wanted to keep you updated as we approach these attractive levels.

Spot 10Y: 5.180%

1m: 5.184%
3m: 5.187%

6m: 5.214%
9m: 5.240%
12m: 5.276%

Please feel free to be in touch if you would like to discuss further.

James

From: Clyne, Stefan+
Sent: Tuesday, September 25, 2007 9:52 AM
To: 'Feltz, Stephen'; Gerhart, James+
Cc: Donovan, Ryan+; Fleming, Ryan+
Subject: RE: Fwd Starting Swap Quotes

Steve,

This morning we've seen a rally in Treasuries as the market sees signs that the worst of the housing slump is not yet over. This morning Lennar Corp, the largest US homebuilder, reported its largest ever quarterly loss of $514mm. At 10am ET today the Existing Home Sales for August will be released, with consensus of 5.48mm down 4.6% from the prior period, and would be the lowest level since August 2002.

Currently the 2Y UST has rallied 9bps to 3.95%, the 5Y is down 8.5bps to 4.22% and the 10Y is down 6bps to 4.57%.

Since we last updated you, the 10Y swap rate has declined by approximately 12bps. Please find below updated indicative pricing for a 10Y forward starting swap:

Spot 10Y: 5.22%

1m: 5.224%
3m: 5.229%
6m: 5.249%
9m: 5.283%
12m: 5.321%

If you have any questions, or would like to discuss further, please let us know.

Regards

Stefan

Stefan Clyne
UBS AG
Fixed Income Derivatives
Tel. +1-203-719-8184
stefan.clyne@ubs.com

From: Clyne, Stefan+
Sent: Thursday, September 20, 2007 4:21 PM
To: Feltz, Stephen; Gerhart, James+
Cc: Donovan, Ryan+; Fleming, Ryan+
Subject: RE: Fwd Starting Swap Quotes

Hi Steve,

I heard from Ryan that you'd called and were enquiring as to where the forward points on forward starting swaps were.

As you may, have noticed, post the Fed meeting the curve has steepened, while rates in the long end have risen. The unexpectedly strong reaction by the Fed to the recent financial market and housing issues has prompted concerns about inflation, resulting in a rise in US Treasury yields in the long end of the curve. Oil has risen to a record $83.90, which is also impacting inflation concerns, and the DJIA is currently up 360 points so far this week.

Please find below updated indicative pricing for a 10Y forward starting swap:

Spot 10Y: 5.347%

1m: 5.349%
3m: 5.348%
6m: 5.373%
9m: 5.399%
12m: 5.426%

If you have any questions, or would like to discuss further, please let us know.

Regards

Stefan

Stefan Clyne
UBS AG
Fixed Income Derivatives
Tel. +1-203-719-8184
stefan.clyne@ubs.com

From: Feltz, Stephen [mailto:spf@nwnatural.com]
Sent: Tuesday, September 11, 2007 2:14 PM
To: Gerhart, James+
Cc: Donovan, Ryan+; Clyne, Stefan+
Subject: RE: Fwd Starting Swap Quotes

Thank you.

From: James.Gerhart@ubs.com [mailto:James.Gerhart@ubs.com]
Sent: Tuesday, September 11, 2007 9:46 AM
To: James.Gerhart@ubs.com; Feltz, Stephen
Cc: Ryan.Donovan@ubs.com; Stefan.Clyne@ubs.com
Subject: RE: Fwd Starting Swap Quotes

Steve -

Please find below updated indicative pricing for a 10Y forward starting swap:

Spot 10Y: 4.990%

1m: 4.984%
3m: 4.975%
6m: 4.985%
9m: 5.011%

12m: 5.043%

The curve is flatter today so the forward premium has dropped.

James

From: Gerhart, James+
Sent: Friday, September 07, 2007 3:32 PM
To: Feltz, Stephen
Cc: Donovan, Ryan+; Clyne, Stefan+; Gerhart, James+
Subject: Fwd Starting Swap Quotes

Steve -

Please find below forward starting swap quotes for 10Y swaps from each respective forward date. I also put the spot 10Y swap rate for your reference. The yield curve is kinked in the front end which creates the somewhat counter-intuitive forward rate schedule.

Spot 10Y: 5.028%

1m: 5.027%
3m: 5.018%
6m: 5.038%
9m: 5.099%

As Ryan shared with you earlier, the best way to get a competitive quote is to get a couple banks on the phone at the same time and have them both bid their rate live. Lowest rate wins. These markets are fairly volatile as of late and with the slim margins banks have in their quotes, we are only able to hold a price for the few seconds after we give them. For this reason you want to have two phone lines open dealing with both counterparties in real time. You will get very sloppy execution if you try to get a quote from one bank, hang up and call another, then call back the first etc.

Ahead of that call its best to share with the banks a term sheet to be sure everyone is bidding on the same swap. Below would be a sample term sheet for a 6m forward starting swap:

Notional: $50 mm
Effective Date: March 11, 2008
Maturity Date: March 11, 2018
Fixed Rate Payer: Northwest Natural
Fixed Rate: [tbd], semi-annual, 30/360, unadjusted
Floating Rate Payer: Financial Institution
Floating Rate: 3M LIBOR, quarterly, ACT/360

I am happy to walk through any of the above in more detail if you would like -- just give me a call.

James Gerhart
Fixed Income Derivatives
UBS Investment Bank
(203) 719-8184
james.gerhart@ubs.com

Feltz, Stephen

From: Mau, Jacky (GMI - CAPMKTS) [Jacky_Mau@ml.com]
Sent: Friday, October 19, 2007 7:51 AM
To: Feltz, Stephen
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
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Steve - we've hit 4.41% on the 10y Treasury!

Jacky

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Sent: Friday, October 19, 2007 1:00 PM
To: Stefan.Clyne@ubs.com
Subject: Market Update - October 19th
Attachments: Legal Disclaimer

Market Update

The bond rally that began on Monday has continued at a strong pace today, with UST yields down between 8 - 14bps. The 2Y UST is currently at 3.77% (down 14bps), 5Y is down 12bps to 4.02%, and the 10Y is down 11bps to 4.38%. Swap spreads have gapped wider by between 1 - 2bps as risk aversion increases, with much of the bond rally attributed to the large equity sell off - the DJIA is down 368 points today (-2.4%).

Over the week the 2Y UST yield has declined by 45bps (the largest price increase in 5 years), while the 10Y UST yield has declined by 30bps since last Friday's close - the 15bps of steepening this week is the most since the Fed meeting on Sept 18th. Meanwhile, the market's expectation of a Fed rate cut on October 31st has reversed since the start of the week - according to Fed Funds Futures there is currently a 92% chance of a cut to 4.50%, whereas this probability was only 32% a week ago.

Regards

Stefan

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Feltz, Stephen

From: Schlopy, Karl (IBK-HOU) [karl_schlopy@ml.com]
Sent: Friday, October 19, 2007 8:43 AM
To: Feltz, Stephen
Subject: Next Steps for NWN Hedge

Steve,

I have been closely following the updates from Christine and Jacky and am excited to see the market has moved in your direction. Patience is a virtue.

Regarding process and next steps I understand the need to show it to multiple parties for regulatory reasons.

That being said, we believe we will be competitive.

Have you considered the notion of a "last look" prior to execution, in order to meet or beat the tightest levels shown?

All the best,

Fritz

Karl Fritz Schlopy
Managing Director
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Feltz, Stephen

From: robin.bauer@jpmorgan.com
Sent: Friday, October 19, 2007 2:34 PM
To: Feltz, Stephen
Cc: robert.bussa@jpmorgan.com; jennifer.m.saltarelli@jpmorgan.com; michael.k.murphy@jpmorgan.com
Subject: NWN Market Update

Attachments: pic08805.jpg

pic08805.jpg (62 KB)

Hi Steve,

Treasuries rallied dramatically this week, and the 10-year UST yield fell to within 7 bps of its lowest level since January 2006 (see chart below).
As fears of conflict between Turkey and Iraq pushed crude oil prices to new record highs, some analysts predicted an upward spiral in energy prices would compound the housing slowdown. The flight to quality was exacerbated by a rise in weekly jobless claims and weak Q3 earnings in the financial
sector (particularly the dismal results reported by Citi and BofA). The yield curve steepened to reflect resuscitated expectations of future Fed easing, with 2Y UST yields down 45 bps while 10Y UST yields dropped 29 bps.

Nonetheless, this week's news did not materially change the economic outlook. Although uncertainty remains high, money and credit markets continue to improve. Meanwhile, consumer and corporate spending have remained resilient in the face of both the housing downturn and this summer's credit turmoil. JPMorgan economists expect the key drivers of consumer spending, labor income and wealth, will remain largely unaffected by the ongoing housing slump. In addition, the weak dollar should continue to spur manufacturing activity.

Today's market offers an excellent opportunity to lock hedge rates near this year's cheapest levels. Market rates once again reflect the expectation of three Fed rate cuts (25 bps each) by mid-2008. Meanwhile, JPMorgan economists expect the Fed to be on hold for the foreseeable future (i.e. we believe current hedge rates are too low).

Below are up-to-date indications for the hedge strategies we have been discussing. Knowing the market remains fickle and vulnerable to sudden shifts based on headlines (such as early-October's stronger-than-expected employment data), please let us know if we can provide anything further at this time.

Best regards + have a great weekend!

Robin

++

	T-Lock (THOR 10Y UST)	Swap Rate Lock (10Y Swap Rate)
Locked until	15-Sept-08	15-Sept-08
Spot	4.395%	5.10%
Fwd Premium	0.12	0.111
All-In Rate	4.515%	5.211%

Please let us know if we can provide anything further at this time.

Thanks + have a great weekend!

Robin

(Embedded image moved to file: pic08805.jpg)

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Feltz, Stephen

From: Mau, Jacky (GMI - CAPMKTS) [Jacky_Mau@ml.com]
Sent: Friday, October 19, 2007 3:14 PM
To: Feltz, Stephen
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve - as we close out for the weekend, we're marking the 10y UST at 4.39% (after hitting 4.38% briefly this afternoon). The curve has flattened slightly since this morning, which results in lower forward premiums:

to 08/31/08: 7.60 bps
to 09/30/08: 9.50 bps
to 10/31/08: 10.40 bps

This week's movement has been impressive -- it's the largest week-over-week Treasury move (rally or sell-off) since April 2004. The 10y rally (29 bps) is also the largest since January 2004. There are no economic data releases on Monday, so we'll see where Asian/London trading momentum takes us. Further, if you have a moment on Monday, we'd like to walk you through a dry-run execution -- we can send you screens and show you how we price the forward drops, etc.

Let us know what works for you.

Have a great weekend!
Jacky

Jacky Mau | Derivative Solutions | Merrill Lynch & Co. | Office: 212 449 7018 | Fax: 212 449 5057 | jacky_mau@ml.com

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From: Mau, Jacky (GMI - CAPMKTS)
Sent: Friday, October 19, 2007 10:51 AM
To: 'Feltz, Stephen'
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve - we've hit 4.41% on the 10y Treasury!

Jacky

From: Mau, Jacky (GMI - CAPMKTS)
Sent: Friday, October 19, 2007 9:35 AM
To: 'Feltz, Stephen'
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve - despite no economic data releases today, the Treasury market continues to rally on credit concerns. The 10y UST is currently trading below 4.47%, a level only seen during the market dip in early September. Furthermore, the 20+ bps rally this week represents the largest week-over-week rally or sell-off for the entire year.

Below are updated forward drops:
to 08/31/08: 7.75 bps
to 09/30/08: 9.75 bps
to 10/31/08: 10.5 bps

Let us know if you'd like to discuss further.

Regards,
Jacky

From: Mau, Jacky (GMI - CAPMKTS)
Sent: Thursday, October 18, 2007 9:35 AM
To: 'Feltz, Stephen'
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve - both Jobless Claims (337k vs. 312k exp) and Continuing Claims (2534k vs. 2525k exp) came in slightly above consensus. The initial reaction was a rally across the curve (10y UST touched below 4.50%) but has since given back some of the overnight gains. The 10y UST is currently trading between 4.51 - 4.52%. With the curve is a bit steeper, the forward drops are roughly 0.2 bps higher than yesterday afternoon.

We'll continue to keep you updated.

Regards,
Jacky

From: Mau, Jacky (GMI - CAPMKTS)
Sent: Thursday, October 18, 2007 8:28 AM
To: 'Feltz, Stephen'
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve - we saw good follow-through buying from Asia and Europe overnight. Interest rates have rallied another 6-8 bps in the front-end and 2-4 bps in the back-end. The 10y UST is currently trading around 4.50%, last seen during the first week of September (right before the dip below 4.40% and subsequent bounce-back).

We're awaiting the Jobless Claims data to be released in a few minutes. We'll let you know how the market reacts.

Regards,
Jacky

From: Feltz, Stephen [mailto:spf@nwnatural.com]
Sent: Wednesday, October 17, 2007 8:26 PM
To: Mau, Jacky (GMI - CAPMKTS)
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Jacky,

Yes, this is more attractive and close to opportunity we were looking for.

From: Mau, Jacky (GMI - CAPMKTS) [mailto:Jacky_Mau@ml.com]
Sent: Wednesday, October 17, 2007 11:22 AM
To: Feltz, Stephen
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS); Ginfrida, Christine (GMI CAPMKTS)
Subject: RE: Hedging / Market Update

Steve - we're seeing a massive rally this afternoon. The 10y UST is over 12 bps lower on the day and nearly 20 bps lower than last week's highs.. The stock market is lower for the third consecutive day as housing starts fell to 1.191 million, the lowest since March 1993. Core CPI was reported in-line with expectations at 0.2% and 1.7% for m/m and y/y, respectively. This suggests a core PCE print of 0.2% m/m and 1.7% y/y, in-line with the Fed's implicit target. While these figures seem to give the Fed both reason to reduce rates at the next FOMC Meeting and the room to do so on the inflation side, it remains a close call given the divergent opinions on the FOMC about the downside risks to the economy.

Below are updated forward drops:
to 08/31/08: 7.75 bps
to 09/30/08: 9.70 bps
to 10/31/08: 10.5 bps

While the drops are slightly higher from a steeper curve, interest rates are now below this year's average.

Let us know if this seems attractive to you.

Regards,
Jacky

From: Ginfrida, Christine (GMI CAPMKTS)
Sent: Wednesday, October 10, 2007 9:57 AM
To: Mau, Jacky (GMI - CAPMKTS); 'Steve Feltz (spf@nwnatural.com)'
Cc: Schlopy, Karl (IBK-HOU); Trachsel, Scott (GMIT - CAPMTS)
Subject: RE: Hedging / Market Update

Steve -

Good morning. As Jacky noted yesterday, the implied probability of a Fed ease at the Oct. 31st meeting continues to decline on robust economic data. As of this morning, the Fed Funds options market is implying a 66% chance that the Fed leaves rates unchanged at the next meeting - this is a nearly complete reversal from late last week, where the market was implying a nearly 70% likelihood that the Fed would ease by 25 bps.

This change in market sentiment has caused rates to sell off 3-4 bps at the long end since last Friday. However, the short end remains largely unchanged, resulting in slightly lower forward drops:

to 08/31/08: 6.5 bps
to 09/30/08: 8.25 bps
to 10/31/08: 9.00 bps
to 11/30/08: 10.5 bps

These are .25 - .50 bps lower than our last indications.

Have you made a decision on how you want to proceed with this? Please let us know if we can provide additional information to assist you with your decision.

Regards,
Christine and Jacky

Christine Ginfrida | Director, Merrill Lynch & Co | Phone: 212-449-2657 | Mobile: 917-494-9592 |
christine_ginfrida@ml.com

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View from the desk

"Reverse" conundrum points to deeper rate cuts

Typical monetary policy transmission path is significantly obstructed by the dysfunctional state of the financial markets

Many market participants are worried that the Federal Reserve's 50bps rate cut was too aggressive and will stoke inflationary pressures. However, we think that a 50bps rate cut in today's financial environment will amount to far less than it would in more-normal times. In our view, what's happening is this: the Bernanke-led Fed faces a reverse 'conundrum' from what the Greenspan-led Fed faced during 2004-2006, since the typical monetary policy transmission path is significantly obstructed by the dysfunctional state of the financial markets. Instead of worrying about the possibility of higher inflation, we believe investors should be factoring-in more downside risk for the economy and the likelihood that the Fed will be forced to cut the funds rate even more than otherwise would have been the case, and by more than is currently priced into the markets.

Look back at the original Greenspan Conundrum

The Fed raised the funds rate steadily from mid-2004 to mid-2006, from a low of 1% to 5.25%. However, the key 10-year Treasury yield did not follow in lock step as it normally does. For most of that period 10-year yields drifted lower; it didn't rise until 2006. Even then, the increase in yields was far less than would be expected, and the yield curve 10-year to Fed funds was inverted (10-year yields were lower the Fed funds target). That prompted ex-Fed Chairman Greenspan to use the term 'conundrum' when talking about the frustrating divergent moves in long-term rates.

There were several main forces holding long-term Treasury yields lower

It was frustrating for the Fed because policymakers were trying to raise long-term mortgage rates (which move in tandem with 10-year note yields) to stem the ongoing boom in the housing market (at that time home prices were still galloping at a double-digit pace). There were several main forces holding long-term Treasury yields lower; foreign buyers were increasing their purchases of Treasuries at a time when the long-term supply of Treasury issues was declining (the Treasury Department was not issuing 30-year bonds) and risk premiums were low. The divergent move in long-term rates essentially blocked the Fed's monetary policy transmission channel for housing.

Not true today

The Fed is dealing with a reverse 'conundrum'

Since the Fed cut rates on September 18th, 10-year Treasury yields have risen by 12 basis points, creating a reverse 'conundrum' for the Fed

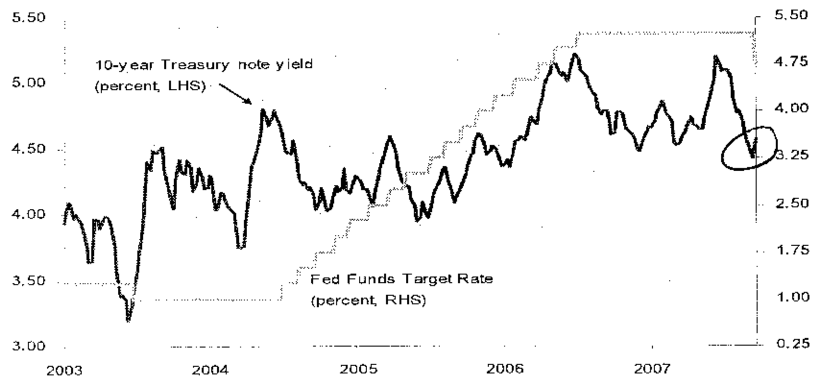
Today, the Bernanke-led Fed is cutting the funds rate in large part to slow the downward deflationary housing spiral and buffer the rest of the economy from its negative impact. However, since the Fed cut rates on September 18th, 10-year Treasury yields have risen by 12 basis points, creating a reverse 'conundrum' for the Fed. Compounding the back-up in Treasury yields, greatly diminished liquidity in the secondary mortgage market has widened the spread between 30-year mortgage rates and 10-year yields. Consequently, since September 18th, rates on conforming 30-year mortgages (those less than $417,000) are 11 basis points higher at 6.11%. Jumbo rates have eased a bit to 6.94%, but the spread between those rates and conforming rates is still exceptionally wide at 83 basis points; it typically is closer to 15 basis points.

Spread between 10s and 30s growing

These higher mortgage rates increase the downward pressure on home prices (August median prices for existing homes and new homes were reported down 2.4% and 8.3%, respectively); that, in turn, depresses consumer confidence and spending. We view the sharp drop of 12.1 points in the Conference Board's consumer confidence index in the past two months as just the beginning of a steep erosion in consumer confidence. The same is true for the back-to-back weekly declines in the weekly retail chain store sales; back-to-school sales in September look anemic despite retailers' widespread use of promotions.

Under these circumstances, the Fed must lower the funds rate by more than it otherwise would have been the case to offset the effect of higher long-term rates on asset prices. Look at what Fed Governor Kohn (who has served under Mr. Greenspan and Mr. Bernanke) said last week. "Asset prices have mattered in the determination of policy because they have mattered for our outlook. I am confident that the federal funds rate would not have been as high in 2000 if it had not been for the level of equity prices that year, nor would the federal funds rate have been as elevated in 2006 in the absence of the tight credit spreads, low term premiums, and the impetus from housing wealth. And I doubt policy would have been eased this week if housing prices had continued their upward march. In each instance, however, policy was motivated not by the desire to achieve any particular level of asset prices, but rather by the Federal Reserve's assessment of how changes in asset prices were affecting the forecast of growth and inflation."

Chart 1: The Fed's conundrum: They only control the funds rate, not 10-year yields



Source: Federal Reserve Board, Merrill Lynch

Money market crisis narrows another key path for monetary easing

Despite the Fed's 50bps rate cut, and generous infusions of liquidity by the Fed, ECB, and more recently the BoE, a high degree of illiquidity continues to plague the money markets. As we wrote in our piece titled, *Credit crunch in the money markets* dated September 6th, uncertainty about the credit quality of asset-backed commercial paper is causing banks to hoard cash on their balance sheets. As banks are less willing to lend cash to other banks in the interbank market, Libor (London interbank offer rate) rates have become elevated.

The 50bps of Fed easing only produced a net 13bps reduction in three-month LIBOR

Spread between LIBOR and Fed funds rate remains wide

As we predicted in our above-mentioned piece, the Fed's rate cut did have the effect of lowering the level of the key three-month LIBOR rate to 5.23% from its crisis-peak of 5.73%. However, prior to the financial crisis that erupted in August, three-month LIBOR rates were 5.36%. That means that the 50bps of Fed easing only produced a net 13bps reduction in three-month LIBOR; in other words, only 26% of the easing filtered through to LIBOR.

Right now, the spread between the three-month LIBOR and the targeted Fed funds rate (4.75%) is a wide 47 bps. Such a sizable gap usually would be associated with Fed tightening, not easing. Leading up to and during the early stages of a Fed easing, three-month LIBOR rates typically lead the way down and fall below the targeted funds rate in anticipation of further Fed easing. Even far into an easing cycle, the spread between 3-month LIBOR and funds usually is just a skinny 15 bps.

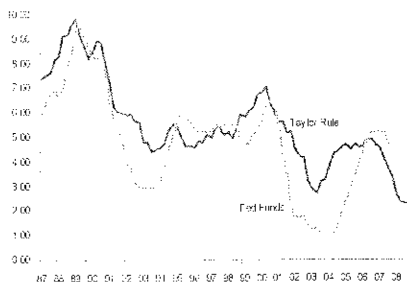
LIBOR rates remain stubbornly high

LIBOR is an important rate because it is the global benchmark for everything from large global corporate loans and deals to US mortgage rates, consumer loans, and student college loans. The Fed can only exert direct control over the Fed funds rate (although the financial market crisis is even hampering policymakers' ability to keep the effective funds rate at target), and it moves the funds rate with the aim of lowering or raising market rates, such as LIBOR. It is market rates, not policy rates, that affect spending and borrowing decisions, and those decisions ultimately brings about changes in macro output and prices.

Stubbornly high LIBOR rates are a signal that the interest rate channel through which monetary policy operates is impaired. That, in turn, means that as long as the markets remain dysfunctional, Fed easing will be less effective. And even if the markets start to become more normal in the medium term (we see no sign that they'll do so in the near term or before the end of the year), the Fed will still be further behind the curve than the funds rate alone would suggest. That argues for even more Fed easing and supports our view that the Fed will eventually bring the Fed funds rate down to 3.5% by mid-2008, with the risk of a 2%-handle.

Taylor Rule

Chart 2: Taylor rule signals more easing ahead



Source: Merrill Lynch, Federal Reserve Board

Our updated Taylor rule (see Chart 2), which incorporates our GDP and core inflation forecasts for the rest of this year and for 2008, also argue for further meaningful cuts in the Fed funds rate. The Taylor rule, developed by Stanford Professor and ex-Treasury Under Secretary John Taylor, suggests how much the Fed should change the funds rate in response to divergences of real GDP from potential GDP and divergences of actual inflation rates from a target inflation rate. (Potential GDP is the ideal level of GDP the economy is estimated to generate if it is running at a non-inflationary full employment pace; in other words, an economic nirvana.)

The rule recommends that the funds rate should be high or rising when actual inflation is running above its target or actual growth is running above its potential. The opposite would be true if inflation is below target or actual growth falls below its potential (the Fed should be cutting rates then). The Fed does not explicitly follow the Taylor rule, but the rule does provide a guidepost about where the balance of risks lies and where the funds rate needs to go to achieve better balance.

Fed could go as low as 2.25%

Chart 2 signals that, based on our economic forecasts, the Fed could end up easing the funds rate down to as low as 2.25%. That is far more than the markets are currently pricing-in, but it would be in line with other recent episodes of Fed easing. In fact, in the 1989-1992 and 2001- 2003 easing cycles, the Fed cut the funds rate below what the Taylor rule suggested and kept it lower for a longer period of time. Those easing cycles, we believe, will serve as a template for what course the Fed is likely to follow in the next year. Why? Those easing cycles coincided with sharp economic downturns and financial events.

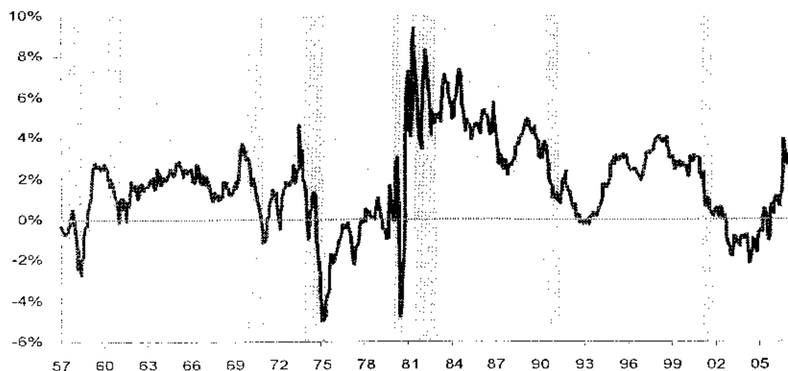
Historical view suggests more easing is ahead

A longer historical view of what happens to the funds rate during economic downturns also suggests that a lot more easing is ahead

A longer historical view of what happens to the funds rate during economic downturns also suggests that a lot more easing is ahead. As shown in chart 3, the Fed ends up taking the real funds rate (nominal funds rate less CPI year-over-year % change) to at least zero or less. That supports our view that the Fed could wind up lowering the nominal funds rate to 3% or 2% in the next year.

If we are correct, the current euro/dollar strips beyond January 2008 hold a lot of value and are a buy because they are not even pricing-in one full 25bps rate cut beyond the January 30th FOMC meeting. The market seems to be betting that the current problems are only a temporary "financial event" and that the Fed only needs to lower the Fed funds rate moderately, the way it did in 1987, 1995, and 1998. It's difficult to see that things will play out that way as the housing recession deepens.

Chart 3: Real Fed funds rate goes to zero or below during economic downturns
Effective Fed funds rate minus year/year % change of CPI



Source: Federal Reserve Board, Merrill Lynch

Kathleen Bostjancic, Economist, MLPF&S, +1 212 449 2650

Hot Topic

Debunking the five latest market myths

The reduction in the funds rate to 4.75% is not a panacea for the ailments of the credit markets, the housing market, or the broad economy

The Fed's 50bps rate cut has sparked a groundswell of equity-bullish and bond-bearish sentiments from our clients and sales force. The most common views that we have heard are:

1. The stock market is pricing recession-risks out and boom-times in;
2. The bond market is signaling that inflation will come back;
3. The credit market is back to normal;
4. The global economy is booming; and
5. The weak dollar will provide a high level of stimulus. We view each of these assessments as market myths and will debunk each one in the sections below.

Market participants hoping for too much from the Fed's initial rate cut

The reduction in the funds rate to 4.75% is not a panacea for the ailments of the credit markets, the housing market, or the broad economy. It is a good and necessary first step, but it is occurring in this context: the massive unwind of the largest credit boom in history is underway, and that process will for sometime overwhelm the effects of Fed easing. As for the reflation concerns, we do not see anything left in the US economy to reflate.

1. Stock market pricing recession-risks out and boom-times in

We do believe that the Fed is going stay on an aggressive easing campaign, but we question whether or not it is already too late

We've been asked many times if the Fed has ever cut interest rates with the stock market only 2% from its all-time highs. Few people seem to recall that just as the Fed cut the discount rate for the first time and hinted loudly at an easing in the funds rate back on August 17th, the stock market had been down by 10% intra-day from its recent peak reached in late July, so in some sense the damage was already done. Stocks geared to the domestic economy were down more than 20% at the market trough, and even as it now stands with the latest rally, 40% of the stocks that make up the S&P 500 are still in negative terrain year-to-date. Moreover, there is ample evidence that the rebound in equities has been fuelled primarily by a vicious short-squeeze. As Kopin Tan in Barron's points out this week (page M5), the stocks that had the largest short position were the ones that outperformed the most in the days following the Fed's aggressive 50bp rate cut. Indeed, the latest NYSE data show that bearish positions on the Big Board (short interest) plunged by 5% in the past month to 11.84 billion shares from 12.47 billion in mid-August.

It is not obvious to us that the stock market has really told us much of anything other than that investors have high hopes that the Fed is going to do everything it possibly can to prevent a recession from taking hold. We do believe that the Fed is going stay on an aggressive easing campaign, but we question whether or not it is already too late. All the classic recession signs are there: the 5-to-6 quarter lags from an inverted yield curve (which the Fed engineered in July/06); house price deflation (this always lands the economy in recession); declines in both official measures of employment; a 60bp drop in the employment/population ratio (a 100% track record); a 96.7 reading in the Conference Board's coincident-to-lagging ratio; a near-50% collapse in housing starts. Maybe there is enough strength in the global economy to prevent an outright recession via a huge export offset; we are skeptical on this score, but willing to keep an open mind.

If you go back to the 1990 and 2001 experiences, the Fed cut rates 150bp both times before the recessions began, but the grim reality is that the recessions did begin and the Fed was too late both times. Both episodes represented the unwind of asset and credit bubbles and an ensuing deleveraging process, which history teaches us is a very tricky and difficult thing for the central bank to get ahead of. On both occasions, bonds sold off, curves steepened and equities rallied initially on reflation and recovery hopes, as they are doing today.

One thing we can say with certainty is that the script from the early 2001 rate-cutting cycle is being revisited

Caveat emptor

Go back to June-July 1990; after the Fed had cut rates, the S&P 500 put in a classic double-top. Who knew at the time that the recession was about to commence? Then backtrack to July-Sept of 2000, and once again, the S&P did another double-top as the 1500 threshold was retested around Labor Day. Again, who knew recession pressures were building and about to take hold in the opening months of 2001? In both periods, 150bp of Fed easing did not stop the recession from coming. The Fed thought it had it nipped a recession in the bud, but it was too little, too late. We have seen this movie before. And for all the talk about inflation, recall that the unemployment rate was 4.2% in Jan/01, not 4.6% as it is today, and headline inflation was almost 4%, not 2%. If anything, Bernanke has more leeway than Greenspan did back in early 2001.

The script from the early 2001 rate-cutting cycle is being revisited

One thing we can say with certainty is that the script from the early 2001 rate-cutting cycle is being revisited. Bonds got crushed initially when the Fed cut rates by 50bps on January 3rd, but this proved to be a massive buying opportunity as reflation expectations proved faulty. The front end rallied and the curve steepened, and the front end was accurate in foreshadowing further Fed ease as the economic backdrop worsened. Yes, today the steeper yield curve is saying that there will be a light at the end of the economic tunnel in early 2009, but we are going to pay for the inversion that began just over a year ago. History is on our side on that call (as the San Fran Fed just ratified in a report published in July).

The data in the next few months are likely to be so bad that many pundits will be questioning the effectiveness of monetary policy

The beauty for equity investors is that the die is cast

When the Fed cut 50bps on January 3rd, 2001, tech rallied by 18%, consumer discretionary by 9%, and financials by more than 5%. The defensives were spanked; health care, utilities and consumer staples underperformed the broad market that day by 1,000 basis points. (Didn't you know? The Fed was going to save the day. Wrong.) All of the groups that surged on the day of that 50bp move were sold during the rest of the year; from that day on to December 31st 2001, tech slid by 33%, consumer discretionary fell by 7%, and financials sagged by 11%. Meanwhile, the sectors that lagged on the day of the Fed's first volley – utilities, staples, health care – outperformed by 700 basis points.

So what happened this time around as the Fed cut 50 bps on September 18th? Homebuilders rallied by 5% (today's tech equivalent), financials surged by 5%, and consumer discretionary rose by 3.5% – all handily beating the 2% gain in the market. Once again, the defensives lagged by 100 basis points. But if the last cycle was any indication, the thing to do with a view to year-end is underweight what rallied on September 18th and overweight what lagged. The data in the next few months are likely to be so bad that many pundits will be questioning the effectiveness of monetary policy. This is the fallout from cutting by 50 bps – hopes are high that the move will forestall a recession. Those hopes, as we saw in the last two deleveraging disintermediation cycles of 1990 and 2001, are highly likely to be dashed.

2. Bond market is telling the Fed inflation will come back

Inflation in food and fuels in a weak domestic demand environment will prove to be more of a squeeze on retailers' margins than a pervasive source of consumer inflation

One would think that we just came off a tightening in monetary policy rather than easing, and that we just came off the best employment report of the cycle instead of the worst. Here's the story. We are replaying the 2001 movie. On January 3rd of that year, the Fed cut the funds rate by 50 bps and the markets did basically the same thing they are doing now – buying into the "reflation trade". The NASDAQ soared by 23% that month, the S&P 500 climbed by 7%, and the 10-year note yield surged by more than 40bps as investors built the view that the Fed was going to successfully reflate the tech sector and avert a recession. Wrong call on both counts. In fact, even with those massive stock market gains and the "message" from the bond market that the Fed was "buying inflation", the Fed cut by 50 bps again on January 31st. And guess what? That was the day that the NASDAQ began to roll over as the sinking feeling that the Fed was way behind the growth curve began to sunk in. And recession began two months later. The backup in bond yields, however, represented the buying opportunity of the year. Time will tell if we will see a repeat.

As for all the inflation talk; forget it

The theme for the next year will be deleveraging and disintermediation and the impact on the aggregate demand curve will be disinflationary; and the lingering deflation in residential real estate is likely to be followed by price weakness in the commercial space. Inflation in food and fuels in a weak domestic demand environment will prove to be more of a squeeze on retailers' margins than a pervasive source of consumer inflation.

Fed's rate cut did not ignite inflation expectations

The last leg of the commodity story is not about the Fed, or about a supposed global economic boom

Another myth making the rounds is that the Fed's rate cut ignited inflation expectations. That is quite untrue. For one, TIPS breakevens have not moved all that much. Second, neither has the 10/30 spread along the curve. Third, the dollar is going down, not so much because of the Fed, but because we came off a week where single housing starts sagged to a 12-year low and single starts are down at nearly a 50% annual rate over the past three months. The Fed is merely responding to that weakness (and so is the dollar). As for gold and oil, again, this is a "Fed story" only for folks who are not watching geopolitical events. So no – the last leg of the commodity story is not about the Fed, or about a supposed global economic boom. And insofar as it is not demand-related, this last leg of the commodity story promises to be a margin squeeze on US producers, especially with domestic final sales growth on the verge of stagnating.

3. The credit market is back to normal

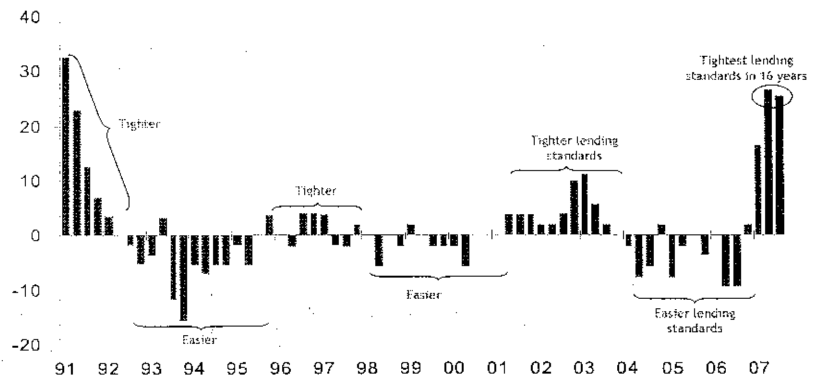
This is certainly not true at all, even though many credit market barometers have improved in the past two weeks. The Fed's 50bp move has only offset between one-half and three-quarters of the summertime credit tightening. The LIBOR rate has come down to a bit below where it was just before the financial stress began in July, but the spread over the funds rate has barely budged at 46bps. That is not normal (pre-crisis spread was 13 bps), and it signals that only a small part of the Fed easing filtered through to the level of LIBOR. The TED spread at 141 bps has only unwound one-quarter of the summertime widening. Is that all we get despite the massive liquidity infusion from the ECB, the bailouts from the BoE, all the repos and discount rate cuts and the big easing in the Fed funds rate? A one-quarter retracement for all that effort? Thirty-year jumbo mortgage rates at just under 7% are still 75 bps above their pre-July levels, and the moderate improvement in recent weeks has reversed less than one-quarter of the runup. Ditto for high-yield spreads which are now at 395 bps (down from 460 bps at the nearby high but well above the 250 bp level pre-July).

Lending standards have tightened

Lending standards for the residential mortgages, per the latest Fed surveys, have tightened at a pace last seen during the 1991 credit crunch. Firms such as Countrywide have announced that they are abandoning the subprime market, which, along with the boom in Alt-A issuance, basically funded almost 1% of the annual growth that GDP posted over the past three years. The 16% plunge in outstanding commercial paper has coincided with a surge in C&I loans on the banking sector balance sheet; that indicates that the re-intermediation of credit already has begun to tie up capital, which in turn could impair loan extension going forward. And in the LBO–financed M&A market, the era of 'no cov' and 'cov lite' loans is clearly over; that, too, will have repercussions for future growth (the past six years represented the most leveraged economic cycle in history).

Chart 1: Tightest mortgage standards in 16 years

Fed Sr. Loan Officer Survey: Bank tightening standards for mortgages to individuals (percent)



Source: Federal Reserve Board, Merrill Lynch

4. The global economy is booming

The BRICs may still be booming, but they account for less than 10% of US exports and only about 1% of US GDP

Wrong tense. The global economy <u>was</u> booming. After all, the housing market in the UK is showing signs of rolling over again, and the angst in the financial market there could cause a US-style tightening in credit conditions. The data out of Euroland has been rather poor lately, including the weaker-than-expected German IFO business measure (which hit a 19-month low), a deterioration in German consumer confidence as signaled by the German GfK consumer confidence survey, and a plunge in the region's purchasing managers' diffusion index to 54.5 in September from 57.4 in August (the steepest decline since October/01). The world's second largest economy, Japan, just came off a negative second quarter GDP print, and the consensus is looking for a very weak Tankan business confidence survey to be released on October 1st (consensus sees 21 for the September index from 23 in June).

Canada reported a sharp 0.8% slide in July retail sales, the second decline in a row, and Mexico's Finance Ministry has cut its 2007 GDP growth projection to 3% from 3.3%. When you add America's NAFTA and G-7 trading partners, where growth is now slowing, they represent 60% of US exports (and over 60% of global GDP). The BRICs may still be booming, but they account for less than 10% of US exports and only about 1% of US GDP (and barely more than 12% of global GDP). So the view out there that a BRICs boom will be enough to offset a slowing in US consumer spending and a sustained downturn in the housing market – which together represent 75% of U.S. GDP – seems to be hopelessly optimistic. The numbers just aren't there.

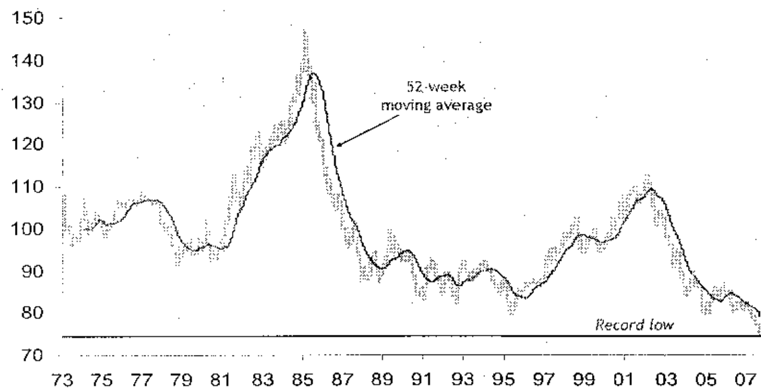
5. The weak dollar is going to provide a huge stimulus

Eighteenth-century mercantilist thought seems to be staging a revival. But it begs the question, why doesn't every country merely devalue its currency to maximize economic growth? They don't because devaluation doesn't work. Recall that the heyday for the US economy in the second half of the 1990s coincided with a strong dollar. Also recall that during the same period, the weakness of the Canadian dollar coincided with that country's pronounced economic underperformance. In fact, looking back over the past 20 years, you will see that, in the US, the years in which the dollar fell saw real GDP growth that was, on average, more than one-half of a percentage point lower than what it was when the dollar rallied. The lesson is that DOLLAR WEAKNESS IS NO PANACEA. The dollar, being a relative price, should be sending the Fed a warning sign that the FX market is rapidly downgrading America's growth outlook at a far faster pace than other markets are doing.

Another view to consider is that the depreciating US dollar will add considerable stimulus to the U.S. economy and earnings. The decline in the dollar is really nothing new; the greenback has actually been a bear market two-thirds of the time over the past 20 years, and the current account deficit is still nearly 5.5% of GDP. But the DXY's breakout to new lows that has caught everyone's attention.

Chart 2: US Dollar in a secular bear market

Trade weighted US dollar vs. major currencies (March 1973 = 100)



Source: Federal Reserve Board, Merrill Lynch

A declining currency yields both winners and losers

It's important to note that even though a declining currency does raise a country's export competitiveness on a static stand-alone basis, there are at least as many losers as there are winners. That's because the US is a very large exporter, selling $1.2 trillion of goods and services to the rest of the world; moreover, it is an even larger buyer, importing $2 trillion (excluding oil, these figures are $1 trillion and $1.5 trillion, respectively).

Export oriented sectors stand to gain the most

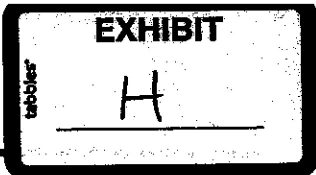
The areas that stand to gain the most are the ones which are most export oriented: aircraft, tech, chemicals, machinery, food products, and metals. On the other hand, the sectors of the economy that are the most sensitive to imports are highly likely to see their margins squeezed by the lower dollar. The reason is that their success in passing on higher currency costs to consumers will be limited in an environment of declining domestic demand. Industries in that category include autos, clothing, textiles, fabrics, appliances, furniture, wood, paper, printing, and electronic products; together; they represent 85% of the discretionary goods that Americans buy. As we see it, retailing or wholesaling companies geared to the US consumer are likely to find that the dollar's decline will be a crushing blow to profit margins.

Meanwhile, the price of oil has surged in the past month or so from $72 a barrel to more than $83 a barrel. When you do the math, this is a pretty daunting development. The US imports some 11 million barrels of oil a day from the rest of the world. That means that the latest price increase represents a dead-weight drag of almost $50 billion per year on the US economy, or a tax equal to nearly 0.5% of GDP at an annual rate that goes into the coffers of other countries. So to think that we get a full offset from this economic drag from Abu Dhabi's decision to take a 7.5% stake in the Carlyle Group is only slightly myopic. It would be nice to believe that there has been an explosion in global demand to justify a 15% surge in the oil price in a four-week span, but that hardly seems to be the case (nor can the weak dollar be the culprit since it has declined by 3% over this time span). The news out of the Mideast and heightened geopolitical risks have likely been pushing oil higher.

Latest leg up in oil prices will likely show through more visibly

Yes, we know that we have been living with high and rising energy prices for years, but keep in mind that from 2002 to 2006 the economy was benefiting from some powerful underpinnings – the easiest fiscal and monetary policies since the 1940s in the first two years of that period, and the biggest housing boom and most pronounced credit boom on record in the last two years. Those forces acted as very strong antidotes to the energy shock. To say that we didn't feel the negative effects of very high energy prices isn't entirely true; as good as the good times were from 2002 to 2006, real GDP growth would have been more than half-a-percentage point stronger if WTI had merely stabilized near $40 a barrel. Now the problem is that the offsets to higher oil prices – easy money, easy credit, house price inflation, fiscal stimulus – have gone by the wayside. That strongly suggests that the latest leg up in oil prices is likely to show through more visibly.

David A. Rosenberg, Chief North American Economist, MLPF&S, +1 212 449 2650



Feltz, Stephen

To: *[handwritten:]* This list was Bcc copied on the original Notification e-mail below. Ginfrida, Christine (GMI CAPMKTS); 'Schlopy, Karl (IBK-HOU)'; 'Mau, Jacky (GMI - CAPMKTS)'; 'James.Gerhart@ubs.com'; Ryan.Donovan@ubs.com; 'robin.bauer@jpmorgan.com'; robert.bussa@jpmorgan.com; Rogers, Casey; 'Crumpler, Jonathan'; 'Willis, Bo'; Willer, Margaret M; 'Steven.D.Hawk@wellsfargo.com'; larpenlm@wellsfargo.com

Subject: FW: NOTIFICATION: Request for Price Quote on Forward Starting Interest Rate Swap

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From: Feltz, Stephen
Sent: Wednesday, October 24, 2007 6:35 AM
To: Feltz, Stephen
Cc: Dodson, Mark; Anderson, David; Miller, C. Alex; Rue, C.J.; Luther, Richelle; Aimone, David; 'Hood, John'; Jordan, Sue; Warren, Linda; Johnson, Leslie
Subject: NOTIFICATION: Request for Price Quote on Forward Starting Interest Rate Swap

For Your Immediate Attention:

NW Natural plans to issue $50,000,000 of fixed rate, senior secured notes (notes) on or about Septebmer 30, 2008 to fund the acquisition and construction of property, the improvement or maintenance of service and the refinancing of maturing long-term debt. The Company anticipates issuing 10-year notes which will be priced off the then current benchmark 10-year U.S. Treasury rate plus NW Natural's 10-year credit spread.

Hedging Objective: NW Natural intends to enter into a forward-starting fixed-rate swap to mitigate the interest rate exposure associated with our planned issuance of notes on or about September 30, 2008. Through the use of a forward-starting fixed-rate swap, NW Natural expects to hedge against adverse changes in the first 20 semi-annual interest cash flow payments on the anticipated notes due to changes in the 10-year benchmark swap rate over the next 11 months.

Hedging Instrument: Forward Starting Interest Rate Swap

Notional Amount:	$50,000,000
Trade Date:	October 24, 2007
Effective Date:	September 30, 2008
Maturity Date:	September 30, 2018
Fixed Rate Payer:	NW Natural
Fixed Rate:	[TBD]%
Fixed Rate Payer Dates:	Semiannual, 30/360, unadjusted
Floating Rate Payer:	[Financial Counterparty]
Floating Rate Payer Dates:	Quarterly, actual/360, adjusted
Floating Rate Benchmark:	3 month LIBOR
Collateral Requirements:	None

Price Quote: Offers must be submitted for the all-in price on a 10-year fixed-rate forward-starting swap, including forward premiums, with an accrual commencement date of September 30, 2008 and a maturity date of September 30, 2018.

Timing: Each counterparty is hereby notified, by email, that NW Natural expects to be entertaining offers for the forward starting interest rate swap described above on Wednesday, October 24, 2007.

- NW Natural will contact each counterparty's trading desk by phone prior to the pricing call to answer questions and confirm the name and phone number of the primary contact for the pricing call. Counterparty may designate a secondary contact in case the primary contact is unavailable for the pricing call. The contact person will be responsible for submitting a timely offer to NW Natural.
- NW Natural expects to place the pricing call to each counterparty sometime after 10:30 a.m. on Wednesday, October 24, 2007 to initiate the bid process.
- Once we are in communication by phone with all counterparties who are invited to submit a bid, we will simultaneously solicit an offer from each counterparty. NW Natural will compare the offers and award the hedge contract to the lowest bidder. NW Natural may elect to split the notional amount of the hedge between two counterparties if the low bids are comparable, but the pricing for each contract will be same. We expect to award the bid immediately upon receiving offers and will confirm the price quote with the awarded counterparty.
- REMINDER: Offers must be submitted for the all-in price on a 10-year fixed-rate forward-starting swap, including forward premiums to September 30, 2008.
- NW Natural expects to unwind the hedge contract on the note issuance date, with the resulting unwind payment to (or from) NW Natural based on the difference between the spot rate at the unwind date and the fixed rate per the above executed hedge contract.

We will promptly notify each counterparty who has not been awarded the transaction.

Stephen P. Feltz

Cc:

M.S. Dodson, NW Natural
D.H. Anderson, NW Natural
C. A. Miller, NW Natural
C.J. Rue, NW Natural
R.T. Luther, NW Natural
D.W. Aimone, NW Natural
J.T. Hood, Thelen Reid Brown Raysman and Steiner

BID TICKET ON FORWARD STARTING SWAP *[Assigned to: ~~C.J. Rue~~]*

5.083

Bank Name: UBS

Contact Name: James Gerhart

Contact Phone: 203.719.8184

[Place the call and ask to speak with above named contact; if that individual is not available, then ask to speak with someone else who can participate on a swap pricing call with NW Natural. Once you've confirmed that you are speaking with the right person, then proceed with the following]

Hello, my name is C.J. Rue, and I'm with NW Natural Gas. I'm calling to initiate today's pricing call on a 10-year fixed-rate forward starting swap contract. Please stand-by while we connect with other parties.
[Pause and wait until instructed to begin the bid process]

We are ready to receive your all-in price quote for the 10-year fixed-rate forward starting swap. May I ask for you bid please?
[Write the price offer in the upper right hand box and confirm the rate with your contact]

Awarded Bid: Congratulations, you are low bidder and we are awarding the hedge contract to you. Please stay on the line so that we can confirm the details of the trade.

Declined Bid: Thank you very much for your bid, but I regret to say that we must decline your offer. We appreciate your time this morning.

5.08 wouldn't be accepted because it was a follow-up bid after acceptance.

BID TICKET ON FORWARD STARTING SWAP *[Assigned to: Linda Warren]*

Bank Name: Wachovia Bank

Contact Name: Casey Rogers Brent Jacobsen

Contact Phone: 704.715.8491

5.0875
5.09

[Place the call and ask to speak with above named contact; if that individual is not available, then ask to speak with someone else who can participate on a swap pricing call with NW Natural. Once you've confirmed that you are speaking with the right person, then proceed with the following]

Hello, my name is Linda Warren, and I'm with NW Natural Gas. I'm calling to initiate today's pricing call on a 10-year fixed-rate forward starting swap contract. Please stand-by while we connect with other parties.
[Pause and wait until instructed to begin the bid process]

We are ready to receive your all-in price quote for the 10-year fixed-rate forward starting swap. May I ask for you bid please?
[Write the price offer in the upper right hand box and confirm the rate with your contact]

Awarded Bid: Congratulations, you are low bidder and we are awarding the hedge contract to you. Please stay on the line so that we can confirm the details of the trade.

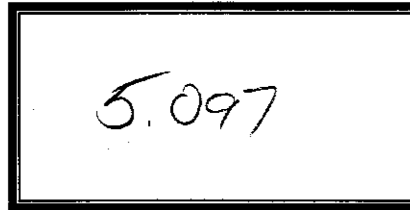
Declined Bid: Thank you very much for your bid, but I regret to say that we must decline your offer. We appreciate your time this morning.

BID TICKET ON FORWARD STARTING SWAP *[Assigned to: Sue Jordan]*

Bank Name: Wells Fargo Bank__________

Contact Name: Steven Hawk_______________

Contact Phone: 415.222.1162_______________



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Hello, my name is Sue Jordan, and I'm with NW Natural Gas. I'm calling to initiate today's pricing call on a 10-year fixed-rate forward starting swap contract. Please stand-by while we connect with other parties.
[Pause and wait until instructed to begin the bid process]

We are ready to receive your all-in price quote for the 10-year fixed-rate forward starting swap. May I ask for you bid please?
[Write the price offer in the upper right hand box and confirm the rate with your contact]

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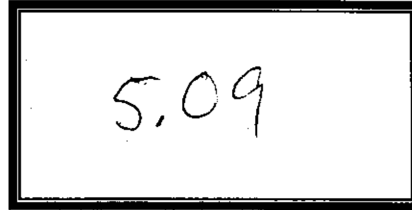
Declined Bid: Thank you very much for your bid, but I regret to say that we must decline your offer. We appreciate your time this morning.

BID TICKET ON FORWARD STARTING SWAP *[Assigned to:Dave Aimone]*

Bank Name: JP Morgan_______________

Contact Name: Robin Bauer_______________

Contact Phone: 312.732.5605_______________



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Hello, my name is Dave Aimone, and I'm with NW Natural Gas. I'm calling to initiate today's pricing call on a 10-year fixed-rate forward starting swap contract. Please stand-by while we connect with other parties.
[Pause and wait until instructed to begin the bid process]

We are ready to receive your all-in price quote for the 10-year fixed-rate forward starting swap. May I ask for you bid please?
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Awarded Bid: Congratulations, you are low bidder and we are awarding the hedge contract to you. Please stay on the line so that we can confirm the details of the trade.

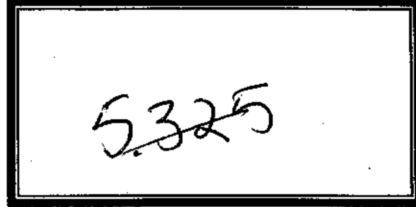
Declined Bid: Thank you very much for your bid, but I regret to say that we must decline your offer. We appreciate your time this morning.

BID TICKET ON FORWARD STARTING SWAP *[Assigned to: Leslie Johnson]*

Bank Name: Bank of America

Contact Name: Bo Willis

Contact Phone: 415.622.1675



5.320

[Place the call and ask to speak with above named contact; if that individual is not available, then ask to speak with someone else who can participate on a swap pricing call with NW Natural. Once you've confirmed that you are speaking with the right person, then proceed with the following]

Hello, my name is Leslie Johnson, and I'm with NW Natural Gas. I'm calling to initiate today's pricing call on a 10-year fixed-rate forward starting swap contract. Please stand-by while we connect with other parties.
[Pause and wait until instructed to begin the bid process]

We are ready to receive your all-in price quote for the 10-year fixed-rate forward starting swap. May I ask for your bid please?
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Declined Bid: Thank you very much for your bid, but I regret to say that we must decline your offer. We appreciate your time this morning.

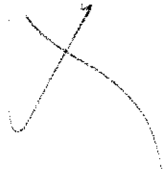
BID TICKET ON FORWARD STARTING SWAP *[Assigned to: Richelle Luther]*

Bank Name: Merrill Lynch

Contact Name: Jacky Mau

Contact Phone: 212.449.7018

5,099



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Hello, my name is Richelle Luther, and I'm with NW Natural Gas. I'm calling to initiate today's pricing call on a 10-year fixed-rate forward starting swap contract. Please stand-by while we connect with other parties.

[Pause and wait until instructed to begin the bid process]

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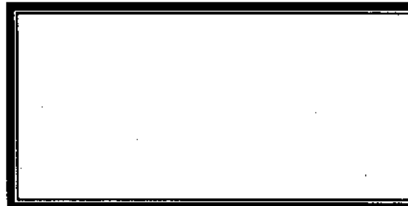
BID TICKET ON FORWARD STARTING SWAP *[Assigned to: Sue Jordan]*



Bank Name: Wells Fargo Bank__________

Contact Name: ✓Steven Hawk______________
LISA LARPENTEUR 503.886.2211

Contact Phone: ✓415.222.1162______________

[Place the call and ask to speak with above named contact; if that individual is not available, then ask to speak with someone else who can participate on a swap pricing call with NW Natural. Once you've confirmed that you are speaking with the right person, then proceed with the following]

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BID TICKET ON FORWARD STARTING SWAP *[Assigned to: C.J. Rue]*

Bank Name: UBS______________________

Contact Name: ✓James Gerhart______________
RYAN DONOVAN 203.719.8495

Contact Phone: ✓203.719.8184______________

[Place the call and ask to speak with above named contact; if that individual is not available, then ask to speak with someone else who can participate on a swap pricing call with NW Natural. Once you've confirmed that you are speaking with the right person, then proceed with the following]

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BID TICKET ON FORWARD STARTING SWAP *[Assigned to: Dave Aimone]*

Bank Name: JP Morgan________________

OR JENNIFER OR BEN

Contact Name: ✓Robin Bauer________________

BOB BUSSA 312.732.1742

Contact Phone: ✓312.732.5605________________

[Place the call and ask to speak with above named contact; if that individual is not available, then ask to speak with someone else who can participate on a swap pricing call with NW Natural. Once you've confirmed that you are speaking with the right person, then proceed with the following]

Hello, my name is Dave Aimone, and I'm with NW Natural Gas. I'm calling to initiate today's pricing call on a 10-year fixed-rate forward starting swap contract. Please stand-by while we connect with other parties.

[Pause and wait until instructed to begin the bid process]

We are ready to receive your all-in price quote for the 10-year fixed-rate forward starting swap. May I ask for you bid please?

[Write the price offer in the upper right hand box and confirm the rate with your contact]

Awarded Bid: Congratulations, you are low bidder and we are awarding the hedge contract to you. Please stay on the line so that we can confirm the details of the trade.

Declined Bid: Thank you very much for your bid, but I regret to say that we must decline your offer. We appreciate your time this morning.

BID TICKET ON FORWARD STARTING SWAP *[Assigned to: Richelle Luther]*

SCOTT TRACHSEL 212.449.4912

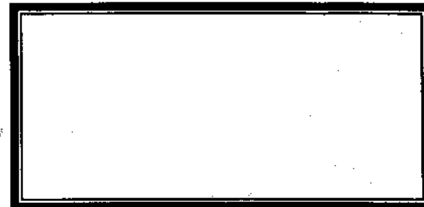
Bank Name: Merrill Lynch________________

FRITZ SCHOPP 713.759.2552

Contact Name: ✓Jacky Mau________________

CHRISTINE [illegible] 212.449.2657

Contact Phone: ✓212.449.7018________________



[Place the call and ask to speak with above named contact; if that individual is not available, then ask to speak with someone else who can participate on a swap pricing call with NW Natural. Once you've confirmed that you are speaking with the right person, then proceed with the following]

Hello, my name is Richelle Luther, and I'm with NW Natural Gas. I'm calling to initiate today's pricing call on a 10-year fixed-rate forward starting swap contract. Please stand-by while we connect with other parties.

[Pause and wait until instructed to begin the bid process]

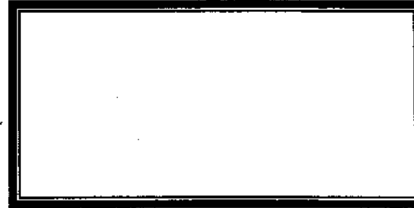
We are ready to receive your all-in price quote for the 10-year fixed-rate forward starting swap. May I ask for you bid please?

[Write the price offer in the upper right hand box and confirm the rate with your contact]

Awarded Bid: Congratulations, you are low bidder and we are awarding the hedge contract to you. Please stay on the line so that we can confirm the details of the trade.

Declined Bid: Thank you very much for your bid, but I regret to say that we must decline your offer. We appreciate your time this morning.

BID TICKET ON FORWARD STARTING SWAP *[Assigned to: Linda Warren]*



Bank Name: Wachovia Bank______________
BRENT JACOBSEN
Contact Name: Casey Rogers______________
JONATHAN CRUMPLER 704.715.1045
Contact Phone: ✓704.715.8491______________

[Place the call and ask to speak with above named contact; if that individual is not available, then ask to speak with someone else who can participate on a swap pricing call with NW Natural. Once you've confirmed that you are speaking with the right person, then proceed with the following]

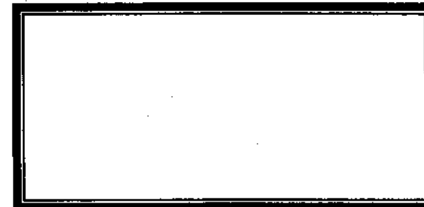
Hello, my name is Linda Warren, and I'm with NW Natural Gas. I'm calling to initiate today's pricing call on a 10-year fixed-rate forward starting swap contract. Please stand-by while we connect with other parties.
[Pause and wait until instructed to begin the bid process]

We are ready to receive your all-in price quote for the 10-year fixed-rate forward starting swap. May I ask for you bid please?
[Write the price offer in the upper right hand box and confirm the rate with your contact]

Awarded Bid: Congratulations, you are low bidder and we are awarding the hedge contract to you. Please stay on the line so that we can confirm the details of the trade.

Declined Bid: Thank you very much for your bid, but I regret to say that we must decline your offer. We appreciate your time this morning.

BID TICKET ON FORWARD STARTING SWAP *[Assigned to: Leslie Johnson]*



Bank Name: Bank of America______________

Contact Name: ✓Bo Willis______________
PEGGY WILLER 503.279.3538
Contact Phone: ✓415.622.1675______________

[Place the call and ask to speak with above named contact; if that individual is not available, then ask to speak with someone else who can participate on a swap pricing call with NW Natural. Once you've confirmed that you are speaking with the right person, then proceed with the following]

Hello, my name is Leslie Johnson, and I'm with NW Natural Gas. I'm calling to initiate today's pricing call on a 10-year fixed-rate forward starting swap contract. Please stand-by while we connect with other parties.
[Pause and wait until instructed to begin the bid process]

We are ready to receive your all-in price quote for the 10-year fixed-rate forward starting swap. May I ask for you bid please?
[Write the price offer in the upper right hand box and confirm the rate with your contact]

Awarded Bid: Congratulations, you are low bidder and we are awarding the hedge contract to you. Please stay on the line so that we can confirm the details of the trade.

Declined Bid: Thank you very much for your bid, but I regret to say that we must decline your offer. We appreciate your time this morning.

2007 Utility Sector Fixed Income Issuance

Date	Issuer	Security Type	Ticker	Amount ($mm)	Coupon (%)	Maturity Date	Callable	Issue Spread (bps)	Moody's	S&P
12/06/07	West Penn Power Company	Unsecured	AYE	275	5.950	12/15/17	Non-call	+200	Baa2	BBB+
12/04/07	Alabama Power	Unsecured	SO	250	4.850	12/15/12	Non-call	+160	A2	A
11/29/07	Southwestern Electric Power Company	Unsecured	AEP	300	5.875	03/01/18	Non-call	+200	Baa1	BBB
11/29/07	New York State Electric & Gas Corporation	Unsecured	EAS	200	6.150	12/15/17	Non-call	+225	Baa1	BBB+
11/28/07	Pacific Gas and Electric Company	Unsecured	PCG	500	5.625	11/30/17	Non-call	+167	Baa1	BBB+
11/27/07	Dominion Resources, Inc.	Unsecured	D	350	6.000	11/30/17	Non-call	+210	Baa2	BBB
11/27/07	Virginia Electric and Power	Unsecured	D	600	5.100	11/30/12	Non-call	+175	Baa1	BBB
11/27/07	Virginia Electric and Power	Unsecured	D	450	6.350	11/30/37	Non-call	+200	Baa1	BBB
11/15/07	Illinois Power Company	Secured	AEE	250	6.125	11/15/17	Non-call	+190	Baa3	BBB-
11/14/07	NSTAR Electric Company	Unsecured	NST	300	5.625	11/15/17	Non-call	+140	A1	A+
11/13/07	Potomac Electric Power	Secured	POM	250	6.500	11/15/37	Non-call	+190	Baa1	BBB+
11/13/07	Wisconsin Public Service Company	Secured	TEG	125	5.650	11/01/17	Non-call	+140	Aa3	A
11/08/07	Public Service Company of Oklahoma	Unsecured	AEP	250	6.625	11/15/37	Non-call	+200	Baa1	BBB
10/18/07	CenterPoint Energy Resources	Unsecured	CNP	250	6.125	11/01/17	Non-call	+165	Baa3	BBB
10/18/07	CenterPoint Energy Resources	Unsecured	CNP	250	6.625	11/01/37	Non-call	+190	Baa3	BBB
10/15/07	Idaho Power	Secured	IDA	100	6.250	10/15/37	Non-call	+135	A3	A-
10/11/07	Alabama Power	Wrapped	SO	200	6.000	10/15/37	NC5	+108	Aaa	AAA
10/03/07	Florida Power & Light	Secured	FPL	300	5.550	11/01/17	Non-call	+100	Aa3	A
09/28/07	PacifiCorp	Secured	BRK	600	6.250	10/15/37	Non-call	+140	A3	A-
09/25/07	Exelon Generation	Unsecured	EXC	700	6.200	10/01/17	Non-call	+165	A3	BBB+
09/20/07	Great Plains Energy	Unsecured	GXP	100	6.875	09/15/17	Non-call	+225	Baa2	BBB-
09/17/07	San Diego Gas & Electric	Secured	SRE	250	6.125	09/15/37	Non-call	+142	A1	A+
09/13/07	Enel Finance International	Unsecured	ENEL	1,000	5.700	01/15/13	Non-call	+157	A1	A
09/13/07	Enel Finance International	Unsecured	ENEL	1,500	6.250	09/15/17	Non-call	+180	A1	A
09/13/07	Enel Finance International	Unsecured	ENEL	1,000	6.800	09/15/37	Non-call	+209	A1	A
09/13/07	Florida Power Corp	Secured	PGN	250	5.800	09/15/17	Non-call	+135	A2	A-
09/13/07	Florida Power Corp	Secured	PGN	500	6.350	09/15/37	Non-call	+160	A2	A-
09/12/07	FPL Group Capital, Inc.	Hybrid	FPL	350	7.450	09/01/67	NC5	+276	A3	BBB+
09/10/07	FPL Group Capital, Inc.	Hybrid	FPL	250	7.300	09/01/67	NC10	+300	A3	BBB+
09/10/07	Connecticut Light & Power	Secured	NU	100	5.750	09/01/17	Non-call	+145	A3	BBB+
09/10/07	Connecticut Light & Power	Secured	NU	100	6.375	09/01/37	Non-call	+175	A3	BBB+
09/06/07	Virginia Electric Power	Unsecured	D	600	5.950	09/15/17	Non-call	+150	Baa1	BBB
09/05/07	Kentucky Power	Unsecured	AEP	325	6.000	09/15/17	Non-call	+160	Baa2	BBB
09/04/07	Commonwealth Edison	Secured	EXC	425	6.150	09/15/17	Non-call	+163	Baa2	BBB-
08/28/07	NiSource Finance	Unsecured	NI	800	6.400	03/15/18	Non-call	+188	Baa3	BBB
08/27/07	Pennsylvania Electric	Unsecured	FE	300	6.050	09/01/17	Non-call	+150	Baa2	BBB
08/24/07	Georgia Power	Wrapped	SO	250	6.000	09/01/40	NC5	+108	Aaa	AAA
08/23/07	MidAmerican Energy Holdings	Unsecured	BRK	1000	6.500	09/15/37	Non-call	+164	Baa1	BB[illegible]
08/23/07	ConEdison of NY	Unsecured	ED	525	6.300	08/15/37	Non-call	+140	A1	[illegible]
08/14/07	Appalachian Power Company	Unsecured	AEP	250	5.650	08/15/12	Non-call	+119	Baa2	[illegible]
08/14/07	Appalachian Power Company	Unsecured	AEP	250	6.700	08/15/37	Non-call	+170	Baa2	[illegible]

UBS Investment Bank

EXHIBIT
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2007 Utility Sector Fixed Income Issuance

Date	Issuer	Security Type	Ticker	Amount ($mm)	Coupon (%)	Maturity Date	Callable	Issue Spread (bps)	Moody's	S&P
08/14/07	Western Mass Electric	Unsecured	NU	40	6.700	08/15/37	Non-call	+175	Baa2	BBB
08/08/07	Wisconsin Power & Light	Unsecured	LNT	300	6.375	08/15/37	Non-call	+138	A2	A-
08/08/07	PPL Electric Utilities	Secured	PPL	250	6.450	08/15/37	Non-call	+143	A3	A-
08/08/07	Public Service of Colorado	Secured	XEL	350	6.250	08/15/37	Non-call	+130	A3	A-
07/12/07	Rochester Gas & Electric	Unsecured	EAS	100	6.470	07/15/32	Non-call	+125	A3	BBB+
07/10/07	PPL Capital Funding	Unsecured	PPL	100	6.850	07/01/47	NC5	+170	Baa2	BBB-
07/10/07	Georgia Power	Wrapped	SO	300	6.375	07/15/47	NC5	+114	Aaa	AAA
06/26/07	MidAmerican Energy Company	Unsecured	BRK	400	5.650	07/15/12	Non-call	+70	A2	A-
06/26/07	MidAmerican Energy Company	Unsecured	BRK	250	5.950	07/15/17	Non-call	+90	A2	A-
06/25/07	Nevada Power Company	Secured	SRP	350	6.750	07/01/37	Non-call	+153	Ba1	BB+
06/25/07	Sierra Pacific Power	Secured	SRP	325	6.750	07/01/37	Non-call	+153	Ba1	BB+
06/19/07	CMS Energy	Unsecured	CMS	150	FRN	01/15/13	NC2	3mL+95	Ba1	BB+
06/19/07	CMS Energy	Unsecured	CMS	250	6.550	07/17/17	Non-call	+150	Ba1	BB+
06/19/07	Idaho Power	Secured	IDA	140	6.300	06/15/37	Non-call	+108	A3	A-
06/19/07	Northern States Power-Minnesota	Secured	XEL	350	6.200	07/01/37	Non-call	+100	A2	A-
06/12/07	Indianapolis Power & Light	Secured	AES	165	6.600	06/01/37	Non-call	+128	Baa1	BBB-
06/12/07	Union Electric	Secured	AEE	425	6.400	06/15/17	Non-call	+117	A3	BBB-
06/12/07	UGI Utilities	Unsecured	UGI	20	6.196	06/15/17	Non-call	+95	A3	A-
06/06/07	FPL Group Capital, Inc.	Hybrid	FPL	400	6.650	06/15/67	NC10	+170	A3	BBB+
06/05/07	Gulf Power	Unsecured	SO	85	5.900	06/15/17	Non-call	+93	A2	A
06/05/07	Pepco Holdings	Unsecured	POM	250	6.125	06/01/17	Non-call	+122	Baa3	BBB-
06/04/07	Georgia Power	Unsecured	SO	450	5.700	06/01/17	Non-call	+80	A2	A
05/31/07	Duke Energy Carolinas	Unsecured	DUK	500	6.100	06/01/37	Non-call	+107	A3	A-
05/30/07	Puget Sound Energy	Hybrid	PSD	250	6.974	06/01/67	NC10	+210	Ba1	BB
05/30/07	Kansas City Power & Light	Unsecured	GXP	250	5.850	06/15/17	Non-call	+100	A3	BBB
05/22/07	Tampa Electric	Unsecured	TE	250	6.150	05/15/37	Non-call	+120	Baa2	BBB-
05/16/07	Jersey Central Power & Light	Unsecured	FE	250	5.650	06/01/17	Non-call	+99	Baa2	BBB
05/16/07	Jersey Central Power & Light	Unsecured	FE	300	6.150	06/01/37	Non-call	+129	Baa2	BBB
05/14/07	Virginia Electric and Power	Unsecured	D	600	6.000	05/15/37	Non-call	+114	Baa1	BBB
05/11/07	Westar Energy	Wrapped	WR	150	6.100	05/15/47	NC5	+126	Aaa	AAA
05/08/07	Wisconsin Electric Corporation	Hybrid	WEC	500	6.250	05/15/67	NC10	+165	Baa1	BBB-
05/08/07	MidAmerican Energy Holdings	Unsecured	BRK	550	5.950	05/15/37	Non-call	+118	Baa1	BBB+
05/07/07	Public Service Electric & Gas	Secured	PEG	350	5.800	05/01/37	Non-call	+100	A3	A-
04/12/07	Portland General Electric Company	Secured	POR	130	5.810	10/01/37	Non-call	+90	Baa1	BBB+
04/12/07	Florida Power & Light	Secured	FPL	300	5.850	05/01/37	Non-call	+93	Aa3	A
04/11/07	Source Gas	Unsecured	SOGAS	325	5.900	04/01/17	Non-call	+125	Baa3	BBB-
04/04/07	Alabama Power	Wrapped	SO	250	5.875	04/01/47	NC5	+101	Aaa	AAA
04/03/07	Ohio Power Company	Unsecured	AEP	400	FRN	04/05/10	NC18-mo	+112	A3	BBB
03/22/07	Cleveland Electirc Illuminating	Unsecured	FE	250	5.700	04/01/17	Non-call	+112	Baa3	BBB-
03/20/07	Connecticut Light & Power	Secured	NU	150	5.375	03/01/17	Non-call	+87	A3	BBB+
03/20/07	Connecticut Light & Power	Secured	NU	150	5.750	03/01/37	Non-call	+110	A3	BBB+

2007 Utility Sector Fixed Income Issuance

Date	Issuer	Security Type	Ticker	Amount ($mm)	Coupon (%)	Maturity Date	Callable	Issue Spread (bps)	Moody's	S&P
03/20/07	Central Hudson Gas & Electric	Unsecured	CHG	33	5.804	03/23/37	Non-call	+107	A2	A
03/19/07	Empire District Electric	Secured	EDE	80	5.875	04/01/37	Non-call	+115	Baa1	BBB+
03/16/07	PPL Capital Funding	Hybrid	PPL	500	6.700	03/20/67	NC10	+220	Baa3	BB+
03/16/07	Commonwealth Edison*	Secured	EXC	300	5.900	03/15/36	Non-call	+147	Baa2	BBB
03/13/07	TXU Energy	Unsecured	TXU	1000	FRN	09/16/08	NC6mo	+75	Baa2	BB
03/13/07	Oncor Electric Delivery	Unsecured	TXU	800	FRN	09/16/08	NC6mo	+62.5	Baa2	BBB-
03/12/07	PECO Energy	Secured	EXC	175	5.700	03/15/37	Non-call	+102	A2	A-
03/09/07	PacifiCorp	Secured	BRK	600	5.750	04/01/37	Non-call	+100	A3	A-
03/08/07	Pacific Gas & Electric	Unsecured	PCG	700	5.800	03/01/37	Non-call	+116	Baa1	BBB
03/06/07	Georgia Power	Unsecured	SO	250	5.650	03/01/37	Non-call	+100	A2	A
02/07/07	Northern Natural Gas	Unsecured	BRK	150	5.800	02/15/37	Non-call	+95	A3	A
02/01/07	CenterPoint Energy Inc	Unsecured	CNP	250	5.950	02/01/17	Non-call	+115	Ba1	BBB
02/01/07	CenterPoint Energy Resources Corp	Unsecured	CNP	150	6.250	02/01/37	Non-call	+135	Baa3	BBB
01/30/07	Alabama Power	Unsecured	SO	200	5.550	02/01/17	Non-call	+72	A2	A
01/11/07	Southern Company	Unsecured	SO	500	5.300	01/15/12	Non-call	+60	A3	A-
01/10/07	Alabama Gas Corp	Unsecured	EGN	45	5.900	01/15/37	Non-call	+113	A1	BBB+
01/08/07	Southwestern Electric Power	Unsecured	AEP	250	5.550	01/15/17	Non-call	+93	Baa1	BBB
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			2006 Total	29,073						

* Re-opening

EXHIBIT

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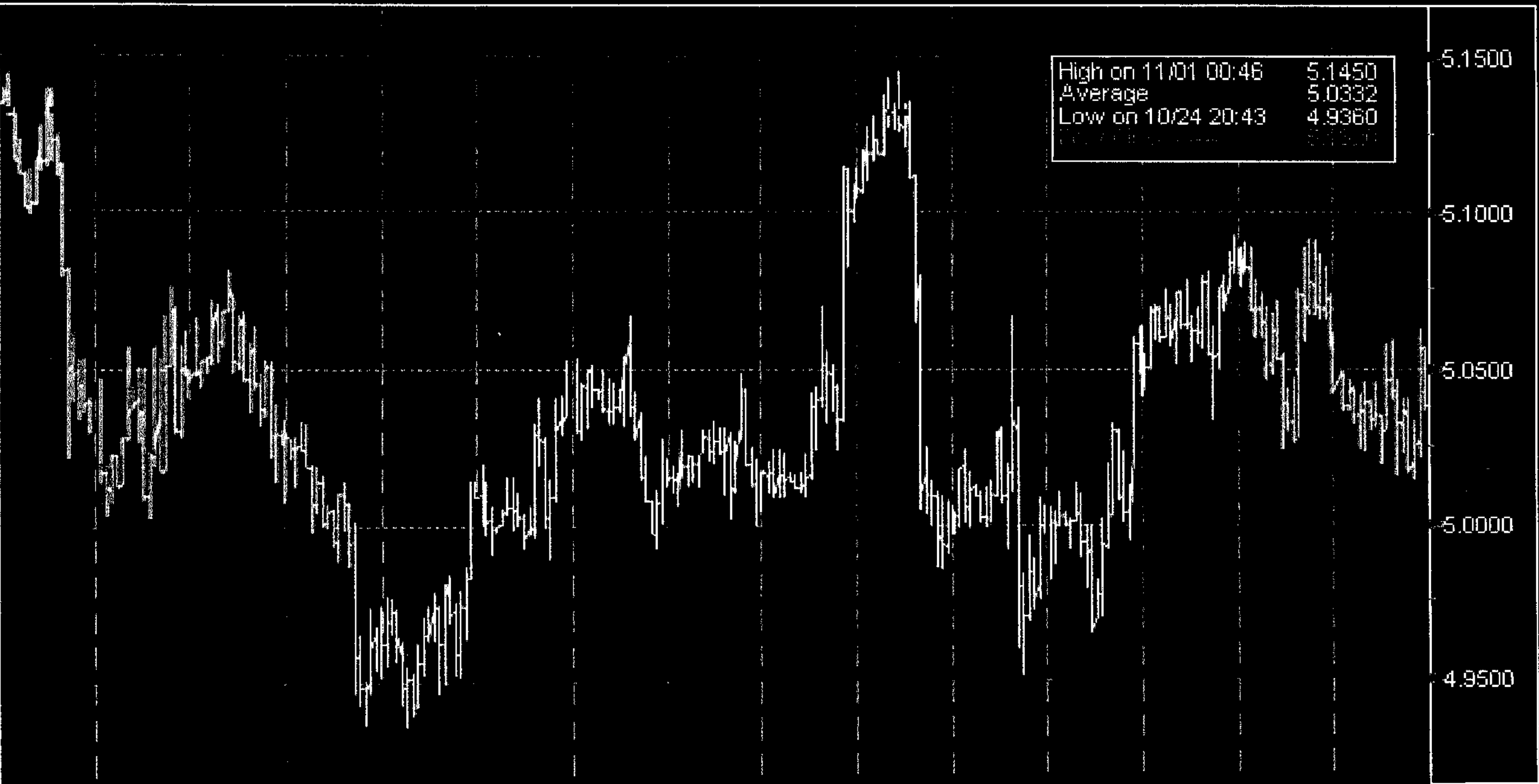
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