Liquidity Issues In Short Term Deposits

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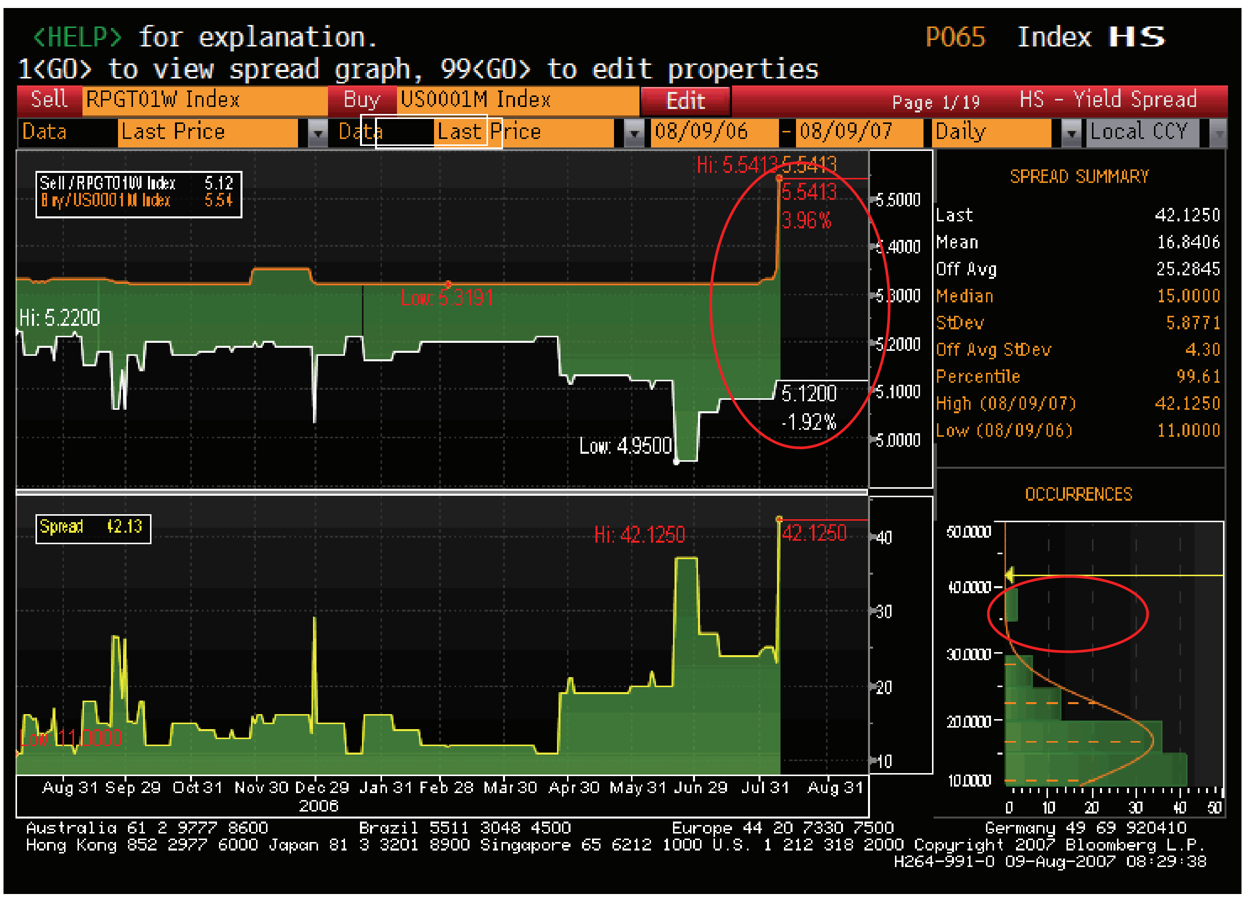
The liquidity crisis affecting fixed income markets has spilled over into the short term debt markets, resulting in a 19 basis point spike in the 1 month LIBOR setting overnight. The European Central Bank reacted strongly by tendering for 94billion in Euro notes to add liquidity to the marketplace. Europe's second largest bank, BNP Paribas, announced that it was suspending redemptions in three of its funds holding mortgage backed securities. This stoked market fears given the uncertainty of bank securities holdings and the inability to value certain assets due to a lack of liquidity.

The current spread between unsecured bank deposits (LIBOR) and secured bank deposits (Repo) is at a 1 year high. The fact that the movement occurred in LIBOR is a clear indication of increased credit risk assigned to unsecured deposits. The current spread of 42.125 basis points is 4.6 standard deviations above the mean over a 1 year period and 3 standard deviations above the mean over a 4 year period.



Kensington Capital Advisors is a derivative advisory firm focused on assisting borrowers and users of derivative products in evaluating, pricing and executing hedge structures. As always, we welcome your questions and look forward to providing independent and expert advice.

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