MJX
Asset Management

CLOs, RMBS, CMBS, and ABS

- **Summary Comments**

In our last Structured Credit missive, we discussed how prices across many asset classes while generally higher offered the opportunity to add to exposures which offer attractive risk adjusted returns (albeit lower now) while at the same time exit exposures which offered less value. In our opinion, the same theme still exists, however, the pool of assets that offer significant value at current observable prices has shrunk, while the pool that should be regarded as better disposition candidates has risen.

The Mortgage and CLO asset classes continue to see no new issue supply pipeline. As a result, most of the quarter's bid lists which contained these asset classes (and there were many) were met with significant buyer interest. It appears that investors who got shut out on the earlier lists rather than being discouraged were only more encouraged to bid aggressively on the subsequent lists. This is particularly true in the CLO asset class, with mezzanine and sub classes as well as equity enjoying a significant uptick in price.

New issue was somewhat active in consumer ABS in September, approximating $10 billion, the highest amount since March 2010. Pricing on the senior tranches has been significantly tighter than pre-summer levels; yet the sector still offers decent value, particularly sub notes. We would draw a comparison between these consumer ABS asset classes and the strong rally in IG corporate spreads as many investors treat consumer ABS as corporate surrogates.

The principal fears generated by European Sovereign risks seemed to have subsided, at least for the time being. The exception seems to be Ireland, but, perhaps, the recent Government actions will convince the global markets that the amount of austerity the Irish people are willing and able to withstand will stem the tide of the binge years of the last decade.

- **Structured Credit**

The secondary securitized mortgage market continues to be active. Of note is the fact that average notional size is significantly smaller than it has been in recent history. It would appear that much of the large risk transfer transactions are behind us and many market participants want to retain as much liquidity possible, thus depending on velocity trading of smaller notional.

However, a fly in the secondary MBS market ointment may have appeared at quarter end with Ally Financial's (formerly GMAC Mortgage) announcement that it has stopped all current foreclosures on delinquent loans in its portfolio. On September 20, Ally told its brokers and agents that there might be issues with "judicially required forms" tied to home repossessions. An Ally employee, in a December 2009 deposition, confirmed that he signed thousands of documents without verifying their accuracy. In addition, the Attorneys General of California and Connecticut (as well as many others) are demanding that JPMChase suspend all foreclosures unless it can prove that it is complying with state law and its titles to properties it is foreclosing on are not defective.

The "defective mortgage title" story presents serious valuation issues for securitized mortgage pools. At the end of the US real estate boom in 2005 and 2006 about 70 percent of the $6.1 trillion in mortgage lending was packaged into bonds. As Susan Wachter, a real estate professor at Penn's Wharton School stated, "Title is everything. There's no collateral without possession, and that is title."

In our last report, we mentioned that CLO tranche price movement had been muted. That all changed starting with the liquidation of the "Stanton CLO I" CLO^2 deal that MJX executed. The supply presented to the market in that sale generated strong interest which led not only to a liquidation of another CLO^2 (Cheyne) but also selling or "de-risking" from a number of bank balance sheets, broker/dealer and a smattering of hedge funds. The re-distribution of risk appears to have been placed to insurance companies and various newly created fund structures.

MJX continues to believe that this reflects the positive underlying fundamentals regarding the collateral, and is also a reflection of the much faster than expected payment speed. Mezzanine and Sub tranches, while not all created equal, have generally traded up to dollar prices last seen in 2008 while on the way down.

- **Trading data points**

Equity markets higher, Investment Grade and High Yield tracing higher, Structured Credit rallying-all while interest rates remain at or near historic lows. Is it due to the fact that the "spread" offered by spread product is huge compared to the absolute yields? Or, are some folks wrong and others right, regarding the flight to risk free assets vis-à-vis the chase for returns?

If a sound credit selection or investment process is strictly adhered to, better credit managers may well produce better returns, on a risk adjusted basis or maybe even outright, than managers of other assets classes such as global equities, treasuries or commodities.

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MJX ASSET MANAGEMENT LLC
12 EAST 49TH STREET, 29TH FLOOR ● NEW YORK, NY 10017
Telephone: (212) 705-5300 ● Facsimile: (212) 705-5390