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Bear Stearns Shares Fall on Liquidity Speculation (Update6)

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Published: March 10, 2008 5:37 PM

(Bloomberg) - Bear Stearns Cos. denied that the firm lacked sufficient access to capital, after speculation about a liquidity crisis pushed the stock down 11 percent in New York trading, the most since the 1987 stock market crash.

Bear Stearns, the second-biggest underwriter of mortgage- backed bonds, said in a statement that ``there is absolutely no truth to the rumors of liquidity problems." The shares declined $7.78 to $62.30 in composite trading on the New York Stock Exchange at 4:08 p.m., the lowest level since March 2003.

``There's an insolvency rumor and concerns on liquidity, that they just have no cash," said Michael Mainwald, head of equity trading at Lek Securities Corp. in New York. ``There's been rumors of this for the past week or two."

Bear Stearns led Wall Street shares lower in the past six months as the world's largest banks and securities firms wrote down $188 billion of assets linked to the subprime mortgage market. The company's fourth-quarter loss of $854 million was its first, and analysts in the past month have lowered expectations for earnings in the first quarter.

``Bear Stearns's balance sheet, liquidity and capital remain strong," Chief Executive Officer Alan Schwartz said in the company's statement. Alan ``Ace" Greenberg, the former Bear Stearns chief executive officer and current board member, told CNBC that the liquidity rumors were ``totally ridiculous."

In December, Chief Financial Officer Sam Molinaro said Bear Stearns reduced its reliance on short-term commercial paper and increased secured term funding.

Meeting Obligations

The firm was able to meet all its ``unsecured debt maturities over the next 12 months without issuing additional unsecured debt or liquidating assets," Molinaro said at the time.

Bear Stearns's so-called liquidity pool, consisting of ``high quality" money market instruments, stood at $17.4 billion at the end of November, according to Molinaro. ``Readily available secured and unsecured committed bank lines" were $8 billion.

Sanford C. Bernstein & Co. today advised investors against buying Bear Stearns and three of its rivals until the credit market stabilizes.

More writedowns are likely for these companies as ``financial leveraging that had benefited the group" since 2004 ``continues to unravel," Bernstein analysts including Brad Hintz wrote in a report.

Credit-Default Swaps

Credit-default swaps protecting against a default by Bear Stearns for the next two years soared to 900 basis points, according to broker Phoenix Partners Group in New York. That's up from 514 basis points last week, CMA Datavision prices show.

Credit-default swaps are financial instruments based on bonds and loans that are used to speculate on a company's ability to repay debt. They pay the buyer face value in exchange for the underlying securities or the cash equivalent should a borrower fail to adhere to its debt agreements. A decline indicates improvement in the perception of credit quality; an increase, the opposite.

``If liquidity is the elixir of life for any Wall Street firm, the current market certainly has the potential to be lethal," Kenneth Hackel, managing director of fixed-income strategy at RBS Greenwich Capital Markets in Greenwich, Connecticut, wrote in a report. ``Which firms are most at risk? We would focus on any broker/dealer that has a narrowly defined critical business impact -- such as being `just' or primarily a mortgage-backed securities shop."

Bond Revenue

Bear Stearns was the second-largest underwriter of mortgage bonds last year behind Lehman Brothers Holdings Inc. About 30 percent of the firm's fixed-income revenue came from mortgages and related securities before those markets froze, according to estimates from Bernstein's Hintz.

Moody's Investors Service downgraded 163 portions of 15 mortgage bonds underwritten by Bear Stearns today, and said 78 of those may be cut further. Wall Street firms sell most such bonds to their clients, though they have written down the value of some tranches remaining on their books.

Moody's downgraded 46 classes from Bear Stearns so-called Alt-A deals on Jan. 8, and 24 classes on Jan. 15. Fitch Ratings last week put $160 billion of Alt-A mortgage securities under review for downgrades.

Analysts cut their first-quarter profit estimates for Bear Stearns and other brokers last week partly on expectations of increasing Alt-A writedowns. Fox-Pitt Kelton Cochran Caronia Waller analyst David Trone expects four Wall Street firms to cut their Alt-A portfolio values by $6 billion in the quarter.

Fund Collapse

Two Bear Stearns funds invested in subprime securities collapsed in July, wiping out $1.6 billion of investors' money. While Bear Stearns had less than $40 million of its own money in the funds, it was forced to bail one of them out. Most of its $1.9 billion writedown from subprime assets in the fourth- quarter was due to the securities seized from that fund.

Options traders increased their bets today that Bear Stearns shares will continue to fall. Put-option volume rose to 158,599 contracts, seven times the 20-day average. Bearish bets outnumbered bullish ones, or calls, by about 2.6 to 1.

The price of today's most-active contracts, which give the right to sell the stock at $30 before this month's options expire at the

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end of next week, rose 13-fold to 65 cents. For those wagers to pay off, the shares must drop 52 percent in the next eight trading sessions. March $60 puts, the second-most active, quadrupled to $5.

Implied volatility, the key factor in determining the value of option contracts, rose to 105.40 after earlier surging to a record 111.33. An increase indicates traders anticipate bigger stock-price swings.

Calls give the right to buy a security for a certain amount, the strike price, by a given date. Puts convey the right to sell.

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