

Good morning,

I think we started the week with a lot of unnecessary noise, which somehow prevents us from noticing what may be underlying trends in the making.

As we had foreseen back on September 2nd (www.sibileau.com/martin/2009/09/02) situations like the one played out of Dubai could be expected and could spiral to become a real problem, given that the world had seen coordination among developed nations' monetary authorities, while in emerging markets that was still a speculation. Yesterday, the United Arab Emirates Central Bank announced that it "stands behind" the country's local and foreign banks. Of course, as we also commented in the past two letters, this is becoming by the hour a political rather than a financial crisis. In addition, as rumors abound in politics, during yesterday's session we read and heard a lot of them. The result was more discrimination within the Gulf region in corporate credit, with Dubai at the top and Qatar at the bottom of the spectrum. As well, it appears that the initially announced \$59BN in liabilities affected by the announced restructuring is in fact significantly inferior, with some analysts now hinting at approximately \$18BN.

Having said this, I have included this morning the already classic chart that shows the spread between 3-month Libor and the Overnight Index Swap (OIS) rate. Let's take the opportunity to review what this spread means. The OIS is an interest rate swap between financial institutions, where the (volatile) overnight interest rate is exchanged for a fixed rate. The OIS rate is based on the average overnight interest rates transacted during a day. The overnight rate is the rate of the overnight market, where banks transact to ensure they have enough reserves at their respective central banks. The 3-month Libor rate is the USD rate banks pay when they borrow to fund the loans they extend to their customers. Therefore, the difference between the 3-month Libor and the Overnight Index Swap rate represents the cost of "renting" the balance sheet of a bank. When liquidity becomes scarce, as one would have intuitively guessed would be the case after the news out of Dubai, this cost of renting balance sheets should increase. During the worst months of 2008, it did in fact increase, and it increased exponentially. The chart below shows that during since last week the spread has remained almost flat and at record lows (10.96bps), instead of increasing....

Generally, one hears many opinions about the markets, but money always speaks too, and when it does, it leaves an echo in the 3-mo Libor – OIS spread. I heard it yesterday and it was very clear. We are awash in liquidity and yesterday wise money covered shorts in fashion. Perhaps this noise however did not let us see something more fundamental unfolding. For the first time in a while, intraday, I saw weakness in US stocks and the USD as if a weak USD no longer meant higher stocks, but rather true fundamental capital flowing out of the US. Maybe I am wrong, because at close, the equity markets were slightly higher. But I sure felt a tectonic shift yesterday... Was it not the expectation of an upcoming intervention of the Yen?



Martin Sibileau

martin@sibileau.com

(647) 999-2055

Disclaimer: The comments expressed in this publication are my own personal opinions only and do not necessarily reflect the positions or opinions of my employer. I prepared and distributed this publication as an independent activity, outside my regular salaried work. No part of the compensation I receive from my current employer was, is or will be directly or indirectly related to any comments or personal views expressed in this publication. All comments are based upon my current knowledge. You should conduct independent research to verify the validity of any statements made in this publication before basing any decisions upon those statements. The information contained herein is not necessarily complete and its accuracy is not guaranteed. If you are receiving this communication in error, please notify me immediately by electronic mail or telephone. The comments expressed in this publication provide general information only. Neither the information nor any opinion expressed constitutes a solicitation, an offer or an invitation to make an offer, to buy or sell any securities or other financial instrument or any derivative related to such securities or instruments. The comments expressed in this publication are not intended to provide personal investment advice and they do not take into account the specific investment objectives, financial situation and the particular needs of any specific person. All rights reserved.