

University of California Fixed Income Strategy Update

Over the last few weeks, uncertainty has intensified surrounding the solvency of the two major government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. The publicly traded stocks of both entities have declined by approximately 70-80% since the beginning of June and preferred stock prices have declined sharply, as well.

Like many other institutional investors in the U.S. and abroad, the University's pension (UCRP), endowment (GEP), and defined contribution plans (UC Savings Fund and UC Bond Fund) have substantial investments in GSE senior debentures. These bonds have traditionally offered the advantages of an AAA rating, very good liquidity, and a material yield advantage over comparable maturity U.S. Treasuries.

Despite the turmoil in the equity markets, GSE senior debentures have maintained their value and the Office of the Treasurer is highly confident they will continue to do so. The GSEs hold capital well in excess of their regulatory minimum requirements and are playing a critical role in supplying liquidity to the U.S. housing market during the current turmoil. Recognizing their importance, U.S. Treasury Secretary Henry Paulson has proposed that Congress immediately pass legislation allowing GSEs to borrow up to \$300 billion directly from Treasury and empower Treasury to make a temporary equity injection in the GSEs *if deemed necessary*. Paulson testified as follows on July 15, 2008, to the Senate Finance Committee, "Continued confidence in the GSEs is important to maintaining financial system and market stability. The GSEs are central to the availability of housing finance, which will determine the pace at which we emerge from this housing correction."

The Office of the Treasurer supports the efforts of the U.S. Treasury and the Federal Reserve to calm the mortgage market. The Office continues to believe that holding GSE debt—and the aforementioned Funds' policies and strategies—are appropriate, given the Funds' objectives. These policies, as with all funds managed by the Treasurer, have been reviewed and approved by the Regents Committee on Investments.

Source: Office of the Treasurer of The Regents
July 18, 2008