Bianco Research L.L.C.
An Arbor Research & Trading Company
Independent · Objective · Original

Volume 13, No. 44 | 1731 North Marcey, Chicago IL 60614 | www.biancoresearch.com

Market Facts

Expected 3-Month LIBOR Rising

By Howard L. Simons (847) 304-1511
April 9, 2008

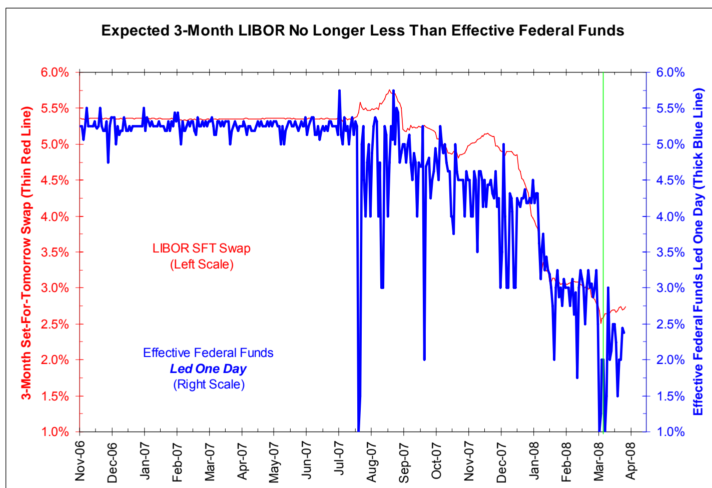
We concluded a January Market Facts on the 3-month LIBOR set-for-tomorrow (SFT) swap market:

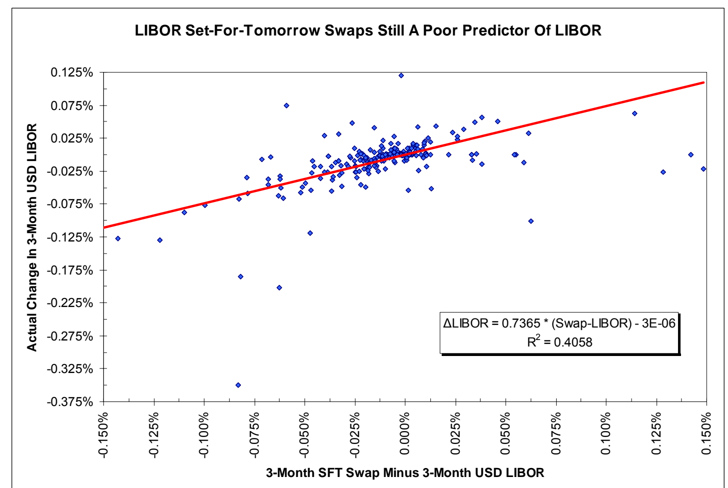
> *If the normal relationship is not restored and expected 3-month LIBOR is weak as a function of weak credit demand, then we have prima facie evidence of a macroeconomic decline that will require a Plan B from the central banks. If we consider how long it took to arrive at Plan A and the costs involved, can we be confident a Plan B either exists or will be effective if it does? The opinion here is, "No" on both counts.*

Maybe Plan B was optimistic; by the time we got through various emergency rate cuts, bailouts, lending facilities and expansions of acceptable collateral we went deep into the 26-letter Latin alphabet, which should make us grateful we are not saddled with the 24-letter Greek alphabet. Delta, gamma and theta, as most option traders would attest, have caused enough trouble over the years, and let's not enter the conversation whether psi matters.

Regardless, the (SFT) swap (thin red line, left-hand chart) has moved comfortably but not excessively over the effective federal funds rate led one day (thick blue line) after weeks of oscillating through it. The SFT market began moving higher after the Bear Stearns rescue on March 17th (green vertical line).

Moreover, while the SFT market is still a poor predictor of 3-month LIBOR itself (right-hand chart), the r^2 of the relationship improved significantly with the addition of 70 data points, from .1074 to .4058.





Conclusion

While the spread between both 3-month LIBOR and the SFT market to effective federal funds is moving back toward a normal relationship, they are still far from its pre-credit crunch levels of 10-12 basis points. A complete restoration will require, of course, for banks to have faith in each other's balance sheets, and that may take years given the outstanding volume of dubious securities. The Federal Reserve may have to continue its role of lender of last and possibly only resort for much longer than it intended.

Still, the ability of markets to function with rising SFT levels in excess of federal effective funds and for this to occur within the "tradable bottom" conditions prevailing since March 17th is a positive step. However, a similar configuration between mid-November and mid-December 2007 ended badly for risk-seekers. Until the realized volatility of effective federal funds declines, the present situation should be considered a welcome respite and nothing more.

Bianco Research L.L.C.

1731 North Marcey, Suite 510
Chicago IL 60614

Phone: (847) 304-1511
Fax (847) 304-1749
e-mail: research@biancoresearch.com
http://www.biancoresearch.com

For more information about the contents/ opinions contained in these reports:

President (847) 756-3599
James A. Bianco jbianco@biancoresearch.com

Strategist/Analysts (847) 304-1511
Howard L. Simons hsimons@biancoresearch.com
Greg Blaha gblaha@biancoresearch.com
Ryan Malo rmalo@biancoresearch.com

For subscription/service Information:

Arbor Research & Trading, Inc.
Director of Sales & Marketing (800) 625-1860
Fritz Handler fritz.handler@arborresearch.com

Arbor Research & Trading, Inc.

1000 Hart Road, Suite 260
Barrington IL 60010

Phone (847) 304-1560 Fax (847) 304-1595

e-mail inforequest@arborresearch.com
http://www.arborresearch.com

Domestic - For more information about Arbor Research & Trading and its services:

New York Sales Office

The Chrysler Building, 405 Lexington Ave
New York, NY 10174
Edward T. McElwreath ed.mcelwreath@arborresearch.com
Phone (212) 867-5326 Fax (212) 370-1218

International - For more information about Arbor Research & Trading and its services:

London Sales Office

4 Broadgate, 2nd Floor, Room 57
London England EC2M 2QY
Phone 44-207-965-4784 Fax 44-207-965-4787

Neil Tritton neil.tritton@arborresearch.com
Ben Gibson ben.gibson@arborresearch.com

European Sales

James L. Perry james.perry@arborresearch.com
Phone (847) 756-3510 Fax (847) 304-1595
Rich Kleinbauer rich.kleinbauer@arborresearch.com
Phone (41) 22 363-9229

Far East Sales

Robert Reynolds robert.reynolds@arborresearch.com
Phone (847) 756-3680 Fax (435) 647-3073

Copyright © 2008 Bianco Research, L.L.C.
This message is intended only for the personal and confidential use of the designated recipient(s) named above. If you are not the intended recipient of this message you are hereby notified that any review, dissemination, distribution or copying of this message is strictly prohibited. This communication is for information purposes only and should not be regarded as an offer to sell or as a solicitation of an offer to buy any financial product, an official confirmation of any transaction, or as an official statement of Bianco Research LLC. Email transmission cannot be guaranteed to be secure or error-free. Therefore, we do not represent that this information is complete or accurate and it should not be relied upon as such. All information is subject to change without notice.