

Please log onto <http://www.interactivedata-fia.com/nl/06-q1/index.asp> if you cannot view this email.



On the Edge



Quarter 1, 2006, Volume 21, No.1

General

- New Year's Greeting from the President of CMS BondEdge
- 2006 CMS BondEdge Annual Fixed Income Workshops
- 4th Quarter 2005 Fixed Income Markets Review: *Market Flash*
- New Cashflow Testing File Output Facilitates Data Transfer to Excel®

BondEdge

- BondEdge News: Preview of Upcoming Releases
- BondEdge and Risk Management
- CMO, ABS & CMBS - Issuance and Trends in 2005

Q & A

Tradeshaw Schedule

New Year's Greeting from the President of CMS BondEdge

As we begin the year 2006, I want to provide you with an update on the progress that we made in 2005 as well as summarize some of our key initiatives for 2006.

During 2005, the CMS BondEdge business continued to grow in the North American markets as well as overseas in both Europe and the Asia/Pacific region. We attained our first Australian BondEdge® client, one of the largest asset managers in Sydney, and we will continue to build out data coverage and product functionality for that market. While we find heavy use of spreadsheets across the front office in non-North American markets, that trend appears to be diminishing as greater risk control processes are implemented in response to changing internal and regulatory requirements.

During 2005, we saw increased demand for fixed income performance attribution tools globally. In response to this demand, we released two significant upgrades to the Performance Attribution (PART) module. First, we released a return-based attribution approach which examines the weightings between the portfolio and benchmarks and highlights return differences by user-specified categories. This type of analysis is complementary to the factor-based approach we have traditionally offered. The returns-based approach is more of an equity-type attribution approach and has an advantage over the factor-based in that the output can be easily communicated to non-fixed income professionals. Second, we activated a full transaction processing capability in both the factor-based and returns-based attribution methodologies which integrates actual trades including the transaction prices. This benefits clients by improving the accuracy of the results, reducing attribution residuals.

We continued to work on our structured finance coverage as well as the mortgage prepayment models that are provided with BondEdge. We generally released the new ARM/Hybrid ARM prepayment model along with a new model for 10- and 20-year fixed rate mortgage collateral. We also finalized the research and began implementation of a re-designed fixed rate mortgage model which takes into account a series of new factors. This model will be released early this year in version 5.40. Later in 2006, in Version 5.50, we will release revised ABS prepayment models, dollar rolls and TBA mortgages.

We continued to upgrade the functionality and 'look and feel' of a variety of reports, releasing a re-designed Policy capability. This has greatly benefited our clients that manage dozens or hundreds of portfolios. We added numerous fields to the reports as well as direct linkage to the What If and Portfolio Compliance functions. We released a new Excel®-based printer capability for most BondEdge and Additional System reports which provides more professional looking reports than were previously available. Being committed to the BondEdge user experience, during 2005 we improved the exception handling processes and released a command line capability, allowing clients greater flexibility in scheduling BondEdge jobs. In 2006, we will be upgrading the BondEdge user interface to create a more modern look and feel.

We also embarked on a new initiative during 2005 to make CMS BondEdge fixed income analytical calculations available via a datafeed service. This new datafeed service, delivered via a product called ACE (Advanced Computing Engine), accommodates investment managers who do not wish to utilize the BondEdge graphical user interface (GUI), but prefer to feed CMS BondEdge calculated values directly into another application, such as a data warehouse. To date, we have seen the most interest in this capability from back and middle offices.

We also began to work more closely with a number of vendors to integrate the BondEdge calculations via APIs with their products. An example of this was the alliance announced during 2005 with Milliman to integrate the CMS BondEdge dynamic cashflow/Regulatory 126 product with Milliman's MG-ALFA® product. This was in direct response to increased demands by the insurance regulators for the cashflow testing process to tightly integrate the analysis of assets and liabilities. We look forward to announcing and making available additional product linkages during 2006.

If you are interested in learning more about the datafeed service or API linkage, please contact your CMS BondEdge consultant or salesperson.

In 2006, we will be augmenting the derivatives capabilities in BondEdge by adding a model for credit default swaps and by expanding our futures coverage. We will release a global database of inflation-linked government and corporate issues and anticipate modeling a TIPS index.

As we see increased interest from municipal only or blended portfolio managers delivering asset management for high net worth clients, we have committed to significant expansion of the BondEdge municipal features, expanding reporting capabilities, improving VRDN treatment and municipal sector designation, introducing a municipal duration beta, and adding pre-refunding features to Portfolio Alerts. We are also optimistic that early this year, we will be able to make the Lehman Municipal Indices, including constituents, available to Lehman-approved clients.

We appreciate your business and continue to strive to deliver a high quality service to you. We hope that your holiday season was wonderful and that you enjoy a healthy and prosperous 2006.

I am always available to you if you have areas of concern or suggestions for how we could improve our processes.

Sincerely,



Laurie S. Adami
President
CMS BondEdge, an Interactive Data division

[Top](#)

2006 CMS BondEdge Annual Fixed Income Workshops

We are pleased to announce the dates for the **2006 CMS BondEdge Annual Fixed Income Workshops**. This year's workshops will again be presented in two tracks, with topics covering both fixed income theory as well as practical application of various features in BondEdge. This year we are featuring eleven sessions that are specifically designed to address current issues in fixed income as well as an optional session for one-on-one training with a CMS BondEdge senior consultant. We hope you will be able to join us this year at one of the following locations:

Thursday, March 23	Wednesday, April 19	Friday, April 21
San Francisco	New York (Downtown)	Chicago (North Michigan Avenue)
Grand Hyatt San Francisco	NY Marriott Financial Center	The Drake Hotel

While the topics are presented in lecture format, the event is intended to be as interactive as possible; we encourage attendees to ask questions during the sessions or during the break times provided. This year's workshop sessions are:

	TRACK A	TRACK B
7:30a	Registration & Breakfast	
8:30a	Keynote Address	
9:30a	Dissecting Returns-Advances in Performance Attribution	New CMS BondEdge Fixed-Rate Prepayment Model
11:00a	AM Break	
11:15a	New Developments in CMS BondEdge Benchmarking Tools	Understanding Credit Derivatives
12:30p	Lunch/Q&A Panel	
2:00p	BondEdge & Municipal Markets	Prepayment Modeling: Home Equity & Other Collateral
2:50p	PM Break	
3:00p	Hands-On Training Sessions	Key Rate Durations: Observations & Oddities
3:50p		PM Break
4:00p		Yield Curves: Construction & Interpretation
4:30p	Cocktails	
4:50-6:00p	Cocktails	

To view detailed session descriptions, please [click here](#).

To register, please [click here](#).

[Top](#)

Fourth Quarter 2005 Fixed Income Markets Review: *Market Flash*

The U.S. treasury curve continued its persistent flattening trend during the 4th quarter, as two Federal Reserve rate hikes pushed short-term rates 50 basis points (bps) higher and induced a slight yield curve inversion at year-end. The treasury curve has flattened for each of the past 8 quarters, dating back to the end of 2003.

The above is a partial reprint of our quarterly capital markets report, "Market Flash". **To view this report in its entirety, please [click here](#).**

[Top](#)

New Cashflow Testing File Output Facilitates Data Transfer to Excel®

The Dynamic Cashflow Testing Module now offers a special comma delimited format that facilitates data transfers to Excel® spreadsheets, Access® or Oracle® databases and other external systems including Tillinghast/MoSes. Every line of the Dynamic Asset Cashflow Testing output file now includes the security identifier, pricing date, scenario and portfolio names.

These additional data fields address the previous challenge of multiple files and enable the client to easily identify which security cashflows belong to which portfolio and scenario, as well as streamlining the process of parsing and analyzing large volumes of data.

As an additional benefit, this single file allows for an unlimited number of scenarios, portfolios or bonds.

For more information about this additional capability, please contact your CMS BondEdge consultant in Los Angeles at (310) 479-9715 or New York at (212) 771-6771.

[Top](#)

BondEdge News

The following is a description of the new features that will soon be available in version 5.40 (initial release targeted for January 31, 2006) and a list of the enhancements planned for version 5.50 (target release date: October 2006).

<p>BondEdge Version 5.40 - Coming Soon! Targeted intital release: January 31, 2006</p>
--

New Fixed Rate MBS Prepayment Model – Version 5.40 includes a new fixed rate MBS prepayment model that incorporates additional data items, such as Loan-to-Value, Spread at Origination and other characteristics that affect prepayment behavior. The new model shows greater responsiveness to changes in the refinancing incentive, producing convexities that are more negative for many collateral types than in the current model.

Fitch Qualities/User-Defined Ratings – We're adding Fitch ratings to the BondEdge database and are giving you the ability to define your own quality rating scheme. In reports where two ratings are shown side-by-side, you'll be able to specify which ratings types you want to include (e.g., Fitch, Moody's, S&P or User-defined).

Database of Inflation-Linked Securities – including U.S. Treasuries (TIPS), non-US sovereign linkers, (e.g., Gilts, OATI's and OATei's), and corporate linkers. We are also working to add the new UK gilt linkers that use a 3-month lag, in addition to the existing issues that use an 8-month lag.

Credit Default Swaps model – For clients who are incorporating these instruments in their portfolios, we are adding a model for these derivatives. The model will provide valuations based on the deal spread and the issuer's CDS curve, and CDS will be incorporated throughout BondEdge reports, simulations and analyses, including performance attribution.

Muni "Duration Beta" – This feature will allow managers of taxable and tax-exempt portfolios to reflect the relationship between changes in the muni yield curve and the taxable market. In a portfolio containing both taxables and tax-exempts, the duration of tax-exempt securities will be adjusted by a user-defined beta to "gross down" the duration of the munis relative to the taxables (since shifts in the Muni curve typically do not match the bp shifts in the Treasury curve). Alternatively, clients can "gross up" the duration of the taxable securities by the reciprocal of the beta.

Controlling Clean-up Calls for ABS & CMO Deals – In version 5.40, clients will have the choice to activate or de-activate the clean-up call for ABS and CMO deals, which is displayed on the Security Calculator screen. The effective duration, as well as static measures of average life, yield, and modified duration will reflect the shortening of the cash flow profile if the clean-up call is in effect.

Interest-Only MBS Pools – We have enhanced our Pool-Specific mortgage cash flow generating routines to accommodate fixed and adjustable-rate pools with an Interest-Only (IO) period, during which there is no scheduled repayment of principal. These pool-specific mortgages will be accessible via the BondEdge Extended Database.

New Data for High Yield Bonds – For managers who hold distressed debt, we're adding the ability to stop the accrual of interest when a default has occurred, and to designate a recovery rate and recovery date assumptions for securities that are in default. The recovery assumptions will determine the yield and the timing and amount of the principal repayment for cash flow analyses, attribution and simulations.

Indices Data for Returns-Based Attribution – In this release we're providing the Index returns data needed to construct Returns-based Attribution analyses. Because the Returns-based Attribution framework allows clients the flexibility to define their own return categories, the index data must be aggregated from security-level detail, according to each client's report definitions.

Please contact your CMS BondEdge representative if you would like to access version 5.40 when it is released.

<p>BondEdge Version 5.50 Targeted release: October 2006</p>

Work has already begun on version 5.50, due out in October of 2006. Here is a preview of the enhancements planned for that release:

- TBA CUSIPs will be added to the CMS database, with the ability to capture Dollar Roll strategies;
- An enhanced Specified Scenario simulation will be introduced, along with a completely revised Probability Weighted Return simulation in the Compare module, including the ability to input corporate spread changes at the industry (secondary sector) level;
- New features for Municipal portfolio managers, including more descriptive fields and Contribution to Duration by muni type (e.g., GO, REV, Insured, Pre-Refunded, ETM);
- We will release a new prepayment model for Home Equity Loan deals;
- The ability to add a portfolio as a separate holding into another portfolio, e.g., for clients who hold mutual funds or ETFs within a portfolio, or if you have created a replicating strategy involving two or more securities that you wish to add to a portfolio.

[Top](#)

BondEdge and Risk Management

The start of a new year is a good time for firms to reassess their risk management practices to make sure they are adequate in light of the firm's current circumstances and the general environment. Although different types of institutions will define their risk management needs somewhat differently, all firms have a need for some type of risk management to objectively assess whether their investment activities are being managed in a way that is consistent with the firm's risk philosophy. In this article, we discuss some of the ways BondEdge can provide investment managers, insurance companies and depository institutions with tools for improving the risk management process¹.

To begin, we ask what is meant by "risk management"? We observe that the portfolio manager's job is to maximize the return on assets, subject to investment policy guidelines, and performance is judged based on the manager's track record versus a benchmark. In contrast, risk management is more concerned with macro exposures and whether or not the firm's strategy and policies are reflected in the way the portfolios are being managed. Risk managers are also typically responsible for ensuring that traders adhere to limits assigned, including the instruments and amounts that may be traded.

While risk management practices are likely to differ between those firms whose investment activity involves its own capital, such as an insurance company's invested assets and a bank's investment portfolio or proprietary trading desk, and those who manage money for others, such as an investment management firm or bank trust department, there are common goals to be achieved by all. The U.S. Office of the Comptroller of the Currency's guidance on risk management for banks with an asset management business is applicable to all of firms with investment activities. The OCC observes that the risk manager should:

- Establish the strategic direction, risk tolerance standards, and ethical culture for asset management activities.
- Adopt and implement an adequate and effective risk management system.
- Monitor the implementation of asset management risk-taking strategies and the adequacy and effectiveness of the risk management system in achieving the company's strategic goals and financial objectives.

Tools in BondEdge for Risk Managers

BondEdge can help risk managers achieve the goals stated above by providing these easy to use, effective tools for measurement and monitoring of individual portfolios as well as overall exposures in terms of the critical criteria defined by the firm:

- **Policy reports** – these reports summarize the exposures of a group of portfolios across various categories. For firms with dozens, or even hundreds of accounts managed by different portfolio managers, the Policy Reports allow the risk manager to quickly review the option-adjusted durations and convexities, sector and industry exposures, currency exposures (if applicable) and other characteristics. Policy reports can be customized to include the information that is most relevant to your firm.
- **Merge portfolios/Scan Portfolios** – To obtain an overall view of risk and exposure when investments are separately managed according to asset class or line of business (e.g., for insurers with multiple product lines), the risk manager can use the dynamic Portfolio Merge or Portfolio Scan features (where a merged portfolio automatically reflects the changing composition of its constituents). For example, if Corporate, Mortgage and Government allocations are separately managed, the Merge function allows the risk manager to compute key characteristics, such as duration, issuer limits, etc. across all invested assets to ensure the firm's strategic goals and regulatory or other restrictions are being met. Alternatively, a risk manager may need to monitor the combined exposures across a large number of separate accounts. For example, the firm may wish to limit its total dollar exposure to a particular issuer or industry (in addition to the investment policies in place for each account), or for strategic reasons may wish to limit (or increase) its overall exposure a type of mortgage collateral. A risk manager can readily determine these aggregate exposures using the Portfolio Scan feature, which scans across any group of portfolios for holdings by one or more selected categories.

- **Key Rate Durations** – Yield curve risk is one of the most important factors in managing fixed income portfolios and the risk manager may be responsible for assessing whether exposures at the individual account and/or overall level reflect the firm's current strategy. Key Rate Durations disaggregates the total option-adjusted duration into measures of sensitivity across the term structure². The Key Rate Duration "Policy" report (in the Compare system) computes these measures for a group of selected portfolios, with comparison to a benchmark index or model portfolio, if desired. Key Rate Durations can also be computed for a merged portfolio that represents a combination of sub-accounts to give the risk manager a summary view of the firm's term structure exposure across all asset classes.
- **Stress-testing** – One of the most important risk management tools is stress-testing portfolios under extreme market conditions, and the Specified Scenario return simulation and Cash Flow Testing module in BondEdge are designed with this in mind. Recent history provides a number of examples of unusual market moves that should guide the risk manager in creating realistic stress-testing scenarios, such as the 50bp drop in the 10 year Treasury rate over a 6-week period in June/July 2004, the halving of credit spreads levels on corporate bonds since 2002 (what if this trend reversed itself in the coming year?), the inverted yield curve that persisted throughout the year 2000 (can today's flat yield curve persist much longer?), and the market disruption of Fall 1998, where corporate spreads widened by 40-50bps virtually overnight while Treasuries rallied in a "flight to quality". BondEdge allows the risk manager to assess the impact on total return and/or cash flow generation under these types of scenarios, including derivatives used to hedge or adjust exposures.
- **Advanced Risk Measures** – Another type of risk is "model risk", the risk that one's analyses are imprecise due to misspecification or error in a model. In some respects, this risk is unavoidable – there is no single "correct" way to specify certain aspects of modeling, such as volatility estimates and MBS prepayment parameters. BondEdge allows risk managers to assess the potential implications of model risk using the Advanced Risk Measures report (on the Simulations menu), which includes the measures Vega and Prepayment Uncertainty. These values show the impact on a portfolio's value of different key volatility inputs and of increasing or decreasing the prepayment speeds on mortgage-backed securities.
- **Tracking Error** – This analysis shows the expected return difference between a portfolio and benchmark due to changes in key market risk factors, where the "expectation" is driven by the volatility of, and correlations among those risk factors. While portfolio managers rely on this analysis to assess their structural "bets" versus the benchmark, risk managers can also use it to determine whether risk is increasing or decreasing over time, which may be due to a change in the portfolio manager's strategy or to changes in the volatilities and correlations derived from the market.
- **Performance Attribution** – While we may typically think of performance attribution as a way of showing clients, consultants and internal management how and why the portfolio manager outperformed or underperformed a benchmark, attribution can also be a useful risk management tool. It can show whether or not the portfolio manager took on exposures that were permissible under investment guidelines and quantifies the impact, ex post, of the firm's strategy.

These are just some of the tools BondEdge offers to help assess the risk profile of a portfolio, a group of portfolios, a segment of a portfolio, or the firm's overall fixed income investments. If you have any questions or would like more information about these features, please contact your CMS BondEdge Consultant.

¹ Note that while "risk management" extends beyond the investment process, this article focuses on investment-related activities.

² For more information, please see the Back to Basics article on Key Rate Durations, available via the BondEdge Private Client Website or at www.bondedge.com.

[Top](#)

CMO, ABS & CMBS – Issuance and Trends in 2005

Issuance Trends

As the year 2005 comes to a close, CMO, ABS and CMBS total number of deals issued is expected to increase more than 10% over the volume for 2004. These past two years have seen steady increases but not as high as previous years. Between 2000 and 2001 deal issuance rose by 36% and in 2003 the percent increase over 2002 was about 30%. Although percent increases have tapered off a bit, total deal count for 2005 is still impressive and will likely finish just short of 2,000 deals issued. The sector with the largest number of deals issued is Whole Loan CMO, currently at 624 deals representing a 19% increase over last year.

Agency CMO issuance actually fell by 18%, dropping from 472 to 385 deals. This decrease is likely due to more borrowers obtaining Jumbo and Alt-A loans, and to the flat yield curve environment. In the ABS arena, Credit Card deals issued increased by 17%, Auto Loans by 10% and Student Loans by 12%. CMBS issuance remained the same with about 75 deals issued. Deal counts for 2005 (as of mid-December), were 82, 77 and 29 for Cards, Autos and Student Loans, respectively.

Increasing Complexity

An increase in deal volume is often associated with an increase in structural complexity. We have observed that a large number of Whole Loan CMO deals now include alternative credit enhancements, such as over-collateralization and negative amortization. The most complex forms of credit enhancement are still typically found in Home Equity deals, however. Issuance of Home Equity deals increased slightly above 6% in 2005, considerably less than in previous years where increases were running above 40%. Modeling Home Equity Deals remains a difficult challenge, as they often contain complex, deal specific features that occupy significant reverse engineering time.

BondEdge CMO/ABS/CMBS Coverage

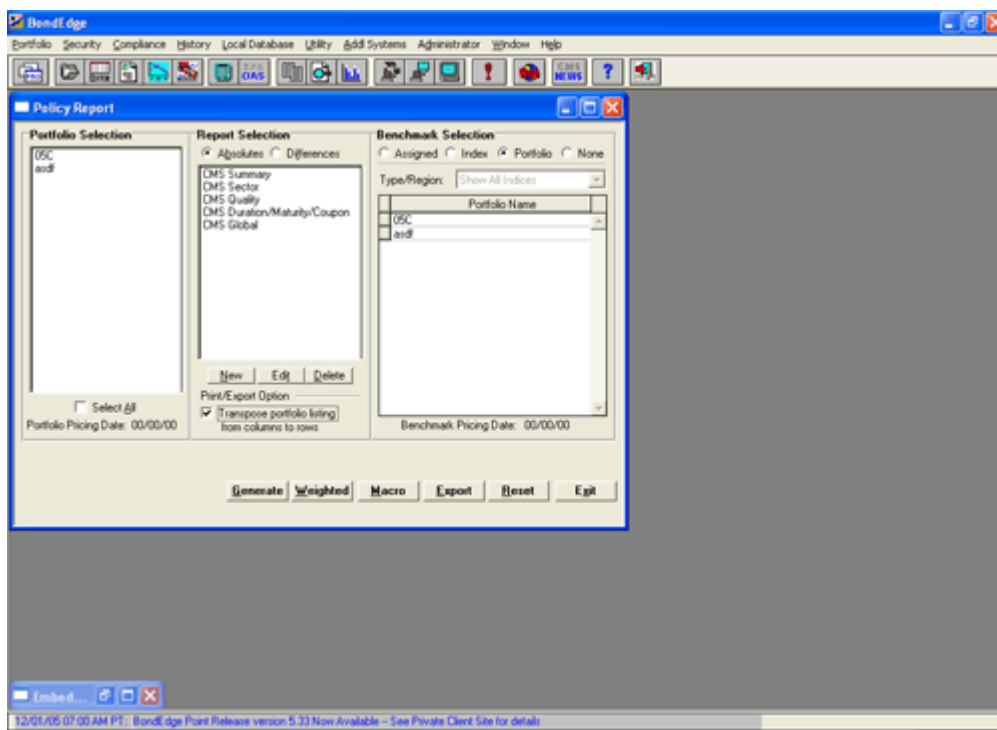
The CMS Structured Finance Department maintains consistently high coverage of outstanding Public Issues. We model approximately 4,000 CMO, ABS and CMBS tranches per month and added about 44,300 bonds to the database in 2005. In total, our CMO database has over 8,500 deals, representing almost 112,000 active tranches (tranches with factors greater than 0.00). Our ABS/CMBS database includes over 4,000 deals with approximately 25,200 tranches. Overall, our coverage is just under 95% of total issuance, with coverage of agency CMO deals greater than 98%, and whole loan CMO coverage at just under 95%. Our ABS coverage is similar for most collateral types, with Credit Card and Auto deal coverage at close to 100%, and Home Equity deals at over 90% of issuance. Home Equity Line of Credit (HELOC) deals continue to present a challenge due to the limited information provided in the prospectus, but we have over 50% of those deals in the database. Priority is given across all types to reverse-engineering new issues within a few days of settlement.

[Top](#)



Q. The Policy Reports now show my Portfolios in Columns, with the various characteristics

displayed by rows. For printing and/or exporting, can I switch this so that the Portfolios are listed in rows, with characteristics in columns?



A. In version 5.3x, you can choose to print and export your Policy reports with the Portfolios listed in rows. Located below the 'Report Selection' box, is the Print/Export Option. Check the 'Transpose portfolio listing from columns to rows' box. This allows you to print/export the report with portfolios displayed in rows, even though the on-screen report continues to show the portfolios in columns.

[Top](#)

To unsubscribe please [click here](#) (when email message pops up, simply hit 'Send').
 To add others to the list please [click here](#) to subscribe and be sure to include their names and email addresses in the message body.