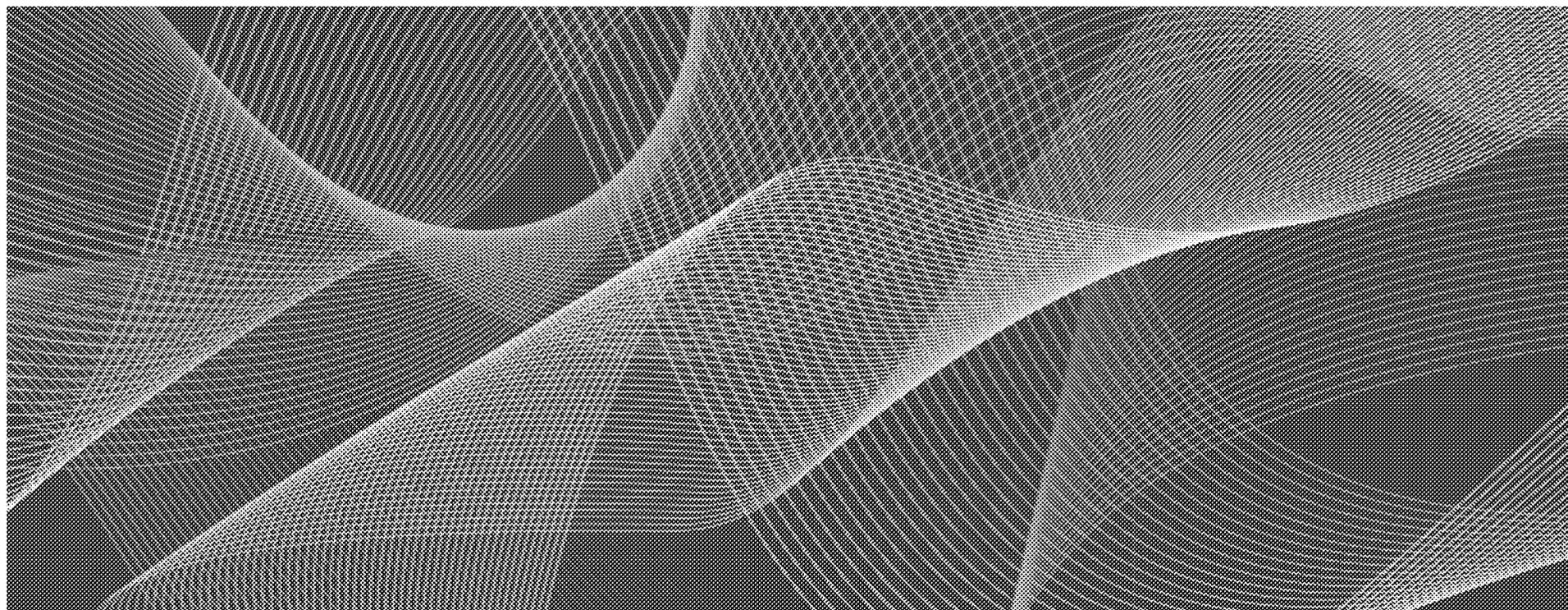


April 2008

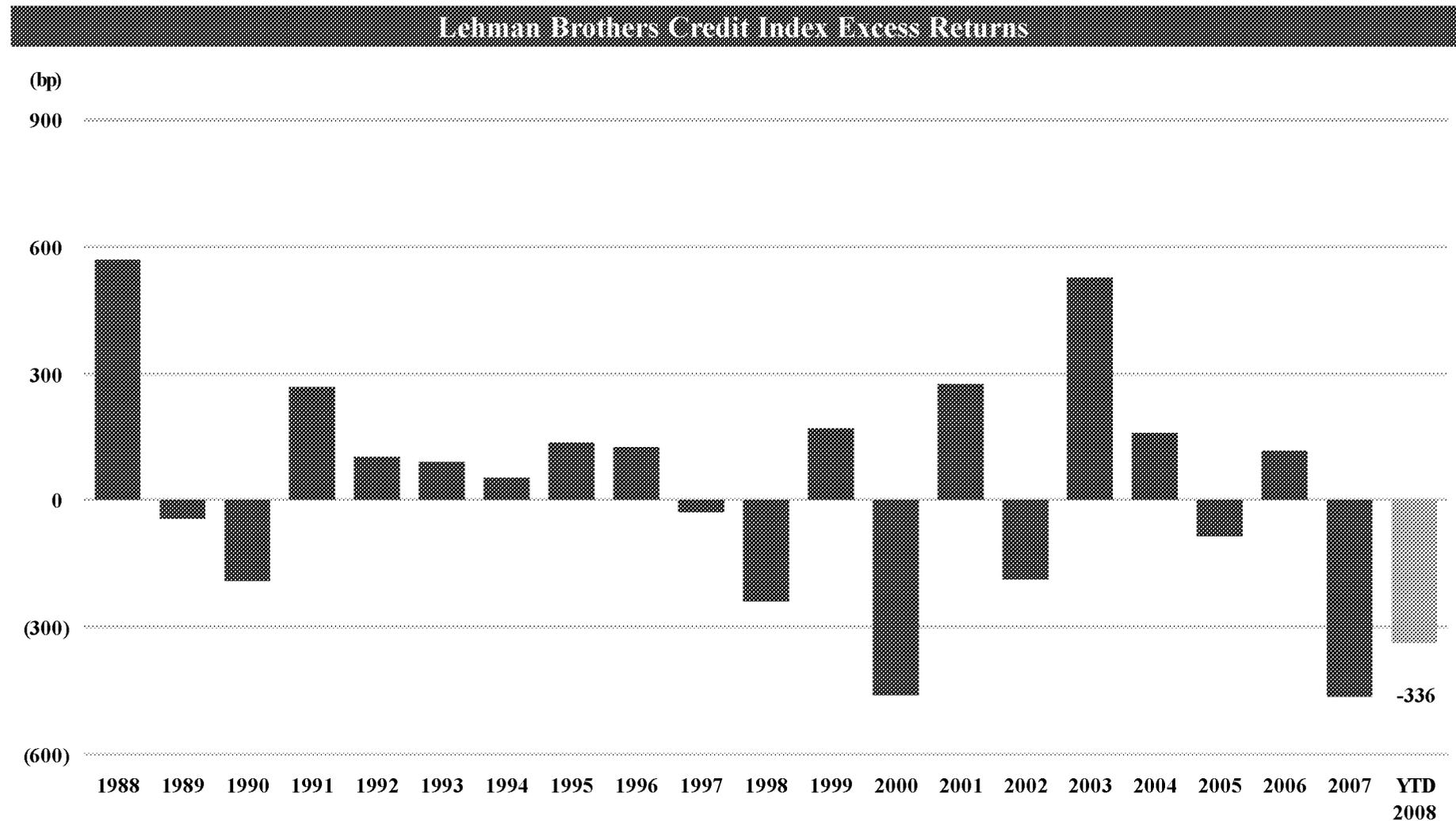
Eric Felder

Credit Outlook

This material has been prepared by Credit Trading and is not a product of Lehman's Research Department. It is for information purposes only. All levels and prices are indications only and do not represent firm market levels. Changes in market conditions since the issuance of this document may affect some or all of the levels and prices listed. For firm levels and prices please call the desk. Lehman Brothers Inc. and/or its affiliates may trade and/or have a principal position in the securities, financial instruments and/or related derivatives mentioned herein.



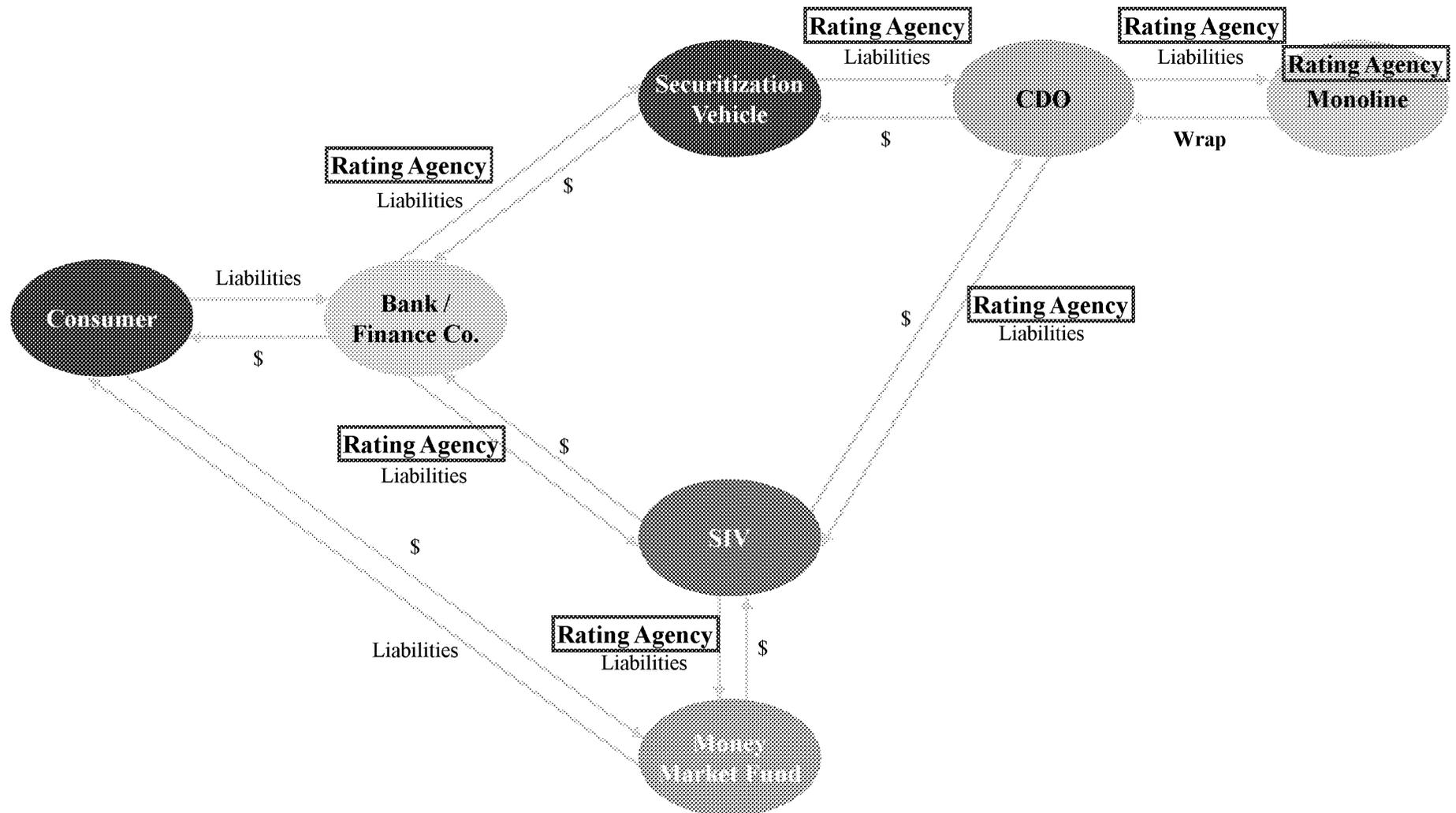
After a Period of Low Volatility, 2007 was a Turning Point in the Credit Cycle. In 2008, Credit has had its Worst Start to a Year on Record.



Source: Lehman Brothers.

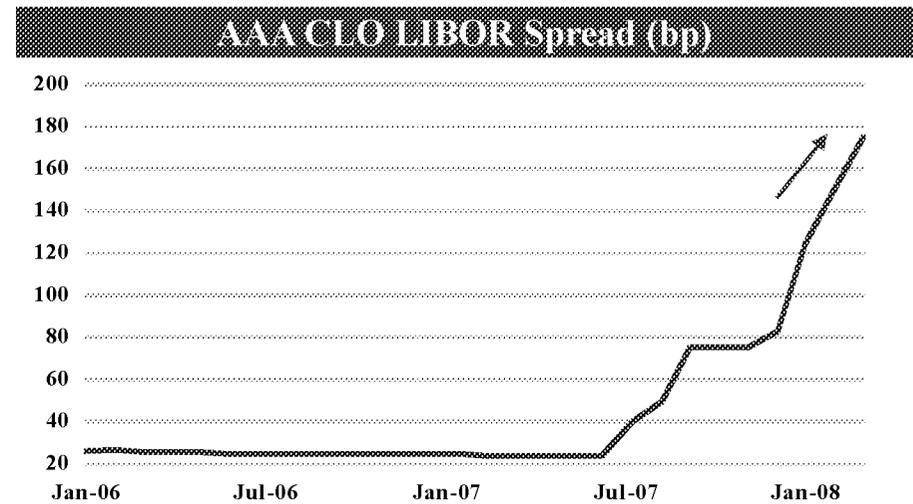
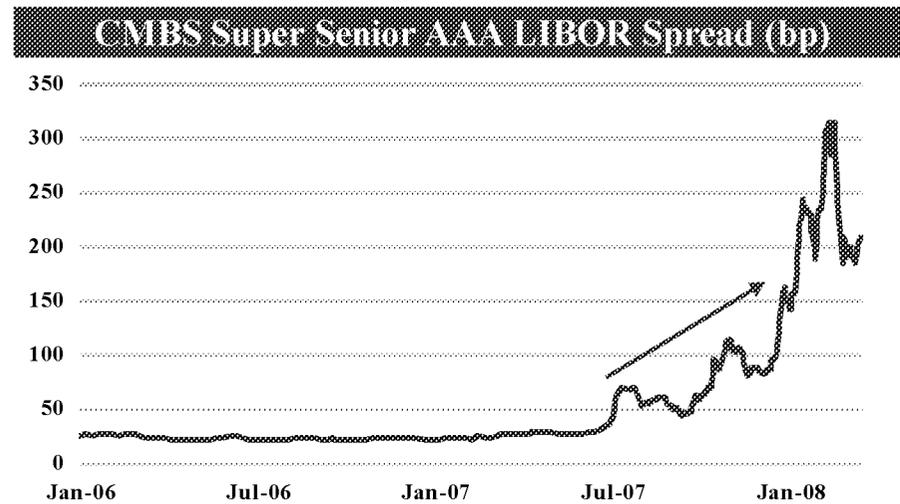
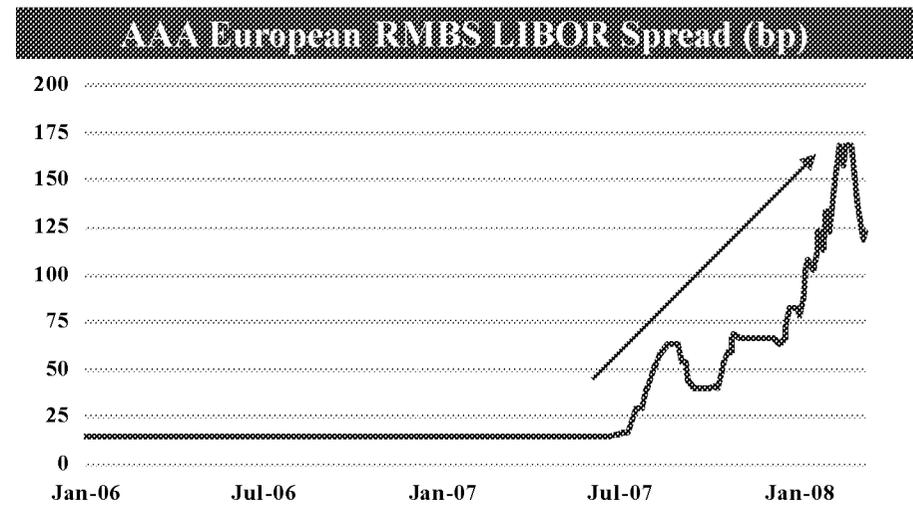
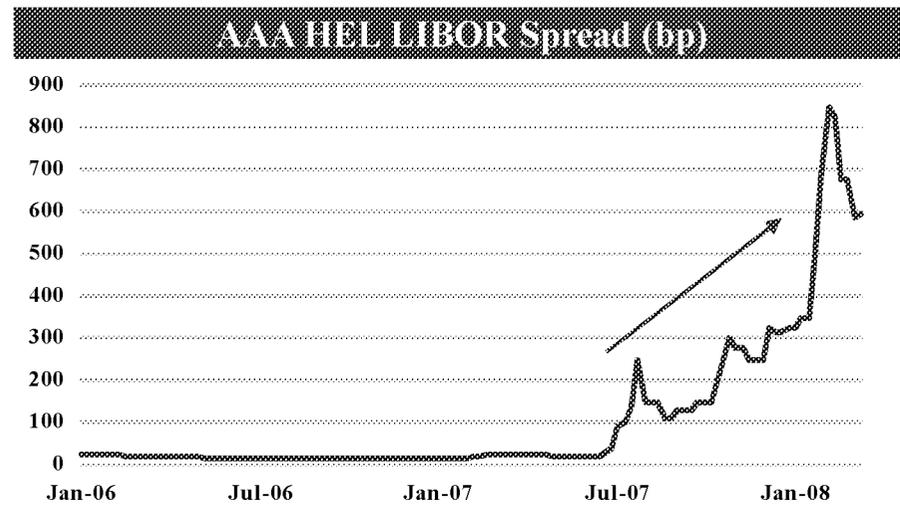
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As a Loss of Faith in Rating Agency Models Impaired the Securitization Process ...



LEHMAN BROTHERS

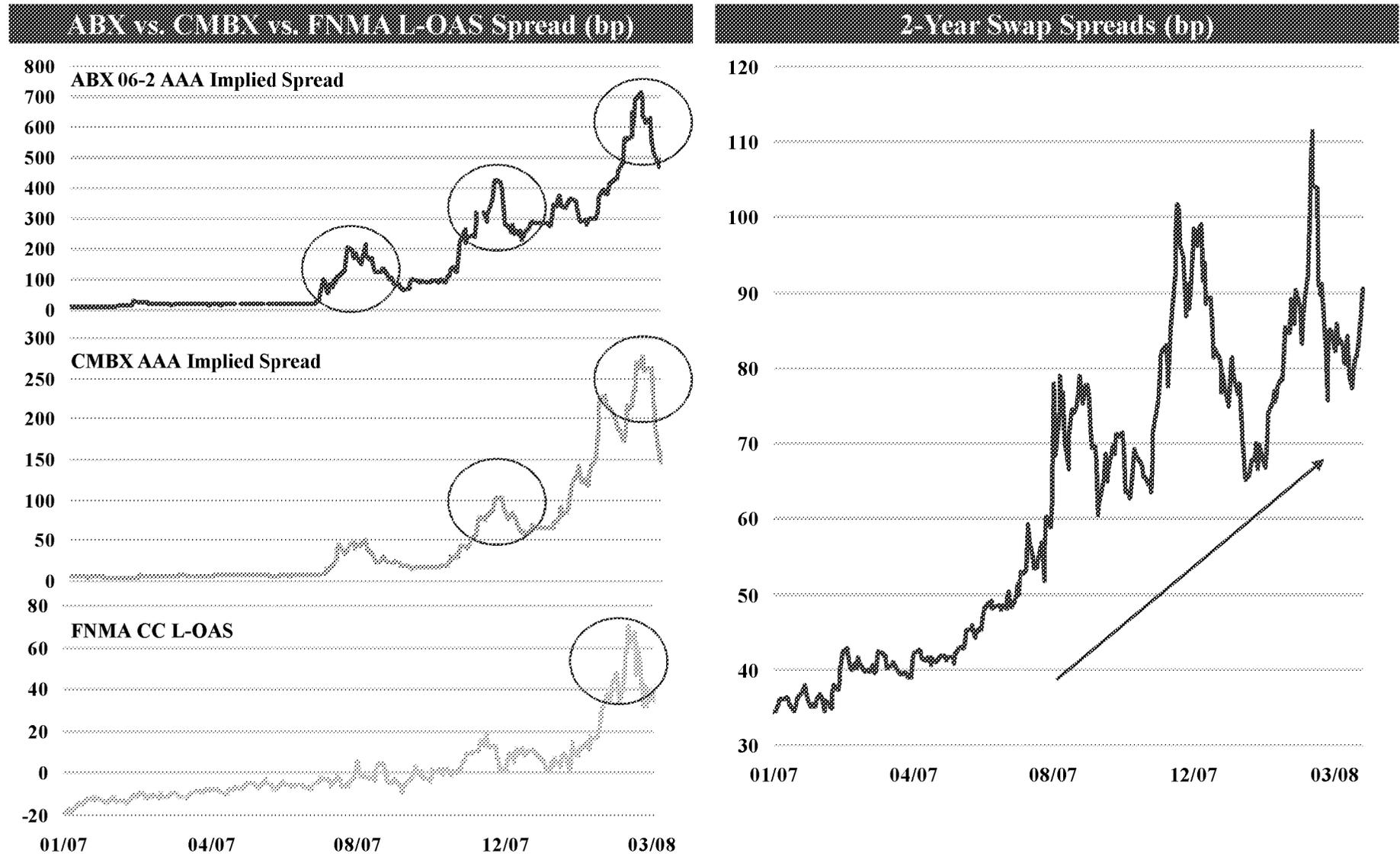
And pushed “Risk-Free” Asset Spreads to All-Time Wides, Which, in Turn, Made Credit Appear Very Rich on a Relative Basis



Source: Lehman Brothers.
Spread to LIBOR shown, European RMBS Spread indicates Dutch AAA Spreads — 5 yr Fixed to Swap.

LEHMAN BROTHERS

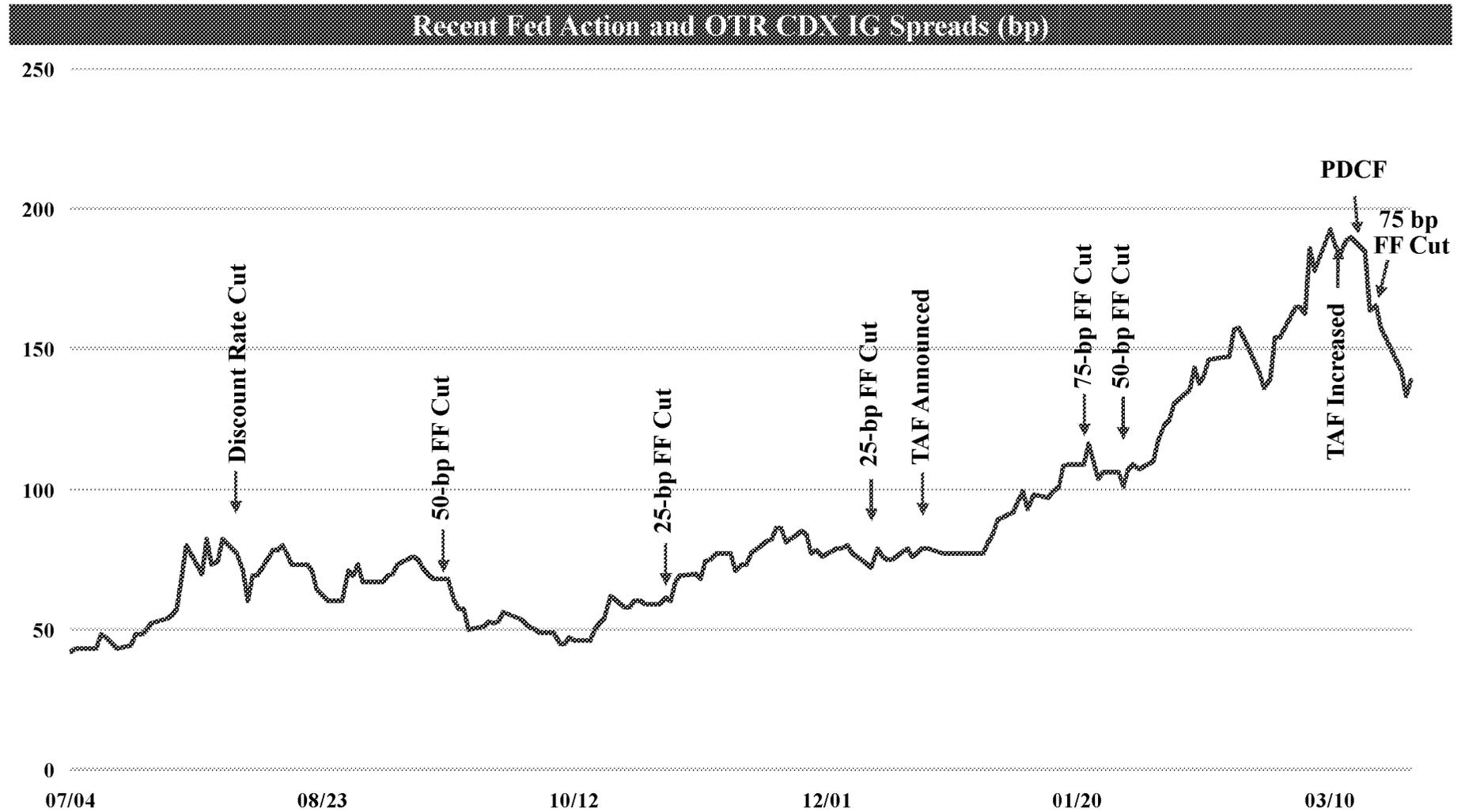
And Locked the Market into a Vicious Cycle Where Delevering in One Asset Class Caused Delevering in Another



Source: Lehman Brothers.

LEHMAN BROTHERS

Culminating in a Series of Regulatory Actions by the Fed . . .



Source: Lehman Brothers.

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Which Have Materially Reduced the Likelihood of a Liquidity Event in the Financial Markets

Comments on the Primary Dealer Credit Facility

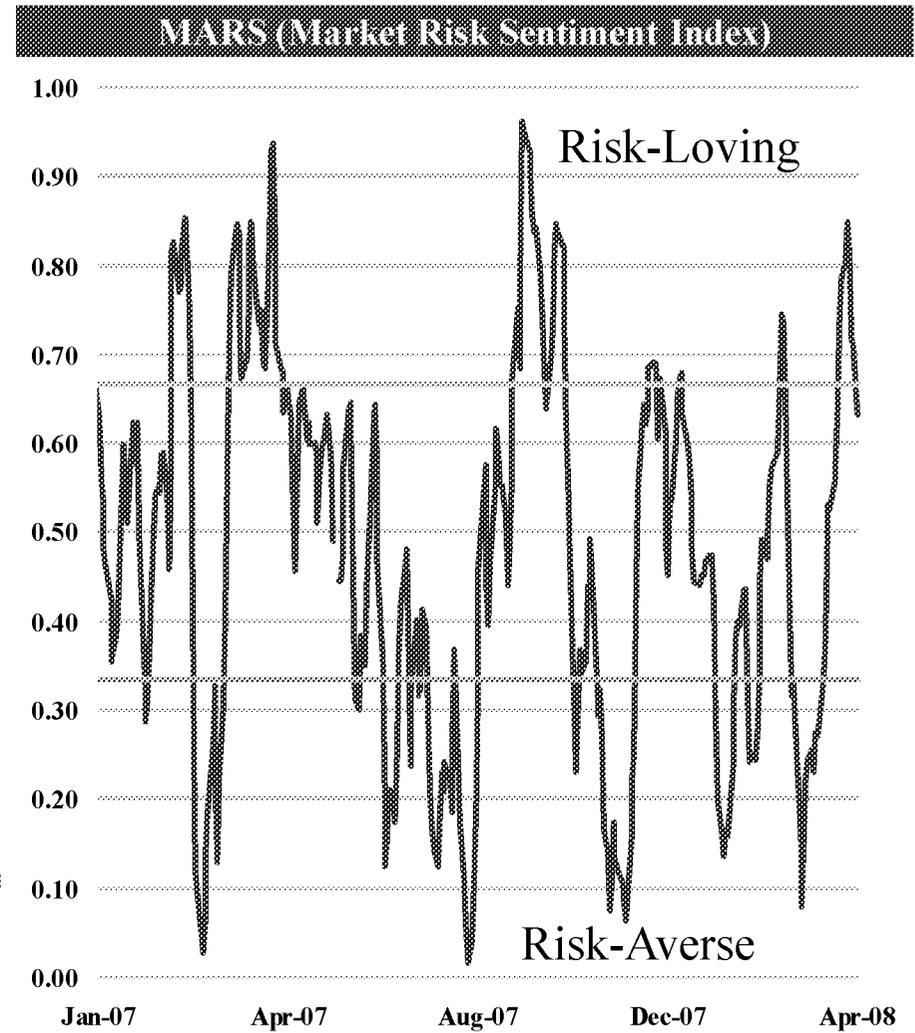
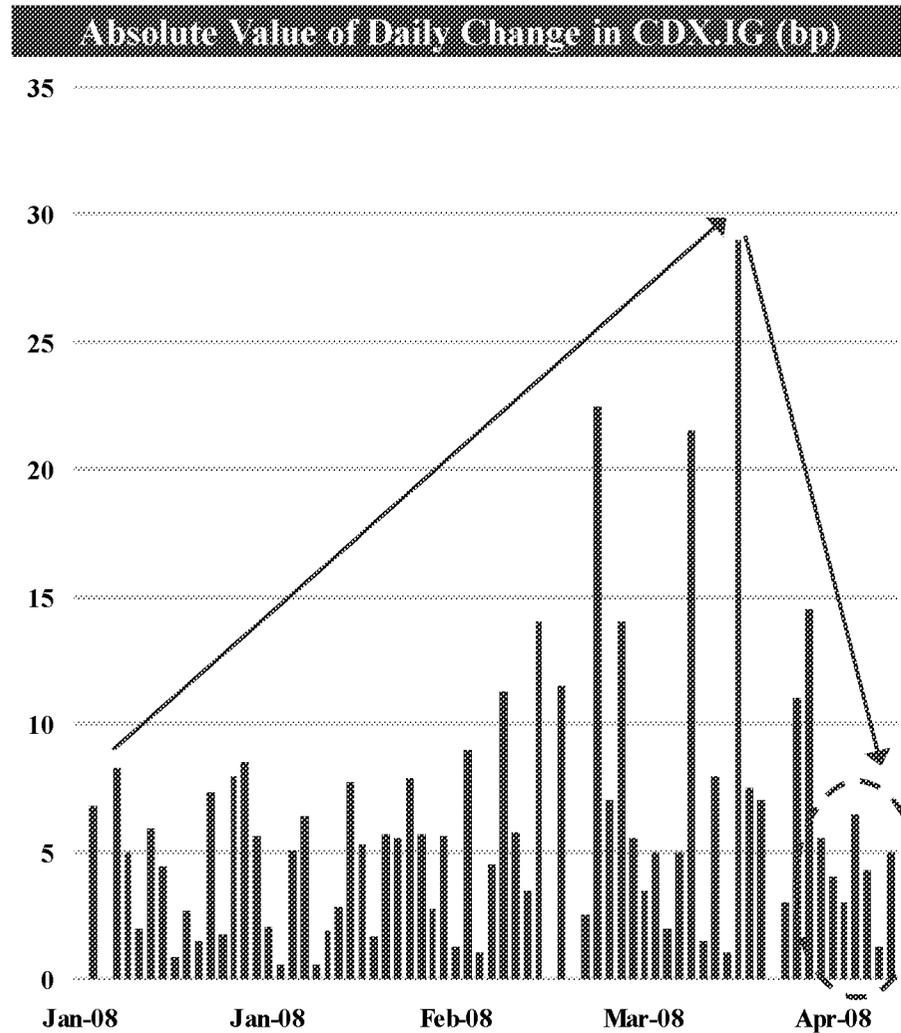
- ◆ **Discount window will** now be extended to **include primary dealers** (20 large, non-bank broker / dealers)
- ◆ There is **no limit** on the amount of money that can be borrowed
- ◆ The Fed will accept a **wide range of investment grade collateral** – including, but not limited to ABS, CP, convertible bonds, munis, and private label CMOs
- ◆ For difficult to finance products, the **haircuts are quite generous** compared to current market margin levels
- ◆ The **rate charged will be 25 bp over Fed Funds**
- ◆ The new program is for overnight funding – but it is assumed to be renewable daily using the same collateral
- ◆ Should help prevent forced liquidations

Source: Lehman Brothers.

LEHMAN BROTHERS

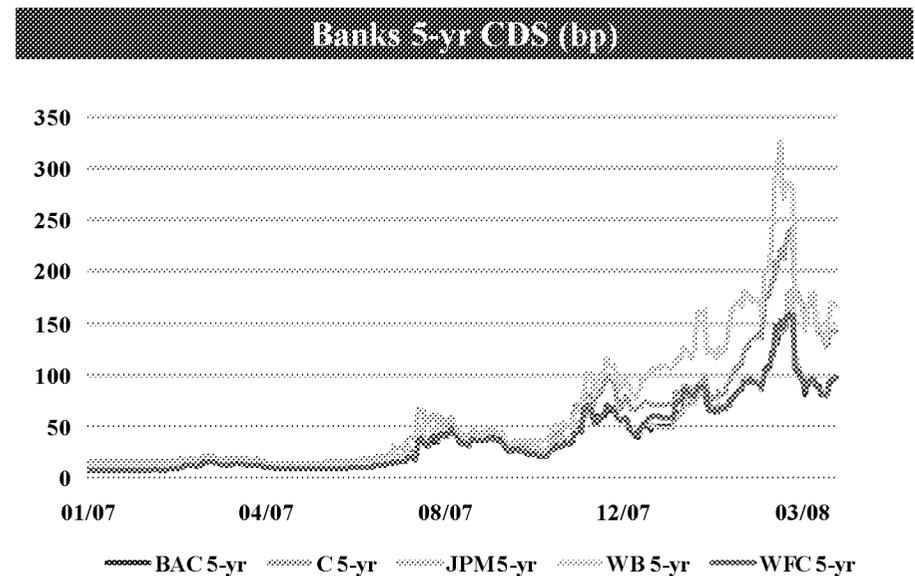
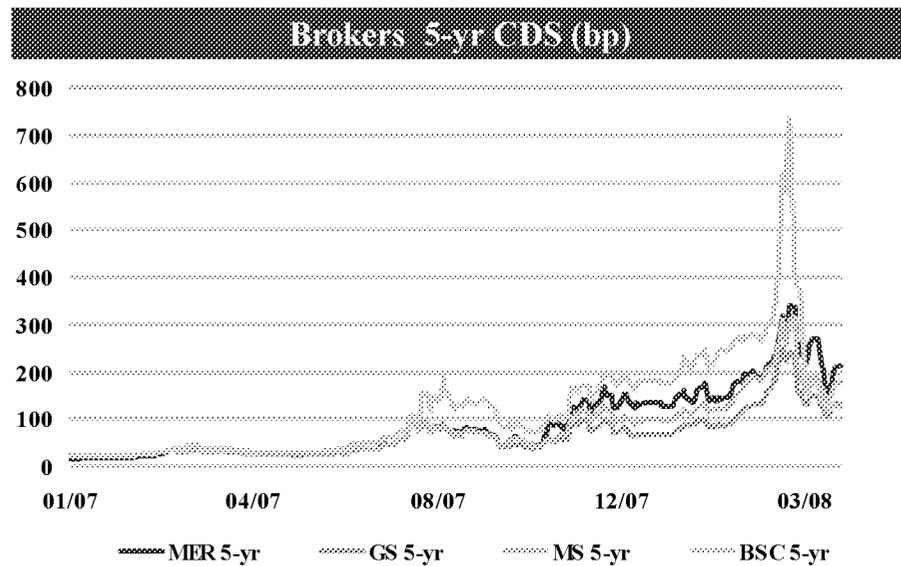
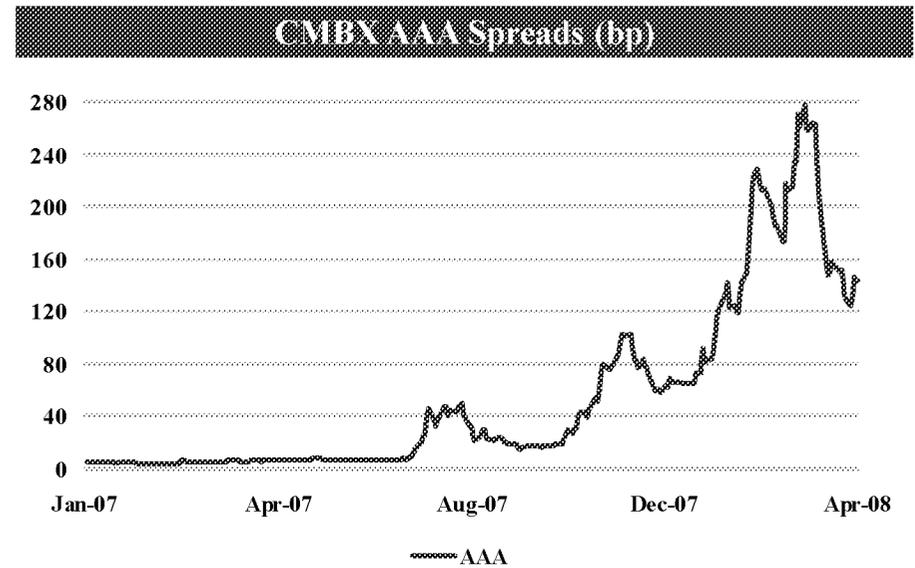
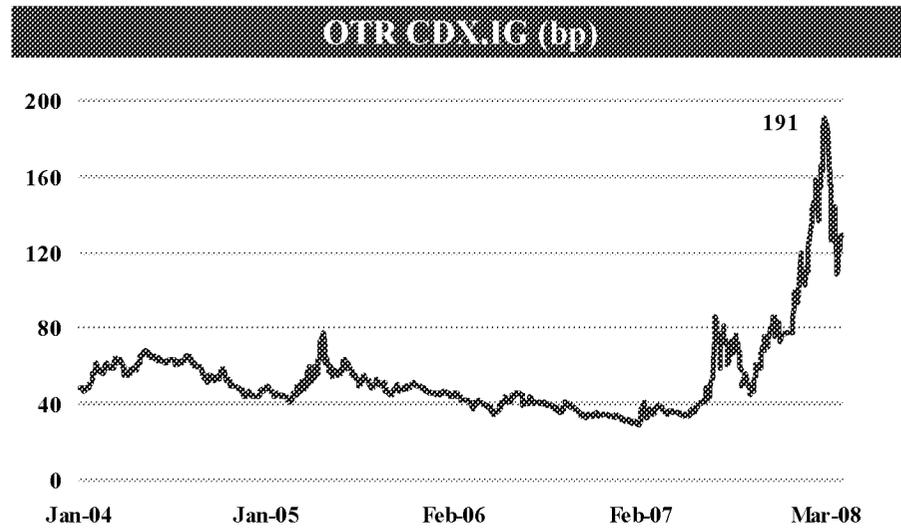
6

With a Meaningful Reduction in the Likelihood of a Tail Event, Markets have Stabilized and Sentiment has Improved Significantly



Source: Lehman Brothers.
LEHMAN BROTHERS

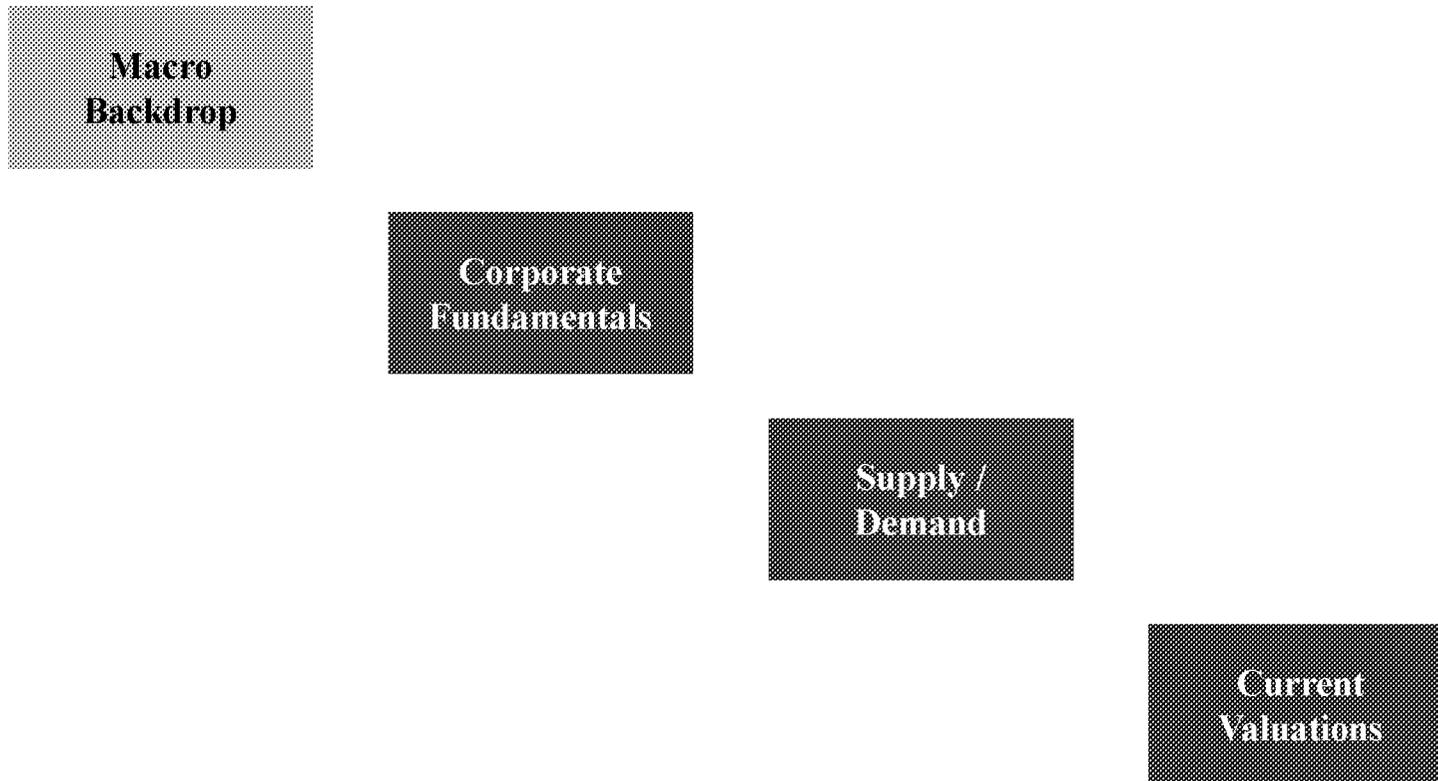
Spreads Have Retraced a Significant Portion of the Recent Widening, (Particularly in Derivatives) as Hedges Have Been Unwound



Source: Lehman Brothers.
LEHMAN BROTHERS

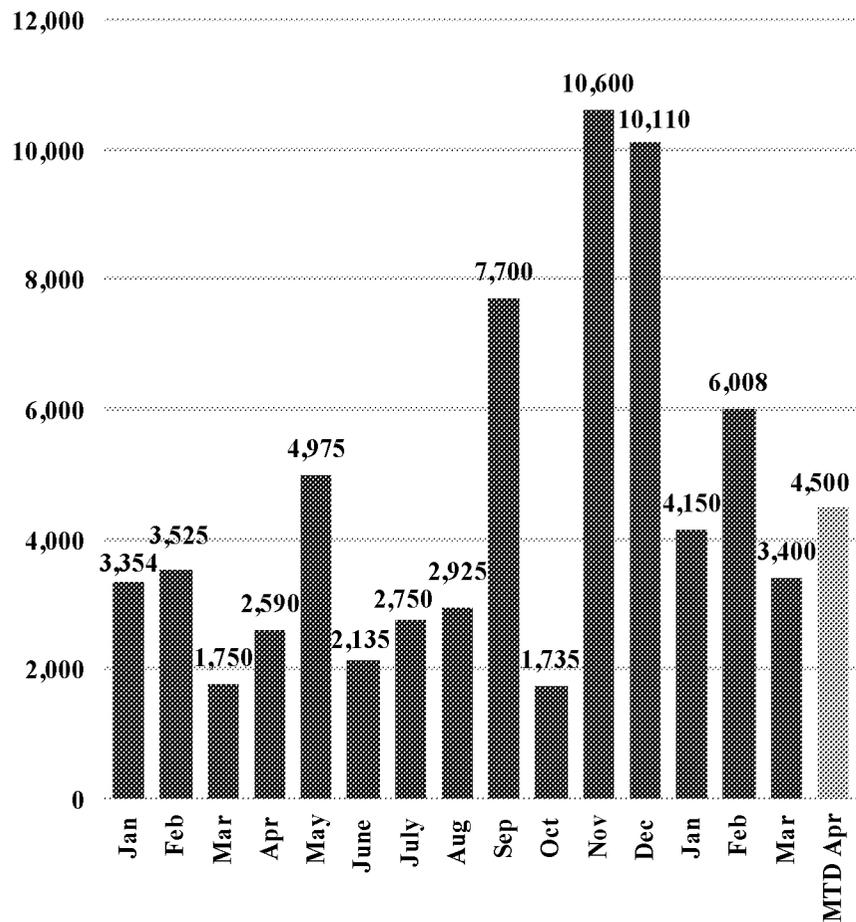
However, Questions Regarding the Fundamental Outlook and Potential Ongoing Stress From the High Leverage Levels Left in the System Remain

Along these lines, we see several key drivers for credit going forward

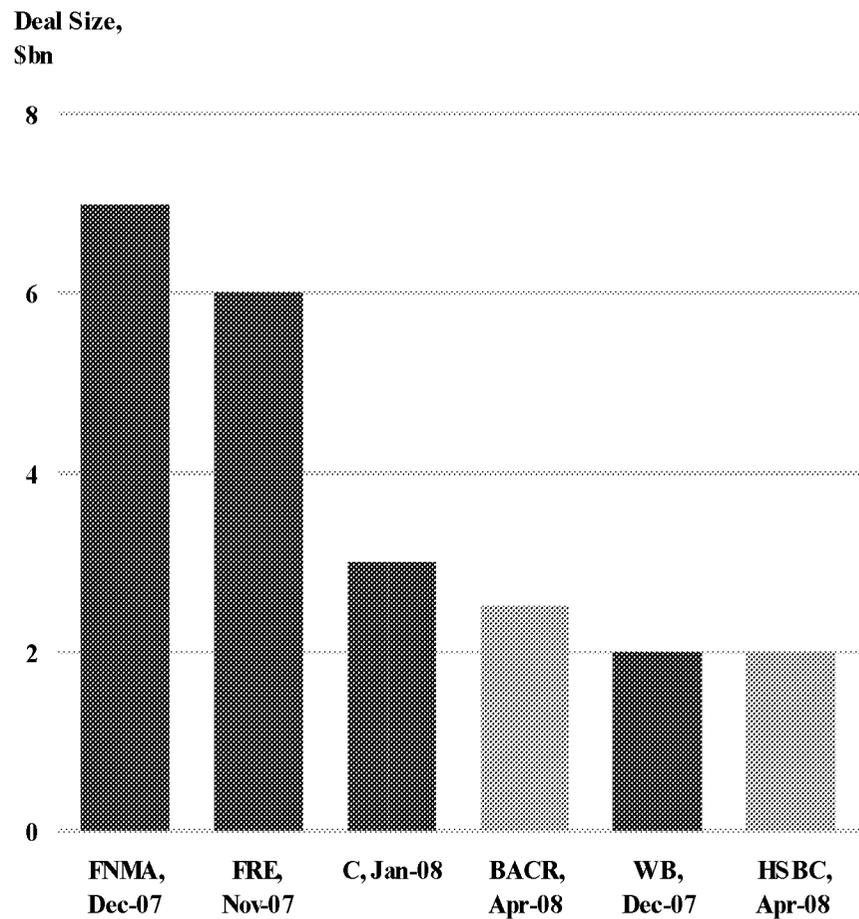


Recently, There Have Been Signs of Liquidity Normalization as Firms Have Been Able to Raise Capital in Segments of the Market That Appeared Shut Just One Month Ago...

Retail Preferred Issuance (\$mn)

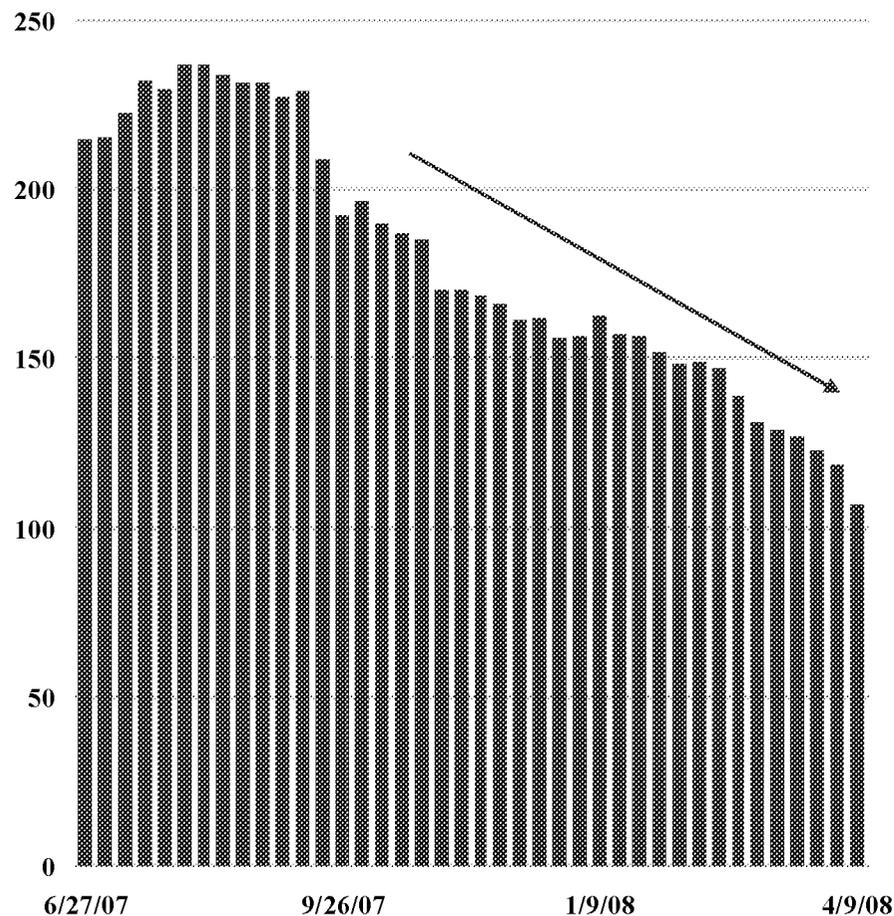


Largest Retail Preferred Deals Since Jan-07 – (Ticker, Issue Date)



And There Has Been Renewed Demand for Leveraged Loans (Particularly from Private Equity)

Leveraged Loan Pipeline (Sbn)



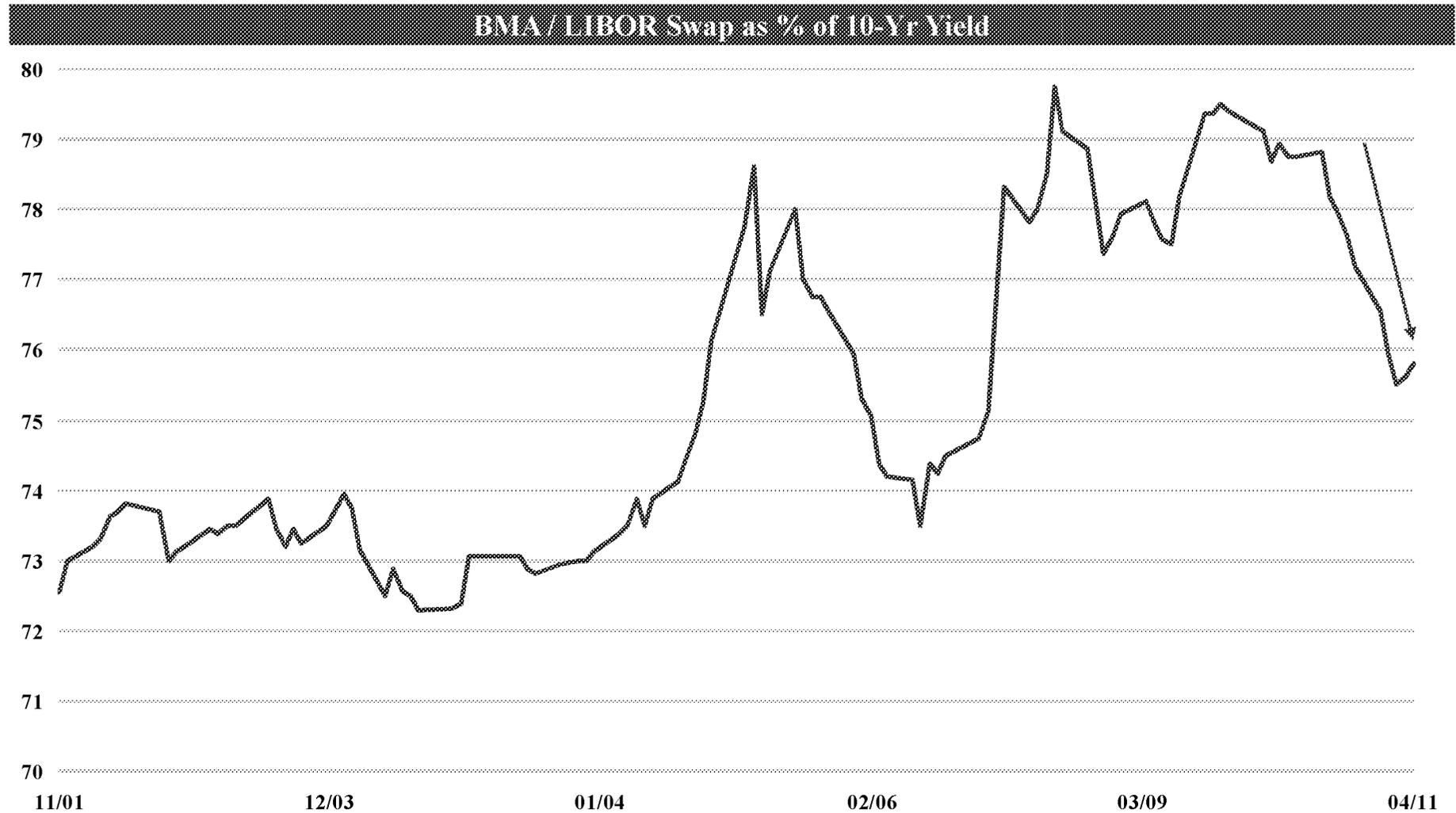
Returns for a Leveraged Investment in Loans

LIBOR	2.70%
Loan Coupon	2.75%
Loan Price	88
Leverage	3
Funding Cost	1.25%
Cash On Cash Yield	12.92%

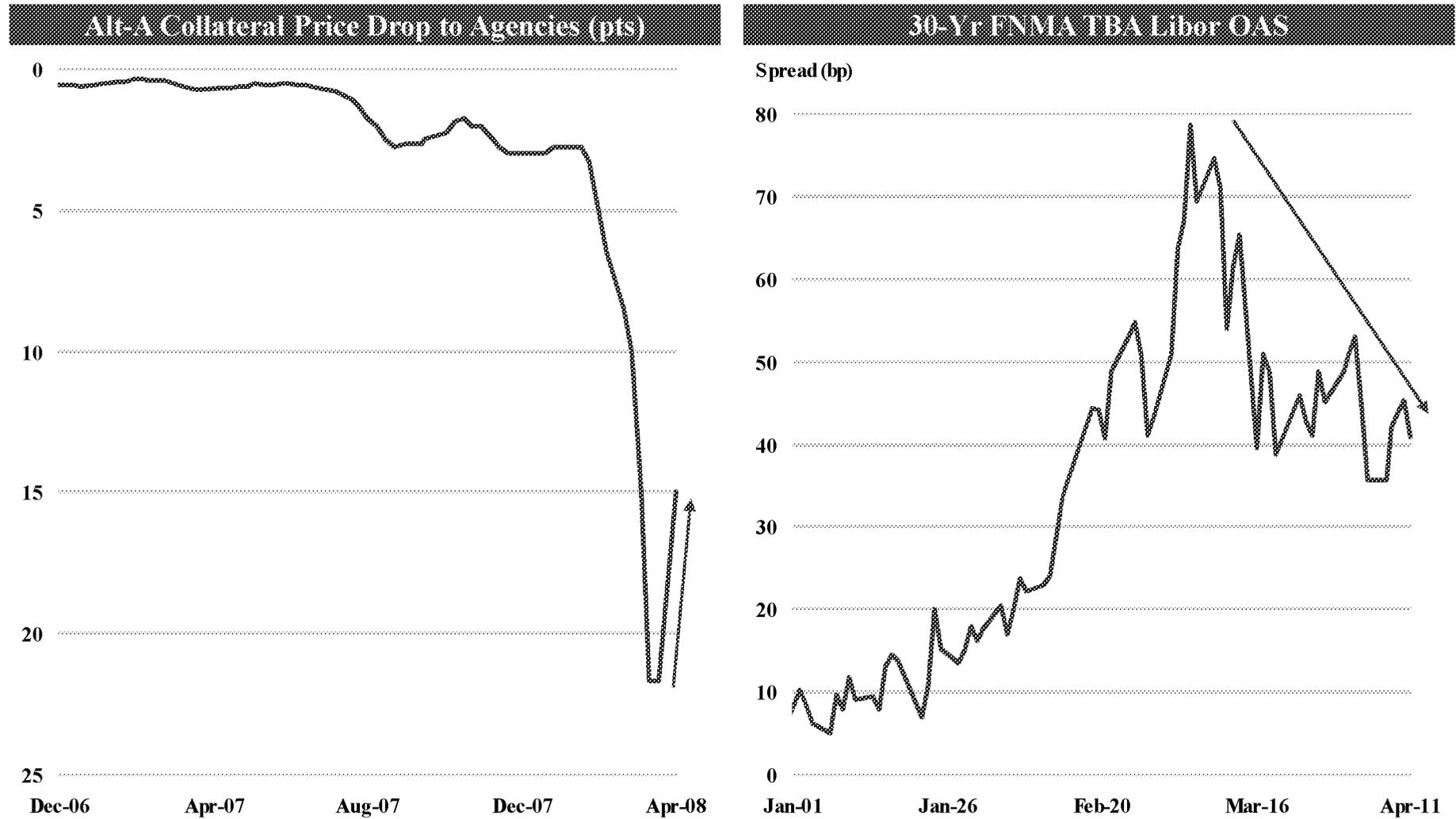
IRR Assuming Principal Repayment at End of Period

End of 3 Years	29.01%
End of 4 Year	24.23%
End of 5 Years	21.50%
End of 6 Year	19.74%
End of 7 Years	18.52%

There Have Also Been Signs of Stability in the Muni Market, Where Record Yields (When Compared to Other Assets) Have Helped Expand The Buyer Base



Certain Segments of the Mortgage Space Have Shown Signs of Stabilization

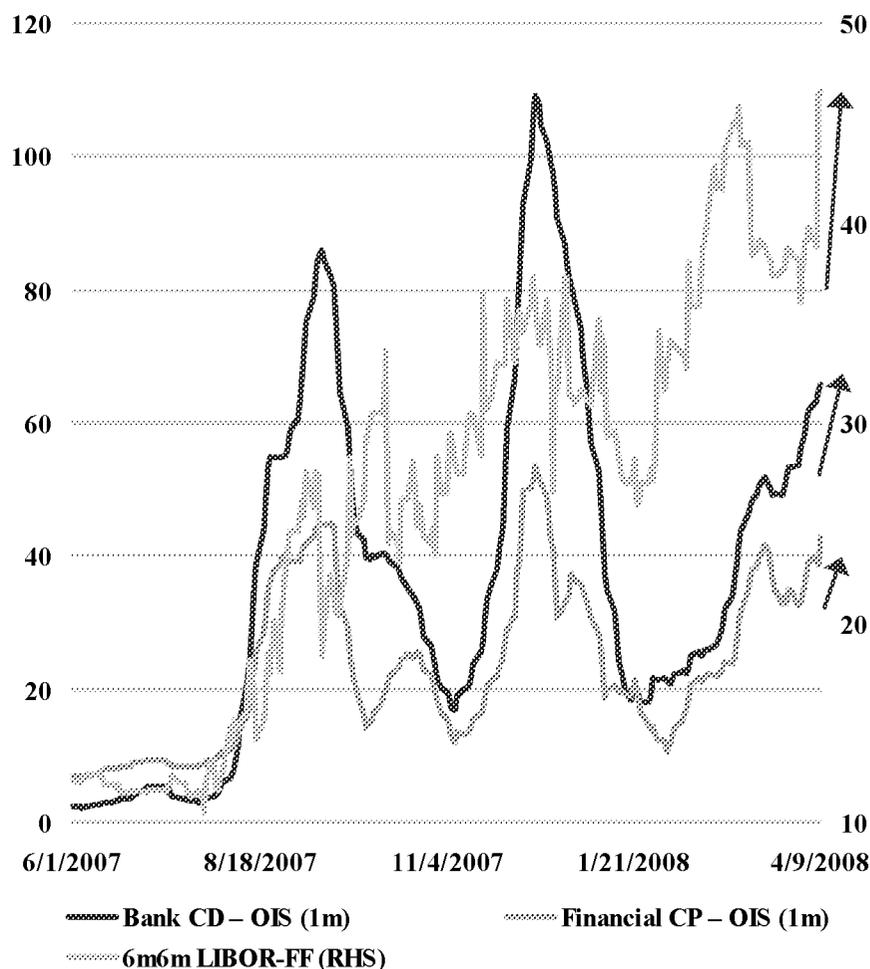


While There Have Been Many Positive Developments on the Liquidity Front in Recent Weeks, Renewed Signs of Stress in the Funding Markets Indicate That Normalization Is Unlikely to Be an Overnight Process

Change in Rates & Spreads

	Change From (bp)			
	10-April	15-Mar	15-Dec	Jun-07
Rates				
2y Tsy	1.86	28	-119	-311
10y Tsy	3.53	-1	-51	-157
2y2y BE	2.03	-40	-16	-39
5y5y BE	2.45	-23	5	0
Spreads/Vol				
2y Sprd	81	-17	-16	35
10y Sprd	65	-14	-5	4
Mtg LOAS	40	-26	33	46
CDX HG	117	-61	41	80
CDX HY	617	-135	131	328
3m2y Vol	135	-27	5	69
Money Market				
3m LIBOR-FF	76	3	-26	64
6m6m LIBOR-FF	42	0	7	30
FF GC (1m)	15	-27	-32	1

Bank Funding Spreads (bp)



Source: Lehman Brothers Interest Rates Strategy.
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And the Economic Backdrop has Deteriorated. The Consumer is Facing Massive Headwinds as the Housing Crisis, Tightening Lending Standards, and High Commodity Prices Take Their Toll

Consumer Backdrop – 2007 vs. 2008

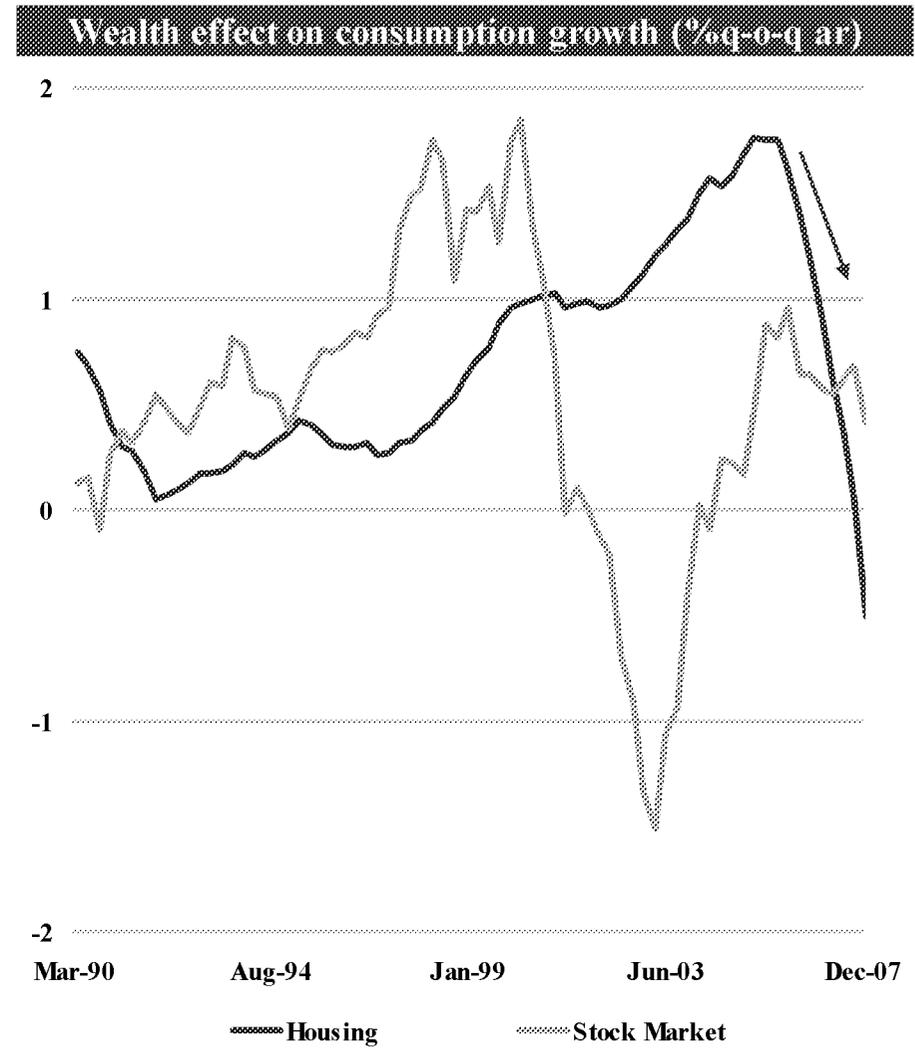
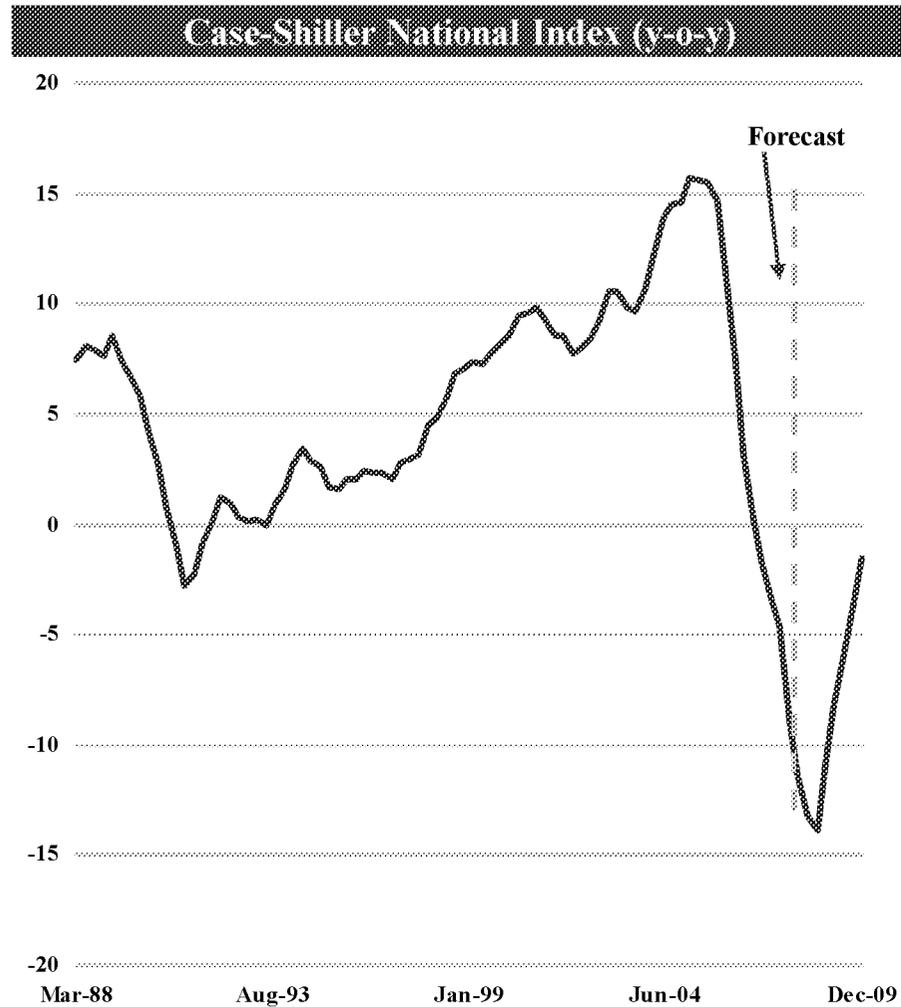
Factor	January 2007	Current	Impact
Unemployment Rate	4.6	5.1	Negative
Payroll Growth (6-Month MA)	189K	2K	Negative
Gas Prices	\$2.30	\$3.39	Negative
Lending Standards	Loosening	Tightening	Negative
Housing Wealth Effect	1.1%	(0.3%)	Negative
Trailing 12-Month S&P 500 Return	15%	-7.56%	Negative
Savings Account Yield	4.08%	2.57%	Negative
30-Year Jumbo Mortgage Rate	6.07%	7.02%	Negative

State of the Consumer – December 2006 vs., Current

Factor	December 2006	Current	Impact
Consumer Confidence	110.0	64.5	Negative
Automobile Sales (SAAR)	16.6	15.3	Negative
Holiday Retail Sales (YoY)	5.9	4.2	Negative
Credit Card Delinquency Rate	3.92	4.55	Negative
Auto Loan Delinquency Rate	1.27	2.67	Negative
Prime Mortgage Delinquency Rate	2.57	3.24	Negative
Subprime Mortgage Delinquency Rate	13.33	17.31	Negative

Source: Bloomberg.

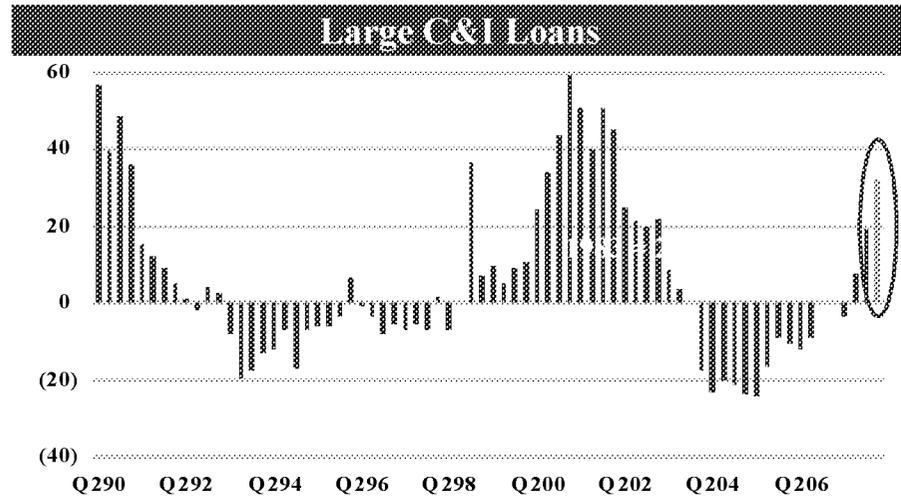
And we can Expect More Pressure to Come as Home Prices Continue to Deteriorate...



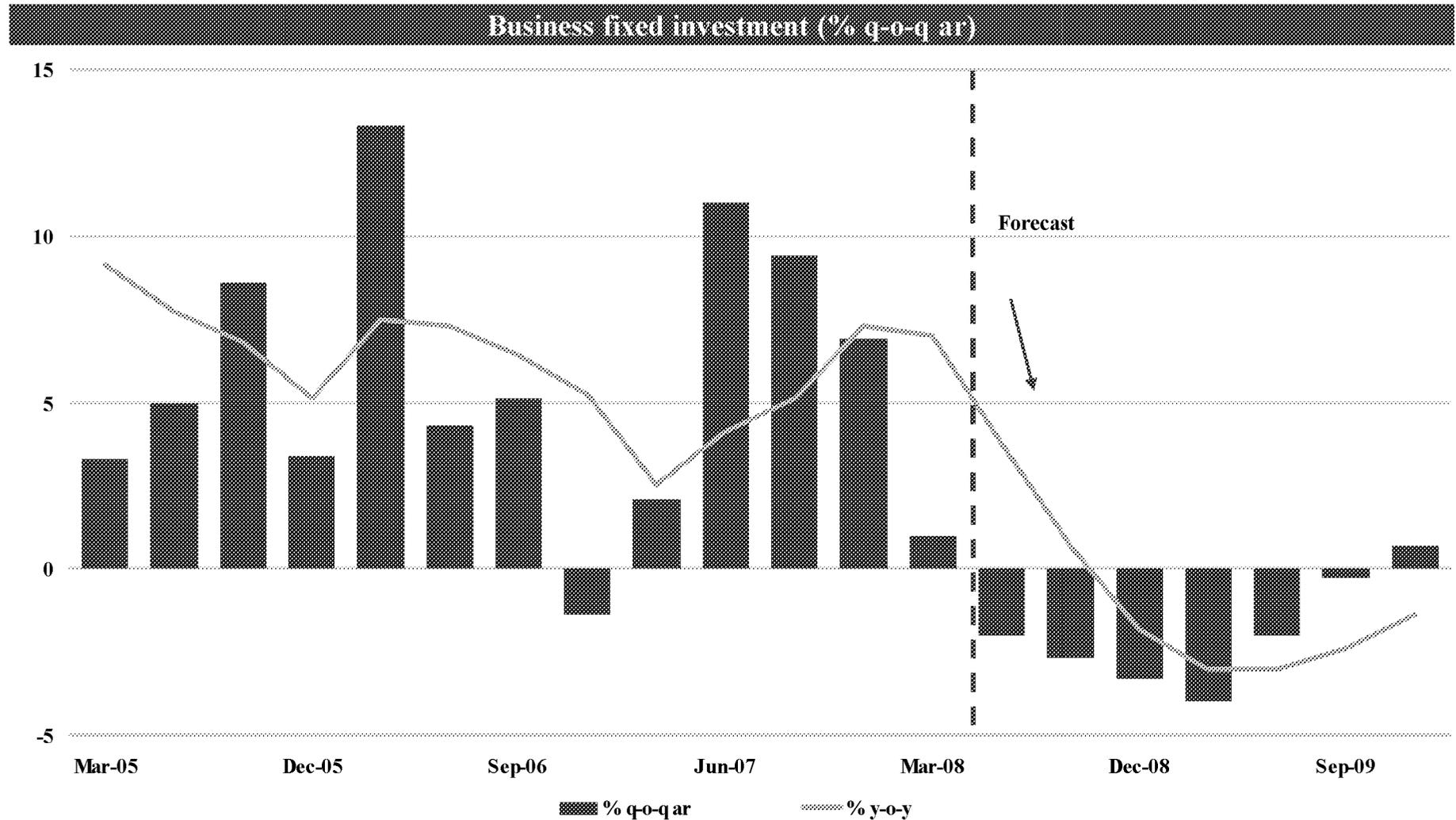
Source: Federal Reserve Flow of Funds, Commerce Dept, Lehman Brothers;
 Note: Housing wealth effect assumes consumers spend 6¢ for every additional dollar of housing wealth over a two year adjustment period. Stock market wealth effect assumes consumer spend 6¢ for every additional dollar of equity wealth over a three year adjustment period (assuming a 10% increase in equities from now through year-end and 10% average increase next year).

Lending Standards Continue to Tighten for Consumers and Corporates

Fed Senior Loan Officer Survey: Net % of banks reporting tightening of standards



And Corporates are Pulling Back on Investments...



Source: Federal Reserve Flow of Funds, Commerce Dept, Lehman Brothers;

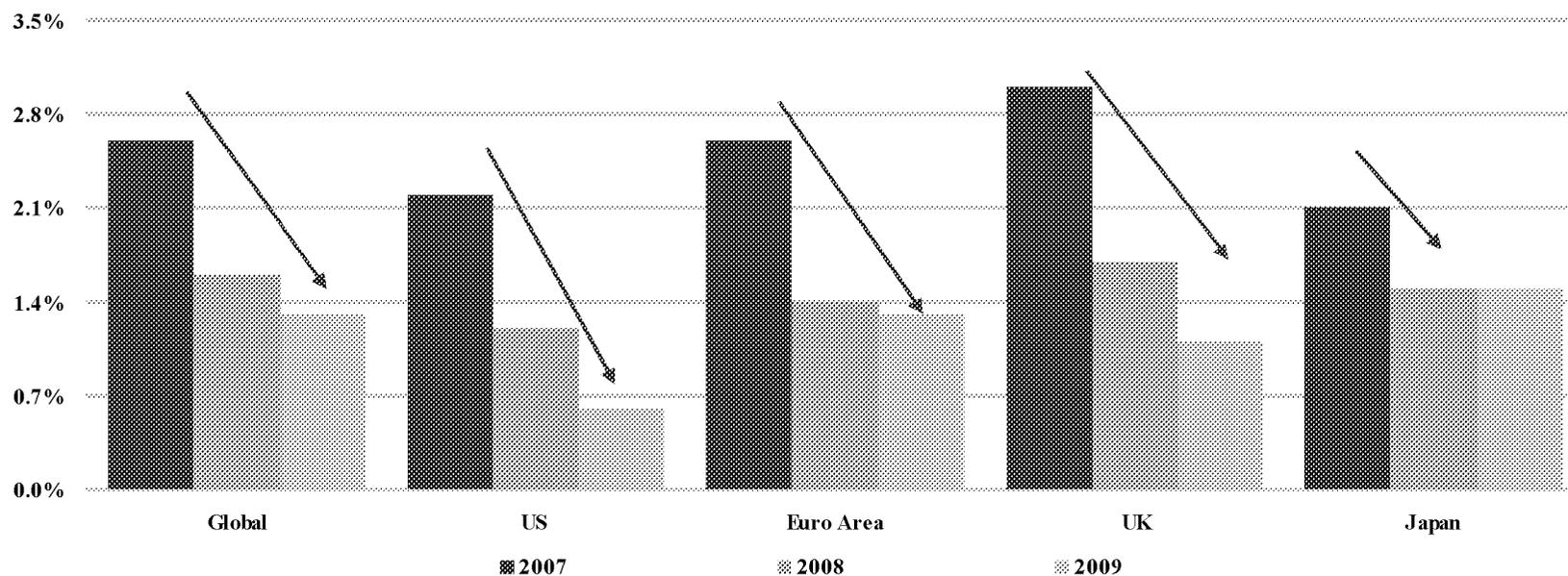
On the Back of All of These Issues, Growth is Expected to Slow. Importantly, we Believe this Will be a Global Slowdown...

... And the macro backdrop will remain increasingly challenging for credit

Lehman Economics on Global Growth

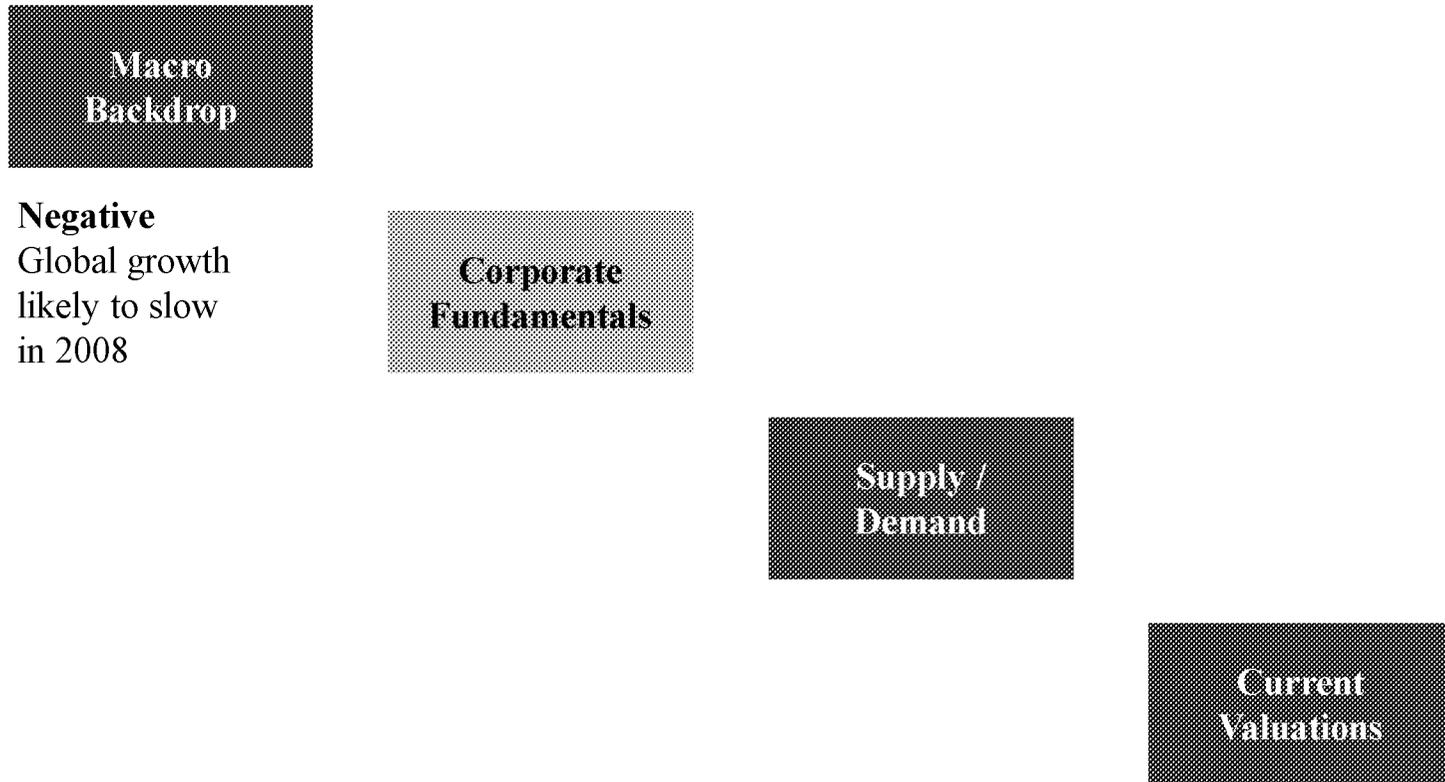
- ◆ We expect an extended period of slower growth as housing hits the US consumer and credit dislocation crimps activity. Aggressive fiscal and monetary easing – with a 1% terminal funds rate – should prevent a deep recession
- ◆ Despite strong fundamentals in EM, the world will not be able to “decouple”: we expect a slowdown across the board

2007 GDP Growth vs. 2008 & 2009 Estimates



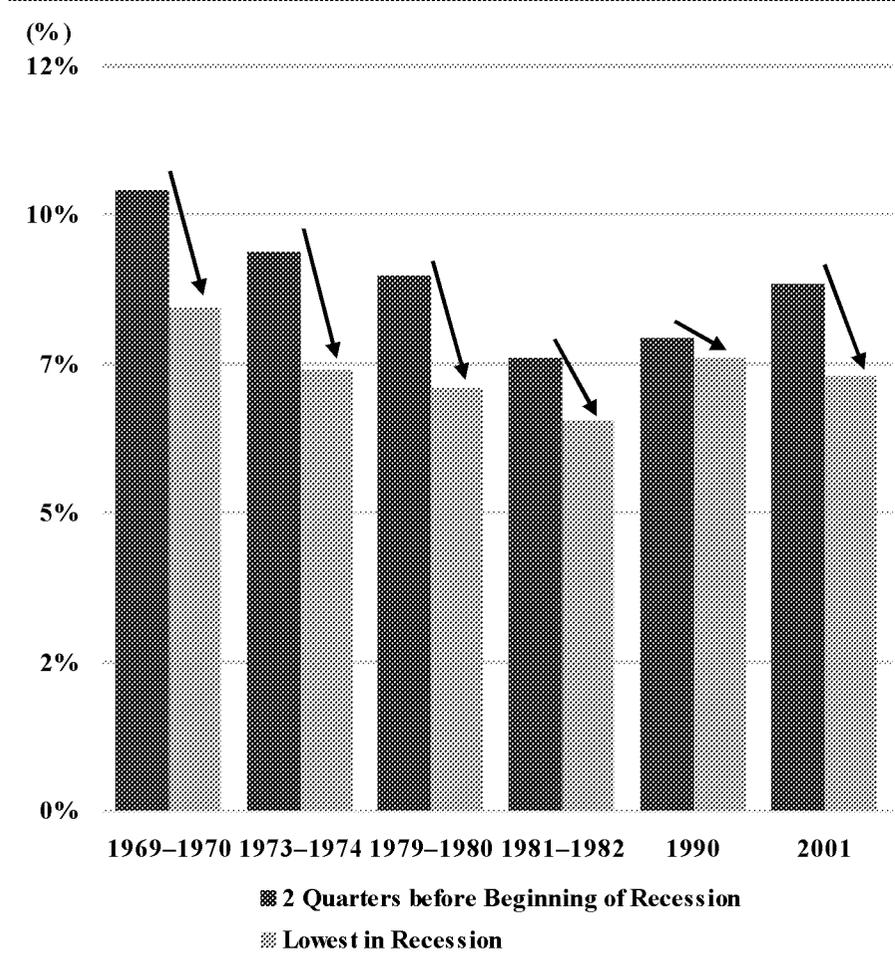
Source: Lehman Brothers Economics.
Note: 2007 Includes 4Q07 Estimate.

Challenging Macro Backdrop Will Weigh on Fundamentals

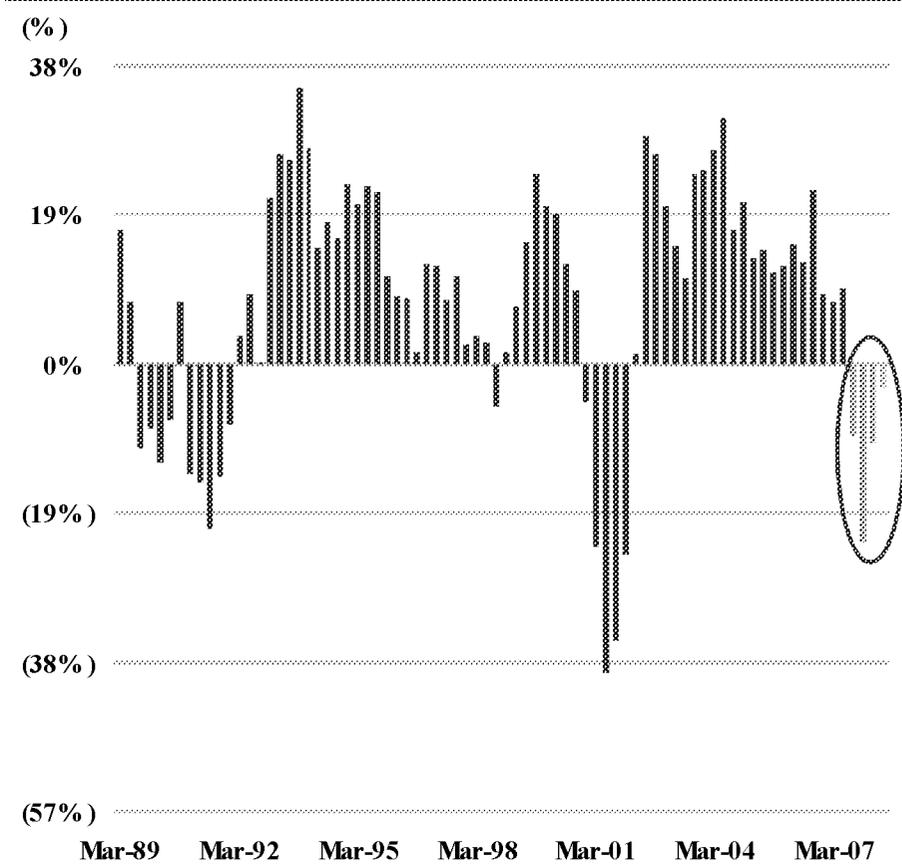


With Global Growth Slowing, we Would Expect Corporate Fundamentals to Deteriorate

Corporate Share of Profits Typically Fall During Recessions

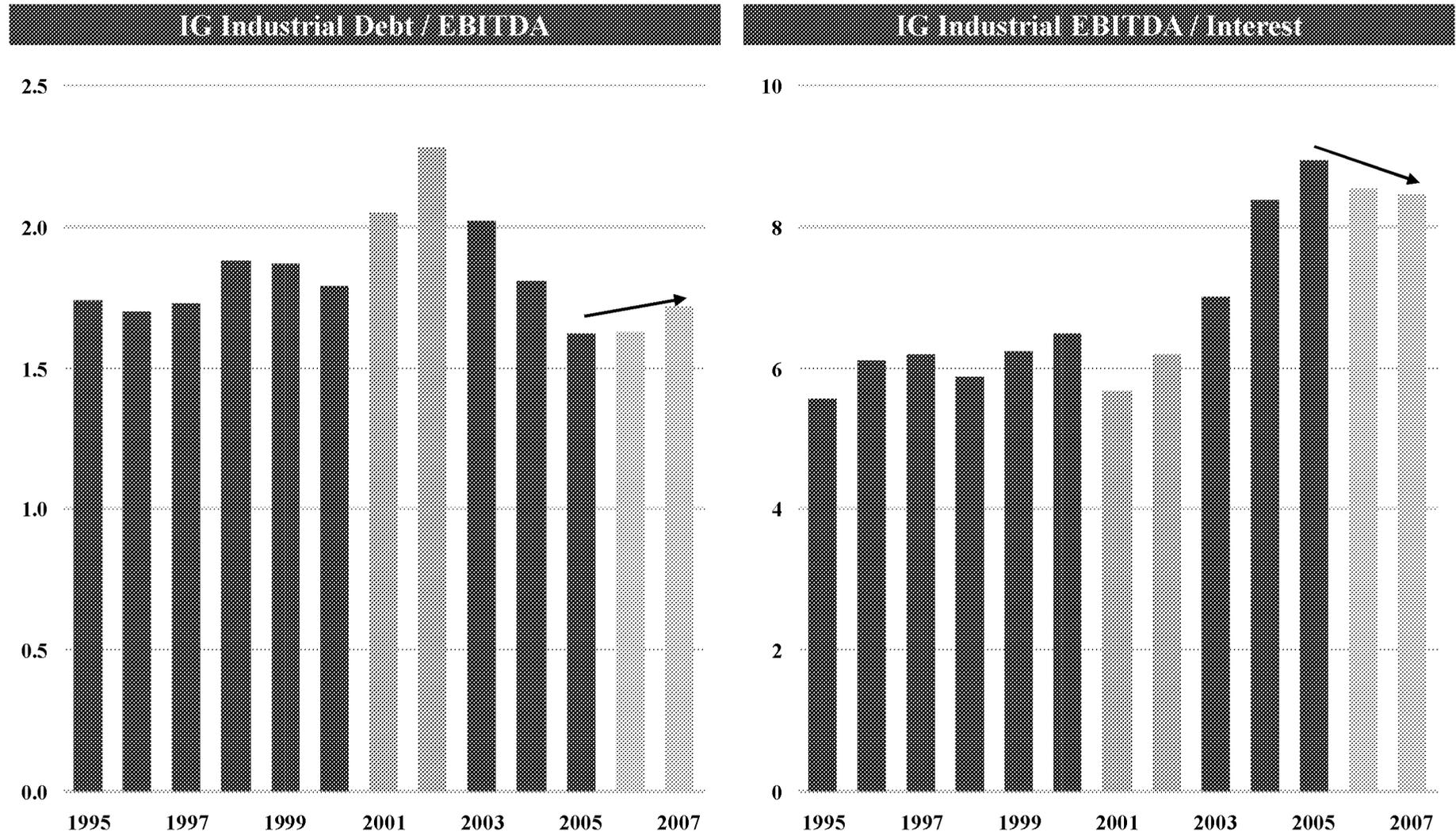


S&P 500 Quarterly Operating EPS Growth YoY



Source: BEA, Commerce Department, Lehman Brothers Economics, Q4 Estimates.

However, Unlike the Previous Cycle, Leverage for Non-Financials is Starting Off at Lower Levels

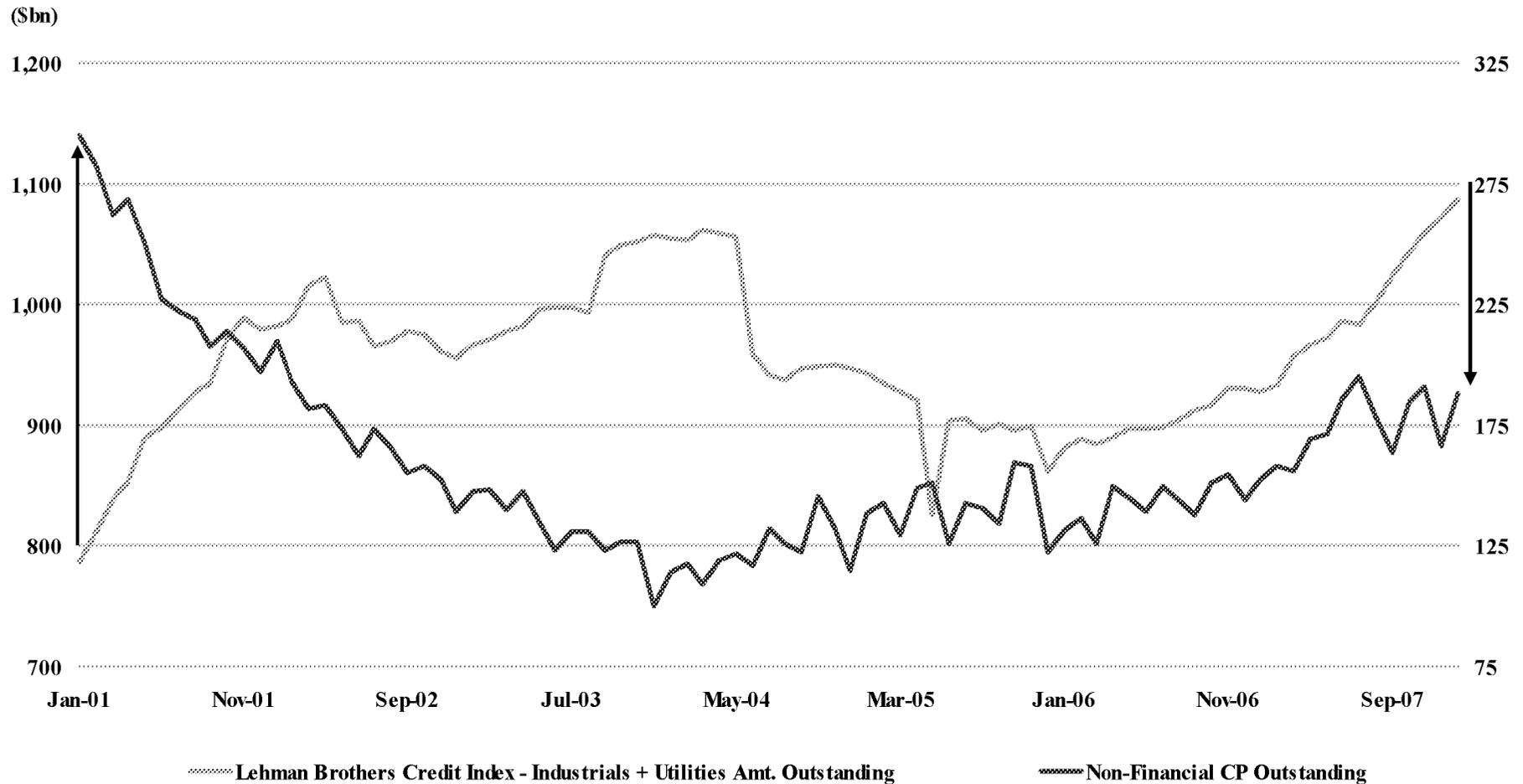


Source: Lehman Brothers, Factset.
 Note: 2007 Includes 4Q07 Estimate.

And the Liquidity Profile for Non-Financials Is Much Improved

Non-Financial CP outstanding has declined significantly as corporates have termed out liabilities

Non-Financial CP Outstanding vs. Non-Financial Bonds Outstanding



Source: Lehman Brothers, Federal Reserve.

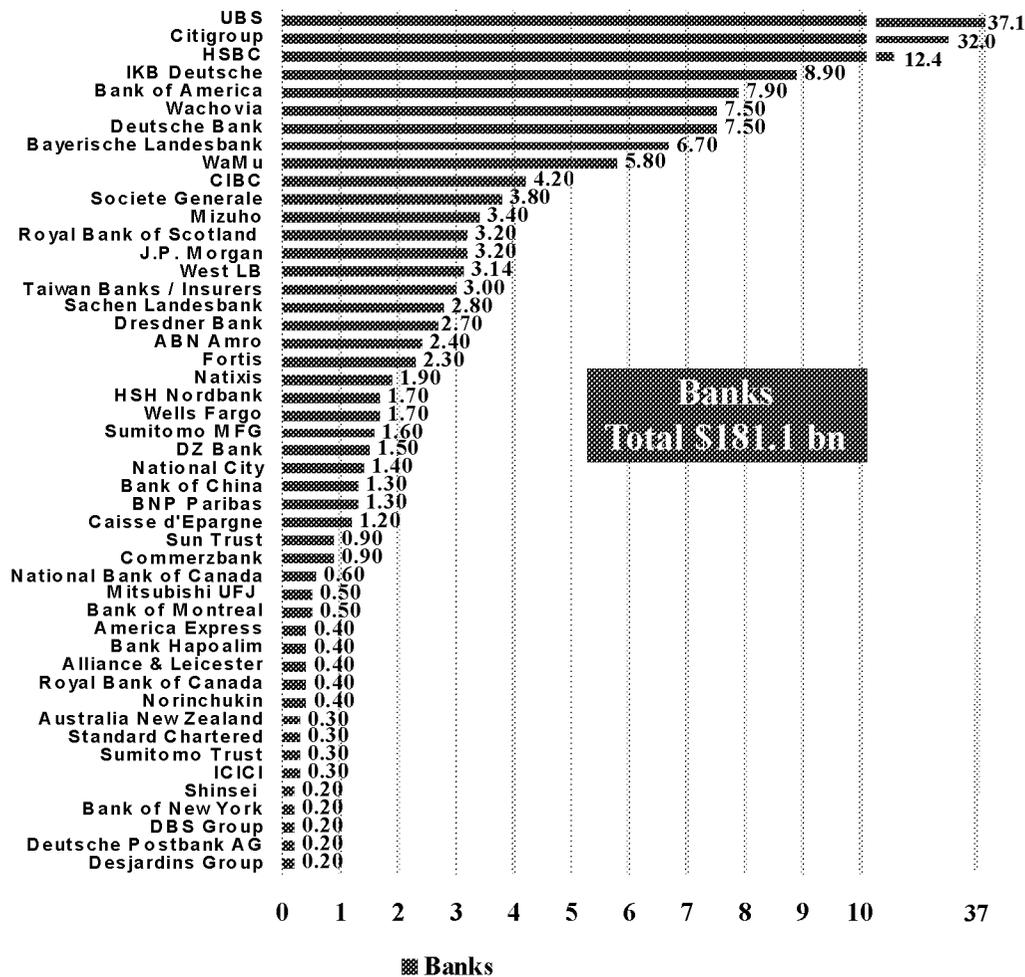
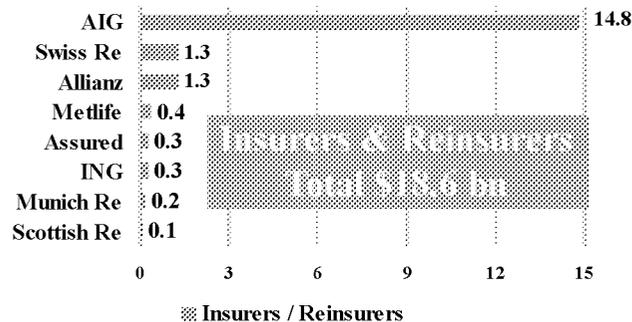
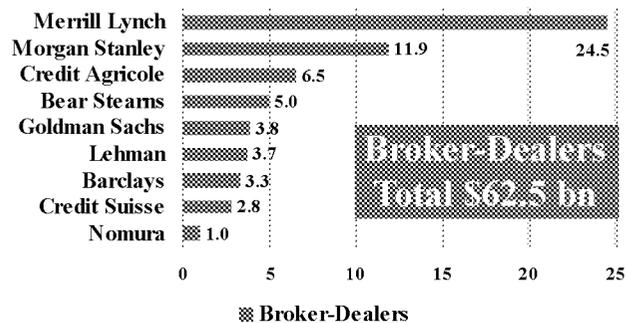
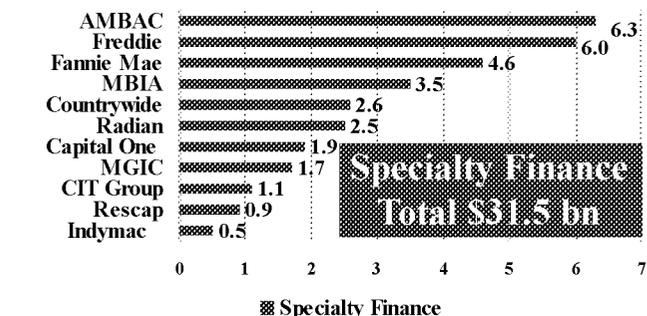
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23

With Respect to Financials, Many Issuers have Taken Substantial Losses and Seen Significant Erosions in their Book Values

Global Financial Sector Write-Downs

\$U.S. in billions



Source: As of April 14, 2008. Lehman Brothers Research

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A Critical Issue for Market Liquidity Will be How Quickly Issuers are Able to Repair Their Balance Sheets. Many Issuers have Raised Large Amounts of New Capital to Offset Their Losses

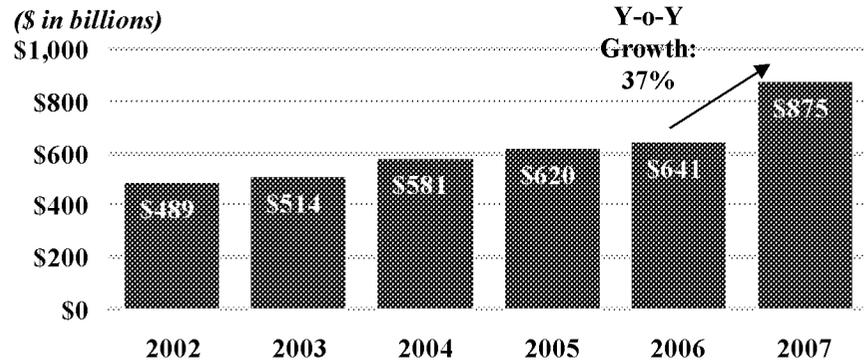
	Equity	Convertible	Preferred
Domestic Capital Markets	SLM – \$1.5bn UBS – CHF 6.4bn GLE - \$ 8.7bn WM - \$ 1.5bn	SLM – \$1.0bn C - \$2.0 bn BAC - \$6.9bn LEH - \$ 4.0bn	FNM – \$7.0bn FRE – \$6.0bn WM – \$8.5bn BAC - \$6.0bn WB - \$3.5bn
Sovereign Wealth Funds	MER – \$5.0bn	MS – \$5.0bn BSC – \$1.0bn C – \$14.4bn UBS – CHF 13.0bn	
Long-Term Domestic Investors	MER – \$1.2bn MBI – \$1.0bn	C - \$5.6 bn MER- \$6.6 bn	

Source: Lehman Brothers equity research.

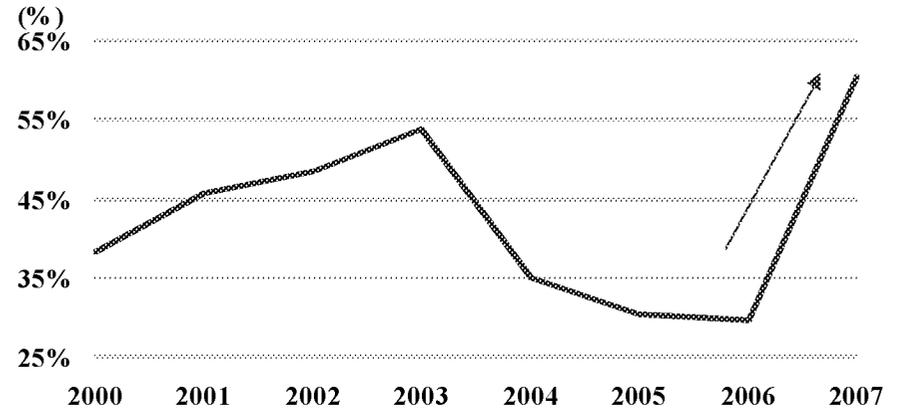
Note: Mandatory convertible preferred treated as a convertible. MER – \$600mn option to buy stock is considered as exercised. UBS – Treasury stock reissuance and stock dividend is treated as equity issue.

And Have Been Able to Obtain Funding From a Variety of Traditional and Non-Traditional Sources

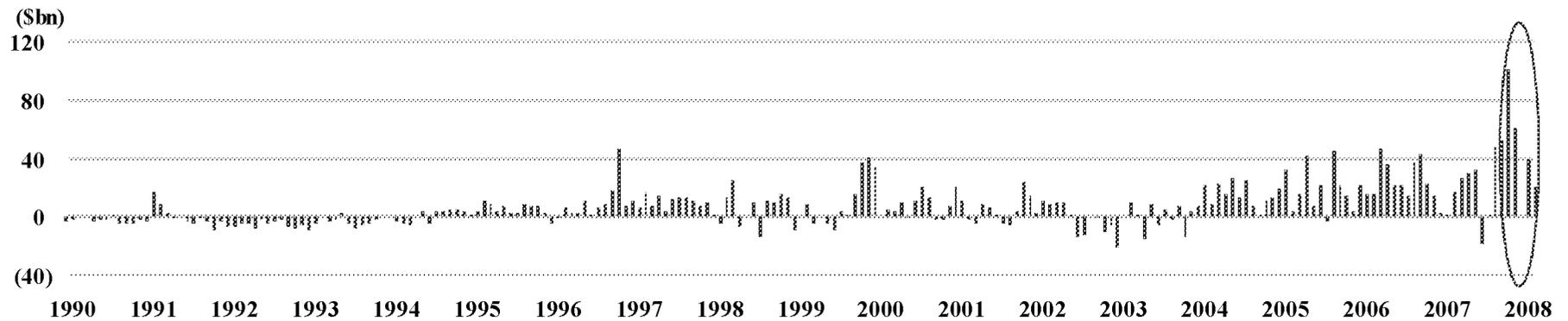
FHLB Advances



Agency Guaranteed % of Mortgage Origination

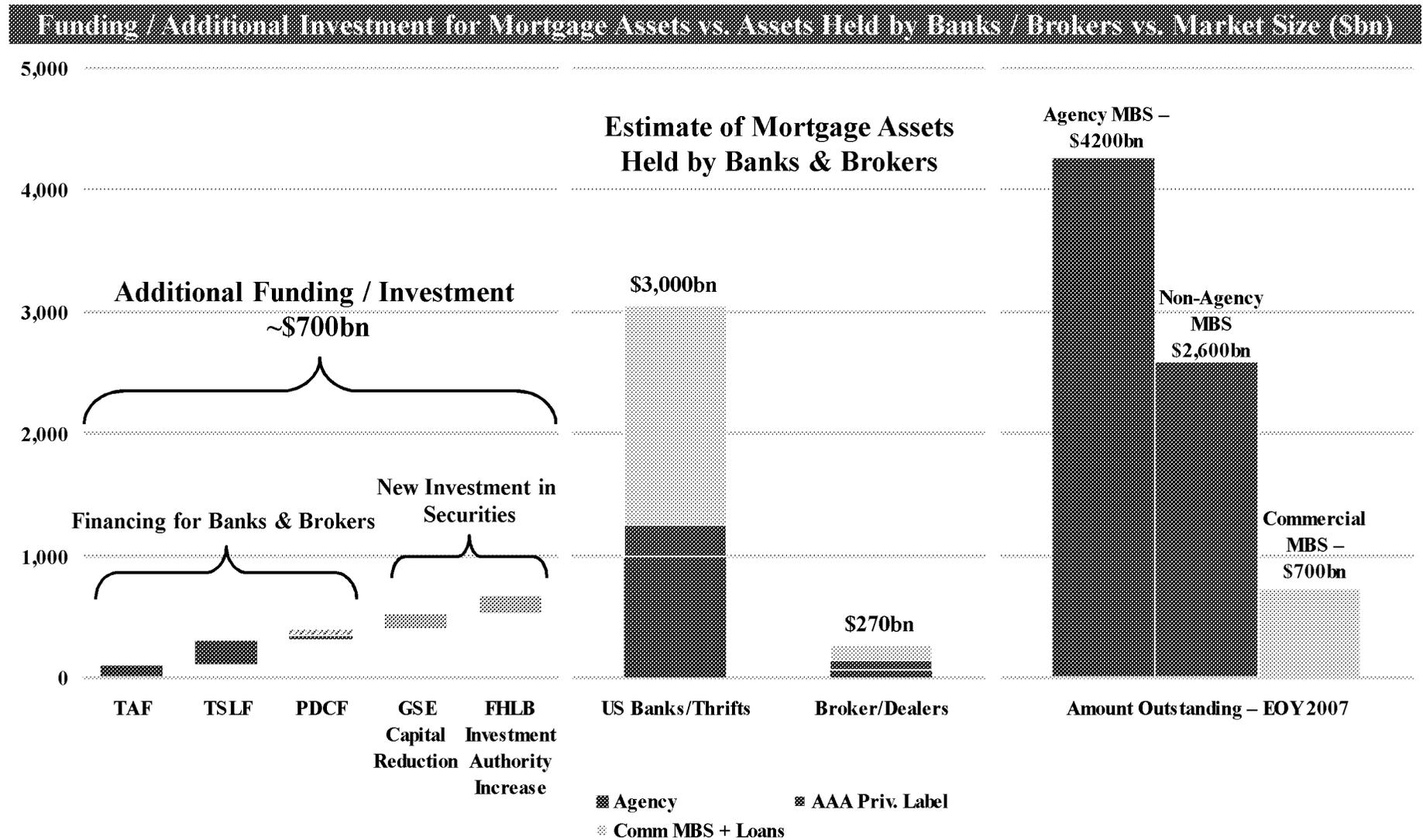


Monthly Change in Large Time Bank Deposits



Source: FHLB, Lehman Brothers securitized products strategy.

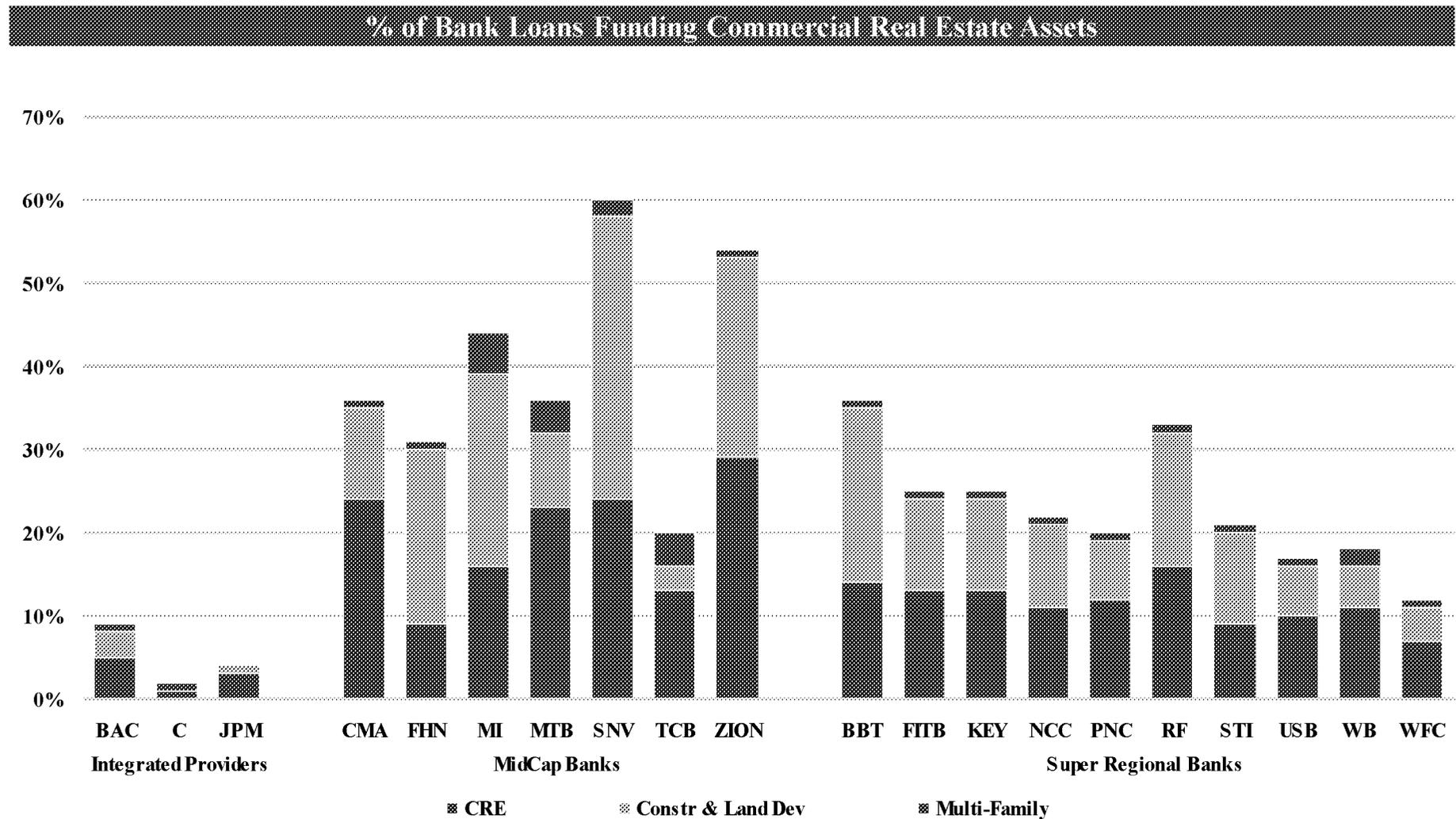
In Particular, the Cumulative Actions of the Fed and Other Institutions will Ease Funding Constraints on Highly Rated Assets Owned by Banks and Brokers, which Removes a Key Risk for Those Issuers



Source: Lehman Brothers Economics, Lehman Brothers Securitized Products Strategy.

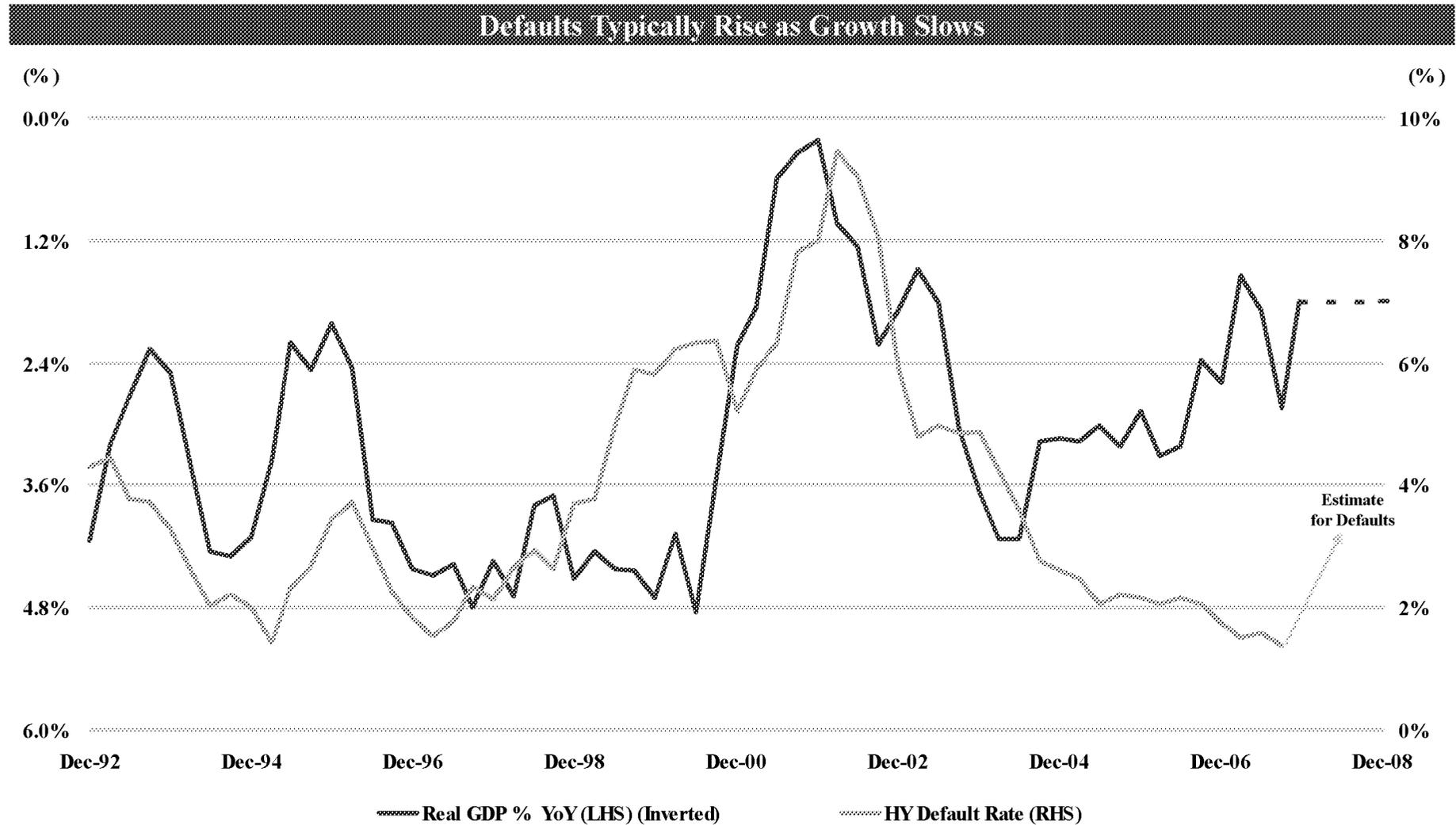
Note: PDCF Size is unlimited. Figures represent estimates of financing that is likely to be used. Mid-point of range used for Broker/Dealer Mortgage Holdings Estimate

However, it is Important to Note that Less Diversified Financials have Outsized Exposures to Real-Estate Lending. Thus, the Fundamental Outlook Across Subsectors is Not Uniform



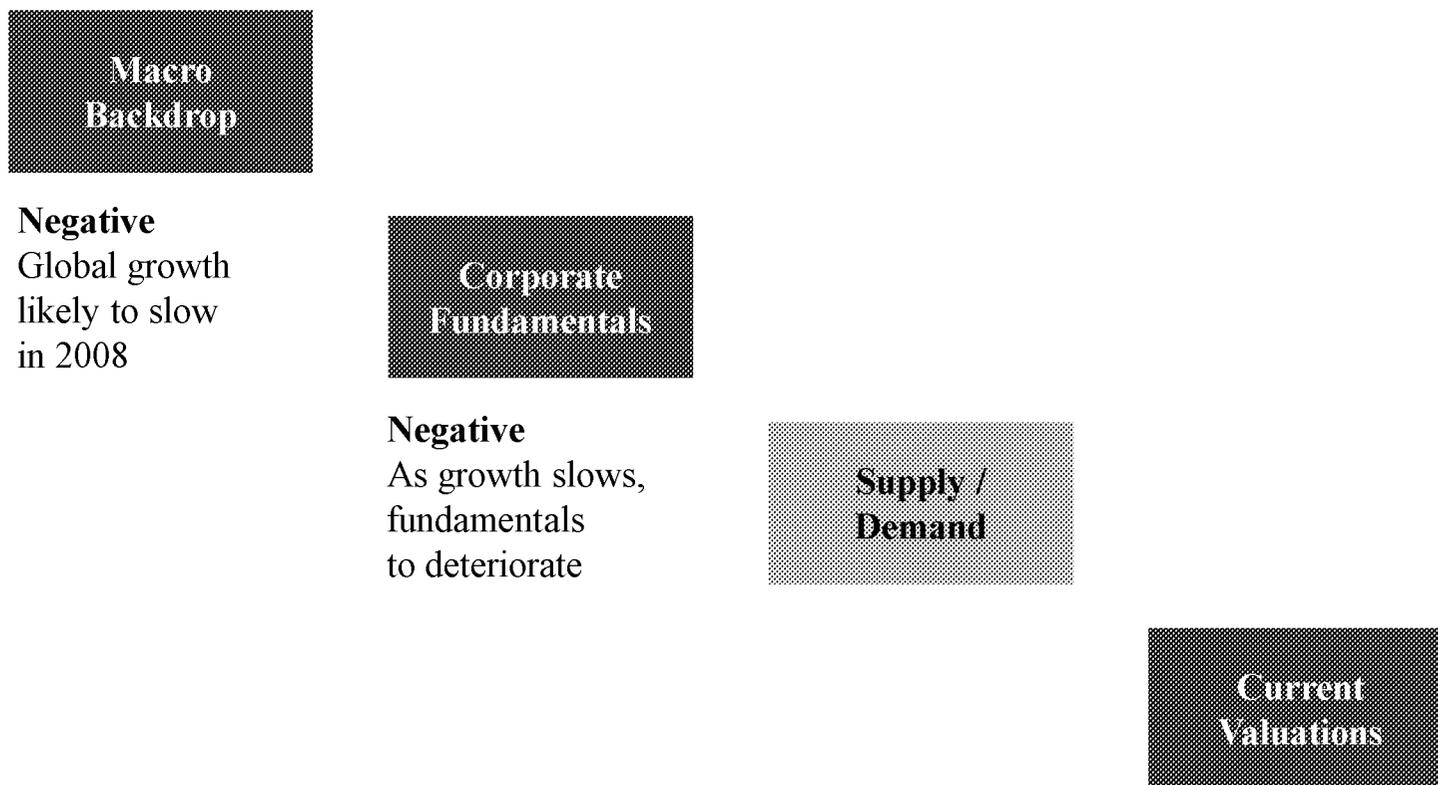
Source: Lehman Brothers, SNL Financials.

Overall, as the Market Struggles with Liquidity and Asset Quality Issues and Fundamentals Deteriorate Across Industrials Due to Weaker Growth, We Expect Default Rates to Pick Up From Multi-Year Lows

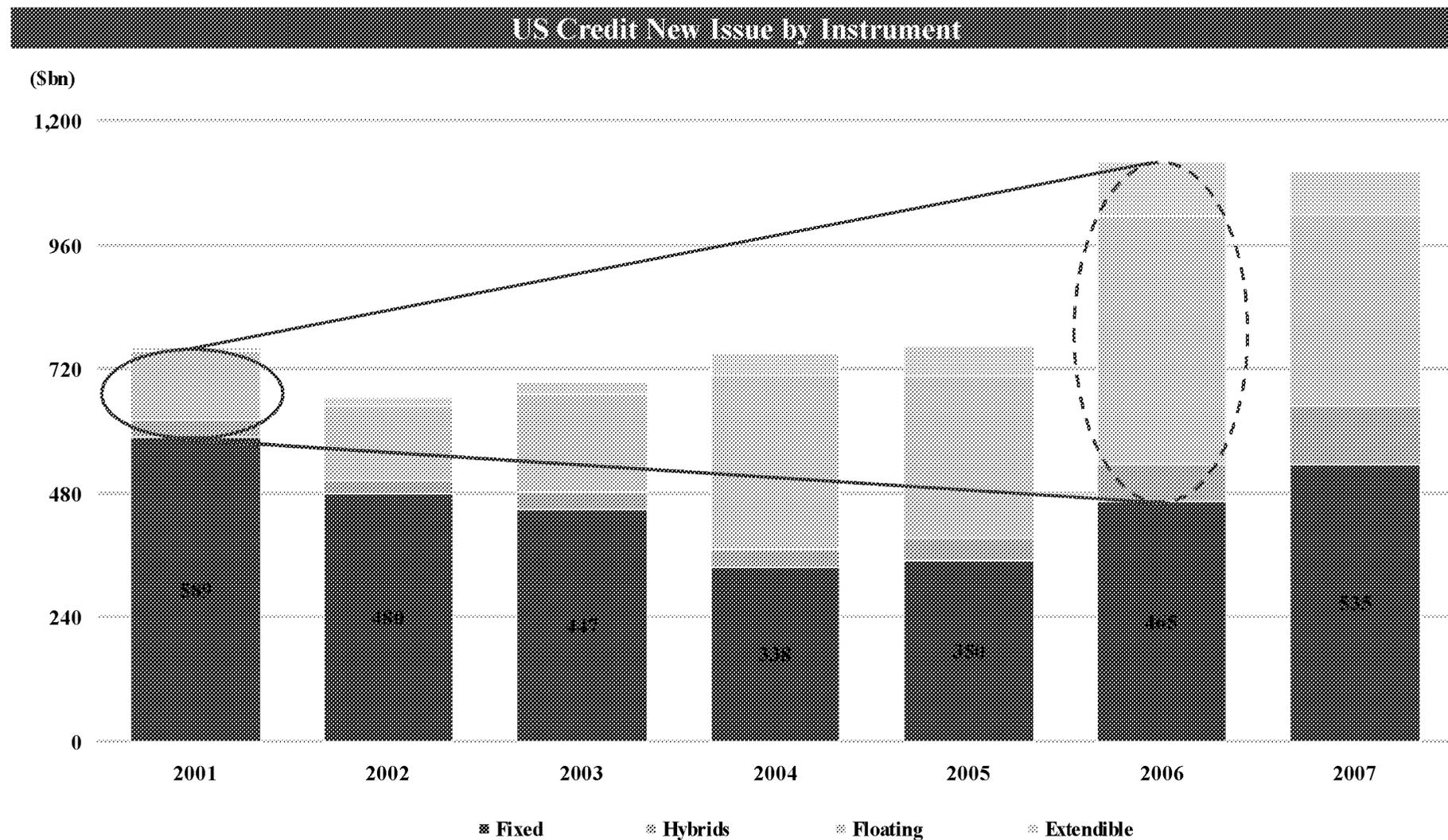


Source: Lehman Brothers, Federal Reserve, Moody's.

So the Fundamental Backdrop Is Unlikely to Be Supportive Going Forward ... What about the Technical Backdrop?



In Recent Years, a Large Amount of Debt has been Raised in Segments of the Market where Liquidity has Declined

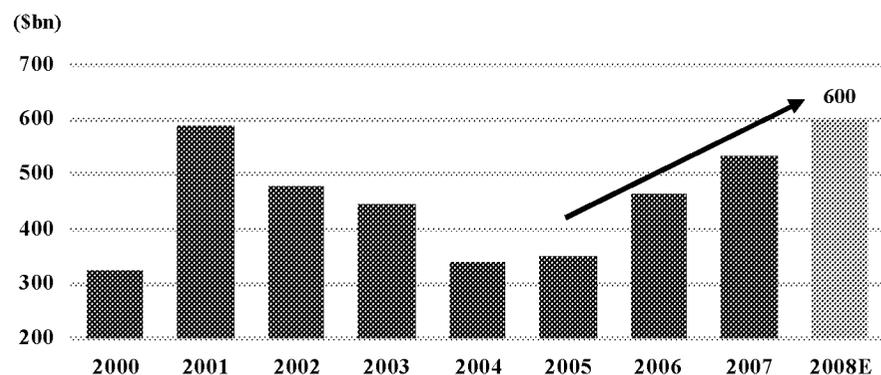


1. Source: Lehman Brothers.

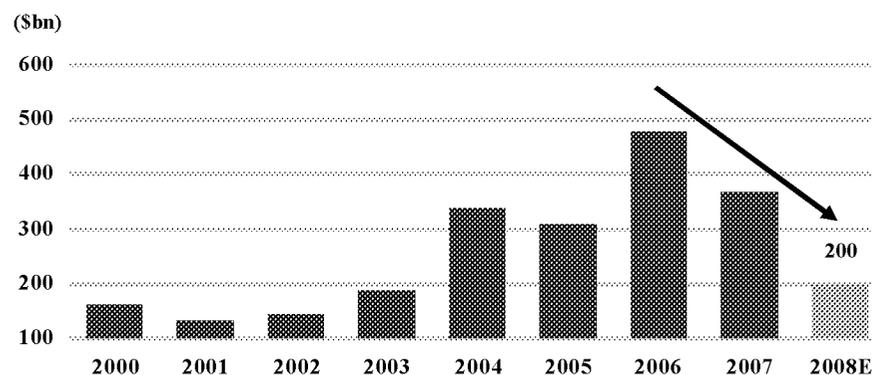
And With Limited Demand For The Front End, Supply is Likely to be Concentrated in Longer Duration Instruments...

- ◆ Although aggregate investment grade supply in 2007 was in line with 2006 – totaling over \$1trn for the second year in a row – the composition differed significantly. We expect the trends which developed in late 2007 to carry over into 2008, resulting in approximately \$950bn total issuance

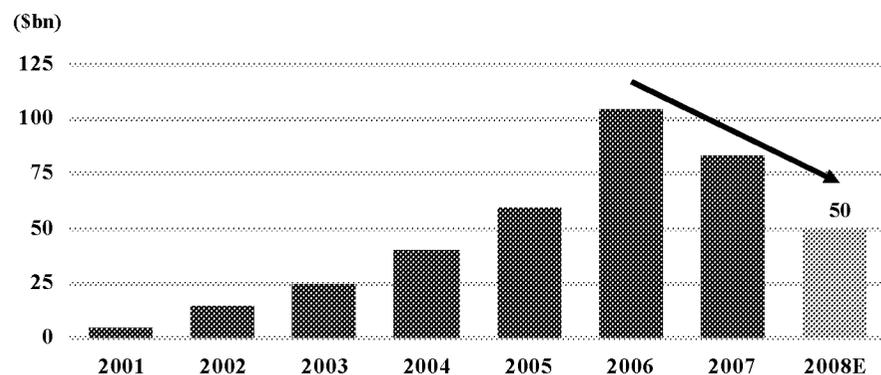
Fixed Rate Issuance



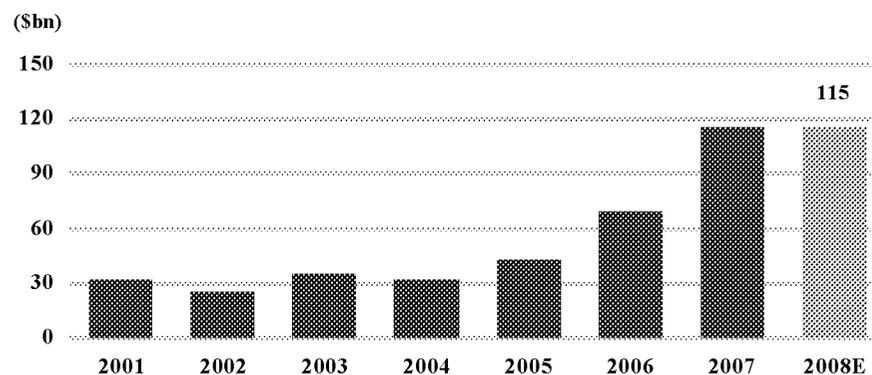
Floating Rate Issuance



Extendible Note Issuance

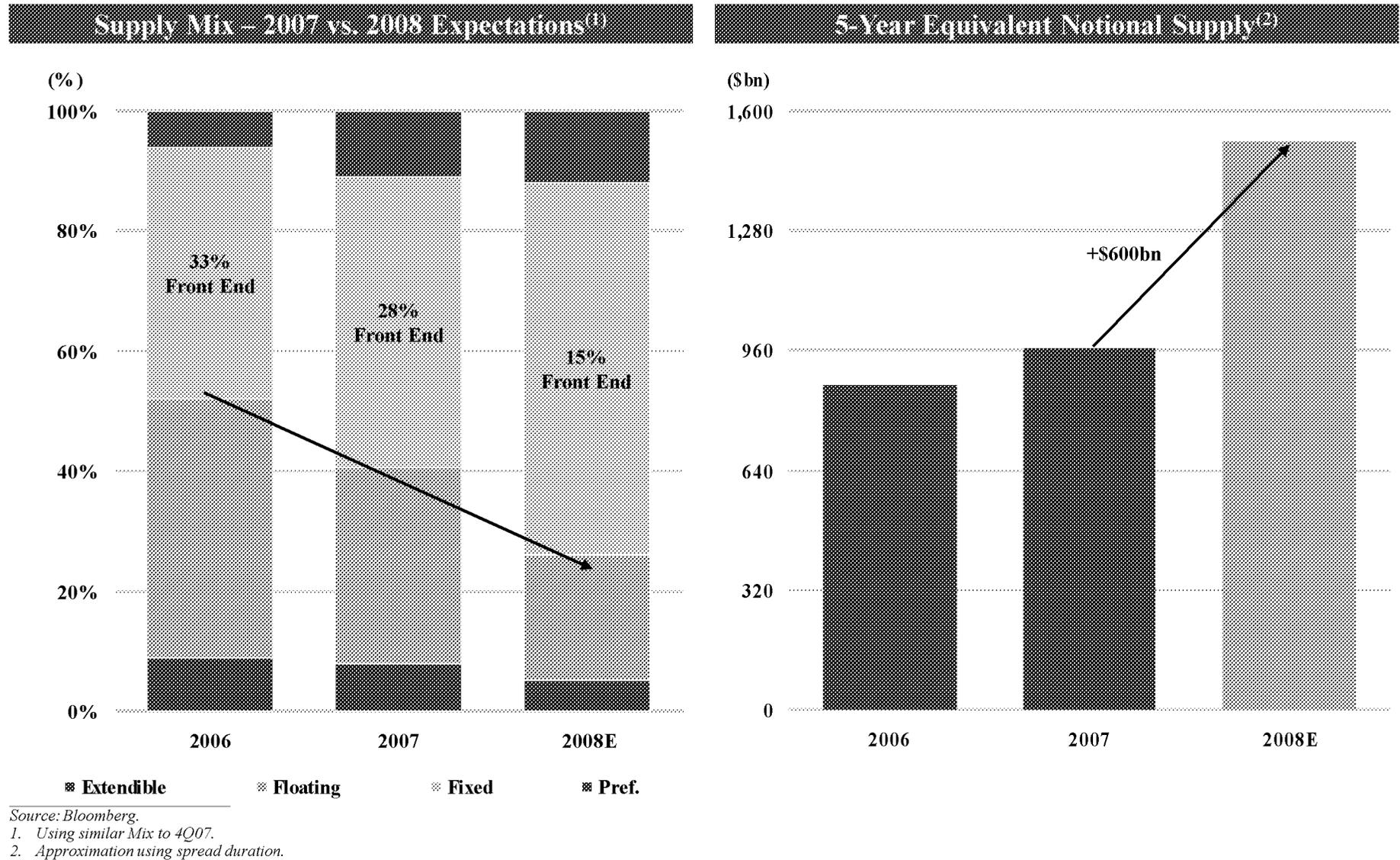


Hybrid Issuance

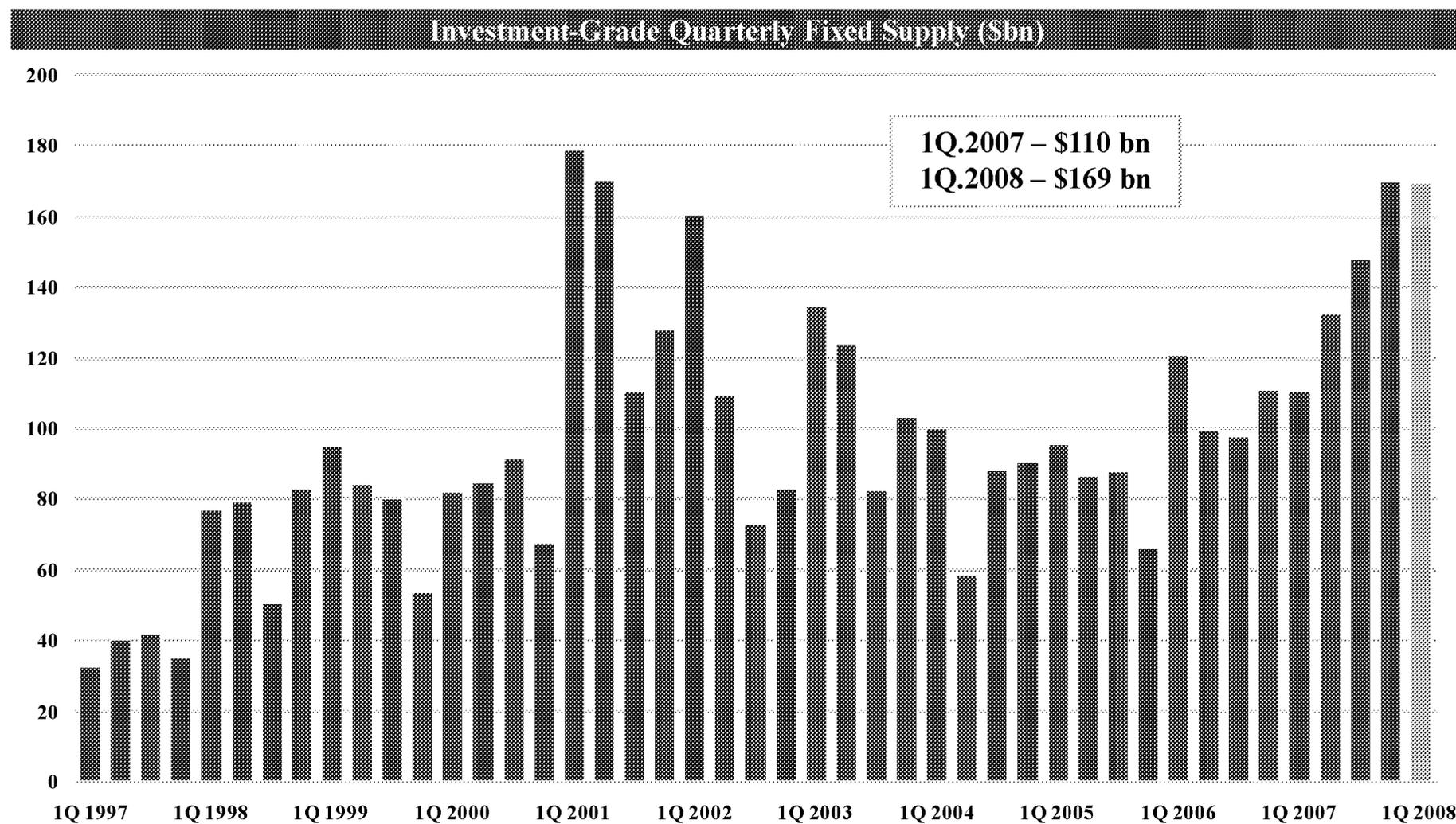


Source: Lehman Brothers.

As a Result, We Estimate Risk-Adjusted Supply to Be up Significantly



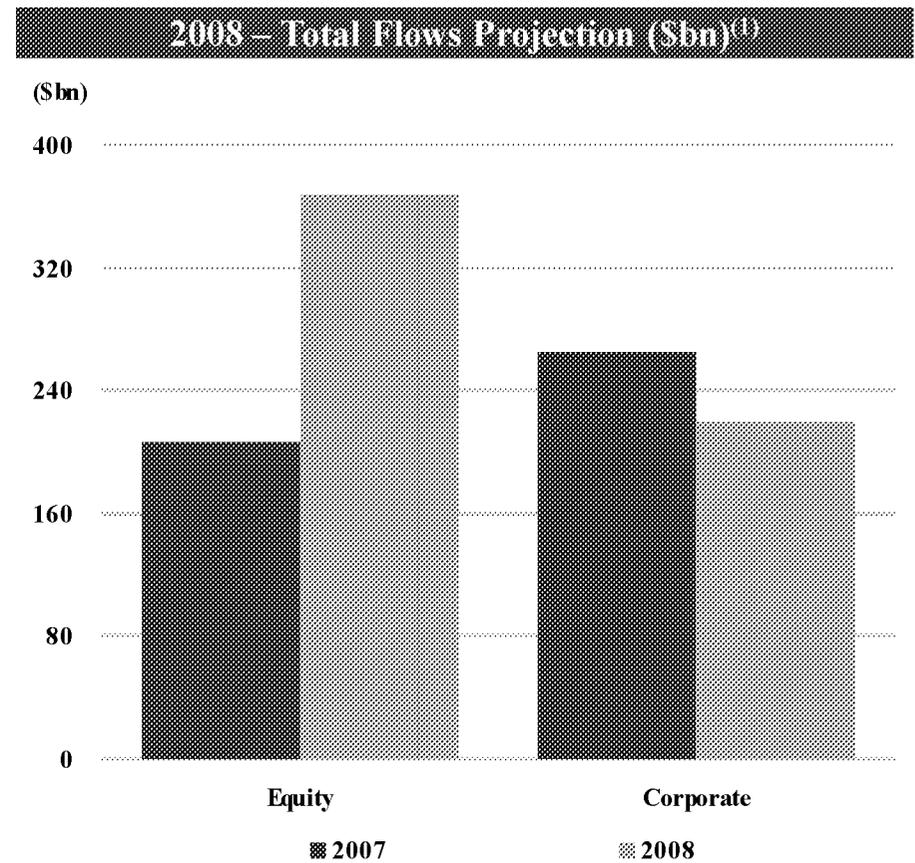
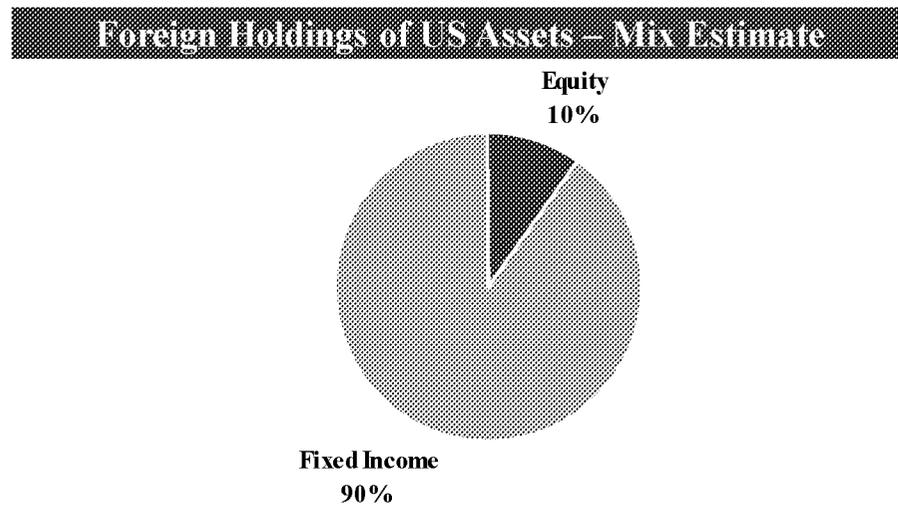
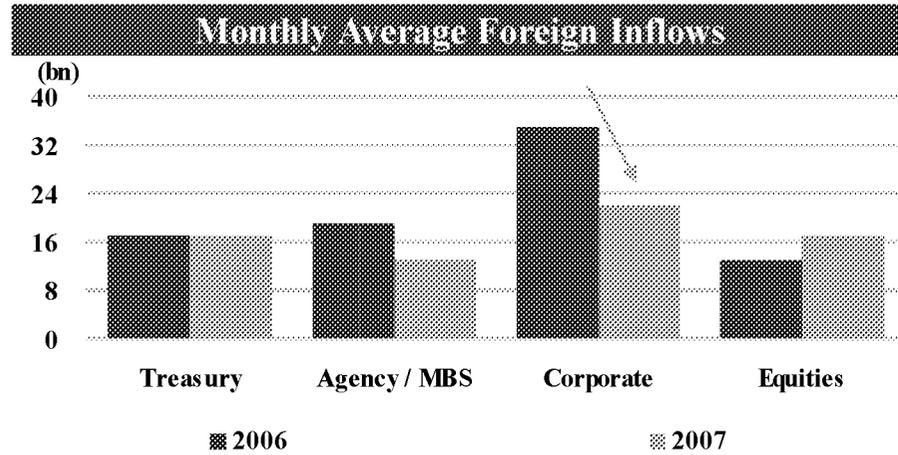
In Line with Expectations, Fixed Issuance in the First Quarter has Outpaced 2007 and Will Likely Remain Strong as Other Sources of Funding Remain Tight



Source: Lehman Brothers.

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On the Demand Side, Inflows from Abroad have Slowed and Will Likely Remain Biased Towards Equities



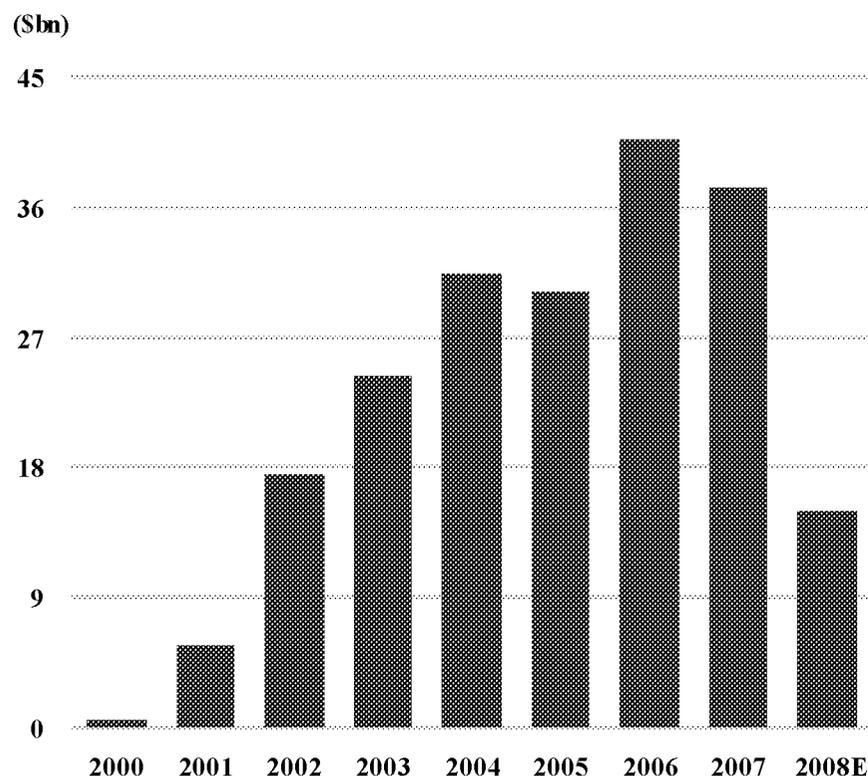
While official institutions have diversified away from fixed income assets, given the current size of equity exposure there is scope for further diversification. Assuming an fixed income/equity shift to 85%/15% and a \$130bn slowdown in official flows(1), foreign purchases of US corporate bonds would decline by \$50bn in 2008

Source: Lehman Brothers; TIC.

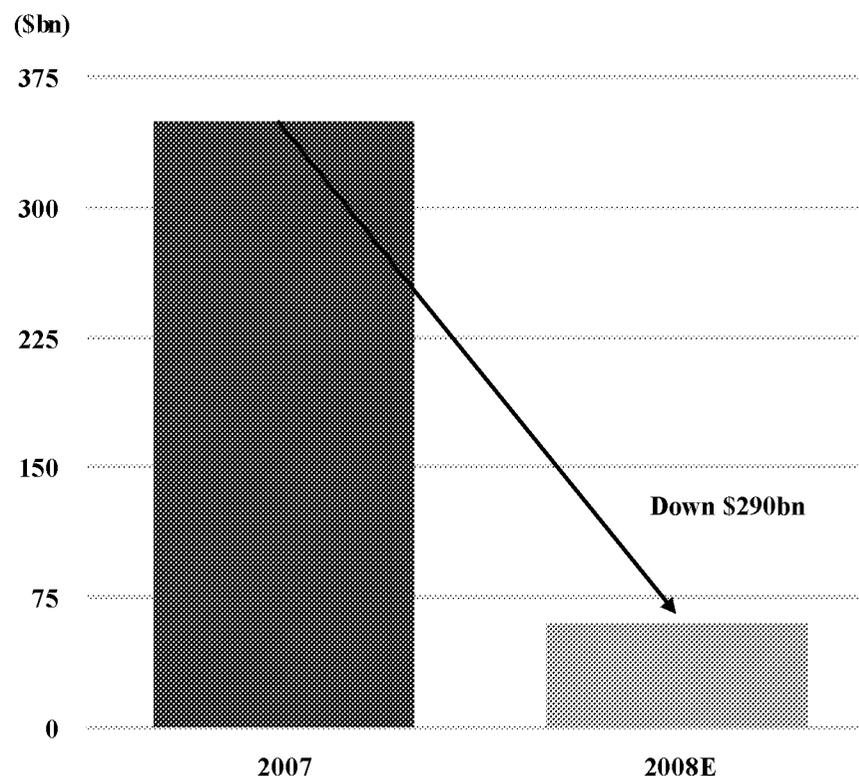
The Drop in Synthetic CDO Issuance Will Result in a Further Decrease in Demand for Credit Risk

- ◆ We expect Synthetic CDO Issuance to decline by approximately 60% in 2008 due a combination of limited investor confidence in structured products and rating agency models
- ◆ A 60% drop in issuance and decreased leverage on new deals would result in approximately a \$290bn drop in 5year equivalent notional demand for risk

Global Synthetic CDO Issuance



Synthetic CDO Issuance – Delta-Adjusted 5-Year Equivalent



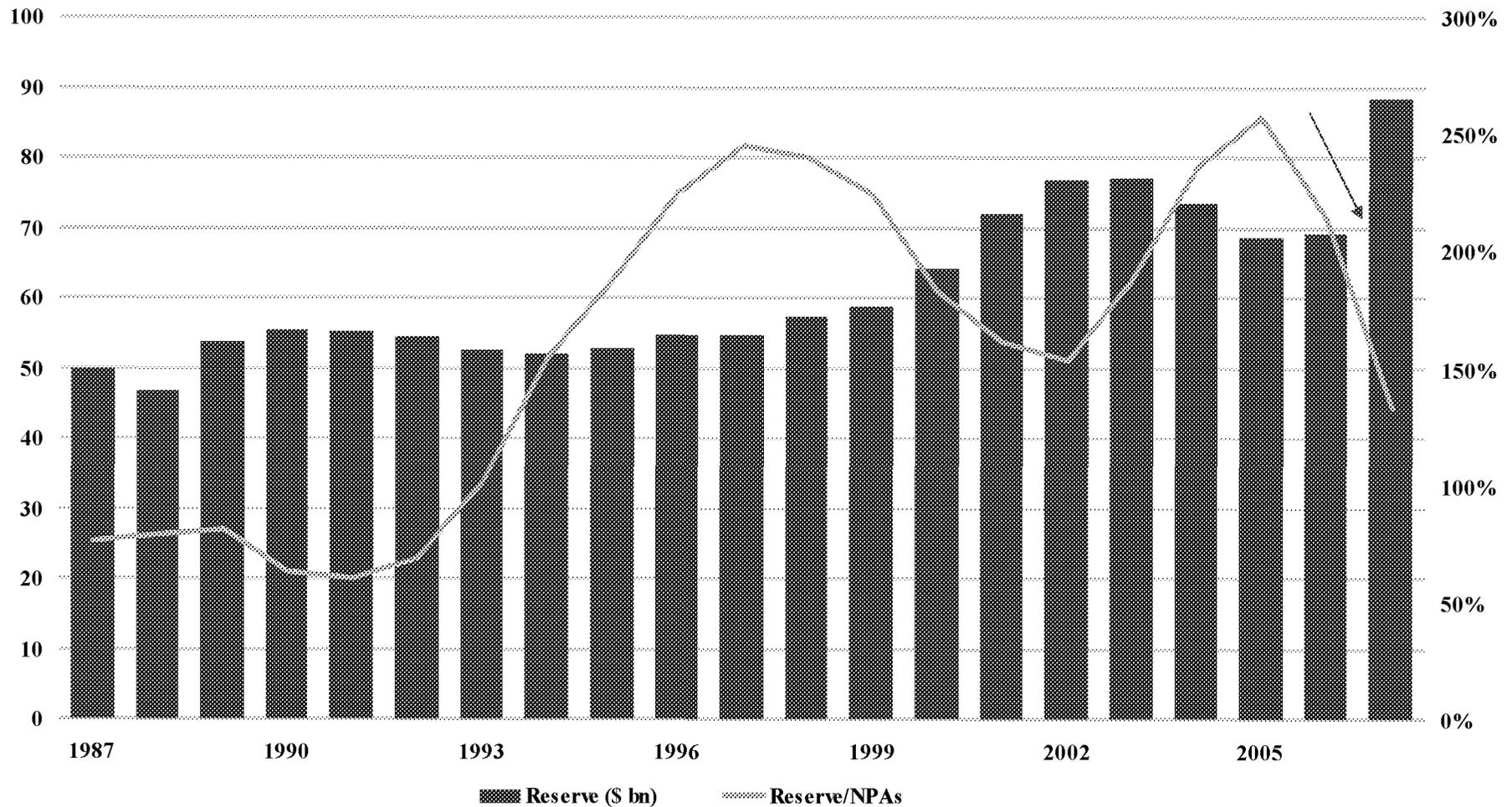
Source: Lehman Brothers, Intex, IFR, Moody's, S&P.

Note: Synthetic issuance only includes only public transactions that were in funded format. 2008 Estimate is based on a projected decline of 57% in cash and 50% in synthetic transactions.

In addition, Stressed Financial Issuer Balance Sheets will Likely Continue to Weigh on Demand for Risky Assets

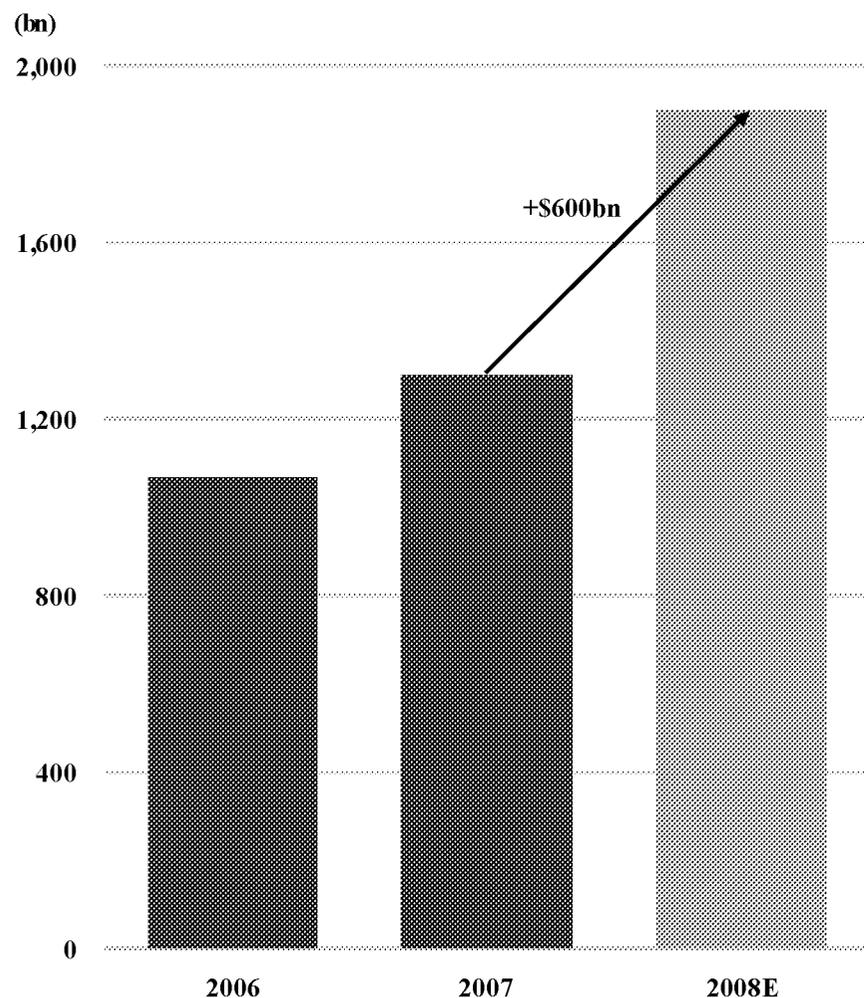
Even though reserves have increased substantially, the Reserve/NPA Ratio has dropped

Average Bank Reserves vs. Reserve to NPA Ratio



Putting it All Together, the Supply / Demand Imbalance Will Likely Continue To Weigh On Credit

5-Year Equivalent Notional Supply



Source: Lehman Brothers.
Note: Approximation using spread duration.

Demand – 2007 vs. 2008

- ◆ International Demand: **Down \$50bn**
- ◆ Synthetic Demand: **Down \$290bn**
- ◆ Front End Demand: **Down \$280bn**
- ◆ Redemptions: **Down \$75bn**
- ◆ **Total: Down \$600bn**

No Discussion of the Technical Backdrop Would be Complete Without Looking at Spreads

**Macro
Backdrop**

Negative
Global growth likely
to slow
in 2008

**Corporate
Fundamentals**

Negative
As growth slows,
fundamentals
to deteriorate

**Supply /
Demand**

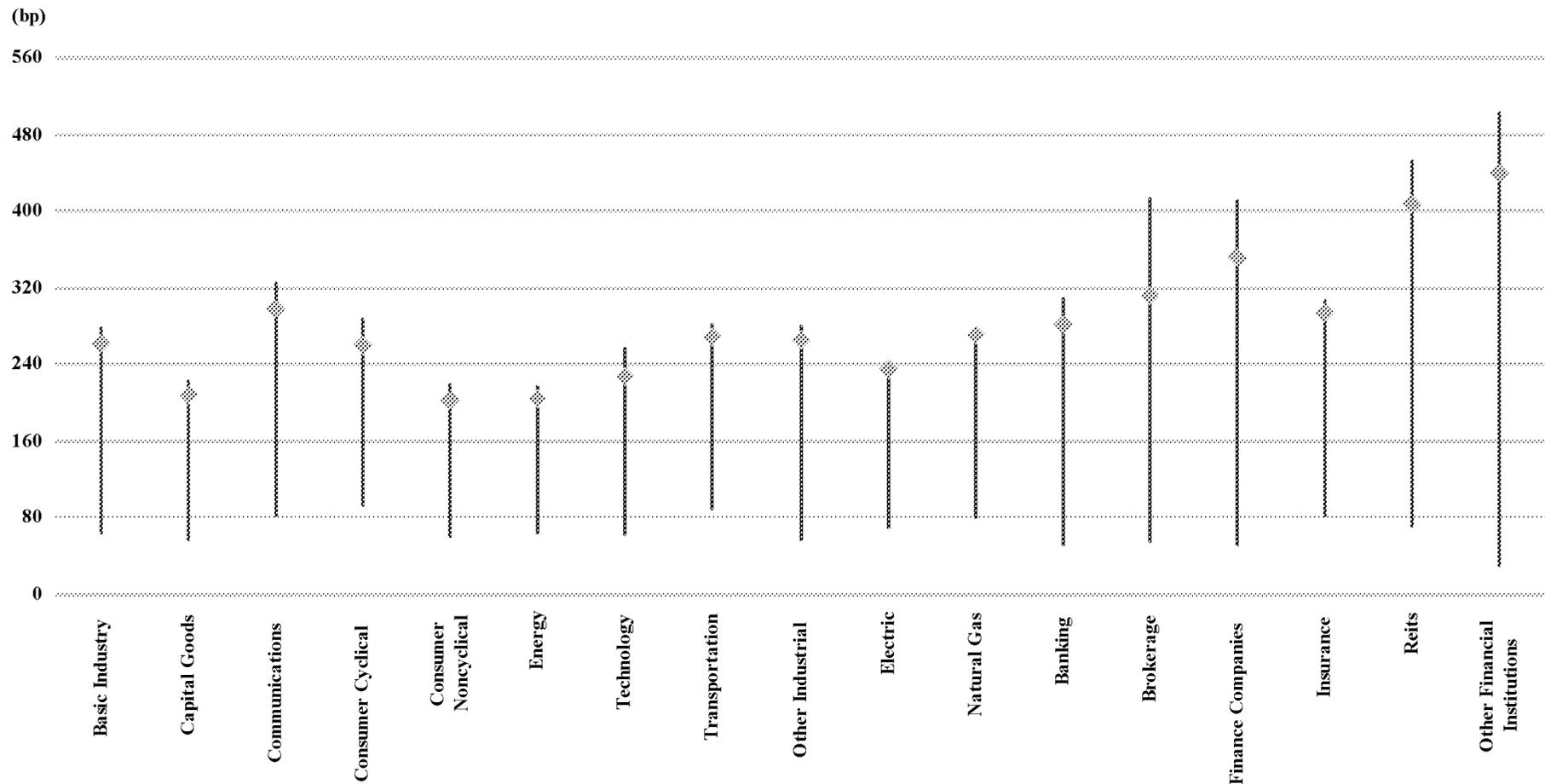
Negative
Large supply /
demand imbalance
to persist

**Current
Valuations**

Across Sectors, Spreads Remain Close to Their Widest Levels in Cash

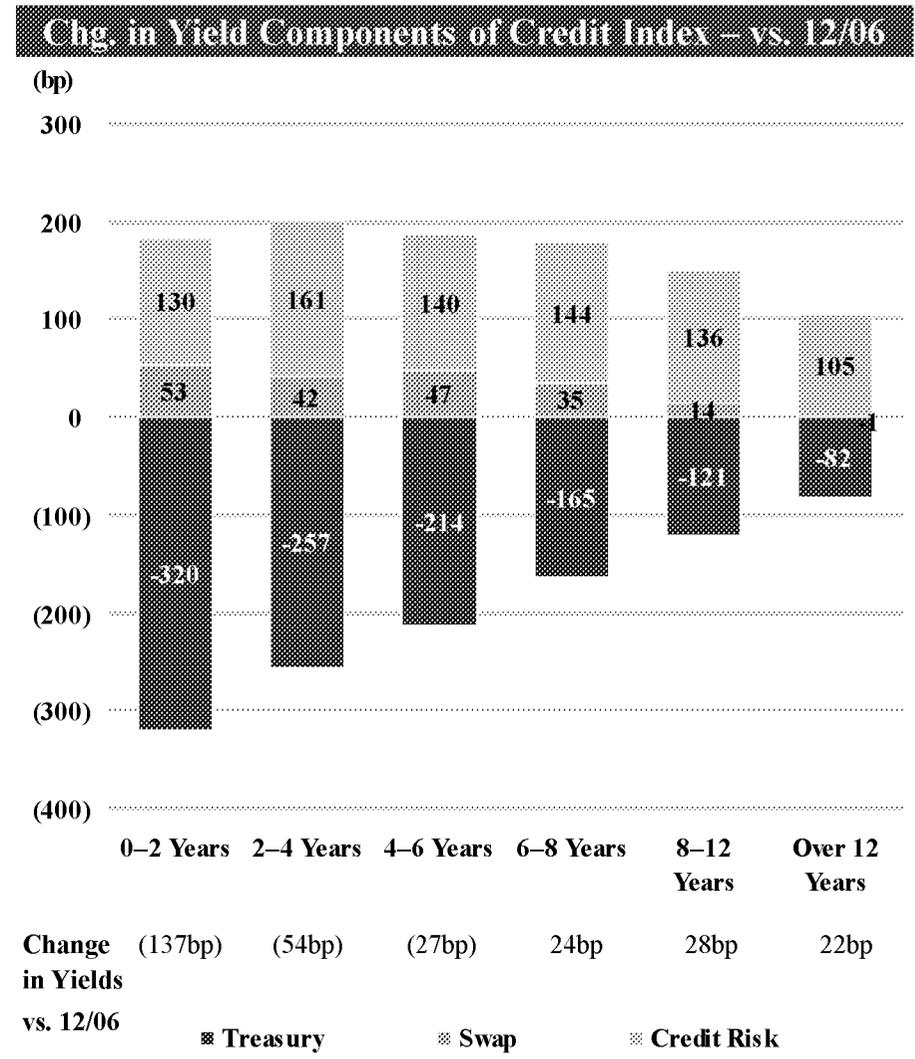
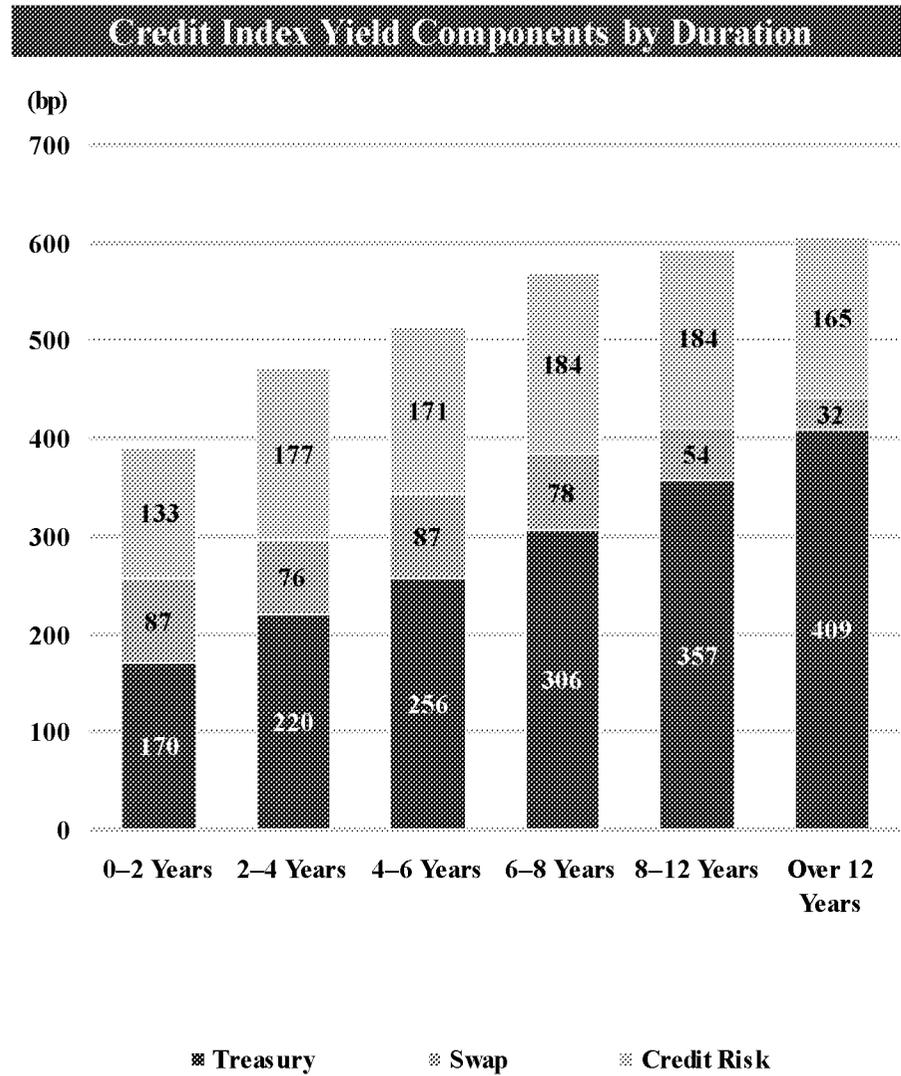
... since 2002 and investors must put much more focus on relative value going forward

US Credit Index Sectors – Current Levels vs. 5-Year Week High and Low



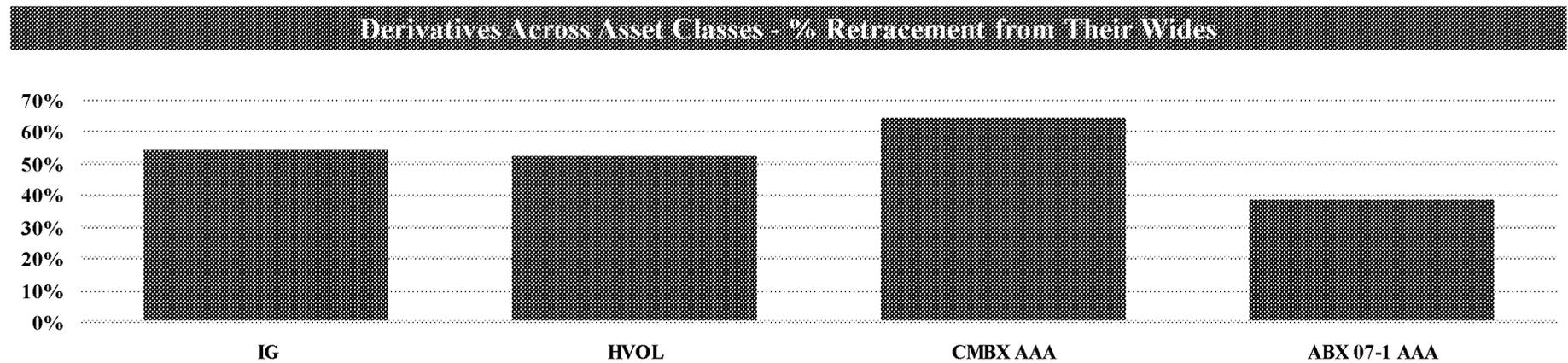
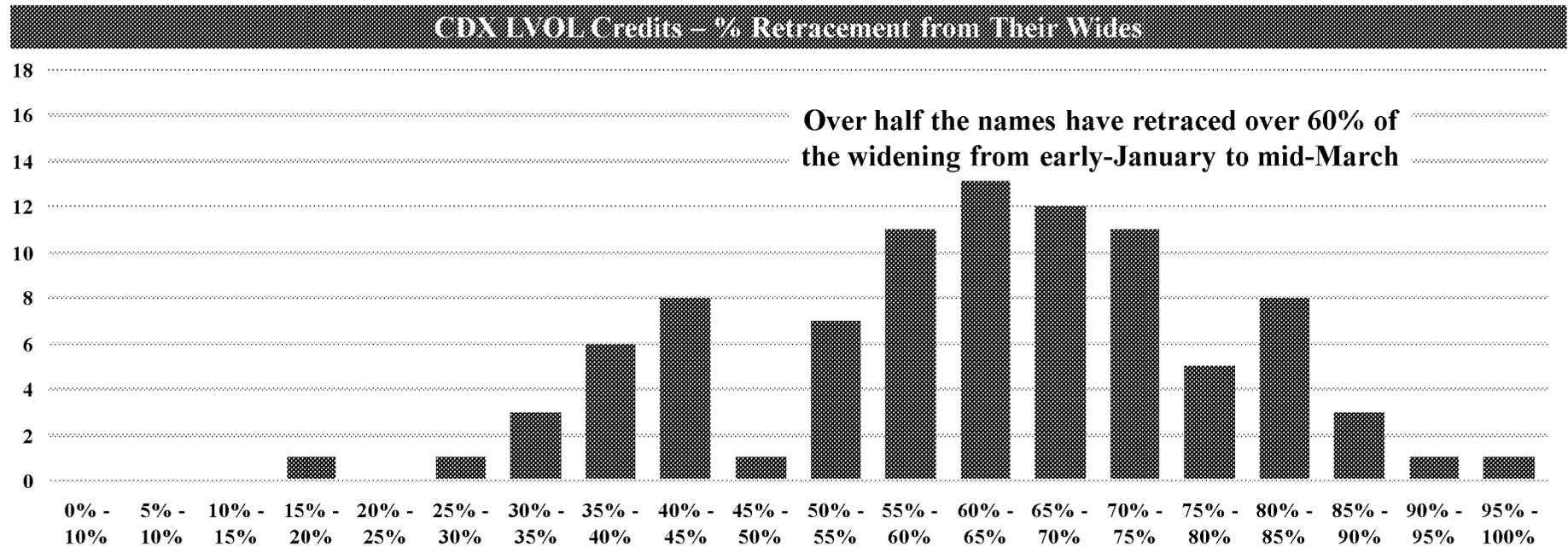
Source: Lehman Brothers.

However, While Spreads Are Much More Supportive Than Last Year, All-In Yields are Essentially the Same



Source: Lehman Brothers.

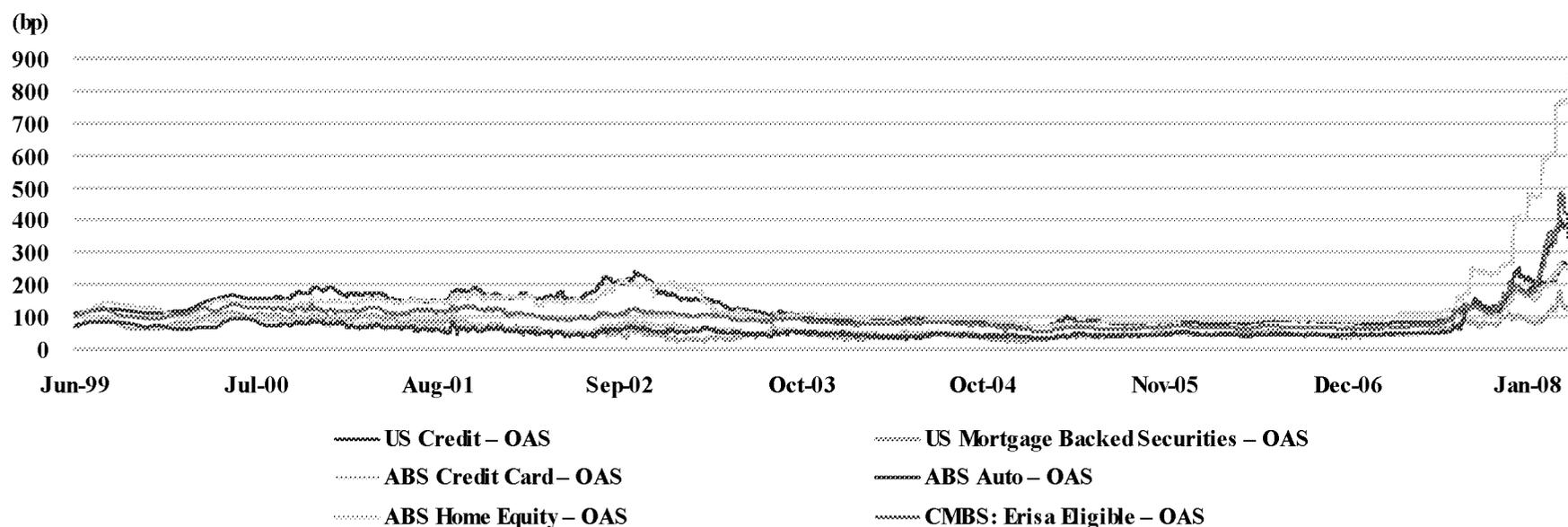
And in Derivatives, Spreads Have Retraced a Substantial Portion of the Recent Widening



Source: Lehman Brothers.

In Addition, Corporate Credit has not Cheaped as Much as Some Other Spread Sectors. As the Deleveraging Continues we Believe Spreads Will Need to Remain at Levels That Deliver Attractive Returns Even at No or Low Leverage

OAS of Spread Sectors in Lehman Brothers Aggregate Index



Asset Class	Average Rating	Wides Since 2001	OAS (bp)	Chg Since 12/31/07 (bp)
ABS Home Equity	AAA	855	851	+373
ABS Auto	AAA	403	382	+168
US Credit	A1/A2	268	245	+63
CMBS	AAA/AA1	486	330	+161
ABS Credit Card	AAA	263	251	+90

Source: Lehman Brothers.
Note: As of 4/14/2008

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Bringing it all Together, what is the Outlook for Different Parts of Credit ?

Macro Backdrop

Negative
Global growth likely
to slow
in 2008

Corporate Fundamentals

Negative
As growth slows,
fundamentals
to deteriorate

Supply / Demand

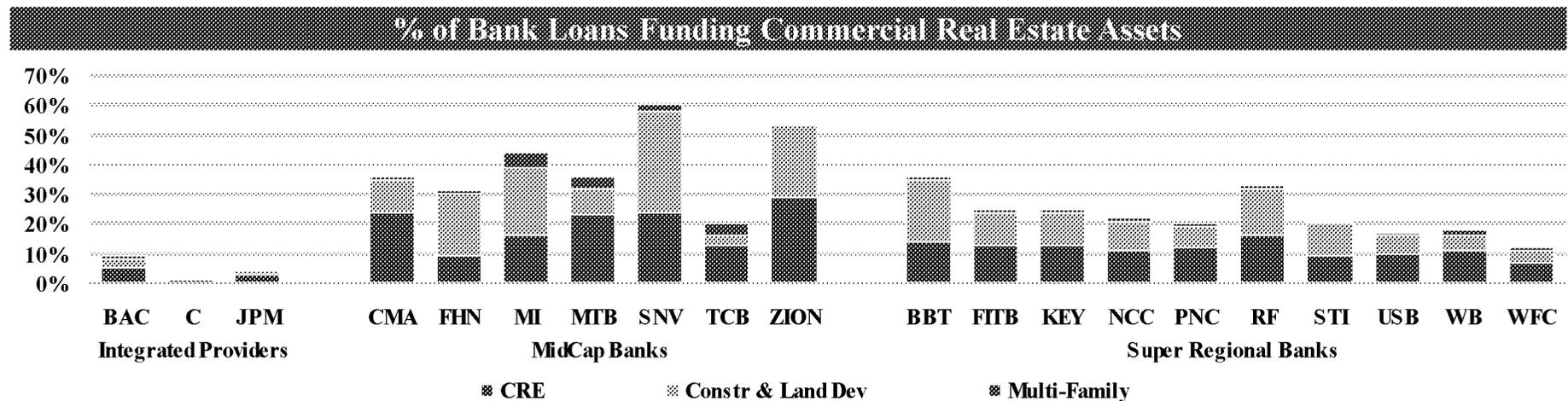
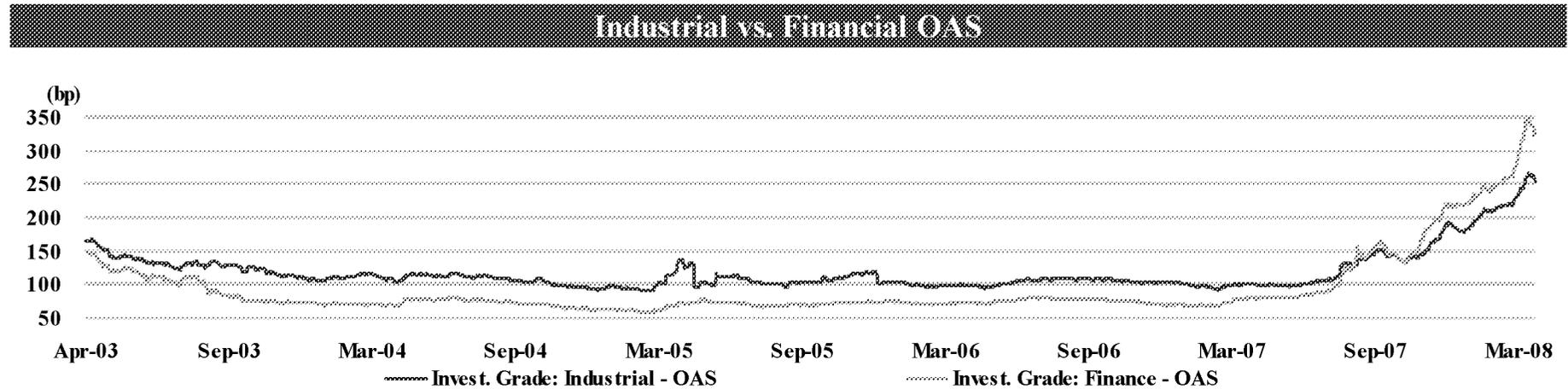
Negative
Large supply /
demand imbalance
to persist

Current Valuations

Positive
Cash Spreads near
multiyear wides.
However, liquidity
situation needs to
improve further to get
full benefit

We Remain Generally Bearish on Investment Grade Credit Despite Current Valuations. However, this has Become a More Bifurcated View.

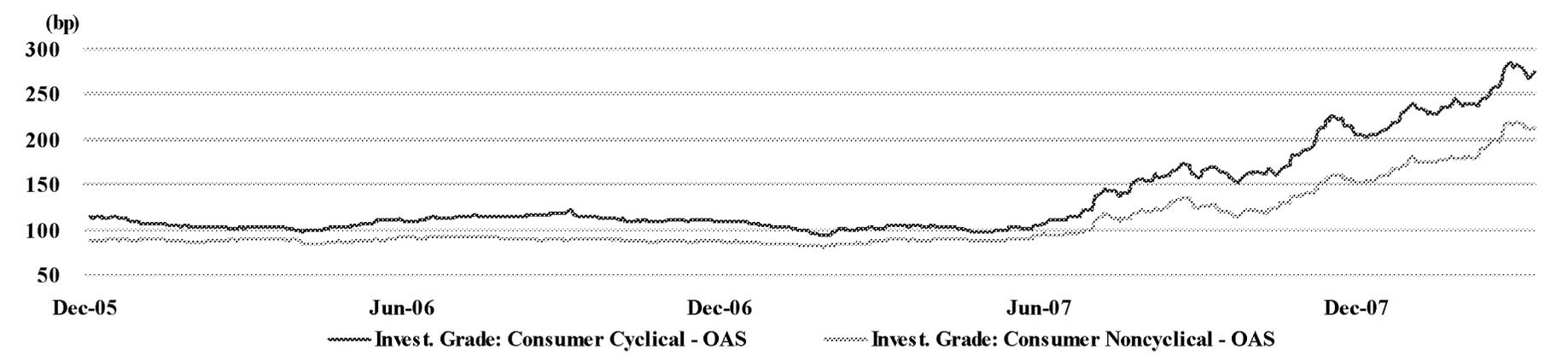
High quality financials, especially money center banks and brokers, have seen significant widening and provide attractive value at these levels. We remain cautious on independents and regional banks due to ongoing asset quality concerns



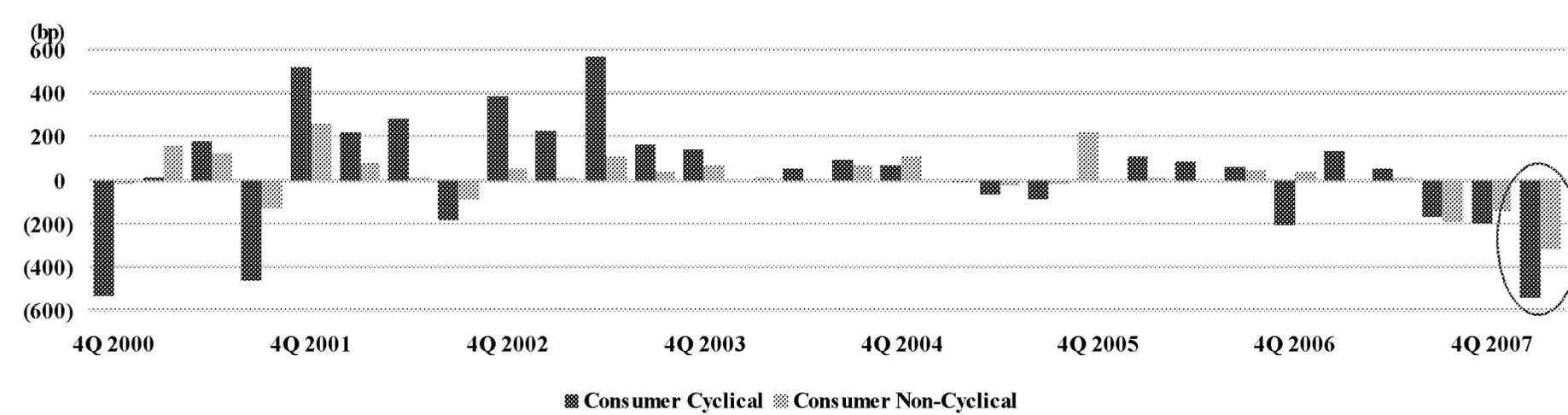
Source: Lehman Brothers.

Given Our Expectations for Slower Growth we Believe That the Credit Cycle Turn Will Continue. We Thus Expect More Cyclical Sectors to Remain Under Pressure.

Cyclical vs. Non Cyclical Spreads (bp)

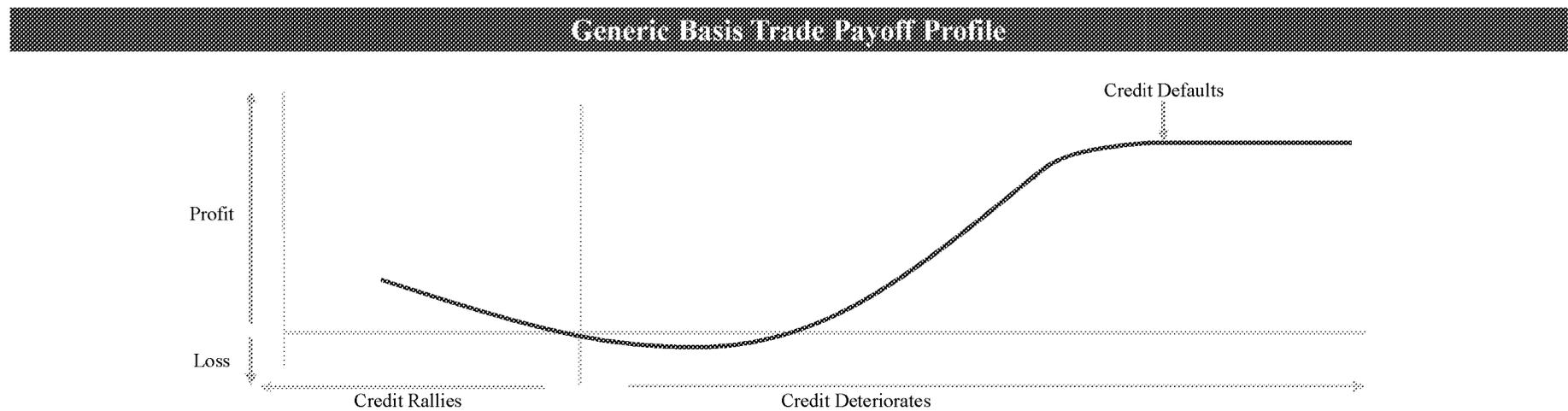
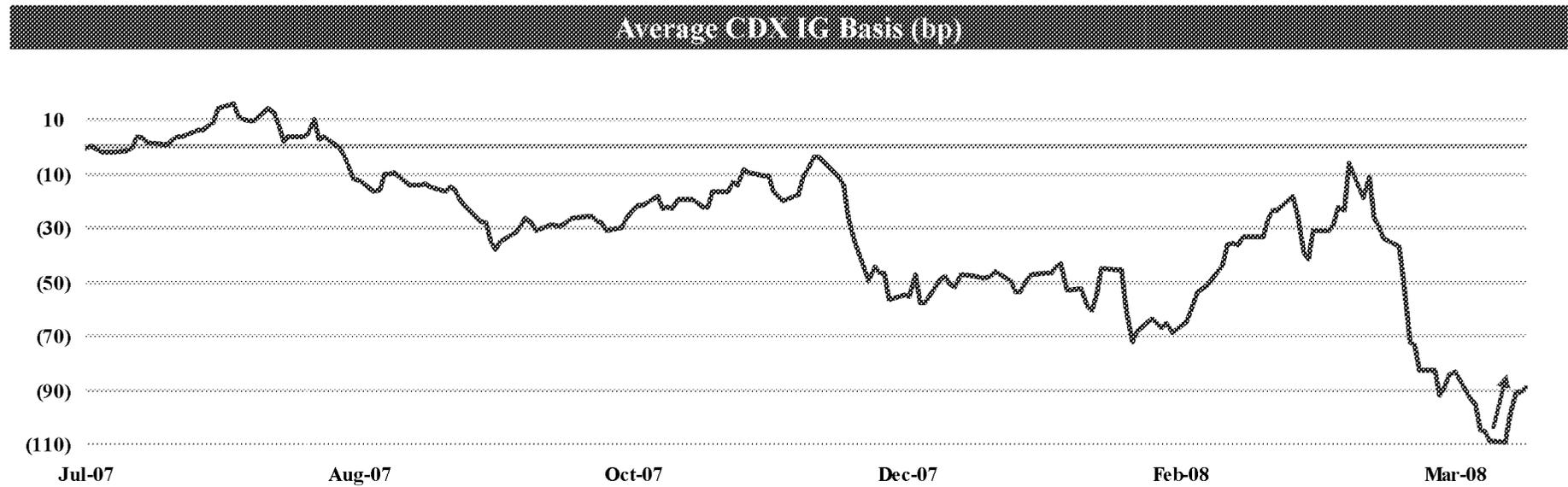


Consumer Cyclical vs. Non Cyclical – Excess Returns



Source: Lehman Brothers.

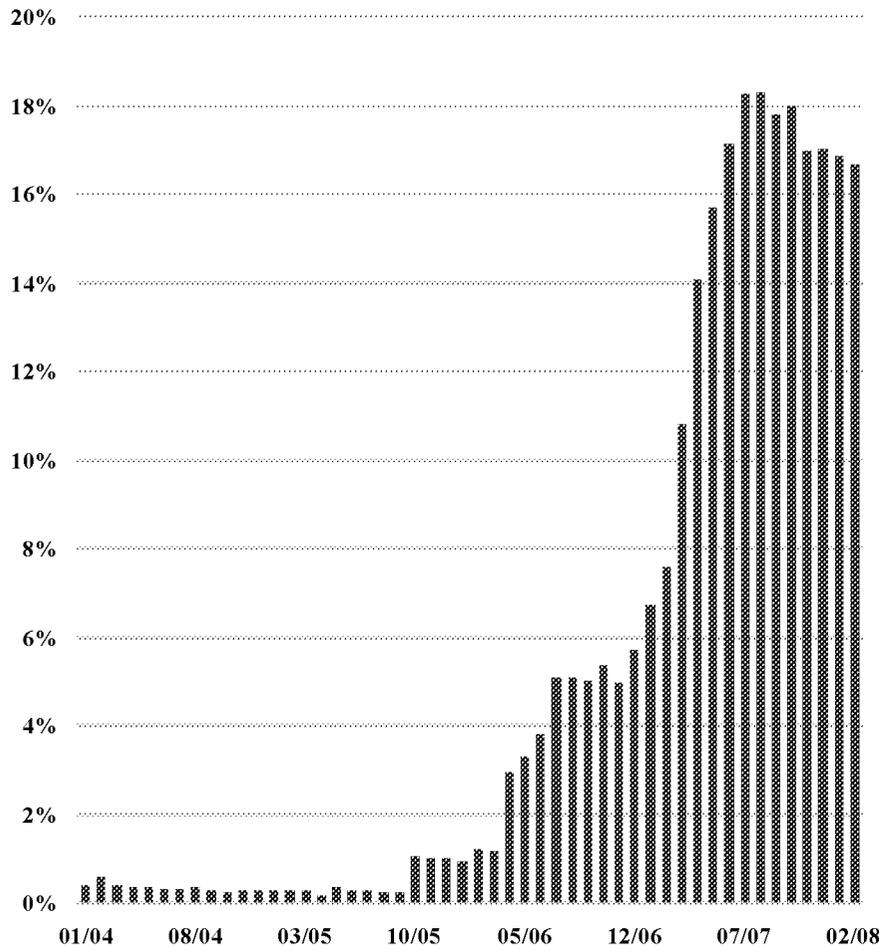
We Recommend Negative Basis Trades for Investors with Access to Cheap Funding and for Those Looking to Source Convexity in This High Volatility Environment



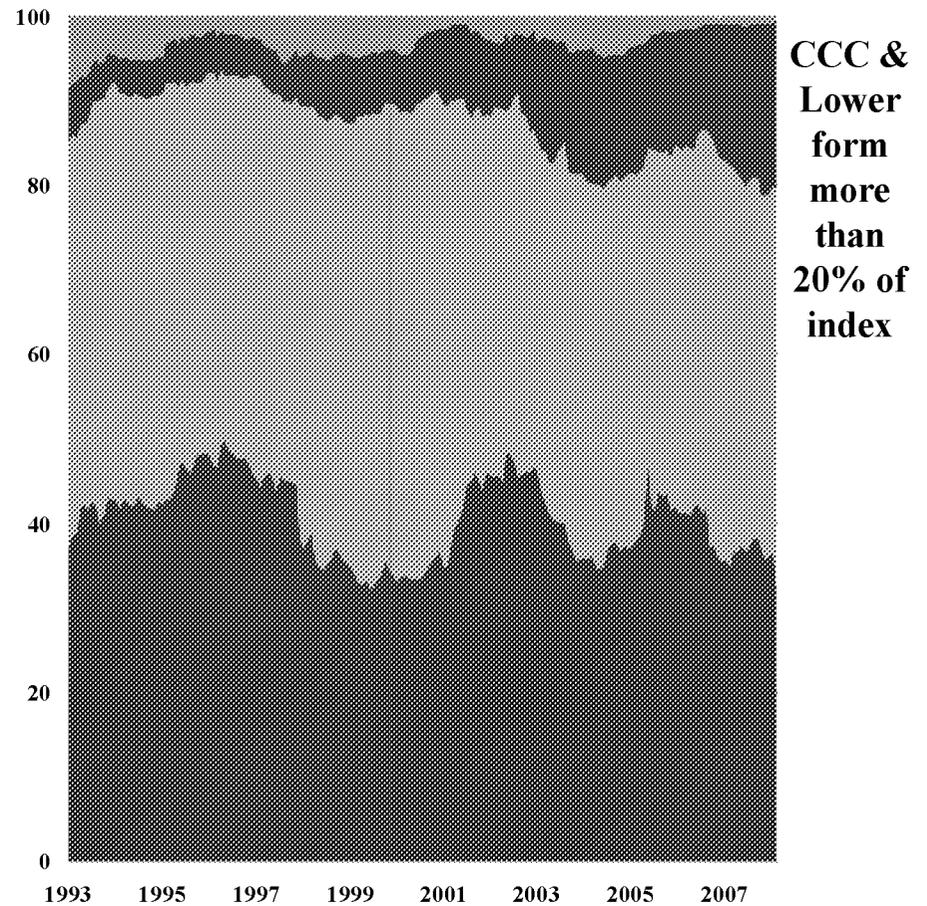
Source: Lehman Brothers.
 Note: Assumes 40% Recovery

In High Yield, the Default Cycle will be Unique as we are Coming Off of a Period of Lenient Lending Standards. A Combination of a Worse Credit Profile and Increased Issuer Flexibility will Likely Lead to Lower Recoveries for Unsecured Bonds.

Covenant-Lite Loans as % of Total



High Yield Index by Credit Quality

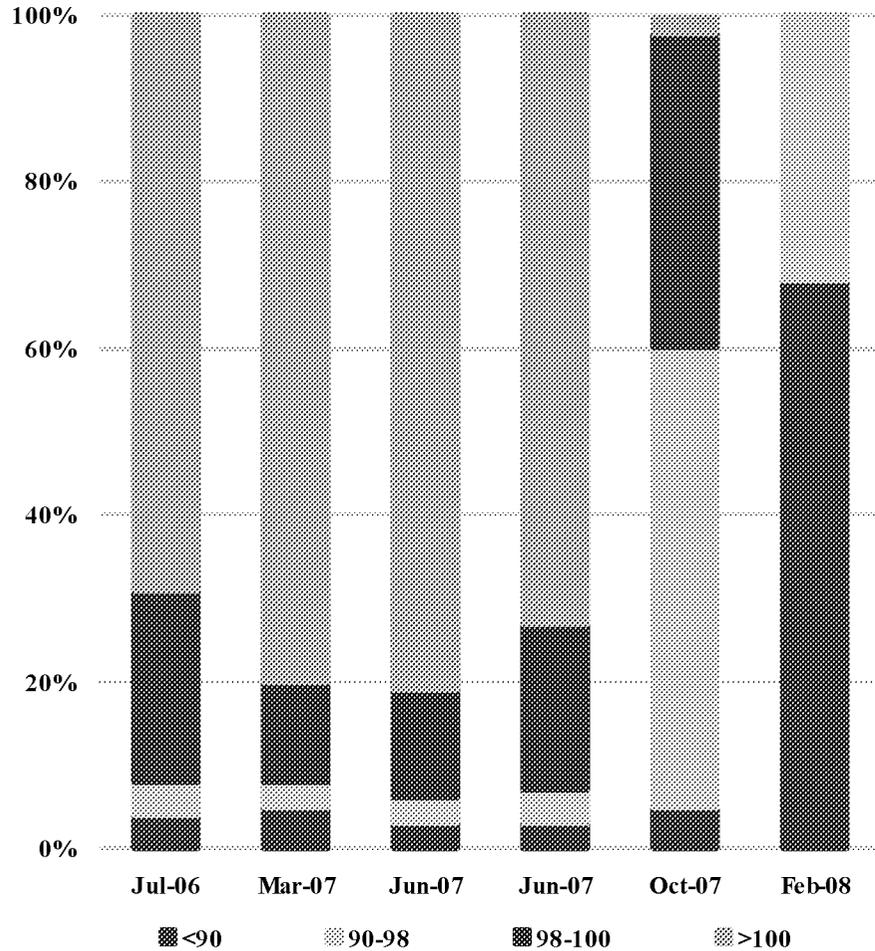


Source: Lehman Brothers.

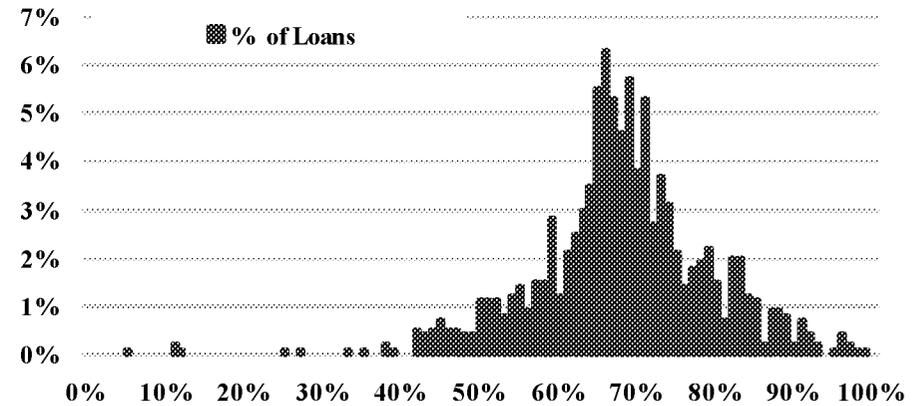
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At Current Levels, We Prefer Leveraged Loans to High-Yield Bonds Given Their Structural Seniority and Low Dollar Price

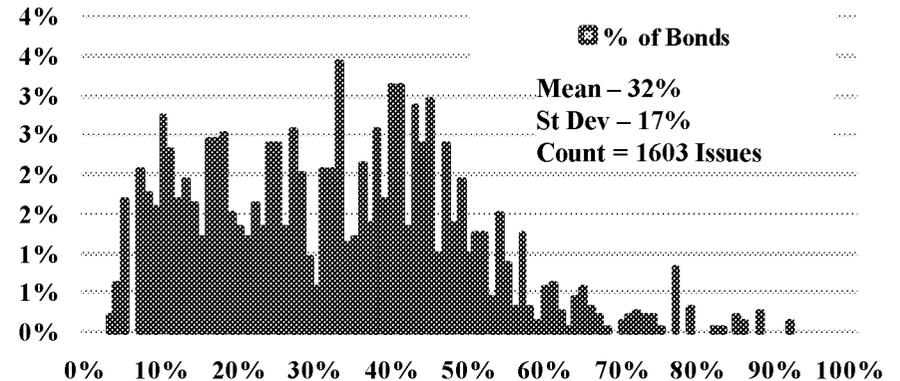
Large % of loans trading at a discount



US First Lien Term Loan Recoveries



Recovery Estimates for Bonds



Source: Lehman Brothers.

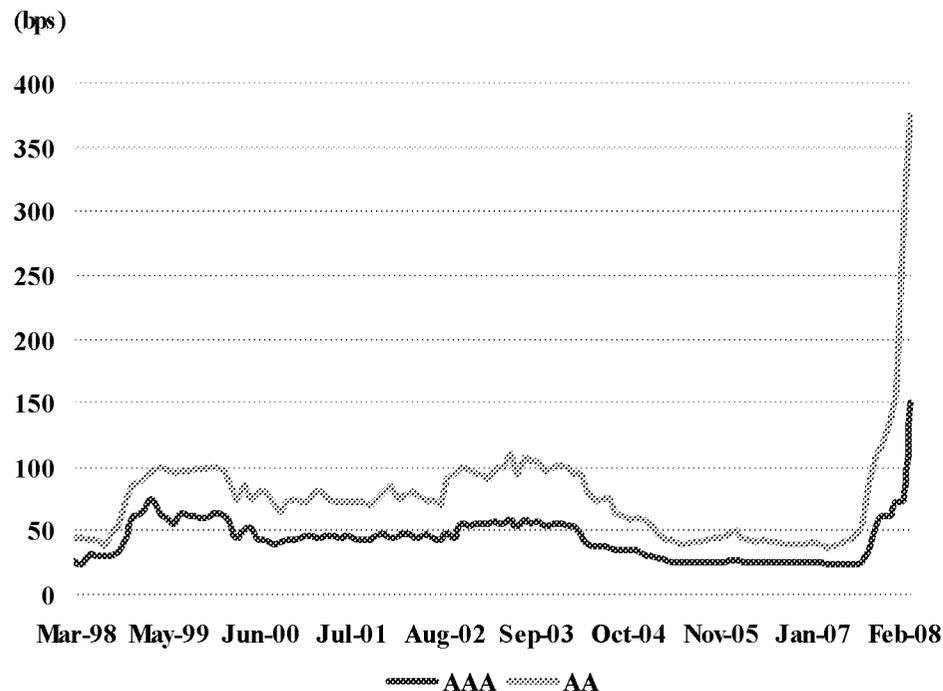
Within Structured Credit, AAA Tranches of CLOs present the Best Opportunity for Investors with Stable Funding. While CLO's are Fundamentally Different from ABS CDO's.....

	CLO	ABS CDO
Collateral	Primarily high yield corporate senior secured loans	Primarily HELs
Asset Diversity	Highly diversified, typically 150-200 issuers across different sectors	Concentrated in residential real estate, consumer risks
CDO within CDO	“Structured finance buckets” are capped at 3-5% – Managers rarely use more than 1-2%	10 to 30+% of portfolio consist of other ABS CDO tranches
Leverage/Subordination	Rating agencies require more par subordination for HY collateral (~8% equity)	Rating agencies require less par subordination for IG collateral (<1% for HG and ~5% for Mezz equity)
Cash flow Triggers	Waterfall structure diverts cashflow to senior holders if coverage tests fail	Transactions from 2006 were increasingly without triggers
Impact of Asset Downgrades	Caa/CCC assets in excess of 5.0-7.5% are carried at market value for OC purposes (typical size is 0-2% now)	OC haircuts kick in when downgrades to BB and B are in excess
Excess Interest and Deleveraging	Higher excess interest means faster deleveraging in the event of an OC breach	Very slow deleveraging, especially with HG assets
Portfolio Management	Almost all are actively managed	Some are static or partially managed
Modeling	Simpler	Complex (re-securitization)

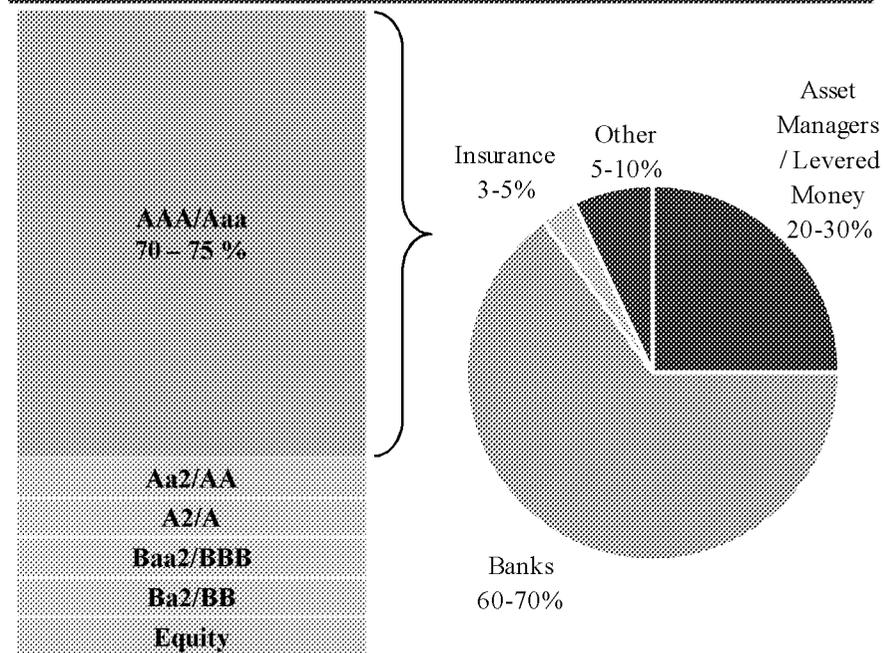
Source: Lehman Brothers.

Spreads have Widened Substantially In Line With other Structured Products, Even Though AAAs are well Protected Against Principal Losses

AAA and AA CLO New-Issue Coupon Spreads to LIBOR



Estimated Investor Breakdown for AAA US CLOs⁽¹⁾

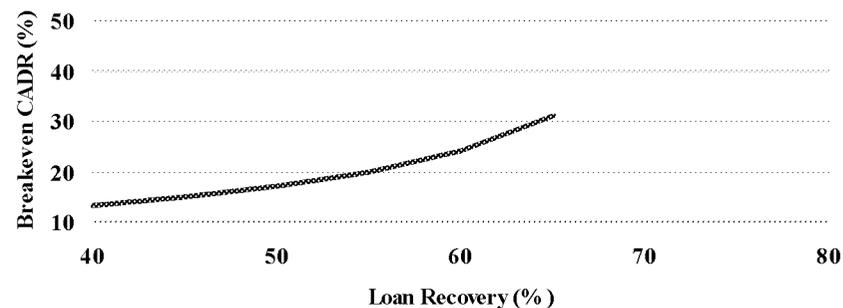


Spreads of AAAs reflect the price of liquidity

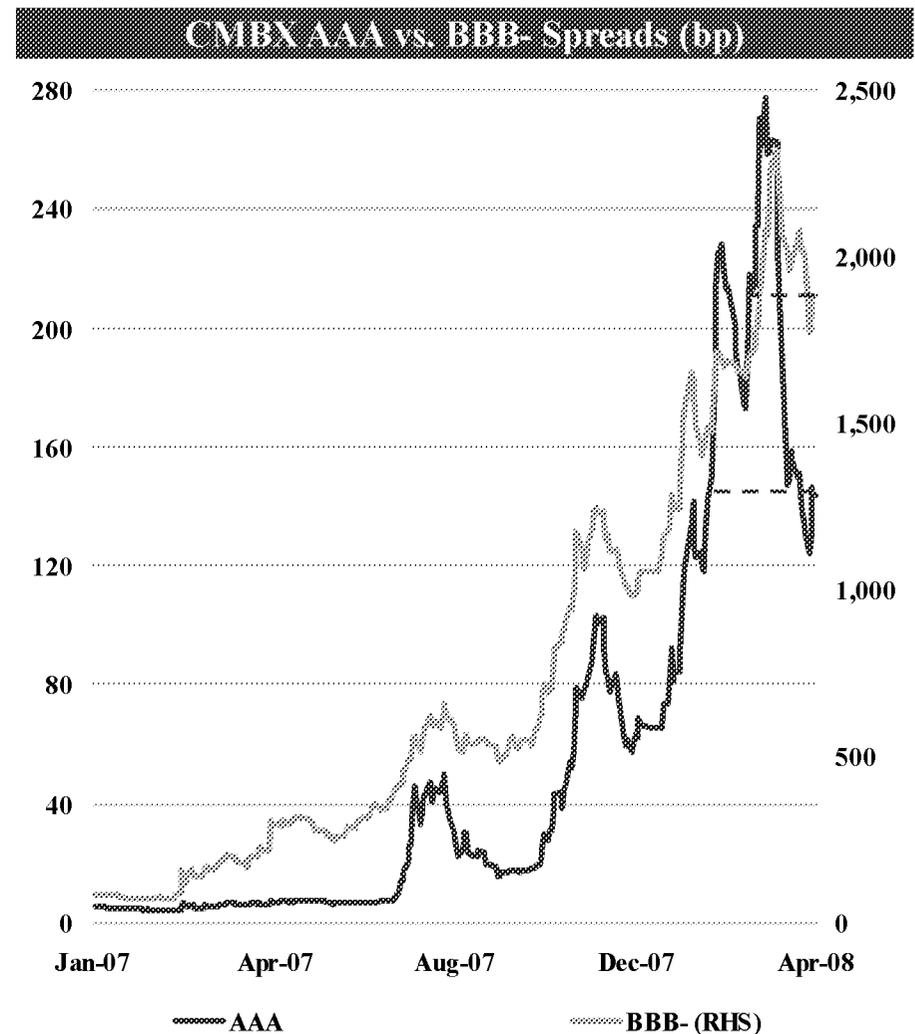
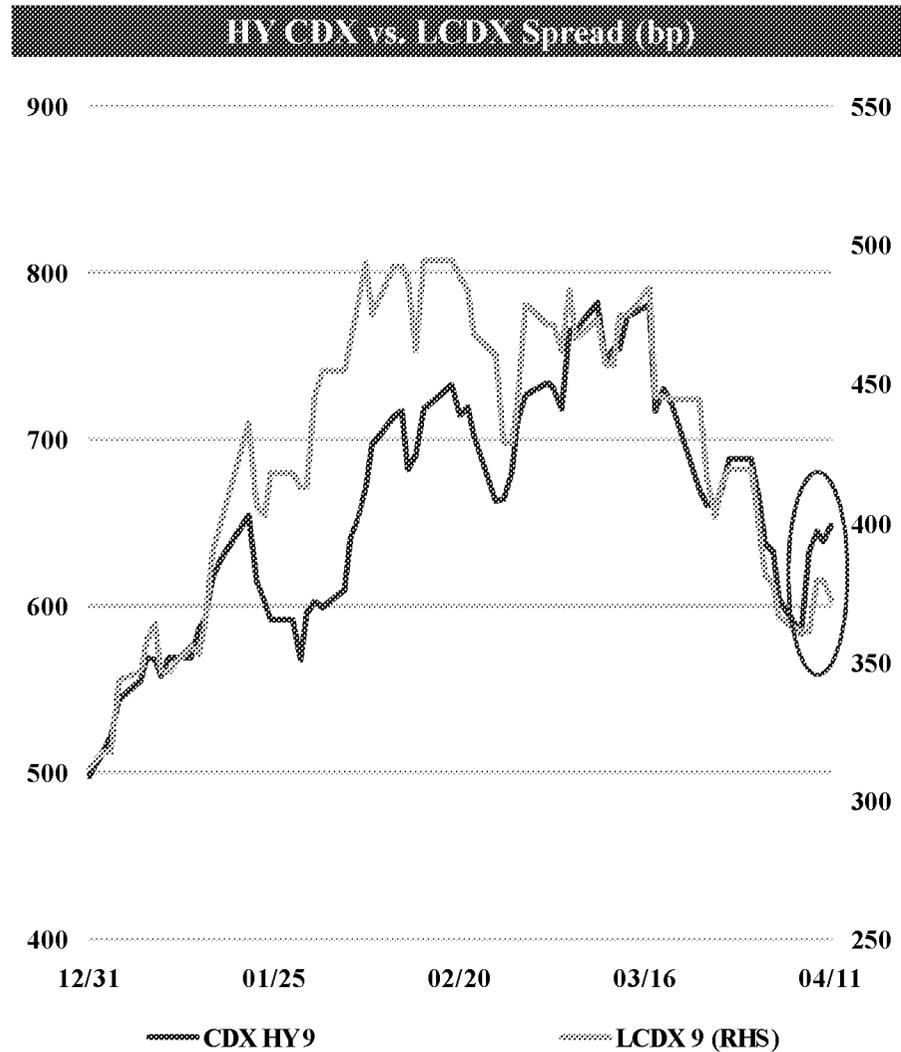
- ◆ Recent widening seems to have been driven by concerns over investors' ability to finance AAA assets going forward
- ◆ Even under extreme stress scenarios, AAA CLOs are well protected against principal losses. Even at 60% average recovery, annual default rates must be greater than 31% per annum to break AAA CLOs

Source: Lehman Brothers.
1. 2006-2007.

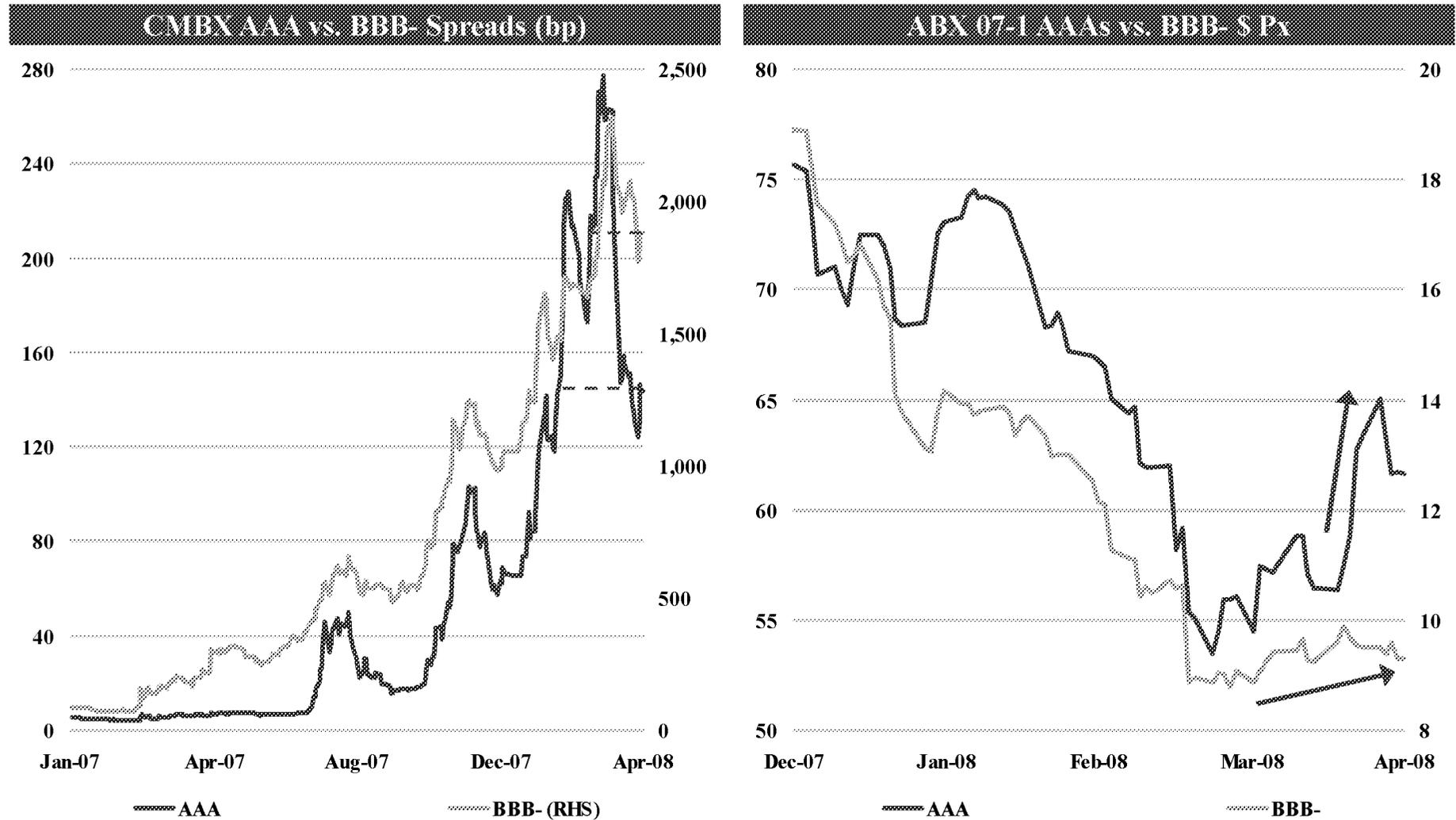
AAA CLOs Break-Even CADR vs. Loan Recovery



As Growth Slows and Fundamentals Deteriorate, Junior Parts of the Capital Structure Should Continue to Underperform Both Within Issuers



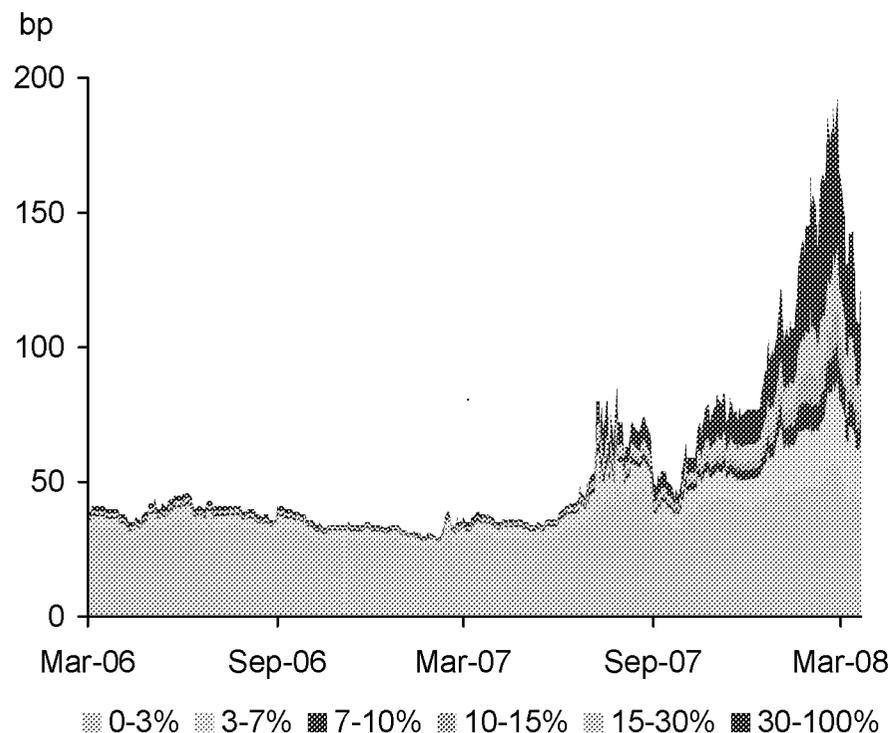
And Across Asset Classes



Source: Lehman Brothers.
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And the Best Shorts Are Likely to Be Those That Could Actually Experience Losses Rather Than Those That Are Simply Trading Too Tight

5Y CDX IG Expected Loss Distribution



Hold-to-Maturity Performance Summary

		Similar to Last Cycle	Severe, Credit Cycle	Extremely Severe Credit Cycle
Liquid IG Tranches (7Y)	0%-3%	Severe Principal Loss	Wiped Out	Wiped Out
	3%-7%	✓	Slight Principal Loss	Heavy Loss
	7%-10%	✓	✓	✓
	10%-15% & Above	✓	✓	✓
Liquid HY Tranches (5Y)	0%-10%	Wiped Out	Wiped Out	Wiped Out
	10%-15%	Wiped Out	Wiped Out	Wiped Out
	15%-25%	Heavy Loss	Wiped Out	Wiped Out
	25%-35%	✓	Wiped Out	Wiped Out
	35%-100%	✓	Just Touched	Significant Loss

Source: Lehman Brothers. Credit cycle data based on Moody's default data for IG and HY. Regular recession scenarios are run on flat periodic default rates. Front / back loaded scenarios assume linearly decreasing / increasing default rates with a minimum of 0% and a maximum of two times the periodic default rate. "✓" stands for non-impairment in the tranche.

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Concluding Thoughts

Macro Backdrop	Negative	Global growth likely to slow in 2008	<ul style="list-style-type: none"> ◆ Deteriorating macro backdrop combined with a large demand / supply imbalance should prevent spreads from rallying materially ◆ Aggressive central bank action should lead to liquidity normalization in the intermediate term, but underlying asset quality issues will remain ◆ Ability of spreads to rally will be a function of the amount of economic damage done by the credit crunch
Corporate Fundamentals	Negative	As growth slows, fundamentals to deteriorate	
Supply / Demand	Negative	Large supply / demand imbalance to persist	
Current Spread Levels	Positive	Cash Spreads near multiyear wides. However, liquidity situation needs to improve further to get full benefit	

- Favor high quality financials (money center banks and brokers) over regional banks
- Prefer non-cyclicals to cyclicals in the backdrop of a global growth slowdown
- CLO AAAs tranches present an excellent opportunity for investors who have access to stable funding
- Prefer to go up-in-quality as growth slows and fundamentals deteriorate

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