Investor fatigue?

Interest in previously popular bid-lists waning

Two Maiden Lane II (ML II) bid-lists were presented to the market last week and, after weeks of being well-received, the most recent auctions drew a tired response (SCI 13 May). As early fears about secondary market bifurcation subside, new concerns regarding the durability of investor appetite are being raised.

The New York Fed put out a total of US$2.54bn in current face bonds from the Maiden Lane portfolio last week, with the bulk of that (US$2.08bn) on the second list. MBS analysts at Bank of America Merrill Lynch report that 34% of the bonds on that second list did not trade, but the amount that buyers are willing to pay has also decreased.

Bret Ackerman, head of RMBS trading at Odeon Capital Group, believes that the scale of the ML II supply has begun to wear on the market. He says: "When Maiden Lane II first came to market, there was a concern that the additional supply would weigh heavily on bond valuations. While the first two lists traded through the offered side of the market, technicals have weighed more heavily on more recent lists and the market as a whole."

Ackerman continues: "The market has traded off 4-5 points since the beginning of ML II liquidations. While not the driver of the sell-off, the ML II supply has certainly been an exacerbating factor."

The BWIC process usually favours large dealers over customers, but the execution on the Maiden Lane BWICs has been more customer-bid driven than dealer-bid driven, notes Ackerman. He says customers are currently taking a buy-and-hold position as they look for long-term yield projection.

A softening in prices had been seen ever since the first list came out, even before last week's lists drew a muted response. Although the market in general has softened, another contributing factor could be less participation from Wall Street, where the first ML II list in particular was embraced as an opportunity for one-upmanship.

"There was an 'ego premium' placed on the first list, as larger banks were willing to trade at a loss in exchange for the press," explains Ackerman. "Basically, every dealer stepped up for the first lists because there was a risk of being removed from future lists. Of course, the Fed needs all participants to be involved to get best execution."

He continues: "Since then, there has been less press surrounding these and henceforth there is less upside to be had from one dealer buying a significant portion of the list and being deemed to 'control the market'."

The main concern at the time of the first Maiden Lane lists was about bifurcation in the market: while the Maiden Lane lists were very well-received, other lists were unable to attract the same bid levels. Ackerman does not think this was ever going to be a particularly worrying trend. Indeed, as Maiden Lane prices have come down since the ML II auctions started, the issue of bifurcation has also become less important.

"I do not think the Maiden Lane lists are creating a two-tier market. That seems to have been the case on the first list because of all the accompanying press, publicity and the pressures to be involved. But the most recent lists have come and gone with much less fervour," says Ackerman.

The BAML analysts note that another type of split is occurring though. Although 34% of bonds on the most recent list did not trade, that includes 51% of the subprime bonds which had been offered. This continues a recent trend of subprime prices becoming progressively weaker.

The Maiden Lane auctions are expected to continue up to the end of the year. With more than US$30bn of securities being delivered to the market in a series of bite-size chunks, it is possible that investors will eventually tire of being drip-fed and interest in Maiden Lane assets will dry up completely.

However, Ackerman does not believe the subdued reaction to last week's lists marks an end to the market's interest in ML II. He concludes: "There is a lot of money on the sidelines and US$250m dissipates from the market in paydowns and losses every month, so US$1bn-US$2bn is not more than the market can absorb every month."

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