

KYNEX 2008 Stress Framework

To simulate the 2008-2009 market environment, we chose a time period starting with the beginning of Q3 2008 (9/2/2008 to be specific) which was a few weeks prior to the Lehman default and finishing with the end of Q1 2009 (3/30/2009). This time period captures the decline of the S&P 500 Index.

Equity Movement:

During this time period the S&P 500 Index fell 39% and therefore we are moving equity prices down by 39% in this scenario.

Volatility Movement:

We used the CBOE Market Volatility Index (VIX Index) which measures the market expectations of near term volatility for the S&P 500 Index prices to capture the increase in volatility. During this time period, the VIX increased 107% so we are widening the implied volatility by 107% for options and warrants. However, this volatility increase was not observed for convertibles. In fact the risky volatilities of convertible securities remained flat during this time so in this scenario we are not moving the volatility for convertibles.

Interest Rate Movement:

We observed the US Swap Curve during this time to see how the behaved. The 2 year point tightened 57%, the 10 year point tightened 35% and the 30 year point tightened 32%. In this scenario we will adjust the curve to simulate this movement.

Spread Movement:

From Reuters data we observed how corporate bond spreads moved during this time. For securities with spread (implied spread for convertibles) less than 170 bps we widen the spread approximately 75%. For securities with an implied spread above 1000 bps we widen the spread 500%. For implied spreads from 170-1000 bps we use a sliding scale.