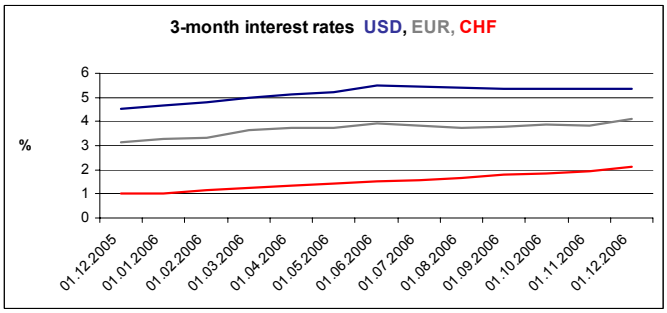
Structured interest rate linked products in 2006

Neue Privat Bank

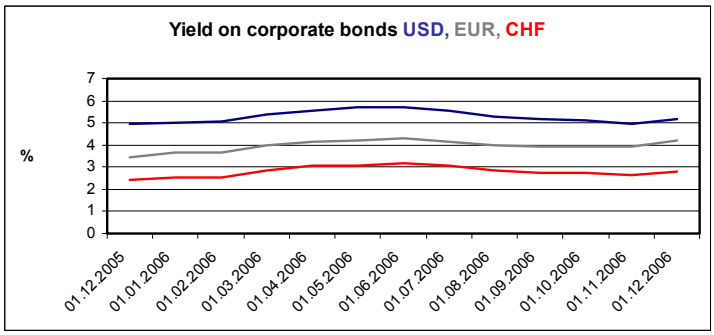
Unexpectedly strong rise in EURO interest rates

To put it in a nutshell, 2006 was a year of low or even negative performance for secure investments such as bonds or interest-bearing products, whilst riskier papers such as equities and structured equity products enjoyed another cheerful year. The most important reason for this development and the poor performance of interest-bearing papers was that the dynamism of the European economy last year was well above the expectations. Due to the very robust economic development worldwide and higher commodity prices, many players in the market believe that there are risks of accelerated inflation. In these circumstances, it is hardly surprising that the policies of the world's central banks have become considerably more restrictive. Whilst the clear rise in short-term US interest rates was largely expected by the markets, the Euro rates have been raised by the European Central Bank much more strongly than the market anticipated (see the illustration below).



Source: Bloomberg

The long-term rates have risen less strongly than those of the short term. This is particularly true for the Dollar; 10-year corporate bonds have risen from slightly under 5% to slightly over 5%, although they reached a peak of 5.8% during the course of the year. There is a different picture for European bonds with the same term; they rose from about 3.45% to a peak for the year of 4.35% and then fell back to 4.2% at the end of the year (see the graph). As a consequence of the significant rise in the short-term rates and the moderate upward movement of the long-term rates, the interest curves which combine the rates for the various terms have become considerably flatter.



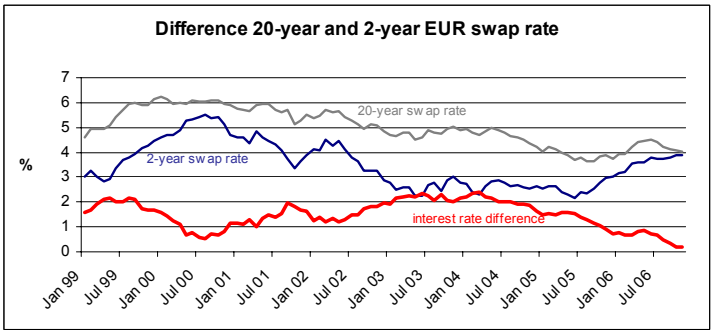
Source: Bloomberg

Effects on prices depend on product structure

A glance at the various interest-related structured products shows clearly that the higher interest rates and the flatter rate curves are reflected in very different ways in the current prices, depending on the structure of the relevant product. Basically, the following product structures can be differentiated:

1) Interest products on a multiple of the difference between the 20- and 2-year EUR swap rate (so-called **CMS-Spread Notes with a multiple**);
2) Interest products for which the interest payment depends on a positive difference between the 30- and 10-year USD swap rate (so-called **digital CMS-Spread Notes**);
3) So-called **Target Redemption Notes (TARN)**, for which there is a fixed interest payment in the first annual periods and thereafter a variable interest payment which, as in the case of the CMS-Spread Notes, depends upon the difference between various swap rates. There is automatic termination of the Note if a certain added up coupon payment (e.g. 20% "target") is reached;
4) **Range Accrual Notes**, for which the interest payment depends on the reference rate (usually a Libor or Euribor rate) moving within a defined bandwidth (e.g. between 0% and 7% in USD).

Basically, the structured products based on the Euro have developed very much more weakly than USD interest products. This is primarily due to the fact that the interest rates in Euro have risen significantly more strongly than the market expected and the interest curve has flattened a lot more strongly than was generally anticipated only a year ago. A glance at the illustration below shows that the difference between the 20-year and the 2-year Euro swap rate sank within a year from about 150 basis points to a mere 20 basis points. However, the same graph shows that on a long-term average, the difference of about 150 basis points between these two reference interest rates existed and most of the phases with low rate differences (or a very flat movement of the curve) were relatively short.
We therefore recommend that at the moment, interest-bearing papers with the structures described under 1) and 3) should be held or accumulated, given that most of those products are available at a large discount to the issue price and they will all be repaid at prices of 100% when their terms come to an end. A similar situation exists for interest-bearing papers with the product structure described under 4) above and which also show a significant discount to the issue price.

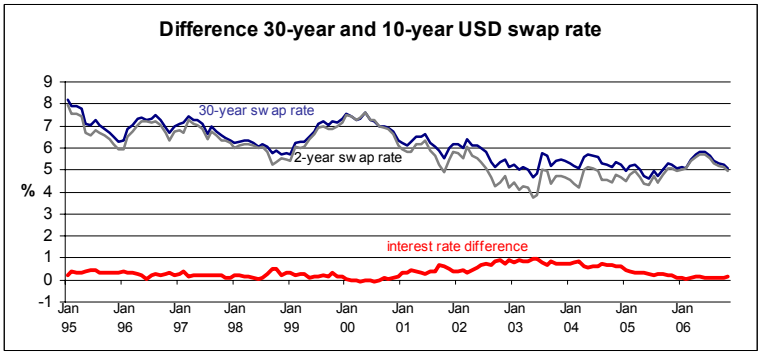


Source: Bloomberg

Pleasing performance of most USD products

The products denominated in Dollars have performed considerably better than those interest products issued in Euros. This applies particularly for the so-called digital CMS-Spread Notes with the structure described under 2) above.

Several of those products show a total income (price gain plus coupon) which is significantly higher than the performance of comparable bonds. Most of these products provide an interest payment which depends on the 30-year swap rate lying above its 10-year counterpart. As the following graph shows, this difference, currently of about 15 basis points, remained positive throughout the year with the exception of just a few days. It was also possible to achieve a positive annual performance with most of the Range Accrual Notes in USD (see the product description under 4) above), given that most of these products have an interest bandwidth which moves upwards in the course of time (so-called step-up Range Accrual Notes).



Source: Bloomberg

MR/29.12.2006

Overview of NPB structured interest products

Valor	Coupon eff.*	Coupon	FX	Issue	Issuer	Product	Maturity	Price	Price	Performance 06
Interest rate linked products (a selection of products launched by NPB)						**Product structure 1)2)3)4)**		**30.12.2005**	**29.12.2006**	**incl. Coupons**
1'631'639	4.10%	6.25%	USD	03.07.2003	Dexia	Step-up DRAN 4)	03.07.2013	95.90%	**97.68%**	5.96
1'636'861	3.95%	7.10%	USD	21.07.2003	Dexia	Step-up DRAN 4)	21.07.2013	96.40%	**98.58%**	6.21
1'687'202	2.50%	8.00%	EUR	14.10.2003	Lloyds	4 x CMS (20y-2y) Spread Note 1)	14.10.2013	90.91%	**82.42%**	-6.84
1'822'275	7.00%	7.00%	USD	26.03.2004	Dexia	CMS (30y-10y) Spread Note 2)	26.03.2014	94.63%	**95.87%**	8.31
1'621'144	7.00%	7.00%	USD	23.06.2003	BCEE	CMS (30y-10y) Spread Note 2)	22.06.2013	95.00%	**96.00%**	8.05
1'611'166	7.02%	7.02%	USD	29.05.2003	BCEE	CMS (30y-10y) Spread Note 2)	29.05.2013	95.00%	**96.00%**	8.07
1'628'247	4.00%	5.50%	USD	09.07.2003	RBS	Step-up DRAN 6m USD Libor 4)	09.07.2013	96.95%	**95.43%**	2.43
1'853'670	2.17%	11.25%	EUR	28.05.2004	CBA	4 x CMS (20y-2y) Spread Note 1)	28.05.2014	91.00%	**80.98%**	-8.84
1'940'874	2.20%	11.25%	EUR	20.09.2004	KBC	4 x CMS (20y-2y) Spread Note 1)	20.09.2014	91.00%	**80.37%**	-9.48
1'945'726	2.12%	11.00%	EUR	30.09.2004	Lloyds	4 x CMS (20y-2y) Spread Note 1)	30.09.2014	91.00%	**80.31%**	-9.63
1'960'068	7.02%	7.70%	USD	21.10.2004	Dexia	CMS (30y-10y) Spread Note 2)	21.10.2016	96.56%	**96.36%**	6.81
1'992'196	2.3%	10.00%	USD	24.11.2004	Dexia	24.5 x CMS (30y-10y) 1)	24.11.2014	88.00%	**85.60%**	-0.43
1'993'935	8.06%	8.06%	USD	30.11.2004	Lloyds	CMS (30y-10y) Spread Note 8.06 / 11.06 2)	30.11.2016	95.00%	**97.00%**	10.17
2'005'662	3.21%	8.00%	USD	29.12.2004	CBA	Snowball / Step-up Note	29.12.2016	97.17%	**92.64%**	-1.45
2'024'626	6.93%	10.85%	EUR	06.01.2005	CBA	4 x CMS (20y-2y) Spread Note 1)	06.01.2017	90.18%	**75.46%**	-9.39
2'068'289	4.05%	9.50%	EUR	25.02.2005	Lloyds	4 x CMS (20y-2y) Spread Note 1)	25.02.2016	90.00%	**76.99%**	-10.41
2'090'294	5.00%	5.00%	CHF	29.03.2005	Lloyds	5 x CMS (10y - 3y), NC1Y, Coupon fix 1-2Y	29.03.2017	90.00%	**83.45%**	-2.28
2'177'201	5.30%	5.30%	EUR	24.06.2005	Lloyds	5.30% TARN, Zielcoupon 20% 3)	24.06.2020	90.75%	**82.15%**	-4.18
2'177'233	5.30%	5.30%	EUR	24.06.2005	Calyon	5.30% TARN, Zielcoupon 20% 3)	24.06.2018	94.08%	**85.39%**	-3.94
2'182'897	2.56%	4.00%	CHF	24.06.2005	KBC	4% CMS (10y-2y) Spread Note 2)	24.06.2017	90.00%	**78.95%**	-9.72
2'182'109	2.63%	6.00%	USD	30.06.2005	IXIS CIB	5.25% Step-up DRAN 4)	30.06.2012	94.47%	**95.570%**	3.79
2'196'903	4.40%	4.40%	EUR	14.07.2005	IXIS CIB	4.40 CDRAN Note, 2010 4)	14.07.2010	92.59%	**88.270%**	-0.26
2'209'808	6.32%	8.00%	EUR	29.07.2005	Lloyds	4 x CMS (20y-2y) Spread Note 1)	29.07.2017	94.00%	**73.92%**	-15.04
2'218'090	0.00%	5.00%	USD	26.07.2005	Calyon	5% Step-up Range Accrual Note 4)	26.07.2008	93.11%	**95.48%**	2.55
2'230'848	1.77%	2.50%	CHF	20.07.2005	BGL	2.50%-4% Range Accrual Note 4)	09.08.2012	93.84%	**91.49%**	-0.73
2'311'241	1.81%	5%-6.25%	EUR	01.11.2005	ING Bank NV	Daily Range Accrual Note 4)	01.11.2011	95.85%	**85.65%**	-8.83

* distributed coupons