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Are iPath ETNs Running Into iProblems?

Not just yet, but keep a wary eye.

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In recent days, Barclays Bank has been in the news with topics ranging from having capital worries (Reuters, Jan. 21: “*Barclays Dogged by Capital Worries*”) to having to give up some independence (Bloomberg, Jan. 22: “*Barclays May Have to Give More Control to Gulf Group*”) to government takeover (Bloomberg, Jan. 21: “*Barclays Falls Seventh Day on Nationalization Concern*”).

While holders of Exchange Traded Funds (“ETFs”) - of which Barclays controls around 50% of the U.S. market - should not be concerned, holders of Barclays iPath Exchange Traded Notes (“ETNs”) are beginning to feel restless – as ETNs are backed solely by the credit quality of the issuer. This means that in the case of default, ETN holders would “get in line” with other creditors; certainly an unpleasant scenario for an investor who did not intend for this portion of an investment to be “fixed income.”

We addressed the nationalization concern with Guy LeBas, Fixed Income Strategist for Janney Montgomery Scott and he reports that “Nationalization generally does not create an event of default for debt, and I would argue that any nationalization of any financial company would be triggered by concerns about the potential for default.” LeBas goes on to say that “... large financial institutions these days fall squarely into the definition of too big to fail, and given worldwide government support for a number of firms, I would anticipate that the appropriate US, UK, or European Government would provide support for any systemically important financial institution rather than permit it to default on its senior debt.”

Barclays has not been silent on the matter, issuing statements in support of its solvency. On January 16, 2009, Barclays posted that, “The Board of Directors knows no justification for the fall in the share price.” It goes on to say that on February 17, 2009 ... “the Board ... expects to report profit before tax ... well ahead of the ... consensus estimate of sell-side analysts.” Still, there has been a continuing decline in Barclays stock price - down more than 50% since the statement was issued.

We do not see market panic with regard to the ETNs - as we would suspect the funds to start trading at a substantial discount to net asset value (“NAV”) if there was concern about backing. In a review of the Barclays universe of ETNs this morning, we have not seen any substantial gaps between price and NAV.

Still, it is important for investors to determine if they are comfortable holdings positions that have even a very remote chance of a problem. I repeat that we see no issue at all with the collateralized Exchange Traded Funds and, in fact, don’t mind comfortably purchasing them. But we certainly do not have the same degree of comfort with the Exchange Traded Notes. In this environment, everyone seems to be jumping at every shadow. But this might just be one shadow that is too big to ignore.

Alphabetical listing of Barclays Exchange Traded Notes

Exchange Traded Notes	Ticker	Intraday IV Ticker
iPath® CBOE S&P 500 BuyWrite IndexSM ETN	BWV	BMV.IV
iPath® Dow Jones-AIG Agriculture Total Return Sub-IndexSM ETN	JJA	JJA.IV
iPath® Dow Jones-AIG Aluminum Total Return Sub-IndexSM ETN	JJU	JJU.IV
iPath® Dow Jones-AIG Cocoa Total Return Sub-IndexSM ETN	NIB	NIB.IV
iPath® Dow Jones-AIG Coffee Total Return Sub-IndexSM ETN	JO	JO.IV
iPath® Dow Jones-AIG Commodity Index Total ReturnSM ETN	DJP	DJP.IV
iPath® Dow Jones-AIG Copper Total Return Sub-IndexSM ETN	JJC	JJC.IV
iPath® Dow Jones-AIG Cotton Total Return Sub-IndexSM ETN	BAL	BAL.IV
iPath® Dow Jones-AIG Energy Total Return Sub-IndexSM ETN	JJE	JJE.IV
iPath® Dow Jones-AIG Grains Total Return Sub-IndexSM ETN	JJG	JJG.IV
iPath® Dow Jones-AIG Industrial Metals Total Return Sub-IndexSM ETN	JJM	JJM.IV
iPath® Dow Jones-AIG Lead Total Return Sub-IndexSM ETN	LD	LD.IV
iPath® Dow Jones-AIG Livestock Total Return Sub-IndexSM ETN	COW	COW.IV
iPath® Dow Jones-AIG Natural Gas Total Return Sub-IndexSM ETN	GAZ	GAZ.IV
iPath® Dow Jones-AIG Nickel Total Return Sub-IndexSM ETN	JJN	JJN.IV
iPath® Dow Jones-AIG Platinum Total Return Sub-IndexSM ETN	PGM	PGM.IV
iPath® Dow Jones-AIG Precious Metals Total Return Sub-IndexSM ETN	JJP	JJP.IV
iPath® Dow Jones-AIG Softs Total Return Sub-IndexSM ETN	JJS	JJS.IV
iPath® Dow Jones-AIG Sugar Total Return Sub-IndexSM ETN	SGG	SGG.IV
iPath® Dow Jones-AIG Tin Total Return Sub-IndexSM ETN	JJT	JJT.IV
iPath® EUR/USD Exchange Rate ETN	ERO	ERO.IV
iPath® GBP/USD Exchange Rate ETN	GBB	GBB.IV
iPath® Global Carbon ETN	GRN	GRN.IV
iPath® JPY/USD Exchange Rate ETN	JYN	JYN.IV
iPath® MSCI India IndexSM ETN	INP	INP.IV
iPath® Optimized Currency Carry ETN	ICI	ICI.IV
iPath® S&P GSCI™ Crude Oil Total Return Index ETN	OIL	OIL.IV
iPath® S&P GSCI™ Total Return Index ETN	GSP	GSP.IV

Source: Barclays Data thru 1-22-2009

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