WHAT THOMAS JEFFERSON CAN'T TEACH US

by Steve Brown

Of all the humans that have walked this earth, none disappoints us more than Thomas Jefferson. The President was brilliant and made significant contributions in art, engineering, agriculture and politics. His math was exceptional. His thought and structure in writing was so good in the Declaration of Independence that it makes us cry every time we read it. Despite all his intelligence and notable skills, however, Jefferson was weak. Here was a man with such moral and intellectual clarity that he put forward the single most important idea in history when he wrote, "We hold these truths to be self-evident, that all men are created equal." Despite this clarity, Jefferson lacked the courage and fortitude to act on the freedom of slaves, women and Indians. His actions failed to follow his words. Different than most in his day, Jefferson not only knew better, he had the power to change history and rise above the popular thinking at the time. Unfortunately, he was too concerned with retribution and what his peers might say. Not as dramatic perhaps, but in a similar vein, there are many bankers that know they must make difficult decisions. Yet they fail to act because it is seen as an admission of weakness. For banks that are starting to work on their budget and strategic plan for 2008, many know that growth will be harder to come by, credit quality will decrease and margins will be squeezed. If this is what you believe, then submitting to your board double digit growth, lower loan loss allowance, higher headcount and constant margins isn't exactly setting your bank up for success. Last year most banks agreed with a similar outlook, yet many teams went right on ahead and budgeted as if it was business as usual. As a result, almost 70% of banks are still bellow budget on a year-to-date basis. Now missing your budget isn't exactly the worst thing in the world, but the problem is in the percentage of banks that are trying to catch up now by taking on more risk. Further, a more accurate budget would have allowed a better allocation of resources and risk. It might have also made the institution stronger. We have been eye witness to banks at the end of 2006 that intellectually agreed a slowdown was coming. Yet, they also went ahead and booked more construction loans than they should have, took on more interest rate sensitive customers than necessary and became more asset sensitive Â– all outcomes that are currently eroding shareholder value. By better planning for a more competitive funding environment or lower customer acquisition numbers, banks could have been more proactive in reacting and mitigated some of the negative performance effects they are now feeling. Our point here is only that bank managers have to be intellectually honest with both themselves and the boards. Their actions should follow their beliefs and true expectations. The 2008 planning cycle is an inflection point for bank management to break a chain of negative events. Great managers will tell their boards what they believe, not what they think the board wants to hear. Confidence and alignment of words to actions are true qualities of a leader. Jefferson failed to do this and as a result we believe the man is one of the most overrated Presidents in American history. Then again, he is also the man that caused distrust in banks when he said, "Banking establishments are more dangerous than standing armies" Â– so, maybe we are biased.

BANK NEWS

M&A

RBC Centura Bank ($25B, NC) will acquire Alabama National Bancorporation ($5.7B, AL) for $1.6B, or 2.4x book. The purchase will help expand RBC's footprint, giving them 45 locations in AL, 45 in FL and 13 in GA.

M&A

Community Bankers Acquisition Corp, a "blank check" company that focuses on banking businesses, will acquire TransCommunity Financial Corp for $48.5mm, or 1.65x book.

More Layoffs

2 weeks after closing its subprime mortgage lending business, Lehman Brothers announced it will cut 850 jobs in its mortgage operations. Separately, Countrywide Financial said it would eliminate an additional 900 jobs.

Mortgage Hit

National City Corp. ($138B, OH) warned investors that it is facing a $200mm loss in its mortgage banking business. In addition, the company will fire 1,300 employees (about 4% of its workforce) in the unit.

Foreclosures Set Record

The amount of mortgages facing foreclosure soared to an all-time high in the 2Q. Additionally, the percentage of delinquent subprime borrowers reached 1 out of every 7 loans.

No Support for Cuts

Fed Presidents Lockhart and Poole declined to endorse a rate cut, citing inconclusive evidence that housing problems will affect the broader economy and amid worry about continued inflation pressure. Of note, however, only Poole is a voting member of the FOMC.