LUCK, THE FED AND THE MARKETS

by Steve Brown

This morning we have so much to write about, we are not even sure where to start. To kick things off, the whole Catholic Church thing of moving St. Patrick's Day to Sat. (because of the conflict with Holy Week) is really throwing us for a loop. Since we like to keep finance and religion separate, we will recognize the Day O' Green in the more secular, beer and corned beef way and take a moment to wish all a happy St. Patrick's Day.

Luck, it seems, is in short supply. So much so that over the weekend it was announced that Bear Stearns would be acquired for a paltry $240mm. The lessons of risk are stark. Late last Thursday they were rumors about the viability of Bear. No major earnings or writedowns ahead, just rumors. By Friday afternoon, clients withdrew $17B of assets. If you think the market holds perfect information from your CAPM days, you are not even in the right ballpark. The market valued the 5th largest broker-dealer at $30/share (and $100 back in Dec.) or roughly its breakup value. Less than 24 hours later, Bear found that it couldn't meet is obligations on Monday and was forced to have its value established by a take-under by JP Morgan at $2 / share. This is roughly the price of their headquarter-building alone, let alone a going concern. Bear Stearns CEO Alan Schwartz went on TV last week to try to head off rumors and denied Bear had a cash shortage, saying the Company's "liquidity cushion" was sufficient to weather the credit-market contraction. Obviously, this was not the case and undermines management's denial of liquidity issues at other firms. Given that Bear was set to post $1/share of 1Q earnings and will have asset values and future revenues discounted at such an extreme manner, it brings up the question over the solidity of the financial system. This data point does not bode well for credit spreads and asset valuations. Mark to market at liquidation value now takes on a whole new meaning.

By Sunday, the news touched off panic in the international markets that things are worse than they seem, and futures tanked. Today's Fed, being one of the most reactionary ever (which will prove to be a good thing), over the weekend cut the discount rate by 25bp, to 3.25% and opened the discount window to Primary Dealers. Not since Paul Volcker in 1979 have we seen a weekend Fed move (and it was up to stem inflation).

For those looking for perspective, some are calling this the worst financial crisis since World War II. Consider that only on Black Monday, in 1987, have all 10 sectors of the S&P been down 20%. This time, it is consistent and you would have to go back 40+ years for a worst and more sustained downturn in both credit and equities. This time around, it is the wide breadth of market dysfunction that is different from the past - Housing, CP, securitizations, credit, equities, financials, the dollar, gold, energy and the list keeps getting longer. The concept of a small recession in the first half of the year and then a turn around by the 2nd half is largely gone.

As of this morning, the talk in the market is that we will see the largest Fed Funds Target rate cut ever at 1% tomorrow. The other alternative would be the Fed to move 75bp and announce the scheduling of a separate emergency meeting a couple of weeks out. Whatever the case, the good news is that the Fed has shown a willingness and aggressiveness in preventing a seize-up of any sorts.

In these precarious times, bankers must communicate with their clients, boards and regulators. We will be publishing a risk review later today on Bear, since they are our primary clearing agent. In addition, we will look to further analyze the interest rate and credit environment over the next week in hopes of providing insight into bank performance for the rest of the year. Fear is rampant and the lack of confidence, not fundamentals, is our largest issue. Increasing risk monitoring and communication will be important. Also, a little more Irish Luck couldn't hurt.

BANK NEWS

Closed

Hume Bank ($19mm, MO) was shut down by Federal and State banking regulators as a result of "alleged improprieties by management." Management apparently failed to report the true conditions of several loans. Security Bank ($52mm, MO) will take over the $13mm in deposits.

FDIC Insurance

The FDIC Board voted to keep assessment rates for the Deposit Insurance Fund unchanged in 2008. Despite a surplus, the FDIC believes that due to looming bank failures, "preparedness should be our overriding concern."

Credit Card Rates

The average credit card rate dropped to 13.29%, the lowest in 2Ys.

New Mortgage

Archie Mae has rolled out its new lending line which is a 2nd deed of trust home equity line of credit that requires no interest or no principal until the sales of the home. The catch is that the borrower must keep the loan for 5Ys and then give up 4% of the home's appreciation on sale in exchange for no P&I payments. While the Company has already made 700 of these loans with great success, they will be working through a series of banks to introduce this product nationwide this month.