THE POWER OF BANK DEPOSITS

by Steve Brown

Today is your lucky day if you are reading this, because we see a marketing opportunity that extremely few community banks exploit. First, a story:

Once upon a time there were two sisters. The older sister was more aggressive and after looking at a 3Y average S&P500 performance that was in excess of 28% back in 1999, decided to invest $10k in a no-load, no-fee index fund that mimicked the S&P500. Every dividend that was earned on the underlying stock, would be reinvested back into the index of stocks. At the time, this was one of the best investments available, as it outperformed almost 80% of professional money managers. This sister set an investment plan that invested $10k the first business day of every January.

The younger, and more conservative sister, took a different approach. She, had the same investment plan, but instead of equities, she put her money in 6-month CDs of her local community bank. On the first business day of July she rolled the amount and on the first business day of January she added her $10k of savings for the year. Now, she wasn't happy with the rate, because the local community bank only paid the median price in the market for those 6-month CDs. To put this in perspective, the median APY would have been 0.57% last week. However, despite these seemingly low returns, the bank was so nice and gave such great service, that she felt comfortable with the strategy. Despite a couple of Christmases where the older sister laughed at the younger one for her single digit returns (particularly in 1999 and 2007), the younger sister stuck with her plan.

The funny thing is that we just checked both sisters' investment strategies last week and were amazed at what we found. The older sister had amassed $305k, while the younger sister had outperformed that by producing an impressive balance of $310k, or 2% better. For the S&P500, the compounded annualized return would have come out to 7.32%, while the compounded annualized return for the 6-month CD strategy, would have resulted in close to a 13% return.

If you run different dates, the story even gets better. We ran the numbers and found if you stared the plan in 1994, community bank CDs would have done 29% better. If you started the same plan in 1999, you would have done almost 70% better. We also ran a variety of other dates and CD maturities (3-month, 1-year, etc.) and found much the same conclusion.

While single digit returns are nothing sexy, having your principal guaranteed by the FDIC is. To get a 38% return in the S&P (like in 1995), you most likely have to suffer 37% losses (like in 2008). In fact, investors need to know that from 1990, the average standard deviation of returns from the S&P500 was 19.5 versus 2.01% from the average community bank CD rates. In other words, to have a chance at double digit equity returns, investors have to take on almost 10x the amount of risk when compared to bank CDs.

Of course, the past is not a prologue to the future, we are not sure of the deposit rates that your particular bank offered and had the equity market not dropped in 2008, we would not have such a great story to tell. However, the fact is that it did and the equity vs. CD performance continues to hold true for 2009.

As an industry, we need to get this story out and take dollars back from the equity market to lower our collective cost of funds. Right now is the perfect opportunity to capitalize on history with this very powerful rabbit-vs.-hare-message.

BANK NEWS

Charter Conversion

The FFIEC reminded banks that charter conversions or changes in the primary federal regulator should be for strategic business reasons only and not to escape regulation or pending enforcement action.

OTS Anti-Takeover

A Federal court upheld an OTS rule that limits minority shareholders to 10% of the stock in a mutual holding company subsidiary after a private investor challenged the rule as being anti-takeover in nature.

Consumer Debt

According to the ABA, credit card delinquencies rose nearly 20% to 6.60% in the 4Q, payments pas due on home loans and LOCs jumping 16% to 3.52% and 29% to 1.89%, respectively. At the end of 1Q, consumers held $940B outstanding in revolving lines of credit, down 2.22% from the 4Q.

CA IOU Clarification

To clarify a story we ran yesterday - BofA, Wells and other large banks will refuse to accept CA State IOUs after this Friday.