GETTING YOUR COSTUME

by Steve Brown

Halloween is right around the corner and it is time to start thinking of a costume. Growing up, the default Halloween move was to throw on some fake blood and put in those plastic glow-in-the-dark vampire teeth. The problem was that those teeth either invoked a strong gag reflex if you put them all the way in your mouth or promoted drool (if you just kept them floating out in the mouth). Instead of some cool Twilight-like Prince of Darkness, homeowners would normally find some pathetic, retching kid with drool at their door step.

This year, bankers should consider a fortune teller costume. With the exception of Senator Baucus, nothing is scarier than a banker these days. So, if you can be one that can see the future - so much the better. To help with your conversation at cocktail parties, we have looked at 590 banks that filed their call reports already. Banks that file early share several traits - they are usually less complicated, they are usually smaller and they usually don't have many problems. As a result, by looking at early fliers, we can get a glimpse of how core operations at usually better-than-average performing banks are doing.

For this cohort, ROE rose from 5.45% to 6.36%. NIM remained flat, as decreases in loan yield (not enough banks using floors), were offset by lower cost of funds. Leverage decreased, as banks shed assets and top performing banks had a loan-to-deposit ratio around 77%. The number of employees at banks remained unchanged, but compensation rose slightly. Premise expense also rose, but due to slightly higher income, most expense ratios decreased.

Asset quality remained the largest driver of whether or not a bank in this group produced earnings improvements. Most banks continued to add to their loan loss allowances, as non-current loans to total loans continued to tick up from 2.03% to 2.11% (remember these are the better performing banks). ALLL to non-current loans stayed steady at 67%, but non-current loans to total capital plus reserves rose 38bp to 11.84%. Total risk-based capital remained largely unchanged at 16.60%.

In terms of asset mix, loan composition at this group of banks remained largely unchanged, with a slight decrease in construction/land holdings and a slight increase in CRE concentrations. Funding mix remained relatively unchanged, with a slight decrease in the use of wholesale funds (to below the 10% level for the first time in more than 6Ys).

Other items of note: banks are still helping earnings by taking gains on sales of securities, but there were some core earnings gains noted (as many banks increased their deposit fee income). This increase came not only from overdraft fees, but also from raising deposit charges.

If you are looking to foretell the future of banking for 3Q performance, the bottom line is that banks still have to scrap for earnings improvements. Until credit deterioration abates, even top performing banks have to look to the fringes of profitability for improvement. Given these preliminary numbers, it looks like 3Q earnings will be flat to down for the industry, with some improvement hopefully coming in 4Q.

If you are interested in finding more information about 3Q performance, be sure to check out the bottom right section of our BIG Metrics application (https://biganalytics.bancinvestment.com/) as we

posted some free dashboards. If you are a subscriber, we will have full 3Q data towards the end of the month.

If these numbers don't look good to you, then maybe the fortune teller isn't your thing. Of course if you don't like the idea of going as a fortune telling banker, there is always the balloon boy.

BANK NEWS

Insider Trading

6 were charged on Friday with illegally earning $20mm from the biggest hedge fund insider trading scheme. Rajaratnam, the founder of the hedge fund Galleon, and ex-Bear Stearns' Directors were included in the group.

Banking While Texting

BBVA will begin a text messaging program warning customers when their accounts are overdrawn.

Higer Rates

The cover story in Barron's over the weekend was very hawkish calling on the Fed to raise rates to 1.00% to 2.00% soon in order to head off inflation.

Earnings Trends

Of the 61 companies that have reported earnings from the S&P 500, 79% have posted earnings gains above analyst's projections. At this rate, 3Q is on track to be the best earnings season since early 2004.

Compensation

A Grant Thornton study showed that 55% of US companies reduced bonuses this year and 26% stopped their 401k match.

Working Past 55

A new study finds 46% of people over 55Y and of low income are looking for work, in order to stay in their home. More than 33% are coming out of retirement and 90% of those over 75Y expect to work for another 5Y.

CD Pricing

CD rates at banks are now at their lowest level in more than a year. Because of this decline, if you are a buyer of CDs, that is most likely a 30%+ total return for 3Y or longer CDs purchased in 2008 (but the past is no indication of the future).