
CURRENT ECONOMICS AND BANKING

by [Steve Brown](#)

Much has been made of the recent Terrafugia introduction. That is the car that both flies and drives. While great in concept, we wonder about the execution as it seems like the least safe of all worlds - a heavy low flying plane with limited speed and a pilot that only needs 20 hours of training; and, an awkward car that has compromised safety features (such as line of sight, full bumpers or enough engine power to accelerate). Further, with only about 4K custom planes sold each year and a \$200k price tag, we question the commercial viability. Don't get us wrong, while we are all for it, the press makes the Terrafugia out like everyone is going to have one.

The hype of the Terrafugia gives us the same feeling as the hype surrounding the \$30B additional stimulus that is being considered for banks to help small business. While like the Terrafugia, we are all for it, but want to make sure we have our concepts straight.

One of the myths of the current economic malaise is the fact that banks are not lending. Because of low capital, fear of the economy, deleveraging or tight liquidity, banks just can't put needed dollars to work to help small business.

First, we question the notion that there is anything special about small business that society should anoint with special stimulus. Yes, small business is responsible for most of the job creation, but that is because there is just more of them. Small business happens to have a higher failure rate (50% fail within 5Ys) than larger or mid-sized business, so small business also happens to lose the most jobs. In addition, wages tend to be less so those jobs end up putting fewer dollars back in the system in the form of disposable income, taxes and the like. In other words, a higher failure rate combined with large positive and negative job changes most likely means our expected job creation is no different than promoting job creation at larger companies. As investors, what we really want to see is which investment gives us our best return for the number of jobs and wage levels. We admit that we don't know the statistics here, but that is our point. Someone should really do the math before we invest another \$30B.

The other faulty premise is that there is strong demand for credit by businesses, but not enough supply of credit by banks. This assumption makes even less sense. No one knows better than our industry that it is actually the demand side of the equation that is weak. There are plenty of banks willing to lend, however they just can't. Companies are sitting on record amounts of cash and are unsure about the future of demand for their respective products and services. As such, businesses of all types are slow to expand infrastructure.

Another way to look at this is economically. If there was more demand than supply, we would see healthy banks rushing in to fill the void, grabbing higher margins and demanding premium loan pricing. We are seeing none of this. On the other side of the equation, large companies have plenty of access to cheap capital given low interest rates and a record number of private equity/investment funds running around looking to make acquisitions that return 17%+. We have seen these firms struggle to deploy their capital. More to that point, mid and larger companies aren't exactly rushing to take up market share by purchasing cheap retail space or opening up new factories in rock-bottom

priced industrial space. With Fortune 500 companies slowing growth or shedding stores, do we really want small business rushing in because they know better?

We got in this mess because capital was too cheap and we enabled companies and investors to make sub-optimal decisions. Cash flows at small businesses are significantly off so putting cheaper credit in the market to take on some of this risk is going in the wrong direction in our opinion.

BANK NEWS

Downsizing

Wells Fargo announced plans to cut 3,800 jobs (1.4% of its workforce) and close its 638 consumer-finance branch network. The bank will take a \$185mm charge and stop its non-prime mortgage business.

Stepping Down

Ed Yingling, the President of the ABA, announced a surprise retirement.

Promotion

A marketing approach we like by Sovereign Bank that gave an entry into a sweepstakes every time a signature-based debit transaction was completed. First place was a 3G iPad, but 2nd place was an interesting Live Nation VIP membership where by the holder gets their shot at advance tickets to local concerts and sporting events.

Lower Hotel Rates

Travelocity indicates hotel rates for stays this summer are down 2% compared to the same period last year and down 12% compared to 2008, as hoteliers seek to attract vacationers.

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