HALLOWEEN PRANKS AND BANKS

by Steve Brown

Halloween is a weird and fun time of year, as some people enjoy being scared; others love to provide spooky thrills; while still others simply enjoy pulling fun pranks. The key to any halfway decent Halloween prank is to have an unsuspecting victim, to prepare adequately and to ensure it doesn't go too far. One harmless prank the kids in the neighborhood are quite fond of is called "forking." Here, the unsuspecting target family wakes up on Nov 1, only to find hundreds of plastic forks sticking up in the grass in their front yard. Sure it is hard on your back to pull up all those forks, but as you do, remember the fun you used to have around this time of year when you were just a bit younger. Speaking of how things used to be in banking, remember the days of a 1% ROA and a 15% ROE?

We were talking recently to a banker who asked us a good question so we thought we would share. The banker said that although the industry had undergone significant upheaval, deleveraging was underway in earnest and the regulatory tone was aggressive, investors and shareholders seemed to expect the same historical ROA and ROE. The banker also pointed out that customer's had become even more empowered and knowledgeable as a result of the power of the internet. These days, it isn't at all uncommon for customers to shop both the loan and deposit side of the equation to try and get a better rate.

As we thought about these comments, we found ourselves pondering how to communicate the "new normal" for community bank performance and what to expect. After doing some research, we found our banker was right on the money. Experts now predict the average bank will earn a 7% to 8% ROE and top performing banks will have an ROE of 11% to 12%. It is time for shareholders and investors to get realistic about the future performance of the industry.

The underpinnings of the industry have also changed sharply over the years. Since 1990 in fact, the 10 largest banks have increased their asset share from 22% to about 55%. Rolling forward, since 2006 alone, the 13 largest banks have grown their total assets by an aggregate of 50%. This has come as community banks (assets < $1B) have seen total assets fall by an aggregate of 3% over the same period. Clearly, the biggest banks have become bigger and community bankers have been fighting hard to hold the line.

Another thing to know about this crisis is that it is deeply embedded into the banking fabric. This time around, we are talking about financial deleveraging, which studies show take about 9Ys to fully work through the system. That means things could remain tough, with higher unemployment and lower economic growth through 2016 or 2017. Patience is going to be critical and performance is going to come in the form of lots of little things vs. one big thing.

One positive piece of news in this discussion comes from the business community, a core customer of community banks. Here, the most recent Fed data finds business loans climbed 2.4% in 3Q vs. 2Q and are up 6.6% from the same period last year. Some loan growth is occurring out there and while small and sporadic, community bankers won't let the ghosts and goblins of the big banks in this sector scare them. Keep focused on what you do best, keep up strong customer service and stay in front of your customers. Do that and no matter how scary a costume the big banks put on, small business customers will continue to seek out your community bank to do business.

As we close, we highlight another prank worthy of considering, known as "pumpkin shifting." Instead of smashing pumpkins and making a big mess, grab pumpkins from all around the neighborhood and pile them up in one yard. This is humorous and it doesn't do any major damage. Whether you TP someone's house, dress in spooky clothes or just turn off all the lights and lie on the floor to avoid anyone seeing you; enjoy the evening and have a very Happy Halloween.

BANK NEWS

Closed (85)

All American Bank ($38mm, IL) was closed by the FDIC and was assumed by International Bank of Chicago ($238mm, IL) without premium and with loss share.

Debit Fees

Despite their $3 monthly fee debit card test, Wells Fargo has decided not to charge.

Corporate Earnings Performance

Of the 295 of the S&P 500 members that have reported (some don't have a calendar quarter and won't report), 75% have been "upside surprises" to earnings, but only 58% met revenue targets. Keep in mind that earnings estimates were materially reduced last quarter after flagging GDP reports.

Small Business

Small Businesses added about 30K jobs in Oct, fewer than the 40K added in Sept.

Bonds over Stocks

For the first time since 1861, bonds beat stocks over a 30Y period. Since 1981 Treasuries and Agencies gained 11.5% vs. 10.8% for the S&P.

Weak Consumers

A Gallup poll finds 22% of people say their financial situation is "poor," the highest percentage in a decade. In addition, 48% say their financial situation is "getting worse," nearly tying the record high of 49% in Apr 2008.

Deleveraging

TransUnion indicates credit card debt in 2011 has fallen to a 10Y low of $4,700 per borrower.