Following Clear Signs To National Donut Day

by Steve Brown

A customer called in the other day looking to enhance the return on their investment portfolio and in so doing they happened to ask about purchasing pork belly futures. Beyond whether such investments were even contemplated in their investment policies, or considering capital treatment, we wondered what had possessed this banker to ask that

question in the first place.

In response, the banker reminded us that it was National Donut Day. Along with the general jubilation surrounding such a holiday, this year there was a new offering from Dunkin Donuts - the Glazed Donut Breakfast Sandwich. The sandwich has bacon and eggs served up on a glazed donut and sales have reportedly been brisk. This bank investment officer got thinking that bacon futures could increase in value and give the investment portfolio a much needed pop in return. Being a more traditional sort of firm and worried about the potential impact to the customer, we politely declined this piece of business and suggested the banker review the risks carefully before launching ahead.

We don't know what that banker ultimately did on the pork belly futures, but we do know just about every community banker is trying to increase the return on their investment portfolio. The problem is that the market is slow to cooperate and the yield right now for anything simple is about 1.50% - even after the Fed meeting from yesterday. That means ANY money put into the investment portfolio is still unlikely to cover bank operating expenses. As if that weren't enough, banks are confined by policies and procedures (which in the pork belly case is probably a good thing), so options are limited. The good news is that there has been an upward shift in longer-term interest rates in the last month and the Fed really pushed things along yesterday with their comments about ending quantitative easing later this year. Since the end of last year, the 5Y Treasury yield is up about 60bp, the 10Y is up 65bp and the 30Y has climbed 50bp. It is anyone's guess whether this increase in yields will last, but it has reduced gains in community bank investment portfolios and volatility is now probably the operative word for the environment.

To analyze options for community bankers, it is worth a little exploration of what has caused rates to rise. Bankers have known for some time that the Fed intends to keep short term interest rates at rock-bottom until there is strong improvement in the unemployment rate and inflation rises. The target for unemployment is tracked each day in the grid box in this publication. The Fed's stated area of rate increase is 6.50% for unemployment and 2.50% for inflation. As can be seen, we are nowhere close, so short-term rates are projected to remain at these levels for awhile (probably 2015).

The Fed has moved the longer-end of the curve, however, with their comments that QE can come off later this year, so that has pushed longer maturities higher. Given all this, creativity in structure for investments and market volatility are likely to increase the rest of the year.

Given that backdrop, we recommend bank investment officers avoid more exotic options and stick to the safe and sane to avoid unintended consequences. The markets are in flux, but the signs are clear that now is probably a good time to stop, step back and be cautious about what the future could bring.

BANK NEWS

M&A

Guernsey Bancorp ($130mm, OH) will buy The Ohio State Bank ($112mm, OH) for about $5mm.

M&A Correction

To correct our announcement yesterday, please note People's Utah Bancorp and Lewiston Bancorp jointly announced that the companies will merge their holding companies and operate their bank subsidiaries under People's Utah Bancorp.

Regulators

The OCC in a recent publication defines "risk" as the potential that events, expected or unanticipated, may have an adverse effect on a bank's earnings, capital, or franchise value. They also remind bankers that significant asset concentrations are an example of activities that may expose a bank to risk so great that no level of sound risk management or capital can effectively control or mitigate it. Be sure to measure and manage concentrations even as you seek to build the loan portfolio in this difficult environment.

GAO Study

The Government Accounting Office reports its analysis of the causes of community bank failures (<$1B in assets) from 2008 to 2011 found failures were largely driven by: credit losses on CRE loans, particularly loans secured by land development and construction; aggressive growth strategies supported by nontraditional, riskier funding sources; weak underwriting; weak credit administration practices; and accounting rules for loan loss reserves that did not allow banks to use forward looking analysis (lead to inadequate allowances to absorb losses). These are all "lessons learned" so bankers should make sure to review each one and monitor things going forward in these areas specifically, as regulatory exam teams certainly will do so.

Busted

A former Bank of America personal banker has been sentenced to 2Ys in prison and ordered to pay $126,445 in restitution for stealing from an elderly customer of the bank. The banker issued herself a debit card and then linked to the customer's account so she could steal $103,000 in 173 ATM withdrawals over 9 months.