No Bull - Bear In Mind

by Steve Brown

Market traders on Wall St. often speak in terms of bull and bear markets. Many people have a childhood personal reference toward those particular animals based on Ferdinand the Bull and Winnie the Pooh, respectively. Of note, neither one of them seemed

?market savvy or even particularly interested in the movement of financial metrics. In Wall Street parlance, the official definition of a bear market is a downturn of 20% or more in an index, sector or security over at least a 2 month period. Conversely, a bull market is an upturn of 20% (also of 2 months duration at least). Why the animal naming of market movements every came to pass and why these particular animals you may wonder? Well, the most common story of the origins of the terms is that when bulls attack, they strike upward with their horns, whereas bears swipe downward with their paws (even if covered in honey) and donkey's and elephants were already taken.

We swipe at you this morning because we recently were reminded of the story of the longest known bear market in history. It was the price of gold, which suffered a price decline from the year 1500 until 1965 and lost over 80% of its value over that four and a half century period. Why was gold such an abysmal investment for that period? It pays no dividends, it costs money to store (just think of the cost to keep an army well fed in medieval times as they protected the castle's gold from trolls, dragons and other marauders). Truly gold has only offered investors a return when opportunity costs are low and specifically when real interest rates are negative. This is the reason that gold has traditionally had a role as an inflation hedge.

Consider that there have been two periods in history of below zero interest rates - one during the high inflation era of the 1970s and the other is the period we are in right now (low inflation and low interest rates). The 1970s inflationary period ended when central banks worldwide raised interest rates. The market action of the last few weeks has caused a substantial rise in interest rates, so the same may also be occurring now. Real rates on 10Y Treasuries has moved from -0.3% at the end of May to 0.64% recently and this is the first time since a brief period in early 2012 that this has been a positive number. The bear paws have spoken and the price of gold has tumbled in response.

Community banks may find some similarities in deposit behavior. Consider that it has been a long time since deposits were hard to find and liquidity has been abundant for years. As economic conditions return to normal, the funding mix in many banks will likely shift back to time deposits, with a shorter duration than core (which typically stay around longer). This is likely to happen at the same time as the loan portfolio begins to substantially extend in duration (as customers race to lock in long term fixed rate loans before rates move any higher).

These factors could create an unexpected increase in interest rate risk so bankers should be careful to avoid getting gored by the bull's horns. There are a couple of solutions that include wrapping the horns with hedging tape (changing long term fixed rate loans into shorter floating rate) or by waving a cape and dodging the bull with a sweeping dance (by reinforcing high touch customer service to keep long term customer relationships). No matter what, don't take any deposits for granted and be prepared for rising interest rates in the not to distant future.

BANK NEWS

M&A

First Federal ($548mm, AR) will buy the parent of First National Bank (710mm, AR) and Heritage Bank ($245mm, AR) for about $134mm in cash ($74mm) and stock ($60mm).

Twitter

Research by the Social Media Explorer and The Financial Brand finds the top 7 US banks on Twitter ranked by their total number of followers as of 2Q were: Bank of America (199k), Citibank (149k), Capital One (75k), Goldman Sachs (52k), Wells Fargo (44k), Capital One 360 (42k) and JPMorgan Chase (22k).

YouTube

Research by the Social Media Explorer and The Financial Brand finds the top 7 US banks on YouTube ranked by their total number of all-time video views through 2Q were: E*TRADE (12.3mm), Wells Fargo (5.6mm), Bank of America (5.2mm), Capital One (4.7mm), Citibank (2.8mm), PNC (2.6mm) and Ally (1.1mm).

Facebook

Research by the Social Media Explorer and The Financial Brand finds the top 7 US banks on Facebook ranked by their total number of "Likes" as of 2Q were: JPMorgan Chase (3.8mm), Capital One (2.9mm), Bank of America (1.0mm), Citibank (736k), Wells Fargo (522k), PNC (129k) and US Bank (101k).

Competition

Private Equity firm Blackstone Group LP will bypass banks and offer loans of $10mm or more directly to landlords that have portfolios of single family homes to rent, according to Bloomberg.

Office Lending

Research service Reis reports the US vacancy rate for office space remained at 17% in 2Q, down 0.2% from the prior quarter. This is also down from the post-recession high of 17.6% hit in 2010.

Concentrated

The Washington Post highlights research by financial consulting firm Strunk & Associates. It finds overdraft revenue accounted for 51% of its credit union client fee income last year vs. 78% at its community bank clients.

Jobs Picture

The latest jobs report shows 144mm Americans were employed in June, or about 59% of the civilian adult population (245mm). Of those working, about 80% were working full time (116mm) and 20% were working part time (28mm).