



"Unequaled Personalized Service"

May 2009

Market Commentary: Bank Nationalization, an Unlikely Outcome

In our February Market Commentary we pledged to follow-up with another communication to share our thoughts on the government's incentive and desire to attract private capital into the banking sector, rather than to nationalize it.

Having the government as a regulator is one thing, but as a business partner... Let's just say that wouldn't be most capitalists' first choice. Government intervention has been necessary to facilitate orderly credit (and financial) markets over the last few quarters and it kept the financial system from collapsing last fall. Unfortunately, it is presently deterring private capital from coming to the aid of the banking system. For example, TARP monies received by banks may be converted into common stock therefore diluting shareholders. New investors are reluctant to commit until the government makes a decision as to whether or not it intends to convert its preferred shares into common. A game plan that is adhered to and that outlines the government's strategy for exiting its bank investments would likely boost the interest of private investors.

Another factor reducing the nationalization impetus is the government's own need for capital. The administration's ambitious spending program (stimulus, healthcare reform, alternative energy, etc.) competes for funds, so stretching each dollar is critical. Nationalization would be costly.

Treasury's announcement of the Legacy Asset Program on March 23rd (a part of the Public-Private Investment Program) was actually a public statement that the government had little interest in nationalizing banks. This program, which is scheduled to be funded with public and private funds, is designed to facilitate price discovery and to help remove souring assets from banks' balance sheets, thus promoting lending. Participating banks will work with their primary regulator to identify assets to be sold to the Public-Private Investment Funds. The FDIC is responsible for overseeing the program and for guaranteeing the debt issued by the Funds. Auctions are expected to start in the latter part of May or possibly early June.

Like with many recent government programs, the details are still in a state of flux and as of this writing the euphoria that initially accompanied this announcement has been tempered with some skepticism. Why is this? Because of the government's varying actions to-date and its "quasi-nationalization" of some banks by attaching government-strings to those who accepted (or had forced on them) the TARP money. This has frustrated many investors. Some financial firms are also frustrated, as evidenced by a number of institutions withdrawing their application for capital injections after receiving preliminary approval or trying to repay TARP money.

In closing, it is our opinion that the government will take any action necessary to prevent the failure of a large U.S. banking institution, but it seemingly has no interest in formally nationalizing one. If the government were to increase its equity stake in the banking system, which is possible, it may divest a percentage of the investment over a set period of time or even place the assets in a trust so as to lessen the perception of government involvement in the day-to-day operations. Either could be a plus, as they both demonstrate the government's willingness to be a regulator rather than an owner/operator. The government needs private capital to solidify the healing process; it appears to now acknowledge this. There continues to be no playbook for dealing with the current situation and as we previously stated in our quarterly letter, you should expect economic (and political) crosscurrents to continue in the near-term.

We would be glad to answer any questions that you may have. Please do not hesitate to call.

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