Forbes.com

February 24, 2009

Street Surges On Bernanke Bounce

By Steve Schaefer

Investors welcomed a rare display of clarity from a key government official Tuesday, as Federal Reserve Chairman Ben Bernanke's testimony on Capitol Hill drew cheers. The resulting afternoon rally that pushed the major averages up 3.0% may have been a technical bounce for an oversold market, but the nation's chief banker certainly had a hand in it.

Bernanke's frank admission that the banking system will need additional capital, and that the Treasury Department's "stress testing" will determine how much, was tempered by his assertion that banks will probably not be nationalized, with the government taking less than a majority stake.

Dan Alpert, managing director at investment firm Westwood Capital, said he would like to see the Treasury cease its incremental response to the crisis. Alpert would prefer the government wipe out as much shareholder equity as necessary in one fell swoop, but with the guarantee that any additional capital would not push common stock further down the totem pole.

Bernanke also said the U.S. recession could end in 2009, with signs of recovery in 2010, helping fuel a sorely needed rally on Wall Street. The Fed chief cautioned that policymakers expect a full recovery to take two to three years, but the oversold market rode his comments and a technical bounce higher after testing its bear market lows Monday. (See "Bernanke's Bold Prediction.")

The S&P 500 finished the day up 30 points, or 4.0%, to 773, rising from just above the 741 floor it put in back in November. The Dow Jones industrial average added 236 points, or 3.3%, to 7,351, and the Nasdaq was up 54 points, or 3.9%, to 1.442.

A banking surge led the way, with Citigroup 16.4% higher. This week reports have suggested the Treasury could convert its preferred shares in the bank into a 40.0% common equity stake. Fellow Dow components Bank of America and JPMorgan Chase were up 19.7%, and 7.1%, respectively, late in the session. The industry-tracking SPDR KBW Bank exchange-traded fund added 12.0%. (See "Stocks Soar On Bernanke Bank Talk.")

Bill Stone, chief investment strategist at PNC Wealth Management, said the possibility that additional capital would be provided to banks under terms that would only trigger a conversion into common stock under worst-case scenarios may mean existing shareholders would not be diluted further, but uncertainty persists.

Still, Stone cautioned not to read too much into the rally off Monday's lows. The retest of the S&P's low is a psychological positive, but the danger remains that further details on the stress tests could undermine Bernanke's remarks.

Tuesday also featured a $40.0 billion auction of two-year notes from the Treasury Department, which drew healthy interest at a high yield of 0.96%. The auction comes after the S&P/Case-Shiller home price index recorded an 18.2% 2008 decline, the steepest annual drop on record. Meanwhile, the Conference Board's consumer sentiment reading for February was the lowest since the gauge debuted in 1967. Home Depot, a company that has been hit on two sides by the downturn in housing and slowing consumer spending, managed to gain 10.1% Tuesday, after its profits topped estimates when excluding charges related to store closures. (See "Home Depot Builds In Bad Weather.")

Traders pulled gains off the board in the gold markets, sending prices tumbling $30.20, to $964.80 an ounce. The SPDR Gold Trust, an ETF that is traded as a proxy for the gold market, lost 3.0%.