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Stocks Slip On Financial Reshuffle

Goldman and Morgan morph into bank holding companies while investors mull Paulson's $700B bailout plan.

By Steve Schaefer

Wall Street history was rewritten again over the weekend, as the Treasury Department outlined its plan to bail out the troubled financial sector and more changes went into effect. Sunday night, the Federal Reserve announced it had approved applications from Morgan Stanley) and Goldman Sachs to become bank holding companies. During the transition, the New York Fed will extend credit to the two firms' broker-dealer subsidiaries against all types of collateral, which are accepted under its primary credit facility for depositary institutions or its Primary Dealer Credit Facility. The same collateral agreement was also extended to Merrill Lynch, which agreed to a takeover offer from Bank of America last week. (See "Say Goodbye To The Investment Banks.")

Financial stocks were mixed to open the week, as the broader market dipped. Morgan Stanley added $2.79, or 10.3%, to $30.00; while Goldman lost $1.05, or 0.8%, to $128.75; and Merrill Lynch shares dipped 52 cents, or 1.8%, to $28.98. The Dow Jones industrial average fell 57 points, or 0.5%, to 11,331; the Standard & Poor's 500 lost 8 points, or 0.7%, to 1,247; and the Nasdaq slipped 19 points, or 0.8%, to 2,255.

Investors were also absorbing the basic framework of the government's plan to take on toxic assets from banks' balance sheets. The legislative package, sent to Congress by the Treasury over the weekend, would give the department the authority to issue up to $700.0 billion of Treasury securities to finance the purchase of troubled assets.

The plan would give unprecedented powers to Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke, who will have the authority to purchase residential and commercial mortgage related assets as well as any others deemed necessary to stabilize markets.

The Treasury Department's press release offered few details about how the assets will be valued, a point of concern for Westwood Capital managing director Daniel Alpert. In an e-mail message, Alpert suggests that a Dutch auction could be a workable solution, but the issue of what reserve prices the Treasury will set, and what will happen if no other bidders play the game, remains. Because of this conflict, he is concerned the bailout "will end up being just that for the financial services industry, with insufficient protection for the U.S. taxpayer and an unwarranted gift to management and shareholders of affected institutions."

Alpert and Westwood also have their concerns about how Morgan Stanley and Goldman will be able to get their capitalization in line with requirements for bank holding companies, and expect additional equity funding will be necessary. That suggestion was broached Monday morning, with reports that Japan's largest bank, Mitsubishi UFJ Financial Group (nyse: MTU - news - people), is finalizing plans to buy a 10.0% to 20.0% stake in Morgan Stanley. American depositary receipts of Mitsubishi UFJ were down 9 cents, or 1.1%, to $8.27.

The SEC's temporary ban on short-selling in certain financial related stocks was also back in the headlines Monday, after the regulator expanded the list of companies under the ban to include General Electric and credit card companies like American Express Shares of GE were up 22 cents, or 0.8%, to $26.84, while American Express fell $2.13, or 5.3%, to $38.27.

Their fellow Dow component Microsoft moved higher, after the company upped its dividend and announced a $40.0 billion share buyback. Microsoft shares added 69 cents, or 2.7%, to $25.85. The blue chip index also has a slightly different look Monday, as American International Group is out and Kraft Foods is in.