Forbes.com

October 14, 2008

Rescue Plan Rally Struggles To Hold

By Steve Schaefer

Wall Street surged at the open but got grounded by midday Tuesday.

Wall Street flattened out Monday, after the Treasury Department's plans to inject capital directly into the banking system was greeted with cheers at the open. The U.S. government followed a blueprint set by Europe, and said it will shuttle $250.0 billion worth of the Troubled Asset Relief Program's $700.0 billion budget directly into banks in return for preferred shares. Meanwhile, the FDIC will temporarily guarantee the senior debt of all its insured institutions and insure all deposits in non-interest bearing accounts, and the Federal Reserve is moving ahead with its plan to backstop the commercial paper market.

More news was trickling out during morning trading, including an early look at which firms may be among the nine initial participants government leaders mentioned Tuesday morning. According to TradeTheNews.com, the Treasury will initially invest $25.0 billion in Citigroup, Bank of America, JPMorgan Chase and Wells Fargo; $10.0 billion each in Goldman Sachs and Morgan Stanley; and between $2.0 billion and $3.0 billion in Bank of New York Mellon and State Street. Merrill Lynch is also believed to be among the firms receiving one of the first investments under the program.

It has also been suggested that banks receiving capital injections from the government will be required to raise additional funds on their own. After starting the day sharply higher, the financial sector and the broader market surrendered a chunk of their early gains. Among the reported participants in the program, JPMorgan Chase (had slipped to a loss, down $2.11, or 5.0%, to $39.88, while Morgan Stanley paced the gainers, adding $3.16, or 17.5%, to $21.26. The Dow was still up 38 points, or 0.4%, at 9,425, but well off its earlier highs; the S&P 500 added 3 points, or 0.3%, to 1,007; and the Nasdaq was off 28 points, or 1.5%, to 1,816.

Investments that track the financial sector also shed a portion of their opening gains, including the Financial Select Sector SPDR exchange-traded fund, still up 59 cents, or 3.6%, to $16.87, and the SPDR KBW Bank index fund, which gained $1.97, or 7.2%, to $29.47.

Despite the backslide in equities, selling continued in the bond markets after the Columbus Day break shuttered trading in that arena Monday. Treasury prices slipped, pushing yields higher, as traders wrapped up some safety plays.

Indications that interbank lending may finally be loosening up -- the overnight London interbank offered rate was down to 2.18%, from 247%, while three-month Libor fell to 4.64%, from 4.75% -- eased some fears of frozen credit markets and took some of the money that had been pouring into short-maturity Treasuries off the table.

The yield on the one-month T-bill was up to 0.12%, from 0.08%, while the three-month T-bill offered 0.40%, up from 0.22%. On the longer end of the curve, the two-month note was yielding 1.79%, from 1.61% Friday, while the 10-year note returned 4.01%, from 3.86%.

As the initial losses were being pared, many observers were contrasting the response of the U.S. government with Monday's actions by European leaders, including those in the U.K.

Dan Alpert and Len Blum, managing directors at Westwood Capital, said in an e-mail message they would prefer a solution more in line with that from Britain, where the government gave a greater upside to the taxpayer rather than existing shareholders who made bets on troubled banks.

Westwood suggests at least one possible alteration that would have provided more taxpayer protection: creating a situation where the Treasury purposely underpays for assets or securities from the banks, then allowing shareholders an option to purchase the government's position. Alpert and Blum contend that this solution would put a "safety valve" onto the price the Treasury pays.

Outside of the financial sector, PepsiCo made news after narrowly missing third-quarter earnings expectations and announcing it will cut 3,300 jobs worldwide. The beverage maker, which also trimmed its 2008 guidance, lost $5.38, or 8.7%, to $56.39. Rival Coca-Cola lost $2.18, or 4.6%, to $45.08.

Dow component Johnson & Johnson also reported third-quarter results, but managed to beat expectations by a fair margin. The diversified consumer products and health care company earned $1.17 a share, compared with the consensus estimate of $1.11, thanks in part to a 13.1% increase in international sales, which helped overcome domestic sales growth of just 0.4%. Shares of Johnson & Johnson added $1.82, or 2.9%, to $64.50.