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The Big Three: Not dead yet!

Stocks held up reasonably well Friday as experts think a GM bankruptcy may be avoided. But should the government let the automakers fail?

By Paul R. La Monica

NEW YORK (CNNMoney.com) -- There wasn't much holiday good cheer on Wall Street Friday morning after the collapse of the Big Three bailout in the Senate late Thursday night. But investors started to feel merrier later in the day as hopes grew for a loan from the Treasury Department instead.

Stocks tumbled Friday morning following steep losses overseas. Not surprisingly, some of the biggest decliners were General Motors (GM, Fortune 500) and Ford Motor (F, Fortune 500), as well as the U.S.-listed shares of rivals Toyota Motor (TM) and Honda Motor (HMC).

However, it's worth noting that even though stocks were in the red Friday morning, they didn't plunge in the United States as sharply as they did in Japan and Europe. And when all was said and done, the Dow and S&P 500 each gained about 0.7% while the Nasdaq rose more than 2%.

Phil Dow, director of equity strategy with RBC Capital Markets in Minneapolis, suggested that stocks were holding up a little bit better than first feared since the White House and Treasury Department have indicated they may use money from the $700 billion bank bailout fund to stave off an imminent collapse of GM or Chrysler.

"If the government let the autos fail, we'd have a pronounced increase in unemployment. That makes a stronger case that the economy could head into a depression instead of just a long recession," he said. "You have to bail out Detroit. Somebody is going to help. I don't know who it's going to be but this has to be resolved."

Can stocks continue to weather such bad news? Just a few days ago, hopes were growing that the market may have actually hit bottom. Experts said the fact that stocks wound up rallying last Friday and this Monday in light of November's gruesome job report was an encouraging sign.

Maybe -- just maybe -- all the bad economic news was already baked into prices. Still, optimism for a bailout of Detroit has now dimmed significantly, and the threat of a bankruptcy of General Motors or Chrysler is very real, even with a possible Treasury loan. And that's not something that experts think is priced into the market.

"The market can take a bankruptcy if it's pre-packaged. If there is faith that the businesses can continue, that may be priced into stocks," said Doug Roberts, chief investment strategist for ChannelCapitalResearch.com, an investment research firm based in

Shrewsbury, N.J. "It's more the uncertainty surrounding what's going on. Chapter 11 bankruptcy could lead to Chapter 7 liquidation and that's not factored in."

Of course, it's understandable that Congress is now gun-shy to lend $14 billion to Detroit after agreeing to give $700 billion to the Treasury Department for a bank bailout that has been, to put it mildly, not handled in the most highly effective manner.

With that in mind, Daniel Alpert, managing director with Westwood Capital, a New York-based investment bank, said that the Senate was right to reject the bailout and that forcing the Big Three might be a good thing in the long-run for the markets and economy.

"The auto companies need to be restructured in a way that the government can't just ask constituents nicely to compromise and give more concessions but to do it with the authority of a bankruptcy judge," he said. "Congress doesn't want to keep throwing money after bad."

Still, Alpert conceded that the government, be it Treasury or the Federal Reserve, will probably "throw some money" at the Big Three before year's end so they can "pay their bills."

And he believes that it's highly likely that the next session of Congress, which will have a bigger Democratic majority in both the House and Senate, will have enough votes to pass some form of bailout next month. So bankruptcy may not be in the cards anyway.

John Brady, head of hedge fund sales at MF Global, a futures and options brokerage, agreed that bankruptcy is probably not likely ... although he thinks it would be a better solution in the long run.

"At the end of the day, the government is going to step in and do something for the auto companies," Brady said. "It's unfortunate. Longer-term, we are going to have to revisit these issues because the automotive companies refuse to change their business models. If you're an investor, why would you want to buy any of their stocks?"

Another expert predicts that ultimately, one or more of the Big Three will go away, but perhaps not by bankruptcy. And that could be something investors are now starting to anticipate.

"There is a growing realization that there will be consolidation in the automotive industry. There will not be three U.S. car companies in the future," said Quincy Krosby, chief investment strategist with The Hartford. "A merger is now possible with either a foreign automaker or among the Big Three."