COMMENT

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Out of the Frying Pan and Into the Fire?

Further to our report of last week entitled "Inauguration, Aggregation and Aggravation," we wanted to follow up on this week's events in Washington regarding economic stimulus and the banking crisis.

As much as we have been longing for the commencement of the Obama administration and its 100 days to evidence change, we are starting to get a bit nervous. Based on the content of the House stimulus bill and the daily leaks out of Treasury and the FDIC on proposals being considered to rescue the banking system, we are detecting more of the same 'ole, same 'ole than we had hoped for. OK, we're a little impatient - but perhaps its time to fire a few stabilizing bursts to make sure Starship Obama is heading in the right direction.

Well Prepared, Well Seasoned Pork still comes from a Pig

Many of the programs contained in the current version of the stimulus bill HR 1 appear as unassailable as Mom and Apple Pie. But let's pretend for a moment that we are all progressive, enlightened friends here with a common agenda – this bill is not a new deal for Americans trying to survive the worst economic crisis since the 1930's, this is a list of all the things we wished we could implement since the Reagan Revolution began, with huge dollars attached.

All in the name of government spending to stimulate the economy, the House bill is, sad to say, a politically achieved tasting menu. It bears almost no evidence of a targeted plan to do what is vital, now, to stimulate the economy and ensure the essential well being of the average American worker and family. Sadly, HR 1 is a bill of fare composed in a kitchen with too many cooks, with the hand of an executive chef nowhere in sight. One offering uncoordinated with the next and each bearing the unmistakable signature of a dish cooked up for the benefit of one or another Congressman's provincial interests.

Where is the administration in all of this? Where is the patriotic, shared-sacrificial, national interest legislation rising to the level of President Obama's ringing oratory?

As if to underscore these questions, on Wednesday of this week, we received a blast email from a congressman seeking to measure his worth by his achievement in tacking onto the bill largess for what he views as the interests of his constituency. We won't mention the NY Congressman by name, but his email trumpeted:

"[Name of Congressman] Secures an Additional $3 Billion in Transit Funding in H.R. 1"

"New York to be a Top Beneficiary of this Key Increase to Stimulus Bill"

"[Name of Congressman] secured an additional $3 billion in transit funding when his amendment to H.R. 1, the American Economic Recovery and Reinvestment Plan, passed the House of Representatives."

".......New York standing to gain a considerable share of the $3 billion increase – some $214 million in formula money.......(possibly including the Second Avenue Subway and the East Side Access tunnel)."

Now, much as we personally like this particular Congressman and have been praying for a Second Avenue Subway all our adult lives, this is sort of thing is just plain tasteless in the face of our national emergency. Multiply the above offering by the 435 members of the House and you can see the pork-fest that is the "American Economic Recovery and Reinvestment Plan" is.

Enough! We need the 10-day-old administration to take over this debate and send up legislation that would result in near-term focused relief and job creation without leaving resource allocation to the inescapable local interests of the 535 individuals under the Capitol dome. We must put provincial interests aside for the relief of nation as a whole. HR 1, as it stands, simply doesn't meet this challenge.

Recapitalizing the Banks: Freedom from Four Fears

Last week, we voiced our opinion on the appropriate approach to the rehabilitation of the banking system with a fair result to the economy, taxpayers and existing bank shareholders. Please see: www.westwoodcapital.com/opinion/images/stories/articles_oct/012109inaugurationaggregationandaggravation.pdf

The debate within the administration continues. Bad bank concepts are said to have been modified so that assets may be acquired at book, rather than overpaid for. Insurance regimes are being considered to put a floor under remaining balance sheet risk. Different methods of infusing sorely needed additional capital are being floated - including immediately dilutive core common equity, convertible debt that may dilute equity later, or more of the same 'ole preferred shares with warrants.

William Seidman, the former head of the Resolution Trust Corporation, who has been highly critical of the slapdash attempts at bank rehabilitation to date, noted in today's Wall Street Journal that the initiatives under consideration are "a horse designed by a committee that looks like a camel." We couldn't agree more.

There is a lot of fear of focused engagement of the economic crisis out there in government circles. Understandably, no one wants to make mistakes.

What we need most right now, however – to mix two of Franklin Roosevelt's metaphors – is Freedom From Four Fears, when it comes to getting the banks back to business, as follows:

- FREEDOM from the FEAR of abandoning ideological nostrums. Ideological "certainties" are never so. We've been through a quarter century of so-called "conservative" (there has never been an adjective more ill suited to the outcome of its common application) economic dogma, and here we are. November's election resulted in a mandate to pursue pragmatic solutions to the damages caused by those who, at best, felt that unfettered economic freedom was critical to prosperity and, at worst, represented the interest of a narrow class at the expense of the majority.

- FREEDOM from the FEAR of the economic N-word, "nationalization." We have suggested a carefully measured approach to having the government claim the economic rights to future improvement in the banks the government recapitalizes, while declaring to all and sundry that our systemically critical banks (from a few dozen to maybe 150 of our 8,400 banks) that there will be no failures among them. See our plan, but the bottom line is that this action need occur swiftly and conclusively - setting a practical floor in bank value and allowing the banks to attract outside equity and get back in the capital formation business as swiftly as possible.

- FREEDOM from the FEAR of politicizing the banking sector. There is no reason why the government, even with a substantial economic interest in the largest banks, need have any influence in banking operations beyond the otherwise essential stepping up and enforcement of prudential regulation. We see this as a red herring issue, provided that enabling legislation specifies no board membership for the government and the establishment of a non-governmental public trust to hold and vote any common shares the government holds, with trustees from the private sector appointed by the President (we nominate Bill Seidman) with instructions to "above all, do no harm."

- FREEDOM from the FEAR of failure and unintended consequences. We've been through a stack of some pretty ineffectual, and bordering on haphazard, government actions. That said, the Treasury Department and the Federal Reserve have implemented some good programs as well. The danger lies not in taking a position and taking action. It lies in taking slapdash and inconsistent actions without focus – hence our concern about the "camel" we may be faced with when the administration announces its plans next week.

It is critical that President Obama have an opinion about the competing ideas of his advisors. We need an aggressive approach to healing our banking sector – not a fear driven list of partial solutions that can only have an incremental impact. Leadership now, please!

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