



## More Bank Failures Likely Before Financials Recover

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More banks are likely to fail before the financial sector recovers, market pros say, which is creating a cautionary environment for both investors and consumers.

With the **housing rescue package that made its way through Congress last week** aimed primarily at mortgage giants **Fannie Mae** and **Freddie Mac**, the rest of the industry will essentially be left to fend for itself amid a largely dour outlook for consumers and the economy.

That lesson got sent home in a big way over the weekend, when the **Federal Deposit Insurance Corp ordered the closing of two small banks**, First National Bank of Nevada and First Heritage Bank of California, and sold them to the Mutual Omaha Bank.

It all creates a difficult environment that has market pros strictly advising caution in the days ahead until the crisis in the financials shake out completely—whenever that might be.

### **Not Over Yet**

"My real concern is that we're not finished," says Kathy Boyle, president of Chapin Hill Advisors in New York. "Wall Street would like to think that the worst is over, but we've been saying that for a while."

Boyle sees the impact weighing on both the consumer, whose assets could be at risk in endangered banks, and the investor, who could be lulled into buying beaten-down shares with the attitude that they can't go any lower, only to see a further wipeout.

Conversely, she thinks the surge of the past three weeks in financials still has legs before more trouble washes in for the industry as the bear market rally runs its course.

"I do think we're going to continue to have a little bit of a rally here, but you can see any day that the market is down the financials do drop," Boyle says. "All of this is just more sign to me that this credit crunch is going to continue."

To capitalize on the current state of affairs Boyle is following two ETFs: **Ultra Financials ProShares** , a 2x, or double-return fund that benefits from a move higher in banking stocks, and its inverse, **UltraShort Financials ProShares** , which benefits from the sector's losses.

"I don't see a catalyst" for a long-term move higher, Boyle says. "I think we're got a lot more pain to go and we're talking about a global economic slowdown."

### **Consumers the Key**

Indeed, banks depend on consumers for their business, and as economic pressures continue to slow the rate of spending and GDP ekes out anemic growth, there will be little to help the industry ride higher except optimism that things will turn around soon.

Indications of when that will happen come Thursday when unemployment numbers come out and the government releases gross domestic product results. If that data show continued pressure on the consumer, that will make a recovery even more difficult and likely foretell more bank failures.

"So far the macroeconomic data have not been dramatic enough to really scare off investors in terms of the local and regional banks, but that may change," says Quincy Krosby, chief investment strategist at The Hartford.

Like many other advisors, Krosby believes a cautious approach to investing is critical until something comes along to propel financials higher.

"Some banks are in good shape and they have been tarnished, as have some insurance companies been tarnished, by the ones grabbing the headlines," she says. "If you've got a very long-term horizon, as these share prices come down you may want to build a position in the best of breed, in those companies in financials that do have good balance sheets and are not sitting there with bad loans, and their share prices have been hit."

In the interim, Crosby expects a lot of traders continuing to be active in bank stocks, selling on rallies and buying on dips. Such volatility is what will make a long-term view important.

As for a turnaround, Crosby thinks one could come when the government enacts another stimulus program, which she sees as necessary once Washington politicians realize that the economy needs more help in the form of consumers spending, as well as taking personal loans and mortgages.

"At the end of the day so much of this hinges on the housing market and mortgages. I don't think that they're finished with the packages they have in mind," Crosby says. "They're going to be a force whether the market likes it or doesn't like it. Washington is not finished."

### **Careful Investing**

As for individual stock plays in such an uncertain market, Todd Salamone of Shaeffer's Investment Research advises caution, and even then sticking with the tried and true--banks that have survived earnings season, taken their subprime writedowns, and have balance sheets that appear strong enough to withstand more turmoil.

"From an investment perspective, if you're going to dip your toe in the financial area, dip your toe in companies that have already come out and reported earnings that came in above expectations," he says.

"If we are not near the end of the cycle, those are the stocks that are going to provide the best opportunities," he adds. "We're not saying back up the truck necessarily, because there's still a lot of uncertainty out there."

Salamone cited **Wells Fargo** and **Charles Schwab** as two companies in the sector that he sees as resilient during the credit crunch and whose earnings fit the description as fit going forward.

As an ETF hedge, Salamone said the **Financial Select Sector SPDR**, which is diversified across a range of financial, insurance and real estate companies, provides cover against individual shares taking unexpected plunges.

## **A Warning For Depositors**

Stock market players aren't the only ones who have to worry about investment risk with banks. Depositors, too, have exposure, particularly on funds that exceed the \$100,000 limit covered by the FDIC.

What some may not know is that even though they may think they are under the insured limit, if they have money in investment banks they could have additional exposure if the investment banks have money placed in Insured Cash Accounts, or ICAs.

If the ICAs are at banks where depositors already have money, anything over \$100,000 is not covered.

"That's something people doesn't understand," Boyle says.

She advises depositors to check their investment banks to see where their ICA money has been deposited.

"I don't care how big your bank is or how safe you think you are," Boyle says.

"There's lots of rumors. We hear them everyday, and they're going to continue."

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