

A Long Week in Banking

Bhavin Dhanani

On Sunday Bear Stearns was sold to JP Morgan for \$2 per share. At the close of markets on the previous Friday one share could be purchased for over \$30, the \$2 price representing a 93.3% discount on the banks market capitalisation. Ultimately Bear Stearns' liquidity problem cost investors.

Soon after the sale of Bear there was heavy speculation that Lehman Brothers could be the next to go. On Tuesday they reported that first quarter profits fell by 57% to \$489 million, better than analysts expected. This

sent the share price rocketing up 46%, essentially eliminating the falls experienced in the previous two trading days. The bank was quick to point out that it had \$94 billion in cash and liquid assets assuring investors it will not go the same way Bear Stearns did.

Goldman Sachs and Morgan Stanley also beat analyst expectations with their first quarter results. Goldman experienced a profit fall of 53% to \$1.51 billion whilst recording around \$2.5 billion in write-downs. Morgan Stanley's profits fell by 42% to \$1.55

billion, writing down \$2.3 billion of debt. Both banks openly admitted they have used, or in their words "tested", the discounted credit facility set up by the Federal Reserve which provides cheap financing to banks.

Ending the week Standard & Poor's downgraded the credit ratings of Goldman and Lehman from stable to negative. Both banks could now face higher borrowing costs.



How much is Bear Stearns' actually worth? Liquidity problems, but a price lower than the market value of its head office alone.

Fed cut Again in Volatile Market

Phillip Butler

Markets

- The FTSE 100 suffered a substantial loss this week falling 2.42% to 5,495.20. The Dow Jones however reacted positively to Federal Reserve actions and rallied 3.43% to 12,361.32.
- Flotations in the markets of late have definitely suffered amid the current market conditions. In 2005 IPOs reached 519 in number but now they are at a mere 30.
- Recent conditions have resulted in many companies becoming under-priced, especially in the AIM market. This has increased the number of acquisitions of late.

Winners, Losers

Company	Price	Change
Rentokil (health)	85.5p	11.0%
British Energy (energy)	621p	8.7%
Expro (services)	1200p	7.3%
Carnival (tourism)	1986p	6.8%
Partygaming (gambling)	19.25p	-16.3%
Antofagasta (mining)	622p	-17.1%
Yell (comms)	138p	-17.5%
Kazakhmys (commodities)	1435p	-19.8%

The US central bank, the Federal Reserve, has cut rates by 75 basis points this week. This is the eighth time rates have been dropped since the credit crisis began back in August 2007.

The interest rate in the US now stands at 2.25% the lowest it has been for 3 years. This interest rate slash had more significance than the previous rate changes over the past seven months. Unlike the majority of other rate cuts the markets did not get exactly what they wanted.

The markets knew rates would be cut due to increasing unemployment and a reduction in economic growth in the US.

Market analysts were predicting a 100 basis points cut. What the market wants the market normally gets in the US. The last point cut was fully expected by the market.

In spite of this the Federal Reserve decided to keep some control of the economy, dictating what it wanted rates to be rather than be pressured in to what the markets requested.

Nevertheless the US stock markets responded well to the cuts, rallying to large increases.

Optimistic analysts now envisage the US economy picking up as bank stocks have reached a fifteen year low.

Company Profile

Name: Schroders Plc

Share price: 849.5p

Business sectors:

Asset Management, offers financial advisory including investment management in life, pension and business assets

Private Banking, offers investment management and banking to high net worth individuals and small institutions

Private Equity, funds private equity, venture capitalists and buy out funds

Employees: 2,633

Recent M&A:

February 2007, the company acquired 99.7% of Aareal Asset Management Group

Sales Revenue: Investments 3%, Asset Management 69%, Other 28%

Total Revenue: Total pre-tax profit increased £102.5million to £395.5 million for the fiscal year ending 2007

Bank Liquidity

The recent collapse of Northern Rock and Bear Stearns have been attributed to liquidity problems. A company faces bankruptcy when its assets are less than it owes. However the current liquidity problems pose another threat. Lack of liquidity and thus no ability to meet short term liabilities renders a bank useless and leads to a Northern Rock, Bear Stearns issues. Neither of these banks were bankrupt in the strictest sense of the word but both could not meet their short term liabilities.

The problems at Bear led to its sale at 6% of its market value. This more than likely, was not the true price of the company. The headquarters of Bear Stearns in Manhattan, New York, is worth six times this figure alone. While the Federal Reserve was happy to help JP Morgan Chase in its acquisition of Bear Stearns for a knockdown price the UK government was not willing to do the same for Rock. The UK Treasury felt that a "fire sale" was not needed but both central banks acted in the same way over one issue. The two banks in question were both too big to fail. Their collapse would have led to worse liquidity problems in their key markets of mortgages and asset backed securities. The funds offered to Bear and the rest of the market were a first in investment banking.

Any queries, comments or requests?
Please contact us at,

mail@strictlyBIF.com

Chinese Wall For Inflation

Bhavin Dhanani

The People's Bank of China, the central bank, has increased the reserve ratio for banks in an attempt to slowdown the country's rapid rate of inflation. The reserve ratio is the amount of a bank's capital that must be deposited with the central bank. It now stands at a record 15.5% and will take effect from Tuesday.

The latest inflation figure for China is 8.7%. Supplies of crops were crippled after extraordinary

blizzards hit the nation recently. This has been a major factor in the soaring price level. In addition to the increased retention ratio it seems likely that interest rate rises will also come about in the near future.

With the United States facing a recession and raising prices it may prove to be a difficult year for the Chinese economy. It would seem unlikely that the economy will grow by the magnitude it has been in recent years.

Strictly Bites

Citigroup has appointed **John Havens** to oversee their investment banking division. The bank also made a further **1800** employees redundant, taking the total since 2007 to **23,000**.

Fannie Mae and **Freddie Mac** have effectively been given **\$200 billion** after their capital requirements were reduced by 30% and 20% respectively.

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Credit Suisse issued a first quarter profit warning after rogue traders in its fixed income division forced the bank to write **£1.43 billion** off its assets.

Northern Rock shareholders have taken their case for compensation to **court**. The Rock will also cut its workforce by a third by 2011.

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Merrill Lynch will sue **Security Capital Assurance**, the bond insurer, for not meeting obligations for credit default swaps.

Marcel Ospel, the chairman of **UBS**, has taken a **90%** pay cut after Switzerland's biggest bank reported its first full year loss for over a decade. Mr Marcel Ospel will be remunerated **SwFr2.5 million**.

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After the turmoil in the markets **BNP Paribas** has decided not to bid for struggling rival **Societe Generale**. However, a bid at a later date has not been ruled out

The number of **initial public offerings** (IPO's) in the UK has decreased dramatically. In the year so far there have only been **three** flotations. In December last year there were **nine**. Analysts are predicting a dry spell until autumn.

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Chinese insurer, **Ping An**, has bought half of **Fortis'** asset management business for **£1.7 billion**.

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The **Bank of England's** Monetary Policy Committee voted **7-2** to hold the UK base rate this month.

More than half of the funds raised from the IPO of **Visa** are to be returned to existing shareholders, including the **American banks Citigroup, Bank of America** and **JP Morgan**.