

Boenning Morning Comment

This report is prepared for us by Tower Bridge Advisors

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Stocks continued their winning streak rising modestly. After the close Google (GOOG-\$595) reported better than expected revenues and earnings per share. But the stock declined almost 4% in after hours trading as analysts were a bit concerned about declining costs per click and the absence of CEO Eric Schmidt on the company's conference call. Those sound like slim reasons for such a big decline. More likely the reality is that the stock has run up sharply in front of earnings and Google's results didn't beat expectations by enough to push the stock higher.

This morning General Electric (GE-\$19#) and Bank of America (BAC-\$19) are scheduled to report. How they perform versus expectations will have a lot to do with how stocks perform today. Greece still makes daily headlines. Today, a lead story is how abuse and graft are costing Greece so much. But the reality is that Europe cannot afford to let the Greek problems escalate and infect everyone else. In the end, the major powers of Europe simply have to step up and keep the situation under control. Market reaction suggests that investors understand this.

This week there has been a lot of additional rhetoric surrounding financial reform. As is normal in Washington, that rhetoric is getting increasingly partisan and, almost as a consequence, increasingly full of half truths. The bill as it stands today in the Senate isn't a bank bailout bill and it doesn't completely perpetuate the same situation that existed prior to the 2007-2009 recession. But it does lack the teeth so far to move the needle as far as necessary. Setting up a bank funded backstop of \$50 billion or anything like that won't stop disaster. Just look at this past year when more than a half dozen institutions needed at least \$25 billion a piece to stay afloat.

The following is clear:

- Today, the four largest banks are simply too big to fail. That is the reality. If you want to create a world where no institution is too big to fail, Congress has to decide if there are special rules for these four or there is a mechanism to break them up. During the financial crisis, they were enticed/encouraged/forced/allowed to absorb weaker competitors and become as big as they are today. Obviously Fannie and Freddie are too big to fail as well. In fact, they have already failed. The issue not even discussed in Congress so far is what to do with the carcass.
- TARP worked. It was a process developed and adjusted many times on the fly but the end result was better than anyone could have hoped 18 months ago. The government (that means us taxpayers) made spectacular returns on our "bailout" investments. The only remaining TARP exposure is to non-banks like GMAC and the car companies.
- The FDIC works. The fund is almost depleted but it has been able to absorb bank losses to date.
- The argument that there are adequate rules in place but the regulatory framework failed to prevent disaster thus suggesting the lack of need for further rules and regulation is a foolish one. If the regs are adequate, then why did the system almost completely fail? The reality is that simply establishing a regulatory structure isn't the solution. History has demonstrated constantly that regulators are no match for the financial industry. Letting the fox loose in the chicken coop and telling him to leave the chickens alone is always going to get the expected results. If you chain the fox to a stake, the damage will be limited. Explicit easily interpreted and

enforceable limitations (e.g. leverage limitations) will work much better than giving regulators broad discretion. You can guarantee that regulators will demonstrate lax behavior at exactly the wrong time.

Parts of the bill are coming together well. Many of the reporting requirements for derivatives are both obvious and will likely prove effective. Rules governing leverage also are encouraging. But the “solutions” to backstop failing banks are still inadequate, consumer protections are needlessly complex and unproductive, and the bill writers are still stuck on what to do with proprietary trading. There are still inadequate rules that prevent excessive speculation via credit default swaps and there is still little pain forced up those who create and sell toxic assets.

Futures are modestly negative in the early hours but GE earnings are expected momentarily and that will affect the course of the day as I mentioned at the beginning.

Today Ellen Barkin is 55. Pope Benedict XVI is 83.

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