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# Grandview

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## Financial stocks: Is it safe yet?

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The global financial crisis sparked by defaults on US subprime mortgages has exacted an excessively heavy toll on the financial institutions around the world.

Following the failure of Bear Stearns, Lehman Brothers, burdened by USD 60 billion in sour-estate holdings, filed for chapter II bankruptcy after attempts to save the 158-year-old firm failed.

Merrill Lynch, fearing a similar fate, ran for the exit and was snapped up by Bank of America in a USD 50 billion, all stock deal.

The world's largest insurance company, AIG, hit hard by credit deterioration, was rescued by the Fed from bankruptcy at the last minute in a US$ 85 billion bailout.

As the shock waves from the subprime crisis roiled the US financial system more than a year with aggravating intensity, we cannot help asking when it is going to end.

Events taking shape recently have shown hopes on the horizon that financial stocks are bottoming and will soon be on way of recovery.

**Cheap valuation of financial stocks**

Fundamentally, the financial stocks are at a rock bottom price in terms of PE ratio. Downside risk for the financial stocks is very limited as their earnings multiplies are mostly below 10.

**SEC Actions**

Securities Exchange Commission (SEC) announces new regulatory rules governing short selling, practically banning the short selling of securities of 119 US financial companies.

The new SEC rules, though controversial, are considered the best approach to stopping the onslaught by hedge funds and private equity funds on the financials.

Worthy of notice, a similar set of rules is adopted by the United Kingdom simultaneously. In the meantime, pension funds and equity funds are advised not to lend stocks to short sellers.

In shutting out short selling from the market, the government is trying to shore up the investors' confidence.

**Fed Relief**

The Federal Reserve has chipped in with more largesse in its emergency lending program by broadening the types of collateral that financial institutions may use to obtain loans from it.

This new Fed measure will provide tremendous relief to troubled financial companies as they are presently short of cash but hording on a huge amount of Collaterized Debt Obligations (CDO), Mortgage Backed Securities (MBS) and the likes, which are practically illiquid at this moment. Being able to turn these dead assets alive, those troubled financial companies are now in a better position to weather the ravaging financial storm.

**Helping Each Other Out**

A global consortium of banks, namely, Bank of America, Barclays, Citibank, Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan, Merrill Lynch, Morgan Stanley and UBS- each agreed to contribute USD 7 billion in constituting a funds pool of USD 70 billion to be used to lend to financial companies in distress. The aim of this newly formed funds pool will serve to prod up the troubled financial companies and to help enhance and mitigate the unprecedented volatility and other adversities affecting global equity and debt markets.

**Financials M & A**

Many financial companies such as Washington Mutual, Morgan Stanley and Wachovia are now seeking a merger partner; instances of financials merger are expected to increase within a couple of months. The result is as positive as it is intended that when two financial companies join forces to become one that will emerge stronger to endure hard times.

**Favorable Market Conditions for Financials**

The global financial landscape has undergone sea change during these few months, but the surviving financial firms are likely to gain more business with the competition thinning.

Though the extreme stock volatility still persists and the investors’ confidence is at a low ebb; events can develop rapidly and unexpectedly; evidence is gathering that a stage is set for the financial stocks to make a sudden turnaround.