THE LONGWAVE ANALYST

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FORWARD WITHOUT FEAR

Those who cannot remember the past are condemned to repeat it. Santayana

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WINTER WARNING

The Clash of Cultures

For decades, particularly during the years after the Second World War, the Canadian investment industry was comprised of 4 corporate groups (colloquially known as the "four pillars") and consisted of investment dealers, insurance companies, trust companies and investment counselors. Basically, each of these corporate entities specialized in its own field of expertise and didn't intrude in another's realm of operations. During these decades, the Canadian chartered banks were primarily focused on making loans and trading the foreign exchange markets for their balance of revenue. However, all of this changed in 1987, when new federal government legislation allowed the banks to purchase up to 100% of a Canadian investment dealer. Needless to say, 22 years later while the far-reaching tentacles of the banking industry have enabled its dominance of many sectors of the Canadian financial services industry; all of these changes have not necessarily resulted in change for the better. The culture of the Canadian banking industry has historically been one of avarice, while the investment dealer culture has been based upon risk / reward. A takeover by, or merger of these two cultures has usually been difficult because it is like trying to mix oil and water.

It is no different in the United States of America, when we examine a commercial bank trying to take over an investment bank. Witness how greed and poor insight in the recent Bank of America $30 billion (U.S.) takeover of Merrill Lynch have exposed alarming shortcomings at the senior management level of the American banking system. Amid the sharp stock market declines of mid-September /08, Bank of America President and CEO Ken Lewis, made a very hasty, ill advised and costly takeover decision: "*Merrill Lynch was the strategic opportunity of a lifetime*" he stated and its "*power and market share would be a thing of beauty over the longer term of 1-1/2 years.*" What a classic example of banker ignorance and incompetence! Not only, did Mr. Lewis pay far too much for Merrill Lynch, but also, his B of A compliance team didn't perform anywhere near the proper due diligence required to satisfy Bank of America directors and shareholders alike. As a cryptic irony, in the past Mr. Lewis has spoken about his dislike of the investment banking business. As recently as October /07, after the B of A posted a 32% drop in 3rd. quarter profit as a result of investment banking losses, Mr. Lewis stated: "*I've had all of the fun I can stand in investment banking at the moment. So, to get bigger in it is not something I really want to do.*" Moreover, Mr. Lewis is a repeat offender in the takeover arena because he made a similar error in judgment in 2007, when he made an equally absurd takeover offer for Countrywide Financial Corp. in order to increase B of A's market share in the mortgage business. This at a time when Countrywide was under investigation by the FBI for mortgage fraud, and still is!

Furthermore, the New York law firm of Wolf Popper has filed a class-action lawsuit against the Bank of America, alleging that B of A and its officers should have warned shareholders that Merrill would post a 4th. quarter loss of $15.3 billion (U.S.) before the shareholders voted to approve the takeover on December 5 /08. The suit also contends that Merrill's huge loss forced the Bank of America, already in receipt of $25 billion (U.S.) from the Federal government under the Troubled Asset Relief Program (TARP); to seek an additional $20 billion (U.S.) under the same program. In turn, the suit says this caused Bank of America's stock price to plummet. Indeed, Bank of America shares are languishing at a price of $6.00 (U.S.) as at the close today, down from $45.00 (U.S.) one year ago. Moreover, B of A has now begun eliminating up to 42,500 jobs, while its common share dividend has been cut to one cent. However, there is no need to shed a tear for Mr. Lewis, personally, since government bailout money will likely ensure the survival of the Bank of America; he is covered by a supplemental executive retirement plan (SERP) to the annual tune of $52.3 million (U.S.).

Flaherty Will Get You Nowhere

In his recent Federal budget, Finance Minister Flaherty completely abrogated his long held conservative values on finance, at the expedience of his Party's primary motivation to stay in power. What a shameful display of shallow behaviour! Perhaps, if Mr. Flaherty and his underling at the time Mr. Carney (now Governor of the Bank of Canada), as well as Mr. Harper (Prime Minister of Canada) had not made their infamous, Halloween night /06 decision to destroy the Income Trust market; they would have received their illusive political majority in 2008 and Canadians would not be saddled with fiscal deficits for the foreseeable future. The memories of a herd of pacaderms place a distant second compared to those of the Canadian electorate.

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