



Hovde

Financial Institutions
Monthly Overview

Capital Markets
Economic Data Review
M&A Statistics

October 2009

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About Hovde

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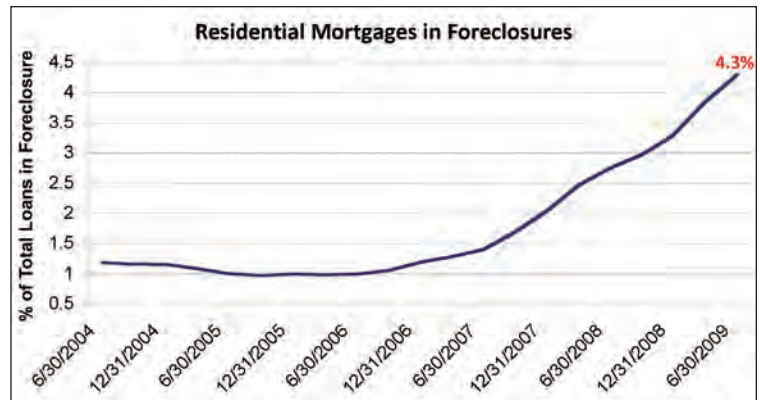
Given the rollercoaster year of 2009, the massive rally that the equity markets have experienced—particularly in financials—and the ongoing debate as to whether we have in fact entered a sustainable period of economic recovery or simply are in the midst of a bear market rally wrapped inside a continued downtrend, we thought it would be helpful to spend some time walking you through what we and, importantly, some other knowledgeable people in the financial industry really believe is occurring. Specifically, given our long track record and expertise in the financial and real estate realms, we wanted to discuss some of the fundamental underpinnings of what is occurring at the ground level of the financial system, real estate markets, and, in our view, the economy as a whole.

The Housing Market Remains on Shaky Footing Despite Unprecedented Government Intervention

A number of datapoints over the last few months that some interpreted as indications that the housing market may have stabilized was the first and most pronounced signal to many to support the view that the economy had bottomed and is now turning. While many people have excitedly focused on the seasonal uptick in sales activity and the recent month-over-month increases in the S&P/CaseShiller home price index over the last four months as signs that the housing market is improving, we believe that there are some other important data points that people are overlooking.

In our view, there are three basic reasons why sales activity has picked up and home prices in a number of markets have flat lined over the last six months. First and foremost were the various mortgage foreclosure moratoriums that were put in place at both the national and state levels as well as a variety of other measures enacted by individual states and financial institutions themselves that have delayed the foreclosure process and temporarily kept those homes off of the market. Second was the Federal Reserve's mortgage-backed securities (MBS) purchase program, which artificially compressed mortgage rates to historically-low levels and greatly improved affordability. Third, there were the first-time home buyer tax credits that were put in place at the national level and in many states (e.g., California). However, when analyzed in more detail, it is our view that all of these programs and plans will only end up having a temporary impact on the housing market and end up being rather short-term in nature—particularly as many of them wind down and come to an end.

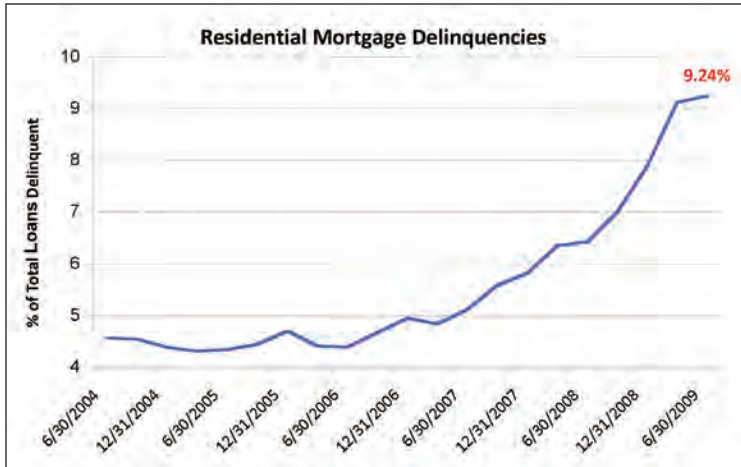
We would first ask you to consider the following graph of mortgage foreclosure activity:



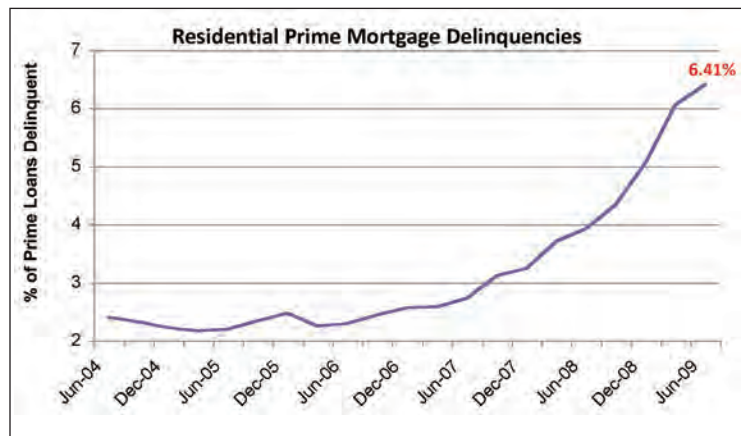
(Source: MBA, Bloomberg)

The level of homes currently in the foreclosure process is obviously unprecedented. Yet, consider what those numbers would look like and how the housing market would have fared if the foreclosure moratoriums were not in place and the foreclosed homes that have been backed up in the system and sitting on banks' balance sheets had actually been on the market for sale? It is highly unlikely that prices would have shown the recent degree of "stabilization" observed in the market. To understand the true level of "shadow inventory" of foreclosed homes that have yet to make it through the system in most markets, we would encourage you to click [here](#) to read a report by Amherst Securities, which, in our view, is one of the best pieces we have seen on the housing market and housing inventories in quite some time. In this piece, Amherst estimates that **7 million loans are now in some form of delinquent status or in foreclosure (close to 13% of all mortgages)—thereby creating a massive housing overhang.**

Further, with nearly 1 in every 10 mortgages currently delinquent and 1 in every 7 mortgages now either delinquent or in foreclosure (figures that are both on the rise), many homeowners are left in an extremely uncompromising position. Importantly, as we have highlighted in the past (and is shown in the graphs below), this is also clearly not just a subprime and Alt-A borrower phenomenon at this point—with significant deterioration now evident amongst prime borrowers, as well. As a result, future foreclosure and distressed sale trends will put further pressure on home prices and the overall housing market.

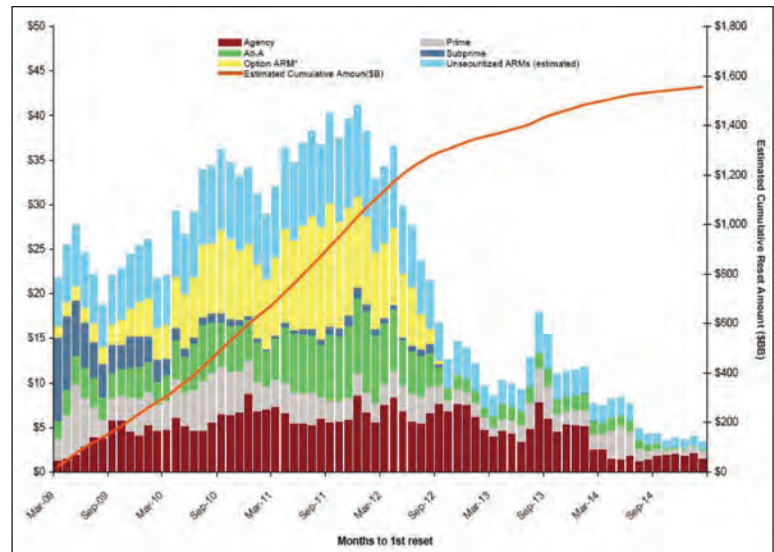


(Source: MBA, Bloomberg)



(Source: MBA, Bloomberg)

What most people also do not fully appreciate is that, given the already 30% nationwide decline in housing values from the July 2006 peak, 1 in every 4 homes is now worth less than the current mortgage—a ratio that Deutsche Bank disturbingly estimates could reach 48% by 2011 (please click [here](#) to refer to the report for more details). As illustrated in the chart below, what is even more daunting for homeowners and the housing market is that **cumulative mortgage resets could reach nearly \$1.2 trillion by 2012**, which, despite the currently low level of interest rates, will lead to significant payment shock for many borrowers as the massive amount of Option ARM and interest-only loans move into their amortization periods. Consequently, with such a large number of homeowners now underwater—and more every month hitting a significant pricing shock as their mortgages reset—the future prospects for the health of the housing market and homeowners will likely not improve for some time.



(Source: Credit Suisse)

Now, on top of the negative dynamics we have outlined in the graphs above, we would ask you to also consider the additional impact on housing affordability and the overall housing market that a rise in mortgage rates off of the current historical low levels would have—a prospect that is surely possible once the Federal Reserve finally winds down its MBS purchase program and/or longer-term rates begin to rise as inflation picks up or foreigners are no longer as willing to support our massive budget deficits. To say the least, the effects would be devastating.

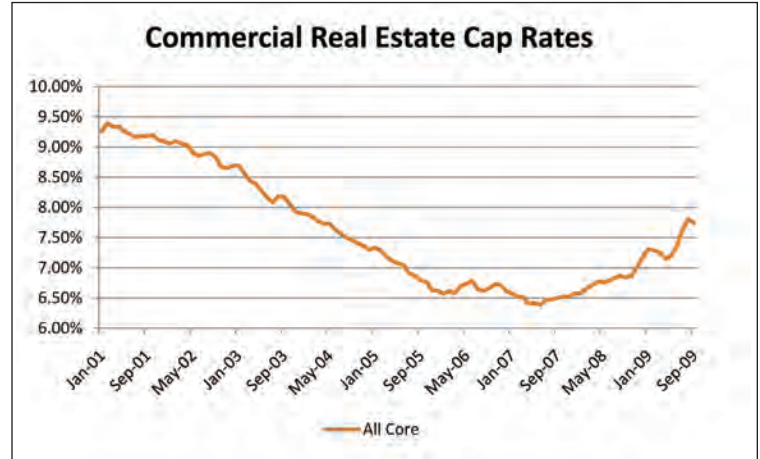
While we fully recognize that the government and the banks are aggressively working to modify mortgages in an attempt to stave off the current wave of defaults and prevent a further downturn in the housing market, it is also important to understand that, to date, **approximately 60% of modified mortgages redefaulted within six months** (please click [here](#) for more details). Clearly, without significant debt forgiveness—which would be devastating to most lenders and mortgage investors—the prospects for the current modification efforts are not all that promising.

Commercial Real Estate Remains One of the Next Big Problem Areas for Banks and the Overall Economy

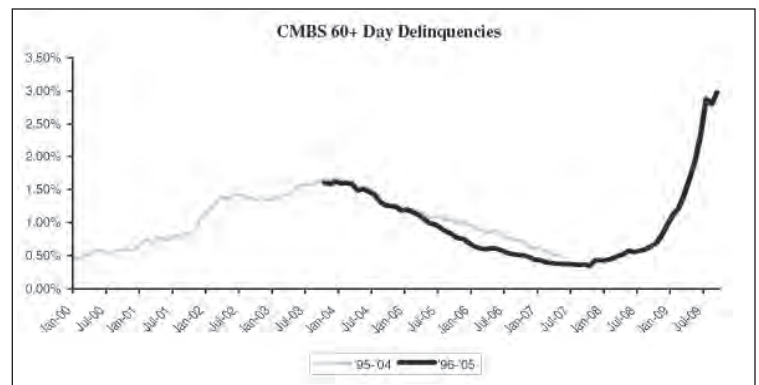
While the housing market is still in a very precarious position, the commercial real estate market is obviously not far behind. Although everyone seems to agree that commercial real estate is now under significant stress and is continuing to deteriorate, there is also a substantial disconnect as to the degree to which that weakness will impact financial institutions and the broader economy.

Further, there has been an even more extreme disconnect with how those assets have performed in the capital markets (i.e., CMBS and REIT equities) in light of this deterioration. To put the commercial real estate market into perspective, while it is not as large as the \$11 trillion residential mortgage market, at \$3.7 trillion, the commercial mortgage market is substantial enough that a severe contraction—one that has already begun—would have a devastating impact on an already weakened financial system and the economy as a whole. It is amazing that peoples' memories are so short today as not to remember that it was the commercial real estate collapse in the late 1980's and early 1990's that was the dominant reason that 784 banks and thrifts failed during that era.

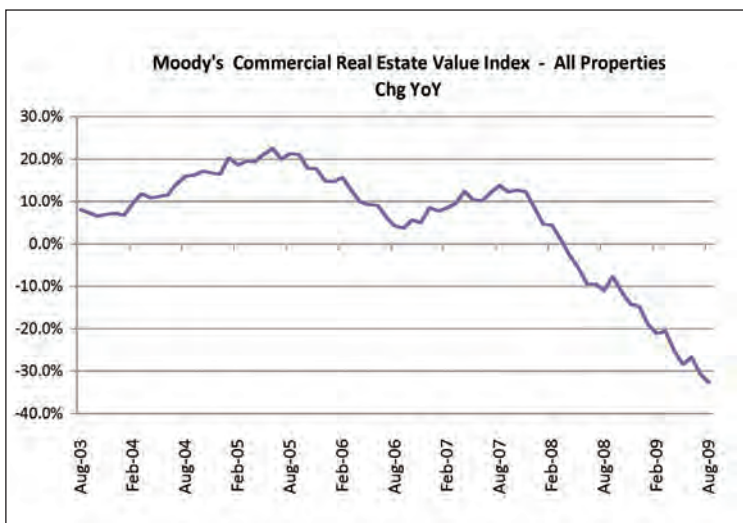
Like the residential housing market, the commercial real estate sector went through a similar dynamic of ever-escalating prices, combined with increasingly loose underwriting standards. Capitalization rates, which are the key valuation metric for commercial real estate, compressed to historically low levels from late 2004 through 2007. As a result, with cheap and easy financing readily available and valuations continuing to move higher, commercial developers started to provide a significant new supply of properties into a market that was not tight to begin with. Now, with deteriorating fundamentals driven by the current economic downturn, the increase in unemployment, rising vacancy rates, the contraction in available financing, and an increase in supply brought on at the peak of the market, the commercial real estate market and property values are now under significant pressure (as illustrated in the following graphs).



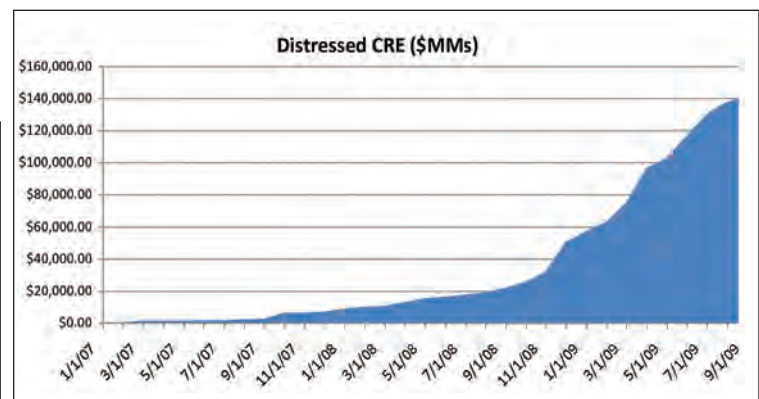
(Source: Real Capital Analytics)



(Source: Credit Suisse)



(Source: Moody's)



(Source: Real Capital Analytics)

Obviously, this is not a very pretty picture. Importantly, though, almost any commercial real estate professional will tell you that we are, unfortunately, just at the early stages of this cycle. The best way to demonstrate this is to more closely examine the commercial vacancy rate, as highlighted below. Now, some bulls will argue that we are just back to the 2003 highs in commercial vacancies, and, at that time, commercial real estate did not have

a significant negative impact on the economy. However, what these observers fail to understand is that the rate of unemployment had already peaked in 2003 and did not reach anywhere near today's levels. Further, financing costs for commercial properties had collapsed, where today financing costs have increased exponentially and, for many property types, financing is now nearly nonexistent with the collapse of the CMBS market and the devastation that has already occurred in the banking industry. What is also important to understand is that the banking industry's balance sheet had not already been destroyed by losses from residential real estate loans in 2003; in fact, the exact opposite occurred, which provided a base to help absorb commercial real estate losses.



(Source: Bloomberg)

Unfortunately, in light of these negative dynamics, and the fact that over \$2 trillion in commercial mortgages are estimated to mature between late 2009 and 2013, the commercial real estate market will remain under significant stress for years to come. This will obviously put additional pressure on bank balance sheets and result in huge losses for investors. That said, many parties argue that the banks will simply make modifications to existing loans instead of recognizing these losses (particularly in light of a recent policy statement from the FDIC—which you can access by clicking [here](#)—that appears to give the banks a bit more wiggle room when it comes to dealing with problem CRE loans). However, what these people fail to understand is that the cash flows from many commercial real estate (CRE) projects are collapsing at enormous speeds, which makes a modification of these loans without taking substantial principal losses for the investors and banks extremely difficult to achieve. So, while the new FDIC policy statement may provide a stronger basis for not taking a loss on a loan solely because the value of the underlying

property has declined below the loan value, it does not provide much, if any, flexibility for the increasing number of situations where the cash flows simply no longer support the interest payments and ultimate repayment of the loan. Moreover, that argument ignores a simple fact: when a borrower knows the value of their property has declined to such an extent that they will likely remain underwater on their mortgage for the foreseeable future, they have very little—if any—motivation to continue to make payments on that loan unless they have personally guaranteed it or it is an owner occupied building that is the primary location of their business.

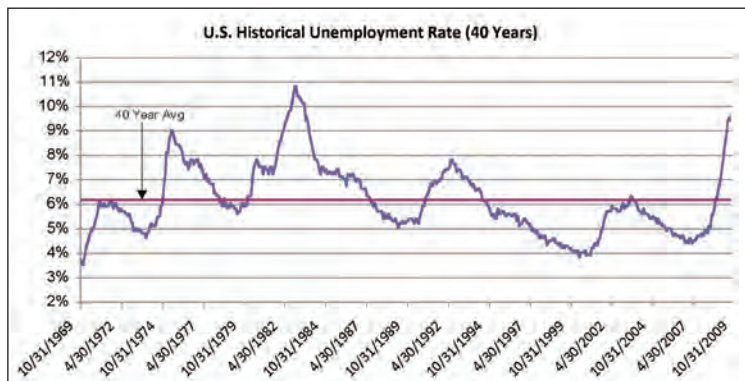
Importantly, despite this recent “guidance,” it also remains somewhat unclear as to how “flexible” and “forgiving” the examiners on the ground level are truly going to be when it comes to dealing with the banks and their problem CRE loans during their exams. In fact, it was just a month or so ago when stories—such as the one found by clicking [here](#)—started circulating that another regulatory agency, the Office of the Comptroller of the Currency (OCC), was considering implementing a stronger directive that would push the banks to become much more aggressive in writing down their problem CRE loans and getting them off their books. Further, if you look closely at the FDIC’s recent announcement, it cites that in order for the banks to make any of the problem CRE loan adjustments, an assessment first has to be made of the borrower’s credit worthiness and of their “willingness and capacity to repay the loan.” Again, as we just mentioned above, with many borrowers underwater on their mortgages they have little to no motivation to continue to make payments on that loan. Consequently, the language, as currently worded in this directive, provides a wide level of discrepancy for the onsite examiners not to deem many of these modifications allowable based upon the financial health of the borrower. As such, we urge bankers and investors alike to not rush to judgment at this point and assume that the regulators are simply going to give banks a “free pass” when it comes to dealing with the growing number of underwater mortgages on their books and properties that can no longer service their debt burdens.

The Severely Weakened Consumer Has a Long Way To Go Before They Can Lead This Economy Forward

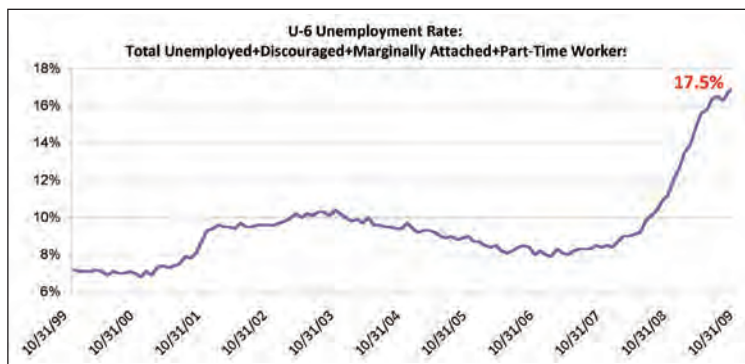
Representing 70% of U.S. economic activity, the U.S. consumer is undoubtedly the most vital cog in the overall economy. However, with the worst housing crisis since the Great Depression and the unemployment rate at

10.2%, the consumer is under severe financial stress. To make matters even worse, consumer credit has been contracting at a record pace, which clearly is a hindrance to any sustainable economic recovery. Please refer to our *September 2009 Monthly Overview* for more on this trend.

Amidst a severely weakened economy, businesses have been forced to conduct massive layoffs to the tune of over seven million workers since the official beginning of the downturn in December 2007. While many people focus on the stated unemployment rate, we feel that it is even more important to look at the “real” unemployment rate. This level, which includes those marginally employed and people who have stopped looking for work altogether, is now an astounding 17.5%.



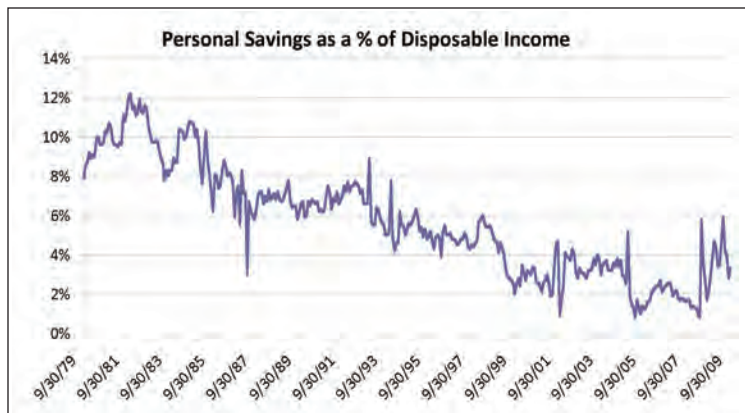
(Source: Department of Labor; Bloomberg)



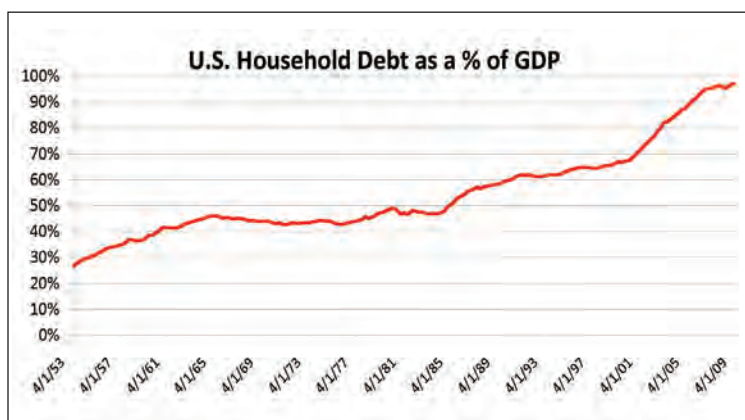
(Source: Department of Labor; Bloomberg)

If it is not bad enough that the labor markets have been contracting so severely, what is even more disconcerting is the utter lack of jobs available, as businesses are simply not hiring workers—let alone adding the 150,000 or so employees required each month for the economy to be functioning at a normal pace. **In fact, over 56% of those unemployed have now been without work for at least 15 weeks and 36% have been so for at least 27 weeks. This unfortunate dynamic has contributed to a social breakdown in some of the hardest hit regions in the U.S., as a shocking 1 in every 9 Americans is on food stamps.**

The financial pressures facing the U.S. consumer amidst the housing crisis and the mounting job losses have obviously done nothing to help household balance sheets, as the consumer has still not come close to “delevering” to the extent needed. Even with the savings rate now in the 3% to 4% range (as shown in the first chart below)—which remains well below the 30-year average of almost 6%—the U.S. consumer is still burdened by massive amounts of debt (as shown in the second chart below).

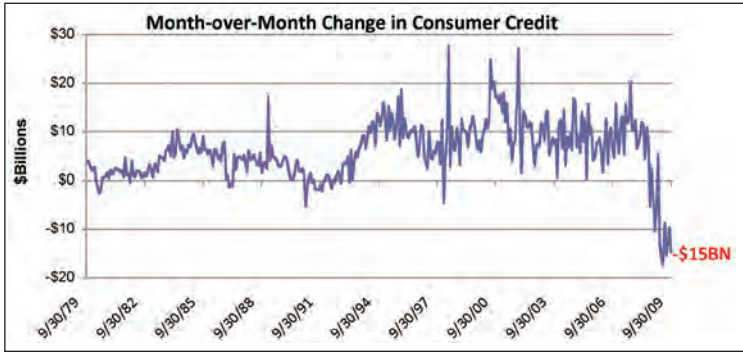


(Source: Bloomberg; Bureau of Economic Analysis)



(Source: Department of Commerce)

Additionally, what will only further compound the mounting challenges now facing the consumer is the collapse in credit that has accelerated at all levels. We have now had an unprecedented eight consecutive months of consumer credit contraction—with the last three months contracting by \$13 billion, \$10 billion, and, most recently, in September, \$14.8 billion, respectively. Therefore, absent the inexpensive and readily available credit of the last 30 years, we find the whole argument highly unconvincing that the U.S. consumer (and its spending habits) is going to resume its role as the consumption machine for not only the U.S. economy, but for the global economy as well.



(Source: Federal Reserve; Bloomberg)

Health of the Financial System: Don't Let Higher Stock Prices Fool You Into Thinking We Are Already Out of the Woods....

No sector has experienced a greater rally in the equity markets since the March 2009 lows than financials. In our view, this sharp rally has caused most people to mistakenly believe that the financial sector is now out of the woods and

that credit quality and profitability will soon return to normal levels. If there are any misperceptions in the equity markets today, this may be the greatest one. Fundamentally, banks are levered to the assets that they have lent on and, as we have already described above, those “assets”—housing, commercial real estate, business loans and consumer credit—remain under significant strain. To illustrate this, we have outlined in the table below the level of nonperforming assets (NPAs) and the rate of credit deterioration for the entire banking industry from the second quarter to the third quarter 2009. With nearly all of the call reports filed by publicly traded banks and thrifts, we would encourage you to look particularly closely at the rate of increase in NPAs and 90-day delinquencies (NPAs+90s)—excluding troubled debt restructurings (TDRs)—which experienced a 11.2% quarter-over-quarter increase. What is important to understand is that this percentage increase occurred on what was already an extremely large base of NPAs.

	2009Q3	2009Q2	% Chg	% Delinq
NPA+90s (excl TDRs)	341,292,061	306,999,814	11.2%	
NPA+90%	4.77%	4.25%	8.8%	
30-89s	120,400,359	117,954,160	2.1%	
30-89%	1.77%	1.69%	1.5%	
Charge-offs	48,440,418	46,582,309	4.0%	
LLR%	3.22%	3.00%	4.2%	
Res Cov'g of NPA+90s (excl TDRs)	67%	70%		
construc'n NPA+90s	64,788,857	63,003,555	2.8%	
construc'n 30-89s	10,548,250	11,262,929	-6.3%	
	<u>75,337,107</u>	<u>74,266,484</u>	1.4%	21.4%
multifam NPA+90s	6,821,017	6,207,170	9.9%	
multifam 30-89s	1,817,749	1,858,777	-2.2%	
	<u>8,638,766</u>	<u>8,065,947</u>	7.1%	5.0%
income property NPL+90s	18,152,207	14,804,017	22.6%	
income property 30-89s	5,579,997	5,331,810	4.7%	
	<u>23,732,204</u>	<u>20,135,827</u>	17.9%	5.7%
owner-occ'd NPL+90s	9,776,754	8,574,394	14.0%	
owner-occ'd 30-89s	3,826,735	3,167,361	20.8%	
	<u>13,603,489</u>	<u>11,741,755</u>	15.9%	3.6%
C&I NPL+90s	41,158,436	33,815,140	21.7%	
C&I 30-89s	9,973,661	10,237,155	-2.6%	
	<u>51,132,097</u>	<u>44,052,295</u>	16.1%	4.6%
HELOC NPL+90s	11,049,829	10,958,573	0.8%	
HELOC 30-89s	8,313,661	7,717,357	7.7%	
	<u>19,363,490</u>	<u>18,675,930</u>	3.7%	3.2%
2nd lien NPL+90s	5,668,409	5,870,304	-3.4%	
2nd lien 30-89s	4,512,924	4,475,779	0.8%	
	<u>10,181,333</u>	<u>10,346,083</u>	-1.6%	6.3%
RFM NPL+90s	133,391,852	114,560,290	16.4%	
RFM 30-89s	48,259,739	47,383,166	1.8%	
	<u>181,651,591</u>	<u>161,943,456</u>	12.2%	12.8%
Card NPL+90s	10,857,861	12,122,157	-10.4%	
Card 30-89s	10,107,247	9,444,435	7.0%	
	<u>20,965,108</u>	<u>21,566,592</u>	-2.8%	6.6%

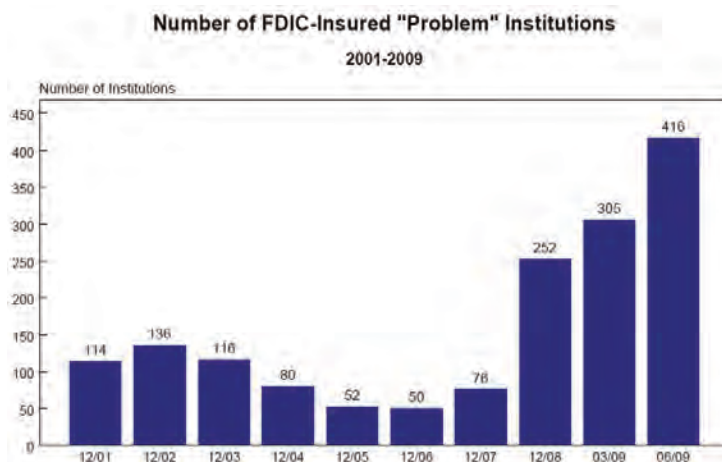
(Source: SNL Financial; Hovde)

Moreover, it is important to recognize that the banking industry has been extensively engaging in what we would call “modify and deny” or “extend and pretend.” What this implies is that banks are trying their best to avoid recognizing the full depths of their credit problems and are aggressively altering loan terms in an effort to push those ultimate losses out to another day. This can be done by making a new loan to fund payments on an existing loan, modifying loan terms and repayment schedules, or not recognizing losses on a loan despite the fact that it is only being funded by interest reserves (money initially set aside to make interest payments for a short period of time when there is insufficient cash flow to do so) even when the underlying collateral has been impaired. Beyond the dozens of real life examples that we see and hear about all the time, the regulators are finally beginning to put the banks on notice that they can no longer fail to recognize losses on impaired collateral solely because funds being released from the established interest reserve have allowed the loan to remain “current” on its interest payments for some period of time.

Probably the best way to demonstrate what is occurring is to draw your attention again to the banking industry credit quality table included above. We would encourage you to look at the delinquency rates of HELOCs (revolving home equity loans that are typically in a second or third lien position), second liens (i.e., second mortgages), and finally RFMs (residential first mortgages). If you look closely, you will notice a very strange anomaly with what is happening among those three categories. Specifically, while the overall delinquency rates of RFMs were up to 12.8% (and increased by 12.2% quarter-over-quarter), the delinquency levels were only 6.3% for second liens and 3.2% for HELOCs—half to a third of the delinquency rate of first mortgages. Does this make sense? Quite simply: no, it does not. The reason that this is occurring is simple: because most home equity loans and second liens have smaller balances, are initially non-amortizing and are tied to low short-term interest rates, banks have had much more latitude in making modifications and adjusting payment terms for these loans to keep them “current,” even when the first mortgage is not performing. Like the games being played with interest reserves by many banks, the regulators have also now started to figure this “strategy” out and recently put out a notice to bankers (please click [here](#)) essentially telling them that, if the first mortgage is impaired, they need to start recognizing some level of impairment on second and third-lien mortgage positions even if they are still current on their interest payments. That said, one of the most telling signs that the

“denial” game is well underway (and that regulators are gradually catching on) is to track what is typically happening to individual banks’ earnings results immediately after their latest regulatory exam. Almost invariably, banks will take significantly higher provisions and charge-offs than in past quarters and, in many cases, may even have to restate prior numbers to reflect additional credit problems.

As a result of this ever-increasing credit deterioration—whereby the banking industry has had double digit increases in NPAs over the past 14 quarters—the rate of troubled banks is increasing at an alarming pace, as illustrated by the next graph below. Further, we believe that the FDIC’s measurement of “problem” institutions dramatically understates the real level of problem banks in the industry. That is because if you use a more accurate indicator of the true stress that is enveloping the banking industry, such as a “Texas” ratio (NPA+90s as a percentage of tangible equity and reserves), it would indicate that there are over 1,200 banks and thrifts that are in trouble (i.e., a Texas ratio greater than 50%). Consequently, there have been 123 FDIC bank failures year-to-date—by far, the most since the early 1990’s. In fact, the 28 bank failures since just the beginning of October exceed the 25 failures which occurred in all of 2008. Additionally, the banks being taken over by the FDIC are not just smaller community banks but have now begun to include larger regional banks such as FBOP Corporation with \$19.4 billion in assets taken over at the end of October and, recently, United Commercial Bank with \$11.2 billion in assets.



(Source: FDIC)

One final item we would like to address on the credit quality front in the banking system is the recent syndicated loan review that is done annually on a joint basis by all of the

banking regulators. For your reference, a syndicated loan is simply a loan of \$20 million or more that is syndicated and split up between at least three parties (typically to domestic and foreign banks, mutual funds, and hedge funds). Quite simply, the rate of deterioration in these loans was staggering, with the total level of “classified” loans tripling to 15.5% of the total syndicated loan market; if you also include “special mention” loans that are likely to soon fall into distress, that number was an astounding 22.3%—please click [here](#) to refer to an article with more details. These are the worst annual numbers that have ever been reported and easily surpass those seen during the last banking collapse of the late 1980’s and early 1990’s.

Frankly, the most ironic part of this massive rally is that it was only six short months ago that we were on the verge of a near collapse of our financial system. Yet, within the span of only two quarters, investors now believe that financial companies’ balance sheets and earnings are almost back to normal or soon will be. At times like this, we find that it is often helpful to study history and, in this case, to look back at the last banking collapse which occurred during the late 1980’s and early 1990’s. As we explained earlier, that crisis was largely caused by a collapse of the commercial real estate market during which 784 banks and thrifts failed from the beginning of the crisis in 1987—which started in Texas—to 1995, when it finally ended in California. Notably, the reason that banking crises take so long to play out is that there is a substantial lag affect between what happens in the real economy and when banks finally recognize the full degree of losses on their balance sheets. As such, while it has been painful to be positioned short amidst this massive rally in financials, we are confident that it remains the right positioning, as investors will ultimately have to digest the reality of the situation as it unfolds over the next year.

New Legislative and Regulatory Environment Will Likely Pressure the Financial Industry and Equity Markets

One other major issue that we do not believe the markets have come to appreciate is the significant legislative and regulatory changes that our financial system will be forced to operate under in the future. For almost 16 years during the W. Clinton and G.W. Bush presidencies, the financial system, and, particularly, the banking industry and Wall Street, operated with little to no oversight or regulatory costs. In addition, for the past eight years, taxes, as a whole, have been reduced—with some areas, such as taxes on long-term capital gains and corporate dividends, seeing significant cuts. It is our view that, in both of these cases,

the government pendulum has begun to swing, and swing hard. From a regulatory perspective, a meaningful change is already underway. The days of the banking industry being able to push back on new regulations with ease, are now over. Further, the regulatory examination process has now become a very grueling experience for most banks. Even Wall Street, which has, in our opinion “owned” Washington, D.C. most of those 16 years, is now having to deal with potentially significant oversight. As such, a variety of government regulatory agencies are examining ways to deal with issues, such as greater capital requirements, restrictions on commodities speculation, the establishment of central clearing of credit default swaps (CDS), a review of high-frequency trading, etc.—all of which will likely lead to a significantly greater regulatory burden and lower levels of profitability

From a legislative standpoint, the changes are slower to take place, but the tone has clearly changed. We fully expect new legislative laws to be enacted that will also put pressure on financial industry profitability. As we have already seen, Congress has passed changes to the billing practices of credit card companies and is currently considering a new law addressing abusive overdraft fees as well as a bill regarding interchange fees for debit and credit card processing. Possibly, the most significant change Congress is proposing is the creation of a Consumer Protection Agency that would regulate all new consumer financial products. The impact of these regulatory and legislative changes will be, without question, significant. As an example, it is estimated that the changes Congress is proposing for overdraft fees (fees which became egregious) will reduce the overall level of deposit fees by 25% for the large banks. Another clear example is the new capital requirements for the large banks, some of which were levered an amazing 40-to-1. At a minimum, many of these banks will have to carry twice the amount of capital in the future, which will cut their ultimate ROEs in half, even when the economy and credit return back to “normal”. From every vantage point, the business model of many of these companies will become far less profitable, and yet, many buy-side and sell-side analysts are projecting that these companies will quickly return to their former levels of profitability.

Lastly, another significant weight on financials, the business community, and the economy as a whole will be the cost of this new regulatory oversight and additional taxes. For the banks, FDIC insurance premiums will either be meaningfully increased or the industry will be continuously hit by special

assessments—such as those which occurred in the second quarter of 2009. New costs are being added regularly to the oversight process in almost every industry. Even more significant are the variety of new taxes that are now being discussed in Congress. Clearly, the Bush tax cuts related to higher-level incomes, capital gains, and dividends will be allowed to expire at the end of 2010. Additionally, new federal taxes are being discussed that would add taxes onto all financial transactions, premium health care plans, carried interest of hedge and private equity funds, and even on items such as soda and juices. With the annual federal deficit having exploded to over \$1.4 trillion in 2009 and cumulative U.S. debt at nearly \$12 trillion (for a truly disturbing picture of what we are up against, please visit www.usdebtclock.org), there is only one probable outcome for tax rates—and that is up.

The Federal Reserve Continues to Provide a Temporary Lifeline to the Economy and Financial Markets

In an attempt to minimize the fallout from the greatest economic collapse since World War II, the Federal Reserve, Treasury, and various government organizations have taken extraordinary steps not seen before.

The Federal Reserve has more than doubled its own balance sheet from approximately \$940 billion to \$2.2 trillion since this crisis began to accelerate in severity in September 2008. Additionally, the Federal Reserve, Treasury, and FDIC have established funding commitments or guarantees totaling an estimated \$10 trillion, as outlined in this recent [report from Keefe, Bruyette and Woods](#). On top of all of that, the Federal Reserve moved to a quantitative easing policy in March 2009, which effectively took short-term interest rates to zero and had the Federal Reserve monetizing the federal government's deficit spending. This, coupled with the federal government's escalating spending through its ever-growing annual budget and the \$787 billion stimulus package, delivered an historic injection of liquidity into the economy and the capital markets. Normally, if the Federal Reserve were to provide such a significant liquidity injection into the capital markets, that liquidity would find its way into the broader economy, as banks would lend that liquidity to businesses and consumers. However, that is not at all what has occurred this time around. Instead, due to a variety of factors that we discussed in more detail in our [September 2009 Monthly Overview](#), banks are now actually collapsing the amount of money they are lending out. As a consequence, this liquidity has not been absorbed into the real economy but, instead, has cycled through into a

ballooning of the excess reserves at the Federal Reserve from \$60 billion a year ago to \$987 billion today. In turn, this has helped provide the Federal Reserve with the ability to purchase \$300 billion of Treasuries and a planned \$1.25 trillion of MBS (\$975 billion of which has been purchased to date). Consequently, rather than making its way directly into the economy where it would be most helpful, this liquidity has more or less stayed within the capital markets, where it has simply helped to “bid down” credit spreads and “bid up” equity values.

As we hope we demonstrated above through our discussion of what is truly happening with the real estate markets, the consumer, and the health of the financial services sector, we believe that there is little fundamental basis for the degree to which the equity and credit markets have rallied beyond the fact that the risk of a systemic failure of our financial system has been at least removed for now. Therefore, as discussed above, we believe that the key driver of this massive rally has been the injection of over \$1 trillion of liquidity into the capital markets, which, in turn, also ignited a huge short-covering rally. This rally then fed on itself as it helped create a renewed sense of confidence among investors and market participants that ultimately led to a return of risk-taking, which has only been further supported as the equity markets have continued to rise. In essence, we feel as if we are back to a period very similar to the early 2000's when the markets were rising simply because they were rising.

One of the most glaring pieces of evidence to support our view that we are in the midst of a manic market is the extreme level of valuations—with the S&P 500 Index now trading at an astounding 140x trailing 12-month reported earnings. Even based on what we feel are optimistic forward estimates for 2010 earnings (which we can assure you are outrageously optimistic for the financial sector), the S&P 500 is still trading at over 16x, well above the historical average of 14x. We would urge you to read [this piece by David Rosenberg](#), the former Chief Economist at Merrill Lynch, to delve into this valuation issue in more detail. What is surprising to us is how little most investors are looking back at history to put this rally into perspective. As we pointed out at the time we released our July 2009 investor update, the equity markets had already rallied 46% off of the lows—surpassing even the 1933 historic rally. Now that the rally has gone even further, with the market up 64% in just eight months, it has surpassed all other previous rallies in both its speed and magnitude. Why do we find this relevant? Put simply, it demonstrates the classic

characteristics of a bear market rally. Bear market rallies tend to have two dynamics. One, the moves are very rapid and are almost always straight up or hyperbolic—much different than classic longer-term bull markets, which tend to grind slowly higher and, along the way, have a number of periods of retrenchment. Two, bear markets tend to be led by very low-quality/high-beta companies, which massively outperform high-quality companies. Both of these dynamics have clearly played out in this rally. Another troubling sign is that trading volumes continue to decline as the market makes new highs—even in light of the unprecedented level of high-frequency trading that has dominated the equity markets recently. Also troubling is the massive level of correlation that has developed between the dollar, commodities, credit spreads, and equities, even when some of these correlations make little to no fundamental sense (e.g., oil prices moving up and financial stocks rallying).

Thus, if history can be used as a helpful guidepost, these dynamics do not auger well for this rally. In particular, we would encourage you to look at the numerous rallies that took place amidst the Great Depression and in the Japanese bear market of the 1990's, which had some or all of these same characteristics and, importantly, all ended up reversing course at some point with the markets ultimately moving back down. During the Great Depression, there were five such rallies of between 23% and 48% and, since Japan's real estate and equity market collapse, there have been four rallies of at least 50%—as shown here. Obviously the reason why we highlight the rallies that took place during these two timeframes is that they also occurred during periods of severe economic distress that were caused by an explosion of an unprecedented credit and asset valuation bubble. The tight correlation between a variety of different asset classes that we discussed above is also disturbing because history has typically shown that when certain markets become highly correlated and that correlation starts to unravel, it tends to do so in a disorderly fashion with markets overshooting in the opposite direction.

Please do not misinterpret this discussion as meaning that we have now become market strategists or technicians. We are simply students of economic history and cannot help but draw correlations to the current market environment. Far more important to us than the nature of this rally is the fact that this market will soon have to digest one of two clear outcomes. Either the unprecedented stimulus pumped into the economy actually gains meaningful traction and leads banks to begin lending again—which, given the

massive increase in the money supply and liquidity, would quickly lead to a period of hyperinflation. Or, the stimulus does not ultimately take hold and economic weakness continues. The outcomes of either of these scenarios will likely be extremely damaging to the equity markets. If the economy begins to recover and inflation starts to surge, the Federal Reserve will almost certainly be forced to immediately start raising rates and pulling stimulus from the system. Importantly, the last time the Federal Reserve had to aggressively address surging inflation as a result of an overly active government and persistently low interest rates (which is nothing compared to the level of stimulus today) was between 1981 and 1983—which was followed by a very damaging recession and a decline in almost all asset prices. That said, given the multitude of reasons we have previously discussed in this and other pieces as to why we expect economic weakness to persist for some time, we believe this outcome to be less likely. However, the other probable outcome is just as bad and, likely, much worse. As the stimulus begins to fade and economic weakness persists, corporate earnings will not rebound as expected, financial balance sheets and earnings will continue to suffer, and employment trends and consumer spending will deteriorate further. Clearly, if this dynamic plays out, the equity markets and financial stocks, which we believe are wildly overvalued, will roll over hard. The economy is rapidly approaching the inflection point that will determine which one of these paths the economy and markets will take.

In conclusion, despite our negative views and the length of time that we have remained bearish on the overall state of the economy and financial markets, we are by no means “perma-bears” who are dogmatically locked into our opinions and enjoy constantly having a negative view on the markets. In fact, for the sake of everyone in this country, we truly hope that things will soon turn for the better. However, until we do finally see things starting to turn—such as property values truly stabilizing absent a significant amount of government intervention and consumer and financial balance sheets actually improving—we cannot simply ignore the various data points and trends which indicate that the economy continues to face many headwinds and will likely not sustain a meaningful recovery until these subside. Accordingly, as we have shared before, we would encourage you to hope for the best but prepare for the worst.

Federal Reserve Aggregate Bank Data

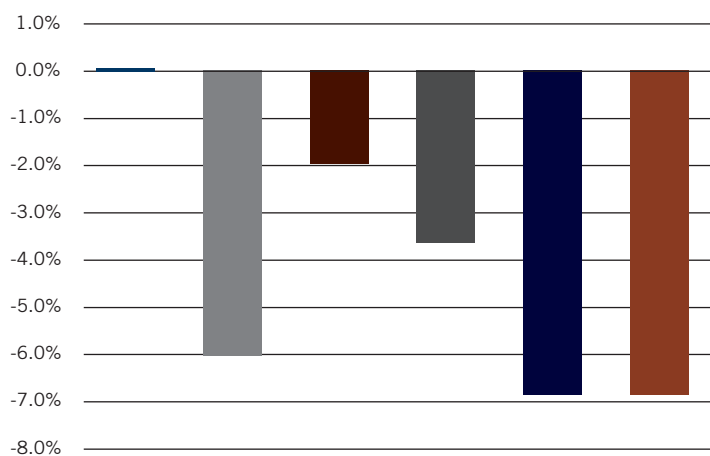
	9/2008	1/2009	2/2009	3/2009	4/2009	5/2009	6/2009	7/2009	8/2009	9/2009	MoM	YoY
ASSETS												
Securities												
Secs in Bank Credit	2,532	2,113	2,134	2,166	2,184	2,210	2,259	2,280	2,315	2,320	0.2%	-8.4%
Treasury & Agency	1,155	1,269	1,259	1,273	1,262	1,266	1,300	1,324	1,361	1,384	1.7%	19.8%
Other	1,377	844	875	893	922	944	958	956	954	936	-1.9%	-32.0%
Loans and Leases												
C&I	1,537	1,602	1,587	1,563	1,544	1,527	1,504	1,489	1,452	1,412	-2.8%	-8.2%
Real Estate	3,666	3,803	3,818	3,828	3,834	3,882	3,868	3,840	3,820	3,776	-1.1%	3.0%
Consumer	852	871	882	874	863	863	860	850	847	849	0.2%	-0.4%
Other	655	909	895	866	845	876	860	801	758	759	0.2%	16.0%
Other Assets	1,043	1,134	1,145	1,163	1,127	1,143	1,173	1,140	1,112	1,107	-0.4%	6.1%
Total Assets	11,333	12,179	12,031	12,085	12,054	12,151	12,024	11,869	11,807	11,773	-0.3%	3.9%
LIABILITIES												
Deposits												
Large Time	2,161	1,891	1,845	1,815	1,840	1,870	1,885	1,907	1,908	1,883	-1.3%	-12.9%
Other	4,271	5,379	5,422	5,486	5,482	5,589	5,644	5,611	5,647	5,712	1.1%	33.7%
Borrowings	2,397	2,403	2,429	2,440	2,407	2,420	2,361	2,246	2,156	2,047	-5.1%	-14.6%
Other Liabilities	715	447	439	442	429	437	464	452	413	415	0.5%	-42.0%
Total Liabilities	10,122	10,969	10,795	10,814	10,813	10,887	10,809	10,639	10,556	10,537	-0.2%	4.1%
Residual (assets less liabilities)	1,211	1,211	1,236	1,271	1,242	1,264	1,215	1,231	1,251	1,236	-1.1%	2.1%

all values in \$ billions

SOURCE: Federal Reserve Documents

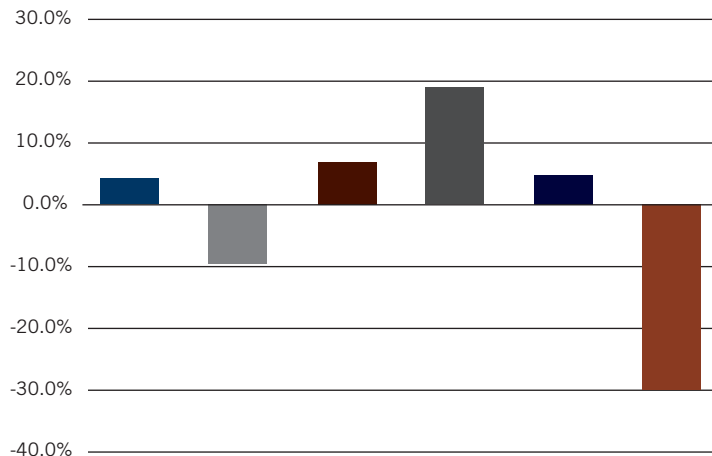
Major Market Index Performance

October 2009



SOURCE: Bloomberg, LLC

Last Twelve Months



SOURCE: Bloomberg, LLC

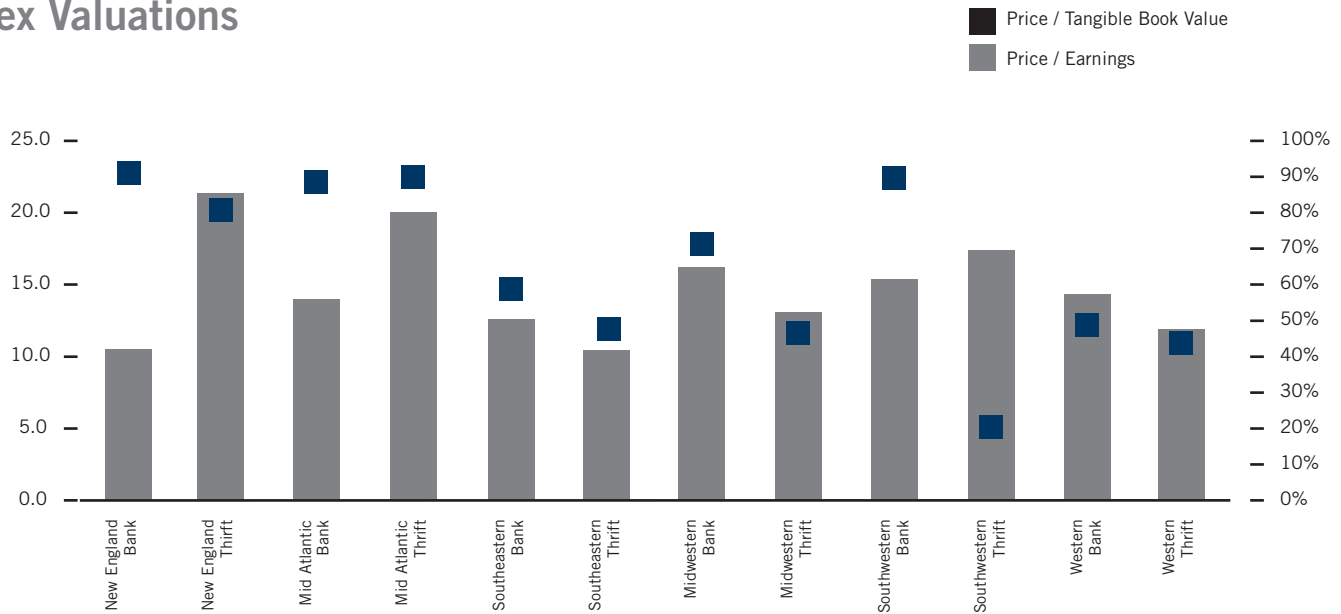
	11/2008	12/2008	1/2009	2/2009	3/2009	4/2009	5/2009	6/2009	7/2009	8/2009	9/2009	10/2009
Dow Jones	-5.3%	-0.6%	-8.8%	-11.7%	7.7%	7.3%	4.1%	-0.6%	8.6%	3.5%	2.3%	0.0%
S&P Financial	-18.7%	-0.7%	-26.5%	-18.4%	17.7%	22.2%	13.1%	-2.2%	8.8%	12.9%	1.9%	-6.0%
S&P 500	-7.5%	0.8%	-8.6%	-11.0%	8.5%	9.4%	5.3%	0.0%	7.4%	3.4%	3.6%	-2.0%
NASDAQ	-10.8%	2.7%	-6.4%	-6.7%	10.9%	12.3%	3.3%	3.4%	7.8%	1.5%	5.6%	-3.6%
Russell 2000	-12.0%	5.6%	-11.2%	-12.3%	8.7%	15.3%	2.9%	1.3%	9.5%	2.8%	5.6%	-6.9%
NASDAQ Bank	-8.8%	-1.2%	-21.8%	-11.9%	8.1%	5.1%	1.7%	-4.1%	8.4%	0.6%	0.2%	-6.9%

SOURCE: Bloomberg, LLC

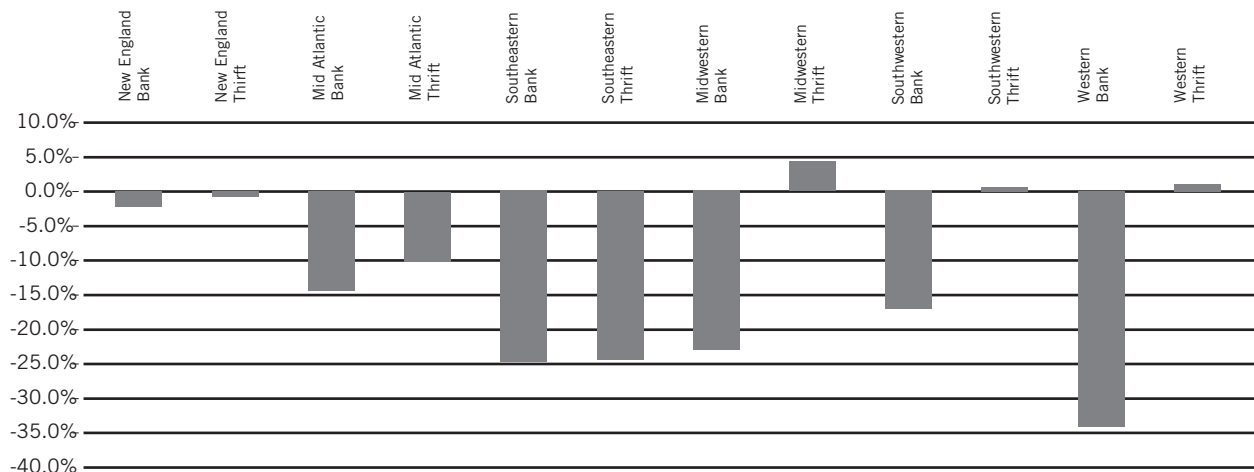
Bank and Thrift Index Valuations

		Price / Earnings		Price / Book Value		Price / TBV		Price Performance			Component Companies
		Weighted Avg	Median	Weighted Avg	Median	Weighted Avg	Median	1 Mo	YTD	12 Mo	
New England	Bank	9.7	10.5	84%	84%	124%	91%	-5.7%	-2.3%	-12.6%	20
	Thrift	26.9	21.3	81%	76%	101%	81%	-0.4%	-0.8%	-10.7%	22
Mid Atlantic	Bank	9.6	14.0	94%	82%	138%	89%	-6.7%	-14.4%	-23.6%	88
	Thrift	17.8	20.0	107%	78%	140%	90%	-3.8%	-10.1%	-16.2%	54
Southeastern	Bank	8.4	12.6	66%	53%	94%	59%	-10.7%	-24.8%	-34.7%	117
	Thrift	1.6	10.4	36%	41%	43%	48%	-9.1%	-24.4%	-37.4%	11
Midwestern	Bank	13.7	16.2	123%	58%	161%	70%	-8.4%	-23.1%	-32.8%	86
	Thrift	16.6	13.0	120%	46%	123%	47%	-7.1%	4.3%	-23.3%	43
Southwestern	Bank	9.3	15.3	100%	88%	123%	90%	-9.3%	-17.1%	-30.5%	20
	Thrift	15.1	17.4	101%	21%	103%	21%	-4.0%	0.7%	-6.1%	7
Western	Bank	6.5	14.3	84%	47%	65%	49%	-10.1%	-34.2%	-43.8%	64
	Thrift	14.4	11.9	57%	41%	62%	45%	-12.3%	1.1%	-14.7%	12

Index Valuations



YTD Price Performance



Economic Data Points - October 2009

Date	Event	Period	Survey	Actual	Prior	Revised	Date	Event	Period	Survey	Actual	Prior	Revised
10/1	Challenger Job Cuts YoY	SEP	--	-30.20%	-13.80%	--	10/15	Initial Jobless Claims	10-Oct	520K	514K	521K	524K
10/1	Personal Income	AUG	0.10%	0.20%	0.00%	0.20%	10/15	Continuing Claims	3-Oct	6000K	5992K	6040K	6067K
10/1	Personal Spending	AUG	1.10%	1.30%	0.20%	0.30%	10/16	Industrial Production	SEP	0.20%	0.70%	0.80%	1.20%
10/1	PCE Deflator (YoY)	AUG	-0.60%	-0.50%	-0.80%	--	10/16	Capacity Utilization	SEP	69.80%	70.50%	69.60%	69.90%
10/1	PCE Core (MoM)	AUG	0.10%	0.10%	0.10%	--	10/16	U. of Michigan Confidence	OCT P	73.1	69.4	73.5	--
10/1	PCE Core (YoY)	AUG	1.30%	1.30%	1.40%	--	10/16	Monthly Budget Statement	SEP	-\$31.0B	-\$46.6B	\$45.7B	--
10/1	Initial Jobless Claims	26-Sep	535K	551K	530K	534K	10/20	Producer Price Index (MoM)	SEP	0.00%	-0.60%	1.70%	--
10/1	Continuing Claims	19-Sep	6170K	6090K	6138K	6160K	10/20	PPI Ex Food & Energy (MoM)	SEP	0.10%	-0.10%	0.20%	--
10/1	ISM Manufacturing	SEP	54	52.6	52.9	--	10/20	Producer Price Index (YoY)	SEP	-4.30%	-4.80%	-4.30%	--
10/1	ISM Prices Paid	SEP	66	63.5	65	--	10/20	PPI Ex Food & Energy (YoY)	SEP	2.00%	1.80%	2.30%	--
10/1	Construction Spending MoM	AUG	-0.10%	0.80%	-0.20%	-1.10%	10/20	Housing Starts	SEP	610K	590K	598K	587K
10/1	Pending Home Sales MoM	AUG	1.00%	6.40%	3.20%	--	10/20	Building Permits	SEP	595K	573K	579K	580K
10/1	Pending Home Sales YoY	AUG	--	12.10%	12.90%	--	10/21	Fed's Beige Book	15-Oct	--	--	--	--
10/1	Total Vehicle Sales	SEP	9.50M	9.20M	14.09M	--	10/22	Initial Jobless Claims	17-Oct	515K	531K	514K	520K
10/1	Domestic Vehicle Sales	SEP	7.20M	6.80M	10.20M	10.19M	10/22	Continuing Claims	10-Oct	5970K	5923K	5992K	6021K
10/2	Change in Nonfarm Payrolls	SEP	-175K	-263K	-216K	-201K	10/22	RPX Composite 28dy YoY	AUG	--	-9.76%	-12.46%	--
10/2	Unemployment Rate	SEP	9.80%	9.80%	9.70%	--	10/22	RPX Composite 28dy Index	20-Aug	--	200.29	198.4	--
10/2	Change in Manufact. Payrolls	SEP	-52K	-51K	-63K	-66K	10/22	House Price Index MoM	AUG	0.30%	-0.30%	0.30%	--
10/2	Average Hourly Earnings MoM	SEP	0.20%	0.10%	0.30%	0.40%	10/23	Existing Home Sales	SEP	5.35M	5.57M	5.10M	5.09M
10/2	Average Hourly Earnings YoY	SEP	2.60%	2.50%	2.60%	--	10/23	Existing Home Sales MoM	SEP	4.90%	9.40%	-2.70%	-2.90%
10/2	Average Weekly Hours	SEP	33.1	33	33.1	--	10/27	S&P/CaseShiller Home Price Ind	AUG	--	146	144.23	144.3
10/7	Consumer Credit	AUG	-\$10.0B	-\$12.0B	-\$21.6B	-\$19.0B	10/27	S&P/CS Composite-20 YoY	SEP	-11.90%	-11.32%	-13.30%	-13.26%
10/8	Initial Jobless Claims	3-Oct	540K	521K	551K	554K	10/28	Durable Goods Orders	AUG	1.00%	1.00%	-2.40%	-2.60%
10/8	Continuing Claims	26-Sep	6105K	6040K	6090K	6112K	10/28	Durables Ex Transportation	SEP	0.70%	0.90%	0.00%	-0.40%
10/9	Trade Balance	AUG	-\$33.0B	-\$30.7B	-\$32.0B	-\$31.9B	10/28	New Home Sales	SEP	440K	402K	429K	417K
10/14	Import Price Index (MoM)	SEP	0.20%	0.10%	2.00%	1.60%	10/28	New Home Sales MoM	SEP	2.60%	-3.60%	0.70%	1.00%
10/14	Import Price Index (YoY)	SEP	-11.40%	-12.00%	-15.00%	-15.30%	10/29	GDP QoQ (Annualized)	3Q A	3.20%	3.50%	-0.70%	--
10/14	Advance Retail Sales	SEP	-2.10%	-1.50%	2.70%	2.20%	10/29	GDP Price Index	3Q A	1.40%	0.80%	0.00%	--
10/14	Retail Sales Less Autos	SEP	0.20%	0.50%	1.10%	1.00%	10/29	Core PCE QoQ	3Q A	1.40%	1.40%	2.00%	--
10/14	Retail Sales Ex Auto & Gas	SEP	0.20%	0.40%	0.60%	--	10/29	Initial Jobless Claims	24-Oct	525K	530K	531K	--
10/14	Minutes of Sept. 23 FOMC Meeting						10/29	Continuing Claims	17-Oct	5905K	5797K	5923K	5945K
10/15	Consumer Price Index (MoM)	SEP	0.20%	0.20%	0.40%	--	10/30	Personal Income	SEP	0.00%	0.00%	0.20%	0.10%
10/15	CPI Ex Food & Energy (MoM)	SEP	0.10%	0.20%	0.10%	--	10/30	Personal Spending	SEP	-0.50%	-0.50%	1.30%	1.40%
10/15	Consumer Price Index (YoY)	SEP	-1.40%	-1.30%	-1.50%	--	10/30	PCE Deflator (YoY)	SEP	-0.50%	-0.50%	-0.50%	--
10/15	CPI Ex Food & Energy (YoY)	SEP	1.40%	1.50%	1.40%	--	10/30	PCE Core (MoM)	SEP	0.20%	0.10%	0.10%	--
10/15	CPI Core Index SA	SEP	--	220.053	219.692	--	10/30	PCE Core (YoY)	SEP	1.30%	1.30%	1.30%	--
10/15	Consumer Price Index NSA	SEP	215.865	215.969	215.834	--	10/30	U. of Michigan Confidence	OCT F	70	70.6	69.4	--

SOURCE: Bloomberg, LLC

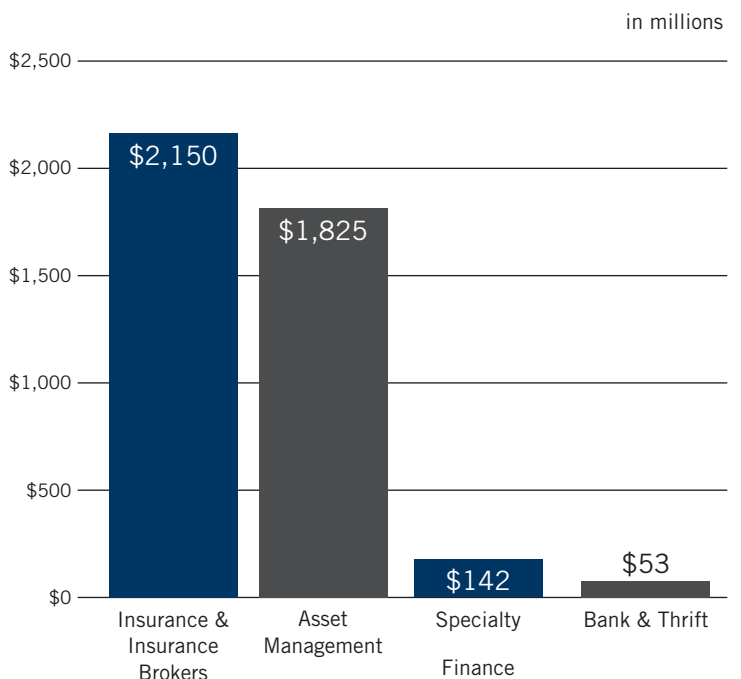
Economic Data Points - November 2009

Date	Event	Period	Survey	Actual	Prior	Revised	Date	Event	Period	Survey	Actual	Prior	Revised
11/2	ISM Manufacturing	OCT	53	55.7	52.6	--	11/17	Capacity Utilization	OCT	70.80%	--	70.50%	--
11/2	ISM Prices Paid	OCT	64	65	63.5	--	11/18	Consumer Price Index (MoM)	OCT	0.20%	--	0.20%	--
11/2	Construction Spending MoM	SEP	-0.20%	0.80%	0.80%	-0.10%	11/18	CPI Ex Food & Energy (MoM)	OCT	0.10%	--	0.20%	--
11/2	Pending Home Sales MoM	SEP	0.00%	6.10%	6.40%	--	11/18	Consumer Price Index (YoY)	OCT	-0.20%	--	-1.30%	--
11/2	Pending Home Sales YoY	SEP	--	19.80%	12.10%	--	11/18	CPI Ex Food & Energy (YoY)	OCT	1.60%	--	1.50%	--
11/3	Total Vehicle Sales	OCT	9.80M	10.45M	9.20M	--	11/18	Housing Starts	OCT	599K	--	590K	--
11/3	Domestic Vehicle Sales	OCT	7.30M	7.94M	6.80M	--	11/18	CPI Core Index SA	OCT	--	--	220.053	--
11/4	Challenger Job Cuts YoY	OCT	--	-50.70%	-30.20%	--	11/18	Building Permits	OCT	580K	--	573K	--
11/4	ISM Non-Manf. Composite	OCT	51.5	50.6	50.9	--	11/18	Consumer Price Index NSA	OCT	--	--	215.969	--
11/4	FOMC Rate Decision	4-Nov	0.25%	0.25%	0.25%	--	11/19	Initial Jobless Claims	14-Nov	--	--	--	--
11/5	Nonfarm Productivity	3Q P	6.50%	9.50%	6.60%	6.90%	11/19	Continuing Claims	7-Nov	--	--	--	--
11/5	Unit Labor Costs	3Q P	-4.20%	-5.20%	-5.90%	-6.10%	11/19	RPX Composite 28dy YoY	SEP	--	--	-9.76%	--
11/5	Initial Jobless Claims	31-Oct	522K	512K	530K	532K	11/19	RPX Composite 28dy Index	17-Sep	--	--	200.29	--
11/5	Continuing Claims	24-Oct	5750K	5749K	5797K	5817K	11/23	Existing Home Sales	OCT	--	--	5.57M	--
11/5	ICSC Chain Store Sales YoY	OCT	--	2.10%	0.10%	0.60%	11/23	Existing Home Sales MoM	OCT	--	--	9.40%	--
11/6	Change in Nonfarm Payrolls	OCT	-175K	-190K	-263K	-219K	11/24	GDP QoQ (Annualized)	3Q S	--	--	3.50%	--
11/6	Unemployment Rate	OCT	9.90%	10.20%	9.80%	--	11/24	GDP Price Index	3Q S	--	--	0.80%	--
11/6	Change in Manufact. Payrolls	OCT	-42K	-61K	-51K	-45K	11/24	Core PCE QoQ	3Q S	--	--	1.40%	--
11/6	Average Hourly Earnings MoM	OCT	0.10%	0.30%	0.10%	--	11/24	S&P/CaseShiller Home Price Ind	SEP	--	--	146	--
11/6	Average Hourly Earnings YoY	OCT	2.20%	2.40%	2.50%	--	11/24	S&P/CS Composite-20 YoY	SEP	--	--	-11.32%	--
11/6	Average Weekly Hours	OCT	33.1	33	33	--	11/24	S&P/Case-Shiller US HPI	3Q	--	--	132.6	--
11/6	Consumer Credit	SEP	-\$10.0B	-\$14.8B	-\$12.0B	-\$9.9B	11/24	S&P/Case-Shiller US HPI YOY%	3Q	--	--	-14.90%	--
11/12	Initial Jobless Claims	7-Nov	510K	502K	512K	514K	11/24	House Price Index MoM	SEP	--	--	-0.30%	--
11/12	Continuing Claims	31-Oct	5700K	5631K	5749K	5770K	11/24	House Price Purchase Index QoQ	3Q	--	--	-0.70%	--
11/12	Monthly Budget Statement	OCT	-\$165.0B	-\$176.4B	-\$155.5B	--	11/25	Personal Income	OCT	--	--	0.00%	--
11/13	Trade Balance	SEP	-\$31.8B	-\$36.5B	-\$30.7B	-\$30.8B	11/25	Personal Spending	OCT	--	--	-0.50%	--
11/13	Import Price Index (MoM)	OCT	1.00%	0.70%	0.10%	0.20%	11/25	Durable Goods Orders	OCT	--	--	1.00%	--
11/13	Import Price Index (YoY)	OCT	-5.50%	-5.70%	-12.00%	--	11/25	Durables Ex Transportation	OCT	--	--	0.90%	--
11/13	U. of Michigan Confidence	NOV P	71	66	70.6	--	11/25	PCE Deflator (YoY)	OCT	--	--	-0.50%	--
11/16	Advance Retail Sales	OCT	0.90%	--	-1.50%	--	11/25	PCE Core (MoM)	OCT	--	--	0.10%	--
11/16	Retail Sales Less Autos	OCT	0.40%	--	0.50%	--	11/25	Initial Jobless Claims	21-Nov	--	--	--	--
11/16	Retail Sales Ex Auto & Gas	OCT	--	--	0.40%	--	11/25	PCE Core (YoY)	OCT	--	--	1.30%	--
11/17	Producer Price Index (MoM)	OCT	0.50%	--	-0.60%	--	11/25	Continuing Claims	14-Nov	--	--	--	--
11/17	PPI Ex Food & Energy (MoM)	OCT	0.10%	--	-0.10%	--	11/25	U. of Michigan Confidence	NOV F	--	--	--	--
11/17	Producer Price Index (YoY)	OCT	-1.90%	--	-4.80%	--	11/25	New Home Sales	OCT	--	--	402K	--
11/17	PPI Ex Food & Energy (YoY)	OCT	1.40%	--	1.80%	--	11/25	New Home Sales MoM	OCT	--	--	-3.60%	--
11/17	Industrial Production	OCT	0.30%	--	0.70%	--	11/25	Minutes of Nov. 4 FOMC Meeting	25-Nov	--	--	--	--

SOURCE: Bloomberg, LLC

M&A Transaction Update

Announced Transactions - October 2009



SOURCE: SNL Financial, Bloomberg, Factiva

Deal Count - October 2009

Insurance & Insurance Brokerage	20
Bank & Thrift	11
Specialty Finance	10
Asset Management & Broker/Dealer	9

SOURCE: SNL Financial, Bloomberg, Factiva

Deal Count - 2009 YTD

Insurance & Insurance Brokerage	142
Bank & Thrift	83
Asset Management & Broker/Dealer	82
Specialty Finance	42

SOURCE: SNL Financial, Bloomberg, Factiva

Financial Deal Alert

Hovde Financial is pleased to announce that its client, Tri City National Bank (a unit of Tri City Bankshares Corporation), headquartered in Oak Creek, Wisconsin, agreed to assume certain assets and deposits of Racine, Wisconsin-based Bank of Elmwood from the FDIC on October 23, 2009. Tri City will assume approximately \$327 million in assets and \$243 million of deposits.

Tri City was founded in 1963 and, as of September 30, 2009, had \$790 million in assets. The transaction will result in Tri City surpassing the \$1 billion asset mark.

Hovde Financial is also pleased to announce that its client, DG Bancorp, Inc. (which has \$258 million in assets), parent company of Downers Grove National Bank headquartered in Downers Grove, Illinois, has agreed to be acquired by Schaumburg, Illinois-based Diamond Bancorp, Inc. (which has \$285 million in assets). Terms of the all-cash transaction were not disclosed.

Top Financial Advisors in Bank and Thrift Transactions

Last Five Years, Sell-Side Advisory Transactions

Rank	Firm	# of Deals
1	Sandler, O'Neill & Partners, L.P.	100
2	Keefe, Bruyette & Woods, Inc.	91
3	Hovde Financial	76
4	Howe Barnes Hoefer & Arnett, Inc.	51
5	Stifel, Nicolaus & Company, Inc.	39
6	Sheshunoff & Co. Investment Banking LP	24
7	Morgan Keegan & Company, Inc.	19
8	Austin Associates, LLC.	17
9	Carson Medin Company	16
10	Professional Bank Services Inc.	15

SOURCE: SNL Financial (data from 10/31/2004-10/31/2009)

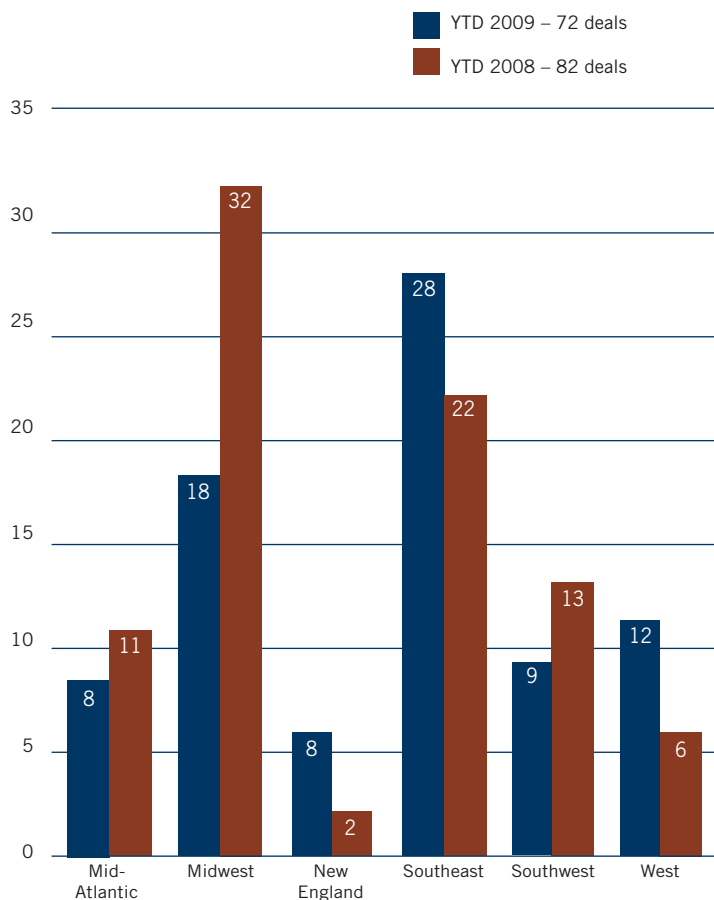
Bank & Thrift Transactions - October 2009

Buyer	Buyer State	Target	Buyer State	Announced	DV (\$MM)	P/LTM Ern	P/TBV (%)	Core Deposit Premium (%)
BancFirst Corporation	OK	First Jones Bancorporation, Incorporated	OK	10/2/09	NA	NA	NA	NA
Investor group		Riverside Central Florida Banking Company	FL	10/5/09	NA	NA	NA	NA
Stockmens Limited Partnership	SD	Valentine Bancorporation	NE	10/6/09	6.1	NM	129.40	2.27
Investor group		City State Bancorporation, Inc.	IA	10/9/09	3.9	NM	117.39	1.02
Bridgewater Financial, MHC	MA	East Bridgewater Savings Bank	MA	10/9/09	NA	NA	NA	NA
Diamond Bancorp, Inc	IL	DG Bancorp, Inc.	IL	10/14/09	NA	NA	NA	NA
Florida Shores Bancorp, Inc.	FL	Shamrock Bank of Florida	FL	10/15/09	NA	NA	NA	NA
R Financial Services, Inc.		Ohio State Bancshares, Inc.	OH	10/20/09	6.0	NM	207.90	3.89
Investor group		First Republic Bank operations	CA	10/21/09	NA	NA	NA	NA
Two Roa LLC	AL	RB Bancorporation	AL	10/26/09	NA	NA	NA	NA
Union Savings Bank	CT	First Litchfield Financial Corporation	CT	10/25/09	36.9	NM	155.76	1.34

SOURCE: SNL Financial

Bank & Thrift Transactions

by Region



SOURCE: SNL Financial

Deal Pricing by Region - 2009 YTD

Region	Deal Value (MM)	Price/TBV (%)	P/ LTM Ern (x)	P/ Core Dep Prem (%)
Mid-Atlantic	\$364	0.0	19.8	-3.3
Midwest	\$98	112.9	20.4	0.8
New England	\$156	124.8	NA	1.1
Southeast	\$414	87.3	19.8	1.7
Southwest	\$41	120.6	11.3	2.9
West	\$105	101.2	18.3	4.0
Total	\$1,177	92.6	18.1	1.3

SOURCE: SNL Financial

Deal Pricing by Quarter

Quarter	Deal Value (MM)	Price/TBV (%)	P/ LTM Ern (x)	P/ Core Dep Prem (%)
2Q2007	\$30,841	229.3	26.5	16.4
3Q2007	\$9,324	215.3	26.2	17.9
4Q2007	\$11,660	196.5	23.5	11.8
1Q2008	\$5,093	190.3	26.9	12.4
2Q2008	\$1,855	197.3	30.1	8.4
3Q2008	\$27,195	149.9	25.9	9.0
4Q2008	\$1,680	123.0	32.6	2.1
1Q2009	\$278	93.0	18.8	-1.9
2Q2009	\$398	95.4	19.4	3.2
3Q2009	\$448	97.4	14.0	2.6
4Q2009	\$53	152.6	NA	2.1

SOURCE: SNL Financial

Insurance and Insurance Brokerage Transactions - October 2009

Buyer	Target	Announced	DV (\$MM)
Buren Insurance Group, Inc.	Padgett-Young & Associates, Inc.	10/1/09	NA
Wells Fargo & Company	Sierra Self Insurance Services, LLC	10/1/09	NA
William Gallagher Associates	RPG Insurance Administrators, Inc.	10/1/09	NA
Woodruff-Sawyer & Co.	Western Region Direct Practice of Carpenter Moore Ins. Services Inc.	10/5/09	NA
Coventry Health Care, Inc.	Preferred Health Systems, Inc.	10/5/09	NA
Marsh & McLennan Companies, Inc.	Rattner Mackenzie Limited	10/5/09	NA
Seubert & Associates Inc.	Heritage Agency, Inc.	10/5/09	NA
Blue Cross and Blue Shield of South Carolina	Intermediary Insurance Services, Inc.	10/7/09	NA
Arthur J. Gallagher & Co.	Triad Insurance Agency, Inc.	10/9/09	NA
Investor group	Nan Shan Life Insurance Company, Ltd.	10/12/09	2150
Keystone Insurers Group, Inc.	Synergy Insurance Group Benefits division	10/12/09	NA
New York Long-Term Care Brokers Ltd.	Dan Ross Financial Services	10/12/09	NA
Tower Group, Inc.	Aequicap Financial renewal rights	10/15/09	NA
American Capital Acquisition Corporation	GMAC Property & casualty business	10/16/09	NA
Reinsurance Group of America, Incorporated	ING Reinsurance U.S.	10/16/09	NA
Undisclosed Recipient	Walshire Assurance Company	10/19/09	NA
Undisclosed buyer	Avalon Risk Management, Inc.	10/19/09	NA
Aon Corporation	Carpenter Moore Insurance Services Inc.	10/26/09	NA
Group Benefit Services, Inc.	Client First Brokerage Services, Inc.	10/27/09	NA
Aquesta Bank	Oswald, Trippe and Company of the Carolinas, Inc	10/30/09	NA

SOURCE: Factiva, AM Best

Asset Management/Broker-Dealer Transactions - October 2009

Buyer	Target	Announced	DV (\$MM)
Miles Capital Holdings, Inc.	WB Capital Management Inc.	10/1/09	3.2
Central Bancompany, Inc.	Springfield Trust & Investment Company	10/6/09	NA
Management group	Westfield Capital Management Company, L.P.	10/6/09	59
U.S. Bancorp	First Citizens Bank bond trustee business	10/7/09	NA
Invesco Ltd.	Retail asset management business	10/19/09	1504
Ares Capital Corporation	Allied Capital Corporation	10/26/09	623.1
National Investment Managers, Inc.	Block of business from Stancorp	10/29/09	NA

SOURCE: Factiva, Bloomberg

Specialty Finance Transactions - October 2009

Buyer	Target	Announced	DV (\$MM)
International Business Machines Corporation	Wilshire Credit Corporation	10/5/09	NA
MF Holdco, LLC	Mariner Finance, LLC	10/7/09	10.5
First Independence Corporation	Warren Mortgage Company, LLC	10/7/09	NA
Gjensidige Bank Holding AS	Citigroup Consumer finance business	10/8/09	NA
efferies Group, Inc.	Capmark financial military housing business	10/16/09	9
Sandringham Capital Partners Limited	Premier Asset Management Company	10/19/09	NA
Dollar Financial Corp.	Merchant cash advance business	10/21/09	4.9
EverBank Financial Corp.	Tygris Commercial Finance Group, Inc.	10/22/09	NA
Dollar Financial Corp.	Military Financial Services, LLC	10/28/09	118
JCMG Financial Services	Northwest Financial Advisors	10/28/09	NA

SOURCE: Factiva, Bloomberg, Reuters