



Global Securities Market Bulletin

January 22, 2010

Issue No.35

Courtesy: Global Securities Research

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COMMENTARY – How big is “too big (to fail)”?

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President Obama yesterday proposed to limit the size and scope of US banks and financial institutions, saying that while the financial system is far stronger than it was a year ago, it is still operating under the “exact same rules” that led to its near-collapse. Essentially, the President’s proposals call for limits on the excessive growth of market share of the largest financial firms, as well as limits on trading activities – including prohibiting proprietary trading – at such firms.

Judging by the market carnage that was unleashed by the bankruptcy of Lehman and the near-failure of AIG, Fannie Mae et al in September 2008, there may be a case for imposing limits on the size of major financial institutions. But just how big is “too big”?

For the purpose of our analysis, we use the “Large and Complex Financial Institutions” (LCFIs) identified by the Bank of England and International Monetary Fund. These LCFIs include the world’s largest banks, securities houses and other financial intermediaries that carry out a diverse and complex range of activities in major financial centres. While there were 15 LCFIs in 2008, Lehman’s bankruptcy and the takeover of Merrill Lynch by Bank of America has reduced their ranks to 13.

Table 1 shows the change in market capitalization for these LCFIs over the past year, when most of them were trading close to multi-year lows. Since January 2009, these 13 LCFIs have added a combined \$657 billion in market cap, which now stands at over \$1 trillion in total. The combined asset base of these LCFIs exceeds \$25 trillion.

Table 1: Change in market capitalization of LCFIs over past year

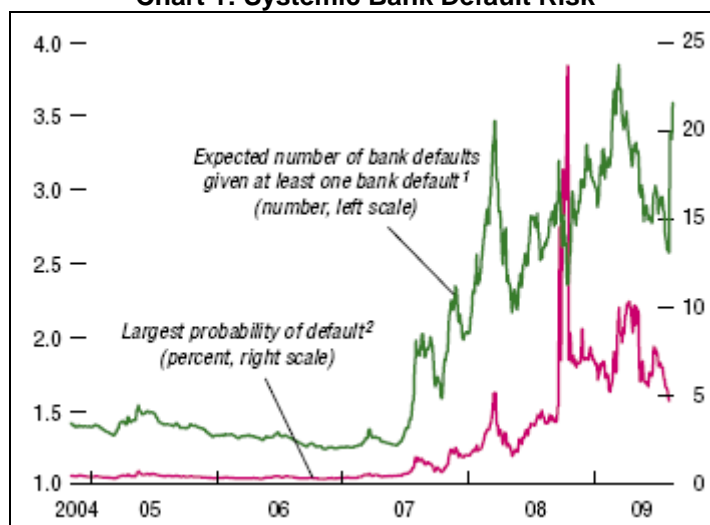
LCFIs	Mkt.Cap.(US\$ bn)		Change in mkt.cap.(%)	Total	
	Current	Year ago		Assets (US\$ bn.)	Assets / Mkt.cap.
HSBC	\$189.7	\$85.7	121%	\$2,420	12.8
JP Morgan Chase	\$157.4	\$75.2	109%	\$2,030	12.9
Bank of America	\$132.0	\$36.2	265%	\$2,220	16.8
Citigroup	\$95.4	\$17.3	451%	\$1,860	19.5
BNP Paribas	\$87.9	\$28.5	208%	\$3,220	36.6
Goldman Sachs	\$83.5	\$30.5	174%	\$882	10.6
Credit Suisse	\$53.5	\$23.3	130%	\$1,030	19.3
UBS	\$50.8	\$33.2	53%	\$1,420	28.0
Barclays	\$50.0	\$7.7	549%	\$2,540	50.8
Societe Generale	\$44.5	\$20.6	116%	\$1,490	33.5
Deutsche Bank	\$39.5	\$13.0	204%	\$2,430	61.5
Morgan Stanley	\$38.2	\$15.8	142%	\$769	20.1
RBS	\$31.6	\$9.9	219%	\$2,980	94.3
TOTAL...	\$1,054.0	\$396.9		\$25,291	24.0

Source: Global Securities Research, Bloomberg

The last column in Table 1 provides a rough idea of leverage, by comparing total assets to market cap. As can be seen, the LCFIs with very large retail networks such as HSBC and JP Morgan have lower degrees of leverage by this metric, while the European institutions are still highly leveraged.

The sheer size and scale of these behemoths means that problems at one of them will invariably cascade through the global financial system. Fortunately, the risk of systemic bank default (as measured by the probability of default and expected number of bank defaults given at least one bank default among 15 selected LCFIs) had receded significantly by October 2009 (see Chart 1), as compared to October 2008 when the global financial system seemed to be on the verge of collapse.

Chart 1: Systemic Bank Default Risk



Source: IMF Global Financial Stability report, Oct. 2009

Table 2 shows changes in market cap for Canadian banks over the past year. Note that the larger Canadian banks are bigger in terms of market cap but have substantially smaller asset bases than the smaller LCFIs.

Table 2: Change in market capitalization of Canadian banks over past year

Canadian Banks	Mkt.Cap.(US\$ bn)		Change in mkt.cap.(%)	Total	
	Current	Year ago		Assets (US\$ bn.)	Assets / Mkt.cap.
Royal Bank	\$71.9	\$34.1	111%	\$605	8.4
TD Bank	\$50.5	\$26.2	93%	\$515	10.2
Bk. of Nova Scotia	\$43.3	\$22.7	91%	\$459	10.6
Bank of Montreal	\$27.5	\$12.9	113%	\$359	13.1
CIBC	\$23.1	\$13.1	76%	\$311	13.5
TOTAL...	\$216.3	\$109.0		\$2,249	10.4

Market cap for Canadian banks in US\$; exchange rate US\$1 = C\$1.0575

Source: Global Securities Research, Bloomberg

TRADE UPDATES

Galleon Energy – Raising our target price to \$7.00

Galleon Energy (TSX: GO, \$5.85), recommended as a Buy for investors with moderate risk tolerance at \$4.62 on December 11, traded at a two-month high of \$6.24 last week. The company yesterday reported promising results from its Q4 2009 drilling program. We are raising our target price on Galleon to \$7.00, from \$6.00-\$6.50 earlier.

Market Snapshot at 12:45

S&P TSX	11339.22	-129.88	Commodities		Yields (%)		Can.	US
TSX Venture	1548.53	-10.38	Canadian \$	94.52	-0.52	90 Day T-Bill	0.12	0.05
DJIA	10190.67	-199.21	Gold (Spot)-US\$	1091.52	-2.43	2-Year Bond	1.16	0.80
S&P 500	1093.52	-22.96	Oil (WTI-Feb.)	74.31	-1.77	10-Yr. Bond	3.36	3.59
NASDAQ	2206.84	-58.86	CRB Index	275.56	-1.95	30-Yr. Bond	3.99	4.51

Thought for the Day

“I leave NBC primetime the same way I found it – a complete disaster.” – Jay Leno

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