SHAUNESSY
INVESTMENT COUNSEL INC.

Psssst: invest in U.S. banks.

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For the record: For many years Terry Shaunessy was a top ranked research analyst specializing in banks. He understands banks and the banking sector very well.

Bank crises are not a new phenomenon: In the 1970's and 1980's banking crises involved profound credit losses on the part of the world's major banks (e.g. Third World Debt, Commercial Real Estate, Savings & Loan) and these events were accompanied by dire warnings from the investment community about the poor prospects for bank share prices. In every case, bank stocks weakened as credit losses spiked and earnings plummeted. However, once credit reserves were in place and the crisis passed, credit loss expenses dropped sharply with the result that bank earnings and share prices skyrocketed --- typically in fairly short order. While the banking fiasco of 2008/2009 is the worst since the 1930's, there is no reason to believe that the historical bank earnings cycle has changed, so much higher earnings must lie over the horizon.

To illustrate: both **JP Morgan** (JPM) and **Bank of America** (BAC) charged US$38 billion and US$49 billion respectively to their 2009 income statements for credit losses amounting to roughly 2% of total assets. Under normal circumstances, credit charges amount to 0.25% of total assets so that the 2009 provisions for credit losses are 8 times the norm. Over and above that, in spite the staggering loan loss provisions, both JPM and BAC had, before special TARP repayment fees, a very profitable 2009 (and record bonus payments adding to the furor about big banks) --- a testament to their underlying franchise value. It is our view that when loan loss charges revert to historical norms, the credit charge to income must drop back to $5 - $6 billion *freeing up $30 to $40 billion per year to the bottom line,* bolstering capital and paving the way for the resumption of dividends.

Regulation and bank bashing: After every financial crisis the political finger pointing goes into overdrive and everyone gets very excited that the day of reckoning has come for 'big' banks and 'greedy' bankers. Yet the current melodrama in Washington and on Wall Street will have no bearing on the historical earnings cycle of US banks, and only serves to mask what a good investment banks will be in the medium term. As to the current (and now shrill) debate, **David Champion**, senior editor at the **Harvard Business Review,** says: "the Obama reforms [are] neither radical nor particularly useful, except perhaps as political theatre."

Our view ---- Terry Shaunessy: "Investors are simply unaware or perhaps not ready to listen yet to the positive cyclical story involving banks so, in my view US financial stocks, especially the likes of the **SPDR Financial Services Index ETF** (XLF) have excellent upside potential in 2010. A recovery by US banks in conjunction with strong export earnings by S&P500-listed companies is the basis for out-performance by the index in 2010 and paves the way for the next bull market in equities."

For more info call Mark Kryzan or Terry Shaunessy at 403-802-3108.