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# Two Strikes for Tim

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**Markets expected Geithner to be the man with the plan. Instead, it was amateur hour.**

We agree with the widely voiced view that the Financial Stability Plan announced yesterday by Tim Geithner was an embarrassing flop -- hardly a "plan" at all, but rather a grab-bag of half-baked notions wrapped in feel-good rhetoric. The new administration created expectations that it would replace the chaotic *ad hoc* style of Henry Paulson's execution of TARP with the smooth professionalism that characterized Barack Obama's presidential campaign. So the vagueness -- and the sheer amateurishness -- of Geithner's presentation was a heavy disappointment. The "fact sheet" distributed following his speech even included a highly visible typographical error, giving the impression that the document, and perhaps the whole conceptual superstructure of the plan it embodies, had been rushed out at the last moment without adequate review. This is "two strikes" for Geithner. It's harsh, but markets must now be wondering whether a man who couldn't figure out how to pay his Social Security taxes is now supposed to figure out how to save the banking system.

| **Update to strategic view** |
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| **US STOCKS:** We continue to believe that stocks will flail until we have clarity on the Obama administration's bank policy, and Geithner's amateurish "plan" did nothing to provide it. To the good, there are signs that Geithner will resist the impulse to impose excessively punitive conditions on future interventions. |
| [see Investment Strategy Dashboard] |


Hard to believe now that the rally off the bottom for stocks so far in this bear market began at mid-day on November 21, at the moment Geithner was named as Obama's choice for Treasury secretary (see "Another Rescue, A New Rescue Ranger" November 24, 2008). It makes sense to us -- Geithner has lived through the botched banking interventions of September (see "Death by Rescue" November 17, 2008), and is a unique repository

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of on-the-job knowledge of *what not to do.* Most important, he is unlikely to repeat the mistake of making federal assistance unduly punitive to existing stakeholders in troubled firms. Indeed, it was reported yesterday that Geithner had prevailed against top Obama political advisors who preferred draconian terms for future assistance. Perhaps the incomplete and disorganized nature of Geithner's presentation reflects an ongoing dispute. But whatever the reason, it seems that Geithner has learned nothing from his predecessor's failures when it comes to the critical tasks of managing expectations, communicating clearly, and at least giving the impression of being in control of the situation.

**Recommended reading**

*The Collapse of a Country*
Jon Danielsson and Gylfi Zoega, London School of Economics, February 9, 2009
*Financial Stability in Iceland*
Frederic S. Mishkin and Tryggvi T. Herbertsson, Iceland Chamber of Commerce, May 2006

[Recommended Reading home]

A particular disappointment was Geithner's non-vision for a "Public-Private Investment Fund" to take troubled assets off banks' balance sheets. We have no idea what Geithner may mean when he says the fund "could" -- his word, not "will" -- put "public and private capital side-by-side." How would public capital be deployed? Co-investment? Loans? Guarantees? Unknown, only that it would "leverage private capital" -- in a world that is desperately trying to de-leverage. Perhaps he intends to evoke nostalgia for the Resolution Trust Corporation, which relied on private investment in, and rehabilitation of, assets seized from failed thrifts, bought at near-zero prices. But an RTC analogy is disturbingly inapt. Today's troubled assets are in the hands of going concerns, and pricing them at near-zero would do nothing but bring about the further losses the banks wish to avoid. Geithner says that the fund "allows private sector buyers to determine the price" for troubled assets. What about the sellers? If the buyer alone determines the price, it will be zero.

In an appearance yesterday on Bloomberg TV after the plan announcement, Geithner was asked by a persistent interviewer no less than three times how the Public-Private Investment Fund would actually work -- because, as the interviewer put it, "people out in the marketplace, even after hearing you just a short time ago, still don't know." Though Geithner's plan grandly promises a "new era of transparency," he spent 686 words -- about the number of words on this page -- *not* answering the repeated questions. The most specific thing he said was that private capital "is important because it will help protect the government from the risk that we're taking on risk and assets we don't understand." Geithner would appear to have it exactly backwards. The whole idea of a government intervention in the banking system is for government to protect private capital, not for private capital to protect government. The private market is paralyzed with respect to troubled assets precisely because they entail risks that are not clearly understood -- and it is the unique role of government to step in and take the "Knightian uncertainty" no one else will take (see "Unknown Unknowns" January 30, 2009).

Having admitted that he is dealing with "risk and assets we don't understand," Geithner's plan whips up a whole new regulatory regime of bank examination, including a "stress test" to determine capital adequacy that could "result from a more severe decline in the economy than projected." How can a government that doesn't understand risks and assets administer such a test? Unknown, but the regulators will do it "in a coordinated way," he promises. And failing will result in Treasury providing a "capital buffer" in the form of convertible preferred stock, struck at a given bank's stock price as of February 9. *Huh?* Of what possible relevance could the February 9 price be to a convertible security issued, say, six months from now? Who knows -- but for some reason, a plan lacking so many important specifics

**Key documents**

**Geithner speech**
**Financial Stability Plan**
**FRB TALF**
**Bernanke testimony**

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nevertheless included this spurious one.

Finally, in some sense it's a fine thing to see TALF -- the Treasury/Fed joint venture, the Term Asset Backed Lending Facility -- expanded from $200 billion to $1 trillion, to try to resurrect the moribund loan securitization market (see "Got You Covered" January 23, 2009). But in another sense this, too, reeks of amateur hour. TALF was first announced on November 25, yet it still doesn't even have a concrete date for starting operations. And we can't help but be fundamentally concerned by any program that has the Treasury using the Fed's balance sheet. The Fed's political independence -- an absolutely essential precondition to prudent monetary policy -- was first put into play when the Fed allowed itself to be used by Treasury as the instrument of September's AIG intervention (see "AIG: Rescue or Bag Run?" September 17, 2008). In November, TALF was another nail in the coffin of independence, and now that nail has gotten bigger -- and along with it, the risk that the Fed will ultimately make a serious inflationary error as it prints money to do the Treasury's bidding. No wonder that gold was up $20 yesterday, while virtually every other risky asset fell. And how ironic that, following his Congressional testimony yesterday, Ben Bernanke should describe the Fed's balance sheet as "gold plated secure."

**BOTTOM LINE:** We continue to believe that stocks will flail until we have clarity on the Obama administration's bank policy, and Geithner's amateurish "plan" did nothing to provide it. To the good, there are signs that Geithner will resist the impulse to impose excessively punitive conditions on future interventions.