



More pain than profits lay ahead for banks

A repeat of the third quarter bust is unlikely, argue analysts, but housing woes and credit market tightness should keep a lid on earnings.

By **David Ellis**, CNNMoney.com staff writer

October 25 2007: 7:00 PM EDT

NEW YORK (CNNMoney.com) -- Merrill Lynch stunned Wall Street this week when the company said it would take a loss totaling \$8 billion, punctuating a particularly dismal earnings season for the banking sector.

Writedowns even approaching that magnitude may be unlikely going forward, according to analysts, but they caution that both investment and diversified banks will face an uphill earnings battle in the coming year.

"Certainly we will not be at the level of profits we saw within the last 12 months," said Mark Batty, an financial services analyst at PNC Wealth Management in Philadelphia, which manages about \$77 billion in assets.

Right now, investment banks and brokerages in the S&P 500 like [Goldman Sachs \(Charts, Fortune 500\)](#) and [Merrill Lynch \(Charts, Fortune 500\)](#) are expected to experience a 10 percent decline in earnings growth in the fourth quarter, according to Thomson Financial. Similarly, diversified financial firms like [Citigroup \(Charts, Fortune 500\)](#) and [JPMorgan Chase \(Charts, Fortune 500\)](#) are expected to report a 1 percent decline in growth.

Probably the biggest challenge facing banks, say analysts, is continued housing weakness, which was the closest thing to a cash cow when the real estate market was at its peak.

Nowadays the housing sector looks pretty bleak with home prices continuing to freefall and sales hovering at multi-year lows.

As a result, banks are not only facing weakened demand for mortgages and home equity loans, but are also seeing rising delinquencies and foreclosures among homeowners.

"Housing is the wild card," said Batty. "I think that will remain a headwind over the next several quarters."

In a sign of the housing sector fallout, Bank of America said late Thursday it was getting out of the [wholesale mortgage business](#) altogether, cutting 700 jobs after posting a steep drop in earnings last week.

Then there are the credit markets. Even though conditions have improved somewhat, demand for structured finance products like asset-backed commercial paper, which companies and financial institutions rely on to raise funds for short periods of time, are still soft, according to analysts, and will keep earnings under pressure.

As the banking sector flounders, pure-play investment banks like Goldman Sachs or [Lehman Brothers \(Charts, Fortune 500\)](#), which dodged a devastating blow from the mortgage crisis, are expected to buck the larger trend.

Just within the last month, Wall Street has raised its earnings estimates for the two banks.

<http://cnnmoney.printthis.clickability.com/pt/cpt?action=cpt&title=More+pains+than+profits+lay+...> 10/26/2007



More pains than profits lay ahead for banks - Oct. 25, 2007

"That's why they [investment banks] have pretty good returns over a long period of time because they can take advantage of opportunities in the market," said Ryan Lentell, an analyst for Morningstar.

Look no further than Goldman Sachs' most recent results, which were saved after it positioned itself nicely when credit markets crumbled this summer.

One pressing question that remains to be answered however, is whether banks will announce more writedowns after Merrill Lynch added a shocking \$3.4 billion in mortgage losses when it reported results Wednesday.

To date, banks have written down more than \$20 billion in losses.

That is very possible, said Kris Niswander, a senior banking analyst at SNL Financial, given the sizeable number of loans committed for leveraged buyouts that are sitting on banks' books.

With corporate merger and leveraged buyout activity showing no signs of picking up since this summer's credit crisis, it's not out of the realm of possibilities that some banks start marking down these loans, said Niswander.

"Absolutely," he said. "The question is really how much further unwinding we could see." ■

[Wall Street superfund: Not so super](#)

Find this article at:

http://money.cnn.com/2007/10/25/news/companies/banks_outlook/index.htm

Check the box to include the list of links referenced in the article.

© 2007 Cable News Network LP, LLP.