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Clash of the Wall Street Titans!

Did Warren Buffett not get Nouriel Roubini's memo that the banking system is headed off a cliff?

Thomas Brown (about me)
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bankstocks.com
tbrown@bankstocks.com

Did you get a chance to read Nouriel Roubini's February 12 column in *Forbes*? I don't know if he gets to write his own headlines, but whoever did write it got to the nugget of the message he's been spreading ever since:

"Nationalize Insolvent Banks"

Pithy! Nouriel Roubini seems to be on television every other night lately, so you've probably heard his argument already as to why the government needs to take over the country's big banks, and the sooner the better. If you missed it, though, it boils down to two words: "toxic assets." FAS 157 or not, the banks still haven't marked down their bad assets to their true value, he believes. And once they do, the balance sheets of most banks will essentially be wiped out. Or, as he put it in his *Forbes* column last month:

> **A true valuation of the [large banks'] bad assets**--without a huge taxpayer bailout of the shareholders and unsecured creditors of banks--**implies that banks are bankrupt** and should be taken over by the government.
>
> Thus, all the schemes that have so far been proposed to deal with the toxic assets of the banks may be a big fudge--one that either does not work or works only if the government bails out shareholders and unsecured creditors of the banks.

Better to shoot 'em now, and put them out of their misery. Once Roubini started pushing for bank nationalization, of course, the drumbeat only got louder. Even people like Lindsey Graham and Alan Greenspan allow that it might be a sensible idea.

I mention all this because I was struck by what Warren Buffett—who knows a thing or two about the banking business, don't forget--had to say, during his interview with CNBC this week, about the very same bad assets that has Roubini so alarmed. Buffett seems to be watching an entirely different movie:

> The interesting thing is that the toxic assets, **if they're priced at market, are probably the best assets the banks has**, because those toxic assets presently are being priced based on unleveraged buyers buying a fairly speculative asset. So **the returns from this market value are probably better than almost anything else**, assuming they've got a market-to-market value, you know, they have the best prospects for return going forward of anything the banks own. **The problems of the banks are overwhelmingly not toxic assets. . .**

Dizzy yet? Roubini believes banks' toxic assets haven't been written down by enough, while Buffett says they've been written down by too much. And while Roubini says the U.S. banking industry is "essentially insolvent." Buffett thinks the industry is on the verge of unprecedented profitability. Here's more from the CNBC interview:

> The spreads have never been wider. **This is a great time to be in banking**, you know, if you just get past the past and they are getting past the past. I mean, right now every time a loan is made to somebody to buy a house--and we're making, you know, making millions of loans--four and a half million houses will change hands this year out of a total stock of less than 80 million. So those people are making good mortgages. **You want those assets on your books and you get a great spread in putting them on now.** So it's a great time to be in banking, but you do have to get past this past. But **the toxic assets**, in my view, you know, if they've been written down to market, **I'd rather buy those assets from the bank than any other assets they've got.**

"This is a great time to be in banking." Now there's a sentence I'll wager you haven't read too often lately. On Wells Fargo in particular, which Roubini has described as a "zombie," Buffett is rhapsodic:

> Now, if I looked at the performance of Wells Fargo we'll say, I see that, you know, in a couple years--and

management doesn't have anything to do with what I'm saying here. I--these are not from them. But **I would expect $40 billion a year pre-provision income.** And under normal conditions I would expect maybe $10 to $12 billion a year of losses. I mean, you lose money in banking, you just try not to lose too much. So, you know, you get to very interesting figures. I mean, **the spreads are enormous on what they're doing.** They're getting the money at bargain rates. So I--if there were no quote on Wells Fargo and I just owned it like I own my farm, I would look at the way the business is developing, and I would say, you know, it's--`These are a couple of tough years for losses in the banking business, but you expect a couple tough years every now and then.' And that **the earning power is never--is going to be greater by far** than it's ever been when you get all through with it. . . .

One of these two guys is going to turn out to be really, really *wrong*. You'll have your own view as to which one makes more sense. To me, it's not even close: Buffett does. First off, a lot of the work we've done around here confirms his view of the marks banks have taken on their iffy assets. There's often a huge gap between the "fair value" marks banks have put on those assets and their corresponding cash flow marks—with the fair value marks typically being much lower.

And don't forget that, by his own admission, Roubini doesn't know what he's talking about when it comes to individual banks. He only looks at the macro data, without getting into details of specific institutions. Buffett does know—he's Wells Fargo's biggest shareholder, for crying out loud!—which means he has a lot more detailed knowledge about what's really going on in the business. Oh, and Buffett's been through a few more cycles.

In any event, these two gurus don't just have mildly diverging opinions about the outlook for the banking business. Their views are at 180-degree odds with each other. One says the industry is about to go tapioca, the other says it's about to enjoy huge profitability.

Whom do you trust? I know I'm ready to vote.

What do you think? *Let me know!*