RADY ASSET MANAGEMENT, LLC

What is the real value of the Bank Stress Test?

Banks are faced with a no win situation with the federal government and investors. The regulators are using a doomsday scenario to stress test the banks balance sheets when doomsday has already occurred. It's kind of like calling the fire department after the building has been burnt to the ground. If the government deems a given bank to be undercapitalized, this will dilute the existing shareholders even more thereby leaving little incentive for investors. Additionally, the best and brightest management talent will simply gravitate towards new opportunities. This brain drain is a very serious, unquantifiable byproduct of this incessant vilification of the banks and their compensation structure.

All banks are not created equally and therefore each should be looked at differently. We are worried that the stress test is too homogeneous and quantitative. We feel the stress test does not take into account the qualitative factors like quality of management, franchise value, cost of capital, quality of assets, etc.

Expectations are already so low for bank earnings that banks will likely use "the fog of war" as an opportunity to build additional reserves which will allow them to report improved future earnings when the environment is such that they may be rewarded by a higher multiple and increased stock price. We see no reason to spit into the wind now.

We see a significant amount of dilution on the horizon for both Bank of America and Citigroup. Both banks face extremely complex operational issues that need to be dealt with in the most hostile environment since the great depression. Kind of like changing an airplane engine in mid flight during a hurricane. We are most bearish on Citigroup as we think it's simply too big and complex to manage in any environment.

It is important to recognize that cycles take years to unfold and we are only 18-24 months into this cycle which could last five years or more. When markets get more uncertainty from the stress test we believe this will cause the markets to drop, especially because the stress test was supposed to reduce uncertainty.

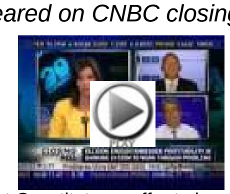
We are very bearish on the financial sector as we see loan losses continuing to increase thereby exacerbating investor uncertainty for the foreseeable future. As we said during our last appearance on CNBC, we have been short Northern Trust for the past few weeks because we see the stock as too expensive and expectations were ahead of themselves. With the recent capital raise and stock price decline we are reevaluating this position.

We are focusing on building short positions in other securities within the financial sector and are considering investing in the SKF (ultra-short financials) ahead of the stress test results because we don't think it's going to provide "quality" information. We feel that it is impossible to predict the future and these stress tests are based on assumptions.

On a long-term basis we see opportunity with certain stocks and are bullish on Wells Fargo and Goldman Sachs. However, we believe it will be at least a year before we are comfortable investing in this space on the long side.

Stress tests can be a valuable tool in providing more transparency and providing critical data as to what's on the banks balance sheets. The issue we see is that these quantitative measures must be paired with the appropriate qualitative measures to be used effectively. Stress tests have been used successfully by the regulators for years but the results need to be considered in the context of good old fashioned human judgment.

-Harry Rady, Portfolio Manager of Rady Asset Management appeared on CNBC closing bell on 4.28.09 to discuss the bank stress tests. Please click video link to view appearance.



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