



CAPITAL ALPHA
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Capital Call

Junk Boosting Banks' Stable-Funding Case; Mortgage Servicers Challenged In House; Summer Summitry in Washington; Congress; Social Security; Elections

Financials

Banks: Are Junk Bonds the Canary in the Regulatory Coal Mine?

Junk-bond selloffs highlight banks' concerns that new capital rules and pending liquidity requirements could damage repo & bond markets. These concerns will likely prompt moderation of the proposed net stable funding ratio.

Mortgage Servicers: When It Rains, It Pours

Unheralded before recess was House passage of a bill blocking Basel III's constraining MSR weightings for non-systemic banks while regulators conduct a related study. Enactment is unlikely, but the thought is scary enough for beleaguered non-bank servicers.

Macro

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Also Inside, other quick takes for the Week of August 4: Health; Telecom, Media & Tech; Defense and Infrastructure
(click [here](#) for the full report).

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Tickers

Student Loans: SLM, NAVI, NNI

Payday Lenders/Installment Loans:

CSH, DLLR, FCFS, QCCO, EPPZ, WRLD

Auto Lenders/Auto Dealers:

ALLY, TD, F GM, GPI, SAH, ABG, LAD, PAG, AN, KMX

Campus-based Debit: ONE, HPY

Prepaid Cards: GDOT, NTSP,

TPNL, AXP, V, MA, DFS

Banks: JPM, BAC, WFC, C, RDN

Mortgage Insurers/Non-bank

Servicers: MTG, GNW, ESNT, NMIH, OCN, NSM, WAC

Homebuilding/Retail: PUL, TOL,

PHM, LEN, HD, LOW

GSE Common/Preferreds: FNMA,

FMCC, FNMA, FMCKJ

Exchanges: CME, ICE, GS, MS,

BAC, C

Mutual Funds/Asset Managers:

FII, BLK, SCHW

Insurance: MET, PRU, AIG

This Week's DC Financial Catalysts

MULTI-DAY

The House and Senate are out of session for a five-week summer recess.

CFPB may propose a rule to define large participants of a market for auto lending
All Week

CFPB may propose new rules for prepaid cards
All Week

CFPB may release a white paper to explain their use of disparate impact theory
All Week

Download the full Catalyst Calendar [*here*](#).

Financials

Banks: Are Junk Bonds the Canary in the Regulatory Coal Mine?

In our view, recent market trends (i.e. lower trading volumes and turnover, as well as decreased bond inventories by bank market makers) will lead the Basel Committee to soften the final net stable funding ratio (NSFR). Basel regulators issued a proposed NSFR in January and may finalize it by the end of this year. The banking industry, however, has [expressed](#) serious concerns, many of which have focused on the likely negative impact the NSFR would have on the ability of banks to provide liquidity in key markets should the rules be finalized without any changes. While the capital and leverage rules have already put pressure on bank bond inventories (as has the Volcker rule for U.S. banks), the NSFR is still being reviewed, and regulators may decide to perform a quantitative impact study before finalizing it. This would provide an opportunity for banks to demonstrate the potential negative impact on repo and other lending markets. While it may be too late to adjust the Basel III capital, leverage and liquidity coverage ratio, there is a good chance that adjustments will be made to improve the final NSFR.

Mortgage Servicers: When It Rains, It Pours

Unheralded before recess was House passage of a bill blocking Basel III's constraining MSR weightings for non-systemic banks while regulators conduct a related study. Enactment is unlikely, but the thought is scary enough for beleaguered non-bank servicers.

The bipartisan "[Community Bank Mortgage Servicing Asset Capital Requirements Study Act of 2014](#)," sponsored by Rep. Blaine Luetkemeyer (R-MO), was approved 44-9 in the House Financial Services Committee on July 30 and subsequently adopted on the House floor. The measure responded to recent lobbying from community banks against Basel III rules which have largely forced the industry to sell off mortgage servicing rights or, in the case of smaller institutions, consider abandoning mortgage originations altogether.

Per a [Committee release](#), "H.R. 4042 requires the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation to conduct a study to determine the appropriate capital requirements for mortgage servicing assets for any banking institution other than an institution identified by the Financial Stability Board as a global systemically important bank. H.R. 4042, as amended, also prohibits the implementation of Basel III capital requirements related to mortgage servicing assets for non-systemic banking institutions from taking effect until three months after a report on the study mandated by the bill is transmitted to Congress."

Investment Significance: Enactment of relief for the smaller banks could substantially dilute the positive windfall seen for non-bank servicers, which have been experiencing growing pains as they gobble up MSRs from banks and otherwise expand to fill the void being caused by the new banking regs.

Nevertheless, industry sources doubt passage of the bill—despite the political clout of the community banks—in no small part due to the sensitivity of amending the international agreement and legislative stasis in the Senate, where Majority Leader Reid's refusal to allow Republican amendments has ground consideration of even routine bills to a halt. This pent-up frustration only adds to the likelihood that any bank-reg-related legislation would become mired with amendments to amend or delay rules relating to the Dodd-Frank Act.

In any event, we will be trolling for any evidence of traction with an eye toward the brief lame duck session to begin after the November 4 elections. And in the interim, we will be keeping an ear out for news relating to a model capital standard for servicers which the Council of State Banking Supervisors (CSBS) has been expected to release late summer (but didn't appear imminent as of last week).

Meanwhile, stakeholders in the publicly-traded non-bank/specialty servicers need additional bad news like a hole in the head, after Ocwen (**OCN**), for the second straight quarter, revealed during its quarterly earnings report last week that it is having to endure substantial costs in adapting to new CFPB-imposed regulations. Those regs, which OCN signed onto in a consent agreement last fall, are designed to impose the servicing standards adopted by large banks as part of the 2012 National Mortgage Settlement (NMS). OCN's 20% swoon since Tuesday, July 29, has drawn

attention to the results of Nationstar (**NMS**), which dropped 6 percent last week and will report its own earnings before the market opens tomorrow, August 5.

Macro

Summer Summitry: Africa Comes To D.C.

With Congress out until September 5, Washington will host a 3-day "U.S.-Africa Leaders Summit," featuring heads of state, business representatives, and Obama cabinet/World Bank officials.

The President will speak at the [event](#), the theme of which is "Investing in the Next Generation," on Tuesday, August 5, at 2:45 p.m. EDT.

Per the *Washington Post*, "The 2014 U.S.-Africa Leaders Summit is designed to strengthen ties between continents and bolster economic development and trade. This many heads of state have not visited Washington at one time since the Nuclear Security Summit in 2010, during which 40 leaders met at the Washington Convention Center."

Despite this historical context, initial [focus](#) in the capital has been on the significant road closures and other hassles expected to be visited upon daily commuters, even with Congress now gone.

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As highlighted during a July 29 CRFB [event](#) designed to "decode" the Social Security trustees report, Congress will almost assuredly have to act by 2016 to at least shift the allocation of payroll tax revenues in order to prop up the depleting Disability Insurance (DI) fund. But given the success of the Greenspan Commission, which paved the way for tax hikes and benefit changes that helped to extend the solvency of Social Security during the Reagan administration -- and more recently, the also-arguably successful Simpson-Bowles Deficit Reduction Commission -- some, like the bipartisan duo of Rep. Tom Cole (R-OK) and John Delaney (D-MD), argue that [the time is right](#) for bolder action. Specifically, it's time for Congress and the Obama administration to address the long-term insolvencies of Medicare and the Social Security OASI programs, as well.

The earlier that corrective action is taken, the less painful it will be for beneficiaries and taxpayers alike, it is argued. But with the trustees' report moving the Medicare x-date back another 4 years, to 2030, and the Social Security trust funds blended together still non-threatening before 2033, the odds of Congress agreeing to another commission are (perhaps unfortunately) small, according to budget experts.

Elections: GOP Primaries Set To Further Test Establishment Incumbents

Sens. Pat Roberts and Lamar Alexander are expected to fend off primary challengers in KS on Tues (Aug 5) and TN on Thurs (Aug 7). Though upset seems remote, Tea Party involvement makes the KS contest worth watching.

Alexander has touted endorsements from former House Speaker Newt Gingrich and Kentucky Sen. Rand Paul (R-KY), and has succeeded in blocking any major endorsements or funding from Tea Party or conservative groups to his competitors State Rep. Joe Carr and radiologist George Flinn.

Roberts, for his part, has seemed to face a bigger challenge from Tea Party-backed Milton Wolf (another radiologist), who still trailed by 20 points in a recent Survey/USA poll. As some sources have noted, Tea Partiers have recently turned their attention to the Kansas race, after helping to knock off former House Majority Leader Eric Cantor (R-

VA), who resigned last week, and coming up just short in the race to displace Mississippi Sen. Thad Cochran (R-MS). But mitigating against broader conservative-group involvement have been recent embarrassing news reports that Wolf posted x-rays of deceased patients on Facebook.

As a side-bar, the *Washington Post* has reported that, also on Tuesday, MS State Senator Chris McDaniel promises a "major development" regarding the July 23 runoff results in which he lost to Cochran.

Meanwhile, Democrats will be showcasing their own - and only- competitive primary in Saturday's August 9 contest between Hawaii's Lt. Governor Brian Shatz and Rep. Colleen Hanabusa (D-HI) to take the seat of former Sen. Dan Inouye (D-HI). Whoever wins is expected to beat a lesser-known Republican nominee in the deep-blue Aloha State.

Elections: Signs of Lifting Economy Help Dems, But Messaging Clouded

Improving GDP, job data comport w/ our 55% odds of Dem. Senate retention. But dismal consumer sentiment shows voters are unimpressed, while gloomy foreign policy stories back out income inequality, other campaign narratives.

Almost like a tree falling in the woods was President Obama's weekly [address](#), in which he bragged about his administration's role in U.S. economic revival and urged fellow Democrats to exhort their constituents to demand that Republicans stop blocking legislation to help the middle class. This prompted a mention of, among other things, bills to raise the minimum wage and reduce the costs of student loans, neither of which has a shot of enactment.

Meanwhile, as we noted in Friday's *Trending Ten* [list](#), surprising GOP prospects in Colorado and Iowa could yet lead us to cross the line to predict a Senate shift. And, in our view, this could produce a boost for energy, financials, defense, for-profit education, and other "red" stocks.

Upcoming Capital Alpha Events

- Spotlight Call: Hydraulic Fracturing State of Play, August 7th
- Spotlight Call: DoD Budget Issues for 2015, August 14th
- Spotlight Call: Mid-Year Financial Policy Update, August 21st

Contact [Rich Linville](#), [Tom Butler](#), or [Courtney Oldham](#) for details. MP3 replays of our past calls are also available upon request.

Other notes today from Capital Alpha below
(with extended commentary available [here](#)).

Multi-Industry - Loren Smith

House Border Bill Affects Immigration Debate

Late on Friday, the House succeeded in passing a bill to address the border crisis. It's likely that the Senate will reject the proposal, but some compromise remains plausible.

Health Care - Kim Monk & Rob Smith

Congress Overwhelmingly Passes Veterans Health Reform Measure

In a win for services, the bill infuses \$10b into private healthcare facilities & providers. It is unlikely the VA will be fixed before the money runs out. Congress will likely appropriate more in the not-too-distant future.

GILD: Stable Part D Premiums May Deflate Sovaldi Cost Fears

PhRMA claims that CMS's \$1 projected premium increase means that Sovaldi won't break Medicare. But we expect plans and payers to keep up their public shaming effort. We still see the risk of government price controls as low.

Final FY15 Inpatient Hospital Pay Rules Out This Week

Hospitals may see a slight improvement in the overall 0.8% cut included in May's proposed rule. The proposed rule did not include much in the way of policy changes - the cuts were due to ACA statutory provisions.

Final Hospice Rule This Week Likely Unchanged from Proposed

We expect the final rule to follow the proposed version's 1.3%, \$230 million increase with no payment reforms. CMS addressed controversy over drug benefit coordination with hospice and Part D in a separate rule last month.

ACA: Losing Parties File Appeals in Halbig and King

The cases are likely headed to the Supreme Court, and possibly sooner than anticipated. A wildcard, but we think the law will be upheld.

Telecom & Media - Robert Kaminski

Telecom REITs: Easier for WIN than VZ or T

We are not surprised that fiber and copper can be REIT property, but we suspect that spinning off REITs will be easier for smaller telcos

T-Mobile: Anything is Better Than Sprint

Nearly any other deal for T-Mobile—now including French telco Iliad—would be easier to get approved than Sprint.

Spectrum JVs & S/TMUS on Alert

The FCC's forthcoming "competitive bidding" rulemaking is not the dealbreaker for S/TMUS (there are many others, in our view), but it is a bad headline.

Defense - *Byron Callan*

Some Reasons Why Defense Stocks Aren't Reacting to "Geopolitics" in '14

While "geopolitical risk" may be higher on the minds of investors, it does not appear to be seeping through to higher defense stock valuations.

Defense Week Ahead

The AIAA/USU Conference on Small Satellites takes place on Aug. 2-7.

Capital Alpha: Ten Trending Policy Issues for Investors

We recently launched our quick takes on the top policy issues for institutional investors. This "Trending Ten" will be updated regularly.

Download the full report with detailed coverage [here](#).

- GOP's final Senate-run casting awaits Aug primaries in TN, KS, AK. 45% odds of control shift, but surprise CO, IA prospects could trip our "red" line.
- Oil & gas, utes, for-profit colleges, financials, IT outsourcers, student loans, defense, beverages, tobacco, auto dealers among prominent "red stocks."
- "Blue stocks" (better w status quo): hospitals, construction, homebuilders, MIs, GSE preferreds, alt. fuels, online gaming, ACA-leveraged managed care.
- EPA's delayed 2013 RFS compliance deadline moves 2014 RFS release nearer to Nov 4; positive for higher-mandate, Dems' Braley in IA Senate race.
- Veteran's Health Reform bill is win for services, pumping up to \$12 billion to non-VA hospitals & facilities. Opens door to VA privatization: **THC, HCA, UHS**.
- CMS issues positive final 2015 updates for IRFs, SNFs, and IPFs. Post-acute faces ongoing offset risk. CMS hints at future IPF changes: **KND, HCP, UHS**.
- FDA move to regulate lab developed tests a negative for **DX, LH**, positive for diagnostic manufacturers like **ABT** and **Roche**. House GOP may try to block.
- Any deal for **T-Mobile**, now potentially including French telco Iliad, would be easier to get approved than the **Sprint** deal.
- Balanced GAO funding-subsidy report offers no reprieve for 8 largest banks, now almost certain to be hit w/ a SIFI buffer/higher-capital requirement.
- FHFA reviews on MI min capital, GSE fees + FHA's dismal HMDA report card to sync in September; net positive mortgage mkt impact to result early '15.

Analyst Certification

The following analysts hereby certify (1) that their views about any and all of the subject companies and securities discussed in this report are accurately expressed and (2) that no part of their compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this report: Charles Gabriel, Joseph Engelhard, Kim Monk, Rob Smith, Byron Callan, Loren Smith, James Lucier, Robert Kaminski.

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