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BANKING
stocks
to watch

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NAVIGATING GLOBAL BANKING

The tailwinds, headwinds and whirlwinds that could leave lenders lost at sea

- → Citigroup [C]
- → JPMorgan Chase [JPM]
- → Bank of America Corporation [BAC]
- → Wells Fargo [WFC]
- → Goldman Sachs [GS]
- → RBS [RBS]
- → Lloyds [LLOY]
- → Barclays [BARC]
- → HSBC [HSBA]
- → Standard Chartered [STAN]
- → Deutsche Bank [DBK]
- → Commerzbank [CBK]
- → UBS [UBSG]
- → Caixabank [CABK]
- → Crédit Agricole [ACA]
- → China Merchants Bank [CIHKY]
- → BNP Paribas [BNP]
- → PNC Financial Services [PNC]
- → Bank Central Asia [BBCA]
- → Banco Santander [BNC]
- → Westpac [WBC]

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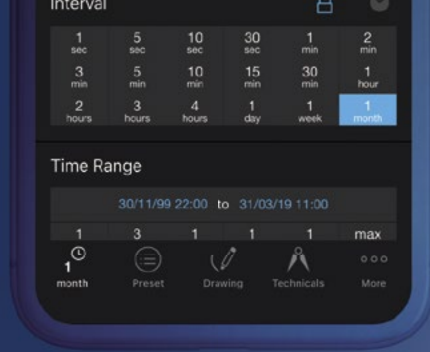

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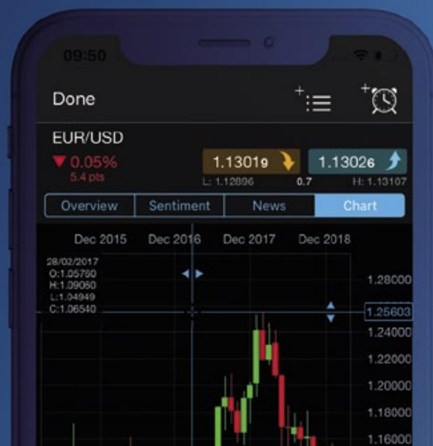

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It is almost 12 years since some of the most established — and trusted — banks helped send the global economy into **FINANCIAL CRISIS**. At the start of 2020, banks around the world are facing more unprecedented **UNCERTAINTIES** in the way of a global pandemic. How can investors navigate this market storm?

1

PART 01:
An overview

"Banks were disappointing performers the world over in 2019, as respective local indices for bank shares lagged the major benchmarks, sometimes by some distance, with the sole exception of the US," Russ Mould, investment director at AJ Bell, tells *Opto*.

Looking at the global market compared to banking sector returns in 2019, excluding dividends and share buybacks, the numbers are indeed mixed. All the main banking indices managed to finish lower than their market benchmarks in 2019, though they varied in strength.

In Europe, the Stoxx Europe 600 rose 23%, while the Stoxx Europe 600 Banks index was up by only 8.3%. Indeed, the UK-based FTSE All-Share index rose 14.18%, outpacing its bank index's 2.16% gain. For Asian markets, Japan's Nikkei 225 increased by 20%, with its index for banks up by a fraction at 1.15%.

In the US, however, that wasn't the case, as the S&P 500 index was up by 28% while its banks index soared by 36%. "US banks benefited from above average economic growth, buoyant capital markets and, above all, the decisive action taken in 2008-2009 to clean up their balance sheets," Mould adds. "Robust finances mean they are now able to run more generous dividend policies and also buy back substantial amounts of stock. This is in contrast to say, Europe, where nagging fears over non-performing loans and brittle, over-banked economies persist."

Aside from country-specific issues for banks to contend with, such as Brexit and the August deadline for payment protection insurance (PPI) compensation claims in the UK, lenders the world over faced three major headwinds in 2019: debt, competition from fintech and challenger banks, and pressured net interest margins. "The world is becoming ever more indebted. Banks are lending to customers who are already up to their necks in debt," says Mould. "This raises the risk of increased bad loan provisions should the global economy turn down or interest rates unexpectedly go up quickly. Technology and challenger banks mean the banking market is becoming ever more competitive at a time when Western markets, at least, are mature, low growth at best and tightly regulated. Finally, net interest margins are under pressure, as an unintentional consequence of zero and low-interest rate policies as well as quantitative easing."

These three headwinds came to a head earlier this year when the markets were taken hold by the coronavirus pandemic that prompted the fastest stock market correction in history. Central banks around the world rushed to provide stimulus measures to prevent a major economic fallout, although this did not garnere the positive response

> "Having to face shutdowns of the economy around the globe is obviously going to affect **BANKS MORE THAN ANY OTHER SECTOR**"
>
> *— Guy de Blonay, Jupiter Asset Management*

from investors that was expected.

The rate cuts may give some support to lenders, but they also create more long-term problems because banks aren't able to make healthy returns in a low-interest rate environment, Mould explains. Lenders also require a steep yield curve and wide credit spreads to perform positively, however, all three are missing at the moment, resulting in missed returns on tangible equity targets and terrible share price performances.

These conditions are not anything new for banks to navigate. For the past 30 years Japan has been trying zero or negative interest rates to prop up its economy since the stock market bubble of 1989, Mould notes, however since the Topix Banks peaked it is down 92%. "The FTSE All-Share Banks index peaked in June 2007, just as a debt-fuelled property and stock market surge was about to pop in the West. Since then, it has fallen by 75%," he adds.

"A comparison of the Topix Banks index since 1998, when the boom was in full swing, and the FTSE All-Share banks index since the start of 2006 (giving the UK index the same starting point), makes for sober viewing. It suggests that the longer rates stay near zero and the yield curve stays flat the tougher life will stay for UK banking shares, if the Japanese experience is any guide. Central bankers and investors beware."

Tracking the banking sector's market performance

A survey by Retail Banker International found that 75 of the world's 100 largest banks by market capitalisation posted rises in their share prices last year. Citigroup [C] led with a 57% annual gain followed by JPMorgan Chase [JPM] gaining 47.2% and Bank of America Corporation's [BAC] 46.2% rise.

Much of that boost in the US occurred in the final quarter of 2019, with the country's five-largest banks posting average share price gains of almost 17%, according to the *Financial Times*. They were helped by the US Federal Reserve's interest rate cuts as well as the lessening in tensions in the US-China trade dispute, positive domestic economic trends and strong investment banking returns. Share buybacks also boosted stock prices, with the five biggest US banks collectively spending more than $57bn buying back stock.

The start of 2020 however, has been a much different story. US bank stocks have been pummelled so far this year as the viral outbreak spreads around the world. The KBW Nasdaq Bank Index has fallen by more than 42% since the start of the year through March, wiping out over 30% annual gain from last year. Shares of JPMorgan, Bank of America and Citigroup are all down more than 30% from their January highs. As a result, the Financial Services Forum, which includes major US banks such as JPMorgan, Bank of America and Citigroup, announced in March that it would suspend all stock buybacks through the second quarter in order to use excess cash to support the economy. The outlook remains murky though, as two of Wall Street's biggest banks forecast diverging outlooks. While Morgan Stanley [MS] equity strategist Michael Wilson believes "the worst is behind us", JPMorgans' equity strategists are more cautious, advising clients to "keep a defensive sector allocation", according to the *Financial Times.*

UK banks have mirrored these measures to stop the falling share prices. Standard Chartered [STAN], NatWest, Santander [SAN], Royal Bank of Scotland [RBS], Nationwide, Lloyds [LLOY], HSBC [HSBA] and Barclays [BARC] all announced at the start of April that they would cancel dividends and share buybacks this year on the Bank of England's request. The decision was well received in the UK.

"From a UK policy perspective it is understandable... but this is damaging in Asia and around the world," Ronit Ghose, an analyst at Citigroup, told the *Financial Times*. "UK institutional investors and

Hong Kong retail investors own bank shares for the dividend. This isn't billionaires and hedge funds, a lot of these people are ordinary folk."

Compared to the FTSE 100's 24% decline in the first quarter of 2020, the FTSE 350 Bank Index has shed 34%, as shares in the partly state-owned Royal Bank of Scotland and Lloyds dropped by 57% and 49% in the same period of time. Indeed, shareholders are nursing historic losses with lenders sinking to levels below those of 2008. "Having to face shutdowns of the economy around the globe is obviously going to affect banks more than any other sector," Guy de Blonay, portfolio manager at Jupiter Asset Management, told *Bloomberg*. "You got share prices that have gone down even further, pricing in Armageddon."

An uncertain outlook

As the markets enter the second quarter of 2020, investors and analysts are pointing to more rough seas ahead. In Europe, dividend futures have collapsed even more than stock benchmarks, erasing all attractive prospects among the regions' banking stocks. Barry Norris, founder of Argonaut Capital Partners, has long held the view that European banking stocks are uninvestable. "In a lot of these sunset industries, the only way investors get hooked on the equity story is for dividends because there's very little growth, very little terminal value and there's not really a narrative," he told *Bloomberg*. "That's just proven to be a complete illusion."

Across the pond, the coronavirus looks set to impact earnings throughout the sector, with Moody's Investors Service projecting a contraction in global economic growth in 2020. The financial services firm downgraded 11 other countries' banking sectors in the Asia-pacific region at the start of April due to the coronavirus outbreak and broad economic deterioration.

To find some banking stocks that could prove to emerge from this market downturn relatively unscathed, *Opto* takes a look at financial institutions across the the globe.

2

PART 02:
UK and European banks under pressure

UK banking stocks had a tough time in 2019, as they were hit by fears over Brexit and how it might affect regulations, the domestic economy, near-record low interest rates and revenues. As a result, businesses fretted about a return to recession, delaying their investment and expansion plans. In addition, banks faced more provisions for compensation claims related to PPI.

In the UK, the FTSE 350 banks index was up by just 2.2% in 2019, trailing the FTSE 100's gains of 12%. Given the headwinds, the UK banking sector's major stocks were volatile. For example, shares in RBS started 2019 at 214p, reached a high of around 273p in March, plunged to a low of 176p in August and ended the year up 13% at 240p.

Lloyds' shares began the year at around 51p, reached a high of 67p in April, hit a low of 48p in August and finished the year up 27% at 63p. Barclays' share price started at around 148p, hit a low of 135p in August, reached a high of 175p in November and ended up by 24% at 180p.

"In 2019, the UK market was characterised by competitive pressures in mortgage lending driven by ring-fencing regulation forcing banks to deploy their UK deposits back into the market as well as new challenger banks looking to take market share," Niklas Klammer, equity analyst at Morningstar tells *Opto*.

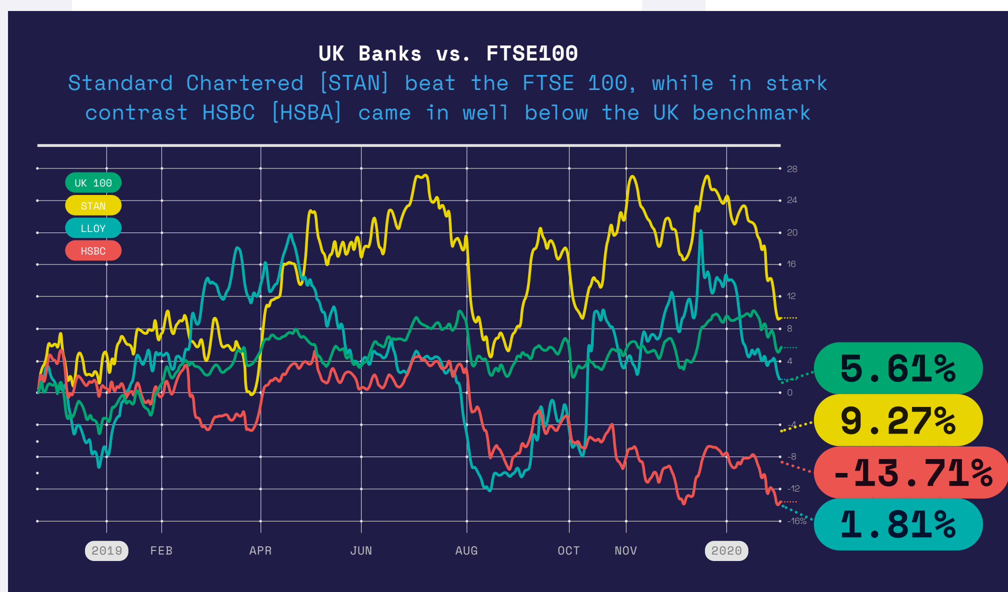
"On the corporate banking side, Brexit uncertainty meant many corporates delayed investment decisions, which resulted in subdued loan growth. Additionally, the largest UK banks saw a surge in PPI claims towards the end of August 2019, resulting in higher provision charges."

In Europe, one of last year's worst-performing banks was Deutsche Bank [DBK]. Its shares fell from around €7 at the start of the year to a three-year low of €5.78 in August, before closing the year at €6.92.

The German bank issued profit warnings, suffered a failed merger with Commerzbank [CBK], received misconduct fines and stuck too long to outdated technology. Its management responded by aggressively cutting costs, shedding thousands of jobs and scaling back operations.

But overall, European banks, buoyed by a forward dividend yield of 5.7%, remained in favour with investors. This helped the Stoxx Europe 600 banks index to finish the year up by 17%.

> "The UK economy still looks in **REASONABLE SHAPE** at the moment… however, it is still vulnerable to a **SUSTAINED DOWNTURN**"
>
> *– Michael Hewson, CMC Markets*



Source: TradingView 03.02.20

Banks prepare for coming storm

As the epicentre for the coronavirus moved from China to Europe in March, prospects for the region's banking sector deteriorated. Compared to the Stoxx Europe 600's 23% decline in the first quarter of 2020, the iShares Stoxx Europe 600 Banks ETF has fallen more than 38% in the same period. As the Eurozone's weakest link, the banking sector has been trying to stay out of a downward spiral ever since the euro bank bubble imploded in 2008. However, the landscape of negative interest rates has slowly deteriorated the banks ability to turn a profit, causing them to engage in greater risk taking.

"The issue (for banks) isn't so much on the supply side for credit, but on the demand side between the virus, the oil shock. The message that the market is hearing is that the demand side of the economy is definitely going to slow down more," Donald Calcagni, chief investment officer at wealth manager Mercer Advisors, told *Reuters* in March.

As of 19 March, banks were trading at the bottom of their valuations but — at least — have roughly maintained the hierarchy of performers as they were before the crisis. According to *Barron's*, Deutsche Bank trades at about 17% of its book value, and Société Générale trades at about 19%. The strongest lenders in Eurozone, such as BNP Paribas [BNP] and Banco Santander [BNC], trade at about a third of their book value.

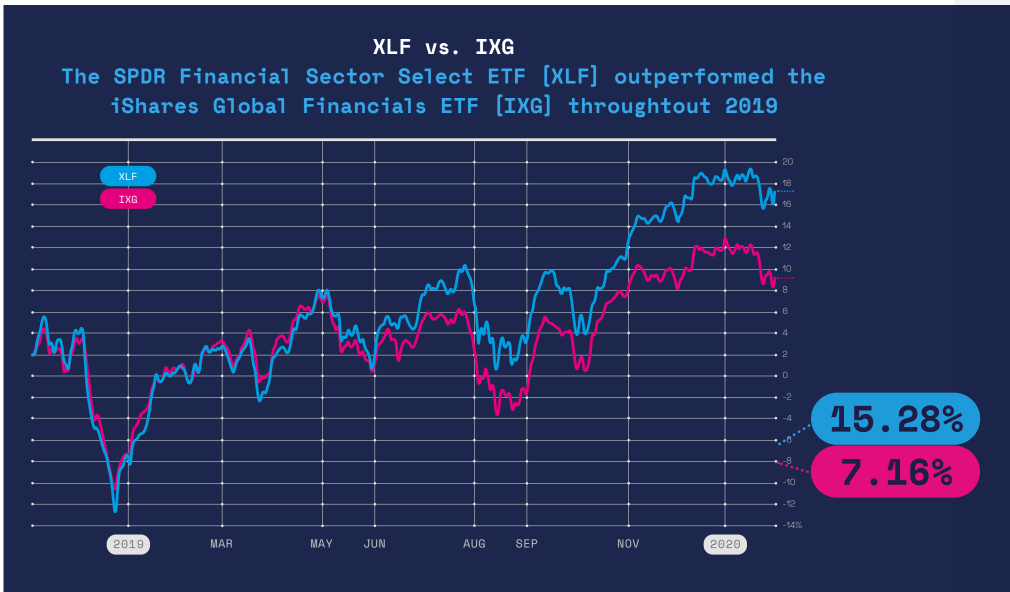
How these industry stalwarts will fare over the coming months comes down to how long the period of Covid-19 disruption lasts and the degree of government response, according to Justin Bisseker, European banks analyst at Schroders. "The first point is of course unknown at this stage. However, we have seen myriad government responses announced across Europe: tax payment deferrals, debt moratoria, credit guarantees, etc, to mitigate the effects of the crisis," he notes. "What is clear is that not all banks will experience the impact in exactly the same way. Some are better positioned than others to weather this crisis and that is why stock selection will be critical when investing in the sector."

Moody's sees choppy waters ahead. The ratings agency downgraded its outlook for banking systems in France, Italy, Spain, Denmark, the Netherlands and Belgium to "negative" at the end of March, saying that it "projects cumulative contraction over the first and second quarters of 2020".Furthermore it said that this environment means "banks' problem loans will increase, while higher loan loss provisions will reduce banks' profitability, which is already low compared to global peers," it added. It also maintained a negative outlook for the banking sectors in the UK and Germany, noting that the coronavirus outbreak will "exacerbate pressures" that already weigh on the sector.

A tidal wave of challenges

Prior to the crisis, Klammer had noted that many of the challenges from 2019 would remain in the UK. "Headwinds around corporate loan growth related to Brexit could persist," he notes. "Finally, banks will start to ramp up for the final step of Basel III regulations. The exact impact is still unclear, although it is fair to say that larger banks, which currently make use of internal risk models will be affected more than smaller peers."

Although the impact of Brexit negotiations —



Source: TradingView 03.02.20

BELOW
A pedestrian wearing a protective face mask passes a shuttered shop. A protracted lockdown could see the UK economy shrink by more than a third in the second quarter of 2020

when the resume — is still a factor to consider, for now at least, Basel III regulations are less prescient. In response to the spread of Covid-19, the Basel committee announced in March that it would suspend consultation on all policy initiatives and postpone all outstanding jurisdictional assessments. Graham Spooner, investment research anaylst at had also previously stressed a a number of negative factors weighing on banking stocks, chiefly the lower interest rate environment, now at historic lows not to mention the "confidence in the sector, which has taken a pummelling over the past decade, leaving investors still wary," he tells *Opto*.

Brexit hasn't fully gone away as a risk factor, according to Michael Hewson, chief market analyst at CMC Markets. At the start of the year, Hewson notes, rising wages and low unemployment meant the UK economy was "in reasonable shape", however he was still war that it would be "vulnerable to a sustained downturn." Indeed, with many banks suspending dividends and share buybacks, income investors will be the hardest hit. Does that mean dividends are doomed?

What to watch

At the start of the year there were three UK banking stocks, singled out by Spooner, which could provide opportunities that trading volatility offers. HSBC's share price dropped from a high of 688p in late April to 589p at the start of this year, and has seen fallen to a low of 454p as of end of March this year. Investors had already been cautious as a result of the bank's exposure to the protests taking place in Hong Kong last year — about 75% of the bank's pre-tax income comes from Asia.

> "The European banking sector is not prepared at all for what is definitely a recessionary shock and potentially a full-blown recession over the next couple of quarters"
>
> *— Dr Edmund Barter, CheckRisk*

"With a significant profit coming from Hong Kong, [the protest] has added to the pressure on the group, which was already weathering the China-US trade war, net interest margin pressure, cuts to performance measures and investment banking performance," Spooner says. "The CEO is set to take more action. But with so much uncertainty surrounding the bank, investors taking a longer-term view should only drip feed and be aware of the increased risk," Spooner had previously noted.

While the broader geographic nature of its business model means that it experiences reduced profit volatility compared to its UK peers, as evident during the financial crisis, it comes with higher capital requirements — HSBC is required to hold an extra 2% capital buffer, according to Morningstar. The bank had a PE ratio of 16.4 as of 8 April, which is below the UK market's average of 12.3, according to data from *Simply Wall Street*.

The second banking stock on Spooner's radar was Standard Chartered. Its share price was up by around 20% in 2019, but wiped out those gains in the first three months of 2020. The stock fell 36% in the first quarter, as it battled with the myriad of "external shocks" that delivered it to rock bottom. As a result, Standard Chartered noted that its return on tangible equity of 10% will be delayed. As it stands, the bank is good value based on its PE ratio of 9.1 on 8 April, compared to the industry's average. The third bank

Big banks report: JPMorgan and Citigroup

JPMorgan's share price has risen to nearly **$139** from around **$96** at the start of last year, has had a strong start to 2020. The bank posted a **21%** year-on-year rise in fourth-quarter profit to **$8.52bn**, in January. Managed revenue jumped **9%** to **$29.2bn.** It says its corporate and investment bank had delivered record revenue, helped by a rebound in bond and stock trading revenues. This offset the hit on margins in retail and commercial banking as interest rates fell.

JPMorgan is expanding its corporate and investment bank, joint ventures in China and its credit card business in the US, as consumer confidence remains strong.

"This sets the high-water mark for the banks and we continue to like the JPM market share/wallet story," Evercore ISI analyst Glenn Schorr says. Citigroup's share price has increased to around **$80** from **$51** last January, could also be a good bet after its recent results. It reported adjusted earnings per share of **$1.90** in the fourth quarter, surpassing analysts' estimates of **$1.82**. Its revenues grew 7% to **$18.4bn**, with net income of **$4.98bn**, up **15%**. Investment banking revenues at Citigroup defied the wider industry's struggles and were strong, up **6%** to **$1.4bn**. It returned **$6.2bn** to shareholders during the period through stock repurchases and dividends.

Analysts at Bank of America have called Citigroup shares their "pick of the decade".

LEFT
Analysts at Bank of America recently called Citigroup shares their "pick of the decade"

that was of interest to Spooner is Lloyds, which had continued to feature regularly as a top traded share at The Share Centre in 2019. Indeed, many investors and traders have been attracted to the UK bank's dividend yield of 5.46% in 2019, which was in the top 25% of dividend payers in the market at the time, according to data from *Simply Wall Street*. Lloyds' share price climbed nearly 30% in 2019, outpacing the UK banking industry's gains. However, in the first three months of 2020 the stock has tanked 49% to 32p, its lowest point since 2012.

In Europe, prior to the pandemic banks faced had already faced a number of headwinds such as pressures to increase their spending on technology investments as well as new regulations, including those related to anti-money laundering and the aforementioned Basel III regulations, according to Jon Peace, head of European banks research at Credit Suisse. "Earnings momentum is weak for the banking sector, with investment banks set to lose share to US peers," he had said, poiting to Deutsche Bank, for example, which he said was expected to report losses in 2020. Ultimately, Dr Edmund Barter, lead data scientist at CheckRisk, thinks that European banks are not in a good position for a period of contraction.

"The European banking sector has never really recovered from the last financial crisis. And even prior to [Covid-19], banks were struggling to find sources of profit. As the long-term negative rates have kicked in, they have really affected the profit margin. And as a result, the European banking sector is not prepared at all for what is definitely a recessionary shock and potentially a full-blown recession over the next couple of quarters," he recently told *Financial Director*.

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PART 03: Can US banks weather the storm in 2020?

US banks had a stellar 2019, most notably in the final quarter. This was helped by the still-strong domestic economy and the first signs of a breakthrough in the US' trade war with China.

The five largest banks in the US — JPMorgan, Bank of America, Citigroup, Wells Fargo [WFC] and Goldman Sachs — posted average share price gains of around 40% in 2019. By comparison, the S&P 500 was up by 30%, while the KBW Nasdaq Bank Index rose by 32% over the same period. The majority of these banks have also announced strong results for the fiscal year 2019 at the start of the year (see boxout, *Big banks report: JPMorgan and Citigroup*).

Above
JPMorgan CEO and chairman Jamie Dimon recently told investors in the bank that earnings would "be down meaningfully in 2020".

US banks' return on capital stood at 18% in 2019, supported by a strong return on assets of 1.5%, according to Deloitte's 2020 banking outlook. Tax cuts and higher federal funds rates until mid-2019 were significant contributors to increased profits.

Indeed, since the financial crash of 2008, major US banks have completed a much-needed restructuring that has helped them build scale, and in terms of return on equity are strong performers compared to their European counterparts. While US banks may have appeared to be better prepared for a market downturn, no number of life rafts could have readied them for the downward spiral that was approaching. The pandemic-induced meltdown dragged the S&P 500 down 20% in the first quarter of 2020, its worst quarter performance since 2008. Banks were among the hardest hit during the quarter, with the KBW Bank and KBW Regional Bank indices both clocking record declines of 43% and 41% respectively.

In a bid to prevent a severe economic downturn, the US Federal Reserve announced an emergency cut of a full percentage point to a range of 0% to 0.25% on 15 March, a level not seen since 2015. It had already cut rates three times in 2019. Sentiment for the sector has soured considerably since, as low interest rates put further pressure on net interest margins and investors worry about defaults on mortgages and loans. "As we've seen over just this weekend, the effects of the Fed cutting rates have not been as positive for the markets as people

Climate change takes centre stage

The growing demand to make countries and companies around the world carbon neutral by 2030 poses "physical and transitional risks" for banks, S&P says. "Regulators are encouraging banks to better quantify climate-related risks and embed them in their strategy and in setting risk appetite. There is an urgent need for banks to improve and standardise data transparency," it states.

Huw van Steenis, a senior adviser at UBS, recently told the *Financial Times* that the greening of "the financial system is going to become a top issue for banks" this year. "Lenders will be making a priority of stepping up climate-related risk management and disclosures," he adds.

Banks' lending decisions over the next 10 years will be steered by the environment. "You will not see banks calling in long-term loans. It is more of a commitment that they will gently reduce that kind [of non-sustainable] lending and find new industries. It could improve their attractiveness to sustainable investors," Rob James, senior equity analyst at Merian Global Investors, says.

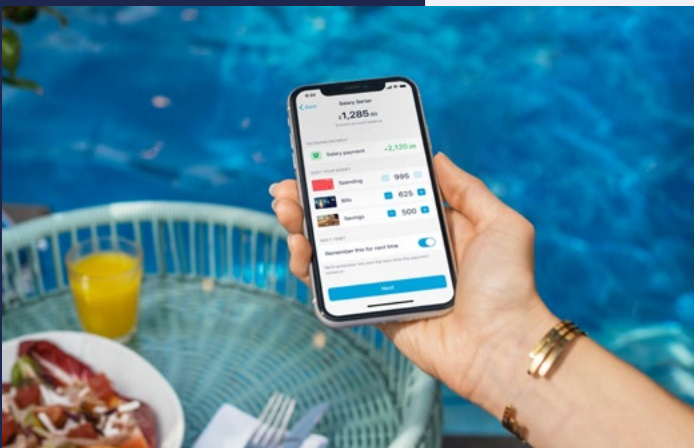
The threat of challenger banks

The rise of agile challengers and fintech banks is posing a threat to established operators, which are often weighed down by clunky and inefficient legacy systems. NatWest and TSB Bank have been hit by IT failures, causing severe inconveniences for customers and knocks to the banks' reputations.

There are also concerns about banks' capabilities to fight off a cyber hack or ransomware attack. Such developments suggest that banks will need to either find ways to grow organically or merge with partners to become more digitally prepared.

"The word of 2020 will be 'scale'," Huw van Steenis, a senior adviser at UBS tells the *Financial Times*. "It's all about banks coping with low rates and funding an ever increasing need to invest in tech."

Investors can expect to see growth in new, independent platforms, such as RBS's digital bank Bó and Marcus by Goldman Sachs, as banks move to compete and attract more digitally savvy customers.



ABOVE In January last year banking startup Monzo had one million users and in January this year the company said that it now has 3.6 million people banking with them

might expect or expected them to be. I think it's fair to say that America is in better place but definitely not a safe haven that you can just run to," Barter told *Financial Director*. As it stands, long-term interest rates remain very low by historical standards, according to Dr Daniel Bachman, senior manager at Deloitte. "The current baseline assume that long-term US interest rates settle in at an equilibrium rate of around 3% during the five-year forecast horizon. This is lower than we previously forecast, and lower than historical experience would suggest," he writes.

> "We believe [by 2020] the **IMPACTS OF ELEVATED PROVISIONING WILL BE REDUCED** and investors can evaluate bank stocks on **POST-RECESSION RETURNS**"
>
> – *Brian Kleinhanzl, Keefe Bruyette & Woods*

Going into the next earnings season, investors should disregard quarterly results, and instead consider a difficult economic cycle through 2021, according to Philip Van Doorn writing for *MarketWatch*. Most analysts have lowered their full-year earnings estimates for the largest US banks, according to van Doorn, however "stragglers" dull the consensus. "So at this time it may be more useful to look at individual projections, which factor in the expected coronavirus-led recession," he writes.

Analysts at Keefe Bruyette & Woods, for example, lowered their median earnings estimates on 31 March for "universal banks" by 58% for 2020 and 50% for 2021. The decision was based on the fact that historically banks have experienced significant upticks in loan losses during recessions, especially six months after unemployment peaks, according to the firm. While the downgrades are servere for the next two years, the bank also introduced estimates for 2022, "since we believe at that point the impacts of elevated provisioning will be reduced and investors can evaluate bank stocks on post-recession returns". Still, Keefe Bruyette & Woods has an outperform ratings for JPMorgan and Goldman Sachs. "For JPM, we believe this is an opportunity to upgrade to quality, and we believe that JPM is well-positioned to withstand a recessionary environment and come out of the recession in a better position than most banks, as the company can use the balance sheet to gain market share," analyst Brian Kleinhanzl wrote.

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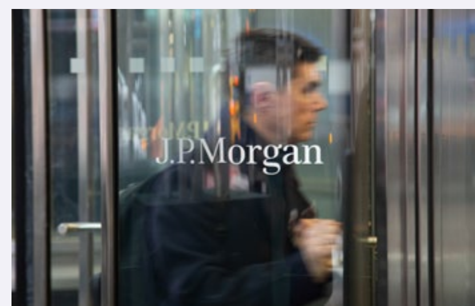
PART 04: Global Banking Outlook

In the face of myriad regional, country-specific and macroeconomic factors at play last year, global banks' share prices showed a resilient performance in 2019. The S&P Global 1200 composite equity index was up by 25% for the year, with the S&P Global 1200 financials index up by around 20%.

As 2019 came to close, major banks such as Credit Agricole, Citigroup, JPMorgan, Bank of America and China Merchants Bank [CIHKY] recorded average share price growth of over 30%, according to a survey by Retail Banker International. Goldman Sachs, BNP Paribas [BNP], PNC Financial Services [PNC] and Bank Central Asia [BBCA] also made significant gains. Those suffering price drops included Banco Santander [BNC] and Westpac [WBC].

Credit conditions stayed broadly supportive of global bank asset quality in 2019, S&P Global Ratings says. "Most banks globally should be able to contend with challenging credit conditions in 2020 at current rating levels," Emmanuel Volland, a Europe-based credit analyst at S&P Global Ratings, writes in a note.

A significant majority of S&P's outlooks for banks globally were stable toward the end of last year, mainly because of few credit losses and solid capitalisation. However, that has largely changed as a result of the coronavirus crisis with the negative performance of global equity markets in the first quarter, prompting a grim outlook for the rest of the year. The S&P Global 1200 index fell 21% in the first three months of 2020, while the S&P Global 1200 Financials index was dragged down by more than 31% in the same period of time.



> "The difference with 2008 is that **WE WERE SEEN AS THE PROBLEM** then, everybody today knows the problem is the virus"
>
> — *Frédéric Oudéa, Société Générale*

Below Jerome Powell, chairman of the US Federal Reserve, announces an emergency rate cut during a news conference in Washington on 3 March 2020.

S&P Global Ratings forecasts bank net interest margins to fall closer to the level they were at when the Fed started raising rates at the end of 2015. "If the US economy can rebound from the impact of Covid-19 in the second half of 2020, as S&P Global economists tentatively expect, we would not expect to lower many ratings on US financial institutions, which generally have strong balance sheets, because of the epidemic's impact," analysts from the ratings agency wrote in an April update. "That said, if Covid-19 has a longer or larger impact on the economy, it could significantly disrupt the generally benign operating environment for US Financial Institutions and lead to a rise in problem loans, a drop in earnings, a weakening of funding conditions for non-bank financial institutions, and negative rating changes." It also expects the US banking industry, which generated $195bn in profits last year, to potentially record a loss a $15bn loss in the next 12 months. While analysts at Berenberg forecast an average 30% loss in profits this year and next for US and European lenders, according to the *Financial Times*. "Confronted with reduced activity, lower-for-longer interest rates, inflexible costs and higher loan losses, the outlook for bank earnings is one-way traffic," they reportedly wrote in a note to clients.

In Asia, the banking systems of China, India and Indonesia are expected to be among the hardest hit

with negative rating momentum inevitable, according to the agency. "Asia-Pacific banking's nonperforming assets and consequent credit losses could rise by $600bn and $300bn, respectively, in 2020 because of Covid-19, the oil price shock, and market volatility."

Banks take leadership position during pandemic

Compared to 2008 when banks were admonished for their role in the financial crash, many are trying to help stop the downturn this time round. A few key stalwarts have been called on to help distribute the unprecedented stimulus programmes worth trillions of dollars. Although governments and central banks are providing a lot of the cash, lenders are serving as a "transmission mechanism" to ensure the support is distributed to those most in need, according to the *Financial Times*. "The difference with 2008 is that we were seen as the problem then, everybody today knows the problem is the virus," Frédéric Oudéa, chief executive of Société Générale, told the publication. "We are one of the activities that has to function… we are the doctors of the economy."

Indeed, many European bank CEOs have announced that they would sacrifice part of their salaries as a gesture of compassion and solidarity in the face of the widespread turmoil prompted by the viral outbreak. The latest being Barclays chief executive Jes Staley, chairman Nigel Higgins and chief financial officer Tushar Morzaria, who said on 8 April that they would all donate a third of their fixed pay for the next six months to go into a new £100m community aid fund launched by the bank. Spain's Banco Sabadell chairman also announced that he would join the effort. "It is an act of responsibility at a time when all of us need to act with the utmost commitment and solidarity," Sabadell chairman Josep Oliu said, according to Retail Banker International. Ultimately, whether banks can maintain this newfound trust depends in large part on their ability to withstand the coronavirus and its aftermath.

Low interest rates create profitability concerns

Low global interest rates are a major concern for banks, as they put pressure on profitability. The current interest rate environment is hurting banks' net interest margins, creating a significant structural problem. S&P Global notes that the pressure is particularly strong in Europe and Japan, with the latter choosing to leave its interest rate unchanged at -0.1% in March. Instead the Bank of Japan has pledged to buy ETFs at an annual pace of around 12tn. That decision was echoed in the UK where the Bank of England kept interest rates at the record low level of 0.1% in March as well as Europe. Because the European Central Bank (ECB) had already lowered its key interest rate into negative territory of -0.5% in September 2019, it decided not to join central banks from around the world in cutting its policy rate further. Despite market expectations for a reduction amid the ongoing coronavirus outbreak, the central bank decided to instead announce measures to support bank lending and expand its asset purchases programme by €120bn. "Rates are in negative territory in Europe and it is difficult for the ECB to cut them further," Frédérique Carrier, head of investment strategy at RBC Wealth Management tells *Opto*. "Although the rate cuts are helpful for market confidence, more action is needed in fiscal policy such as the stimulus programmes announced by the Italian and UK governments." Carrier says that RBC Wealth Management watches the credit markets closely but notes that prior to the outbreak in the US, UK and European economies were strengthening. "If this is a growth scare not a recession, there should be limited downside. However, we remain vigilant of any changes to this scenario."

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