TRICUMEN

Press release

Performance of the Top 11 Investment Banks in 3rd Quarter 2011

Tricumen today publishes its Investment Banking sector update for 3Q 2011, comprising granular analysis of product revenue for the Top 11 global Investment Banks.

The report highlights the following trends in the quarter:

- In Capital Markets, ECM deals have been postponed, rather than cancelled. As participants await stabilisation of equity valuations, banks are looking at a healthy – and growing - backlog. In Europe, however, there are signs of fee margin compression, possibly below the important 2% mark. The DCM business remains generally depressed.
- The FX trading revenues recorded solid growth in client flows, tempered by tighter margins. Revenue weakened sequentially, but grew 5% (in US$ terms) relative to 3Q10.
- Rates trading revenues also benefitted from strong client flow: revenue declined versus the previous quarter, but jumped 20% year/year.
- Credit suffered a disastrous quarter almost across the board, particularly in structured credit area, with a number of banks recording negative revenues in the quarter.
- The mortgage business dried up, with at least two banks taking losses on relatively recent deals. Looking ahead, market leaders – e.g. Credit Suisse, Barclays Capital – are very unlikely indeed to match last year's $1bn+ revenue.
- Following several turbulent quarters in late 2010 and 1H11 – marked by significant position-taking – the Commodities business provided solid revenue in 3Q11. Goldman Sachs retained its revenue lead.
- Cash equities registered seasonal decline; year/year, the market leaders – Bank of America, Citi, Goldman Sachs, UBS - extended their share of the revenue pool. Our sources generally agree that new entrants in 'traditional' cash equities – BNP Paribas and Barclays Capital – are not making (profitable) headway against the incumbents.
- Equity derivatives revenues were generally depressed, except in corporate derivatives. Flow derivatives and cash equities are converging.
- Prime Services revenues were steady in the quarter. Investment banks are increasingly bundling execution, clearing and settlement services.
- A much diminished Prop trading still operates in stand-alone units (e.g. JP Morgan, Goldman Sach), in arbitrage desks attached to equity derivatives trading teams (e.g. Societe Generale), and within Group Treasury management teams.

About Tricumen

Tricumen is a specialised market intelligence provider. Its clients include Investment Banks, strategy consulting firms and technology firms working with banks.

Tricumen is based near Cambridge in the UK. The firm leverages its core staff by drawing on its 50-strong global network of research partners. Tricumen has links with Cambridge University and is proud to sponsor an Economics Bursary.

For further details please contact:

Seb Walker on 07789 917763; or
Darko Kapor on 07817 562 296

The perfect storm

Markets overview

Depressed by the ongoing macro crisis in Europe – and therefore the rest of the world - the 3Q11 very nearly established a new record: as of the last week of September, it was the second-worst quarter for stock prices in nearly 24 years of MSCI All-Country World share index.

On the earnings front, the banks faced the perfect storm during much of 3Q11: equity prices dropped in the US and globally; debt spreads generally widened; investors were doing their level best to avoid risk; and the volatility depressed the primary fee generation. In words of ever-quotable GS' CFO Viniar: 'Faced with a challenging global economic outlook, CEO confidence and investor sentiment remained under pressure. Whether it was a volatile and unpredictable market that made new equity issuances very difficult to execute, our asset management clients having much less conviction on investment decisions, the broader environment served as a significant headwind to clients moving forward with their business objectives.'

Also, it comes as no surprise to us that CEEMEA and LatAm continue to degrade in importance. With possible exception of Brazil (where JPM, Citi, GS, UBS and others are investing), year-to-date LatAm results were generally underwhelming, CEE capital markets remain small, and most of the banks we cover announced reductions in their MENA capital markets activities. We do not expect a reversal of these trends anytime soon; nor do we expect APAC emerging markets – where strong competition is shrinking the overall operating margins - to fully compensate.

Primary markets highlights:

- M&A volumes nosedived in 3Q11 vs 3Q10, with EMEA, non-investment grade corporates and private equity firms (which typically need leveraged loans and HY bonds) doing particularly badly. Our sources generally agree that the lack of financing is the key reason for the slowdown; and more than a few expect a further – and possibly quite severe - slowdown in 4Q11.
- A slump in global stock markets lowered the ECM investors' risk appetite, and in turn caused issuers to postpone/shelve IPOs. According to Bloomberg data, $34bn worth of IPOs were withdrawn/postponed in 9m11, a sharp annualised rise compared to FY10 $40bn. Several of our sources also stressed deteriorating IPO margins. In the stalling European market – which we hear was hit worse than the USA in 3Q11 - several deals were reportedly done at sub-2% fee level, which some market participants believe is the breakeven point on a medium-sized deal. Various sources agreed that APAC volumes were reasonably strong; but we see no sign of competitive fee pressures abating.
- The US leveraged finance (bonds and loans) nosedived in Aug-11, following the US sovereign downgrade and the heightened concerns about the macro situation in Europe; there was some improvement in September, but not enough to compensate. The weak 3Q11 may extend into weak 4Q11 and 1Q12; or not: our sources broadly agree there was no sign of panic selling, probably because *healthy* US corporates reduced their leverage over the past 3 years, yields are attractive, and banks are willing to lend.
- The market for new foreign-currency bond issues by the emerging markets corporates dried up in 3Q11. The key drivers of the decline were a drop in the value of emerging markets' currencies relative to the US dollar, which raised the cost of refinancing; and the spreading concerns that economic slowdown in Western economies will reduce the demand for emerging markets exports.
- The CMBS market, which appeared on the mend in 2010 (some analysts were predicting FY11 issuance volume at $40bn+), suffered a severe slowdown in 3Q11 as investors avoided assets perceived as risky. Sources generally agree that banks have been unable to securitise many of the CMBS loans made in late 2010 and 1H11. If true, this alone may well freeze new issuance, temporarily at least: with so much uncertainty in markets and the regulatory outlook, banks are very reluctant to keep such loans on own books. In early Oct-11, the risk premiums on top-rated 10-year CMBS paper reached 370bp over interest rate swap (vs approximately 200bp in July), and yields are pushing 6%, up from 5.3% in July.

The sales & trading revenue declined sharply in 3Q11, both vs 3Q10 and 2Q11. The lack of identifiable trading trends in equities *and* bond markets both discouraged client activity in high-margin products and complicated banks' hedging of the risk in inventories. In the US, exchange-traded fund (ETF) volumes – especially in leveraged and inverse ETFs - boomed as investors shorted and/or hedged their equity holdings. By late August, SEC issued a 'concept release' – which normally precedes regulation - querying mutual and ETF funds' leverage, and composition and risk profile of derivatives holdings.

Equity markets highlights:

- In cash and derivatives, the seasonal slowdown and escalating cost of hedging in exceptionally volatile markets depressed income almost across the board. As they gain in popularity - and thus become integrated into the 'mainstream' investment process - equity swaps and options are increasingly driven by the same macro trends determining the activity in cash equities.
- Corporate derivative revenue did reasonably well in 3Q11. Looking ahead, several of our sources opined that, in Europe and the US, 2012 may be a good year as clients increase their use of flow and structured OTC equity products and focus shifts from counterparty risk to individual banks' practical expertise.
- The high volatility in global equity markets rendered active stock-picking all but meaningless. Investors flocking to high-beta shares could prompt a small year-end rally – and an attendant rise in VaR - in 4Q11; but more lastingly, it may well imply troubling times ahead for the 'traditional' cash equity players outside of the 'Tier 1' league.
- Electronic equity – particularly algo trading - continues to gain in importance, with a number of 'our' banks boosting their e-platforms.
- Our sources generally agree that hedge funds may continue deleveraging in the next few quarters; still, prime service providers did relatively well in 3Q11, and most of 'our' banks are investing in this business. We expect that full-service 'solutions' providers will outpace their smaller peers in the medium term. There is growing evidence that hedge funds are abandoning the 'multiple prime broker' model (which caused operational difficult even in large funds) in favour of one or two – preferably highly-rated - universal providers.

Fixed income markets highlights:

- Credit markets suffered a terrible 3Q11, with number of players reporting losses, especially in structured products. Liquidity declined sharply during 3Q11 as market participants reduced the size of their bond holdings; both investment grade and high yield bonds were hit.
- In FX, 'our' banks generally did well in 3Q11. We expect the solid performance was down to increased client flow, rather than position-taking: European sovereign crisis, the likelihood of it triggering a global recession, and central banks in intervening in currency markets from Chile to Japan all translated into very pronounced losses, or gains, for active traders (most visibly, hedge funds); while the flow facilitators – led by banks we follow - generally benefitted from clients' increased activity. Not surprisingly, some banks – BNPP, CS, RBS, among others - are actually hiring, though our sources generally agree that guaranteed bonuses (be it cash or stock options) are but a fading memory.
- Commodities revenues were impacted by the global sell-off in 3Q11, the price falls exacerbated by several large players liquidating their positions. Coupled with the pessimistic global macro outlook, this may well prompt some players to review the size of their Commodities teams.

On the operating cost front, a fresh round of redundancies is well under way. Weak 2Q11 and 3Q11 revenues are the key contributor; but – as we pointed out in the past - the rising proportion of fixed component (i.e. the salary) in the total comp packages is unlikely to be far behind. 'Greedy' bonuses have buckled under the weight of popular opinion and new regulation; banks responded by increasing the salary component of the comp package; and hence, now banks looking to make a meaningful dent in their costs have little choice but to reduce the headcount: even today, few banks – GS is *rumoured* to be among them – have inserted a clause in new contracts that gives them an option of reducing base salaries.

Product Revenue: Momentum

(Peer Group Average*, TRIC product definitions, post-writedowns, US$m, Global Level 1 estimate)

	FY09	1Q10	2Q10	3Q10	4Q10	FY10	1Q11	2Q11	3Q11	3Q11/3Q10: Top 3 growth
Total: TRIC definition	18,233	5,167	3,943	4,267	4,112	17,099	5,643	4,489	2,601	BARC / JPM / MS
Primary	2,643	855	909	1,003	1,344	3,851	1,130	1,247	765	DBK / MS / BAC/MER
DCM	1,016	253	185	298	270	1,072	274	219	100	CS / SG / MS
Loan Orig & Synd	552	166	251	218	320	857	278	336	250	Citi / MS / UBS
Securitisation	-815	77	89	68	82	254	102	103	46	Citi / BAC/MER / BARC
ECM	1,034	179	173	167	362	788	221	261	120	UBS / BAC/MER / MS
M&A	856	180	212	252	311	880	256	328	249	BNPP / UBS / MS
Secondary	15,703	4,227	3,048	3,159	2,678	12,986	4,461	3,191	1,887	JPM / MS / BARC
FX	1,813	428	456	431	392	1,782	465	424	413	MS / UBS / DBK
Rates	4,543	1,046	799	795	537	3,235	977	768	663	MS / GS / JPM
Credit	3,067	1,232	626	706	357	3,056	1,260	652	-26	JPM / DBK / Citi
Commodities	976	180	163	149	236	661	241	163	188	DBK / BNPP / BARC
EQ Cash	1,458	346	320	294	352	1,231	424	318	290	BAC/MER / GS / MS
EQ Derv & Converts	1,750	509	354	430	435	1,621	597	504	326	BARC / MS / CS
Prime services	770	166	194	192	205	672	211	210	191	UBS / MS / GS
Prop Trading	1,326	321	137	161	164	728	287	152	-158	N/M
Principal Inv	-112	86	-15	105	89	262	52	51	-51	N/M

** (1) Peer Group: BARC, BNPP, Citi, CS, DBK, GS, JPM, MS, SG, and UBS. (2) 'Averages are calculated on a line-by-line basis.*

Product Revenue: Momentum*

Year-to-date: y/y (TRIC product definitions, post-writedowns, % change, Global Level 1 estimate)

	BAC/MER	BARC	BNPP	Citi	CS	DBK	GS	JPM	MS	SG	UBS	Top 25%	Bottom 25%
Total capital markets	↓	↑	→	↓	↓	→	↓	↑	↑	→	↓	-5%	-15%
Primary	↑	↓	→	↓	→	↑	→	↓	↑	↓	↓	9%	-3%
DCM	→	↓	→	↓	↑	↓	↑	↓	↑	→	↓	-11%	-25%
Loan Orig & Synd	↓	↓	↓	→	→	↓	↑	↑	↑	↓	→	82%	24%
Securitisation	→	↑	↑	↓	↑	N/M	→	→	↓	↓	N/M	-36%	-60%
ECM	→	↑	↑	↓	→	↑	↓	↓	→	↓	↓	24%	-3%
M&A	↑	↓	↑	↓	↓	→	↓	→	→	↓	↑	39%	8%
Secondary	↓	→	↓	↓	→	↓	↓	↑	↑	↑	→	-4%	-20%
FX	↓	↑	→	↓	↓	↓	↓	→	→	↑	↑	-1%	-11%
Rates	↓	→	↓	↓	↓	↓	→	↑	↑	↑	→	-8%	-22%
Credit	↓	→	↓	→	↓	↑	↓	↑	↓	N/M	→	-18%	-45%
Commodities	↓	→	↑	↓	↓	→	↓	↑	↓	→	↑	145%	-17%
EQ Cash	→	↓	↑	↓	↓	↓	↑	↓	↑	→	→	11%	-10%
EQ Derv&Conv't	↓	↑	↓	↓	→	↓	→	→	↑	↑	↓	10%	-8%
Prime services	↓	↑	↓	→	→	↓	→	↓	↑	↓	↑	10%	-10%
Prop Trading	↓	↑	↑	N/M	→	N/M	↓	→	↓	→	↑	8%	-77%
Principal Inv	N/M	↑	N/M	→	↑	↓	↓	N/M	↓	N/M	N/M	6%	-66%

** Arrows graph % change rankings versus peers. Up-/down-arrows: top-/bottom-quartile.*

Product Revenue: Momentum*

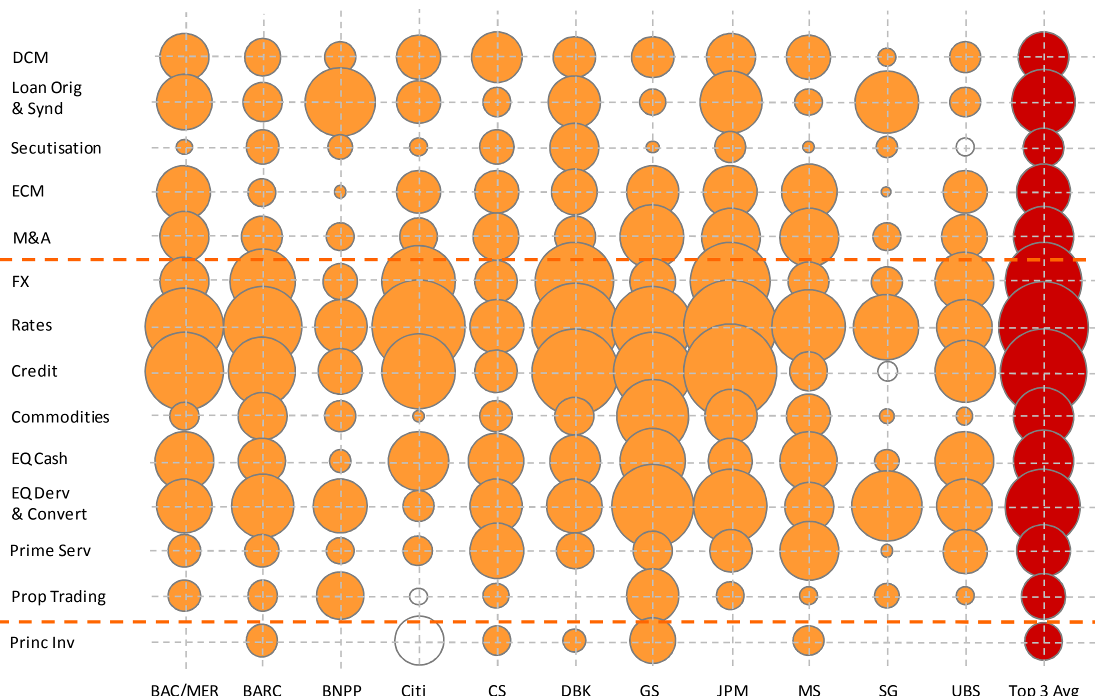
3 months: y/y (TRIC product definitions, post-writedowns, % change, Global Level 1 estimate)

	BAC/MER	BARC	BNPP	Citi	CS	DBK	GS	JPM	MS	SG	UBS	Top 25%	Bottom 25%
Total capital markets	↓	↑	↓	→	→	→	↓	↑	↑	↓	↓	-28%	-41%
Primary	→	↓	→	→	→	↑	↓	↓	→	→	↓	-20%	-31%
DCM	↓	↓	↓	→	↑	N/M	↓	↓	→	↑	→	-50%	-65%
Loan Orig & Synd	↓	↓	↓	↑	↓	→	→	→	↑	↓	↑	48%	10%
Securitisation	→	→	↓	→	↓	N/M	↓	↓	↓	N/M	N/M	-3%	-47%
ECM	↑	↓	↓	→	→	→	↓	↓	↑	↓	↑	-13%	-48%
M&A	↓	↓	↑	↓	→	→	→	↓	↑	↓	↑	11%	-14%
Secondary	↓	↑	↓	↓	→	→	↓	↑	↑	↓	→	-23%	-51%
FX	↓	→	→	↓	↓	↑	↓	↓	↑	→	↑	13%	-19%
Rates	↓	→	↓	↓	↓	↓	↑	↑	↑	→	→	5%	-33%
Credit	N/M	N/M	N/M	↓	↓	↓	↓	↓	N/M	N/M	N/M	0%	-68%
Commodities	↓	↑	↑	→	↓	↑	↓	→	↓	→	N/M	102%	1%
EQ Cash	↑	↓	→	↓	→	↓	↑	↓	↑	↓	→	22%	-25%
EQ Derv&Conv't	↓	↑	↓	↓	↑	↓	→	→	↑	→	↓	-2%	-48%
Prime services	↓	→	↓	→	→	↓	↑	↓	↑	↓	↑	13%	-27%
Prop Trading	N/M	N/M	↓	N/M	↑	N/M	N/M	↓	↓	↓	N/M	0%	-25%
Principal Inv	N/M	N/M	N/M	N/M	N/M	N/M	N/M	N/M	N/M	N/M	N/M	0%	0%

** Arrows graph % change rankings versus peers. Up-/down-arrows: top-/bottom-quartile.*

Product Revenue: Absolute* 4-quarter moving average

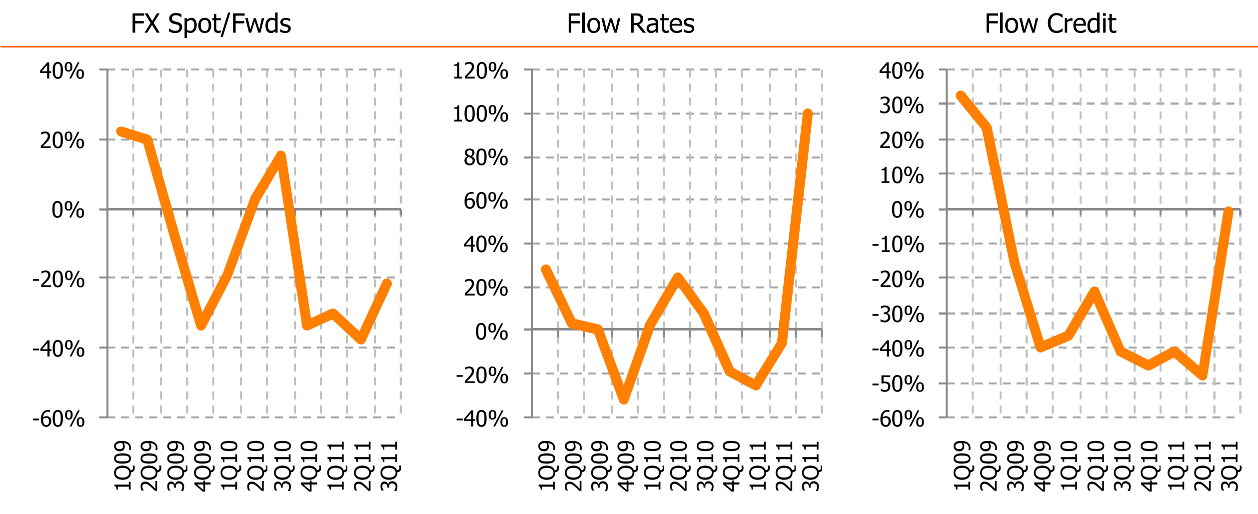
3 months: US$m (TRIC product definitions, post-writedowns, US$m, Global Level 1 estimate)



** Bubble size indicates absolute revenue; empty bubbles = negative revenue.*

Tricumen Client Flow Index

Tricumen's new Client Flow (CF) Index tracks dynamics of flow product revenue opportunity/'wallet' from institutional clients. Currently, the CF Index covers FX Spot/Forwards Trading, Flow Rates Trading, and Flow Credit Trading. Each index combines the volume of business traded with the average bid-offer spreads.



Source: public data, Tricumen analysis

CF Index methodology

The CF Index is based on trading volumes reported by governmental institutions and supranational agencies. We first structure this raw data to extract an approximation of the notional volume of client business transacted by the top 15 investment banks. Next, we multiply the notional volume for each quarter by the average bid-offer spread for benchmark products (e.g. EUR/USD spot trade, or a 5Y US Treasury); this provides an indication of the potential client revenue. We plot the result against the average figure for the 1Q-4Q09 periods (which we chose to reflect a 'normalised market'): using the charts above as an example, the revenue opportunity from the institutional flow credit market in 1Q09 was 33% higher than was the case during the benchmark 1Q-4Q09 period.

Notes & Caveats

Tricumen Limited has used all reasonable care in writing, editing and presenting the information found in this report. All reasonable effort has been made to ensure the information supplied is accurate and not misleading. For the purposes of cross-market comparison, all numerical data is normalised in accordance to Tricumen's proprietary product classification and may contain +/-10% margin of error.

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