As residents of Cambridge and sponsors of a University Economics Bursary, we commend Moody's assigning, in Oct-12, the Aaa rating to the University of Cambridge, with the 'stable' outlook. This decision ranks Cambridge as safer than the British Government: Moody's put the UK's sovereign rating on 'negative' outlook in Feb-12. Without drawing comparisons between the two ratings, we merely note Moody's highlighting the University's 'almost debt-free' status, 'strong' cashflow, and the University's 'sophisticated' governance and management.

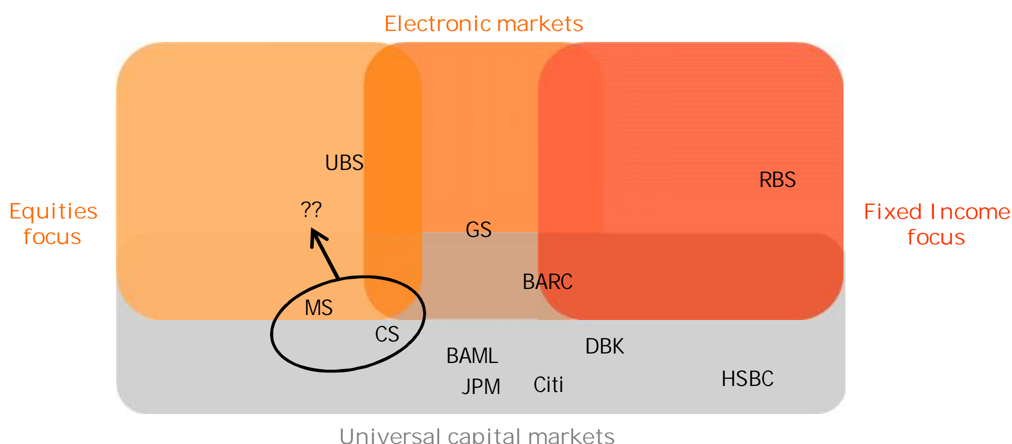
Shifting landscapes

The 'war of attrition' in global capital markets continues and the new competitive order is emerging. In recent months, most banks we follow made strategic announcements; highlights:

- Bank of America Merrill Lynch continued its CIB/Markets rollout (1Q12 Update) with the merger of MENA corporate and investment banking (CIB) units. APAC CIB and Markets units are also being brought closer together under Loh Boon Chye, who arrived from Deutsche Bank in Oct-12. The bank has also been investing in commodity trading.
- Barclays Investment Bank merged equity and fixed income trading and distribution, and, deemphasised emerging markets. In equities, the accent is on derivatives and risk oversight; EMEA Equities is letting c.10% staff go. Barclays will detail its 'transformational plan' in 1Q13.
- Deutsche Bank Corporate Banking & Securities (CB&S) announced ambitious – and realistic - 'Aspiration 2015' targets. CB&S will invest in FX and emerging markets (especially APAC) but is 'reviewing' EMEA and APAC equities; UK and MEA corporate finance cuts are underway. In Sept-12, CB&S formed the new cross-product electronic trading team under Zar Amrolia, ex-Head of FX. CB&S moved db x-trackers ETFs to the newly formed Asset & Wealth Management unit; and its 'exit assets' into the new 'Non-Core Operations' division.
- Goldman Sachs' CEO Blankfein in Nov-12 outlined his vision of GS as the leader in electronic markets, confirming our view of where the bank is heading. GS has been moving away from 'traditional' sales and trading for almost two years now, and we expect it will continue to do so: in our 'Bank of the Future' report (Sept-12), we projected 'low touch' leaders will push cost/income down to 48% and pre-tax return on equity to as much as 41%.
- In July-12, JP Morgan combined Investment Bank, Treasury & Securities Services and Corporate Bank in the new CIB division and made a number of senior appointments since then. Significantly, JPM also merged a part of its Securities Services with Prime Services.
- In Oct-12, UBS Investment Bank announced a strategic reorganisation which impacts fixed income units particularly hard. The IB management was overhauled in Nov-12.
- In Oct-12, Wells Fargo formed the new Markets division, combining equities, convertibles, prime services, fixed income, commodities, and futures clearing. Wells Fargo is not a major player, but it could put further pressure on already tight flow margins in the US markets.

Further detail is provided in the Company Section of this report.

Shifting landscapes - highlights



Source: Tricumen.

Results Overview

In European primary markets, the pivotal event of 3Q12 was ECB's public commitment to buy sovereign paper of countries that request financial aid. Announced in Sept-12, it offered more than a hint that there is a limit to GIIPS downside. As spreads tightened in response, corporate DCM bankers rejoiced: barring some unforeseen calamity, we expect that 4Q12 will show healthy issuance volumes, especially from non-financial corporates in GIIPS countries. The highlights of 3Q12:

- The continued weakness of M&A/advisory volumes – which some believe are at the lowest level since the original Credit Crunch - received a widespread coverage. The sum of the fees that were reported by the 11 banks in this report (and normalised by us), however, were hardly disastrous: \$2.6bn in 3Q12, -7% y/y, +4% q/q and barely below the quarterly run-rate of the previous ten quarters. Anecdotal evidence suggests that global banks are extending their lead, especially in fees/volume: to a large extent, we would attribute this to the growing share of cross-border deals and the clients' favouring the globals' cross-product capability. Fee margins in Europe and APAC ex-Japan remain under severe pressure.
- In the US, high grade corporates in 3Q12 issued the greatest volume of securities since 1995, according to WSJ/Dealogic, as corporates rushed to the market while Europe was (relatively) quiet. In spite of mini- yields - Bank of America Merrill Lynch US Corporate 7-10 year effective yield declined steadily from c.5% in early 2011 to barely 3% now – there are few investment alternatives available (in the US or Europe) and so we see no reason to expect investors' enthusiasm to diminish over the coming months.
- The 3Q12 high yield bond issuance volumes in the USA almost relative to 2Q12, and our sources generally agree that top banks managed to increase their fee margins even faster. We are not particularly optimistic regarding the outlook, however, largely on account of valuations vis-à-vis equities. Indexed to the start of 2008 and omitting seasonal adjustments, S&P 500 has declined slightly, while Bank of America Merrill Lynch US High Yield B index (a subset of the US High Yield Master II) is 40%+ above its Jan-08 level. The Fed's Sept-12 announcement of QE3[1] and its intention to keep interest rates below 0.25% until at least mid-2015 did not help high yield valuations: yields on BAC/MER US HY Master II index extended their almost uninterrupted year-long decline to barely above 5%. Investors appear to be voting already: despite softening somewhat in 3Q12, S&P 500 (adjusted for inflation and reinvested dividends) was, at end-Oct-12, up 15% y/y and 5% in 3Q12 alone. Looking ahead, we expect future earnings from high yield paper will be weighted towards income, rather than capital appreciation.
- In the structured issuance markets, the US weakened, on lower FIG securitisation volumes. Europe volumes, however, surged, driven corporate ABS and CMBS issuance. We expect 4Q12 will be strong, lifting FY12E overall fees to 25% above FY11 levels. We are not, however, very optimistic regarding the 2013 outlook, mostly due to the abundance of state-sponsored low-cost funding (e.g. ECB's LTRO and UK equivalents) and the unfavourable incoming regulation.
- Presenting 3Q12 results, Barclays Group CFO Lucas said that the bank has made 'considerable progress' with the UK's Financial Services Authority (FSA) regarding contingent convertible (CoCo) bonds. Back in mid-2011, Barclays' was seriously considering a CoCo issue, which would not count as Tier 1 capital, but as Tier 2 until the conversion; and there was to be a mechanism for the recovery once the bank has restored its capital position. The plan was shelved, but Barclays is now soliciting investors' views. This could be an interesting development: Barclays' issue would undoubtedly help a development of this nascent market. The 1Q12 Update provides background.

In Secondary markets, two important new pieces of legislation went into effect in recent weeks. In the USA, 12-Oct-12 was designated as the 'regulatory cliff' for Commodity futures Trading Commission's (CTFC) new swaps regulation; and in EU, the European Securities & Markets Authority (ESMA) banned, from 1-Nov-12, short sales of shares, EU sovereign debt and 'naked' CDS. Both new rules prompted an avalanche of research and opinions from market participants including prominent law firms, and rightly so. It is, however, too early to determine the ultimate impact this legislation may have on markets affected by this legislation: the rules will take some time to bed down and may well be amended in the coming months. For example, in the run-up to the 12-Oct-12 deadline, CTFC issued over a dozen no-action and interpretive letters and FAQs, all designed to smooth over a transition

[1] We foresaw a QE action in our 1Q12 Update, though we did not quite expect it to be open-ended.

period; market observers do not expect major shifts, but that is far from guaranteed. Europe, as ever, is more complex: within days of the aforementioned rules coming into force, Rodrigo Buenaventura, Head of ESMA's markets division, was quoted by eFinancialNews as saying that the agency was revisiting its guidelines following a market consultation (including, we dare assume, howls of protest from frustrated marketmakers); in the meantime, the UK's Financial Services Authority reportedly granted exceptions within a day – rather quicker than the 30-day process (guess)estimated by ESMA.

In Equity markets, banks' results met the analysts' decidedly downbeat consensus forecasts: analysts, quite correctly, focused on thinning margins (not helped by the growing share of electronic trading), lack of volatility, and declining trading volumes. Highlights:

- In Cash equities, we note the continued growth of off-exchange volume in Europe and APAC, but also the mixed impact of the regulatory changes in Canada. Overall, revenues extended a downward trend of recent quarters (3Q11-2Q12 Updates). We do not expect a lasting improvement in overall trading commissions in any of the three major regions. We do, however, expect equity leaders - most of whom are included in this report – to gradually improve their market share vis-à-vis smaller competitors, for two reasons. Firstly, while banks with a developed full-scale offering (i.e. those that have and wish to maintain strong ECM and M&A/advisory) will continue to reshape their geographic/sector coverage (undoubtedly, with the reduced headcount, even from current levels), they are likely to persist in their core markets until the bounce - and there is always one - happens. On a related note, firms with stronger prime brokerage should do better than those without such units, because clients are more likely to trade with them. Secondly, those same banks also have the resources to commit to electronic equities, one of the more RoE-profitable businesses (see our 'Bank of the Future', Sept-12).
- Equity Derivatives put in a very strong performance in 3Q12. Europe did well, particularly in the UK and Scandinavia; while the US growth was fuelled by structured MTNs. In our view, though, APAC offered the most interesting dynamics: while the flow continues to decline, the regional competitors could do worse than follow JP Morgan's fine example of targeting institutional clients with algo-type products, packaged into a derivative format. Our recent work highlights Singapore, Hong Kong, and Japan as growth markets; and Korea as impacted by adverse regulation.
- In Prime services, the average 3Q12 revenue from 'our' banks was flat-ish relative to both 3Q11 and 2Q12; Top 3 players gained some market share from their smaller peers. Not surprisingly, 3Q12 also saw acceleration of trends evident in recent times: that of prime brokers carefully reviewing the underlying profitability of their hedge fund client portfolios; and of institutional funds playing an increasingly important role relative to high net worth investors. Large/active hedge funds are set to benefit from recent trends: banks are competing ever harder to win their business and their share of assets under management vis-à-vis smaller funds is rising.

  By contrast, prime brokers are probably facing leaner-than-expected near-term revenues and will likely be reviewing their costs, both in operations (e.g. capital intro) and regionally (APAC, in particular). We also, however, expect hedge funds to continue moving away from the 'multiple prime broker model' (which was gaining popularity in the immediate aftermath of the original Credit Crunch - 3Q11 Update) and toward the leading providers – which should, in turn, extend their share of the clients' overall wallet.

Fixed income markets highlights:

- In foreign exchange markets, the weak-ish headline numbers masked the detail: banks that rely on G10 institutional and retail business suffered a q/q decline in revenue, while those with strong captive businesses and emerging markets franchises saw some growth. Volatility has all but disappeared and carry trade volumes (a short-end rates product) are down as investors, weary of ongoing uncertainty regarding the macroeconomic outlook, remain on the sidelines.
- Credit trading surged in 3Q12, driven by European banks' offloading assets in preparation for Basel 3 and investment banks servicing such reduction strategies of other institutions; the return of CLOs; and the reduced liquidity in the bond markets as some banks cut their balance sheet, which in turn led to wider bid-offer spreads on bonds outside the main indices.

  Following a lucrative 2011 and 1H12, and diminishing returns in 'mainstream' assets, institutional investors' appetite for structured credit – ranging from mortgage-backed paper to credit derivatives - remains undiminished. Securities Industry and Financial Markets Association (SIFMA)

figures show that, to end-1H12, Global CDO issuance totalled $23bn ($18bn+ of which was collaterised by high yield loans), compared to $31bn for the whole of 2011, and 3Q12 did not disappoint, either: $17bn total (collateral: $11bn HY, $6bn structured finance). We expect collateral loan obligations (CLOs) will remain popular.

There are important differences to the 'pre-Crunch' era. Investors appear increasingly willing to commit their money for much longer than the usual <90-day notice period for redemptions: for funds investing in illiquid assets, a minimum of one year lock-up period may well become a norm. Also, anecdotal evidence from prime brokers suggests that investment funds' demand for borrowing is subdued. Finally, banks are unlikely to return to this market as strong buyers anytime soon, courtesy of stringent Basel 3 requirements.

- The new high yield electronic platform launched in the USA in Oct-12. Vega-Chi U.S. Limited, an offshoot of the European parent, is the first platform that operates without dealers: it focuses on high yield/distressed bonds and is only open to 'buyside' institutional investors (40 of which were reportedly active at the launch, with 60+ waiting to sign on), dealing directly with each other. This is but the latest 'e-initiative' in fixed income marskets[2]; as stringent regulations take hold (most immediately, the 'Volcker rule'), there is no doubt of the overall direction of the market.
- Mortgage-related revenues jumped in 3Q12. RMBS volumes in Europe dropped to 1/3 of 2Q12 level as unfavourable regulation and pricing concerns took hold; we expect no recovery in 1H13. In CMBS, volumes were very strong: Europe jumped 13x q/q, while the US volumes were roughly in line with 2Q12. Margins in the US continued to widen, allowing a significant increase in revenue. Agency trading, however, was less favourable: while volumes held up well, margins continued to decline vs 1Q12.
- Commodities revenues were stronger than expected, but those expectations were depressed by the combination of regulatory concerns and a persistent lack of price volatility in major assets. Energy markets remain soft in anticipation of the full impact of 'Volcker rule'. Banks continue shifting their focus to the physical markets, with inventories growing by <26% versus 2Q12; derivative exposures, by contrast, fell by as much as 30% q/q.

  One of the more pressing issues in this market concerns hedging of clients' underlying exposures. Clearly, banks that maintain meaningful presence in this arena have the expertise and most of our sources agree that they are currently growing in the tough market. There is less agreement on whether regulation will drive this business away from banks and towards alternative providers, such as specialised traders and hedge funds; most view the 'Volcker rule' as the main constraint, followed by the new charge for credit valuation charge (CVA), which would impact long-dated hedges to some counterparties. We expect there will be a shift away from banks – over and above the banks' 'voluntary' withdrawal from the market – but this trend will not be linear: hedge funds and independent traders will likely find it difficult to compete head-on with banks' (reinvigorated) balance sheets.

  Citi's Sept-12 Global Commodity Finance platform announcement is noteworthy: the bank hired Kris Van Broekhoven (from Deutsche Bank) to run the new commodity trade financing unit, from London. Citi is filling the gap that opened up when French heavyweights started pulling out of the Tier 2 commodity trade financing market in late 2011 (though they reportedly still work with Tier 1 houses); we expect Citi's US peers will join in. Further details are in the Company Section.

Staffing levels were down slightly compared to 2Q12; on average, banks in this report reduced their headcount (full time equivalent) by only 2% q/q, to 42,000. Cash equities saw the biggest reduction: 4% on average, but as high as 10% in some banks. On the whole, commodities teams are holding up well; while banks are indeed reviewing the size of their teams (see 3Q11 and 4Q11 Updates), some of them are investing selectively: in 3Q12, the average headcount grew 3% q/q.

[2] Significant new initiatives of 2012 include: Goldman Sachs' GSessions, launched in June-12 (2Q12 Update, Company section); UBS' introduction of a new algorithm which trades $250m of high grade and $50m high yield benchmark in one transaction, inOct-12; Blackrock's Aladin (Apr-12); Tradeweb adding, in Oct-12, with widespread support from existing European dealers, CEEEMA bonds onto its electronic cash credit platform, which already facilitates CDS, high-yield and APAC credit. In Sept-12, the software provider iTB Holdings launched iTBconnect, a platform which links institutional investors to electronic fixed income trading venues.

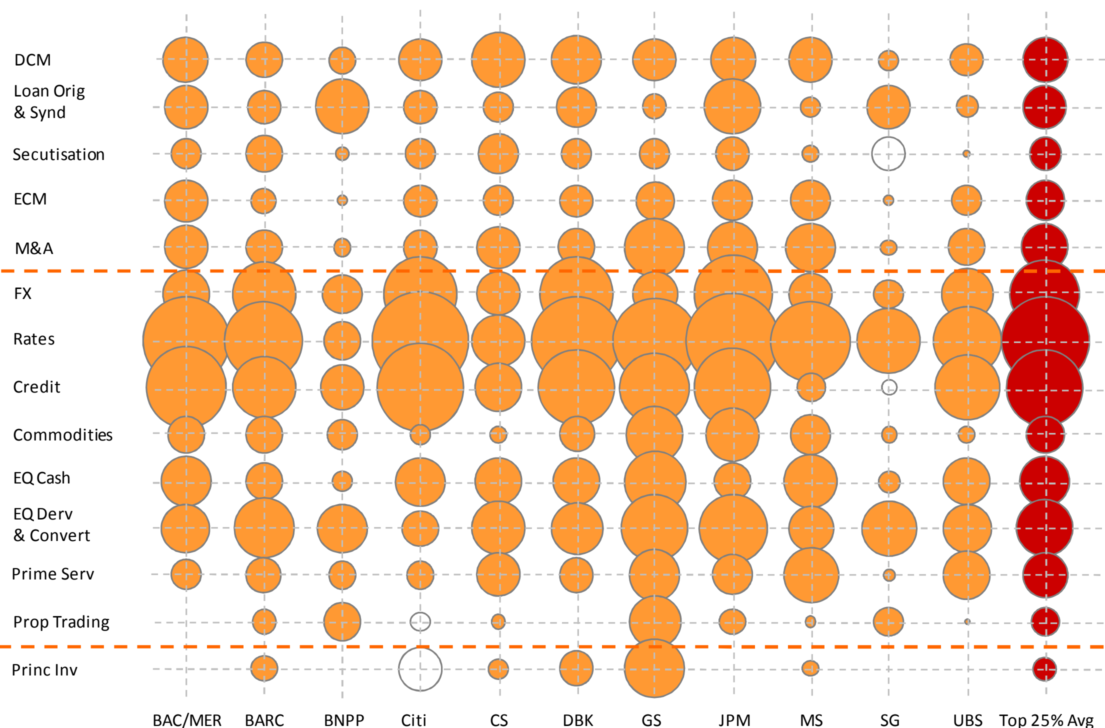
Results Summary

Product Revenue: Summary
(Peer Group[1] Top Quartile[2], TRIC product definitions, post-writedowns, US$m, Level 1 estimate)

	FY09	FY10	1Q11	2Q11	3Q11	4Q11	FY11	1Q12	2Q12	3Q12	3Q12/3Q11: Top #1/2/3 % ch.
Total: TRIC definition	26,985	22,308	6,997	5,285	3,302	3,168	18,242	6,385	4,356	5,164	GS / BAML / CS
Primary	3,946	5,058	1,439	1,529	881	898	4,521	1,192	1,107	1,309	CS / GS / BARC
DCM Bonds	1,417	1,295	309	265	134	209	969	335	197	356	SG / GS / JPM
DCM Loans	739	1,276	370	479	325	268	1,475	296	282	307	GS / BAML / MS
DCM Securitisation	-283	672	204	144	108	111	494	156	190	183	CS / GS / SG
ECM	1,711	1,389	332	379	157	174	1,073	210	204	188	BNPP / SG / GS
M&A	1,328	1,257	337	458	319	338	1,493	256	302	319	CS / BARC / JPM
Secondary	21,502	17,351	5,558	3,609	2,548	2,236	13,851	5,177	3,314	4,015	BAML / GS / BNPP
FX	2,456	2,713	625	605	685	626	2,542	733	579	533	MS / BAML / BNPP
Rates	7,048	4,304	1,267	1,027	795	794	3,609	1,458	1,105	1,141	UBS / DBK / BAML
Credit	6,001	4,414	1,849	1,008	269	239	3,043	1,692	722	816	Citi / GS / JPM
Commodities	1,487	907	340	166	264	195	933	336	184	220	CS / BAML / SG
EQ Cash	2,270	1,739	576	493	445	372	1,831	454	297	294	DBK / SG / BARC
EQ Derv&Conv't	2,807	2,178	665	571	402	327	1,971	638	411	516	Citi / BNPP / UBS
Prime services	1,187	973	253	290	305	271	1,087	286	296	277	BARC / MS / SG
Prop Trading	2,278	770	197	168	96	77	438	155	89	98	CS / JPM / SG
Principal Inv	0	477	102	125	0	61	275	46	56	69	n/a

(1) Peer Group: BAC/MER, BARC, BNPP, Citi, CS, DBK, GS, JPM, MS, SG, UBS. (2) Top Quartile is calculated on a product-by-product basis, for each period shown. One-off and extraordinary items, fully described in the Company Section, are excluded.

Product Revenue: Absolute* 4-quarter moving average
(TRIC product definitions, post-writedowns, US$m, Global Level 1 estimate)



Source: Tricumen. (1) Bubble size = absolute revenue; empty bubbles = negative revenue; missing bubbles = no revenue. One-off and extraordinary items, as described in the Company Section, are excluded.

Product Revenue: Momentum*

3Q12/3Q11 (TRIC product definitions, post-writedowns, % change, Global Level 1 estimate)

	BAML	BARC	BNPP	Citi	CS	DBK	GS	JPM	MS	SG	UBS	Top 25%	Bottom 25%
Total capital markets	↑	↓	↓	→	↑	→	↑	↓	↓	↓	→	67%	24%
Primary	→	↑	↓	→	↑	↓	↑	→	↓	↓	↓	45%	2%
DCM Bonds	→	↓	→	↓	↓	N/M	↑	↑	↓	↑	↓	221%	135%
DCM Loans	↑	→	↓	↓	→	↓	↑	→	↑	↓	↓	22%	-37%
DCM Securitisation	→	→	↓	↓	↑	↓	↑	↓	→	↑	↓	134%	-27%
ECM	↓	→	↑	→	↓	→	↑	↓	↓	↑	↓	98%	18%
M&A	↓	↑	↓	→	↑	→	→	↑	↓	↓	↓	6%	-24%
Secondary	↑	↓	↑	→	→	↓	↑	↓	↓	→	↓	97%	34%
FX	↑	↓	↑	→	↓	↓	→	→	↑	↓	↓	20%	-23%
Rates	↑	↓	N/M	→	↓	↑	→	↓	↓	↓	↑	66%	12%
Credit	N/M	↓	↓	↑	N/M	↓	↑	→	N/M	N/M	N/M	297%	94%
Commodities	↑	→	↓	↓	↑	↓	↓	→	↓	↑	↓	37%	-34%
EQ Cash	↓	↑	→	↓	→	↑	↓	↓	↓	↑	→	-4%	-39%
EQ Derv & Converts	↓	→	↑	↑	↓	→	↓	↓	→	↓	↑	81%	13%
Prime services	↓	↑	→	→	↓	↓	↓	→	↑	↑	↓	13%	-9%
Prop Trading	N/M	↓	↓	N/M	↑	N/M	N/M	→	N/M	→	N/M	3%	-39%
Principal Inv	N/M	↓	N/M	N/M	↑	N/M	N/M	N/M	N/M	N/M	N/M	0%	-37%

9m12/9m11 (TRIC product definitions, post-writedowns, % change, Global Level 1 estimate)

	BAML	BARC	BNPP	Citi	CS	DBK	GS	JPM	MS	SG	UBS	Top 25%	Bottom 25%
Total capital markets	→	→	↓	↑	↑	↓	↑	↓	↓	↓	→	8%	-9%
Primary	→	↑	↓	→	↑	↓	↑	→	↓	↓	↓	1%	-18%
DCM Bonds	↓	→	↓	→	↓	↑	→	↓	↓	↑	↑	34%	13%
DCM Loans	↑	↑	↓	↓	→	→	↑	→	↓	↓	↓	-14%	-38%
DCM Securitisation	↓	→	↓	↑	↑	↓	↑	↓	→	N/M	↓	44%	-47%
ECM	↓	↑	→	↑	↓	↓	→	↓	↓	N/M	↑	-21%	-32%
M&A	→	→	↓	↑	↑	→	↑	↓	↓	↓	↓	-10%	-35%
Secondary	↑	↓	↓	↑	↑	↓	→	↓	↓	→	→	13%	-3%
FX	↑	↓	↑	→	↑	↓	↓	→	→	↓	↓	15%	-7%
Rates	↑	→	↑	→	↓	↓	→	↓	↓	↓	↑	31%	17%
Credit	↑	↓	→	→	↑	↓	↓	↓	↓	N/M	↑	33%	-6%
Commodities	↑	→	↓	↑	↓	↓	↓	↓	→	↑	→	10%	-15%
EQ Cash	↓	→	→	↓	↑	↑	↑	↓	↓	→	↓	-11%	-30%
EQ Derv&Conv't	↓	↑	↓	↑	→	↑	→	→	↓	↓	↓	1%	-13%
Prime services	↓	↑	→	↓	↓	↓	→	↓	↑	→	↑	8%	-6%
Prop Trading	N/M	↓	↓	N/M	→	N/M	N/M	↑	↓	↑	N/M	-8%	-51%
Principal Inv	N/M	→	N/M	→	↓	N/M	↑	N/M	↓	N/M	N/M	19%	-27%

Source: Tricumen analysis. * Arrows show % change in revenue vs peers. Up-/down-arrows: top-/bottom-quartile. One-off and extraordinary items, as described in the Company Section, are excluded.

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