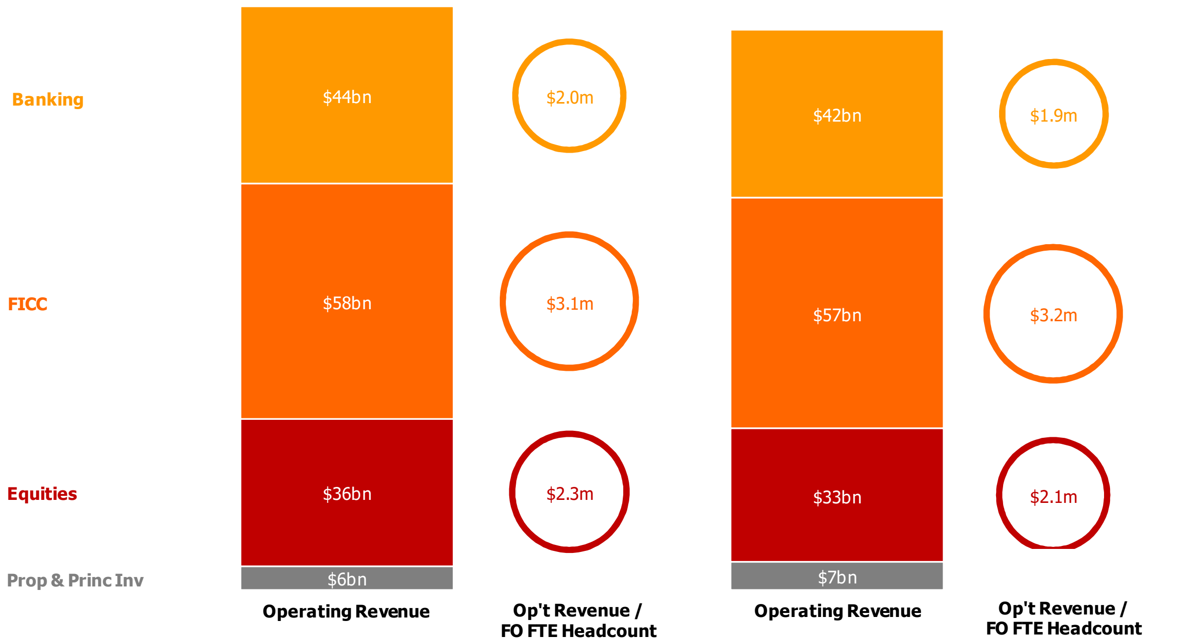
Results Review 3Q19 / 9m19

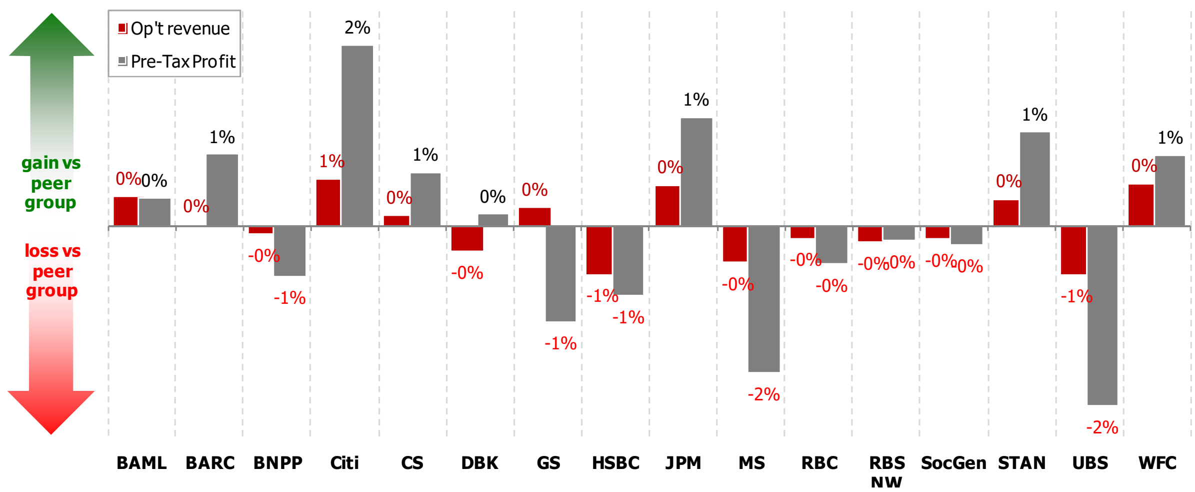
Capital Markets: Overview

- The banks in this report generated $138bn revenue in 9m19, slightly below 9m18 as Banking, FICC and Equities all declined; only dedicated prop & PI posted modest growth. However, most banks also kept costs under control; the aggregate 9m19/9m18 pre-tax profit declined by a relatively modest 6%. The US banks' held up well, with only a 3% y/y fall in profit; in contrast, Europeans' Banking and Equities profits dropped sharply, more than offsetting higher FICC profits.
- The hiring in middle-market space continues apace, in CIB and money management divisions: BAML, Goldman Sachs, J.P.Morgan and Morgan Stanley all announced significant new initiatives in recent months. Tricumen has a dedicated coverage of this market segment.
- There is a great need, but few signs that the end of 'Japanification of Europe' (and, to a lesser degree, the US) is anywhere in sight. Inflation remains well below what most economists would call healthy, while the utility of ever-lower rates in stimulating the major economies – which remain mired in next-to-no-growth - has been in question for years. Ongoing trade wars and customers (retail and corporate) in major democracies addicted to interest rates at or near zero almost guarantee the continuation of QEs and variants, even though it is entirely unclear what tools will central banks deploy to counter the next – probably overdue – economic slowdown.

Operating Revenue (9m18) (9m19)



% change share of peer group operating revenue and pre-tax profit (9m19 / 9m18)

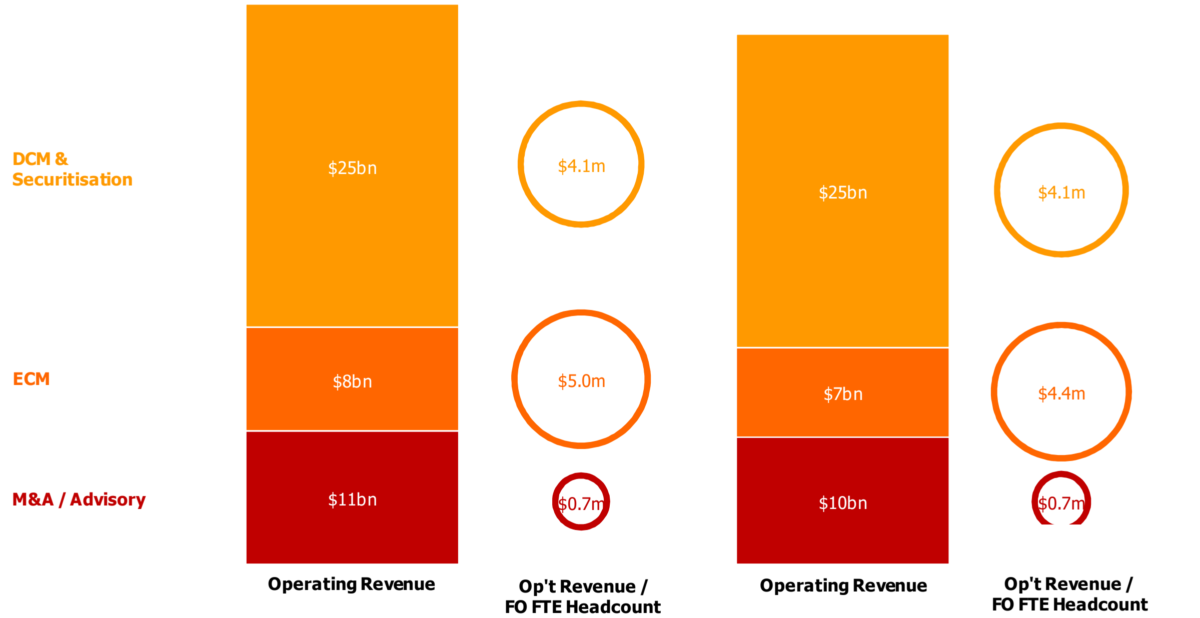


Notes: (1) Tricumen product definitions throughout. (2) Revenue is post-writedowns, excludes DVA/equivalent and one-offs. (3) Headcount: Front office full-time equivalent, adjusted for seniority. (4) Pre-tax profit excludes Prop & Principal Investments..

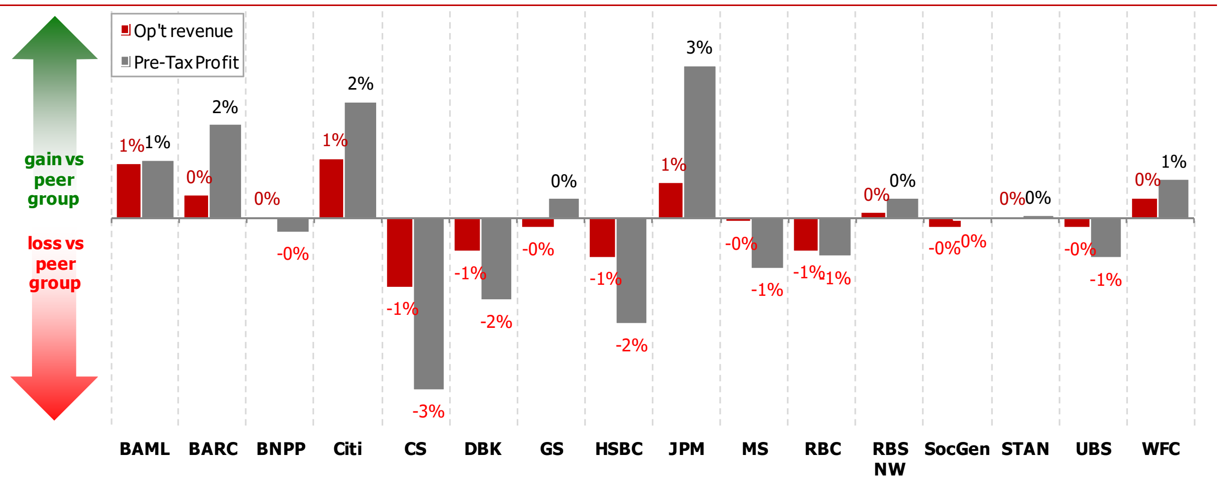
Capital Markets (cont.): **Banking**

- Investors' hunt for yield extended a boom in HY corporate debt issuance: the 9m19 volume was at a two-year high and 3Q19 was the highest 3Q since 2013; Chinese corporates almost doubled their share of global volumes. Emerging markets and APAC local-currency issues also jumped vs 3Q18; but HG suffered a slowdown. The 3Q19 and 9m19 fees from syndicated lending fell 10-15% y/y, broadly in line with global volumes; leveraged loans underperformed investment grade.
- In ECM, the market conditions still favour the US banks: their home market was by far the strongest, especially in IPOs; and 'Big 5 sectors' (tech, financials, real estate, healthcare and energy) account for 70% of global volumes. In contrast to the US, EMEA fees dropped 30-50% y/y in APOs, rights and converts, and 10% in IPOs. Unsurprisingly, EMEA banks suffered a sharp drop in productivity.
- M&A/Advisory volumes and fees dropped 15-20% vs 3Q18; on 9m basis, fees declined 10% y/y. The USA (again) demolished most league-table historical records, especially on 'all-US' domestic and mega deals, giving a huge advantage to US leaders. EMEA, APAC and Japan dropped vs 3Q18.

Operating Revenue (9m18) (9m19)



% change share of peer group operating revenue and pre-tax profit (9m19 / 9m18)



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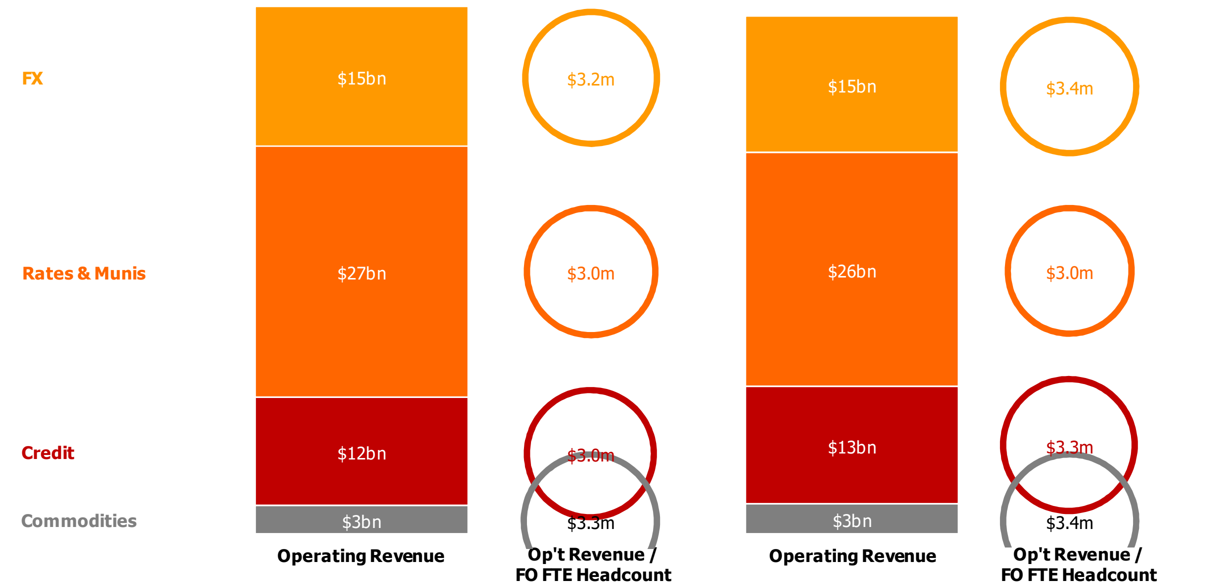
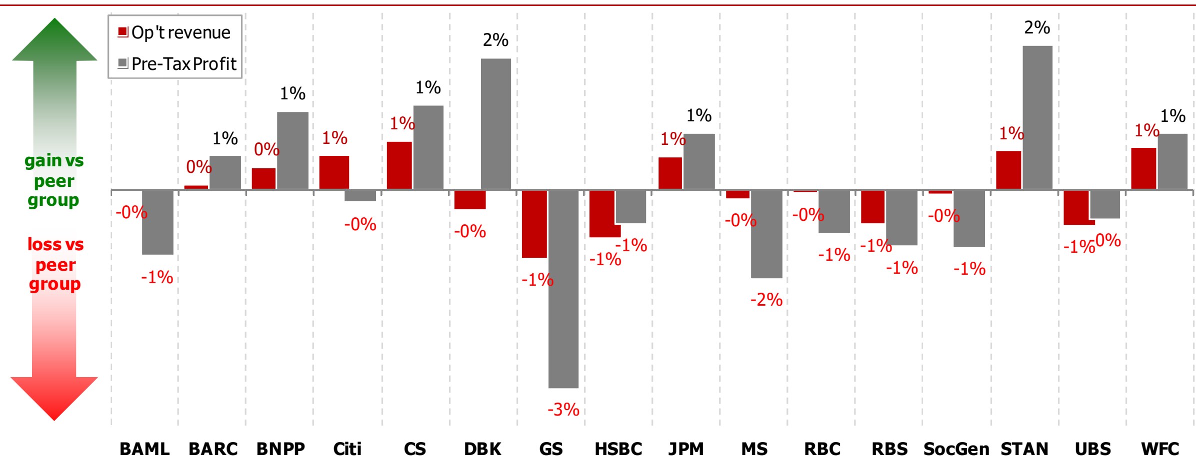
Capital Markets (cont.): FICC

- The FX volumes were partly offset by the shift from structured products into swaps, leading to a wide divergence in individual banks' performance. CryptoFX is gaining in credibility: BIS will publish a paper on the capital requirements of crypto assets, UK Jurisdiction Taskforce' made crypto recognisable in English law, and Hong Kong is ready to issue licences for crypto trading exchanges.
  Vanguard, not best known for its respect of convention, is testing blockchain which could allow big asset managers to trade FX directly, bypassing banks, even for execution. Success is not a given: most obviously, available liquidity will be the key, and that requires a critical mass of participants. Still, if this takes off, we expect banks' swaps and forwards revenue will be hit the hardest.
- Rates revenue strengthened in 3Q19, supported in particular by clients' demand for hedges. Munis also did well vs 3Q18, and Oct-19 surge in issuance to $53bn (+25% y/y) bodes well for 4Q19. The demand for UK gilts grew in 3Q19 as investors eyed the possibility of a disorderly Brexit.
- Credit revenues grew in 3Q19, but that's from a *very* weak 3Q18; the bulk of meaningful growth came via acquisition of new clients. Strong tech helps: e.g. HSBC and UBS' new tools match clients with banks' inventories, making sales calls more relevant. Institutions, concerned about liquidity, are looking to derivatives. HY dollar debt in EM is under pressure, and CLO markets look shaky.
- In commodities, strong energy operators outperformed (again), especially in North America. Investors' demand for gold (incl. ETFs) is not diminishing: a favoured hedge against volatility and uncertainty, gold is also seen as an effective hedge against deflation. Deflation increases the borrower's debt burden and the counterparty risk; but gold has no counterparty risk – it's a real asset, especially in the over-leveraged world. Silver offers beta opportunity.

Operating Revenue (9m18) (9m19)



% change share of peer group operating revenue and pre-tax profit: (9m19 / 9m18)



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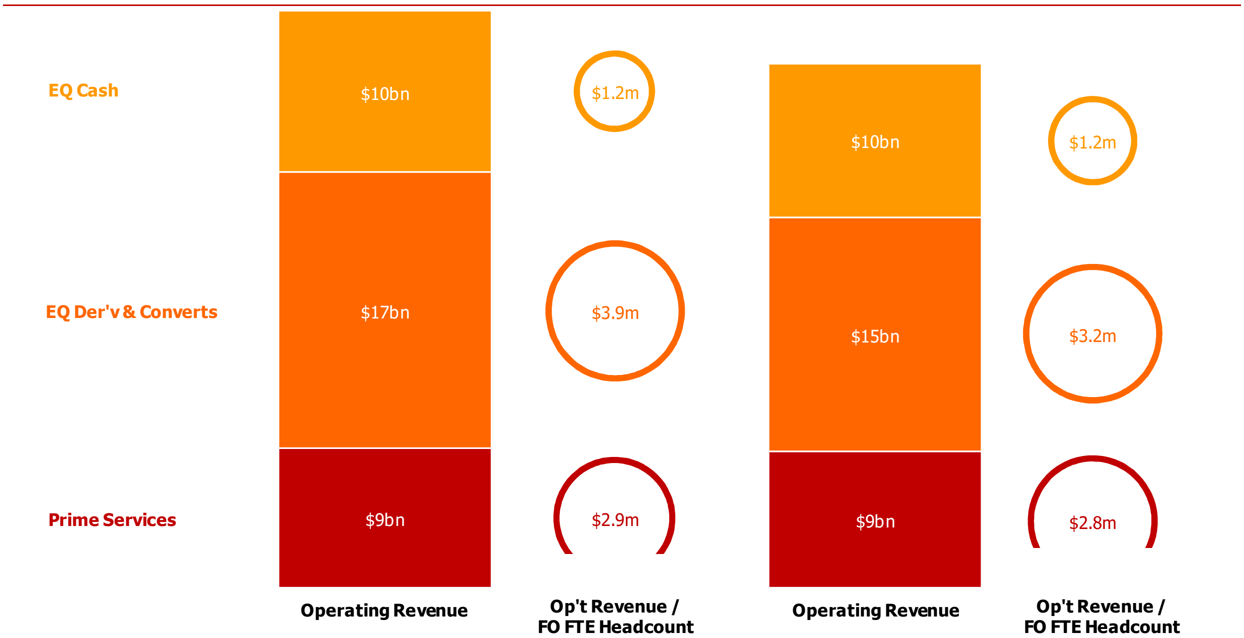
Capital Markets (cont.): Equities

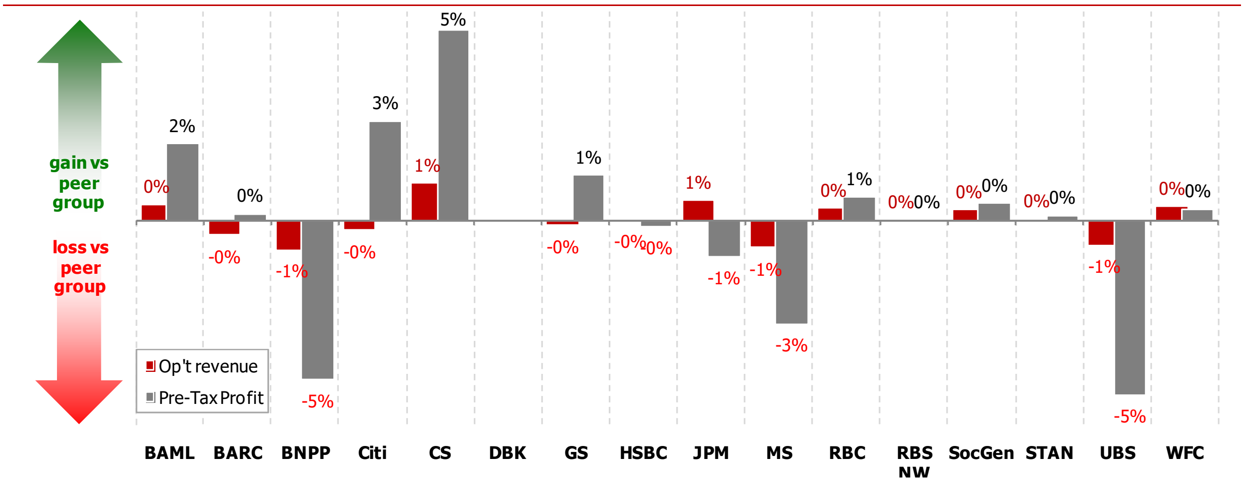
- <u>Cash equity</u> held up well in 3Q19, but questionable outlook and a continued decline in commissions led to further reductions in staff.

  MiFID 2 is making meaningful inroads in the US: surveys show that most large buy-side firms now favour unbundling of research and execution payments. For the moment, the majority of small(er) firms favour the bundled approach, but the trend is obvious, especially after SIFMA weighted in with recommendation for SEC to let brokers accept payments from US clients just for research.
- <u>Equity derivatives</u> A couple of 'our' banks booked strong gains in structured derivatives; but others suffered from volatile markets, low(er) client flows, and inventory losses. The popularity of options hedging US equities is on the rise; while in APAC, dealers are trying to replace corridor variance swaps with forwards which enable a reduction of risk in their structured product portfolios. Finally, ART (alternative risk transfer) products – which gained in popularity as a direct result of central banks' misguided QE drive – continue to flourish.
- <u>Prime services</u> posted strong revenue growth in 3Q19; leading banks, in particular, benefitted from strong financing and higher client balances. In terms of hedge funds' main sectors AuM, emerging markets, distressed, and fixed income funds suffered the most serious outflows in 3Q19.

Operating Revenue (9m18) (9m19)



% change share of peer group operating revenue and pre-tax profit (9m19 / 9m18)



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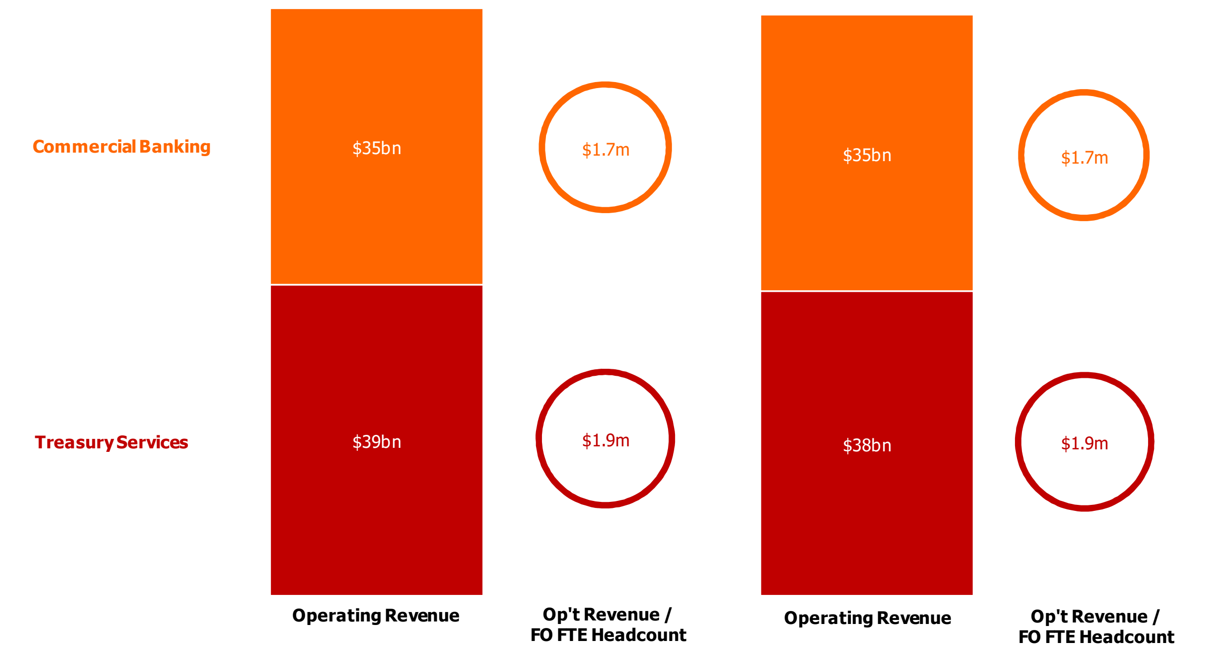
Commercial Banking & Treasury Services

- In 3Q19, commercial lending volumes fell slightly in the US and flatlined in large EU economies. Adding to this, there was no let-up in margin pressures, however, and several large banks have (again) reported higher hedging costs.

  In response, banks are utilising (new) technology, focusing on profitable clients, and fostering collaboration between commercial banking and other parts of organisation, chiefly investment banking. In Europe – most significantly, in Germany - banks are also increasingly shifting the burden of low/negative interest rates to their large clients.

  The combined operating costs of 10 banks in this note declined 4% from 9m18, led by Europeans.
- Trade finance volumes accelerated the y/y decline seen in 1H19. Banks' 9m19 revenue fell 2% y/y, but the hit to profits was cushioned by better cost control, especially at European banks.

Operating Revenue (9m18) (9m19)



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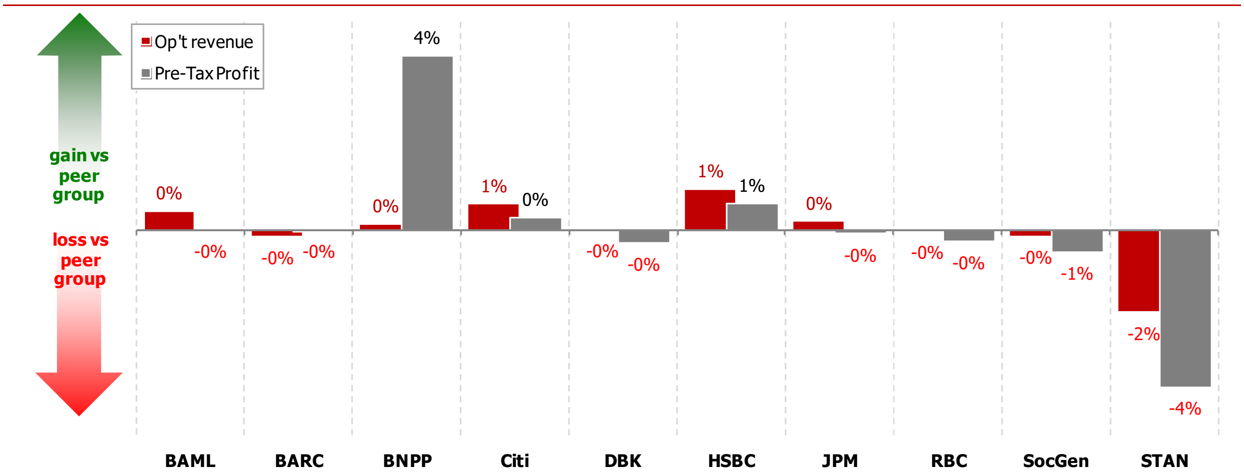


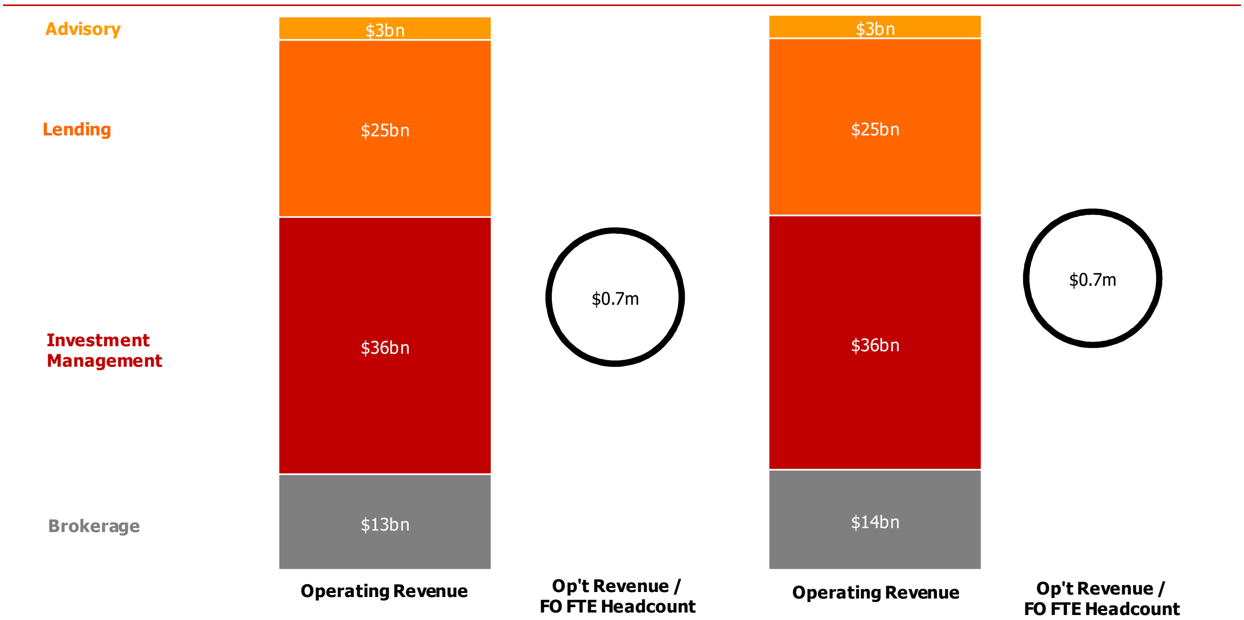
Notes: (1) Tricumen product definitions throughout. (2) Revenue is post-writedowns, excludes DVA/equivalent and one-offs. (3) Headcount: Front office full-time equivalent, adjusted for seniority. (4) In-scope: Large Cap/MNC and Mid-Cap/SMEs.

Wealth Management

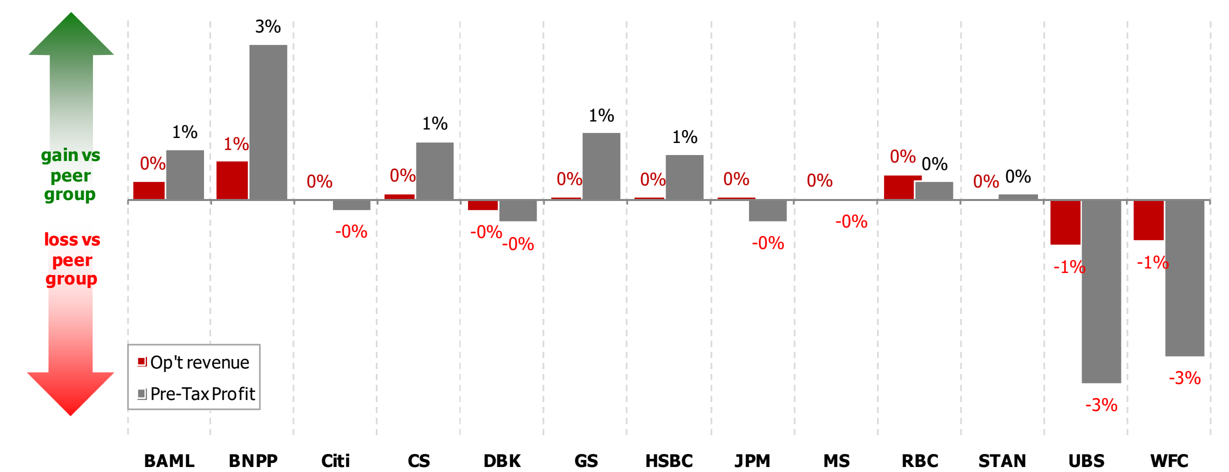
- The aggregate revenue of wealth managers in this note totalled $78bn in 9m19, unchanged from the prior-year period (3Q19/3Q18 revenue grew 2%). However, the strong cost control – reflected, for most part, in pay-per-head - resulted in pre-tax profit growth of 5%, led by European peers.
- In early Oct-19, Charles Schwab Corporation abolished retail commission fees for US stocks, ETFs and options trades; TD Ameritrade, ETrade and Fidelity swiftly followed. Commenting on the move, Schwab's founder predicted that this move will lead to the consolidation in retail brokerage – lo and behold, within weeks, news emerged that the firm is in talks to take over TD Ameritrade, one of its key rivals.

  This development will probably not have a huge immediate impact on banks in this report because they are global, already provide some commission-free services (especially in the US – see BAML page) and because it's the advisory (though those are under pressure, too, especially in APAC) and (increasingly) lending fees that really matter. Regardless, longer term … the writing was on the wall ever since robo-advisors arrived on the scene. The industry is headed to zero commission in various forms and fashions and banks – including the globals in this note - will need to find a replacement for a significant revenue stream.

Operating Revenue (9m18) (9m19)



% change share of peer group operating revenue and pre-tax profit (9m19 / 9m18)



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Revenue dynamics

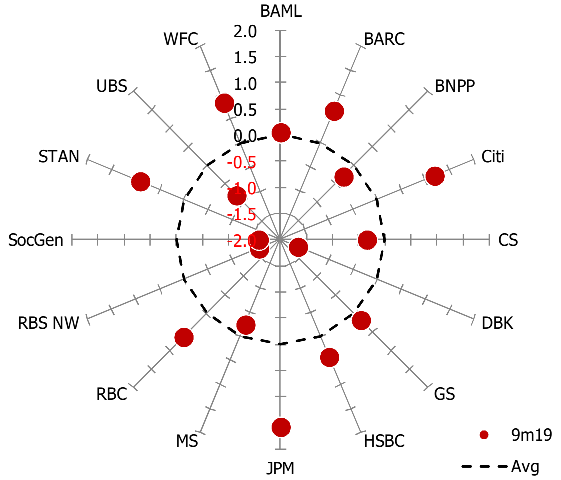
9m19/9m18 (Operating revenue, % change, US$, Global Level 1)

	BAML	BARC	BNPP	Citi	CS	DBK	GS	HSBC	JPM	MS	RBC	RBS NW	SocGen	STAN	UBS	WFC
Capital Markets	↗	↘	↘	↗	↘	⇩	↘	⇩	↗	↘	↘	⇩	↘	⇧	⇩	⇧
Banking	↗	↗	↗	⇧	⇩	↘	↗	⇩	↗	↗	⇩	⇧	↘	↗	↘	↗
DCM Bonds	↗	↘	↘	↗	⇩	⇩	⇩	⇩	↗	↘	⇩	⇧	↘	↘	⇧	↗
DCM Loans	↘	↗	⇧	⇧	↘	⇧	↘	⇩	⇧	⇩	↘	↗	↗	⇧	↗	↗
Securitisation	↘	⇧	⇩	↗	↘	⇩	↘	↘	↘	↗	⇩	↘	↘	↘	↘	↗
ECM	⇧	↗	⇧	⇧	↗	⇩	↗	↗	⇧	⇧	↗		⇩		↗	↗
M&A / Advis	⇧	⇧	⇩	↗	⇩	↗	↗	⇩	↘	↘	⇩		⇩	↗	⇩	↗
Markets	↘	↘	↘	↗	⇧	↘	↗	↘	↗	↘	↗	⇩	↘	⇧	⇩	⇧
FICC	↘	↗	⇧	↗	⇧	↘	⇩	↘	↗	↘	↘	⇩	↘	⇧	⇩	⇧
FX	⇩	⇩	⇧	↘	⇧	⇩	↘	⇩	↘	⇩	⇩	↘	↗	↘	⇩	↘
Rates & Munis	⇧	↗	↗	↗	⇧	↘	↘	⇧	↗	↘	↗	⇩	↗	⇧	⇩	⇧
Credit	⇩	↘	↘	↘	↘	⇩	⇩	⇩	↘	↘	⇩	⇩	⇩	⇧	⇩	↘
Commodities	⇩		↗	↗	⇩		↗	⇩	⇩	⇧	⇧		⇩	⇩	↘	↗
Equities	↗	⇩	⇩	↘	⇧		↘	↘	↗	↘	⇧		↗	↗	⇩	⇧
EQ Cash	↗	↘	⇩	⇩	⇧		↗	⇩	↗	↘	⇧		↗		↘	↗
EQ Der'v & Conv't	⇩	⇩	⇩	↘	⇧		⇩	↘	↘	⇩	↗		↘		⇩	⇧
Prime Services	⇧	↗	↘	↘	↗		↗	⇩	⇧	↘	↗		↘	↘	⇩	⇧
Prop & PI			⇩		⇩		⇧	⇩	↗	⇧		⇩				
Comm Bank / Treas Serv	⇧	⇧	⇧	⇧		⇧		⇧	⇧		⇧		⇧	⇩		
Comm Bank	↗	⇩	↗	↗		⇧		↗	↗		⇧		↘	↗		
Treas Serv	⇧	⇧	⇧	⇧		⇧		⇧	⇧		↗		⇧	⇩		
Wealth Management	↗		⇧	↘	↗	⇩	↗	↗	↘	↘	⇧			↘	⇩	⇩
Advisory	⇧		↗	⇩	↘	⇩	↘	↘	↗	↘	↘			↗	↘	⇩
Lending	↗		⇧	↗	⇩	⇩	↘	↗	↘	↘	⇧			↘	⇩	⇩
Investment Management	↘		⇧	↗	⇩	⇩	↗	↗	↗	↘	⇧			↗	↘	⇩
Brokerage	↘		↗	⇩	⇧	⇩	↘	↘	↘	↗	↘			↘	↘	↘

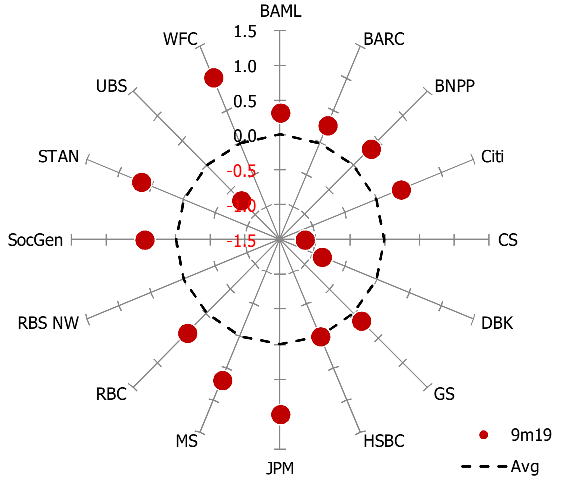
Source: Tricumen. Notes: (1) Tricumen product definitions throughout. (2) Arrows show % change in revenue vs peers. Up-/down-arrows: top-/bottom-quartile. (3) Operating revenue is post-writedowns, excludes DVA/equivalent and one-offs. (4) Commercial/Transaction Banking includes Large Cap/MNC and Mid-Cap/SMEs.

Operating cost / income (US$, Global Level 1)

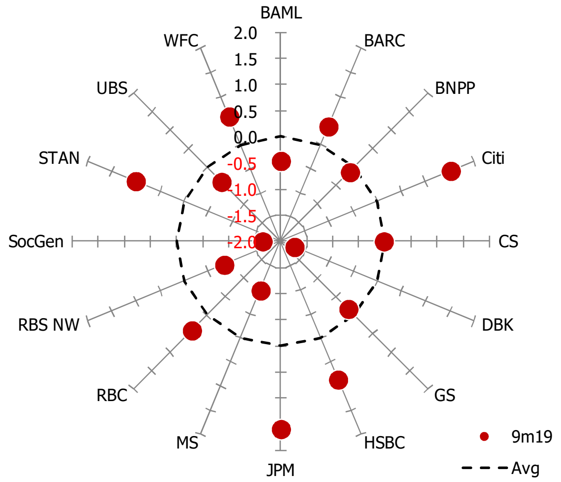
Capital Markets



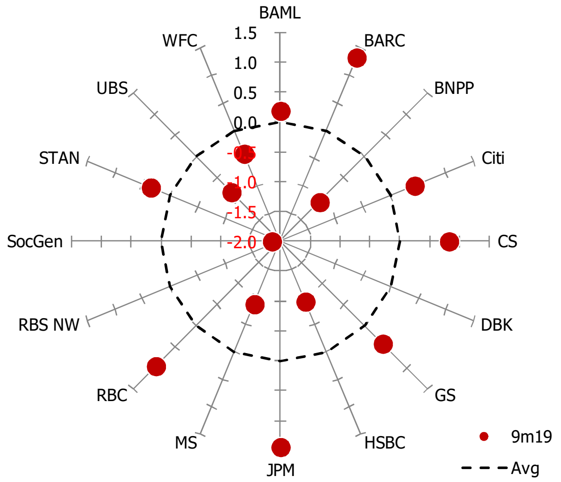
Banking



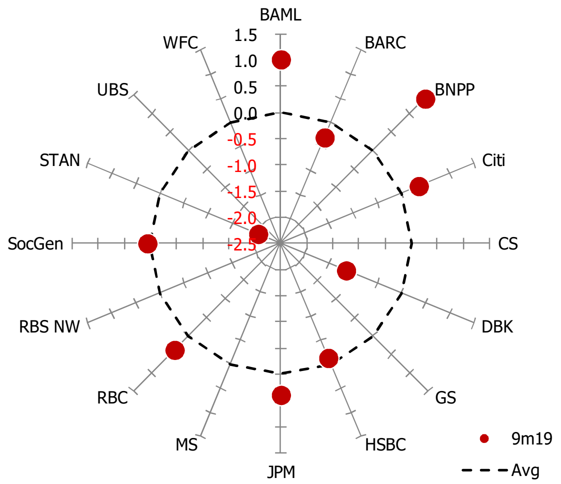
FICC



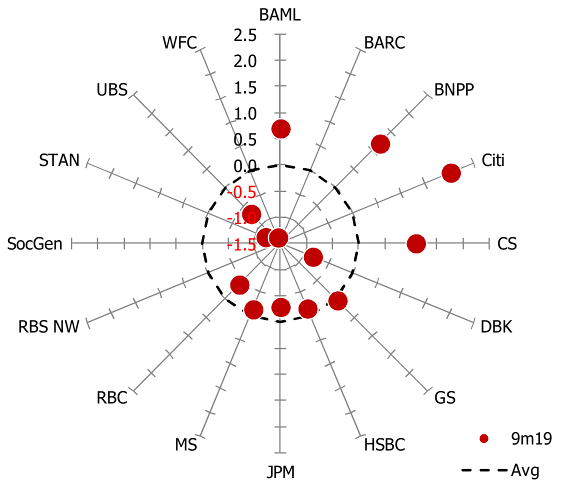
Equities



Commercial Banking / Treasury Services



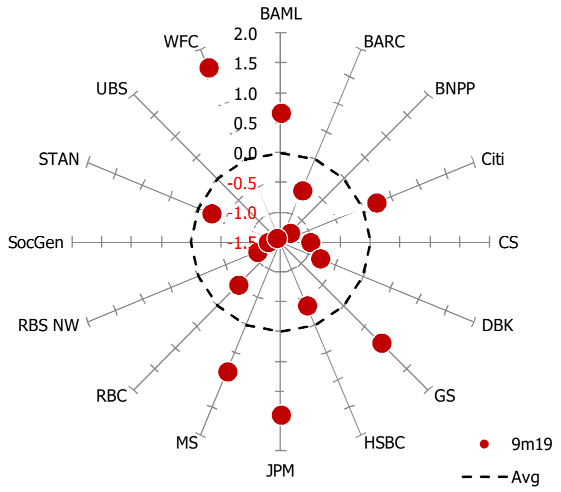
Wealth Management



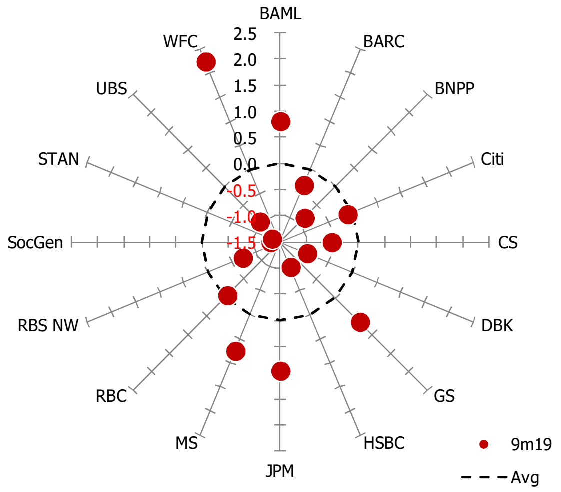
Source: Tricumen. Notes: (1) TRIC product definitions, standard deviation, product Level 1; (2) Operating expenses exclude one-off non-operational items, insurance-related benefits & claims, and credit expense/recovery/NPL provisions. Capital expenditure is included as accrued. Litigation expense is allocated to front-line units. (3) positive values = outperformance; negative values = underperformance, relative to the peer group featured in this report; (4) missing values = not included in ongoing coverage or a bank is not a significant competitor in this market; (4) outliers are excluded.

Operating Revenue / Front Office FTE (US$, Global Level 1)

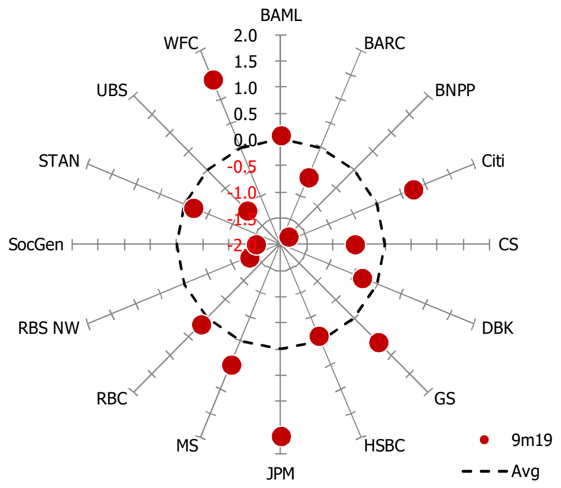
Capital Markets



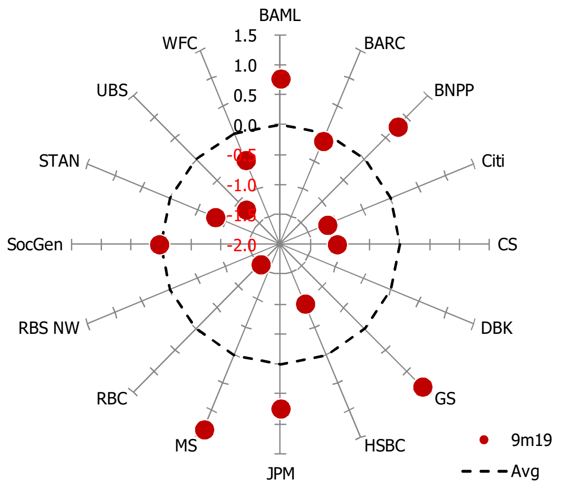
Banking



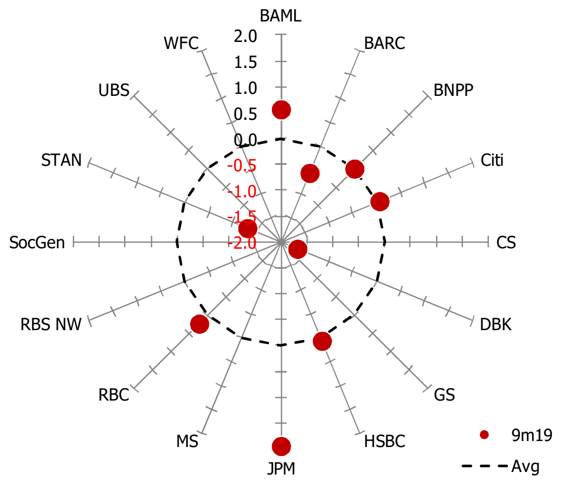
FICC



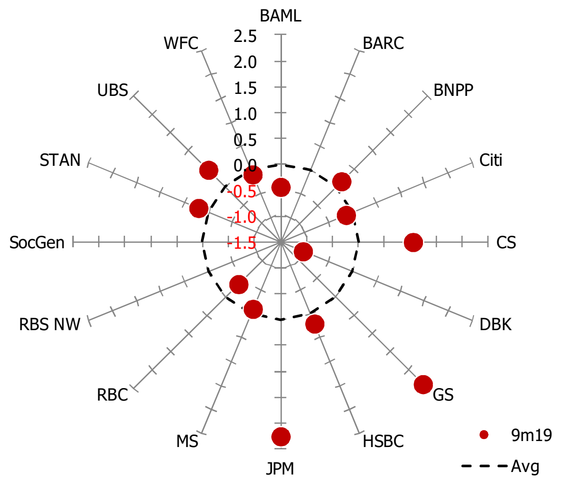
Equities



Commercial Banking / Treasury Services



Wealth Management



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Tricumen was founded in 2008. It quickly became a strong provider of diversified market intelligence across the capital markets and has since expanded into transaction and corporate banking as well as asset and wealth management. Tricumen's data has been used by many of the world's leading investment banks as well as strategy consulting firms, investment managers and 'blue chip' corporations.

Situated near Cambridge in the UK, Tricumen is almost exclusively staffed with senior individuals with an extensive track record of either working for or analysing banks; and boasts what we believe is the largest capital markets-focused research network of its peer group.

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