

US Banks

Higher = Harder

Industry Overview

Stocks looking past 2H23 stability to 2024 hard landing

Bank stocks (BKX) have slumped in recent weeks, -12% since late July highs vs. -5%/-6% S&P/Nasdaq. This sell-off has occurred despite relatively inline intra-quarter updates (moderating deposit pricing, credit quality in-check). We attribute this sell-off to the spike in UST yields which have engineered a “bear steepening” (2yr/10yr -63bp vs. -108bp in July) as markets come to grips with higher for longer interest rates.

Higher for longer rates = bad news

We came into the year with the view that higher for longer interest rates are bad for bank stocks/EPS. Higher for longer rates are: #1 bad for growth (customer activity has all but stalled: loan growth, investment banking); #2 bad for net interest margins (squeezed by rising funding costs and less than ideal balance sheet positioning relative to the sharp rise in rates); and #3 bad for credit quality.

Act III: Credit quality deterioration

While the first two (growth, margins) have played-out on script, it is the deterioration in credit quality that is yet to kick-in. Excess consumer savings and govt. spending appear to have delayed a credit cycle. However, we see no reason why the next 12 months could not lead to a significant worsening in credit quality, especially if the US economy receives no relief on interest rates. The wildcard is the job market, where a reversal to negative monthly job growth has the potential to lead to a more pronounced credit cycle.

Still waiting for a clearing event

A shift toward Fed rate cuts (or confidence that rates have peaked), visibility on the shape of the coming credit cycle needed before stocks/EPS can bottom, in our view. Add to this the potential for sweeping regulatory changes to capital requirements that is causing investors to recalibrate the steady state profitability and near-term capital return potential for the sector. Not surprisingly, investor sentiment on the group is lukewarm. As a silver lining, we note that bank stocks have outperformed the S&P/Nasdaq MTD, likely reflecting some valuation support. Relevant research: [Reading the Tea Leaves: Scratch that](#)

Owning “opportunities” within a bear market

Other than positioning for bear market rallies, we believe adding exposure to beaten down stocks that have idiosyncratic catalysts has the potential to deliver alpha. Buy-rated KeyCorp-KEY and Neutral-rated Truist Financial-TFC exhibit the combination of discounted valuations and potential for strategic actions that could deliver stock outperformance. Goldman Sachs-GS/Morgan Stanley-MS could benefit from a pick-up in IPO/M&A activity (+ credit defensibility), however a broader sell-off in equities could throw cold water on hopes for a revival in investment banking. Buy-rated BNY Mellon-BK also offers an attractive relative risk/reward.

Relevant recent research: [KEY: EPS power nearing inflection](#) / [TFC: Takin’ Care of Business](#) / [BK: Transformation afoot](#) / [MS: Built to succeed](#)

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Stocks mentioned

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
BK	BK US	BNY Mellon	US\$ 42.89	B-1-7
GS	GS US	Goldman Sachs	US\$ 328.84	B-1-7
KEY	KEY US	Key Corp	US\$ 10.63	B-1-8
MS	MS US	Morgan Stanley	US\$ 83.03	B-1-7
TFC	TFC US	Truist Financial	US\$ 28.84	B-2-7

Source: BofA Global Research

Price objective basis & risk

Goldman Sachs (GS)

Our \$388 PO incorporates recession risk (via applying a trough multiple). We apply a 50% weighting to our 2023 P/E multiple, with the remaining 50% evenly split between 2024 P/E and 2023 P/TBV multiples. We assign 12.6x/12.0x/1.5x multiples, respectively, above peers (9.3x/8.5x/1.5x) due to lower credit risk relative to peers into a potential recession.

Risks to the upside is stronger capital markets activity.

Risks to the downside are a weaker economy/capital markets, macro or geo-political issues, competition, structural pressures, tougher global regulation, and litigation.

KeyCorp (KEY)

Our \$13 PO incorporates recession risk. We apply a 50% weighting to our 2023 P/E multiple, with the remaining 50% evenly split between 2024 P/E and 2023 P/TBV multiples. We assign 10.0x/9.0x/1.5x multiples respectively, below peer multiples (9.3x/8.5x/1.5x).

Downside risks to our PO are a higher for longer interest rate environment increasing deposit costs, greater than expected expenses, inability to maximize balance sheet efficiency, and the announcement of expensive deals. Upside risks are lower than expected credit losses and better than expected PPNR growth.

Morgan Stanley (MS)

Our \$100 PO incorporates recession risk (via applying a trough P/TBV multiple). We apply a 50% weighting to our 2023 P/E multiple, with the remaining 50% evenly split between 2024 P/E and 2023 P/TBV multiples. We assign 16.7x/15.5x/2.3x multiples respectively, above peers (9.3x/8.5x/1.5x) given a more recurring revenue mix and rising ROE due to strategic shift in business which correlates to our ROTE/ROE estimates. Significant change in business mix renders historical relative multiples less applicable to MS.

Risks to the upside is stronger wealth/asset management trends and capital markets activity and higher rates.

Risks to the downside are a weak economy/capital markets, increased macro issues, tougher regulation, and litigation.

The Bank of New York Mellon Corporation (BK)

Our \$55 PO incorporates recession risk. We apply a 50% weighting to our 2023 P/E multiple, with the remaining 50% evenly split between 2024 P/E and 2023 P/TBV multiples. We assign 11.5x/10.5x/2.1x multiples respectively, above trust bank peers (11.0x/9.8x/2.1x) reflecting cyclical and self-help factors that should drive EPS defensibility.

Risk to the upside is stronger equity/bond markets.

Risks to the downside are a severe selloff in equity/bond markets that could put downward pressure on fee growth and M&A that could temper capital return.

Truist Financial (TFC)

Our \$35 PO incorporates recession risk (via utilization of historical trough P/TBV multiple). We apply a 50% weighting to our 2023 P/E multiple, with the remaining 50% evenly split between 2024 P/E and 2023 P/TBV multiples. We assign 9.5x/9.0x/1.6x multiples respectively, above peer multiples (9.3x/8.5x/1.5x).

Risks to our price objective are macro risks such as a sooner and more severe than expected economic recession, execution risk tied to merger integration, enhanced regulatory scrutiny and restrictions on capital distributions.

Analyst Certification

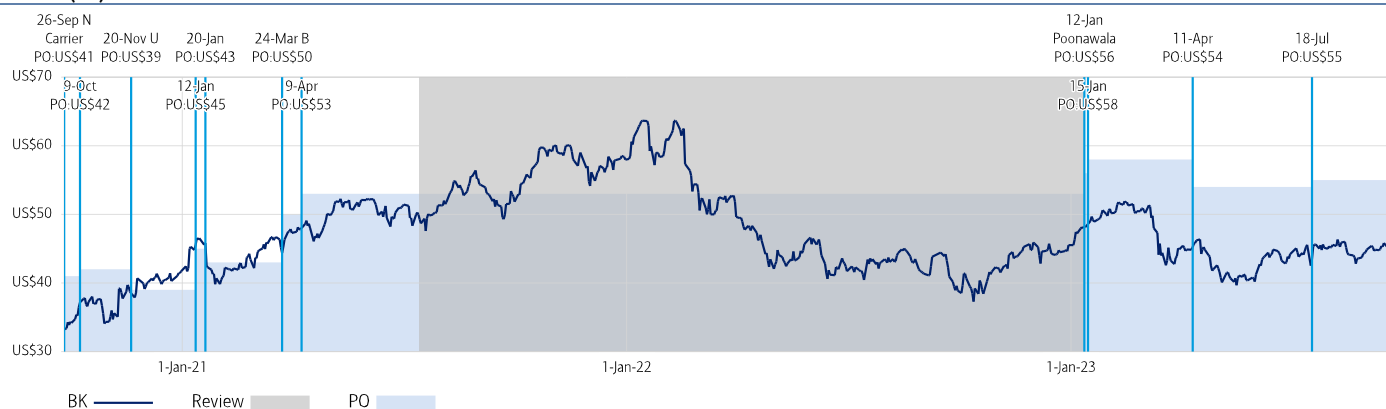
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North America - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Citigroup Inc.	C	C US	Ebrahim H. Poonawala
	Cullen/Frost Bankers Inc	CFR	CFR US	Ebrahim H. Poonawala
	East West Bancorp, Incorporated	EWBC	EWBC US	Ebrahim H. Poonawala
	Fifth Third Bank	FITB	FITB US	Ebrahim H. Poonawala
	First Bancorp Puerto Rico	FBP	FBP US	Brandon Berman
	First Horizon Corporation	FHN	FHN US	Ebrahim H. Poonawala
	Goldman Sachs	GS	GS US	Ebrahim H. Poonawala
	JPMorgan Chase & Co.	JPM	JPM US	Ebrahim H. Poonawala
	KeyCorp	KEY	KEY US	Ebrahim H. Poonawala
	M&T Bank	MTB	MTB US	Ebrahim H. Poonawala
	Morgan Stanley	MS	MS US	Ebrahim H. Poonawala
	New York Community Bancorp	NYCB	NYCB US	Ebrahim H. Poonawala
	Synovus Financial Corp.	SNV	SNV US	Ebrahim H. Poonawala
	The Bank of New York Mellon Corporation	BK	BK US	Ebrahim H. Poonawala
	Toronto-Dominion Bank	TD	TD US	Ebrahim H. Poonawala
	Toronto-Dominion Bank	YTD	TD CN	Ebrahim H. Poonawala
	U.S. Bancorp	USB	USB US	Ebrahim H. Poonawala
	Wells Fargo & Company	WFC	WFC US	Ebrahim H. Poonawala
	Western Alliance Bancorp	WAL	WAL US	Ebrahim H. Poonawala
NEUTRAL				
	Ally Financial	ALLY	ALLY US	Brandon Berman
	Associated Banc-Corp	ASB	ASB US	Brandon Berman
	Bank of Montreal	BMO	BMO US	Ebrahim H. Poonawala
	Bank of Montreal	YBMO	BMO CN	Ebrahim H. Poonawala
	Bank of Nova Scotia	YBNS	BNS CN	Ebrahim H. Poonawala
	Bank of Nova Scotia	BNS	BNS US	Ebrahim H. Poonawala
	Citizens Financial Group	CFG	CFG US	Ebrahim H. Poonawala
	Comerica Incorporated	CMA	CMA US	Ebrahim H. Poonawala
	Huntington Bancshares Inc.	HBAN	HBAN US	Ebrahim H. Poonawala
	Regions Financial	RF	RF US	Ebrahim H. Poonawala
	Royal Bank of Canada	RY	RY US	Ebrahim H. Poonawala
	Royal Bank of Canada	YRY	RY CN	Ebrahim H. Poonawala
	State Street Corporation	STT	STT US	Ebrahim H. Poonawala
	Truist Financial	TFC	TFC US	Ebrahim H. Poonawala
UNDERPERFORM				
	Bank of Hawaii Corp.	BOH	BOH US	Brandon Berman
	Canadian Imperial Bank of Commerce	CM	CM US	Ebrahim H. Poonawala
	Canadian Imperial Bank of Commerce	YCM	CM CN	Ebrahim H. Poonawala
	First Hawaiian Inc.	FHB	FHB US	Brandon Berman
	Prosperity Bancshares Inc	PB	PB US	Ebrahim H. Poonawala
	Texas Capital Bancshares Inc.	TCBI	TCBI US	Brandon Berman
	The PNC Financial Services Group, Inc.	PNC	PNC US	Ebrahim H. Poonawala
	Zions Bancorp	ZION	ZION US	Ebrahim H. Poonawala

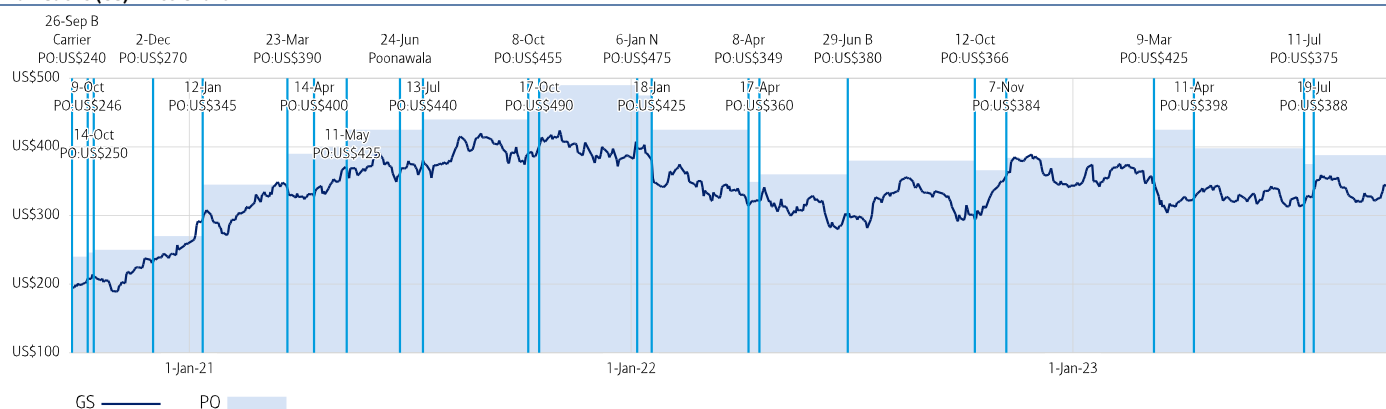
Disclosures

Important Disclosures

BNY Mellon (BK) Price Chart

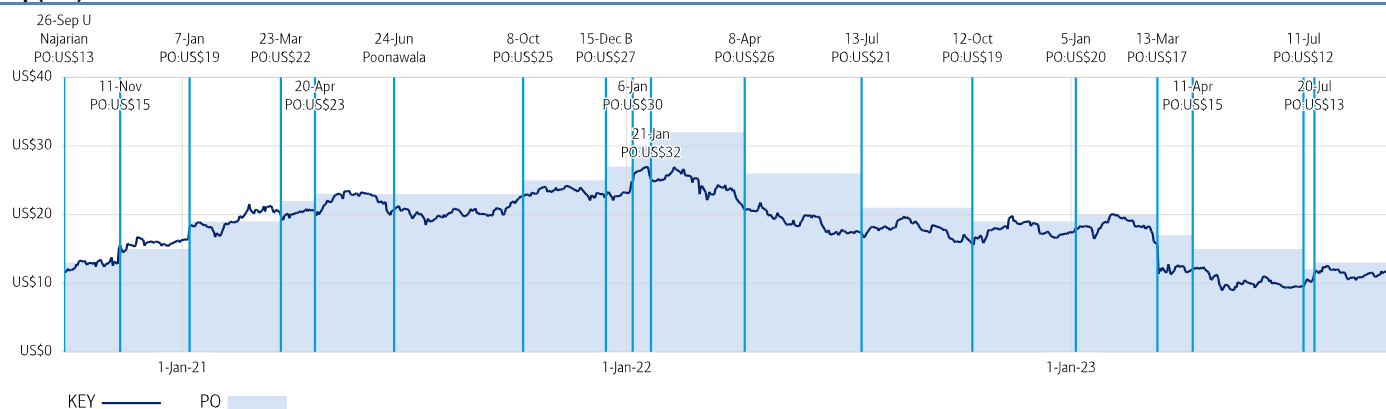
B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Goldman Sachs (GS) Price Chart

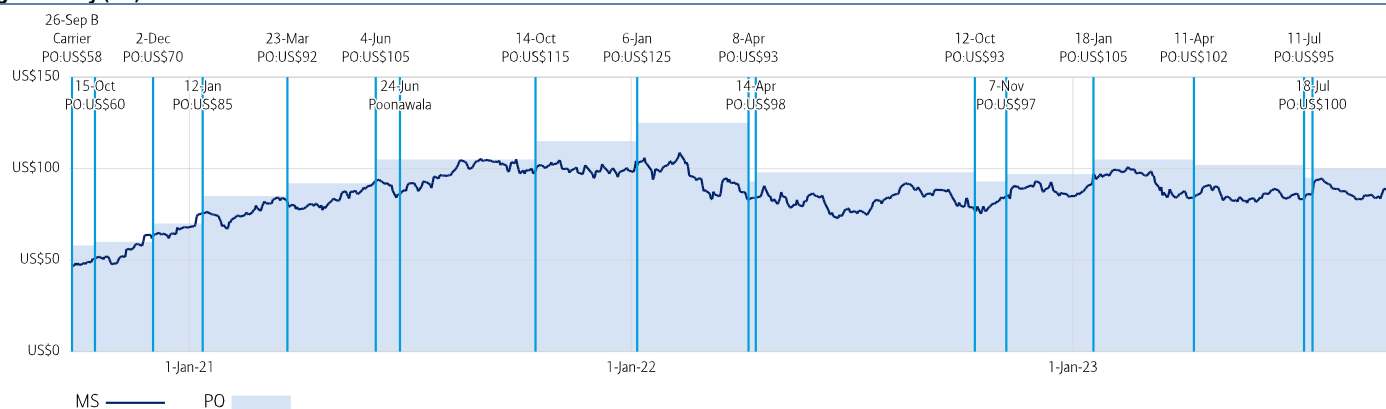
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KeyCorp (KEY) Price Chart

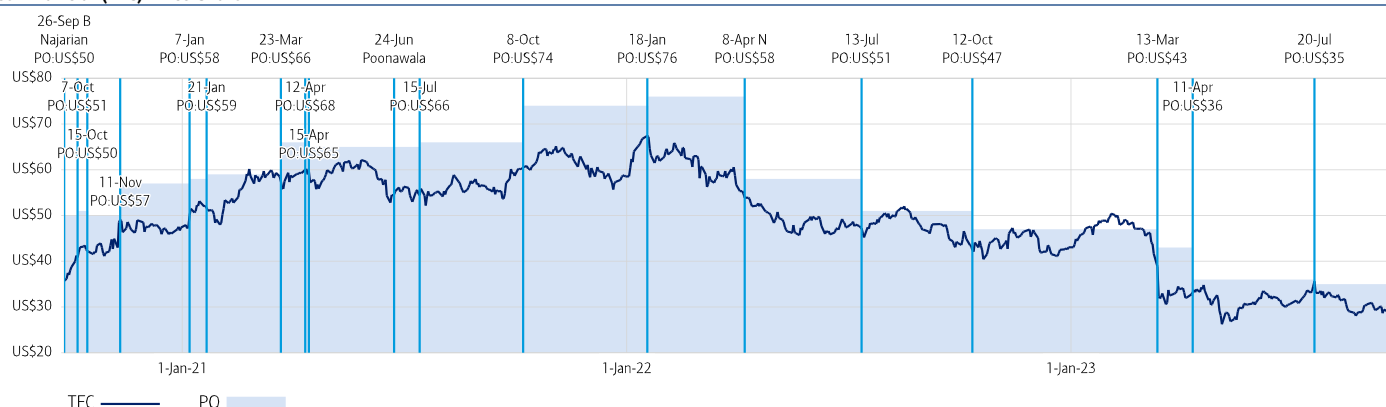
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Morgan Stanley (MS) Price Chart

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Truist Financial (TFC) Price Chart

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Equity Investment Rating Distribution: Banks Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	98	50.52%	Buy	81	82.65%
Hold	45	23.20%	Hold	33	73.33%
Sell	51	26.29%	Sell	37	72.55%

Equity Investment Rating Distribution: Financial Services Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	145	50.52%	Buy	91	62.76%
Hold	78	27.18%	Hold	47	60.26%
Sell	64	22.30%	Sell	38	59.38%

Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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