

US Banks: Reading the Tea Leaves

No cuts = elevated downside risks

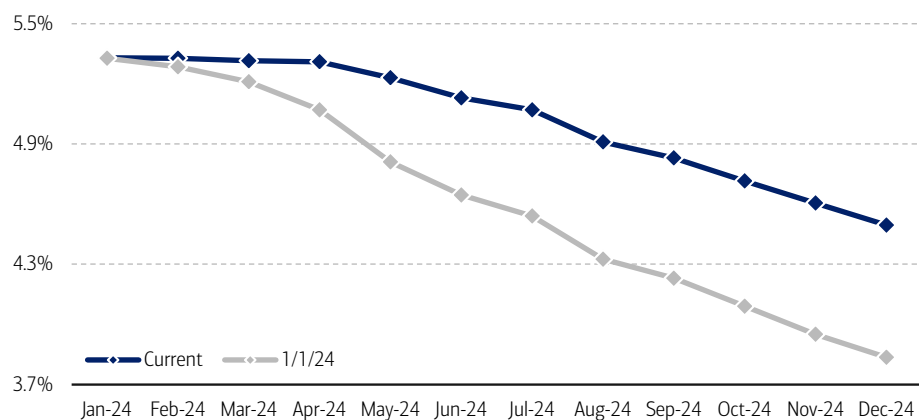
Industry Overview

Higher for longer rates reintroduce tail risk events

Fewer and later Fed rate cuts pose downside risk to bank stocks. We are especially concerned about the failure of the broader market to project the trajectory of interest rates – a consistent theme since the Fed began raising interest rates in March 2022. We worry about the risk from no rate cuts in 2024 and a far more elevated level of interest rates across the UST yield curve. In the immediate term, this is likely to temper investor appetite to add exposure to bank stocks (= drag on P/E multiples) as evidenced by today's sell-off. Fundamentally it has the potential to lead to a worse-than-expected credit cycle, squeeze net interest margins (= downside risk to EPS outlooks), while pressuring capital levels due to MTM losses on bonds.

Exhibit 1: Fed funds futures incorporate significantly reduced rate-cut expectations

Current fed funds futures expectations vs. Jan 1st



Source: BofA Global Research, Bloomberg

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When did a strong economy become a bad thing?

While today's sell-off in bank stocks is driven by hotter inflation data, over the last few weeks the market has treated stronger economic data as a negative for bank stocks. A stronger economy would imply healthier credit quality, better growth. However, we believe investors are concerned about a prolonged period of tight monetary policy (higher for longer rates, QT) given "perceived" liquidity-related risks. This in a backdrop where banking regulators seem laser focused on wanting banks to build balance sheet liquidity and preserve capital – both limiting banks' ability to benefit from stronger GDP growth. Moreover, warranted or not, higher-for-longer rates will likely further fuel concerns tied to credit risk from the repricing of commercial real estate loans.

Bank stocks at the mercy of investor sentiment

An environment in which the fed funds rate is in the 3-4% range with a positively sloping yield curve should be positive for the banking industry...continued on page 2

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12659083

Timestamp: 13 February 2024 03:15PM EST

13 February 2024

Equity
United States
Banks

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Abbreviations:

CRE - commercial real estate

MTM - mark-to-market

QT - quantitative tightening

UST - U.S. Treasury bond

However, investor concerns partly stem from balance sheets that are exposed to low-yielding bonds that will reprice over several years while the hit to funding costs from higher-for-longer rates is occurring in real time (= negative carry). Lack of clear catalysts to drive positive EPS revisions makes the group susceptible to sentiment.

Backdrop favors larger-cap, asset sensitive, less CRE

We don't believe that the bullish thesis on bank stocks is dead just yet, but it has taken a hit on the back of a fast-evolving outlook for interest rates and rising concerns tied to regulatory actions. Overall, we think the current backdrop favors larger-cap, asset sensitive, less CRE exposed banks. We highlight Buy-rated: JPMorgan-JPM, Goldman Sachs-GS, BNY Mellon-BK. Among regionals: Truist-TFC, US Bancorp-USB, First Bancorp/Puerto Rico-FBP, First Horizon-FHN and F.N.B. Corporation-FNB. Relevant research: [US Banks: Reading the Tea Leaves: Implications: NYCB, FOMC 31 January 2024](#).

Exhibit 2: Stocks mentioned

Prices and ratings for stocks mentioned in this report

Stocks mentioned

Prices and ratings for stocks mentioned in this report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
FBP	FBP US	First Bancorp PR	US\$ 16.96	B-1-7
FHN	FHN US	First Horizon Corp.	US\$ 14.07	C-1-7
FNB	FNB US	FNB Corp	US\$ 13.36	B-1-7
GS	GS US	Goldman Sachs	US\$ 392.64	B-1-7
JPM	JPM US	JP Morgan Chase	US\$ 175.79	B-1-7
BK	BK US	BNY Mellon	US\$ 55.62	C-1-7
TFC	TFC US	Truist Financial	US\$ 36.01	B-1-7
USB	USB US	U.S. Bancorp	US\$ 41.07	B-1-7

Source: BofA Global Research

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Price objective basis & risk**First Bancorp Puerto Rico (FBP)**

Our \$19.50 PO is based on applying a 50%/50% weighting between our 2024e EPS and 2024e TBV. We assign 13x/1.8x multiples respectively, in-line/above the bank's 5 year pre-pandemic median of 13.9x/0.8x due to a higher return profile.

Downside risks to our price objective are a worse-than-expected restructuring of PR government debt and a deterioration in the Puerto Rican economy that could hurt the ongoing credit and earnings recovery at FBP. Upside risks to our price objective are a much stronger economic improvement in Puerto Rico, deployment of excess capital into share purchase agreement and a better-than-expected improvement in asset quality trends at FBP.

First Horizon Corporation (FHN)

Our \$17 PO is based on 50%/50% weighting between our 2024e EPS and 2024e TBV. We assign 12.5x/1.2x multiples respectively, below the bank's 5 year pre pandemic median of 15.4x/1.7x given heightened uncertainty surrounding EPS/ROTCE outlooks, owing to the macro backdrop.

Risks to the upside are stronger-than-expected loan/deposit growth and better-than-expected mgmt. execution post-TD acquisition termination. Risks to the downside are: greater than expected expense growth as mgmt plays catch-up on tech spend, a deterioration in the funding backdrop that drives higher than expected deposit pricing, worse than expected credit losses.

FNB Corporation of Pennsylvania (FNB)

Our \$16 PO is based on a 50%/50% weighting between our 2024e EPS and 2024e tangible book value (TBV). We assigned 10.5x/1.6x multiples, respectively, improved



capital levels and above-average ROTCE profile.

Upside risk: stronger than expected balance sheet growth, quicker return to profitability, and greater NIM expansion relative to peers. Downside risk: higher than expected expense growth, accelerated credit migration, and slower balance sheet growth.

Goldman Sachs (GS)

Our \$412 PO is based on a 50%/50% weighting between our 2024e EPS and 2024e TBV. We assign 13.5x/1.4x multiples, respectively, above the bank's 5 year pre pandemic median of 10.6x/1.2x given lower credit risk into a potential recession. Downside risks to our PO: weaker economy/capital markets, macro or geo-political issues, competition, structural pressures, tougher global regulation, and litigation. Upside risks: stronger capital markets activity.

JPMorgan Chase & Co. (JPM)

Our \$188 PO is based on a 50%/50% weighting between our 2024e EPS and 2024e TBV. We assign 12.9x/1.9x multiples, respectively, in-line with/above 5Y pre-pandemic average (11.8x/1.7x, respectively) due to the bank's best-in-class revenue generation and better EPS defensibility.

Downside risks to our price objective are macro risks, such as slower-than-expected rate increases, additional regulatory requirements, and scrutiny of the financials industry. Upside risks are better-than-expected credit quality (i.e., lower loan losses) and better interest rate defensibility.

The Bank of New York Mellon Corporation (BK)

Our \$64 PO is based on 50%/50% weighting between our 2024e EPS and 2024e TBV. We assign 13.8x/2.0x multiples respectively, in-line/below the bank's 5 year pre pandemic median of 13.4x/3.1x given heightened uncertainty surrounding EPS/ROTCE outlooks, owing to uncertainty surrounding the outlook for interest rates and equity/bond prices.

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 \$45 PO is based on 50%/50% weighting between our 2024e EPS and 2024e TBV. We assign 13.5x/1.8x multiples respectively, in-line with the bank's 5 year pre pandemic median of 13.2x/2.2x given reduced uncertainty surrounding EPS/ROTCE outlooks, owing to the macro backdrop.

Downside risks to our PO: higher than expected credit losses, greater than expected revenue pressure, regulatory changes that would impact growth/profitability, execution risk tied to STI/BBT merger of equals that completed in December 2019.

U.S. Bancorp (USB)

Our \$49 PO is based on 50%/50% weighting between our 2024e EPS and 2024e TBV. We assign 13.0x/2.2x multiples respectively, below the bank's 5 year pre pandemic median of 13.3x/2.5x given heightened uncertainty surrounding EPS/ROTCE outlooks, owing to the macro backdrop.

Downside risks to our PO: higher than expected credit losses, greater than expected revenue pressure, regulatory changes that would impact growth/profitability, not fully realizing synergies expected with the acquisition of Union Bank.

Analyst Certification

I, Ebrahim H. Poonawala, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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North America - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Ares Capital Corporation	ARCC	ARCC US	Derek Hewett
	Ares Commercial Real Estate Corporation	ACRE	ACRE US	Derek Hewett
	Bank of Montreal	BMO	BMO US	Ebrahim H. Poonawala
	Bank of Montreal	YBMO	BMO CN	Ebrahim H. Poonawala
	Barings BDC Inc	BBDC	BBDC US	Derek Hewett
	Blackstone Mortgage Trust Inc	BXMT	BXMT US	Derek Hewett
	Blue Owl Capital Corporation	OBDC	OBDC US	Derek Hewett
	Carlyle Secured Lending Inc	CGBD	CGBD US	Derek Hewett
	Citigroup Inc.	C	C US	Ebrahim H. Poonawala
	Compass Diversified Holdings	CODI	CODI US	Derek Hewett
	Crescent Capital BDC	CCAP	CCAP US	Derek Hewett
	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
	FNB Corporation of Pennsylvania	FNB	FNB US	Brandon Berman
	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 Mountain Finance Corporation	NMFC	NMFC US	Derek Hewett
	Northern Trust Corporation	NTRS	NTRS US	Ebrahim H. Poonawala
	Royal Bank of Canada	RY	RY US	Ebrahim H. Poonawala
	Royal Bank of Canada	YRY	RY CN	Ebrahim H. Poonawala
	Safehold, Inc	SAFE	SAFE US	Derek Hewett
	Sixth Street Specialty Lending, Inc	TSLX	TSLX US	Derek Hewett
	Starwood Property Trust	STWD	STWD US	Derek Hewett
	Synovus Financial Corp.	SNV	SNV US	Ebrahim H. Poonawala
	The Bank of New York Mellon Corporation	BK	BK US	Ebrahim H. Poonawala
	Truist Financial	TFC	TFC US	Ebrahim H. Poonawala
	U.S. Bancorp	USB	USB US	Ebrahim H. Poonawala
	Webster Financial Corp.	WBS	WBS US	Brandon Berman
	Wells Fargo & Company	WFC	WFC US	Ebrahim H. Poonawala
	Western Alliance Bancorp	WAL	WAL US	Ebrahim H. Poonawala
NEUTRAL				
	AGNC Investment Corp	AGNC	AGNC US	Derek Hewett
	Ally Financial	ALLY	ALLY US	Brandon Berman
	Annaly Capital Management	NLY	NLY US	Derek Hewett
	Apollo Commercial Real Estate Finance	ARI	ARI US	Derek Hewett
	Associated Banc-Corp	ASB	ASB US	Brandon Berman
	Bain Capital Specialty Finance, Inc.	BCSF	BCSF US	Derek Hewett
	Bank of Nova Scotia	YBNS	BNS CN	Ebrahim H. Poonawala
	Bank of Nova Scotia	BNS	BNS US	Ebrahim H. Poonawala
	Blackstone Secured Lending Fund	BXSL	BXSL US	Derek Hewett
	BrightSpire Capital Inc.	BRSP	BRSP US	Derek Hewett
	Canadian Imperial Bank of Commerce	CM	CM US	Ebrahim H. Poonawala
	Canadian Imperial Bank of Commerce	YCM	CM CN	Ebrahim H. Poonawala
	Citizens Financial Group	CFG	CFG US	Ebrahim H. Poonawala
	Comerica Incorporated	CMA	CMA US	Brandon Berman
	Commerce Bancshares Inc.	CBSH	CBSH US	Brandon Berman
	Goldman Sachs BDC, Inc.	GSBD	GSBD US	Derek Hewett
	Golub Capital BDC, Inc.	GBDC	GBDC US	Derek Hewett
	Huntington Bancshares Inc.	HBAN	HBAN US	Ebrahim H. Poonawala
	Ladder Capital Corp	LADR	LADR US	Derek Hewett
	New York Community Bancorp	NYCB	NYCB US	Ebrahim H. Poonawala
	Palmer Square Capital BDC	PSBD	PSBD US	Derek Hewett
	PennyMac Mortgage Investment Trust	PMT	PMT US	Derek Hewett
	Popular Inc	BPOP	BPOP US	Brandon Berman
	Regions Financial	RF	RF US	Ebrahim H. Poonawala
	The PNC Financial Services Group, Inc.	PNC	PNC US	Ebrahim H. Poonawala
	Toronto-Dominion Bank	TD	TD US	Ebrahim H. Poonawala

North America - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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	TPG RE Finance Trust, Inc.	TRTX	TRTX US	Derek Hewett
UNDERPERFORM				
	Bank of Hawaii Corp.	BOH	BOH US	Brandon Berman
	First Hawaiian Inc.	FHB	FHB US	Brandon Berman
	Guild Holdings Company	GHLD	GHLD US	Derek Hewett
	Invesco Mortgage Capital, Inc.	IVR	IVR US	Derek Hewett
	loanDepot Inc	LDI	LDI US	Derek Hewett
	MidCap Financial Investment Co	MFIC	MFIC US	Derek Hewett
	Prosperity Bancshares Inc	PB	PB US	Ebrahim H. Poonawala
	State Street Corporation	STT	STT US	Ebrahim H. Poonawala
	Texas Capital Bancshares Inc.	TCBI	TCBI US	Brandon Berman
	Zions Bancorp	ZION	ZION US	Brandon Berman

Disclosures

Important Disclosures

Equity Investment Rating Distribution: Banks Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	100	49.75%	Buy	84	84.00%
Hold	54	26.87%	Hold	41	75.93%
Sell	47	23.38%	Sell	35	74.47%

Equity Investment Rating Distribution: Financial Services Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	156	53.79%	Buy	94	60.26%
Hold	72	24.83%	Hold	48	66.67%
Sell	62	21.38%	Sell	35	56.45%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{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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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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