

US Banks: Reading the Tea Leaves

Basel rethink: reduced profitability = a weaker not stronger banking system

Industry Overview

David Solomon turning a corner...

Goldman Sachs shares continue to outperform peers post 3Q results. This move hasn't gone unnoticed based on our investor conversations. We attribute this to the Street beginning to see the light at the end of the tunnel on the consumer pivot (marked most recently by news of a potential sale of the GM credit card portfolio), ongoing capital optimization via the sale of private investments (= lower stress capital buffer) and hopes (albeit diminished) for an investment banking rebound.

...stock should continue to outperform

We see risk/reward as attractive at 1.1x P/TBV. Sharpened focus on core businesses (targeting mid-teens returns), a consumer footprint limited to online deposit gathering, and visibility on capital return should drive stock outperformance. **Morgan Stanley** shares will need to see stable/positive EPS revisions in order to reverse recent underperformance, defend premium valuation at 1.8x P/TBV. 10-Q disclosure on 40% RWA inflation due to Basel end game proposal consistent with our expectations. Relevant research: [GS: Sharpened focus should \(eventually\) pay-off](#) / [MS: Patience tested](#)

Monetary policy + 2024 election cycle = volatility

Investors continue to assess the risk of an air pocket on trading revenues (+35% 2023 vs. 2019 for big five banks; [Exhibit 1](#)). While impossible to handicap, uncertainty around global monetary policy, a consequential 2024 election cycle spanning ~60% of global GDP should underpin market volatility (although could be a drag on investment banking). QTD measures of market vol +18% QoQ; investment banking trends not too encouraging. [Exhibit 3-5](#).

Basel end game rules require a rethink

We expect meaningful changes to the proposed rules given the significant duplication and the lack of obvious reasons to add capital to the already gold-plated US GSIB bank capital standards which Fed Chair Jay Powell recently described as "very well-capitalized and highly liquid." The lack of unanimity at the Fed, pushback in Congress and upcoming US Presidential elections should incentivize regulators/industry to reach common ground. Relevant research: [Reading the Tea Leaves: Peak rates solve a lot \(not all\) of problems](#) / [US Banks: Earnings & beyond: Bleak](#)

Reduced ROEs = weaker not stronger banking system

In their zest to add more capital, regulators are underestimating the risk created by reduced profitability. A regulatory/policy regime that benefits non/foreign banks over regulated US banks, discourages growth (GSIB score, asset thresholds that create cliff events), and micro-manages revenue models (such as cap on interchange fees) are sowing the seeds for future crises and is not a recipe for a healthy banking industry that would benefit all stakeholders (shareholders, employees, communities). We are all for strong regulations that safeguard the system, but adding more capital to overcome supervisory oversight is unlikely the right approach. Relevant research: [US Banks: de-coding Fed's proposal on capital changes](#) / [Basel Capital NPR: As advertised](#)

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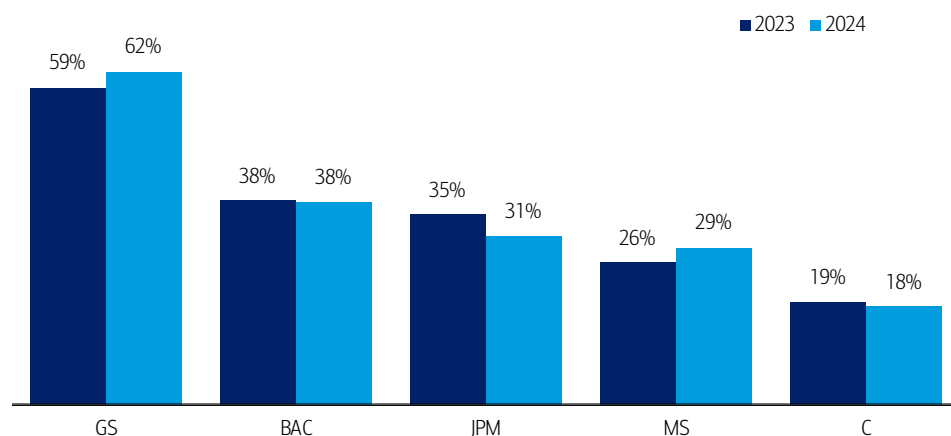
Acronyms

CVA: credit valuation adjustment
GSIB: Global systemically important banks
ROE: Return on equity
RWA: Risk weighted assets

During last week's fixed income call Goldman discussed advantageous treatment for its financing business under the proposed Basel end game rules; investments in modelling capabilities should also help when complying with market risk (FRTB) and CVA requirements.

Exhibit 1: Street forecast assumes elevated trading activity to continue

Trading revenue buoyed by fiscal/monetary policies, geo-politics

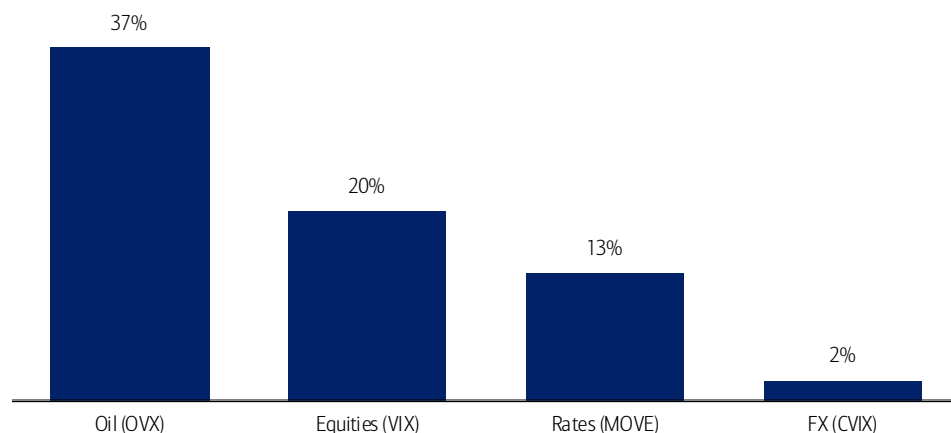


Source: BofA Global Research, Visible Alpha

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Exhibit 2: Measures of market volatility up QoQ should underpin healthy trading activity

4Q23 QTD average vs. 3Q23 average



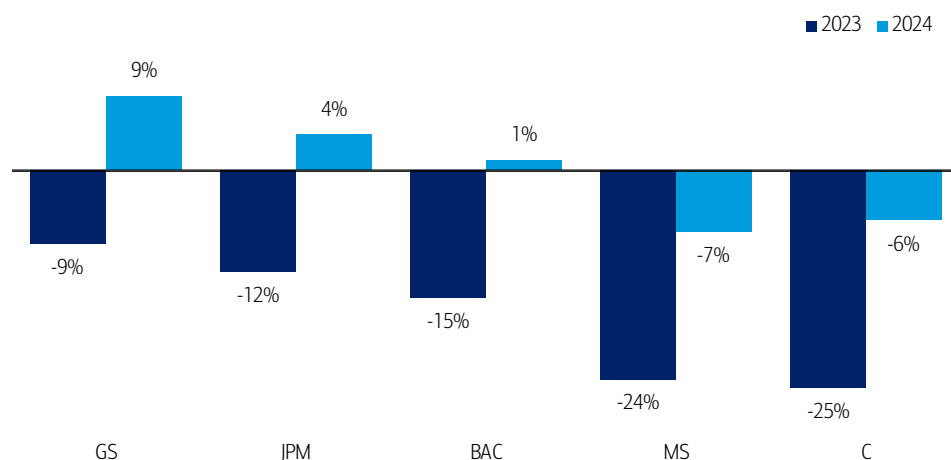
Source: BofA Global Research, Bloomberg

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A strong rebound in M&A/IPO activity seems unlikely in the absence of subsiding macro uncertainties, geo-political risks, regulatory overhang.
Consensus forecast for investment banking revenues

Exhibit 3: Street forecast assumes a rebound in investment banking in 2024

Macro uncertainty a headwind to investment banking activity

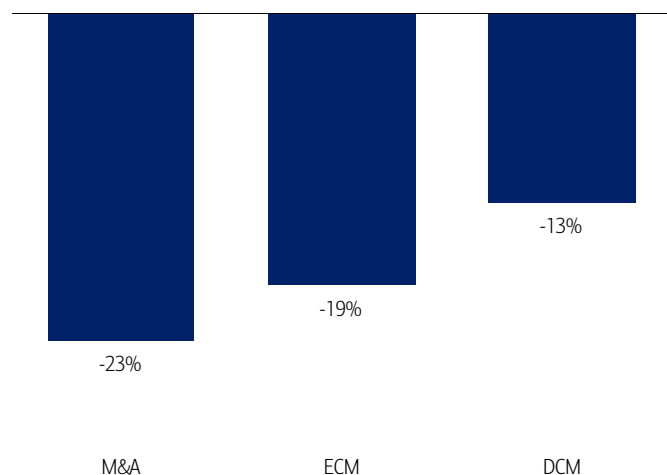


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Exhibit 4: Investment banking trends not too encouraging...

Net revenue YoY – 4Q23 QTD vs. 4Q22 QTD

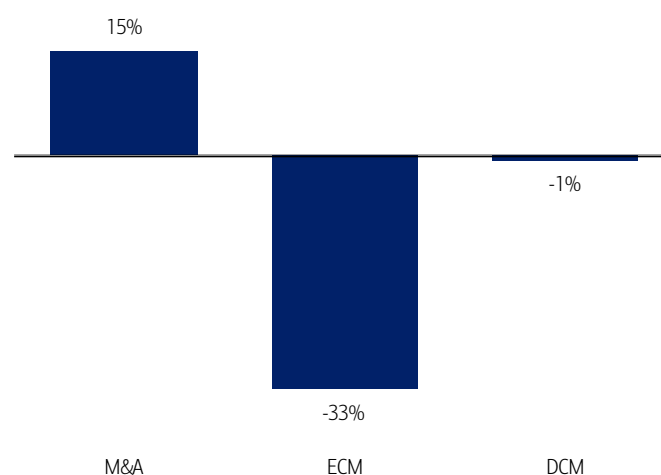


Source: BofA Global Research, Dealogic

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Exhibit 5: ...although there is a pickup in M&A QoQ

Net revenue QoQ – 4Q23 QTD vs. 3Q23 QTD



Source: BofA Global Research, Dealogic

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Exhibit 6: Stocks mentioned

Prices and ratings for stocks mentioned in this report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
GS	GS US	Goldman Sachs	US\$ 325.51	B-1-7
MS	MS US	Morgan Stanley	US\$ 75.33	B-1-7

Source: BofA Global Research

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Price objective basis & risk

Goldman Sachs (GS)

Our \$388 PO is based on a 50%/50% weighting between our 2024e EPS and 2024e TBV. We assign 12x/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.

Morgan Stanley (MS)

Our \$90 PO is based on 50%/50% weighting between our 2024e EPS and 2024e TBV. We assign 17.0x/1.8x multiples respectively, above the bank's 5 year pre pandemic median of 11.7x/1.3x given an improved (stickier) revenue mix driven by its wealth and asset management segments.

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.

Analyst Certification

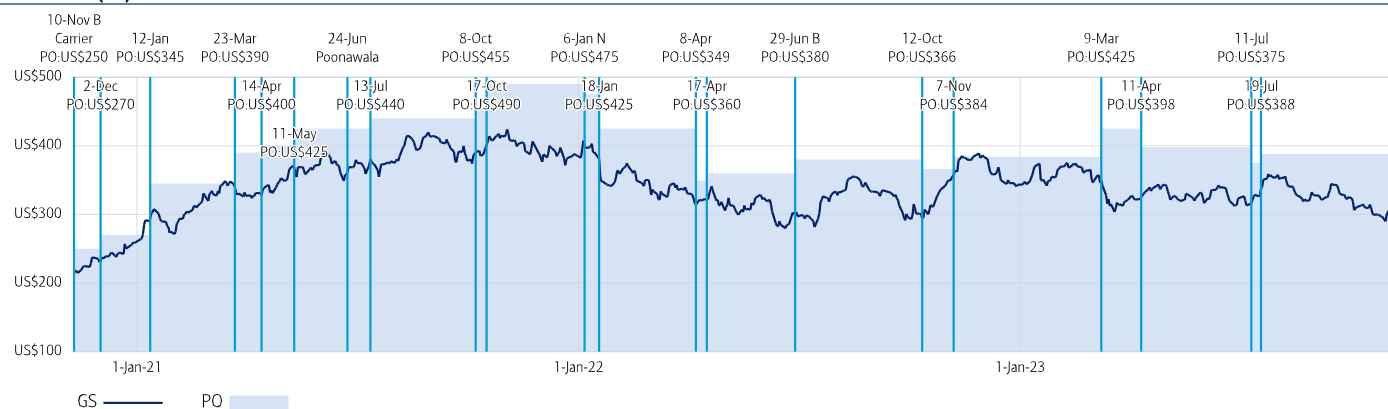
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North America - Banks Coverage Cluster

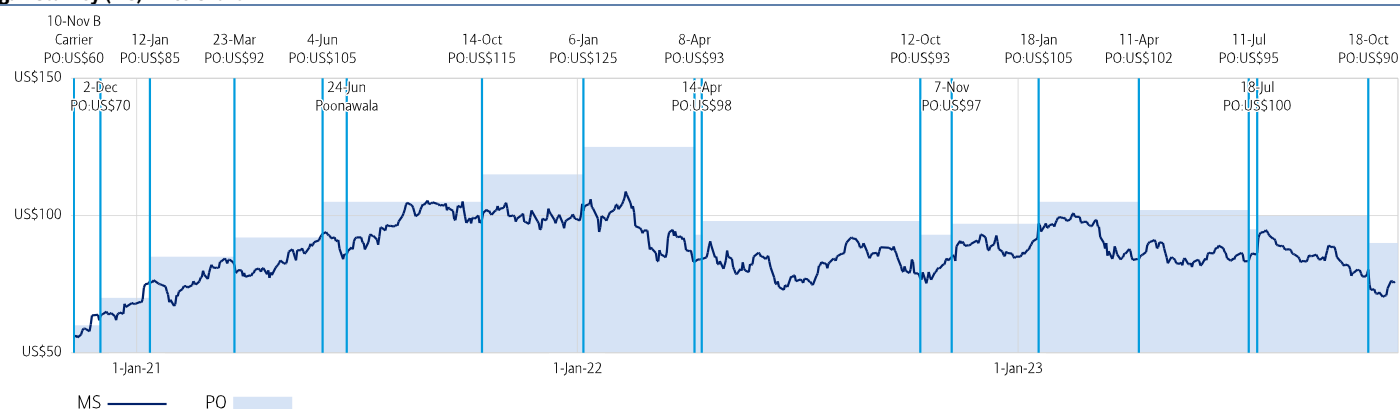
Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Citigroup Inc.	C	C US	Ebrahim H. Poonawala
	Cullen/Frost Bankers Inc	CFR	CFR US	Ebrahim H. Poonawala
	East West Bancorp, Incorporated	EWBC	EWBC US	Ebrahim H. Poonawala
	Fifth Third Bank	FITB	FITB US	Ebrahim H. Poonawala
	First Bancorp 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
	Northern Trust Corporation	NTRS	NTRS 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
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	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
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	Comerica Incorporated	CMA	CMA US	Ebrahim H. Poonawala
	Huntington Bancshares Inc.	HBAN	HBAN US	Ebrahim H. Poonawala
	Popular Inc	BPOP	BPOP US	Brandon Berman
	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
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	Prosperity Bancshares Inc	PB	PB US	Ebrahim H. Poonawala
	Texas Capital Bancshares Inc.	TCBI	TCBI US	Brandon Berman
	Zions Bancorp	ZION	ZION US	Ebrahim H. Poonawala

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Morgan Stanley (MS) Price Chart

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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	98	50.78%	Buy	81	82.65%
Hold	47	24.35%	Hold	35	74.47%
Sell	48	24.87%	Sell	36	75.00%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	156	53.24%	Buy	94	60.26%
Hold	79	26.96%	Hold	52	65.82%
Sell	58	19.80%	Sell	32	55.17%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1869	53.48%	Buy	1046	55.97%
Hold	828	23.69%	Hold	461	55.68%
Sell	798	22.83%	Sell	370	46.37%

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

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