Company Name: JPMorgan
Company Ticker: JPM US
Date: 2017-07-14
Event Description: Q2 2017 Earnings Call

Market Cap: 324,335.46
Current PX: 91.29
YTD Change($): +5.00
YTD Change(%): +5.794

Bloomberg Estimates - EPS
Current Quarter: 1.675
Current Year: 6.724
Bloomberg Estimates - Sales
Current Quarter: 25803.250
Current Year: 103074.182

Q2 2017 Earnings Call

Company Participants

- Marianne Lake
- Jamie Dimon

Other Participants

- Glenn Schorr
- Ken Usdin
- Betsy Graseck
- John McDonald
- Erika Najarian
- Saul Martinez
- Matthew O'Connor
- Gerard Cassidy
- Steven Chubak
- Andrew Lim

MANAGEMENT DISCUSSION SECTION

Marianne Lake

Financial Highlights

Net Income and EPS

- Starting on page 1, the Firm reported record net income of $7B, EPS of $1.82, and a return on tangible common equity of 14%, on revenue of $26.4B
- Included in the result is a legal benefit of approximately $400mm after-tax from a previously announced settlement involving the FDIC's Washington Mutual Receivership

Core Loan Growth, Sales and Volume

- Other notable items, predominantly net reserve changes and legal expense, were a small net negative this quarter, so underlying adjusted performance was really strong
- And highlights for the quarter include:
  - Average core loan growth of 8% year on year, reflecting continued growth across products
  - Double-digit Consumer deposit growth
  - Strong Card sales, up 15%, and merchant volume up 12%; #1 global IB fees, up 10%
  - And we delivered record net income in both Commercial Banking and in Asset & Wealth Management

Revenue and Net Interest Income

- Moving on to page 2 and some more details about the quarter
- Revenue of $26.4B was up $1.2B, or 5% year on year, with the increase predominantly in Net Interest Income, up approximately $900mm, reflecting continued loan growth and the impact of higher rates

Fee Revenue and Adjusted Expense

- Fee revenue was up $300mm year on year, but adjusting for one-time items in both years was down modestly, with lower Fixed Income Markets, Mortgage and Card revenue, all as guided, being offset by strong fee revenue growth across remaining businesses
- Adjusted expense of $14.4B, was up a little less than $400mm year on year, with Auto leases being the biggest driver, but also including the impact of the FDIC surcharge and broader growth, being offset by lower compensation

Credit Costs

- Credit costs of $1.2B, were down $187mm year on year, on lower reserve build, as a net reserve build in Consumer of a little over $250mm, driven by Card, was offset by a net release in Wholesale of a little under $250mm, driven by Energy
- Anticipating you may have questions, given the recent stress in oil prices, I would emphasize that we guided to expect reserve releases given we started the year with $1.5B of Energy-related reserves
- And with oil prices having found a lower but seemingly stable level, we feel appropriately reserved

Balance Sheet and Capital

- Shifting to balance sheet and capital on page 3
- You can see in the red circle on the page here that we ended the quarter with binding Fully Phased-In CET1 of 12.5%, under the Standardized approach, with the improvement being primarily driven by capital generation, offset by net loan growth
- We've been hovering around the inflection point under the Collins Floor for a while now, and expect Standardized to remain our binding constraint from here
- Given that, we've replicated this page under Standardized rules in the appendix for you to read

Liquidity

- Balance sheet, Risk-Weighted Assets, and SLR all remained relatively flat from the prior quarter
- And while not on the page, I would also note that we remain compliant with all liquidity requirements

Dividend

- We were pleased to announce gross repurchase capacity of up to $19.4B over the next four quarters
- And the Board announced its intention to increase common stock dividends 12% to $0.56 per share, effective in Q3

- In addition, we recently submitted our 2017 Resolution Plan, which we believe fully addresses outstanding regulatory feedback

Consumer & Community Banking

- Moving on to page 4 and Consumer & Community Banking
- CCB generated $2.2B of net income and an ROE of 16.5%
- We continue to grow core loans, up 9% year on year, driven by strength in Mortgage, up 12%
- Card and Business Banking were each up 8%
- And Auto loans and leases were also up 8%, driven by strong lease performance from our manufacturing partners

Deposit Growth

- Deposit growth continues to be strong, up 10% year on year, with household retention remaining at historically high levels
- We saw improvement in our deposit margin, up 16BPS
- Sales growth in Card was very strong again this quarter, up 15%, as new accounts mature
- And merchant processing volumes grew double digits, up 12%

Revenue

- Revenue of $11.4B was flat year on year, but recall that last year included a net benefit of about $200mm, principally driven by the Visa Europe gain
- So excluding that, revenue was up modestly
- Consumer & Business Banking revenue was up 13%, on both strong deposit growth and margin expansion
- Mortgage revenue was down 26%, as higher rates drove higher funding costs, which together with lower MSR risk management and lower production margins put pressure on Mortgage revenue year on year
- In addition, revenue included a reduction of approximately $75mm to Net Interest Income, related to capitalized interest on modified loans

Card, Commerce Solutions & Auto

- And Card, Commerce Solutions & Auto revenue was down 3%, but if you exclude the non-core items I mentioned, sic [revenue] was up 2%, with NII growth on higher loan balances and higher auto lease income, predominantly offset by the continued impact of investments in Card new account acquisitions
- Expense of $6.5B was up 8% year on year, on higher auto lease depreciation, higher marketing expense, and continued underlying business growth

Credit Performance

- Finally, on credit performance, Card services drove higher net charge-offs year on year, but still within our guidance for the full year of less than 3%

- Net reserve builds were around $250mm, building $350mm in Card, $50mm in Business Banking, and $25mm in Auto, in part due to loan growth and in part higher loss rates in Card
    - This was partially offset by a release of $175mm in Mortgage, reflecting continued improvement in home prices and lower delinquencies
- To touch on consumer delinquency trends, in particular in Card, we are seeing some key signs of normalization, which are generally in line with our expectations and our credit risk appetite
- And in Auto, our trends are relatively flat

Corporate & Investment Bank

- Now turning to page 5 and the Corporate & Investment Bank
- CIB reported net income of $2.7B, on revenue of $8.9B and an ROE of 14.5%
- In Banking, IB revenue of $1.7B, was up 14% year on year, with strong performance across products, but particular strength in DCM.
    - We ranked #1 in global IB fees and #1 in North America and EMEA.
- We were also #1 in ECM and DCM globally, in each case gaining share for H1 this year

Fees Growth

- Advisory fees were up 8%, benefiting from a large number of deals closing this quarter
- Equity underwriting fees were up 29%, better than the market, but relative to a weak prior-year quarter
- With a strong market backdrop and supportive valuations, we saw continued momentum in global issuance, especially IPOs
- And Debt underwriting fees were up 5%, from a strong quarter last year, driven by the high flow volume of repricing and refinancing activity even with fewer large acquisition financings

Outlook

ECM Issuance

- In terms of the outlook, we expect IB fees in H2 to be down year on year, given that we had the highest IB fees on record for a third quarter last year
- That said, overall sentiment remains positive
- ECM issuance is expected to continue given the stable market backdrop, and the M&A backlog is healthy, with conditions remaining constructive for refinancing activity

Revenue Growth

- Treasury Services revenue of $1.1B, was up 18%, driven by higher rates, as well as operating deposit growth
- Lending revenue of $373mm, was up 35%, reflecting lower mark-to-market losses on hedges of accrual loans

Market Growth

- Moving on to Markets, total revenue was $4.8B, down 14% year on year
- Fixed income revenue was down 19%, with decent performance across products, relative to a very strong second quarter last year, which was driven by higher levels of volatility and activity broadly, including as a result of Brexit
  - This quarter conversely can be characterized by a lack of idiosyncratic events, resulting in sustained low volatility, reduced flows, and continued credit spread tightening, all of which impacted activity levels in Rates, Credit trading, and Commodities
- Emerging markets performance was relatively stronger on a weaker dollar and lower rates, as well as some regional events

Derivatives

- Equities revenue was down 1%
- In Derivatives, on the structured side we did quite well and outperformed, and on the flow end, we held our own in a quiet and therefore challenging environment
- Prime was a bright spot, as we are realizing the benefit of the investments we've been consistently making

Markets Revenue

- Before I move on, I would also like to remind you that Q3 2016 Markets revenue was also a record since 2010
- In fact, it was about $1B more than the average of the previous five years
- And so while that isn't guidance, it is context, as this quarter has felt quiet, more like prior years
- Securities Services revenue of $982mm was up 8%, driven by higher rates and higher asset-based fees, on higher market levels
- And remember, Q2 benefits from dividend seasonality

Expenses

- Finally, expense of $4.8B was down 5% year on year, driven by lower compensation expense and a comp-to-revenue ratio for the quarter of 28%

Commercial Banking

- Moving on to page 6 and Commercial Banking
- Another quarter of excellent performance, with record revenue and net income, and an ROE of 17%
- Revenue grew 15%, driven by deposit NII, as the rate environment continues to be favorable and on higher loan balances, with spreads remaining steady
- IB revenue was down due to the lack of large deal activity during the quarter, but underlying flow activity was solid across products, as momentum continued, and forward pipelines appear strong

Loan Balance and C&I

- Expense of $790mm was up 8%, and we expect this to grow modestly in H2, as we continue to execute on the investments in bankers and technology that we outlined at Investor Day
- Loan balances were up 12% year on year and 3% quarter on quarter
- C&I loans were up 4% sequentially, ahead of the industry, on broad-based growth across markets and within specialized industries
- CRE saw growth of 2%, in line with the industry, but below last year's pace, on reduced origination activity, as we continue to be selective at this stage in the cycle

Credit Performance

- Finally, credit performance remains very strong, with a net charge-off rate of 2BPS
- Leaving the Commercial Bank and moving on to Asset & Wealth Management on page 7
- Asset & Wealth Management reported record net income of $624mm, with pre-tax margin of 32% and an ROE of 27%
- Revenue of $3.2B, was up 9% year on year, driven primarily by higher market levels, but also strong banking results on higher deposit NII.
- Expense of $2.2B, was up 4% year on year, driven by a combination of higher external fees and compensation on higher revenue
  - This quarter we saw net long-term inflows of $9B, with positive flows across multi-asset, fixed income, and alternatives, being partially offset by outflows in equity products

Net Liquidity Outflow

- We saw net liquidity outflows of $7B, largely due to specific client deal related cash needs
- Record AUM of $1.9 trillion and overall client assets of $2.6 trillion were both up 11% year on year, on higher market levels
- Deposits were flat year on year and down 5% sequentially, reflecting the beginning of balance migration into investment related assets, as expected, and those balances remained with us
- Finally, loan balances were up 9% year on year, driven by mortgage, up nearly 20%

Corporate

- Moving on to page 8 and Corporate
- Corporate reported net income of $570mm, which includes the legal benefit I mentioned earlier of $645mm in revenue or $400mm after-tax
- And a reminder, this is the same $645mm that was publicly announced in August 2016 and represents partial reimbursement for costs that we've previously incurred and paid that remain the responsibility of the WaMu receivership

Outlook

NII

- Finally, turning to page 9 and the outlook
- Starting with the quarter, we guided second quarter NII to be up about $400mm from Q1, given the March rate hike, but you'll see that the NII for the quarter increased by only $150mm
  - While we did fully realize the expected benefit of higher rates and continued growth, against that we had the one-time $75mm mortgage adjustment, as well as lower CIB Markets NII
- These effects together with modest downward pressure from lower 10-year rates, with all other things equal, point to a full-year number of closer to $4B up, rather than the previous $4.5B, but with the potential to be higher if we continue to benefit from tailwinds of lower deposit reprice
- So you will see we have adjusted the guidance on the page, but it will be market dependent
- And any near-term forecast is sensitive to a number of factors, none of which changes our conviction that we will ultimately deliver $11 billion-plus of incremental NII as rates normalize, and we are well on our way

Adjusted Expense

- On expense, we continue to expect full-year adjusted expense of $58B
- Second quarter was in line with our expectation and our guidance, at a little better than $14.5B, which is also where we expect Q3 to come in

Core Loan Growth

- Finally, we have revised our full-year core loan growth down to 8% y-over-y, but a couple of comments
- First, we are seeing slightly lower growth than we expected coming into the year
- It is only modestly lower
- And more importantly, we remain encouraged by the consistency and breadth of client demand across products

Mortgage

- Secondly, we noted that Mortgage could be a big driver, and with a smaller market and a more competitive environment, fewer loans have met our hurdle rate
- And of course, we remain appropriately focused on quality and not quantity of growth, and as such loan growth is an outcome, not a target

Firm's Performance

- So to wrap up, we are very pleased with the Firm's performance this quarter, with all of our businesses showing broad strength
- We maintained or improved leadership positions and are delivering the benefits to both clients and shareholders of our operating model and our continued investments
- We remain encouraged by the growth outlook for the global economy, and expect continued solid growth here in the U.S., which positions us well going forward

QUESTION AND ANSWER SECTION

<Q - Glenn Schorr>: During the quarter, Jamie had made a comment on potential disruptions related to the unwinding of the U.S. balance sheet. And I'm just curious, it's supposed to be slow and deliberate, but I'm curious how you think that impacts liquidity, the yield curve, trading, deposit betas. And is there anything you can do to protect JPMorgan against those disruptions?

<A - Marianne Lake>: I would just stop for a second to just point out that what Jamie actually said was this is uncharted territory. It's not something that we've seen before. And so while it is the case that the Fed is communicating clearly and has every intention to make this gradual and predictable, things can change, and we should just be prepared for that. Not to say that that would have a particularly significant impact necessarily on JPMorgan, but that that would just be a downside risk, not a probability.

So on the balance sheet, it's still the case that we expect to start seeing normalization in the balance sheet in September, if not in September, by the end of this year, we're still actually calling for the next rate hike in December. The market is calling for March of next year. And as we said, the communication has been pretty consistent and pretty clear across the Fed space, which is to say that it's mostly priced into the market at this point as far as we can tell.

And so based upon what we've understood, all things equal, we would see the balance sheet shrink about $1.5 trillion over about the next four years. So that would ultimately slow growth, not stop growth. And if we saw $1.5 trillion come out of the Fed's balance sheet, empirical evidence would suggest that we don't see a dollar-for-dollar reduction in deposits. So if you just pick a point between $500B and $1 trillion of deposit outflows, at our 10% market share that would be about $75B over four years. So it would slow growth. It would not stop growth. And it is what we've been expecting and what we've been talking about now for an extended period, and gradually it's good in that sense.

In respect of which deposits we would like to see, so that's the sort of post-scenario. In terms of liquidity, again, evidence would suggest, and we've been communicating this quite clearly, that we think the preponderance of that deposit outflow would be Wholesale deposits and it would be non-operating deposits. And those are deposits we ascribe little to no liquidity value to. So assuming that we're close to right, we would see those deposits ultimately leave the system, but it wouldn't affect materially, if at all, our liquidity position.

So ultimately, the yield curve has priced, I think, all of this in. What I think the Fed's been clear about is that they expect the balance sheet, or hope the balance sheet to be in the background and to use short rates as their primary monetary policy tool. And so as a result, we would ultimately expect to see perhaps a flattening yield curve, but with the front end ultimately pulling the long end up. And you heard Chair Yellen talk about being conscious of the shape of the curve as they go about normalization. I think you may have asked about something else. Did I miss anything?

<Q - Glenn Schorr>: No, that was absolutely awesome. I do have one tiny follow-up. I always get a little more than I wanted there, thank you. The one tiny follow-up, Marianne, is I just want to make it clear the whole $4B vs. $4.5B, and you spelled out what happened in the quarter. It sounded like most of that full-year guidance happened in this second quarter, but I just want to clarify that. In terms of H2 NII, do you think it's overly different from where we were a quarter ago?

<A - Marianne Lake>: No, that's correct. If you saw that compared to $400mm expectation, we were up $150mm, so it would be fair to say that most of it was in this quarter. When we gave the last set of guidance at $4.5B, we pointed out that the 10-year was low and that that was ultimately pressuring that $4.5B. So it really isn't that significant of a change.

The only thing I would caution you to remember is that when we think about asset sensitivity and we think about market NII, which we wouldn't consider to be in the traditional sense core, can exhibit volatility geographically with NIR. If you think about a market-making business, where we can have assets that are throwing off NII, hedged by derivatives that ultimately have an offset in NIR, we actually think about that in total revenue numbers. So there could be a little noise in there, but no, I'm not expecting there to be significant changes.

But I think what this makes me realize acutely is that no good deed ever goes unpunished, and chasing our tails reforecasting the full-year NII every three quarters isn't as important – or every quarter isn't as important as keeping our eye on the long term, which is nothing has changed. We are absolutely realizing the benefits we expected in the banking book of assets and liabilities. And that means that our long-term projections will be good, and the path is a little bit less important.

<Q - Ken Usdin>: So thanks for that clarity on the trading-related NII. I wanted to follow up on the loan yield side, which not much moved. You mentioned the $75mm in Mortgage. Can you just help us walk through the loan portfolio and whether you're seeing the assets move and whether there's a lag or whether there's any spread compression underneath that?

<A - Marianne Lake>: So I understand why you're asking. If you look at the loan yields, they look relatively flat or even slightly down. If you adjust for the Mortgage, it would be flat. If you decompose them into Wholesale vs. Retail, we are absolutely seeing all of the yield improvement on the Wholesale side, about 10-ish basis points. And on the Consumer side, with respect to this quarter, there were some mix impacts in the Card business as we saw a higher level of transactors, and so a few other things. So it's not to say that the loan yields aren't moving in line with our expectations, and they are, but mix will matter for any one quarter.

<Q - Ken Usdin>: Okay. So would that naturally say that as we go forward that should – if they're moving the right way, mix adjusted, they should move the right way from here?

<A - Marianne Lake>: Yes, that's right. And if you look back last quarter, they did too.

<Q - Ken Usdin>: Yes, okay.

<A - Marianne Lake>: It's just that we had a couple of opposing things going on this quarter.

<Q - Ken Usdin>: Understood, okay. And then my second question is it was nice to see the Card revenues on the fee side and the revenue capture rate move towards the way you've been saying. It actually eclipsed the 10.5% you had said for the year already. Can you just help us understand? Have we turned the corner then on Card income and your expectations for that going forward? Thanks.

<A - Marianne Lake>: Yes. So obviously, one of the biggest drivers over the last recent while in Card revenues has been the extraordinary success we've had in capturing new Chase Sapphire Reserve accounts. And so the end of Q3, but importantly both Q4 and Q1 were extraordinary in terms of the number of accounts they acquired. And of course, we amortized or contra-revenued those expenses over one year.

So at a 10.5% revenue rate right now and with having adjusted the premium with those originations stabilizing out into Q2, we will see ultimately we'll lap that impact a year from now, and we'll see our revenue rates start improving from here towards the 11.25% that we guided to in the medium term, and we expect to get to that point, all other things equal, mid next year.

And of course, that's just one facet. We're also seeing significant momentum on the sales front, obviously, as a result of those accounts. We're growing core loans up 8%, and so we're having higher NII on those balances. So there's a lot of dry powder. We just need to get past these account acquisition costs, which we will.

<A - Marianne Lake>: And I'm also compelled to point out that these are extraordinarily good customers, their characteristics, their engagement, their spend. These are the customers that everybody wants to acquire. We now have them, and we intend to deepen relationships with them.

<Q - Betsy Graseck>: Hey, two questions, one on M&A strategy. I know there was some discussion that maybe you were interested in acquiring something. That's not really the question to comment on that specific rumor. But more in this regulatory environment and the changes that we've had already, do you feel like there's a little more flexibility for your strategic actions or outlook than maybe a year ago?

<A - Marianne Lake>: So I would characterize our strategy as unchanged. We've always been pretty consistent over an extended period that we would prioritize first and foremost strategic investments for growth in our businesses, be that organic or otherwise. And obviously, you've seen us be investing, whether it's in growing loans or introducing new products, hiring bankers, opening offices in our expansion markets and the like. But yes, it's been heavily skewed to being organic over the most recent while.

We've also been pretty clear and active, I would say in terms of partnering with, investing in, collaborating with partners that can accelerate our growth potential. So we would always be interested, whether that's FinTech or otherwise, in getting capabilities that allow us to accelerate our growth potential. We don't have big gaps, but we would always be interested in that. Having said that, I'm not going to comment on the state of the regulatory environment except to say you should expect for any of these events or transactions that we would have the appropriate regulators at the – conversation with regulators at the appropriate time.

<Q - Betsy Graseck>: Second question is on – a little bit of a ticky-tacky but on FASB. They're working on changing some of the hedge accounting rules. And I wondered how you're thinking about areas in your balance sheet you might be able to utilize that in a way that makes your business more efficient. I don't know if that's something that you're thinking about.

<A - Marianne Lake>: Yes, so obviously we are supportive of the new hedge accounting rules, and it will allow us to consider taking advantage of hedge accounting for a wider set of products than we currently do. But we actually have reasonably limited hedge ineffectiveness in our P&L right now. So from a practical perspective, it won't make a big difference to the business, but it is more flexibility in terms of the scope, and we're looking at that.

<A - Jamie Dimon>: I would just add as a policy matter, we make economic decisions, not accounting decisions. Accounting is a fiction. Marianne spoke about the credit card. You expense the acquisition costs over 12 months. The benefit comes over seven years. So we make huge investments all the time based on economics, and we'll never make a decision based upon accounting. And then we'll describe it to our shareholders. Do you understand why we're doing what we're doing?

<A - Marianne Lake>: Right.

<Q - John McDonald>: I wanted to ask about the credit cards fee. The outlook for charge-offs remains the same at about below 3% for the year, and you're about...

<A - Marianne Lake>: Yes.

<Q - John McDonald>: …3% now in H1. So maybe you're expecting a little bit of improvement in the back half of the year. Is that seasonal?

<A - Marianne Lake>: Yes, it's seasonality. So you've seen H1 at or around that guidance level. We would expect that to go down slightly due to some seasonality in H2 for a full year, a bit below 3%.

<Q - John McDonald>: And then at Investor Day, the outlook for the medium term was not much higher, 3% to 3.25%. Does that allow for the seasoning over the next year or two of all the growth that you've had and allow for some normalization too? Is that enough cushion to get all that in there?

<A - Marianne Lake>: So I would say obviously, anytime you reach an inflection point, you need to be cautious about understanding the pace of change. At least for 2018, 3% to 3.25% feels right. I think when you get beyond that, we'll be updating you with our views as we experience a bit more in reality. It doesn't feel significantly different from that, but I think 2018 is a good number, and 2019 we'll update you.

<Q - Erika Najarian>: I just wanted to follow up to the questions that Glenn and Ken had on margin. Marianne, could you give us a little bit of insight on how deposit betas trended Wholesale vs. Retail during the quarter? And also just going back to your comments, if the Fed balance sheet reduction drives Wholesale deposits out of the system, can we assume that that should not affect deposit betas negatively for JPMorgan?

<A - Marianne Lake>: Yes, okay. So to just talk about what we've seen so far, I think the industry has been really quite disciplined, which is what we would have expected at this early stage of a normalization, in terms of the rate cycle, it is a tale of two cities. We said that this quarter the Wholesale space necessarily experiences higher reprice more quickly, and we are seeing that pretty much in line with our expectations. It matters. You need to get granular.

The type of deposit, the client segmentation, it matters. So in the Wholesale space, we're seeing it. We're on that journey. In the Retail space, we haven't seen that yet. So while there have been small changes in the industry in CDs, there's been nothing in checking or savings. But again, I'd just point out to you that we wouldn't have expected there to be at this point yet in the cycle.

And I would say with respect to deposit betas and the Fed's balance sheet, if we are right and we believe we'll be close to right and that we see the wholesale non-operating deposits flowing out of the system assuming everybody else has reached that same conclusion, then it shouldn't really materially impact the liquidity position of Financial Institutions. And if you couple that with the expectation of a very gradual and measured pace, which gives people a lot of time and opportunity to plan accordingly, we wouldn't expect there to be a significant impact on beta, if any.

<Q - Erika Najarian>: Thank you. And my second question, you mentioned at the beginning of the call that Standardized will ultimately be your CET1 binding constraint, and I'm wondering, if you were allowed to float off your current op risk floor, and I think it's still $400B, does that mean if Standardized is your constraint that being able to float off the floor and model out your op risk may not be an incremental source of capital because Standardized is binding?

<A - Marianne Lake>: First of all, I would say focusing on any one – so we would be very supportive of changes to how operational risk capital is treated under reg capital rules. But I think focusing on one facet and not the whole thing, it's unlikely to be that only one thing changes. So we'd like to see changes made over time. But for the foreseeable future, as we are growing our loans quite strongly and these are extraordinarily high-quality loans where the differential between Advanced and Standardized is quite big, we still expect Standardized to bind us.

<A - Jamie Dimon>: And as you point out, at Standardized we're at 100% in the United States. In Europe, they're talking about 75%, so there will be some changes over time in how all these capital ratios get calculated for international competitiveness reasons.

<A - Marianne Lake>: Yes. So whether it's because the operational risk rules change or whether it's because the Standardized rules become at least somewhat more risk-sensitive, there should be changes over time. But I think for the foreseeable future, this is what we expect.

<Q - Saul Martinez>: First question is on Commercial Banking. Can you just comment a bit on the sustainability of the growth in profitability you've had there? Your earnings are up 30% year on year, loan growth C&I 9%, CRE up 15%. And we're not talking about small numbers anymore. I think your loan book now is about $200B in Commercial Banking. Can you maybe just talk about some of the initiatives that you've discussed of the Middle Market, the IB, and how sustainable that is, and whether you're comfortable with the risk profile of the book you have there? Because you are growing quickly, it is a big book now, and you're certainly growing faster than the industry.

<A - Marianne Lake>: So I would start with if you go back a couple of years ago, 2013, 2014, 2015, when we were doing our business simplification agenda and de-risking and uplifting the controlled environment, the Commercial Bank was blocking and tackling and doing a lot of inwardly focused work. And we talked I think all the way back in 2016, that the outbound calls, opening offices, hiring bankers, and that if you waited a minute you'd see that come to our results, and this is the fruits of that labor. So I do think it is sustainable. There's nothing in these results that is particularly noisy outside of reserve releases, which I'll come back to.

I would also say the partnership between the Commercial Bank and the IB in terms of covering our clients, the introduction of 16 specialized industries, which is an advantage we can bring to our clients nationally and in fact globally that other competitors can't bring, all of those things set us up for continued solid growth.

With respect to loan growth, I would say if you look at our C&I loans, this quarter as an example was pretty broad-based. There wasn't a specific – in the Middle Market, there wasn't a specific industry or market segment that was strong, but over the last – stronger, I should say. But over the last few years, a lot of our growth has been driven by the investments we've been making in the expansion markets. So we got into some new markets with the WaMu acquisition. We continue to build out those markets, add bankers, open offices, and that has been a sort of growth for us that perhaps others haven't been able to enjoy, and also, as I said, specialized industries. And then...

<A - Jamie Dimon>: I would just add; I think we're in all major 50 markets now.

<A - Marianne Lake>: Yes.

<A - Jamie Dimon>: Unlike Retail, where one day we'll embark on expansion in cities we're not in. And the product set is just fabulous. We're adding more and more online things. We're adding simpler and faster credit approvals. We're making it easy to do merchant processing when you sign up for Middle-Market loans. The online systems are great. So all that stuff, I think this is going to grow for a long period of time, and thanks for pointing out how well it did. And, Doug Petno, if you're listening, congratulations.

<Q - Saul Martinez>: Yes, no problem.

<A - Marianne Lake>: The only thing I would say on Commercial Real Estate, just because I think it's really important, is Commercial Real Estate, it depends what you do. And more than half of our Commercial Real Estate exposure is commercial term lending. It's a very specific strategy. We don't deviate from that strategy. And I would just point to you because it was interesting to me. If you look at the Fed's CCAR stress results, the Commercial Real Estate across the industry, and look at how our results compared to others, I think you can hopefully get somewhat more comfortable, and we are very comfortable with what we have right now.

Now that said, the performance of course did benefit from reserve releases and benign credit, and at some point there will be a cycle. But the risk appetite we have and the way we have managed risk discipline, we're very happy with that.

<A - Jamie Dimon>: And the IB, bringing JPMorgan Investment Banking to Chase corporate clients we still think it has a long way to go.

<Q - Saul Martinez>: That's great, thank you. If I can follow up with a bigger picture question and, Jamie, you've been, and correct me if I'm wrong, you've been pretty vocal about believing that the underpinnings of our economy are healthy and strong and not buying into the whole secular stagnation argument. But at what point does political dysfunction and political paralysis really start to dent that confidence? Because you've also indicated that we do need structural reform to lift trend growth, whether it's infrastructure, tax reform, whatever it is. And can you just comment on that?

And I guess as an adjunct to that, what are your conversations with clients like? Is there a risk that is materializing that clients are also starting to become more frustrated with the lack of progress politically?

<A - Jamie Dimon>: I would look at it the other way around. So since the Great Recession, which is now eight years old, we've been growing at 1.5% to 2% in spite of stupidity and political gridlock because the American business sector is powerful and strong and is going to grow regardless. When people wake up in the morning, they went to feed their kids. They want to buy a home. They want to do things the same as American businesses. What I'm saying is that it would be much stronger growth had we made intelligent decisions and were there not gridlock. And thank you for pointing it out because I'm going to be a broken record until this gets done. We are unable to build bridges. We're unable to build airports our inner city school kids are not graduating.

I was just in France. I was recently in Argentina. I was in Israel. I was in Ireland. We met with the Prime Minister of India and China. It's amazing to me that every single one of those countries understands that practical policies that promote business and growth is good for the average citizens of those countries for jobs and wages, and that somehow this great American free enterprise system, we no longer get it. And so my view is that corporate taxation is critical to that, by the way. We've been driving capital and bringing it overseas, which is why there's $2 trillion sitting overseas, benefiting all these other countries and stuff like that. So if we don't get our act together, we can still grow. It's unfortunate, but it's hurting us. It's hurting the body politic. It's hurting the average American that we don't have these right policies. And so no, in spite of gridlock, we'll grow at maybe 1.5% or 2%.

I don't buy the argument that we'll relegated to this forever. We're not, if this administration can make breakthroughs in taxes and infrastructure, regulatory reform, we have become one of the most bureaucratic, confusing, litigious societies on the planet. It's almost an embarrassment being an American citizen traveling around the world and listening to the stupid (expletive) we have to deal with in this country. And at one point, we all have to get our act together or we won't do what we're supposed to do for the average Americans. And unfortunately, people write about this thing like it's for corporations. It's not for corporations. Competitive taxes are important for business and business growth, which is important for jobs and wage growth. And honestly, we should be ringing that alarm bell, every single one of you every time you talk to a client.

<A - Marianne Lake>: And then I would just say that in terms of how our clients are behaving and how the dialogue is going, whether you look at Middle Market, Corporate Client Banking, M&A, it's not to say that the possibilities of performing and the impacts that could have isn't a part of the dialogue, but they're fundamentally really just getting on with things. And so if there's a client that has a compelling strategic deal to be done or some spending or hiring or growth, then they're pretty much getting on with it, which is why we are seeing solid growth.

<Q - Matthew O'Connor>: You guys obviously had a very big approval for a share buyback from the latest CCAR here. And I just wanted your thoughts on terms of using it all, given where your stock price is, given loan growth has slowed a tad, and given the flatter yield curve makes buying securities a little less interesting. How do you put that all together?

<A - Marianne Lake>: Yes, so look. Obviously, you know the deal with CCAR approvals, which is it is capacity, it's not necessarily a commitment to utilize it. Although we are, as we fairly clearly articulated at Investor Day and as you see in the numbers here, we are at 12.5% in terms of our CET1. And we believe we ought to be able to over time operate the company lower than that, within the range of 11% to 12.5%, albeit that we would take time to do that.

So we're in the market buying our stock every day. We're at 1.8x tangible book value. You saw it in Jamie's shareholder letter. We still think that there's significant value in the stock, we believe in the earnings power and the franchise that we have here. And so not to say that we'll utilize all the capacity because other things can come up, but we put in the request based upon our desire to want to ultimately move lower.

<A - Jamie Dimon>: Yes and there's a very important policy issue here too. So our preference is always to build organically, to not buy back stock, but to build branches and grow and lend more. But there's an argument that people are making that banks can't lend it, and even if there's excess lending capability they wouldn't have done it, and that is not true.

The counter-factual would have been had banks been free to use their capital and their liquidity five years ago, there would have been a lot more lending in the system. We pointed out two areas where it would have taken place. One is mortgages, where regulations have held back lending to first-time buyers, immigrants, self-employed, prior defaults, et cetera. And the second is small business, where it's not existing small businesses. Think of it as startup small businesses. And they are having a hard time getting capital, maybe at the community bank level et cetera. The counter-factual would have been that $1 trillion or $2 trillion would have been lent out had these rules have been changed five years ago. That's the counter-factual. It's not that, well, the banks wouldn't have lent the money and so again, there's a false notion that all this stuff didn't hold back the economy. Yes, it did.

<Q - Gerard Cassidy>: Can you give us some color? Federal Reserve Chairwoman Yellen indicated that she sees that there could be some relief on the horizon for the banks. And one of the areas that's been talked about is changing the calculation of the SLR. Have you guys modeled out what that could do to your SLR and then how that may change your view on capital going forward, if there are changes where, for example, they take the cash that's sitting at the central banks out of the equation?

<A - Marianne Lake>: Yes, so obviously, they haven't been specific. Although the Treasury report had some ideas, they haven't been specific about what the calibration would look like and whether there would be recalibration to the numerator and the denominator or one or the other. Clearly, we've been pretty clear that we think cash at central banks shouldn't necessarily be included, and there are other things, different people have different opinions.

So we've done the calculations. I would just point you back to the fact that we have some 20 potentially binding constraints right now, of which leverage in a variety of forms is part of that. So to the degree that we get the opportunity to recalibrate that, it could have impact at the margin, but we take all of those things into consideration when we think about the direction of travel of the company.

So we're being as thoughtful as we can. We're not specifically leverage constrained right now. That doesn't mean we're not supportive of making those changes. And we will obviously model it out. But we take the potential for those changes into consideration when we think about the direction we grow our businesses.

<Q - Gerard Cassidy>: Very good. And then as a follow-up, coming back to credit cards, obviously Sapphire has been a huge success in growing your business there. Are the acquisition costs higher today than when you compare them to maybe two or three years ago? And in that vein, when you guys look at the economics of putting on new cards, is the net present value or whatever measure you use to determine the economics, has that improved, stayed the same, or weakened from maybe a year or two ago?

<A - Marianne Lake>: So I think I want to point out something because I know that Sapphire Reserve gets a significant amount of attention for obvious and good reasons, but it is only one product in a platform of successful products, both proprietary and co-brand. And so in reality, while we obviously do all the modeling and the math, it's not about what the cost of any one individual card acquired is or the NPV of that is, how the portfolios ultimately together perform over time, and it's still very early on Sapphire Reserve. It's not even a year old yet, and these are portfolios and products that develop and season over time. And as I said, these are extraordinarily good customer relationships.

So you know we've done a bunch of things in the Card business over the last few years. We've renegotiated our co-brands. That was ultimately with lower economics but still very good economics. We've been out on the front foot issuing new products, not just Sapphire Reserve, but Freedom Unlimited, the Amazon Prime card, Ink. And so we think about everything in the total portfolio and its collective performance over time, and it's still generating very good returns.

<A - Jamie Dimon>: If I could just mention about the regulatory SLR, so look at it very broadly. If you look at – it's not just capital liquidity, but mortgage rules, requirements, capital liquidity, collateral rules, what collateral can be used and not used. If these things were just calibrated differently, the cost of credit would go down, swap spreads would go down, mortgage would become more available, the cost of mortgages would come down, and those are kind of important in total if they're done right, without changing at all the risk to the system. In fact, the system is healthier if the economy is healthier.

<Q - Steven Chubak>: So, Marianne, I wanted to start off with a question on liquidity. You spoke of how the Fed balance sheet unwind should have little impact on your LCR. But just given the strength of your liquidity position and the significant excess reserves that you have at the Fed, how should we be thinking about the current capacity to deploy some of that excess into higher-yielding MBS? And maybe what's your appetite to redeploy, just given some of the tougher liquidity treatment for agency MBS, in particular?

<A - Marianne Lake>: So when we think about the liquidity position of this company, we're obviously managing not just to regulatory requirements but also to what we want the ultimate duration of equity and position of our balance sheet to be through the cycle. So we take into consideration not just the amount of liquidity we have and how that could be utilized, but also the mortgage portfolio we have, agency MBS. So all of that goes into our determinations, and we will continue to add to duration opportunistically when it makes sense to do it and manage our balance sheet with discipline.

<Q - Steven Chubak>: Okay, understood, and then just one more question for me just on capital targets. I appreciate all the detail, Marianne, you provided indicating that over time there could be a path or trajectory towards getting to the lower end of that 11% to 12.5% range. I'm just wondering. Given the very favorable CCAR results we saw this year coupled with some of the Treasury reforms that have been outlined, is there the potential for you to actually manage to a target even below that 11%, especially if gold-plating of GSIB surcharges in fact goes away?

<A - Marianne Lake>: So I would start by saying that a lot can change between now and the next cycle of CCAR or the next two cycles of CCAR. And so we never did actually say that we necessarily wanted to the low the end of the range, but just operate for the short to medium term within the range while we let all of the potential changes to the regulatory environment at large play out.

And so as to whether or not over time there's a sort of recalibration of whether 11% is our minimum, that will play out over time. So for the next one or two cycles of CCAR, this cycle and the next one, I would just expect that we want to be on a measured pace to be within the range to allow us to better understand all of the changes that will take place over time and make appropriate decisions. I wouldn't start imagining necessarily how low that goes. I think we would want to operate with a sufficiency of capital and liquidity.

<**Q - Andrew Lim**>: Coming back to the Treasury's proposals for the new calculation of the SLR, can you give any color as to whether that's actually even possible within the global context as to how the Basel Committee wouldn't want harmonization across the whole world? Of course, if it did happen, then you would have a massive advantage along with other U.S. banks vs. other European investment banks.

<**A - Marianne Lake**>: So I would say, of course, it's possible. We've seen a number of situations where implementing global standards in the U.S. have differed in meaningful ways from how they've been implemented elsewhere. You have rarely seen that be to the advantage of the U.S., and the SLR is no exception. So while there may be recalibrations of either the numerator or the denominator, know that to the European 3% standard, our current depository institutions are held to a 6% standard. So there's plenty of room for there to be adjustments before it would create an unlevel playing field. And my suspicion is there will also be adjustments elsewhere. And it's supposed to be as I think Chairwoman Yellen said, a backstop not binding in the way that perhaps it has become. So I think the answer is yes, but we'll see.

<**A - Jamie Dimon**>: The key point Marianne said is almost every single thing that's been done in America added to Basel requirements, the gold-plating in SLR, calculation of LCR, calculation of stress, GSIB, almost every single thing. And remember, America doesn't have to listen to Basel either. And you may have noticed that basically France, Germany, India, China are [inaudible] Basel. They better take a deep breath and stop doing more of what they're doing.

<**Q - Andrew Lim**>: Great, thanks. And just a follow-up question, also on the reduction in the op risk, you talked about advances at standardized. Looking at the CCAR, your SLR as a binding constraint there, so isn't it really a moot argument, a non-argument really as to whether that happens or not; i.e., if you reduce your op risk, it doesn't really change your excess capital?

<**A - Marianne Lake**>: Sorry, go ahead.

<**A - Jamie Dimon**>: Go ahead.

<**A - Marianne Lake**>: So look, there are a number of different people talking about forward-looking standards for operational risk under Basel 3.5 or Basel IV or whatever, is talking about it. There were some proposals in the CHOICE Act. So there's no question that there should be a revisitation of the mechanisms to calculate operational risk.

And then you're right, the way that all of these rules ultimately interplay with each other matters. And so from a pure stress test perspective, at the margin we had a little bit more binding constraint on leverage than CET1. But if you look at just what we could run the company at if CCAR was our only constraint, it would be lower than where we are. So it's a complicated dynamic of trying to make sure that we are maximizing against all of these constraints, and not just the mathematical ones, but also the operational and practical ones. So it's necessary to go back and rethink the calculation of operational risk just because it's the right thing to do. Ultimately, how that plays out into how we optimize against our constraints is less of what we're focused on.

<**Q - Betsy Graseck**>: Hey, just two other quick things. One, on the accounting with hedges, just to get back on it, the effect, a little bit, the question also was, was there any opportunity for your clients too? Because if there is an opportunity for, say, institutions to hedge their books of business more, that could feed into your revenues?

<**A - Marianne Lake**>: I wouldn't imagine it. It's not going to change our risk management strategy in a meaningful way, so I wouldn't imagine it would be.

<A - Jamie Dimon>: This affects corporations only? Does the new hedging rules affect other corporations or non-banks?

<Q - Betsy Graseck>: Yes, in the sense that you can potentially hedge your commodity risks, so would that be something?

<A - Jamie Dimon>: We haven't looked at whether it creates more demand from the corporate side, so we'll look at that and see.

<Q - Betsy Graseck>: Yes, okay. And then is there a timeframe here where you have to start telling us what your LCR is? I wasn't sure if that was coming up soon. Was that this quarter or next quarter? Has that just been put on hold?

<A - Marianne Lake>: No, it is still this quarter. There are requirements to make public disclosures in August. So depending on whether you make them in your 10-Q, in your Pillar 3 or not will determine whether it's the beginning or middle or end of August. We, as you know, as an industry are being quite public about the fact that we think – by the way, we provide an extraordinary amount of real-time same-day granular information on liquidity to our regulators in order for them to be able to properly supervise not just us, but the system.

And so really, we believe the regulators do have and can have anything they need when they need it. It's just a question about whether there is any added benefit of those information being made public near real-time. While it wouldn't matter today when everyone is running very significant liquidity surpluses, it could have unintended consequences if we were in an environment that was more stressful than we are today. So right now, the requirement is that we have to disclose. I suspect although we've asked for a delay as an industry that we might have to disclose, we will continue to debate I think with regulators, the merits of those public disclosures over time.

<Q - Betsy Graseck>: I get that. I was just thinking that there's the opportunity to show us the non-operating deposits going away, which would help people understand the strength of the deposit franchise.

<A - Marianne Lake>: Yes, I would suggest, although it's not something we show you every quarter, that we've been pretty forthcoming about showing you the level of our deposits and the split at least in Investor Day now and then between operating and non-operating deposits. And as we start to see the impact of the Fed balance sheet unwind and the like, we will be very forthcoming. We try to be incredibly transparent, and we'll take that under advisement regardless of what the regulatory disclosures are about the quality of our deposit franchise. But we have I think periodically been more disclosive than most in terms of the quality of our deposits.

<A - Jamie Dimon>: Not only that, you could see that we have $500B of cash, $300B of securities, $300B of repo. It's a pretty liquid company, as liquid as any bank I've ever seen on this planet.

<A - Marianne Lake>: And we removed $200B of non-operating deposits proactively, so we manage it very carefully.

<A - Jamie Dimon>: There's nothing that would happen because of all this that would affect JPMorgan that much. And very important to LCR, it doesn't affect us. We're fine disclosing however they want us to disclose. It's an issue of whether it is good for monetary policy and will it cause a problem, not for us, but the system when there's a crisis. Do they want banks to use their liquidity or not? It's very simple. Because if the answer is you've got to maintain over 100%, then you can't use your liquidity. That's what it means.

And they've said publicly, someone said probably if there's a crisis, why don't you go below 100%? And we're saying what bank is going to be the first to go below 100%? So it's a policy issue. Whatever happens, we're completely fine at JPMorgan. If I was the regulators, I wouldn't want to put myself in that kind of position.