

## Equity Research

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Earnings Revised — October 13, 2021

## Large-Cap Banks

## J.P. Morgan Chase &amp; Co. (JPM)

## JPM: Spending More Money with No Apologies

## Our Call

The main news from the 3Q21 earnings call is that JPM intends to continue its elevated pace of investment spend, meaning expense growth of est. 7% in 2021 and another 4% in 2022 (vs. only 2-3% in 2019-2020). Conceptually, JPM is using the windfall from record credit quality to fund investments in tech and other areas (branches, advisors, marketing). JPM has the obligation to better spell out how these investments will achieve the desired "digital dividend", esp. when the CEO says JPM will spend "whatever it takes to compete" and when spending is certain and payoffs uncertain. Nonetheless, even while absorbing the extra spend, JPM still has est. core operating leverage that was flat in 3Q21 YoY and will turn positive in 2022. Indeed, after its last "reset year" in 2013, JPM showed favorable operating leverage for the subsequent few years. Most importantly, efforts in aggregate are working based on share gains in most areas, though we'd like more detail.

**We divide the bank story for JPM and the industry in 3 acts.** The continuation of "Act 1" (credit, capital markets) is going stronger for longer. In 3Q21, credit losses were the lowest in its modern history (21bp, down 10bp QoQ); NPAs declined 9% QoQ. JPM improved guidance for card losses (from <2.5% to about 2%). Capital markets are aided by still strong mergers and equities and remain well above the perceived normalized 2019 levels.

**The start of "Act 2" – better NII growth.** Net interest income growth has come in small strides given slight QoQ improvement and the absence of any change in guidance. Yet, there are signs of progress. First, JPM intends to deploy more idle cash (est. \$200bn-plus) if and as rates stay higher. Second, loan growth seems around the corner given more utilization on middle-market lending, stabilization on corporate lending, and declining PPP run-off. Third, CRE growth should improve as JPM shows less restraint post-pandemic. Fourth, there's slight card growth (less paydowns) and higher spend volume should translate to higher loan balances, which matters the most to NII.

**The handling of "Act 3" – the tech revolution.** JPM's overall expense level has gotten investor attention given the pace of JPM's tech investments has accelerated this year. In particular, expense growth in 2021 will increase est. 7% vs. 2-3% in 2019-2020 and with another est. 4% increase in 2022. On the one hand, this should not be an issue since JPM made it very clear in Jan. 2021 that its investments were increasing from \$10bn to \$12.5bn as it invests more in areas where it is seeing progress, such as branches (deposits up big), digital (9% YoY growth), wealth advisors (strong growth), and marketing (cards seem poised). On the other hand, JPM can do a better job at providing more transparency around the return from these investments since, to those on the outside, the results get lost in the soup, albeit a tasty one currently.

**Raising 4Q21 Est.** We increase our est. 4Q21 EPS from \$2.89 to \$3.08, reflecting much better than expected credit quality going into 4Q as we now project firmwide NCOs to be 29bps (vs. 20bps in 2Q21 and 29bps in 1Q21; previously modeled 49bps), partially offset by higher expenses (no change in full-year guidance and lower than projected 3Q21 expenses implies higher 4Q21 costs all else equal). Reflecting 3Q21 results and our new 4Q21 EPS, we increase FY 2021 est. EPS from \$14.20 to \$15.12. Our 2022, 2023, 2024, and 2025 estimates are unchanged (\$12.60, \$14.30, \$16.10, and \$17.90, respectively).

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Rating	Overweight
Ticker	JPM
Price Target/Prior:	\$200.00/NC
Upside/(Downside) to Target	20.9%
Price (10/12/2021)	\$165.36
52 Week Range	\$95.24 - 171.51
Shares Outstanding	2,988,155,355
Market Cap (MM)	\$494,121
Enterprise Value (MM)	\$773,548
Average Daily Volume	12,533,260
Average Daily Value (MM)	\$2,072
Dividend (NTM)	\$3.80
Dividend Yield	2.3%
Net Debt (MM) - last reported	\$279,427
ROIC - Current year est.	18%
3 Yr EPS CAGR from current year (unless otherwise noted)	17%

\$	2020A	2021E	2021E	2022E	2022E
EPS		Curr.	Prior	Curr.	Prior
Q1 (Mar)	0.78 A	4.50 A	NC	3.28 E	3.17 E
Q2 (Jun)	1.38 A	3.78 A	NC	3.12 E	3.05 E
Q3 (Sep)	2.92 A	3.74 A	2.99 E	3.07 E	3.15 E
Q4 (Dec)	3.79 A	3.08 E	2.89 E	3.13 E	3.23 E
FY	8.88 A	15.12 E	14.20 E	12.60 E	NC
P/E	18.6x	10.9x		13.1x	

Source: Company Data, Wells Fargo Securities estimates, and Refinitiv.  
NA = Not Available, Volatility = Historical trading volatility

## 3Q21 Summary

**3Q21 Above.** JPM reported 3Q21 EPS of \$3.74 and adjusted EPS of \$3.03 after excluding (a) firmwide net credit reserve releases (52c) and (b) tax benefits (19c). We estimate run-rate core EPS of \$3.22 (comparable to consensus of \$3.00) after adjusting for (c) securities losses (est. 9c), (d) MSR hedge loss (est. 4c), (e) legal expense (2c), and (f) est. reserve release already in consensus (est. 7c).

**Flattish core operating leverage.** Core revenue and expenses were up 4% YoY, and down 3% each QoQ. Fees led the way YoY given good growth in IB and asset management. Specifically, total trading was down 5% YoY, which was better than Sept guidance (down 10%), led by strong results in equities (up 30% YoY; good share gains in prime), offset by weaker fixed income (down 20%; lower spreads from a strong 3Q20). IB was up up about 1/2 YoY, led by M&A, but ECM and DCM were up YoY as well. Also, asset & wealth mgmt. grew well (+5% QoQ; +20% YoY). NII increased slightly QoQ (\$13.1bn vs. \$12.9bn), which to us sets a bottom with a degree of inflection point that can get debated. Credit quality remains strong with record-low charge-offs (21bp, down 10bp QoQ) and NPAs (down 9% QoQ).

### Guidance:

- **NII:** ~\$52.5bn (unchanged) - implies 4Q21 managed NII of ~\$13.5bn (given 3Q21 YTD managed NII of \$39bn) or up about 3% QoQ and 1% YoY
- **Expenses:** ~\$71bn (unchanged) - implies 4Q21 adjusted expenses of ~\$17.8bn (given 3Q21 YTD adj. expenses of \$53.2bn; excl. \$0.3bn of YTD legal expense) or up about 4% QoQ and 10% YoY
- **Card NCO:** 2.0% (down from 2.5%) - implies 4Q21 NCO of 1.5% (given 2.2% 3Q21 YTD card NCO) or up from 1.4% during 3Q21 and down from 2.2% during 4Q20

## Financials

### Exhibit 1 - JPMorgan Chase Summary Income Statement and Key Operating Metrics

Per share information (\$)	2020A	2021E	2022E	2023E	2024E	2025E	'20-'25 CAGR
EPS	8.88	15.12	12.60	14.30	16.10	17.90	15.1
Dividend per share	3.60	3.80	4.20	4.44	4.54	4.66	5.3
Book value	81.75	87.58	92.62	99.42	107.73	117.54	7.5
Tangible book value	66.11	70.90	75.11	81.12	88.61	97.52	8.1
Avg diluted shares O/S (MM)	3,087.4	3,024.1	2,884.1	2,756.1	2,640.2	2,526.2	(3.9)
EOP common shares O/S (MM)	3,049.4	2,920.6	2,782.6	2,661.7	2,546.9	2,433.8	(4.4)
Key operating metrics (%)	2020A	2021E	2022E	2023E	2024E	2025E	
Revenue growth	3.6	2.5	2.8	5.1	4.7	4.5	
Expense growth	1.8	6.7	2.9	1.8	2.3	3.0	
Core revenue growth	3.1	3.5	2.4	5.1	4.7	4.5	
Core expense growth	1.8	5.9	3.7	1.8	2.3	3.0	
Reported efficiency ratio	56.1	57.8	57.9	56.1	54.7	54.0	
Core efficiency ratio	54.6	55.8	56.5	54.7	53.5	52.8	
Net interest margin	1.98	1.64	1.74	1.85	1.93	1.96	
Net charge-off ratio	0.53	0.30	0.45	0.55	0.57	0.58	
Tier 1 common	13.1	12.9	12.4	12.3	12.3	12.3	
ROTCE	14.4	22.5	17.4	18.5	19.2	19.5	
ROA	0.91	1.28	1.00	1.06	1.11	1.15	
Income statement (US\$MM)	2020A	2021E	2022E	2023E	2024E	2025E	'20-'25 CAGR
Net interest income (FTE)	54,981	52,573	57,332	60,765	64,339	67,712	4.3
Fee revenues	67,153	73,821	72,090	75,233	77,985	80,964	3.8
Non-core revenues (incl. sec gains)	795	(371)	118	137	242	367	NM
Total revenues	122,929	126,022	129,540	136,135	142,567	149,043	3.9
Operating expenses	(66,656)	(71,109)	(73,138)	(74,436)	(76,120)	(78,440)	3.3
Non-core expenses	-	-	-	-	-	-	NM
Total expenses	(66,656)	(71,109)	(73,138)	(74,436)	(76,120)	(78,440)	3.3
Pre-provision net revenues	56,273	54,913	56,402	61,700	66,447	70,603	4.6
Net charge-offs	(5,324)	(3,139)	(4,872)	(6,289)	(6,806)	(7,133)	6.0
Reserve releases & other	(12,156)	10,515	(585)	(500)	(600)	(840)	NM
Net provisions	(17,480)	7,376	(5,457)	(6,789)	(7,406)	(7,973)	(14.5)
Pretax net income	38,793	62,288	50,945	54,911	59,041	62,630	10.1
Taxes	(9,662)	(14,749)	(12,783)	(13,684)	(14,706)	(15,591)	10.0
Minority interest	-	-	-	-	-	-	NM
Net income	29,131	47,539	38,162	41,227	44,335	47,039	10.1
Preferred dividends & other	(1,721)	(1,811)	(1,820)	(1,820)	(1,820)	(1,820)	1.1
Net income available for common	27,410	45,728	36,342	39,407	42,515	45,219	10.5

Source: Company reports, Wells Fargo Securities LLC estimates

## Price Target Basis and Risk

### Price Target for JPM: \$200.00 from NC

We arrive at a price target of \$200, which implies 15.9x our 2022E EPS, based on the simple average of six valuation techniques (PE, price-to-book, discount dividend model, PEG ratio analysis and sum of the parts for both PE and PB).

### Risk for JPM

Macro downside risk factors include a slowdown in global economic activity, greater-than-expected increases in unemployment and bankruptcies (in the US and abroad), and adverse changes in US and foreign laws and regulations. Company-specific downside risks include higher-than-projected credit losses (especially in credit cards and home equity but also other consumer areas and commercial lending), market and interest-rate risks (which can affect JPMorgan's businesses and portfolios in a variety of ways, especially MSRs and investment securities), and operational risks (primarily associated with regulatory compliance across the firm's domestic consumer and global wholesale businesses).

## Investment Thesis

### JPM

JPMorgan Chase (rated Overweight) has excelled at both offense and defense over the past decade in which it has been gaining market share in all major business lines while optimizing its businesses, showing consistent earnings relative to other global banks and creating a fortress balance sheet (as defined by its CEO). During this period of COVID, playing defense has carried more importance, but greater offense is expected to play a role as JPM continues to invest long-term. We expect JPMorgan's ROTCE to trend higher from a low of 14% in 2020 to est. 19% in 2023.

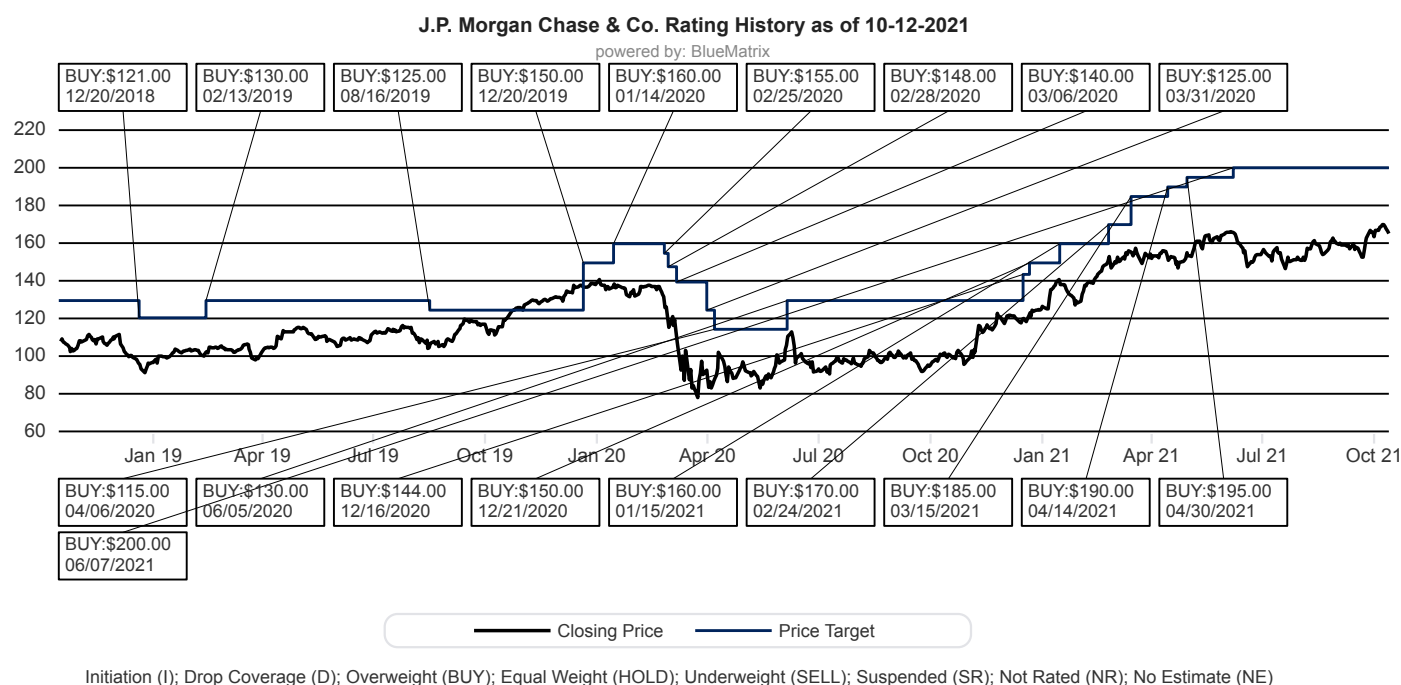
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