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PALOS

Weekly Commentary

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By Charles Marleau CIM® and William Mitchell CIM®

The U.S. Big Four Report: Crisis? What Crisis?

By Charles Marleau CIM® and William Mitchell CIM®, Palos Management Inc.

The U.S. "Big Four" banks began reporting their quarterly earnings on April 14. The slew of earnings has been much anticipated given the recent turmoil surrounding the failures of Silicon Valley Bank (SVB), Signature Bank and Credit Suisse. Observers were hoping to see signs that the crisis, which resulted from a "perfect storm" of poor risk management, fear, and social media inspired panic, was an isolated event. Investors were looking for validation that this was not a repeat of the widespread systemic failures of prior financial crises. They were not disappointed.

JP Morgan (JPM:NYSE) reported before the markets opened on April 14. Results came in significantly above analysts' expectations with a Q1/2023 net income of $12.6 billion and earnings per share (EPS) of $4.10. This compared favorably with analyst expectations of $10.2 billion and $3.41 per share. Record revenues of $38.3 billion (versus $36.2 billion expected) showed a year-over-year increase of 25%. The solid beat was mostly attributable to a 49% increase in net interest income. Higher interest rates widen the "spread" which in plain English is the difference between the rate that banks lend at and the cost of borrowing.

Markets reacted positively with JPM shares jumping by 9% on the day and by last Friday, JPM shares were up by 10.5% over six trading days and are higher by 4.8% in 2023. Chairman and CEO Jamie Dimon has described JPM as a "pillar of strength" while the smaller banks that were most impacted by the recent crisis navigate the turmoil. Nervous depositors, who have taken flight from the "regionals," have provided a tailwind for the bigger banks. JPM confirmed that "significant" new account opening activity and "meaningful" inflows had occurred. Despite falling deposits prior to the "crisis", it was confirmed that retained deposits were up by approximately $50 billion (2%) by the end of the first quarter. Other segments like consumer debit and credit card spending, banking, and wealth management remained resilient, while revenues from financial markets (-4%) and investment banking (-24%) fell.

Citigroup (C:NYSE) also reported results before markets opened on April 14. Following encouraging news, Citi shares jumped 4.8% on the day and as of Friday's close, were up 8.4% year-to-date. The company reported a net income of $4.6 billion and an EPS of $2.19, well ahead of estimates. On the earnings call CEO Jane Fraser remarked that Citi "benefits from a diversified earnings base, a resilient business model, robust balance sheet management, liquidity and risk management." In our view, this is precisely what differentiates the big banks from the regionals: diversification, prudent risk oversight and a global client base.

By Charles Marleau CIM® and William Mitchell CIM®

Wells Fargo & Company (WFC:NYSE) rounded out the day's big bank trifecta with another beat. Net income of $5 billion and EPS of $1.23. Share buybacks resumed after a three-month pause with $4 billion in shares being purchased on the open market. Like its peers, WFC benefited from a diversified depositor base and a bump in deposit inflows. As mentioned in the earnings call, and in keeping with what we have heard from the other big banks, consumer loan delinquencies, commercial real estate weakness (mostly office), declining deposits, and narrowing interest margins are becoming more apparent as the economy slows. Action to tighten credit is common across the board.

The last to report was **Bank of America (BAC:NYSE)** with numbers released on April 18. For Q1/2023, BAC reported a net income of $8.2 billion and EPS of $0.94. This was one of BAC's highest core earnings results ever with EPS up 18% compared with Q1/2022 and 13% y-o-y revenue growth. Debit and credit card spending grew at about 6% and the consumer remains healthy despite a softening economy. The balance sheet is in great shape with regulatory capital at its highest nominal level ever ($184 billion). The bank has access to over $900 billion in liquidity. Of note, the bank sees a soft landing for the economy by sometime in Q3.

The first quarter's performance of the big four was consistent with a broad consensus that the big banks have capitalized on massive depositor inflows, clearly related to the well-documented liquidity stresses facing their smaller, regionally based brethren. This should come as no surprise. The panic-fueled depositor exodus from the smaller banks to the larger "too big to fail" banks is simply a rational decision. Protection of capital rules.

Canada's "big five" are set to report in late May. We believe that the robust performance of the big banks from south of the border may prove to be a harbinger of things to come for Canadian banks. Most observers would agree that our banks are amongst the safest and most conservative. We will be following the Canadian earnings season closely and will report back in early June. In the meantime, this week will see "peak earnings" with one-third of S&P500 companies and a half of the Dow Industrials reporting. The roster includes the likes of mega-cap companies like Alphabet (Google) and Microsoft on April 25, Meta (Facebook) on April 26 and Amazon on April 27. We'll follow up with our thoughts in next week's edition.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$8.63	7.09%
Palos Equity Income Fund - RRSP	PAL101	$6.87	5.96%
Palos WP Growth Fund - RRSP	PAL213	$12.87	3.23%
Palos-Mitchell Alpha Fund [3]	PAL300	$9.33	17.42%
S&P TSX Composite (Total Return with dividends reinvested)			7.77%
S&P 500 (Total Return with dividends reinvested)			8.20%
S&P TSX Venture (Total Return with dividends reinvested)			7.76%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			3.57%
Canadian Government 10-Year			2.94%
Crude Oil Spot			US $77.87
Gold Spot			US $1,979.50
US Gov't10-Year/Moody BAA Corp. Spread			206 bps
USD/CAD Exchange Rate Spot			US $0.7387

[1] *Period ending April 21st, 2023. Data extracted from Bloomberg*

[2] *Fund is priced annually*

[3] *Fund is priced weekly on Tuesdays*

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Disclaimer:

PALOS

1 Place Ville Marie, Suite 1670
Montreal (QC) H3B 2B6, Canada

T. +1 (514) 397-0188
F. +1 (514) 397-0199

1 St. Clair Avenue East Suite 504
Toronto, Ontario M4T 2V7

T. +1 (647) 276-0110
F. +1 (647) 343-7772

www.palos.ca