Daily Macro Insights: Banks in from the cold
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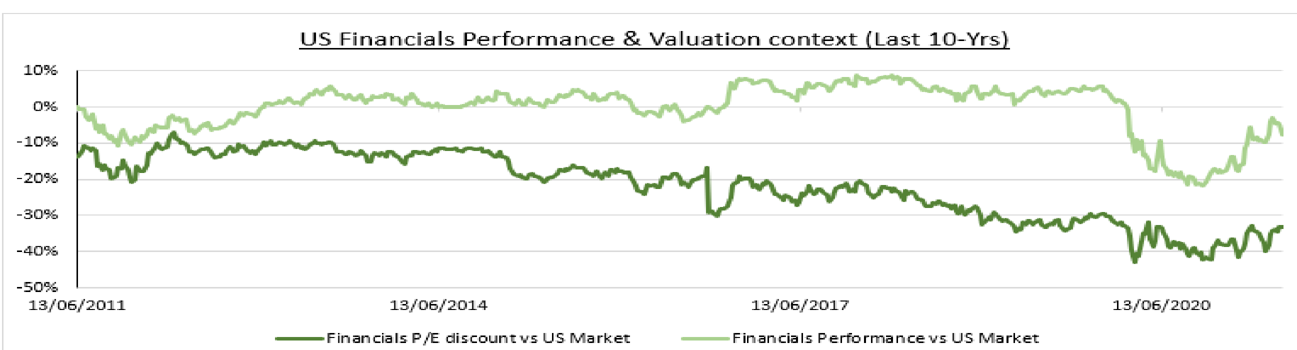
IN FROM COLD: Financials have been 2nd best performing sector YTD, +25% vs US equities +14%, behind only energy. Comes after years lagging tech strength, held back by low economic growth and bond yields, and tighter post-2008 crisis capital regulations. This is now changing with outlook for more growth, higher bond yields, a still huge 35% P/E valuation gap vs market (see chart), and high capital levels giving room to weather any downturn and distribute capital to shareholders. Financials is the 4th largest US sector, but largest Value segment (c20% weight).

NOT JUST BOND YIELDS: We see four drivers for banks +45% EPS rebound this year (+10% above market), and upside to +0% consensus next (11% below market). **1)** *Bond Yields.* Sector is very correlated with 10-yr bond yields. These will rise from the current 1.5% level as Fed moves to cut its US$120bn/m bond buys, whilst real yields (current yield minus 5% inflation) rise from uniquely negative levels. This would boost profits, as amounts earned on loans (priced vs bond yield) rise vs costs of deposits (priced vs 0% Fed rate). **2)** *Loan Growth*. Slowly improving with US Financials lead-indicator (PMI) at 72, 2nd highest of any sector, and GDP outlook rising. **3)** *Other activities.* JP Morgan CEO Dimon see' surging investment banking to part-compensate for lower trading activity, after their record 2020. **4)** *Capital*. Fed to release annual 'stress-test' (hypothetical ability to withstand crisis) results June 24th. Major banks to pass with capital 3x minimums. Would see removal of last of restrictions, allowing buyback and dividend increases.

INSTRUMENTS: US banks ETF exposure via KBE and regional banks KRE. Broader exposure including diversifieds such as Berkshire Hathaway (BRK.B) and asset managers like Blackrock (BLK) via XLF and VFH. Global banks exposure via 25 stock @TheBigBanks including largest global banks, such as JP Morgan (JPM), ICBC (1398.HK), and Société Générale (GLE.PA).

TODAY: Fed outlook for start of 'tapering' US$120bn/m bond buys by year-end, and updates to its forecasts, bringing its first interest rate increase into 2023, but still behind market forecasts.



Source: Refinitiv, eToro calculations

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