The IRA Bank Book

Q3 2024 Industry Review & Outlook

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www.theinstitutionalriskanalyst.com

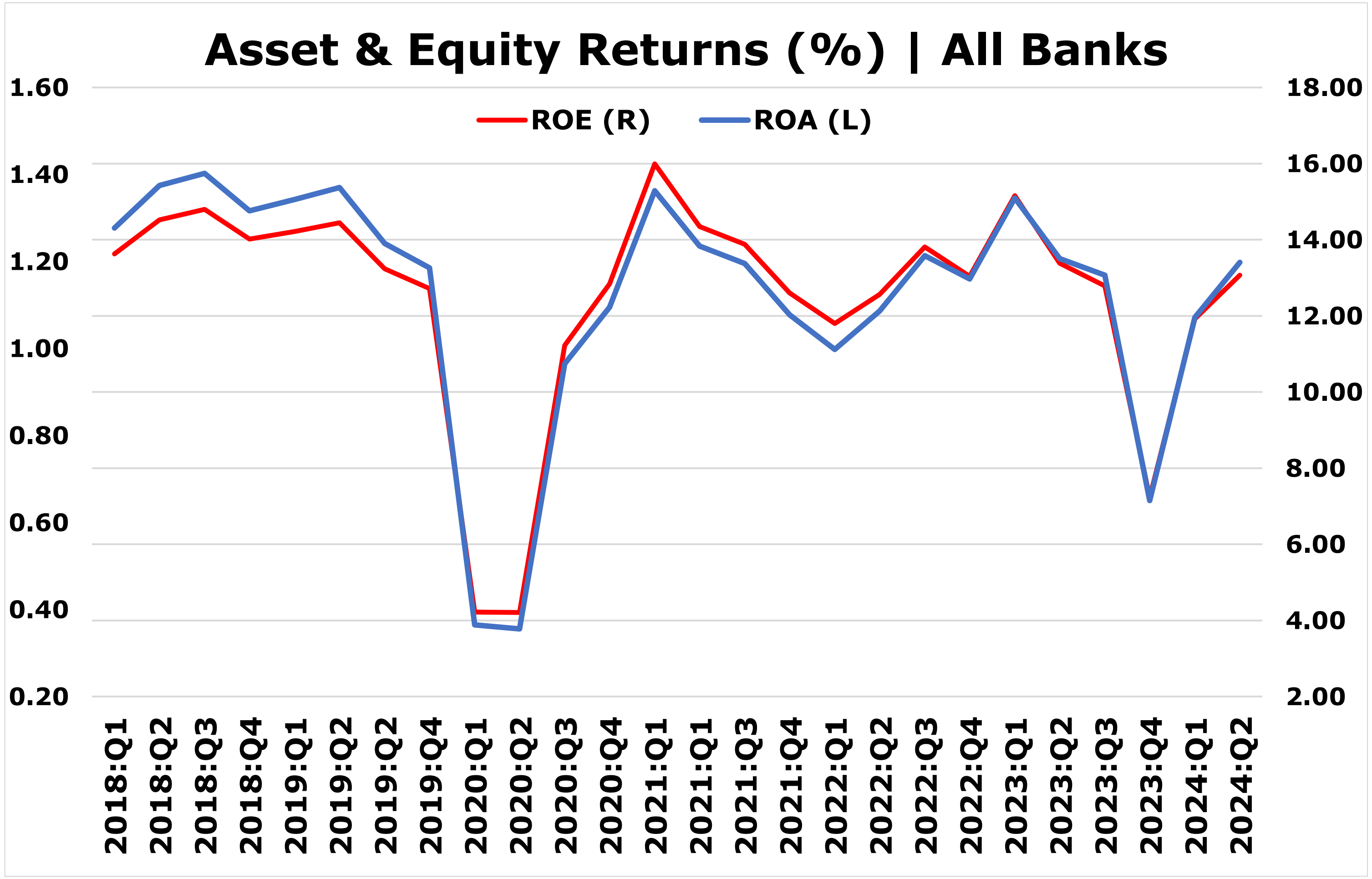
Review 1H 2024

- The US banking industry was relatively stable in terms of income and credit loss rates in Q2 2024, with commercial real estate credit past due and charge offs rising but consumer credit lines showing falling delinquency. Net loss on $2.7 trillion in bank owned 1-4 family loans was -25% in Q2 2024, illustrating the huge downward skew in realized losses caused by soaring residential home prices. But there were a lot of “extraordinary” items in Q2, as FDIC summarized nicely:

  “The quarterly increase in net income was largely driven by nonrecurring items including an estimated $4 billion reduction in reported expense related to the FDIC special assessment, approximately $10 billion in one-time gains on equity security transactions, and the sale of an institution’s insurance division that resulted in an after-tax $4.9 billion gain. These nonrecurring items were partially offset by several large banks selling bond portfolios at a loss and the industry’s $2.7 billion increase in provision expense.”

Q2 2024 Bank Earnings

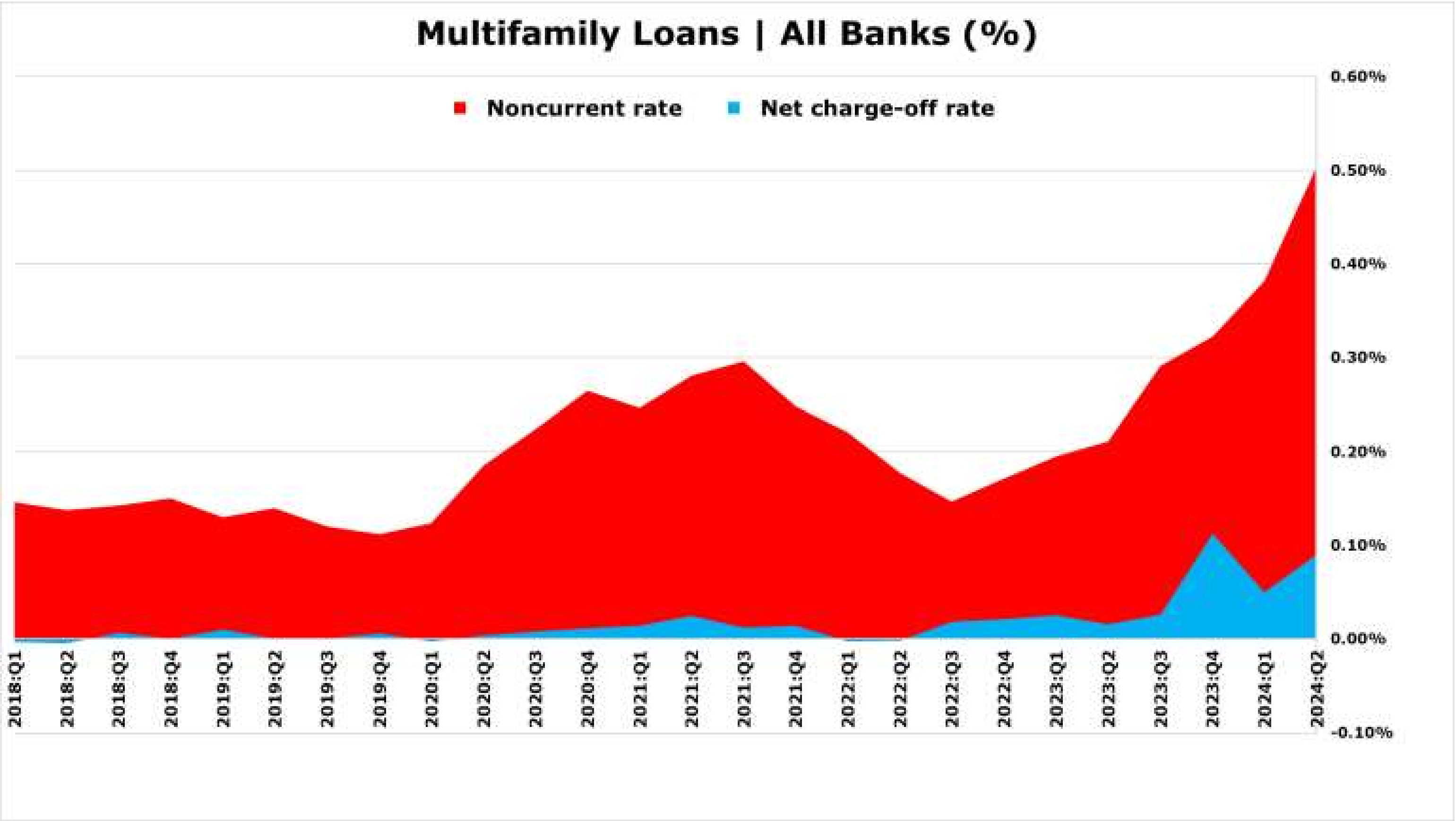
- In Q1 we saw relatively strong bank earnings. That trend has continued, with industry equity returns back in the mid-teens and asset returns back over 1%.
- The banking industry reported an aggregate return-on-assets ratio of 1.20 percent in second quarter 2024, FDIC reports, up 12 basis points from first quarter 2024 but down 1 basis point from first quarter 2023 and far from the peak of 1.4% ROA in 2021.



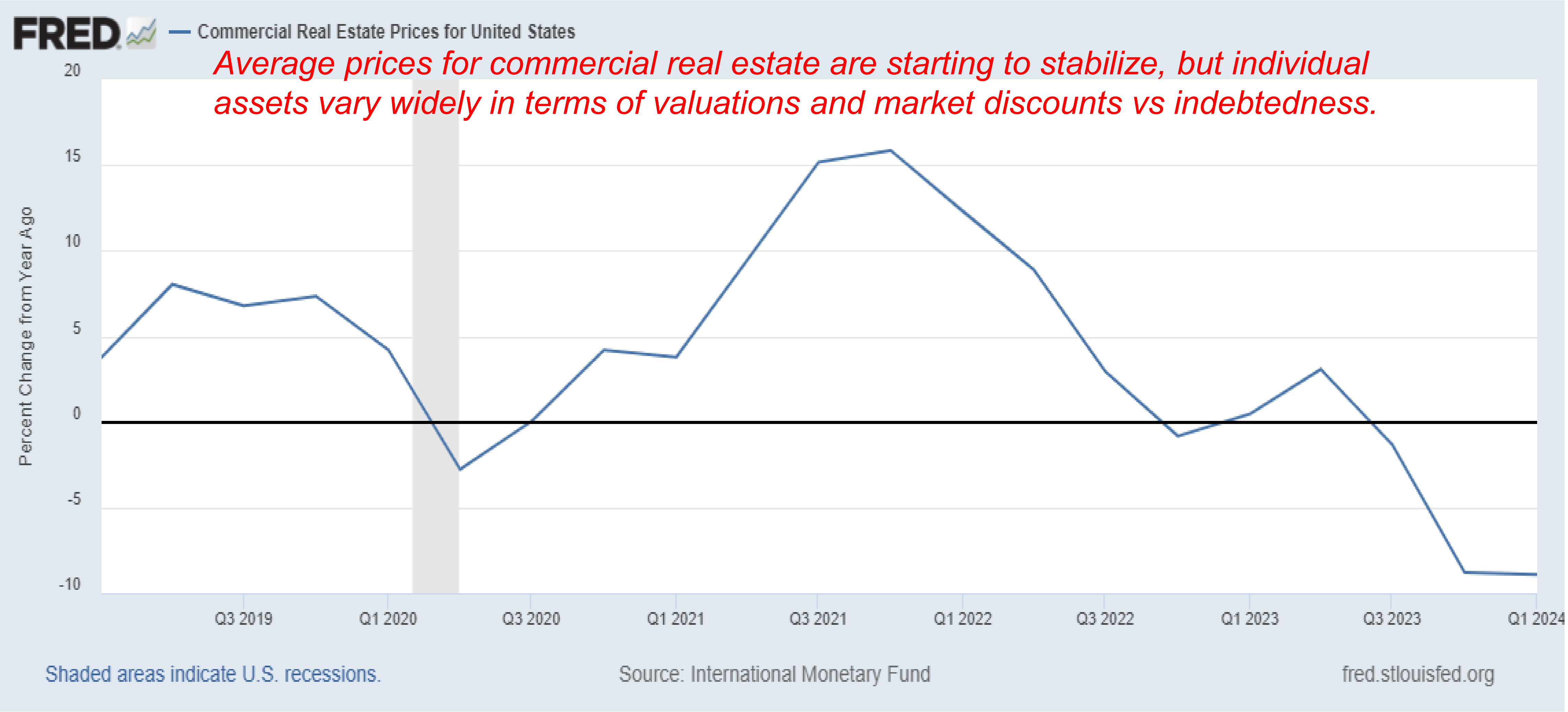
Source: FDIC/WGA LLC

Q2 2024 Commercial Credit

- *Commercial credit continues to deteriorate, with delinquency levels for $625 billion in bank owned multifamily assets up for 8th consecutive quarter.*
- *As discussed in the Charts section, net loss rates for bank multifamily loans are averaging near 100% of the loan amount even as delinquency levels rise, but we are still nowhere near 2008 default levels.*



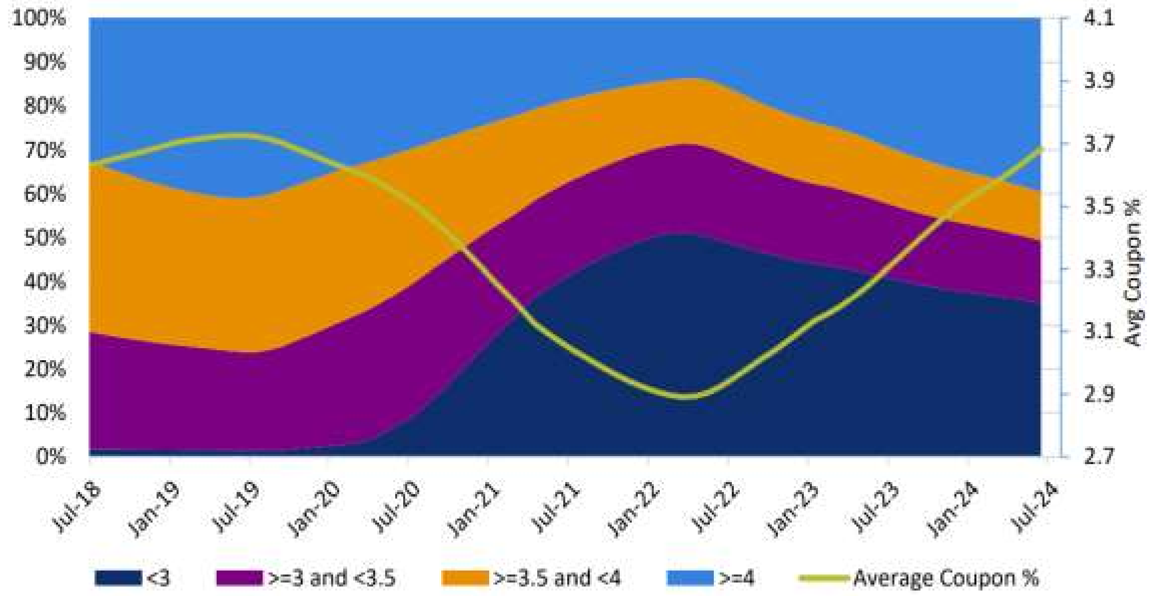
Source: FDIC/WGA LLC


FRED
Commercial Real Estate Prices for United States
Average prices for commercial real estate are starting to stabilize, but individual assets vary widely in terms of valuations and market discounts vs indebtedness.
Percent Change from Year Ago
20
15
10
5
0
-5
-10
Q3 2019
Q1 2020
Q3 2020
Q1 2021
Q3 2021
Q1 2022
Q3 2022
Q1 2023
Q3 2023
Q1 2024
Shaded areas indicate U.S. recessions.
Source: International Monetary Fund
fred.stlouisfed.org

Outlook for 2H 2024

- The market has already taken much of the gains to be expected by the FOMC's action this week, but lenders are anticipating higher volumes in Q4 and 2025. In theory, roughly a trillion in residential mortgages will be in the money for refinance, but competition for these assets will be intense.
- A 1-point decrease in short-term rates will increase levered returns on MSRs (assuming 60% leverage ratio) by 1.5 points, according to SitusAMC. But we expect banks to remain net sellers of mortgage exposures in Q3 as the housecleaning opportunity of a 3.65% 10-year Treasury forces the worst offenders in the industry to clean house.
- We expect that downbeat earnings guidance for banks in Q3 will end up being realized as losses are taken and NIM comes under pressure. <u>Asset yields will fall faster than funding costs in 2H 2024</u>.

Figure 28. Outstanding Ginnie Mae MBS Balance, by Coupon



Outlook for 2H 2024

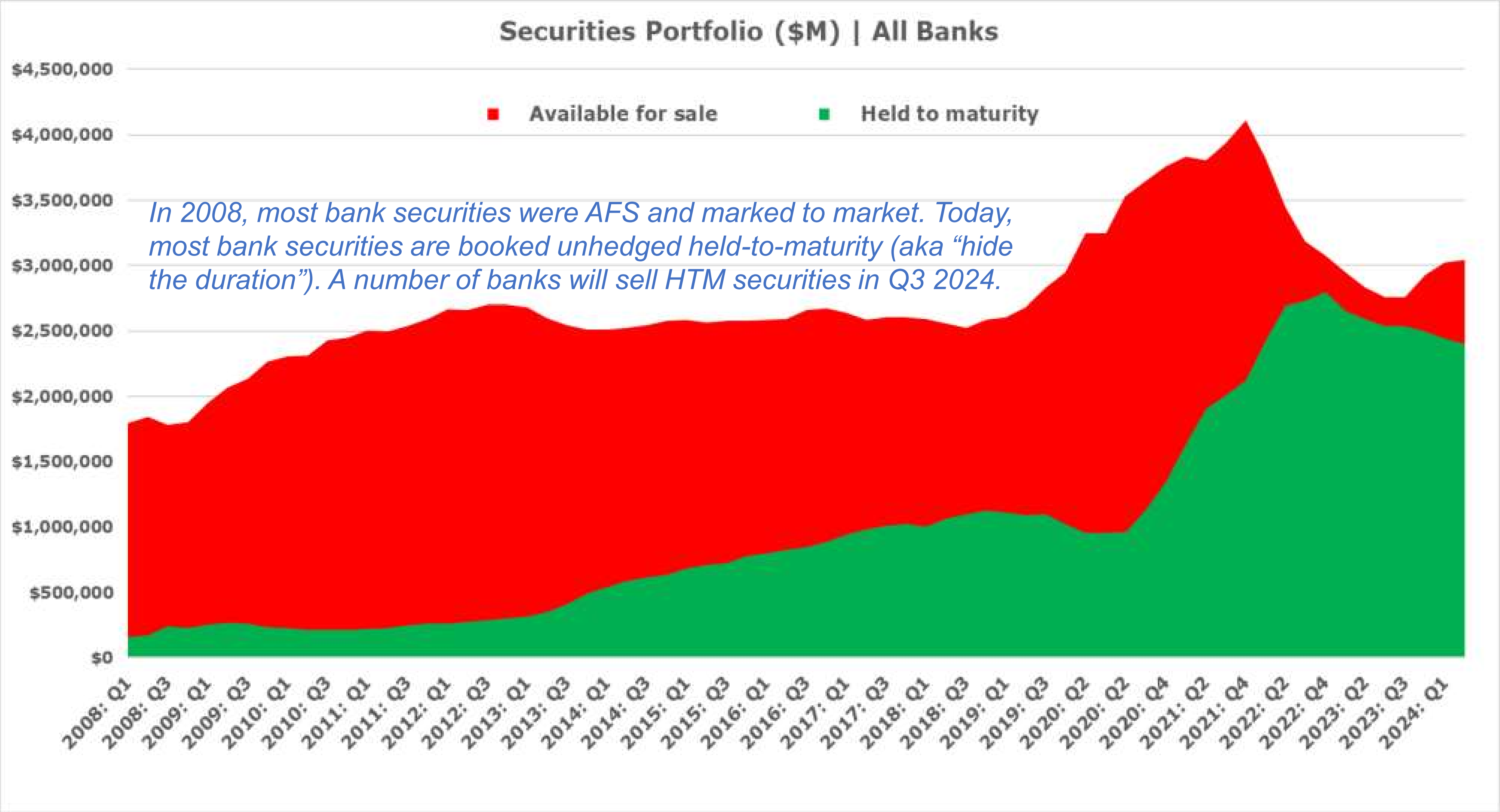
- As market yields fall in anticipation of a change in Fed policy, a growing number of banks are taking low-yielding securities to the curb for sale. **KeyCorp (KEY)** and **Truist Financial (TFC)** are some of the banks that have taken large losses and KEY may sell more in the second half of 2024. While realized losses hurt earnings, the benefit of reinvesting proceeds at higher yields are compelling.
- KEY's recent sale of some $7 billion of low-yielding investment securities predominantly consisted of low-coupon agency CMOs and CMBS, according to Nomura. Even though credit expenses remain muted, analysts have been cutting earnings estimates for financials in Q3, in part because lower market yields are encouraging more banks to sell low-coupon securities. These sales will hurt earnings in the short-run but help earnings longer term. <u>Market gains on current coupons will hide a lot of losses taken on low coupon securities in Q3 2024</u>.
- It is notable that **JPMorgan (JPM)** guided analysts lower in terms of expectations for Q3 2024 earnings. President Daniel Pinto said estimated net interest income of $89 billion for the year was "not very reasonable" and would be lower than the $90 billion reported for the full year 2023, causing the stock to drop almost 10%. In 1H 2024, JPM was on a run rate to exceed $90 billion, thus results for 2H 2024 could be significantly lower than 2023 levels. **Goldman Sachs (GS)** likewise told analysts to expect down trading results in Q3 2024

WGA BANK TOP 25

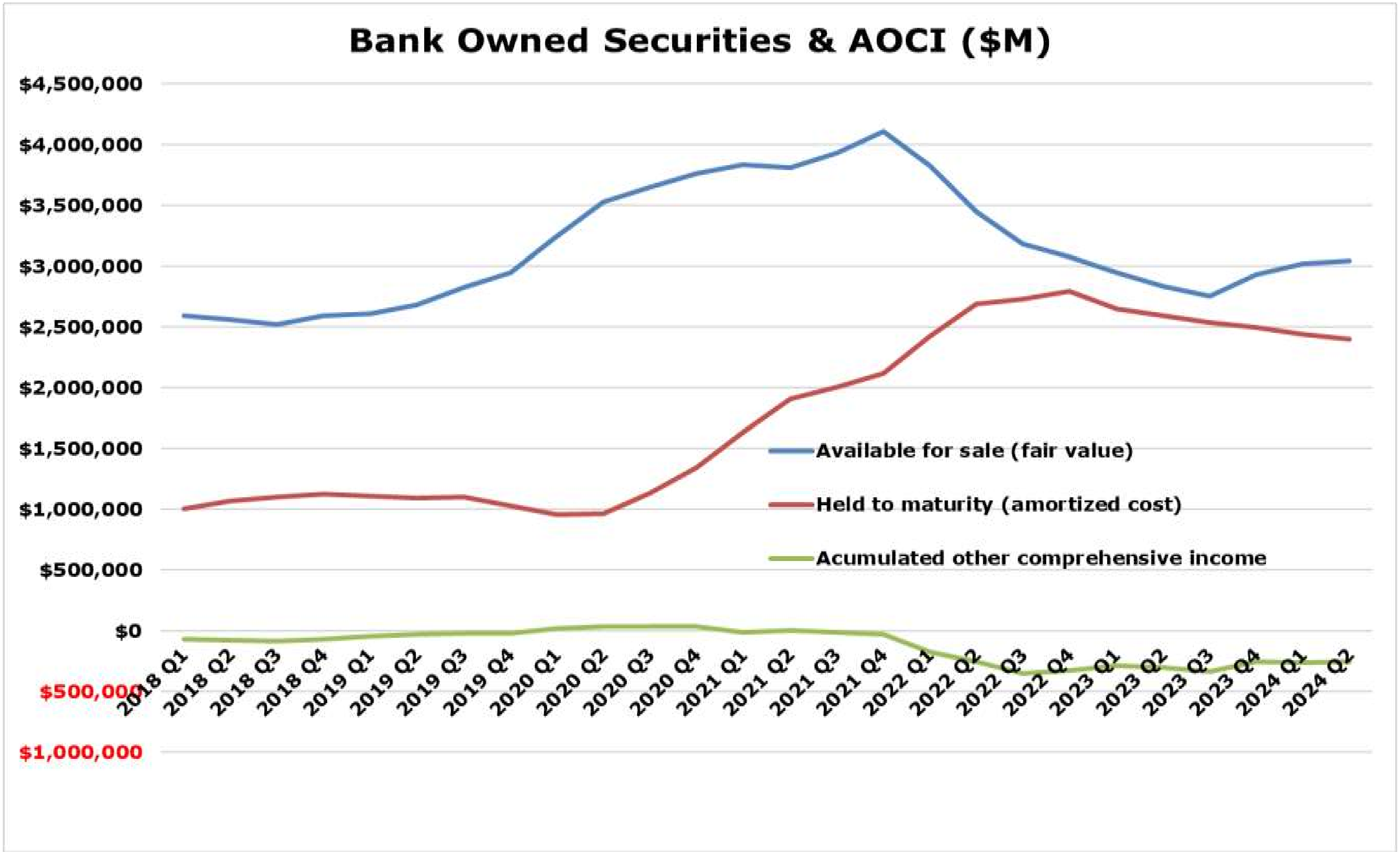
Sector rotation out of large cap financials continues unabated. Only three names – FCNCA, JPM and IBOC in the top ten banks over the past three quarters.

Rank	Q3 2024	Q2 2024	Q1 2024
1	SFBS	DFS	FBP
2	FCNCA	JPM	FCNCA
3	DFS	SYF	IBOC
4	JPM	FCNCA	AX
5	FFIN	EWBC	AXP
6	AMP	AXP	DFS
7	CUBI	SCHW	JPM
8	FBP	IBOC	MBIN
9	BOH	FITB	OFG
10	IBOC	AMP	SYF
11	SYF	FBP	AMP
12	RF	CFR	BANF
13	BK	RJF	CUBI
14	AXP	WFC	EWBC
15	NTRS	FFIN	SFBS
16	FCF	AX	FFIN
17	ZION	BANF	RJF
18	AX	SFBS	CFR
19	RJF	RF	FITB
20	CBU	HOMB	OZK
21	WAL	COF	BOH
22	UMBF	WTFC	BPOP
23	MS	PNC	CVBF
24	GS	TD	HE
25	EWBC	OZK	HOMB

https://www.theinstitutionalriskanalyst.com/indices

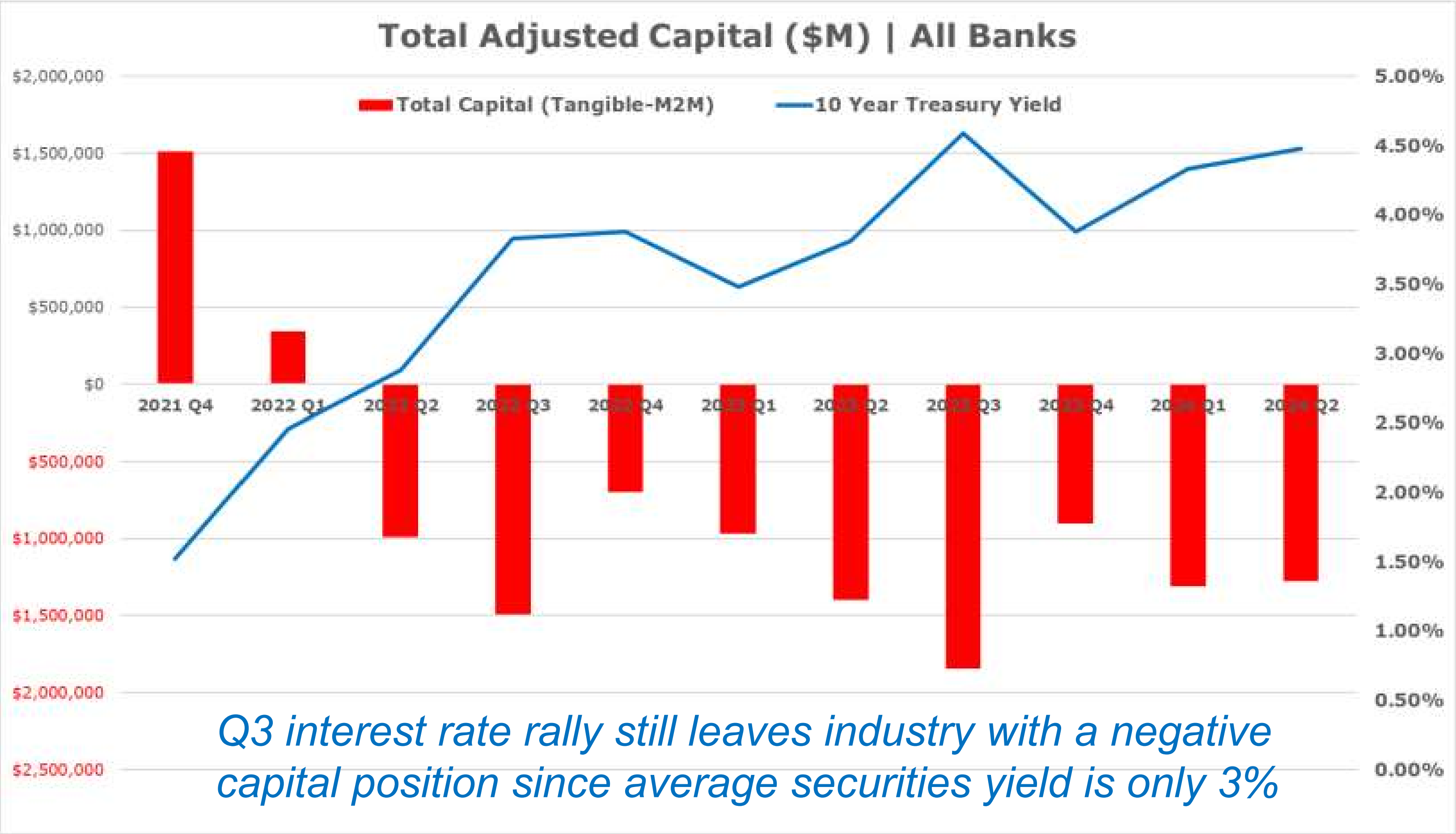

Securities Portfolio ($M) | All Banks
Available for sale
Held to maturity
$4,500,000
$4,000,000
$3,500,000
$3,000,000
$2,500,000
$2,000,000
$1,500,000
$1,000,000
$500,000
$0
In 2008, most bank securities were AFS and marked to market. Today, most bank securities are booked unhedged held-to-maturity (aka “hide the duration”). A number of banks will sell HTM securities in Q3 2024.
2008: Q1
2008: Q3
2009: Q1
2009: Q3
2010: Q1
2010: Q3
2011: Q1
2011: Q3
2012: Q1
2012: Q3
2013: Q1
2013: Q3
2014: Q1
2014: Q3
2015: Q1
2015: Q3
2016: Q1
2016: Q3
2017: Q1
2017: Q3
2018: Q1
2018: Q3
2019: Q1
2019: Q3
2020: Q2
2020: Q2
2020: Q4
2021: Q2
2021: Q4
2022: Q2
2022: Q4
2023: Q2
2023: Q3
2024: Q1

Source: FDIC



Source: FDIC/WGA LLC

Industry Mark-to-Market Capital



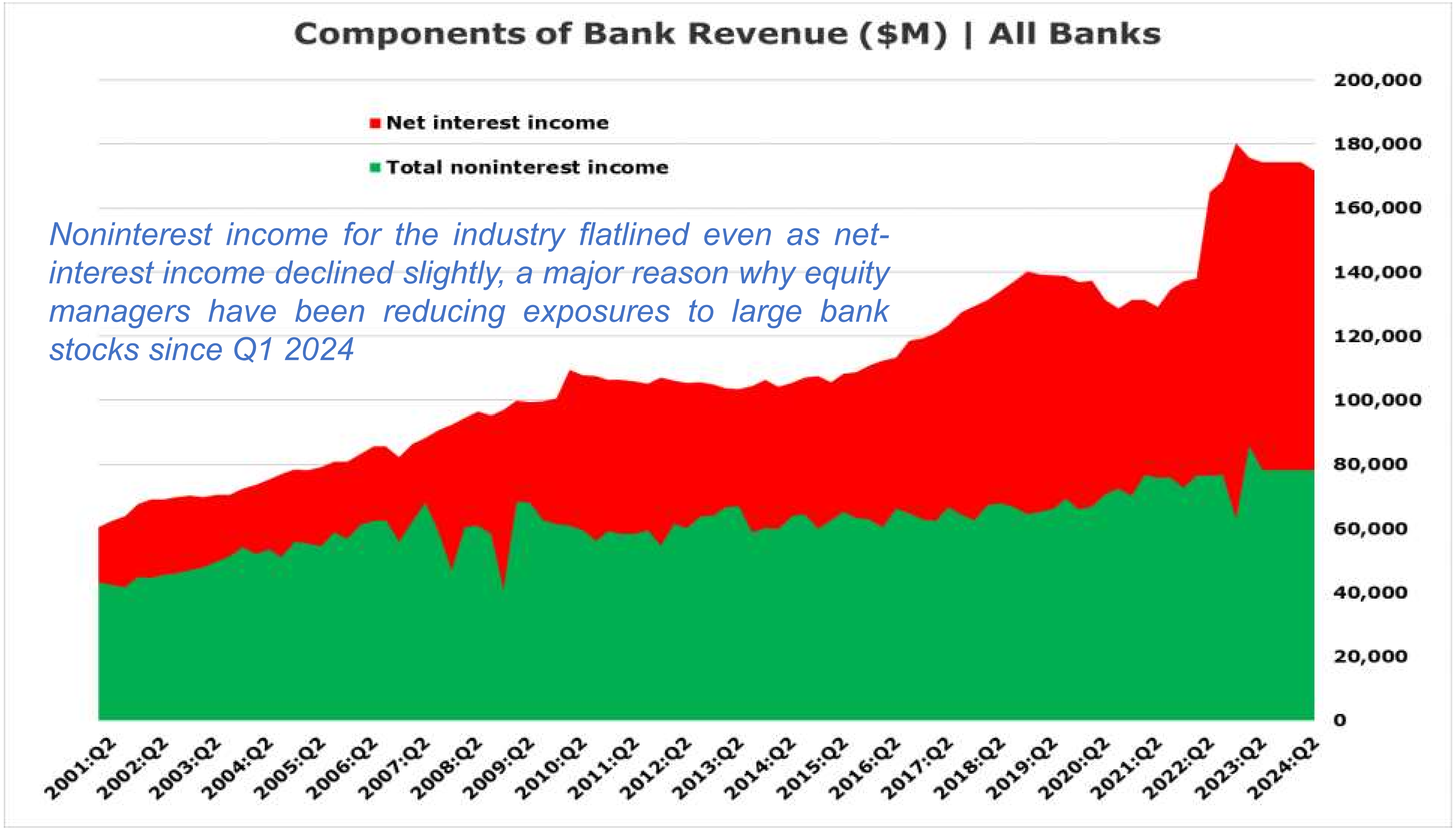
Source: FDIC/WGA LLC

Industry Mark-to-Market Capital

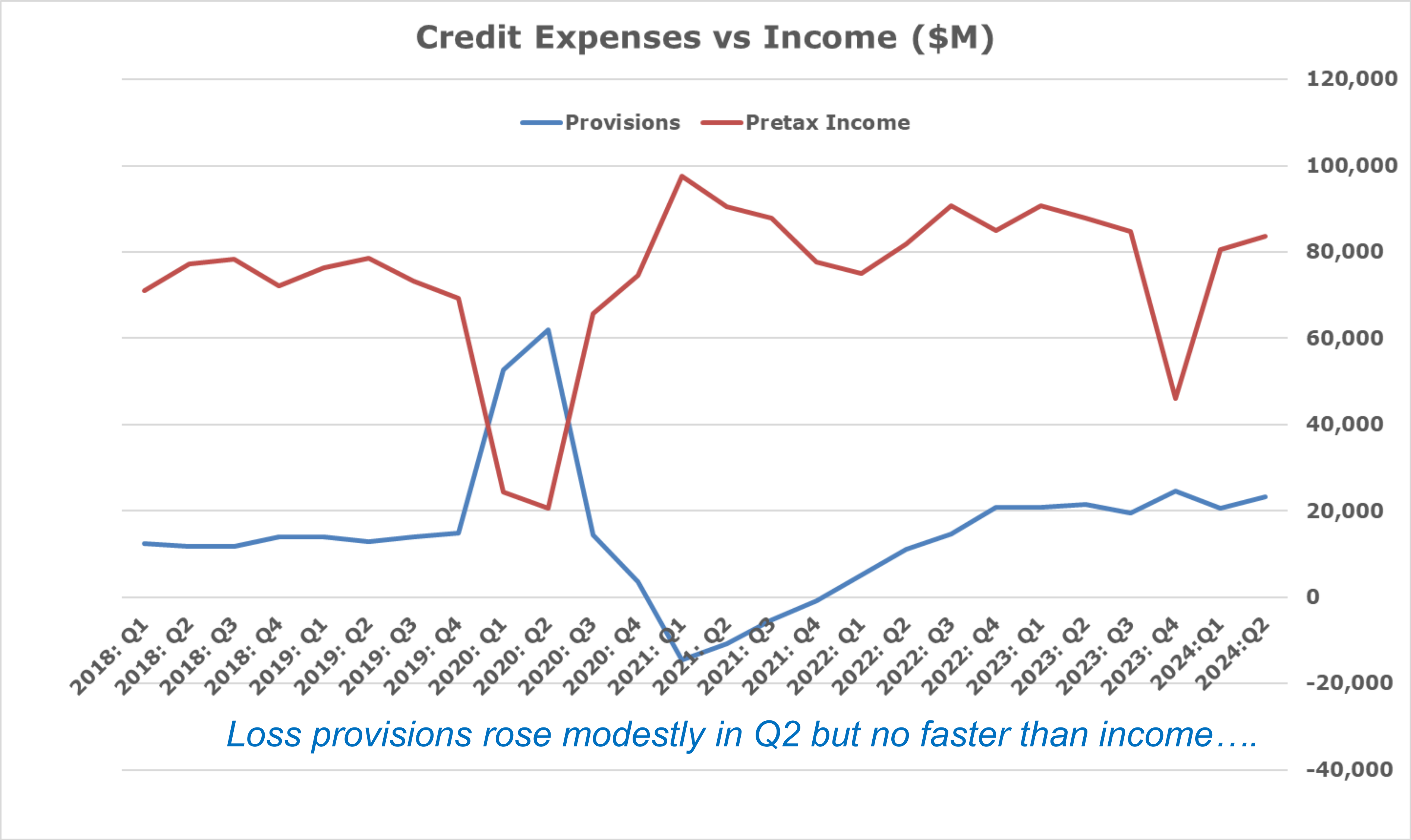
$M	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4	2023 Q1	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2
Total Equity Capital	**$2,357,424**	**$2,257,908**	**$2,218,286**	**$2,165,245**	**$2,207,319**	**$2,262,762**	**$2,253,341**	**$2,245,224**	**$2,294,498**	**$2,317,676**	**$2,357,976**
Intangible assets	$404,349	$415,379	$421,498	$355,596	$430,077	$435,471	$435,999	$436,192	$423,262	$422,892	$417,058
$M	**2021 Q4**	**2022 Q1**	**2022 Q2**	**2022 Q3**	**2022 Q4**	**2023 Q1**	**2023 Q2**	**2023 Q3**	**2023 Q4**	**2024 Q1**	**2024 Q2**
Total Capital (Tangible)	**$1,953,075**	**$1,842,529**	**$1,796,788**	**$1,809,649**	**$1,777,242**	**$1,827,291**	**$1,817,342**	**$1,809,032**	**$1,871,236**	**$1,894,784**	**$1,940,918**
AOCI (AFS net of hedges)	$31,079	$170,176	$253,454	$347,851	$326,083	$283,309	$301,626	$336,936	$253,678	$262,811	$254,579
$M	**2021 Q4**	**2022 Q1**	**2022 Q2**	**2022 Q3**	**2022 Q4**	**2023 Q1**	**2023 Q2**	**2023 Q3**	**2023 Q4**	**2024 Q1**	**2024 Q2**
Total Capital (Tangible-AOCI)*	**$1,921,996**	**$1,672,353**	**$1,543,334**	**$1,461,798**	**$1,451,159**	**$1,543,982**	**$1,515,716**	**$1,472,096**	**$1,617,558**	**$1,631,973**	**$1,686,338**
Net Loans & Leases (HTM)	$11,068,770	$11,181,401	$11,592,512	$11,815,804	$12,226,876	$12,009,849	$12,089,498	$12,131,306	$12,234,254	$12,198,735	$12,322,508
M2M Adjust ($)	$276,719	$894,512	$1,738,877	$2,067,766	$1,528,359	$1,801,477	$2,115,662	$2,426,261	$1,835,138	$2,134,779	$2,156,439
$M	**2021 Q4**	**2022 Q1**	**2022 Q2**	**2022 Q3**	**2022 Q4**	**2023 Q1**	**2023 Q2**	**2023 Q3**	**2023 Q4**	**2024 Q1**	**2024 Q2**
U.S. Treasury securities (HTM)	$1,443,819	$1,481,802	$1,510,721	$1,456,722	$1,434,279	$1,326,458	$1,247,658	$1,247,123	$1,309,615	$1,389,354	$1,382,312
Mortgage-backed securities (HTM)	$3,557,069	$3,522,187	$3,381,850	$3,202,320	$3,150,227	$3,032,304	$2,962,311	$2,870,131	$2,921,476	$2,914,463	$2,910,504
State and municipal securities (HTM)	$423,815	$415,939	$405,028	$389,779	$384,029	$367,099	$348,528	$326,512	$333,453	$318,011	$309,776
Total (HTM)	**$5,424,703**	**$5,419,928**	**$5,297,599**	**$5,048,821**	**$4,968,535**	**$4,725,861**	**$4,558,496**	**$4,443,767**	**$4,564,544**	**$4,621,828**	**$4,602,593**
M2M Adjust ($)	$135,618	$433,594	$794,640	$883,544	$621,067	$708,879	$797,737	$888,753	$684,682	$808,820	$805,454
Total Capital (Tangible-Adjusted)**	**$1,509,659**	**$344,247**	**$990,182**	**$1,489,512**	**$698,267**	**$966,374**	**$1,397,683**	**$1,842,919**	**$902,261**	**$1,311,625**	**$1,275,554**
M2M Adjust (%)	**2.5%**	**8.0%**	**15.0%**	**17.5%**	**12.5%**	**15.0%**	**17.5%**	**20.0%**	**15.0%**	**17.5%**	**17.5%**
10 Year Treasury Yield	**1.52%**	**2.46%**	**2.88%**	**3.83%**	**3.88%**	**3.48%**	**3.81%**	**4.59%**	**3.88%**	**4.33%**	**4.48%**

Source: FDIC/WGA LLC

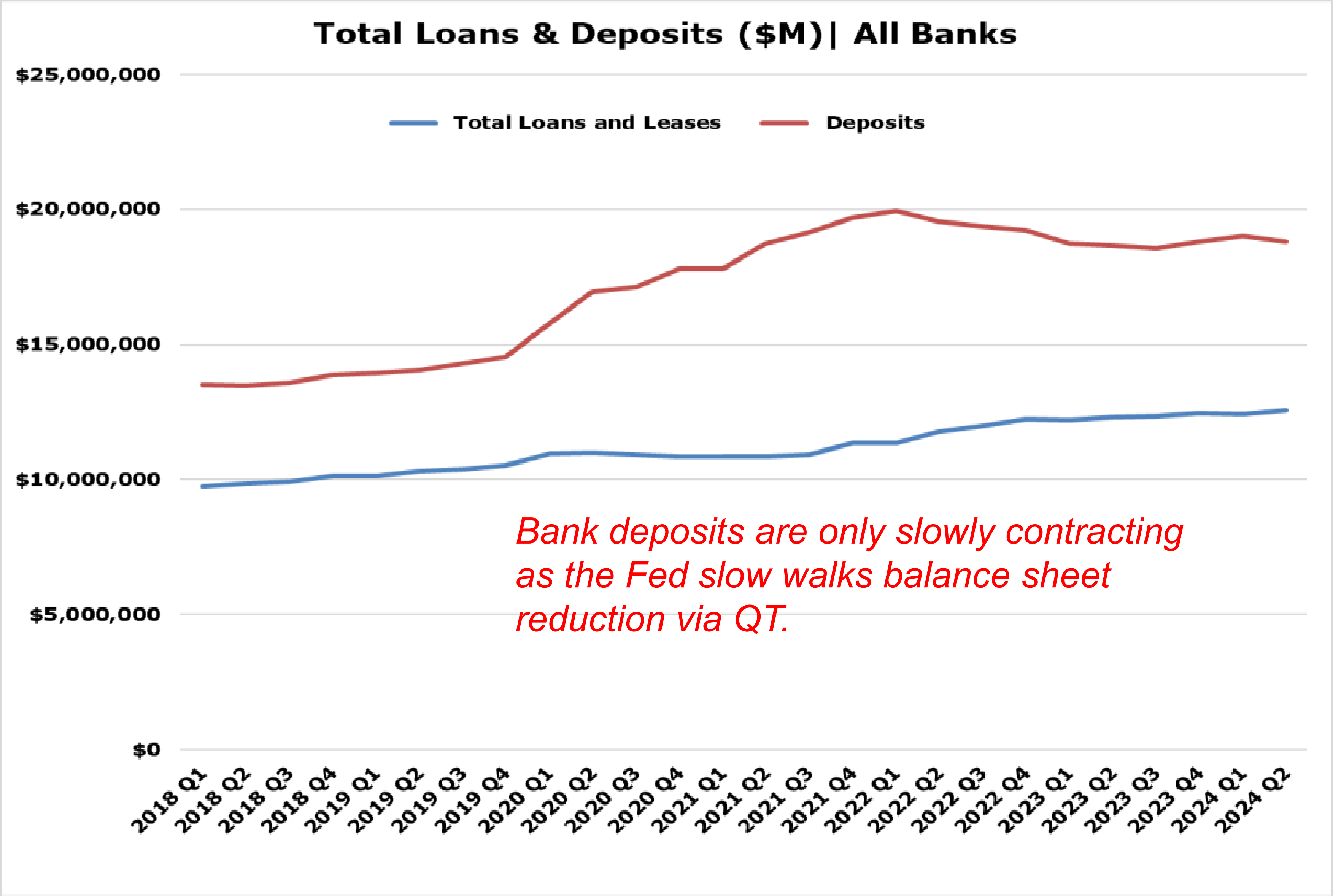
Bond market rally in Q3 has made these numbers better, but….


Components of Bank Revenue ($M) | All Banks
Net interest income
Total noninterest income
Noninterest income for the industry flatlined even as net-interest income declined slightly, a major reason why equity managers have been reducing exposures to large bank stocks since Q1 2024
200,000
180,000
160,000
140,000
120,000
100,000
80,000
60,000
40,000
20,000
0
2001:Q2
2002:Q2
2003:Q2
2004:Q2
2005:Q2
2006:Q2
2007:Q2
2008:Q2
2009:Q2
2010:Q2
2011:Q2
2012:Q2
2013:Q2
2014:Q2
2015:Q2
2016:Q2
2017:Q2
2018:Q2
2019:Q2
2020:Q2
2021:Q2
2022:Q2
2023:Q2
2024:Q2

Source: FDIC


Credit Expenses vs Income ($M)
Provisions
Pretax Income
120,000
100,000
80,000
60,000
40,000
20,000
0
-20,000
-40,000
2018: Q1
2018: Q2
2018: Q3
2018: Q4
2019: Q1
2019: Q2
2019: Q3
2019: Q4
2020: Q1
2020: Q2
2020: Q3
2020: Q4
2021: Q1
2021: Q2
2021: Q3
2021: Q4
2022: Q1
2022: Q2
2022: Q3
2022: Q4
2023: Q1
2023: Q2
2023: Q3
2023: Q4
2024:Q1
2024:Q2
Loss provisions rose modestly in Q2 but no faster than income….

Source: FDIC


Total Loans & Deposits ($M)| All Banks
$25,000,000
$20,000,000
$15,000,000
$10,000,000
$5,000,000
$0
Total Loans and Leases
Deposits
2018 Q1
2018 Q2
2018 Q3
2018 Q4
2019 Q1
2019 Q2
2019 Q3
2019 Q4
2020 Q1
2020 Q2
2020 Q3
2020 Q4
2021 Q1
2021 Q2
2021 Q3
2021 Q4
2022 Q1
2022 Q2
2022 Q3
2022 Q4
2023 Q1
2023 Q2
2023 Q3
2023 Q4
2024 Q1
2024 Q2
Bank deposits are only slowly contracting as the Fed slow walks balance sheet reduction via QT.

Source: FDIC

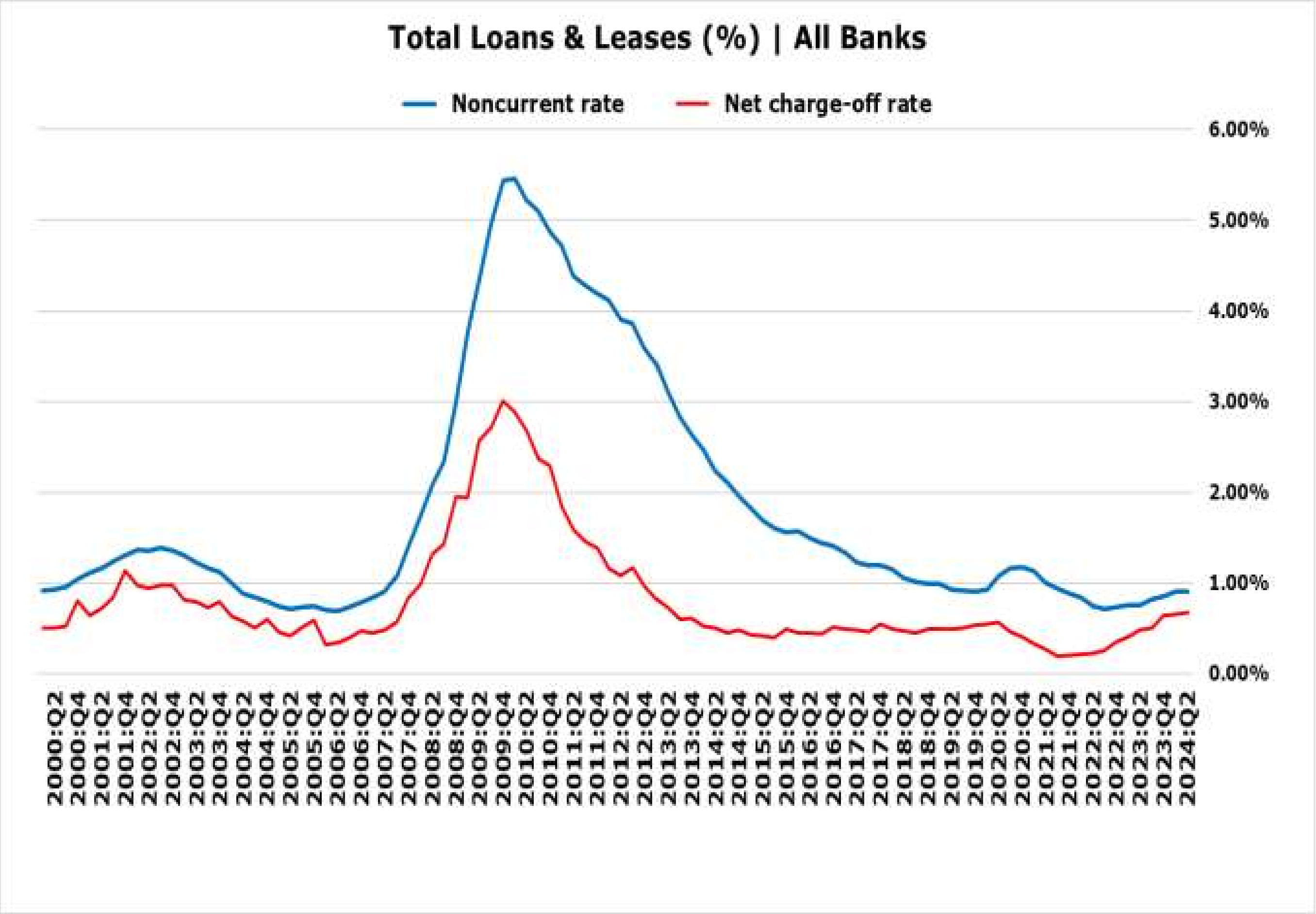
Credit Charts

FDIC SCHEDULE RC-C DEFINITIONS

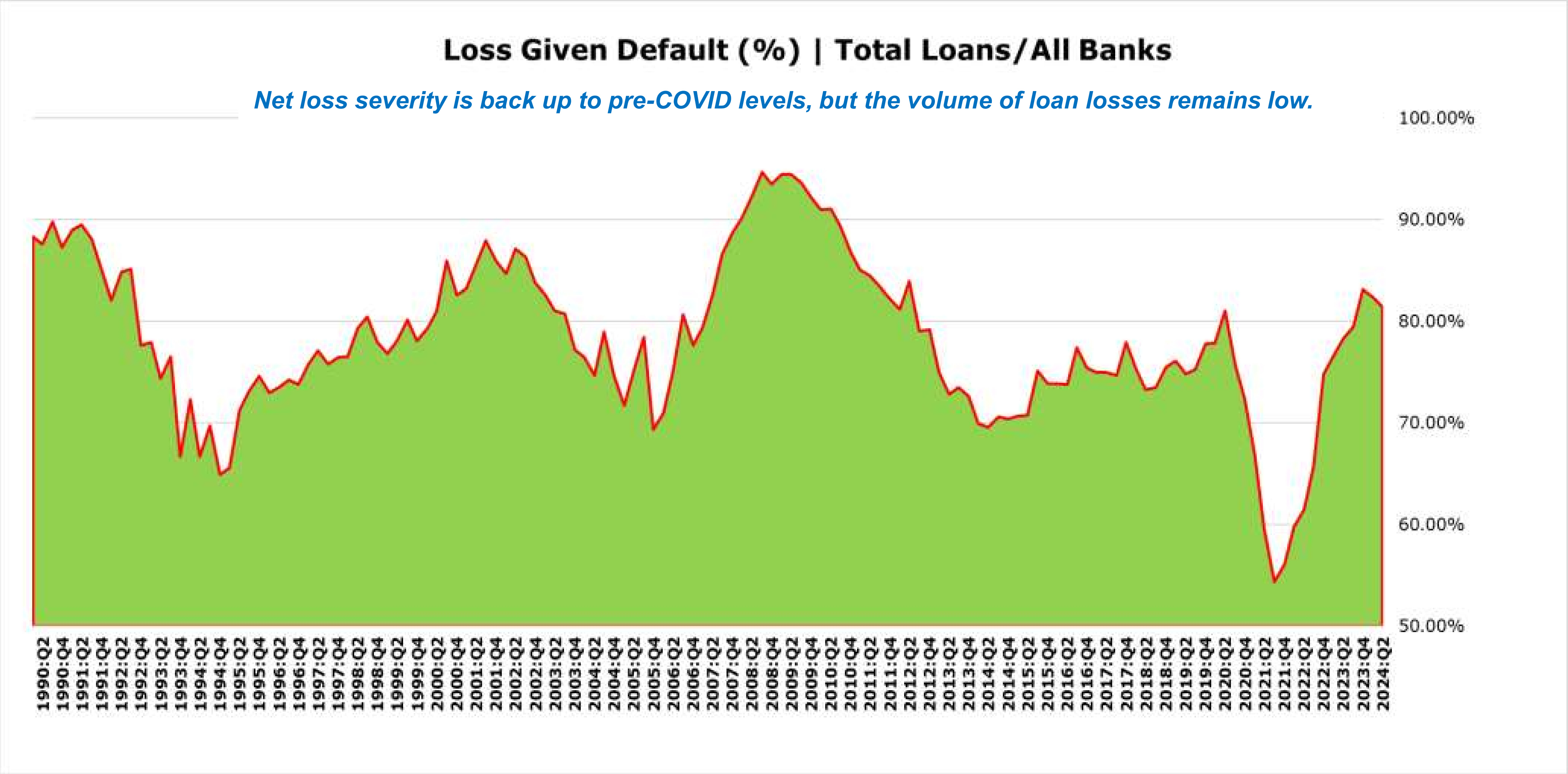
Total Loans & Leases

- Loss rates for all of the $12.5 trillion in bank loans continued to rise even as delinquency overall flattened out in Q2 2024. The distortion in credit metrics caused by the Fed during COVID and other factors make it difficult to predict what happens next, but we still do not see any indication of a serious consumer recession in the Q2 bank data.

- That said, the recession in commercial real estate is serious and continues to build. “The noncurrent rate for non-owner occupied commercial real estate loans of 1.77 percent was at its highest level since third quarter 2013, driven by office portfolios at the largest banks,” FDIC reports.



Source: FDIC

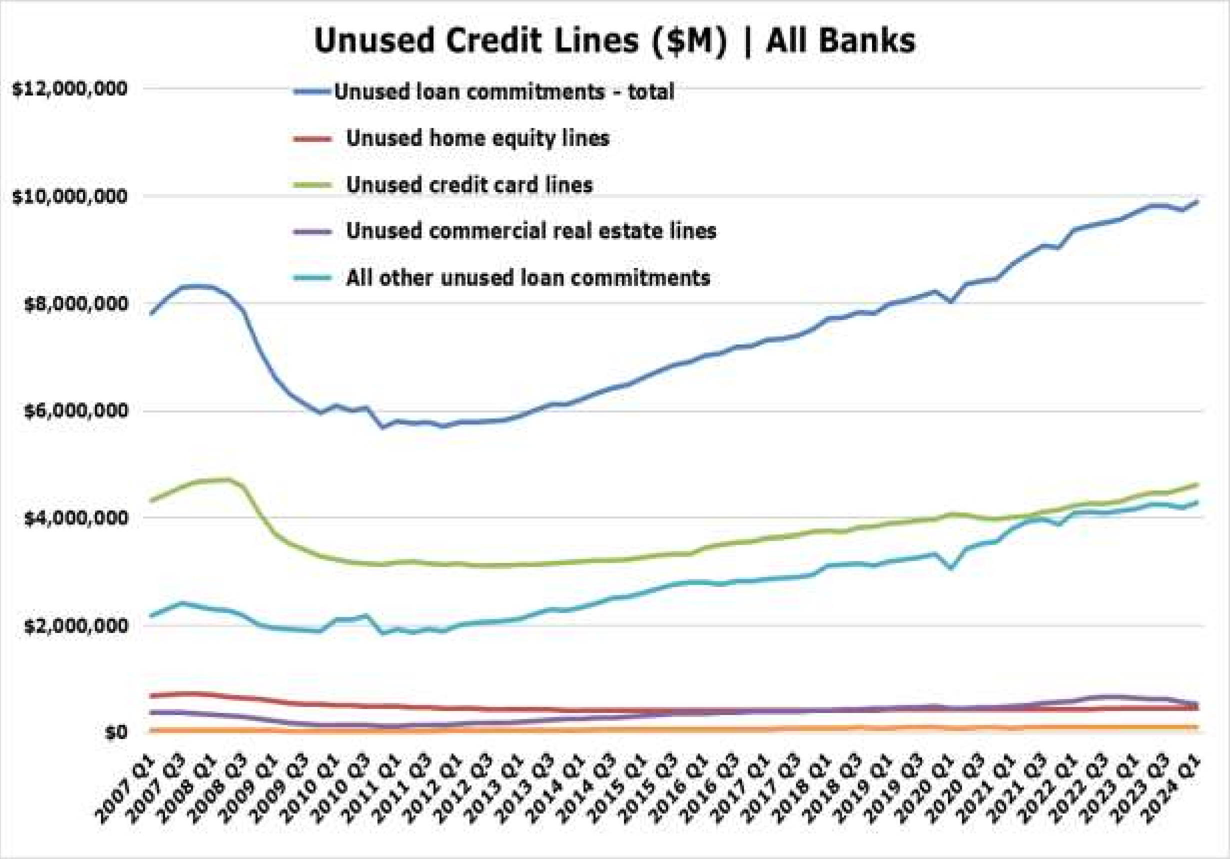


Source: FDIC/WGA LLC

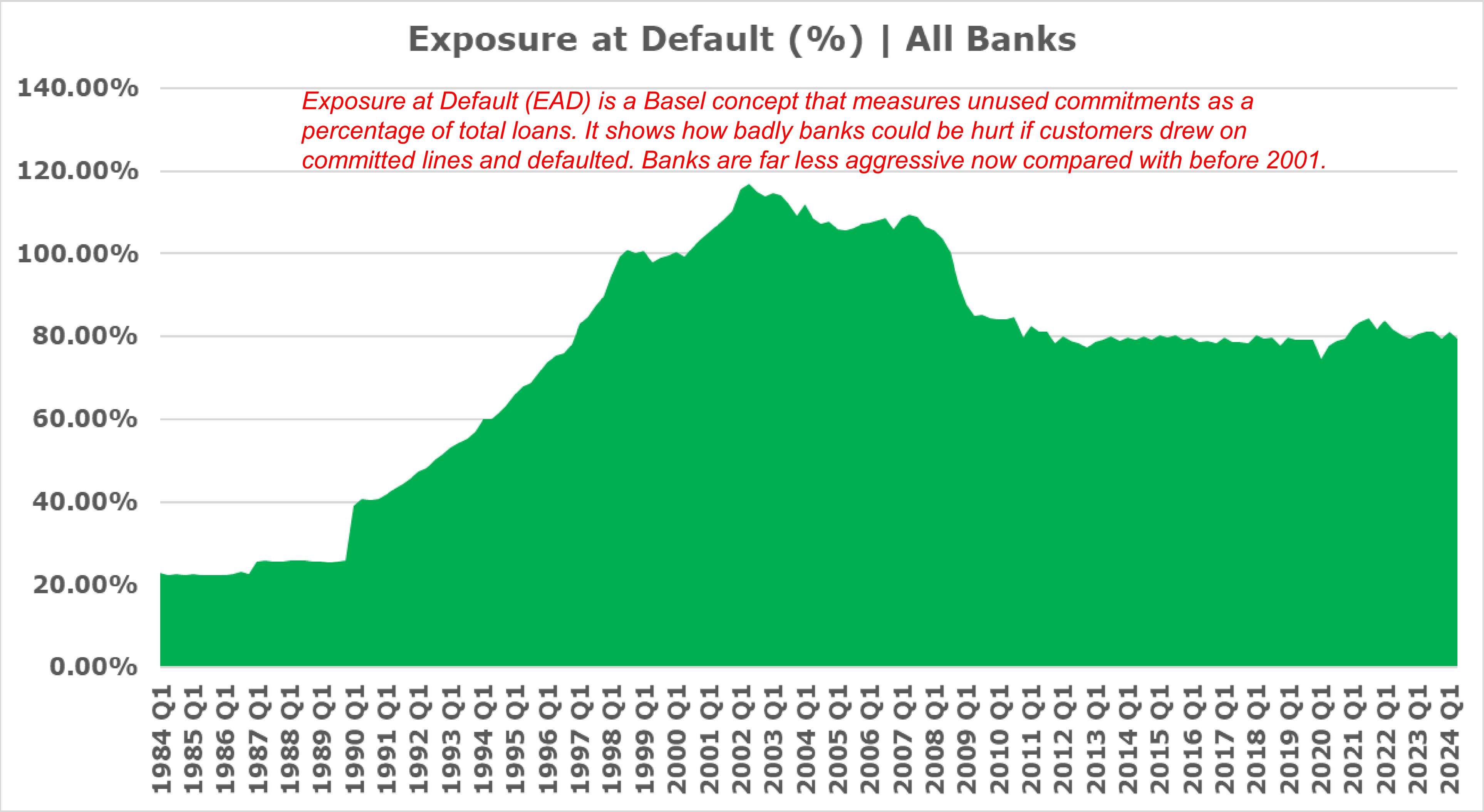
Exposure at Default (EAD)

- Exposure at default (EAD) is a way of measuring how much credit banks have approved but is not yet drawn. Unused credit lines at Q2 2024 equaled over 80% of the $23 trillion in total assets for all US banks.

- Overall, the posture of the industry remains quite aggressive, with $4 in unused credit card lines for every $1 currently drawn. The big change in the past year has been unused credit lines related to commercial real estate, which have fallen almost 20% or more than $100 billion in the past year.

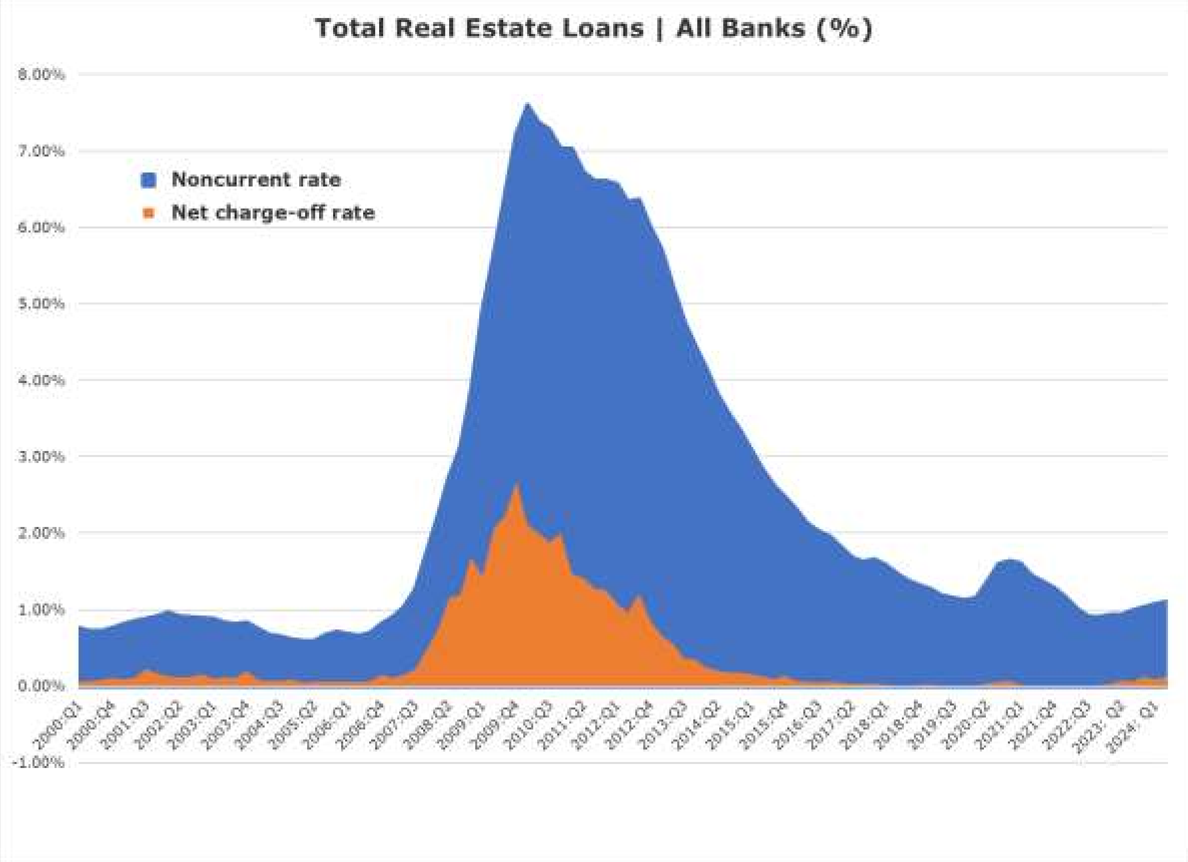


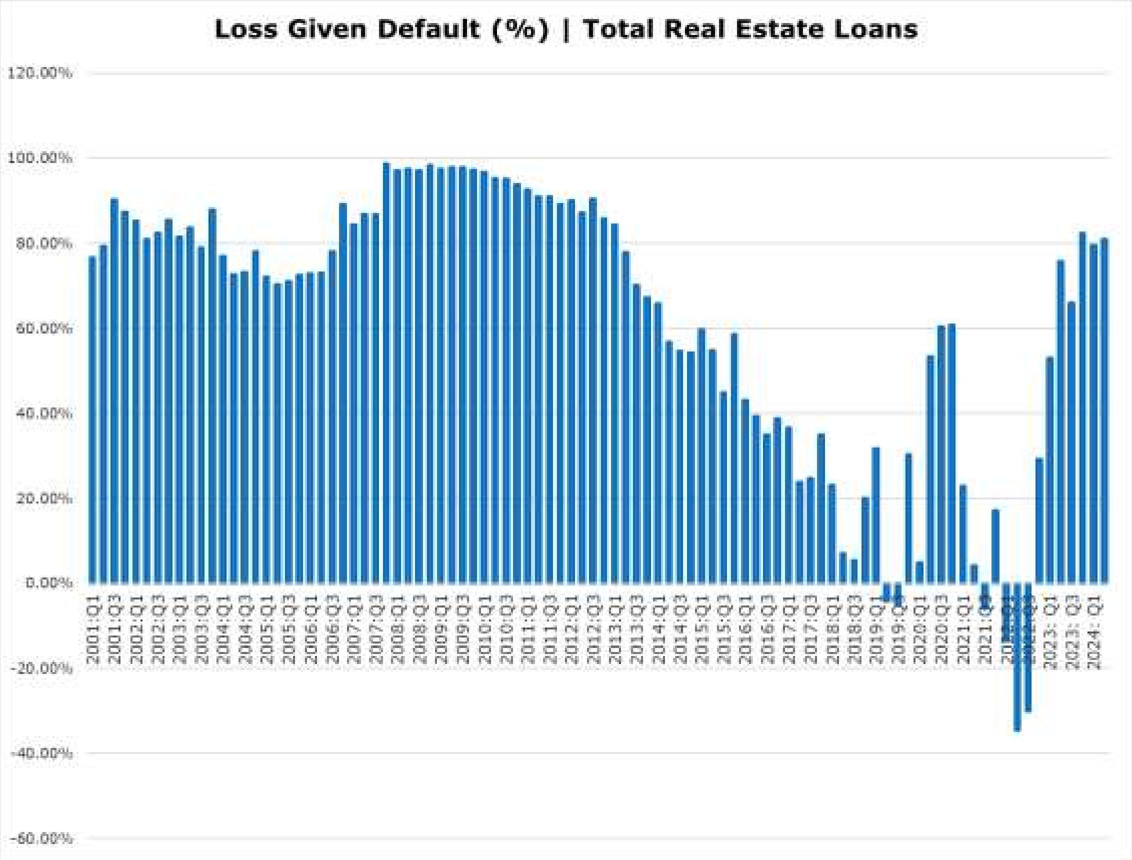
Source: FDIC



Source: FDIC/WGA LLC

CRE Severity Boosts Loss for Real Estate Loans



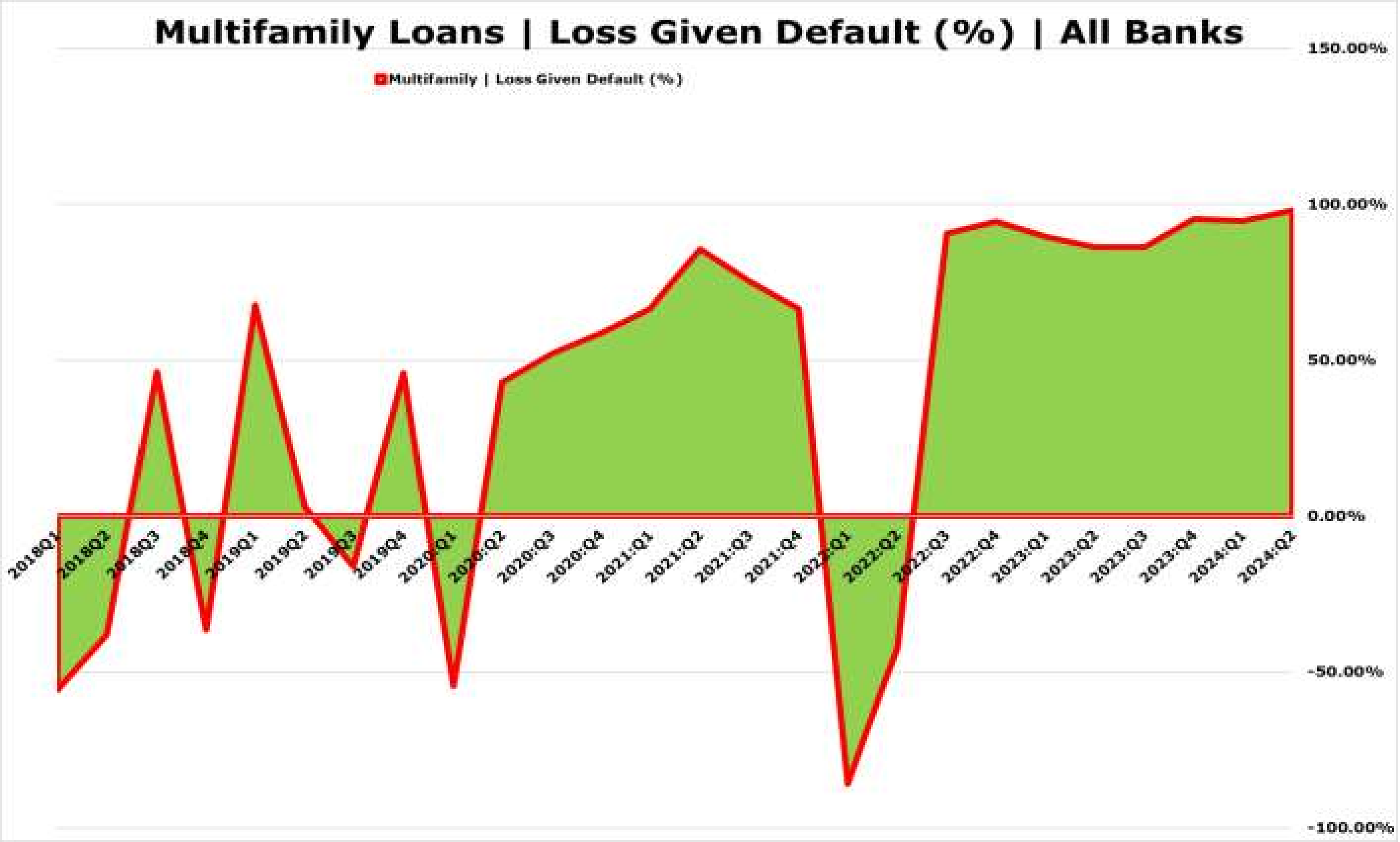


Source: FDIC

Source: FDIC/WGA LLC

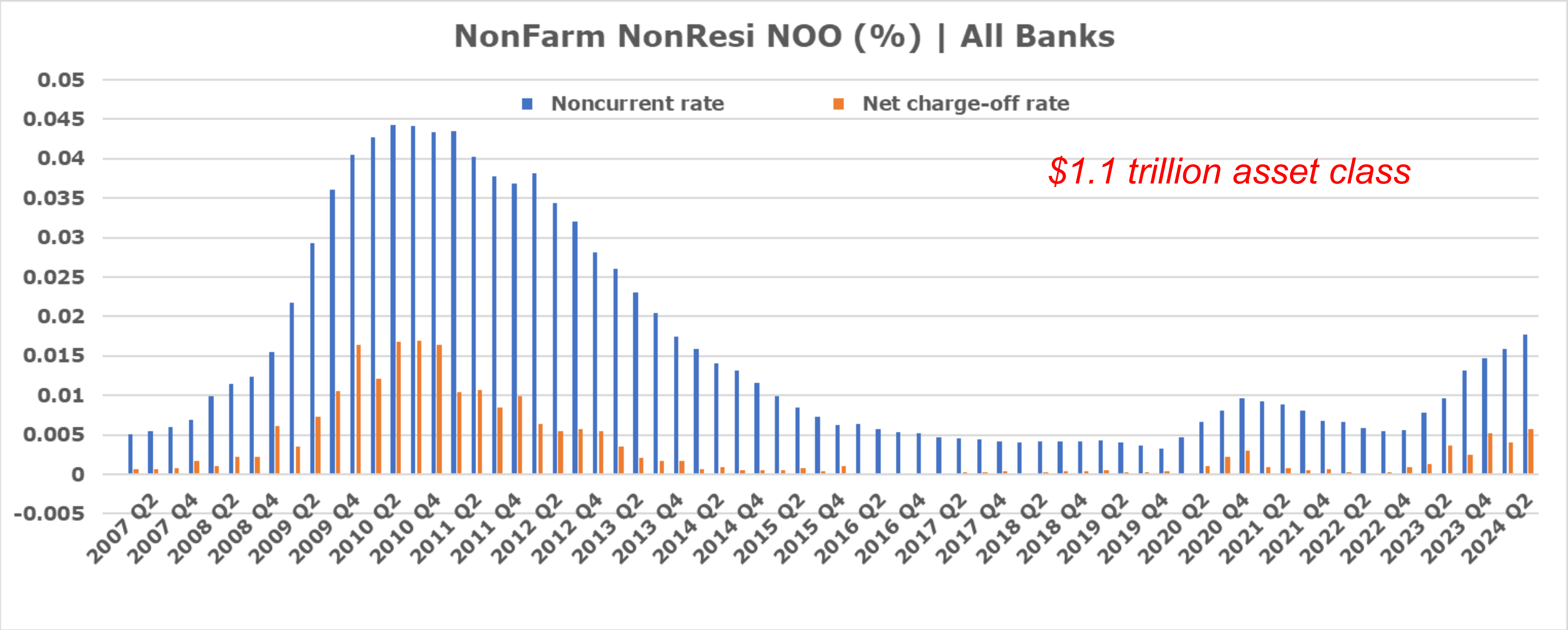
Multifamily Assets Lead Loss Severity on CRE

- Multifamily assets were the first loan category to normalize after COVID and the loss rates have hoovered near 100% net loss ever since that time. Rising levels of delinquency for the $600 billion in multifamily loans suggests that higher loss volumes and net loss rates lie ahead. Multifamily is one of those loan categories where net loss can be well more than the loan amount because of the cost of disposing of a moribund urban CRE property.



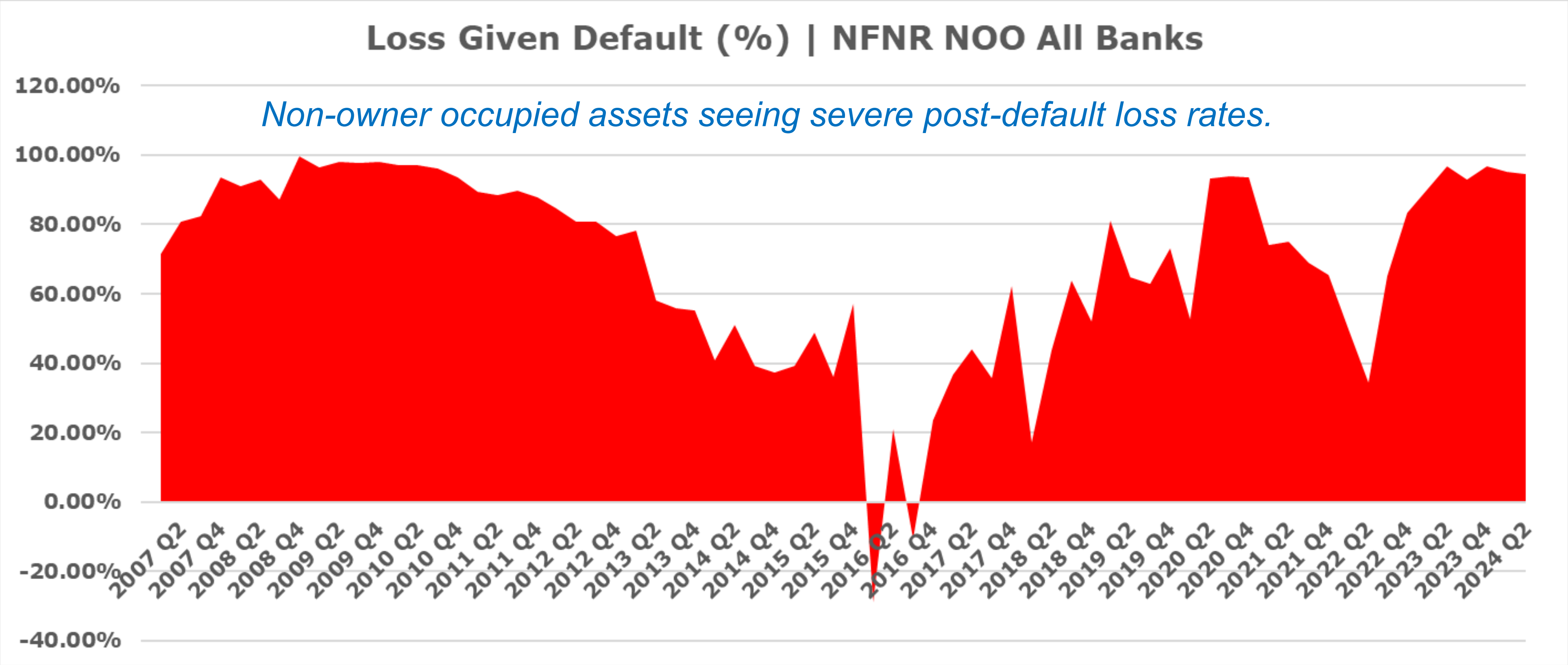
Source: FDIC/WGA LLC

NF NR Non-Owner Occupied CRE Loss Severity Rising



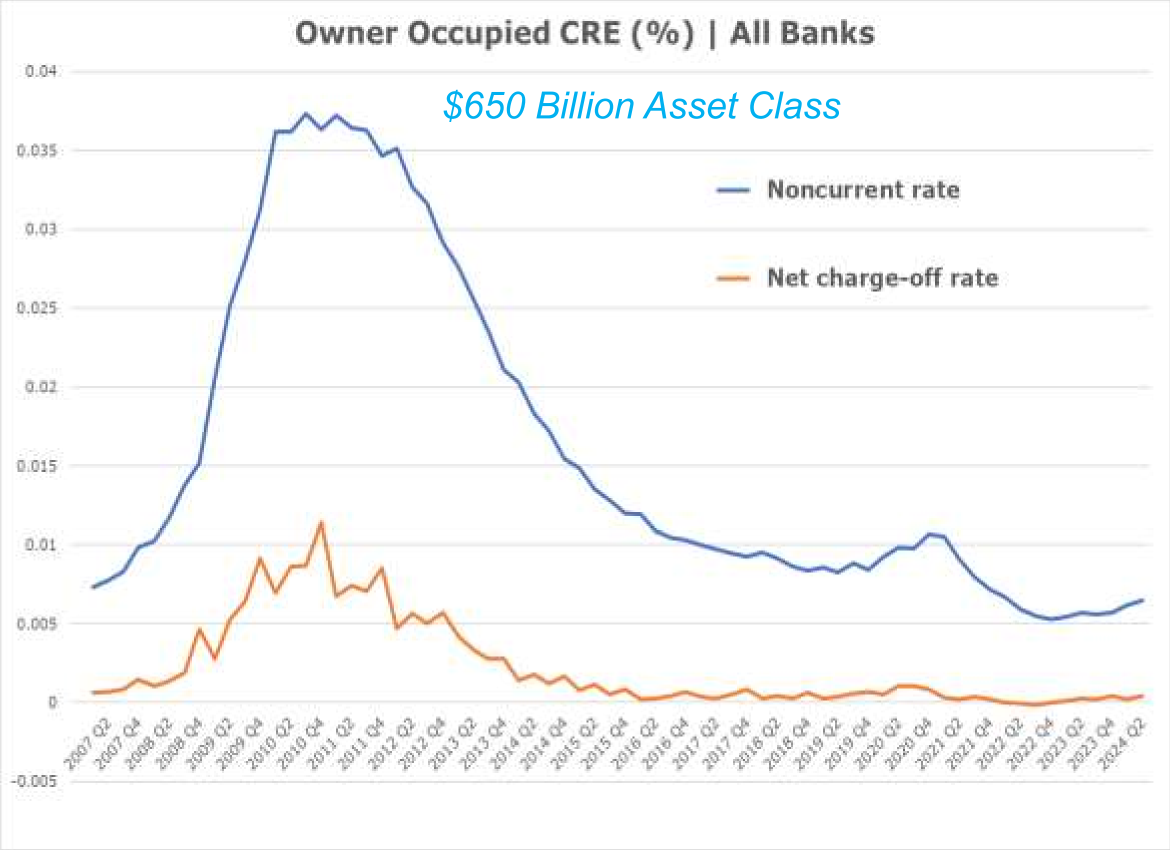
Source: FDIC

NonFarm NonResi NOO Loss Severity at 2008 Levels

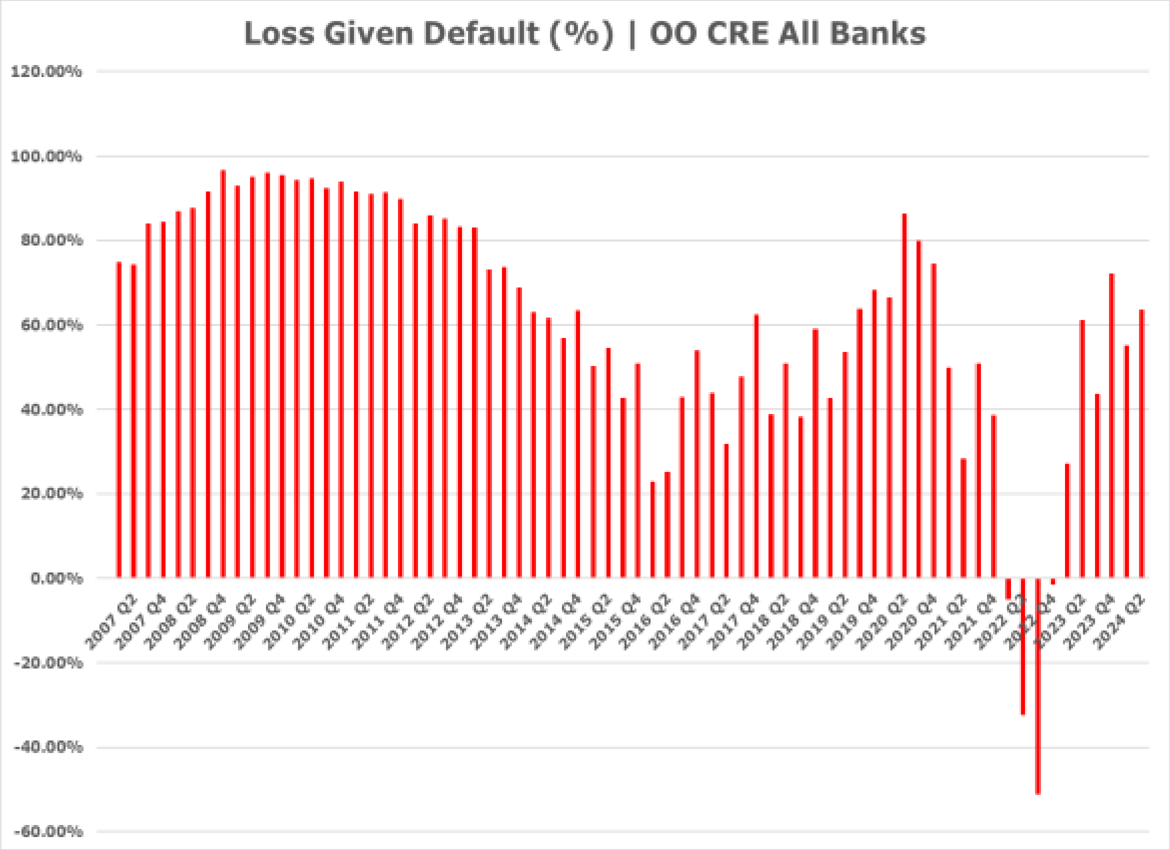


Source: FDIC/WGA LLC

Owner Occupied CRE Loss Rates Normalizing

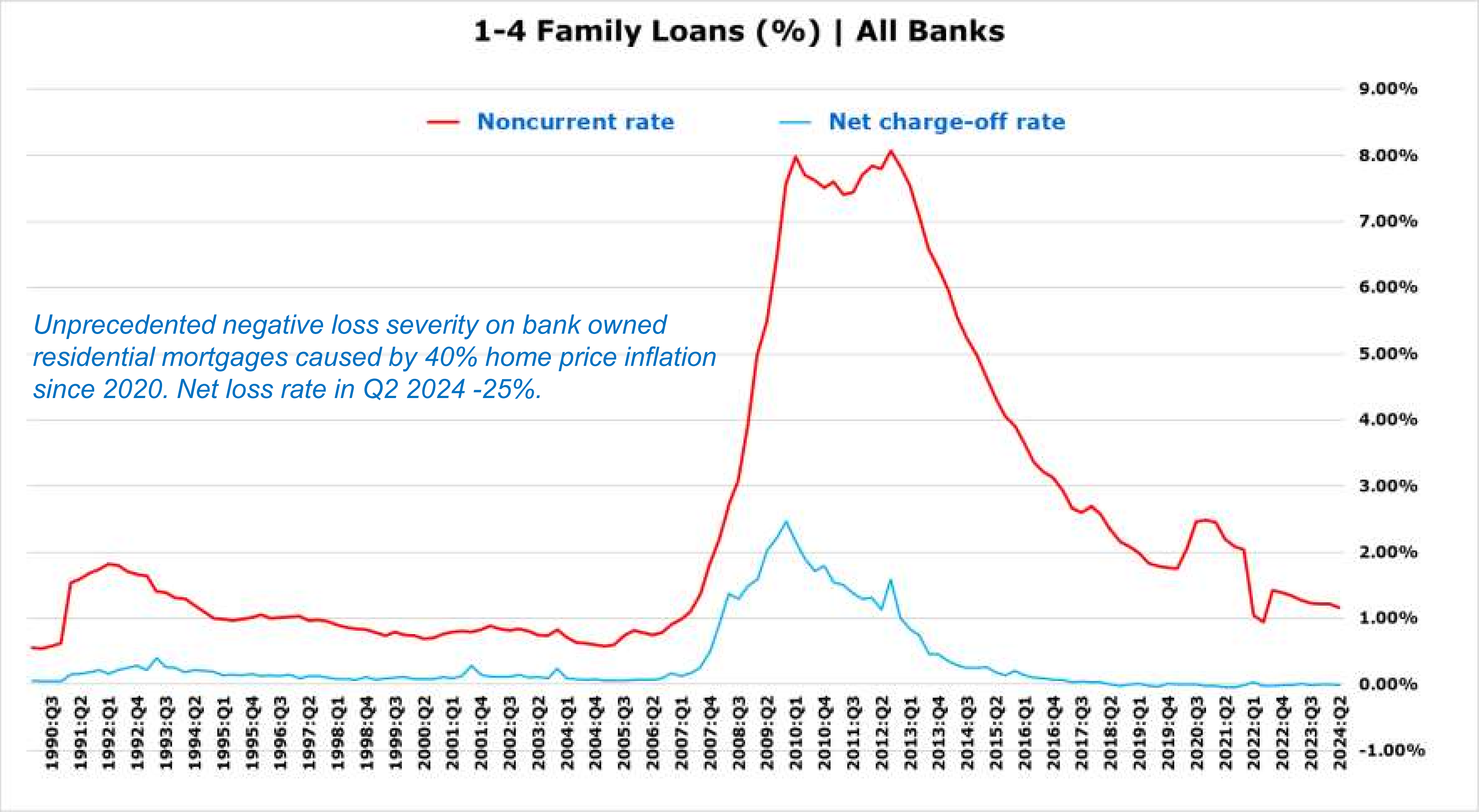


Source: FDIC

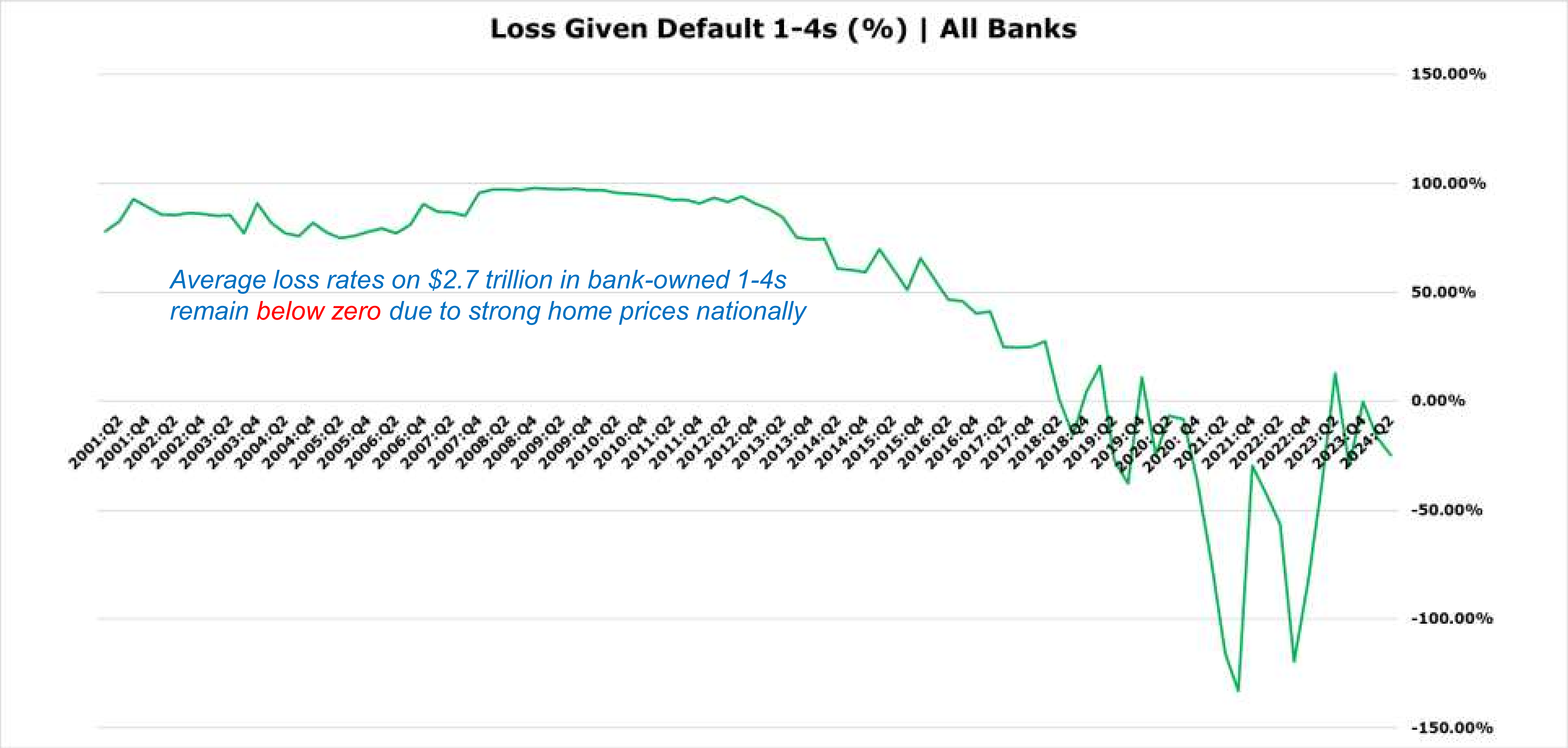


Source: FDIC/WGA LLC

Residential Mortgage Loans



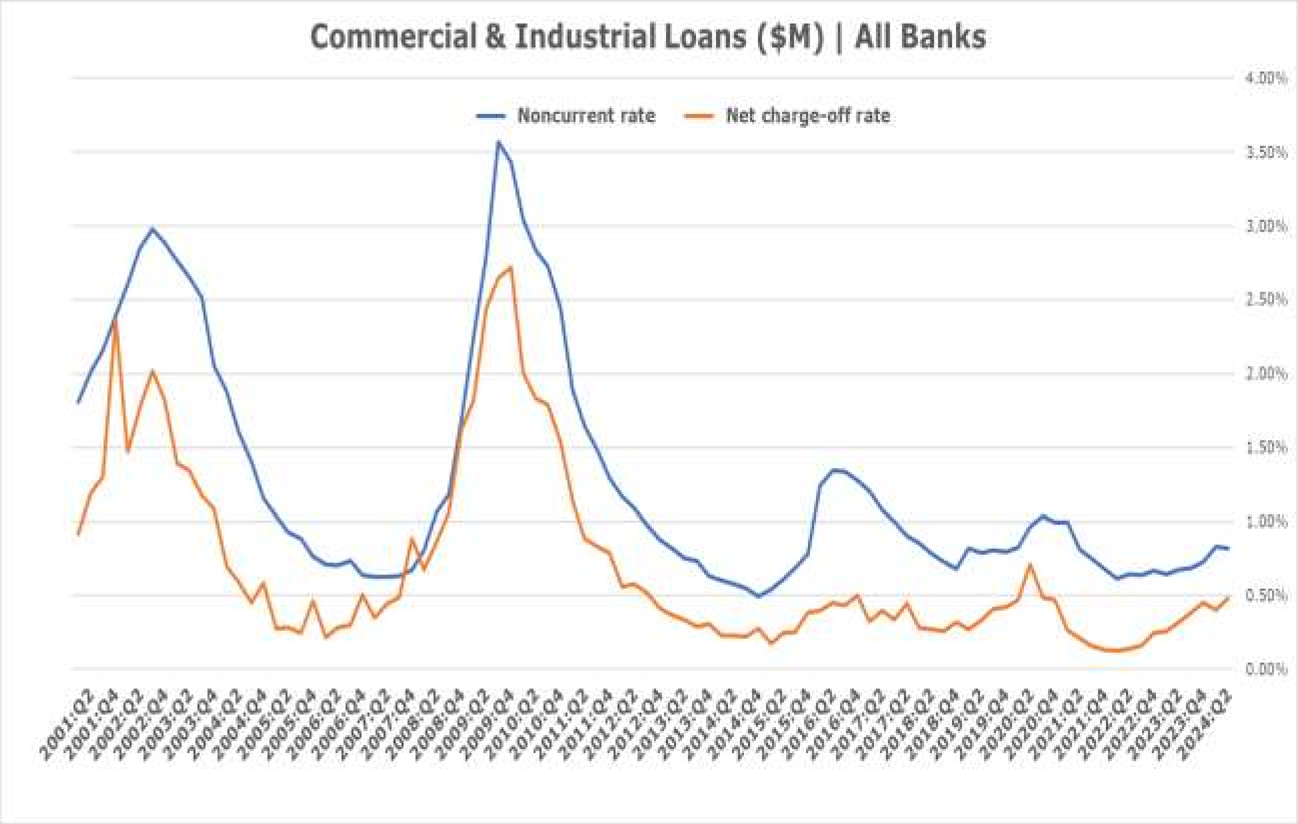
Residential Mortgage Loans



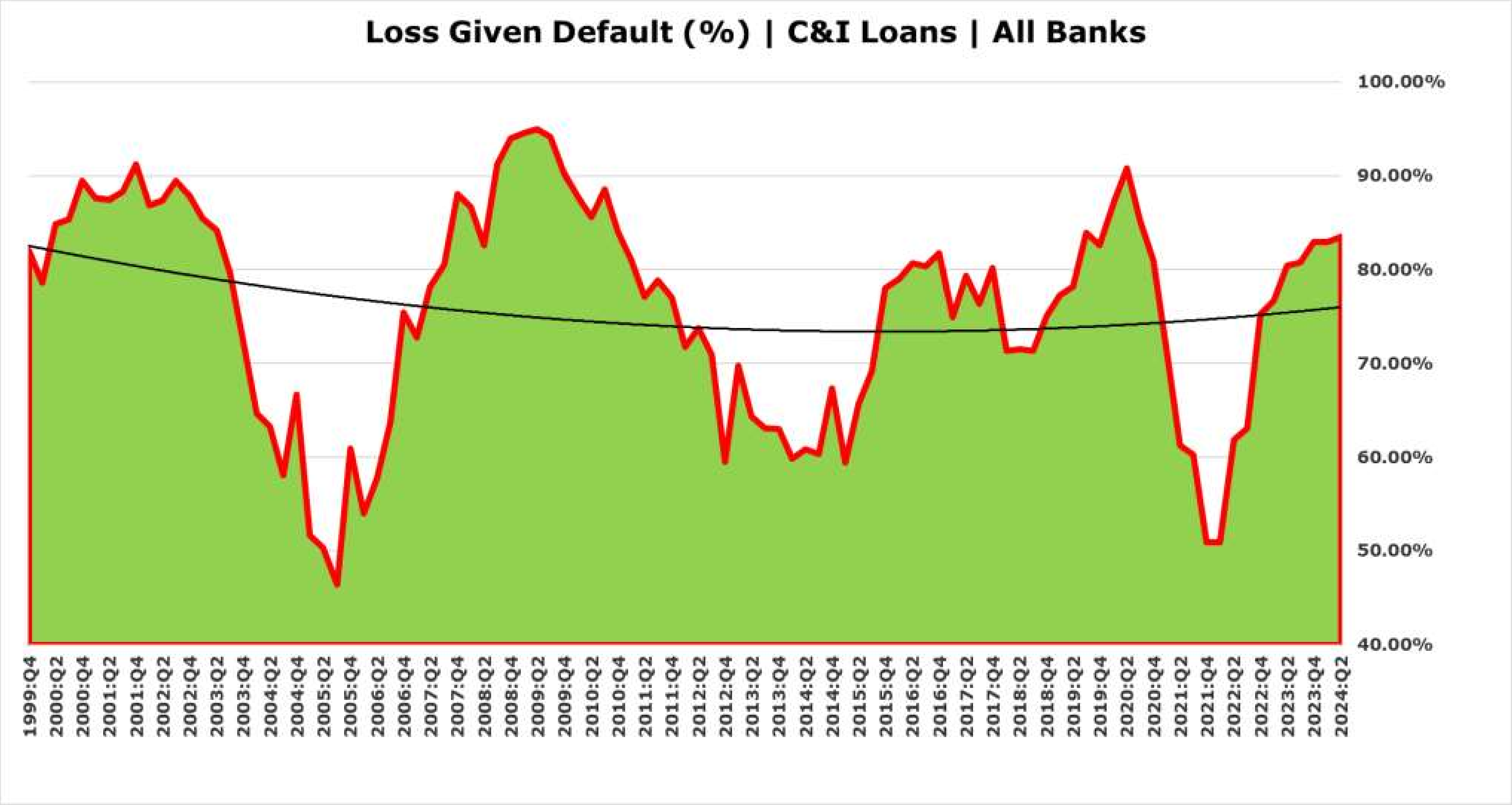
Source: FDIC/ WGA LLC

Commercial & Industrial Loans

- Unlike commercial real estate, the C&I category has normalized since COVID but is otherwise unremarkable. The $2.5 trillion asset C&I category shrank by 0.5% YOY.
- Commercial bankruptcy filings increased by more than a third in the first half of 2024, compared to the same period in 2023. There have been There have been a total of 346 total bankruptcy filings so far in 2024, which is "also higher than any comparable figure in the prior 13 years," says S&P Global.



Source: FDIC



Loss Given Default (%) | C&I Loans | All Banks
100.00%
90.00%
80.00%
70.00%
60.00%
50.00%
40.00%
1999:Q4
2000:Q2
2000:Q4
2001:Q2
2001:Q4
2002:Q2
2002:Q4
2003:Q2
2003:Q4
2004:Q2
2004:Q4
2005:Q2
2005:Q4
2006:Q2
2006:Q4
2007:Q2
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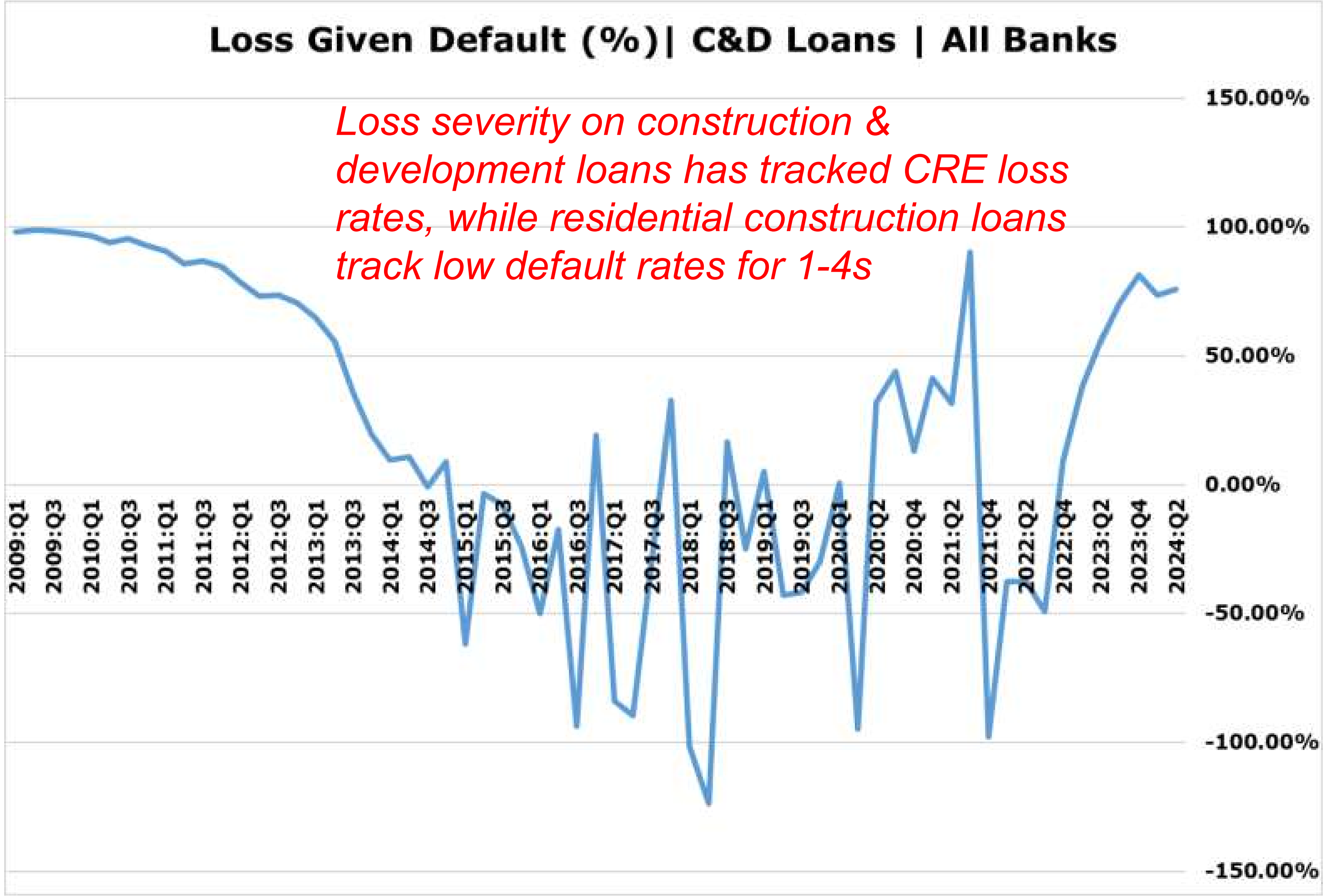
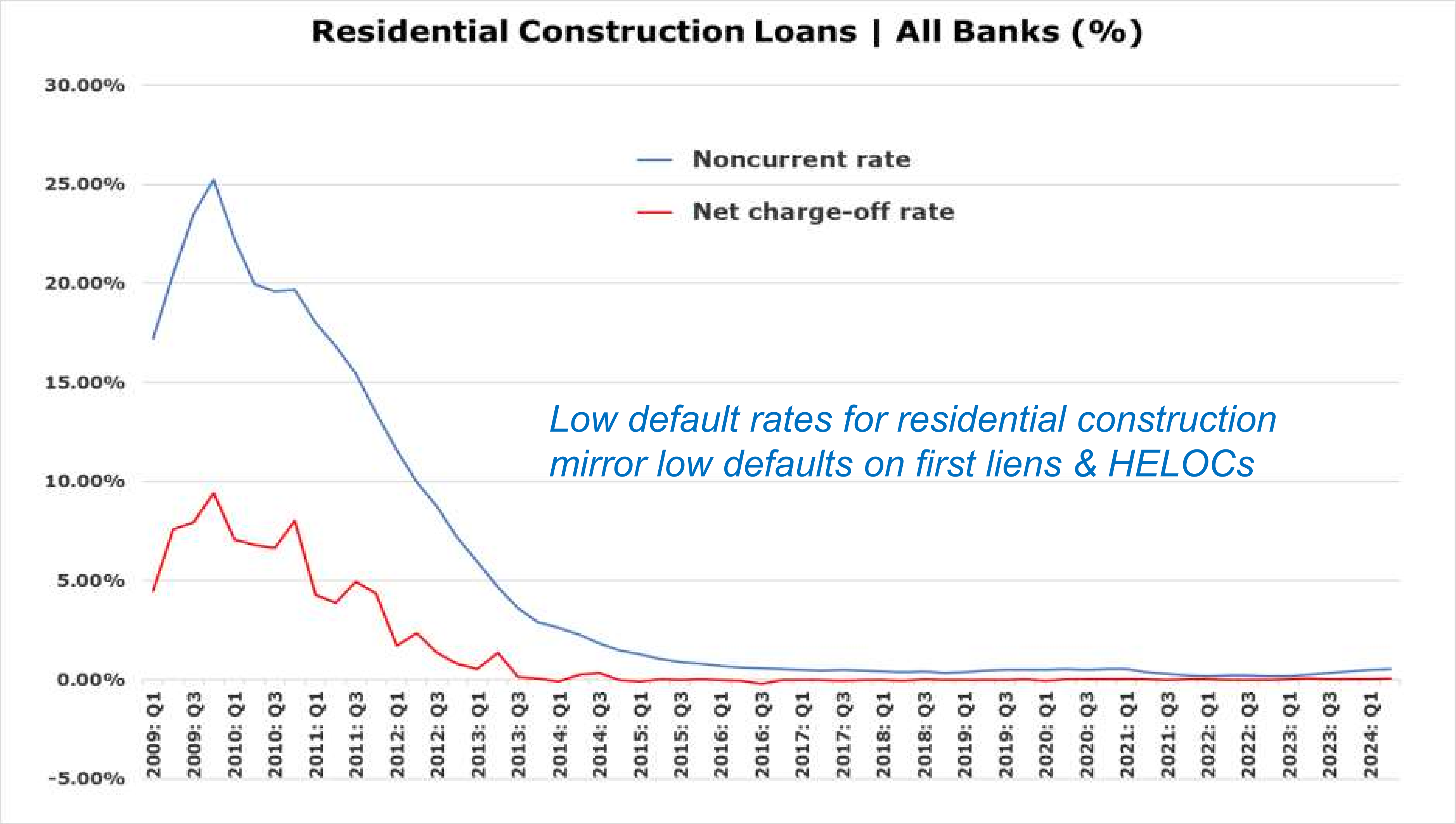
2019:Q4
2020:Q2
2020:Q4
2021:Q2
2021:Q4
2022:Q2
2022:Q4
2023:Q2
2023:Q4
2024:Q2

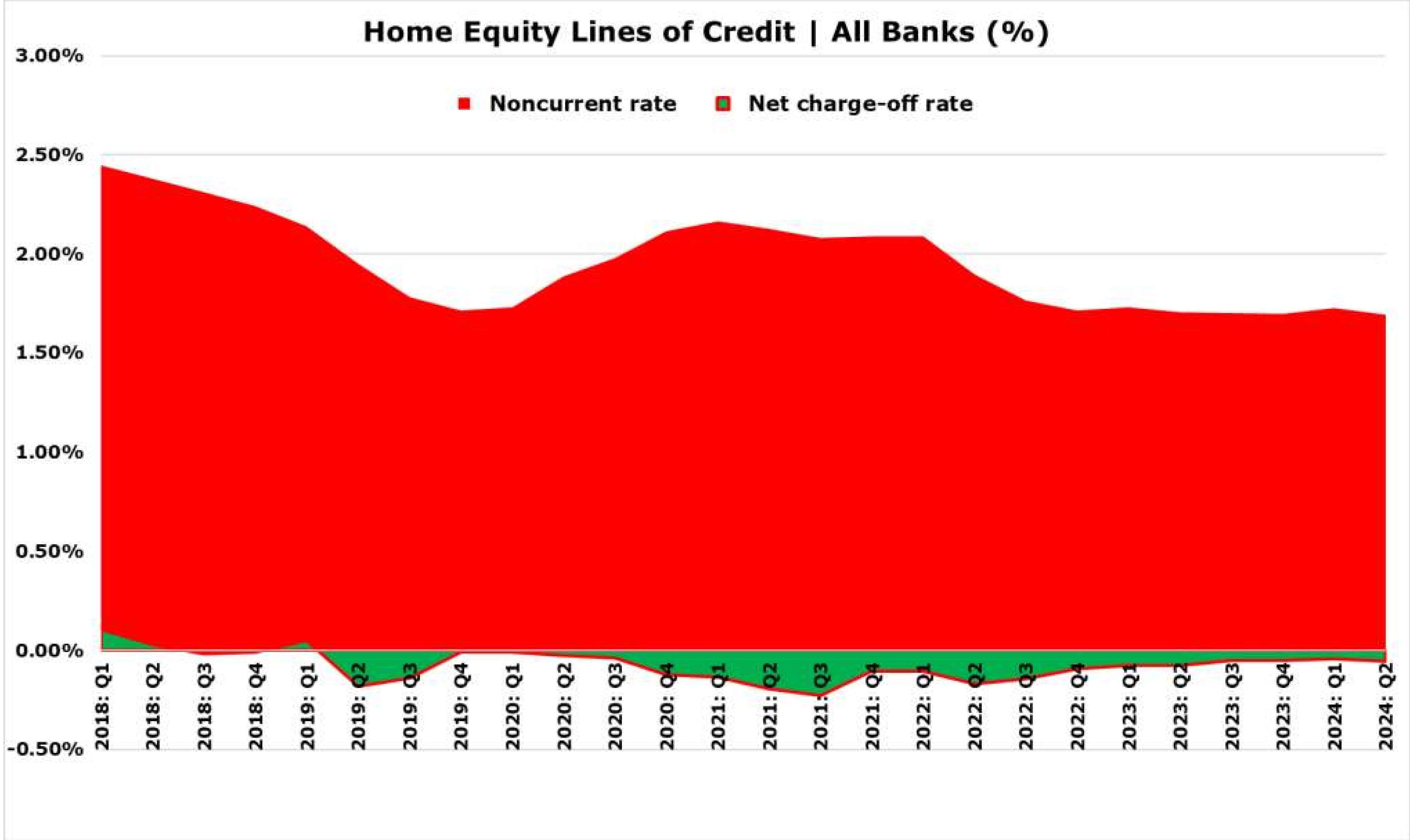
Source: FDIC



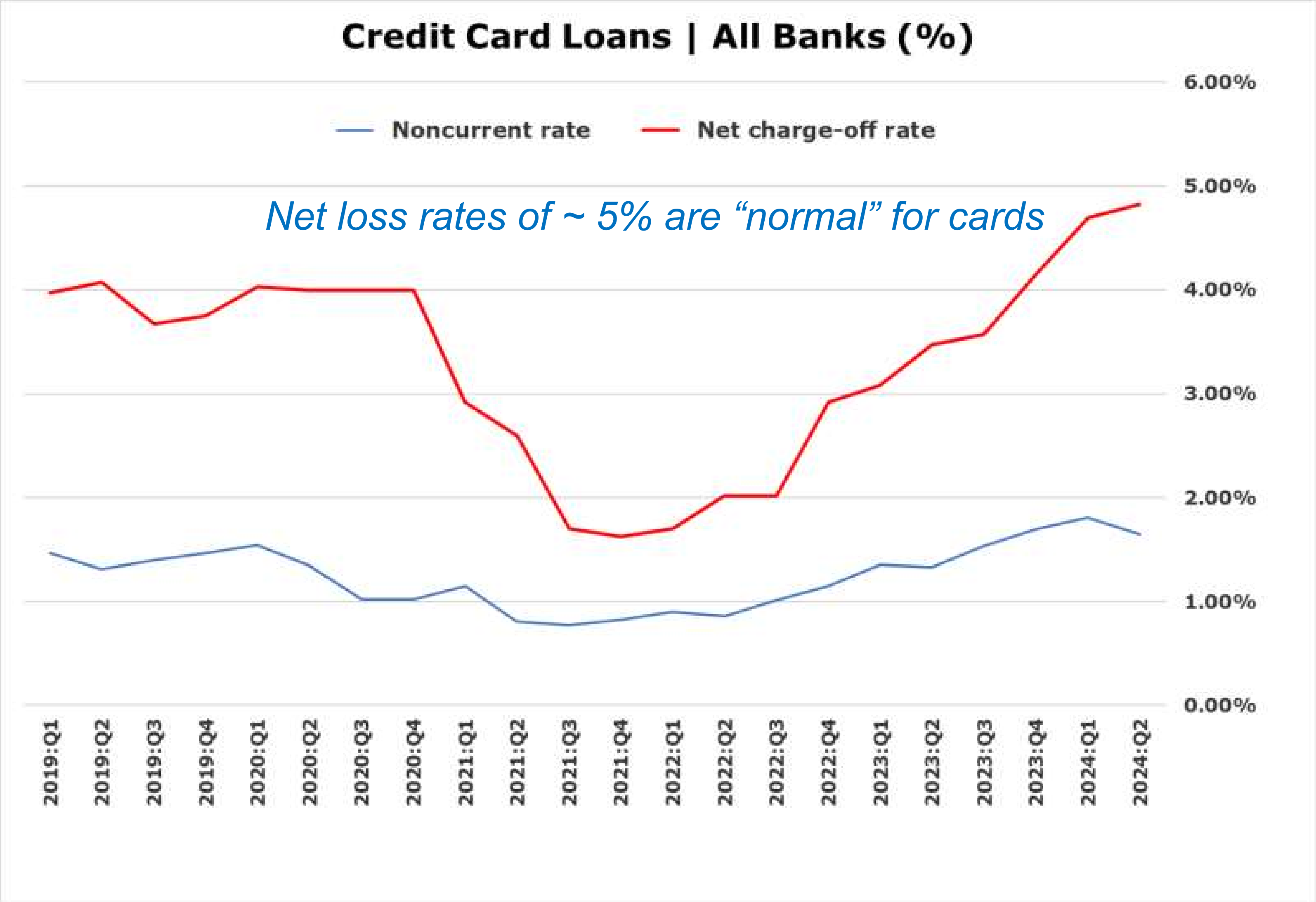
Source: FDIC/WGA LLC


Residential Construction Loans | All Banks (%)
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
-5.00%
Noncurrent rate
Net charge-off rate
Low default rates for residential construction mirror low defaults on first liens & HELOCs
2009: Q1
2009: Q3
2010: Q1
2010: Q3
2011: Q1
2011: Q3
2012: Q1
2012: Q3
2013: Q1
2013: Q3
2014: Q1
2014: Q3
2015: Q1
2015: Q3
2016: Q1
2016: Q3
2017: Q1
2017: Q3
2018: Q1
2018: Q3
2019: Q1
2019: Q3
2020: Q1
2020: Q3
2021: Q1
2021: Q3
2022: Q1
2022: Q3
2023: Q1
2023: Q3
2024: Q1

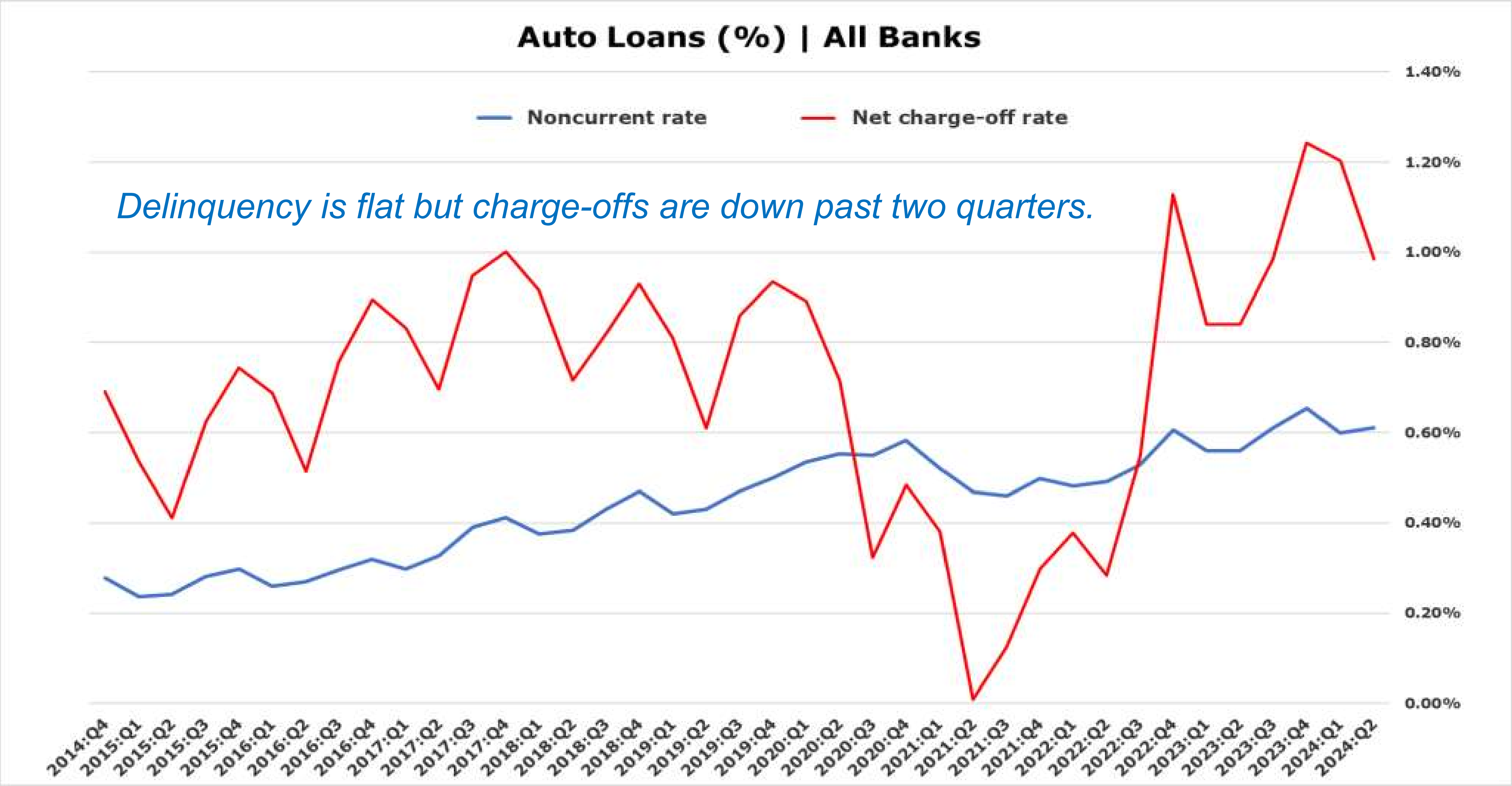
Source: FDIC


Home Equity Lines of Credit | All Banks (%)
Noncurrent rate
Net charge-off rate
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
-0.50%
2018: Q1
2018: Q2
2018: Q3
2018: Q4
2019: Q1
2019: Q2
2019: Q3
2019: Q4
2020: Q1
2020: Q2
2020: Q3
2020: Q4
2021: Q1
2021: Q2
2021: Q3
2021: Q4
2022: Q1
2022: Q2
2022: Q3
2022: Q4
2023: Q1
2023: Q2
2023: Q3
2023: Q4
2024: Q1
2024: Q2

Source: FDIC


Credit Card Loans | All Banks (%)
Noncurrent rate
Net charge-off rate
Net loss rates of ~ 5% are "normal" for cards
6.00%
5.00%
4.00%
3.00%
2.00%
1.00%
0.00%
2019:Q1
2019:Q2
2019:Q3
2019:Q4
2020:Q1
2020:Q2
2020:Q3
2020:Q4
2021:Q1
2021:Q2
2021:Q3
2021:Q4
2022:Q1
2022:Q2
2022:Q3
2022:Q4
2023:Q1
2023:Q2
2023:Q3
2023:Q4
2024:Q1
2024:Q2

Source: FDIC


Auto Loans (%) | All Banks
Noncurrent rate
Net charge-off rate
Delinquency is flat but charge-offs are down past two quarters.
1.40%
1.20%
1.00%
0.80%
0.60%
0.40%
0.20%
0.00%
2014:Q4
2015:Q1
2015:Q2
2015:Q3
2015:Q4
2016:Q1
2016:Q2
2016:Q3
2016:Q4
2017:Q1
2017:Q2
2017:Q3
2017:Q4
2018:Q1
2018:Q2
2018:Q3
2018:Q4
2019:Q1
2019:Q2
2019:Q3
2019:Q4
2020:Q1
2020:Q2
2020:Q3
2020:Q4
2021:Q1
2021:Q2
2021:Q3
2021:Q4
2022:Q1
2022:Q2
2022:Q3
2022:Q4
2023:Q1
2023:Q2
2023:Q3
2023:Q4
2024:Q1
2024:Q2

Source: FDIC

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Questions? Comments?