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Dimon calls time on trading – and higher loan provisions

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JPMorgan chief executive Jamie Dimon indicated that trading revenues could fall by 50% from their current elevated levels, but the boom has already helped to offset Covid-related loan provisions.

JPMorgan's Jamie Dimon expects trading revenues to fall sharply, possibly by as much as half

JPMorgan and Citigroup are the two biggest fixed income dealers and their second-quarter results on Tuesday confirmed another surge in debt trading revenues.

JPMorgan generated $7.3 billion of fixed income trading revenue for a 99% increase over the same quarter in 2019, while Citi produced $5.59 billion for a 68% rise.

The two banks were also beneficiaries of the Federal Reserve-sponsored boom in corporate bond issuance. JPMorgan's debt capital markets revenue rose by 55% compared with the second quarter of 2019, for a total of $1.26 billion, while Citi increased bond underwriting income by 41% to just over $1 billion.

> When things get bad in trading, spreads gap out – and all of sudden you're making money in trading
>
> \- Jamie Dimon, JPMorgan

JPMorgan's value-at-risk for its corporate and investment bank also increased sharply to $127 million, for a rise of 189% compared with the second quarter of 2019, and 119% compared with the first quarter of 2020.

The extra risk – almost all in higher fixed income exposure – seems to have been taken wisely, given that the increase in trading revenue was helped by what chief financial officer Jennifer Piepszak described as an ability "to better monetize flows", especially in macro products.

On an earnings call with analysts, chief executive Jamie Dimon explained the market backdrop with characteristic bluntness.

"When things get bad in trading, spreads gap out – and all of sudden you're making money in trading," he said.

Dimon also took time at the end of the call to volunteer that he does not expect the boom in trading revenue during the Covid crisis to continue, as market volumes were already showing signs of returning to normal seasonal levels towards the end of June.

"For trading, cut it in half and that will probably be closer to what will happen," he said.

Uncertainty

Dimon stressed that the economic outlook and the shape of a recovery remains uncertain and joined Piepszak in maintaining that JPMorgan does not currently envisage a need for a meaningful increase in provisions for loan losses in the third quarter.

That is the key question facing banks that can partly offset their losses from the economic strain of the Covid crisis with investment banking revenues.

JPMorgan added roughly $9 billion of new provisions for loan losses in its second-quarter results. Citi said its total provision was almost $8 billion.

They have both made hefty windfall profits from higher trading and underwriting volumes, however.

JPMorgan's total corporate and investment banking revenue for the first half of 2020 is around $6.4 billion higher than during the same period in 2019, while Citi has added almost $5 billion of incremental revenue for its institutional clients group.

There have been boosts from a variety of sources that might have seemed unlikely as the Covid crisis developed momentum in the first quarter of the year.

Decisive steps from central banks, led by the Federal Reserve, to support asset prices and liquidity resulted in an unprecedented financing surge that was not limited to bond sales.

Equity issuance also boomed, especially for convertible deals, which played to one of JPMorgan's strengths and helped to drive an increase in its equity capital markets revenue of 93% in the second quarter, compared with 2019, and an increase for the first half of the year of 70% to a total of $1.3 billion.

Key divisions

Debt underwriting is normally a fairly pedestrian business that might seem an unlikely source of windfall profit, but it is an important revenue contributor to a bank like Citi.

Last year, DCM generated almost $3 billion of revenue for Citi, which was the majority of its total advisory and underwriting revenue of just over $5 billion, for example.

This year Citi has already seen $1.82 billion of debt underwriting revenue for a 19% increase compared to the first half of 2019 – in a rise that is not spectacular but will nevertheless be welcome.

And at just over $10 billion for the first half of this year, Citi has already generated most of the roughly $12 billion of total revenue it has seen in most recent years for fixed income trading, which seems guaranteed to outpace treasury and trade solutions in 2020, another key division that typically contributes about $10 billion a year.

> I wouldn't completely rule [share buybacks] out in the fourth quarter
>
> \- Jamie Dimon

Losses and provisions for 2021 remain unpredictable, given uncertainty about the ongoing impact of the health crisis.

But there seems unlikely to be any short-term pressure on the capital adequacy of the biggest US banks, which should allow the payment of dividends.

JPMorgan confirmed on its earnings call that it will continue to pay dividends, and Dimon even mischievously raised the possibility of a resumption of share buybacks this year.

"I wouldn't completely rule it out in the fourth quarter," he said.

The approach of a possible Democratic administration that may secure both the presidency and control of Congress after the US elections in November is likely to restrain rival senior bank executives from following Dimon in dangling the revival of share buybacks in front of investors.

Senator Elizabeth Warren and other leaders of the reformist wing of the party are unlikely to abandon efforts to curb buybacks if they finally get a chance to pass financial market legislation, after all.

That could undermine the potential appeal to shareholders of banks such as Morgan Stanley that appear to have enough capital to make large returns to shareholders (central bank support for asset prices has also helped to bolster the performance of banks including Morgan Stanley with big wealth management businesses).

There are enough pockets of outperformance among different banks to encourage near term optimism among investors, however. The decision by Goldman Sachs to maintain commodity trading scale has generated a revenue windfall from the highly stressed markets in oil and other energy sources, for example.

And even some European banks that have struggled to defend investment banking market share from much bigger US firms are seeing benefits from the trading and financing bonanza.

Jamie Dimon may be trying to sell the market a dummy with his forecast that trading revenues will fall by half from their current elevated levels – as a prelude to a pleasant third quarter "surprise".

The dealing boom has nevertheless already gone a long way to offsetting the cost of higher loan provisions.

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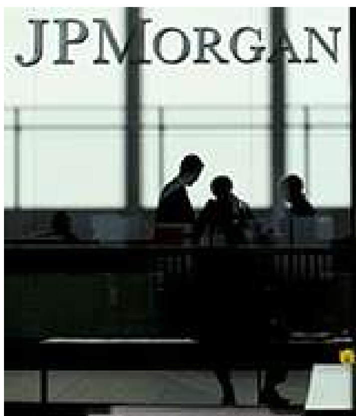

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