JPMorgan Chase 3Q20 Earnings Analysis

The earnings season started yesterday with JPMorgan Chase reporting third quarter earnings, which were better than expected.

JPMORGAN CHASE (JPM)

Net revenue on a reported basis was $29.1 billion, $33.0 billion, and $29.3 billion for the third quarter of 2020, second quarter of 2020, and third quarter of 2019, respectively.

Results for JPM				2Q20		3Q19	
($ millions, except per share data)	3Q20	2Q20	3Q19	$ O/(U)	O/(U) %	$ O/(U)	O/(U) %
Net revenue - managed	$ 29,941	$ 33,817	$ 30,014	$ (3,876)	(11)%	$ (73)	— %
Noninterest expense	16,875	16,942	16,372	(67)	—	503	3
Provision for credit losses	611	10,473	1,514	(9,862)	(94)	(903)	(60)
Net income	$ 9,443	$ 4,687	$ 9,080	$ 4,756	101 %	$ 363	4 %
Earnings per share	$ 2.92	$ 1.38	$ 2.68	$ 1.54	112 %	$ 0.24	9 %
Return on common equity	15 %	7 %	15 %				
Return on tangible common equity	19	9	18				

We can see a great improvement from last quarter, as the provision for credit losses falls to $611 million. This also shows that the economy is recovering (or that the Fed printing money is working). We will need to look a little deeper to really understand what these earnings mean for the economy.

CONSUMER & COMMUNITY BANKING (CCB)

Results for CCB				2Q20		3Q19	
($ millions)	3Q20	2Q20	3Q19	$ O/(U)	O/(U) %	$ O/(U)	O/(U) %
Net revenue	$ 12,755	$ 12,217	$ 13,958	$ 538	4 %	$ (1,203)	(9)%
Consumer & Business Banking	5,557	5,107	6,782	450	9	(1,225)	(18)
Home Lending	1,714	1,687	1,465	27	2	249	17
Card & Auto	5,484	5,423	5,711	61	1	(227)	(4)
Noninterest expense	6,770	6,626	7,025	144	2	(255)	(4)
Provision for credit losses	794	5,828	1,311	(5,034)	(86)	(517)	(39)
Net income/(loss)	$ 3,873	$ (176)	$ 4,245	$ 4,049	NM	$ (372)	(9)%

Slight improvement in Consumer and Community Banking confirms that the economy is recovering.

CORPORATE & INVESTMENT BANK (CIB)							
Results for CIB				2Q20		3Q19	
($ millions)	3Q20	2Q20	3Q19	$ O/(U)	O/(U) %	$ O/(U)	O/(U) %
Net revenue	$ 11,503	$ 16,352	$ 9,522	$ (4,849)	(30)%	$ 1,981	21 %
Banking	3,709	5,027	3,485	(1,318)	(26)	224	6
Markets & Securities Services	7,794	11,325	6,037	(3,531)	(31)	1,757	29
Noninterest expense	5,797	6,764	5,504	(967)	(14)	293	5
Provision for credit losses	(81)	1,987	92	(2,068)	NM	(173)	NM
Net income	$ 4,304	$ 5,464	$ 2,831	$ (1,160)	(21)%	$ 1,473	52 %

Compared to last quarter, Corporate and Investment banking is doing worse as the Fed has now limited their intervention and even the stock market growth has slowed down a little. But overall, we can say that things are getting back to normal.

We're not going to look at other business segments as there is nothing interesting to note.

3Q20 Financial results[1]

$B, except per share data

		$ O/(U)	
	3Q20	2Q20	3Q19
Net interest income	$13.1	($0.8)	($1.2)
Noninterest revenue[2]	16.8	(3.0)	1.2
Managed revenue[1,2]	29.9	(3.9)	(0.1)
Expense[2]	16.9	(0.1)	0.5
Credit costs	0.6	(9.9)	(0.9)
Reported net income	$9.4	$4.8	$0.4
Net income applicable to common stockholders	$9.0	$4.8	$0.4
Reported EPS	$2.92	$1.54	$0.24
ROE[3]	15%	7%	15%
ROTCE[3,4]	19	9	18
Overhead ratio – managed[1,3]	56	50	55
Memo: Adjusted expense [5]	*$16.4*	*($0.5)*	*($0.0)*
Memo: Adjusted overhead ratio [1,3,5]	*55%*	*50%*	*55%*

$B	3Q20	2Q20	3Q19
Net charge-offs	$1.2	$1.6	$1.4
Reserve build/(release)	(0.6)	8.9	0.1
Credit costs	$0.6	$10.5	$1.5

3Q20 Tax rate
Effective rate: 19.0%
Managed rate: 24.2%[1,6]

3Q20	ROE	O/H ratio
CCB	29%	53%
CIB	21%	50%
CB	19%	42%
AWM	32%	70%

It seems that JPMorgan Chase is back to where it was last year, before the recession. ROE is back to 15% even if interest rates are lower now than they were a year ago.

3Q20 Reserves

Allowance for credit losses ($B)[1]

	12/31/2019	CECL adoption impact	1H20 Build/(release)	6/30/2020	3Q20 Build/(release)	9/30/2020
Consumer						
Card	$5.7	$5.5	$6.7	$17.8	$0.0	$17.8
Home Lending	1.9	0.1	1.2	3.2	(0.3)	2.9
Other Consumer[2]	0.7	0.3	0.9	1.9	(0.1)	1.8
Total Consumer	8.3	5.9	8.8	22.9	(0.4)	22.5
Wholesale[2]	6.0	(1.6)	7.0	11.4	(0.3)	11.1
Securities	N/A	0.0	0.0	0.0	0.1	0.1
Firmwide	$14.3	$4.3	$15.7	$34.3	($0.6)	$33.8

U.S. unemployment rate[3]

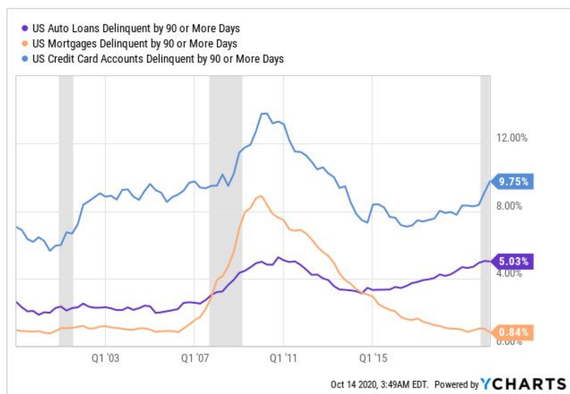
Base Case Outlook at:	4Q20	2Q21	4Q21
1Q20	6.6%	5.5%	4.6%
2Q20	10.9%	9.0%	7.7%
3Q20	9.5%	8.5%	7.3%

U.S. real GDP – cumulative change[4]

Base Case Outlook at:	4Q20	2Q21	4Q21
1Q20	(5.4%)	(2.3%)	0.3%
2Q20	(6.2%)	(4.0%)	(3.0%)
3Q20	(5.4%)	(3.7%)	(2.4%)

Key drivers/statistics ($B) – detail by business

	3Q20	2Q20	3Q19
Consumer & Business Banking			
Business Banking average loans[5]	$44.4	$38.7	$24.2
Business Banking loan originations[6]	1.4	23.0	1.6
Client investment assets (EOP)	376.1	356.1	337.9
Deposit margin	1.43%	1.52%	2.47%
Home Lending			
Average loans[4]	$192.2	$199.5	$226.1
Loan originations[7]	29.0	24.2	32.4
EOP total loans serviced	654.0	683.7	774.8
Net charge-off/(recovery) rate	0.02%	(0.01)%	(0.08)%
Card & Auto			
Card average loans	$140.4	$142.4	$158.2
Auto average loans and leased assets	82.0	82.9	83.1
Auto loan and lease originations	11.4	7.7	9.1
Card net charge-off rate	2.92%	3.33%	2.95%
Credit Card net revenue rate[2]	10.96	11.02	10.40
Credit Card sales volume[8]	$178.1	$148.5	$193.6



Most of the delinquencies come from the credit card business segment as delinquency rates increase. However, they have been able to minimize the losses.

However, JPMorgan Chase has been preparing for a rainy day with their Fortress Balance Sheet.

Fortress balance sheet

$B, except per share data	3Q20	2Q20	3Q19
Risk-based capital metrics[1]			
CET1 capital	$198	$191	$188
Basel III Standardized			
CET1 capital ratio	13.0%	12.4%	12.3%
Risk-weighted assets	$1,517	$1,541	$1,528
Basel III Advanced			
CET1 capital ratio	13.8%	13.2%	13.1%
Risk-weighted assets	$1,431	$1,451	$1,436
Leverage-based capital metrics[2]			
Firm SLR (3Q20 Firm SLR excluding temporary relief[2]: 5.8%)	7.0%	6.8%	6.3%
Total leverage exposure	$3,247	$3,228	$3,405
Liquidity sources[3]			
HQLA and unencumbered marketable securities	$1,330	$1,257	$849
Balance sheet metrics			
Total assets (EOP)	$3,246	$3,214[4]	$2,765
Tangible book value per share[5]	$63.93	$61.76	$60.48

There's actually improvements from last year as far as the CET1 Capital Ratio is concerned, JPMorgan Chase wants to be a little more concervative than usual as there's a lot of uncertainties ahead.

Let's look at what was discussed during the conference call.

Matthew O'Connor

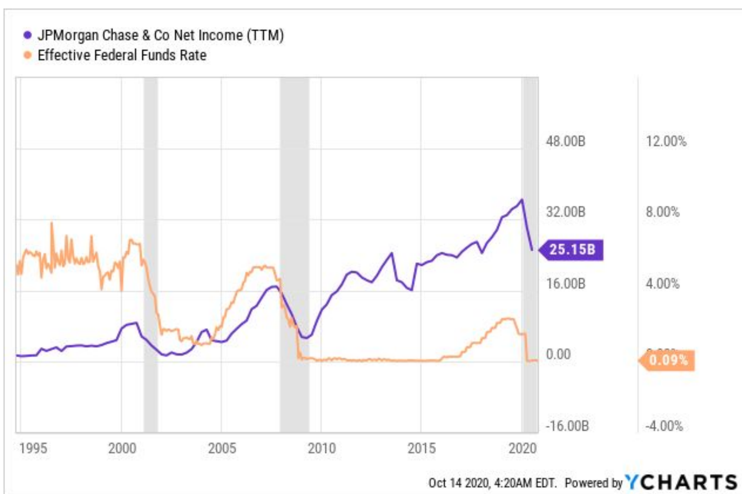
Good morning. So, I think one of the key questions on investors' minds right now is how will banks grow revenue kind of medium-term here as we think about lower-for-longer rates? And I was hoping you could just talk about how you think about managing the company if rates stay very low for a long time and how you can grow revenue. And obviously, year to date, the revenue has been very good, up 4%. And if you could [just reason] the branch expansion that you alluded to in the comments as part of that answer, that would be helpful? Thank you.

Jennifer Piepszak

Sure. So, in terms of how we think about the revenue outlook for 2021, first of all, it's early and we'll come back to you in the first quarter with more details, but it is true that if we think about the NII outlook that that will be under pressure relative to 2020 and I can't give more detail on that. But also, we are on pace for record revenue in markets and investment banking, and so that will be a tough compare.

Having said that, we're not going to change the way we run the company because of what might be temporary rate headwinds, and we see significant franchise value in the growth that we're seeing in the deposit base. And with that branch expansion – we are continuing on our plans in branch expansion. We have, I think, almost a 120 branches open in our expansion markets. We'll do more than another 150 so far this year. We got approval to enter 10 additional states, which we'll ultimately put us in all lower 48. So, we continue with the branch expansion and remain very excited about it with those new branches, in most cases, performing well above the original business case.

CFO Jennifer Piepszak answered one of the most interesting questions, how the bank intends to keep growing in a low interest rate environment?



While it is true that generally, higher interest rates are better for banks, including JPMorgan Chase, net income has been increasing nevertheless with zero interest rates from 2008 to 2015. That's mainly because of their expanding business. As Jennifer Piepszak pointed out, they got approval to enter 10 more states. Wells Fargo is in decline and JPMorgan Chase and Bank of America are here to take market share.

Mike Mayo

And I know this is a tough question, but you're in the middle of the stress test part two. When all is said and done, Jamie or Jen, where do you think these charge-offs go as a percentage of the global financial crisis? You have to have – I know you have scenarios, but where should we think – is it like half the GFC level, same as GFC level, twice the GFC level? What are you guys thinking at the back of your mind?

Jennifer Piepszak

It's a very difficult question to answer. It's very different, of course, because the GFC was heavily mortgage-related, and this will probably be less so. We also – our portfolios are in significantly better shape coming into this, whether it's mortgage or card. But just given the amount of uncertainty about where this could go, we still have 12 million people unemployed, I think it's very difficult. I don't know, Jamie, whether you would add.

Jamie Dimon

It's very hard – I agree with you, Jen. It's very hard to say. And, Mike, it depends on the outcome. Again, we look at the good case, the medium case, the relative adverse case and the extreme adverse case. And there, the answers are completely different, and we don't know the future. So it's hard to predict what it's going to be. But our reserves are prepared for relative to the adverse case, which is equal to the – roughly equivalent to CCAR extreme adverse case that we just got, roughly. Again, it's very hard to compare apples-to-apples in these things.

Like we said, they are being rather conservative because of all the uncertainties lying ahead but knowing Jamie Dimon, he's always thinking long-term.

Jamie Dimon

So, Jen, I just want to say that we're not going to do anything to protect the NII. We have $300 billion of cash we can invest today, and that becomes 400 billion. We're not going to invest it in stuff making 50, 60 or 70 basis points, so we get to see a teeny little bit more of NII. But we're going to make long-term decisions for the company. And if your NII gets squeezed a little bit, so be it. But we don't want to be in a position where we lose a lot of money because you may invest in some 5-year or 10-year securities, which you'll lose a lot if rates go up. So, we're not protecting NII.

For example, he would rather sacrifice earnings than endanger the financial stability of the Fortress in the long-term.

Jim Mitchell

Hey. Good morning. Maybe just a question on deposit growth, I think we've all been surprised at the continued growth. Can you just kind of talk to what you're seeing? It looked like we had further growth in September. Are you expecting this to continue? Is it sort of moving out of money markets into deposits? What do you think is driving the growth? And do you expect it to continue?

Jennifer Piepszak

Sure. So, there's no doubt that with the Fed being this active that there is significant excess liquidity in the system. We did think that we would see deposits normalized in the third quarter, both on consumer spending on the consumer side and then on just the wholesale side in places like security services, with asset managers holding cash on the sidelines. We didn't what we thought we would. So yes, we did continue to see deposit growth here in the third quarter.

Going forward, I think that normalization is still just very much a part of our outlook except for that. Given that the normalization is a bit deferred here, it will likely be offset by the continued organic growth, perhaps more than offset by continued organic growth.

The last interesting question was a confirmation on what we already hypothesized, the reason why we're seeing such a fast recovery is the Fed printing money. Jamie Dimon even said that if there are no more stimulus, there may be higher delinquency rates ahead.

To conclude, I'll say that JPMorgan Chase still looks strong even with this pandemic and recession and I'm still very bullish on this stock, which is still cheap right now.

14th of October 2020