SECOND QUARTER 2024

Banking earnings season kicks off.

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Major U.S. banks have begun reporting their second-quarter earnings. We examine the latest numbers to see what, if any, effect higher interest rates have had on some of the world's largest lending institutions.

Mixed earnings for banks

Earnings season commenced with Citigroup, JP Morgan, and Wells Fargo leading the charge. We were looking for these banks to provide guidance regarding the impact of higher-for-longer interest rates on their balance sheets and the effect of these higher rates on consumers, particularly on their spending habits. We remain vigilant for weakness in the banking system, as demonstrated through deposit levels, net interest income, and investment banking fees.

Balance sheet buffers

According to the Federal Deposit Insurance Corporation, banks are sitting on over $500 billion dollars in balance sheet losses. In a perfect world, banks should never have to realize these losses, the bonds would just mature. Of course we don't live in a perfect world, and if banks get into trouble they may need to sell at depressed prices to shore up their balance sheets. Concerns are also bubbling around banks' asset quality and loan growth due to the higher-for-longer interest-rate environment. To date, banks have shown resiliency, but the earnings reports provided a mixed message despite all three banks outperforming their earnings estimates, as shown in Exhibit 1.

Exhibit 1: Banks beat estimates

Bank	Reported earnings	Estimated earnings
Citigroup	$1.52	$1.40
JP Morgan	$1.33	$1.29
Wells Fargo	$6.12	$5.41

Source: Bloomberg. Data as of 7/12/2024

A sampling of results

Among the banks eligible for consideration in our portfolios, a summary of recent results includes:

Citigroup: Revenue exceeded estimates—$5.09 billion versus $4.75 billion—while costs rose at the bank, similar to its peers. Equity sales and trading showed strength, while FICC (Fixed Income, Currency and Commodities) fell short. The U.S. personal banking division and wealth divisions both showed strength with more room to grow.

JP Morgan: JP Morgan's net income was up 25%, earning $18.1 billion for the quarter. Profits jumped on equity trading revenue up 21%, while investment banking also contributed to results. Meanwhile, net interest income was only up 4%, falling short of analyst expectations.

Wells Fargo: Wells Fargo is slowly emerging from a myriad of issues dating back to 2016. Despite the modest earnings beat some issues remained as expenses rose 2% to $13.3 billion, versus an expected 0.2% increase. The bank's net interest income fell to its lowest level in two years. Similar to its peers, the bright spot was within the investment banking unit as markets rallied in the quarter.

Broadly speaking, banks continue to post results that show business remains good and on solid footing. There are pockets of weakness within the sector as expenses remain high and consumers begin to run out of discretionary spending money. Banks will need to grapple with this weakness and figure out how to manage through the changing landscape—a task that they have done before.

Our portfolios

We prefer bonds issued by the larger, money-center banks with more broadly diversified sources of revenue opportunities. Notably, this is one of the few corporate bond sub-sectors to outperform in the second quarter. Conversely, we are largely avoiding regional and super-regional banks, which still face a hangover from the bank failures in 2023—and continue to suffer from lingering doubts from as far back as 2008—in addition to continued headwinds from interest rates and rising delinquencies.