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Analysis by Ramsden (Banor Capital): too much pessimism

"The US banks? At a discount"

Good risk/return ratio. "They're beating the Europeans"

Two weeks from the mid-year mark, Wall Street has confirmed its position as best of the major financial markets, with the S&P 500 index firmly in command at +3.5%. The American financial giants, however, are tagging along behind the lines: from Morgan Stanley (-16%) to Goldman Sachs (-14%), from Bank of America (-14%) to Citi (-11%), the major merchant banks are preparing to file the semester away under an unlovely minus sign.

"Each time the shares of the big banks fall, investors find themselves wondering if we're in for another 2008. There's too much pessimism", observes Eddie Ramsden, lecturer in value investing at the London Business School and advisor to the management team at London-based Banor Capital. "Right now, however, the risk/return profile in the sector is the best I've ever seen".

There's no shortage of problems: interest rates, Ramsden explains, could stay low for a very long time, squeezing interest margins. Some observers fear increased losses on loans, fuelled by the slowdown in the Chinese economy and other emerging markets and the fall in commodities. The expert is reassuring. "The slowdown in Beijing is less marked than many analysts suggest", he comments. "The negativity over China is not entirely justified by the numbers. And although it's hard to product how commodities will perform, at present oil-linked loan losses seem to be limited".

"The big banks have another two roads available to increase their return on capital", explains Ramsden, "fees and restructuring processes". And there's more: "right now, valuations are too low, especially in the light of the increased American rates. We need only consider that Citigroup, Goldman Sachs and Morgan Stanley are trading below their tangible book value, with single-figure price/earnings ratios, even though they're very competitive and have profits that could grow significantly".

Banor sim
Massimiliano Cagliero

Banor Capital's view is more prudent, as far as the European financial system is concerned. "From now until the end of 2019", notes Francesco Castelli, manager of the Banor Euro bond fund, "the capital requirements of European banks will go on rising, in line with the legislation".

And as if that weren't enough, the weight of non-performing loans and the fragility of the recovery continue to discourage many investors from dipping a toe in the waters. “In the Italian stock market, we prefer very sound banks; the rest of the market is a tactical, rather than strategic, opportunity. Valuations are extremely low, but mergers will be ‘stock-for-stock’ and there’s a risk of further capital increases. The most interesting opportunities in the banking sector, selectively, are in hybrid bonds”.

In any case, to get the most out of investments in the financial sector, the experts recommend a long-term view. From this perspective, Banor SIM manages Value Investments, a private investment holding with a broad shareholder base and total assets of nearly 200 million euro. “This approach is perfectly compatible with a vehicle such as Value Investments, which has a pre-established duration: the scheduled end-date is 2021”, notes Massimiliano Cagliero, partner and CEO at Banor SIM. At present 39.5% of the portfolio is in fixed income investments and 51.5% in shares, plus a cash buffer of 9%. The equity component mainly consists of shares listed in Milan and London: the first five places are occupied by Snam, Terna, Save, Intesa Sanpaolo Risparmio and Atlantia.