

Say What, Ben?

Regional Bank Stocks Post the “No Taper” Decision

- **Some Key Variables Have Changed at the Margin...** — Despite the hoopla following the Fed’s “no taper” announcement, we observe that (1) as shown in Figure 1, the Fed Funds future curve has shifted only modestly and still suggests that the first rate hike will take place in early ’15 (2) the Fed Funds futures curve is back to where it was in mid-July when stock prices and valuation metrics were on average ~5% higher than they are now (3) holding all else equal in our models, using the current forward curves would lower our ’14/’15 estimates by only ~2%.
- **...But the Stock Prices Have Changed Somewhat More than Marginally** — Our regional bank coverage universe is down ~4.5% since the Fed announcement versus the S&P 500 which is roughly flat over that period (Figure 2). This price action suggests that equity investors may be interpreting the Fed’s “no taper” announcement differently than fixed income investors. Importantly, we note that during the bank stock rally in 1H13, bank stocks were a leading indicator for the Fed Funds futures curve. That is, by late May when “taper talk” started and the Fed Funds curve started to price in rate hikes sooner rather than later, our regional coverage universe was already up ~32% from its November lows.
- **Expectations About Short Rates Remain the Key Driver** — In our view, investor expectations about when the Fed Funds rate will move up has been and remains the single biggest driver of these stocks. As a result, the salient question to ask and answer is: have investor expectations about short rates changed at the margin or have they changed in a wholesale fashion? If the former, then our sense is that these stocks may continue to trade sloppy for a bit a longer but that downside from here is limited. If the latter, then that would likely be “thesis changing” and there could be considerable more downside.
- **How We Shake Out on the Stocks** — Our sense is that last week’s events are not thesis changing, that the stocks will not roll over completely but they may continue to trade sloppy for a bit longer. For those investors who have been long, we see little to disabuse them of the view that (1) short rates will go up in ’15 and (2) regionals remain a good vehicle to express a positive view on an economic recovery. We’d also note that these stocks remain very much disliked by a large swath of dedicated financials investors who missed the rally. At the same time, we think these stocks are in near-term purgatory as the incremental buyer may not feel any sense of urgency to own these just yet given (1) near-term fundamentals are nothing to get excited about and (2) the “asset sensitivity” trade won’t regain its mojo until investors believe tapering is on the horizon. For our part, we have only one Buy-rated name (ZION) in the regional space and will look to feather in to names which either have an idiosyncratic story we think is mispriced or where optionality on higher rates gets inexpensive enough.

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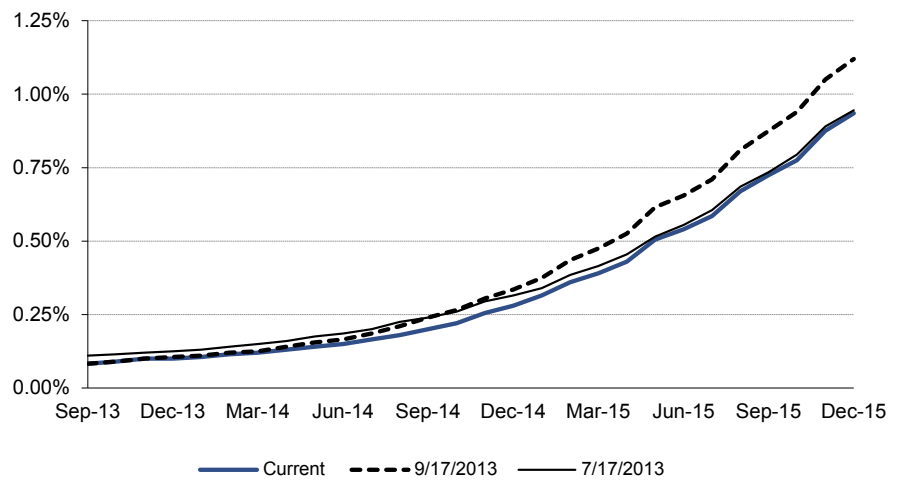
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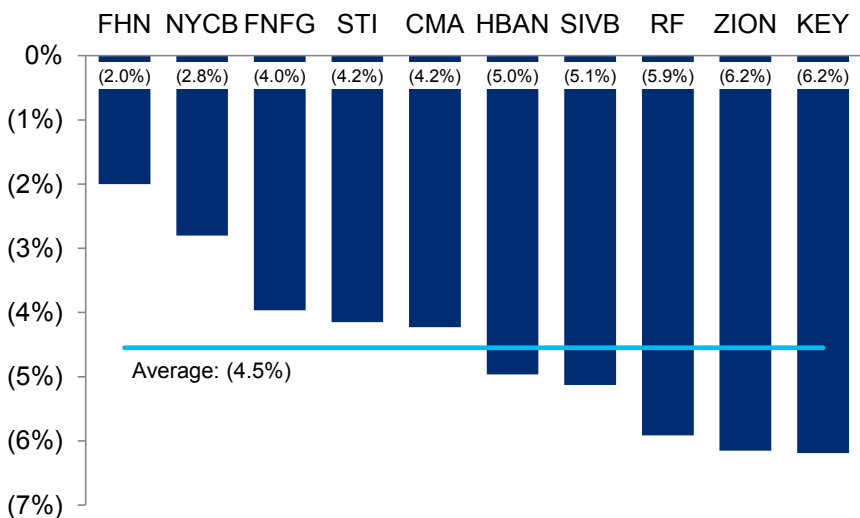
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Figure 1. Fed Funds Futures Curve



Source: Citi Research, Bloomberg

Figure 2. Stock Performance Since 9/17/13



Source: Citi Research, SNL Financial

(CMA.N; US\$39.41; 2); (FHN.N; US\$11.27; 2); (FNFG.O; US\$10.06; 2); (HBAN.O; US\$8.23; 2); (KEY.N; US\$11.37; 2); (NYCB.N; US\$14.92; 3); (RF.N; US\$9.07; 2); (SIVB.O; US\$81.79; 2); (STI.N; US\$32.55; 2); (ZION.O; US\$27.62; 1)

Zions Bancorp

(ZION.O; US\$27.62; 1)

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Appendix A-1

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Data current as of 30 Jun 2013

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% of companies in each rating category that are investment banking clients	53%	50%	45%	58%	51%	49%

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