

Fitch: Mortgage and Markets Weigh on JPMorgan 2Q'14 Results

Written by Australian Business

NEW YORK--([BUSINESS WIRE](#))--While core operating performance remained solid, JPMorgan Chase & Co.'s (JPM) 2Q'14 net earnings continued to be weighed down by weaker performance in mortgage and markets, according to Fitch Ratings. Net income of \$6.0 billion was down 7.9% from the prior year, but return on tangible equity remained strong, at 14%, which is expected to compare favorably to large bank peers.

Bright spots in the quarter were a continuation of prior quarter trends, and included record business banking loan growth, market-leading credit card purchase volume growth, record investment banking fees in commercial banking, positive client flows in asset management, and a continuation of solid asset quality trends in consumer and commercial loan categories. The only significant item of note in the quarter was a \$500 million firm-wide legal expense, which is not too surprising given the current operating environment.

Results for the Corporate and Investment Bank (CIB) were down 31% from 2Q'13, or 28% adjusting for FVA and DVA. The decline was driven by a 15% drop in fixed income markets, a 10% decline in equity markets, and a 6% reduction in debt underwriting volume; all of which was anticipated, given market volumes. Markets revenue was down 12% overall, but investment banking fees were up modestly, as growth in advisory and equity underwriting offset weaker debt issuance. The overhead expense ratio grew to 67%, due largely to continued investment in controls. The CIB average VaR remained relatively low, at \$43 million for the quarter, which was effectively flat with 1Q'14 and 2Q'13. DVA/FVA was a gain of \$173 million in the quarter compared to a gain of \$355 million a year ago.

Net income in the Consumer and Community Banking (CCB) segment, was down from 2Q'13, given declines in mortgage revenue and higher provision expense, offset to some extent by lower operating expenses. Mortgage origination volume was down 66% year over year, but relatively flat with the prior quarter. JPM is likely losing market share in the space, based on peer trends, as it holds firm on terms and pricing, which Fitch believes is prudent. Production pre-tax income was a negative \$74 million in the quarter, which was above expectations, given higher revenue margins, resulting from a positive mix shift, and progress on expense cuts. Management expects production income to be relatively similar in 3Q'14.

Pre-tax earnings in the servicing business improved due to MSR risk management

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gains and declines in costs. Total servicing expenses were \$552 million in the quarter, which compares to a target of approximately \$500 million per quarter by year-end, which Fitch believes, is achievable. MSR risk management gains were \$338 million, and included \$220 million of gains related to model updates associated with slower prepayment speeds. Credit metrics in the real estate portfolio continued to decline, which supported \$300 million of reserve releases in the purchased-credit impaired portfolio. Fitch expects additional reserve releases over the balance of the year, although at lower levels than seen in 2013.

Card segment fundamentals were solid, with market-leading purchase volumes, lower net charge-off rates, and modest portfolio growth, but earnings declined 33% given lower reserve releases, spread compression, and higher expenses, due to investment in controls, marketing, and legal expenses. Fitch expects provision expenses and continued margin compression to be headwinds over the remainder of 2014. Reserve releases, which were limited to \$50 million in student loans, appear largely complete. Positively, sales growth was up 12% from the prior year and the loan portfolio has surpassed its inflection point, with 1% average growth in the quarter.

Commercial Banking (CB) remains a very steady contributor to JPM. Loan growth was up about 7% from 2Q'13, with continued strength in commercial real estate. Credit quality remained very strong, with net recoveries in the quarter. Asset Management (AM) earnings were up due to net client inflows and higher market levels, partially offset by higher costs associated with the control agenda. Assets under management (AUM) were above \$1.7 trillion at quarter-end.

The bank's core net interest margin, which excludes the impact of CIB's market-based activities, was down 2 basis points sequentially, to 2.64% due to lower loan yields. JPM is expecting Treasury to report breakeven net interest income (NII) by year-end, but reported negative NII of \$10 million in 2Q'14.

JPM made more meaningful progress toward its year-end Basel III Tier 1 Common equity (CET1) target in the quarter, due largely to retained earnings. The CET1 ratio improved to 9.8% compared to a year-end 2014 target of 10%. Progress was also made on the supplementary leverage ratio (SLR), which improved 30 basis points sequentially at the firm and bank level in 2Q'14, reaching 5.4% and 5.6%, respectively. JPM expects to target firm SLR of 5.5% and a bank SLR of 6% longer-term. Fitch regards JPM's capital levels to be consistent with its current ratings and would expect the bank to achieve full compliance with all regulatory requirements, well ahead of required implementation.

JPM repurchased \$1.5 billion of common equity during the quarter, which leaves about \$5 billion of authorization based on the annual CCAR process. Dividends per share were \$0.40, which equates to a payout ratio of approximately 27% on a fully diluted basis.

Additional information is available at 'www.fitchratings.com'.

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