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Bank concerns

On Jan. 30, concerns about regional banks were reignited when New York Community Bank (NYCB) revealed that its earnings were well below expectations.

Sector impact

While we're seeing an impact on regional bank stock prices, we believe the problems remain contained to a very small portion of smaller banks.

Market reaction

The S&P 500 Index shrugged off the news and made gains despite bank headlines, topping the 5,000 mark for the first time ever last week.

Weekly Market Compass | February 12, 2024

Last spring saw a sell-off in regional bank stocks as several smaller banks failed, starting with Silicon Valley Bank. The situation ultimately cooled down, but we always had a sense that, while the situation was contained, there could be flare ups in the form of one or a few individual banks that came under pressure. In late January, concerns about a regional bank crisis were reignited when New York Community Bank (NYCB) revealed that its earnings were well below expectations. While we're seeing an impact on the stock prices of some regional banks in the US — and globally — we believe these problems remain isolated, contained to a small portion of the smaller banks.

What happened with New York Community Bank?

Most of New York Community Bank's issues are rather unique. Its problems stem partly from its acquisition of Signature Bank's assets last spring when that bank failed; that put NYCB into a different bank category — Category IV (assets over \$100 billion) — which means greater regulation in general, including higher capital, liquidity, and loan loss requirements.

NYCB's decision to strengthen its balance sheet liquidity in line with its peer group was an important contributor to the earnings miss and the dividend cut. Also, the bank, which has a relatively high exposure to commercial real estate, wrote off some distressed loans in the fourth quarter — although two loans with special circumstances accounted for much of the charge-offs in the period.

Investors are clearly worried about NYCB, sending its stock price down dramatically since the earnings announcement, although it has stabilized in the last several trading days. NYCB does have a relatively low Tier 1 capital ratio; it is under 10% versus 12.3% on average for US banks.¹ On the positive side, NYCB has a relatively higher percentage of insured deposits, which means less flight risk for deposits, and its underlying operating performance was strong. Finally, the departure of senior executives may point to issues that could be specific to NYCB.

What's the impact on US regional banks?

Because of NYCB's woes, a reverse halo effect, not dissimilar to last spring, has started to impact regional banks in the US — and globally. The S&P 500 Regional Banks Index has fallen 8.9% year-to-date.² US regional bank bonds have experienced widening spreads, indicating that markets view them as riskier. But in our view, there is only a small subset of US regional banks that have material vulnerabilities. It is their stocks that are being most punished by investors.

The reality is that, in general, US banks are well-capitalized. Based on the latest aggregate sector balance sheet data by the US Federal Reserve (Fed), there is enough cash to cover commercial real estate loans in their entirety.³ The issue is that, generally speaking, the smaller banks have

more of the loans and the larger banks have more of the cash, which explains the recent weakness in some regional bank stocks.

In fact, in the last six months, the percentage of total assets that are high quality liquid assets has increased for large banks and decreased for smaller banks.⁴ However, many of the issues that have created stress for New York Community Bank are unique to that bank.

Some global banks have come under pressure

In the last week, concerns have spread outside the US. However, this again appears to be limited to a small group of banks that have substantial exposure to US commercial real estate – for which their stock prices may be getting unfairly punished. The European Central Bank is nevertheless on alert with regard to commercial real estate and has reportedly warned banks about managing commercial real estate risks and bolstering their capital.

Three key points about US commercial real estate

But what about US commercial real estate itself? There are three key points to keep in mind:

- US office utilization is slowly improving. The Kastle Back to Work Barometer, which measures return-to-office conditions in 10 major US cities, has shown a marked improvement in recent weeks. The current level is 53%, up from 48.5% for the week of Jan. 10.⁶ And while occupancy rates for non-office property types have softened for the industrial and apartment sectors to just below pre-COVID levels, they remain materially higher than occupancy rate troughs of the global financial crisis period. Also, US non-mall retail center occupancy rates are at a two-decade high.⁷
- A large portion of US commercial real estate loans won't come due and be ready to refinance until 2025 and beyond. It's true that 2024 is a significant year for maturities – with 17% of all US commercial real estate loans coming due this year.⁸ However, that means the vast majority of commercial real estate loans won't come due until later. In fact, 17% of commercial real estate loans come due in 2025, and 58% won't come due until 2026 and beyond when US interest rates could be significantly lower than where they are now.⁸
- Yes, delinquencies in the office sector have increased; the US office delinquency rate rose 48 basis points to 6.30%.⁹ However, other areas of commercial real estate have actually fallen. For example, the industrial delinquency rate fell 17 basis points to 0.40%.⁹ And we must keep in mind that office is only one component of overall commercial real estate.

Bank problems appear contained

In short, we believe bank problems remain isolated, contained to a very small portion of smaller banks. We could see issues arising for a few individual banks periodically as long as we remain in a higher interest rate environment, even if the sector is profitable and stable in aggregate. Also, our base case of a “bumpy landing” followed by a reacceleration of economic growth in the US could imply higher loan growth and an improving ability of borrowers to service debts. And the eventual start of easing in monetary policy could also support growth, while reducing the pressure in net interest margins, by reducing the need to increase deposit rates.

Perhaps the strongest signal that the overall market isn't worried about commercial real estate is that the recent headlines didn't stop the S&P 500 Index from closing above 5,000 for the first time ever on Feb. 9.¹⁰ You may recall that the S&P 500 only hit 2,500 in September 2017.¹¹ Given all the challenges between then and now, it's clear stocks really climbed a "wall of worry."

This serves as a reminder of the importance of remaining invested (and well-diversified) for the long run, rather than getting unnerved by headlines. (And the S&P 500 wasn't the only milestone last week. The Nikkei 225 benchmark index breached 37,000 intra-day for the first time in 34 years.¹²)

Dates to watch

Looking ahead, this week's US Consumer Price Index print will be closely watched. The Fed is looking for more confirmation about the strong disinflationary trend; this print could help provide that confirmation – or not – and is likely to move markets.

With contributions from Andras Vig, Mike Sobolik, and Nicholas Buss

Date	Report	What it tells us
Feb. 13	UK unemployment, average earnings	Indicates the health of the job market.
	US CPI	Tracks the path of inflation.
Feb. 14	UK CPI	Tracks the path of inflation.
	Euro area industrial production	Indicates the economic health of the industrial sector.
Feb. 15	US retail sales	Reveals the latest decision on the path of interest rates.
Feb. 16	UK retail sales	Measures consumer demand.
	US PPI (Producer price index)	Measures the trend in the selling prices received by domestic producers for their output.
	University of Michigan Survey of Consumers (preliminary)	Assesses US consumers' expectations for the economy and their personal spending.

Notes

¹Source: United States Banks Index, Datastream, Dec. 31, 2023.

²Source: Bloomberg, L.P., as of Feb. 9, 2024

³Source: "Assets and liabilities of commercial banks in the United States," Federal Reserve, Feb. 9, 2024.

⁴Source: "Assets and liabilities of commercial banks in the United States," Federal Reserve Bank of New York, as of Feb. 8, 2024.

⁵Source: Federal Deposit Insurance Corporation, speech transcript from FDIC Chairman Martin J. Gruenberg, Sept. 20, 2023

⁶Source: Kastle Back to Work Barometer, as of Feb. 25, 2024

⁷Source: CBRE-EA, as of Dec. 31, 2023

⁸Source: MSCI Real Assets, as of Sept. 26, 2023

⁹Source: Trepp CMBS Research, February 2024

¹⁰Source: "S&P 500 closes above key 5,000 level for first time," CNN Business, Feb. 9, 2024

¹¹Source: Bloomberg, L.P., as of September 2017

¹²Source: "Japan's Nikkei hits fresh 34-year highs; most Asian markets are closed for Lunar New Year holiday," CNBC, Feb. 9, 2024

Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

Investments cannot be made directly in an index.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

Should this contain any forward looking statements, understand they are not guarantees of future results. They involve risks, uncertainties, and assumptions. There can be no assurance that actual results will not differ materially from expectations.

Diversification does not guarantee a profit or eliminate the risk of loss.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Alternative products typically hold more non-traditional investments and employ more complex trading strategies, including hedging and leveraging through derivatives, short selling and opportunistic strategies that change with market conditions. Investors considering alternatives should be aware of their unique characteristics and additional risks from the strategies they use. Like all investments, performance will fluctuate. You can lose money.

Investments in real estate related instruments may be affected by economic, legal, or environmental factors that affect property values, rents or occupancies of real estate. Real estate companies, including REITs or similar structures, tend to be small and mid-cap companies and their shares may be more volatile and less liquid.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Tier 1 capital refers to the core capital held in a bank's reserves and is used to fund business activities for the bank's clients. It includes common stock, as well as disclosed reserves and certain other assets

A basis point is one hundredth of a percentage point.

Inflation is the rate at which the general price level for goods and services is increasing.

Disinflation, a slowing in the rate of price inflation, describes instances when the inflation rate has reduced marginally over the short term.

The reverse halo effect is the phenomenon whereby positive perceptions of a person can yield negative consequences.

Monetary easing refers to the lowering of interest rates and deposit ratios by central banks.

Net interest margin reveals the amount of money that a bank is earning in interest on loans compared to the amount it is paying in interest on deposits. NIM is one indicator of a bank's profitability and growth.

Yield spread is the difference between yields on differing debt instruments, calculated by deducting the yield of one instrument from another.

The US Consumer Price Index (CPI) measures change in consumer prices as determined by the US Bureau of Labor Statistics.

The Kastle Back to Work Barometer tracks daily security card swipes of employees for over 300,000 Kastle users in 10 US cities.

The Nikkei 225 Index is a price-weighted average of 225 top-rated Japanese companies listed in the first section of the Tokyo Stock Exchange.

The S&P 500 Regional Banks Index is a modified equal-weighted index designed to measure performance of the stocks comprising the S&P Total Market Index that are classified in the GICS regional banks subindustry.

The opinions referenced above are those of the author as of **Feb. 12, 2024**. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.