Lloyds Chambers
1 Portsoken Street
London E1 8HZ
Tel: 020 7702 0888 Fax: 020 7702 9452
www.hermes.co.uk

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Formidable JPMorgan can withstand ongoing litigation

Filippo Alloatti, Senior Analyst at Hermes Credit, reacts to today's JPMorgan Q4 results

JPMorgan remains a formidable franchise, even as litigation settlements dampen down near-term profitability.

Results

Its 4Q net income came in at $5.3bn, down 7.3% quarter-on-quarter – with the company hit by $2.3bn in negative extraordinary items, split 50/50 between litigation costs and funding valuation adjustments. Positive one-offs amounted to $1.8bn, including reserves releases.

Investment banking revenue was up 12% quarter-on-quarter, to $1.7bn, and down 2% year-on-year. Asset management saw a $23bn inflow. In terms of guidance, the company sees 2014 adjusted expenses below $60bn.

Litigation costs as percentage of total expenses have gone up from 12% in 2008, to 20% in 2013. We expect this to come down, as the remaining mortgage-related issues do not represent a capital event. The WaMu private label and monoline are the two last major items, while it also needs resolution on the LIBOR manipulation. On both side of the Atlantic, litigation is set to remain with us for quite some time yet.

Capital

JPM's balance sheet remains a fortress, with B3 Tier 1 Common of $146bn. Its 9.5% ratio lags behind Citi at 10.4%, BAC at 9.9% and the brokers-dealers – but this could translate in a more conservative pay-out request to the Fed in the 2014 CCAR stress test. This would be positive for credit spreads, while JPM confirmed it is targeting a T1-C of 10.5% in any event.

While legal expenses have depressed JPM's profitability, these actions have significantly reduced tail risk. I expect subsiding and eventually stabilising legal costs – say of approximately $5bn a year – as a key step in its normalised earnings walk. Also JPM's big loan loss release may soon come to an end so that we can focus on core divisions performance.

-ENDS-

For further information, please contact:

Hermes Fund Managers

Jean Dumas
+44 (0)20 7680 2152
j.dumas@hermes.co.uk

Melanie Shelley
+44 (0) 20 7680 2110
m.shelley@hermes.co.uk

Notes to Editors:

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