# MRP CAPTIAL INVESTMENTS, LLC

## Déjà vu All Over Again

11/22/2016

**Inside this report:**



# Introduction

As I was driving down the road yesterday and listening to Business Talk Radio, a commentator mentioned something that reminded me of a report I wrote in February of 2009 entitled "The Beginning of the Bull…"

The commentator was talking about the incredible rally we have been witnessing in bank stocks recently. He said the driving force behind this rally was a belief that the economy was recovering and that Dodd-Frank might be repealed.

I totally agreed with him and was reminded of the cyclical nature of the business banking cycle, which prompted me to think of the aforementioned report. That report is 27 pages long and I'll spare you the agony of having to read it again. However, one section of that report was entitled "Déjà vu All Over Again." I will re-print that section over the next few pages and then add some additional comments regarding our current market environment.

# Article Excerpt from 2/16/2009

*Reading these words, listening to the news on a daily basis, and pondering what might happen when the government jacks up it deficit spending in the midst of bank failures and an economic crisis can induce the emotion of fear. Fear of catastrophe, fear of the unknown, fear of an unprecedented series of events.*

*Funny enough, it seems we have lived this nightmare time and time again. And interestingly enough, we, as a nation, are still here and still the dominant economy, military, and society on the face of the planet.*

*This fact smacked me right in the face while perusing the February 2, 2009 edition of "Time" magazine (The Obama Commemorative Edition, if you must know). Inside this edition on page 61 was an article entitled "Teetering Since 1812". This article detailed the story of Citigroup. Per the article, Citigroup (then City Bank of New York) was founded in 1812 and nearly went under in 1837 but was bailed out by John Jacob Astor (the Bill Gates of his time). Mr. Astor tightened up lending standards, built capital reserves, which helped the bank to finance the Union during the Civil War and easily withstand the panic of 1873.*

*Then the bank (and the American financial system) started down the alternating path of conservative operations and risk-taking endeavors, which led it to numerous successes and near failures. The bank survived the Panic of 1893. Citi and JP Morgan bailed out the Federal Government in 1895. In the 1920's the bank came up "creative ways" to lend to the booming middle class and these actions became one of the main culprits for the emergence of the turmoil that existed in the 1930's. In fact, the Glass-Steagall Act put an end to many of Citi's "creative" ideas, including their financial supermarket business plan.*

*Although a much maligned, tarnished, and smaller bank Citi reinstated conservative practices and grew throughout the 1940's and was positioned to take advantage of the extraordinary growth of the coming decades.*

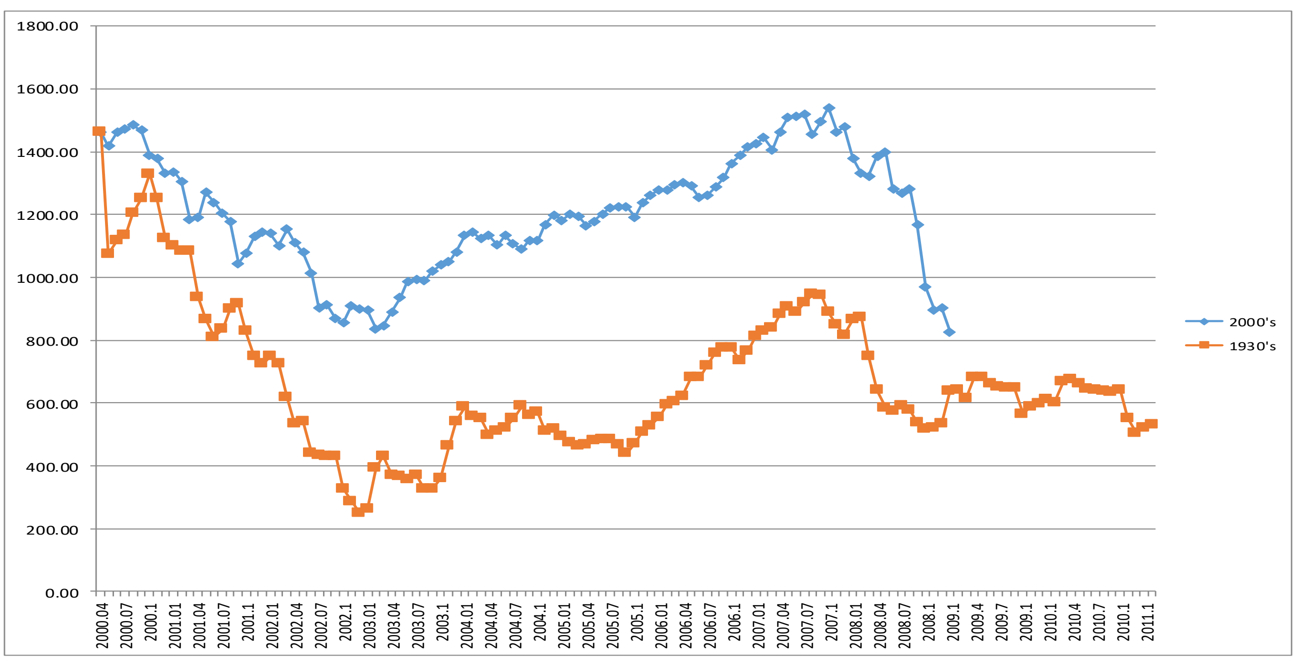
*The 1950's saw more innovation and expansion which continued for quite sometime until the early 80's. Bad loans to Latin America, the recessions of the 70's and 80's, put Citi back on its knees. Only forbearance by U.S. regulators and a wad of cash from Saudi royalty could save the bank…and it did.*

*Then again the idea of a financial supermarket resurfaced. Travelers merged with Citi, Glass-Steagall was repeal and Citi was off and running again until now. They are currently in the middle of another trauma and bail-out and back to their knees.*

*Does history repeat itself? Without a doubt. These last few paragraphs have used Citigroup as a proxy for financial institutions and although I am not 100% sure that Citi will exist in the future I am sure the financial system will. Bailouts, restructurings, and recapitalizations will occur and fear will preside. But once again, human nature will take over and greed will re-emerge, boom times in the economy will drive profits sky high, poor decisions will be made, and the banks will be back in trouble.*

## S&P 500 1930s vs. 2000s

Chart Supplied from MRPCI Database



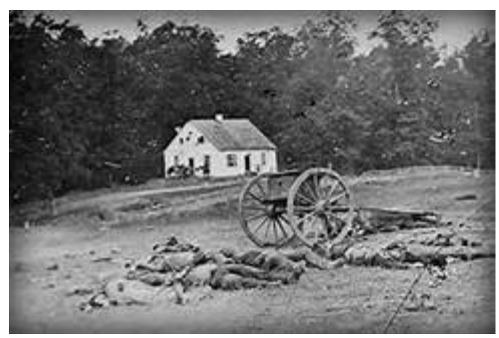
# Review

Before moving on to some current thoughts I want to illustrate the facts outlined in that article relative to Citigroup (our proxy for the banking system).

-1812 The bank is Founded.

-1837 It is bailed out and institutes conservative practices and tight lending standards, while rebuilding its reserves.

-1861-1865 Its financial strength helps it survive the Civil War.



-1873 Its financial strength helps it survive the Panic of 1873.

-1893 and 1895 They survived the Panic of 1893 and, in fact, bailed out the U.S. Government in 1895.

-1920's They find creative ways to lend to the Middle Class and the economy booms.

-1930s The Stock Market crash and Great Depression cripples them.

-1940s They re-institute conservative practices and build their financial strength.

-1950-1980s They embark on another round of innovation and expansion.

-Early 1980s Bad Loans to Latin America and recession cripples the bank until Saudi Royalty makes a huge investment and bails them out.


-1990s Glass-Steagall is repealed and the Financial Sector booms.

-2008 The Financial Crisis, once again, brings them to their knees.

# Today's Market

As I was driving, I thought of that article because I feel the banks have turned the corner and are about to enter the next phase of their repetitious cycle; the rapid expansion phase.


Fortunately, I've been a big investor in banking stocks ever since the crisis of 2008. I had done my homework and I had a strong belief that they would continue to strengthen their balance sheets and rebuild their war chests.

To illustrate an example of how these banks have rebuilt their war chests and strengthened their balance sheets, I have put together a chart regarding some fundamental data of 3 big US Banks; JP Morgan, Bank of America, and Citigroup. I picked JPM and BAC because they are, by far, the two biggest banks my clients and I have investments in. And I put C in here because that Time article focused on them. However, MRPCI clients have, almost, zero exposure to Citigroup.

| | **JPM** | **BAC** | **C** |
|---|---|---|---|
| 2007 Revenue | $71.3 billion | $66.3 billion | $81.9 billion |
| TTM Revenue | $95.2 billion | $81.2 billion | $71.3 billion |
| | | | |
| 2007 Profits | $15.3 billion | $14.9 billion | $3.6 billion |
| TTM Profits | $23.4 billion | $15.2 billion | $14.7 billion |
| | | | |
| 2007 Equity | $123 billion | $146 billion | $113 billion |
| 2016 Equity | $254 billion | $270 billion | $231 billion |
| | | | |
| Stock Price 12/31/2007 | $43.65 | $41.26 | $292.90 |
| | | | |
| Stock Price 11/22/2016 | $78.53 | $20.32 | $56.20 |
| | | | |
| 2007 P/B | 1.19 | 1.29 | 1.42 |
| 2016 P/B | 1.24 | 0.86 | 0.76 |

The above data was provided by Morningstar. TTM stands for Trailing twelve months. Equity is the standard Assets minus Liabilities. And stock prices are split adjusted.

When you take a second to examine those numbers, a few things need to be looked at and considered.

First off, the only stock price that has appreciated since 12/31/2007 is JP Morgan's. In fact, it is up 79.9%. Which makes sense when you consider they have grown revenues by about $25 billion. Their profits are up almost $9 billion. And their balance sheet equity is up over $100 billion.


JPM Chart from 12/312007 to 11/22/2016

Chart Provided by Bigcharts.com

However, Bank of America's stock is down over 50% and Citigroup's is down almost 81%!!! As investors, we need to ask ourselves, "Does that make sense?" And, of course, this is a question I've asked myself every single day for about 9 years. To be frank, the answer I keep coming up with is, "NO!!"

Bank of America's revenue is up by about $15 billion. Their profits are higher than they were in 2007 and their balance sheet equity has almost doubled, but their stock has been cut in half. Citi's improvement in their numbers isn't quite as good as BAC's, but I still don't think the fall in their stock of over 80% makes a lot of sense.


BAC Chart from 12/31/2007 to 11/22/2016

Chart Provided by Bigcharts.com


C Chart from 12/31/2007 to 11/22/2016

Chart Provided by Bigcharts.com

So, why has this happened? Were the stocks severely over-valued in 2007? Or are they super cheap now?

Maybe a little bit of both, is the answer. But the biggest factor in those stock price declines was the massive amount of new shares Citi and Bank of America had to issue to meet the enhanced capital requirements placed on them by the regulators after the 2008 crisis.

This is precisely why I looked at the Price to Book metrics for all these banks. This takes those new shares into consideration and levels the valuation playing field. When you do that, you can see that those two banks are still trading at significantly lower valuation levels then they were at the beginning of the crisis. And this is still the case despite the improvements in the fundamentals of their balance sheets and businesses.

# Conclusion

When analyzing this data in concert with our current market conditions, it appears there is a real chance for the banks to final be able to unleash their capital on our economy.  If this does happen, I think we can expect a pretty significant boom in spending and investment, which usually sets the table for an economic expansion.

Historically, these expansion phases last quite a few years, if not decades, and I have some methods to track how far along the path they get.  In fact, I have some prior articles I've written on the subject...which I'll share with you all at the appropriate time.  But, in the meantime, let's hope this expansion takes place.  And, if it does, enjoy the ride.  I'll be behind the scenes making sure we don't get out ahead of ourselves.

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