

**North American Banks: Cheaper and Better Positioned Than 2008**

Banks have been under pressure so far in 2020 as the sudden stop in economic activity resulting from the COVID-19 pandemic has raised fears that borrowers will be unable to repay their loans. With memories of the 2008 Global Financial Crisis still fresh in our minds, at times it seems as though the market is anticipating a similar result for the banks in 2020. However, we believe that there are many differences between 2008 and the current environment, and several reasons why the banks will fare better this time around.

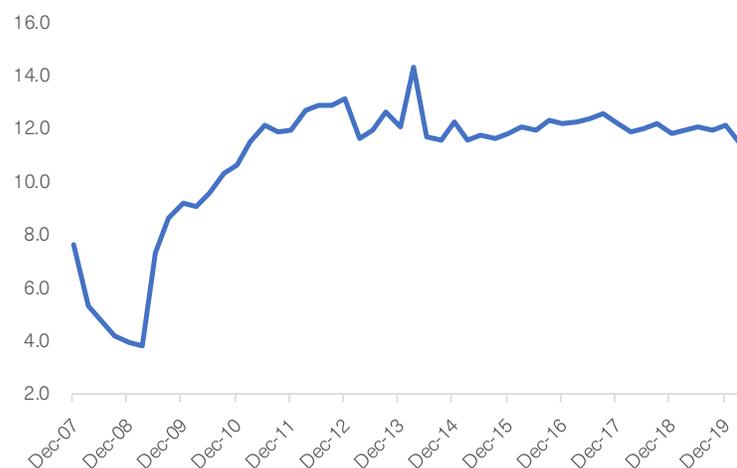
The Global Financial Crisis originated in the financial sector after banks had spent many years using increased leverage to buy risky assets. As this spiraled out of control, banks were stuck with billions of dollars of bad loans and other assets. This resulted in a solvency issue where several banks and other financial institutions went bankrupt (Lehman) or were acquired for pennies on the dollar (Bear Stearns). For those that survived, many were forced to raise equity at depressed valuations.

In 2020, we have a pandemic-induced crisis as a result of the sudden stop in economic activity with many areas of the world going into temporary lockdown to stop the spread of the virus. This has resulted in a liquidity crisis as many businesses and consumers are temporarily unable to make payments on their loans. However, we believe that there are several reasons for why these liquidity issues will not turn into a solvency crisis like the one we saw in 2008.

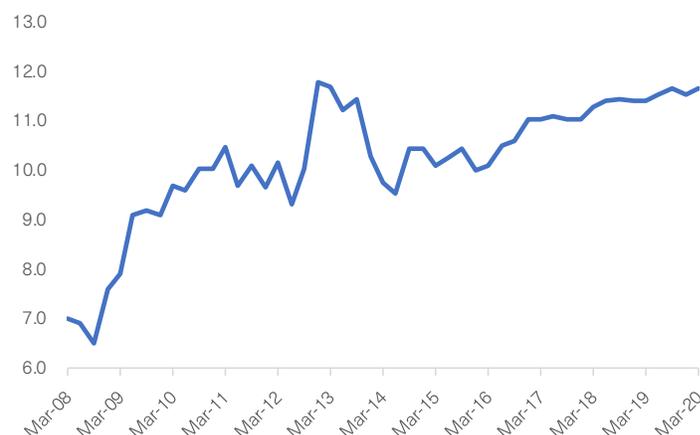
**1. Banks are better capitalized this time around**

In the aftermath of the 2008 financial crisis we saw several regulatory changes that forced banks to raise their capital levels over the past decade. As a result, the median Common Equity Tier 1 (CET1) ratio, which is a measure of the capital adequacy of a bank, for the eight U.S.-based global systemically important banks (G-SIB) has gone from 3.8% at the lows in 2009 to 11.6% today. Similarly, the median CET1 ratio for the six largest Canadian banks has gone from 6.8% at the financial crisis lows to 11.7% today. Additional regulatory changes, such as the annual stress test for the largest banks, have reduced the banks' appetite for the riskiest loans, meaning that their balance sheets are in much better shape than they were in 2008.

**Median CET1 Ratio  
(8 U.S. G-SIBs)**



**Median CET1 Ratio  
(Big 6 Canadian Banks)**

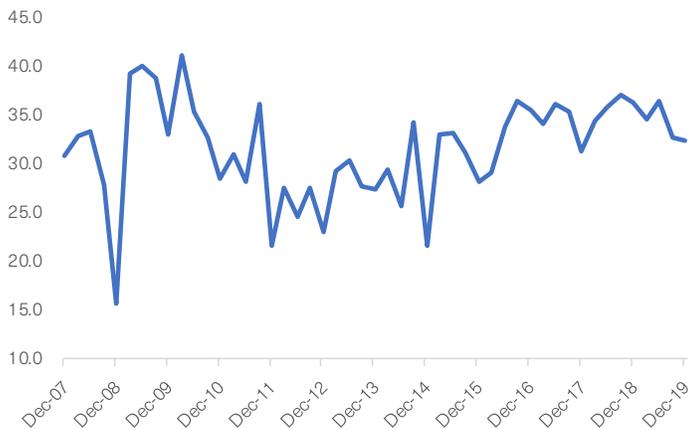


Source: Bloomberg

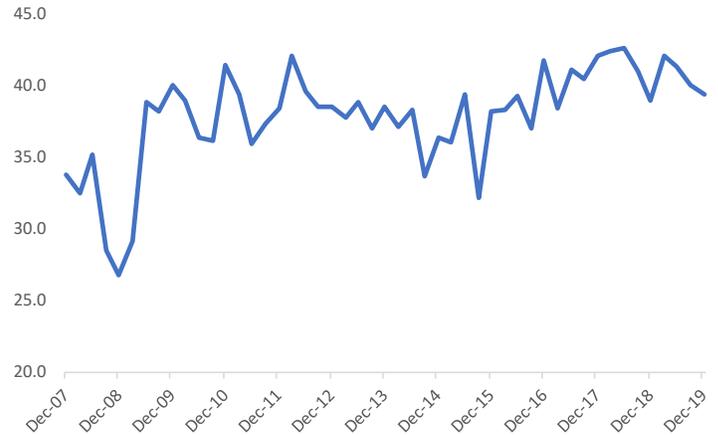
**2. Banks are more profitable and can withstand higher provisions**

Banks are also more profitable than they were in 2008. One way of looking at bank profitability is to look at the pre-provision profit margin, which is calculated by taking operating profits before credit provisions and taxes as a percentage of net revenues. This measure shows how profitable a bank is before the impact of the credit cycle and gives an indication of how well a bank can withstand credit losses. The median pre-provision profit margin for the eight U.S. G-SIBs has gone from 15.6% at the lows in 2008 to 32.3% as of the end of 2019, while the margin for the big six Canadian banks has gone from 26.8% to 39.4%. This shows that the banks are better able to withstand credit losses than they were in 2008.

**Median Pre-Provision Profit Margin  
(8 U.S. G-SIBs)**



**Median Pre-Provision Profit Margin  
(Big 6 Canadian Banks)**



Source: Bloomberg

**3. Actions from governments and central banks have been swift and enormous**

With the acceleration of economic shutdowns across the globe in March 2020, governments and central banks have been swift to act with fiscal and monetary stimulus on a scale we have never seen before. Additionally, regulators have relaxed certain rules with the aim of supporting the economy in general and, in particular, the banking sector, which acts as the backbone of our economy. Many of these measures have been put in place to ensure that the banks have capacity to continue lending to individuals and businesses. For example, banks in the U.S. and Canada are now able to work with borrowers to restructure the payment terms on their loans without having to set aside additional capital to cover losses and without being forced to classify these loans as non-performing. At the same time, governments in the U.S. and Canada are supporting business and individuals with loan programs and enhanced social security, while the Federal Reserve and the Bank of Canada have implemented several liquidity facilities to keep the flow of credit going.

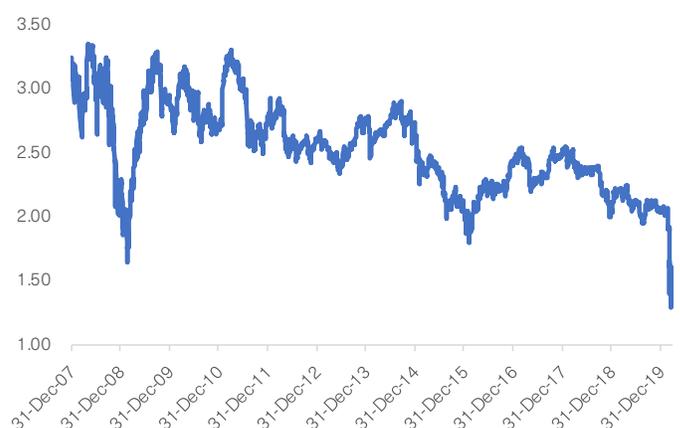
**4. Banks are already trading near financial crisis lows**

Despite strong capital levels, improved profitability in the sector, and the extreme measures put in place by governments and central banks, North American banks are already trading at levels near or below the lows in 2009.

**S&P 500 Banks - Price to Tangible Book**



**TSX Banks - Price to Tangible Book**



Source: Bloomberg

In our view, the fiscal and monetary response we have already seen will prevent the current economic slowdown from turning into a solvency crisis like the one we witnessed in 2008. As such, we believe the current environment is an excellent entry point for investors to consider adding banks to their portfolios.

## Brompton's Approach

At Brompton, we have decades of experience investing in Financials and have several products that investors can use to get exposure to the banks, including in our split share funds and ETFs. The following Brompton funds all trade on the TSX and focus specifically on Financials:

Fund Name:	Pref. Ticker	Class A Ticker	ETF Ticker
<a href="#">Brompton Split Banc Corp.</a>	SBC.PR.A	SBC	
<a href="#">Life &amp; Banc Split Corp.</a>	LBS.PR.A	LBS	
<a href="#">Brompton North American Financials Dividend ETF</a>			BFIN

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