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Why Does JPMorgan Trade at Book Value?

By ANTONY CURRIE

Jamie Dimon needs an even better postcrisis. The chief executive of JPMorgan Chase runs one of the only major banks in the United States that did not post a quarterly loss during the crash. And he has maneuvered his firm into a strong position to grow as the economy rebounds. But investors don’t yet seem convinced that it will.

The shares have been stuck trading around book value, or assets less liabilities, since last summer. Put in perspective, that’s not all bad. They had tumbled to less than half that in the depths of the crisis. But to price the bank now at only a fraction more than breakup value seems overly cautious. Another crisis outperformer, Wells Fargo, by comparison, trades at 1.4 times book.

The two lenders are more equal using another measure. Investors value Wells at 14.8 times this year’s expected earnings, and JPMorgan at a multiple of 13.9. This still means, however, that Mr. Dimon’s bank is getting no credit for a faster growth rate. Analysts reckon its net income should jump by a third this year compared with just 8 percent at Wells. Moreover, by 2011 JPMorgan could be earning twice what it did in 2009, and Wells 65 percent more.

At first glance, JPMorgan looks unfairly penalized. After all, both banks are heavily exposed to consumer loans. JPMorgan expects its credit card unit will lose as much as $2 billion in the first half of this year and that quarterly losses on its mortgage loans may be still higher than last year. Both banks will also lose income from legislation limiting credit card and overdraft charges, perhaps as much as $1.25 billion for JPMorgan. And Mr. Dimon still sees a chance of a double-dip recession.

The difference is that JPMorgan has a much larger investment bank. It accounted for nearly three-fifths of last year’s profit as the consumer arm suffered. When equilibrium eventually returns, it should represent less than a third of the bank’s earnings. Mr. Dimon’s fortress balance sheet and solid risk management helped the investment bank solidify its position as a top-tier adviser and underwriter.

The investment bank faces numerous uncertainties. Sure, it generated some $2 billion of revenue from or for JPMorgan’s commercial bank and treasury services last year. But the unit requires

more capital than any other business and has the lowest return on equity target, at 17 percent.

And investment bank trading desks will need to perform without higher leverage as bid-offer spreads narrow further. New regulation looms, and only some of the costs can be estimated so far.

Shifting derivatives trading onto exchanges could shave $300 million off JPMorgan's revenue. The proposed bank levy to help the federal government recoup losses on the Troubled Asset Relief Program could cost JPMorgan more than $1 billion a year. The Volcker Rule, if enacted, would ban proprietary trading and some other businesses, curbing trading income. And there's no guarantee Washington is finished changing the rules on Wall Street.

JPMorgan will have more than regulation to contend with. Most of its competitors stumbled — or disappeared — in the crisis. That allowed the House of Dimon to become the best bank for credit. It proudly boasts it lent or underwrote $824 billion last year, $250 billion more than any one of its rivals. But the liquidity advantage is waning. Bank of America, for one, is in a better position to put its balance sheet, and consequently its bankers at Merrill Lynch, to work.

There may still be a Bill Winters effect too. The ousted but admired co-head of JPMorgan's investment bank has yet to land elsewhere. When he does, and depending on where, former colleagues may be inclined to join him. While hardly a threat to the franchise, losing even a few top deal makers could be enough to dent revenue and morale.

Mr. Dimon may have more carrots for shareholders though. He's one of the few chief executives who can credibly dangle the prospect of raising the dividend this year. And JPMorgan has enough excess capital — perhaps as much as $20 billion in reserves alone — which, once deployed, according to Deutsche Bank analysts, could add at least 16 percent to earnings.

For JPMorgan to trade at book value appears overly harsh. But the three-year rough ride in the banking sector — and investment banking in particular — is keeping investors cautious. Having a good crisis, it seems, just isn't good enough.

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