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Newspaper reporter: *"Willie! Why do you rob banks?"*
Serial bank robber, Willie Sutton: "*Because that's where the money is!"*

-Circa 1933

While it has been debated if this exchange actually occurred, it is hard to argue with the sentiment. Based on the performance of financial stocks over the past year (to include insurance companies and financial holding companies such as Berkshire), there clearly has been money in the banks. How well have they done? From the lows late last March, the Dow has advanced nearly 80% if you can imagine such a thing. Our five largest financial holdings (JP Morgan, Berkshire Hathaway, Fifth Third Bank, insurer Protective Corporation and US Bank) have advanced on average by 124%.*

Why the disconnect? We never get to know for certain but herewith follows our best guesses:

1. You have to go back to the Spanish Flu Pandemic of 1918 as precedent in which an estimated 500 million people were infected and 10% of those perished. Illnesses of that magnitude in modern times would literally crush an economy, in particular leveraged lenders such as banks. Fortunately, not this time!
2. Pain from the banking crisis of 2008-2009 remained fresh in people's minds. Shareholders suffered when 400+ banks failed and many survivors had to sell shares to raise capital resulting in substantial dilution to shareholders. Fear of a repeat was widespread…but no pandemic induced capital crunch arose.
3. Businesses were closed. People were out of work. The prospects for mortgage defaults and failed loans were ominous. No one knew if this work from home thing would work. It did. Bank deposits soared. Instead of collapsing, housing values soared. Even used cars moved up in price. None of this was in the cards as reflected by banks collapsing in price last March and April.

And the banks?

1. Government transfers made up 31% of personal income in April of 2020. Core bank deposits grew by 29% and bank reserves grew by 110%. Deposits so far exceeded loan demand that banks paid a rounding error to nothing for them.
2. Banks earn their money on the *spread* between what they have to pay for capital and where they can rent it out. In recent months as the economy picked up it became clear this spread was *widening* and, at the same time, loan demand began to pick up in a recovering economy. Fine equation for lenders there.

*Takeover offer for Protective Insurance favorably helped these returns.

3. In a recent article entitled “Payday Is Nearly Here For Bank Investors,” the *Wall Street Journal* commented, “The Federal Reserve is now set to end special restrictions implemented during the pandemic on most big banks’ ability to buy back shares and raise dividends depending upon results of the annual stress tests.” The article went on to opine that big banks have the capacity to buy back up to *$22 billion worth of their stock* in the second quarter alone and that this figure could *triple* in the second half of the year. Hope also exists for a pickup in loan demand allowing banks to increase the return they are earning on loans while the cost of their capital remains extremely low.
4. The average valuation for the companies included in the S&P 500 in relation to estimated earnings for the year 2021 is currently 22.6 times. Bank stock prices in relation to estimated earnings for the year are approximately one third less. Let’s see…more earnings for less money. A fine equation that.
5. Bank dividends are already over a third greater than other components of the S&P 500 and will likely be raised faster than in other industries. The Journal closed its story by opining, “…the bottom line is that investors can mostly start to think about bank payouts like they did pre-pandemic. That alone should be good for banks’ shares.”

Generally speaking we believe we are in the sixth inning of the game as it relates to banks. The value is demonstrably greater than in most sectors of the stock market, dividends are greater and likely to be raised and it is our sense there will be more money flowing into bank stocks than out as managements report results for the first quarter commencing in about two weeks. Now that we think about it, if Willie Sutton had simply taken some of the cash he was holding and deposited (or better yet invested) it into the banks as opposed to “withdrawing” it, he might not have ended up spending so much time in the pokey.

Barring another bolt out of the blue and largely thanks to the great job the healthcare and pharmaceutical industries have done, we anticipate this will be the last of our COVID Client Notes sent your way. We hope they have been informative as to the strategies we have employed and that you are as pleased with the outcomes achieved over the past year as are we. Next up? Driven by elevated expectations and among the highest valuations on record we believe a healthy dose of de-risking in the form of gains taking to be the order of the day. Stay tuned. Stay well.

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