

## EUROPE'S BANKS HISTORY OF DEPENDING ON GERMAN INTEREST RATES

A look at the correlation between Eurozone bank stocks and Bund yields shows historically how much banks have been dependent on long-term interest rates. The reasons for this are revealing.

You may not want to be a bank analyst these days. Large, mostly globally positioned, complex institutions with diverse business areas and models. Besides that, there are always new regulations and young financial-technology companies pressuring already tight margins. This is certainly no fun. But it is even less fun if you don't just have to analyze this sector, but have been invested in it. In mid-August, the sector was valued on Europe's stock exchanges at its lowest level since 1989.<sup>1</sup>

But what to do, if you still want to invest in this sector, perhaps for anti-cyclical reasons? After all, in addition to the long-term price being low, a price-to-book ratio of only 0.6 is tempting – if you take the reported accounting figures at face value. At first glance, one way of escaping the complexity of the sector seems to be a striking correlation. As our "Chart of the Week" shows, the performance of the banking sector relative to the overall market is almost parallel to that of 10-year German government bonds (Bunds).

The correlation coefficient, based on the weekly performance over the past ten years, is an astonishing 0.91.

It is probably the combination of two reasons that can explain this synchronicity: On the one hand, long-term interest rates are seen as an indicator of how investors assess growth prospects. As a highly cyclical sector, banks are thus predestined to benefit from brightening economic sentiment. Secondly, there is the interest margin, on which European banks depend much more than their U.S. counterparts, where corporate loans hardly play a role any more. Since the short end of the yield curve, in particular the European Central Bank's (ECB's) refinancing rate, has been close to or at zero for some time, the margin depends largely on the interest-rate level at the long end of the curve. So investing made easy? Unfortunately only from an ex-post perspective again. Ex-ante you have to have a clear opinion of how 10-year interest rates may develop. Anyone who also believes that interest rates will remain low for some time, will probably have to look elsewhere for returns.



Sources: Refinitiv, DWS Investment GmbH as of 9/17/19

\* Relative performance of the Euro Stoxx Banks Index over the Euro Stoxx Index

<sup>1</sup> Measured by the Euro Stoxx Banks, which comprises the banks in the Eurozone

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Source: DWS Investment GmbH

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## APPENDIX: PERFORMANCE OVER THE PAST 5 YEARS (12-MONTH PERIODS)

	08/14 - 08/15	08/15 - 08/16	08/16 - 08/17	08/17 - 08/18	08/18 - 08/19
Euro Stoxx Index	6.5%	-4.3%	14.3%	1.9%	-2.2%
Euro Stoxx Banks Index	-2.2%	-32.7%	36.6%	-20.7%	-22.6%

Past performance is not indicative of future returns.

Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 9/19/19

## GLOSSARY

**Bunds**

**Bunds** is a commonly used term for bonds issued by the German federal government with a maturity of 10 years.

**Correlation**

**Correlation** is a measure of how closely two variables move together over time.

**Correlation coefficient**

The **correlation coefficient** measures the strength and direction of a linear relationship between two variables.

**Euro Stoxx**

The **Euro Stoxx** is a broad-based equity index comprising 301 constituents from the Eurozone.

**Euro Stoxx Banks**

The **Euro STOXX Banks** is an index that tracks a supersector of the relevant benchmark index Euro Stoxx. Companies are categorized according to their primary source of revenue.

**European Central Bank (ECB)**

The **European Central Bank (ECB)** is the central bank for the Eurozone.

**Net interest margin**

The **net interest margin** of a financial institution is the difference between the average interest rate paid and the average interest rate received by the institution.

**Price-to-book (P/B) ratio or multiple**

**Price-to-book (P/B)** ratio or multiple compares a stock's market value with its book value.

**Yield curve**

A **yield curve** shows the annualized yields of fixed-income securities across different contract periods as a curve. When it is inverted, bonds with longer maturities have lower yields than those with shorter maturities.

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