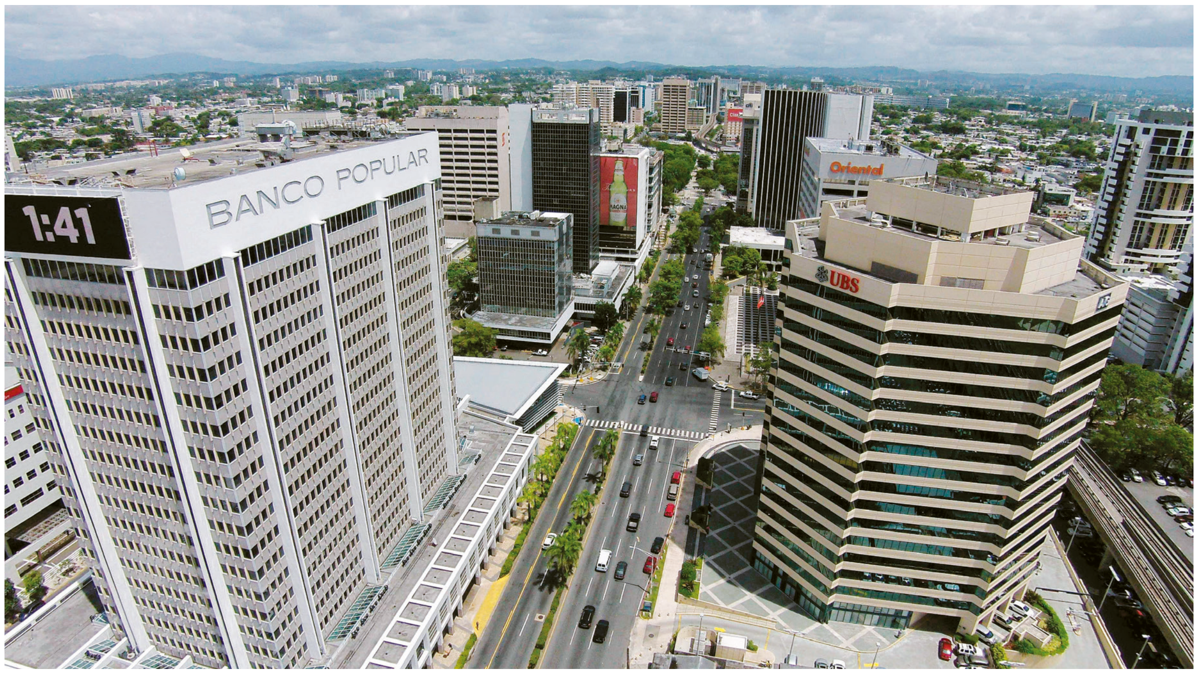
ECONOMY

Perpetual Optimism

THINK STRATEGICALLY:



Puerto Rico Banks as a Force Multiplier

BY FRANCISCO RODRÍGUEZ-CASTRO | frc@birlingcapital.com

A Fresh Look at the Birling Puerto Rico Bank Index

As the second trading week of the year has passed and investors perform their stock and asset rotations, it is vital to review the Birling Capital Puerto Rico Stock Index's 2021 and 2022 year-to-date returns, especially three of its stocks. The index consists of the five public companies that are based or originate in Puerto Rico.

One of the sectors that will significantly benefit from the projected interest rate increases is the banking sector, thus we will evaluate Puerto Rico's homegrown sector. The Birling Capital Puerto Rico Stock Index achieved a 48.56 percent return in 2021, beating the Dow Jones Industrial Average, S&P 500 Index and Nasdaq Composite.

So far in 2022, the index has returned 9.83 percent; however, when you isolate the bank stocks, the return rises to 17.97 percent.

Let's look at the three Puerto Rico banks and their 2021 and year-to-date (YTD) returns.

1. Firstbank Corp. (FBP) achieved a 49.46 percent return on investment in 2021, which beat the Dow, S&P, Nasdaq and Birling index handsomely. YTD, it has returned 18.94 percent. The stock closed at $16.39, rising $2.61 YTD.

2. Popular Inc. (BPOP) achieved a 2021 return of 45.67 percent, higher than the Dow, S&P and Nasdaq but less than the Birling index. It has returned 20.01 percent YTD. Closing at $98.46, it rose $16.06 YTD.

3. OFG Bancorp. (OFG) achieved a return in 2021 of 43.26 percent, which beat the Dow, S&P, Nasdaq and Birling U.S. Bank Index but lagged behind the Birling P.R. Stock Index. It has had a 14.98 percent return YTD. The stock closed at $30.54, or $3.98 higher YTD.

Our review demonstrates how the management teams of the Puerto Rico banks have successfully navigated through one of the worst economic exogenous shock periods in several generations.

In line with their 2021 performance, Puerto Rico banks should deliver faster growth and rising profitability during 2022.

Volatility, Inflation, Omicron and Interest Rates Spook Markets

In the second trading week of the year, the markets continued to be highly volatile, with most of the indexes showing negative YTD returns. Last Friday, before the bell, JP Morgan reported its 4Q21 earnings, a record of full-year earnings of $48.3 billion. However, the bank warned that rising costs could impact 2022 net income. Since the bank is primarily considered a vital indicator for the U.S. economy, the market reacted severely, taking the stock down 6.16 percent. In our view, revelation adds more uncertainty to an already foggy environment.

Since April, when the U.S. Consumer Price Index (CPI) rose to 4.16 percent, most everyone, including the Federal Reserve, stated that the CPI reading was temporary. Well, the increase continued for the eight months that followed: May, 4.99 percent; June, 5.39 percent; July, 5.37 percent; August, 5.25 percent; September, 5.39 percent; October, 6.22 percent; November, 6.81 percent; and December, 7.04 percent

In addition to the reasoning that inflation was temporary, the Fed did not want to impact the nascent economic recovery and that the U.S. labor market needed to reach full employment before it acted.

A slew of price increases across economic sectors has made inflation the critical risk in the current markets and for the whole of 2022. The combination of inflation, CPI, and Producer Price Index (PPI) increases forces the Fed to begin changing its monetary policy tone and gearing to begin to raise interest rates—as we said previously—by July, if not earlier. We have predicted that four interest rate hikes could happen in 2022, and we also believe the economy will be able to absorb the rate increases easily.

The CPI reported its latest reading of 7.04 percent, the most significant jump since 1982, the fastest pace since 1982, and the ninth straight month in which inflation exceeded 4 percent, or double the Fed's target of 2 percent.

Some of the most dramatic price increases we have examined:

– Price of gasoline: 58 percent
– Car rentals: 42.9 percent
– Used cars: 37 percent
– Hotels: 18 percent
– Meats, poultry, fish, and eggs: 13.1 percent
– TVs: 12.7 percent
– Furniture: 14 percent
– New cars: 11.5 percent

We expect that as global supply chain disruptions subside and energy prices begin to fall, we may see a material decrease in inflation. However fast, the Fed is now clearly focused on curbing inflation. Thus, most investors should prepare for an environment of rising rates and continued economic growth even as the pace has slowed. It is essential to mention that in this context, we may see lower returns, higher volatility with a continuance of the current bull market.

Usually, during rate increases, equities see periods of volatility following the change in monetary policy and around the first rate increase. However, historically, markets continue their rising path from six months to a year down the road. The key is patience and focus.

A vital asset class that plays a central role during rising rates are bonds, performing as a stabilizing force in your portfolio in times of increased equity-driven volatility. So, it is appropriate to allocate U.S. and international high-yield bonds to help enhance your overall returns. A reasonable allocation to domestic and international high-yield bonds may help improve returns.

We believe that the stock and asset rotation will continue favoring value investments and those sectors that benefit from rising interest rates.

Wall Street summary for the week ending Jan. 14:

– Dow Jones Industrial Average: closed at 35,911.81, down 319.85 points, for a YTD return of -1.17 percent.
– Standard & Poor's 500: closed at 4,662.85, down 14.18 points, for a YTD return of -2.17 percent.
– Nasdaq Composite Index: closed at 14,893.75, down 42.15 points, for a YTD return of -4.8 percent.
– Birling Capital Puerto Rico Stock Index: closed at 3,336.07, up 89.04 points, for a YTD return of 9.83 percent
– The U.S. Treasury 10-year note: closed at 1.78 percent.
– The U.S. Treasury 2-year note: closed at 0.99 percent.

The Final Word: Three of the Largest U.S. banks report 4Q21 earnings

JP Morgan (JPM): Revenues of $29.2 billion, down 1 percent, and net income of $10.4 billion, down 11 percent. The bank achieved full-year earnings of $48.3 billion, a record, but the stock fell as it warned that rising costs could impact 2022 net income. The stock closed at $157.87, down $10.36, or 6.16 percent.

Citigroup (C): Revenues of $17.01 billion, down 2 percent, and net income of $3.173 billion, down 32 percent. The stock closed at $66.96, down $0.82, or 1.21 percent.

Wells Fargo (WFC): Revenues of $20.8 billion, up 11 percent, and net income of $5.75 billion, up 12 percent. The stock closed at $58.05, up $2.05, or 3.66 percent.

Weekly Market Close Comparison	1/14/22	1/7/22	Return	YTD
Dow Jones Industrial Average	35,911.81	36,231.66	-0.88%	-1.17%
Standard & Poor's 500	4,662.85	4,677.03	-0.30%	-2.17%
Nasdaq Composite	14,893.75	14,935.90	-0.28%	-4.80%
Birling Puerto Rico Stock Index	3,336.07	3,247.03	2.74%	9.83%
U.S. Treasury 10-Year Note	1.78%	1.76%	1.14%	1.15%
U.S. Treasury 2-Year Note	0.99%	0.87%	13.79%	15.00%

Francisco Rodríguez-Castro is president and CEO of Birling Capital LLC. Think Strategically© is a publication by Birling Capital LLC that summarizes recent geopolitical, economic, market and other developments. This report is intended for general information purposes only and does not represent investment, legal, regulatory, or tax advice. Recipients are cautioned to seek appropriate professional counsel regarding any of the matters discussed.