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Markit Commentary

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European financials deflate in 2016

The potential for a prolonged sub-to-near-zero interest rate environment has turned the market tide against European banking shares, but investor sentiment is not unanimously bearish.

- Strong sell off in European financials as sector plummets 20% year to date
- Investors pull over $1bn in funds from European ETFs exposed to financials
- Despite the recent underperformance, few short sellers have jumped on the sector

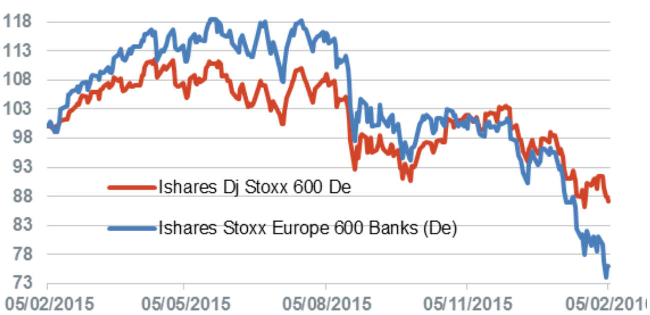
Whatever it takes

2016 has seen continued stimulus efforts and ambitions of central bankers fighting deflation square off against European financials. With Japan **surprising markets** with the implementation of negative interest rates last week, sentiment has turned aggressively sour towards major **European banks**.

In the past few weeks, the decline of financials has accelerated at nearly twice the pace that is seen in across the broader European market, as gauged by the iShares Stoxx 600 Europe Banks which is down by a staggering 20% year to date, twice that of its broader full index peer.

European Financials versus broader market

100 = 5th Feb 2015



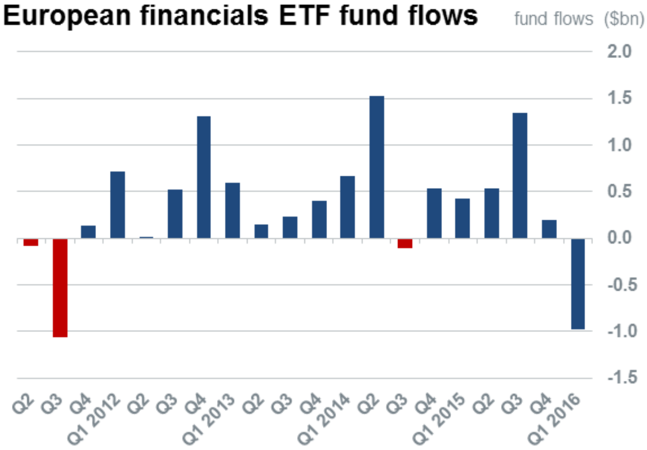
Source: Markit

ETF investors ahead of sell off

ETF investors seem to have no appetite to call the bottom of this trend as the 73 financial ETFs listed in Europe have seen significant outflows since the start of the year, with net withdraws approaching the $1bn mark year to date. This already outpaces the previous largest quarterly outflow of $1.1bn, seen in Q3 2011 when fears of financial contagion gripped European markets.

The recent outflow combined with poor price performance means that the AUM from these funds has shrunk by over $2bn, over 15% of last year's year end total.

European financials ETF fund flows



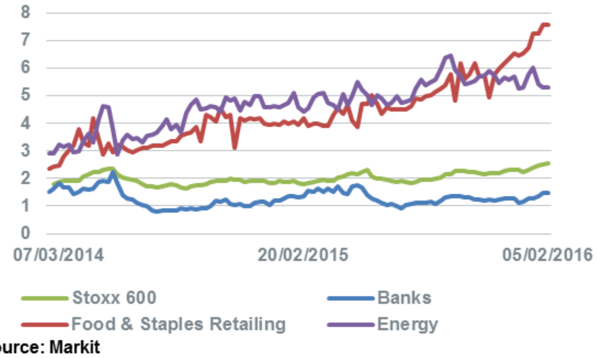
Source: Markit

Short sellers may have missed the sell off

But investor sentiment is not uniformly pessimistic sector wide, as short selling across European banking firms has continued to stay below that seen in the wider market. Banking shares now see 1.5% of their shares out on loan on average, one-third less of that of the average for Stoxx 600 constituents which stands at 2.6%.

Average short interest

% of Shares Out on Loan



Source: Markit

This gap has also shown no signs of closing in the recent weeks as demand to borrow stocks of banking firms in Europe has only increased by 9% in the last 12 months, while the rest of the market has seen a 33% increase in short interest.

The relatively low demand to sell banking firms short has revolved around periphery banks featuring Italian, Portuguese and Spanish banks. Even this trend has failed to see the kind of concentrated short selling seen in energy names, as only three European banks currently have short interest north of 5% of shares outstanding.

Top 10 Most Shorted Stoxx 600 Banks

Name	Ticker	Exchange	Short Interest	Change over Month	Quantity on loan (m)
Banca Monte Dei Paschi Di Siena Spa	BMPS	Milan Stock Exchange	7.6	783%	224
Banco Comercial Portugues Sa	BCP	Euronext Lisbon	6.8	6%	4022
Banco Popular Espanol Sa	POP	SIBE - Mercado continuo Espanol	6.1	0%	132
Unione Di Banche Italiane Spa	UBI	Milan Stock Exchange	4.6	18%	43
Banco De Sabadell Sa	SAB	SIBE - Mercado continuo Espanol	4.5	-18%	244
Raiffeisen Bank International Ag	RBI	Vienna Stock Exchange - Cash Market	4.5	-12%	13
Standard Chartered Plc	STAN	London Stock Exchange	2.9	123%	95
Caixabank Sa	CABK	SIBE - Mercado continuo Espanol	1.6	-26%	95
Banca Popolare Di Milano Scarl	PMI	Milan Stock Exchange	1.6	44%	69
Svenska Handelsbanken Ab	SHB A	OMX Nordic Exchange Stockholm AB - (	1.6	50%	29

Perhaps in the wake of the recent sell off in major European banks, combined with increasing **CDS** spreads, short sellers may be more tempted to go short financials if the uncertainty in the sector increases.

To receive more information on **Securities Finance**, **Research Signals**, **Exchange Traded Products**, **Dividend Forecasting** or our Short Squeeze model please **contact us**

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