Accidents Waiting to Happen - Deutsche Bank

31 May 2019

Deutsche Bank shares closed the month just barely above €6, down 24% since their 2019 high.

Deutsche Bank shares continue their steady decline—down almost 70% in just over 2 years. The share price went into an Unstable Contraction Mode in January of 2018 and is now almost 50% below the resulting Correction Level (Fig. 1). Our tail model says there's a high probability that the price will decline to less than €5. How long can the German government avoid a rescue?

One accident avoided.

The announcement that Commerzbank and Deutsche Bank were abandoning their merger talks avoided a repeat of the ill-advised bank mergers of the 2008-2009 financial crisis. Then, several pairs of banks which were in Unstable Contraction—an indicator of an anti-bubble of panic selling—merged. This was the financial equivalent of two drowning men clinging to each other instead of reaching for a life preserver[1].

But even with a potentially disastrous merger avoided, as Ferdinando Giugliano pointed out[2], Deutsche Bank is still a worry for the ECB, and rightly so. As Lehman Brothers demonstrated in 2008, Unstable Contractions needn't correct. Share prices can go to zero.

Third time not likely to be lucky.

This is the third time in the past decade that Deutsche Bank shares have been in Unstable Contraction. The first began in October 2007. By November 2008 its share price was 60% below the Correction Level. After losing 78%, the shares finally bounced back to the correction level in March 2009 as Central Bank intervention produced a global equity market rebound. The second time began in April 2012 and was reversed only after Mario Draghi's 'Whatever it takes' speech in July of that year.

It's not likely that either a global market recovery or a speech by the ECB President can be expected to stem the tide this time.

Drawdown Risk is Now Very High.

By the end of May, our tail model for 10-day returns on Deutsche Bank shares has the 99% VaR at over 19% , well over the loss required for the share price to fall below €5. The 10-day drawdown required for that should happen once every 4 months. That would take Deutsche Bank's market capitalisation *below €10 billion*.

Can the bank the IMF identified as the most systemically dangerous in the world[3] continue to support its enormous balance sheet on a minuscule market cap? It can't be long before the German government will face extreme pressure for a rescue. Who else is going to do it?

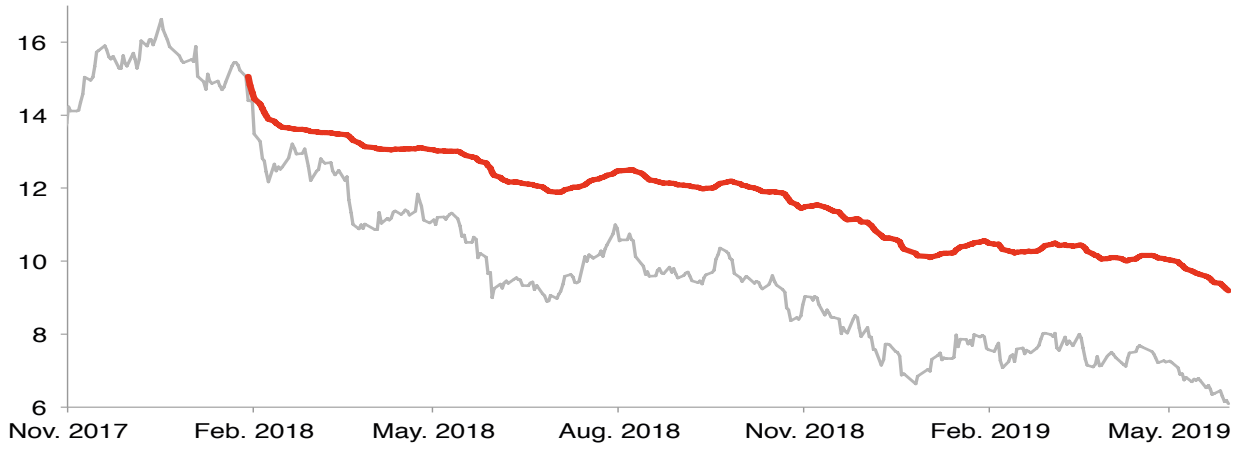

Figure 1. Deutsche Bank has an uncorrected Unstable Contraction that began in October 2018. This is an indicator of an Anti-Bubble of panic selling. The Correction Level is shown in red. As of the 31 May 2019 close, the share price was 47% below this level.

---

[1] *Bank Mergers: Back to the mistakes of 2008?* What Just Happened? 18 October 2016, https://www.omegaanalysis.com/bank-sector

[2] Ferdinando Giuliano *Deutsche Bank Is Still a Worry for the ECB*, 6 May 2019, https://www.bloomberg.com/opinion/articles/2019-05-06/deutsche-bank-is-still-a-worry-for-the-ecb

[3] Hans Benzine, *Deutsche Bank Poses Greatest Risk to Global Financial System, IMF Says.* Wall Street Journal June 30, 2016 https://www.wsj.com/articles/deutsche-bank-poses-greatest-risk-to-global-financial-system-imf-says-1467239405

Omega Analysis Notes

LEGAL NOTICE

Please read this notice carefully:
The contents of this document are for illustrative and informational purposes only. No information in this document should be considered a solicitation or offer to buy or sell any financial instrument or to offer any investment advice or opinion as to the suitability of any security in any jurisdiction. All information is subject to change and correction due to market conditions and other factors.This document has been created without any regard to the specific investment needs and objectives of any party in any jurisdiction. Specific instruments are mentioned in this document but this should not be construed in any way as a recommendation to invest in them or in funds or other instruments based on them. They are used for informational purposes only. Omega Analysis Limited does not provide investment advice. Investors need to seek advice regarding suitability of investing in any securities or investment strategies. Any decisions made on the basis of information contained herein are at your sole discretion and should be made with your independent investment advisor.