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The discreet charm of a Swiss private bank

James Rutter, Deputy Editor

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Who would have thought old-fashioned private banking could be such a profitable business? Last week's results from Credit Suisse and UBS showed the big two Swiss banks can still teach their rivals a thing or two about the more discreet side of moneymaking.

Not so long ago private banking looked like a business in decline. Undermined by the internet and then decimated by the equity bear market, wealth management was in a sorry state. Now it looks like an engine for growth and a vital foundation for earnings at many of the world's biggest banks.

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UBS's private bank saw 9% net new money growth in the first quarter, bringing in Sfr19bn (€12bn), while Credit Suisse pulled in Sfr11bn at an annualised growth rate of 8%. Importantly, the situation is different from that at their respective investment banks: expenses are not set to rise as profits rebound over the next year or two. Revenues from new assets go straight to the bottom line. Private banking also offers exposure to many of the hot spots in financial markets.

Hedge funds, structured products and Asia are the three that spring most readily to mind.

It's not only the Swiss who are getting excited about wealth management prospects. Merrill Lynch splits the two Swiss banks at the top of the ranks of the world's biggest private banks. "I believe the wealth management side offers great potential for growth and we've only begun to scratch the surface," said Stan O'Neal, chief executive, earlier this year.

Merrill's first-quarter results duly bore out his optimism, with the bank's global private client division posting record pre-tax earnings. O'Neal also said he would think about buying in order to accelerate growth.

Certainly, the private banking sector is ripe for consolidation. Ray Soudah at Millenium Associates reckons at least 50 deals involving Swiss banks will be attempted this year. Merrill, meanwhile, remains highly dependent on the domestic US market. Rather than trying to attack Europe, Asia looks set to offer it more exciting growth opportunities.

Both Merrill and Citigroup have expanded their private client businesses into China this year, with the former announcing a joint venture with Bank of China last month. Four-fifths of Chinese wealth is now concentrated in the hands of a fifth of the population, according to China's National Bureau of Statistics. There's nothing private bankers like more than a bit of inequality.

Testing Pimco's progress

These could be testing times for Pimco, by far the biggest buyside power in the bond market. Last week, its smaller equity arm was charged by the US Securities and Exchange Commission over market-timing. While there is no link to its bond business, the brand damage could spill over. Then there is the gloomy outlook for bonds, which threatens to end a remarkable period of growth for the firm.

Under the leadership of Bill Gross, Pimco has ridden the bond bull with peerless skill.

Gross & Co secured an extremely lucrative sale to Allianz in 2000, for which the German insurer is still paying – €137m in loyalty bonuses to Pimco management last year. In return, Allianz has got an asset-gathering machine that has added $150bn in assets in the past three years. The question is whether it will continue to flourish.

Betting against Pimco in the bond market is like betting against the house in Las Vegas. Its size and global resources are second to none. What it may lose in terms of growth momentum in the US, it should easily make up in Europe and Asia, where it is a relative newcomer. Its institutional business is also rock solid. The firm has come out with a string of innovative products in recent years that take some of the pressure off its US bond business. Gross – who played professional blackjack in his youth – also has a knack for making big bets that pay off handsomely.

The really big test is likely to come when 60-year-old Gross steps down. In the meantime, Pimco should negotiate the scandal over market-timing better than many of its rivals.