Financials Sector Update
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Table of Contents

Section I
Overview
Section II
Business Analysis
Section III
Economic Analysis
Section IV
Financial Analysis
Section V
Valuation
Section VI
Recommendation
Overview
Overview

Sector Weighting: S&P 500 vs. OSU SIM Fund\(^{(1)}\)

- Cash and Dividend Receivables
- Telecommunication Services
- Utilities
- Materials
- Energy
- Consumer Staples
- Industrials
- Consumer Discretionary
- Healthcare
- Financials
- Information Technology

\(^{(1)}\) As of February 27, 2015
Overview (cont’d.)

OSU SIM Fund Sector Weights

- Information Technology: 24%
- Financials: 20%
- Healthcare: 15%
- Consumer Discretionary: 9%
- Industrials: 8%
- Consumer Staples: 9%
- Energy: 8%
- Materials: 3%
- Telecommunication Services: 3%
- Cash and Dividend Receivables: 1%

(1) As of February 27, 2015
Overview (cont’d.)

Financials Sector - Industries:\(^{(1)}\):

- Banks
- Capital Markets
- Consumer Finance
- Diversified Financial Services
- Insurance
- Real Estate Investment Trusts (REITs)
- Real Estate Management and Development
- Thrifts & Mortgage Finance

Largest Firms by Market Cap:\(^{(2)}\):

- **Wells Fargo**: $288.2B
- **J.P. Morgan**: $230.2B
- **Berkshire Hathaway Inc.**: $180.1B
- **HSBC**: $167.4B
- **Bank of America**: $166.7B

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(1) Sources: Fidelity Investments and Yahoo Finance
(2) As of March 19, 2015
LTM Sector Performance Relative to Index\(^{(1)}\)

- S&P 500
- S&P 500 Financials

Sources: Yahoo Finance and us.spindices.com
Business Analysis
Business Life Cycle

The traditional financials sector is in a late growth stage
## Banking Industry Analysis

*5 forces indicate low industry wide profitability*

<table>
<thead>
<tr>
<th>Threat of New Entry</th>
<th>Low</th>
<th>Onerous regulatory hurdles, extremely difficult to receive new banking charter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Threat of Substitutes</td>
<td>High</td>
<td>Credit cards, mobile payments, online brokerage, crypto currencies, etc.</td>
</tr>
<tr>
<td>Rivalry</td>
<td>High</td>
<td>Constant fight for a relatively fixed “pie” of customers</td>
</tr>
<tr>
<td>Power of Buyers</td>
<td>Medium</td>
<td>Low switching costs, easy to compare rates, many institutions to choose from</td>
</tr>
<tr>
<td>Power of Suppliers</td>
<td>High</td>
<td>Heavy regulation by government and Federal Reserve, low switching costs for depositors</td>
</tr>
</tbody>
</table>
Macroeconomic Factors

Financials industry highly correlated with primary economic indicators

Interest Rates\(^{(1)}\)
- Current 10-year Treasury Yield: 1.92% ; 10-year Treasury Yield in 2005: 4.61%
- Federal Reserve upcoming taper of quantitative easing will have positive impacts on industry
- EU embarking on similar quantitative easing policy

Foreign Exchange
- Recent rally of the US dollar relative to international currencies
- Removal of Swiss Franc peg to Euro

Employment Rate
- Increased employment domestically is a driving force behind increased consumer spending and the home mortgage market

GDP Growth
- Stagnant growth/recovery in Europe; China growth cooling off

Regulation

Firms within the Financials sector face high costs of regulatory compliance

**Basel III Capital Requirements**
- Capital level stress tests; less leverage in operations
- Citigroup (NYSE: C) recently failed a federally mandated stress test

**Dodd Frank**
- Separation of investment and commercial banking activities
- Significantly reduced profitable proprietary trading activities
- Imposed many new regulations with relatively high costs of compliance
Economic Analysis
Economic Analysis

Rate Increases - Net Interest Income

- Wide expectations of rising rates
- Rising interest rates positively impact NII
  - NII has been depressed for an extended period

Interest Income vs Federal Funds Rate
Economic Analysis

Rate Increases - Net Interest Income

- Wide expectations of rising rates
- Rising interest rates positively impact NII
  - NII has been depressed for an extended period
  - Lower unemployment encourages Fed
Economic Analysis

*GDP Expansion – Loan Growth*

- GDP expansion accelerates loan growth
- Rising interest rates can lower loan growth
  - Largely based on timing

![Real GDP Graph](image-url)
Financial Analysis
Financial Analysis

Revenue/share slow to rebound; Stronger earnings and profitability

Revenue/Share\(^{(1)}\)

EPS\(^{(1)}\)

(1) Source: Bloomberg as of March 23, 2015.
Financials vs. S&P 500-ROE(1)

(1) Source: Bloomberg as of March 23, 2015..
Current financial performance metrics are in-line with historical levels

(1) Source: Bloomberg as of March 23, 2015..
Valuation
# Valuation

**Financials Sector vs. S&P 500**

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>5 yr High</td>
<td>37.69</td>
<td>19.00</td>
<td>2.41</td>
<td>1.85</td>
<td>1.39</td>
<td>2.73</td>
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</tr>
<tr>
<td>5 yr Low</td>
<td>10.71</td>
<td>12.24</td>
<td>1.23</td>
<td>1.06</td>
<td>0.78</td>
<td>1.76</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 yr Median</td>
<td>13.58</td>
<td>15.49</td>
<td>1.65</td>
<td>1.30</td>
<td>1.06</td>
<td>2.11</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Current</td>
<td>15.25</td>
<td>18.78</td>
<td>2.36</td>
<td>1.84</td>
<td>1.41</td>
<td>2.90</td>
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</tbody>
</table>

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</tr>
</thead>
<tbody>
<tr>
<td>5 yr High</td>
<td>1.98</td>
<td>1.30</td>
<td>0.51</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>5 yr Low</td>
<td>0.88</td>
<td>1.16</td>
<td>0.44</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>5 yr Median</td>
<td>0.88</td>
<td>1.27</td>
<td>0.50</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current</td>
<td>0.81</td>
<td>1.28</td>
<td>0.49</td>
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</tbody>
</table>

(1) Source: Bloomberg as of March 23, 2015. Note: S5FINL used for financials sector index, SPX used for S&P 500 index.
Valuation (cont’d.)

Financials Sector vs. S&P 500

(1) Source: Bloomberg as of March 23, 2015. Note: S5FINL used for financials sector index, SPX used for S&P 500 index.
Valuation (cont’d.)

SIM Portfolio Financials Sector Holdings Analysis

<table>
<thead>
<tr>
<th>SIM Holding</th>
<th>Beta</th>
<th>Trailing P/E</th>
<th>Forward P/E</th>
<th>P/S</th>
<th>P/B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wells Fargo (WFC)</td>
<td>0.96</td>
<td>13.60</td>
<td>13.39</td>
<td>3.31</td>
<td>1.75</td>
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<tr>
<td>Citigroup (C)</td>
<td>1.23</td>
<td>10.15</td>
<td>9.79</td>
<td>1.76</td>
<td>0.79</td>
</tr>
<tr>
<td>JP Morgan Chase (JPM)</td>
<td>1.15</td>
<td>10.30</td>
<td>10.49</td>
<td>2.25</td>
<td>1.07</td>
</tr>
<tr>
<td>Keycorp (KEY)</td>
<td>1.15</td>
<td>13.80</td>
<td>12.91</td>
<td>2.91</td>
<td>1.22</td>
</tr>
<tr>
<td>Suntrust Banks (STI)</td>
<td>1.12</td>
<td>11.88</td>
<td>13.01</td>
<td>2.54</td>
<td>1.01</td>
</tr>
<tr>
<td>S5FINL Index</td>
<td>1.88</td>
<td>15.25</td>
<td>14.49</td>
<td>2.36</td>
<td>1.41</td>
</tr>
<tr>
<td>SPX Index</td>
<td>1.37</td>
<td>18.78</td>
<td>17.83</td>
<td>1.84</td>
<td>2.90</td>
</tr>
</tbody>
</table>

(1) Sources: Bloomberg as of March 23, 2015 and SIM Fund February Appraisal. Note: S5FINL used for financials sector index, SPX used for S&P 500 index.
## Valuation (cont’d.)

### Level 2 Sub-Sectors (Industry Groups) of S5FINL Index\(^{(1)}\)

<table>
<thead>
<tr>
<th>Sub-Sector</th>
<th>Trailing P/E</th>
<th>Forward P/E</th>
<th>P/S</th>
<th>P/B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks (S5BANKX)</td>
<td>11.79</td>
<td>11.77</td>
<td>2.68</td>
<td>1.1</td>
</tr>
<tr>
<td>Diversified Financials (S5DIVF)</td>
<td>18.20</td>
<td>16.09</td>
<td>2.62</td>
<td>1.72</td>
</tr>
<tr>
<td>Insurance (S5INSU)</td>
<td>12.52</td>
<td>11.36</td>
<td>1.14</td>
<td>1.1</td>
</tr>
<tr>
<td>Real Estate (S5REAL)</td>
<td>36.46</td>
<td>39.04</td>
<td>7.17</td>
<td>3.53</td>
</tr>
<tr>
<td><strong>S5FINL Index</strong></td>
<td><strong>15.25</strong></td>
<td><strong>14.49</strong></td>
<td><strong>2.36</strong></td>
<td><strong>1.41</strong></td>
</tr>
</tbody>
</table>

\(^{(1)}\) Sources: Bloomberg as of March 23. Note: S5FINL used for financials sector index, SPX used for S&P 500 index.
Recommendation
Recommendation

• S&P 500: 16.07%  |  SIM Weight: 18.76%
• SIM portfolio is 2.69%  overweight in Financials relative to the index
• We recommend a HOLD rating

Rationale

• The financials sector is entering into a mature growth stage of its business cycle and we expect continued growth over the next few years

• Consumer confidence is increasing and the housing market is still improving

• Risks: strict regulation, legal fees, uncertainty of the global economy