

Financial Sector Report
Brett Stewart
Investment Management Program (IMP) 2021 Fall Semester

Size and Composition of the Sector:

- The Market Cap of the financial sector as of September 8th is \$8.70Trillion and includes seven industries. Those industries include Banks (\$3.86T), Capital Markets (\$2.03T), Consumer Finance (\$395.39B), Diversified Financial Services (\$694.85B), Insurance (\$1.54T), Mortgage REITs (\$74.20B), and Thrifts and Mortgage Finance (\$96.83B).
- The one-year percent change in the financial sector has gained 49.27% as of September 8th, 2021, which was the highest of all the sectors in that time period.
- The largest companies in this sector include Berkshire Hathaway, JP Morgan Chase & Co, Bank of America Corp (we own), Wells Fargo & Co, Morgan Stanley, Citigroup Inc, Goldman Sachs Group Inc, BlackRock Inc (we own), Charles Schwab Corp, and American Express Co.
- As of September 8th, 2021, the financial sector in the last 3 month has a return of -1.88%. Only two industries have posted positive returns during this time period one of which being capital markets with 5.52% and insurance with 0.52%.
- The S&P 500 has the financial sector weighted at 10.95% as of July 30th, 2021, of the overall allocation, the Wiseman Fund has the financial sector weighted at 12.94% as of July 30st, 2021. The S&P Dow Jones Indices has it weighted at 11.2% as of August 31st of 2021. This shows that we have overweighted the financial sector compared to the S&P 500 and S&P Dow Jones Indices at a time that the financial sector outperformed every other sector.

Business Analysis:

- According to Fidelity the US business cycle is in the mid-cycle with only China ahead of it. The Eurozone, UK, Australia, and Canada have just entered the mid-cycle, while Japan and Korea are in a transition period between the early and mid-cycle. This leaves Brazil, India, and Mexico behind in the early stage of the business cycle. In the early business cycle the financial sector typically experiences larger than normal gains and normal gains in the remaining three stages of the business cycle.
- An important external factor that needs to be taken into consideration is the interest rates. When rates are low more capital projects and investments come about due to the affordable interest rate, but with small profits. Ideally financial services companies want interest rates to moderately rise because they can earn more on the money they have and on credit they issue to their customers. On the flip side if interest rates increase rapidly the demand for credit drops which in turn negatively affects the financial sector.
- Government regulation is also an external factor that can impact the financial sector. If governments reduce regulation, profits will increase while lessening the burden on corporations in the financial sector. On the other hand, governments could increase regulation thus decreasing profits while increasing the burden on businesses in the financial sector.
- Lower consumer debt levels are another external factor that impacts the financial sector. If consumers decrease their debt, then they have a lower risk of defaulting on loans. This also allows for consumers to increase their debt tolerance, further increasing profitability.

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- The yield curve also plays a huge role in the profitability of the financial sector. If the yield curve flattens then profitability falls because the spread on lending is tight. A steep yield curve allows for a wider spread thus increasing profitability on lending.
- The financial sector has a multitude of barriers to entry which include licensing laws, capital requirements, access to financing, and regulatory compliance and security concerns. High fixed costs and large sunk costs make it challenging for startups to compete with established firms.

Economic Analysis:

- The financial sector is primarily a cyclical sector. Cyclical stocks are companies whose stock prices are affected by macroeconomic or systematic changes in the overall economy. Simply put cyclical stocks do well when the economy is booming, and people are spending money opposed to when the economy is in a recession. This reinforces the notion that the financial sector outperforms in the early business cycle and then levels off in the remaining stages.
- As mentioned earlier interest rates, government regulation, and consumer debt levels are external economic variables that impact the profitability of companies in the financial sector.
- We own five stocks in this sector. Bank of America is in the banking industry. Horizon Technology and BlackRock are in the capital market industry. Visa and Capital One are in the consumer finance industry. Luckily, two of our five stocks are in the capital market industry which is one of two industries to post a positive return in the past three months (5.52%).

Financial Analysis:

- The average EPS in the banking industry is \$6.38, revenue growth is -5.75%, ROE is 13.22%, ROI is 5.07%, and with a dividend yield of 2.64% as of September 8th, 2021. Comparing that to Bank of America in the same period, their EPS is \$3.00, ROE of 10.56%, a dividend yield of 2.09%, revenue growth of -15.77%, and FCF/Net Income ratio is 2.12. Bank of Americas ROI was not listed. A majority of these valuations are worst than the industry average which suggests I should look at other stocks in this industry.
- The average EPS in the capital market industry is \$11.55, revenue growth is 59.59%, ROE is 37.57%, ROI is 11.52%, and has a dividend yield of 1.93%. Comparing that to Horizon Technology in the same period, their EPS is \$0.59, ROE is 5.59%, and with a dividend yield of 7.21%, revenue growth of 2.32%, and FCF/Net Income ratio of 6.53. Horizon Technology ROI was not listed. BlackRock is also in the capital market industry and has an EPS of \$35.55, revenue growth of 20.22%, ROE of 15.97%, ROI of 13.60%, dividend yield of 1.80%, and FCF/Net Income ratio of 0.72. As we can see here HRZN only outperformed the industry with its dividend yield, while BLK was able to outperform the industry in EPS and ROI. This suggests that I should look at other stocks in this industry.

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- The average EPS in the consumer finance industry is \$11.77, revenue growth is 3.70%, ROE is 28.33%, ROI is 11.07%, and has a dividend yield of 1.34%. Comparing that to Visa in the same period of time, their EPS is \$4.95, revenue growth of -1.03%, ROE of 33.49%, ROI is 21.73%, has a dividend yield of 0.57%, and FCF/Net Income of 1.17. Capital One is also listed in the consumer finance industry and has an EPS of \$25.14, revenue growth of -4.98%, ROE of 19.04%, a dividend yield of 1.51%, and has FCF/Net Income of 1.05. Capital One's ROI was not listed. This shows us that HRZN has a better ROE and ROI than the industry average but is underperforming in all the other aspects mentioned, while COF is outperforming in EPS and dividend yield.

Valuation Analysis:

- The Financial Select Sector SPDR Fund (XLF) is used to track the performance of the financial sector. It has a P/E ratio of 13.64, P/B ratio of 1.49, P/S ratio of 2.46, and a dividend yield of 1.92%.
- The SPDR S&P 500 ETF (SPY) is used to track the performance of the S&P 500. It has a P/E ratio of 21.83, P/B of 4.06, P/S of 2.86, and a dividend yield of 1.42%.
- Bank of America: Current P/E 13.65, P/B of 1.36, P/S 4.17, and trailing dividend yield of 1.83%.
- Horizon Technology: Current P/E 28.86, P/B 1.52, P/S 20.16, and trailing dividend yield of 7.17%.
- Visa: Current P/E 44.73, P/B 13.78, P/S 21.79, and trailing dividend yield of 0.57%.
- Capital One: Current P/E 6.32, P/B 1.10, P/S 2.54, and trailing dividend yield of 0.94%.
- BlackRock: Current P/E 25.77, P/B 3.87, P/S 7.82, and trailing dividend yield of 1.75%.
- As we can see only Capital One has a smaller P/E ratio than the average with 6.32. Visa and BlackRock have higher than average P/B ratios with 13.78 and 3.87 respectively. All the stocks we own in the finance sector have higher than average P/S ratios and only Horizon Technology has a higher dividend yield than the average.
- I expect the valuations in this industry to fluctuate depending on the interests' rates and the economic cycle since these directly impact the financial sector's ability to make a profit. As we dive further into the mid-cycle, I would expect profits to decrease. I would expect the same result if interest rates were to drop as well.

Recommendations:

- I believe that IMP should underweight the financial sector comparative to the S&P 500. Currently the IMP weight is 12.94% and the S&P 500 weight is 10.95%. I recommend that we lower the IMP weight to 10%. Last year's recommendation to overweight the financial sector paid off, but this year I fear that the financial sector will not outperform the market. As noted earlier the financial sector has had negative returns in the last 3 months (-1.88%) with only two industries posting positive returns. This coupled with the subpar expected returns based on the economic condition make me think that underweighting the financial sector would be beneficial to our portfolio.

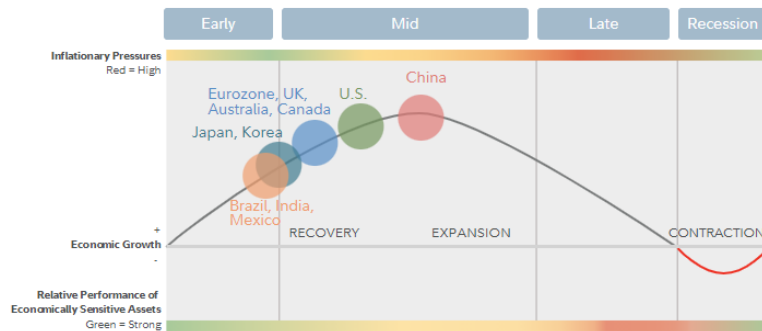
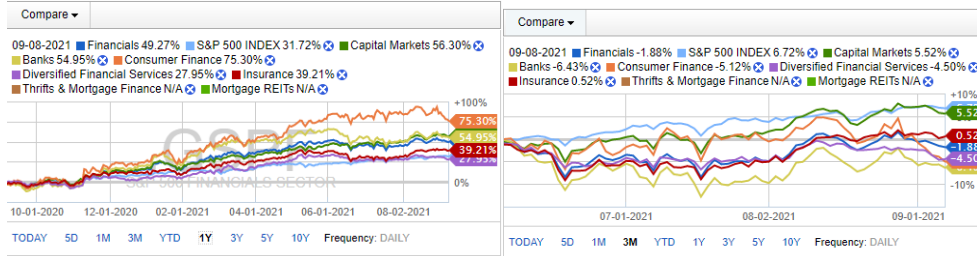
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- Underweighting the financial sector will give us the freedom to overweight other sectors that historically overperform during the mid to late cycle of the economy.

Charts and Graphs:



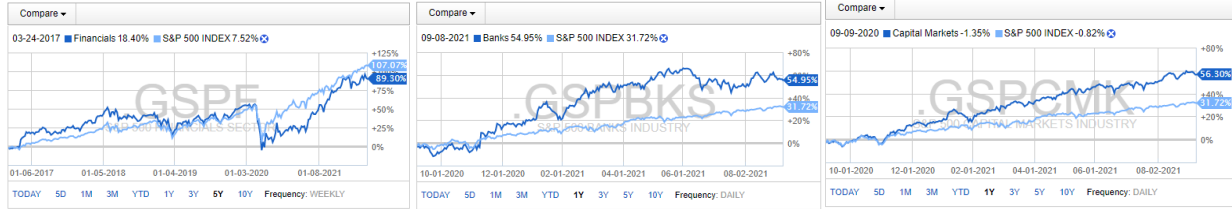
Industries in This Sector

Industry ▲	Last % Change 03:44 PM ET 09/09/2021	% CHANGE 09/08/2021			
		YTD	1 - Year	3 - Year	5 - Year
Financials	+0.66%	+27.59%	+49.27%	+33.53%	+89.73%
Banks	+1.04%	+27.48%	+54.95%	+15.85%	+78.96%
Capital Markets	+0.41%	+32.37%	+56.30%	+66.97%	+136.32%
Consumer Finance	+1.28%	+38.16%	+75.30%	+52.03%	+112.52%
Diversified Financial Services	+0.03%	+20.47%	+27.95%	+30.26%	+87.40%
Insurance	+0.58%	+23.11%	+39.21%	+34.74%	+63.23%
Mortgage REITs	--	--	--	--	--
Thriffs & Mortgage Finance	--	--	--	--	--
S&P 500 © Index	-0.19%	+20.18%	+31.72%	+57.19%	+106.48%

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Sector Fundamentals AS OF 09/08/2021

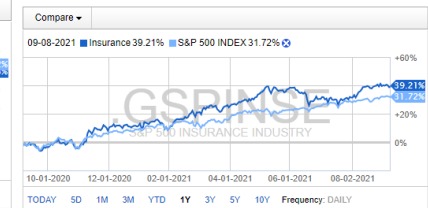
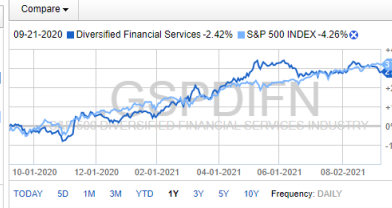
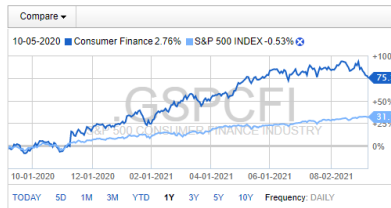
P/E (Last Year GAAP Actual)	10.84
P/E (This Year's Estimate)	9.24
Enterprise Value	\$138.02B
EPS (TTM)	\$11.55
EPS Growth (TTM vs. Prior TTM)	162.01%
Revenue Growth (TTM vs. Prior TTM)	19.34%
Return on Equity (TTM)	21.48%
Return on Investment (TTM)	8.93%
Total Debt/Equity (TTM)	165.62
Dividend Yield	2.54%

Industry Fundamentals AS OF 09/08/2021

P/E (Last Year GAAP Actual)	10.85
P/E (This Year's Estimate)	8.77
Enterprise Value	\$85.68B
EPS (TTM)	\$6.38
EPS Growth (TTM vs. Prior TTM)	102.72%
Revenue Growth (TTM vs. Prior TTM)	-5.75%
Return on Equity (TTM)	13.22%
Return on Investment (TTM)	5.07%
Total Debt/Equity (TTM)	194.35
Dividend Yield	2.64%

Industry Fundamentals AS OF 09/08/2021

P/E (Last Year GAAP Actual)	15.61
P/E (This Year's Estimate)	13.33
Enterprise Value	\$125.32B
EPS (TTM)	\$11.55
EPS Growth (TTM vs. Prior TTM)	207.46%
Revenue Growth (TTM vs. Prior TTM)	59.59%
Return on Equity (TTM)	37.57%
Return on Investment (TTM)	11.52%
Total Debt/Equity (TTM)	222.83
Dividend Yield	1.93%



Industry Fundamentals AS OF 09/08/2021

P/E (Last Year GAAP Actual)	9.19
P/E (This Year's Estimate)	7.28
Enterprise Value	\$89.59B
EPS (TTM)	\$11.77
EPS Growth (TTM vs. Prior TTM)	587.14%
Revenue Growth (TTM vs. Prior TTM)	3.70%
Return on Equity (TTM)	28.33%
Return on Investment (TTM)	11.07%
Total Debt/Equity (TTM)	202.00
Dividend Yield	1.34%

Industry Fundamentals AS OF 09/08/2021

P/E (Last Year GAAP Actual)	6.51
P/E (This Year's Estimate)	5.89
Enterprise Value	\$551.97B
EPS (TTM)	\$41.75
EPS Growth (TTM vs. Prior TTM)	226.34%
Revenue Growth (TTM vs. Prior TTM)	35.33%
Return on Equity (TTM)	21.99%
Return on Investment (TTM)	16.80%
Total Debt/Equity (TTM)	34.81
Dividend Yield	2.70%

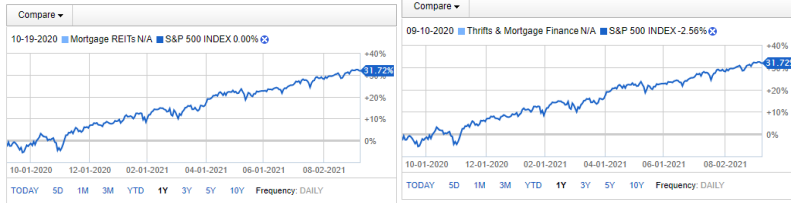
Industry Fundamentals AS OF 09/08/2021

P/E (Last Year GAAP Actual)	10.83
P/E (This Year's Estimate)	9.18
Enterprise Value	\$43.29B
EPS (TTM)	\$11.78
EPS Growth (TTM vs. Prior TTM)	109.73%
Revenue Growth (TTM vs. Prior TTM)	11.48%
Return on Equity (TTM)	16.74%
Return on Investment (TTM)	10.86%
Total Debt/Equity (TTM)	47.40
Dividend Yield	3.00%

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Industry Fundamentals AS OF 09/08/2021		Industry Fundamentals AS OF 09/08/2021	
P/E (Last Year GAAP Actual)	6.87	P/E (Last Year GAAP Actual)	7.78
P/E (This Year's Estimate)	...	P/E (This Year's Estimate)	8.81
Enterprise Value	\$36.80B	Enterprise Value	\$345.76B
EPS (TTM)	\$2.00	EPS (TTM)	\$4.55
EPS Growth (TTM vs. Prior TTM)	218.06%	EPS Growth (TTM vs. Prior TTM)	44.27%
Revenue Growth (TTM vs. Prior TTM)	5.63%	Revenue Growth (TTM vs. Prior TTM)	7.90%
Return on Equity (TTM)	15.56%	Return on Equity (TTM)	17.40%
Return on Investment (TTM)	2.98%	Return on Investment (TTM)	6.52%
Total Debt/Equity (TTM)	444.59	Total Debt/Equity (TTM)	128.30
Dividend Yield	8.06%	Dividend Yield	2.88%

Sector	Last % Change AS OF 04/03 PM ET 09/08/2021	Market Cap 09/08/2021	1-Year % Change 09/08/2021
Communication Services 5 Industries	-0.33%	\$7.01T	+40.19%
Consumer Discretionary 11 Industries	-0.23%	\$9.14T	+20.83%
Consumer Staples 6 Industries	-0.61%	\$4.63T	+12.14%
Energy 2 Industries	+0.11%	\$2.64T	+37.18%
Financials 7 Industries	+0.25%	\$8.70T	+49.27%
Health Care 6 Industries	-1.17%	\$8.52T	+28.68%
Industrials 14 Industries	-0.47%	\$5.89T	+32.32%
Information Technology 6 Industries	-0.42%	\$16.15T	+34.27%
Materials 5 Industries	+0.07%	\$2.67T	+29.82%
Real Estate 2 Industries	-2.12%	\$1.78T	+34.82%
Utilities 5 Industries	-0.59%	\$1.68T	+17.67%
S&P 500 Index	-0.46%	--	+31.72%

Sector Breakdown



SECTOR	INDEX WEIGHT
Information Technology	27.9%
Health Care	13.4%
Consumer Discretionary	11.9%
Communication Services	11.5%
Financials	11.2%
Industrials	8.2%
Consumer Staples	5.8%
Real Estate	2.6%
Materials	2.6%
Utilities	2.5%
Energy	2.4%

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Financials 7 Industries	+0.25%	\$8.70T	+49.27%
Banks	+0.58%	\$3.86T	+54.95%
Capital Markets	+0.02%	\$2.03T	+56.30%
Consumer Finance	+0.78%	\$395.39B	+75.30%
Diversified Financial Services	-0.26%	\$694.85B	+27.95%
Insurance	+0.12%	\$1.54T	+39.21%
Mortgage REITs	--	\$74.23B	--
Thriffs & Mortgage Finance	--	\$96.83B	--

Equity Sector Weights		
Sector	IMP	S&P 500
Communication Services	6.50%	11.24%
Consumer Discretionary	14.13%	12.05%
Consumer Staples	6.29%	5.85%
Energy	2.45%	2.55%
Financials	12.94%	10.95%
Health Care	10.90%	13.42%
Real Estate	2.21%	2.63%
Industrials	6.22%	8.41%
Information Technology	31.89%	27.82%
Materials	4.55%	2.59%
Utilities	1.92%	2.48%
Total	100.00%	100.00%

Value & Growth Measures	Fund
Price/Earnings	21.83
Price/Book	4.06
Price/Sales	2.86
Price/Cash Flow	15.09
Dividend Yield %	1.42
Long-Term Earnings %	13.30
Historical Earnings %	2.73
Sales Growth %	2.91
Cash-Flow Growth %	6.46
Book-Value Growth %	4.77

SPY

Value & Growth Measures	Fund
Price/Earnings	13.64
Price/Book	1.49
Price/Sales	2.46
Price/Cash Flow	--
Dividend Yield %	1.92
Long-Term Earnings %	--
Historical Earnings %	-3.33
Sales Growth %	7.34
Cash-Flow Growth %	--
Book-Value Growth %	6.36

XLFF

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Resources:

<http://www.sectorspdr.com/sectorspdr/sectors>

https://eresearch.fidelity.com/eresearch/markets_sectors/sectors/sectors_in_market.jhtml

<http://library.morningstar.com/Markets/MarketsHome.aspx>

<https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview>