"Financial Fling"

It has been said that, "Sarbanes-Oxley may be the most detrimental Act to small business ever passed." I bring that topic up this morning because of the numerous emails I received yesterday about the KBW Bank Index’s upside breakout in the charts (see chart). A few of my emailers even suggested the breakout could be driven by the potential for a Donald Trump presidency because he has hinted he would replace SarbOx with a business friendly version. While I seriously doubt that is the reason said breakout, in this crazy election, who knows? I will note the Financials have underperformed for a long time and they are relatively cheap. As for what to play in the banking complex, our fundamental bank analyst team wrote this yesterday:

Look for NIM stability in a challenging rate environment: Throughout 1H16 bank net interest margins (NIM) have generally been under pressure and, looking forward, we expect the low interest rate environment to continue pressuring loan yields and margins during 2H16. In this edition of the Bank Weekly, we take a closer look at banks within the Raymond James coverage universe that have been able to maintain relatively strong and stable NIMs over the past 12 months. The adjacent table [found in the linked report] shows a list of the top 15 banks in our coverage universe with NIMs (net interest income divided by average earning assets) above 3.50% and relative stability on a year-over-year (up or down by six basis points or less). It is important to note that the margins shown in the table include discount accretion income on acquired loans where applicable. However, that should not diminish the relative margin stability shown by these banks. The ability to maintain relatively strong and stable margins better positions these banks to outperform peers in the persistently low interest rate environment. Specifically, we will highlight Outperform-rated Banner Corporation (BANR/$43.95), National Commerce (NCOM/$26.56), First Bancorp (FBNC/$20.08), Hanmi Financial (HAFC/$26.11), First Financial Bancorp (FFBC/$21.84), and First Business Financial Services, Inc. (FBIZ/$22.58).

If you don’t care to be “stock specific,” you might consider David Ellison’s large and small capitalization mutual funds: Hennessy Large Cap Financial Fund (HFNX/$15.77) and Hennessy Small Cap Financial Fund (HSFNX/$23.28). I first met David in the early 1980s when he managed the Fidelity Select Financial Fund. (Continued on page 2.)

“The costs of compliance with Sarbanes-Oxley divert capital away from activities that create jobs. Yet the committee is actually considering imposing Sarbanes-Oxley-like regulations on the mutual funds industry! Instead of expanding the regulatory state, the committee should examine the economic effects of Sarbanes-Oxley and at least pass legislation exempting small businesses from the law’s requirements.”

... Ron Paul (2004)
He then managed financial-centric mutual funds at FBR, and now at Hennessy Funds. David raised 50% cash in the 1Q08; needless to say he is my kind of investor, and a friend. BTW, yesterday the Financials were the “stars” of the session. Still while the S&P 500 (SPX/2180.38) recaptured our key 2175 “pivot point,” it failed to better last Friday’s high of ~2187 leaving our short-term model neutrally configured. However, that is not true for the Financials, which look to want to go substantially higher. As I write at 5:30 a.m. the preopening S&P futures are flat on no overnight news.
**U.S. Markets Index Information:** U.S. Treasury securities are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The Dow Jones Transportation Average is the most widely recognized gauge of the American transportation sector. The Dow Jones Utility Average keeps track of the performance of 15 prominent utility companies. The S&P 500 is an unmanaged index of 500 widely held stocks. The S&P Mid Cap 400 Index is a capitalization-weighted index that measures the performance of the mid-range sector of the U.S. stock market. The S&P Small Cap 600 Index is an unmanaged index of 600 small-cap stocks. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. The Russell 2000 Index is an unmanaged index of small cap securities which generally involve greater risks. The KBW Bank Sector (BXX) is a capitalization-weighted index composed of 24 geographically diverse stocks representing national money center banks and leading regional institutions. The NYSE Arca Biotechnology Index (BTK) is an equal dollar weighted index designed to measure the performance of a cross section of companies in the biotechnology industry that are primarily involved in the use of biological processes to develop products or provide services. The NYSE Arca Oil Index (XOI) is a price-weighted index of the leading companies involved in the exploration, production, and development of petroleum. The PHLX Semiconductor Sector Index (SOXX) measures the performance of U.S.-traded securities of companies engaged in the semiconductor business, which includes companies engaged in the design, distribution, manufacture, and sales of semiconductors. The Philadelphia Gold and Silver Index (XAU) is an index of 16 precious metal mining companies that is traded on the Philadelphia Stock Exchange.

**Futures:** Futures prices are current as of the publication of this report, but will fluctuate. Please contact your financial advisor for updated information.

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Small-cap stocks generally involve greater risks. Dividends are not guaranteed and will fluctuate. Past performance may not be indicative of future results.

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<th>Coverage Universe Rating Distribution*</th>
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<td><strong>RJA</strong></td>
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<td>Strong Buy and Outperform (Buy)</td>
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*Percentage distribution as of the date of this report.
Market Perform (Hold)  
42% 31% 47% 35%  
8% 16% 0% 0%  
Underperform (Sell)  
4% 1% 0% 14%  
5% 0% 0% 0%  
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