

# THE MONTHLY RESEARCH CONFERENCE CALL

## FINANCIAL SERVICES: THE FED CHANGES DIRECTION



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***Wednesday, May 1, 2019***

***11:00 a.m. ET***

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ARGUS RESEARCH COMPANY



# WHAT'S NEW AT ARGUS

## MAY 2019

### ■ **Theme Model Portfolios: Dividend Growth**

- Dividend Growth is an enduring theme spanning all industries
- Companies raising dividends signal balance sheet strength
- Confidence in new products & operating outlook
- Clear focus on shareholder return
- Dividend growth rises in importance as earnings growth slows
- Find it on website: Portfolio Strategy tab, Theme Portfolios

### ■ **Analyst Quick Notes**

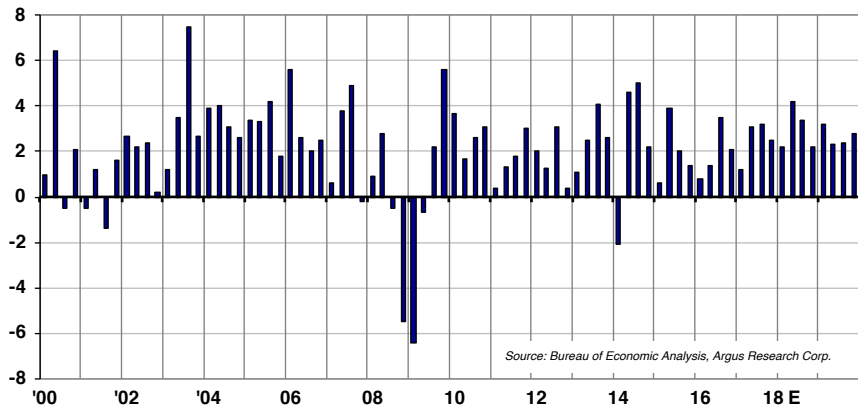
- Weekly Stock List: Companies raising guidance
- Weekly Stock List: Double-digit Dividend Growers
- Weekly Stock List: Consumer Discretionary stocks
- Find it on website: home page, top center

### ■ **New Names added to Argus Analyst Coverage Universe**

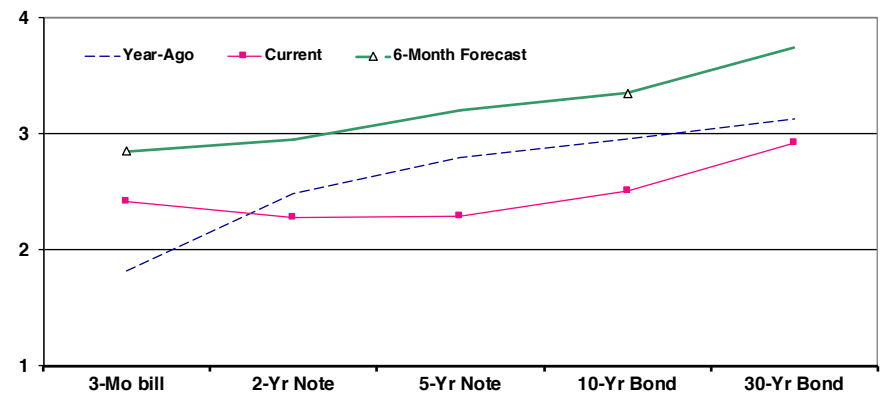
- Dow Inc. - the basic chemicals spin-out from DowDuPont
- J.M. Smucker - specialty name in consumer staples
- Find it on website: home page, top, “search companies”

# MACRO FORECASTS

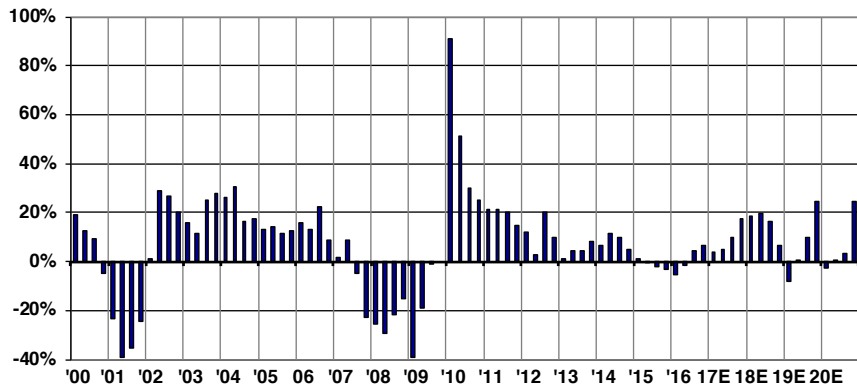
### REAL GDP W/FORECASTS (%)



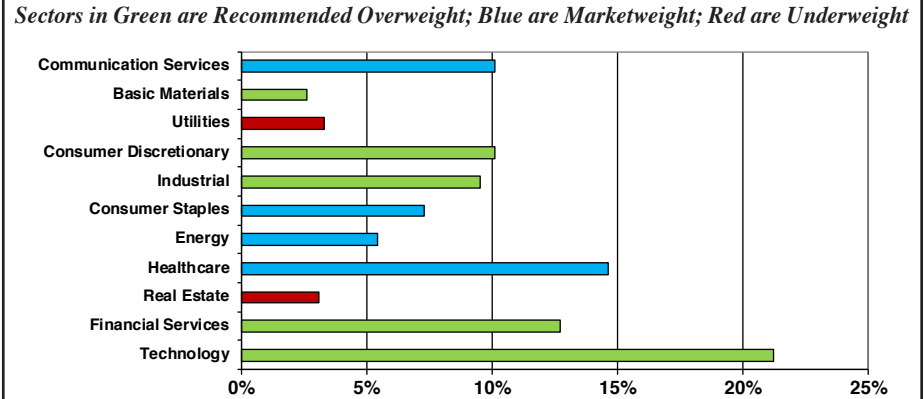
### TREASURY YIELD CURVE (%)



### S&P 500 QUARTERLY EARNINGS GROWTH



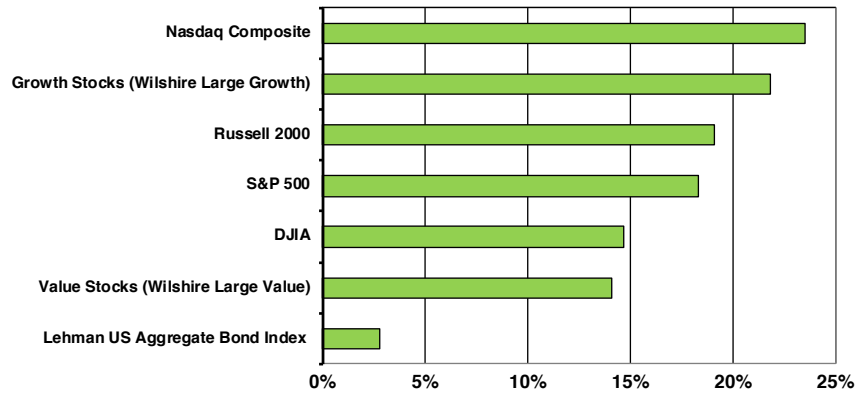
### MARKET SECTOR DISTRIBUTION - PERCENT OF S&P 500



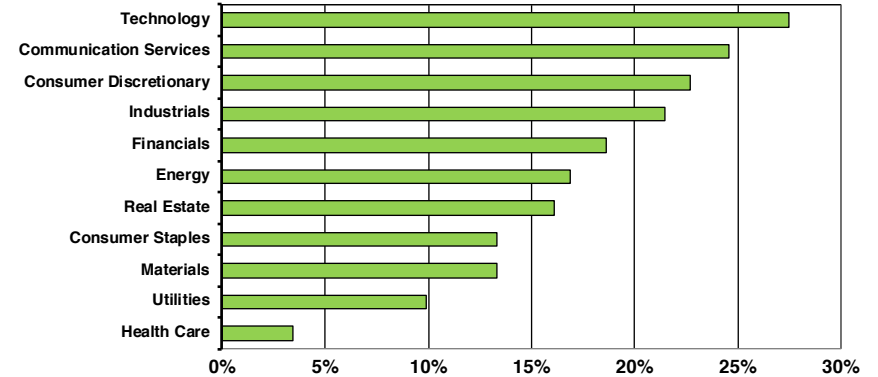
# MARKET PERFORMANCE

DATA AS APRIL 26, 2019

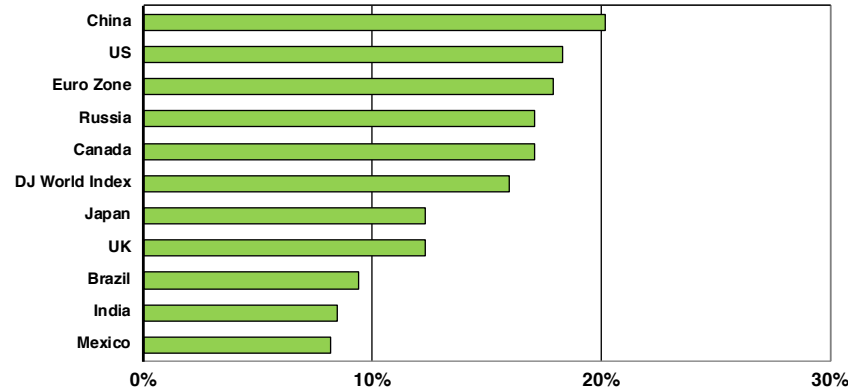
## MAJOR INDEX



## SECTOR



## GLOBAL EQUITY MARKETS



# FINANCIAL SERVICES: RELATIVE PERFORMANCE

	2019 YTD*	2018	5-yr. CAGR
S&P 500	+13.1%	-6.2%	+8.6%
Financial Sector	+7.9%	-14.7%	+7.2%
Diversified Banks	+8.2%	-17.8%	+6.3%
Regional Banks	+9.0%	-20.2%	+5.3%
Consumer Finance	+16.2%	-18.0%	+2.3%
Asset Managers/Custody	+9.2%	-25.9%	+1.9%

Argus has a neutral-weight sector recommendation on Financials

*\*March 31, 2019*

# FINANCIAL SERVICES: MAJOR BANK THEMES

## ■ Loan Growth

- Slowing along with GDP and higher interest rates
- Mid-single digit growth has moved to the low- to mid-single digits
- Strength in credit card and other consumer lending offset by weaker home mortgage/equity and auto lines and low single-digit commercial lending growth

## ■ Net Interest Margins

- We see modest NIM expansion in 2019, aided by 2018 rate hikes
- Weighed by pressure from rising deposit costs

## ■ Credit Quality

- Credit quality normalization is continuing from sub-standard loss rates
- Banks maintaining underwriting standards, unlike prior cycles
- Strong correlation between good employment and credit quality

# FINANCIAL SERVICES: MAJOR BANK THEMES

## ■ Capital Markets

- Lower volatility has led to fewer large allocation changes, less trading
- Steady grind higher for equities does not provide trade opportunities
- IPO calendar is improving for equity underwriting
- Advisory remains a bright spot (CEO optimism, good currency for deals)

## ■ Capital Levels

- Robust capital has led strong increases to dividends and buybacks

## ■ Regulation

- Administration change was seen as a big opportunity for de-regulation...
- ...but no major upsets to Dodd-Frank
- Modest changes to the Volcker Rule, reprieve for mid-sized banks (\$100-\$250B assets)
- Compliance/legal costs have moderated

## ■ Merger Activity

- Back in the news recently with BB&T and SunTrust combination
- Efficiencies, scale and leveraging technology/compliance spend remain compelling rationales

# FINANCIAL SERVICES: FAVORED FINANCIALS

## ■ Diversified Banks

- Bank of America (BAC)
- JPMorgan Chase (JPM)
- Morgan Stanley (MS)

## ■ Regional Banks

- BB&T/SunTrust (BBT/STI)
- Fifth Third Bancorp (FITB)
- PNC Financial Services (PNC)
- US Bancorp (USB)

## ■ Consumer Finance

- Capital One Financial (COF)
- Discover Financial Services (DFS)

## ■ Asset Management

- BlackRock (BLK)
- Blackstone Group (BX)
- Schwab (SCHW)



# FINANCIAL SERVICES: STOCK PICKS - REITS

## ■ American Tower (AMT)

Recent Price: \$193

- **Thesis**: Mobile data usage to grow 50% annually over the next five years, which should increase the demand for tower leases. It has also raised the dividend at an average annual rate of 23.7% over the last five years.
- **Risks**: Low cash flow to debt (despite steady/reliable cash flow), concentration risk from few large wireless carriers, and higher interest rates (which we see as off the table in 2019).
- **Valuation**: Mkt Cap: \$85B. P/FFO: 24.7 – in-line with peers, but faster FFO growth, 20%+ annual dividend growth (1.9% yield).
- **Performance**: Stock up 23% YTD vs. 20% for S&P.

# FINANCIAL SERVICES: STOCK PICKS - REITS

## ■ AvalonBay Communities (AVB)

Recent Price: \$198

- **Thesis**: Upscale apartment market with high barriers to entry, experienced management, and currently low costs to finance developments.
- **Risks**: Rising supply (offsets oversupply in cities with suburb communities) and interest rates.
- **Valuation**: P/FFO 21.1 – in line with peers despite NOI growth of 4.9% vs. 3.3% for peers, slightly higher yield (3.0%) than EQR (2.9%).
- **Performance**: Stock up 18% YTD vs. 20% for S&P

# FINANCIAL SERVICES: STOCK PICKS - REITS

## ■ Simon Property Group (SPG)

Recent Price: \$176

- **Thesis:** We expect the transformation of its department store space (which make up 27% of square footage, but contribute less than 1% of rent) to smaller, higher-paying tenants (including popular mall stores, restaurants, hotels, and residences) will result in higher rent revenue. We note that dept store anchor tenants (J.C. Penney and Macy's) pay \$6 per square foot, while nonanchors pay \$51. Additionally, the mall operator has taken a profitable stake in the formerly-bankrupt apparel tenant, Aeropostale, and is open to similar small deals. We view Simon as one of the best-managed REITs, as it has steadily improved its operating metrics.
- **Risks:** Retail issues, including bankruptcies and competition from Amazon, as well as heavy debt.
- **Valuation:** P/FFO 14.2 – vs. 12.9 peers. NOI growth of 2.3% vs. 2.1% for peers & 4.5% yield.
- **Performance:** Underperformance – up 6.5% YTD – vs. S&P.

# FINANCIAL SERVICES: STOCK PICKS - INSURERS

## ■ Progressive (PGR)

Recent Price: \$77

- **Thesis**: The company consistently generates much higher revenue and EPS growth and ROE than peers. We see the momentum in the rising stock price continuing.
- **Risks**: Competition from Allstate, Geico, and State Farm; static interest rates – which poses a challenge to investment returns on PGR’s bond portfolio; and volatile equity markets.
- **Valuation**: Mkt Cap: \$44B. P/E: 14.8 vs. 12.7 for peers – but with a recent ROE of 26.5% vs. 10.5% for peers, we feel the premium is appropriate.
- **Performance**: Stock up 28% YTD vs. 17% for S&P & 18% for both ALL and TRV

# FINANCIAL SERVICES: STOCK PICKS - INSURERS

## ■ Sun Life Financial (SLF)

Recent Price: \$41

- **Thesis:** The Canadian insurer and asset manager has also had consistently strong earnings results and above-average ROE that has often come in ahead of management's guidance. In addition, the core Canadian business has seen a slight uptick in life insurance sales - a turnaround from recent declines. Sun Life has also made several small acquisitions that should help to boost EPS, and is generating solid results from its investment holdings, which was impressive in a tumultuous 2018.
- **Risks:** Uneven economic growth, volatile financial markets, adverse currency movements, and low interest rates.
- **Valuation:** Mkt Cap: \$25B. P/E 11.1 vs. 9.0 for peers. 3.6% dividend yield in line with peers.
- **Performance:** Stock up 25% YTD vs. 17% for S&P, 11% for MET and 29% for PRU

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