CIF Sector Update Report (Spring 2014)

Sector: Financial **Analyst:** Battson, Paul

Presentation Date: April 16, 2014

Review Period— **Start Date:** March 20, 2014 **End Date:** April 11, 2014

Section (A) Sector Performance Review

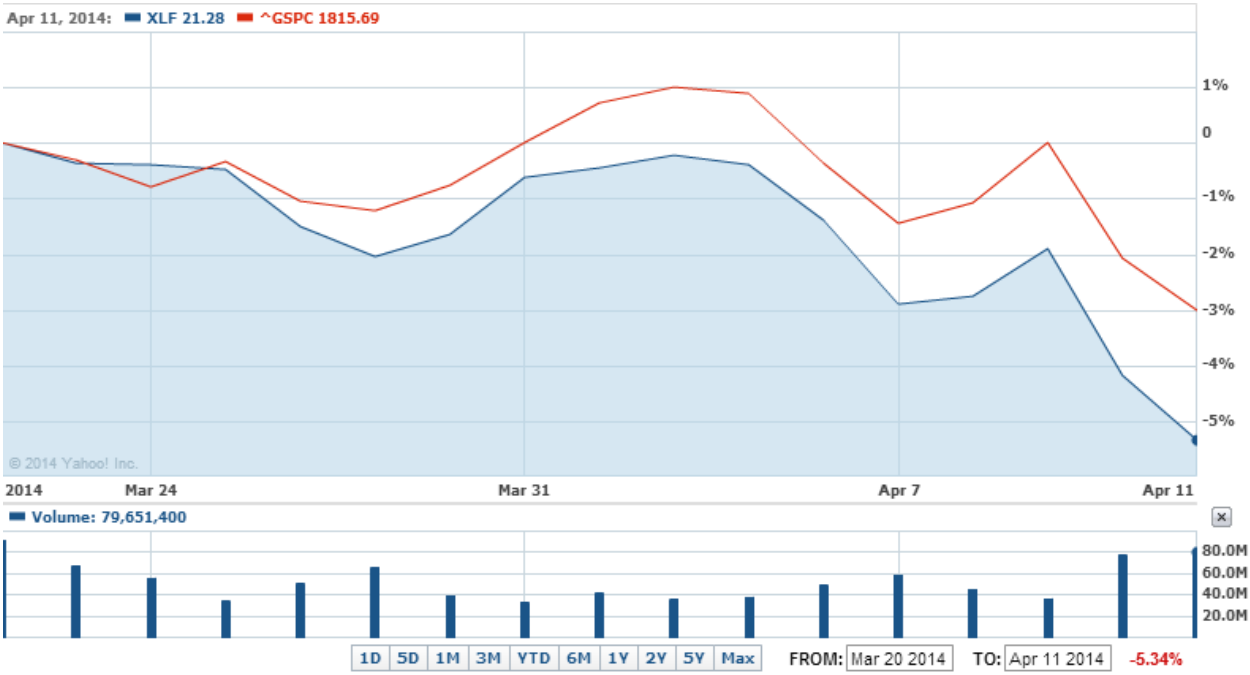
(A-1) Sector Performance Relative to SP500

XLF

	Ticker	Current Price	Beg. Price	Stop-loss Price	Target Price	% Capital Gain	# Shares	Current Value	vs. Sector	vs. S&P 500
S&P 500	$INX	1815.69	1872.01			-3.01%				
Sector ETF	XLF	$21.28	$22.48			-5.34%	15,280	$325,158.40		-2.33%

Current Holdings
N/A

One-Month Price Chart
XLF and S&P500 (GSPC)



Relative Performance:

From March 25th and on, the financial sector underperformed the S&P500 with the end of the review period displaying a 2% disparity between the XLF and GSPC (S&P500) ending at -5% and -3%, respectively. Albeit, the XLF and GSPC move in relatively close tandem with the difference in return remaining between 1% and 2% throughout the period. The close proximity in movement is conventional, especially considering the movement being modestly leveraged by a 1.12 Beta against Standard Index over 3 years (Yahoo! Finance).

Over this period, the XLF declined 5.34%, and relative to the S&P500, -2.33%. With respect to price, beginning price at March 20th equated to $22.48, later closing at $21.28 (-$1.20) at the end of the period (April 11th). The current value of the shares outstanding is $325,158.40 which accounts for 15.72% of the portfolio at the time of research.

Macro Factors:

Because this index is designed to replicate the financial sector broadly, it is well diversified by including commercial banks, diversified financial-services firms, capital markets companies, insurers, REITs, and consumer financial firms (Morningstar). It is a fairly indicative satellite holding because of this diversity, but as such, it makes this ETF susceptible to volatility.

The shape of the yield curve itself conjured some headwinds going into late March and early April which has been further exacerbated by the greater concern of rising interest rates. The interest rate environment coupled with troubling economic reports, such as weak winter numbers being release and disaster brewing in Ukraine, made investor trepidations this season. Banks however have been especially troubled by low interest margins. Morningstar analysis expresses that banks have been forced to reduce expenses in ways such as cutting staff and branch locations, but on a positive note, enduring the stress tests bodes well in the future outlook. Worth noting, commercial banks comprise 18% of the XLF.

Sector/Industry Factors:

Considering more immediate issues, from March 31st to present, the S&P500 and the XLF declined simultaneous with similar peaks and troughs. The week prior to the 31st, the Federal Reserve telegraphed increasing overnight lending rates as early as 2015 (Seeking Alpha). In addition, consumer influenced stocks were the weakest amongst all stocks for the prior 3 months, making ETF investors extremely cautious. With consumer stocks weighing on financial stocks, profit-taking in biotech, and trifling wage growth (aprox. 0.5%), the XLF bore a large burden of the impact along with the S&P500.

Noteworthy News and Events

ETF Outlook For The Week Of April 14, 2014 (XLF) Citigroup (NYSE: C) reported better than expected earnings early Monday morning as it beat on both the top line and bottom line. The stock was rebounding in pre-market trading after closing out last week at the lowest level since June of last year. The stock could be in the early stages of a rally after holding above the June low and trading at oversold levels. The stock is the fifth largest holding in XLF with an allocation of 5.3 percent. Two of the three largest holdings reported mixed earnings last week and pushed XLF to the lowest level in two months. XLF is getting an early boost from the C news and the fact the chart shows it is also oversold. (NASDAQ)

This Sector is Setting Up for a Rally (April 14, 2014) The Financial SPDR ETF (XLF) saw a nice boost Monday on the heels of a Citigroup earnings beat. The sector was up half a percent, while Citi shares shot up around 4%. The news is welcome relief to investors, who will see a slew of other financial companies release results this week, including Bank of America, Northern Trust, Comerica, U.S. Bancorp, PNC Financial, Huntington Bancshares, American Express, Capital One, BlackRock, Goldman Sachs, Morgan Stanley, BB&T and KeyCorp. (Yahoo! Finance)

Banking System Continues To Restructure (April 12, 2014)

- Loan growth is taking place in the commercial banking sector.
- The loan growth, however, is helping the economy to restructure.
- This restructuring is necessary before real economic growth can take place once again. (Seeking Alpha)

Financial Stocks Fall After Weak Bank Earnings (April 11, 2014) Financial stocks fell on Friday after two of the nation's biggest banks reported first-quarter earnings. The Financial Select Sector SPDR Fund XLF +0.14% , which tracks financial stocks in the S&P 500 SPX +0.82% , was down 0.5%. J.P. Morgan Chase & Co. JPM +0.24% shares fell more than 3% after the firm reported earnings fell 19% from the same period a year ago, making it the biggest loser in the Dow Jones Industrial Average DJIA +0.91% (MarketWatch)

March saw 34,399 job cuts—the lowest for Q1 in nearly 20 years (April 10, 2014) First-quarter job cuts were led by the retail sector, where employers announced 18,231 job cuts through the first three months of 2014, including 2,989 in March. The financial sector followed closely, with 15,306 job cuts announced over the first three months of 2014. Neither retail nor financial firms saw the heaviest job cuts last month, however. The top job-cutting sector in March was healthcare, which announced plans to reduce payrolls by 5,768, bringing its year-to-date total to 10,984, which ranks fourth among all industries. (Yahoo! Finance)

(A-2) Big Sector Movers

1-Month Price Chart of HCP, Inc. (HCP) +9.07%

1-Month Price Chart of The Macerich Company (MAC) +6.12 %

1-Month Price Chart of E*TRADE Financial Corporation (ETFC) -15.2%

1-Month Price Chart of The Nasdaq OMX Group, Inc. (NDAQ) -12.51%

HCP, Inc. (HCP) was the largest "winner" in the 1-month horizon showing a 9.07% increase to arrive at $40.53. This stark increase in price is attributable to two of the biggest managers of US health-care facilities merging. HPC was near its lowest price since '09 in part to losing a real estate investment trust compounded by the firing of the CEO, James F. Flaherty. This unfavorable conditions prompted acquisition discussions estimated at $17B by HCN. (Bloomberg)

The Macerich Company (MAC) had the second largest return over the period (+6.12%) closing at $63.64 at the time of research. In mid-March, MAC received an upgrade from "HOLD" to "BUY" by Sandler O'Neil while also submitting a press release for a release of Q1 FY14 Earnings. (Zacks) On Feb 4th, Macerich reported strong Q4 results, and approximately a month later, investors posited that the positioning of high quality malls was going to come to fruition in

the near future. Steady increases in demand for new properties is expected to carry MAC into surprise territory in the next earnings report at the end of April.

E*TRADE Financial Corporation (ETFC) was the biggest "loser" in the 1-month horizon arriving at $19.20 after a -15.2% decline since mid-March. Much of the anxiety surrounding this company is the hyped current stigma of high-frequency trading correlating companies such as E*Trade and TD Ameritrade with corruptible, unleveled advantages.

The Nasdaq OMX Group, Inc. (NDAQ) had the second largest losses within a month falling 12.51% to close at $34.41 as of April 14th. Technical analysis unveils the SMA50 surpassing the SMA20 at the beginning of April with the 20 nearly falling under the SMA200 to date. On April 10th, "the Nasdaq NDAQ Composite Index notched its biggest one-day slide in nearly 2½ years, as investors dumped momentum stocks in droves (WSJ)." The sell offs were primarily comprised of biotech, social media, and internet stocks. Additionally, short interest increased 63.1% in the month of March.

3-Month Price Chart of Health Care REIT, Inc. (HCN) +11.88

3-Month Price Chart of Boston Properties Inc. (BXP) +10.41

3-Month Price Chart of IntercontinentalExchange Group, Inc. (ICE) -12.87%

3-Month Price Chart of Prudential Financial, Inc. (PRU) -12.57%

Health Care REIT, Inc. (HCN) is up 11.88% over the 3-month timespan closing at $61.69 on April 14th. This stock was the biggest gainer within this horizon much in part to key moving averages. On April 4th, HCN crossed above their 200 day moving average of $60.30, selling as high as $60.56 per share (NASDAQ). HCN has fared well amidst the Ukrainian-Russian turmoil in large part to investors gravitating towards stable defensive names, such as health-care REIT's along the lines of HCN.

Boston Properties Inc. (BXP) is the second largest "winner" over 3 months at +10.41% closing at $115.44. BXP began trading ex-dividends on March 27th, but from the onset of FY14, beat Q4 estimates propelling them into the fiscal year. One of the largest driving factors for momentous gains was total revenue climbing 20.5% year-over-year. The barrier for entry is glaring because of its dominant position in exclusive geographic markets in addition to a strong balance sheet (Zacks).

IntercontinentalExchance Group, Inc. (ICE) had the worst 3-month performance declining 12.87% to close at 191.52, $37.98 below the 52-week high. According to the most recent 8-K, there was a termination of an entry into a material definitive agreement. With regard for technical analysis, the SMA20 fell beneath the SMA50 in late January, and fell even further to cross the SMA200 as of last week. In news abroad, "ICE Futures Europe's COT reports include futures-only and futures-and-options-combined data, as well as open interest concentration among the contracts' largest traders (WSJ)."

Prudential Financial, Inc. (PRU) had the second weakest performance in the financial sector over 3 months closing at $78.40, at this time, a 12.57% decline. On April 7th, PRU crossed below their 200MA of $82.89. The half-year performance is down 0.63%, and quarter performance is down 10.88%. In the review period, Prudential named Michelle Crecca Senior Vice President of Strategy and the net loss of financial services businesses attributable to Prudential Financial, Inc. for year 2013 of $713 million, or $1.55 per Common share. (10-K)

(A-3) Two Largest Stocks in the Sector

- **Wells Fargo (WFC): 8.77%**
- **Berkshire Hathaway (BRK.b): 8.34%**

1-Month Price Chart Comparing XLF, WFC, BRK.b, & S&P500

Wells Fargo (WFC) maintains the greatest index weight at 8.70% within the financial sector. WFC trended similarly to the S&P500 and the XLF but surpassed them in early March to stay in near tandem with Berkshire until closing 0.5% beneath BRK.b at $48.11 at the time of research. Despite the Federal Reserve Board enforcing tougher rules on the big 8 banks, the dependence on more equity capital rather than debt and risky assets (Zacks) has not paralyzed WFC, presently. As stated early, most commercial banks are enduring the same plight of cutting expenses via employee and branch reductions. In addition to the tightening restriction on banks, WFC, among others, exceeded expectations in the Federal Reserve Stress Test. Wells Fargo outperformed its major competitors and posted a tier 1 capital ratio 8.2% in addition to having one of the lowest debt levels amongst its competitors (Seeking Alpha). The company filed its 10-K on Feb 26th and beat EPS estimates, which coincides with the incline in the graph thereafter.

Berkshire Hathaway (BRK.b) has the second largest weight in the XLF at 8.34%. BRK.b moved in unison with the both indexes, staying approximately 2% greater until surpassing both the XLF and GSPC for the remainder of the horizon closing at $122.29, $3.62 short of the 52-week high. As seen to the right, the MA's had extremely promising movement, with both the SMA20&50 overcoming the SMA200, and the SMA20 overcoming the SMA50 to provide strong support levels in the rising market for BRK.b. The reasoning behind the gargantuan

incline in March is due to Warren Buffet commentating on the annual report, and typical, investors reacting strongly to the guru's words. Quarterly performance is up 7.26% and half-year performance, +5.60%. In more recent news, Berkshire is set to acquire WPLG-TV from Graham Holdings. In response, the stock has endured lengthy shadows with closes far lower than opening prices over the past week-to-date.

(A-4) Short-term (up to Three Months) Outlook of the Sector

My short-term outlook for the Financial Sector is mixed. Financial companies hinging on capital markets will be forced to continue enduring fluctuating returns stemming from international unrest in Ukraine in addition to European bank issues cascading into the US market. Banks on the other hand ought to benefit from the hikes in interest rate, albeit, a 3-month horizon will most likely not be enough of a timespan to recognize these marginal gains. There is considerable sentiment that the XLF will be a major contributor to S&P500 dividend growth, but with current sell-offs of momentum stocks and weak consumer related statistics, the approaching earnings season will be critical in assessing the forward-looking returns of the Financial Sector as a whole. Ideally, an investor should let the market sell-off, identify well positioned banks and REITs, then put one's money to work.

Section (B) Sector Holding Updates

NO SECTOR HOLDINGS

Work Cited

1&3 Month "Winners" and "Losers": News Articles

http://finance.yahoo.com/q/rk?s=XLF

http://www.marketwatch.com/story/financial-stocks-fall-after-weak-bank-earnings-2014-04-11?siteid=yhoof2

http://finance.yahoo.com/news/march-saw-34-399-job-130015584.html

http://seekingalpha.com/article/2105953-etf-investors-react-with-caution-to-a-weakening-consumer

http://blogs.wsj.com/moneybeat/2014/04/10/nasdaqs-selloff-by-the-numbers/?mod=yahoo_hs

http://online.wsj.com/news/articles/SB10001424052702304819004579489802706065832?mod=WSJ_qtoverview_wsjlatest&mg=reno64-wsj&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2FSB10001424052702304819004579489802706065832.html%3Fmod%3DWSJ_qtoverview_wsjlatest

http://www.zacks.com/stock/news/126623/Balanced-View-on-Boston-Properties

http://online.wsj.com/article/BT-CO-20140407-703588.html?mod=WSJ_qtoverview_wsjlatest

All Companies Reviewed. *Financial Data & Charts.* http://finance.yahoo.com

Berkshire Hathaway, Inc. *Quote and Analysis.* *http://seekingalpha.com/symbol/BRK.A*

Morningstar Analysis. *FIN438 Class Resource.*

Technical Analysis Charts. *(Each Stock Reviewed).* *www.finviz.com*

Wells Fargo. *Zack's Commentary.* *http://www.zacks.com/stock/research/WFC/commentary*