

Mitch on the Markets

Why Are Bank Stocks Getting a Trump Boost?



By Mitch Zacks
Portfolio Manager

U.S. Financials have far outpaced the S&P 500 index in the weeks following the U.S. presidential election. If you take a look at the iShares U.S. Financials ETF versus the S&P 500 from November 8 – December 1, you will see bank and financial services domination with +9.16% for US Financials vs. +2.79% for the S&P 500. IYF includes some of the biggest banks in the world (JP Morgan, Wells Fargo, Citigroup) as well as some of the largest financial services firms like Berkshire Hathaway and Visa. Is this outperformance just a fluke or are there fundamental drivers at work?

Our thought is that there could be several fundamental forces at work, many of which could support financial stocks even further in the coming year. Investors should consider how much portfolio weighting they currently have to U.S. Financials, as it could be time to tilt the scales a bit more towards this sector. If you're unsure of how you're currently allocated to the U.S. Financials sector, and you want someone at Zacks Investment Management to assist you,

just call us at 1-800-245-2934, and we'll happily review your portfolio and make suggestions.

Three Fundamental Factors Supporting U.S. Financials

1. Steeper Yield Curve – bonds have gotten somewhat clobbered since the election, with the yield on the 10-year U.S. Treasury bond jumping from 1.88% to 2.45% and the 30-year following similar motion from 2.63% to 3.10% (through December 1). There are many possible forces behind the rout – rising inflation expectations tied to the likelihood of increased infrastructure spending and lower taxes; a rotation away from 'safe havens' and into risk assets; or some combination of the two. With the Fed yet to incrementally raise interest rates off the zero bound, this has led to a healthy steepening of the yield curve. Steeper yield curves favor banks since they can borrow on the short end of the curve and lend at higher rates on the longer end of the curve. This means net interest margins go up, which means expected earnings also rise. That's good for stock prices.

2. Looser Regulations – President-elect Trump has made it fairly clear that he stands in opposition to many of the

new financial regulations under Dodd-Frank, and one of his goals as president would be to reverse or eliminate many restrictions on banks. The market generally favors less regulation over more regulation, and looser restrictions could allow for more profitability and risk-taking – both of which would support higher prices.

3. Lower Corporate Tax Rates –

lower corporate taxes have a fairly obvious effect on corporate profitability, which is especially important for banks given the capital controls put in place by Dodd-Frank specifying the amount of Tier 1 capital they are required to keep on hand. For investors, it could make sense to run a screen on banks and financial services institutions that have high effective corporate tax rates, as those companies would benefit the most from a cut in the corporate tax rate.

Bottom Line for Investors

The outlook for U.S. Financials looks good from here, but it is really a matter of whether the policy adjustments discussed above go from talk to action. It seems likely given the Republican control of the House and the Senate, but there is always the potential for gridlock. Time will tell, but in the meantime, we believe it makes sense to have exposure to U.S. Financials in portfolios that investors could potentially ratchet-up as these proposed conditions become known quantities. We'd prefer U.S. Financials over a global play.

-Mitch

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.



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