From: Ens, Amanda <amanda.ens@baml.com>
Sent: Monday, November 14, 2016 5:05 PM
To: jeffrey E.; Richard Kahn
Subject: RE: Financials trade for Monday

We continue to see buyers of XLF today. Funds are underweight financials in all regions, valuations are reasonable, earnings are improving and financials tend to outperform when bond yields rise.

Vol is higher today – refreshed pricing below.

Buy an XLF 17March2017 call spread:

* Buy the 105% call / sell a 110% call with a 115% at-expiry knock-in

* Total premium: 1.86%

Global Positioning in Stocks: Nigel Tupper notes the 4000 funds in our "Positioning in Stocks" analysis are more underweight Financials, on average, than any other sector and are underweight this sector in all regions of the world <http://rsch.baml.com/r?q=jRLQWvxU!1KzOfQftl0uhA&e=amanda.ens%40baml.com&h=PcgvLg> . If earnings continue to improve and yield rise, which is often the case in an upturn in our Global Wave, then the unloved Financials sector has the potential to continue to outperform.

Global Quant Panorama: "Bearish on Bonds" stocks (which tend to move in the opposite direction to bond yields) tend to outperform our "Bullish On Bonds" when bond yields rise <http://rsch.baml.com/r?q=zsm1hvaX5olm6avQytEolg&e=amanda.ens%40baml.com&h=--LPjw> . The sectors that tend to perform best as bond yields rise are Energy, Tech, Materials, Banks, and Diversified Financials. Of these sectors, the laggards this year have been Banks and Diversified Financials. With a PE of 15.9x and a PB of 2.0x, Global valuations are reasonable. Also, Risk is near all-time lows in terms of PE in most regions. Now that macro and earnings data have triggered the beginning of a rotation, Value becomes very relevant.

From: Ens, Amanda
Sent: Friday, November 11, 2016 4:04 PM
To: 'jeffrey E.'; 'Richard Kahn'
Subject: Financials trade for Monday

It's not too late to buy financials as a medium term trade. They've run up a lot this week but we're getting endless calls from generalists asking which banks to buy – there is still more upside to the sector. Banks also provide some offset to your bonds if interest rates continue to move. Our financials sector specialist thinks XLF could have another 20-25% upside given its many levers to the Trump trade: less regulation, higher interest rates/steeper yield curve, higher vol, economic growth, etc. The regional banks are asset sensitive and more of a pure play on a rates move but we view the larger cap banks as having even more upside to the Trump Trade given the above points.

Buy an XLF 17March2017 call spread:

* Buy the 105% call / sell a 110% call with a 115% at-expiry knock-in

* Total premium: 1.75%

All eyes are on Sunday's 60 Minutes interview with Trump. Market is pricing that all regulations will be rolled back (very optimistic). Any hint that this is not true could lead to pullback on Monday.

Note on tech: we're seeing FANG used as a source of funds with the rotation from growth into value. There's also the tax read-through: tech is already relatively tax advantaged @ 22%; Industrials are at 30%, Financials at 29%. Next year, tech could benefit from a repatriation tax holiday but that is viewed as more of a Q1/Q2 trade.

More thoughts on financials:

With respect to the economy, the market is certainly indicating that there will be a large fiscal stimulus which may send US growth higher and that's a good thing for financials for a wide variety of reasons, from employment to wages to loan growth and credit quality (even if somewhat offset by higher rates). It does remain to be seen exactly how much of this expected policy actually gets done, but at the moment, investors are willing to take a certain amount of growth on faith.

So those are positives for financials before we even discuss regulation. The move in the financials since the election would seem to indicate that investors have concluded that nearly every piece of financial regulation will get put into a shredder on day one of the new administration. The incoming administration has fueled that with comments about rolling back pieces (or more) of Dodd-Frank in particular. I can see making the case for that to the American public by saying that banks need less regulation in order to get more capital flowing into the economy to drive growth. Not only does that mean that the E is likely too low (meaning that the P/E is not as high as it seems) but it could help improve ROE's as well which could increase the multiple of that higher E investors are willing to pay. Note that while ROEs could go higher, it's unlikely that they can get back to the peaks...

Regards,

Amanda

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