

SNV Financial Institutions Group Initiation

Thesis

Our recent stock filters have been sparsely populated by non-financials companies. The companies which do appear have been evaluated already and we are left with a sparser population of investment candidates in the US equities market, as the indices approach newer highs with the +20% YTD run-up.

The universe of stocks in Korea is much more to our liking and we will take full advantage of shifting more of our capital into the Korean equities market, which has seen a 3.5% July appreciation vs. our 6% for the SN Korea portfolio. However, the US equity market is the component of our flagship portfolio and as such, we will continue to monitor the universe for potential entry points.

We noticed for the past 2 years, financials, namely banks, insurance, and investment companies, comprised more than 75% of the resulting filtered stock list but we failed to write reports on them in detail. Our automated valuation model doesn't work with financials so we pushed forward with the goal to cover as many companies as possible, to ramp up the valuation process, and return to financials at a latter date.

Today is that awaited day and we are excited to launch coverage of financials. Financials play on the spread between the interest income received and the interest expenses paid out. The spread will then cover the SG&A, and the residual more often than not will be paid out as dividend to the shareholders. The stocks tend to trade close to the book value, which we favor, and as such, the returns generated from operations tend to be the main driver of value, both intrinsically and in the market. Also, to compensate for the rather lackluster multiples, financials pays out dividends which are ensured returns for investors, much like fixed income coupons.

The risk is the mayhem we witnessed with the fallout in the economy and financial system at large, which can create a domino effect of losses. Granted, a lot of the excess was shed during the past 5 years, but we remain skeptical of the long term intentions of the bankers, and the implemented risk management, which will lead to repeated fallouts in the near future. Therefore, we will seek to uncover companies which deal with mainly vanilla securities and operations, with high visibility into the portfolio and operation, and stable cash flow, and low leverage.