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TOP 25 FINANCIAL STOCKS

THE TOP 25 FINANCIAL STOCKS SET TO CLEAN UP IN THE TRUMP ADMINISTRATION

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The Donald Trump administration is off and running — and investors are sitting up and taking notice. They're dog-piling into stocks that should clean up under the new presidency ... helping send the Dow Industrials through 21,000 for the first time, and boosting the S&P 500 and Nasdaq Composite to all-time highs.

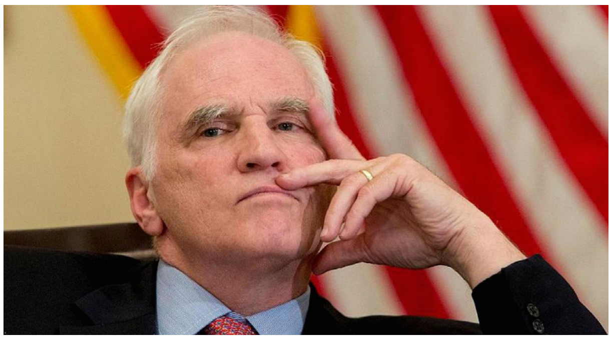
But one group of stocks has really been turning on the afterburners: Financials! Indeed, financial stocks surged more than 22% between Election Day and the end of 2016. That was more than double the S&P 500's return during the same period.

What's behind the gains? A perfect, positive storm of rising inflation ... promises of deregulation ... looser lending standards ... the potential for bigger dividend payouts ... accelerating economic growth ... and a Federal Reserve that is all but certain to hike interest rates again and again in the rest of 2017 and 2018.

In fact, I believe this is the best collection of catalysts for the financial sector since the last century. That means the potential gains could be phenomenal. Between 1992 and early-2001 ... the previous Gilded Age for financial stocks ... the KBW Bank Index surged more than 349%. Many individual banks performed even better, with **Wells, Fargo & Co. (WFC, Rated "B-")** returning more than 537%, including reinvested dividends, and **Citigroup (C, Rated "B-")** handing investors a total return of more than 1,454%!

So how can you profit from the surge in financial stocks? What will Trump's regulatory and economic policies mean for the financial industry in the months and years ahead? And what impact will rising interest rates have on the sector? Let's dive into those critical questions now.

TRUMP ADMINISTRATION PUTTING THE KIBOSH ON THE ERA OF EXCESSIVE REGULATION



On Friday, February 10, a man by the name of Daniel Tarullo resigned. If you don't recognize him, he was the Federal Reserve Governor who led the agency's bank regulatory efforts.

Tarullo took office in 2009 when the financial sector was in shambles in the wake of the Great Recession and housing market collapse. When former President Barack Obama nominated him, he promised that "financial regulatory reform will be one of the top legislative priorities of my administration" and that Tarullo would "help put in place new, common-sense rules of the road that will protect investors, consumers, and our entire economy."

Tarullo didn't have any of that lofty, high-minded rhetoric in his resignation letter. It was reportedly very brief. But I have no doubt whatsoever that he stepped down because he could see the writing on the wall. Specifically, he could see that the Trump administration is putting the kibosh on the era of excessive bank regulation.

Think about everything the nation's banks have had to deal with since 2009:

- The Dodd-Frank Wall Street Reform and Consumer Protection Act
- The Consumer Financial Protection Bureau
- Federal Reserve stress tests
- Tight restrictions on lending and investing activity
- Even veiled threats that the federal government might break up the nation's largest institutions.

You can debate whether banks and brokers deserved all the additional restrictions. After all, financial executives helped cause the collapse of the financial system in 2007-2008 with their massive greed, and lack of prudence and foresight. But regardless of whether the shackles were justified, many of them will clearly be removed during Trump's four-year term.

On February 3, the new president met with top executives across the financial industry — including **J.P. Morgan Chase & Co. (JPM, Rated "B")** CEO Jamie Dimon and **BlackRock Inc. (BLK, Rated "B")** CEO Larry Fink. He promised then and there to conduct a top-to-bottom review of many of the post-crisis regulations.

That review will encompass Dodd-Frank, as well as a separate rule that impacts the delivery of retirement advice. He also ordered the Treasury Department and other regulators to explain whether existing laws and rules are truly anti-bailout and pro-growth and if not, what to do about it.

How much additional profit will flow to the bottom line of our nation's banks if excessive regulation goes the way of the dodo? It depends on how much those regulations cost the industry in the first place. The estimates I've seen are all over the map. But they're instructive because they give you an idea of the kinds of shocking totals we could be looking at ...

- Leading bank analyst Mike Mayo estimates that the four biggest banks are in the midst of a five-year, $100 BILLION spending wave tied to regulatory and compliance requirements. That's billion with a "B."

- The Washington-based advocacy group American Action Forum estimated that implementing Dodd-Frank alone cost more than $36 billion. By its count, some 73 million hours were spent on paperwork throughout the financial industry.

Hard to believe? Not really when you consider the bill itself was 2,300 pages long. Moreover, it included sections pertaining to everything from proprietary trading to executive compensation to consumer protection to systemic stability.

- It takes a lot of employees to push that much paper around. That's why JPM said it has a whopping 43,000 employees whose jobs are directly or indirectly tied to regulatory and compliance functions. For its part, Citigroup reportedly had 26,000 compliance employees as of 2015.

- No accurate tally exists for the thousands of smaller banks around the U.S. But SNL Financial conducted a survey in 2015 of smaller bank execs and employees. Thirty-five percent of the respondents said compliance costs had surged by 30% or more in the previous half-decade. Another 27% said costs jumped by 20% to 30%.

Bottom line: While precise figures may be difficult to pin down, the elimination of excessive regulatory costs will undoubtedly fatten the bottom lines of both Wall Street- and Main Street-focused banks.

HIGHER INFLATION + HIGHER RATES = GREATER MARGINS + FATTER PROFITS

Then there's the issue of bank profitability, and the positive impact that rising interest rates will have on it.

Net interest margin, or NIM, is at the core of any bank's bottom line. It's the difference between the cost of borrowing and the returns from lending. Or more accurately, it's the spread between the yields a bank pays to depositors, bondholders, and other entities it borrows money from … and the yields it earns on loans, securities, and other assets.

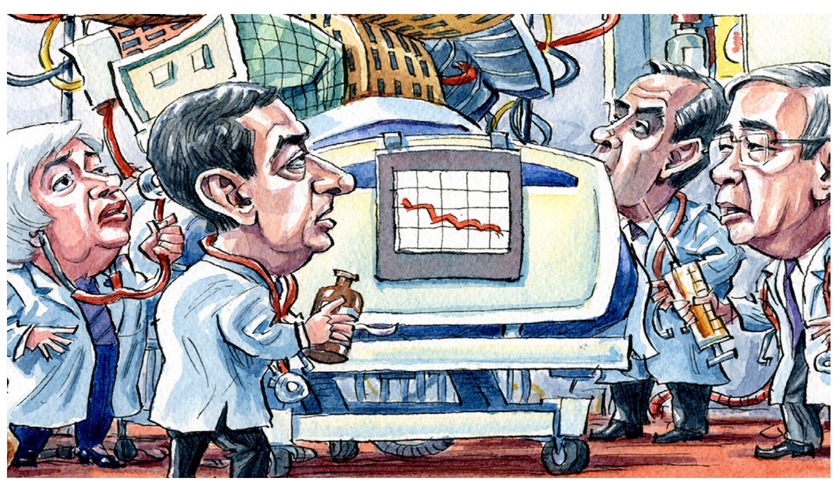
Over the past several years, central banks around the world cut interest rates more than 667 times. Several lowered rates to zero … or even BELOW zero. When that wasn't enough, they promised to buy hundreds of billions of dollars in bonds issued by their home governments, regardless of price, rates, credit quality, or anything else. The overall tally: More than $12 TRILLION of global QE.

Given access to no-limit credit cards by their central bankers, governments around the world did exactly what you expected them to: They went on a borrowing binge unlike any other in history. They issued bonds with maturities as far out as a hundred years into the future, and offered investors virtually nothing in interest too.

As a matter of fact, demand for bonds got so out of control during the bubble days that a whopping $14 trillion in government — and even CORPORATE — debt traded into negative-yield territory.

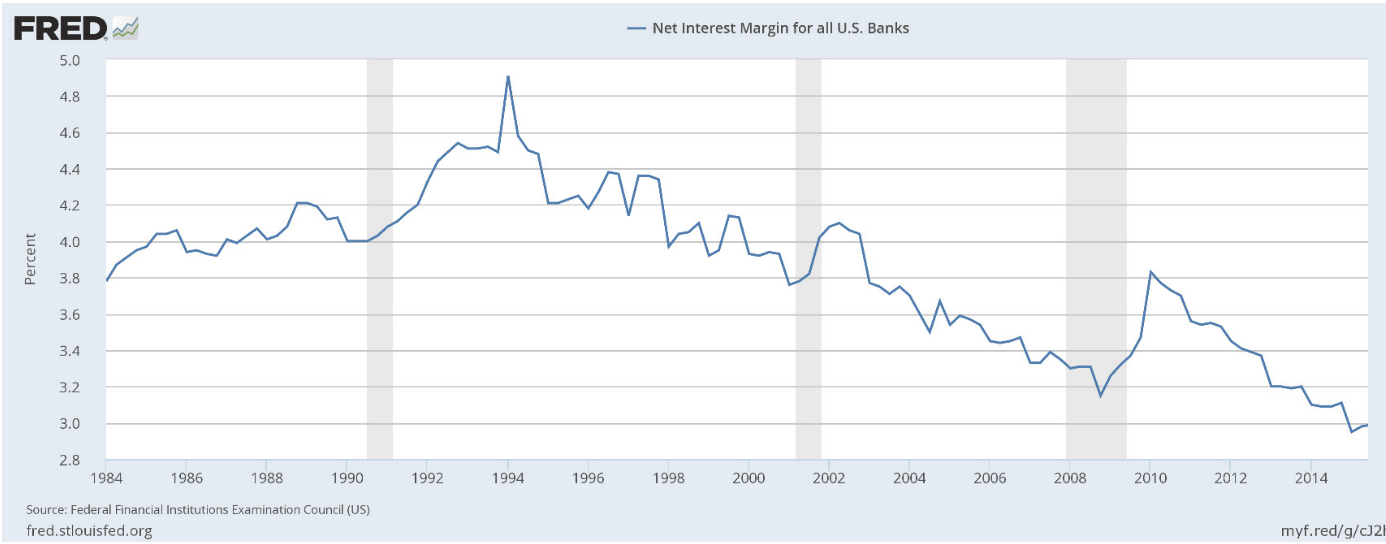
One team of highly respected analysts crunched the numbers, pored over reams of data, and concluded that we literally had ***never seen anything like this in the entire 5,000-year course of recorded human financial history!***

All of those rate cuts, QE programs, and collapsing bond yields helped inflate asset prices. But they also crushed NIMs across the banking industry.



Image(s) Copyright: Financial Times

This chart shows how margins in the U.S. banking industry collapsed to an all-time low of 2.95% in early 2015 from 3.83% a half-decade earlier. In fact, lending margins fell to levels we didn't even see at depths of the Great Recession in 2008!



But just like the great Roman, Greek, and Mayan empires passed into the annals of history centuries ago ... or just like Tsarist Russia fell apart in the early 1900s ... the unprecedented low-rate regime, one 5,000 years in the making, is now collapsing.

The Fed has started raising interest rates for the first time since 2006. Foreign central banks have started to backtrack from QE. Bond investors have collectively woken up from their madness, and started dumping the very same bonds they couldn't get enough of before last summer. And of course, Trump's election has taken our nation in an entirely different political and economic direction.

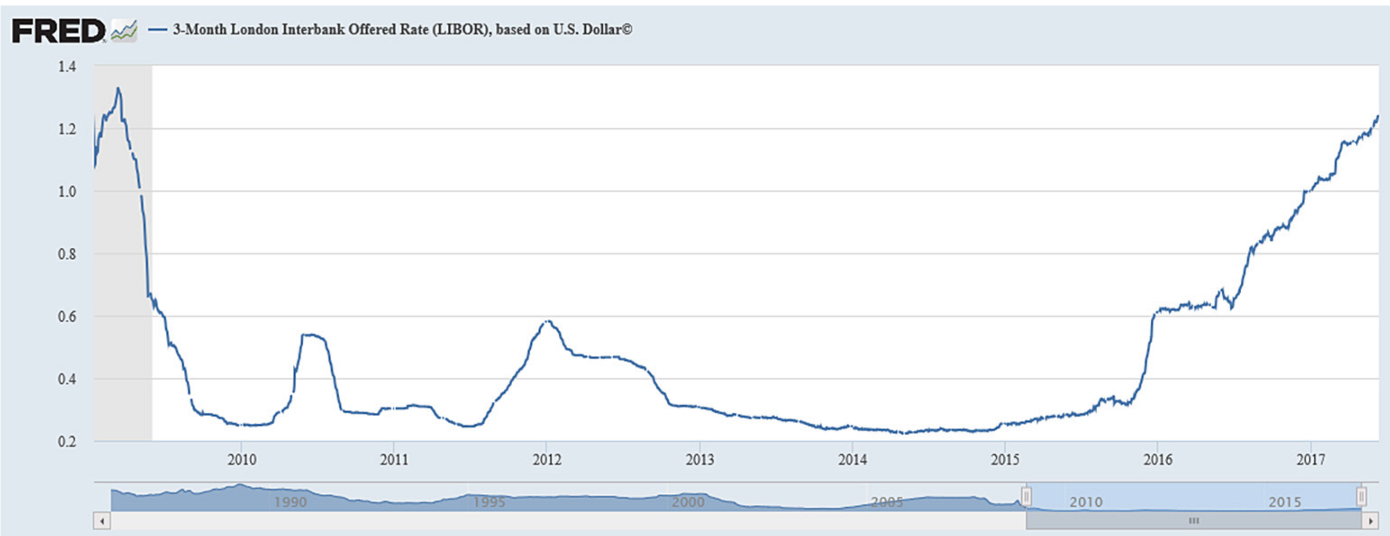
Meanwhile, wholesale prices rose at a 0.6% rate in January 2017. That was twice the expectation of economists and the biggest monthly surge since September 2012.

At the consumer level, inflation also jumped 0.6% – the biggest rise in almost four years and double the gain in December. The core Consumer Price Index (which excludes food and energy) rose a greater-than-expected 0.3% on the month, pushing year-over-year core inflation to 2.3%. That's well above the Fed's target of 2%. The hotter inflation data also come amid other positive reports on everything from job growth to retail sales.

As a result, the yield on the 30-year Treasury bond soared more than 100 basis points between late summer and the beginning of 2017, while the spread between 2-year Treasury Note yields and 10-year Treasury Note yields recently blew out to a 12-month high.

Three-month LIBOR, a benchmark interest rate that closely tracks expectations for future Fed policy, just hit 1.24%. That was more than quintuple the low of 0.22% in mid-2014, and the highest in more than eight years.

Or in other words, bond investors are voting with their wallets and pocketbooks. They're saying



they believe Trump's proposed tax reductions, massive infrastructure and defense spending plans, and regulation cuts will unleash a boom in GDP growth, a large boost in lending, and a surge in inflation.

For banks, this is great news. Lending activity will jump alongside GDP growth. Plus, the profitability of lending and investing will balloon as the spread between shorter-term rates and longer-term rates widens out.

Another very important point: It's unlikely the four Fed rate hikes through June will be the last — or even close to the last, based on the historical record.

Over the past several decades, there have been four major "up" cycles for interest rates. The most painful was the late-1970s/early-1980s cycle, which was driven by a massive outbreak of inflation. The least painful was the early-1990s cycle, which stemmed from the need for the Fed to tweak policy after the nation emerged from the Savings and Loan crisis and associated recession.

The average length of the preceding interest rate "nadirs" was 12.3 months. The average length of those four rate hiking cycles was 24.8 months. And the average increase in rates was 660 basis points, or 6.6 percentage points. Even stripping out the 1,525 basis point "mega-cycle" from the Carter and Reagan years, you get an average increase of around 370 basis points.

This time around, rates fell to 0% in December 2008 ... and stayed there until December 2015. That means the nadir was a mind-boggling seven years in duration. It was also accompanied by the greatest wave of global interest rate cuts, negative rates, and QE in the history of mankind.

Since then, we have only seen four interest rate hikes, for a total of 100 basis points.

That means even an AVERAGE cycle would dictate we get another 560 basis points worth of hikes. Since we started this journey at 0%, that also means short-term rates would need to hit 6.6% for the cycle to just be considered average. But if this is the greatest interest rate cycle in 5,000 years, that target could ultimately prove tame.

Bottom line: Interest rates could be working in the banking sector's favor for a long, LONG time.

SIX RECOMMENDATIONS FOR PROFITING FROM THE FINANCIAL SECTOR SURGE

If you wanted to get diversified exposure to the financial sector, you could purchase something like the **Financial Select Sector SPDR Fund (XLF, Rated "B").** This highly liquid ETF owns 68 leading banks, brokers, and insurance companies, including stocks like **JPM, WFC, and Goldman Sachs Group (GS, Rated "C+")**. It features a low gross expense ratio of just 0.14%, and has delivered solid double-digit gains in the last year.

But I believe there's a better approach — one that relies on the power of our time-tested, completely unbiased Weiss Ratings. You see, our stock Ratings represent a completely independent, unbiased opinion of a stock's historical risk-adjusted performance and value relative to the company's earnings prospects. Each stock's rating is based on two primary components: (1) its **Performance Rating** and (2) its **Risk Rating**.

A stock's **Performance Rating** is based on its total return to shareholders over the last trailing four years and its prospects for future returns based on sales, net income, earnings trends and economic factors. Additionally, credit is given for relatively low valuations (i.e., price to earnings, price to sales and price to book) based on the stock's current price.

Returns and trends are weighted to give more recent performance a greater emphasis. Thus, two stocks may have provided identical returns to their shareholders over the last four years, but the one with the better performance in the last 12 months will receive a slightly higher performance rating.

The **Risk Rating** is primarily based on the level of volatility in the stock's daily and monthly returns and on the underlying company's financial stability, as well as economic factors. Stocks with more volatility relative to other common stocks are considered riskier, and thus receive a lower risk rating. By contrast, stocks with very stable returns are considered less risky and receive a higher risk rating.

Likewise, companies with weak financial stability (e.g., those with high levels of debt) are riskier investments than those that are financially sound. Adjustments have also been made for stocks that appear to be overvalued at their current prices.

Based on Weiss Ratings' evaluation of the investment, an individual performance rating and a risk rating are assigned to the stock. Then these measures are combined to derive the stock's composite Weiss Investment Rating. Keep in mind, however, that the overall rating is not a simple average of the risk and performance grades. Rather, it involves a dynamic assessment of how well investors have been compensated for the level of risk they have taken.

Rarely will you ever find a stock that, at the same time, has both a very high Performance Rating plus a very high Risk Rating. Therefore, the stocks that receive the highest overall Weiss Investment Ratings are those that provide the ideal combination of both primary components. There is always a tradeoff between risk and reward.

Every stock in the Ratings universe is graded, from a low of "E" to a high of "A+". Stocks in the "E" and "D" categories are roughly equivalent to SELLS in traditional Wall Street lingo, while "C" stocks are HOLDS and "B" and "A" stocks are BUYS.

My team and I recently used the Ratings system to screen the entire financial sector. We eliminated stocks with less than $50 million in market cap and 50,000 shares in average daily trading volume. We also narrowed the search to U.S.-based financials, as they're primed to benefit the most from Trump's "American First" approach to policy.

The list on page 15 shows the results of our screening methodology. At the top of it are a pair of smaller banks, **First Connecticut Bancorp (FBNK)**, with a market cap of $412 million, and **WashingtonFirst Bankshares (WFBI)**, with a market cap of $446 million.

FBNK is a New England bank that dates back all the way to 1851. It operates 24 branches in Connecticut and Massachusetts, and recently garnered our top-notch "A+" rating. Net income in the first quarter surged 41% to $5.1 million, or 32 cents per share, from $3.6 million, or 24 cents per share, in the year-earlier period.

Its NIM (that core bank profitability margin I mentioned earlier) widened to 2.94% in the quarter from 2.75% three months earlier. Delinquency rates and charge offs of bad loans were low, while loans grew a healthy 10% from the same period of 2016.

As for WashingtonFirst, the Reston, Virginia-based bank recently agreed to be purchased by **Sandy Spring Bancorp (SASR)**. So it's better to focus on the third financial stock on our list, **Arch Capital Group (ACGL)**.

ACGL is a Bermuda-based company that offers a range of insurance and reinsurance products in the property and casualty and mortgage markets. Net income jumped to $241.9 million, or $1.74 per share, in the first quarter from $149.3 million, or $1.20 per share, in the same period a year prior. Premiums grew nicely, as did net investment income.

Next up is the exchange operator **Intercontinental Exchange (ICE)**. The company brings together investors, speculators, corporations, and other parties interested in trading futures and options on commodities, currencies, interest rates, stock indices, and more. It also owns the New York Stock Exchange.

ICE shares have set a series of all-time highs in 2016 and 2017, with no sign of momentum letting up. Strong trading volume and new product roll outs bode well for its long-term growth.

Following ICE are three insurance industry players. They include the insurance broker and risk management firm **Marsh & McLennan Companies (MMC)**, the property and casualty insurance company **Progressive Corp. (PGR)**, and the reinsurance company **Everest Re Group (RE)**.

My recommendation: Buy an equal-weighted basket of six of our top-rated financial stocks — FBNK, ACGL, ICE, MMC, PGR, and RE. If you have $120,000 to invest, for instance, buy $20,000 worth of shares in each company.

If you prefer more diversification, or you'd like to check the health of other financial stocks we track, then here is our complete list of **The Top 25 Financial Stocks Set to Clean Up in the Trump Administration**.

I believe they could all deliver handsome profits to you over the next few years, and are well worth your investment consideration.

APPENDIX A: THE TOP 25 FINANCIAL STOCKS SET TO CLEAN UP IN THE TRUMP ADMINISTRATION

Rating	Ticker	Stock Name	Market Cap (in Millions)
A+	FBNK	First Connecticut Bancorp, Inc.	$412 M
A	WFBI	WashingtonFirst Bankshares, Inc.	$446 M
A	ACGL	Arch Capital Group Ltd.	$12,273 M
A	ICE	Intercontinental Exchange, Inc.	$38,230 M
A	MMC	Marsh & McLennan Companies, Inc.	$41,366 M
A	PGR	The Progressive Corporation	$26,046 M
A	RE	Everest Re Group, Ltd.	$10,497 M
A	PSTB	Park Sterling Corporation	$635 M
A	NTB	The Bank of N.T. Butterfield & Son Limited	$1,821 M
A	SRCE	1st Source Corporation	$1,270 M
A	FRC	First Republic Bank	$15,848 M
A-	WSBF	Waterstone Financial, Inc.	$420 M
A-	PVTB	PrivateBancorp, Inc.	$4,872 M
A-	JRVR	James River Group Holdings, Ltd.	$1,184 M
A-	CB	Chubb Limited	$68,909 M
A-	FRME	First Merchants Corporation	$1,673 M
A-	AFG	American Financial Group, Inc.	$8,977 M
A-	TRI	Thomson Reuters Corporation	$32,765 M
A-	MAIN	Main Street Capital Corporation	$2,180 M
A-	RNR	RenaissanceRe Holdings Ltd.	$5,766 M
A-	SBCF	Seacoast Banking Corporation of Florida	$1,060 M
A-	WSFS	WSFS Financial Corporation	$1,447 M
A-	EIG	Employers Holdings, Inc.	$1,367 M
A-	MSFG	MainSource Financial Group, Inc.	$861 M
A-	ALL	The Allstate Corporation	$32,741 M

ABOUT MIKE LARSON

Mike Larson is a Senior Analyst for Weiss Ratings, specializing in interest rates, real estate, and financial stocks. He is also the editor of the Ratings newsletter *High Yield Investing*. A graduate of Boston University, Mike Larson formerly worked at Bankrate.com and Bloomberg News, and is regularly featured on CNBC, CNN, Fox Business News and Bloomberg Television as well as many national radio programs. Due to the astonishing accuracy of his forecasts and warnings, Mike Larson is often quoted by the Washington Post, Chicago Tribune, Associated Press, Reuters, CNNMoney and many others.