Rinehart Wealth Management
Greater Trust

The Changing Landscape – Financials Have a Place in Your Portfolio

In 2009, the financial sector underperformed the broad market, rising 14.8% versus the S&P 500's 23.5%. So far in 2010, however, a reversal has occurred: financials outperformed the S&P 500, increasing 10.8% versus 4.9% in the first quarter. Looking ahead, we think this trend may mark the beginning of a period of relative outperformance by certain financials. In general, stocks in the sector are inexpensive, sentiment continues to be negative and institutional money managers are significantly underweight in financials versus their benchmarks. All of these factors suggest money may flow into the financial sector throughout 2010.

Recent headlines have targeted financial institutions, specifically large banks, as a key reason for the second worst recession in our country's history. As we look forward, however, the financial system still drives the economy and will play an important role in the economic recovery. We therefore think there is a place in your portfolio for financials, though within the sector we prefer asset managers, international financial institutions and some smaller regional banks to large retail banks.

What to expect in your portfolio:

- **De-emphasize Large Banks.** We believe the days of assuming the large banks will always pay dividends and weather economic crises are gone. Many banks' dividend yields are now null or negligible, their balance sheets are in shambles, and government restrictions could still prove debilitating. Although many banks have rallied sharply off of their lows in 2009, we are skeptical that their fundamentals will support significant upward stock price movement from current levels. We recommend an underweight position in the large banks, with exposure to the highest quality name in this space: JP Morgan (JPM).

- **Overweight Asset Managers.** Several factors suggest that asset managers should perform well in the current environment. First, an improving economy and an upwardly moving stock market have historically been positive catalysts for revenue growth among asset managers. Second, because significant cash reserves (approximately $9 trillion in Q4 2009) are sitting in money market funds and savings accounts yielding less than 1%, we expect to see cash move into riskier assets as investors demand higher returns. We favor companies that have a high degree of product diversification and exposure to equity and international markets. Our favorite names in the asset manager space, BlackRock (BLK) and Franklin Resources (BEN), recently increased their quarterly dividends 28% and 5%, respectively.

- **International Financial Opportunities.** We will continue to explore areas with higher long-term growth potential and favorable demographics, such as China, India, South East Asia, Australia, Eastern Europe and Latin America. To do this we will look to use Exchange Traded Funds (ETFs) which, like mutual funds, assist with diversification and risk control. One that we like is iShares Emerging Market Financial ETF (EMFN).

- **Regional banks.** In recent years, small cap banks have significantly underperformed both their benchmark and their large cap brethren: small cap banks are off 59.5% from their peak in 2004, while the S&P 600 (the small cap index) is only down 18.1% from its peak in 2007. Year-to-date we have seen small cap banks gain relative strength against the index, up 15.1% as of March '10 versus an 8.6% gain in the S&P 600. Given the depressed valuations and moderating balance sheet deterioration, we believe small cap banks could be entering a period of outperformance. For those clients with a higher risk tolerance, we believe it is time to allocate to regional banks. Due to liquidity and company-specific risks in this area, we prefer to invest in a diversified, thematic manner through two ETFs: Regional Bank SPDR (KRE) and First Trust ABA Community Bank ETF (QABA).

If you would like to discuss any of these ideas, please do not hesitate to give us a call.

Regards,
Mary Rinehart, CFP®
Treven Ayers MA, CFS, CFP®

521 East Morehead Street • Suite 580 • Charlotte, NC 28202 • (704) 374-0646 • Fax (704) 377-0746