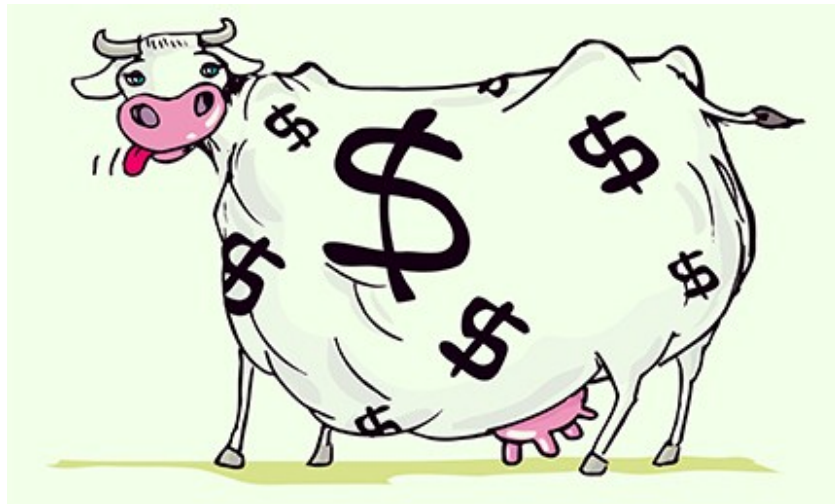




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02-04-2015

Opportunities in the unpopular financial sector

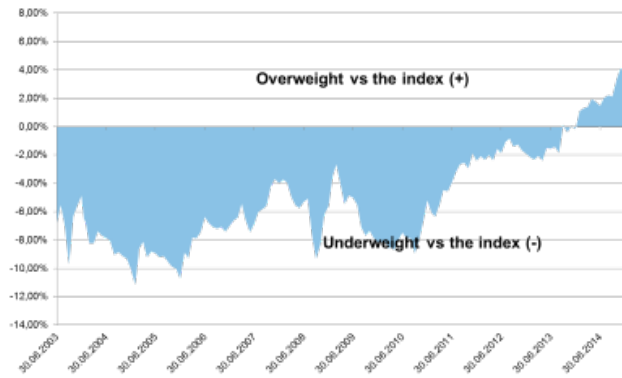


Since the 2007-2008 financial crisis, financial companies have been losing popularity among global investors. However, the lower prices for financial equities are now creating new opportunities. At the end of February, four of the ten largest holdings in SKAGEN Global were from the financial sector.

Financial enterprises – which include banks, insurance companies and real estate companies – account for around 20 percent of the world index (MSCI AC). This is five percentage points less than in 2007 when this sector accounted for one quarter of the global index.

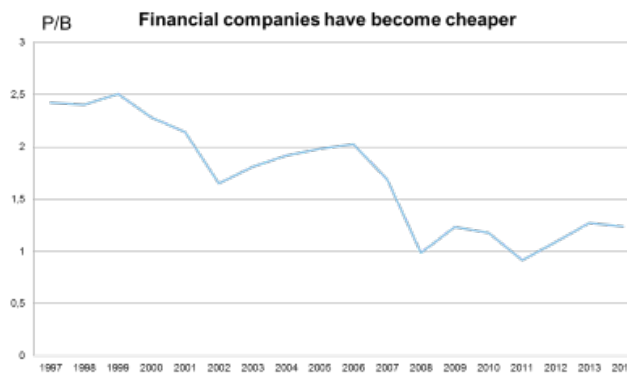
Weighting up in financial companies

For SKAGEN, the reverse is true (see the graph below). At the end of May 2007, financial companies accounted for almost 18 percent of the global equity fund SKAGEN Global, whose benchmark index is the MSCI All Country World Index. This was around seven percentage points less than the benchmark index. By the end of February 2015, however, financial companies accounted for 28 percent of the portfolio, an overweight of seven percentage points relative to the benchmark.



Less popular

As a consequence of the financial crisis, investors have become more cautious about buying equities in banks and insurance companies. The valuation of financial companies, measured as price to book value (P/B), has declined considerably (see the graph below), from more than 2 in 2006, before the financial crisis, to 1.2 at the end of 2014. The lower price tag has created opportunities for fund managers like SKAGEN that are keen to buy equities in low-priced, high-quality companies with the potential for repricing.



Source: Bloomberg

In the years since the financial crisis, several banks and insurance companies in both the US and Europe have built up substantial capital buffers. As times have improved and conditions normalised, many companies are now well-capitalised.

"Increased regulation and a more prudent approach by many financial companies' boards and management have caused many companies to take on too much capital. As a result, they are over-capitalised. We investors can benefit from this by selectively investing in banks and insurance companies as the dividend potential increases," says Knut Gezelius, lead portfolio manager of SKAGEN Global.

Good potential

American [Citigroup](#) is an example of a crisis-stricken bank that has now made a recovery. This is one of the world's largest commercial banks, with activities in more than 100 countries. Citigroup was rescued by the US government during the financial crisis. Since then, the bank has been brought back on an even keel and the US government sold the last of its equity holdings in December 2010. The bank's capital plan recently got the green light in the Federal Reserve's stress test of US banks. This will enable Citigroup to increase dividends to shareholders, or buy back its own

shares. We estimate the share price's upside to be over 40 percent.

AIG is an insurance company that has made a strong recovery. This company was at the epicentre of the financial crisis in autumn 2008, and was rescued by the US government with a bail-out package to the tune of USD 180 billion. New management subsequently came on board, and for the last four years has worked to fundamentally restructure the company and reposition the strategy from unrestrained growth to increased profitability. The US government divested its shares in the company in 2012. AIG is currently priced as though the company's low return on equity will continue for several years to come, which is not an opinion shared by SKAGEN. On the contrary, AIG has good opportunities for sustained higher returns on equity, at normalised levels, which should have a positive impact on the share price development.

Nordea is an example of a bank on the other side of the Atlantic. This bank is the leading player in the Nordic region, with 11.2 million private clients and 625,000 corporate clients. It is the most diversified bank in the Nordic region. Despite sound profitability, the bank is less popular among analysts. 62 percent of the analysts who follow this bank have either sell or hold recommendations for the Nordea share. The Swedish state was previously a major owner, but sold the last of its holdings in the summer of 2013, at the same time as SKAGEN Global made its first investment in the company. The bank's chairman, Björn Wahlroos, stated a while back that Nordea is over-capitalised and that the "bank is swimming in money". This is a luxury problem that the bank intends to resolve by successively increasing dividends to shareholders. Nordea can be seen as a formidable "dividend machine" that, quite erroneously, is still priced by the market as a weak bank share. Finally, SKAGEN's top ten list also includes an emerging markets bank, namely the

State Bank of India. This is India's largest bank, with a market share of 22 percent, a network of local bank offices throughout India, and no real rivals. The bank has faced a number of internal problems, while the country's weak macroeconomic development has also negatively affected the bank. The Indian economy has started to pick up again, however, and important structural reforms are being undertaken by the reform-minded Prime Minister, Narendra Modi. The bank is expected to benefit from this. Streamlining of the bank, with the sale of non-core assets such as insurance activities, will also be positive for the share price.

Less state involvement

The common denominator for the above four companies is varying degrees of state involvement in their ownership. As the world has normalised after the financial crisis, the state control of Citigroup, AIG and Nordea has diminished, with the state either reducing ownership, or selling off all their shares. This process has been favourable for the companies, since it signals that a company is once again independent, with greater scope to return capital to shareholders in the form of higher dividends or share buy-backs.

Largest holdings in SKAGEN Global as of the end of February 2015

	Holding size, %	Price	P/E 2014e	P/E 2015e	P/BV last	Price target
CITIGROUP	7.0	52.4	9.8	9.0	0.8	75
SAMSUNG ELECTRONICS	6.3	1 048 000	6.8	7.3	0.9	1 300 000
AIG	4.6	55.3	11.3	9.9	0.7	80
NORDEA	3.4	112.5	13.2	12.5	1.6	150
DSM	3.2	49.9	18.5	15.9	1.5	65
LG CORP	2.7	63 600.0	10.1	9.6	0.9	84 000
AKZO NOBEL	2.7	66.4	17.5	15.8	2.8	81
GENERAL MOTORS	2.5	37.3	8.3	7.7	1.7	50
STATE BANK OF INDIA	2.5	301.7	13.0	10.3	1.5	380
ROCHE	2.3	258.8	18.7	17.2	11.2	380
Weighted top 10	37.2		10.6	10.0	1.1	34%
Weighted top 35	77.5		12.0	10.8	1.2	28%
MSCI AC World			17.6	16.7	2.1	

Fact box: the financial crisis

In the autumn of 2008, the world held its breath when the US investment bank Lehman Brothers, the fourth largest investment bank in the US at the time, filed for chapter 11 bankruptcy protection. This was the largest financial bankruptcy filing the world had ever seen. A tsunami of credit failure activity swept across the financial world in the wake of the Lehman collapse. Once the dust had settled, large parts of the western world's financial system were under threat. A number of rescue measures were launched. The state went in and took direct control of some banks and insurance companies (a frequently used method in the US) and capital adequacy requirements of financial companies were tightened, forcing many financial companies to raise new capital via share issues. In some countries, such as Sweden, the state intervened by guaranteeing various types of loans, to avoid completely cutting off the credit supply. A number of other regulatory measures were introduced to enhance the robustness of banks and insurance companies, and thereby the entire financial system.

Historical returns are no guarantee for future returns. Future returns will depend, inter alia, on market developments, the fund manager's skill, the fund's risk profile and subscription and management fees. The return may become negative as a result of negative price developments.