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# Can Financial Sector Kick Higher?

## JPMorgan Gives Hope

Bank's Q1 results beat views, but the group still faces headwinds

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The first quarter of 2016 is being called the worst for U.S. banks since the financial crisis and the rest of the year doesn't look much better.

This week, the big money center banks report first-quarter earnings and expectations are for them to be worse than the year-earlier quarter.

Since financials are the third-largest sector in the S&P 500, they could be a harbinger for the rest of the market.

The biggest ETFs focused on financials are $15.71 billion Financial Select Sector SPDR[XLF], down 5.41% year to date; $3.71 billion Vanguard Financials[VFH], down 4.48%; and $2.25 billion SPDR S&P Bank[KBE] down 10.25%.

### The Headwinds Banks Face

The headwinds facing the sector are strong. They include low interest rates and a flat yield curve, leading to slim interest margins, which make up a big part of a bank's earnings.

Throw in slumping merger-and-acquisition activity, underreserved energy-sector loans, higher capital reserve requirements and weaker trading revenue, and it all adds up to declining return on equity.

"Earnings expectations have come in," said David George, senior banking analyst at Robert W. Baird. "Given how poorly the stocks have done, the expectations are reasonable."

**JPMorgan Chase**[JPM], the biggest U.S. lender by assets, kicked off the proceedings Wednesday.

### Beat Estimates

The New York-based lender reported that Q1 earnings fell 7% to $1.35 a share. But that beat consensus estimates by 9 cents. Revenue slipped 3% to $24.1 billion, above forecasts of $23.4 billion.

Investors were happy to see net income beat Wall Street estimates. JPMorgan's shares surged 4% in the stock market Wednesday.

The news sparked a rally in the financial sector. The IBD bank-money center group popped 3%. The group ranks 183 out of 197.

Have the banks bottomed out? Is this the beginning of a rally or just a head fake?

"There are very few positives today except for the pure valuation," said Mark DeVaul, co-portfolio manager of Touchstone Large Cap Fund[TLCYX]. "JPMorgan's earnings weren't great, but expectations were so low, the stock went up."

Touchstone Large Cap had nearly 25% of its $302.8 million assets in financial services stocks as of Dec. 31.

Of the four other big banks, the fund owns **Bank of America**[BAC] and **Wells Fargo**[WFC], but not **Citibank**[C]. He said both Bank of America and Wells look cheap compared to their long-term history.

"The near-term environment is terrible, but it's hard to imagine it getting worse," said DeVaul. "If you buy banks when there is a lot of near-term negativity, that provides strong downside protection, especially if they have strong balance sheets."

It's very interesting that the failure of the big banks to pass the regulators' "living wills" test had no effect on the rally, said Paul DeSisto, senior portfolio manager at M&R Capital Management a New York-based registered investment advisor.

### What Will Spark Rally

DeSisto said the continuation of a rally depends oil prices increasing, the Federal Reserve raising interest rates, and weaker wage increases, but all this is unlikely in an election year.

"I expect the rally to be short-lived," said DeSisto. "But I see limited downside. Patient investors who buy now and hold until after the election may be well rewarded."

The banks haven't bottomed out," countered Sid Jain, president of AAAUM, an investment advisor in Hoboken, N.J.

Jain worries about the Fed pushing interest rates negative, like in Europe and Japan. He said there's a 15% chance of it happening. But if it does occur, it will shock the stock market.

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