Opportunities in Financials

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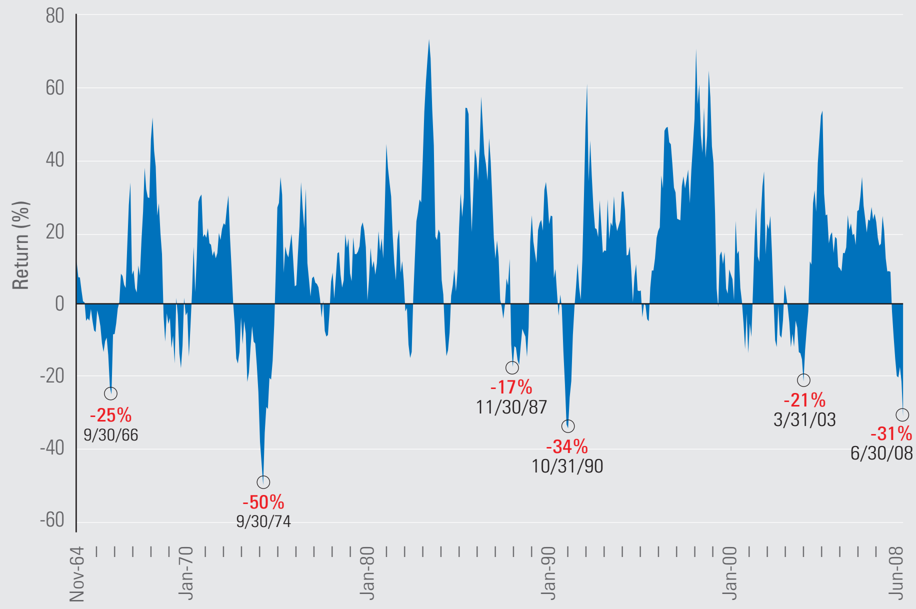
Even though the financial sector is the current market pariah, history tells us that this is an excellent opportunity to buy into financial stocks. As radioactive as the sector may seem to most investors at the moment, this is not a unique market environment in the context of history — and in the past, similar sell-offs of financial stocks have been followed by huge rebounds. When faced with fear, investors too often seek security when instead they should be searching for opportunity.

The decline has certainly been ugly: the S&P 500 Financials index is down -43.5% from a year ago and approximately $1.2 trillion of market value has been eradicated from the 90 constituents of the index. Over the last 12 months many of the best known financial firms, including Citigroup (-66.7%), Bank of America (-50%), AIG (-60.7%) and Washington Mutual (-88.8%) have fallen to multi-year lows. The S&P 500 Financials index is currently trading at a price-to-sales ratio of 1.66, the lowest observed level since the data becomes available in 1995.

OSAM Large Financials — Rolling 12 Month Returns
Financial downturns have usually been followed by periods of strong returns

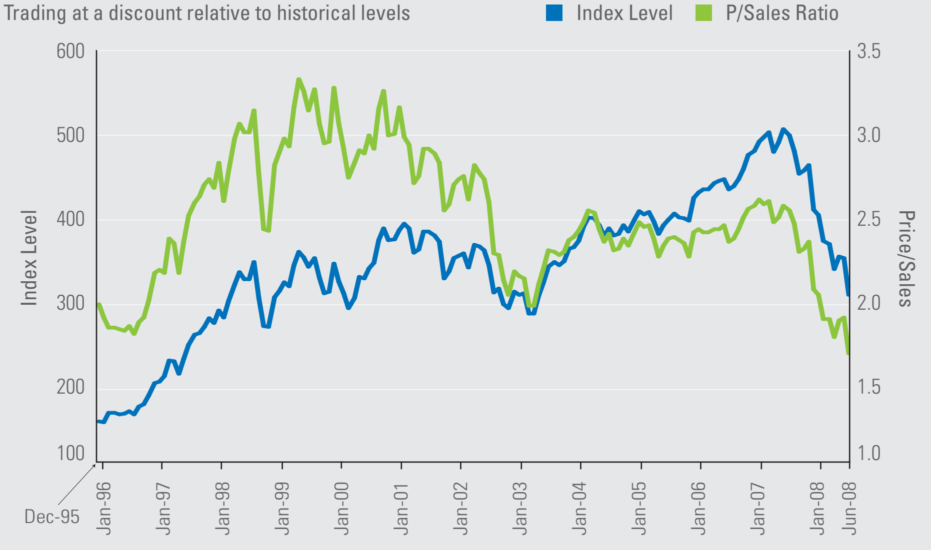


Source: FactSet

In order to gauge the current downturn in the context of market history, we need to look as far back as possible. To do so, we created a proxy "index" for large financial stocks. The rules for inclusion in the index are simple; the company must be in OSAM's "Large Stocks"[1] universe and must be a financial firm.[2] The companies are equally weighted in our index. The chart above represents the rolling 12-month returns to OSAM Large Financials back to 1964.

Clearly, financial downturns are a normal occurrence throughout the past 44 years, and have usually been followed by periods of strong returns. The 20 worst rolling one-year periods for OSAM Large Financials averaged -34.96% — surely scaring many investors out of the financial sector. Those who saw these downturns as great buying opportunities were generally rewarded over the following one-to-three year period: OSAM financials averaged 30.47% over the following one-year periods and 19.68% annualized over the following three-year periods. These are outstanding numbers in the large cap space.

S&P 500 Financials
Trading at a discount relative to historical levels



Source: Bloomberg

1 OSAM's Large universe is comprised of all companies on the S&P Compustat database with a market cap greater than the database average.

2 Based on S&P GICS sector classification methodology.

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Considered in the isolation, the recent turmoil could not inspire any confidence in the financial stocks, but we have seen this all before. The year 1990 was a similarly tough time for large financial stocks. In many ways, that market environment was very much like today's: a small recession was looming, the overall market was sharply down, and Americans were dealing with a tough real estate market. Like today, many of the biggest financial firms were decimated in the 12 months ending October 1990. At right is a look at the returns to the 15 biggest U.S. financial firms in our universe at that time.

Company	Market Cap ($ Billions)	Price-to-Sales	Trailing 12-Month Return (%)	Subsequent 12-Month Return (%)
American International Group Inc.	13,344.7	0.9	-25.4	40.7
American Express Co.	8,726.9	0.3	-44.8	5.6
Berkshire Hathaway Inc. (Cl A)	6,818.7	2.9	-29.8	44.0
J.P. Morgan & Co. Incorporated	6,786.8	0.7	-8.2	82.2
The Dun & Bradstreet Corporation	6,774.3	1.5	-21.2	38.8
Fannie Mae	6,718.8	0.6	-28.8	125.9
General Re Corporation	6,662.6	2.4	-14.9	27.6
Loews Corp.	5,536.8	0.5	-38.9	38.1
Marsh & McLennan Cos.	4,865.1	1.9	-18.2	17.5
BankAmerica Corporation	4,014.8	0.3	-35.6	130.1
Citicorp	3,704.3	0.1	-56.2	8.9
SLM Holding Corp.	3,445.3	1.0	-25.2	70.9
Chubb Corp.	3,405.1	0.9	-3.8	71.3
American General Corporation	3,287.6	0.8	-18.6	64.7
Banc One Corporation	3,203.1	0.9	-28.8	130.3
Average	**5,819.7**	**1.0**	**-26.6**	**59.8**

Source: FactSet, Compustat

Large Cap Financials
Worst Rolling 1-Year Returns (%)

12 Months Ending	Return	Subsequent 1-Yr Return	Subsequent 3-Yr Return*
Sep-74	-49.98	30.07	20.73
Aug-74	-44.04	34.99	19.66
Jul-74	-38.06	27.83	15.32
Oct-74	-35.56	8.54	9.66
Oct-90	-34.33	60.71	32.28
Sep-90	-33.25	48.74	30.75
Jun-08	-31.09	—	—
Dec-74	-29.00	13.78	11.52
Nov-74	-28.45	15.80	12.18
Nov-90	-25.82	33.73	24.99
Sep-66	-24.99	33.44	17.64
Jun-74	-24.31	26.57	12.09
Aug-66	-22.98	27.26	17.03
Aug-90	-22.26	29.31	24.53
Nov-73	-21.56	-28.45	0.04
May-08	-21.45	—	—
Mar-03	-21.39	53.30	29.38
Dec-90	-21.33	45.07	24.72
Feb-75	-20.89	16.18	4.26
Jan-75	-20.41	12.80	4.51
Minimum	**-49.98**	**8.54**	**9.66**
Maximum	**-25.82**	**60.71**	**32.28**
Mean	**-34.96**	**30.47**	**19.68**
Median	**-33.79**	**30.07**	**19.66**

Source: OSAM Research, Compustat

* Subsequent three year returns are annualized.

The 15 biggest financials lost, on average, -26.6% of their value in one year, but over the next 12 months, those firms returned averaged a 59.8% return.

In the table below is a look at how the U.S. financial landscape looks as of June 30, 2008.

Fear is a powerful emotion and, unfortunately for investors, it tends to override patience and reason which are the keys to long term investment success. The reasonable approach to evaluating the financial sector is to gauge the turmoil through the lens of history, which tells us that now is a great time to buy.

Company	Market Cap ($ Billions)	Price-to-Sales	Trailing 12-Month Return (%)	Subsequent 12-Month Return (%)
Berkshire Hathaway Inc. (Cl A)	187,041.7	1.7	10.3	—
JPMorgan Chase & Co.	118,475.1	1.0	-26.0	—
Bank of America Corp.	106,288.0	0.9	-45.9	—
Citigroup Inc.	91,244.1	0.6	-64.0	—
Wells Fargo & Co.	78,437.3	1.4	-28.9	—
American International Group Inc.	71,144.9	0.7	-61.1	—
Goldman Sachs Group Inc.	68,946.1	0.9	-18.7	—
U.S. Bancorp	48,544.4	2.4	-10.3	—
American Express Co.	43,637.4	1.4	-37.3	—
Bank of New York Mellon Corp.	43,270.6	2.3	-11.7	—
Morgan Stanley	39,935.2	0.4	-46.6	—
MetLife Inc.	37,482.8	0.7	-17.0	—
Wachovia Corp.	33,199.3	0.5	-65.2	—
Merrill Lynch & Co. Inc.	31,244.9	0.5	-60.4	—
AFLAC Inc.	29,851.2	1.9	23.9	—
Average	**68,582.9**	**1.2**	**-30.6**	—

Source: FactSet, Compustat

For More Information

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Backtested performance is calculated by using a computer program and monthly returns data set that starts with the first day of the given time period and evaluates the returns of simulated indexes and strategies

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