



Pick Your Bank Benchmark Wisely: Not all Banks Are the Same!

Summary

The banking industry is highly fragmented with institutions that are different in both their size and the type of services offered. These differences are reflected in the equity market through unique valuation multiples and price performance. Investors using associated ETF products to either make positions or hedge equity exposures benefit from using precise bank indices. These indices also provide the most relevant bank benchmarks for comparative purposes.

- **Banks provide investors with unique exposures, performance and valuation trends.** Universal and large-regional banks are most impacted by industry regulation and Federal Reserve policy. Their exposure to higher associated regulatory costs and fewer M&A opportunities is reflected in lower valuations relative to their regional peers. Regional banks provide investors with geographical exposure as well as M&A takeout opportunities.
- **Regional banks trade at higher valuation multiples:**
 - **On a price to forward-earnings basis**, at 3Q16, regionals traded at premiums of 34% to universals and 16% to large regionals.
 - **On a price to book basis**, at 3Q16, regionals traded at premiums of 38% to universals and 17% to large regionals.
- **In 2016 through 3Q16, regional banks were the best-performing**, rising 8.5% on average, while large regionals rose 0.2% and universals fell 7.2%.
- **For investors looking to differentiate bank performance:**
 - The **KBW Nasdaq Bank Index (BKX)** and **S&P Banks Select Industry Index (SPSIBK)** are used to measure universal and large regional banks. *The PowerShares KBW Portfolio (KBWB) tracks BKX and the SPDR S&P Bank ETF (KBE) tracks SPSIBK.*
 - The **KBW Nasdaq Regional Banking Index (KRX)** and **S&P Regional Banks Select Industry Index (SPSIRBK)** are used for the regional banks. *The PowerShares KBW Regional Banking Portfolio (KBWR) tracks KRX and the SPDR S&P Regional Banking ETF (KRE) tracks SPSIRBK.*
- **BKX and KRX have a longer history back to 1991 and 2005, respectively while SPSIBK and SPSIRBK were launched in September 2011.**
- **BKX and KRX** are maintained by an index committee to replicate investable large-cap and regional-bank segments, respectively. There is no membership overlap between BKX and KRX.
- **SPSIBK and SPSIRBK are constructed as sub-indices of the S&P Total Market Index (SPTMI), based on GICS sub-industry classifications.**
- **SPSIBK includes non-banking institutions due to their GICS classifications** - VOYA (insurance), MTG and RDN (both mortgage finance) contribute 6% of SPSIBK's weighting.
- **About 90% of SPSIRBK weighting coming from SPSIBK** since both indices include members in the Regional Banks sub-industry group,
- **This significant membership overlap erodes differentiated bank performance. On average, the quarterly spread between the BKX and KRX is nearly 2.5x that of SPSIBK-SPSIRBK.**
- **SPSIBK and SPSIRBK trade at nearly identical index fundamentals - price to forward earnings, price to book and dividend yield.** BKX and KRX trade at differentiated fundamentals with the KRX trading at higher multiples, reflective of the investable regional bank universe and its valuation premiums.
- **SPSIBK and SPSIRBK are nearly identical with a 0.99 correlation!** For comparison, BKX and KRX are also meaningfully correlated, owing to their similar industry, but at a significantly lower 0.90.
- *Please view pages 2-14 for our full analysis.*

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[Glossary of Terms](#)



Taking a Closer Look at the Investable Banking Universe

The investable banking industry is highly fragmented but can be broken down by asset size into three main types of banking institutions:

□ *Universal Banks (Assets Greater than \$500 Billion)*

Universal banks are the largest, most established and complex institutions with global exposures. They offer a wide array of banking, capital markets and financial services, and their revenues are typically generated outside of traditional lending channels. Universal banks are mostly focused on scale businesses such as capital markets, mortgage servicing and credit cards.

There are six publicly traded banks classified as universal banks based on their June 30, 2016, asset size.

Exhibit 1: Universal Banks as of June 30, 2016, asset levels

Ticker	Name	Assets (\$B) as of 6/30/16
JPM	JPMorgan Chase & Co.	2,466
BAC	Bank of America Corporation	2,187
WFC	Wells Fargo & Company	1,889
C	Citigroup Inc.	1,819
GS	The Goldman Sachs Group, Inc.	897
MS	Morgan Stanley	829

Source: KBW Research, SNL DataSource

□ *Large Regional Banks (Assets Between \$50 and \$500 Billion)*

Large regional banks offer an array of banking and financial-related services, typically with a large deposit footprint that spans several states. These banks have more of a traditional lending focus and a greater degree of deposit funding than the Universal banks. There are 18 publicly traded banks classified as large regional banks based on their June 30, 2016, asset size.



Exhibit 2: Large Regional Banks as of June 30, 2016, asset levels

Ticker	Name	Assets (\$B) as of 6/30/16
USB	U.S. Bancorp	438
BK	Bank of New York Mellon Corporation	372
PNC	PNC Financial Services Group, Inc.	361
COF	Capital One Financial Corporation	339
STT	State Street Corporation	255
BBT	BB&T Corporation	222
STI	SunTrust Banks, Inc.	199
CFG	Citizens Financial Group, Inc.	145
FITB	Fifth Third Bancorp	144
RF	Regions Financial Corporation	126
MTB	M&T Bank Corporation	124
NTRS	Northern Trust Corporation	122
KEY	KeyCorp	101
HBAN	Huntington Bancshares Incorporated	74
CMA	Comerica Incorporated	71
CIT	CIT Group, Inc.	67
FRC	First Republic Bank	65
ZION	Zions Bancorporation	60

Source: KBW Research, SNL DataSource

□ Regional Banks (Assets Less than \$50 Billion)

Regional banks are smaller-scale institutions whose funding and lending is focused across a narrower geographical footprint. These institutions are typically less involved in high fee-income business due to the cost and complexity involved in running non-lending businesses. This is the broadest grouping of the banks as there are nearly 400 publicly traded banks within this asset size classification.



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Differences among the Banks Result in Differences in Performance and Valuation

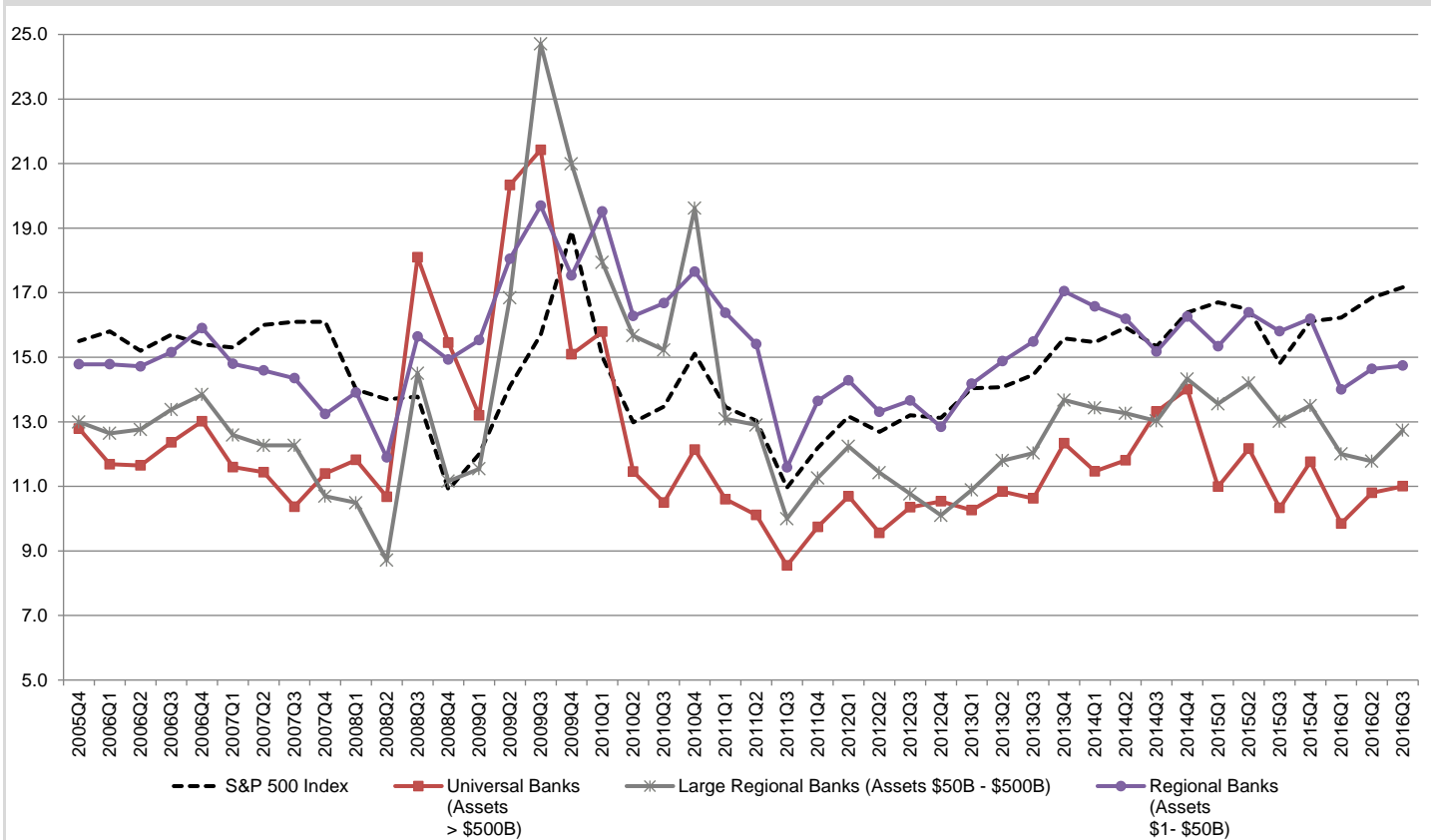
Universal and large regional banks are valued more similarly by the market than their regional peers. Both universal and large regional banks provide investors with exposure to Federal Reserve policy as well as the credit cycle. Universal and large regional banks are most impacted by enhanced industry regulation, and consequently have lower dividend yields and fewer merger and acquisition opportunities owing to these constraints. Aside from historically offering higher yields, regional banks often trade on perceived merger and acquisition activity, which is often viewed as a catalyst for outperformance. In turn, all of these factors translate into reduced forward multiples for both the universals and large regionals.

Price to Forward Earnings Multiples

At the end of the third quarter, universal banks traded at 0.89x next-12-months consensus earnings estimates while large regional and regional banks traded at 12.7x and 14.7x. Regional banks are currently trading at premiums of 34% to universal banks and 16% to large regional banks. This is slightly above the 10-year historical premium of 29% for the regionals relative to universals but nearly in line with the 17% 10-year historical average premium to large regionals.

All three banking groups traded at a discount to the market at the end of the third quarter. Universal banks traded with the largest discount of 36%, followed by the large regionals at 26% and regionals at 14%. This compares to 10-year historical average market discounts of 17% for the universals and 9% for the large regional banks. Historically, regional banks traded at a 5% premium to the market, on average.

Exhibit 3: Price to Forward Earnings Multiples for Banks (by asset size) and the Market



Source: KBW Research, SNL DataSource, Factset and Bloomberg.

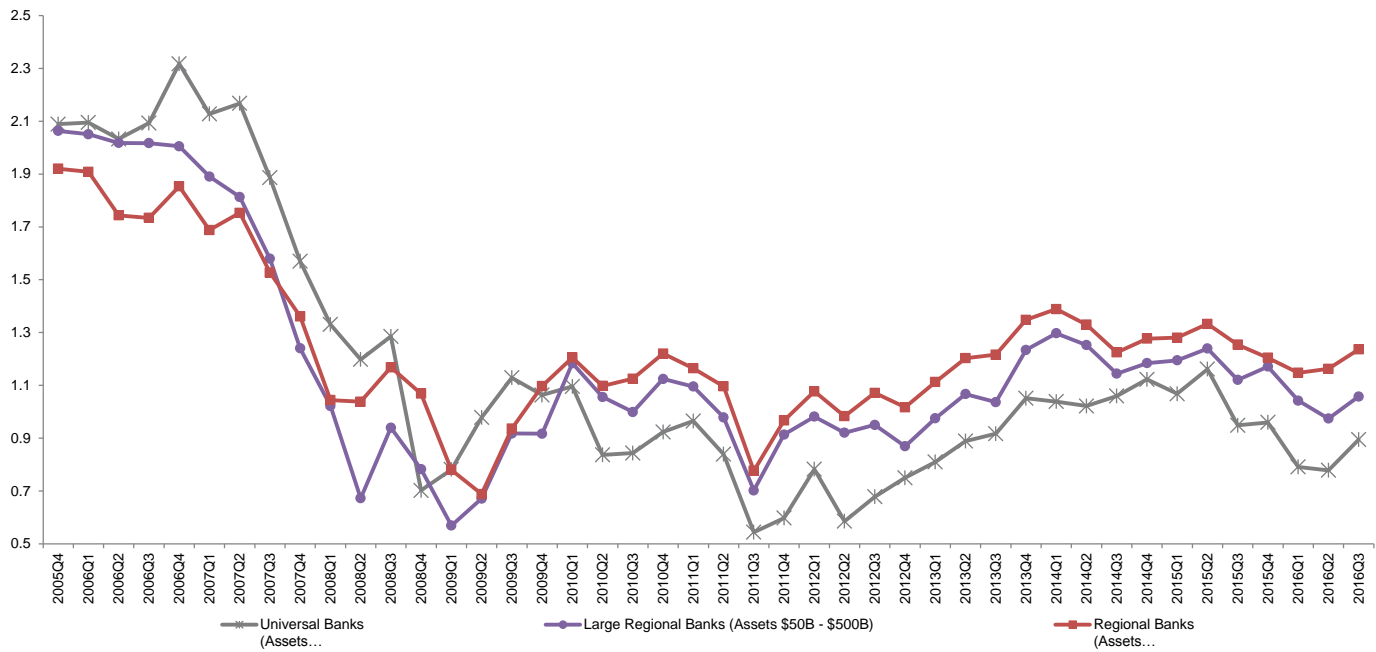


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Price to Book Multiples

At the end of the third quarter, universal banks traded at 0.89x book value while large regional and regional banks traded at 1.06x and 1.24x. Regional banks are currently trading at premiums of 38% to universal banks and 17% to large regional banks. This is significantly higher than the 10-year historical premiums of 5% for the regionals relative to universals and 6% to large regionals.

Exhibit 4: Price to Book Multiples for Banks (by asset size) and the Market



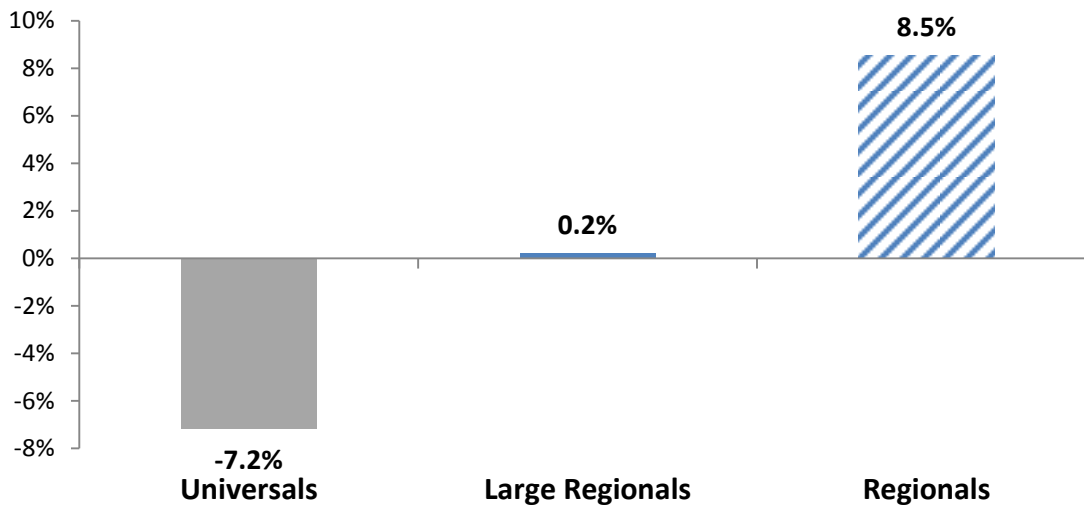
Source: KBW Research, SNL DataSource, Factset and Bloomberg.

Performance Trends in 2016

Similar to their unique valuation multiples, in 2016 through third quarter, the banking groups demonstrated distinct price trends. On average, universal banks were the worst performers, falling 7.2% on average while Large Regionals rose a mere 0.2% and regionals advanced 8.5%.



Exhibit 5: Average Price Performance in 2016-YTD (through 3Q16)



Source: KBW Research, SNL DataSource and Factset.

Given these meaningful differences in both price performance and valuation multiples, investors can benefit from enhanced performance clarity by sub-dividing the banks based on size and business mix.

Indices Designed to Measure Domestic Banking Industry Trends

There is no shortage of index products designed to track the various sectors or industry groups within the market. There are two index families with associated investable trading products widely recognized as ways to siphon the banking industry.

KBW, in partnership with Nasdaq, offers two modified market-cap weighted indices - the KBW Nasdaq Bank Index (BKX) and the KBW Nasdaq Regional Banking Index (KRX). The BKX tracks the performance of the universal and large regional banks and includes banking stocks representing large domestic money centers, banks and thrifts while the KRX tracks the performance of domestic regional banks and thrifts. Both the BKX and KRX are constructed and maintained by an index committee consisting of KBW and Nasdaq staff.

In addition, the BKX and KRX have Invesco PowerShares sponsored ETFs tracking them. ***The PowerShares KBW Bank Portfolio (KBWB) tracks the BKX and the PowerShares KBW Regional Banking Portfolio (KBWR) tracks the KRX.***

S&P Dow Jones Indices (SPDJI) offers two modified equal-weighted indices - the ***S&P Banks Select Industry Index (SPSIBK)*** and the ***S&P Regional Banks Select Industry Index (SPSIRBK)***. SPSIBK focuses on the larger banks and SPSIRBK focuses on regional banks.

SPSIBK and SPSIRBK have State Street Global Advisors (SSgA) sponsored ETFs tracking them. The SPDR S&P Bank ETF (KBE) tracks SPSIBK and the SPDR S&P Regional Banking ETF (KRE) tracks SPSIRBK.



Exhibit 6: A Closer Look at the KBW Nasdaq and S&P Bank Indices

Index Name	Index Ticker	# of Stocks	Weighting Methodology	Rebalancing Frequency	Launch Date	ETF Linked to Underlying Index	Constituent Criteria
S&P Banks Select Industry Index	SPSIBK	64	Modified Equal Weighted	Quarterly	9/9/2011	SPDR S&P Bank ETF (KBE)	Index includes S&P Total Market Index members classified in the GICS Sub-Industries: Asset Management & Custody Banks (40203010), Diversified Banks (40101010), Regional Banks (40101015), Other Diversified Financial Services (40201020) and Thrifts & Mortgage Finance (40102010)
S&P Regional Banks Select Industry Index	SPSIRBK	97	Modified Equal Weighted	Quarterly	9/9/2011	SPDR S&P Regional Banking ETF (KRE)	Index includes S&P Total Market Index members classified in the GICS Regional Banks (40101015) Sub-Industry.
KBW Nasdaq Bank Index	BKX	24	Modified Market-Cap Weighted	Quarterly	10/21/1991	PowerShares KBW Bank Portfolio (KBWB)	Index includes banking stocks representing large U.S. national money centers, regional banks and thrift institutions. Must have minimum 1-M ADTV of 100K shares, minimum average trailing-30-day stock closing price of \$2.00, minimum float of 20%, have listed options, seasoned for at least 3 months, be listed on Nasdaq, or NYSE.
KBW Nasdaq Regional Banking Index	KRX	50	Modified Market-Cap Weighted	Quarterly	7/25/2005	PowerShares KBW Regional Banking Portfolio (KBWR)	Index designed to track the performance of U.S. regional banks and thrifts that are publicly traded in the U.S. Must have minimum 1-M ADTV of 100K shares, minimum average trailing-30-day stock closing price of \$2.00, minimum float of 20%, have listed options, seasoned for at least 3 months, be listed on Nasdaq, or NYSE

*Data as of 9/31/16

Source: KBW Research, Nasdaq, Invesco PowerShares, SPDJI, SSgA.



Exhibit 7: A Closer Look at the KBW Nasdaq and S&P Bank Index Fundamentals

Index Name	Index Ticker	# of Stocks	Smallest Constituent Mkt Cap (\$M)	Median Constituent Mkt Cap (\$M)	Largest Constituent Mkt Cap (\$M)	Total Constituent Mkt Cap (\$M)	Largest Constituent Contribution (%)	Price to Fwd Earnings	Price to Book	Dividend Yield (%)
S&P Banks Select Industry Index	SPSIBK	64	\$1,395	\$3,954	\$245,145	\$1,290,861	2.8	14.6	1.1	2.1
S&P Regional Banks Select Industry Index	SPSIRBK	95	\$447	\$2,326	\$45,267	\$407,159	3.90	15.2	1.2	2.2
KBW Nasdaq Bank Index	BKX	24	\$4,939	\$17,438	\$245,145	\$1,211,573	8.2	11.5	1.0	2.4
KBW Nasdaq Regional Banking Index	KRX	50	\$754	\$2,587	\$6,494	\$140,898	4.2	15.2	1.4	2.4

Source: KBW Research, Nasdaq, Invesco PowerShares, SPDJI, SSgA.



Key Differences between KBW Nasdaq and S&P Bank Indices

History

While SPSIBK and SPSIRBK were launched on September 9, 2011, the KBW Nasdaq bank indices, ***BKX and KRX***, have significantly longer pricing histories available back to ***October 21, 1991 and July 26, 2005***, respectively.

Index Membership

KBW Nasdaq: The KBW Nasdaq bank indices, BKX and KRX, are maintained by a five-member index committee with the objective to design and maintain indices that replicate investable large-cap and regional-bank segments. Subject to specified index eligibility constraints:

- BKX consists of 24 large publicly traded U.S. national money centers, regional banks and thrift institutions.
- KRX consists of 50 publicly traded U.S. regional banks and thrifts.

There is no overlap between constituents of BKX and constituents of KRX.

SPDJI: SPSIBK and SPSIRBK are constructed as sub-indices of the S&P Total Market Index (SPTMI), based on sub-industry classifications as defined by the Global Industry Classification System (GICS). GICS is a four-tiered industry classification system jointly developed by S&P and MSCI.

- SPSIBK includes SPTMI members classified in the following GICS sub-industries: Asset Management & Custody Banks, Diversified Banks, Regional Banks, Other Diversified Financial Services and Thrifts & Mortgage Finance.
- SPSIRBK includes SPTMI members classified in the GICS Regional Banks sub-industry.

Since SPSIBK and SPSIRBK both include SPTMI members classified in the Regional Banks sub-industry group, there is considerable membership overlap.

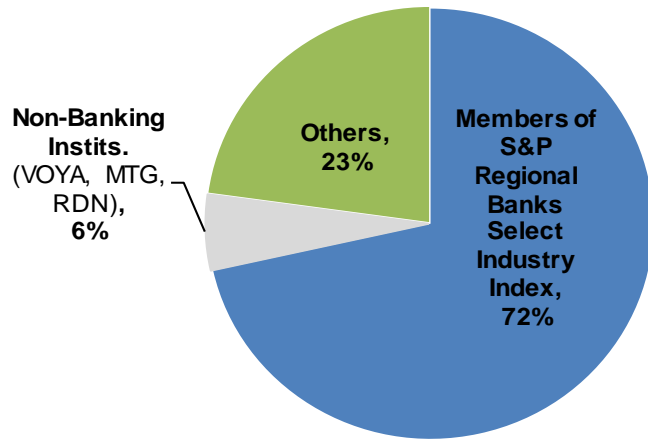
In addition, under GICS, non-banking entities are classified within the Thrifts & Mortgage Finance and Other Diversified Financial Services sub-industry groups. Consequently, SPSIBK includes non-banking institutions VOYA (insurance), MTG and RDN (both mortgage finance).

- ***About 72% of SPSIBK's weighting comes from SPSIRBK members while an additional 6% of weighting comes from non-banking institutions.***
- ***SPSIRBK even more closely mirrors SPSIBK with SPSIBK members contributing 90% of overall SPSIRBK weighting!***
- ***Ten of SPSIB's 15 largest members are also among the 15 largest SPSIRBK members.***



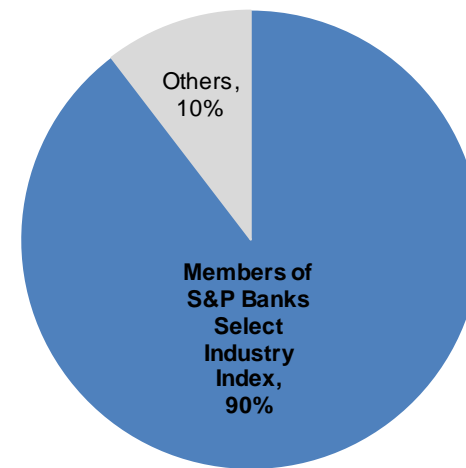
Exhibit 8: Weighting Distributions of S&P Banks Select Industry Index and S&P Regional Banks Select Industry Index

**Weighting Distribution of
S&P Banks Select Industry Index**



As of 10/6/16.

**Weighting Distribution of
S&P Regional Banks Select Industry Index**



As of 10/6/16

Source: KBW Research, Bloomberg, SsgA, SPDJI.



KBW Nasdaq Bank Indexes Offer Investors a Narrower Focus

BKX and KRX, are more narrowly defined than the S&P bank indices, with tighter constituent market cap ranges and smaller constituent groups, representative of their respective capitalization focus.

At October 6, 2016:

- *BKX consisted of 24 members ranging in market caps from \$5 billion to \$245 billion*, with a median constituent capitalization of \$17 billion.

- *SPSIBK consisted of 64 members ranging in market caps from \$1 billion to \$245 billion*, with a median constituent capitalization of \$4 billion.

- *KRX consisted of 50 members ranging in market caps from \$754 million to \$7 billion*, with a median constituent capitalization of \$3 billion.

- *SPSIRBK consisted of 95 members ranging in market caps from \$447 million to \$45 billion*, with a median constituent capitalization of \$2 billion.

Significant Membership Overlap Erodes Differentiated Bank Performance

Investors making a differentiated call on universal/large-regional versus pure regional banks would have benefitted from the differentiated performance of the BKX and KRX as evidenced by their greater average quarterly spread over the past four years. On average, the quarterly spread between the BKX and KRX is nearly 2.5x that of SPSIBK-SPSIRBK.

The fact that 90% of SPSIRBK's weighting comes from SPSIBK is a major driver of this undifferentiated performance.

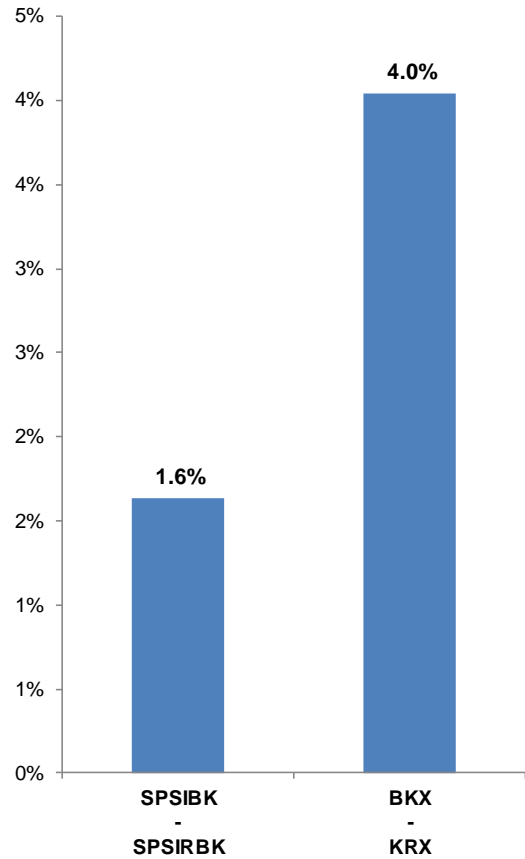


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Exhibit 9: The Average Quarterly Spread between BKX-KRX is about 2.5x that of SPSIBK-SPSIRBK

Quarterly Price Returns					Absolute Spread Between:	
Quarter	BKX	SPSIBK	KRX	SPSIRBK	BKX - KRX	SPSIBK - SPSIRBK
4Q11	11.4%	15.2%	26.9%	24.1%	15.5%	8.8%
1Q12	26.3%	20.6%	14.1%	16.5%	12.2%	4.1%
2Q12	-7.9%	-7.9%	-3.1%	-3.9%	4.8%	4.0%
3Q12	8.3%	6.6%	2.9%	4.7%	5.3%	1.9%
4Q12	3.4%	1.7%	-3.0%	-2.0%	6.4%	3.7%
1Q13	9.8%	13.2%	12.6%	13.7%	2.9%	0.5%
2Q13	9.1%	6.4%	4.9%	6.4%	4.3%	0.0%
3Q13	1.4%	4.7%	7.0%	5.2%	5.7%	0.5%
4Q13	11.3%	10.5%	13.6%	14.0%	2.4%	3.5%
1Q14	4.4%	2.6%	0.9%	1.9%	3.4%	0.7%
2Q14	-1.4%	-1.9%	-3.0%	-2.5%	1.6%	0.6%
3Q14	0.4%	-4.6%	-6.2%	-6.2%	6.5%	1.6%
4Q14	3.8%	5.3%	9.1%	7.7%	5.3%	2.4%
1Q15	-2.8%	-0.2%	0.8%	0.3%	3.7%	0.5%
2Q15	7.0%	8.3%	9.5%	8.1%	2.5%	0.2%
3Q15	-9.5%	-8.5%	-7.2%	-6.8%	2.3%	1.6%
4Q15	4.7%	2.0%	1.0%	2.1%	3.7%	0.2%
1Q16	-12.1%	-10.4%	-5.4%	-10.2%	-6.7%	-0.1%
2Q16	1.0%	0.5%	3.1%	2.1%	-2.1%	-1.6%
3Q16	9.2%	9.5%	8.2%	9.8%	1.1%	-0.3%
Median:					3.7%	0.6%
Average:					4.0%	1.6%

Average Absolute Quarterly Spread From 4Q11 - 3Q16 Between BKX-KRX vs. SPSIBK-SPSIRBK



Source: KBW Research, Nasdaq, and Bloomberg.

In addition, SPSIBK and SPSIRBK trade at nearly identical fundamentals. At the end of third quarter-2016, SPSIBK traded at 14.6x forward earnings while SPSIRBK traded at a similar 15.2x. On a price to book basis, SPSIBK and SPSIRBK traded at 1.1x and 1.2x, respectively. Lastly, the indices offered similar dividend yields with SPSIBK offering a 2.1% yield and SPSIRBK offering a 2.2% yield.

The BKX and KRX trade at differentiated fundamentals. At the end of the third quarter-2016, BKX traded at 11.5x forward earnings while KRX traded at 15.2x. On a price to book basis, similar differences in valuation were noted. The BKX traded at 1.0x book value while the KRX traded at 1.4x at the end of the third quarter. The KRX trades at higher multiples, reflective of the investable regional banking universe and the valuation premiums discussed earlier.



Exhibit 10: Index Fundamentals as of 3Q16

Index Name	Index Ticker	Price to Fwd Earnings	Price to Book	Dividend Yield (%)
S&P Banks Select Industry Index	SPSIBK	14.6	1.1	2.1
S&P Regional Banks Select Industry Index	SPSIRBK	15.2	1.2	2.2
KBW Nasdaq Bank Index	BKX	11.5	1.0	2.4
KBW Nasdaq Regional Banking Index	KRX	15.2	1.4	2.4

Source: KBW Research, Nasdaq, SPDJI and Bloomberg.



Membership Overlap Drives Correlation between SPSIBK and SPSIRBK to 0.99

Since both BKX and KRX as well as SPSIBK and SPIRKB are comprised solely of banking institutions within the same broader banking industry group, correlations between indices are likely to be significant. Correlations coefficients are considered statistically significant if they are greater than or equal to 0.81. Correlation coefficients can range from -1.00 to +1.00.

The BKX and KRX exhibit a significant 0.90 correlation coefficient while SPSIBK and SPSIRBK exhibit a nearly perfect correlation of 0.99.

Exhibit 11: Correlation Coefficient Matrix for Banking Indices and the S&P 500 Index.

CORRELATION COEFFICIENTS					
	SPX	BKX	KRX	SPSIBK	SPSIRBK
SPX	1.00	0.85	0.78	0.83	0.80
BKX	0.85	1.00	0.90	0.98	0.94
KRX	0.78	0.90	1.00	0.97	0.99
SPSIBK	0.83	0.98	0.97	1.00	0.99
SPSIRBK	0.80	0.94	0.99	0.99	1.00

Source: KBW Research, Bloomberg, Nasdaq, SPDJI.



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			Count	Percent
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Market Perform [HOLD]	352	56.77	96	27.27
Underperform [SELL]	43	6.94	10	23.26
Restricted [RES]	0	0.00	0	0.00
Suspended [SP]	29	4.68	4	13.79
Covered -Not Rated [CNR]	4	0.65	1	25.00

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KBW Model Portfolio: “Model Portfolio Buy” - Companies placed on this list are expected to generate a total rate of return (percentage price change plus dividend yield) of 10% or more over the next 3 to 6 months. “Model Portfolio Sell” - Companies placed on this list are expected to generate a total rate of return (percentage price change plus dividend yield) at or below -10% over the next 3 to 6 months.

The purpose of the Model Portfolio is to inform institutional investors of KBWI’s short-term (as described above) outlook for a particular industry sector. The Portfolio is not available for purchase or sale, cannot be duplicated as shown, is hypothetical and is for illustrative purposes only. For a more detailed description of the selection criteria and other specifics related to the construction of the Model Portfolio, please refer to the January 5, 2010 Model Portfolio Primer and/or contact your KBWI representative for more information.

The Model Portfolio should be viewed as a short-term outlook of a particular industry sector, not as individual security recommendations. The Model Portfolio uses a three-to-six-month time horizon and should not be considered when making longer term investments. KBWI Research publishes research with a 12-month outlook on each issuer of securities contained in the Model Portfolio. Investors who are interested in a particular security should request KBWI Research’s coverage of such securities by contacting your KBWI representative. KBW research contains analyses of fundamentals underlying each issuer.

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