



# FINANCIALS INDUSTRY REPORT

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# Executive Summary

This report is designed by being separated up into a few sections, starting with a basic analysis of both past performances and the future outlook of the financial services sector, and an analysis of Oakwood's financials portfolio. Firstly, we dive into an assessment of the past performance of the industry, specifically over the past year, through an overview of this year's financials mergers and acquisitions, with a small focus on one acquisition, combined with a summary of the impacts of events over the previous year.

Secondly, we discuss our future outlook on the financials industry and aim to provide an in-depth look into the future of the insurance industry and what recent information about this specific industry may mean for investors.

Lastly, we analyze the outstanding financials investments currently held by Oakwood and provide a scaling from 1-5 on how we believe they will perform in the future based on a brief overview.

I'd like to make thanks to Bailey, Charlie, David, and Ria for their efforts in producing this report, I am grateful for their dedication and commitment in writing this report.



## Toby Coogan

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# Past Performance

One of the most important developments for the financial industry is falling inflation rates. Throughout 2024, the European Central Bank, Bank of England and Fed began to cut their interest rates, starting with the ECB in June [1], followed by BofE in August [2] and lastly, the Fed in September [3], with all rate cuts being 0.25%. Following this trend, and as central banks are opting to further reduce interest rates in 2025, this will cause a shift in the credit and equity market respectively.

The impact of this will most likely be reduced demand for loans as high-yield fixed income investments are starting to disappear, more mortgage refinancing as debtors opt to reduce the cost of debt, and treasury yields, however this will also largely be impacted by Trump and his cabinet's future economic agenda. In

Q1 of 2024, global debt reached \$315 trillion, largely due to widespread spending across economies, with the US and Japan leading in advanced economies and China, Mexico and India being the largest drivers in emerging markets [5]. This means global debt-to-GDP ratio is 333%, an abnormally large number compared to previous years. This amount of debt will lead to increased credit servicing costs in the future, something which in the US is now higher overall than defense spending.

## Climate change and Insurers

Extreme weather events like floods, heatwaves, hurricanes, and wildfires are becoming more commonplace and damaging. This is putting more pressure on insurers as they must readjust their risk assessments and pricing [7]. The main thing insurers will consider is how unpredictable natural disasters are becoming, hindering ability to assess and price.

As such, insurers are shifting to use more 'climate resilient strategies' as well as looking at how they assess long-term risks, especially within the context of sustainability disclosures, like the EU's Corporate Sustainability Reporting Directive (CSRD). On the other side, they are also looking at new products like parametric insurance to provide faster payouts for climate-related issues [8] and health insurers factor in climate and heat-related mortality and diseases.[9]



# Mergers and Acquisitions

## Aviva Acquires Motor Insurer Direct Line

At the start of 2024, M&A activity was somewhat sluggish compared to the upcoming months, with most deals being seen more as restructuring projects rather than corporate growth. However, during Q2, the pace has started picking up in anticipation of a period filled with governmental elections, ranging from countries such as Romania, the UK, South Korea and 57 other countries, with these events impacting over half of the world's population, however the most noticeable election in terms of coverage has been the US elections. The US banking sector completed 105 deals during Q2, still down 11% in terms of number of deals compared to Q1, however the YTD deal value was higher, largely driven by major transformative transactions. Capital Markets completed 775 deals, similar volume to Q1, mainly because of investor uncertainty about fluctuating interest rates. The Insurance sector specifically had 266 deals, up 13.7% from Q1, mainly fueled by an abundance of strategic buyers over corporate acquirers and insurance/asset management convergence, despite an overall 45.1% drop in total M&A deal value compared to Q2 2023. However, the commercial real estate sector is currently in possession of \$1.1 trillion of maturing loans amid a high interest rate environment, with several prolific investors raising potential risks of distress within the industry, something which may either present opportunities within property repositioning or acquisitions [10].

Recently, headlines of the UK motor insurance giant Direct Line finally agreeing to Aviva's buyout offer made the news, with a £3.61 billion deal following previous rejected takeover bids from the acquiring firm, which will result in the corporation controlling 20% of the UK motor insurance market and 15% of the home insurance sector. This cash-and-stock deal will involve Aviva paying 275p for each of Direct Line's shares, a 45p premium over the target's share price on 6 December. This deal will make Aviva the UK's largest home and motor insurer, but also provide major Direct Line shareholders with a combination of immediate returns, more specifically £1.29 in cash for every share owned, and influence in the UK's leading corporation in the insurance industry through 0.2867 new Aviva shares per share, also including a 5p dividend.



# Future Outlook

## Geo-political conflicts and Cybersecurity

There are currently a variety of ongoing geo-political tensions, including conflicts such as the war between Ukraine and Russia plus wars in the Middle East. Additionally, in the new year, Trump and his new administration will be presiding over the US office. Currently, this administration is suggesting an extremely aggressive tariff policy stance that has already started a small tariff war between the two largest economies, the US and China. Increasing global tensions have many consequences to all sectors, and the financial sector is no different. Inflation sky-rocketed across most Western markets, due to shocks in the energy market following Russia's invasion in Ukraine. Consequently, we saw Central Banks respond in turn by increasing Bank Rates. Evidence suggests that this did have a negative impact on the performance of the financial sector [1]. Rising political tension may see people flock to more stable currencies, therefore increasing the value of currencies such as the dollar, which is considered extremely stable, or potentially an increase in decentralized cryptocurrencies such as Bitcoin.

For the banking sector, increased tension can cause greater credit risk and higher levels of default. International firms may face losses due to assets in countries that become sanctioned, this was seen with firms with assets in Russia.

Firms may also face a greater risk of cyber-attacks. This risk may cause firms additional costs in preventative measures to ensure that they do not lose consumer confidence. Overall, this is likely to have a larger impact on emerging economies as they face devaluation in currency and investors move to safer markets. It is also likely to see an increase to firms with better ESG ratings as these are perceived to be more detached from the global tension and are doing good.



# Insurance Outlook

The insurance industry has an opportunity to be a key player in the climate change transition. According to Cara Eckholm from Cornell Tech, without insurance, it is very difficult to secure financing for clean energy projects. As detailed in the FT, currently in the US, the state is primarily funding clean energy projects but to reach international scale investors will have to be involved. Experts compare what is needed in terms of collaborations between insurers, businesses, and standards bodies to what was done in the industrial revolution where the insurance sector played a key role. Every industry has huge opportunities in the form of digital transformation, insurance is no different. According to Insurance Edge, first-mover technology will open a \$1 trillion global opportunity for the insurance industry. AI can be used to help adapt to consumer demands and allow the industry to be more agile when dealing with risks. A study by Accenture forecasts that AI will automate up to 62% of underwriting and claims processed. As with the use of AI in other industries, this will allow individuals to participate in 'higher value' tasks hopefully adding more customer value.

As reported in the Financial Times, according to two of the world's biggest insurance groups, cyber-attacks pose a risk as big as terrorism and flooding. Lloyds of London estimated that a major cyber-attack on a global payment system could cost the world economy \$3.5 trillion. The industry is seeking state involvement to help cover losses, with their view being that the risk is too big for the insurance industry to take on alone. Due to high levels of sensitive data, and high use of technology within the sector (as mentioned above) the industry is vulnerable to cyber-attacks, and costs will continue to increase to deal with this. As seen in the FT, 200 of the world's financial regulators have approved new global rules for how big Insurers calculate their capital requirements which is suspected to increase compliance costs.

The rules apply to the biggest 58 and most important insurers and it will provide a framework to make comparisons between companies in the industry easier. This regulation will undoubtedly have an impact on reporting costs, but the magnitude of this impact is still unknown. According to plans seen by the Financial Times, the Bank of England's Prudential Regulation Authority (which oversees the insurance industry) wants some of the biggest firms to report their liquidity positions more frequently and consistently. It seems to only relate to insurance firms that use complex derivative contracts. This regulation is seen as a response to the 'mini budget' and LDI crisis. The extra disclosure requirements costs have been estimated at £11m up front and £3.6 million of ongoing costs.

Overall, AI technology and digital transformation are providing the industry with risks they need to try and manage and opportunities they can explore. I think we will see a transition in the coming years in terms of the industry's role in the move towards net zero.





# Current Portfolio Analysis

## HSBC

HSBC was allocated £714.00 on December 1st, 2023, at a share price of £38.62, as of 12th December 2024, the portfolio value stands at £898.51, with 18.49 shares held, at a now share price of £48.59, delivering a gain of £184.51 and an ROI of 25.84%. HSBC's performance can be credited to HSBC's known presence in the UK Asia which accounts for about half of its revenue. HSBC's total revenue of \$64.26 billion roughly increased by 1.97% from the previous year and £1.24 billion higher than the previous year, indicating a positive momentum in the business, however, this momentum is slower and lower than that of its peers in financial services, who are expected to grow at a 7.7% rate [4]. Whilst HSBC's growth expectations are lower than that of the S&P 500 which has estimates typically from 10% and upward, estimating slower growth than the previous year, HSBC is considered one of the larger dividend providers with a yield ranging from 6.3% to 8.46% [5]. This illustrates that slightly stronger than S&P 500 growth can be expected when dividend payouts are included.

The bank also announced £4.8 billion in shareholder returns, which includes a dividend of £0.07582 per share and a share buyback of up to \$3 billion. After a steady third quarter with a low PE ratio, the stock is undervalued because its stock levels trade lower relative to their fundamentals [6]. Analysts offering 12-month price targets for HSBC Holdings plc have a median target of 804.01 representing a 5.64% increase from the last price of 761.10, with a 'buy' recommendation confidence in the stock may be strong, especially given how they have beaten all 3 of their most recent forecasts in EPS and revenue [7]. This may be set to continue even as growth forecasts shrink, but the stock is rated as 3 (hold) on a 1-5 scale.

It has strong financials to support this decision, alongside the companies' steps to strengthen its focus on Asia due to the acknowledgment of the role it plays in its revenue. Additionally, HSBC is making big changes to streamline its operations and tackle concerns about growth in a challenging market. They are planning senior level job cuts, aiming to save £300 million, and have reorganized their banking structure by merging commercial and institutional banking. Starting January 2025, the bank will split into East and West divisions, with Hong Kong and the UK operating independently with aims to reduce the effects of organizational diseconomies of scale by ensuring a more structured managerial component. quantitative tightening, as it presents a positive for deposit growth across all scenarios[3], with many different analysts either maintaining or upgrading their current outlooks for the firm.





# Current Portfolio Analysis

## State Street

Since the initial investment date of 15th March 2024, with a share price of £72.27, State Street has seen a gain of £278.78 from its initial allocation of £714.00. With a ROI of 39.04% State Street outperforms the S&P 500 which returned 18.25% over the same time by over double. This strong performance can be credited to State Street's annual revenue for 2024 increasing from £11.945B in 2023 to £12.55B in 2024 showing a 5% increase. The companies Q3 2024 earnings per share beat analysts' consensus of £2.12 by £0.14 and beat the two previous consensuses' beforehand.

The company also had revenue of £3.26 billion for the quarter, again beating the consensus by £70 million, with earnings increasing to £682 million, growing at a slower rate than earlier in the year. Analysts providing a 12-month price target, has set an average target of £103.53 [1], observing a 3.04% increase from the current average of £100.48. State street sees a variety of outlooks from analysts with the majority holding a buy outlook, some however believe the stock will underperform and should be sold.

Given State Street's strong market position and prediction to generate stronger earnings growth over the next few years due to a massive share repurchase program and tailwind from rising asset prices it is rated as 4 (overweight) [2] with growth estimates suggesting it will outcompete the S&P 500 in growth over the next year and endure higher growth than seen this year. Additionally, Morgan Stanley upgraded State Street to Overweight from Equal Weight with a price target of £139, up from £102 due to the end of quantitative tightening, as it presents a positive for deposit growth across all scenarios [3], with many different analysts either maintaining or upgrading their current outlooks for the firm.



# Current Portfolio Analysis

## BNY Mellon

The initial allocation of £714.00 on May 10th, 2024, at a share price of £58.57, now stands at a value of £960.82, which is a £246.82 gain or a 34.57% ROI. BNY is outperforming the sector due to returns of 51.45% since the start of the calendar year, with financial stocks gaining an average of 23.7% [1] compared to the S&P 500, which returned an average of 15.86% [2] over the same given period. BNY's achievement in less than a year could be linked back to the bank's CEO, Robin Vince, who has taken up a strong role in evaluating market trends and constructing new products such as Alts Bridge, which allows investors to trade with PE giants, with the bank pivoting towards its own focus in private equity, a sub-sector experiencing enormous growth [3].

Vince intends to identify further trends within banking and utilize these to further grow and develop the bank, and this could offer strong confidence to investors with promises of growth. As of December 9th, 2024, BNY has an average rating of overweight and a mean price target of \$83.73 with analysis at Morgan Stanley recently upgrading their assessment of BNY from a hold to a buy stock. This comes as no surprise given BNY has consistently beaten all its estimates across the last year, with it looking likely to continue over the next quarter.

However, as we enter the first quarter of 2025 the banks' EPS estimate falls from 1.55 from Q4 of 2024 to 1.42 in Q1 of 2025. But given the consistency of how well BNY has performed against these estimates, it could be strongly assumed that they will likely outperform these estimates. With a strong market position, the BNY can be given a rating of 4 (overweight) with the assumption that their strong performance will likely continue further.



# Concluding Statements

Investment adjustments should be a focus on financial providers and insurers that prioritize sustainable bonds, renewable energy projects, and ESG-compliant portfolios. The reason for this being regulatory trends and changes in consumer preferences highlight ESG as a key driver and thus insurers and asset managers need to increase their offering of products aligned with sustainability.

An area for further analysis would be the debt dynamic.

How will these record high debt levels effect financial resilience? This could be analyzed through researching debt service patterns, particularly when in different scenarios like inflation or decline. Additionally, another area worth further analysis would be interest rate sensitivities. As the central banks cut interest rates, what impact is this going to have, additionally in the light of the mentioned debt issues. A good way of analyzing this would be to assess how different sectors will react to the rate changes.



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