Special Commentary

Financials Sector Update

March 1, 2021

The Financials sector is currently experiencing tailwinds not seen in some time. Unlike many parts of the market, this sector should flourish with higher rates. We believe that bank stock appreciation is still in front of us.

The Backdrop

- Trillions of dollars in additional stimulus should lead to a meaningful increase in GDP, which generally leads to lending growth
- The Fed is maintaining low short-term interest rates
- An expanding economy generally leads to rising, mid-yield curve rates, with short rates anchored for the foreseeable future

Implications for Banks

- Increased revenue seems likely due to:
  - Increasing loan growth, thanks to government stimulus
  - Rising interest rates, which should benefit margins and stimulate loan growth
- Increased economic activity should lead to decreased credit concerns
- Lower credit costs should lead to improving operating leverage
- Improving operating leverage should lead to increased profitability ratios, e.g. ROE, which, in turn, should lead to improved valuation, e.g. P/BV

This argument only strengthens when viewed through the lens of a M&A overlay. 2020 was one of the quietest years for merger activity in a very long time, as management teams were unsure of the depths of a potential economic downturn. With the historic stimulus efforts from the government, confidence has been restored. In a recent note, KBW stated:

> *"The aftermath of COVID-19 has amplified the need for bank M&A given PPNR pressure from lower NII/NIM, the need to realize efficiencies, weaker loan growth, the need to compete against FinTechs, etc. FinTech competition is real with names like PayPal and Chime easing their way to the top of the ladder and becoming forceful competitors to banks, banks need scale to compete. We expect much of the bank M&A to be focused in the southeast and southwest regions. After underperformance from most bank M&A in '18/'19, we believe '21 M&A could be more appreciated."*

The recent PBCT/MTB announcement is a prime example of this M&A activity. The valuation discrepancy between larger acquirors and smaller targets, shown on the chart below, makes M&A more interesting, as it creates powerful economics in combined entities that the market has been rewarding.

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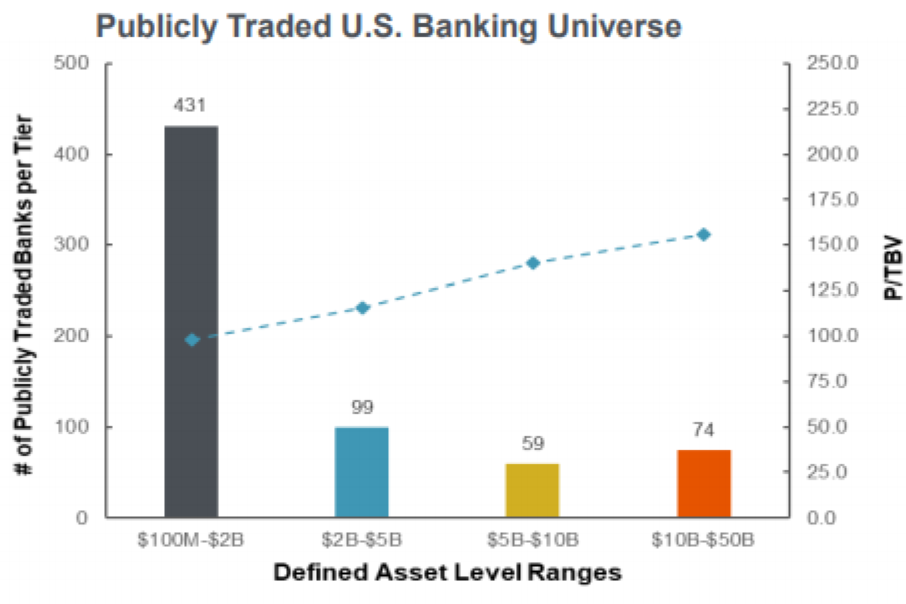

SOURCE: Piper Sandler

We believe the tailwinds for Financials are many and robust and that a stronger economy, with higher rates and elevated M&A activity, may lead to continued outperformance for the sector.