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RMB MENDON FINANCIAL FUNDS

Commentary: October 2017

October proved to be a busy month with most financials reporting third-quarter earnings. Bank earnings, for the most part, were very much in line with expectations. Lest we think the market only pays attention to the 'FANG' stocks (Facebook, Amazon, Netflix, and Google), the outliers within financials that beat or missed consensus expectations were swiftly revalued. Loan growth overall was weaker than anticipated, but not the same for all sizes or geographies. Deposit betas (the measure of deposit rate changes relative to changes in the Fed Funds rate) continue to rise, but are certainly manageable at this point. Not surprisingly, mergers and acquisitions (M&A) remained a topic on earnings conference calls, whether it be for business lines to increase fee income or whole bank acquisitions to expand geographies and/or balance sheet flexibility. No matter what form future M&A will take, the drivers remain consistent: banks looking to put "trapped" capital to work, the ever-increasing importance of scale, and the improvement in balance sheets that can result from certain business combinations. We believe several larger institutions that have been prevented from being in the market due to regulatory issues are exiting or will soon exit their regulatory orders and will resume being active acquirers. Also positive for the M&A environment is how quickly deals are closing. After the financial crisis, transactions could be in regulatory purgatory for a year or longer. During the month, Pacific Premier Bancorp Inc. (PPBI) announced that they would close their most recently announced deal on November 1, two months ahead of analysts' expectations and less than three months since the announcement.

While we are reluctant to discuss Washington (yet again), we feel we must, as there continues to be plenty of ramifications for the sector and overall economy that depend on the actions of both elected and appointed officials. The administration's appointments thus far are starting to bring regulatory reform to their respective agencies. The appointment that has been of most interest to the market is whom will lead the Federal Reserve (the Fed). The Chair of the Board of Governors of the Federal Reserve System is appointed to a four-year term, and current Chair Janet Yellen's term is set to end in February. As of this writing, the administration is expected to announce that Jerome Powell will replace Yellen when her term ends. Mr. Powell's background includes serving as an Assistant Secretary and Undersecretary of the Treasury under President George H.W. Bush, with responsibility for policy on financial institutions, the Treasury debt market, and related areas. Prior to joining the administration, he worked as a lawyer and investment banker, including being a partner at The Carlyle Group. In a recent article, *The American Banker* wrote the following about Mr. Powell:

> *"In many ways, Powell represents the best of all worlds among the five candidates that were the subject of considerable speculation in recent weeks. Powell, who served in George H.W. Bush's Treasury, has extensive experience in the private sector, and is seen as open to deregulatory efforts by the administration and Congress. But he also provides the continuity and capability with current Fed Chair Janet Yellen, who has been a stabilizing force in the financial markets…Moreover, Powell has a long history of working well with new Fed Vice Chair for Supervision Randal Quarles, which suggests the central bank would approach any changes to the Dodd-Frank Act in a united manner. Moreover, unlike some other candidates for the Fed job, Powell has spelled out his views on bank regulation, having served as head of the central bank's banking committee after former Fed Gov. Daniel Tarullo left in April."*

We agree with the author and think the confirmation process will be relatively straightforward as Mr. Powell has served on the Fed for five years and was approved 74-21 in 2012 and 67-24 in 2014. We believe it is important that he and Mr. Quarles worked together at Treasury and at Carlyle, which should result in consistency from the Fed in regulatory and monetary policies. If nominated and confirmed, Mr. Powell would be the only head of a banking agency that was present when Dodd-Frank rules were being implemented. Importantly, we think Powell would provide the most continuity for the Fed going forward.

Also of note in Washington is tax reform, which has been on the forefront of congressional debate. Late in the month, discussion arose about gradually phasing in a reduction in corporate tax rates, which weighed on the group. Tax reform still seems a high legislative priority and we continue to monitor it closely. We acknowledge we are being redundant when we restate that banks are the largest tax payers among all S&P industry groups, which we see reflected in our portfolio whose median tax rate is in the low-30% range as of this year's third quarter.

The Team continues to constantly meet with management teams across the country to establish themes and separate the winners from the losers, whether it be by company or geography. Our process remains unchanged and we continue to be excited about the opportunities in front of us.

As always, we welcome your feedback, comments, and questions.