

RMB Mendon Financial Funds

Commentary: July 2018

July was a frustrating month, to say the least, as the Funds underperformed their benchmarks. Our positions are more heavily weighted toward smaller market caps, as we believe small caps tend to offer greater return potential due to information dislocations, more distinct and varied geographic characteristics, and their mergers and acquisition (M&A) potential. We are comfortable being positioned as such, particularly against the backdrop of a potential global trade war affecting multi-national companies much more than domestic ones. However, in July, large-cap banks outperformed small-cap banks by almost 600 bps as a market-wide rotation from growth to value overwhelmed any industry-specific dynamics. So we found ourselves in a position where our long positions underperformed due more to macro factors than fundamentals. While small cap generally outperforms large cap over time, we have certainly experienced other months where that was not the case. However, we feel strongly that the risk/reward profile of smaller-cap bank stocks remains quite compelling.

Against this macro backdrop, there were several noteworthy company-specific developments during the month that, while not affecting the indices overall, illustrate investor sentiment toward the group, several examples of which are detailed below.

Following Fifth Third Bancorp's (FITB) expensive acquisition of MB Financial Inc. (MBFI) in May, the market was further disrupted when Synovus Financial Corp. (SNV) announced the acquisition of FCB Financial Holdings, Inc. (FCB) on July 24. In its earnings call earlier in the month, BB&T Corp. (BBT) publicized it was considering whole-bank M&A again after a multi-year hiatus. This caused several potential targets, including SNV, to immediately trade higher. Surprising the market, SNV used its newfound currency to acquire Miami-based FCB, whipsawing shareholders as a company believed to be a seller became a buyer.

Another transaction was followed by a market reaction that further illustrates the myopia present in today's market. On July 24, Dallas-based Veritex Holdings, Inc. (VBTX) announced it was purchasing Houston-based Green Bancorp, Inc. (GNBC) for 250% of tangible book value. As a result of the transaction, VBTX will be an \$8 billion franchise in two of the strongest markets in the U.S., with pro forma earnings accretion estimated in the 25% range along with a high-teens return on tangible common equity (ROTCE) and about a 1.60% return on assets (ROA). GNBC's CFO will become CFO of the combined company and is well known to us, having served at Yadkin Financial Corp., which was acquired in 2016. Despite this positive setup, the stock was down -4.75% on the deal announcement and currently trades at 12x 2019 estimates.

Lastly, we'd like to highlight Ameris Bancorp (ABCB). The stock was down -12.65% for the month, despite 2019 estimates being reduced by only 2%. At the end of the month, ABCB saw the greatest 10-week multiple contraction of any \$500 million-plus market cap bank. The cause for this move was careless aftermarket sales by two private equity funds that received ABCB shares as a result of the bank closing its purchase of Hamilton State Bancshares (PRIVATE) outside Atlanta. Despite projected earnings growth of 13% this year and 59% next year (as a result of closing two accretive transactions, one of which is detailed above), the stock closed July as the cheapest bank stock in the Southeast. As of this writing, the stock recovered some of its July losses (up +5.75% MTD) and remains a more meaningful holding of the Funds.

We hope detailing several stock-specific situations illustrates our frustrations with the month and provides investors a sense of the opportunities within the portfolio. During the month, we have been opportunistic as always, capitalizing on the mispricings we see in the market. Widening the aperture somewhat, other items of interest during the month included payments processor Square, Inc. (SQ) withdrawing its application to become a depository institution; Q2 earnings being generally positive, although a marked increase in deposit betas was evident; a small steepening in the yield curve toward the end of the month; and an optimistic tone at KBW's Community Bank Investors Conference, where the team met with 30 banks.

In closing, we remain excited about the opportunities in front of us. Increased profitability from tax reform, higher rates, and deregulation coupled with accelerating M&A should provide a powerful investment backdrop for the group. We continually source new ideas as the banking landscape evolves. We greatly value your support and look forward to working hard for you going forward.

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

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All investing involves risk including the possible loss of principal. The RMB Mendon Financial Services Fund and the RMB Mendon Financial Long/Short Fund are sector funds. These types of funds may be susceptible to factors affecting their industries, and the funds' net asset values may fluctuate more than a fund that invests in a wider range of industries. Because these funds concentrate their investments in one sector of the economy (financial services) and invest in derivative securities (currently RMB Mendon Financial Long/Short Fund engages in short sales of equities), investors should consider the risk that the funds may experience greater volatility than funds that invest across several sectors.

An investment cannot be made directly in an index. The index data assumes reinvestment of all income and does not bear fees, taxes or transaction costs. The investment strategy and types of securities held by the comparison index may be substantially different from the investment strategy and types of securities held by your account.

The KBW Bank Index [BKX; PHLX/KBW Bank Index] is an unmanaged index comprised of 24 geographically diverse stocks representing national money center banks and leading regional institutions. One may not invest directly in an index. The KBW Bank Index performance data quoted above are total return numbers.

The NASDAQ Bank Index includes securities of NASDAQ-listed companies classified according to the Industry Classification Benchmark (ICB) Banks. The NASDAQ Bank Index performance data quoted above are total return numbers.

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