

January 23, 2018

**Financial Services Separately Managed Account Program (FS SMAP)
December 2017 Update**

The Financial Services Separately Managed Account Program continued to perform positively for the quarter ended December 31, 2017.

We are in a new era for financials. Today, we see a potentially long runway of upward earnings revisions and higher returns on capital, which we believe will provide significant upside for well-positioned banks over the next one to two years. Management teams can now sell at or above premiums they missed the last time around, and buyers can generally afford to pay those prices with their own stock. In our opinion, the anticipated legislation to relax some Dodd-Frank bank rules should expand the universe of buyers.

Changing the asset threshold for the Systemically Important Financial Institution (SIFI) designation from \$50 billion to \$250 billion, along with other potential changes, makes sense to us and will engender continued healthy consolidation going forward, particularly in the South Central part of the United States where many of our recommendations are located. Increasing interest rates, bank consolidations and the relaxation of the Dodd-Frank bank rules are the reasons for our enthusiasm. This consolidation could take the form of: 1) Larger mergers of equals (MOEs) of highly profitable community banks, creating a class of region-specific “super-community” banks with highly rationalized expense structures; 2) The re-emergence of regional banks as active acquirers; and 3) As always, the prospect of international banks wanting to create or extend franchises into the U.S. Time will tell how this eventually plays out, but we expect that once the first institution moves on one of these fronts, there will be a predictable rush to follow. This enhances the market share shift thesis mentioned above and we think the big acquisitions will cause significant disruption, feeding the community banks for years to come.

In conclusion, we remain very enthusiastic about the upside in this “niche area” and appreciate your support.

If you have any questions, please feel free to contact us directly.

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