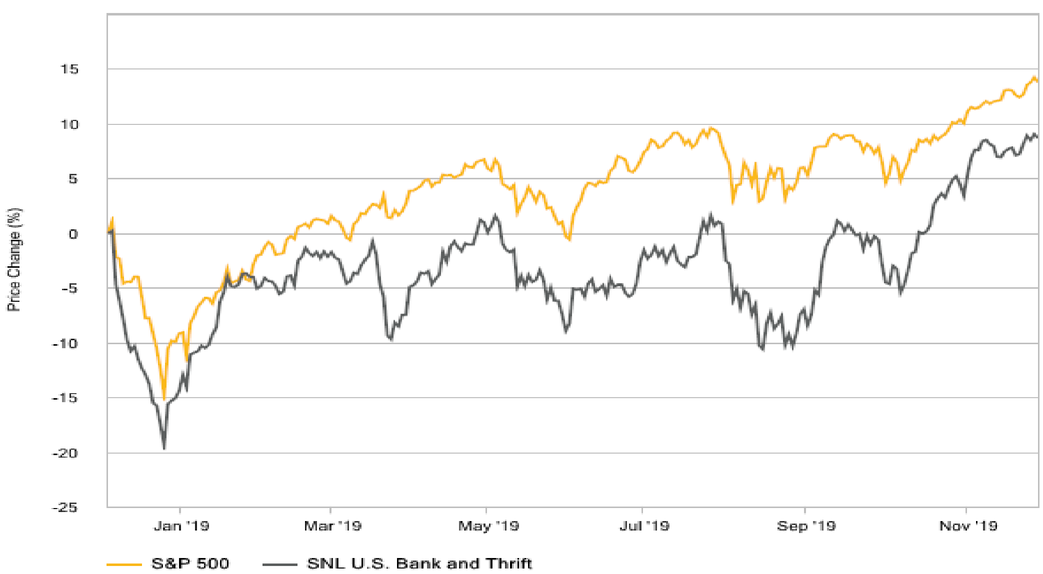
Slower, But Better-Than-Expected Economic Reports Drive Solid Gains in Broad Market Indices as well as Bank Stocks in November.

The month of November showed little volatility in the markets, but what it lacked in drama, it made up for in good vibes. The markets moved steadily upward during the month, with several of the major market indexes hitting records late in the month. Economic reports have not been as robust as last year or early in 2019, but despite showing slower growth, many economic readings are still coming in better than expected. There are several issues that still have the potential to disrupt the ongoing growth, including trade disputes, tensions with Iran, North Korea and other rivals, and an unfavorable yield curve. Political turmoil has so far not affected economic performance in the U.S., but there is some possibility that deep partisan divides could lead to some paralysis as the impeachment process progresses. As of last week, with about 96% of S&P 500 companies reporting 3Q19 results, roughly 75% had reported better-than-expected results, but this leaves 3Q19 earning down roughly 3% year-over-year. In addition, modest increases in medium- and long-term interest rates have helped drive a very slight upward tilt to the yield curve.

Economic reports during November were mainly positive. Signs in the U.S. manufacturing sector remain uneven, as several regional Federal Reserve manufacturing indices have turned or remain in negative territory, though others still show expansion. In addition, trade disputes have had a clear negative impact on many trade-dependent enterprises. However, consumer spending remains strong, but consumer confidence fell for the fourth consecutive month. Broad market indices, such as the S&P 500 recorded gains of 3.4% for the month, and bank stocks rose a similar amount, after outperforming the broader markets in the two prior months.

Last week, the BEA reported its revised estimate of 3Q19 GDP, which showed growth of 2.11%, an increase from the original estimate of 1.91%, and up slightly from the 2.00% growth posted in 2Q19. In terms of stock prices, the broader markets posted solid gains in the month of November, as noted above. The same concerns we have voiced for months regarding tariffs and trade, international tensions, and an unfavorable yield curve remain, but developments over the past month continue to reduce concerns about these issues. We maintain our expectations of modest overall loan growth for banks this year, though even our modest expectations continue to fall. We also anticipate continued margin pressures.



Source: SNL Financial

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A look at the Fed's H8 data through November 20, 2019 shows that loan growth remains slow. Using the data for domestically chartered small US banks, we calculate loan growth for the first forty-seven weeks of the year at 4.1%, which translates to a full year pace of 4.6%. This is up modestly from the 4.4% pace we calculated a month ago, but well below the 6.1% figure from five months ago. Meanwhile, deposit growth also seems to have picked up recently. The first eight weeks of 4Q19 exhibited deposit growth of 1.4% (9.6% annualized). Year-to-date growth of 6.7%, which annualizes to 7.5%, is also up from the 6.9% annualized year-to-date growth we reported a month ago. Large time deposits have been the driving force in deposit growth for much of the year, but this growth has been slowing as interest rates have declined. This category has grown at an 10.7% annualized year-to-date pace, but this is down from a 11.3% pace as measured a month ago and 12.4% pace recorded two months ago, indicating that large time deposits were a smaller component of total deposit growth in November. Still, we anticipate continued margin pressure, as declines in loan yields are likely to exceed falling deposit costs. As noted above, the yield curve has started to show a slightly upward slope, but we are still far from a normal yield curve.

Fed policy actions remain a major driver of bank performance and stock market valuations. Investors are now placing a 95.6% probability on the Fed leaving rates unchanged at the December FOMC meeting, according to the CME Group's FedWatch tool. Instead of the remainder expecting a rate cut, we now see that the odds of the Fed raising rates by 25 bps at the December meeting is at 4.4%. The majority of investors see rates remining at current levels through the January and March FOMC meetings, with 80.1% projecting no change, while 16.2% anticipate rate cuts of 25 bps or more, and 3.7% projecting a 25 bps increase according to FedWatch.

Bank stocks enjoyed a very strong performance in November, as anxiety about trade frictions and the possibility of an oncoming recession continued to ease during the month. The SNL Bank and Thrift Index ended the month of November with a 3.3% gain, a smaller gain than the 4.1% posted in October and the 6.4% recorded in September, but still impressive. This performance was similar to the 3.4% rise in the S&P 500 during the month.

In regard to economic statistics, the October employment report released early in the month showed job gains of 128,000 in the month, surpassing the consensus estimate of 75,000. Revisions to the prior two months added a net 95,000 jobs, though this still resulted in the three month moving average declining 1,000 to 156,000. Meanwhile, the unemployment rate edged up to 3.6% from 3.5% the prior month. The workforce participation rate held steady at 63.3%, up slightly from 63.2% in the prior month. The year-over-year increase in average hourly earnings accelerated to 3.0% from the 2.9% figure in the prior month.

On the inflation front, the core PPI accelerated and the core CPI both decelerated in September. The core PPI decreased to up 1.63% on a year-over-year basis, compared to up 1.99% the prior month. Meanwhile the core CPI slipped to up 2.31% YoY from 2.36% in the previous month. While these measures bracket the Fed's stated target of 2.0% inflation, the Fed's preferred inflation measure, the core PCE Price Index, has fell again, as the October report showing the core PCE deflator up 1.59% year-over-year compared to up 1.71% YoY a month ago. Mortgage rates declined modestly in November with the 30 year fixed rate dipping 10 bps from the prior month according to Freddie Mac data. Existing home sales in October were up 4.6% year-over-year compared to up 3.5% in the prior month. New home sales climbed to up 31.6% YoY compared to up 21.6% YoY in the prior month. Meanwhile, mortgage applications increased 1.5% Wk/Wk in the latest weekly report and they are currently up 69.0% yr/yr.

Consistent with the shift in our view reported last month, we believe a downturn in the economy is still a possibility, but modest or slow growth seems to be the more likely path. In either case, the outlook is not particularly favorable for the banking industry. The combination of potential further Fed rate cuts, a flat or slightly upward sloped yield curve, and slow economic growth are likely to lead to restrained bank earnings growth. Most major economic indicators (labor market, GDP, consumer sentiment) suggest continued slow economic expansion. Consumer spending remains the main support for GDP growth, but business investment and trade figures are not so healthy. The ISM Manufacturing Index rose in October, but remains in contractionary territory. Meanwhile, construction spending was up for the third month in a row, climbing 0.5% in September, but it remains down 2.2% on a year-to-date basis. Furthermore, the U.S. leading indicators for October fell 0.1% to 111.7. Durable goods rose 0.6% in October. Transportation equipment spending led the increase, aided by strong defense aircraft spending. Retail sales, which has been one of the bright spots for the economy this year, rebounded in October after a September drop, rising for the seventh time in eight months, climbing 0.26% from the prior month, while industrial production declined 0.84%. Loan growth remains modest at best, and despite some improved investor sentiment and a slightly improved yield curve, we are not expecting a significant acceleration in loan growth. Though recent signals in the US-China trade dispute are encouraging, we remain concerned about the impact of existing tariffs and high-stakes trade negotiations on the economy. Despite year-over-year wages & salaries growth of 4.89%, inflation still appears to be under control. In addition, expectations that the Fed will cut rates further have diminished considerably. This suggests that the investors expect slow economic growth to continue. It still seems unlikely that our international trading partners will provide any boost to our economic outlook, as most of them face challenges of their own. The mood is currently upbeat about our trade dispute with China, but this issue has been through several cycles of joy and panic over the past year. We are encouraged that falling short-term interest rates are finally resulting in movement toward a more normal slope of the yield curve and hope that further movement could prove beneficial for bank stock valuations.

Performance & Valuations

- Though overshadowed by news headlines on the impeachment inquiry in Washington, largely good economic news has pushed continued advances in broad market indices. Coupled with a pause in Fed rate cuts, this economic news has also benefitted bank stock valuations. The gradual return to a slight upwardly-sloped yield curve is a positive for banks, but further movement on this front will be needed to ease margin pressures. Bank stocks followed good gains in September and October with another solid performance in November. While large-cap banks noticeably outperformed the broader markets in November, smaller-cap banks posted solid gains, but did not quite meet the performance of the broader market indices. On a year-to-date basis, both bank indices and broader market indices are posting significant double digit gains through November. Recent economic reports still show modest growth, though no signs of a recession. We still believe that low unemployment and solid GDP growth should keep bank balance sheets healthy. However, the yield curve remains a hindrance to bank earnings. Bank stock valuations currently range from around 11.2x projected 2019 EPS for regional banks to 31.3x for micro-/small-cap thrifts, but they seem to be averaging in the 11.2x-13.6x range. These valuations are up modestly from last month, reflecting lowered expectations for further Fed rate cuts and reduced concerns about the impact of trade disputes and the possibilities of a recession.

- With earnings season largely done and no new Fed rate cuts to fuel significant movement in November, bank stocks largely moved with the broader markets during the month. Though the dueling impeachment narratives from the two parties have dominated the headlines, Fed interest rate policy and the ongoing trade dispute with China still hold considerable sway on market movements. Economic reports during the month were good enough to further allay recession fears, allowing the yield curve to move a little bit closer to a positive slope. With no new interest rate moves by the Fed, the continued slight steepening of the yield curve could lessen the ongoing margin pressures banks are feeling from the overall decline in interest rates. With the economy still generally healthy and recession fears diminishing, businesses may feel more comfortable about planning for growth and taking out loans. The economic climate also remains positive for continued strength in bank asset quality. Though the yield curve is no longer inverted, it is still far from its normal upward slope and this remains a concern for bank results and valuations. Among the broader market indices, the S&P 500 Total Return Index, the Russell 1000 and the Russell 2000 recorded advances of 3.63%, 3.78%, and 4.12%, respectively, in November. Meanwhile, the large-cap weighted S&P Bank Index jumped 5.66%, and the smaller-cap weighted NASDAQ Bank Index posted a 3.11% increase.

Recent Common Stock Performance: Total Returns by Index

Index	Week (%)	Month (%)	QTD (%)	YTD (%)	1 Year (%)	3 Year (%)	5 Year (%)
S&P Bank Index	0.44	5.66	10.74	35.01	15.14	45.93	77.92
NASDAQ Bank Index	0.66	3.11	5.89	17.29	0.71	6.83	47.75
S&P 500 Total Return Index	1.04	3.63	5.87	27.63	16.11	51.62	68.34
Russell 1000 Index	1.07	3.78	5.98	27.74	16.10	50.78	66.98
Russell 2000 Index	2.28	4.12	6.86	22.01	7.51	27.96	48.44

- There were no Fed rate moves to influence bank stock performance in November. However, public pronouncements and FOMC meeting minutes suggesting rate cuts are on hold for the time being, have had a significant impact on investor perceptions. The CME Group's FedWatch tool suggests investors no longer anticipate any additional rate cuts this year. In November, advancing bank stocks outnumbered decliners by just above a nine-to-two margin, 323 to 71. The greatest changes in common stock price witnessed among U.S. bank stocks during the month were in shares of Heartland BancCorp (HLAN, 19%), Old Point Financial Corp. (OPOF, 18%), First National Bank of Alaska (FBAK, 18%), Salisbury Bancorp Inc. (SAL, 17%), and Bank of Utica (BKUT, 14%). Roughly 82% of banks with assets above $1.0 billion and a market cap above $25 million saw price gains during the month of November, while 17% saw price drops.

Publicly Traded U.S. Banks & Thrifts[1]: Top 5 Price Gainers & Losers (Prior Month)

Gainers			Losers		
Company	Ticker	Price Change (%)	Company	Ticker	Price Change (%)
MutualFirst Financial Inc.	MFSF	26.55	Cadence Bancorp.	CADE	-12.31
First National of Nebraska	FINN	15.84	Dime Community Bancshares Inc.	DCOM	-9.90
Opus Bank	OPB	13.87	MetroCity Bankshares Inc.	MCBS	-8.73
Customers Bancorp Inc	CUBI	13.69	Citizens National Bancshares	CNBL	-7.45
Amalgamated Bank	AMAL	13.67	OFG Bancorp	OFG	-7.26

1 Excludes banks with less than $1B in assets or a market cap below $25M

- The U.S. bank market ($500M+ Assets) trades at a median 2019 Forward P/E ratio of 12.9x (up from 12.7x a month ago), a 2020 forward P/E of 12.5x, and a Price-to-TBV ratio of 165.6% (up from 157.7% a month ago). We believe that the increases in P/E and P/TBV multiples largely result from continued gradual improvements in the yield curve, increased optimism regarding the US-China trade dispute, and reduced worries about a possible recession. Valuations remain below where they stood a year ago in terms of the current year forward P/E which stood at 13.1x at the end of November 2018, but higher than the prior year's P/TBV ratio, which was 158.3%. After several months of strong performance in bank and broader market valuations, it now appears that the markets are priced for solid economic growth. Anxiety about a potential recession, which seemed to be prevalent in late summer, seems to have almost disappeared, and the potential for renewed efforts in the trade negotiations with China helped bank stocks in November. At present, the median 2019 EPS growth estimate for banks with assets greater than $500 million stands at 7.8%, up from 7.5% a month ago, but still below the 8.2% growth in 2019 that was projected at the end of November 2018. The consensus 2020 EPS growth figure has dropped to 1.4% from 2.4% a month ago and 4.4% two months ago. We remain concerned about slower loan growth and continued margin compression, though recent economic reports have mitigated these concerns slightly. We continue to believe good asset quality and expense reduction efforts will continue to provide a modest benefit to bank earnings. The chances of a significant steepening of the yield curve still appear modest at best for the immediate future, leading us to believe that loan growth and margin will remain under pressure.

Publicly Traded U.S. Banks & Thrifts[1]: Current Common Stock Valuations

	Forward P/E		EPS Growth		LTM	Price/	Price/
	2019	2020	2019	2020	P/E	TBV	BV
Bank Chartered ($200M-$1B Assets)	13.6	13.6	15.7	10.8	12.1	114.6	110.0
Thrift Chartered ($200M-$1B Assets)	31.3	31.4	-159.5	0.4	16.3	111.3	108.3
Super Community Banks ($1B-$20B Assets)	13.0	12.7	8.6	1.1	13.2	147.6	126.2
Regional Banks ($20B-$100B Assets)	11.2	11.3	6.7	-2.0	11.4	155.8	116.8
Large Banks ($100B+ Assets)	12.0	11.8	5.4	3.1	12.4	182.5	129.7
Banks & Thrifts ($500M+ Assets)	12.9	12.5	7.8	1.4	12.8	165.6	123.2

Source: SNL Financial, All figures represent median values.

- After cutting interest rates for the third meeting in a row at the October 30 FOMC meeting, the Fed has signaled that it intends to pause before making any further adjustments to interest rates. As a result of the previous rate cuts, the yield curve has moved from slightly inverted to a very slight upward slope. Short maturities saw significant yield declines again in November while the middle and long ends saw small yield increases. While we have still not gotten back to the traditional upward sloping yield curve, further progress was made in November. The 3-month T-Bill rate fell 29 bps in November while the 1-yr maturity decreased 15 bps. Meanwhile, the 3-yr, and 5-yr rates increased 5 bps and 7 bps, respectively, while the 10-yr rose 10 bps and the 30-yr bond yield climbed 9 bps. This movement built upon last months in tilting the yield curve slightly upward. The spread between the 1-year and 10-year rates increased to 18 bps at the end of November from 16 bps at the end of October. This spread is still well below the 31 bps recorded twelve months ago at the end of November 2018. Spreads between the 10-year and 3-month treasuries climbed to 19 bps from 15 bps as of October 30, 2019. The conforming 30-year fixed rate mortgage rate decreased modestly, falling to 3.68% from 3.78% at the end of October and stood 113 bps lower than at the end of November 2018.

Treasury Yields & National Mortgage Rates

	Year-Ago	12/31/18	9/30/19	Current	4Q19 Change
3 Month T Bill	2.37	2.45	1.88	1.59	-0.29
1 Year Bill	2.70	2.63	1.75	1.60	-0.15
3 Year T Note	2.83	2.46	1.56	1.61	0.05
5 Year T Note	2.84	2.51	1.55	1.62	0.07
10 Year T Note	3.01	2.69	1.68	1.78	0.10
30 Year T Bond	3.30	3.02	2.12	2.21	0.09
5/1 Yr ARM	4.12	4.00	3.38	3.43	0.05
15 Yr FRM	4.25	4.01	3.16	3.15	-0.01
30 Yr FRM	4.81	4.55	3.64	3.68	0.04

Source: Freddie Mac & SNL Financial

Disclosure Appendix

Analyst Certification:

I, Joseph Gladue, the primary analyst covering this issuer, certify that: 1) all of the views expressed in this report accurately reflect my personal views about the subject security or issuer, and 2) no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Risk Factors:

The realization of any or all of the following risk factors, among others, may adversely affect the company's stock price and prevent it from reaching our target price, if one is established:

- a weakening of the United States economy and the regional and local economies in which the company conducts operations
- unanticipated loan losses or securities-related losses
- a weakening of local real estate markets or the soundness and liquidity of the securities market for real-estate backed assets
- failure to maintain sufficient excess capital or liquidity to conduct operations
- the effects of trade, monetary, and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System
- the effects of increased inflation, a flatter yield curve, or increased volatility in financial markets
- inability to attract core deposits or continue to obtain third party financing on favorable terms
- adverse legal action against the company or litigation initiated by the company
- inability to successfully integrate acquired operations or to maintain sufficient excess capital post the close of a transaction

Investment Rating Definitions:

Investment ratings reflect the analyst's assessment of the subject stock's return potential relative to the NASDAQ Bank Index. There are three investment rating tiers:

- **Outperform/Buy:** The subject stock's total return is expected to exceed the return of the NASDAQ Bank Index by 10% or more over the next 12-month period.
- **Neutral/Hold:** The subject stock's total return is expected to be comparable with the return of the NASDAQ Bank Index over the next 12-month period.
- **Underperform/Sell:** The subject stock's total return is expected to be less than the return of the NASDAQ Bank Index by 10% or more over the next 12-month period.

Investment Rating Distributions (as of September 30, 2019)

	All Covered Companies		Investment Banking Services Provided in the Last 12 Months	
Rating Categories	**Count**	**% of Total**	**Count**	**% of Category**
Outperform/Buy	9	60%	0	0%
Neutral/Hold	6	40%	0	0%
Underperform/Sell	NA	0%	0	0%
Total	15	100%		

Other Important Disclosures:

J. Alden Associates, Inc. (DBA Alden Securities) is a FINRA-registered broker-dealer.

Alden Securities expects to receive compensation for investment banking services from the subject company in the next three months and/or seeks to receive such compensation.

Analyst compensation is based, in part, on Alden Securities' profitability, which includes revenues from investment banking.

Target prices, if applicable, are derived from our 12 Month Valuation Assessment. Our 12 Month Valuation Assessment is based on a blend of several relative value methodologies.

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