FJ CAPITAL MANAGEMENT, LLC

Investing in Financial Services for Decades

White Paper

Community Banks Reaching Positive Inflection Point
Frequently Asked Questions (FAQ)

October 2020

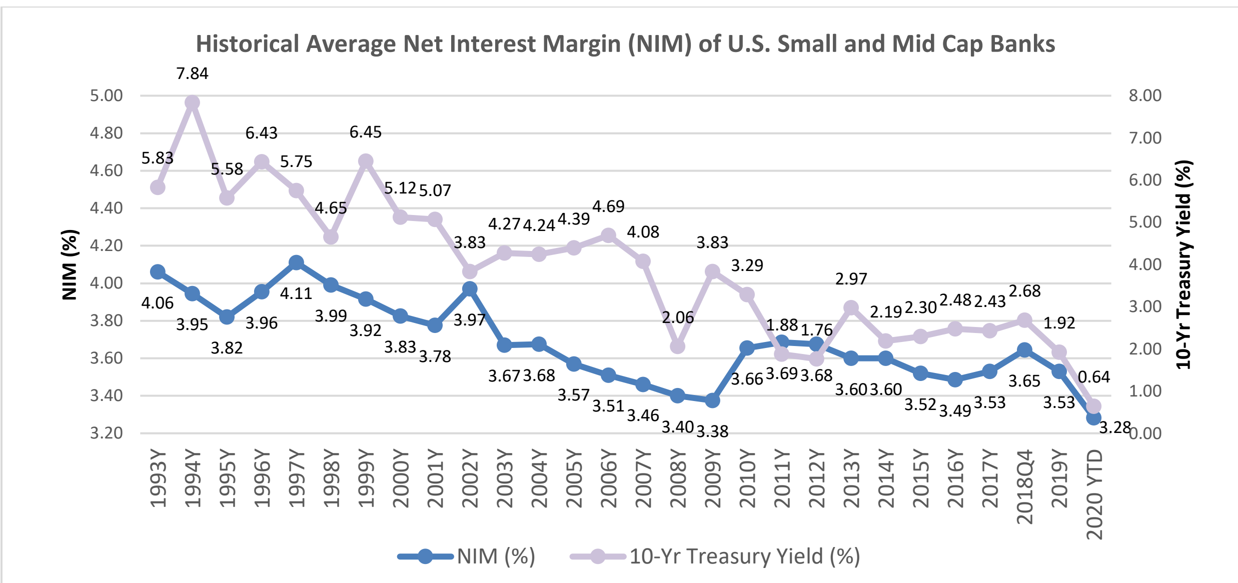
Executive Summary

In this white paper, we endeavor to answer the following questions that are top of mind by investors about the U.S. banking industry and bank stocks. As we mentioned in our previous white paper, we believe bank stocks are set up for a multi-year bull market after the sharp decline due to the COVID-19 pandemic in 2020.

FJ CAPITAL MANAGEMENT

What Will Happen to Bank Profitability in A Zero Interest Rate Policy (ZIRP) Environment?

U.S. Small and Mid-Cap (SMID) bank net interest margins (NIM) have steadily declined since the early 1990s due to the decreasing interest rates in U.S. over past 30 years. After a prolonged period of near-zero short-term interest rates since the 2008 Great Recession, the Fed raised rates by 25 basis points for the first time in December 2015 and announced eight subsequent hikes between 2016 and 2018. In turn, SMID bank NIM expanded 16 bps on average off the 2016 lows, benefiting from the increase in short-term rates, and peaked in 2018Q4. The Fed had a 360-degree change in its monetary policy in 2019 and 2020, cutting the Fed Fund Target Rate back to the all-time low level of 25 bps in response to the economic recession caused by the COVID-19 Pandemic. The U.S. 10-Yr Treasury Yield also declined to the historical low levels since the outbreak of COVID-19 in 2020Q1. As a result, SMID bank NIM has compressed more than 35 bps on average from the peak level in 2018, primarily due to the decline in both short-term and long-term interest rates, which negatively impacted bank asset yields.



Source: FJ Capital Management

The current near-zero interest rates and flattening yield curve in the U.S. cause fears about the long-term NIM outlook for the banking sector, which is one reason that bank stocks are trading at historically low valuation multiples. What will happen to bank profitability if interest rates stay lower for a longer period? Our analysis shows that U.S. SMID Bank NIM will eventually bottom around 3% vs. 3.5% in 2019, if interest rates stay at 0% forever across the entire yield curve.

The following table illustrates our detailed modeling based on the current earnings assets and funding mix of SMID banks on average. The spread of each earnings asset's yield over its benchmark index is based on the historical average coupled with our current market observations. Even under ZIRP, loan yield will not fall to 0% because banks need to price a loan at appropriate spread to justify the credit risk and overhead for origination and servicing. The continued decline in deposit costs if interest rates stay lower-for-longer will offset some earnings yield pressure on NIM. Additionally, it will take time for the entire balance sheet to reprice. We estimate it will take 5-7 years for the balance sheet to fully reflect ZIRP.

Even under a 3% NIM, our analysis shows SMID banks could still generate close to 10% return on average tangible common equity (ROATCE) with normalized credit costs, which would imply 180% Price-to-

Tangible Book Value (P/TBV) based on historical regression analysis, a significant upside from current 99% P/TBV.

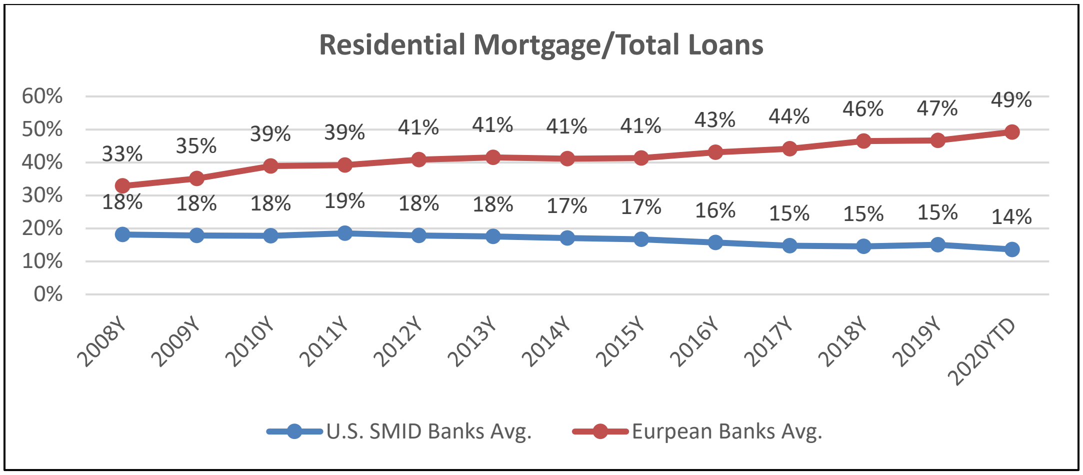
U.S. SMID Banks Average	Mix	Index	Index Rate Under ZIRP	Spread	Yield/Cost Under ZIRP
Interest Earning Assets					
Cash	3%	Fed Funds	0.00%	0.00%	0.00%
Securities	19%	Corresponding UST Rate	0.00%	1.25%	1.25%
Loan	79%				3.63%
1-4 Family	13%	Corresponding UST Rate	0.00%	2.75%	2.75%
CRE	37%	Corresponding UST Rate	0.00%	3.25%	3.25%
C&I	21%	Prime Rate	3.25%	1.00%	4.25%
Consumer	8%	Prime Rate	3.25%	2.00%	5.25%
Total	**100%**				**3.09%**
Interest Bearing Liabilities					
Total Deposits	93%	NA			0.10%
Borrowings	7%	NA			0.25%
Total	**100%**				**0.11%**
Net Interest Margin (NIM)					**2.98%**

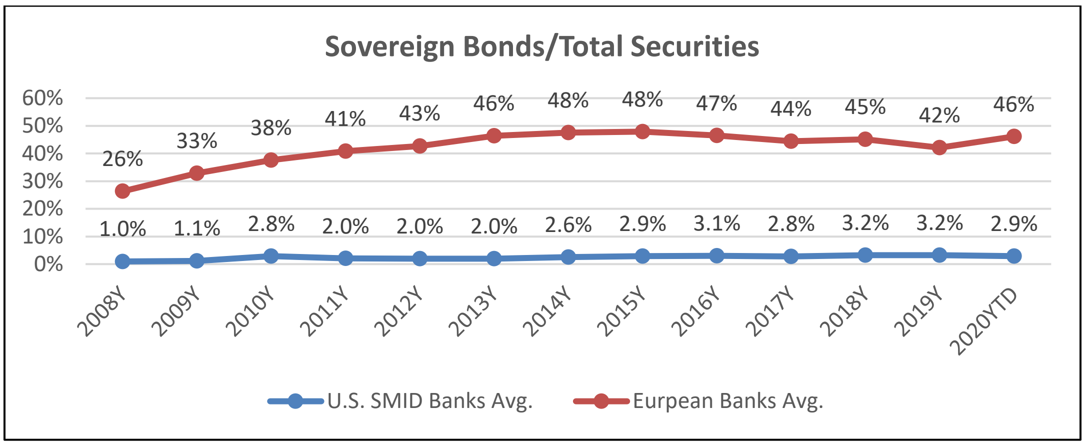
Pro Forma ROATCE, All Else Equal	**9.72%**
P/TBV Based on Historical Regression	**178%**
Current Avg. P/TBV	**99%**

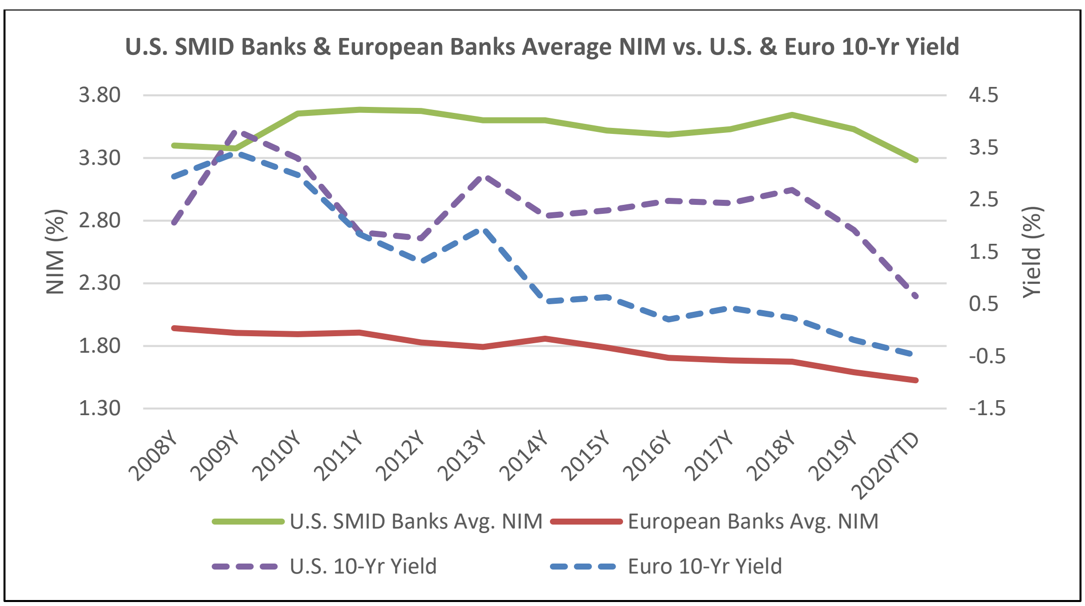
Source: FJ Capital Management

Low interest rates across the globe also caused concerns on U.S. bank NIMs. Some even look at NIMs in Europe and Japan and think those should be applied to U.S. financials. Although we think the NIM of SMID banks in the U.S. could face pressure if the yield curve stays flat over time, we do not expect the NIM to fall to Japanese or European levels. This is due to structural differences between balance sheets in the U.S. and those regions. As shown in the charts below, U.S. financials do not hold low spread assets such as residential mortgage and sovereign bonds on balance sheets to the same magnitude of financial firms in Europe. Their low spread assets are offloaded to the capital markets in U.S. Even when interest rates were similar in the two regions in the early part of this decade, U.S. NIM was higher. Therefore, if U.S. rates were to fall to European levels, the NIM of U.S. community banks could face additional pressure but would stay structurally higher.

CAPITAL MANAGEMENT





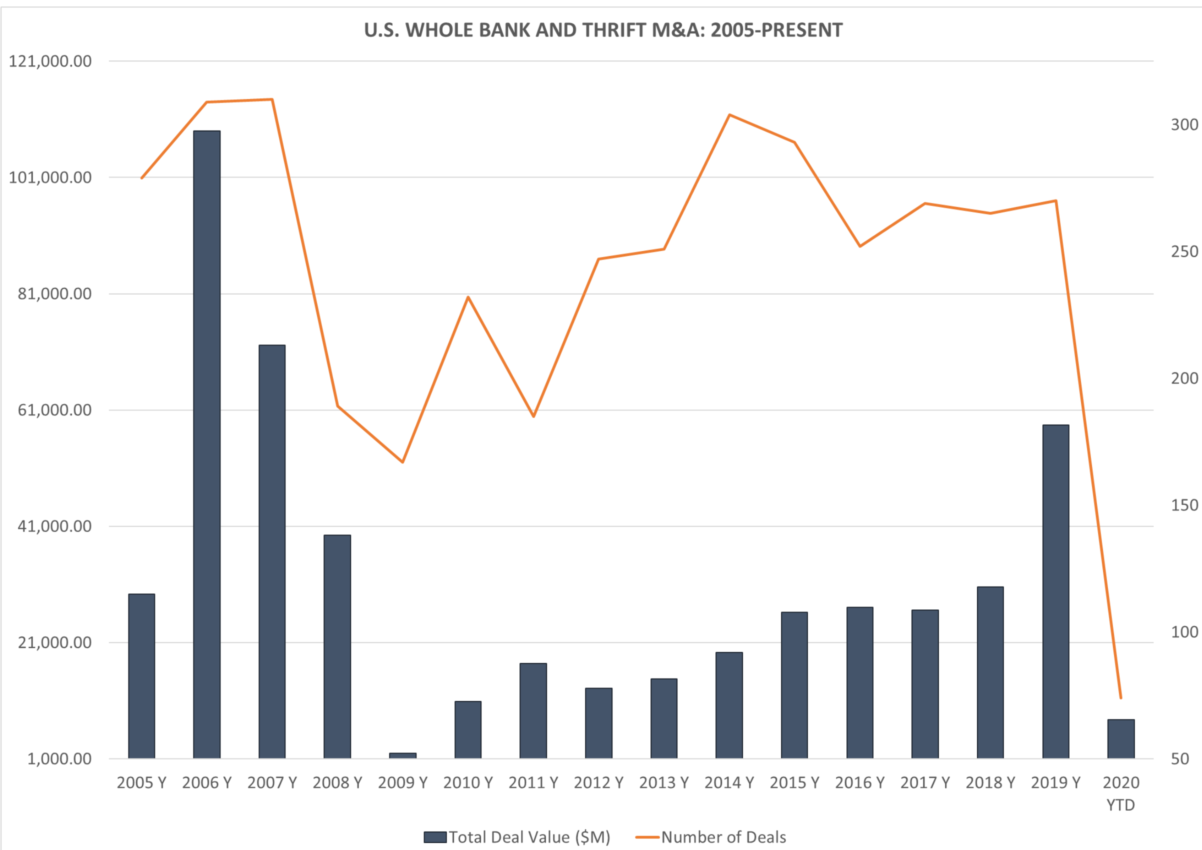


Data Source: FJ Capital Management

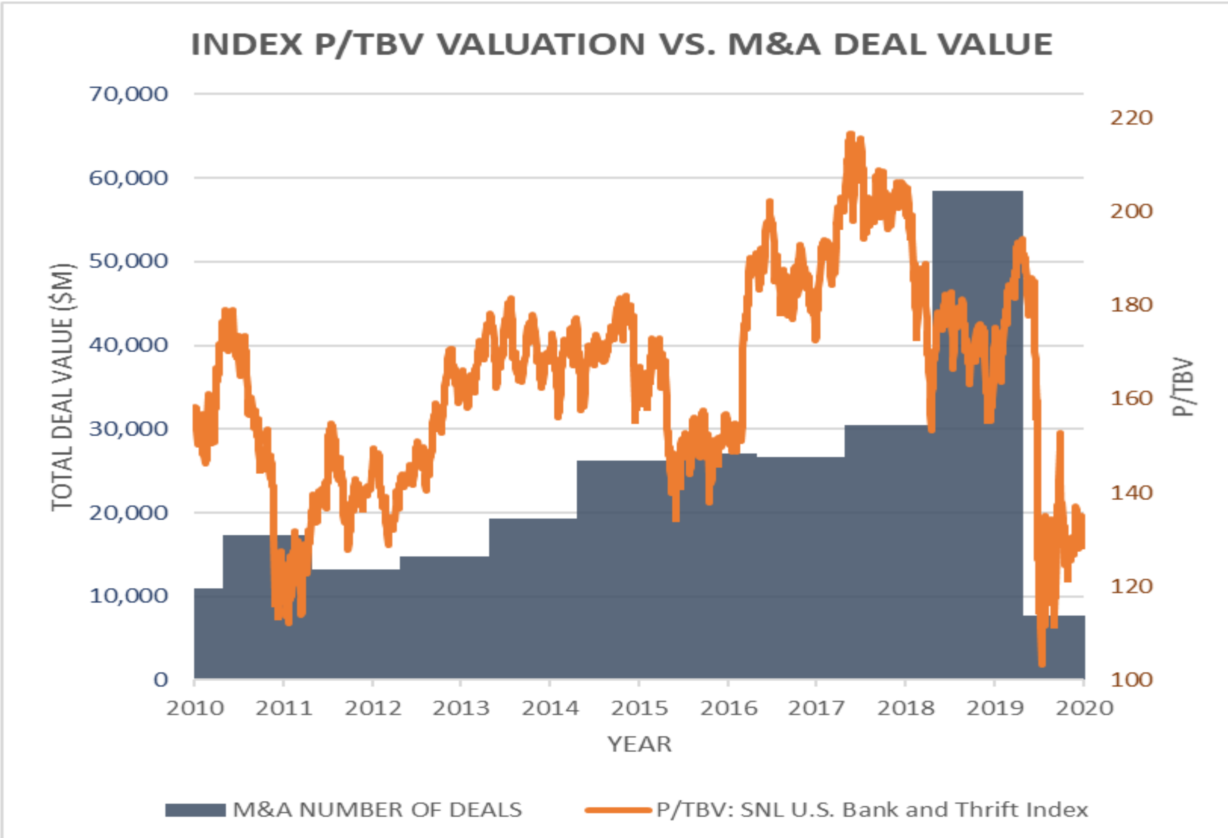
FJ CAPITAL MANAGEMENT

When Will Bank Consolidation Come Back?

One question we often get during periods of economic distress is "when is consolidation coming back?" To answer this, it is important to stop and think about the question. Typically, we invest in management teams that invest a significant portion of their own personal net worth in the institutions they run. These managers thus have alignment with shareholders to maximize the value of their holdings and are very sensitive to the price they would receive in an M&A transaction. As the economy improves and there is more transparency in loan losses, we expect the cream to start to rise, thus creating a better currency to make acquisitions. We have already started to see an uptick in activity in recent months. Year to date, 74 banks and thrifts have announced sales, which is down from the levels of the last few years. We expected this drop off as this is typical in recessionary periods, but we also expect a surge in activity once the economy resumes growth, as has taken place in the past. The first chart below illustrates the typical drop off in M&A activity year to date, which compares similarly to 2009. During the recovery following the GFC, M&A made a robust return and FJ believes the upcoming consolidation cycle will rival, if not exceed, the level of consolidation in the last cycle. The second chart below demonstrates the significant correlation between Total M&A Deal Value and bank P/TBV trading multiples.



Source: FJ Capital Management



Source: FJ Capital Management

Consolidation remains an extraordinary earnings growth opportunity. As alluded to above, in a zero interest rate environment we would expect M&A activity to surge as pressure continues to mount on margins – a particular concern for small banks that rely on that for the majority of revenues. Our expectations are that activity will begin to pick up in the first half of 2021 and accelerate through the year and continue to be robust over the next 3-5 years. Higher bank stock prices and clarity on credit are the two big issues. First, loan deferrals should largely play out by the end of 2020. The CARES Act allowed banks to provide financial support to borrowers by delaying or modifying loan payments for up to 180 days and permanently restructure loans with a hard deadline of 12/31/20. Given that many deferrals were granted in the Spring, the fourth quarter of 2020 would represent 180 days and the closure of opportunity for favorable accounting and regulatory treatment of long-term restructuring. Once borrowers start to default and nonperforming asset start moving through the system, there will be more price discovery on loan and property sales. We expect the hard restructure deadline of year-end 2020 to accelerate problem loan identification and liquidation compared to prior cycles. In addition, bankers will be able to see the problems more clearly without the haze of government stimulus, which can help them better evaluate loss content. Having more information should give bankers more confidence, which should then allow them to execute M&A deals.

How Should Credit Losses Be Evaluated During the Recession Caused by the COVID-19 Pandemic?

COVID-19 Pandemic-Sensitive Loan Exposures are Manageable for SMID Banks

The economic fallout from the effects of the COVID-19 Pandemic has raised serious concerns on the credit risk of SMID banks given their lending exposure to commercial real estate (CRE) and small and medium-sized enterprises (SMEs), which has weighed on bank stocks. The most impacted industries by COVID-19 include retail, hotel, restaurant, and energy. As of 2020Q2, total loan exposure to high-risk industries due to COVID-19 among SMID banks is 15% on the median base, including 5.9% retail, 3.2% hotel, 1.5% restaurant, 0.6% energy, and 3.6% other, which are very manageable credit exposures for many SMID banks given their strong capital ratios and earnings power going into the COVID-19 pandemic.

It is worth mentioning that not all borrowers in these high-risk industries are negatively impacted by the pandemic. For example, in the hospitality industry, limited service and economy hotels in drive-to leisure markets on the coast and in the mountains are performing very well as the vacation season started in the Summer. In the retail sector, properties anchored by essential businesses such as grocery stores still have very healthy rent collections. On the restaurant side, quick-service restaurants, a sub-sector that comprises the largest exposure in many SMID banks' restaurant portfolios, are still generating strong cash flows thanks to their drive-thru, takeout and delivery capacities. These encouraging trends as the economy reopens make the credit risk even more manageable for SMID banks in this recession.

Loan Payment Deferrals are Trending Downward in 2H2020

The CARES Act allows banks to provide financial support to borrowers impacted by the COVID-19 pandemic through loan payment deferrals, and the modified loans would not be categorized as Troubled Debt Restructurings (TDRs) under GAAP. Most of the deferrals allow borrowers to defer loan payments for 90 days in most cases, and up to 180 days in some instances, with the deferred payments added to the end of the loan.

On the median base, deferrals increased to 17% of total loans for SMID banks during Q2 earnings season in July, from 13% during Q1 earnings season in April. These deferrals have raised great concerns among investors about banks' true credit quality trends, as delinquent and nonperforming loans which would normally show up in a bank's earnings report are now masked by the deferrals under the CARES Act.

While we believe these concerns are valid to some extent as some of the deferrals eventually will become problematic loans that will lead to credit losses for banks, we do not think it makes bank stocks un-investable nor unattractive at current historically low valuations. The primary reason is that we believe the deferrals likely will decrease significantly for the industry over the next two quarters.

Most of the initial deferrals were granted in April, May, and early June. Thus, as banks reported 2Q earnings in late July and in some cases have filed presentations in August for investor meetings, they have provided data regarding the percentage of borrowers returning to their normal payment schedule and also for those that have requested an extension of the deferral periods. The trends are encouraging as most banks we have spoken with through August expect deferrals as a percentage of total loans to fall to the single-digit range somewhere between 2%-8% over the next two quarters. Most of the borrowers that need another round of deferrals are concentrated in the hotel, restaurant and retail industries more heavily impacted by the COVID-19 pandemic.

There are several reasons for the potential sharp decline in deferrals. First, borrowers that were under significant pressure when the pandemic started in March and April are doing much better now as the economy reopens. Second, many borrowers who were doing well and did not necessarily need a deferral requested one more as an insurance policy due to the uncertainty regarding the virus and the impact on the economy. They will return to normal payments as the deferrals expire. Third, many banks took a very liberal approach in the first round of deferrals by granting deferrals to any borrower who requested one without requesting proof of need. Banks will employ a more discerning approach in the second round of deferrals and only give deferral extensions to borrowers who actually need help. Finally, a provision of the CARES Act sunsets December 31, 2020 that is acting as a catalyst for converting deferred loans to permanent restructures thereby qualifying for regulatory and accounting relief.

We believe the drop in deferrals in 2H2020 will serve as a positive catalyst for bank stocks, as it will provide more clarity on the ultimate credit losses for banks in this recession. For example, if the total deferrals as a percentage of total loans stabilize in the 5% range for the industry on average by the end of the year, and 50% of the deferrals eventually become nonperforming loans, the total credit losses in this cycle will be capped at 2-3% of total loans, which are manageable for many banks as illustrated in the next section.

Credit Loss Sensitivity Analysis

Banks likely will start to incur credit losses, as measured by Net Charge-offs Ratio (NCOs), in 2020Q4/2021Q1 as deferrals expire and nonperforming loans emerge. Historical analysis shows that bank NCOs usually peak over the next 2 years following an economic recession, with 2008 Great Financial Crisis (GFC) being the worst of all time as banks posted ~200 bps cumulative NCOs in 2009 and 2010 on average, vs. 10-20 bps annual NCOs in a normal credit environment.

When we underwrite an investment in the current environment, we assume this recession could be as severe as the GFC in our base case. We then apply industry average NCOs of each loan category in the two peak loss years (2009 & 2010) during the GFC to a bank's current loan mix to estimate its potential credit losses over the next two years. Below is an example of our credit loss estimates for *Pacific Premier Bancorp (NASDAQ: PPBI),* a $20 billion asset commercial bank with a footprint in key metropolitan areas throughout the Western U.S. Even assuming ~190 bps cumulative NCOs over next two years in the base case, the bank is still expected to generate ~12% return on average tangible common equity (ROATCE) in 2022, which would generate over 30% IRRs based on historical P/TBV-ROATCE analysis.

Loan Category	Industry Average		Current vs. GFC	PPBI Loan Mix	PPBI Estimated	
	2009	2010			2021	2022
1-4 Family NCOs (%)	0.64%	0.67%	1.0x	2%	0.64%	0.67%
Multi Family NCOs (%)	0.73%	0.89%	1.0x	37%	0.73%	0.89%
CRE NCOs (%)	0.61%	0.59%	1.0x	39%	0.61%	0.59%
C&I NCOs (%)	1.80%	1.56%	1.0x	19%	1.80%	1.56%
C&D NCOs (%)	2.65%	2.55%	1.0x	3%	2.65%	2.55%
Consumer NCOs (%)	1.35%	1.18%	1.0x	0%	1.35%	1.18%
Total NCOs (%)	**1.01%**	**0.91%**		**100%**	**0.93%**	**0.93%**

Source: FJ Capital Management

	Current	Projected	Projected	Projected
	7/31/2020	12/31/2022	12/31/2022	12/31/2022
Price	$21.01	$30.78	$34.63	$38.48
TBV	$17.58	$20.79	$20.79	$20.79
P/TBV	119%	160%	180%	200%
Holding Period (Years)		2.4	2.4	2.4
IRR		26%	32%	38%

Source: FJ Capital Management

We also conduct sensitivity analysis around credit losses to evaluate a bank's safety and soundness in the recession. Using PPBI as an example, as shown in the table below, the bank is not expected to have tangible book value (TBV) degradation even if credit losses are 2x the GFC level over the next 2 years. The bank will remain well capitalized even if credit losses are 4x the GFC level over the next 2 years. Therefore, as mentioned in our previous white papers, we expect COVID-19 to be an earnings event, not a capital event for many banks like PPBI, even if credit losses are 3x-4x higher than the GFC level.

Credit Losses vs. GFC	1.0x	2.0x	3.0x	4.0x
2022 TBV	$20.79	$18.74	$16.69	$14.64
Current TBV	$17.58	$17.58	$17.58	$17.58
% Impact	18%	7%	-5%	-17%
2022 TCE/TA	9.7%	8.8%	7.8%	6.9%
2022 ROATCE	11.9%	8.7%	4.9%	0.2%

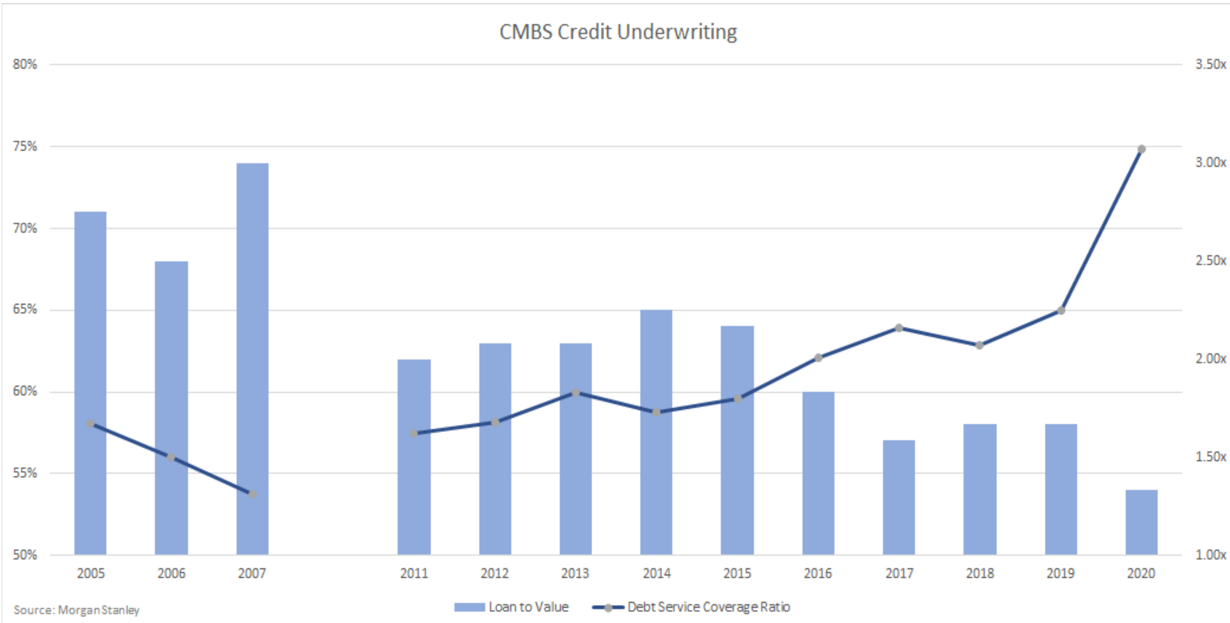
Source: FJ Capital Management

Credit Underwriting Has Significantly Improved Since GFC

Bank lending standards were much tighter coming into the COVID-19 pandemic than they were going into the GFC, and management has improved to feature more risk-averse lending. In fact, many of the loan underwriting "best practices" post 2008 are now standard. Global cash flows are analyzed for nearly any commercial credit. Stress testing of individual credit assumptions are performed at underwriting to identify potential early warning signs. Credit automation tools are used to enhance controls, portfolio management, monitoring and analysis. Deliberate concentration limits and proactive risk management of concentrations are now required. Portfolio management and stress testing feed into enterprise risk management systems that directly link to capital planning. The underwriting process generally is much more robust, conservative, and forward looking than it was pre-GFC. The more deliberate and proactive portfolio management practices have translated into improved transparency and risk disclosures in public findings which we closely monitor.

Taking CRE lending as an example, it is quite evident that underwriting standards today are substantially better than those going into the GFC. Perhaps one of the best ways to look at this is through the lens of the commercial mortgage back security (CMBS) market, with a particular focus on loan to values (LTVs) and debt service coverage ratios (DSCR). As shown below, CMBS deals originated in 2007 featured average LTVs of 74% and DSCRs of 1.31x. In the aftermath of the GFC, lenders clearly learned their lesson with credit metrics coming in substantially more conservative. CMBS transactions in 2019 featured cycle-low

LTVs of 54% and cycle-high DSCRs of 2.25x. While this data is for CMBS and not necessarily banks, we think it is important to recognize that loans that fall into CMBS deals usually are originated and underwritten by the largest national banks, and there is a general understanding that bank underwriting is considerably more conservative than that of CMBS.

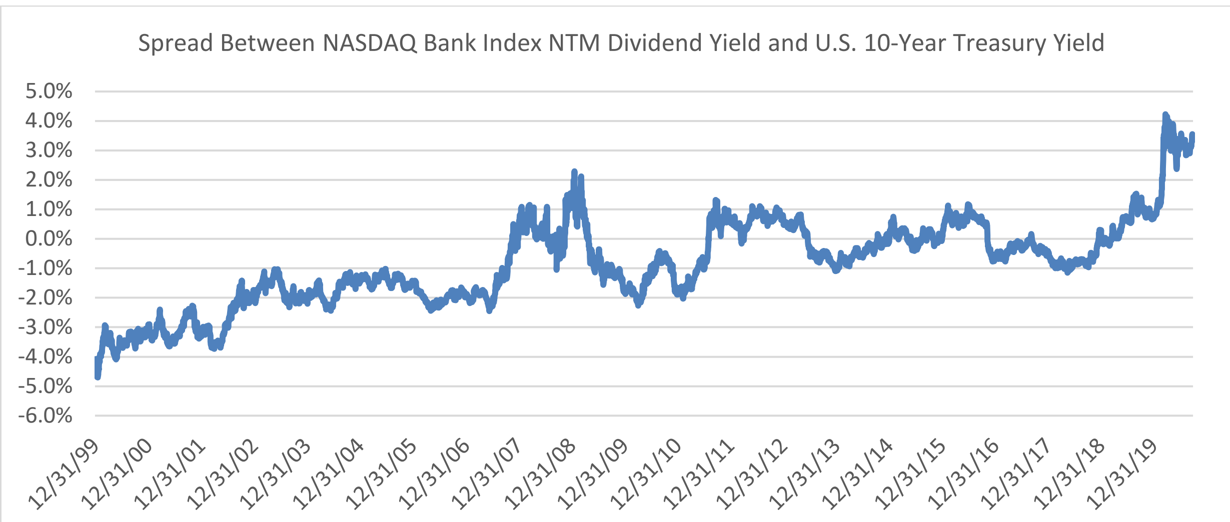


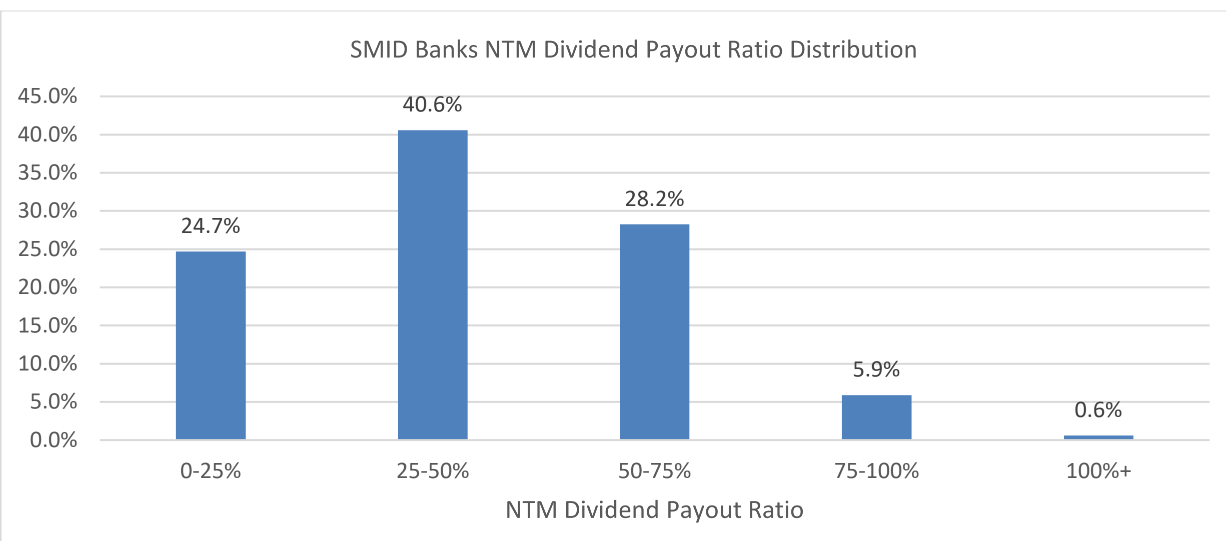
What Will Happen to Bank Dividends and Stock Buybacks?

Are Dividends Safe for Bank Stocks?

Bank stock dividend yields have significantly increased this year due to the sharp decline in stock prices. As shown in the chart below, the spread between the NASDAQ Bank Index Next-Twelve-Month (NTM) dividend yield and the U.S. 10-Year Treasury yield has reached its highest level over past 20 years. Bank dividends are garnering significant attention today on the headline due to the economic fallout from the effects of the COVID-19 Pandemic. Year-to-date, 8 Small and Mid-Cap (SMID) banks have announced dividend cuts, representing less than 5% of the SMID bank universe.

We believe dividends are broadly safe for SMID banks going forward. Based on consensus estimates, the median NTM dividend payout ratio for SMID banks is 42%. Most banks could still generate enough earnings to support dividends in this tough interest rate and credit environment. As shown in the chart below, 6% of banks (or 11 banks on an absolute basis) have NTM dividend payout ratios above 75%, including less than 1% of banks (or 1 bank on an absolute basis) that has over 100% NTM dividend payout ratio. Therefore, we believe dividends are safe for the majority of SMID banks, which make the current 4% median dividend yield very attractive for the sector.





Data Source: FactSet, FJ Capital Management

When Will Bank Stock Buybacks Restart?

Share repurchase activity for the banking sector has broadly been on hold due to economic uncertainty related to COVID-19 Pandemic. The suspension of stock buybacks was led by the largest banks earlier this year, as their capital return plans are heavily regulated by regulators. Although buyback rules are less defined for SMID banks, most, but not all, of them followed the big banks and announced formal suspensions of share repurchase programs after the outbreak of COVID-19 earlier this year. Coming into the second half of 2020, we have seen more than 20 smaller cap banks that have either restarted buybacks or announced new stock repurchase programs. Based on our recent conversations with over 100 bank management teams across the country, we believe the resumption of stock buybacks will likely become a powerful trend for SMID banks over next two quarters, as bank management teams start to have better visibility on credit losses in this recession, which has been the biggest reason for the suspension of stock buybacks. With more than 50% of bank stocks trading below tangible book value (TBV) today, stock buybacks would be very accretive to both TBV and EPS, which will provide a major catalyst for the sector.

It is worth mentioning that banks have been actively raising inexpensive, offensive capital in the form of subordinated debt and preferred equity between 4-7% since the pandemic started. Year-to-date, SMID banks have raised closed to $10 billion subordinated debt and preferred equity, a record level in recent years. We believe banks will utilize the fresh capital to support stock buybacks over the next few quarters once the credit condition stabilizes.

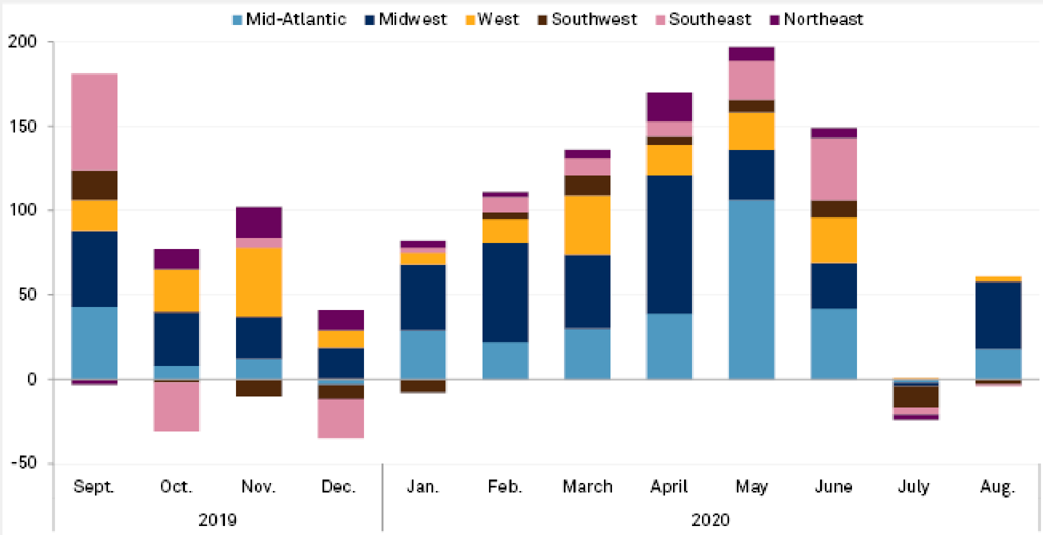
How Would Banks Manage Operating Expenses to Offset Net Interest Margin Pressure?

Banks have for many years sought greater efficiencies by replacing physical branch offices and employees in non-customer-facing support functions with more scalable technology-based delivery channels and back office systems. This trend has accelerated in recent years as consumer preferences have migrated to mobile phone and online banking applications while regulatory costs have risen. In fact, the trend of replacing physical infrastructure with virtual infrastructure has begun to occur even more quickly in response to the COVID-19 health epidemic and the flat yield curve that has pinched bank margins. We expect this trend to continue at an elevated pace as long as the current operating environment prevails.

The chart below illustrates that the ongoing trend of closing branches picked up in 2020 during the heavy lockdown and early reopening phases of the pandemic. The trend temporarily stalled as the economy picked-up steam in July and then resumed in August. “Over the last year, U.S. banks and thrifts have closed 2,303 branches and opened 1,110, leaving 85,143 active branches in the U.S. at the end of August,” according to S&P Global Market Intelligence.

Our conversations with bank management teams in recent due diligence meetings have demonstrated that they are working hard to reduce expenses to create operating leverage in a challenging revenue environment. The pandemic has accelerated mobile adoption as customers were forced to do business away from the branch. While personalized service is still key to the community bank value proposition, most realize they can do more with less, particularly with fewer brick and mortar locations. Our conversations indicate that approximately 10% of bank budgets consist of discretionary items, allowing for more than a modest amount of offset to cushion against loan losses, which mostly have been reserve builds for potential losses.

Regional trend of monthly branch net closings across US banks and thrifts



Data compiled Sept. 8, 2020.
Analysis includes bank and thrift branches that were located in the following U.S. regions: Mid-Atlantic, Midwest, Northeast, Southeast, Southwest and West.
Branch openings and closings are limited to cases where opening and closing dates are available.
Branch data collected on a best-efforts basis.
Excludes credit unions.
Source: S&P Global Market Intelligence

One example is Midland States Bancorp (MSBI) in Illinois, which this September announced "a series of planned branch and corporate office reductions as part of its ongoing efforts to enhance efficiencies and financial performance. Midland will close or consolidate 13 branches, or 20% of its branch network, and vacate approximately 23,000 square feet of corporate office space by the end of 2020." "Additionally, Midland plans to renovate and upgrade five other branches to reduce the size and better utilize those facilities to serve retail and commercial customers."

Our conversations with banks also indicate that a good number are evaluating and renegotiating vendor relationships to achieve cost savings. Banks lock into multi-year contracts with vendors that specialize in providing core technology systems, as well as ancillary platforms that plug into those core systems. The current operating environment calls for banks to carefully reassess those contracts as they approach renewal periods. Savings on core systems can be significant, as such systems drive one of the largest costs in any bank.

Another example is Byline Bancorp (BY) in Chicago, IL, which in September announced it would consolidate 20% of its branch network from 57 to 46 branches, achieving $4.3 million in annual cost savings. This improves run-rate expenses by approximately 3% while it increases our estimated 2022 pretax earnings by 5%. BY has for years operated with many branches close to the Chicago metro area. While acquisitions have added branches that were consolidated, BY was careful to preserve its deposit base by not over-consolidating too quickly. It is reasonable to conclude the pandemic has shifted customers from branches to online and mobile banking channels, providing the bank with the confidence to further reduce what has been a somewhat branch-heavy footprint.

Associated Bancorp (ASB) of Wisconsin also announced a group of efficiency initiatives in September. First is the sale or consolidation of 21 of its branches to reduce the branch network by 8% and achieve a $10 million annual expense reduction. Second is the reduction of corporate, managerial, and back office expenses to save $30 million in annual expenses. Third is the prepayment of a $950 million Federal Home Loan Borrowing to save $20 million annually. Finally, ASB is reorganizing its securities and real estate lending subsidiaries to create a net income tax benefit of approximately $40 million. This stems from the recognition of a built-in capital loss within an investment subsidiary. The expense savings alone represent an 8% reduction to annualized operating expenses.

How Would A Change in the Administration and Regulatory Regime Impact Banks?

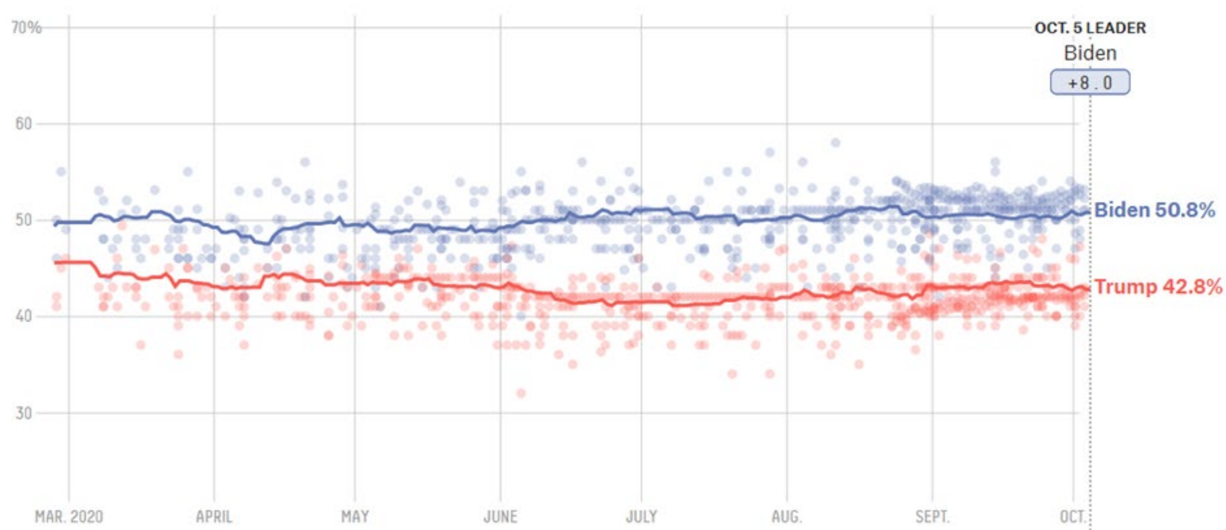
Won't Bank Stocks Trade Lower if Biden is Elected President?

While bank stocks may not get the immediate boost, they received after Donald Trump was elected President ("the Trump Bump"), that does not necessarily mean bank stocks are not discounting a Biden win. On the contrary, we think the consensus view is that Biden will win the Presidency, and that in turn is a factor in the underperformance of bank stocks We would be more concerned if bank stocks were trading at robust multiples and did not seem to be discounting a Biden win.

While we understand bank stocks may be in some relative "holding pattern" until the outcome of the election is known, this could end up being a "sell the rumor, buy the news" event that at least adds some certainty to the market.

Additionally, we do not bank stocks, or the market, is assuming or pricing in a Trump re-election victory. Remember how nobody (or almost nobody) thought Trump would win last time? While a Trump win may not drive a Trump Bump 2.0 for bank stocks, we do think the market nonetheless would favorably reward bank stocks.

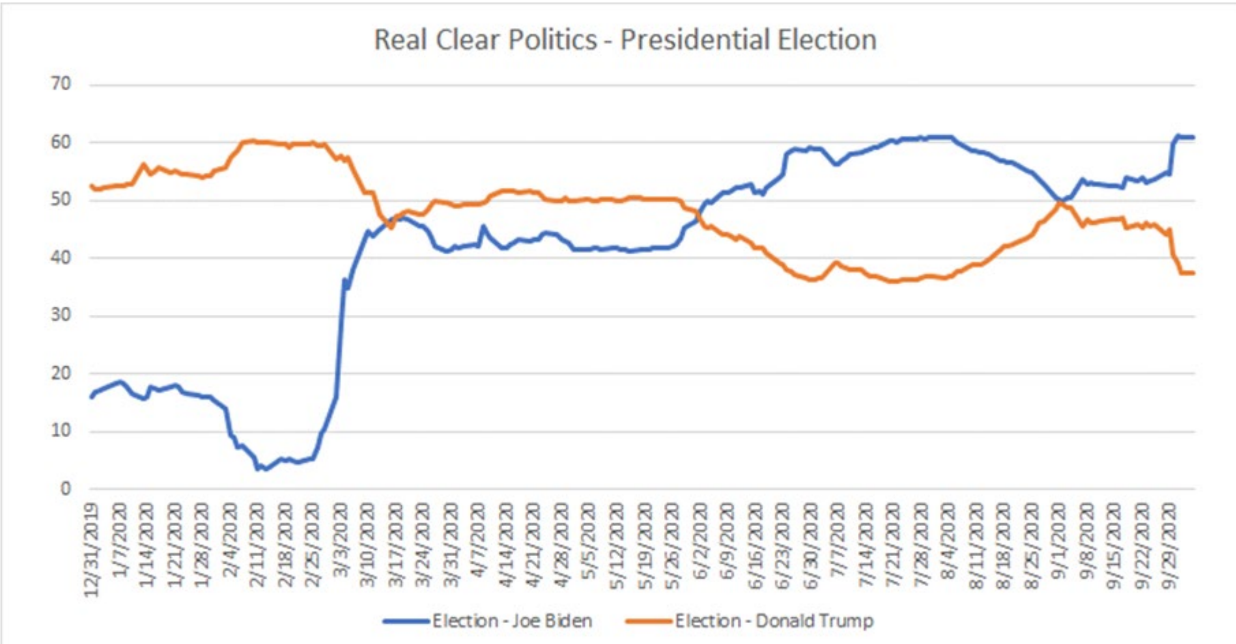
To that end, poll data does in fact currently suggest Biden will win the election. Data from FiveThirtyEight, which compiles and aggregates a variety of poll data from over 20 sources, has Biden leading Trump by a margin of 8% at October 5. While this gap has narrowed a bit over the last few weeks, it does help solidify the view that markets are forward looking and, as it relates to banks stocks, are anticipating a Biden victory.



Source: FJ Capital Management

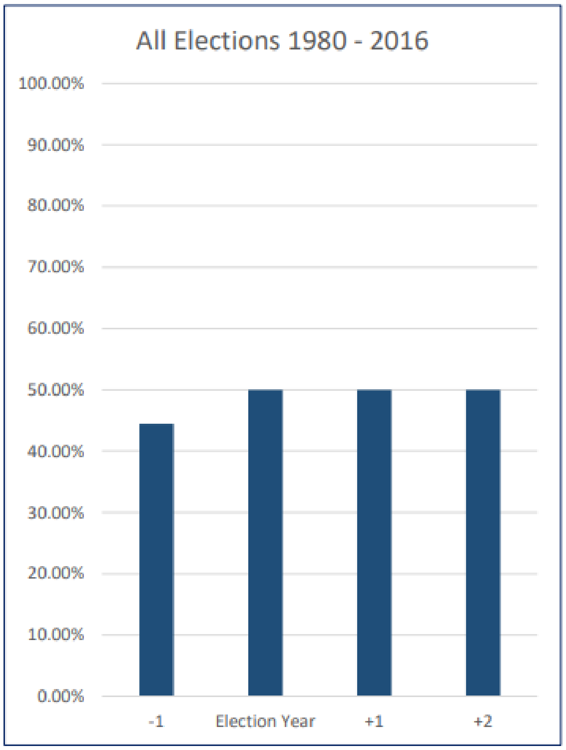
RealClear Politics indicates that Biden also has the lead over Trump at October 5, 2020 at 61% Biden / 38% Trump. Of course, polls are indicative of the General Election or the Popular Vote and, as we all know, it is the Electoral College that really matters. To that end, regardless of what the broader poll data shows, the election likely will be determined by a handful of "swing states." This may end up being similar to the 2016 election in which Hilary Clinton won the general election by nearly 3 million votes or a 2.1%

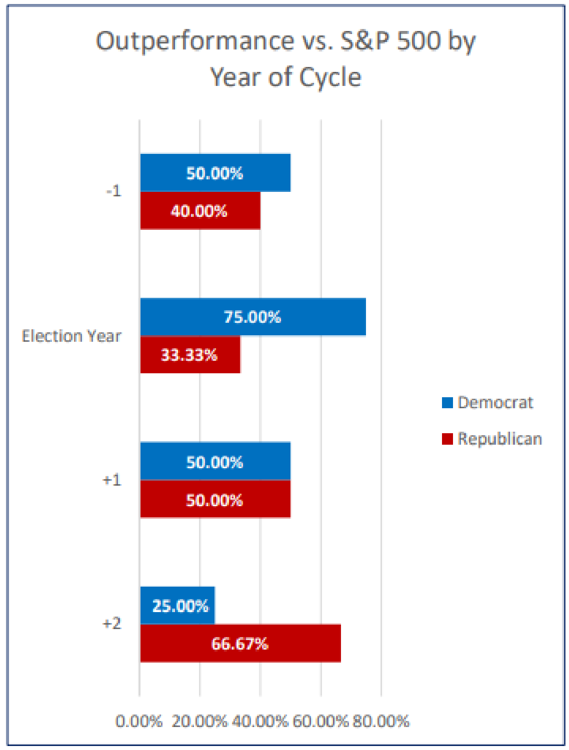
margin, but lost the electoral votes by a whopping 77 votes as Trump received 46 votes in three key swing states yet with under a 1% margin of victory in the general election (Michigan, Pennsylvania, and Wisconsin).



Source: FJ Capital Management

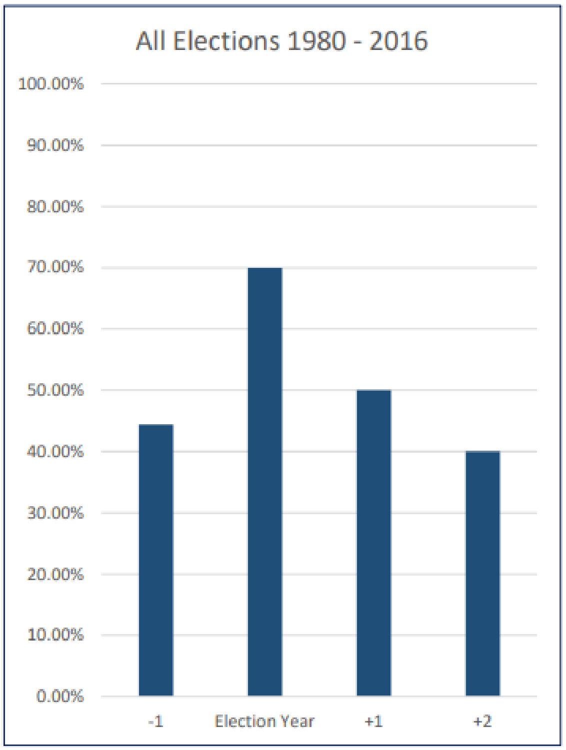
Raymond James Financial also put together some interesting statistics on the performance of financial stocks around elections. What is shown in the first chart is that in election years, financials outperform the S&P 500 about 50% of the time. Similarly, financials outperform the S&P 500 about 50% of the time in the following 1- and 2-years post-election. This second chart shows what percentage of the time financials outperform the S&P 500 by who wins the White House. This shows that when a Democrat wins the White House, financials outperform 75% of the time in an election year, followed by a 50% probability of outperformance in the subsequent year.

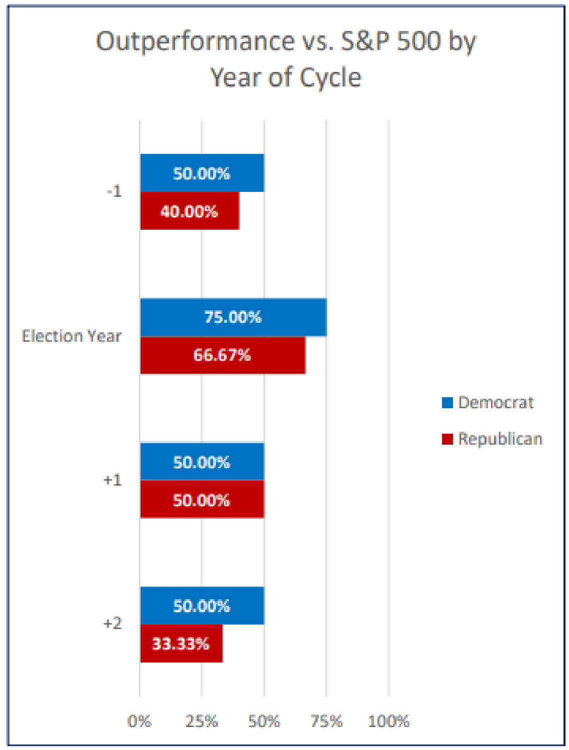




Source: FJ Capital Management

Below we show the same data set, only for banks specifically. The trends are somewhat similar as it shows bank stocks outperform 70% of the time in election years vs. the S&P 500, followed by 50% outperformance in the following year post election. Notably, bank stocks outperform the S&P 500 75% of the time in an election year when a Democrat wins, and 50% of the time in the following two years when a Democrat wins the White House.





Source: FJ Capital Management

Raymond James also analyzed how different type of financial stocks trade into an election, from election to inauguration, and then the first six moths after inaugration. The time period is from the last 10 election cycles. The conclusions are noteworthy in that under a Republican victory, all financial subsectors perform reasonably well, only to give back some of that performance after the first six months of taking office. Financial subsectors, meanwhile, trade more mixed from the election into inauguration when a Democrat wins, but regains ground after the first six months post inauguration.

Source: FJ Capital Management

Won't Biden Raise Corporate Taxes?

Yes, there is some risk that Biden could raise corporate taxes as his plan calls for partially reversing the cut in the federal corporate statutory tax rate. Specifically, the statutory corporate tax rate was reduced from 35% to 21% in 2017, and the Biden tax plan calls for a 50% reversal or retracement, to a 28% federal statutory corporate tax rate.

While that would not be helpful for banks, we estimate the negative, or downward, impact to EPS is around 8-9%, which is a manageable level. Importantly too, as mentioned above, given that valuations for bank stocks remain very underwhelming, we think it is possible that the risk of a corporate tax change is "priced into" bank valuations.

Won't Biden Introduce Harsh Regulations Against Banks?

While a Biden Administration could look to add reforms to the financial services industry, we believe some objectives may be more centered around <u>non-bank financial companies</u>, rather than banks.

- **Bankruptcy Reform.** Specifically, Biden has discussed bankruptcy reform, which could allow for the discharge of student debt at bankruptcy. Most banks, however, do not underwrite and retain student loan debt as most is provided for by the government, while private student debt is typically underwritten by non-bank financial institutions. Additionally, Biden has mentioned protecting individuals' automobiles during bankruptcy. While some banks do originate auto loan credit, most is done by captive financial institutions, some banks that are more "pure play" directly involved in auto lending, and other non-bank financial companies.
- **Interest Rate Caps on Credit Card Debt.** Further, some have suggested a Biden administration could pursue interest caps on credit card debt. While that too would be incremental regulation of the financial services industry, credit cards are usually a staple of money center banks, and not that of community banks.
- **Financial Transaction Tax**. Part of Biden's tax plan (see above) has focused on enacting a Financial Transaction Tax (FTT), which is popular from the standpoint of revenue-raising capacity, along with the populist nature of taxing "Wall Street." In turn, while this could have negative ramifications for large money center banks with significant trading operations, the impact would likely be felt more at the financial exchanges and other capital markets/trading-oriented businesses.
- **Fiduciary Standards**. Another potential agenda item for a Biden administration could be re-engaging in tightening Fiduciary Standards/Fiduciary Duty as it relates to retirement products. Both the Department of Labor (DOL) and the Securities and Exchange Commission (SEC) had separate rules, though due to state level actions and litigation, were reversed. This could find itself back on the agenda, though likely would be more of an issue for regional brokerages, e-Brokers, asset managers, and life insurers, and less of a risk for banks.

Negative Impact for Banks in a Biden Administration?

As mentioned above, a change in corporate tax rates would be the most immediate, and quantifiable negative for banks. That said, recent reports indicate the new administration will not rush to increase taxes and, therefore, this would probably be a 2022 event.

As discussed below, there is currently an opening at the Office of the Comptroller of the Currency (OCC) as Joseph Otting made an early departure. This is in turn could be one of the first areas that a Biden

Administration looks to fill. Prior to leaving, Otting released an updated CRA proposal, so a new head of the OCC at the direction of the Biden Administration could look to take this further.

While none of the below items are "set in stone" for a Biden agenda, these are the particulars most commonly being discussed in policy circles.

- **Restricting What Qualifies as Banking Activities.** OCC could narrow the definition of banking and equivalent activities under the National Bank Act to restrict permissible business by financial firms.
- **Forcing Divestitures.** The Federal Reserve has further unilateral authority to compel divestitures of subsidiaries if there is ample concern over risk to "financial safety, soundness, or stability" under the Bank Holding Company Act.
- **Restricting M&A/Limiting Financial Products.** Authority is also provided under Dodd-Frank for the Fed to restrict M&A, limit the offering of certain financial products, require the termination of activities, or order the divestment of operations of an entity with at least $50 billion in assets after a two-third majority FSOC vote.
- **Limiting the Size of Balance Sheets.** Regulators could also cap the assets of financial institutions to control their size and growth under the Federal Deposit Insurance Act. We saw a restriction on an asset cap as an enforcement action against Wells Fargo.
- **Restricting Deposit Insurance to Change Bank Behavior.** In effect, the FDIC could deny deposit insurance for firms to steer them away from activities deemed to pose significant risk.
- **Changes at the Board of Directors.** The enforcement action against Wells Fargo forced the change at the board of directors, a precedent that should be watched for potential future enforcement actions.

Is There Anything Positive for Banks Under a Biden Administration?

Banks undoubtedly were a primary beneficiary of the Trump Administration given the reduction in corporate taxes and the deregulatory agenda. That said, the majority of the Great Financial Crisis-Era Dodd-Frank Wall Street Reform and Consumer Protection Action ("Dodd-Frank") legislation remails largely in place, and thus we see little material new regulation on community banks. This point was mentioned specifically by President Barack Obama on July 21, 2020, at a virtual conference celebrating the 10-Year anniversary of Dodd-Frank in which he remarked, "… The core of Wall Street reform remains intact. Our reforms are still promoting financial stability. They are still blocking taxpayer bailouts. They are still protecting consumers and investors. And even with a pandemic that is added a historic level of joblessness and contraction, so far these reforms have helped prevent the crisis from spiraling into a financial crisis too."

While a Biden Administration certainly could present some negatives as mentioned above, we think it would be short sided to not consider potential positives under a new regime.

- **Mortgage Affordability**. Biden has suggested he would like more support for minority homeownership and more affordable housing. Given that banks already play a key role in this, particularly with the *Community Reinvestment Act (CRA),* it is possible this could end up being a net positive for banks. This could manifest itself through an expanded credit box and origination tailwinds for banks with significant or growing mortgage businesses.
- **Tax Policy That is Credit Positive for Individuals.** While higher corporate tax rates would be negative for bank earnings, there are elements of Biden's tax policy that would be credit positive for individuals. In particular, the Biden campaign has proposed (a) a first time home buyer tax credit of up to $15,000, (b) refundable tax credits for low-income renters (c) $8,000 child care

credit, (d) $5,000 tax credit for caregivers, and (e) expanding the earned income tax credit. These proposals would be credit positive mostly for low-to-moderate income individuals and families, as well as banks.

- **Growing Fiscal Policy to Support Small Businesses and Individuals**. As we have written about extensively, growing fiscal policy during *COVID-19* has been a clear lifeline for small businesses and individuals. Banks particularly have been a key conduit of the solution to deliver credit to those in need. Under a Biden Administration (especially if Congress moves to a Democratic majority), continued, and expanded fiscal support likely would be an early priority. To the extent this improves credit for both small businesses and the low-to-moderate end of the consumer/economic spectrum, this would be credit positive for banks.
- **"Wall Street" Banks May be More Impacted by "Main Street Banks."** While increased regulation could ultimately impact banks of all sizes, the "populist" view of increasing regulation seems to be more focused on "Wall Street" than "Main Street." To that end, if the Biden Administration wants to garner positive headlines, the more burdensome banking regulations likely will be targeted to mega-cap money center banks, super-regional large cap banks, and those with large investment banking/capital markets practices than the smaller community banks.
- **Regulation as a Catalyst for Bank M&A.** However, if we are wrong, and a Biden Administration does in fact look to re-regulate banks more strictly, this could serve as an incremental catalyst for bank M&A. Small banks, especially, would face a more difficult operating environment and thus the need for size, scale, and operating efficiency could become even more paramount. Given cost synergies are a key motivation for consolidation, a more challenging operating environment with higher costs could be just the thing to restart the structural bank consolidation trend.

Won't There Be Immediate Turnover at all the Regulatory Agencies?

We expect there could be turn over in some key agencies including Treasury, Office of the Comptroller of the Currency (OCC), Securities and Exchange Commission (SEC) and Consumer Federal Protection Bureau (CFPB). At the same time though, there will likely be other agencies that do not turnover as fast, or at all. We show below the agencies that could be subject to change. At this point, however, it is too early to speculate who would occupy each position and how that individual may or may not look to change their agency.

Agency	Treasury	OCC	CFPB	SEC	CFTC	NCUA	Fed Vice Chair for Supervision	Federal Reserve Chair	FDIC	DOL	HUD	FHA	FHFA
Official in Place	Steve Mnuchin	Vacant	Kathy Kraninger	Jay Clayton	Heath Tarbert	Rodney Hood	Randal Quarles	Jerome Powell	Jelena McWilliams	Eugene Scalia	Ben Carson	Brian Montgomery	Mark Calabria
Term Start	2/2017	N/A	12/2018	5/2017	6/2019	03/2019	10/2017	2/2018	6/2018	9/2019	3/2017	6/2018	4/2019
Term	N/A	5-Yr	No Fixed Term	5-Yr	5-Yr	6-Yr	4-Yr	4-Yr	5-Yr	No Fixed Term	No Fixed Term	No Fixed Term	5-Yr
Trump Appointee	Yes	N/A	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Early Changeover Risk	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No	Potentially	Potentially	Potentially	Potentially

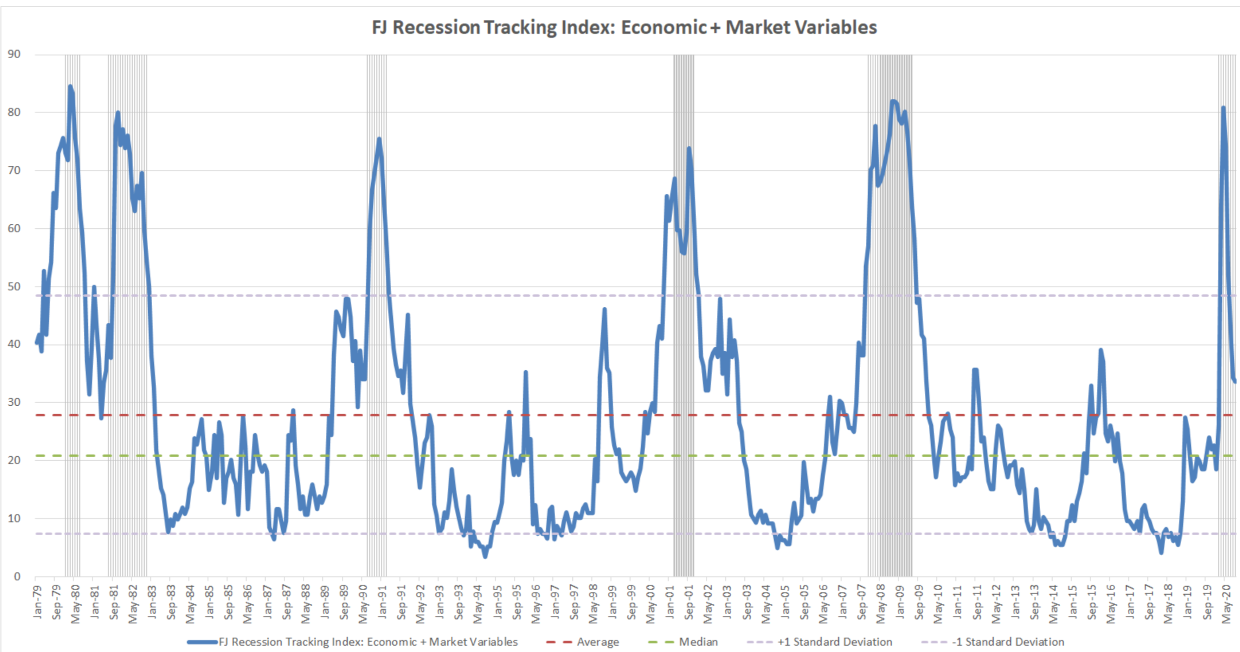
Source: FJ Capital Management

How is the Economy Recovering and Are We Seeing Any Green Shoots?

While there has no doubt been substantial fiscal and monetary stimulus pumped into the economy, we would be remiss not to mention that, so far, both seem to be extremely effective in launching the economic recovery despite the fact the pandemic still rages on and a vaccine for COVID-19 remains absent. Below, we highlight a few areas of the economy that are not only recovering but are exhibiting "V-shaped" like behavior to pre-pandemic levels. To that end, there is a growing contingency of economists that believe the recession is over and the economy has already reached the early stages of expansion.

Before exploring some specific sectors of the economy, we highlight FJ's proprietary "Recession Tracking Index" that is built upon 73 different economic and capital markets indicators. Historically, when the index (as represented by the blue line) has crossed above a +1 standard deviation level (represented by the purple line), this has been a very reliable and consistent indicator that a recession was on the forefront.

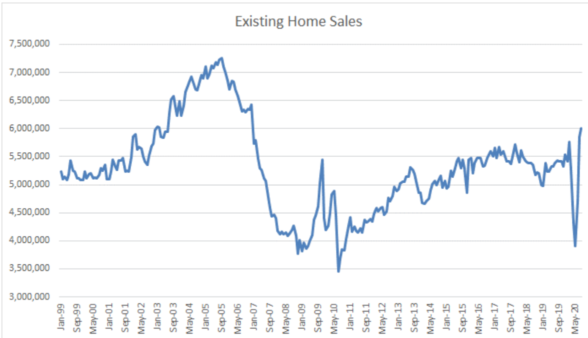
Similarly, when the index has fallen below +1 standard deviation level, this too has been a reliable and consistent indicator that the recession has subsided. The current reading of the index is 33.6, well below the +1 standard deviation level of 48.4, though still above the long-term average of 27.9 and the long-term median of 20.8. Accordingly, while the National Bureau of Economic Research (NBER) has not yet officially declared the recession finished, we believe that based on the data, it is reasonable to conclude that the recession has ended.

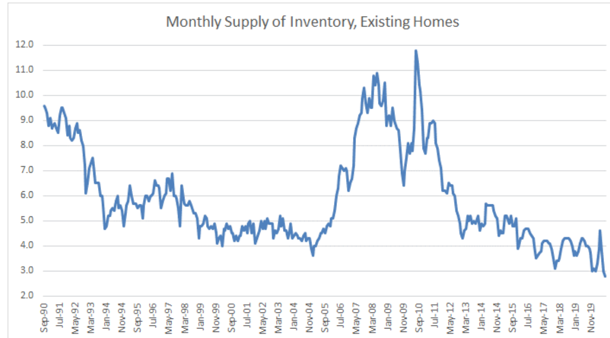


Housing

Perhaps the clearest evidence of an expansion in the economy sits within the housing market. Prior to the pandemic, housing was already "hot", as judged by the pace of both new and existing home sales, along with housing starts, combined with relatively low inventory and a booming demographic trend around the need for affordable/entry-level housing and millennials. While the pandemic put some "pause" to housing, the return of a low-interest-rate environment ensured that the housing market barely skipped a beat and is now back above pre-pandemic highs.

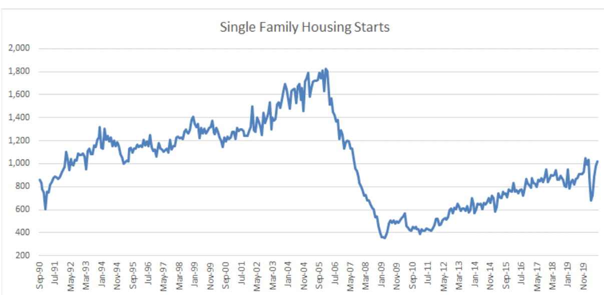
Existing home sales in August came in at a seasonally adjusted annualized rate of 6 million, up 10.5% year over year, and back to levels not seen since 2006. Meanwhile, inventory levels of existing homes for sale are at just 2.8 months, levels conducive to a strong sellers' market, keeping home prices rising particularly as the interest rate environment remains accommodative.

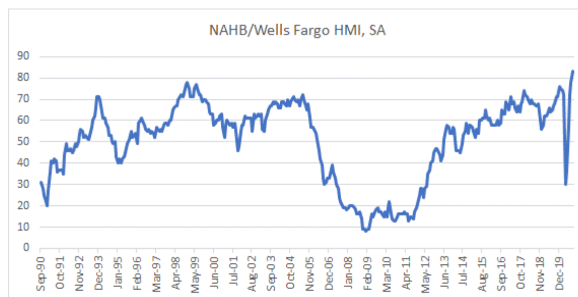




Source: FJ Capital Management

This dynamic in the existing home sales market is also creating boon-like conditions for homebuilders in the new home sales market. In August, new single-family housing starts rose 12.1% to over 1 million homes on a seasonally adjusted annual basis, back to levels last seen in 2007. With household formation growing by 1.6 million in 2019, above the long-term average of ~1.2 million, combined with years of subdued housing starts as homebuilders cautiously worked their way out of the last housing crisis and a dearth of existing homes for sale, it's no wonder the National Association of Home Builders Housing Market Index reached a level of 83 in September, a record high for the survey over its 35-year history.





Source: FJ Capital Management

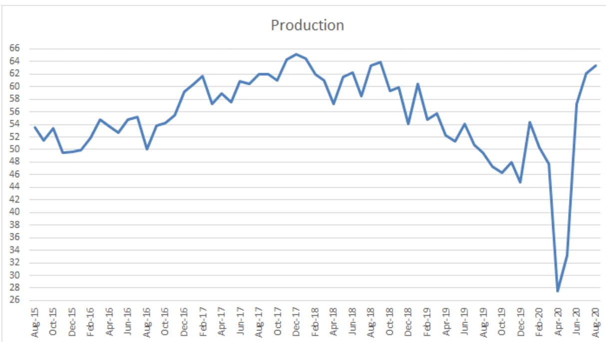
Although we will discuss the consumer in more detail below, we should also mention that according to the Bureau of Labor Statistics, real estate has amongst the highest employment multipliers at 8.8 for every one job created, so the return of a housing boom has direct positive consequences for the labor market and, ultimately, the consumer.

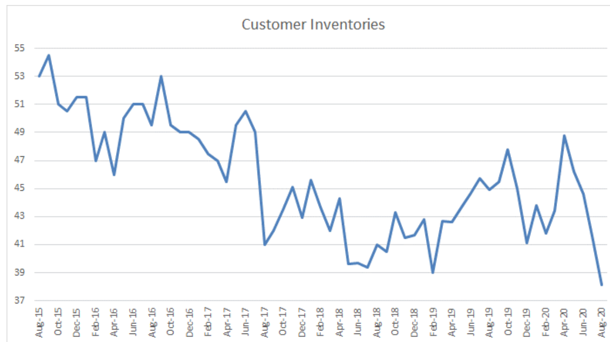
Manufacturing

Perhaps the most widely cited indicator of manufacturing in the United States is the Institute for Supply Management (ISM) Manufacturing Index. This index is one of the key components of the leading Indicators and historically has been followed closely as a gauge for the health of the manufacturing sector of the country. As a diffusion index, a reading above 50 indicates expansion, while a reading below 50 indicates contraction. The August reading of 56 is well above the pre-Pandemic February level of 50.1, as well as the highest reading since January 2019.

Below we show the headline index and some component indices of the ISM Manufacturing Index, including New Orders, Production, and Customer Inventories. With the pandemic leading to significant supply chain issues, employment challenges, and work stoppages, the resulting impact here is quite pronounced. The

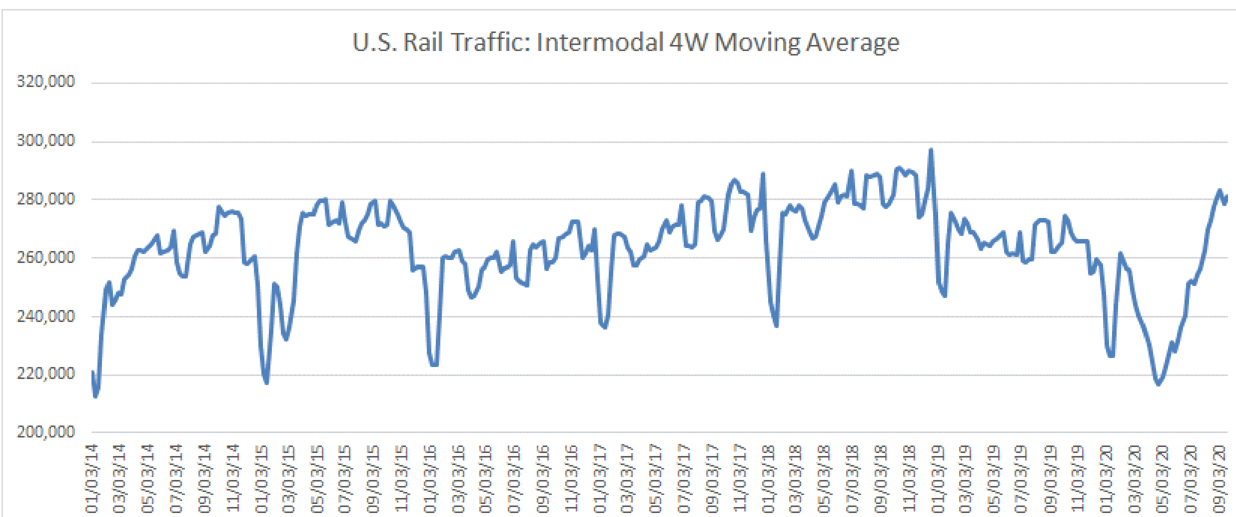
U.S. manufacturing complex is firing on all cylinders as customers are short on inventory, leading to a significant restocking as new orders surge and production comes back online.





Source: FJ Capital Management

While we could show countless examples of the manufacturing rebound, one of our preferred indicators is U.S Rail Traffic Shipments of intermodal units. As shown below, the four-week moving average is 281,000 units, levels not only well above the beginning of COVID-19, but back to levels from late 2018.



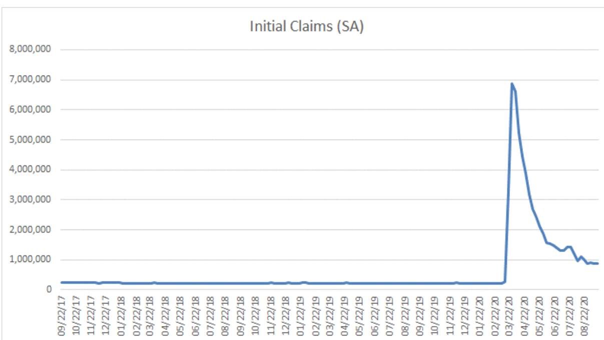
Source: FJ Capital Management

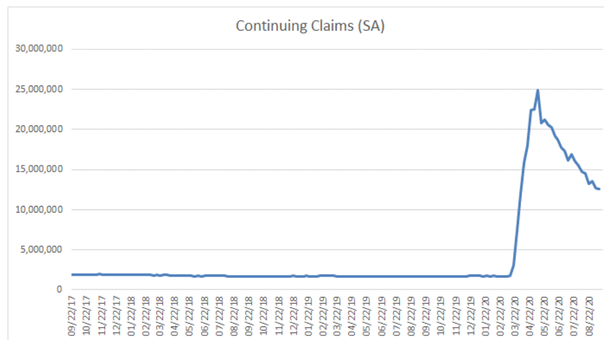
Like housing, manufacturing has a very high jobs multiplier. According to the Bureau of Labor Statistics, for every one manufacturing job created, there are roughly 7.4 additional jobs created. So, while manufacturing clearly has become a smaller part of the U.S. economy at just over 10% of total GDP, the impact of manufacturing on the broader labor market and resulting consumer should not be underestimated.

Consumer

Given that consumer spending makes up approximately two-thirds of GDP, true economic expansion would not be complete without a recovery in the consumer. Moreover, a rebound in the consumer starts with an improvement in the labor market. As we have mentioned before, key cyclical sectors such as housing and manufacturing are job multipliers of roughly 8x and 7x, respectively. While these sectors of the economy are not necessarily large on a standalone basis, they become increasingly important towards driving a labor recovery, which ultimately feeds into an improving backdrop for consumer spending.

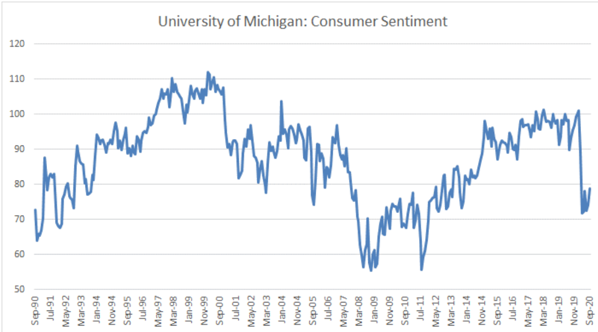
The best datapoints on the status of the labor market are initial and continuing jobless claims. Below we show both, and while they remain highly elevated compared to pre-pandemic levels, there is also validation that these metrics continue to show gradual improvement. Historically, labor markets can deteriorate extremely fast during a recession, but take many years to recover to pre-recessionary levels. We expect this economic expansion will follow a similar trend, but the data overall demonstrates that the labor market is healing, and this too will drive an improved consumer outlook.

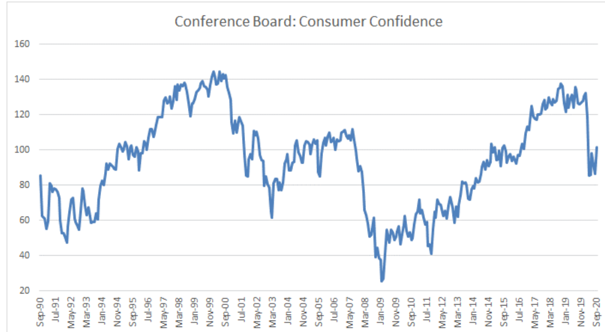




Source: FJ Capital Management

We also believe consumer confidence metrics are important to observe as these surveys reflect current and expected conditions, while also taking account of the labor market, income, and business conditions. Interestingly, consumer confidence surveys from the University of Michigan and the Conference Board have not *yet* shown a significant improvement in consumer confidence. We view it favorably that confidence levels remain elevated compared to the depths of the Great Financial Crisis, and the early economic recovery from that time. However, we believe it is also important that consumers have not *yet* become overly optimistic, and rather confidence still reflects one of uncertainty. We believe confidence is unlikely to experience a significant rebound until a COVID-19 vaccine is available and proven effective, at which time there is substantial room for a significant leg up in economic expansion. We would be more concerned if consumer confidence was extremely high sans a vaccine, which could lead to significant disappointment and downside, versus a consumer that appears to be on the sidelines, poised to re-enter as the housing market, labor market and manufacturing sector are all improving in the background.

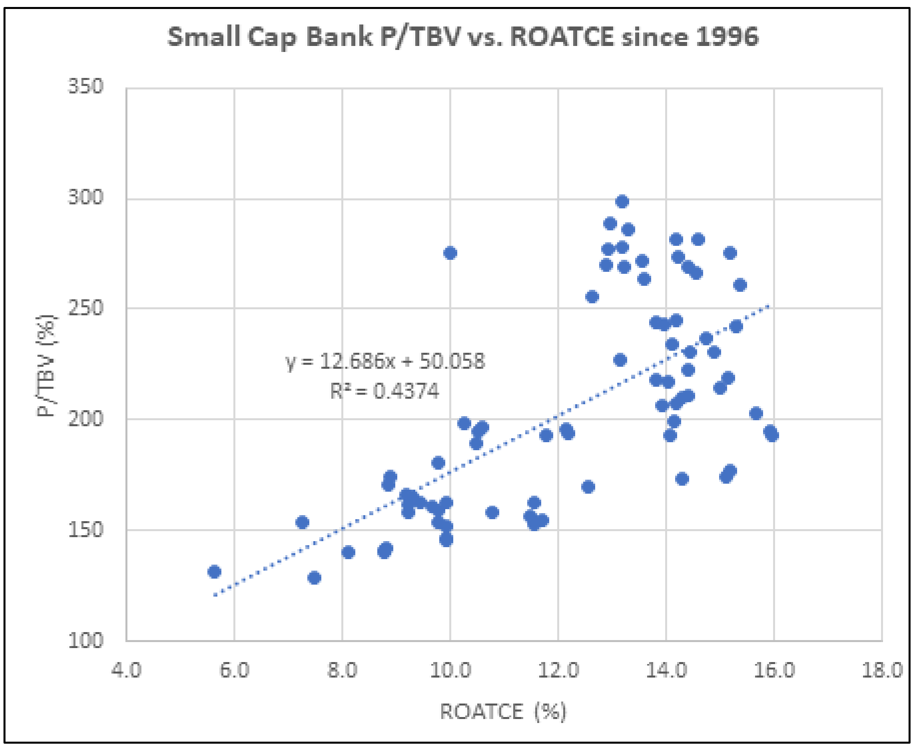




Source: FJ Capital Management

How Should Bank Stocks Be Valued?

The correct valuation for banks depends largely upon the Return on Average Tangible Common Equity (ROATCE). The chart below summarizes the relationship between ROATCE and Price-to-Tangible Book Value (P/TBV) for Small Cap banks based on a long-term average regression model that starts in 1996.

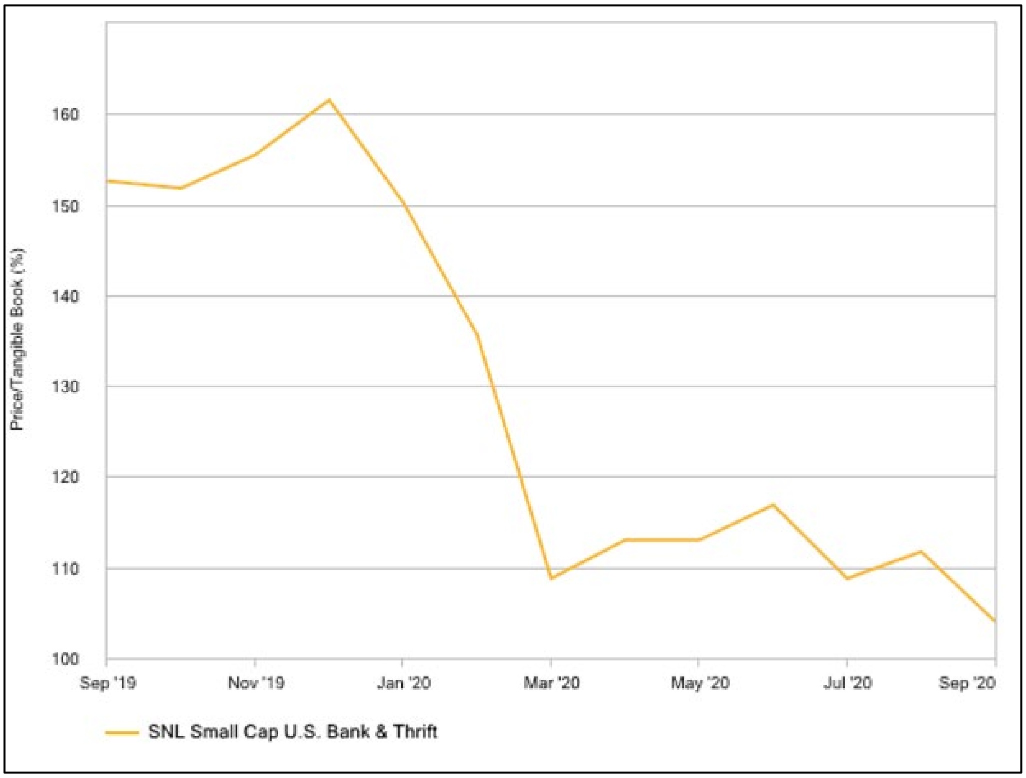


Source: FJ Capital Management

The average bank in FJ Capital Management's Financial Opportunity Fund today trades at 88% of TBV, with an expectation of producing average ROATCEs of 8% in 2021 and 11% in 2022. Yet, given the long-run average regression model for small-cap banks, the portfolio should trade at 151% of TBV based on the 8% 2021 ROATCE estimate, and 190% based on the 11% 2022 ROATCE estimate.

The average small-cap bank currently trades at 104% of TBV, with average ROATCE consensus estimates of 8.7% for 2021 and 9.5% for 2022. Application of the long-term average regression model suggests the appropriate P/TBV would be 160% based on the 8.7% 2021 ROATCE estimate, and 171% based on the 2022 ROATCE estimate of 9.5%.

Small cap banks have sold off from 160% in late 2019 to nearly TBV, despite consensus estimates that TBV will grow in 2021 and 2022, glaringly inconsistent with the long-run average approach to the space and positioning it for a major reversion to the long-term approach.



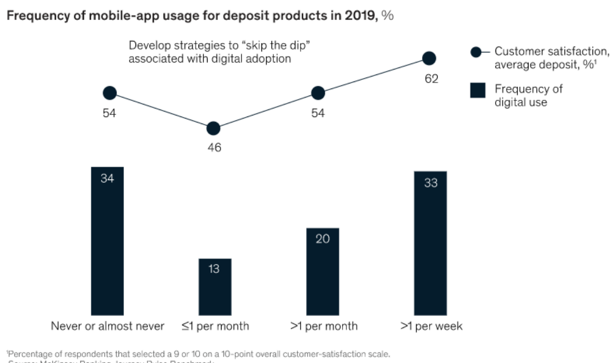
Source: S&P Global Market Intelligence

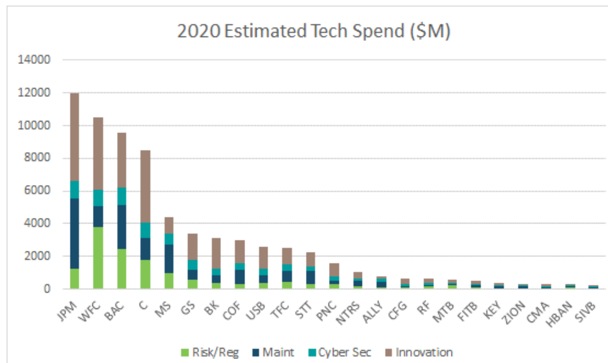
Technology, Banking, and Fintech - Friend or Foe?

The way that banks interact with customers, provide services, and achieve operating success is rapidly changing due to technology. Consumers push for simple, digital access to the bank, driving the need for investment in front-end technology. These trends are being accelerated by COVID-19. People want to be able to access and transfer money without walking into a branch, for example. Simultaneously, banks seek productivity improvements and lower costs, which drives investment in internal operating systems and data management. One might improve productivity by performing routine tasks with robots. A falling interest rate environment and pressure from new fintech entrants only intensifies the urgency to make those investments. Without scale, however, it can be difficult to budget for numerous technological investments. How can a community bank keep up with JPMorgan Chase, which could spend $12 billion this year on technology? Whether a consumer or commercial bank, to fend off competition and continuously improve profitability, it is imperative that banks have targeted technology strategies that support differentiated services, outsource non-differentiated capabilities, or participate in M&A to achieve scale. While strong digital offerings are necessary, a positive customer experience and employee interaction is a key differentiator, according to McKinsey.

Consumers demand nearly flawless, wide-ranging banking services through their phone or computer, which is why the largest banks with corresponding budgets have dominated consumer market share. The top 5 banks in the country account for over 40% of the total U.S. deposit share. Each of the following functions seems small on a standalone basis but can be expensive to integrate and maintain.

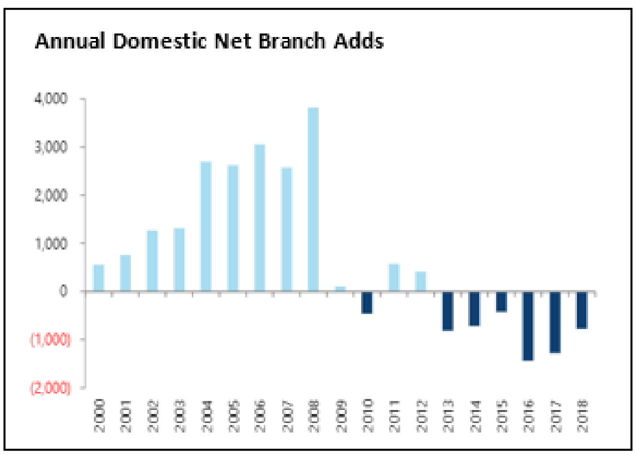
For example, people access bank accounts through the Internet or mobile, over 70% of the time with those numbers only increasing with COVID-19. Customers expect features like signing into one's account with their fingerprint, a smooth user experience, bill pay, digital account opening/closing, FICO scores, remote check deposits, and card management all through a cell phone app. As an individual accesses or opens an account online, numerous fraud checks are run in the background to confirm the user's identity: hardware familiarity, location, KYC, and cookies, for example. That information is stored in data centers, where the flow of money must be meticulously tracked. Those data centers are incessantly attacked by hackers trying to access accounts and must be protected by cyber security. Checking account customers can use payment apps like Venmo (owned by PayPal), Zelle (owned by a group of banks), and Cash App (owned by Square) to pay peers for brunch. When that customer has questions about the app, they can contact the bank through an omni-channel system supporting online chat, email, phones, or in person. Any remote contact is routed to the optimal customer support system, designed to limit hold times. Each of these banking necessities - a smooth user experience, omni-channel presence, infrastructure, and cyber security – are costly to build and maintain. When contemplating each of these aspects underlying what otherwise seems to be a simple consumer interaction, it becomes obvious why the largest banks dominate the consumer market share – they can afford the software developers to create and support the features the consumer demands.



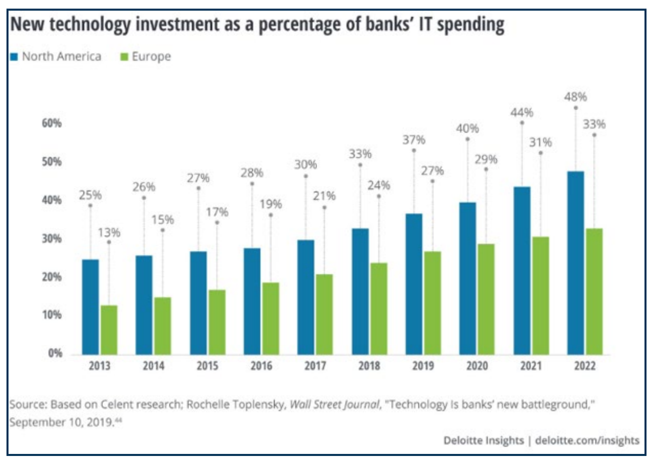


Data Source: Mckinsey, Barclays, FJ Capital Research

Due to the increasing prominence of digital banking, it is unsurprising that industry technology spend has continued to increase and help drive cost saves from reduced branch count. Prior to 2007, there was a tight correlation between a bank's branch network and deposit share. However, that correlation has broken down, according to McKinsey, as bank deposits in the top 25 banks have doubled over the past decade while their branch footprint shrank 15%. That pattern will likely accelerate post COVID as more users adopt digital access to their banks. Bank of America said 23% of its first-time digital users during April 2020 were seniors or boomers. Additionally, M&T noted that digital banking enrollment is up 40% from the 60 days prior to the pandemic. That said, a Jefferies survey found that ~75% of customers visited their banking branch at least once a month prior to COVID. Therefore, despite the increasing importance of digital access, an effective branch footprint is still critical. To reduce their real estate footprint and employee base, while improving service, many banks are focusing on a more technology-forward banking branch. Square footage per branch has decreased, as has the number of employees per branch, and many of the day-to-day interactions can be performed at an ATM. Capital One was opening Capital One Cafés emphasizing "digital lifestyle coaches", free WIFI and coffee, and video teller ATMs. McKinsey highlights that a smooth omni-channel experience across branches and digital is key for high customer satisfaction, which directly correlates with deposit growth. They point out how banks with top quartile customer satisfaction scores in their surveys grew deposits at 5.9% on average from 2014-2017, while those with bottom quartile scores grew only 3.2%. Bank CEOs understand that importance. A survey of bank executives by Cornerstone Advisors showed the most important aspect of their technology strategy is improving customer experience. Digital account opening, payments, and lending and credit were the leading functionalities executives wanted to invest in to drive customer experience. The retail customer is focused on seamless interaction across channels and will reward their bank with loyalty and asset growth.



Data Source: Jefferies, FDIC



Data Source: Deloitte

Q. How important are following functional/product areas to your fintech partnership, collaboration and/or investment plans for 2019 ?

	Very important	Somewhat important	Not very important	Not at all important
Digital account opening	70%	26%	2%	2%
Payments	53%	37%	5%	5%
Lending and credit	48%	45%	7%	0%
Fraud/risk management	35%	51%	11%	4%
New banking products	34%	50%	14%	2%
Personal financial management	20%	51%	21%	8%
Investment management	16%	36%	34%	14%
Insurance	9%	12%	31%	48%
International remittances	3%	10%	29%	57%

Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

In contrast to having a digit first requirement, a commercial client tends to have greater emphasis on relationship, industry and local knowledge, confidence in closing the transaction, and pricing when borrowing from a bank. Therefore, this is where the small and mid-size community bank has an advantage. They serve the small business with a smaller branch footprint and personalized service. Small businesses care about the human connection with their bankers and emphasize the importance of understanding their business. While JD Power's small business banking survey across 8,287 businesses shows that mobile banking is key for higher satisfaction levels, they note that technology will only help address the gap between limited human resources and the desire for human interaction. The survey further showed that only 32% feel their bank understands their business. The banks that achieved the higher satisfaction ratings provided human account managers. Small businesses want a banker who knows the market and can bring suggestions to the table. The challenge is simply managing close relationships with limited account managers. JD Power's VP of Banking Intelligence highlights how technology can help with the "bandwidth issue". While 61% of small businesses use their bank's mobile app and that technology is directly linked to customer contentment, local banking still relies on human relationships. The most successful community banks emphasize those relationships and can take share from the largest players in the localities where they specialize.

Regardless of whether a bank focuses on retail or commercial customers, smooth internal processing, utilizing data, managing treasury, efficient loan, and deposit underwriting, and maximizing productivity of employees are key tenants of a successful business. Technologies to automate or enable these processes are becoming more prevalent and investing in this infrastructure is becoming increasingly necessary to improve profitability. Despite the need for new tools, many firms are using core systems with decades-old technology. Deploying new functionality across the legacy cores delays the ability to innovate. McKinsey highlights how deploying new complex functionality into a next-gen core can take 10-30 FTE days, down from 200-400 FTE days in a legacy system. The difficulty is that changing a core system has been likened to open heart surgery. Core providers like Fidelity National Information Services Inc (FIS), Fiserv (FISV), and Jack Henry (JKHY) have been modularizing their new cloud offerings so they can run in parallel with legacy systems to help with the transition. Deloitte highlights how core system modernization is not a new goal but relying on a patchwork of archaic systems is a significant risk as they undergo digital transformation efforts. Banks will be forced to invest in new systems or merge with others that can provide newer technology.

Some of the newest technologies that banks are beginning to invest in to improve operating results include robot process automation, artificial intelligence, chatbots, machine learning, blockchain, real-time-payments, cybersecurity, and others. These technologies become more necessary in a low-rate higher credit risk environment, when cutting costs are a key lever to drive earnings. We discuss each briefly. Robot process automation (RPA), automates back-end tasks such as data entry or basic customer service communication. Artificial intelligence is related and can be used for customer conversation, middle office fraud detection, and back office credit underwriting. Business Insider's AI in banking report could account for $447 billion of cost cuts across the industry. Customers expect fast customer service at any time of the day. Banks are addressing that expectation with chatbots that can help users ask and answer questions. For example, Bank of America has promoted its bot, Erica (derived from the name Bank of Am*Erica*), where you can ask for information like your FICO score, balance, and spending summary. Blockchain is being explored as a method to transfer money or securities around the world, shared distributed ledger for trade finance, decentralized know your customer (KYC) and anti-money laundering (AML) compliance checks. Little regulation, the reliance on heavy computing power, little collaboration across the industry, and slow transaction speeds are limitations to widespread use of blockchain. More generally, payment speeds are increasing between people and businesses as the world digitizes and new real-time-payment networks develop.

The U.S. has the RTP Network, Zelle, and the Fed is expected to launch a new network called FedNow in 2023 or 2024. The Fed is creating its own system to make sure that all institutions, including the smallest banks, can access the infrastructure. In addition, one can use Visa or Mastercard for real-time payments between accounts. These methods allow real-time funds availability and improved liquidity management. Each jurisdiction around the world has different real-time payment networks, which reduces cross-border ubiquity. Lastly, cybersecurity is a top concern for bank executives after numerous high-profile data breaches across industries. Verizon said that breaches involving web applications and unsecured cloud storage doubled in 2019, and Symantec said the number of threats has increased with COVID. A Deloitte survey highlights how the typical financial institution pays $3,000 per employee for cybersecurity and that number has been rising. IBM said the financial sector was the target of 19% of all cybersecurity attacks. Banks must continue to invest in their technological infrastructure to avoid cyber threats, improve operational efficiency, and remain relevant amongst their competitors, banks or not.

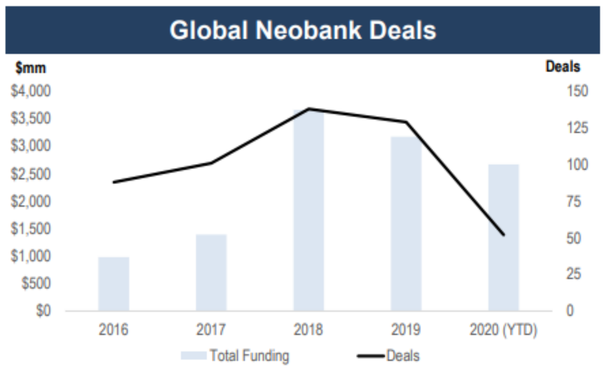
USES OF AI IN BANKING				
Channel	**Front office**		**Middle office**	**Back office**
Size of cost savings opportunity	$199B		$217B	$31B
Key use cases (More mature)	Conversational banking		Anti-fraud & risk	Credit underwriting
Key use cases (Less mature)	AI biometrics technology	Personalized insights	Anti-money laundering/Know-your-customer	Smart contracts infrastructure

Source: Business Insider Intelligence, Autonomous NEXT, 2019

For those banks that have not invested and are burdened by archaic technology and customer interactions, fintech's have entered the space to take advantage of competitive niches. Numerous fintech companies have surfaced over the years to help improve the user experience. According to KPMG International Limited (KPMG), while investment in fintech startups has decreased from the rapid pace of 2018, funding continues to flow into the space. According to Statista, there are ~5,800 fintech startups in the U.S. Many of those firms focus on those very technologies where banks are investing such as cybersecurity, payments, and cryptocurrency. Neobanks, a hybrid between banking and fintech, have a number of advantages such as being 100% digital on newer operating systems, lower customer acquisition costs (typically $1 to $38 versus $200 for traditional banks), API integration, lower fees in some cases, and a focus on branding and feel. While fintechs surely impact the banking sector, catalyze investment in technology, and attract customers to their platforms, they will not fully replace banks for the following reasons. Fintechs typically focus on consumers versus commercial borrowers, have a narrow range of services, have poorer cost of funding, no branches, lower tech budgets, have not been tested in a downturn, do not want to be regulated like banks, are usually not profitable, and therefore often partner with banks. The total value of the six latest neobanks' deals exceeded $26 billon, so they have a growing presence. Over 80% of fintechs focus on consumer-centric solutions, according to PricewaterhouseCoopers (PWC). For reasons discussed earlier, consumer banking is dominated by the largest U.S. banks which can compete with these newer fintechs. Those banks spend tens of billions of dollars on technology to provide the services that consumers want. Fintechs will continue to attract users with sleek apps and marketing, but the largest banks will likely stay relevant with substantial tech budgets.

On the other hand, smaller commercial banks will grow by focusing on the relationship and human interaction, which cannot be replaced by technology. One shortfall of many fintech companies are that they are funded with wholesale sources or private equity money. Those sources of capital will likely be more stressed in substantial dislocations. Similarly, many fintechs which make algorithmic loans don't know how their portfolio will perform in a challenging economic environment. Therefore, it is hard to predict how many of these fintechs will perform through the cycle. For those startups that seek lower costs of funding than from the wholesale channel, many partner with banks that ultimately hold the deposits. Chime is a rapidly growing fintech firm with over 8 million customers and partners with banks, for instance. The company has a smooth interface and is very consumer friendly with no fees. They send their deposits to The Bancorp Bank and Stride Bank.

Google just announced its intent to offer checking accounts, but those deposits will sit with Citi or a number of smaller banks. Apple created its new credit card, but that is managed by Goldman Sachs. Fintechs partner with banks because they do not want the burden of bank regulation. If they want to offer deposit accounts directly, they have to apply for a national bank charter, state charter, ILC, thrift or savings, or trust charter. With those, the firm will come under the banking regulatory umbrella. The FDIC is modernizing regulation so that deposits channeled to a bank through a fintech can receive better treatment than typical brokered deposits, which will improve the relationship between those partners. Fintechs are disrupting the financial services industry and banks that fail to adapt will lose business; but the large budgets of the nation's largest banks, the regulatory and economic forces that cause fintechs to partner with banks, and the importance of relationships in commercial banking all suggest that the banking industry will continue to grow alongside the fintechs.



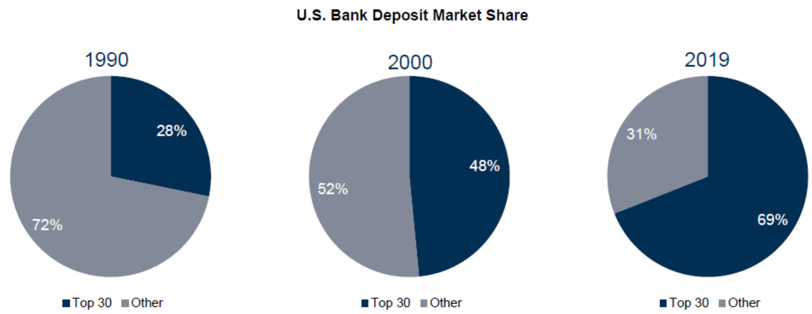
Source: *KBW A New Landscape for Banking: Neobanking*

Technology is driving financial institutions to focus on their competitive advantages while investing to remain relevant. The largest banks have won the consumer with their tech-forward offerings while the smaller community banks rely on relationships and local knowledge to grow with small businesses. As the community banks don't have the financial flexibility or focus to keep up with the technological offering of the large caps or fintechs, they must outsource their solutions to firms like FIS, Jack Henry, and Fiserv and will, by definition, be less differentiated in those areas. As customer demands for technology change the banking landscape, there will be those who are left underinvested. Those that have underinvested should consolidate with larger players to achieve technological synergies. Indeed, many of the recent acquisitions have explicitly focused on creating a larger technology budget and merging the "best of" systems. **As the pace of change continues to accelerate, there willl be more banking M&A focused on improving customer satisfaction by providing the best employees and relationships while simultaneously investing in technology.**

Competitive Advantages of Community Banks vs. Large Banks?

While many customers, from sophisticated corporate clients to a child opening their first checking account, choose community banks for a variety of reasons, service and community reinvestment remain at the top of the list.

To understand the service-oriented value-add provided by community banks, it is important to understand the banking market today and how it has changed over the past 20 years. In 1990, the largest 30 banks in the country only controlled 28% deposit market share. Today, nearly 70% of the market is controlled by these banks. The large banks have gotten larger, slower, and less focused on providing service to customers. The large banks control so much of the market, that they have little incentive to covet current and prospective customers. For example, a client who wishes to purchase a home but needs to close in three weeks would find it nearly impossible to get a quick turnaround at one of the largest banks, but can find certainty and speed of execution with a community bank. Clients are willing to pay for that service, which is one driver of stronger net interest margins at community banks. That mortgage client in the example would easily pay a modestly higher interest rate for certainty of execution with a community bank, a reality corroborated in repeated discussions with bankers across the country.



Source: FJ Capital Management, Company filings

Community banks also reinvest dollars in their community, which is a key differentiator compared to the larger banks. A dollar deposited in a large bank may be lent out across the country, but that dollar is reinvested into the local community with a community bank. These banks provided a significant 88% of farmland loans nationwide, 60% of the small business CRE loans, and 32% of small business commercial loans. Despite having a minority market share, community banks consistently pull more than their own weight and are the lifeblood of their local economies.

Asset Category	CRE* (% total Small Bus CRE)	C&I (% total Small Bus C&I)	Farmland (% total Small Bus Farmland)	Agri Prod Loans (% total Small Bus Ag Prod)
Top Four Banks ($1 trillion ~ $2.5 trillion)	8	24	1	4
Large Banks ($50 billion ~ $500 billion)	14	30	3	3
Regional Banks ($10 billion ~ $50 billion)	19	14	7	7
Community Banks (<$10 billion)	60	32	88	86

Source: FJ Capital Management, Company filings

How Do Community Banks and FJ Relate to Environmental, Social, and Governance (ESG)?

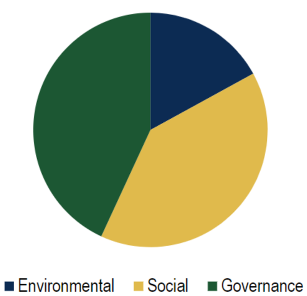
Community Banks

On August 10, 2020, Bank of America published its own "ESGMeter" for U.S financial companies in which they analyzed and ranked 112 U.S. financial stocks in its research coverage universe. To use Bank of America's own words, "Financials were in the proverbial hot seat from a governance standpoint in 2007, and poor governance, misaligned compensation incentives and lack of diversity of thought leadership may have contributed. But we find much has changed since 2007. The financial sector scored well as a whole… In aggregate, governance factors were the main drivers of ESGMeter within financials, specifically board profile, ownership and control, and business ethics categories."

To that end, below we show the results for Bank of America's ESGMeter, specifically as it relates to banks. As mentioned above, governance factors make up a large portion of the total weighting at around 45%, with social accounting for roughly a one-third weighting.

Chart 1: Governance factors are most important for Banks vs. Environmental and Social factors

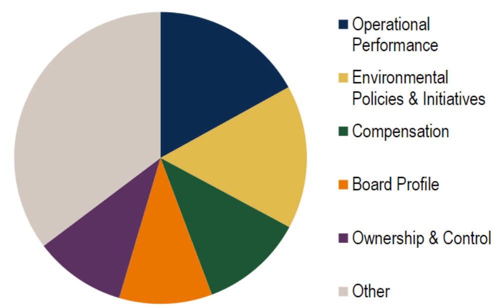
ESGMeter weightings for the Banks industry group



Source: BofA Global research

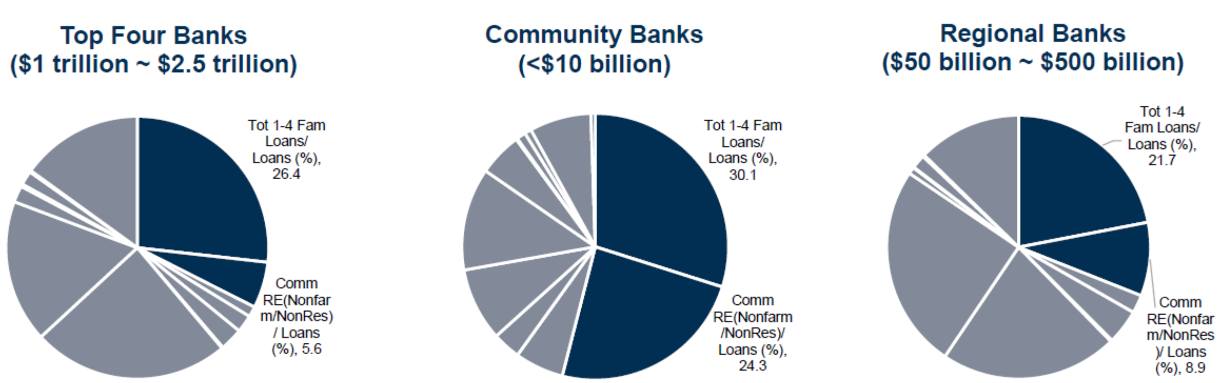
Note: Weightings reflect quantitative results and fundamental analyst inputs. See ESGMeter calculation section for detailed methodology.

Chart 2: Top 5 ESGMeter subcategory weightings for Banks



Source: BofA Global Research, ICE Data Services

- Community banks are key providers of capital to local residential housing and commercial real estate. Importantly, community banks provide a significantly larger share of their balance sheets to these key areas (~55%) compared to the top four banks with assets greater than $1 trillion (~30%) and regional banks with greater than $50 billion in assets (~30%).



- Community banks are the key player in small balance lending, which is primarily done on a more local level. For loans under $1 million, community banks maintain the largest share of lending activity across commercial real estate, commercial and industrial, and agricultural loans.

Asset Category	CRE* (% total Small Bus CRE)	C&I (% total Small Bus C&I)	Farmland (% total Small Bus Farmland)	Agri Prod Loans (% total Small Bus Ag Prod)
Top Four Banks ($1 trillion ~ $2.5 trillion)	8	24	1	4
Large Banks ($50 billion ~ $500 billion)	14	30	3	3
Regional Banks ($10 billion ~ $50 billion)	19	14	7	7
Community Banks (<$10 billion)	60	32	88	86

Source: FJ Capital Management

FJ Capital meets with company management groups regularly to discuss financial performance and better understand ESG issues that may affect them. Given that banks are highly regulated institutions, ESG policies can often be consistent with maintaining compliance with those regulations, such as compliance with The Community Reinvestment Act and anti-money-laundering laws. Banks have made significant investments in risk management employees, consultants, and systems – particularly over the last decade – to achieve a process with strong control and reporting functions. The lack of strong control and reporting functions would be a large red flag for FJ in its underwriting process, as this could signal a high risk for unfavorable actions by bank regulators which could temporarily prohibit a bank from engaging in important business activities such as lending, taking new deposits, acquiring other banks, paying dividends or repurchasing stock.

FJ prides itself on being active (but not activists) with its portfolio companies. For instance, we have been directors on the boards of nearly 10 portfolio companies, and execution of these fiduciary duties encompasses compensation oversight as a major responsibility. Whether we have a board seat or not, FJ actively monitors insider compensation, stock ownership and related business dealings, and continually evaluate the robustness of risk management and internal controls for both financial and non-financial concerns. We communicate frequently with the management teams of our portfolio companies, via telephone calls and conferences (now virtual) to ask questions and provide feedback. As such, we are in the process of making significant financial disclosure recommendations for the loan portfolios of the banks in which we are invested. We conduct due diligence to identify practices that could result in compliance risk to banks and seek to counsel them about this risk and avoid those that appear to have potentially elevated risks.

Environmental

- Environmental issues such as climate change are not presently a large focus for FJ or our investment strategy. However, we do consider banks in certain geographic locations, i.e. coastal real estate markets or sub-markets at potential risk for flooding from climate change in the near term. We would investigate these factors and determine if the risk is substantial.
- Another area we consider as part of the investment process are banks with specific, commodity-price related risk – i.e. the price of oil and related exposures. Moreover, we look to minimize exposure to banks with energy loan portfolios that are more dependent upon the commodity price as a key input into the credit risk of the borrower, and ultimate repayment.

- However, there are many community banks, for instance, that participate in clean energy lending - some banks provide financing for the installation of home solar panels, while others provide financing for larger C&I type solar infrastructure projects. While it is difficult to build an investment thesis solely around these types of lending products, we view them more favorably when considering investments.

Social

- FJ invests primarily in community banks, and bank business models incorporate some important social considerations. This is true because community banks provide financial services to individuals and small businesses in their local communities and regulations require that they do so on a non-discriminatory basis. Banks are, in fact, tested by regulators to ensure they serve the banking needs of underserved communities. Many community banks focus on specific social groups in their markets (for instance, Asian-American, Native American or immigrants) that may not otherwise have access to financial services. Larger banks often focus on large customers and neglect smaller customers, while community banks make such under-served markets their priority and provide customized, high-touch banking solutions to small businesses. Given that banks typically lever their equity at a roughly 10:1 ratio, a dollar invested in community bank equity supports roughly 10x that amount in loans to the bank's community.
- More than a handful of banks in our portfolio engage in tax credit financing for low-income housing and economic development and revitalization strategies for low income markets.
- Under the Community Reinvestment Act, most banks are subject to a service review that scrutinizes the bank's product offerings geared toward low-to-moderate income consumers (LMI), minority businesses and businesses located within LMI communities. The "service test" also examines the bank's involvement with community-based organizations serving LMI populations and small disadvantaged businesses.
- Another example of community bank support is their significant embracement and high utilization of the *Payroll Protection Program (PPP)* put into place by the U.S. government's Small Business Administration (SBA) as a primary fiscal policy tool used to support small businesses during the Coronavirus pandemic. Larger banks either did not participate in PPP entirely or focused their PPP lending efforts on the larger parts of their eligible client base. This highlights the community bank role in servicing the small business customer.

Governance

- FJ considers governance factors as part of its investment process. Key governance factors considered include insider ownership requirements, management compensation and equity incentive plans, insider conflicts of interests, independence of board directors, gender diversity at the management and board level, and board stock ownership.
- As mentioned above, corporate governance has an outsized weighting and impact upon bank ESG factors. Specifically, as part of the investment analysis, we closely review annual proxies for management teams, and particular Board of Directors. The Investment Team reviews the compensation and stock ownership of each individual manager and director to better understand alignment with shareholders. We strongly believe management teams and directors that are large shareholders themselves ultimately will do the right thing for other shareholders as interests are more aligned. FJ will vote AGAINST board members, and other governance issues it believes are not in the best interest of shareholders.
- FJ utilizes ISS to obtain additional input for proxy voting and to monitor non-financial risks such as certain lending categories.

FJ Capital Management

FJ recognizes and respects the importance of environment, social, and governance (ESG) factors, particularly as we believe these factors will provide long-term benefits to our investors, partners, and employees. All Investment Team members are expected to incorporate ESG into their analysis and decision-making process. FJ Capital Management also adheres to and follows many ESG policies and efforts.

Environment	Social	Governance
➢ To promote a cleaner environment and reduce waste, we use water coolers, provide recycling containers to employees, recycle ink cartridges, and use green cleaning supplies and kitchen products.	➢ We are committed to enhancing and promoting ethnic, racial, and gender diversity across our company	➢ We operate under a Code of Ethics, which each employee is required to recertify annually. The Code of Ethics is a comprehensive document encompassing Fiduciary Duty, Client Opportunities, Insider Trading, Personal Trading and Transactions for FJ Funds/Managed Accounts, Gifts, Entertainment, and Contributions, Outside Business Activities, and Confidentiality.
➢ To reduce energy usage, we use Energy Start certified desktops, monitors, and printers. We also utilize motion sensor lighting, along with non-peak hour reduction in heating and cooling.	➢ FJ promotes continuous learning and education programs, including language classes and a continuous internship program with local universities.	➢ FJ maintains a robust set of supervisory procedures in its Compliance Manual, including 26 individual topics ranging from Conflicts of Interest, Investor Offerings and Suitability, to Email Retention and Review Policy, Cybersecurity, and Trading and Brokerage.
➢ FJ's McLean, Virginia, headquarters is conveniently located near mass transportation.	➢ Senior members of management support and sponsor numerous charitable causes and programs.	➢ FJ Capital Management LLC is 100% employee owned.
	➢ FJ sponsors children's sporting events and teams.	➢ Employees are investors in one or more FJ funds, aligning the interests of our employees with our valued clients. ➢
	➢ FJ provides 100% matching to employee 401(k) programs.	➢ FJ employees and principals have approximately $26 million invested in one or more FJ funds.
	➢ All FJ employees have the option to participate in FJ-sponsored health insurance, of which FJ provides a significant subsidy to employees.	➢ We are a Registered Investment Advisor with the Securities and Exchange Commission.
	➢ FJ is an Equal Opportunity Employer.	➢ We conduct annual Compliance meetings requiring 100% employee attendance and participation.
		➢ We are committed to significant disclosure and transparency for our limited partners.

Growth vs. Value – When Will Leadership Change?

Below, we discuss one of the more prevalent and contentious debates around allocations within equities, notably growth versus value. Given that financial services, and especially banks, are one of the key sectors within the value universe, this is a key topic and one we find ourselves addressing often with current and prospective investors.

While FJ has been and continues to be a long-time proponent of fundamentals in combination with valuation, which, ultimately, are the long-term components of stock performance, it would be foolish to ignore the fact that there are a whole host of other factors that determine sector allocation for investors. In fact, we have noticed an increasingly larger focus on "factor" analysis for all types of institutional investors that is designed to invest in sectors and individual stocks based upon key "macro" inputs such as momentum, quality, interest rates, valuation, cyclicality, etc. We find there has been more broad-based interest in owning "baskets" of stocks that fit certain factors and characteristics, and arguably less focus on key business fundamentals and management.

The last few years especially has seen a notable shift to owning more growth-oriented equities (notably technology) and less value-oriented equities (notably financial services and banks). Historically, growth has been a favored equity class to own late cycle as investors are wary of owning cyclical value stocks that could have their earnings materially deteriorate in an economic downturn, and are more willing to pay up on valuation to own companies that can still have earnings growth in a challenging economic period or are believed to be secular earnings growth stories.

To that end though, rotation into value has typically been associated with early cycle economic recoveries, as investors rush into to buy "beaten down" stocks that may have outsized earnings growth potential over the near-term, which are trading at relatively attractive valuations. Economic recoveries are also usually associated with steadily rising inflation and interest rates that also benefit the desire to own value stocks.

As discussed in more detail below, we believe the shift from growth to value is beginning. These changes normally do not happen overnight and can take many months or even quarters to play out. However, we are growing increasingly optimistic that as a COVID-19 vaccine is getting closer to becoming reality, combined with increased realization the economy is at or is close to working itself into an early-stage recovery, value stocks will come back into favor, with banks stocks in particular leading the charge.

Market Concentration Around FAAMG and All-In on Tech

Perhaps no discussion on growth versus value would be complete without identifying a significant market concentration risk/issue that exists with the "FAMMG" stocks, or Facebook, Apple, Amazon, Microsoft, and Alphabet (or GOOGL). As shown below, these five stocks account for nearly 25% of the market weight of the S&P 500 Index. This is an all-time high for overall market concentration and is a good place to start when examining the current set-up between growth and value stocks.

Exhibit 24: Largest companies in Tech today, Tech 1990s and Nifty Fifty

Tech Bubble data as of 24/03/2000, Nifty 50 data as of 02/01/1973, except 1972 actual for P/E

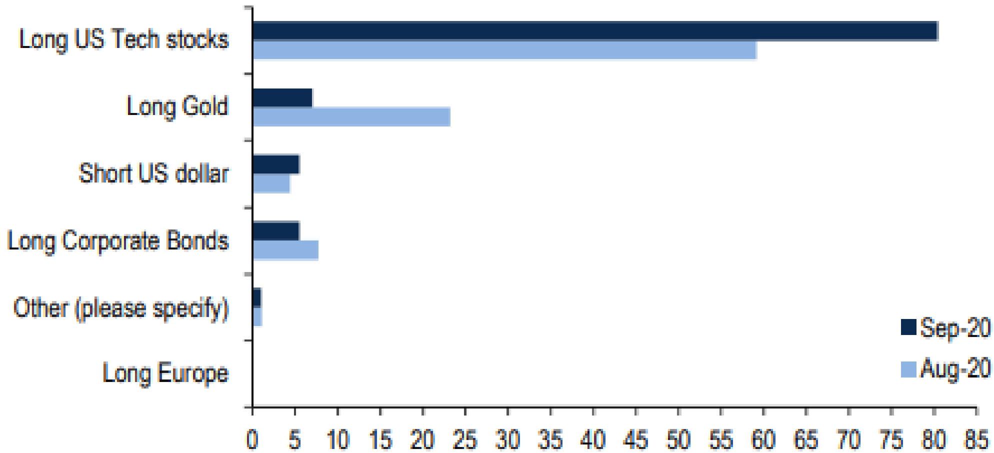
	Size		Valuation
	Market weight	Market Cap ($ Bn)	P/E (FY2)
FAAMG			
Apple	7.6%	2247	34.0
Amazon	5.1%	1504	80.4
Microsoft	5.9%	1753	31.6
Alphabet	3.6%	1058	30.5
Facebook	2.3%	691	29.9
FAAMG Aggregate	**24.5%**	**7253**	**31.6**
Tech Bubble			
Microsoft	4.5%	581	55.1
Cisco Systems	4.2%	543	116.8
Intel	3.6%	465	39.3
Oracle	1.9%	245	103.6
Lucent	1.6%	206	35.9
Tech Bubble Aggregate	**15.8%**	**2040**	**55.1**
Nifty 50			
IBM	7.1%	48	35.5
Eastman Kodak	3.6%	24	43.5
Sears Roebuck	2.7%	18	29.2
General Electric	2.0%	13	23.4
Xerox	1.8%	12	45.8
Nifty 50 Aggregated	**17.1%**	**116**	**35.5**

Source: Datastream, I/B/E/S, Worldscope, Goldman Sachs Global Investment Research

Additionally, below we show the results of the Bank of America September Global Fund Manager Survey ("FMS") in which participants were asked to identify what they believe is the "Most Crowded Trade." This monthly survey featured 224 institutional panelists representing nearly $650 billion in assets under management. In the September survey, not only does Long U.S. Tech remain the "Most Crowded Trade," for the fifth consecutive month, but at 80%, is the highest consensus view ever for a "Most Crowded Trade" in the survey's history.

Over time, trends do reverse, and we are optimistic that the concentration in U.S. tech stocks, and five stocks in particular, will unwind, and money will have to flow into other sectors. To that end, we believe the banking sector could be one of the key areas that money rotates into when the growth/tech trade evaporates.

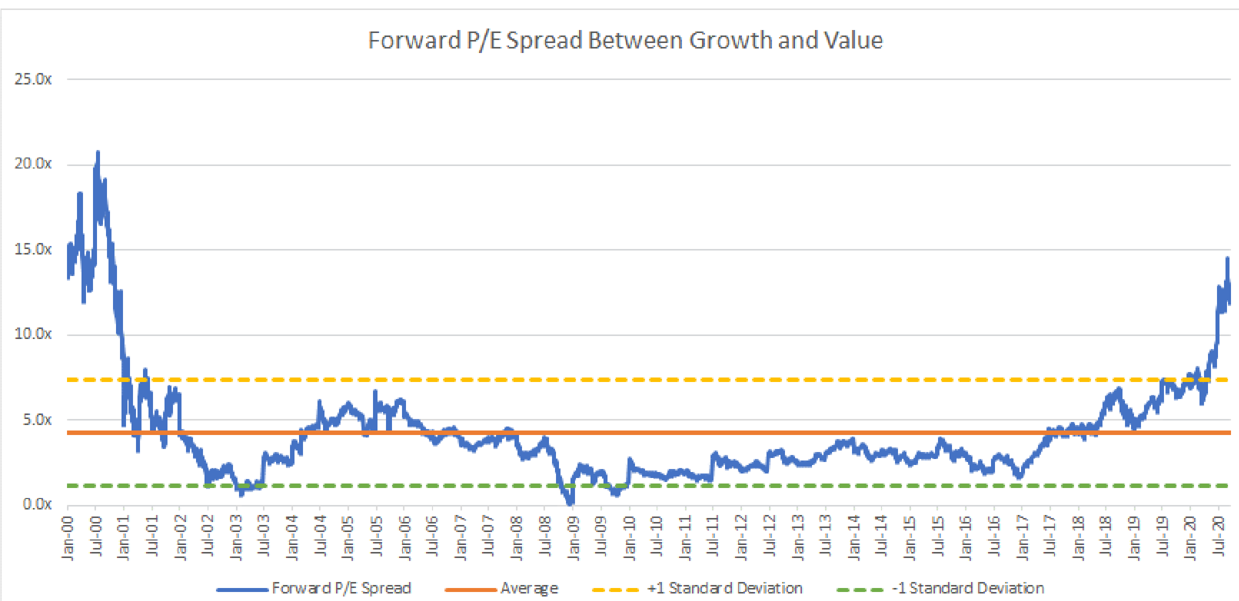
Exhibit 21: What do you think is currently the most crowded trade?



Source: BofA Global Fund Manager Survey

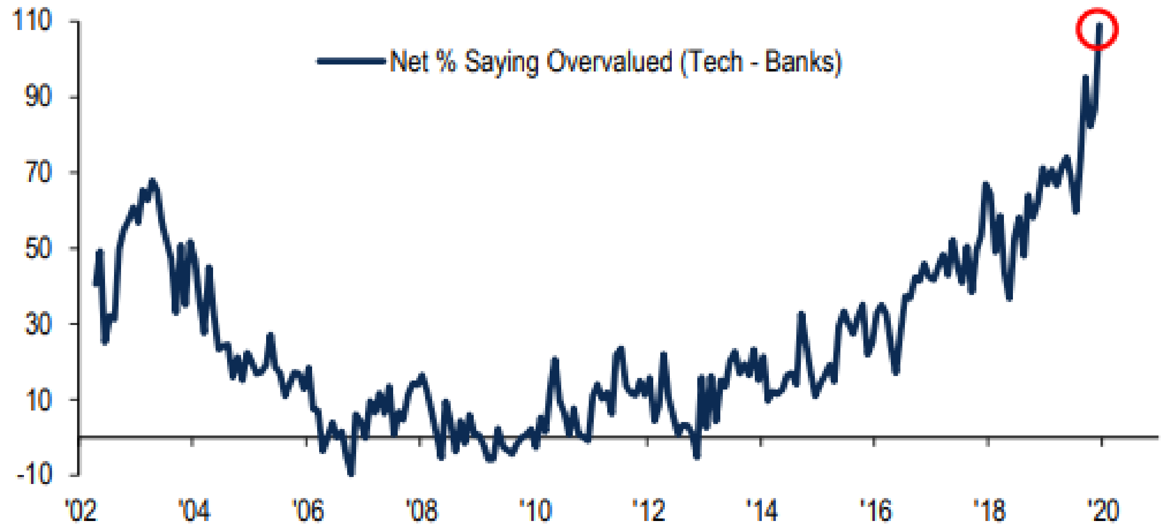
Valuation Disconnect Between Growth and Value at Dot-Com Widens

Below we show the valuation dispersion on forward P/E multiples for the Russell 3000 Growth Index vs. the Russell 3000 Value Index since January 1, 2000. As of September 21, 2020, the respective Growth Index was trading at around a 12x valuation multiple premium to the respective Value Index. Although slightly off its recent highs, these are levels not seen since the peak of the Dot-Com bubble. Additionally, current levels are still well above its +1-standard deviation of over 7x spread and long-term average of around 4x spread.



We once again reference the September FMS in which basically 100% of survey participants agree that tech was overvalued relative to banks. Perhaps, not surprisingly, the response rate of this question very closely aligns with the chart above identifying an increasingly wider P/E multiple spread between growth and value stocks.

Exhibit 13: Banks at a record undervaluation vs tech

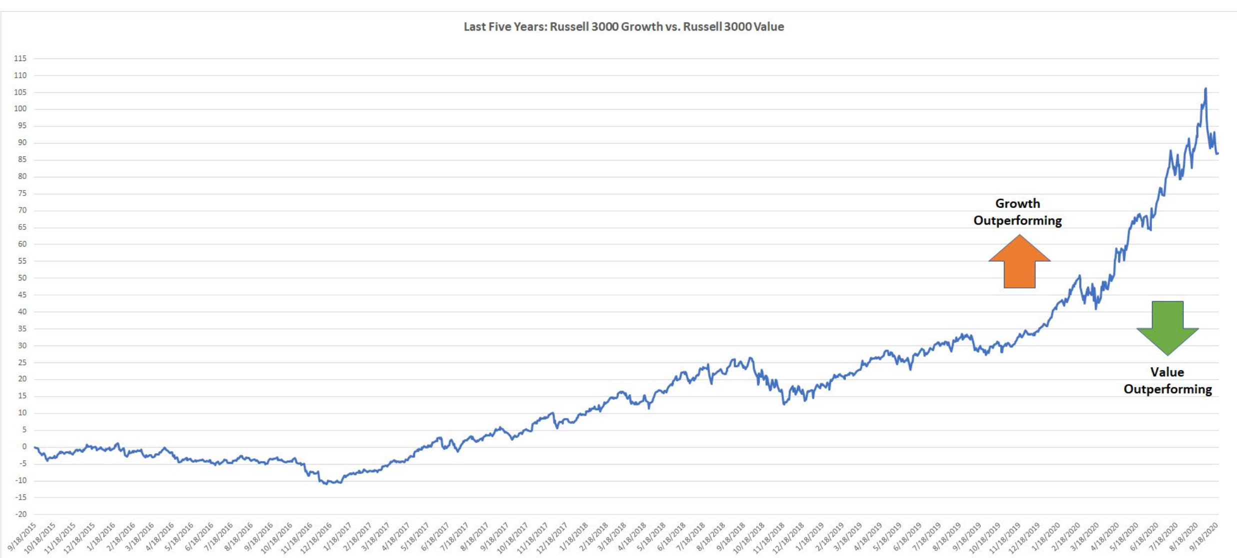


Source: BofA Global Fund Manager Survey

Value Leadership Slowly Beginning to Come Back?

Although it sometimes does not seem or feel like it, we should point out that the value sector as of late is slowly starting to return to its leadership position over growth. Below, we show an indexed chart of performance for the Russell 3000 Growth Index versus the Russell 3000 Value Index over the last five years. As of September 18, 2020, the Russell 3000 Growth Index was up over 112% while the Russell 3000 Value Index was up only 25.8%.

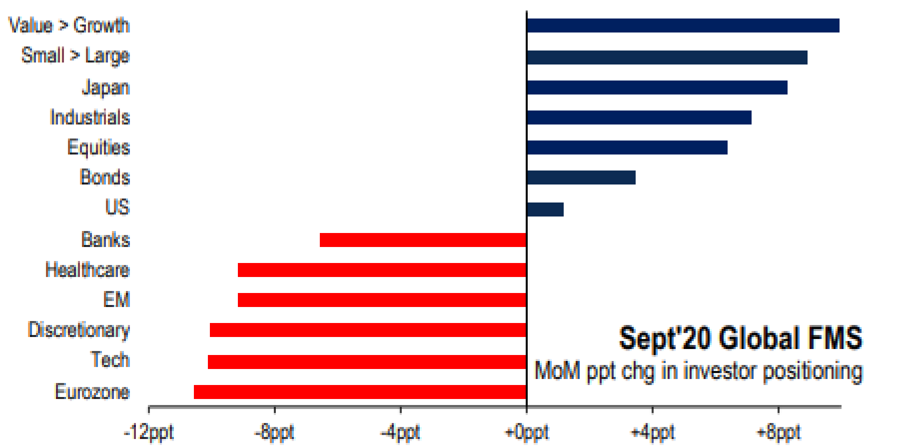
However, as mentioned above, leadership into value has started to return as the respective value index over the last month was down less than 1%, while the respective growth index was down nearly 3% over the same time frame.



Source: FJ Capital Management

Below, we also once again reference the September FMS which demonstrates how positioning has shifted month over month. What the survey shows in September was a significant re-allocation into value and out of growth, along with rotation into small-cap versus large-cap stocks. Although the survey showed continued rotation out of bank stocks, if investors are in fact beginning a more meaningful rotation into both value and small-cap stocks, it is likely just a matter of time before community bank stocks start to catch up, particularly since the financial services sector accounts for roughly 40% of the Russell 2000 Value index.

Exhibit 8: Sept FMS shows start of rotation to cyclicals

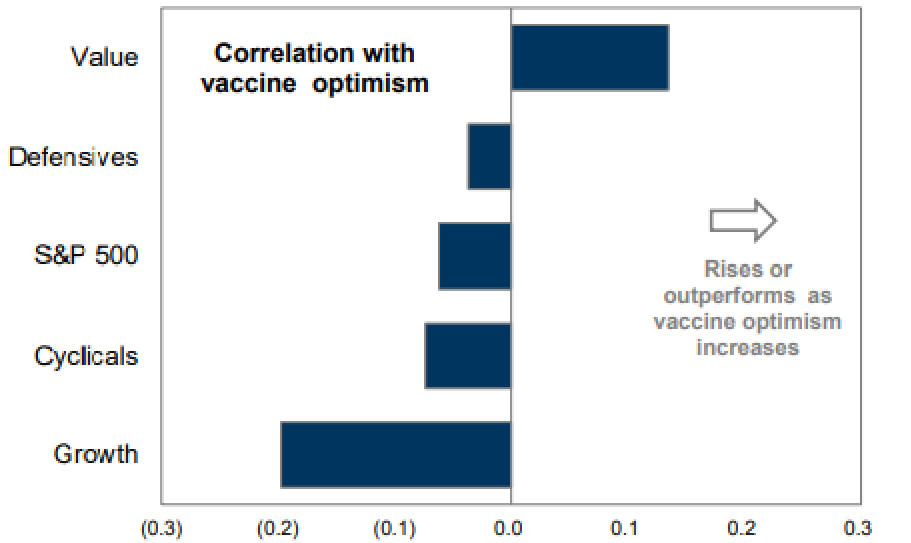


Source: BofA Global Fund Manager Survey

Vaccine as a Catalyst for Value

We would also be remiss if we did not mention that a COVID-19 vaccine could be a very significant catalyst for the value sector. As demonstrated below by Goldman Sachs, the value sector is the only sector in the S&P 500 Index that has been exhibiting a positive correlation with increasing optimism around a vaccine.

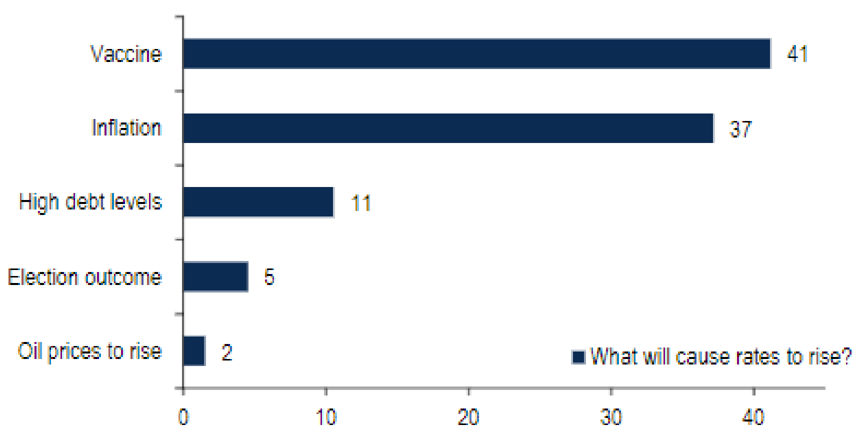
Exhibit 3: Value, not Cyclicals, is positively correlated with vaccine optimism
as of September 17, 2020; based on GS Cyclicals/Defensives baskets & S&P 500 Growth/Value



Source: The Good Judgment Project, FactSet, and Goldman Sachs Global Investment Research

To that end, we again reference the September FMS in which respondents were asked what was needed for interest rates to rise. The most popular answer at 41% was a vaccine to COVID-19. If they are correct, higher interest rates would probably be perceived favorably for financial stocks, notably banks.

Exhibit 6: FMS investors believe a vaccine needed for rates to rise



Source: BofA Global Fund Manager Survey

About FJ Capital Management, LLC

FJ Capital Management, LLC is a fundamentally driven, *SEC*-Registered Investment Advisor firm founded in 2007 that analyzes and invests in public and privately traded U.S. community and regional banks through private investment vehicles. The firm utilizes proprietary fundamental research to uncover value disparities in the small- and mid-cap bank sector and seeks to take advantage of these disparities by building core positions with longer term holding periods. The firm also seeks to generate attractive, risk-adjusted investment returns by uncovering opportunities with identifiable, near-term catalysts. For more on *FJ Capital* or to further explore opportunities in the bank sector, please visit www.fjcapital.com or contact:

Andrew Jose
O: 703.875.8378
M: 703.408.0394
ajose@fjcapital.com
www.fjcapital.com

FJ Capital Management, LLC
1313 Dolley Madison Blvd.,
Suite 306
McLean, VA 22101

Important Disclosures:

This White Paper is provided for informational purposes only, does not constitute investment advice and should not be relied upon as such. It is neither an advertisement for investment advisory services nor an offer to sell or solicitation of an offer to buy securities.

The information presented in this White Paper has been developed internally and/or obtained from resources believed to be reliable; however, *FJ Capital Management, LLC* does not guarantee the accuracy, adequacy, or completeness of such information. References to securities or asset classes do not constitute recommendations to purchase or sell any specific securities or asset classes. *FJ Capital* may have investments in securities or asset classes mentioned in this White Paper.

There is no guarantee that the investment objective of any fund will be achieved. Moreover, the past performance (if any) of the investment team should not be construed as an indicator of future performance. Any projections, market outlooks or estimates in this document are forward-looking statements and are based upon certain assumptions. Other events which were not considered may occur and may significantly affect the returns or performance of a fund. Any projections, outlooks or assumptions should not be construed to be indicative of the actual events which will occur.

The performance results of the funds advised by FJ Capital shown herein are calculated for the non-proprietary members taken as a whole and are net of all management and performance fees and expenses but include the reinvestment of dividends and other earnings. An individual investor's return may vary from the returns shown herein based on the timing of capital contributions or withdrawals, different fee arrangements and eligibility to participate in certain investments. Comparison of the funds' returns to market indices or other benchmarks may not be appropriate because a fund's portfolio, among other things, may contain materially different investment objectives, include the reinvestment of dividends and other earnings, may include short sales of securities, may not be as diversified as such market indices or benchmarks and the volatility thereof may differ. The information in this White Paper has been furnished by FJ Capital and has not been independently reviewed or audited by outside certified public accountants, except that the funds' year-end financial statements are audited by certified public accountants. Past performance is not indicative of future performance.

This White Paper may contain forward-looking statements. FJ Capital undertakes no obligation to update these forward-looking statements for events or circumstances that occur subsequent to the date of this White Paper or such other dates noted herein or to update or keep current any of the information contained herein. Any estimates or projections as to events that may occur in the future are based upon the best judgement of FJ Capital from information received and other publicly available information as of the date of this White Paper. There is no guarantee that any of these estimates or projections will be achieved. Actual results will vary from the projections and such variations may be material. Projections are not a guarantee of future results.

Nothing contained herein is, or shall be relied upon as, a promise or representation as to the past or future. FJ Capital, its affiliates, directors, employees, and/or agents expressly disclaim any and all liability relating to or resulting from the use of all or any part of this White Paper or any of the information contained therein.