VT DE LISLE AMERICA FUND

Research Note

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For Professional Advisers Only

Community Banks

Community banks have long been the epitome of the steady growth stock, typically having an underlying trend earnings growth rate of 10% going on for decades. With a reasonable dividend and stock buybacks they have been a long-term outperforming group. The single statistic which originally attracted me is that low-beta is an outperforming category and this is one of the lowest beta groups in the market. Sadly, all these long-term statistics were turned upside down from 2017 until 2020. We've been overweight since 2013.

2020 Election and Biden's Presidency

In November 2016 Trump had a surprise victory with the slogan 'Make America Great Again' and his red states were the landlocked heartlands. His support cohorts were middle income whites who were hoping for infrastructure spending to reverse their relative decline. This would have helped small businesses and hence small banks and for two months our banks rose in anticipation. Then came four years of falling growth and falling inflation with tariffs being the only policy initiative that are also deflationary.

Growth slowed to such an extent there was a recession scare in December 2018 and a full stop to the economy in March 2020, all of which was not beneficial for our banks because the yield curve became flatter and margins got thinner and thinner. Banks kept on coming through with the goods and growing earnings, so we didn't lighten at the time. The market just let them drift to cheaper and cheaper ratings. Ironically, Trump's rival Biden has made pledges to do what middle-America had hoped would have happened in 2016. Now there are even more holes in the road and the stimulus will be felt even more.

Macro Landscape & Yields

A key figure for a bank is its Net Interest Margin (NIM) which is the spread between average deposits and average loans. As the yield curve flattens, the spread gets narrower and bank stocks underperform on anticipation of falling earnings.

From 2017 to 2020, weak growth meant the Fed was easing and short-term rates headed to zero. By September 2019, $17 trillion or a third of sovereign debt in the world had a negative yield and long term rates were little more than 1% and these figures were still the same in September 2020.

All policy to stimulate the economy was done through monetary policy but if there were no longer any interest rates, how could banks make any reasonable spread at all? At its worst there was an argument that by paying depositors zero, banks were squeezing themselves because zero was too high a rate to pay! Finally, the conventional wisdom that monetary policy will do it has been abandoned and today the Keynesian view that zero rates are no better than pushing on a piece of string has been resurrected and called Modern Monetary Theory (MMT) to placate the Americans that they have thought of something new. Today Fiscal policy is back in order to revive the economy at all costs and the forthcoming deficit spending, like the $1.9 trillion stimulus package, has already got the yield curve the steepest in two years.

Big Banks Vs. Community Banks

Community banks were on fire while big ones were only up a bit this month. Our banks still need to rise another 25% to restore their traditional relationship in terms of P/E, market cap/assets and price/book with their larger peers. We know it's just a lag because, if anything, our banks have reported better earnings than their big brothers as they were able to get closer to their customers by administrating government loans and helping local businesses. Also, trading has not picked up in them until this week but it had after November 9th (vaccine day) for regional banks. Thus it's not as though anyone was selling on a bear case, it's just that no one has got round to them until now. Expect our Fund to remain surprisingly strong relatively as this normalizes as we have 37% in this group.

For examples, look at **Oregon (ORBN)** where we have 0.9% of the company, bought 3 years ago at $14. As of 25/02/2021 the price is $57 and announced an extra dividend of $3.50 on 22/03/2021. We are the only institutional holder. This is a key point in that not only did we spot it but no one else can get in.

Another important one is **F S Bancorp**, our largest holding. We've gone from $17.35 to $60 in 6 years and for a long time we were the only institutional holder there too. Today we don't even make the list of top holders. I feel this one should go up 50% to $90 to be correctly re-aligned. If it did the impact on the Fund would be significant.