PL Capital Advisors, LLC

QUARTERLY REPORT TO THE PARTNERS Q1 2021

BANK STOCK VALUATIONS CONTINUE TO IMPROVE

Bank stock valuations began to meaningfully improve in Q4 2020, after the Covid-19 vaccines were found to be efficacious and interest rates began to increase. This trend continued in Q1 2021. Similar to its bank and thrift benchmarks, the Partnership has now more than fully recovered the declines incurred during the beginning of the pandemic.

In hindsight, and for all the reasons we discussed in detail in the 2020 letters, bank stocks should not have gone down as much as they did given how well banks performed throughout the pandemic. While it was painful to endure, we are pleased to see the market correct its misjudgment and the Partnership back in the black!

We will not repeat all of the detailed information and predictions included in the year end 2020 letter. Suffice it to say that Q1 2021 was entirely consistent with what we then observed and predicted, and we foresee no reason to change our views.

The following recaps our current views, reinforced by the events of Q1 2021:

- Bank earnings are strong and will improve even more over the course of 2021 and beyond.
- Bank M&A will accelerate, driven by deals delayed by the pandemic.
- Banks will engage in meaningful return of capital to shareholders through higher dividends and stock buybacks.
- Bank stock valuations are much improved but are still attractively valued on an absolute and relative basis versus their small-cap peers as measured by the Russell 2000 and the broader market as measured by the S&P 500. **See Exhibits 1 & 2.**

Exhibit 1: Relative Price / 2022E EPS – NASDAQ Bank Index vs. Russell 2000

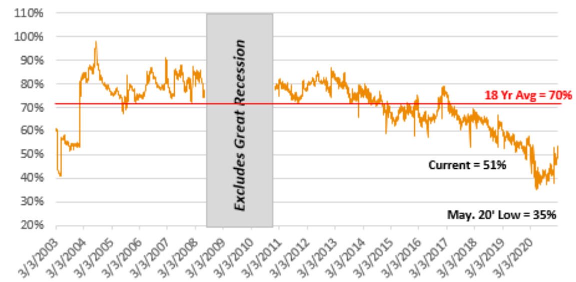
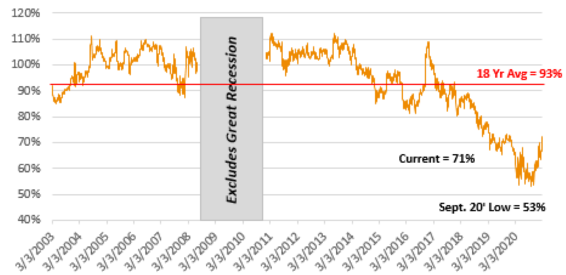


Exhibit 2: Relative Price / 2022E EPS – NASDAQ Bank Index vs. S&P 500



Source (Exhibit 1 & 2): KBW Research and Bloomberg; as of 3/1/2021

- The 'reversion' in bank stock valuations from the extreme bank stock undervaluation of early and mid-2020 to more reasonable valuations today, occurred rapidly in the past six months, at a pace that cannot continue. In future quarters and years, steadier and sustainable valuation improvements will come from continued increases in valuation multiples (PEs and Price to Tangible Book Value) as well as increased earnings, increased tangible book values, and M&A.
- The 2021 economy will be very strong, driven by the pandemic rebound, massive government stimulus spending and Federal Reserve monetary stimulus.
- Tax increases are being sought by the Biden administration and Congress. Details to come. So far, the prospect of higher taxes has not

derailed the stock market, but there is downside risk to the economy and stock market from higher tax rates.
- Interest rates have risen, mostly on the long end of the yield curve. This should continue, in recognition of massive government spending and monetary stimulus leading to higher inflation and GDP growth. See the discussion below for the impact on banks.
- Wall Street analysts have been scrambling to upgrade bank stock price targets and earnings estimates in an attempt to catch up with improved bank stock prices and fundamentals. This will continue.
- Banks will have no problem growing low-cost deposits, but net loan growth will be challenging as many borrowers are flush with cash and do not need bank loans, and prepayments of existing loans remain high.
- Banks will continue to cut costs, including by closing branches and reducing head count.
- Banks will accelerate their spending on technology, including so-called 'fintech' initiatives.

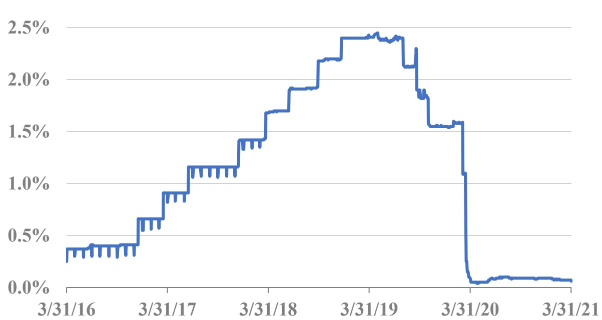
INTEREST RATES ARE RISING—THE POSITIVE IMPACT ON BANKS

Exhibit 3: U.S. 10 Year Treasury Yield – Last Five Years

Source: SNL Financial

As noted in the table above, longer term interest rates have risen sharply off the pandemic induced lows of early 2020. However, in relative terms, they are still below where they were for most of 2017-2019.

Exhibit 4: U.S. Effective Fed funds Rate – Last Five Years



Source: SNL Financial

Unlike long-term rates, short-term rates remain low, anchored by the Federal Reserve's current 0-0.25% short-term interest rate target.

We do not foresee the Fed changing their short-term interest rate target anytime soon despite inflation and the economy heating up rapidly in 2021.

The Fed will not adjust their short-term interest rate targets the way they might have in the past due to a recent, historically important policy shift. Under its new policy, the Fed will no longer move short-term interest rates preemptively based on *forecasts* of economic overheating (rising GDP, accelerating inflation, low unemployment, etc.) or economic deceleration (lower GDP, lower inflation, higher unemployment). Instead, they will now only change short-term rates in response to *actual* changes in GDP, inflation, and unemployment.

And the Fed Chairman went even further when he recently declared the Fed wants: (1) actual reported inflation to be well *above* the policy goal of 2% for an extended period, to overcompensate for the below 2% average inflation of the past few years, and (2) the economy to recover all of the approximately 10 million jobs lost since the pandemic began, before they will change the current short-term interest rate target or their pace of bond purchases under quantitative easing.

This policy shift is controversial and risky because waiting too long to remove excessive monetary accommodation could allow the economy to overheat, creating long-term inflation issues that might be painful to extinguish. After incurring years of economic pain defeating inflation in the early 1980s, it would be a shame of the Fed allowed inflation to grow materially and uncontrollably.

If it did allow this to happen, the Fed would then have no choice but to raise interest rates materially, putting the economy and markets at great risk. For now, a bit of inflation is accelerating the economy as well as buoying real estate and stock markets, but we are wary about the long-term risks of an ultra-dovish Fed.

We are sure there will be much more discussion on this topic in future letters.

Of course, banks are always impacted to some degree by Fed policy and changes in interest rates. In general, the recent changes in rates are positive for the banks because the increase in long term rates and the lack of change in short term rates has created a much 'steeper yield curve' (a term we have discussed numerous times in previous letters—a steeper curve is when short term interest rates are much lower than long-term interest rates).

Although most banks would prefer if both short-term and long-term interest rates moved up in tandem (a so-called ‘parallel’ shift), a steeper curve is very welcome particularly after the ‘flat’ yield curve of the past year (a flat curve is when both short-term and long-term interest rates are similar).

The steeper curve is undoubtedly one of the reasons the market has favored bank stocks in the past six months. While we have always felt the market dramatically overstates the impact of the yield curve on bank fundamentals, there is no doubt that Wall Street’s trading algorithms are tied to the yield curve. Yield curve up today? Buy bank stocks. Yield curve down today? Sell bank stocks. This obsession on Wall Street with minor changes in the yield curve is frustrating to us as long-term fundamental investors but it is a factor in the Partnership’s performance, at least in the short-term. We do not expect a flat curve to return anytime soon, given current Fed policy and the strong economy. However, if the yield curve were to flatten, it would be a material headwind for bank stocks. We will be on the lookout for that risk in late 2021 and 2022.

Spring has arrived!! We hope everyone is able to get out and enjoy the warmer weather and everyone remains healthy!

Please feel free to contact us at any time with questions or comments.

Best regards,

Rich, John, Curt and Martin

Richard Lashley
(908) 347-7874
RLashley@plcapitalllc.com

John Wm. Palmer
(239) 777-0187
(630) 848-1342 (fax)
JPalmer@plcapitalllc.com

Curtis J. Thompson
(312) 560-2675
(630) 848-1342 (fax)
CThompson@plcapitalllc.com

Martin Alwin
(630) 742-7060
MAlwin@plcapitalllc.com

April 12, 2021