

INSIDE THIS ISSUE

1 Recent News

- 1 Credit Trends and Commentary
- 2 Banking Trends
- 2 Profitability
- 2 The Prudent Man Analysis

RECENT NEWS

Loan Growth Pressures Loan Loss Reserves

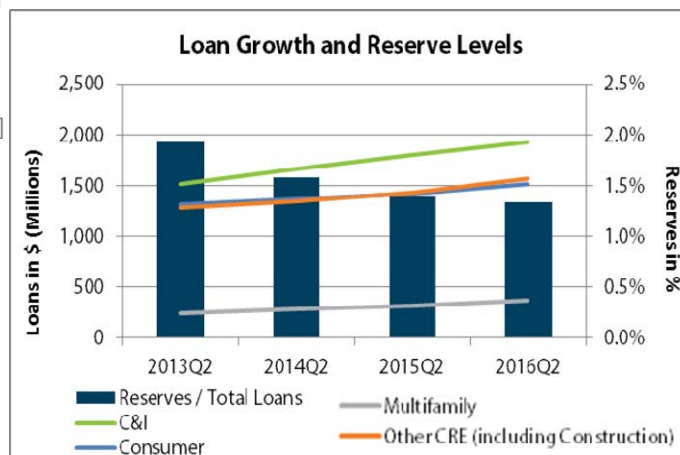
Over the last several years, loan growth has been rapidly increasing at banks of all sizes across the United States. This growth has been led by commercial & industrial loans (C&I), with three year loan growth at \$412 billion. This is followed by commercial real estate and construction (\$287 billion), consumer (\$205 billion) and multifamily (\$122 billion). This higher demand for loans is also accompanied by lower underwriting standards for some categories, including consumer and C&I loans.

Although these loans have allowed the banking industry to experience record earnings, today's loan growth could lead to tomorrow's problem loans. Banks are preparing for the effects of loan growth as they have been boosting their provisions for loan losses for the last several quarters.

According to the FDIC, "Banks set aside \$11.8 billion in loan-loss provisions in the second quarter, an increase of [44.2 percent] compared with the second quarter 2015." However, the boost in provisions has not kept up with loan growth. In 2011, the ratio of total loan loss reserves to total loans at June 30 was 2.84%, which has dropped to the current level of 1.33%.

Banks have argued that credit quality may not rapidly decline. The Wall Street Journal reports that "Banks say consumers' financial health remains strong overall, and they cite a low unemployment rate, rising home values and default rates that remain near historic lows as reasons to be optimistic about consumers." Corporate balance sheets are also healthy overall despite a recent rise in leverage. Through the first half of the year, total nonperforming assets continue to decline and only C&I loans experienced a modest increase in nonperforming assets.

Sources: Federal Deposit Insurance Corporation, Federal Reserve, SNL Financial, Wall Street Journal

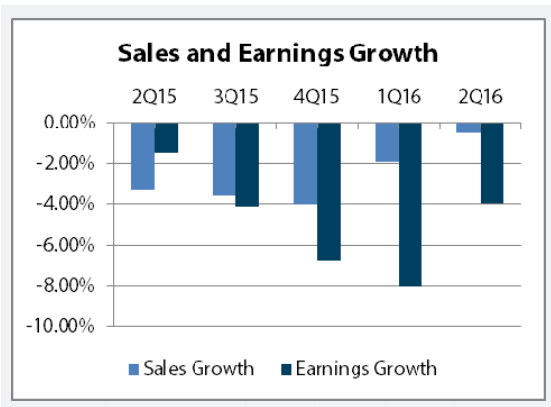


Source: SNL Financial

SALES AND EARNINGS GROWTH:

The percentage of aggregate growth of sales and earnings for S&P 500 companies

CREDIT TRENDS AND COMMENTARY



Source: Bloomberg

Publicly traded companies have struggled to grow sales and earnings in recent quarters. During 2016, companies in the S&P 500 have seen improved (albeit negative) sales and earnings growth numbers. Although growth numbers have been sluggish for the last several quarters, firms have remained profitable as a whole.

BANKING TRENDS

2nd Quarter 2016 Highlights

FDIC-insured institutions earned net income of \$43.6 billion for the second quarter of 2016, an increase of 1.4% over the prior year period, largely due to an increase in average interest-bearing assets and higher noninterest income. Only 4.5% of banks reported negative quarterly net income, down from 5.8% in the second quarter of 2015.

Noncurrent loans (90 days or more past due or nonaccruing) declined by 3.4% during the second quarter. While noncurrent commercial and industrial (C&I) loans increased for a sixth consecutive quarter, rising by 8.9%, all other major loan categories saw declines. The average noncurrent rate declined from 1.58% to 1.49%, which is the lowest level for the banking industry since 2007. Despite this improvement, chargeoffs were higher than the year before for the third consecutive quarter led by an increase in C&I chargeoffs.

The FDIC reported that 93% of institutions with less than \$10 billion in assets are expected to pay less for deposit insurance. The reduction in assessments will occur because the reserve ratio (the amount in the Deposit Insurance Fund to insured deposits) reached 1.17% percent for the second quarter. This is the highest level in eight years and a large improvement from the negative levels during the financial crisis.

Source: FDIC: Quarterly Banking Profile

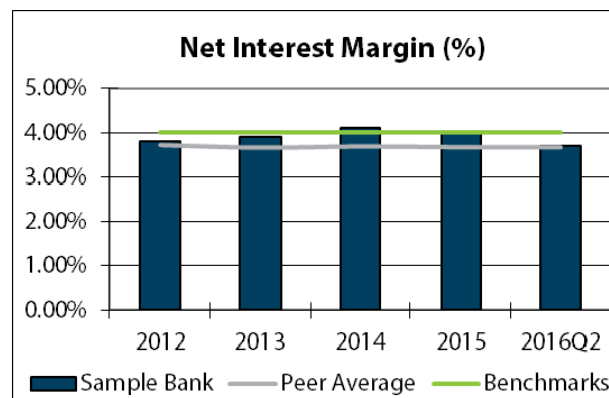
PRUDENT MAN PROCESS

The Prudent Man Analysis

The Prudent Man Process includes four steps which begin with gathering data and analyzing a bank's credit quality and continues with ongoing risk management throughout the life of a deposit. The process helps public funds investors avoid repayment, reinvestment and reputation risk that may be associated with a bank failure.

Step 2: Data Analysis - Quantitative

Net Interest Margin (NIM) is typically a bank's main source of income. It is calculated as interest income on earning assets including loans, leases and securities minus the amount of interest paid to depositors and other lenders to the bank, divided by average total assets. NIM reflects a bank's pricing on loans and deposits as well as its management of interest rate risk. In the Prudent Man Analysis, it is graphed to compare a bank to historical trends, bank peers and performance benchmarks.



PROFITABILITY

2016	95.3%
2015	94.0%
2014	93.0%

Percentage of banks generating positive 2nd quarter earnings

Source: SNL Financial

CONTACT

BRIAN D. HEXTELL

630.657.6485
bhextell@pmanetwork.com

REBECCA M. SMITH

630.657.6488
rsmith@pmanetwork.com

This document was prepared for PMA Financial Network, Inc., PMA Securities, Inc. and Prudent Man Advisors, Inc. (hereinafter "PMA") clients. It is being provided for informational and/or educational purposes only without regard to any particular user's investment objectives, financial situation or means. The content of this document is not to be construed as a recommendation, solicitation or offer to buy or sell any security, financial product or instrument; or to participate in any particular trading strategy in any jurisdiction in which such an offer or solicitation, or trading strategy would be illegal. Nor does it constitute any legal, tax, accounting or investment advice of services regarding the suitability or profitability of any security or investment. Although the information contained in this document has been obtained from third-party sources believed to be reliable, PMA cannot guarantee the accuracy or completeness of such information. It is understood that PMA is not responsible for any errors or omissions in the content in this document and the information is being provided to you on an "as is" basis without warranties or representations of any kind. Securities, public finance services and institutional brokerage services are offered through PMA Securities, Inc. PMA Securities, Inc. is a broker-dealer and municipal advisor registered with the SEC and MSRB, and is a member of FINRA and SIPC. Prudent Man Advisors, Inc., an SEC registered investment adviser, provides investment advisory services to local government investment pools and separately managed accounts. All other products and services are provided by PMA Financial Network, Inc. PMA Financial Network, Inc., PMA Securities, Inc. and Prudent Man Advisors (collectively "PMA") are under common ownership.

©2016 PMA Financial Network, Inc.