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Industry Spotlight: Regional Banks

In the investment world, we're constantly reminded that everything cycles. When the FDIC closed Silicon Valley Bank in March 2023, the regional banking industry was left for dead. It was widely assumed that unrealized losses on bank balance sheets would take years for banks to recover.

While there were extensive losses, the new political climate sweeping in over two years later puts us on the other side of the cycle. With the changing regulatory climate and improving interest rate environment, regional banks have a new catalyst that could bring them back to life.

Understanding the Regional Banking Industry

As opposed to large, national, or international banking chains, the regional banking industry is made up of mid-sized banks that operate and serve clientele within specific geographical areas. These banks can play a critical role in providing banking services and various financial products to local communities.

Regional banks typically deal more with consumer and commercial banking than other types of finance, and this specialization provides them with a more nuanced and in-depth understanding of the economics of the regional market that they serve.

This gives regional banks a greater ability to offer personalized financial services to their customers. These banks generally place a high emphasis on customer relationships and community engagement through services such as mortgage loans, local and small business support, and personalized banking solutions that may not be available from larger national banks.

Why Invest in Regional Banks?

We feel that investing in the regional banking sector can be a good option for the astute investor for numerous factors, but here are three of the most compelling to consider.

1. Greater Benefit from Favorable Economic Conditions

According to Value Line's sector analysis, regional banks are well-positioned to benefit from economic expansions, particularly in regions experiencing population growth and business investment.

As regional economies grow, the banks that service these areas tend to derive significant benefits from more favorable economic conditions. This kind of growth typically means an increased need for borrowing, which positions these banks well to capitalize on lending opportunities.

This will boost a bank's overall profitability through interest income and an increase in the number and size of loans issued. These are among the key revenue streams for any bank, and regional banks are uniquely situated to serve local communities that larger lenders may overlook or require prohibitive prerequisites for lending.

2. Beneficial Interest Rate Sensitivity

Value Line also notes that regional banks, with their more focused deposit base and regional asset portfolio, are often better suited to adjust to changing interest rates than larger national banks.

Unlike these large banking institutions, regional banks can more quickly manage their net interest margins, which is the difference between the interest earned on loans and the interest paid on deposits. This makes regional banks an attractive option during periods of high interest rates when borrowing costs increase for customers, but the significantly lower interest rate paid by savings accounts varies much less.

3. Potential for Dividends and Shareholder Returns

Because regional banks often prioritize providing returns for their shareholders, they typically offer appealing dividend yields. Many of these regional banks can take advantage of strong capital positions, which allow them to return a greater portion of their earnings to investors in the form of dividends.



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