

MARCH 23, 2023

Aligned MidCap and First Republic Bank

SUMMARY

- Bank stocks have sold off in March (KBW Bank Index -24% from March 9-22).
- Started primarily with Silicon Valley Bank, which experienced a full-fledged bank run. The fear then spread to other banks.
- Principal MidCap Fund holding First Republic (0.69% as of February 28, 2023) is among the banks that have faced the most selling pressure.
- However, First Republic was a small position and the only bank held by the Principal MidCap Fund.
- The Principal MidCap Fund has *outperformed* over the two weeks since the crisis started, with *positive net contribution* specifically from the bank industry (index has heavier weight in banks).
- First Republic was sold from the Principal MidCap Fund on March 13.

PRINCIPAL MIDCAP FUND'S OWNERSHIP OF FIRST REPUBLIC

- Owned since 2018.
- Led by founder and executive chairman Jim Herbert.
- Industry leading credit track record and client service, which has led to better returns on equity and book value growth.
- High quality loan book and securities portfolio, with strong capital cushion. Its A1 credit rating (pre-crisis) was higher than, for example, JP Morgan, Bank of America, and Wells Fargo.
- Fundamentally, there was no reason for the fear to spread to First Republic. Besides both being headquartered in the Bay Area, First Republic is very different than Silicon Valley Bank (SVB).
 - First Republic's customer base is not concentrated in venture capital (tech-related business deposits were only 4% of total First Republic deposits).
 - First Republic never lent to more risky, venture capital backed companies. At SVB, this was their core business.
 - First Republic's unrealized losses on its securities portfolio total ~30% of equity (at SVB they amounted to more than 100% of equity).
 - First Republic's credit rating remained strong (SVB was about to be downgraded).

PRINCIPAL ALIGNED'S DECISION TO SELL

- In banking, fear alone—whether it's warranted or not—can end the business. Every bank ultimately relies on confidence.
- While it was unwarranted and regrettable, this crisis has done permanent damage to First Republic.
- Even if they survive the moment (still uncertain), their earning power is likely to face significant pressure. At minimum, funding costs will increase meaningfully.
- Given the uncertainty and the changed reality of First Republic's business, we decided to sell our shares and preserve the remaining value.

Carefully consider a fund's objectives, risks, charges, and expenses. Contact your financial professional or visit www.PrincipalAM.com for a prospectus, or summary prospectus if available, containing this and other information. Please read it carefully before investing.

Past performance is no guarantee of future results. Investing involves risk, including possible loss of principal.

Equity investments involve greater risk, including higher volatility, than fixed-income investments. Mid-cap stocks may have additional risks including greater price volatility.

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