BANKERS' BANK

VIEW FROM THE TRADING DESK

Third Quarter 2024

The highlight of Q3 was the Fed's aggressive move to initiate their rate reduction trajectory with a 50-basis point cut on September 18th. At the timing of the decision, the 10YR had dropped 76 basis points from the beginning of Q3 to 3.70%. Traders immediately priced in an additional 75-100 basis points in cuts by year-end, which proved to be a bit aggressive. Subsequent economic reports showed a still strong labor and consumer market, giving the Fed reason to consider slowing, or even pausing additional rate cuts. Yields bounced off lows in late September, rising slightly in deference to the strong economic data. Current market bets are that the Fed cuts 50 basis points by year end, but the vote is split with nearly 50% of those surveyed suggesting just a single 25 basis point cut remains in 2024.

2024 FOMC Meetings: January 31st, March 20th, May 1st, June 12th, July 31st, September 18th, November 7th & December 18th

Key Indices Returns

	Q3 Returns	2024 Returns
Bloomberg Global Aggregate	+4.02%	+1.35%
US Treasuries	+2.89%	+2.22%
US Aggregate Bond Index	+2.90%	+2.95%
MBS	+3.14%	+3.02%
Municipal Bonds	+2.03%	+1.85%
Taxable Municipal Bonds	+3.01%	+3.51%
Corporate Bonds	+3.54%	+3.96%

OUR TAKE FROM A COMMUNITY BANK INVESTMENT PORTFOLIO PERSPECTIVE:

U.S. Treasuries – After peaking on July 1st, US Treasury yields in Q3 moved notably lower culminating in the FOMC announcing a 50-basis point cut at the conclusion of their September 17-18 meeting. Yields ended the quarter 50-112 basis points lower and while the market saw a little spike in yields at the beginning of Q4, the longer-term view is that short-term rates have room to move lower.

Trading volume in UST remained heavy in September with daily volumes at $976 billion, just below the $1 trillion record average day in August. With the small drop in volume, September's average volume was still the second highest ever and $90 billion over the third-highest record. Trading volumes are expected to remain firm in Q4 as traders and investors position securities while trying to predict the magnitude and timing of future rate cuts by the Fed along with volatility surrounding the upcoming Presidential election and geopolitical concerns.

US Treasury Bond Yields			
Maturity	7/1/2024	9/30/2024	Shift (bps)
1YR	5.10%	3.98%	-112
2YR	4.76%	3.64%	-112
3YR	4.58%	3.55%	-103
5YR	4.43%	3.56%	-87
7YR	4.43%	3.65%	-78
10YR	4.46%	3.78%	-68
30YR	4.63%	4.12%	-51

U.S. Agencies – As yields moved lower in Q4, agency bond calls more than doubled from Q2. More than $100 billion in securities were redeemed in Q3 bringing the YTD total to just over $300 billion. Structurally, issuers filled up the quarter with $12 billion in 6M/9M callable bonds and $10.3 billion in 1YR lockouts. With the limited calls, obtaining 5%+ on many of these bonds was attainable in July & August with many yields dropping into the sub 5% range as we moved into the end of the quarter. Q4 has started to see an uptick in supply of 1YR and longer calls, which has aligned with customer demand.

Callable US Agency Bond Calls (billions)			
Q1 Calls	Q2 Calls	Q3 Calls	YTD
148	56	101	305

Bullet (non-callable) agencies remain tight to UST yields. While there is limited availability of deeply discounted bullets, some additional spread can be found in those structures. Much of the supply of agencies that were issued in 2020-2021 (and carry low coupons) are still held in bank portfolios with managers reluctant to realize losses through liquidation. As yields continue to trend lower, the opportunity to restructure out of those securities will grow, potentially providing a much-needed boost to secondary supply.

UST vs Current Coupon US Agency Bullets - 9/30/24			
Maturity	UST	US Agency	Spread (bps)
1YR	3.96%	3.96%	0
2YR	3.64%	3.69%	5
3YR	3.55%	3.60%	5
5YR	3.56%	3.59%	3
7YR	3.65%	3.72%	7
10YR	3.78%	3.96%	18

Municipals Focusing on Bankers' Bank's market footprint of IA, IL, IN, OH, MI and WI, Q3 saw a 46% decline in bank qualified issuance. Much of this can be attributed to the traditional seasonality of issuance. Projects often get approved, and bonds are issued in the spring to fund summer and fall construction. Roads and

general municipal civic improvement projects being the most typical. Year-to-date data is a bit uneven within the six-state grouping, but issuance overall is relatively flat.

State	BQ Issuance Q1 (millions)	BQ Issuance Q2 (millions)	BQ Issuance Q3 (millions)	2024 YTD Issuance (millions)	Year over Year Change
Illinois	200.22	106.53	105.80	412.56	54.67%
Indiana	30.94	72.66	59.50	163.10	-37.80%
Iowa	55.04	214.68	45.88	315.60	2.51%
Michigan	109.15	115.25	89.88	314.28	7.65%
Ohio	22.81	22.42	10.50	55.73	-35.00%
Wisconsin	122.65	235.52	103.76	461.92	-12.47%
Total	540.81	767.06	415.31	1723.18	-1.09%

Yields within the bank qualified market largely followed US Treasuries in Q3. Both markets experienced a steepening yield curve with the front end collapsing by 100 or more basis points to roughly half of that compression on the long end. Looking at absolute yields, the BQ market saw the disappearance of 3% and greater yields in the 1–10-year range. Not only is this a psychologically important barrier but from a taxable equivalent yield perspective, this challenges the relative value municipals offer to investors when compared to treasuries. The nuances of the municipal space still provide opportunity on a deal-by-deal basis and the steepness of the muni curve provides ample return as one extends. 2YR vs 10YR muni curve is 49 basis points steep while the same spread in US Treasuries is just 14 basis points.

"A" Rated Bank Qualified Municipal Yields			
Maturity	7/1/2024	9/30/2024	Shift (bps)
1YR	3.70%	2.70%	-100
2YR	3.67%	2.58%	-109
3YR	3.57%	2.57%	-100
5YR	3.57%	2.65%	-92
7YR	3.59%	2.82%	-77
10YR	3.61%	3.07%	-54
30YR	4.61%	4.06%	-55

Mortgages – Not surprisingly, agency mortgage-backed security pre-payments have been accelerating along with yields moving lower. With yields bottoming in late Q3, refinancing applications have grown foreshadowing even faster pre-payment speeds ahead. September prepayment speeds are up 47% from a year ago with GNMA issues seeing the largest volume.

CMO issuance expands support for the MBS market by being able to create structures that appeal to a broader range of investors which demand a variety of duration targets. In 2023, CMO creation was all but halted with the heavily inverted yield curve but has seen a strong rebound in Q3 2024 as the yield curve has begun to normalize. Demand for shorter-duration structures such as sequentials and floaters has also benefitted from improved bank demand, further driving the improved technical of the CMO market.

DTC Brokered CD's –From an issuer's perspective, the brokered CD market performed extremely well in the third quarter. The gravitational pull of falling US Treasury yields resulted in lower yields throughout all major fixed income markets including DTC CDs. In addition to lower yields, technical considerations also came into play in the DTC CD market. Due to improved bank liquidity, supply in the DTC CD market dropped considerably in Q3 which led to an outperformance of the sector. "All in" issuing yields (see chart below) started the quarter slightly higher than their UST counterpart but ended the quarter with "all in" rates lower than comparable US Treasuries. The result is a market that presents an opportunity for banks to lock in funding rates below UST yields. This is non-typical and is expected to reverse should supply in the DTC market increase.

Brokered CD's & UST Throughout Q3			
	7/1/24	9/30/24	Shift (bps)
DTC CD: 1 Year	5.20%	3.90%	-130
DTC CD: 2 Year	4.95%	3.75%	-120
DTC CD: 5 Year	4.60%	3.65%	-95
UST 1 Year	5.10%	3.98%	-112
UST 2 Year	4.75%	3.64%	-111
UST 5 Year	4.43%	3.56%	-87

IN CLOSING

Some quick takeaway ideas for banks:

1. Determine strategic balance sheet allocations to the investment portfolio for the remainder of 2024 and 2025. With portfolios running off throughout 2024, banks are relooking at earnings contribution, liquidity cash flows, and interest rate risk mitigation. Call the Bankers' Bank team on ideas for adding yield to the portfolio, managing cash flows, and strategic repositioning.
2. Many banks were hoping for rate cuts in the second half of 2024 to pull yields lower across the curve. We continue to recommend analyzing impacts from those potential changes on the portfolio to identify opportunities. Our Portfolio AdvantEdge reports model interest rate changes impact on securities level cash flows and market values. Use interest rate tools to model where your bank can better manage changing cash flows in a potentially volatile 2025.
3. Banks considering selectively repositioning the portfolio may hesitate selling bonds due to realizing losses. As you look into the remainder of 2024, there may be opportunities to take gains elsewhere in the bank and offset losses when strategically restructuring investments. Examples include selling MSR portfolios or one-time transaction gains. Other banks have considered selling variable rate MBS at a gain and netting out longer holdings at loss. These opportunities may allow for putting the portfolio into better position for future cash flow and yield needs.

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