BANKERS' BANK

VIEW FROM THE TRADING DESK

Fourth Quarter 2024

The doom and gloom sentiment that had a firm grip on the market at the end of the third quarter has flipped to one of optimism. End of year data along with commentary by the Federal Reserve has investors feeling good about the FOMC's ability to bring inflation under control while navigating a soft landing for the economy. At the conclusion of the FOMC December meeting, Federal Reserve Chairman Powell went so far as to announce rate cuts are on the table in 2024. While the market still has yet to be released economic data to analyze, it would appear the rate hike portion of this interest rate cycle has concluded.

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

Key Indices Returns

	Q4 Returns	2024 Returns
Bloomberg Global Aggregate	+8.10%	+5.72%
US Treasuries	+5.66%	+4.05%
US Aggregate Bond Index	+6.82%	+5.53%
MBS	+7.48%	+5.05%
Municipal Bonds	+7.89%	+6.40%
Taxable Municipal Bonds	+7.88%	+8.84%
Corporate Bonds	+8.50%	+8.52%

OUR TAKE FROM A COMMUNITY BANK INVESTMENT PORTFOLIO PERSPECTIVE:

<u>U.S. Treasuries</u> – The month of October experienced the highest yields of 2023 as the market continued to face strong inflation headwinds. Although the 10YR never closed higher than a 5%, that significantly important level was breached during intra-day trading on October 19th before closing at a 4.99%. Although not a straight line decline from its peak, Treasuries began their slide to its current 4% level as optimism grew that the Fed would reverse their rate hike policy along with some new economic data indicating slowing consumer demand and cracks in the strong labor market.

The December FOMC decision and subsequent press conference by Fed Chairman Powell proved to be the catalyst for the rally. During his press conference, Chairman Powell unexpectedly revealed that the Fed is projected to cut rates by as much as 75 basis points in 2024. While no firm timetable was provided, the immediate response by the market was to peg March as a date when the first rate cut could be implemented.

As the year closed out, longer maturities performed better relative to intermediate and short maturities but throughout the curve all sectors were positive. The benchmark Bloomberg UST index closed the year with a 4.05% total return in 2023. In totality, the bond market reversal the last two months of the year brought the index into positive territory and in a strange twist, ended the year with yields throughout much of the curve that are essentially the same as at the beginning of 2023.

US Treasury Bonds – Q4			
Maturity	9/29/2023	12/30/2023	Shift (bps)
1YR	5.46%	4.77%	(-69)
2YR	5.04%	4.25%	(-79)
3YR	4.80%	4.01%	(-79)
5YR	4.61%	3.85%	(-76)
7YR	4.61%	3.88%	(-73)
10YR	4.57%	3.88%	(-69)
30YR	4.70%	4.03%	(-67)

The broad belief in the economy setting up for a "soft landing" has pressed rates lower but with the front end of the curve anchored in place by the Fed, the yield curve as a whole remained inverted throughout the quarter. This is the seventh consecutive quarter of an inverted yield curve. Treasury 2s to 10s closed the year at a negative 37 basis points which is a notable difference when compared to the negative 106 bps slope we encountered at the end of the second quarter. While still inverted, optimism abounds that the curve will normalize as the Fed has hinted that Fed cuts are likely in 2024.

Quarter Ending US Treasury Slope (bps)				
Curve	Q1	Q2	Q3	Q4
2yr vs 5yr	-45.61	-73.82	-43.87	-40.48
2yr vs 10yr	-56.12	-106.29	-47.66	-37.28
5yr vs 10yr	-11.78	-32.07	-4.14	3.02
10yr vs 30yr	17.84	1.70	12.60	14.81

U.S. Agencies – Early in Q4 the market was still under duress as rates continued to rise along with tepid demand. To generate activity, agency issuers were coming to market with coupons in excess of 7%. FHLB issued eight (short call) structures with 7% coupons and FHLMC came to market with one. Moving into November and December issuing yields dropped considerably as investors flocked to the market to lock in cash flow. Closing out the year the market has seen a dramatic increase in 4-handle coupons entering the market so to drive interest, issues are structuring more bullets or bonds with better call provisions. It's not uncommon to see one-time, annual only or one-year (or longer) call provisions.

FHLB Issuing Coupons				
Month	4% Cpn	5% Cpn	6% Cpn	7% Cpn
Oct	6	38	41	8
Nov	2	67	41	1
Dec	30	95	9	0

Municipals Municipal bonds started the first leg of Q4 with a negative (-0.85%) return in October. This was the culmination of three consecutive negative performing months. YTD, the muni index stood at (-2.22%). In an unexpected turn of events, November gave investors a stunning rally on the heels of a strong UST rally. Due to limited supply, high grade general market municipals outperformed the strong UST rally by an incredible 33%. It was no surprise that the November MTD return surged to 6.35% and the once negative YTD return flipped to a positive 3.98%. Rounding out the quarter, December continued to experience strong demand and with supply constrained, municipals continued to outperform their UST counterparts. While December could not replicate the multi-year record return that November provided, falling yields continued provided a month-to-date return of 2.32%. This was the third best December since 1980 and capped of a year-to-date return of 6.4%.

"A" Rated Bank Qualified Municipals – Q4			
Maturity	9/29/2023	12/30/2023	Shift (bps)
1YR	4.18%	3.39%	(-79)
2YR	4.14%	3.29%	(-85)
3YR	4.03%	3.09%	(-94)
5YR	3.94%	2.88%	(-106)
7YR	3.95%	2.82%	(-113)
10YR	4.03%	2.92%	(-111)
30YR	5.12%	4.12%	(-100)

Mortgages – Following the broader trend in rates, MBS had a strong performance the final two months of 2023 as investors priced in a dovish Federal Reserve along with improved demand. Although quiet the last two weeks of the year, bank purchases did show some improvement in November and early December. Fed data showed bank MBS holdings increased for seven straight weeks during those months before dropping slightly at year end. The increase in demand combined with a falling rate environment generated total returns in November of 5.21% followed by a 4.31% return in December. Like UST, longer (30-year conventional) Fannie Mae and Ginnie Mae instruments fared better than their shorter 15-year offerings. Technical indicators suggest weak housing seasonals will cap originations in the next month or two which continues the low supply theme experienced throughout the year. Overall issuance in 2023 was the lowest since 2014.

In closing, 2023 finished with a positive 5.05% return which compares favorably to the historically notable negative (-11.42%) return investors were left with at the end of 2022.

DTC Brokered CD's – Issuing rates were at their highest at the end of Q3 into early Q4. By the end of December rates had come down nearly 40 bps when issuance dwindled. Moving into early 2024, issuance is up nearly 200% from a month ago with shorter term, 3 and 6 month CDs, being most popular. The inverted yield curve remains intact as we move into 2024. As such, extending out on the curve continues to afford lower issuing yields than those maturing inside of 12 months.

IN CLOSING

Banks have been approaching our team regarding strategic repositioning of bonds in the investment portfolio. Rather than restructuring the portfolio, the exercise is recognizing the late-year bond price improvements in parts of the portfolio to reinvest or pay off higher cost borrowings. These conversations discuss what percentage of the bank's balance sheet to be committed to investments for liquidity purposes.

Considerations for these sales: liquidity profile, pledging needs, and the bank's contingency funding plan. The conversations quickly review the bank's anticipated loan opportunities and comparable investment yields. With 2023 hindsight, 2024's likely focus will be utilizing the investment portfolio as source of liquidity first, interest rate risk management second, and earnings engine third. Please contact members of the Bankers' Bank Investments team to discuss potential portfolio strategies you would like to consider.

Tom Underkofler	SVP - Chief Investment Officer
John Kozak	SVP - Investment Director
Dave Murray, CFA	SVP - Investment Director
Anthony Parkhill	AVP - Investment Director
Lucas Miller	Investment Analyst

CONTACT US
Phone: 800.955.4468 | Email: Sales-TradingDesk@BankersBank.com | Website: BankersBank.com