First Quarter 2024

The sentiment at the end of the first quarter was a near full reversal of where it was at the beginning of the year. Some intra-quarter economic reports showed inflation was still a problem and was proving to be resilient despite the previous 11 FOMC rate hikes totaling 525 basis points. Rate cut projections in January were at 175 basis points. By the end of the quarter, that projection has slipped to 75 basis points and trending lower.

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

Key Indices Returns

	Q1 Returns	2024 Returns
Bloomberg Global Aggregate	-2.08%	-2.08%
US Treasuries	-0.96%	-0.96%
US Aggregate Bond Index	-0.78%	-0.78%
MBS	-1.04%	-1.04%
Municipal Bonds	-0.39%	-0.39%
Taxable Municipal Bonds	+0.10%	+0.10%
Corporate Bonds	-0.40%	-0.40%

OUR TAKE FROM A COMMUNITY BANK INVESTMENT PORTFOLIO PERSPECTIVE:

U.S. Treasuries – Long-dated Treasury yields finished the quarter at their highest levels in more than four months as traders re-embrace the higher-for-longer theme in interest rates. Year-to-date, the US Treasury index returned a negative (0.96%). With the front end of yield curve anchored by the Federal Funds Target Rate, the 1-3 year portion of the index was a positive 0.28. Moving out on the curve, inflation expectations rule the day so it was no surprise that the long end contributed the most negativity with a -3.26% contribution year-to-date.

Despite the FOMC participants' dot plots indicating three cuts are scheduled in 2024, the timing of said cuts continues to be pushed further out in time along with the increasing belief fewer than three rate cuts may be more likely than not. Repeatedly, Chairman Powell and other Fed Governors are reiterating the lack of urgency to make a move while inflation continues persist in the US economy.

US Treasury Bonds – Q1			
Maturity	12/30/2023	3/29/2024	Shift (bps)
1YR	4.77%	5.03%	26
2YR	4.25%	4.62%	37
3YR	4.01%	4.41%	40
5YR	3.85%	4.21%	36
7YR	3.88%	4.21%	33
10YR	3.88%	4.20%	32
30YR	4.03%	4.34%	31

U.S. Agencies – Early in Q1, the market was still extremely optimistic about a broad decline in yields. As such agency issuers were able to capitalize on lower coupon issuance, some were successfully placed with sub 4% yields. As the quarter progressed, so did the fear that the bond market rally in late 2023 was not warranted. As UST yields gradually rose, issuers were forced to attract investors with two strategies. The first is to expand the issuance of 6% coupon structures, but with limited call protection. Most typical would be a three-month lockout then callable anytime or quarterly thereafter. The second structure that saw more issuance were 5%-handle coupons with longer and fewer calls. The pick-up is a 5%-handle coupon offers over short UST is negligible, but the promise of securing a 5% or higher coupon for at least one or two years offsets that shortfall and is enticing if one believes the longer term projection for lower rates proves accurate. Furthermore, it is not uncommon for the call feature in these issues to be one-time events or an annual event rather than the traditional quarterly calls we have seen over the previous cycle.

FHLB New Issue Coupons (# of issues)				
Month	3% Cpn	4% Cpn	5% Cpn	6% Cpn
Jan	2	72	111	11
Feb	0	41	162	25
Mar	0	31	127	30

Municipals Following Treasuries, municipals also felt pressure during the first quarter with yields up throughout the curve. As a whole, the Bloomberg Municipal Bond Index finished the quarter at an uninspiring 0.39% return. Counter to the total return lacking is that these higher yields could be the answer to what has turned out to be an anemic amount of interest from buyers in the Bank Qualified market. With banks earning over 5% in cash, the muni market was challenged to attract investors with most 1-10 year new issue maturities coming to market with exempt yields of 3% (or less). Despite higher borrowing costs, banks are reporting stable loan demand and while liquidity has improved from late 2024, there is not an abundance that would compel banks to chase yield in the muni space at this time.

"A" Rated Bank Qualified Municipals – Q1			
Maturity	12/30/2023	3/29/2024	Shift (bps)
1YR	3.39%	3.73%	34
2YR	3.29%	3.54%	25
3YR	3.09%	3.38%	29
5YR	2.88%	3.14%	26
7YR	2.82%	3.17%	35
10YR	2.92%	3.23%	31
30YR	4.12%	4.55%	43

Bank Qualified municipal supply in the Bankers' Bank region is up 20% year-over-year led by Illinois which has surpassed Q1 2023's supply by an impressive $116 million. Iowa and Indiana saw declines in issuance during Q1. Iowa's $55 million in issuance is the least amount issued in Q1 since 2018's $58 million. Similarly, Indiana's $31 million is the least amount of bonds issued since 2019's $23 million. The muni market as a whole (both general market & BQ) saw issuance jump by 33% to almost $100 billion in Q1 as issuers flocked to the market to take advantage of last fall's strong drop in rates. With yields increasing as the quarter dragged on, it will be interesting to see if supply falters or if renewed interest by investors due to higher yields continues to keep the supply lines open.

BQ Municipal Supply by State ($ millions)			
State	Q1 2023	Q1 2024	YoY Change
Illinois	98.919	215.24	117%
Indiana	47.675	30.94	-35%
Iowa	75.395	55.04	-27%
Michigan	70.897	109.15	54%
Ohio	74.035	74.387	0%
Wisconsin	151.265	139.65	8%

Mortgages – Issuance in 2024 remains lackluster while demand slowly increased as the quarter progressed. The MBS index was up 1.06% on a total-return basis for March, but are still negative 1.04% year-to-date. As a whole, it's been relatively calm in the MBS sector in Q1 giving investors more confidence to put money into the market. As mentioned, supply is still quiet with just $77.7 billion in gross issuance in March on top of February's $67.7 billion. That marks three consecutive months with issuance below $80 billion. High housing costs were partly to blame, but supply could pick up as the spring housing seasonal moves into high gear.

<u>DTC Brokered CD's</u> – While there was a small drop off in bank's accessing the brokered CD market, interest remains stable. The inverted yield curve remains intact and as such, extending out on the curve continues to afford lower issuing yields than those maturing inside of 12 months. Furthermore, interest from investors trying to acquire CD's remains constant which has allowed banks to issue debt at, very near or at even lower yields than comparable treasuries.

IN CLOSING

During a relatively quiet quarter for purchases, we are starting to see some bank portfolio managers dip their toes in the market. Predominant interest has been in securities where can meet their bank's liquidity profile, pledging needs, and fits overall asset liability mix. For Bankers' Bank safekeeping customers in Q1 2024, significant purchasing activity by type was 26% in MBS, 23% US Treasuries, and 18% municipals.

Our team's conversations discuss the bank's anticipated loan opportunities and comparable investment yields. The focus in 2024 continues to be utilizing the investment portfolio as source of liquidity first, interest rate risk management second, and earnings engine third. Please reach out to the members of the Bankers' Bank Investments team to discuss your bank's potential portfolio needs.

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