CAPITAL MARKETS *monthly*

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GENERAL MARKET OVERVIEW

The sticky inflation narrative has been dispelled by two consecutive months of a lower Consumer Price Index (CPI), which reduced interest rates. What's more, lower prices were broad-based and not isolated to gasoline. Services were flat, with rents and new/used auto prices all finally slowing.

Importantly, June marks the first consecutive multi-month decline in the CPI since the pandemic lockdown of March-May 2020. Prior to that was the oil crash in 2016. This helps policymakers and markets find signal in the statistical noise of volatile data points.

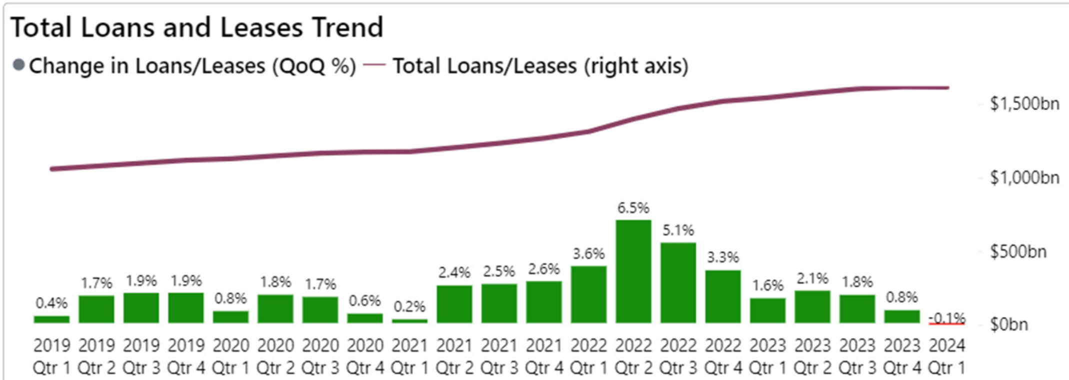
Albeit short, this streak of disinflation coupled with eight to 10 weeks of soft economic prints has rate cuts priced in for the September Fed meeting. It remains to be seen if cutting rates will have a short-term stimulative effect on borrowing and the economy, considering how resilient the U.S. economy was in the face of rising rates.

As highlighted in a recent ***CU Today* article**, loan growth has slowed and is projected to remain weak through 2025. Same goes for our banking brethren. In the credit union space, outstanding loans and leases shrank beginning in Q1 2024 for the first time in many years. The decline was modest at 11 basis points, but high rates and a softening economy will continue to put downward pressure on loan demand. The net growth in loans outstanding has steadily declined since Q2 2022 and finally went negative. At $114 billion, quarterly loan originations were the lowest since Q1 2019, leading to the decline in net outstanding loans. *Continued on page 2*

The credit allocation to loan types remained steady over the past five years with two notable drifts.

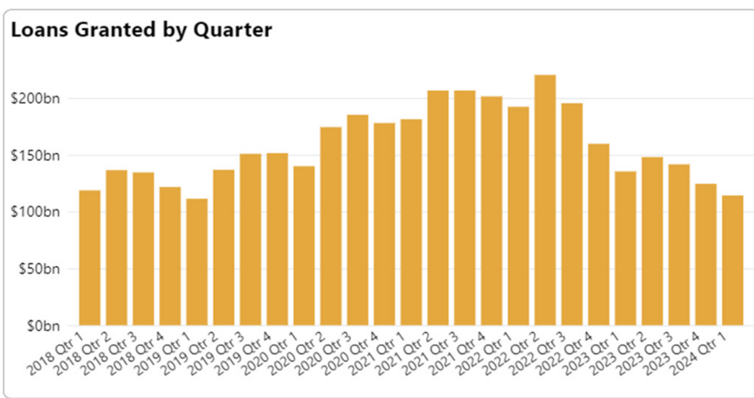
1 The loan allocation to commercial real estate has increased from 6.4% in 2019 to 9.4% as of Q1 2024.

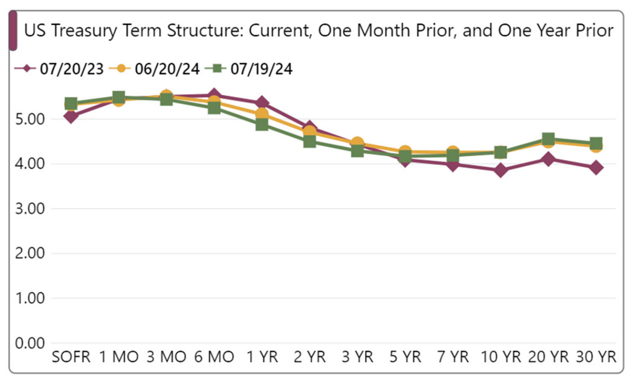
2 New vehicle loans have decreased from 14.0% to 10.8% of outstanding loans over the past five years. Some of this decline is due to credit unions tapping the securitization market (more on this later).

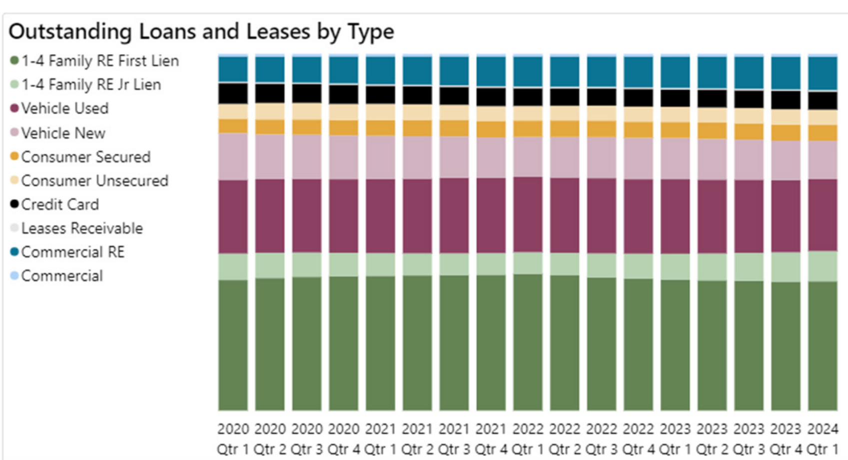


Stagnant bank loan demand creates balance sheet capacity for non-lending activities, with many market participants turning bullish on Treasuries and other fixed income securities.

July 6 marked the two-year inversion anniversary of the U.S. Treasury yield curve. At the time of this writing, that's a record 750+ days of inversion, significantly outlasting the previous longest inversion streak of 624 days starting in August 1978. The previous record inversion in the late '70s preceded a double-dip recession. The timing of the yield curve's normalization largely depends on the U.S. Treasury's taming of their issuance schedule as well as the Fed's looming rate cut.







This month, the curve did briefly un-invert but not in the oft-referenced 2-year/10-year pair. Rather, the 2-year/30-year pair normalized to a positive term structure. This is an important signal for the broader un-inversion to come. In all likelihood, the 2-year will fall further in a bull steepening as it historically front-runs Fed policy. Perhaps a misnomer, the "bull" in "bull steepening" does not mean an overall growing economy. Rather, it is bullish for bond holders and those already invested in safety and liquidity as rates generally decline, which lifts their existing holdings.

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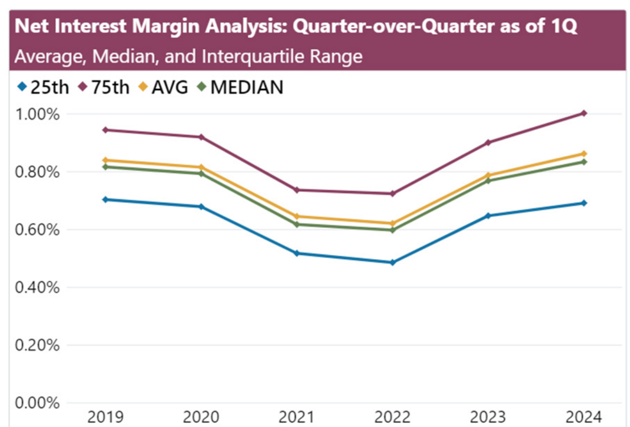
The long bond fell out of favor when the U.S. Treasury stopped issuing them in 2001 in the aftermath of former President George W. Bush's position that the U.S. would run surpluses for the foreseeable future and didn't need 30-year paper to fund smaller deficits. In 2006, as deficits got bigger, the Treasury began re-issuing the 30-year long bond with $14 billion issued (which was a lot back then) at 4.5%, nearly a full percentage point lower than what they yielded in 2001. At the time, the strong demand for 30-year paper was a warning of the unravelling about to ensue, but that is a story for another letter.

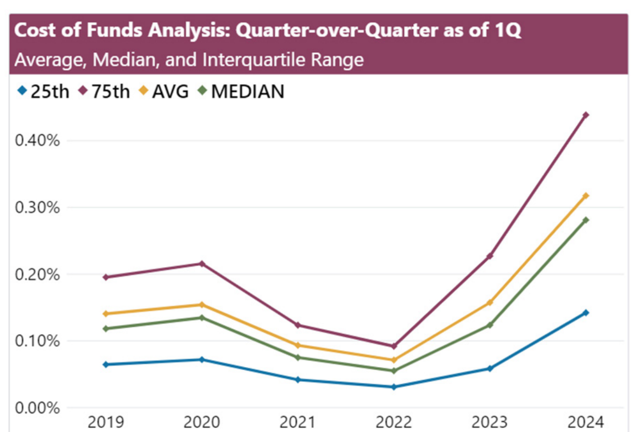
Today, market participants are betting that the curve will start to become a normal upward-sloping curve in the near future. The following factors point to this:

1. The Federal Reserve's preferred inflation measure, core personal consumption expenditures (PCE), was trending lower for June along with the core CPI.
2. Gross domestic product (GDP) for the first quarter was revised lower to +1.3%, showing an economic slowdown, and the second quarter is expected to continue that trend.
3. June's Federal Open Market Committee (FOMC) dot-plot showed a 25-basis-point cut at their December meeting. However, given the data on inflation, economic growth, and the labor market, Treasury yields have fallen since the FOMC's June meeting.
4. Swap futures have priced in a 100% chance of a 25-basis-point cut at the FOMC's September meeting and a probability of 87% for another 25-basis-point cut in December.
5. Federal Reserve Chairman Powell's recent remarks confirm that the Fed will not need to wait until inflation hits their 2.0% goal before reducing the fed funds rate.

The next FOMC meeting is July 30-31, and traders and economists are not expecting a change at that meeting.

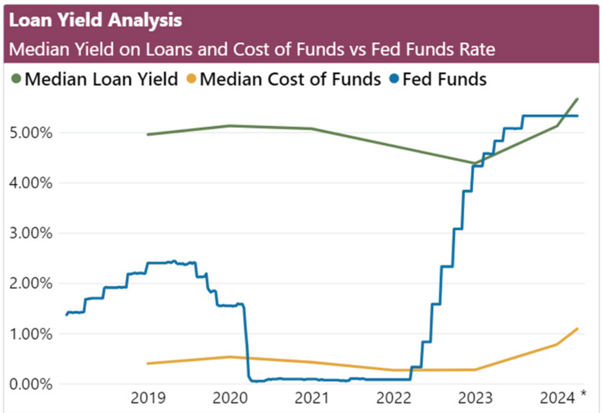
Falling rates will help alleviate some balance sheet pressure from underwater securities, though the majority of credit unions have successfully weathered the higher short-term rate regime and inverted yield curve. Rising short-term rates and the increase in cost of funds have not compressed margins as much as one would have predicted at the beginning of the hike cycle. Lenders reliant on wholesale funding have experienced margin compression, but most credit unions enjoy stable, loyal members and a relatively low cost of funds compared to non-traditional lenders. Members are willing to keep shares in near 0% yielding checking accounts. Net interest margins (NIM) continue to expand. See the trend charts at right for both quarter-over-quarter NIM and cost of funds. Each respectively shows the average, median and interquartile range (between the 25th and 75th percentile) to gain a more complete, data-driven picture of the credit union industry's financial condition. *Continued on page 4*



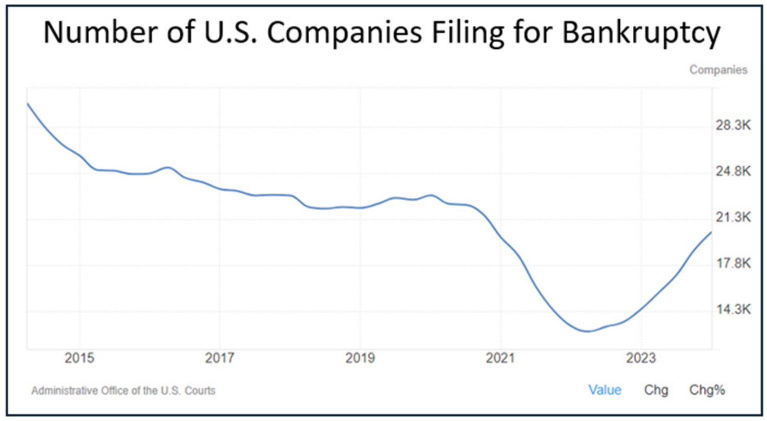


In 2023, the median loan yield temporarily fell below the fed funds rate due to the rapid rate increases beginning in March 2022. One in four credit unions lost money in Q4 2023, whereas only one in five lost money in Q1 2024. As of Q1 2024, the median credit union once again had an estimated loan yield above fed funds. While the cost of funds is increasing, the median credit union has a comfortable margin of safety between interest income and expense.

While there are a few underperforming outliers, credit unions are overwhelmingly managing interest rate risk while navigating the current environment to their advantage. Less can be said about U.S. corporations in general. Over the same period of NIM expansion, U.S. companies filing for bankruptcy is up over 50%.

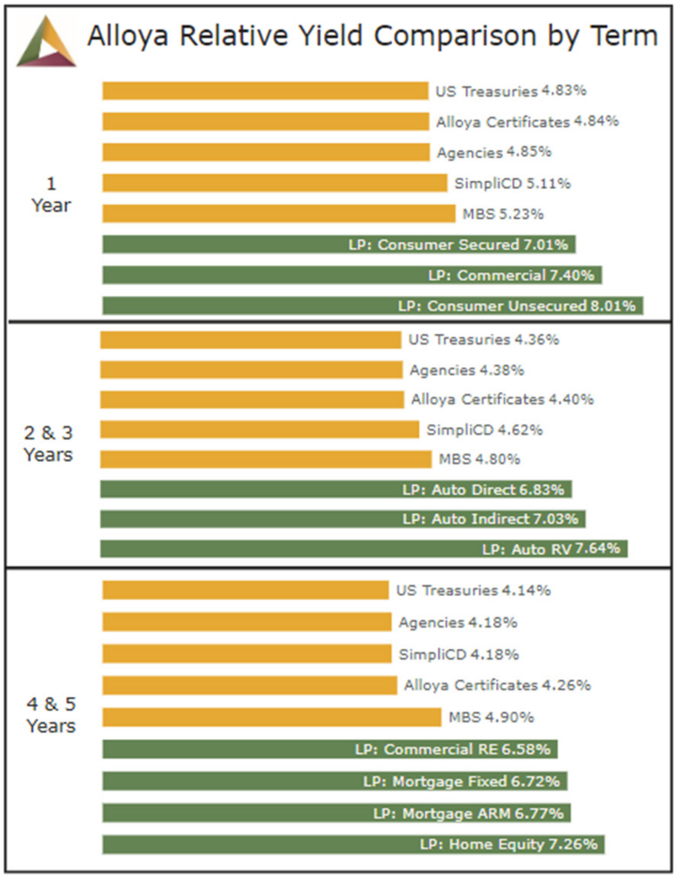


* 1Q24 annualized estimate.



LP MARKET OVERVIEW

This month we bring you enhanced visibility into the nascent market of loan participation investor net yields. To the right is a chart showing the relative value of various loan participation asset types compared with other typical investments credit unions hold on their balance sheet. As you can see, participations offer attractive risk-adjusted returns across all loan types and durations. What's more, these macro net yield estimates include an imbedded annual loss estimate, which is standard on Alloya's Loan Participation Platform. Be wary of brokers foregoing loss estimates to boost their yield expectations.



The subordinated debt market has been slower through the first half of 2024 but is poised to finish strong throughout the remainder of the year. Applications are being submitted to the NCUA ahead of the widely anticipated September rate cut. Bank acquisitions are at the forefront for credit unions right now and subordinated debt is helping to fund these initiatives. We are also seeing both smaller and larger credit unions take advantage of subordinated debt opportunities to help expand their operations for their members. Applications typically take 60 days to receive NCUA approval, and once approved, credit unions have 24 months to access the approved funds for various purposes.

Alloya served as co-placement agent on the subordinated debt transaction at right. We anticipate more deals to come in the months ahead. If you're looking to invest in an upcoming issuance, consider discussing the opportunities with your Alloya Investment Services representative.

AltaOne FEDERAL CREDIT UNION

RIDGECREST, CA

HAS ISSUED

$20 MILLION

IN SUBORDINATED DEBT

JUL 12, 2024

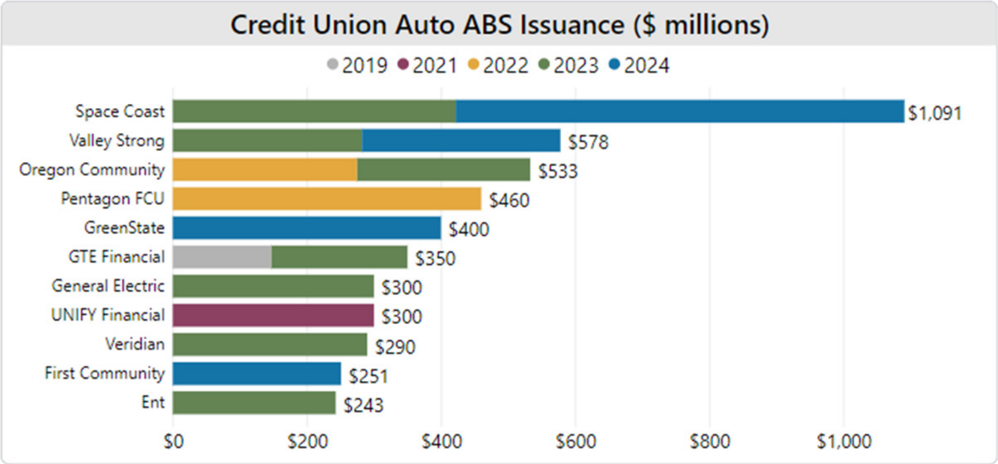
ALLOYA SERVED AS CO-PLACEMENT AGENT

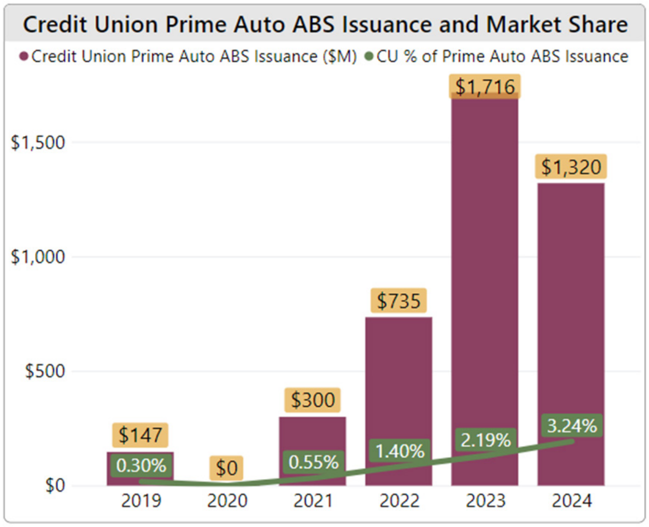
alloya

Issuance Size	IG Egan Jones	Kroll BBB-	Kroll BBB	Kroll BBB+	Unrated
50MM	8.500% +/-	8.500% +/-	8.500% +/-	8.500% +/-	8.500%-9.000% +/-
50MM-100MM	8.500% +/-	8.500% +/-	8.500% +/-	8.500% +/-	-
100MM+	8.500% +/-	8.500% +/-	8.500% +/-	8.500% +/-	-

Space Coast Credit Union 2024-1

Class	Size ($M)	WAL	Rating	Spread	Coupon	Yield	Price
A1	81.1	0.13	A-1+	30	5.66%	5.66%	100
A2	256.7	1.01	AAA	68	5.45%	5.52%	99.9938
A3	173.9	2.39	AAA	82	5.11%	5.17%	99.9952
A4	103.87	3.59	AAA	105	5.16%	5.22%	99.9739
B	20.96	4.14	AA	125	5.33%	5.39%	99.9985
C	24.34	4.14	A	155	5.62%	5.69%	99.9866
D	8.45	4.14	BBB	220	6.25%	6.34%	99.9717





Footnote: As of 7/20/2024

Congratulations to Space Coast Credit Union on their second auto asset-backed-security (ABS) issuance. At $669 million, this is the largest credit union ABS issuance by a considerable margin. The second largest issuance was $460 million from Pentagon Federal Credit Union back in 2022. The latest Space Coast prime auto deal offers spreads ranging from 30 to 220 basis points depending on risk tranche.

Eleven credit unions have issued an auto ABS since 2019, with several credit unions successfully issuing multiple ABS deals. This most recent Space Coast deal pushes their total issuance over $1 billion while propelling the credit union industry's 2024 prime auto ABS market share up to an impressive 3.24%.

STRATEGY: Did You Know?

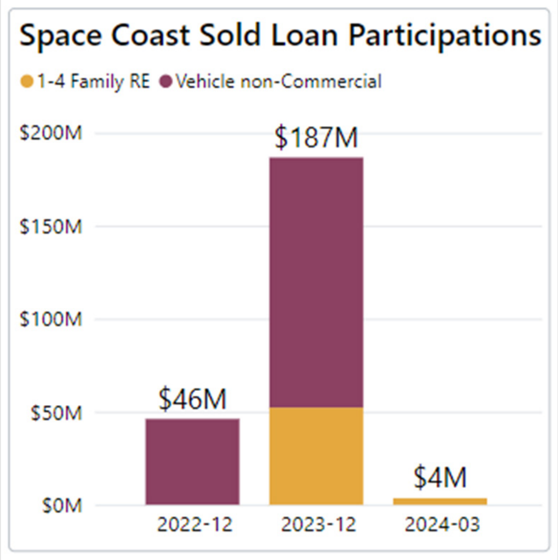
The Borrowing Ladder Solution

Laddering out investments for a credit union investment portfolio has proven to be an effective tool to balance a financial institution's liquidity and cash flow. This same concept and its principles of using a borrowing ladder (think inverse) can also be applied to a credit union's borrowing needs. By matching maturities to assets, this results in a better asset-liability management (ALM) profile, lowers interest expense and is an efficient plan of deleveraging. The borrowing ladder concept even works with an inverted yield curve.

This approach mitigates two potential problems the NCUA has addressed: the lack of liquidity and the mismanagement of a financial institution's balance sheet. Regarding your balance sheet, think of a twin step ladder – a step ladder with rungs on both sides.

FINAL THOUGHTS

"Risk means more things can happen than will happen," according to Elroy Dimson of the London School of Business. That is why we think in probabilities and contingencies at Alloya. We are proactively building solutions for the ever-shifting opportunity landscape in capital markets. Case in point, with more credit unions issuing ABS, auto assets will likely continue to migrate from loan participations to auto ABS, and this secondary market asset migration could have a material impact on credit union business models and balance sheet strategies. For instance, Space Coast sold a material amount of loan participations in 2022 and 2023 but moved to the ABS market in 2024. As more credit unions explore ABS, the supply of loan assets available for loan participation purchases will decrease. Rest assured, Alloya is poised to provide credit unions with solutions to take advantage of the growing securitization outlet.



Lastly, we congratulate Bill Paton on his promotion to Capital Markets Sales Director. Bill has done an excellent job managing the Loan Participation and Subordinated Debt sales teams and will now also take over management of the Alloya Investment Services sales team. Bill is always eager to accept new challenges and we know that he will excel in his new role. We are also grateful that Tom Slefinger has graciously stayed on board as Market Strategist to continue delivering credit union-focused economic and market insights through speaking engagements and his weekly and daily newsletters.