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# CAPITAL MARKETS *monthly*

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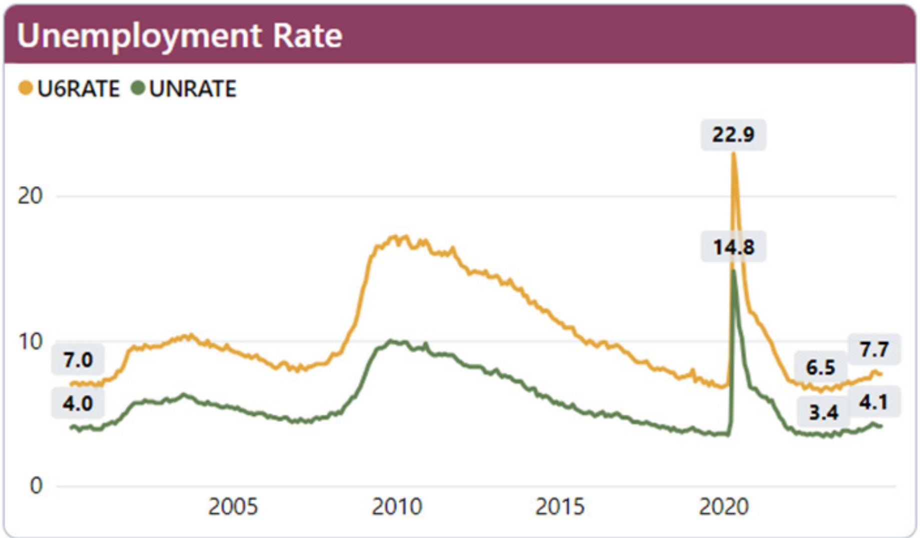
## GENERAL MARKET OVERVIEW

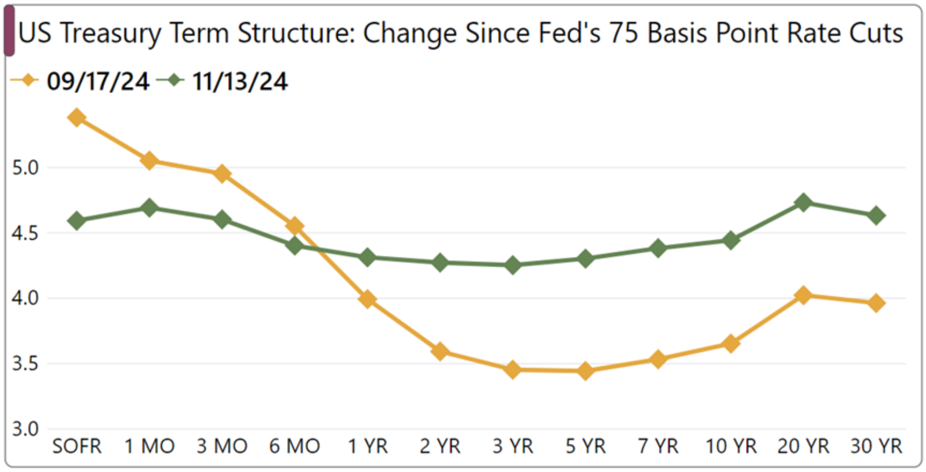
***Where do we go from here?*** Macro weakness at the onset of November paved the way for further interest rate cuts. The October jobs report revealed the worst labor market since late 2020. Just 12,000 new payrolls were reported, a huge miss from the 100,000 consensus estimate. The Bureau of Labor Statistics noted the survey was impacted by Hurricane Helene and the 44,000 worker Boeing strike. The unemployment rate as well as the U-6, which includes broader underemployed and discouraged workers, came in flat at 4.1% and 7.7%, respectively.

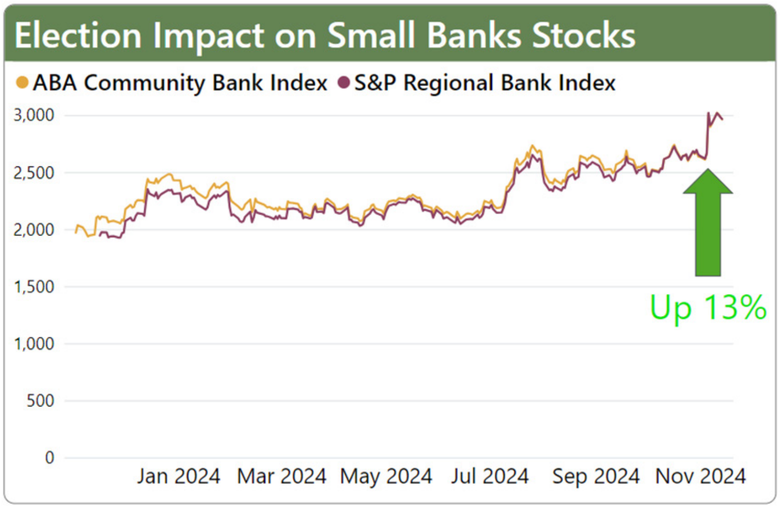
It is noteworthy that alongside October's numbers came several downward revisions to the prior month's payrolls. August was revised to 78,000, while September was trimmed to 223,000. In total, 112,000 jobs were removed from prior prints, which follows the trend of many downward revisions made over the past year. The downward revisions have become so common that economists are now baking them into models. Under the hood, we find disparity between private labor force versus government workers. Private payrolls have stalled while government workers have increased by 188,000 since March and now represent 14% of the total U.S. labor force. Post-election, this dynamic will likely come under much scrutiny. What's more, the Federal Reserve has made clear they do not see inflation risk coming from the labor market, so there was no reason to slow down rate cuts. *Continued on page 2*




Third quarter GDP growth came in at a healthy 2.8% annualized pace but was a slowdown from 3% in Q2. The GDP print highlighted the continued strength of consumer spending, which accelerated to 3.7% annualized growth. However, the problem with consumer-led growth is that it is bifurcated across society. Bloomberg economist Eliza Winger explains, “The headline GDP print for 3Q makes the economy look strong, but beneath the surface things are less stable. Consumer spending, the main growth driver, has been narrowly boosted by upper-income households, while lower-income ones have grown more price-sensitive.” These strong aggregate numbers are driven by wealthier households, which mask the experience of the median consumer. Enter the 2024 election.

The election had an immediate impact on market sentiment and the fed funds futures with a post-election bias towards growth and fewer interest rate cuts. Treasury yields from the last month have drastically risen across the curve despite the Fed decreasing interest rates by a total of 75 basis points in their last two Federal Open Market Committee (FOMC) meetings. The Treasury curve continues to steepen, especially after five years, which indicates inflationary fears. Long-term Treasury buyers want an additional yield for inflation and interest rate risk. The future Trump Administration’s potential new policies on tariffs and immigration have created a market environment of uncertainty. Chairman Powell recently stated, “The economy is not sending any signals that we need to be in a hurry to lower rates.” As of this writing, the Atlanta Fed’s GDPNow forecast for Q4 GDP is at +2.5%. However, most likely, the Fed is preempting the possibility of higher inflation in 2025. The Consumer Price Index (CPI) and Producer Price Index (PPI) data in October reinforced that inflation is “sticky” and is expected to remain so or to go even higher next year. The FOMC December rate projection dot-plot is expected to verify the slowdown in the Fed cutting rates in the future. *Continued on page 3*






The consensus is that the election boosts investors' mood and risk appetite. Bank stocks jumped on November 6, giving us a window into market sentiment. Both the American Bankers Association (ABA) Community Bank Index and the S&P Regional Bank Index traded up 13% post-election.

It is worth noting below other potential impacts of Trump's key issues.

| | Impact | | |
|---|---|---|---|
| **Key Issue** | **GDP** | **Inflation** | **Interest Rate** |
| Extension of tax cuts | ↑ | ↔ | ↑ |
| Increased Tariffs | ↓ | ↑ | ↑ |
| Reduced Immigration | ↓ | ↑ | ↑ |
| Deregulation | ↑ | ↔ | ↔ |

While some believe higher long-end rates are sending a warning to the Fed, the more optimistic point out that the 10-year Treasury tracks nominal GDP over time and could signal good times ahead. A simple way to think about policy impact is to consider internal, U.S. supply-constrained inflation versus external, global non-supply-constrained deflation. Both tariffs and the Trump immigration policy point north on inflation. History rhymes. Inflationary periods lead to protectionism and populism, where policies pivot to maximize median outcomes instead of mean outcomes. Many observers got this wrong over the past four years by focusing on aggregate and average outcomes that did not consider the nuance and skew in the K-shaped recovery since the Global Financial Crisis. The "median" voter pulled the lever in the booth, not the "average," which caused pollsters and pundits to miss the Republican sweep.

Interest rates rising at the long end with a steeper curve will likely also lead to a stronger dollar and acceleration of structural trends. Monetary and fiscal policy on full tilt could only work in the U.S. This cannot work in Egypt or Turkey without 80-100% inflation like with President Erdogan in Turkey. But as long as the U.S. can maintain the exorbitant privilege of an entrenched reserve currency status, we can enjoy short-term tail winds. The problem is dealing with the repercussions of the inflationary tax that is exported to the rest of the world. Rome can grow by taxing its provinces for a long time while accumulating power and resources, but it is that very dynamic that undermines the system. There are already signs of the rest of the world maneuvering for a new geopolitical order. Indeed, just a couple of weeks ago, the takeaway from the sixteenth annual BRICS Summit is that we are firmly on trend away from the USA as hegemon and moving toward a multi-polar world. Read more about these takeaways in ***International Banker.*** *Continued on page 4*

Tariffs are a classic example of a "tit-for-tat" game theory conundrum for repeated games. The game generally begins with cooperation (e.g., free trade agreements), but descends into bouts of defection, retaliation, forgiveness and/or escalation. A 2x2 matrix is a classic way to represent a game-theoretic scenario between two players. For illustrative purposes, the tit-for-tat strategy payoff matrix might look something like this:

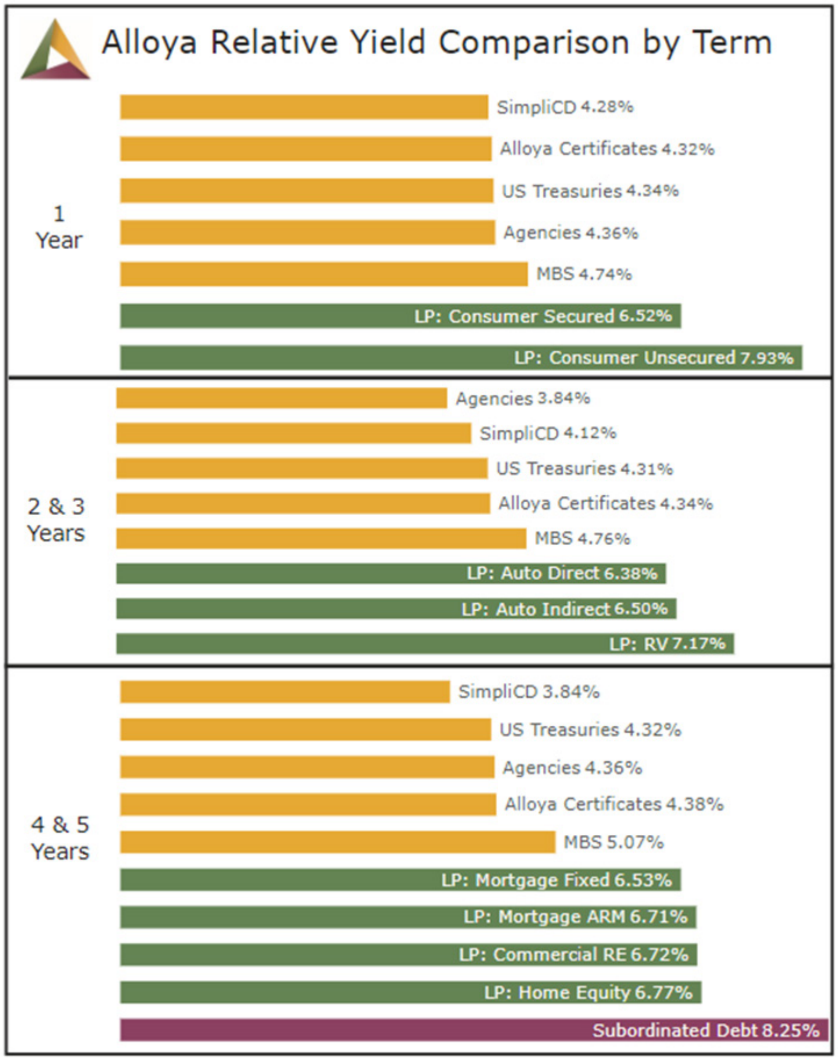
| Player A / Player B | Cooperate | Defect |
|---|---|---|
| Cooperate | (3, 3) | (0, 5) |
| Defect | (5, 0) | (1, 1) |

Players begin with cooperation leading to a payoff of (3, 3), or a mutually beneficial outcome. If only one player defects (imposes a tariff) then they can increase their payout, say to +5. However, when the other player retaliates, the payoffs drop to (1, 1), below the original cooperative payout. Players can return to cooperation by mimicking the other's cooperation, lowering tariffs and restoring the higher cooperative payout (3, 3). In theory, the incentives promote mutual cooperation in repeated interactions, as they yield the best long-term outcomes. In reality, non-economic incentives are in play that pro-tariff strategists believe are worth pursuing to weaken a geopolitical adversary.

Lastly regarding tariffs, interestingly, the Fed's **September 2018 Tealbook** recommended that tariffs should be viewed as transient (just like inflation in 2021?) and that hiking rates to combat tariff-related inflationary pressures causes recession.

## *LP MARKET OVERVIEW*

***We once again offer readers*** enhanced visibility into the nascent loan participation market. The accompanying chart shows the relative value of various loan participation asset types compared with other typical investments credit unions hold on their balance sheet. Yields are rising, while loan participation spreads remain constant across various loan types. Our Loan Participation Platform is experiencing strong trade activity in both autos and mortgages as our members come together to both shore up liquidity and invest excess cash going into the end of the year.



***Where do we go from here*** in the subordinated debt market? With volumes soaring in 2023 with over $600 million issued in the credit union market, we saw things slow down quite a bit in 2024 with projected issuance totals being less than $100 million to close out the year. We think there were a few factors that contributed to this. Higher rates and tight liquidity made it difficult for issuers and investors to participate in the subordinated debt market.

As rates have begun to come down during the second half of 2024, we have seen more appetite in the market for subordinated debt issuance in 2025. Credit unions are feeling more confident in current market rates, and where they are headed over the next few years is causing a surge of applications to be submitted to the NCUA for approval. This means that for issuers, growth strategies are in motion, and they are utilizing subordinated debt to help supplement their capital to fuel these plans.

blue FEDERAL CREDIT UNION

CHEYENNE, WY

HAS ISSUED

$10 MILLION

IN SUBORDINATED DEBT

OCT 29, 2024

ALLOYA SERVED AS PLACEMENT AGENT

alloya

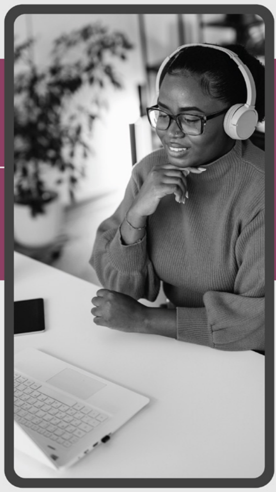
EDUCATIONAL EVENT

**Subordinated Debt 101**

DECEMBER 5
2:00 pm CT

REGISTER NOW

Join us to learn the ins and outs of subordinated debt investment and how your credit union can get involved in 2025!



What does that mean for investors? Are the days of high return yields over? Well, not quite. We feel that spreads on these investments will remain consistent over the 10-year Treasury. These spreads are typically much wider than other comparable investments in the market, making it a great opportunity for credit unions to increase their earnings. With the NCUA stamp of approval on each issuance, what better way to utilize excess liquidity to invest in credit unions, earning strong yields with each investment.

Alloya served as placement agent on the subordinated debt transaction featured above. 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.

***Current Market Rates***

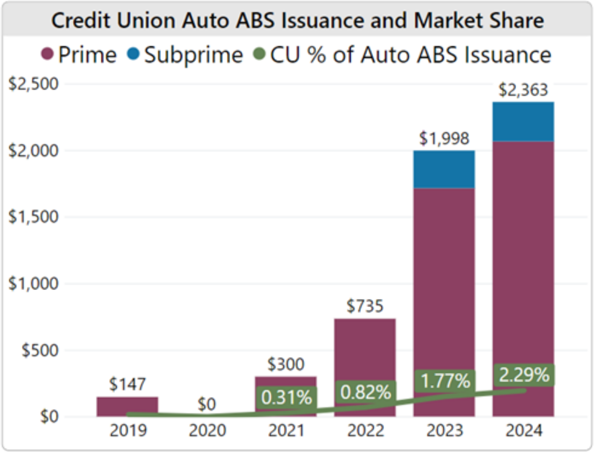
| Issuance Size | IG Egan Jones | Kroll BBB- | Kroll BBB | Kroll BBB+ | Unrated |
|---|---|---|---|---|---|
| 50MM | 8.000% +/- | 8.000% +/- | 8.000% +/- | 8.000% +/- | 7.500%-8.500% +/- |
| 50MM-100MM | 8.000% +/- | 8.000% +/- | 8.000% +/- | 8.000% +/- | - |
| 100MM+ | 8.000% +/- | 8.000% +/- | 8.000% +/- | 8.000% +/- | - |

***Congratulations to American Heritage Credit Union*** on their inaugural auto asset-backed-security (ABS) issuance! The $300 million deal offers yield spreads ranging from 15 basis points in the short duration A1 tranche to 215 basis points in the riskier residual risk tranche. The weighted-average credit score is 763, while the weighted-average APR is 7.8% on nearly 12,000 car notes.

***American Heritage CU (AHART 2024-1)***

| Class | Size ($M) | WAL | Rating | Spread | Coupon | Yield | Price |
|---|---|---|---|---|---|---|---|
| A1 | 42.5 | 0.23 | A-1+ | 15 | 4.67% | 4.67% | 100 |
| A2 | 117.6 | 1.09 | AAA | 58 | 4.83% | 4.88% | 99.99997 |
| A3 | 81 | 2.42 | AAA | 68 | 4.90% | 4.96% | 99.98964 |
| A4 | 34.8 | 3.49 | AAA | 85 | 5.07% | 5.12% | 99.99967 |
| B | 8.8 | 3.9 | AA | 110 | 5.32% | 5.38% | 99.99089 |
| C | 8.8 | 3.9 | A | 142 | 5.63% | 5.70% | 99.9812 |
| D | 6.5 | 3.9 | BBB | 215 | 6.34% | 6.43% | 99.97444 |

This $300 million American Heritage deal brings credit union year-to-date auto ABS issuance to over $2.3 billion. Credit union ABS issuance has steadily increased over the past five years and so has credit union market share. While credit unions have made strong inroads into a securitization market dominated by both banks and captives, there is still a lot of potential for our industry to compete. Capital market ABS investors are excited about the risk-return profile of credit union auto paper.



## *FINAL THOUGHTS*

***We are in a period of immense change.*** Whether managing consternations or bemused with a sardonic smile, we are one nation and are co-producing the future together. On balance, sentiment is optimistic. Business outlook can be a self-fulfilling prophecy as optimism spurs both investment and lending. Therewith, investment and credit expansion fuels growth and further optimism in a self-reinforcing virtuous cycle. Historically, markets prefer congressional gridlock, but a "red wave" could accelerate change. Alloya is positioned to add value to credit unions' members not only throughout an election cycle, but, most importantly, during the business and interest rate cycles. The American system was designed to withstand colossal pressure without breaking. The game theory on respective checks and balances will continue to serve American interests. So where do we go from here? Here are some thoughts and suggestions:

- Ladder marketable securities that are highly liquid (e.g., Treasury notes, non-callable agencies, mortgage-backed security pools (not collateralized mortgage obligations), and high-rated corporate bonds rated A or better).
- Remember: Spread relationships are constantly changing due to economic, credit ratings, and Treasury Market yields.
- Again, be very mindful of your liquidity.
- Know your strategic plan for 2025, especially as it relates to loan goals and investment protocols.
- Look for potential relative value in other asset classes like loan participations and subordinated debt offerings.
- Pay close attention to economic reports and political events.

***And finally, ask questions***. Need additional analysis? Alloya's Capital Markets group has tools free of charge that can help. This includes investment portfolio analysis, investment "what if" scenarios and loan portfolio analysis.

> ***Games people play, you take it or you lose it. If I promise you the moon and the stars, would you believe it?***
>
> "Games People Play" by Alan Parsons