



Monthly Market Update Webinar Series | January 12, 2022

ALM First Market Update

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Speaker



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Chief Investment Officer



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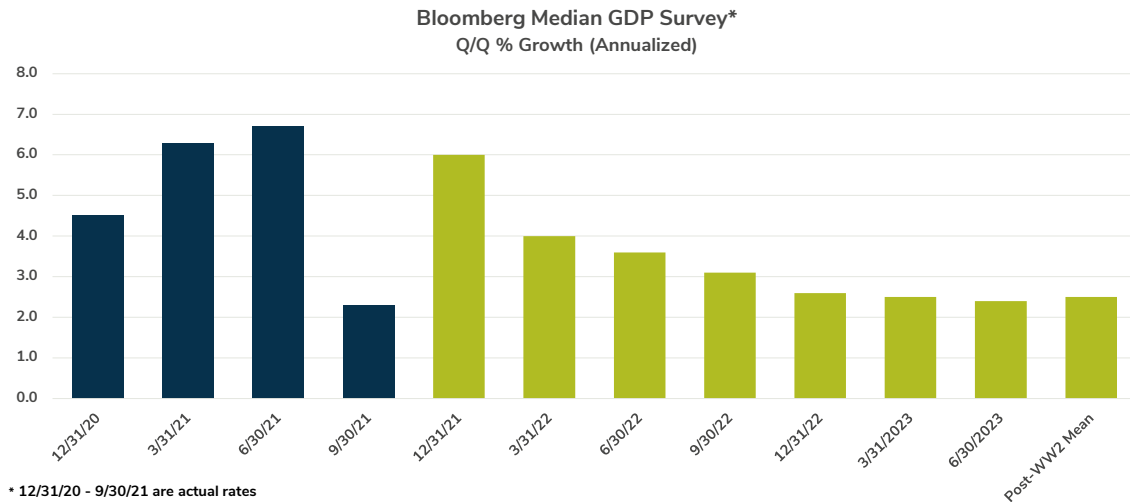
Agenda

- Economic themes
- Market themes
 - Review December and 2021 performance
- 2022 Thoughts

Economic Themes

- **When doves become hawks**
 - Sharp reversal of guidance from the Fed from “not thinking about thinking about” rate hikes for much of 2021 to potentially 3-4 hikes in 2022, potentially as early as March
 - From QE to QT
 - Asset purchases (quantitative easing) now being tapered at \$30 billion per month (on pace to end in March)
 - 12/15 FOMC minutes suggested balance sheet reduction may be a 2022 event
 - “Participants judged that the appropriate timing of balance sheet runoff would likely be close to that of policy rate liftoff than in the Committee’s previous experience”
 - 24 bps increase in 5yr Treasury yield last week tied with 2003 for the most to start a new year in at least 3 decades
- **Economy still on a solid footing; Covid still a nuisance**
 - Tailwind of significant monetary and fiscal stimulus still fueling expansion to begin 2022
 - Growth expected to normalize toward longer-run trend rates in second half of the year
 - Dec. purchasing managers indices (PMI) in Europe, Asia, and U.S. indicated that supply-chain disruptions and associated cost increases abated somewhat
 - Omicron variant likely a greater impact on supply side than demand (i.e., net inflationary)
 - Housing market still has strong momentum, but affordability is now at the lowest level post-financial crisis
 - Higher mortgage rates would further accelerate affordability decline

Actual & Projected GDP Trend



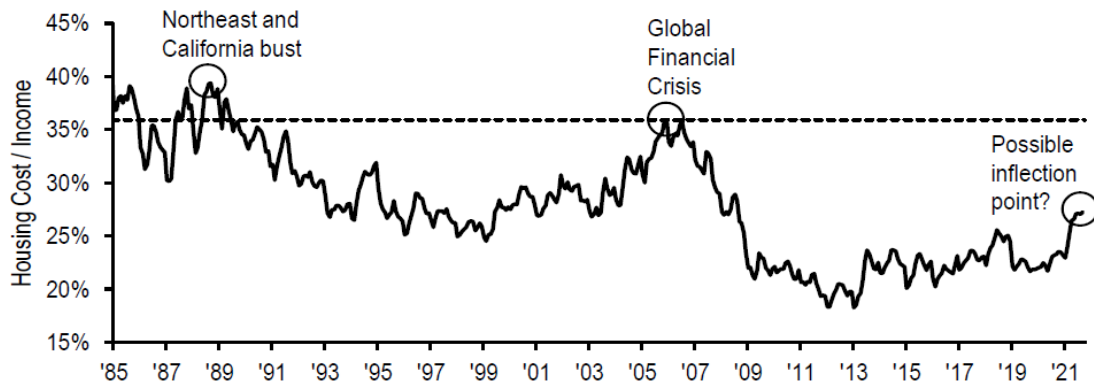
Source: Bloomberg



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Housing Affordability

Ratio of monthly mortgage housing costs to monthly median income (%)



Note: The calculation for housing costs assumes an 80 LTV loan for a median priced house which as of 3Q21 stood at \$351,000. It includes average property taxes.

Source: J.P. Morgan, Case-Shiller, CoStar, Bloomberg Finance L.P.



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Changes in Treasury Rates & Slope

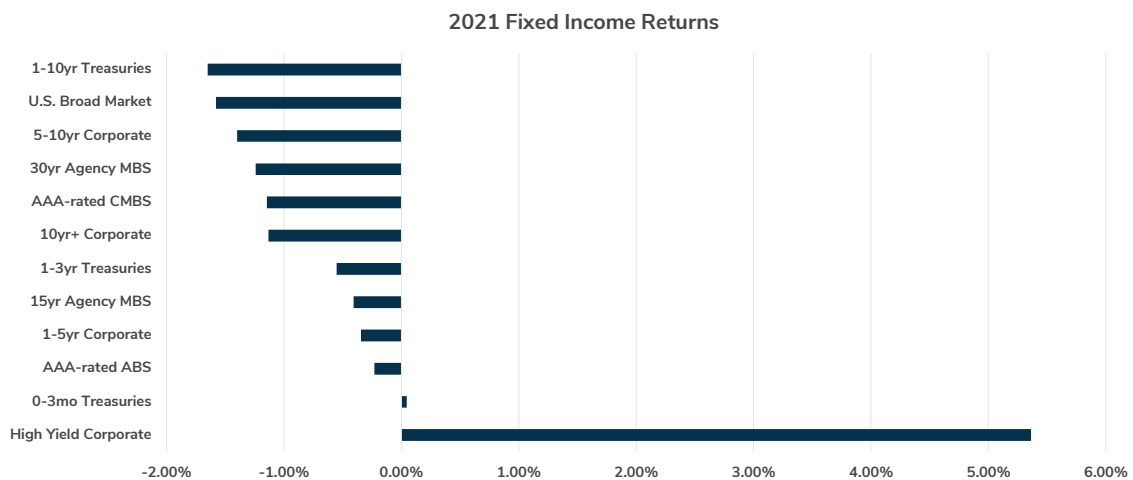
Treasury Curve							
Tenor	1/10/2022 (%)	12/31/2021 (%)	9/30/2021 (%)	12/31/2020 (%)	YTD Change (bps)	Q4 Change (bps)	2021 Change (bps)
1-Month	0.04	0.02	0.04	0.03	0.02	-0.03	-0.02
3-Month	0.09	0.03	0.03	0.06	0.06	0.00	-0.03
6-Month	0.25	0.18	0.05	0.08	0.07	0.13	0.10
1-Year	0.43	0.38	0.07	0.10	0.05	0.31	0.27
2-Year	0.89	0.73	0.28	0.12	0.16	0.46	0.61
3-Year	1.19	0.96	0.51	0.17	0.23	0.45	0.79
5-Year	1.52	1.26	0.97	0.36	0.26	0.30	0.90
10-Year	1.76	1.51	1.49	0.91	0.25	0.02	0.60
20-Year	2.14	1.93	1.99	1.44	0.20	-0.05	0.49
30-Year	2.09	1.90	2.05	1.65	0.19	-0.14	0.26
Curves							
3mo-10yr	1.67	1.48	1.45	0.86	0.60	0.03	0.63
2yr-5yr	0.63	0.53	0.69	0.24	0.45	-0.16	0.29
2yr-10yr	0.87	0.78	1.21	0.79	0.42	-0.43	-0.01
2yr-30yr	1.20	1.17	1.77	1.52	0.25	-0.60	-0.35
5yr-10yr	0.24	0.25	0.52	0.55	-0.03	-0.28	-0.31

Source: Bloomberg



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Negative 2021 Returns For Much of the Investment Grade Universe



Source: ICE BofA Indices



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Market Themes

- **Rates market repricing for more hawkish Fed**
 - Treasury yields up 15-25 bps YTD for 2yr and beyond, extending the Q4 sell-off
 - Front-end yields continue to reprice for rate hikes (futures and swaps markets now pricing for 3-4 hikes in 2022)
 - Increase in long-end yields largely attributable to balance sheet runoff speculation (QT)
 - 3mo/10yr UST spread more than 20 bps steeper YTD (through Monday)
- **Fixed income performance rebounded in December on a hedged basis**
 - In a microcosm of 2021 as a whole, total returns were mostly negative for IG fixed income amid higher rates, but hedged/excess returns were mostly positive on the month thanks to general spread tightening
 - Bloomberg US Aggregate Index OAS -3 bps in December and -6 bps for 2021
 - Agency MBS tightened 5 bps in December but now 6 bps wider in January
 - Balance sheet runoff is biggest question mark for 2022 hedged performance

Sector Returns

	Sector Returns							
	December-21		Year To Date		2020	2019	2018	Average Annual
	TROR	Excess *	TROR	Excess *				
Cash ¹	0.01	-	0.05	-	0.54	2.21	1.83	1.53
Treasury ²	-0.28	-0.01	-1.10	-0.01	4.25	4.20	1.52	3.31
Agy Bullet & Callable ³	-0.17	0.08	-0.86	0.05	3.35	3.78	1.71	2.94
15 Year MBS ⁴	-0.09	0.17	-0.41	0.56	4.43	5.49	1.01	3.63
30 Year MBS ⁵	-0.12	0.19	-1.24	-0.81	4.09	6.98	1.02	4.00
US Taxable Muni	-1.47	-0.56	1.40	4.81	11.82	13.69	-1.10	7.93
US ACMB ⁷	-0.24	0.13	-1.85	0.57	9.02	7.42	1.06	5.77
IG Credit ⁸	-0.03	0.25	-0.35	0.81	5.71	7.15	1.00	4.59
HY Credit ⁹	1.28	1.50	6.00	6.75	3.68	10.09	-0.05	4.49
S&P 500	4.47	-	28.68	-	18.39	31.48	-4.39	14.17
KBW Bank Index	1.20	-	38.34	-	-10.31	36.13	-17.71	0.16

Sources:

- 1 ICE Treasury Bills 0-3 mo
- 2 ICE US Treasuries 1-5yr
- 3 ICE AAA US Agy 1-5yr
- 4 ICE BoA FNMA 15yr MBS
- 5 ICE BofA FNMA 30yr MBS

- 6 ICE US Taxable Municipal
- 7 Bloomberg/Barclays Agency CMBS
- 8 ICE US Corp 1-5yr
- 9 ICE US HY 1-5yr Constrained

* Excess vs. duration-matched Treasuries

ALM First Model Portfolio Returns

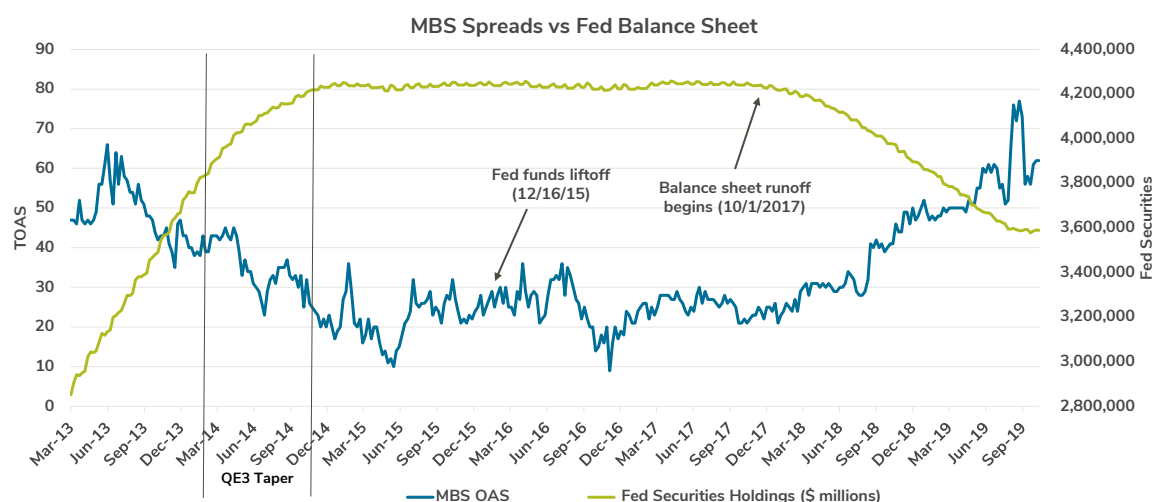
ALM First Model Portfolios Total Return (%) Summary								
As of December 31, 2021	1-Month	3-Month	YTD	1-Year	3-Year Avg. Annual	5-Year Avg. Annual	Inception Avg. Annual	Inception Date
Core Spread Portfolio¹	-0.11	-0.40	-0.75	-0.75	2.99	2.42	1.96	1/1/2011
ICE BofA 1-5yr Treasury & Agency Bullet Index	-0.28	-0.68	-1.08	-1.08	2.42	1.89	1.52	
Excess Return	0.17	0.28	0.34	0.34	0.57	0.54	0.44	
Enhanced Liquidity Portfolio²	-0.04	-0.16	0.23	0.23	1.84	1.74	1.09	1/1/2011
50/50 blend of ICE BofA 6mo & 12mo T-Bill Indices	-0.05	-0.09	-0.03	-0.03	1.40	1.37	0.79	
Excess Return	0.01	-0.08	0.26	0.26	0.45	0.38	0.30	
IG Credit Portfolio³	0.12	-0.52	0.54	0.54	4.39	3.16	2.83	10/1/2011
ICE BofA 1-5yr Treasury & Agency Bullet Index	-0.28	-0.68	-1.08	-1.08	2.42	1.89	1.36	
Excess Return	0.40	0.17	1.62	1.62	1.97	1.27	1.47	

¹ Returns are shown net of a 0.10% model fee. ² Returns are shown net of a 0.05% model fee. ³ Returns are shown net of a 0.15% model fee.

* Actual fees will vary. Please see Model Fee disclaimer.

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The Last Fed Exit



Source: ICE BofA, Federal Reserve, Bloomberg, ALM First

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Looking Ahead

- **Uncertain outlook for fixed income in 2022**
 - Additional increases in Treasury yields would be negative for fixed-rate bond returns on an unhedged basis
 - A hasty Fed exit, including 2022 balance sheet reduction/runoff, would expectedly be negative for hedged portfolios
 - Potential combination of spread widening and heightened rate volatility
 - More positive (and possible) scenario: Inflation subsides faster than market anticipates allowing the Fed a more gradual exit
 - Remain long-run investors and keep portfolio duration on target
 - Still constructive on shorter duration credit, both corporate and securitized
- **Higher rates/steeper curve positive for banking**
 - Through Monday, KBW bank stock index +9.91% YTD vs. S&P 500 -1.97% YTD
 - Market pricing for more valuable deposit franchises
 - Depository bond portfolios are funded, so any accounting loss from declining asset values is offset by positive economic impact on core liabilities (and wider NIM looking forward)



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