alloya

CAPITAL MARKETS *monthly*

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GENERAL MARKET OVERVIEW

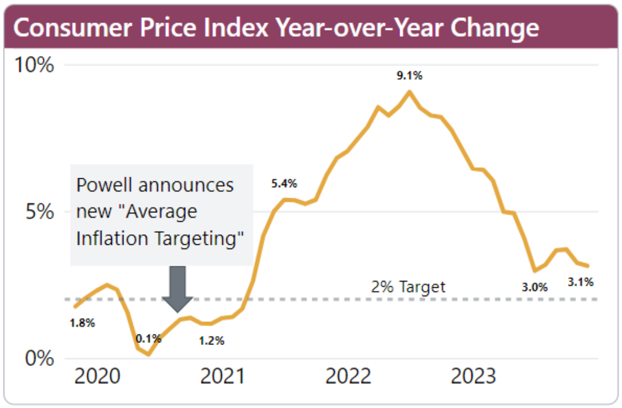
As we begin 2024, we are excited to reaffirm our commitment to providing you with unique capital market insights. We will focus on data, context and frameworks, providing readers with transparency into challenging and opaque markets, while offering useful information for portfolio positioning in times of uncertainty. You have indubitably read your fair share of "2024 outlooks." At Alloya, we are not young enough to know everything. Screenwriter William Goldman warned "nobody knows anything" with his witty style that illustrates the limitations of human decision-making. Perhaps it is better to follow William Goldman than Goldman Sachs. Here is a summary of Wall Street's recent S&P 500 return forecasts versus reality.

Year	Forecast	Actual
2021	7%	27%
2022	9%	-19%
2023	7%	24%
2024	8%	???

Higher for not much longer, the eagerly awaited "Powell Pivot" signal has arrived. Or has it? Markets often hear what they want to.

On December 1, 2023 markets heard Fed Chairman Jerome Powell say it was premature to talk about easing. Then on December 13, a normally reticent Powell spoke clearly on the path forward signaling dovish rate cuts in 2024. Markets rallied, but not two days later New York Fed President John Williams came out to tell us that talk of rate cuts was premature. What changed in two weeks, let alone two days? *Continued on page 2*

Many are aggravated with the Fed's forward guidance. Even former Chief Investment Officer of PIMCO Mohamed A. El-Erian, who took over managing the largest bond fund in the world from the legendary "Bond King" Bill Gross, took to social media platform X to lament his frustration at the Fed's communication consistency (or lack thereof). Further, El-Erian believes the Fed's approach leaves market participants with conflicting interpretations as the Fed walks back prior statements. However, market participants should keep in mind that this communication style is a feature, not a bug, of the Fed's prerogative.



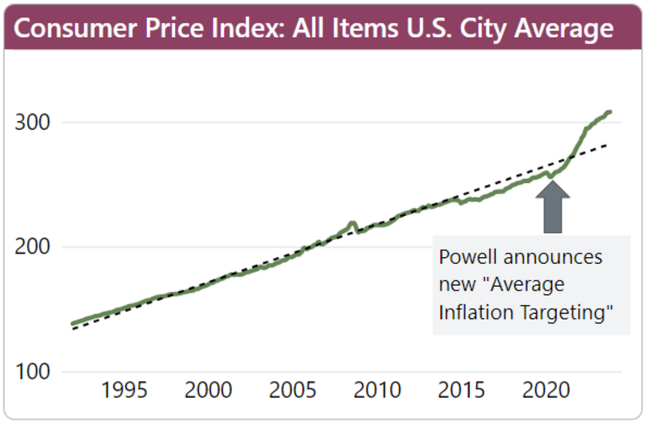
This intentional communication strategy is called "constructive ambiguity" and dates back to former Fed Chair Alan Greenspan. Constructive ambiguity is a deliberate use of vague or unclear language, usually in diplomatic communications, but it has application in other strategic situations. Vagueness allows for greater flexibility but runs the risk of misinterpretation and unnecessary volatility. Greenspan famously quipped, "If I seem unduly clear to you, you must have misunderstood what I said." As a bonus for markets and monetary policy, constructive ambiguity helps build two sides of a trade as the ambiguity draws speculators like moths to a flame. Healthy markets need both buyers and sellers. A one-sided market is a fragile market. Powell never said he was going to cut. He did, however, say the Fed is available to cut and that he has Mr. Market's back.

> ***It's tough to make predictions, especially about the future.***
>
> \- Yogi Berra

The market is forecasting double the number of rate cuts compared to Fed guidance. At year-end, the fed funds futures market was pricing in six rate cuts while the Federal Reserve's "Summary of Economic Projections" (the oft-cited "dot plot") foresees only three cuts. The Fed typically underestimates how much it needs to both tighten and loosen monetary policy. Recall in June 2020 when Chairman Powell said, "We're not even thinking about thinking about raising rates." One year later, in June 2021, the Fed's dot plot forecasted 2022 and 2023 year-end fed funds at 25 basis points and 75 basis points, respectively.

While off from June highs, year-over-year Consumer Price Index (CPI) inflation is still over 3%. We like the downward trend in the rate of change, but the All Items Index is still up and ugly. Inflation feels high for most people. One of Powell's favorites, core services excluding housing, was up a sizzling 0.44% month-over-month (month-over-month x 12 = 5.28%!).

> ***The reports of my death are greatly exaggerated.***
>
> \- Mark Twain on taming inflation, 1897



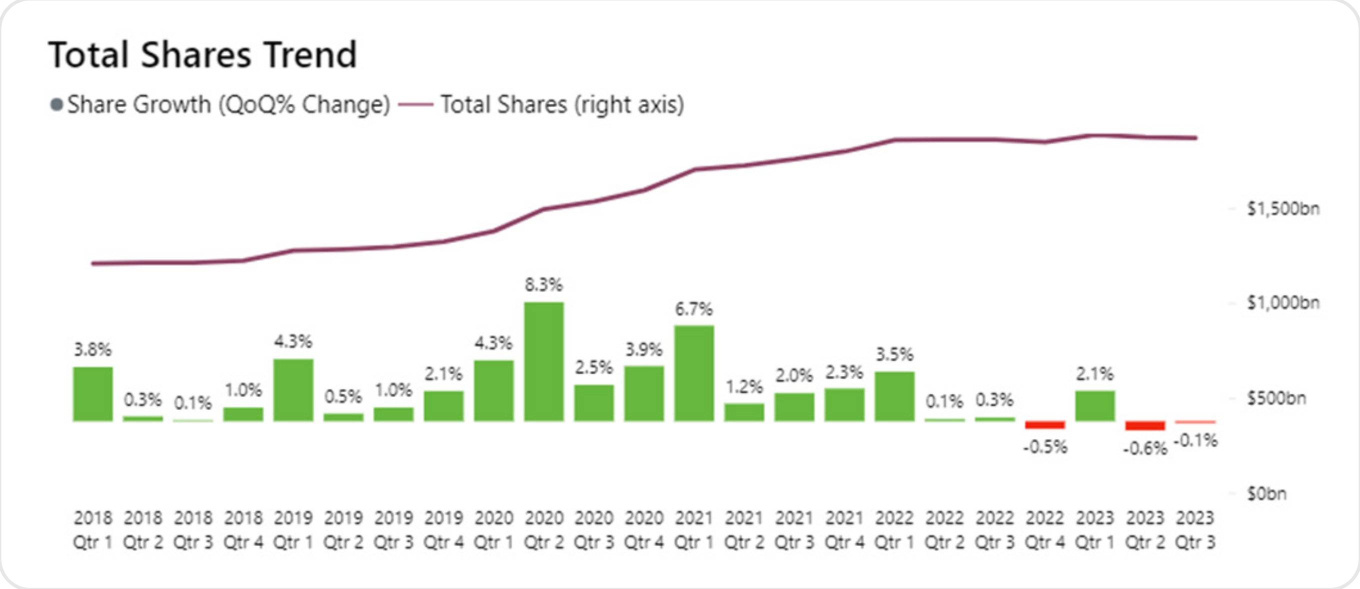
**CPI through Nov 2023*

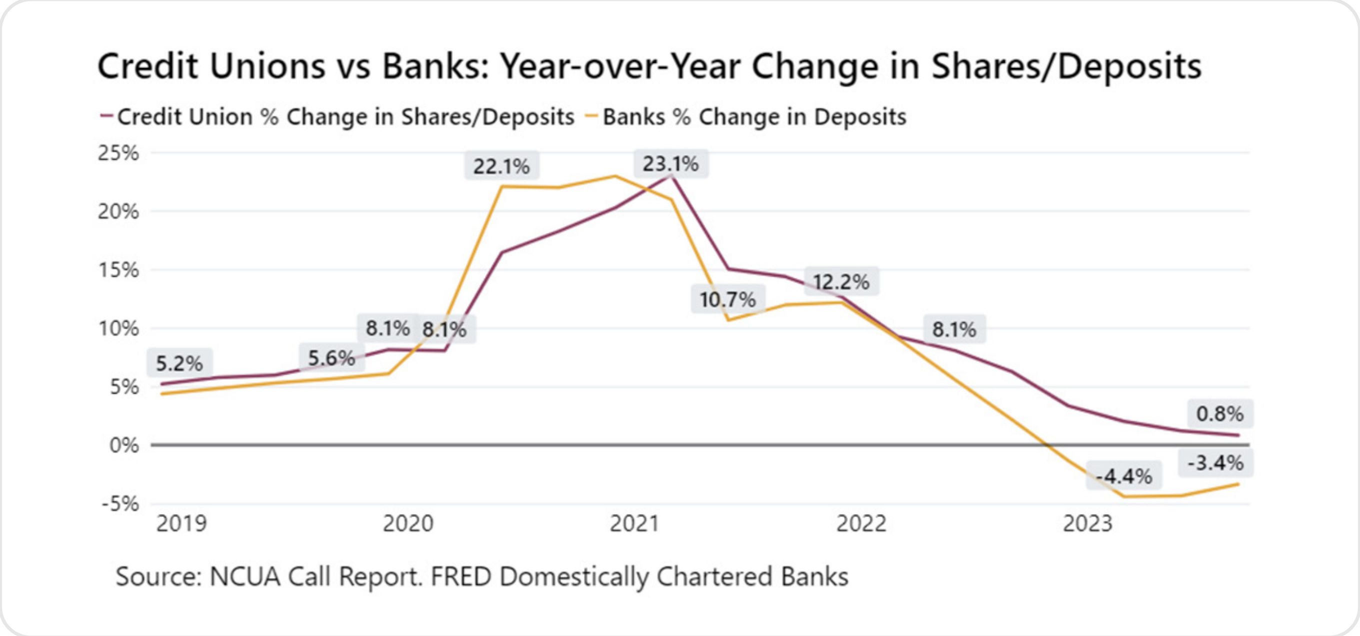
We debate whether the Fed will force inflation back to the 2% target. In August 2020, the Fed announced a shift to "average inflation targeting." We recall being surprised by how little attention such a significant policy change should have received. Changes in Fedspeak are never an accident. Interesting timing on the announcement, don't you think?

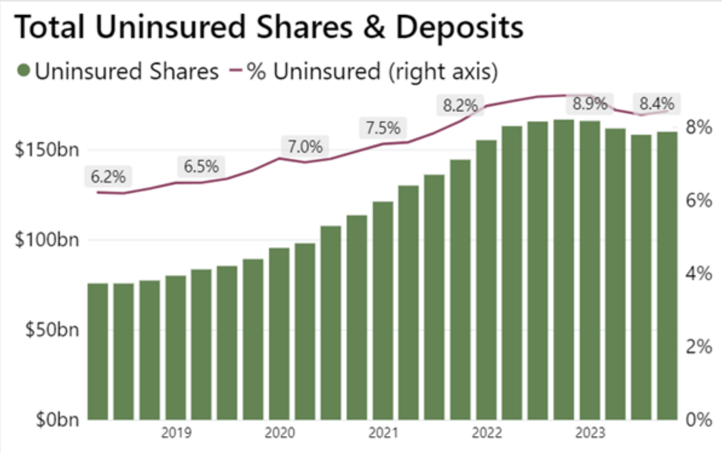
Call Report Update

Turning to the most recent Call Report, below is a series of credit union industry aggregates on loans, shares, uninsured deposits, unrealized investment losses, whole funding and loan participations.

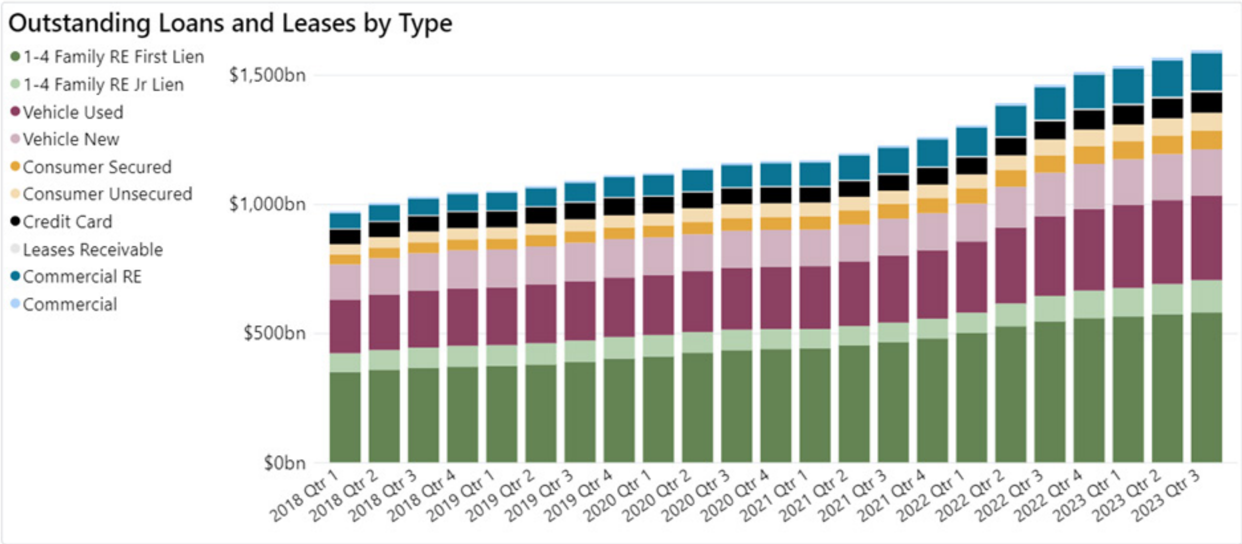
Total shares decreased by a modest 0.1% in Q3, decreasing for the second quarter in a row. Credit unions in aggregate still have a positive year-over-year share growth of 0.8%. This is remarkable considering domestic banks have sustained year-over-year negative deposit growth since late 2022. *Continued on page 4*

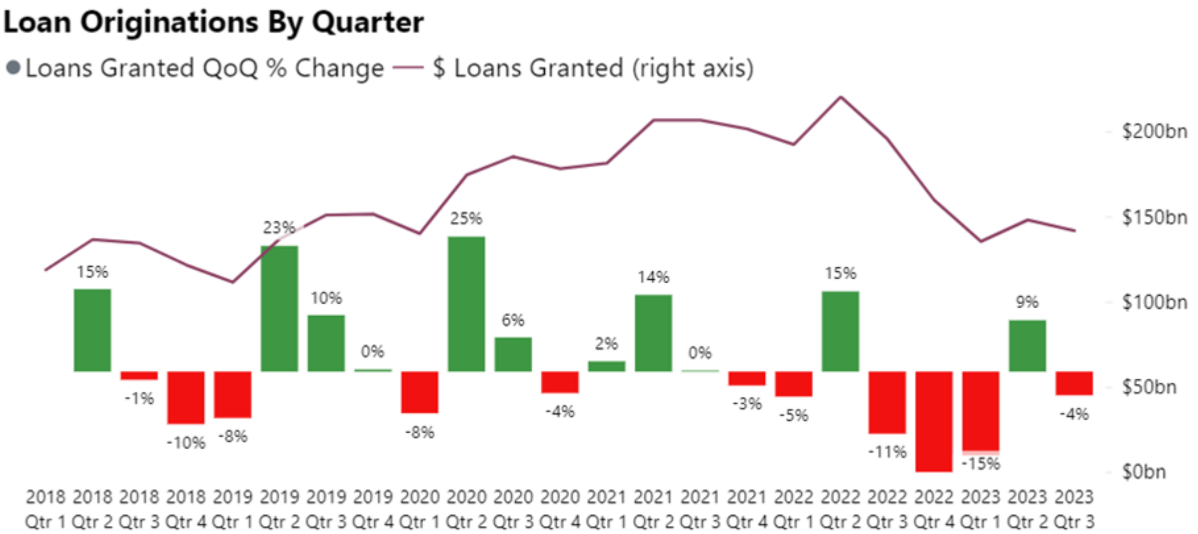




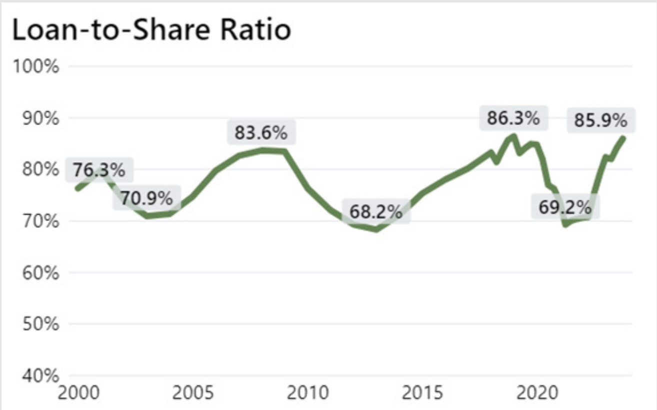


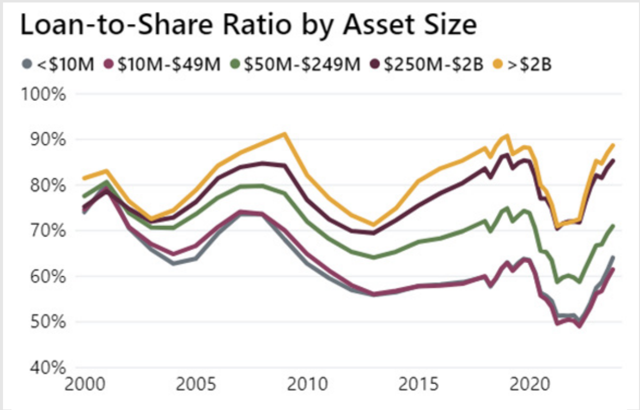
Uninsured shares increased in Q3 to 8.4% of total shares. Uninsured shares reached an all-time high in Q1 2023 at 8.9% of total shares before reversing the upward trend in the aftermath of high-profile bank failures that accumulated a lot of uninsured deposits. Interestingly, **an article recently published by the *Wall Street Journal*** discussed the need for deposit insurance overall and referenced the credit union industry as a potential model. From the article: "There is already a model that legislators, regulators and banks could follow: Credit unions have offered excess deposit insurance through private-sector insurance companies for over two decades." Total loans and leases outstanding increased a modest 1.8% as the pace of loan originations has slowed since Q3 2022. *Continued on page 5*





Credit unions continue to extend credit even as shares decrease. Looking back 20 years, loan-to-share ratios are at cyclical highs. Also, below is a table of the two-year change in both loans and shares by asset size showing the divergent experience based on size.

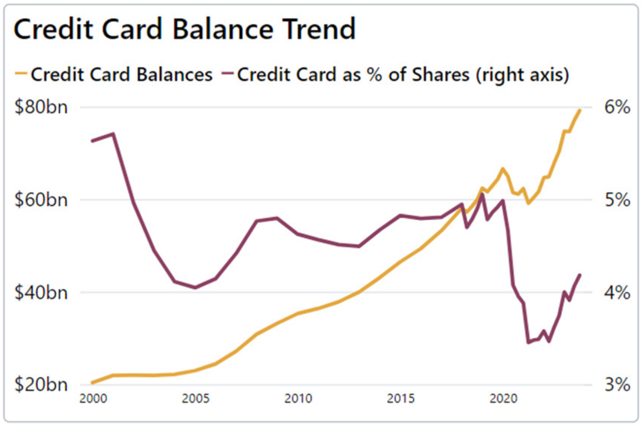




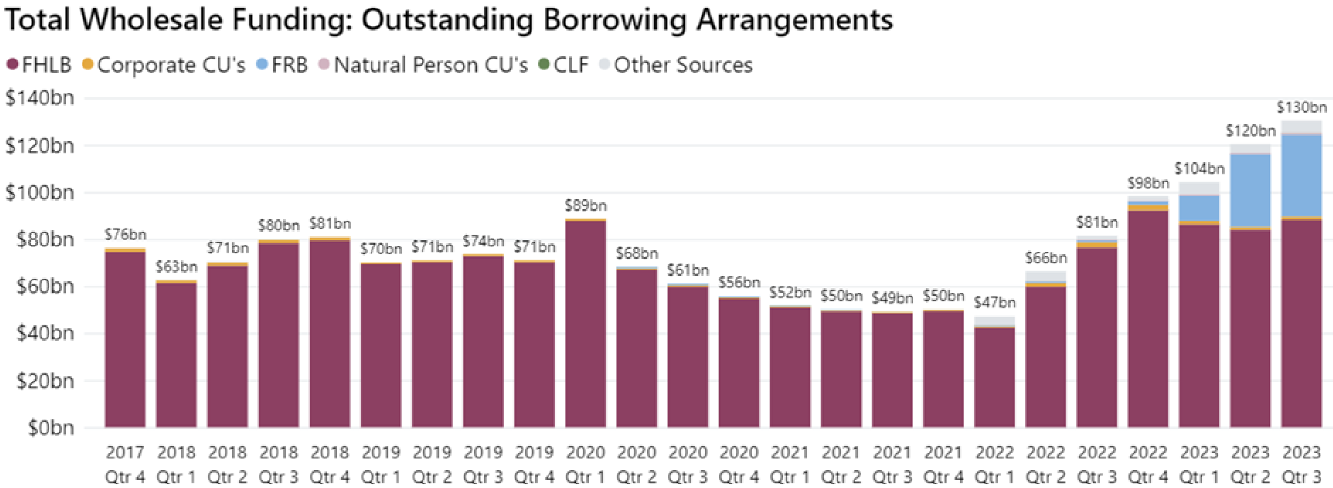
2-Year Change in Shares and Loans By Assets Size

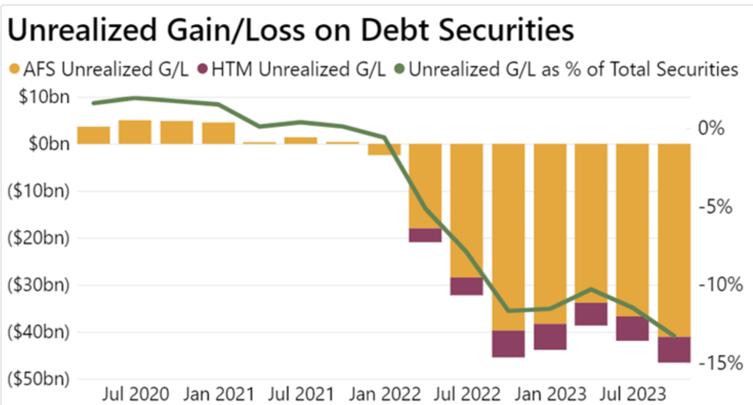
Asset Size	# of CUs	% of CUs	2 Yr $ Shares Change	2 Yr % Shares Change	2 Yr $ Loans Change	2 Yr % Loans Change
<$10M	966	20%	($0.4bn) ▼	-11%	$0.0bn ▲	2%
$10M-$49M	1353	28%	($2.8bn) ▼	-8%	$0.5bn ▲	3%
$50M-$249M	1374	29%	($6.6bn) ▼	-4%	$5.7bn ▲	6%
$250M-$2B	880	18%	($16.4bn) ▼	-3%	$38.7bn ▲	10%
>$2B	241	5%	$154.4bn ▲	15%	$264.3bn ▲	36%
Total	**4814**	**100%**	**$128.2bn**	**7%**	**$309.3bn**	**25%**

Market participants continue to wonder about the health of the consumer. Not only are excess savings running low, but a staggering 40% of student loan borrowers skipped their payment in October 2023 when the pandemic-era moratorium on student loans expired. Many members have resorted to using credit cards to compensate for the increased costs. It's important to note that, despite higher balances, consumers' personal balance sheets are stronger compared to previous years when considering credit card balances as a percentage of shares.



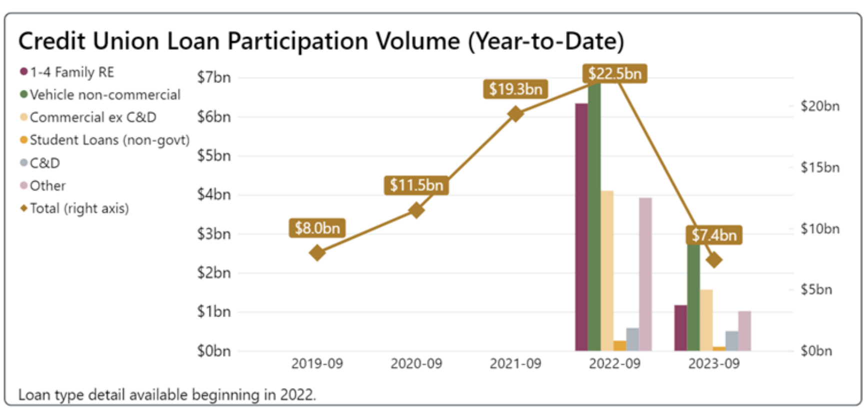
Liquidity indicators are showing signs of improvement even though wholesale funding continues to trend upward. The largest component of the increase, excluding the Federal Home Loan Bank (FHLB), is from credit unions participating in the Fed's attractive Bank Term Funding Program (BTFP). In Q3, balances with the Fed increased another $4 billion to a total of $35 billion. Unrealized losses on investment securities prompted the Fed to create the new BTFP liquidity facility. Unrealized losses increased in Q3 to $46 billion, which equates to 13.3% of total securities, or a paltry 2.2% of total assets. *Continued on page 6*



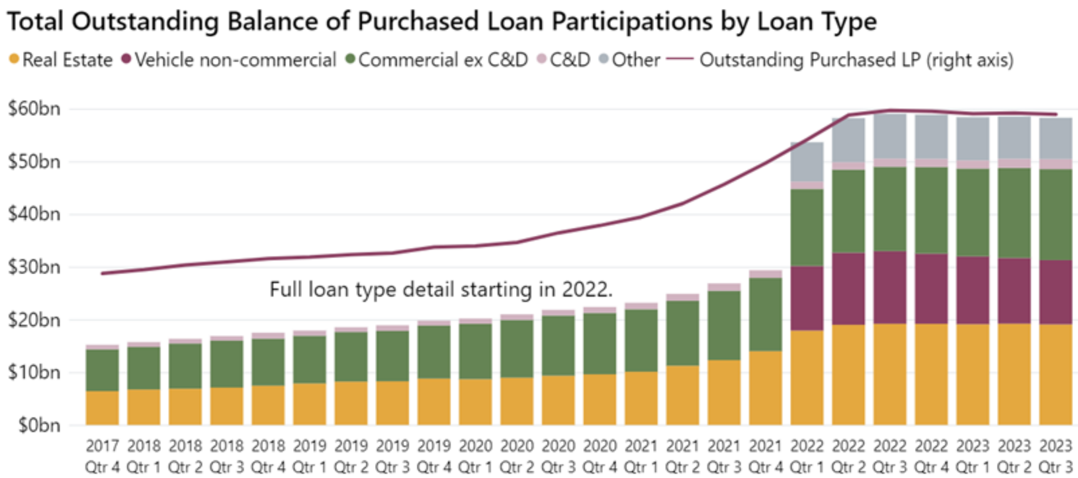


LP MARKET OVERVIEW

Loan participations (LP) across the industry are down markedly from 2022. Year-to-date, participation purchases of $7.4 billion are a fraction of the $22.5 billion traded over the same period in 2022. Vehicle and commercial loans, excluding construction and development (C&D) loans, lead volume in 2023, with the 1-4 family real estate asset type decreasing the most year-over-year. New LP deal volume is keeping pace with portfolio runoff. The total outstanding of LP purchases has been flat since mid-2022. *Continued on page 7*



		9/30/2023
CU's with LP Outstanding		2045
% of CU's with LP Outstanding		43%
CU's with LP Purchased		1936
CU's with LP Sold		869
5 Yr Change in # of CU's with LP	▲	149
5 Yr Change in % of CU's with LP	▲	8%
LP Purchased Outstanding		$59bn
5 Yr $ Change in LP Purchased Outstanding	▲	$28bn
5 Yr % Change in LP Purchased Outstanding	▲	91%



CAPITAL SOLUTIONS MARKET & SPREAD OVERVIEW

Subordinated debt ended 2023 strong with multiple issuances closing in the month of December. We expect to see a significant increase in activity heading into 2024 as many credit unions stayed on the sidelines last year due to increased rates. At the time of this writing, the 10-year Treasury yield is 3.95%, the lowest yield in five months and a sharp drop from when we were trading at 5% in mid-October. We expect this trend to continue as inflation has stabilized and the talk of rate cuts is becoming a hot topic heading into the new year. With liquidity still tight for many credit unions and growth opportunities limited, subordinated debt approval can give your credit union the flexibility it needs to achieve its growth goals in the coming years. Once approved, credit unions have 24 months to issue the approved amount to increase their capital position.

Another option credit unions will look to utilize in 2024 to increase their capital position is a sale-leaseback transaction. Credit unions will have the ability to receive free valuations on their real estate assets to see if a sale-leaseback makes sense. Real estate prices remain high, giving credit unions the option to sell a corporate office or branch in exchange for a long-term lease. The gain on the sale counts directly towards net worth and can help raise future earnings during this advantageous market cycle. These leases are typically 15 years, with a triple net lease structure. Alloya has partnered with a leading real estate investor as the direct buyer, which helps streamline the process for the seller. This no-cost service is a great opportunity for credit unions in 2024. *Continued on page 8*

SUBORDINATED DEBT

- Increases net worth and risk-based capital ratios for credit unions with a low-income designation
- Supports future growth, including mergers and field of membership expansion
- Delivers full-service, end-to-end support, including ALM/application advisory, legal counsel, sales and distribution
- Includes a strategic partnership with a preeminent legal firm for capital issuance
- Approved by the NCUA

SALE-LEASEBACK

- Leverages real estate assets by selling branches or a corporate office in exchange for a long-term lease
- Increases capital, raises future earnings, restructures investments and fuels M&A during an advantageous market cycle
- Includes free valuations within five to eight business days
- Offers an arm's length transaction, meaning all valuations are completed by an impartial third party of the credit union's choosing, allowing for full transparency
- Guarantees full confidentiality, ensuring the credit union's information is safe and secure

Current Market Rates

Issuance Size	IG Egan Jones	Kroll BBB-	Kroll BBB	Kroll BBB+	Unrated
50MM	8.500% +/-	8.500% +/-	8.500% +/-	8.500% +/-	8.500%-8.750% +/-
50MM-100MM	8.500% +/-	8.500% +/-	8.500% +/-	8.500% +/-	-
100MM+	8.500% +/-	8.500% +/-	8.500% +/-	8.500% +/-	-

ABS MARKET & SECURITIZATION

Congratulations to Space Coast Credit Union for their first asset-backed security (ABS) issuance! At $422 million, this is the largest credit union ABS since PenFed in August 2022. Space Coast was the sixth and final credit union ABS issuance to hit markets in 2023, bringing credit union issuances to $1.7 billion for the year and $3 billion since 2019. We expect ABS activity to increase in 2024, and we will continue to provide insights into the ABS market.

Space Coast Credit Union (SCCU) Auto Receivables Trust 2023-1 Deal Specifics

CLASS	SZE(M)	WAL	SP	SPRD	CPN	YLD	PRICE
A1	55.5	0.17	A-1+	24	5.62%	5.62%	100
A2	164.5	1.07	AAA	89	5.85%	5.93%	99.99474
A3	108	2.44	AAA	130	5.70%	5.78%	99.97814
A4	57.43	3.57	AAA	150	5.70%	5.77%	99.98464
B	15.1	4.16	AA	195	6.08%	6.16%	99.99119
C	14.26	4.17	A	250	6.61%	6.71%	99.97419
D	7.46	4.17	BBB	325	7.34%		

BALANCE SHEET STRATEGY

Emergency Liquidity

All credit unions over $250 million in assets need to have access to an emergency source of liquidity per NCUA regulations. However, **a recent LinkedIn post from the NCUA** reinforces the need for all credit unions to plan for emergency liquidity scenarios. At the end of the day, credit unions have two options for emergency liquidity sources: the Federal Reserve Bank's (FRB) Discount Window and the NCUA's Central Liquidity Facility (CLF). These are the two approved emergency sources of liquidity. On the following page is a snapshot comparing the two sources of emergency liquidity. *Continued on page 10*

	Central Liquidity Facility	Discount Window
Capital Required	$120,000 deposited with the CLF plus $120,000 held at the credit union on call.*+	None
Fees	None	No direct fees
Cost to Establish	None	You must have an account with the Fed or work through a correspondent such as Alloya.
Cost to Maintain	None if through corporate correspondent	Collateral must be maintained and reported. Compliance costs: $50/hr = $600/year
How to Access	Direct	Through Alloya or direct
Total Costs	**$0, but capital must be contributed**	**Approximately $600 per year**

* Summarized are costs for the CLF and the Fed Discount Window, assuming a $1,000,000 line of credit for a $50,000,000 credit union that settles through a corporate. + Note: CLF stock pays a dividend based on short-term Treasury holdings less administrative costs.

A few things to consider when comparing these two options are highlighted below. Regardless of which option a credit union chooses for their emergency liquidity, both provide clear and unique benefits.

Length of Borrowing

In general, the CLF is the NCUA's version of the FRB's Discount Window. The CLF allows credit unions to borrow for 90 days consecutively for up to two consecutive periods (i.e., for a total of 180 days). The FRB allows credit unions to borrow for a week at a time for two consecutive weeks (i.e., for a total of 14 days).

Collateral

The CLF works in conjunction with corporate credit unions for posting collateral. The CLF will take the collateral utilized to secure the line of credit at a corporate for their advances. Thus, no additional collateral needs to be posted by credit union borrowers. The FRB requires additional collateral to be posted to secure access to the Discount Window, which needs to be maintained and reviewed by credit unions and could be an added administrative burden.

Cost

Neither the CLF nor the FRB Discount Window has any direct costs associated with their programs. However, credit unions will need to invest capital into the CLF and hold additional funds on call at the credit union. This could be challenging for credit unions that are low on investible cash. The Discount Window has no cost and does not require any investment.

FINAL THOUGHTS

We believe 2024 will deliver a slight reprieve from the liquidity crunch, but nothing like what happened during the pandemic. That said, credit unions should feel optimistic about what lies ahead. Together, we will continue to come up with creative solutions to widespread credit union challenges, allowing credit unions to continue thriving today and setting up the industry for tremendous success in the future.