CAPITAL MARKETS *monthly*

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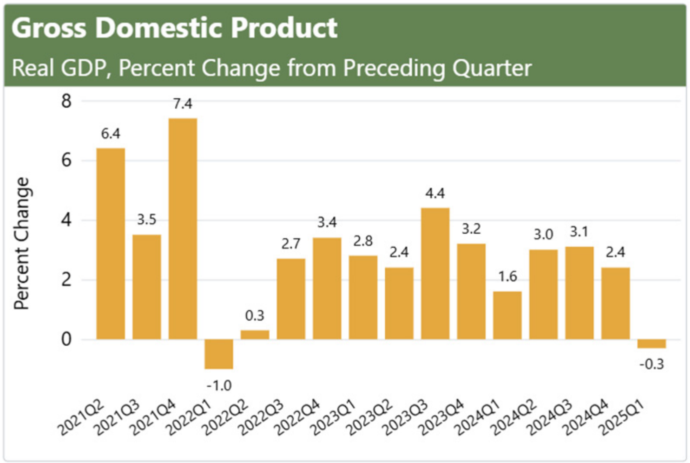
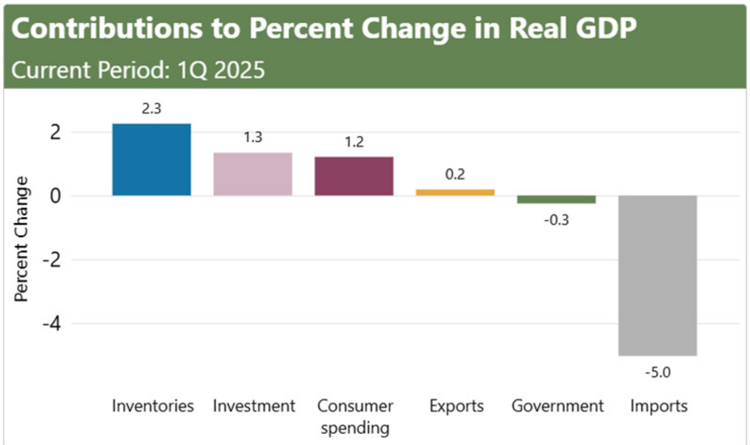
GENERAL MARKET OVERVIEW

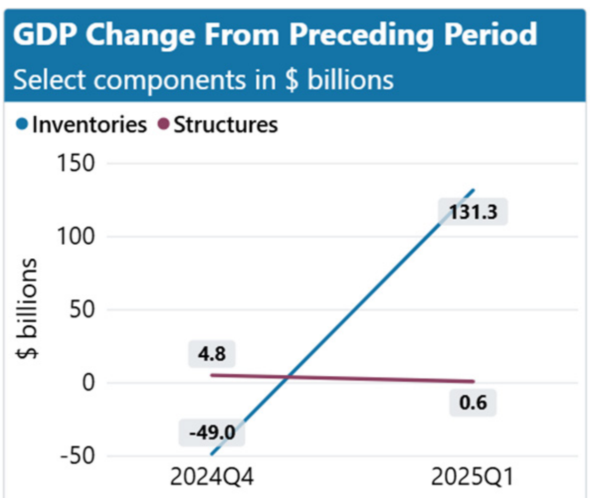
The Bureau of Economic Analysis's advance estimate of real gross domestic product (GDP) indicated a 0.3% contraction for Q1 2025. This 30-basis point decrease marks the first quarterly decline since Q1 2022. With the negative GDP print dominating headlines and sparking diverse interpretations, we are taking this opportunity to examine some of the quirks behind the numbers.

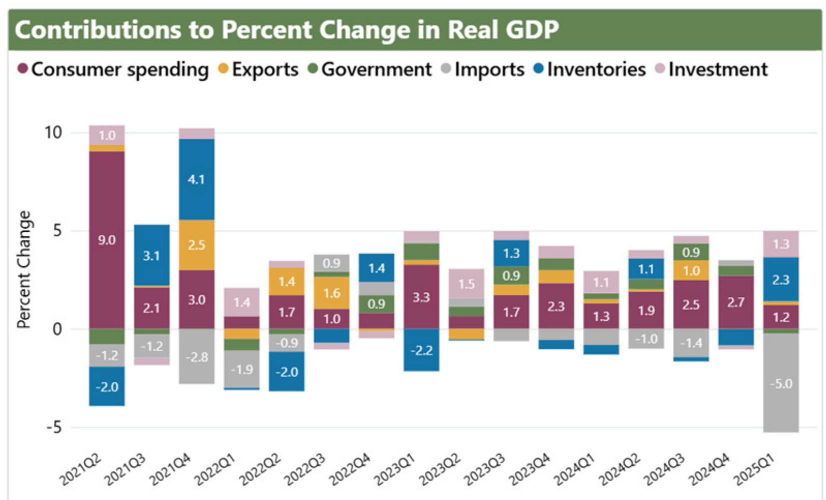
The negative GDP figure is primarily due to a surge in imports, which, in the GDP calculation, subtracts from the total (GDP = Consumption (C) + Investment (I) + Government Spending (G) + Net Exports (NX), where NX equals exports minus imports). This increase in imports, driven by businesses accelerating purchases ahead of anticipated tariff hikes, doesn't necessarily reflect a weakening economy. Additionally, a rise in private domestic investment and a modest reduction in government spending can be indicators of economic strength, suggesting that the real economy may still be growing. *Continued on page 2*





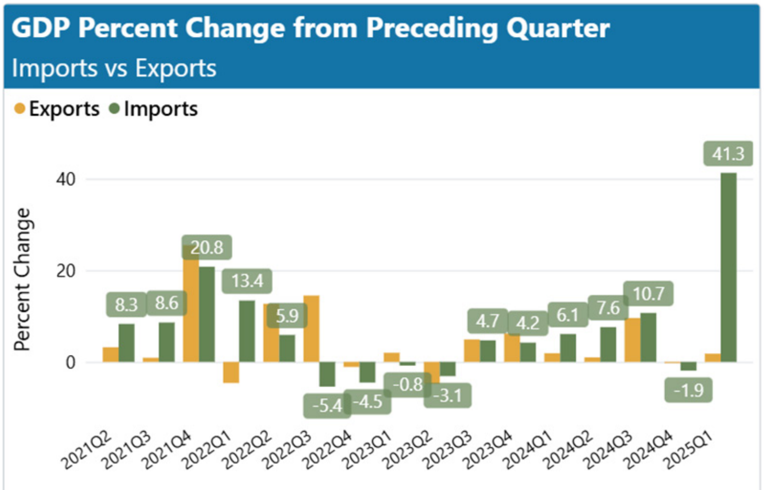
The government component subtracted 25 basis points, which was the first negative government contribution since 2022. Consumer spending decelerated, increasing by only 1.8%. On a related note, U.S. consumer confidence is at a 13-year low, which does not bode well for growth, with U.S. consumer spending accounting for roughly 80% of GDP. Conversely, business investment showed strength, with gross private domestic investment rising, mostly due to companies stockpiling inventory in anticipation of higher trade costs. However, the promise and claim of onshoring manufacturing and business production is premature. Going directly to the source, looking at Table 3 of the **Bureau of Economic Analysis's GDP Report**, we find that structures rose a paltry $600 million. For context, the preceding period (Q4 2024) saw real spending of nonresidential structures rise by $4.8 billion. The real driver of big "I" investment numbers was the surge in private inventories. Of the $218.6 billion incremental increase in investment, $131.3 billion was due to an increase in the growth of private inventories.





Much can be said about how inventories interact with the official GDP statistics, but the methodology is economically sound. The GDP measure is getting at how much is produced (of final goods and services) during a particular period. In practice, economists have better data on sales than the production side, so the focus is on sales of the four main components (C+I+G+NX). Businesses placing units in a warehouse for future sales will not be picked up in this period's C because the consumer hasn't purchased them yet. The implicit business investment in stockpiling inventory is counted as part of GDP working its way through the I component. In future periods, drawing on inventories to sell to consumers would have offsetting effects. Consumer spending would increase GDP while the negative inventory adjustment would reduce it. Without knowing more, we can't yet determine if a surge in private inventories in Q1 2025 points to a productive economy or not. *Continued on page 3*

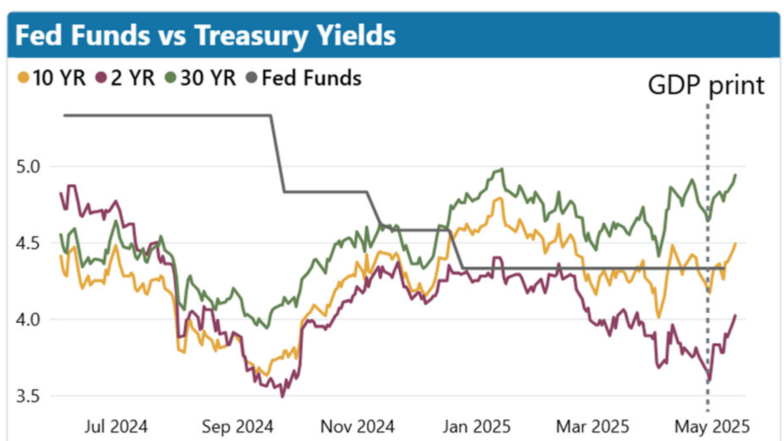
The role inventories play in the GDP calculation methodology has been contentious for decades. While the conventional interpretation of inventory changes is technically sound to avoid double-counting, misinterpretations can lead to misleading conclusions about economic health. For instance, a reduction in inventories contributing to GDP growth doesn't necessarily indicate robust economic activity. Instead, it may reflect businesses depleting existing stock without corresponding production increases, potentially signaling caution about future demand. We articulate this nuance to underscore the importance of analyzing the underlying contributing factors rather than relying solely on headline GDP figures.



Turning to NX, imports rocketed at a positive 41.3%, the largest jump in five years, contributing to a negative 5.03% in GDP. While there is nothing intrinsically anti-productive about imports, we "subtract" them from GDP because the C and I capture all private spending on consumption and investment (even if the items were produced abroad), and therefore imports need to be subtracted to correct the overcount. The surge in private inventories consists of businesses pulling forward imports ahead of tariff hikes that have ended up in storage.

Imports are negative to avoid double counting, but it would be a mistake to think that imports decrease production. Our capacity to produce isn't impaired by bringing in goods ahead of tariff increases. As a thought experiment, consider the reality of a small nation with zero natural fossil fuels or other alternative energy sources. This nation must import all its energy. Now consider, does importing energy, the largest input into an economy, decrease production? No, quite the opposite. The energy import is a driver of production, not a hindrance.

A deep dive into the four components of GDP reveals that it's essential to recognize that such adjustments may oversimplify complex economic dynamics. For instance, attributing increased investment solely to positive economic sentiment overlooks potential motivations like tariff avoidance strategies. Moreover, dismissing the impact of reduced government spending on GDP may ignore the multifaceted role government expenditures play in economic activity.



In a significant trade development on May 12, the U.S. and China agreed to a 90-day tariff reduction, signaling an easing of trade tensions. Under the agreement, the U.S. will reduce tariffs on Chinese imports from 145% to 30%, while China will lower its tariffs on U.S. goods from 125% to 10%. This mutual reduction aims to alleviate the economic strain caused by the escalating trade war and to foster a more collaborative environment for addressing underlying trade issues. President Donald Trump described the agreement as a "total reset" in U.S.-China relations, emphasizing the intention to avoid economic decoupling. The announcement had an immediate positive impact on global equity markets, but bond yields refuse to decrease. The risk premia for term inflation uncertainty is expanding with all eyes on the fiscal situation.

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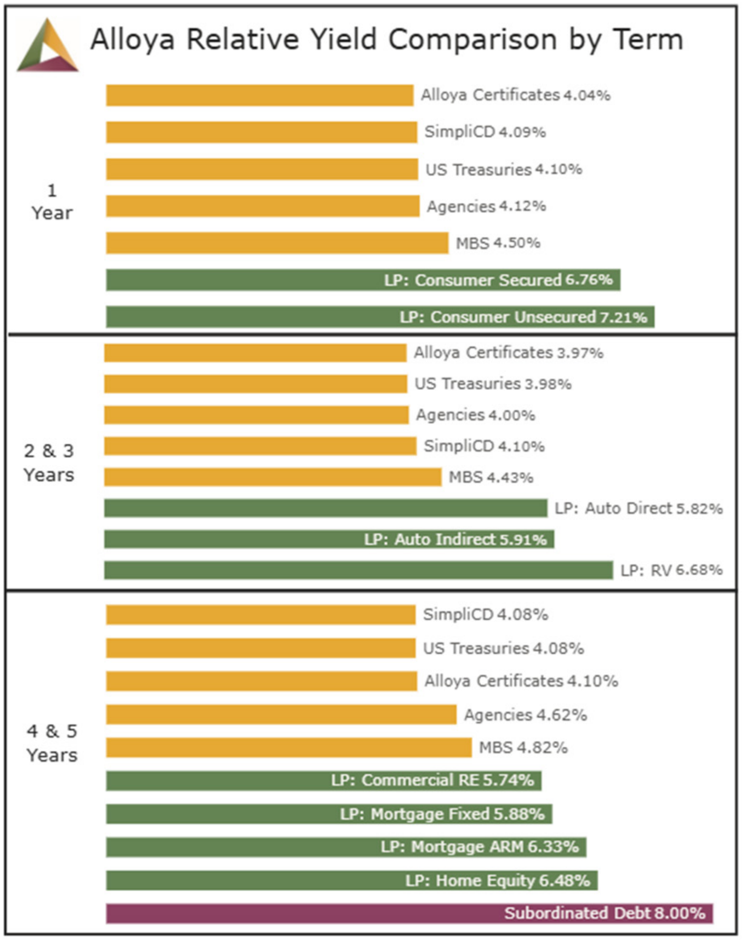
Even a near-record U.S. government surplus didn't push yields down materially. On the heels of a U.S.-China tariff ceasefire came a U.S. Treasury monthly statement release showing the second largest budget surplus in history. The U.S. government posted a $258 billion budget surplus after a strong April from both tax receipts and surging collections of import duties. Markets were not impressed. Surpluses are few and far between, and spending is projected to outstrip revenues by a considerable margin.

Trump has gotten the world's attention on trade imbalances. The 90-day tariff pause could be extended to properly negotiate the extraordinary repercussions of trading partners of this scale and complexity. The near term will remain volatile, but in the end, we are optimistic that China has the incentives to make a deal.

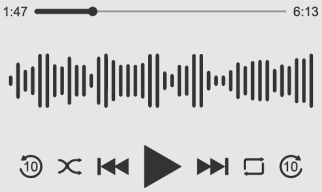
LP MARKET OVERVIEW

Credit unions' liquidity is rising, and 2025 year-to-date loan participation volumes are similar to 2021. The accompanying relative value chart offers readers enhanced visibility into the opaque loan participation market with respect to other investments credit unions hold on their balance sheets. Yield trends are consistent with broader fixed income markets while maintaining a consistent spread to Treasuries. Some of our Loan Participation Platform sellers are selling loan participation pools at a healthy premium, taking gains on loans before rates fall. Recall that the loan participation net yield estimates prudently include an imbedded annual loss estimate.



Give it a listen!

LOAN PARTICIPATIONS ARE BIG BUSINESS
With Flying Colors Podcast



BILL PATON
VP, Capital Markets
Sales Director

Subordinated Debt Current Market

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+	7.500% +/-	7.500% +/-	7.500% +/-	7.500% +/-	-

WEBINAR RECORDING

SUBORDINATED DEBT 101

- What due diligence information is provided and how to access it
- Ongoing review of best practices
- The current market for sub debt versus comparable investments

WATCH NOW

Alloya recently held part two of a webinar on subordinated debt investment. In this second part of our investment series, we discussed best practices for subordinated debt investment due diligence. Give it a watch at **alloyacorp.org/subdebt-webinar-022525.**

Sale-Leaseback

The Key to Unlocking Capital: Have you ever wondered what other financial tool would unlock your capital for growth, enhance your balance sheet and help manage risk? Consider the sale-leaseback transaction. This transaction allows your credit union to sell their real estate assets while leasing them back. This immediate liquidity can then be used to invest in your other strategic business goals. Consider the following advantages:

Increases Liquidity

Sale-leasebacks convert illiquid real estate assets into cash, providing capital for acquisitions, mergers and other investments.

Strengthens Balance Sheets

The sale of real estate improves financial ratios and capital adequacy and reduces debt costs.

Reduces Debt

Sale-leasebacks can become an alternative to a credit union's typical borrowing structure, thereby lowering financing costs and loan restrictions.

Operational Continuity & Flexibility

Credit unions retain control of their branch locations, allowing seamless member service and maintaining their core business functions.

Drives Earnings

An efficient transaction allows a gain over the purchase price as well as net income improvement, and it also raises the enterprise value of the credit union.

Improves Capital Ratios

Sale-leasebacks help improve capital ratios, which can be a major benefit given today's uncertain economic climate.

Manages Risk

Sale-leasebacks can provide a hedge against today's interest rate volatility by locking in a long-term lease agreement.

Adapts to Changing Markets

Sale-leasebacks provide the ability needed to invest in modernization, digital banking and growth strategies to get ahead of your financial institution competitors.

Want to explore and potentially unlock this benefit for your credit union? Please contact Parker Hausknecht, Coordinator, Capital Markets, at **parker.hausknecht@alloyacorp.org**.

Recent Sale-Leaseback Transactions

Shoreline Credit Union

$4,828,235
ONE BRANCH

FEBRUARY 2025

Seasons Federal Credit Union

$3,750,000
ONE BRANCH

MARCH 2025

At only 4% of the global population, the U.S. accounts for 15% of global GDP. Sure, the rise of China and India is to be commended; however, the U.S., with one-fourth the population size, is still the driver of production and, more importantly, innovation.

There are several factors driving U.S. excellence, and these are to be conserved and nurtured to continue providing superior economic opportunity for our communities. An **illustrative chart** from Andrew McAfee plots the value creation between the U.S. and Europe, highlighting in bold relief the prowess of U.S. entrepreneurship and innovation.

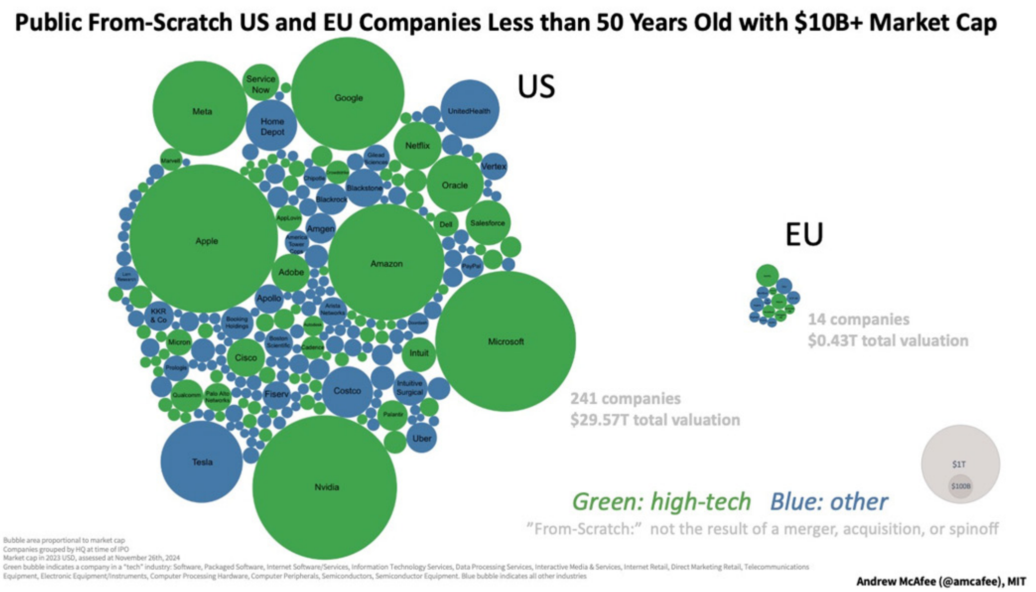
McAfee found the disparity driven by the following factors:

Unified Market: The U.S. boasts a large, homogenous market with over 330 million consumers sharing a single language, currency and regulatory environment.

Culture and Structure: The entrepreneurial culture in the U.S. encourages risk-taking and rewards success generously.

Market Size and Integration: The U.S. market is not only large but also cohesive, offering startups a smoother path to national scale.

Access to Capital: U.S. startups benefit from a capital markets ecosystem with a greater appetite for risk among investors.



Credit unions have a role to play in conserving and developing America's competitive advantage. All this production is built on the back of the savings and credit of your members, and it is a privilege to shepherd our members' savings and capital stock for an ever-brighter future. Quarter-over-quarter production may ebb and flow but will ultimately continue to expand, and we are just scratching the surface of what productivity gains will be added to the U.S. economy with artificial intelligence tools.

Navigating economic indicators requires prudence. The complexities inherent in GDP calculations and interpretations necessitate a cautious approach. While the current contraction is modest, ongoing trade tensions and policy uncertainties pose risks to sustained economic growth. It's crucial to consider the broader economic context and potential underlying factors influencing data in forming a comprehensive view of economic health.

For market participants and policymakers, these insights reinforce the importance of delving beyond surface-level statistics to grasp the multifaceted nature of economic indicators. Such diligence ensures more informed decision-making in navigating the ever-evolving economic landscape.