Capital Markets Group

Weekly Review—January 28, 2022

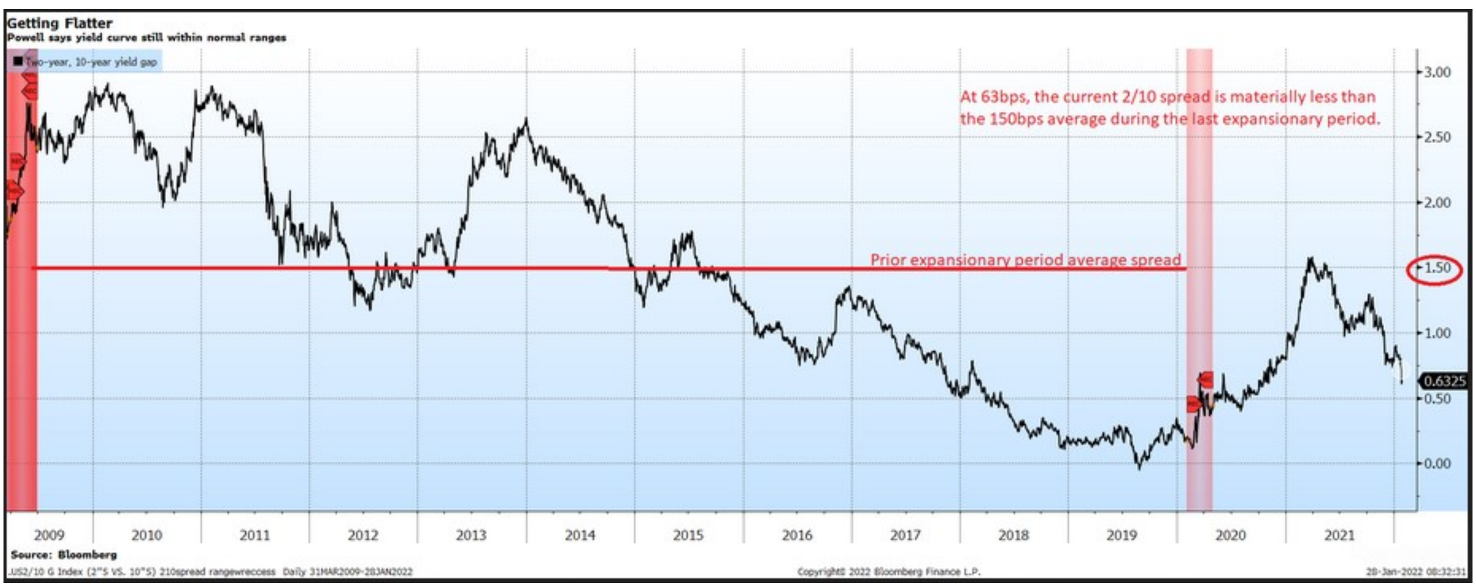
The Fed and Interest rates

Two key takeaways from this week's Fed Policy meeting - expect faster-than-expected benchmark rate hikes with the first commencing in March and expect the process of balance-sheet reduction to begin after initially raising rates. In response to the Fed's increasing hawkish guidance, front end treasury yields continue marching higher. At 1.19%, the two-year treasury yield is now at levels not seen since the beginning of the pandemic. Although short-term interest rates continue to increase, longer-dated treasury yields remain little changed for the week resulting in a flatter yield curve. This shift in the shape of the treasury curve is best defined by investors as a bear-flattening move whereas short-term rates increase faster than longer-term rates. Such shifts in the shape of the curve signal that market participants are pricing in a potentially more aggressive tightening - enough to risk a rapid slowdown in the broader economy. Evidenced in the below graph, the 2-10 treasury spread (difference between the 2-year yield and 10-year yield) is now at 63bps for the first time since 4QTR20 - down from last year's peak spread of nearly 160bps. (When asked about the current steepness of the yield curve, Fed Chairman Powell stated that the 2-10 spread is "still within normal ranges." Although his comment was technically correct, the current spread is materially below its 150bps average achieved during the last expansionary period and well off its previous cycle high of 291bps.) At 63bps, the bond market is signaling that it believes that policy makers are capable of inflicting plenty of economic pain to meet their policy goals. Investors are less confident that the Fed can achieve their policy mandates without doing major damage to the economy. Unless the Fed fast tracks its reduction in the overall size of its balance sheet further distorting the market fundamentals of supply/demand, it would be reasonable to expect that the curve will continue its flattening ways.

Economic Growth

The economy expanded faster than expected in the final quarter of last year largely driven by the increase in inventories as companies continue the process of restocking which helped bolster production. Specifically, gross domestic product (GDP) expanded at a 6.9% annualized rate following a 2.3% pace in the third quarter. The 6.9% growth marks the strongest quarterly growth in over a year. The median forecast in a Bloomberg survey of economists called for a 5.5% increase in GDP.

Dennis Zimmerman Jr. | Senior Vice President | Senior Manager – Asset/Liability Services | Commerce Bank – Capital Markets Group (CMG)



NEW ISSUE MUNICIPAL CALENDAR			
Date	Amount ($)	Description	Maturity
02/02/2022	$470,000	GARDEN PLAIN KS-TEMP NTS UT GO BQ	2025

ECONOMIC CALENDAR

Monday 1/31	Tuesday 2/1	Wednesday 2/2	Thursday 2/3	Friday 2/4
MNI Chicago PMI	Markit US Manufacturing PMI	MBA Mortgage Applications	Initial Jobless Claims	Change in Nonfarm Payrolls
Dallas Fed Manf. Activity	ISM Manufacturing	ADP Employment Change	Durable Goods Orders	Unemployment Rate
	JOLTS Job Openings		Factory Orders	Labor Force Participation Rate

KEY INDICES

	Current	Last Month	One Year Ago
Prime Rate	3.25	3.25	3.25
Discount Rate	0.25	0.25	0.25
Fed Funds Rate	0.08	0.08	0.08
IOER	0.15	0.15	0.10
1-Month Libor	0.11	0.10	0.12
11th Dist COFI	0.22	0.23	0.47
1-Yr. CMT	0.75	0.33	0.09
Dow	34,725.47	36,398.21	30,603.36
NASDAQ	13,770.57	15,781.72	13,337.16
S&P 500	4,431.85	4,786.35	3,787.38
Bond Buyer	2.33	2.05	2.14

MUNI AA—BQ

3 Mo.	0.57
6 Mo.	0.62
1-Year	0.65
2-Year	0.91
3-Year	1.07
5-Year	1.26
7-Year	1.50
10-Year	1.67
30-Year	2.16

Treasuries & New Issue Agencies *(Spread to Treasuries)*

	Treasuries	Bullets	NC-6 Mo.	NC-1 Year	NC- 2 Year
3 Mo. Bill	0.18				
6 Mo. Bill	0.42				
1-Year Bill	0.73				
2-Year Note	1.17	1	1	1	
3-Year Note	1.39	1	4	2	0
5-Year Note	1.63	2	18	13	6
7-Year Note	1.76	7	26	19	9
10-Year Note	1.79	23	40	31	19
20-Year Bond	2.17				
30-Year Bond	2.10				

CMO Spreads to Treasuries

	PAC	Vanilla
1-Year	N/A	+35
2-Year	35	45
3-Year	50	55
5-Year	56	65

MBS Current Coupon Yields

GNMA 30 Yr.	2.52%
FNMA 30 Yr.	2.60%
GNMA 15 Yr.	0.44%
FNMA 15 Yr.	1.93%

About the Author, Dennis Zimmerman

In 2015, Dennis joined Commerce Bank's Capital Markets Group as Manager of Asset/Liability Services. With his leadership, the Capital Market's ALM team provides asset/liability management consulting services to community banks.

Prior to joining Commerce, he was employed for nearly 26 years at one of the largest privately-held banks in Kansas. In addition to managing a $775 million bond portfolio, his Asset/Liability Chairman responsibilities included managing margin, interest rate risk, liquidity and capital. Prior to becoming the bank's Finance Treasury Officer, he was a Registered Investment Representative and Supervising Principal in the bank's Capital Markets division.

As a seasoned professional, Mr. Zimmerman offers a comprehensive understanding of bank finance treasury, fixed income, complex financial analysis as well as regulatory and operational awareness. As a banker, he understands the challenge of balancing shareholder expectations within appropriate levels of risk.

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The Weekly Review is a publication of the Capital Markets Group of Commerce Bank.