Capital Markets Group

Weekly Review—February 4, 2022

Today's strong jobs report is moving bond yields up across the curve. The Change in Nonfarm Payrolls exceeded expectations: an increase of 467,000 for January as well as a positive 709,000 revision of the trailing two months. At time of writing, the 10-year treasury yield was trading close to 1.90% and the 2-year was around 1.30% - a spread of nearly 60bps. While the curve remains flatter than most of last year, yields are rising in preparation for Fed actions – both hikes in the overnight rate and the reduction of its balance sheet.

Fed funds markets predict as much as 5 rate hikes by the FOMC this year. This will affect areas from how much it costs banks to borrow from correspondent banks to how much consumers pay on credit cards and loans tied to Prime. For banks, this could help in areas of lending and floating rate investments. One of the interesting things to watch is the relationship between the Fed funds rate and SOFR. This will be the first real test of the Libor replacement for many contracts.

The real interesting part is the quantitative tightening (QT) that is supposed to occur – the Fed balance sheet reduction. I read a nicely written article on Bloomberg's terminal this morning about the possible impacts of QT. Alexandra Harris' "Fed Tightening Will Rumble Funding Markets from T-Bills to Repo" highlights some of the ramifications for the likely Fed balance sheet reduction. I will concentrate on the areas which affect some of our client base who invest primarily on the shorter end of the curve. Firstly, since we are not market makers, we will have to be more reactive, or at least be the beneficiaries of what the market makers do. Money Market managers have had to look for yield in many different places since the level of short-term T-bills have challenged profitability requirements. Many have gone to the Fed's Reverse Repo facility which has paid more than simply buying treasuries. Short-term funds typically invest in short-term debt to help put clients' money to use and provide a reasonable return. The Fed has been a significant purchaser of treasuries along the curve as well as playing a significant role in offering other liquidity solutions or short-term investment options. One thought is as the Fed reduces purchases of treasuries and looks to reduce its overall balance sheet size; liquidity levels will tighten. The question is what role the Treasury Department will take in filling the void left in supply. Will they issue more short-term debt to supply money managers? Or will they look more to long-term debt issuance to fund the government. This could have a crucial role in where we see short-term interest rates go. The higher the risk (liquidity risk in this case), usually the higher the interest rate will be. For clients in Money Market funds or in the T-bill space, we could see some higher yields as risks increase in various investment vehicles. Stay tuned for what roles the various players take on, we are positioned to see something very interesting which hopefully results in increased profitability for investors.

Have a nice weekend!

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NEW ISSUE MUNICIPAL CALENDAR			
Date	Amount ($)	Description	Maturity
02/07/2022	$3,015,000	LARNED KS UT GO BQ NR	2022-2033
02/07/2022	$2,865,000	TONGANOXIE KS - TEMP NTS-C UT GO BQ MIG1	2023
02/07/2022	$1,060,000	TONGANOXIE KS-A UT GO BQ A2	2023-2032
02/07/2022	$1,185,000	TONGANOXIE KS-TXBL-B-REF UT GO TAXABLE A2	2023-2033
02/07/2022	$5,880,000	AUGUSTA KS-A-REF-TXBL	2022-2044

ECONOMIC CALENDAR

Monday 2/7	Tuesday 2/8	Wednesday 2/9	Thursday 2/10	Friday 2/11
Consumer Credit	Trade Balance	MBA Mortgage Applications	CPI MoM/YoY	U. of Mich. Sentiment
	NFIB Small Business Optimism	Wholesale Inventories MoM	Initial Jobless Claims	U. of Mich. 1 Yr Inflation
		Wholesale Trade Sales MoM	Monthly Budget Statement	U. of Mich. 5-10 Yr Inflation

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	0.07	0.08
IOER	0.15	0.15	0.10
1-Month Libor	0.11	0.10	0.12
11th Dist COFI	0.22	0.22	0.46
1-Yr. CMT	0.78	0.40	0.08
Dow	35,089.74	36,799.65	31,055.86
NASDAQ	14,098.01	15,622.72	13,777.74
S&P 500	4,500.53	4,793.54	3,871.74
Bond Buyer	2.32	2.06	2.14

MUNI AA—BQ

3 Mo.	0.59
6 Mo.	0.64
1-Year	0.67
2-Year	0.94
3-Year	1.70
5-Year	1.26
7-Year	1.44
10-Year	1.59
30-Year	2.07

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

	Treasuries	Bullets	NC-6 Mo.	NC-1 Year	NC- 2 Year
3 Mo. Bill	0.22				
6 Mo. Bill	0.54				
1-Year Bill	0.86				
2-Year Note	1.31	1	1	1	
3-Year Note	1.54	1	5	2	1
5-Year Note	1.78	2	18	14	6
7-Year Note	1.89	9	25	18	8
10-Year Note	1.92	22	40	31	19
20-Year Bond	2.21				
30-Year Bond	2.10				

CMO Spreads to Treasuries

	PAC	Vanilla
1-Year	N/A	+35
2-Year	35	42
3-Year	50	55
5-Year	57	67

MBS Current Coupon Yields

GNMA 30 Yr.	2.49%
FNMA 30 Yr.	2.60%
GNMA 15 Yr.	0.44%
FNMA 15 Yr.	1.92%

About the Author, Matthew Maggi

Prior to joining CMG in 2016, Matthew was the Corporate Treasurer at a $1.2 billion publicly-traded community bank headquartered in Missouri. During his tenure, he developed and implemented balance sheet strategies to maximize margin while managing acceptable levels of interest rate risk, liquidity, and capital. Matthew not only managed the investment portfolio, but also conducted extensive loan portfolio performance analyses.

Previously, he was a Treasury Analyst for one of the largest privately held banks in the U.S. He monitored cash flow and liquidity and developed funding strategies. Matthew leverages his extensive balance sheet management experience to provide tactical and strategic solutions to maximize performance while mitigating risks for the community banks.

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