[Flash Update:]() US Rate Markets – Tuesday 7/2/2024

- **Rates edge lower as market braces for key employment data**
- **Currently, SOFR swap rates are down ~2-5 basis points this morning**
- **Highlight for the week is Friday's release of the June Employment Report at 8:30 AM**
- **FOMC Chairman Powell spoke on a panel this morning at 9:30 AM**
- **Powell's comments this morning were interpreted as leaning "dovish", a positive for market rate cut hopes**
- **May JOLTS jobs report posts better-than-forecasted, hinting at continued labor market resilience**
- **FOMC releases the June Meeting Minutes tomorrow at 2:00 PM**
- **Market closes early tomorrow (2:00 PM), so the market reaction to tomorrow's data and the meeting minutes may be delayed until Friday**

US Treasury yields and SOFR swap rates opened lower this morning, after yesterday's seesaw ride for rates reminded market participants that the presidential election season is upon us. Rates popped higher yesterday after an announcement that the US Supreme Court had ruled in favor of Trump, thereby eliminating a potentially insurmountable legal roadblock to his candidacy. From the market's perspective, the Supreme Court decision, coupled with Biden's suspect performance at last week's debate, significantly increases the likelihood that Trump will win the election. Broadly speaking, a Trump presidency is expected to lead to increased spending and higher tariffs. Both are a negative for economic growth and can lead to higher inflation. Rates initially surged higher on the Supreme Court ruling, but then gradually settled back down throughout the afternoon as traders realized they may have gotten ahead of themselves. Realistically speaking, it is far too early to call the election result and it is premature to assign policy decisions to either candidate – the election season is just beginning.

The market's focus will now shift to the employment data we will see the remainder of the week. This morning's JOLTS jobs report (a report that tracks job openings) posted at 8,140 vs. expectations calling for 7,946. The pace of hiring also increased to 3.6% vs. 3.5% last month. The JOLTS data was not the precursor to weaker employment data the market wanted. The market reaction, however, was minimal, given that Chairman Powell was speaking when the data was released, but rates did pare the rate declines seen earlier in the morning. Tomorrow we will see the ADP jobs data, along with ISM Services data for June, May Factory Orders and May Durable Goods Orders. The big number for the week, however, is Friday's June employment report. A weak employment report would bolster hopes for two rate cuts this year and likely accelerate the timetable for the first rate cut to September.

The FOMC also release the June Meeting Minutes tomorrow at 2:00 PM. The minutes are for the most part, old news, but market participants are keen to see if they can glean more information surrounding the "dot-plot" discussion that occurred during the meeting. Fed officials' public remarks sounded hawkish immediately following the meeting, but have softened over the past week or so as favorable inflation data, and somewhat weaker economic data, have increased the odds that the FOMC will be prompted to cut rates two times in 2024. This morning, Federal Reserve Bank of Chicago President Goolsbee said policymakers should cut interest rates if US inflation continues to fall back towards the 2% target. The Chicago Fed chief, speaking also said he feels "we are on a path to 2%" inflation and "if you just hold the rates where they are while inflation comes down, you are tightening — so you should do that by decision, not by default." Goolsbee's dovish comments were music to the market's ears, but Goolsbee is not a voting member of the FOMC this year, so the hope is that other voting members are beginning to think like Goolsbee. Bottom line, Goolsbee is urging his Fed colleagues to prepare for rate cuts. Upcoming Fed speak will continue to be a primary focus for market participants.

Chairman Powell spoke this morning, joining a panel discussion that included the heads of the ECB and Central Bank of Brazil. Powell answered questions on the US economy and inflation, but his tone was jovial and seemed to lean dovish. Fed Chair Powell said prices are now showing a disinflation trend. He also mentioned that although the labor market remains strong, it is showing signs of cooling-off. He also issued his standard caveat, which is that cutting "too soon" is also a danger for the economy. He did also acknowledge that cutting too late also poses a risk, but he added that he doesn't think that is currently the case. That said, market participants took his comments as leaning dovish, and rates continued to tick lower as a result. From my perspective, Powell's remarks

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were neutral at best. Powell said that “because the US economy is strong and the labor market is strong, we have the ability to take our time and get this right, and that’s what we’re planning to do.” It is still unclear to me if Powell is ready to cut rates or not. Perhaps the employment data we see this week will provide additional clarity.

CHART 1: ***US RATES SNAPSHOT: 11:15 AM Eastern***

	UST YIELDS		SWAP SPREADS		SOFR SWAP RATES	
2Y	4.720	-0.036	-14.0707	-0.3707	4.5820	-0.0380
3Y	4.533	-0.043	-19.6300	+0.1110	4.3373	-0.0417
4Y	4.438	-0.043	-26.5280	-0.1500	4.1947	-0.0428
5Y	4.385	-0.040	-27.2900	-0.1650	4.1132	-0.0418
7Y	4.399	-0.034	-35.6770	-0.1890	4.0433	-0.0362
10Y	4.436	-0.025	-41.9967	-0.2502	4.0170	-0.0290
20Y	4.723	-0.007	-72.2385	-0.3635	4.0025	-0.0111
30Y	4.620	-0.003	-80.0000	+0.0285	3.8204	-0.0046

Source: Bloomberg, LLP | 11:15 AM NY Rates Snapshot

***Note:** First column is the current market level, second column is the change on the day; ‘Red’ = Lower; ‘Green’ = Higher; ‘White’ denotes active trading*

CHART 2: ***Rates Drift Lower Ahead of Key Data Releases This Week***

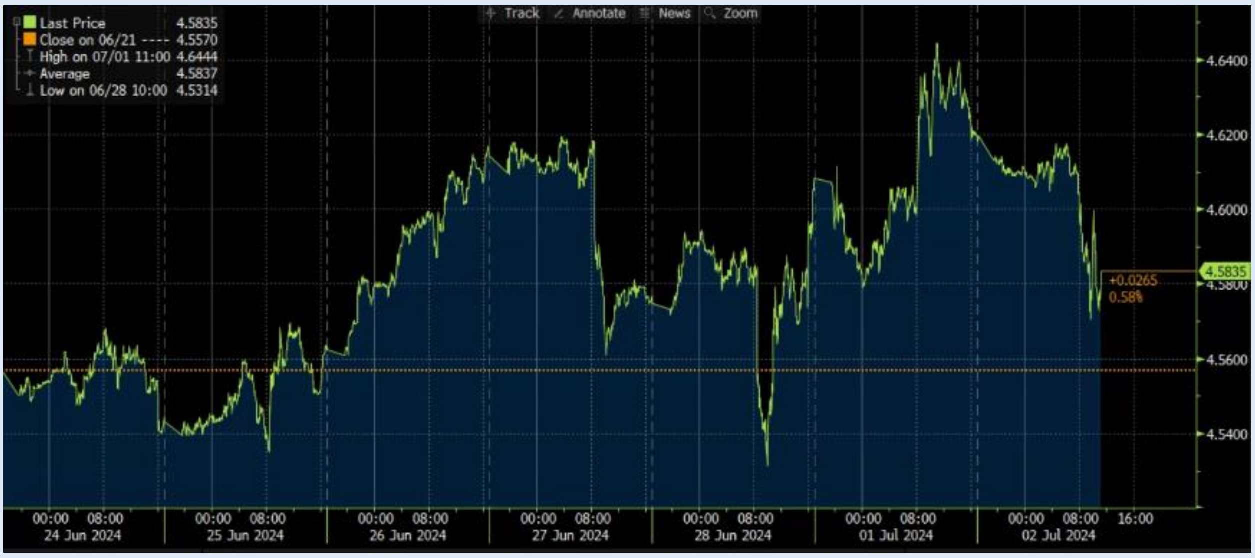
After a volatile day yesterday, SOFR swap rates settled down and closed near Friday’s end-of-day levels. This morning rates moved lower in anticipation that weaker jobs data will increase the likelihood for Fed rate cuts this year. Weaker data and increasingly dovish Fed speak are bolstering market hopes that the Fed will cut rates twice this year, ideally beginning at the September meeting. There is the possibility for elevated levels of volatility in the near term as the market digests data and monitors Fed-speak. Any hawkish surprises in Fed-speak or data could cause rates to pause as the market continues to assess the path for forward rates.

The Bloomberg graph below shows the 2y SOFR swap rate for the prior 7 trading sessions. At the far right of the graph you can see the increase in 2Y swap volatility. Rates popped up yesterday, then drifted lower this morning on Powell’s comments. Rates reversed somewhat after the stronger-than-expected JOLTS jobs report, and then moved lower again, particularly on the short-end of the swap curve. We may see a reaction to the data tomorrow morning, but I expect markets to quiet down as the day progresses and we prepare for the 4th of July holiday.

Please note, market updates will resume Monday, July 8th. *Stay tuned!*

Chart 2: Yesterday Was A Reminder…Presidential Elections Can Lead to Increased Rate Volatility

RateCap Advisors



Source: Bloomberg, LLP | 2Y SOFR SWAP RATE, PRIOR 7 TRADING SESSIONS

RCA Product Update:

Week of 7/1/2024 - *What We Are Seeing In The Rates & Derivatives Markets*

Markets are extremely volatile and there could be even more volatility on the horizon. Borrowers should be as nimble as possible in this market environment. Cap purchasers should onboard as quickly as possible – there is no cost to onboard. It is important to be in a position where you can take advantage of market opportunities quickly and efficiently. We have all seen how fleeting these opportunities can be, so it is important to be ready to execute.

New cap volume continues to increase slightly, as does existing cap extension volume. Despite a shift in market pricing regarding Fed rate cuts, the forward curve is *still* pricing in ~2 rate cuts for 2024 – just starting a bit later in the year. Should inflation continue to trend higher, rate cut expectations may be reduced further. We are also seeing increased demand for interest rate floor indications – to offset high loan floors or simply to benefit from declining variable rates.

Given the uncertainty that still remains about forward rates, many clients are grappling with when or if to extend. This is a difficult question – our advice has been to monitor the market closely and be on-boarded and ready to trade, should the market move in your favor. We also advise borrowers to check the market pricing for extensions, similar to how you purchased the original cap. Market pricing discovery is a key component to any cap transaction – new caps, extensions or terminations.

We also encourage our clients to speak to their lenders. In some cases recently we have seen lenders approve shorter term extensions (i.e. 3 months) – some borrowers may need to extend, but not for the *full* year. Other borrowers are simply looking to dynamically manage hedging rate risk by entering shorter term caps and hoping cap premium costs will drop ahead of the next cap purchase. This is not without risk, but could be a viable strategy if you believe rates are going down next year.

There is an increasing interest in exploring interest rate swaps as a possible hedge alternative. IR Swaps lock in a synthetic fixed rate and do not require an upfront premium. Unlike an interest rate cap, swaps are secured derivatives, so the counterparty selection process is more challenging with a swap. There are also additional variables that factor into the decision to pursue an interest rate swap, or to unwind an existing swap. *Please let us know if you would like to learn more about interest rate swaps.*

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On another front, borrowers who have "floors" embedded in their loan have been considering purchasing a separate, stand-alone interest rate floor to *offset* the loan floor. Borrowers with a loan floor will *not* be able to benefit from floating rates that drop below the loan floor rate. They will miss out on the benefit of lower floating rates, which depending on the rate environment can be significant. To offset the loan floor, borrowers can purchase an interest rate floor which will payout should floating rates drop below the floor's strike rate. Details vary depending on the individual situation – some borrowers prefer to choose a strike on the floor that matches the floor rate on the loan, whereas others look to use a strike rate below the loan floor. (For example: Your loan floor is 3.50% - the floor you purchase can be priced at the loan floor of 3.50%, or you could look at a strike of 3.00%). The lower the floor strike, the cheaper the premium cost of the floor. Pricing ultimately depends on the individual situation and objective.

We also continue to see clients grappling with ways to manage burdensome replacement cap escrow costs. In certain cases there *may* be a way to restructure the existing cap to extract value which can offset escrow created cash-flow pressure. Short of biting the bullet and purchasing the replacement cap and ceasing escrow deposits, restructuring the cap can add risk. Many of the solutions are designed to alleviate short term cash flow pressure but as mentioned, often create additional rate risk.

Please contact us if you would like to discuss an upcoming rate cap extension, explore ways to reduce or eliminate escrow deposits for replacement caps or learn more about interest rate Swaps or Floors.

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AST Defeasance Consultants, one of the nation's leading commercial real estate consulting firms, was founded in 2007. We have extensive experience in commercial real estate defeasance, hedging, derivatives, and financial instruments. More than $50 billion worth of transactions have been executed by the AST team. Only AST can combine innovation, expertise, and exceptional customer service.

Rate Cap Advisors was established in 2015 that focus on providing commercial real estate interest rate cap solutions. Our innovation and desire to explore new possibilities that benefit our clients have allowed us to save our clients millions of dollars. No matter the service or product, we take great pride in our pursuit of perfection with a unparalleled closing track record.

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