Hi «Name»,

Good Morning! Please see below for the RCA | AST Defeasance Rate Market Update for February 8, 2023. Please let us know if you would like additional market color or have any questions. We are also always happy to provide indications for your defeasance needs, or for interest rate caps, swaps or other derivative hedging products. Please feel free to reach out anytime! *-RCA | AST Interest Rate Hedging Desk*

RATE MARKET UPDATE | February 8, 2023:

- **Treasury and Swap yields moved materially higher late last week and early this week**
- **Increase in rates was fueled by delayed reaction to Chair Powell's post-meeting remarks and a robust U.S. jobs report**
- **Market pricing now calls for Fed terminal rate of ~5.15% into early 2024**
- **Powell's speech yesterday echoed his post-meeting comments; rate market reaction was muted**

Although the rate market initially interpreted Chairman Powell's post-meeting comments as leaning dovish, sentiment quickly shifted back toward the hawkish end of the spectrum. The market *wanted* Powell to be dovish and that is what they heard, *at first.* Upon more careful review, Powell was very clear that policy makers have further work to do until inflation is contained, do not expect to cut rates this year, believe further rate hikes are warranted and believe the U.S. economy can withstand continued rate hikes without dipping into a major recession. Yes, he acknowledged some positive inflation trends and mentioned that the Fed would *react to the data*, but what does that really mean? I *expect* him to acknowledge a positive trend – *it means monetary policy is working*. In addition, the Fed should always be data dependent (barring catastrophic circumstances or events), so I think the market read too much into that statement – he *also* said the data may warrant rate *increases* beyond what is currently anticipated.

As mentioned, Treasury and SOFR swap rates moved significantly higher on Friday and then again on Monday. (See Table 1 below). Market participants woke up Friday to a robust U.S. employment report. The strong jobs report, in conjunction with more careful analysis of Powell's comments, pushed yields materially higher. The yield move is basically the result of the rate market capitulating to the FOMC *for the short term*. The rate market had hoped the Fed would signal that they were "done" raising rates and considering a dovish pivot in the short term. Based on Powell's comments recently and bolstered by Friday's strong jobs report, that is not the case. For the time being, the rate market has grudgingly accepted the FOMC is not done raising rates.

TABLE 1: ***1-Week Movement in Term SOFR Interest Rate Swaps***

Swap Tenor	February 1, 2023 Rate	February 8, 2023 Rate	Change:

2 Year SOFR Swap	**4.138%**	**4.467%**	**+32.9 bps**
3 Year SOFR Swap	**3.680%**	**4.016%**	**+33.6 bps**
5 Year SOFR Swap	**3.312%**	**3.608%**	**+29.6 bps**
10 Year SOFR Swap	**3.131%**	**3.362%**	**+23.1 bps**
1M CME Term SOFR	**4.57172%**	**4.56113%**	**-1.05 bps**

Table 1 (above) shows SOFR swap yield movement for the past 7 days. The rate market was forced once again to reprice FOMC expectations, so the yield move tells me the market is currently expecting the Fed to raise rates 25 basis points at the March meeting and starting to lean towards 25 bps more at the meeting in May. Powell's comments yesterday, which essentially affirmed his post-meeting remarks, did not have a noticeable impact on the market. Rates have been stable since yesterday with yields trading in a relatively tight range. We have seen an uptick in rate volatility the past week as well, which we expect to continue for the near term. There is still a high degree of uncertainty in the rate market, so we could continue to see knee-jerk market reactions to economic data or Fed-speak causing intra-day rate volatility.

The Bloomberg graph below illustrates the increase in rates mentioned above. You can see that the 2Y SOFR swap rates initially moved lower after the Fed meeting and Powell's comments, but *quickly* reversed after Friday's employment report and further reflection on the tone of Powell's remarks. Rates paused on Tuesday as the market waited for *more* Powell – his remarks yesterday were similar to his post-meeting comments and the rate market reaction was muted. Traders had already pushed yields higher to account for another FOMC rate hike or two, so Powell's largely repetitive comments were already priced into the market. Right now the market is catching its breath as it awaits the next set of economic data.

2-Year SOFR Swap Rate Move WoW

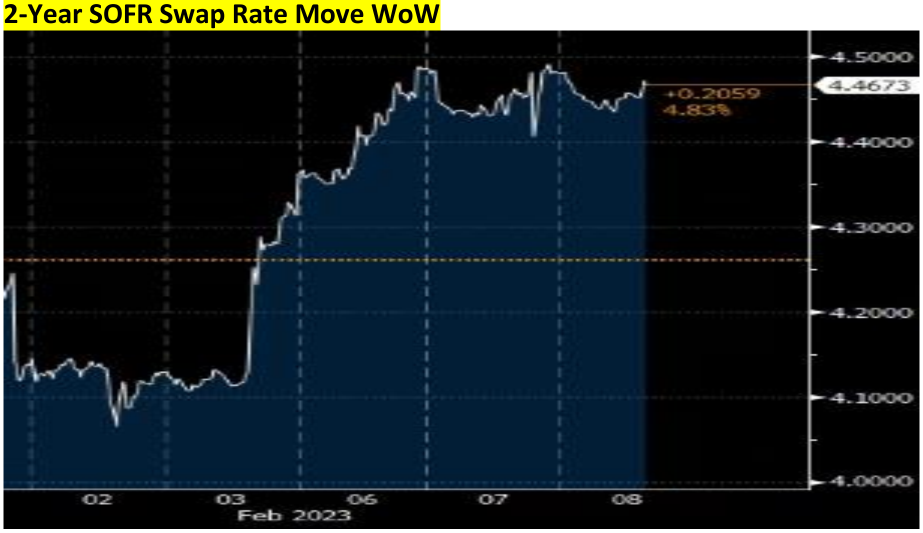
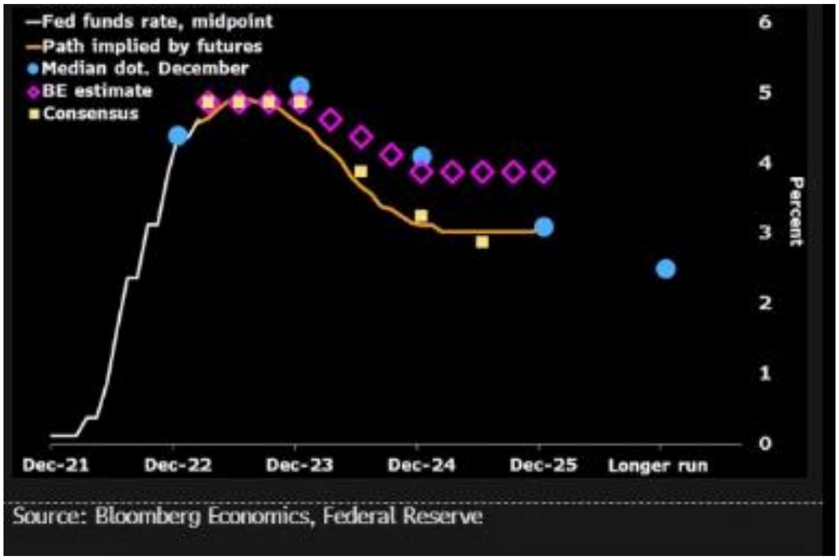


CHART 1: FOMC Expectations | Some consensus…but uncertainty remains

The following Bloomberg chart depicts forward FOMC expectations, from various perspectives, through 2025. I would first caution you not to put to much faith in the forward projections. *Forward curves rarely manifest as predicted.* I found the chart interesting as it does show two key points that are accurate *at the moment*. The first is that there is some degree of market/Fed/economist consensus for 2023. All of the sources referenced, including the Fed median dot, forecast rates to increase a bit more and then stabilize until early-to-mid-2024. Beyond that timeframe, you can see consensus wanes, but one thing is evident – all of the sources are calling for lower rates, to varying degrees, beginning mid-2024. The chart provides a good summary of what market participants, traders and economists are currently thinking, how Fed Funds futures are trading and what the Fed has most recently communicated via their "dot plot".



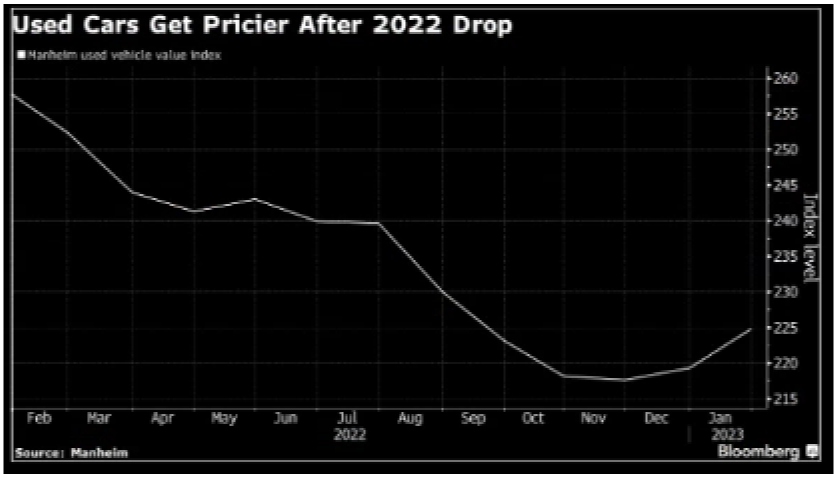
Rates Market: ***The Week Ahead***

- **Used Car Salesman's Jobs Just Got Harder!**
- **CPI data released Tuesday, 2/14 at 8:30 a.m.**
- **Various Fed officials "on the tape" this week and next**

The rates market will now look ahead to the next batch of upcoming economic data, the most important of which will be next week's CPI inflation report (released 2/14, 8:30 a.m.). We will also see Univ of Michigan inflation data tomorrow, and there are a host of Fed officials slated to speak over the next two weeks. As we have seen, "Fed-speak" can and will move the market, but it is unlikely Fed officials will want to say anything too dramatic as we await the CPI data. We will preview next week's CPI report in greater detail in the next market update.

CHART 2: Used Car Prices Moving Higher | CPI Impact?

Finally to close out today's update, we point out that our friendly used car salesman's jobs just got tougher. The Bloomberg chart below shows used car prices are escalating after dropping significantly during 2022. All kidding aside, used-car prices are one of the larger components of the Consumer Price Index, making up 4.5% of core CPI. We point this out only to emphasize that despite positive trends recently, there is still a tremendous amount of uncertainty in the rate market. Inflation has been trending lower but will that be sustained? Will the Fed be forced to increase rates higher than a peak of 5%-5.25%? Will the FOMC pivot sooner than expected as hopeful expectations become reality? These are the market forces that will continue to take shape between now and the next FOMC meeting on March 22nd.



Best Regards,

Mark Perlow
AST Defeasance Consultants
Rate Cap Advisors
Direct: (212) 500-0922
Email: mperlow@astdefeasance.com

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