AST DEFEASANCE RATE MARKET UPDATE

Good Morning! Please see below for the RCA | AST Defeasance *Rate Market Update* for May 5, 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: May 5, 2023 | Week In Review

- **Rates higher after better than forecast Jobs report**
- **US job gains and wages rise, signaling labor market resilience**
- **FOMC raised the overnight rate 25 bps to 5.00% at Wednesday's meeting**
- **Fed did not communicate an official "pause" in rate hikes, but hinted that could happen at June meeting**
- **Powell reiterated FOMC does not plan to cut rates in 2023; Market continues to disagree**
- **Volatile week for bank stocks, but market fears are waning and bank stocks are recovering this morning**
- **Market now looks ahead to CPI on 5/10 at 8:30 AM; Debt ceiling showdown also in focus**

Short-end swap rates moved higher in the wake of stronger than anticipated US employment and wage data that could help support Federal Reserve interest rates remaining "higher for longer". Rates increased as soon as the employment data printed – US job gains and wages increased more than forecast, signaling a resilient US labor market. Wage inflation is watched closely by the Fed as it can quickly become entrenched in the labor market and become more difficult to curtail. The FOMC has communicated they would like to see a looser labor market and wage stabilization before they are willing to consider a pause in rate hikes. There is still a high level of uncertainty in the market concerning the forward path for interest rates and the forecast for the US economy. It is difficult to imagine that the FOMC will cut rates this year given we are still far from the Fed's 2.00% inflation target and the US labor market remains near maximum employment.

Week Ahead Preview:

Next week's highlights are led by CPI on May 10th at 8:30 AM. The next FOMC meeting is not until June 14th, so we will see plenty of economic and inflation data prior to that meeting. Sentiment concerning the banking sector appears to be slowly improving – stock and bond movement today signal a shift to "risk-on" positioning. We also see PPI and Univ. of Michigan inflation data next week and there are a number of Fed officials on the tape as well. The banking sector will remain in focus, and the debt ceiling showdown will also continue to grow in market significance the longer a decision lingers. We continue to expect elevated levels of volatility in the rate market as various geopolitical, economic and monetary crosswinds continue to blow.

Some data highlights for next week:

5/10 CPI

5/11 PPI

5/12 Import Prices

5/12 Univ. of Michigan Data Series: Inflation Data

TABLE 1: Week-on-Week SOFR Swap Rate Movement

SOFR Swap Term	4/28/23 Closing Rate	~5/5/23 Rate	WoW Change
1 Year	4.791%	4.648%	-14.3 bps

2 Year	4.015%	**3.830%**	**-18.5 bps**
3 Year	3.609%	**3.463%**	**-14.6 bps**
5 Year	3.287%	**3.215%**	**-7.2 bps**
10 Year	3.148%	**3.171%**	**-2.3 bps**
1M CME Term SOFR	4.97052%	**5.01870%**	**+4.8 bps**

CHART 1: SOFR Swap Rates – Prior 30 Days

The Bloomberg graph below details the 2Y (white), 3Y (blue), 5Y (orange) and 10Y (purple) SOFR swap rates for the past 30 days. Despite elevated intraday volatility during the prior 30 days, rates have largely bounced around in a relatively wide range. Per the graph below 2Y SOFR swap rates are down ~4.6% over the prior 30 DAYS. Market uncertainty *remains* – there was consensus in the market regarding the May 3 rate hike, but beyond that, there is little consensus in the market. As mentioned, we expect elevated levels of rate volatility while the market sorts out the path for forward rates and the US economy.

CHART 2: FOMC Recap

The Bloomberg chart below shows the current disconnect between the Fed's communicated "dot plot" for forward rates vs. market expectations. The chart clearly illustrates the dichotomy that currently exists in the rate market. Despite Powell's comments that there are no plans to cut rates this year, the market priced-in rate cuts as soon as the July meeting! (Blue line vs. Orange line). In fact, the FOMC did not even shift to a neutral monetary policy and only *hinted* it could happen at the June meeting. We expect market expectations and forward pricing to be volatile as the dichotomy between market expectations and the FOMC reach a critical mass. We are likely to see this develop as we approach the June meeting. Bottom line, the below chart spells volatility for the market in the near term. Most market participants fund short term and lend and invest longer term – at some point one side will need to capitulate or the imbalance in the market will continue to exert pressure on the banking sector, and by extension, the US economy and US consumers.

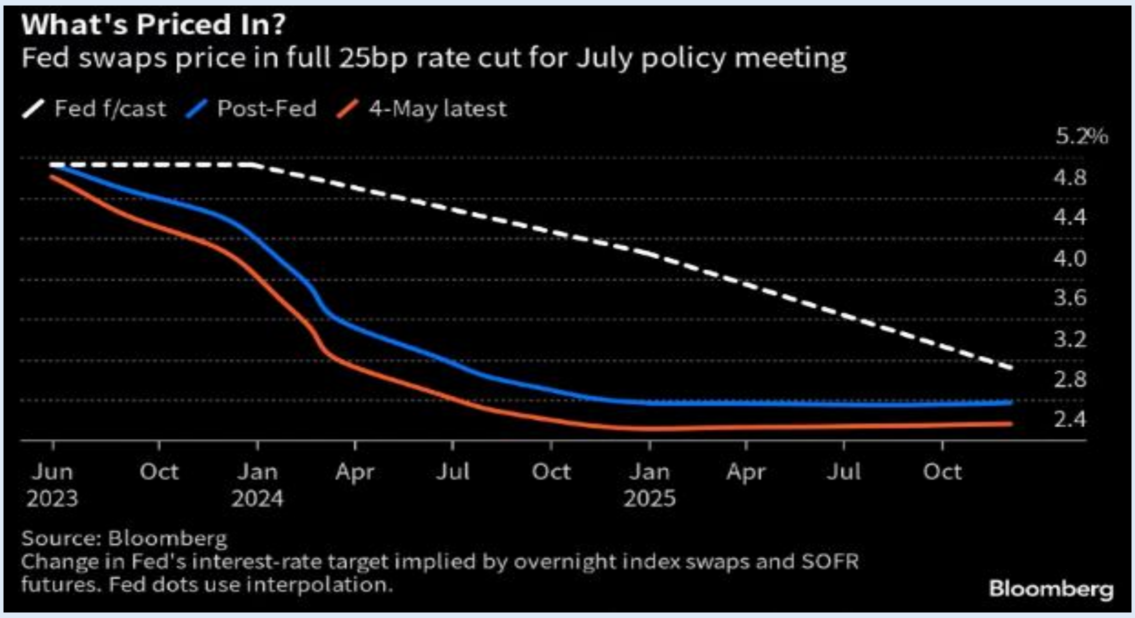
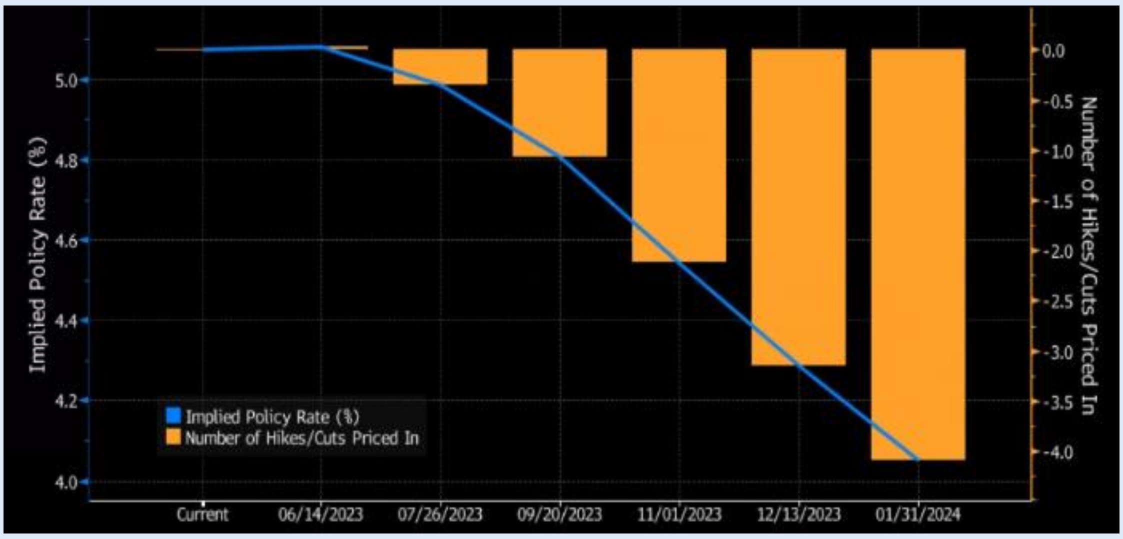


CHART 2: Forward Curve Pricing In Rate Cuts This Year

The Bloomberg chart below also shows the market's expectations for forward rates. I wanted to show this chart as it starkly illustrates that the market has currently priced-in multiple rate cuts *this year*, in direct contrast to Chairman Powell's comments at the post meeting press conference Wednesday. For cap market participants, this has provided some relief on cap premiums recently. Should the market rethink forward rate expectations, expect cap premiums to increase in tandem with rate volatility.



Disclaimer: *The information provided in this communication is intended for discussion purposes only. Nothing presented in this communication should be taken as a recommendation. All market data shown is indicative only and subject to change depending on current market conditions.*