AST DEFEASANCE RATE MARKET UPDATE

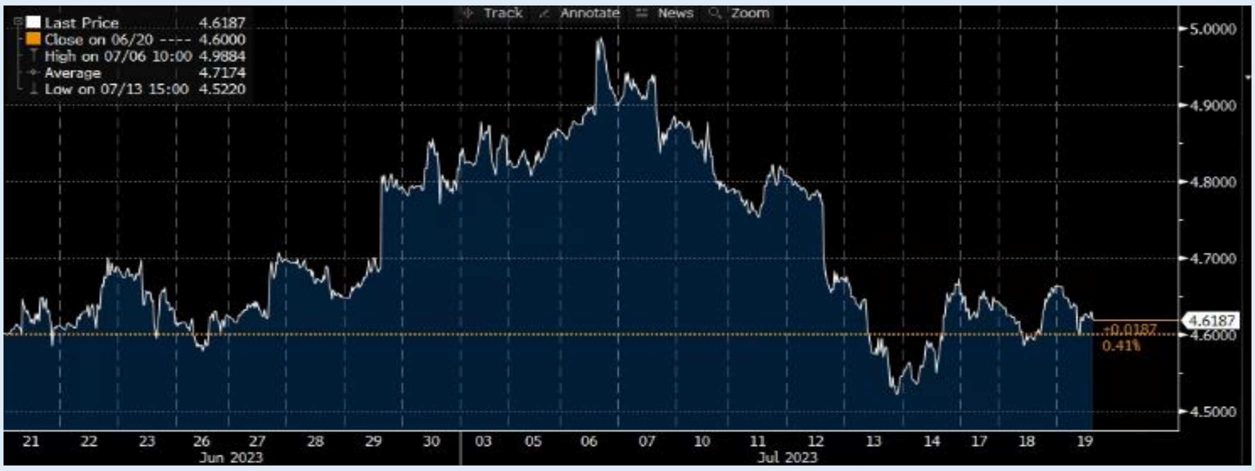
RATE MARKET UPDATE:

- **Market sentiment improves on inflation forecast**
- **FOMC meeting and rate decision on 7/26; Powell press conference to follow**
- **Market pricing still calls for a 25 basis point hike at the July meeting – potentially the last one in this cycle**
- **Odds for a September rate hike have dropped considerably since last week's positive inflation data**
- **However, the possibility of a 25 bp rate hike in September is still in play**

US Treasury yields and SOFR swap rates are little changed this week, as the market awaits the critical FOMC meeting on 7/26. After an initial drop in rates late last week due to better than expected inflation numbers, SOFR swap rates, the main drivers of cap premiums, have traded in a very narrow range. The 2Y SOFR swap started the week at 4.644% and is currently trading at 4.622%. Last week's inflation data definitely improved market sentiment, but Retail Sales showed the US consumer is still strong. The market is likely waiting for the FOMC rate decision and Powell's press conference next week before committing to a path forward for rates. Although market sentiment has improved, there is still plenty of uncertainty out there. At the moment the uncertainty centers on what happens beyond the July Fed meeting – speculation is growing that a 25 bp hike in July may indeed be the last rate hike of the cycle. Generally, the market has been more optimistic than the Fed, so Chairman Powell's press conference is highly anticipated. Does the Fed agree with the market; +25 bps in July and done? Does the FOMC pull a surprise move and hold off on a rate hike in July to keep some powder dry for a rate hike in September or later this year? Even if the FOMC is done with raising rates, will they provide some insight into how long they believe they will need to hold rates? These are questions the market is desperately hoping to get some clarity on next week. Fed officials, although lauding the improvement in inflation, certainly sound like they feel further rate increases may be needed. Commenting on inflation data, Chicago Fed president Goolsbee said yesterday that "It's still higher than where we want it but it's making progress." Fed governor Christopher Waller was even more specific in his recent comments: "I see two more 25-basis-point hikes in the target range over the four remaining meetings this year as necessary to keep inflation moving toward our target." He added, "I see no reason why the first of those two hikes should not occur at our meeting later this month."

CHART 1: 2Y SOFR SWAP RATES – PRIOR 30 DAYS

The Bloomberg chart below shows 2Y SOFR swap rate movement over the prior 30 days. You can see below that July started out with higher rates, based on fears a strong labor market would prompt further rate increases. As the month progresses, market participants have reassessed forward rate expectation once again and are now hoping that the July meeting may be the last rate hike for this monetary policy cycle. Regardless, market uncertainty remains as evidenced by the fact that short term SOFR swap rates are little changed from one month ago (see gold dotted line below). 2Y SOFR swap rates are ~1.87 basis points higher than they were 30 days ago.



Source: Bloomberg, LLP

CHART 2: Student-Loan Repayment in Focus

The repayment of student debt has been in focus recently, as student loan repayments will resume this September. Economists are increasingly concerned that the resumption of student debt payments will put pressure on consumer spending, retails sales and the broader economy in general. More troubling however, is the fact that consumers with student loan debt took on significant *new* debt during the payment moratorium (see

Bloomberg chart below). This only adds to the uncertainty surrounding this situation. We will be keeping an eye on this and the potential impact on rates and the broader economy.

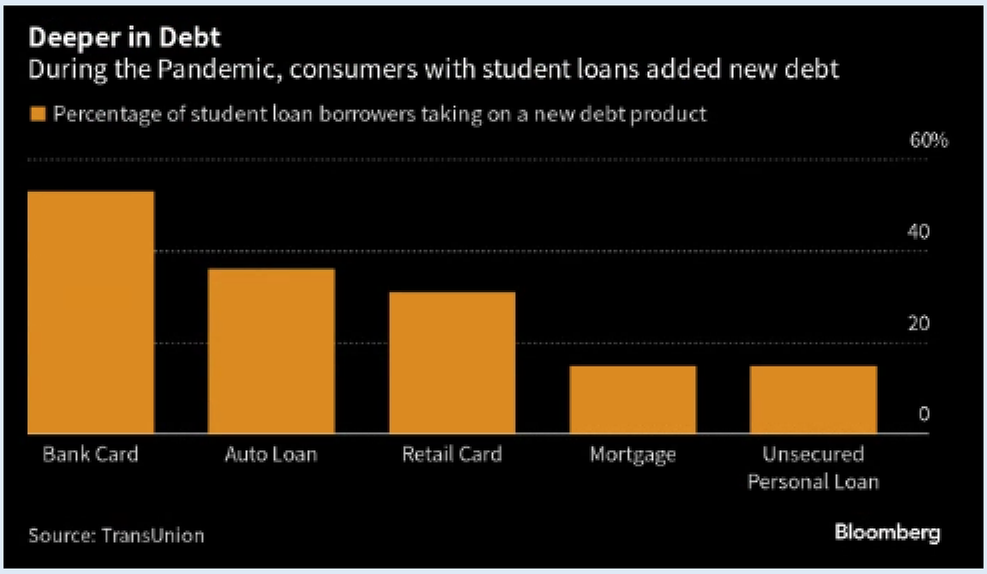
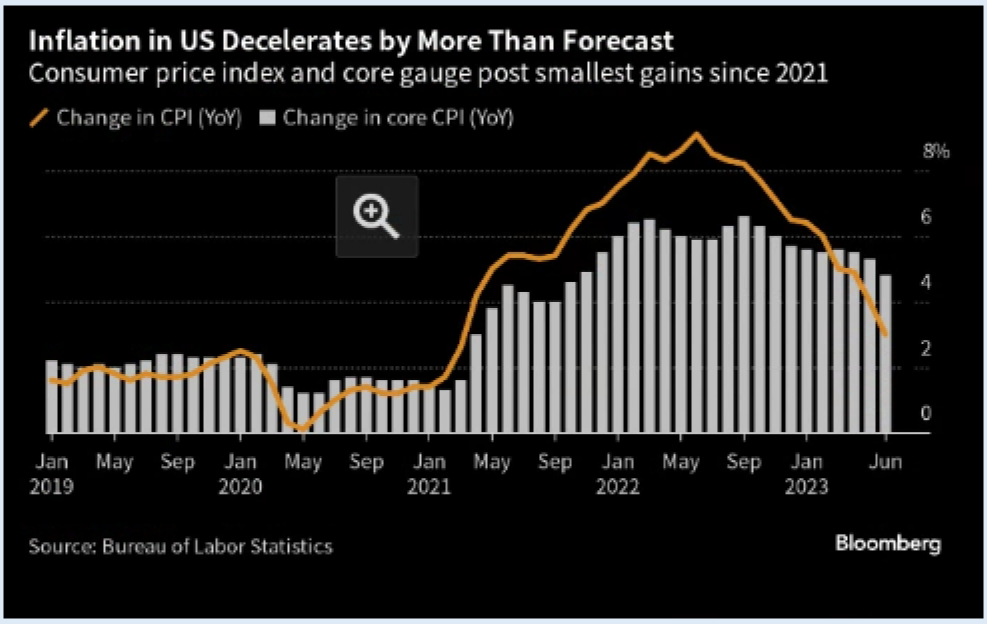
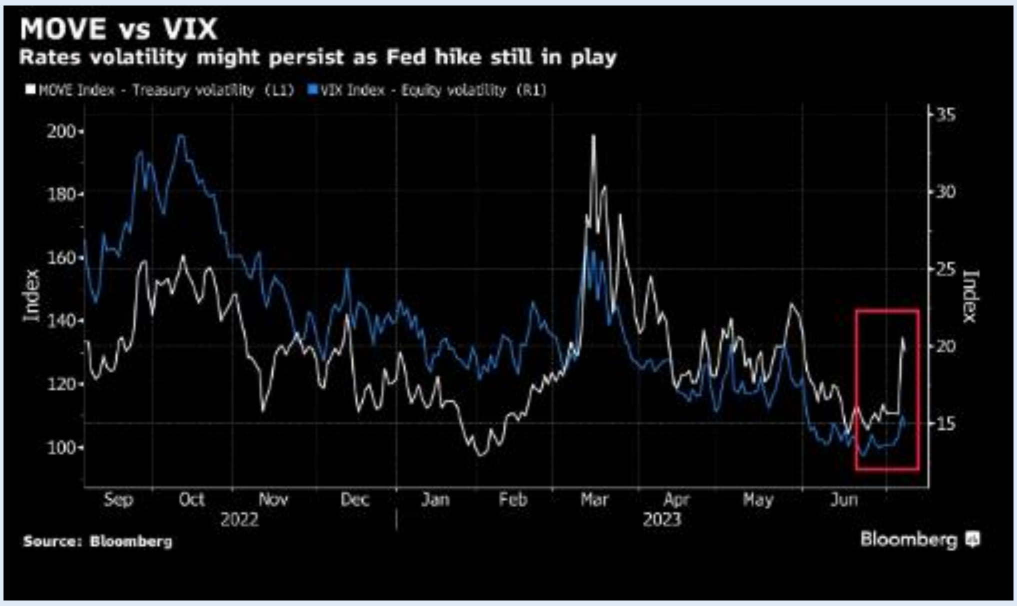


CHART 3: Inflation Decelerates: Is it Enough to Call off the Fed?

You can see from the Bloomberg graph below that inflation decelerated by more than forecast. Headline and Core CPI posted their smallest gains since 2021, a very encouraging sign. However, despite the progress made to date, inflation remains far from the FOMC's stated 2.00% target level. From our viewpoint, that has led Powell and other policymakers to judge that there is still a greater danger of the Fed *not doing enough* to rein in inflation than in it *doing too much* and triggering a deep recession. Recently, they have also said those risks are more in balance now after repeated rate increases, leading to growing market speculation the Fed is nearing the end of this historic rate tightening cycle. Stay tuned!





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