

AST DEFEASANCE RATE MARKET UPDATE

Tuesday, 15th 2023

Good Morning! Please see below for the RCA | AST Defeasance *Rate Market Update* for August 15, 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, swaptions or other derivative hedging products. Please feel free to reach out to us anytime!

RATE MARKET UPDATE:

- **U.S. Retail Sales print better than expected**
- **Upward revisions to prior month's RS data also highlights U.S. consumer resilience**
- **U.S. Treasury and SOFR Swap rates initially moved higher after the data release**
- **However, the Treasury sell-off quickly stalled as investors poured in to pick up bonds at attractive yields**
- **FOMC July meeting minutes release tomorrow at 2:00 PM**

U.S. July Retail Sales printed much stronger than expected, and the prior month's data was revised higher. Both the July data and the revised June data point to a *resilient* US consumer, despite lingering inflation. July retail purchases increased 0.7% (vs. 0.4% expected) and we saw upward revisions to the prior two months data. The upbeat figure this morning reflected increases in a variety of sales categories, including sporting goods stores, clothing outlets and restaurants and bars. The latest retail sales data illustrates how U.S. households — bolstered by a strong employment market and rising wages — are *so far* shielding the U.S. economy against recession in the face of high interest rates. The risk here though, is that *too much* consumer strength could force the FOMC to pursue more aggressive policy should inflationary pressures remain sticky. Optimism is slowly growing that the Fed can engineer a soft-landing. As we pointed out, this could mean the Fed will need to raise rates further or hold rates at these levels (or slightly higher) for the foreseeable future.

We will see the FOMC July meeting minutes tomorrow at 2:00 PM. This will give the Fed the opportunity to emphasize if next month's meeting remains in-play for a rate hike, or not. The Federal Reserve has not ruled out another rate increase this year, though markets seem to be leaning that way. Market participants will be combing through the minutes for clues about forward monetary policy — will they hold rates here? Will there be an official policy shift? Or will they continue the hawkish drumbeat and remain in rate-hiking mode? Hopefully the release of the meeting minutes will help answer at least some of those questions.

CHART 1: 2Y, 3Y & 5Y SOFR Swap Rates – Prior 30 Days

The Bloomberg chart below shows the movement in 2Y, 3Y and 5Y SOFR swap rates over the prior 30 days (Key: 2Y white, 3Y blue, 5Y orange). As you can see from the graph, short term swap rates initially rose this morning on the positive retail sales data. (A strong consumer makes it more likely inflation will remain sticky — that could mean more rate hikes.) However, the rate move higher was *quickly* curtailed as investors poured in to grab Treasuries at attractive yields — some of the highest we have seen in several years. This morning, the 2y Treasury touched 5.00%, the highest yield we have seen since early March. I expect this situation to keep a lid on rates for the near term and there is no compelling reason at the moment for rates to move materially lower. Investors are likely looking to add duration to portfolios at attractive yields — this should keep yields from running away to the upside. Should economic data show rates may need to move higher, that rate move will likely be capped by investors who will be eager to buy Treasuries. This should keep rates range bound until we see more economic data, or hear more Fed-speak. This current bond market investor sentiment could change if the FOMC meeting minutes provide any surprises on the Fed's current mindset.

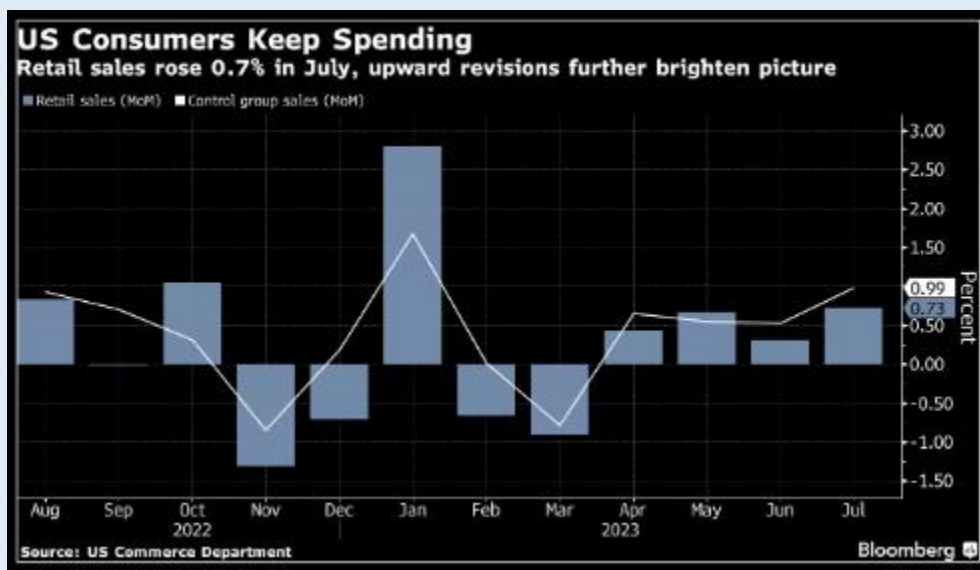
SOFR SWAP RATES



Source: Bloomberg, LLP

CHART 2: Retail Sales – The U.S. Consumer Remains Resilient

The below Bloomberg chart details U.S. retail sales over the prior 12 months. With this morning's number and the positive revisions to the prior two months Retail Sales figures, the U.S. consumer is *alive and well*. I would also point out, however, that as positive as the numbers were this morning, they only highlight *retail* sales – they do not take into account (at all) retail spending related to the service sector. That is also an important consideration when gauging the health of the U.S. consumer. We will see some service-spending related data in the coming weeks. Overall, the retail sales number was viewed cautiously, but positively, by market participants.

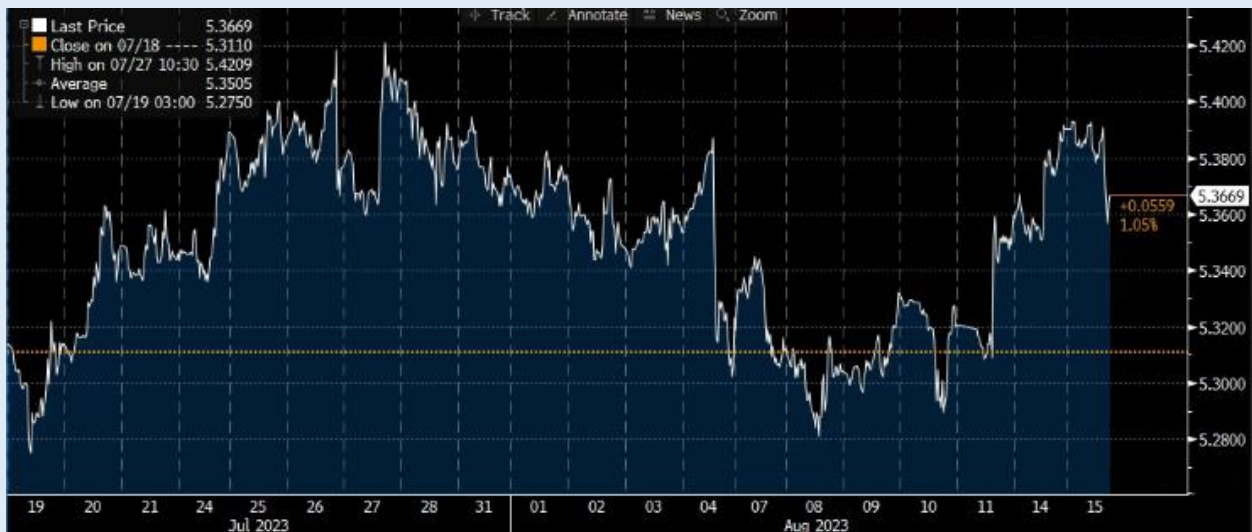


Source: Bloomberg, LLP

CHART 3: 1Y SOFR SWAP RATES: Prior 30 Days

I thought I would quickly show the below 1Y SOFR swap graph to highlight how range bound the short term rate market has been since the prior Fed meeting. You can see that despite some intra-day volatility, the 1Y SOFR swap has basically traded in a 10-12 basis point range for the past 30 days. Overall the 1y SOFR swap rate is up ~1.05% over the prior month. Although rate volatility has remained slightly 'bid', for the most part short-term implied rate volatility has been relatively stable. That said, rate volatility has not dropped as much as I anticipated, which tells me we still have a nervous and uncertain rate market that is prepared for more volatility on the horizon. Perhaps the FOMC minutes will move the needle tomorrow!

1Y SOFR SWAP RATE



Source: Bloomberg, LLP

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