AST DEFEASANCE RATE MARKET UPDATE

RATE MARKET UPDATE:

- **Market prepares for FOMC meeting on July 26**
- **Rates drift higher but generally remain range bound ahead of the FOMC meeting next week**
- **Powell press conference to follow meeting at ~2:30 pm eastern**
- **Market pricing indicates the Fed will raise rates 25 basis points to 5.25%**
- **Fed likely to proceed thereafter on a meeting-by-meeting basis for the remainder of the year**
- **Going forward the FOMC will be in a "data dependent" mode**

US Treasury yields and SOFR swap rates drifted higher yesterday, but overall remain range bound as the market prepares for the FOMC meeting on July 26th. Market pricing now indicates traders feel the Fed will definitely proceed with a 25 basis point rate hike on 7/26. We may see rates bounce around ahead of next week's meeting, but barring anything unforeseen, rates should remain in the recent range through the rate announcement. Keep in mind, Fed officials are blacked out from public comments until after the meeting. From a data standpoint, market participants will only see some minor economic data before the meeting. Both of those factors probably lead to range bound rates until we hear from the Fed.

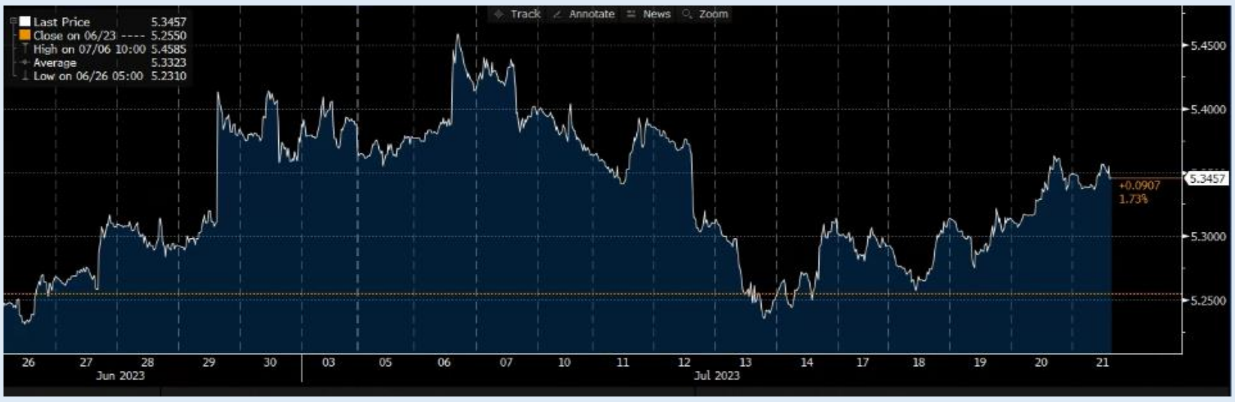
CHART 1: 2Y, 3y, 5y, 10y SOFR SWAP RATES – PRIOR 30 DAYS: Rates Remain Range Bound

The Bloomberg chart below shows the movement in the SOFR swap curve over the prior 30 days (Key: 2Y white, 3Y blue, 5Y orange, 10Y purple). You can see below that despite some clear intraday volatility, SOFR swap rates have generally remained in a range over the prior 30 days. The dotted white line in the graph below represents where the 2Y SOFR swap was 1 month ago - incredibly, the 2Y rate is almost *unchanged* (up less than 1 basis point!). This underscores market uncertainty – the anticipated 25 bp hike next week has been priced into the curve since the last meeting - since then, the market has been reluctant to stray *too* far in either direction, despite some very favorable inflation data recently. Next week's Fed meeting is highly anticipated - the market *wants* to believe this will be the last rate hike in what has been a historic tightening cycle.

Source: Bloomberg, LLP

CHART 2: 1Y SOFR Swap Rates – Prior 30 Days

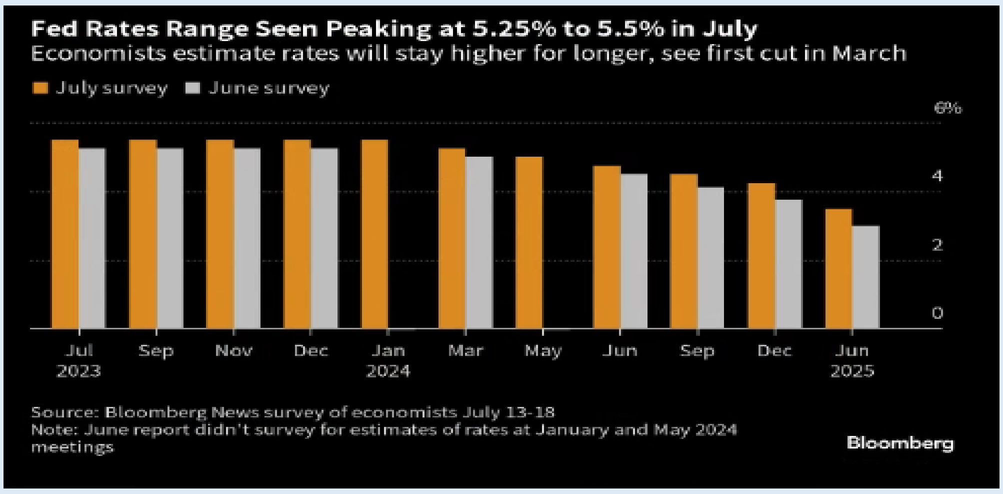
1Y SOFR swap rates have been the most volatile part of the SOFR swap curve over the past 30 days. The 1Y SOFR swap rate is the slice of the swap curve that is most sensitive to FOMC rate decisions. You can see from the below Bloomberg chart that the 1Y swap rate bounced around as the market was constantly reassessing the path for forward rates. The month started with strong employment data and rates crept higher, but quickly adjusted lower on better than expected inflation data. Rates then began to drift higher again on hawkish Fed-speak and strong retail sales data. As we have mentioned, the market has priced in a 25 bp hike in July for some time – the volatility in the chart below reflects the market's uncertainty regarding monetary policy *beyond* the July meeting. A 25 bp hike will raise the overnight rate to 5.25% - you can see from the below chart that market sentiment still thinks there *could be* one more additional rate hike (current 1Y SOFR swap = 5.34%).



Source: Bloomberg, LLP

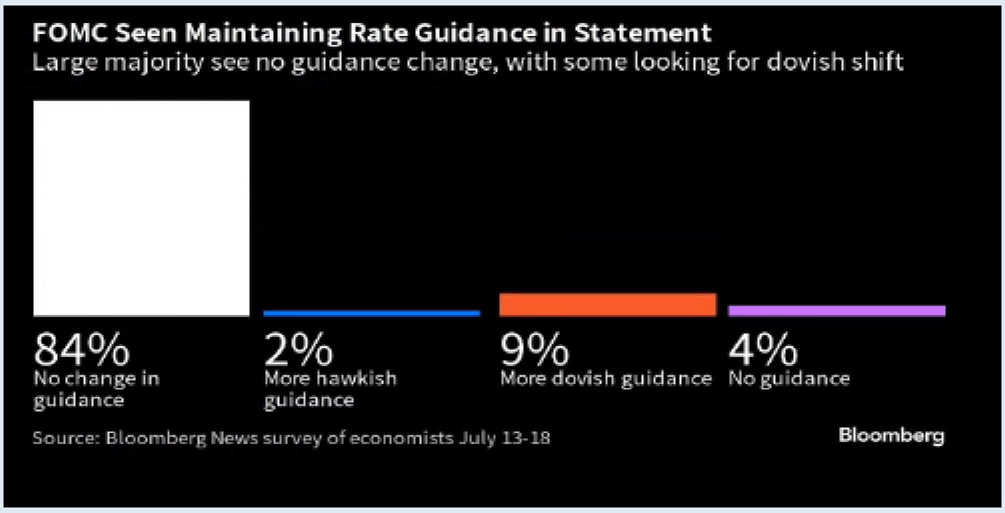
<u>CHART 3:</u> FOMC Terminal Rate: Bloomberg Economists Survey

The most recent Bloomberg survey of economists shows their forecasts call for a rate hike next week and 1 more potential rate hike this year. That would put the terminal rate between 5.25% and 5.50%. At the moment most traders in the market share a similar view. We will see if the Fed's post-meeting guidance statement and Powell's press conference back this up, or if the Fed continues to position monetary policy with a hawkish slant. More telling, economists polled by Bloomberg now agree the Fed is likely to hold rates at these levels (or slightly higher) through the first quarter of 2024 – economists do not expect the first potential rate *cut* until March of 2024. We will see if Mr. Powell can provide more clues regarding how long he expects rates to remain at these levels. Remember, inflation still has a good ways to go to reach the FOMC's target level – that is still their primary mandate.



<u>CHART 4:</u> Forward FOMC Guidance Statement – No Change, or a Dovish Slant?

We found this Bloomberg chart interesting – the majority of economists surveyed by Bloomberg expect the Fed to maintain their current forward guidance for rates in the post-meeting statement. A small percentage surveyed felt the Fed would shift slightly to a more *dovish* policy guidance. The Fed's guidance last meeting revealed a data-dependent Fed leaning toward *possibly* needing more rate hikes this year to curb inflation. They have also been consistent in saying they do not expect a rate cut this year. We will see if they keep that neutral-to-hawkish tone, or if they adopt a more dovish slant to the guidance statement.



[CHART 5:]{.underline} Recession on the Horizon? Does the FOMC believe it??

Finally, we leave you with another breakdown chart from the Bloomberg economists survey – 82% of the economists polled by Bloomberg expect a recession (or a soft landing) in the next 12 months. As we know, economists and market prognosticators have been predicting a recession since the beginning of (and throughout) the Fed's current monetary policy cycle that *has not materialized*. That said, there is merit to the argument that we have yet to see the full extent of the economic damage the Fed's historic rate hiking cycle *may* wreak. Remember, Chairmen Powell has repeatedly said that he expects rate hikes to create some economic weakness. Economic weakness can be a precursor to, or a result of, inflation returning to 2.00%. They have also been adamant that the US economy can *withstand* aggressive rate hikes and so far the *US economy has remained resilient*. Yes, we are seeing some cracks in the employment market and the US consumer may be finally faltering, but so far the FOMC has been able to navigate a massive rate increase without severe damage to the US economy. Going forward, both the Fed and the market will be watching forward economic data *closely*.

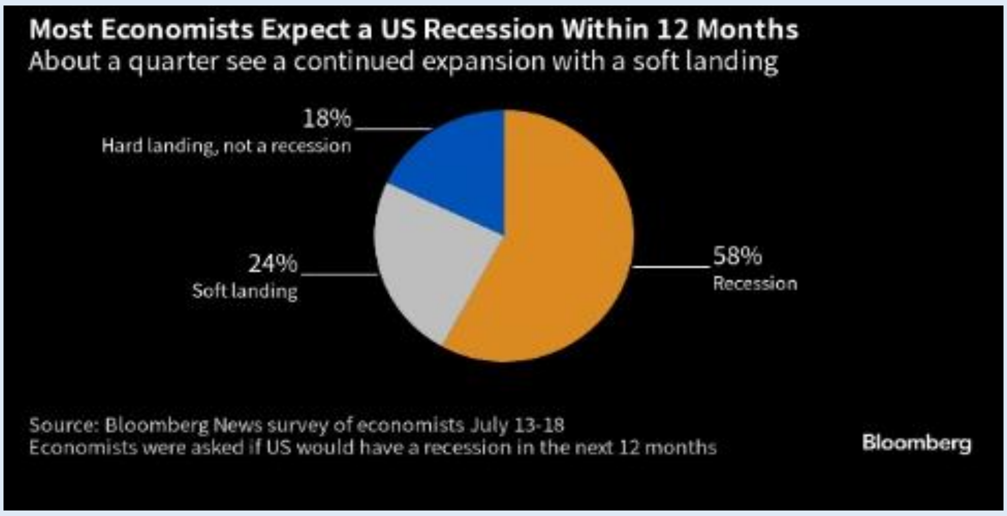
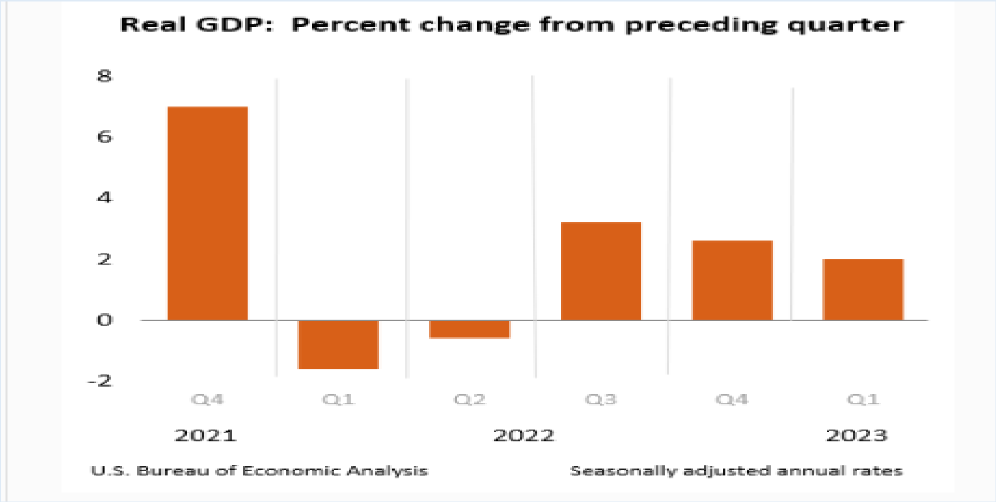


CHART 6: US GDP - Detail Since 2021

We will get GDP data next Thursday, July 27th at 8:30 am. Expectations call for Q2 GDP to print at **+1.7%**. GDP has been declining over the past three quarters (See Chart 6), so this is an important number. This will be the first new significant economic data the FOMC (and the market) will see after the meeting and it may set the tone for the remainder of the summer. The FOMC does not meet in August, so the market will be watching the economic data released during the month all the more closely. *Stay tuned!*



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