Market Update

Seth D. Rosenthal, CFA
John Gilmore

April 2023

The recent failures of Silicon Valley Bank, Signature Bank, and Credit Suisse have caused a shock to the banking system. Although fears have subsided and risk assets have somewhat recovered, we are closely monitoring the market and economy for more cracks in the foundation. As a result, we have seen a flow of bank deposits to "safe havens" such as GSIBs, initially due to bank stability. Recently depositors have become aware of the low yields they are receiving on their deposits and moved to higher yielding alternatives.

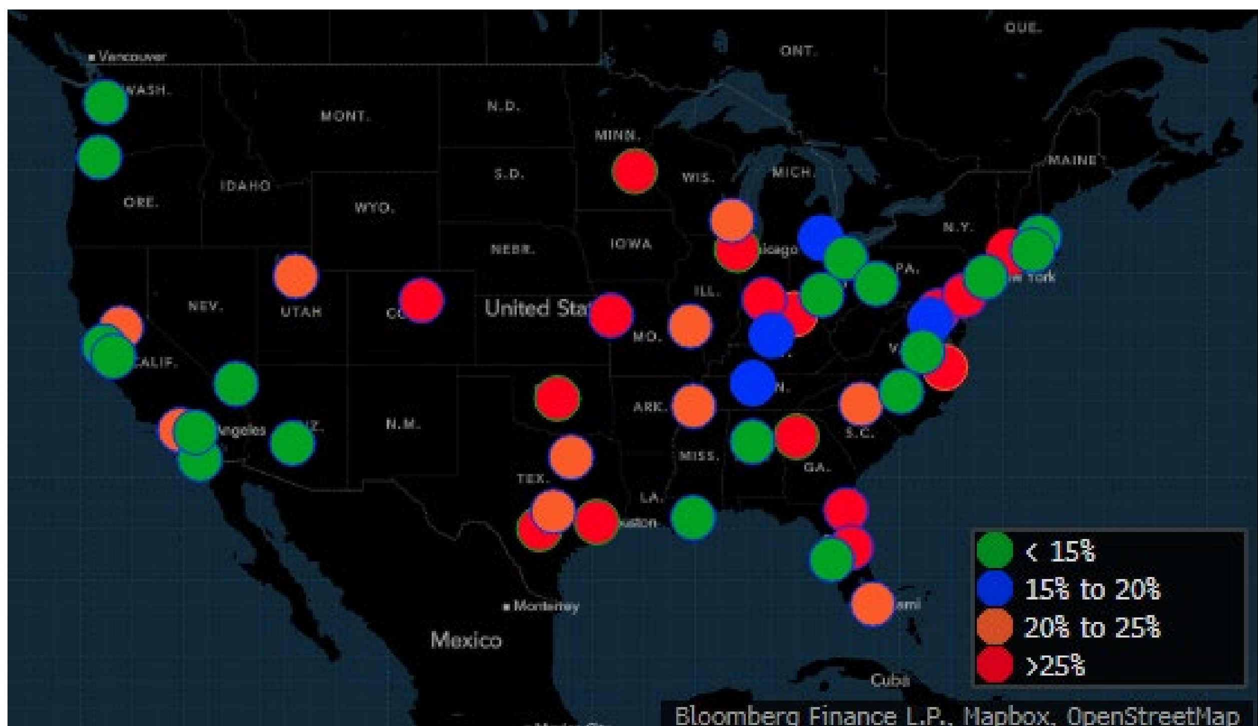
In 2015, JP Morgan announced that it would be pushing out $100 billion of deposits due to unfavorable regulatory treatment on certain deposits. Although it is not imminent, we anticipate a similar event once the post-SIVB and Signature regulatory reforms are implemented. Current bank regulatory deposit runoff assumptions for "operational" deposits are 25%. However, SIVB reportedly lost 25% of its deposits on a single day in March.

One area where we see potential cracks is in the commercial real estate market. Although this market has so far withstood the impact of the Amazonification of commercial retail properties and the hybrid work environment's impact on the office sector, higher rates, and pending refinancings may catch up to this sector. We are already seeing strategic defaults by PIMCO and Brookfield Asset Management, as well as Blackstone's limiting redemptions on its REIT. This is only the early stages of a potential trend.

Last month, we raised concerns about bank lending standards tightening. The outflow of deposits and overall credit concerns are likely to lead to further tightening, which is a bad sign for economic growth. The latest estimate of the Atlanta Fed GDPNow for Q1'23 is 1.7%. We remain concerned about negative leading indicators and the likely reduction in corporate earnings.

Finally, we still have uncertainty around the debt ceiling, likely in late July, which is barely on the market's radar. We remained concerned the polarization of Congress could lead to a technical default.

Top 50 MSAs (% of Securitized Properties Watchlisted-Office Sector)



Seth D. Rosenthal, CFA
John Gilmore

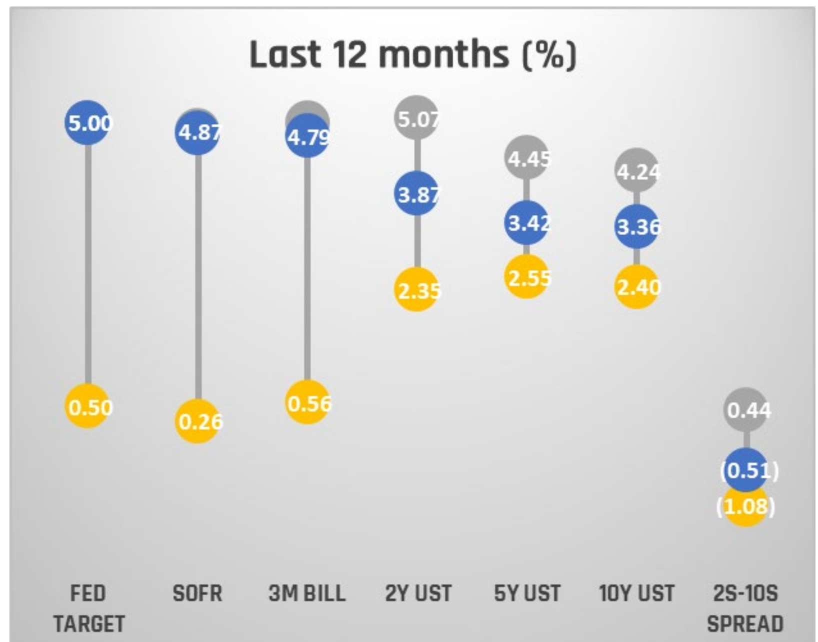
Product Views

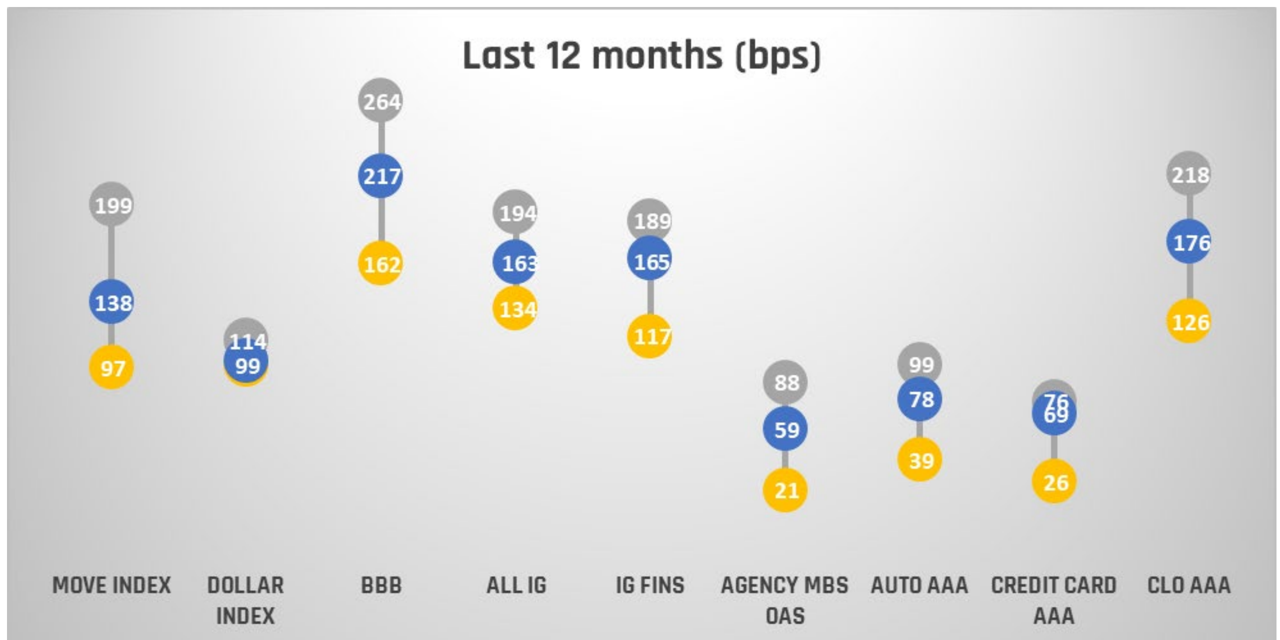
Rates- The market is currently pricing a terminal rate of 5.25% with ~200 bps of cuts over the next two years. Given this construct we prefer the 3-year Treasury around 3.70%, as we anticipate markets will price in more cuts at the outset of policy easing. The recent rally in the 10 year makes longer duration less attractive. However, we don't anticipate rates to run substantially higher as long as markets believe Fed can keep inflation from running away.

Credit- Credit spreads touched the October '22 highs in the wake of the March bank crisis before recovering about half of the widening. Generally, corporations are in good shape, and default risk is reasonably contained. We continue to focus on up in quality credits and sectors that will be less impacted by an economic downturn.

Securitized- ABS spreads still have room to recover post March widening and we remain focused on those asset classes that have withstood multiple downturns, particularly prime consumer, large equipment, and fleet lease.

Municipals- On a spread basis, taxable municipals look attractive across the curve relative to corporates albeit with modest liquidity give up.





12 month high
Current
12 month low

Seth D. Rosenthal, CFA
John Gilmore

The following risks could cause the Strategy's portfolio to lose money or perform more poorly than other investments.

Investments in bonds and other debt securities will change in value based on changes in interest rates. If rates rise, the value of these investments generally drops. Some investors may be subject to the Federal Alternative Minimum Tax and to certain state and local taxes.

Investing in fixed income products is subject to certain risks, including interest rate, credit, inflation, call, prepayment, and reinvestment risk. Any fixed-income security sold or redeemed prior to maturity may be subject to substantial gain or loss.

DISCLAIMER

This material is not an offer or solicitation for the purchase or sale of any financial instrument in any jurisdiction, nor is it a commitment by Academy Asset Management or any of its subsidiaries (collectively "AAM") to enter into any transaction referenced herein. All information provided by AAM herein is indicative, is based on certain assumptions and current market conditions and is subject to change without notice. Accordingly, no reliance should be placed on the information herein. In deciding whether to enter into any transaction or strategy referenced herein, the recipient should rely solely on the final documentation which will contain the definitive terms and conditions relating to any referenced transaction or strategy.

These materials have been provided for illustrative purposes only and should not be relied upon by you in evaluating the merits of investing in any securities or strategies mentioned herein. Past performance is not a guide to the future. Any forecasts, opinions, and statements of financial market trends expressed are AAM's own at the date of this document and may be subject to change without notice. Any research in this document has been obtained and may have been acted upon by AAM for its own purpose. The results of such research are being made available as additional information only and do not constitute investment advice. The value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yield may not be a reliable guide to current and future performance. Changes in exchange rates may have an adverse effect on the value, price or income of the product or underlying overseas investments. AAM makes no representation or warranty regarding the accuracy or completeness of the information herein. AAM is not an advisor to any person who receives information on any referenced transaction.

The recipient must make an independent assessment of legal, credit, tax, regulatory, and accounting issues and determine with its own professional advisors any suitability or appropriateness implications of any transaction referenced herein in the context of its particular circumstances. AAM assumes no responsibility or liability whatsoever to any person in respect of such matters. AAM, or any connected or associated person, may hold long or short positions or derivative interest in or act as a market maker in the financial instruments of any issuer referred to herein or act as the underwriter, distributor, advisor, or lender to any such issuer. AAM may conduct trading activities, including hedging, in connection with any transaction referenced herein which may have an adverse impact on the recipient.

Issued in the United States by Academy Asset Management

Copyright 2023 Academy Asset Management. All rights reserved. January 2023