The ADVISOR

Focus on Community Banking Issues

Fourth Quarter 2023

ECONOMIC ENVIRONMENT

Higher For Longer

Last quarter, we highlighted several dynamics which led us to believe that the Federal Reserve would be required to maintain a higher level of rates to achieve price stability in the economy. Over the last three months, we have only seen further evidence of this. The labor market has regained significant momentum after finally exhibiting signs of weakness over the summer, while the last three months displayed a lack of progress in headline inflation amid still-heightened consumer spending. Though small, this resurgence of inflationary pressures all but confirms the "higher for longer" rate path, and recent commentary from Fed officials implies that further monetary tightening is possible if this trend does not reverse. Many economists now believe the U.S. economy will avoid a recession and achieve a soft landing, but in our view, it is still too early to make this assertion. A number of headwinds that may pressure near-term GDP growth have appeared, including the resumption of student loan payments, a lower level of savings, geopolitical turmoil, tighter credit conditions, a prolonged United Auto Workers strike, and the looming threat of government shutdown. We do not see one specific factor causing a downturn, but these challenges, in combination with the pressures associated with previous rate hikes, lead us to the continued belief that a mild recession may occur in 2024.

How Strong is the Consumer Really?

This summer, a combination of wage growth, low unemployment and remaining pandemic-related savings caused American consumers to spend more and save less than was previously expected, leading Fed officials and Wall Street economists to adopt an optimistic outlook for near-term growth. Entertainment led the charge, with Bloomberg estimating that sellout concert tours by Taylor Swift and Beyonce, alongside the *Barbie* and *Oppenheimer* movie releases, added roughly $8.5 billion to third quarter GDP. Is this pace of spending sustainable? Several indicators suggest otherwise,

EPG RATE FORECAST

September 2023

MARKET RATE	Actual (%) 9/30/2023	Projected (%) 9/30/2024	Yr1 Δ	Projected (%) 9/30/2025	Yr2 Δ
FedFunds	5.50	5.25	-0.25	4.25	-1.00
Prime	8.50	8.25	-0.25	7.25	-1.00
3mthTsy	5.55	5.00	-0.55	4.00	-1.00
6mthTsy	5.53	4.80	-0.73	3.80	-1.00
1yrTsy	5.46	4.70	-0.76	3.70	-1.00
2yrTsy	5.03	4.30	-0.73	3.55	-0.75
3yrTsy	4.80	4.10	-0.70	3.45	-0.65
5yrTsy	4.60	3.85	-0.75	3.35	-0.50
10yrTsy	4.59	3.75	-0.84	3.25	-0.50
30yrTsy	4.70	3.60	-1.10	3.15	-0.45

RATE OUTLOOK DESCRIPTION:

This represents EPG's current view of interest rates.
Depending on the actual timing of the ALM meeting, the forecast may be altered and/or updated.
For the most accurate current rate forecast, please call EPG, Inc. at (781) 235-2666.

Features

Economic Environment: Economic resilience indicates Fed likely higher for longer.

Fixed Income Strategy: Yields at the longer end of the curve at 10 year highs.

Equity Strategy: Is a conservative equity strategy being confirmed with today's environment?

ALM Strategy: A renewed focus on IRR impacts balance sheet strategy.

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ECONOMIC ENVIRONMENT

beginning with a savings rate that decreased to 3.5%, the lowest since November. Speaking of savings, the graph below shows that cash reserves accumulated during the pandemic have now been depleted for most American households. Only the top 20% of earnings households still have excess pandemic savings. If this consumption driver is out of the picture, it is difficult to see a continuation of the current pace of consumer spending without a further decrease in the savings rate or increase in credit utilization.

Inflation: Too Early to Declare Victory

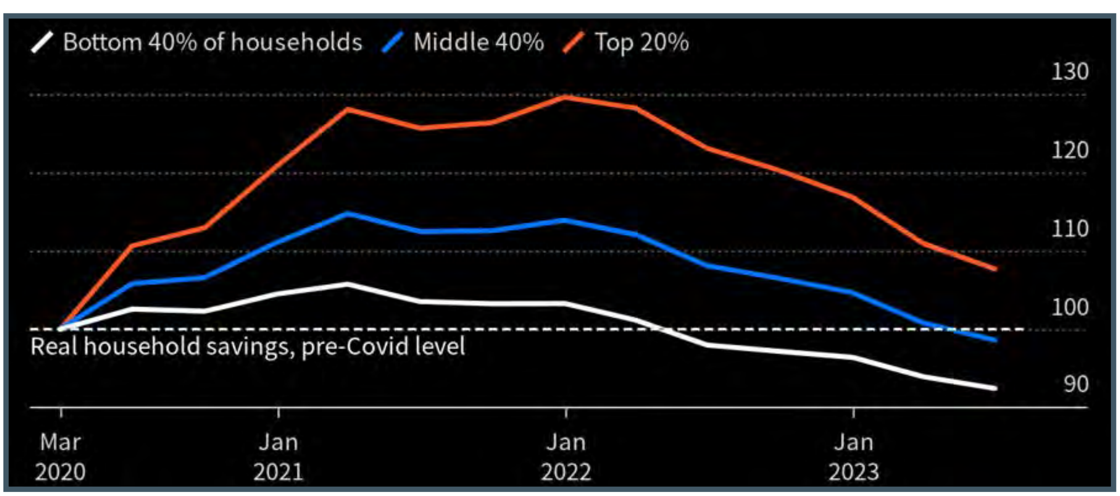
After the economy experienced significant disinflationary progress in the spring and early summer, we have now seen three consecutive months with a higher or constant annualized CPI. Volatility in energy prices has captured headlines, a category that contributed about 11 basis points to the headline figure last month. Gasoline prices have declined in early October, which has created the expectation that the annualized CPI will drop this month. However, this dynamic may be short-lived if the Israel-Hamas conflict broadens. Additionally, an uptick in core services inflation such as shelter, medical services, and recreational services has flown under the radar and could prove stickier than the elevated oil and energy prices. Fiscal stimulus has likely been a hidden driver of the recent CPI uptick as well; the Infrastructure Investment and Jobs Act, Chips and Science Act, and Inflation Reduction Act authorized nearly $1.8 trillion in total new government spending. Increases in government spending have accounted for about 20% of the rise in GDP since mid-2022 per the Wall Street Journal, stimulating economic growth but putting upward pressure on inflation.

These trends raise an important question: How will the Fed operate if annualized inflation settles in the 3% - 3.5% range? This would be well below last year's historic levels that triggered the tightening campaign, but still above the Fed's stated 2% target. Chair Powell reaffirmed the FOMC's commitment to 2% at his Jackson Hole speech, and we think altering the target is unlikely. Therefore, maintaining a "sufficiently restrictive" level of rates is appropriate, with the potential for additional tightening if another inflationary spike occurs.

EPG Rate Forecast: Listen to the Data

Since the first "pause" of the tightening cycle in June, the Federal Reserve has doubled down on its data-dependent posture on a meeting-to-meeting basis, essentially abandoning traditional forward guidance in favor of a wait-and-see approach. With the trajectory of inflation in focus, the FOMC opted for a 25 basis

Inflation-Adjusted Liquid Assets by Income Group



Source: Bloomberg

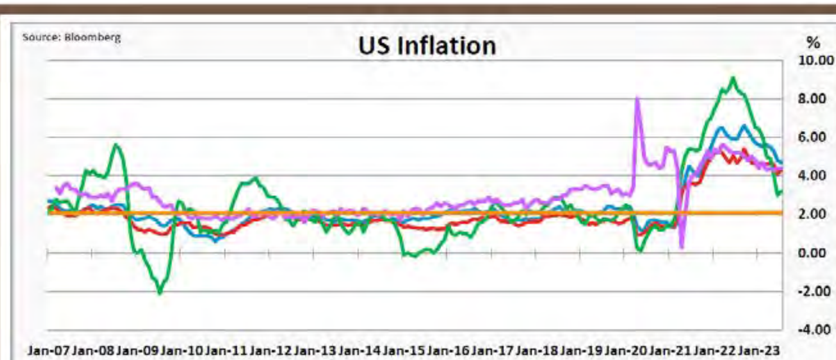
ECONOMIC ENVIRONMENT

point hike in July and another pause (or skip, depending on your view) in September. While higher energy and rent costs have stalled the downward trend in Headline inflation, we expect the FOMC to hold the Fed Funds rate at the current 5.25% - 5.50% target range through the end of the year. Currently, Fed Funds futures contracts are pricing in a 7.8% probability of a 25 basis point hike in November, which has interestingly fallen throughout the month after the strong payroll report and stagnant CPI and PPI data. It seems investors have shifted focus to the December meeting, where the probability of a hike has increased to 29.1%, up from 17.1% prior to the recent Nonfarm Payrolls release. Fed officials appear to be split on whether more tightening is needed at this point, with different members recently vocalizing opinions on each side of the debate. Bloomberg News notes that policy often remains constant during times where officials hold conflicting views, and we would expect upcoming data releases to provide further clarity to the Fed's path going forward. We do expect the higher-for-longer rate environment to persist, as the previous tightening is still working its way into the economy amid elevated spending, stagnant inflation, and a strong labor market. That said, we believe further tightening could be on the table if inflation continues to move higher.

Last quarter, we pointed to inflation as the wild card that could cause yield curve steepening in the short term, and this has since played out to a degree. In the eyes of many economists, the lack of progress towards 2% inflation has delayed the point when cuts are expected to occur but has not increased the probability of additional rate hikes. This has caused less demand for longer dated Treasuries, because investors believe higher yields on the short end of the curve will be available for a longer period, putting upward pressure on the demand-driven long end. Since becoming inverted by 108 basis points on July 3, the spread relationship between 2 and 10 year Treasuries has narrowed to about 40 basis points in mid-October. In our view, the effects of lessened savings and tighter lending standards will take time to fully materialize in consumer spending and therefore inflation, leading the Fed to begin cutting rates in mid to late 2024.

What About Student Loans?

In October, over 43 million Americans saw their federal student loan payments resume, with the average borrower owing just over $37,000 in total. Putting this into context, most studies estimate that the payment resumption creates an additional monthly expense between $200 - $400 per borrower. How will this impact the broader economy? At surface level, Bloomberg Economics estimates the payment resumption could cause a 0.2% - 0.3% reduction in fourth quarter annualized GDP growth, but this only reflects a corresponding decrease in spending without considering potential flow-through effects, namely those related to credit. It is no secret that the inflationary environment forced many to rely on revolving credit to bridge the



	Latest	Maximum		Minimum		Average	2023 Avg.
Core CPI (Sep'23)	4.10	6.60	Sep-22	0.60	Oct-10	2.39	5.04
Core PCE (Aug'23)	3.88	5.42	Sep-22	0.93	Dec-10	2.04	4.36
Headline (Sep'23)	3.70	9.10	Jun-22	-2.10	Jul-09	2.47	4.43
Wage Growth (Sep'23)	4.20	8.00	Apr-20	0.30	Apr-21	2.99	4.38

Sep'23 Core CPI down to 4.1 from 4.3, headline inflation stays at 3.7, wages down to 4.2 from 4.3.

gap between income streams and rapidly rising prices of essential goods, as evidenced by U.S. credit card debt surpassing $1 trillion earlier this year. Credit card delinquency rates have already increased, which comes as little surprise given an average household credit balance of $10,170 and St. Louis Fed data showing credit card interest rates above 20%. Notably, the increase in delinquencies is more concentrated among younger Americans, who are most likely to carry student loan debt. Considering this occurred *before* the student loan payment pause ended, we anticipate a potential uptick in both credit card and auto loan delinquencies in the fourth quarter and beyond.

Labor Market: Up, Down, or Sideways?

Prior to September, the labor market was beginning to show signs of weakness, albeit slowly. Monthly job gains were declining, the unemployment rate & labor force participation rate were gradually moving higher, and many felt that monetary tightening was finally taking effect. In a stunning reversal, the September jobs report showed the economy added 336,000 positions for the month, nearly double the 170,000 consensus estimate. Furthermore, the July and August Nonfarm Payroll figures were revised upward by a total of 119,000, showing that the summer's dip in job creation may not have been completely accurate. Clearly, labor demand is robust with 1.5 jobs still available for every unemployed worker. Services-oriented sectors such as healthcare and leisure & hospitality have seen the most hiring activity, and layoffs have fallen across the board after several high-profile Tech companies reduced headcounts earlier this year.

This latest employment report confirms that the effects of monetary tightening have not been fully integrated into the labor market and therefore reinforces a higher for longer rate view. There are some signals of cooling such as an upward trending labor force participation rate, downward trending quits rate, and moderating wage growth. The combination of these indicators shows that employees are becoming slightly more nervous about the employment picture, but we are likely still far away from a material labor market slowdown. Based on the recent economic data being continually stronger than market expectations, we would expect the Fed to remain data dependent on whether additional monetary policy will be implemented. ◆

FIXED INCOME STRATEGY

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Have We Seen the High in Interest Rates?

The third quarter began after the Fed paused in June, allowing the investment community to breathe a sigh of relief that the tightening campaign may be nearing the end of this cycle. Liquidity in the banking community remains extremely tight, with portfolio run-off impacted by slow prepayment speeds with interest rates at their highest levels in nearly 20 years. The deposit environment remains competitive, applying continued pressure on liquidity and borrowing levels.

As expected, in September the Federal Reserve held rates steady for a 2nd time since the tightening cycle began in March of 2022. However, Federal Reserve Chair Powell stressed during the Jackson Hole symposium and during his September press conference that Fed officials are not done with their fight to contain inflation. This continues to set a hawkish tone as we enter the 4th quarter. Powell continues to signal that interest rates will stay high, and the Fed Funds rate could rise even higher if the economy and inflation fail to cool. Two percent remains the policy target level, with price stability needed for the economy to function properly.

That said, geopolitical concerns and supply shocks such as climbing oil prices currently present the central bank with a dilemma as they attempt to contain inflation. Elevated fuel and energy prices were factors in tipping the U.S. into recession in the 1970's and 1980's. The risk of headline inflation heating up over the next few months has risen, and that could complicate the Fed's decisions at upcoming policy meetings. Crude oil is over $85 a barrel and up over 20% since the start of the third quarter. The Consumer Price Index has risen in recent months after reaching a low of 3.0% in June, and if this trend were to continue later in the 4th quarter, it would likely put additional pressure on policymakers to raise rates. To this point, however, the economy has mostly shrugged off the 525 basis points of rate increases implemented thus far. It is unknown if policymakers are convinced whether enough has been done to further cool the economy and pricing pressures, despite a resilient labor market which has shown minimal signs of weakness, with a low unemployment rate of 3.7% and higher than expected consumer spending.

If core inflation struggles to drop further, the higher for longer regime will ultimately last longer than the market has priced in. Federal Reserve Bank of Boston President Susan Collins recently commented that policymakers will need to be patient as they assess incoming economic data to evaluate if further tightening will be needed. Interpretation of policy at this point in the cycle requires additional time and patience, as we continue to see the results of prior policy action flow through the system. This continues to suggest

Source: Bloomberg

Yield Curve Changes

Term	12/31/2022	9/30/2023	Change
2 Year	4.43	5.04	0.61
3 Year	4.22	4.80	0.58
5 Year	4.00	4.61	0.61
7 Year	3.97	4.61	0.65
10 Year	3.88	4.57	0.70
20 Year	4.14	4.89	0.75
30 Year	3.96	4.70	0.74

that although we may be close to the peak for the terminal Fed Funds rate, it still implies that further tightening may be warranted. We should expect policymakers to continue to be data dependent on decisions at upcoming policy meetings, which makes forward guidance challenging. However, we still believe the current level of rates has made investment opportunities look attractive.

Investment Environment and Opportunities

Interest rates on the long end of the yield curve are at their highest level in more than 10 years, and spreads across Agency products continue to offer value in comparison to U.S. Treasuries. We are likely near the peak in rates, which creates an opportunity to increase current book yields. Looking forward, even if in the short term the Fed raises rates one more time before the end of the year, current investment yields are highly accretive to current book yields, with most economists projecting interest rates to drop over the next year. With this belief as a backdrop, adding AAA assets that yield north of 6.0% will be extremely beneficial to existing lower yielding holdings over time. In addition, fixed income investment values typically move inversely with interest rates, so a decline in rates could positively impact bond valuations. Although investments may need to be funded with additional borrowings, we believe the long-term value of the accretive yield, combined with the impact of lower yields on valuations, will benefit existing balance sheets.

The graph below illustrates the spread relationship between 30 Year Agency Mortgage-Backed Securities and 10 Year Treasuries over the last 10 years. Not only are interest rates at the higher end of their range over this period, but the spread relationship of MBS to Treasuries also offers a yield advantage that is near its peak in comparison to the last 10 years. While Agency spreads have widened, credit spreads remain below long-term historical averages. As such, municipal bond spreads have widened minimally due to demand for longer term call protection in an inverted yield curve environment. Why have mortgage and other Agency products widened in spread this year? For the better part of the last 10 years, the Federal Reserve was an active participant in purchasing Treasuries and Mortgages, creating excess demand that pushed both interest rates and spread levels lower. Now, the Fed is letting existing holdings roll off to decrease the size of their balance sheet, which puts pressure on institutional investors to make up for the Fed's absence from the market. The other contributing factor to wider MBS spreads has been bank liquidations from earlier this year. Broker dealer balance sheets absorbed the majority of the liquidations, as appetite for risk and duration from the investment community has been light.

We believe the absolute level of yields has created an opportunity for 30 and 20 year Agency MBS, with the current level of interest rates and spreads near the wider side of historic relationships. This also applies to Agency Hybrid ARM's and Callable Agencies. The recent lack of demand for Agency securities across the yield curve has created opportunities in highly rated assets. ◆

Historical Spread Relationship of 30 Yr. Agency MBS – 10 Yr. Tsy.

Source: Bloomberg

EQUITY STRATEGY

EQUITY STRATEGY

Is a Conservative Equity Strategy Being Confirmed with Today's Environment?

With Chairman Powell stating that the strength of the economy and labor markets may create less availability for credit (i.e. higher rates leading to higher funding costs for banks leading to less credit availability), the Fed is beginning to acknowledge that there are other factors besides short term rate hikes that may cool the economy and impact inflation. From this, investors have surmised that continued rate hikes are likely to be delayed in November, and while an additional hike may occur at the end of year, the peak of rates is effectively here. If so, why have equity markets been so volatile recently? The S&P 500, for example, is down 8% since July. For equity investors, Fed action leading to rising rates and an inverted yield curve has been the primary dynamic affecting both equity market performance and sector selection. For more than a year, shifting investor outlook on likely Fed action, related rate direction and levels, and actual rate movement is what has led to positive equity performance earlier in 2023 in select sectors and names, and equity pullback in the last several months.

Treasury Yields Now Compete for Equity Dollars

Now, with Treasury rates, including the 10 year, being near, at, or above 5.00%, the competitive pressure of fixed income yields is feared as a negative influence on equity market performance. The concern that the "longer end of the curve" will continue to rise and thus create even more competitive pressure for investor dollars has also been amplified with the fear that the Fed will not interfere with bond pricing and will "let it play out." Dollars can now be allocated to the "safe harbor" of Treasuries and fixed income alternatives creating yield that competes with equity market returns, at both income and possible total return levels, if the equity markets are flat to down over the coming months. Aside from several Tech names, equity markets have been effectively flat over the last several years. Stock dividend yields are "orbiting" around 2-2.5%. Investors can achieve the same potential total return that uncertain equity markets may provide going forward, simply by investing in shorter or laddered Treasuries and select bank CD products.

Additional Dynamics that are Creating Uncertainty with Equity Markets

One dynamic which has influenced institutional investment in equities has been the unprecedented price volatility in bonds. As the Fed continued to raise rates, even as expectations for a recession to occur in late 2023 grew, pricing on bonds collapsed. This created a liquidity squeeze. Bond sales, as a strategy to fund equity purchases or reinvest into then current coupon fixed income holdings, have not occurred for most institutions. This is because reinvestment of proceeds on bonds sold at a loss has not met reinvestment performance goals due to lengthy breakeven calculations on bonds and the overall equity market outlook. Additionally, expectations for higher rates has justified an overall "wait and see" approach.

Macro-oriented investor focus is also seen as fueling current equity market volatility. With earnings season here, it is important to note that unlike the last several quarters, macro versus company-specific news is the focus of investors. Not only has the prospect of rates being elevated for longer had a negative influence on stocks, but also geopolitical events which are creating an uncertain outlook for energy, supply chains, and overall global economic activity. Fears of an expanding war in the Middle East

EQUITY STRATEGY

when combined with the ongoing Russia-Ukraine war, create elevated levels of concern for global stability. Equity markets are forward-looking, and these factors are starting to influence overall equity investing activity.

The consumer has continued to be extremely resilient to the pressures which rising rates were expected to exact upon spending behavior. Whether due to pandemic savings being spent or an extremely strong labor market and resulting wage growth, inflation has stayed strong, rates high, and expectations for continued elevated rates, extended. Now, with rates dramatically higher on consumer debt, personal savings dwindling for most Americans, and wage increases slowing, historically high consumer debt levels are starting to show "cracks" with credit losses beginning to occur. According to a recent article from Bloomberg, Clarie Ballentine writes, "the percentage of subprime borrowers at least 60 days past due on their loans was 6.11% in September," the highest going back to 1994 according to Fitch ratings.

With rates effectively 500 basis points higher than the pandemic lows, commercial real estate loans scheduled for rate resets in 2024 are being carefully watched. For example, concerns about loans on large office buildings that continue to have limited occupancy are growing. Resets of associated loan rates to levels not supported by borrower financials may have a material impact on regional and large bank loan portfolios, with increasing credit issues associated with those borrowers unable to meet new payment terms due to higher loan rates. The pullback in lending is also being fueled by this dynamic, in addition to the higher funding costs banks are experiencing- another pressure on economic activity.

Implications for Equity Investing

As highlighted, equity market performance has been overall, one of a "sidewards" pattern for the last several years, aside from a small number of Technology names. Now, with the additional competitive pressures for investor dollars that higher rates have created, and the various factors that may impact economic activity in the coming months, value focused investing in top quality, recession resistant names is being reinforced as a potential best strategy to manage risk-return, based on investor profiles and goals.

With the assumption of gradual to possibly accelerated economic slowdown, and growing competition for what may be reduced available investor dollars, companies that will benefit from selective consumer spending remain a preferred base for equity portfolio construction and management.
A sense of investor confidence derived from equities with reliable and visible earnings growth, and dominant market positioning cannot be underestimated. While the achievement of performance goals with such a portfolio may take longer than the potential returns of a more "aggressively" constructed portfolio, such returns can

Equity Index Performance: 1 Year

come with relatively less volatility and price risk.

“Vet” Current Positions Against a Backdrop of a Slowing Economy and Elevated Rates:

While current sentiment reflects a growing confidence in a “perfect landing” of a slowing of economic growth without a recession, and therefore a peak and gradual decline in rates, as outlined, there are many factors that could create a weaker than expected economy as well as continued market volatility. With most agreeing that interest rates are at or near peak, inflation abating, and key measures of economic strength slowing, this is an appropriate timeframe to review current holdings for possible repositioning, leaving overall equity exposure at current levels.

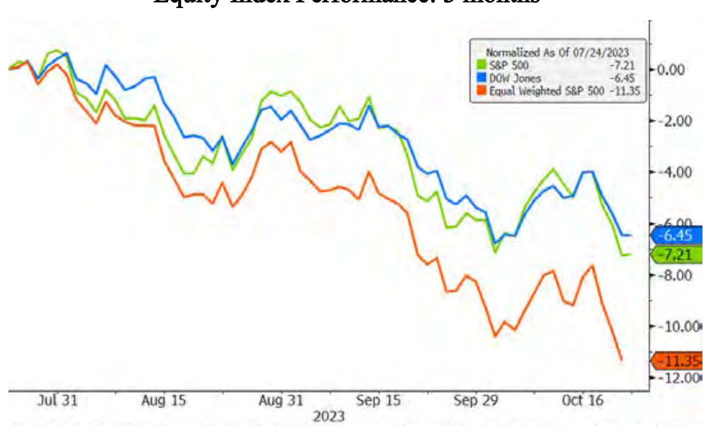
EQUITY STRATEGY

Stock valuations, investor sentiment, corporate profitability, and current equity valuations have and will continue to be the criteria for individual equity investment selection, whether to buy, hold, or sell.

Third quarter earnings reports, resulting updates to the economic outlook, and equity analyst forecasts incorporating the above, are platforms upon which equity positions should be reviewed. Consolidating current holdings by moving from any positions that are not expected to respond positively to the outlined changing dynamics can be undertaken, with proceeds repositioned into existing holdings that are anticipated to lead their industries and be best positioned for the economy going forward. This provides the benefit of concentrating allocation to holdings that best meet the likely economic and market environment with the goal of providing a lift to performance. ◆

Equity Index Performance: Year to Date

Equity Index Performance: 3 months



ALM STRATEGY

Interest Rate Risk Becomes A Key Operating Focus As We Enter Q4

With measured IRR levels continuing to rise, it appears that community financial institutions are now evaluating their risk position with a much more critical eye. Until recently, through most of the current Fed tightening cycle, many institutions had taken a less-than-aggressive approach to steadily rising risk levels, but that seems to have changed recently. For most, this is specifically a valuation (EVE / NEV / NPV, etc.) issue, as the measured risk in Net Interest Income simulations has not increased to nearly the same degree, and the shorter-term nature of the NII sensitivity measurement more easily allows for active management. In addition, the vast majority of institutions prefer to manage to NII as opposed to valuation, so historically the valuation results received far less scrutiny by both management and directors.

What Has Changed?

The key driver appears to be the 'higher-for-longer' stance taken by the Fed, and although the Fed has clearly stated this mantra throughout the current tightening cycle, people seem to be taking this more seriously lately. Early in the cycle there was much more uncertainty about the terminal rate for Fed Funds, and rather than implement immediate changes to balance sheet strategy, most opted for a wait and see approach. However, as time advanced and the reality of the new rate dynamic set in, it became clear that rates would not fall back to previous levels, and higher-for-longer was real. As a result, what was once thought to be potentially temporary levels of high modeled risk has turned into a longer-term proposition.

A second driving force behind the change in attitude toward a more conservative risk management approach is a renewed regulatory focus. Similar to the initial response to higher-for-longer, in which financial managers took a measured and patient approach, regulators seemed to have followed the same pattern. Understandably, scrutiny of higher levels of measured risk has intensified. This is leading to intensified active management and oversight in the most recent two quarters. What might underly the current regulatory approach? This could include a responsive shift adding to the focus on liquidity, (which poses an immediate and potentially lethal risk to financial institutions) in the post Silicon Valley Bank world to a risk that can also result in institutional failure, but one that generally takes quite a bit more time to set in. Taking this a step further, the rigorous regulatory approach to elevated levels of IRR could be driven by regulatory concern that additional institutions could fail in the future, and with rates at current levels or higher, the impact that failures could have on the economy and sentiment.

How are Institutions Approaching Extreme Risk Levels?

As part of a more active Interest Rate Risk management approach (specifically regarding valuation, as opposed to net interest income sensitivity), institutions are utilizing a variety of strategies that have proven successful during various economic and interest cycles, including some of the following:

- Impact the duration of lending through pricing and marketing outreach
- Sell/retain loan production vs. holding on balance sheet
- Funding extension through CD specials or wholesale
- Asset / Investment sales
- Hedging

From a financial management perspective, each of the above is a viable option in the current environment, except for asset sales. Institutions are finding it challenging to sell loans or investments to generate liquidity, as anything that has been held for some time is likely significantly underwater. However, with the ongoing focus on interest rate risk, we are seeing some institutions consider the sale of underwater investments, even

though it would create realized losses.

How are Institutions Implementing Risk Management Strategies?

With a growing number of institutions now experiencing heightened, and in some cases extreme interest rate risk exposure, strategies to address this must be actionable and as important, measurable. Addressing the duration of assets in order to positively impact measures of risk needs to incorporate an understanding of the tradeoffs associated with the strategy. Shortening the duration of the loan portfolio will improve the EVE sensitivity, but also has implications for the spread as these loans would likely be lower yielding. Regarding the sale of assets, understanding the context of possible future rate environments is important to determine the longer-term benefit of retaining what could be high coupon assets if rates in the market do decline, versus the shorter-term benefit of addressing current interest rate risk exposure.

The balancing of different and intersecting goals for balance sheet management is particularly important in this unprecedented and challenging environment. Liquidity, interest rate risk, and capital management are always important drivers of strategy. With current rates where they are, and the view that they stay "higher for longer," implementing risk management strategies must be done in a way where the impact can be understood and measured.

Best Practices for Risk Management

Keeping with the risk management theme, with the Fed at or near the end of its tightening cycle, it is a good time to review the scenarios being run in the Asset Liability Management process. With the risk that rates could move in either direction, it may be timely to consider migrating back to the traditional Up 300 / Down 300 scenarios for static modeling purposes. The Up 400 shock was added when rates were near all-time low levels, but with the likelihood of that event being remote at best, the Down 300 may be a more important risk measurement tool at the current time.

For business planning purposes, EPG has started to move away from some of the higher magnitude Up Shock scenarios in favor of more likely Down Ramp scenarios. While this is being addressed currently with the Forecast scenario, which assumes a modest down cycle starting in Q3 of 2024, including a more significant Down rate scenario could provide valuable business planning information.

A Quick Update on the Current Operating Environment

Credit standards continue to tighten while loan rates remain on an upward trend. Loans with a rate of less than 7% are becoming less common, and with overnight FHLB borrowing near 5.50%, institutions should hold their ground with loan rates, as tighter credit conditions should translate into increased pricing power. Prevailing opinion seems to be that losing out on a deal today is largely viewed as an opportunity to either hold additional cash and build liquidity, or pay down borrowings. The overall climate is one of heightened caution, in which the bar has been raised significantly with respect to what assets are attractive enough to add to the balance sheet. Unfortunately, it also appears that it will remain this way for an extended period of time. ◆

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