



The ADVISOR

Focus on Community Banking Issues

Second Quarter 2025

ECONOMIC ENVIRONMENT

Murky Waters Ahead

‘Uncertainty’ just might be the most popular word in the English language right now. With the second quarter underway, implementation of the most aggressive tariff policy in decades has completely overshadowed a slew of encouraging economic data in the fourth quarter, flipping the domestic growth outlook on its head. Most forecasters, including the Federal Reserve itself, have reduced GDP and employment projections for the year, creating talks of the dreaded “R-word” among investors. So how would a tariff-induced recession affect the Fed’s plans? This depends on whether inflation continues its downward trend or spikes due to higher manufacturing input

costs. Either way, the next six months should be interesting, to say the least.

Inflation: Cold Now & Hot Later?

Journalists and economists have recently cited the threat of stagflation, an environment of elevated inflation and slow economic growth. How would this be possible? Historically, inflation typically falls in an economic slowdown because reduced demand tends to limit prices businesses can charge for goods and services. However, tariffs are a factor that can create upward price pressure unrelated to consumer demand, driving these concerns. Fed Chair Powell mentioned this risk in a speech at the Economic Club of Chicago, stating that tariffs are creating a challenging scenario that is likely to result in at least

temporarily higher inflation and slower growth.

Despite these fears, data is showing an improving inflationary picture to begin the year. March’s CPI report showed an unexpected 0.1% decline- the first monthly drop since May 2020- bringing the year-over-year increase to 2.4%, below expectations and marking the smallest annual gain in six months. We may not see a distinct increase in inflation until the summer, when retailers are expected to run out of inventories of tariff-free goods at presumably lower price points. Once these inventories have been sold, retailers will be forced to restock at

Features

Economic Environment: Tariff driven uncertainty clouds the outlook.

Fixed Income Strategy: How aggressive does the Fed need to be?

Equity Strategy: When will visibility return?

ALM Strategy: Operating environment is resilient so far.

EPG RATE OUTLOOK

April 2025

MARKET RATE	Actual (%) 3/31/2025	Projected (%) 3/31/2026	Yr1 Δ	Projected (%) 3/31/2027	Yr2 Δ
FedFunds	4.50	4.00	-0.50	3.75	-0.25
Prime	7.50	7.00	-0.50	6.75	-0.25
3mthTsy	4.29	3.90	-0.39	3.80	-0.10
6mthTsy	4.22	3.75	-0.47	3.85	0.10
1yrTsy	4.02	3.75	-0.27	3.90	0.15
2yrTsy	3.88	3.80	-0.08	3.95	0.15
3yrTsy	3.87	3.80	-0.07	4.00	0.20
5yrTsy	3.95	3.85	-0.10	4.05	0.20
10yrTsy	4.21	3.90	-0.31	4.15	0.25
30yrTsy	4.57	4.00	-0.57	4.20	0.20

RATE OUTLOOK DESCRIPTION:

This represents EPG's current view of interest rates. Depending on the actual timing of the ALM meeting, the outlook may be altered and/or updated. For the most accurate current rate outlook, please call EPG, Inc. at (781) 255-2666.





ECONOMIC ENVIRONMENT

higher prices, and if the labor market has softened by that point, companies may lack the pricing power to pass along costs without impacting demand.

EPG Rate Outlook

Entering the year, the Fed funds futures market was forecasting less than two 25 basis point rate cuts in 2025, a view that quickly changed once growth projections began to slow. Last quarter, we spoke about the Fed's difficult position of potentially having to choose between cutting rates to stimulate consumer activity and reduce unemployment, or maintaining current levels if inflation increases. Since then, this choice has only become more complicated. Chair Powell recently cited this challenge, also noting that "For the time being, we are well positioned to wait for greater clarity before considering any adjustments to our policy stance." We agree, which is why we continue to project two 25 basis point cuts this year, with a third midway through 2026. The Fed is still focused on managing inflation expectations, which in our opinion provides them leeway to be conservative with rate cuts this year. However, if the economic slowdown is broader than anticipated, the outlook may shift once again.

What about the yield curve? Long term interest rates have been highly volatile in recent weeks, as the initial drop in the 10-year Treasury yield has been counteracted by hefty selling action by China and Japan, which pushed yields higher. This "bear steepening" could certainly persist if foreign selling action continues and Treasury auctions show weakness, but may be balanced out by hawkish messaging from Fed officials. We do see the yield curve steepening somewhat throughout the remainder of the year, but primarily through rate cuts on the short end rather than the long end moving significantly higher.

How Meaningful are Public Sector Job Cuts?

In conjunction with the inflation picture, the labor market is experiencing a disconnect between actualized results and forward-looking expectations. At surface level, employment has rebounded from

the slump seen in mid-2024, with remarkably steady payroll additions and an unemployment rate that has stabilized around 4.2%. To highlight this consistency, the economy has averaged 174K in average monthly payroll gains since December's blowout report, with the prior three months showing a 170K average. Looking ahead, however, we do expect a degree of labor market contraction due to the ongoing federal workforce reductions; according to the Bureau of Labor Statistics, the public sector represented 22% of total nonfarm payroll additions in 2024, a sizeable proportion that will likely shrink meaningfully.

Putting this into context, the Trump administration's initiatives to downsize the federal government resulted in over 275,000 announced job cuts in March alone, in comparison with

Job Openings Per Unemployed Worker are Shrinking



Source: Bloomberg

ECONOMIC ENVIRONMENT

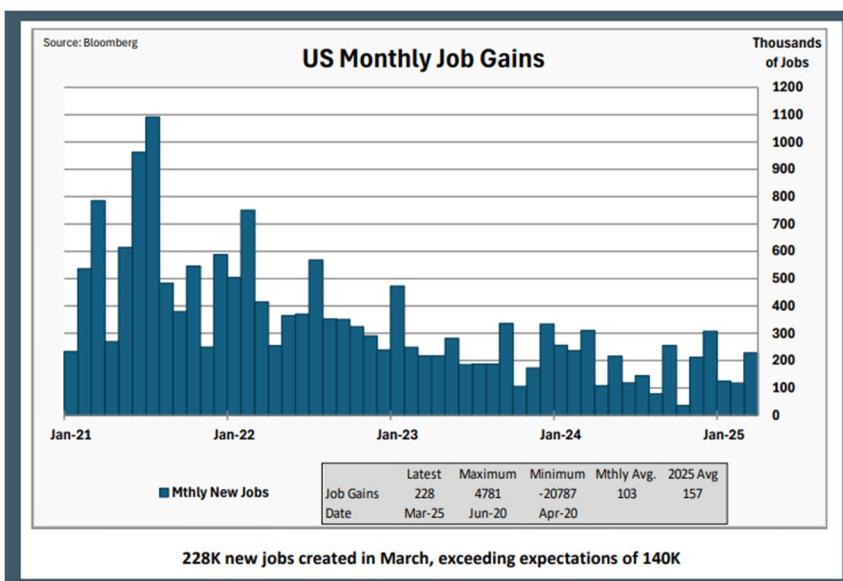


the ~490,000 government jobs added in the entirety of 2024. Many of these cuts have not yet been reflected in the unemployment rate due to ongoing legal disputes, resulting in thousands of federal employees remaining on paid leave. Therefore, we may see cooling labor market data over the coming months, especially if federal job cuts continue at their current aggressive pace.

Payscale’s salary budget survey is currently forecasting 3.5% wage growth this year, modestly lower than the 4% actual rate observed in 2024. This trend indicates a shift to more conservative compensation strategies as companies balance the need to attract and retain talent with economic uncertainties and budget constraints. ◆

What about wages? Over the last year, we have pointed to the positive spread between income growth and inflation as a driver of consumer spending, a relationship that has held steady thus far in 2025.

Looking forward, however, federal workforce reductions will likely result in some wage growth deceleration. Intuitively, this makes sense because more individuals will be competing for a shrinking number of job openings, shifting the upper hand back towards employers.





FIXED INCOME STRATEGY

FIXED INCOME STRATEGY

Tariffs Come With Economic Uncertainty to Start the Year

It would be an understatement to say that the 2025 capital markets landscape has been unpredictable. The S&P 500 reached an all-time high in mid-February, only to quickly reverse course and go in the red, with major indices then entering correction territory earlier this month. This reversal was the result of a flight to quality trade in Treasuries, as economic policy drove volatility higher sending stocks plummeting. Prior to tariff implementation it was perceived that policy makers were going to be patient with monetary policy and that the next rate cut may not come until later in the year. However, the global trade war has increased the probability of stagflation and a recession, causing investors to sell Treasuries in early April on expectations

that the tariffs could prevent inflation from reaching the long-term target level. The above-target inflation and surprisingly better than anticipated employment data already has the Federal Reserve questioning how aggressive they need to be in coming months with regards to lowering the funds rate.

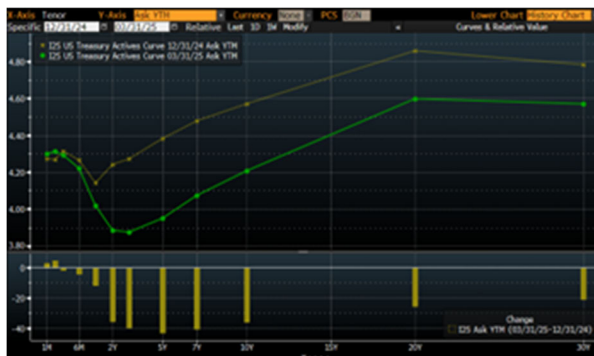
The trade war has increased volatility across markets and the Investment Committee would expect it to continue until there is more clarity on tariffs across the globe. The sharp rally in the stock market on Wednesday, April 9th resulted from the 90 day pause on select tariffs, which immediately created a reversal in trade negotiations that had wiped out trillions of wealth in global markets. The S&P 500 posted a 10% gain that afternoon, and the index had its best weekly gain since 2023. Consumer sentiment has dropped to start the year, and it is widely anticipated that consumer spending will slow in conjunction with a reduction in government worker head count. We would expect this would ultimately raise the unemployment rate, giving policy

makers greater justification to cut rates. In the short term, we expect volatility to remain high, and over the longer-term we expect the U.S. economy will weaken as a result of the tariffs. Even with inflation running slightly above longer-term expectations, a rising unemployment rate would give policy makers stronger conviction to stimulate the economy with rate cuts to avoid a potential recession scenario.

Balance Sheet and Economic Policy Modifications

At the March FOMC meeting, policy makers did make some minor changes to their economic outlook and balance sheet policy. Although they made no changes to their rate outlook, they did increase their unemployment rate projection from 4.1% to 4.3% at the end of 2025. They also lowered their 2025 growth outlook from 2.1% to 1.7%, and 2026 from 2.0 to 1.8%, implying a more cautious outlook from policy makers. Also beginning in April, the Fed will reduce the monthly redemption limit on Treasury securities to \$5 billion from \$25 billion but maintain their cap on Agency Debt and Mortgage

Yield Curve 12/31/2024 - 3/31/2025



Source: Bloomberg

Yield Curve Changes First Qtr. 2025

Term	12/31/2024	3/31/2025	Change
2 Year	4.24	3.88	-0.36
3 Year	4.27	3.87	-0.40
5 Year	4.38	3.95	-0.43
7 Year	4.48	4.07	-0.41
10 Year	4.57	4.20	-0.37
20 Year	4.86	4.60	-0.26
30 Year	4.78	4.57	-0.21

FIXED INCOME STRATEGY

-Backed Securities at \$35 billion. The likely reason for no change on this portion of their balance sheet is that at current interest rate levels prepayment speeds remain slow, so the portfolio runoff is slower than desired. In addition, the Fed has commented that they would prefer to hold a higher percentage of Treasuries. What the new cap means for Fed holdings is when \$25 billion of the central bank's holdings mature, they will now reinvest \$20 billion starting in April, rather than \$5 billion under the old redemption limit, thus adding \$20 billion of additional monthly demand to the Treasury market. This could have a dovish impact on markets and help contain interest rate volatility with the additional purchases. The move could be interpreted as an attempt to align with Treasury Secretary Scott Bessent's recent comments desiring lower long-term rates. Jerome Powell characterized the move as a commonsense modification, as the Treasury holdings have shrunk by \$1.5 trillion since the program adjustment began. Powell also cited they need to manage liquidity within the repurchase markets, as the Fed is a large supplier of collateral within funding markets.

The Investment Environment with Increased Volatility

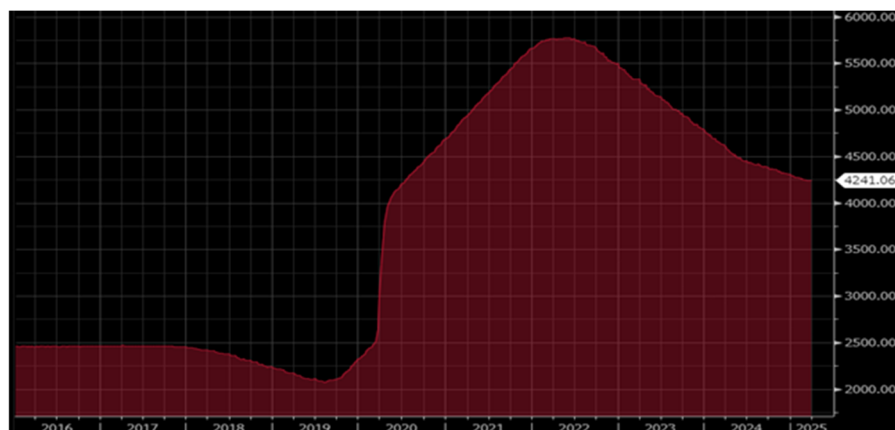
Investors welcomed the 100 basis points of rate cuts to close out 2024, although above target inflation and tariff uncertainty has kept policy makers on the

sidelines for the first two meetings in 2025. It is widely anticipated that additional interest rate cuts will be implemented later in the year. The recent bond market volatility briefly sent the ten-year Treasury yield inside of 4.0%, only to drift higher after the tariffs were walked back on April 9th. For reference, long term Treasury yields were hovering near 4.75% in mid-January. As uncertainty emerged on new policy and equity investors fled for safer haven U.S. Treasuries, yields dropped nearly 75 basis points. However, with overnight funding at 4.5%, investment yields remain accretive to existing balance sheets. With the recent interest rate volatility, Callable Agencies continue to offer a yield enhancement above comparable duration Treasuries. Even under the assumption of lower rates on the horizon, if a newly purchased bond position were to be called away in the near future, it would help increase liquidity at a time when loan demand would likely be increasing into lower interest rates.



For interest rate sensitive balance sheets, Agency floating rate securities continue to offer spreads of 130 basis points above the SOFR rate. Credit markets have been resilient, and spreads remain firm, even with heightened volatility and the anticipated economic impact of tariff implementation. The Bloomberg U.S. Aggregate Corporate Index spread has increased to 94 basis points from 80 basis points at the end of 2024. Although higher in yield, credit spreads are still well below the longer-term average of 147 basis points of additional yield above Treasuries. The Investment Committee will continue to monitor Corporate and Municipal markets as relative value opportunities become apparent. ♦

Federal Reserve Holdings of U.S. Treasury Securities



Source: Bloomberg



EQUITY STRATEGY

EQUITY STRATEGY

*With no visibility, comes
no confidence*

Now that the impact of the Trump administration's tariff philosophies to support the "golden age of America" is starting to be felt, one of the biggest questions for equity investors is, "when will visibility return?" Whether looking at damage being done to global economic growth or drilling down to individual company earnings, the outlook has become dramatically cautious at best and dire at worst, due in no small part to the inability to "size" how the current tariffs applied to so many countries will impact economic growth, inflation pressures, consumer spending and ultimately corporate earnings. The upward movement in the price of gold, for example, reflects a negative sentiment about one of those elements that are likely negatively impacted by the administration's global trade policies and related tariff strategies – inflation. Additionally, investors value transparency and forward guidance, but neither are available due to the current unprecedented actions taken around tariffs. Setting aside whether the administration's policy makes sense for "leveling the playing field" and bringing back prosperity

and "self-determination" to the U.S., the extreme and chaotic nature of the application and modification of tariffs has caused equity investor sentiment to dramatically shift from a more positive outlook prior to the tariff environment, to one of caution and fear.

*Recession or Stagflation:
"Are those my only choices?"*

The degree to which investor capital will return to the equity market and how robust such investing will be, is being framed against how the tariff policies and actions of the Trump administration will affect the shorter-term economic outlook. While there are a variety of robust models showing the longer-term benefits of leveling the playing field and onshoring production, the shorter-term impact is being gauged against a scenario of a slow or no growth environment with higher prices (stagflation) followed by or alternatively a negative growth environment with lower prices (recession). Currently, it appears the equity markets have not yet fully incorporated a recession assumption into valuations. Previous recessionary environments have produced declines in the S&P 500 of anywhere from 20% to 57%, peak to trough, according to Henry Allen, a strategist at Deutsche Bank. The current markets have not entered this range. It is not to say these levels are inevitable but rather, this can be

an indication that investors are not convinced a recession is inevitable. In 2022, it was just the fear of recession that was enough to cause a market correction in the S&P greater than 20%. In addition, institutional outlooks vary, with JP Morgan anticipating a recession this year while Bank of America believes a recession will be avoided. If the pathway to a recession is that tariffs create higher prices, higher prices slow demand, and slow demand reduces need for labor, then even with possible long-term benefits of tax cuts, short term damage can certainly create a recession.

Hanging on every "pivot"

Tariff related actions are changing daily, along with factors now outside of the spotlight: dramatic shifts in government employment, regulation and likely tax policy. Combined, the impact on the economy and corporate earnings is impossible to gauge at this point. Thus, every action or statement made by key players such as the White House or the Fed creates an amplified reaction in the equity markets. Looking forward, with the combination of recession fears and the lack of transparency regarding policy and application of tariffs, guidance on corporate earnings is difficult if not impossible. First quarter earnings are now coming forth with an understanding that the numbers may be skewed based on tariff impacts not being fully felt



EQUITY STRATEGY

for the quarter. This is due to timing and variables such as how much preemptive buying occurred in the quarter, ahead of tariffs. If companies cannot pass on the higher costs to the consumer related to import prices of parts etc., then earnings will be negatively impacted. If, in fact, companies do pass on higher costs to the consumer, inflation would likely rise and create additional longer term “headwinds” for corporate earnings. Any policy or tariff “pivots” by the administration that reduce the antagonism and confrontational stance for negotiation will be highly favored by equity investors, as would any accommodative policy by the Fed in lowering rates – in the shorter term. In similar event risk environments, or as some would say, “black swan” events, longer term equity market strength and momentum was achieved once it was determined that the contagion effect on the economy was limited and contained.

Looking forward to “forward guidance”

One reasonable take-away from all of what is being discussed is that we will likely be in an “information vacuum” for the coming months until trade policy and related economic model assumptions are clear and understood by the general

investor population. Forward-looking guidance for corporate earnings is difficult, and in addition, the expectation for earnings meeting or exceeding consensus has dramatically dropped over the previous weeks. There are simply too many moving parts to capture a clear and confident view of how bad the economy will recede, and which industries and companies will that tide take with it. Positive investor conviction must be confirmed to move from a “sell rally mode” to a return to a “stay invested add at the dip” philosophy. This will likely occur, we believe, when the full impact of tariffs will be seen in second quarter earnings, namely hard data versus survey or expectations.

Equity Strategy

Confirming that as always, the equity portfolio is comprised of “quality investment grade” holdings that represent leadership in the economy and their respective industries is a first step in managing through such a period. Uncertain economic periods create opportunities for such companies to take strategic actions that will lead to and ensure market leadership over the longer term. This is typically reflected in earnings recovery and price appreciation that outpaces competitors and “leads the pack” when the current state of the economy is understood, and more reliable guidance returns. ◆



ALM STRATEGY

ALM STRATEGY

An Uncertain Turn for the Operating Environment for the Balance of 2025

Just a mere three months ago we discussed how the operating environment had improved over the last 12 months, but oh, have times changed... or have they? With all the additional economic uncertainty and financial market volatility, has the operating environment really changed, or are we simply feeling the anticipation of problems likely to emerge down the road?

Over the last quarter, but actually closer to the last few weeks or so since early April, there has certainly been an increase in anxiety, even if it has not materialized in problems quite yet. A quick recap of where we stand today (generally speaking) vs. a few weeks ago:

- ◆ CD rates have declined modestly, on average 25 basis points or so, from about 4.25% to the high 3% to 4% area. Not dramatic, but a move in the right direction. More and more institutions are lowering rates to under 4%.
- ◆ Residential mortgage loan demand remains slow, driven by continued high rates, slow prepayment speeds and a lack of inventory. This is similar to

a quarter ago and remains an attractive asset category if opportunities present themselves.

- ◆ Commercial real estate lending seems to have slowed a bit, and could continue to deteriorate. There seems to be more cause for concern here, as the unsettled playing field leaves business owners with no confidence in their future forecasts. If you cannot accurately forecast business demand, or even what raw materials may cost in the near term, many will exhibit caution and hold off on capital investments.

Where does this leave us today? Surprisingly, not as bad as you may be expecting.

Short Term vs. Long Term

Unfortunately, it is easy to be drawn into the headlines of the day. The tariff-on, tariff-off induced swings in the market create paralysis for business leaders. If this climate were to continue indefinitely, putting major decisions on hold would be a smart move. We have heard lately that borrowers are retrenching, keeping their powder dry, exhibiting caution, etc., with respect to longer term decisions. From the lending perspective, caution is justified with companies that cannot reasonably forecast cashflows for potential projects.

However, when taking a longer view and assuming that the

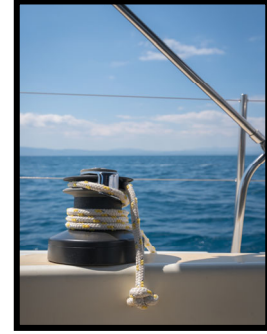
current uncertainty will subside, the future does look brighter. While tariffs dominate the shorter-term discussion, once we move past this phase, conditions should improve, but questions remain. How quickly will we move back to a 'normal' operating environment, and which of the current problems will become permanent? In addition, is the current environment bad enough to significantly pull back on lending, or cease it completely?

How Do We Move Forward?

Although things look unsettled currently, we have weathered these storms before, and eventually they do pass. Some observations about how to approach the current environment:

Lending

Residential fixed rate mortgages continue to look attractive, even though many institutions still actively avoid this asset class (although not as many as 6 months ago). With rates in the low to mid 6% range, combined with a likely less aggressive Fed moving forward, the prepayment profile looks better than it has in the past. Going back a year or so, when the Fed was expected to cut at a much faster pace, the 7% rate would probably not have lasted long before being refinanced, so although the rate was solid, the expected life was short compared to the operational cost and time required to book that asset. The outlook is quite different today, and although



the current rate is 75bp or so below that level, the loan is more likely to stick around for longer, making it more appealing over the longer term.

Commercial real estate remains ultra-competitive, but with more activity than in the residential space, although it appears to be slowing. Rates have come down a bit, roughly 25 basis points over the last month, but remain attractive. Credit has held up well so far, but that could also be in jeopardy if the tariffs return in full force and business expenses rise. However, if you take a longer-term view and believe that the tariff overhang will be resolved, there is no reason to pull back from this sector.

Home equity lending remains relatively strong, as people remain 'stuck' in their homes due to a combination of their existing low pandemic era mortgage rates, higher current rates, the runup in home prices and the low level of housing inventory. Financial institutions are responding with competitive offerings, largely in the line of credit space. Fixed rate equity loans, however, could be appealing to the segment of borrowers that have a low rate, long-term fixed rate loan and do not want to move (or can't) but need more space or want to renovate their home. This would be a targeted marketing campaign that reaches out specifically to existing borrowers with low rates and a likely high level of appreciation. In this scenario, both the lender and borrower would benefit.

Funding

Historically, many financial institutions have tended to follow the Fed in terms of CD pricing- when the Fed cuts rates, they will lower their CD rates, etc. However, significantly lowering funding costs in the current environment could be challenging given that the modest anticipated easing cycle from now through the end of 2026 may not provide enough downward movement. As a result, institutions will need to 'decouple' from the Fed by more aggressively lowering funding costs. Although this runs the risk of deposit outflow, liquidity in the banking sector is better overall than it has been in quite some time, and this new pricing methodology will likely start with the 'hot money' CDs that have been written over the past year. The eventual goal is to return to a relationship banking model from the exception pricing that we have seen throughout this cycle.

In the worst-case scenario in which deposits flow out too quickly, deposits can be backfilled rather easily with attractive wholesale funding:

- ◆ Medium term FHLB Option Advances are priced under the anticipated Fed Funds terminal rate of 3.75%; for example, the recent rate of 3.42% for a 3-year non-call 6-month advance provides reasonable call protection with the opportunity to boost margins with a

rate more than 50 basis points below CD specials.

- ◆ Broker CD rates have declined recently, and with rates near 4% for a one-year term, look attractive for a bullet structure with a relatively short final maturity. ◆

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Jon Rankin
Contributing Author/ Editor

Jason Beshansky
Illustrator

Dave Thomas
Contributing Author

Scott Miller
Contributing Author

Nick Papageorge
Contributing Author

Daniel Dube
Publication Coordinator

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205 Newbury Street, Suite 403, Framingham, MA 01701 • 781•235•2666 or

1•800•535•4544 Fax: 781•235•9688 • www.epgadv.com