Investment Trends & Insights For Credit Unions

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Today's Agenda

- ALM First Market Update
- Credit Union Trends
- TCU Portfolios Update

About Trust for Credit Unions

- Institutional investment options, **created specifically for credit unions**
- **ALM First** serves as *investment advisor*
- **Callahan Financial Services** serves as *distributor*
- Hundreds of credit union investors in our **30+ year history**

TRUST FOR CREDIT UNIONS

It's our mission to support credit union investment strategies through a professionally managed family of mutual funds that respond to the needs of the credit union industry.

Our mutual fund options keep credit unions always invested, are professionally managed, and are delivered with great client service and the cooperative values of credit unions always in mind.

Since 1987, TCU has helped credit unions invest excess member deposits, focusing on adding maximum value through collaboration.

We value what you value. Our core values, which have been derived from long-standing client relationships, say it all:

- Partnership and Collaboration
- Knowledge and Resource Management
- Access to Information
- Loyal Partners
- Strategic Resource

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TCU Investor Webinar | March 29, 2022

ALM First Market Update

Economic Themes

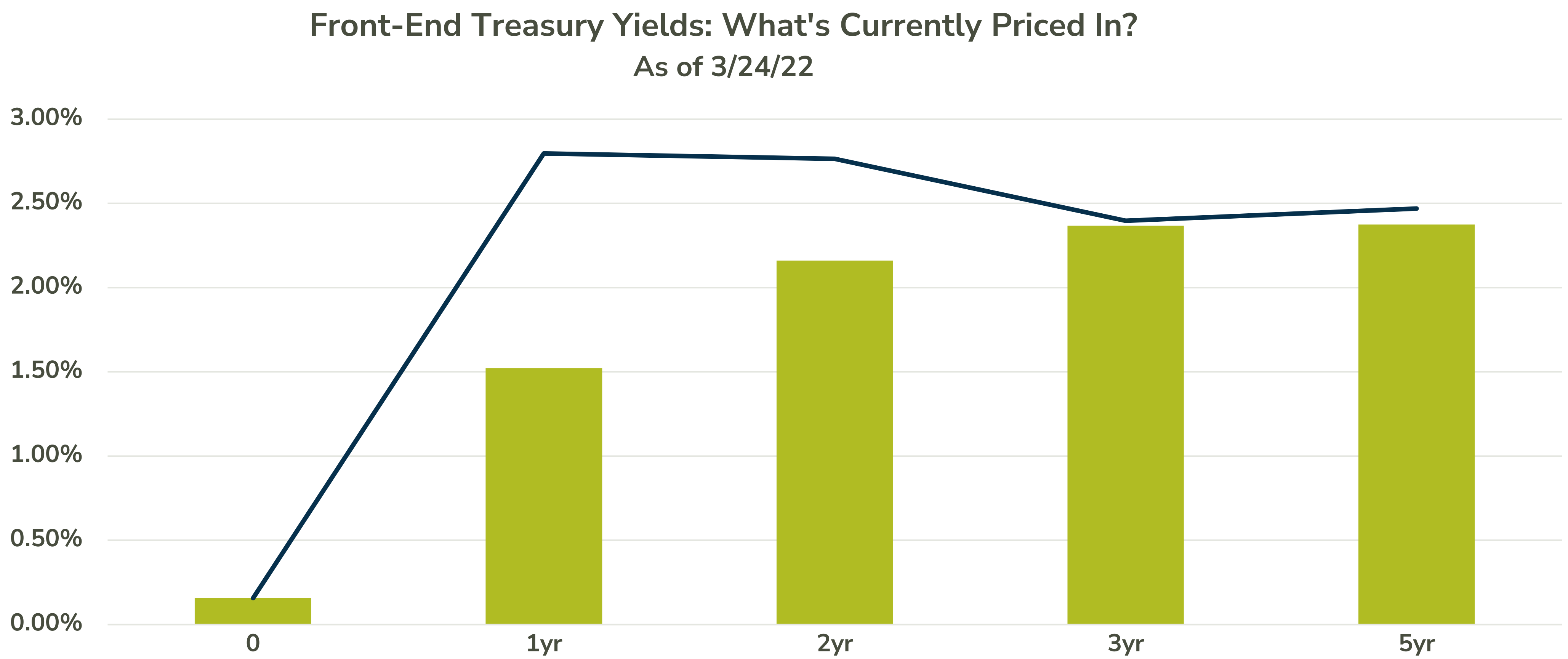
- **Sources of uncertainty**
  1. Course of inflation
  2. Fed response to inflation risks
     - Hesitant to provide firm guidance because inflation course is highly uncertain
  3. Russia/Ukraine war
     - Near-term and long-term uncertainties/risks for global economy and inflation
  4. Covid
     - Still lingering as a risk; recent flare up in China sparked lockdowns in multiple regions (supply chain issues)

- **Fed turns much more hawkish**
  – Seemingly unnerved by current inflation risks, the March 16 FOMC meeting presented a much more hawkish path for future monetary policy for both rate hikes and balance sheet reduction
    - Median participant projection for fed funds rate showed more than 250 bps of rate hikes in 2022 & 2023, including 7 hikes this year

  – In recent appearances, Fed Chair Powell has suggested the Fed is open to 50 bps hikes at upcoming meetings if warranted

  – Balance sheet reduction plan could be announced as soon as the May 4 FOMC meeting
    - Biggest source of rate volatility and spread widening in fixed income markets this year, particularly prior to Russia invasion of Ukraine

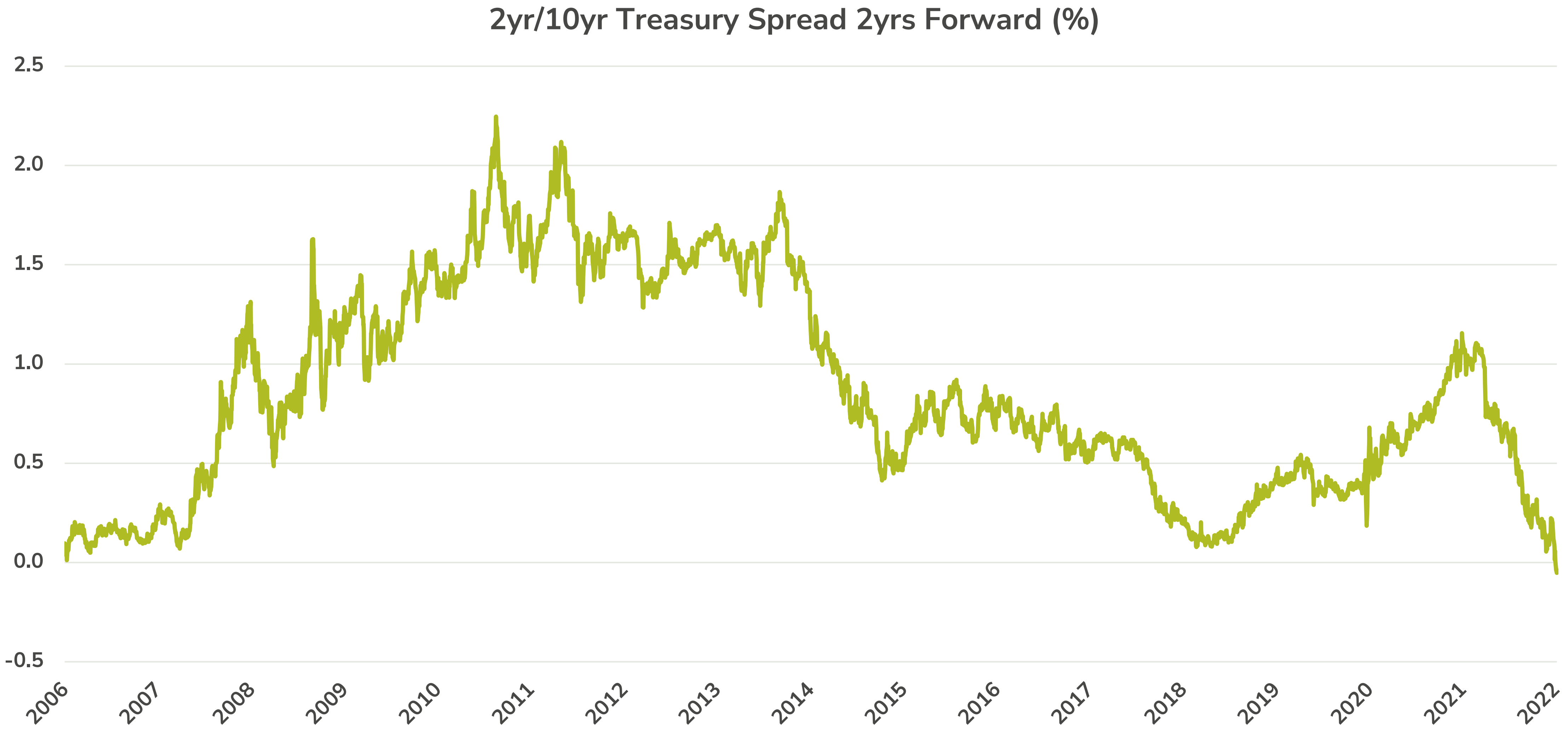
Repricing for Fed Rate Hikes



	0	1yr	2yr	3yr	5yr
Spot Rate	0.16%	1.52%	2.16%	2.37%	2.37%
Implied 1mo Rate	0.16%	2.80%	2.76%	2.40%	2.47%

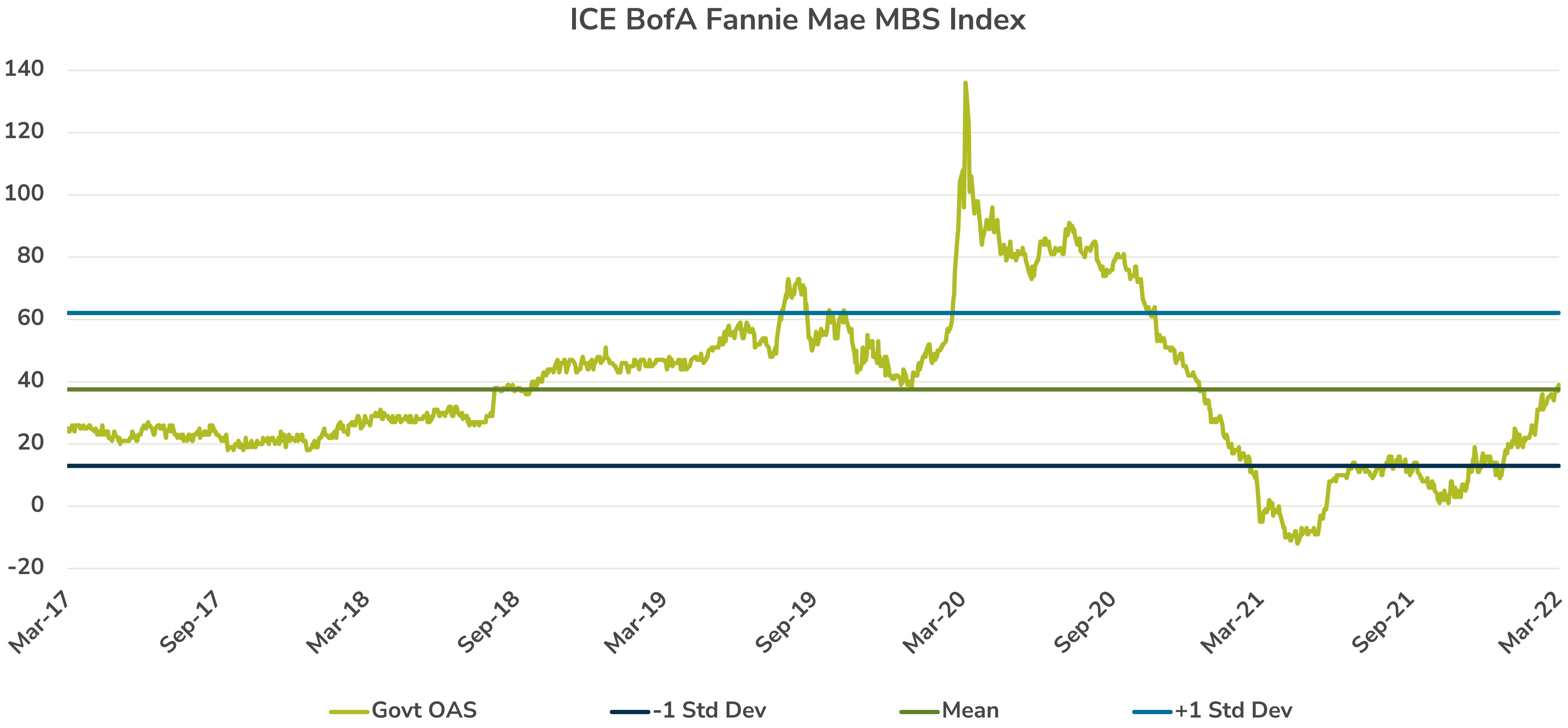
Source: Bloomberg, ALM First

More Hawkish Fed → Flatter Forward Treasury Curve



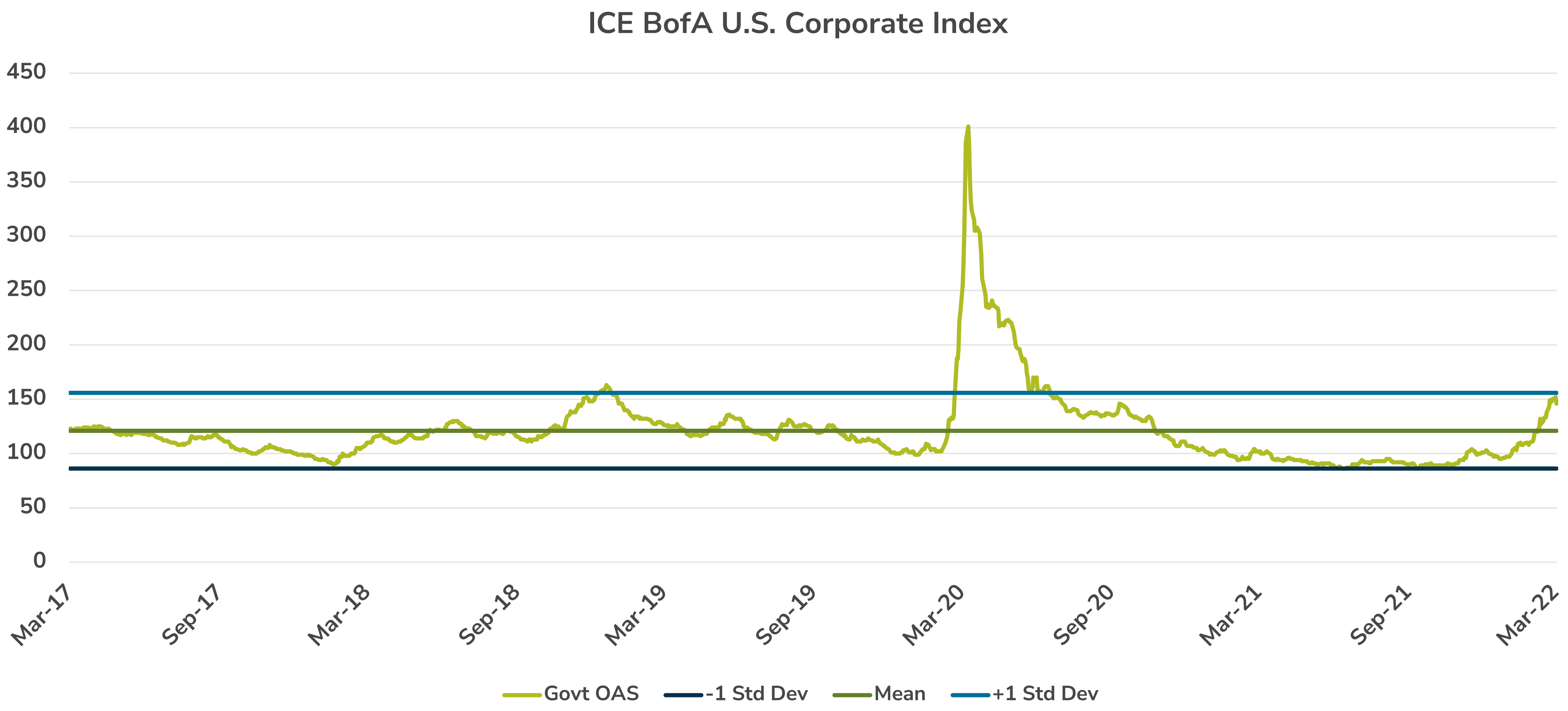
Source: Bloomberg

Fed Balance Sheet Effect: Mortgage Spreads



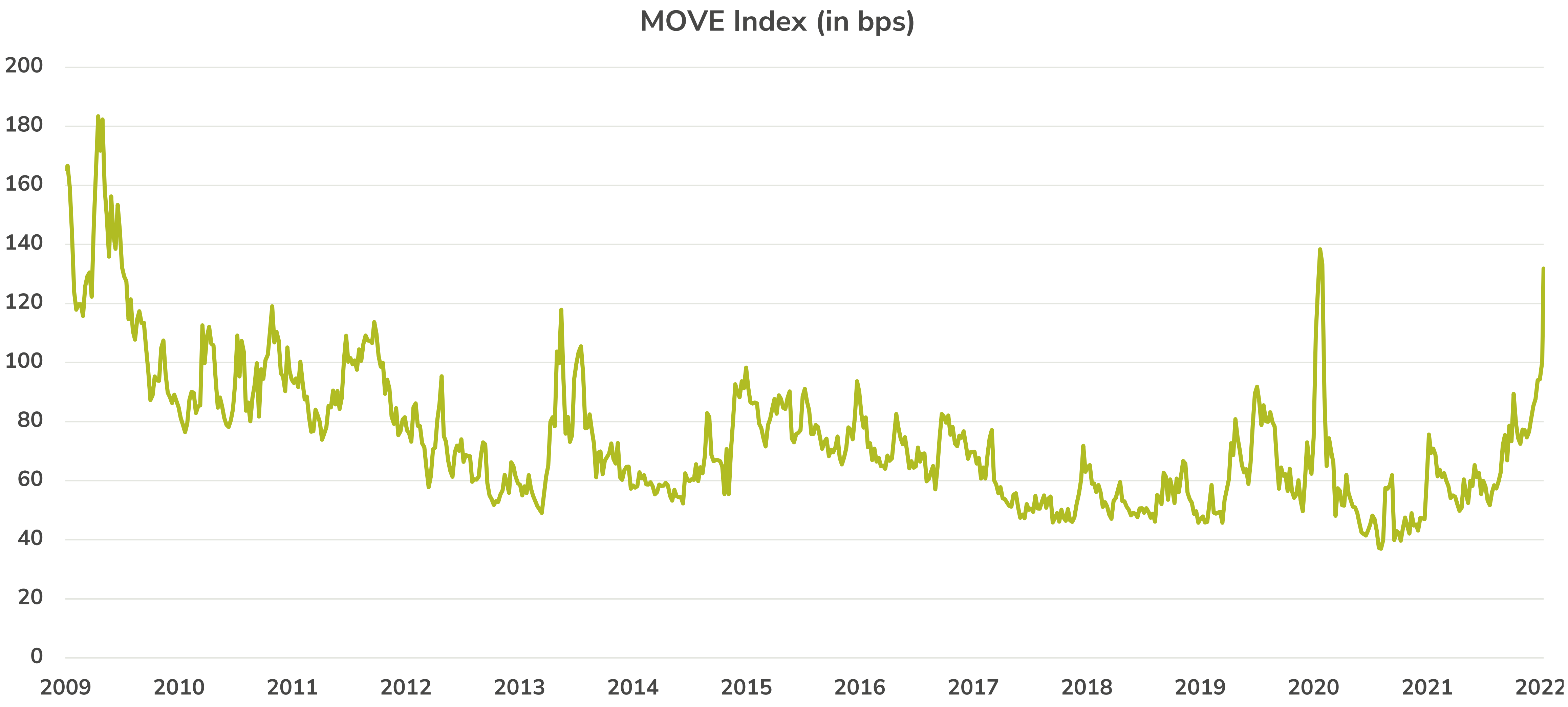
Source: ICE BofA; Bloomberg

Fed Balance Sheet Effect: Corporate Bond Spreads



Source: ICE BofA; Bloomberg

Surging Interest Rate Volatility



Source: ICE BofA; Bloomberg

Impact for Depository Institutions

- Higher rates → higher unrealized losses for core AFS bond portfolios
- Higher rates → higher deposit franchise value
- Higher rates → higher net-interest margins
- These longer-term trends should be more important to stakeholders than short term accounting measures
- KBW Regional Bank Index has outperformed the S&P 500 by 6 points YTD through 3/25

Credit Union Trends

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Loan and membership growth accelerates year-over-year

	12/31/2021	12-mo. Growth 4Q21	12-mo. Growth 4Q20
Assets	$2,085.0B	11.8%	17.7%
Loans	$1,268.9B	8.0%	4.9%
Shares	$1,810.3B	12.7%	20.3%
Investments	$722.3B	20.0%	54.6%
Capital	$220.2B	6.7%	9.8%
Members	131.1M	4.3%	3.2%

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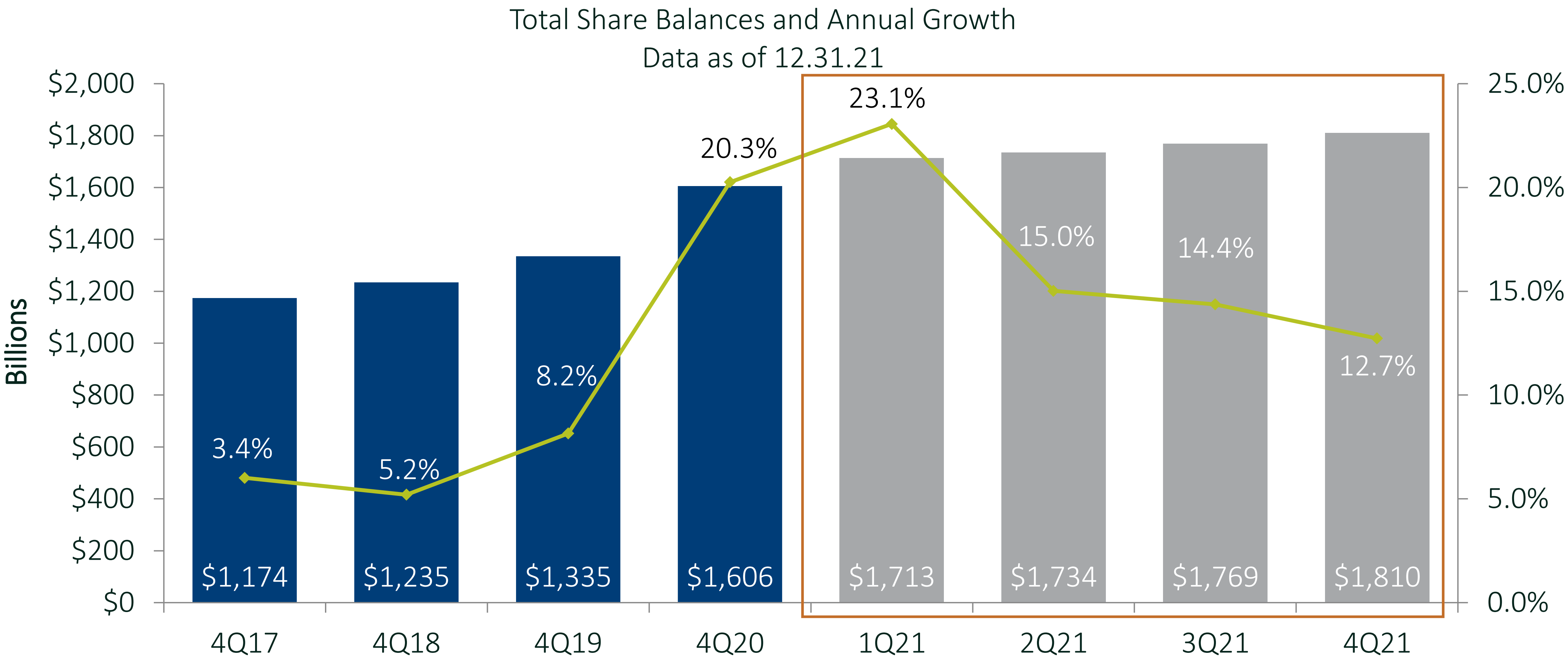
Share growth continues at above-average rates but begins to slow from pandemic highs



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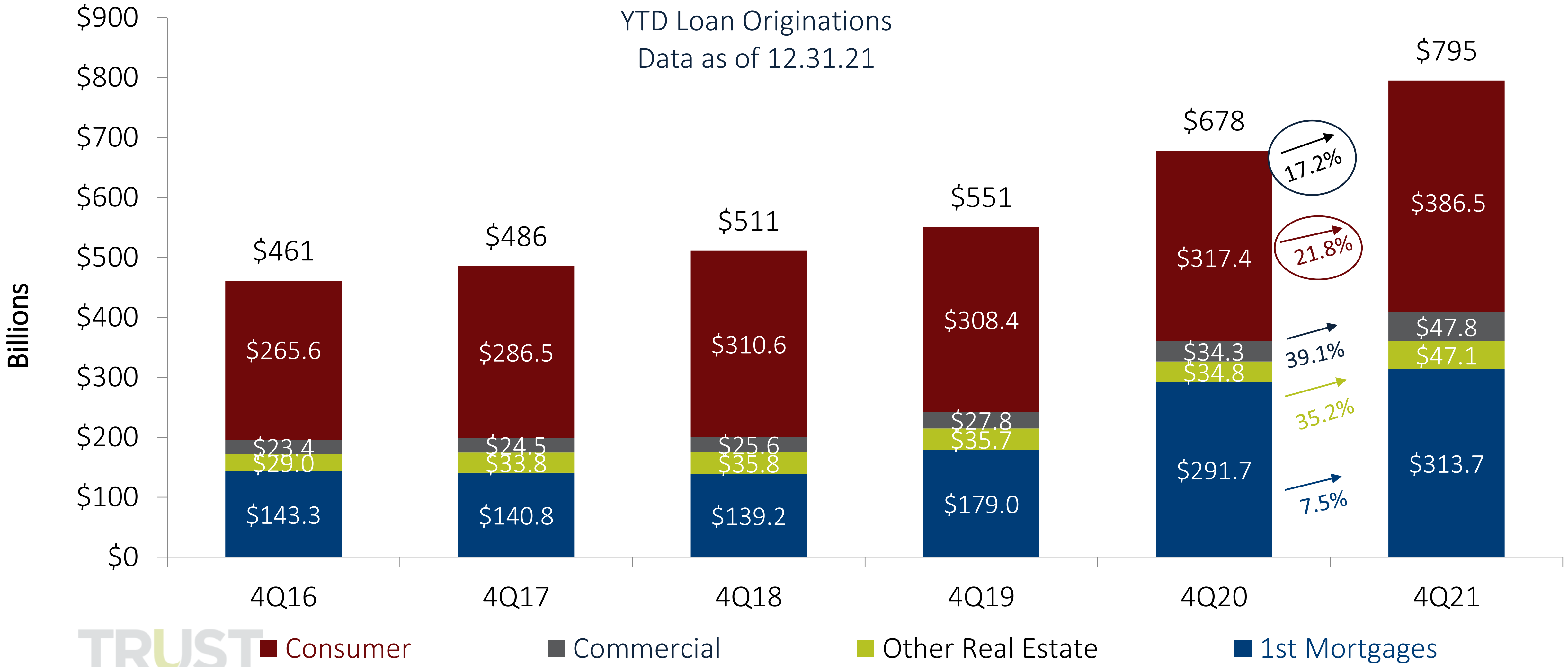
Consumer lending leads origination growth in 2021, as credit unions see another record year for lending



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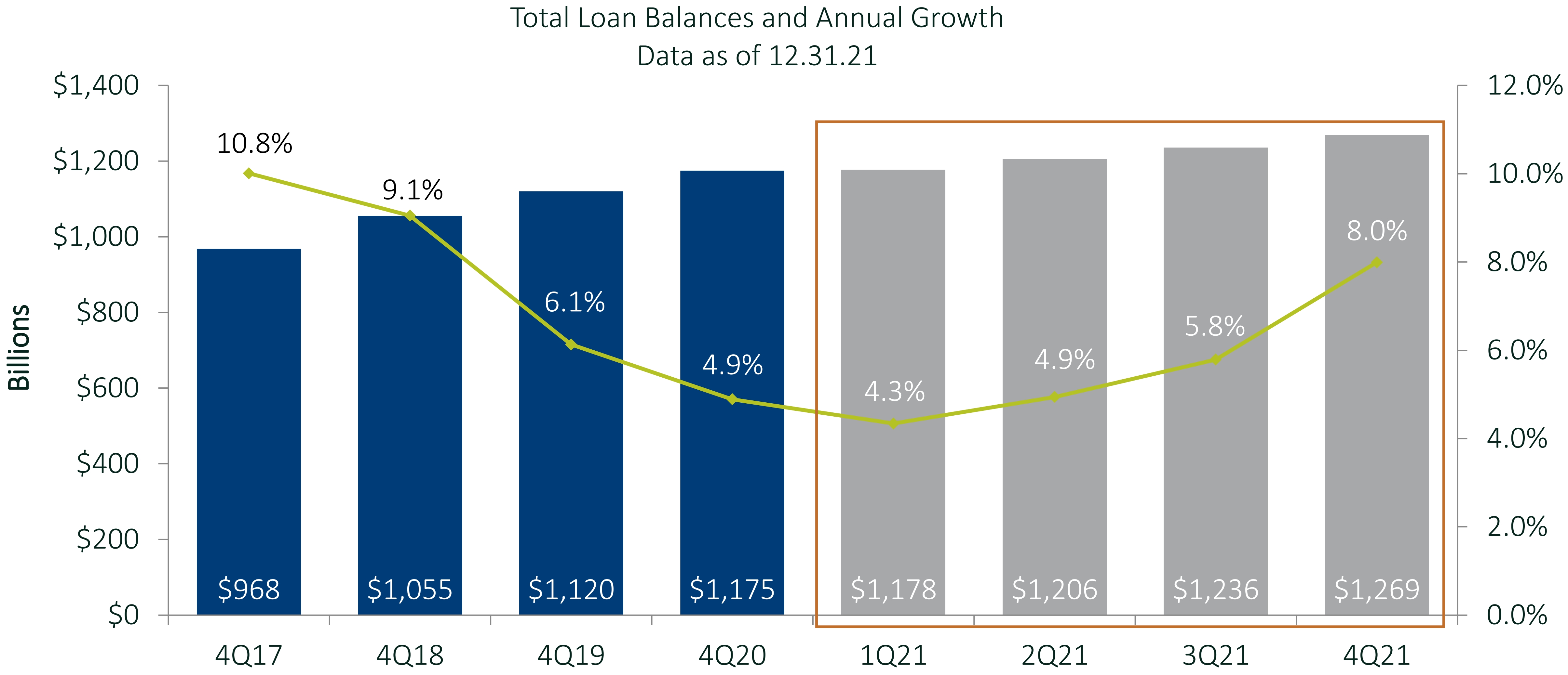
Loan growth accelerates for the year, as originations outpace early paydowns



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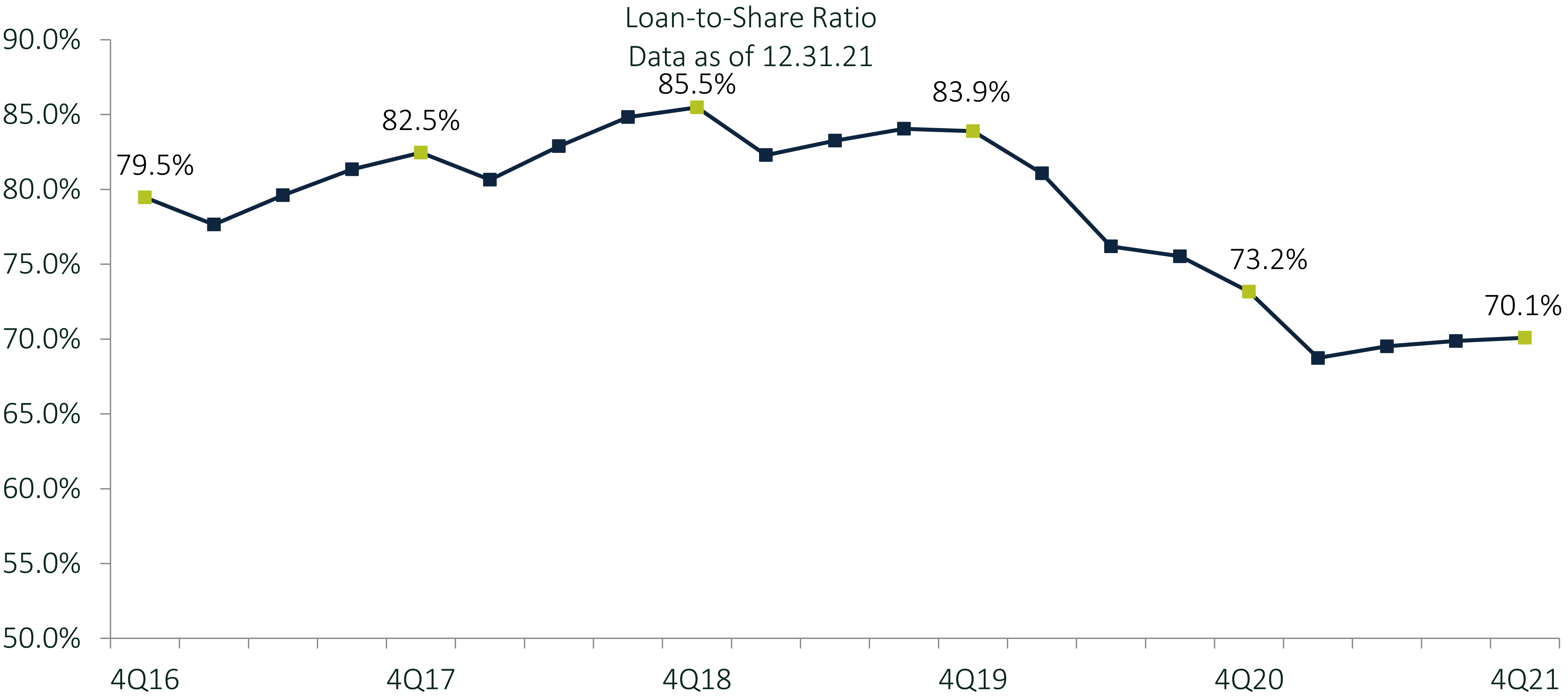
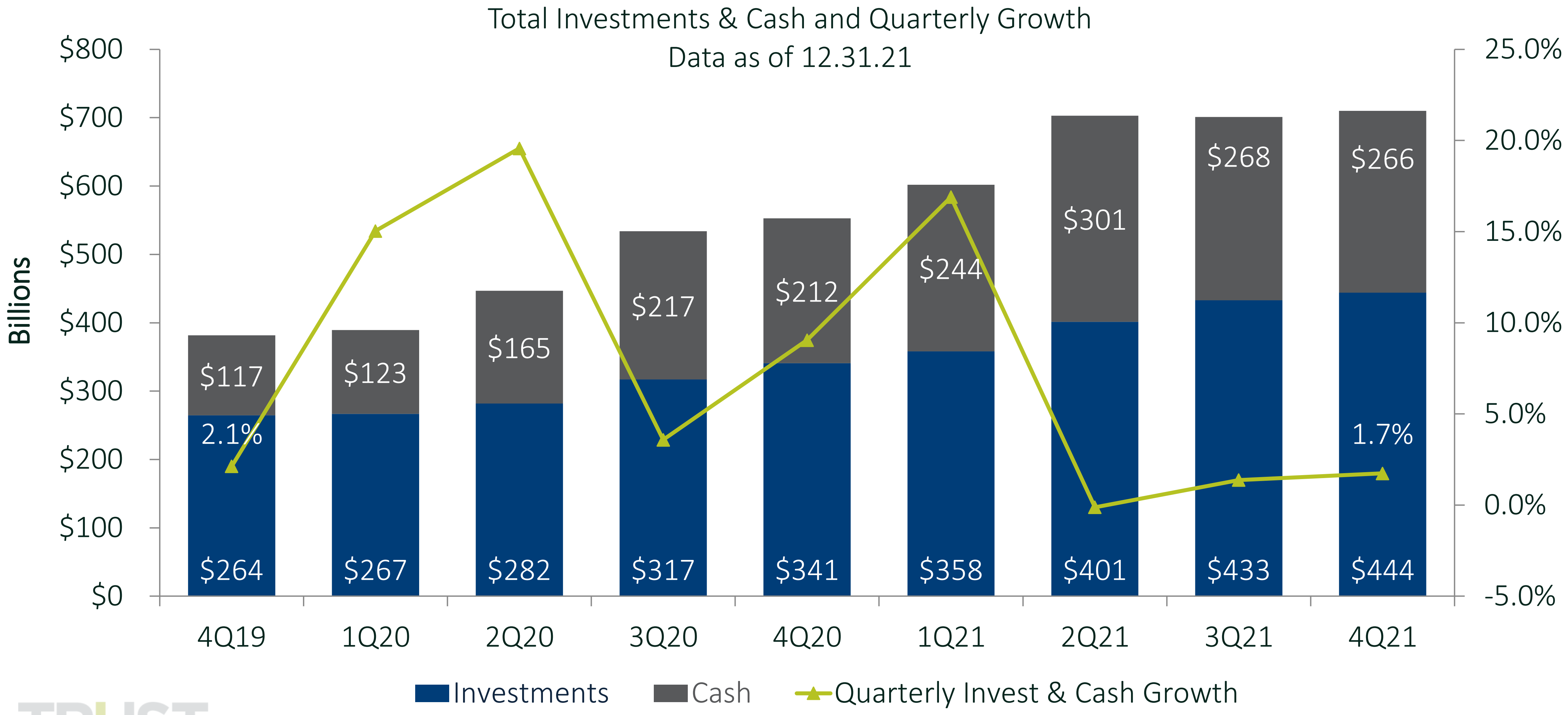
The loan-to-share ratio increases for the third straight quarter, crossing 70% for the first time in 2021



Cash falls for second consecutive quarter; Still up 20.4% year-over-year



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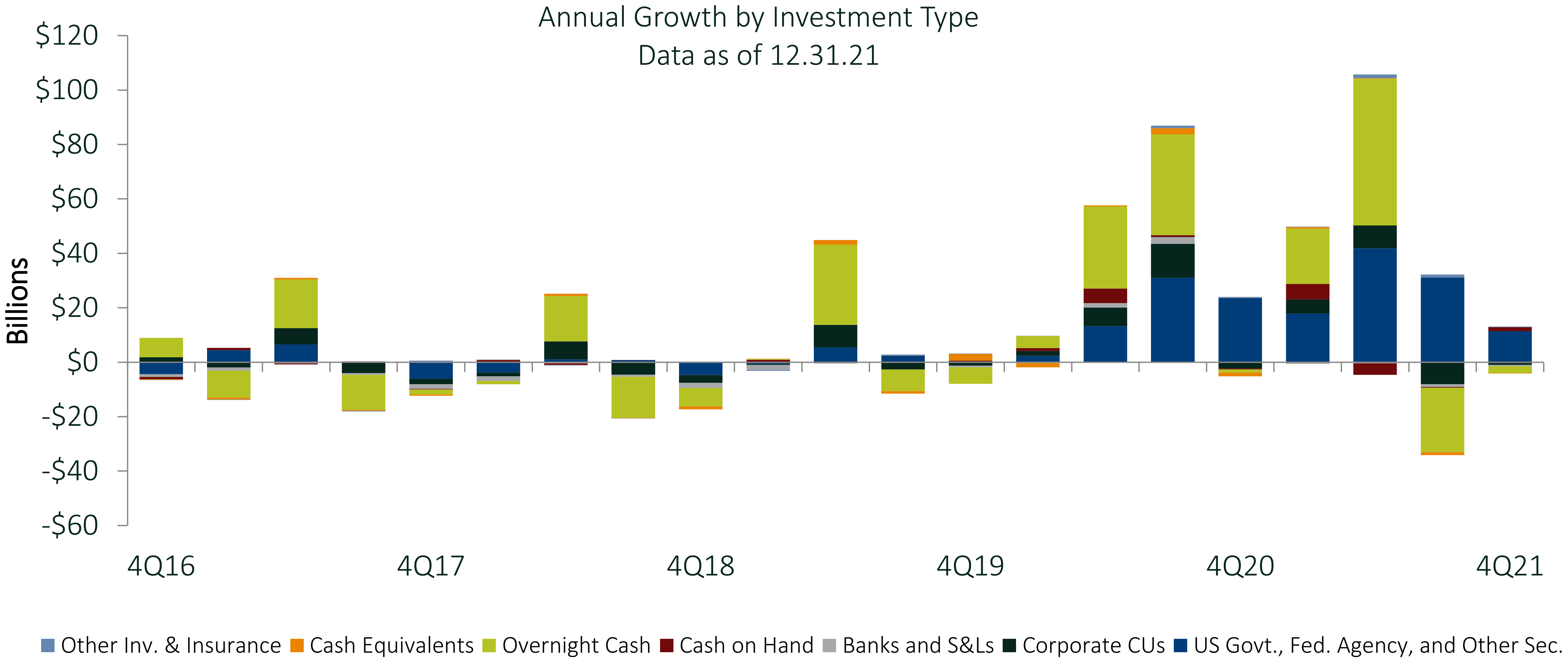
Fourth quarter saw growth in Govt. and Agency allocation, while cash on hand continues to decline



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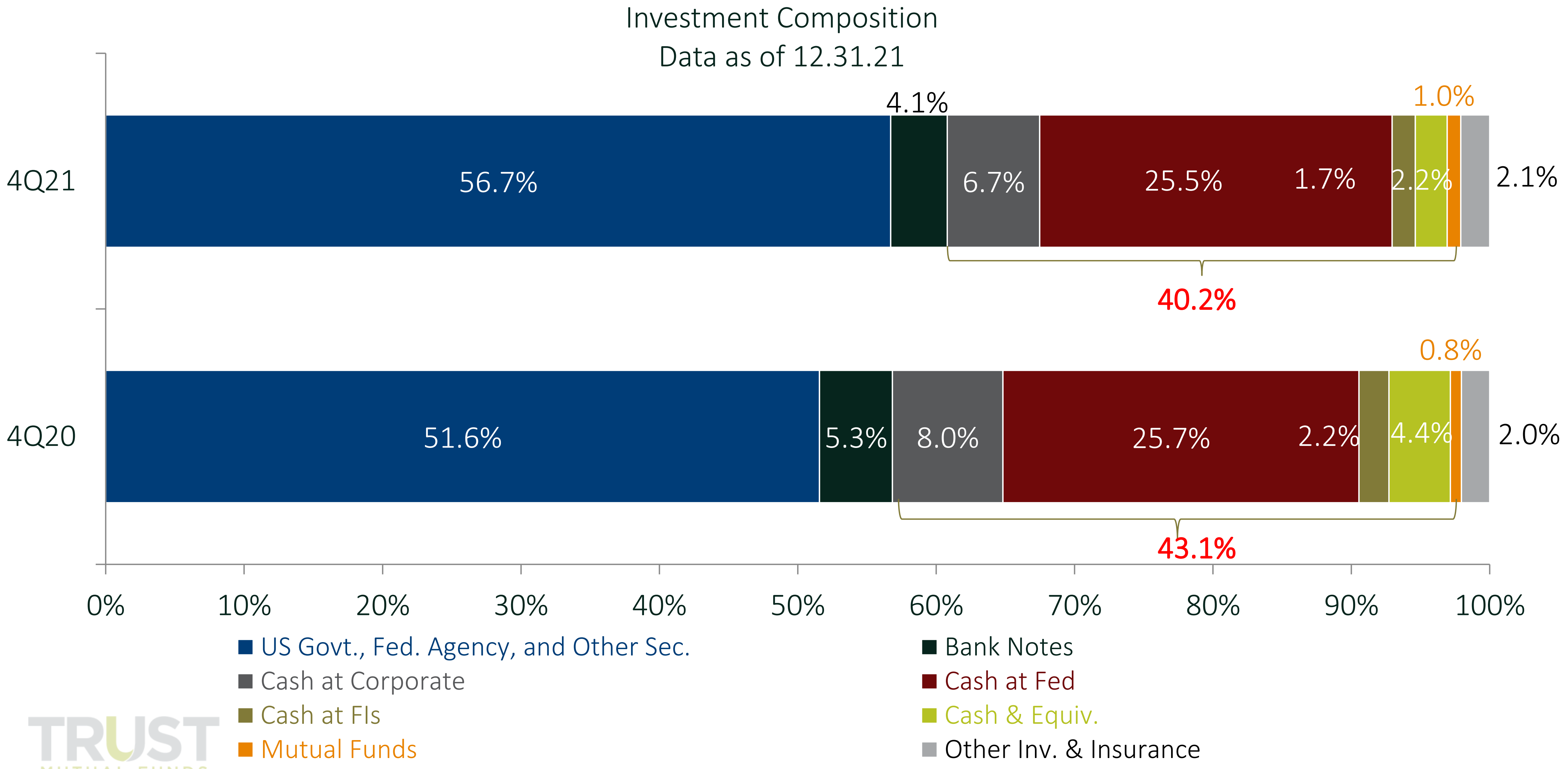
Investment balances shift from Cash to US Govt and Agency securities over the past year



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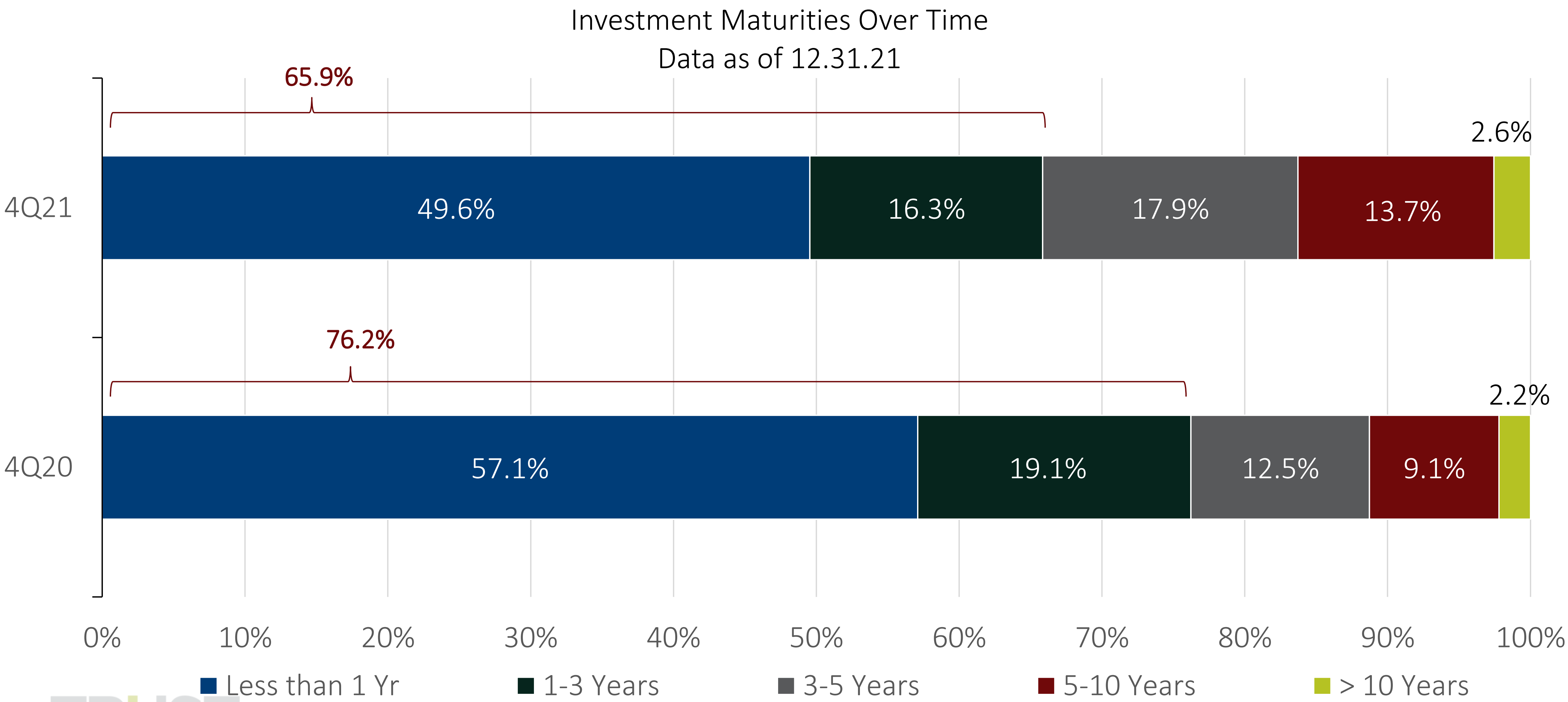
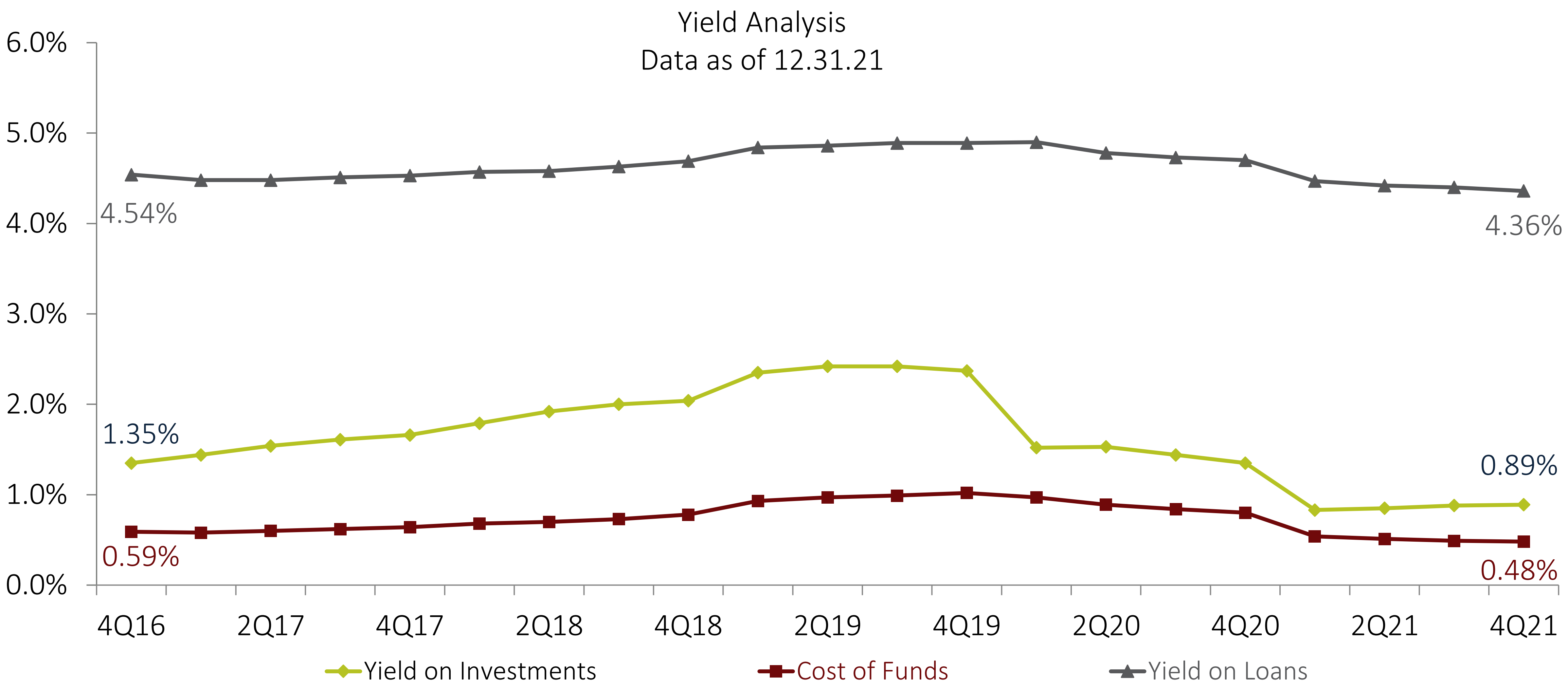
Weighted average life increases in 4Q to 2.39 years

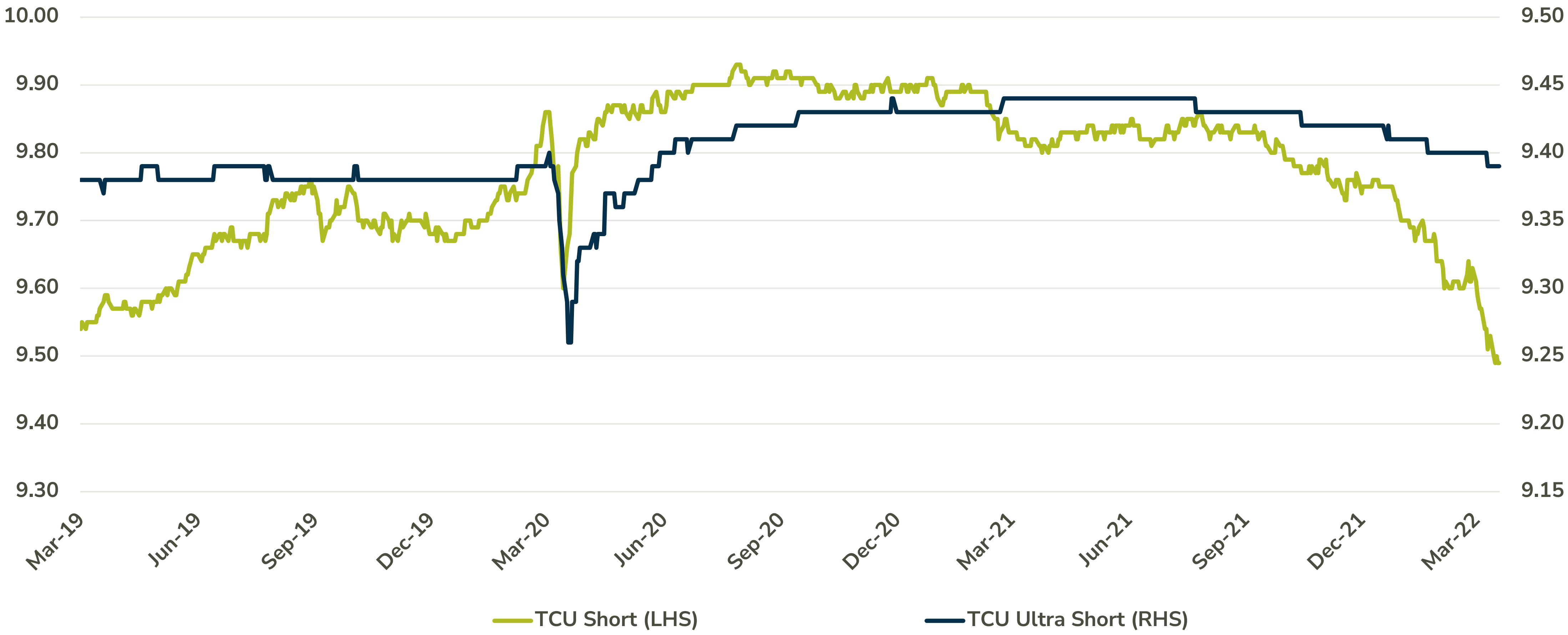


Yields remain flat, with a slight increase in investment yield



TCU Portfolios Update

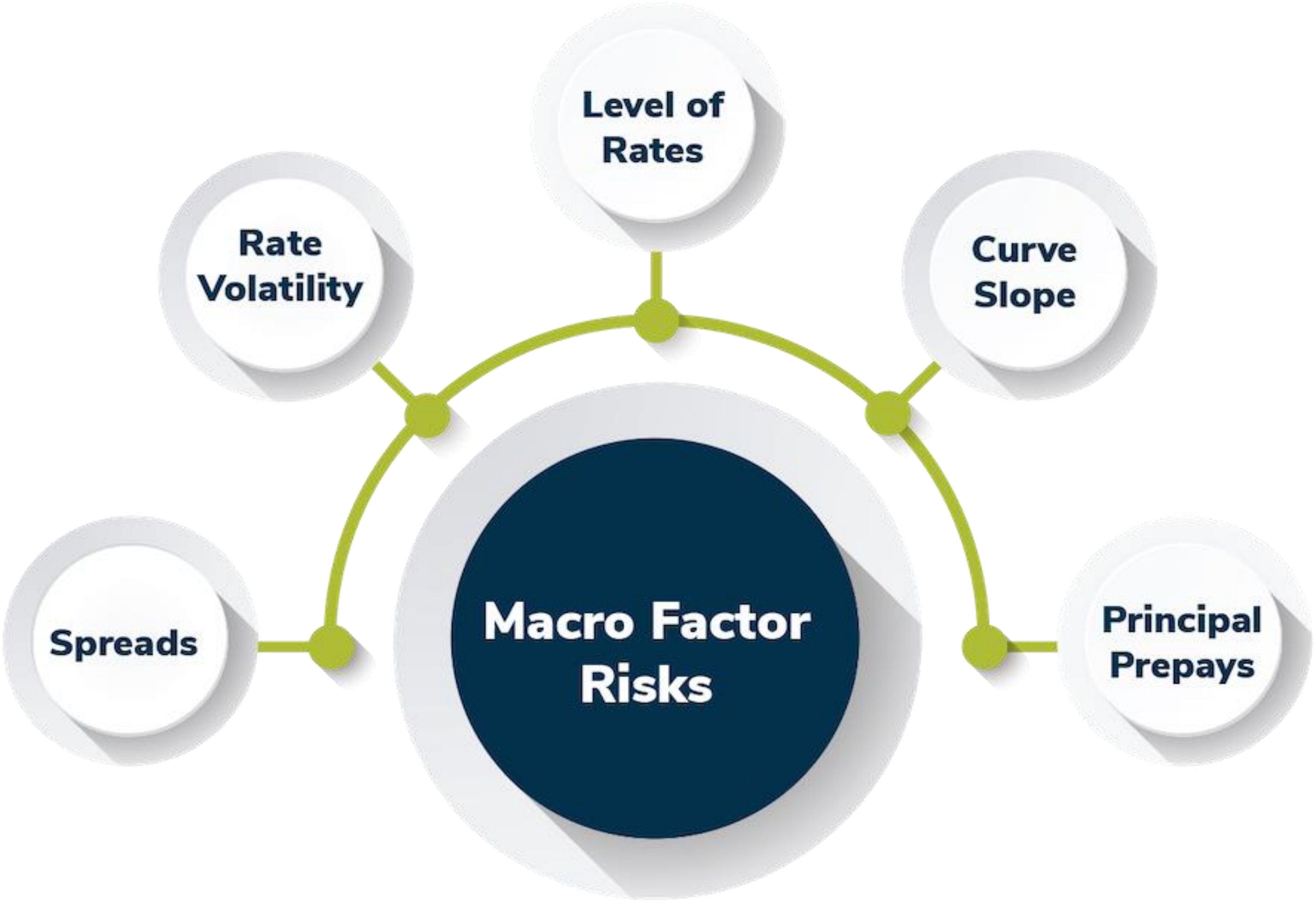
TCU Portfolios NAV *



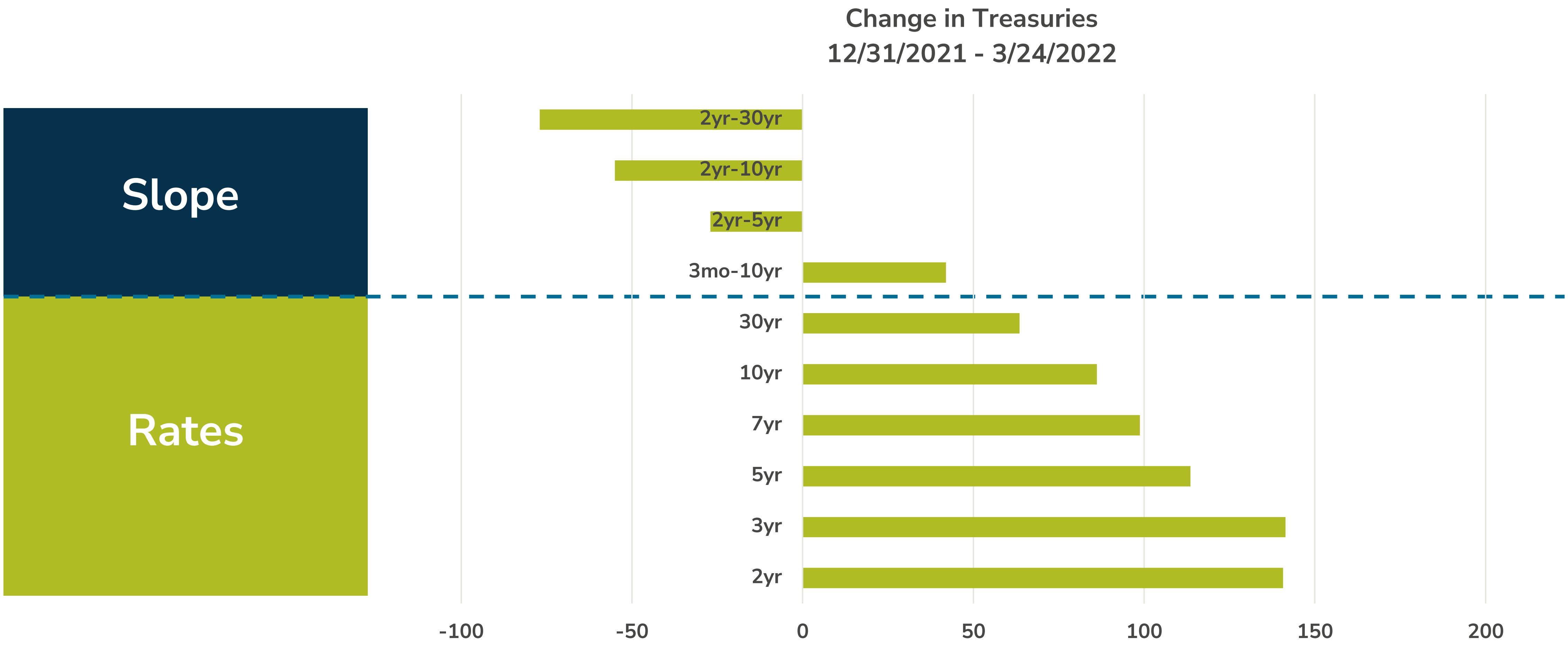
* *Investor share class*

Source: Bloomberg

Drivers of Fixed Income Performance

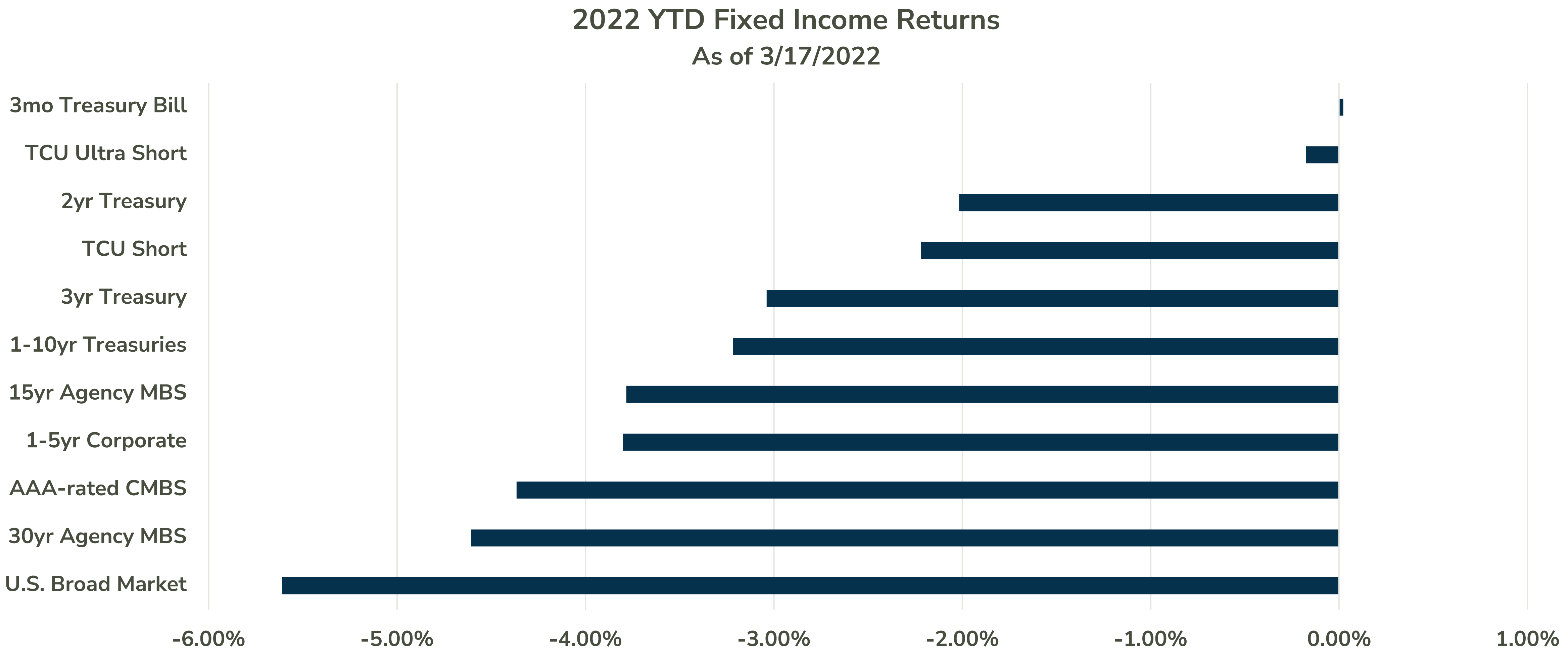


Treasury Curve Repricing



Source: Bloomberg

Rates Higher, Rate Volatility Higher, & Spreads Wider



Source: ICE BofA Indices, Bloomberg

Strategies to Maximize Risk-Adjusted Returns Vs. Benchmark

1. **Buy the benchmark**
   – Return variance relative to benchmark would be eliminated, but return would lag benchmark persistently by the level of fund expense ratio

2. **Purchase duration- and curve-matched credit risk (corporate bonds, ABS, & RMBS)**
   – 2 of the 3 sectors are impermissible for FCUs, and RMBS is not currently permissible under TCU guidelines

3. **Take curve and spread risk via duration barbell**
   – Current strategy for TCU portfolio
   – Uses a mixture of fixed-rate and floating-rate 703 permissible assets

4. **Hedged portfolio using interest rate derivatives/futures**
   – New NCUA rule allows for potential use of derivatives in mutual funds
   – Interest rate risk and curve risk can be mitigated, but it wouldn't extinguish all price/NAV volatility (i.e., spread risk, volatility risk, prepay risk)

TCU Short Duration Portfolio

TCU Short Duration Portfolio Summary[1]				
	Current Allocation	Ex-Ante Analytics Eff. Dur	Sprd. Dur	OAS
ARM	1%	0.68%	2.74%	68
Bank Note Fixed	14%	2.64%	2.79%	75
Bank Note Float	1%	0.18%	0.17%	143
CMBS Fixed	18%	3.48%	3.54%	74
CMO Fixed	3%	1.81%	5.75%	59
CMO/ACMBS Floaters	38%	0.19%	3.44%	31
MBS Fixed	25%	3.75%	4.24%	58
Muni	1%	3.82%	3.76%	56
UST	0%	0.00%	0.00%	0
Repo	1%	0.00%	0.00%	8
	100%	2.07%	3.58%	53

Total Return Summary[1]	TCU Short[2]	Benchmark[3]	Excess
3 month	-1.30%	-1.38%	0.08%
YTD	-1.23%	-1.11%	-0.12%
12 month	-1.68%	-1.60%	-0.08%
Avg Annual[4]	1.53%	1.27%	0.26%

Portfolio Characteristics	TCU Short	Benchmark
Total assets[1]	918,108,052	
Effective Duration	2.07%	1.97%
Spread Duration	3.58%	1.96%
30 day Eff Yield[5]	0.72%	NA
OAS	53	4

[1] *As of 02/28/2022*

[2] *Investor Shares*

[3] *Benchark is 2-year Treasury index*

[4] *Since 4/30/2017 (when ALM First became portfolio manager)*

[5] *Investor shares*

Source: ALM First, Bloomberg, U.S. Bank

TCU Ultra-Short Duration Strategy

- Interest-rate target
  - 3-month Treasury bill
- Strategy aims to minimize interest-rate risk while maintaining a yield spread over Interest on Reserve Balances (IORB) rate
- ***Not a money market fund (and not intended to be)***
  - Most institutional government money market funds yield <0.05% currently
- Typical portfolio composition
  - Combination of short-term repo (~30%) and agency floating rate securities (~70%)
- In order to generate excess return relative to the Fed's IOER rate (currently 0.15%), the portfolio must target risk other than interest-rate risk
  - Spread risk of floating-rate securities is the primary source of Ultra Short Portfolio return

TCU Ultra Short Duration Portfolio

TCU Ultra Short Duration Portfolio				
	Current Allocation	Ex-Ante Analytics: Eff. Dur	Sprd. Dur	OAS
ARM	0%	0.46%	2.66%	84
Agency Floater	0%	0.38%	1.17%	79
Bank Note Float	1%	0.14%	0.46%	65
CMBS Fixed	0%	0.00%	0.00%	0
CMO Fixed	0%	3.20%	3.38%	50
CMO/ACMBS Floaters	58%	0.25%	3.99%	36
MBS Fixed	0%	2.59%	3.43%	78
UST	20%	0.34%	0.34%	-1
Repo	21%	0.07%	0.07%	13
	100%	0.23%	2.40%	24

Total Return Summary[1]	TCU Ultra[2]	Benchmark[3]	Excess
3 month	-0.16%	0.02%	-0.18%
YTD	-0.08%	0.01%	-0.09%
12 month	-0.11%	0.04%	-0.15%
Avg Annual[4]	1.17%	1.12%	0.05%

Portfolio Characteristics	TCU Ultra	Benchmark
Total assets[1]	2,494,463,170	
Effective Duration	0.23%	0.25%
Spread Duration	2.40%	0.25%
30 day Eff Yield[5]	0.16%	NA
OAS	24	9

[1] *As of 02/28/2022*

[2] *Investor Shares*

[3] *Prior to 1/1/2019, benchmark was effectively a 9-month Treasury bill index; current benchmark is 3-month Treasury bill index*

Source: ALM First, Bloomberg, U.S. Bank

Looking Ahead

- **Forward-looking expected returns are improved**
  - While negative for current portfolio valuations, higher yields and wider spreads are positive for forward-looking expected returns
  - MBS spreads are near historical average
  - Until there is more certainty regarding the inflation course and the Fed’s plans for interest rate policy and balance sheet reduction, general market volatility will likely remain elevated

Q&A

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