

Citizens Market Update

September 24, 2024

- CPI rose 0.2% in August on a seasonally adjusted basis, after rising 0.2% in July. Over the last 12 months, the all items index increased by 2.5% before seasonal adjustment, the smallest 12-month increase since February 2021. The all items less food and energy index rose 3.2% over the last 12 months.
 - CPI has changed dramatically as compared to a year ago - CPI rose 0.5% in August 2023, or 3.7% over a 12-month period, and core CPI rose 4.3% over a 12-month period as of August 2023
 - The index for shelter rose 0.5% in August 2024 and was the main factor in the all items increase – the index for shelter has risen 5.2% over the past 12 months. Shelter accounts for 36% of the index with owners' equivalent rent of residencies ("OER") being the single largest line item at 27%. OER peaked at 8.1% in spring 2023
 - The energy index decreased 4.0% over the past 12 months as of August 2024, which was driven by the decreases in gasoline and fuel oil of 10.3% and 12.1%, respectively. Gasoline is the third largest line item in CPI with a weighting of 3.6%.
- Total nonfarm payroll employment increased by 142,000 in August and the unemployment rate was unchanged at 4.2% with 7.1 million unemployed persons – these numbers are higher than a year earlier when the unemployment rate was 3.8% and the number of unemployed persons was 6.3 million and is the highest rate since October 2021. The labor force participation rate remains little changed at 62.7% and has held fairly constant over the past 12 months. The increase in employment in August was in line with average job growth in recent months but was below the average monthly gain of 202,000 over the prior 12 months.
- At the onset of COVID-19 the Fed undertook two historic rate cuts at unscheduled emergency meetings (0.50% cut on March 3, 2020 and 1.00% cut on March 16, 2020) to a target range of 0.00%-0.25%. Unemployment skyrocketed to 14.7% as 20.5 million jobs were lost in April 2020 alone. The economy began to expand in May 2020 to end the shortest recession in history primarily due to unprecedented federal stimulus measures, which also had an effect on inflation and that led to the Fed increasing rates by 5.25% from March of 2022 to July 2023 before taking a long pause for 14 months until the most recent Federal Reserve Meeting on September 18, 2024.
- The Fed cut its benchmark rate for the first time this month since March 2020 with a 0.50% rate cut to the current range of 4.75%-5.00%. We expect the Fed to further cut rates by 50-75 basis points in 2024 and an additional 100 basis points in 2025 before reaching to its terminal rate of 3% in 2026. The shift in strategy for the Fed is due to the "recalibration" of policy as the Fed shifts from a strategy to fight inflation as it is returning to a target rate of 2% to shore up the labor market. Comments from Chair Powell emphasized that this strategy shift is not due to a weakening of the economy and rather an attempt to extend the current period of economic growth.

- We expect GDP to increase 2.1% this year and 1.9% in 2025. While we believe the U.S. economy will slow this year, we do not believe that the slowdown is going to be enough to bring economic growth to negative territory for two consecutive quarters, or a technical recession.
- Two of the reasons for a “soft landing” is resiliency in the housing market and continued non-residential investment. The lack of supply of homes, especially in the existing homes market has increased real residential construction and new homes construction as well as sales is going to continue to keep real residential investment in positive territory. The lower interest rates will also help the residential investment.
- The yield curve is changing from inverted to upward sloping as a result of the change in Fed policy with the spread between the spread between the 2-year and 10-year Treasury at approximately 0.14% as compared to -0.38% at the beginning of 2024. The 2-10 year spread from January 2010-2020 averaged 1.44%. Since the beginning of the year, the 1-year and 2-year UST has decreased by approximately 0.75%-0.90% and the 10-year UST has decreased approximately 0.25%. We expect the 10-year Treasury to remain relatively range bound between 3.5% to 4% due to large fiscal spending while 2-year Treasury rates to come down to a range of 2.75% to 3% due to Fed rate decreases leading to steepening of the yield curve.

U.S. Treasury Rates						
	1-Year	2-Year	3-Year	5-Year	10-Year	2-10 Yr Spread
Current (9/19)	3.93	3.59	3.47	3.49	3.73	0.14
Beginning of 2024 (1/2)	4.80	4.33	4.09	3.93	3.95	(0.38)
1-Yr Prior	5.47	5.12	4.82	4.52	4.35	(0.77)
2-Yrs Prior	4.03	3.96	3.94	3.75	3.57	(0.39)
3-Yrs Prior	0.07	0.23	0.45	0.83	1.31	1.08
5-Yrs Prior	1.79	1.66	1.61	1.59	1.70	0.04
5-Yr Average	2.46	2.38	2.35	2.38	2.55	0.18
10-Yr Average	1.84	1.90	1.97	2.14	2.43	0.53
15-Yr Average	1.29	1.42	1.57	1.90	2.48	0.91
Current as % Above / Below 5-Yr Average	60%	51%	48%	47%	46%	-21%
Current as % Above / Below 10-Yr Average	114%	89%	76%	63%	54%	-73%
Current as % Above / Below 15-Yr Average	204%	153%	121%	83%	50%	-85%

- The current unrealized losses in the portfolio have continued to decrease, however, these values are non-economic and non-cash as these negative values pull to par as the securities mature. Our portfolio duration is much shorter today than it was a year ago, so the evaporation pace will increase as short-end rates decrease and we expect mark-to-market to completely evaporate over the next 18-24 months.

- Lastly, our income return is stable and historically high interest rates are economically beneficial as they lead to higher interest income. Currently, the book yield for the portfolio is 3.38% and with \$3.4 billion maturing over the next six months and \$4.6 maturing over the next 12 months, we expect our 2024 income return to be 3.6% and total return to be 5.50%.