

Investment Opportunities in the Current Rate Environment

ATLANTIC CAPITAL STRATEGIES, INC.

May 12, 2015

This Webinar is Being Recorded

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Outline

- Economic Review
- Discussion of Federal Reserve Policy
- Interest Rate Outlook
- Investment Recommendations
- Strategy Highlights

Current Economic Environment

Headwinds

- Strong Dollar
- Oil
- Fiscal Restraint
- Geopolitical Events

Current Economic Environment

Tailwinds

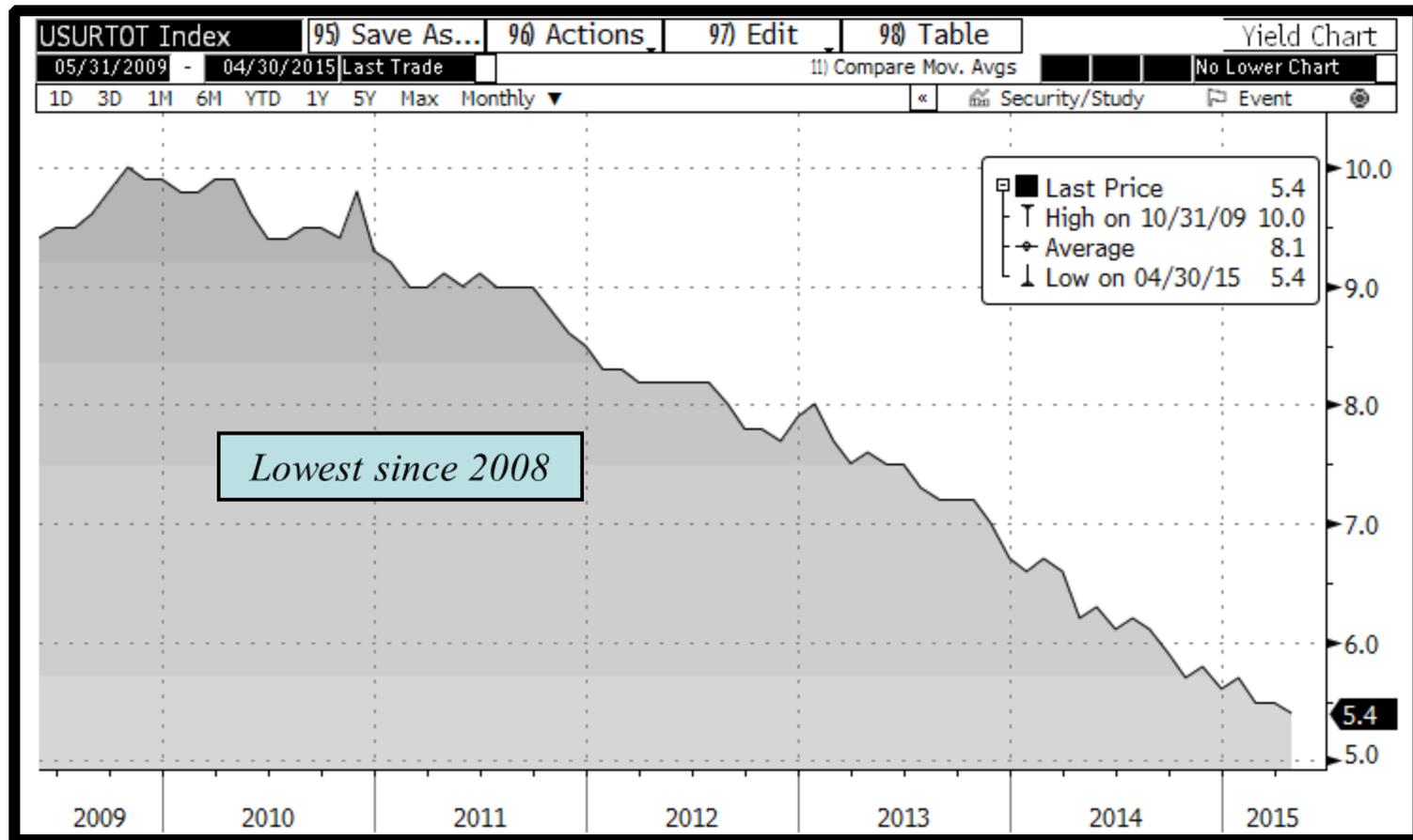
- Favorable Financial Conditions
- Improving Consumer Balance Sheets
- Disposable Income Growth
- Pent-Up Demand

Current Economic Environment

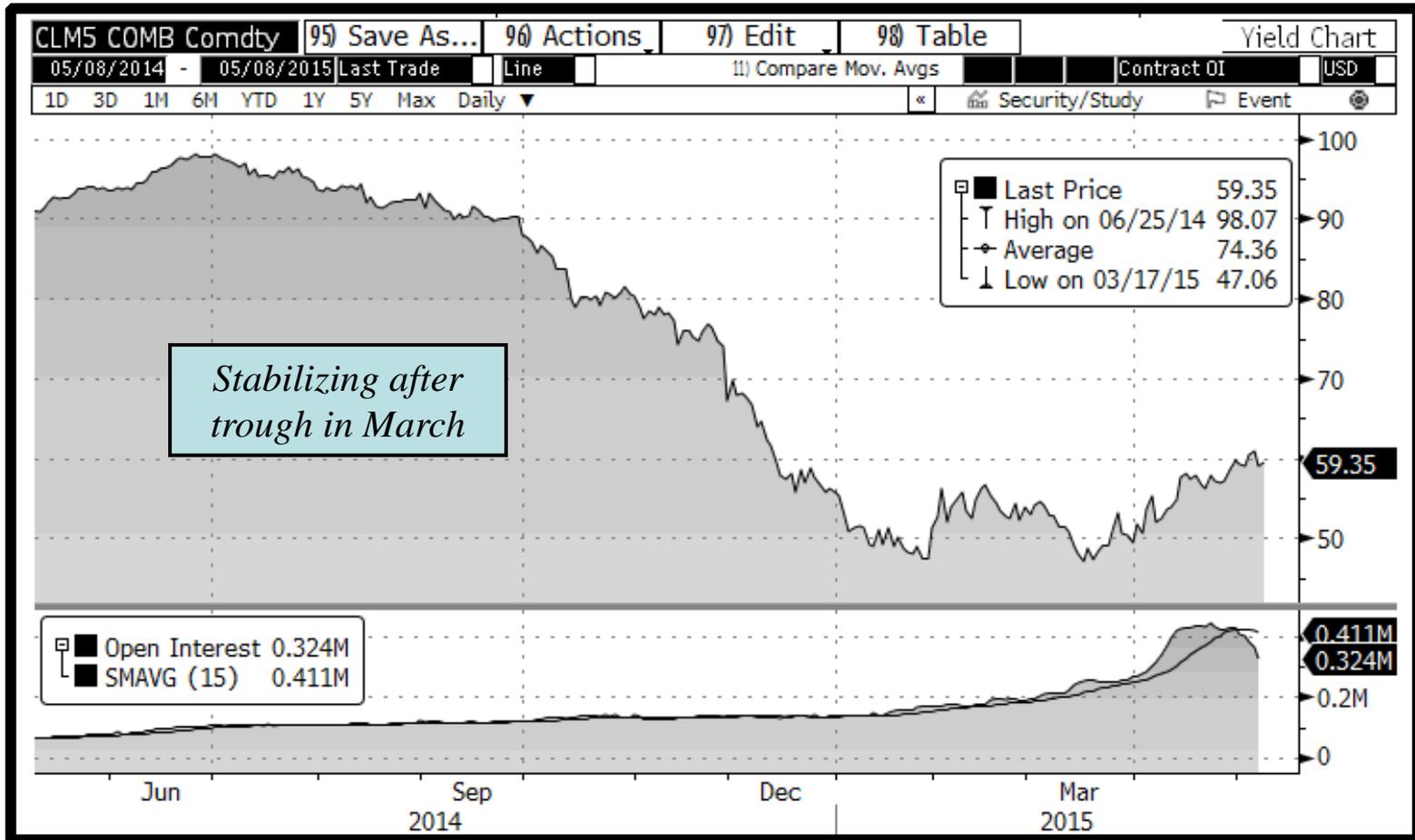
Present Conditions

- 1st Quarter 2015 GDP- 0.2%
 - Down from 2.2% in prior quarter- corporate investment fell 2.5% and the trade deficit increased \$51 billion; severe weather also played a role
- Generally Consistent Job Growth- 2.9 million new jobs in 2014; most since 1999 (Exception in March – 85,000)
- Temporary Softness in Housing- February housing starts were fewest in 12 months
- Weakness in Factory Orders- Lowest ISM manufacturing reading since May 2013
- Falling Exports- Bounced back in March, though trending lower
- Inflation Below Fed's 2% Target- Core PCE at 1.3%

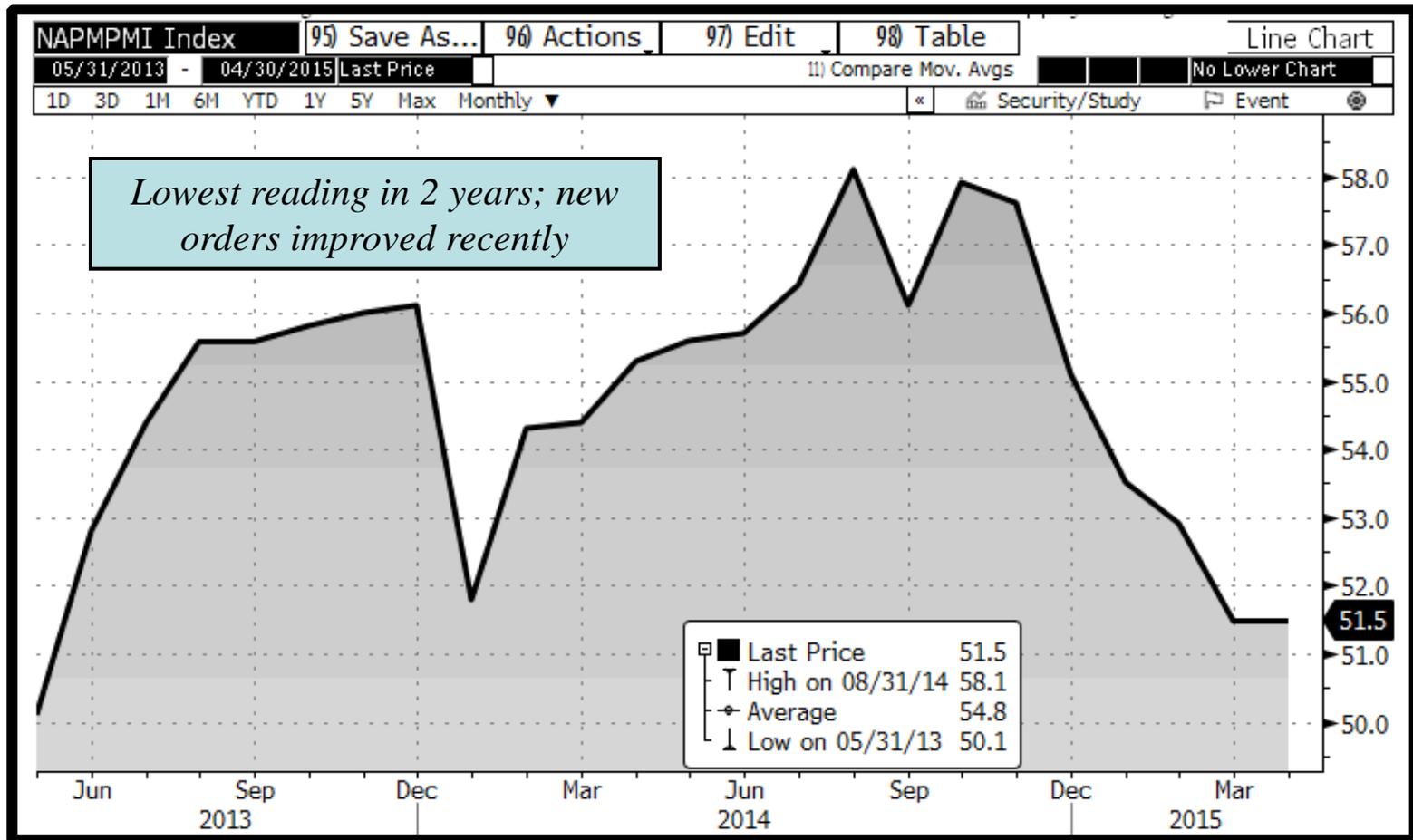
Unemployment Rate



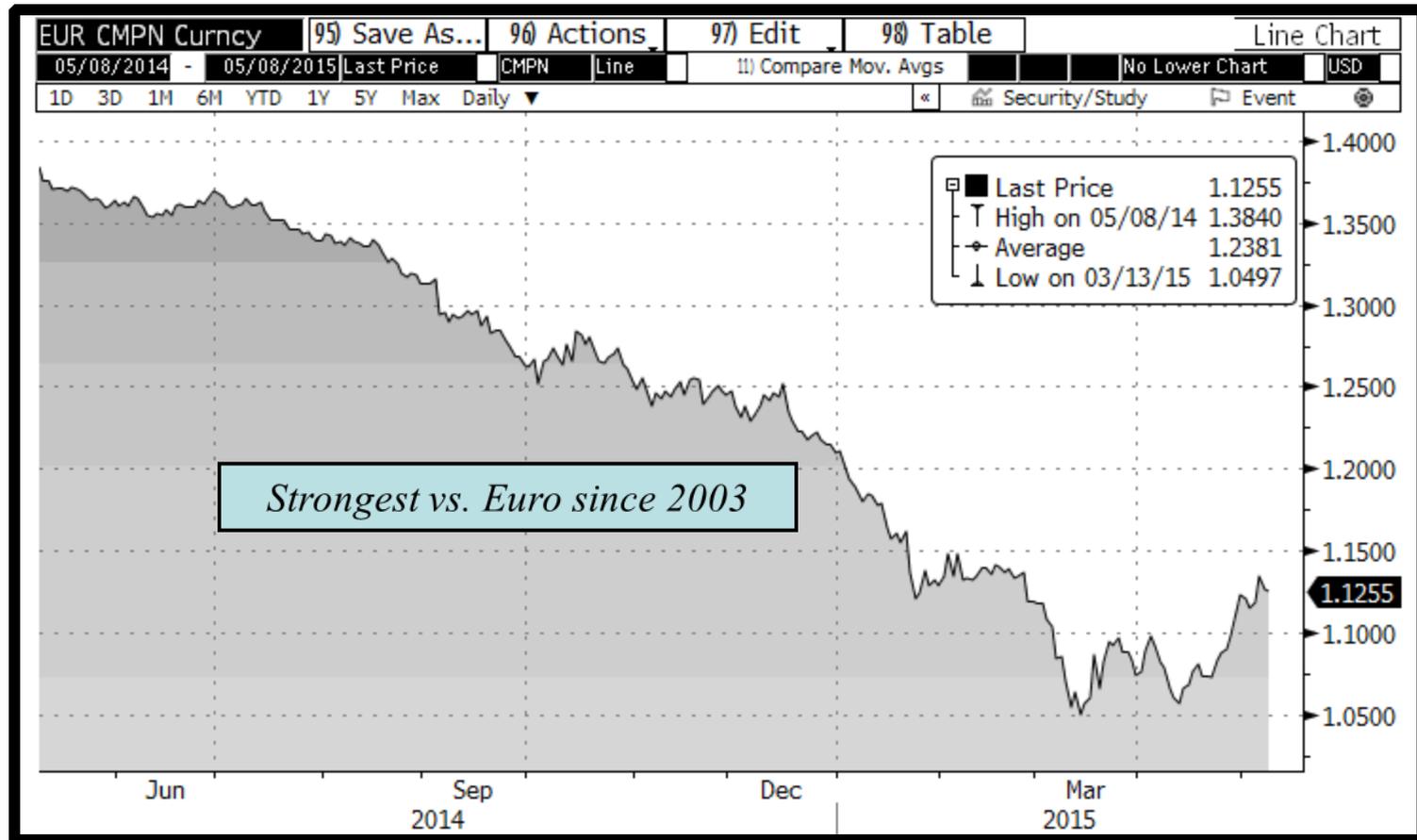
Oil



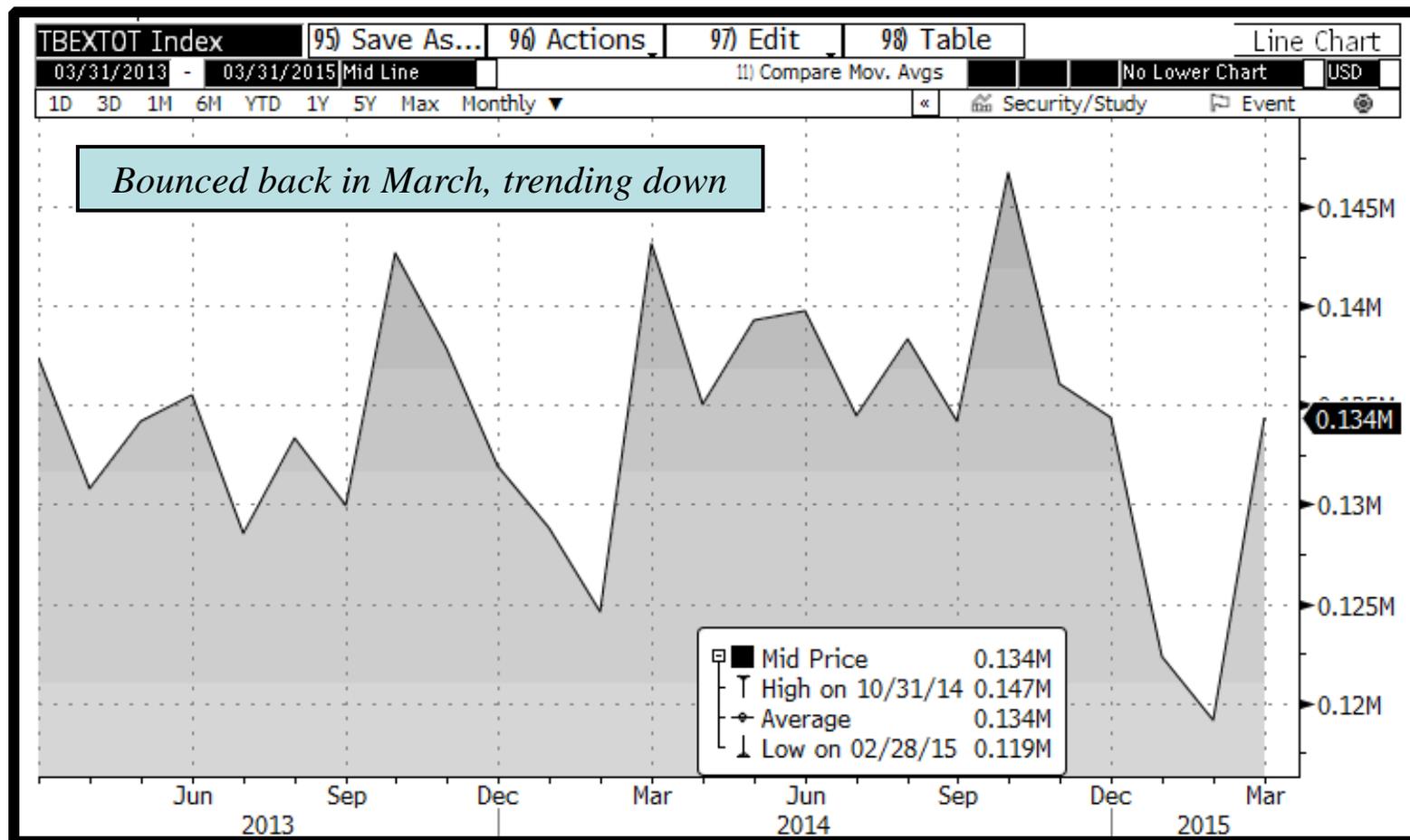
ISM Survey



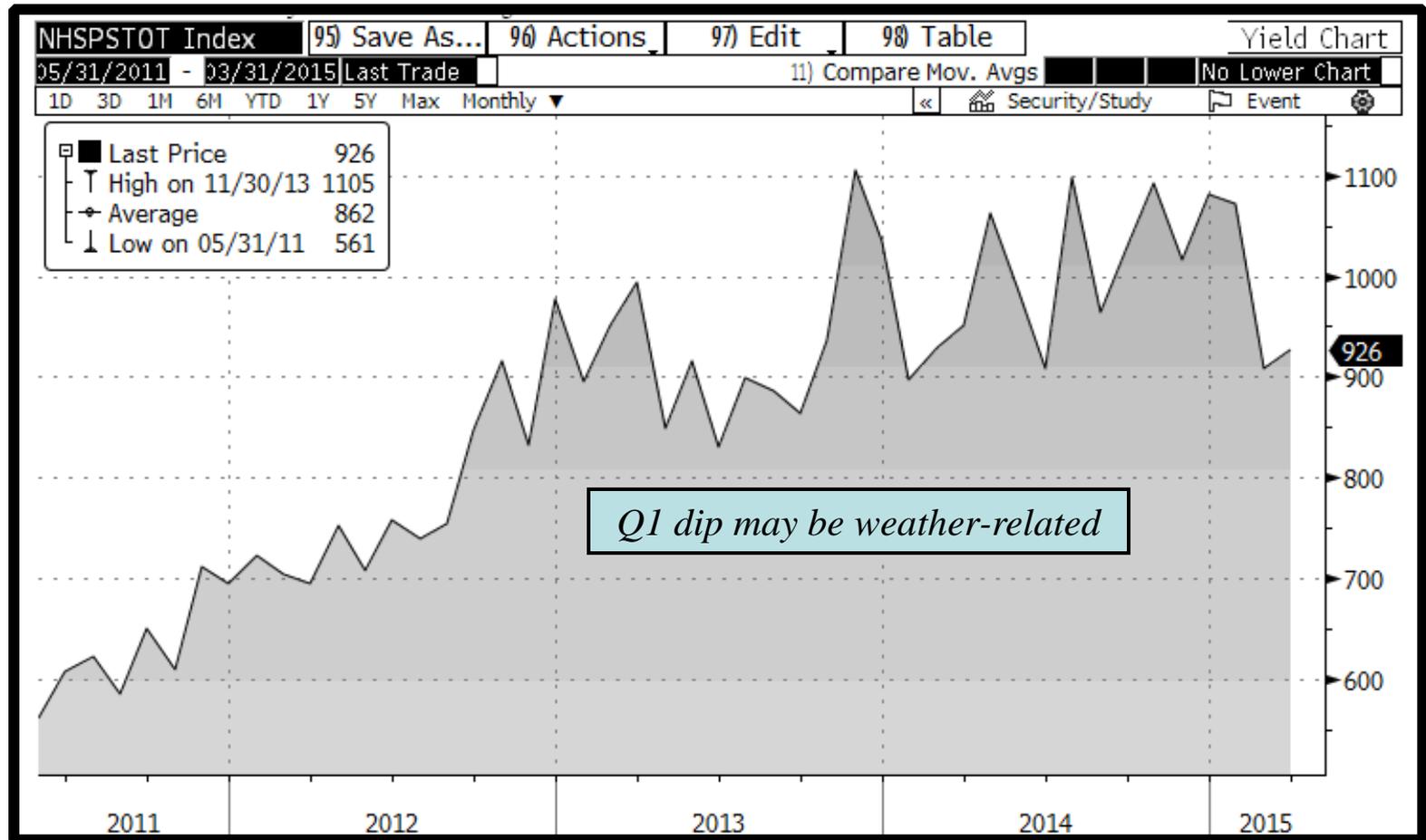
Dollar



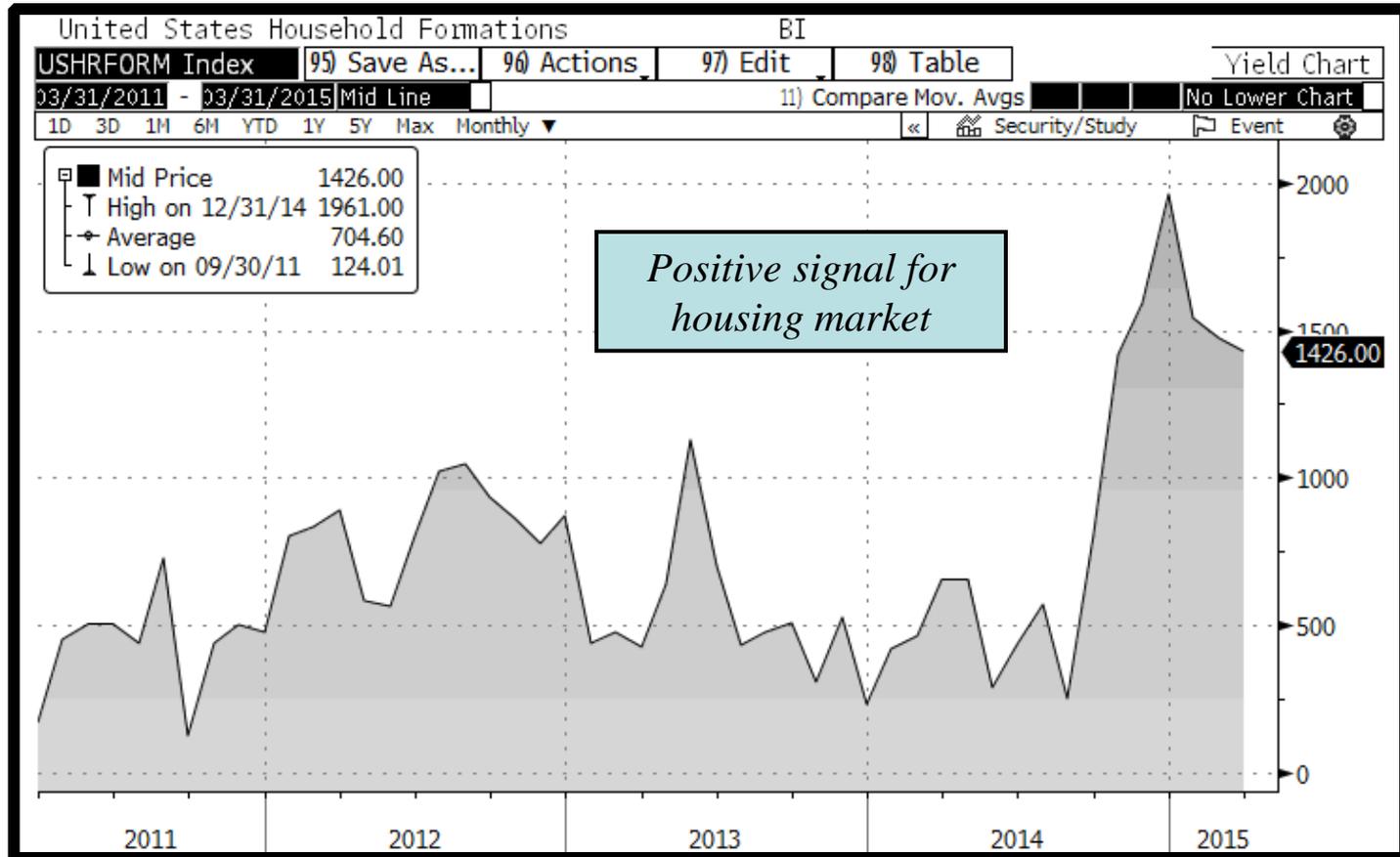
Exports



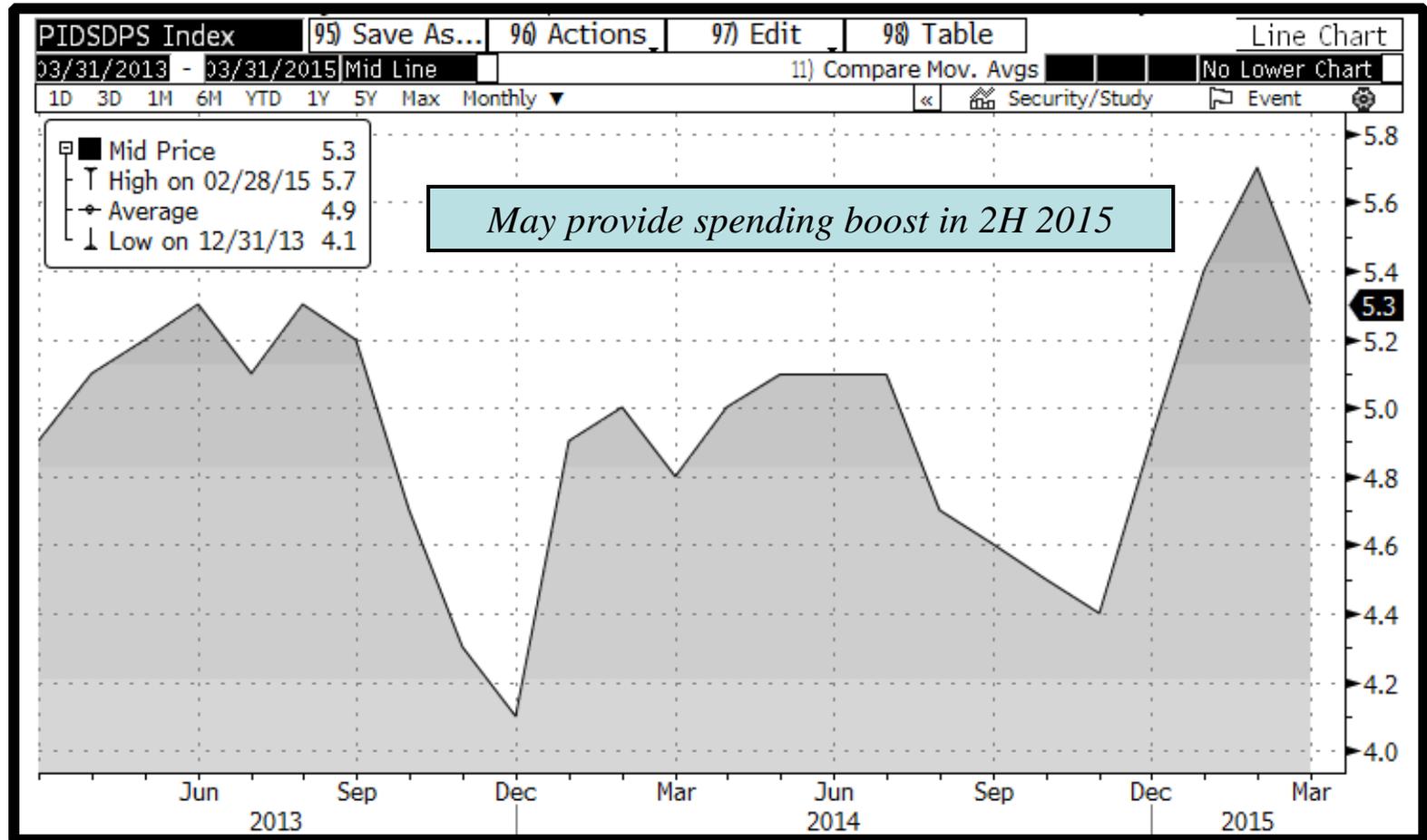
Housing Starts



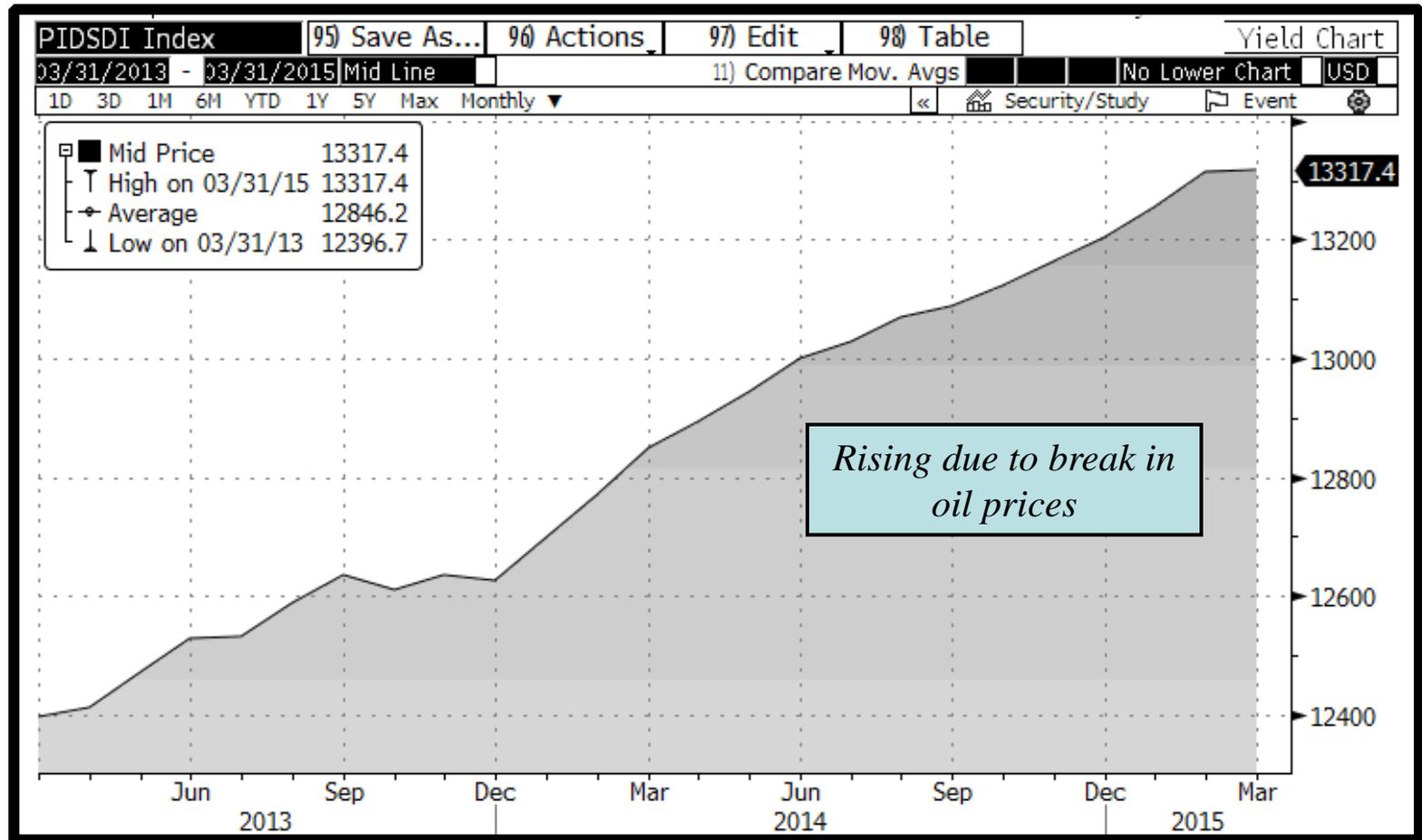
Household Formations



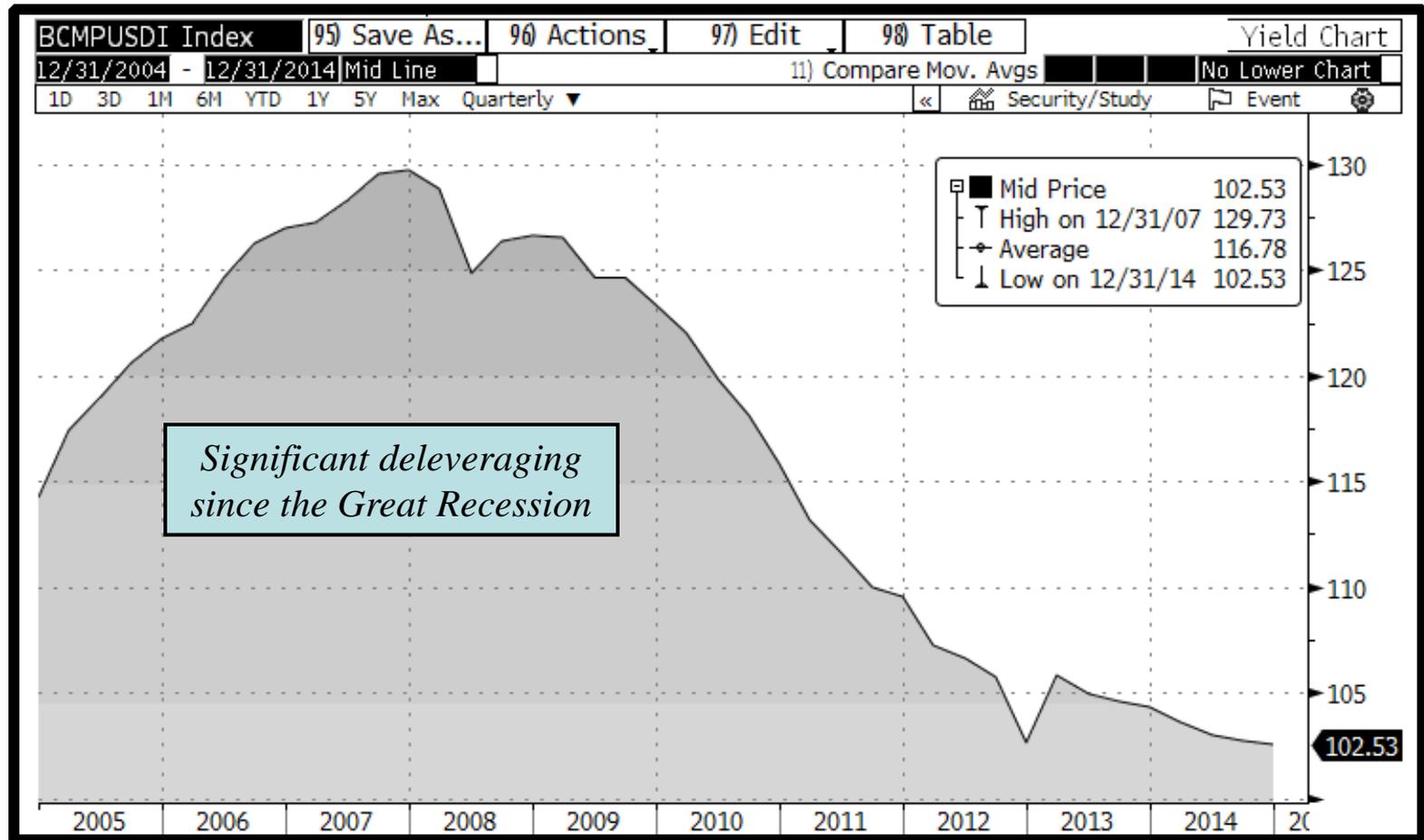
Consumer Saving



Disposable Income



Consumer Debt Ratio



Economic Forecast

		<u>Federal Reserve</u>	<u>Bloomberg Survey</u>
<i>GDP</i>	2015	2.3 to 2.7	2.8
	2016	2.3 to 2.7	2.8
	2017	2.0 to 2.4	2.7
<i>Unemployment</i>	2015	5.0 to 5.2	5.4
	2016	4.9 to 5.1	5.0
	2017	4.8 to 5.1	4.9
<i>Inflation</i> <i>(Core PCE)</i>	2015	1.3 to 1.4	0.2
	2016	1.5 to 1.9	2.2
	2017	1.8 to 2.0	2.2

Federal Reserve Policy

April 2015 Policy Statement

- Growth slowed during winter months, partly reflecting transitory factors
- Business fixed investment softened, the recovery in the housing sector remained slow, and exports declined
- Households' real incomes rose strongly
- Committee continues to expect:
 - Labor market indicators will continue to improve
 - Inflation will rise gradually toward 2%
 - It will be appropriate to raise rates with further improvement in the labor market and with confidence that inflation will move back to 2%

Federal Reserve Policy

April 2015 Policy Statement

- The Committee is maintaining its existing policy of reinvesting principal and of rolling over maturing Treasury securities at auction. This policy should help maintain accommodative financial conditions. [This will place a cap on longer-term interest rates]
- Even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run. [Rates will stay lower for longer]

Federal Reserve Policy

Chair Yellen Speech – March 2015

- “I am cautiously optimistic that labor market conditions are likely to improve further in coming months.”
- “Consumer spending is likely to expand at a good clip this year.”
- “GDP is likely to expand somewhat faster than its potential in coming quarters.”
- “I would not consider it prudent to postpone the onset of normalization until we have reached, or are on the verge of reaching, our inflation objective.”
- “I expect that conditions may warrant an increase in the federal funds rate target sometime this year.”

Federal Reserve Policy

SF President Williams Interview – April 2015

- “I do believe that we should be initiating rate increases later this year.”
- “I think the more important part of this story is not the date of the liftoff but what is the pace of tightening expected to be.”
- “I expect us to be back at full employment late this year or early next year.”
- “My view is based on the evidence that when you push the unemployment rate down, you push the economy to the point where the labor market is stronger than normal, that’s going to create wage pressures in the labor market and be one of the factors that pushes inflation back to 2 percent.”

Fed Funds Forecast

TARGET FED FUNDS RATE

<u>End of Year</u>	<u>Federal Reserve</u>	<u>Futures Markets</u>
2015	0.625	0.500
2016	1.875	1.000
2017	3.125	1.750
Long-Run	3.750	2.250

The above represent median forecasts

Fed Funds Forecast

- First rate hike in Q4 2015
- Rate increases are gradual- 100 basis points per year
- Terminal rate of fed funds – 2.00% to 2.50%

Interest Rate Outlook

➤ Yield curve continues to flatten

- *2-Year to 5-Year Spread*

- ❑ *Current - 0.81%*
- ❑ *One Year - 0.49%*
- ❑ *Two Years – 0.37%*
- ❑ *Three Years – 0.22%*

➤ Rate increases are gradual and more pronounced at shorter part of yield curve

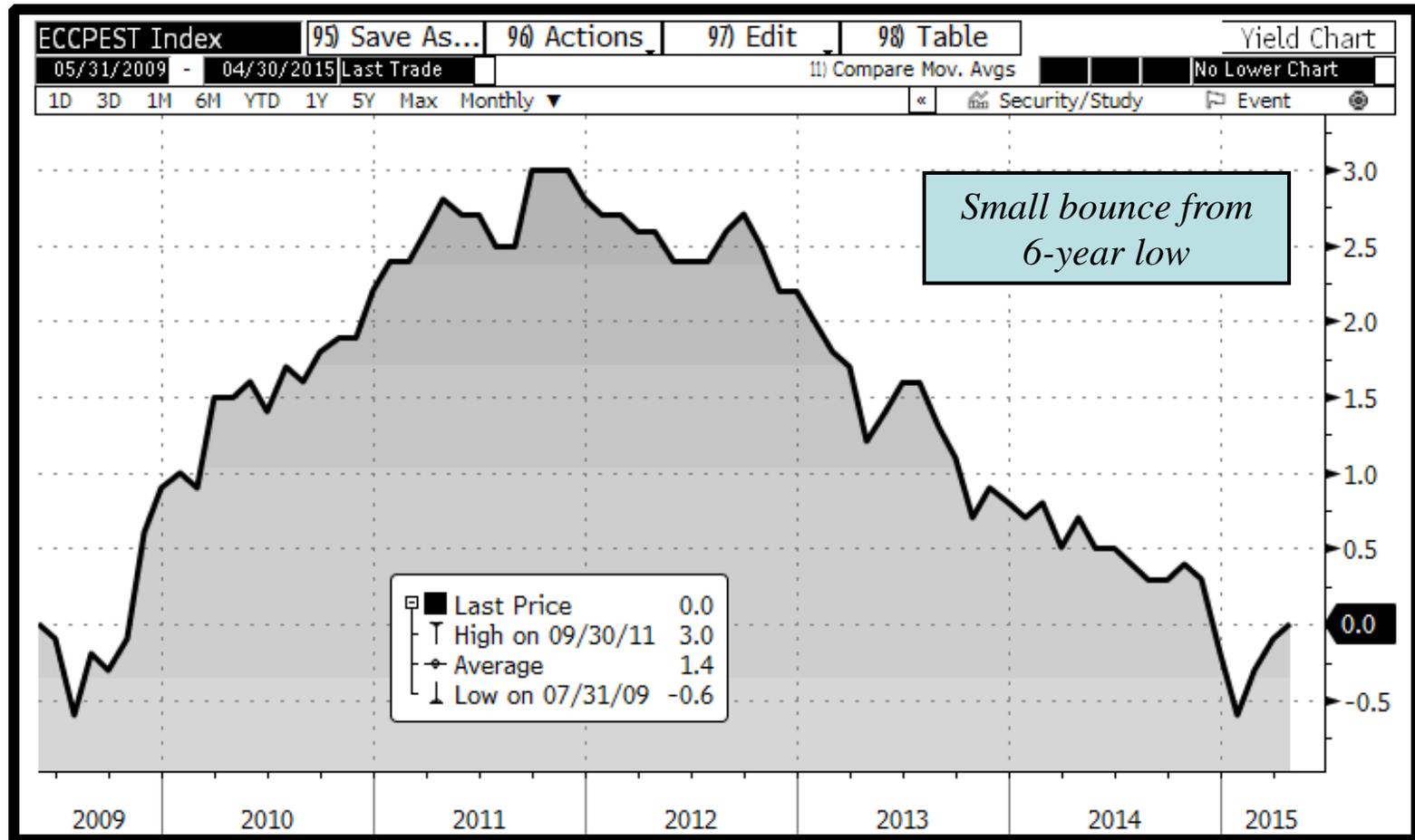
Above spreads reflect swap curve indications

Interest Rate Outlook

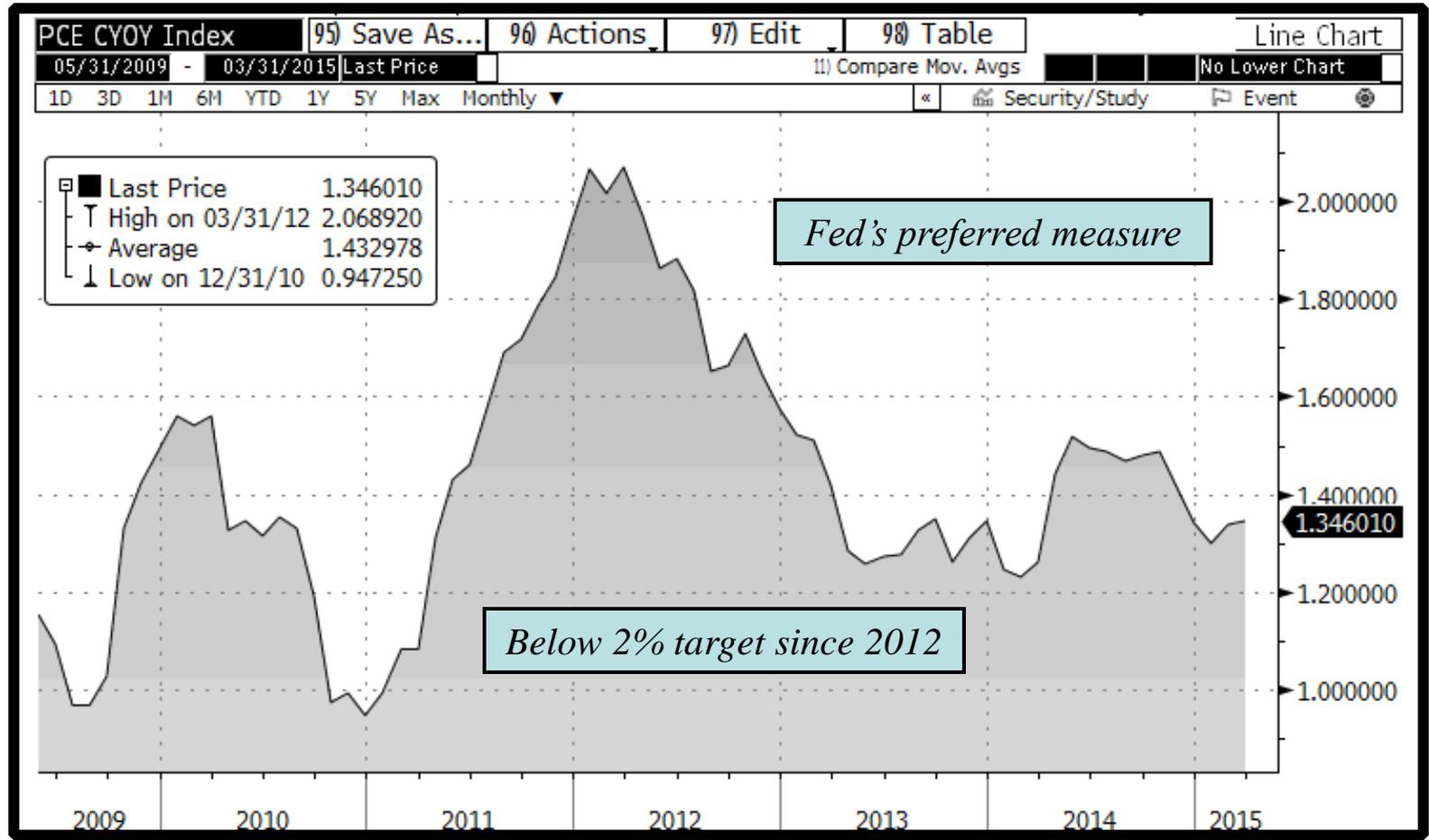
Factors Impacting Long-Term Treasury Yields

- Fed Policy
- Economic Outlook
- Geopolitical Risks
- Global Bond Yields
- *Eurozone Inflation*

Eurozone Inflation



U.S. Inflation



German 10-Year Yields



U.S. 10-Year Yields



Interest Rate Outlook

Interest Rate Forecast

	<u>May</u> <u>2015</u>	<u>May</u> <u>2016</u>	<u>May</u> <u>2017</u>	<u>May</u> <u>2018</u>
<i>Fed Funds</i>	0.25	0.75	1.50	2.00
<i>5-Year Treasury</i>	1.50	1.99	2.41	2.59
<i>10-Year Treasury</i>	2.15	2.37	2.53	2.64

The above is based on current market activity

Investment Implications

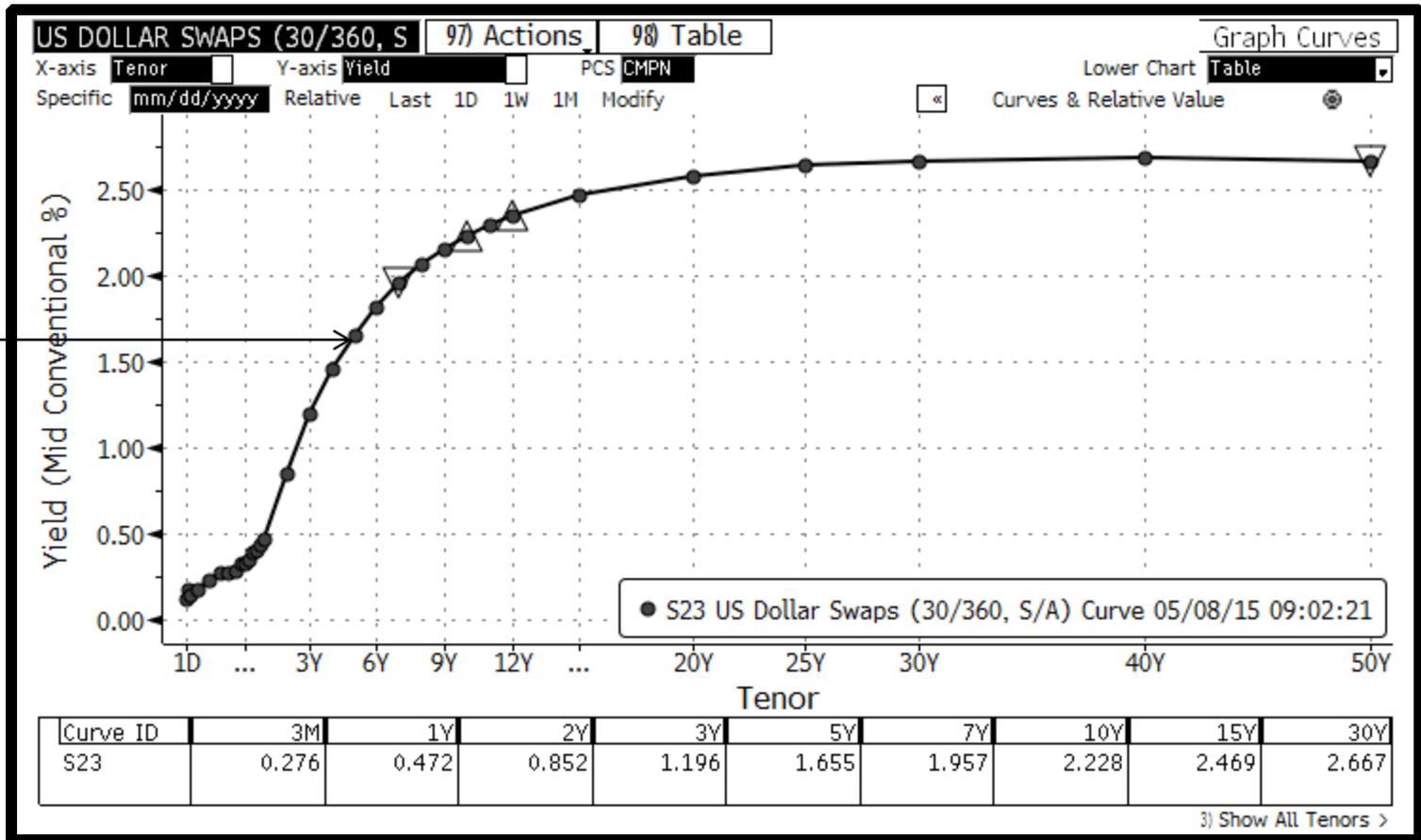
Outlook

- Short-term rates to remain low for 18-24 months
- Yield curve flattens by 15 to 30 basis points (2-to 5-year term) per year for up to 36 months

Strategy

- Barbell
 - *4- to 6-year average life for short-end*
 - *12- to 15-year average life for long-end*
- Favor stable and consistent cash flow
- Caution regarding extension risk

Investment Environment



Steepest Point

Fixed-Income Sectors

- Seasoned 15-Year MBS
- 5-Year Municipal Bonds
- 15-Year Municipal Bonds

15-Year MBS

Pool	FN AL5450	5) Generic	FNCI 2.5 2013	Information as of Apr '15									
Type	(CI)	Conventional Conv Level pay		Issue Date				06/01/14					
Traits	30/360, Mega			Maturity Date				03/01/29					
6) Originator Mega Pool													
7) Pool Information (PDI)										Balance			
Coupon	2.500	WAC	2.942	Orig WAC	2.942	Factor		0.90207153					
		WARM	149	Orig WAM	159	Orig Amt		34,013,082					
		WALA	26			Curr Amt		30,682,233					
8) Collateral Information (CLC)										Prepay		CPR	PSA
WAOLTV	64	AOLS	218,521			1 Month		6.5	124				
WAOLTV-HPI	59	WAOLS *	262,500	Curr TPO	31.29	3 Month		5.7	114				
		MAXLS	721,000			6 Month		5.3	112				
WAOCS	99.9%	763	WAOLT	178		1 Year		n.a.	n.a.				
						Life		5.8	134				
# Loans	13,751	Delay	54	(24)		11) States (GEO)		%UPB					
						NY		16.4					
						CA		15.2					
TRACE Eligible						PA		6.7					
						* Calculated Values							
10) Prepayment	Apr'15	Mar	Feb	Jan	Dec'14	Nov	Oct	Sep	Aug	Jul	Jun	May	
1 Month CPR	6.5	4.7	6.0	5.1	3.4	6.0	5.4	8.0	7.1	5.7			

15-Year MBS

		<GO> 3138ENBU2		MBS:FNCI		LOANS: 13,751		Vectors 99 <Go>							
<GO> 65 FNCI 2.5 N		2.942(149)26		WAC(WAM)WALA APR15											
APR 1mo	124P 6.50	6/ 1/14: 34,013,082		next pay 6/25/15 (monthly)		NY	CA	PA	OTHR						
15 3mo	114 5.7	4/ 1/15: 30,682,233		rcd date 5/31/15 (24 Delay)		16.4	15.2	6.7	61.7						
6mo	112 5.3	factor 0.902071530000		accrual 5/ 1/15- 5/31/15		2011	2012	2013	2014						
12mo	-					0.0	59.3	36.7	4.0						
Life	134 5.8														
5/18/15 YIELD TABLE															
B. Median:		0bp ¹⁷⁵		+300bp ¹⁰¹		+200bp ¹¹²		+100bp ¹³⁴		-100bp ⁴⁵⁵		-200bp ⁷⁶⁷		-300bp ¹⁰⁵⁷	
Uary PRICE	1/32	175	PSA	101	PSA	112	PSA	134	PSA	455	PSA	767	PSA	1057	PSA
102-14		1.872	1.966	1.953	1.925	1.427	.755	-.103							
AvgLife	4.36	5.16	5.03	4.79	2.50	1.51	1.00								
Mod Dur	4.05	4.74	4.63	4.41	2.40	1.49	1.00								
DATEWindow	6/15- 9/25/27	6/15- 9/25/27	6/15- 9/25/27	6/15- 9/25/27	6/15- 9/25/27	6/15- 9/25/27	6/15- 9/25/27	6/15- 9/25/27	6/15- 9/25/27						
Spread I	+51/AL	+39/AL	+41/AL	+44/AL	+62/AL	+32/AL	-33/AL								
APR15 MAR FEB JAN DEC14 NOV OCT SEP AUG JUL14		124 93 124 110 78 143 135 210 196 166p		6.5 4.7 6.0 5.1 3.4 6.0 5.4 8.0 7.1 5.7c		Treasury Curve - BGN 11:07 +									
6mo -1- -2- -3- -5- -7- -10- -30-		0.07 0.22 0.62 0.97 1.54 1.93 2.19 2.92													

15-Year MBS

CASH FLOW FORECAST

Issue			<i>Year 2- Base</i>		<i>Year 3- Base</i>		<i>Year 2- Up 200</i>		<i>Year 3- Up 200</i>	
	Avg Life	Yield	Avg Life	Balance (%)	Avg Life	Balance (%)	Avg Life	Balance (%)	Avg Life	Balance (%)
10-Year MBS	3.79	1.56%	2.85	71%	2.58	54%	3.41	79%	3.03	62%
15-Year MBS-Seasoned	4.36	1.87%	3.86	69%	3.59	57%	4.37	75%	4.02	64%
15-Year MBS-New	5.29	2.03%	4.32	80%	4.08	66%	5.21	83%	4.87	73%

Characteristics

- Stable and consistent cash flow
- Cash flows should continue to accelerate due to seasoning
- Reduced extension risk
- Lower price volatility

Municipal Bonds

Ticker KIN Cpn 1.750 Maturity 02/01/2020 Dated 05/11/2015 State NJ	
21) Municipal Bond	22) Series 23) Issuer Description
Pages	Municipal Bond Information
1) Bond Info	Issue Type GENERAL OBLIGATION UNLTD
2) Addtl Info	Ult Borrower Borough of Kinnelon NJ
3) Involved Parties	Maturity Type NON-CALLABLE
4) Adj Cpn Info	Ext Redemption NONE
5) Credit Enhance	Coupon 1.750 FIXED
6) Credit Ratings	Prc/Yld @ Iss 101.823/1.350
7) Call Sched & ERP	Coupon Freq SEMI-ANNUAL
8) Put Schedule	Tax Provision FED BQ/ST TAX-EXEMPT
9) Sink & Est Sink	
10) Refunding Info	
11) DES Notes	Credit Enhancement
Quick Links	Bond Ratings (Recent Changes)
31) TDH MSRB Trade	MOODY'S(Underlyi Aa1
32) CACS Material Evt	
33) CF Filings	
34) CN Sec News	
35) HDS Holders	
66) Send Bond	
	Trading Information
	WI (Firm Stl) 05/11/2015
	Next Settle Dt 05/11/2015
	Int Accrual Dt 05/11/2015
	1st Coupon Dt 02/01/2016
	Sale Date 04/29/2015
	Award 04/29/2015 11:15
	First Trade 04/29/2015 15:00

Municipal Bonds

Bank Qualified Calculator											PAGE 1 OF 2			
ISSUER: KINNELON NJ			SIZE: 9558		STATE: NJ		MD/S&P: NR/NR							
COF: 0.50%		FED TAX: 34.00%		STATE TAX: 0.00%		TEFRA: 3.40 bps								
YIELD CURVE # 345			Bank Qualified AAA			CURVE DT 5/ 6/15		SHIFT: 0						
FMC Curve:			1yr	2yr	3yr	4yr	5yr	7yr	10yr	15yr	20yr	30yr		
			0.34	0.43	0.58	0.83	1.17	1.62	2.57	3.55	3.83	4.98		
SCALE N											TRUE BQ TAXABLE		TAXABLE EQUIVALENT SPREADS	
MATURITY	PAR/SIZE	COUPON	YIELD	INTERPOLATED TSY YLD.	PERCENT TSY YLD	EQUIVALENT YLDS	WITH TEFRA	STATE + TEFRA	WITHOUT TEFRA	FMC WITH TEFRA				
2/ 1/16	440	1.000		0.194										
2/ 1/17	445	1.250		0.527										
2/ 1/18	475	1.500		0.898										
2/ 1/19	475	1.500		1.203										
2/ 1/20	500	1.750	1.400	1.488	94.10	2.070	58.2	58.2	63.3	10.2				
2/ 1/21	500	2.000		1.706										
2/ 1/22	525	2.000		1.902										
2/ 1/23	555	2.000		2.015										
2/ 1/24	580	2.000		2.100										
2/ 1/25	580	2.000		2.186										
2/ 1/26	605	2.250		2.235										
2/ 1/27	605	2.500		2.272										
2/ 1/28	630	2.750		2.308										

Municipal Bonds

9) SEE DES NOTES Ticker CANSCD Cpn 3.250 Maturity 07/15/2029 Dated 04/28/2015 State NY
2) Municipal Bond 2) Series 2) Issuer Description

Pages	Municipal Bond Information	Trading Information
1) Bond Info	Issue Type GENERAL OBLIGATION UNLTD	1st Settle Dt 04/28/2015
2) Addtl Info	Ult Borrower Canandaigua City School Dist	Next Settle Dt 05/08/2015
3) Involved Parties	Maturity Type CALL	Int Accrual Dt 04/28/2015
4) Adj Cpn Info	Ext Redemption NONE	1st Coupon Dt 07/15/2015
5) Credit Enhance	Coupon 3.250 FIXED	Next Par Call 07/15/2025@Par
6) Credit Ratings	Prc/Yld @ Iss 103.520/2.850	Week of Sale 04/06/2015
7) Call Sched & ERP	Coupon Freq SEMI-ANNUAL	Award 04/07/2015 17:03
8) Put Schedule	Tax Provision FED BQ/ST TAX-EXEMPT	First Trade 04/08/2015 13:00
9) Sink & Est Sink		
10) Refunding Info	Credit Enhancement	
11) DES Notes	Insurance/Program - MAC ST AID WITHHLDG	
	Bond Ratings (Recent Changes)	
Quick Links	MOODY'S(Underly) Aa3	
31) TDH MSRB Trade	S&P'S  AA STA	
32) CACS Material Evt	KBRA(Insured) AA+ Stab	
33) CF Filings		
34) CN Sec News		
35) HDS Holders		

Municipal Bonds

Bank Qualified Calculator											PAGE 2 OF 2			
ISSUER: CANADAIGUA SD-RE			SIZE: 8250		STATE: NY		MD/S&P: NR/AA							
COF: 0.50%		FED TAX: 34.00%		STATE TAX: 0.00%		TEFRA: 3.40 bps								
YIELD CURVE # 345		Bank Qualified AAA					CURVE DT 5/ 5/15		SHIFT: 0					
		1yr	2yr	3yr	4yr	5yr	7yr	10yr	15yr	20yr	30yr			
FMC Curve:		0.34	0.43	0.58	0.83	1.17	1.62	2.57	3.55	3.83	4.98			
SCALE N											TRUE BQ TAXABLE		TAXABLE EQUIVALENT SPREADS	
MATURITY	PAR/SIZE	COUPON	YIELD	INTERPOLATED TSY YLD.	PERCENT TSY YLD	EQUIVALENT YLDS	WITH TEFRA	STATE + TEFRA	WITHOUT TEFRA	FMC WITH TEFRA				
7/15/28	400	3.250		2.294										
7/15/29	410	3.250	2.946	2.330	126.42	4.412	208.2	208.2	213.3	276.1				
7/15/30	425	3.250		2.367										
7/15/31	435	3.250		2.404										
7/15/32	450	3.250		2.440										
7/15/33	470	3.250		2.477										
7/15/34	480	3.250		2.513										
7/15/35	500	3.250		2.550										
7/15/36	510	3.250		2.587										

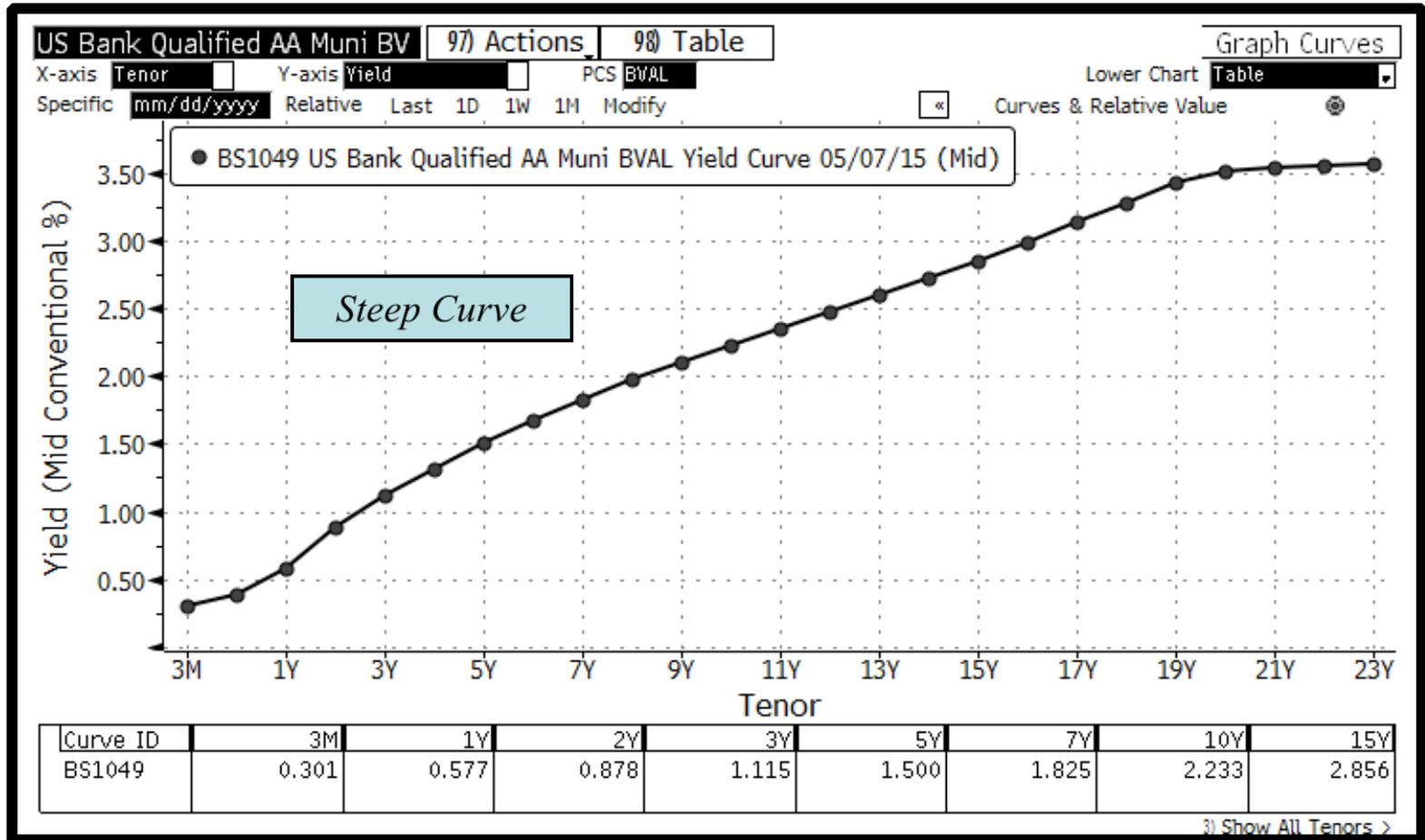
Municipal Bond Holders

	<u>Individuals</u>	<u>Mutual Funds</u>	<u>Banking Institutions</u>	<u>Insurance Companies</u>	<u>Other</u>	<u>Total</u>
2009	1,827.9	1,005.9	263.2	442.5	132.9	3,672.5
2010	1,871.4	1,001.4	297.2	460.7	141.4	3,772.1
2011	1,806.0	989.6	334.8	452.8	136.2	3,719.4
2012	1,662.4	1,062.2	398.5	459.6	131.8	3,714.4
2013	1,618.4	1,018.0	445.6	467.4	121.7	3,671.2
2014	1,540.4	1,039.5	476.9	475.7	120.0	3,652.4

Holdings are stated in billions

Source: Federal Reserve System

Municipal Yield Curve



Characteristics

- Improved yield
- Call protection
- Potential to roll down the yield curve
 - ✓ *Price appreciation for stable or declining rates*
 - ✓ *Price protection in a rising rate environment*
- Lower price volatility

Considerations

- Income requirements
- Liquidity needs
- Marketability
- Pledging capabilities
- Risk tolerance
- Tax situation

Risk Management

- Pre-purchase Analysis
- Ongoing Monitoring
- Reporting

Pre-Purchase Analysis

- Highlight risk and return characteristics
- Average life
- Price volatility
- Cash flow forecast
- Credit write-up and documentation
- Describe investment objective

Ongoing Monitoring

- Market value
- Credit surveillance
- Corporate actions

Reporting

- Credit spread tracking
- Impairment tracking
- MBS pre-payments
 - Pre-payment risk
 - Extension risk
- Watch list reporting

Profile

Bob Segal is founder and chief executive officer with Atlantic Capital Strategies, Inc. Bob has been in the banking industry since 1982, having worked in several community banks with roles in mortgage banking, sales and trading, and asset liability management. He is a frequent contributor to many regional and national finance publications, writing on the capital markets, technology and risk management.

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