



TRENDWATCH 4Q21



February 16, 2022

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Today's Lineup

Market Update

Jason Haley, Chief Investment Officer, Investment Management Group, ALM First

4Q 2021 Credit Union Results

Jon Jeffreys, Chief Executive Officer, Callahan & Associates
William Hunt, Industry Analyst, Callahan & Associates

Banking on Values

Jack Lawson, Chief Executive Officer, Clearwater Federal Credit Union





Callahan Quarterly Trendwatch | February 16, 2022

ALM First Market Update

Speaker



Jason Haley
Chief Investment Officer

- **Rough Start for Financial Markets**

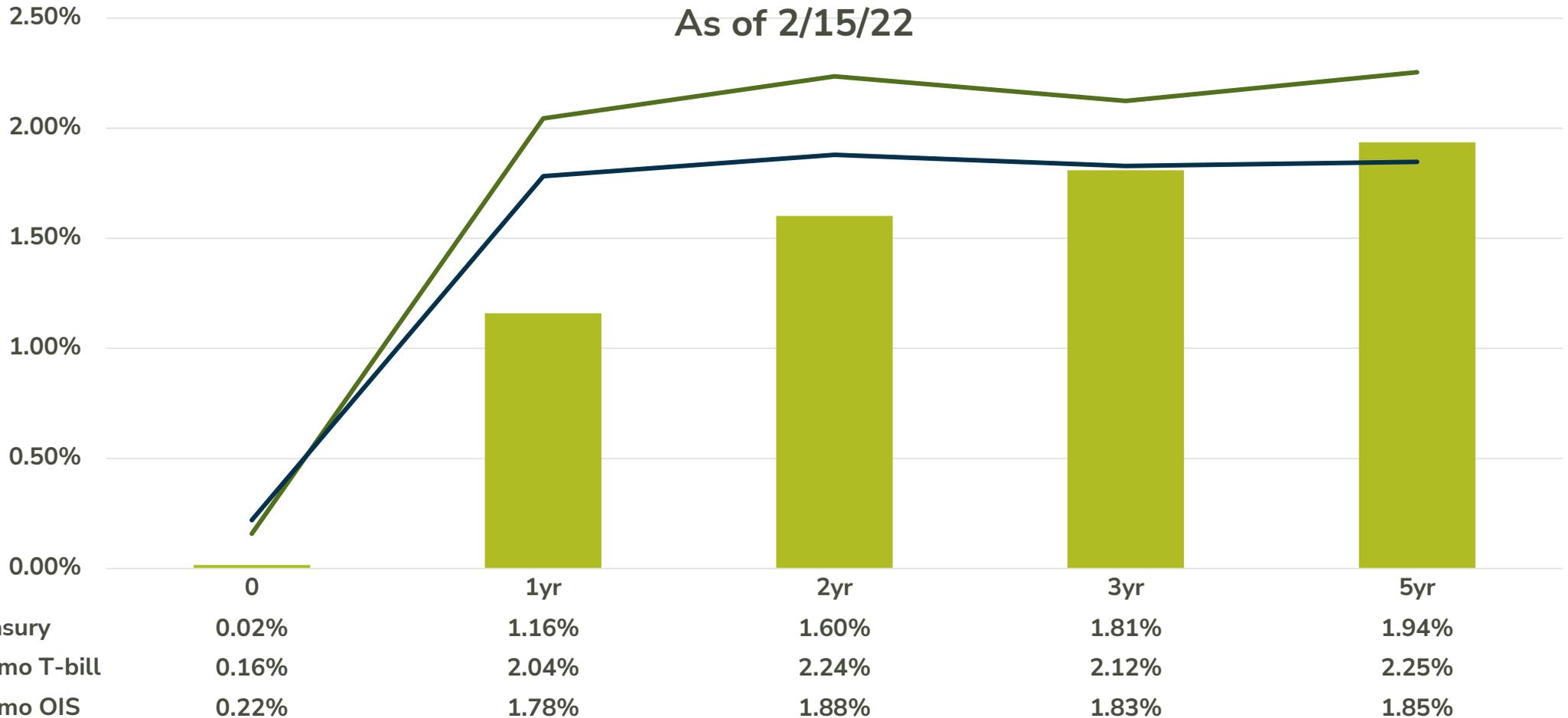
- Worries about an aggressive Fed response to inflation risks has fueled poor performance in both equities and bonds so far in 2022
- S&P 500 posted a -5.17% return in January, its worst month since March 2020 and worst January return since 2009
- Investment grade and high yield bonds have struggled amid higher rates, higher volatility, and wider spreads

- **What's been driving market volatility?**

- Uncertainty related to the Fed's intentions with regards to 1) the path of the fed funds rate, and 2) the timing/method of Fed balance sheet reduction
- Six to seven 25 bps rate hikes currently priced in for 2022 and another two 25 bps hikes in 2023
 - Short-term rate markets were priced for 3-4 rate hikes at the end of last year
- Minutes from December FOMC meeting said “almost all participants” favored initiating balance sheet runoff at some point after liftoff and that it would likely happen sooner “than the Committee's previous experience”
 - Following tapering of QE3 in 2014, the Fed didn't begin shrinking its balance sheet until late 2017, nearly 2 years after fed funds liftoff
 - Asset sales still haven't been ruled out

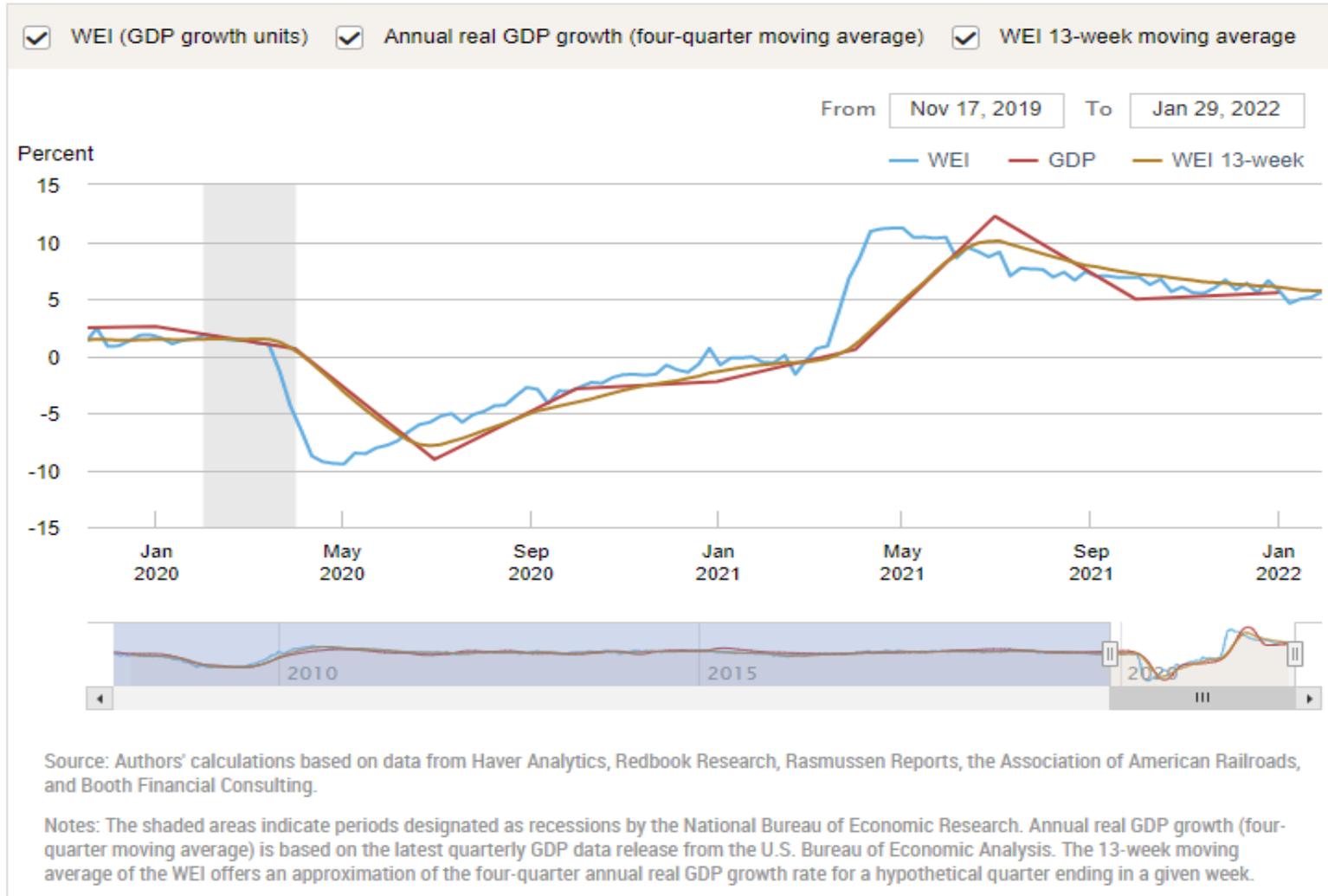
Repricing for Fed Rate Hikes

Front-End Treasury Yields: What's Currently Priced In?
As of 2/15/22



Fed's Weekly Economic Index (WEI)

Latest Release 11:30 a.m. EST February 3, 2022



Market Themes

- **Rates sharply higher since Q3 2021**

- 2-3yr yields up 130 bps over the last 4.5 months
 - 5yr note yield the highest since May 2019 when fed funds target range was 2.25%-2.50%
- 2yr/10yr spread 80 bps lower to 0.41%
 - Slope is 0 bps using 2yr forward curve
 - Fed funds terminal/neutral rate assumption a key input
- MOVE Index (implied rate volatility) now at the highest level since March 2020

- **Fixed income has struggled**

- Higher rates, higher volatility, and wider spreads are a poor recipe for bond returns
- ICE BofA U.S. Broad Market Index -3.78% return since Q3 2021
 - -0.65% return relative to duration-matched Treasuries over that same timeframe
- Spreads have widened across most sectors YTD on speculation related to the Fed's balance sheet reduction plans

Treasury Curve			
Tenor	2/14/2022 (%)	9/30/2021 (%)	Change (bps)
1-Month	0.00	0.04	-0.04
3-Month	0.37	0.03	0.34
6-Month	0.72	0.05	0.67
1-Year	1.04	0.07	0.98
2-Year	1.57	0.28	1.30
3-Year	1.80	0.51	1.29
5-Year	1.91	0.97	0.95
10-Year	1.99	1.49	0.50
20-Year	2.35	1.99	0.36
30-Year	2.29	2.05	0.24
Curves			
3mo-10yr	1.62	1.45	0.17
2yr-5yr	0.34	0.69	-0.35
2yr-10yr	0.41	1.21	-0.80
2yr-30yr	0.71	1.77	-1.06
5yr-10yr	0.08	0.52	-0.45

Source: Bloomberg

- **Higher rates → higher unrealized losses for core AFS bond portfolios**
 - Bond portfolios are liability-funded, and the source of funding is a critical aspect of portfolio construction decisions in an ALM framework
 - Unrealized losses do not mean you're losing money on your portfolio, just that the institution is earning a yield from a time when interest rates across the board were lower
 - Unrealized losses go away with time as a result of reinvesting cashflow from the portfolio at today's yields
- **Regarding inflation risks, maintain a sound ALM framework**
 - Past studies have been inconclusive on impact of rising inflation on depository institutions, but interest income and interest expense are both impacted by changes in anticipated rates of inflation
 - Stay disciplined with asset/liability pricing and cash reinvestment
- **Higher rates are a positive for forward looking profitability for depository institutions**
 - KBW Bank Index has outperformed S&P 500 by 14 points YTD through Monday

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Credit unions served members in 2021

The Industry...

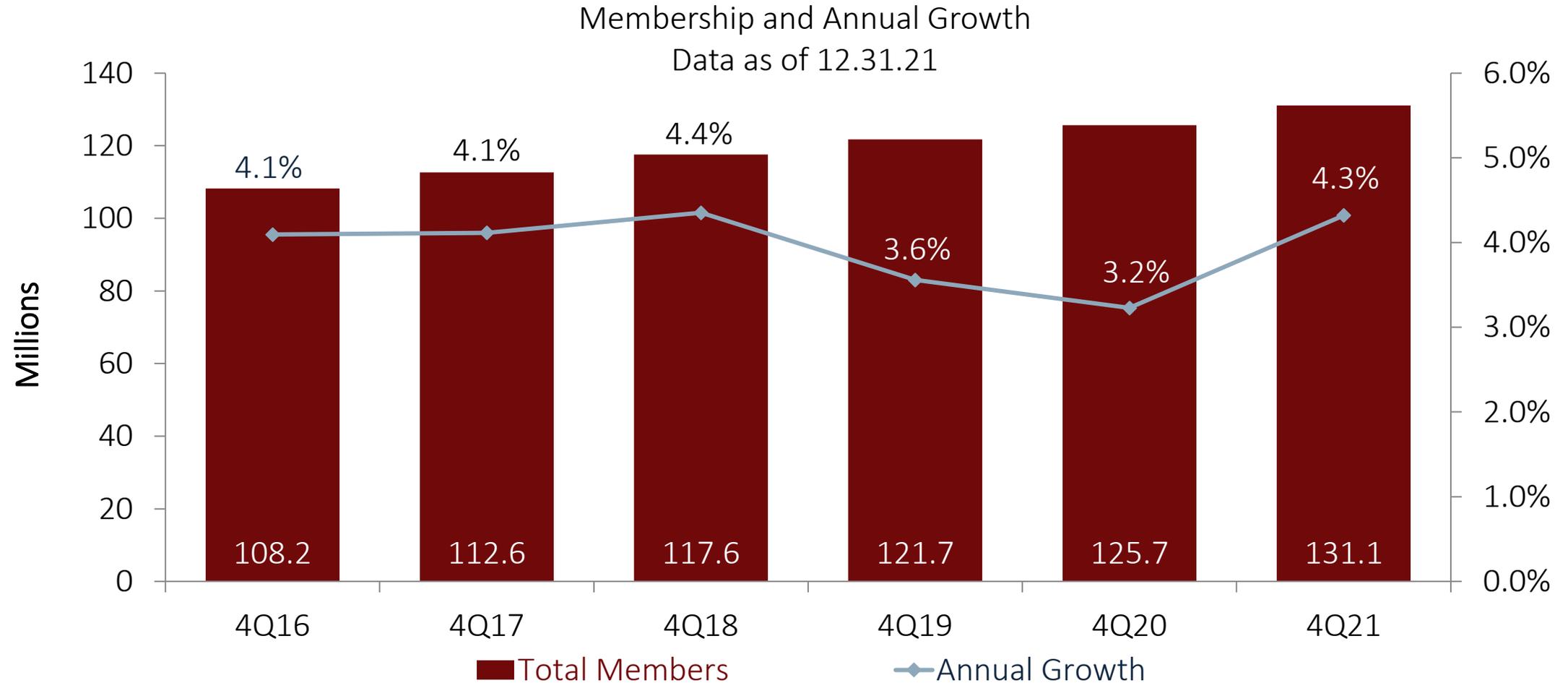
- Added over **5.4 million** new members
- Opened more than **4.5 million** share draft accounts
- Originated over **39.0 million loans**
 - Put or kept **1.2 million** Americans in their homes with first mortgages
 - Granted nearly **36.7 million** consumer loans



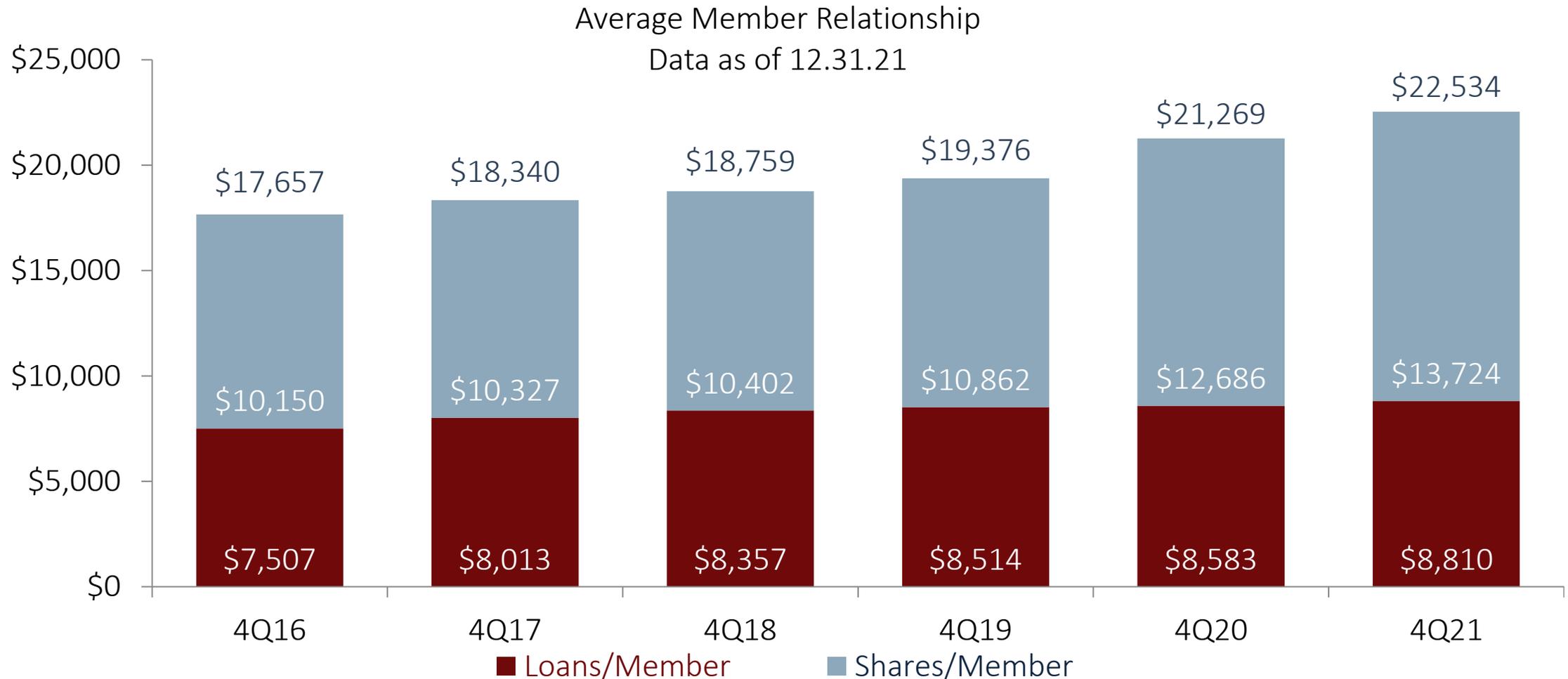
Loan and membership growth accelerates year-over-year

	12/31/2021	12-Mo. Growth	12/31/2020	12-Mo. Growth
Assets	\$2,085.0B	11.8%	\$1,865.4B	17.7%
Loans	\$1,268.9B	8.0%	\$1,175.0B	4.9%
Shares	\$1,810.3B	12.7%	\$1,605.9B	20.3%
Investments	\$722.3B	20.0%	\$601.8B	54.6%
Capital	\$220.2B	6.7%	\$206.6B	9.8%
Members	131.1M	4.3%	125.7M	3.2%

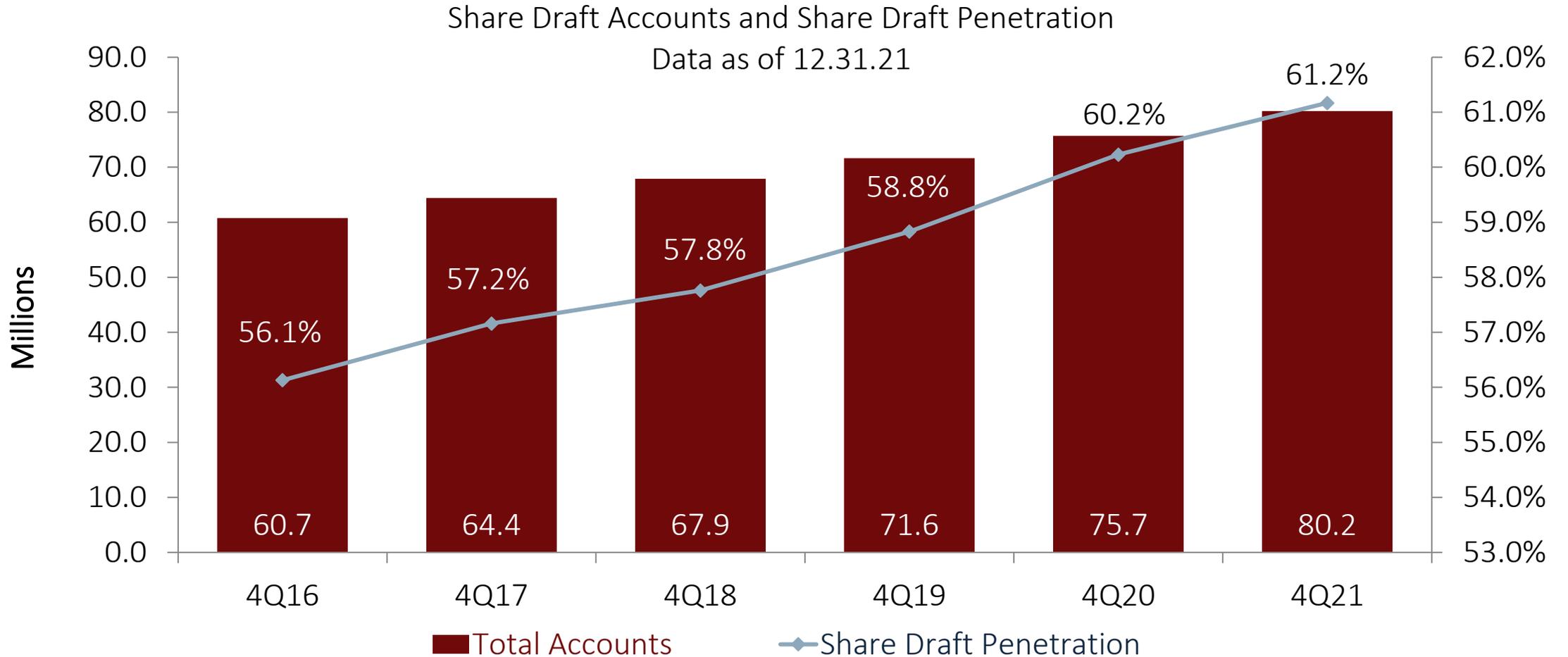
Consumers are turning to credit unions to serve their financial needs, adding over 5.4 million members in 2021



The average member relationship grows \$1,265 year-over-year driven by a surge in deposit relationships



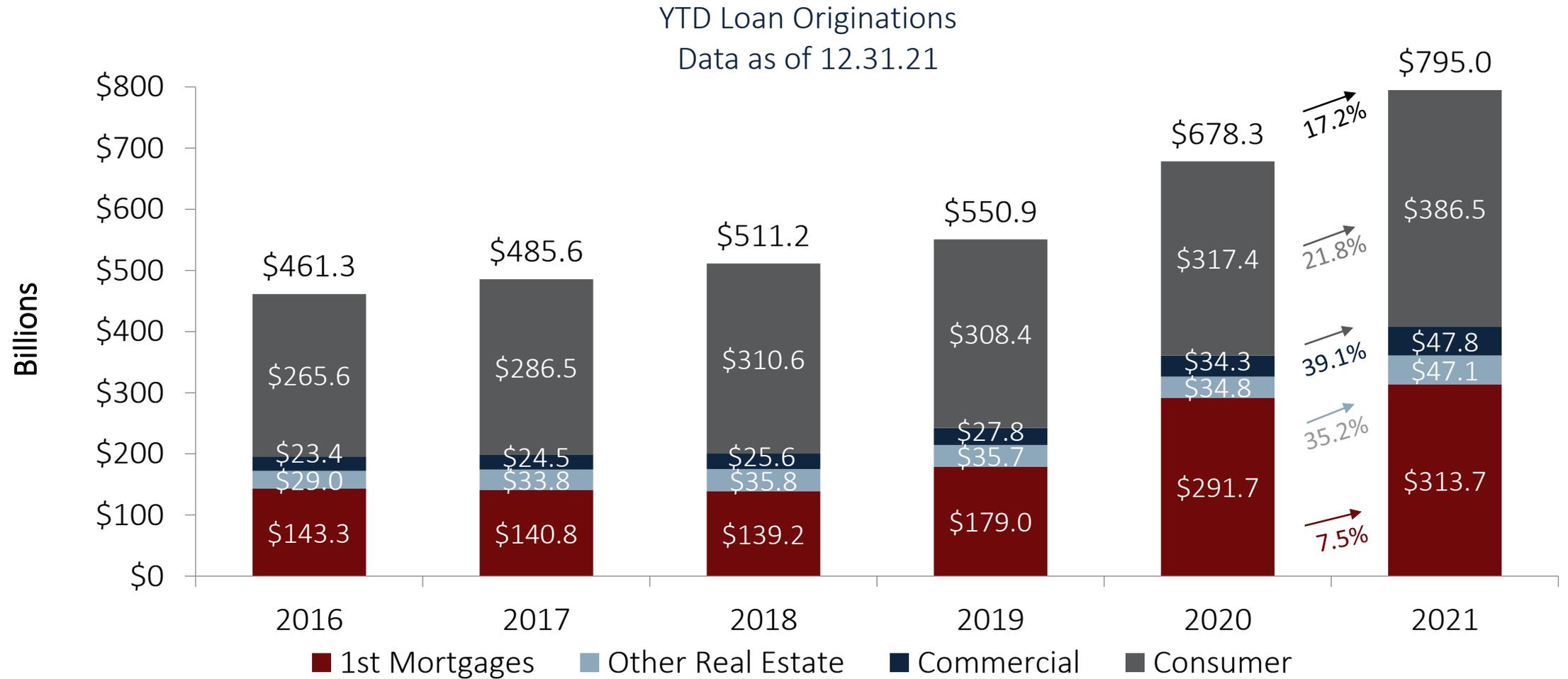
Total share draft accounts and penetration both hit record highs





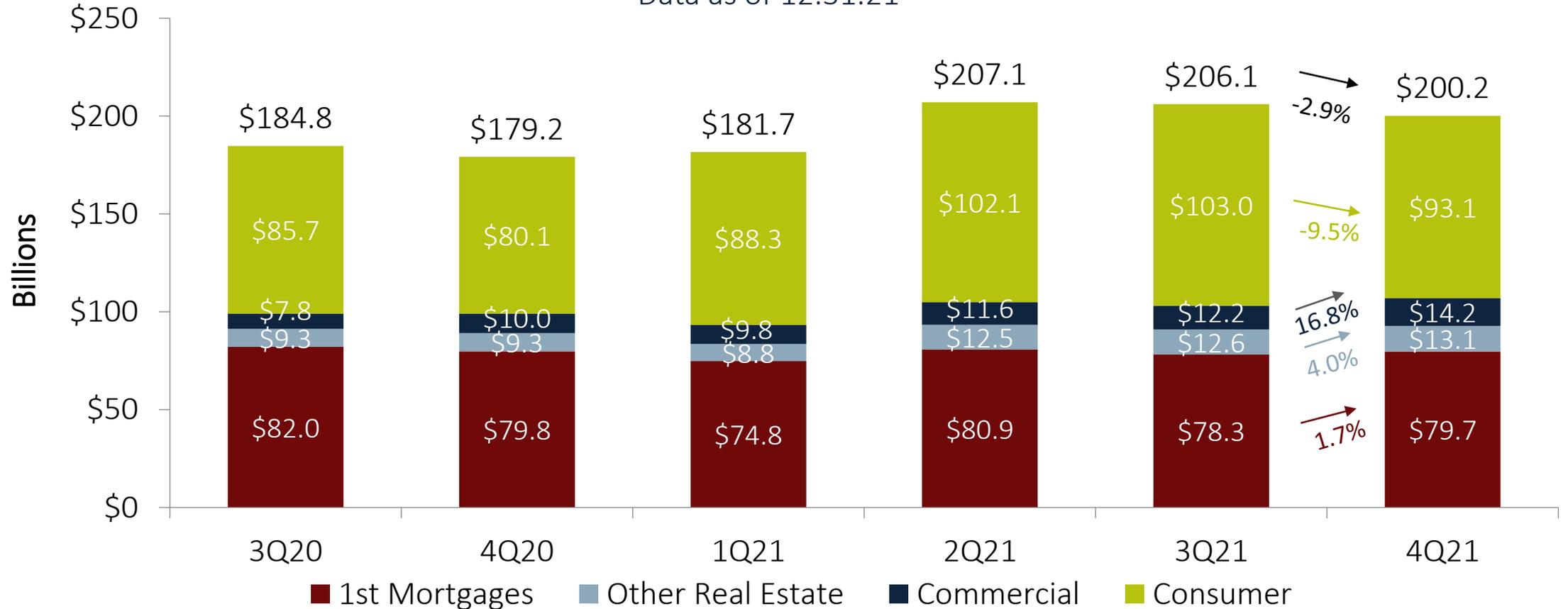
Lending

In another record year for credit union lending, consumer lending leads origination growth in 2021

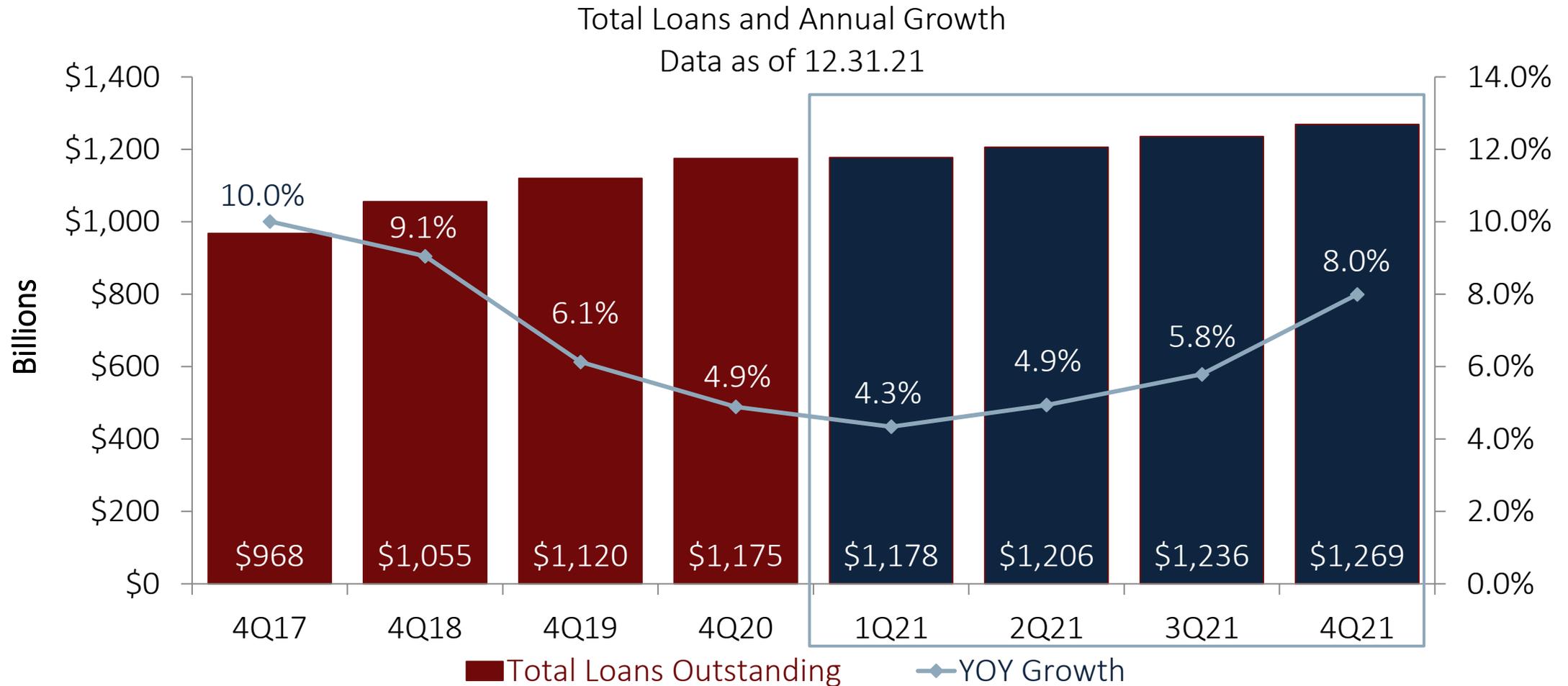


But consumer originations slowed in the fourth quarter

Quarterly Loan Originations Booked
Data as of 12.31.21



On the balance sheet, loan growth accelerates during the year as originations outpace early paydowns

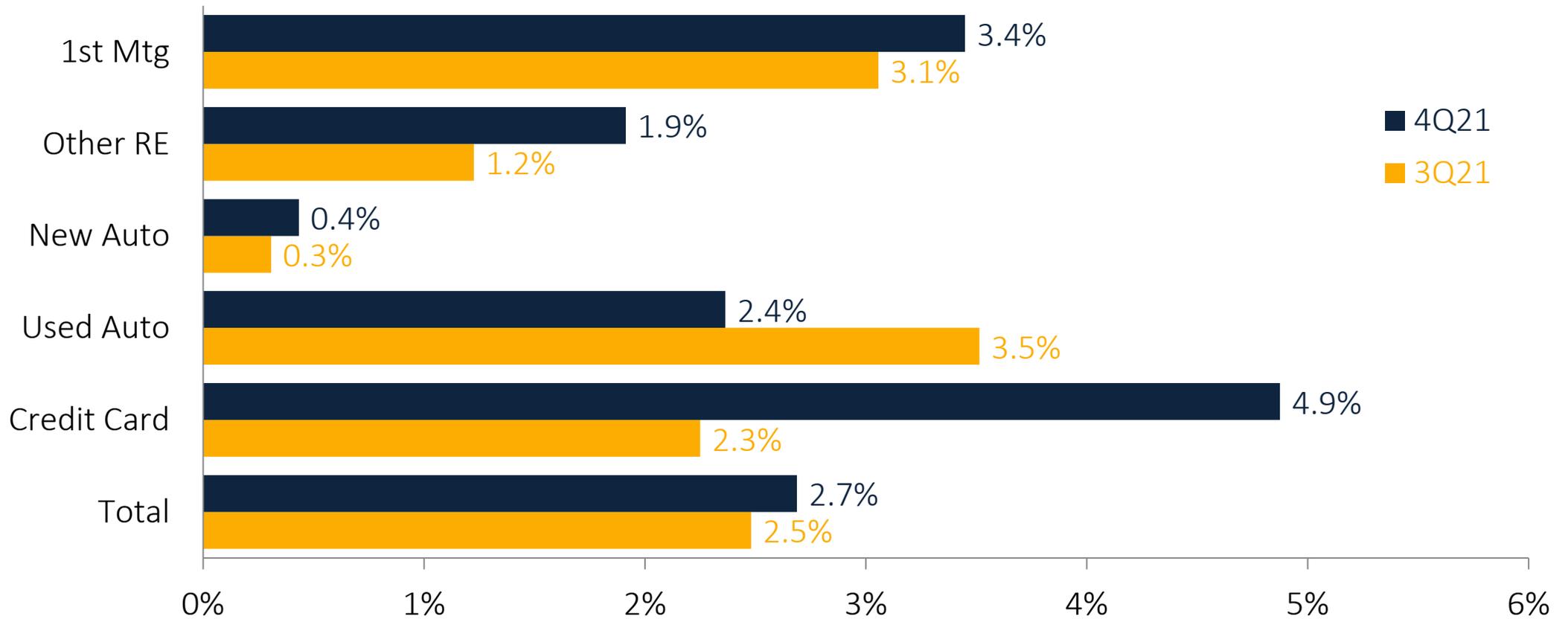


Loan portfolios are expanding at a faster rate in larger credit unions

	# of CUs	12-Mo. Loan Growth
All Credit Unions	5012	8.24%
CUs Over \$10B	19	8.65%
CUs \$1B-\$10B	390	8.64%
CUs \$500M-\$1B	288	8.23%
CUs \$100M-\$500M	1110	6.85%
CUs Under \$100M	3205	4.29%

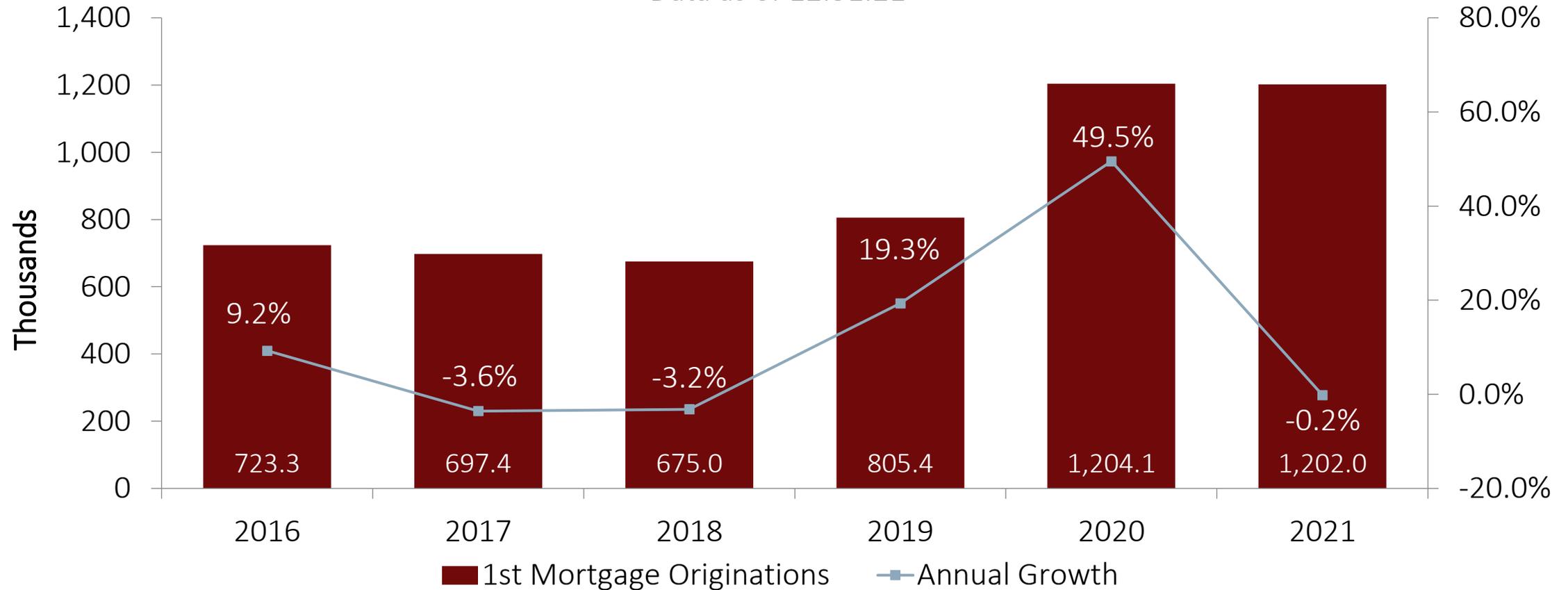
Credit cards and 1st mortgages lead quarterly loan growth

Quarterly Growth in Loans Outstanding
Data as of 12.31.21

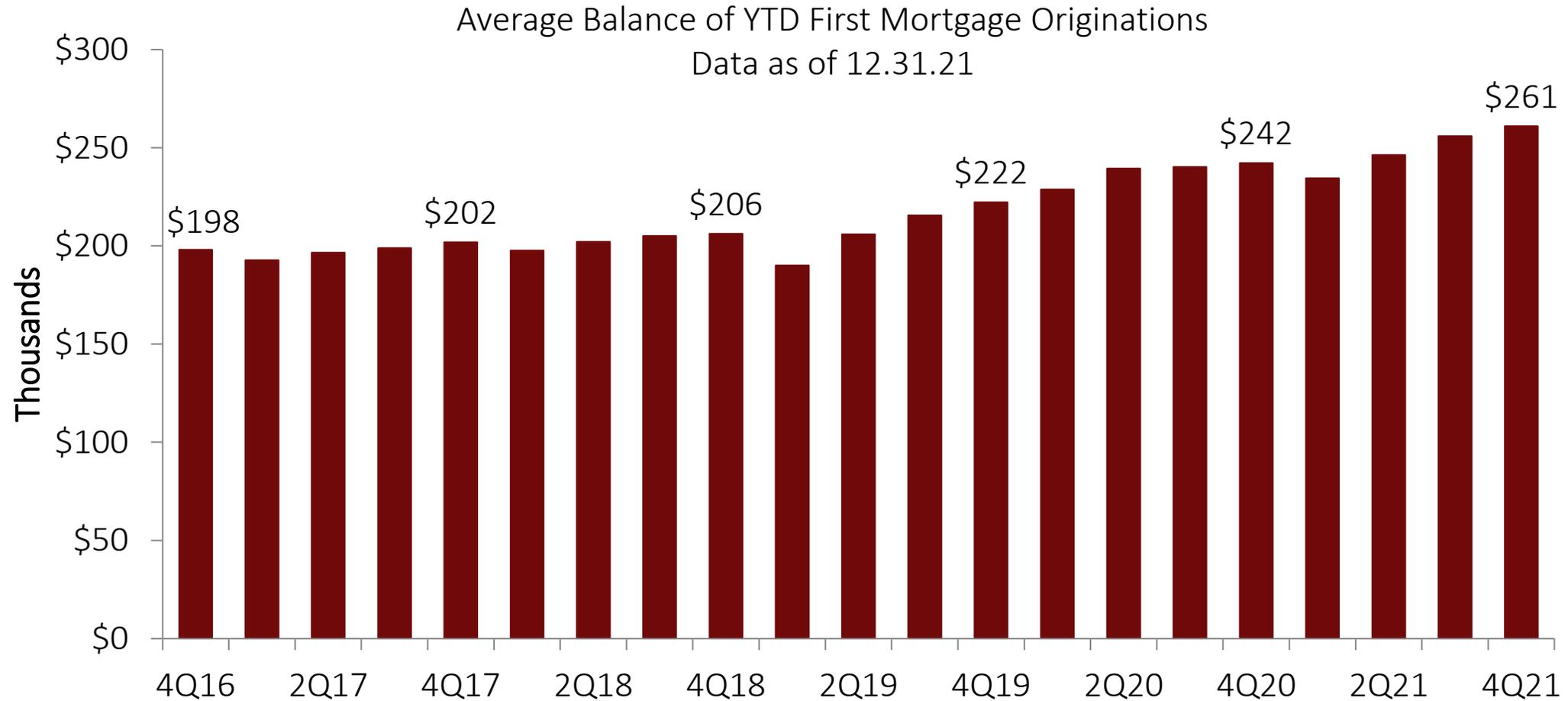


The number of mortgage originations is down slightly from the peak in 2020, but remains well above the historical average

Number of YTD Mortgage Originations and Annual Growth
Data as of 12.31.21



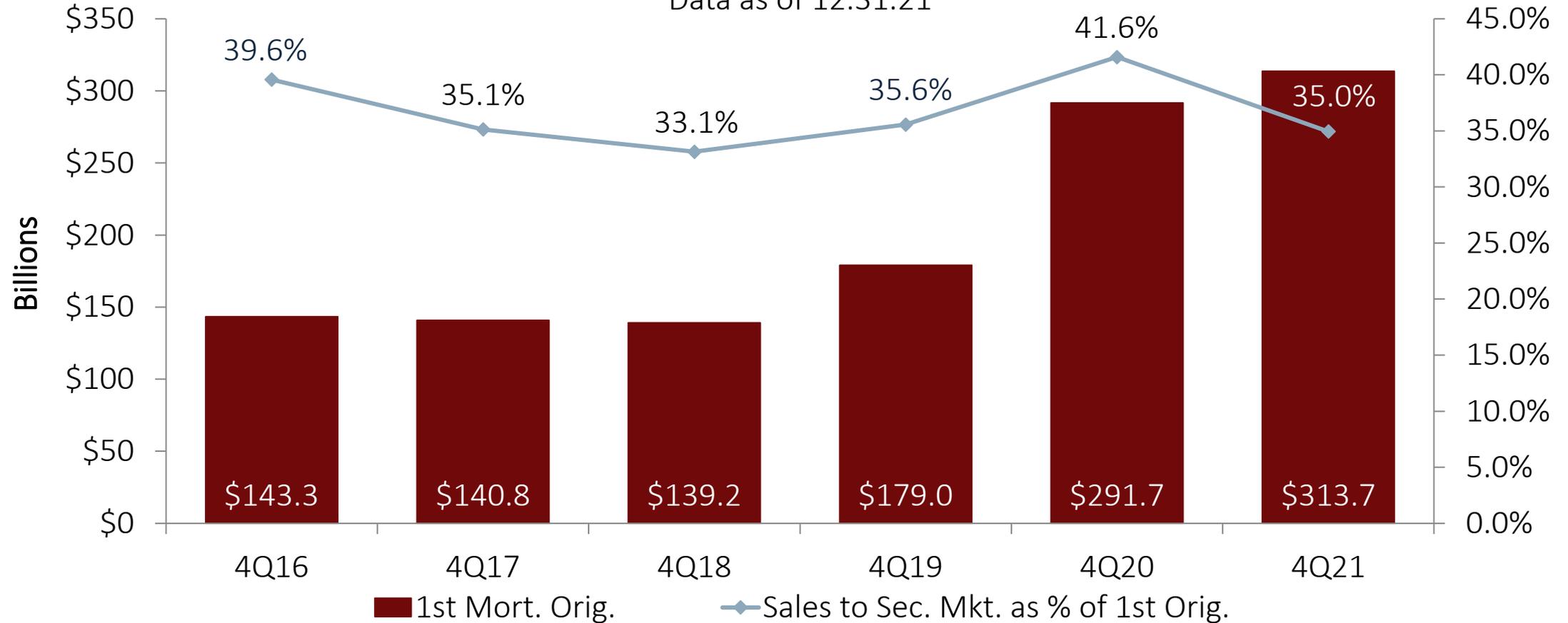
Average first mortgage origination balances climb as asset prices skyrocket



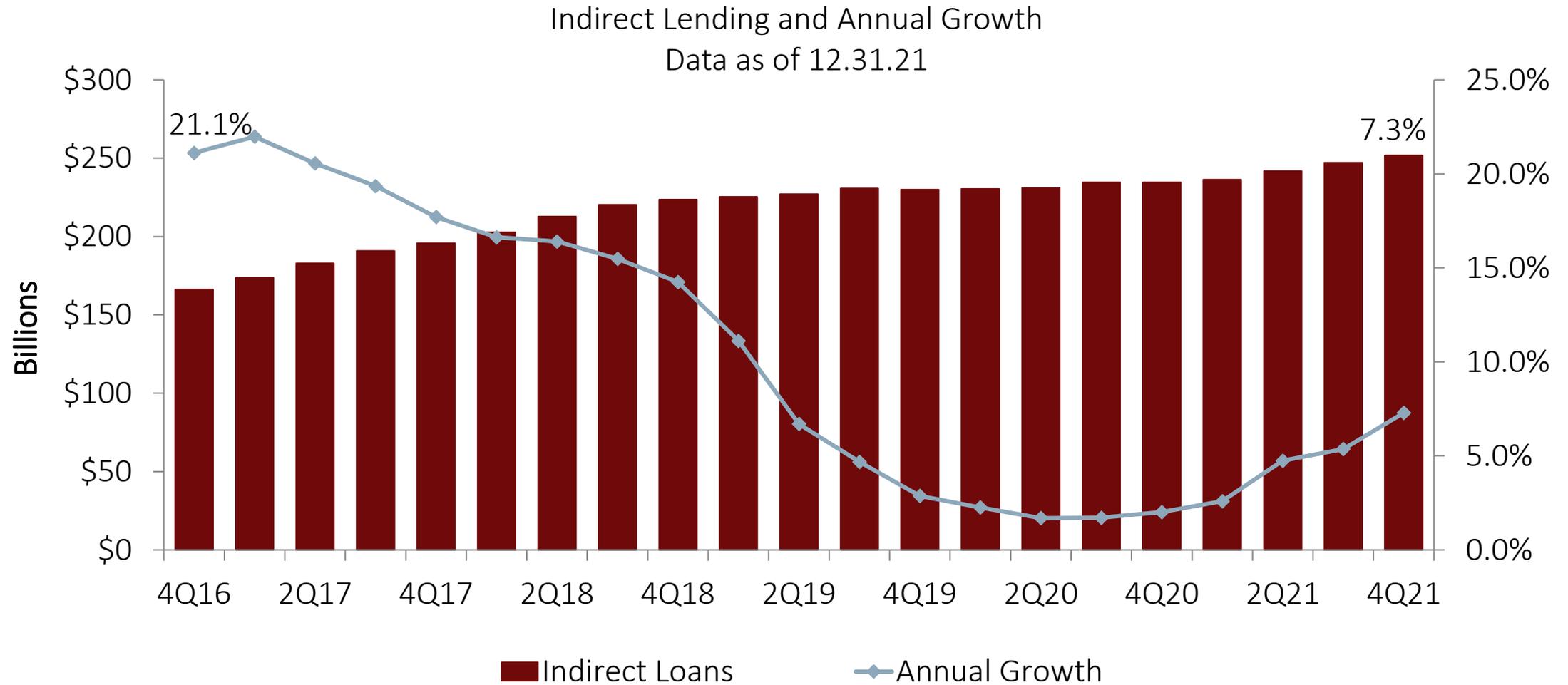
Credit unions are holding more long-term mortgages

YTD 1st Mortgage Originations & Secondary Market Sales as % of 1st Orig.

Data as of 12.31.21



Indirect lending activity is on the rise again

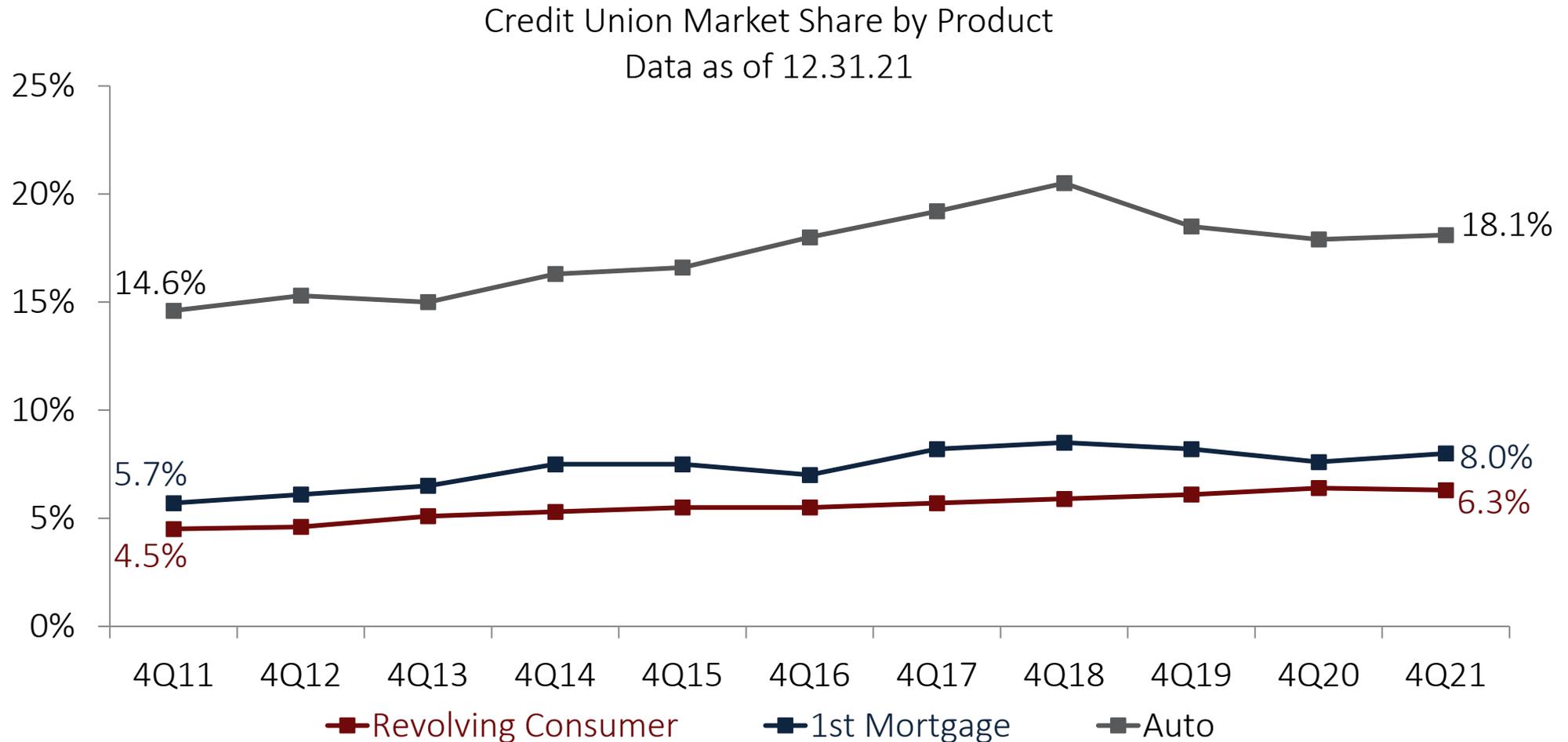


As are secondary market participations

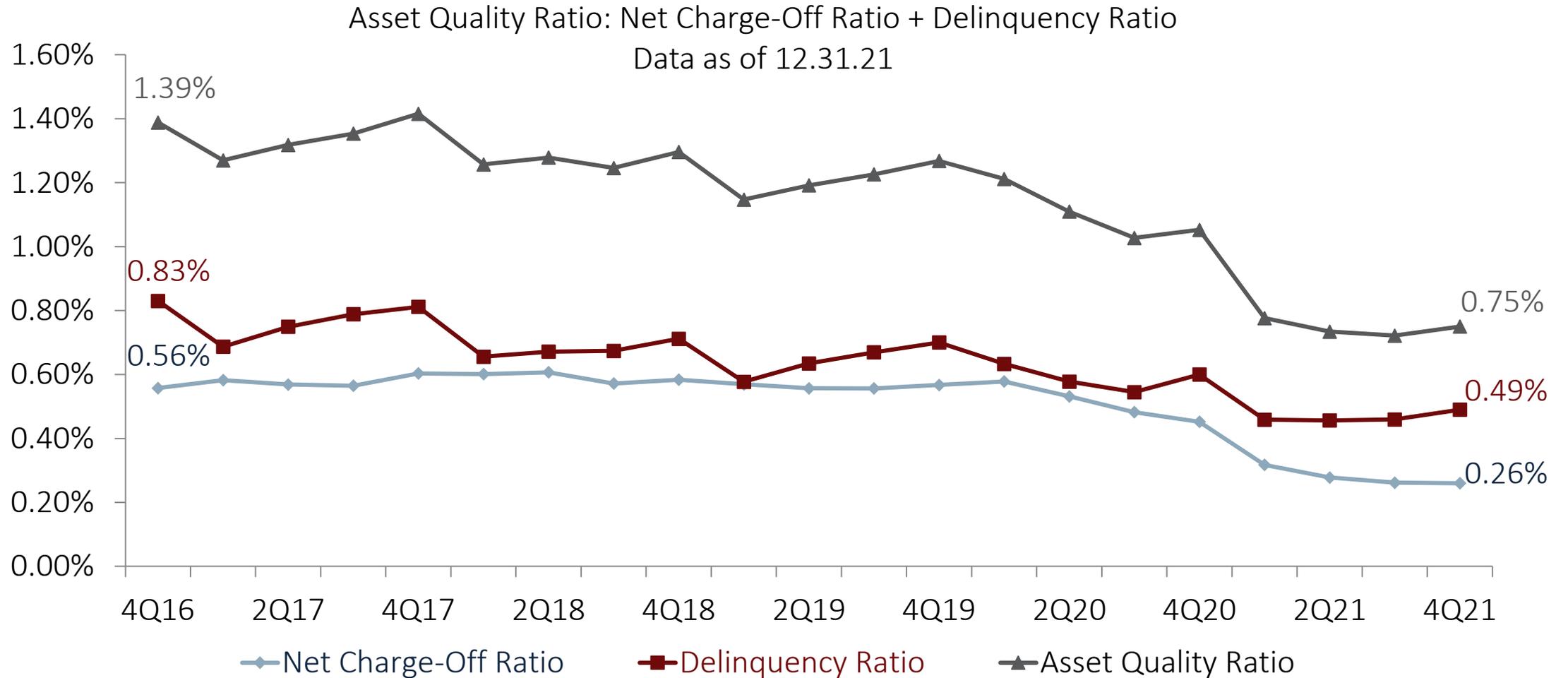
Participations Purchased by Quarter & Annual Growth
Data as of 12.31.21



Market share remains fairly flat through COVID – but that may be a success in and of itself

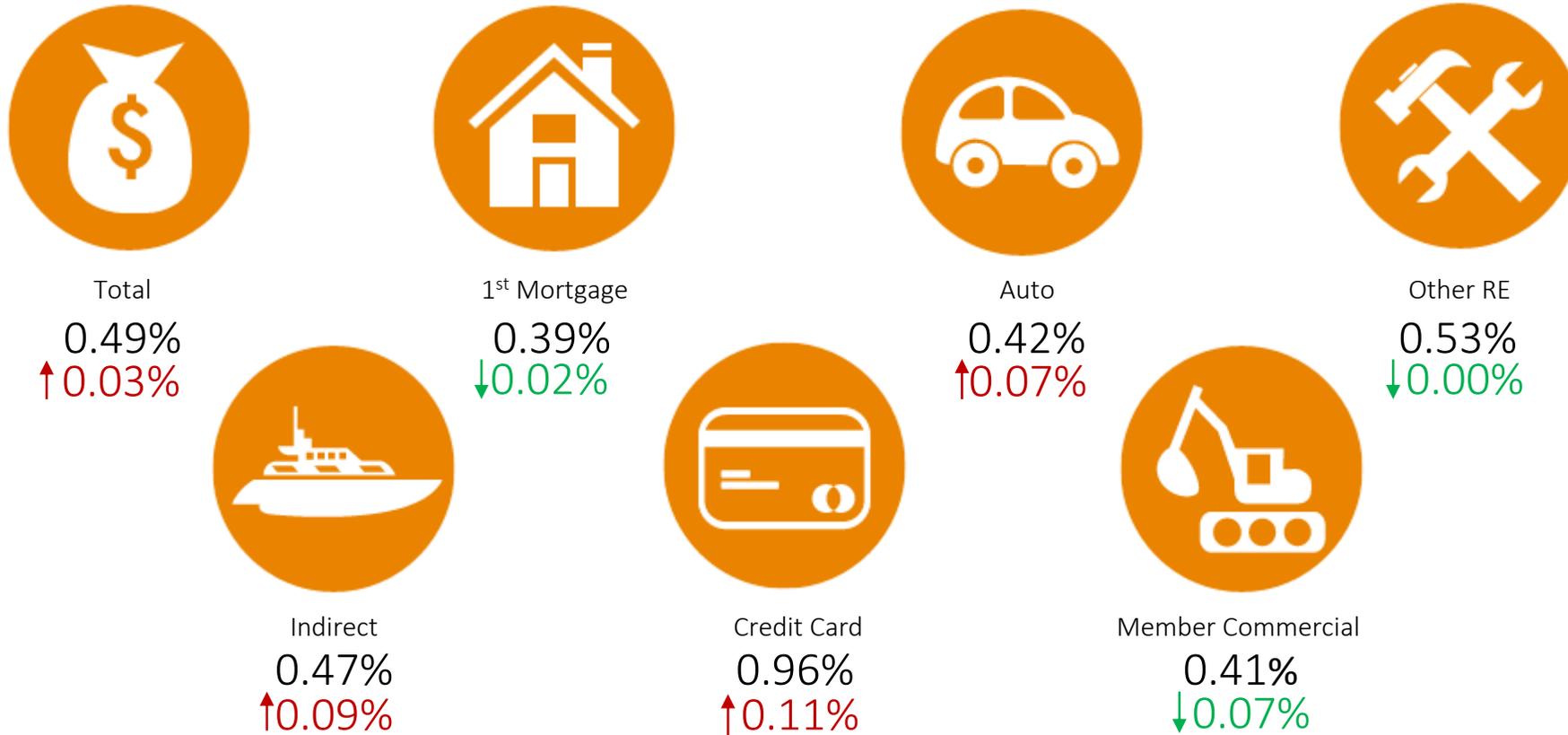


Delinquency ticks up in the fourth quarter, but asset quality remains strong

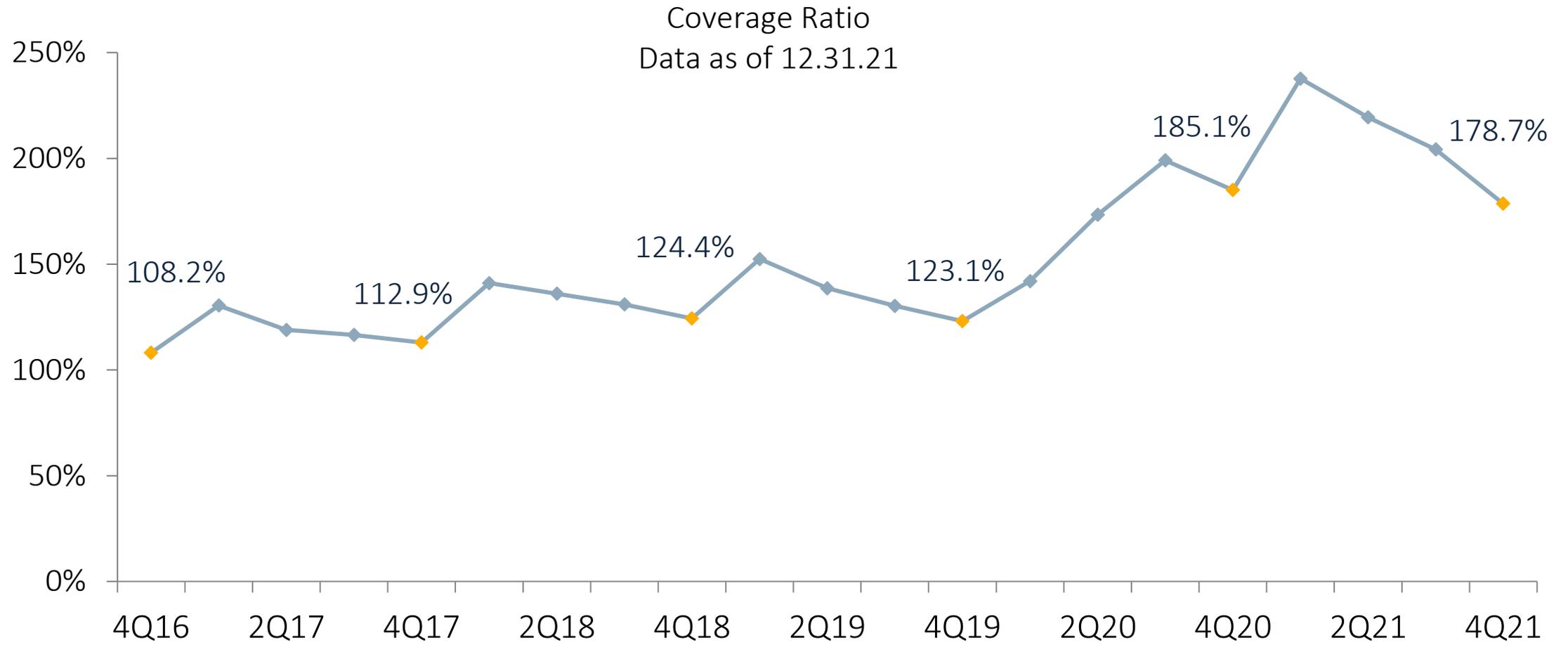


As stimulus programs end, delinquency starts to rise - especially in consumer lending

Annual Change in Delinquency
Data as of 12.31.21



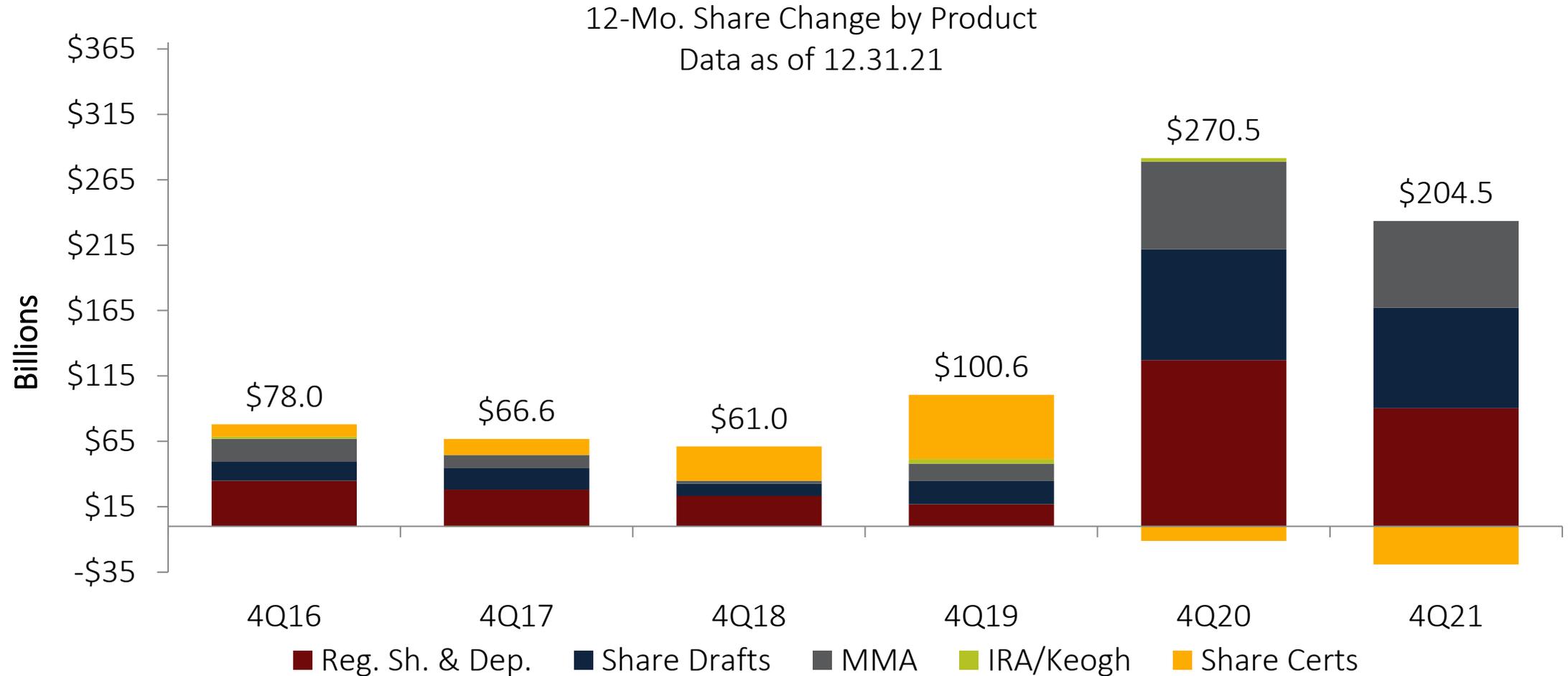
Credit unions remain well-reserved for potential loan losses



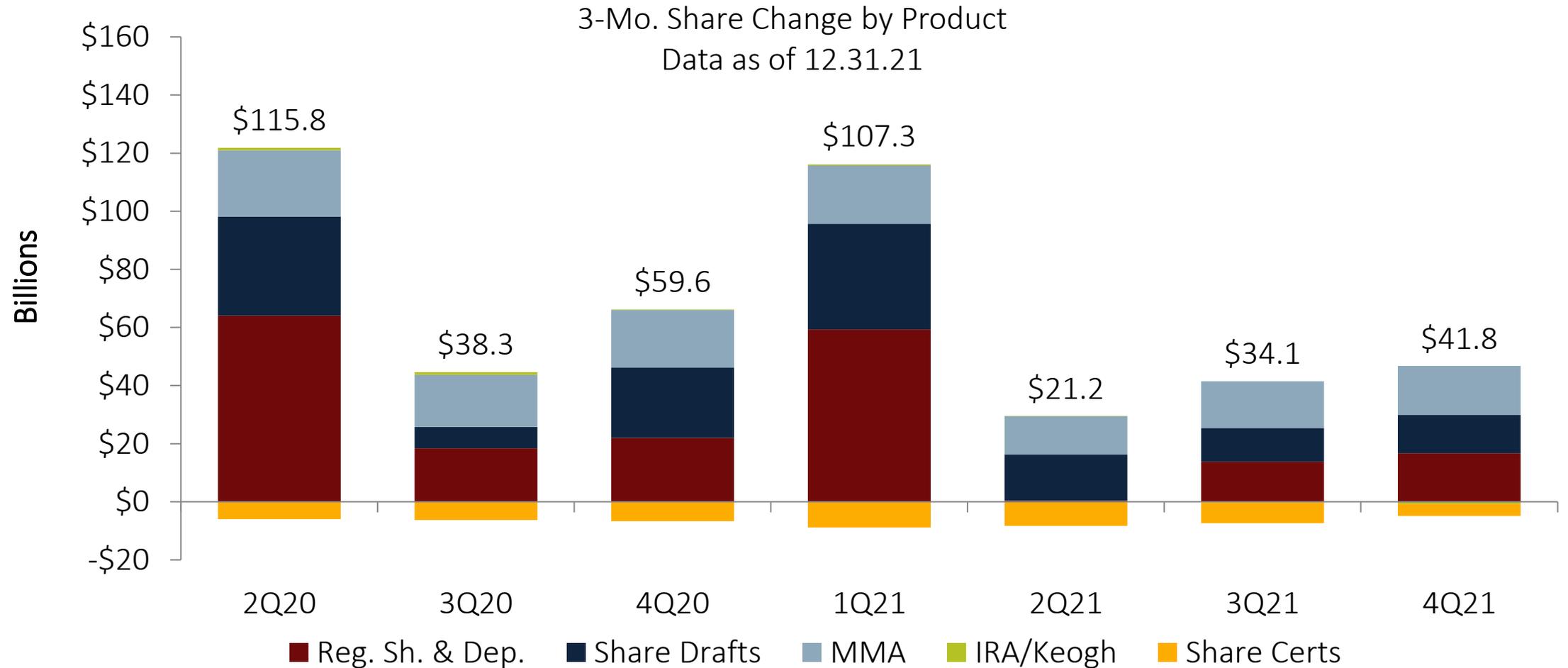


Savings

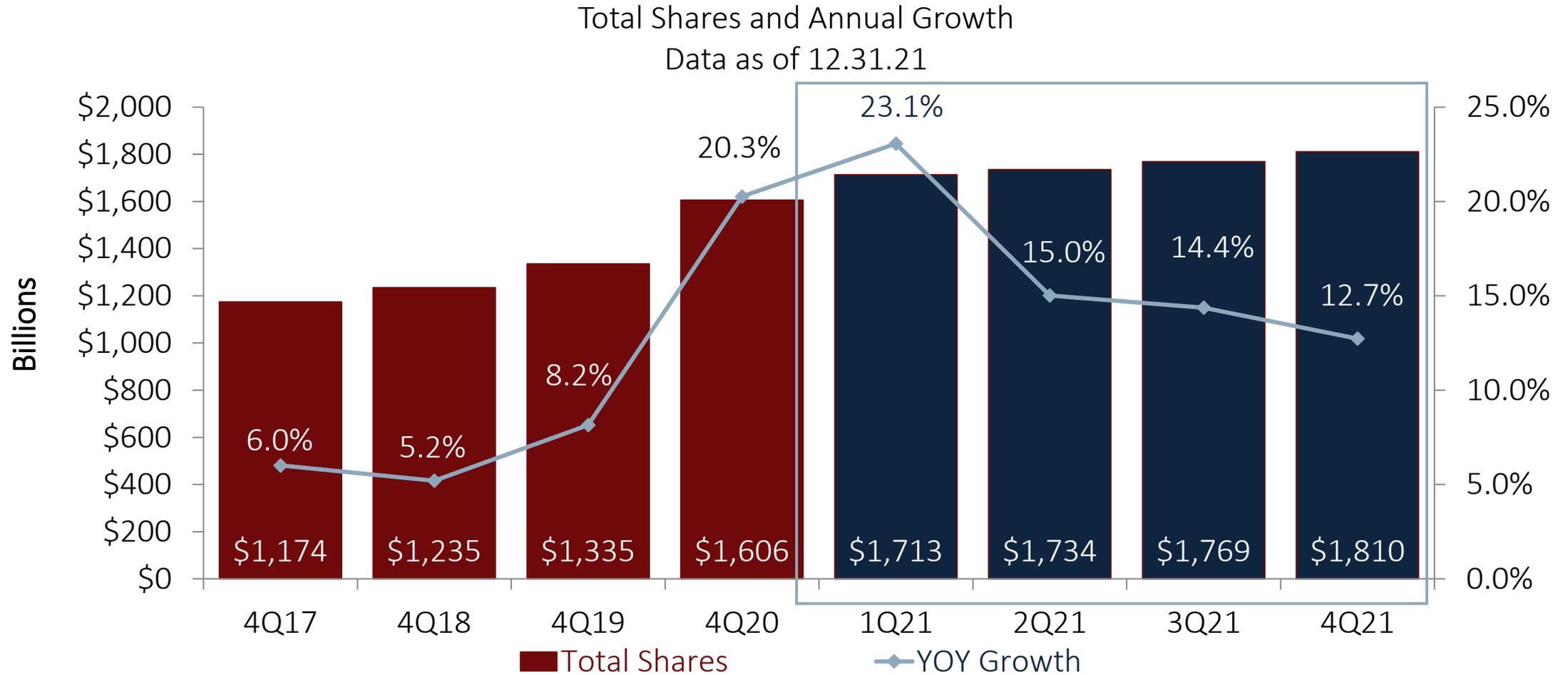
Regular shares, drafts, and money market shares continue to grow annually while certificates dwindle



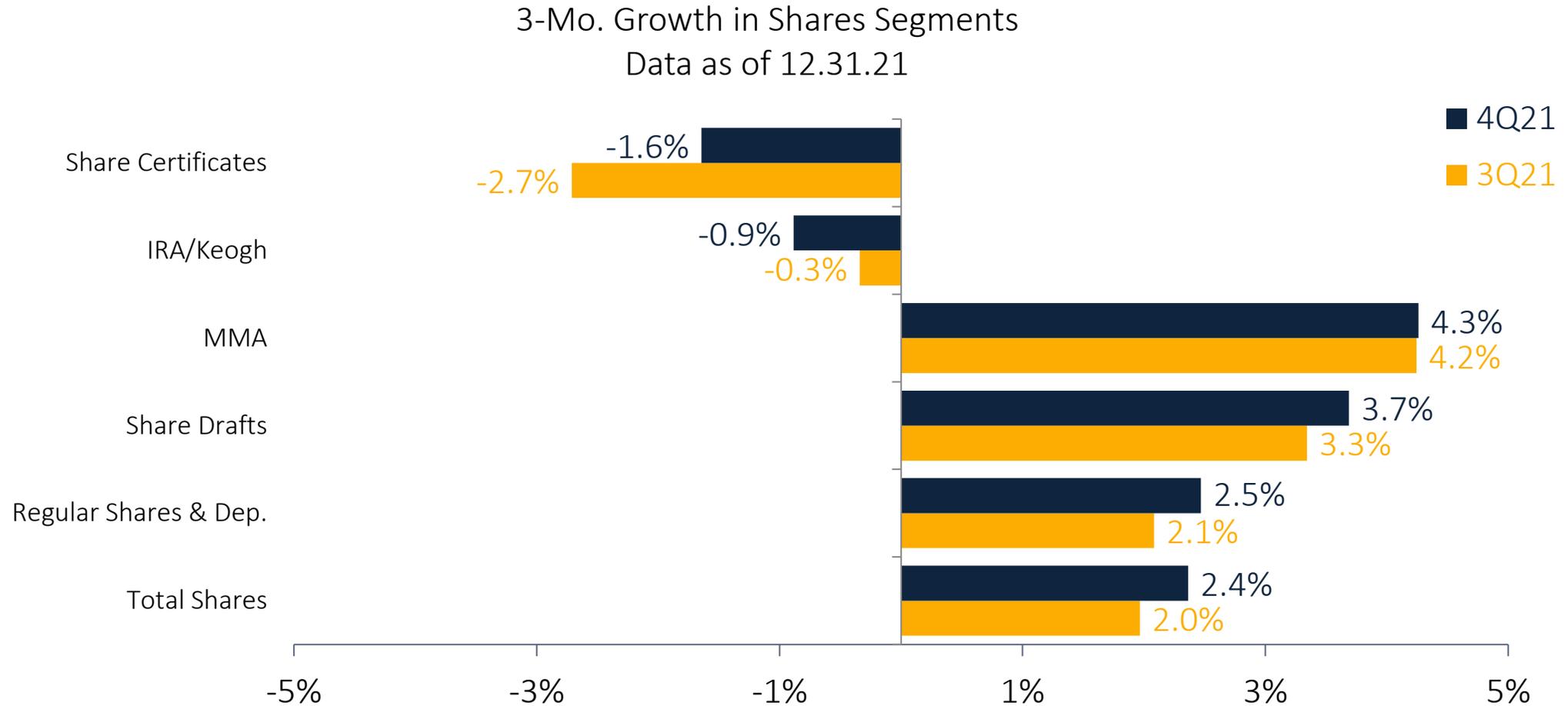
Reduced government relief made a clear impact in recent quarters, but members are still making deposits



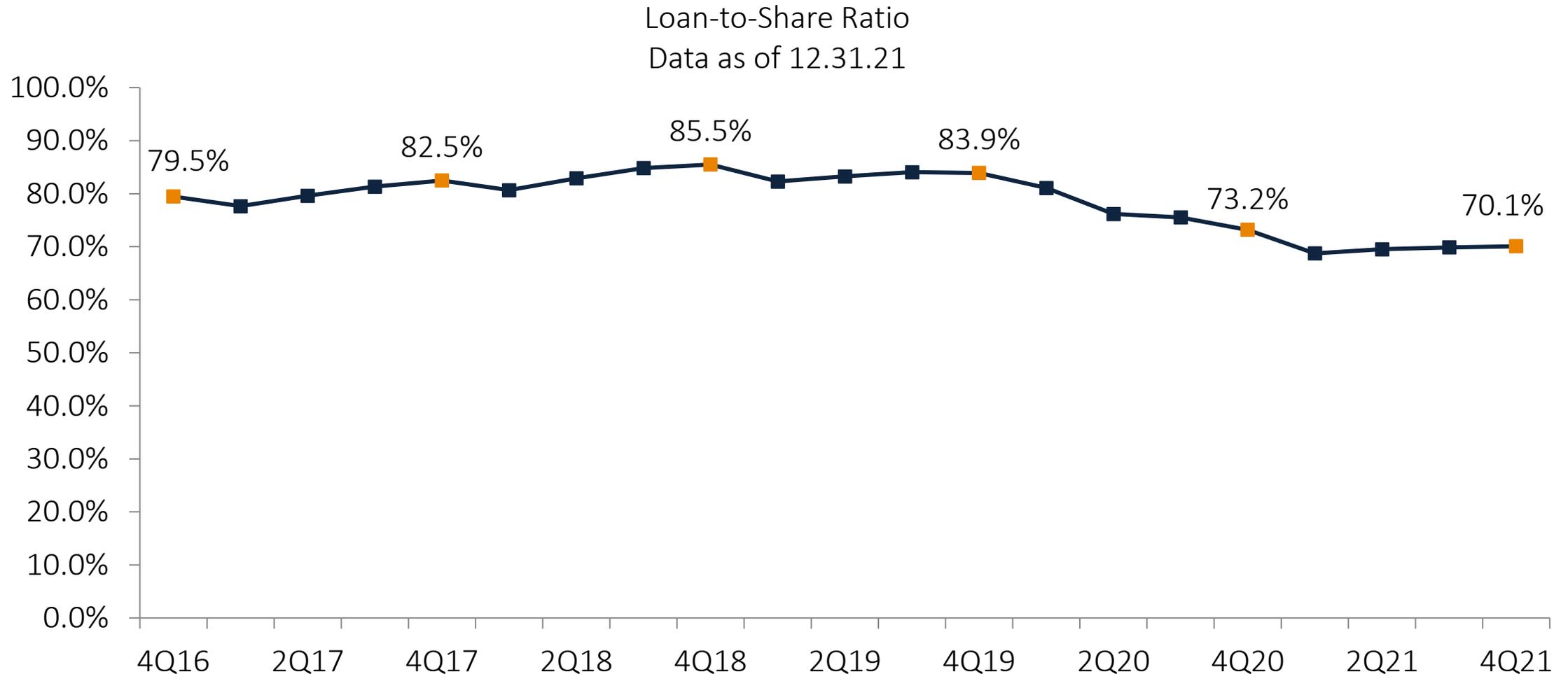
Share growth continues at above-average rates but begins to slow from pandemic highs



Money market accounts gained popularity in recent months as members balance liquidity and dividend yields



The loan-to-share ratio crossed back above 70.0% for the first time in 2021





clearwater
CREDIT UNION

Jack Lawson
President & CEO



Change in Scale

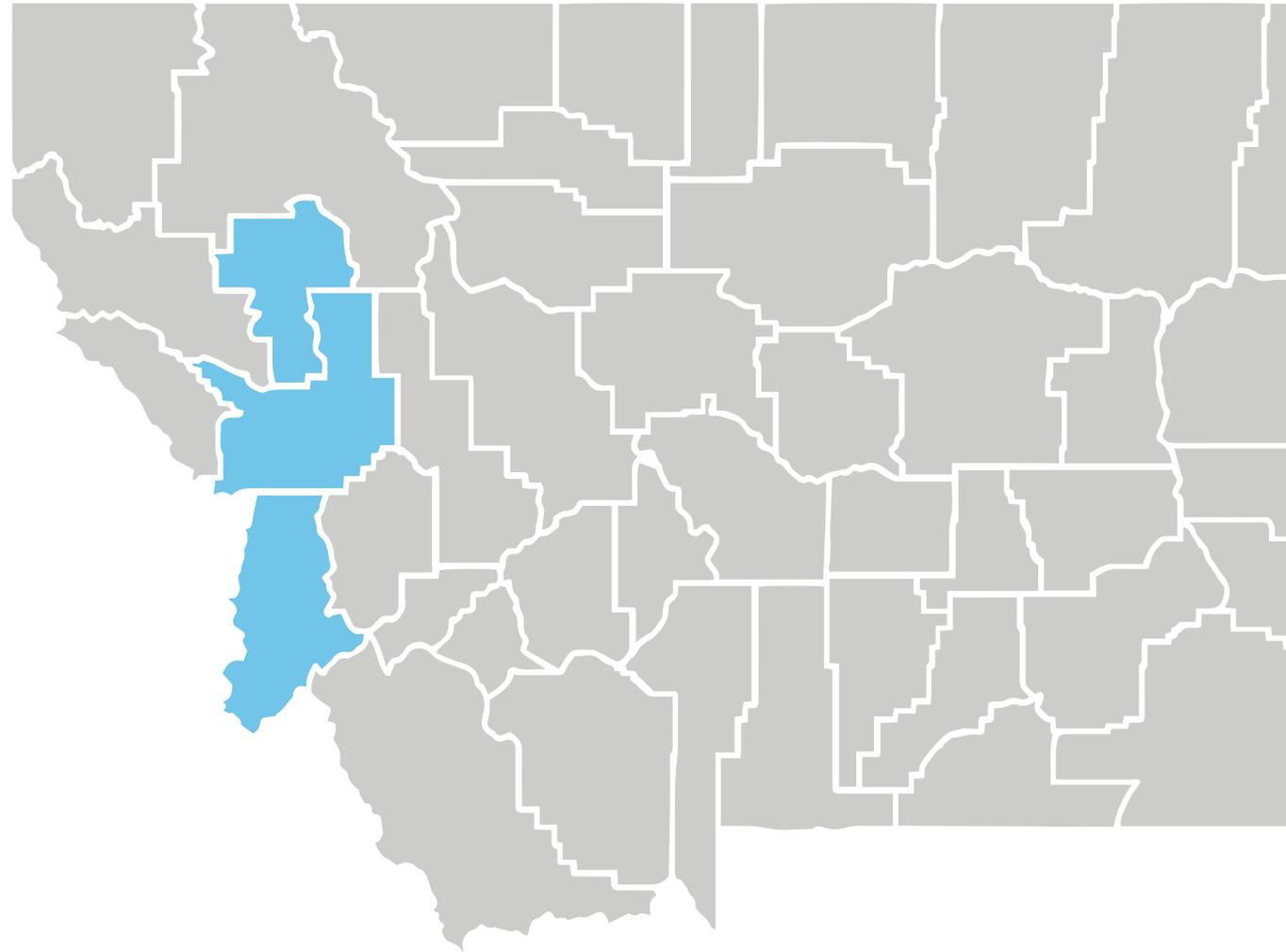


	YE 2013	YE 2021
Total Assets (on balance sheet)	\$383 million	\$875 million
Managed Assets (off balance sheet)	\$222 million	\$265 million
Members	45,758	54,633
Total FTEs	136	163

Change in Purpose



YE 2013 we served
three counties in
western Montana.



Change in Purpose

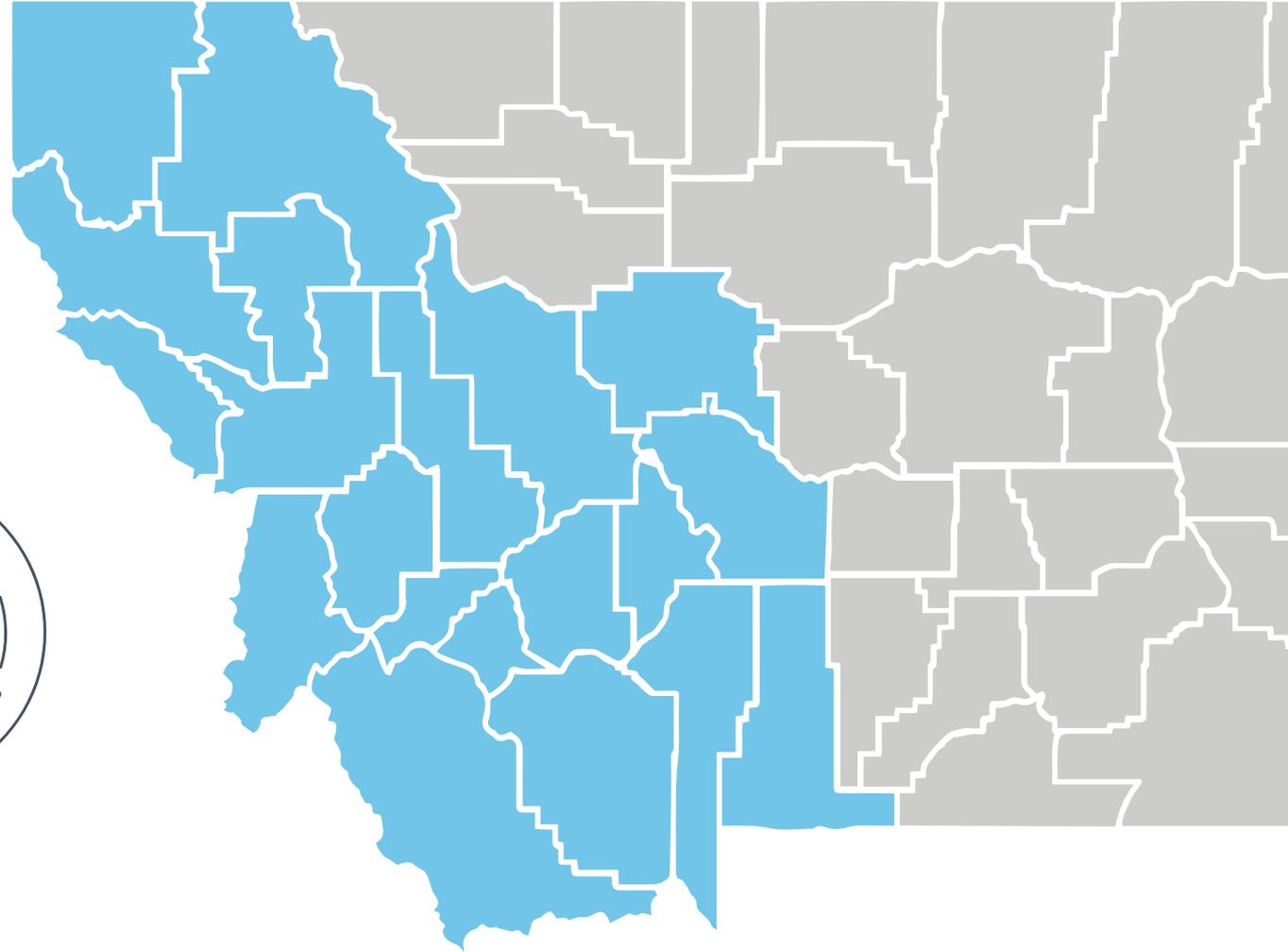


Montana's
Largest



U.S. DEPARTMENT OF THE TREASURY
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Change in Financial Performance



	YE 2013	YE 2021
3 YR Avg Deposit Growth	6%	20%
3 YR Avg Loan Growth	-11%	25%
Loan to Asset Ratio	32%	59%
DQ + C/O	244 bps	13 bps
3 YR Avg ROAA	22 bps	136 bps
Net Worth Ratio	9.13%	9.79%

How did this happen?



Health of the Local Economy
Right People, Right Seats
Good Strategy



What is Good Strategy?



Purpose

Differentiation

Success



Phase 1 - Rebalance & Modernize (2014 – 2016)



Turn on the lending engines (no silver bullet)

- Right people, right seats
- Risk tolerances in policies and procedures
- Pricing
- Marketing
- Goal setting

Phase 2 - Pivot to Values-Based Banking

Our Mission

To be a force for good in banking, in the communities we serve, and in the lives of our members.

Together We Own

We practice responsible banking, grounded in cooperative ownership.

Together We Empower

We solve problems and create opportunities for a better tomorrow.

Together We Include

We choose to be inclusive, not exclusive.

Together We Matter

We are committed to making a difference in the world.

Our Vision

By living our values, we will redefine the role financial institutions play in building thriving, sustainable communities.

Principles of Values-Based Banking



Member Centered

Long-term relationships with members and direct understanding of the problems they are trying to solve and opportunities they seek to take advantage of.

Transparency

Radically transparent and inclusive governance.

Long Term Resiliency

Self-sustaining, with a long-term outlook, and resilient to outside disruptions.



Culture

All of these principles embedded in the culture of the credit union.



Social & Environmental Impact

Resources and balance sheet aim to deliver positive social and environmental impacts.

Local Economy

Grounded in communities and serving the local economy.

Why Values-Based Banking?



Consumers

Employees

Differentiation

**Existing
Competitive
Advantage**

Thank You

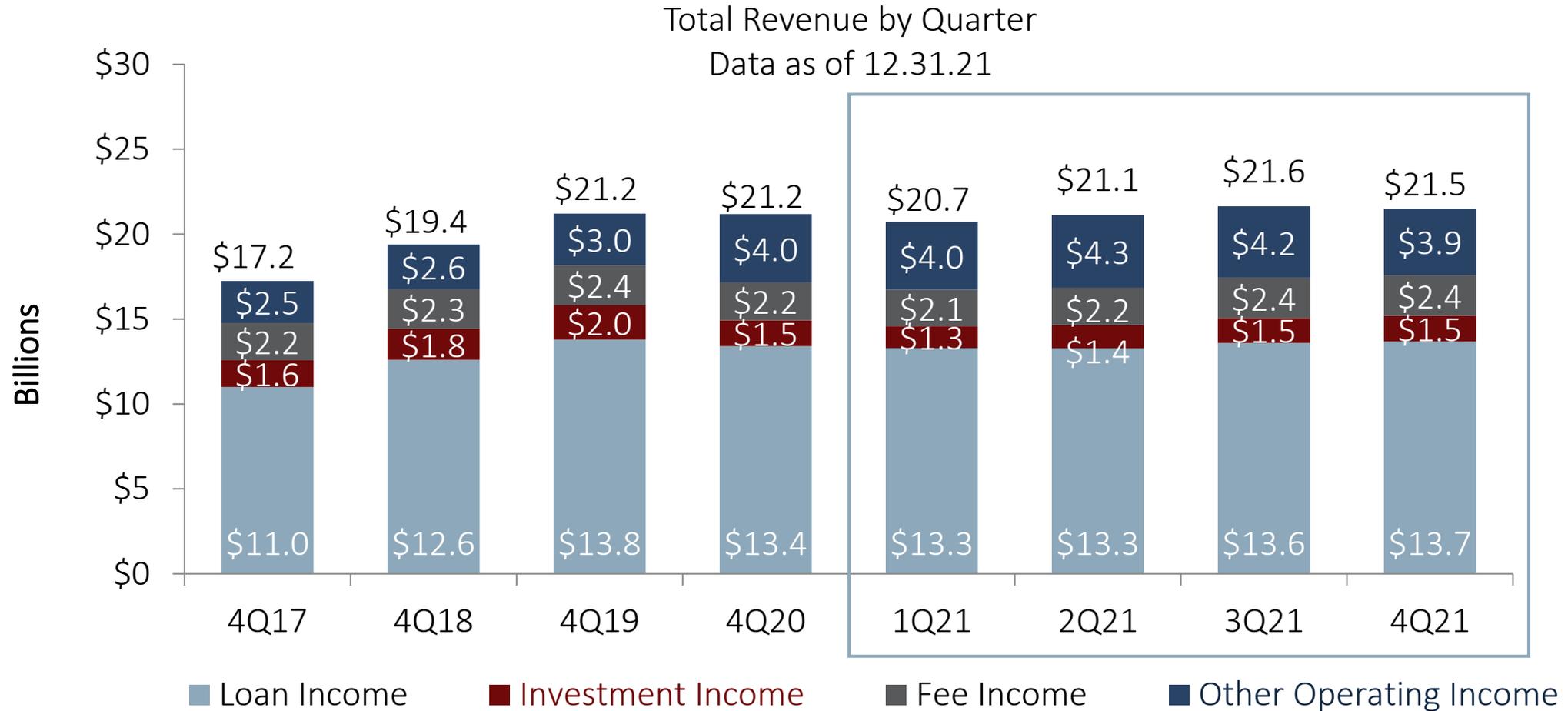




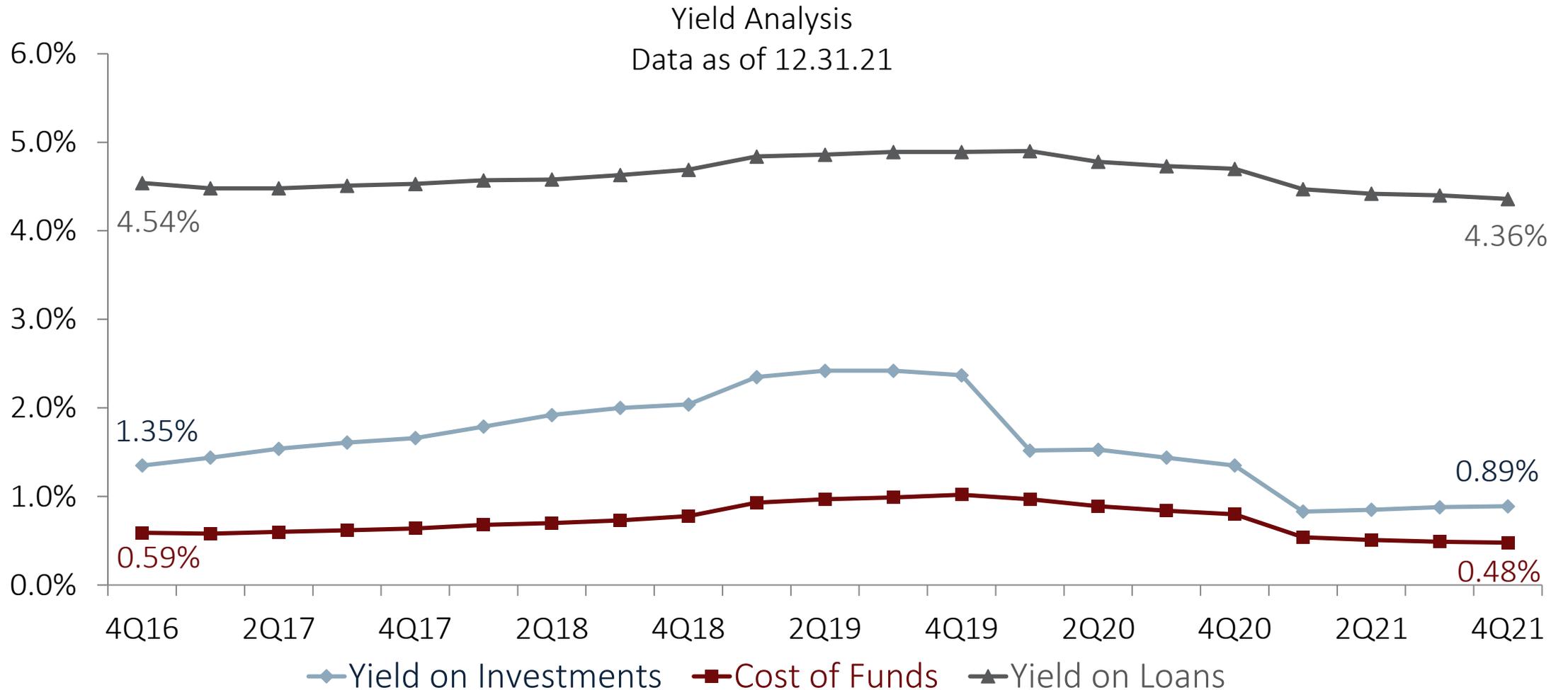
Earnings & Capital



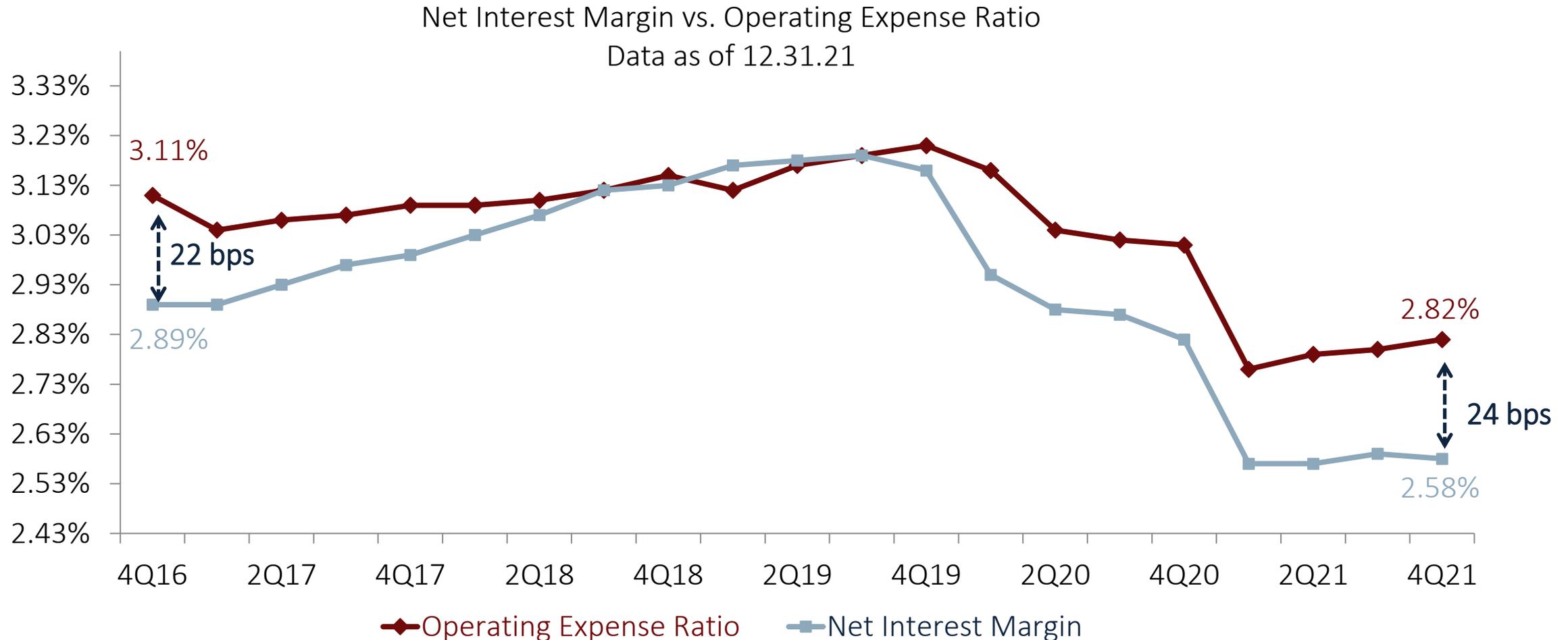
Revenue declines slightly between the third and fourth quarters, but consumer lending drives growth in loan income



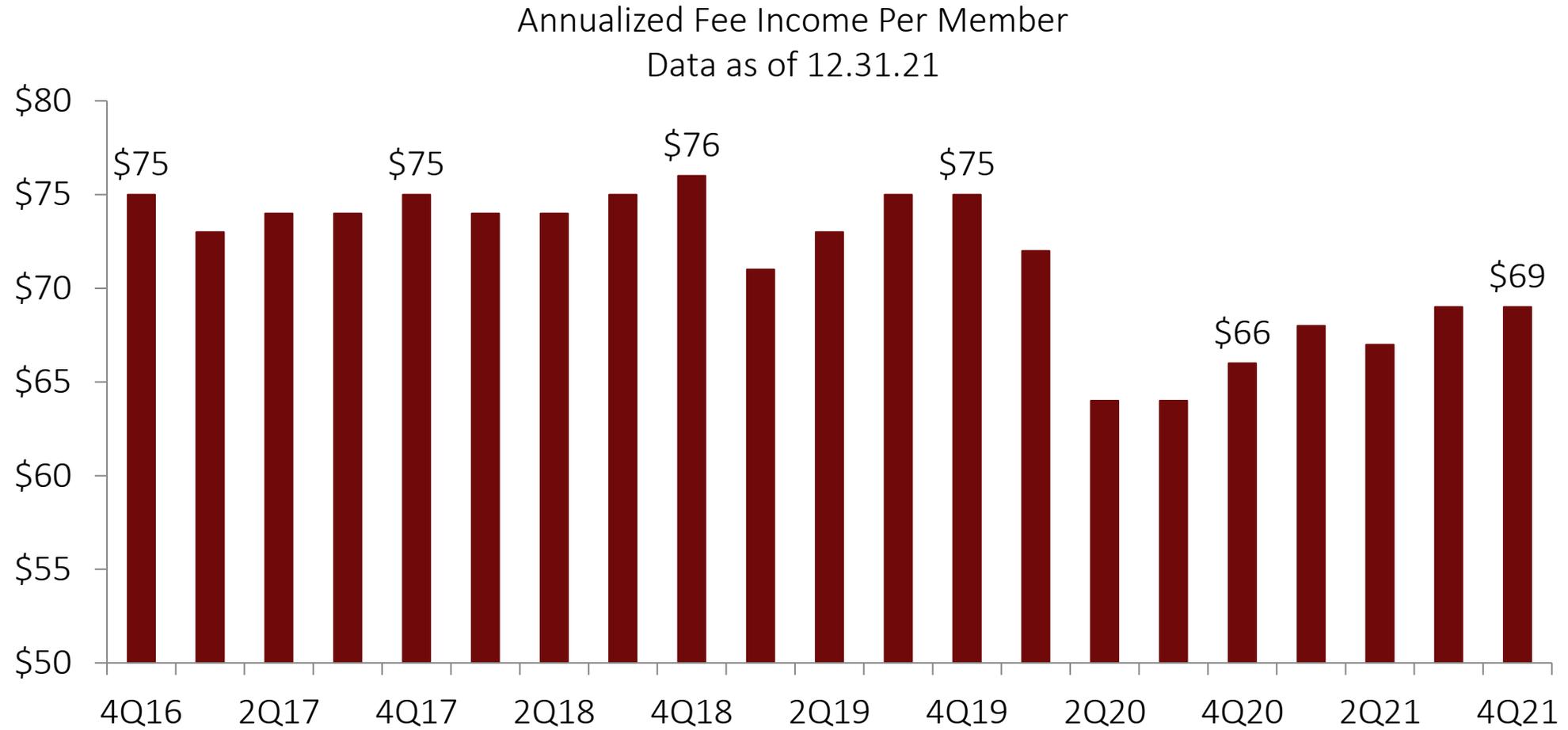
Yields remain flat with modest uptick in yield on investments



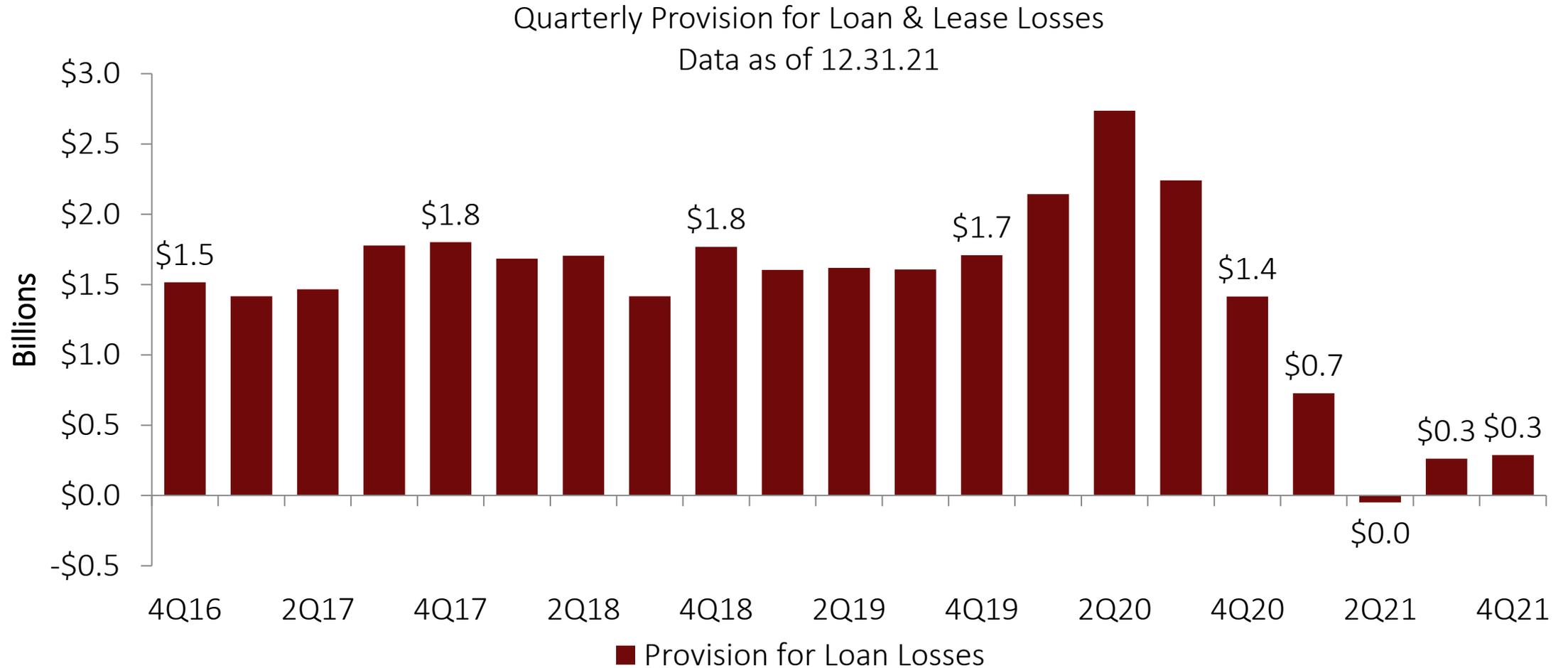
Credit unions are spending more on operations to deliver a better member experience



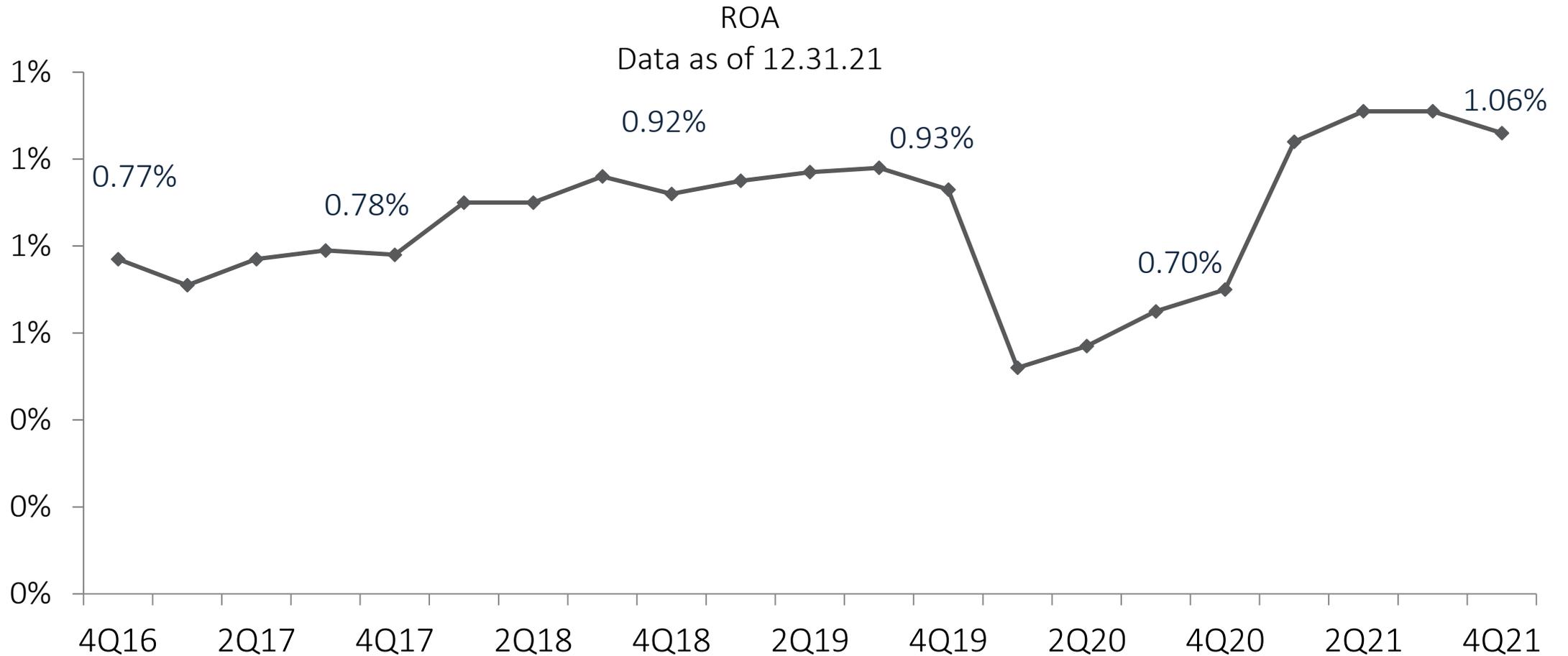
Fee income per member rises in 2021 but remains below pre-pandemic levels



Given the strong asset quality, credit unions are contributing little to their allowance accounts

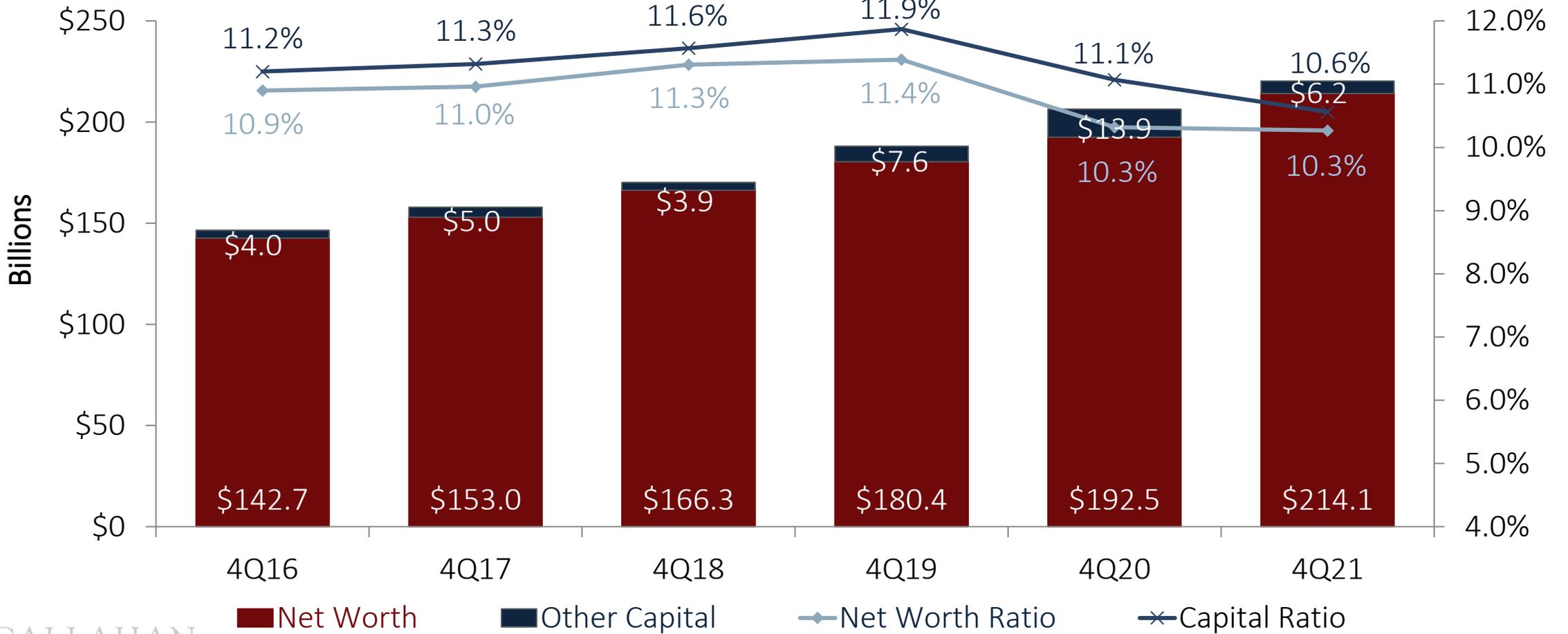


Lower fourth quarter income brought year-to-date returns down slightly, but earnings remain near record highs



Industry net worth remains above 10%

Net Worth and Other Capital
Data as of 12.31.21



Impact of NCUA Capitalization Requirement Changes

	Total # of CUs	% of CUs Over 7% NWR	# of CUs over \$500M	% of \$500M CUs Over 7% NWR
4Q21	4315	94.5%	697	99.6%

	# of CUs under \$500M	% of <\$500M CUs over 7% NWR	# of CUs over \$500M	% Qualifying for CCULR (9%)
1Q22*	4315	94.5%	697	69.9%

207 of our reporting CUs – representing ~18.5% of industry assets – would need to complete RBC reporting

Source: Callahan's Peer-to-Peer Analytics – 99.6% of Industry Data
 *Using 4Q21 data, would a CU be considered well-capitalized in 1Q22?

Lessons & Looking Forward

- Best way to create safety is soundness
- Focus on purpose and use that to drive engagement with employees and members
- Let this purpose drive innovation
- Members still need peace of mind

THANK YOU FOR WATCHING



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