

Credit Union Economics Group (CUEG) Panel

Presented by

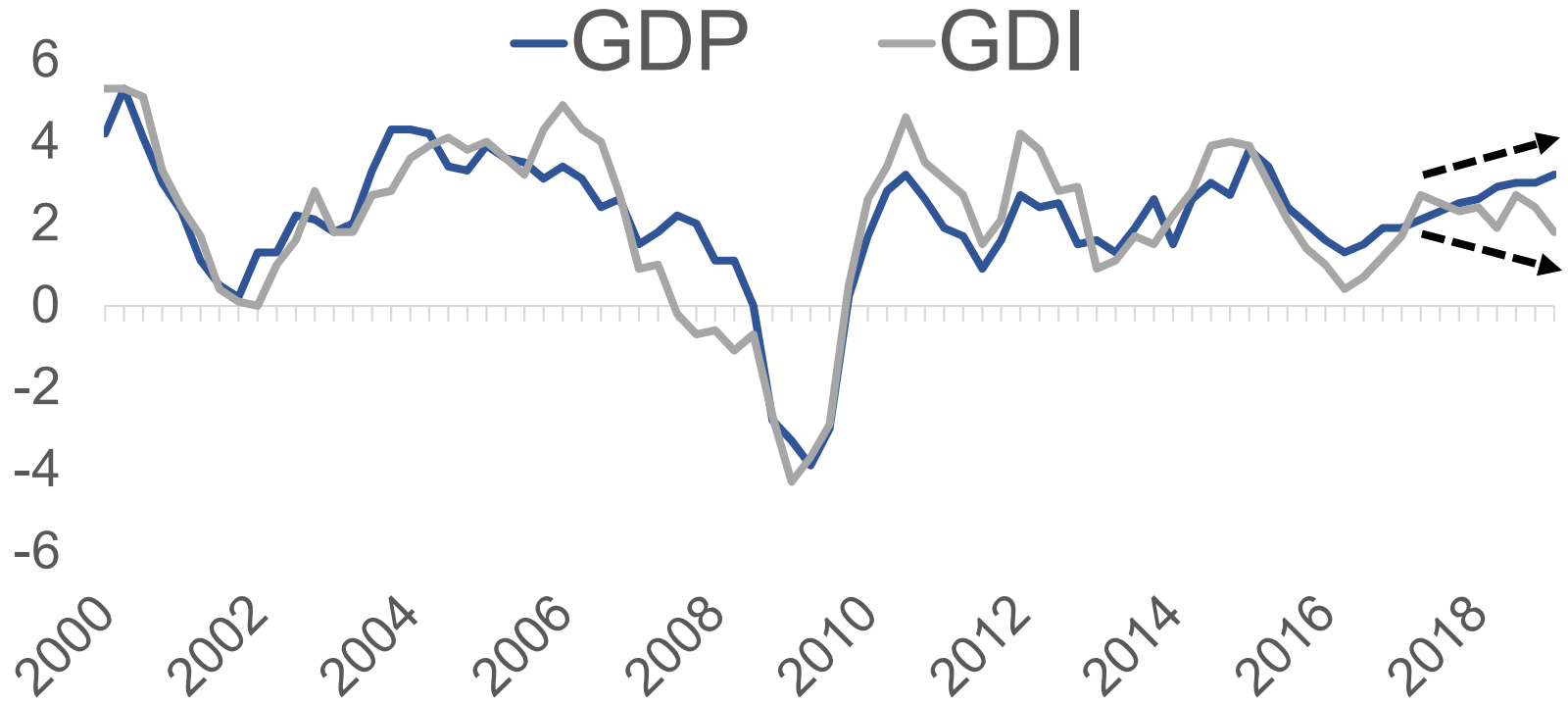
Curt Long, NAFCU

Scott Knapp, CUNA Mutual Group

Fred Eisel, Vizo Financial Corporate CU



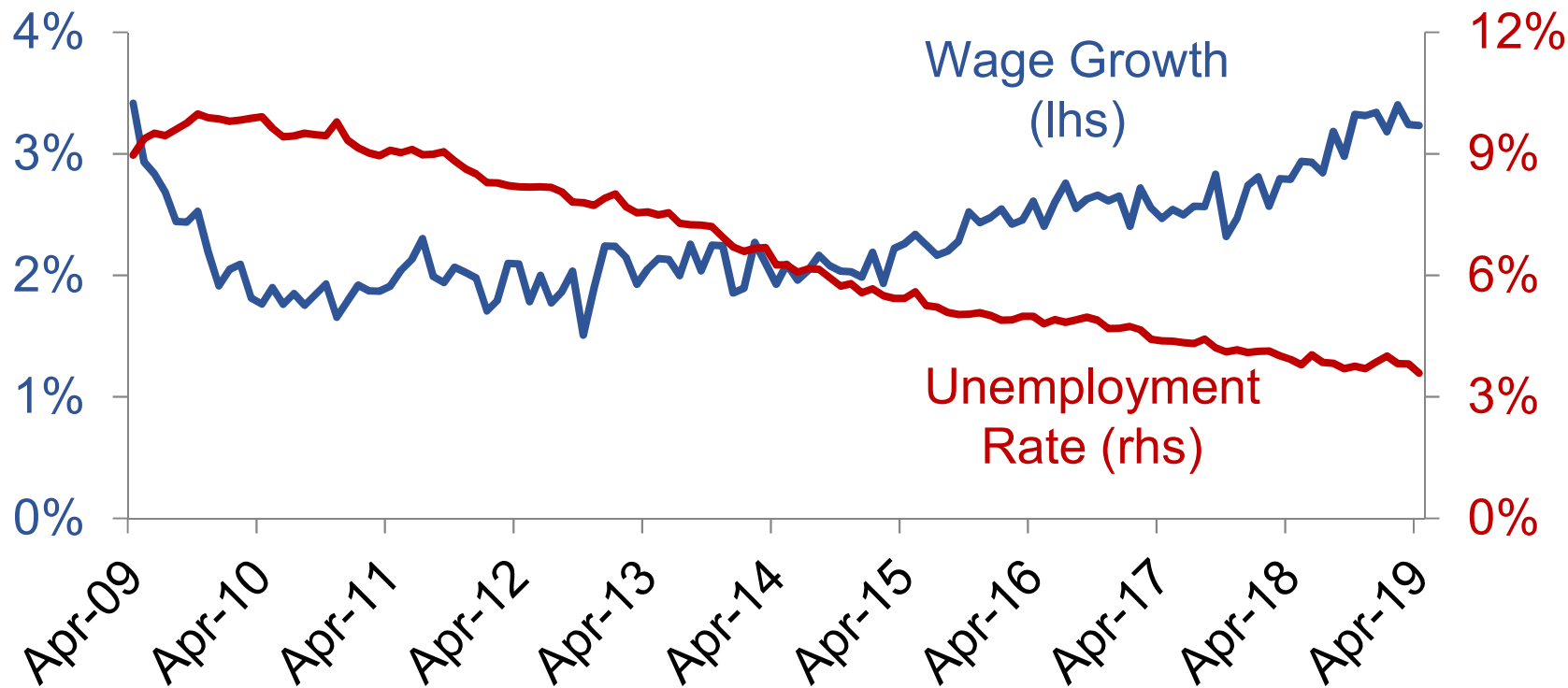
GDP or GDI?



Source: Federal Reserve Bank of St. Louis



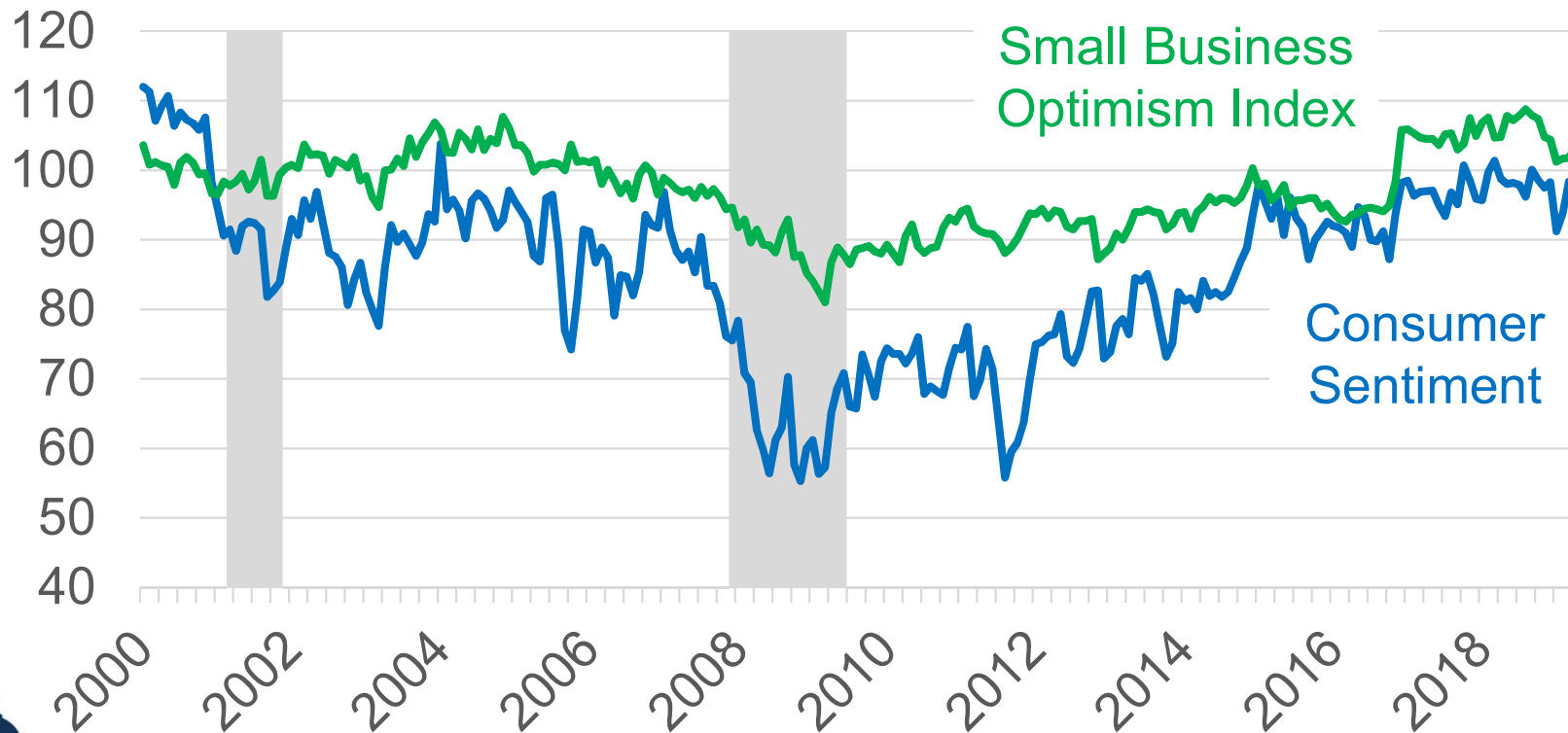
Labor Market



Source: Bureau of Labor Statistics



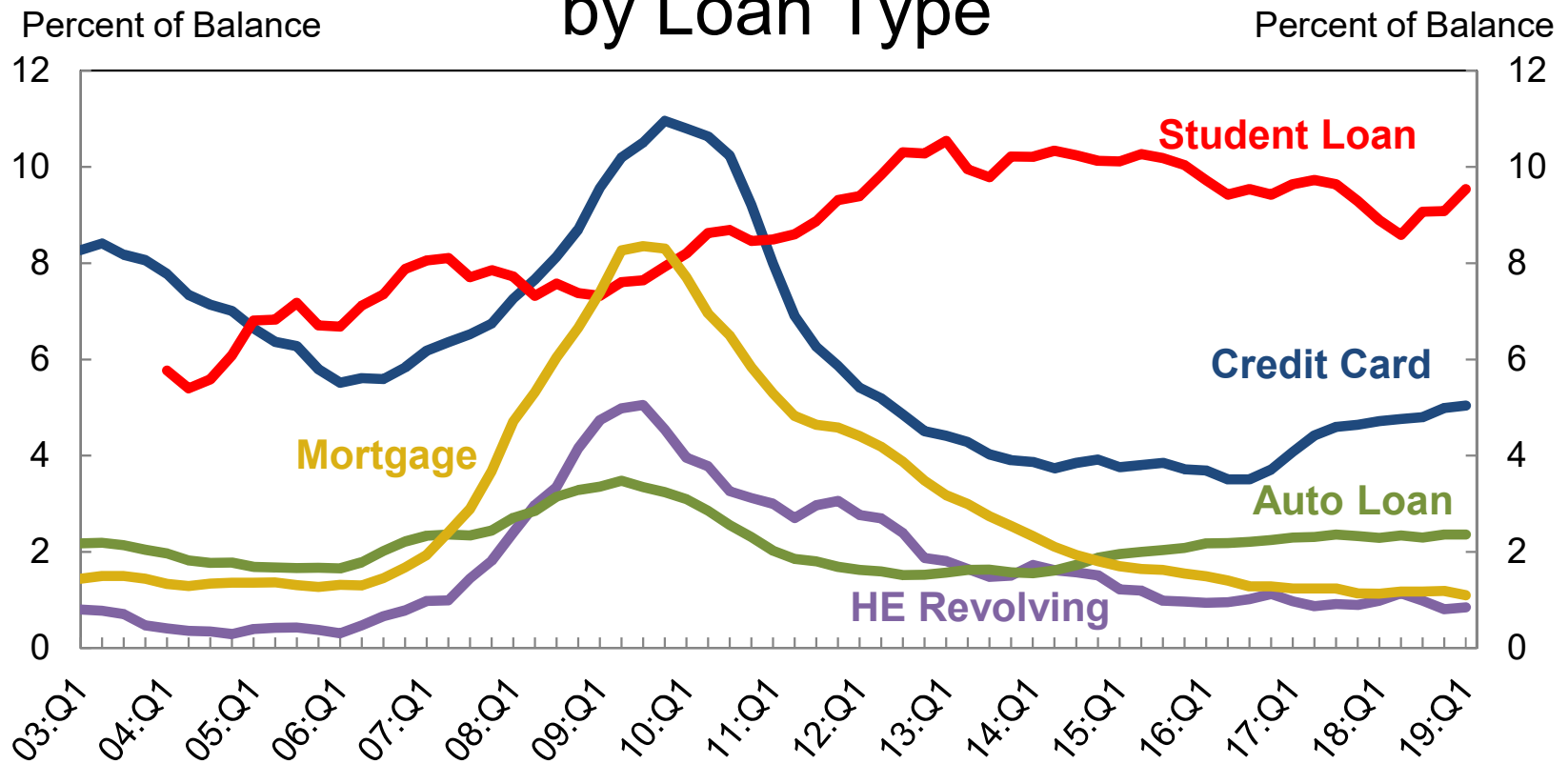
Business & Consumer Sentiment



Sources: U. of Michigan, NFIB



Transition into Serious Delinquency (90+) by Loan Type

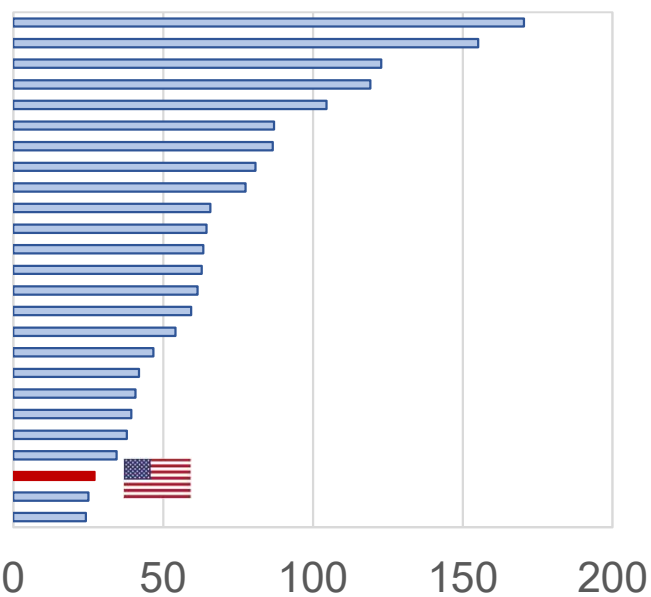


Source: New York Fed Consumer Credit Panel/Equifax

Note: 4 Quarter Moving Sum
Student loan data are not reported prior to 2004 due to uneven reporting

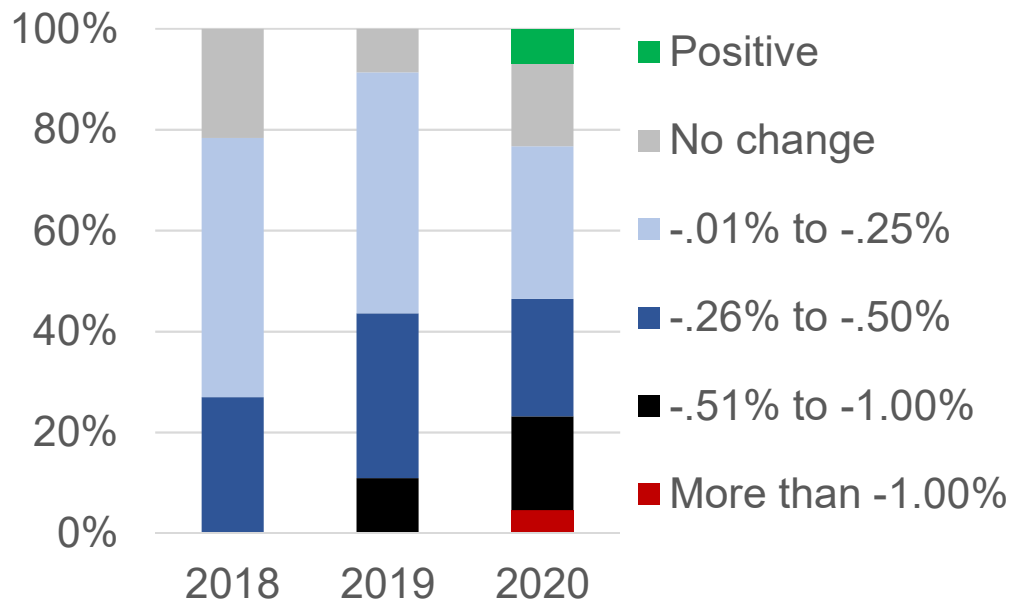
Trade

Total Trade as % of GDP
25 largest economies



Source: World Bank

Estimates of Impact of U.S. Trade Policy on GDP

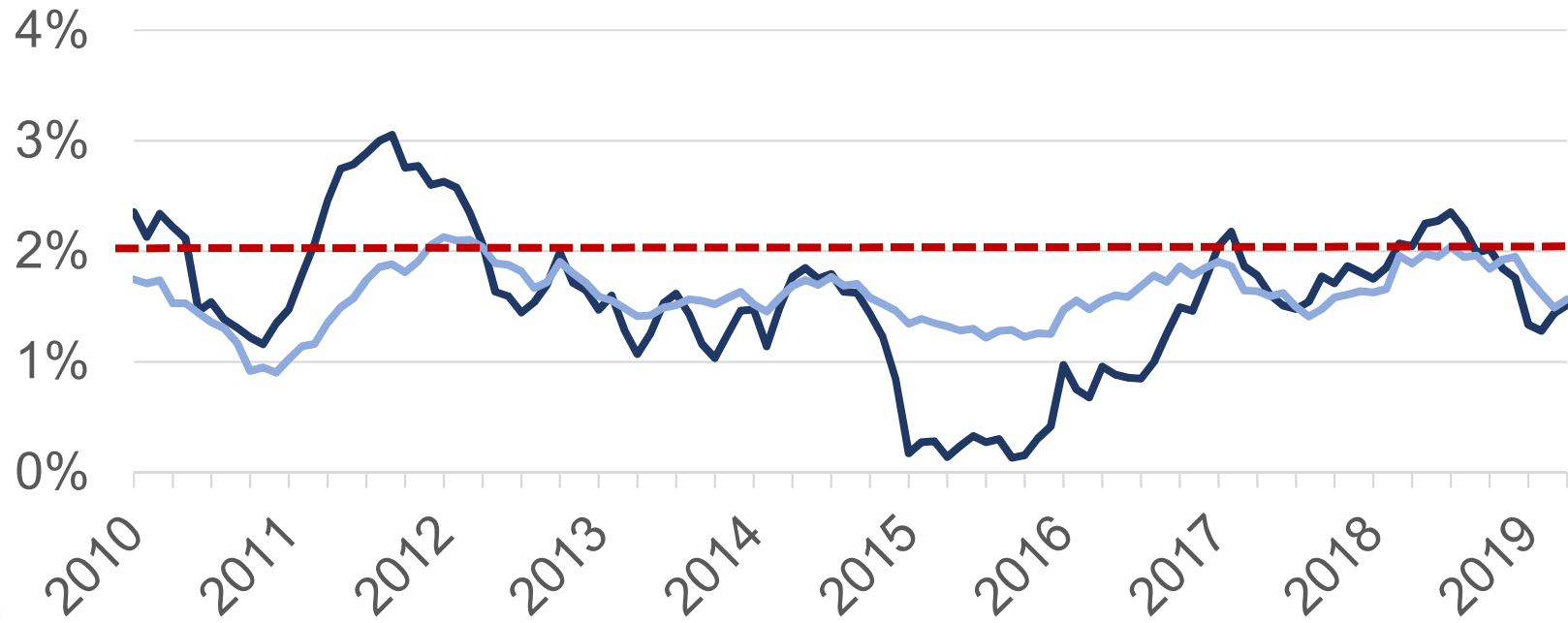


Source: NABE June 2019 Outlook



PCE Inflation

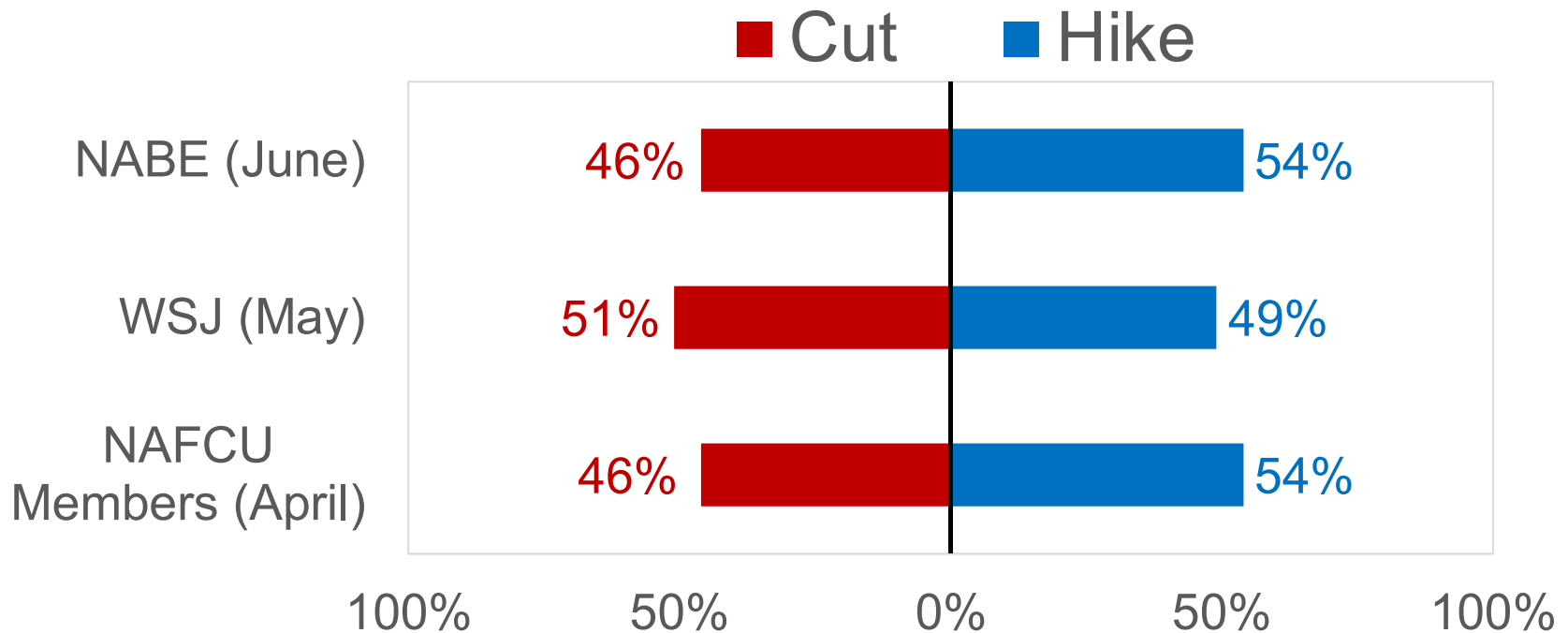
—Overall —Core



Source: Federal Reserve Bank of St. Louis



Fed's Next Move

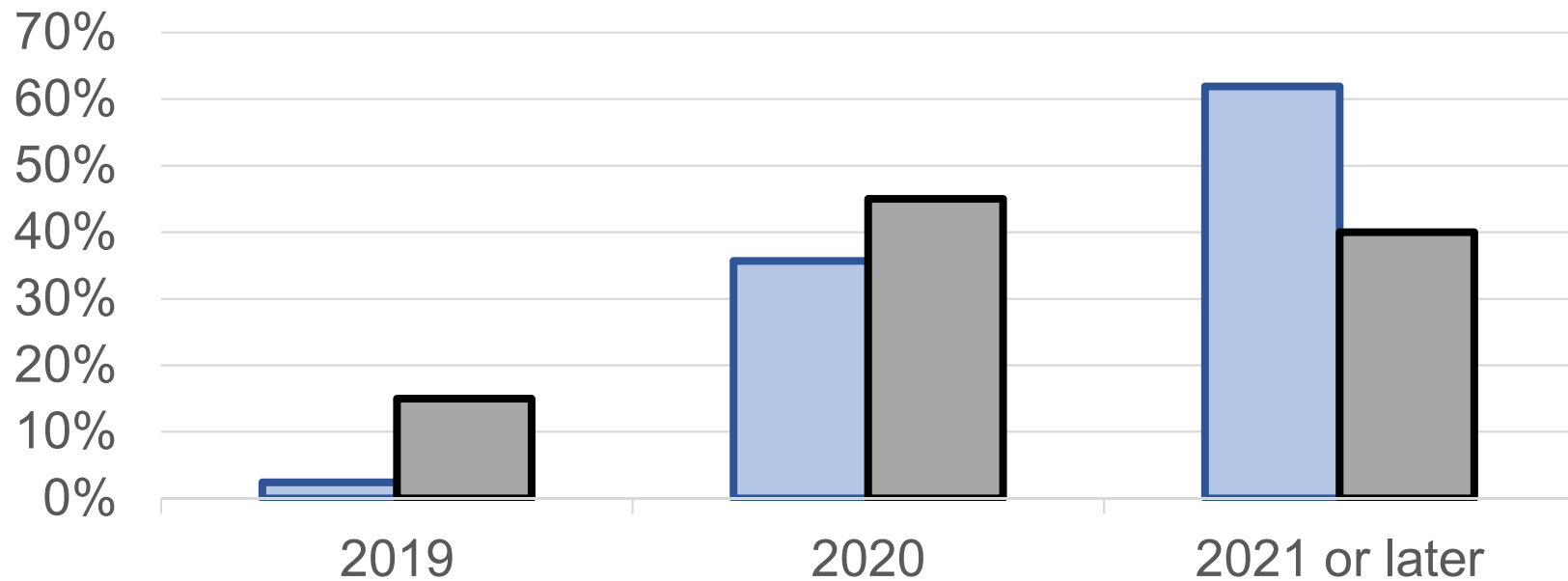


Sources: WSJ Economic Forecasting Survey, NABE Outlook Survey, NAFCU Economic & CU Monitor survey



Recession Timing

■ WSJ ■ NABE



Sources: WSJ Economic Forecasting Survey, NABE Outlook Survey



The Economist's View

- GDP growth in Q1 was probably overstated. Slowing growth is consensus view.
- Risks are weighted to the downside, but a recession in the next 12 months is unlikely if trade doesn't derail us (???). Expect recession by late-2020.
- Fed is done with rate hikes. Next move will be a cut in Q3.

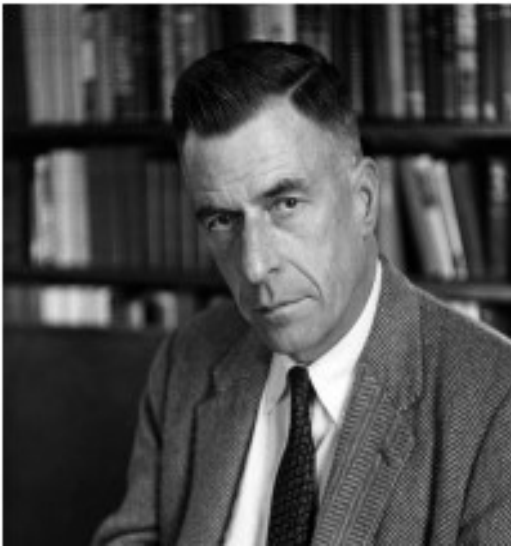


Structural Change, Modest Investment Returns

Scott D. Knapp, CFA



Disclaimer



Source: Harvard University

“The only function of economic forecasting is to make astrology look respectable.”

John Kenneth Galbraith



CUNA Mutual Fiduciary Consultants

Disclaimer



Source: AZQuotes.com

“The reason the word GURU is so popular in finance is the word CHARLATAN is so hard to spell.”

William J. Bernstein



The Arsonist

"Interest rates are still accommodative, but we're gradually moving to a place where they will be neutral. We may go past neutral, but we're a long way from neutral at this point, probably."

- Fed Chair Jay Powell on October 2, 2018

*"What could reverse all of this? Simple: The Fed, as it has so frequently in the recent past, blinks and sends signals that **tightening is either paused or is complete** due to evolving conditions. In that case we'll likely see yet another rescue that ends the selloff."*

- CBI commentary published November 26, 2018

*"[M]arkets were susceptible to news about the balance sheet, so we thought carefully about how to normalize it and thought to have it on **automatic pilot** and use rates to adjust to incoming data."*

- Fed Chair Jay Powell on December 19, 2018



Asset Class % Returns as of December 31, 2018

“A long way from neutral”

Asset Class	Index	3 Mos.	YTD	1 Year	3 Year	5 Year
U.S. Large-Cap Stock	S&P 500	-13.52	-4.38	-4.38	9.26	8.49
US Large Cap Growth	Russell 1000 Growth	-15.89	-1.51	-1.51	11.15	10.40
US Large Cap Value	Russell 1000 Value	-11.72	-8.27	-8.27	6.95	5.95
U.S. Mid-Cap Stock	Russell Mid-Cap	-15.37	-9.06	-9.06	7.04	6.26
U.S. Small-Cap Stock	Russell 2000	-20.20	-11.01	-11.01	7.36	4.41
International Stock	MSCI EAFE (NET)	-12.54	-13.79	-13.79	2.87	0.53
Emerging Market Stock	MSCI EM (NET)	-7.47	-14.58	-14.58	9.25	1.65
Investment Grade Bond	Barclays Capital US Aggregate	1.64	0.01	0.01	2.06	2.52
High Yield Bond	Barclays Capital US Corp High Yield	-4.53	-2.08	-2.08	7.23	3.83
US Real Estate	DJ US Select REIT	-6.61	-4.22	-4.22	1.97	7.89

Source: Morningstar Direct



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Volatility Spikes for Opposite Reasons



Source: CNBC.com on January 22, 2019



The Arsonist's Firehose

"Interest rates are still accommodative, but we're gradually moving to a place where they will be neutral. We may go past neutral, but we're a long way from neutral at this point, probably."

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- Fed Chair Jay Powell on December 19, 2018

*"We have the ability to be **patient** and watch **patiently** and carefully as the economy evolves."*

- Fed Chair Jay Powell on January 9, 2019



Asset Class % Returns as of March 29, 2019

“Patiently patient”

Asset Class	Index	3 Mos.	YTD	1 Year	3 Year	5 Year
U.S. Large-Cap Stock	S&P 500	13.65	13.65	9.50	13.61	11.09
US Large Cap Growth	Russell 1000 Growth	16.10	16.10	12.75	16.67	13.70
US Large Cap Value	Russell 1000 Value	11.93	11.93	5.67	10.54	7.91
U.S. Mid-Cap Stock	Russell Mid-Cap	16.54	16.54	6.47	12.00	9.05
U.S. Small-Cap Stock	Russell 2000	14.58	14.58	2.05	13.11	7.45
International Stock	MSCI EAFE (NET)	9.98	9.98	-3.55	7.77	2.45
Emerging Market Stock	MSCI EM (NET)	9.91	9.91	-7.28	11.68	3.89
Investment Grade Bond	Barclays Capital US Aggregate	2.94	2.94	4.48	2.10	2.74
High Yield Bond	Barclays Capital US Corp High Yield	7.26	7.26	5.93	8.84	4.70
US Real Estate	DJ US Select REIT	15.72	15.72	19.73	5.43	9.09

Source: Morningstar Direct



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“The Powell Pivot”



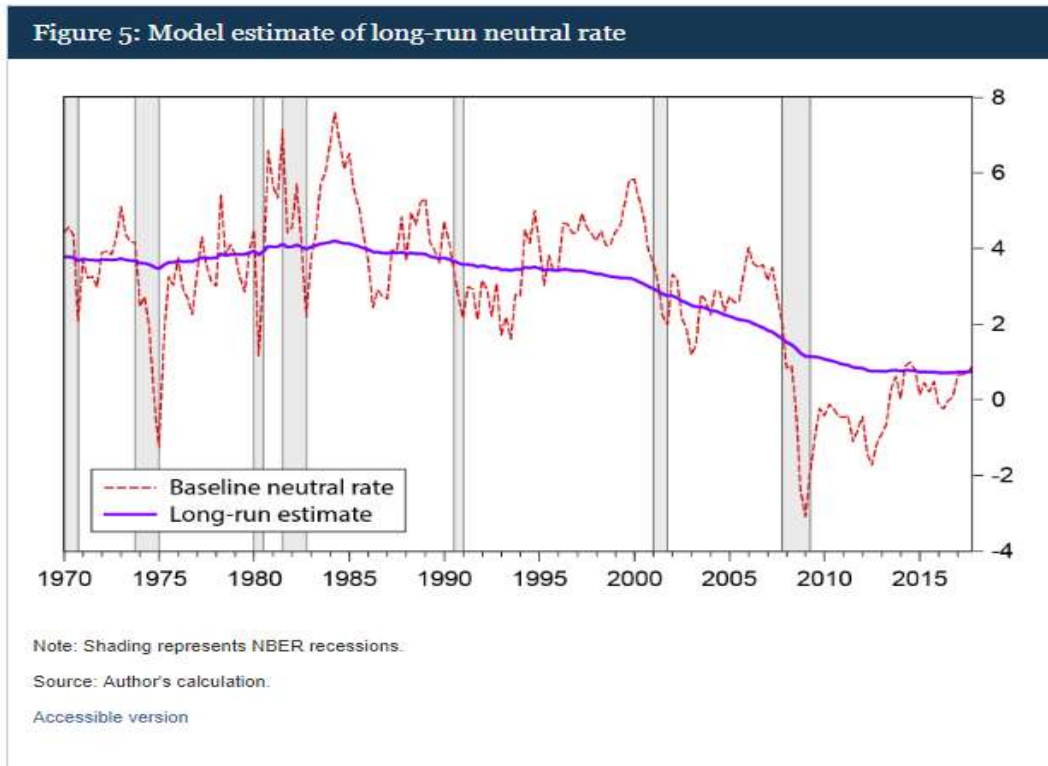
Source: Retrieved from CNBC.com on April 4, 2019



Secular Downward Trend



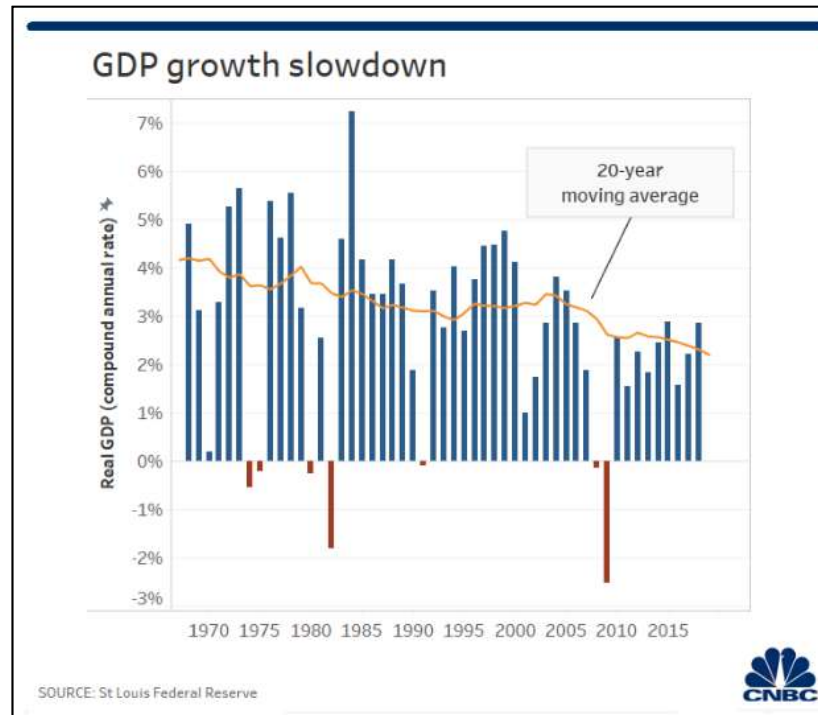
Equilibrium Rate Heading Lower



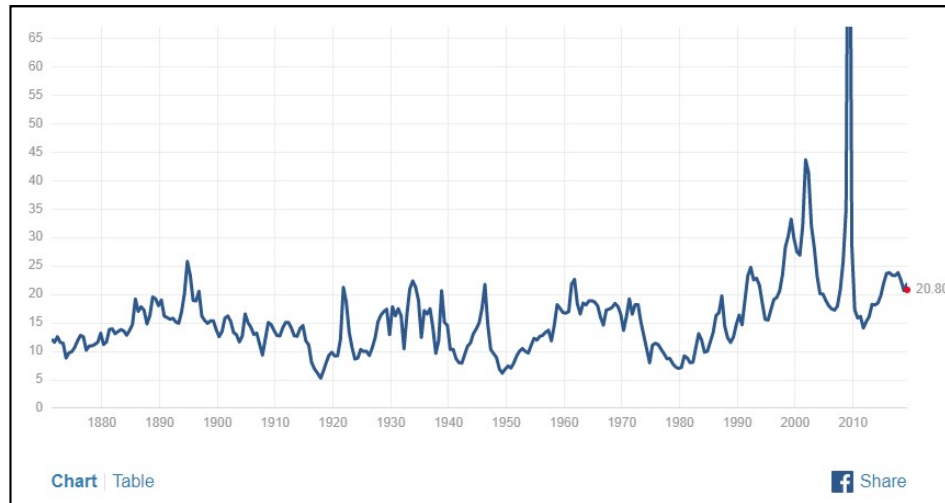
Source: U.S. Federal Reserve Bank of San Francisco



Why It's Happening



S&P 500 PE High But Not Crazy



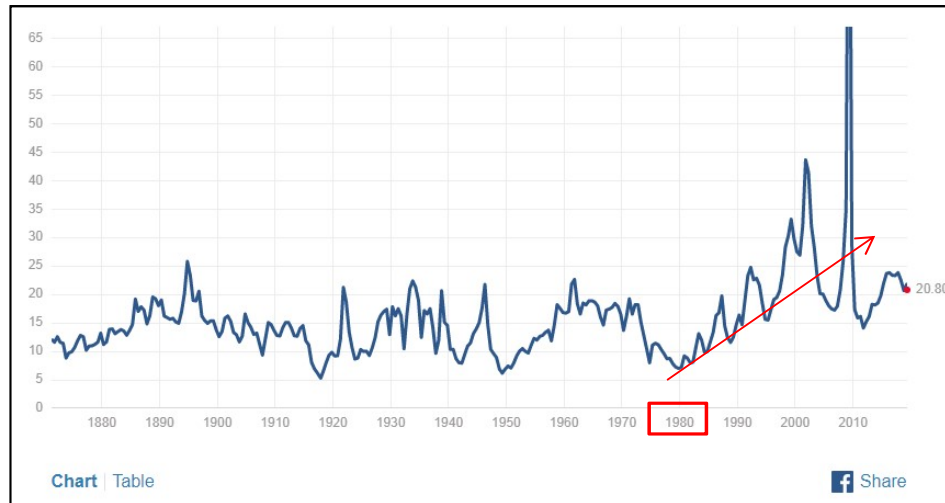
Source: Retrieved from multpl.com on May 28, 2019

Current: 20.80

Average: 15.75



S&P 500 PE High But Not Crazy



Source: Retrieved from multpl.com on May 28, 2019

Current: 20.80

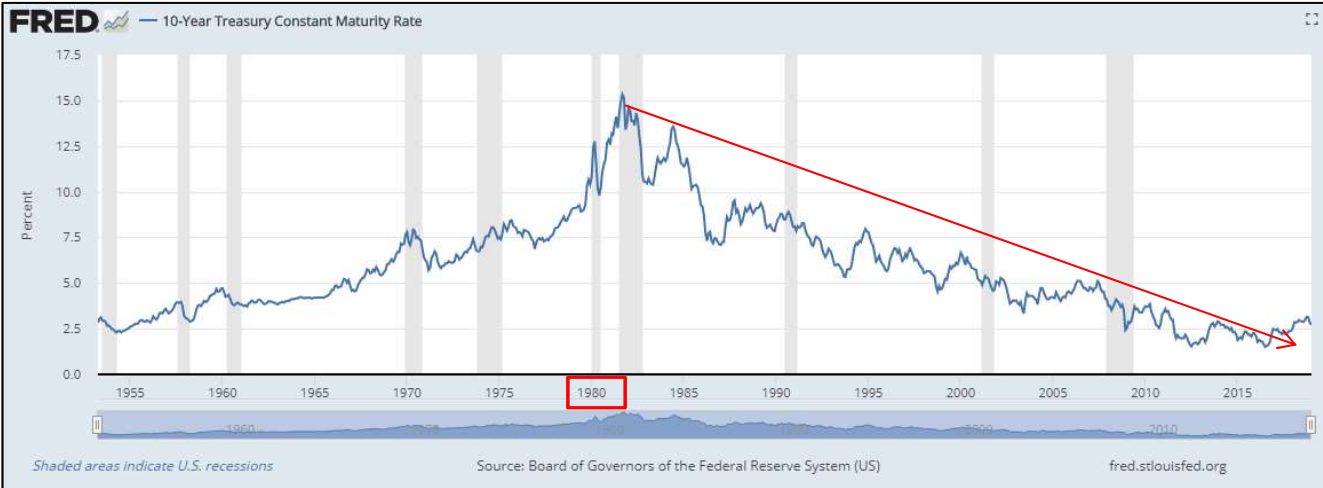
Average: 15.75



Secular Downward Trend



Secular Downward Trend



2019 Estimated Equity Returns

2019 Forecast

Source: CUNA Mutual Fiduciary Consultants

EQUITY	Large Cap Core	Large Cap Value	Large Cap Growth	MidCap	SmallCap	EAFE	EM	REIT	Infrastructure
Real Growth	1.48	1.48	1.48	2.09	1.96	1.48	4.00	-	-
CPI	2.13	2.13	2.13	2.13	2.13	1.70	2.90	2.13	2.04
Dividend Yield MONTHLY	1.90	2.50	1.27	1.78	1.42	3.13	2.52	4.44	4.28
Valuation Adj MONTHLY	(0.93)	(0.70)	(1.19)	(0.38)	(0.20)	2.29	0.22	-	-
Total	4.58	5.40	3.68	5.63	5.31	8.60	9.63	6.57	6.32

2018 CMAs

EQUITY	Large Cap Core	Large Cap Value	Large Cap Growth	MidCap	SmallCap	EAFE	EM	REIT	Infrastructure
Real Growth	2.03	2.03	2.03	2.69	2.52	1.61	4.14	-	-
CPI	2.30	2.30	2.30	2.30	2.30	1.70	2.99	2.30	2.13
Dividend Yield	1.89	2.44	1.26	1.73	1.40	3.00	2.30	4.39	3.93
Valuation Adjustment	(1.65)	(1.78)	(1.46)	(1.25)	(1.44)	0.33	(0.88)	-	-
Total	4.56	4.99	4.13	5.47	4.78	6.63	8.55	6.69	6.06

Difference: 2019 2nd pass vs 2018 CMAs

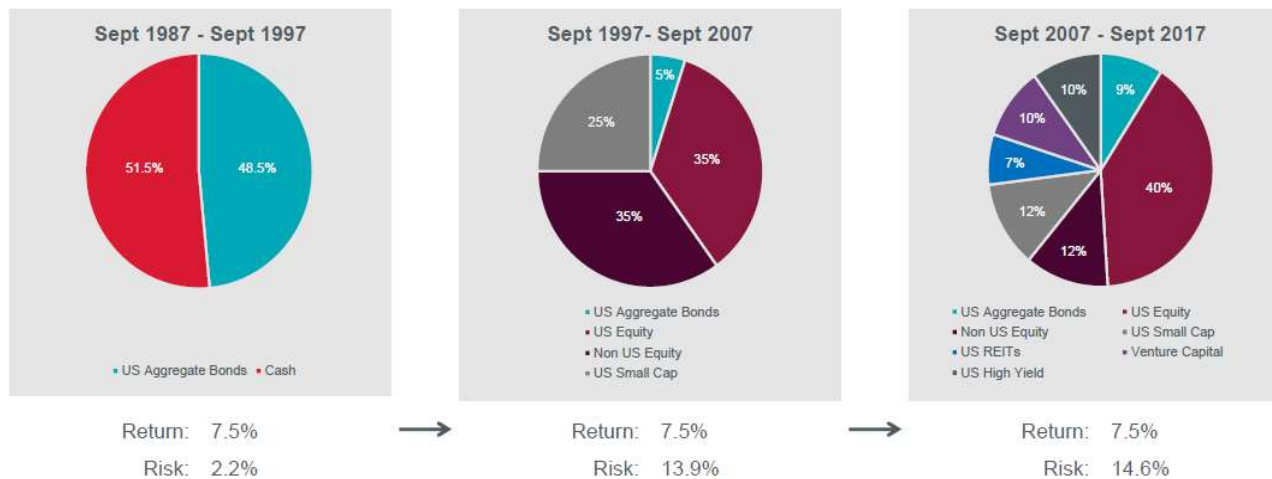
Difference	0.01	0.41	(0.45)	0.16	0.53	1.96	1.09	(0.12)	0.26
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What happened to double-digit expected stock returns?



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ASSET ALLOCATIONS WITH MORE RISK NEEDED TO ACHIEVE THE SAME RETURN



Source: Wilshire Analytics. Hypothetical portfolios were created using historical index risk, return and correlations, to achieve a 7.5% total return. Portfolios rebalanced monthly. All dates are as of September 30, 2017.
 Cash represented by Cit 3 Month T-Bill, Non-US Equity represented by MSCI EAFE Index, US Aggregate Bonds represented by Bloomberg Barclays U.S. Aggregate Index, US Equity represented by S&P 500 Index, US REITs are represented by FTSE NAREIT - All Equity REITs Index, US Small Cap represented by Russell 2000 Index, Venture Capital represented by Wilshire - Venture Capital Index.
 MFS Fund Distributors, Inc., Boston, MA



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Looking Forward – Long Term

Recent data suggest the economy and financial markets have evolved

- Evidenced by an outsized negative reaction to recent hikes in interest rates and shrinkage of the Fed’s balance sheet
- Likely attributable to changing demographics, i.e. general aging of the population
- After a long period of extraordinary post-GFC monetary policy, including negative interest rates overseas

Equilibrium interest rates and inflation expectations have been reset lower

Interest rates are the first building block of investment returns

- Structurally lower interest rates likely lead to below-historic-average returns
- Financial markets will not “save for investors”

Something will have to give:

- Save more
- Spend less
- Take more risk



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*As of April 31, 2019

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Preparing For Uncertainty

Presented by

Fred Eisel

Chief Investment Officer
Vizo Financial Corporate
CU



“Preparing For Higher Rates”

(2018)

Presented by

Fred Eisel

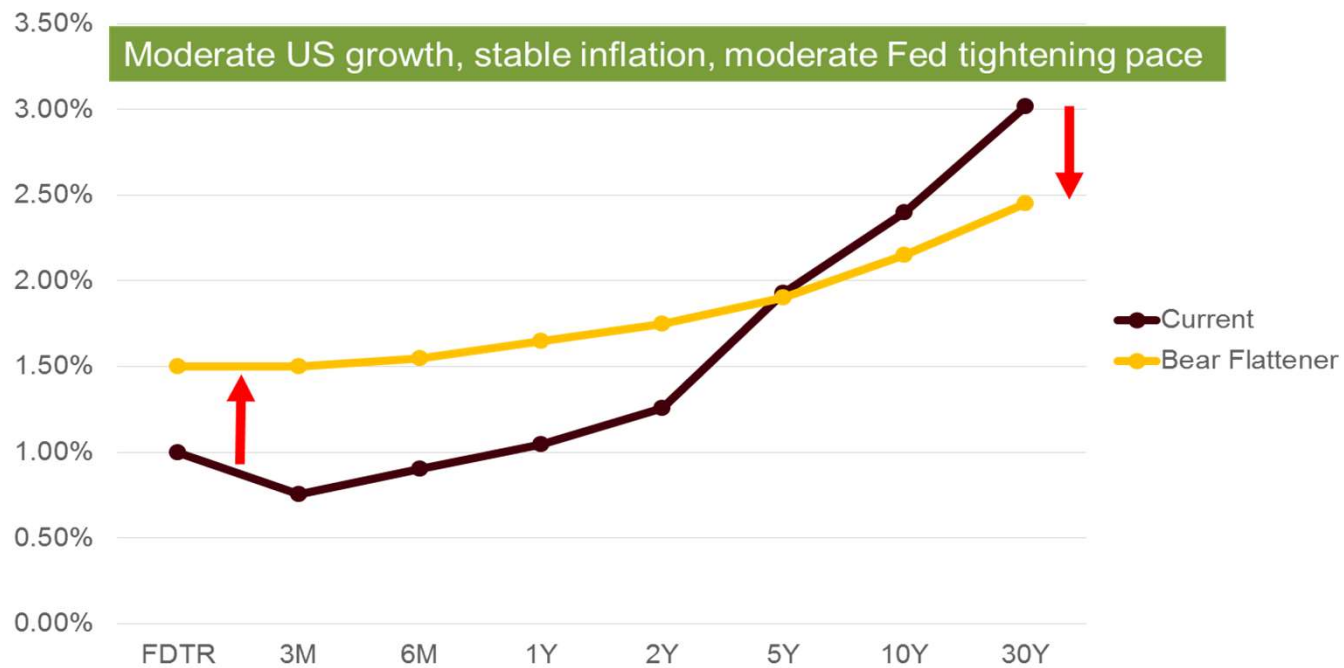
Chief Investment Officer

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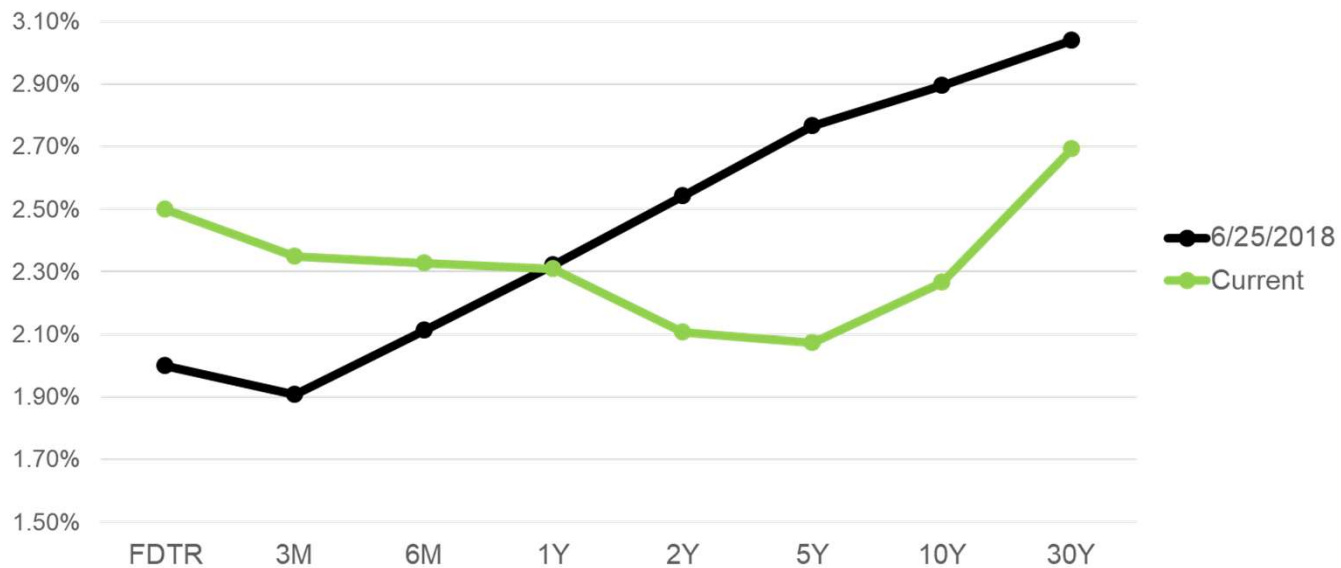


Curve - Bear Flattener (2018)



Curve – Inversion??

Moderate US growth (*slowing?*), stable inflation (*falling?*) and Fed on hold



FOMC Comments

*"Participants noted that **even if global economic and financial conditions continued to improve, a patient approach would likely remain warranted, especially in an environment of continued moderate economic growth and muted inflation pressures.**"*

FOMC Minutes, *from May 1st meeting*



Markets Pricing in a Cut

United States Instrument Futures: Fed Funds - Effective Fed Effective Rate 2.38

1) Overview 2) Future Implied Probability

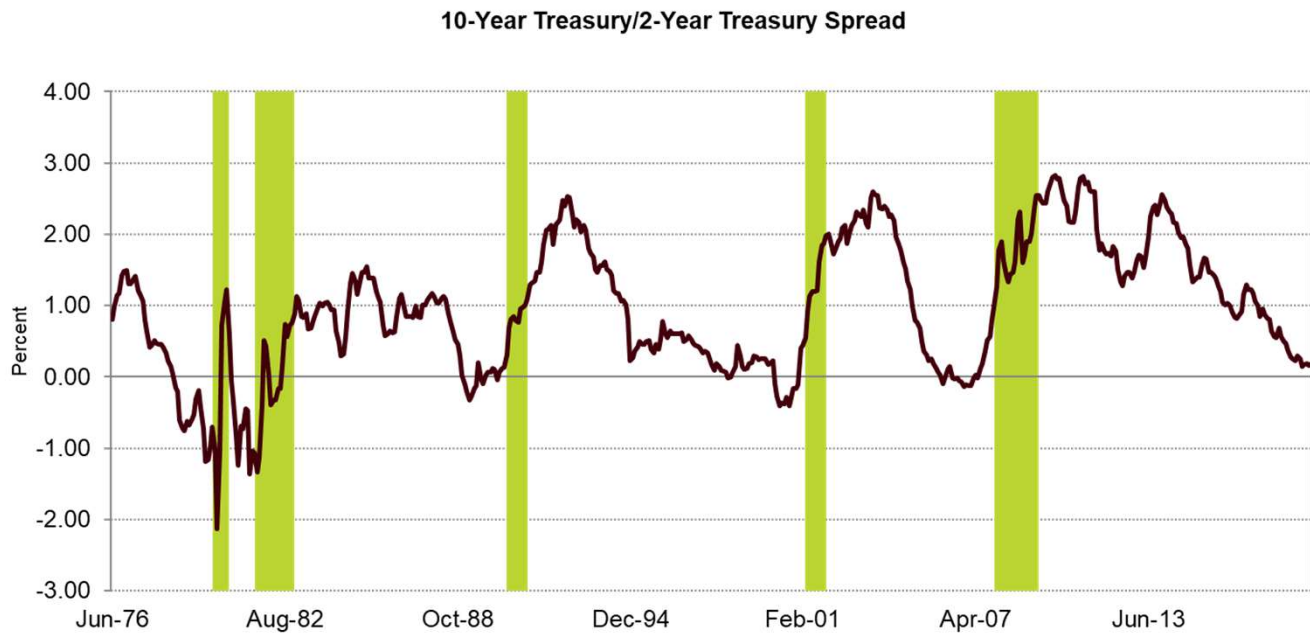
Current Implied Probabilities 3) Add/Remove Rates

Dates Meeting Calculation Calculated 05/28/2019 Based on rate 2.25-2.50

Meeting	Hike Prob	Cut Prob	1-2.5	2.5-1.5	1.5-1.75	1.75-2	2-2.25	2.25-2.5	Fwd Rate
06/19/2019	0.0%	6.3%	0.0%	0.0%	0.0%	0.0%	6.3%	93.7%	2.37
07/31/2019	0.0%	19.4%	0.0%	0.0%	0.0%	0.9%	18.5%	80.6%	2.34
09/18/2019	0.0%	52.1%	0.0%	0.4%	8.1%	43.7%	47.9%	2.24	
10/30/2019	0.0%	64.3%	0.1%	2.3%	17.1%	44.8%	35.7%	2.17	
12/11/2019	0.0%	82.1%	1.2%	9.7%	30.9%	40.2%	17.9%	2.05	
01/29/2020	0.0%	87.1%	3.6%	15.7%	33.5%	34.0%	12.9%	1.98	
03/18/2020	0.0%	90.7%	7.0%	20.7%	33.7%	28.1%	9.3%	1.91	
04/29/2020	0.0%	92.6%	9.7%	23.3%	32.5%	24.3%	7.4%	1.86	
06/10/2020	0.0%	94.4%	13.0%	25.5%	30.5%	20.2%	5.6%	1.80	



Curve flattening



Source: Federal Reserve Bank of St. Louis/FRED



Liquidity Considerations: *Rising Interest Rates (2018)*

- Loan Demand?
- Share Loss?



Prospective IRR Considerations (2018)

- Potential changes in share mix to more rate sensitive funds and/or share attrition
- Impact of changing yield curve

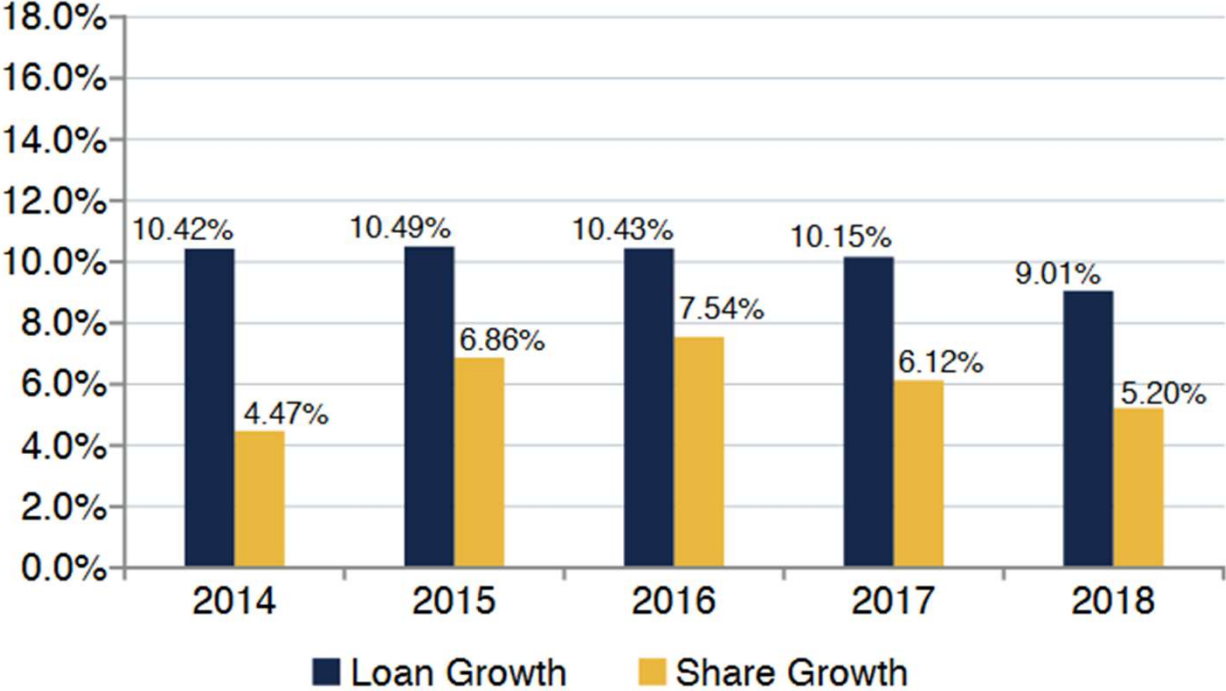


Prospective IRR Considerations (2018)

- Pricing is critical in managing risk when rates begin to increase – especially share pricing
- Managing levels of loan vs share growth



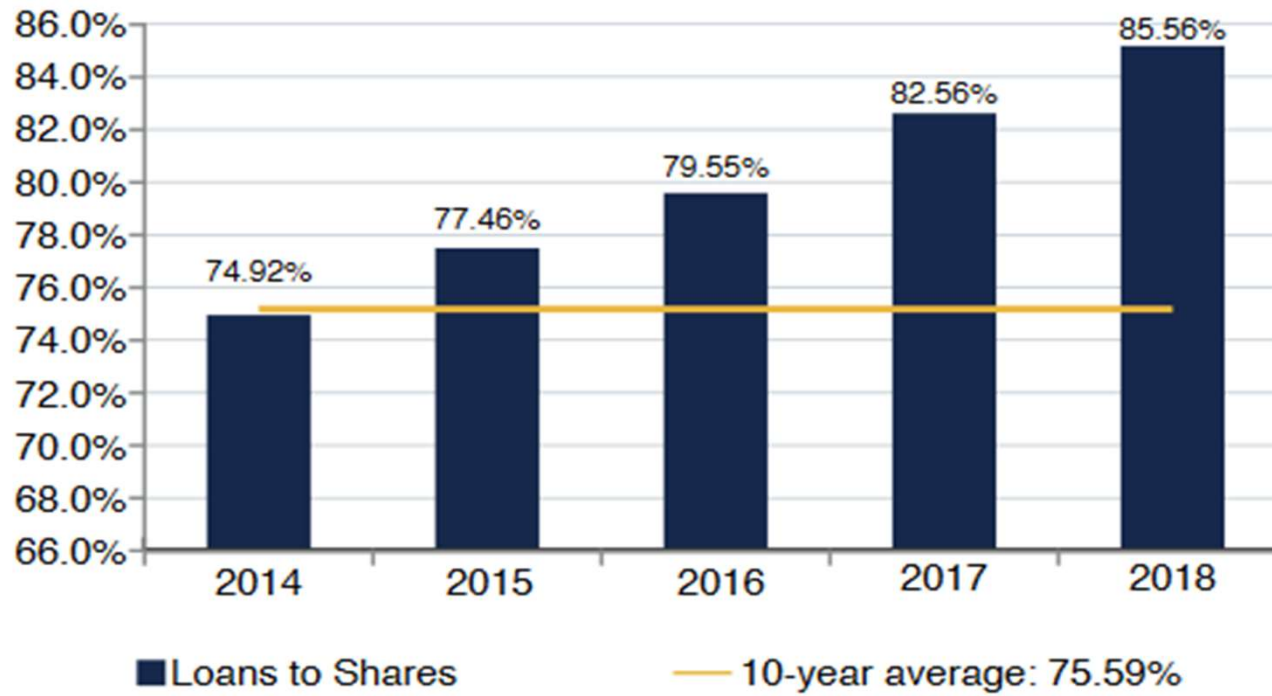
Loan Growth vs. Share Growth



NCUA – December 2018

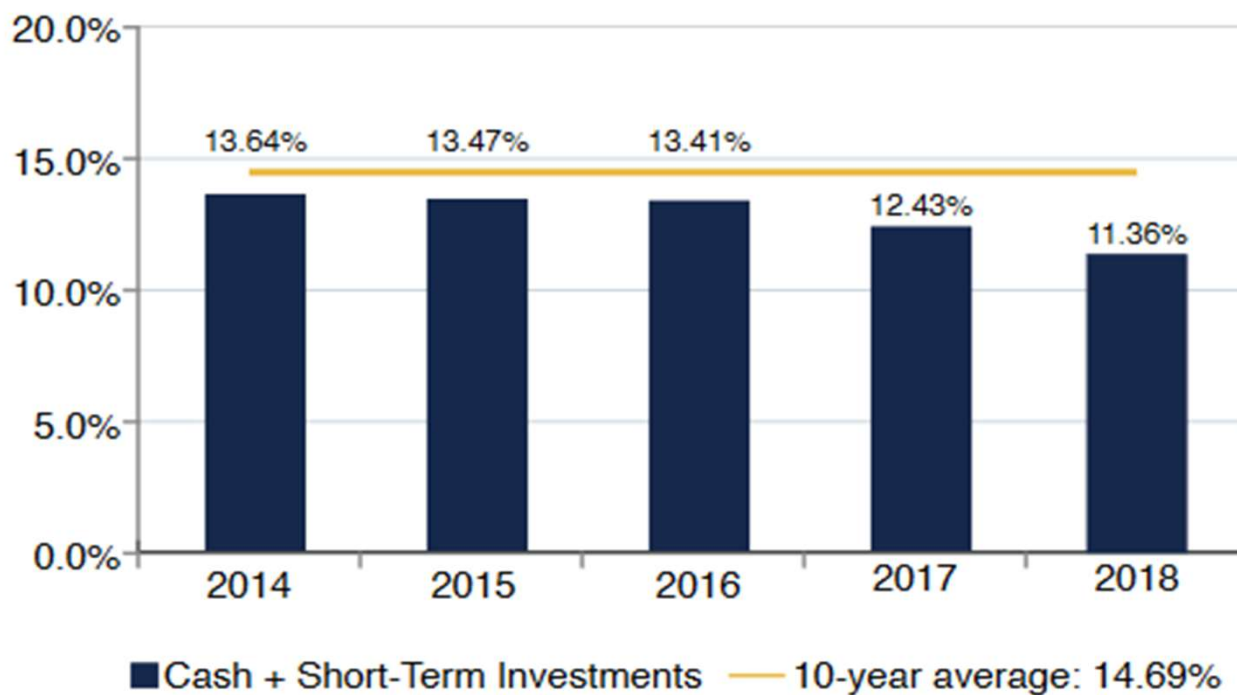


Total Loans / Total Shares



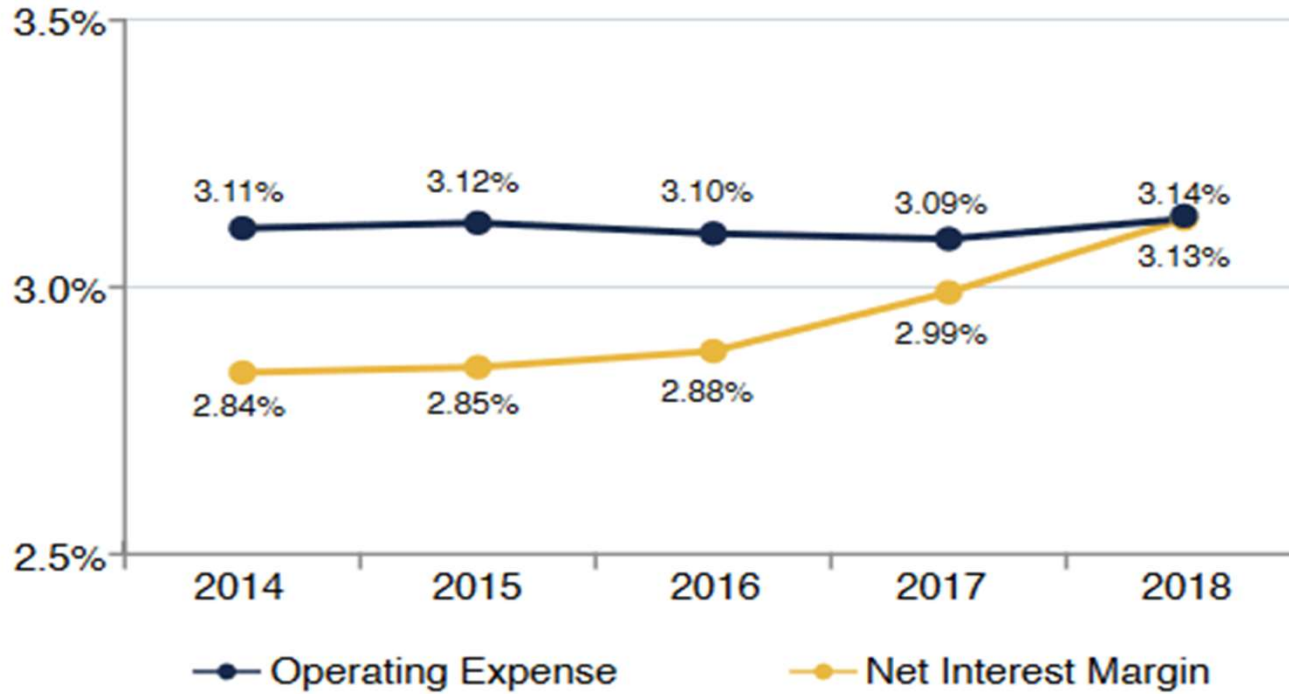
NCUA – December 2018

Cash + Short-Term Investments / Assets



NCUA – December 2018

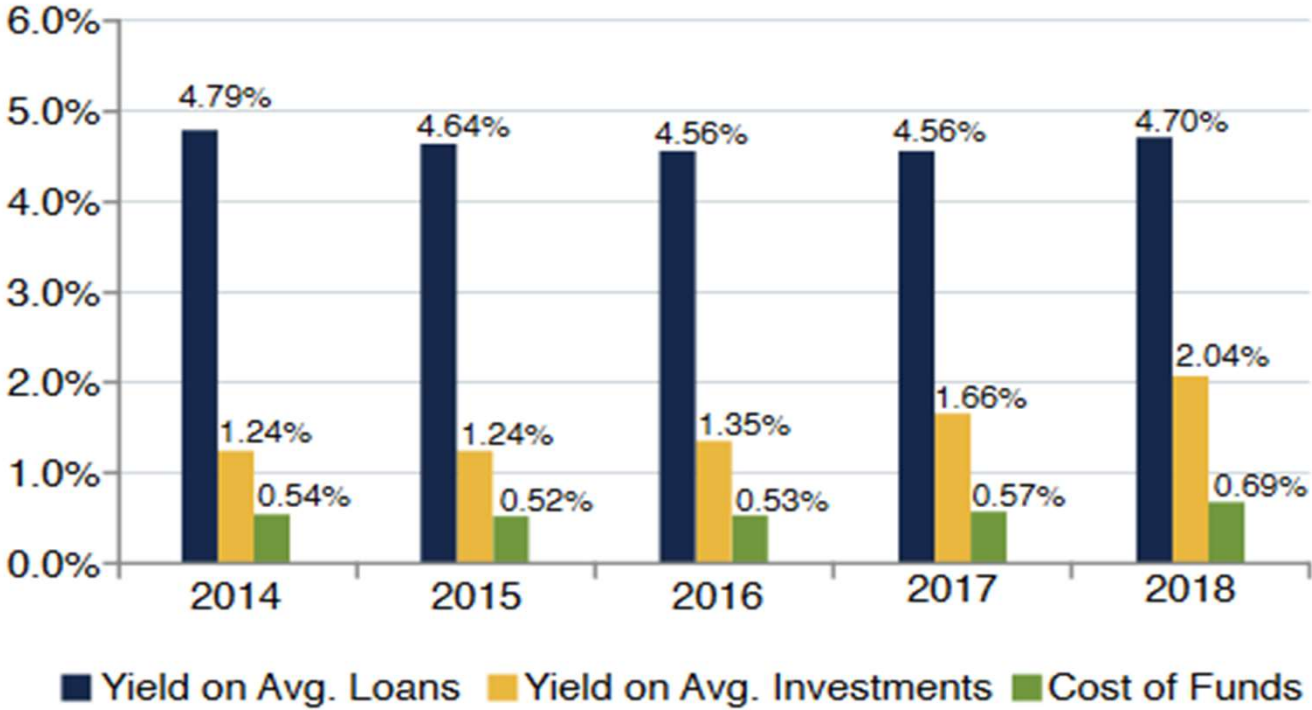
Operating Expenses vs. Net Interest Margin



NCUA – December 2018



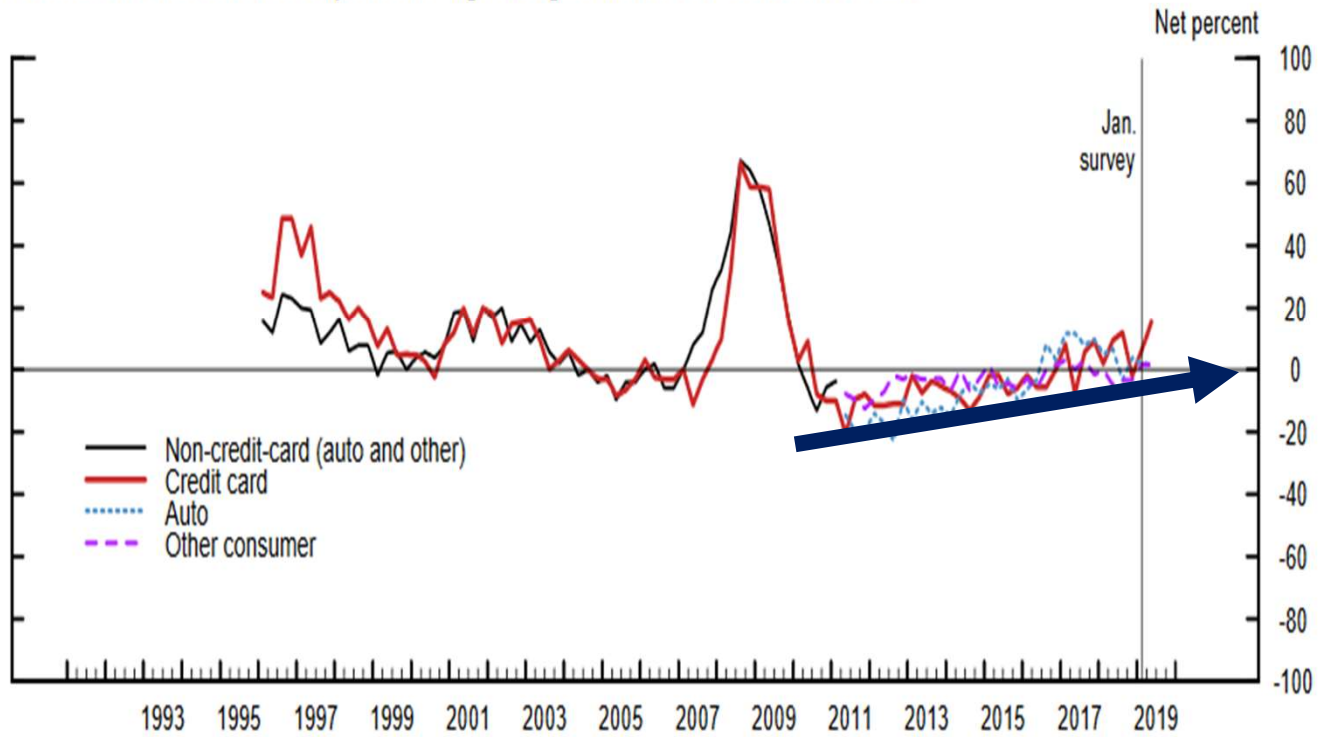
Yields vs. Cost of Funds



CUNA – December 2018



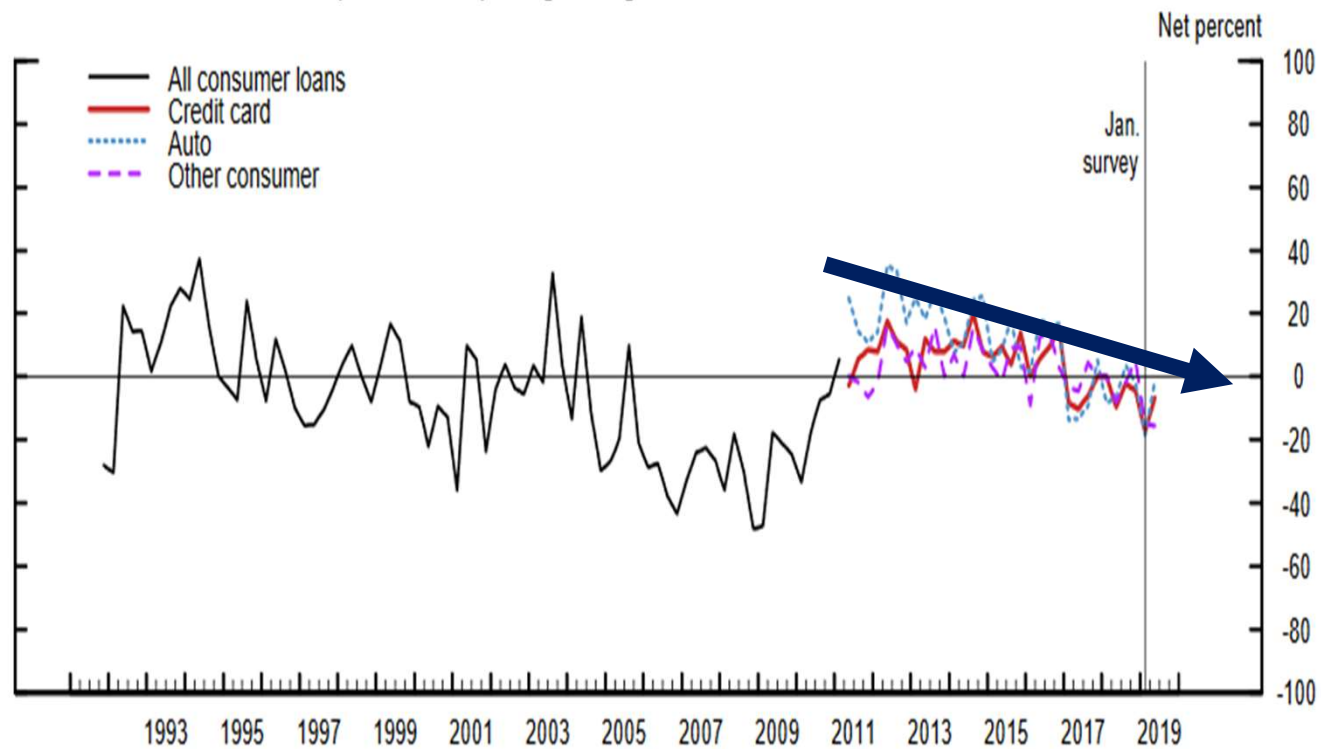
Net Percent of Domestic Respondents Tightening Standards for Consumer Loans



Federal Reserve - Senior Loan Officer Opinion Survey on Bank Lending Practices – April 2018



Net Percent of Domestic Respondents Reporting Stronger Demand for Consumer Loans



Federal Reserve -Senior Loan Officer Opinion Survey on Bank Lending Practices – April 2018



Liquidity has become KEY

- NCUA focused on liquidity
- Resources: cash, LOCs, FHLB, etc.
- Contingency Funding Plan (CFP)
 - Need to focus on this!



What we haven't done in awhile

- Testing or planning for various yield curve scenarios
 - Flat for 2019? 2020?
 - Inverted for how long? Quick inversion? Curve steepens?
- Is this the new normal?
- Run “recessionary” environment scenarios
 - Tighter liquidity? Will deposits ever come back?
 - Tighter margins? Are you repricing quick enough?
 - Higher liquidity and lower rates? Are you repricing quick enough?
 - Higher delinquency and charge-offs?
- Looked at “core” deposits lately?



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