Date: March 14, 2022

Subject: Eagle Eye - Market Commentary, March 14

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V is for Volatility – i.e., Why SBA Debenture Rates Rose in March

Q. What happened to credit markets with the following unique combination of conditions:

- The US labor market is tight and supply chains stay stressed
- Europe experiences the first conventional war in the region since 1945 and commodities spike
- The financial system getting stressed from sanctions against Russia
- US inflation above 7% for months and inflation expectations getting unmoored
- The Fed under great pressure - Quantitative Easing will turn to Quantitative Tightening
- The Fed, therefore, cannot have the markets' back in a crisis

A. The answer is that markets experienced "*macro-induced volatility*" *with a flight to liquidity*.

This is the technical phrase for when investors and traders are highly risk-averse and therefore markets get messy and very challenging to navigate. Treasuries and Treasury-collateralized short-term loans become the preference to raise liquidity and reduce risk. Other markets may not closely track Treasury yields in such conditions, even government-guaranteed securities like SBA. *It's about liquidity, not credit quality.*

In the chart below you can see a picture of the resulting volatility we're referencing with this portion of the narrative. Note that the underwriting cycle for the SBA 504 pools typically starts on the Friday before pricing and ends on the Friday after when the pools are freed to trade in the secondary market.

- When Eagle started preliminary discussions with the underwriters for the March sale on the 4th, the 10-year Treasury note yield was 1.7%
- The week before the yield had dropped from over 2% to 1.7%
- Yet over just three days before our discussions, the yield flipped up from 1.7% to 1.9% and back down to 1.7%
- The yield then rose off that 1.7% base throughout the marketing period of March 8-9
- By pricing on March 10, it was 30 basis points higher, at 2%, versus the start of the underwriting cycle, and nearly identical to the February 8 spot of 1.99%

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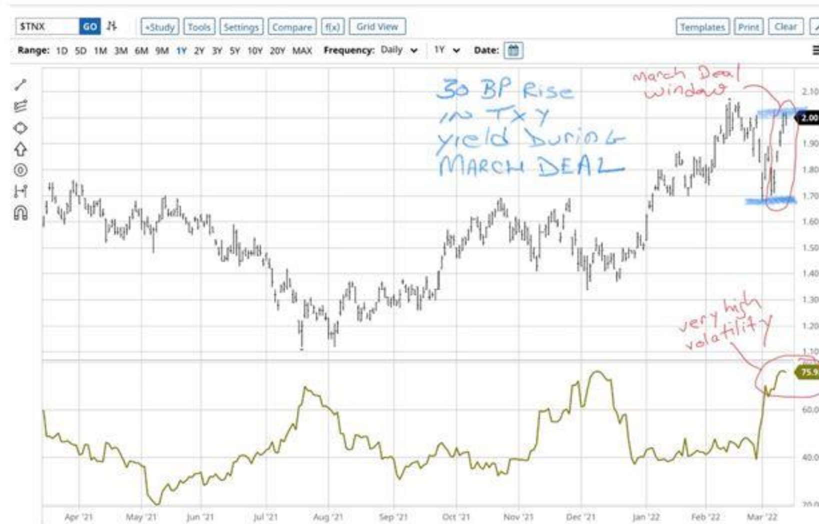
That was tremendous volatility for a highly liquid interest rate like the 10-year Treasury. It was this intense intraday whipsaw of volatility that drove all types of investors, not just SBA buyers, to seek liquidity as shelter.



It therefore took additional "spread" to entice investors to buy into the March SBA pools. The debenture rate required to place the 25-year pool, for example, increased on a monthly basis by 33 basis points while the Treasury benchmark was almost unchanged. That is a sharp m/m increase in the "spread" looking back over the last 20 years, something experienced on a frequency of about once every two years, not unheard of, but not common. Looking at the chart below of the debenture spread versus Treasury since 1999 we've highlighted in red some periods of time where the spread moved up sharply. You can see they involved times of high stress in the markets.

Only referencing the Treasury benchmark in estimating SBA 504 debenture rates may be misleading in the kind of markets we now have. If we look at other interest rates, including mortgage rates, we see they all had risen since February. Below is a table of interest rates and changes on a monthly and year-to-date basis.

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Instrument	Rate	MTD change	YTD change
SBA 504 25-year	2.75%	+33 bps	+90 bps
10-year Treasury	2.00%	+ 1 bps	+48 bps
FNMA CMBS	2.69%	+25 bps	+81 bps
FNMA RMBS	3.05%	+30 bps	+104 bps
Inv. Grade Corporate	3.83%	+63 bps	+123 bps
30-year Mortgage	3.85%	+14 bps	+74 bps

You'll see in the table referenced not only Treasury, the most liquid instrument in the world, but three federal agency instruments (from SBA and FNMA). We also referenced the ICE investment grade corporate bond index for a measure of credit, and also the national average 30-year mortgage rate.

What we see in the table is that the outlier is the relatively low change in the 10-year Treasury. Every other interest rate moved up quite a bit on a year-to-date basis and, with the exception of the 30-year mortgage rate (which already moved up in advance), the other interest rates moved up a lot on a month-to-month basis. It's important to place the movement of the March vs February SBA debenture rate in this context.

In summary, SBA is government-guaranteed but, like all federal agency paper, does not benefit from a flight to liquidity in volatile markets. In such markets the SBA pool interest rate must increase, sharply at times (see esp. 2008 in the second chart), relative to Treasury to place all the debentures. SBA 504 borrowers were funded even in cataclysmic markets (again, see 2008) but one could not easily predict the interest rate it took to clear.

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