

Balance Sheet Insights

PIPER SANDLER FINANCIAL STRATEGIES

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Key Themes and Trends Heading Into 2021

Please see this week's [Rate Sheet](#) and [Yield Curve Opportunities](#).

As everyone's minds turn to wrapping up 2020, we thought we'd share some of the recent topics that have dominated our conversations, across a variety of different areas. Thanks to all of you that tuned in to our 2020 seminar earlier this week. These topics will look familiar to you.

Beyond reading these topics and seeing which ones are immediately applicable to your institution, we encourage prudent managers to do two things:

1. Identify which topics might not apply to you now, but may come into focus in 2021 as balance sheets and industry trends shift. Get the education process started early.
2. Recognize that while some of these topics may not wind up being directly relevant to your institution, even in the mid-term, they may affect some of your closest competitors. Understanding the effect these strategies or topics will have on their ability to compete with you will prepare you better for the challenge.

Let's dig into the topics:

Preparing Balance Sheets for 2021

- Institutions are delevering balance sheets and branches, taking losses, and allocating cash
- Understand the difference between tactics and strategy
- Define how you measure liquidity strategically
- Value the right things in 2021 — adapt and improvise

The US Economic Environment: Under the Grip of COVID-19

- A chronic shortfall in aggregate demand created by COVID-19 relative to the economy's productive capacity should keep inflationary pressures muted throughout 2021
- The official unemployment rate should remain elevated above 6% as health risks linger and some degree of social distancing remains in place. Furthermore, many companies will not recover from the damage they experienced in 2020
- Interest rates are not predictable over the short run, but are controlled by fundamentals on a long-term basis. Strong disinflationary forces will continue to pressure the long end of the yield curve lower keeping the 10-yr Treasury rate within its 30yr old trading channel

Asset Liability Management Trends

- It's an opportune time to review deposit assumptions, with a full rate cycle in just two years quantifying customer-specific historical data points, coupled with the OCC data release providing peer metrics for context
- Topics to consider for exam prep include: dynamic balance sheet modeling, back-testing previous falling rate projections, and understanding potential outliers vs. peers regarding AL profiles, policies, and key assumptions

- Explore opportunities to moderate earnings volatility, position for a variety of scenarios, and consider adding protection when it's inexpensive

Hedging Balance Sheets in 2021

- Ignore the urge to bet on rates and instead manage the interest rate risk specific to your institution
- Historically low interest rates make it an attractive time for liability-sensitive banks to buy upside rate protection
- Asset-sensitive banks can add income today by receiving fixed on a swap

Optimizing Investment Portfolio Liquidity, Credit, and Tax-Efficiencies Amidst Uncertainty

- Moving down the coupon stack in Agency MBS helps with yield stability, but make sure extension risk is being monitored
- Increasing cash positions, tightening corporate spreads, and margin pressure are spurring banks to look at alternatives such as bank subordinated debt, RPLs, and FFELP
- Supply/demand makes tax-exempt munis rich—look to taxable munis for relative value
- MBS have held in despite the recent Treasury sell-off; still opportunity to offset MBS gains with losses in other areas of the portfolio needing cleanup
- Sell what the Fed is buying. Buy what they are not

Balance Sheet Trends, Transaction Trends, and Franchise Value

- The most consistent way to demonstrate franchise value is to deliver low-cost core funding, good profitability, and paying attention to liquidity, NPAs, and NIM depending on the market environment
- The environment in 2020 made it difficult to measure these metrics
- Take advantage of a market that cannot appropriately value traditional metrics and use the opportunity to build franchise value for a future return to normalcy
- Depending on your institution's metrics, there are tactics and strategies available that can enhance franchise value in 2021
 - Delever non-core balance sheet items
 - Revisit M&A and consider more creative solutions
 - Add non-interest income
 - Prepare policies and procedures for new asset classes
 - Consider capital needs for the future

These are just teasers for deeper explorations of each area. Reach out—we'd love to explore with you.

If any of our observations pique your interest, please contact your Piper Sandler representative or email us at PSFS@psc.com. For derivatives, please email our affiliate, Piper Sandler Hedging Services, LLC, at FSG-Derivatives@psc.com.

Other Thoughts from Around the Firm

Technology is at the forefront of senior bank executives' minds as winning new customers, increasing efficiency and managing risk, through the implementation of new technology, is core to their strategic plans. This was highlighted in the results of Piper Sandler's 1st Fintech Survey. Senior bank executives are steadfast in their commitment to grow and evolve their business through technology, although concerns around cost, return on investment, business interruption and interoperability with current systems can slow adoption.

As we endeavor to better understand our depository clients' views on Fintech, we have prepared our 2nd Fintech Survey - please see the link below. By clicking on the link, you will be taken to Survey #2 which builds on Survey #1 by gathering additional information on tech strategy, vendor selection and core banking systems.

This 5 minute survey can be filled out by any and all members of your senior leadership team and, when completed, will meaningfully contribute to our continuing efforts to provide unparalleled thought leadership and best-in-class advice.

Thank you in advance for taking the time to respond to this survey and we look forward to sharing our insights with you.

LINK TO SURVEY:

[Piper Sandler FSG Fintech Survey #2](#)

If learning more about our recent work is of interest to you, please don't hesitate to contact FSG-Solutions at FSG-Solutions@psc.com for more information.

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