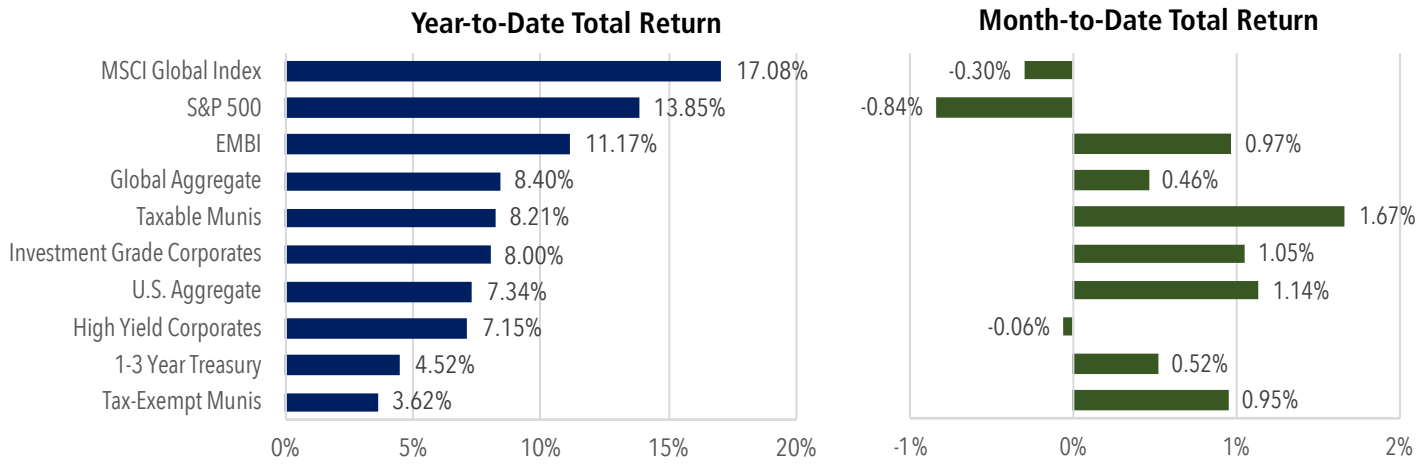
Week Ending: **October 17, 2025**

Out Of Bounds

Economic Overview:

Fed Chair Jerome Powell delivered remarks on the Fed's balance sheet on Tuesday—a well-timed speech, we say. As Powell outlined, "since June 2022, [the Fed] has reduced the size of [its] balance sheet by $2.2 trillion—from 35 percent to just under 22 percent of GDP," the so-called QT process. But Powell admitted the Fed doesn't want to push things too far, as shrinking Fed assets also reduces a key liability: bank reserves. Remember, the Fed's goal is to return reserves to an "ample" level. Market pricing suggests we may have already breached that level. The Secured Overnight Financing Rate (SOFR) spiked above the upper bound of the Fed's target range this week. As a result, 20 institutions borrowed from the Fed's Standing Repo Facility (SRF), the tool designed to enforce the ceiling on the Fed's target range, as banks can borrow from the SRF at the fed funds upper bound rate. Is there a shortage of reserves? Are Treasury security settlements clogging dealer balance sheets? Are there other credit issues in the banking system? For policymakers, out-of-bounds overnight rates warn of a similar funding market stress to that in September 2019. Consequently, the Fed could soon end QT and start buying T-bills to ensure bank reserves remain "ample."

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

Corporates: Volatility picked up this week as regional banks came into the spotlight once again: Zion Bancorp and Western Alliance Bancorp disclosed loan fraud losses related to First Brands Group and Tricolor Holdings. As a result, 74 of the biggest US banks shed more than $100 billion in market value on Thursday.

Municipals: In the most recent week, LSEG Lipper recorded $678 million in muni fund inflows, driven entirely by $807 million in flows into muni ETFs. Year to date, total muni fund inflows are tracking around $35.5 billion.

Equities: The U.S. equity market posted gains for the week, driven by an overall solid start to the corporate earnings season, despite heightened volatility amid shifting trade policies and renewed concerns over regional bank credit conditions. Sector performance was broadly positive with communications, real estate, and consumer staples leading markets higher while financials, health care, and energy lagged.

Securitized Products: Residential mortgage credit issuance has maintained its rapid pace. Year-to-date gross issuance is up 73% for non-QM and 85% for closed-end second liens/HELOCS on a year-over-year basis. Despite the onrush of supply, investor demand has remained strong even as macro conditions soften. Substantial credit enhancement and solid housing fundamentals, such as conservative underwriting and significant embedded HPA, serve as a tailwind for demand and credit performance.