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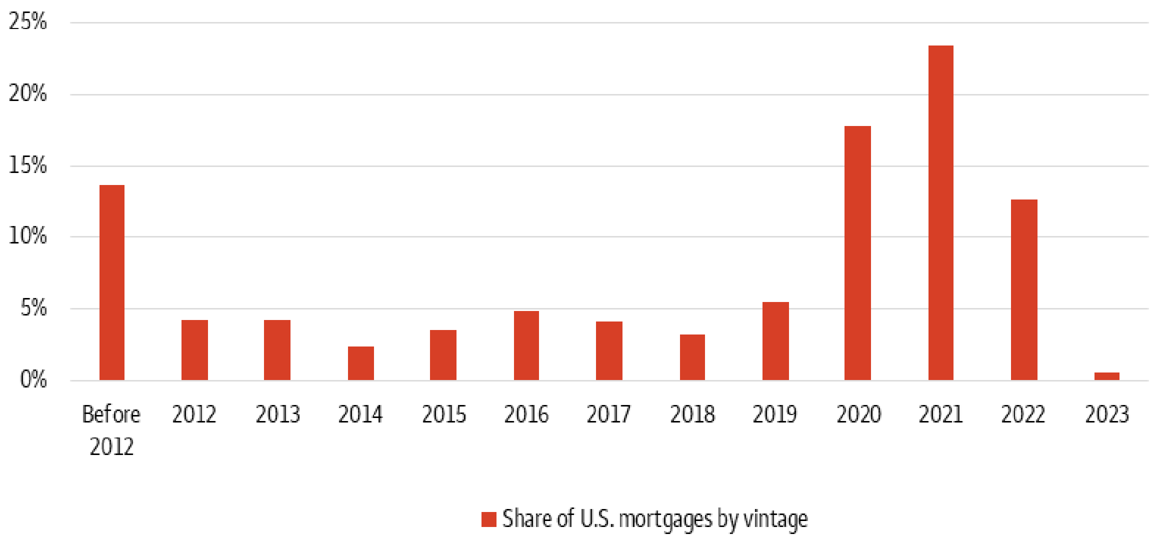
Investment Institute

Chart of the Week

Weekly market analysis on key market indexes — **March 21, 2023**

Regional banks — A mortgage puzzle



Sources: Bloomberg, Black Knight, and Wells Fargo Investment Institute. Data as of January 2023. Mortgage pool consists of the percentage of outstanding first lien mortgages by vintage — that is, when the mortgage was originated.

More than half of U.S. mortgages originated in 2020 or after

In 2020, federal funds rates were pinned near zero as the Federal Reserve (Fed) aimed to support the economy during the pandemic. These conditions led many consumers to take out a mortgage to buy a home or refinance an existing mortgage. More than half of the U.S. mortgages today originated in or after 2020, and approximately 70% have an interest rate under 4% according to S&P Global Market Intelligence.

Many of the mortgages originated in 2020 and 2021 found their way into other securities (such as mortgage-backed securities, or MBS). Government stimulus gave extra liquidity to consumers that helped increase deposits in banks, which the banks often invested in agency-backed MBS or in other government securities. In 2022, with the Fed aggressively raising interest rates to fight inflation, many of these securities portfolios began to show unrealized losses. What were once investments that would have been relatively easy to sell, if extra liquidity was needed by the bank, have now become problematic for some smaller banks. Selling now might realize losses that could reduce a bank's capital.

What it may mean for investors

In complex and fast-moving markets, we think investors should remain focused on the traditional drivers of the Financials sector: liquidity, capital, demand for credit, interest rates, and loss cycles.

With broad sources of deposits relative to smaller, more geographically concentrated regional banks, we believe the large universal banks look stable in this uncertain environment. Should market stress continue and investors become concerned about smaller institutions — whether that is a well-founded concern or not — we believe the universal banks could see deposits come their way.

Mike Ruesy, CFA, *Equity Sector Analyst*

This chart was excerpted from "Views on developments in regional banking," *Sector Insights* (March 13, 2023)

Risk Considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **Real estate** has special risks including the possible illiquidity of underlying properties, credit risk, interest rate fluctuations and the impact of varied economic conditions.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector.

In addition to the risks associated with investment in debt securities, a fund's investments in mortgage-backed and asset-backed securities will be subject to prepayment, extension and call risks. Changes in prepayments may significantly affect yield, average life and expected maturity. Extension risk is the risk that rising interest rates will slow the rate at which mortgages are prepaid. Call risk is the risk that If called prior to maturity, similar yielding investments may not be available for the Fund to purchase. These risks may be heightened for longer maturity and duration securities.

U.S. government securities are backed by the full faith and credit of the federal government as to payment of principal and interest. Unlike U.S. government securities, agency securities carry the implicit guarantee of the U.S. government but are not direct obligations. Payment of principal and interest is solely the obligation of the issuer. If sold prior to maturity, both types of debt securities are subject to market risk.

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