Total Risk Index and Economic News

Hello everyone, I'm Jamie Sumner, chief analyst of Seifried&Brew. For this week's webcast we want to cover the ***risk of the community bank benchmark*** over the past four quarters and see how that risk has changed. Last week we looked at the performance in terms of returns, as well as asset growth, and now we want to flip [to Slide 2] and look at the risk.

As you can see here [on Slide 2], the ***overall risk index*** for community banks has increased slightly when we look back four quarters. At the beginning of the year in 2016Q1 we were at a risk index of 41.64, and then we kind of picked a little up, and now we are up to a 42.28. So just a slight bit of an increase on the overall risk aspect of community banks.

Then we look at the different components of this risk index here [on Slide 3]. The first component is the ***credit risk*** area. Some might say that this is the biggest area of risk for community banks and banking in general. We can see here [Slide 3] that over the past four quarters we grew in this risk area from a 42.19 up to a 44.39. To put this into perspective, we always mark off the low to moderate risk around the 33 mark within our index. The high risk is somewhere around that 75 mark. So we are on the lower end of the moderate, which tends to typically be where we fall. With inside of your institution this is probably where you should be (42-43 mark). Below the 50's is where we like to see the overall credit risk index. If we float above the 50 mark and get into the 60 and 70 mark that is where we need to step back and ask ourselves "*if we are taking too much risk in that credit area*".

Moving on from credit risk we are going to look at ***liquidity risk*** [Slide 4]. Over the course of the year we can see that the liquidity risk picked up ever so slightly from 41.17 to 41.77 in 2016Q4. Overall throughout this time period what we have seen is that we have had this strong loan growth. We had deposit growth but it hasn't been able to keep up with that of loan growth. So we have either pulled from the investment portfolio which reduces liquidity or we are going out and getting wholesale borrowings, which in turn also increases liquidity risk. So overall we saw just a little bit of an increase in liquidity risk throughout the past year.

Looking at **capital risk** [on Slide 5] we focus in on capital ratios. We see this trail off just a little bit from 45.35 to 44.98. So it's just came down very little throughout this time period.

Lastly, the last component that we will look at today with inside this risk index is the ***Earnings at Risk Index*** **[Slide 6]**. We measure this earnings at risk by looking at the volitility with inside the net interest margin going back nine quarters. And we start to see this trail just a little bit off, it basically stays the same, from a 23.85 to a 23.65. So it just comes down ever so slightly. But this is where we see on average within that low level of risk with inside earnings at risk. Now remember, this is backwards looking; obviously your ALM model is forward looking and that's where you want to link up and say, "*are we seeing this similar layout with inside of our ALM model when we are looking at earnings at risk?"* or "*are we starting to see our sensitivities go beyond our risk tolereance* or *go beyond what the regulators are allowing?"* So we need to take that into consideration. But overall when we look at our index here for earnings we are still in that low level of risk looking at the sensitivity of that net interest margin. So overall with inside of that risk component, we have had a little bit of an uptick in risk in community banks, but not too much and it's kind of consistent with where we have seen the balance sheet moving throughout the past four quarters.

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We now want to end this webcast by just looking at the different economic news that came out over the past week. And we can see here (on Slide 7) that we had the ***Producer Price Index (PPI)*** come out. And it was a good 1.6% year-over-year growth in that index. So we saw a little bit of price inflation at the producers. The question *is, will we start to see this flow down into the retailers and out into the customers*? So maybe we saw a little bit of a foreshadow, maybe some inflation. The core PPI came in at 1.2%. When we are looking at the ***Consumer Price Index (CPI),*** another indicator of inflation, we can see this year-over-year is at a 2.5% so that's pretty robust. And then we look at the core 2.3% growth year-over-year that is showing a little bit of a bump up in the inflation according to CPI; we will see if this flows through to the ***Personal Consumption Expenditure Index (PCE)*** when we get that next release.The PCE is what the Fed tends to look at when they measure inflation, and they like to have that core at or around the 2% mark which we have been inching towards but are still below.

Looking at ***Retail Sales*** [cont'd on Slide 7], we saw a pretty good number come in at 0.4%, month over month. They revised December, and this is a pretty big revision.They revised December up to 1% growth month-over-month. That's important because that includes that last month of 2016. So potentially this 1% increase in retail sales is going to mainly have a positive impact in our GDP when they re-release that in the next release**. So keep an eye on the re-release of the GDP.** ***Retail Sales, Less Autos & Gas*** was actually up 0.7% month over month, which is another big positive for the retail sector and for our GDP because as you recall last December, when the December release came out, that was actually neutral. So you see some growth in that and that's positive and that was revised as well but from 0% to 0.1%. So it was a slight bit of an increase. But this Less Auto and Gas up 0.7% is a positive for our economy. So these numbers are looking good for a stronger **GDP**. And then we end with the ***leading indicators*** month over month up 0.6% continuing that momentum that we saw over the past couple of months and that's a big positive. We want to continue to see those leading indicators remain positive and increasing. So overall when we look at the economic numbers that came out last week it's a positive perspective. As we look into 2017 as we are beginning this year off, from what we see right now we are beginning this year on a pretty good footing and that's a big positive.

Hope everyone has a great short week (Presidents Holiday weekend) and everyone had a great long weekend and we look forward to seeing you next week back here at Seifried&Brew. Have a great week everyone!

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