BCBA
BLUEGRASS COMMUNITY BANKERS ASSOCIATION

2026 ANNUAL CONVENTION

AUGUST 24, 2026

ICBB

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Capital Markets

SERVICE BEYOND COMPARISON

What You're Probably Expecting

Region: United States »

Instrument: Fed Funds Futures »

Target Rate 3.75

Effective Rate 3.63

Pricing Date

Cur. I[illegible] Rate

Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate
09/16/2026	[illegible]	[illegible]	+0.131	3.762
10/28/2026	[illegible]	+26.3%	+0.196	3.828
12/09/2026	+1.230	+44.5%	+0.308	3.939
01/27/2027	+1.385	[illegible]	+0.346	3.977
03/17/2027	+1.450	[illegible]	+0.412	4.044
04/28/2027	[illegible]	[illegible]	+0.436	4.068
06/09/2027	[illegible]	+8.3%	+0.457	4.088
07/28/2027	+1.815	-1.3%	+0.454	4.085
09/15/2027	+1.768	-4.7%	+0.442	4.073
10/27/2027	+1.715	-5.3%	+0.429	4.060
12/08/2027	+1.607	-10.8%	+0.402	4.033

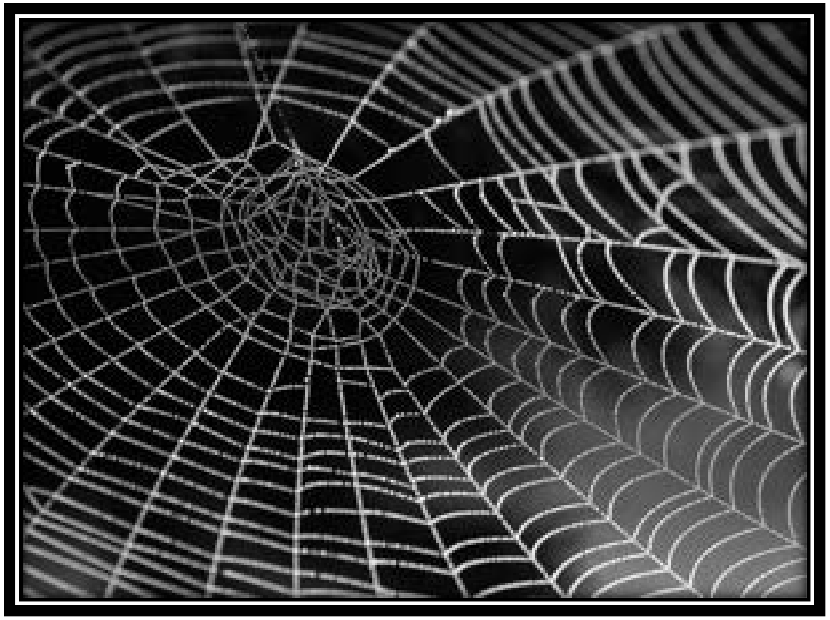
This Year

We Are Going Off-Road!

What If We're Wrong?

Risk, Fragility, Optionality and Decision-Making in an Unknowable World

And We Thought This Was True Several Years Ago!



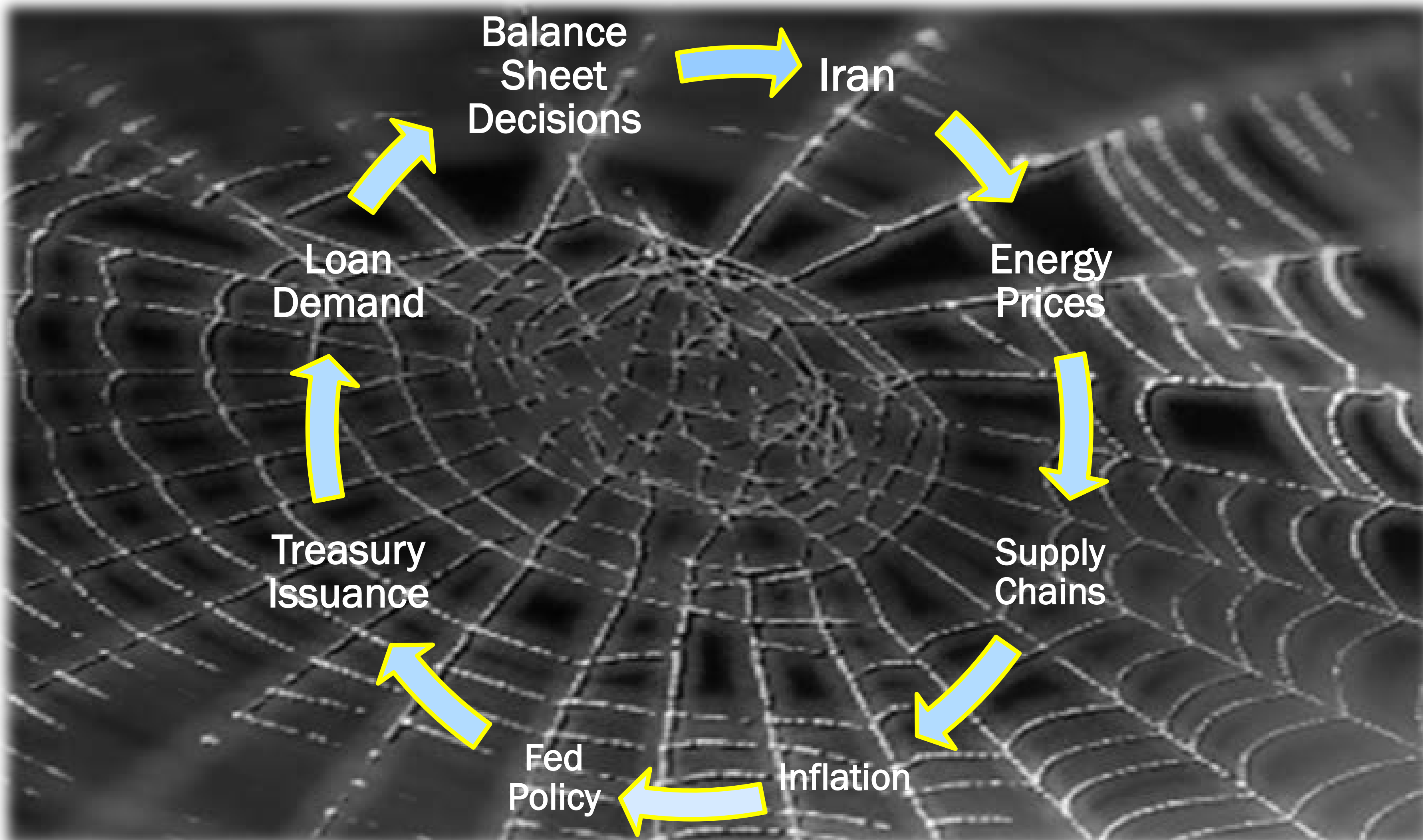
"...the world (economy) is like an enormous spider web and if you touch it, however lightly, at any point the vibration ripples to the remotest perimeter...It does not matter whether or not you meant to brush the web of things."

- Robert Penn Warren

(Born 1905 in Guthrie, KY)

- We are not helpless
- Your bank (and investment portfolio) must be designed to survive multiple plausible outcomes

Linear Forecasts Too Often Being Applied To Nonlinear Systems



Observation → Interpretation → Forecast → Action

Observation:
The Curve Is Inverted

Interpretation:
The Market Expects Slower Growth

Forecast:
Rates Are Going Lower

Recommendation:
Extend Duration

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Observation → Interpretation → Forecast → Action

- The problem isn't that the data is wrong
  - The problem is how quickly the facts became a story, and how quickly the story becomes actionable
  - We Mistake High Confidence For High Accuracy
- Each step may be reasonable BUT**...**

...<u>each step layers on assumptions</u>

Maybe We Really Don’t Understand Risk

In An Unknowable World

As Banks, What Do We Mean by Risk?

- *Probability* → Odds of something we have imagined

- *Risk* → What remains AFTER we have planned for what we can imagine

→ Risk Is The Part That Refuses To Fit Neatly In Our Models

→ "Risk is what's left over when you think you've thought of everything" – Carl Richards (The Behavior Gap)

The Fact That Something Isn't In The Report Does Not Mean It Isn't On The Balance Sheet

As Banks, What Do We Mean by Risk?

- Credit Risk
- Interest Rate Risk
- Liquidity Risk
- Deposit Betas
- Refinancing / Prepayment Risk
- Loan Losses
- Convexity

Are These *Your* Risks?

– Or -

Just The Risks You Thought To Model?

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How Many Of These "Black Swans" Were In Your 5-Year Plan?

- Dot-Com Bust
- 9/11
- 2008 Financial Crisis
- Zero / Negative Rates
- Covid-19
- Supply Chain Failures
- Inflation Surge
  - (Not "Transitory")
- 525 bps Fed Tightening
  - (In 16 Months)
- Liquidity Evaporation
- SVB Failure
- AI
- Energy Shocks
- Iran War

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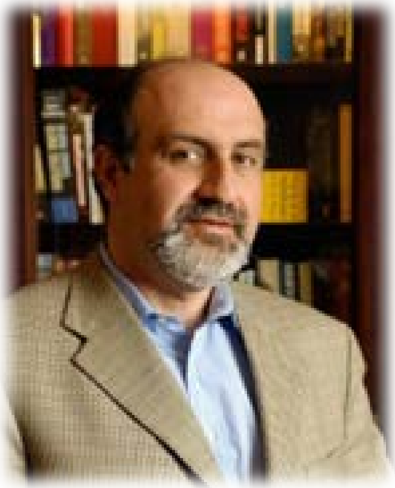
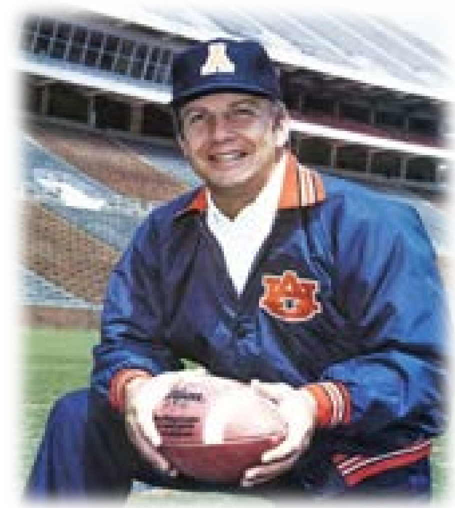
How Many Of These "Black Swans" Were In Your 5-Year Plan?



Black Swans Don't Look Black In The Rear View Mirror

(Foreshadowing: Bonus Deep Dive)

"Hindsight is Always 50/50"



Risk and Forecasting

The Wrong Lesson:

- Forecasts are unreliable, so planning is futile

The Right Lesson:

- Because forecasts are imperfect, resilience matters more

Let's Talk A Little About Fragility

Unknowable World

What Makes Something Fragile?

- ***(Def) A property of things that break or degrade when exposed to stress, shocks, volatility, randomness or disorder***

- ***Fragile systems prefer tranquility, predictability and lack of change***

In Banking Terms:

- ***An organization, balance sheet or strategy that is dependent on the world behaving in a fairly specific way***

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Fragility

Fragile

- Harmed Disproportionately By Stress

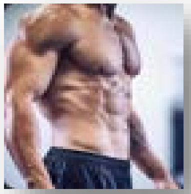
Robust

- Withstands Stress

Resilient

- Recovers From Stress

Anti-Fragile



An Applied Example: Covid Supply Shock

- ***Efficiency Can Hide Fragility***

Prior to The Shock (Hyper-Efficient)	**After The Shock (Fragility Exposed)**
Just-In-Time Logistics	Delays
Lean Inventories	Shortages
Minimal Redundancy	Bottlenecks
Low Cost Of Carry	Inflation
Strict Control	Loss of Control

The efficiency wasn't imaginary. The redundancy was.

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Areas Banks Might Optimize Away Redundancy

Where Does Efficiency Become Fragility?
Minimal Liquidity
Loan Concentration
Reliance on Rate Sensitive Deposits
Thin Capital
Complex Securities (Foreshadowing: Bonus Deep Dive)
Long Durations

Performance Often Masks Fragility…Before The Shock

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Fragility Often Hides During "Good Times"

Efficiency	Why It Looks Attractive
Credit Reach	Improves Spread / Earnings
Longer Durations	Improves Yield / Earnings
Surrendering Optionality	Improves Yield /Earnings
Low Liquidity	Improves Earnings

Reduces Choices In Times of Stress

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Fragility Creates Forced Decisions During Stress

- **Forced:**
  - Deposit Pricing
  - Selling
  - Capital Preservation
  - Credit / Loan Contraction
  - Explanations
    - Regulators
    - Directors, Shareholders and Customers

The Worst Position Is Not Being Wrong…
It's Not Being Able To Wait

Efficiency vs. Resilience

Often Competing Psychological Objectives

Efficiency	Resilience
Optimizes *Expected* Outcomes	Accepts Imperfect Outcomes
Minimizes “Idle” Resources	Maintains Reserves
Assumes Normal Conditions	Anticipates Disorder
Maximizes Current Return	Preserves Future Choices
Looks Best Before Stress	Looks Better During / After Stress

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Inside The Bank,
Where Are We Structurally Fragile?

- Liquidity
- Credit
- Funding
- Duration
- Capital
- Succession Planning
- Complexity (Foreshadowing: Bonus Deep Dive)
- Optionality

Outside The Bank,

Where Are We Structurally Fragile?

- Energy
- Geopolitics
- Supply Chains
- AI
- Interest Rates
- Fiscal Deficits
- Deposit Sources / Competition
- Consumer Confidence
  - Consumer Spending Accounts For Roughly 2/3 of U.S. GDP

You Don't Have To Predict The Shock,

But Identify Where The Balance Sheet Is Vulnerable

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Optionality:

You Always Give Up Something To Get Something

Every Decision Creates or Consumes Optionality
(and makes you more or less fragile)

Creates Optionality	Consumes Optionality
Liquidity	Illiquidity
Excess Capital	Minimum Capital
Simple Structures	Complexity
Predictable Cash Flows	Uncertain Cash Flows
Strong Credit Quality	Credit Reach
Reasonable Duration	Long Duration

Yield Today ⟷ Choices Tomorrow

The "3+1" Ways To Make More Money In Your Investment Portfolio (And Bank)

1. Compromise on Credit
2. Extend Duration
3. Sell Optionality

+1. Add Complexity (Foreshadowing: Bonus Deep Dive)

- *Every extra basis point comes with a cost*

- Complementary question to, *What Does It Yield*?

- Is -

- *What Future Choices Am I Surrendering*?

The Portfolio Has A Job Description

- Liquidity
  - Income
    - Collateral
      - Cash Flow
        - Diversification
          - Flexibility

Sleep

Boring Is A Feature – Not A Bug

- If the securities portfolio is the most exciting thing on the balance sheet, we should probably talk.

Better Decisions In An Unknowable World

Let’s Reframe…

What Do We Think Will Happen?

- - With - -

- What Do We Know?
    - What Do We Think?
        - What Don’t We Know
            - What Happens If We’re Wrong?

Advice and Decisions Should Survive The Forecast

And be defensible if…

- Rates Move "The Other Way"
- Inflation Persists
- Credit Deteriorates
- Deposits Behave Differently
- The Market Simply Changes Its Mind

Sound Advice Should Not Require Clairvoyance

6 Questions Worth Asking At Your Next ALCO…

- **Where Are We Most Fragile?**
  - What part of our balance sheet depends most on the world behaving the way we expect?

- **What Would Force Us To Act?**
  - What combination of events could make us forced to sell, borrow or aggressively reprice deposits?

6 Questions Worth Asking At Your Next ALCO…

- **What Are We Giving Up For Today's Earnings?**
  - **Where are we exchanging liquidity, credit quality, predictable cash flow or optionality for incremental return?**

- **What If Our *Most Important* Assumption Is Wrong?**
  - **Rates, Deposits, Credit, Loan Growth, Prepayments, The Economy.**
    - ***Which assumption would hurt us most if the opposite occurred?***

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6 Questions Worth Asking At Your Next ALCO…

- **How Much Ability Do We Have To Wait?**
  - Do we have enough liquidity, capital and dependable cash flow to avoid making decisions based on someone else's timetable?

- **Where Are We Relying On A Forecast?**
  - And if that forecast is wrong, does it merely cause us to underperform - or does it impair our flexibility?

We Cannot Know The Next Shock…

But We Can Work To:

- Identify Fragility
  - Preserve Optionality
    - Avoid Forced Decisions
      - Build Enough Margin of Safety To Be Wrong

Since We Cannot Know The Next Shock…

"The function of the margin of safety is, in essence, that of rendering unnecessary an accurate estimate of the future."

- Benjamin Graham (The Intelligent Investor, 1949)

A Thought Roadmap…

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Bonus Deep Dive

In fact, trying to overpredict and overanalyze highly complex systems is futile since these systems are full of hard-to-detect features. Instead, we maneuver around them by keeping things simple — to the extent we can. The complex tends to develop a life of its own. "*Complications lead to multiplicative chains of unanticipated consequences, followed by apologies about the "unforeseen" aspect of the consequences, then another intervention to correct the secondary effects, leading to an explosive series of branching "unforeseen" responses, each one worse than the preceding one.*" As structures gain in complexity, they become increasingly vulnerable to collapse. This is also why experts who operate with complex parameters, more data, formulas, and models might seem impressive but are rarely able to predict where complex systems will go because their tools increase confidence, not their ability to predict. **- Nassim Taleb**