Industry In-Sight™

Analysis of Liquidity in the U.S. & Canadian Capital System

JANUARY 2025

JORDAN KNAUFF & COMPANY

BALMORAL® ADVISORS

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The U.S and Canadian Capital Systems Work as One

The U.S. and Canadian capital systems and their economies are tightly linked such that they are one, symbiotic system that operates together as one capital system. Illustrations of this can be seen at various points in the balance sheet. At the top of the balance sheet, senior lenders Canadian Bank of Commerce (now known as CIBC) purchased The PrivateBank in Chicago to further establish a beachhead here in America. Similarly, BMO (Bank of Montreal) is among the most aggressive lenders in America based on their transactions and the types of credit agreement proposals they are presenting to clients. Therefore, at the top of the balance sheet, we see purely aggressive capital moving from and wanting to be deployed from a Canadian base into America.

Moving down the balance sheet to the equities section. A small group of Canadian public pension funds jointly opened an office in New York City to make investments in American companies. These investments would typically be mezzanine down to equity. These types of activities demonstrate the fact that the two systems operate together as one.

Why Cash Liquidity[1] is Important in the Middle-Market

For mergers and acquisitions (M&A) transactions in the middle-market, one of the most important concerns is the amount of liquidity in the marketplace. Greater liquidity can result in easier borrowing at lower rates. Thus, the cash positions of central bank reserves and non-banking finance companies (NBFCs) provide a general forecast for middle-market M&A. Much like in real estate, the ability to borrow at low rates usually increases the prices paid for assets and decreases the transaction time as more money chases a shrinking pool of desirable deals.

However, NBFCs and commercial banks do not frequently engage in M&A activities themselves, except as strategic buyers in their own industries. Private equity (PE) and strategic buyers are, by far, the most frequent participants in M&A. Thus, a forecast for the market can be obtained by measuring the level of uncommitted funds in PE and the amount of cash residing on corporate balance sheets, supplemented by the amount of cash reserves available to their financiers, the commercial banks. This is the "dry powder" that fuels the M&A middle-market. High levels of uninvested funds lead to pressure from investors to put capital to good use or return cash to the Limited Partners of PE funds and shareholders of cash rich corporations. This pressure can create an excellent climate for pitching deals.

All charts in this report are updated to the latest information available at the time of publication. Due to differing reporting dates for various data used throughout the report, all charts are not updated to the same ending period.

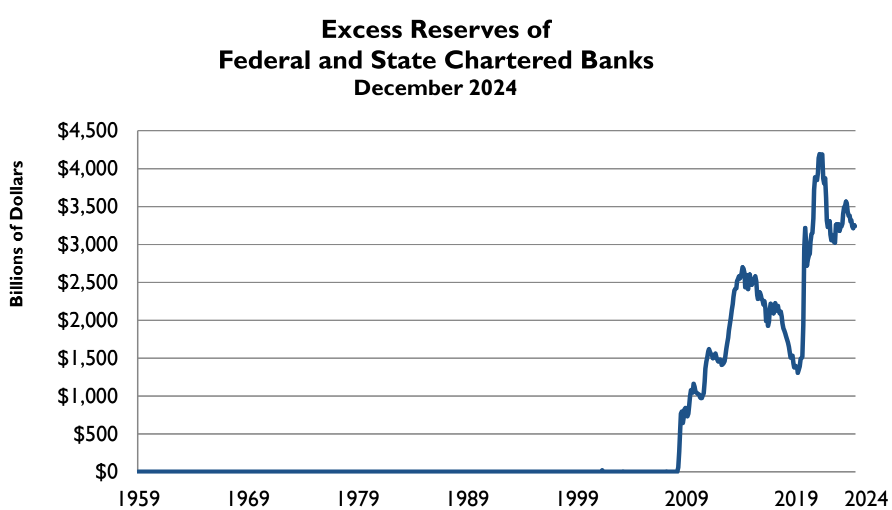
(1) Cash liquidity is defined as cash and cash equivalents for the purpose of this analysis.

Analysis of Liquidity in the U.S. & Canadian Capital System

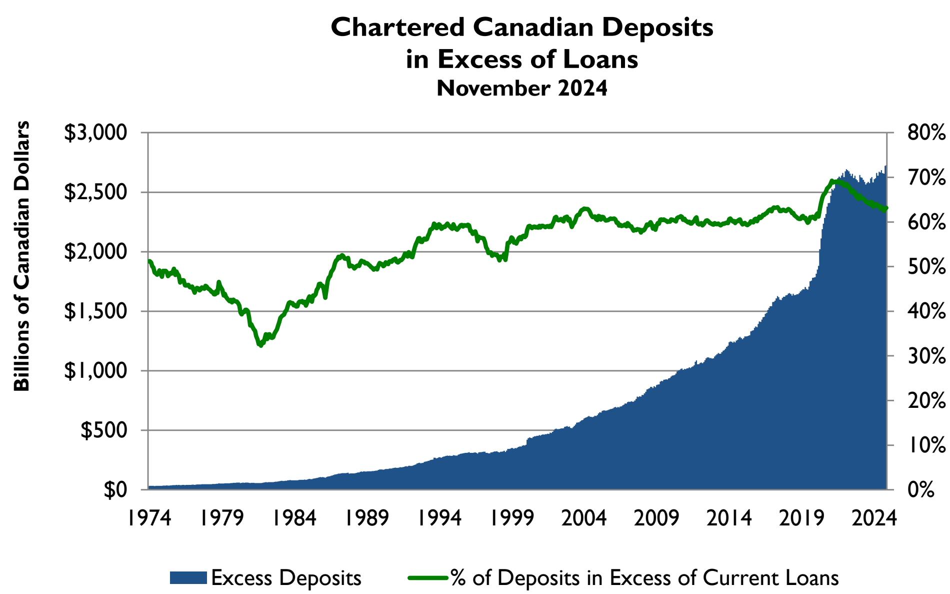
Analysis of Liquidity in the U.S. & Canadian Capital System

- Banking System: Excess Reserve Deposits

U.S. = $3.2 trillion(1)



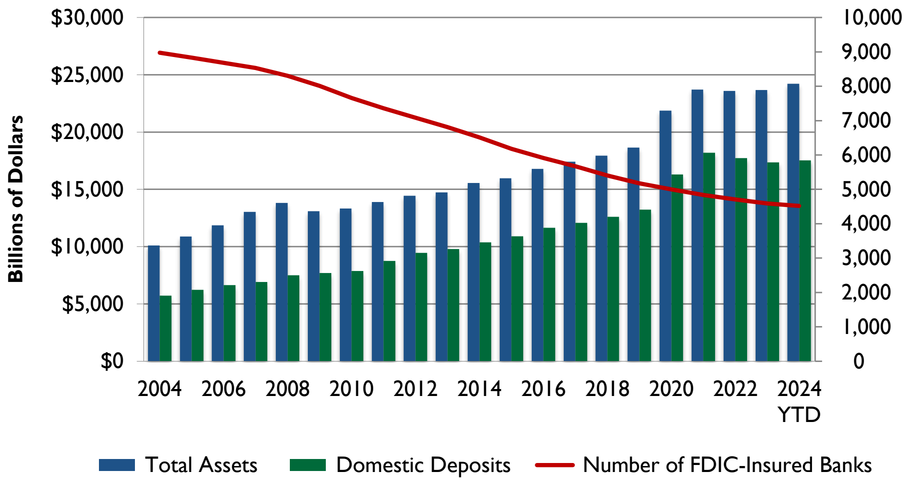
Canada = $1.9 trillion (U.S.)(2,3)

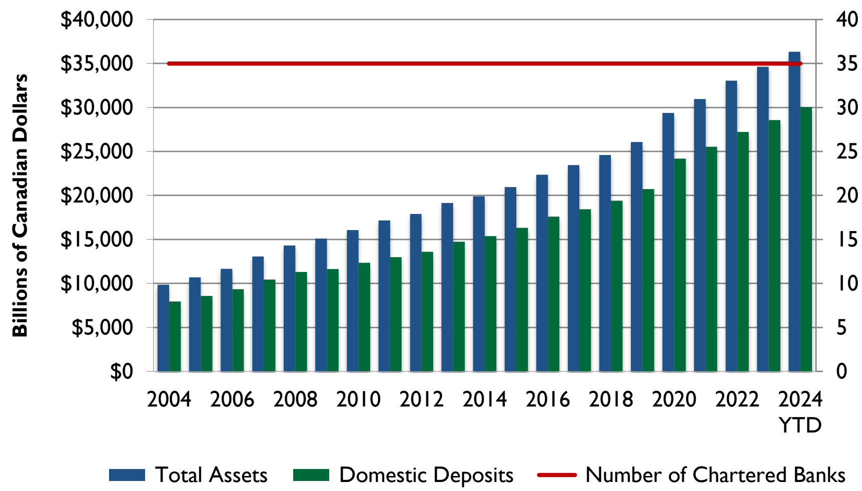


(1) Federal Reserve Bank of St. Louis. Federal Reserve Economic Data, January 28, 2025.
(2) Bank of Canada. Table 10-10-0116-01 - Chartered bank assets and liabilities and monetary aggregates, monthly average, seasonally adjusted, January 20, 2025. Conversion rate of 1 CAD = 0.701901 USD.
(3) The Canadian banking system does not require official levels of cash reserves, as in the U.K. and Australia. The data we have compiled to approximate U.S. excess reserves is the amount by which Canadian Chartered Bank Deposits exceed recorded loans.

Analysis of Liquidity in the U.S. & Canadian Capital System

Banking System: Historical Trends





(1) The Federal Deposit Insurance Corporation, Statistics at a Glance, September 30, 2024.

(2) Bank of Canada. Table 10-10-0109-01 - Chartered banks, assets and liabilities, month-end, January 20, 2025. Office of the Superintendent of Financial Institutions (number of chartered banks). Regulations make it difficult for new firms to enter the Canadian banking industry.

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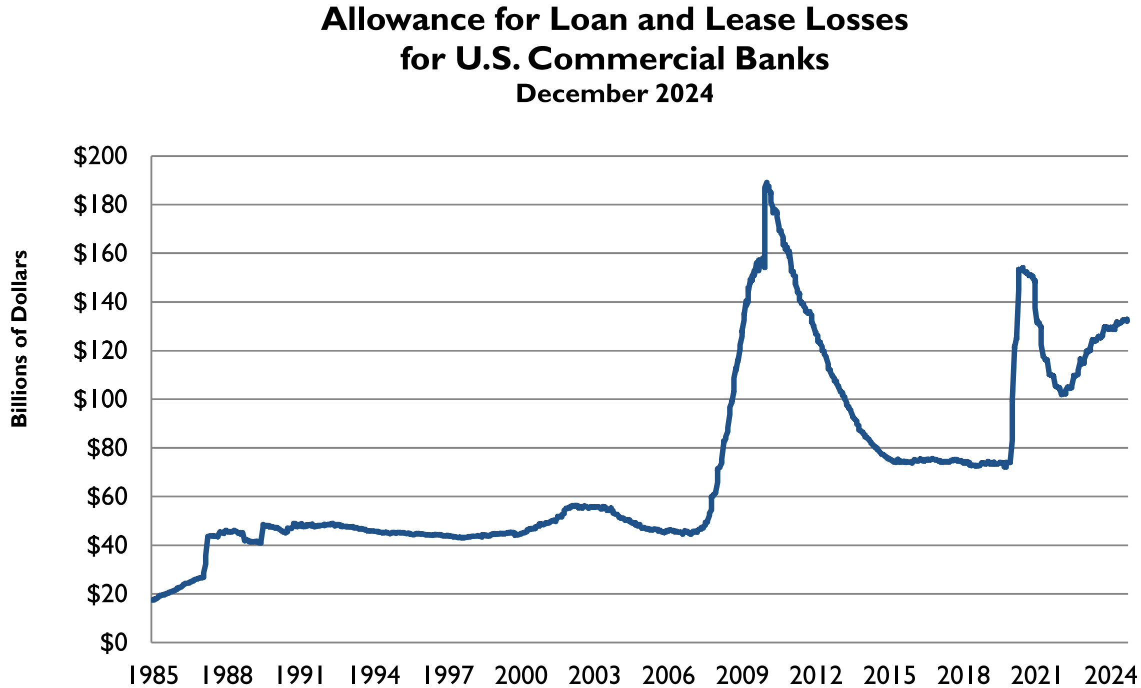
Analysis of Liquidity in the U.S. & Canadian Capital System

U.S. Commercial Banks Allowance for Loan and Lease Losses[(1)]

U.S. = $0.13 trillion[(2)]

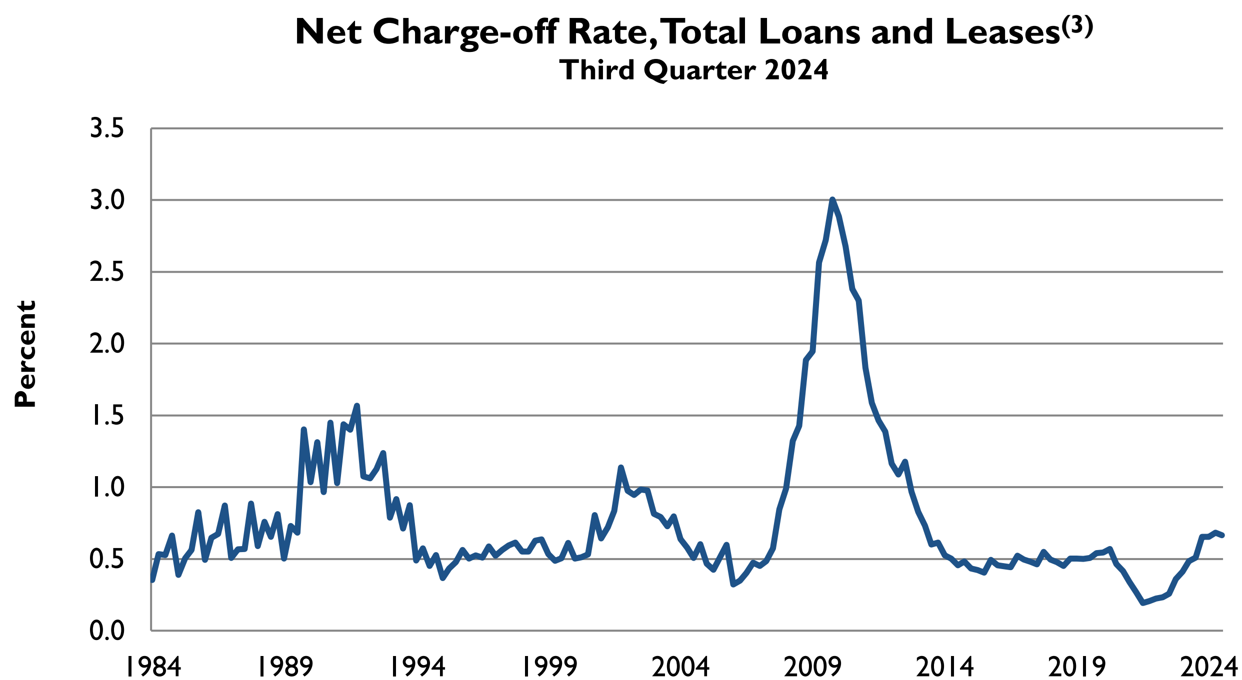


(1) The allowance for loan and lease losses refers to a reserve created by lenders for anticipated bad debts likely to arise due to the non-recovery of loans. The Bank of Canada does not have a reserve requirement for loan losses. However, the Office of the Superintendent of Financial Institutions (OSFI) requires banks to set aside funds to cover losses during financial uncertainties called the Domestic Stability Buffer (DSB). The DSB as of June 2024 is 3.5% of risk-weighted assets. Since launching the DSB in 2018, OSFI has increased the buffer six times. It applies to Canada's largest banks and is set twice a year.

(2) Federal Reserve Bank of St. Louis. Federal Reserve Economic Data, January 24, 2025.

Analysis of Liquidity in the U.S. & Canadian Capital System

- U.S. Net Charge-off Rate, Total Loans and Leases[1,2]



(1) Charge-off rates are the value of loans and leases removed from the books and charged against loss reserves. Charge-off rates are annualized, net of recoveries.
(2) Canada does not collect national level data on this sector.
(3) Federal Reserve Bank of St. Louis. Federal Reserve Economic Data, December 13, 2024.

Analysis of Liquidity in the U.S. & Canadian Capital System

■ U.S. Finance Companies[1,2]

U.S. = $0.05 trillion[3]

Total Cash Outstanding
Third Quarter 2024

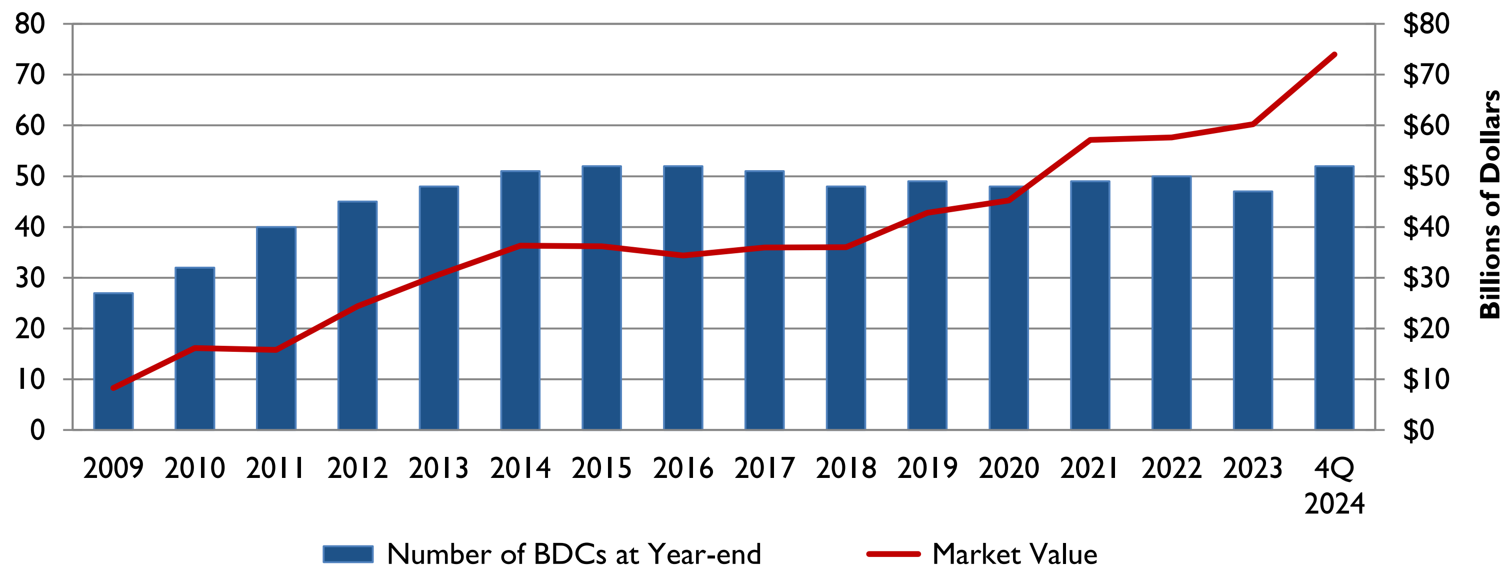
(1) The Federal Reserve defines finance companies as firms meeting the following criteria: (a) 50% or more of assets are business or consumer loans or leases; (b) the institution does not accept deposits; and (c) the institution is not an industrial loan corporation.
(2) Canada does not collect national level data on this sector.
(3) Federal Reserve Bank of St. Louis. Domestic finance companies, cash and cash equivalents outstanding, quarterly, not seasonally adjusted. December 20, 2024.

Analysis of Liquidity in the U.S. & Canadian Capital System

- U.S. Business Development Companies (BDC)[1,2]

U.S. = $0.07 trillion[3]

Size of Public BDC Market



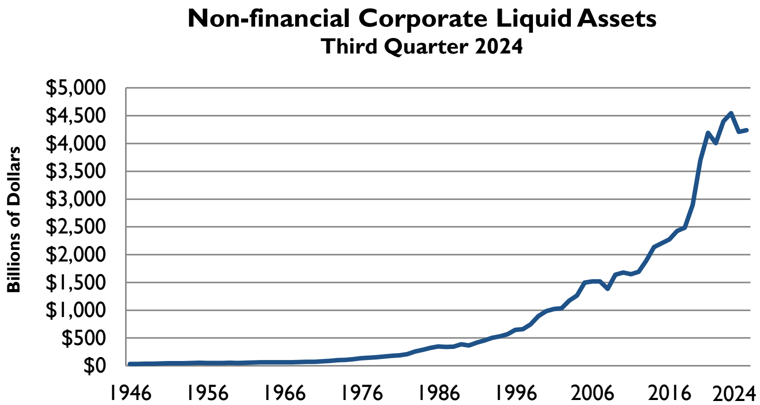
(1) Defined in a 1980 amendment to the Investment Company Act of 1940. A BDC may be either private or publicly traded.
(2) BDCs are similar to a closed-end mutual fund or REIT with the following investment restrictions: (a) a BDC must only purchase equity or offer debt to non-public firms with more than $2 million in capital and surplus, but less than $4 million in assets; and (b) a BDC must provide significant managerial assistance to the firms in its debt and equity portfolios.
(3) Compustat and Closed-End Fund Advisors, Quarterly Closed-End Fund & BDC Review and Outlook, Fourth Quarter 2024 Review, January 16, 2025.

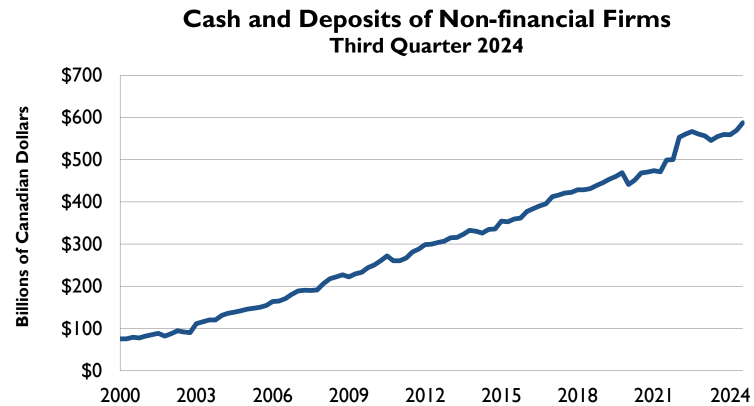
Analysis of Liquidity in the U.S. & Canadian Capital System

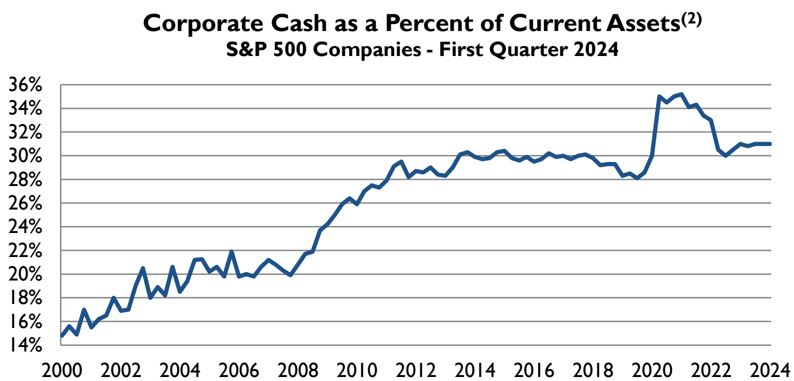
Non-financial Corporate Balance Sheets

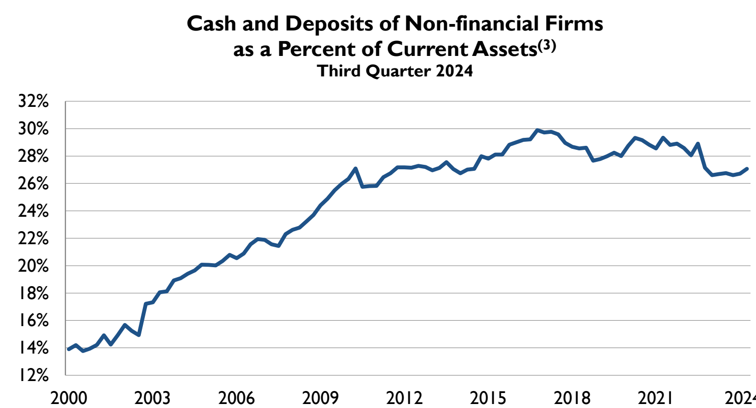
U.S. = $4.2 trillion[(1)]

Canada = $0.41 trillion (U.S.)[(3)]









(1) Board of Governors of the Federal Reserve System. Z.1 Financial Accounts of the United States – Third Quarter 2024, December 12, 2024, p. 81.
(2) J.P. Morgan Asset Management. Guide to the Markets 4Q 2024, September 30, 2024.
(3) Statistics Canada. Table 33-10-0225-01 - Quarterly balance sheet and income statement, November 25, 2024. Conversion rate of 1 CAD = 0.701901 USD.

Analysis of Liquidity in the U.S. & Canadian Capital System

U.S. Non-financial Corporate Cash Offshore

- What has driven the dramatic rise in U.S. corporate cash? The run-up is not uniform across firms but is concentrated in the foreign subsidiaries of multinational firms.(1)
- At the end of 2016, U.S. multinational corporations held over $2.5 trillion in foreign earnings overseas, of which approximately $850 billion to $1.2 trillion is estimated to be held in cash and other financial assets.(2)
- One explanation for the large foreign cash holdings is that the U.S. tax system, which until January 2018 deferred the U.S. taxation of active foreign subsidiary earnings until repatriation to the U.S., motivated firms to retain cash offshore.
- Falling foreign tax rates, coupled with relaxed restrictions on income shifting, are other reasons for the changing foreign cash patterns.(1)

Gross U.S. Non-financial Corporate Liquid Assets	**=**	**$4.20 trillion**
<Estimated Offshored Cash>	**=**	**<1.03 trillion>**
U.S. Domestic Cash on Balance Sheets	**=**	**3.17 trillion**
+ Canadian Cash and Deposits	**=**	**0.41 trillion**
Net U.S. and Canadian System Cash	=	U.S. $3.58 trillion

(1) Oxford University Press on behalf of The Society for Financial Studies. Understanding the Rise in Corporate Cash: Precautionary Savings or Foreign Taxes, 2019.
(2) Stanford Graduate School of Business. The Effect of Foreign Cash Holdings on Internal Capital Markets and Firm Financing, October 2018.

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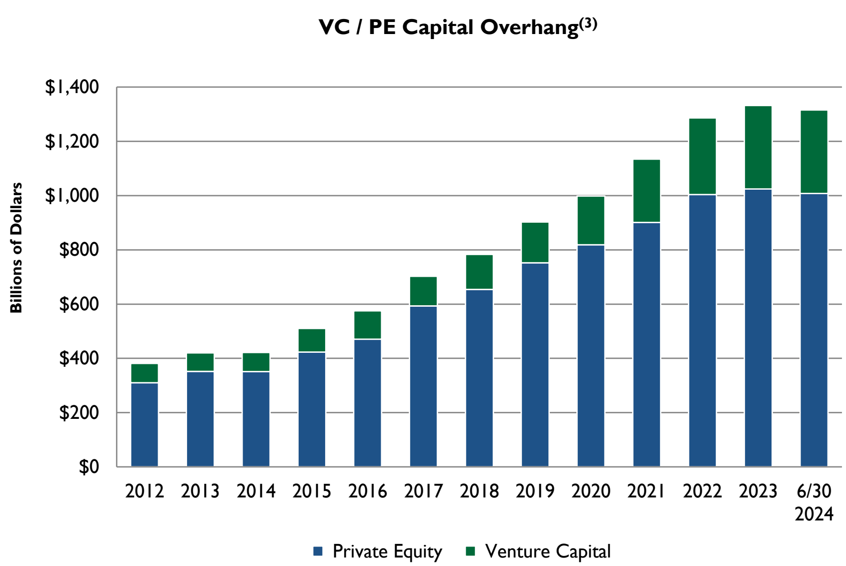
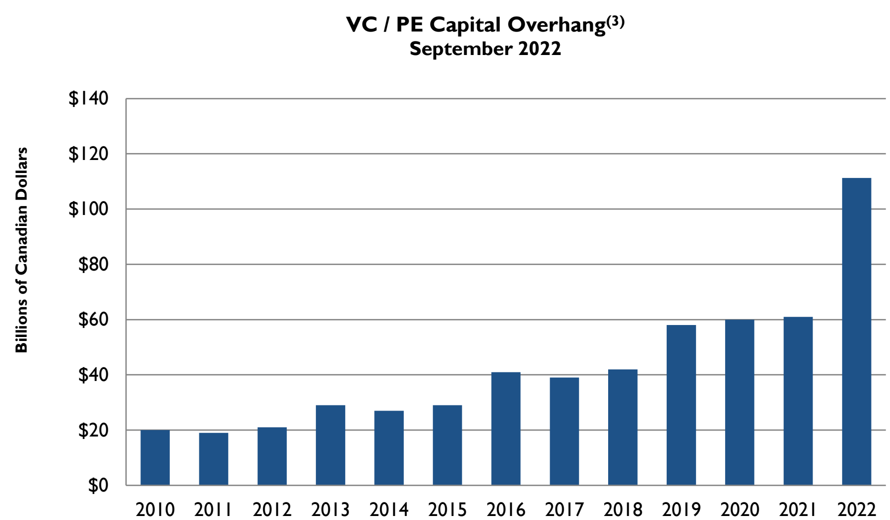
- Venture Capital / Private Equity Uninvested Commitments

U.S. = $1.3 trillion[1]



Canada = $0.08 trillion (U.S.)[2]

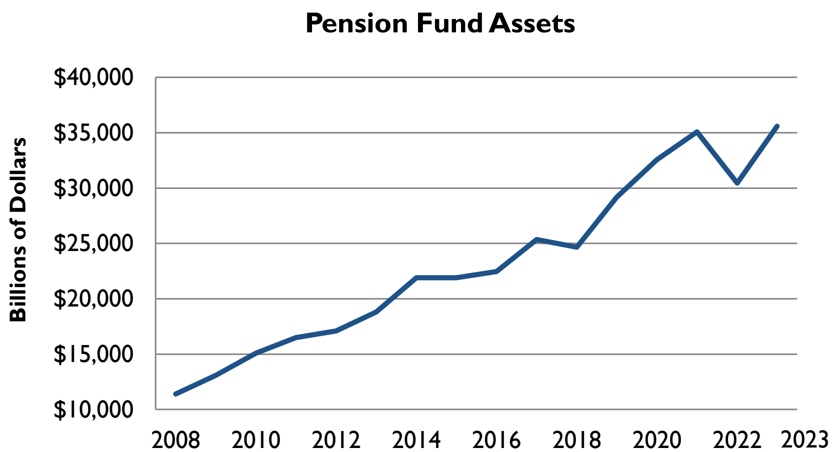


(1) Pitchbook, 2024 Annual U.S. PE Breakdown, January 14, 2025. PitchBook-NVCA Venture Monitor, January 13, 2025.
(2) Preqin Territory Guide: Private Capital in Canada 2023, February 2023. Published in association with the Canadian Association of Alternative Strategies & Assets. Conversion rate of 1 CAD = 0.701901 USD.
(3) Overhang refers to uninvested commitments to private equity and venture capital funds.

Analysis of Liquidity in the U.S. & Canadian Capital System

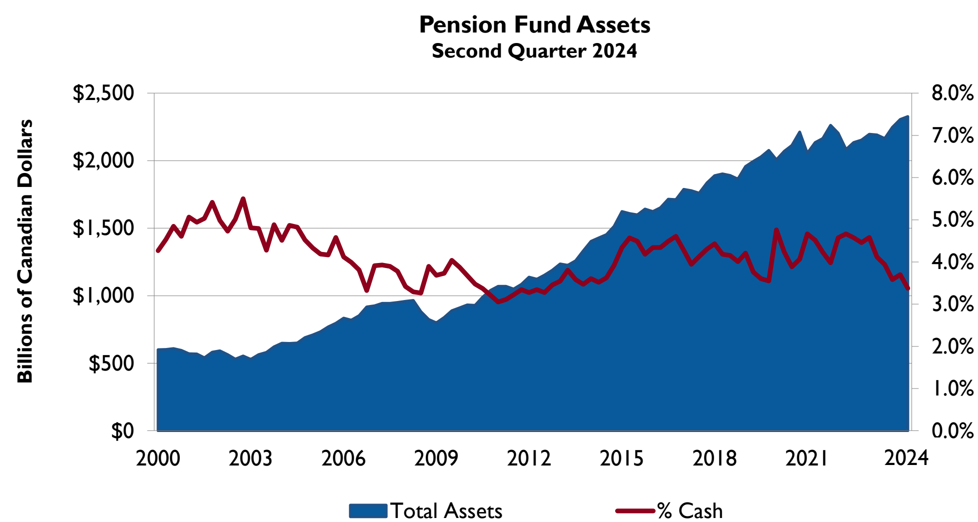
- Public and Private Pension Funds

U.S. = $35.6 trillion[1]



Current Average Cash Balance = 2.0% or U.S. $0.71 Trillion[1]

Canada = $1.6 trillion (U.S.)[2]



Current Average Cash Balance = 3.4% or U.S. $54 Billion[2]

(1) Willis Towers Watson, Thinking Ahead Institute's Global Pension Assets Study 2024, February 23, 2024. Reported annually in February.
(2) Statistics Canada. Table 11-10-0085-01 - Trusteed pension funds, value of assets by foreign and domestic holdings, quarterly, December 11, 2024. Reported quarterly. Conversion rate of 1 CAD = 0.701901 USD.

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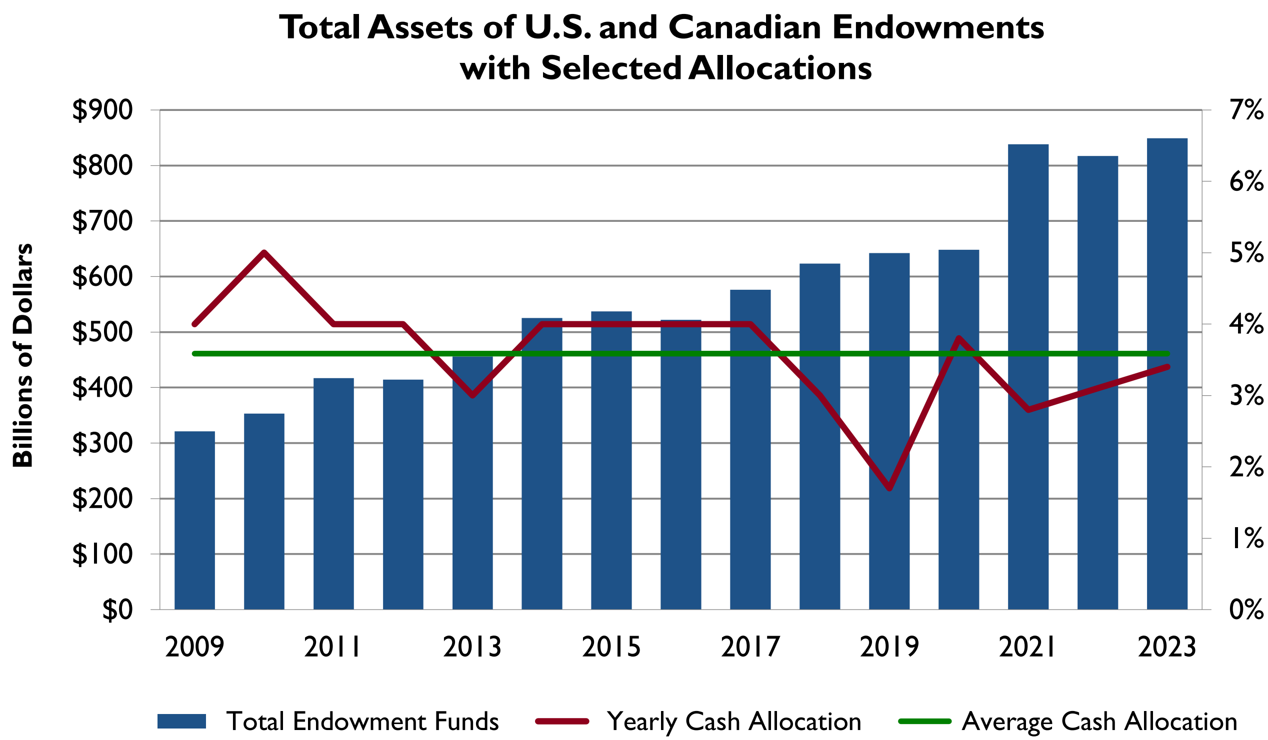
Endowments

U.S. and Canada = $0.84 trillion (U.S.)[1]



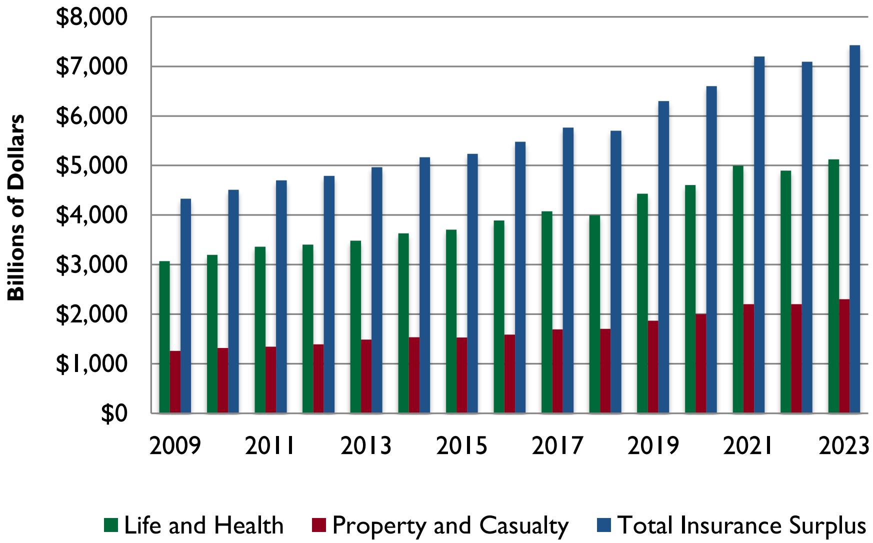
2023 Cash Balance = 3.4% or U.S. $28.9 billion

(1) National Association of College and University Business Officers. 2023 NACUBO-Commonfund Study of Endowments®, February 15, 2024. Reported annually in February. In U.S. dollars.

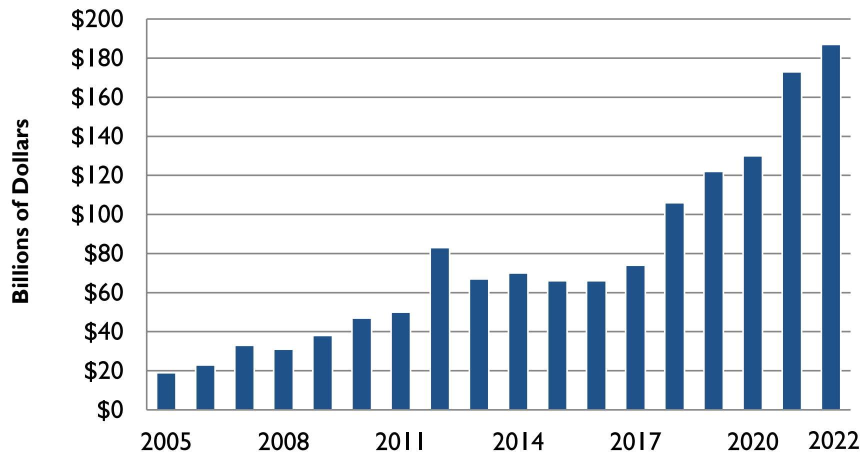
Analysis of Liquidity in the U.S. & Canadian Capital System

U.S Insurance Industry

U.S. Insurance Industry Invested Assets[1]



Private Equity Investments by U.S. Insurers[2]



(1) Federal Insurance Office. U.S. Department of the Treasury, Annual Report on the Insurance Industry, September 2024. Reported annually in September.
(2) National Association of Insurance Commissioners, Capital Markets Bureau. Insurance Topics, Private Equity, February 7, 2024. Schedule BA listing of long-term invested assets excluding real estate and mortgages. Life insurance companies account for the largest PE exposure.

The Impact of Liquidity in the Current M&A Climate

An increasingly important factor in the M&A market is the presence of pension, insurance, endowment and family office funds. These investors are typically focused on much longer-term investments than other market participants. The public frequently views these participants as conservative investors benefitting "widows and orphans." However, the long liability horizons and predictable pay out requirements for these participants enable them to place large portions of their assets in illiquid, long-term investments. Although trends indicate that these funds are increasing their level of direct investment in private firms, the vast majority of these participants' impact on the M&A market is via PE funds. The lower the yields on fixed income, the more desirable PE investments become. The willingness and timing of PE firms to launch new funds often depends on the participation and sponsorship of these institutional investors.

A secular trend of low returning, fixed income assets and large amounts of corporate cash currently prevails. This environment leads PE operators into being more inclined to fill launched funds quickly in order to launch subsequent funds while conditions are still favorable for institutional investments. The desire of PE funds to make hay while the sun shines is augmented by corporate cash flowing into strategic acquisitions which places even more upward pressure on M&A pricing. All of these factors point to a prime sellers' market in M&A.

Analysis of Liquidity in the U.S. & Canadian Capital System

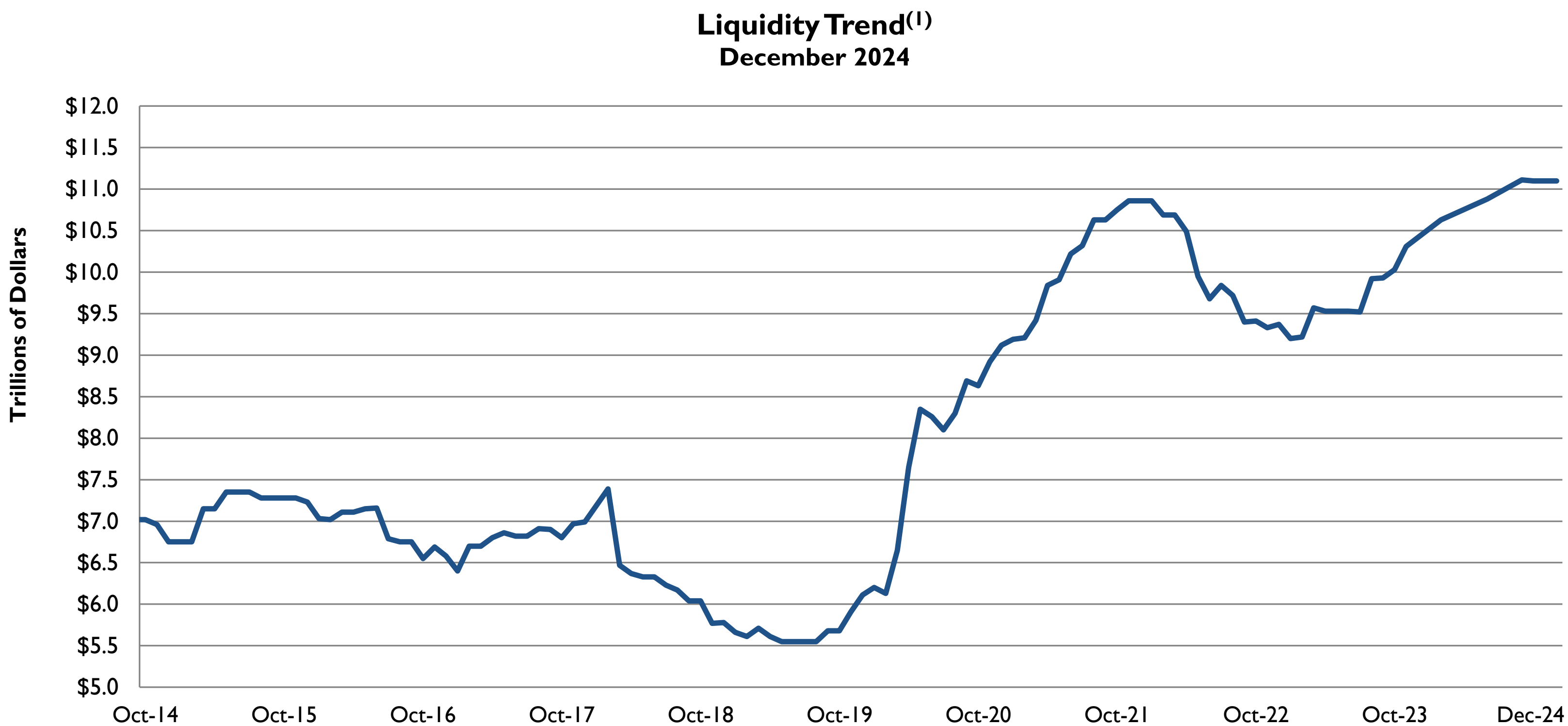
Summary of Cash Liquidity in the U.S. and Canada

	U.S.	Canada
Banking System: Excess Reserve Deposits	$3.2 trillion	$1.9 trillion
Commercial Banks Allowance for Loan and Lease Losses	$0.13 trillion	unavailable
Finance Companies	$0.05 trillion	unavailable
Business Development Companies	$0.07 trillion	unavailable
Non-financial Corporate Balance Sheets with Offshoring Adjustment	$3.17 trillion	$0.41 trillion
Venture Capital / Private Equity Uninvested Commitments	$1.3 trillion	$0.08 trillion
Public and Private Pension Funds: Cash Positions	$0.71 trillion	$0.05 trillion
	$8.63 trillion +	$2.44 trillion
Endowments (U.S. & Canada): Cash Positions	+ $0.03 trillion	

Total Cash Liquidity Pool (December 2024) — $11.1 trillion (U.S.)

Analysis of Liquidity in the U.S. & Canadian Capital System

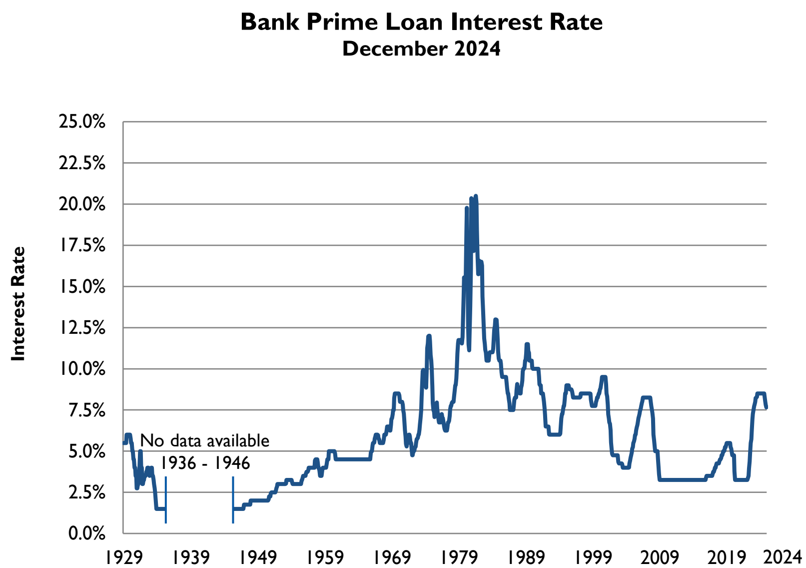
Cash Liquidity in the U.S. and Canada Over Time

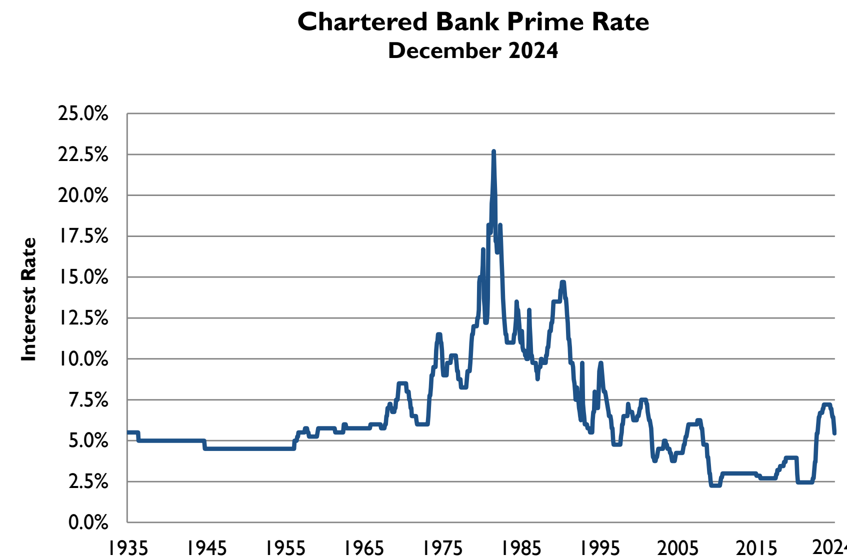


(1) Jordan Knauff & Company. As of December 2024, commercial banks allowance for loan and lease losses and business development companies are included in Total Cash Liquidity Pool.

Analysis of Liquidity in the U.S. & Canadian Capital System

- U.S. Bank Prime Interest Rate(1) and Canadian Chartered Bank Prime Interest Rate(2)



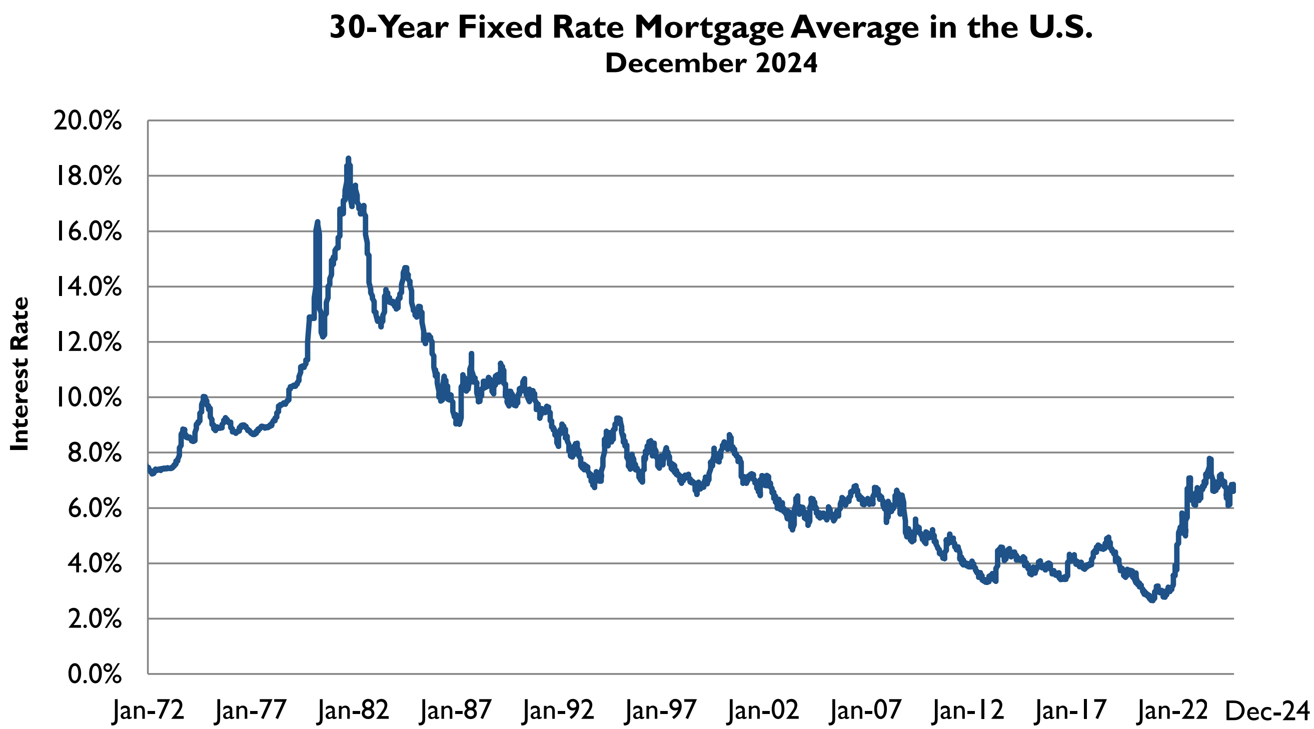


(1) Board of Governors of the Federal Reserve System. Federal Reserve Bank of St. Louis, January 12, 2025. Rate posted by a majority of top 25 insured U.S.-chartered commercial banks. Averages of daily figures. No data available 1936 – 1946.

(2) WOWA.ca, January 31, 2025. The prime rate is the interest rate charged to the most credit-worthy borrowers.

Analysis of Liquidity in the U.S. & Canadian Capital System

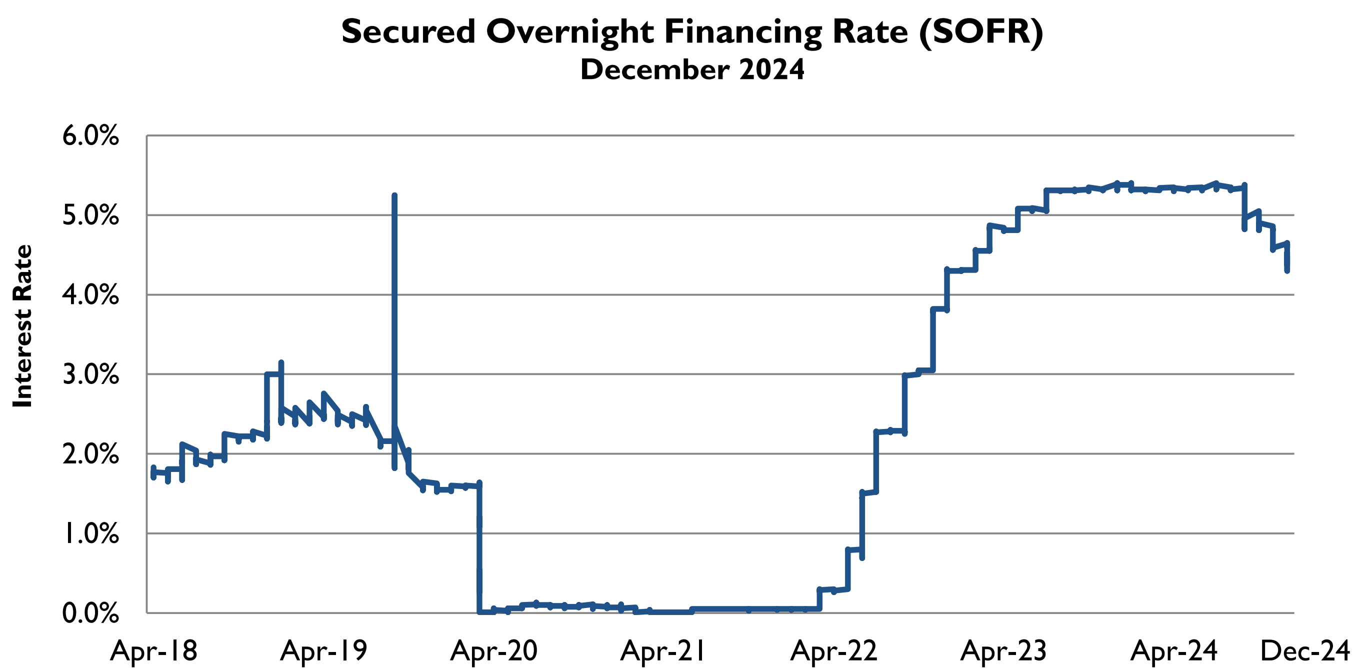
- U.S. 30-Year Fixed Rate Mortgage Average[1]



(1) Freddie Mac. Federal Reserve Bank of St. Louis, January 30, 2025. The weekly mortgage rate is based on applications submitted to Freddie Mac from lenders across the country.

Analysis of Liquidity in the U.S. & Canadian Capital System

U.S. Secured Overnight Financing Rate (SOFR)[1]



(1) Federal Reserve Bank of New York. Federal Reserve Bank of St. Louis, February 3, 2025. SOFR is a broad measure of the cost of borrowing cash overnight collateralized by U.S. Treasury securities in the repurchase agreement (repo) market.

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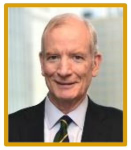

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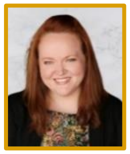

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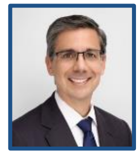

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