Texas LGIP Strategy Update

Q1 2023

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Economic Update

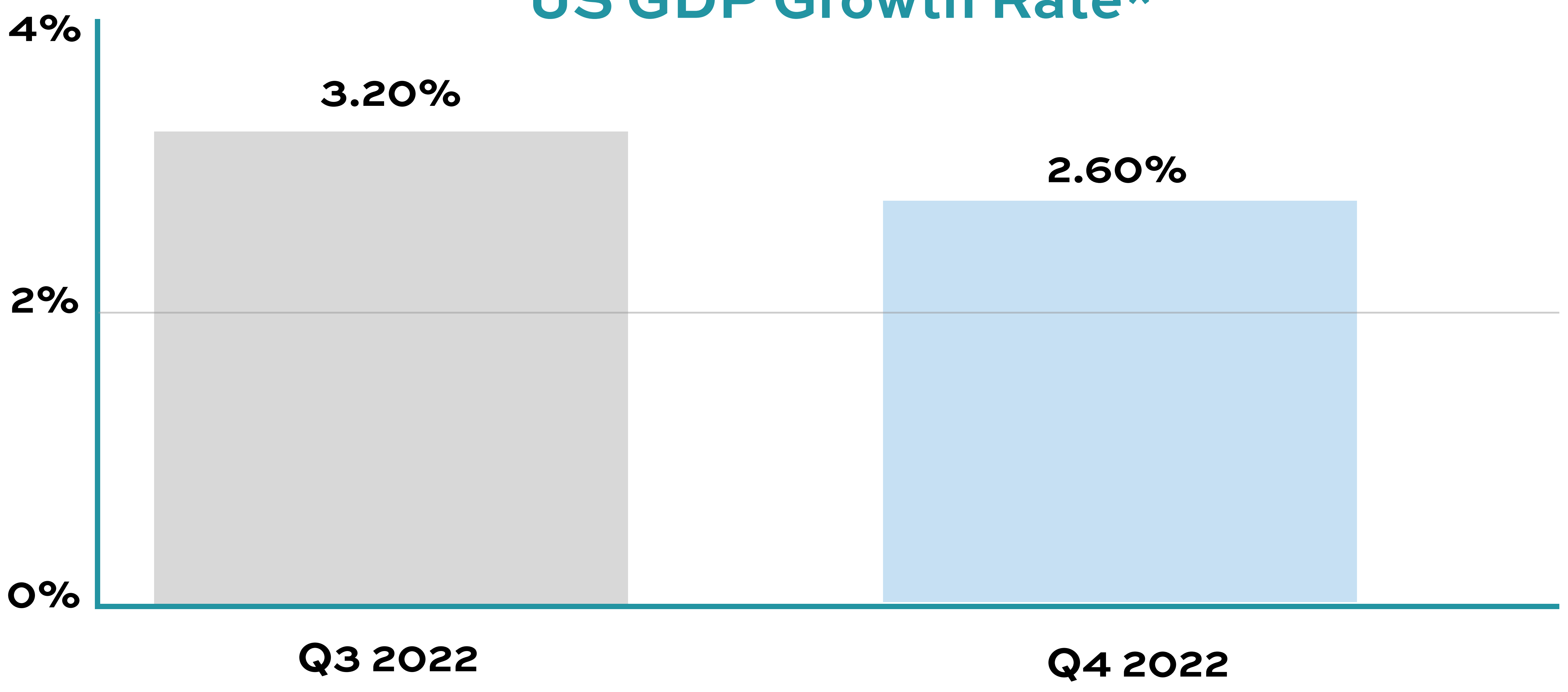
The **US Gross Domestic Product (GDP) slowed** slightly to 2.60% in the fourth quarter, after showing a larger than-expected increase of 3.20% in Q3. Markets expect growth to slow throughout 2023 as fallout from regional banking issues cause a slowdown in commercial activity alongside persistent inflationary pressures.

Inflationary pressures have moderated from their recent 40-year highs but are anticipated to remain elevated throughout 2023. Headline CPI (year over year) still sits at 6% while the "core" reading that excludes volatile food and energy costs, rests at a stubborn 5.5%.

The **Federal Reserve maintains its hawkish stance** (higher interest rates) with a commitment to keep rates "higher for longer" until inflation hits their 2% goal. Unemployment remains at the lowest levels since the 1950s, providing ongoing opportunity for the Fed to pursue tighter monetary policy.

The **Treasury curve** continues to show a **substantial inversion** with shorter-term (three to twelve month) maturities to pay more than their longer-term counterparts. Inversions typically imply a recession is imminent within the next year. Economists surveyed by Bloomberg put the probability of a recession this year at 65%.

US GDP Growth Rate*



KEY TAKEAWAY

The question of a recession remains **"when and for how long?"** Markets fully expect a slowdown in the broad economy in 2023 but are undecided on the magnitude and duration of any such event. The Federal Reserve remains steadfast on its commitment to get inflation back to 2%, even if it must keep rates high for a long period of time. Markets now expect the federal funds rate to top out at 5% in May, and to fall to ~4.25% by year-end.

***Bureau of Economic Analysis** | https://www.bea.gov/data/gdp/gross-domestic-product

Economic Update (cont.)

Volatility is expected to persist as investors balance persistent inflationary pressures amid moderately positive economic figures leading to uncertainty in both bond and equity markets.

Financial markets are pricing in just **one further 25-basis point hike** for the fed funds rate in May. The "higher for longer" mantra has disappeared in the wake of last month's bank failures (SVB, Signature, etc.) and markets are concerned with an economic slowdown later this year. The Federal Reserve's path forward will be highly dependent on the strength of macroeconomic data, including CPI and the US job market. The Fed itself sees rates closer to 5.5% and sees this rate holding for the remainder of 2023 as their "base case" scenario.

> **Economists surveyed by Bloomberg put the probability of a recession this year at 65%.**

US Treasury Yields

Date & Yield

Tenor	12/30/22	1/31/23	2/28/23	3/31/23
1M	4.12	4.58	4.65	4.74
3M	4.42	4.70	4.88	4.85
6M	4.76	4.80	5.17	4.94
1Y	4.73	4.68	5.02	4.64
2Y	4.41	4.21	4.81	4.06
3Y	4.22	3.90	4.51	3.81
5Y	3.99	3.63	4.18	3.60

US Department of the Treasury
https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_yield_curve&field_tdr_date_value=2023

LGIP Investment Strategy

We believe the Fed will do everything in its power to fulfill its mandate of "stable prices" (aka 2% inflation goal) by raising short-term rates and keeping them high until CPI is convincingly low.

Bank deposit rates are steadily increasing alongside of Fed rate hikes, but not all are moving in lockstep. We continue to negotiate rates with our depository institutions to provide additional spread over the effective federal funds rate. All of our bank deposits in the state of Texas are FDIC insured.

STRATEGY

Focus on quality: selectively adding US Treasuries, US Agencies, high-quality municipal bonds and tier-one (highest rated) commercial paper where apppropriate.

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TX LGIP Comments

TX FIT Government Pool

Yield continues to be driven by FDIC insured overnight deposits, with tri-party repurchase agreements and money market funds. In recent months, we actively broadened our money market funds, adding incremental yield while providing further capacity for additional deposits. We expect this pool to continue outpace the S&P LGIPG 30-day index.

MTD/YTD return: +0.39%, +1.09%

End of month yield: 4.76%

TX FIT Cash Pool

Ample same-day and next-day liquidity provided by bank deposits and maturing securities. Focus on floating-rate commercial paper to capture further rate hikes. We're currently targeting an average life around 110 days and continue to add to liquidity sources (money markets, deposits and ultra-short bond funds) to remain nimble given uncertain interest rate changes. We expect the pool to continue to outpace the S&P 30-day LGIP index.

MTD/YTD return: +0.41%, +1.17%

End of month yield: 5.02%

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