Florida LGIP Strategy Update

Q2 2023

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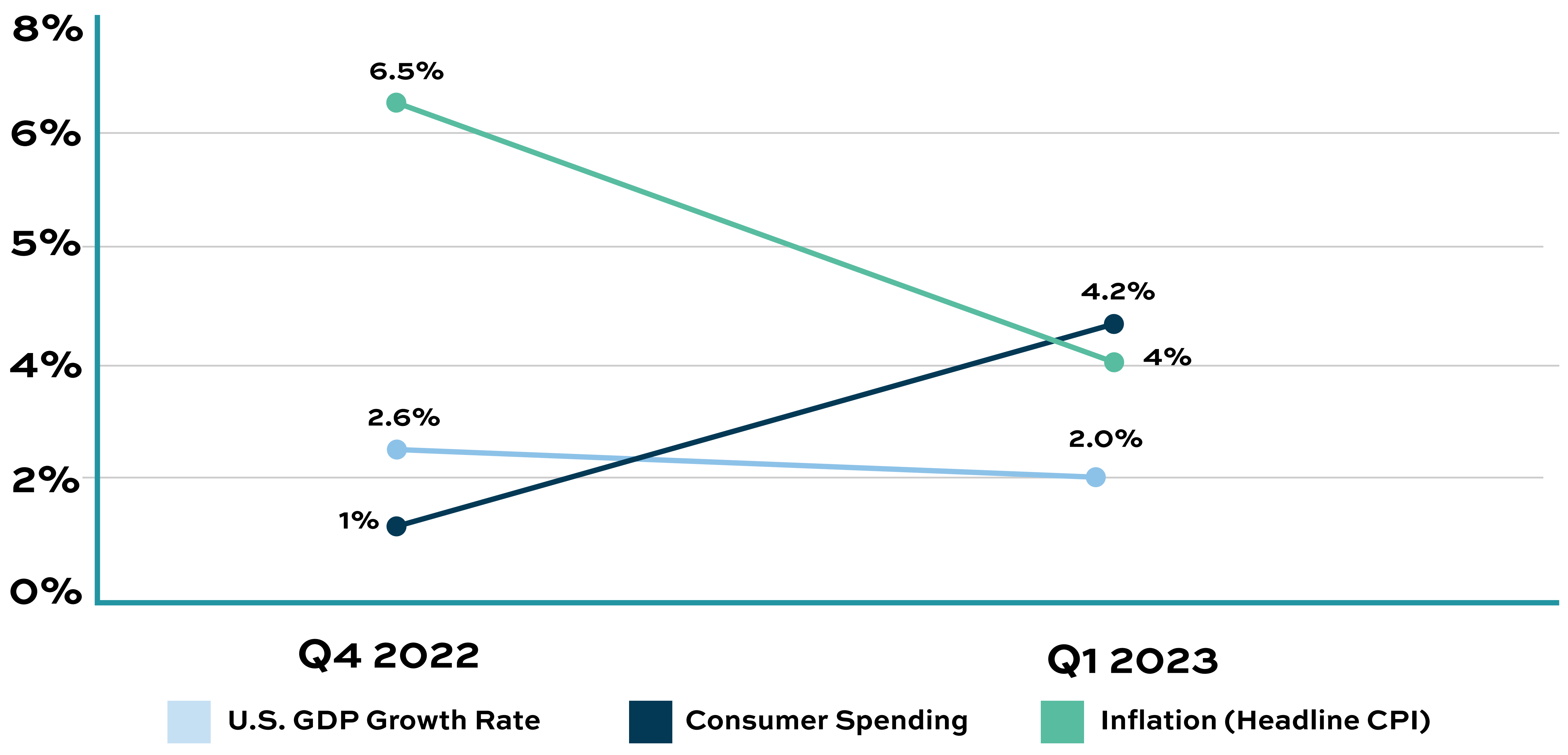
Economic Update

The U.S. Gross Domestic Product (GDP) for Q1 arrived at 2%, a slight slowdown from Q4, with a strong underlying figure from consumer spending (+4.2%) paired with softening inflation. As per usual, the U.S. consumer continues to spend, helping bolster a domestic economy that is heavily reliant on consumption. Markets expect growth to slow in the latter half of 2023, although estimates rose slightly as Q1 economic data was stronger than expected. Many economists expected a recession in late 2023, but that estimate is being pushed further out on the horizon.

The Federal Reserve remains steadfast on its mandate 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 hit ~5.5% by November and to slowly decline to ~4.40% over the next twelve months. Economists surveyed by Bloomberg put the probability of a recession over the next twelve months at 65%, unchanged from the prior survey.

Inflationary pressures have moderated from their recent 40-year highs but are anticipated to remain elevated throughout 2023 and into 2024. The Federal Reserve has maintained 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.

Economic Indicators*



The **Treasury curve** continues to show a **substantial inversion** shorter-term (three- to twelve-month) maturities paying more than their longer-term counterparts. Inversions typically imply a recession is imminent within the next year.

KEY TAKEAWAY

Many economists expected a recession in late 2023, but that estimate is being pushed further out on the horizon.

Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics

Economic Update (cont.)

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

Financial **markets are pricing in approximately two 25-basis-point rate hikes** for the fed funds rate in 2023. The Federal Reserve's path forward will be highly dependent on the strength of macroeconomic data, including CPI and the U.S. job market.

> **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.**

US Treasury Yields

Date & Yield (%)

Tenor	3/31/23	4/28/23	5/31/23	6/30/23
1M	4.74	4.35	5.28	5.24
3M	4.85	5.10	5.52	5.43
6M	4.94	5.06	5.46	5.47
1Y	4.64	4.80	5.18	5.40
2Y	4.06	4.04	4.40	4.87
3Y	3.81	3.75	4.04	4.49
5Y	3.60	3.51	3.74	4.13

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.

Floating-rate instruments and/or floating–rate bank deposits are still prominently incorporated into the FL-FIT Cash Pool for the time being. However, we are keeping a close eye on relative value between floating- and fixed-rate instruments as market opportunities are presented. During Q2 we found relative value in floating-rate instruments as yield spreads (the additional yield provided above U.S. Treasuries) moved higher.

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. In the state of Florida, all deposits are FDIC insured or QPD programs.

STRATEGY

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

Florida LGIP Comments

FL-FIT Preferred Deposit Pool

Qualified Public Deposits (QPD) and FDIC-insured deposit yields continued to move up alongside the federal funds rate, providing a direct benefit for pool participants. The FL-FIT PDP pool remains a competitive alternative for Florida municipalities seeking yield away from any credit exposure. We expect this pool to closely track the effective federal funds rate.

QTD/YTD return: +1.23%, +2.33%

End of month yield: 5.01%

FL-FIT Cash Pool

Strategically, we are focused on shorter-term floating-rate instruments, but are now selectively adding fixed-rate securities as markets provide opportunity. We're targeting a blended average life around 3-4 months, maintaining ample liquidity utilizing prime money markets, ultra-short bond funds and bank deposits. We expect the pool to continue to outpace the S&P 30-day LGIP index.

QTD/YTD return: +1.28%, +2.45%

End of month yield: 5.21%

FL-FIT Enhanced Cash Pool (floating NAV, total return focus):

We continue to focus on balancing liquidity while opportunistically taking advantage of heightened rates. We remain short of the benchmark in terms of overall duration and expect yields to continue to move up gradually as floating-rate instruments reset upward. We see ample opportunities in some fixed-rate securities, which are being selectively added to the portfolio to help lock in yield for the longer term. The pool has outpaced its benchmark over the last year, and we expect the performance of this pool to be in-line with its 0-1 year benchmark moving forward. See below for further details.

FL-FIT Select Cash Pool (floating NAV, total return focus):

During Q1, we made the decision to reduce and eventually remove the portfolio insurance (interest rate futures) as we are likely in the latter stages of the rate cycle. Although we cannot perfectly time the end to rising rates, it appears that consensus is for only a few more hikes in 2023 before rates are eventually cut in 2024. Like our Enhanced Cash pool, the strategy is to utilize both floating and fixed coupon structures with high credit quality, sufficient diversification, and an eye toward liquidity. We see ample opportunities in fixed-rate securities, which are being selectively added to the portfolio to lock in >5% yields for several years. We are targeting a duration near the benchmark of ~1.75 years. The pool continues to outpace its 1-3 year benchmark over the longer-term due to prior outperformance, and we expect yields will continue to reset higher, further helping to insulate the pool.

Florida Floating NAV Pool Details†

As of 06/30/23, all returns are nominal & figures are %

FL Enhanced Cash:

PERFORMANCE

Benchmark: 75/25 split of ICE 0-1y US Treasury and 0-1y AAA-A Corporate

- June 2023 QTD/YTD %: (+0.94, +2.12)
- Benchmark: (+0.99, +2.19)

STRATEGY

We continue to see opportunities in AAA and AA-rated, short-dated municipal bonds across the country.

Focus on increasing credit quality gradually and reducing corporate exposure over time.

Pool yield continues to rise through reinvestment opportunities and resets on floating-rate securities.

- Yield at end of the quarter: 4.77%

Targeted duration band of 0.35 to 0.70 years

- Continue to target an avg duration close to 0.50 years (currently ~0.57)
- Decrease floating-rate instruments over time (currently ~50% of portfolio) in favor of fixed.

FL Select Cash:

PERFORMANCE

Benchmark: 75/25 split of ICE 1-3y US Treasury and 1-3y AAA-A Corporate & Gov't Index

- June 2023 QTD/YTD: (+0.45, +1.58)
- Benchmark: (-0.54, +0.99)

STRATEGY

We're finding select opportunities in high-quality, shorter-dated US Agency and US taxable municipal debt with call protection to provide consistent yields for years to come.

- The inverted yield curve, where longer-term rates are shorter than overnight rates, provides some challenges in providing near-term yield.

Pool yield continues to rise, but focused on yield maintenance for the long-term

- Yield at end of the quarter: 4.10%

Targeted duration band of 1.00 to 2.00 years, currently 1.70 years.

- Removed portfolio insurance as we're likely entering the end stage of the rate cycle.
- Increase allocation to fixed-rate securities with call protection to "lock in yield" (~64% of portfolio)

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