Texas LGIP Strategy Update

Q3 2023

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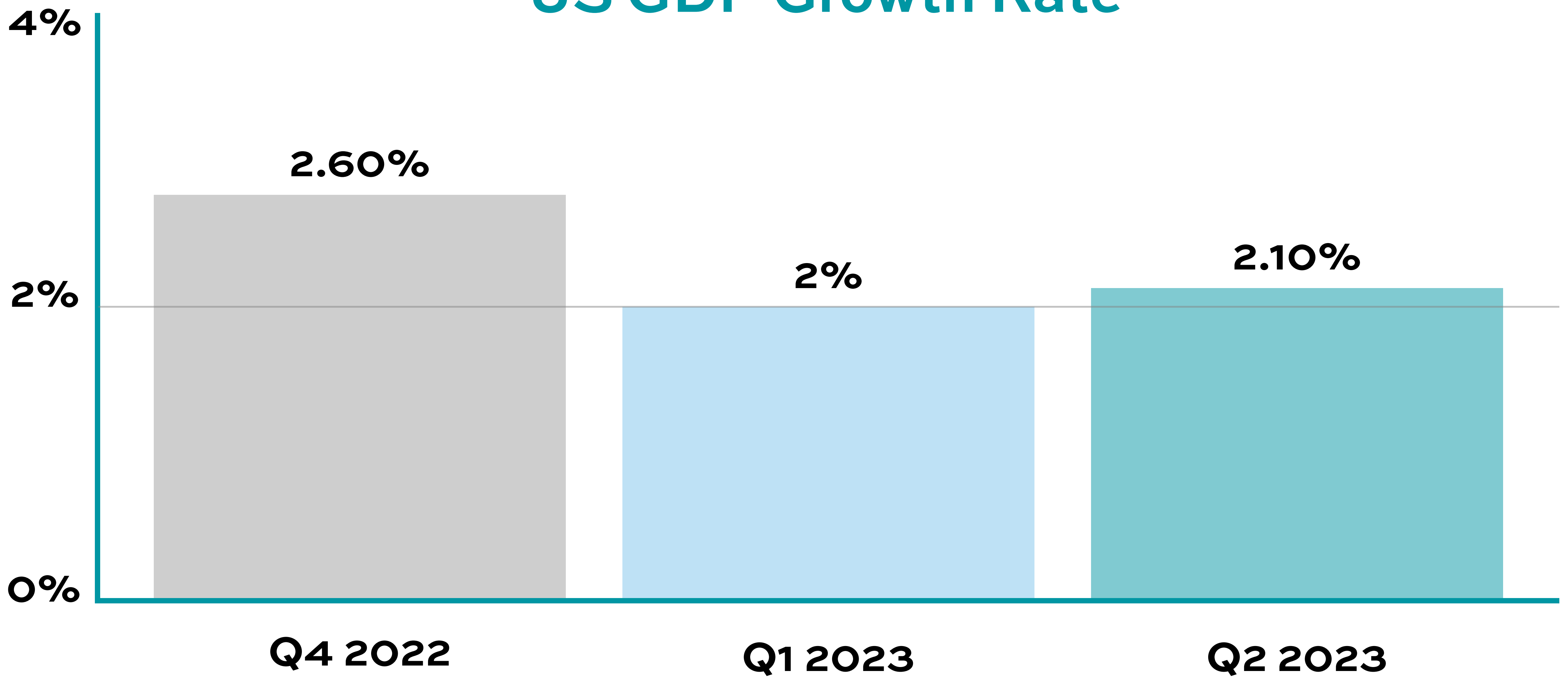
Economic Update

Real U.S. Gross Domestic Product (GDP) for Q2 arrived at 2.1%, continuing a trend of more normalized growth in the post-COVID era. Of course, the most important aspect of the number is that it is positive, refuting any claims of an imminent recession after March's bank failures. As per usual, the U.S. consumer continues to spend, helping bolster a domestic economy that is heavily reliant on consumption. Further aiding the headline number were increases in imports, accelerating business investment, as well as an uptick in local and federal government spending.

The Federal Reserve remains steadfast on its mandate to get inflation back to 2%, even if it must keep rates "higher for longer". Economists surveyed by Bloomberg put the probability of a recession over the next twelve months at 60%, down slightly from the last 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 at or near current levels until inflation hits their 2% goal. Unemployment remains near the lowest levels since the 1950s, providing an ongoing opportunity for the Fed to pursue tighter monetary policy.

US GDP Growth Rate



KEY TAKEAWAY

Markets now expect the upper range for federal funds rate to hit ~5.75% by year-end and to slowly decline to ~4.75% over the next 12 months.

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

Economic Update (cont.)

The Treasury curve is flattening as longer-term rates begin to move higher. Much of the recent move in longer rates is due to the latest Fed press conference where the committee upgraded their projection for the U.S. economy and reiterated that rates will stay high.

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

> **Financial markets are pricing in approximately one 25-basis-point rate hike for the fed funds rate in either November or December of 2023. After this, a long pause is expected well into 2024.**

US Treasury Yields

Date & Yield

Tenor	6/30/22	7/28/23	8/30/23	9/29/23
1M	5.24	5.47	5.55	5.55
3M	5.43	5.52	5.56	5.55
6M	5.47	5.54	5.51	5.53
1Y	5.40	5.37	5.39	5.46
2Y	4.87	4.87	4.90	5.03
3Y	4.49	4.52	4.57	4.80
5Y	4.13	4.18	4.27	4.60

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.

During Q3 the goal was to slowly reduce floating-rate exposure in the TX-FIT Cash Pool in favor of more fixed-rate positions. However, there will be a mixture of the two through year-end. We are keeping a close eye on the relative value between floating- and fixed-rate instruments as market opportunities are presented.

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.

KEY TAKEAWAY

During Q3 we found particular value in fixed-rate instruments, especially in the four to six-month maturity range.

STRATEGY

Focus on quality: Short-term U.S. Treasuries provide excellent relative value given the increasing supply available. Additionally, we continue to see value in high-quality municipal bonds and tier-one (highest-rated) commercial paper (where appropriate).

TX LGIP Comments

TX FIT Government Pool:

Yield continues to be driven by FDIC-insured overnight deposits alongside laddered securities, both fixed and floating-rate. 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 to outpace the S&P LGIPG 30-day index.

QTD/YTD return: +1.30%, +3.67%

End quarter yield: 5.20%

TX FIT Cash Pool:

Focus on a balance between fixed and floating-rate commercial paper as we near the end of the rate cycle. Currently targeting an average life of around 110 days and continuing to add to liquidity sources (money markets, deposits, and ultra-short bond funds) to remain nimble and take advantage of investment opportunities amidst ongoing volatility in yields. We expect the pool to continue to outpace the S&P 30-day LGIP index.

QTD/YTD return: +1.36%, +3.87%

End of quarter yield: 5.47%

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