Texas LGIP Strategy Update

Q4 2023

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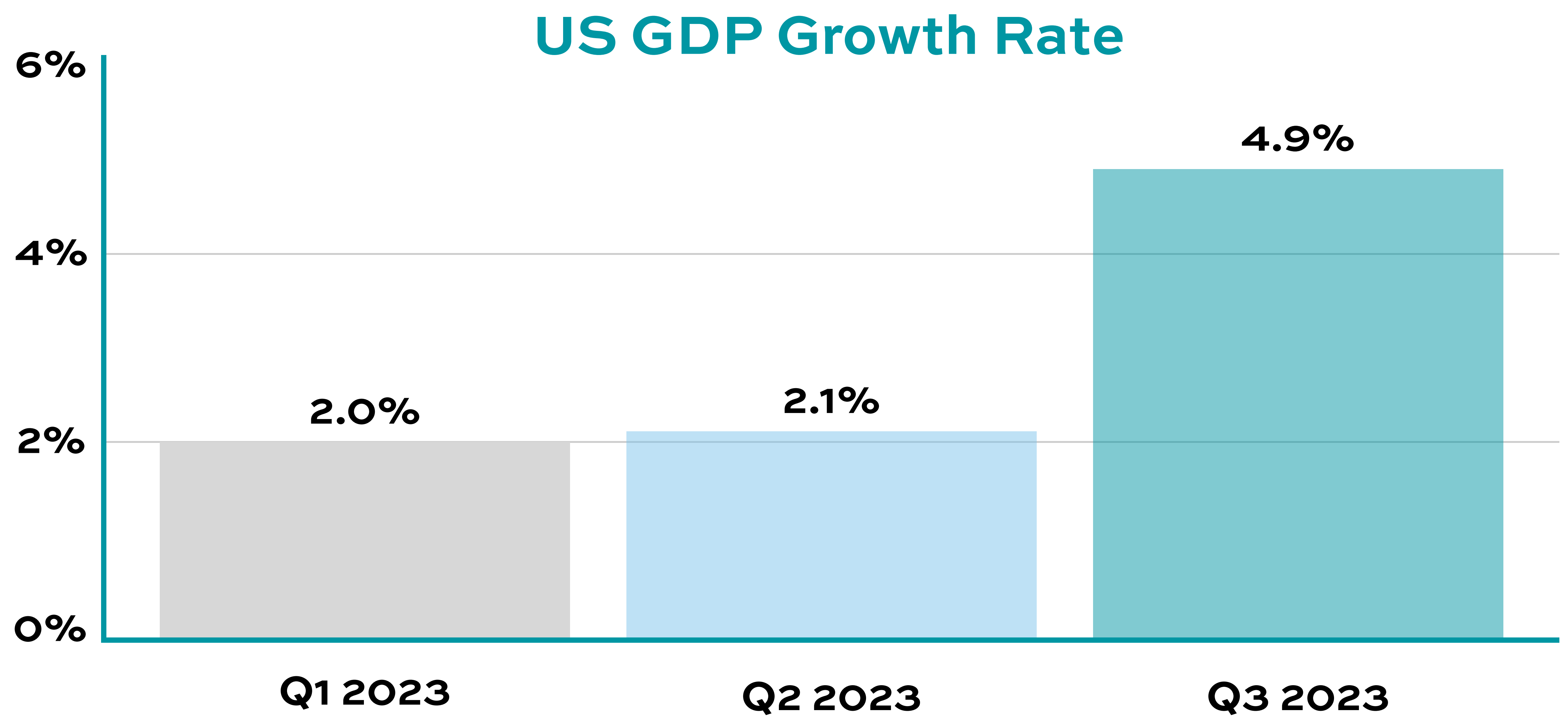
Economic Update

Q3 Real US Gross Domestic Product (GDP), which subtracts out the effects of inflation, arrived at a whopping 4.9% and followed a more “normal” read of 2.1% for Q2. The U.S. economy continues to show signs of strength despite lingering inflationary pressures and high consumer prices. As per usual, the US consumer continues to spend, helping bolster a domestic economy that is heavily reliant on consumption.

Meanwhile, the December jobs report beat expectations: Total nonfarm payroll employment increased by 216,000 in December, and the unemployment rate was unchanged at 3.7%. Employment continued to trend up in government, health care, social assistance, and construction, while transportation and warehousing lost jobs. The United States needs ~100k new jobs per month to maintain existing employment levels.

> **The Federal Reserve** policymakers agreed in December that it would be appropriate to maintain a restrictive stance “for some time,” while acknowledging they would likely need to begin cutting rates late in 2024.



KEY TAKEAWAY

The U.S. economy continues to show signs of strength despite lingering inflationary pressures and high consumer prices.

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

Economic Update (cont.)

Inflationary pressures have moderated from their recent 40-year highs but are anticipated to remain above the Fed's target of 2% for some time. 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 ongoing opportunity for the Fed to pursue tighter monetary policy.

Markets are pricing in 5–6 quarter-point rate cuts this year (-125 or -150 basis points in total), while the Fed's median projection is for three (-75 basis points in total). Additionally, markets see a ~50% chance of the first rate cut in March, while the Fed itself sees the first cut later in the year, likely in September.

Volatility is expected to persist as investors balance the expectations for rate cuts with generally positive economic data.

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US Treasury Yields

Date & Yield

Tenor	12/30/22	9/29/23	11/30/23	12/29/23
1M	4.12	5.55	5.56	5.60
3M	4.42	5.55	5.45	5.40
6M	4.76	5.53	5.38	5.26
1Y	4.73	5.46	5.16	4.79
2Y	4.41	5.03	4.73	4.23
3Y	4.22	4.80	4.48	4.01
5Y	3.99	4.60	4.31	3.84

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" by holding short-term rates near current levels until CPI gets closer to their 2% goal.

Since early December, fixed-rate bonds appear very expensive, while floating-rate bonds appear unexpectedly cheap.

Focus on quality: We continue to see value in high-quality municipal bonds and tier-one (highest rated) commercial paper (where appropriate). Domestic banks, especially short-term corporate bonds, are an excellent alternative to traditional money market instruments and provide considerable yield pickup to commercial paper.

STRATEGY

At this juncture, we are focused on relative value between fixed and floating-rate instruments.

TX LGIP Comments

TX FIT Government Pool:

Yield continues to be driven by FDIC insured overnight deposits alongside laddered securities US Treasuries and Agencies, 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: +1.34%, +5.06%

End quarter yield: 5.29%

TX FIT Cash Pool:

Focus on a balance between fixed- and floating-rate commercial paper (CP) as we near the end of the rate cycle. Currently targeting an average life around 100 days and continue to add to liquidity sources (money markets, deposits, and ultra-short-term bond funds) to remain nimble and take advantage of investment opportunities amidst ongoing volatility in yields. A balance of longer-date fixed CP and shorter-term floating CP will be the focus moving forward. We expect the pool to continue to outpace the S&P 30-day LGIP index.

QTD/YTD return: +1.41%, +5.33%

End of quarter yield: 5.64%

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