Florida LGIP Strategy Update

Q1 2023

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Economic Update

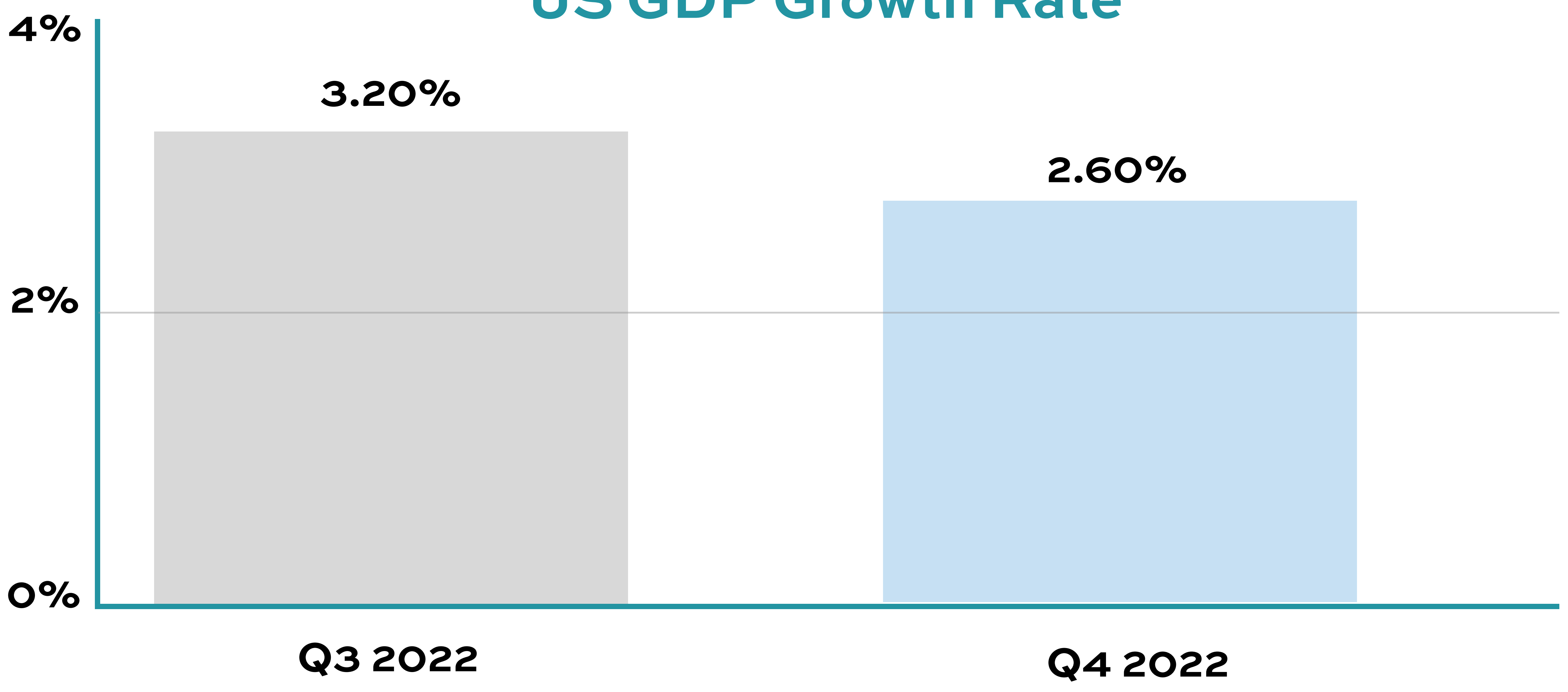
The **US Gross Domestic Product (GDP) slowed** slightly to 2.60% in the fourth quarter, after showing a larger than-expected increase of 3.20% in Q3. Markets expect growth to slow throughout 2023 as fallout from regional banking issues cause a slowdown in commercial activity alongside persistent inflationary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

STRATEGY

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

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 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.

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

End of month yield: 4.77%

FL FIT Cash Pool

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

MTD/YTD return: +0.41%, +1.16%

End of month yield: 4.99%

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

We continue to focus on balancing liquidity while opportunistically taking advantage of heightened rates. A barbell-like approach is being implemented with floating-rate on the front-end, and high-quality fixed rate securities on the back end. We remain short of the benchmark in terms of overall duration and expect yields to continue to move up as floating-rate instruments reset upward. We see ample opportunities in some fixed-rate securities, which are being selectively added to the portfolio. 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 Enhanced Cash Pool (floating NAV, total return focus):

We continue to opportunistically utilize treasury futures as portfolio insurance, currently sitting at approximately 10% of the portfolio to help limit duration in this volatile environment. 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 towards 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 below the benchmark, the portfolio sits at roughly one-year, but it will increase slowly as we add fixed-rate securities. The pool continues to outpace it's 1-3 year benchmark over the longer-term due to the lower duration profile and floating-rate securities, and yields will continue to reset higher, further helping to insulate the pool. See below for further details.

Florida Floating NAV Pool Details†

As of 03/31/23, 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

- March EOM/YTD %: (+0.47, +1.17)
- Benchmark: (+0.54, +1.18)

STRATEGY

We continue to see opportunities in AAA and AA-rated, short-dated municipal bonds across the country. Pre-refunded municipal bonds (backed by US Treasuries) being added on incremental yield.

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 beginning of the month: 3.96%
- Yield at end of the month: 4.59%

Targeted duration band of 0.35 to 0.70 years

- Continue to target an avg duration close to 0.50 years (currently ~0.50)
- Decrease floating-rate instruments over time (currently ~55% 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

- March EOM/YTD: (+0.41, +1.12)
- Benchmark: (+1.57, +1.54)

Peer comparison (February MTD/YTD)

- FL-FIT Select Cash: (+0.11, +0.71)
- FLGIT Short-term Bond Fund (-0.44, +0.47)

STRATEGY

We're finding select opportunities in high-quality, shorter-dated US Agency and US taxable municipal debt with shorter-term yields approaching or even surpassing 5% for several years.

The pool is currently positioned to mitigate volatility and focus on consistent/stable returns. For example, the return profile of this pool has shown seven consecutive months of positive returns, while the index has only four during the same horizon.

Pool yield rising continue to move upwards:

- Yield at beginning of the month: 3.56%
- Yield at end of the month: 4.02%

Targeted duration band of 1.00 to 2.00 years

- Our goal is to align the pool towards average "natural" duration of ~1.5 years eventually (without partial hedge the natural duration is ~1.13 years)
- Current effective duration is ~0.80 years w/partial hedge.
- Increasing allocation to floating-rate instruments, lower duration (currently ~50% of portfolio)

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