Texas 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.

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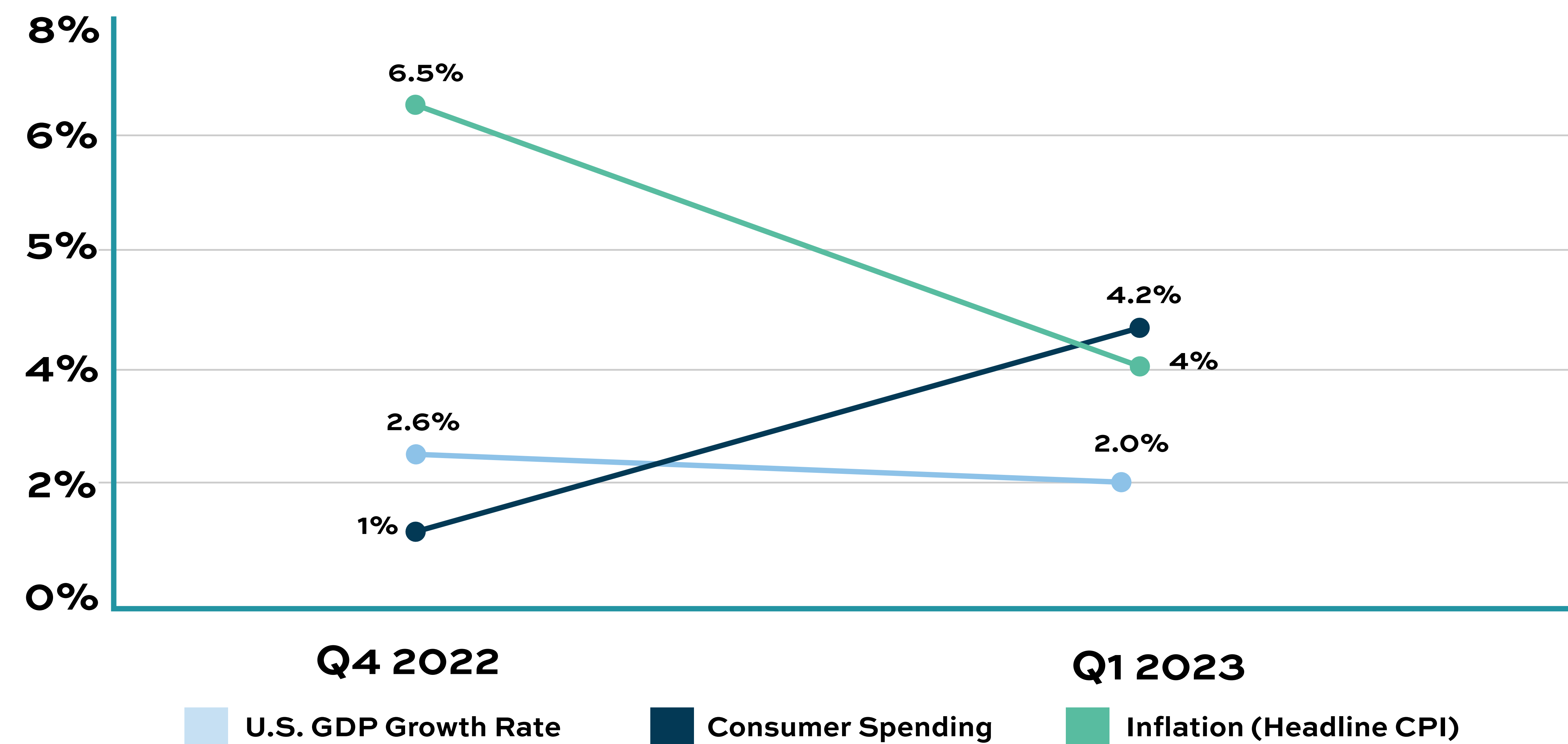
Economic Indicators*



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 US 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.**

U.S. 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 US 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.

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.

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 to outpace the S&P LGIPG 30-day index.

QTD/YTD return: +1.23%, +2.34%

End quarter yield: 5.03%

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. Currently targeting an average life around 110 days and continuing 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.

QTD/YTD return: +1.28%, +2.47%

End of quarter yield: 5.25%

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The performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance quoted. Investments in the TX-FIT Pools are not insured or guaranteed by the FDIC or any other government agency. The investment pools may invest in fixed income securities, which are subject to risks, including interest rate, credit, and inflation.

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