Texas LGIP Strategy Update

Q1 2024

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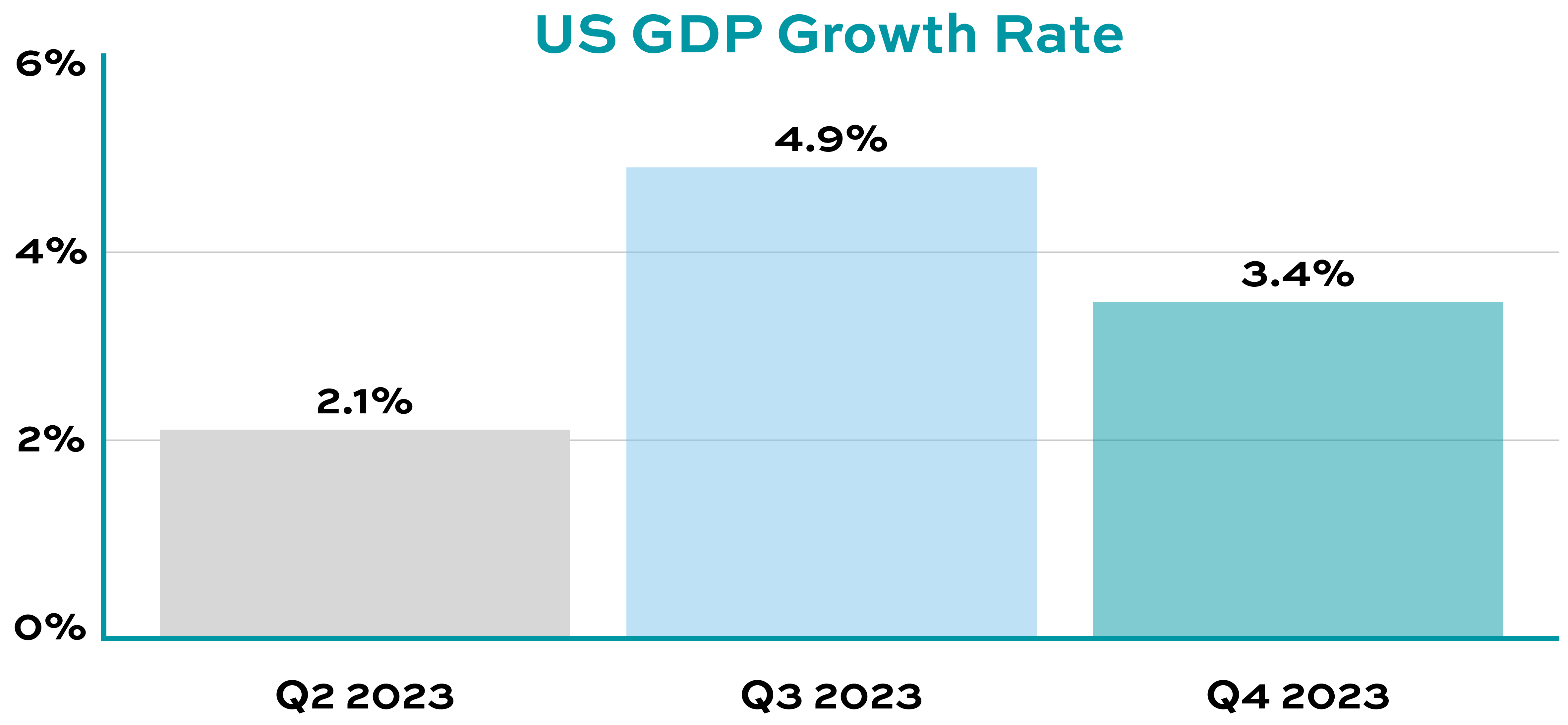
Economic Update

Q4 Real US Gross Domestic Product (GDP), continues to surprise to the upside with a final revision print of 3.4% for 4Q 2023, surpassing expectations of 3.2%. Consumer consumption, comprising ~70% of US GDP, is forecasted to moderate in 2024 while remaining strong overall. Fitch Ratings revised its real consumer spending forecast from 0.6% to 1.3% in February 2024 as consumers continue to show signs of strength despite lingering inflationary pressures.

Monthly US jobs reports continue to beat expectations: Total nonfarm payrolls increased by 303k in March, exceeding expectations of 202k. The unemployment rate fell from 3.9% to 3.8%, and average hourly earnings increased by 0.3% month-over-month, in line with expectations. JOLTS data (US job openings) indicates ~1.162 million more job openings than pre-Covid peak levels, signaling ongoing tightness in the labor market.

The Federal Reserve policymakers agreed in March that it would be appropriate to maintain a restrictive stance "for some time," acknowledging that decisions around rate cuts would be made "meeting by meeting".



KEY TAKEAWAY

Consumer consumption, comprising ~70% of US GDP, is forecasted to moderate in 2024 while remaining strong despite lingering inflationary pressures.

***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 March CPI data came in hotter than expected (3.2% YoY vs 3.1% estimate) with Fed chair Powell describing the disinflation road ahead as a "bumpy path". Unemployment remains near the lowest levels since the 1950s, providing ongoing opportunity for the Fed to pursue tighter monetary policy.

Markets are now pricing in fewer than 3 quarter point rate cuts in 2024, a shift down from recent expectations of five to six quarter point cuts, while the Fed's median projection for 2024 stands at three quarter point cuts (-75 basis points, or 0.75% in total).

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	3/31/23	1/31/24	2/28/24	3/28/24
1M	4.74	5.53	5.50	5.49
3M	4.85	5.42	5.45	5.46
6M	4.94	5.18	5.31	5.38
1Y	4.64	4.73	5.00	5.03
2Y	4.06	4.27	4.64	4.59
3Y	3.81	4.05	4.44	4.40
5Y	3.60	3.91	4.26	4.21

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_%20value=2024

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 at or near current levels until CPI gets convincingly closer to their 2.00% goal.

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

At this juncture, we are **focused on relative value between fixed and floating-rate instruments**. Since early December, fixed-rate bonds appear very expensive, while floating rates appear unexpectedly cheap. A delay in rate cuts has made floating-rate securities more attractive.

Compression in yield spreads (extra yield above a comparable treasury) in commercial paper has made treasuries and municipal bonds look more appealing on a relative basis. With spreads near historic lows, there is potential for spreads to widen on news events, especially regarding inflation, global growth, or geopolitical events. We seek to identify fairly valued securities and avoid instruments where yield spreads have moved too low.

KEY TAKEAWAY

We continue to see value in high-quality municipal bonds and tier-one commercial paper. 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

Unemployment remains near the lowest levels since the 1950s, providing ongoing opportunity for the Fed to pursue tighter monetary policy.

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 LGIP 30-day index.

March 2024 QTD net return: 1.32%.

End of quarter net yield: 5.30%.

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. We continue to seek relative value in this market where yield spreads are very low. Identifying alternative sources of yield, such as floating-rate US Treasuries can provide high relative yields compared with corporate credit. We're also adding duration to the pool while balancing liquidity sources (money markets, bank deposits and ultra-short 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 into Q2 2024. We expect the pool to continue to outpace the S&P 30-day LGIP index.

March 2024 QTD net return: 1.38%.

End of quarter net yield: 5.49%.

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 FL-FIT or 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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