Florida LGIP Strategy Update

Q2 2024

PREPARED BY

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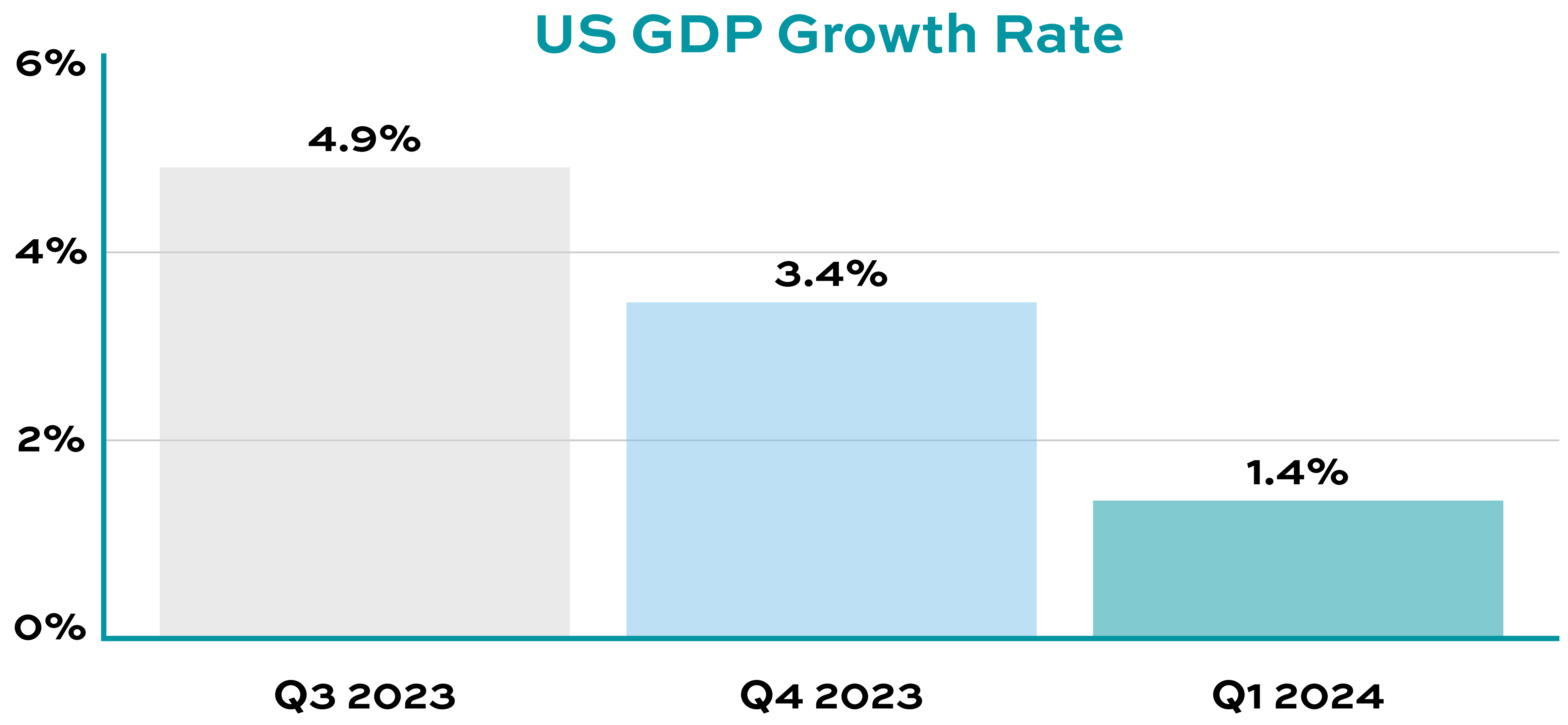
Economic Update

Q1 2024 Real US Gross Domestic Product (GDP), which subtracts out the effects of inflation, registered at 1.4% for its final revision, in line with expectations, but down from 2.2% in the first quarter of 2023. Consumer consumption, comprising ~70% of US GDP, is forecasted to moderate in 2024 while remaining strong overall. Fitch Ratings has now revised its real consumer spending forecast from 1.3% in February up to 1.9% as of May 2024 as consumers continue to show signs of strength despite lingering inflationary pressures.

Monthly US jobs reports continue to remain strong: Total nonfarm payrolls increased by 272k in May, exceeding expectations of 180k. The unemployment rate increased from 3.9% to 4.0%, and average hourly earnings increased by 0.4% month-over-month in May, exceeding expectations of 0.3%. JOLTS data (US job openings) indicates ~546,000 more job openings than pre-Covid peak levels, signaling ongoing tightness in the labor market.

The Federal Reserve policymakers agreed in June that it would be appropriate to maintain a restrictive stance *"for some time,"* **citing a need to gain greater confidence that inflation is heading back to their 2% target**. The Summary of Economic Projections showed a median forecast of 25 basis points of rate cuts in 2024, down from 75 basis points in March.



KEY TAKEAWAY

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

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

Economic Update (cont.)

The May CPI data was one of the more encouraging CPI reports that we have seen in quite a while with the headline (3.3% YoY vs 3.4% estimate) and core (3.4% YoY vs 3.5% estimate) figures both coming in below expectations. The core print (which is the preferred inflation gauge by many economists), rose at the slowest pace in more than three years. It is encouraging to see inflationary pressures continue to moderate; however, inflation is still stubbornly above the Fed's target of 2%.

Markets are now pricing in one to two 25 basis point rate cuts in 2024 (~0.50%), a shift down from Q1 expectations of 5 to 6 quarter point cuts (~1.25 to 1.50%).

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

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US Treasury Yields

Date & Yield

Tenor	6/30/23	4/30/24	5/30/24	6/28/24
1M	5.24	5.48	5.48	5.47
3M	5.43	5.46	5.46	5.48
6M	5.47	5.44	5.42	5.33
1Y	5.40	5.25	5.19	5.09
2Y	4.87	5.04	4.92	4.71
3Y	4.49	4.87	4.74	4.52
5Y	4.13	4.72	4.57	4.33

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=2024

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 holding short-term rates at, or near current levels until CPI gets convincingly closer to their 2.00% goal.

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-rate appear unexpectedly cheap. A delay in rate cuts has made floating-rate securities more attractive. In our opinion, it makes sense to include both fixed- and floating-rate securities in most portfolios as each has unique characteristics and benefits.

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

Compression in yield spreads (extra yield above a comparable treasury) in commercial paper and most corporate bonds 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 future news events, especially regarding inflation, global growth, US and global elections, and ongoing geopolitical events. We seek to identify what we believe are cheap, or fairly valued securities, and avoid instruments where yield spreads have moved too low. Our patient investment strategy allows us to take advantage of markets when they move in our favor, and we expect spreads to widen at some point.

KEY TAKEAWAY

We continue to see value in US treasuries, high-quality municipal bonds, callable US Agencies, and tier-one (highest rated) commercial paper (where appropriate). Yield spreads remain near their lowest levels in years.

STRATEGY

In our opinion, it makes sense to include both fixed- and floating-rate securities in most portfolios as each has unique characteristics and benefits.

Florida LGIP Comments

FL FIT Preferred Deposit Pool:

Qualified Public Deposits (QPD) and FDIC insured deposit yields have stabilized close to the federal funds rate and will closely track any future changes in the benchmark overnight rate. The FL-FIT 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, which finished the quarter at 5.33%.

YTD net return: 2.66%. | End of quarter net yield: 5.29%

FL FIT Cash Pool:

Strategically, we continue to seek relative value and identify securities that can help provide both safety and yield regardless of the economic backdrop. Geographically, we continue to focus on adding exposure to domestic issuers and seek out short-term corporate bonds as an alternative to commercial paper. There are abundant opportunities is short-dated agency MBS as well as callable US Agencies. Additionally, we employ a strategic allocation to prime money markets, ultra-short bond funds and bank deposits. We expect the pool to continue to outpace the S&P 30-day LGIP index.

YTD net return: 2.77%. | End of quarter net yield: 5.48%

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

We continue to focus on balancing liquidity while opportunistically taking advantage of market opportunities to lock-in yields for the coming years. For now, we see limited opportunities in longer-dated, fixed-rate securities but prefer municipal credit spreads to those found in corporate bonds. The pool has closely tracked its benchmark over the last twelve months, and we expect the performance of this pool to be in-line with its 0-1 year benchmark over time. See below for additional details.

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

Late last year, we made the decision to tactically reintroduce the portfolio insurance (interest rate futures) to help insulate the portfolio from ongoing volatility. Like our Enhanced Cash pool, the strategy is to utilize both floating and fixed coupon structures with high credit quality, appropriate issuer diversification, and an eye towards liquidity. We are targeting a duration near the benchmark of ~1.75 years while also providing reinvestment flexibility should rates stay "higher for long". We continue to see ample opportunities in the high-quality, taxable municipal market as it provides suitable yield spread while also increasing credit quality from more traditional corporate/credit instruments. The pool continues to outpace its 1-3 year benchmark over the longer-term and has outpaced its benchmark by ~51 basis points year-to-date. See below for further details.

Florida Floating NAV Pool Details†

(as of 06/30/2024, all return figures are %, net of fees)

FL Enhanced Cash:

PERFORMANCE

Benchmark: 75/25 split of ICE 0-1y US Treasury and 0-1y AAA-A Corporate Index.

- June 2024 YTD return %: (+2.26).
- Benchmark return %: (+2.47).

STRATEGY

Focus on maintaining high credit quality while reducing corporate bond exposure over time in favor of high-quality municipal bonds. Extend duration, lock-in yields.

Pool yield remains resilient as we've previously implemented non-callable securities with favorable/high credit spreads.

- Yield at end of the quarter: 5.08%.
- Reminder: Focus on total return for floating-nav pools, not just daily yield.

Targeted duration band of 0.75 to 1.25 years.

- Extend duration to target an avg duration close to 1 year (currently 1.2 years).
- Decrease floating-rate instruments over time (currently ~44% 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.

- June 2024 QTD return %: (+2.00).
- Benchmark return %: (+1.26).

STRATEGY

Continue to focus on high-quality instruments with call protection to provide consistency in yield for years to come.

- Yield at end of the quarter: 4.52%.
- Reminder: Focus on total return for floating-nav pools, not just daily yield.

Targeted duration band of 1.00 to 2.00 years, currently 1.87 years.

- Increased duration as we extend maturities and lock-in yield.
- Hedge the portfolio during volatile periods to provide better total returns over longer horizons.
- Maintain a high allocation to fixed-rate securities (~67% of portfolio).

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Disclaimer

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