Texas LGIP Strategy Update

Q3 2024

PREPARED BY

Dan Marro, CFA
Portfolio Manager

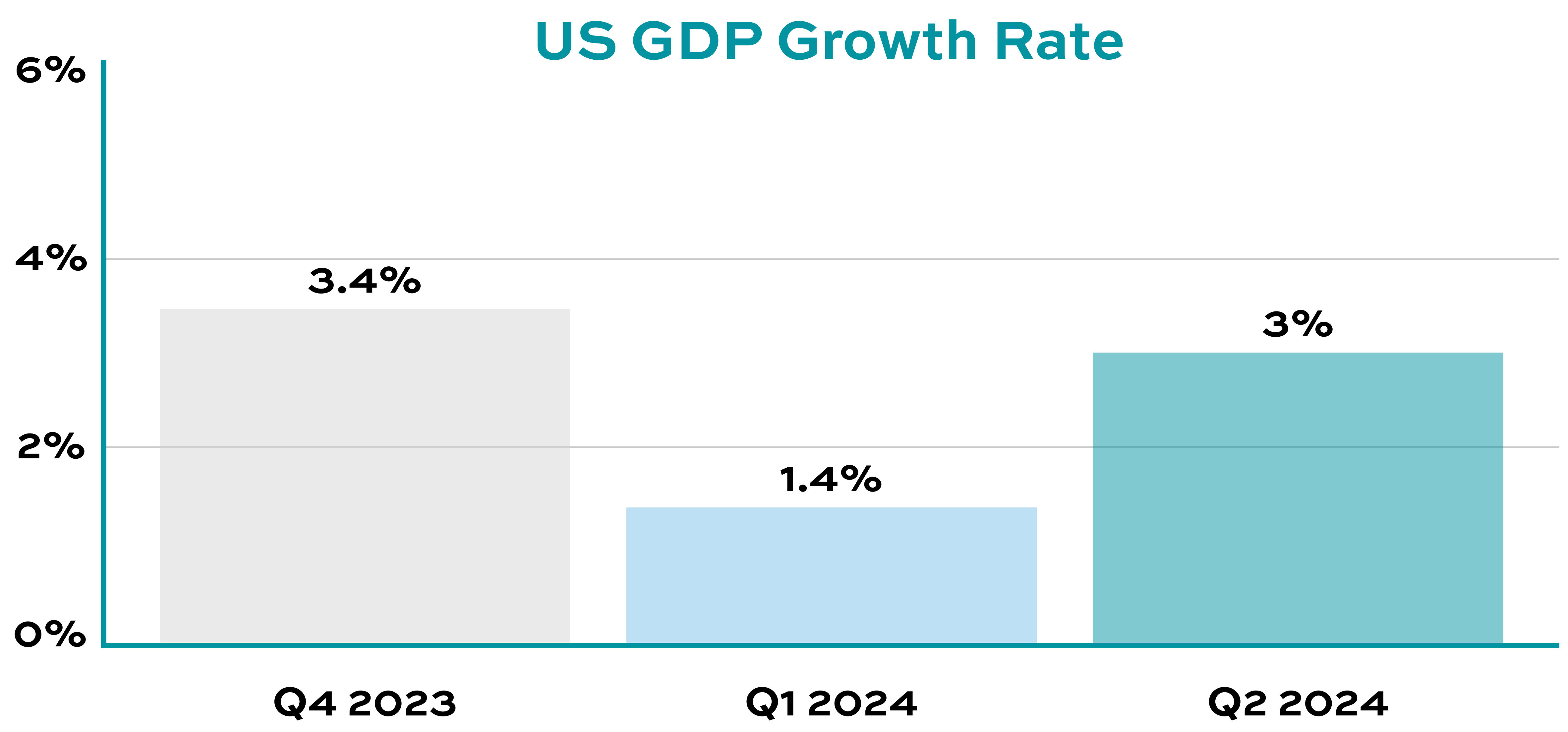
Vito Resciniti
Investment Strategist

Economic Update

Q2 2024 Real US Gross Domestic Product (GDP), which subtracts out the effects of inflation, registered at 3% for its final revision, slightly above expectations of 2.9%, and up from 2.1% in the second quarter of 2023. Consumer consumption, comprising ~ 70% of US GDP, is forecasted to match 2023's growth. Fitch Ratings has now revised its real consumer spending forecast from 1.9% in May up to 2.2% as of September 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 254k in September, easily exceeding expectations of 150k. The unemployment rate decreased slightly from 4.2% to 4.1%, and average hourly earnings increased by 0.4% month-over-month in September, exceeding expectations of 0.3%. JOLTS data (US job openings) remains above pre-Covid levels at 8,040k, but the gap continues to shrink.

On September 18th, Federal Reserve policymakers agreed to cut rates by 50 basis points, the first time they have cut rates since 2020.



KEY TAKEAWAY

Consumer consumption, comprising ~ 70% of US GDP, is forecasted to match 2023's growth.

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

Economic Update (cont.)

The likely combined drop in the inflation rate in conjunction with the rise in the unemployment rate in 2024 led the Federal Reserve to begin easing its policy. The Federal Reserve forecasts a year-end Fed Funds rate of 4.375%, implying 2 more rate cuts in 2024.

Inflation has continued to drop substantially since the Federal Reserve began its rate-hiking cycle in 2022. With the initial onset of rate cuts, market participants are now expecting another 1-2 rate cuts by year-end, in line with the Federal Reserve's own projections.

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

> **In September, year-over-year CPI came in at 2.4%, versus 3.7% at the same time in 2023. However, core CPI, which came in at 3.3% versus expectations of 3.2% in September, is still well above the Fed's target inflation of 2%.**

US Treasury Yields

Date & Yield

Tenor	9/30/23	7/30/24	8/30/24	9/30/24
1M	5.36	5.38	5.26	4.82
3M	5.45	5.29	5.12	4.78
6M	5.55	5.11	4.86	4.58
1Y	5.46	4.80	4.41	4.01
2Y	5.05	4.36	3.92	3.64
3Y	4.80	4.17	3.78	3.55
5Y	4.61	4.03	3.70	3.56

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 continue to be focused on relative value between fixed and floating-rate instruments. However, for most of 2024, spreads have remained very tight relative to their long-term ranges. Despite the initiation of the Federal Reserve's rate cutting cycle, floating rate spreads have not widened out.

However, that is broadly speaking, and we are always on the lookout for relative value opportunities in both fixed and floating-rate securities.

Emphasis on quality: Given persistently tight yield spreads in non-callable securities, we continue to see value in callable fixed-rate and callable fixed-to-float securities.

The persistent compression in yields spreads (as previously mentioned), which is extra yield investors demand above comparable treasury yields for securities such as commercial paper and corporate bonds, has made treasuries more appealing for the time being. There are always potential news catalysts that can drive markets into risk-off mode (wider credit spreads), such as the US election, geopolitical events, and unforseen economic data releases.

Given how tight spreads are, we believe that there is potential for spreads to move much higher on any adverse market-or-other related news events. 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, callable US Agencies, and tier-one (highest rated) commercial paper (where appropriate).

STRATEGY

We believe the Fed will continue to lower interest rates, although at a gradual pace, as inflation numbers continue to head towards 2% and the labor market continues to balance out.

TX LGIP Comments

TX FIT Government Pool:

The performance continues to be driven by FDIC Insured overnight deposits alongside laddered securities in US Treasuries and Agencies, both fixed and floating-rate. We continue to broaden exposure to money market funds, given spread compression elsewhere. Furthermore, we are still consistently seeing opportunities in short-dated, agency MBS with final maturities within one year. We expect this pool to continue to track the S&P LGIPG 30-day index.

September 2024 YTD net return: 4.01%.

End of quarter net yield: 5.21%.

TX FIT Cash Pool:

Performance has been driven by favorable rates in FDIC overnight deposits as well as callable agencies and relative value opportunities in commercial paper, among other things. Regardless of the initiation of the rate-cutting cycle, we continue to exercise patience and seek out relative value where it exists. Identifying alternative sources of yield, such as floating-rate US Treasuries, can provide high yields compared with corporate credit. We continue to see value in callable US Agencies, where current coupons are above the Fed Funds rate in many cases. While keeping the pool liquid through money market, bank deposit, and ultra-short bond fund allocations, we have also locked in more duration well in advance of the rate-cutting cycle (that has now commenced). We expect the pool to continue to outpace the S&P 30-day LGIP Index.

June 2024 YTD net return: 4.17%.

End of quarter net yield: 5.30%.

Contact Us

KEN COUCH
ken@deepblue-inv.com
(210) 240-9464

ED POLANSKY
ed@deepblue-inv.com
(813) 992-3145