Florida LGIP Strategy Update

Q4 2024

PREPARED BY

Dan Marro, CFA
Portfolio Manager

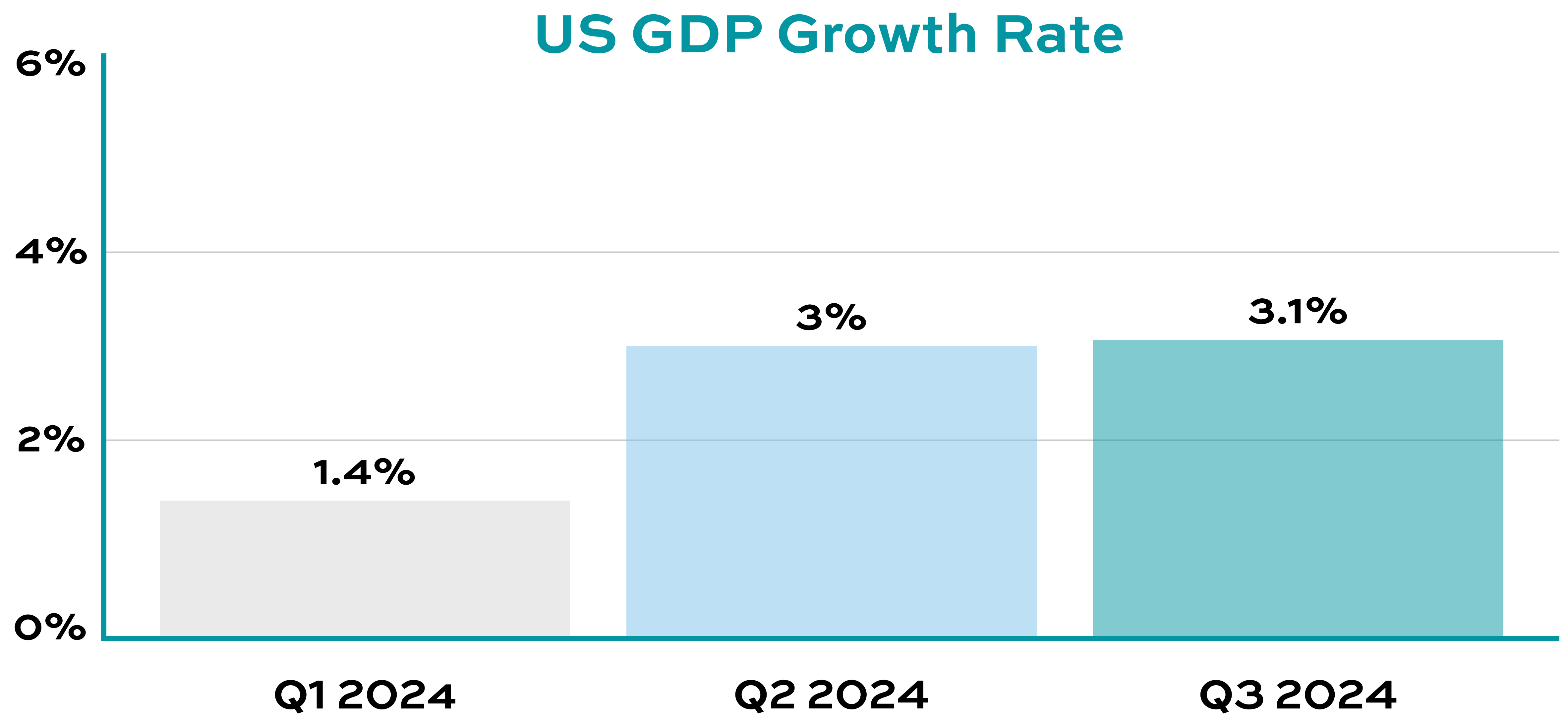
Vito Resciniti
Investment Strategist

Economic Update

Q3 2024 Real US Gross Domestic Product (GDP), which subtracts out the effects of inflation, registered at 3.1% for its final revision, up above expectations of 2.8%, and down from 4.9% in the third quarter of 2023. Consumer spending, which accounts for ~70% of US GDP, grew at a 3.1% annual rate in the third quarter, up from 2.8% in the second quarter. Catalysts for growth, according to Fitch, included strong household balance sheets and increasing household wealth.

The trend in monthly US jobs reports has been generally sideways since March of 2023: Total nonfarm payrolls increased 227k in November, above expectations of 220k. The unemployment rate in November came in at 4.2%, slightly above expectations. Average hourly earnings increased 0.4% month-over-month, beating expectations of 0.3%. Finally, the JOLTS Job Openings came in at 7,744k, below expectations of 7,519k. The long-term trend in job openings remains down.

> **The unemployment rate in November came in at 4.2%,** slightly above expectations. Average hourly earnings increased 0.4% month-over-month, beating expectations of 0.3%.



KEY TAKEAWAY

Consumer spending, which accounts for ~70% of US GDP, grew at a 3.1% annual rate in the third quarter, up from 2.8% in the second quarter.

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

Economic Update (cont.)

The Federal Reserve Board met on December 17-18 and decided to proceed with its rate-cutting cycle, implementing a 25 basis point reduction. However, the move was seen as "hawkish," indicating that the Fed may pause further cuts due to persistent inflation above 2%, which has begun to show signs of reaccelerating. According to the Federal Reserve's dot plot, board members expect a total rate reduction of 50 basis points by the end of the year.

The November headline CPI report showed a 2.7% year-over-year increase, up from 2.6% the previous month but significantly lower than the 3.5% peak earlier in the year. Core CPI (excluding food and energy) came in at 3.3% year-over-year, slightly higher than the 3.2% from the previous month but still below the 3.9% highs seen in 2024. With inflation cooling, the Fed has shifted its focus more towards the labor market.

Market participants are in line with the Federal Reserve's 2025 forecast for rate cuts, pricing in 50 basis points of rate cuts by year-end.

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

US Treasury Yields

Date & Yield

Tenor	12/31/23	10/31/24	11/30/24	12/31/24
1M	5.60	4.76	4.76	4.40
3M	5.40	4.64	4.58	4.37
6M	5.26	4.43	4.42	4.24
1Y	4.79	4.27	4.30	4.16
2Y	4.23	4.16	4.13	4.25
3Y	4.01	4.12	4.10	4.27
5Y	3.84	4.15	4.05	4.38

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

> **The Federal Reserve Board met on December 17-18** and decided to proceed with its rate-cutting cycle, implementing a 25 basis point reduction.

LGIP Investment Strategy

We expect the Fed to continue lowering interest rates in 2025, though at a slower pace than the 100 basis points of cuts seen in 2024. Although progress on inflation has somewhat stalled, the Fed Funds rate remains well above the reported CPI.

Spreads in both fixed and floating-rate bonds remained tight throughout 2024, with occasional false starts suggesting that spreads might rise, only to retreat back to their yearly lows. While this is the general trend, there are still selective opportunities in spread products. We believe that patience remains crucial in navigating fixed income markets and implementing strategy.

Emphasis on quality: Given persistently tight credit spreads in the corporate bond market, we continue to see relative value in higher-rated securities, such as US treasuries, callable agencies, and asset-backed commercial paper. While general credit spreads in corporates remain tight, larger allocations to higher-rated credits make sense.

While spread products, such as corporate bonds, offer higher yields than benchmark treasury bonds, the key issue is opportunity cost. In other words, the cost of fully allocating to corporate bonds at tight spreads is that it limits your ability to deploy capital when spreads become more attractive in the future.

Although patience was tested in 2024 due to persistently tight credit spreads, we believe there is greater potential for spreads to widen rather than tighten, given their position within historical ranges. This is more of an analysis of risk versus reward than a prediction.

KEY TAKEAWAY

Given persistently tight credit spreads in the corporate bond market, we continue to see relative value in higher-rated securities, such as US treasuries, callable agencies, and asset-backed commercial paper.

STRATEGY

We expect the Fed to continue lowering interest rates in 2025, though at a slower pace than the 100 basis points of cuts seen in 2024.

Florida LGIP Comments

FL FIT Preferred Deposit Pool:

Qualified Public Deposits (QPD) and FDIC Insured deposit yields continue to track the Federal Funds rate and will closely track future changes in the rate, including the 25 basis-point rate cut on December 18th. 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 4.33%.

YTD net return: 5.21% | End of quarter net yield: 4.39%

FL FIT Cash Pool:

As G7 central banks, in synchronicity, begin to loosen monetary policy as unemployment rates tick up, we continue to focus geographically on the United States, as it shows a relatively resilient economy. The pool is anchored by allocations to Qualified Public Deposits as well as prime money market funds and ultra-short bond funds. Tactically, we continue to see opportunities in fixed-to-float corporates, short-dated agency MBS, and callable Agencies. We expect the pool to continue to outpace the S&P 30-day LGIP index.

YTD net return: 5.47% | End of quarter net yield: 4.70%

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

As mentioned earlier, given persistently tight credit spreads, we continue to focus on keeping a solid liquidity profile, balanced with selective opportunities to add duration and lock in yield. At the moment, longer-dated municipal bonds are generally preferable to longer-dated corporate bonds, as spread compensation is fair and the credit quality is stronger than that of corporates. 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):

Similar to the Enhanced Cash Pool, the Select Pool maintains a strong liquidity profile, comprised of deposits, money market funds, and short-term mutual funds. We proactively extended duration ahead of the Federal Reserve's rate-cutting cycle and are now 100 basis points into the cycle. In preparation for these developments, we locked in higher yields by investing in high-quality corporate and municipal bonds. We continue to seek longer-dated, relatively attractive bonds, with a particular focus on municipal bonds, as they offer spread compensation relative to their strong credit ratings. The pool continues to outperform its 1-3 year benchmark return. See below for additional details.

Florida Floating NAV Pool Details†

(as of 12/31/2024, 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.

- December 2024 YTD return %: (4.81%).
- Benchmark return %: (5.30%).

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: 4.70%.
- 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 (1.58 years).
- Decrease floating-rate instruments over time (currently ~42% 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.

- December 2024 YTD return %: (4.14%).
- Benchmark return %: (4.13%).

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: 4.30%.
- Reminder: Focus on total return for floating-nav pools, not just daily yield.

Targeted duration band of 1.00 to 2.00 years, currently (2.10 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 (~70% of portfolio).

Contact Us

Dominick Cristofaro
dominick@deepblue-inv.com
(813) 556-9778

Ed Polansky
ed@deepblue-inv.com
(813) 992-3145

Disclaimer

† 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 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.

This quarterly update is for informational purposes only. This report is prepared by Deep Blue Investment Advisors ("Deep Blue"). Deep Blue makes no representation or warranty, expressed or implied, regarding the accuracy or completeness of the information contained herein. The report is not meant as a solicitation of any investment offered by Deep Blue or its affiliates. To the extent permitted by applicable law, no member of the Deep Blue Team and/or US-FIT Trust or any officer, employee, or associate accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents, including for negligence. The views expressed within this report constitute Deep Blue's perspective at the time of distribution and are subject to change. Any forecast, projection, or prediction of the market, the economy, and economic trends are based upon current opinion as of the date of issue and are also subject to change. FL-FIT investments are not available for sale to the general public and only to certain qualified entities.