

Texas LGIP Strategy Update

Q4 2024

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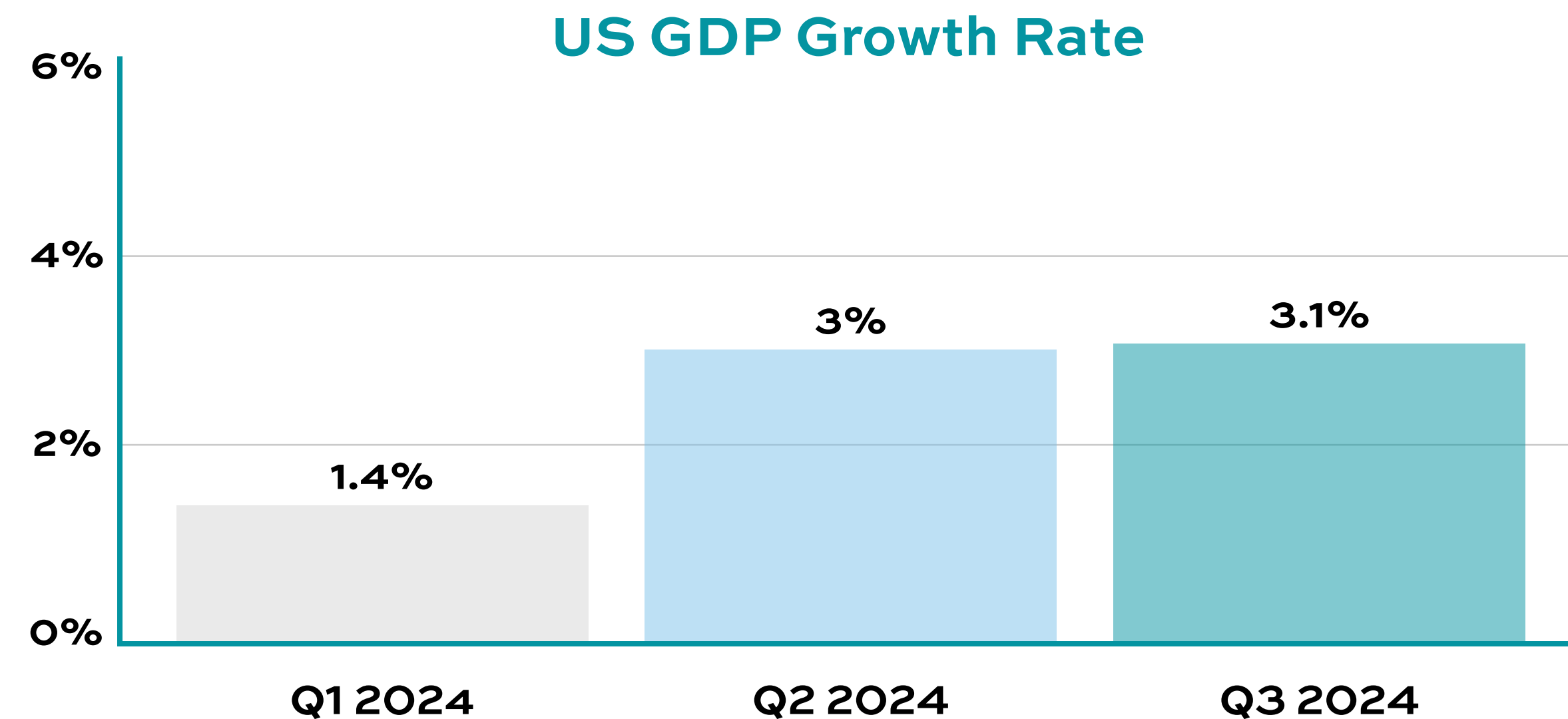


Economic Update



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.



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.

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*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

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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.

The ongoing compression in spreads - the additional yield investors seek above comparable Treasury yields in securities like commercial paper, agencies, and mortgages - has made relative value opportunities harder to find. In this market environment, we believe patience is key, allowing us to wait for selective, attractive opportunities in agency callables, short-dated mortgages, and commercial/asset-backed commercial paper as they arise. With the start of 2025 and a new presidential administration, new policy directions bring uncertainty, which could lead to more favorable opportunities down the line.

KEY TAKEAWAY

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STRATEGY

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TX LGIP Comments



TX FIT Government Pool:

The government pool is anchored by FDIC overnight deposits as well as government money market funds. Additionally, the fund is tactically laddered out in treasuries and agencies, both fixed and floating-rate. The pool also purchases agency MBS with final maturities within one year, as they currently provide yield pickup to comparable treasuries and non-callable agencies.

December 2024 YTD net return: 5.24%.

End of quarter net yield: 4.44%.

TX FIT Cash Pool:

The Cash Pool is primarily composed of FDIC-insured overnight deposits, along with money market funds and mutual funds. In line with our current outlook, the pool remains selective in its security allocations due to generally tight spreads. Callable agencies, asset-backed commercial paper, and short-maturity agency mortgage-backed securities continue to offer the best relative value. Duration was strategically locked in ahead of the Federal Reserve's rate-cutting cycle, which has seen a 100 basis point reduction and continues. We expect the pool to continue outperforming the S&P 30-day LGIP index.

December 2024 YTD net return: 5.47%.

End of quarter net yield: 4.79%.

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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