Texas LGIP Strategy Update

Q1 2025

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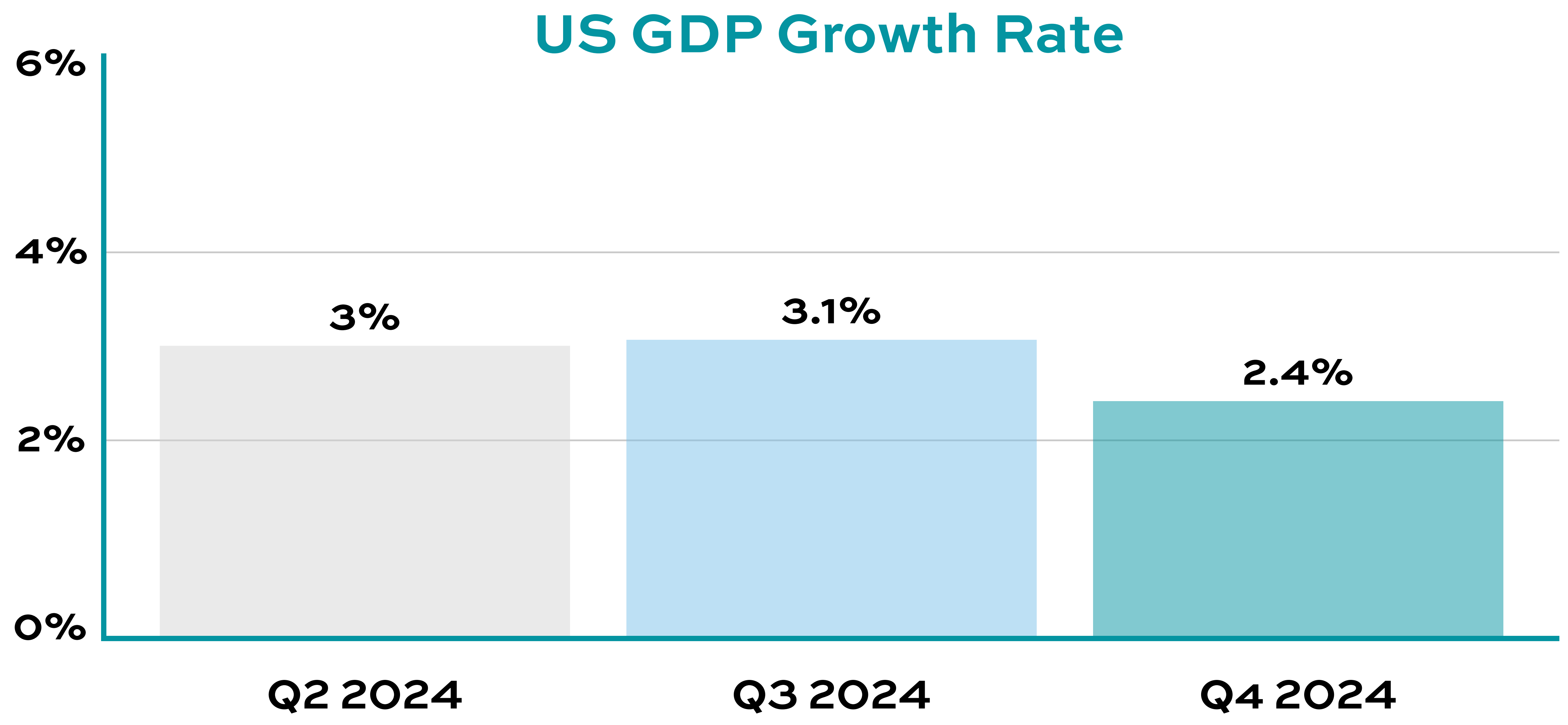
Economic Update

Q4 2024 Real US Gross Domestic Product (GDP), which subtracts out the effects of inflation, registered at 2.4% for its final revision, slightly above expectations of 2.3%, and down from 3.4% in the 4th quarter of 2023. Consumer spending, which accounts for ~70% of US GDP, grew at a 4% annual rate in the fourth quarter of 2024, up from 3.3% in the fourth quarter of 2023. Catalysts for personal consumption continue to be strong with healthy 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 151k in February, below expectations of 160k. The unemployment rate in February came in at 4.1%, slightly above expectations. Average hourly earnings increased 0.3% month-over-month, right in line with expectations. Finally, the JOLTS Job Openings came in at 7,740k for January, above expectations of 7,600k. The long-term trend in job openings remains down.

> **The unemployment rate in February came in at 4.1%,** slightly above expectations. Average hourly earnings increased 0.3% month-over-month, right in line with expectations.



KEY TAKEAWAY

Consumer spending, which accounts for ~70% of US GDP, grew at a 4% annual rate in the fourth quarter of 2024, up from 3.3% in the fourth quarter of 2023.

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

Economic Update (cont.)

The Federal Reserve Board met on March 19th – 20th, agreeing to continue its “pause” on cutting interest rates. This was in line with the expectations of market participants. However, market participants expect 3 total rate cuts by year-end (75 basis points), while the Federal Reserve itself only anticipates cutting rates twice (50 basis points) by year-end. Chairman Jerome Powell acknowledged the potential for inflation to accelerate and growth to slow down in the face of uncertain tariff policies.

The February headline CPI report showed a 2.8% year-over-year increase, down slightly from 3% the previous month, but down decently from 3.2% in February 2024. Core CPI (excluding food and energy) came in at 3.1% year-over-year, slightly below 3.3% from the prior month, but significantly below 3.8% reported in February 2024. Progress on reducing inflation has slowed as of late, but overall the trend remains down.

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	3/31/24	1/31/25	2/28/25	3/31/25
1M	5.49	4.37	4.38	4.38
3M	5.44	4.31	4.32	4.32
6M	5.36	4.28	4.25	4.23
1Y	5.06	4.17	4.08	4.03
2Y	4.72	4.22	3.99	3.89
3Y	4.51	4.27	3.99	3.89
5Y	4.34	4.36	4.03	3.96

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 expect the Fed to continue lowering interest rates in 2025. Market participants are currently pricing in 75 basis points in rate cuts this year. Progress on lowering inflation remains a challenge, yet economic growth forecasts have deteriorated recently.

Bond spreads in both fixed and floating-rate notes remain tight so far in 2025 (off their lows but still below historical averages), despite recent market volatility over the uncertainty of Trump administration's tariff policies. We believe that generally, there is more potential in downside risks (wider spreads) if the economy deteriorates, as opposed to upside rewards (tighter spreads) if the economy remains robust.

Emphasis on quality: With credit spreads persistently tight, investors are not well compensated to take on additional credit risk. An up-in-quality approach with minimal credit risk still makes sense. Hence, treasuries, callable agencies, asset-backed commercial paper, agency mortgage backed securities, and highly rated fix-to-float corporates continue to make sense.

Generally speaking, persistently tight credit spreads in bullet (non-callable) coporates and other spread products continue to raise the issue of opportunity cost. While technically spread products offer more yield than products like treasuries, hence spread, their yield pickup over treasuries is near historically tight levels.

While it can test one's patience, it is prudent to avoid overly tight credit spreads now so that these spread products can be taken advantage of in the future if/when spreads do eventually widen. The risk versus reward phenomenon is always something we take into consideration.

KEY TAKEAWAY

With credit spreads persistently tight, investors are not well compensated to take on additional credit risk. An up-in-quality approach with minimal credit risk still makes sense.

STRATEGY

> **We expect the Fed to continue lowering interest rates in 2025.** Market participants are currently pricing in 75 basis points in rate cuts this year.

TX LGIP Comments

TEXAS FIT FIXED INCOME TRUST

TX FIT Government Pool:

The performance remains anchored by FDIC Insured overnight deposits, alongside laddered securities in US Treasuries and Agencies, both fixed and floating-rate. We continue to allocate to agency MBS with final maturities within one year, capitalizing on their yield pickup relative to comparable treasuries and non-callable agencies. We expect this pool to continue to track the S&P LGIPG 30-day index.

March 2025 YTD net return: 1.09%.

End of quarter net yield: 4.40%.

TX FIT Cash Pool:

The Cash Pool is primarily composed of FDIC-insured overnight deposits, along with money market funds and mutual funds. Reflecting our current market perspective, the pool maintains a selective approach to security allocations amid persistently tight spreads. Callable agencies, asset-backed commercial paper, and short-maturity agency mortgage-backed securities remain the most attractive for relative value. We expect the pool to continue tracking the S&P 30-day LGIP Index.

March 2025 YTD net return: 1.13%.

End of quarter net yield: 4.65%.

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