Texas LGIP Strategy Update

Q2 2025

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Economic Update

Q1 2025 Real Gross Domestic Product (GDP), which subtracts out the effects of inflation, registered at -0.5% for its final revision, below expectations of -0.2% and down from 1.4% in the first quarter of 2024. The negative GDP print was largely due to an increased trade deficit, spurred by companies front-running inventory in anticipation of a large hike in tariff rates. The negative GDP print could ultimately be due to temporary forces. However, consumer spending, which makes up ~2/3 of the economy, fell to -0.1% in the second quarter.

Nonfarm payrolls reported continue to be rangebound since the Spring of 2023, with volatility in between. Viewing longer-term trends helps eliminate the noise that can occur from month-to-month prints. Nonfarm payrolls increased to 147k in June, above expectations of 106k. The unemployment rate for June came in at 4.1%, surprisingly below expectations of 4.3%. Finally, the JOLTS Job Openings came in at 7,769k for May, above expectations of 7,300k.

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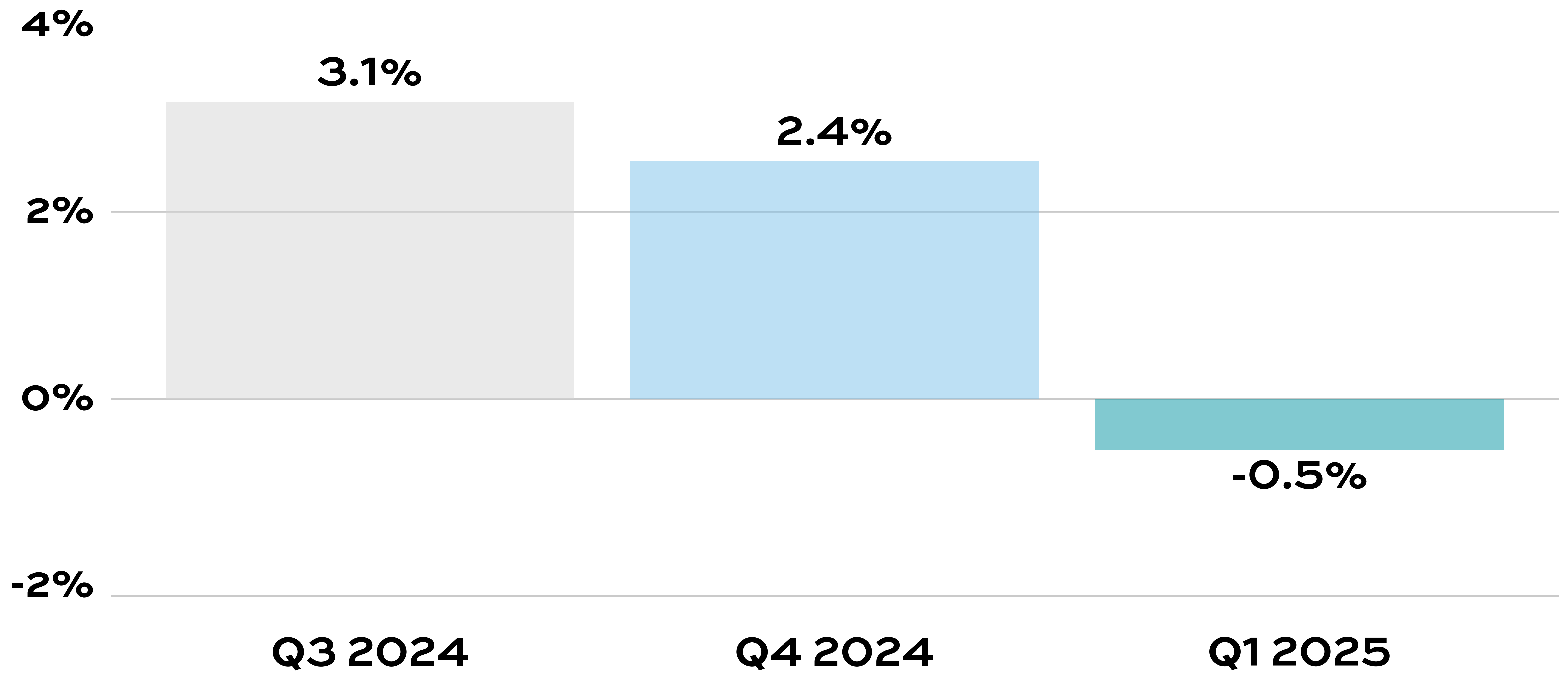
US GDP Growth Rate



KEY TAKEAWAY

The negative GDP print could ultimately be due to temporary forces. However, consumer spending, which makes up ~2/3 of the economy, fell to -0.1% in the second quarter.

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

Economic Update (cont.)

Federal Reserve Chairman Jerome Powell recently stated that he would have resumed the rate-cutting cycle had it not been for tariff policy implemented by the Trump administration. Despite pressure from the White House, The Federal Reserve is more-than-likely to hold rates steady at its next meeting at the end of July. This should be no surprise given continued below average levels of unemployment and inflation still above the Fed's 2% target.

The June headline CPI report came in at 2.7% year-over-year, slightly above expectations of 2.6%. Core CPI (excluding food and energy) came in at 2.9% year-over-year, in line with expectations. Inflation continues to move sideways with a slight downward tilt. That being said, inflation is still above the Federal Reserve's 2% target, and with uncertainty over tariff and fiscal policy, The Fed is in no rush to resume its rate-cutting cycle.

Expect volatility from changes in interest rates to changes in market expectations for rate cuts to continue to persist.

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US Treasury Yields

Date & Yield

Tenor	6/30/24	4/30/25	5/31/25	6/30/25
1M	5.48	4.35	4.33	4.28
3M	5.47	4.31	4.36	4.41
6M	5.37	4.19	4.36	4.29
1Y	5.10	3.85	4.11	3.96
2Y	4.77	3.60	3.89	3.72
3Y	4.58	3.58	3.87	3.68
5Y	4.44	3.72	3.96	3.79

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

The Fed remains paused in its rate-cutting cycle, but we expect them to resume their rate cuts in the 2nd half of the year. Inflation is still above the Fed's 2% target and tariff uncertainty has thrown a wrench in the Fed's plans, but GDP printed negative in Q1.

Bond spreads recently widened out a decent amount during the tariff tantrum in April, but have since snapped back quickly to cycle lows, highlighting investors continued demand for risk, regardless of the price. Spreads can remain tight for long periods of time, but we believe there is more downside potential if the economy deteriorates than upside potential if the economy holds up.

High Quality – Domestic: With continued economic uncertainty globally, the focus continues to be on US-based investments, as compensation is generally not large enough to be positioned in high quality names from other developed nations. Select opportunities are available in callable agencies, asset-backed commercial paper, agency mortgage-backed securities (fixed & floating), and fix-to-float corporates.

Generally speaking, risk spreads (corporates, municipals, bullet agencies, etc). continue to trade near historically tight levels. It is important to continue to express patience despite the fact that risk spreads can remain overly compressed for long periods of time.

Additionally, with a negative GDP print in Q1, negative retail sales in May, and forecasts of deteriorating payrolls numbers and rising unemployment numbers, it is important to be selective where approproiate and let risk spreads come back to more attractive levels before committing capital.

KEY TAKEAWAY

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STRATEGY

The Fed remains paused in its rate-cutting cycle, but we expect them to resume their rate cuts in the 2nd half of the year.

TX LGIP Comments

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.

June 2025 YTD net return: 2.17%.

End of quarter net yield: 4.23%.

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 (fixed & floating) remain the most attractive for relative value. We expect the pool to continue tracking the S&P 30-day LGIP Index.

June 2025 YTD net return: 2.27%.

End of quarter net yield: 4.47%.

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