Texas LGIP Strategy Update

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Economic Update

The economy slowed significantly in the 4th quarter, with the second revision of 4th quarter GDP coming in at just 0.7% annualized, which was a sharp drop from the 4.4% GDP reported in the 3rd quarter of 2025. A notable driver in the slowdown of GDP growth was the 43-day government shutdown, which was estimated to have shaved 1% off of GDP growth. It is worth noting that this slowdown came before the energy price shock due to the war in Iran, which is expected to further weigh on growth.

February nonfarm payrolls surprised to the downside, coming in at -92k vs. estimates of 50k. Two things are notable here: first, the number came in well below already low estimates by economists, and second, this is the third month out of the last five months that nonfarm payrolls have printed negatively. The unemployment rate came in at 4.4%, up from 4.3% in January, but still hovered near historically low levels.

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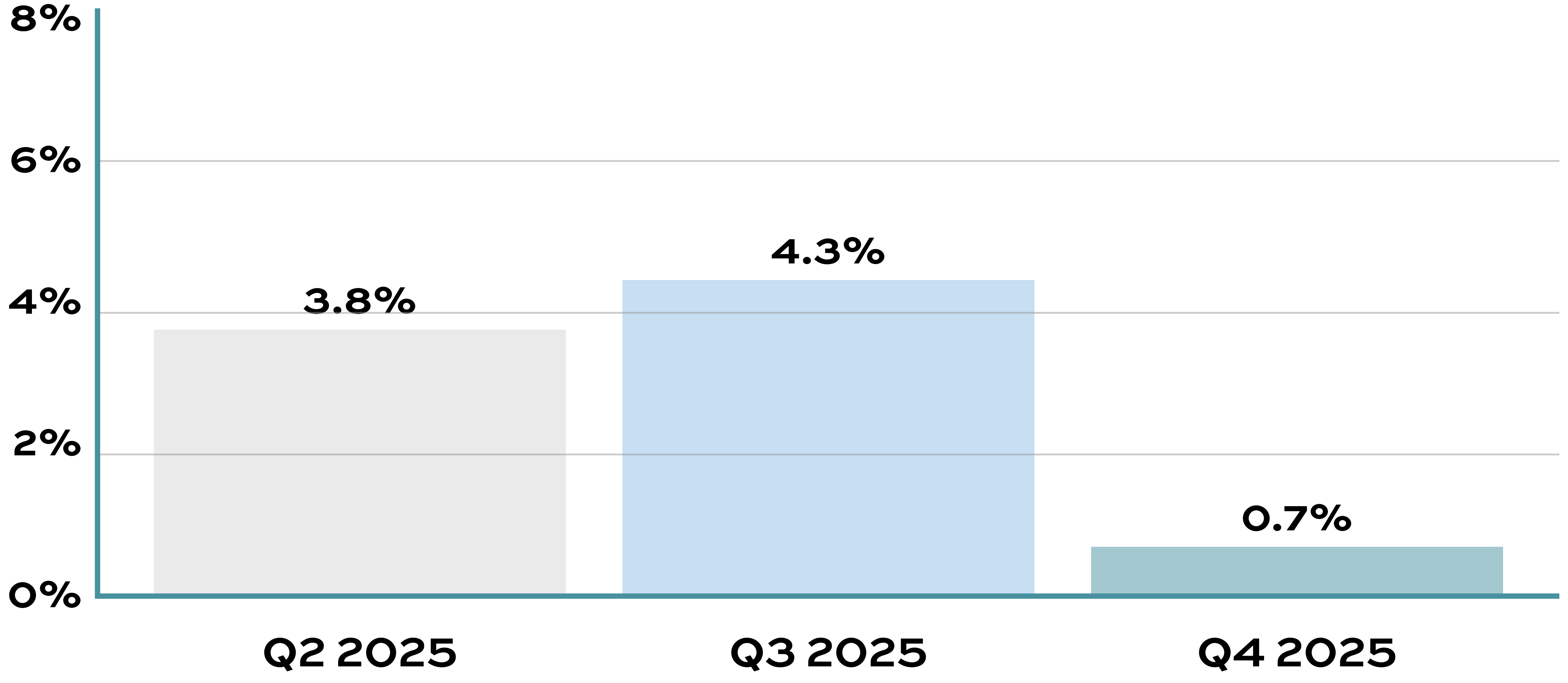
US GDP Growth Rate



KEY TAKEAWAY

A notable driver in the slowdown of GDP growth was the 43-day government shutdown, which was estimated to have shaved 1% off of GDP growth.

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

Economic Update (cont.)

The March 17th – 18th FOMC meeting delivered as expected, with the Fed holding overnight rates steady in a 3.50% - 3.75% range. What has changed is that the Fed is now less optimistic about its fight against inflation. While inflation had been stalling out in the 2.4% - 3.0% range for some time, the war in Iran has reignited inflation risks that have not yet shown up in CPI reports. The FOMC, per its updated DOT plot (rate movement projections), expects to cut interest rates only once in 2026. What might be more noteworthy is the behavior of the 2-year Treasury rate, which tends to foreshadow the Fed Funds rate. It has moved up to 3.80%, implying no rate cuts this year.

February headline CPI came in at 2.4% year-over-year, in line with expectations. However, this number has yet to include any consequences of higher prices from the Iran war. Also, the Producer Price Index (PPI) came in at 3.4% year-over-year, much hotter than expectations of 3%. Not only does this index tend to lead headline CPI, it also has yet to factor in any price disruptions due to the Iran war. March CPI and PPI headline numbers are expected to be higher.

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US Treasury Yields

Date & Yield

Tenor	3/31/25	1/31/26	2/28/26	3/31/26
1M	4.38	3.72	3.74	3.74
3M	4.32	3.67	3.67	3.70
6M	4.23	3.61	3.60	3.72
1Y	4.03	3.48	3.48	3.68
2Y	3.89	3.52	3.38	3.79
3Y	3.89	3.60	3.39	3.81
5Y	3.96	3.79	3.51	3.92

Source: Treasury.gov, DBIA

LGIP Investment Strategy

Federal Reserve activity is always heavily scrutinzed as its overnight (Fed Funds rate) aligns closely with interest rate movements in the Treasury bill markets (0 – 12 month duration), of where our Cash Pool target duration lies in between.

We have been in a rate-cutting cycle for 18 months, although the cycle has been on pause since December. For a while, the 2-year Treasury was leading the Fed Funds rate lower, implying future rate cuts. Now, however, the 2-year rate sits just above the upper bound of the Fed Funds rate, implying uncertainty on where the next move will be a hike or a cut. The pools have benefited from locking in higher rates throughout the duration of rate cuts.

The starting point for any pool is a large core position in liquidity, which is composed of bank deposits and same-day/next-day money market and mutual fund positions. However the Federal Reserve moves next, a core base of liquidity allows each pool flexibility to adapt to static or changing Fed policies. Two examples of tactical positions that have benefited the pools during this cycle are Ginnie Mae floating rate securities with just 1-day duration risk and callable agencies.

In addition to tactical positions mentioned above, such as floating rate Ginnie Mae securities and callable agencies adding relative value, both security sets carry explicit and implicit guarantees, respectively, from the U.S. government. In a weakening economic environment, de-risking the portfolio from a credit perspective is important.

KEY TAKEAWAY

In a weakening economic environment, de-risking from a credit perspective is important — Ginnie Mae floating rate securities and callable agencies both carry explicit and implicit U.S. government guarantees.

STRATEGY

The 2-year Treasury now sits just above the upper bound of the Fed Funds rate, implying uncertainty on whether the next move is a hike or a cut.

Texas 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. Additionally, we recently negotiated a higher deposit rate for our FDIC-insured deposits. We expect this pool to continue to track the S&P LGIPG 30-day index.

YTD net return: 0.89%.

End of quarter net yield: 3.62%.

TX-FIT Cash Pool:

The Cash Pool is composed of a diversified mix of high quality, short duration securities with a strong emphasis on liquidity sources. This high liquidity enables us to strategically allocate to longer duration opportunities such as short-dated agency MBS, floating rate MBS, callable agencies, and asset-backed commercial paper, that should continue to benefit the pool in a falling rate environment.
We expect the pool to track the S&P 30-day LGIP Index over time.

YTD net return: 0.97%.

End of quarter net yield: 3.91%.

Disclaimer

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