

Texas LGIP Strategy Update

Q3 2026

PREPARED BY

Dan Marro, CFA
Portfolio Manager

Vito Resciniti
Investment Strategist



Economic Update

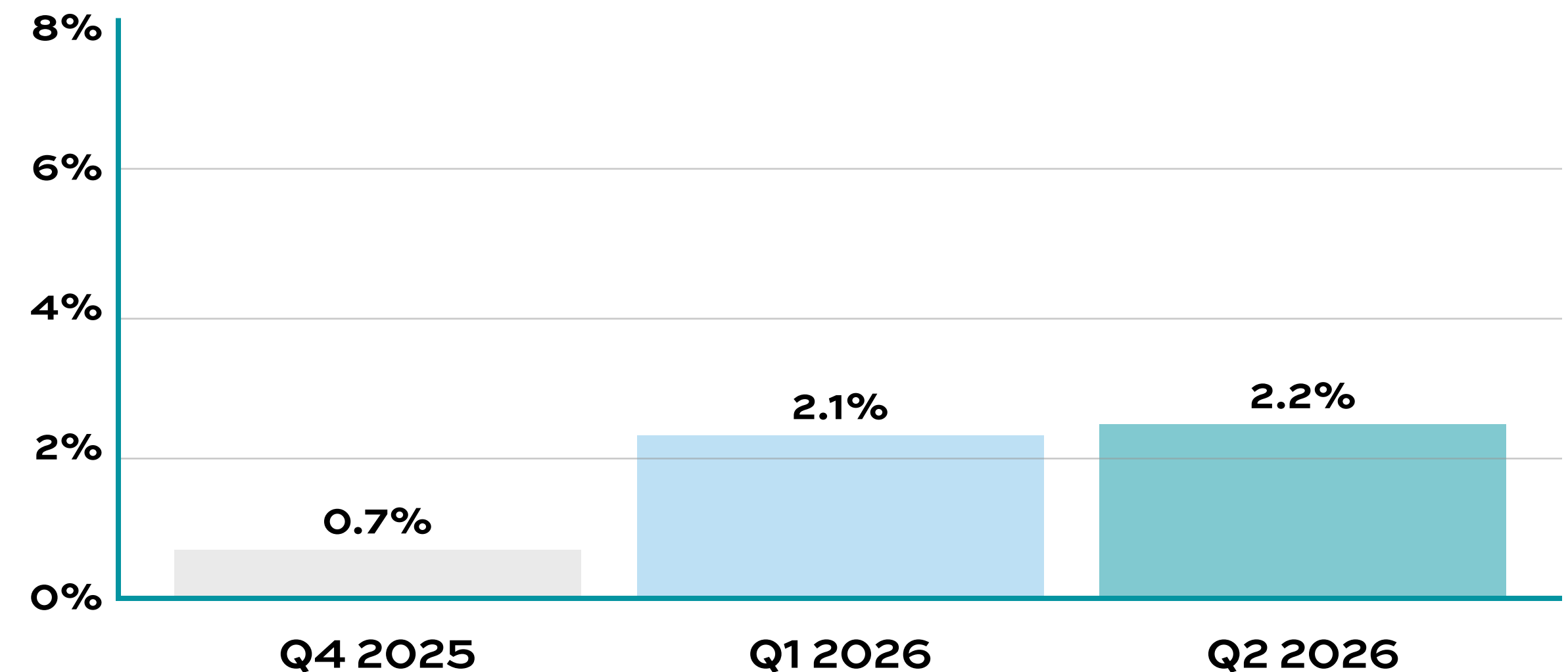


The economy grew in the 2nd quarter, with the third and final estimate of GDP coming in at 2.2% annualized, revised sharply higher from the prior estimate of 1.5%. Underlying demand appears to be strong, with consumer spending up 3.8% and business investment up 9.0%. Business investment again reflected the buildout in Artificial Intelligence, though that spending has broadened from software and research into physical capacity, with intellectual property investment up 9.2% and equipment spending up 13.4%. First quarter growth was also revised higher, to 2.5%, as part of the Bureau of Economic Analysis annual update.

Nonfarm payrolls weakened through the quarter. September payrolls came in at just 29k, versus expectations of 90k, and revisions took July to a loss of 10k and August down to 133k, reducing the previously reported employment count by 60k across those two months. The three-month average has slowed to roughly 50k per month, though the level needed to hold the unemployment rate steady has fallen as well. The St. Louis Fed puts that breakeven pace between 15k and 87k for 2026, well below the rule of thumb of recent years. The unemployment rate ticked up to 4.2% in September but has remained within a narrow 4.1% to 4.3% range since March, per the Bureau of Labor Statistics.

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US GDP Growth Rate



KEY TAKEAWAY

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

Economic Update (cont.)



The September 15-16 FOMC meeting marked the end of the honeymoon phase for new Fed Chairman Kevin Warsh. His board of 12 voting members proceeded to unanimously vote to hike interest rates by 25 basis points, with further hikes expected. The key word here is “unanimous”, as previously we saw disagreement amongst Fed voting members on whether to hike interest rates. Chair Warsh remains firm in his priority to slow inflation back to its long-term target of 2%, a point at which it has not been since early 2021. Further, the 2-year treasury, a leading indicator for future Federal Reserve policy, has surged 100-basis points above the Federal Funds rate, implying future rate hikes.

In September, the August CPI report came in at 3.4%, unchanged from July and down from 4.2% in May, but still well above the Fed's 2% target. Core CPI, which strips out food and energy, has eased steadily to 2.4%. PPI, or business input prices, came in at 5.4% in August, sharply higher than where it stood at the end of last year. Last quarter's concern was that elevated input costs would pass through to consumers. To date that pass-through has been limited, though producer price growth remains well above consumer price growth, and the gap bears watching, particularly with energy costs moving higher again.

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US Treasury Yields

Date & Yield

Tenor	9/30/25	7/31/26	8/31/26	9/30/26
1M	4.20	3.78	3.85	4.02
3M	4.02	3.83	3.91	4.20
6M	3.83	3.98	3.99	4.33
1Y	3.68	4.08	4.16	4.54
2Y	3.60	4.28	4.34	4.88
3Y	3.61	4.34	4.40	5.00
5Y	3.74	4.45	4.49	5.09

Source: Treasury.gov, DBIA

LGIP Investment Strategy



Federal Reserve Chairman Kevin Warsh, expectedly, began raising interest rates in just his second meeting as the Fed Chair. This is the first time that the Fed has hiked interest rates since July 2023, and more rate hikes are expected.

Chair Kevin Warsh has reiterated his firm objective of slowing the growth in inflation back to its long-term target of 2%. Because that objective has not been achieved since early 2021, it is likely that market participants still believe he will balk before achieving his goal. However, the 2-year Treasury currently sits ~100 basis points above the Effective Federal Funds rate, implying future rate hikes.

Because market participants expect more rate hikes from the Fed, the entire short end of the yield curve has steepened. We referenced the 2-year yield surging, anticipating future rate hikes, but the 1-year Treasury has surged as well, and it currently sits at 4.55%, up 100 basis points since March and ~70 basis points above the Effective Federal Funds rate. The spread on the front end, or the difference between short-term rates and the overnight (Fed) rate, has created opportunities for short-term investors such as us.

Core to our strategy are allocations to floating rate securities, such as commercial paper, mortgage-backed securities, time deposits, and mutual funds. The income on our allocations to floating rate securities will continue to reset higher during each Federal Reserve rate hike.

KEY TAKEAWAY

The Fed has begun raising interest rates, the first hike since July 2023, and more rate hikes are expected. The 2-year Treasury currently sits ~100 basis points above the Effective Federal Funds rate, implying future rate hikes.

STRATEGY

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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. We expect this pool to continue to track the S&P LGIPG 30-day index.

YTD net return: 2.68%

End of quarter net yield: 3.68%

TX-FIT Cash Pool:

The TX FIT Cash Pool will continue to remain anchored by strong liquidity sources such as prime money market funds and ultra-short bond funds. Other staples of the pool include investments in commercial paper, which is short-term by nature, as well as floating rate securities such as floating rate mortgage-backed securities. These coupons will continue to reset higher with the market as long as the Fed continues hiking rates, which is expected.

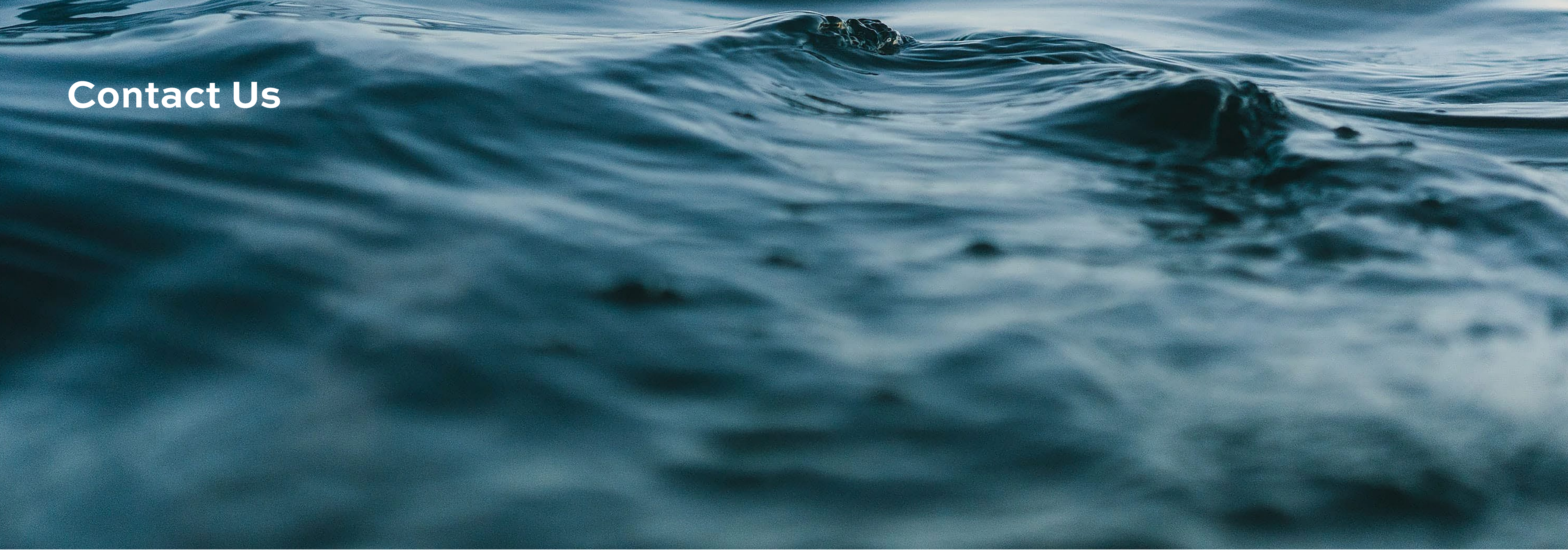
YTD net return: 2.97%

End of quarter net yield: 4.01%

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 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 risk.

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Contact Us

KEN COUCH

ken.couch@deepblue-inv.com
(210) 240-9464

ED POLANSKY

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