

Great Lakes Water Authority

Investment Performance Report – December 2023



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PORTFOLIO RECAP

- **Safety** – The aggregate portfolio is diversified amongst cash, bank deposits, U.S. Treasuries, Federal Agencies, commercial paper, SEC-registered money market funds, and a local government investment pool. The total credit profile of the portfolio is strong with over 97% of the assets invested in bank deposits or securities that are rated within the two highest short and long-term rating classifications as established by S&P.
- **Liquidity** – Great Lakes Water Authority (“GLWA”) has continued to monitor its portfolio with the goal of limiting the allocation to cash and bank deposit accounts and maximizing the use of short-term investments to meet cash requirements. As of December 31, 2023, approximately 67% of the funds were held in cash and money market accounts maturing overnight. The percentage is similar to what was seen in the last quarter.
- **Return** – The overall yield at market decreased to 5.12% as of December 31, 2023, versus 5.15% as of September 30, 2023. The lower yield is reflective of the decline in interest rates that the market has experienced throughout the past quarter. GLWA earned over \$26.9 million (unaudited) in investment income for the first six months of fiscal year 2024 on a book value basis. It should be noted that the budgeted investment income for GLWA for FY 2024 was originally \$41 million and is now projected at \$55.7 million for all fund types. Investment income includes earnings on all fund types, including restricted funds and unrestricted funds combined as well as construction and bond proceeds.

AVAILABLE FUNDS (Unaudited)

Type	Book Value	Market Value	Yield @ Cost (as of 12/31/23)	Yield @ Market (as of 12/31/23)
Deposit Account	\$32,257,188	\$32,257,188	3.61%	3.61%
Deposit Account - Retainage	\$31,282,361	\$31,282,361	0.01%	0.01%
Deposit Account – Flint Security Deposit	\$3,974,670	\$3,974,671	3.61%	3.61%
Trust Money Market Fund	\$389,455,446	\$389,455,446	5.25%	5.25%
Money Market Fund	\$25,861,779	\$25,861,779	5.24%	5.24%
Local Government Investment Pool	\$450,758,820	\$450,758,820	5.53%	5.53%
Managed Funds	\$459,651,966	\$458,331,788	4.86%	5.15%
<u>DECEMBER 2023 TOTALS:</u>	<u>\$1,393,242,230</u>	<u>\$1,391,922,053</u>	<u>5.03%</u>	<u>5.12%</u>
<u>PREVIOUS QUARTER TOTALS:</u>	<u>\$1,090,269,520</u>	<u>\$1,086,727,127</u>	<u>4.82%</u>	<u>5.15%</u>

Investment Strategy

OVERALL STRATEGY

- All investment activity is conducted subject to GLWA's investment policy and state statutes while meeting the primary objectives of safety and liquidity. The portfolio is managed to a disciplined investment plan to provide improved safety and diversification while putting every dollar to work.
- GLWA, working with its investment advisor PFM Asset Management ("PFMAM"), has continued to invest its funds in a mixture of short and intermediate-term individual investment securities to ensure adequate liquidity to cover upcoming debt, pension payments, and operational requirements.
- PFMAM will continue to actively manage long-term portfolios with full discretion and align short-term balances with expected liabilities and identify strategies to maximize future investment income in the current interest rate environment, subject to GLWA's investment policy and state statutes.

PORTFOLIO PERFORMANCE – CURRENT PERIOD*

- The overall portfolio's original yield at cost went from 4.82% as of 9/30/2023 to 5.03% as of 12/31/2023; the higher yield at cost is a result of reinvesting proceeds of lower-yielding securities that have matured in a higher interest rate environment.
- The total portfolio had a market yield of 5.12% at the end of December. Yield at market represents what the market would provide in return if the portfolio was purchased on December 31, 2023 (versus purchased in prior months / years); the higher yield is a result of the increase in interest rates throughout the quarter.
 - We utilize a variety of investment sectors that has led to this 5.12% yield at market as of 12/31/2023.

PORTFOLIO PERFORMANCE – PROJECTIONS

- GLWA earned over \$26.9 million (unaudited) in investment interest income for fiscal year-to-date 2024 on a book value basis.
- It should be noted that the FY 2024 total interest earnings projection forecast was originally estimated to be around \$41 million and is now projected at \$55.7 million.
- The fiscal year period earnings have been slightly higher than budgeted expectations, mainly due to the Federal Reserve's "higher for longer" mantra.

** Yield at cost is based on the original cost of the individual investments from the purchase date to maturity. On the other hand, yield at market is calculated on a specific day (in this case, September 30, 2023) and assumes that all the securities in the portfolio are purchased given the market price/yield on that particular day. If one is to generally hold their investments to the stated maturity date, then the yield at cost would be the better number to use to gauge how the portfolio is performing.*

Summary Market Overview and Outlook

ECONOMIC HIGHLIGHTS UPDATE

- At the conclusion of its meeting on December 13th, a surprisingly dovish Federal Reserve (the “Fed”) suggested it had likely reached the end of its historic rate-hiking cycle. In addition to maintaining the overnight target rate at its current range of 5.25% to 5.50%, the Fed published an updated “dot plot” showing a total of three 25 basis point rate cuts by the end of 2024, more than previously projected. Treasury yields fell notably as a result.
- The December employment report showed non-farm payrolls increased by 216,000, beating expectations, while the unemployment rate was unchanged at 3.7%. For the year, non-farm payrolls showed 225,000 new jobs created per month, down from 2022’s blistering pace of 399,000, while the unemployment rate increased modestly from its historically low level at the beginning of the year. The number of job openings also fell to the lowest level since March of 2021, pointing to a labor market that continues to moderate.
- Inflation, measured by the year-over-year change in the consumer price index (“CPI”), fell to 3.1% in November as lower energy prices continue to offset higher shelter costs. The Fed’s preferred gauge of inflation, the Personal Consumption Expenditure (“PCE”) index, fell slightly on a month-over-month basis between October and November, the first monthly decline in more than 3½ years.
- After a disappointing October, retail sales (which are not adjusted for inflation) surprised to the upside in November, by increasing 0.3%. Lower prices at the gas pump helped fuel a stronger-than-expected start to the holiday shopping season. Eight of 13 spending categories showed growth, including sales at food services and drinking places, non-store retailers, health and personal care and furniture stores.
- Home prices accelerated as the S&P/Case-Shiller Home Price Index increased by 4.8% year-over-year. Mortgage rates mirrored the overall move lower in yields; however, new home sales declined 12% in December while existing home sales remained near record lows.

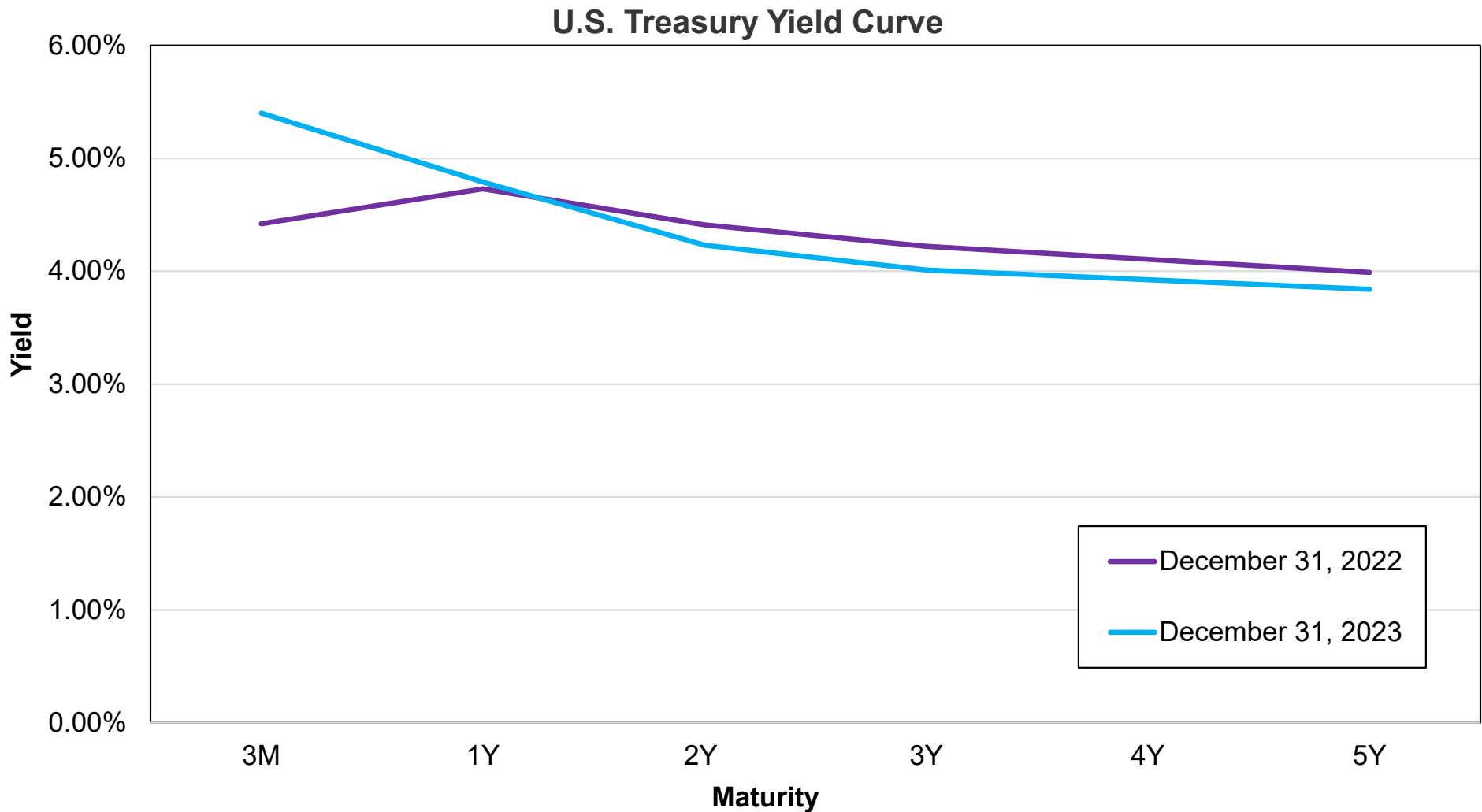
ECONOMIC IMPACT ON PORTFOLIO

- U.S. Treasury yields continued their descent from the multi-year highs reached in October and rallied significantly into calendar year-end. The Fed’s dovish tone added downward pressure on yields as policymakers appeared to affirm that easier monetary policy may be the most likely outcome in 2024.
- The benchmark 2, 5, and 10-year U.S. Treasuries finished the quarter at 4.25%, 3.85%, and 3.88%, moving down for the quarter.
- The dollar index (“DXY”) declined by 2% in December, nearing the lower end of its calendar year range. Gold and oil commodities diverged modestly to close the calendar year as the former closed just shy of its all-time high, while oil prices maintained their multi-month trend lower.
- Portfolio Impact: The market is now viewing that the Fed has reached the end of its historic hiking cycle and is also viewing that the risk of rates moving lower is outweighing the risk of significant moves higher. A neutral duration stance is now preferred. Well-diversified portfolios have generated attractive returns over the past few months and the past calendar year as most non-Treasury sectors produced firmly positive excess returns. Nevertheless, spreads on Agencies spent the better part of the past 12 months in a very low and narrow range, largely as demand for already-light issuance persisted. Short-term credit (i.e., commercial paper) spreads tightened over the quarter and the credit curve flattened modestly. Shorter-term maturities are less attractive and issuers with maturities between 6 and 12 months are now preferred.

Summary Market Overview and Outlook

Treasury Yield Curve Presently Inverted

- U.S. Treasury yields continued their descent from the multi-year highs reached in October and rallied significantly into calendar year-end. The Fed's dovish tone added downward pressure on yields as policymakers appeared to affirm that easier monetary policy may be the most likely outcome in 2024.



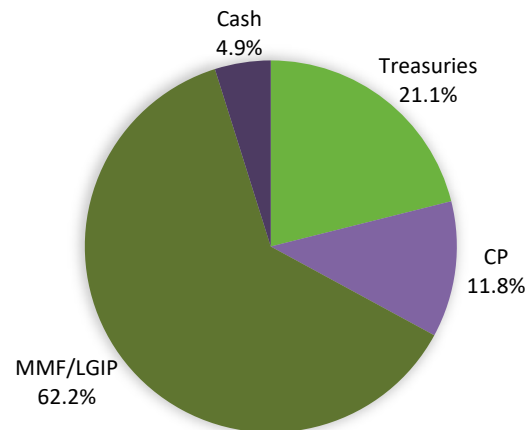
Portfolio Snapshot

Overall Portfolio Composition Summary

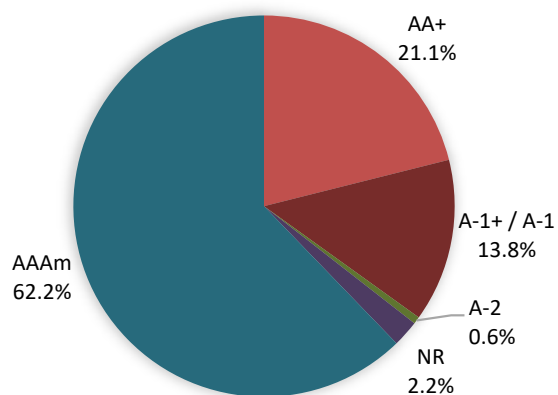
PORTFOLIO STATISTICS

Invested Amount	\$1.392 Billion
Duration	0.23 Years
Yield at Cost	5.03%
Yield at Market	5.12%

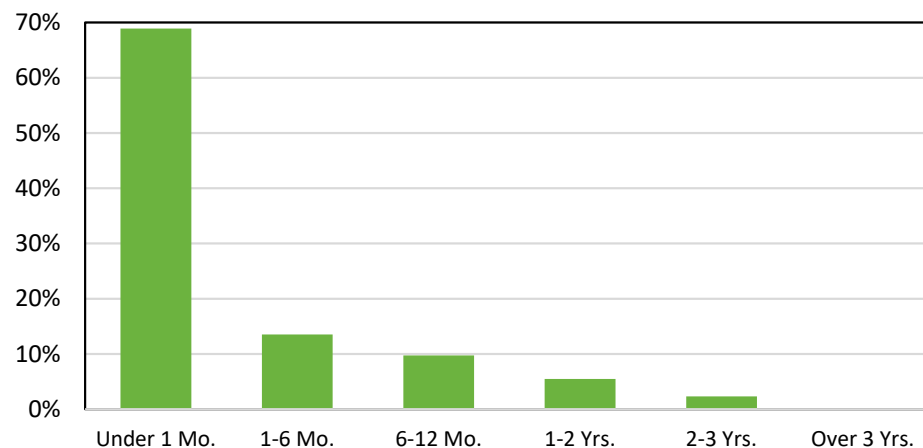
SECTOR ALLOCATION



CREDIT QUALITY



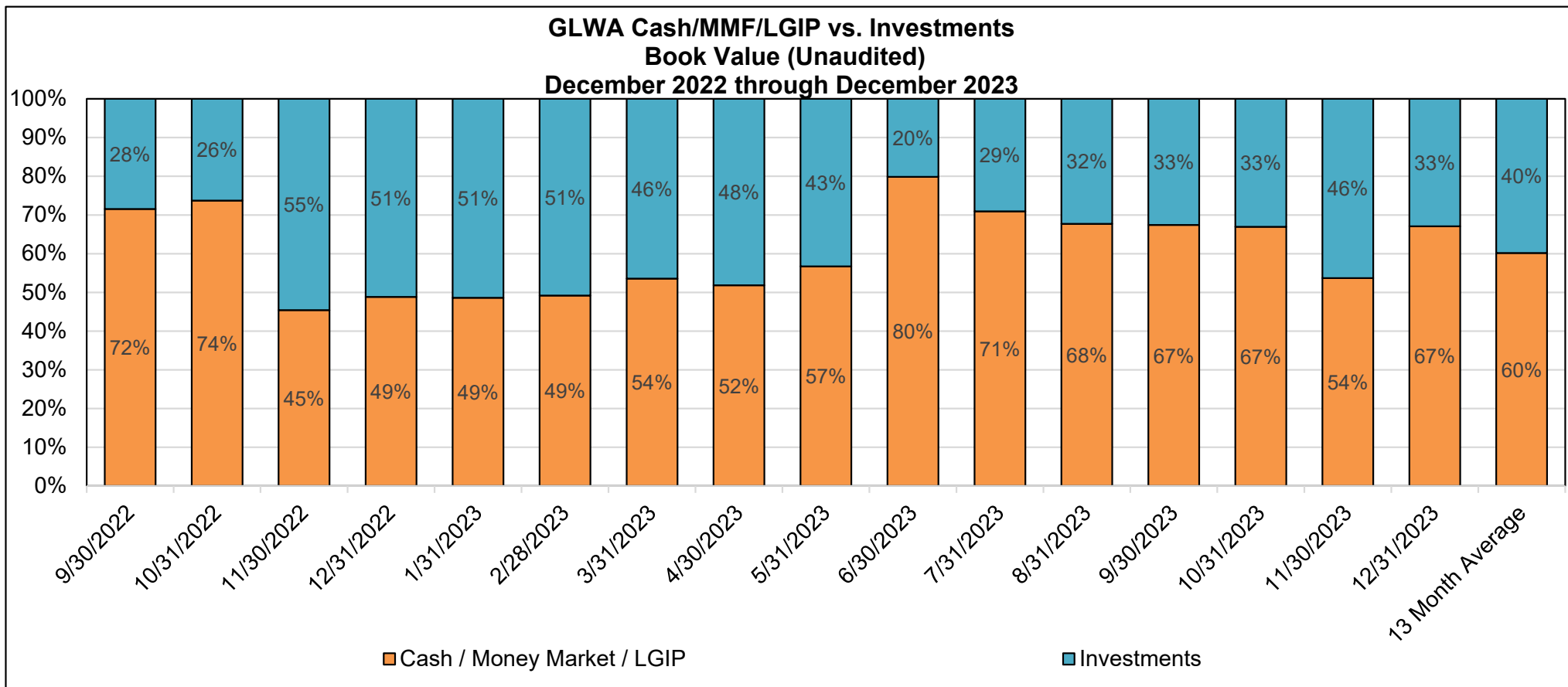
MATURITY DISTRIBUTION



Portfolio Snapshot

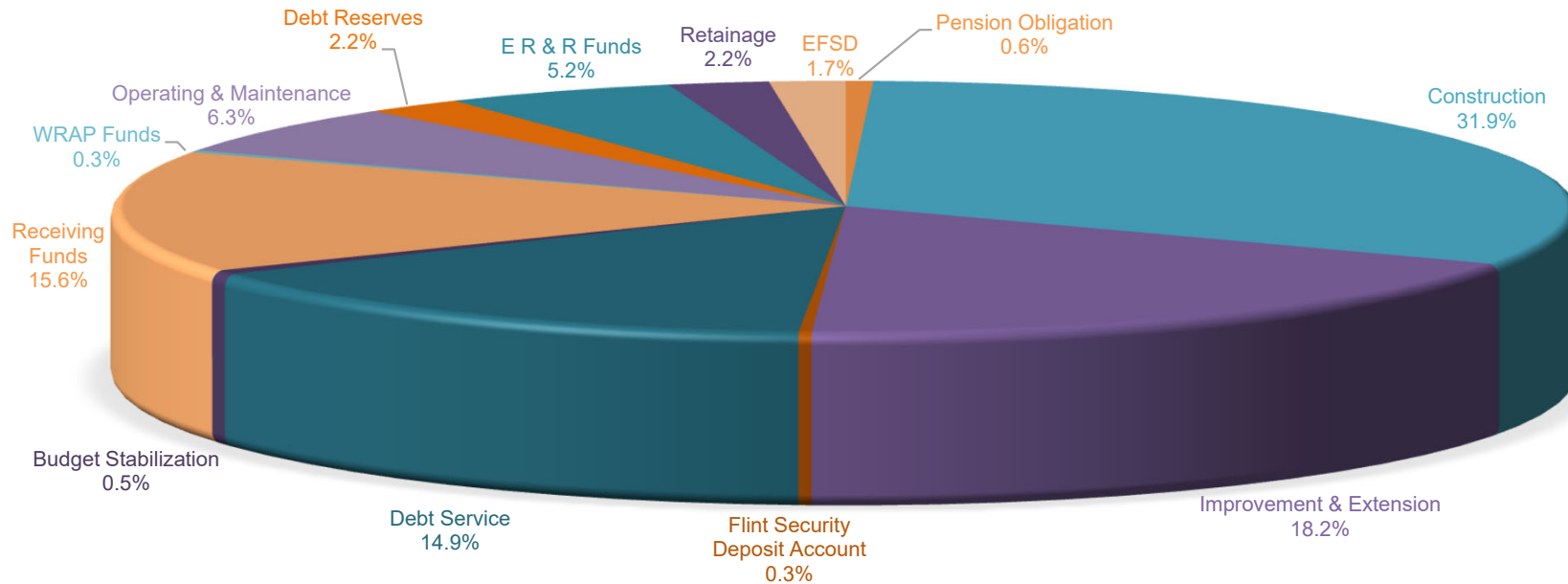
Portfolio Mix – Cash / Money Market vs. Investments

- GLWA's liquidity requirements fluctuate each month based on operational requirements, capital funding, and debt payments. Based on a review of historical activity and refinement of cash flow projections, GLWA has continually tried to balance the allocation of the portfolio's holdings to cash & money market accounts versus the allocation to investments for the portfolio holdings.
- The chart below compares the monthly allocation of the portfolio holdings to the 13-month average. The allocation between cash and investments will vary each month based on liquidity requirements. For December of 2023, about 67% of the overall portfolio was invested in cash, LGIP, and/or overnight money market fund accounts. This is in line with the level seen in the last quarter and is reflective of the inverted yield curve that has been persistent in the market.



Portfolio Snapshot

Investments – By Account Purpose

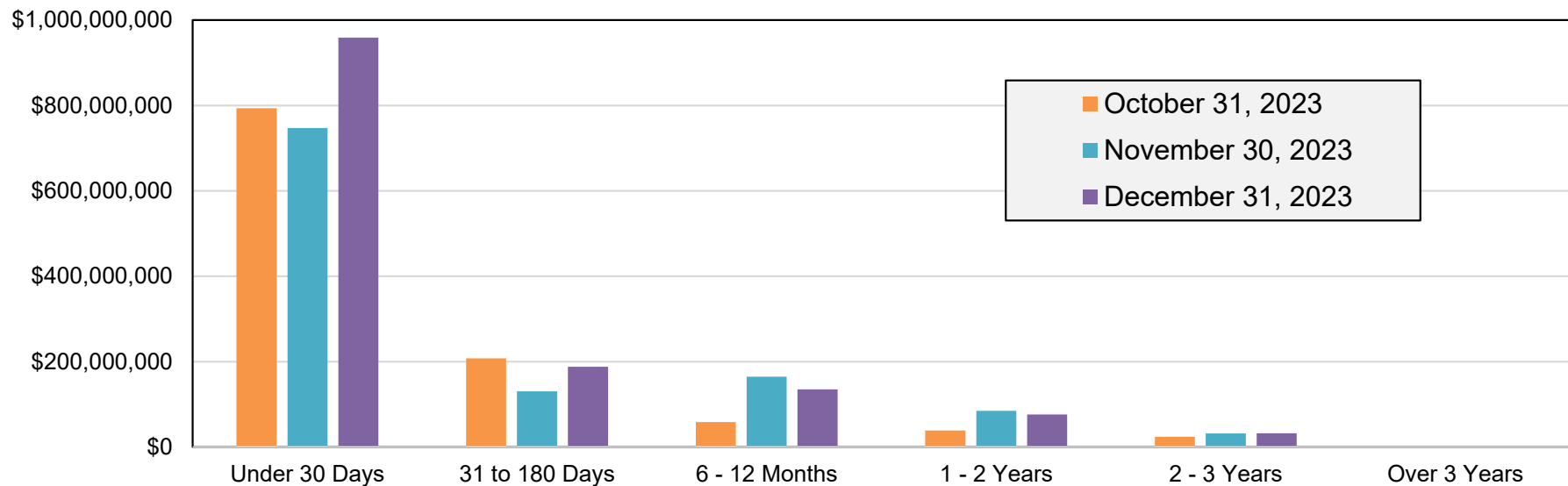


Account Purpose	Value Market	Allocation %	Cost Yield at	Market Yield at	Duration	Strategy
Construction	\$ 444,433,795	31.9%	5.49%	5.52%	0.014 Years	Cash Flow Driven
Improvement & Extension	\$ 253,309,059	18.2%	5.39%	5.19%	0.441 Years	Cash Flow Driven
Receiving Funds (includes lockbox account)	\$ 216,715,395	15.6%	5.21%	5.21%	0.003 Years	Short-Term
Debt Service	\$ 208,071,397	14.9%	5.48%	5.32%	0.306 Years	Short-Term
Operating & Maintenance	\$ 88,113,409	6.3%	5.05%	5.05%	0.003 Years	Short-Term
Extraordinary Repair & Replacement Funds	\$ 71,851,378	5.2%	2.17%	4.35%	1.446 Years	Long-Term
Retainage	\$ 31,282,361	2.2%	0.01%	0.01%	0.003 Years	Restricted Short-Term
Debt Reserves	\$ 30,729,188	2.2%	4.38%	5.15%	0.482 Years	Long-Term
Evergreen Farmington Sewer District	\$ 23,702,827	1.7%	3.76%	3.76%	0.003 Years	Restricted Short-Term
Pension Obligation Funds	\$ 8,507,562	0.6%	5.48%	5.38%	0.395 Years	Short-Term
Budget Stabilization Funds	\$ 7,333,214	0.5%	2.15%	4.34%	1.438 Years	Long-Term
Flint Security Deposit Account	\$ 3,974,670	0.3%	3.61%	3.61%	0.003 Years	Restricted Short-Term
WRAP Funds	\$ 3,897,797	0.3%	5.54%	7.90%	0.035 Years	Short-Term
Total	\$ 1,391,922,053	100.0%	5.03%	5.12%	0.226 Years	

Portfolio Snapshot

Investments – By Maturity

Maturity Distribution	October 31, 2023		%	November 30, 2023		%	December 31, 2023		%
Under 30 Days	\$	793,795,063	70.7%	\$	747,277,307	64.4%	\$	959,198,819	68.9%
31 to 180 Days		207,965,201	18.5%		130,532,635	11.3%		188,389,061	13.5%
6 - 12 Months		58,767,460	5.2%		164,858,103	14.2%		135,460,744	9.7%
1 - 2 Years		38,830,086	3.5%		85,054,116	7.3%		76,403,928	5.5%
2 - 3 Years		24,142,934	2.1%		32,122,802	2.8%		32,469,501	2.3%
Over 3 Years		-	0.0%		-	0.0%		-	0.0%
Totals	\$	1,123,500,744	100.0%	\$	1,159,844,963	100.0%	\$	1,391,922,053	100.0%



Portfolio Snapshot

Investment Accounts – Yield at Cost & Market

	As of December 31, 2023		As of September 30, 2023	
	YTM @ Cost	YTM @ Market	YTM @ Cost	YTM @ Market
Bank Deposits				
Bank A	0.01%	0.01%	0.01%	0.01%
Bank B	0.01%	0.01%	0.01%	0.01%
Flint Deposit Account	3.61%	3.61%	4.01%	4.01%
Bank C	3.61%	3.61%	4.01%	4.01%
Sub-Total Bank Deposits	1.49%	1.49%	1.92%	1.92%
Money Market Funds / LGIPs				
Local Government Investment Pool	5.53%	5.53%	5.48%	5.48%
Trust Money Market Fund	5.25%	5.25%	5.21%	5.21%
Money Market Fund	5.24%	5.24%	5.22%	5.22%
Sub-Total MMF / LGIPs	5.40%	5.40%	5.29%	5.29%
Investment Portfolios				
Sewage SR Debt Serv 5403	5.61%	5.36%	5.60%	5.68%
Sewage SR Res 5400	3.67%	5.11%	3.30%	5.47%
Sew 2nd Debt Serv 5403	5.59%	5.36%	5.62%	5.73%
Sewage 2nd Res 5481	4.82%	5.08%	4.92%	5.47%
Sew SRF Debt Serv 5410	5.57%	5.31%	5.79%	5.87%
Sewage ER & R	2.14%	4.35%	1.51%	5.15%
Sewer Improvement & Extension	5.48%	5.16%	0.00%	0.00%
Sewer Pension Obligation	5.49%	5.38%	5.46%	5.57%
Sewer Wrap Fund	5.64%	7.39%	5.60%	6.36%
Sewer Budget Stabilization Fund	2.14%	4.34%	1.76%	5.15%
Sewer Bond Fund	5.33%	5.56%	5.08%	5.41%
Sewer O&M Pension Sub Account	5.31%	5.30%	5.31%	5.52%
Water SR Debt Ser 5503	5.64%	5.38%	5.62%	5.73%
Water SR Reserve 5500	5.02%	5.18%	4.49%	5.49%
Water 2nd Debt Serv 5503	5.62%	5.39%	5.61%	5.74%
Water 2nd Res 5581	5.15%	5.23%	5.08%	5.49%
Water SRF Debt Serv 5575	5.63%	5.38%	5.82%	5.86%
Water ER & R	2.20%	4.34%	1.67%	5.16%
Water Improvement & Extension	5.48%	5.16%	0.00%	0.00%
Water Pension Obligation	5.52%	5.39%	5.50%	5.59%
Water Wrap Fund	5.59%	11.22%	5.58%	6.54%
Water Budget Stabilization Fund	2.17%	4.33%	1.85%	5.15%
Water Bond Fund	0.00%	0.00%	5.54%	5.69%
Water O&M Pension Sub Account	5.31%	5.30%	5.31%	5.52%
Sub-Total Investment Portfolios	4.86%	5.15%	4.49%	5.51%
Grand Total	5.03%	5.12%	4.82%	5.15%

YTM @ Cost is the expected return, based on the original cost, the annual interest receipts, maturity value and the time period from purchase date to maturity, stated as a percentage, on an annualized basis. YTM @ Market is the rate of return, based on the current market value, the annual interest receipts, maturity value and time period remaining until maturity, stated as a percentage, on an annualized basis.

Portfolio Snapshot

Peer Analysis Comparison

- The comparison agencies included in the list below were selected based on type and/or other non-performance-based criteria to show a broad range of water entities/utilities; this peer group list does not represent an endorsement of any of the public agencies or their services.
- The overall yield of GLWA's aggregate portfolio compares somewhat similarly to those of other short-term market indices (i.e., the S&P LGIP index and the 3-month U.S. Treasury index), despite the volatility of short-term interest rates and the limited ability in managing assets to a longer-term strategy.
- GLWA does have some limitations and unique constraints related to its ordinance and covenants that restricts the potential for a longer duration portfolio when compared to other similar water agencies.

As of December 31, 2023

	Market Value	YTM @ Market	Effective Duration	Weighted Average Maturity
GLWA				
Great Lakes Water Authority	\$1,391,922,053	5.12%	0.23 Years	81 Days
Short/Intermediate-Term Indices				
S&P Rated Government Investment Pool Index		5.43%	0.08 Years	30 Days
BoA / ML 3-Month Treasury Index		5.37%	0.15 Years	55 Days
BoA / ML 6-Month Treasury Index		5.20%	0.39 Years	142 Days
BoA / ML 1-Year Treasury Index		4.80%	0.88 Years	321 Days
BoA / ML 1-3 Year Treasury Index		4.32%	1.75 Years	639 Days
BoA / ML 1-5 Year Treasury Index		4.16%	2.51 Years	916 Days
Peer Analysis (Water Entities / Utilities)				
District of Columbia Water & Sewer Authority, DC	\$364,478,457	4.67%	1.16 Years	459 Days
DuPage Water Commission, IL	\$196,824,141	4.52%	2.03 Years	948 Days
Fairfax County Water Authority, VA	\$203,009,071	4.46%	1.66 Years	638 Days
Metro Wastewater Reclamation District, CO	\$215,791,881	4.39%	2.27 Years	919 Days
Metropolitan Water District of Southern California, CA	\$808,517,983	4.79%	1.49 Years	664 Days
Philadelphia Water Department, PA	\$238,468,182	5.04%	0.89 Years	340 Days
San Bernardino Valley Municipal Water District, CA	\$346,789,475	4.49%	1.70 Years	669 Days
Tohopekalgia Water Authority, FL	\$202,875,512	4.27%	1.72 Years	872 Days
Truckee Meadows Water Authority, NV	\$11,487,598	4.51%	1.62 Years	614 Days

The BoA / ML indexes are unmanaged indexes tracking on-the-run Treasuries. These indexes are produced and maintained by Bank of America / Merrill Lynch & Co. Yield to maturity is the rate of return, based on the current market value, the annual interest receipts, maturity value and time period remaining until maturity, stated as a percentage, on an annualized basis.

Portfolio Snapshot

Monthly Investment Income

(Book Value in 000's)

FY 2024 INVESTMENT INCOME BY MONTH (Unaudited)

Month	Interest Earned During Period (in thousands)	Realized Gain / Loss (in thousands)	Investment Income (in thousands)
July 2023	\$3,920.9	\$0.0	\$3,920.9
August 2023	\$4,068.8	\$0.0	\$4,068.8
September 2023	\$4,060.2	\$0.0	\$4,060.3
October 2023	\$4,313.0	\$0.0	\$4,313.0
November 2023	\$5,068.5	\$0.0	\$5,068.5
December 2023	\$5,491.7	(\$0.1)	\$5,491.6
<u>FY 2024 Y-T-D</u>	<u>\$26,923.1</u>	<u>(\$0.1)</u>	<u>\$26,923.0</u>

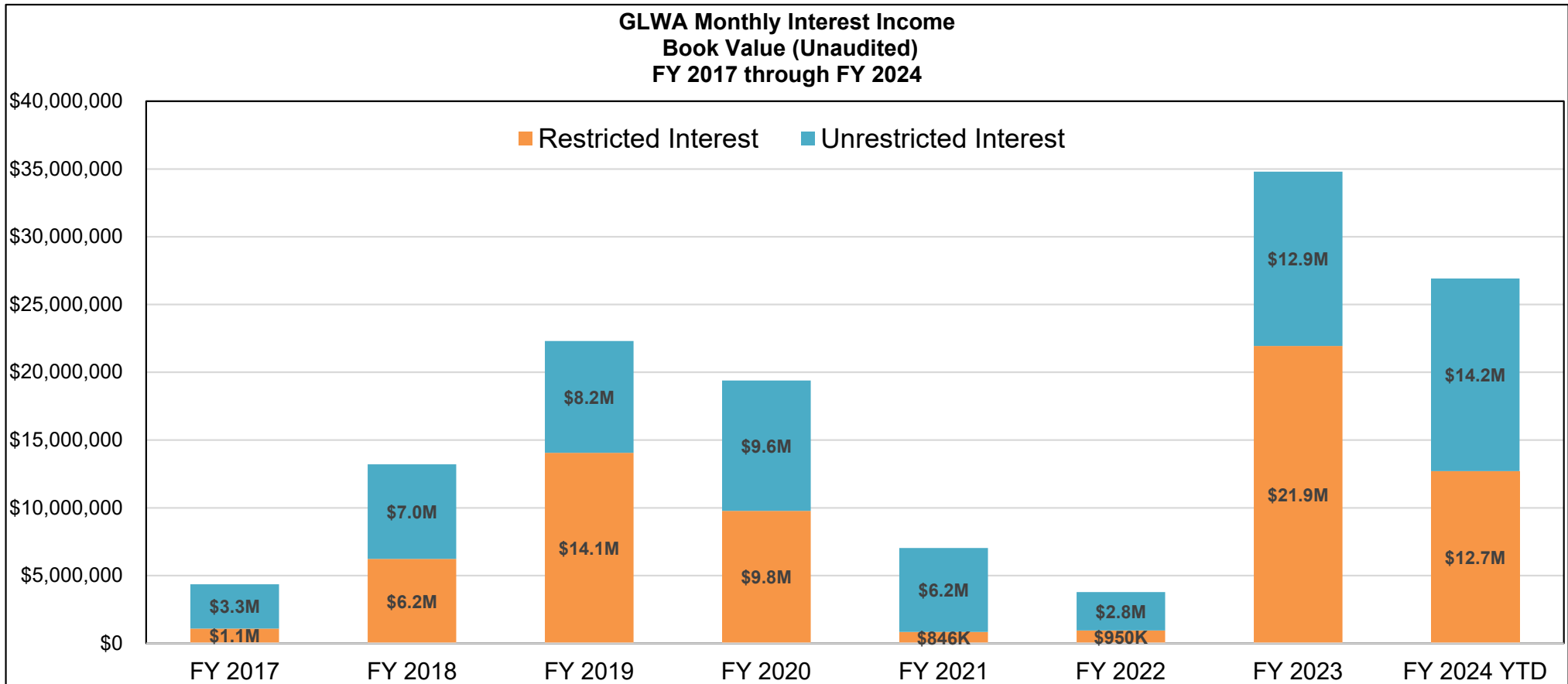
** The realized loss in December of 2023 was due to the sale of investments in the Sewer Second Reserve account in anticipation of liquidity requirements and liquidity needed in the Reserve Fund. The trade settled on December 1st and was available ahead of the bond closing on December 5th.*

These figures are based upon actual interest earned and posted to the Authority's various accounts via book value and does not include any earnings credit rate tied to the Authority's bank deposits.

Portfolio Snapshot

Year-Over-Year Investment Income

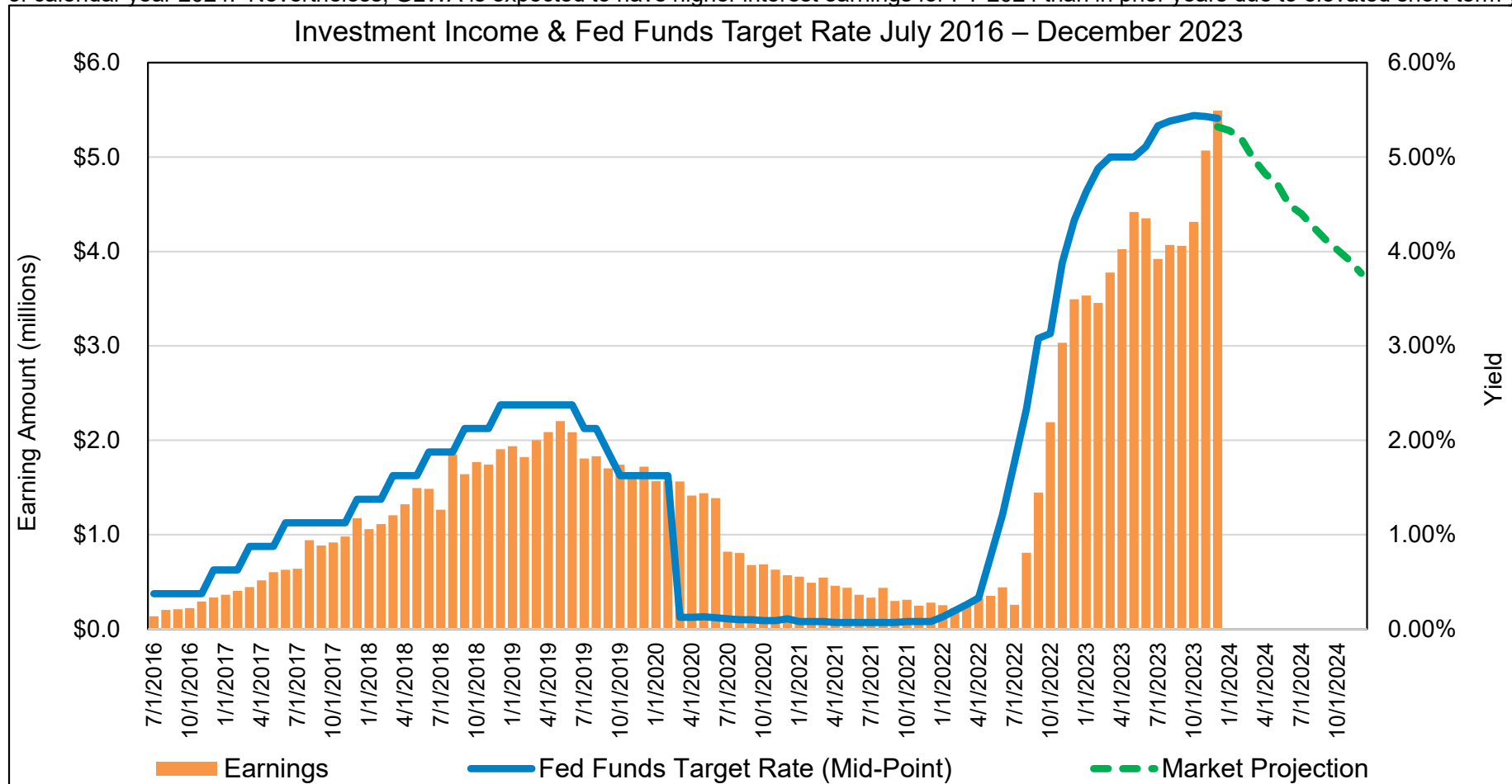
- GLWA earned \$26,923,027 in investment income for the first six months of fiscal year 2024 on a book value basis compared to \$11,228,223 for the first six months of fiscal year 2023.
- Projected investment income for fiscal year 2024 was originally forecasted to be around \$41 million for all fund types (both restricted and unrestricted funds combined). Based on current market assumptions, the addition of assets and proceeds from GLWA's recent bond fund issue, and the expectation of a "higher-for-longer" Fed Funds target rate over the next few months, actual total investment income for fiscal year 2024 is now forecasted to be approximately \$55.7 million (~\$26.3 million in restricted fund income and ~\$29.4 million in unrestricted fund income).



Portfolio Snapshot

Monthly Investment Income Compared to Fed Funds Rate

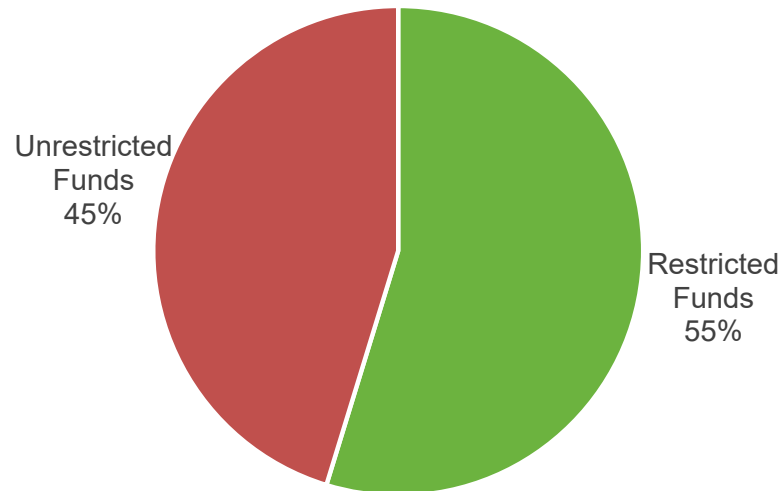
- At least 50% or more of the GLWA portfolio is designated for obligations that are 12 months or less. As a result of the short-term duration of GLWA's portfolio, it is heavily impacted by changes in the Fed Funds target rate; the chart below illustrates that GLWA's income has consistently followed the trend of the Fed Funds rate.
- At the conclusion of its last meeting, a surprisingly dovish Federal Reserve suggested it had likely reached the end of its historic rate-hiking cycle. Though the Fed has maintained the overnight target rate at its current range of 5.25% to 5.50%, it is anticipating a total of three 25 basis point rate cuts by the end of calendar year 2024. Nevertheless, GLWA is expected to have higher interest earnings for FY 2024 than in prior years due to elevated short-term yields.



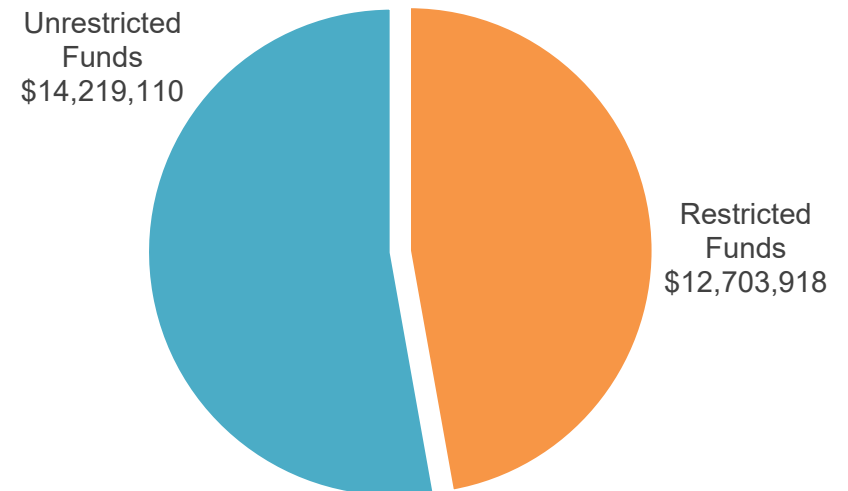
Portfolio Snapshot

Allocation and Income by Fund Type

**Fund Balance as of
December 31, 2023**



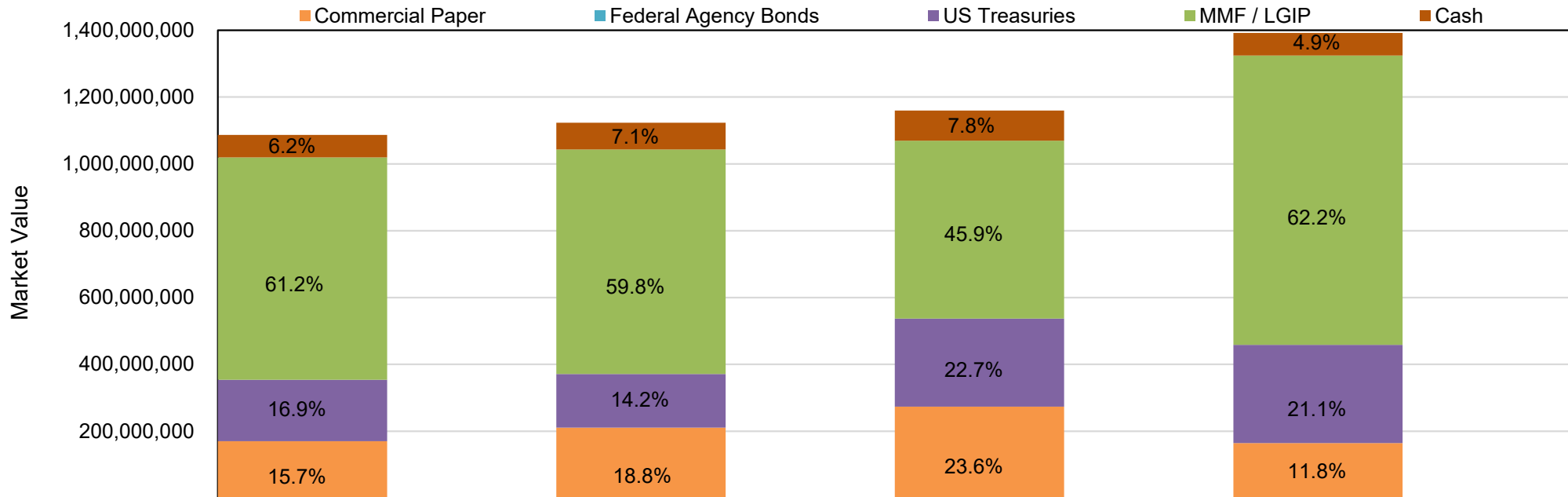
**July 2023 – December 2023
Interest Earnings**



Account Purpose	Restricted Principal	Unrestricted Principal	Restricted Interest	Unrestricted Interest	Notes
Construction	X		X		
Improvement & Extension		X		X	Interest is sent to the Receiving Funds and can be used for operations.
Receiving Funds (includes lockbox account)		X		X	
Debt Service	X		X		
Operating & Maintenance		X		X	
Extraordinary Repair & Replacement Funds		X		X	
Retainage	X		X		
Debt Reserves	X		X		
Evergreen Farmington Sewer District	X		X		
Pension Obligation Funds	X		X		
Budget Stabilization Funds	X			X	Interest is sent to the Receiving Funds and can be used for operations.
Flint Security Deposit Account	X		X		
WRAP Funds	X			X	Interest is sent to the Receiving Funds and can be used for operations.

Portfolio Snapshot

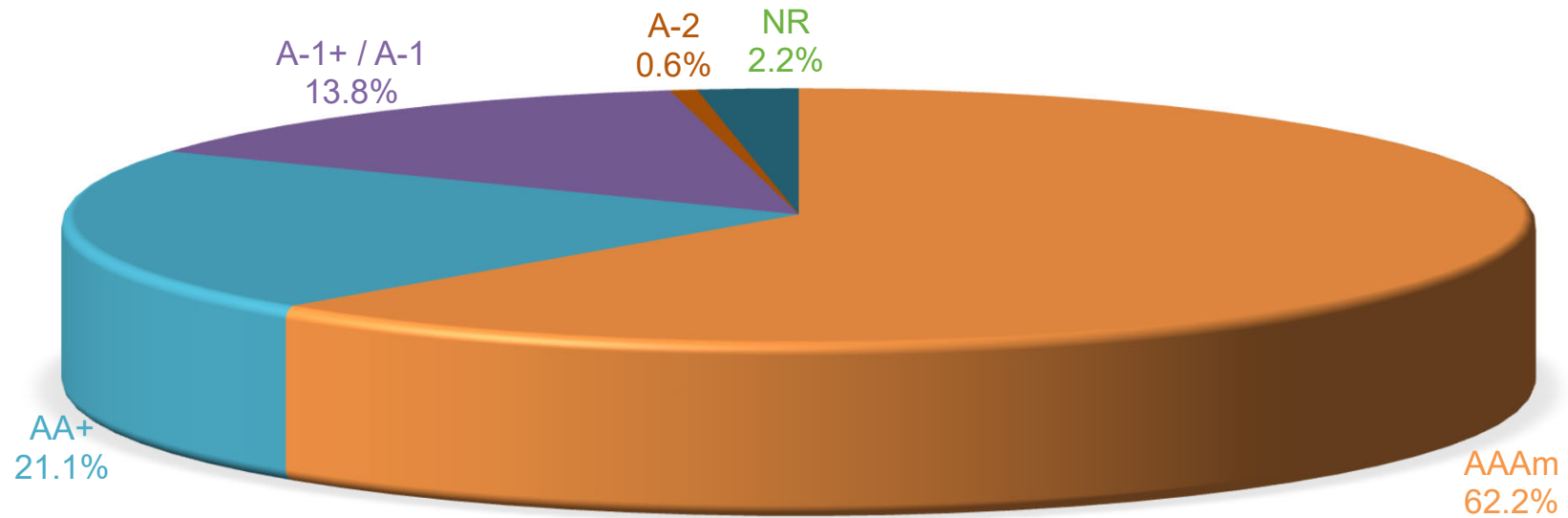
Investments – By Security Type



Security Type	September		October		November		December	
	Market Value	Asset Allocation	Market Value	Asset Allocation	Market Value	Asset Allocation	Market Value	Asset Allocation
Commercial Paper	170,295,243	15.7%	211,115,973	18.8%	273,464,797	23.6%	164,781,332	11.8%
Federal Agencies	-	0.0%	-	0.0%	-	0.0%	-	0.0%
U.S. Treasuries	183,720,457	16.9%	160,008,567	14.2%	263,667,192	22.7%	293,495,328	21.1%
MMF / LGIP	665,532,511	61.2%	672,116,066	59.8%	532,293,452	45.9%	866,076,046	62.2%
Cash	67,178,916	6.2%	80,260,138	7.1%	90,419,522	7.8%	67,569,347	4.9%
Total	1,086,727,127	100.0%	1,123,500,744	100.0%	1,159,844,963	100.0%	1,391,922,053	100.0%

Portfolio Snapshot

Investments – By Credit Quality



Credit Quality	Market Value	Asset Allocation
Ratings		
AAAm	866,076,046	62.2%
AA+	293,515,774	21.1%
A-1 + / A-1	192,561,796	13.8%
A-2	8,486,077	0.6%
NR	31,282,361	2.2%
Totals	1,391,922,053	100.0%

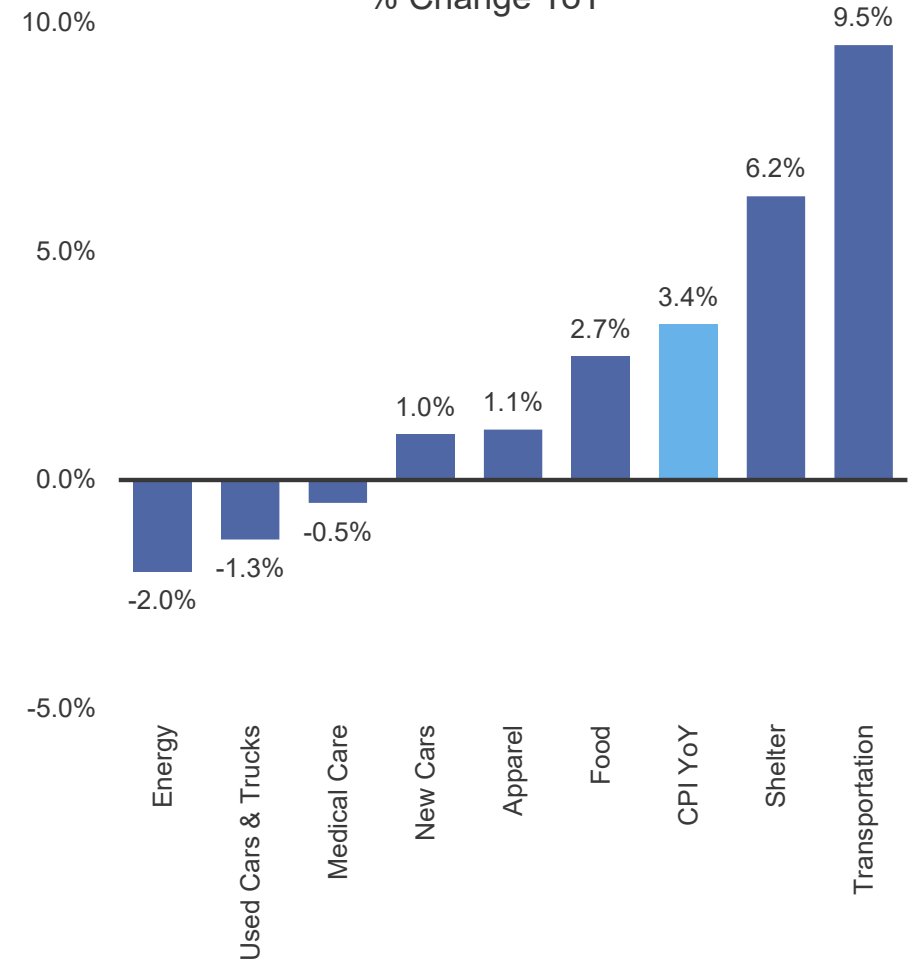
Appendix I: Economic Update

Consumer Inflation

Consumer Price Index
% Change YoY



Key Consumer Price Index Components
% Change YoY

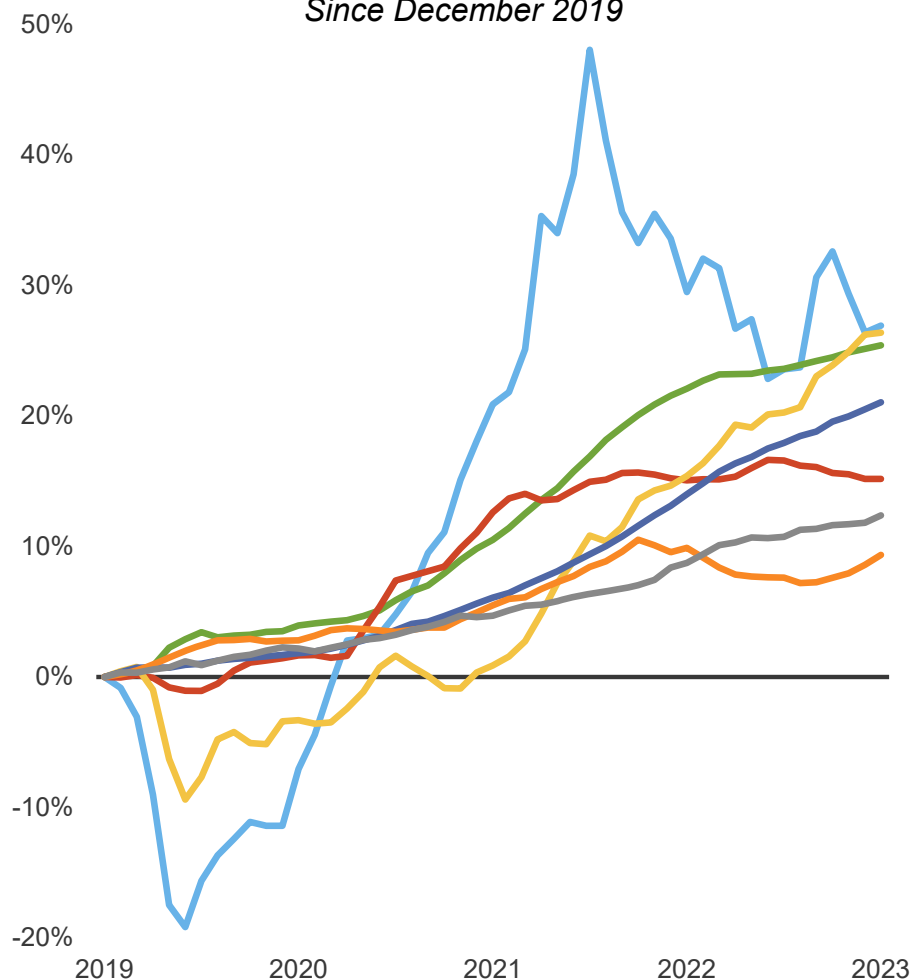


Source: Bloomberg, as of December 2023.

CPI Disinflation Signals Potential for Soft Landing

Price Change of Major CPI Components

Since December 2019



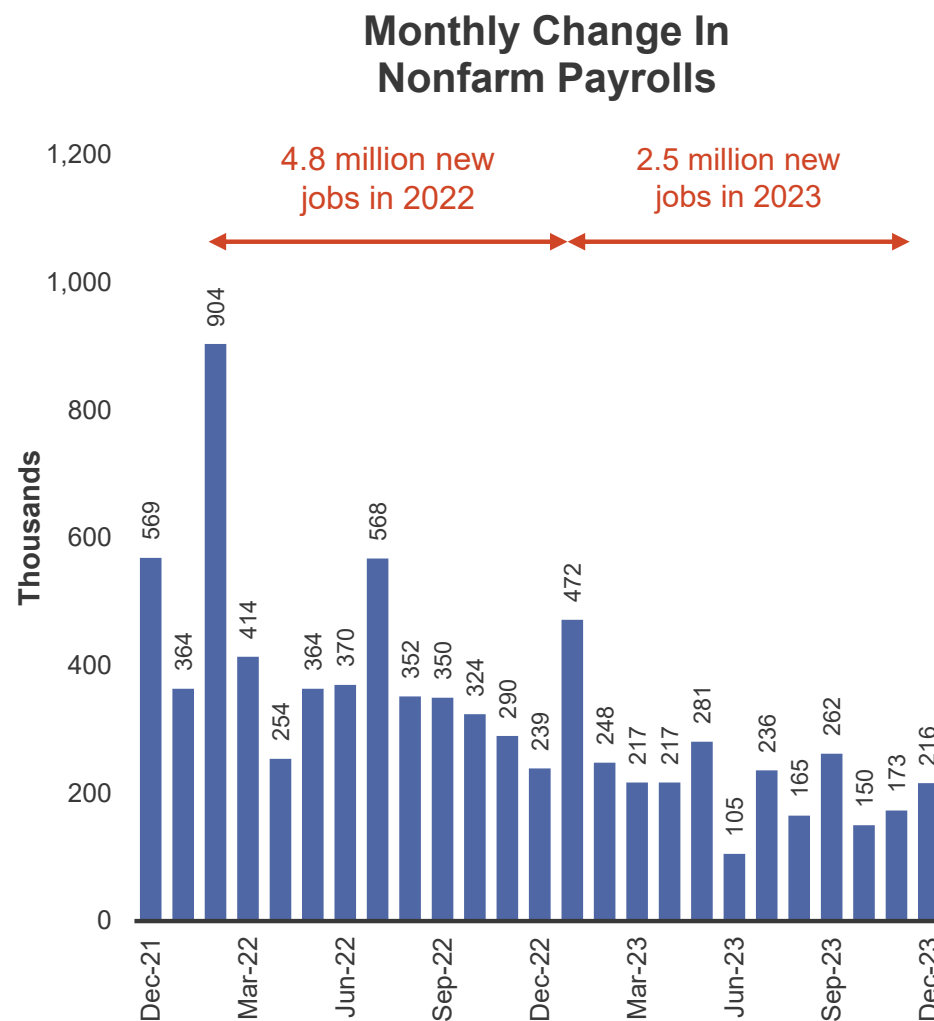
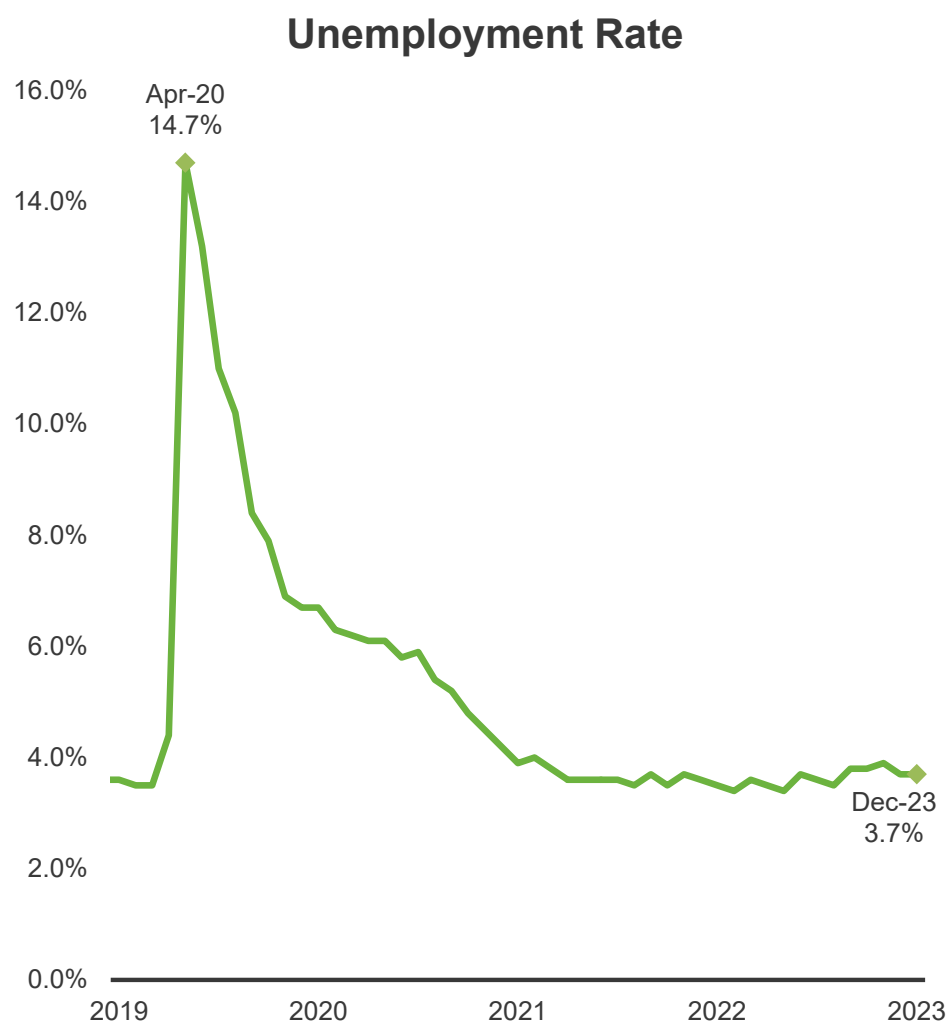
CPI Component	12-mo. Change	Weight ¹	Contribution to YoY CPI
Energy	-2.0%	6.7%	-0.1%
Food	2.7%	13.4%	0.4%
Transportation	9.5%	6.1%	0.6%
Goods	6.2%	35.2%	2.2%
Shelter	0.1%	20.8%	0.0%
Medical services	3.3%	11.4%	0.4%
Other Services ²	-0.5%	6.4%	0.0%
Overall	3.4%		

Source: Bloomberg, Bureau of Labor Statistics as of December 2023.

¹ Index weights are as of November 2023 as they are published on a one-month lag.

² Other services is a weighted blend of Water/Sewer/Trash, Household Operations, Recreation, and Education and Communication services.

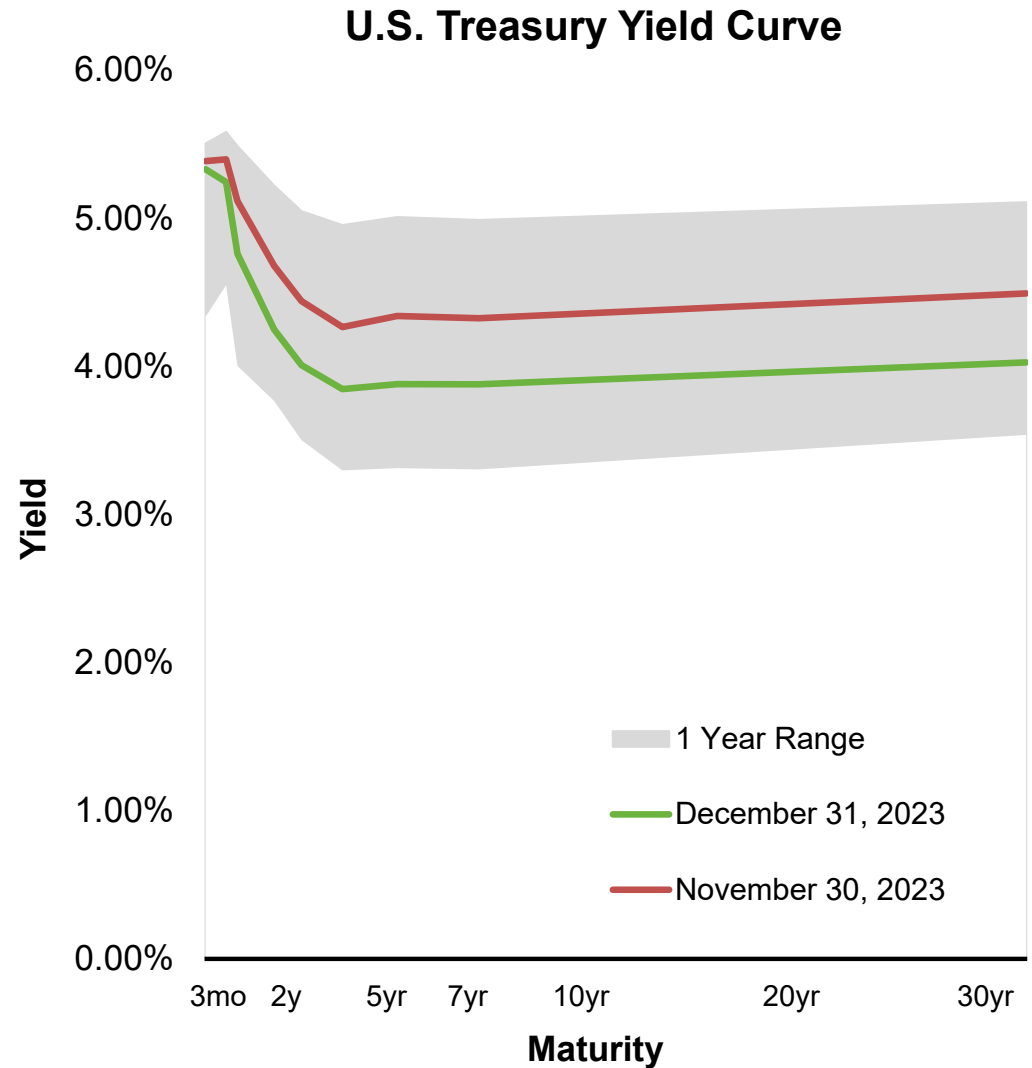
Unemployment Rate Remained at 3.7%



Source: Bloomberg, as of December 2023. Data is seasonally adjusted.

Treasury Yield Curve

	11/30/2023	12/31/2023	Change
3 month	5.39%	5.33%	-0.06%
6 month	5.40%	5.25%	-0.15%
1 year	5.12%	4.76%	-0.36%
2 year	4.68%	4.25%	-0.43%
3 year	4.44%	4.01%	-0.43%
5 year	4.27%	3.85%	-0.42%
10 year	4.33%	3.88%	-0.45%
30 year	4.49%	4.03%	-0.46%



Source: Bloomberg, as of 11/30/2023 and 12/31/2023, as indicated.

Fixed Income Market Overview and Outlook

FIXED INCOME MARKET – ECONOMIC HIGHLIGHTS

- The U.S. economy is characterized by:
 - Economic resilience but expectations for a slowdown
 - Cooling inflation that still remains above the Federal Reserve's target
 - The labor market coming into better balance'
 - Consumers that continue to support growth through spending

- Federal Reserve signals end to rate hiking cycle
 - Fed projected to cut the short-term Fed Funds rate by 75 basis points by December of 2024, with the overnight rate falling to 4.50% to 4.75%
 - Markets are pricing a more aggressive 6 rate cuts by year end
 - Fed officials reaffirm that restoring price stability is the priority

- Treasury yields ended the quarter materially lower
 - After peaking in October, yields reversed course on dovish Fed pivot
 - Yield curve inversion persisted throughout the rally
 - Credit spreads narrowed sharply on increased expectations for a soft landing

- Over the past quarter, the yield on 2, 5, and 10-year U.S. Treasuries declined by 79 basis points, 76 basis points, and 69 basis points, respectively
 - Even the yield on a 3-month U.S. Treasury Bill declined by 11 basis points, reflecting how aggressively the markets have begun pricing in potential Fed rate cuts in the first half of 2024

Fixed Income

Market Overview and Outlook

FIXED INCOME MARKET – ECONOMIC HIGHLIGHTS

- The previous quarter was characterized by economic resilience but expectations for a modest slowdown, cooling inflation that remains above the target set by the Federal Reserve (the “Fed”), the labor market coming into better balance, and consumers that continue to support U.S. economic growth through spending
- The Fed kept the overnight target rate at its current range of 5.25% to 5.50% at its December 13th meeting and indicated that the historic 2022 – 2023 hiking cycle had likely come to an end
 - The Fed also messaged a more dovish policy stance for 2024 as its updated “dot plot” showed three 25 basis point rate cuts for the year, which was more than previously projected
 - Yields fell significantly as a result, and the quarter was defined by a strong rally in bonds
 - With the Fed pivoting to easier monetary policy and a soft-landing scenario coming into focus, yields on U.S. Treasury maturities from one to 30 years declined 65 to 80 basis points during the quarter
- After peaking in October, a more dovish Fed and an increased likelihood that the overnight target rate has reached its cycle-high drove interest rates lower through the prior quarter
 - By the end of the 2023 calendar year, the yield on a 2-year U.S. Treasury reached a 7-month low of 4.25%, while the 10-year U.S. Treasury note ended the year at 3.88%
- Market optimism also drove yield spreads on commercial paper and other non-government fixed income “spread sectors” lower in the quarter
 - Diversification benefited portfolios during the past quarter with longer duration and lower quality adding the most incremental value

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