

# Investing in This Falling Interest Rate Environment

**Presented by PFM Asset Management**

October 2, 2024

**Jeffrey Schroeder**  
Managing Director

**Matthew Hanigan**  
Senior Managing Consultant

*A Division of U.S. Bancorp Asset Management, Inc.*

*For Institutional Investor or Investment Professional Use Only – This material is not for inspection by, distribution to, or quotation to the general public*

# Market Update

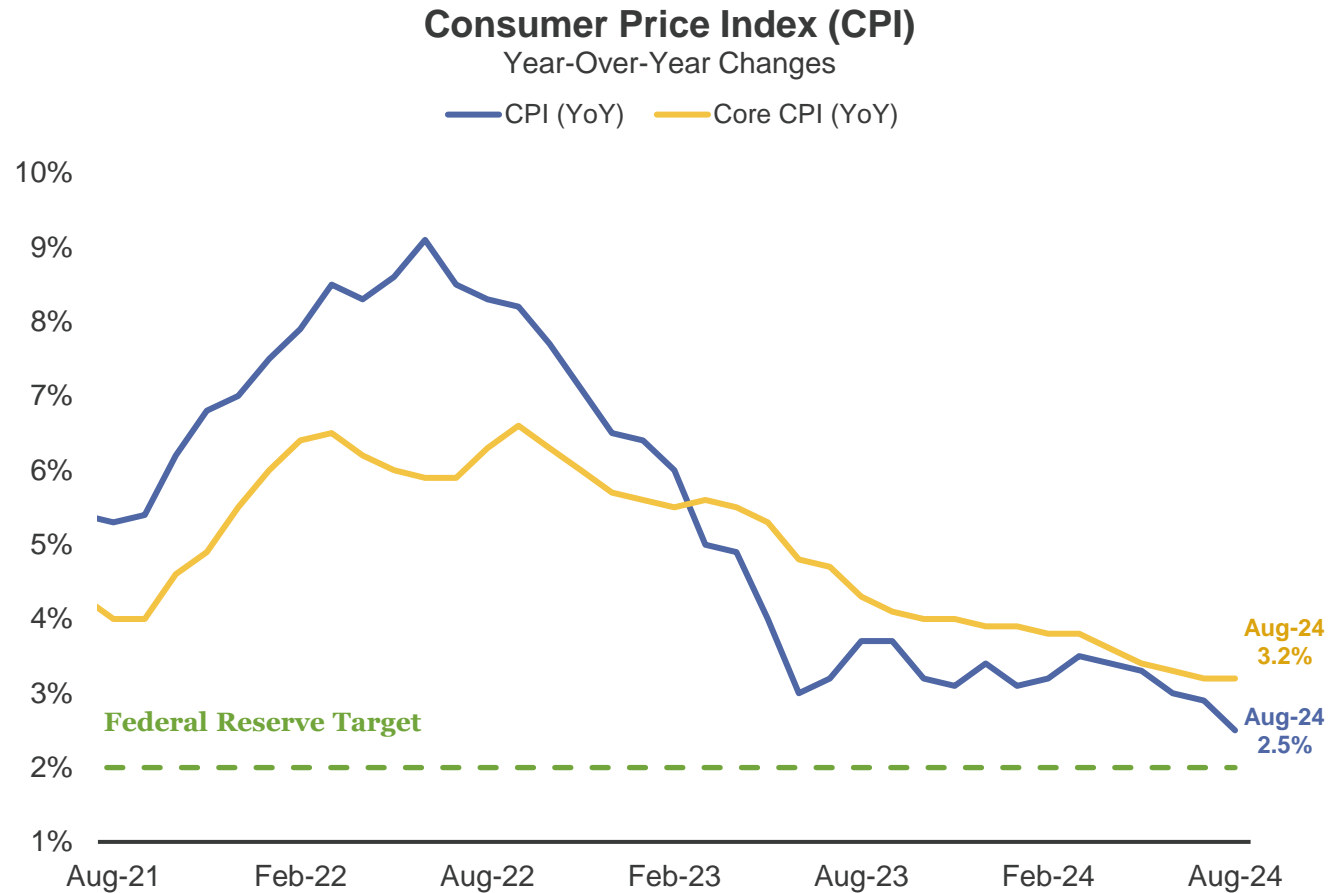


# Inflation Maintains Trend to Fed's 2% Target

*"...we're not saying mission accomplished or anything like that ... [but] we're encouraged by the progress that we have made."*

The Consumer Price Index ("CPI"), commonly referred to as the "headline inflation number", measures the change in the cost of a representative basket of goods paid by consumers.

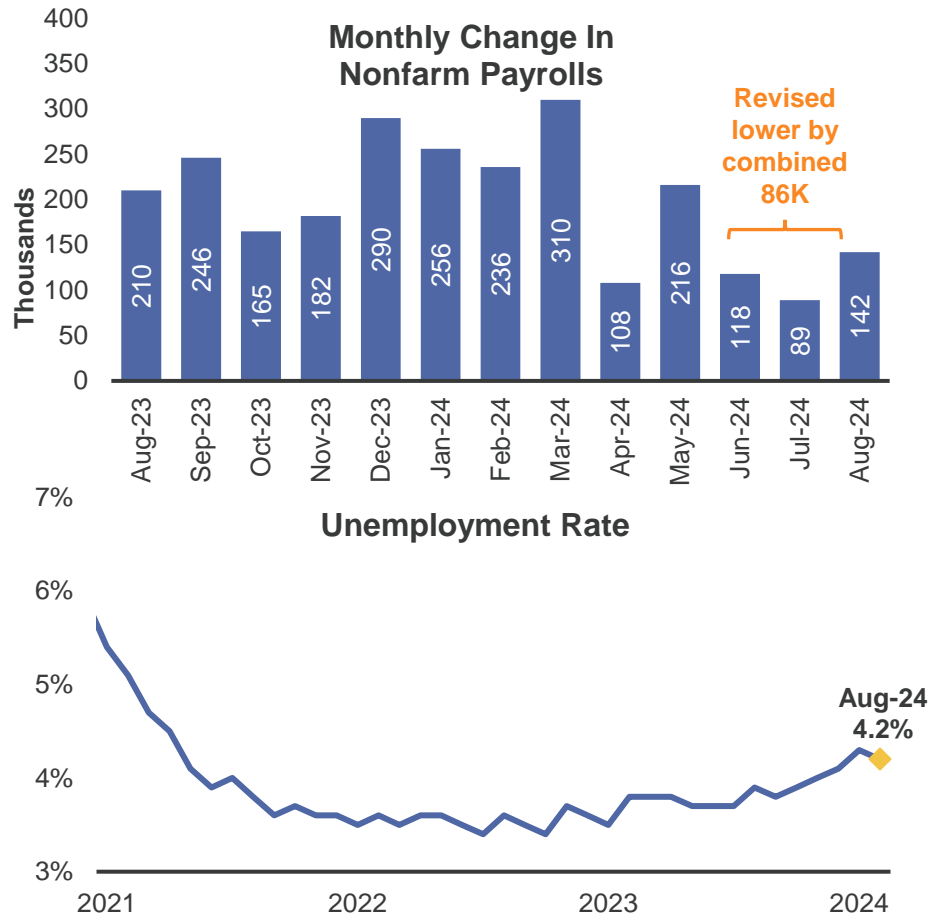
Core CPI strips out volatile food and energy components.



Source: Federal Reserve Chair Jerome Powell Press Conference as of September 18, 2024; Bureau of Labor Statistics, Federal Reserve, and Bloomberg Finance L.P., as of August 2024.

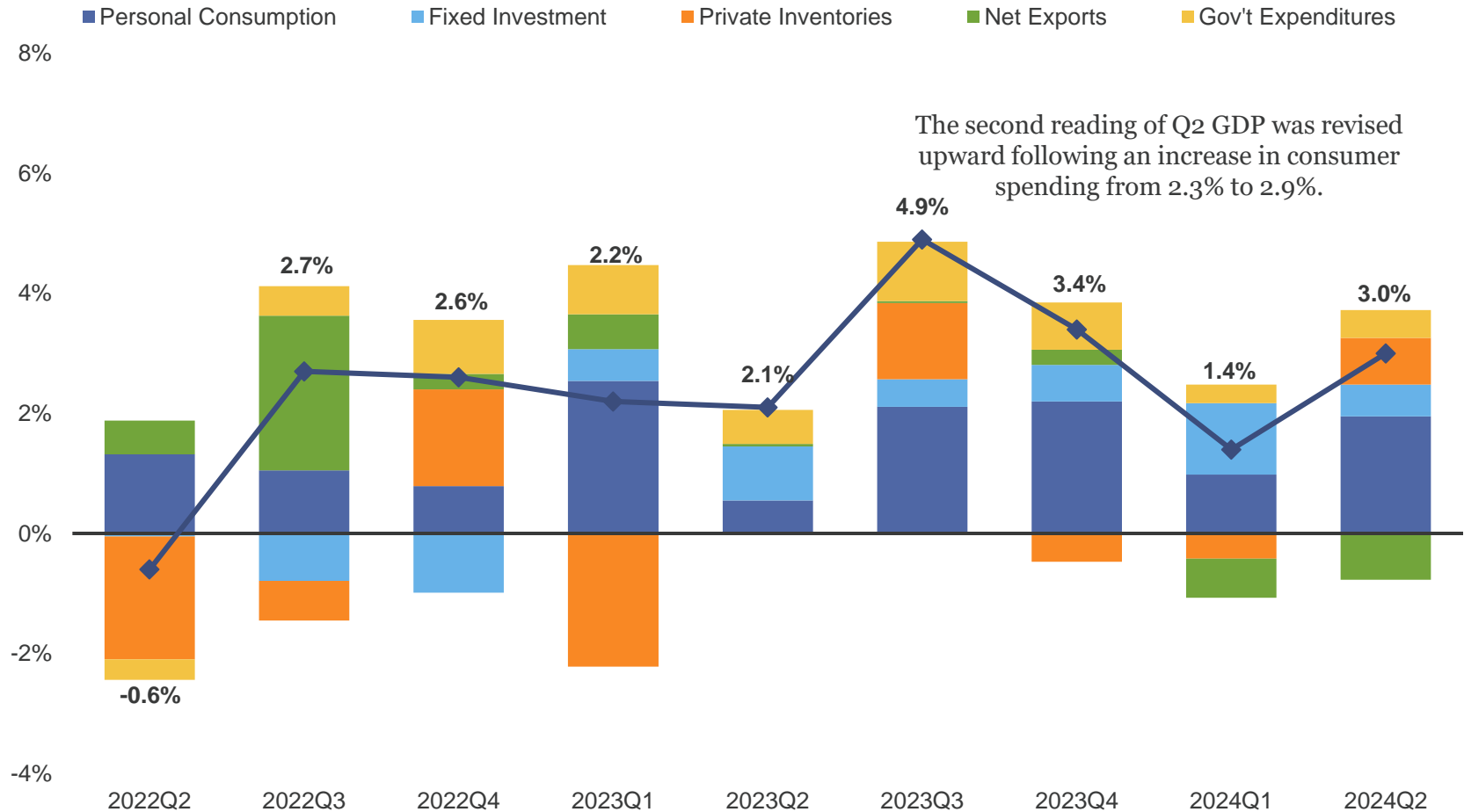
# Labor Market Shows Moderation

“...labor market conditions have cooled off by any measure ... [but] is actually pretty close to what I would call maximum employment”



# GDP Growth Revised Up on Consumer Spending

## U.S. Real GDP Contributors and Detractors



# Fed Cuts 50bps at September FOMC Meeting

## Select Comments from Chair Powell Press Conference

"As inflation has declined and the labor market has cooled, the upside risks to inflation have diminished and the downside risks to employment have increased."

"For a long time the risks were on inflation. ... Part of bringing down inflation though, is cooling off the economy, and a little bit cooling off the labor market. You now have a cooler labor market, in part because of our activity. So what that tells you is its time to change our stance."

"We made a good strong start to this ... we're going to go carefully, meeting by meeting"

"I do not think that anyone should look at this and say [50 basis points] is the new pace ... In the base case, ... look at the SEP."

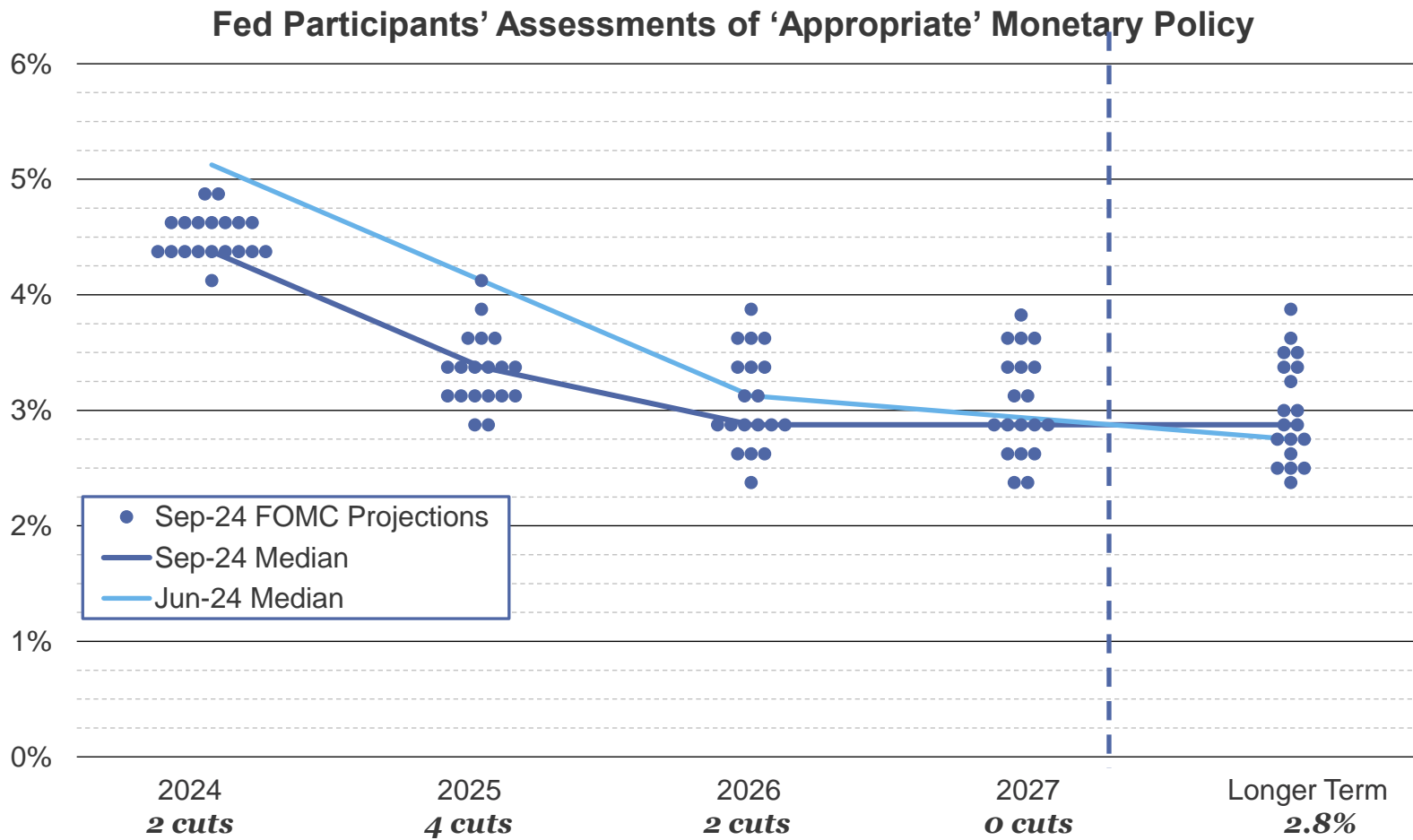
"We believe with an appropriate recalibration of our policy that we can continue to see the economy growing and that will support the labor market."

"The economy is growing at a solid pace; Inflation is coming down... the labor market is still in solid shape.... our intention is really to maintain the strength that we currently see in the U.S. economy."



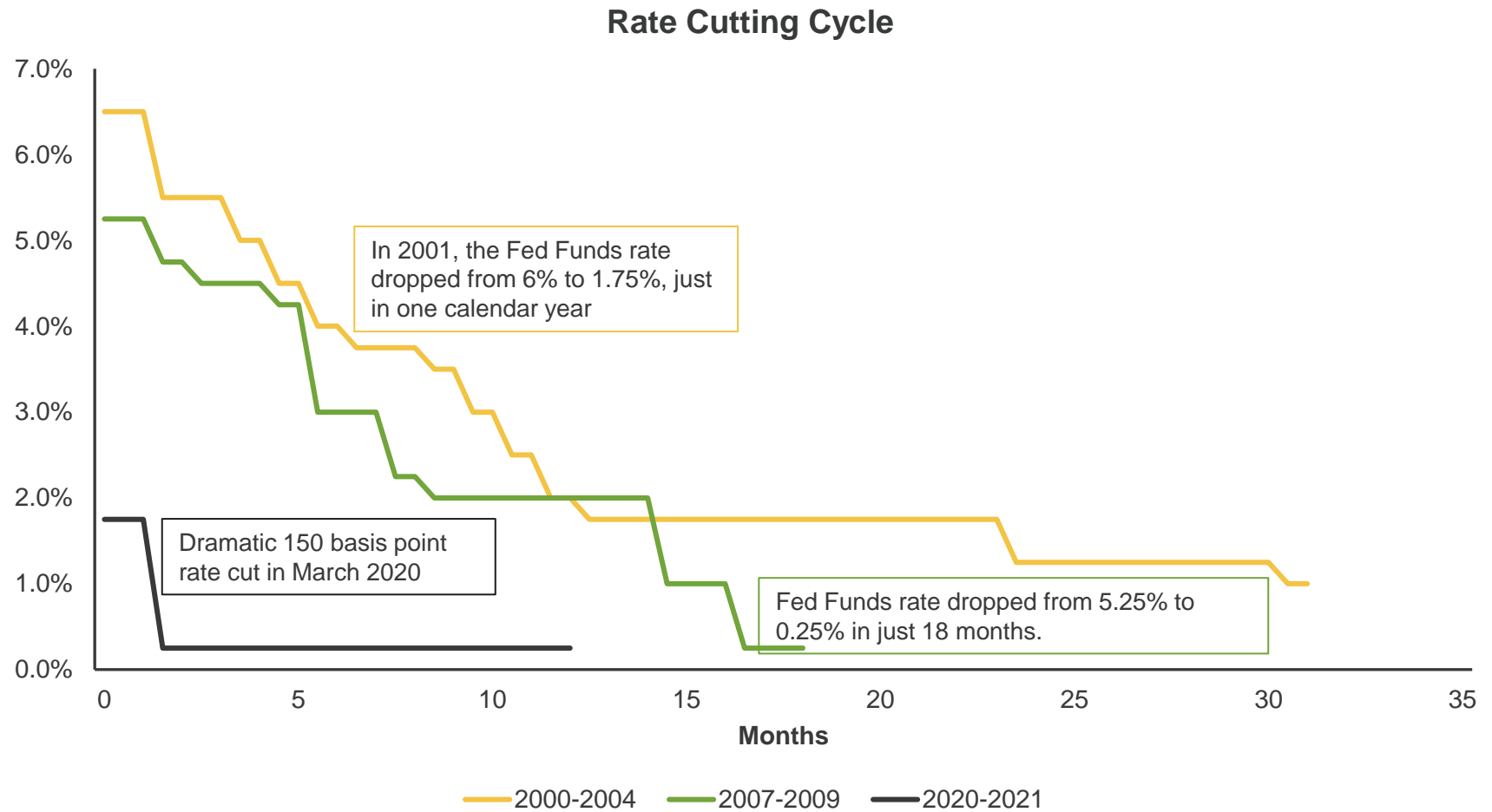
# The Latest Fed “Dot Plot”

*“There’s nothing in the [dots] that suggests the committee is in a rush to get this done.”*



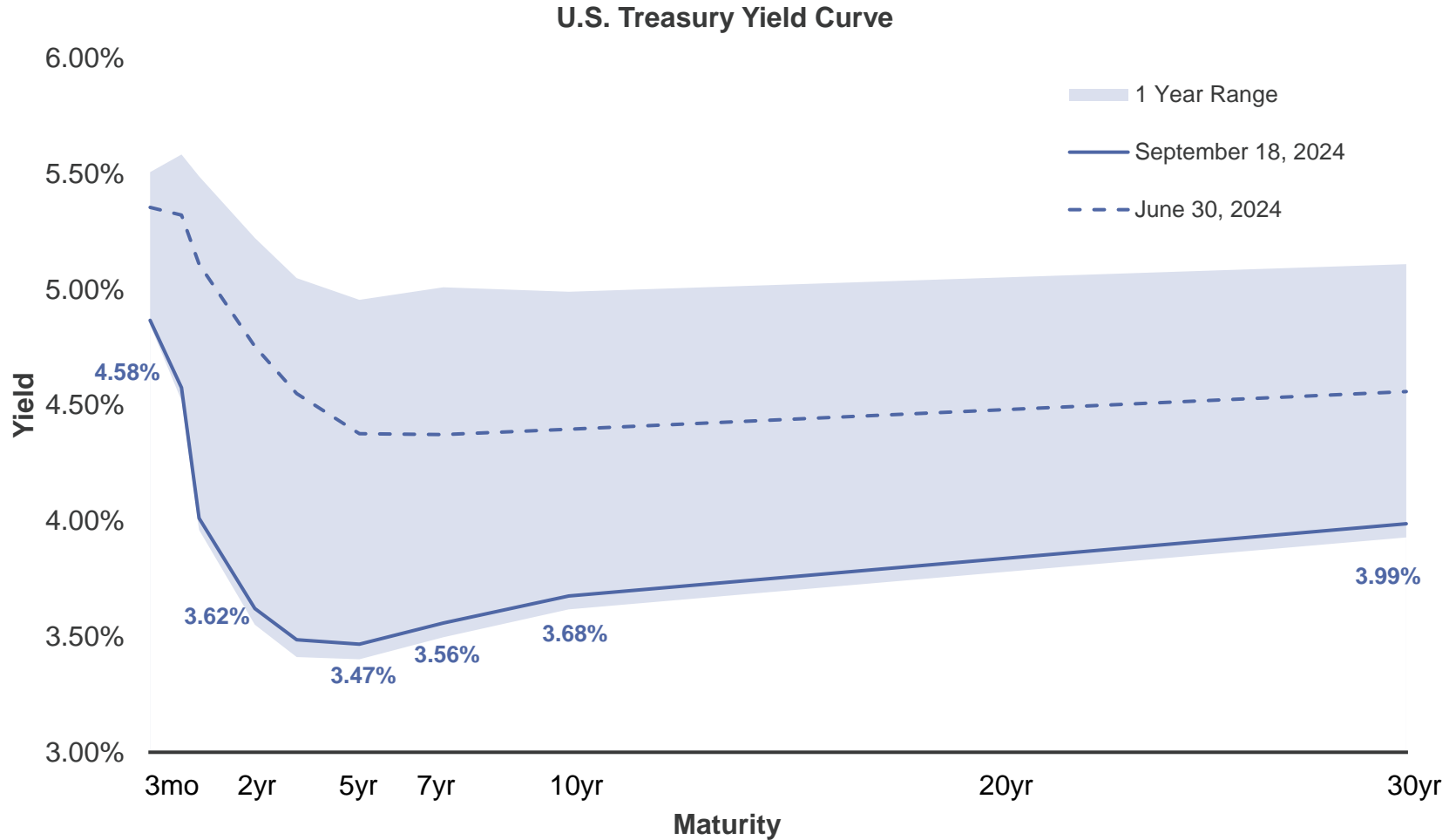
Source: Federal Reserve Chair Jerome Powell Press Conference as of September 18, 2024; Federal Reserve; Bloomberg Finance L.P.. Individual dots represent each Fed members’ judgement of the midpoint of the appropriate target range for the federal funds rate at each year-end.

# Fed's Previous Rate Cutting Cycles





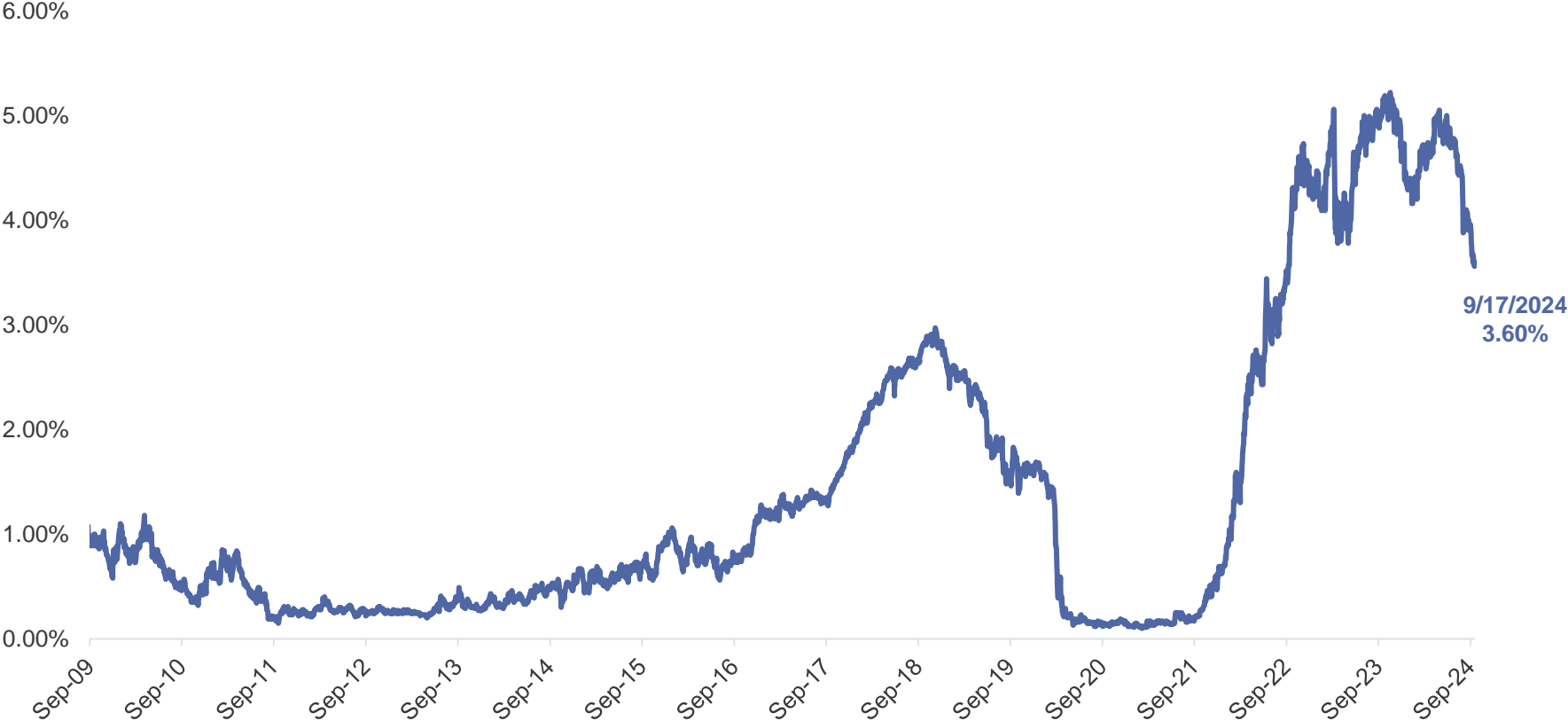
# Treasury Yields Near Bottom of 1-Year Range



Source: Bloomberg Finance L.P., as of September 18, 2024.

# 2-Year Treasury Yield Over Last 15 Years

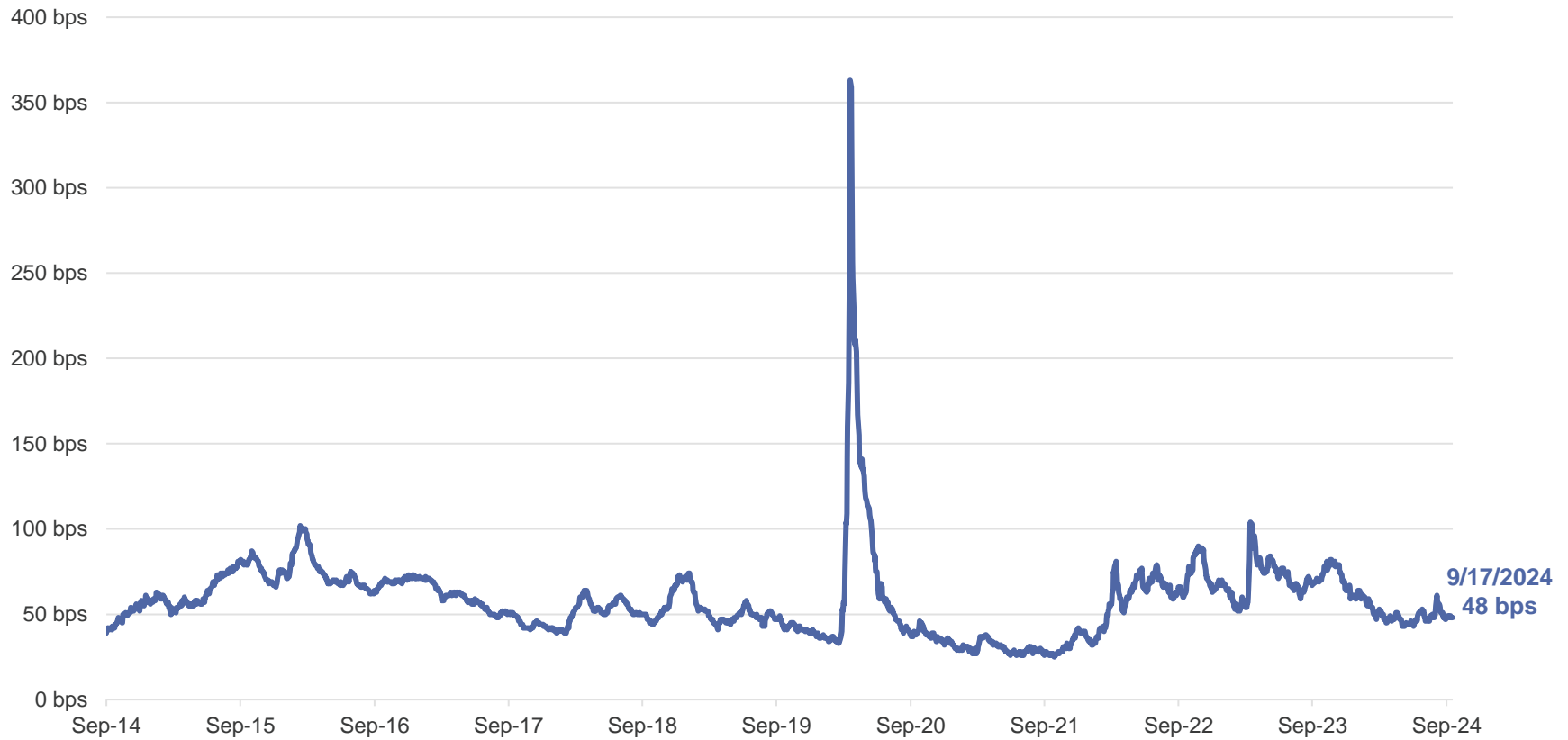
### 2-Year Treasury Yield



Source: ICE BofA Indices.

# Corporate Notes Can Add Value

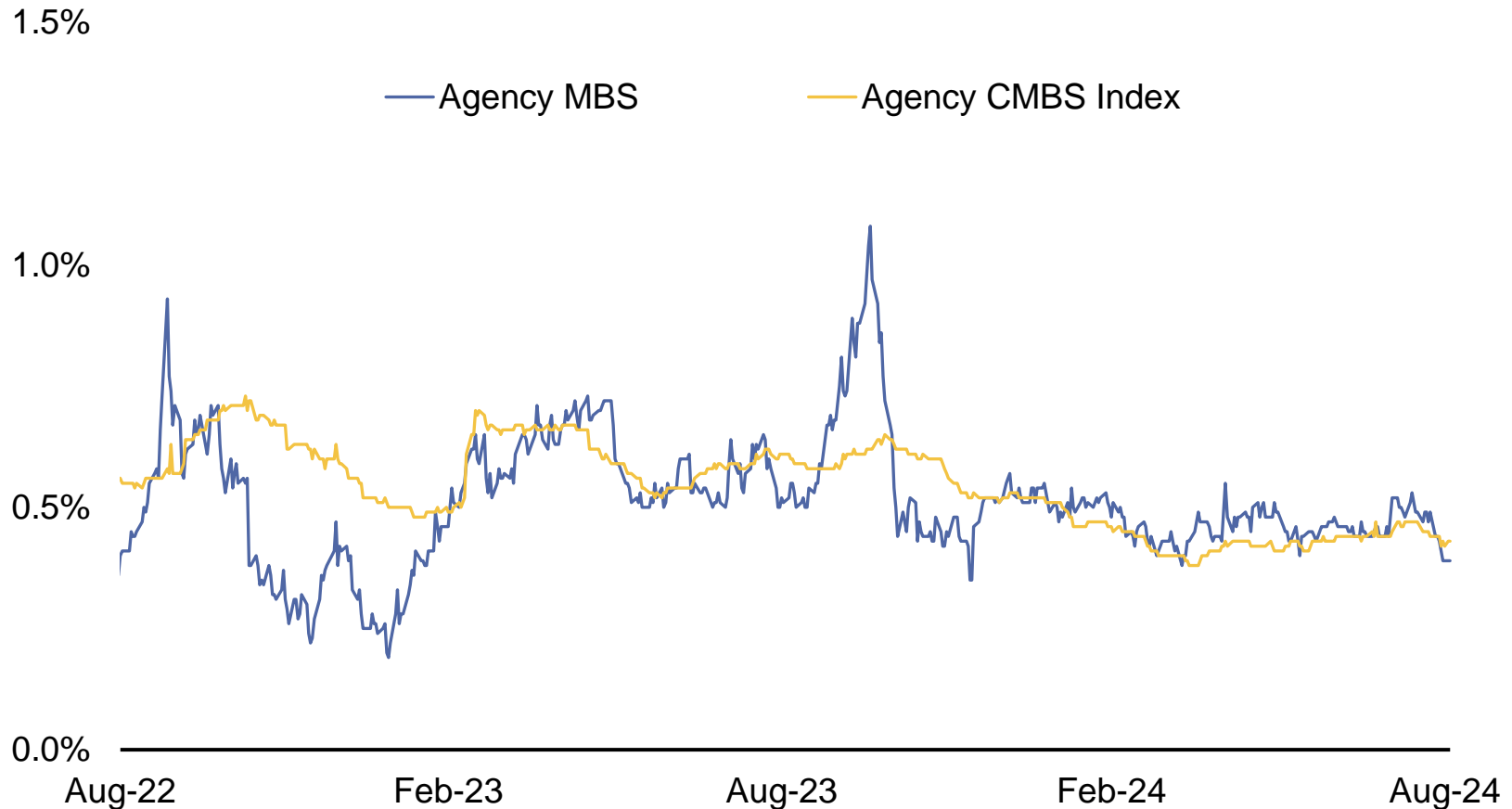
## Corporate Yield Spreads 1 - 3 Year A-AAA (OAS)



Source: ICE BofA Indices. It is not possible to invest in indices. OAS is option adjusted spreads.

# Agency Mortgage Backs Can Add Value

## Mortgage-Backed Securities Yield Spreads



Source: ICE BofA 1-5 year Indices via Bloomberg Finance L.P., MarketAxess and PFMAM as of 8/31/2024. Spreads on MBS are option-adjusted spreads of 0-5 year indices based on weighted average life; spreads on agencies are relative to comparable maturity Treasuries. CMBS is Commercial Mortgage-Backed Securities. It is not possible to invest in indices.

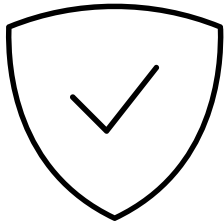
# Investment Strategy Considerations



# Investment Objectives

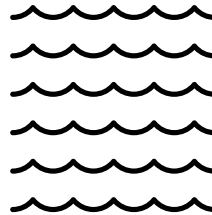
1

Safeguard  
Principal



2

Meet Liquidity  
Needs



3

Achieve a Market  
Return/Yield



# Permitted Investments

- Define in Investment Policy
- Complies with the Illinois Public Funds Investment Act (30 ILCS 235)
- Can set diversification limits
  - Term
  - Sector
  - Credit Quality

Sector	Allowed
Bank Accounts	Yes
Local Government Investment Pools	Yes
Certificates of Deposit	Yes
U.S. Treasuries	Yes
U.S. Agencies	Yes
Instrumentalities (Supras)	Yes
Agency Mortgage-Backed	Yes
Municipal Bonds	Yes
Commercial Paper	Yes
Corporate Notes	Yes
Corporate Bond Fund	Yes
Equities	NO

## Develop, Review, Amend, Improve ... Then Review, Amend, and Improve again 😊

- ▶ Objectives
- ▶ Standard of Prudence
- ▶ Ethics & Conflicts
- ▶ Delegation of Authority
- ▶ Selection of Broker / Dealers
- ▶ Competitive Selection
- ▶ Safekeeping and Custody
- ▶ Internal Controls
- ▶ Authorized Investments
  - ▶ Specifically define
  - ▶ Belts and Suspenders
    - ▶ Diversification
      - ▶ Sector
      - ▶ Issuer
    - ▶ Maximum Maturity
    - ▶ Security Downgrades
      - ▶ What to do?
  - ▶ Performance and Reporting Standards





# Cash Flow is Key

## Liquidity

- ▶ Cash and equivalents, providing immediate availability
- ▶ Manage liquidity needs

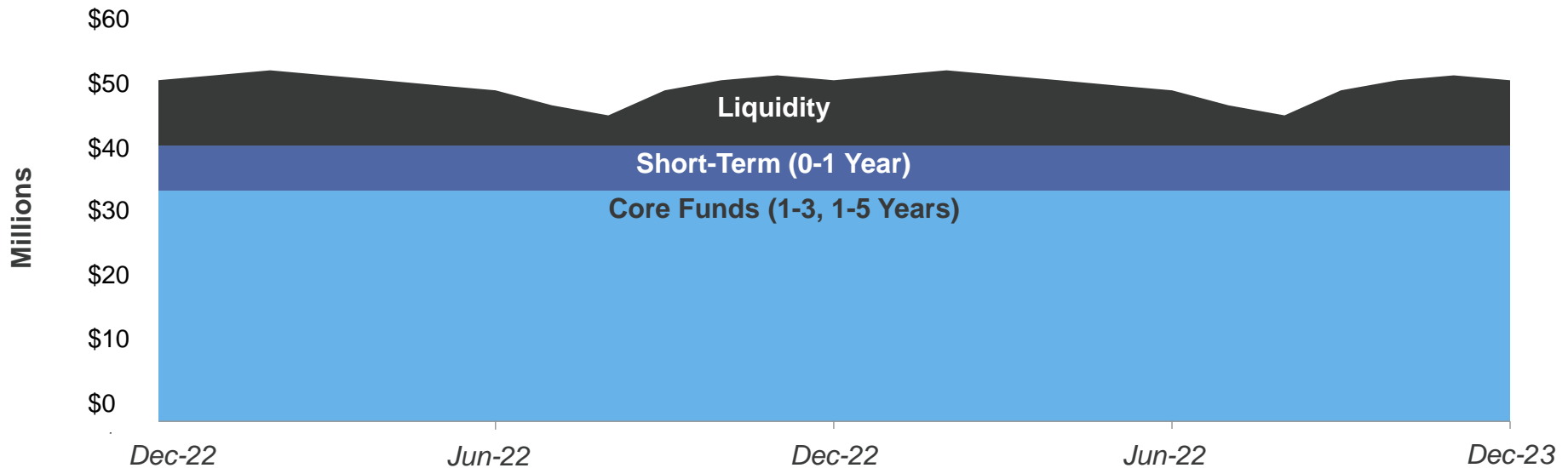
## Short-Term

- ▶ Laddered investments to known and expected cash flows
- ▶ High-quality fixed income

## Core

- ▶ Reserve funds not expected to be spent for the foreseeable future
- ▶ Intermediate- & longer-term investments

### Sample Cash Flow Analysis



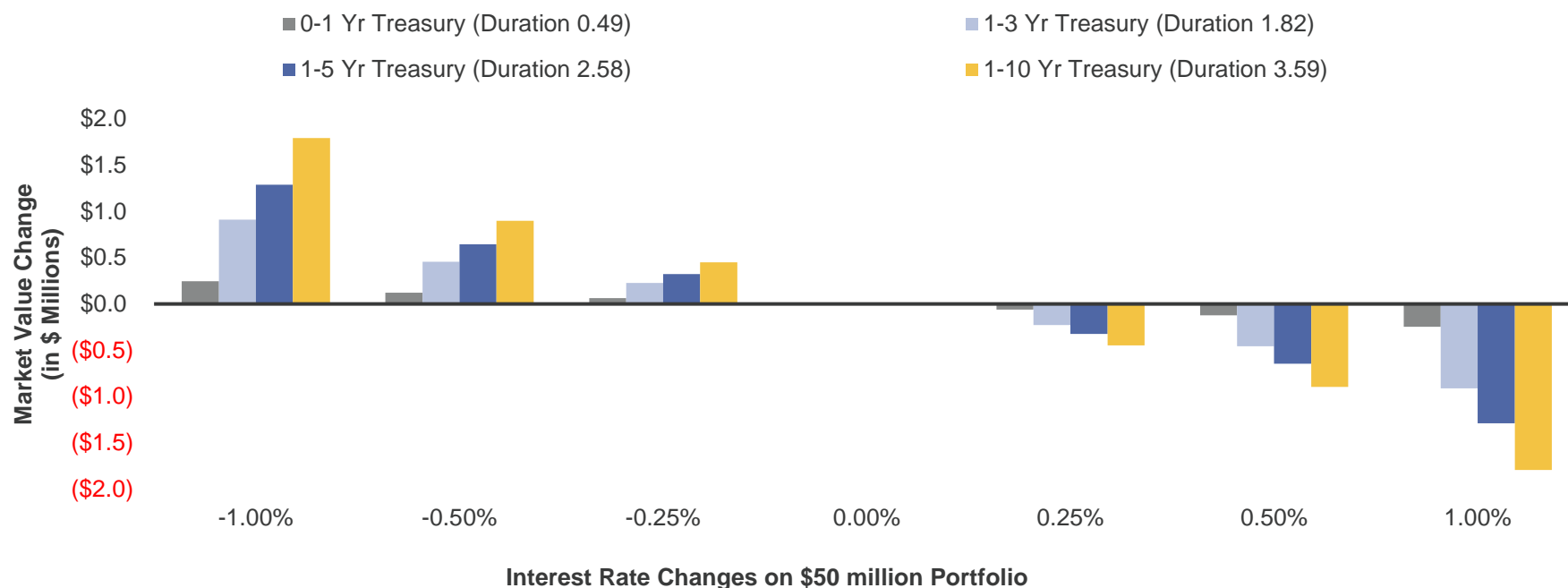
# Extending Duration Can Help Increase Investment Income

- Establishing a longer term, actively managed strategy for your College's core operating reserves could increase the earnings potential of the investment program

30 Years Ended June 30, 2024				
Bank of America Merrill Lynch Treasury Index	Duration (years)	Annualized Total Return	Cumulative Value of \$50 Million	Quarters With Negative Return
3 Month Treasury	0.23	2.47%	\$104,080,806	1 out of 120
1-3 Year Treasury	1.83	3.14%	\$126,321,548	19 out of 120
1-5 Year Treasury	2.60	3.45%	\$138,557,831	30 out of 120
1-10 Year Treasury	3.66	3.81%	\$153,737,256	39 out of 120

Source: Bloomberg, Bank of America / Merrill Lynch Global Indices; based on historical results – future results may vary. As of June 30, 2024. It is not possible to invest in indices.

# Longer-Duration Strategies Are More Sensitive to Changes in Interest Rates

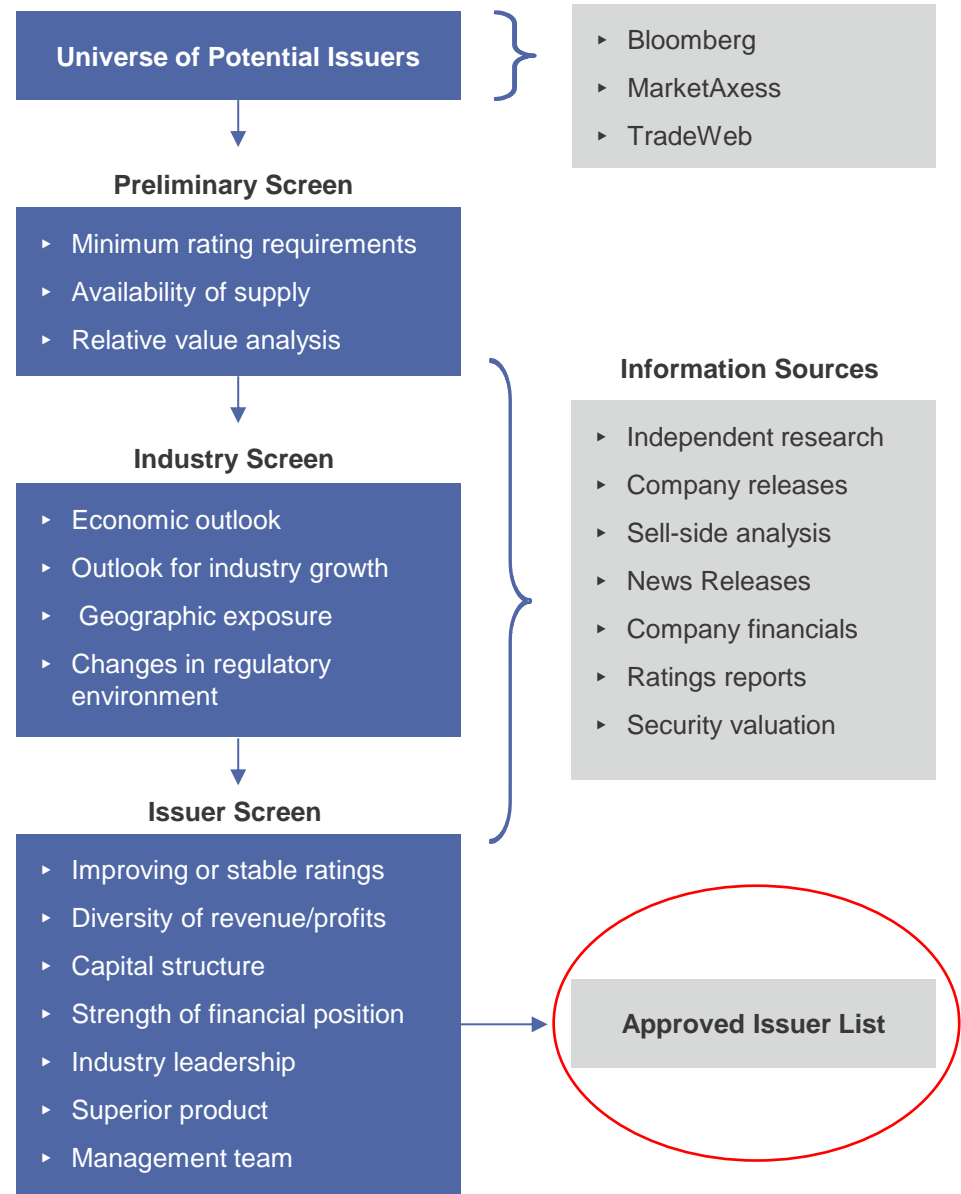


ICE BofA Index	Portfolio Duration (years)	Interest Rates Fall 1.00%	Interest Rates Fall 0.50%	Interest Rates Fall 0.25%	Interest Rates Are Unchanged	Interest Rates Rise 0.25%	Interest Rates Rise 0.50%	Interest Rates Rise 1.00%
0-1 Year Treasury	0.49	\$245,500	\$122,750	\$61,375	\$0	(\$61,375)	(\$122,750)	(\$245,500)
1-3 Year Treasury	1.82	\$911,500	\$455,750	\$227,875	\$0	(\$227,875)	(\$455,750)	(\$911,500)
1-5 Year Treasury	2.58	\$1,290,000	\$645,000	\$322,500	\$0	(\$322,500)	(\$645,000)	(\$1,290,000)
1-10 Year Treasury	3.59	\$1,794,500	\$897,250	\$448,625	\$0	(\$448,625)	(\$897,250)	(\$1,794,500)

Source: Bloomberg Finance LP, ICE BofA Indices. Data as of 6/30/2024. Interest rate changes are assumed to be instantaneous and parallel across the yield curve. It is not possible to invest in indices. For illustrative purposes only.

# Sample Credit Screening Process

- Credit Committee focuses on sectors with positive macro characteristics
- Independent research is conducted to identify issuers who may benefit from macro trends
- Once a potential issuer is identified, thorough review of the company is conducted
- Credit Committee actions:
  - Approve the issuer,
  - Request more data, or
  - Decline



# Summary of Investment Strategy Considerations

- Federal Reserve
  - Dual Mandate
  - Unemployment – 4.2% in August 2024
  - Inflation – CPI 2.5% in August 2024
  - Rates are still near 15-year highs across the yield curve, despite inversion and falling rates
- Interest rates will rise & fall
  - When?
  - What pace?
  - Establish a disciplined investment strategy to weather all market environments
- Cash Flow is Key
  - Identify balances available for longer term investing vs. short term funds
  - Optimize cash balances, excess cash historically leaves investment income on the table
  - Match short term investments with known cash liabilities
  - Funds not intended for spend should be invested in a longer term, reserve portfolio

# Questions?



**Jeff Schroeder**

Managing Director

PFM Asset Management

[schroederj@pfmam.com](mailto:schroederj@pfmam.com)



**Matt Hanigan**

Senior Managing Consultant

PFM Asset Management

[haniganm@pfmam.com](mailto:haniganm@pfmam.com)



# Disclaimer

*The views expressed within this material constitute the perspective and judgment of U.S. Bancorp Asset Management, Inc. at the time of distribution and are subject to change. Any forecast, projection, or prediction of the market, the economy, economic trends, and equity or fixed-income markets are based upon current opinion as of the date of issue and are also subject to change. Opinions and data presented are not necessarily indicative of future events or expected performance. Information contained herein is based on data obtained from recognized statistical services, issuer reports or communications, or other sources, believed to be reliable. No representation is made as to its accuracy or completeness.*

*Indexes shown are not available for investment. The index data referenced herein is the property of the index provider and / or its licensors. The index provider assumes no liability in connections with its use and does not sponsor, endorse or recommend the products or services contained herein. Index returns do not reflect payment of any sales charges or fees an investor would pay to purchase the securities they represent. The imposition of these fees and charges would cause investment performance to be lower than the performance shown.*

*PFM Asset Management serves clients in the public sector and is a division of U.S. Bancorp Asset Management, Inc., which is the legal entity providing investment advisory services. U.S. Bancorp Asset Management, Inc. is a registered investment adviser, a direct subsidiary of U.S. Bank N.A. and an indirect subsidiary of U.S. Bancorp. U.S. Bank N.A. is not responsible for and does not guarantee the products, services, or performance of U.S. Bancorp Asset Management, Inc.*

**NOT FDIC INSURED : NO BANK GUARANTEE : MAY LOSE VALUE**

*For Institutional Investor or Investment Professional Use Only – This material is not for inspection by, distribution to, or quotation to the general public.*

