Is the Fed Done Raising Interest Rates?

ICCCFO Fall Conference 2023

October 12, 2023
The Fed’s Dual Mandate

Price Stability

Maximum Employment
Gasoline May Become a Bigger Driver of Inflation in Coming Months

**Reason:** Higher gasoline prices reflected oil-production cuts by Saudi Arabia and Russia, which extended to the end of 2023.

<table>
<thead>
<tr>
<th>CPI For Energy, by Category</th>
<th>MoM</th>
<th>YoY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Energy CPI</td>
<td>5.6%</td>
<td>-3.6%</td>
</tr>
<tr>
<td>Gasoline</td>
<td>10.6%</td>
<td>-3.3%</td>
</tr>
<tr>
<td>Utility natural gas to home</td>
<td>0.1%</td>
<td>-16.5%</td>
</tr>
<tr>
<td>Electricity service</td>
<td>0.2%</td>
<td>2.1%</td>
</tr>
<tr>
<td>Heating oil, propane, kerosene,</td>
<td>-12.4%</td>
<td>8.4%</td>
</tr>
<tr>
<td>firewood</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: FRED Economic Data; as of August 2023.
Without Oil, Core Inflation Metrics Fell in August


Super core CPI = Core services less housing
Consumers and Businesses Are Both Expecting Higher Prices in Short-Term

**Consumer Side**

**Consumer Sentiment Index**

**Expected Change in Prices During Next Year**

**Business Side**

**NFIB Small Business Optimism Index**

**Small Business Selling Prices**

% Planning to Raise Prices Next 3 Mo.

% Planning to Raise Wages

Source (left): Bloomberg, University of Michigan Consumer Sentiment and underlying index components, as of August 2023.

Retail Sales, Which Excludes Services, Jumped on Rising Energy Costs

- Retail sales are not adjusted for inflation, indicating that consumers continue to hold up well despite rising prices and increasing levels of credit card debt.
Payrolls Came in Higher than Forecast While the Unemployment Rate Climbed

Unemployment Rate

April 20 14.7%

Aug 23 3.8%

Monthly Change In Nonfarm Payrolls

Record 7.2 million new jobs in 2021
4.8 million new jobs in 2022
1.9 million in 2023

Source: Bloomberg, as of August 2023. Data is seasonally adjusted.
Fed’s Update “Dot Plot” Shows Higher Rates for Longer

Fed Participants’ Assessments of ‘Appropriate’ Monetary Policy

Source: Federal Reserve and Bloomberg. Individual dots represent each Fed members’ judgement of the midpoint of the appropriate target range for the federal funds rate at each year-end.
No Fed Move in September, But There Remains Room for a Hike Later This Year

Once the Fed reaches their peak Fed Funds rate, they have historically held rates at that level for around \textit{8 months}.
2-Year Treasury Yield at 15 Year Highs

Source: Bloomberg, as of 9/14/2023.
Treasuries Sell-Off, Yields Climb, Following Fed Meeting

Source: Bloomberg, as of 09/25/2023.
Current Inverted Yield Curve NOT Normal

U.S. Treasury Yield Curve

Source: Bloomberg, ICE BofAML Indices.
Longer Duration Portfolios Have Historically Higher Returns

<table>
<thead>
<tr>
<th>Bank of America Merrill Lynch Treasury Index</th>
<th>Duration (years)</th>
<th>Annualized Total Return</th>
<th>Cumulative Value of $40 Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 Month Treasury</td>
<td>0.23</td>
<td>2.41%</td>
<td>$81,657,575</td>
</tr>
<tr>
<td>1-3 Year Treasury</td>
<td>1.82</td>
<td>3.04%</td>
<td>$98,232,563</td>
</tr>
<tr>
<td>1-5 Year Treasury</td>
<td>2.57</td>
<td>3.34%</td>
<td>$107,141,196</td>
</tr>
<tr>
<td>1-10 Year Treasury</td>
<td>3.68</td>
<td>3.69%</td>
<td>$118,785,054</td>
</tr>
</tbody>
</table>

Source: Bloomberg, ICE BofAML Indices, as of June 30, 2023.
Cash Flow Analysis Leads to Prudent Investment Decisions

**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

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**Sample Cash Flow Analysis**

<table>
<thead>
<tr>
<th>Month</th>
<th>Millions</th>
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<tbody>
<tr>
<td>Dec-18</td>
<td>$60</td>
</tr>
<tr>
<td>Jun-19</td>
<td>$50</td>
</tr>
<tr>
<td>Dec-19</td>
<td>$50</td>
</tr>
<tr>
<td>Jun-20</td>
<td>$40</td>
</tr>
<tr>
<td>Dec-20</td>
<td>$40</td>
</tr>
</tbody>
</table>

For illustrative purposes only.
Corporate Spreads Remain Attractive

Corporate Yield Spreads
1 – 3 Year A – AAA (OAS)

Source: Bloomberg, ICE BofA Indices. OAS is option adjusted spreads. As of 9/22/2023.
Summary Takeaway Considerations

- Federal Reserve
  - Dual Mandate
    - Unemployment – 3.8% in August 2023
    - Inflation – CPI 3.7% in August 2023
  - Potentially nearing restrictive territory, but will remain data dependent
  - Rates are near 15-year highs across the yield curve, despite inversion

- 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 typically 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
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