Payden&Rygel

QUARTERLY PORTFOLIO REVIEW

# FLORIDA LOCAL GOVERNMENT INVESTMENT TRUST

## 2nd Quarter 2018

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## LETTER FROM THE CEO

July 2018

As we begin the second half of the year it's an opportunity to pause and reflect on what our thoughts were in January. Back then, we were coming off very strong economic numbers both from Europe and the U.S. In fact, on the continent, year-over-year growth showed 2.8%, a high point in the last decade. In the U.S. GDP was roughly 3%, and we were confident that the trend would continue.

Our projections for the U.S. were optimistic and we felt that Europe would also continue to show strength. Now at the mid-point of the year, the U.S. economy has maintained growth at a 3% rate. However, in Europe optimism has given way to concerns about trade wars, tariffs, a strong U.S. dollar and political uncertainty.

At this point, the big question facing the U.S. and global economies is how sensitive the financial markets could be to these possible disruptions. First, we do not see any significant signs that the U.S. is overheating and, on this basis, we are comfortable with the Fed gradually increasing rates 3-4 times annually. Further afield, we are somewhat more cautious, as uncertainties have grown regarding the impact of trade wars, tariffs, etc., which are likely to reflect a slowdown from the outstanding numbers produced in 2017. Given this, we continue to look for mispriced opportunities for investments in the Eurozone. You might like to know that within the past few months we have increased our presence in Europe with the opening of our Milan office to complement our entrance into London twenty years ago.

We'd like to conclude by saying that we are mindful of global liquidity and the unexpected becoming reality. Against this background, in your portfolio, diversification and a constant monitoring of factors that could disrupt global financial markets help guide decisions. We'd like to leave you with this important thought and send you and your family our best wishes for the balance of the year.

Sincerely,

Joan A. Payden
President & CEO

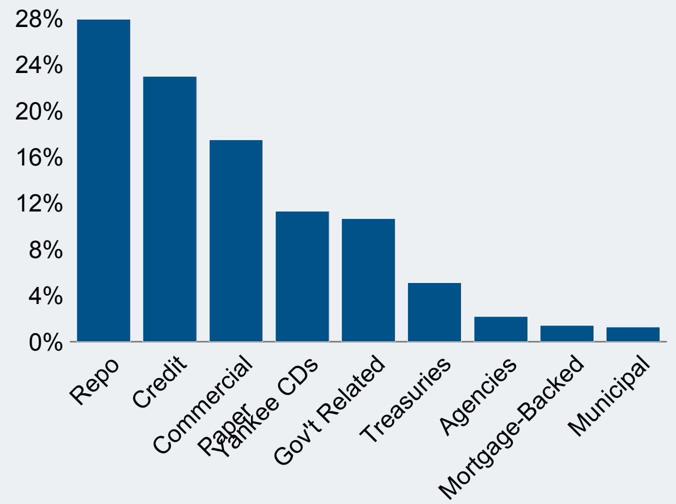
# FLORIDA TRUST DAY TO DAY FUND

## *Portfolio Review and Market Update - 2nd Quarter 2018*

### PORTFOLIO CHARACTERISTICS (As of 6/30/2018)

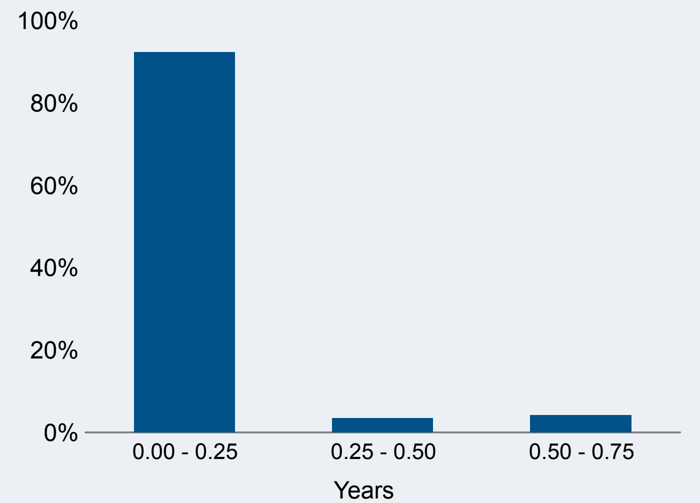
| | |
|---|---|
| Portfolio Market Value | $684.5 million |
| Weighted Average Credit Quality (Fitch) | AAAmmf |
| Weighted Average Maturity | 40 days |
| SEC 30-Day Yield (net) | 1.98% |

### SECTOR ALLOCATION




Government/Government-guaranteed: 46%

### DURATION DISTRIBUTION




### PORTFOLIO RETURNS - Periods Ending 6/30/2018

| | 2nd Quarter | 2018 YTD | Trailing 1 Yr | Trailing 3 Yr | Trailing 5 Yr | Since Inception (1/13/09) |
|---|---|---|---|---|---|---|
| **FLORIDA TRUST DAY TO DAY FUND (gross)** | **0.53%** | **0.91%** | **1.54%** | **0.94%** | **0.64%** | **0.47%** |
| FLORIDA TRUST DAY TO DAY FUND (net) | 0.48% | 0.86% | 1.45% | 0.83% | 0.53% | 0.37% |
| ICE BofAML 3-Month US Treasury Bill Index | 0.45% | 0.81% | 1.36% | 0.68% | 0.42% | 0.29% |

*Periods over one year annualized*

## MARKET THEMES

Headlines dominated second quarter market sentiment, primarily led by Italian politics, emerging markets and trade war fears. Economic data from the U.S. remained strong, allowing the Fed to raise rates another 25 basis points in June. Jerome Powell maintained his optimistic and hawkish policy tone, forecasting two more 25 basis point hikes in 2018 and three hikes in 2019. Consequently, the front-end of the U.S. yield curve moved higher, causing the curve to flatten. Despite strong Q1 corporate earnings, most assets traded with a weak tone during the quarter. The exception was high yield corporate bonds, which outperformed as spreads compressed even with robust outflows. Technical factors dictated a majority of the movement in spreads, which were roughly flat over the quarter but wider on the year. We believe fundamentals remain intact and outright yields remain attractive at the front end of the yield curve.

## STRATEGY

- The portfolio holds a 46% allocation to government and government-guaranteed securities, in addition to a diversified mix of credit sectors for income generation.
- Corporate bond yield premiums were mixed over the quarter. We view short credit as attractive given the strong fundamental backdrop and yield levels that we have not seen since 2009.
- We continue to utilize floating-rate coupon bonds for their short duration profile and yield benefit in a rising rate environment.

## INTEREST RATES

- U.S. Treasury yields moved higher by 13 to 26 basis points across the front-end of the curve, with three-month rates rising 0.21% to 1.91% and one-year yields up 0.23% to 2.31%
- Additional carry from longer out-of-index positions was offset by negative price returns from the increase in Treasury yields.
- Floating-rate positions contributed positively to performance as one-month LIBOR rose 0.21% to 2.09%; however, 3-month LIBOR remained range bound over the quarter.

## SECTORS

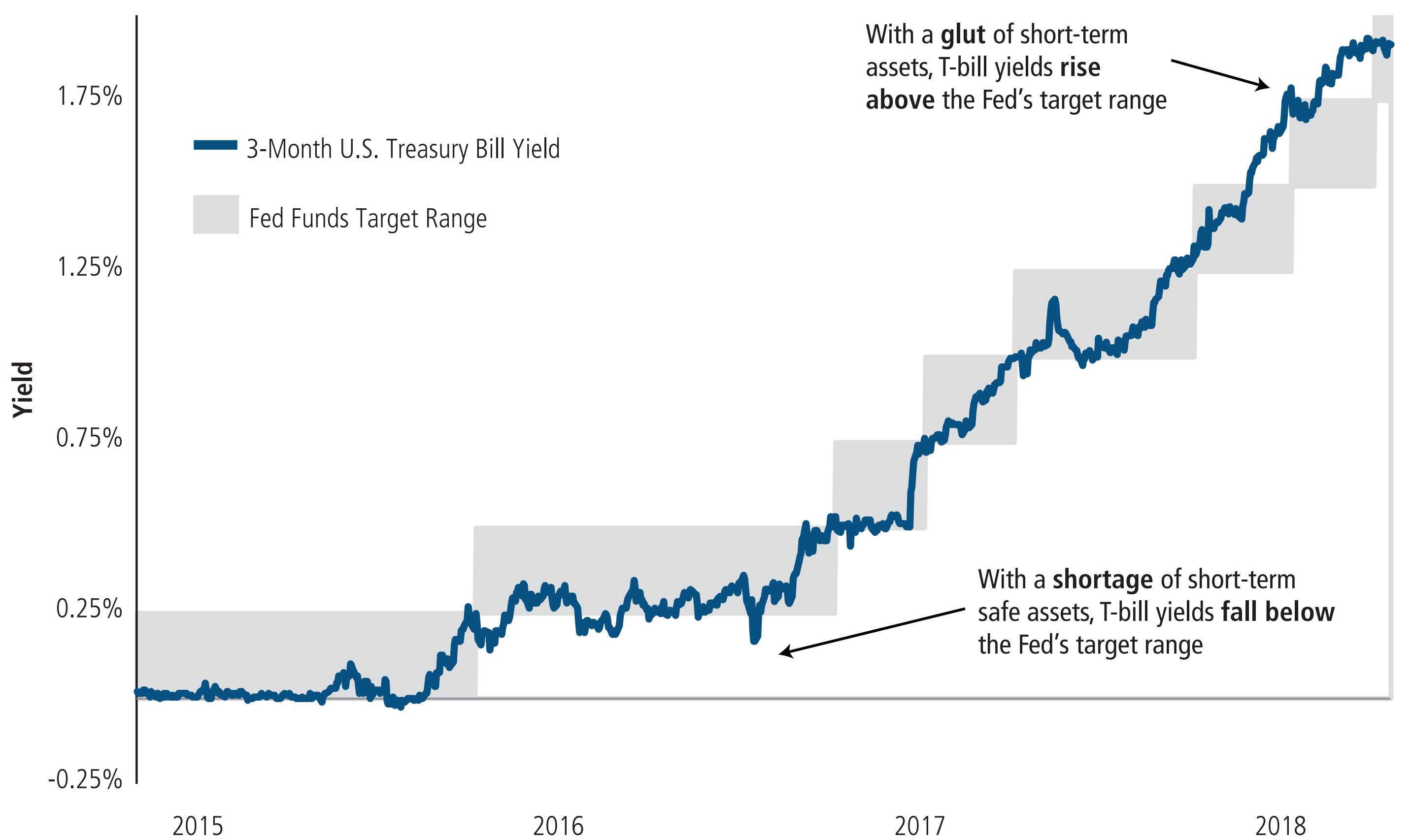
- Short corporate securities outperformed Treasuries during the quarter, benefiting from their yield advantage.
- Commercial paper and Yankee CDs have benefited from the rising rate environment, and have attractive yields.
- We continue to hold high-quality SSAs (Supranational/Sovereign/Agency) securities as spread product and a diversifier from US government securities.

### Follow The Leader as the Shortage of Short-Term Assets Becomes a Glut

Textbooks teach us central banks set overnight interest rates. However, in the United States, a different pacesetter has lately emerged for overnight interest rates: the market. Thanks to a global glut of short-dated, safe, liquid assets, the Fed's administered rate is not as attractive to overnight borrowers as it once was. Where once short-maturity investors faced limited options, today these investors can choose from a pile of new U.S. Treasury bills, an overnight repo facility at the Fed, reserves, attractive USD-hedged return on other government bills (thanks to higher interest rate differentials), and more. Why should investors care? Consider that as the Fed began its hiking cycle in late 2015, 3-month Treasury bill yields nearly always hovered at the low end of the Fed's target rate band (then 0%) and sometimes even traded below the lower bound. Today the situation is quite different. With a surplus of options available to overnight borrowers, market pricing has returned to the front end of the yield curve. The Fed is now following, not leading, overnight interest rates. Perhaps the Fed hikes faster? Perhaps market participants will demand more yield for short-dated credit instruments?

A further repricing of short-term interest rates could have ripple effects across a range of other asset classes. After all, if you can get 2.50% on a 2-year Treasury, why wouldn't you demand even higher yields from similar maturity corporates? The global implications of higher U.S. short-term interest rates might also mean greater interest rate differentials that could boost the USD and hurt emerging markets. In fact, we think such a chain of events played out during the second quarter, explaining asset prices movements from Treasuries to U.S. corporates to emerging markets.

### 3-Month U.S. Treasury Bill Yields vs. the Fed Funds Target Range




*Source: Bloomberg*

## US DOMICILED MUTUAL FUNDS

### CASH BALANCE
Payden/Kravitz Cash Balance Plan Fund

### EQUITY
Equity Income Fund

### GLOBAL FIXED INCOME
Emerging Markets Bond Fund
Emerging Markets Corporate Bond Fund
Emerging Markets Local Bond Fund
Global Fixed Income Fund
Global Low Duration Fund

### TAX-EXEMPT FIXED INCOME
California Municipal Income Fund

### U.S. FIXED INCOME
Absolute Return Bond Fund
Cash Reserves Money Market Fund
Core Bond Fund
Corporate Bond Fund
Floating Rate Fund
GNMA Fund
High Income Fund
Limited Maturity Fund
Low Duration Fund
Strategic Income Fund
U.S. Government Fund

## DUBLIN DOMICILED UCITS FUNDS

### EQUITY
Global Equity Income Fund
U.S. Equity Income Fund

### LIQUIDITY FUNDS
Euro Liquidity Fund
Sterling Reserve Fund
U.S. Dollar Liquidity Fund

### FIXED INCOME
Absolute Return Bond Fund
Global Bond Fund
Global Emerging Markets Bond Fund
Global Emerging Markets Corporate Bond Fund
Global Government Bond Index Fund
Global High Yield Bond Fund
Global Inflation-Linked Bond Fund
Global Short Bond Fund
Sterling Corporate Bond Fund
U.S. Core Bond Fund
USD Low Duration Credit Fund

For more information about Payden & Rygel's funds, contact us at a location listed below.

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