TheINVESTOR May 2022

TheNEWS

New Opportunities for Local Governments After a Multi-Year Rollercoaster Ride

As we all experienced, lockdowns starting in March of 2020 to contain the COVID-19 pandemic sent shockwaves through the financial markets, causing individuals and corporations to grapple with economic uncertainty. Over the course of 2020 and 2021, many individuals and businesses increased their savings and bank deposits as a precautionary measure. During the first half of 2020, commercial bank deposits increased by a record-setting 37% due in large part to Paycheck Protection Program (PPP) loans, nonfinancial companies drawing down their lines of credit, near-zero interest rates, and consumers' general inability and unwillingness to spend money. However, bank analysts have dramatically cut their expectations for deposit levels at the largest banks over the past few months, now anticipating a 6% decline in deposits this year after forecasting a 3% increase just months ago.*

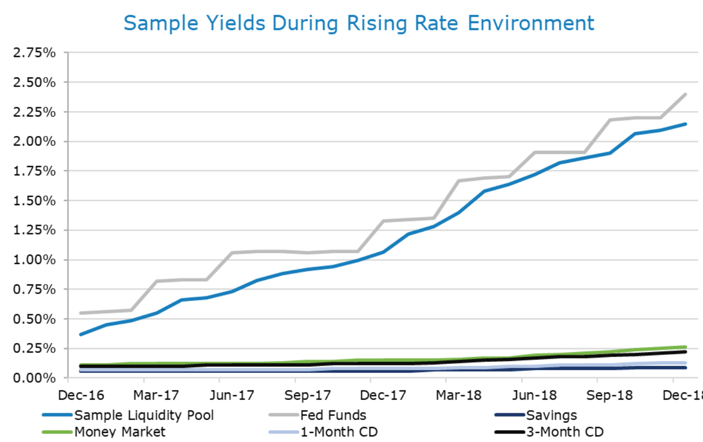
Rapid Rate Increases Expected for 2022

So why the dramatic change in course? In response to rising inflation that now exceeds 8%, forecasts from both economists and Fed officials call for dramatic and rapid increases to the Fed's core interest rate over the next year and beyond. With two rate hikes for a total of 75 bps so far this year, an untraditional and somewhat unpredictable Fed tightening cycle is well underway, resulting in the opportunity for local governments to seek higher yields on their investments than banks are currently willing or able to offer.

The dramatic influx of bank deposits over the past two years has banks nearing regulatory limits on capital. Because many banks were unable to put the deposits to use in the form of loans during the pandemic, they had already begun limiting bank deposits before the Fed's change in course. According to Barclays analysts and the Wall Street Journal, the industry has $8.5 trillion more in deposits than loans so not only do the banks not want new deposits, they are actively looking to offload existing bank deposits to bring their totals more in line with loan demand.

Optimal Time to Move Excess Bank Deposits to VIP

As the Fed moves rates at a faster-than-normal pace, local government investors are well positioned to take advantage of increasing rates, especially in high-quality short-term investment vehicles like money market funds and AAA-rated local government investment pools (such as the VIP Stable NAV Liquidity Pool). Given the short average maturity of pool investments, local government investment pool yields typically adjust rapidly and provide a current market rate, closely mirroring the effective Fed Funds Rate.



Source: FDIC, Federal Reserve Economic Data, and Public Trust Advisors, LLC

As holdings in a local government investment pool mature, fund managers will have the opportunity to reinvest the proceeds into higher-yielding securities thus providing investors with a more current (and higher) market rate. For example, daily yields for the VIP Stable NAV Liquidity Pool have increased over 25 bps since the last rate hike on May 4, a clear reason to consider moving funds now. Conversely, bank deposit interest rates are unlikely to move substantially until loan demand and deposit levels return to normal.

If you'd like to set up a meeting to analyze your current investment program or for more information on how to best navigate your investment portfolio in a rising rate environment, please click here to schedule a meeting with VIP!

**Source: Wall Street Journal. Many factors affect performance including changes in market conditions and interest rates and in response to other economic, political, or financial developments. Investment involves risk including the possible loss of principal. No assurance can be given that the performance objectives of a given strategy will be achieved. This is an example of a prior rising rate environment and may not be an accurate depiction of a future rising rate environment. Past performance is no guarantee of future results. Any financial and/or investment decision may incur losses. All comments and discussion presented are purely based on opinion and assumptions, not fact, and these assumptions may or may not be correct based on foreseen and unforeseen events.*

May 2022

Virginia Investment Pool
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The**ECONOMY**

Picking up the Pace

After raising the Federal Funds Target Rate by 0.25% in March, the Federal Reserve doubled down on policy action at the May Federal Open Market Committee (FOMC) meeting by increasing the target range by another 0.50%. The need to address inflationary pressures has certainly warranted the more aggressive action by the Fed and will likely be followed by additional rate hikes this year. During Chairman Powell's accompanying press conference, he indicated additional 0.50% moves at the next two FOMC meetings but notably commented that the committee is not actively considering a 0.75% rate hike, somewhat of a surprise given the huge run-up in inflation this year. Nonetheless, with the escalating degree and pace of tightening, market volatility will likely remain high as the FOMC may find it difficult to restrain inflationary pressures without tipping the economy into a recession.

Business activity continues to be limited by a tight labor market and higher input costs to which wages are certainly not immune. Payroll data released in early May showed that wages are growing at a pace of 5.5% on a year-over-year basis. Job openings are at a record high with just under two jobs available for every current candidate in the unemployed category. COVID-related production shutdowns in China and the war in Ukraine continue to add to existing supply chain woes but strong new order demand, high levels of order backlogs, and low customer inventory levels should be a tailwind for future production. Business sentiment remains positive given expectations of higher production costs being reasonably passed along to consumers but that could quickly change if consumers begin to pull back due to widespread inflationary pressure.

With mortgage rates above 5% for the first time since 2018, home purchases may be out of reach for some buyers, cooling the red-hot housing market. The National Association of Realtors announced that home prices increased in the U.S. by 15.7% over the last year as of the end of the first quarter. Demand is still outstripping supply by a wide margin and new inventory needs to come online before we expect any sort of downshift in prices.

Treasury Yields

MATURITY	5/9/22	4/8/22	CHANGE
3 Month	0.884%	0.878%	0.006%
6 Month	1.303%	1.139%	0.164%
1 -Year	1.891%	1.735%	0.156%
2 -Year	2.594%	2.512%	0.082%
3 -Year	2.812%	2.725%	0.087%
5 -Year	2.947%	2.754%	0.193%
10 -Year	3.034%	2.700%	0.334%
30 -Year	3.150%	2.718%	0.432%

Source: Bloomberg

Agency Yields

MATURITY	5/9/22	4/8/22	CHANGE
3 Month	1.202%	1.049%	0.153%
6 Month	1.474%	1.291%	0.183%
1 -Year	2.032%	1.821%	0.211%
2 -Year	2.673%	2.585%	0.088%
3 -Year	2.827%	2.726%	0.101%
5 -Year	3.040%	2.839%	0.201%

Source: Bloomberg

Commercial Paper Yields (A-1/P-1)

MATURITY	5/9/22	4/8/22	CHANGE
1 Month	0.870%	0.450%	0.420%
3 Month	1.350%	0.940%	0.410%
6 Month	1.940%	1.490%	0.450%
9 Month	2.350%	1.870%	0.480%

Source: Bloomberg

Current Economic Releases

DATA	PERIOD	VALUE
GDP QoQ	Q1 '22	-1.40%
US Unemployment	Apr '22	3.60%
ISM Manufacturing	Apr '22	55.40
PPI YoY	Apr '22	11.00%
CPI YoY	Apr '22	8.30%
Fed Funds Target	May 10, 2022	0.75% - 1.00%

Source: Bloomberg