Fixed Income
Strategy

The State of Front-end Fixed Income Markets for Public Entity Investors

September 2025
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Data as of September 5th, 2025, unless otherwise noted.

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Investor Trends | 2025

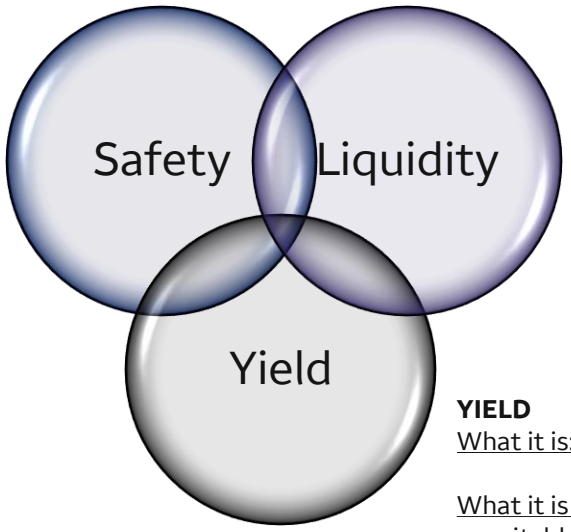
2 general paths

Wait and See	Opportunistic
1. Uncertainty driving a desire for *liquid* alternatives or preference for very short maturities.	1. Incrementally extending maturity. 2. Executing when rates back up beyond front-end (4% is the new 5%). 3. Credit quality preference is very high.

Despite rate or market environment, these are the investment objectives for cash managers:
safety AND liquidity first, followed by earning a **market appropriate yield or generating income** second.

SAFETY
What it is: Capital preservation or getting par back

What it is NOT: Avoidance of investing or overconcentration



LIQUIDITY
What it is: Access to cash

What it is NOT: A guarantee or static

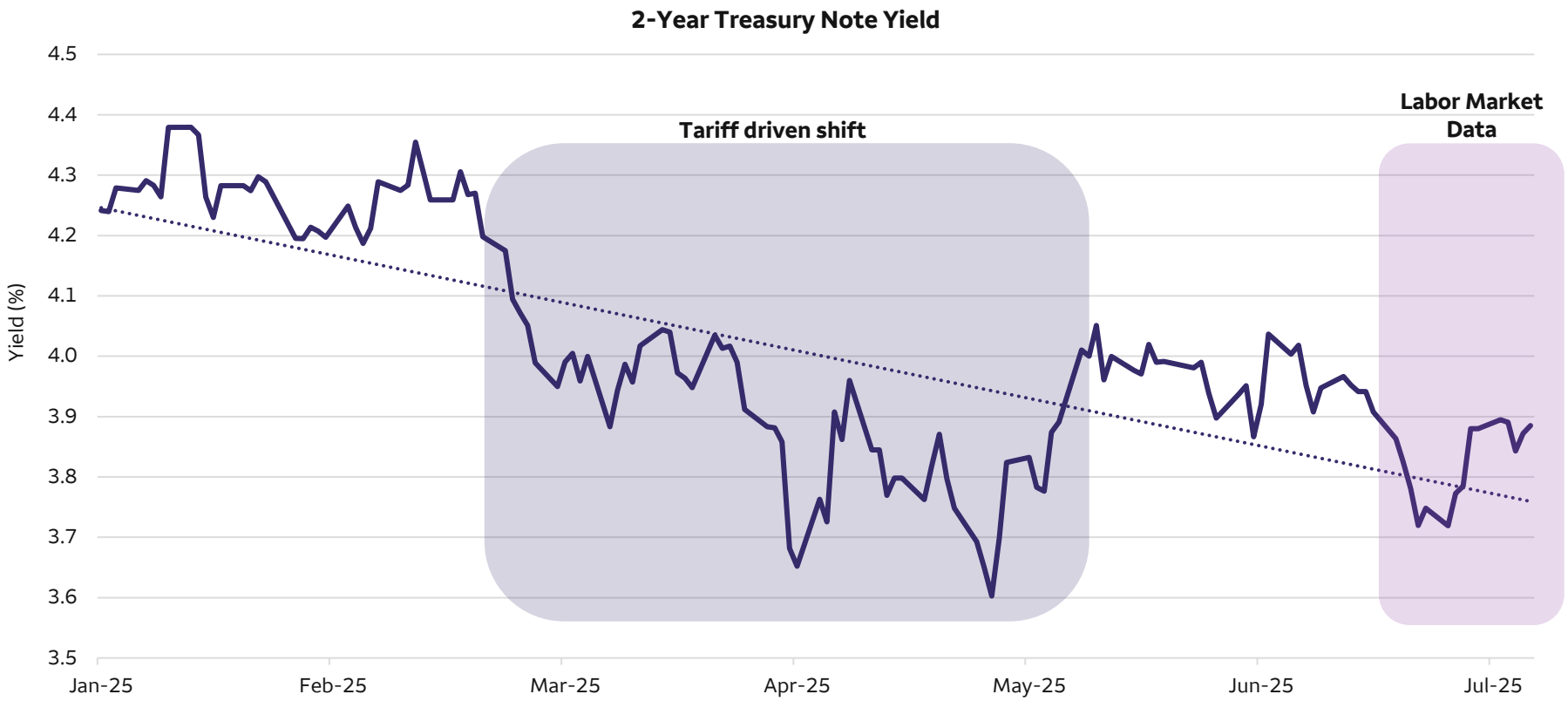
YIELD
What it is: income earned

What it is NOT: Automatic, inappropriate "risk" or an unsuitable alternative

Source: Wells Fargo Corporate & Investment Banking

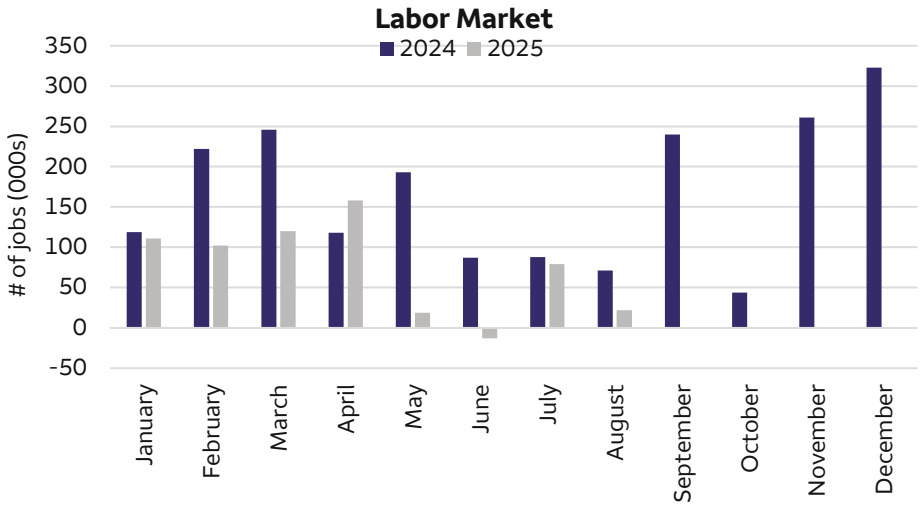
Headlines Dominate 1H 2025 | Data Dominates 2H 2025

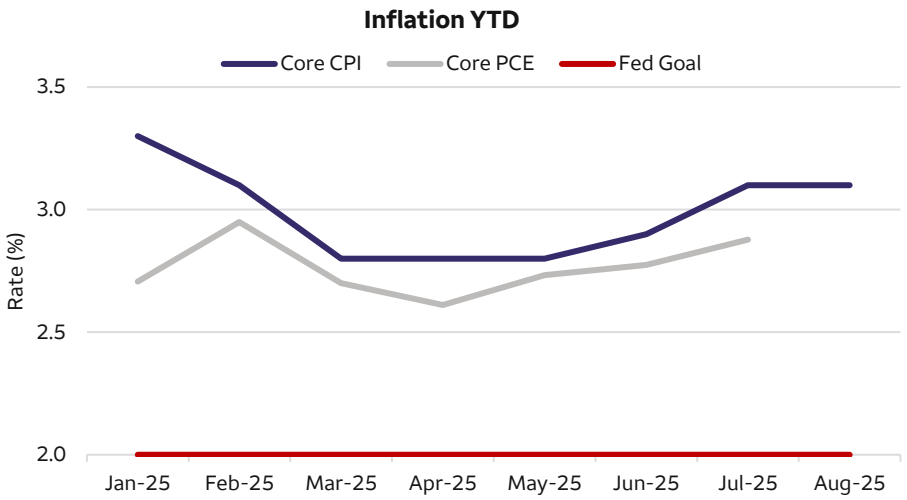
- Headlines seemed to drive market movements more than any economic data point for the 1H 2025.



Source: Wells Fargo Corporate & Investment Banking, Bloomberg

The Data Matters Again

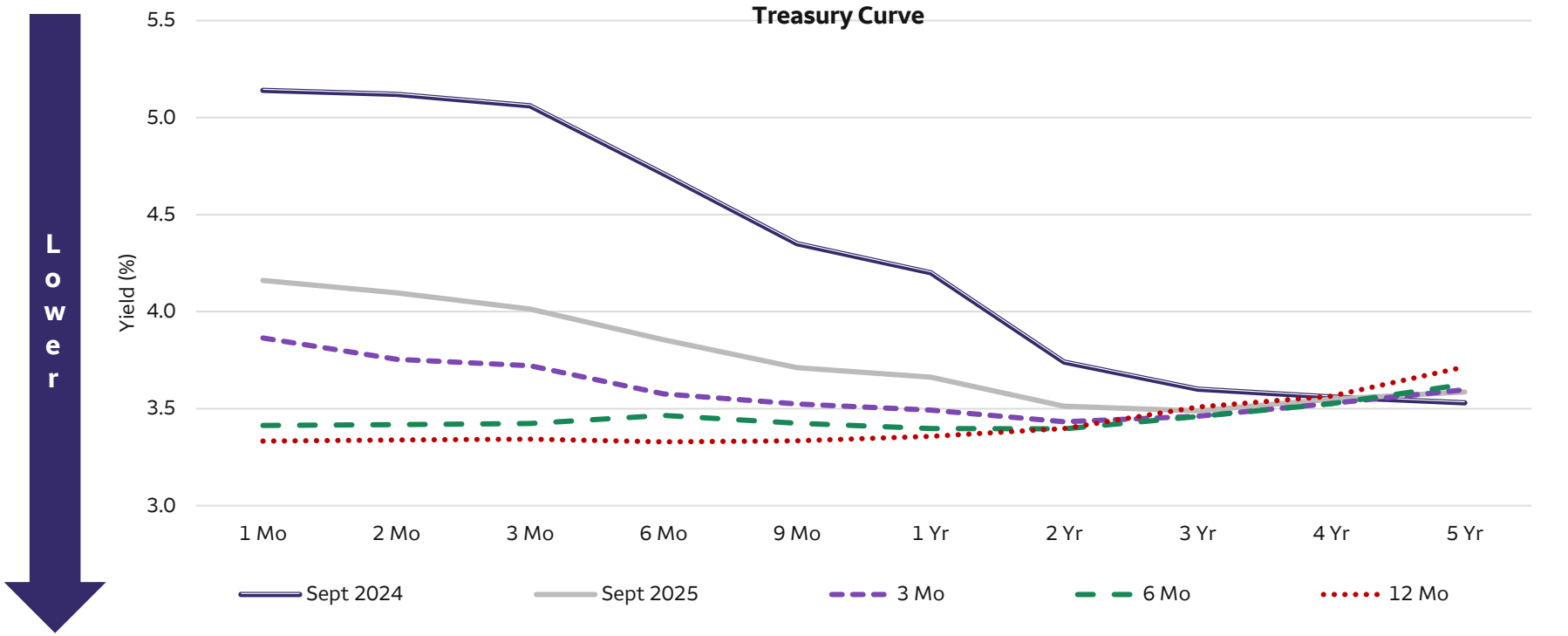




- The labor market continues to show signs of increased weakness, while the inflation picture is still uncertain…
- Given the deterioration in the labor market though, near-term federal funds rate cuts are possible.

Source: Wells Fargo Corporate & Investment Banking, Bloomberg

One Path for Front-end Rates...



Drivers of front-end of curve (O/N to 1Y)

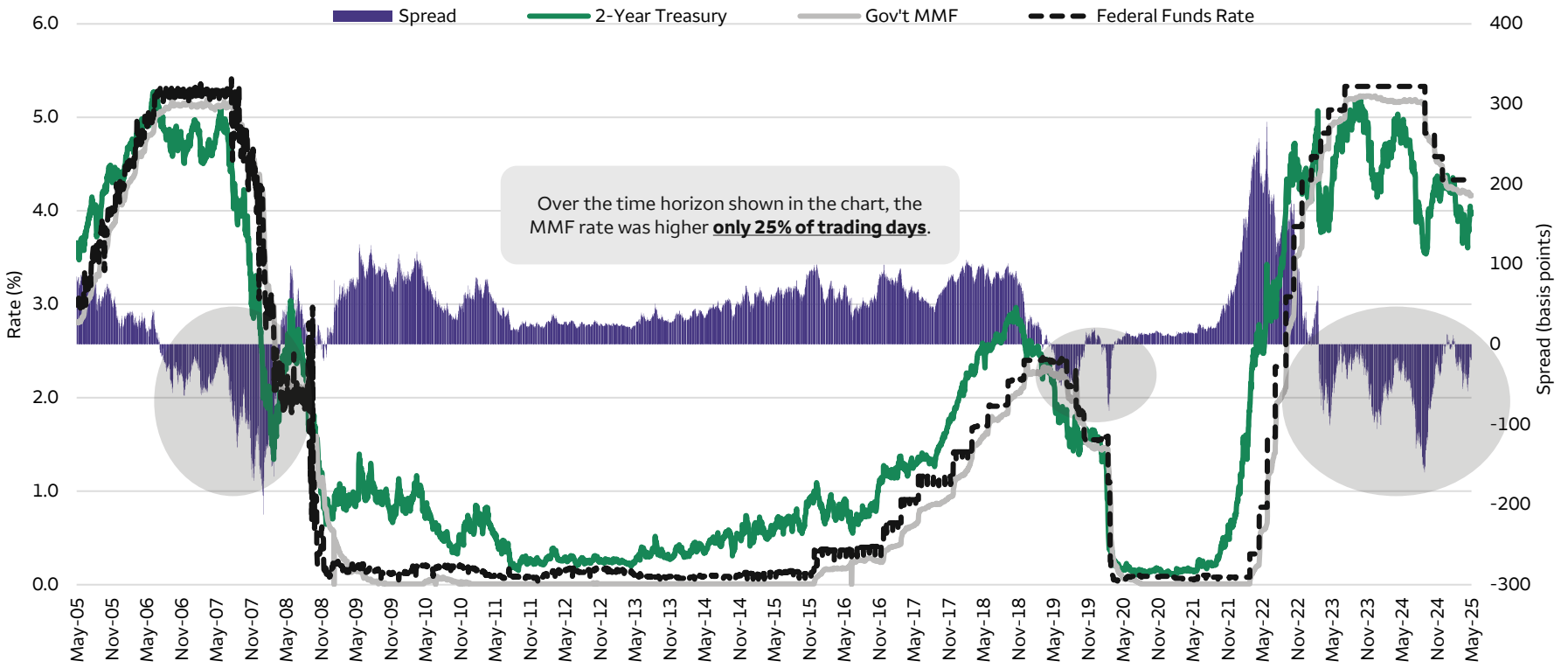
- **Executed** Fed policy
- Short-term technical factors: liquidity, supply/demand, risk sentiment (shocks)
- Inflation

Drivers of belly of curve (1Y-5Y)

- **Expected** Fed policy
- Technical factors: supply/demand, risk sentiment (shocks), term premium
- Economic outlook, inflation, headlines

Source: Wells Fargo Corporate & Investment Banking, Bloomberg

History Lesson



An overallocation to cash alternatives, like funds, is **short-sighted**. History has taught us that this sort of view will leave an organization ***short-changed***.

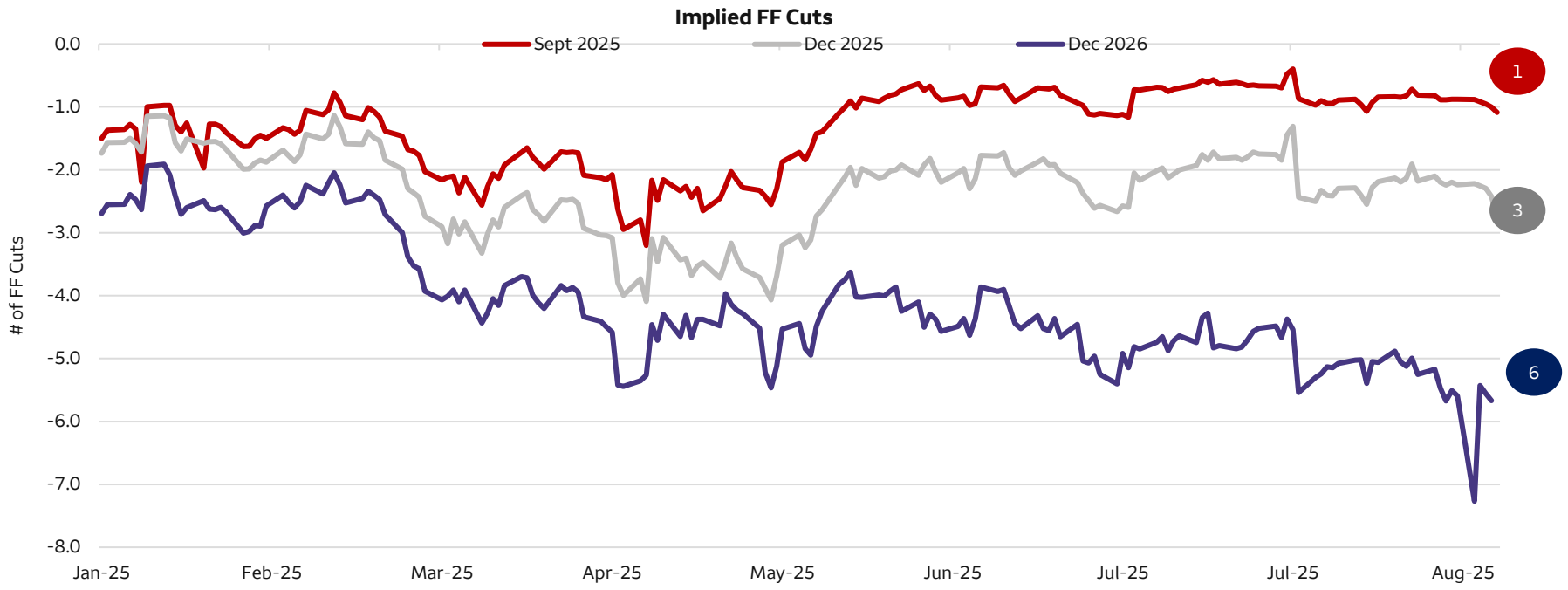
Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Fed Thoughts | 2025 YTD

Committee Member	January	April	August
Chairman Jerome Powell	"We **do not need to be in a hurry** to adjust our policy stance."	"While **uncertainty remains elevated,** it is now becoming clear that the tariff increases will be significantly larger than expected. The same is likely to be true of the economic effects, which will include **higher inflation and slower growth."**	"The stability of the unemployment rate and other labor market measures allows us to proceed carefully as we consider changes to our policy stance. Nonetheless, with policy in restrictive territory, the baseline outlook and **the shifting balance of risks may warrant adjusting our policy stance."**
Governor Christopher Waller	"As always, the extent of further easing will depend on what the data tell us about progress toward 2% inflation, but my bottom-line message is that **I believe more cuts will be appropriate**."	"Despite the fact that the last surge of inflation beginning in 2021 lasted longer than I and other policymakers initially expected, **my best judgment is that higher inflation from tariffs will be temporary**. If this inflation is temporary, I can look through it and determine policy based on the underlying trend."	"With underlying inflation close to 2%, market-based measures of longer-term inflation expectations firmly anchored, and the chances of an undesirable weakening in the labor market increased, proper risk management means **the FOMC should be cutting the policy rate now."**
New York Federal Reserve Bank President John Williams	"The process of disinflation remains in train. But we are still **not at our 2% goal**, and **it will take more time until we can achieve that on a sustained basis."**	"While uncertainty about the economic outlook reflects many factors, **the effects of tariffs and trade policy on the economy** are certainly at the top of the list."	"I definitely think that **every meeting is**, from my perspective, **live**."

Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Rates Outlook | FF Cuts to (Finally) Resume



- The optimism coming into 2025 that caused little change in expectations for the Fed to resume active cuts, faded quickly.
- Expectations for further cuts to the Fed's policy rate have been volatile throughout 2025.

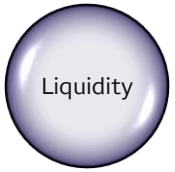
Source: Wells Fargo Corporate & Investment Banking, Bloomberg, Wells Fargo Economics

Asset Class Decisions to Accomplish Safety

	Liquid Bucket	Not Liquid Bucket (Core or Strategic)
Attributes	• Specific liquidity need • Short-term • Readily available • Low volatility	• Either non-specific liquidity need or longer horizon specific liquidity need • Longer-term • Not needed to be readily available but preferred to have ongoing access, if required. • Can take on more volatility
Asset Classes (examples per OR state code)	• Bank demand deposits • Government funds (MMF or LGIP) • Short government instruments	• Government instruments • Credit instruments

Source: Wells Fargo Corporate & Investment Banking

Investment Strategies that Enhance Liquidity



There is more than one way to satisfy AND enhance liquidity.

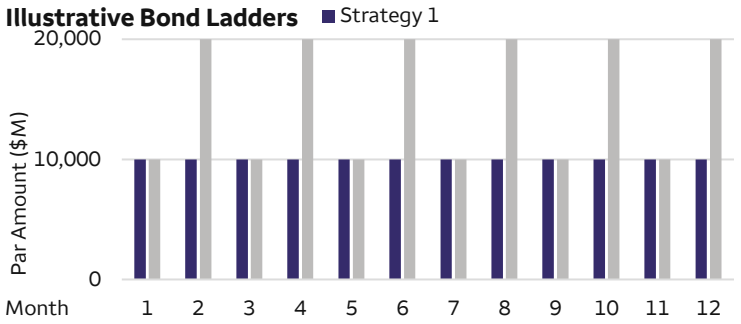
1. Diversify across overnight vehicles

- Specific products include bank demand deposits, other deposit products, and government MMFs.

Product	Same Day Liquid?	Credit Risk
Demand bank deposit	Yes – until end of day	Uninsured deposits subject to **underlying credit of financial institution.**
Government MMFs	Yes –most cutoffs are at 1:30PM PST	Investor owns **pro-rata share of underlying government instruments** (Treasuries, Agencies/GSEs, SSAs)

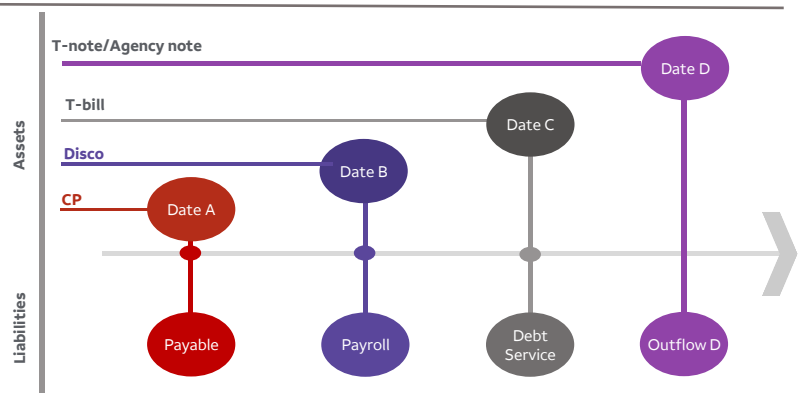
2. Implement and/or maintain a security bond ladder.

- Bond ladders can be set up with short and regular maturities to provide ongoing liquidity.
- While government products are typically used for bond ladders, diversifying among government issuers is important. An investor can use Treasuries, Agencies/GSEs and a SSAs interchangeably, depending on structure (Tbills/Discount Notes)
- Likewise, commercial paper can be incorporated into a bond ladder in a similar manner as Tbills and discount notes (all are discount instruments with a defined maturity that pays par).



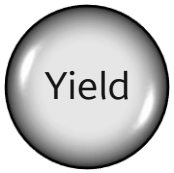
3. Use security maturities to match known expected future outflows.

- The final maturity of high-quality bullet fixed income securities can be used to pay future known cash outflows, which creates liquidity for liabilities.
- Public sector organizations have intermittent/large known cash outflows which is an ideal fit for a matching strategy.



Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Don't Forget About Yield... it is an Investment Goal



Rates/yield matters because income can be generated, and stability of income provides clarity to the budgeting process.

1) For public services
2) For additional Treasury resources (e.g., staff/personnel, technology, office equipment, etc.)
3) For support of general operations
4) For gaps in tax receipts (help stabilize periods where cash inflows are lower than expected)
5) For other miscellaneous outflows….

Contingent on the amount of cash invested

- Annual income generation matters to public organizations.
- The amount of interest income generated depends on the **amount** of cash invested, the **maturity** of the cash invested, and the **asset classes** used for investment.

Income Analysis (assumes annual coupon income)

	$1MM	$5MM	$10MM	$20MM
2.5%	25,000	125,000	250,000	500,000
3.0%	30,000	150,000	300,000	600,000
3.5%	35,000	175,000	350,000	700,000
4.0%	40,000	200,000	400,000	800,000

Assumes rate remains unchanged over an annual period.

There are a few levers that conservative buy-and-hold investors generally use to add yield (income) to a portfolio:

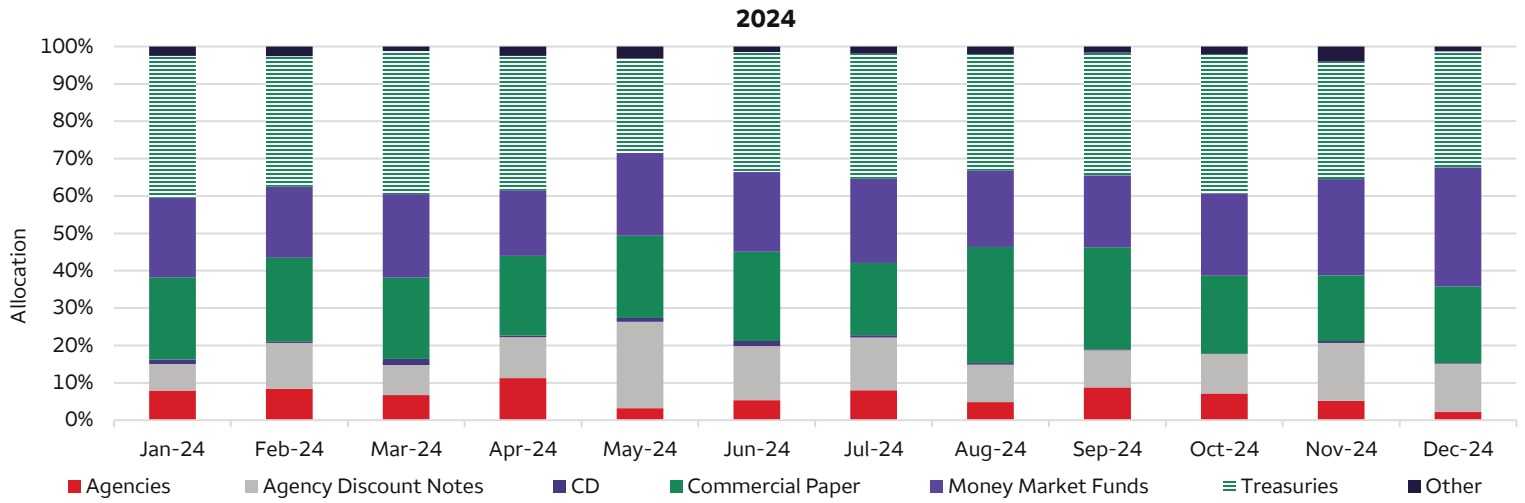
1) Asset class
2) Security structure
3) Credit quality
4) Extend maturity

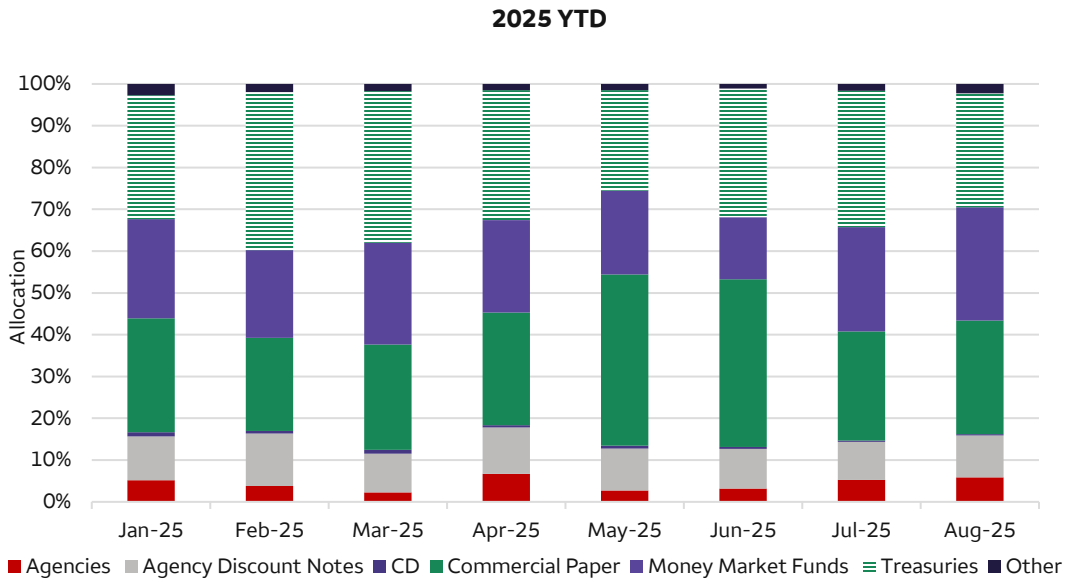
Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Fixed Income Strategy

Peer Investment Trends

Public Entity Investor Peer Trends | Investment Purchases



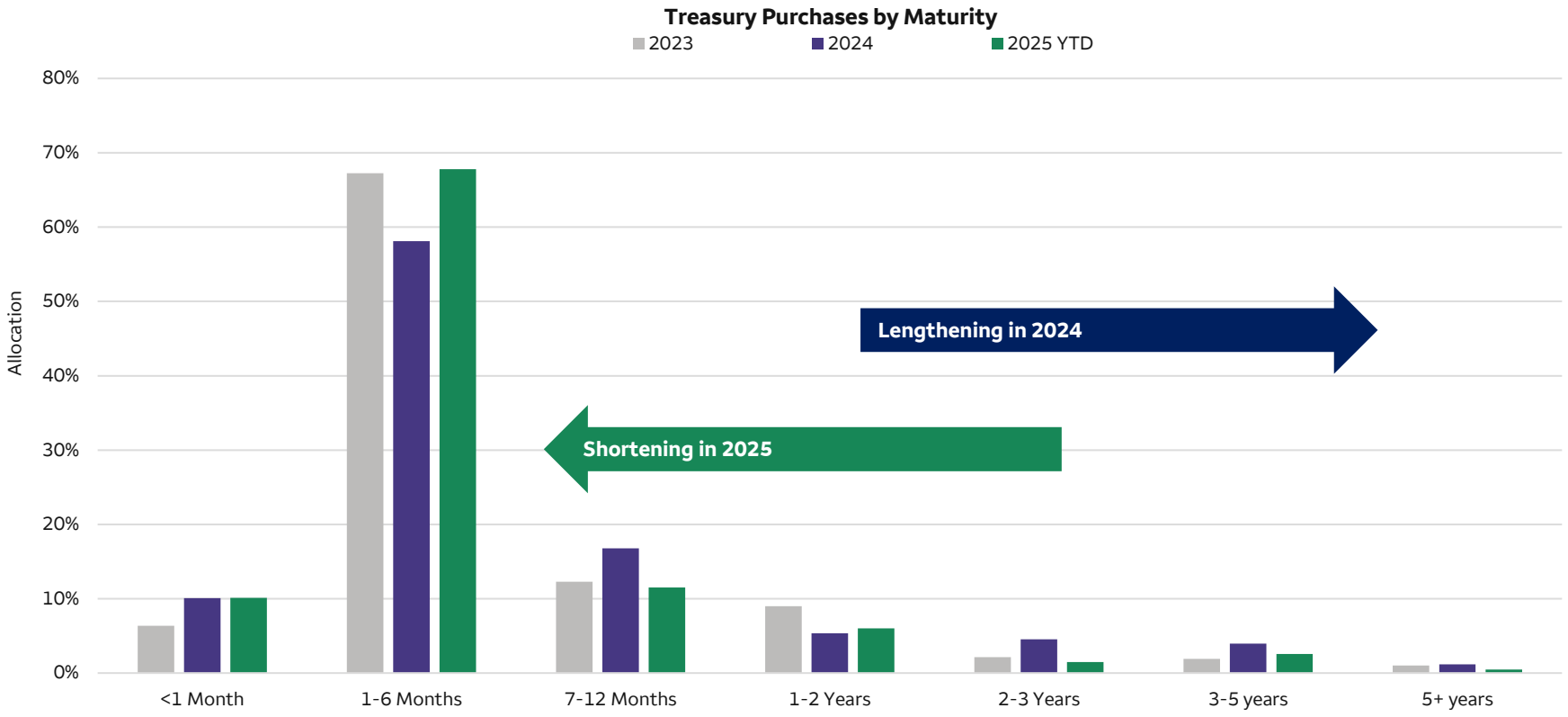


- There are 4 products that dominate public entity investment purchases: MMFs (government), Treasuries, Agencies and Commercial paper.

Source: Wells Fargo Corporate & Investment Banking

Public Entity Investor Peer Trends | Investment Purchases

Treasuries



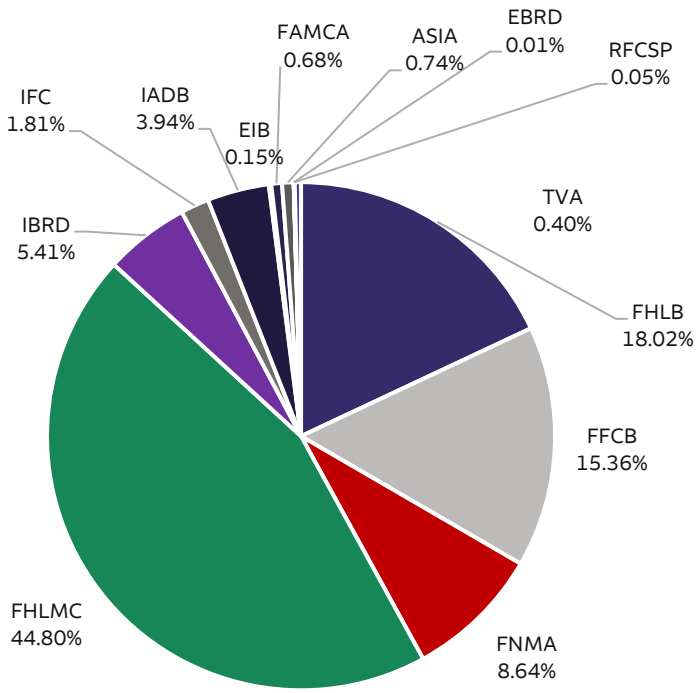
- A trend that stands out with Treasury purchases over the past couple of years is that lengthening was more evident in 2024 but shortening YTD in 2025.

Source: Wells Fargo Corporate & Investment Banking

Public Entity Investor Peer Trends | Investment Purchases

Agencies/SSAs

2025 Debenture Purchases

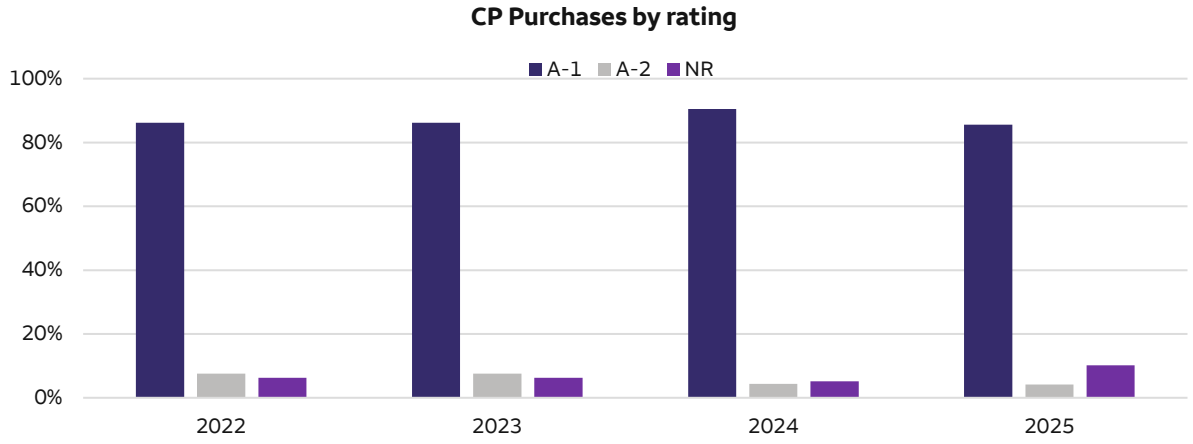


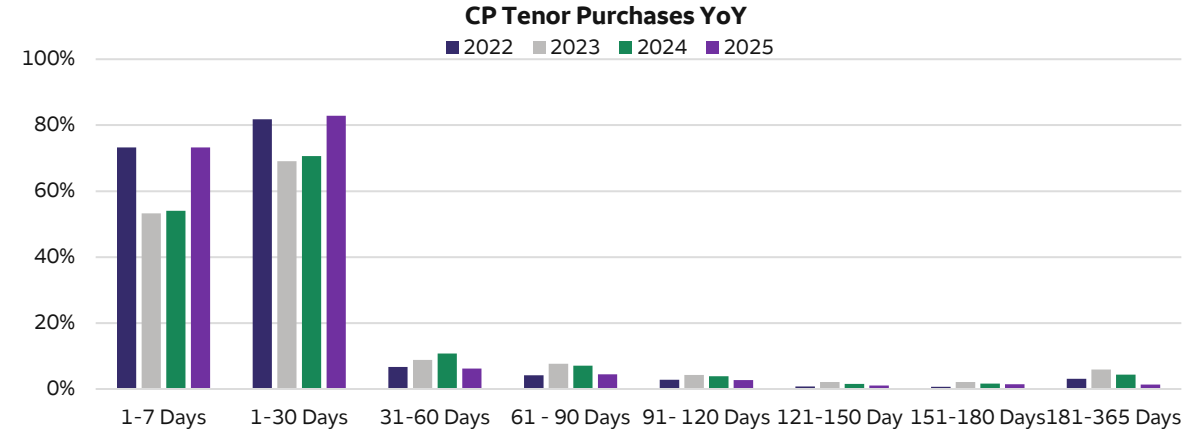
- Though FHLB dominates overall issuance in fixed income markets across the Agency/GSE space, our public entity investors are diversifying name exposure.
- Investors use SSAs as a substitute or enhancement for government exposure; especially investors that are heavily invested in government instruments.

Source: Wells Fargo Corporate & Investment Banking

Public Entity Investor Peer Trends | Investment Purchases

Commercial Paper





- Commercial paper is a prevalent asset class used by public entities though most investors are restricted by law to tier-1.
- Though most CP purchases by public entities are short – this dynamic does reflect the CP supply environment.
- Though CP is a "credit" instrument, public entity investors use CP to satisfy investment goals of safety, liquidity and yield.

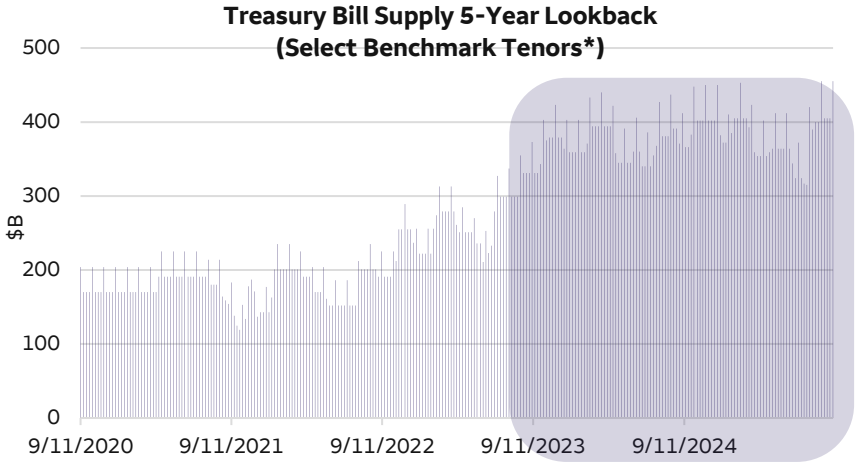
Source: Wells Fargo Corporate & Investment Banking

Fixed Income Strategy

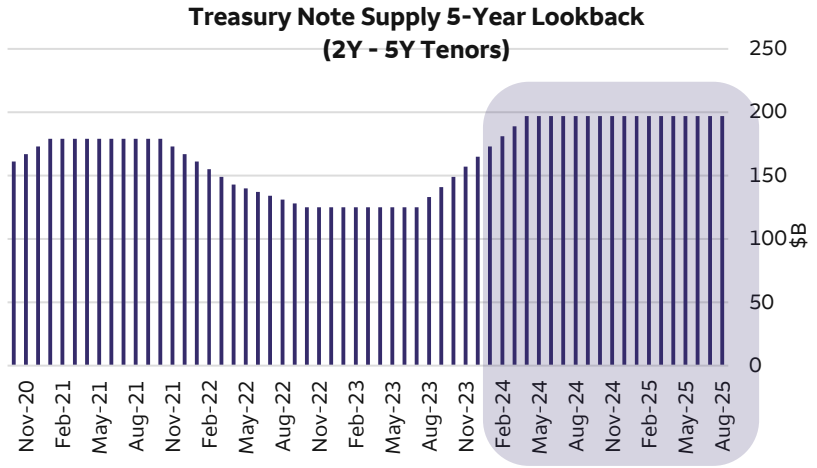
Current Market Dynamics

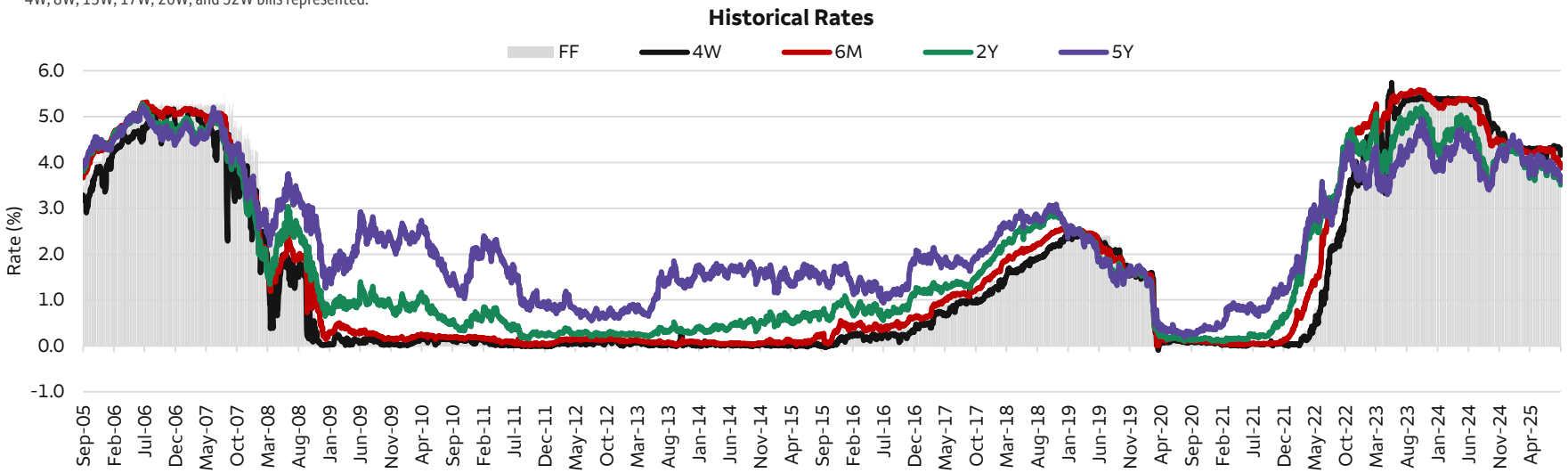
Treasuries | Current Market Dynamics

Supply is elevated, rates remain historically high and the stripping of the U.S. government's only AAA rating was a nonevent.



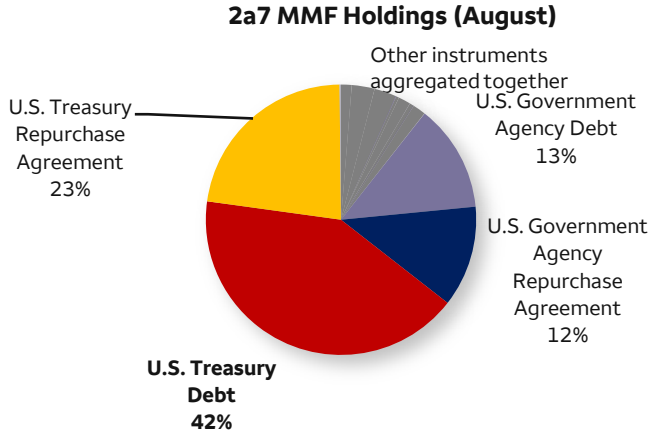
*4W, 8W, 13W, 17W, 26W, and 52W bills represented.

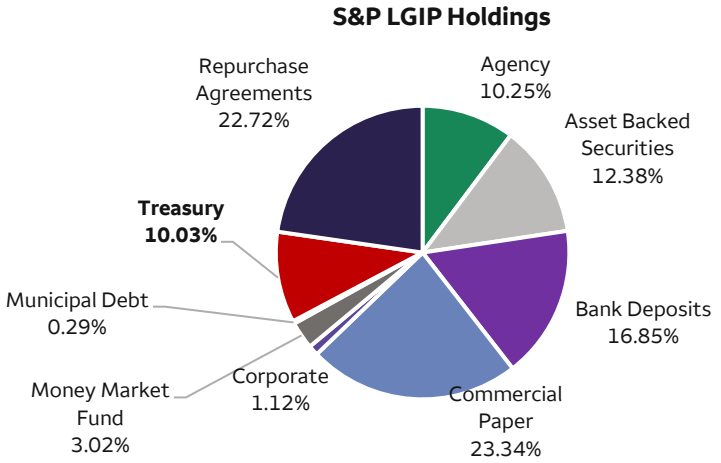




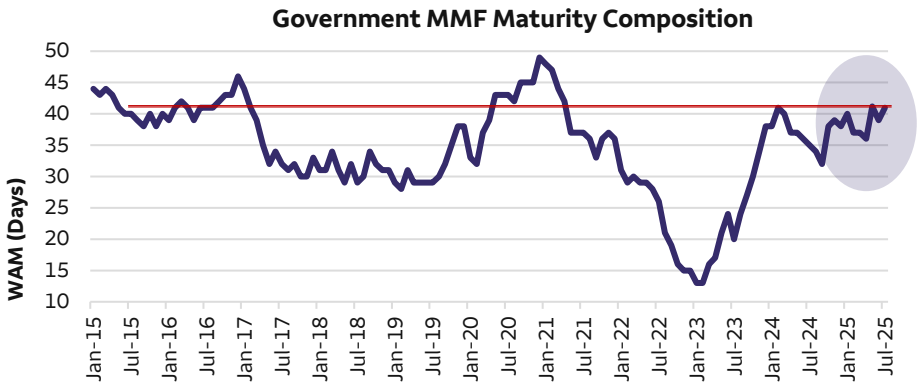
Source: Wells Fargo Corporate & Investment Banking, Bloomberg

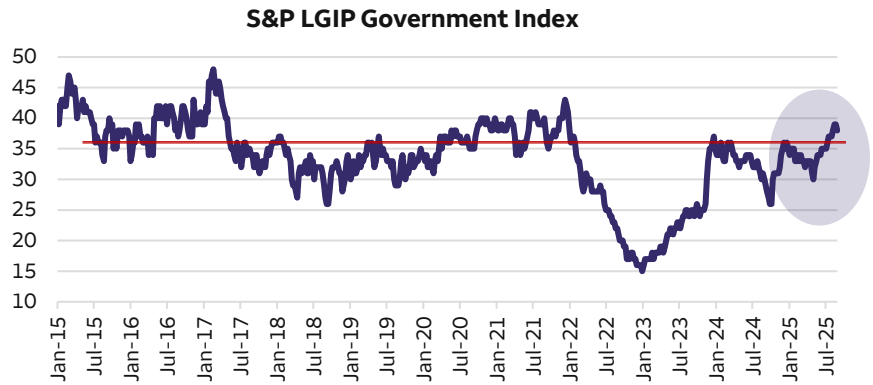
Treasuries | Current Market Dynamics





Rates are far from zero yet fund portfolio maturities are nearly as long as they were during prior ZIRP periods. This speaks volumes about the investment strategy for these funds that are using the same instruments public entities are *generally* allowed to buy.





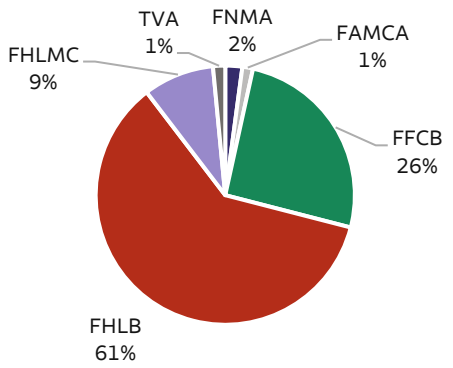
Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Agencies

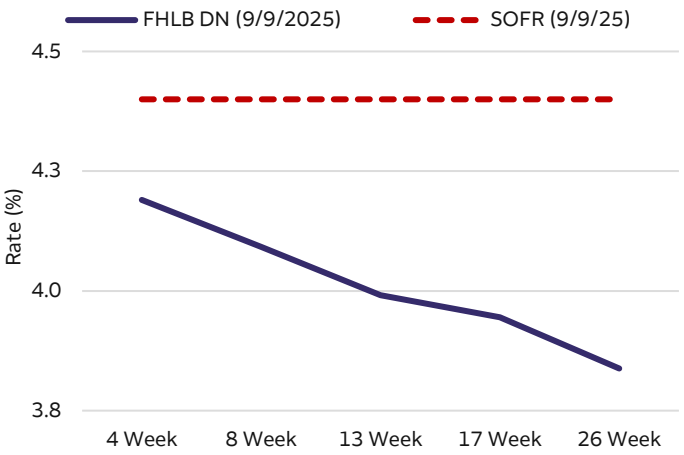
Entity Name
Federal National Mortgage Association
Federal Home Loan Mortgage Corporation
Ginnie Mae
Federal Home Loan Bank
Tennessee Valley Authority
Farmer Mac
Federal Farm Credit Banks
Private Export Funding Corporation
The U.S. International Development Finance Corporation
Small Business Administration

ALL were created by a U.S. legislative action to fulfill a specific mandate to support and provide liquidity for specific parts of the U.S. economy.

Agency/GSE LT Issuance by Issuer YTD



FHLB DN Curve Versus SOFR

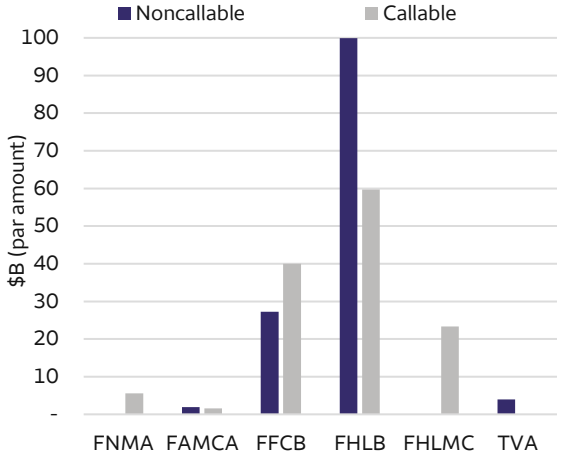


Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Recently, there has been a notable pullback in SOFR FRN issuance from FHLB, which is driven by two concurrent dynamics:

1. Investor demand for term instruments to lock in yield ahead of the next FF cut.
2. Cheaper funding for FHLB, comparatively.

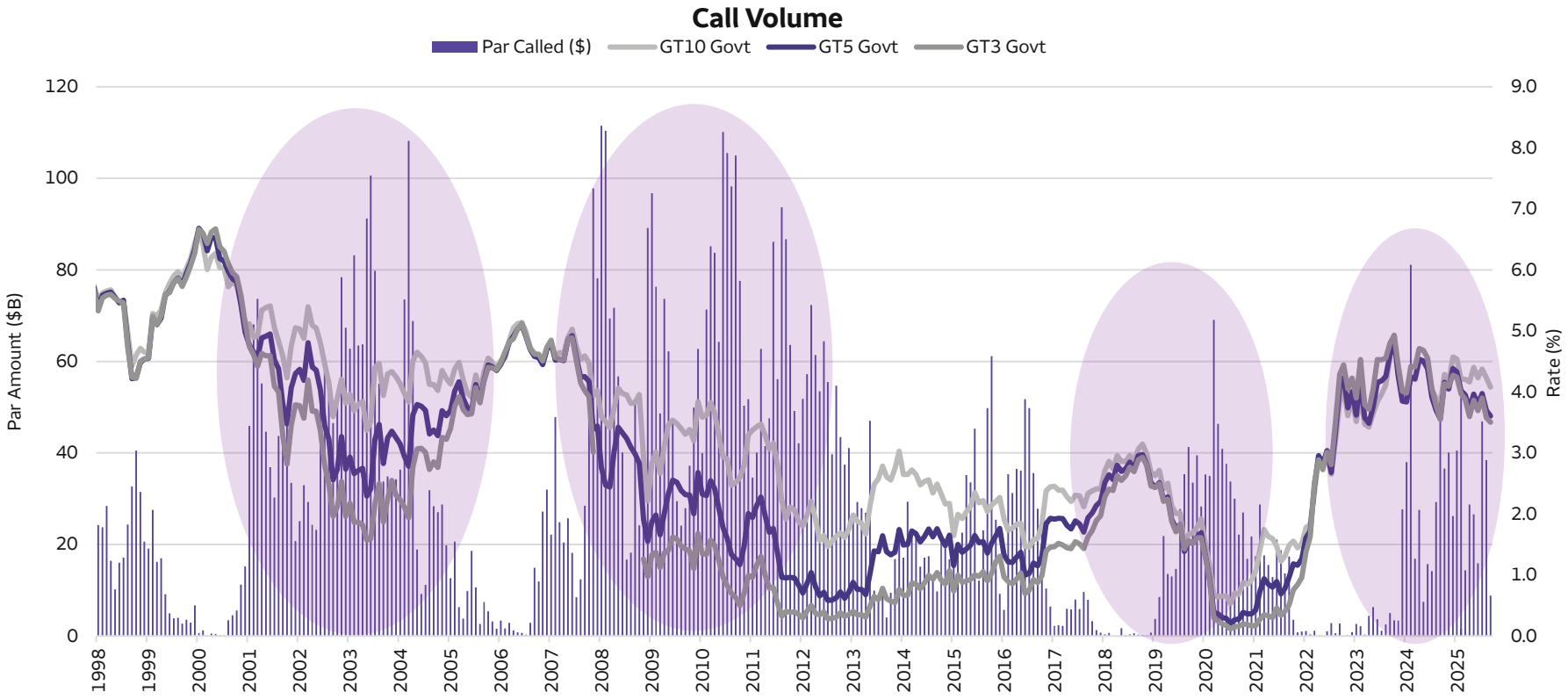
2025 YTD Issuance



Elephant in the Room | Exercised Calls when Rates Fall

- Call redemptions are rate driven, with activity picking up during periods when rates are falling, as highlighted by the purple circles in the chart below.

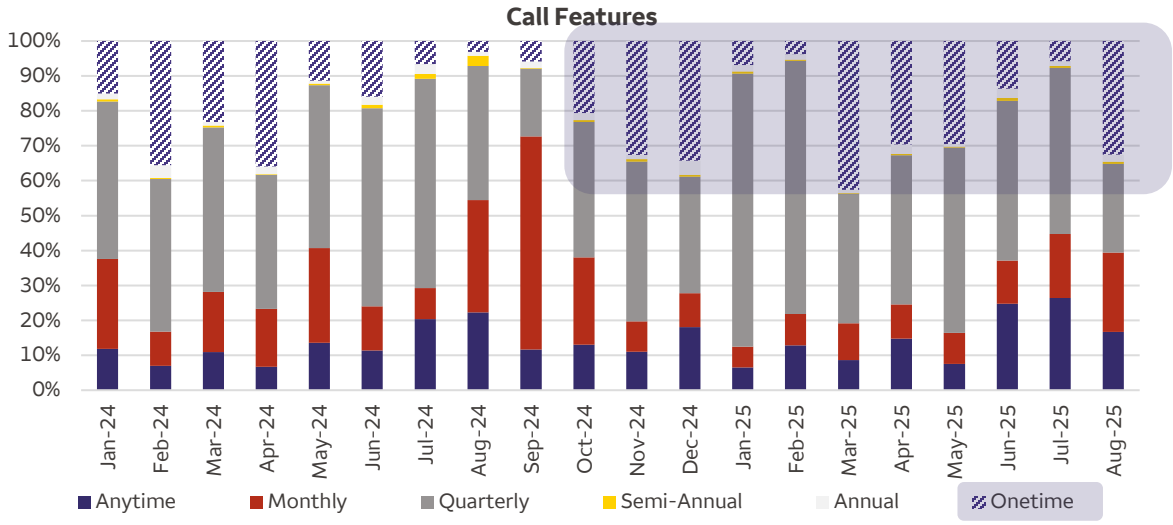
Periods where rates fall and call redemptions pick up



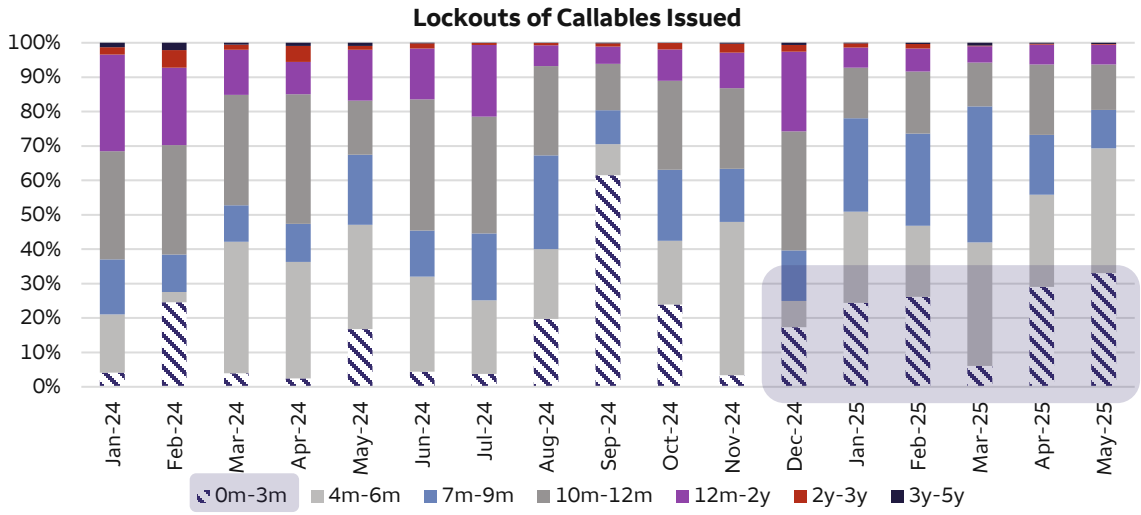
Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Call Protection

- The rate environment has evolved to such that investors are seeking more call protection.



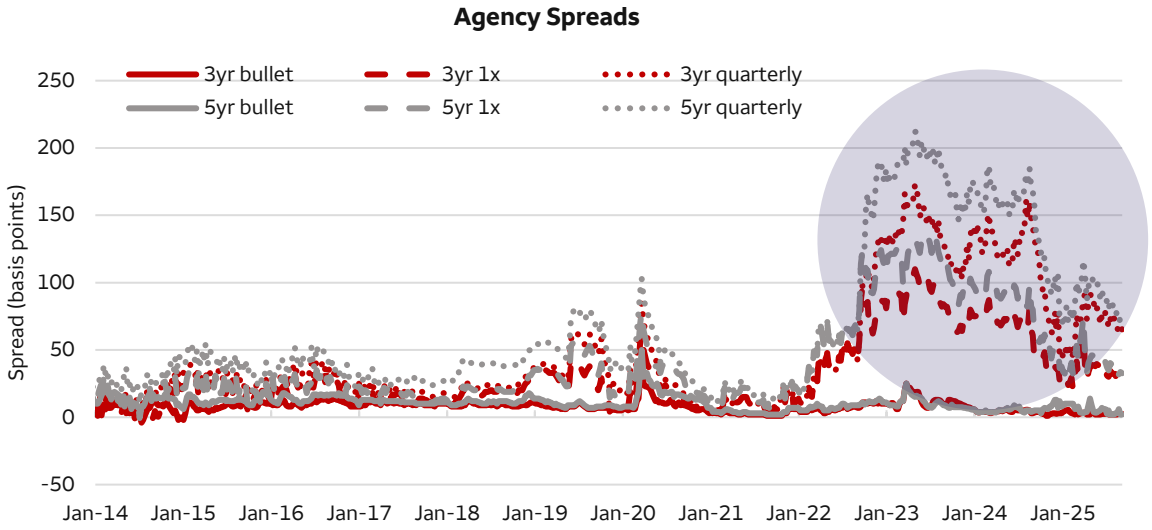
- Interestingly, lockouts have recently shortened during periods when expectations for additional near-term federal funds rate cuts pick up, as the market already prices these cuts in.



Source: Wells Fargo Corporate & Investment Banking, Bloomberg

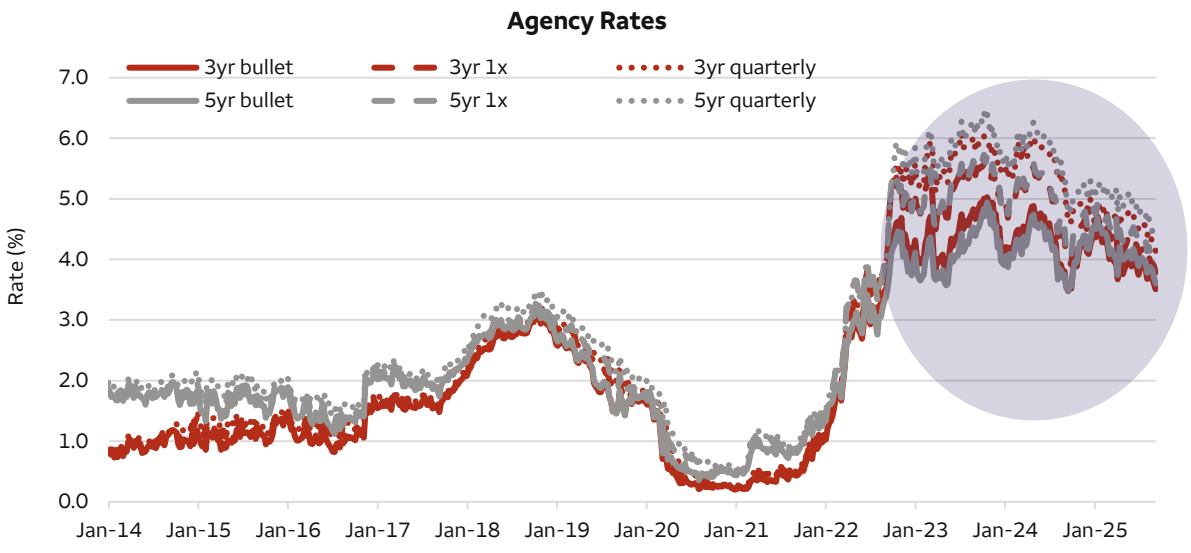
Is the Call Risk Worth it?

- Callable spreads have tightened but are still wide on a historical basis.
- Volatility is the biggest driver for wider callable spreads and has begun to moderate recently.
- Expected easing is also a factor driving wider spreads, as investors must be compensated for taking on the added call risk into a lower rate environment.



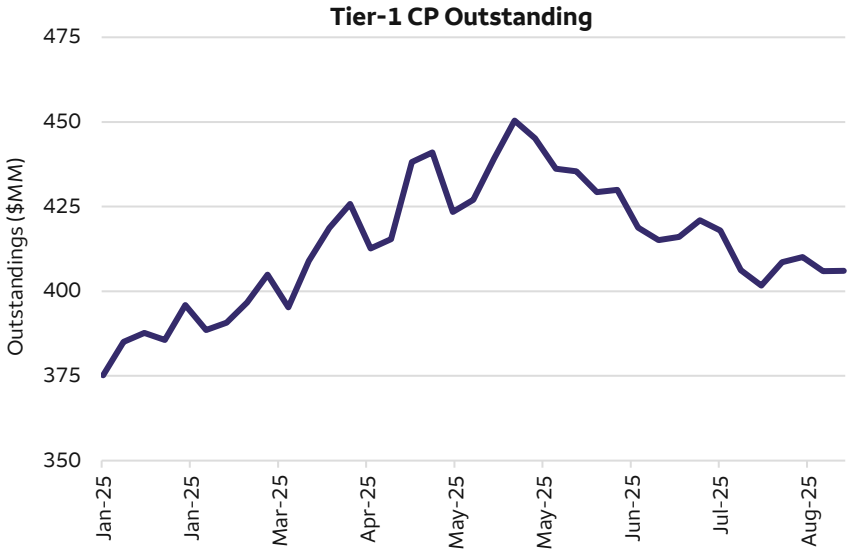
There is no one size fits all…

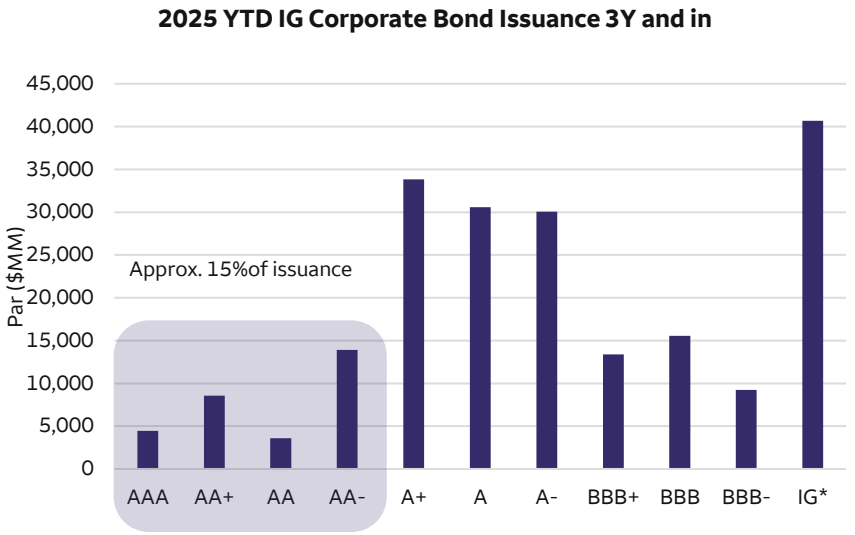
1) Quarterly lockouts offer the most value, however they are most subject to reinvestment risk in a declining rate environment
2) Longer lockouts, for example one-year, are also attractive and offer longer call protection.



Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Corporates





*Bond with no S&P rating, but IG ratings for either Moody's and/or Fitch.

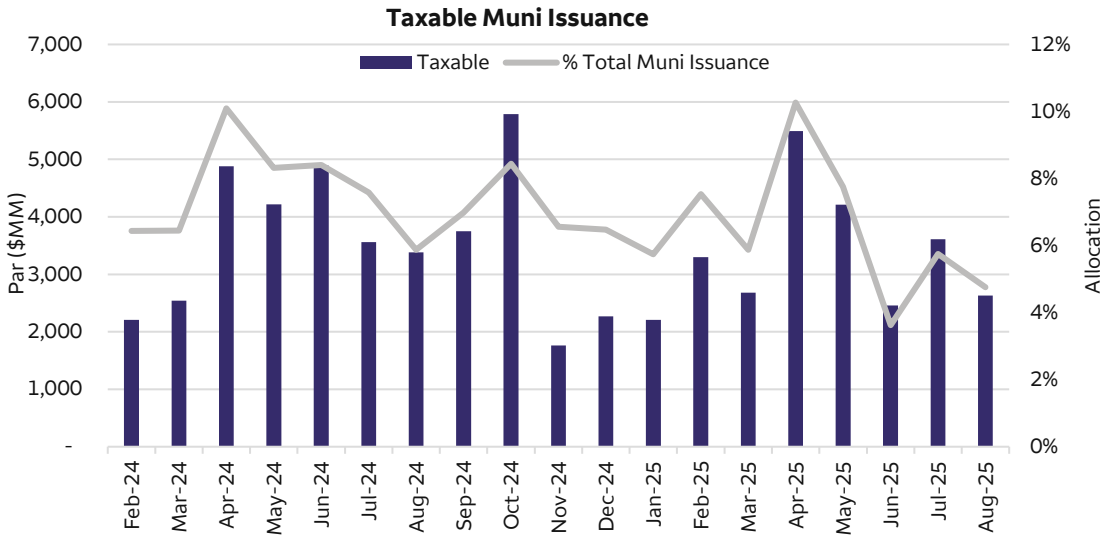
Moody's Investors Service	
P-1	Issuer has superior ability to repay short-term debt obligations.
Aa	High quality and subject to very low credit risk.

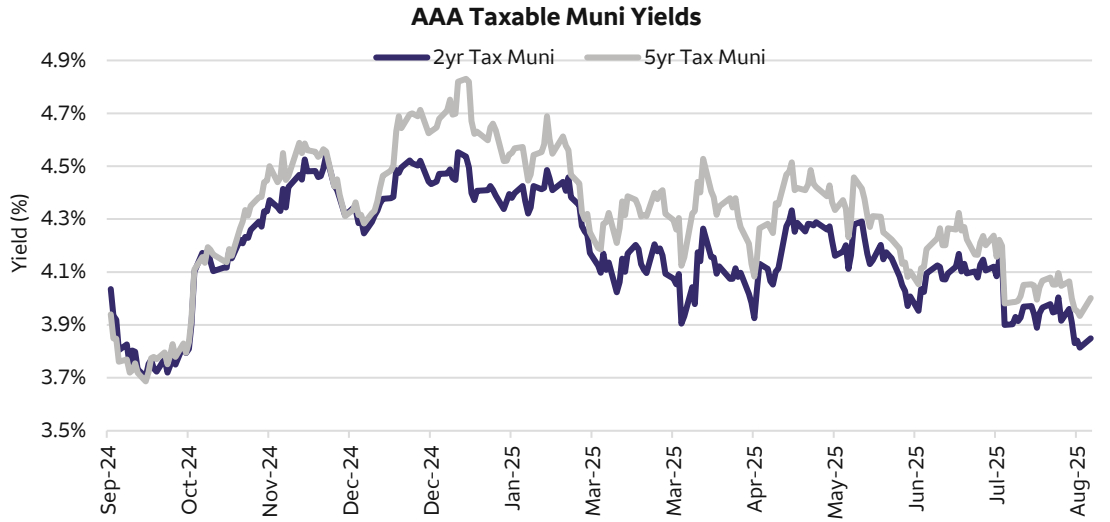
Standard & Poors	
A-1	Capacity to meet financial commitment on the obligation is strong.
AA	. The obligor's capacity to meet its financial commitments on the obligation is extremely strong.

Fitch Ratings	
F1	Strongest capacity for timely payment of financial commitments.
AA	Very strong capacity for payment of financial commitments.

Source: Wells Fargo Corporate & Investment Banking, Bloomberg, Moody's, Standard & Poors, Fitch

Taxable Municipals





- Taxable muni issuance has averaged around 7% of total muni issuance over the last year.
- Around 27% of taxable issuance is State Housing Finance Authority bonds backed by single-family mortgages.
- Much of the volume has come from large issuers (e.g. NYC, States of IL, CA, WA, etc).
- Issuance occurs when the use of proceeds is not eligible for tax-exemption (housing, stadiums, pensions, commercial projects, etc.).

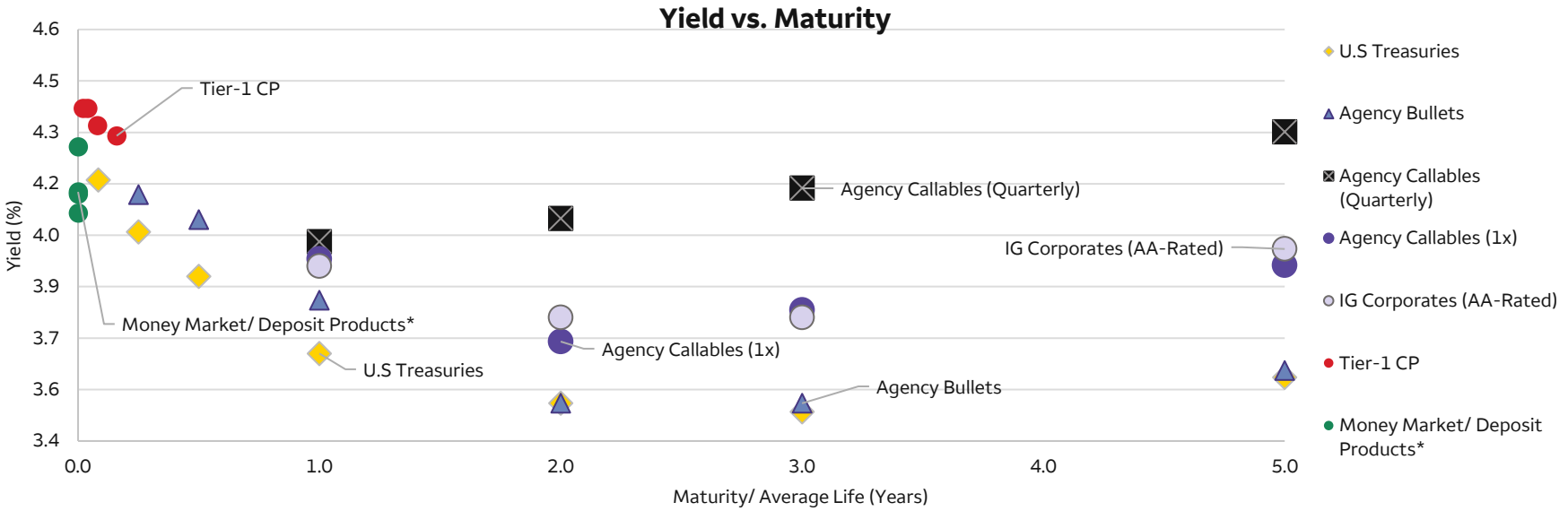
Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Takeaways

- Federal funds rate cuts are resuming. The Fed has been on “pause” for 9-months but the deterioration in the labor market is making it increasingly difficult for the Fed to not respond.

- Despite the decline in rates that has transpired over the past 12-months (and will continue on the front-end), rates are still attractive and opportunities abundant for public entity investors whose priorities for cash are safety, liquidity and yield.

- Although there are periods where one investment goal is more heightened (as an example, the focus on liquidity during the uncertainty during 1H 2025), the other goals do not disappear. Therefore, there is an argument that public entity investors cannot satisfy goals for cash not being immediately deployed for public services, without an allocation to fixed income markets.
  - Our peer data indicates that public entities are utilizing a variety of asset classes in fixed income markets today.



Source: Wells Fargo Corporate & Investment Banking, Bloomberg

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Thank You

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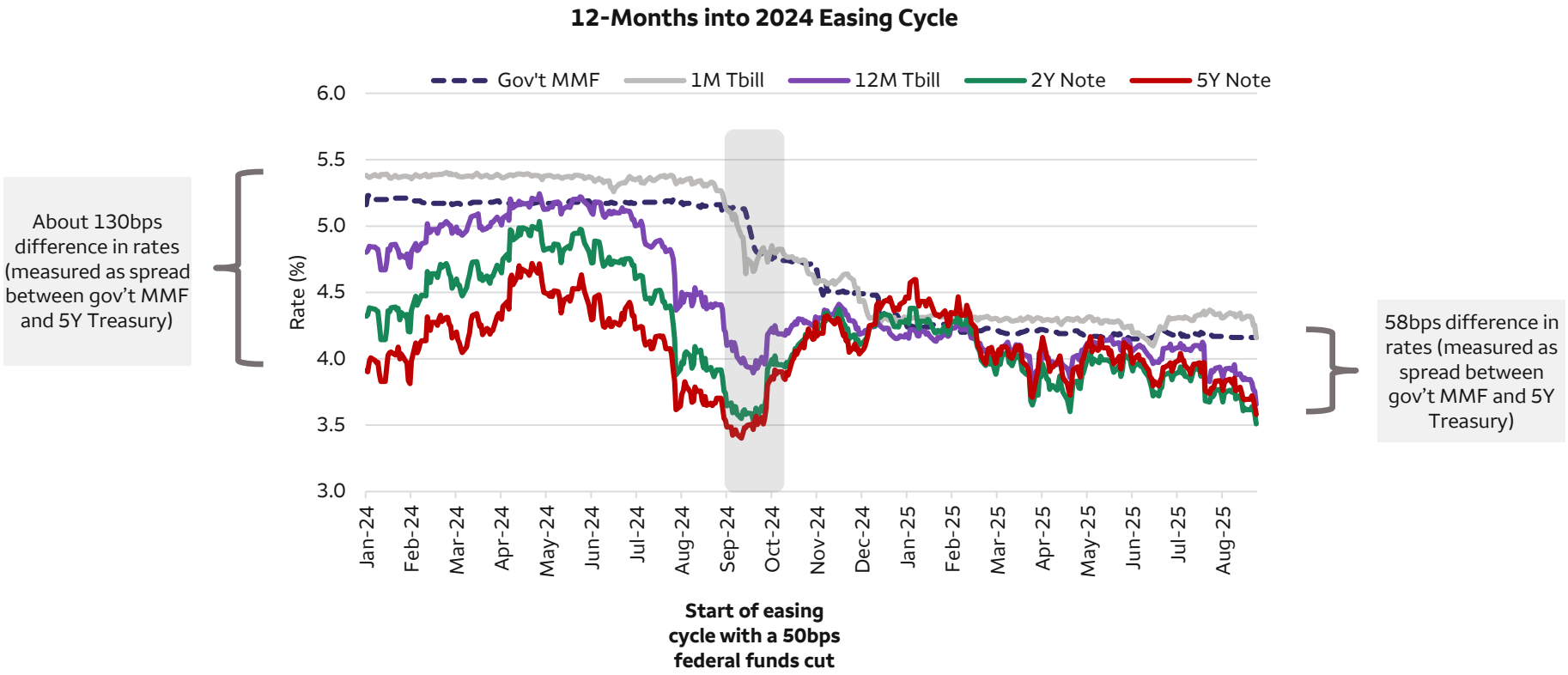
Appendix

Evolution of Value

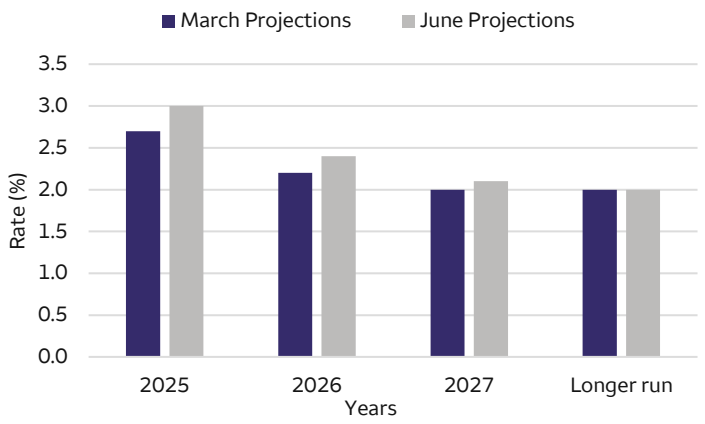


- The best "value" across the bullet government curve, was for a long period of time, at the very front-end.
- Since the Fed began its easing cycle however, this dynamic continues to shift, depending on an investor's horizon.

Source: Wells Fargo Corporate & Investment Banking, Bloomberg

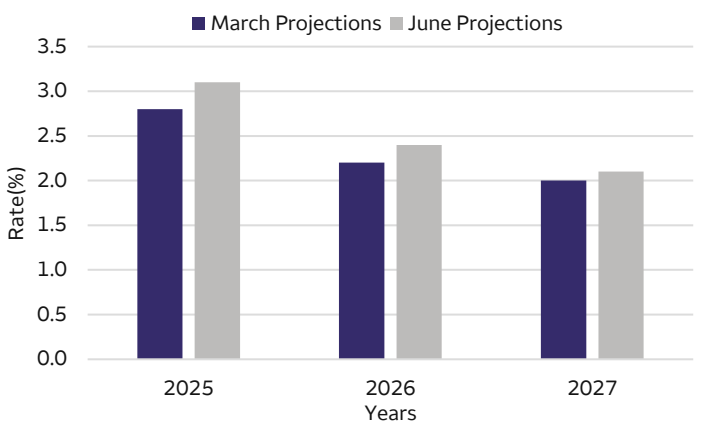
FOMC Summary of Economic Projections

Headline PCE

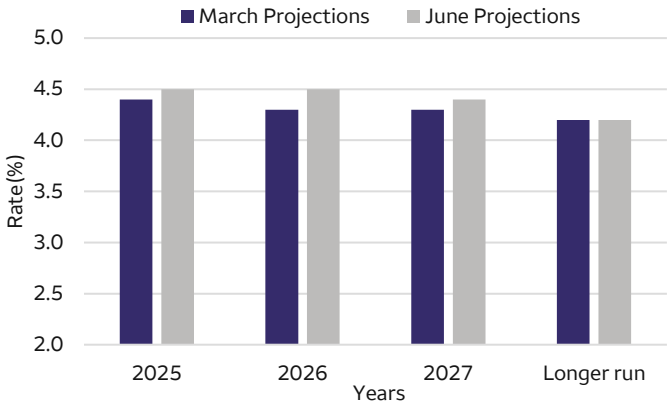


The FOMC's latest Summary of Economic Projections (SEP) highlight the Committee expects to meet its 2.0% inflation goal, though not until after 2027.

Core PCE



Unemployment Rate



Further, the FOMC forecasts that the 2025 year-end unemployment rate will be 4.5%, an incremental increase from the March SEP projection of 4.4%. Although not shown on this slide, the Committee also expects that GDP growth will slow, rising by 1.4% 2025, lower than the March SEP expectation at 1.7%.

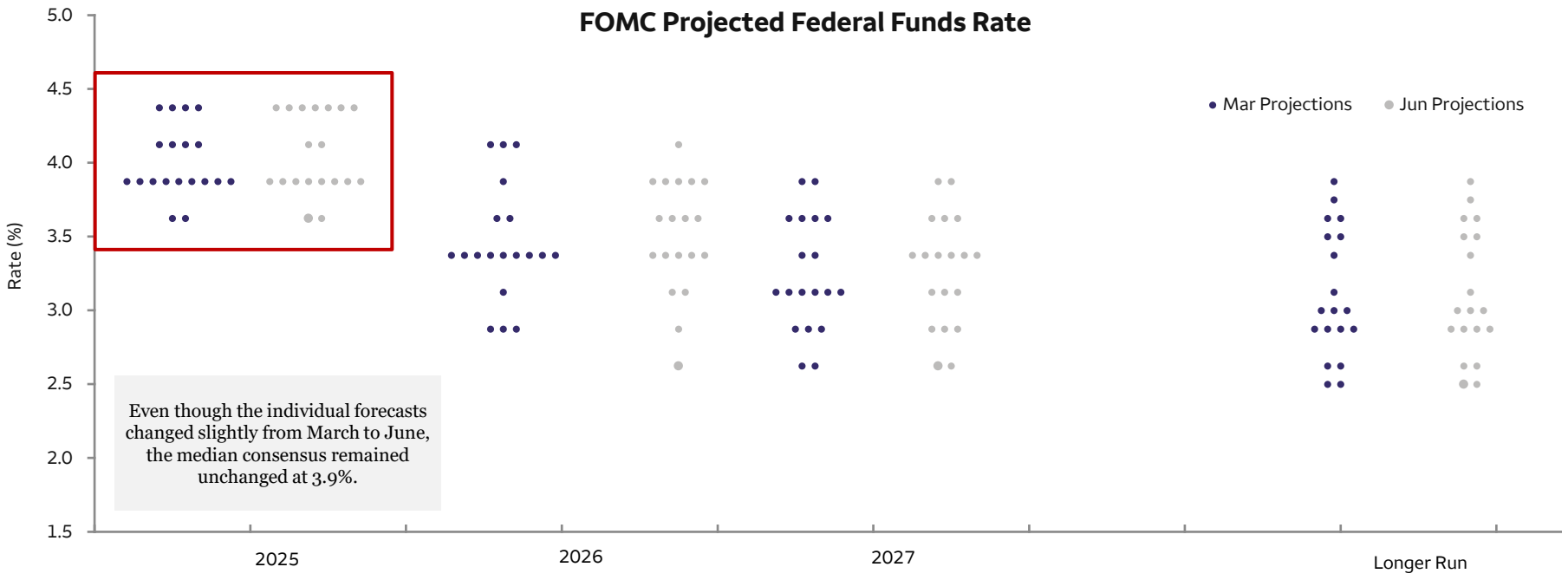
Source: Wells Fargo Corporate & Investment Banking, Federal Reserve

FOMC | Recent Meeting Recap

In December 2024, the FOMC cut the federal funds rate by 25bps, resulting in a target range of 4.25% to 4.50%. Since December though, the FOMC has left the federal funds rate unchanged.

July Meeting Statement highlights:

- Economic growth "moderated" in the first half of the year, while inflation remains above the Committee's long-run target.
- Economic uncertainty is elevated, and the Committee continues to monitor risks that could affect its goals for both sides of its dual mandate.
- "Unemployment remains low," with "labor market conditions solid."



Source: Wells Fargo Corporate & Investment Banking, Federal Reserve

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