



October 27, 2010

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City of Surprise
Investment Guidelines and Objectives
Month Ended September 30, 2010

Investment Objectives: In accordance with the City's Investment Policy, the City's primary objectives in order of priority are:

- A. Safety** – Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to prudently mitigate credit risk and interest rate risk. It is understood by the City that no investment is completely free of risk.
- B. Liquidity** – The investment portfolio shall remain sufficiently liquid to meet anticipated cash flow requirements. This is to be accomplished by structuring the portfolio so that securities mature concurrent with anticipated cash flow needs (static liquidity). Furthermore, because all possible cash demands cannot be anticipated, the portfolio should consist of securities for which there are active secondary markets (dynamic liquidity).
- C. Optimal Yield** – Return on investment is of lesser importance compared to the safety and liquidity objectives described above. The investment portfolio shall be designed to optimize the yield the City obtains from the portfolio taking into account the criteria of the investment policy, the dynamic liquidity needs of the City, and the current interest rate outlook/economic condition.

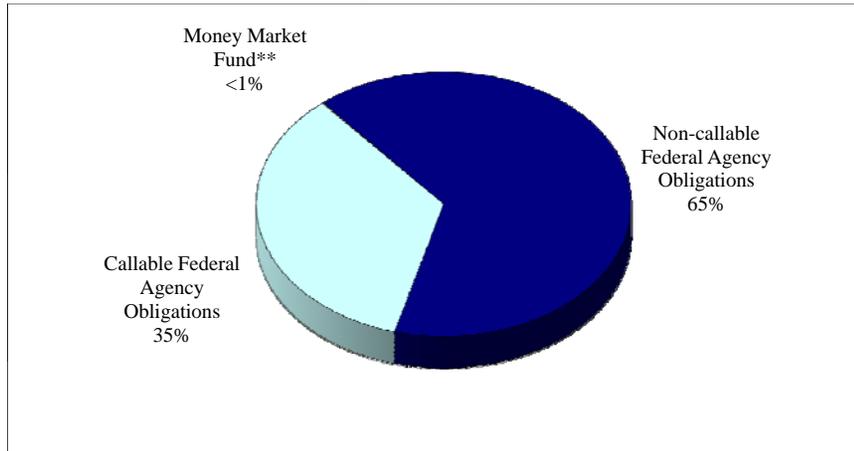
Investment Guidelines: In relation to the investment portfolio, the City's investment strategy focuses on the following:

- Permitted Investments. The City will invest in permitted securities consistent with A.R.S. §35-323. Additionally, the City may desire to be more conservative in its investment portfolio and restrict or prohibit certain of the investments outlined in the Investment Policy.
- Transactions prior to maturity – Securities shall generally be held to maturity with the following exceptions:
 - A security with a declining credit may be sold early to minimize loss of principal.
 - Liquidity needs of the portfolio require that the security be sold.
 - Securities may be sold to better position the portfolio in accordance with better market opportunities. The City will approve all of these transactions but only after PFM Asset Management LLC, the City's investment advisor, provides detailed information about the transaction, including the qualitative and quantitative impacts on the portfolio, and will be cognizant of trades that will result in large material realized losses.

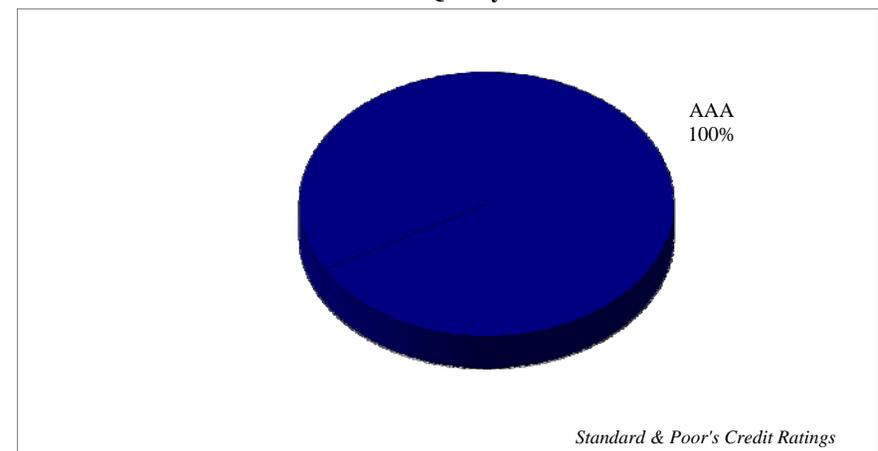
City of Surprise Portfolio Summary and Characteristics
Month Ended September 30, 2010

| <u>Security Type</u> | <u>Current Holdings*</u> | <u>Current Month % of Portfolio</u> | <u>Previous Month % of Portfolio</u> |
|-----------------------------|--------------------------|---|--|
| U.S. Treasury | \$0.00 | 0% | 0% |
| Federal Agency | \$20,289,062.00 | 100% | 100% |
| Discount Federal Agency | \$0.00 | 0% | 0% |
| Callable Federal Agency | \$7,021,278.00 | 35% | 35% |
| Non-callable Federal Agency | \$13,267,784.00 | 65% | 65% |
| FDIC Guaranteed Corporate | \$0.00 | 0% | 0% |
| Wells Fargo MMF | \$17,924.65 | <1% | <1% |
| Total Market Value | \$20,306,986.65 | 100% | 100% |

Sector Distribution



Credit Quality Distribution



Standard & Poor's Credit Ratings

The City's portfolio continues to comply with the investment policy and the Arizona Revised Statutes.

*Security market values excluding accrued interest as of settlement date. Note that PFM monthly statements reflect holdings as of trade date.

City of Surprise Maturity Summary and Key Portfolio Statistics
Month Ended September 30, 2010

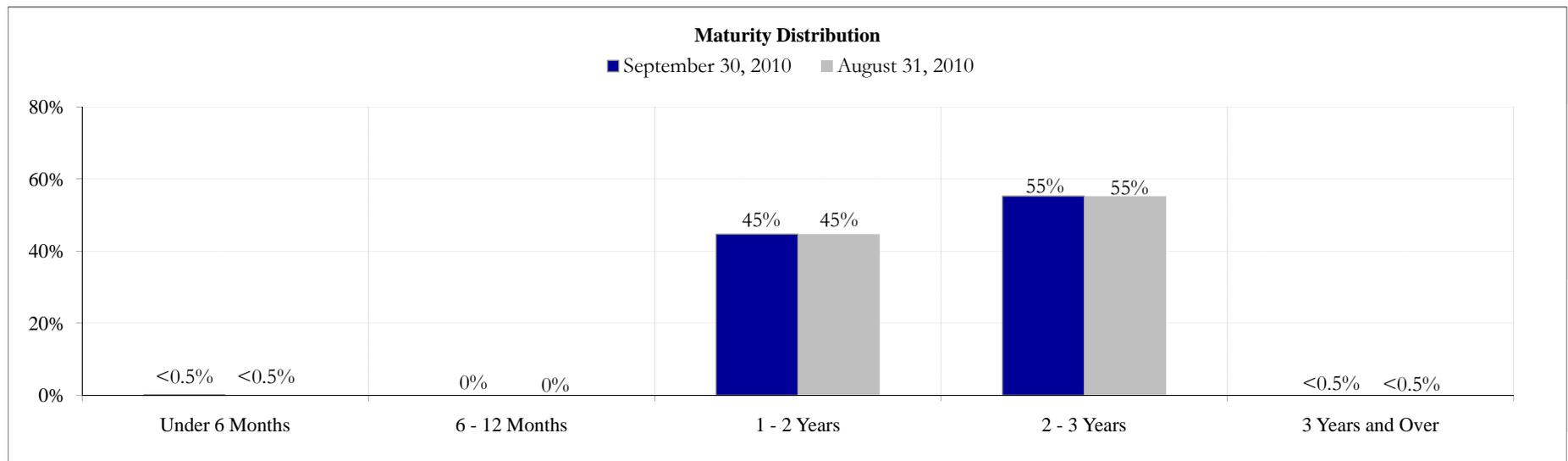
| Maturity Distribution Summary | | |
|--------------------------------------|------------------------|-----------------------|
| <u>Maturity Class</u> | <u>Fair Value*</u> | <u>% of Portfolio</u> |
| Under 6 Months | \$17,924.65 | <0.5% |
| 6 - 12 Months | \$0.00 | 0% |
| 1 - 2 Years | \$9,075,480.00 | 45% |
| 2 - 3 Years | \$11,213,582.00 | 55% |
| 3 Years and Over | \$0.00 | <0.5% |
| Total Market Value | \$20,306,986.65 | 100% |

*Security market values excluding accrued interest as of settlement date. Note that PFM monthly statements reflect holdings as of trade date.

| Key Portfolio Statistics | |
|---------------------------------|-------------------|
| Duration | 1.29 years |
| Benchmark Duration | 1.80 years |
| Yield at Cost | 1.03% |

Please note that the percentages on this page are rounded and may not add up to 100% due to the rounding.

The City's benchmark is the Merrill Lynch 1-3 year U.S. Treasury Index.

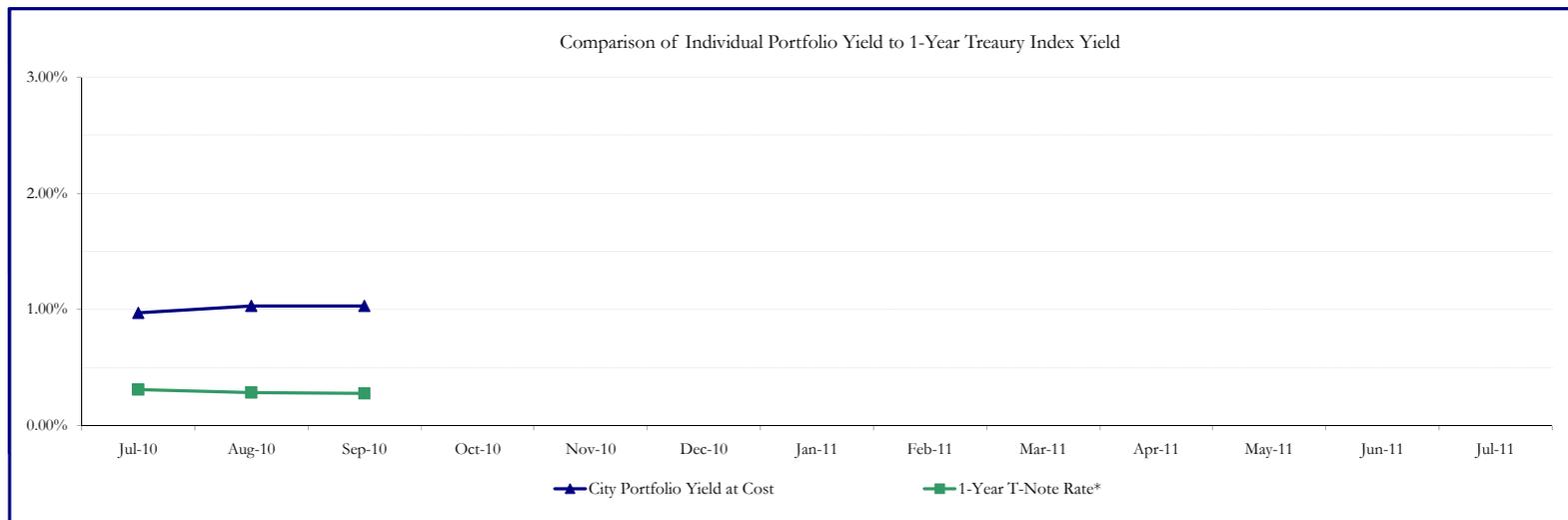


City of Surprise Individual Portfolio Yield Summary Fiscal Year 2010-2011

| Date | Month-End Market Value ¹ | Duration | Portfolio YTM at Cost | 1-Year T-Note Index Rate ² |
|--------|-------------------------------------|----------|-----------------------|---------------------------------------|
| Jul-10 | \$15,279,792 | 1.75 | 0.97% | 0.31% |
| Aug-10 | \$20,296,127 | 1.37 | 1.03% | 0.28% |
| Sep-10 | \$20,306,987 | 1.29 | 1.03% | 0.28% |

¹ Excludes accrued interest and includes balance in the custody account MMF.

² Rate represents the Merrill Lynch 1-Year U.S. Treasury Note Index month-end yield (GC03). Source Bloomberg

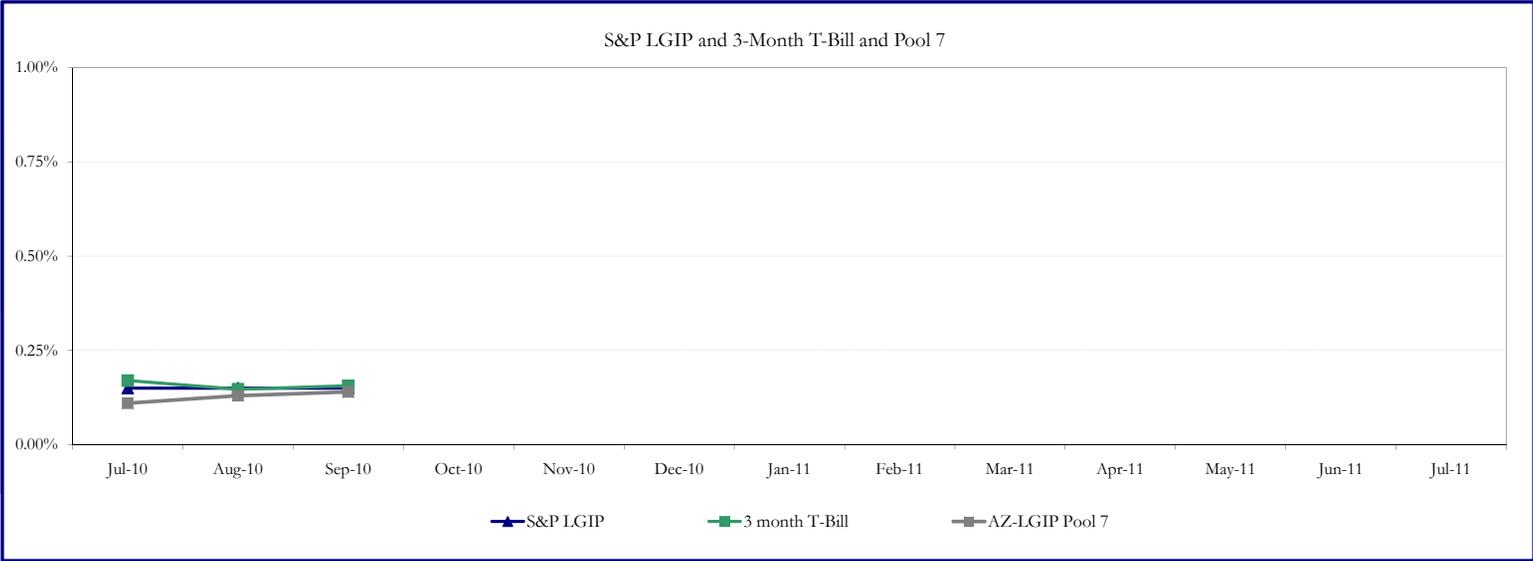


**City of Surprise Short-Term Benchmark Comparisons
Fiscal Year 2010-2011**

| Date | S&P LGIP | AZ-LGIP Pool 7 ¹ | 3 month Treasury Bill ² |
|--------|----------|-----------------------------|------------------------------------|
| Jul-10 | 0.15% | 0.11% | 0.17% |
| Aug-10 | 0.15% | 0.13% | 0.15% |
| Sep-10 | 0.15% | 0.14% | 0.16% |

¹ Monthly Apportionment Yields. Source: Office of the Arizona State Treasurer

² Rate represents the Merrill Lynch 3-Month U.S. Treasury Bill Index month-end yield (G001). Source: Bloomberg



City of Surprise Holdings
Month Ended September 30, 2010

Operating Funds Investment Inventory by Maturity Date

| Issuer | Maturity | Years to Maturity | Fair Value | Yield to Maturity | Next Call Date | Frequency |
|---------------------------|-----------------|--------------------------|----------------------|--------------------------|-----------------------|------------------|
| Wells Fargo MMF | 9/30/2010 | 0.00 | \$17,925 | 0.07% | | |
| FHLB | 12/28/2011 | 1.24 | \$3,022,512 | 0.62% | | |
| FHLB | 1/9/2012 | 1.28 | \$3,008,529 | 0.65% | | |
| FHLB | 6/8/2012 | 1.69 | \$3,044,439 | 0.97% | | |
| FHLMC | 12/21/2012 | 2.23 | \$2,153,218 | 1.09% | | |
| FNMA | 6/26/2013 | 2.74 | \$2,039,086 | 1.41% | | |
| FNMA | 7/19/2013 | 2.80 | \$2,010,158 | 1.39% | 7/19/11 | One-time |
| FNMA | 8/16/2013 | 2.88 | \$5,011,120 | 1.23% | 2/16/11 | One-time |
| Total Market Value | | | \$ 20,306,987 | | | |

City of Surprise Quarterly Performance Month Ended September 30, 2010

Portfolio Performance

| | Quarter Ended September 30, 2010 | | | | |
|--|-------------------------------------|------------------------|-----------------|---------------------------|------------------------|
| Total Return ^{1,2,3,5} | | | | | |
| City of Surprise | 0.72% | | | | |
| Merrill Lynch 1-3 Year UST Index | 0.62% | | | | |
| Effective Duration ⁴ | <u>September 30, 2010</u> | <u>August 31, 2010</u> | Yields | <u>September 30, 2010</u> | <u>August 31, 2010</u> |
| City of Surprise | 1.29 | 1.37 | Yield at Market | 0.75% | 0.80% |
| Merrill Lynch 1-3 Year UST Index | 1.80 | 1.78 | Yield on Cost | 1.03% | 1.03% |



Notes:

1. Performance on trade date basis, gross (i.e., before fees), in accordance with the CFA Institute's Global Investment Performance Standards (GIPS).
2. Quarterly returns are presented on an unannualized basis. Performance numbers for periods greater than one year are presented on an annualized basis.
3. Merrill Lynch Indices provided by Bloomberg Financial Markets.
4. Excludes money market fund in duration and performance computations.
5. Inception date is June 16, 2010.



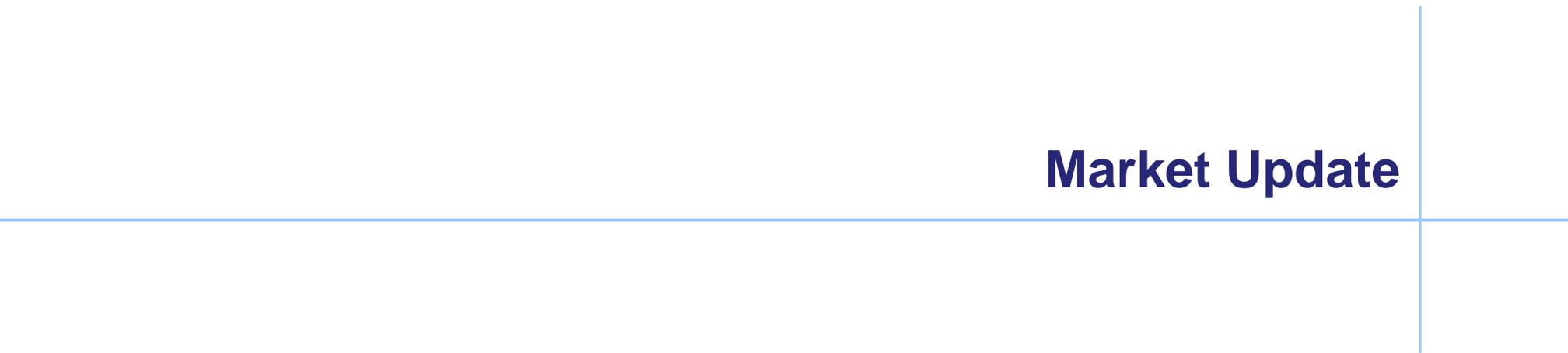
Managed Account Detail of Securities Held

For the Month Ending **September 30, 2010**

CITY OF SURPRISE OPERATING FUND

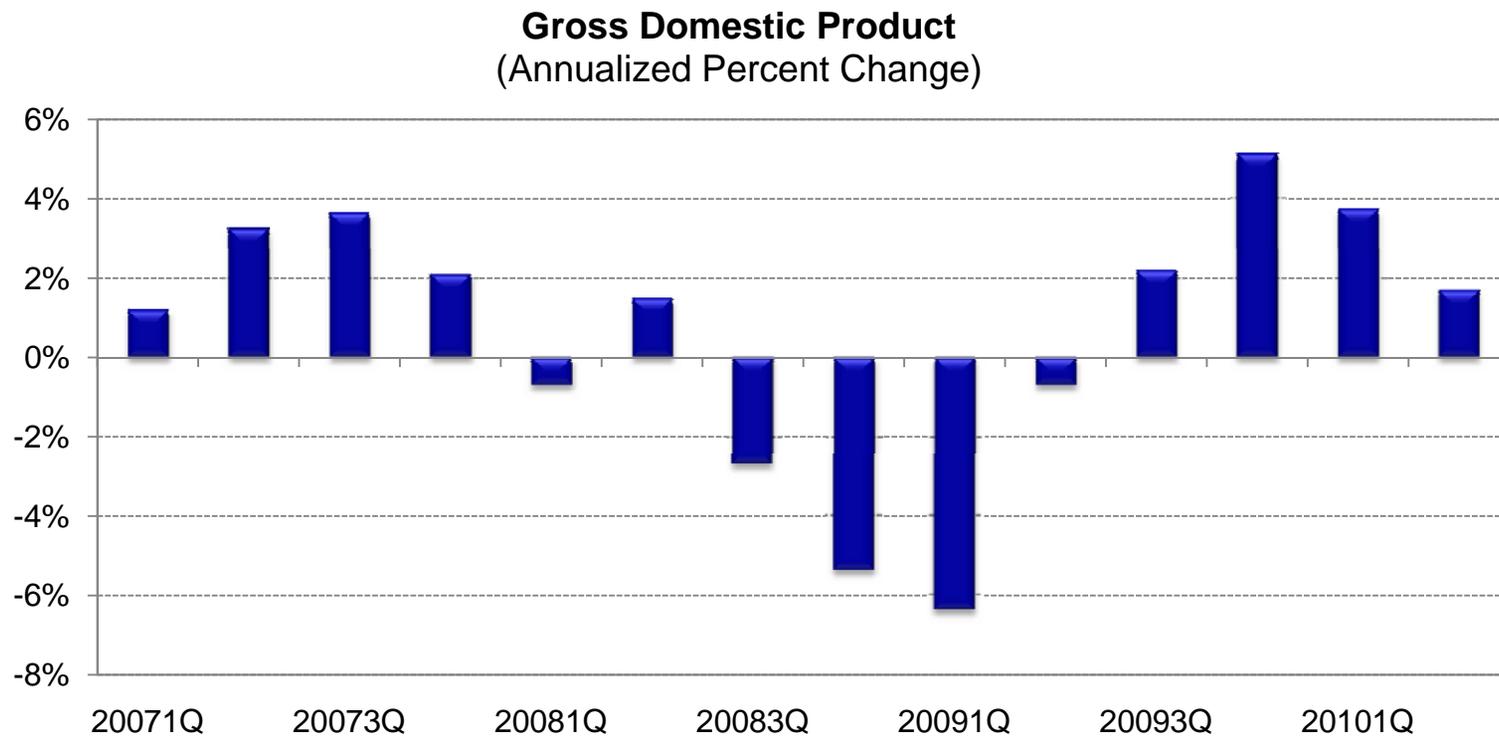
| Security Type/Description Dated Date/Coupon/Maturity | CUSIP | Par | S&P Rating | Moody's Rating | Trade Date | Settle Date | Original Cost | YTM at Cost | Accrued Interest | Amortized Cost | Market Value |
|--|-----------|------------------------|---------------|-------------------|---------------|----------------|------------------------|----------------|---------------------|------------------------|------------------------|
| Federal Agency Bond / Note | | | | | | | | | | | |
| FHLB GLOBAL BONDS DTD 11/16/2009 1.000% 12/28/2011 | 3133XVRS2 | 3,000,000.00 | AAA | Aaa | 06/23/10 | 06/24/10 | 3,016,950.00 | 0.62 | 7,750.00 | 3,013,937.58 | 3,022,512.00 |
| FHLB NOTES DTD 07/09/2010 0.625% 01/09/2012 | 3133703Y2 | 3,000,000.00 | AAA | Aaa | 07/13/10 | 07/14/10 | 2,998,740.00 | 0.65 | 4,270.83 | 2,998,920.87 | 3,008,529.00 |
| FHLB TAP BONDS DTD 01/07/2010 1.375% 06/08/2012 | 3133XWKU2 | 3,000,000.00 | AAA | Aaa | 06/16/10 | 06/17/10 | 3,024,000.00 | 0.97 | 12,947.92 | 3,020,515.86 | 3,044,439.00 |
| FHLMC GLOBAL REFERENCE NOTES DTD 12/17/2007 4.125% 12/21/2012 | 3137EABE8 | 2,000,000.00 | AAA | Aaa | 06/23/10 | 06/24/10 | 2,148,600.00 | 1.09 | 22,916.67 | 2,132,706.32 | 2,153,218.00 |
| FNMA GLOBAL NOTES DTD 05/21/2010 1.500% 06/26/2013 | 31398AT44 | 2,000,000.00 | AAA | Aaa | 06/16/10 | 06/17/10 | 2,005,560.00 | 1.41 | 7,916.67 | 2,005,036.78 | 2,039,086.00 |
| FANNIE MAE (CALLABLE) GLOBAL NOTES DTD 07/19/2010 1.375% 07/19/2013 | 31398AW32 | 2,000,000.00 | AAA | Aaa | 07/13/10 | 07/19/10 | 1,999,280.00 | 1.39 | 5,500.00 | 1,999,327.18 | 2,010,158.00 |
| FNMA NOTES (CALLABLE) DTD 08/16/2010 1.250% 08/16/2013 | 31398A2L5 | 5,000,000.00 | AAA | Aaa | 08/05/10 | 08/16/10 | 5,003,000.00 | 1.23 | 7,812.50 | 5,002,250.00 | 5,011,120.00 |
| Security Type Sub-Total | | 20,000,000.00 | | | | | 20,196,130.00 | 1.03 | 69,114.59 | 20,172,694.59 | 20,289,062.00 |
| Managed Account Sub-Total | | 20,000,000.00 | | | | | 20,196,130.00 | 1.03 | 69,114.59 | 20,172,694.59 | 20,289,062.00 |
| Securities Sub-Total | | \$20,000,000.00 | | | | | \$20,196,130.00 | 1.03% | \$69,114.59 | \$20,172,694.59 | \$20,289,062.00 |
| Accrued Interest | | | | | | | | | | | \$69,114.59 |
| Total Investments | | | | | | | | | | | \$20,358,176.59 |

Market Update



Overall Pace of Recovery Slowing

- Second quarter 2010 GDP increased at a rate of 1.7% (annualized), a growth rate below both the 2009 (5.1%) and 1Q 2010 (3.7%).
- Much of the 2Q growth was fueled by consumer spending.
- A modest expansion is expected over the next year as the slack labor market restricts consumer demand.

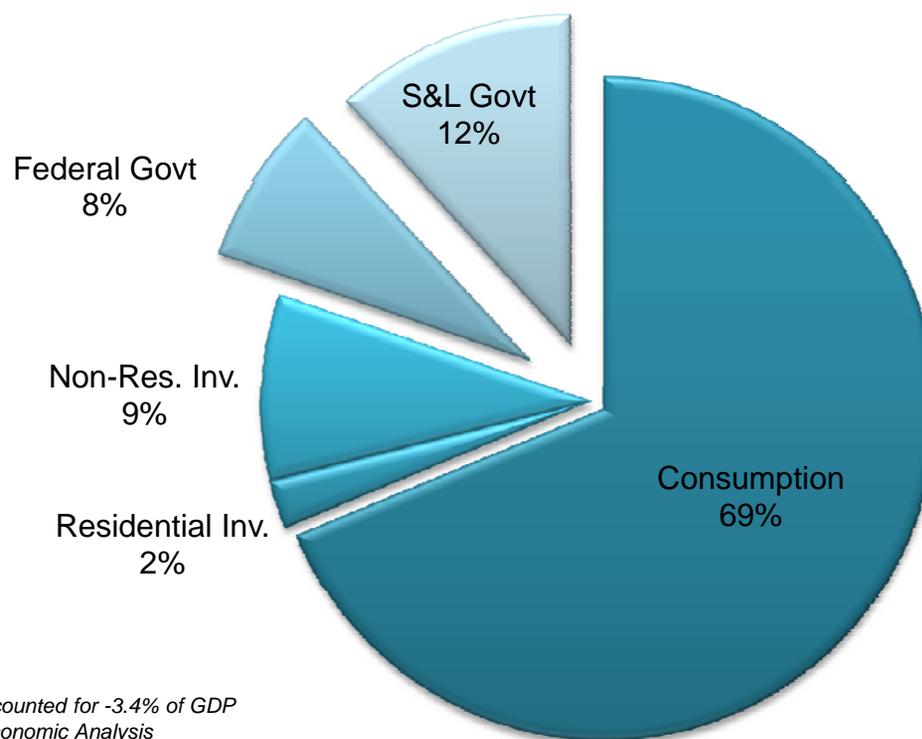


Source: U.S. Department of Commerce – Bureau of Economic Analysis

Consumer Spending Drives Recovery

- Consumer spending represents 2/3 of GDP.
- In the second quarter, consumer spending increased 2.2% and state and local government spending expanded by 0.6% (after three quarters of decline).
- In the coming quarters, the effects of high unemployment and a fragile housing sector are expected to be reflected in diminished spending and modest growth.

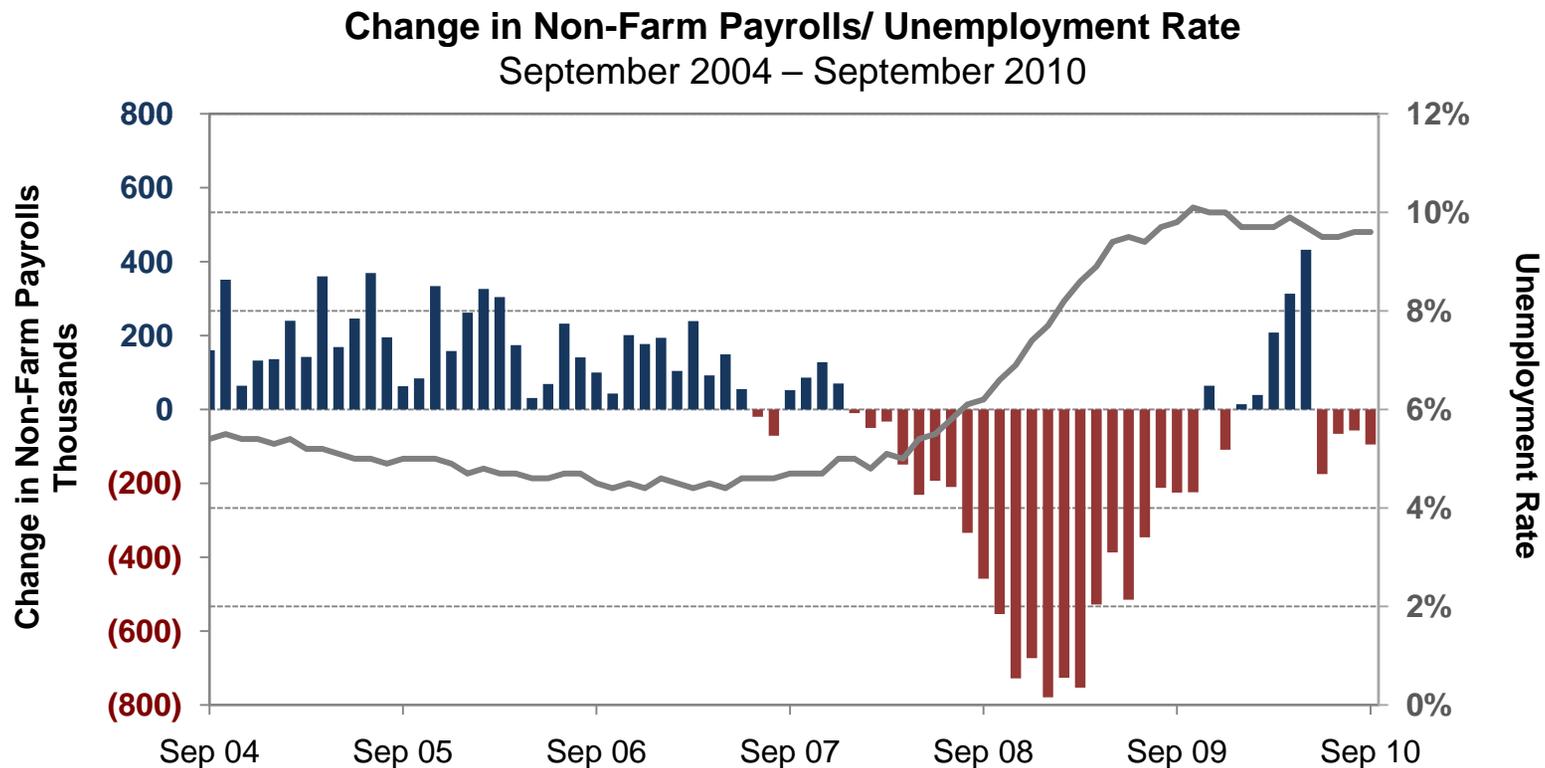
GDP Composition: 2Q 2010



*Note: Net exports accounted for -3.4% of GDP
Source: Bureau of Economic Analysis*

Reduction of Government Payrolls Offsets Modest Private Payroll Expansion

- A gain of 64,000 jobs in the private sector was more than offset by a decline of 159,000 government jobs, including the layoffs of 77,000 temporary census workers.
- The unemployment rate held steady at 9.6%. High unemployment continues to be an obstacle to recovery.

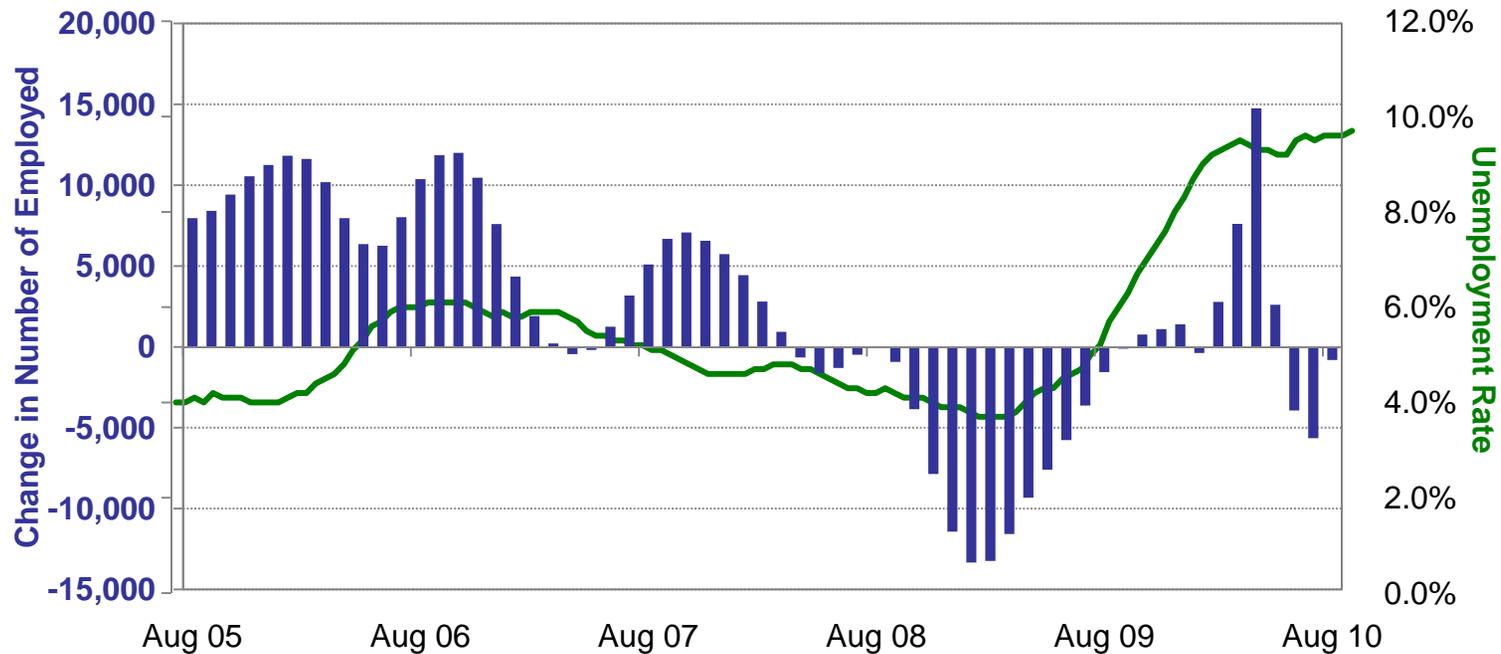


Source: Bloomberg

Unemployment in Arizona Still Edging Upwards

- Arizona's 9.7% unemployment rate in August is the state's highest to date.

Change in Number of Employed (MoM) vs. Unemployment Rate in Arizona
August 2005 – August 2010

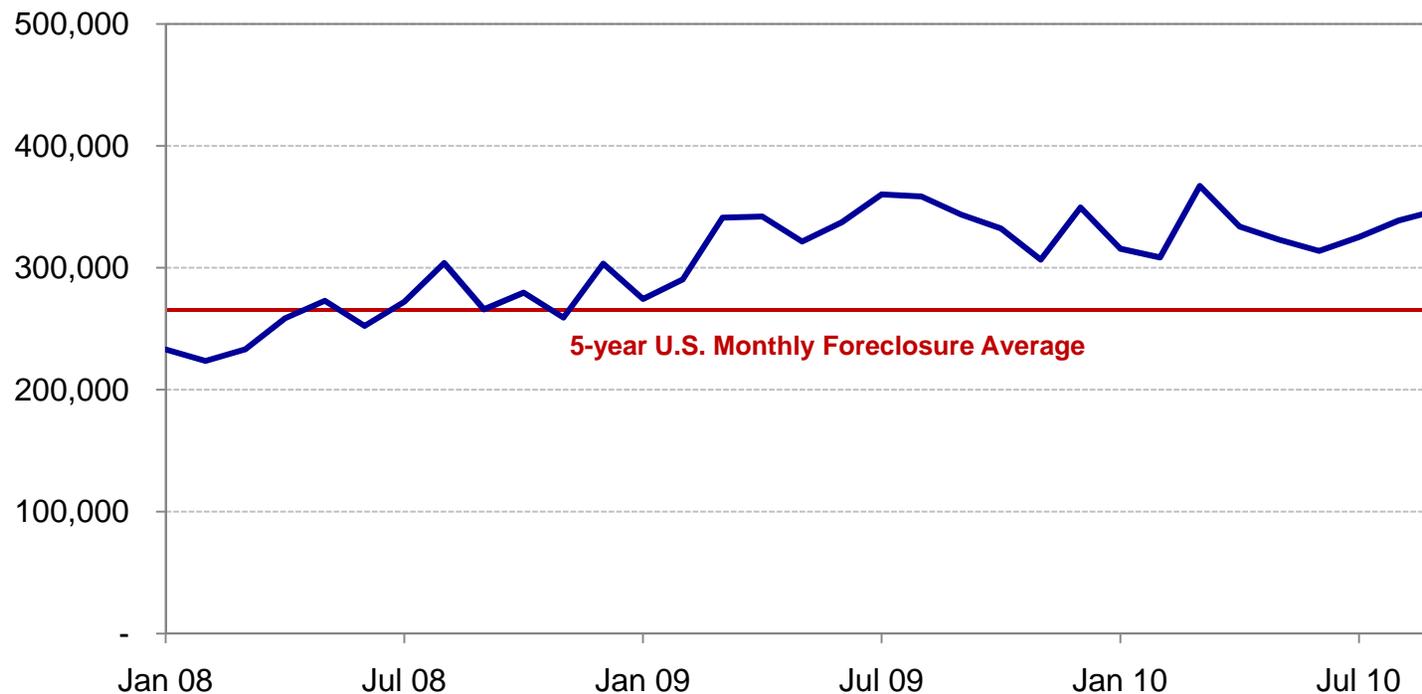


Source: Bureau of Labor Statistics

Foreclosures Hinder Housing Market Recovery

- In September, the foreclosure rate rose 1.1% (YoY). Unemployment or reduced income, continue to be the main catalysts for foreclosures this year.
- More homes were repossessed by banks and lending institutions in September than during any single month since tracking began. An estimated one in every 136 homes is in some stage of foreclosure.

Monthly Number of Homes In Foreclosure
January 2008 – September 2010



Source: Bloomberg

Home Sales/Prices Continue to Fall in Arizona

- In August in the combined Maricopa-Pinal counties metropolitan area, home sales fell 6.5% (MoM) and 17.0% (YoY).
- The drop in sales of new homes, which typically sell for more than resale homes, and relatively strong demand for the lowest-cost home, contributed to the year-over-year decline in median sale prices.

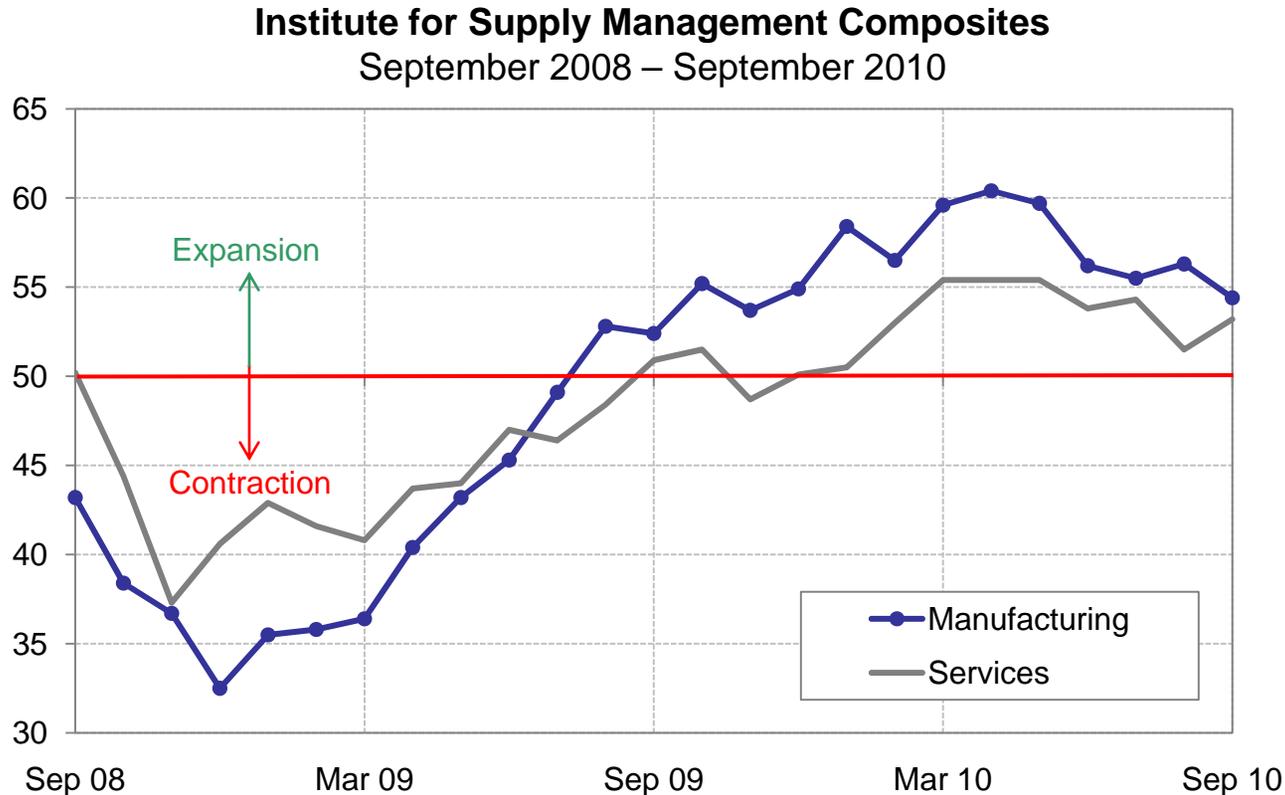
Maricopa-Pinal County Metropolitan Area Year over year change

| Number of sales | Aug-09 | Aug-10 | %Chng |
|-------------------|-----------|-----------|---------|
| Resale houses | 6,953 | 5,628 | -19.10% |
| Resale condos | 755 | 847 | 12.20% |
| New homes | 866 | 638 | -26.30% |
| All homes | 8,574 | 7,113 | -17.00% |
| | | | |
| Median sale price | Aug-09 | Aug-10 | %Chng |
| Resale houses | \$130,000 | \$130,000 | 0.00% |
| Resale condos | \$103,900 | \$78,250 | -24.70% |
| New homes | \$185,866 | \$200,000 | 7.60% |
| All homes | \$135,000 | \$130,000 | -3.70% |

Source: Data quick

Manufacturing Sector Data Remains Positive

- The manufacturing sector has shown a solid recovery over the past year. Much of the gains can be tied to restocking of inventories and the weak dollar in 2009.
- Despite the improvement in manufacturing output, factories are operating at levels well below full employment levels.



Source: Institute for Supply Management

Troubled Asset Relief Program (“TARP”) Ends

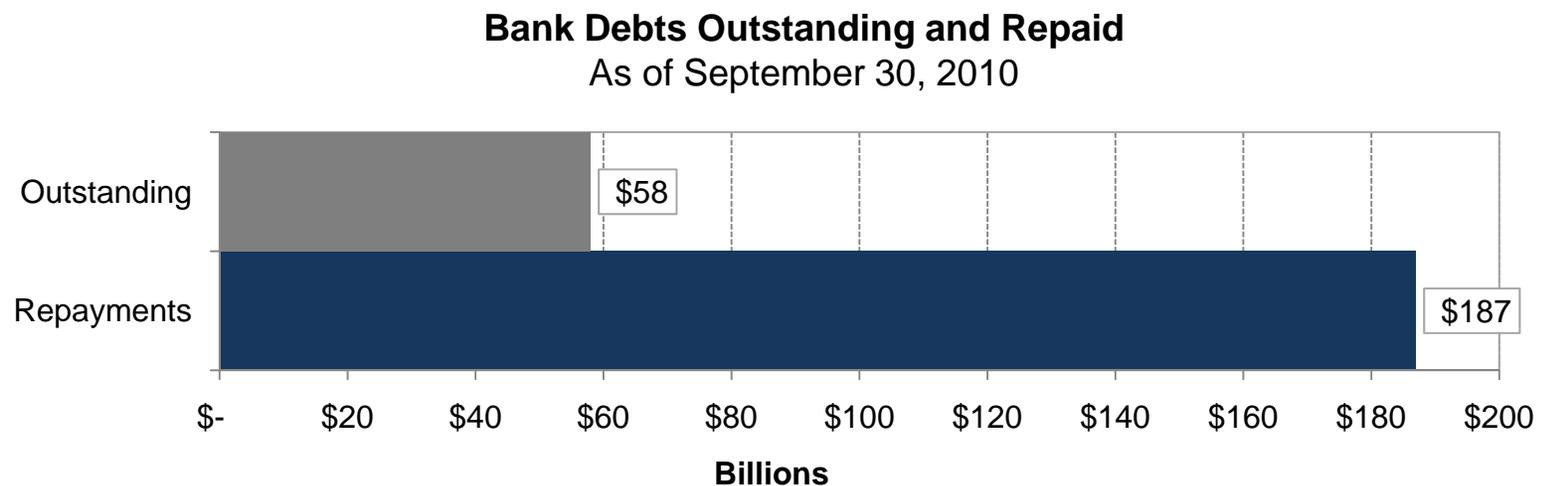
- As of October 5, 2010, the Treasury will no longer make new commitments under TARP.
- The Treasury committed a total of \$475 billion to TARP and stood to gain as much as \$10.2 billion or lose as much as \$130 billion.
 - The Treasury Department expects that the program will end up costing taxpayers \$30 billion.

Financial Commitment and Projected Cost of TARP

| Sector | Government’s Financial Commitment | Projected Final Cost/Profit |
|--------------|-----------------------------------|-----------------------------|
| Banks | \$250 billion | \$5 – 20 billion |
| AIG | \$70 billion | \$(50) – 15 billion |
| Automakers | \$82 billion | \$(34) – (15) billion |
| Housing | \$46 billion | \$(49) – (10) billion |
| Lending | \$27 billion | \$(2) – 0.2 billion |
| Total | \$475 billion | \$130 – 10.2 billion |

TARP Bank Loans Will Likely Be Profitable

- \$187 billion of the Treasury's loans to the banks through the TARP program have been repaid.
- \$58 billion remains outstanding from approximately 600 firms, 15% of which have missed dividend payments.
- The Treasury still expects an overall \$5 billion profit from bank loans.
- Large TARP losses will probably come from loans to automakers, G.M. and Chrysler, and to homeowners for mortgage modifications.



Fed's Initial Quantitative Easing Strategy

- **Quantitative Easing** (“QE”) is a form of monetary policy where the Fed makes large scale purchases of long-term assets in an attempt to keep long-term interest rates low. Similar to open-market purchases, the Fed does repo by crediting bank reserves (creating money out of thin air).
- Risks of the policy include:
 - Spurring rampant inflation.
 - Banks continuing to hold cash to increase their capital reserves.
- QE1 ran from November 2008-March 2010. The Fed purchased:
 - \$1.25 trillion of Agency MBS and \$175 billion in Agency debt in order to reduce the cost and increase the availability of credit for home purchases.
 - \$300 billion of Treasury debt to help improve conditions in private credit markets.
- Analysts estimate that QE1 resulted in a 35 to 50 bp decline in 10-year Treasury term premiums.

Fed Expected to Begin Second Round of Quantitative Easing

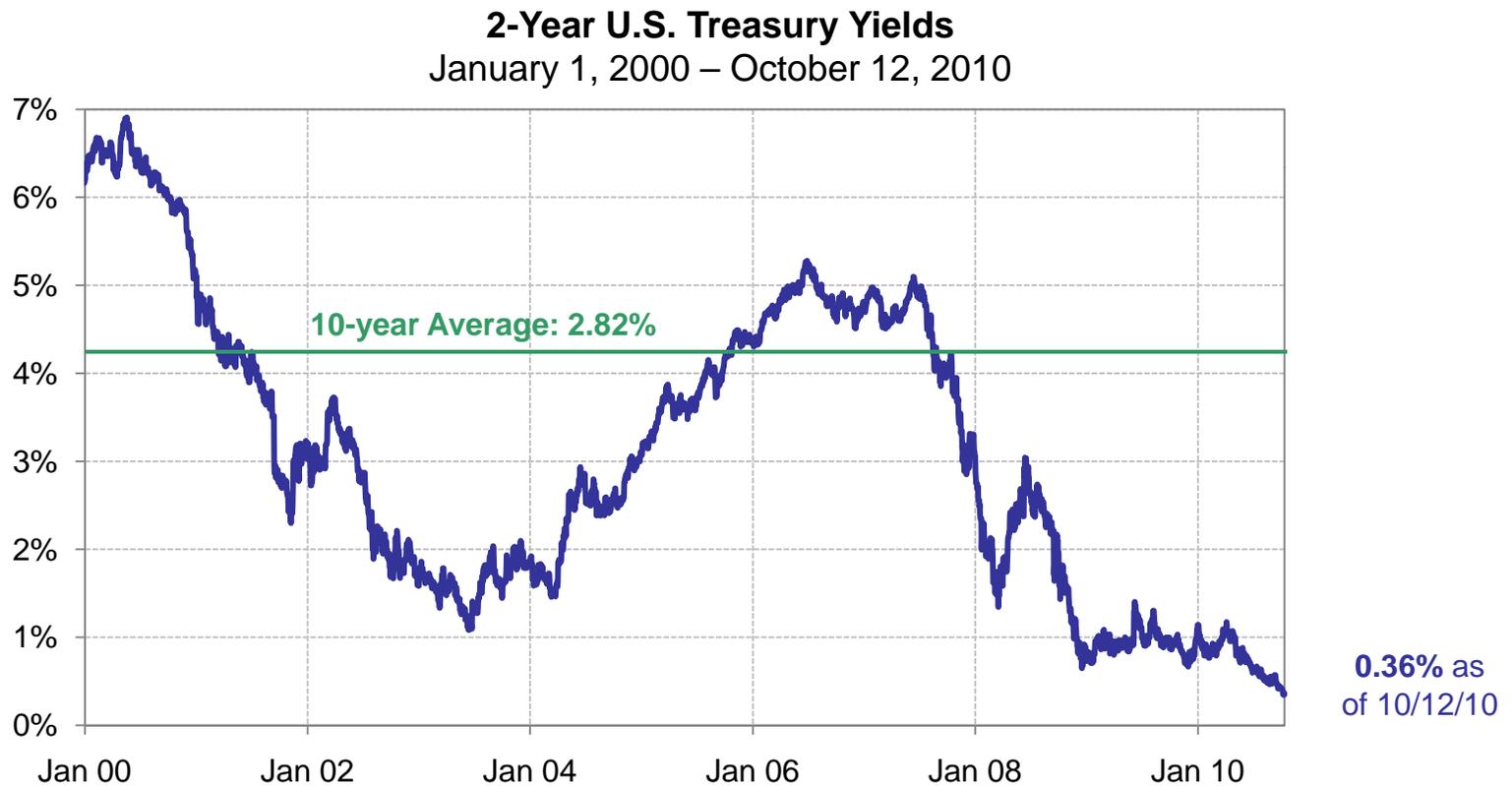
- **WHY:** Economic growth is very sluggish. Fed is concerned with possibility of deflation.
- **WHEN:** The market expects QE2 to be announced at the November Fed meeting.
- **HOW:** The Fed will either implement QE2 similar to QE1 with large scale asset purchases from \$0.75-\$1.5 billion or by declaring a credible rate ceiling.
- **GOAL:** To stimulate inflation so that cash is the least attractive investment option and investors are forced to invest cash back into the market. In theory, this will boost home prices and borrower credit, and lower government debt on a real basis.

Eligible Treasuries Outstanding and Projected

| Sector | Eligible outstanding | Projected Issuance | Projected Eligible | Total Eligible |
|---------|----------------------|--------------------|--------------------|----------------|
| 0-2 | 463 | 408 | 142.8 | 605.8 |
| 2.1-4 | 300 | 384 | 134.4 | 434.4 |
| 4.1-6 | 193 | 396 | 138.6 | 331.6 |
| 6.1-7 | 71 | 348 | 121.8 | 192.8 |
| 7.1-8 | 42 | 0 | 0 | 42 |
| 8.1-9 | 79 | 0 | 0 | 79 |
| 9.1-10 | 37 | 264 | 92.4 | 129.4 |
| 10.1-27 | 38 | 0 | 0 | 38 |
| 27.1-30 | 78 | 168 | 58.8 | 136.8 |
| | 1,301 | 1,968 | 689 | 1,990 |

Interest Rates Fall To Historic Lows

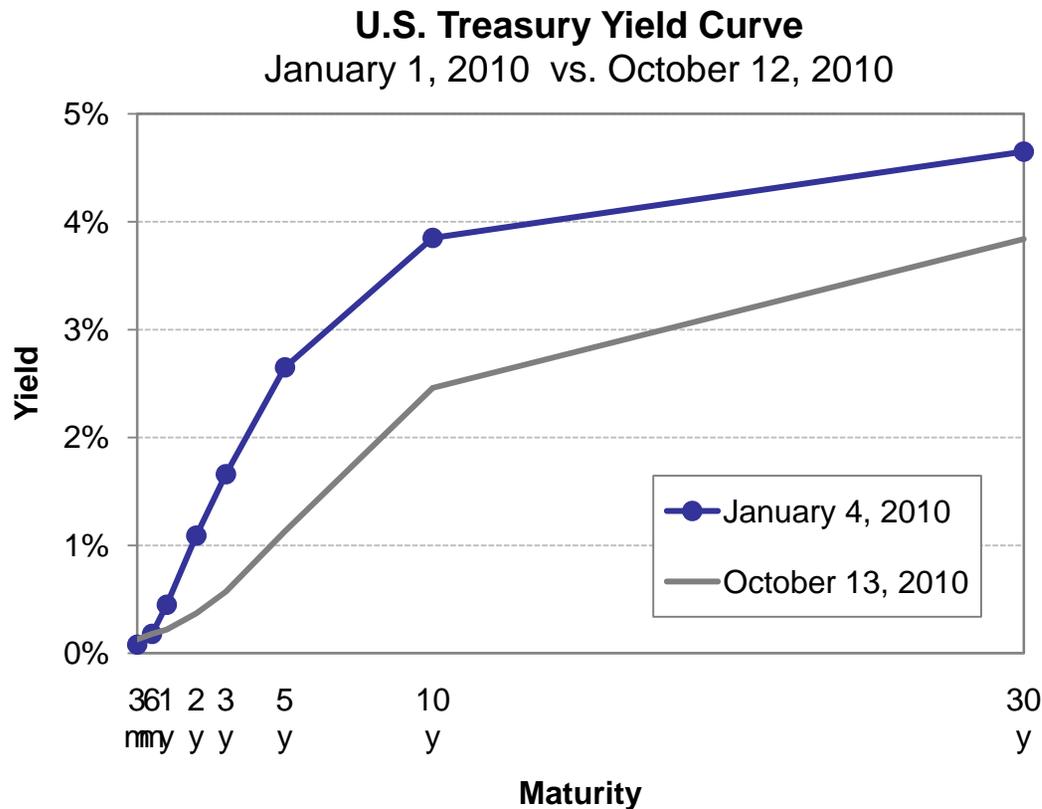
- Weaker than expected employment data and expectations that the Fed will begin buying Treasury securities have driven interest rates to unprecedented lows.



Source: Bloomberg

Steep Yield Curve Offers Value

- The yield curve has flattened since the beginning of the year, but remains steep by historical standards.

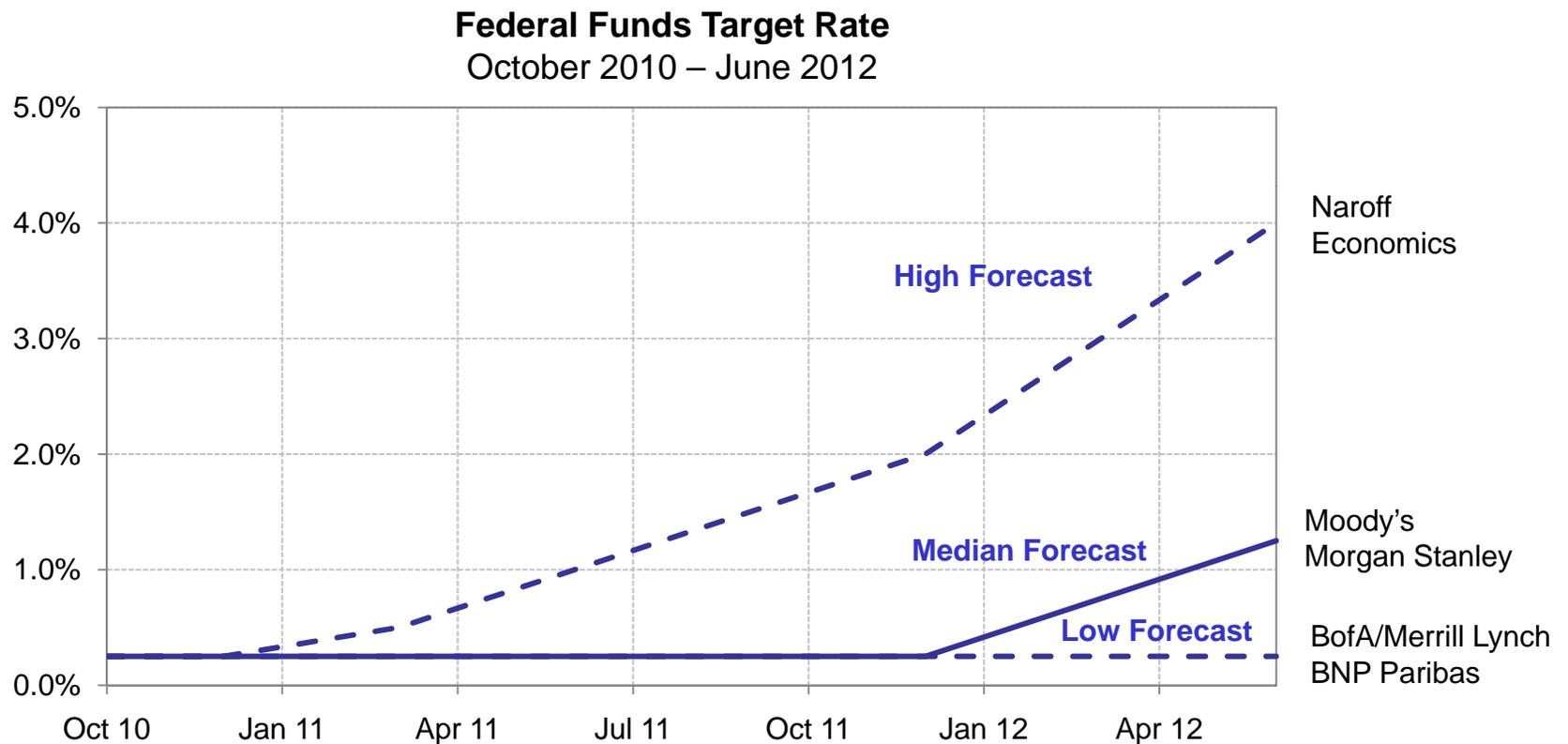


Source: Bloomberg

| | 10/13/10 | Pick up over 3 month |
|---------|----------|----------------------|
| 3 month | 0.12% | - |
| 6 month | 0.17% | 0.04% |
| 1 year | 0.20% | 0.08% |
| 2 year | 0.37% | 0.25% |
| 3 year | 0.56% | 0.44% |
| 5 year | 1.12% | 1.00% |
| 10 year | 2.40% | 2.28% |
| 30 year | 3.77% | 3.65% |

Fed Funds Forecasts – October 2010

- Most economists expect the Fed to keep the target rate at 0-25% through the fourth quarter of 2011, with few expecting a move before the end of first quarter 2012.



Source: October 2010 Bloomberg Survey of Economists

Economic Calendar

 Market-moving economic releases

| Date | Event | Survey | Actual | Prior | Revised |
|------------|---------------------------|--------|--------|---------|---------|
| 10/18/2010 | Total Net TIC Flows | -- | -- | \$63.7B | -- |
| 10/18/2010 | Net Long-term TIC Flows | -- | -- | \$61.2B | -- |
| 10/18/2010 | Industrial Production | 0.20% | -- | 0.20% | -- |
| 10/18/2010 | Capacity Utilization | 74.80% | -- | 74.70% | -- |
| 10/18/2010 | NAHB Housing Market Index | 14 | -- | 13 | -- |
| 10/19/2010 | Housing Starts | 583K | -- | 598K | -- |
| 10/19/2010 | Housing Starts MOM% | -2.60% | -- | 10.50% | -- |
| 10/19/2010 | Building Permits | 575K | -- | 569K | 571K |
| 10/19/2010 | Building Permits MOM% | 0.70% | -- | 1.80% | -- |
| 10/19/2010 | ABC Consumer Confidence | -- | -- | -45 | -- |
| 10/20/2010 | MBA Mortgage Applications | -- | -- | 14.60% | -- |
| 10/20/2010 | Fed's Beige Book | | -- | | |
| 10/21/2010 | Initial Jobless Claims | 453K | -- | 462K | -- |
| 10/21/2010 | Continuing Claims | 4420K | -- | 4399K | -- |
| 10/21/2010 | Leading Indicators | 0.30% | -- | 0.30% | -- |
| 10/21/2010 | Philadelphia Fed. | 0 | -- | -0.7 | -- |
| 10/21/2010 | RPX Composite 28dy YoY | -- | -- | -1.04% | -- |

Source: Bloomberg

Disclaimer

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