



**February 22, 2011**

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**City of Surprise**  
**Investment Guidelines and Objectives**  
**Month Ended January 31, 2011**

**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:

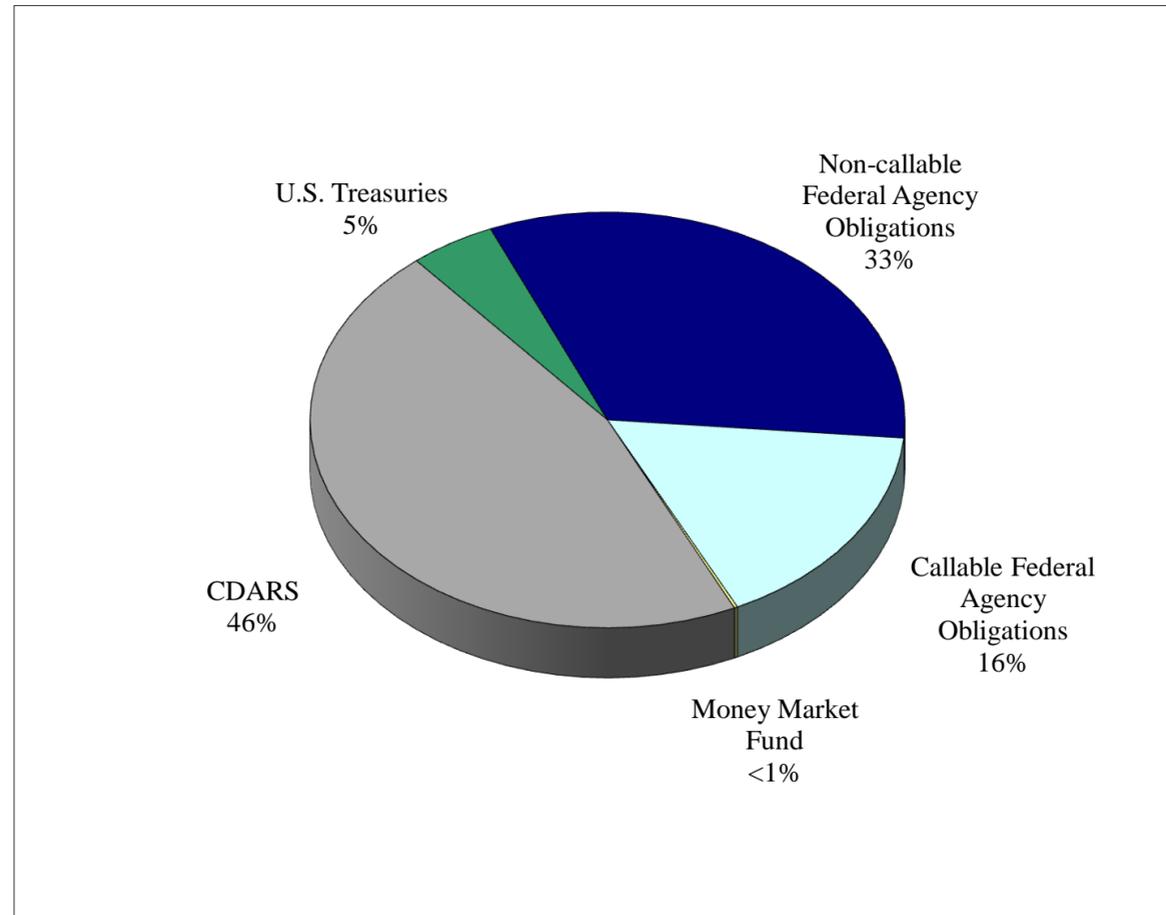
- **Permitted Investments.** The City will invest in permitted securities consistent with A.R.S.§35-323. Additionally, the City may desire to be more conservative in its investment portfolio and restrict or prohibit certain of the investments outlined in the Investment Policy.
- **Transactions prior 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

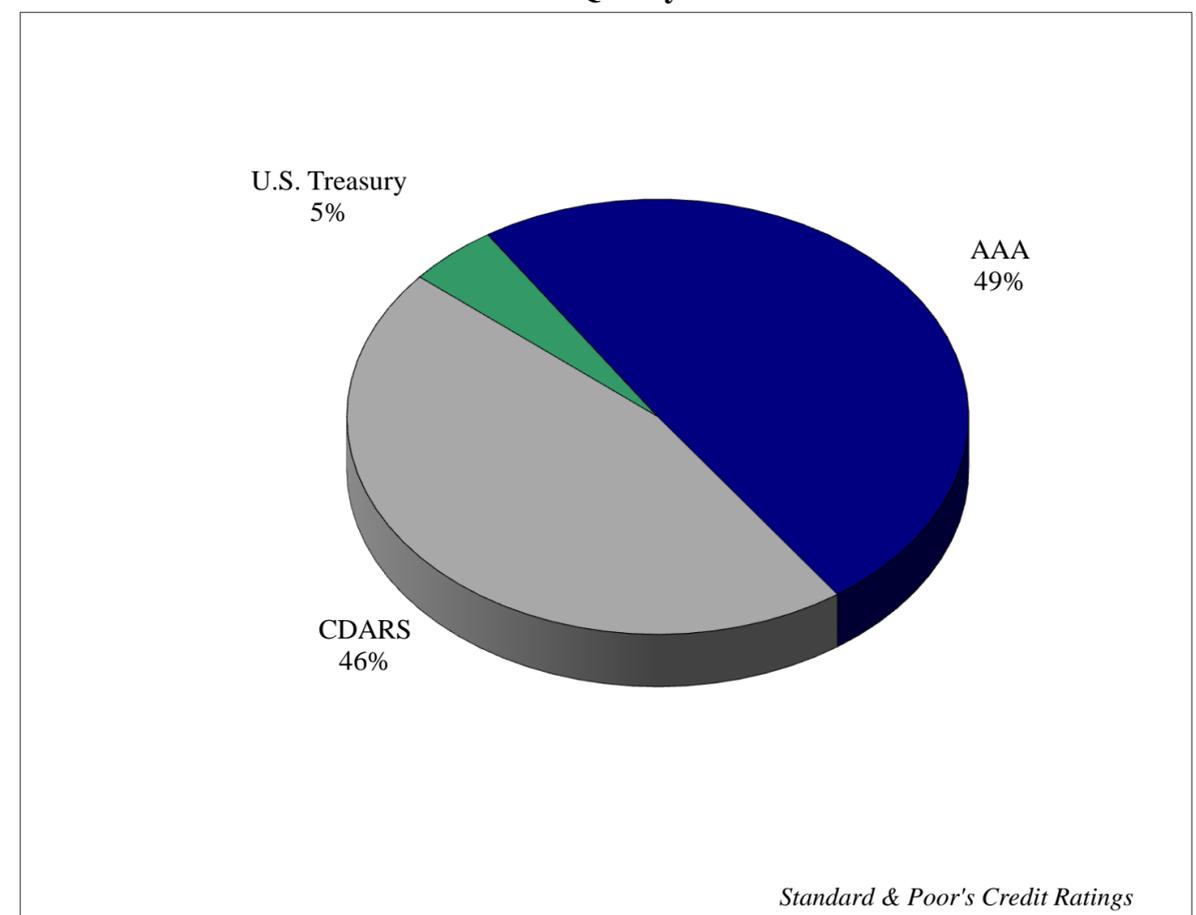
Month Ended January 31, 2011

<u>Security Type</u>	<u>Current Holdings*</u>	<u>Current Month</u> <u>% of Portfolio</u>	<u>Previous Month</u> <u>% of Portfolio</u>
<b>U.S. Treasury</b>	<b>\$3,056,927.34</b>	<b>5%</b>	9%
<b>Federal Agency</b>	<b>\$32,170,208.06</b>	<b>49%</b>	91%
Discount Federal Agency	\$0.00	0%	0%
Callable Federal Agency	\$10,719,901.50	16%	30%
Non-callable Federal Agency	\$21,450,306.56	33%	61%
<b>CDARS</b>	<b>\$30,000,000.00</b>	<b>46%</b>	-
<b>Wells Fargo MMF</b>	<b>\$115,394.44</b>	<b>&lt;1%</b>	<b>&lt;1%</b>
<b>Total Market Value</b>	<b>\$65,342,529.84</b>	<b>100%</b>	<b>100%</b>

**Sector Distribution**



**Credit Quality Distribution**



The City's portfolio complies 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 January 31, 2011

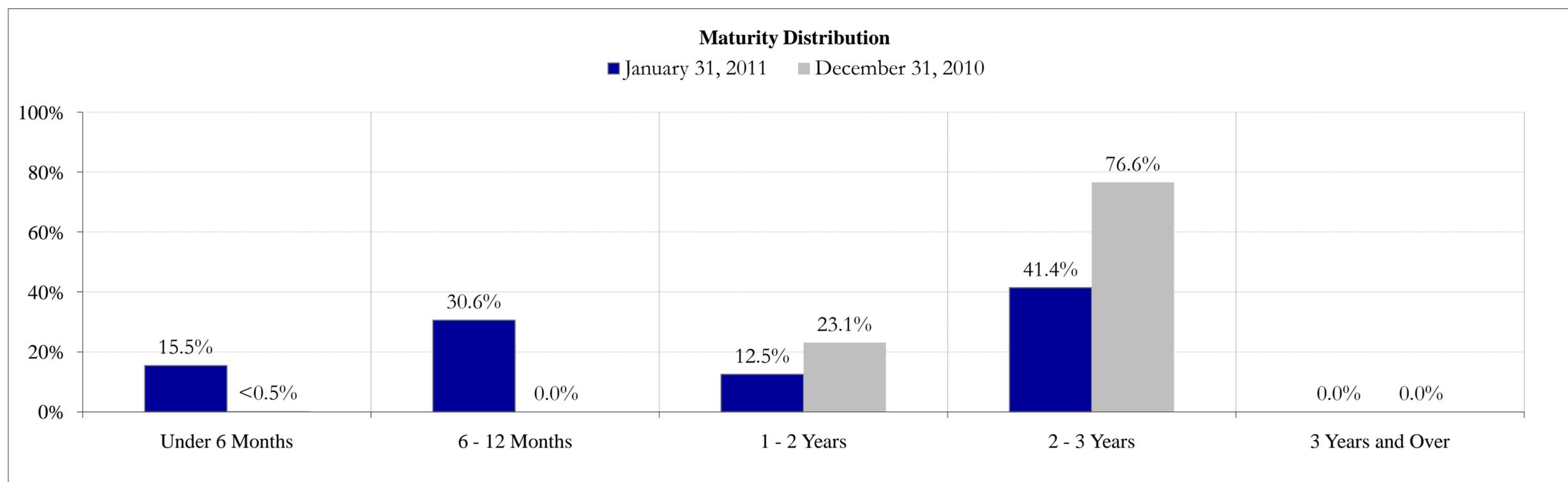
Maturity Distribution Summary		
<u>Maturity Class</u>	<u>Fair Value*</u>	<u>% of Portfolio</u>
Under 6 Months	\$10,115,394.44	15.5%
6 - 12 Months	\$20,000,000.00	30.6%
1 - 2 Years	\$8,154,723.00	12.5%
2 - 3 Years	\$27,072,412.40	41.4%
3 Years and Over	\$0.00	0.0%
<b>Total Market Value</b>	<b>\$65,342,529.84</b>	<b>100%</b>

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

Key Portfolio Statistics	
<b>Effective Duration<sup>1</sup></b>	<b>1.50 years</b>
<b>Benchmark Duration<sup>2</sup></b>	<b>1.76 years</b>
<b>Yield at Cost</b>	<b>0.90%</b>

1. Duration to worst as of 01/31/2011 was 1.89
2. The City's benchmark is the Merrill Lynch 1-3 year U.S. Treasury Index  
Performance statistics exclude money market fund and CDARS investments

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



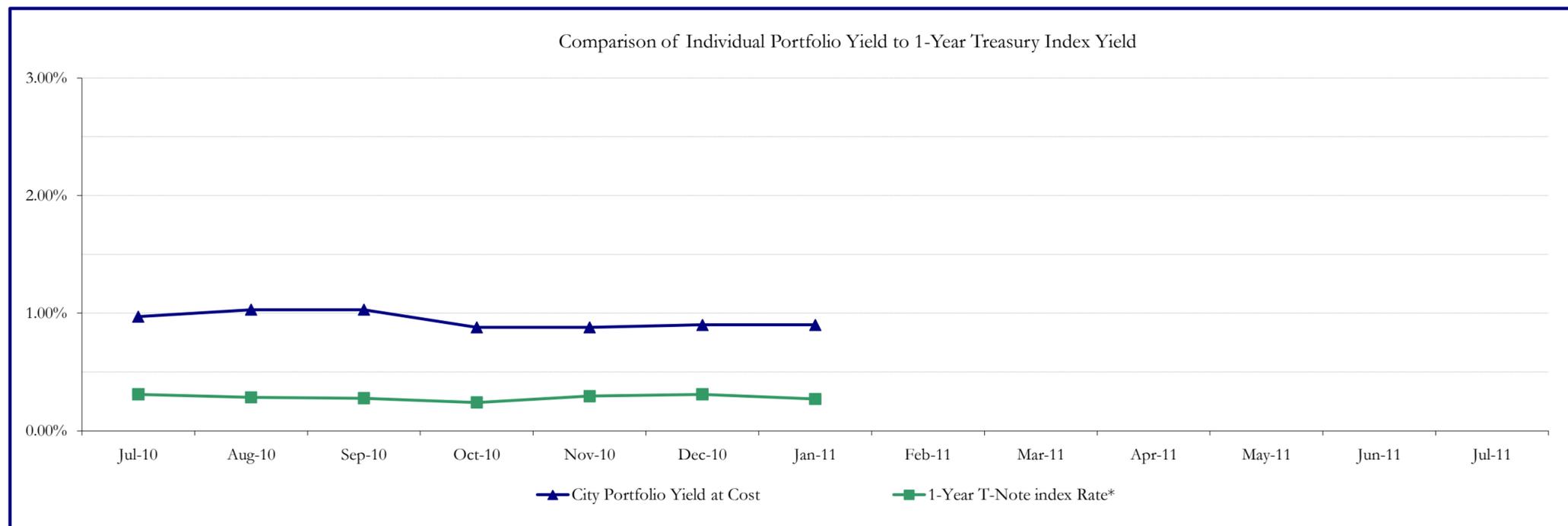
**City of Surprise Individual Portfolio Yield Summary  
Fiscal Year 2010-2011**

Date	Month-End Market Value <sup>1</sup>	Duration <sup>2</sup>	Portfolio YTM at Cost <sup>2</sup>	1-Year T-Note Index Rate <sup>3</sup>
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%
Oct-10	\$34,159,429	1.72	0.88%	0.24%
Nov-10	\$35,295,699	1.82	0.88%	0.29%
Dec-10	\$35,315,499	1.73	0.90%	0.31%
Jan-11	\$35,342,530	1.50	0.90%	0.27%

<sup>1</sup> Excludes accrued interest and CDARS. Includes balance in the custody account MMF

<sup>2</sup> Excludes CDARS and custoday account MMF

<sup>3</sup> Rate represents the Merrill Lynch 1-Year U.S. Treasury Note Index month-end yield (GC03). Source Bloomberg

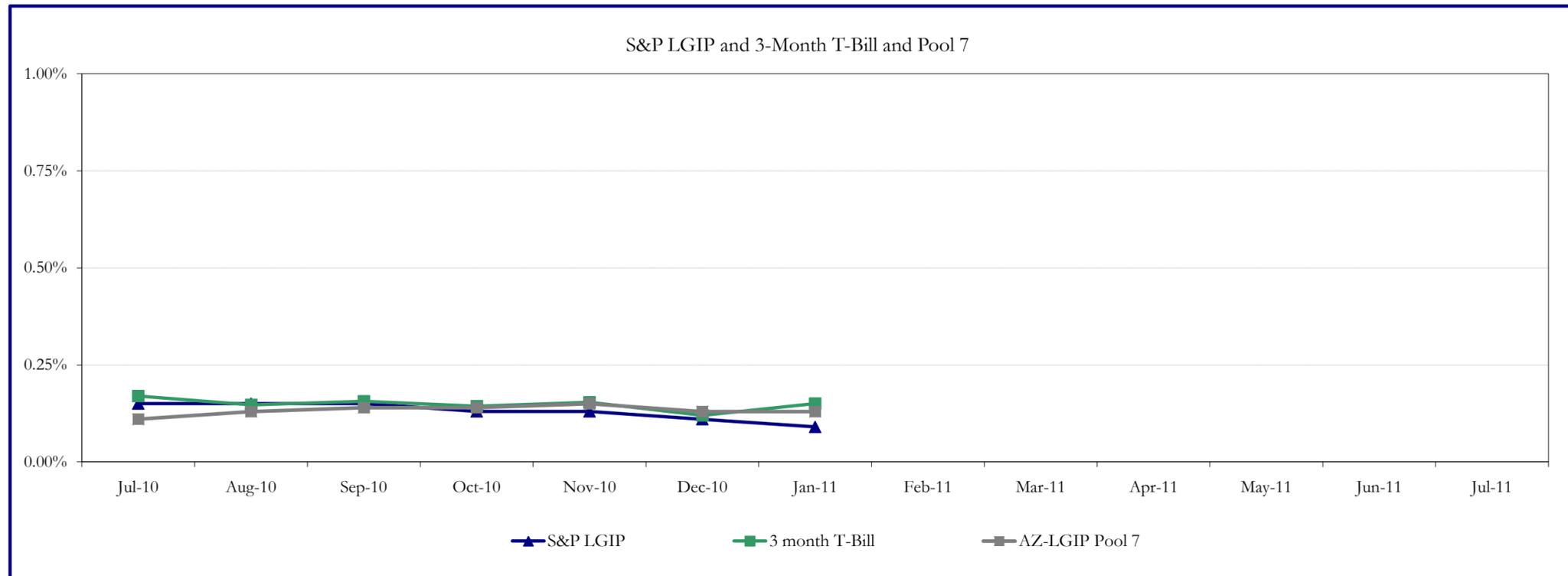


**City of Surprise Short-Term Benchmark Comparisons  
Fiscal Year 2010-2011**

Date	S&P LGIP	AZ-LGIP Pool 7 <sup>1</sup>	3 month Treasury Bill <sup>2</sup>
Jul-10	0.15%	0.11%	0.17%
Aug-10	0.15%	0.13%	0.15%
Sep-10	0.15%	0.14%	0.16%
Oct-10	0.13%	0.14%	0.14%
Nov-10	0.13%	0.14%	0.14%
Dec-10	0.11%	0.13%	0.12%
Jan-11	0.09%	0.13%	0.15%

<sup>1</sup> Monthly Apportionment Yields. Source: Office of the Arizona State Treasurer

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



**City of Surprise Holdings**  
**Month Ended January 31, 2011**

**Operating Funds Investment Inventory by Maturity Date**

<b>Issuer</b>	<b>Maturity</b>	<b>Years to Maturity</b>	<b>Fair Value</b>	<b>Yield to Maturity</b>	<b>Next Call Date</b>	<b>Frequency</b>
Wells Fargo MMF	1/31/2011	0.00	\$115,394	0.01%		
Alliance Bank	6/30/2011	0.42	\$10,000,000	0.55%		
Alliance Bank	9/29/2011	0.66	\$15,000,000	1.00%		
Alliance Bank	12/29/2011	0.91	\$5,000,000	0.88%		
FHLB	6/8/2012	1.36	\$3,036,858	0.97%		
FHLMC	11/30/2012	1.83	\$2,987,571	0.66%		
FHLMC	12/21/2012	1.89	\$2,130,294	1.09%		
FHLMC	4/15/2013	2.21	\$1,237,936	0.56%		
FNMA	6/26/2013	2.41	\$2,030,338	1.41%		
FNMA	7/19/2013	2.47	\$2,006,184	1.39%	7/19/11	One-time
FNMA	8/16/2013	2.54	\$5,001,240	1.23%	2/16/11	One-time
FFCB	9/16/2013	2.63	\$5,032,665	0.43%		
FNMA	9/23/2013	2.65	\$4,994,645	0.73%		
FHLMC	11/15/2013	2.79	\$1,238,463	1.01%	2/15/11	Quarterly
U.S. Treasury	11/15/2013	2.79	\$3,056,927	0.81%		
FNMA	11/26/2013	2.82	\$2,474,015	0.98%	5/23/11	Quarterly
<b>Total Market Value</b>			<b>\$ 65,342,530</b>			



## Managed Account Detail of Securities Held

For the Month Ending **January 31, 2011**

### 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
<b>U.S. Treasury Bond / Note</b>											
US TREASURY NOTES DTD 11/15/2010 0.500% 11/15/2013	912828PU8	3,090,000.00	TSY	TSY	12/01/10	12/02/10	3,062,117.58	0.81	3,329.01	3,063,693.01	3,056,927.34
<b>Security Type Sub-Total</b>		<b>3,090,000.00</b>					<b>3,062,117.58</b>	<b>0.81</b>	<b>3,329.01</b>	<b>3,063,693.01</b>	<b>3,056,927.34</b>
<b>Federal Agency Bond / Note</b>											
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	6,072.92	3,016,486.59	3,036,858.00
FHLMC NOTES DTD 10/22/2010 0.375% 11/30/2012	3137EACP2	3,000,000.00	AAA	Aaa	12/01/10	12/02/10	2,982,900.00	0.66	3,093.75	2,984,299.17	2,987,571.00
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	9,166.67	2,113,008.06	2,130,294.00
FHLMC GLOBAL NOTES DTD 03/04/2010 1.625% 04/15/2013	3137EACJ6	1,215,000.00	AAA	Aaa	10/28/10	11/01/10	1,246,602.15	0.56	5,813.44	1,243,403.10	1,237,935.56
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	2,916.67	2,004,433.64	2,030,338.00
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	916.67	1,999,405.86	2,006,184.00
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	28,645.83	5,000,250.00	5,001,240.00
FFCB (FLOATING) NOTE DTD 09/16/2010 0.420% 09/16/2013	31331JG64	5,000,000.00	AAA	Aaa	10/12/10	10/13/10	5,000,000.00	0.43	2,809.72	5,000,000.00	5,032,665.00
FANNIE MAE GLOBAL NOTES DTD 08/06/2010 1.000% 09/23/2013	31398A2S0	5,000,000.00	AAA	Aaa	10/12/10	10/13/10	5,038,650.00	0.73	17,777.78	5,034,750.65	4,994,645.00
FREDDIE MAC GLOBAL NOTES (CALLABLE) DTD 11/15/2010 1.000% 11/15/2013	3134G1XN9	1,250,000.00	AAA	Aaa	10/28/10	11/15/10	1,249,625.00	1.01	2,638.89	1,249,651.06	1,238,462.50
FNMA NOTES (CALLABLE) DTD 11/26/2010 1.000% 11/26/2013	31398A5Y4	2,500,000.00	AAA	Aaa	11/05/10	11/26/10	2,501,562.50	0.98	4,513.89	2,500,988.70	2,474,015.00
<b>Security Type Sub-Total</b>		<b>31,965,000.00</b>					<b>32,199,779.65</b>	<b>0.91</b>	<b>84,366.23</b>	<b>32,146,676.83</b>	<b>32,170,208.06</b>



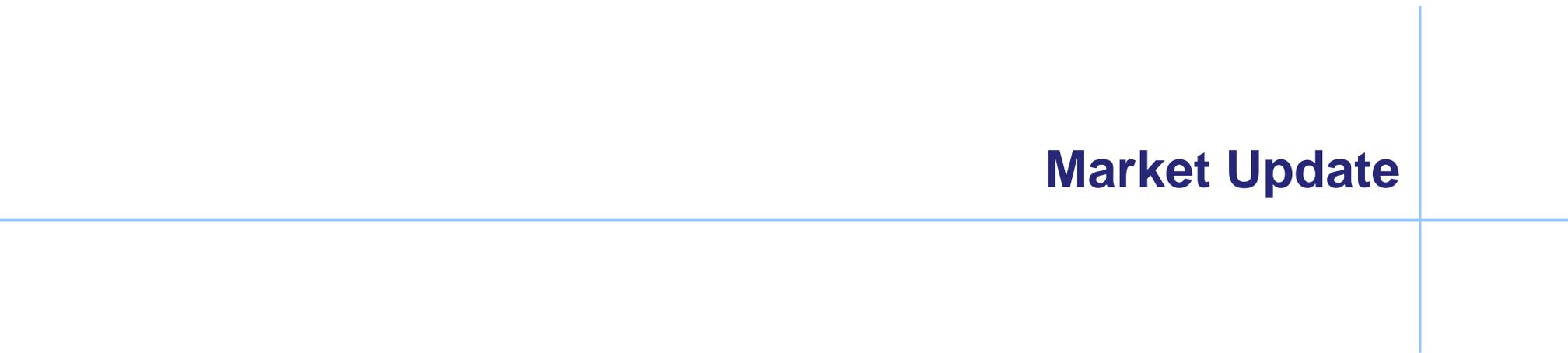
### Managed Account Detail of Securities Held

For the Month Ending **January 31, 2011**

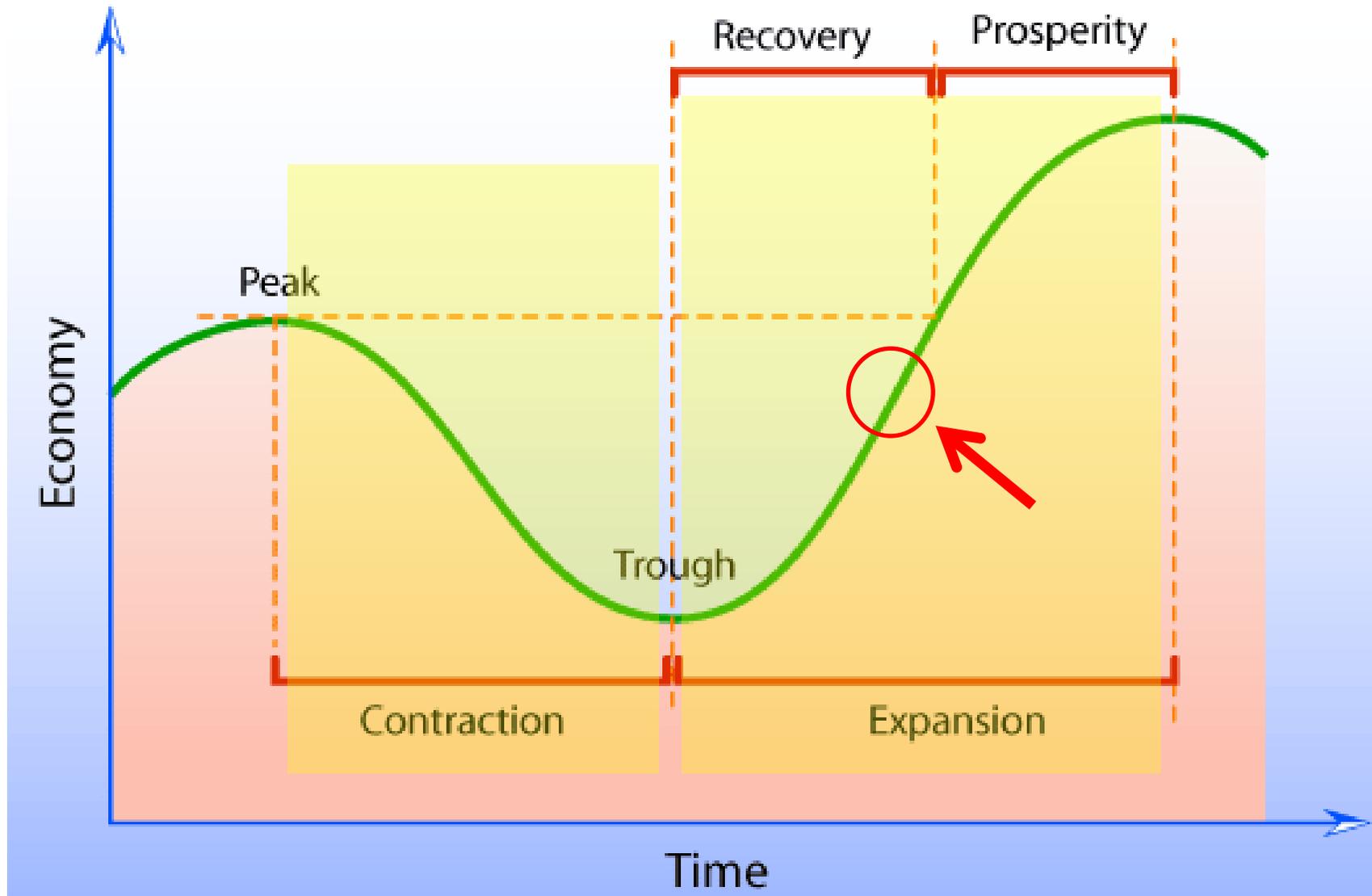
#### CITY OF SURPRISE OPERATING FUND

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
<b>Managed Account Sub-Total</b>		<b>35,055,000.00</b>					<b>35,261,897.23</b>	<b>0.90</b>	<b>87,695.24</b>	<b>35,210,369.84</b>	<b>35,227,135.40</b>
<b>Securities Sub-Total</b>		<b>\$35,055,000.00</b>					<b>\$35,261,897.23</b>	<b>0.90%</b>	<b>\$87,695.24</b>	<b>\$35,210,369.84</b>	<b>\$35,227,135.40</b>
<b>Accrued Interest</b>											<b>\$87,695.24</b>
<b>Total Investments</b>											<b>\$35,314,830.64</b>

**Market Update**



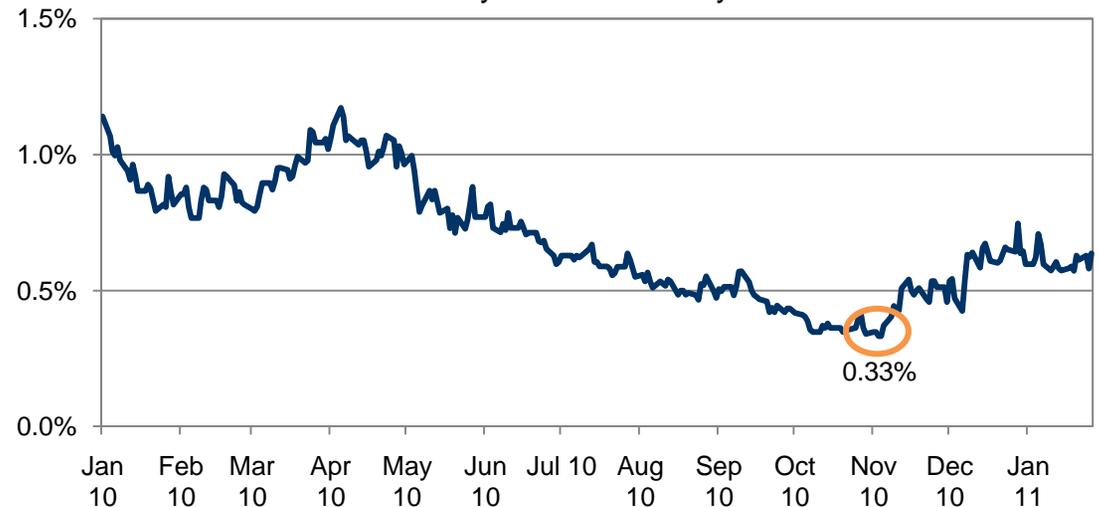
# U.S. Economy Currently Somewhere in the Recovery Phase



# Yields Have Readjusted to New Economic Data

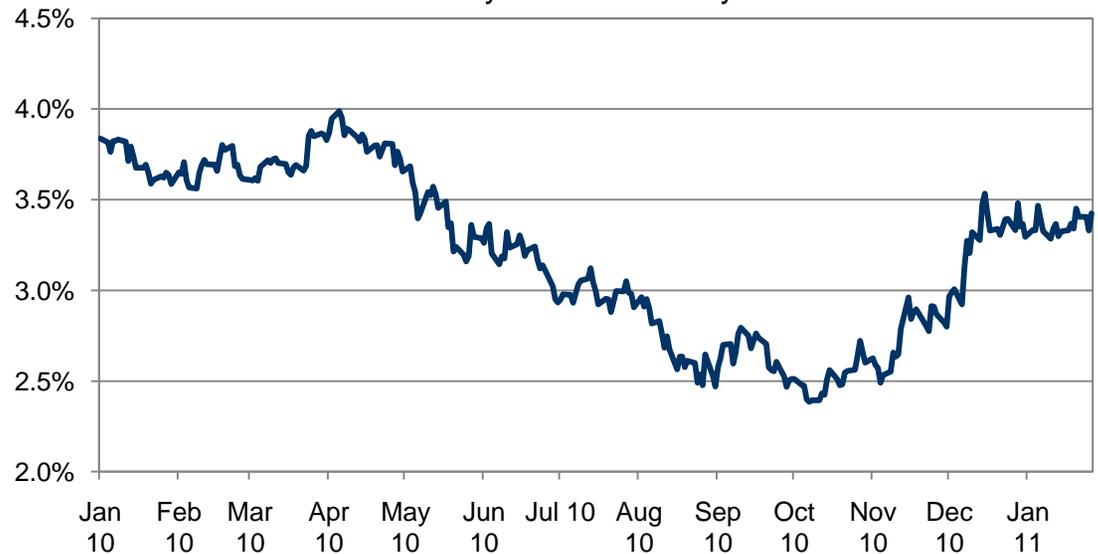
- Treasury yields rebounded from record lows in November and December, propelled by positive economic data and increasing expectations for inflation as growth continues to strengthen.

**2-Year U.S. Treasury Yields**  
January 2010 to January 2011



- Longer-term rates (10 to 30 years), which are less tied to Federal Funds than are shorter rates, also continued to rise on positive data releases.

**10-Year U.S. Treasury Note Yields**  
January 2010 to January 2011



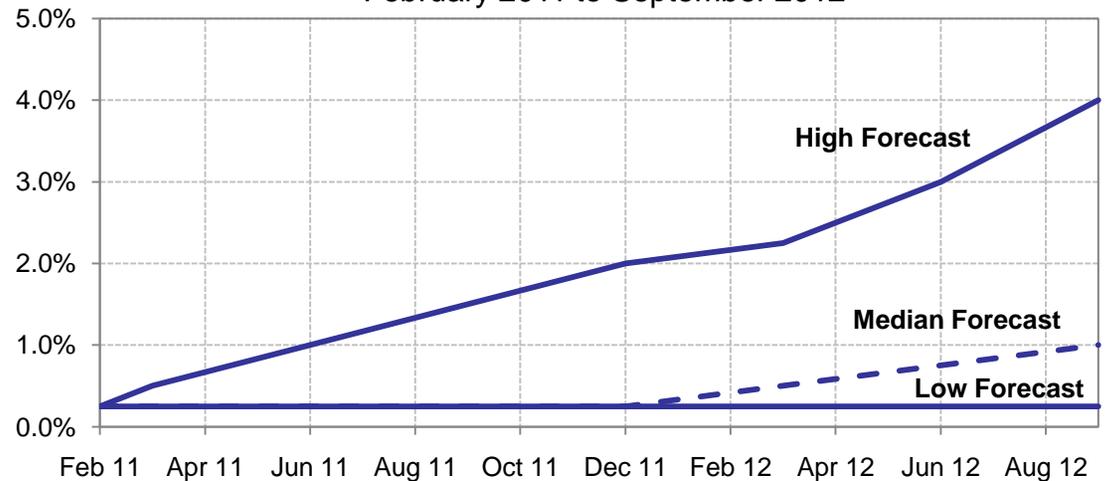
Source: Bloomberg



# Continued Steepening of Yield Curve

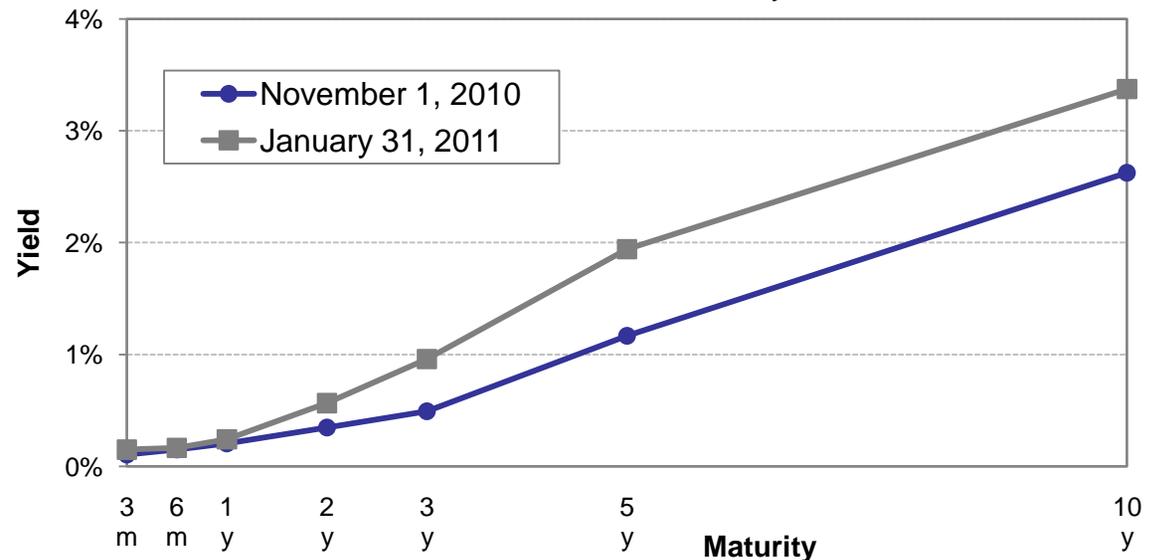
- Most economists expect the Federal Funds target rate to remain at 0.0% to 0.25% through 2011.

**Fed Funds Target Rate – February Forecast**  
February 2011 to September 2012



- With very short terms rates anchored by the Fed's target rate, the yield curve will likely remain steep.

**U.S. Treasury Yield Curve**  
November 2010 vs January 2011

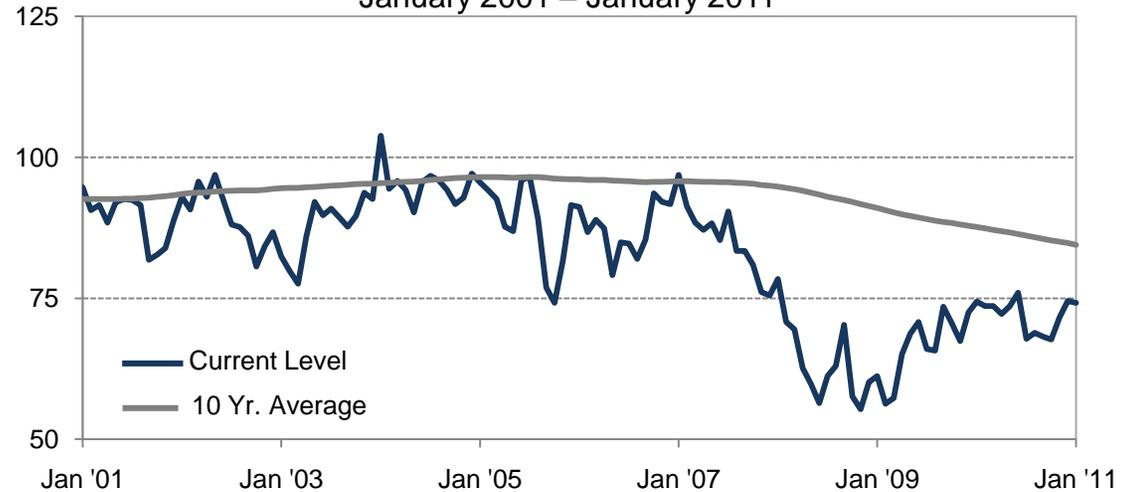


Source: Bloomberg

# Consumers Doing Their Part

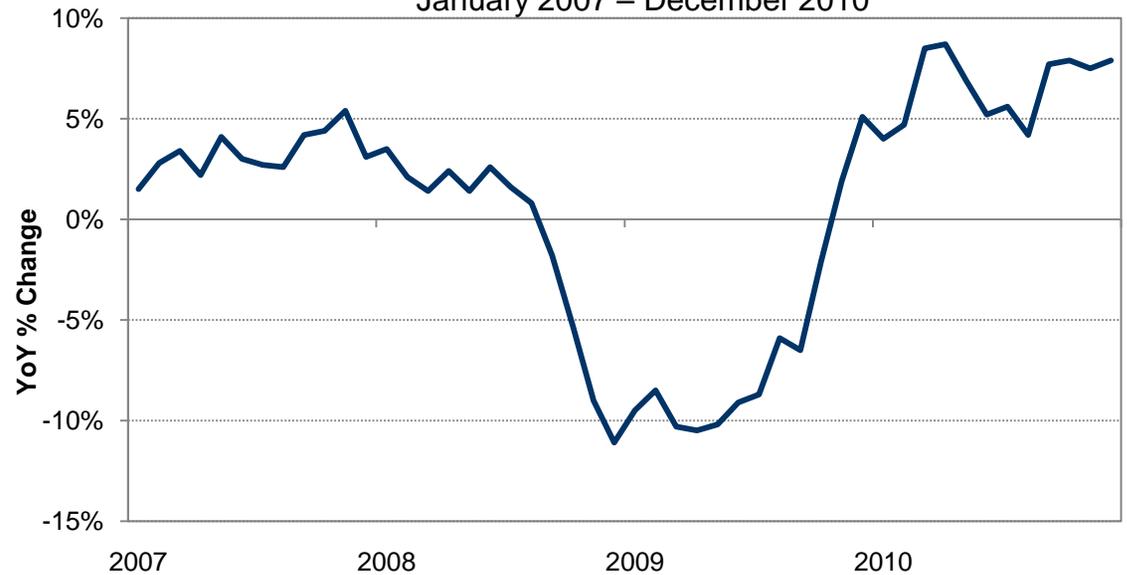
- Survey questioning 500 households on their financial conditions and attitudes about the economy shows improvement.
- Consumer sentiment is directly related to the strength of consumer spending.

**University of Michigan Consumer Sentiment**  
January 2001 – January 2011



- Total retail sales are back above pre-recession levels.

**Retail Sales YOY% Change**  
January 2007 – December 2010



Source: Bloomberg

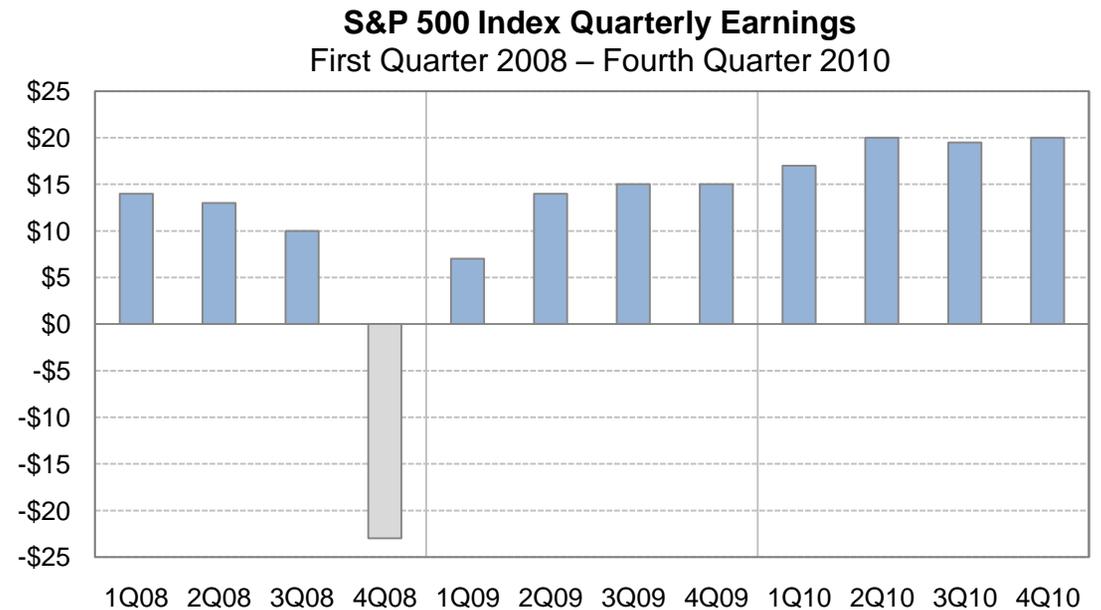


# U.S. Corporations Continue to Strengthen

- The S&P 500 has rallied almost 96% from a 12-year low in 2009 amid improving economic data and higher-than-estimated earnings.



- Fourth quarter profits for U.S. corporations also showed continued strength.

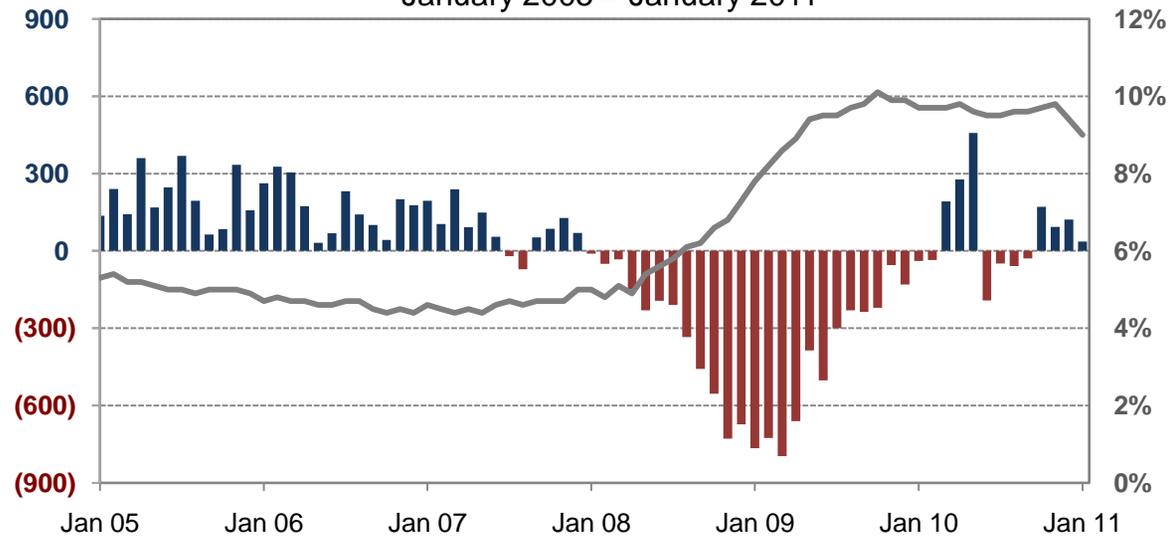


Source: Bloomberg

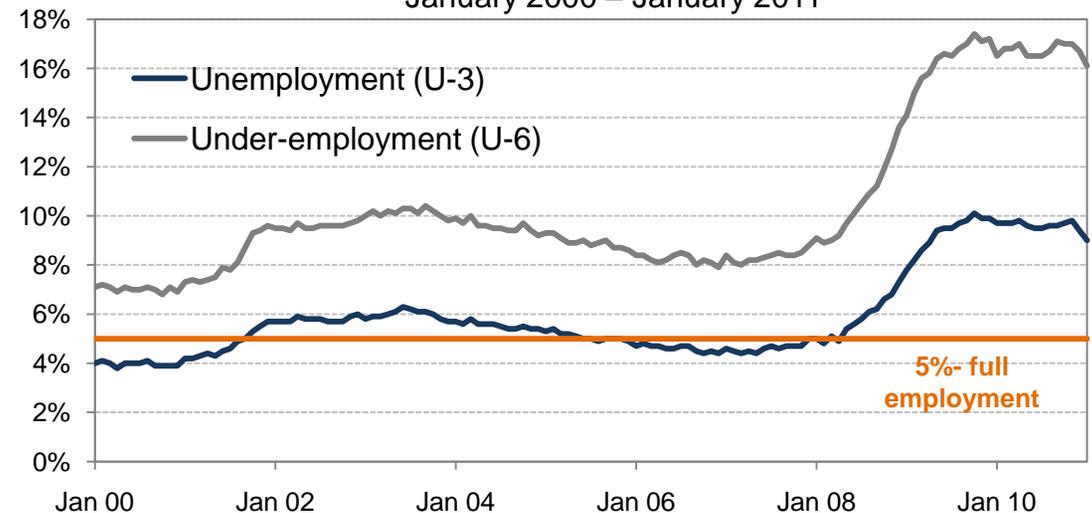
# Unemployment Remains an Impediment to Faster Economic Recovery

- Non-farm payrolls increased and the private sector added jobs in January, however both missed expectations.
  - Harsh winter weather played a part in the disappointing payrolls release as construction jobs fell by 32,000.
- The main driver for the jobs increase was in manufacturing jobs which rose 49,000.
  
- While the unemployment rate fell to 9.0% after reaching 9.4% in the prior month, there remains a significant jobs deficit.

**Change in Non-Farm Payrolls/ Unemployment Rate**  
January 2005 – January 2011



**Unemployment and Under-employment Rates**  
January 2000 – January 2011



Source: Bloomberg

# Unemployment Rate Down to 9%, So Where Are the Jobs?

- Q. How did the unemployment rate drop so much when so few jobs were added?**
- A. The two numbers—jobs added and the unemployment rate—are compiled from two different surveys:**
- Payroll figure comes from the establishment survey—the government asks companies how many people are on their payrolls.
  - The unemployment rate is taken from the household survey—the government asks people about their work status.
  - The rate can fall when people leave the workforce or quit looking for jobs. And it can fall when fewer people report they are unemployed.
  - When both happen in the same month, the unemployment rate can drop rapidly

# In Arizona and the U.S.: Housing Remains “Under Water”

- At least half of homeowners with a mortgage owe more than their homes are worth in 17 of 386 U.S. counties.

**Highest Percentage of Under Water Mortgages by County**

Rank	County	State	Mortgages Under Water
1	Clark	NV	71.1%
2	Osceola	FL	66.5%
3	Merced	CA	63.1%
4	St Lucie	FL	62.4%
5	San Joaquin	CA	59.6%
6	Stanislaus	CA	57.5%
7	Clayton	GA	56.1%
8	Orange	FL	56.1%
9	Solano	CA	55.6%
10	Maricopa	AZ	54.4%
11	Washoe	NV	53.3%
12	Pinal	AZ	52.6%
13	Flagler	FL	52.5%
14	Pasco	FL	51.5%
15	Riverside	CA	50.5%

**Lowest Percentage of Under Water Mortgages by County**

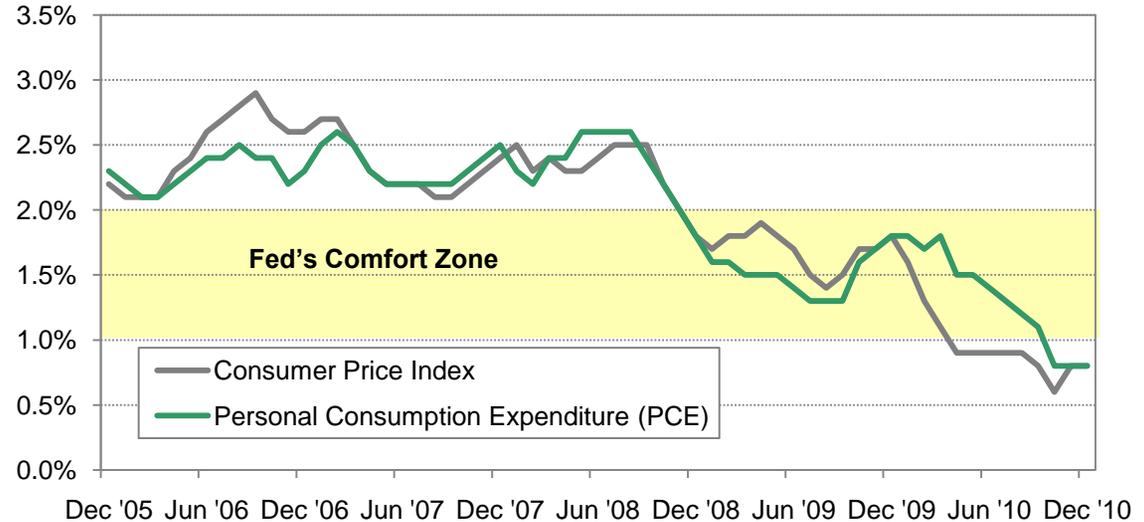
Rank	County	State	Mortgages Under Water
372	Monroe	NY	5.2%
373	Hampshire County	MA	5.2%
374	Sangamon	IL	5.2%
375	Oklahoma	OK	5.2%
376	Lancaster	PA	5.0%
377	Yellowstone	MT	5.0%
378	Allegheny	PA	4.7%
379	Madison	AL	4.7%
380	Benton	WA	4.3%
381	Cleveland	OK	4.2%
382	Cumberland	NC	4.2%
383	Erie	NY	4.2%
384	Manhattan	NY	4.2%
385	Suffolk	NY	2.1%
386	Orange	NY	1.0%

# Commodities Increase But Inflation Remains Low

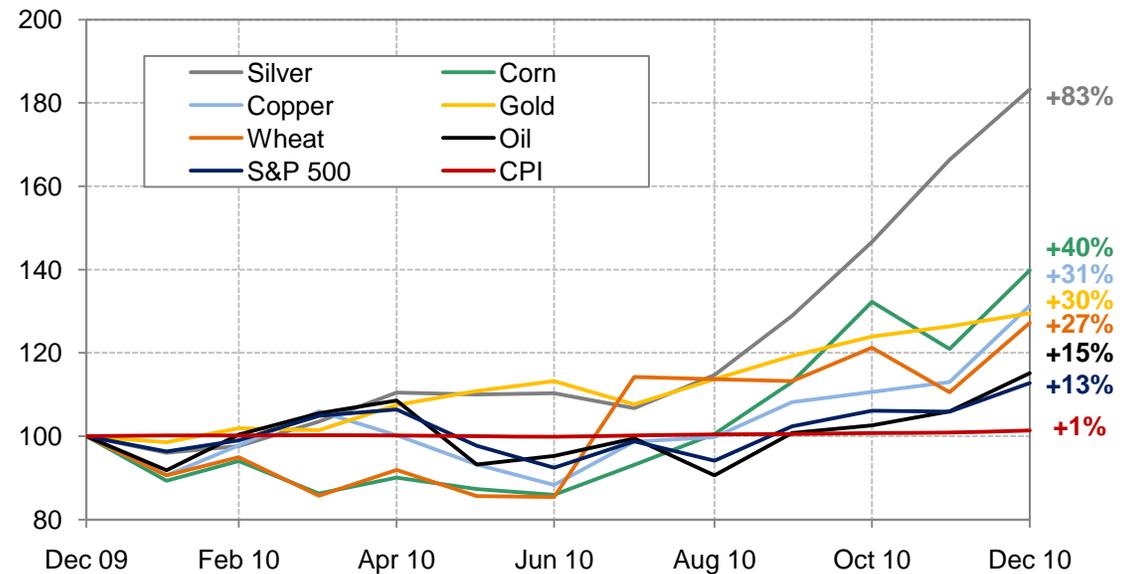
- Core inflation measures are slightly below the Fed's 1% to 2% comfort zone for annual inflation.

- However, prices of food, energy, and commodities have begun to experience large increases in recent months, which has added to market expectations of future inflation.

**Core Inflation Indicators YoY % Change**  
December 2005 – December 2010



**Price Inflation**  
December 2009 = 100



# “Reforming America’s Housing Finance Market”

- U.S. Department of Treasury and the U.S. Department of Housing and Urban Development jointly released to Congress their report on “Reforming America’s Housing Finance Market.”
- The proposal highlights the administration’s desire to :
  - 1) Reduce the role of Fannie Mae and Freddie Mac in the mortgage market and, ultimately, wind down both institutions
  - 2) Secure affordable housing
  - 3) Attract private capital to the sector
- The report expressed the Government’s commitment to Fannie Mae and Freddie Mac:
  - **“Our commitment to ensuring Fannie Mae and Freddie Mac have sufficient capital to honor any guarantees issued now or in the future and meet any of their debt obligations remains unchanged.”**
  - **“The government is committed to ensuring that Fannie Mae and Freddie Mac have sufficient capital to perform under any guarantees issued now or in the future and the ability to meet any of their debt obligations. The Administration will not pursue policies or reforms in a way that would impair the ability of Fannie Mae and Freddie Mac to honor their obligations.”**

# Summary Of Chairman Bernanke's February 3rd Speech

<u>Economic Outlook</u>	<u>Monetary Policy</u>	<u>Fiscal Policy</u>
<ul style="list-style-type: none"> <li>• Recovery is not established until unemployment drops significantly</li> <li>• Overall inflation is still below the Fed's comfort band with only 1.2% growth during 2010</li> <li>• Economy is improving, but at a very slow pace and we are years away from seeing pre-crisis levels</li> </ul>	<ul style="list-style-type: none"> <li>• Fed Funds target rate will stay "exceptionally low for a long period of time"</li> <li>• QE2 has not affected short-term rates, but has put "downward pressure" on longer-term rates</li> <li>• QE1 and QE2 reactions have been similar</li> <li>• Fed will adjust QE2 purchases as necessary</li> </ul>	<ul style="list-style-type: none"> <li>• Congress must change fiscal programs or budget deficit will eventually get too large</li> <li>• Two largest forces driving federal budget are aging of population and high healthcare costs</li> <li>• Controlling health care costs will bring budget deficit to lower levels</li> <li>• Debt to GDP ratio too high</li> </ul>

## Recent Portfolio Swap

- An increased in yields in February brought with it a steeper yield curve, making longer-term investments even more rewarding over shorter-term securities. To take advantage of this, we performed the following swap in the City's portfolio:

Date	Transaction	Security	Maturity	Par	Yield	Realized Gains
2/3/11	Buy	FNMA Notes	2/26/13	\$3,045,000	0.84%	-
2/3/11	Sell	FHLB Bonds	6/8/12	\$3,000,000	0.49%	\$19,400

- The swap benefits the portfolio in a number of ways: boosts the overall yield of the portfolio, extends duration more in line with the benchmark, and the security is well positioned on the yield curve to take advantage of “roll-down” over the coming 12 months.

# Disclaimer

*This material is based on information obtained from sources generally believed to be reliable and available to the public, however PFM Asset Management LLC cannot guarantee its accuracy, completeness or suitability. This material is for general information purposes only and is not intended to provide specific advice or a specific recommendation. All statements as to what will or may happen under certain circumstances are based on assumptions, some but not all of which are noted in the presentation. Assumptions may or may not be proven correct as actual events occur, and results may depend on events outside of your or our control. Changes in assumptions may have a material effect on results. Past performance does not necessarily reflect and is not a guaranty of future results. The information contained in this presentation is not an offer to purchase or sell any securities.*