



July, 2011

PFM Asset Management LLC

2375 E. Camelback Rd, Suite 5118

Phoenix, AZ 85016

602.387.5187

www.pfm.com

City of Surprise
Investment Guidelines and Objectives
Month Ended June 30, 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:

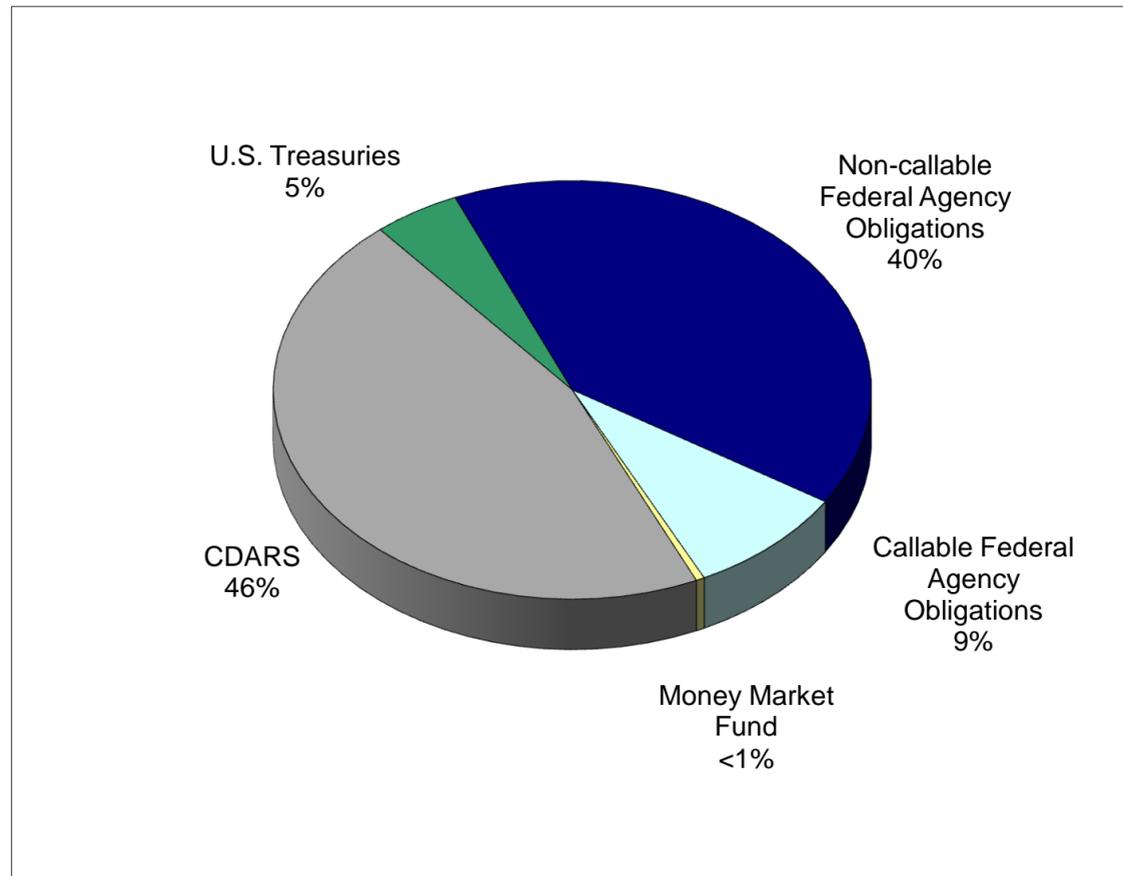
- **Permitted Investments.** The City will invest in permitted securities consistent with A.R.S.§35-323. Additionally, the City may desire to be more conservative in its investment portfolio and restrict or prohibit certain of the investments outlined in the Investment Policy.
- **Transactions prior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

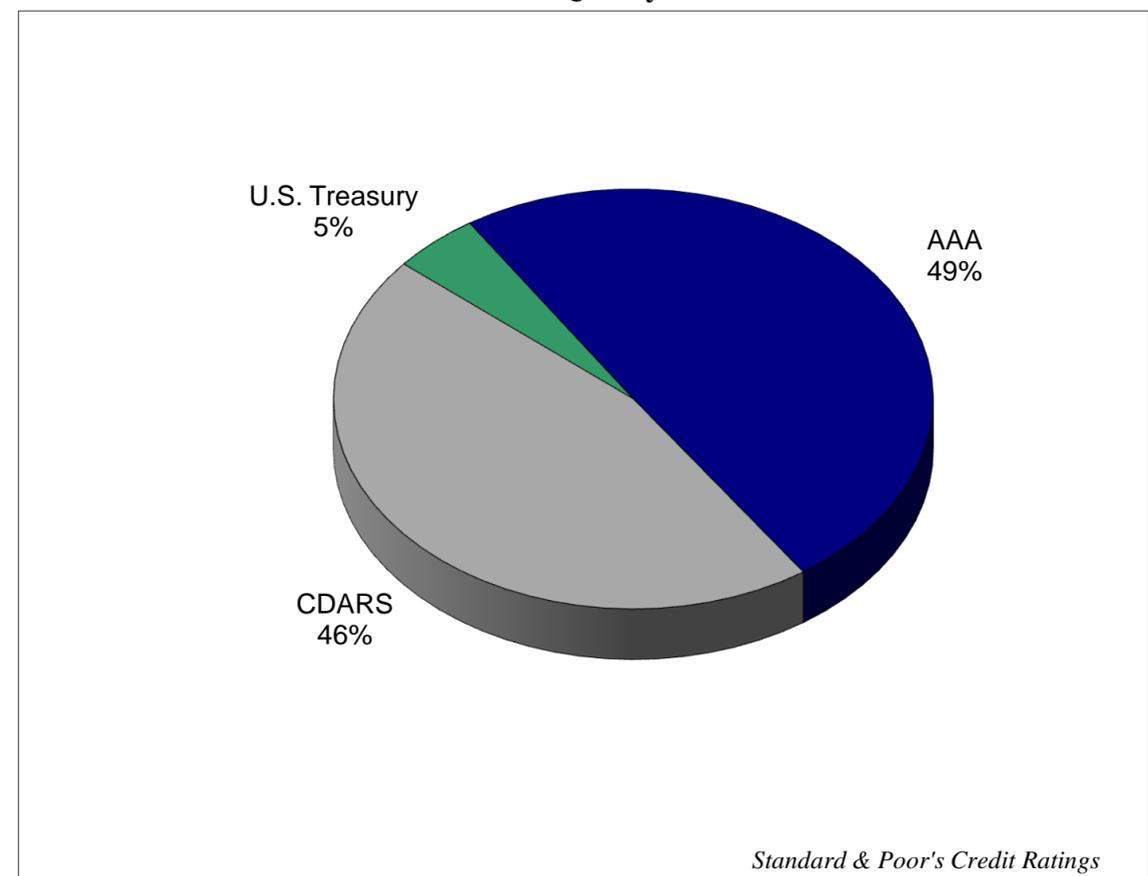
Month Ended June 30, 2011

| <u>Security Type</u> | <u>Current Holdings*</u> | <u>Current Month % of Portfolio</u> | <u>Previous Month % of Portfolio</u> |
|-----------------------------|--------------------------|---|--|
| U.S. Treasury | \$3,082,516.02 | 5% | 16% |
| Federal Agency | \$32,266,097.06 | 49% | 84% |
| Callable Federal Agency | \$5,754,017.75 | 9% | 16% |
| Non-callable Federal Agency | \$26,512,079.31 | 40% | 68% |
| CDARS | \$30,000,000.00 | 46% | 0% |
| Wells Fargo MMF | \$300,510.95 | <1% | <1% |
| Total Market Value | \$65,649,124.03 | 100% | 100% |

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 June 30, 2011

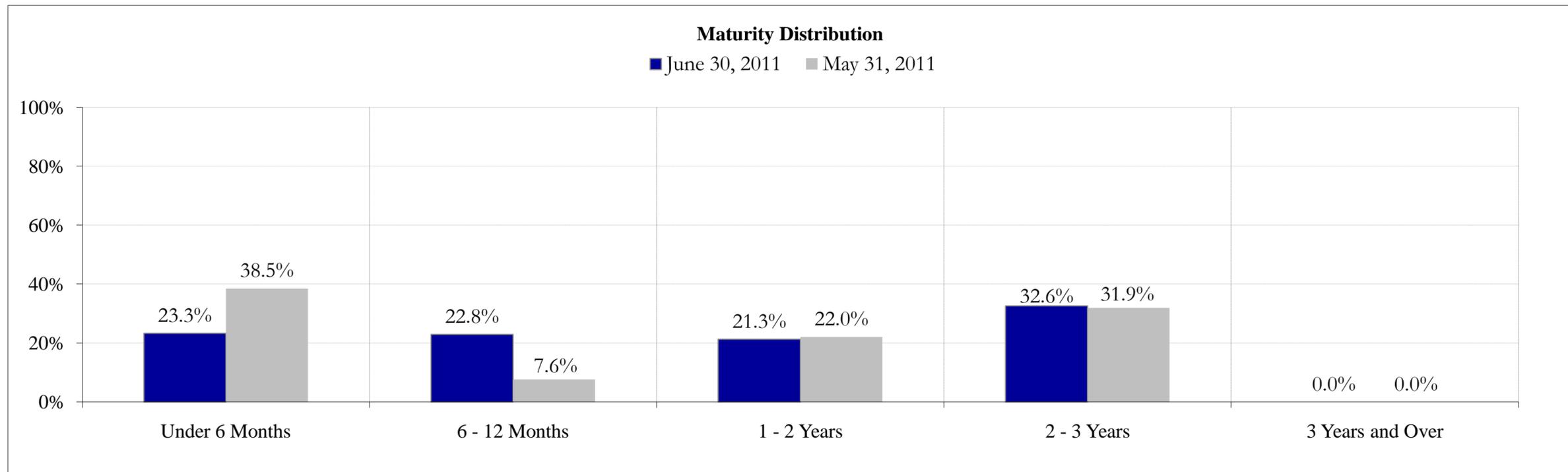
| Maturity Distribution Summary | | |
|--------------------------------------|------------------------|-----------------------|
| <u>Maturity Class</u> | <u>Fair Value*</u> | <u>% of Portfolio</u> |
| Under 6 Months | \$15,300,510.95 | 23.3% |
| 6 - 12 Months | \$15,000,000.00 | 22.8% |
| 1 - 2 Years | \$13,952,701.81 | 21.3% |
| 2 - 3 Years | \$21,395,911.27 | 32.6% |
| 3 Years and Over | \$0.00 | 0.0% |
| Total Market Value | \$65,649,124.03 | 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 | |
|---------------------------------------|-------------------|
| Effective Duration¹ | 1.41 years |
| Benchmark Duration² | 1.80 years |
| Yield at Cost | 0.82% |

1. Duration to worst as of 06/30/2011 was 1.64
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.



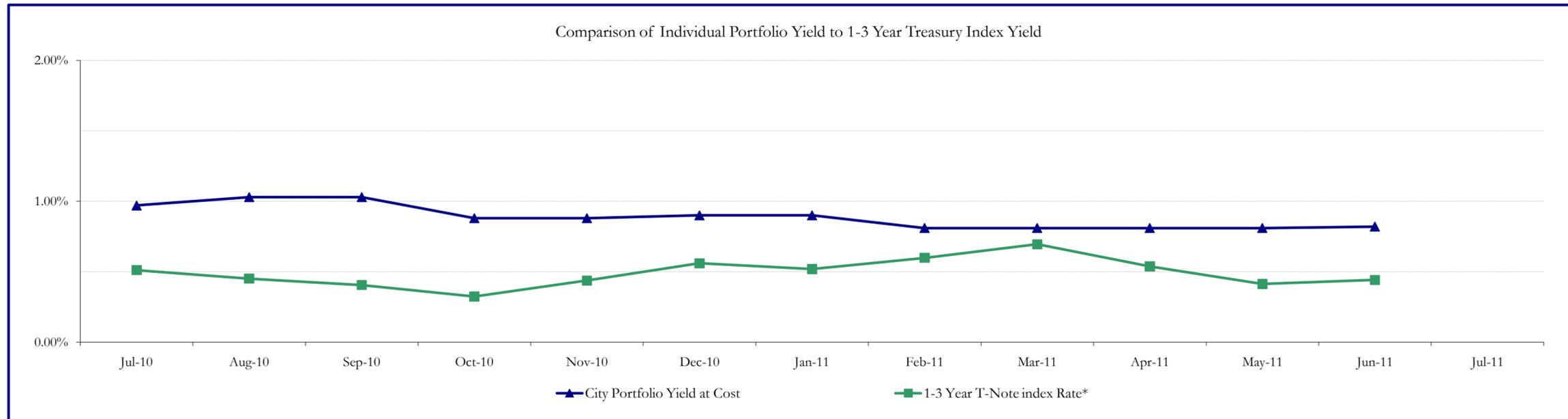
City of Surprise Individual Portfolio Yield Summary
Fiscal Year 2010-2011

| Date | Month-End Market Value ¹ | Duration ² | Portfolio YTM at Cost ² | 1-3 Year T-Note Index Rate ³ |
|--------|-------------------------------------|-----------------------|------------------------------------|---|
| Jul-10 | \$15,279,792 | 1.75 | 0.97% | 0.51% |
| Aug-10 | \$20,296,127 | 1.37 | 1.03% | 0.45% |
| Sep-10 | \$20,306,987 | 1.29 | 1.03% | 0.41% |
| Oct-10 | \$34,159,429 | 1.72 | 0.88% | 0.32% |
| Nov-10 | \$34,159,429 | 1.72 | 0.88% | 0.32% |
| Dec-10 | \$35,315,499 | 1.73 | 0.90% | 0.56% |
| Jan-11 | \$35,342,530 | 1.50 | 0.90% | 0.52% |
| Feb-11 | \$35,312,485 | 1.75 | 0.81% | 0.60% |
| Mar-11 | \$35,311,883 | 1.66 | 0.81% | 0.69% |
| Apr-11 | \$35,456,156 | 1.48 | 0.81% | 0.54% |
| May-11 | \$35,580,243 | 1.39 | 0.81% | 0.41% |
| Jun-11 | \$35,649,124 | 1.41 | 0.82% | 0.44% |

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

² Excludes CDARS and custoday account MMF

³ Rate represents the Merrill Lynch 1-3 Year U.S. Treasury Note Index month-end yield. Source Bloomberg

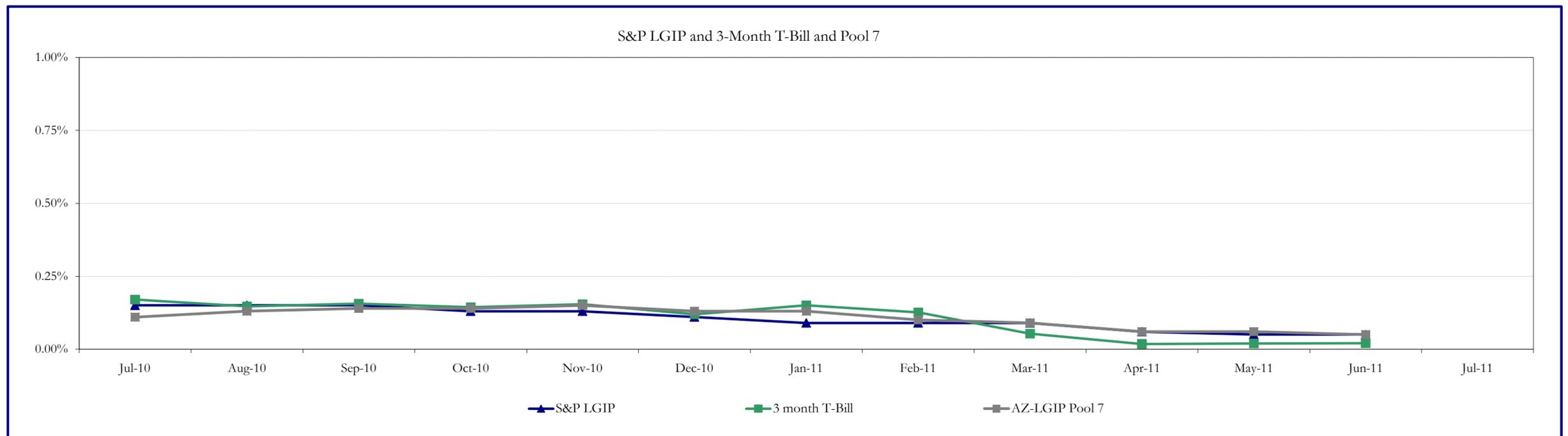


City of Surprise Short-Term Benchmark Comparisons Fiscal Year 2010-2011

| 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% |
| 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% |
| Feb-11 | 0.09% | 0.10% | 0.13% |
| Mar-11 | 0.09% | 0.09% | 0.05% |
| Apr-11 | 0.06% | 0.06% | 0.02% |
| May-11 | 0.05% | 0.06% | 0.02% |
| Jun-11 | 0.05% | 0.05% | 0.02% |

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 (G0O1). Source: Bloomberg



City of Surprise Holdings
Month Ended June 30, 2011

Operating Funds Investment Inventory by Maturity Date

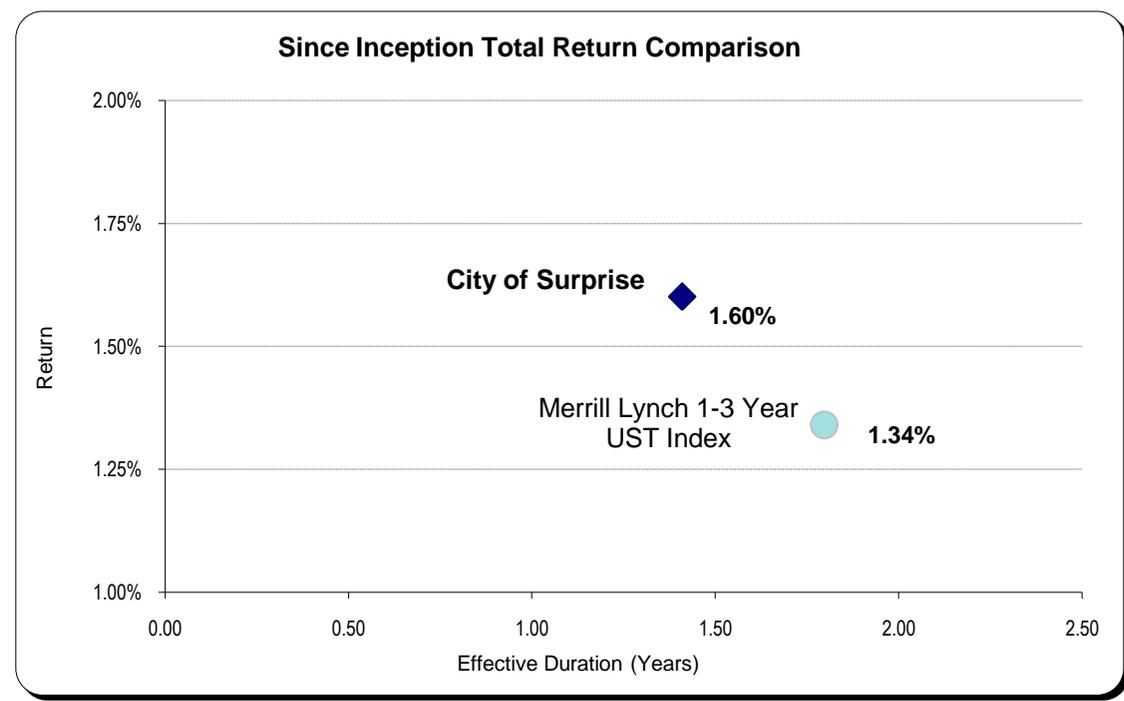
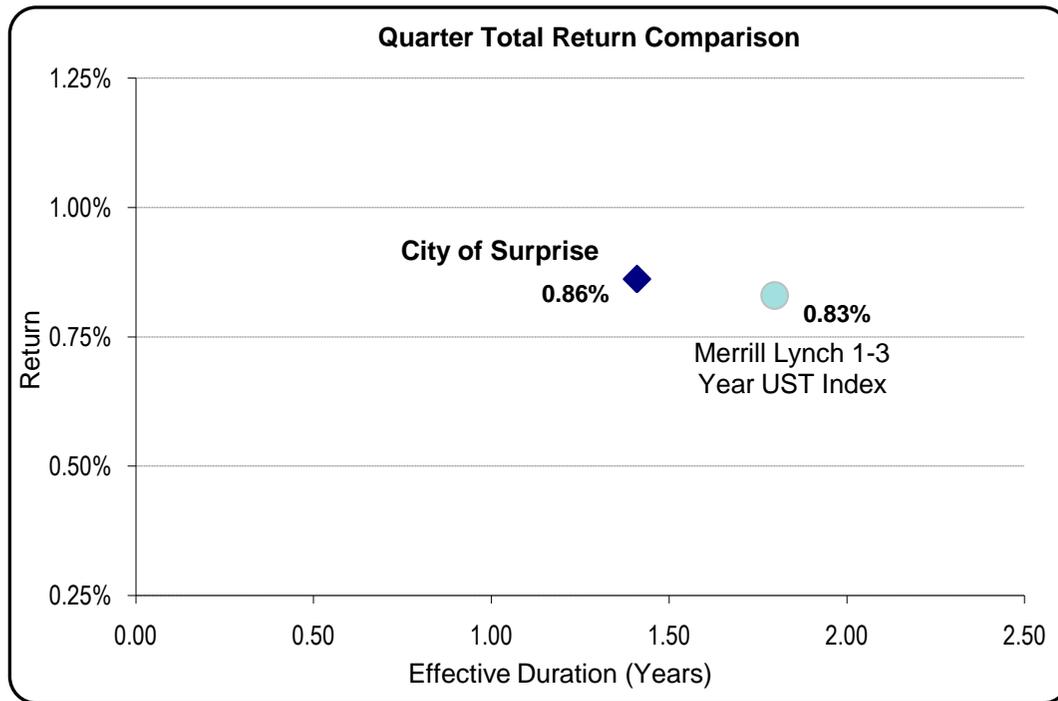
| Issuer | Maturity | Years to Maturity | Fair Value | Yield to Maturity | Next Call Date | Frequency |
|---------------------------|-----------------|--------------------------|----------------------|--------------------------|-----------------------|------------------|
| Wells Fargo MMF | 6/30/2011 | 0.00 | \$300,511 | 0.01% | | |
| Alliance Bank (CDARS) | 9/29/2011 | 0.25 | \$15,000,000 | 1.01% | | |
| Alliance Bank (CDARS) | 12/29/2011 | 0.50 | \$5,000,000 | 0.88% | | |
| Alliance Bank (CDARS) | 6/29/2012 | 1.00 | \$10,000,000 | 0.66% | | |
| FNMA | 10/30/2012 | 1.33 | \$2,504,075 | 0.77% | | |
| FHLMC | 11/30/2012 | 1.42 | \$2,999,409 | 0.66% | | |
| FHLMC | 12/21/2012 | 1.48 | \$2,108,426 | 1.09% | | |
| FNMA | 2/26/2013 | 1.66 | \$3,060,746 | 0.83% | | |
| FHLMC | 4/15/2013 | 1.79 | \$1,240,086 | 0.56% | | |
| FNMA | 6/26/2013 | 1.99 | \$2,039,960 | 1.41% | | |
| FNMA | 7/19/2013 | 2.05 | \$2,001,004 | 1.39% | 7/19/11 | One-time |
| FFCB | 9/16/2013 | 2.21 | \$5,009,685 | 0.43% | | |
| FNMA | 9/23/2013 | 2.23 | \$5,040,000 | 0.73% | | |
| FHLMC | 11/15/2013 | 2.38 | \$1,250,636 | 1.01% | 8/15/11 | Quarterly |
| U.S. Treasury | 11/15/2013 | 2.38 | \$3,082,516 | 0.81% | | |
| FNMA | 11/26/2013 | 2.41 | \$2,502,378 | 0.98% | 8/23/11 | Quarterly |
| FHLB | 12/27/2013 | 2.49 | \$2,509,693 | 0.71% | | |
| Total Market Value | | | \$ 65,649,124 | | | |

City of Surprise Quarterly Performance Month Ended June 30, 2011

Portfolio Performance

| Total Return ^{1,2,3,5} | Quarter Ended June 30, 2011 | Past 6 Months | Past 1 Year | Since Inception |
|--|--------------------------------|------------------|----------------|--------------------|
| City of Surprise | 0.86% | 0.89% | 1.60% | 1.60% |
| Merrill Lynch 1-3 Year UST Index | 0.83% | 0.86% | 1.34% | 1.34% |

| Effective Duration ⁴ | June 30, 2011 | March 31, 2011 | Yields | June 30, 2011 | March 31, 2011 |
|--|---------------|----------------|-----------------|---------------|----------------|
| City of Surprise | 1.41 | 1.66 | Yield at Market | 0.58% | 0.88% |
| Merrill Lynch 1-3 Year UST Index | 1.80 | 1.78 | Yield on Cost | 0.82% | 0.81% |



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 **June 30, 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 |
|---|-----------------------------------|--------------|---------------------|-----------------------|-----------------------|-------------------|--------------------|----------------------|--------------------|-------------------------|-----------------------|---------------------|
| U.S. Treasury Bond / Note | | | | | | | | | | | | |
| 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 | 1,973.23 | 3,067,551.49 | 3,082,516.02 |
| Security Type Sub-Total | | | 3,090,000.00 | | | | | 3,062,117.58 | 0.81 | 1,973.23 | 3,067,551.49 | 3,082,516.02 |
| Federal Agency Bond / Note | | | | | | | | | | | | |
| FANNIE MAE GLOBAL NOTES DTD 10/08/2010 0.500% 10/30/2012 | | 31398A4T6 | 2,500,000.00 | AAA | Aaa | 02/16/11 | 02/16/11 | 2,488,575.00 | 0.77 | 2,118.06 | 2,491,077.90 | 2,504,075.00 |
| 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 | 968.75 | 2,987,858.13 | 2,999,409.00 |
| 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 | 2,291.67 | 2,088,286.28 | 2,108,426.00 |
| FNMA NOTES DTD 01/18/2011 0.750% 02/26/2013 | | 3135G0AK9 | 3,045,000.00 | AAA | Aaa | 02/02/11 | 02/03/11 | 3,039,747.38 | 0.83 | 7,929.69 | 3,040,785.32 | 3,060,745.70 |
| 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 | 4,168.13 | 1,238,063.65 | 1,240,086.11 |
| 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 | 416.67 | 2,003,675.78 | 2,039,960.00 |
| 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 | 12,375.00 | 1,999,504.82 | 2,001,004.00 |
| FFCB (FLOATING) NOTE DTD 09/16/2010 0.330% 09/16/2013 | | 31331JG64 | 5,000,000.00 | AAA | Aaa | 10/12/10 | 10/13/10 | 5,000,000.00 | 0.43 | 698.61 | 5,000,000.00 | 5,009,685.00 |
| 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 | 13,611.11 | 5,029,319.85 | 5,040,000.00 |
| 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 | 1,597.22 | 1,249,702.56 | 1,250,636.25 |
| 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 | 2,430.56 | 2,500,000.00 | 2,502,377.50 |
| FHLB NOTES DTD 11/18/2010 0.875% 12/27/2013 | | 313371UC8 | 2,500,000.00 | AAA | Aaa | 06/30/11 | 06/30/11 | 2,510,225.00 | 0.71 | 243.06 | 2,510,213.68 | 2,509,692.50 |



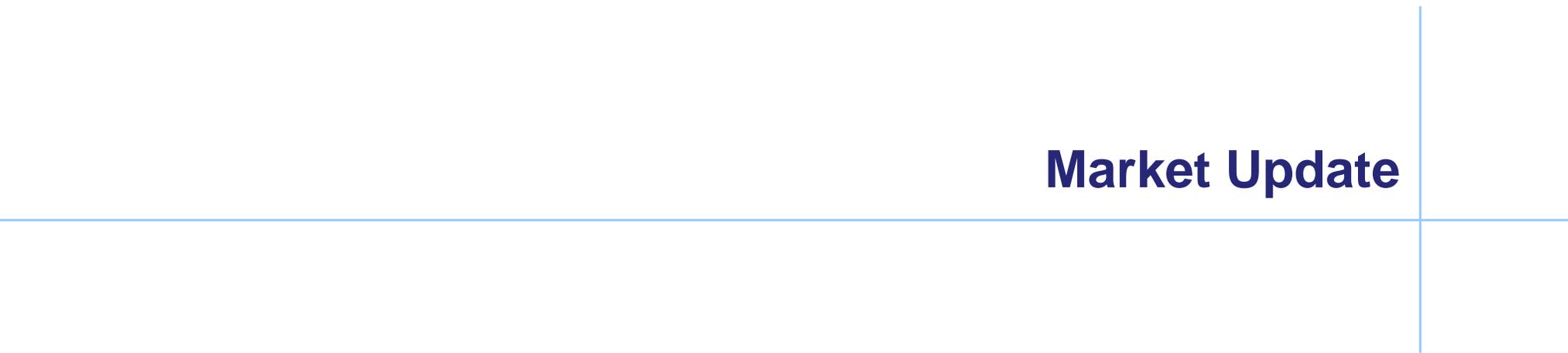
Managed Account Detail of Securities Held

For the Month Ending **June 30, 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 |
|---|-------|------------------------|---------------|-------------------|---------------|----------------|------------------------|----------------|---------------------|------------------------|------------------------|
| Security Type Sub-Total | | 32,010,000.00 | | | | | 32,211,327.03 | 0.82 | 48,848.53 | 32,138,487.97 | 32,266,097.06 |
| Managed Account Sub-Total | | 35,100,000.00 | | | | | 35,273,444.61 | 0.82 | 50,821.76 | 35,206,039.46 | 35,348,613.08 |
| Securities Sub-Total | | \$35,100,000.00 | | | | | \$35,273,444.61 | 0.82% | \$50,821.76 | \$35,206,039.46 | \$35,348,613.08 |
| Accrued Interest | | | | | | | | | | | \$50,821.76 |
| Total Investments | | | | | | | | | | | \$35,399,434.84 |

Market Update



Interest Rates Continue Low Volatile Trend

- The Fed continued to hold its target rate between 0.00%-0.25%, keeping interest rates low.
- Over the past fiscal year, interest rates have experienced extreme volatility due to natural disasters, positive and negative economic data, and geopolitical events.
 - Since last June, 2-year rates reached a high of 0.85% and a new historic low of 0.33%.

2-Year U.S. Treasury Yields
June 30, 2010 – June 30, 2011

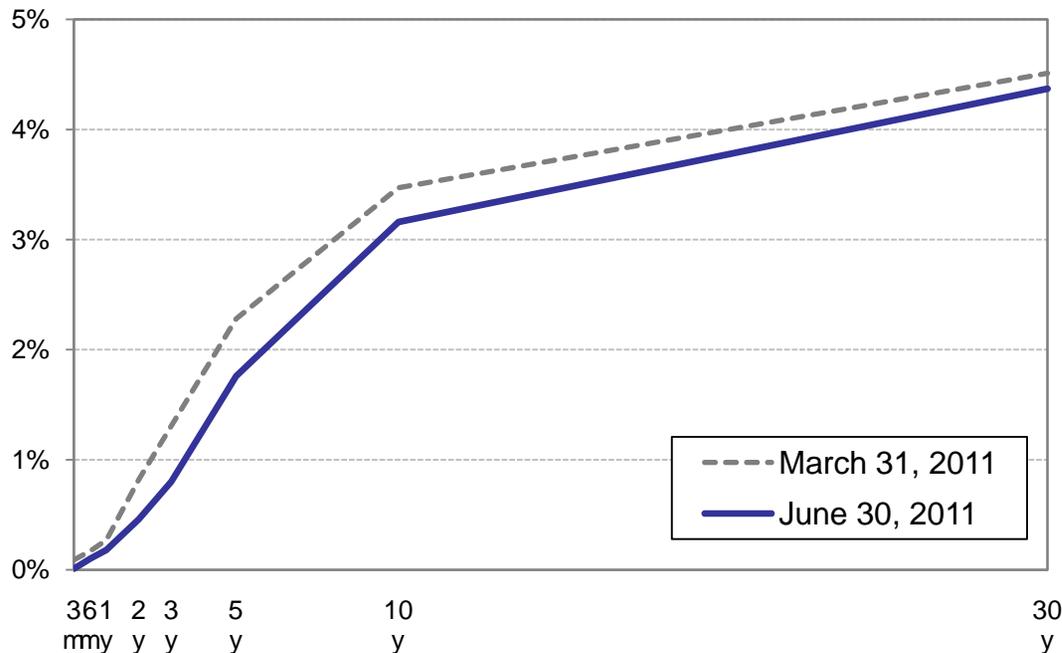


Source: Bloomberg Financial Markets

Yield Curve Remains Steep, But Interest Rates Have Fallen Sharply

- During the quarter, several factors lead to an overall decline of interest rates:
 - Earthquake and nuclear disaster in Japan
 - European debt crisis
 - Weak employment and housing data and lower than expected economic growth
 - Flight-to-quality by investors

U.S. Treasury Yield Curve
June 30, 2011 vs. March 31, 2011

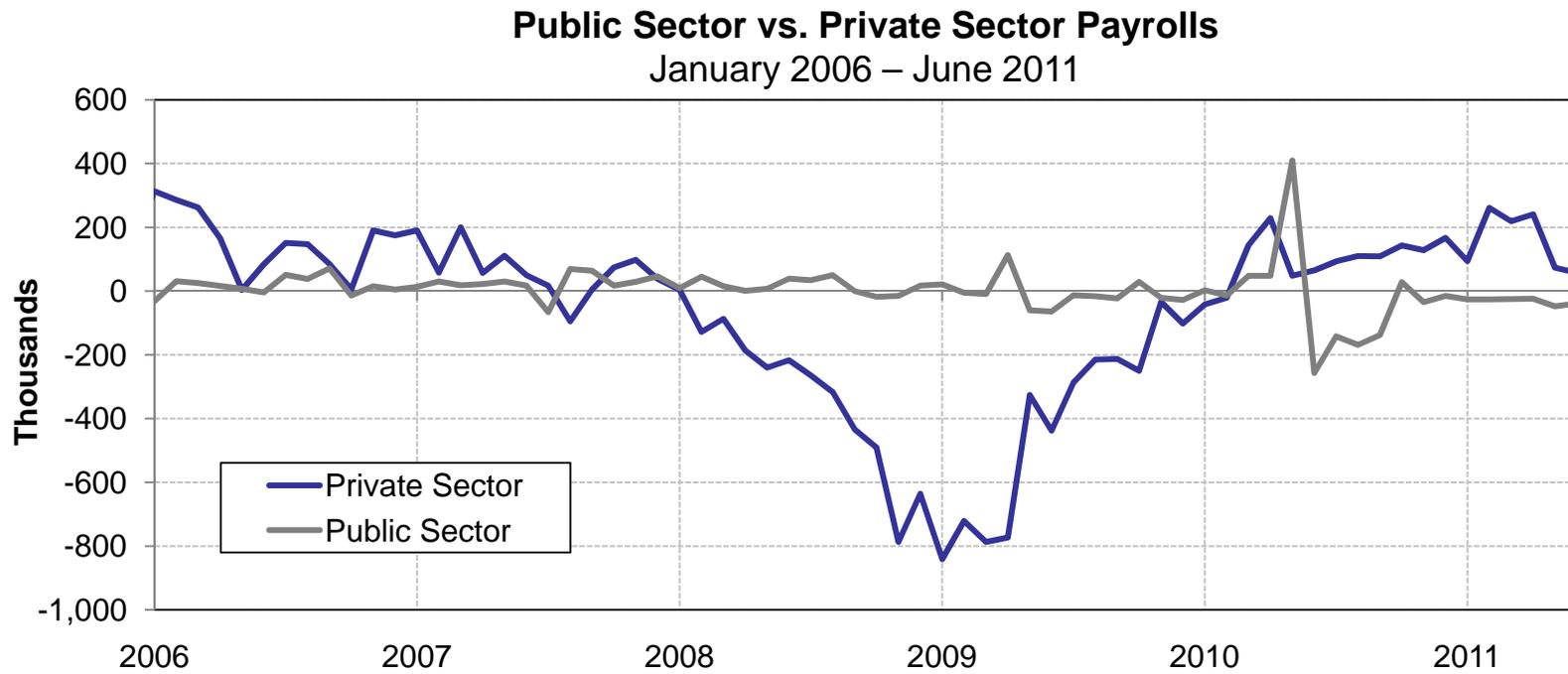


Source: Bloomberg Financial Markets

| | 3/31/11 | 6/30/11 | Change |
|----------------|---------|---------|---------|
| 3 Month | 0.09% | 0.01% | - 0.08% |
| 6 Month | 0.17% | 0.10% | - 0.07% |
| 1 Year | 0.27% | 0.18% | - 0.09% |
| 2 Year | 0.82% | 0.46% | - 0.36% |
| 3 Year | 1.30% | 0.80% | - 0.50% |
| 5 Year | 2.28% | 1.76% | - 0.52% |
| 10 Year | 3.47% | 3.16% | - 0.31% |
| 30 Year | 4.51% | 4.37% | - 0.14% |

Employment Sector Recovery Fails To Gain Traction

- In June, the unemployment rate edged up from 9.1% to 9.2%.
- Only 18,000 jobs were added which disappointed economists, who expected 90,000 new jobs.
- The April and May payrolls were revised to show that 44,000 fewer jobs were created than previously reported.



Source: U.S. Department of Commerce, Bureau of Labor Statistics

A Retrospective View of “QE2”

August 27, 2010: Speech in Jackson Hole, WY
November 4, 2010: Official Announcement of ‘QE2’

- Bernanke’s Original Goals for the “QE2” Program:
 1. Lower mortgage rates to boost housing
 2. Reduce corporate bond rates to encourage investment
 3. Raise stock prices to increase confidence and spending
- Overall intent was to stimulate economic growth and speed-up the pace of recovery.

June 30, 2011: End of “QE2”

- During 8-months of QE2, the Fed made \$600 billion in Treasury-bond purchases.
- The Fed ended QE2 the largest Treasury holder, owning roughly 17% of U.S. marketable debt.
- Any projected rise in interest rates caused by the Fed’s exiting Treasury market has been offset by:
 - Flight-to-quality caused by the European debt crisis, Japan’s financial weakness, and paradoxically the U.S. debt ceiling debate.

Goal #1: Low Mortgage Rates To Increase Home Sales

- Mortgage rates remained near all-time lows.
- In the first week of June, rates on 30-year fixed-rate mortgages hit a 2011 low of 4.49%.

- But, homebuyer response was lackluster and housing sector remains weak.

Source: Bankrate.com; Mortgage Bankers Association
The survey for the index covers over 50% of all U.S. retail residential mortgage applications, and has been conducted weekly since 1990. Respondents include mortgage bankers, commercial banks and thrifts. Base period and value for all indexes is March 16, 1990=100

30-Year Mortgage Rate
June 2010 – June 2011



Mortgage Bankers Association Market Index
June 2010 – June 2011



Goal #2: Provide Cheap Corporate Credit to Stimulate Business Spending

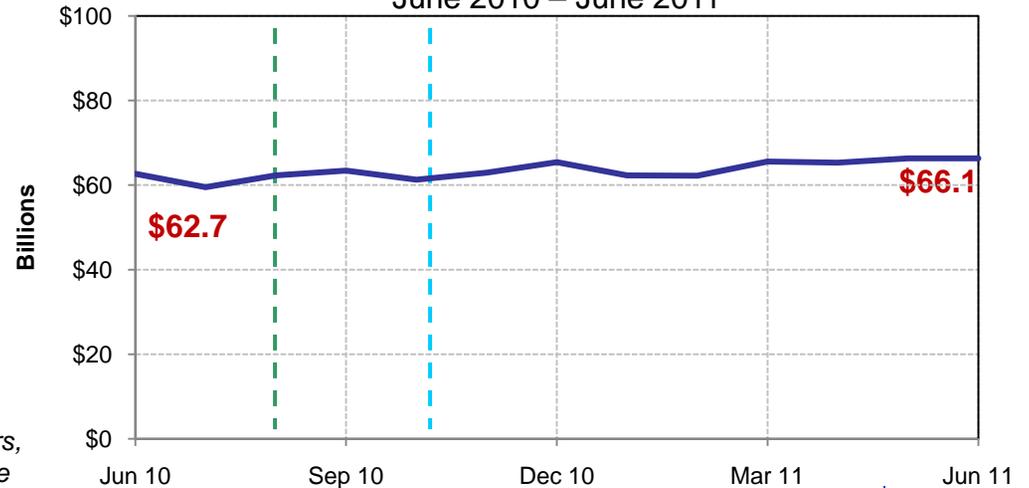
- Corporate borrowing costs did decline and there has been a general improvement in the corporate sector overall.

Yield on Investment Grade Corporate Bonds
June 2010 – June 2011



- But, a meaningful increase in business spending has not materialized.

Non-Defense Durable Goods (Ex Aircraft)
June 2010 – June 2011



Source: Bloomberg Financial Markets;
U.S. Department of Commerce: Census Bureau
The durable goods orders measure the dollar volume of orders, shipments, and unfilled orders of durable goods (goods whose intended lifespan is three years or more).

Goal #3: Stimulate Consumer Confidence & Spending

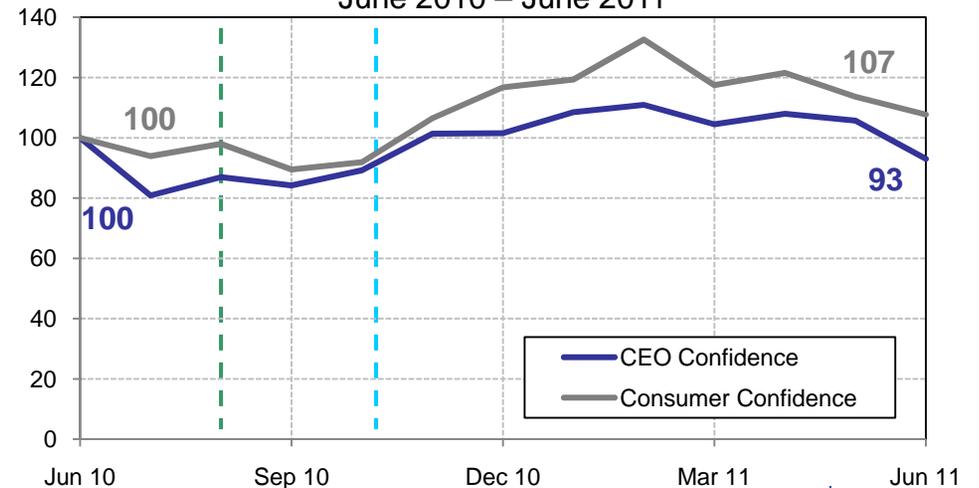
- The DJIA soared 25% over the course of QE2.

Dow Jones Industrial Average
June 2010 – June 2011



- Consumer and business confidence have fallen to near their pre-QE2 levels, a warning sign of continued weakness in the consumer and business spending and retail sales numbers.

CEO and Consumer Confidence
June 2010 – June 2011



Source: Bloomberg Financial Markets; Chief Executive Magazine; Conference Board

Inflationary Fears Shift From Deflation to Inflation

- Pre-QE2, the market prepared to fight deflation due to low interest rates levels, deep discounting, and decreased economic activity.

- Currently, rapidly rising commodity and energy prices are driving up headline inflation. Manufacturers, unable to continue to absorb rising costs, are now passing them onto consumers.

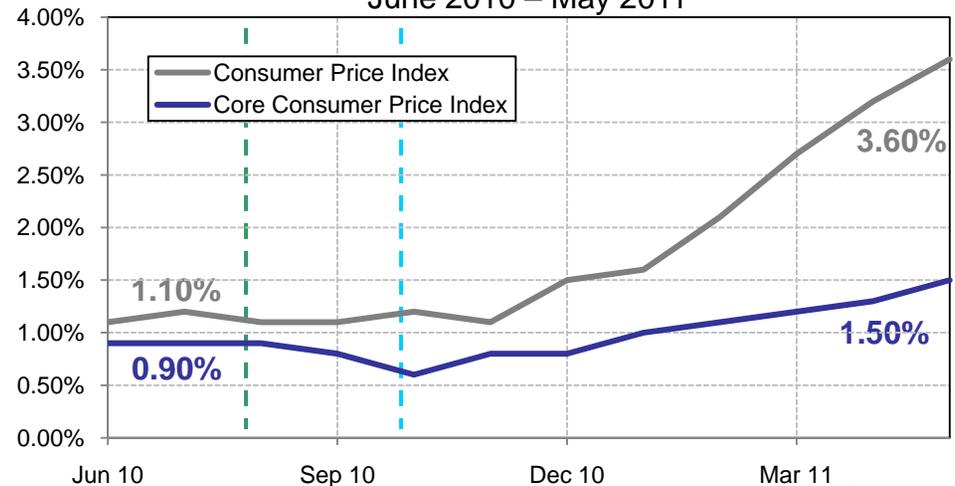
Inflation Expectations

June 2010 – June 2011



Core and Overall Consumer Price Index Inflation

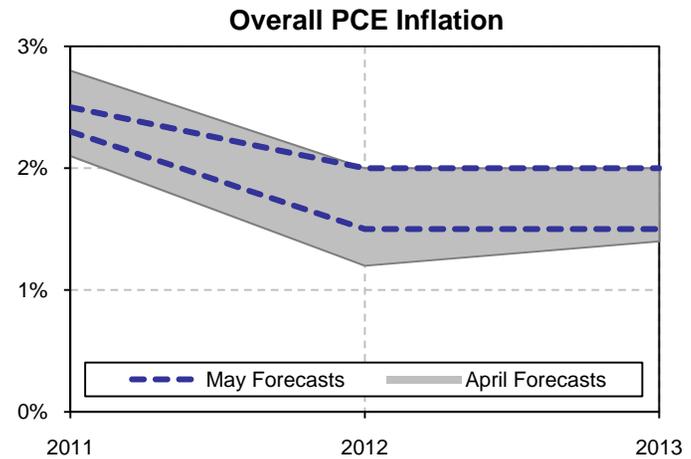
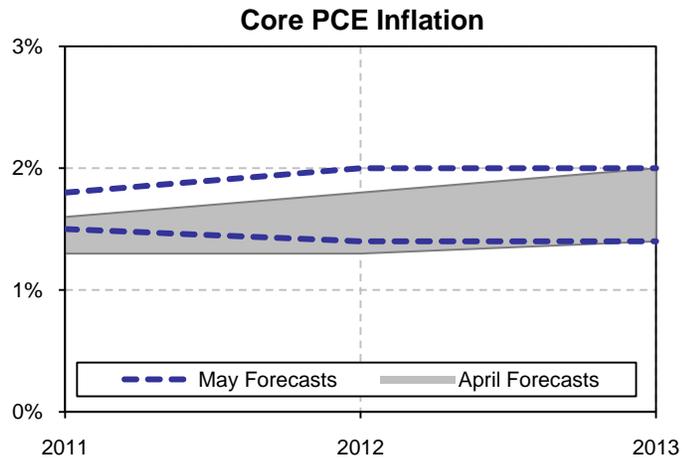
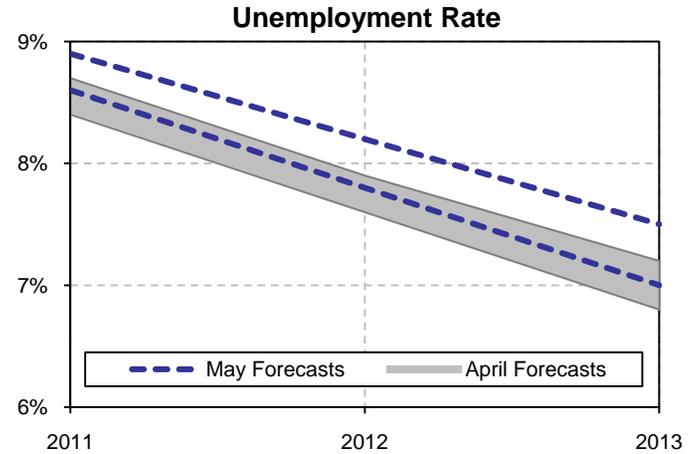
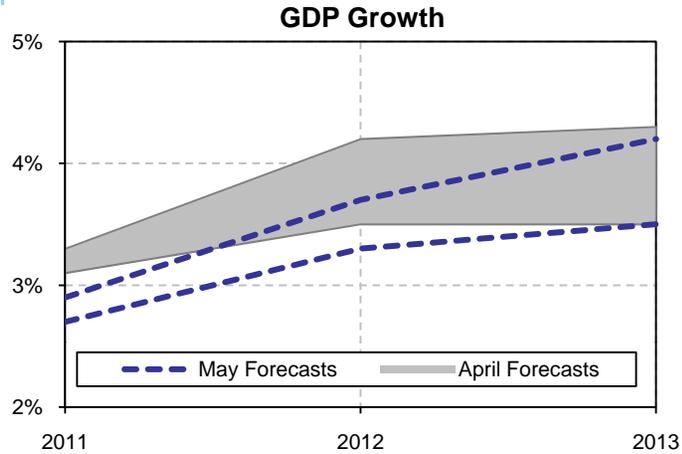
June 2010 – May 2011



FOMC Meeting Highlights: A Slowing Recovery

- The FOMC kept the federal funds target range at 0.00% - 0.25% at its June 22 meeting and stating that conditions will likely warrant “exceptionally low” interest rate levels “for an extended period.”
- The FOMC plans to maintain its security holdings by reinvesting principal payments from its securities holdings.
- Economic growth is proceeding more slowly than expected, which the FOMC partially attributes to temporary factors, including higher food and energy prices and supply chain disruptions associated with Japan earthquake.
- Although inflation has accelerated, reflecting higher food and commodity prices, longer-term inflation expectations remain stable.
- The Committee expects the pace of recovery to pick up over coming quarters and the unemployment rate to resume its gradual decline.
- As such, the FOMC recently revised its range of economic forecasts to reflect the slowing recovery, as illustrated in the charts on the following page.

Federal Reserve Revises Outlook Downward



Source: Federal Reserve Open Market Committee

Disclaimer

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