



**September 30, 2011**

**PFM Asset Management LLC**

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**City of Surprise**  
**Investment Guidelines and Objectives**  
**Month Ended September 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.

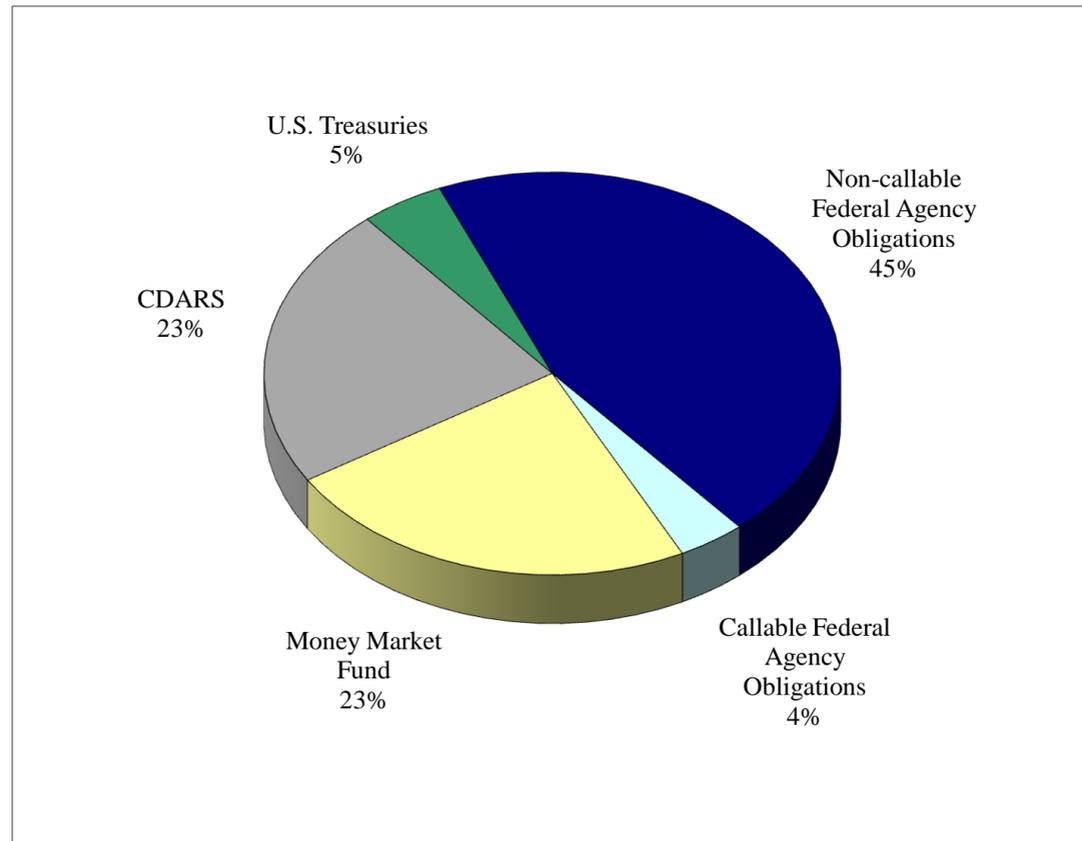
**Investment Guidelines:** In relation to the investment portfolio, the City's investment strategy focuses on the following:

- **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.

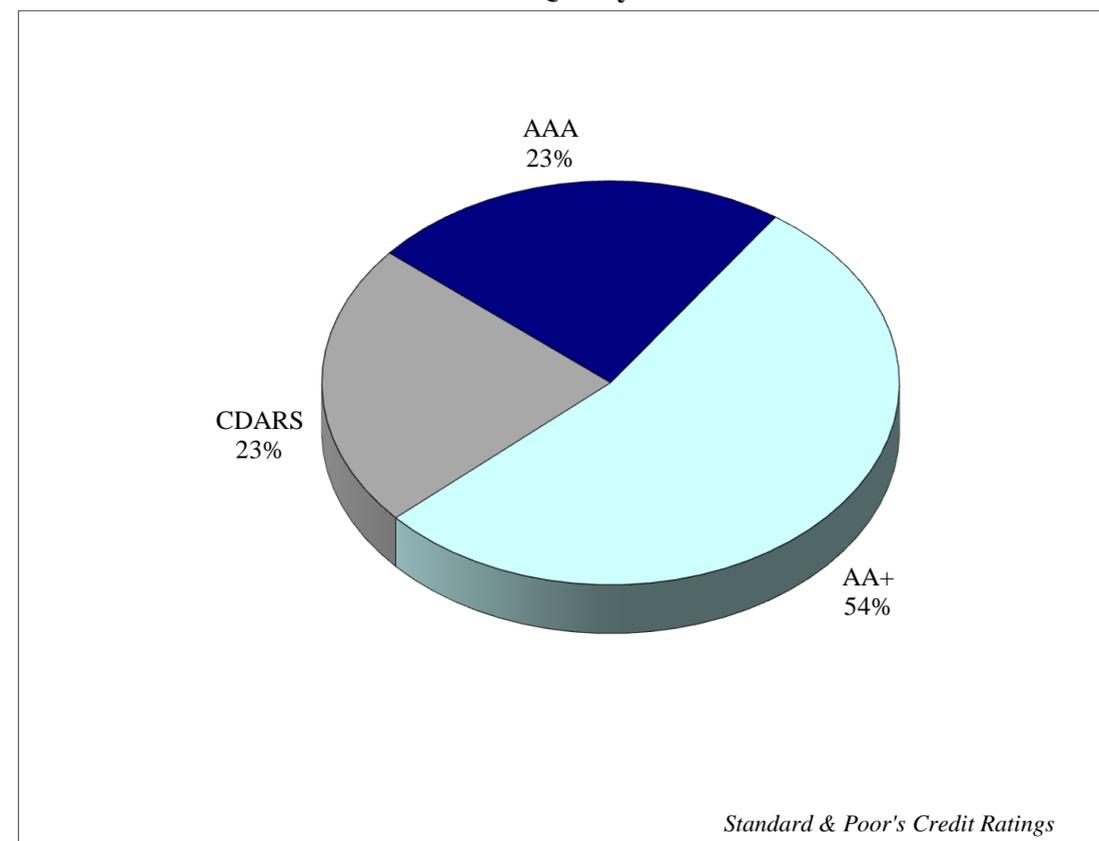
**City of Surprise Portfolio Summary and Characteristics**  
**Month Ended September 30, 2011**

<u>Security Type</u>	<u>Current Holdings*</u>	<u>Current Month % of Portfolio</u>	<u>Previous Month % of Portfolio</u>
<b>U.S. Treasury</b>	<b>\$3,101,828.52</b>	<b>5%</b>	5%
<b>Federal Agency</b>	<b>\$32,256,273.22</b>	<b>49%</b>	49%
Callable Federal Agency	\$2,496,255.00	4%	0%
Non-callable Federal Agency	\$29,760,018.22	45%	49%
<b>CDARS</b>	<b>\$15,000,000.00</b>	<b>23%</b>	46%
<b>Wells Fargo MMF</b>	<b>\$15,522,569.05</b>	<b>23%</b>	<1%
<b>Total Market Value</b>	<b>\$65,880,670.79</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 September 30, 2011**

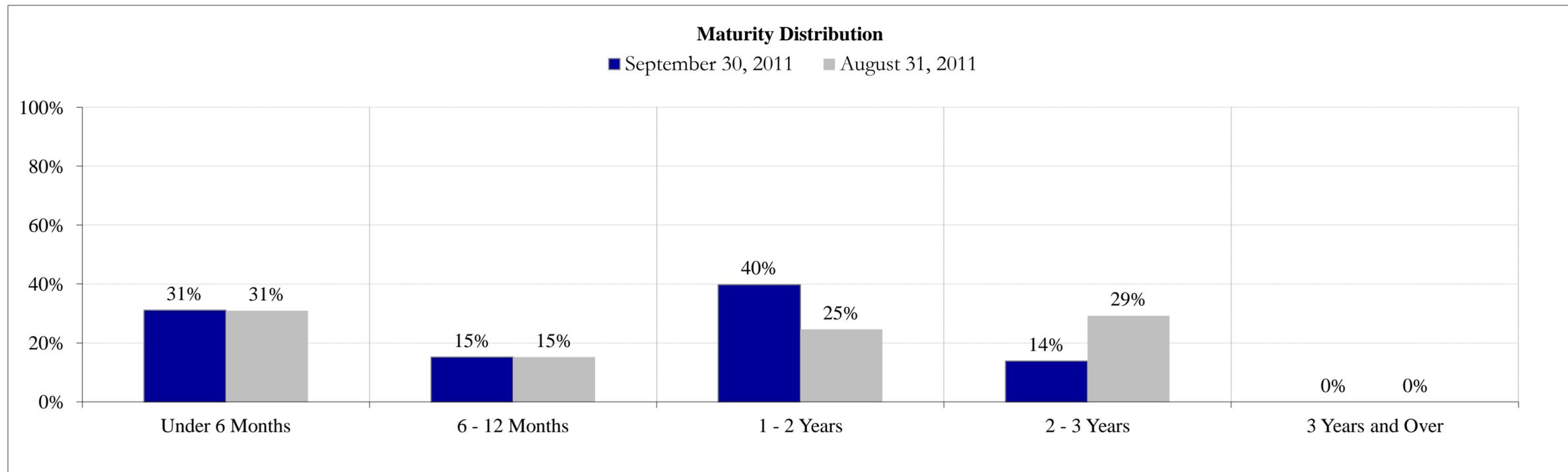
<b>Maturity Distribution Summary</b>		
<u>Maturity Class</u>	<u>Fair Value*</u>	<u>% of Portfolio</u>
<b>Under 6 Months</b>	<b>\$20,522,569.05</b>	<b>31%</b>
<b>6 - 12 Months</b>	<b>\$10,000,000.00</b>	<b>15%</b>
<b>1 - 2 Years</b>	<b>\$26,228,601.46</b>	<b>40%</b>
<b>2 - 3 Years</b>	<b>\$9,129,500.28</b>	<b>14%</b>
<b>3 Years and Over</b>	<b>\$0.00</b>	<b>0%</b>
<b>Total Market Value</b>	<b>\$65,880,670.79</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.

<b>Key Portfolio Statistics</b>	
<b>Effective Duration<sup>1</sup></b>	<b>1.59 years</b>
<b>Benchmark Duration<sup>2</sup></b>	<b>1.81 years</b>
<b>Yield at Cost</b>	<b>0.70%</b>

1. Duration to worst as of 09/30/2011 was 1.88
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.



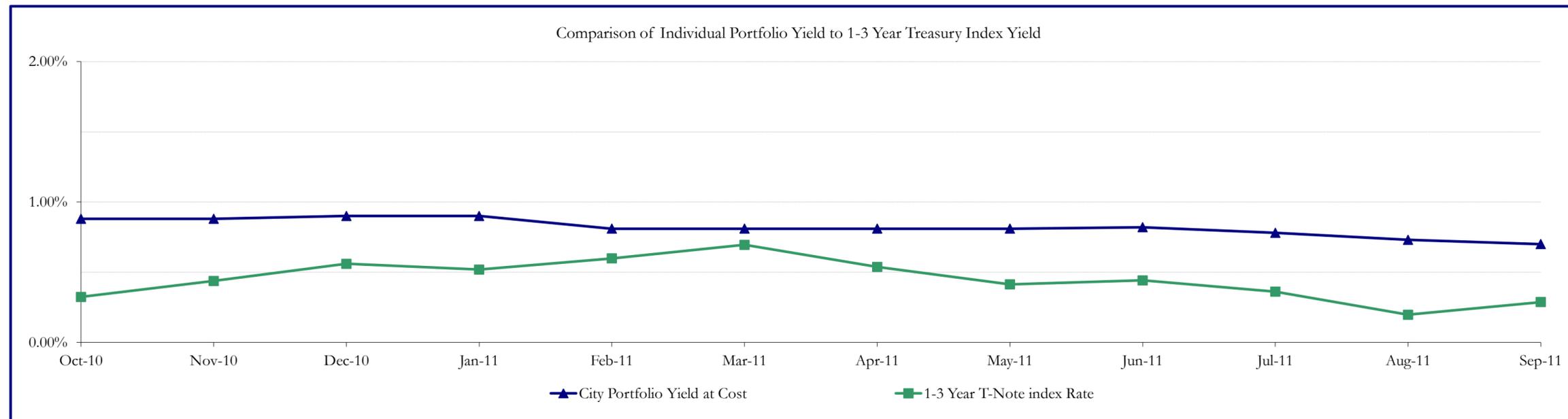
## City of Surprise Individual Portfolio Yield Summary Trailing 12 Months

Date	Month-End Market Value <sup>1</sup>	Duration <sup>2</sup>	Portfolio YTM at Cost <sup>2</sup>	1-3 Year T-Note Index Rate <sup>3</sup>
Oct-10	\$34,159,429	1.72	0.88%	0.32%
Nov-10	\$35,295,699	1.82	0.88%	0.44%
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%
Jul-11	\$35,675,772	1.41	0.78%	0.36%
Aug-11	\$35,758,718	1.60	0.73%	0.20%
Sep-11	\$50,880,671	1.59	0.70%	0.29%

<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 1-3 Year U.S. Treasury Note Index month-end yield. Source Bloomberg

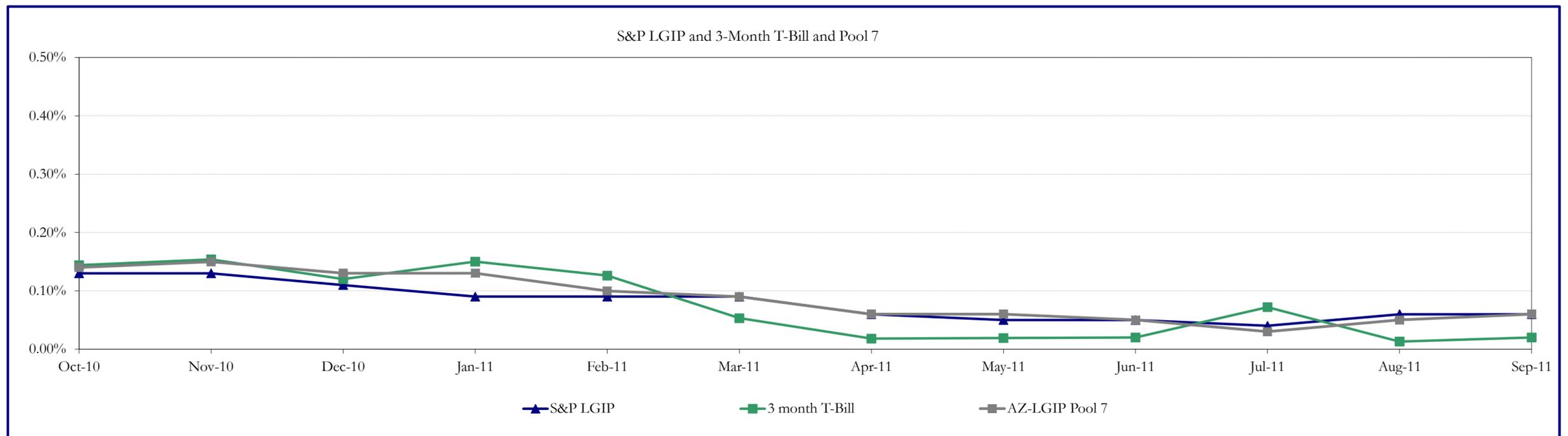


## City of Surprise Short-Term Benchmark Comparisons Trailing 12 Months

Date	S&P LGIP	AZ-LGIP Pool 7 <sup>1</sup>	3 month Treasury Bill <sup>2</sup>
Oct-10	0.13%	0.14%	0.14%
Nov-10	0.13%	0.15%	0.15%
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%
Jul-11	0.04%	0.03%	0.07%
Aug-11	0.06%	0.05%	0.01%
Sep-11	0.06%	0.06%	0.02%

<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. Source: Bloomberg



**City of Surprise Holdings**  
**Month Ended September 30, 2011**

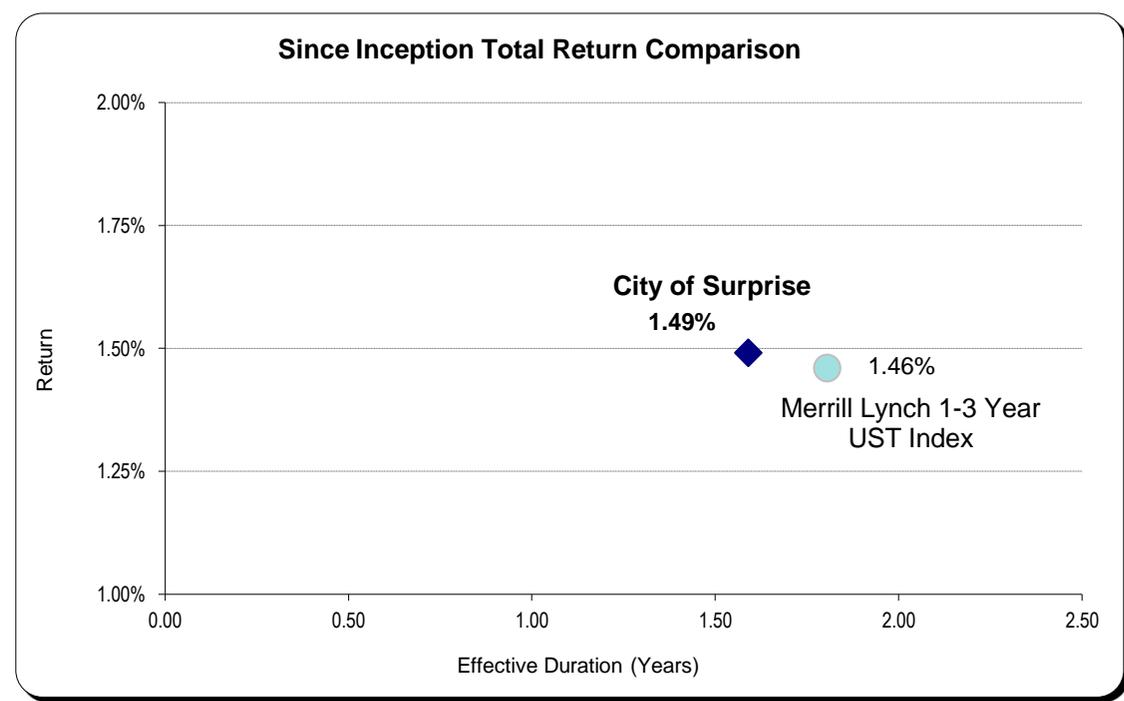
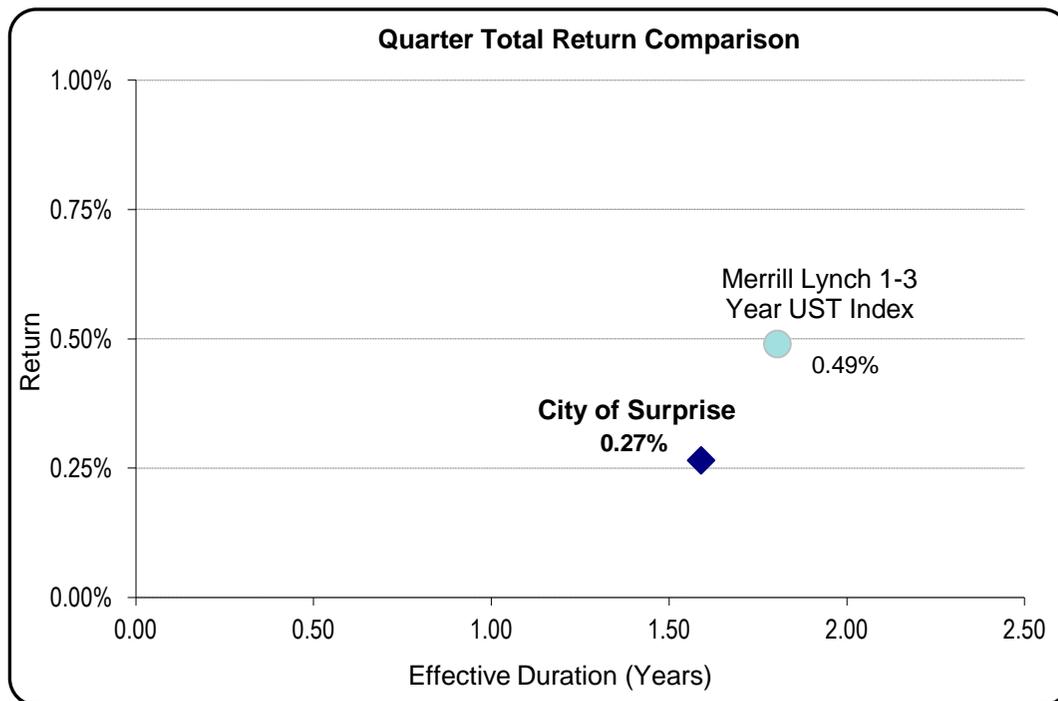
**Operating Funds Investment Inventory by Maturity Date**

<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	9/30/2011	0.00	\$15,522,569	0.01%		
Alliance Bank (CDARS)	12/29/2011	0.25	\$5,000,000	0.88%		
Alliance Bank (CDARS)	6/29/2012	0.75	\$10,000,000	0.66%		
FHLMC	11/30/2012	1.17	\$3,002,124	0.66%		
FHLMC	12/21/2012	1.23	\$2,091,532	1.09%		
FNMA	2/26/2013	1.41	\$3,061,373	0.83%		
FHLMC	4/15/2013	1.54	\$1,238,372	0.56%		
FNMA	6/26/2013	1.74	\$2,037,796	1.41%		
FNMA	8/9/2013	1.86	\$1,251,274	0.36%		
FHLB	8/28/2013	1.91	\$1,001,561	0.57%		
FFCB	9/16/2013	1.96	\$4,998,010	0.43%		
FHLMC	9/20/2013	1.97	\$2,496,255	0.59%	3/20/12	Quarterly
FNMA	9/23/2013	1.98	\$5,050,305	0.73%		
U.S. Treasury	11/15/2013	2.13	\$3,101,829	0.81%		
FHLB	12/27/2013	2.24	\$2,521,740	0.71%		
FNMA	2/27/2014	2.41	\$1,241,487	0.44%		
FHLMC	8/27/2014	2.91	\$1,010,913	0.94%		
FHLMC	8/27/2014	2.91	\$1,253,532	0.54%		
<b>Total Market Value</b>			<b>\$ 65,880,671</b>			

## City of Surprise Quarterly Performance Month Ended September 30, 2011

### Portfolio Performance

	Quarter Ended September 30, 2011	Past 6 Months	Past 1 Year	Since Inception	
<b>Total Return<sup>1,2,3,5</sup></b>					
<b>City of Surprise</b>	<b>0.27%</b>	<b>1.13%</b>	<b>1.14%</b>	<b>1.49%</b>	
Merrill Lynch 1-3 Year UST Index	0.49%	1.32%	1.20%	1.46%	
<b>Effective Duration<sup>4</sup></b>	<b>September 30, 2011</b>	<b>June 30, 2011</b>	<b>Yields</b>	<b>September 30, 2011</b>	<b>June 30, 2011</b>
<b>City of Surprise</b>	<b>1.59</b>	<b>1.41</b>	Yield at Market	<b>0.45%</b>	0.58%
Merrill Lynch 1-3 Year UST Index	1.81	1.80	Yield on Cost	<b>0.70%</b>	0.82%



**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.

# New Portfolio Purchases

Trade Date	Settle Date	Transaction	Security	Maturity	Par	Yield
10/3/11	10/4/11	Buy	FHLB Notes	8/28/13	\$3,875,000	0.42%
10/3/11	10/4/11	Buy	FNMA Notes	2/27/14	\$3,825,000	0.55%
10/3/11	10/4/11	Buy	FNMA Notes	8/28/14	\$3,860,000	0.64%
9/29/11	10/18/11	Buy	FNMA Notes (Callable)	10/18/13	\$3,840,000	0.56%
<b>Total</b>					<b>\$15,400,000</b>	<b>0.54%</b>



## Managed Account Detail of Securities Held

For the Month Ending **September 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
<b>U.S. Treasury Bond / Note</b>											
US TREASURY NOTES DTD 11/15/2010 0.500% 11/15/2013	912828PU8	3,090,000.00	AA+	Aaa	12/01/10	12/02/10	3,062,117.58	0.81	5,835.73	3,069,897.08	3,101,828.52
<b>Security Type Sub-Total</b>		<b>3,090,000.00</b>					<b>3,062,117.58</b>	<b>0.81</b>	<b>5,835.73</b>	<b>3,069,897.08</b>	<b>3,101,828.52</b>
<b>Federal Agency Bond / Note</b>											
FHLMC NOTES DTD 10/22/2010 0.375% 11/30/2012	3137EACP2	3,000,000.00	AA+	Aaa	12/01/10	12/02/10	2,982,900.00	0.66	3,781.25	2,989,995.24	3,002,124.00
FHLMC GLOBAL REFERENCE NOTES DTD 12/17/2007 4.125% 12/21/2012	3137EABE8	2,000,000.00	AA+	Aaa	06/23/10	06/24/10	2,148,600.00	1.09	22,916.67	2,073,377.52	2,091,532.00
FNMA NOTES DTD 01/18/2011 0.750% 02/26/2013	3135G0AK9	3,045,000.00	AA+	Aaa	02/02/11	02/03/11	3,039,747.38	0.83	2,220.31	3,041,419.05	3,061,372.97
FHLMC GLOBAL NOTES DTD 03/04/2010 1.625% 04/15/2013	3137EACJ6	1,215,000.00	AA+	Aaa	10/28/10	11/01/10	1,246,602.15	0.56	9,104.06	1,234,855.48	1,238,371.74
FNMA GLOBAL NOTES DTD 05/21/2010 1.500% 06/26/2013	31398AT44	2,000,000.00	AA+	Aaa	06/16/10	06/17/10	2,005,560.00	1.41	7,916.67	2,003,217.98	2,037,796.00
FNMA NOTES DTD 06/17/2011 0.500% 08/09/2013	3135G0BR3	1,250,000.00	AA+	Aaa	08/26/11	08/29/11	1,253,437.50	0.36	902.78	1,253,280.83	1,251,273.75
FHLB GLOBAL NOTES DTD 07/21/2011 0.500% 08/28/2013	313374Y61	1,000,000.00	AA+	Aaa	07/20/11	07/21/11	998,610.00	0.57	458.33	998,737.39	1,001,561.00
FFCB (FLOATING) NOTE DTD 09/16/2010 0.330% 09/16/2013	31331JG64	5,000,000.00	AA+	Aaa	10/12/10	10/13/10	5,000,000.00	0.43	687.50	5,000,000.00	4,998,010.00
FHLMC (CALLABLE) GLOBAL NOTES DTD 09/20/2011 0.600% 09/20/2013	3134G2D74	2,500,000.00	AA+	Aaa	09/01/11	09/20/11	2,500,250.00	0.60	458.33	2,500,234.73	2,496,255.00
FANNIE MAE GLOBAL NOTES DTD 08/06/2010 1.000% 09/23/2013	31398A2S0	5,000,000.00	AA+	Aaa	10/12/10	10/13/10	5,038,650.00	0.73	1,111.11	5,026,055.50	5,050,305.00
<b>FNMA 0.55% 10/18/13 DTD 10/18/2011 0.550% 10/18/2013</b>	<b>3135G0DV2</b>	<b>3,840,000.00</b>	<b>AA+</b>	<b>Aaa</b>	<b>09/29/11</b>	<b>10/18/11</b>	<b>3,839,232.00</b>	<b>0.56</b>	<b>0.00</b>	<b>3,839,232.00</b>	<b>3,838,579.20</b>
FHLB NOTES DTD 11/18/2010 0.875% 12/27/2013	313371UC8	2,500,000.00	AA+	Aaa	06/30/11	06/30/11	2,510,225.00	0.71	5,711.81	2,509,195.15	2,521,740.00



**Managed Account Detail of Securities Held**

For the Month Ending **September 30, 2011**

**CITY OF SURPRISE OPERATING FUND**

<b>Security Type/Description Dated Date/Coupon/Maturity</b>	<b>CUSIP</b>	<b>Par</b>	<b>S&amp;P Rating</b>	<b>Moody's Rating</b>	<b>Trade Date</b>	<b>Settle Date</b>	<b>Original Cost</b>	<b>YTM at Cost</b>	<b>Accrued Interest</b>	<b>Amortized Cost</b>	<b>Market Value</b>
<b>Federal Agency Bond / Note</b>											
FNMA GLOBAL NOTES DTD 02/01/2011 1.250% 02/27/2014	3135G0AP8	1,220,000.00	AA+	Aaa	08/15/11	08/15/11	1,244,900.20	0.44	1,440.28	1,243,650.55	1,241,486.64
FHLMC NOTES DTD 07/05/2011 1.000% 08/27/2014	3137EACV9	1,000,000.00	AA+	Aaa	07/19/11	07/20/11	1,001,860.00	0.94	944.44	1,001,741.85	1,010,913.00
FHLMC NOTES DTD 07/05/2011 1.000% 08/27/2014	3137EACV9	1,240,000.00	AA+	Aaa	08/26/11	08/29/11	1,257,099.60	0.54	1,171.11	1,256,595.40	1,253,532.12
<b>Security Type Sub-Total</b>		<b>35,810,000.00</b>					<b>36,067,673.83</b>	<b>0.69</b>	<b>58,824.65</b>	<b>35,971,588.67</b>	<b>36,094,852.42</b>
<b>Managed Account Sub-Total</b>		<b>38,900,000.00</b>					<b>39,129,791.41</b>	<b>0.70</b>	<b>64,660.38</b>	<b>39,041,485.75</b>	<b>39,196,680.94</b>
<b>Securities Sub-Total</b>		<b>\$38,900,000.00</b>					<b>\$39,129,791.41</b>	<b>0.70%</b>	<b>\$64,660.38</b>	<b>\$39,041,485.75</b>	<b>\$39,196,680.94</b>
<b>Accrued Interest</b>											<b>\$64,660.38</b>
<b>Total Investments</b>											<b>\$39,261,341.32</b>

Bolded items are forward settling trades.

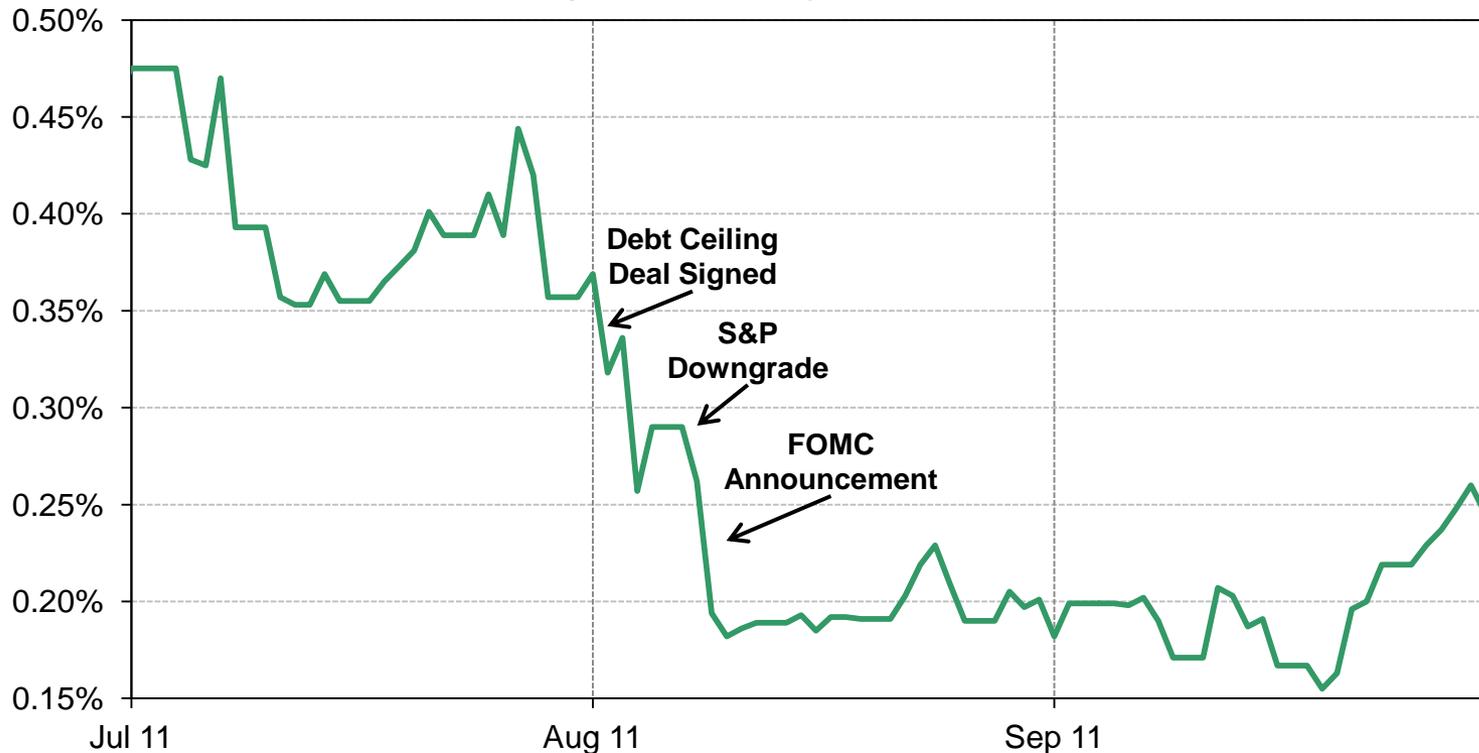
# Market Update

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# Treasury Yields Declined to Record Lows

- Economic uncertainty and ongoing concerns over the European sovereign debt crisis led investors to seek the safety of U.S. Treasury securities, pushing yields to new record lows.
- Investors did not seem concerned about credit downgrades from ratings agencies due to the looming debt ceiling.

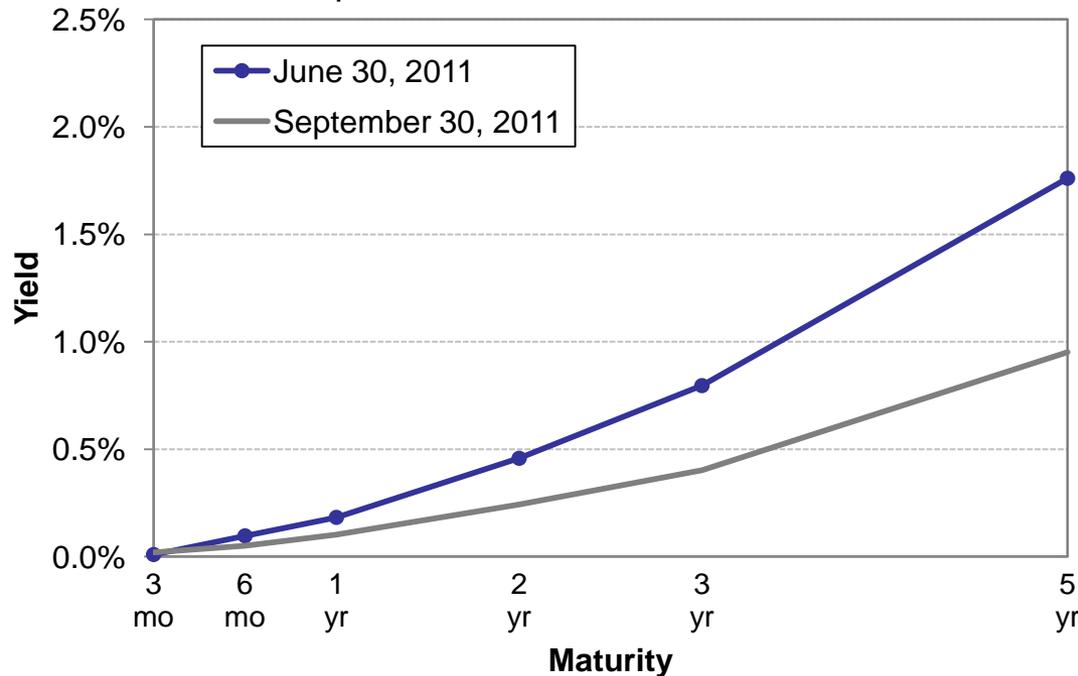
**2-Year U.S. Treasury Yield**  
July 1, 2011 – September 30, 2011



# Yields Are Lower Across the Curve

- Fed monetary policies have targeted short-term rates at very low levels for the past 2 years, but rates were driven even lower by demand for safe securities.

**U.S. Treasury Yield Curve**  
September 30, 2011 vs. June 30, 2011



	9/30/11	6/30/11
3 month	0.02%	0.01%
6 month	0.05%	0.10%
1 year	0.10%	0.18%
2 year	0.24%	0.46%
3 year	0.40%	0.80%
5 year	0.95%	1.76%

# U.S. Treasuries Outperform in Short Run

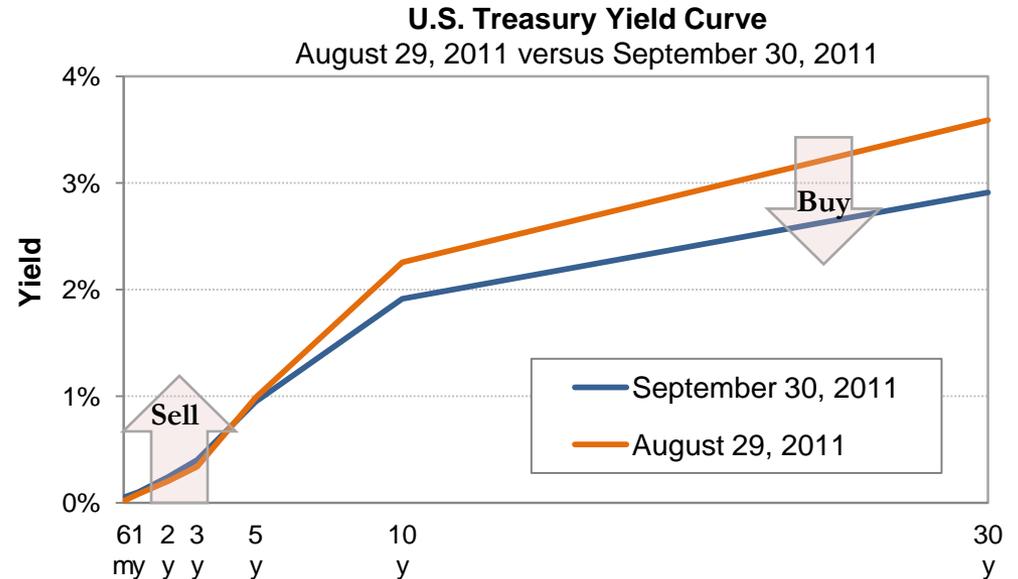
- The unprecedented drop in Treasury rates due to European concerns, U.S. credit rating downgrades, and weak economic data caused the sector to outperform relative to Agencies and Corporates.
- Historically, the U.S. Treasury sector has lower returns than these two sectors.

## Returns for Merrill Lynch 1-3 Year Indices Period Ending September 30, 2011

Sector	Past Quarter	Past Five Years	Past Ten Years
U.S. Treasuries	0.49%	3.83%	3.31%
Federal Agencies	0.38%	4.13%	3.60%
AAA-A Rated Corporate Notes	-0.53%	4.26%	4.02%

# Operation “Twist” Takes Hold

- **What:**
  - Sell \$400 billion in short-term government bonds (<3 years) from its portfolio
  - Buy \$400 billion long-term government bonds (6-30 years) by June 2012
- **Why:**
  - **Fed’s Negative Economic Assessment.** Slow economic growth, high unemployment rates, reduced household spending, and risks related to European crisis
- **Goal:**
  - Lower mortgage rates, car loans, and other bank lending rates to encourage consumer spending
  - Strengthen housing sector
  - Increase business expansion, hiring, and investment in capital goods



	Maturity		
	8/29/11	9/30/11	Change
<b>6 m</b>	0.02%	0.05%	+ 0.03%
<b>1 yr</b>	0.09%	0.10%	+ 0.01%
<b>2 yr</b>	0.20%	0.24%	+ 0.04%
<b>3 yr</b>	0.34%	0.40%	+ 0.06%
<b>5 yr</b>	0.99%	0.95%	(0.04%)
<b>10 yr</b>	2.26%	1.92%	(0.34%)
<b>30 yr</b>	3.59%	2.91%	(0.68%)

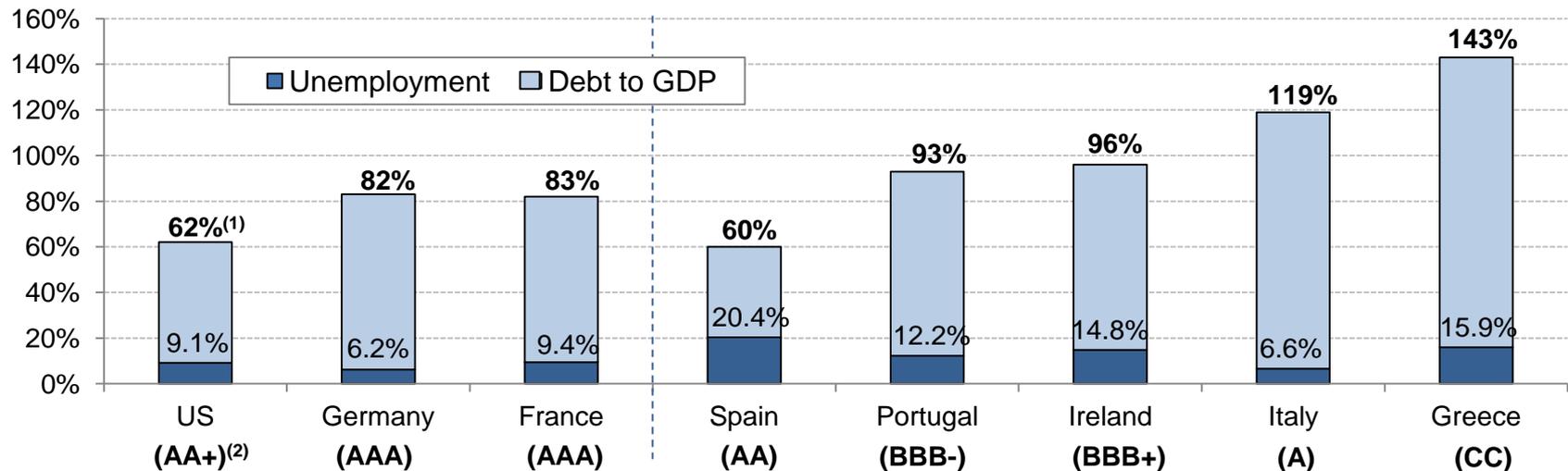
# Europe Debt Crisis Remains At Forefront But Solutions Are In The Works

## European Debt Concerns:

- Italy's cost of borrowing reflects higher credit risk, in August the yield on 6 month sovereign debt rose to 3.07% from 2.14%.
- Spain's central bank warned about high unemployment (20.4%) and slow economic growth in Q1 and Q2, 2011.
- Portugal's Prime Minister said that additional aid would be needed if any euro-zone country were to default.

## Possible Solutions Discussed

- France's lawmakers introduced a budget plan to reduce its deficit to 4.5% of GDP next year from 5.7% this year.
- Greek government pledged to privatize and lease the equivalent of \$68 billion in state assets by 2015.
- The European Financial Stability Facility (EFSF) expanded their funding from € 250 billion in bonds to € 440 billion after getting approval from all 17 Euro nations.



(1) Data covers only what the United States Treasury denotes as "Debt Held by the Public," which includes all debt instruments issued by the Treasury that are owned by non-US Government entities; if data for intra-government debt were added, "Gross Debt" would increase by about one-third of GDP.

(2) Standard and Poor's Ratings.

# U.S. Markets React Positively on Rumors of Possible European Debt Solutions

- As European leaders work to resolve debt crisis, U.S. markets have reacted positively.
- After reaching new all-time lows on September 19, short-term Treasury yields have been on a rise.
- The S&P 500 index has rallied sharply as well.

**2-Year U.S. Treasury Yields**  
January 1, 2011 – October 10, 2011

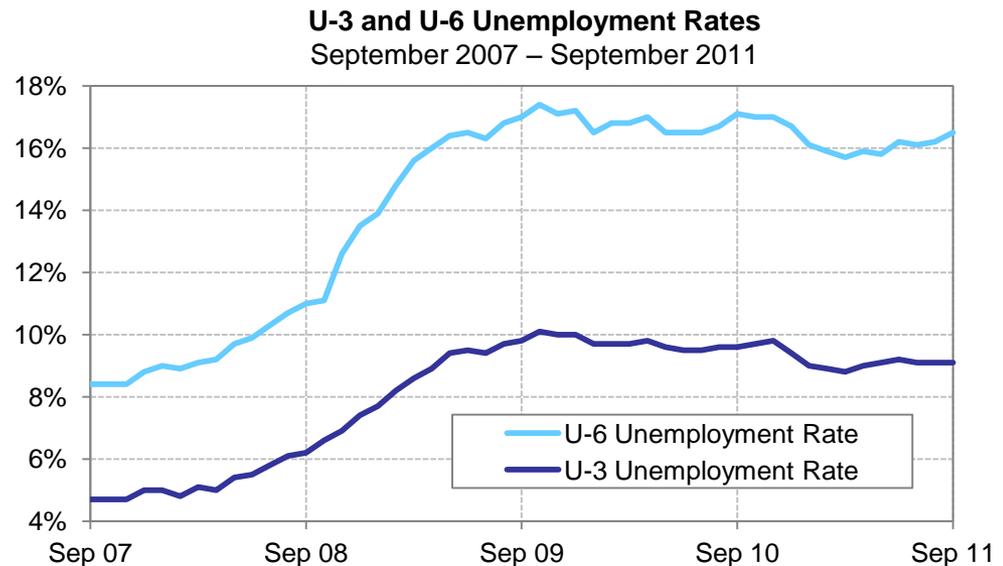


**S&P 500 Index**  
January 1, 2011 – October 10, 2011



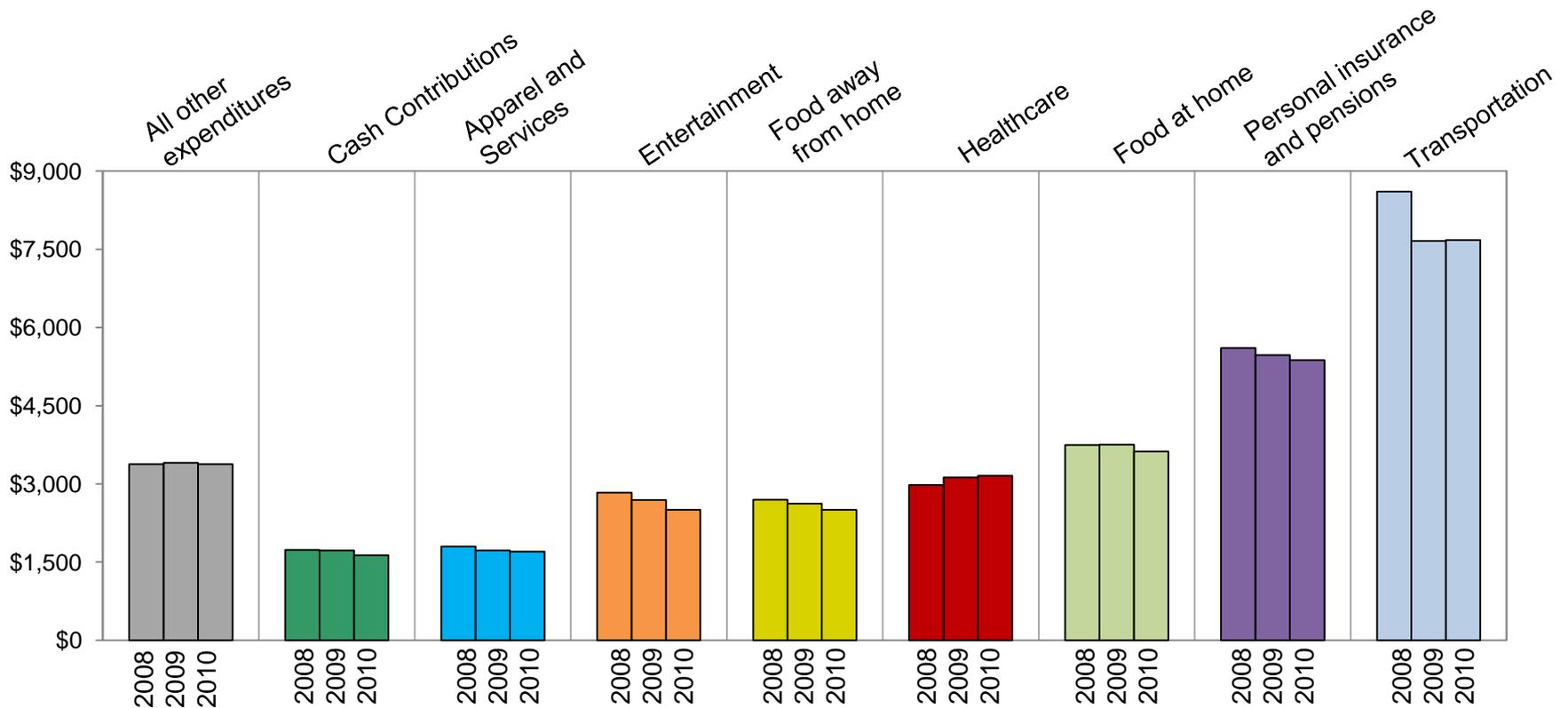
# Same Challenges Remain: Paltry Job Growth

- In September, the private sector added 137,000 jobs while the Government sector lost 34,000, producing a net gain of 103,000 jobs.
- Almost half of jobs added could be attributed to the return of Verizon workers who were on strike in August.
- The unemployment rate (U-3) held steady at 9.1% while the underemployment rate (U-6) ticked up from 16.2% to 16.5%.
  - The U-6 rate includes the total unemployed (U-3), plus all marginally attached workers, plus total employed part time for economic reasons.



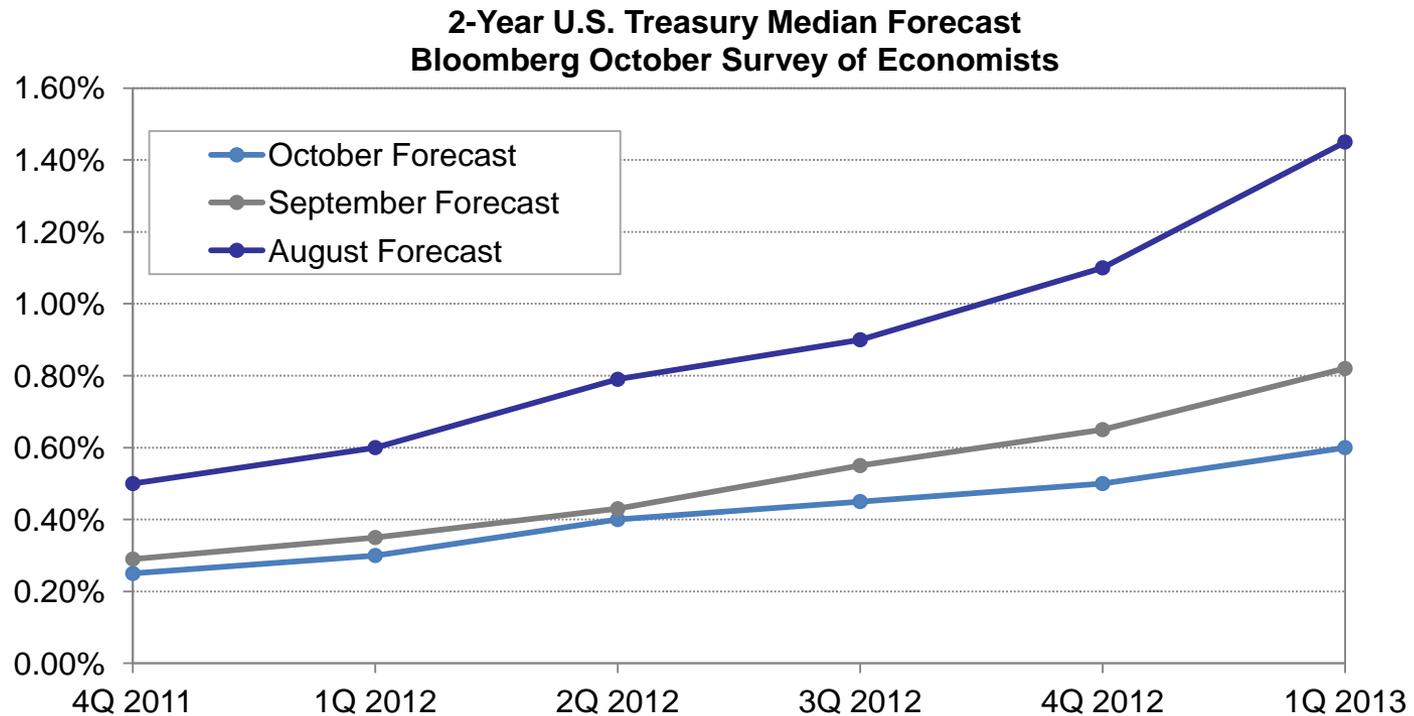
# Weak GDP Growth Due to Sluggish Consumer Spending

- Consumer spending has slowed as average income has dropped.
- All areas of spending declined from 2009 to 2010, excepting Healthcare and Transportation, which was a result of 18% surge in gasoline prices.



# Economists Once Again Lowering Forecasts

- The Fed's August announcement to maintain a low target rate through mid-2013 resulted in revision of economists' forecasts for two-year Treasury.
- Revisions are likely a reflection of concern over a slowing U.S. recovery as well as lasting effects of European debt crisis.



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