



January 30, 2012

PFM Asset Management LLC

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City of Surprise
Investment Guidelines and Objectives
Quarter Ended December 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:

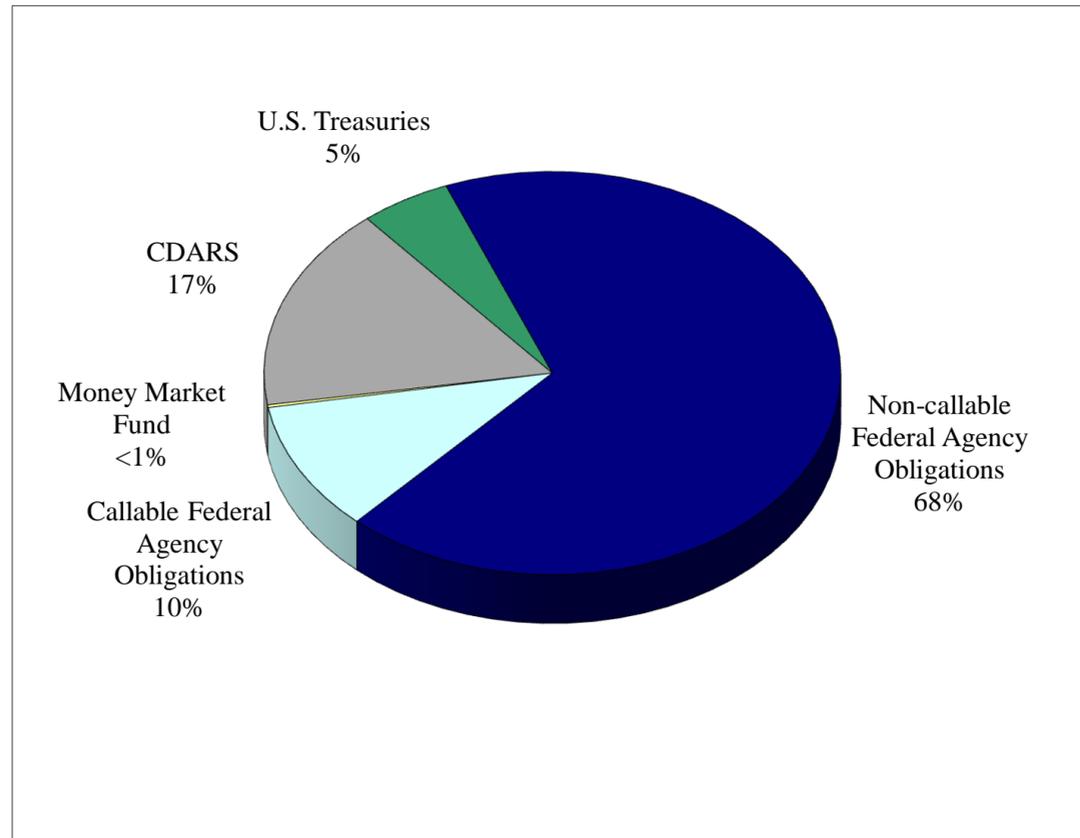
- Permitted Investments. The City will invest in permitted securities consistent with A.R.S.§35-323. Additionally, the City may desire to be more conservative in its investment portfolio and restrict or prohibit certain of the investments outlined in the Investment Policy.
- Transactions prior to maturity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

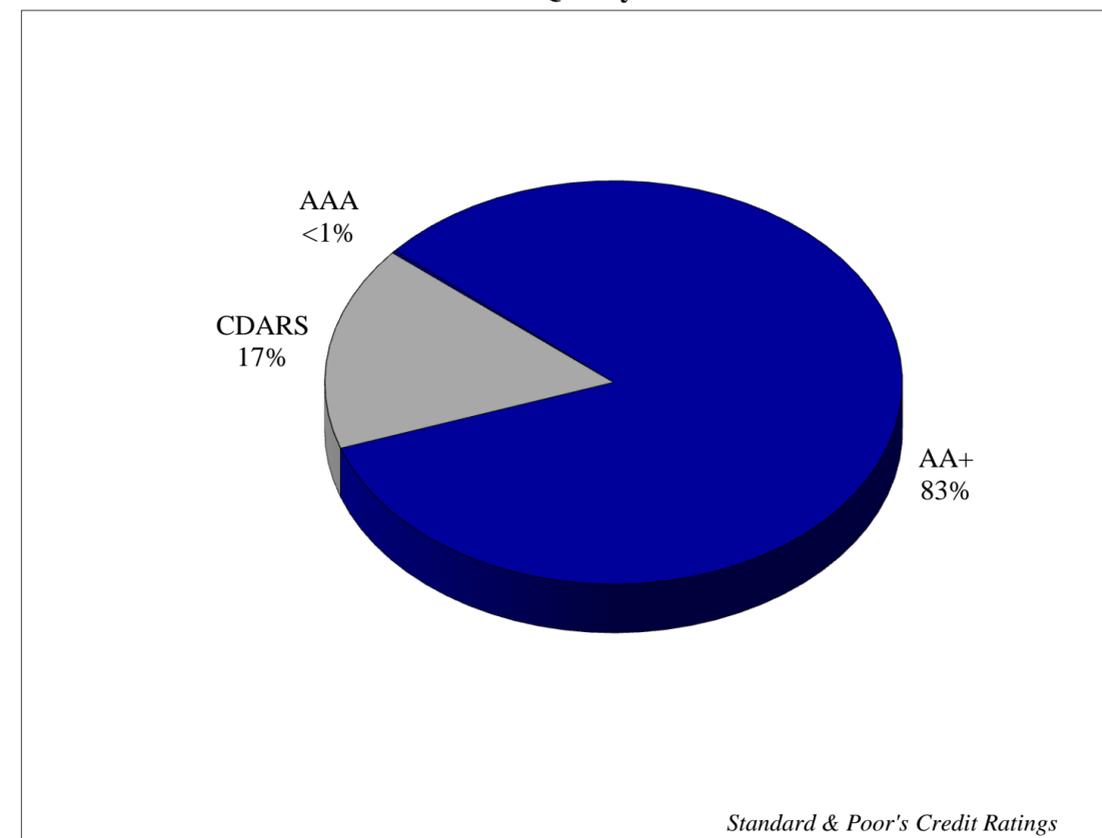
Quarter Ended December 31, 2011

<u>Security Type</u>	<u>Current Holdings*</u>	<u>Current Quarter % of Portfolio</u>	<u>Previous Quarter % of Portfolio</u>
U.S. Treasury	\$3,104,241.81	5%	5%
Federal Agency	\$47,694,924.42	78%	49%
Callable Federal Agency	\$6,339,555.56	10%	4%
Non-callable Federal Agency	\$41,355,368.86	68%	45%
CDARS	\$10,000,000.00	17%	23%
Wells Fargo MMF	\$137,023.81	<1%	23%
Total Market Value	\$60,936,190.04	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.

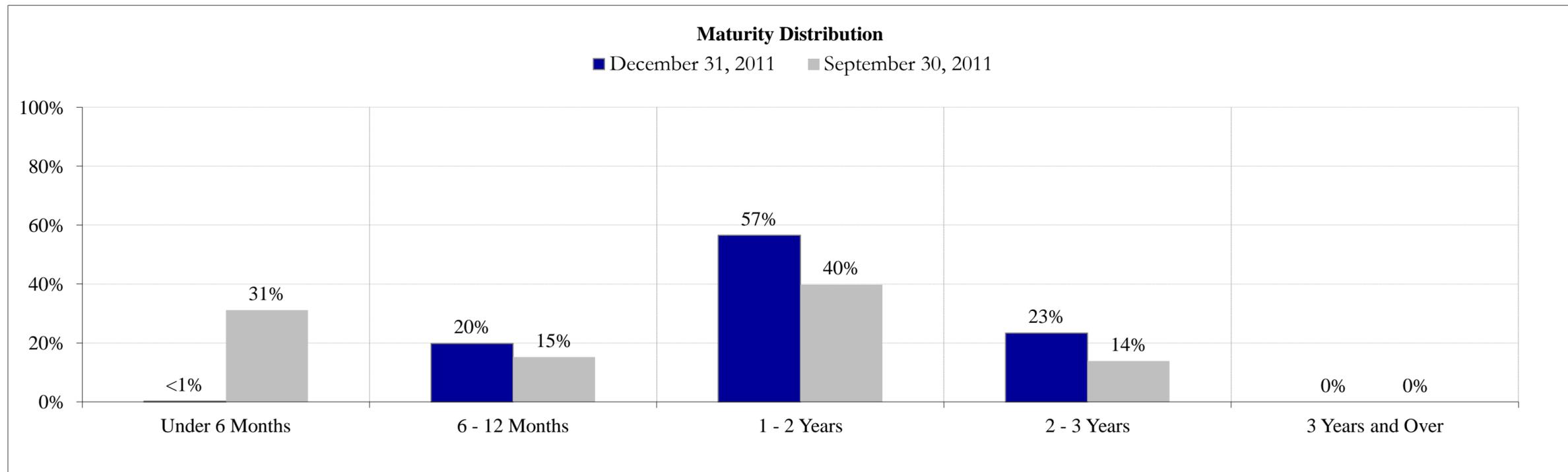
City of Surprise Maturity Summary and Key Portfolio Statistics
Quarter Ended December 31, 2011

Maturity Distribution Summary		
<u>Maturity Class</u>	<u>Fair Value*</u>	<u>% of Portfolio</u>
Under 6 Months	\$137,023.81	<1%
6 - 12 Months	\$12,074,634.00	20%
1 - 2 Years	\$34,468,152.76	57%
2 - 3 Years	\$14,256,379.47	23%
3 Years and Over	\$0.00	0%
Total Market Value	\$60,936,190.04	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	1.58 years
Benchmark Duration²	1.81 years
Yield at Cost	0.65%

1. Duration to worst as of 12/31/2011 was 1.76
 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.



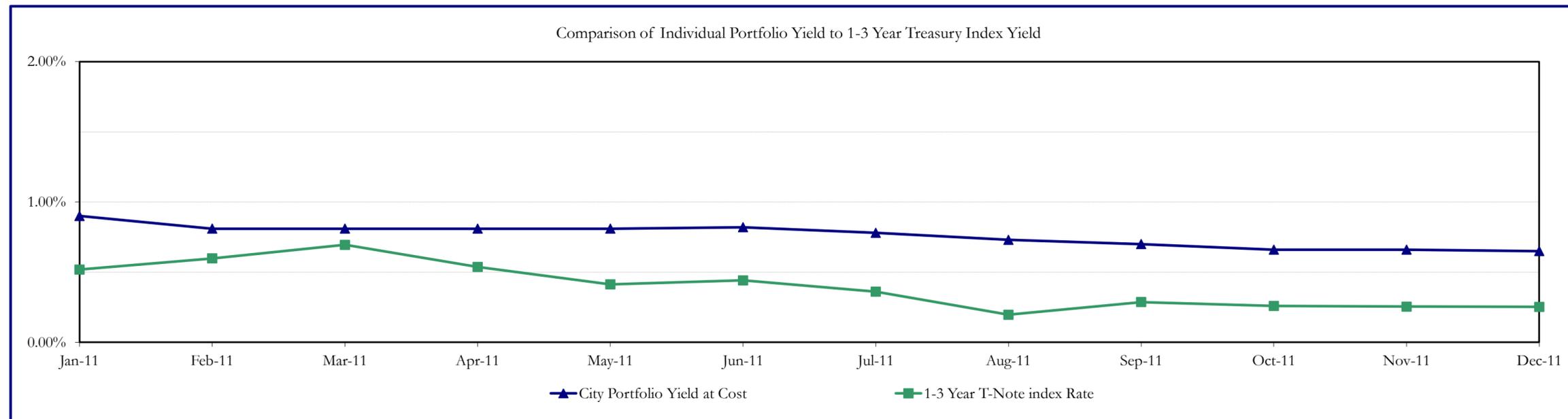
City of Surprise Individual Portfolio Yield Summary Trailing 12 Months

Date	Month-End Market Value ¹	Duration ²	Portfolio YTM at Cost ²	1-3 Year T-Note Index Rate ³
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%
Oct-11	\$50,889,100	1.66	0.66%	0.26%
Nov-11	\$50,879,151	1.55	0.66%	0.25%
Dec-11	\$50,936,190	1.58	0.65%	0.25%

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

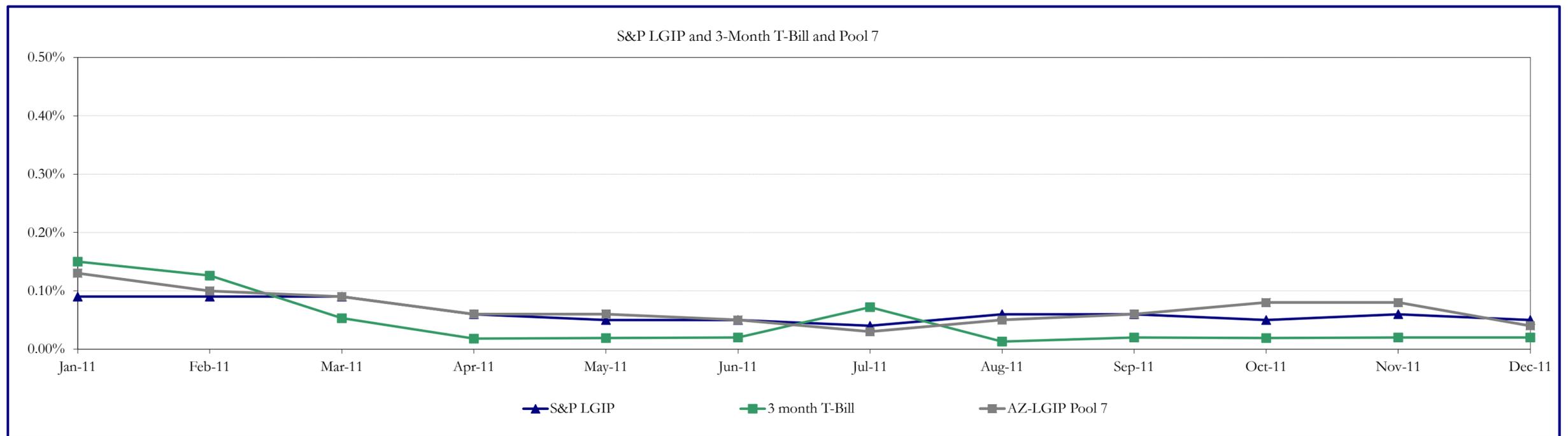


City of Surprise Short-Term Benchmark Comparisons Trailing 12 Months

Date	S&P LGIP	AZ-LGIP Pool 7 ¹	3 month Treasury Bill ²
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%
Oct-11	0.05%	0.08%	0.02%
Nov-11	0.06%	0.08%	0.02%
Dec-11	0.05%	0.04%	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. Source: Bloomberg



City of Surprise Holdings
Quarter Ended December 31, 2011

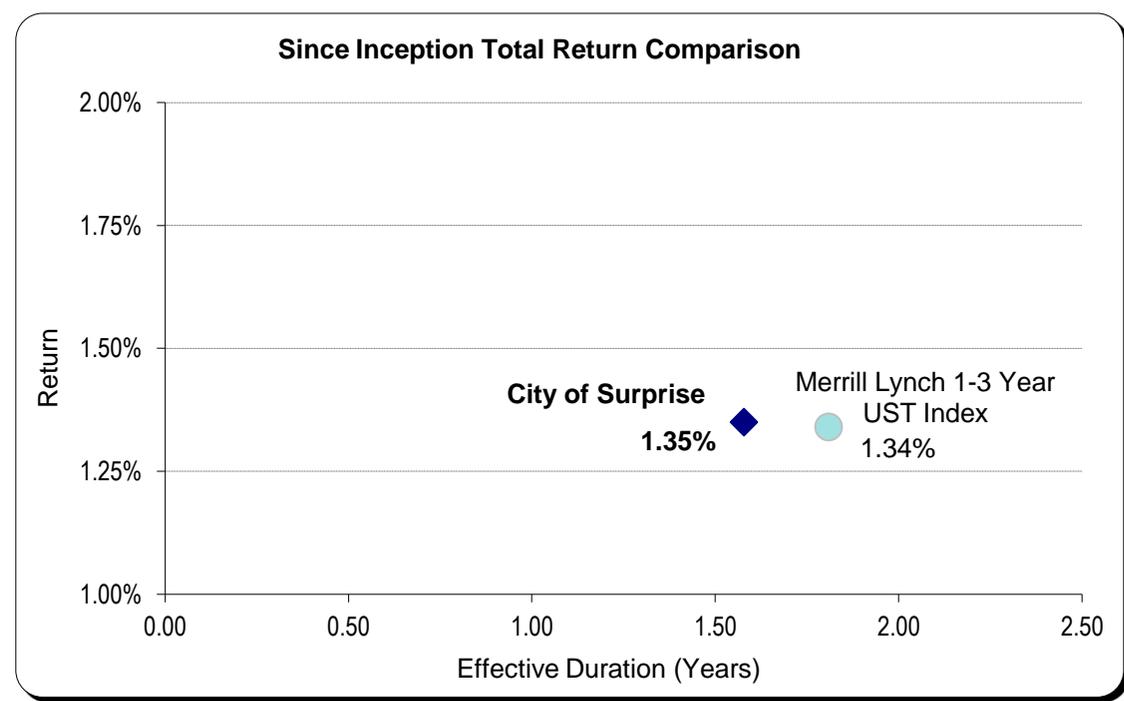
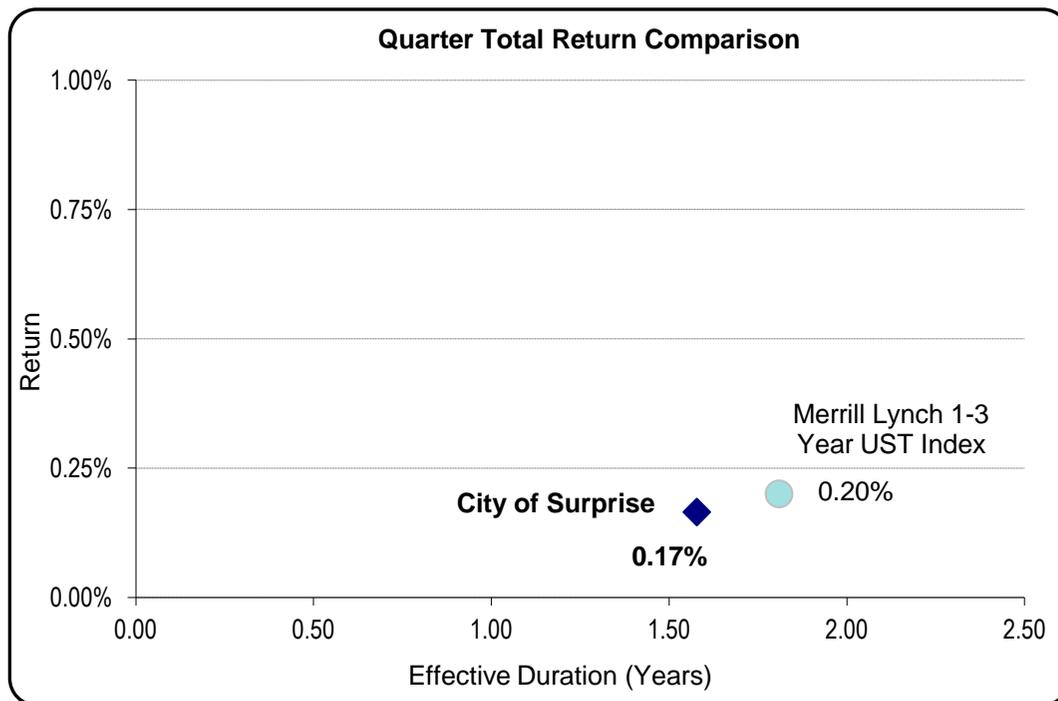
Operating Funds Investment Inventory by Maturity Date

Issuer	Maturity	Years to Maturity	Fair Value	Yield to Maturity	Next Call Date	Frequency
Wells Fargo MMF	12/31/2011	0.00	\$137,024	0.01%		
Alliance Bank (CDARS)	6/29/2012	0.50	\$10,000,000	0.66%		
FHLMC	12/21/2012	0.98	\$2,074,634	1.09%		
FNMA	2/26/2013	1.16	\$3,062,003	0.83%		
FHLMC	4/15/2013	1.29	\$1,235,417	0.56%		
FNMA	6/26/2013	1.49	\$2,035,192	1.41%		
FNMA	8/9/2013	1.61	\$1,252,949	0.36%		
FHLB	8/28/2013	1.66	\$1,001,824	0.57%		
FHLB	8/28/2013	1.66	\$3,882,068	0.42%		
FFCB	9/16/2013	1.71	\$5,003,265	0.43%		
FHLMC	9/20/2013	1.72	\$2,497,025	0.59%	3/20/12	Quarterly
FNMA	9/23/2013	1.73	\$5,051,725	0.73%		
FNMA	10/18/2013	1.80	\$3,842,531	0.56%	4/18/12	Quarterly
U.S. Treasury	11/15/2013	1.88	\$3,104,242	0.81%		
FHLMC	12/23/2013	1.98	\$2,499,913	0.48%		
FNMA	2/27/2014	2.16	\$1,237,639	0.44%		
FNMA	2/27/2014	2.16	\$3,880,302	0.55%		
FHLMC	8/27/2014	2.66	\$1,009,733	0.94%		
FHLMC	8/27/2014	2.66	\$1,252,069	0.54%		
FNMA	8/28/2014	2.66	\$3,878,833	0.64%		
FHLMC	12/29/2014	3.00	\$2,997,804	0.66%		
Total Market Value			\$ 60,936,190			

City of Surprise Quarterly Performance Quarter Ended December 31, 2011

Portfolio Performance

	Quarter Ended December 31, 2011	Past 6 Months	Past 1 Year	Since Inception	
Total Return^{1,2,3,5}					
City of Surprise	0.17%	0.43%	1.33%	1.35%	
Merrill Lynch 1-3 Year UST Index	0.20%	0.68%	1.55%	1.34%	
Effective Duration⁴	December 31, 2011	September 30, 2011	Yields	December 31, 2011	September 30, 2011
City of Surprise	1.58	1.59	Yield at Market	0.46%	0.45%
Merrill Lynch 1-3 Year UST Index	1.81	1.81	Yield on Cost	0.65%	0.70%



Notes:

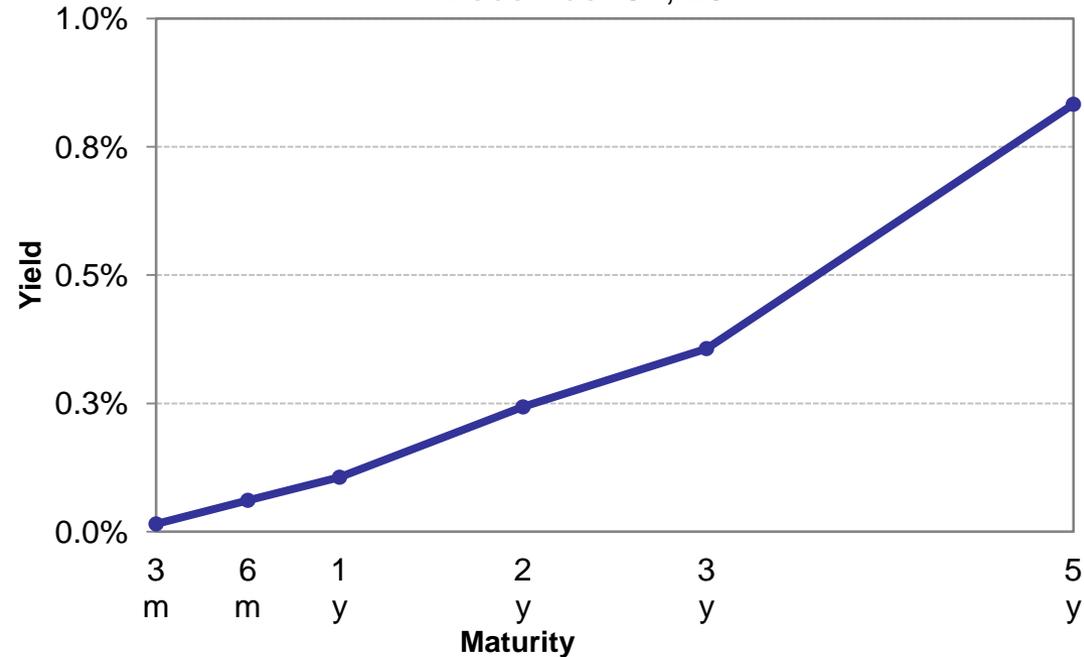
1. Performance on trade date basis, gross (i.e., before fees), in accordance with the CFA Institute's Global Investment Performance Standards (GIPS).
2. Quarterly returns are presented on an unannualized basis. Performance numbers for periods greater than one year are presented on an annualized basis.
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.

Portfolio Activity

Capitalizing on Positively Sloped Yield Curve

- Intermediate-term investments benefit the portfolio immediately with a higher yield and will continue to benefit the portfolio as they “roll down” the curve.

U.S. Treasury Yield Curve
December 31, 2011



Date	Trade Type	Security Description	Par Value	Maturity	Yield	Gain/Loss on Sale
12/19/11	Sell	FHLMC Notes	\$3,000,000	11/30/12	0.19%	\$13,369
12/19/11	Buy	FHLMC Notes	\$3,000,000	12/29/14	0.55%	-

Portfolio Activity (cont)

Capturing Unique Opportunities in the Market

- Relative Value Trade – Duration Neutral
 - This type of trade can occur for a variety of reasons including supply/demand factors and the need for dealers to adjust their inventory.

Date	Trade Type	Security Description	Par Value	Maturity	Yield	Gain/Loss on Sale
12/20/11	Sell	FHLB Notes	\$2,500,000	12/27/13	0.48%	\$14,999
12/20/11	Buy	FHLMC Notes	\$2,500,000	12/23/13	0.41%	-

Reinvestment of CDARS maturity

- The investments help to maintain the portfolio's target duration and diversification, and offer attractive yields.

Date	Trade Type	Security Description	Par Value	Maturity	Yield
1/13/12	Buy	FHLMC Notes	\$2,500,000	8/27/14	0.52%
1/13/12	Buy	U.S. Treasury Notes	\$2,500,000	8/15/13	0.21%



Managed Account Detail of Securities Held

For the Month Ending **December 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
U.S. Treasury Bond / Note											
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	1,994.92	3,072,260.77	3,104,241.81
Security Type Sub-Total		3,090,000.00					3,062,117.58	0.81	1,994.92	3,072,260.77	3,104,241.81
Federal Agency Bond / Note											
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	2,291.67	2,058,459.68	2,074,634.00
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	7,929.69	3,042,054.39	3,062,003.28
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	4,168.13	1,231,639.77	1,235,416.86
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	416.67	2,002,760.00	2,035,192.00
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	2,465.28	1,252,840.16	1,252,948.75
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	1,708.33	998,902.06	1,001,824.00
FHLB GLOBAL NOTES DTD 07/21/2011 0.500% 08/28/2013	313374Y61	3,875,000.00	AA+	Aaa	10/03/11	10/04/11	3,880,735.00	0.42	6,619.79	3,880,008.63	3,882,068.00
FFCB (FLOATING) NOTE DTD 09/16/2010 0.320% 09/16/2013	31331JG64	5,000,000.00	AA+	Aaa	10/12/10	10/13/10	5,000,000.00	0.43	712.50	5,000,000.00	5,003,265.00
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	4,208.33	2,500,109.73	2,497,025.00
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	13,611.11	5,022,780.25	5,051,725.00
FNMA NOTES (CALLABLE) DTD 10/18/2011 0.550% 10/18/2013	3135G0DV2	3,840,000.00	AA+	Aaa	09/29/11	10/18/11	3,839,232.00	0.56	4,282.67	3,839,309.53	3,842,530.56
FHLMC NOTES DTD 11/18/2011 0.625% 12/23/2013	3134G3BF6	2,500,000.00	AA+	Aaa	12/19/11	12/20/11	2,507,025.00	0.48	347.22	2,506,918.45	2,499,912.50



Managed Account Detail of Securities Held

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

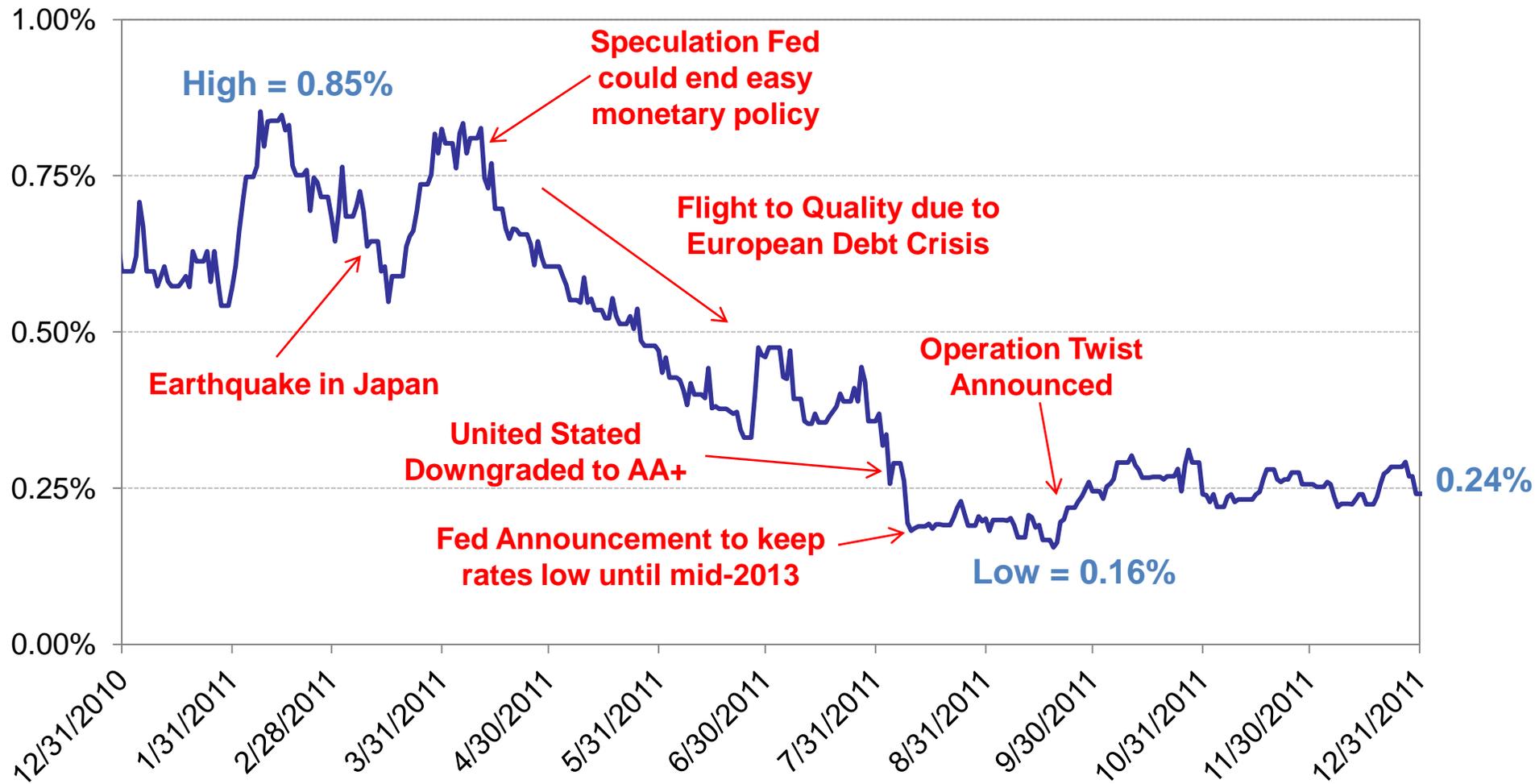
CITY OF SURPRISE OPERATING FUND

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
Federal Agency Bond / Note											
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	5,252.78	1,241,203.83	1,237,638.76
FNMA GLOBAL NOTES DTD 02/01/2011 1.250% 02/27/2014	3135G0AP8	3,825,000.00	AA+	Aaa	10/03/11	10/04/11	3,889,068.75	0.55	16,468.75	3,882,647.76	3,880,301.85
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	3,444.44	1,001,593.79	1,009,733.00
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	4,271.11	1,255,177.35	1,252,068.92
FNMA NOTES DTD 07/18/2011 0.875% 08/28/2014	3135G0BY8	3,860,000.00	AA+	Aaa	10/03/11	10/04/11	3,885,669.00	0.64	11,539.79	3,883,549.32	3,878,832.94
FHLMC NOTES DTD 12/16/2011 0.625% 12/29/2014	3137EADA4	3,000,000.00	AA+	Aaa	12/16/11	12/19/11	2,996,850.00	0.66	625.00	2,996,884.44	2,997,804.00
Security Type Sub-Total		47,370,000.00					47,733,896.58	0.64	90,363.26	47,596,839.14	47,694,924.42
Managed Account Sub-Total		50,460,000.00					50,796,014.16	0.65	92,358.18	50,669,099.91	50,799,166.23
Securities Sub-Total		\$50,460,000.00					\$50,796,014.16	0.65%	\$92,358.18	\$50,669,099.91	\$50,799,166.23
Accrued Interest											\$92,358.18
Total Investments											\$50,891,524.41

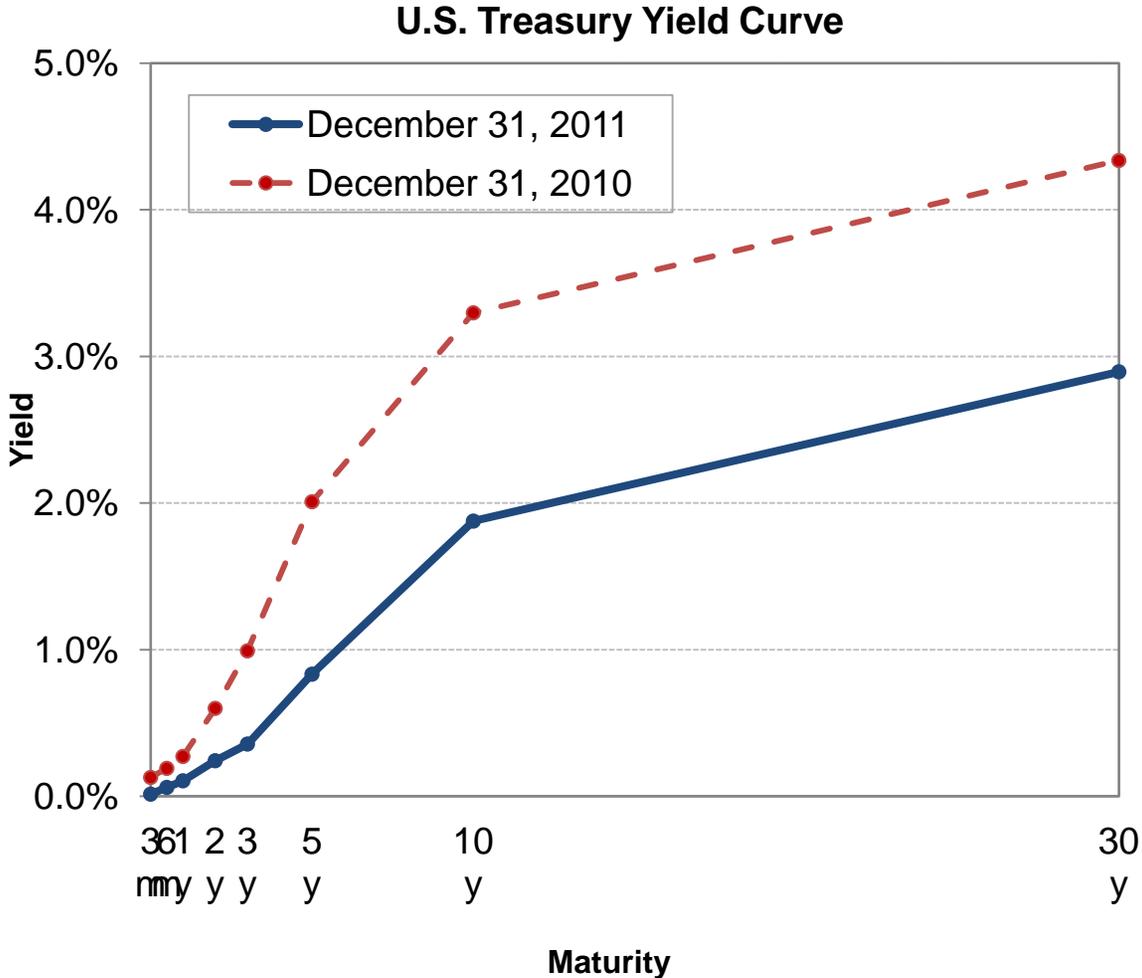
Market Update

Yields End 2011 Lower

2-Year U.S. Treasury Note Yield 2011



For the Year, Yields Are Substantially Lower Across All Maturities



	12/31/10	12/31/11	Difference
3-Month	0.12%	0.01%	-0.11%
6-Month	0.18%	0.06%	-0.12%
2-Year	0.59%	0.24%	-0.35%
5-Year	2.01%	0.83%	-1.18%
10-Year	3.29%	1.88%	-1.41%
30-Year	4.33%	2.89%	-1.44%

Source: Bloomberg

Fed's Zero-Interest Rate Policy Has Resulted in Negative Short-Term Yields

- Intense demand for safe short-term assets and the 0.00%-0.25% overnight rate has resulted in securities sold at negative yields. Investors are essentially paying for vehicles to hold cash.

Sold: FHLMC Discount Notes maturing on 1/13 at a -0.005%.

Trade Recap
Trade Date: 01/05/2012 TradeWeb ADN Trade Time: 09:02:26 EST
SELL 500 FHLMC ADN 01/13/2012 CUSIP: 313396RT2 0:19

Trd	Dir	State	Settlement	Quantity	Yld(strt)	Rate	Action	End	Time
71	HSBC	DQt	01/05/2012	500	0.001	0.001	HIT	END	
71	MSDW	DQt	01/05/2012	500	0.000	0.000	HIT	END	
61	BNPP	DQt	01/05/2012	500	0.000	0.000	HIT	END	0.49
71	UBSW	AGC	01/05/2012	500	-0.005	-0.005			
71	C	DQt	01/05/2012	500	0.000	0.000	HIT	END	

Sold: FHLMC Discount Notes maturing on 1/18 at a -0.005%.

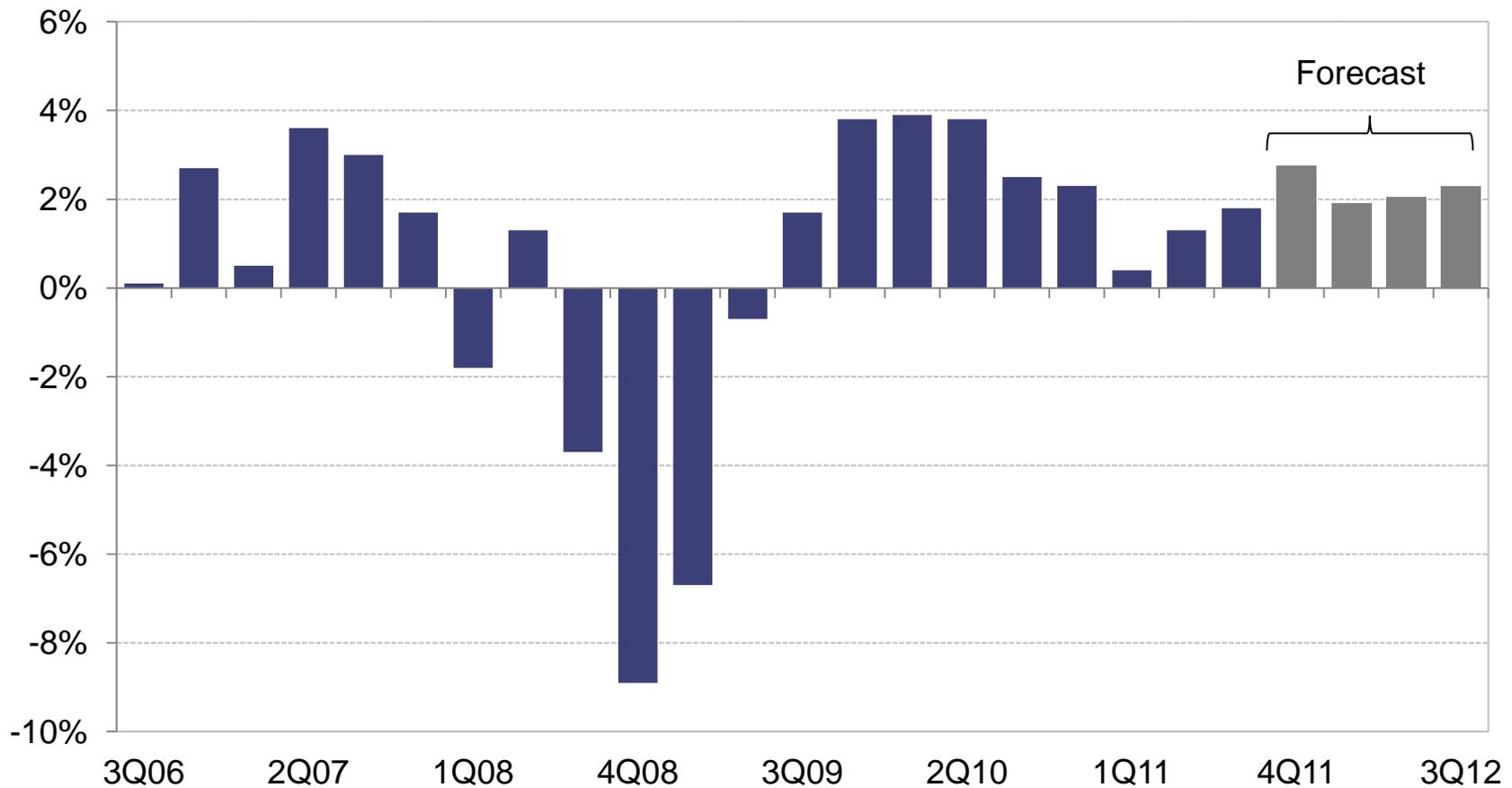
Trade Recap
Trade Date: 01/05/2012 TradeWeb ADN Trade Time: 09:03:37 EST
SELL 700 FHLMC ADN 01/18/2012 CUSIP: 313396RY1 0:13

Trd	Dir	State	Settlement	Quantity	Yld(strt)	Rate	Action	End	Time
62	BNPP	DQt	01/05/2012	700	0.000	0.000	HIT	END	0:53
72	UBSW	AGC	01/05/2012	700	-0.005	-0.005			
51	RBC	DQt	01/05/2012	700	0.005	0.005	HIT	END	0:55
72	C	DQt	01/05/2012	700	0.000	0.000	HIT	END	0:05
51	NOM	DQt	01/05/2012	700	0.000	0.000	HIT	END	0:15

Economic Growth Gradually Improved Over the Course Of The Year

- Economists have raised their Q4 GDP estimate to around 3.00%, although forecasts for 2012 remain muted.

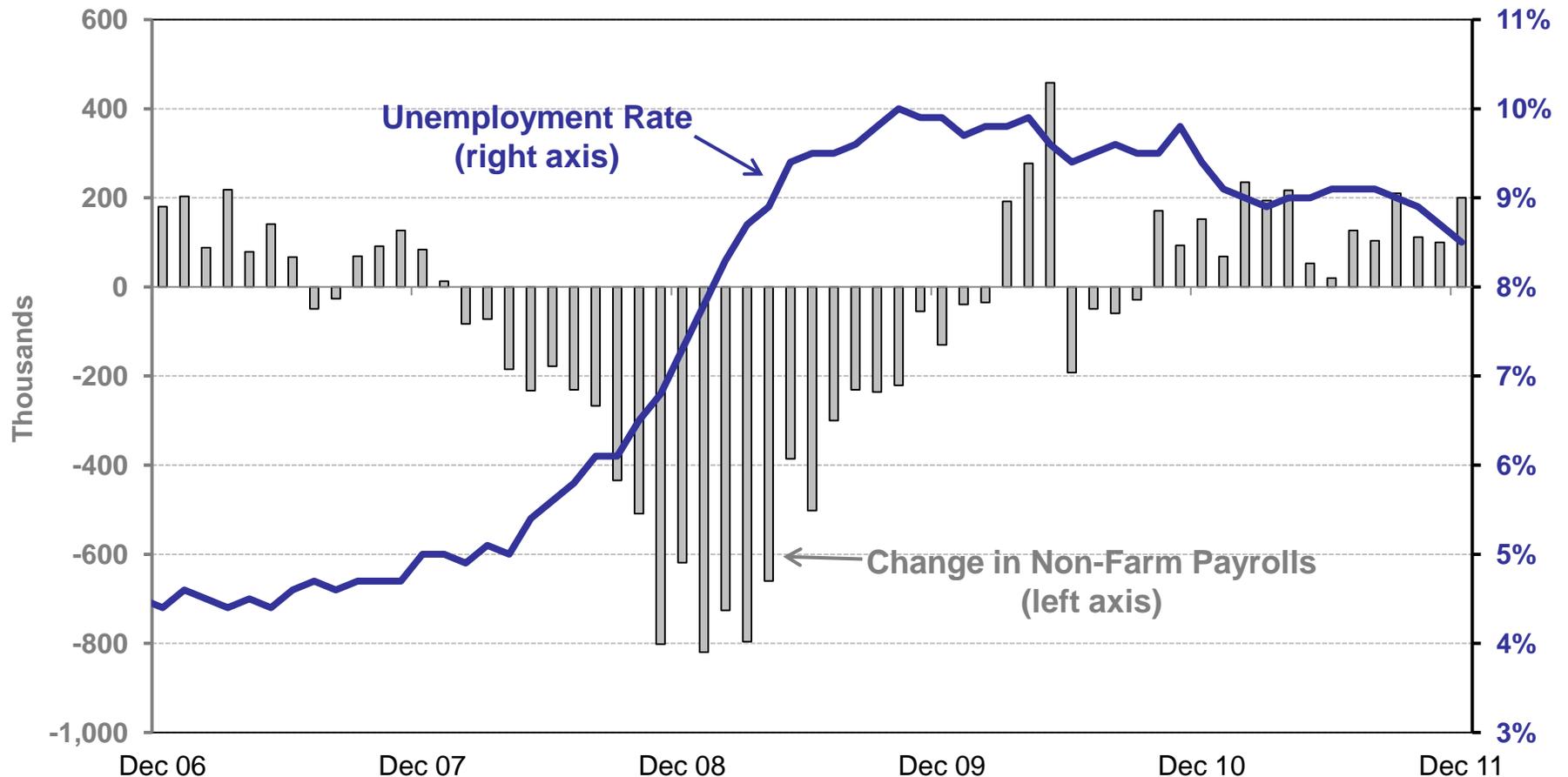
U.S. Gross Domestic Product
Q3 2006 – Q3 2012



Employment Data Encouraging

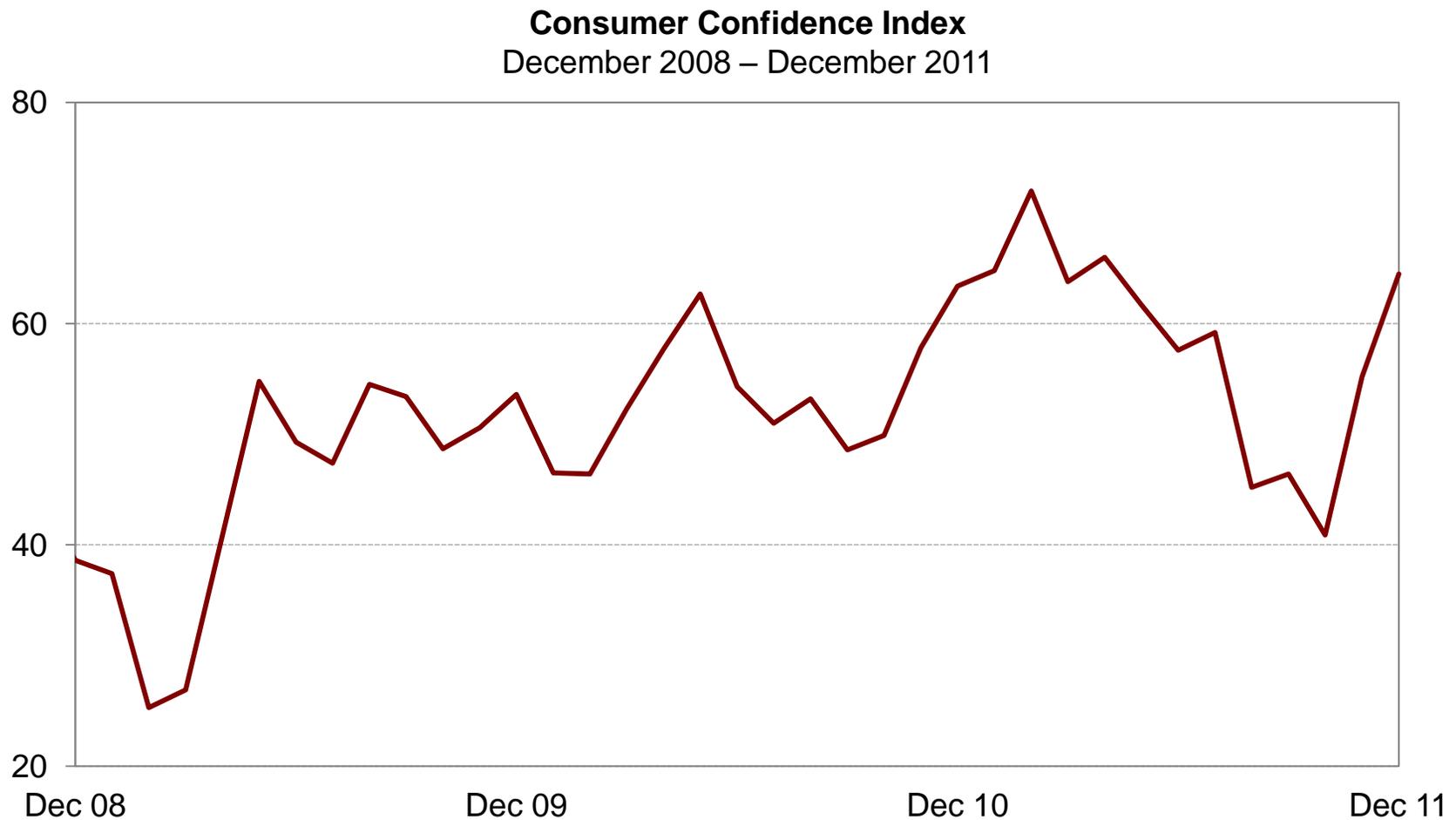
- In December, there were large job increases in the retail, manufacturing, healthcare, transportation and warehousing sectors. 2011 ended with a total of 1.6 million new jobs being created, the highest amount since 2006.

Change in Non-Farm Payrolls vs. Unemployment Rate
December 2006 – December 2011



Consumer Confidence Rises

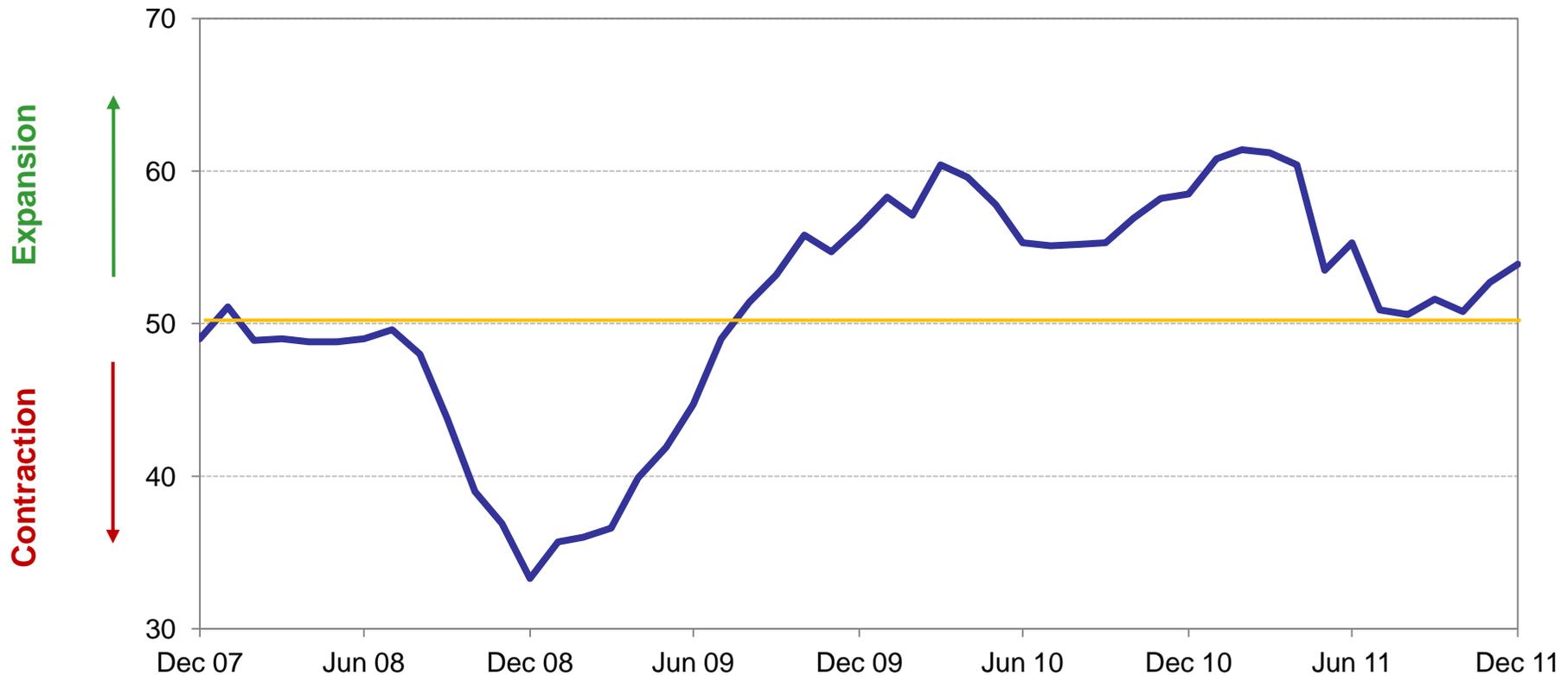
- The consumer confidence index rose 9.3 points to 64.5 in December, the highest reading since April, 2011.
- Perceived strength in the job market, optimism regarding future income, stock market improvement, and positive economic data contributed to the increase in confidence.



Manufacturing Continues Upward Growth Trend

- The manufacturing sector advanced to 53.9 in December from 52.7 in the prior month, indicating that the U.S. economy is gradually improving, despite the turmoil in Europe.

ISM Manufacturing Composite Index
December 2007 – December 2011

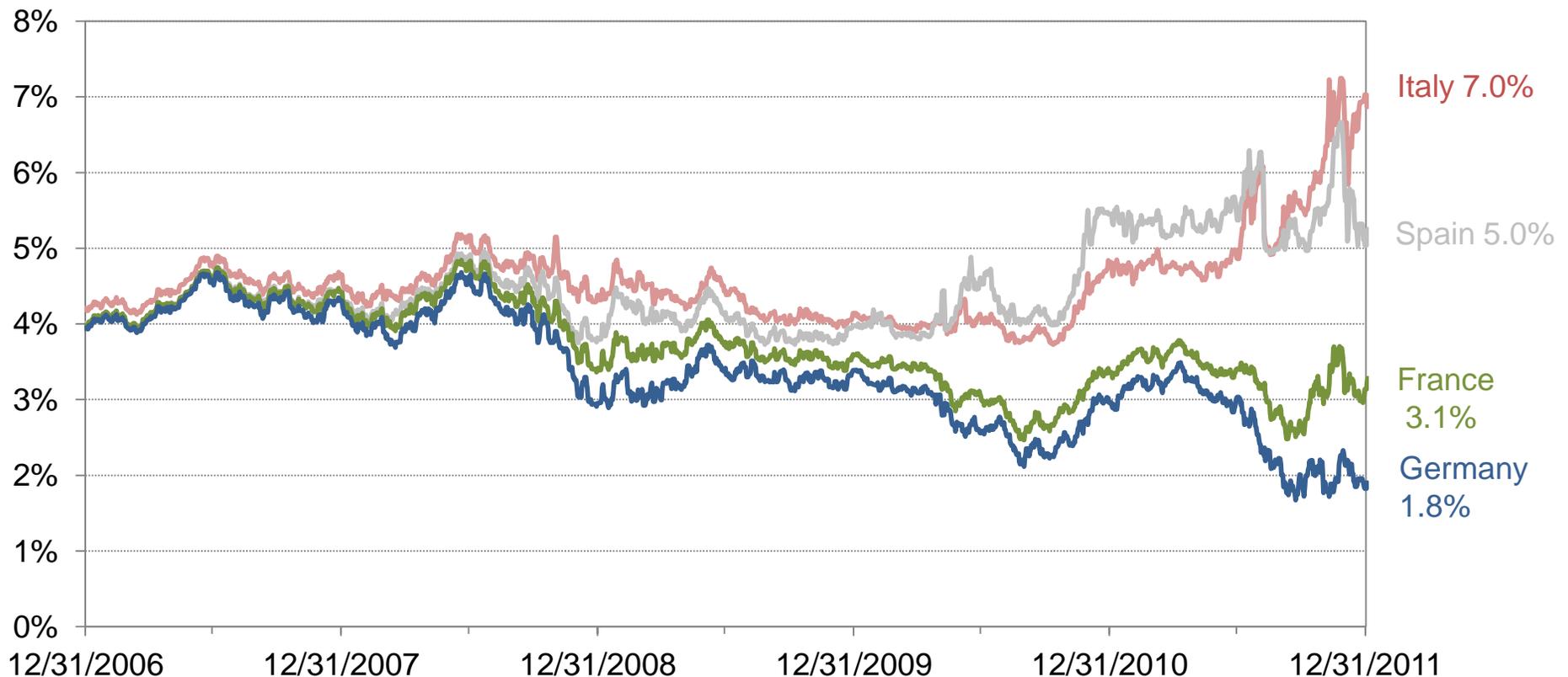


ISM manufacturing is created from a qualitative survey of manufacturing firms covering new orders, production, employment, supplier deliveries, and inventories. Historically, readings of 50 or above are associated with an expanding manufacturing sector and healthy GDP growth. Readings below 50 indicate a contracting manufacturing sector, but GDP growth is still positive until the ISM index falls below 42.7.

Borrowing Costs Skyrocket in Troubled European Nations

- S&P downgraded France, Italy, Spain, Austria, Portugal, Slovakia, Slovenia, Malta, and Cyprus because “the policy initiatives that have been taken by European policymakers in recent weeks may be insufficient to fully address ongoing systemic stresses in the eurozone.”

10-Year Bond Yields of EU Nations
December 2006 – December 2011



Going Forward – The December 13 FOMC Statement

- Economic conditions likely to warrant “exceptionally low” rate “at least through mid-2013”.
- The program to extend the average maturity of its holdings will continue. The policy of reinvesting payments from agency debt and mortgage backed securities into agency mortgage backed securities, and of rolling maturing Treasuries at auction will be maintained.
- A moderate pace of economic growth is expected to continue over coming quarters, however, there are significant downside risks to the economic outlook.
- Inflation will settle, over the coming quarters, at levels at or below those consistent with the Committee’s dual mandate.
- The unemployment rate will decline only gradually toward levels judged to be consistent with its mandate to foster maximum employment.

	<u>2011 Forecast</u>		<u>2012 Forecast</u>		<u>2013 Forecast</u>	
	June	Nov	June	Nov	June	Nov
GDP Growth	2.7% - 2.9%	1.6% - 1.7%	3.3% - 3.7%	2.5% - 2.9%	3.5% - 4.2%	3.0% - 3.5%
Core PCE Inflation	1.5% - 1.8%	1.8% - 1.9%	1.4% - 2.0%	1.5% - 2.0%	1.4% - 2.0%	1.4% - 1.9%
Overall PCE Inflation	2.3% - 2.5%	2.7% - 2.9%	1.5% - 2.0%	1.4% - 2.0%	1.5% - 2.0%	1.5% - 2.0%
Unemployment Rate	8.6% - 8.9%	9.0% - 9.1%	7.8% - 8.2%	8.5% - 8.7%	7.0% - 7.5%	7.8% - 8.2%

Global Challenges for 2012



- Slow, but improving domestic growth
- Continued uncertainty around fiscal situation
- Risk of global slowdown effecting U.S.
- Stubbornly high unemployment



- European Debt crisis continuing
- Future of the Euro zone and single currency
- Brewing recession in Europe



- Slowing manufacturing sector in China
- Government fueled housing bubble in China
- India's GDP slowed to 2.5% in the 3rd Quarter of 2011 after recording 10% for 2010
- Export-driven emerging market economies are slowing due to weakening prospects for developed economies

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