



# City of Surprise

## Quarterly Performance Review

### Third Quarter Ended September 30, 2013



#### The PFM Group

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# Rates Rise Anticipating Fed Stimulus Tapering

- Interest rates rose throughout the third quarter as investors anticipated a reduction, and eventual completion, of FOMC's monthly \$85 billion asset purchases.
- There was little movement in short-term yields (maturities less than a year) as these maturities remained anchored by Fed Policy.



Source: Bloomberg

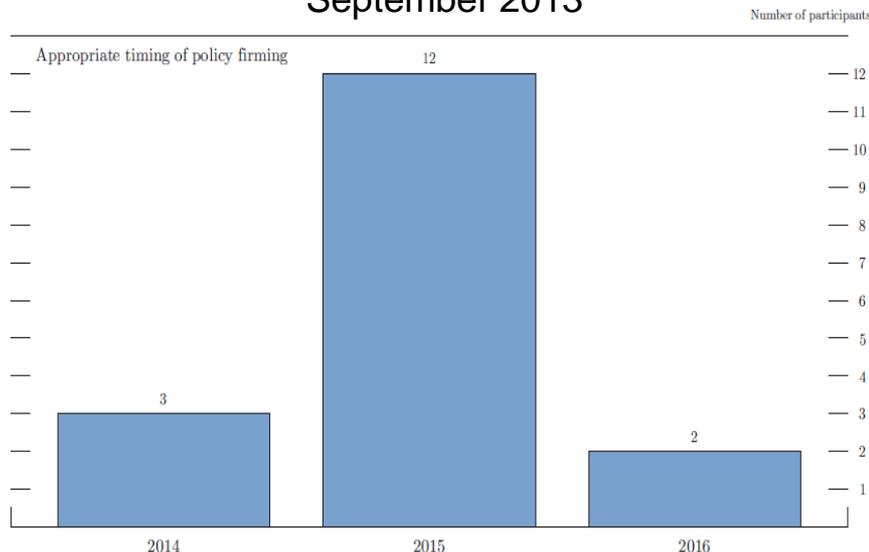
# Taper Tantrum

- The Fed surprised the market at its September meeting with the decision to continue its \$85 billion bond buying program.

*“...the Committee sees the improvement in economic activity and labor market conditions since it began its asset purchase program a year ago as consistent with growing underlying strength in the broader economy. However, the Committee decided to await more evidence that progress will be sustained before adjusting the pace of its purchases.”*

- Fed continued to hold its overnight rate at 0.00%-0.25%.

## Appropriate Timing of Policy Firming September 2013



*Note: The height of each bar denotes the number of Federal Open Market Committee (FOMC) participants who judge that, under appropriate monetary policy, the first increase in the target federal funds rate from its current range of 0 to 0.25% will occur in the specified calendar year.*

Source: Federal Reserve

# Third Quarter Strategy and Recap

- The portfolio complies with the Arizona Revised Statutes and the City of Surprise's investment policy. It is well diversified among U.S. Treasuries, Federal Agencies, and other sectors.
- Our investment strategy is based on the view that interest rates will trend gradually higher as modest economic expansion in the U.S. continues.
- The key pillars of our strategy included:
  - Keeping duration a bit shorter and more conservative than the benchmark's duration.
  - Careful timing of purchases when rates were near the top of their recent range.
  - Analyzing relationships between Agencies and Treasuries to capture the most relative value.
  - Under-weighting callable agencies that typically under-perform in volatile or rising rate environments.
- The portfolio was positioned with a duration shorter than the benchmark for much of the quarter to dampen market value losses as yields rose.
- Interest rates ended the quarter lower than where they began, resulting in positive total return performance for fixed income indices and the City's portfolio.

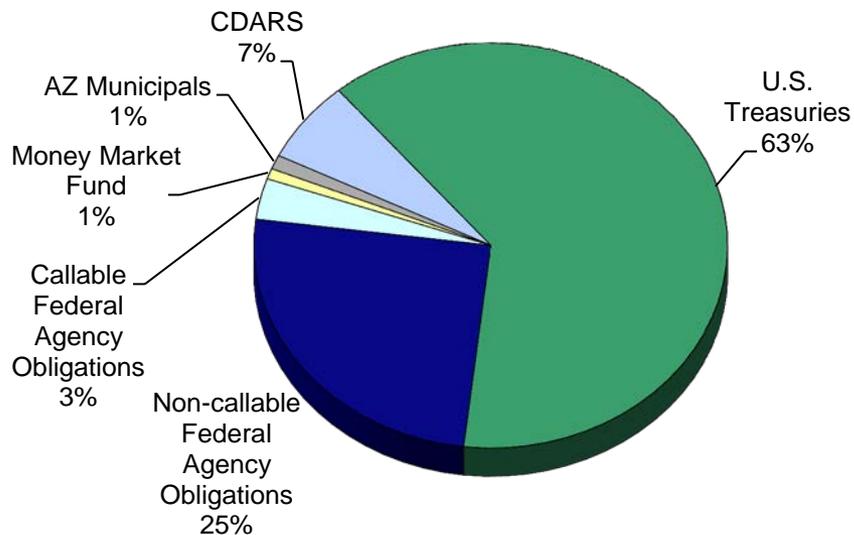
# Fourth Quarter Strategy and Outlook

- We expect a fair amount of uncertainty in the market in the fourth quarter and beyond:
  - Pace of economic growth
  - Another round of budget and deficit negotiations
  - Status and pace of Fed's bond buying taper
  - Effects of sequester cuts
- Treasury yields will likely be range bound due to the unevenness of the economic recovery, but have risen to a new higher trading range.
- The current modestly conservative duration will likely be maintained for the foreseeable future to guard against interest rate volatility and rising rates.
- We favor Agencies in maturity ranges over 2 years and Treasuries with maturities below 2 years. As Agency holdings shorten over time, we may swap into like maturity Treasuries, or reposition into longer maturity Agencies at higher yields and wider spreads.
- As always, we seek to maximize portfolio value through careful and prudent active management. Our strategy will remain flexible and may change in response to changes in interest rates, economic data, or our market outlook.

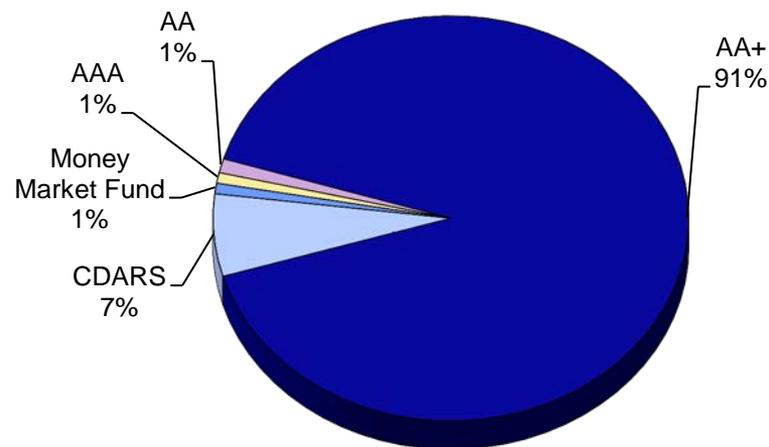
# Portfolio Summary and Characteristics

Security Type*	September 30, 2013	Current Quarter % of Portfolio	Previous Quarter % of Portfolio
<b>U.S. Treasury</b>	<b>\$48,190,792</b>	<b>63%</b>	60%
<b>Federal Agency</b>	<b>\$21,813,106</b>	<b>28%</b>	32%
Callable Federal Agency	\$2,500,460	3%	3%
Non-callable Federal Agency	\$19,312,646	25%	29%
<b>CDARS**</b>	<b>\$5,027,564</b>	<b>7%</b>	7%
<b>AZ Municipals</b>	<b>\$868,330</b>	<b>1%</b>	1%
<b>Wells Fargo MMF</b>	<b>\$650,439</b>	<b>1%</b>	<1%
<b>Total Market Value</b>	<b>\$76,550,232</b>	<b>100%</b>	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 trade date. Note that PFM statements reflect holdings as of trade date.

\*\* CDARS: FDIC-insured time certificate of deposit program through Alliance Bank of AZ. CDARS funds are managed internally by the City and are not included in the PFM-managed portfolio or performance data.

# Maturity Summary and Key Portfolio Statistics

## Maturity Distribution

<u>Maturity Class</u>	<u>Fair Value*</u>	<u>% of Portfolio</u>
Under 6 Months	\$8,235,074.07	11%
6 - 12 Months	\$8,663,776.56	11%
1 - 2 Years	\$38,088,765.38	50%
2 - 3 Years	\$21,562,616.17	28%
3 Years and Over	\$0.00	0%
<b>Total Market Value</b>	<b>\$76,550,232</b>	<b>100%</b>

## Key Portfolio Statistics

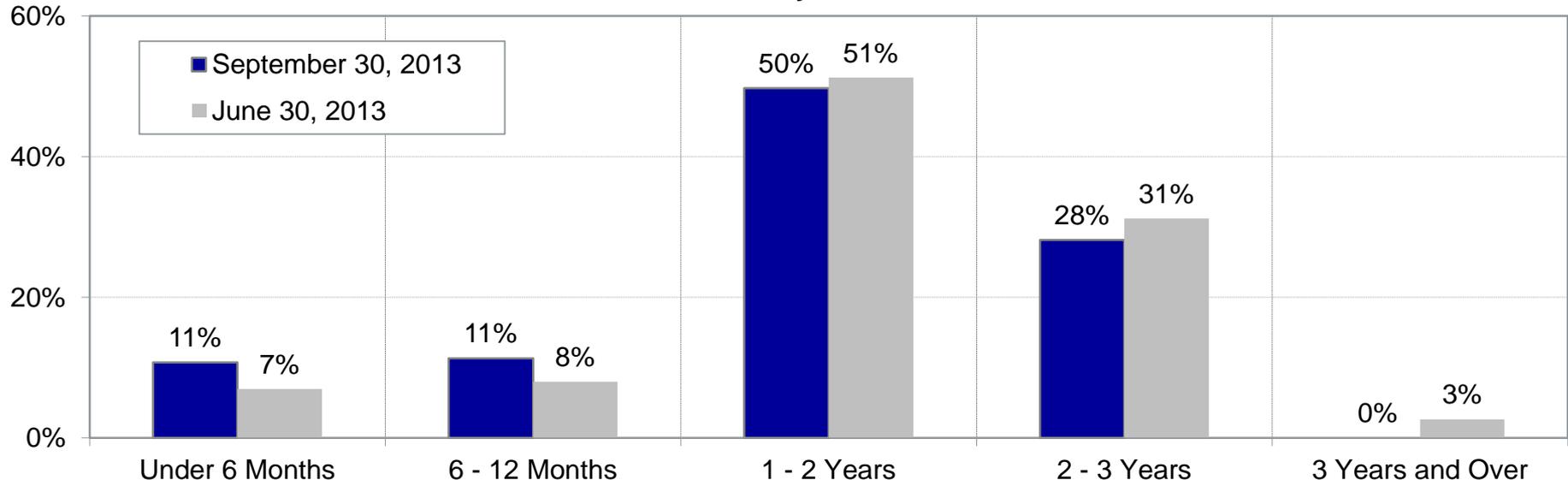
<b>Effective Duration<sup>1</sup></b>	<b>1.67 years</b>
<b>Benchmark Duration<sup>2</sup></b>	<b>1.82 years</b>
<b>Yield at Cost</b>	<b>0.47%</b>

1. Duration to worst as of 9/30/2013 was 1.62.

2. The City's benchmark is the Merrill Lynch 1-3 Year U.S. Treasury Index. Performance statistics exclude money market fund and CDARS.

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

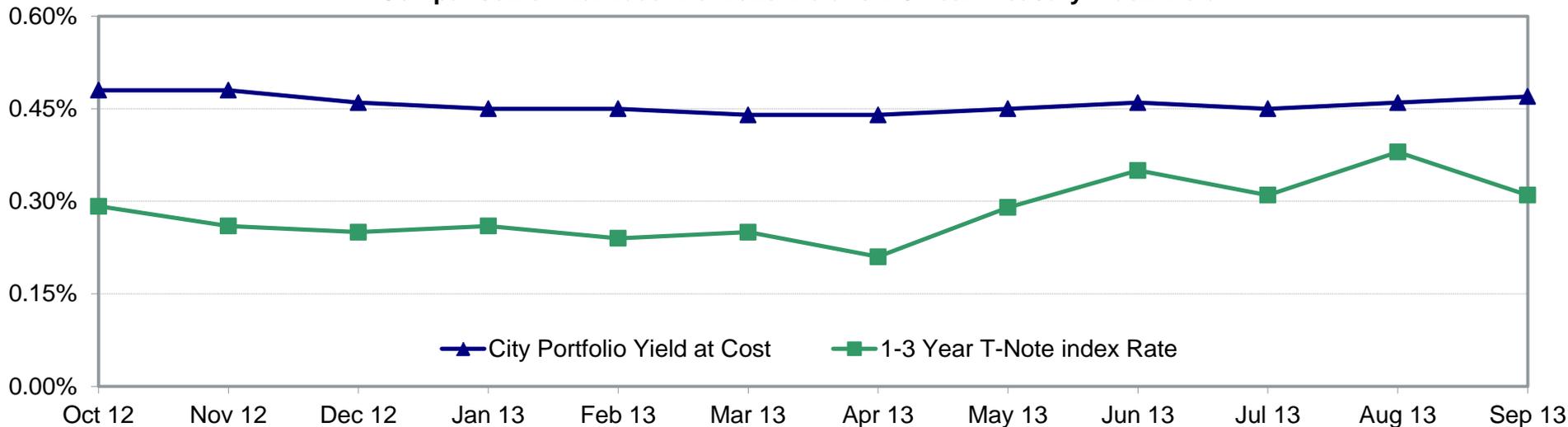
## Maturity Distribution



# Individual Portfolio Yield Summary

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-12	\$71,293,077	1.73	0.48%	0.29%
Nov-12	\$71,348,136	1.78	0.48%	0.26%
Dec-12	\$71,327,603	1.76	0.46%	0.25%
Jan-13	\$71,355,860	1.81	0.45%	0.26%
Feb-13	\$71,535,993	1.75	0.45%	0.24%
Mar-13	\$71,436,261	1.80	0.44%	0.25%
Apr-13	\$71,448,901	1.71	0.44%	0.21%
May-13	\$71,411,221	1.87	0.45%	0.29%
Jun-13	\$71,315,444	1.79	0.46%	0.35%
Jul-13	\$71,447,857	1.71	0.45%	0.31%
Aug-13	\$71,473,114	1.63	0.46%	0.38%
Sep-13	\$71,522,668	1.67	0.47%	0.31%

Comparison of Individual Portfolio Yield to 1-3 Year Treasury Index Yield



<sup>2</sup> Excludes CDARS and custody money market fund.

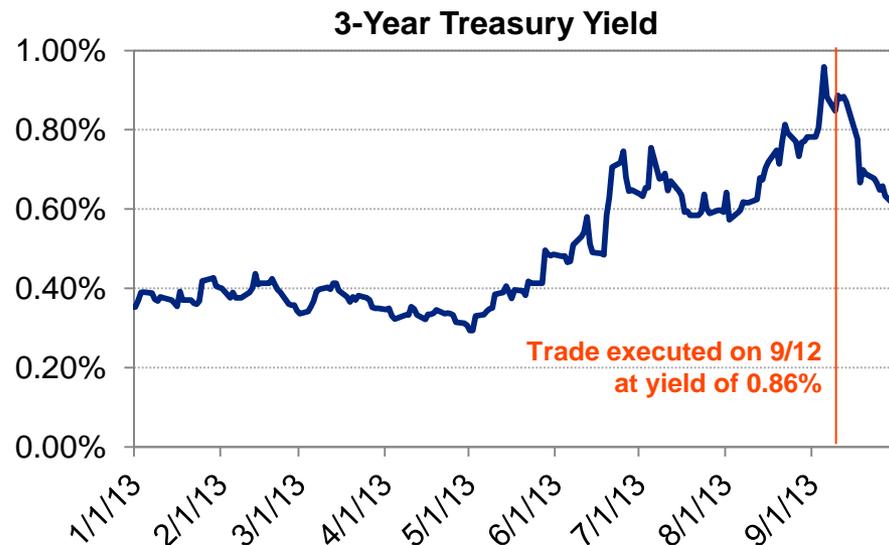
<sup>3</sup> Rate represents the BoA/Merrill Lynch 1-3 Year U.S. Treasury Note Index month-end yield. Source: Bloomberg.

# Holdings by Maturity

Issuer	Maturity	Years to Maturity	Fair Value	Yield to Maturity	Next Call Date	Frequency
Wells Fargo MMF	9/30/2013	0.00	\$650,439	0.01%		
Alliance Bank (CDARS)	2/13/2014	0.37	\$5,027,564	0.33%		
FNMA	2/27/2014	0.41	\$1,225,786	0.44%		
FNMA	2/27/2014	0.41	\$1,331,284	0.55%		
FHLMC	8/27/2014	0.91	\$1,008,064	0.94%		
FHLMC	8/27/2014	0.91	\$1,249,999	0.54%		
FHLMC	8/27/2014	0.91	\$2,520,160	0.52%		
FNMA	8/28/2014	0.91	\$3,885,553	0.64%		
FNMA	10/30/2014	1.08	\$3,747,926	0.49%		
U.S. Treasury	12/15/2014	1.21	\$1,101,203	0.39%		
FHLMC	12/29/2014	1.25	\$3,014,937	0.66%		
U.S. Treasury	1/31/2015	1.33	\$2,404,167	0.40%		
U.S. Treasury	1/31/2015	1.33	\$2,363,070	0.38%		
U.S. Treasury	2/15/2015	1.38	\$2,408,883	0.37%		
U.S. Treasury	2/15/2015	1.38	\$2,366,807	0.33%		
U.S. Treasury	2/28/2015	1.41	\$793,521	0.51%		
U.S. Treasury	5/15/2015	1.63	\$1,907,398	0.28%		
U.S. Treasury	5/15/2015	1.63	\$1,062,617	0.33%		
FNMA	5/27/2015	1.66	\$1,328,935	0.59%		
U.S. Treasury	5/31/2015	1.67	\$5,448,296	0.35%		
U.S. Treasury	6/30/2015	1.75	\$2,384,162	0.43%		
AZ Municipal	7/1/2015	1.75	\$868,330	0.77%		
U.S. Treasury	7/31/2015	1.83	\$2,540,451	0.41%		
U.S. Treasury	7/31/2015	1.83	\$1,847,601	0.34%		
FNMA	8/7/2015	1.85	\$2,500,460	0.51%	11/7/13	Quarterly
U.S. Treasury	11/15/2015	2.13	\$2,990,410	0.34%		
U.S. Treasury	1/31/2016	2.33	\$3,473,009	0.42%		
U.S. Treasury	4/30/2016	2.58	\$3,946,953	0.38%		
U.S. Treasury	4/30/2016	2.58	\$2,233,145	0.39%		
U.S. Treasury	5/31/2016	2.67	\$3,385,318	0.51%		
U.S. Treasury	6/30/2016	2.75	\$1,996,595	0.43%		
U.S. Treasury	8/31/2016	2.92	\$3,537,188	0.86%		
<b>Total Market Value</b>			<b>\$ 76,550,232</b>			

# Quarterly Portfolio Activity

- Each month bond market indexes, including the 1-3 Year U.S. Treasury index utilized by the City, reset as shorter maturity bonds drop out and newly-issued or longer maturity bonds roll into the designated maturity range.
- This causes the average maturity of the typical bond index to extend at the beginning of each new month. The City's portfolio managers normally execute monthly trades to match the extension of the benchmark.
- However, because rates were rising, PFMAM chose not to extend at the beginning of July and August, preferring to wait as rates marched even higher. We did finally extend mid-September to match the indexes' September lengthening. This was fortuitous, as rates fell sharply in late September.



Trade Date	Transaction	Security	Maturity	Par Value (millions)	Yield	Realized G/L
9/12/13	Buy	U.S. Treasury Notes	8/31/16	\$3.50	0.86%	-
9/12/13	Sell	FNMA Notes	2/27/14	\$2.50	0.10%	\$5,150
9/12/13	Sell	U.S. Treasury	2/15/14	\$1.00	0.03%	\$1,138

# Q3 Recoups Some of Q2 Losses

As of 9/30/13

Returns for periods ended 9/30/13

	Effective Duration	Yield	YTD	1 Month	3 Month	1 Year	3 Years
<b>1-3 Year Indices</b>							
U.S. Treasury	1.90	0.25%	0.30%	0.23%	0.29%	0.37%	0.71%
Agency	1.75	0.31%	0.27%	0.20%	0.30%	0.39%	0.87%
Corp A-AAA	1.93	1.02%	0.95%	0.35%	0.74%	1.39%	2.22%
MBS (0 to 3 Years)	1.78	0.87%	0.03%	0.50%	1.03%	(0.28%)	1.92%
Municipals	1.83	0.52%	0.73%	0.20%	0.47%	0.76%	1.25%
<b>1-5 Year Indices</b>							
U.S. Treasury	2.70	0.34%	(0.08%)	0.51%	0.46%	(0.03%)	1.16%
Agency	2.48	0.42%	(0.09%)	0.50%	0.52%	0.07%	1.15%
Corp A-AAA	2.83	1.26%	0.62%	0.70%	1.16%	1.17%	2.79%
MBS (0 to 5 Years)	3.26	0.91%	(0.48%)	0.74%	0.93%	(0.74%)	2.55%
Municipals	2.57	0.71%	0.68%	0.43%	0.67%	0.58%	1.72%
<b>Master Indices (Maturities 1 Year and Greater)</b>							
U.S. Treasury	5.70	0.91%	(2.45%)	0.76%	0.03%	(2.54%)	2.12%
Agency	3.93	0.79%	(1.59%)	0.63%	0.35%	(1.38%)	1.63%
Corp A-AAA	6.44	2.38%	(2.49%)	0.69%	0.86%	(1.72%)	3.83%
MBS (0 to 30 Years)	5.17	0.92%	(0.93%)	1.43%	1.08%	(1.20%)	2.66%
Municipals	8.04	2.48%	(3.25%)	2.34%	(0.41%)	(2.75%)	3.28%

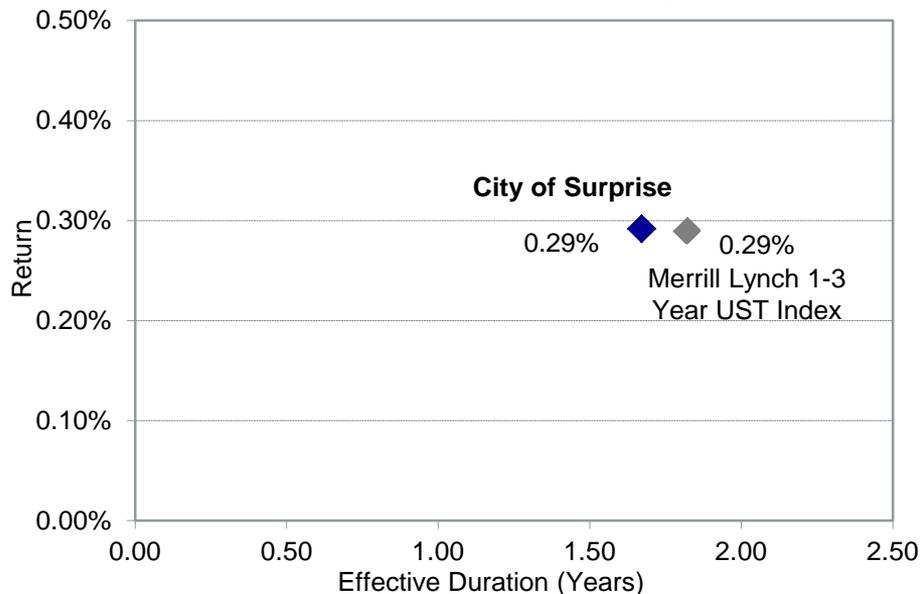
Returns for greater than one year are annualized.

Source: BofA Merrill Lynch Indices

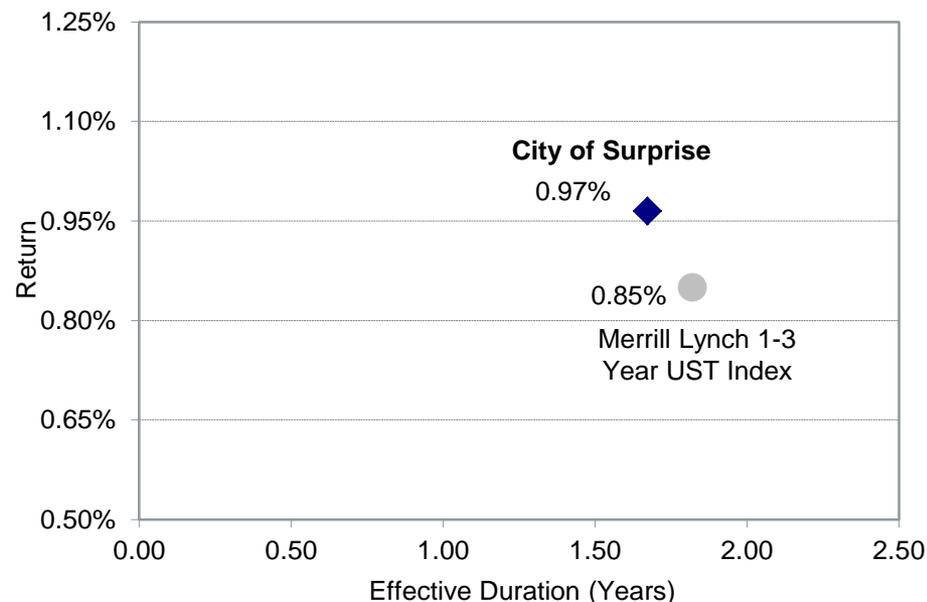
# Portfolio Performance

Total Return <sup>1,2,3,4,5</sup>	Quarter Ended September 30, 2013	Past 1 Year	Past 2 Years	Past 3 Years	Since Inception
<b>City of Surprise</b>	<b>0.29%</b>	<b>0.39%</b>	<b>0.64%</b>	<b>0.81%</b>	<b>0.97%</b>
Merrill Lynch 1-3 Year UST Index	0.29%	0.37%	0.46%	0.71%	0.85%
Effective Duration <sup>4</sup>	September 30, 2013	June 30, 2013	Yields	September 30, 2013	June 30, 2013
<b>City of Surprise</b>	<b>1.67</b>	<b>1.79</b>	Yield at Market	<b>0.31%</b>	0.37%
Merrill Lynch 1-3 Year UST Index	1.82	1.81	Yield on Cost	<b>0.47%</b>	0.44%

Quarter Total Return Comparison



Since Inception Total Return Comparison



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 and CDARS/NOW Account in duration and performance computations.

5. Inception date is June 16, 2010.





## Managed Account Detail of Securities Held

For the Month Ending **September 30, 2013**

### 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 12/15/2011 0.250% 12/15/2014	912828RV4	1,100,000.00	AA+	Aaa	01/05/12	01/09/12	1,095,445.31	0.39	811.48	1,098,121.95	1,101,203.40
US TREASURY NOTES DTD 02/01/2010 2.250% 01/31/2015	912828MH0	2,300,000.00	AA+	Aaa	06/28/12	06/29/12	2,410,777.34	0.38	8,718.75	2,357,129.19	2,363,070.31
US TREASURY NOTES DTD 02/01/2010 2.250% 01/31/2015	912828MH0	2,340,000.00	AA+	Aaa	01/23/12	01/26/12	2,469,522.66	0.40	8,870.38	2,397,416.25	2,404,167.19
US TREASURY NOTES DTD 02/15/2005 4.000% 02/15/2015	912828DM9	2,250,000.00	AA+	Aaa	08/08/12	08/09/12	2,456,542.97	0.33	11,494.57	2,362,840.52	2,366,806.50
US TREASURY NOTES DTD 02/15/2005 4.000% 02/15/2015	912828DM9	2,290,000.00	AA+	Aaa	07/05/12	07/06/12	2,505,760.94	0.37	11,698.91	2,403,702.69	2,408,883.06
US TREASURY NOTES DTD 03/01/2010 2.375% 02/28/2015	912828MR8	770,000.00	AA+	Aaa	03/13/12	03/14/12	812,109.37	0.51	1,566.06	790,186.37	793,521.09
US TREASURY NOTES DTD 05/16/2005 4.125% 05/15/2015	912828DV9	1,000,000.00	AA+	Aaa	09/06/12	09/10/12	1,101,171.88	0.33	15,580.84	1,061,363.14	1,062,617.00
US TREASURY NOTES DTD 05/16/2005 4.125% 05/15/2015	912828DV9	1,795,000.00	AA+	Aaa	08/01/12	08/02/12	1,986,139.45	0.28	27,967.61	1,906,510.01	1,907,397.52
US TREASURY NOTES DTD 06/01/2010 2.125% 05/31/2015	912828NF3	5,285,000.00	AA+	Aaa	11/02/12	11/06/12	5,524,063.67	0.35	37,742.26	5,440,288.26	5,448,295.93
US TREASURY NOTES DTD 06/30/2010 1.875% 06/30/2015	912828NL0	2,320,000.00	AA+	Aaa	06/28/12	06/29/12	2,419,596.88	0.43	10,993.21	2,378,108.30	2,384,161.92
US TREASURY NOTES DTD 08/02/2010 1.750% 07/31/2015	912828NP1	1,800,000.00	AA+	Aaa	09/06/12	09/10/12	1,872,773.44	0.34	5,307.07	1,846,224.76	1,847,601.00
US TREASURY NOTES DTD 08/02/2010 1.750% 07/31/2015	912828NP1	2,475,000.00	AA+	Aaa	08/21/12	08/23/12	2,571,776.37	0.41	7,297.21	2,535,473.93	2,540,451.38
US TREASURY NOTES DTD 11/15/2005 4.500% 11/15/2015	912828EN6	2,750,000.00	AA+	Aaa	12/04/12	12/05/12	3,084,941.41	0.34	46,742.53	2,991,723.76	2,990,410.16
US TREASURY NOTES DTD 01/31/2011 2.000% 01/31/2016	912828PS3	3,350,000.00	AA+	Aaa	01/30/13	01/31/13	3,507,162.11	0.42	11,288.04	3,472,309.04	3,473,008.65



## Managed Account Detail of Securities Held

For the Month Ending **September 30, 2013**

### 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 05/02/2011 2.000% 04/30/2016	912828QF0	2,150,000.00	AA+	Aaa	05/13/13	05/14/13	2,251,705.08	0.39	17,994.57	2,238,706.94	2,233,144.53
US TREASURY NOTES DTD 05/02/2011 2.000% 04/30/2016	912828QF0	3,800,000.00	AA+	Aaa	03/28/13	04/01/13	3,988,070.31	0.38	31,804.35	3,957,776.65	3,946,953.13
US TREASURY NOTES DTD 05/31/2011 1.750% 05/31/2016	912828QP8	3,280,000.00	AA+	Aaa	05/30/13	05/31/13	3,401,334.38	0.51	19,290.16	3,387,828.00	3,385,317.52
US TREASURY NOTES DTD 06/30/2009 3.250% 06/30/2016	912828KZ2	1,860,000.00	AA+	Aaa	05/23/13	05/28/13	2,020,642.97	0.43	15,276.77	2,002,875.77	1,996,594.68
US TREASURY NOTES DTD 08/31/2011 1.000% 08/31/2016	912828RF9	3,500,000.00	AA+	Aaa	09/12/13	09/13/13	3,514,218.75	0.86	2,997.24	3,513,982.99	3,537,187.50
<b>Security Type Sub-Total</b>		<b>46,415,000.00</b>					<b>48,993,755.29</b>	<b>0.42</b>	<b>293,442.01</b>	<b>48,142,568.52</b>	<b>48,190,792.47</b>
<b>Municipal Bond / Note</b>											
MESA, AZ T/E GO BONDS DTD 04/04/2012 2.000% 07/01/2015	590485WN4	845,000.00	AA	Aa2	03/02/12	04/04/12	878,200.05	0.77	4,225.00	863,021.02	868,330.45
<b>Security Type Sub-Total</b>		<b>845,000.00</b>					<b>878,200.05</b>	<b>0.77</b>	<b>4,225.00</b>	<b>863,021.02</b>	<b>868,330.45</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	1,224,004.09	1,225,786.46
FNMA GLOBAL NOTES DTD 02/01/2011 1.250% 02/27/2014	3135G0AP8	1,325,000.00	AA+	Aaa	10/03/11	10/04/11	1,347,193.75	0.55	1,564.24	1,328,774.42	1,331,284.48
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	1,000,547.89	1,008,064.00
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	1,245,199.46	1,249,999.36
FHLMC NOTES DTD 07/05/2011 1.000% 08/27/2014	3137EACV9	2,500,000.00	AA+	Aaa	01/13/12	01/13/12	2,531,275.00	0.52	2,361.11	2,510,848.43	2,520,160.00



**Managed Account Detail of Securities Held**

For the Month Ending **September 30, 2013**

**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 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	3,096.04	3,868,117.00	3,885,553.20
FANNIE MAE GLOBAL NOTES DTD 09/27/2011 0.625% 10/30/2014	3135G0DW0	3,730,000.00	AA+	Aaa	05/25/12	05/29/12	3,742,495.50	0.49	9,778.30	3,735,599.21	3,747,926.38
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	4,791.67	2,998,697.61	3,014,937.00
FANNIE MAE GLOBAL NOTES DTD 04/19/2012 0.500% 05/27/2015	3135G0KM4	1,325,000.00	AA+	Aaa	04/17/12	04/19/12	1,321,170.75	0.59	2,281.94	1,322,949.63	1,328,935.25
FNMA NOTES (CALLABLE) DTD 08/07/2012 0.500% 08/07/2015	3135G0NG4	2,500,000.00	AA+	Aaa	08/07/12	08/08/12	2,499,375.00	0.51	1,875.00	2,499,613.15	2,500,460.00
<b>Security Type Sub-Total</b>		<b>21,700,000.00</b>					<b>21,827,888.80</b>	<b>0.58</b>	<b>29,304.13</b>	<b>21,734,350.89</b>	<b>21,813,106.13</b>
<b>Managed Account Sub-Total</b>		<b>68,960,000.00</b>					<b>71,699,844.14</b>	<b>0.47</b>	<b>326,971.14</b>	<b>70,739,940.43</b>	<b>70,872,229.05</b>
<b>Securities Sub-Total</b>		<b>\$68,960,000.00</b>					<b>\$71,699,844.14</b>	<b>0.47%</b>	<b>\$326,971.14</b>	<b>\$70,739,940.43</b>	<b>\$70,872,229.05</b>
<b>Accrued Interest</b>											<b>\$326,971.14</b>
<b>Total Investments</b>											<b>\$71,199,200.19</b>

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## Economic Update



# Janet Yellen Nominated as Next Fed Chair

- Janet Yellen, current FOMC Vice Chair was nominated by President Obama to succeed Ben Bernanke as Fed Chair.
- Served for three years as Vice Chair, headed up the San Francisco Fed for six years, ran the Council of Economic Advisers for two years, and sat on Fed Board of Governors for three years.
- Must be confirmed by the Senate. Term will begin February 2014.
- Will be first Democrat to lead the Fed since Paul Volcker in 1979.



## Economic and Policy Information

- Job creation and unemployment reduction top priority
- Likely to continue quantitative easing policies
- Advocate of strong financial regulation and Fed transparency
- “Dovish-dove with inflationary bias”: Low interest rates key to growth

# Details of the Government Shutdown

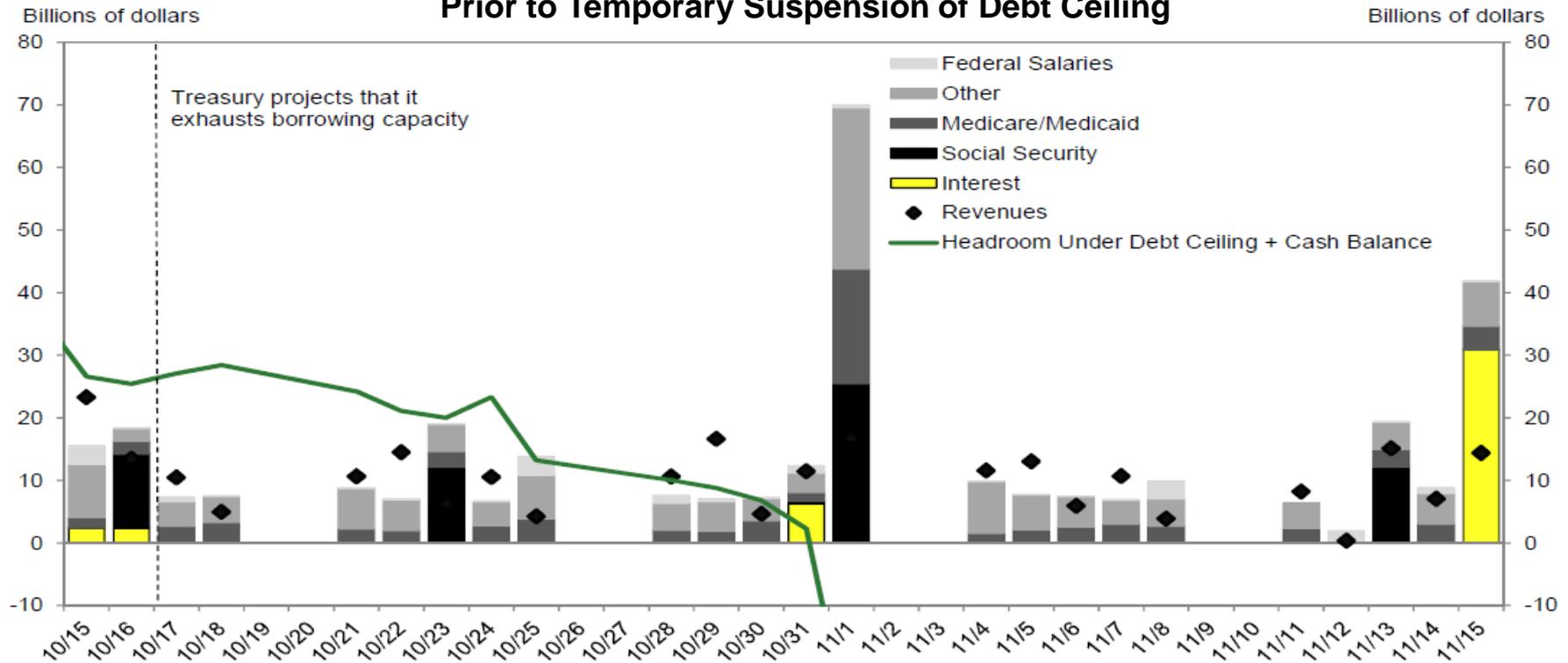
- Annually, the House and Senate are supposed to agree on 12 appropriations bills to fund the federal agencies and set spending priorities. If the bills are not passed, the government shuts down.
- Shutdown ends with the passage of a formal appropriations bill or a “continuing resolution.”



# Debt Ceiling Debate

- The debt ceiling is a legislative mechanism to limit the amount of national debt that can be issued by the Treasury.
- Debt issuance is used to pay for spending already issued by Congress. The Treasury was set to hit the debt limit on October 17, and without a change to debt ceiling limit, would no longer be able to pay its bills.

**Treasury Obligations vs Revenue  
Prior to Temporary Suspension of Debt Ceiling**



Source: Treasury and Goldman Sachs

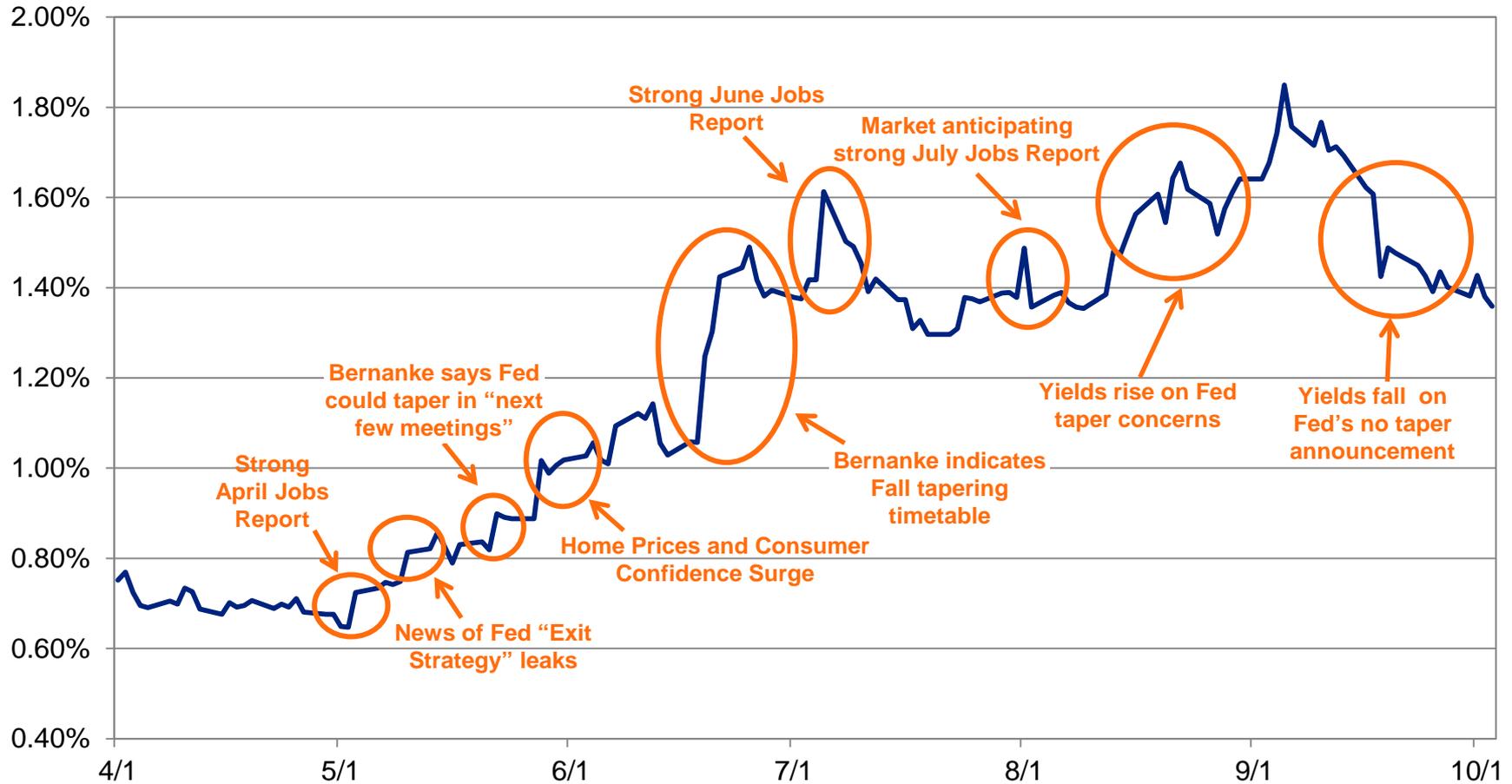
# Details of the Government Re-Opening

- October 17: The President signed a bill to re-open the government through January 15 and suspend the debt ceiling through February 7.
- Impacts of the 16 day Shutdown:
  - \$24 billion loss to overall economy (Standard & Poor's).
  - Annualized 4Q13 GDP revised downward from 3% to 2.4% (Standard & Poor's).
  - Delayed economic data releases: Unemployment, construction-spending, retail sales, consumer price index.
  - \$160 million per day that federal government furloughs cost the economy (IHS Inc).
  - 70,000 furloughed federal workers filed for unemployment insurance for the week ended Oct. 5.
  - \$152 million loss per day in travel spending (U.S. Travel Assn).
  - \$76 million lost in daily visitor spending in national parks in 12 states (Coalition of National Park Service Retirees).
  - \$737.95: The amount the average consumer will spend this holiday season or 2% less than last year as the shutdown caused consumer confidence to fall (National Retail Federation).



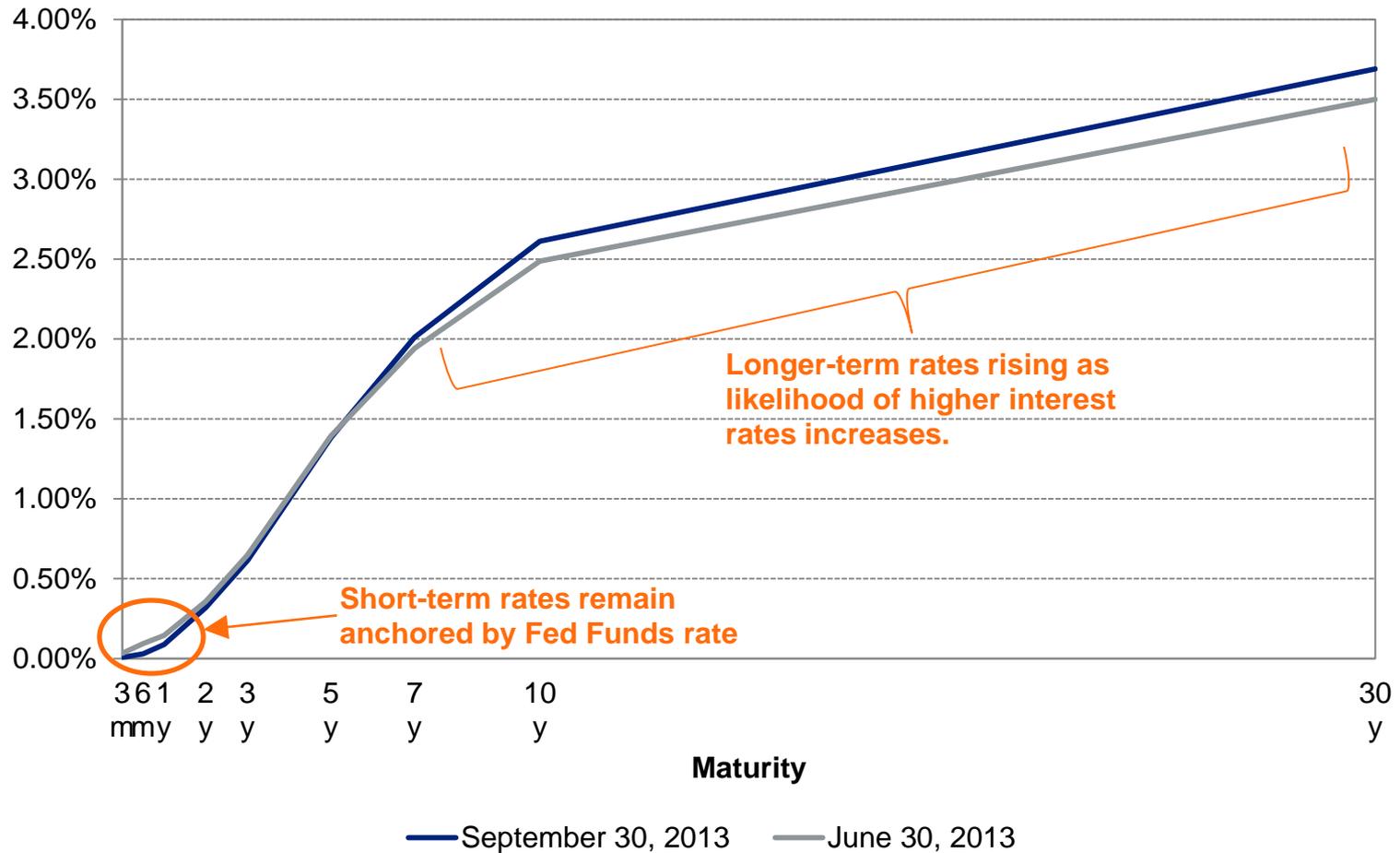
# Recent Interest Rate Movers

## 5-Year U.S. Treasury Yield



Source: Bloomberg

# U.S. Treasury Yield Curve Steepens



Source: Bloomberg

# Economic Round Up

Economic Indicator	Previous data	Newest data
GDP	2.5% (2Q13)	<b>2.8% (3Q13)</b>
Unemployment Rate	7.3% (8/31/13)	<b>7.2% (9/30/13)</b>
Monthly Jobs Gained/Lost	+193,000 (8/31/13)	<b>+148,000 (9/30/13)</b>
Inflation (CPI, less food and energy)	1.5% (8/31/13)	<b>1.2% (9/30/13)</b>
S&P/Case-Shiller Home Price Index YoY % Change	12.3% (7/31/13)	<b>12.8% (8/31/13)</b>
ISM Manufacturing Index	56.2 (9/30/13)	<b>56.4 (10/31/13)</b>

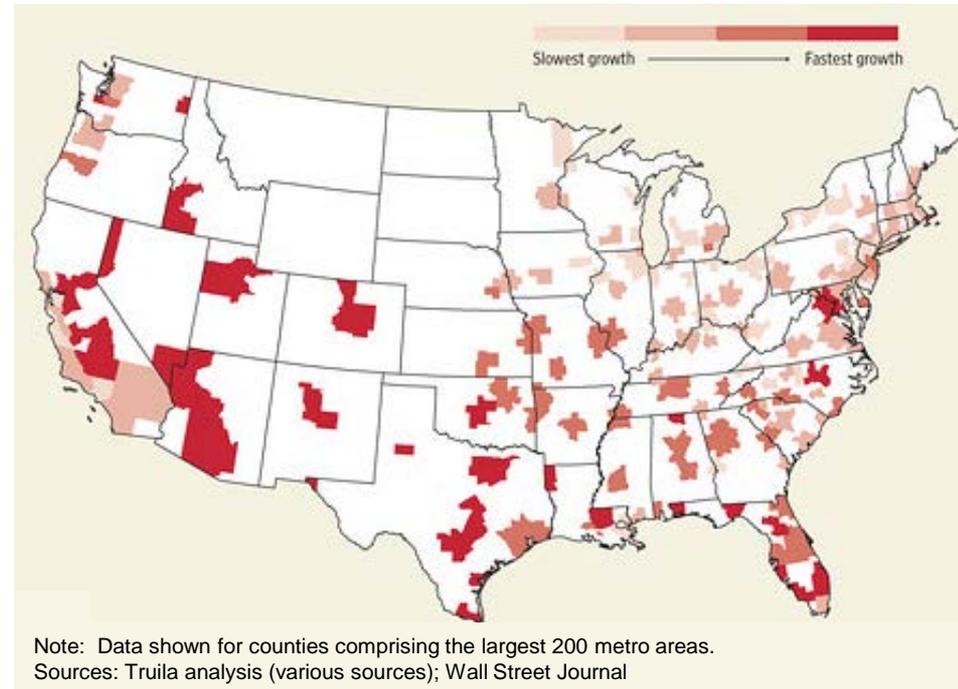
Source: Bloomberg

# Where Will Job Growth Come from this Decade?

- Economy is projected to produce 55 million jobs over the current decade (2012-2020).

Fastest Growing Industries	Types of Jobs
Health Care	Registered nurses, physician assistants, radiology techs, and home health aides
Professional and business services	Professionals skilled in areas such as legal services, accounting, and advertising
Leisure and Hospitality	Hotel and restaurant related jobs
Business and financial operations	Credit counselors, compliance officers and financial examiners
Technology and information services	Computer-systems analysts, information-security analysts and software developers
Trade and Artisan Services	Plumbers and electricians, chefs, college coaches and construction supervisors

Projected Job Growth By Metropolitan Area 2010-2020

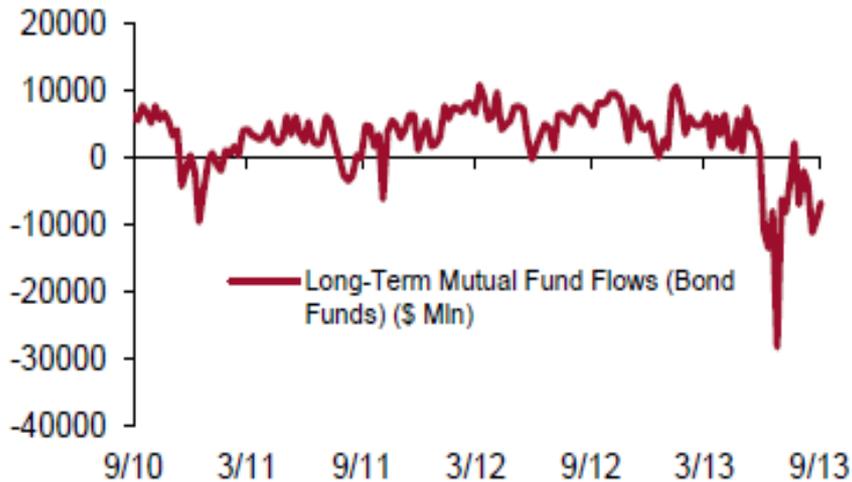


Source: Wall Street Journal

# The Great Rotation, Charlie Brown?

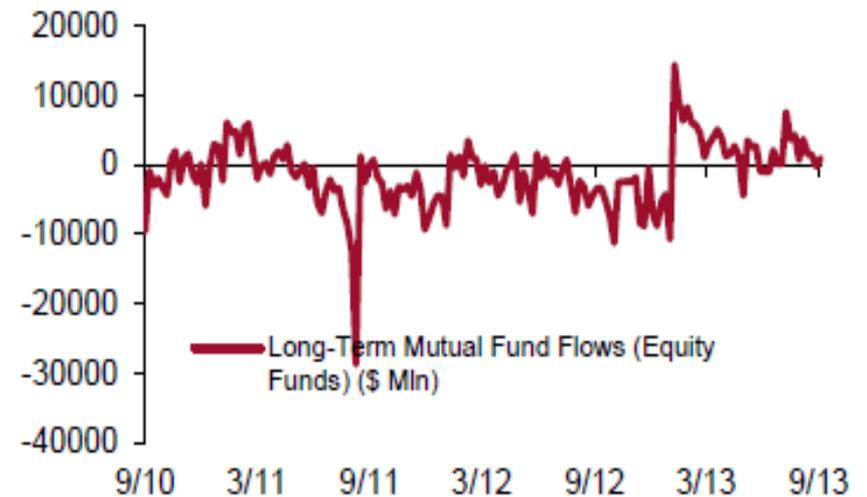
- An estimated \$6.7 billion flowed out of bond funds in the last week of August. Trailing 3-week out flow is \$31.1 billion.
- An estimated \$904 million flowed into equity in the last week of August.

**Estimated Long-Term Mutual Fund Flows  
(Into Bond Funds)**



Source: Investment Company Institute

**Estimated Long-Term Mutual Fund Flows  
(Into Equity Funds)**

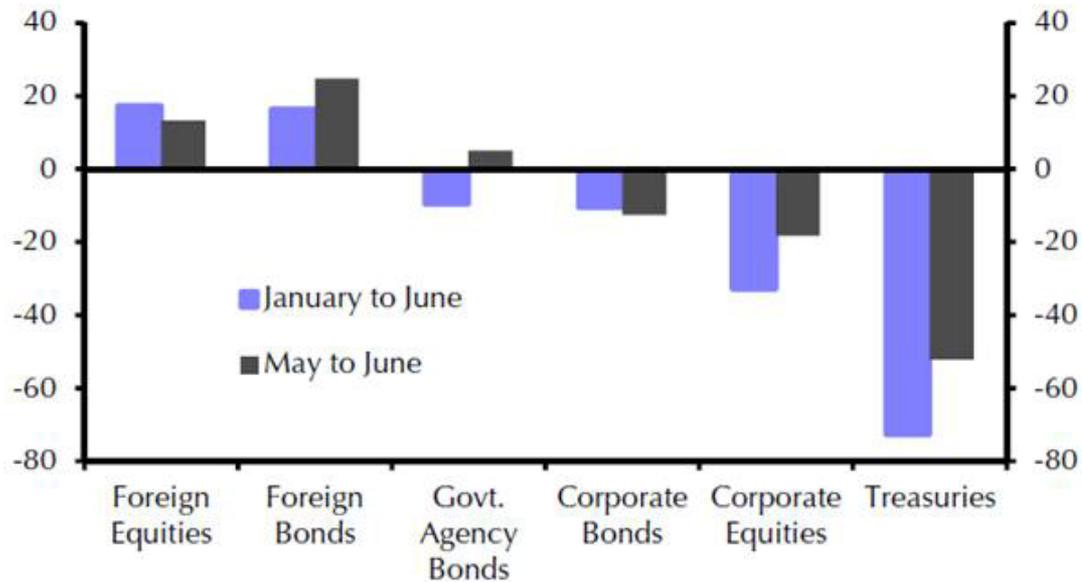


Source: Investment Company Institute

# “The Other” Bond Tapering

- In response to possible reduction of Fed’s stimulus programs and rising interest rates, purchases of U.S. Treasuries by Foreign buyers fell -\$66.9 billion in June, the second largest outflow on record.
- Foreign buyers also sold \$5.2 billion in U.S. agency debt, after selling \$10.3 billion in May.
- U.S. stocks were also out of favor. Foreign buyers pulled \$26.841 billion out of equities in June.

**CHART 2: CHANGE IN NET FOREIGN PURCHASES OF US  
SECURITIES BY ASSET TYPE (\$BN)**



Sources – Thomson Datastream, Bloomberg

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