



City of Surprise

Quarterly Performance Review

Third Quarter Ended September 30, 2014



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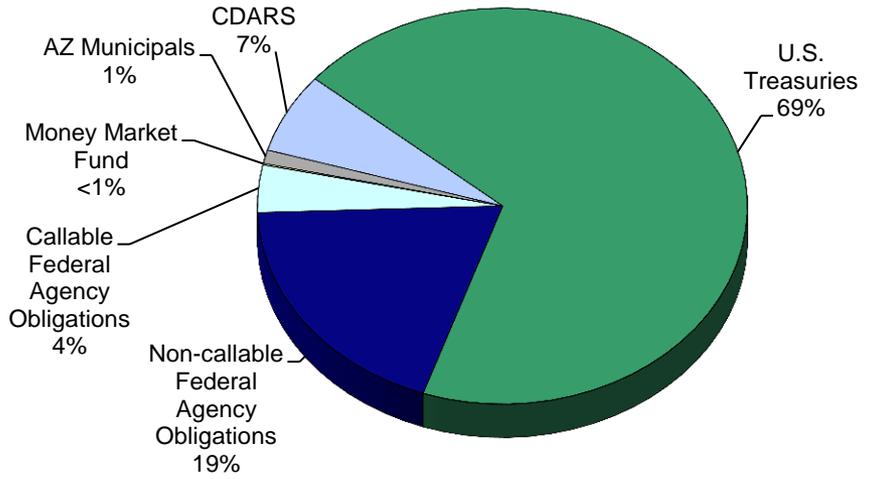
Third Quarter 2014 Strategy and Recap

- U.S. Treasury yields were volatile throughout the quarter, particularly around key economic data releases, Federal Reserve meetings, and in response to swings in global equity markets.
- The Fed continued to taper its bond buying program during the quarter and announced it will end its purchases in October.
- Our duration strategy remained defensive throughout the quarter, driven largely by our positive assessment of U.S. economic conditions and the expected market reaction to an eventual change in Federal Reserve monetary policy.
 - We capitalized on opportunities to modestly extend the portfolio's duration when rates moved toward the higher end of recent trading ranges.
- The yield spread between Treasuries and Agencies widened for a short period in August and early September, which allowed us to increase the portfolio's allocation to the Agency sector.
- The impact of trades during the quarter resulted in an overall increase in the portfolio's yield at cost of +0.05%.
- The yield curve remains steep by historical standards, which means longer maturities continue to benefit from the favorable impact of "roll-down."

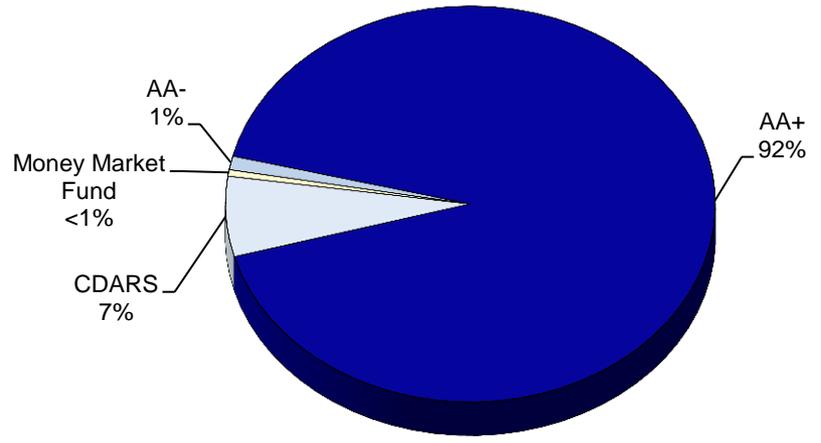
Portfolio Summary and Characteristics

Security Type ¹	September 30, 2014	Current Quarter % of Portfolio	Previous Quarter % of Portfolio
U.S. Treasury	\$53,221,189	69%	78%
Federal Agency	\$17,751,806	23%	14%
Callable Federal Agency	\$2,974,579	4%	7%
Non-callable Federal Agency	\$14,777,227	19%	7%
CDARS²	\$5,044,024	7%	7%
AZ Municipals	\$856,686	1%	1%
Wells Fargo MMF	\$93,143	<1%	<1%
Total Market Value	\$76,966,848	100%	100%

Sector Distribution



Credit Quality Distribution



The City's portfolio complies with the investment policy and the Arizona Revised Statutes.

¹ Security market values excluding accrued interest as of trade date. Note that PFM statements reflect holdings as of trade date.

² 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. Value includes principal and interest at maturity.

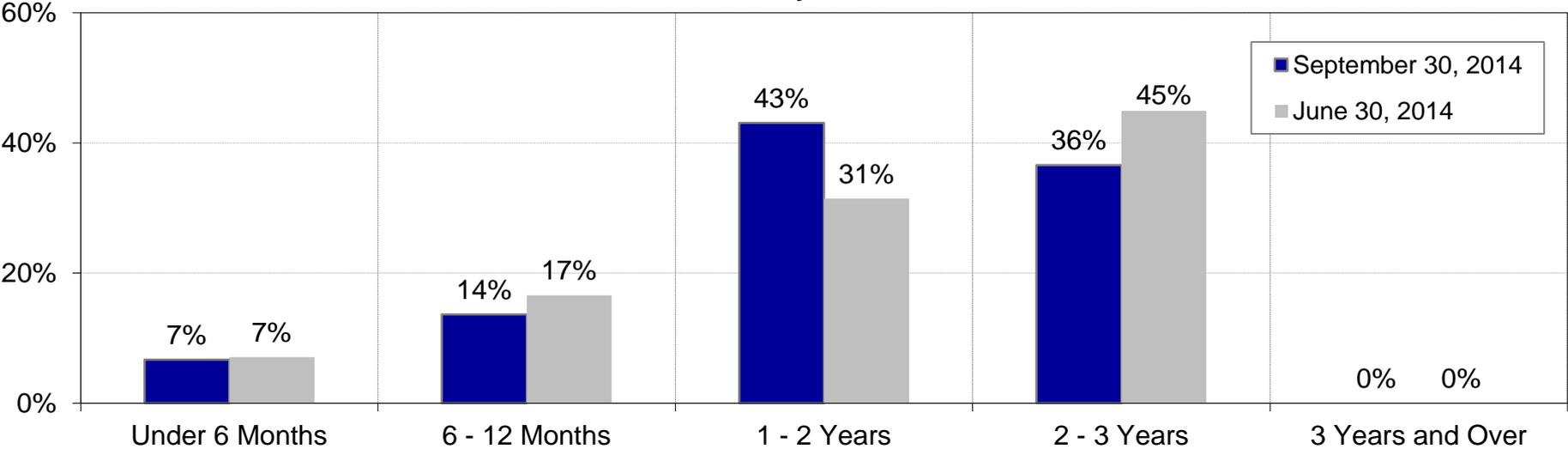
Maturity Summary and Key Portfolio Statistics

Maturity Distribution		
<u>Maturity Class</u>	<u>Fair Value</u> ³	<u>% of Portfolio</u>
Under 6 Months	\$5,137,168	7%
6 - 12 Months	\$10,506,168	14%
1 - 2 Years	\$33,166,991	43%
2 - 3 Years	\$28,156,521	36%
3 Years and Over	\$0	0%
Total Market Value	\$76,966,848	100%

Key Portfolio Statistics	
Effective Duration ¹	1.72 years
Benchmark Duration ²	1.84 years
Yield at Cost	0.60%

1. Duration to worst as of 9/30/2014 was 1.70.
 2. The City's benchmark is the Bank of America /Merrill Lynch 1-3 Year U.S. Treasury Index. Performance statistics exclude money market fund and CDARS.
 3. Security market values excluding accrued interest as of trade date. Note that PFM monthly statements reflect holdings as of trade date.

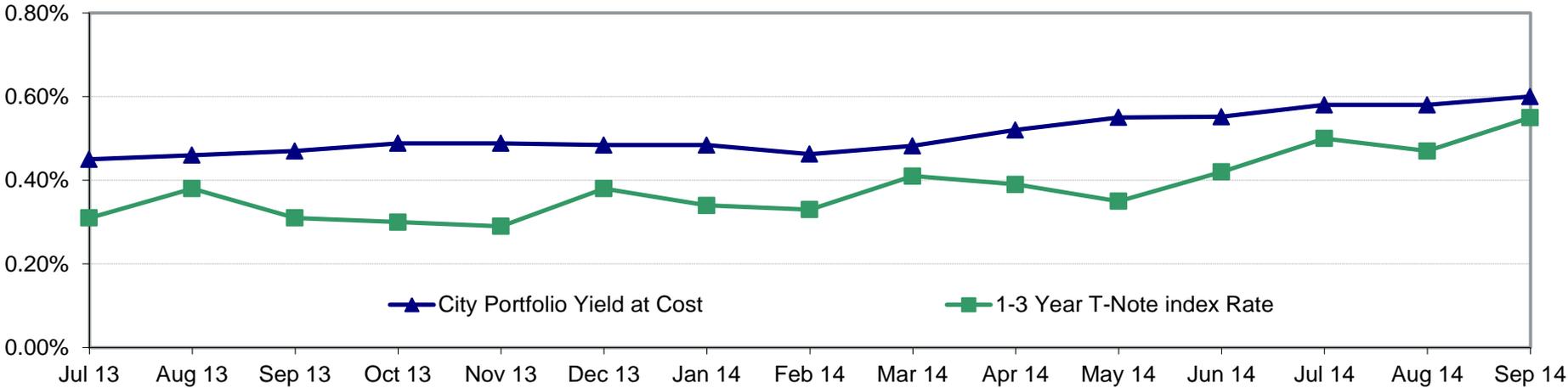
Maturity Distribution



Individual Portfolio Yield Summary

Date	Month-End Market Value ^{1,2}	Duration ²	Portfolio YTM at Cost ²	1-3 Year T-Note Index Rate ³
Oct-13	\$71,527,474	1.73	0.49%	0.30%
Nov-13	\$71,718,093	1.66	0.49%	0.29%
Dec-13	\$71,581,151	1.71	0.48%	0.38%
Jan-14	\$71,692,788	1.63	0.48%	0.34%
Feb-14	\$71,765,140	1.66	0.46%	0.33%
Mar-14	\$71,619,187	1.66	0.48%	0.41%
Apr-14	\$71,700,877	1.59	0.52%	0.39%
May-14	\$71,951,724	1.67	0.55%	0.35%
Jun-14	\$71,929,301	1.72	0.55%	0.42%
Jul-14	\$72,119,635	1.77	0.58%	0.50%
Aug-14	\$72,229,199	1.70	0.58%	0.47%
Sep-14	\$71,922,824	1.72	0.60%	0.55%

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



¹ Excludes accrued interest, CDARS. Includes balance in the custody account MMF.
² Excludes CDARS and custody money market fund.
³ Rate represents the BoA/Merrill Lynch 1-3 Year U.S. Treasury Note Index month-end yield. Source: Bloomberg.

Executed Treasury Sector Extensions

- When spreads are narrow, we prefer to hold Treasury securities as investors are not being compensated to take on any amount of credit risk.
- The extensions took advantage of attractive rates on a steep yield curve and will benefit from appreciation as the “roll down the curve.”
- The Treasury purchases picked-up an average of +0.58% over those sold with a duration extension of 1.51 years.

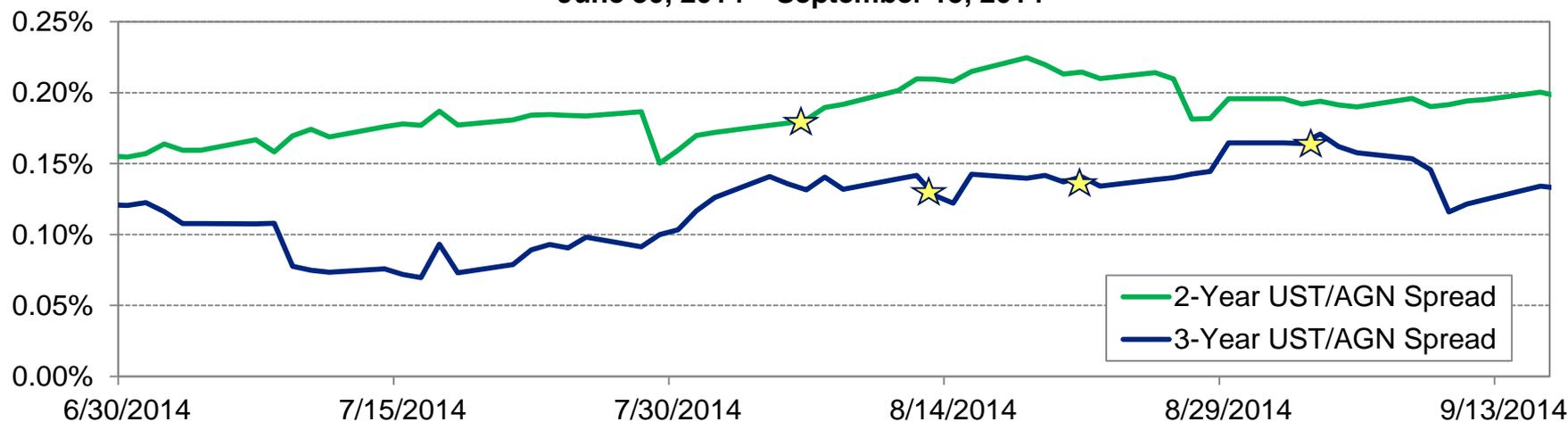
Date	Transaction	Issuer	Maturity	Par Value	Yield
7/2/14	Buy	U.S. Treasury Notes	12/31/15	\$1,500,000	0.28%
7/2/14	Buy	U.S. Treasury Notes	7/31/17	\$1,465,000	1.00%
7/2/14	Sell	U.S. Treasury Notes	5/15/15	\$1,795,000	0.13%
7/2/14	Sell	U.S. Treasury Notes	2/28/15	\$770,000	0.08%
7/30/14	Buy	U.S. Treasury Notes	1/31/16	\$1,135,000	0.31%
7/30/14	Buy	U.S. Treasury Notes	1/31/17	\$1,175,000	0.85%
7/30/14	Buy	U.S. Treasury Notes	7/31/17	\$1,200,000	1.08%
7/30/14	Sell	U.S. Treasury Notes	5/15/15	\$1,000,000	0.11%
7/30/14	Sell	U.S. Treasury Notes	5/31/15	\$2,500,000	0.12%

Traded into Agencies as Spreads Widened

- Spread widening for short periods in early August and the beginning of September created opportunities to sell Treasuries to purchase Agencies.
- The new Agency purchases picked-up an average of +0.39% and will add approximately \$80,000 (to the maturity of the sold security) over the sold securities, with a duration extension of about 1 year.

Date	Transaction	Issuer	Maturity	Par Value	Yield
8/6/14	Buy	FHLB Notes	9/28/16	\$1,485,000	0.61%
8/13/14	Buy	FHLMC Notes	7/28/17	\$2,115,000	0.96%
8/21/14	Buy	FNMA Notes	9/27/17	\$1,100,000	1.12%
9/3/14	Buy	FNMA Notes	4/27/17	\$3,400,000	0.94%

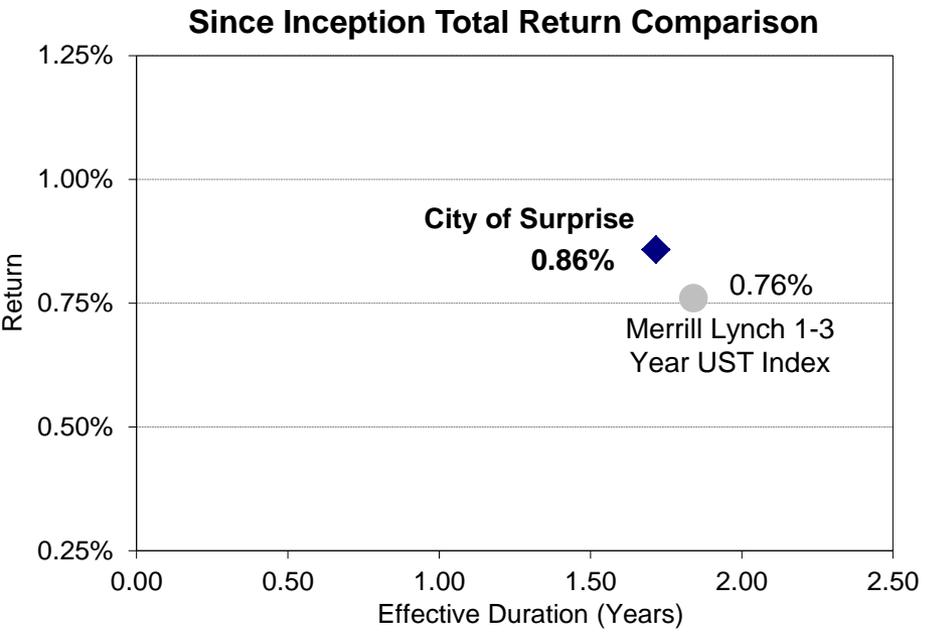
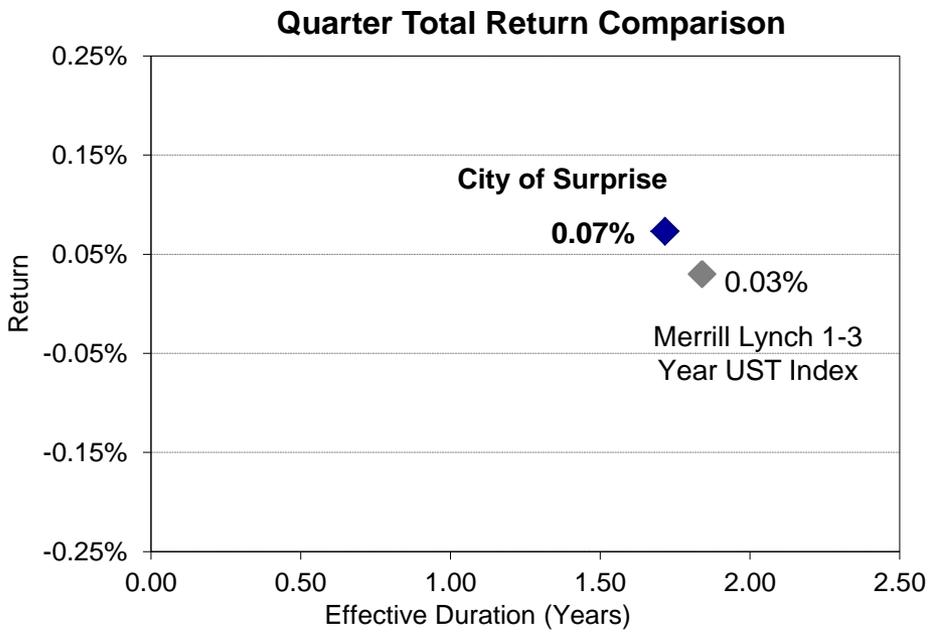
Treasury/Agency Yield Spreads
June 30, 2014 – September 15, 2014



Source: Bloomberg

Portfolio Performance

Total Return ^{1,2,3,4,5}	Quarter Ended September 30, 2014	Past 1 Year	Past 2 Years	Past 3 Years	Since Inception
City of Surprise	0.07%	0.51%	0.45%	0.60%	0.86%
Merrill Lynch 1-3 Year UST Index	0.03%	0.50%	0.43%	0.48%	0.76%
Effective Duration ⁴	September 30, 2014	June 30, 2014	Yields	September 30, 2014	June 30, 2014
City of Surprise	1.72	1.72	Yield at Market	0.56%	0.45%
Merrill Lynch 1-3 Year UST Index	1.84	1.85	Yield on Cost	0.60%	0.55%



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.

Fourth Quarter 2014 Strategy and Outlook

- Economic data is signaling a growing U.S. economy; however, weaker global growth is causing concern impacting:
 - Equity markets;
 - Timing and magnitude of expected rate hikes in 2015.
- The pace of rise in interest rates will determine the optimal investment strategy. Today's challenge is to create a balance between:
 - Conservative duration stance to mitigate unrealized market value losses;
 - Steep yield curve that offers considerably higher yields for even modest maturity extension.
- We expect yield differences/spreads to remain narrow and will favor Treasuries over Agencies, and corporates and other credit instruments over government securities.
- The SEC's recently finalized rules for Money Market Funds have not yet impacted the shortest maturity securities. These new rules, along with a multitude of new bank standards for capital and liquidity, are likely to influence the supply and structure of money market securities in the next year or two.
- We will continue to focus on relative value sector analysis, prudent duration management, and efficient yield curve placement to protect the portfolio and minimize the effects of market volatility.



Managed Account Detail of Securities Held

For the Month Ending **September 30, 2014**

CITY OF SURPRISE OPERATING FUND - 82260100

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 06/01/2010 2.125% 05/31/2015	912828NF3	1,000,000.00	AA+	Aaa	11/02/12	11/06/12	1,045,234.37	0.35	7,141.39	1,011,743.79	1,013,633.00
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	2,344,903.25	2,351,083.36
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	1,821,020.87	1,824,609.38
US TREASURY NOTES DTD 08/02/2010 1.750% 07/31/2015	912828NP1	1,925,000.00	AA+	Aaa	02/04/14	02/07/14	1,969,139.65	0.20	5,675.61	1,949,802.74	1,951,318.36
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	2,502,509.63	2,508,837.89
US TREASURY NOTES DTD 12/31/2010 2.125% 12/31/2015	912828PM6	1,500,000.00	AA+	Aaa	07/02/14	07/07/14	1,540,839.84	0.28	8,055.37	1,534,404.59	1,535,097.00
US TREASURY NOTES DTD 01/31/2011 2.000% 01/31/2016	912828PS3	1,135,000.00	AA+	Aaa	07/30/14	07/31/14	1,163,641.02	0.31	3,824.46	1,160,429.12	1,160,981.29
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	3,419,995.57	3,426,684.85
US TREASURY NOTES DTD 05/02/2011 2.000% 04/30/2016	912828OF0	2,150,000.00	AA+	Aaa	05/13/13	05/14/13	2,251,705.08	0.39	17,994.57	2,204,450.19	2,203,833.85
US TREASURY NOTES DTD 05/02/2011 2.000% 04/30/2016	912828OF0	3,800,000.00	AA+	Aaa	03/28/13	04/01/13	3,988,070.31	0.38	31,804.35	3,896,841.82	3,895,148.20
US TREASURY NOTES DTD 05/31/2011 1.750% 05/31/2016	912828OP8	3,280,000.00	AA+	Aaa	05/30/13	05/31/13	3,401,334.38	0.51	19,290.16	3,347,519.00	3,350,982.48
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	1,951,063.89	1,949,294.88
US TREASURY NOTES DTD 08/01/2011 1.500% 07/31/2016	912828OX1	1,925,000.00	AA+	Aaa	02/04/14	02/07/14	1,973,500.98	0.48	4,864.81	1,960,862.42	1,959,213.03
US TREASURY NOTES DTD 08/01/2011 1.500% 07/31/2016	912828OX1	3,420,000.00	AA+	Aaa	06/02/14	06/05/14	3,495,881.25	0.46	8,642.93	3,484,549.22	3,480,783.66



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For the Month Ending **September 30, 2014**

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U.S. Treasury Bond / Note											
US TREASURY NOTES DTD 08/31/2011 1.000% 08/31/2016	912828RF9	2,030,000.00	AA+	Aaa	09/12/13	09/13/13	2,038,246.87	0.86	1,738.40	2,035,350.78	2,046,493.75
US TREASURY NOTES DTD 10/31/2011 1.000% 10/31/2016	912828RM4	2,600,000.00	AA+	Aaa	05/07/14	05/08/14	2,622,648.44	0.65	10,880.43	2,619,046.61	2,618,483.40
US TREASURY NOTES DTD 10/31/2011 1.000% 10/31/2016	912828RM4	3,420,000.00	AA+	Aaa	06/02/14	06/05/14	3,455,001.56	0.57	14,311.96	3,450,358.52	3,444,312.78
US TREASURY NOTES DTD 11/30/2009 2.750% 11/30/2016	912828MA5	2,310,000.00	AA+	Aaa	10/31/13	11/01/13	2,457,352.73	0.65	21,348.57	2,413,857.55	2,411,783.22
US TREASURY NOTES DTD 11/30/2009 2.750% 11/30/2016	912828MA5	3,600,000.00	AA+	Aaa	12/03/13	12/04/13	3,831,328.13	0.58	33,270.49	3,767,860.48	3,758,623.20
US TREASURY NOTES DTD 01/31/2012 0.875% 01/31/2017	912828SC5	1,175,000.00	AA+	Aaa	07/30/14	07/31/14	1,175,688.48	0.85	1,732.17	1,175,642.48	1,177,203.13
US TREASURY NOTES DTD 03/31/2012 1.000% 03/31/2017	912828SM3	2,780,000.00	AA+	Aaa	03/24/14	03/25/14	2,783,475.00	0.96	76.37	2,782,884.83	2,788,470.31
US TREASURY NOTES DTD 05/31/2012 0.625% 05/31/2017	912828SY7	2,385,000.00	AA+	Aaa	06/02/14	06/05/14	2,369,721.09	0.84	5,009.48	2,371,353.55	2,364,317.28
Security Type Sub-Total		52,240,000.00					53,954,760.95	0.53	245,823.82	53,206,450.90	53,221,188.30
Municipal Bond / Note											
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	852,751.58	856,686.35
Security Type Sub-Total		845,000.00					878,200.05	0.77	4,225.00	852,751.58	856,686.35
Federal Agency Bond / Note											
FHLB (EX-CALLABLE) GLOBAL NOTES DTD 12/30/2013 0.375% 12/30/2015	3130A0GK0	2,175,000.00	AA+	Aaa	12/16/13	12/30/13	2,174,238.75	0.39	2,061.72	2,174,524.63	2,176,983.60
FEDERAL HOME LOAN BANK GLOBAL NOTES DTD 01/24/2014 0.375% 02/19/2016	3130A0SD3	1,925,000.00	AA+	Aaa	02/04/14	02/07/14	1,925,115.50	0.37	842.19	1,925,078.56	1,925,744.98



Managed Account Detail of Securities Held

For the Month Ending **September 30, 2014**

CITY OF SURPRISE OPERATING FUND - 82260100

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											
FHLB NOTES DTD 08/07/2014 0.500% 09/28/2016	3130A2T97	1,485,000.00	AA+	Aaa	08/06/14	08/07/14	1,481,658.75	0.61	61.88	1,481,890.32	1,480,650.44
FNMA NOTES DTD 08/19/2011 1.250% 09/28/2016	3135G0CM3	2,545,000.00	AA+	Aaa	10/02/13	10/03/13	2,583,760.35	0.73	265.10	2,570,946.58	2,575,099.72
FNMA NOTES DTD 03/01/2012 1.125% 04/27/2017	3135G0JA2	3,400,000.00	AA+	Aaa	09/03/14	09/04/14	3,416,252.00	0.94	16,362.50	3,415,801.43	3,417,078.20
FHLB GLOBAL NOTE (CALLABLE) DTD 04/28/2014 1.625% 04/28/2017	3130A1LJ5	2,950,000.00	AA+	Aaa	04/03/14	04/28/14	2,982,745.00	1.25	20,373.44	2,968,846.13	2,974,579.40
FREDDIE MAC GLOBAL NOTES DTD 06/25/2012 1.000% 07/28/2017	3137EADJ5	2,115,000.00	AA+	Aaa	08/13/14	08/14/14	2,117,305.35	0.96	3,701.25	2,117,205.23	2,106,305.24
FNMA NOTES DTD 08/25/2014 1.000% 09/27/2017	3135G0ZL0	1,100,000.00	AA+	Aaa	08/21/14	08/25/14	1,096,073.00	1.12	122.22	1,096,195.90	1,095,364.60
Security Type Sub-Total		17,695,000.00					17,777,148.70	0.82	43,790.30	17,750,488.78	17,751,806.18
Managed Account Sub-Total		70,780,000.00					72,610,109.70	0.60	293,839.12	71,809,691.26	71,829,680.83
Securities Sub-Total		\$70,780,000.00					\$72,610,109.70	0.60%	\$293,839.12	\$71,809,691.26	\$71,829,680.83
Accrued Interest											\$293,839.12
Total Investments											\$72,123,519.95



Economic Update

Stocks Sold Off Sharply, But Have Rebounded

S&P 500
October 13 – 17, 2014



Source: Yahoo

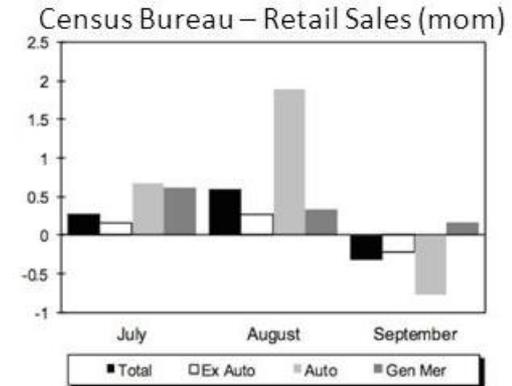
What's Causing Volatility—October 15“Correction”

➤ United States

- Manufacturing and retail sales lower than expected; decline in producer prices
- Ending of Fed's QE program

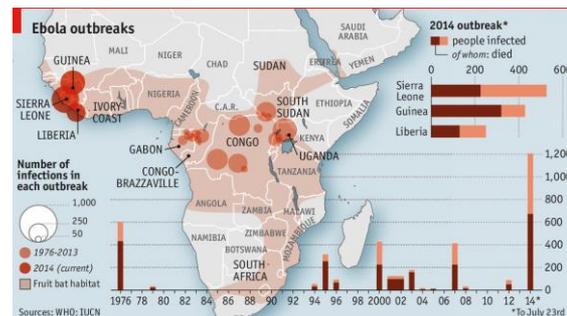
➤ Global Slowdown

- The International Monetary Fund forecast for euro zone 2014 GDP growth is 0.8%
 - Germany projected to expand only 1.4% in 2014
 - Italy will likely contract again in 2014
 - Effect of Russian sanctions on EU countries
- Japan's GDP expected to be 0.9% in 2014
- Chinese economy slowing
- Brazil's economy expected to grow only 0.3% in 2014



➤ Other Factors

- Ebola epidemic
- Declining oil prices
- Middle East conflict



Source: Economist, Telegraph Media Group

Flight to Quality—Reaction in Bond Markets

- After reaching their highest levels in over 3 years in September, the 2-year Treasury, and yields on all maturities, reversed course and declined sharply on October 15th.
- Recently reported weaker than expected economic data has pushed back some expectations on the timing of the Fed's first rate hike.



Source: Bloomberg.

What's Causing Volatility—October 17 “Rebound”

- Strong earnings from Morgan Stanley, General Electric, and others.
- Strong reading on September housing starts: up 17.8% year-over-year in September; up 6.3% from August.
- Michigan's consumer sentiment index rose to a seven-year high.
- A sense the Fed will support the markets if needed.



GE profit tops views as cost cuts drive margins; shares up

- General Electric Co reported a slightly higher-than-expected quarterly profit on F

Honeywell third-quarter profit tops forecast, actively seeks deals

- Honeywell International Inc, a diversified manufacturer of aircraft parts and electronic e
ley aersp

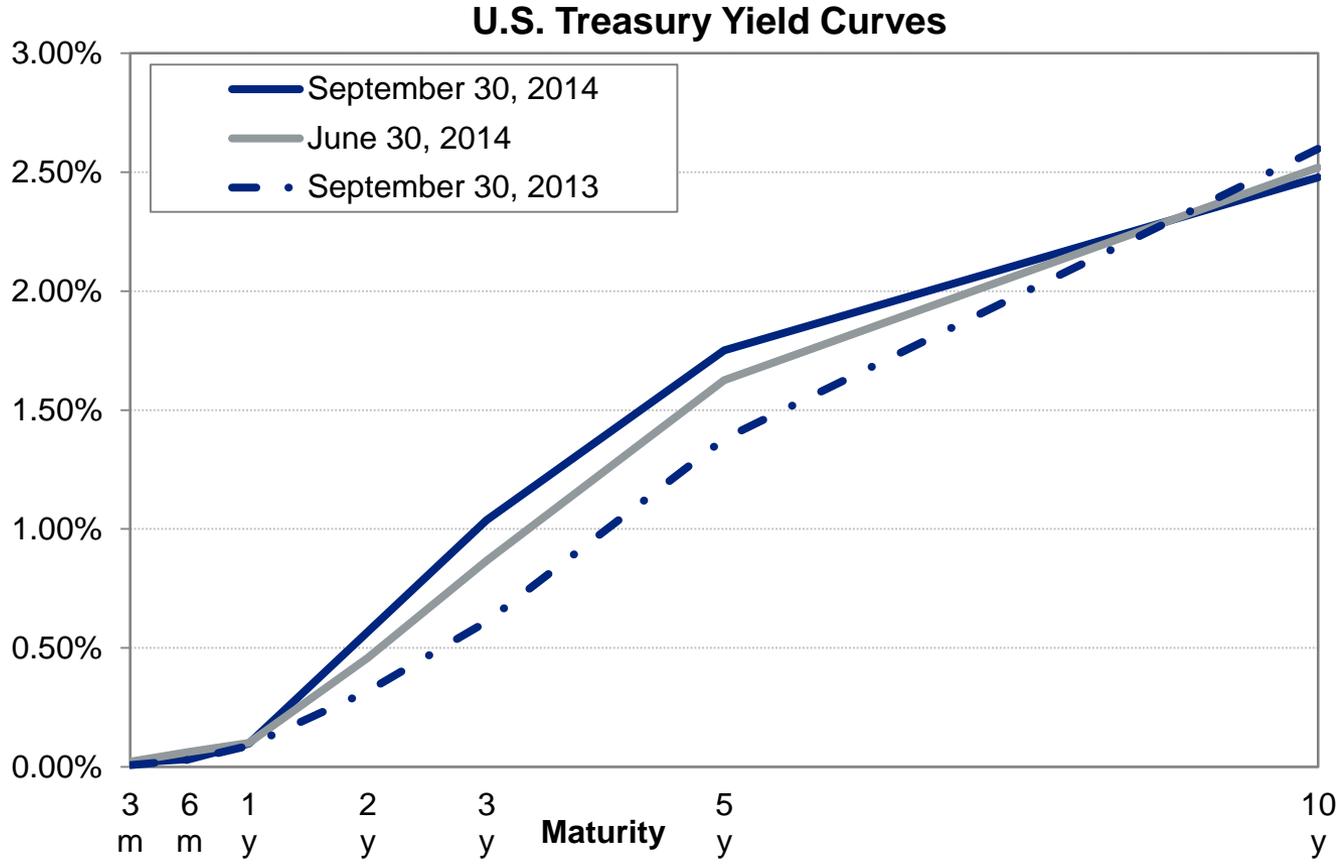
Morgan Stanley profit jumps as trading activity rebounds

- Morgan Stanley reported an 87 percent rise in third-quarter earnings as the Wall Stre
investment banking and wealth management businesses benefited from increased cl

Source: Bloomberg, Reuters

Intermediate Area of the Yield Curve Remains Steep

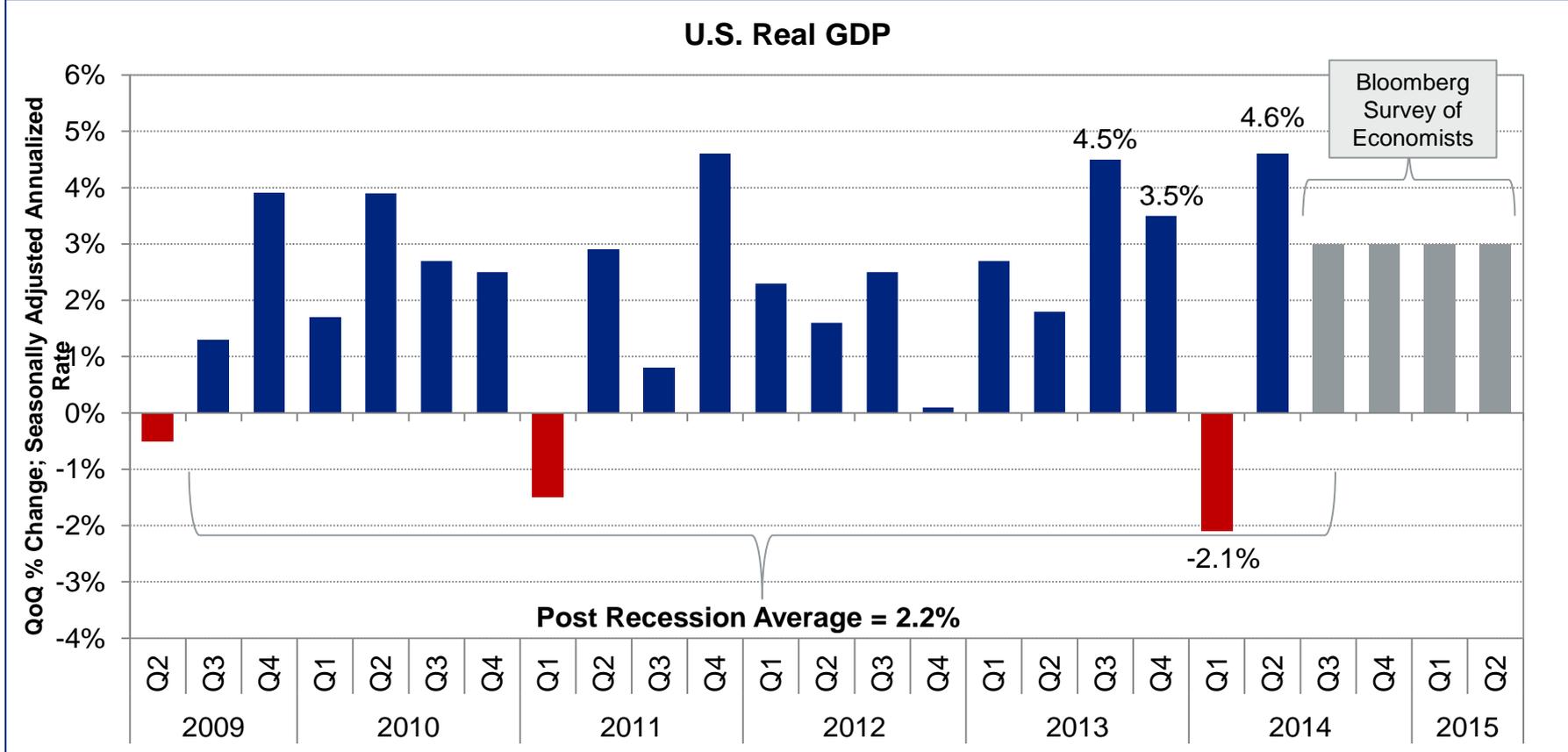
- The yield curve remains steep in the 2-5 year maturity area as the short end of the curve continues to be anchored by the Fed Policy.
- In the longer end of the curve, yields are down slightly year-over-year on low inflation expectations and flights to quality caused by concerns abroad.



Source: Bloomberg

U.S. Economy Surges in 2nd Quarter of 2014

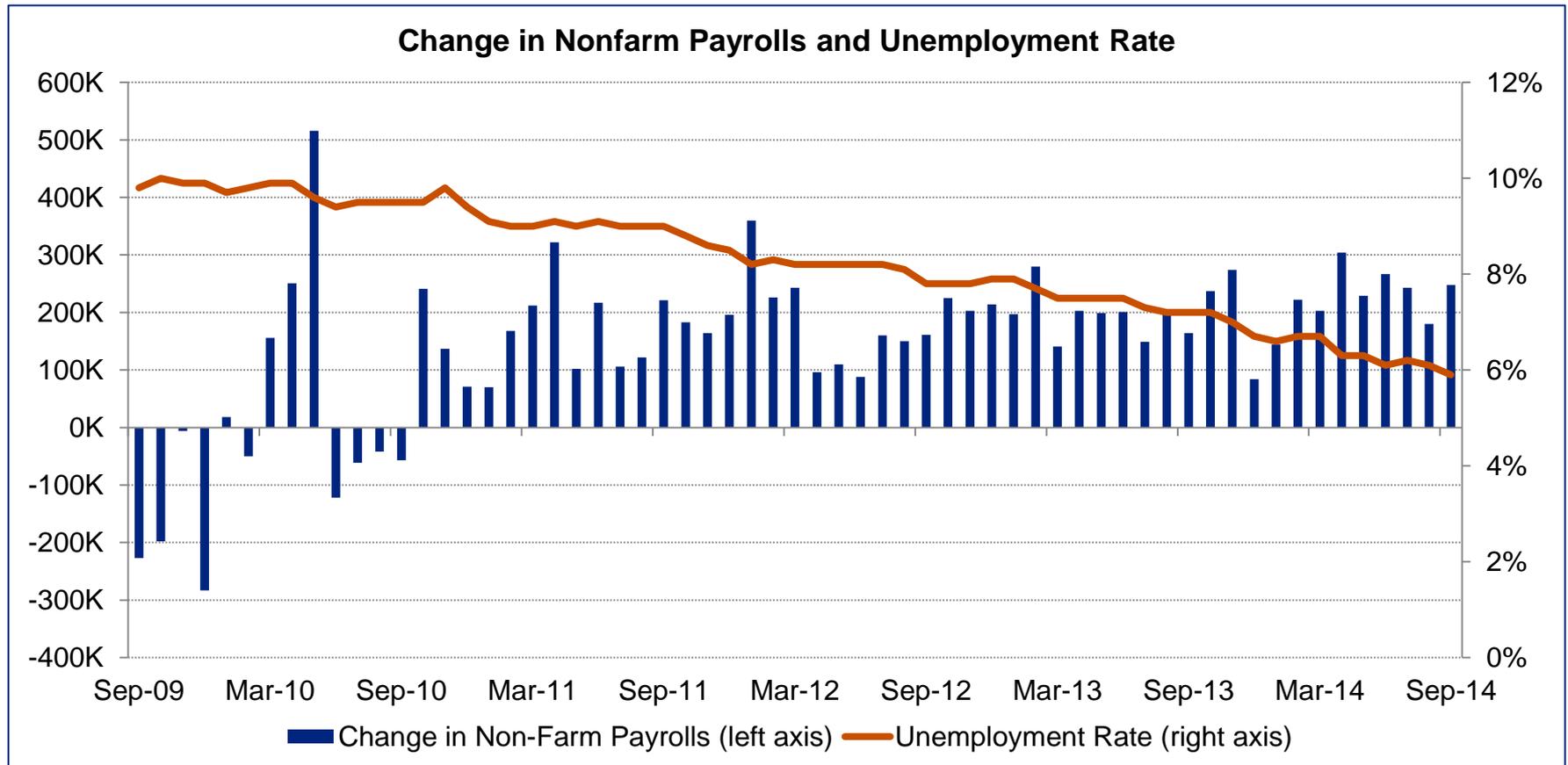
- Second quarter U.S. GDP was revised upward to a 4.6% annualized rate; the increase was mainly due to a larger than previously estimated increase in nonresidential fixed investment and exports.



Source: Bureau Of Economic Analysis

Labor Market Regains Some Momentum

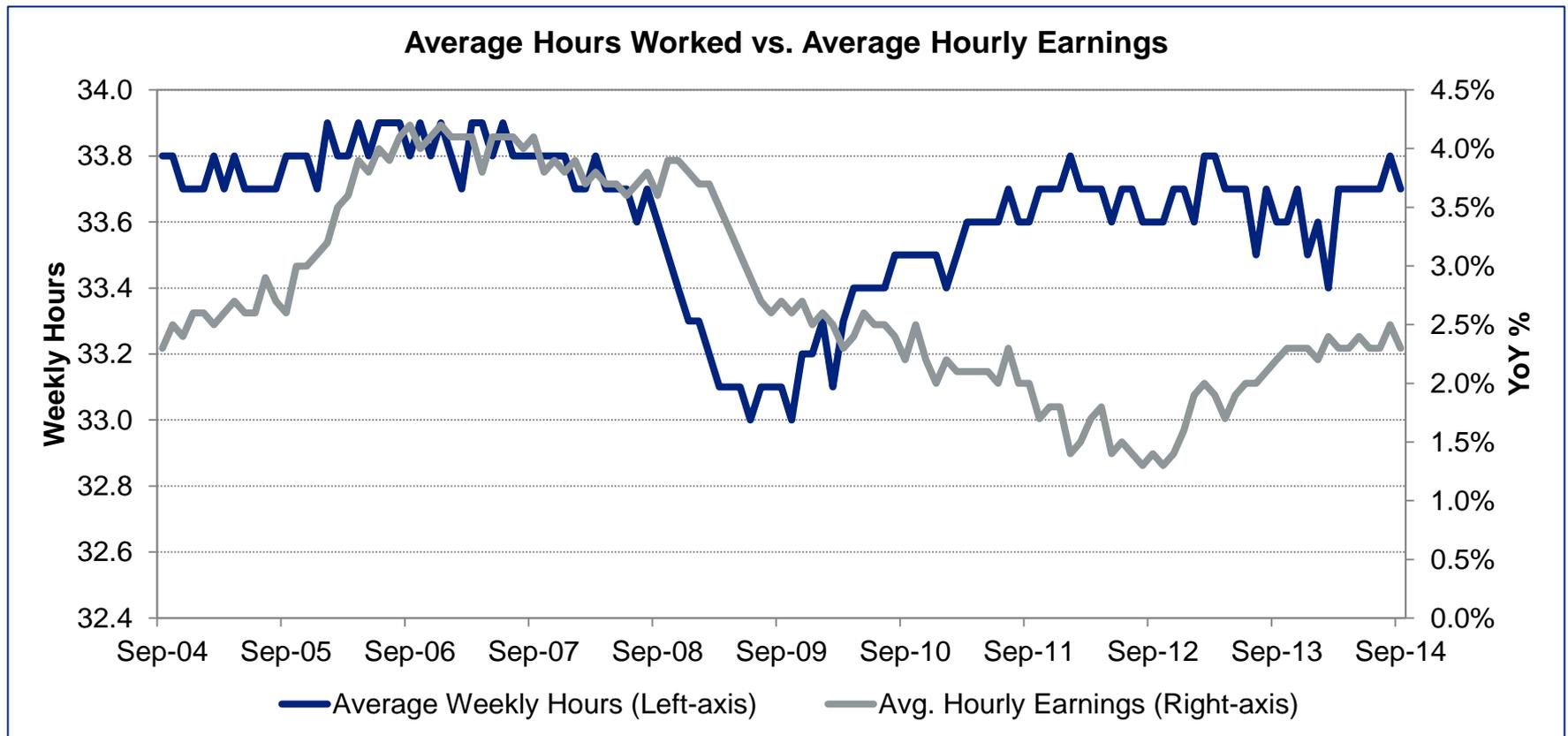
- U.S. job creation rebounded, adding an average of 224,000 net new jobs per month in the third quarter and the unemployment rate fell to 5.9%, hitting the lowest level since before the recession.



Source: Bureau of Labor Statistics

Underlying Slack in Employment Market

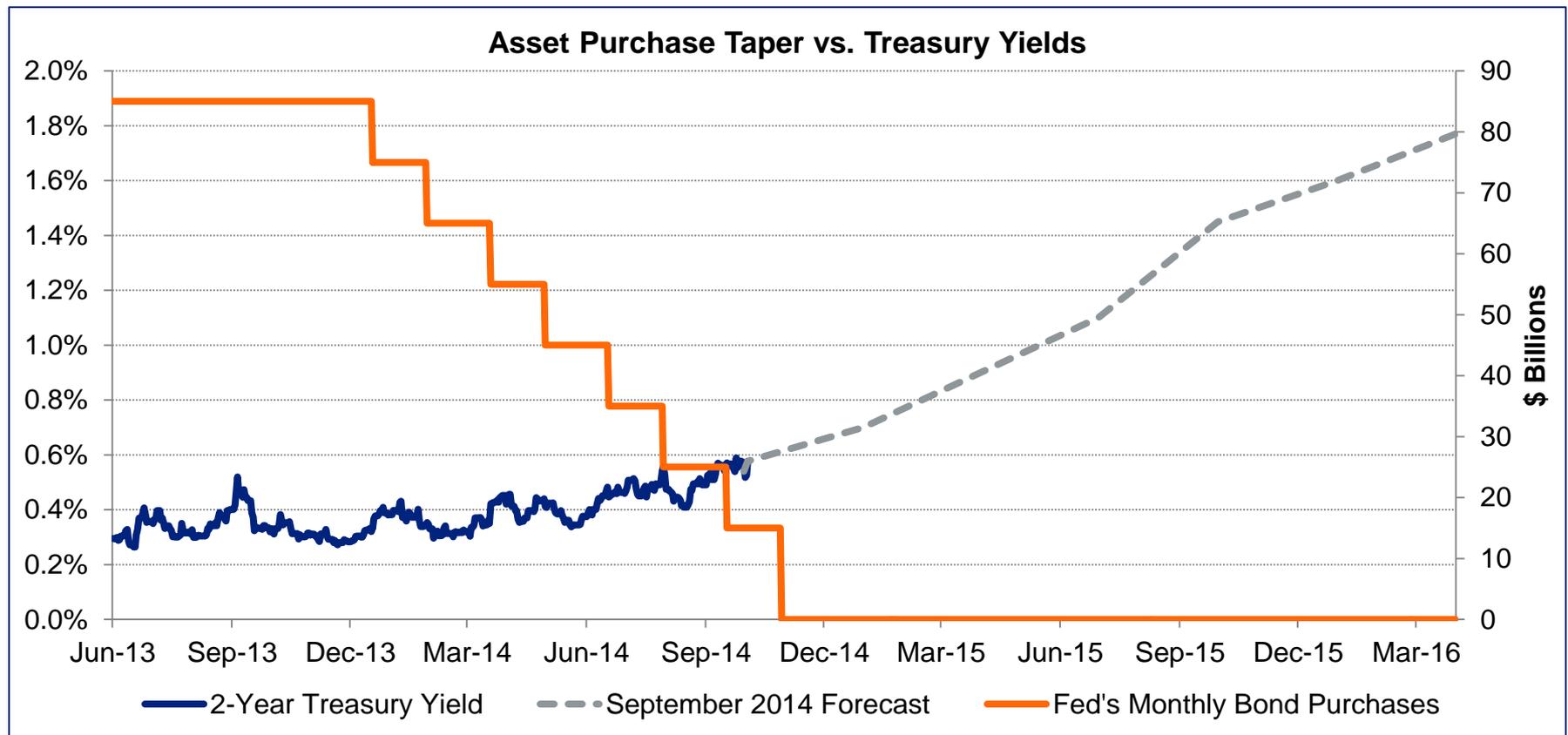
- Recent FOMC meeting minutes have referenced persistent “labor market slack” as a key policy consideration.
- As shown below, measures of weekly hours worked and hourly earnings growth both remain below pre-recession levels.



Source: Bloomberg, Bureau of Labor Statistics

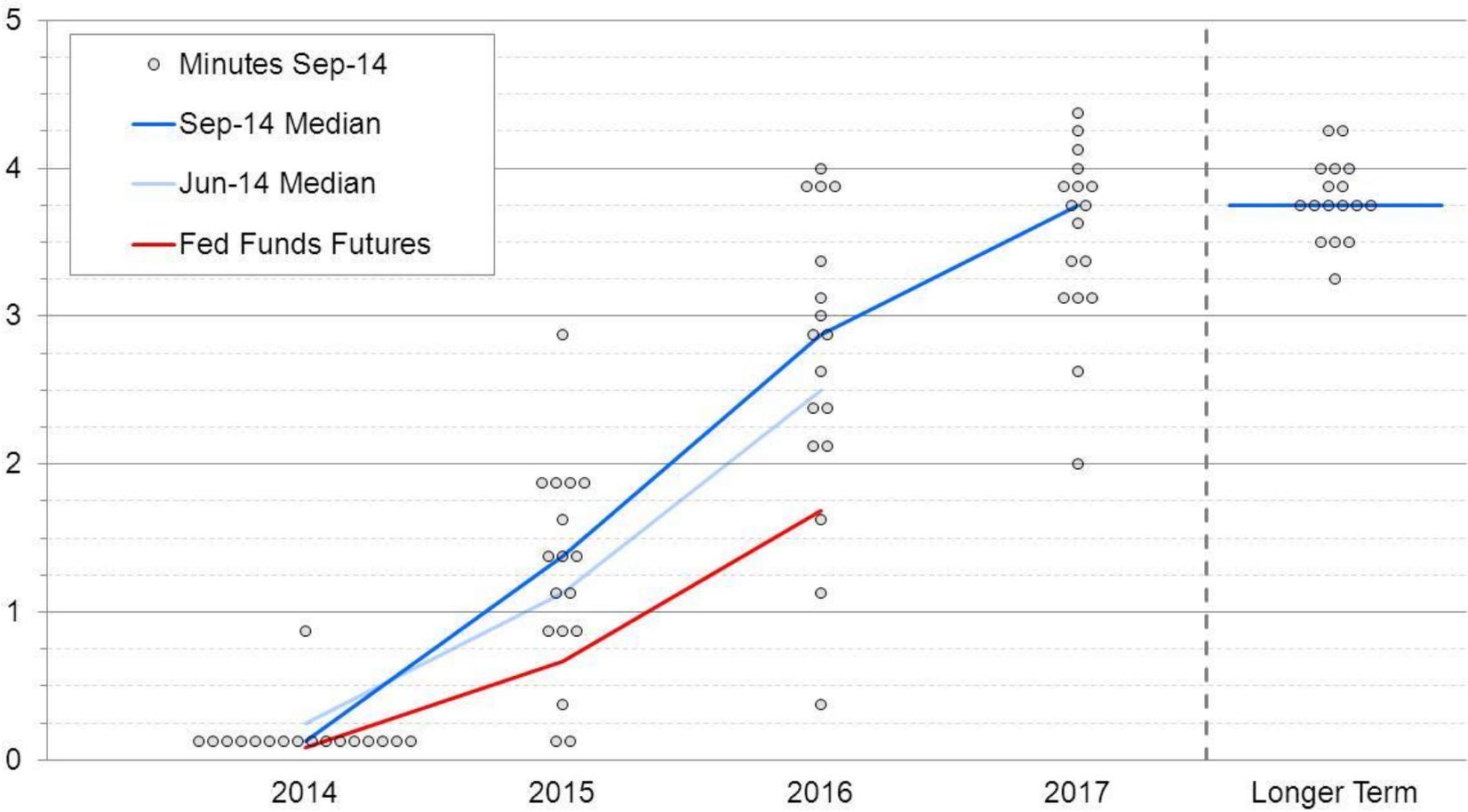
Fed Bond Purchase Program Coming to an End

- Since December 2013, the Fed has been reducing its amount of monthly bond purchases by \$10 billion after each subsequent FOMC meeting.
- The FOMC will end the program in October setting the stage for the Fed to raise its Target Rate.



Source: Bloomberg, Bloomberg Survey of Economists

Outlook: Overnight Market Priced Below Dot Plot



Source: Bloomberg; Federal Reserve

Economic and Market Outlook

Growth Shows Signs of Acceleration

- Rates continue to have an upward bias
 - Intermediate maturities affected most, while long rates are contained
 - Yield curve remains steeply sloped
-

Inflation Remains Benign

- Wage rate growth is stagnant
 - Modest global demand causes prices of headline commodities to rise
 - Inflation remains below trend, but rising towards Federal Reserve targets
-

Fed Policies in Transition

- Bond purchases phased out in October 2014
 - Fed Funds could rise modestly in mid-2015
-

Modest Global Economic Outlook

- Europe out of recession, but growth will likely be moderate
 - Emerging markets will be a moderate drag
 - China growth will moderate
-

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