



# City of Surprise

## Quarterly Performance Review

### Second Quarter Ended June 30, 2014



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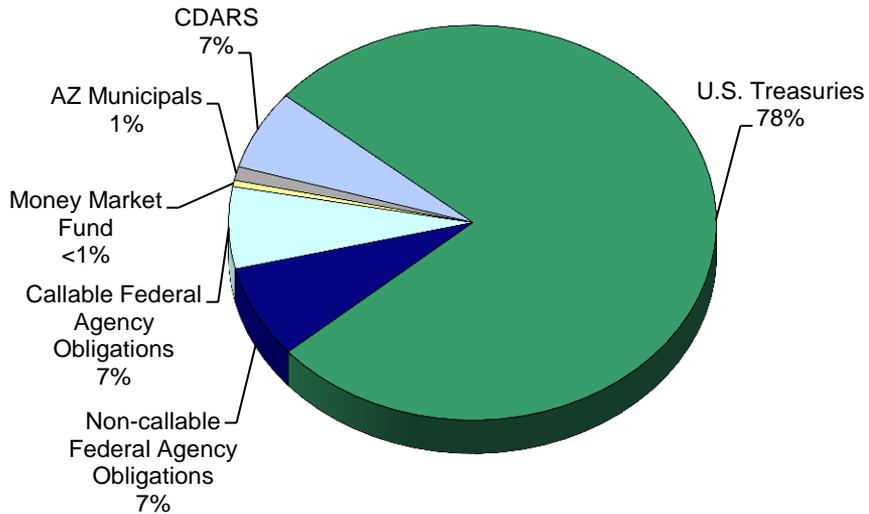
# Second Quarter 2014 Strategy and Recap

- U.S. Treasury yields moved in a somewhat random fashion, despite generally positive economic data.
- Uncertainty around future Fed action (timing and pace of eventual rate increases) posed a significant challenge in assessing the attractiveness of current yields.
- We added duration modestly when rates moved to the higher end of their recent trading ranges.
- We favored Treasuries in all but select issues and maturities as the yield spread between U.S. Treasuries and Agencies remained at historically narrow levels.
- We use quantitative analysis to identify the steepest part of the curve, which benefits most from “roll-down” return, and to measure the relative risk/reward of individual bonds.
  - After generally avoiding callable agencies, our analysis has begun to show value in certain callable structures.
- Our goal was to position the portfolio to minimize the effects of interest rate volatility while capitalizing on opportunities to prudently enhance the portfolio’s yield.

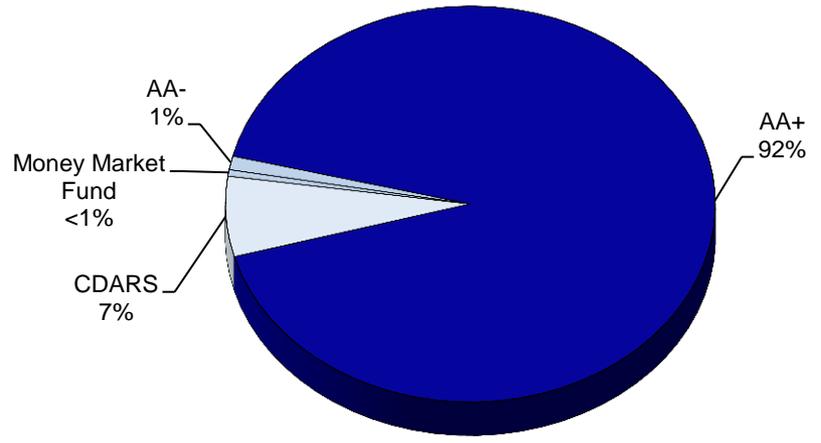
# Portfolio Summary and Characteristics

| Security Type <sup>1</sup>  | June 30, 2014       | Current Quarter % of Portfolio | Previous Quarter % of Portfolio |
|-----------------------------|---------------------|--------------------------------|---------------------------------|
| <b>U.S. Treasury</b>        | <b>\$59,670,248</b> | <b>78%</b>                     | 78%                             |
| <b>Federal Agency</b>       | <b>\$10,994,024</b> | <b>14%</b>                     | 14%                             |
| Callable Federal Agency     | \$5,157,904         | 7%                             | 3%                              |
| Non-callable Federal Agency | \$5,836,120         | 7%                             | 11%                             |
| <b>CDARS<sup>2</sup></b>    | <b>\$5,039,969</b>  | <b>7%</b>                      | 7%                              |
| <b>AZ Municipals</b>        | <b>\$860,185</b>    | <b>1%</b>                      | 1%                              |
| <b>Wells Fargo MMF</b>      | <b>\$404,845</b>    | <b>&lt;1%</b>                  | <1%                             |
| <b>Total Market Value</b>   | <b>\$76,969,271</b> | <b>100%</b>                    | 100%                            |

**Sector Distribution**



**Credit Quality Distribution**



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

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

<sup>2</sup> 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.

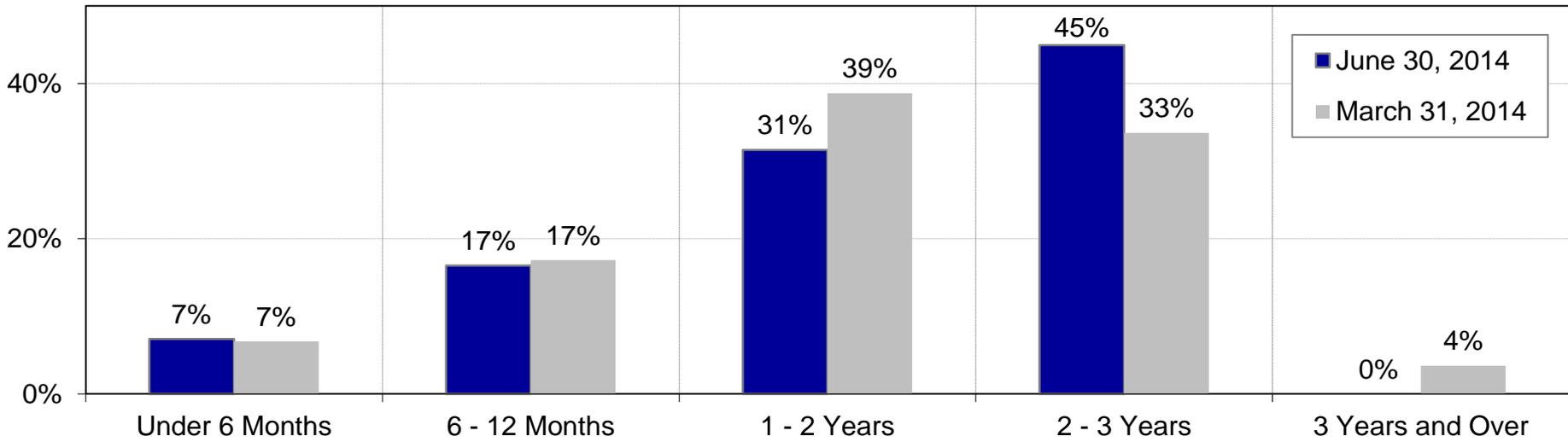
# Maturity Summary and Key Portfolio Statistics

| Maturity Distribution     |                                |                       |
|---------------------------|--------------------------------|-----------------------|
| <u>Maturity Class</u>     | <u>Fair Value</u> <sup>3</sup> | <u>% of Portfolio</u> |
| Under 6 Months            | \$5,444,814                    | 7%                    |
| 6 - 12 Months             | \$12,743,350                   | 17%                   |
| 1 - 2 Years               | \$24,196,592                   | 31%                   |
| 2 - 3 Years               | \$34,584,514                   | 45%                   |
| 3 Years and Over          | \$0                            | 0%                    |
| <b>Total Market Value</b> | <b>\$76,969,271</b>            | <b>100%</b>           |

| Key Portfolio Statistics               |                   |
|--|-------------------|
| <b>Effective Duration</b> <sup>1</sup> | <b>1.72 years</b> |
| <b>Benchmark Duration</b> <sup>2</sup> | <b>1.85 years</b> |
| <b>Yield at Cost</b>                   | <b>0.55%</b>      |

1. Duration to worst as of 6/30/2014 was 1.69.  
 2. The City's benchmark is the 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.

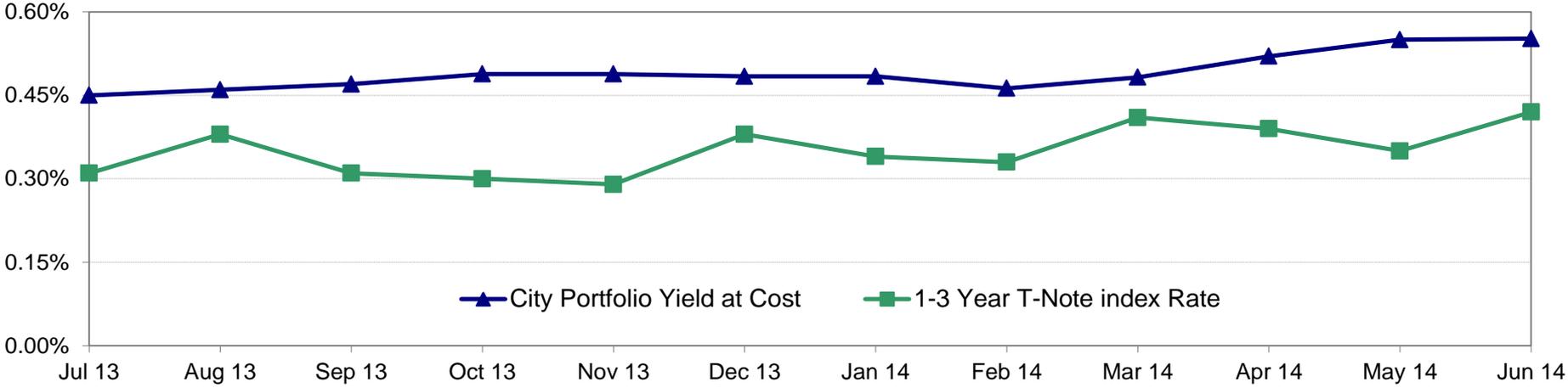
Maturity Distribution



# Individual Portfolio Yield Summary

| Date   | Month-End Market Value <sup>1,2</sup> | Duration <sup>2</sup> | Portfolio YTM at Cost <sup>2</sup> | 1-3 Year T-Note Index Rate <sup>3</sup> |
|--------|---------------------------------------|-----------------------|------------------------------------|---|
| 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%                                   |
| 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%                                   |

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



<sup>1</sup> Excludes accrued interest, CDARS. Includes balance in the custody account MMF.

<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           | 6/30/2014  | 0.00              | \$404,845            | 0.01%             |                |           |
| Alliance Bank (CDARS)     | 8/14/2014  | 0.12              | \$5,039,969          | 0.33%             |                |           |
| U.S. Treasury             | 2/28/2015  | 0.66              | \$781,640            | 0.51%             |                |           |
| U.S. Treasury             | 5/15/2015  | 0.88              | \$1,857,545          | 0.28%             |                |           |
| U.S. Treasury             | 5/15/2015  | 0.88              | \$1,034,844          | 0.33%             |                |           |
| FNMA                      | 5/27/2015  | 0.91              | \$1,328,654          | 0.59%             |                |           |
| U.S. Treasury             | 5/31/2015  | 0.92              | \$5,380,791          | 0.35%             |                |           |
| U.S. Treasury             | 6/30/2015  | 1.00              | \$2,359,876          | 0.43%             |                |           |
| AZ Municipal              | 7/1/2015   | 1.00              | \$860,185            | 0.77%             |                |           |
| U.S. Treasury             | 7/31/2015  | 1.08              | \$2,517,733          | 0.41%             |                |           |
| U.S. Treasury             | 7/31/2015  | 1.08              | \$1,831,079          | 0.34%             |                |           |
| U.S. Treasury             | 7/31/2015  | 1.08              | \$1,958,237          | 0.20%             |                |           |
| FHLB                      | 12/30/2015 | 1.50              | \$2,175,274          | 0.39%             | 9/30/14        | One-time  |
| U.S. Treasury             | 1/31/2016  | 1.58              | \$3,440,685          | 0.42%             |                |           |
| FHLB                      | 2/19/2016  | 1.64              | \$1,925,131          | 0.37%             |                |           |
| U.S. Treasury             | 4/30/2016  | 1.83              | \$3,911,921          | 0.38%             |                |           |
| U.S. Treasury             | 4/30/2016  | 1.83              | \$2,213,324          | 0.39%             |                |           |
| U.S. Treasury             | 5/31/2016  | 1.92              | \$3,363,023          | 0.51%             |                |           |
| U.S. Treasury             | 6/30/2016  | 2.00              | \$1,963,317          | 0.43%             |                |           |
| U.S. Treasury             | 7/31/2016  | 2.08              | \$1,965,003          | 0.48%             |                |           |
| U.S. Treasury             | 7/31/2016  | 2.08              | \$3,491,071          | 0.46%             |                |           |
| U.S. Treasury             | 8/31/2016  | 2.17              | \$3,536,092          | 0.86%             |                |           |
| FNMA                      | 9/28/2016  | 2.24              | \$2,582,335          | 0.73%             |                |           |
| U.S. Treasury             | 10/31/2016 | 2.33              | \$2,624,375          | 0.65%             |                |           |
| U.S. Treasury             | 10/31/2016 | 2.33              | \$3,452,063          | 0.57%             |                |           |
| U.S. Treasury             | 11/30/2016 | 2.42              | \$2,427,667          | 0.65%             |                |           |
| U.S. Treasury             | 11/30/2016 | 2.42              | \$3,783,377          | 0.58%             |                |           |
| U.S. Treasury             | 3/31/2017  | 2.75              | \$2,796,508          | 0.96%             |                |           |
| FHLB                      | 4/28/2017  | 2.83              | \$2,982,630          | 1.25%             | 4/28/15        | One-time  |
| U.S. Treasury             | 5/31/2017  | 2.92              | \$2,980,077          | 0.84%             |                |           |
| <b>Total Market Value</b> |            |                   | <b>\$ 76,969,271</b> |                   |                |           |

# Callable Sector Offers Some Value

- The callable Federal Agency security offers value regardless of whether or not it is called away or extends to final maturity.
  - The security is callable one-time in 1 year and has a final maturity in 3 years.
  - Positioned to perform well, irrespective of the direction of interest rates.

| Date   | Transaction | Security              | Maturity | Par Value (millions) | Yield to Call | Yield to Maturity |
|--------|-------------|-----------------------|----------|----------------------|---------------|-------------------|
| 4/3/14 | Buy         | FHLB Notes (Callable) | 4/28/17  | \$2.95               | 0.51%         | 1.25%             |
| 4/3/14 | Sell        | U.S. Treasury Notes   | 11/15/15 | \$2.75               | -             | 0.30%             |

**Non-Callable vs. Callable Yields**  
April 3, 2014

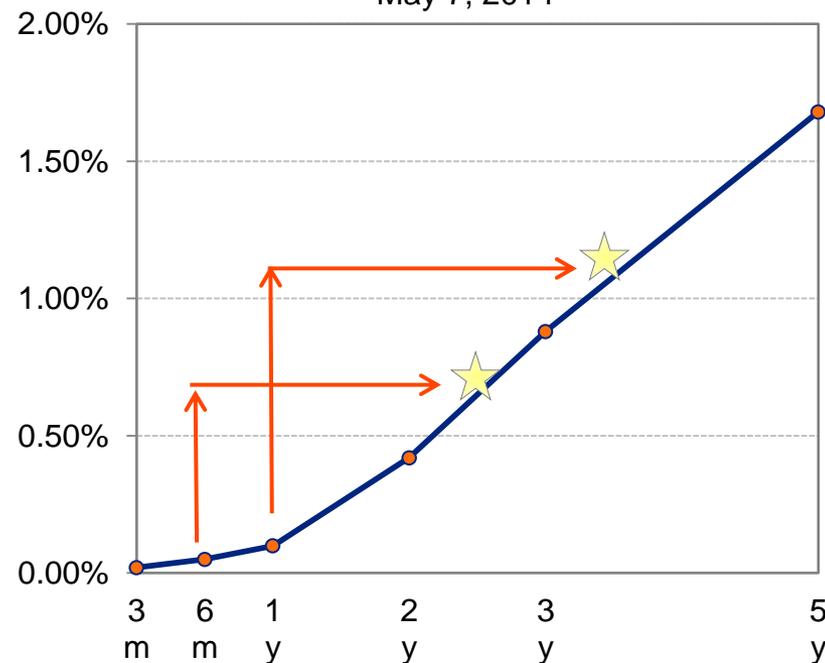
| Maturity | FHLB Non-Callable Yield | FHLB Callable Yield | Yield Pick-up |
|----------|-------------------------|---------------------|---------------|
| 1 Year   | 0.14%                   | 0.51%               | +0.37%        |
| 3 Year   | 0.93%                   | 1.25%               | +0.32%        |

# May Strategic Duration Extension

| Date   | Transaction | Security            | Maturity | Par Value (millions) | Yield | Realized G/L |
|--------|-------------|---------------------|----------|----------------------|-------|--------------|
| 5/7/14 | Buy         | U.S. Treasury Notes | 11/30/17 | \$3.00               | 1.15% | -            |
| 5/7/14 | Sell        | FHLMC Notes         | 12/29/14 | \$3.00               | 0.10% | \$10,873     |
| 5/7/14 | Buy         | U.S. Treasury Notes | 10/31/16 | \$2.60               | 0.65% | -            |
| 5/7/14 | Sell        | U.S. Treasury Notes | 1/31/15  | \$2.34               | 0.09% | \$5,038      |

- We purchased a 3.5-year Treasury to maintain the portfolio's conservative duration position.
  - Took advantage of the steepest area of the yield curve which provides protection should rates rise.
- Yield spreads between Treasuries and Agencies are minimal to nonexistent in many issues.

U.S. Treasury Curve  
May 7, 2014



Source: Bloomberg

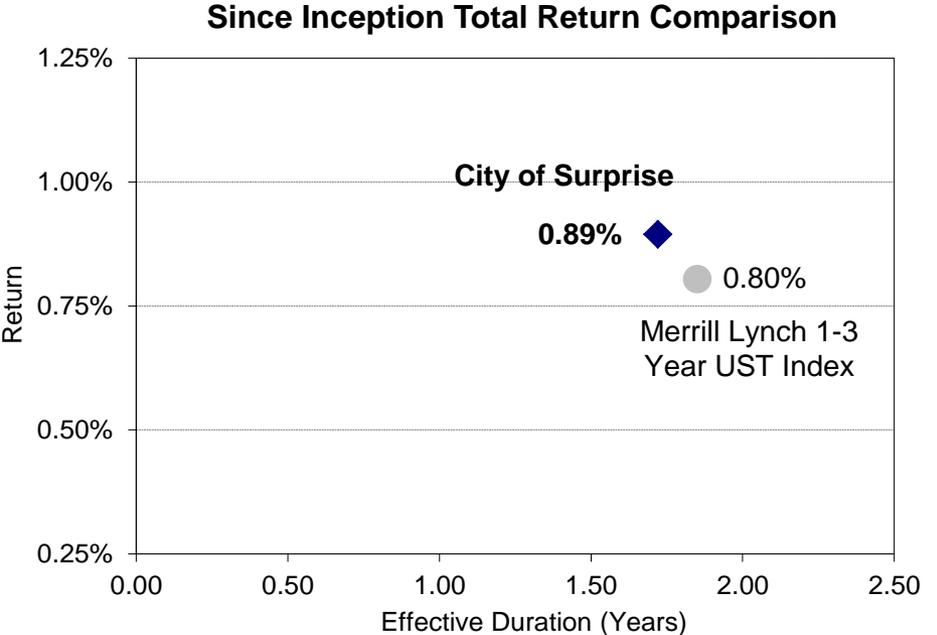
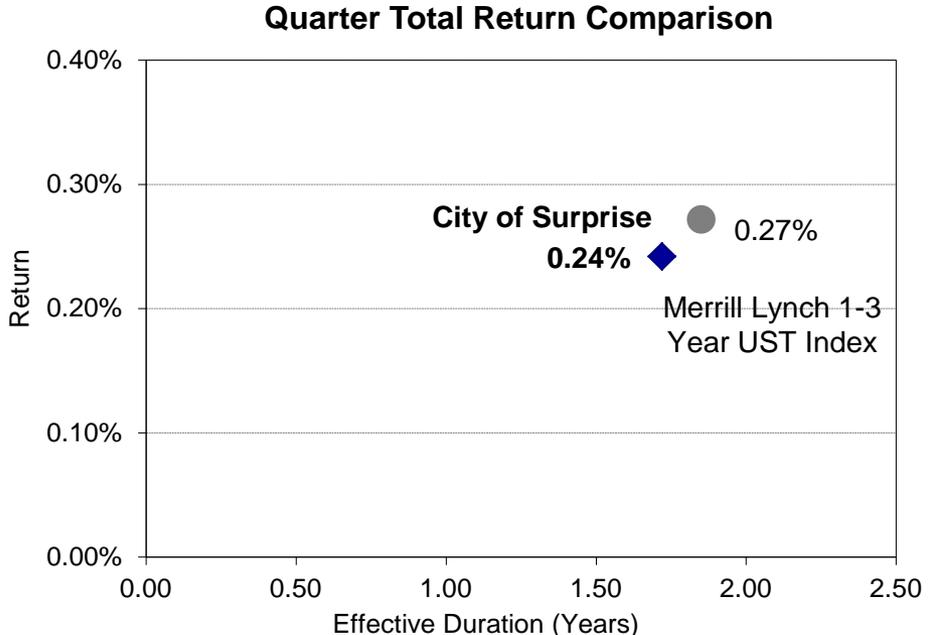
# June Duration Adjustment

- We modestly extended the portfolio's duration by selling securities with an average duration of 1.55 years and purchasing Treasuries with an average duration of 2.51 years.
- The trades resulted in an average yield pick-up of 0.22%.
- The trades represent PFM's dynamic and active portfolio duration management that is responsive to changes in the interest rate environment.

| Date   | Transaction | Security            | Maturity | Par Value (millions) | Yield | Realized G/L |
|--------|-------------|---------------------|----------|----------------------|-------|--------------|
| 6/2/14 | Buy         | U.S. Treasury Notes | 5/31/17  | \$3.00               | 0.84% | -            |
| 6/2/14 | Buy         | U.S. Treasury Notes | 7/31/16  | \$3.42               | 0.46% | -            |
| 6/2/14 | Buy         | U.S. Treasury Notes | 10/31/16 | \$3.42               | 0.57% | -            |
| 6/2/14 | Sell        | U.S. Treasury Notes | 11/30/17 | \$3.00               | 1.07% | \$8,324      |
| 6/2/14 | Sell        | U.S. Treasury Notes | 2/15/15  | \$4.54               | 0.10% | \$8,207      |
| 6/2/14 | Sell        | U.S. Treasury Notes | 1/31/15  | \$2.30               | 0.09% | \$4,740      |

# Portfolio Performance

| Total Return <sup>1,2,3,4,5</sup> | Quarter Ended<br>June 30, 2014 | Past<br>1 Year    | Past<br>2 Years | Past<br>3 Years  | Since<br>Inception |
|-----------------------------------|--------------------------------|-------------------|-----------------|------------------|--------------------|
| <b>City of Surprise</b>           | <b>0.24%</b>                   | <b>0.73%</b>      | <b>0.55%</b>    | <b>0.66%</b>     | <b>0.89%</b>       |
| Merrill Lynch 1-3 Year UST Index  | 0.27%                          | 0.76%             | 0.55%           | 0.63%            | 0.80%              |
| Effective Duration <sup>4</sup>   | June 30,<br>2014               | March 31,<br>2014 | Yields          | June 30,<br>2014 | March 31,<br>2014  |
| <b>City of Surprise</b>           | <b>1.72</b>                    | <b>1.66</b>       | Yield at Market | <b>0.45%</b>     | <b>0.39%</b>       |
| Merrill Lynch 1-3 Year UST Index  | 1.85                           | 1.84              | Yield on Cost   | <b>0.55%</b>     | <b>0.48%</b>       |



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.

# Third Quarter 2014 Strategy and Outlook

- Economic growth appears to be accelerating, accompanied by early signs of an uptick in inflation. The Fed is expected to end its quantitative easing program in October, opening the door to their next possible move—a Fed rate hike.
- Higher interest rates triggered by anticipated Fed action are widely expected in the future. Since rising rates can result in unrealized market losses, we remain somewhat defensive with regard to duration.
- We will continue to assess the benefit of higher yields available on longer maturities today against the negative impact of potentially rising rates in the future for every trade in the portfolio.
- We expect yield spreads to remain narrow, favoring Treasuries over Agencies. However, specific Agency issues may offer value.
- PFM seeks to add value in a variety of ways:
  - Duration management.
  - Adjusting maturities along the yield curve.
  - Emphasizing sectors that offer the best value.
  - Careful issue-level analysis and security selection.
- Our strategy will remain flexible and may change in response to changes in interest rates, emerging economic data, or our market outlook.



## Managed Account Detail of Securities Held

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

### CITY OF SURPRISE OPERATING FUND

| Security Type/Description<br>Dated Date/Coupon/Maturity | CUSIP     | Par          | S&P<br>Rating | Moody's<br>Rating | Trade<br>Date | Settle<br>Date | Original<br>Cost | YTM<br>at Cost | Accrued<br>Interest | Amortized<br>Cost | Market<br>Value |
|---|-----------|--------------|---------------|-------------------|---------------|----------------|------------------|----------------|---------------------|-------------------|-----------------|
| <b>U.S. Treasury Bond / Note</b>                        |           |              |               |                   |               |                |                  |                |                     |                   |                 |
| US TREASURY NOTES<br>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           | 6,112.40            | 779,518.79        | 781,640.09      |
| US TREASURY NOTES<br>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           | 5,268.34            | 1,033,033.52      | 1,034,844.00    |
| US TREASURY NOTES<br>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           | 9,456.67            | 1,855,019.22      | 1,857,544.98    |
| US TREASURY NOTES<br>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           | 9,512.28            | 5,370,533.02      | 5,380,790.63    |
| US TREASURY NOTES<br>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           | 118.21              | 2,353,222.45      | 2,359,876.16    |
| US TREASURY NOTES<br>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           | 13,139.50           | 1,827,364.93      | 1,831,078.80    |
| US TREASURY NOTES<br>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           | 14,051.97           | 1,957,293.16      | 1,958,237.05    |
| US TREASURY NOTES<br>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           | 18,066.82           | 2,510,809.36      | 2,517,733.35    |
| US TREASURY NOTES<br>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           | 27,947.51           | 3,433,167.87      | 3,440,684.50    |
| US TREASURY NOTES<br>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           | 7,244.57            | 2,213,025.51      | 2,213,323.95    |
| US TREASURY NOTES<br>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           | 12,804.35           | 3,912,094.79      | 3,911,921.40    |
| US TREASURY NOTES<br>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           | 4,861.75            | 3,357,672.50      | 3,363,023.36    |
| US TREASURY NOTES<br>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           | 164.27              | 1,964,044.81      | 1,963,317.19    |
| US TREASURY NOTES<br>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           | 12,044.54           | 1,965,760.99      | 1,965,003.43    |



## Managed Account Detail of Securities Held

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

### CITY OF SURPRISE OPERATING FUND

| Security Type/Description<br>Dated Date/Coupon/Maturity          | CUSIP     | Par                  | S&P<br>Rating | Moody's<br>Rating | Trade<br>Date | Settle<br>Date | Original<br>Cost     | YTM<br>at Cost | Accrued<br>Interest | Amortized<br>Cost    | Market<br>Value      |
|--|-----------|----------------------|---------------|-------------------|---------------|----------------|----------------------|----------------|---------------------|----------------------|----------------------|
| <b>U.S. Treasury Bond / Note</b>                                 |           |                      |               |                   |               |                |                      |                |                     |                      |                      |
| US TREASURY NOTES<br>DTD 08/01/2011 1.500% 07/31/2016            | 912828QX1 | 3,420,000.00         | AA+           | Aaa               | 06/02/14      | 06/05/14       | 3,495,881.25         | 0.46           | 21,398.62           | 3,493,366.32         | 3,491,071.02         |
| US TREASURY NOTES<br>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           | 11,698.37           | 3,510,425.42         | 3,536,092.00         |
| US TREASURY NOTES<br>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           | 4,380.43            | 2,621,316.26         | 2,624,375.00         |
| US TREASURY NOTES<br>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           | 5,761.96            | 3,453,978.52         | 3,452,062.50         |
| US TREASURY NOTES<br>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           | 5,380.53            | 2,425,831.05         | 2,427,666.78         |
| US TREASURY NOTES<br>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           | 8,385.25            | 3,787,229.63         | 3,783,376.80         |
| US TREASURY NOTES<br>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           | 6,987.98            | 2,783,171.09         | 2,796,507.64         |
| US TREASURY NOTES<br>DTD 05/31/2012 0.625% 05/31/2017            | 912828SY7 | 3,000,000.00         | AA+           | Aaa               | 06/02/14      | 06/05/14       | 2,980,781.25         | 0.84           | 1,588.11            | 2,981,233.68         | 2,980,077.00         |
| <b>Security Type Sub-Total</b>                                   |           | <b>58,365,000.00</b> |               |                   |               |                | <b>60,539,873.65</b> | <b>0.52</b>    | <b>206,374.43</b>   | <b>59,589,112.89</b> | <b>59,670,247.63</b> |
| <b>Municipal Bond / Note</b>                                     |           |                      |               |                   |               |                |                      |                |                     |                      |                      |
| MESA, AZ T/E GO BONDS<br>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           | 8,450.00            | 855,328.82           | 860,184.65           |
| <b>Security Type Sub-Total</b>                                   |           | <b>845,000.00</b>    |               |                   |               |                | <b>878,200.05</b>    | <b>0.77</b>    | <b>8,450.00</b>     | <b>855,328.82</b>    | <b>860,184.65</b>    |
| <b>Federal Agency Bond / Note</b>                                |           |                      |               |                   |               |                |                      |                |                     |                      |                      |
| FANNIE MAE GLOBAL NOTES<br>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           | 625.69              | 1,323,876.03         | 1,328,654.35         |
| FHLB (CALLABLE) GLOBAL NOTES<br>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           | 22.66               | 2,174,429.56         | 2,175,274.05         |



**Managed Account Detail of Securities Held**

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

**CITY OF SURPRISE OPERATING FUND**

| <b>Security Type/Description</b><br><b>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>                                       |              |                        |                       |                       |                   |                    |                        |                    |                         |                        |                        |
| FEDERAL HOME LOAN BANK GLOBAL NOTES<br>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               | 2,646.88                | 1,925,092.71           | 1,925,130.90           |
| FNMA NOTES<br>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               | 8,218.23                | 2,574,174.10           | 2,582,335.15           |
| FHLB GLOBAL NOTE (CALLABLE)<br>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               | 8,389.06                | 2,977,021.94           | 2,982,629.95           |
| <b>Security Type Sub-Total</b>  |              | <b>10,920,000.00</b>   |                       |                       |                   |                    | <b>10,987,030.35</b>   | <b>0.73</b>        | <b>19,902.52</b>        | <b>10,974,594.34</b>   | <b>10,994,024.40</b>   |
| <b>Managed Account Sub-Total</b>  |              | <b>70,130,000.00</b>   |                       |                       |                   |                    | <b>72,405,104.05</b>   | <b>0.55</b>        | <b>234,726.95</b>       | <b>71,419,036.05</b>   | <b>71,524,456.68</b>   |
| <b>Securities Sub-Total</b>   |              | <b>\$70,130,000.00</b> |                       |                       |                   |                    | <b>\$72,405,104.05</b> | <b>0.55%</b>       | <b>\$234,726.95</b>     | <b>\$71,419,036.05</b> | <b>\$71,524,456.68</b> |
| <b>Accrued Interest</b>   |              |                        |                       |                       |                   |                    |                        |                    |                         |                        | <b>\$234,726.95</b>    |
| <b>Total Investments</b>  |              |                        |                       |                       |                   |                    |                        |                    |                         |                        | <b>\$71,759,183.63</b> |





## July Economic Update



# Economic Summary

## Economic Conditions

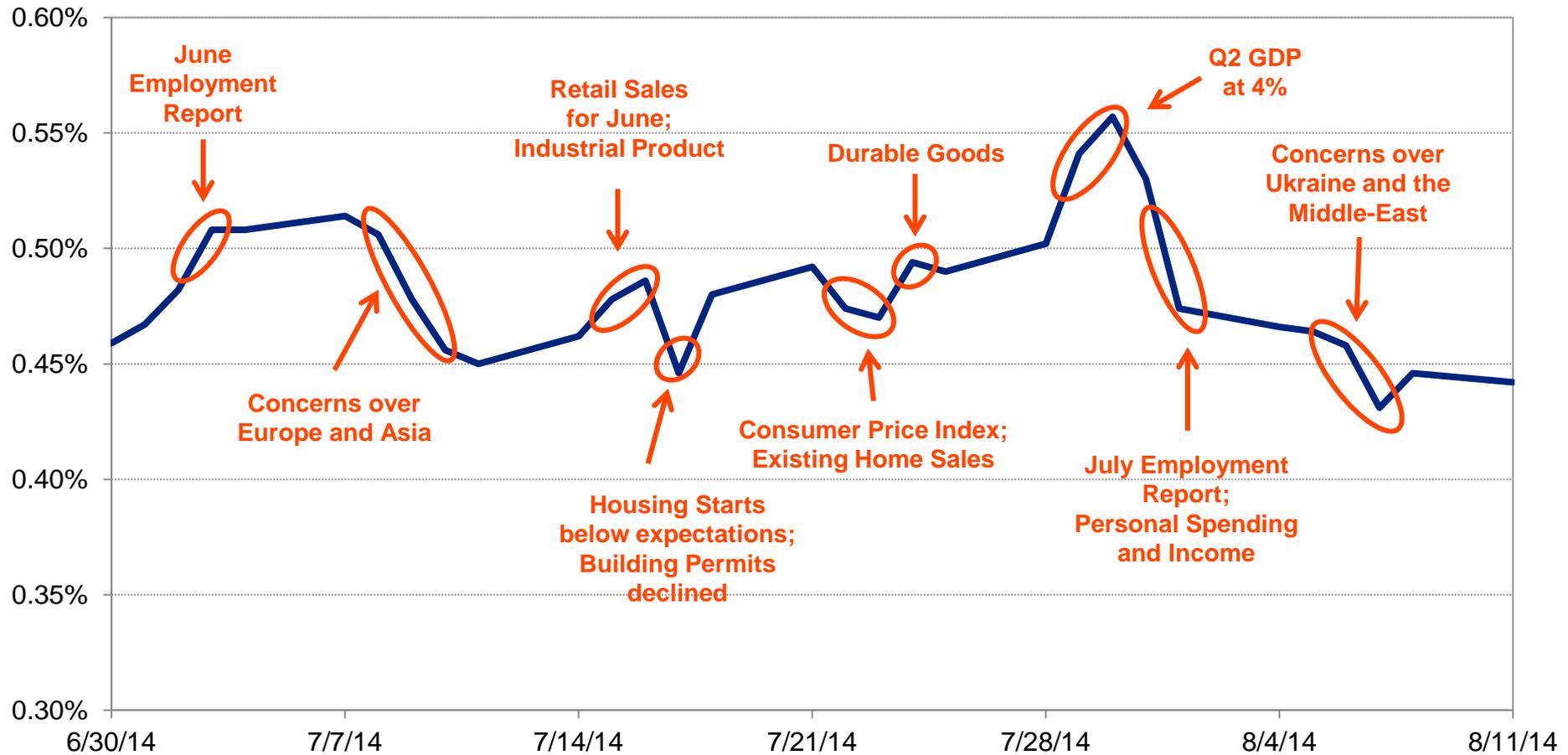
- U.S. GDP grew 4% in the second quarter, with growth consistent across the major components.
- The labor market remained robust in July, however came in lower than expected, with 209,000 nonfarm jobs added.
- The unemployment rate rose slightly to 6.2% on a modest increase in labor participation.
- The Federal Reserve noted an increase in economic activity as it further reduced its bond-purchasing program down to \$25 billion a month.
- Geopolitical issues in Ukraine and the Middle East heightened market volatility.

## Market Reaction

- Aside from brief periods of “flight to quality,” U.S. Treasury yields generally rose during July in response to stronger economic data.
- At the beginning of August yields fell after the payroll announcement and intensified geopolitical events.
- Short-term yields remain anchored by Federal Reserve policy and decreased supply of U.S. Treasury and Federal Agency securities.
- Credit and Federal Agency spreads remained at historically tight levels as demand outstripped supply and investors continue to struggle to find yield.

# July Market Movers

**2-Year U.S. Treasury Yields**  
June 30, 2014 – Aug 11, 2014

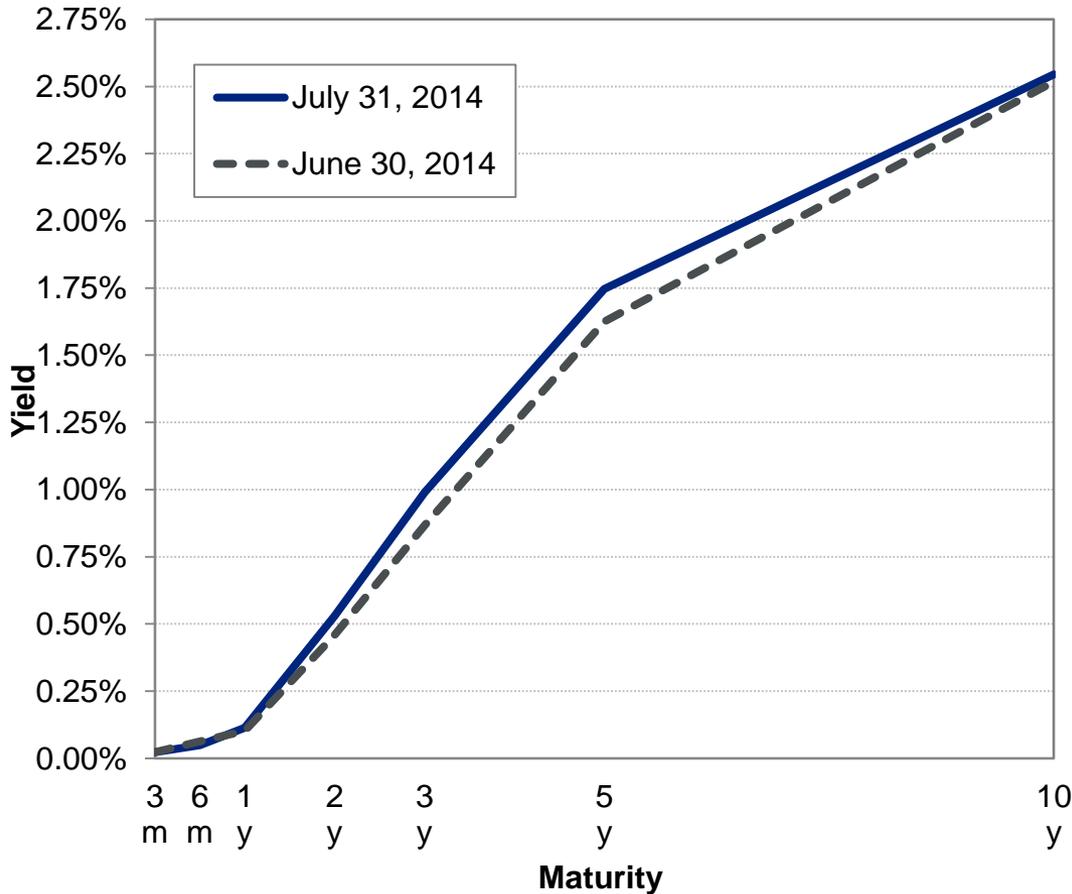


Source: Bloomberg

# Yield Curve Remains Steep

- Encouraging economic indicators caused intermediate yields to rise in July, adding evidence that the labor market is strengthening.

**U.S. Treasury Curves**



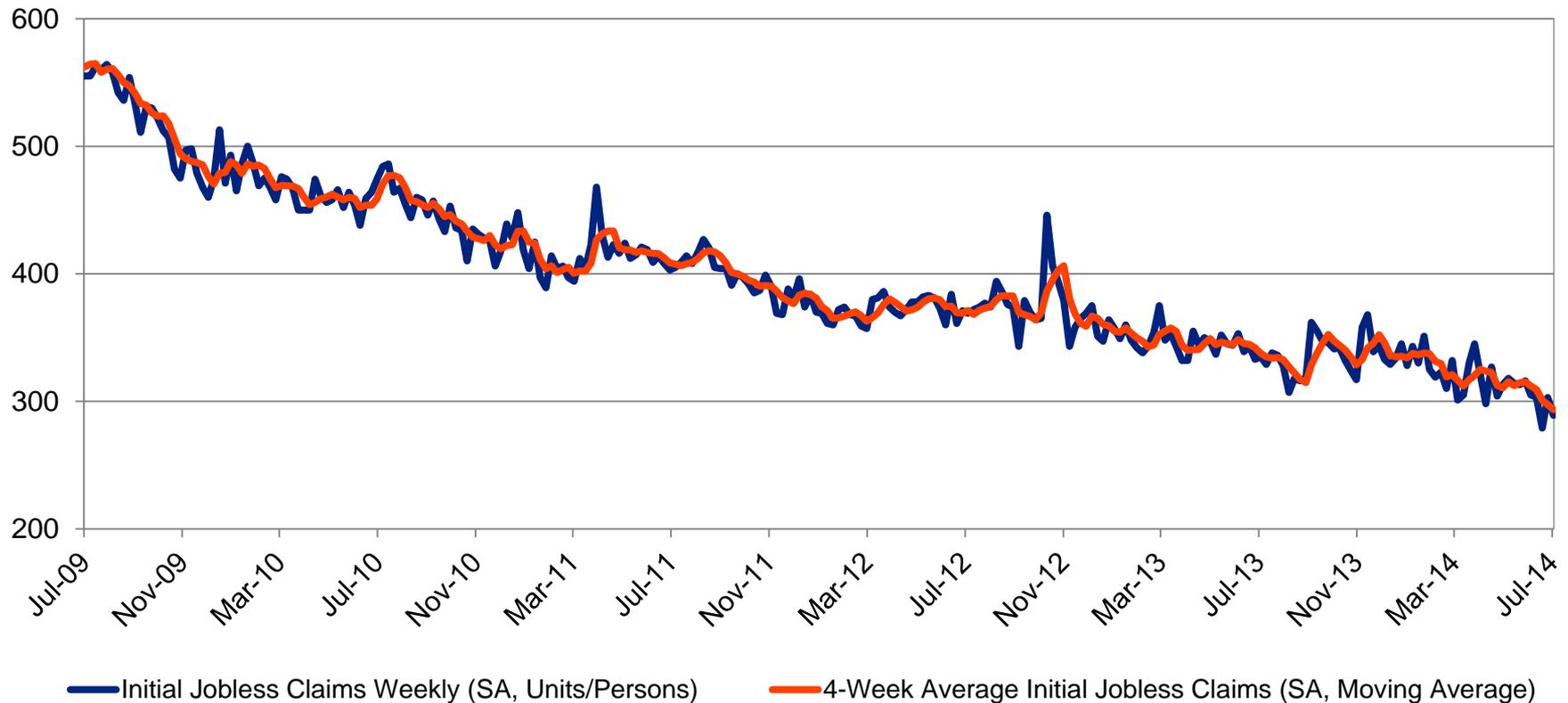
|               | 6/30/14 | 7/31/14 | MoM change |
|---------------|---------|---------|------------|
| <b>3-Mo.</b>  | 0.02%   | 0.02%   | -          |
| <b>6-Mo.</b>  | 0.06%   | 0.05%   | -0.01%     |
| <b>1-Yr.</b>  | 0.10%   | 0.11%   | +0.01%     |
| <b>2-Yr.</b>  | 0.46%   | 0.53%   | +0.07%     |
| <b>3-Yr.</b>  | 0.87%   | 0.99%   | +0.12%     |
| <b>5-Yr.</b>  | 1.63%   | 1.75%   | +0.12%     |
| <b>10-Yr.</b> | 2.52%   | 2.55%   | +0.03%     |

Source: Bloomberg

# Drop in Jobless Claims

- Jobless claims fell unexpectedly by 14,000 to 289,000 for the week ended August 2<sup>nd</sup>.
  - The figure is the year's second-lowest level, a new sign of a further strengthening labor market.
- The four-week moving average of the claims hit 293,500, the lowest level since February 2006.

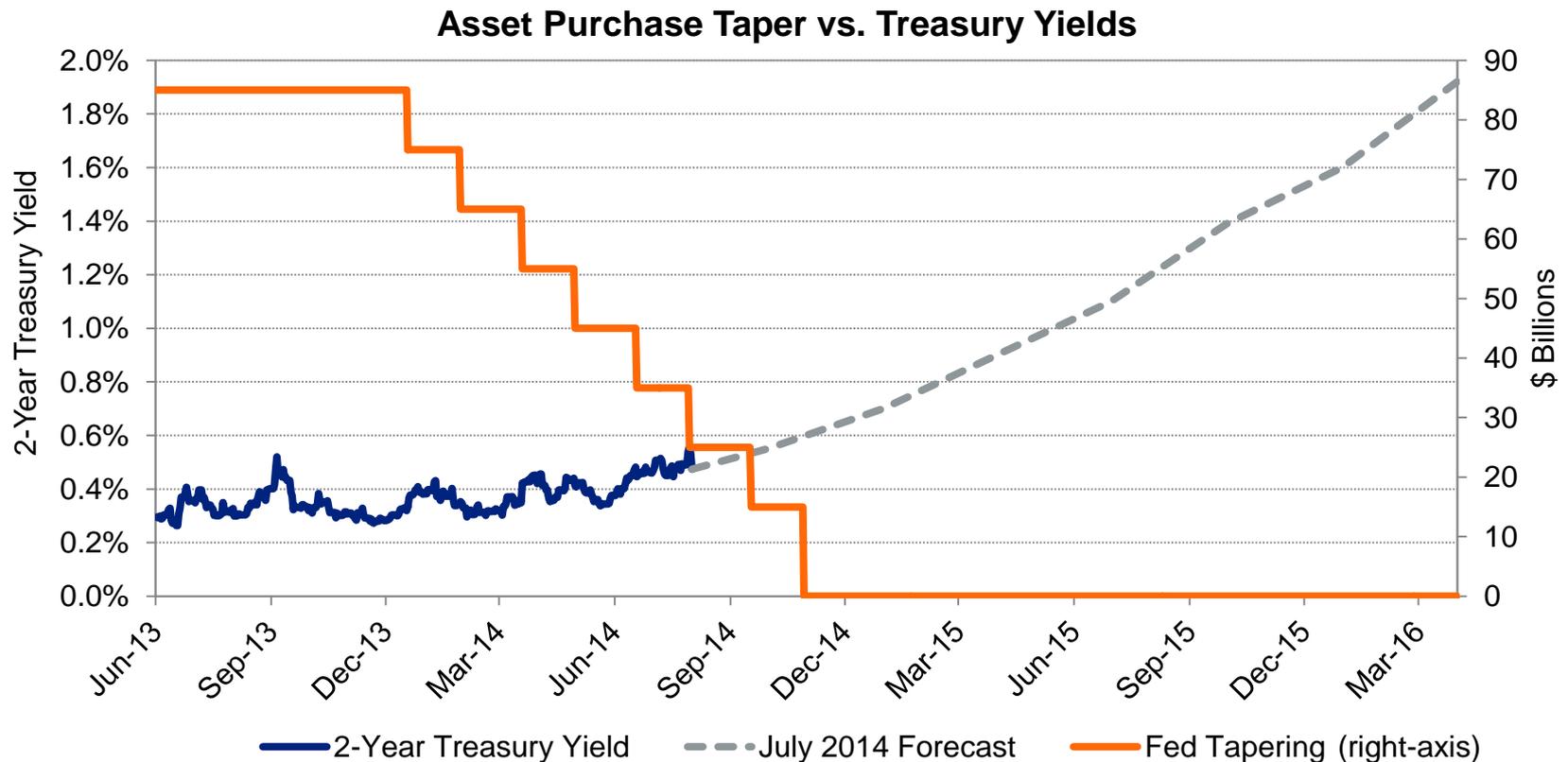
**Initial Jobless Claims**



Source: Bloomberg

# Fed Continues Taper Of Bond Purchase Program

- The Federal Reserve has continued to taper at a \$10 billion pace at each meeting.
  - The FOMC has expressed its intention to end the program in October.
- Market participants have now turned their attention to a change in monetary policy as it relates to the Fed Fund's Rate.

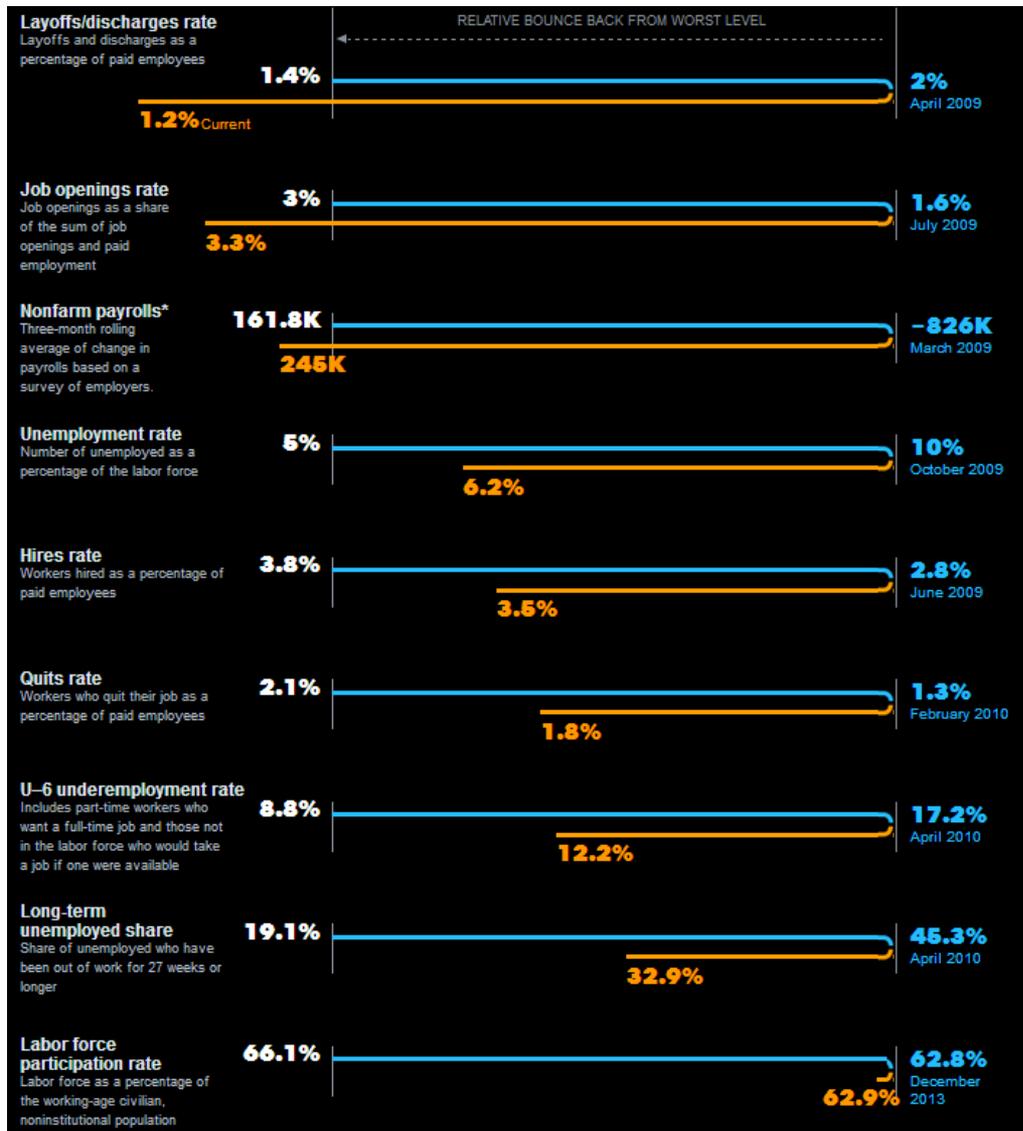


Source: Bloomberg, Bloomberg Survey of Economists

# Janet Yellen's Dashboard of Jobs Data

Pre-Recession Level

Worst Level Since 2008



- Janet Yellen uses an “employment dashboard” to help guide monetary policy.
- Signs of strengthening labor market:
  - The increase in job openings.
  - Highest readings for the number of people hired/leaving their jobs since 2008.
- Improvement is still measured and uneven.



Source: Bureau of Labor Statistics, data compiled by Bloomberg and Bloomberg Visual Data

# Disclaimer

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