SURPRISE
ARIZONA

City of Surprise

Quarterly Performance Review

Second Quarter Ended June 30, 2015

The PFM Group
Financial & Investment Advisors

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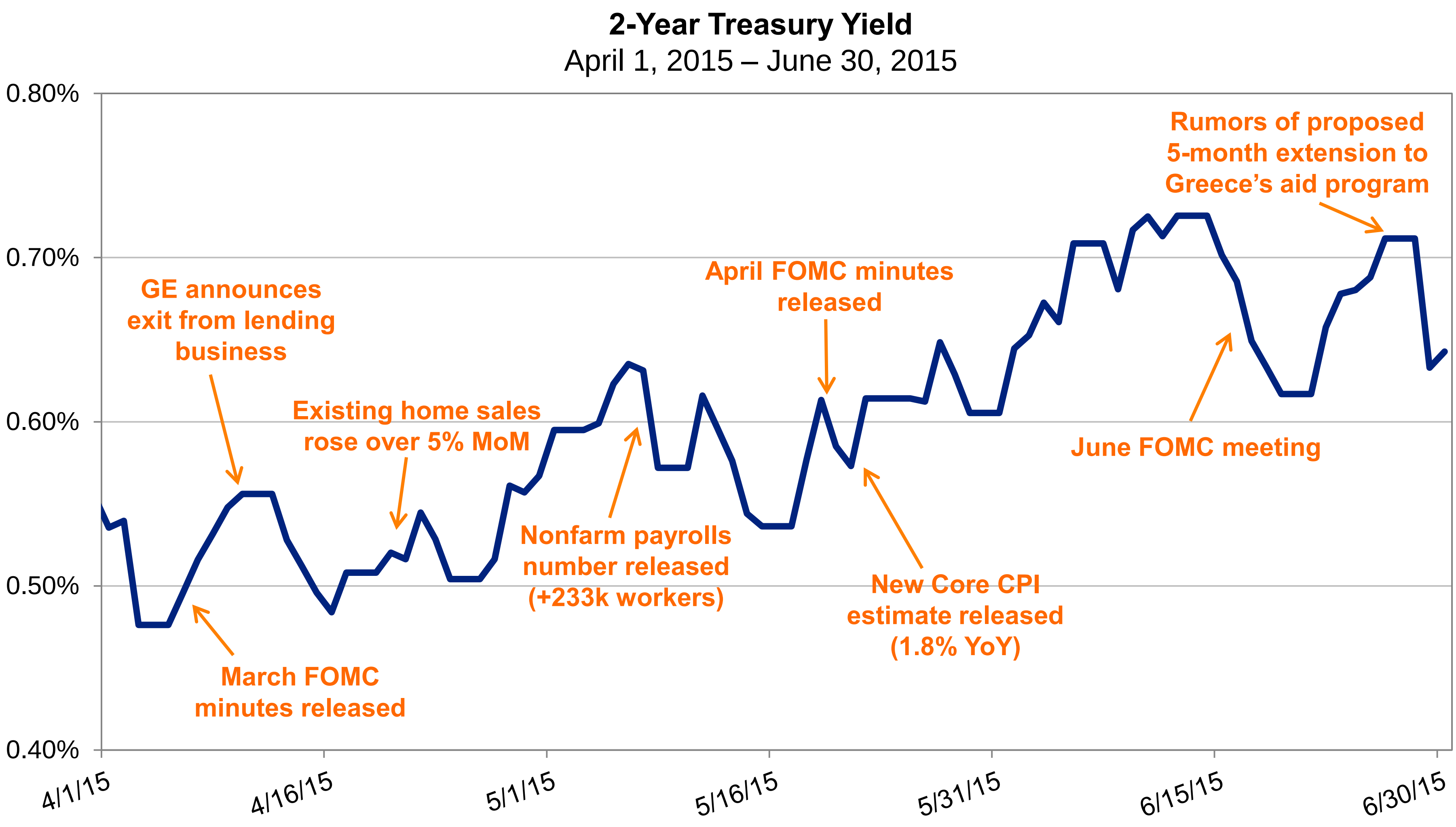
Second Quarter 2015 Strategy and Recap

- Treasury yields fluctuated throughout the quarter:
  - Higher on strong economic news in the U.S.
  - Lower when the Federal Open Market Committee (FOMC) indicated that they are not yet ready to raise rates and as the situation in Greece remained unresolved.
- Overall, the trend was toward higher interest rates with the greatest increases in longer-term yields.
- PFMAM kept the portfolio's duration slightly shorter than the benchmark's duration because of uncertainty regarding the short-term direction of interest rates.
- Yields on Treasuries tend to react more quickly to changing economic conditions, which causes yield spreads to fluctuate.
  - We took advantage of yield fluctuations and added Agency holdings to the portfolio when the yield advantage was wide compared to recent spreads.
- We focused on maturities where the yield curve was steepest and therefore offered both high-current yields and strong potential for "roll down" benefit (the natural tendency for securities to appreciate as they age).

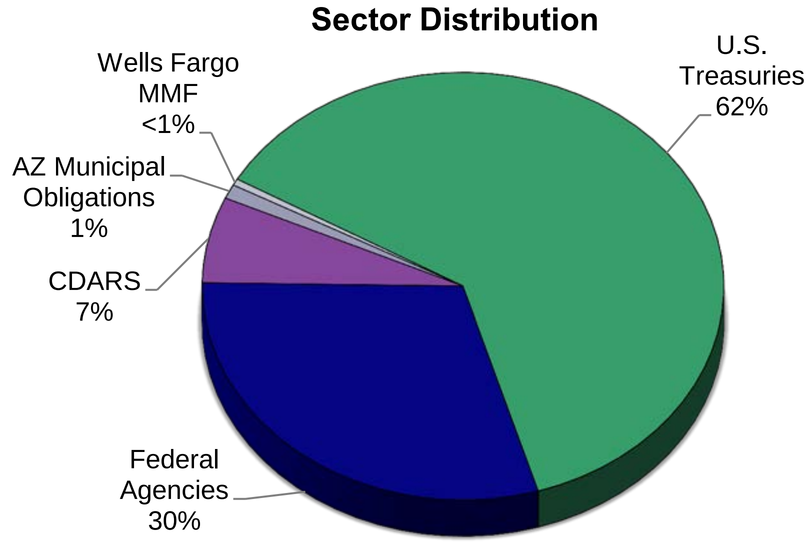
Volatility in Treasury Yields

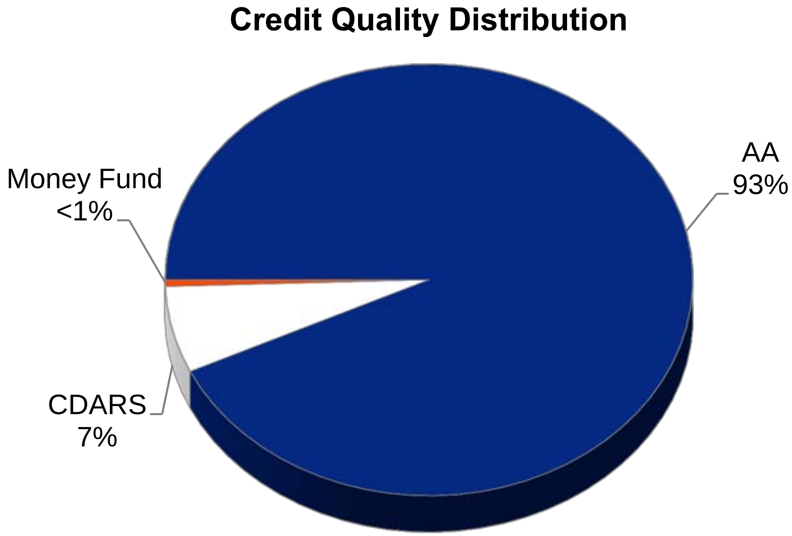


Source: Bloomberg.

Portfolio Summary and Characteristics

Security Type[1]	June 30, 2015	Current Quarter % of Portfolio	Previous Quarter % of Portfolio
U.S. Treasury	**$48,163,118.39**	**62%**	67%
Federal Agency	**$23,217,607.32**	**30%**	26%
Callable Federal Agency	$1,487,763.59	2%	4%
Non-callable Federal Agency	$21,729,843.73	28%	22%
CDARS[2]	**$5,055,716.29**	**7%**	6%
AZ Municipals	**$845,000.00**	**1%**	1%
Wells Fargo MMF	**$387,517.58**	**<1%**	<1%
Total Market Value	**$77,668,959.58**	**100%**	100%





Ratings by Standard & Poor's

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.

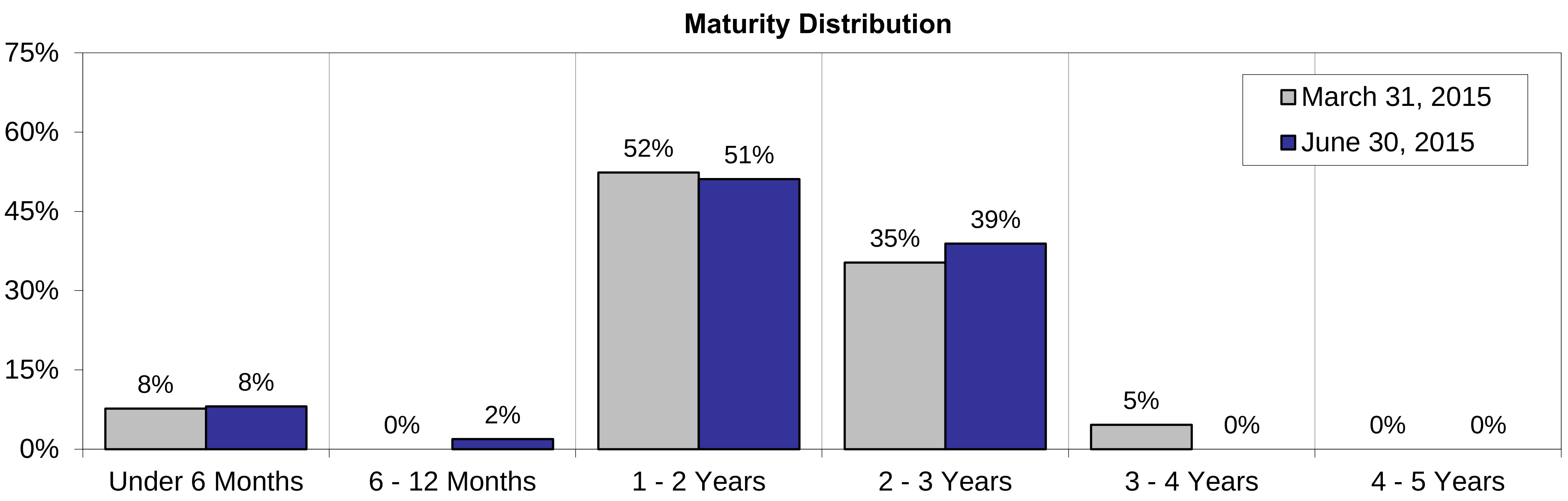
[2] CDARS: FDIC-insured time certificate of deposit program through Alliance Bank of AZ. CDARS funds are managed internally by the City and are not included in the PFM-managed portfolio or performance data. Value includes principal and interest tat maturity.

Maturity Summary and Key Portfolio Statistics

Maturity Distribution		
Maturity Class	**Fair Value[3]**	**% of Portfolio**
Under 6 Months	$6,288,233.87	8%
6 - 12 Months	$1,470,389.90	2%
1 - 2 Years	$39,709,466.32	51%
2 - 3 Years	$30,200,869.49	39%
3 - 4 Years	$0.00	0%
4 - 5 Years	$0.00	0%
Total Market Value	**$77,668,959.58**	**100%**

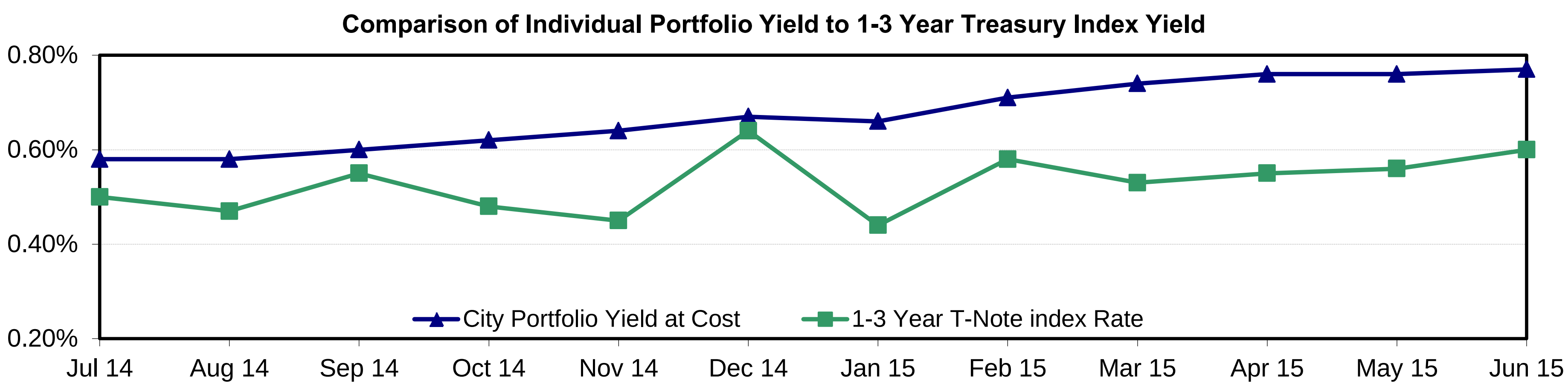
Key Portfolio Statistics	
Effective Duration[1]	1.77 years
Benchmark Duration[2]	1.80 years
Yield at Cost	0.77%

1. Portfolio statistics excludes funds invested in CDARS. Duration to worst as of 6/30/2015 was 1.76.
2. The City's benchmark is the Bank of America /Merrill Lynch 1-3 Year U.S. Treasury Index.
3. Security market values excluding accrued interest as of trade date. Note that PFM monthly statements reflect holdings as of trade date.



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]
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%
Oct-14	$72,142,335	1.70	0.62%	0.48%
Nov-14	$72,289,236	1.71	0.64%	0.45%
Dec-14	$72,133,418	1.77	0.67%	0.64%
Jan-15	$72,482,467	1.69	0.66%	0.44%
Feb-15	$72,239,444	1.76	0.71%	0.58%
Mar-15	$72,418,741	1.80	0.74%	0.53%
Apr-15	$72,490,092	1.86	0.76%	0.55%
May-15	$72,605,214	1.78	0.76%	0.56%
Jun-15	$72,613,243	1.77	0.77%	0.60%



[1] *Excludes accrued interest, CDARS. Includes balance in the custody account MMF.*

[2] *Excludes CDARS and custody money market fund.*

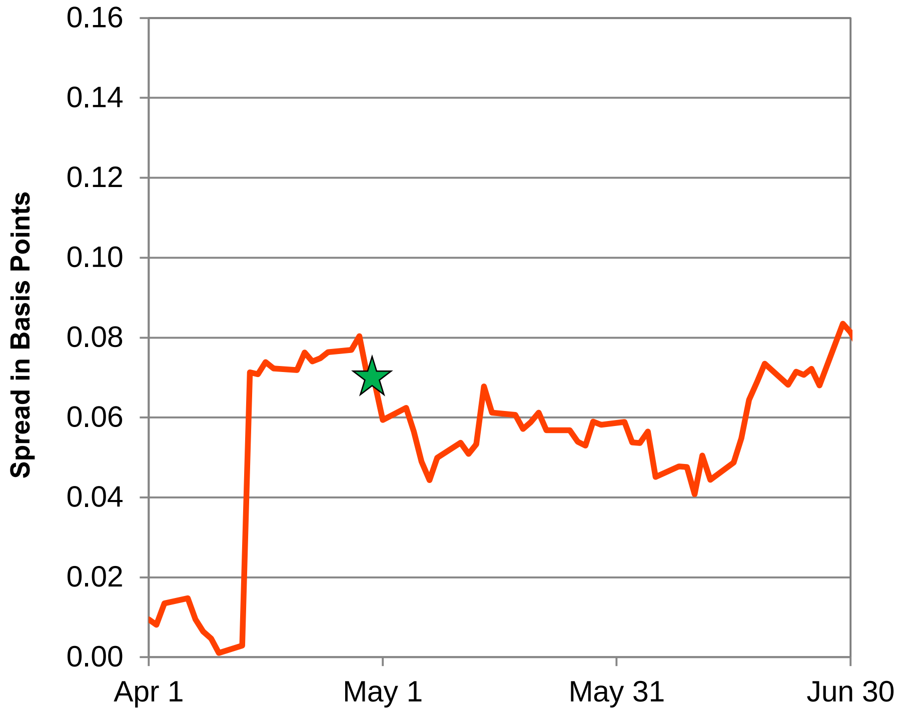
[3] *Rate represents the BoA/Merrill Lynch 1-3 Year U.S. Treasury Note Index month-end yield. Source: Bloomberg.*

Significant Spread Movement During the Quarter

- The yield difference (spread) between Treasuries and Agencies varies by maturity, which influences our sector choice when extending the portfolio's duration.

2-Year Treasury-Agency Spread
April 1, 2015 – June 30, 2015

3-Year Treasury-Agency Spread
April 1, 2015 – June 30, 2015



Source: Bloomberg.

Extension Trades Capitalize on Relative Sector Value

- When spreads are relatively compressed, we purchase Treasury securities to pick up yield and duration.
- These trades extended duration by about 1.71 years and picked-up +0.55% in yield.

Trade Date	Trade Type	Security	Maturity	Par Value	Yield
4/29/15	**Buy**	**U.S. Treasury Notes**	**3/31/18**	**$3,200,000**	**0.90%**
4/29/15	Sell	U.S. Treasury Notes	4/30/16	$2,350,000	0.28%
6/1/15	**Buy**	**U.S. Treasury Notes**	**11/30/17**	**$3,280,000**	**0.79%**
6/1/15	Sell	U.S. Treasury Notes	5/31/16	$3,280,000	0.30%

- When spreads are wide, Agency securities provide more value. The purchases below extended the duration by less than one year and added +0.32% in yield.

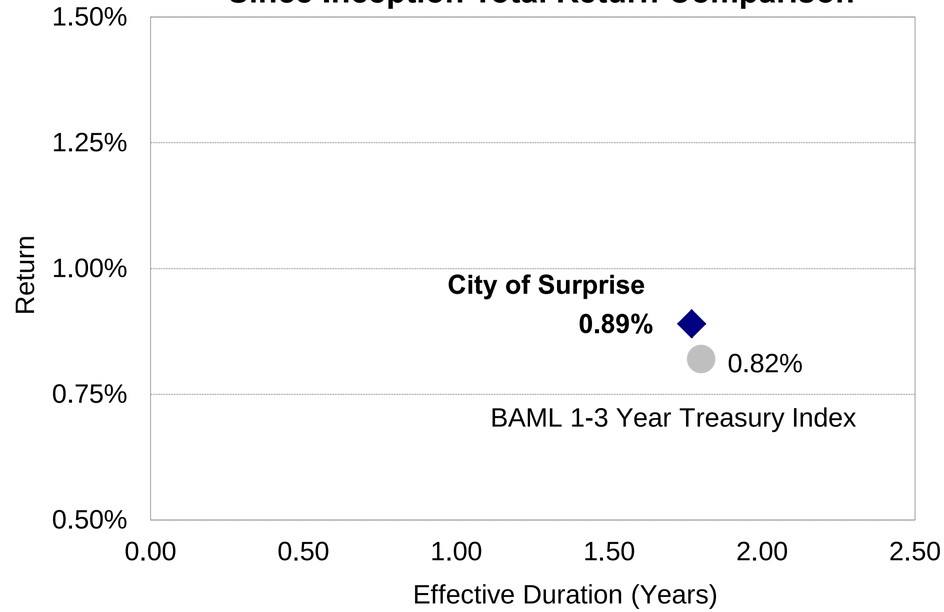
Trade Date	Trade Type	Security	Maturity	Par Value	Yield
4/29/15	**Buy**	**FNMA Notes**	**9/27/17**	**$3,075,000**	**0.80%**
4/29/15	Sell	U.S. Treasury Notes	4/30/16	$2,150,000	0.28%
5/14/15	**Buy**	**FHLB Global Notes**	**5/30/17**	**$1,900,000**	**0.67%**
5/14/15	Sell	U.S. Treasury Notes	5/31/17	$1,900,000	0.61%

Portfolio Performance

Total Return[1,2,3,4,5]	Quarter Ended June 30, 2015	Past 1 Year	Past 2 Years	Past 3 Years	Since Inception
City of Surprise	**0.13%**	**0.85%**	**0.79%**	**0.65%**	**0.89%**
BAML1-3 Year UST Index	0.15%	0.88%	0.82%	0.66%	0.82%
Effective Duration[4]	**June 30, 2015**	**March 31, 2015**	**Yields**	**June 30, 2015**	**March 31, 2015**
City of Surprise	**1.77**	**1.78**	Yield at Market	**0.65%**	**0.59%**
BAML 1-3 Year UST Index	1.80	1.79	Yield on Cost	**0.77%**	**0.74%**

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. Bank of America Merrill Lynch (BAML) 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.

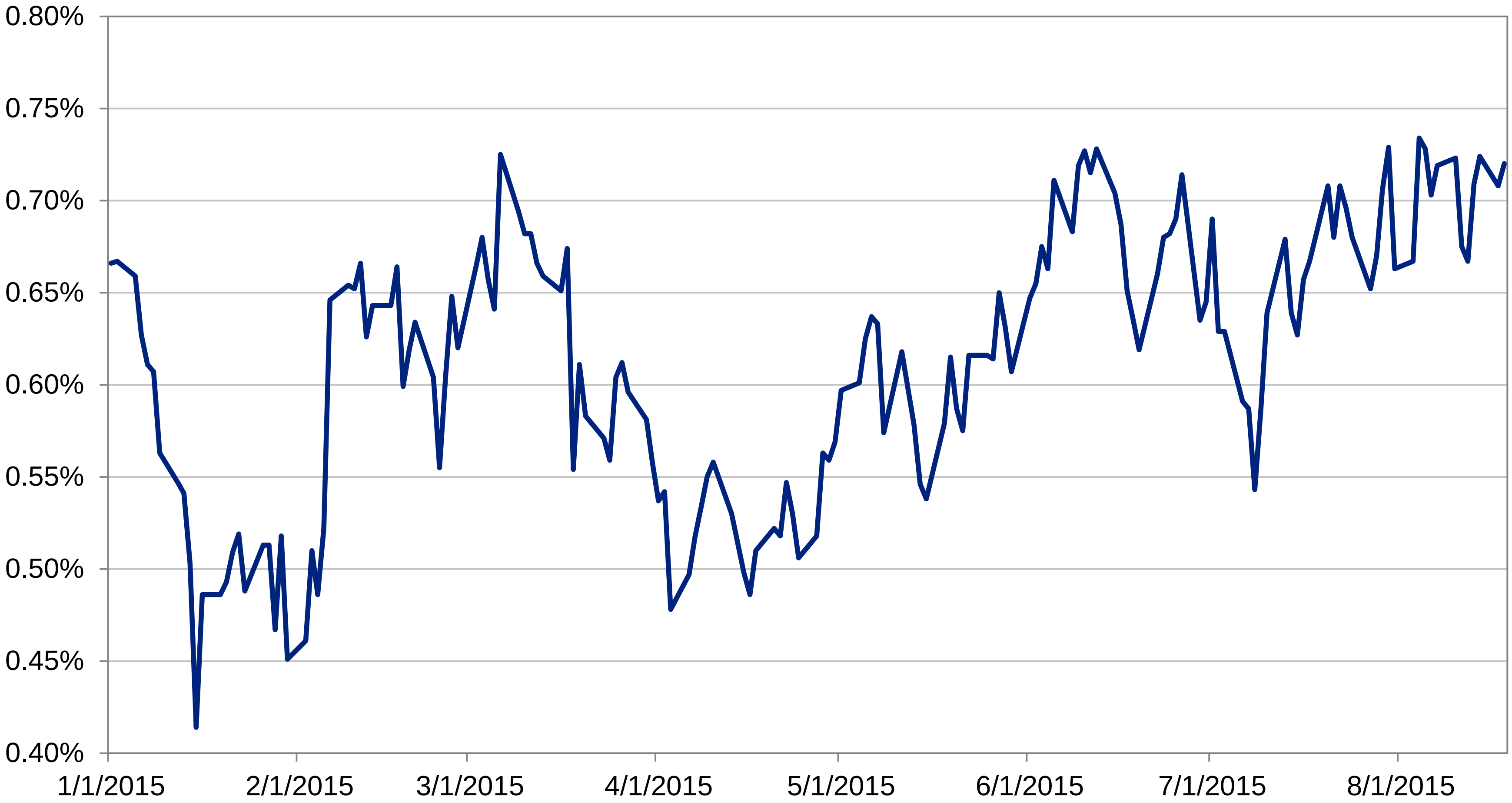
Third Quarter 2015 Strategy

- We expect U.S. economic conditions to rebound from the first quarter 2015 contraction due to:
  - Rising consumer confidence;
  - Growth in personal spending; and
  - A stronger housing sector.
- Stubbornly low inflation remains a concern for policy makers. Market participants still expect the FOMC to initiate at least one rate hike in 2015, but the pace of subsequent increases is likely to be gradual.
- It is likely that developments in Europe and Asia will continue to cause market volatility as investors weigh the impact of possible outcomes on global economic conditions.
- Recovering U.S. economic conditions, heightened geopolitical uncertainty, and expectations that the FOMC will tighten monetary policy slowly should keep rates in their current ranges in the coming months, with a modest bias towards slightly higher levels.
  - Based on this expectation, we will maintain the portfolio's duration near the benchmark duration.
- Federal Agency securities with maturities less than three years continue to offer little incremental yield over comparable maturity Treasury securities. For this reason, we may hold or add to Treasury holdings in this maturity range. We will monitor the spread relationship and shift assets into Federal Agencies if the yield difference widens sufficiently.

Economic Update

Volatility in Treasury Yields

2-Year Treasury Yields
January 1, 2015 to August 18, 2015

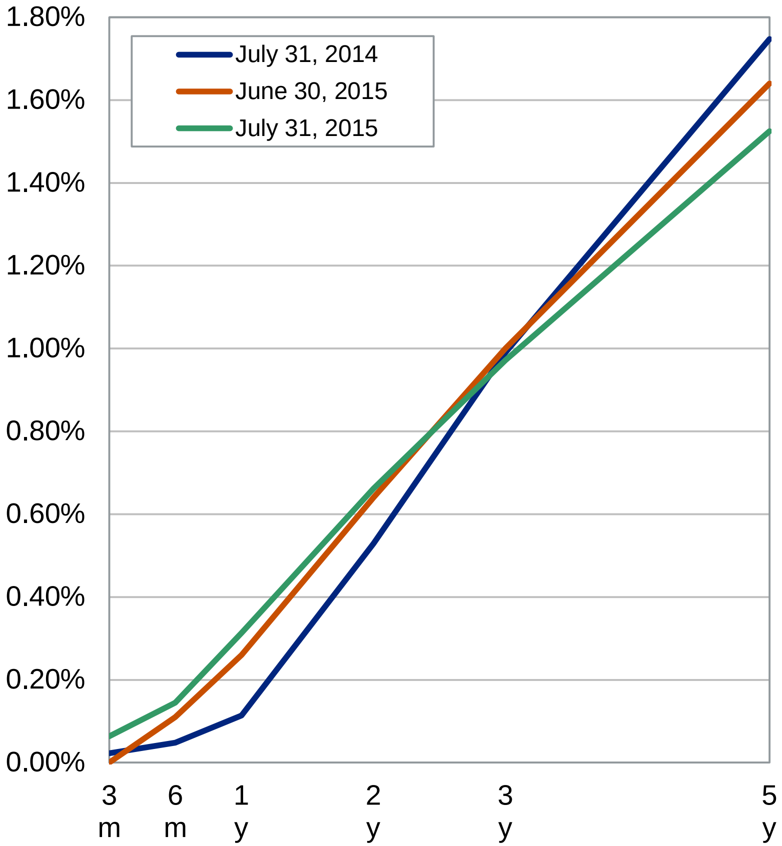


Source: Bloomberg.

Yield Curve Flattens

- Yields flattened slightly as longer-term Treasuries fell and short-term Treasuries rose slightly in anticipation of a rate hike by the Federal Reserve.

U.S. Treasury Yield Curves

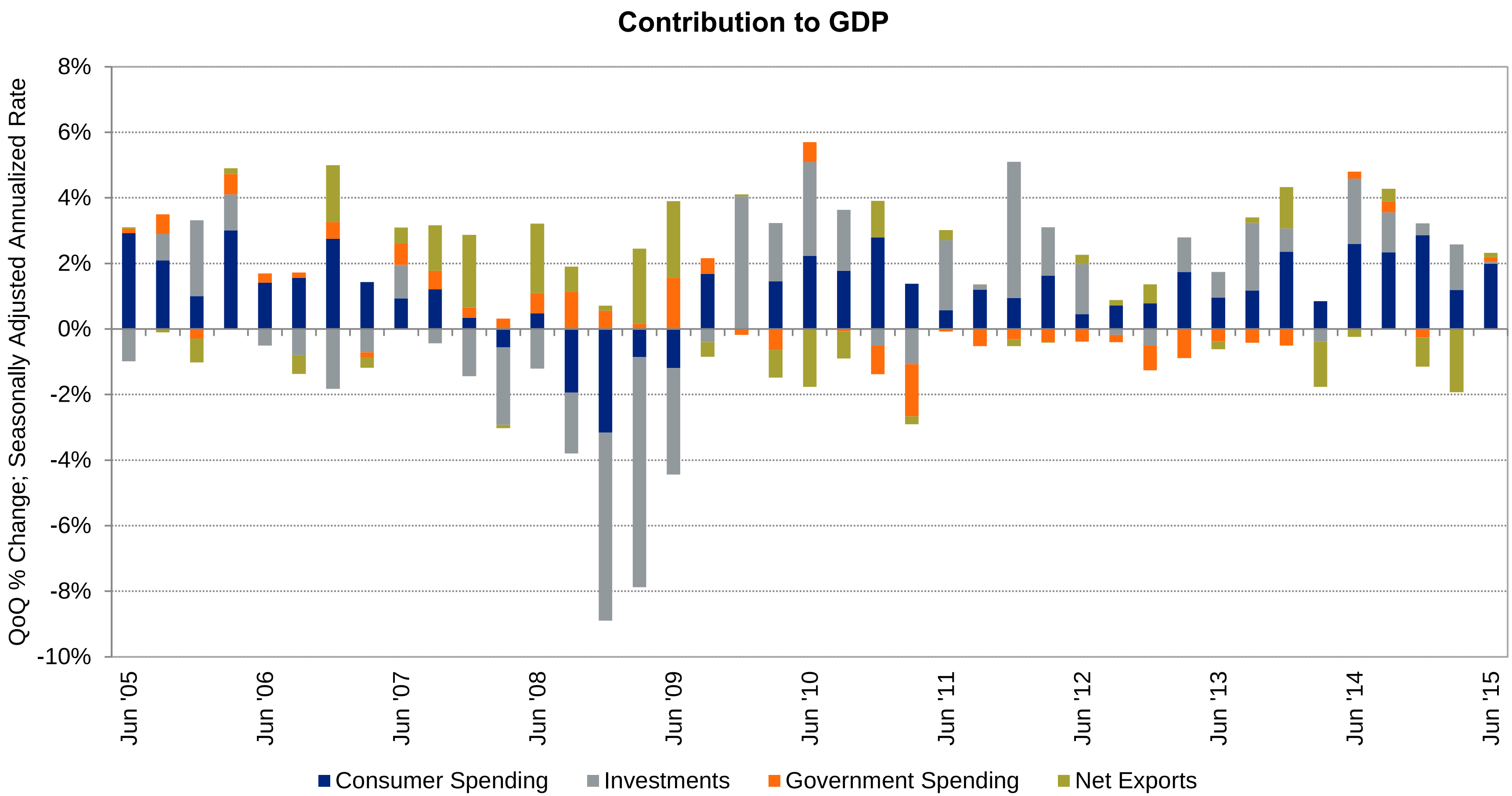


3-Year and 1-Year U.S. Treasury Yield
August 18, 2014 – August 17, 2015

Source: Bloomberg.

U.S. GDP Grew in the Second Quarter

- U.S. GDP grew at an estimated 2.3% in the second quarter.
- The upturn was boosted by higher consumer spending and a strengthening housing market.



Source: Bureau Of Economic Analysis.

August Economic Data

- "The labor market continued to improve, with solid job gains and declining unemployment. A range of labor market indicators suggests that underutilization of labor resources has diminished since early this year." (from July FOMC statement)
- The unemployment rate is approaching the 5- to 5.2 percent range the Fed policy makers have defined as full employment.

1) Calendars 2) Settings 3) Alerts 4) Export Economic Calendars
<Enter a region> 6) Browse 11:16:49 08/05/15 - 08/17/15
(Custom) (Custom) US ECO MKT MONITOR View Agenda Weekly

	Date Time	C	Event	Period	Surv(M)	Actual	Prior	Revised
21)	08/05 07:00	US	MBA Mortgage Applications	Jul 31	--	4.7%	0.8%	--
22)	08/05 08:15	US	ADP Employment Change	Jul	215K	185K	237K	229K
23)	08/05 08:30	US	Trade Balance	Jun	-$43.00B	-$43.84B	-$41.87B	-$40.94B
24)	08/05 09:45	US	Markit US Composite PMI	Jul F	--	55.7	55.2	--
25)	08/05 09:45	US	Markit US Services PMI	Jul F	55.2	55.7	55.2	--
26)	08/05 10:00	US	ISM Non-Manf. Composite	Jul	56.2	60.3	56.0	--
27)	08/06 08:30	US	Initial Jobless Claims	Aug 1	272K	270K	267K	--
28)	08/06 08:30	US	Continuing Claims	Jul 25	2249K	[illegible]	2262K	2269K
29)	08/07 08:30	US	Change in Nonfarm Payrolls	Jul	225K	215K	223K	231K
30)	08/07 08:30	US	Change in Private Payrolls	Jul	212K	210K	223K	227K
31)	08/07 08:30	US	Change in Manufact. Payrolls	Jul	5K	15K	4K	2K
32)	08/07 08:30	US	Unemployment Rate	Jul	5.3%	5.3%	5.3%	--
33)	08/07 08:30	US	Average Hourly Earnings MoM	Jul	0.2%	0.2%	0.0%	--
34)	08/07 08:30	US	Average Hourly Earnings YoY	Jul	2.3%	2.1%	2.0%	--
35)	08/07 08:30	US	Average Weekly Hours All Em	Jul	34.5	34.6	34.5	--
36)	08/07 08:30	US	Underemployment Rate	Jul	10.5%	10.4%	10.5%	--
37)	08/07 08:30	US	Labor Force Participation Rat	Jul	62.6%	62.6%	62.6%	--
38)	08/07 15:00	US	Consumer Credit	Jun	$17.000B	$20.[illegible]B	$16.086B	$16.519B
39)	08/11 06:00	US	NFIB Small Business Optimis	Jul	95.5	--	94.1	--

Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2015 Bloomberg Finance L.P.
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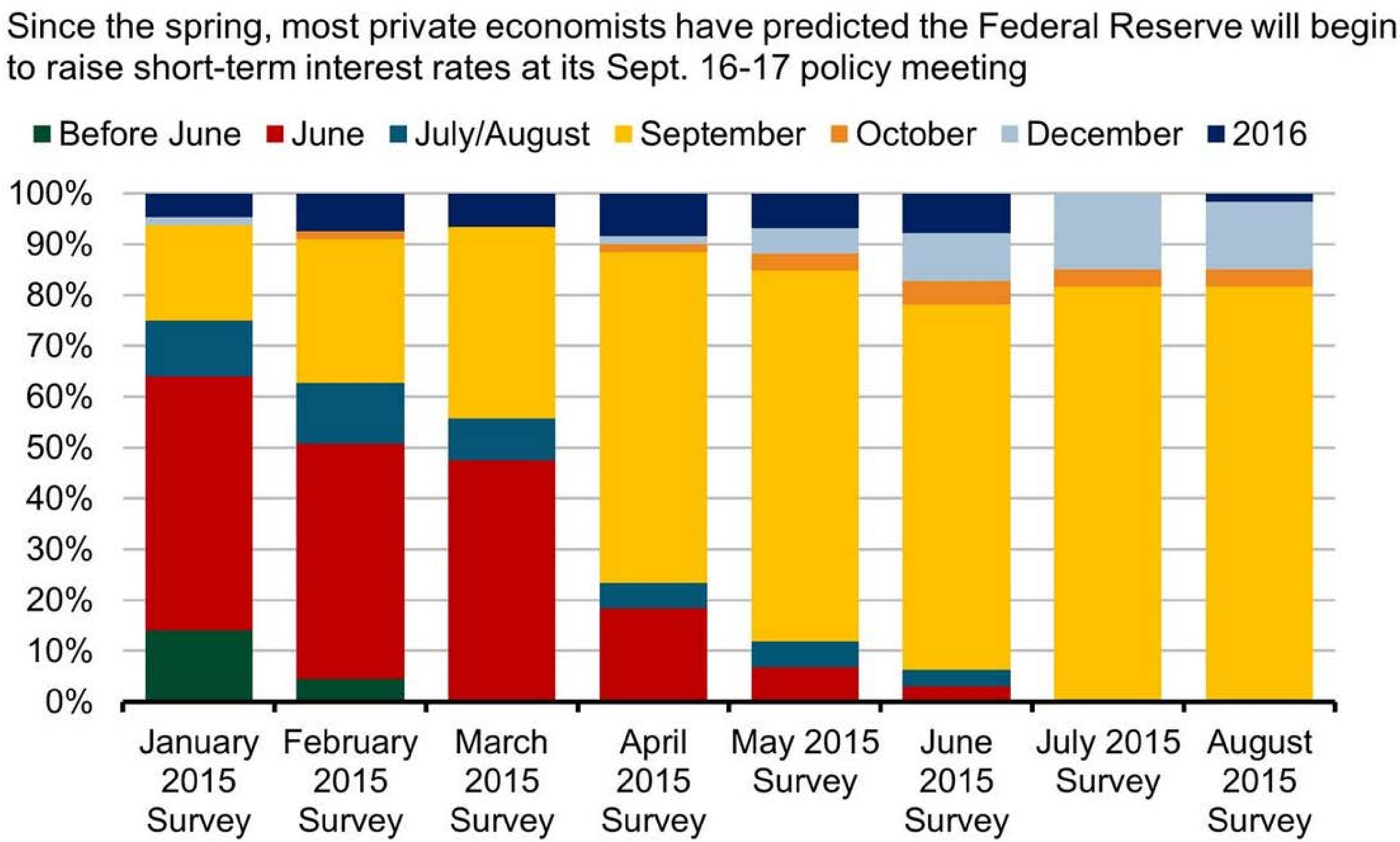
Source: Federal Reserve. Bloomberg.

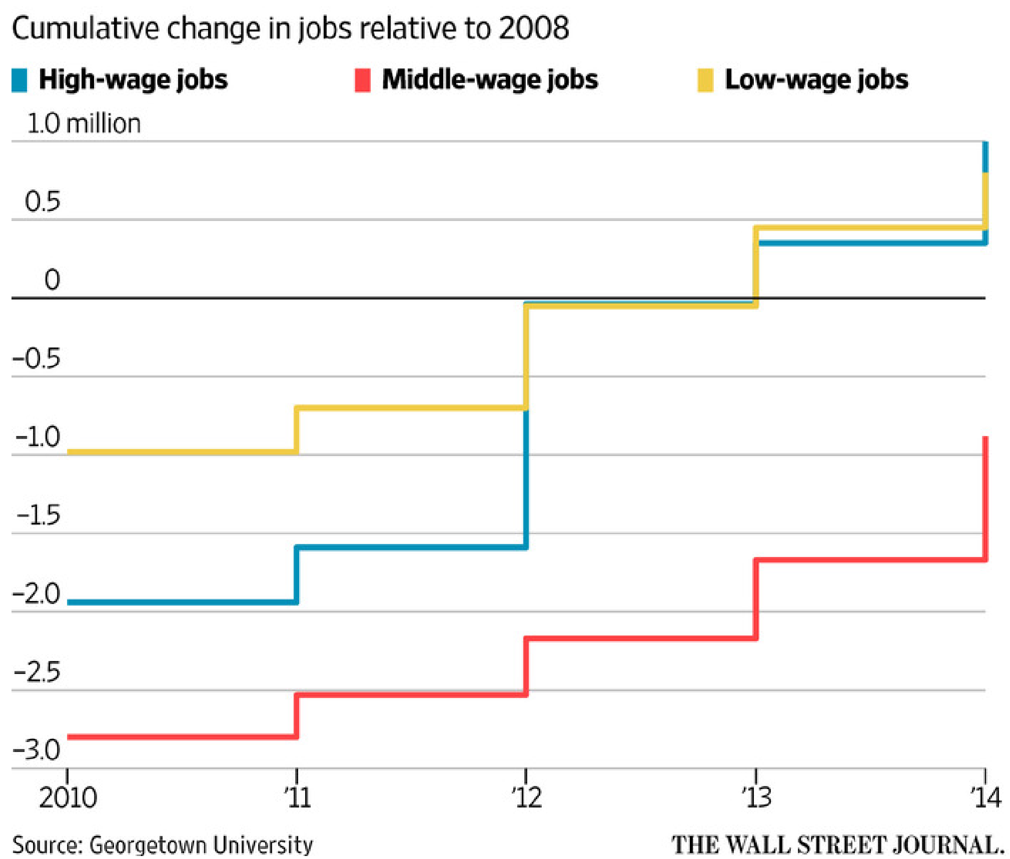
When Will Rate Hikes Begin?



Source: The Wall Street Journal. Survey of economists August 7-11, 2015.

Post Recession Growth in High- and Low- Wage Jobs

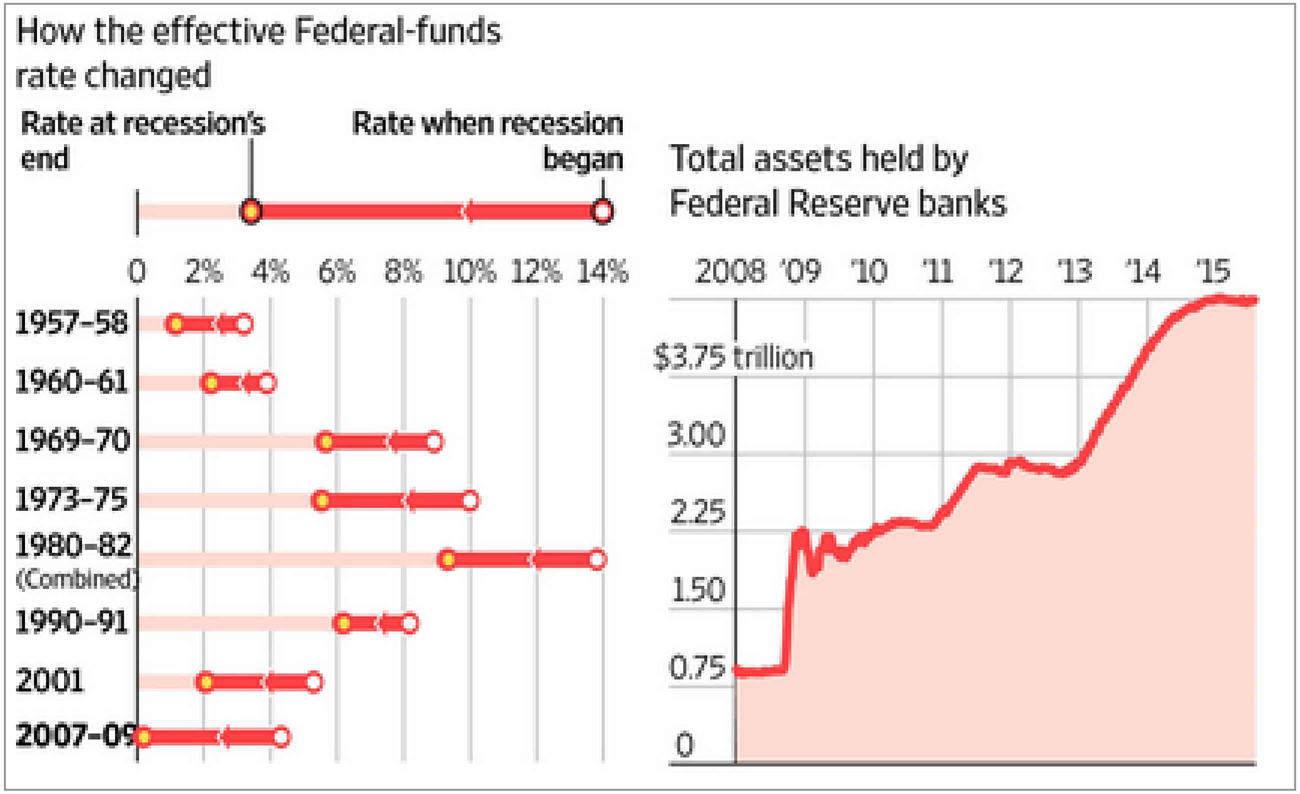
- The U.S. economy has added:
  - 1 million jobs in the top third of income; and,
  - 800,000 jobs in the bottom third.
- However, there are 900,000 fewer workers in middle-wage occupations.
- Well-paying jobs tend to go to those who graduated college.
- Middle-skilled jobs once provided a stable living for those with less education, but have now been replaced with low-wage work.



Source: The Wall Street Journal.

Limited Tools to Handle Next Recession

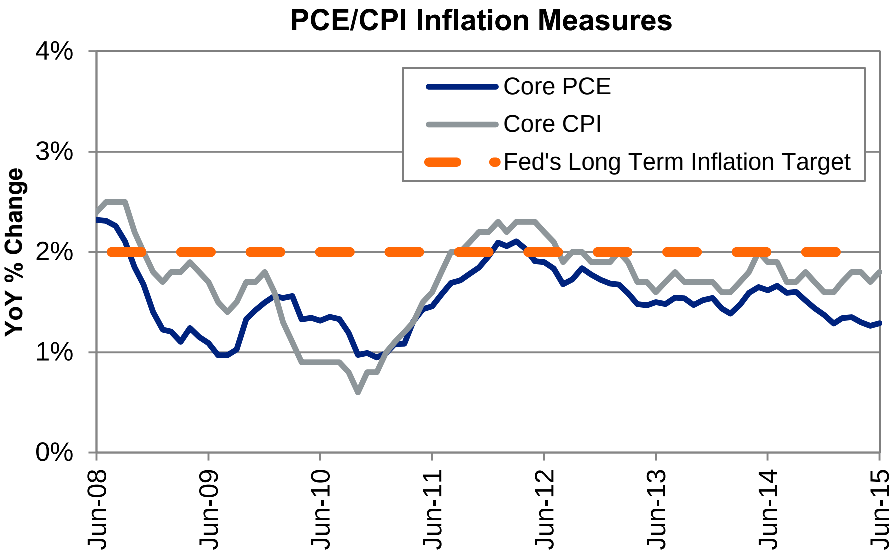
- During the past economic downturns, the government has injected cash into the economy by:
  - Cutting interest rates;
  - Cutting taxes;
  - Increasing federal spending.
- However, these may not be viable options the next time, as interest rates are near zero and the government's debt is at a historic high.

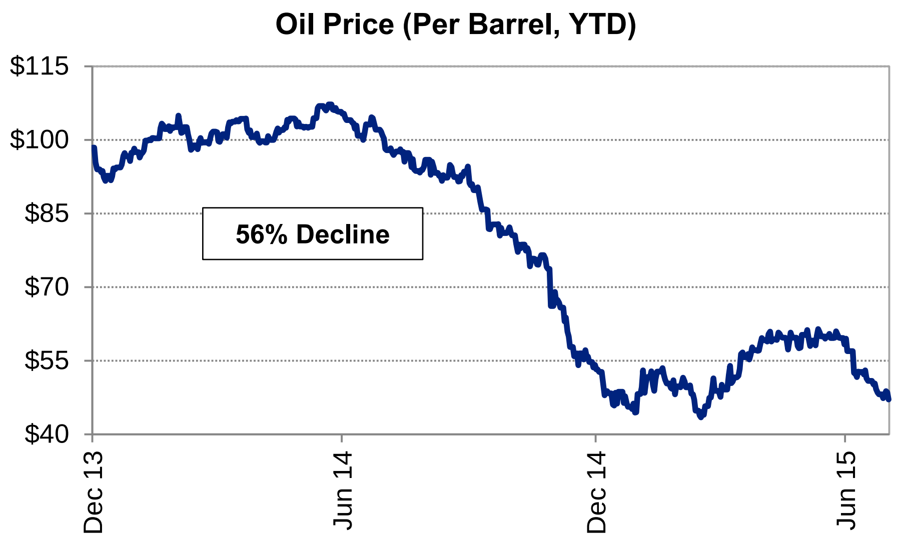


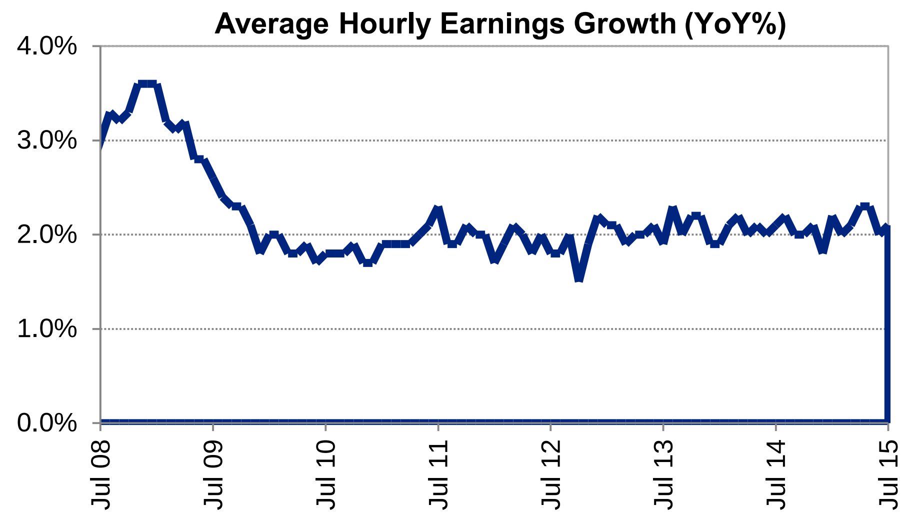
Source: The Wall Street Journal.

Deflationary Threats

- The Fed's desire for a 2% inflation rate is being threatened by:
  - Falling energy prices;
  - Lack of wage pressure;
  - Stronger U.S. dollar.







Source: Bloomberg.

Devaluation of China's Currency

- China's central bank controls the value of its currency by pegging the value of the yuan to the U.S. dollar.
- On August 21, the People's Bank of China unexpectedly dropped the currency rate, stating that the yuan needed to be brought more in line with market-based movements.
- This intentional devaluation occurred following reports of sluggish economic growth in China. Since a weaker currency will boost exports, this may spur Chinese growth.

Source: Bloomberg.

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