



# City of Surprise

## Quarterly Performance Review

### Third Quarter Ended September 30, 2015



Paulina Woo, Senior Managing Consultant  
woop@pfm.com  
1820 East Ray Road  
Chandler, AZ 85225  
855-885-9621



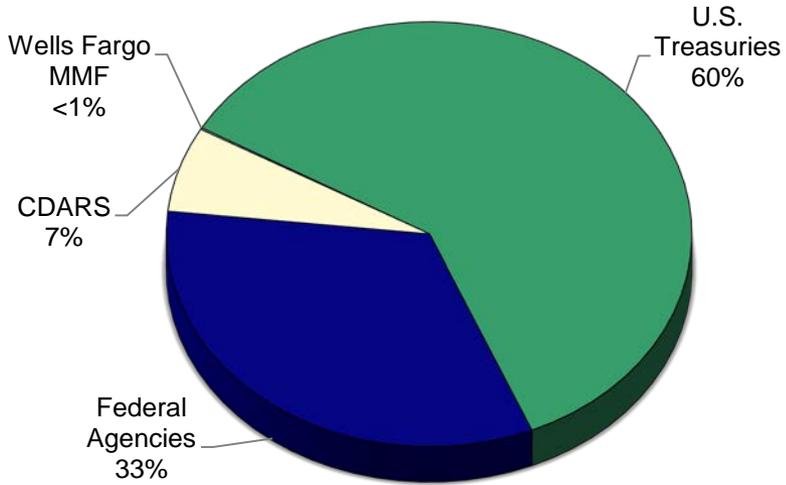
# Third Quarter 2015 Strategy and Recap

- Treasury yields fluctuated in response to evolving economic conditions, tracking:
  - Strength of global economy,
  - Slowdown in China and emerging market economies,
  - Persistent low inflation environment, and
  - Expectations for a Fed rate hike.
- Low inflation and tepid economic data, both in the U.S. and abroad, pushed longer-term yields lower. Yields on securities with maturities of two years or less, the part of the curve that is most dependent on Federal Reserve policy, moved up in advance of the September FOMC meeting, but quickly reversed after the “no hike” decision.
- The end result was that the quarter ended with generally lower yields and a flatter yield curve than at the beginning of the quarter.
- During the third quarter PFMAM moved the portfolio’s duration to be modestly shorter than its benchmark in anticipation of a Fed rate hike sometime before the end of this year. A shorter duration is more conservative and helps mitigate the impact that rising rates have on portfolio market values.

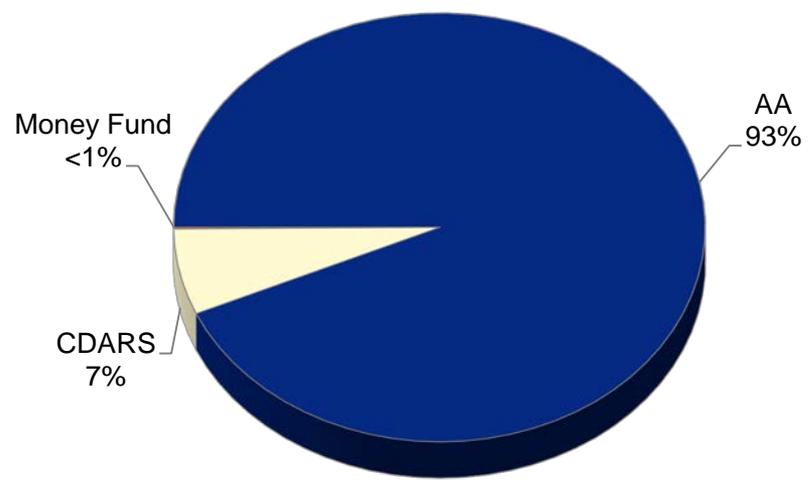
# Portfolio Summary and Characteristics

Security Type <sup>1</sup>	September 30, 2015	Current Quarter % of Portfolio	Previous Quarter % of Portfolio
<b>U.S. Treasury</b>	<b>\$46,965,558.39</b>	<b>60%</b>	62%
<b>Federal Agency</b>	<b>\$25,745,378.99</b>	<b>33%</b>	30%
Non-callable Federal Agency	\$21,749,244.56	28%	28%
Callable Federal Agency	\$3,996,134.43	5%	2%
<b>CDARS<sup>2</sup></b>	<b>\$5,059,662.67</b>	<b>7%</b>	7%
<b>AZ Municipals</b>	<b>\$0.00</b>	<b>0%</b>	1%
<b>Wells Fargo MMF</b>	<b>\$95,895.41</b>	<b>&lt;1%</b>	<1%
<b>Total Market Value</b>	<b>\$77,866,495.46</b>	<b>100%</b>	100%

**Sector Distribution**



**Credit Quality Distribution**



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 at maturity.

# Maturity Summary and Key Portfolio Statistics

## Maturity Distribution

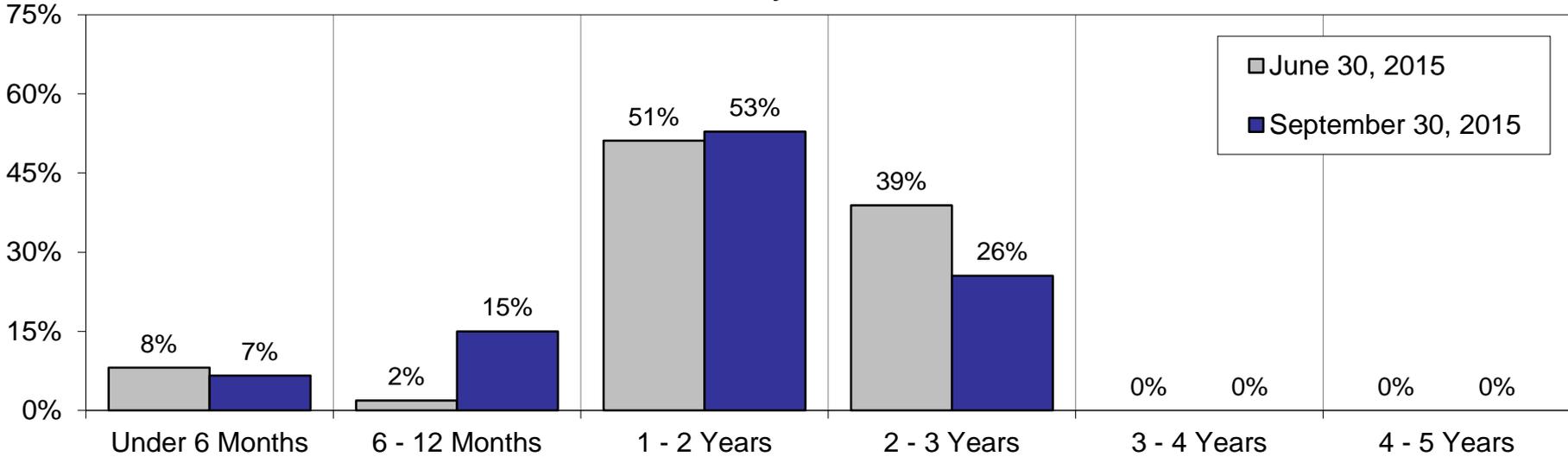
<u>Maturity Class</u>	<u>Fair Value<sup>3</sup></u>	<u>% of Portfolio</u>
Under 6 Months	\$5,155,558.08	7%
6 - 12 Months	\$11,678,599.56	15%
1 - 2 Years	\$41,146,107.73	53%
2 - 3 Years	\$19,886,230.09	26%
3 - 4 Years	\$0.00	0%
4 - 5 Years	\$0.00	0%
<b>Total Market Value</b>	<b>\$77,866,495.46</b>	<b>100%</b>

## Key Portfolio Statistics

<b>Effective Duration<sup>1</sup></b>	<b>1.60 years</b>
<b>Benchmark Duration<sup>2</sup></b>	<b>1.79 years</b>
<b>Yield at Cost</b>	<b>0.79%</b>

1. Portfolio statistics excludes funds invested in CDARS. Duration to worst as of 9/30/2015 was 1.58.
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.

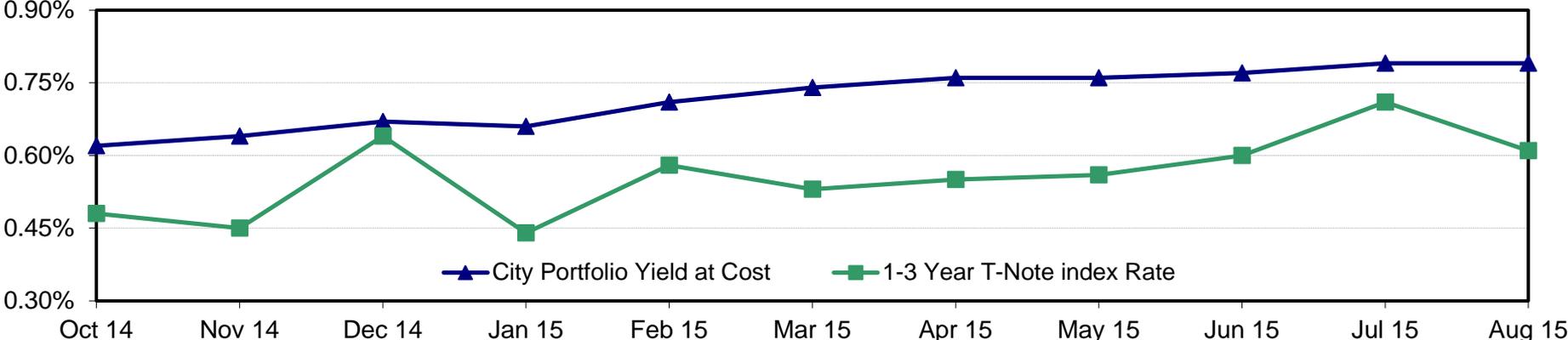
## Maturity Distribution



# 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>
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%
Jul-15	\$72,956,070	1.79	0.79%	0.71%
Aug-15	\$72,615,727	1.69	0.79%	0.61%
Sep-15	\$72,806,833	1.60	0.79%	0.71%

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 BofA/Merrill Lynch 1-3 Year U.S. Treasury Note Index month-end yield. Source: Bloomberg.

# Duration Extension Trade

- We prefer to invest in U.S. Treasury securities when spreads narrow as the City would not be compensated for the risk of investing in any non-Treasury security.
- Using the proceeds from the sale of a shorter maturing U.S. Treasury and a municipal security maturity, we invested further along the yield curve to extend the portfolio's duration and lock in yields near their 3-year highs.
- The Treasury was sold at a gain of approximately \$1,200, and the purchase will create incremental earnings of approximately \$7,800 over the coming months.

Trade Date	Trade Type	Security	Maturity	Par Value	Yield
7/2/15	Buy	U.S. Treasury Notes	7/31/18	\$2,650,000	1.11%
7/1/15	Maturity	Mesa, AZ GO Bonds	7/1/15	\$845,000	-
7/2/15	Sell	U.S. Treasury Notes	4/30/16	\$1,450,000	0.29%

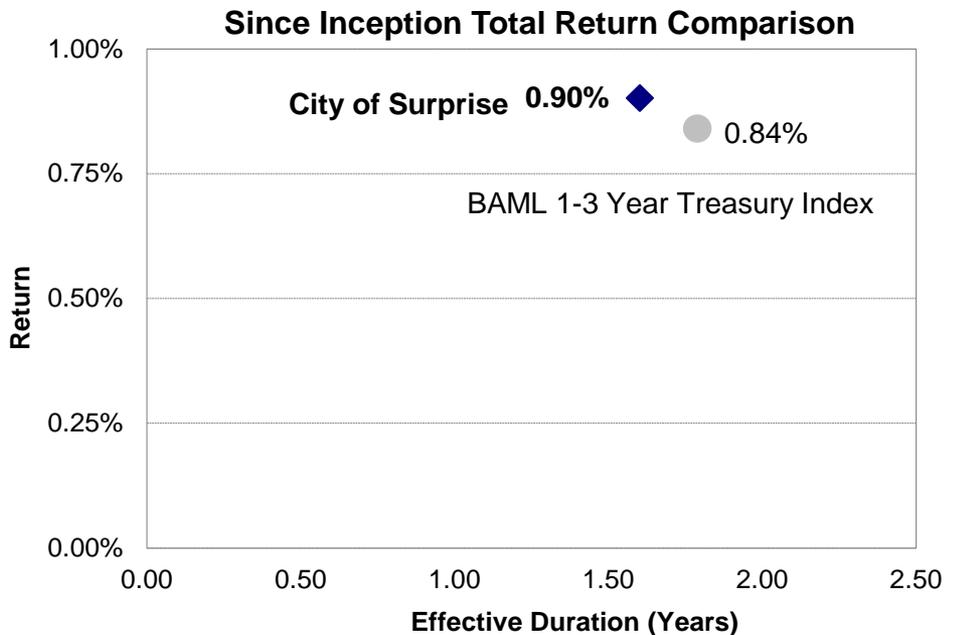
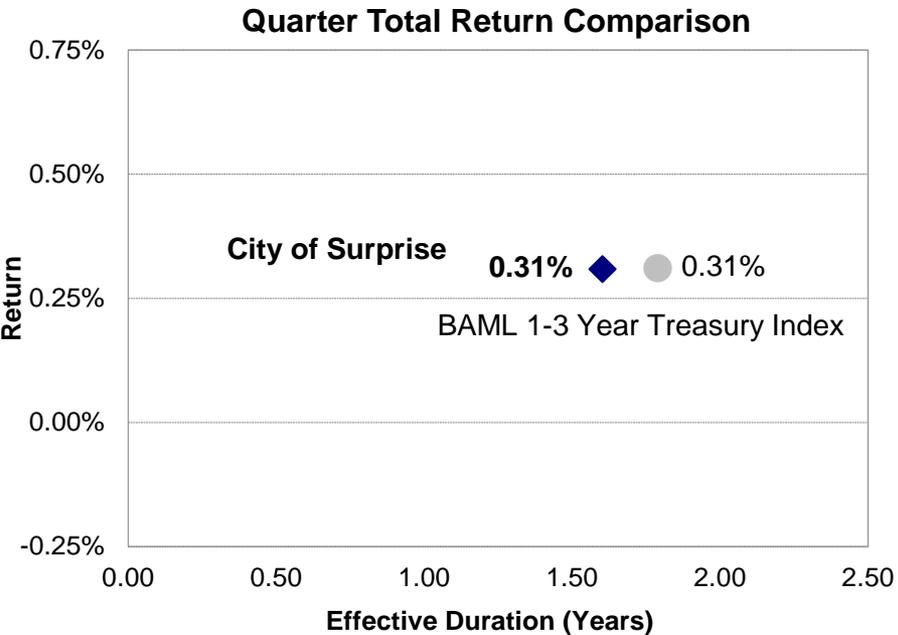
# Value in Callable Agency

- We sold existing U.S. Treasury holdings to purchase a callable security from FHLB. The Agency note is callable in 1 year, one time only, and has a similar maturity to the Treasury notes so the portfolio's duration will remain stable.
- The transactions will generate incremental earnings of more than \$6,600 over the coming year. The sale resulted in a realized gain of \$12,200.

Trade Date	Trade Type	Security	Maturity	Par Value	Yield
7/29/15	Buy	FHLB Notes (Callable)	8/25/17	\$2,500,000	0.91%
7/29/15	Sell	U.S. Treasury Notes	1/31/17	\$160,000	0.55%
7/29/15	Sell	U.S. Treasury Notes	3/31/17	\$2,050,000	0.60%

# Portfolio Performance

Total Return <sup>1,2,3,4,5</sup>	Quarter Ended September 30, 2015	Past 1 Year	Past 2 Years	Past 3 Years	Since Inception
<b>City of Surprise</b>	<b>0.31%</b>	<b>1.09%</b>	<b>0.80%</b>	<b>0.66%</b>	<b>0.90%</b>
BAML1-3 Year UST Index	0.31%	1.16%	0.83%	0.67%	0.84%
Effective Duration <sup>4</sup>	September 30, 2015	June 30, 2015	Yields	September 30, 2015	June 30, 2015
<b>City of Surprise</b>	<b>1.60</b>	<b>1.77</b>	Yield at Market	<b>0.59%</b>	<b>0.65%</b>
BAML 1-3 Year UST Index	1.79	1.80	Yield on Cost	<b>0.79%</b>	<b>0.77%</b>



1. Performance on tradedate 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.

# Fourth Quarter 2015 Strategy

- We expect the U.S. economy to continue to expand, but at a slightly slower pace.
- The FOMC continues to monitor economic progress towards its dual objectives of full employment and price stability. It recently added an acknowledgement that global economic instability has the potential to affect Fed policy.
- We started the quarter with the portfolio's duration generally shorter and more conservative than the benchmark's as the potential for a Fed rate hike over the next few months remains strong.
- We will continue to monitor the spread relationship between Treasuries and comparable maturity Federal Agencies, adding to the Agency sector when attractive issues are identified, and reducing exposure when the benefit diminishes.
- We will execute the one-time purchase of the City's 2007 Debt Service Reserve fund proceeds.



## Managed Account Detail of Securities Held

For the Month Ending **September 30, 2015**

### 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 06/30/2009 3.250% 06/30/2016	912828KZ2	1,640,000.00	AA+	Aaa	05/23/13	05/28/13	1,781,642.19	0.43	13,469.84	1,674,410.78	1,675,938.96
US TREASURY NOTES DTD 08/01/2011 1.500% 07/31/2016	912828QX1	1,925,000.00	AA+	Aaa	02/04/14	02/07/14	1,973,500.98	0.48	4,864.81	1,941,319.13	1,943,347.18
US TREASURY NOTES 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	8,642.93	3,449,371.13	3,452,596.02
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	1,728.85	2,032,567.79	2,041,339.58
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	2,609,927.71	2,616,655.60
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	3,435,818.22	3,441,908.52
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	2,366,041.11	2,371,720.89
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	3,690,543.60	3,696,188.40
US TREASURY NOTES DTD 03/31/2012 1.000% 03/31/2017	912828SM3	730,000.00	AA+	Aaa	03/24/14	03/25/14	730,912.50	0.96	19.95	730,456.35	735,323.16
US TREASURY NOTES DTD 05/31/2012 0.625% 05/31/2017	912828SY7	485,000.00	AA+	Aaa	06/02/14	06/05/14	481,892.97	0.84	1,018.70	483,259.49	485,359.87
US TREASURY NOTES DTD 07/02/2012 0.750% 06/30/2017	912828TB6	1,500,000.00	AA+	Aaa	11/03/14	11/04/14	1,497,246.09	0.82	2,843.07	1,498,182.72	1,504,120.50
US TREASURY NOTES DTD 07/02/2012 0.750% 06/30/2017	912828TB6	1,785,000.00	AA+	Aaa	12/09/14	12/10/14	1,779,142.97	0.88	3,383.25	1,780,985.23	1,789,903.40
US TREASURY NOTES DTD 07/02/2012 0.750% 06/30/2017	912828TB6	2,000,000.00	AA+	Aaa	12/04/14	12/05/14	1,995,625.00	0.84	3,790.76	1,997,017.84	2,005,494.00
US TREASURY NOTES DTD 08/31/2012 0.625% 08/31/2017	912828TM2	1,500,000.00	AA+	Aaa	02/27/15	03/02/15	1,490,625.00	0.88	798.42	1,492,786.13	1,499,941.50



## Managed Account Detail of Securities Held

For the Month Ending **September 30, 2015**

### 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 11/30/2012 0.625% 11/30/2017	912828UA6	1,275,000.00	AA+	Aaa	11/03/14	11/04/14	1,259,660.16	1.02	2,678.02	1,264,143.46	1,272,675.68
US TREASURY NOTES DTD 11/30/2010 2.250% 11/30/2017	912828PK0	2,100,000.00	AA+	Aaa	03/30/15	03/31/15	2,179,242.19	0.82	15,879.10	2,164,414.79	2,168,961.90
US TREASURY NOTES DTD 11/30/2012 0.625% 11/30/2017	912828UA6	3,280,000.00	AA+	Aaa	06/01/15	06/02/15	3,266,675.00	0.79	6,889.34	3,268,427.18	3,274,020.56
US TREASURY NOTES DTD 01/31/2013 0.875% 01/31/2018	912828UJ7	1,445,000.00	AA+	Aaa	12/30/14	12/31/14	1,431,735.35	1.18	2,130.20	1,434,931.79	1,448,837.92
US TREASURY NOTES DTD 04/01/2013 0.750% 03/31/2018	912828UU2	1,500,000.00	AA+	Aaa	02/27/15	03/02/15	1,484,765.63	1.09	30.74	1,487,609.51	1,497,852.00
US TREASURY NOTES DTD 04/01/2013 0.750% 03/31/2018	912828UU2	2,100,000.00	AA+	Aaa	03/30/15	03/31/15	2,088,515.63	0.94	43.03	2,090,417.83	2,096,992.80
US TREASURY NOTES DTD 04/01/2013 0.750% 03/31/2018	912828UU2	3,200,000.00	AA+	Aaa	04/29/15	04/30/15	3,186,625.00	0.90	65.57	3,188,535.33	3,195,417.60
US TREASURY NOTES DTD 08/01/2011 2.250% 07/31/2018	912828OY9	2,650,000.00	AA+	Aaa	07/02/15	07/06/15	2,744,716.80	1.06	10,045.52	2,737,495.13	2,750,962.35
<b>Security Type Sub-Total</b>		<b>46,495,000.00</b>					<b>47,272,982.44</b>	<b>0.77</b>	<b>158,133.55</b>	<b>46,818,662.25</b>	<b>46,965,558.39</b>
<b>Federal Agency Bond / Note</b>											
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	2,557,966.22	2,565,377.82
FHLB NOTES DTD 11/17/2014 0.625% 11/23/2016	3130A3J70	1,000,000.00	AA+	Aaa	02/04/15	02/05/15	1,001,230.00	0.56	2,222.22	1,000,784.14	1,001,476.00
FHLMC REFERENCE NOTE DTD 01/16/2015 0.500% 01/27/2017	3137EADU0	1,015,000.00	AA+	Aaa	01/15/15	01/16/15	1,013,223.75	0.59	902.22	1,013,841.28	1,014,805.12
FHLMC NOTES DTD 01/21/2014 0.875% 02/22/2017	3137EADT3	3,320,000.00	AA+	Aaa	10/08/14	10/09/14	3,326,540.40	0.79	3,147.08	3,323,859.04	3,335,584.08
FHLB GLOBAL NOTES (CALLABLE) DTD 03/24/2015 0.840% 03/24/2017	3130A4OV7	1,485,000.00	AA+	Aaa	03/17/15	03/24/15	1,485,000.00	0.84	242.55	1,485,000.00	1,489,016.93



**Managed Account Detail of Securities Held**

For the Month Ending **September 30, 2015**

**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 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	3,409,705.67	3,428,240.40
FHLB GLOBAL NOTES DTD 05/15/2015 0.625% 05/30/2017	3130A5EP0	1,900,000.00	AA+	Aaa	05/14/15	05/15/15	1,898,423.00	0.67	3,991.32	1,898,712.71	1,900,191.90
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	2,116,432.30	2,129,305.86
FHLB EX-CALLABLE NOTE DTD 08/25/2015 0.900% 08/25/2017	3130A64C8	2,500,000.00	AA+	Aaa	07/29/15	08/25/15	2,499,750.00	0.91	2,250.00	2,499,762.43	2,507,117.50
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	1,097,454.58	1,104,941.20
FNMA NOTES DTD 08/25/2014 1.000% 09/27/2017	3135G0ZL0	3,075,000.00	AA+	Aaa	04/29/15	04/30/15	3,089,852.25	0.80	341.67	3,087,289.61	3,088,812.90
FANNIE MAE GLOBAL NOTES DTD 10/30/2012 0.875% 12/20/2017	3135G0RT2	2,175,000.00	AA+	Aaa	02/04/15	02/05/15	2,170,780.50	0.94	5,339.32	2,171,736.28	2,180,509.28
<b>Security Type Sub-Total</b>		<b>25,630,000.00</b>					<b>25,698,190.60</b>	<b>0.83</b>	<b>38,887.45</b>	<b>25,662,544.26</b>	<b>25,745,378.99</b>
<b>Managed Account Sub-Total</b>		<b>72,125,000.00</b>					<b>72,971,173.04</b>	<b>0.79</b>	<b>197,021.00</b>	<b>72,481,206.51</b>	<b>72,710,937.38</b>
<b>Securities Sub-Total</b>		<b>\$72,125,000.00</b>					<b>\$72,971,173.04</b>	<b>0.79%</b>	<b>\$197,021.00</b>	<b>\$72,481,206.51</b>	<b>\$72,710,937.38</b>
<b>Accrued Interest</b>											<b>\$197,021.00</b>
<b>Total Investments</b>											<b>\$72,907,958.38</b>



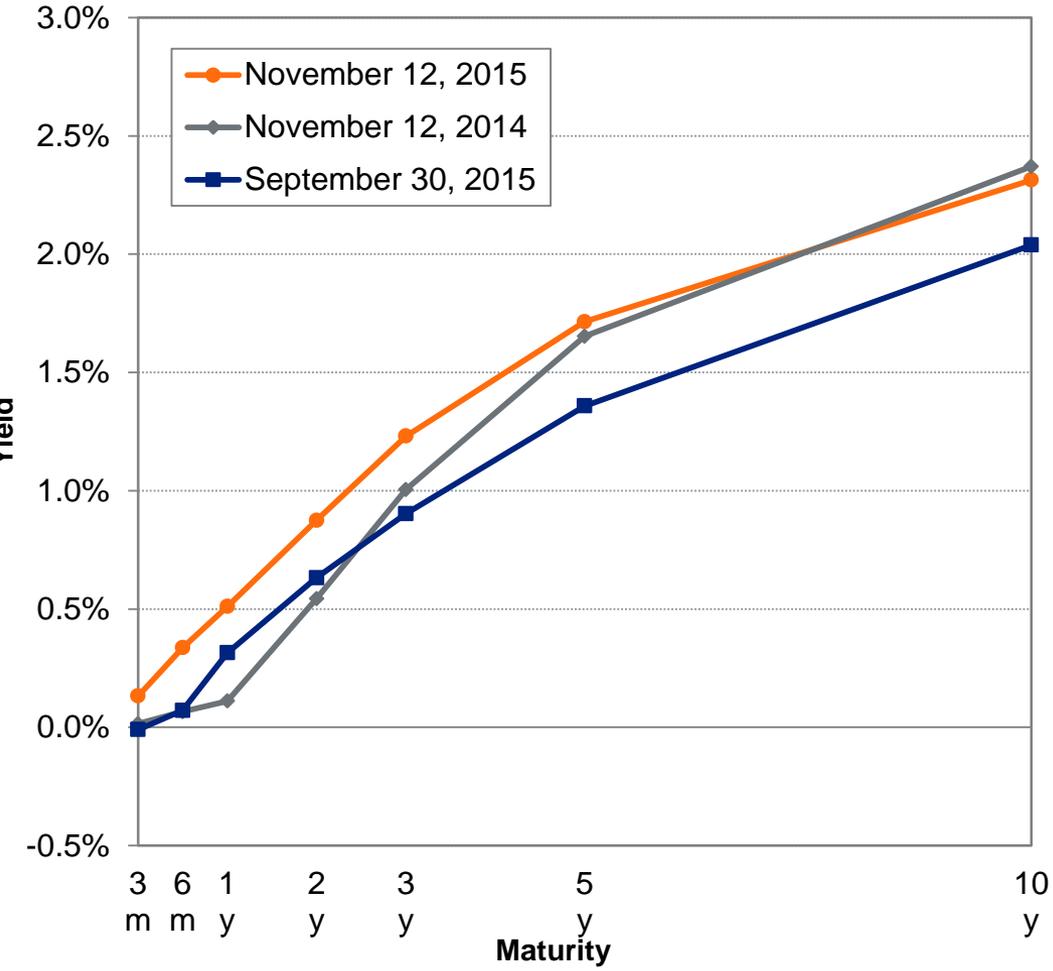


## Economic Update



# Interest Rate Update

U.S. Treasury Yield Curves



	9/30/15	11/12/15	Change since 9/30/15
<b>3 month</b>	-0.01%	0.13%	+0.14%
<b>6 month</b>	0.07%	0.34%	+0.27%
<b>1 year</b>	0.32%	0.51%	+0.19%
<b>2 year</b>	0.63%	0.88%	+0.25%
<b>3 year</b>	0.90%	1.23%	+0.33%
<b>5 year</b>	1.36%	1.72%	+0.36%
<b>10 year</b>	2.04%	2.31%	+0.27%
<b>30 year</b>	2.85%	3.09%	+0.24%

Source: Bloomberg.

# 2-Year Treasury

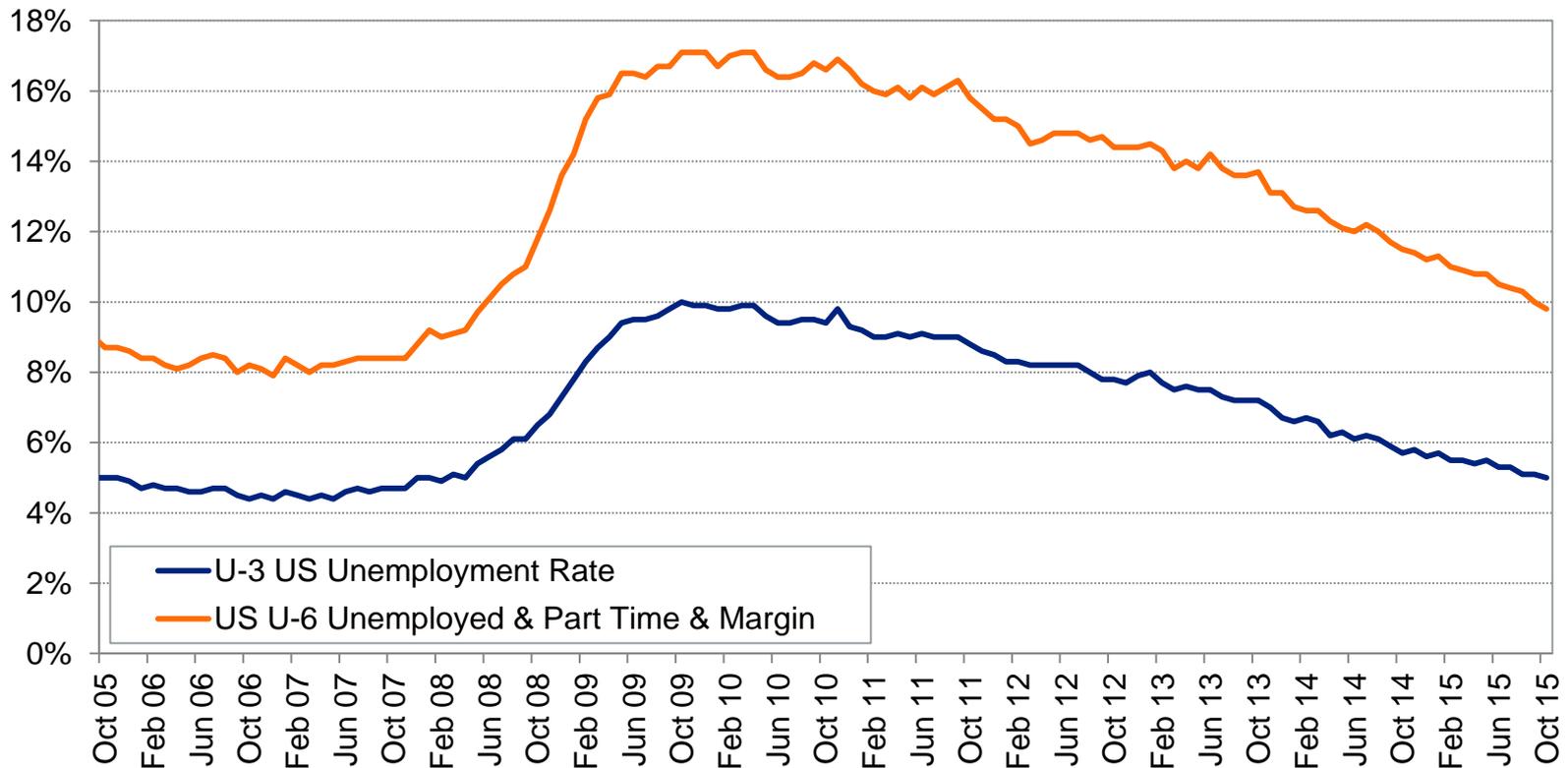


Source: Bloomberg.

# Jobs Report Exceeds Expectations

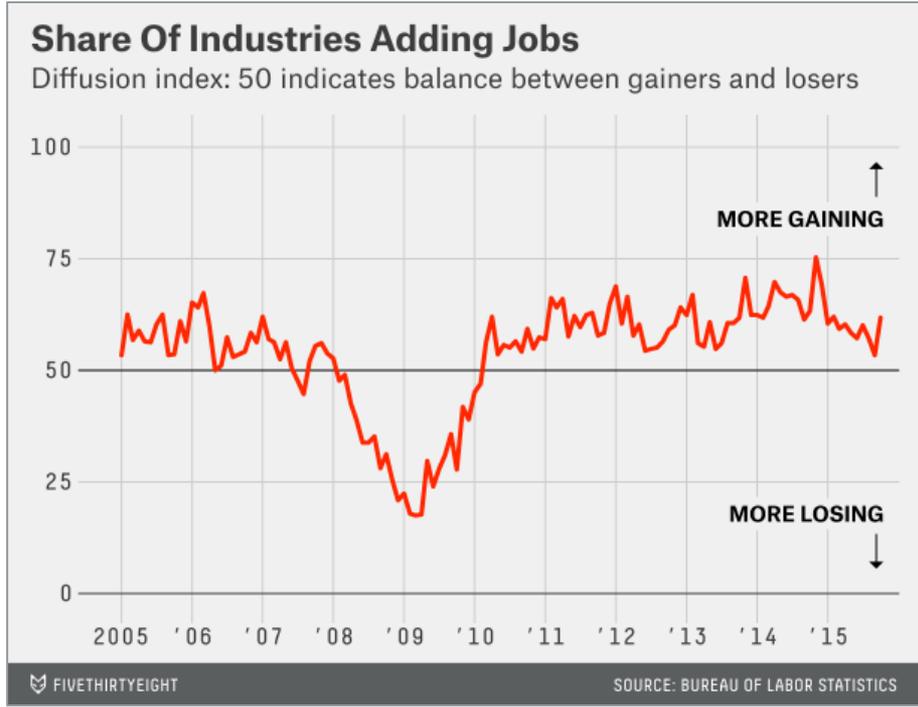
- U.S. Labor market added 271,000 jobs in October, well above the expectation for 185,000. The labor market shows signs of strength as average hourly earnings rose 2.5% and labor market slack diminished.
- The unemployment rate fell to 5% as the labor force participation rate remained at its lowest level since 1977.

### Unemployment Rates



Source: Bureau of Labor Statistics.

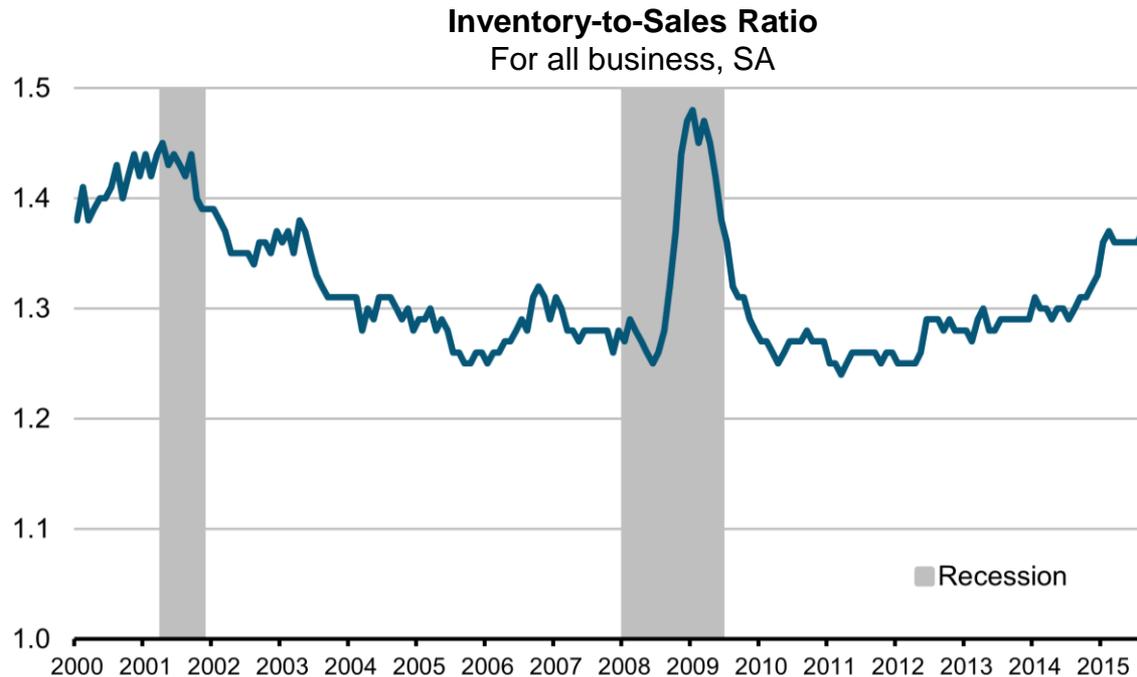
# Other Indications of a Tightening Labor Market



Source: FiveThirtyEight.com.

# Business Are Stocking Up, but Not Selling

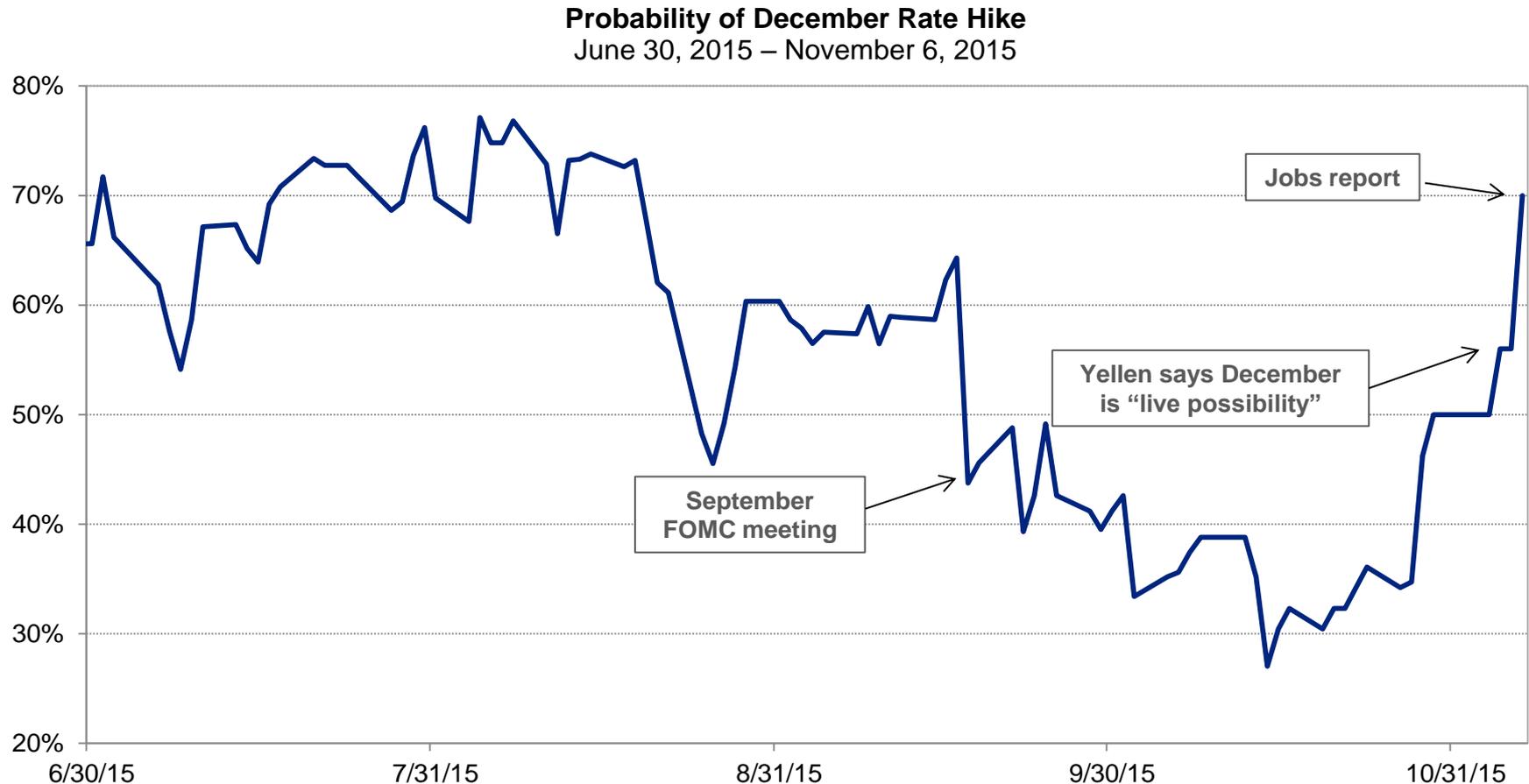
- U.S. businesses are stocking warehouses and shelves with more goods, a position sign for one aspect of GDP.
- However, consumer purchasing hasn't matched the buildup. In September, overall business sales were flat, but inventories climbed 0.3%, pushing the inventory-to-sales ratio to its highest level in 6 years.
- Outsized inventories could be an indication of economic slowdown or recession.



Source: Commerce Department; wsj.com.

# Target Rate Expectations Increase

- The expectations for a December rate hike increased after the October FOMC meeting and strong October jobs report.



Source: Bloomberg, Fed Funds Futures.

# FOMC Statement Highlights

October

28

- Economic activity has been expanding at a moderate pace. Household spending and business fixed investment have been increasing at solid rates in recent months, and the housing sector has improved further... ***The pace of job gains slowed and the unemployment rate held steady.***
- ***Inflation has continued to run below the Committee's longer-run objective, partly reflecting declines in energy prices*** and in prices of non-energy imports... The Committee continues to see the risks to the outlook for economic activity and the labor market as nearly ***balanced but is monitoring global economic and financial developments.***
- The current 0 – 0.25% target range for the federal funds rate remains appropriate... In determining whether it will be appropriate to raise the target range ***at its next meeting,*** the Committee will assess progress—***both realized and expected***—toward its objective of maximum employment at 2% inflation.
- The Committee anticipates that it will be **appropriate to raise the target range for the federal funds rate** when it has seen further improvements in the labor market and is ***reasonably confident that inflation will move back to its 2% objective over the medium term.***

Source: Federal Reserve.

# Upcoming Economic Releases

<b>11-24</b>	GDP yoy
<b>11-25</b>	Core PCE yoy
<b>12-2</b>	ADP Employment Report
<b>12-4</b>	Change in Non-Farm Payrolls Unemployment Rate Average Hourly Earnings yoy
<b>12-10</b>	Imports/Exports Initial Jobless Claims
<b>12-11</b>	Advance Retail Sales Business Inventories
<b>12-14</b>	Survey of Consumer Expectations
<b>12-15</b>	Consumer Price Index Real Earnings

December 15-16  
**FOMC Meeting**

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