

# City of Winter Springs

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Investment Performance Review  
Quarter Ended June 30, 2010



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June 30, 2010 PFM Month-End Statement

This material is based on information obtained from sources generally believed to be reliable and available to the public, however PFM Asset Management LLC cannot guarantee its accuracy, completeness or suitability. This material is for general information purposes only and is not intended to provide specific advice or recommendation. The information contained in this report is not an offer to purchase or sell any securities.

Investors who employed defensive strategies were rewarded in the second quarter as the European sovereign debt crisis dominated all markets, punishing global stock markets, widening credit spreads and pushing some U.S. Treasury yields down to all-time lows.

The sovereign debt crisis, a product of years of poor fiscal policies and over spending, will create significant financial headwinds in the future. It will also likely be one of the main challenges for global economies and investor confidence over the next few months. Additionally, some recent economic indicators suggest that the recovery may be losing momentum. Despite continued growth in GDP, weaknesses still exist throughout the economy with high unemployment, a depressed real estate sector and demands for government austerity threatening to slow what is to date only a modest recovery.

If the sovereign debt crisis is resolved and the recovery picks up speed again, ongoing volatility and the prospect for higher interest rates will continue to justify defensive strategies that are aimed at producing competitive absolute returns while limiting downside market risk.

Defensive strategies focus on maintaining durations short of benchmarks to protect against declines in market value while overweighting U.S. Treasuries and other instruments in the safest asset classes. These strategies are designed to produce competitive absolute returns while simultaneously mitigating market risk.

**Interest Rates and Returns**

Through the first quarter of 2010, strength in the manufacturing sector, a rise in personal spending, and better-than-expected employment reports caused U.S. Treasury yields to continue their upward trend. However, by mid-April, investor sentiment changed as the European crisis took center stage.

As fear of contagion gripped global markets, investors fled from riskier asset classes and began aggressively purchasing U.S. Treasuries, bidding up prices and sending yields sharply lower. By the end of the quarter, the 2-year U.S. Treasury Note had fallen by 0.40% to its all-time low of 0.61%. Longer-term maturities experienced an even greater decline; the 10-year U.S. Treasury Note plummeted by 0.87% to a yield of 2.95%. The following table illustrates quarter-end yields for various U.S. Treasury securities.

In response to the panic-driven flight to quality, the June statement of the Federal Open Market Committee explicitly recognized the overseas challenges

and re-stated a pledge to maintain the Federal Funds target rate at a range of 0.00% to 0.25% for “an extended period.” The market now predicts that the Fed will be on hold at least through the end of the year as illustrated by Fed Funds futures contracts.

**Summary of U.S. Treasury Security Yields**

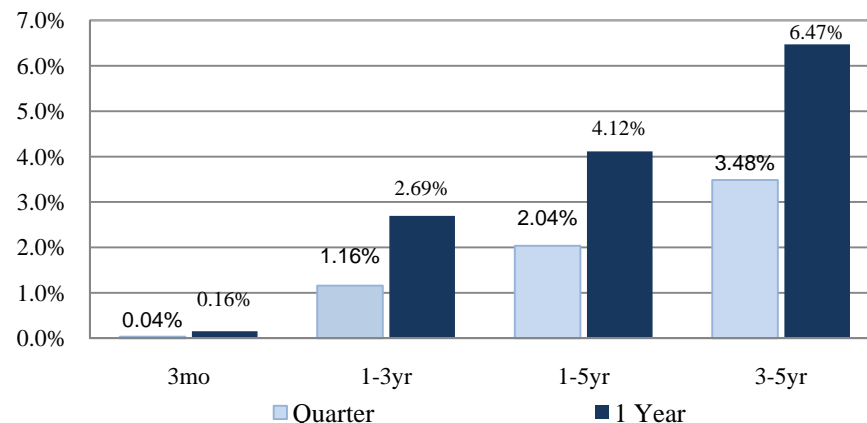
Quarter Ending	3M	6M	1Y	2Y	3Y	5Y	10Y
June 2010	0.17%	0.22%	0.32%	0.61%	0.98%	1.79%	2.95%
March 2010	0.15%	0.23%	0.38%	1.02%	1.57%	2.54%	3.83%
<i>Change over Quarter</i>	0.02%	-0.01%	-0.06%	-0.41%	-0.59%	-0.75%	-0.88%
June 2009	0.18%	0.34%	0.48%	1.11%	1.62%	2.56%	3.53%
<i>Change over Year</i>	-0.01%	-0.12%	-0.16%	-0.50%	-0.64%	-0.77%	-0.58%

Source data: Bloomberg

With the decline in interest rates, the market values of fixed-income portfolios increased. As the accompanying chart illustrates, portfolios with longer durations outperformed those with shorter durations. During the quarter the 1-3 year U.S. Treasury Note Index benchmark returned 1.16% (4.73% annualized), while the 3-5 year U.S. Treasury Note index benchmark returned 3.48% (14.72% annualized). The duration of the 3-5 year U.S. Treasury Note Index benchmark was 3.80 versus 1.82 for the 1-3 year U.S. Treasury Note Index benchmark.

**Merrill Lynch U.S. Treasury Indices**

Quarterly and 12-Month Total Return as of June 30, 2010

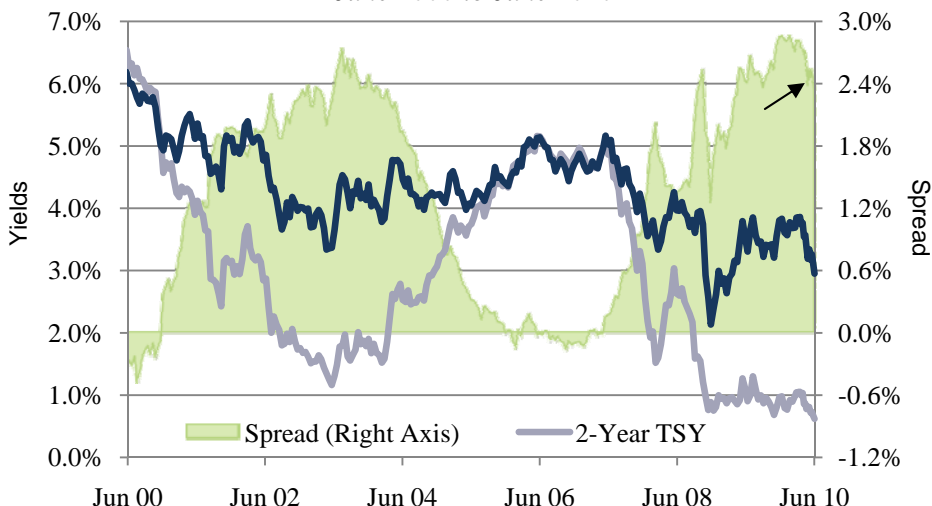


Source data: Bloomberg

The yield curve remained at historically steep levels through April 2010 before flattening slightly as a fixed income market rally took hold. At the beginning of the quarter, the difference between two and ten year U.S. Treasury rates was 2.81%. By quarter end, the difference was 2.33%. With short-term rates at or near historic lows and investors chasing yield at any cost, some speculate that the steepness of the U.S. Treasury curve may be evidence that a new bubble may soon develop.

**U.S. Treasury Yields and Yield Curve Steepness**

*June 2000 to June 2010*



Source data: Bloomberg

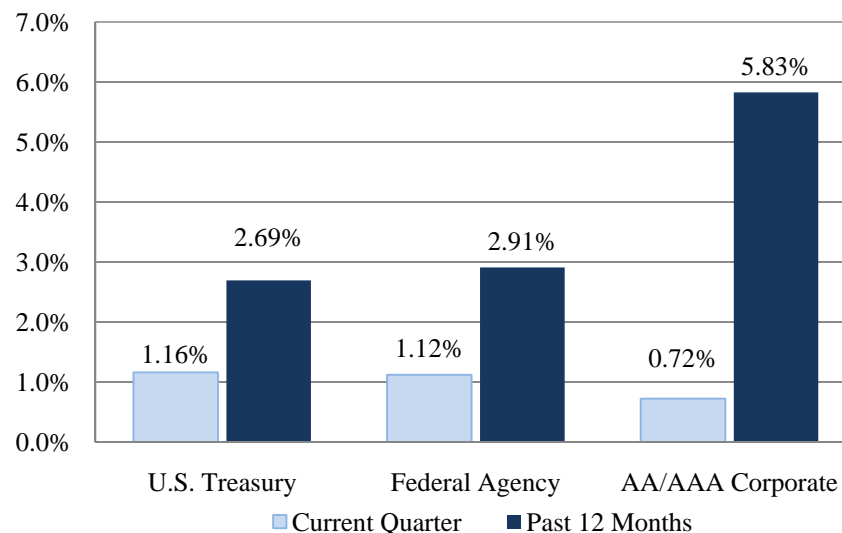
**Interest Rate Spreads**

The difference, or spread, between interest rates on risk-free U.S. Treasury obligations and other asset classes widened during the second quarter. Fears of solvency contagion caused corporate bond spreads to widen during the period. As the next chart shows, this led high-quality (AA/AAA) corporate bonds to underperform U.S. Treasury and federal agency benchmarks of comparable duration by a significant margin. This demonstrates how during times of volatility defensive strategies may outperform strategies which rely on riskier, higher-yielding securities. With high volatility expected to continue through the remainder of the year, we will continue to rely on the safest asset classes of securities and continue to implement defensive strategies to help protect the

market value of portfolios and give us the flexibility to restructure when appropriate.

**Duration Adjusted Returns of Merrill Lynch 1-3 Year Indices**

*Quarterly and 12-Month Total Return as of June 30, 2010*



Source data: Bloomberg

Duration-adjusted return incorporates an adjustment to the market value return (but not the income return) of each benchmark to account for their varied durations, making it easier for investors to assess the relative risk and return of benchmarks of different lengths.

**The Economy**

With increased investor anxiety about spiraling fiscal deficits and mounting sovereign debt, the world leaders at the G20 Summit in June pledged to cut budget deficits by 2013. Paradoxically, in order to cut budget deficits governments must reduce spending, which in turn negatively impacts GDP growth – government spending accounts for a significant portion of GDP. Decreased spending by governments can be detrimental to employment and aggregate demand, which may cause the private sector to refrain from making large business investments or hiring additional workers during this period of uncertainty. Unfortunately, with the economy already suffering from the after-effects of recession, the private sector may not have enough strength to continue to be the catalyst for economic recovery.

During the first quarter, the U.S. economy expanded at a 2.7% rate, revised downwards from 3.2% that was initially reported in April. Current estimates are for the economy to expand at a rate of 3.3% for the entire year. Early reports suggest that corporations will continue to generate strong earnings. Although the oil spill in the Gulf Coast has had a devastating environmental impact and is expected to strain tourism and tourism-related industries, it is not expected to have an impact on overall U.S. GDP growth.

Although the U.S. manufacturing sector continues to expand, the pace of expansion has recently slowed. This trend has continued globally as evidenced by the China Manufacturing PMI Index and Eurozone Manufacturing PMI Market Survey (two surveys that are similar in form to the ISM Manufacturing Index), which showed a declining pace in the expansion of manufacturing. Some believe this provides further evidence that the overall recovery is losing momentum, both globally and domestically.

For many observers, the health of the economy is viewed from the perspective of employment and the housing market in the United States. During the second quarter, non-farm payrolls increased by 621,000. Although this would appear to be a strong result, much of this hiring is attributable to the government hiring census workers. These jobs are only temporary and started to disappear in June. Initial jobless claims remained above 450,000 in June for the sixth straight month. The unemployment rate ended the quarter at 9.5%, which is less than the 9.8% economists expected.

The housing market has been mixed in recent months as the Case-Shiller Home Price Indices showed home prices in major metropolitan areas increased throughout the quarter. Year-over-year, the 20-city composite index is up. However, new home sales in May decreased by 33% to the lowest level since 1963 as the federal homebuyer tax credit expired, leading some economists to speculate that demand for housing is not strong enough without the tax credit.

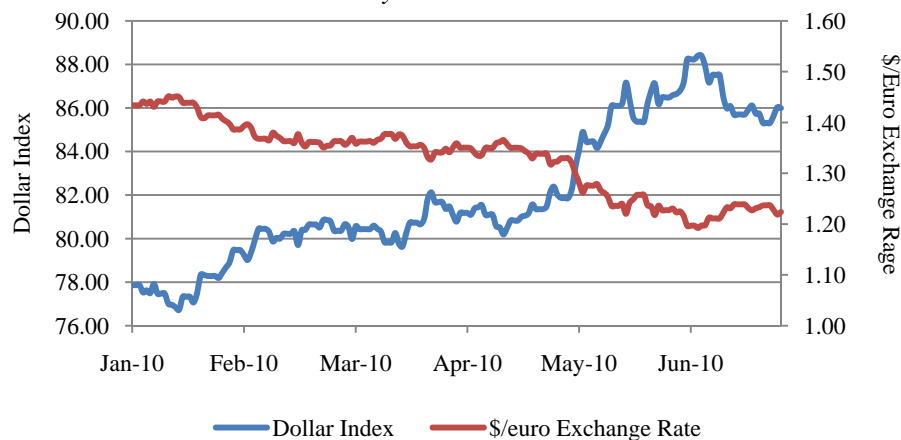
The banking sector showed some signs of strength, although bank failures remained problematic. During the second quarter, 48 banks failed, raising the year-to-date total to 85. The number of banks on the FDIC's problem list increased by 73 to 775 banks and \$431 billion of assets. The FDIC's problem list consists of banks the FDIC is closely monitoring due to concerns regarding solvency. This problem list accounts for approximately 9.8% of all banks reporting to the FDIC and 3% of total system assets. Ninety-one banks and thrifts skipped the May dividend payment under the Troubled Asset Relief Program, or TARP. It was the first missed payment for 23 of the banks. However, with home prices finally stabilizing, the banking sector was able to

reduce the rate of reserves to cover non-performing loans. Loan loss provisions and write-offs were down 16.6% year-over-year. During the quarter ending March 31, 2010, banks and institutions insured by the FDIC posted an \$18 billion profit, and more than half (52.2%) of banks reported growth in net income.

The sovereign debt crisis focused investors on the global economy to help formulate opinions regarding the recovery and guide investment strategies. The sovereign debt crisis stems from concerns that the debt-to-GDP and/or budget-deficit-to-GDP ratios of several countries—most notably Greece, Portugal, and Spain—exceeds thresholds as established in the 1997 Stability and Growth Pact, an agreement among all members of the European Union. Greek, Portuguese, and Spanish credit default swaps (“CDS”), derivative contracts that transfer default risk from the buyer of the CDS to the seller, reached record highs during the quarter. Meanwhile, Standard and Poor's and Moody's downgraded Greece's sovereign debt to junk status. The rating agencies also have taken steps, albeit less severe, to reduce the credit ratings of Portugal and Spain.

The debt crisis caused the Euro to tumble by 12.3% in value relative to the U.S. dollar in the first half of the year. As illustrated in the chart on the next page, the U.S. dollar also has strengthened relative to other currencies. The U.S. Dollar Index, a measure of the value of the dollar versus a basket of foreign currencies including the euro, Japanese yen, Pound sterling, Canadian dollar, Swiss franc, and Swedish krona, increased by 8.4% since the beginning of 2010.

Although a stronger U.S. dollar increases the purchasing power of U.S. consumers, a rapid change can have destabilizing effects. In order to ensure ample liquidity in the U.S. dollar market, the Federal Open Market Committee in May authorized the re-establishment of currency swap lines through January 2011. These currency swap lines are with other central banks including the European Central Bank, Bank of Japan, Bank of England, Bank of Canada, and Swiss National Bank. Currency swap lines are arrangements designed to enhance liquidity in U.S. dollars to overseas markets in which the Fed and a counterparty trade a fixed amount of currency at current market rates, while agreeing to swap back at the same rate in the future.

**Dollar Index vs. Dollar/Euro Exchange Rate***January 2010 - June 2010**Source data: Bloomberg*

Gold, considered a safe haven in times of financial instability, continued to make record highs and finished the quarter up 10.7% while the Dow Jones Industrial Average and S&P 500 Index declined by 11.35% and 12.51%, respectively, during the quarter. By June 30, 2010, the Dow Jones Industrial Average and S&P 500 Index had fallen by 7.11% and 8.30% from December 31, 2009 levels.

**Outlook**

Despite tumultuous market conditions, economists are projecting GDP growth in the range of 3.3% for the second quarter of 2010. Growth is expected to taper off for the remainder of the year, to the 2.8% to 3.0% range.

The challenges of a weak housing market, high unemployment rate, modest income growth, and tight credit remain. The sovereign debt crisis and, more importantly, the austerity measures governments put in place to provide relief will have a significant effect on the global recovery. Increasing taxes and decreasing government spending may smother the embers of a fragile economic recovery.

With volatility expected to remain high for the foreseeable future, we will continue to employ defensive strategies. With rates at such low levels, we will continue to maintain shorter durations relative to benchmarks because a rate rise will depress returns of longer-duration portfolios. Additionally, we will

continue to underweight investments with a credit component, including corporate obligations and, to a degree, federal agency instruments. While these defensive strategies may underperform over the short-run if interest rates remain at current levels or decline even further, defensive strategies should perform well through the next leg of the business cycle when rates rise toward historic norms.

## Executive Summary

### PORTFOLIO STRATEGY

- The City's General City Account portfolio is of high credit quality and maintains adequate liquidity. The portfolio is invested entirely in Federal Agency, U.S. Treasury, Commercial Paper and FDIC guaranteed corporate securities. The securities in the portfolios are allocated among high quality issuers rated AAA and A-1+.
- Short-term rates were generally higher in the second quarter than the first, with 1-month T-bill rates averaging 0.11% in the second compared with only 0.06% in the first. Treasury and federal agency rates moved upward early in the quarter on the growing economic recovery. However, the global growth concerns that led long-term rates lower also led short-term Treasury and federal agency rates down in a flight-to-quality.
- The tumult in Europe led the TED spread, an indication of investor's averseness to risk, to increase in the quarter. Commercial paper spreads widened as a result of the perceived increase in risk associated with corporate securities. Commercial paper now offers a significant yield advantage over Treasuries and federal agencies of comparable maturities.
- The portfolio continues to provide the City with favorable yield relative to the benchmark. At quarter end the portfolio had a Yield to Maturity at Cost of 1.00%, exceeding the Yield to Maturity of its benchmark the Merrill Lynch 6 Month U.S. Treasury Bill Index by 80 basis points (0.80%).
- PFM will continue to follow the prudent investment strategies that have safely provided the City with favorable yield and maintained adequate liquidity during this period of significant market and economic turmoil.

The City's Investment Statistics

<u>Account Name</u>	<u>Amortized Cost<sup>1,2,3</sup> June 30, 2010</u>	<u>Amortized Cost<sup>1,2,3</sup> March 31, 2010</u>	<u>Market Value<sup>1,2,3</sup> June 30, 2010</u>	<u>Market Value<sup>1,2,3</sup> March 31, 2010</u>	<u>Duration (Years) June 30, 2010</u>
General City Account Portfolio	\$19,322,874.54	\$19,354,546.22	\$19,403,163.55	\$19,426,000.38	0.68
Fidelity Institutional Money Market Fund Government Portfolio (Fund #257)	5,992,302.08	6,412,148.09	5,992,302.08	6,412,148.09	0.003
Money Market Fund - State Board of Administration Pool A	40,724.18	0.18	40,724.18	0.18	45.9 Days
Money Market Fund - State Board of Administration Pool B	823,035.67	874,557.33	823,035.67	874,557.33	N/A
Bank of America Cash for Operation - depository	1,518,856.56	2,586,914.75	1,518,856.56	2,586,914.75	0.003
Water & Sewer 2000 - Fidelity Institutional Money Market Fund Government Portfolio (Account #364)	716,548.41	716,530.34	716,548.41	716,530.34	0.003
Water & Sewer 2000 - Money Market Fund - State Board of Administration Pool A	1,181.93	0.01	1,181.93	0.01	45.9 Days
Water & Sewer 2000 - Money Market Fund - State Board of Administration Pool B	23,886.67	25,381.96	23,886.67	25,381.96	N/A
Water & Sewer Series 1992 Refunding Revenue Reserve - BONY	1,305,069.93	1,305,069.93	1,305,069.93	1,305,069.93	0.003
<b>Total</b>	<b>\$29,744,479.97</b>	<b>\$31,275,148.81</b>	<b>\$29,824,768.98</b>	<b>\$31,346,602.97</b>	

<u>Account Name</u>	<u>Yield to Maturity on Cost<sup>4</sup> June 30, 2010</u>	<u>Yield to Maturity on Cost<sup>4</sup> March 31, 2010</u>	<u>Yield to Maturity at Market June 30, 2010</u>	<u>Yield to Maturity at Market March 31, 2010</u>	<u>Duration (Years) March 31, 2010</u>
General City Account Portfolio	1.00%	1.00%	0.39%	0.56%	0.92
Fidelity Institutional Money Market Fund Government Portfolio (Fund #257)	0.01%	0.01%	0.01%	0.01%	0.003
Money Market Fund - State Board of Administration Pool A	0.34%	0.20%	0.34%	0.20%	44.4 days
Money Market Fund - State Board of Administration Pool B	0.00%	0.00%	0.00%	0.00%	N/A
Bank of America Cash for Operation - depository	0.30%	0.30%	0.30%	0.30%	0.003
Water & Sewer 2000 - Fidelity Institutional Money Market Fund Government Portfolio (Account #364)	0.01%	0.01%	0.01%	0.01%	0.003
Water & Sewer 2000 - Money Market Fund - State Board of Administration Pool A	0.34%	0.20%	0.34%	0.20%	44.4 days
Water & Sewer 2000 - Money Market Fund - State Board of Administration Pool B	0.00%	0.00%	0.00%	0.00%	N/A
Water & Sewer Series 1992 Refunding Revenue Reserve - BONY	0.00%	0.00%	0.00%	0.00%	0.003
<b>Weighted Average Yield</b>	<b>0.67%</b>	<b>0.65%</b>	<b>0.27%</b>	<b>0.37%</b>	

**Benchmarks**

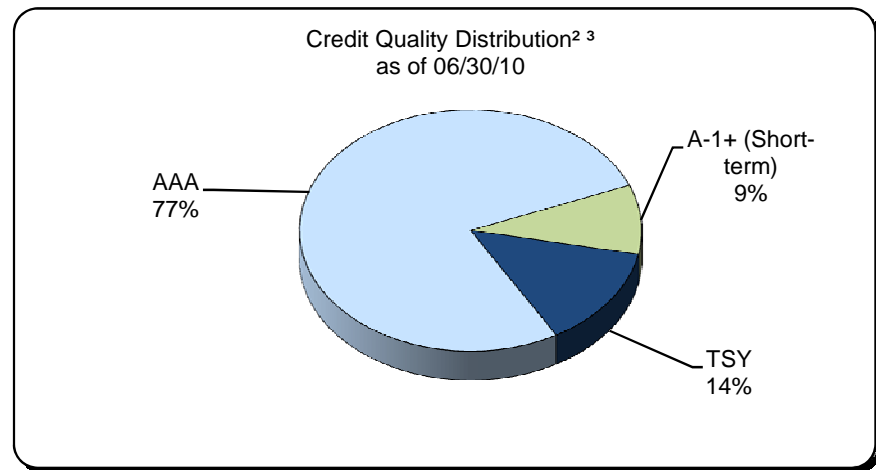
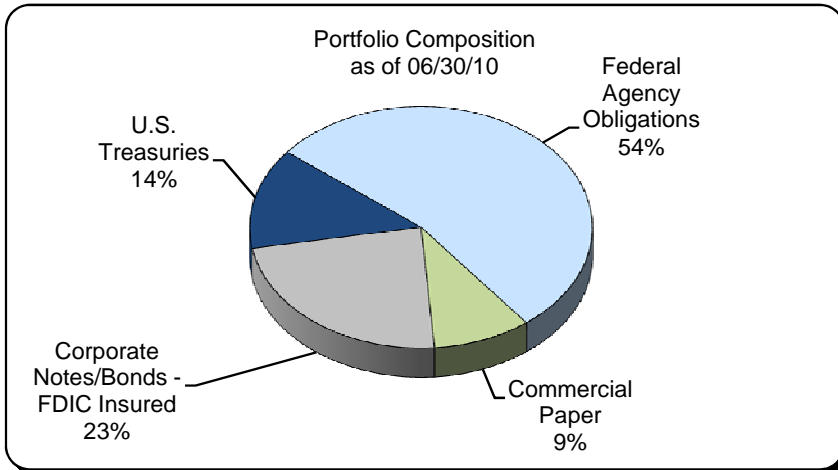
	<u>June 30, 2010</u>	<u>March 31, 2010</u>
6 Month U.S. Treasury Bill Index <sup>5</sup>	0.20%	0.20%

Notes:

1. On a trade-date basis, including accrued interest.
2. In order to comply with GASB accrual accounting reporting requirements; forward settling trades are included in the monthly balances.
3. Excludes any money market fund/cash balances held in custodian account.
4. Past performance is not indicative of future results.
5. Source Bloomberg.

General City Account Portfolio Composition and Credit Quality Characteristics

<u>Security Type</u> <sup>1</sup>	<u>June 30, 2010</u>	<u>% of Portfolio</u>	<u>March 31, 2010</u>	<u>% of Portfolio</u>
U.S. Treasuries	\$2,617,875.82	13.49%	\$2,611,322.64	13.44%
Federal Agencies	10,431,862.76	53.76%	10,458,200.27	53.84%
Commercial Paper	1,799,920.80	9.28%	1,798,750.80	9.26%
Certificates of Deposit	0.00	0.00%	0.00	0.00%
Bankers Acceptances	0.00	0.00%	0.00	0.00%
Repurchase Agreements	0.00	0.00%	0.00	0.00%
Municipal Obligations	0.00	0.00%	0.00	0.00%
Corporate Notes/Bonds	0.00	0.00%	0.00	0.00%
Corporate Notes/Bonds - FDIC Insured	4,553,504.17	23.47%	4,557,726.67	23.46%
Mortgage Backed	0.00	0.00%	0.00	0.00%
Money Market Fund/Cash	0.00	0.00%	0.00	0.00%
<b>Totals</b>	<b>\$19,403,163.55</b>	<b>100.00%</b>	<b>\$19,426,000.38</b>	<b>100.00%</b>

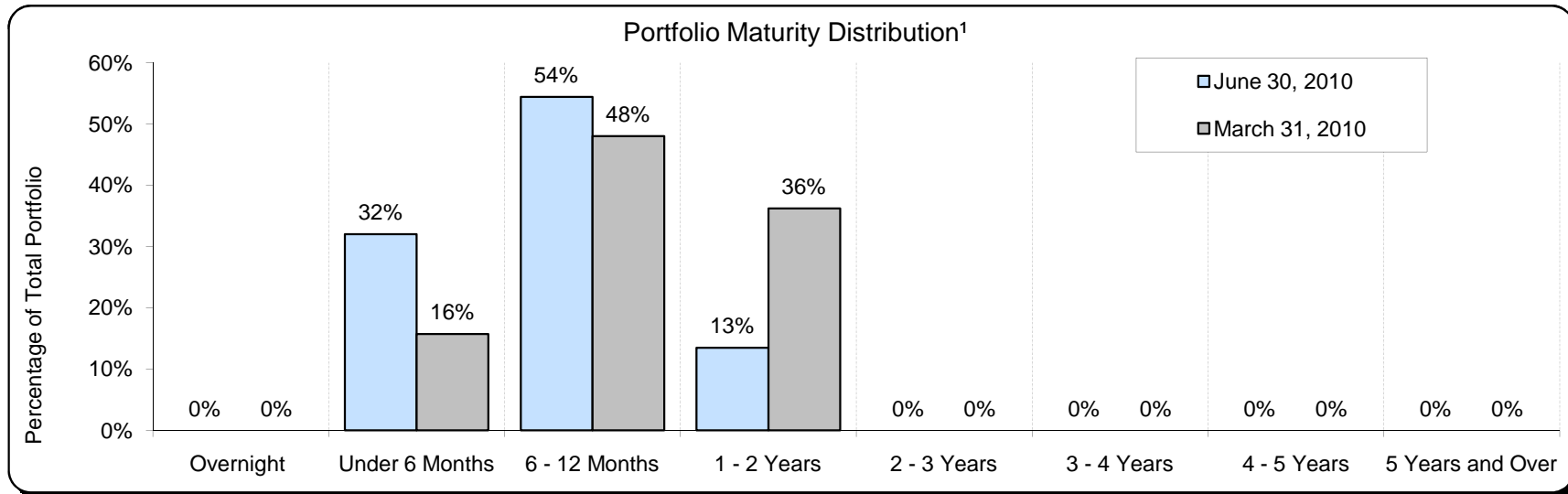


Notes:

1. End of quarter trade-date market values of portfolio holdings, including accrued interest.
2. Credit rating of securities held in portfolio, exclusive of money market fund.
3. A rating of "TSY" indicates the security is an obligation of, or explicitly guaranteed by the U. S. Government.

General City Account Portfolio Maturity Distribution

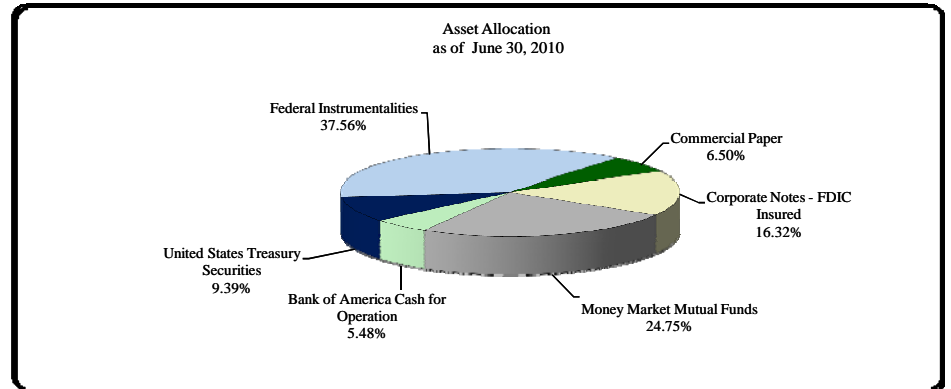
<u>Maturity Distribution<sup>1</sup></u>	<u>June 30, 2010</u>	<u>March 31, 2010</u>
Overnight (Money Market Fund)	\$0.00	\$0.00
Under 6 Months	6,218,961.18	3,053,906.01
6 - 12 Months	10,566,843.46	9,333,620.43
1 - 2 Years	2,617,358.91	7,038,473.94
2 - 3 Years	0.00	0.00
3 - 4 Years	0.00	0.00
4 - 5 Years	0.00	0.00
5 Years and Over	0.00	0.00
<b>Totals</b>	<b>\$19,403,163.55</b>	<b>\$19,426,000.38</b>



Notes:

1. Callable securities in portfolio are included in the maturity distribution analysis to their stated maturity date, although they may be called prior to maturity.

Security Type <sup>3</sup>	June 30, 2010	June 30, 2010	Notes	Permitted by Policy
United States Treasury Securities	2,601,641.02	9.39%		100%
United States Government Agency Securities	-	0.00%		75%
Federal Instrumentalities	10,402,112.16	37.56%		80%
Certificates of Deposit	-	0.00%		25%
Repurchase Agreements	-	0.00%		50%
Commercial Paper	1,799,879.99	6.50%		30%
Corporate Notes - FDIC Insured	4,519,241.37	16.32%		50%
Mortgage-Backed Securities	-	0.00%		0%
Bankers' Acceptances	-	0.00%		30%
State and/or Local Government Debt (GO and Revenue)	-	0.00%		20%
Money Market Mutual Funds	6,856,061.93	24.75%	2	100%
Intergovernmental Investment Pool	-	0.00%		25%
Bank of America Cash for Operation	1,518,856.56	5.48%	2	100%



Individual Issuer Breakdown	June 30, 2010	June 30, 2010	Notes	Permitted by Policy
Government National Mortgage Association (GNMA)	-	0.00%		50%
US Export-Import Bank (Ex-Im)	-	0.00%		50%
Farmers Home Administration (FMHA)	-	0.00%		50%
Federal Financing Bank	-	0.00%		50%
Federal Housing Administration (FHA)	-	0.00%		50%
General Services Administration	-	0.00%		50%
New Communities Act Debentures	-	0.00%		50%
US Public Housing Notes & Bonds	-	0.00%		50%
US Dept. of Housing and Urban Development	-	0.00%		50%
Federal Farm Credit Bank (FFCB)	-	0.00%		25%
Federal Home Loan Bank (FHLB)	3,621,048.44	13.07%		25%
Federal National Mortgage Association (FNMA)	5,187,576.50	18.73%		25%
Federal Home Loan Mortgage Corporation (FHLMC)	1,593,487.22	5.75%		25%
Student Loan Marketing Association (SLMA)	-	0.00%		25%

Individual Issuer Breakdown	June 30, 2010	June 30, 2010	Notes	Permitted by Policy
CD - Bank A	-	0.00%		15%
CD - Bank B	-	0.00%		15%
Fully collateralized Repo - A	-	0.00%		25%
Fully collateralized Repo - B	-	0.00%		25%
Barclays CP	1,799,879.99	6.50%		10%
CP B	-	0.00%		10%
General Electric Corporate Notes - FDIC insured	1,508,286.80	5.45%		25%
JP Morgan Chase Corporate Notes - FDIC insured	1,508,812.09	5.45%		25%
Bank of America Corporate Notes - FDIC insured	1,502,142.48	5.42%		25%
Corporate Notes - FDIC insured D	-	0.00%		25%
Corporate Notes - FDIC insured E	-	0.00%		25%
BA Bank A	-	0.00%		10%
BA Bank B	-	0.00%		10%
BA Bank C	-	0.00%		10%
Municipal Notes/Bonds	-	0.00%		20%
Fidelity Institutional Money Market Fund Government Portfolio (Fund #257)	5,992,302.08	21.63%	2	25%
Money Market Fund - State Board of Administration	863,759.85	3.12%	2	25%

Notes:  
 1. Does not include bond proceeds.  
 2. Managed by the City.  
 3. End of month trade-date amortized cost of portfolio holdings, including accrued interest.