

# City of Winter Springs

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Investment Performance Review  
Quarter Ended June 30, 2011



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(statements are available online at [www.pfm.com](http://www.pfm.com))

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# TAB I

Interest rates across the yield curve fell during the second quarter on fears of an economic slowdown, and as a result, fixed-income portfolios with longer durations posted strong positive returns. With their highest quarterly returns in a year, longer-duration fixed-income portfolios significantly outperformed cash-equivalent portfolios, where returns remained near zero.

Two factors caused the interest rate drop: first, weak economic reports set off fears of slower growth and lowered inflation expectations; second, sovereign debt concerns in Europe sparked a flight-to-quality. By the end of the quarter yields on Treasury securities had fallen from their 2011 highs, in some maturities, to all-time lows. The significant bond market rally made fixed-income investments one of best performing asset classes in the second quarter.

**The Economy**

Worries over slowing growth emerged after a series of releases of weak economic data. The final GDP estimate put first quarter growth at 1.9%, below expectations and lower than the 3% to 4% that is typical at this stage in an economic recovery.

After several months of strong job growth, the labor market appeared to slow down as well. Only 22,000 new jobs on average were created during the last two months of the second quarter compared to 215,000 new jobs on average during the last two months of the first quarter. Manufacturing activity slowed with the ISM manufacturing index falling from 61.2 in March to 55.3 in June, closer to the threshold of 50, which marks the beginning of a contraction in industrial activity.

Although the economic slowdown is troubling, many economists believe it is temporary. The earthquake and tsunami in Japan disrupted supply chains across the world causing repercussions to the global industrial system and affecting U.S. manufacturers who faced shortages of auto and electronics components. Toward the end of the quarter, production levels in Japan rebounded and U.S. companies started to increase production. Other temporary factors were higher

food prices due to the floods in the Midwest and higher oil prices due to the geopolitical tensions in the Middle East and Northern Africa. Higher food and energy prices had a dampening effect on consumer purchasing power and spending. For example, the pace of retail sales excluding automobiles and gas slowed in the second quarter to a monthly average of 0.2% compared to the preceding 3 month average of 1.0%.

**Interest Rates and Returns**

Treasury yields fell steadily over the quarter with intermediate-term Treasuries showing the most change. As the following table shows, the yield on the 5-year U.S. Treasury Note declined by 52 basis points (0.52%) from 2.28% on March 31, 2011 to 1.76% on June 30, 2011. At the end of June, the yield on the 2-year U.S. Treasury Note reached a new all-time low on speculation that Greece’s government would fail to pass austerity measures needed to secure a bailout.

Short-term interest rates, which are anchored to the Federal Funds rate, declined as well. A flight-to-quality, lack of short-term Treasury supply, and quarter-end demand from investors such as banks and securities firms drove the yield on the 3-month Treasury bill to 0.01%, and at some points in June some Treasury bills actually traded at negative yields.

**Comparison of U.S. Treasury Yields**

Date	3M	6M	1Y	2Y	3Y	5Y	10Y
<b>June 30, 2011</b>	0.01%	0.10%	0.18%	0.46%	0.80%	1.76%	3.16%
<b>March 31, 2011</b>	0.09%	0.17%	0.27%	0.82%	1.30%	2.28%	3.47%
<b>Change over Quarter</b>	-0.08%	-0.07%	-0.09%	-0.36%	-0.50%	-0.52%	-0.31%
<b>June 30, 2010</b>	0.17%	0.22%	0.31%	0.60%	0.96%	1.77%	2.93%
<b>Change over Year</b>	-0.16%	-0.12%	-0.13%	-0.14%	-0.16%	-0.01%	0.23%

Source data: Bloomberg

The sharp decline in interest rates through the quarter is illustrated by performance of the 2-year Treasury note (following chart) which ranged from 0.83% to 0.33%.

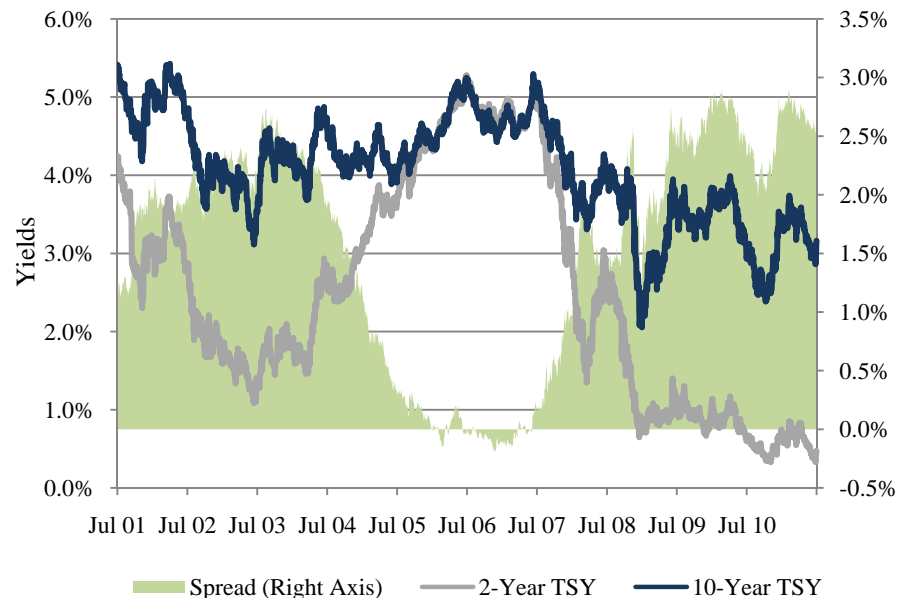
**2-Year U.S. Treasury Note Yield**  
July 1, 2010 through June 30, 2011



Source data: Bloomberg

Despite low absolute yields, the yield curve remained steep. As seen in the chart on the right, the steepness of the yield curve, measured by the spread between 2-year and 10-year U.S. Treasury notes, was approximately 2.70% by the end of the quarter, very close to its 10 year widest spread. Market observers generally view a steep yield curve as anticipating rising growth and inflation, but in this case factors such as the flight to quality and the trillions of dollars of excess cash created by the Fed have boosted demand for short maturities.

**U.S. Treasury Yields and Yield Curve Steepness**  
July 1, 2001 to June 30, 2011

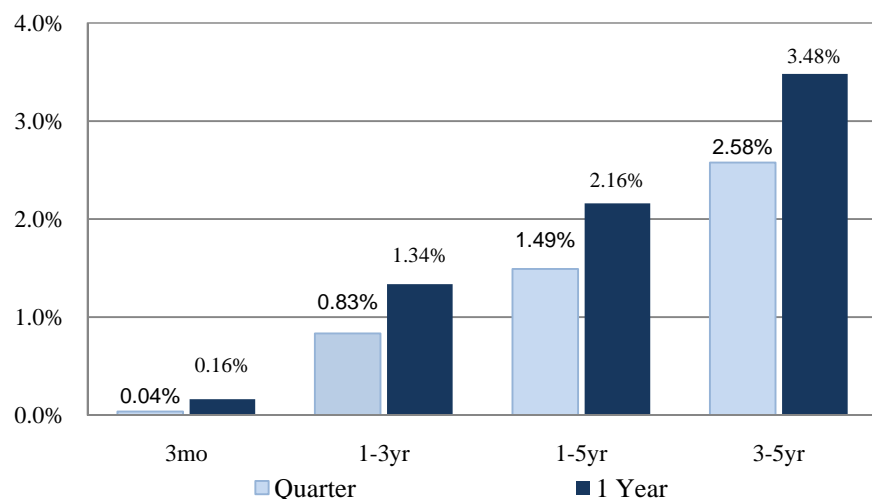


Source data: Bloomberg

Since intermediate and long-term rates fell more than short-term rates, longer-duration strategies outperformed shorter-duration strategies as seen in the following chart. For example, the 3- to 5-year U.S. Treasury index returned 2.58% (10.71% annualized) for the quarter versus a return on the 1- to 3-year U.S. Treasury index of 0.83% (3.36% annualized).

In the current positively sloped yield curve environment, portfolios with less duration than their benchmarks may perform just as well as, if not better than, their benchmarks as securities approaching their maturity dates will “roll-down” the curve and be priced as shorter, lower-yielding securities, increasing their return.

**Total Returns of Merrill Lynch U.S. Treasury Indices**  
*Quarterly and 12-Month Total Return as of June 30, 2011*

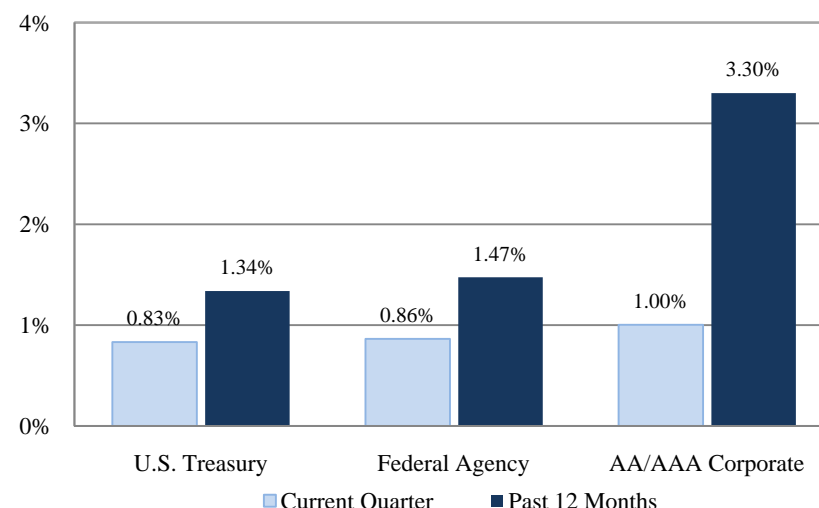


Source data: Bank of America Merrill Lynch; Bloomberg

Performance during the second quarter accounted for most of the return for the trailing 12 months. For example, the total return during the quarter represented more than 74% of the trailing 12-month return on the 3- to 5-year U.S. Treasury Index. Shorter-duration strategies continue to be limited by the extremely low Federal Funds rate and lag the performance of longer-duration strategies. So, for the 12 months ended June 30, 2011, the 3- to 5-year U.S. Treasury index returned 3.48% versus a return of 0.16% on the 3-month index, an outperformance of 332 basis points.

After several quarters of outperforming Treasuries, federal agency and corporate securities barely held their own in the second quarter. On a duration-adjusted basis, agencies and corporates returned 0.86% and 1.00% respectively, while Treasuries returned 0.83% as seen in the chart on the right. In these cases although credit spreads slightly widened, the additional income for agency and corporate securities was higher and offset the spread widening.

**Duration Adjusted Returns of Merrill Lynch 1-3 Year Indices**  
*Quarterly and 12-Month Total Return as of June 30, 2011*



Source data: Bank of America Merrill Lynch; 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.*

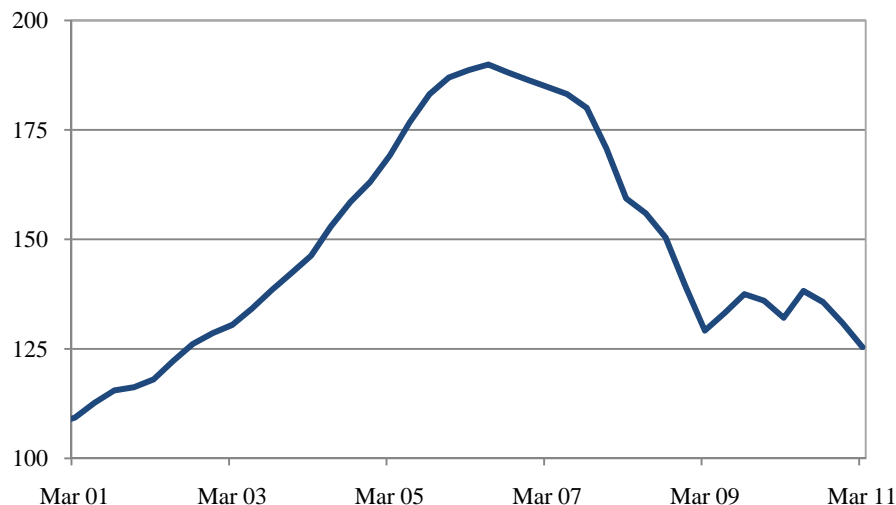
**Economic Outlook**

The temporary factors that slowed the economy in the second quarter should subside and lead to a rebound in the second half. However, Federal Reserve officials have lowered their growth forecasts for the second time this year from 3.1% to 3.3% in April to 2.7% to 2.9%. The Fed’s latest forecast reflects the obstacles that continue to weigh on the domestic and global economies.

The lack of a rebound in the housing market in the United States is a big reason why the current recovery is stagnant. Banks have imposed tighter underwriting standards for home mortgages and uncertain job prospects have constrained the demand for housing. Meanwhile, with a large supply of vacant and foreclosed properties on the market, potential home buyers can strike deals, making new construction a more costly alternative. As shown on the following chart, the Case Shiller Home Price Index fell 4.2% over the first quarter to \$125.41.

Despite the support for sales seen in 2009 and 2010, due to the first-time home buyers' tax credit, there has been no recovery or stabilization in home prices. Home prices are down 5.1% compared to their level a year-ago and continue on their downward spiral with no relief in sight.

**Case-Shiller Home Price Index**  
March 31, 2001 to March 31, 2011



Source data: Bloomberg

Another growth obstacle is the shrinking government sector. State and local governments are cutting spending and government employment is shrinking with a loss of 390,000 government jobs over the past three years. As the stimulus provided by the American Recovery and Reinvestment Act winds down there is a widening revenue gap for state and local government. Cutbacks in Federal spending--which seem inevitable--may in the long run reduce the Federal deficit and boost the private sector but in the short run they will further reduce economic activity and retard the recovery.

Despite these obstacles and the recent economic slowdown, the Federal Reserve believes the recovery is still underway. Though the

pace is slower than desired, the Fed is wary of doing more to bolster growth and a third round of quantitative easing is unlikely.

### **Investment Strategy**

Value is difficult to find in the fixed income markets because interest rates are at or near all-time lows, and the corporate and Federal agency sectors are not particularly attractive, as interest rate spreads have narrowed considerably from recent levels. A stagnant economy, the uncertainty surrounding the sovereign debt situation in both the United States and Europe and commodity-related pressure on global prices add to the challenge.

Our portfolio strategy is a defensive one: we are positioning portfolios somewhat short of benchmark durations with the expectation that the positively-sloped yield curve will reduce the effect of a sharp rise in interest rates, and the additional value gained by rolling down the curve will compensate for the shorter duration. We plan to take advantage of any widening in spreads to add incremental income by re-allocating assets into Federal Agency or high quality corporate obligations where policies permit, but we will carefully manage interest rate risk to minimize the effects of an inevitable rise in rates.

# TAB II

## 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, and Commercial Paper securities. The securities are allocated among high quality issuers rated AAA, A-1+ and A-1.
- The economic recovery continued in the second quarter, albeit at a slower pace. Many economists believe the slower pace of the recovery reflects temporary factors, including the dampening effect of higher food and energy prices on consumer purchasing power and spending, as well as, supply chain disruptions associated with the tragic events in Japan. Although these factors are being considered temporary, Federal Reserve officials lowered their growth forecasts for the second time this year. U.S. central bankers said the economy will expand 2.7% to 2.9% this year, down from forecasts ranging from 3.1% to 3.3% in April.
- Debates over government spending and budget cuts have been at the forefront of the conversation in Europe and the United States during the second quarter. Greece was on the verge of default until Greek officials passed strict austerity measures needed to secure a bailout from the European Union. Meanwhile, in America, Congress has been unable to agree on the Federal budget and debt limit. The ongoing debate almost caused a government shutdown and prompted Standard & Poor's to put America's AAA credit rating on negative watch. Investors are concerned that cuts in government spending in the short run will slow future growth prospects.
- During the quarter, speculation of a Greek default drove intermediate-term U.S. Treasury yields near or below November 2010 lows. The 2-year U.S. Treasury fell for eleven consecutive weeks, the longest rally since the 1980s, until the last week of June, when Greek officials eased concerns of a Greek default by passing large budget cuts. By the end of the quarter, the 2-year U.S. Treasury yield hit 0.46%, approximately 37 bps lower than it was on March 31, 2011.
- The Federal Reserve completed its second round of quantitative easing on June 30, 2011. Although the Fed will continue its existing policy of reinvesting principal payments from its securities holdings, Fed Chairman Ben Bernanke indicated that the Fed is putting extraordinary monetary policy action on hold. However, Chairman Bernanke said the Fed will continue to monitor the economy and act as needed.
- The General City Account 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 0.50%, exceeding the average Yield to Maturity of its benchmark the Merrill Lynch 1 Year U.S. Treasury Bill Index by 29 basis points (0.29%). Next quarter the portfolio's performance will be reported on a total return basis.
- 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></u>	<u>Amortized Cost<sup>1,2,3</sup></u>	<u>Market Value<sup>1,2,3</sup></u>	<u>Market Value<sup>1,2,3</sup></u>	<u>Duration (Years)</u>
	<u>June 30, 2011</u>	<u>March 31, 2011</u>	<u>June 30, 2011</u>	<u>March 31, 2011</u>	<u>June 30, 2011</u>
General City Account Portfolio	\$22,561,363.55	\$19,823,417.14	\$22,610,872.03	\$19,832,204.38	0.96
Fidelity Institutional Money Market Fund Government Portfolio (Fund #257)	1,027,579.29	\$5,115,566.53	1,027,579.29	5,115,566.53	0.003
Money Market Fund - State Board of Administration Pool A	18,317.71	73,676.09	18,317.71	73,676.09	32 Days
Money Market Fund - State Board of Administration Pool B	650,696.19	678,940.57	650,696.19	678,940.57	N/A
Bank of America Cash for Operation - depository	1,743,833.34	2,908,464.21	1,743,833.34	2,908,464.21	0.003
Water & Sewer 2000 - Fidelity Institutional Money Market Fund Government Portfolio (Account #364)	716,641.60	716,618.03	716,641.60	716,618.03	0.003
Water & Sewer 2000 - Money Market Fund - State Board of Administration Pool A	531.64	2,138.30	531.64	2,138.30	32 Days
Water & Sewer 2000 - Money Market Fund - State Board of Administration Pool B	18,884.94	19,704.67	18,884.94	19,704.67	N/A
Water & Sewer Series 1992 Refunding Revenue Reserve - BONY	1,305,931.84	1,305,931.84	1,305,931.84	1,305,931.84	0.003
<b>Total</b>	<b>\$28,043,780.10</b>	<b>\$30,644,457.38</b>	<b>\$28,093,288.58</b>	<b>\$30,653,244.62</b>	

<u>Account Name</u>	<u>Yield to Maturity on Cost<sup>4</sup></u>	<u>Yield to Maturity on Cost<sup>4</sup></u>	<u>Yield to Maturity at Market</u>	<u>Yield to Maturity at Market</u>	<u>Duration (Years)</u>
	<u>June 30, 2011</u>	<u>March 31, 2011</u>	<u>June 30, 2011</u>	<u>March 31, 2011</u>	<u>March 31, 2011</u>
General City Account Portfolio	0.50%	0.65%	0.28%	0.49%	1.12
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	0.23%	0.27%	0.23%	0.27%	40 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	0.23%	0.27%	0.23%	0.27%	40 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>0.42%</b>	<b>0.45%</b>	<b>0.24%</b>	<b>0.35%</b>	

**Benchmarks**

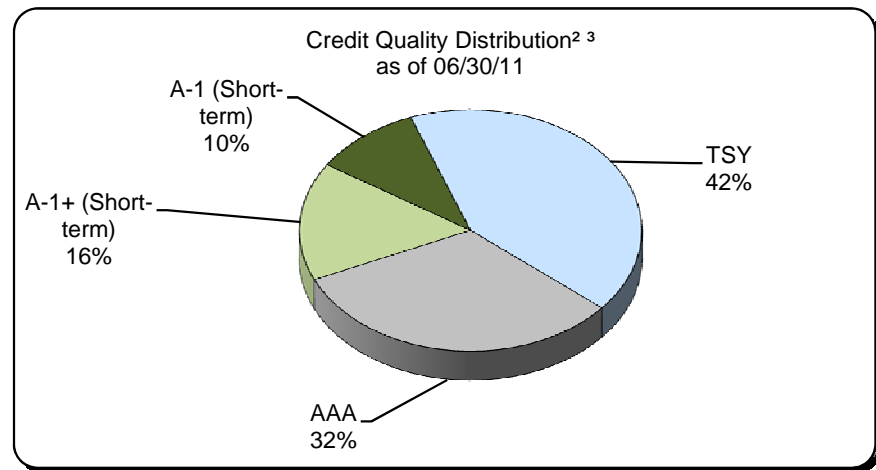
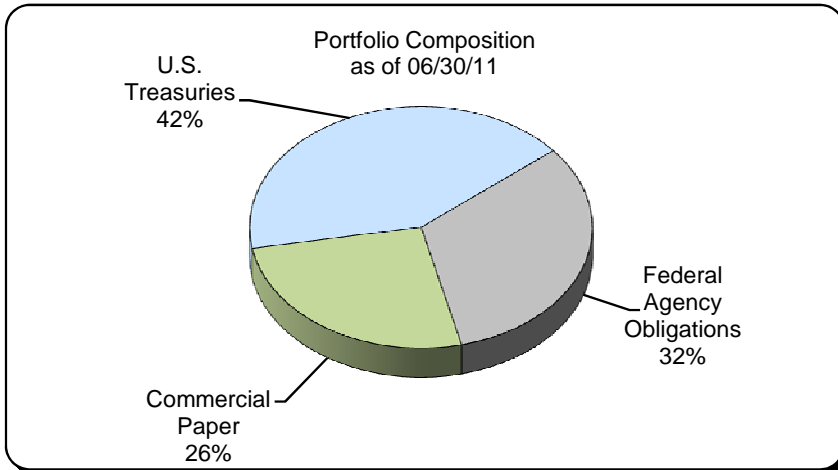
	<u>June 30, 2011</u>	<u>March 31, 2011</u>
Merrill Lynch 1 Year U.S. Treasury Note Index <sup>5</sup>	0.21%	0.27%

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<sup>1</sup></u>	<u>June 30, 2011</u>	<u>% of Portfolio</u>	<u>March 31, 2011</u>	<u>% of Portfolio</u>
U.S. Treasuries	\$9,449,760.82	41.79%	\$7,903,765.40	39.85%
Federal Agencies	7,278,312.40	32.19%	8,932,274.98	45.04%
Commercial Paper	5,882,798.81	26.02%	2,996,164.00	15.11%
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	0.00	0.00%	0.00	0.00%
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>\$22,610,872.03</b>	<b>100.00%</b>	<b>\$19,832,204.38</b>	<b>100.00%</b>

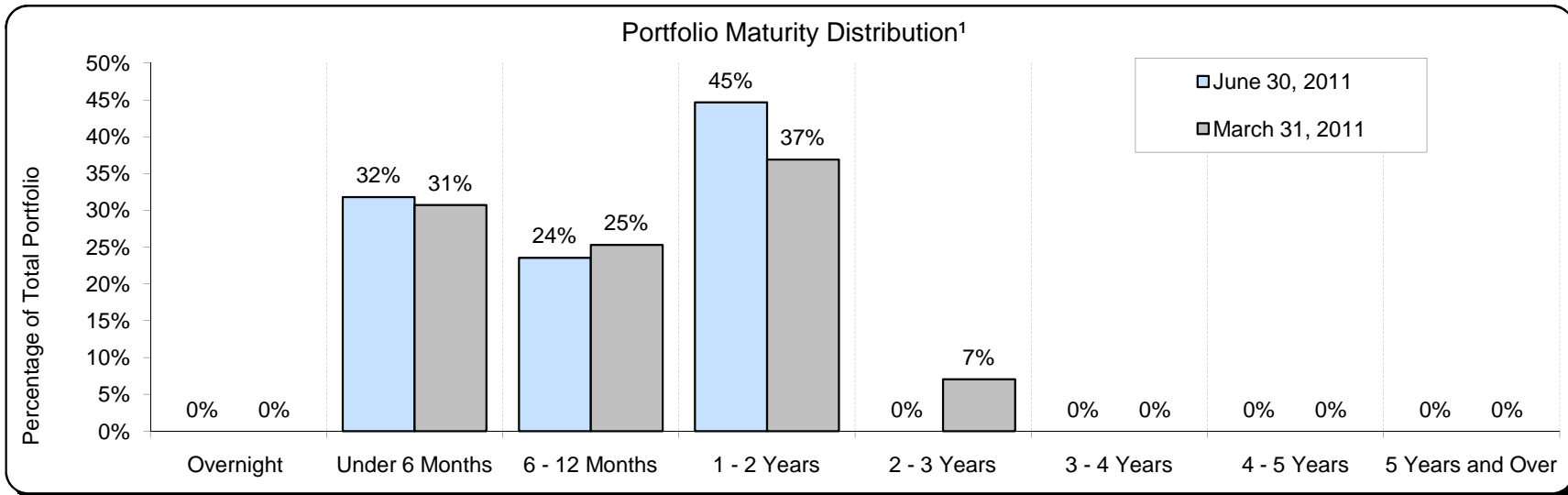


Notes:

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/LGIP. Standard & Poor's is the source of the credit ratings.
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

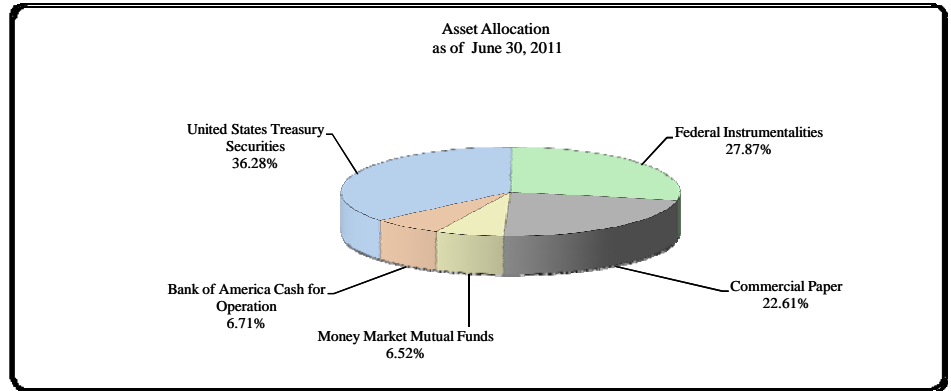
<u>Maturity Distribution<sup>1</sup></u>	<u>June 30, 2011</u>	<u>March 31, 2011</u>
Overnight (Money Market Fund)	\$0.00	\$0.00
Under 6 Months	7,188,231.94	6,094,083.04
6 - 12 Months	5,327,978.96	5,020,114.34
1 - 2 Years	10,094,661.13	7,318,984.25
2 - 3 Years	0.00	1,399,022.75
3 - 4 Years	0.00	0.00
4 - 5 Years	0.00	0.00
5 Years and Over	0.00	0.00
<b>Totals</b>	<b>\$22,610,872.03</b>	<b>\$19,832,204.38</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>2</sup>	June 30, 2011	June 30, 2011	Notes	Permitted by Policy
United States Treasury Securities	9,433,593.28	36.28%		100%
United States Government Agency Securities	-	0.00%		75%
Federal Instrumentalities	7,247,478.55	27.87%		80%
Certificates of Deposit	-	0.00%		25%
Repurchase Agreements	-	0.00%		50%
Commercial Paper	5,880,291.72	22.61%		30%
Corporate Notes - FDIC Insured	-	0.00%		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	1,696,593.19	6.52%	2	100%
Intergovernmental Investment Pool	-	0.00%		25%
Bank of America Cash for Operation	1,743,833.34	6.71%	2	100%



Individual Issuer Breakdown	June 30, 2011	June 30, 2011	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)	4,316,824.12	16.60%		25%
Federal National Mortgage Association (FNMA)	1,410,906.05	5.43%		25%
Federal Home Loan Mortgage Corporation (FHLMC)	1,519,748.38	5.84%		25%
Student Loan Marketing Association (SLMA)	-	0.00%		25%

Individual Issuer Breakdown	June 30, 2011	June 30, 2011	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%
BNP Paribas CP	1,999,125.00	7.69%		10%
Credit Agricole CP	2,297,414.91	8.84%		10%
Rabobank CP	1,583,751.81	6.09%		10%
CP D	-	0.00%		10%
Corporate Notes - FDIC insured C	-	0.00%		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)	1,027,579.29	3.95%	2	25%
Money Market Fund - State Board of Administration	669,013.90	2.57%	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.