

# City of Winter Springs

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Investment Performance Review  
Quarter Ended March 31, 2012



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

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# TAB I

**Summary**

- During the first quarter, short- to intermediate-duration portfolios with diversified fixed-income holdings (including Agencies and corporate bonds) outpaced those that were invested solely in Treasuries.
- Increased optimism about the U.S. economic recovery, specifically a brighter outlook in the labor markets, contributed to a general reduction in risk premiums across asset classes.
- PFM Asset Management obtained value for clients by rotating into Treasuries, as well as into select corporates where appropriate, while moving away from Agencies and callable securities after their exceptional recent performance.

**Economic News**

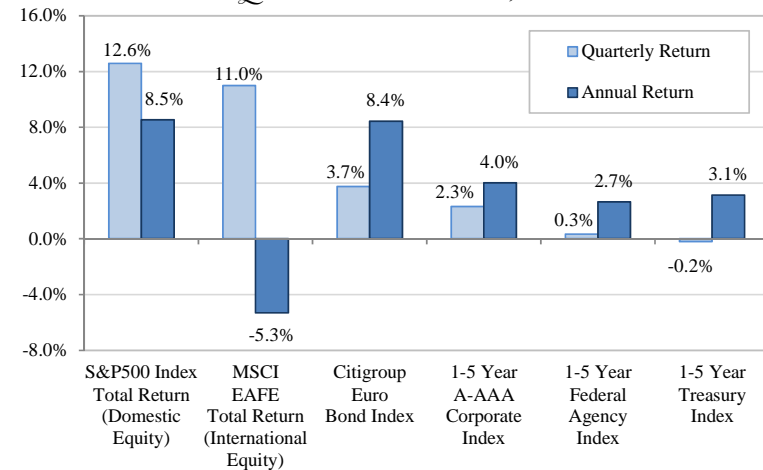
Moderate economic growth in the U.S. continued for the quarter, while troubles in Europe were mitigated for the time being. Gross domestic product (GDP) in the U.S. for the fourth quarter of 2011 was up 3.0%, reflecting modest growth. This quarter was marked by a continuation of loose monetary policy worldwide. After Europe announced another round of long-term refinancing operations (LTRO) at the end of February to help stabilize its financial markets, other central banks followed suit, including the Bank of England and Bank of Japan, which announced further quantitative easing efforts during the quarter. In addition, China reduced its reserve ratio by 50 basis points.

U.S. job market conditions improved during the quarter, as the unemployment rate fell to 8.3%. The labor force participation rate was reported at 63.8% in March, still well below 65.8%, the average level since 1980. The housing market remains lackluster,

with home prices at low levels and foreclosures still in the pipeline, but there have been gradual improvements. For example, homebuilder Lennar reported that new orders were up 33.3% in its earnings report released on March 27.

Oil prices rose to record levels during the quarter, but began to drop somewhat by the end of March. Consumer confidence and consumer spending had healthy results over the quarter, and manufacturing and services activity reflected continued expansion. Demand for riskier assets increased as a result of these positive developments, which led to the S&P 500 Index having its strongest first-quarter performance since 1998, as shown below.

**Total Returns of Various Asset Classes**  
*Quarter ended March 31, 2012*

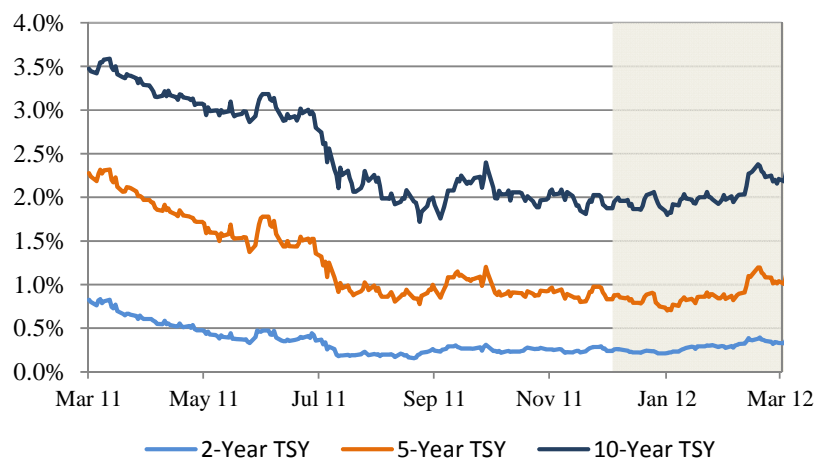


Sources: Bank of America Merrill Lynch, Citigroup, Bloomberg

### Interest Rates

Short-term interest rates remained near zero, as the Federal Reserve (Fed) announced in January that it remains committed to keeping interest rates at low levels until at least late 2014. During the Federal Open Market Committee (FOMC) meeting in March, the FOMC’s economic outlook was relatively brighter. While another round of bond-buying efforts (or quantitative easing) was not ruled out, the stronger economic reports during the quarter suggest that it is considerably less likely. Core inflation remained steady and in line with the Fed’s target limits. Improvements in the U.S. economy pushed yields upward for Treasuries across maturities of six months and beyond, and the yield curve steepened notably.

**2-Year, 5-Year, and 10-Year U.S. Treasury Note Yields**  
 March 31, 2011 through March 31, 2012



Source: Bloomberg

The improvement in the jobs picture suggested the likelihood of fewer mortgage defaults, and therefore less risk for Fannie Mae and Freddie Mac. In addition, the federal housing agencies continued to reduce their debt issuance. As a result, Agencies generally performed well, as spreads to Treasuries narrowed markedly. Corporate bonds outperformed both Treasuries and Agencies, as optimism about the continued economic recovery and stronger corporate balance sheets drove demand.

Agency spreads narrowed from already low levels, and corporate spreads narrowed across the curve, especially on the front end. However, PFM Asset Management believes there is little value left in these sectors, as the yields that they provide are not enough of a trade-off in most cases to justify investments in these securities compared with Treasuries. The European debt crisis and the resolution of U.S. housing policy remain as risks to the outlook for the bond market.

### U.S. Treasury Yields – Quarter and Year-over-Year Changes

| Date                       | 3-month | 1-year | 2-year | 5-year | 10-year | 30-year |
|----------------------------|---------|--------|--------|--------|---------|---------|
| <b>31-Mar-12</b>           | 0.07%   | 0.17%  | 0.33%  | 1.04%  | 2.21%   | 3.34%   |
| <b>31-Dec-11</b>           | 0.01%   | 0.10%  | 0.24%  | 0.83%  | 1.88%   | 2.89%   |
| <b>Change over Quarter</b> | 0.06%   | 0.07%  | 0.09%  | 0.21%  | 0.33%   | 0.44%   |
| <b>31-Mar-11</b>           | 0.09%   | 0.27%  | 0.82%  | 2.28%  | 3.47%   | 4.51%   |
| <b>Change over Year</b>    | -0.03%  | -0.11% | -0.49% | -1.24% | -1.26%  | -1.17%  |

Source data: Bloomberg

**PFM Outlook**

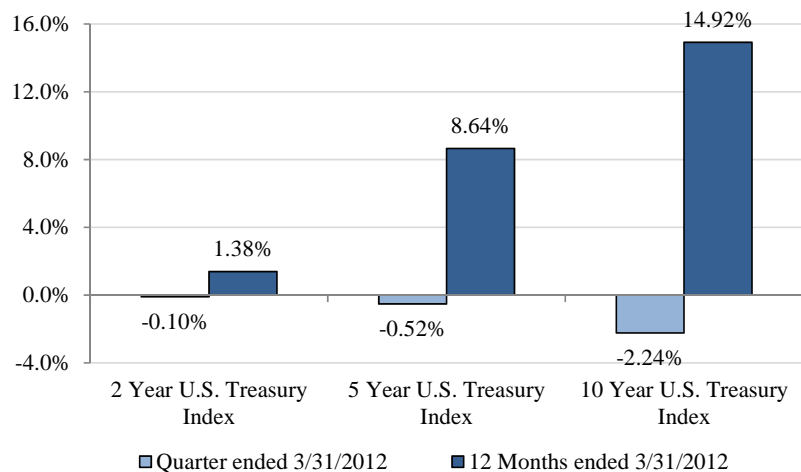
While the economy shows signs of strengthening, uncertainties remain regarding the severity of the downturn in the European economy and the potential for slower growth in China. Interest rates are still range-bound, but the yield curve has steepened sharply. Currently, we do not believe that rates will head higher as the Fed is maintaining a loose monetary policy and inflation remains within the Fed's mandate of 2% for core personal consumption expenditures.

Oil prices are higher, but as yet they do not seem to be adversely impacting manufacturing activity or consumer spending, and the mild winter has contributed to this being less of a threat to growth.

Core inflation has remained mostly stable, driven by a lack of wage pressure. The Fed continues to discuss the possibility of another round of quantitative easing, but as the U.S. economic recovery seems to be on track, further Fed action looks less likely.

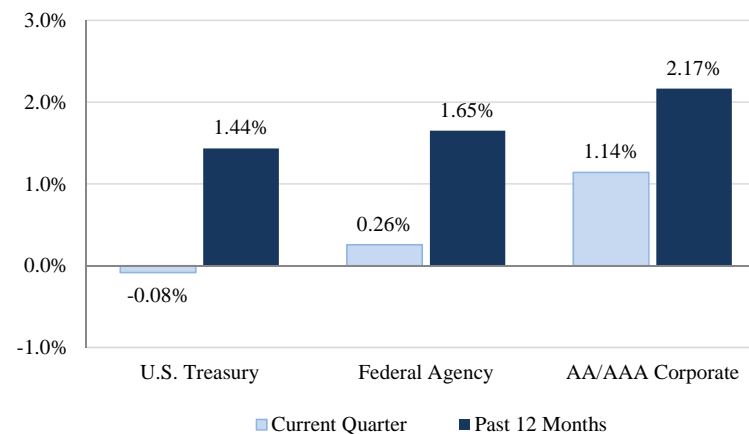
Because of some uncertainty surrounding federal housing policy and ongoing litigation over mortgage originations, we believe that mortgage-backed securities have some degree of event risk at this time. In the money market sector, we expect that short rates will drift lower as seasoned Treasury bills mature, LIBOR stabilizes, and bank deposit issuers resort to alternative financing. Since corporate spreads have tightened significantly over the quarter, we do not see value in this space now. Our feeling about Agencies is similar, so we are focusing on the value that the Treasury space represents.

**Returns for 2-Year, 5-Year and 10-Year Treasuries**  
*Quarter ended March 31, 2012*



Source: Bloomberg

**Duration-Adjusted Returns for Fixed-Income Securities**  
*Quarter ended March 31, 2012*



Source: Bloomberg

The views expressed within this material constitute the perspective and judgment of PFM Asset Management LLC (PFMAM) at the time of distribution and are subject to change. Information is obtained from sources generally believed to be reliable and available to the public; however, PFMAM 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.

# TAB II

## Executive Summary

## PORTFOLIO STRATEGY

- The City's General City Account Portfolio is of high credit quality and invested in U.S. Treasury, Federal Agency, and high quality commercial paper securities.
- In the first quarter, the so called "risk-on" trade benefited investors across the board – and to a general extent, the riskier the asset, the better the performance. As risk aversion waned in the first quarter, spreads narrowed considerably. As a result, spread product, such as corporates, performed exceptionally well. Because rates rose in the quarter, most U.S. Treasuries indices posted negative returns, making them the poorest performing sector and ending the three quarter streak in which Treasuries outperformed Agencies.
- For most of the first quarter, Treasury yields stayed within the established ranges they had been in since August 2011. However, in mid-March, yields moved sharply higher to 8-month highs. Despite the move higher, we concluded that this did not represent a fundamental change in the marketplace nor did it warrant a significant change in strategy. The Federal Reserve has committed to keep low rates through late 2014, and economic conditions continue to reflect only moderate growth.
- Several months of stronger economic news has improved the outlook for the U.S. economy, but we expect interest rates to remain range-bound due to the Federal Reserve's loose monetary policy, lingering worries about Europe and China, and moderate levels of inflation in core prices. In particular, the fed funds target rate—set at 0.00% to 0.25% since December 2008—creates a strong anchor, holding down short- and intermediate-term rates for the foreseeable future.
- 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 0.45%, exceeding the Yield to Maturity of its benchmark the Merrill Lynch 1 Year U.S. Treasury Note Index by 23 basis points (0.23%).
- With short-term investments pegged near zero and interest rates likely to stay within a range, investments with longer maturities are attractive for their higher income generation and roll-down potential. Roll-down has remained a significant contributor to performance over time, and we believe that will continue in the second quarter. We plan to keep portfolio durations near that of the benchmark, with just a slightly conservative posture to provide flexibility. We are a bit more cautious on maturities beyond five years, which have much greater sensitivity to yield changes.
- As always, we strive to maintain the safety of principal, while at the same time seeking opportunities to add value. Our strategy will remain flexible and may change in response to changes in interest rates, economic data, market outlook or specific opportunities that arise.



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>March 31, 2012</u>                 | <u>December 31, 2011</u>              | <u>March 31, 2012</u>               | <u>December 31, 2011</u>            | <u>March 31, 2012</u>   |
| General City Account Portfolio  | \$25,517,711.97                       | \$22,587,444.53                       | \$25,553,386.88                     | \$22,634,632.69                     | 0.92                    |
| Fidelity Institutional Money Market Fund Government Portfolio (Fund #257)                         | \$655,396.19                          | 3,057,827.75                          | 655,396.19                          | 3,057,827.75                        | 0.003                   |
| Money Market Fund - State Board of Administration Pool A  | 48,116.05                             | 25,780.35                             | 48,116.05                           | 25,780.35                           | 34 Days                 |
| Money Market Fund - State Board of Administration Pool B  | 573,608.48                            | 595,911.82                            | 573,608.48                          | 595,911.82                          | N/A                     |
| Bank of America Cash for Operation - depository   | 2,770,097.24                          | 3,034,010.49                          | 2,770,097.24                        | 3,034,010.49                        | 0.003                   |
| Water & Sewer 2000 - Fidelity Institutional Money Market Fund Government Portfolio (Account #364) | 716,695.41                            | 716,677.54                            | 716,695.41                          | 716,677.54                          | 0.003                   |
| Water & Sewer 2000 - Money Market Fund - State Board of Administration Pool A                     | 1,396.45                              | 748.20                                | 1,396.45                            | 748.20                              | 34 Days                 |
| Water & Sewer 2000 - Money Market Fund - State Board of Administration Pool B                     | 16,647.66                             | 17,294.96                             | 16,647.66                           | 17,294.96                           | N/A                     |
| <b>Total</b>  | <b>\$30,299,669.45</b>                | <b>\$30,035,695.64</b>                | <b>\$30,335,344.36</b>              | <b>\$30,082,883.80</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>March 31, 2012</u>                        | <u>December 31, 2011</u>                     | <u>March 31, 2012</u>              | <u>December 31, 2011</u>           | <u>December 31, 2011</u> |
| General City Account Portfolio  | 0.45%  | 0.43%  | 0.28%                              | 0.22%                              | 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  | 0.33%  | 0.29%  | 0.33%                              | 0.29%                              | 37 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   | 0.25%  | 0.25%  | 0.25%                              | 0.25%                              | 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                     | 0.33%  | 0.29%  | 0.33%                              | 0.29%                              | 37 Days                  |
| Water & Sewer 2000 - Money Market Fund - State Board of Administration Pool B                     | 0.00%  | 0.00%  | 0.00%                              | 0.00%                              | N/A                      |
| <b>Weighted Average Yield</b>   | <b>0.40%</b>                                 | <b>0.35%</b>                                 | <b>0.26%</b>                       | <b>0.19%</b>                       |                          |

**Benchmarks**

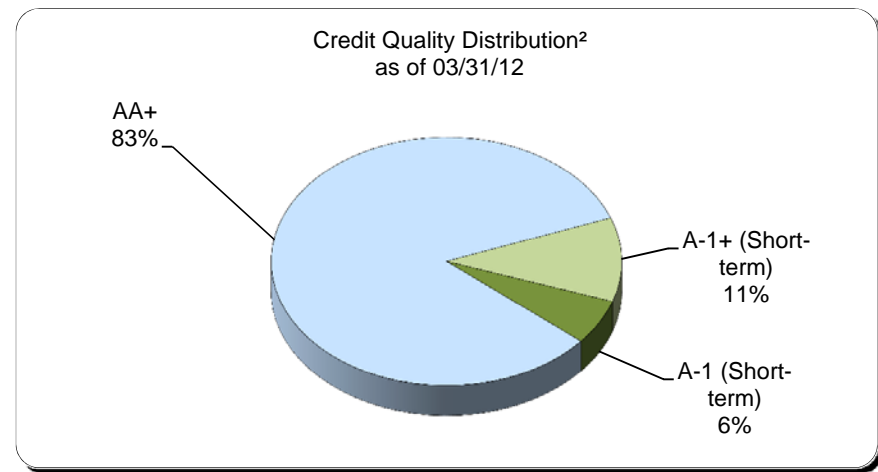
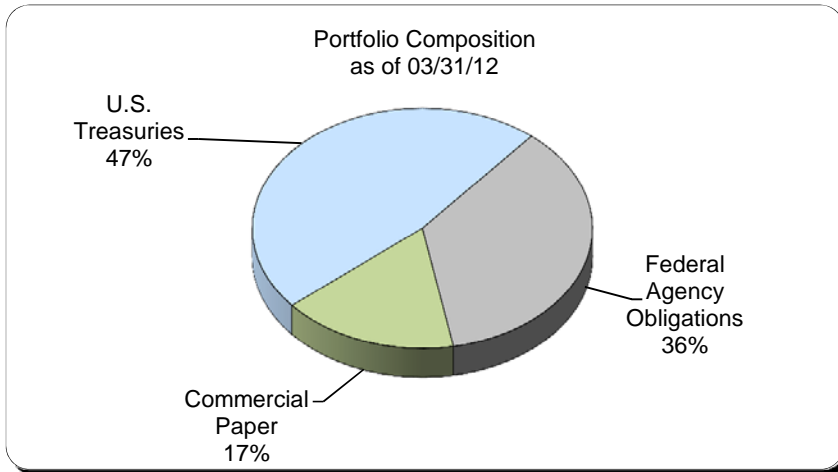
|  | <u>March 31, 2012</u> | <u>December 31, 2011</u> |
|--|-----------------------|--------------------------|
| Merrill Lynch 1 Year U.S. Treasury Note Index <sup>5</sup> | 0.22%                 | 0.14%                    |

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>March 31, 2012</u>  | <u>% of Portfolio</u> | <u>December 31, 2011</u> | <u>% of Portfolio</u> |
|--------------------------------------|------------------------|-----------------------|--------------------------|-----------------------|
| U.S. Treasuries                      | \$12,060,466.24        | 47.20%                | \$12,093,185.85          | 53.43%                |
| Federal Agencies                     | 9,195,775.34           | 35.99%                | 9,241,691.24             | 40.83%                |
| Commercial Paper                     | 4,297,145.30           | 16.82%                | 1,299,755.60             | 5.74%                 |
| 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>\$25,553,386.88</b> | <b>100.00%</b>        | <b>\$22,634,632.69</b>   | <b>100.00%</b>        |

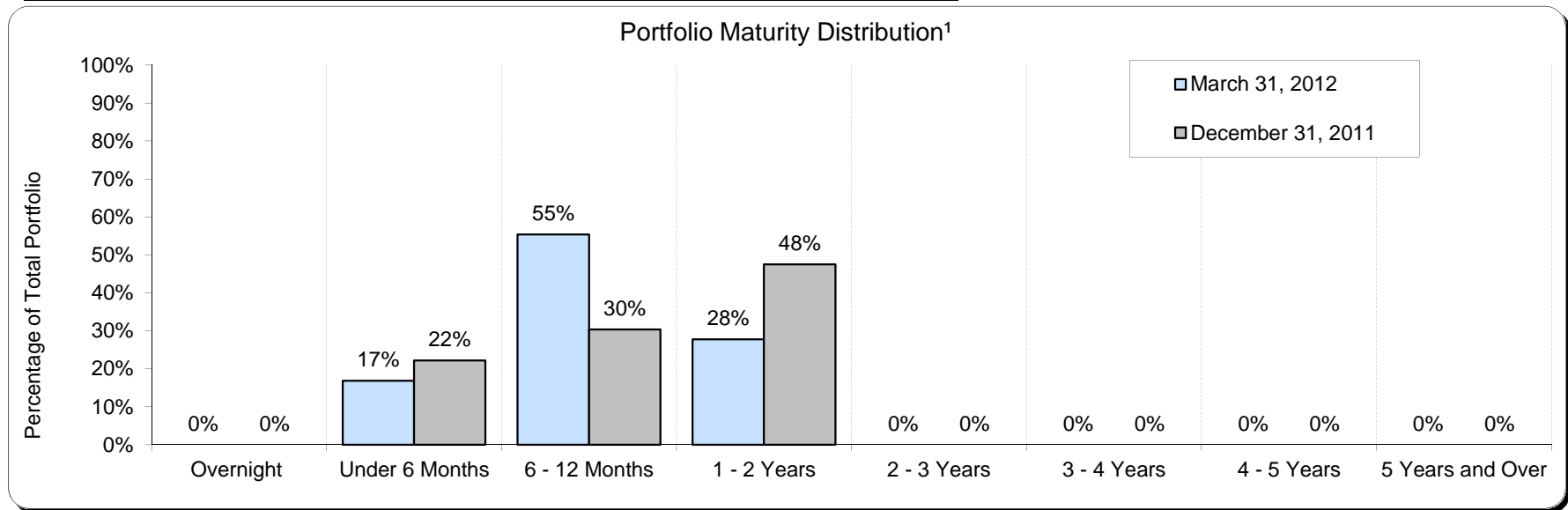


Notes:

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.

General City Account Portfolio Maturity Distribution

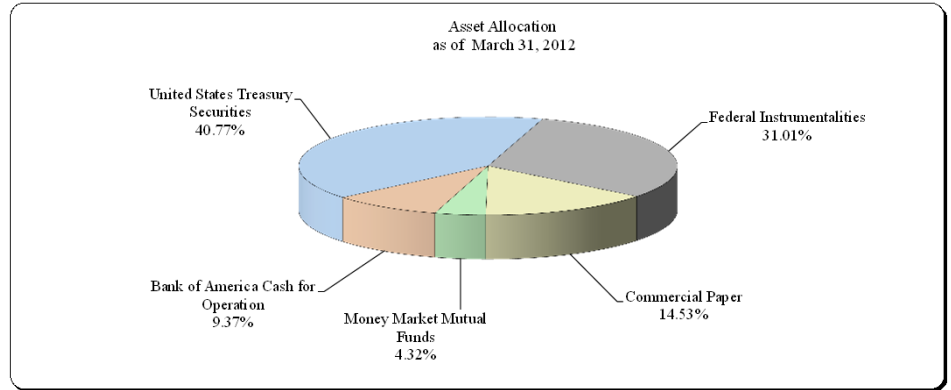
| <u>Maturity Distribution<sup>1</sup></u> | <u>March 31, 2012</u>  | <u>December 31, 2011</u> |
|--|------------------------|--------------------------|
| Overnight (Money Market Fund)            | \$0.00                 | \$0.00                   |
| Under 6 Months                           | 4,297,145.30           | 5,014,970.73             |
| 6 - 12 Months                            | 14,157,952.65          | 6,862,139.63             |
| 1 - 2 Years                              | 7,098,288.93           | 10,757,522.33            |
| 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>\$25,553,386.88</b> | <b>\$22,634,632.69</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>1</sup>                          | March 31, 2012 | March 31, 2012 | Notes | Permitted by Policy |
|---|----------------|----------------|-------|---------------------|
| United States Treasury Securities                   | 12,052,315.82  | 40.77%         |       | 100%                |
| United States Government Agency Securities          | -              | 0.00%          |       | 75%                 |
| Federal Instrumentalities                           | 9,169,537.89   | 31.01%         |       | 80%                 |
| Certificates of Deposit                             | -              | 0.00%          |       | 25%                 |
| Repurchase Agreements                               | -              | 0.00%          |       | 50%                 |
| Commercial Paper                                    | 4,295,858.26   | 14.53%         |       | 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                           | 1,277,120.73   | 4.32%          |       | 100%                |
| Intergovernmental Investment Pool                   | -              | 0.00%          |       | 25%                 |
| Bank of America Cash for Operation                  | 2,770,097.24   | 9.37%          | 2     | 100%                |



| Individual Issuer Breakdown                     | March 31, 2012 | March 31, 2012 | 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)                   | 4,242,277.62   | 14.35%         |       | 25%                 |
| Federal National Mortgage Association (FNMA)    | 3,408,979.71   | 11.53%         |       | 25%                 |
| Federal Home Loan Mortgage Corporation (FHLMC)  | 1,518,280.56   | 5.14%          |       | 25%                 |
| Student Loan Marketing Association (SLMA)       | -              | 0.00%          |       | 25%                 |

| Individual Issuer Breakdown   | March 31, 2012 | March 31, 2012 | 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   | 1,499,120.00   | 5.07%          |       | 10%                 |
| Rabobank USA CP   | 1,498,907.09   | 5.07%          |       | 10%                 |
| Toyota CP   | 1,297,831.17   | 4.39%          |       | 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) | 655,396.20     | 2.22%          | 2     | 25%                 |
| Money Market Fund - Florida Prime (SBA)                                   | 48,116.05      | 0.16%          | 2     | 25%                 |
| Money Market Fund - Florida SBA Fund B                                    | 573,608.48     | 1.94%          | 2     | N/A                 |

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.