



# Town of Fountain Hills Quarterly Investment Review Quarter Ended December 31, 2014



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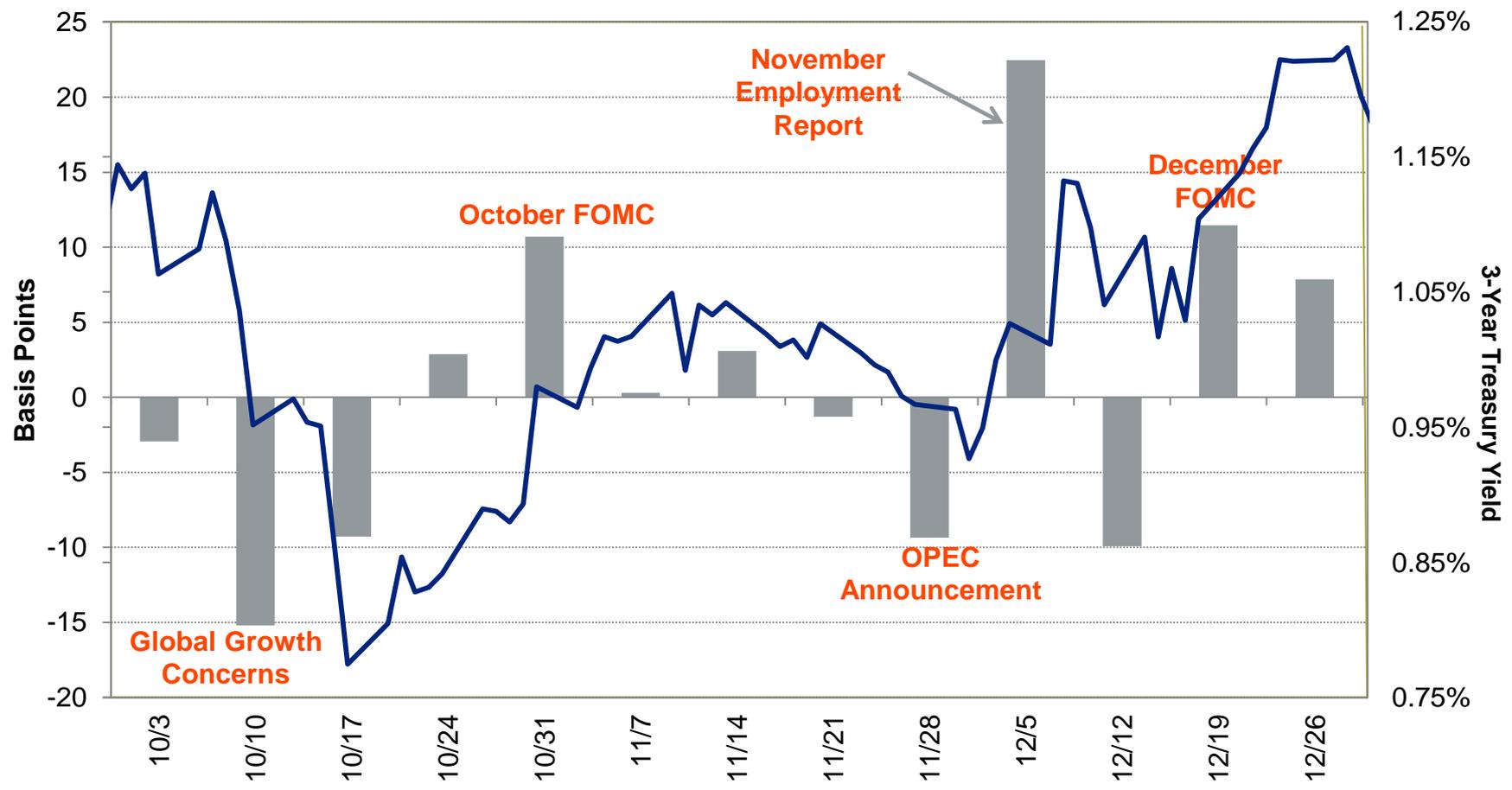


# Fourth Quarter 2014 Strategy and Recap

- Interest rates were volatile in the fourth quarter as market participants continued to weigh an improving domestic economy against declining growth prospects abroad, global deflationary pressures, and diverging policies from central banks around the world.
- Yields under five years continued their trend higher, while longer-term rates trended lower. This resulted in an overall flattening of the yield curve.
- We maintained a modestly defensive duration strategy—keeping the average portfolio maturity shorter than the benchmark—throughout the quarter in an effort to mitigate the impact that rising rates would have on the portfolio's performance.
- The yield spread between Treasuries and Agencies was narrow for most maturities and so we favored the Treasury sector for new purchases. However, in one instance we found value in a Federal Agency and sold a Treasury to purchase a similar maturity Agency, increasing portfolio earnings without adding risk.
- Despite the slight underperformance for the quarter, the yield of the portfolio increased by +0.06% (cost basis) compared to the end of the third quarter as a result of taking advantage of higher rates by redeploying shorter maturities into longer-maturities at higher yields.
  - These actions will positively impact the income generated by the portfolio.

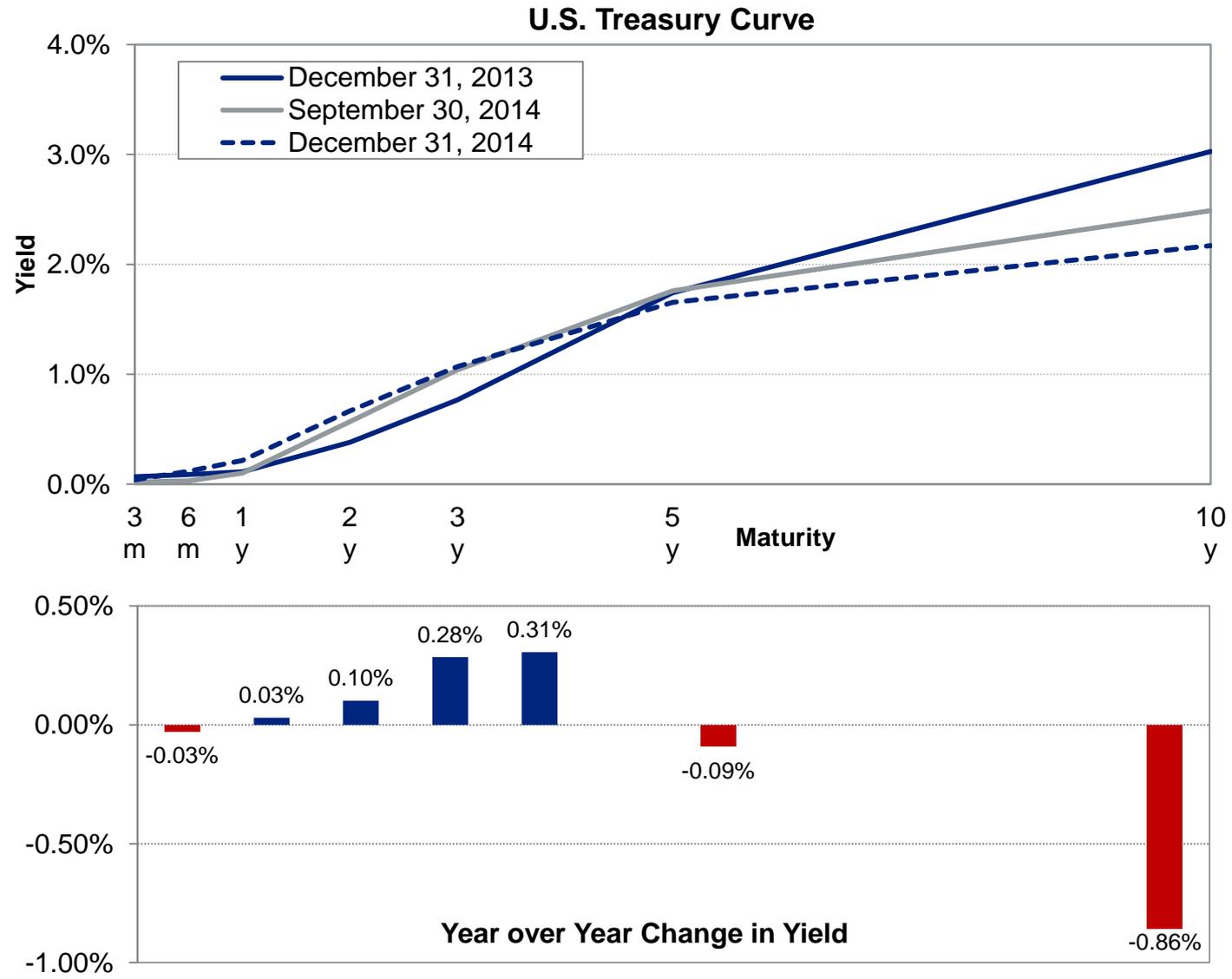
# Treasury Yields Volatile in 4<sup>th</sup> Quarter

3-Year U.S. Treasury Yield and Week over Week Change in Basis Points



Source: Bloomberg.

# Intermediate-Term Yields Rose; Longer Fell

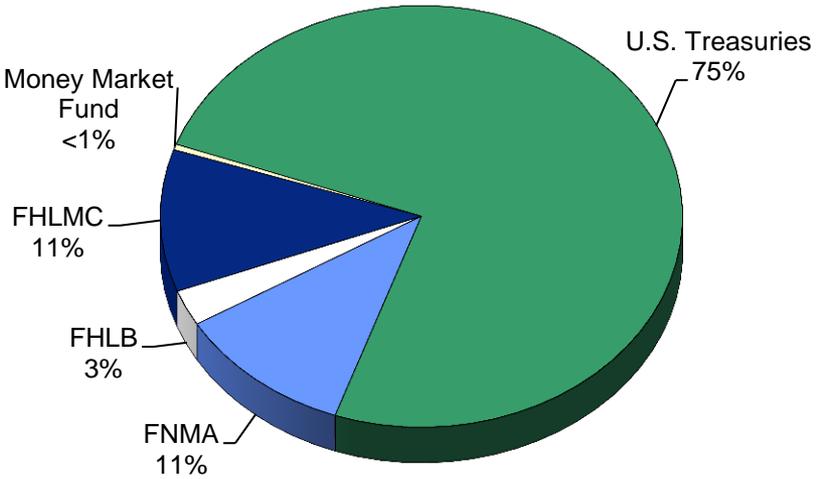


Source: Bloomberg.

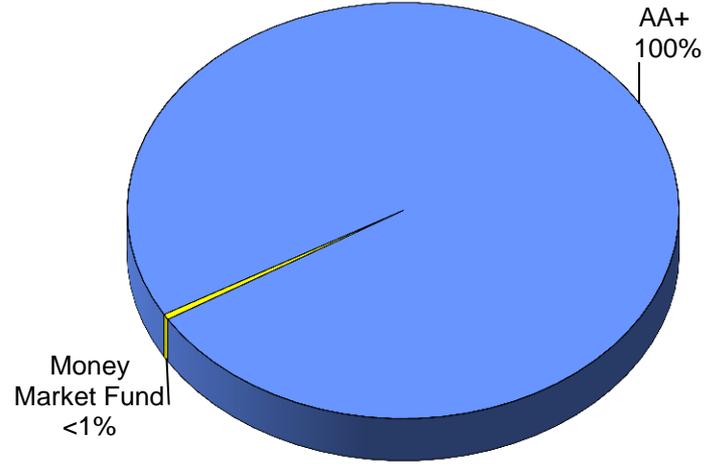
# Portfolio Composition and Credit Quality Characteristics

Security Type <sup>1</sup>	December 31, 2014	% of Portfolio	% Change From Prior Quarter	Permitted by Policy
<b>U.S. Treasuries</b>	<b>\$11,407,538.20</b>	<b>75%</b>	<b>+3%</b>	<b>100%</b>
<b>Federal Agencies</b>	<b>\$3,776,531.97</b>	<b>25%</b>	<b>-3%</b>	<b>100%</b>
<i>FNMA</i>	\$1,693,563.30	11%	-	-
<i>FHLB</i>	\$419,429.08	3%	-3%	-
<i>FHLMC</i>	\$1,663,539.59	11%	+3%	-
<i>FFCB</i>	\$0.00	0%	-3%	-
<b>Money Market Fund</b>	<b>\$66,086.75</b>	<b>&lt;1%</b>	<b>-</b>	
<b>Total</b>	<b>\$15,250,156.92</b>	<b>100%</b>		

**Portfolio Composition**



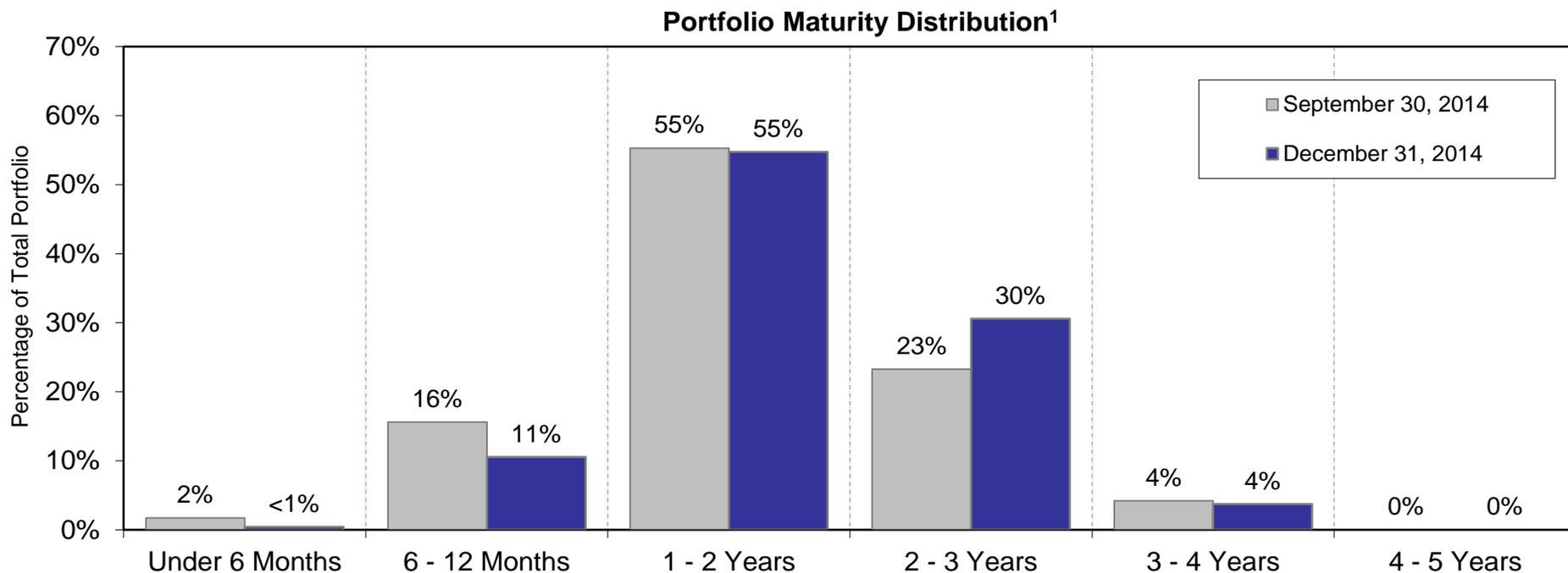
**Portfolio Credit Quality Distribution<sup>2</sup>**



1. End of quarter trade-date market values of portfolio holdings, including accrued interest.  
 2. Ratings by Standard and Poor's.

# Portfolio Maturity Distribution

Maturity Distribution <sup>1</sup>	December 31, 2014	September 30, 2014
Under 6 Months	\$66,086.75	\$256,599.87
6 - 12 Months	\$1,605,292.36	\$2,373,830.07
1 - 2 Years	\$8,346,658.38	\$8,418,333.57
2 - 3 Years	\$4,663,172.04	\$3,540,460.51
3 - 4 Years	\$568,947.39	\$638,948.44
4 - 5 Years	\$0.00	\$0.00
<b>Totals</b>	<b>\$15,250,156.92</b>	<b>\$15,228,172.46</b>



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

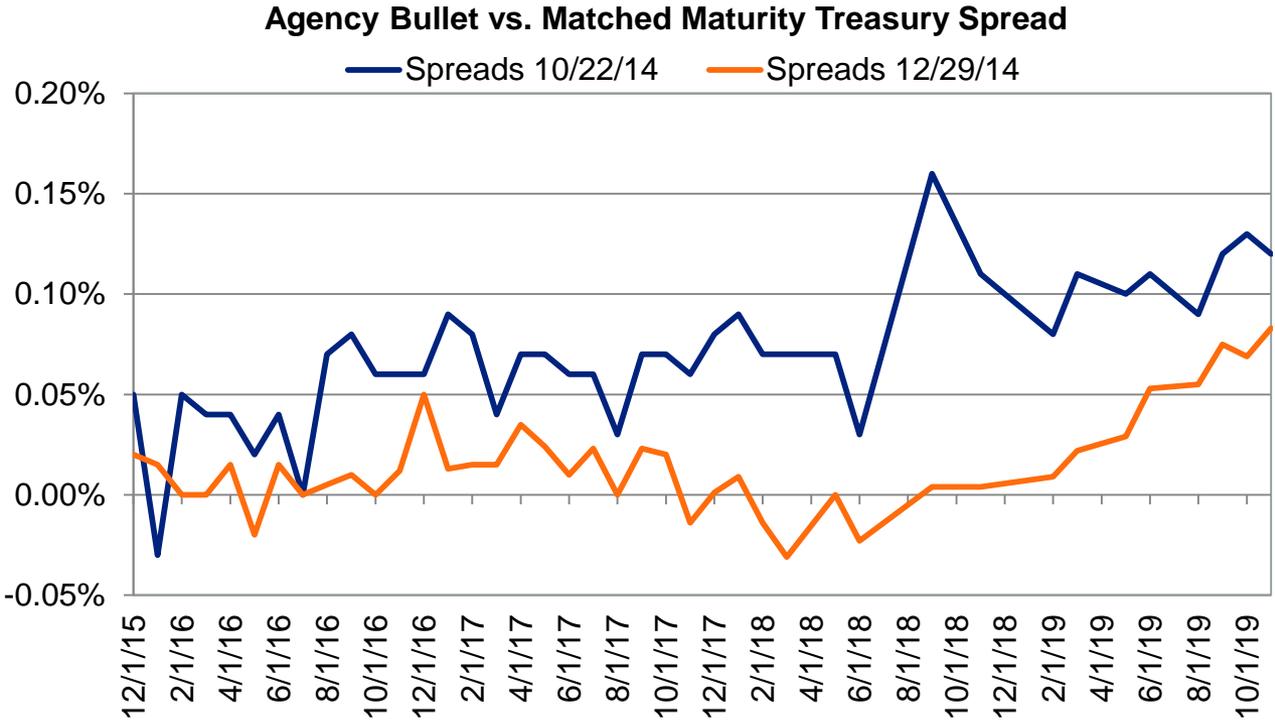
# Treasury Purchases Add Yield and Duration

- Yield spreads on Federal Agency securities reversed the temporary widening that occurred in the third quarter to return to historically tight levels.
- This provided opportunities to swap from select Agency securities into a Treasuries, positioning the Town's portfolio for future opportunities while improving overall liquidity.
- There were also opportunities to sell shorter-maturity Treasuries to purchase longer-maturity Treasuries for their higher yields, as well as to position the portfolio's duration at its target.
- Summary of Treasuries purchased during fourth quarter:

Trade Date	Security	Maturity	Par Value	Yield
10/2/14	U.S. Treasury Notes	3/31/17	\$650,000	0.80%
10/30/14	U.S. Treasury Notes	6/30/17	\$550,000	0.79%
12/1/14	U.S. Treasury Notes	12/31/17	\$575,000	0.91%
12/5/14	U.S. Treasury Notes	12/31/16	\$500,000	0.69%

# Relative Value Analysis: Treasuries vs. Agencies

- Although, generally speaking, yield spreads between Treasuries and Agencies favor Treasuries, the relationship fluctuates and depends on the security maturity.
- This provides opportunities to trade between the two sectors to increase earnings. In November we sold a Treasury to purchase a similar maturity Agency, picking up 10 basis points.

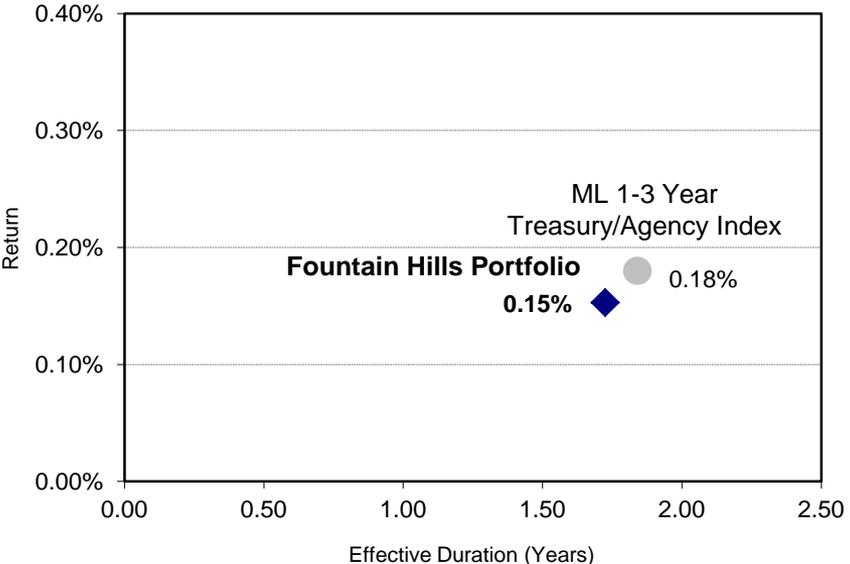


Trade Date	Trade Type	Security	Maturity	Par Value	Yield
11/19/14	Sell	U.S. Treasury Notes	4/30/16	\$475,000	0.32%
11/19/14	Buy	FHLMC Notes	5/27/16	\$500,000	0.42%

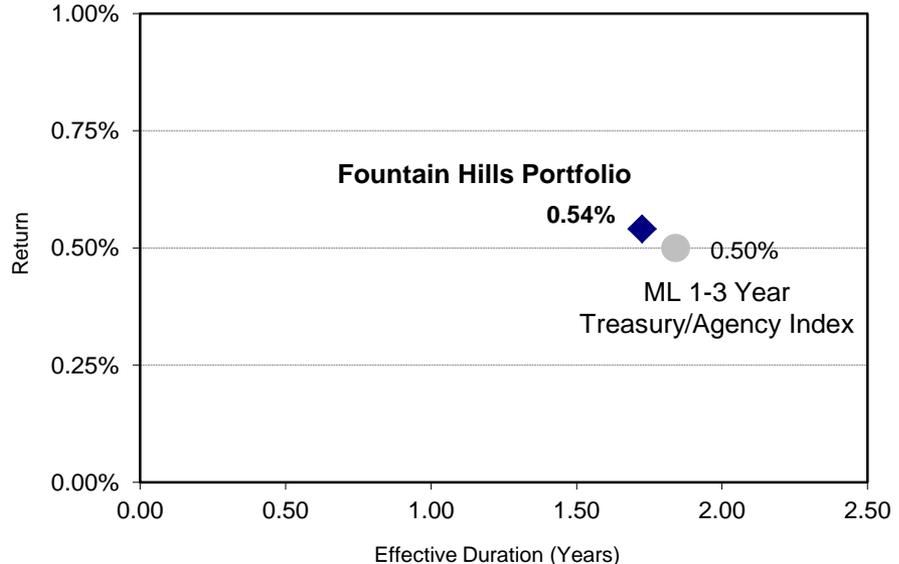
# Portfolio Performance

Total Return <sup>1,2,3,4</sup>	Quarter Ended December 31, 2014	Past 6 Months	Past 12 Months	Past 2 Years	Since Inception
<b>Fountain Hills Portfolio</b>	<b>0.15%</b>	<b>0.19%</b>	<b>0.57%</b>	<b>0.44%</b>	<b>0.54%</b>
ML 1-3 Year Treasury/Agency Index	0.18%	0.21%	0.63%	0.50%	0.50%
Effective Duration	December 31, 2014	September 30, 2014	Yields	December 31, 2014	September 30, 2014
<b>Fountain Hills Portfolio</b>	<b>1.73</b>	<b>1.70</b>	Yield at Market	0.61%	0.51%
ML 1-3 Year Treasury/Agency Index	1.81	1.84	Yield on Cost	0.61%	0.55%

Quarter Total Return Comparison



Since Inception Total Return Comparison



1. Performance on trade date basis, gross (i.e., before fees), in accordance with the CFA Institute's Global Investment Performance Standards (GIPS).  
 2. Merrill Lynch Indices provided by Bloomberg Financial Markets.  
 3. Quarterly returns are presented on an unannualized basis. Performance numbers for periods greater than one year are presented on an annualized basis.  
 4. Inception date is 12/31/11.

# First Quarter 2015 Investment Strategy

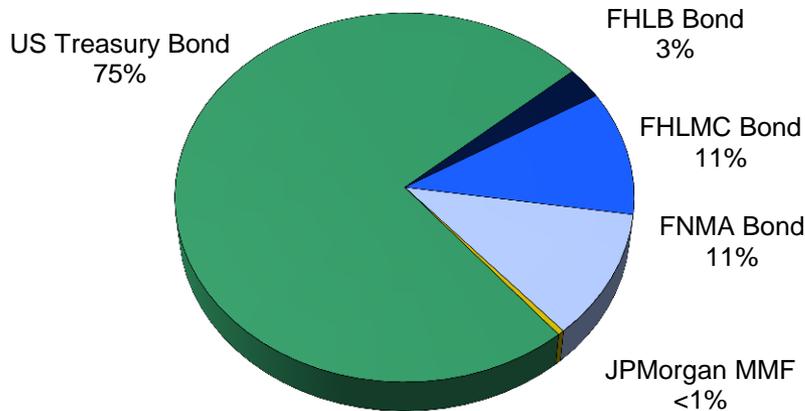
- **We expect similar market forces in 2015:**
  - Central bank action
  - Diverging global economic activity
  - Geopolitical risk
- **Closely monitor movements of the FOMC:**
  - Expect first rate hike in 2015
  - Timing uncertain—possibly late summer to early fall
  - Continue to employ conservative duration management
- **Treasury Agency spreads are very narrow:**
  - Prefer Treasuries where yields are narrow
  - Look to swap between sectors as spreads fluctuate to safely increase earnings

# Town of Fountain Hills Portfolio Summary

Summary By Type	Book Value	Market Value <sup>1</sup>	Days to Maturity	% of Portfolio	% Allowed per Policy	YTM @ Cost
US Treasury Bond	\$11,413,840	\$11,407,538	654	74.80%	100%	0.59%
FHLB Bond	\$419,773	\$419,429	637	2.75%	100%	0.61%
FHLMC Bond	\$1,664,210	\$1,663,540	675	10.91%	100%	0.72%
FNMA Bond	\$1,690,233	\$1,693,563	501	11.11%	100%	0.63%
FFCB Bond	\$0	\$0	-	0.00%	100%	-
JPMorgan MMF	\$66,087	\$66,087	1	0.43%	N/A	0.01%
Total including cash	\$15,254,143	\$15,250,157	636	100.00%		0.61%
Total without cash	\$15,188,056	\$15,184,070				0.61%

Summary by Issuer	Book Value	% of Portfolio
US Treasury	\$11,413,840	74.82%
FHLB	\$419,773	2.75%
FHLMC	\$1,664,210	10.91%
FNMA	\$1,690,233	11.08%
FFCB Bond	\$0	0.00%
JPMorgan	\$66,087	0.43%
<b>Total</b>	<b>\$15,254,143</b>	<b>100%</b>

Issuer Distribution



Weighted Average Maturity (in years)	1.74
Duration Allowed by Policy	5.00
Current Portfolio Duration Including Cash	1.72
Current Portfolio Duration Without Cash	1.73

<sup>1</sup> Market values of portfolio holdings include accrued interest.

<sup>2</sup> Excludes Money Market Balance

Maturity Distribution<sup>2</sup>

