



# Town of Fountain Hills

## Quarterly Investment Review

### Quarter Ended June 30, 2014



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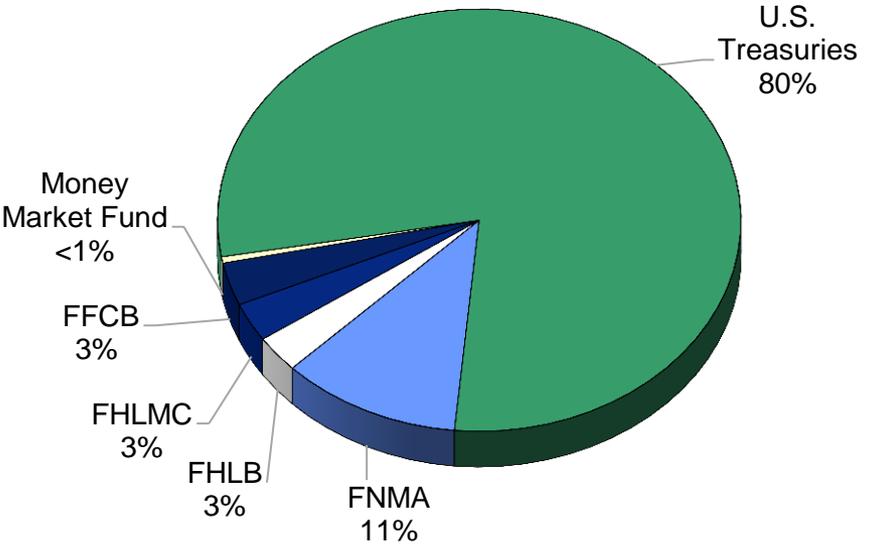
# Second Quarter 2014 Strategy and Recap

- U.S. Treasury yields moved in a somewhat random fashion, despite generally positive economic data.
- Uncertainty around future Fed action (timing and pace of eventual rate increases) posed a significant challenge in assessing the attractiveness of current yields.
- Active duration management was a critical aspect of our strategy to mitigate the effects of rising rates and to maximize relative performance.
  - Employed quantitative analysis to measure the relative risk-reward of individual bonds and to identify the steepest part of the curve, which benefits most from roll-down return.
- We added duration modestly when rates moved to the higher end of their recent trading ranges.
- We favored Treasuries in all (but select issues and maturities) as the yield spread between U.S. Treasuries and Agencies remained at historically narrow levels.
- Our goal was to position the portfolio to minimize the effects of interest rate volatility, while capitalizing on opportunities to prudently enhance the portfolio's yield.

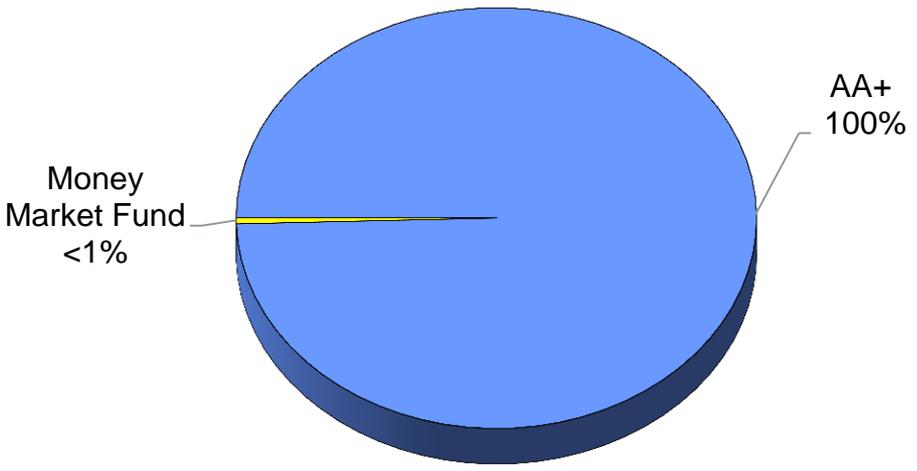
# Portfolio Composition and Credit Quality Characteristics

Security Type <sup>1</sup>	June 30, 2014	% of Portfolio	% Change From Prior Quarter	Permitted by Policy
<b>U.S. Treasuries</b>	<b>\$12,069,680.51</b>	<b>80%</b>	<b>+2%</b>	<b>100%</b>
<b>Federal Agencies</b>	<b>\$3,080,554.71</b>	<b>20%</b>	<b>-2%</b>	<b>100%</b>
<i>FNMA</i>	\$1,696,346.69	11%	-	-
<i>FHLB</i>	\$431,473.36	3%	-	-
<i>FHLMC</i>	\$452,301.10	3%	-2%	-
<i>FFCB</i>	\$500,433.56	3%	-	-
<b>Money Market Fund</b>	<b>\$73,639.19</b>	<b>&lt; 1%</b>	<b>-</b>	
<b>Totals</b>	<b>\$15,223,874.41</b>	<b>100%</b>		

Portfolio Composition



Portfolio Credit Quality Distribution



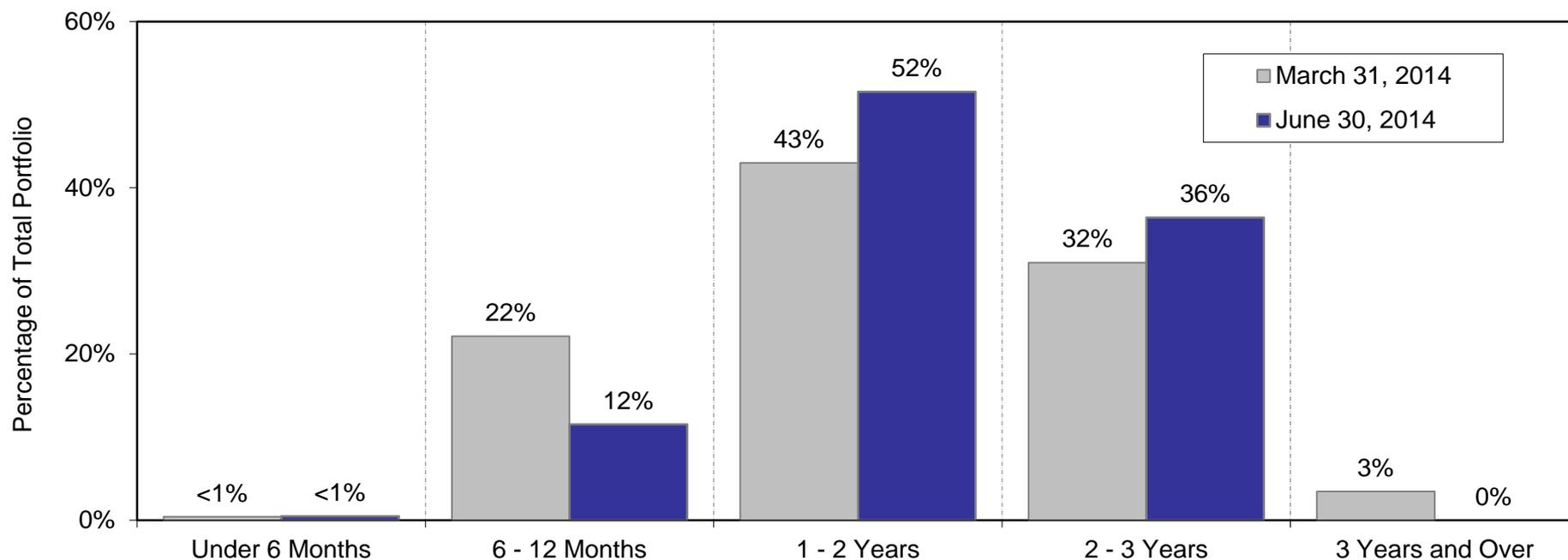
Ratings by Standard & Poor's

1. End of quarter trade-date market values of portfolio holdings, including accrued interest.

# Portfolio Maturity Distribution

Maturity Distribution <sup>1</sup>	June 30, 2014	March 31, 2014
Under 6 Months	\$73,639.19	\$60,172.76
6 - 12 Months	\$1,754,985.95	\$3,362,519.59
1 - 2 Years	\$7,849,249.89	\$6,530,737.06
2 - 3 Years	\$5,545,999.38	\$4,707,998.56
3 Years and Over	\$0.00	\$526,326.84
<b>Totals</b>	<b>\$15,223,874.41</b>	<b>\$15,187,754.81</b>

Portfolio Maturity Distribution



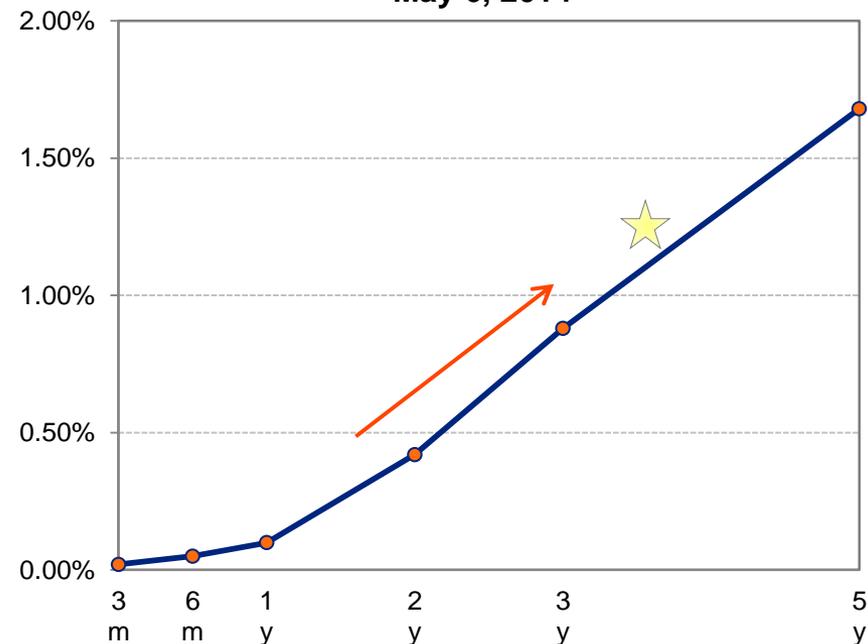
1. Callable securities, if any, in portfolio are included in the maturity distribution analysis to their stated maturity date, although they may be called prior to maturity.

# May Strategic Duration Extension

Date	Transaction	Security	Maturity	Par Value (in Millions)	Yield	Gain/Loss from Sale
5/6/14	Buy	U.S. Treasury Notes	11/30/17	\$0.63	1.18%	-
5/6/14	Sell	FHLMC Notes	11/25/14	\$0.33	0.09%	\$738
5/6/14	Sell	U.S. Treasury Notes	12/15/14	\$0.30	0.06%	\$581

- We purchased a 3.5-year Treasury to maintain the portfolio's conservative duration position.
  - Took advantage of the steepest area of the yield curve which provides protection should rates rise.
- Yield spreads between Treasuries and Agencies are minimal to nonexistent in many issues.

U.S. Treasury Curve  
May 6, 2014



Source: Bloomberg

# June Duration Adjustment

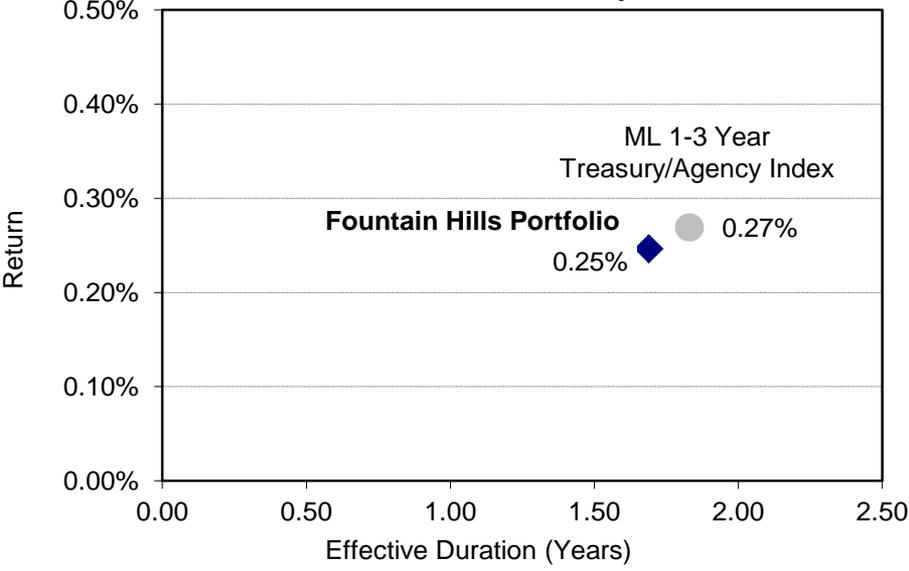
- We modestly extended the portfolio's duration in June by selling securities with an average duration of 1.75 years and purchasing Treasuries with an average duration of 2.50 years.
- The trades resulted in an average yield pick-up of 0.15%.
- The trades represent PFM's dynamic and active portfolio duration management that is responsive to changes in the interest rate environment.

Date	Transaction	Security	Maturity	Par Value (in Millions)	Yield	Gain/Loss from Sale
6/2/14	Buy	U.S. Treasury Notes	5/31/17	\$0.83	0.81%	-
6/2/14	Buy	U.S. Treasury Notes	5/31/16	\$0.83	0.38%	-
6/2/14	Sell	U.S. Treasury Notes	11/30/17	\$0.63	1.04%	\$2,873
6/2/14	Sell	U.S. Treasury Notes	2/15/15	\$0.30	0.08%	\$722
6/2/14	Sell	U.S. Treasury Notes	1/31/15	\$0.25	0.09%	\$522
6/2/14	Sell	U.S. Treasury Notes	12/15/14	\$0.43	0.07%	\$701

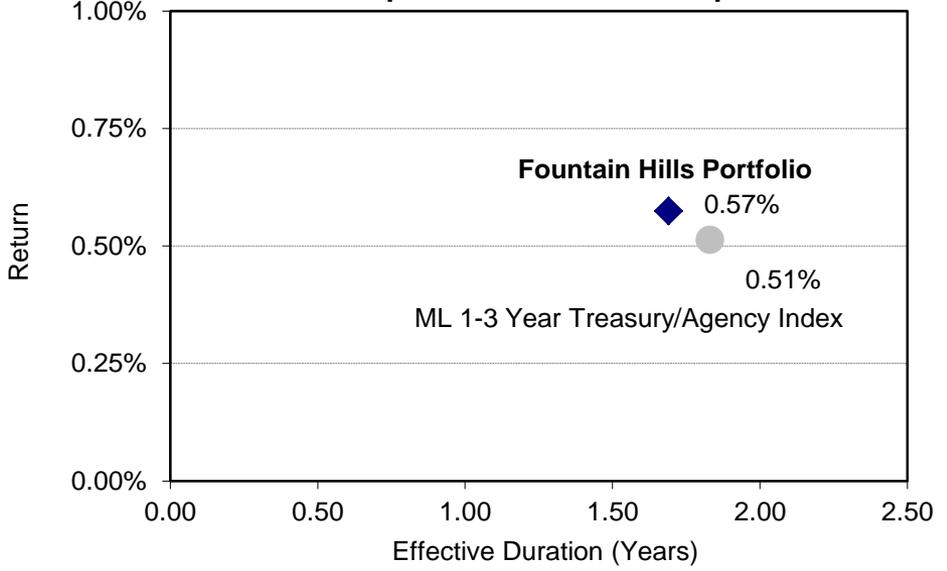
# Portfolio Performance

Total Return <sup>1,2,3,4</sup>	Quarter Ended June 30, 2014	Past 6 Months	Past 12 Months	Past 2 Years	Since Inception
<b>Fountain Hills Portfolio</b>	<b>0.25%</b>	<b>0.38%</b>	<b>0.72%</b>	<b>0.52%</b>	<b>0.57%</b>
ML 1-3 Year Treasury/Agency Index	0.27%	0.41%	0.78%	0.55%	0.51%
Effective Duration	June 30, 2014	March 31, 2014	Yields	June 30, 2014	March 31, 2014
<b>Fountain Hills Portfolio</b>	<b>1.69</b>	<b>1.73</b>	Yield at Market	0.38%	0.40%
ML 1-3 Year Treasury/Agency Index	1.84	1.83	Yield on Cost	0.48%	0.46%

**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.

# Third Quarter 2014 Investment Strategy

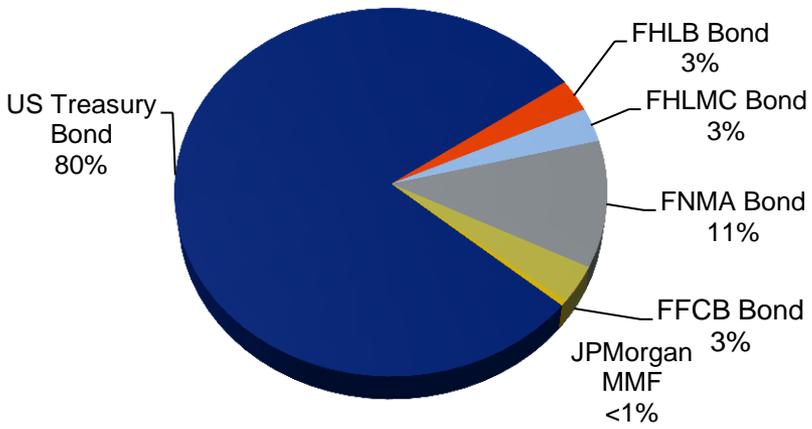
- Economic growth appears to be accelerating, accompanied by early signs of an uptick in inflation. The Fed is expected to end its quantitative easing program in October, opening the door to their next possible move—a Fed rate hike.
- Higher interest rates, triggered by anticipated Fed action, are widely expected in the future. Since rising rates can result in unrealized market losses, we remain somewhat defensive with regard to duration.
- We will continue to assess the benefit of higher yields available on longer maturities today against the negative impact of potentially rising rates in the future for every trade in the portfolio.
- We expect yields spreads to remain narrow, favoring Treasuries over Agencies. However, specific Agency issues may offer value.
- PFM seeks to add value in a variety of ways:
  - Duration management.
  - Adjusting maturities along the yield curve.
  - Emphasizing sectors that offer the best value.
  - Careful issue-level analysis and security selection.
- Our strategy will remain flexible and may change in response to changes in interest rates, emerging economic data, or our market outlook.

# Town of Fountain Hills Portfolio Summary

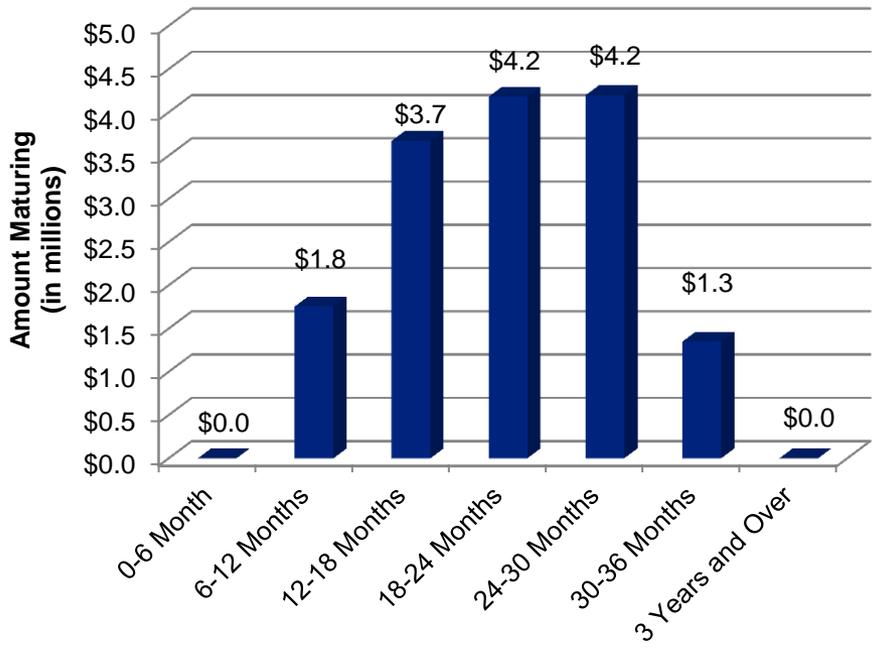
Summary By Type	Book Value	Market Value <sup>1</sup>	Days to Maturity	% of Portfolio	% Allowed per Policy	YTM @ Cost
US Treasury Bond	\$ 12,060,211	\$12,069,681	640	79.28%	100%	0.47%
FHLB Bond	\$ 430,532	\$431,473	424	2.83%	100%	0.38%
FHLMC Bond	\$ 450,955	\$452,301	424	2.97%	100%	0.46%
FNMA Bond	\$ 1,690,714	\$1,696,347	685	11.14%	100%	0.63%
FFCB Bond	\$ 499,934	\$500,434	410	3.29%	100%	0.28%
JPMorgan MMF	\$73,639	\$73,639	1	0.48%	N/A	0.01%
<b>Total including cash</b>	<b>\$15,205,986</b>	<b>\$15,223,874</b>	<b>622</b>	<b>100.00%</b>		<b>0.48%</b>
<b>Total without cash</b>	<b>\$15,132,346</b>	<b>\$15,150,235</b>				<b>0.48%</b>

Summary by Issuer	Book Value	% of Portfolio
US Treasury	\$12,060,211	79.31%
FHLB	\$430,532	2.83%
FHLMC	\$450,955	2.97%
FNMA	\$1,690,714	11.12%
FFCB Bond	\$499,934	3.29%
JPMorgan	\$73,639	0.48%
<b>Total / Average</b>	<b>\$15,205,986</b>	<b>100%</b>

Issuer Distribution



Maturity Distribution<sup>2</sup>



Weighted Average Maturity (in years)	1.70
Duration Allowed by Policy	5.00
Current Portfolio Duration Including Cash	1.68
Current Portfolio Duration Without Cash	1.69

<sup>1</sup> Market values of portfolio holdings include accrued interest.  
<sup>2</sup> Excludes Money Market Balance



## Managed Account Detail of Securities Held

For the Month Ending **June 30, 2014**

### TOWN OF FOUNTAIN HILLS, OPERATING FUNDS

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 02/15/2012 0.250% 02/15/2015	912828SE1	450,000.00	AA+	Aaa	02/22/12	02/27/12	447,662.11	0.43	422.65	449,505.70	450,492.30
US TREASURY NOTES DTD 03/15/2012 0.375% 03/15/2015	912828SK7	300,000.00	AA+	Aaa	03/13/12	03/15/12	298,992.19	0.49	330.16	299,761.37	300,609.30
US TREASURY NOTES DTD 03/15/2012 0.375% 03/15/2015	912828SK7	1,000,000.00	AA+	Aaa	06/27/12	06/28/12	999,218.75	0.40	1,100.54	999,796.00	1,002,031.00
US TREASURY NOTES DTD 08/02/2010 1.750% 07/31/2015	912828NP1	450,000.00	AA+	Aaa	08/21/12	08/22/12	467,525.39	0.42	3,284.88	456,479.19	457,769.70
US TREASURY NOTES DTD 08/02/2010 1.750% 07/31/2015	912828NP1	525,000.00	AA+	Aaa	09/06/12	09/10/12	546,410.15	0.33	3,832.35	533,049.98	534,064.65
US TREASURY NOTES DTD 11/30/2010 1.375% 11/30/2015	912828PJ3	625,000.00	AA+	Aaa	11/29/12	12/05/12	644,018.55	0.35	727.89	634,037.99	635,107.42
US TREASURY NOTES DTD 11/30/2010 1.375% 11/30/2015	912828PJ3	640,000.00	AA+	Aaa	11/01/12	11/05/12	658,950.00	0.40	745.36	648,769.86	650,350.00
US TREASURY NOTES DTD 01/31/2011 2.000% 01/31/2016	912828PS3	115,000.00	AA+	Aaa	01/30/13	02/04/13	120,327.73	0.44	959.39	117,829.99	118,113.05
US TREASURY NOTES DTD 01/31/2011 2.000% 01/31/2016	912828PS3	365,000.00	AA+	Aaa	03/04/14	03/05/14	376,805.47	0.30	3,045.03	374,794.26	374,880.55
US TREASURY NOTES DTD 01/31/2014 0.375% 01/31/2016	912828B41	1,100,000.00	AA+	Aaa	02/04/14	02/07/14	1,101,417.97	0.31	1,720.65	1,101,133.89	1,101,589.50
US TREASURY NOTES DTD 05/02/2011 2.000% 04/30/2016	912828OF0	475,000.00	AA+	Aaa	03/27/13	03/28/13	498,638.67	0.38	1,600.54	489,038.97	488,990.18
US TREASURY NOTES DTD 06/02/2014 0.375% 05/31/2016	912828WM8	825,000.00	AA+	Aaa	06/02/14	06/03/14	824,871.09	0.38	262.04	824,876.03	824,259.15
US TREASURY NOTES DTD 06/30/2009 3.250% 06/30/2016	912828KZ2	475,000.00	AA+	Aaa	05/22/13	05/24/13	516,024.41	0.44	41.95	501,478.04	501,384.77
US TREASURY NOTES DTD 06/30/2009 3.250% 06/30/2016	912828KZ2	500,000.00	AA+	Aaa	05/10/13	05/15/13	544,140.63	0.41	44.16	528,258.44	527,773.44



## Managed Account Detail of Securities Held

For the Month Ending **June 30, 2014**

### TOWN OF FOUNTAIN HILLS, OPERATING FUNDS

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	750,000.00	AA+	Aaa	05/24/13	05/31/13	812,402.34	0.53	66.24	790,544.69	791,660.16
US TREASURY NOTES DTD 08/31/2011 1.000% 08/31/2016	912828RF9	700,000.00	AA+	Aaa	02/27/14	03/03/14	708,832.03	0.49	2,339.67	707,681.95	707,218.40
US TREASURY NOTES DTD 11/30/2011 0.875% 11/30/2016	912828RU6	450,000.00	AA+	Aaa	10/31/13	11/01/13	453,480.47	0.62	333.50	452,735.83	452,777.34
US TREASURY NOTES DTD 11/30/2011 0.875% 11/30/2016	912828RU6	775,000.00	AA+	Aaa	12/03/13	12/04/13	781,932.62	0.57	574.37	780,611.00	779,783.20
US TREASURY NOTES DTD 03/31/2012 1.000% 03/31/2017	912828SM3	525,000.00	AA+	Aaa	03/19/14	03/21/14	526,209.96	0.92	1,319.67	526,100.10	528,117.45
US TREASURY NOTES DTD 05/31/2012 0.625% 05/31/2017	912828SY7	825,000.00	AA+	Aaa	06/02/14	06/03/14	820,423.83	0.81	436.73	820,539.67	819,521.18

<b>Security Type Sub-Total</b>		<b>11,870,000.00</b>					<b>12,148,284.36</b>	<b>0.47</b>	<b>23,187.77</b>	<b>12,037,022.95</b>	<b>12,046,492.74</b>
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<b>Federal Agency Bond / Note</b>											
FEDERAL FARM CREDIT BANK BONDS DTD 02/14/2014 0.200% 08/14/2015	3133EDFC1	500,000.00	AA+	Aaa	02/12/14	02/14/14	499,401.68	0.28	380.56	499,553.27	500,053.00
FEDERAL HOME LOAN BANK GLOBAL NOTES DTD 08/09/2013 0.375% 08/28/2015	313383V81	430,000.00	AA+	Aaa	08/08/13	08/09/13	429,982.80	0.38	541.98	429,990.22	430,931.38
FREDDIE MAC GLOBAL NOTES DTD 07/11/2012 0.500% 08/28/2015	3134G3ZA1	450,000.00	AA+	Aaa	07/30/12	07/31/12	450,525.15	0.46	756.25	450,198.93	451,544.85
FANNIE MAE GLOBAL NOTES DTD 02/15/2013 0.500% 03/30/2016	3135G0VA8	300,000.00	AA+	Aaa	03/12/13	03/13/13	300,141.00	0.48	379.17	300,081.07	300,511.20
FANNIE MAE GLOBAL NOTES DTD 02/15/2013 0.500% 03/30/2016	3135G0VA8	460,000.00	AA+	Aaa	02/14/13	02/15/13	459,475.60	0.54	581.39	459,705.59	460,783.84
FANNIE MAE GLOBAL NOTES DTD 02/15/2013 0.500% 03/30/2016	3135G0VA8	500,000.00	AA+	Aaa	08/29/13	08/30/13	497,335.00	0.71	631.94	498,192.66	500,852.00
FNMA NOTES DTD 08/19/2011 1.250% 09/28/2016	3135G0CM3	170,000.00	AA+	Aaa	10/01/13	10/03/13	172,510.90	0.75	548.96	171,890.01	172,493.90



**Managed Account Detail of Securities Held**

For the Month Ending **June 30, 2014**

**TOWN OF FOUNTAIN HILLS, OPERATING FUNDS**

<b>Security Type/Description</b>	<b>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		3135G0CM3	255,000.00	AA+	Aaa	10/01/13	10/03/13	258,826.56	0.74	823.44	257,880.25	258,740.85
DTD 08/19/2011 1.250% 09/28/2016												
<b>Security Type Sub-Total</b>			<b>3,065,000.00</b>					<b>3,068,198.69</b>	<b>0.51</b>	<b>4,643.69</b>	<b>3,067,492.00</b>	<b>3,075,911.02</b>
<b>Managed Account Sub-Total</b>			<b>14,935,000.00</b>					<b>15,216,483.05</b>	<b>0.48</b>	<b>27,831.46</b>	<b>15,104,514.95</b>	<b>15,122,403.76</b>
<b>Securities Sub-Total</b>			<b>\$14,935,000.00</b>					<b>\$15,216,483.05</b>	<b>0.48%</b>	<b>\$27,831.46</b>	<b>\$15,104,514.95</b>	<b>\$15,122,403.76</b>
<b>Accrued Interest</b>											<b>\$27,831.46</b>	
<b>Total Investments</b>											<b>\$15,150,235.22</b>	





## July Economic Update



# Economic Summary

## Economic Conditions

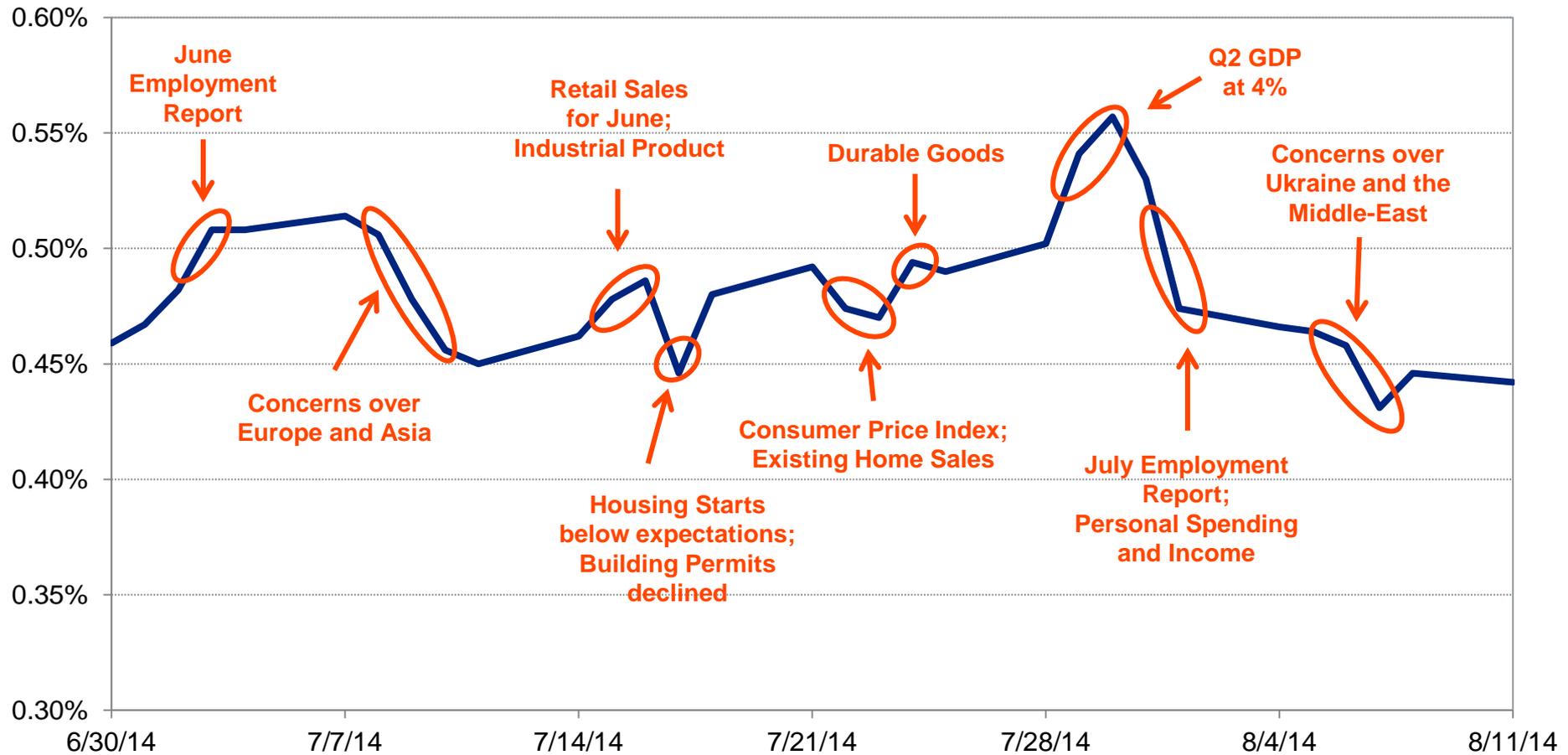
- U.S. GDP grew 4% in the second quarter, with growth consistent across the major components.
- The labor market remained robust in July, however came in lower than expected, with 209,000 nonfarm jobs added.
- The unemployment rate rose slightly to 6.2% on a modest increase in labor participation.
- The Federal Reserve noted an increase in economic activity as it further reduced its bond-purchasing program down to \$25 billion a month.
- Geopolitical issues in Ukraine and the Middle East heightened market volatility.

## Market Reaction

- Aside from brief periods of “flight to quality,” U.S. Treasury yields generally rose during July in response to stronger economic data.
- At the beginning of August yields fell after the payroll announcement and intensified geopolitical events.
- Short-term yields remain anchored by Federal Reserve policy and decreased supply of U.S. Treasury and Federal Agency securities.
- Credit and Federal Agency spreads remained at historically tight levels as demand outstripped supply and investors continue to struggle to find yield.

# July Market Movers

**2-Year U.S. Treasury Yields**  
June 30, 2014 – Aug 11, 2014

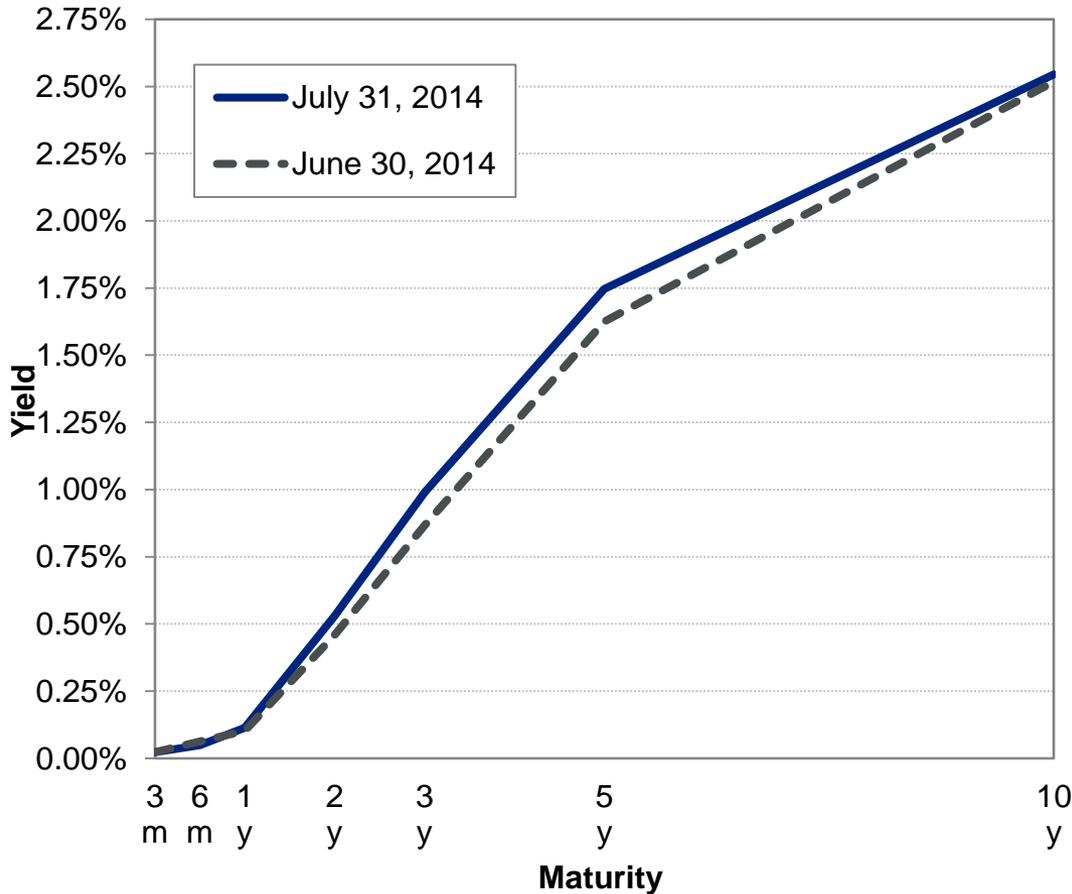


Source: Bloomberg

# Yield Curve Remains Steep

- Encouraging economic indicators caused intermediate yields to rise in July, adding evidence that the labor market is strengthening.

U.S. Treasury Curves



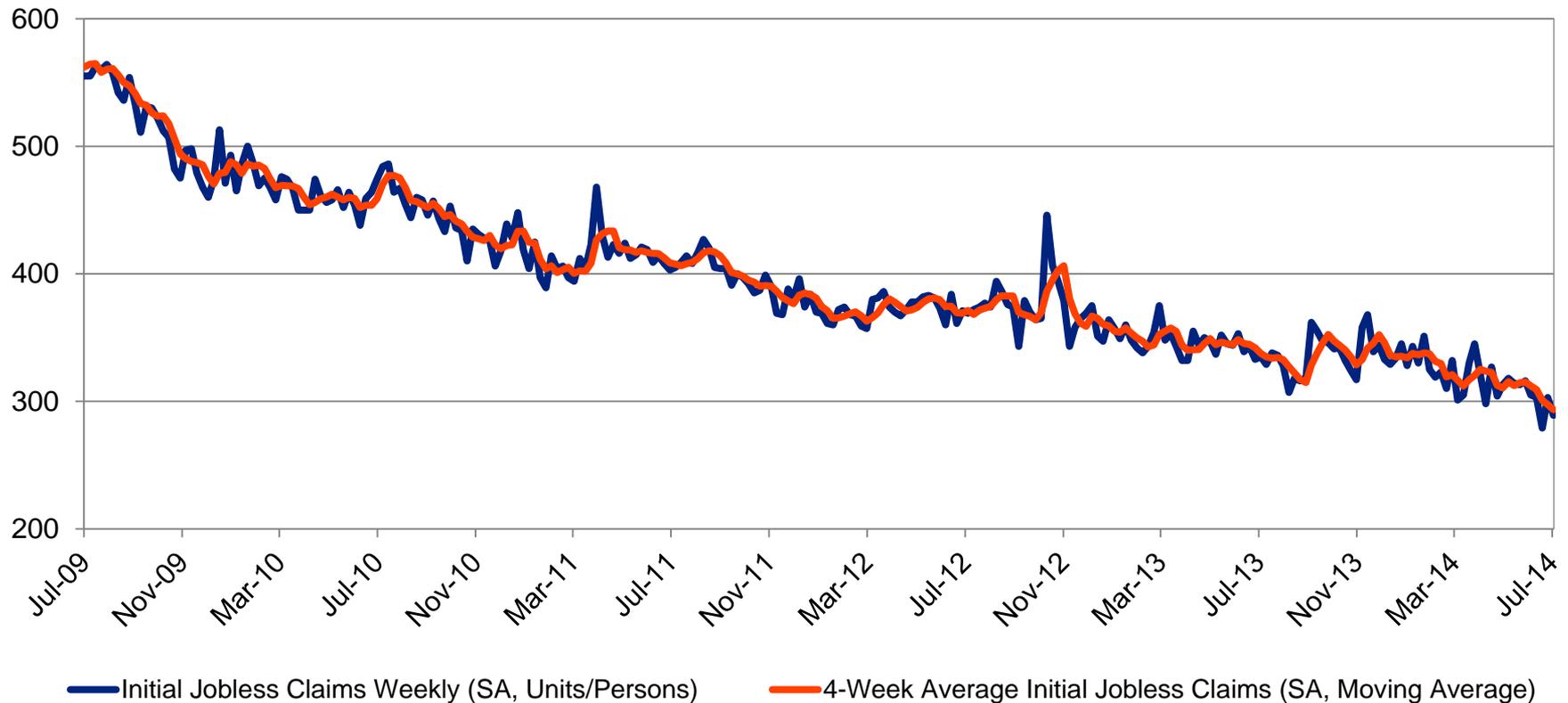
	6/30/14	7/31/14	MoM change
<b>3-Mo.</b>	0.02%	0.02%	-
<b>6-Mo.</b>	0.06%	0.05%	-0.01%
<b>1-Yr.</b>	0.10%	0.11%	+0.01%
<b>2-Yr.</b>	0.46%	0.53%	+0.07%
<b>3-Yr.</b>	0.87%	0.99%	+0.12%
<b>5-Yr.</b>	1.63%	1.75%	+0.12%
<b>10-Yr.</b>	2.52%	2.55%	+0.03%

Source: Bloomberg

# Drop in Jobless Claims

- Jobless claims fell unexpectedly by 14,000 to 289,000 for the week ended August 2<sup>nd</sup>.
  - The figure is the year's second-lowest level, a new sign of a further strengthening labor market.
- The four-week moving average of the claims hit 293,500, the lowest level since February 2006.

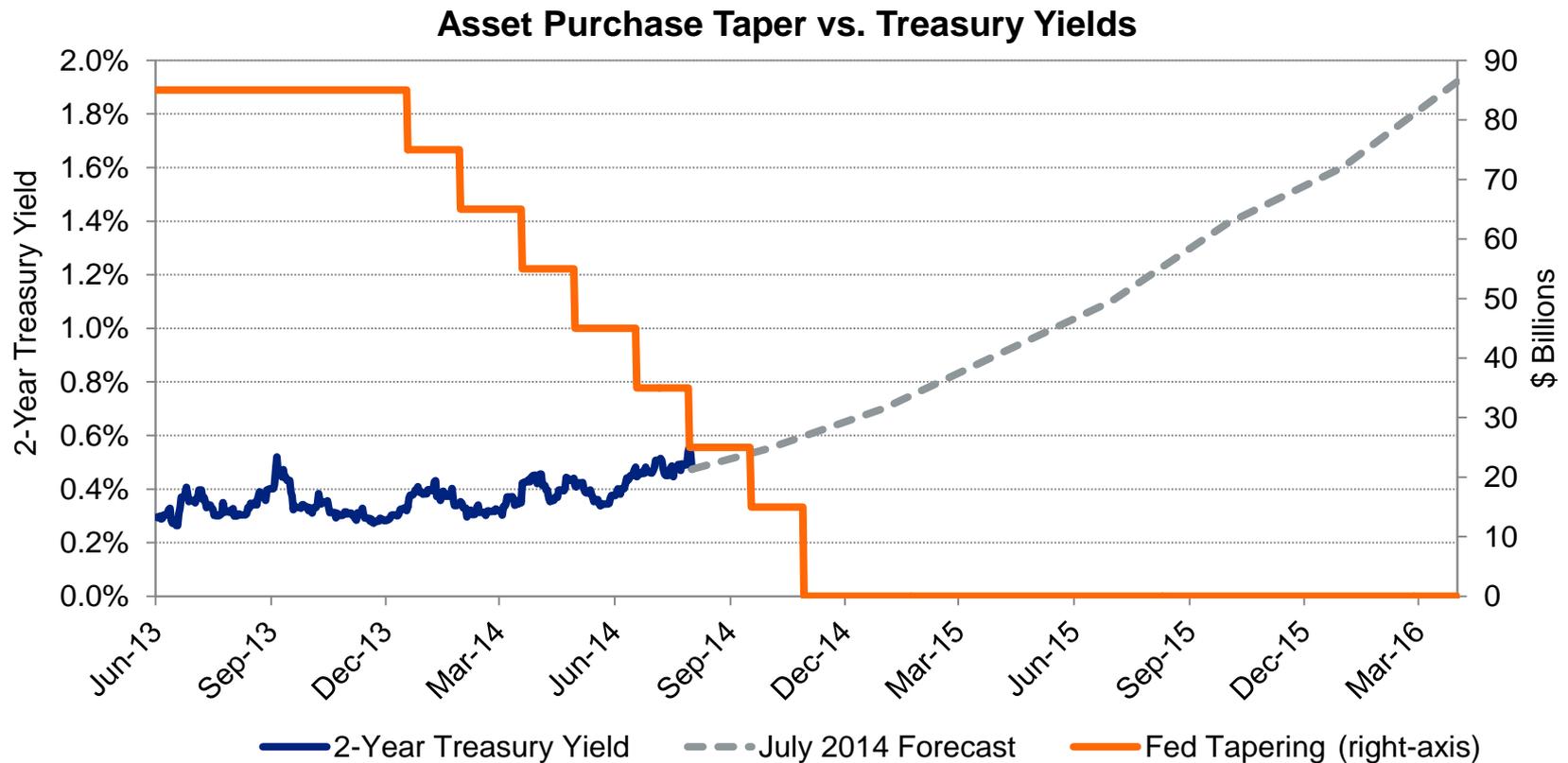
**Initial Jobless Claims**



Source: Bloomberg

# Fed Continues Taper Of Bond Purchase Program

- The Federal Reserve has continued to taper at a \$10 billion pace at each meeting.
  - The FOMC has expressed its intention to end the program in October.
- Market participants have now turned their attention to a change in monetary policy as it relates to the Fed Fund's Rate.

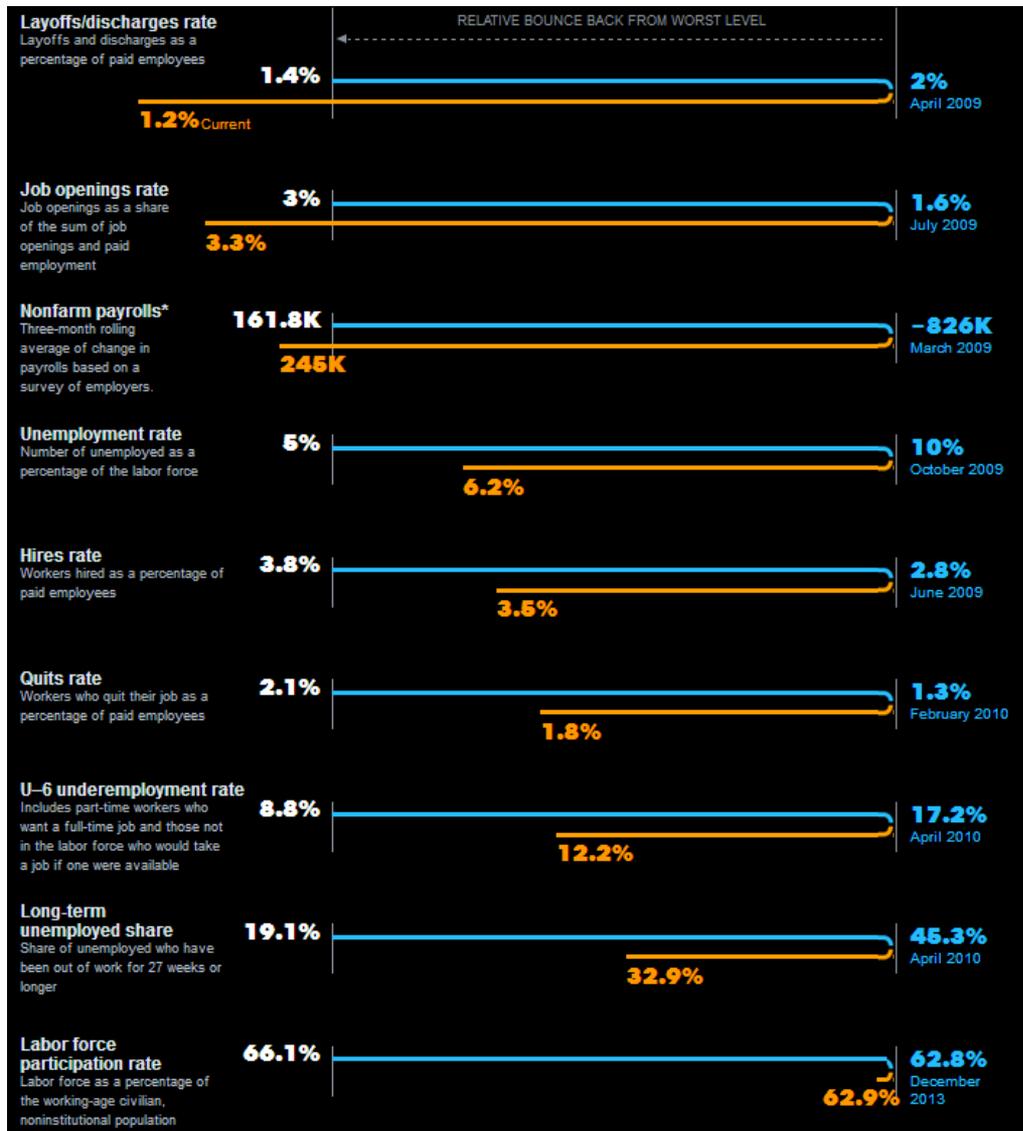


Source: Bloomberg, Bloomberg Survey of Economists

# Janet Yellen's Dashboard of Jobs Data

Pre-Recession Level

Worst Level Since 2008



- Janet Yellen uses an “employment dashboard” to help guide monetary policy.
- Signs of strengthening labor market:
  - The increase in job openings.
  - Highest readings for the number of people hired/leaving their jobs since 2008.
- Improvement is still measured and uneven.



Source: Bureau of Labor Statistics, data compiled by Bloomberg and Bloomberg Visual Data

# Disclaimer

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