



Town of Fountain Hills

Quarterly Investment Review

Quarter Ended March 31, 2014



The PFM Group

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PFM Advisors

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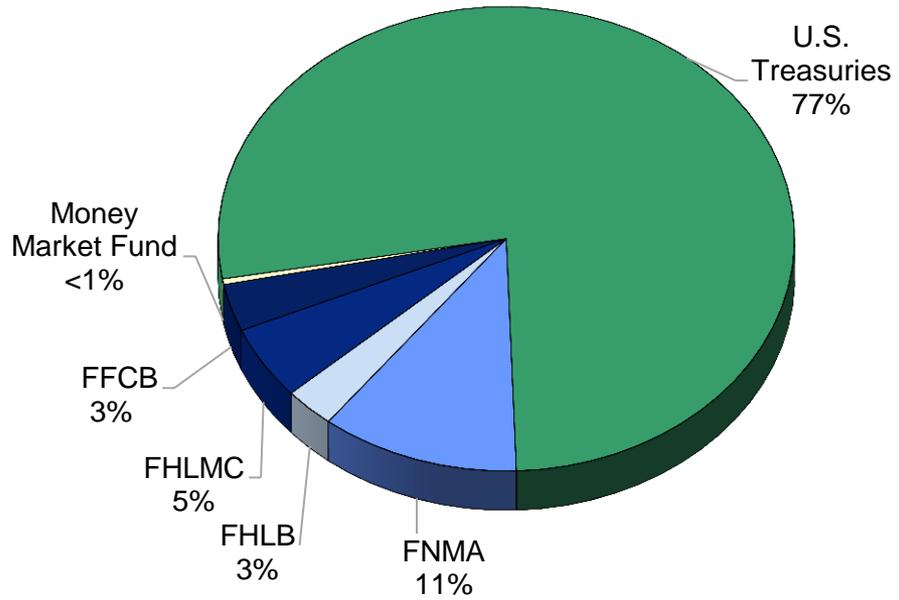
First Quarter 2014 Strategy

- Although harsh weather tempered growth in the first quarter, the resilience and duration of the expansion in the U.S. supported PFMAM's macro-level view that economic growth would continue.
- Our strategy for the first quarter included:
 - Maintaining a defensive duration shorter than benchmark to mitigate the impact of potentially higher rates for most of the first quarter.
 - Modestly extending duration in late March, capitalizing on the significant spike in rates following the March 19 FOMC meeting.
 - Adding value through careful timing of selective purchases in addition to matching benchmark duration extensions each month.
- We favored U.S. Treasuries for many shorter maturities as Agency yield spreads fell to near record lows.
- Investment opportunities in the agency sector have become issue-specific. Recently, new issues have offered the most value.
- The portfolio performed in-line with the benchmark returning 0.13% for the quarter or 0.54% annualized.

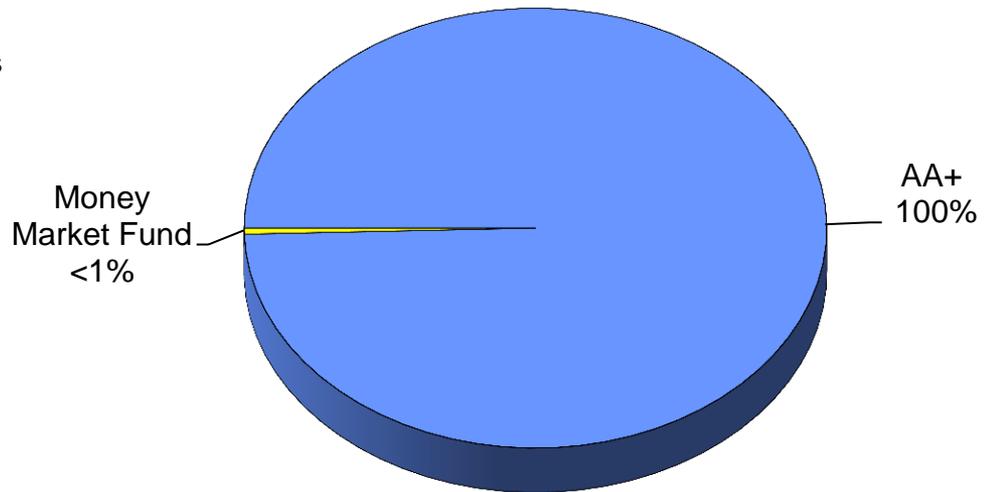
Portfolio Composition and Credit Quality Characteristics

Security Type ¹	March 31, 2014	% of Portfolio	% Change From Prior Quarter	Permitted by Policy
U.S. Treasuries	\$11,727,401.46	78%	+18%	100%
Federal Agencies	\$3,400,180.59	22%	-18%	100%
<i>FNMA</i>	\$1,691,886.13	11%	-12%	-
<i>FHLB</i>	\$430,712.04	3%	-5%	-
<i>FHLMC</i>	\$777,994.36	5%	-4%	-
<i>FFCB</i>	\$499,588.06	3%	+3%	-
Money Market Fund	\$60,172.76	< 1%	-	
Totals	\$15,187,754.81	100%		

Portfolio Composition



Portfolio Credit Quality Distribution



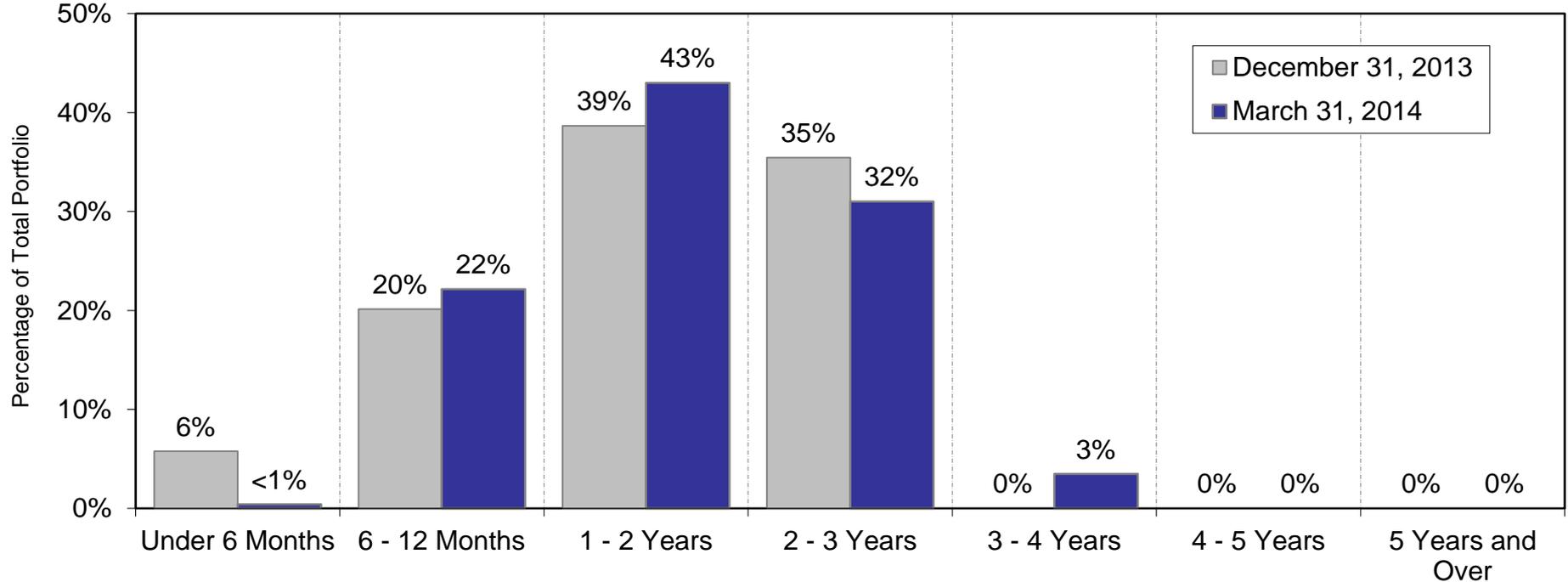
Ratings by Standard & Poor's

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

Portfolio Maturity Distribution

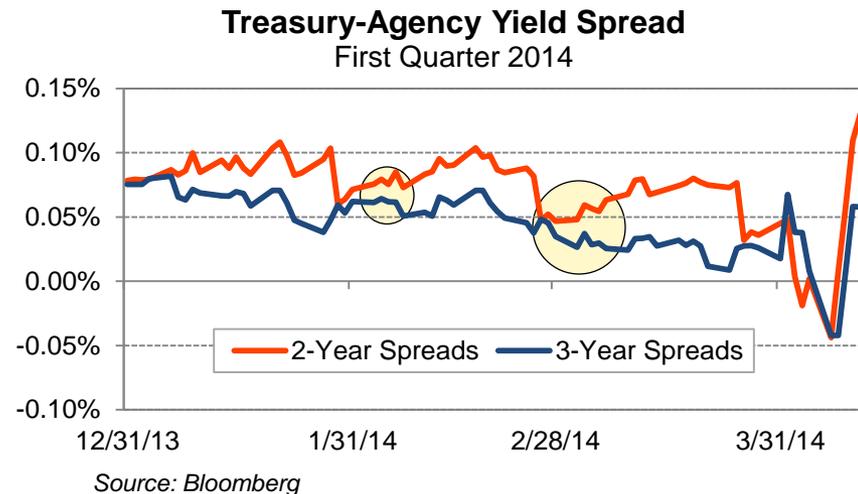
Maturity Distribution	March 31, 2014	December 31, 2013
Under 6 Months	\$60,172.76	\$872,771.84
6 - 12 Months	\$3,362,519.59	\$3,053,982.45
1 - 2 Years	\$6,530,737.06	\$5,866,127.89
2 - 3 Years	\$4,707,998.56	\$5,375,823.96
3 - 4 Years	\$0.00	\$0.00
4 - 5 Years	\$0.00	\$0.00
5 Years and Over	\$0.00	\$0.00
Totals	\$15,187,754.81	\$15,168,706.14

Portfolio Maturity Distribution



Agency Yield-Spreads Fell to Near Record Lows

- When the yield difference between Agencies and Treasuries are narrow, we prefer the Treasury sector as investors are not being adequately compensated for taking additional risk.
- We sold off shorter-maturing securities and reinvested proceeds into U.S. Treasury notes to rebalance portfolio and position duration closer to target duration.

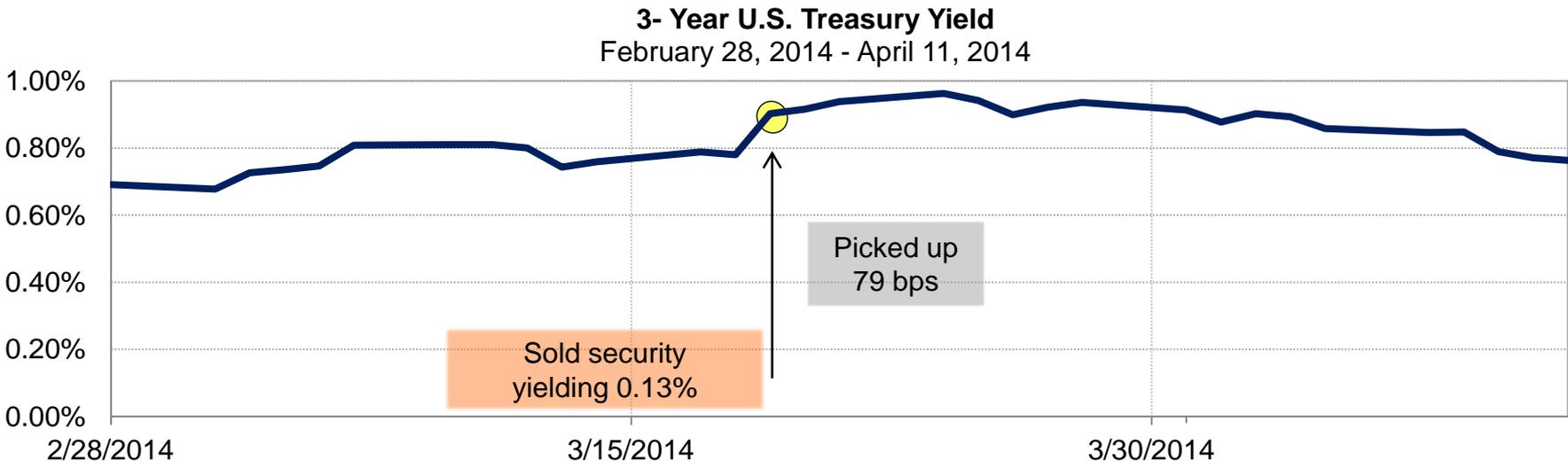


Date	Transaction	Security	Maturity	Par Value (in Millions)	Yield	Gain/Loss from Sale
2/4/14	Buy	U.S. Treasury Notes	1/31/16	\$1.10	0.31%	-
2/4/14	Sell	FHLB Notes	5/28/14	\$0.80	0.09%	\$1,192
2/4/14	Sell	FNMA Notes	8/28/14	\$0.25	0.11%	\$741
2/27/14	Buy	U.S. Treasury Notes	8/31/16	\$0.70	0.49%	-
2/27/14	Sell	FNMA Notes	11/20/14	\$0.70	0.13%	\$2,833
3/4/14	Buy	U.S. Treasury Notes	1/31/16	\$0.365	0.30%	-
3/4/14	Sell	FNMA Notes	12/21/15	\$0.375	0.28%	\$1,127

Capitalized on Higher Interest Rates

- We took advantage of the rise in rates after the FOMC statement and locked-in higher yields.
- We sold off the shortest-maturing security and purchased a 3-Year Treasury security.
 - Moderately increased portfolio duration.
 - Picked up 0.79%.

Date	Transaction	Security	Maturity	Par Value (in Millions)	Yield	Gain/Loss from Sale
3/19/14	Buy	U.S. Treasury Notes	3/31/17	\$0.525	0.92%	-
3/20/14	Sell	FHLMC	11/25/14	\$0.525	0.13%	\$1,314

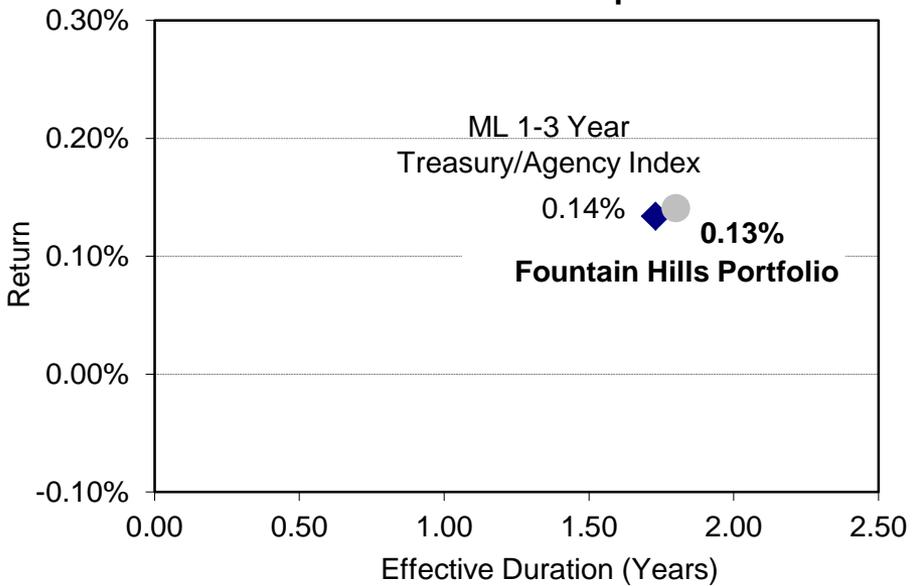


Source: Bloomberg

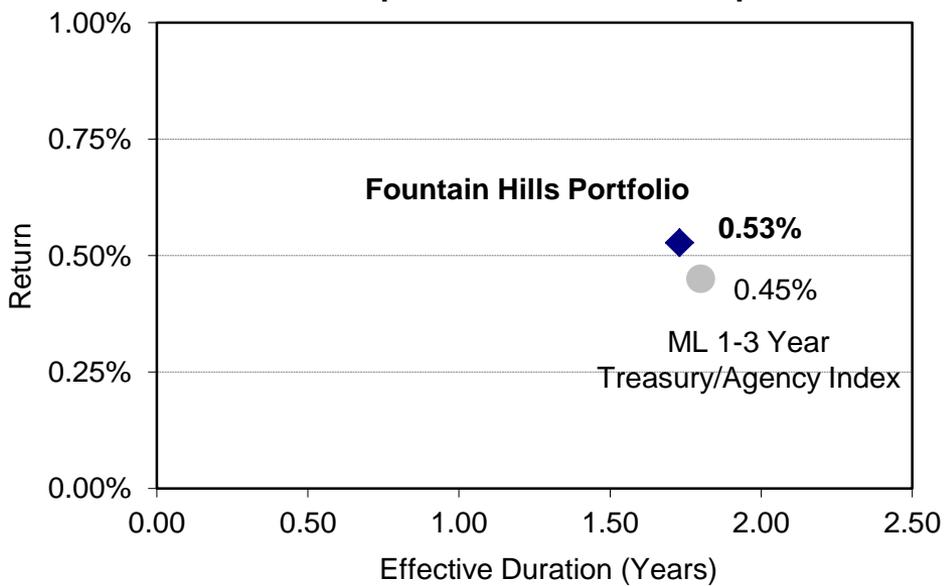
Portfolio Performance

Total Return ^{1,2,3,4}	Quarter Ended March 31, 2014	Past 6 Months	Past 12 Months	Past 2 Years	Since Inception
Fountain Hills Portfolio	0.13%	0.20%	0.33%	0.49%	0.53%
ML 1-3 Year Treasury/Agency Index	0.14%	0.21%	0.39%	0.51%	0.45%
Effective Duration	March 31, 2014	December 31, 2013	Yields	March 31, 2014	December 31, 2013
Fountain Hills Portfolio	1.73	1.66	Yield at Market	0.40%	0.37%
ML 1-3 Year Treasury/Agency Index	1.83	1.80	Yield on Cost	0.46%	0.49%

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.

Second Quarter 2014 Investment Strategy

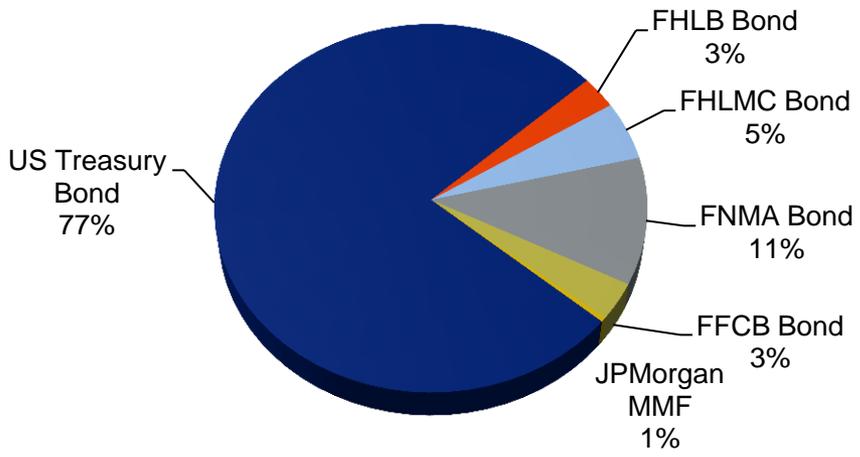
- PFMAM's longer-term view is that interest rates will move higher as market conditions normalize.
- Our strategic plan is to:
 - Maintain a conservative duration bias.
 - Find market opportunities when the steepness of the yield-curve offers sufficient value and roll-down potential.
- Agency yield spreads are narrow, which generally limits opportunities:
 - Shorter agencies are near record tight spread levels and offer little value.
 - Longer agencies offer small incremental yield and modest value.
 - Agencies require issue-by-issue analysis.
- The past 5 years may not be a good roadmap for the next 5 years:
 - Economic conditions are expected to improve.
 - Extraordinarily easy Fed policy is winding down.
 - Potentially higher rates that warrant caution with regard to duration.
 - Expect continued volatility around Fed policy announcements and any global disruptions or surprises.
- 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 ¹	Days to Maturity	% of Portfolio	% Allowed per Policy	YTM @ Cost
US Treasury Bond	\$ 11,728,423	\$11,727,401	648	77.22%	100%	0.45%
FHLB Bond	\$ 430,127	\$430,712	515	2.84%	100%	0.38%
FHLMC Bond	\$ 776,812	\$777,994	399	5.12%	100%	0.48%
FNMA Bond	\$ 1,688,052	\$1,691,886	776	11.14%	100%	0.63%
FFCB Bond	\$ 499,584	\$499,588	501	3.29%	100%	0.28%
JPMorgan MMF	\$60,173	\$60,173	1	0.40%	N/A	0.01%
Total including cash	\$15,183,170	\$15,187,755	639	100.00%		0.46%
Total without cash	\$15,122,998	\$15,127,582				0.46%

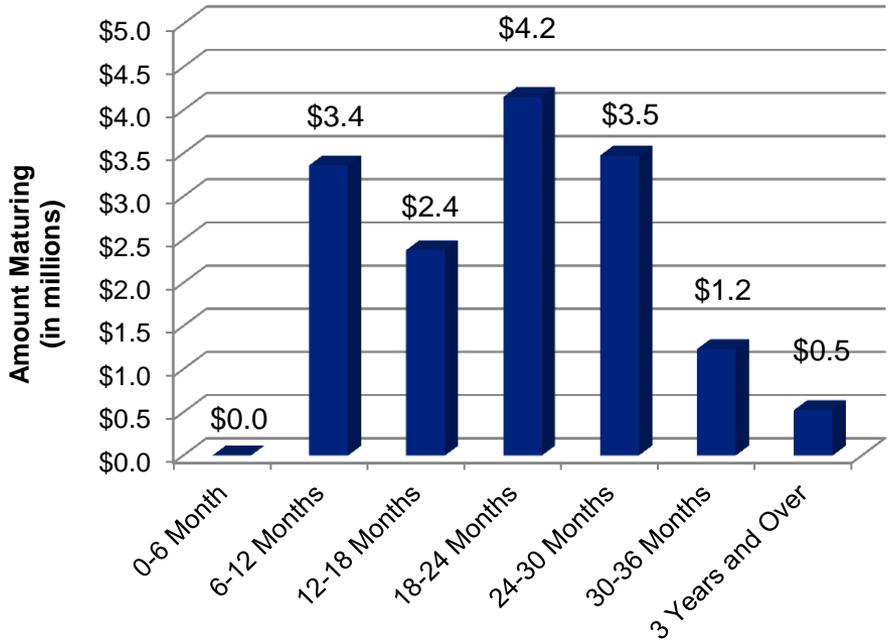
Summary by Issuer	Book Value	% of Portfolio
US Treasury	\$11,728,423	77.2%
FHLB	\$430,127	2.8%
FHLMC	\$776,812	5.1%
FNMA	\$1,688,052	11.1%
FFCB Bond	\$499,584	3.3%
JPMorgan	\$60,173	0.5%
Total / Average	15,183,170	100%

Issuer Distribution



Weighted Average Maturity (in years)	1.75
Duration Allowed by Policy	5.00
Current Portfolio Duration Including Cash	1.72
Current Portfolio Duration Without Cash	1.73

Maturity Distribution



¹Market values of portfolio holdings include accrued interest.

Disclaimer

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Managed Account Detail of Securities Held

For the Month Ending **March 31, 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
U.S. Treasury Bond / Note											
US TREASURY NOTES DTD 12/15/2011 0.250% 12/15/2014	912828RV4	725,000.00	AA+	Aaa	01/05/12	01/06/12	722,167.97	0.38	532.80	724,317.08	725,821.43
US TREASURY NOTES DTD 02/01/2010 2.250% 01/31/2015	912828MH0	250,000.00	AA+	Aaa	01/24/12	01/25/12	263,837.89	0.40	932.32	253,843.60	254,414.00
US TREASURY NOTES DTD 02/15/2012 0.250% 02/15/2015	912828SE1	750,000.00	AA+	Aaa	02/22/12	02/27/12	746,103.52	0.43	233.08	748,845.02	750,762.00
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	51.97	299,678.00	300,656.40
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	173.23	999,724.71	1,002,188.00
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	1,305.25	457,978.97	459,369.00
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	1,522.79	534,914.46	535,930.50
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	2,880.32	635,626.72	636,083.75
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	2,949.45	650,310.75	651,349.76
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	381.22	118,277.57	118,432.06
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	1,209.94	376,345.28	375,893.06
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	683.70	1,101,313.41	1,100,343.20
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	3,988.95	490,937.39	489,991.95
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	3,880.70	504,791.66	503,722.78



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U.S. Treasury Bond / Note											
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	4,084.94	531,796.53	530,234.50
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	6,127.42	795,613.52	795,351.75
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	608.70	708,554.09	706,179.60
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	1,319.71	453,016.09	451,547.10
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	2,272.84	781,186.16	777,664.45
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	14.34	526,198.37	526,312.50
Security Type Sub-Total		11,495,000.00					11,787,436.71	0.45	35,153.67	11,693,269.38	11,692,247.79
Federal Agency Bond / Note											
FREDDIE MAC GLOBAL NOTES DTD 10/06/2011 0.750% 11/25/2014	3137EACY3	325,000.00	AA+	Aaa	05/31/12	06/01/12	326,989.00	0.50	853.13	325,522.91	325,901.23
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	130.56	499,453.69	499,457.50
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	138.85	429,988.10	430,573.19
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	193.75	450,242.15	451,046.25
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	4.17	300,092.62	300,201.30
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	6.39	459,663.65	460,308.66
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	6.94	497,935.62	500,335.50

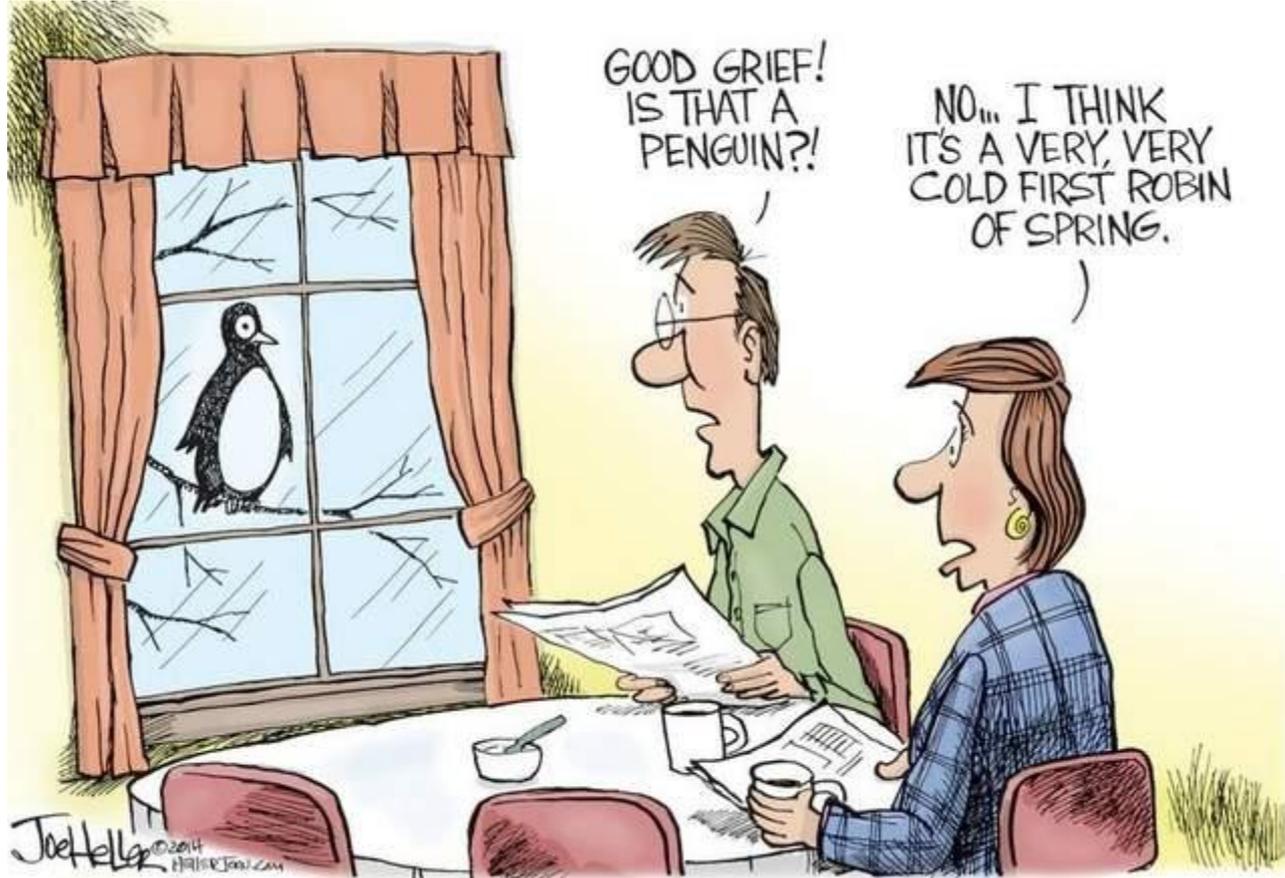


Managed Account Detail of Securities Held

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Federal Agency Bond / Note											
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	17.71	172,099.04	172,391.56
FNMA NOTES DTD 08/19/2011 1.250% 09/28/2016	3135G0CM3	255,000.00	AA+	Aaa	10/01/13	10/03/13	258,826.56	0.74	26.56	258,198.82	258,587.34
Security Type Sub-Total		3,390,000.00					3,395,187.69	0.51	1,378.06	3,393,196.60	3,398,802.53
Managed Account Sub-Total		14,885,000.00					15,182,624.40	0.46	36,531.73	15,086,465.98	15,091,050.32
Securities Sub-Total		\$14,885,000.00					\$15,182,624.40	0.46%	\$36,531.73	\$15,086,465.98	\$15,091,050.32
Accrued Interest											\$36,531.73
Total Investments											\$15,127,582.05



Economic Update

Economic Summary: First Quarter in Review

Economic Conditions

- While the year started with concerns over the pace of job growth, conditions strengthened through the quarter to create a respectable 533,000 net new jobs; the labor force grew modestly leaving the unemployment rate at 6.7%.
- Inclement weather conditions domestically, liquidity anxieties in Emerging Markets, and geopolitical uncertainty surrounding Russian intervention in the Ukraine, combined to threaten global growth prospects.
- In a changing of the guards, Janet Yellen replaced Ben Bernanke as FOMC Chairman and continued to reduce asset purchases at a measured pace; the Fed employment threshold was replaced with a timeline that referenced the end of the asset purchase program.

Market Reaction

- Treasury yield curve continued its steepening trend, particularly for intermediate maturities — this impact was amplified around FOMC meetings; yields for maturities less than a year remained anchored.
- Credit spreads remained tight throughout the quarter as investors embraced new and sizable Corporate supply and Municipal issuance slowed.
- Despite intra-quarter volatility, Global Equity markets continued their march towards new, historically high levels.

Impact of Weather on Economic Data

- December and January Auto Sales saw deviations from their recent growth trends thanks to the impact of multiple winter storms.
- Both indices saw a reversal of this trend in March as winter conditions began to subside.

The Polar Vortex 2013/14 Winter Facts

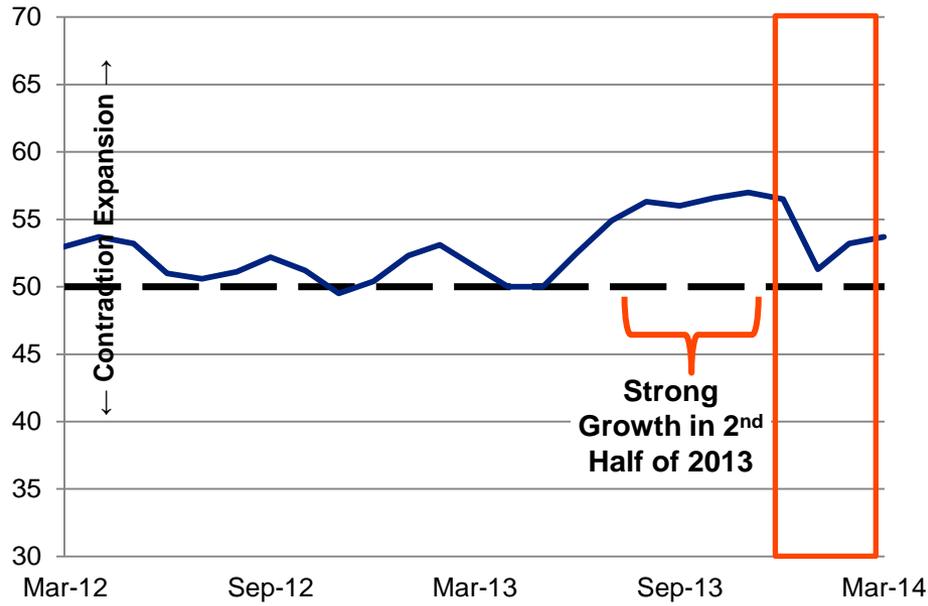
- 34th coldest winter for the contiguous 48 states as a whole since modern records began in 1895.
- Many mid-western states registered a top 10 coldest winter.
- Cities in Minnesota and North Dakota had 70 days with sub-zero temperatures.



Auto Sales



ISM Manufacturing



Source: Institute for Supply Management, Bloomberg.

FOMC Statement Highlights

December

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*“In light of the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions, the Committee decided to **modestly reduce the pace of its asset purchases . . . asset purchases are not on a preset course** and remain contingent on the Committee’s outlook . . . It likely will be appropriate to maintain the current target range for the federal funds rate **well past the time that the unemployment rate declines below 6.5%**”.*

January

29

*“In light of the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions, **the Committee decided to make a further measured reduction in the pace of its asset purchases . . .** It likely will be appropriate to maintain the current target range for the federal funds **rate well past the time that the unemployment rate declines below 6.5%**”.*

March

19

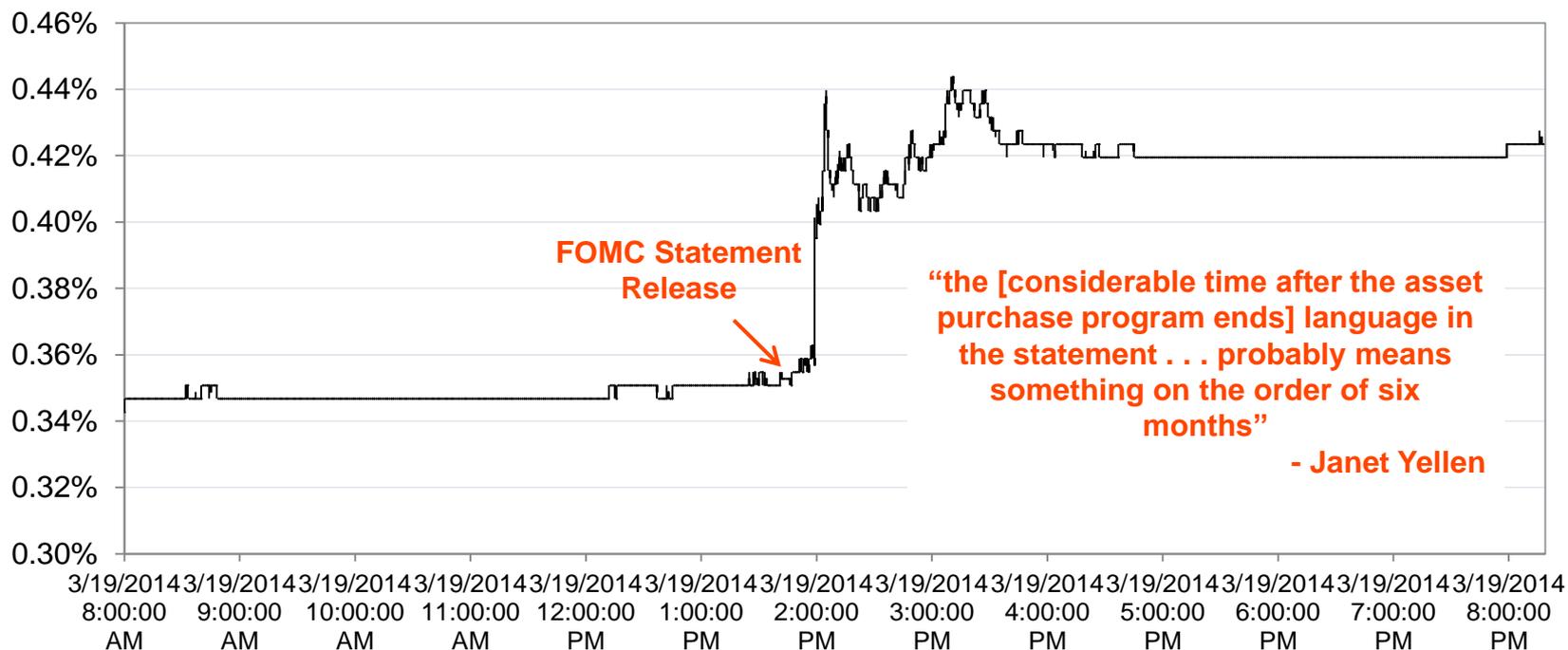
*“The Committee currently judges that there is sufficient underlying strength in the broader economy to support ongoing improvement in labor market condition . . . decided to make a further measured reduction in the pace of its asset purchases . . . **will likely reduce the pace of asset purchases in further measured steps . . .** it likely will be appropriate to maintain the current target range for the federal funds rate for a **considerable time after the asset purchase program ends**”.*

Source: Federal Reserve

Yellen Debut Rattles Markets

- Highlights from Janet Yellen's first press conference as Chairman after a FOMC meeting:
 - Suggested the Fed Fund's target rate could be increased in early 2015
 - Rattled the markets
- As expected, the FOMC reduced asset purchases by an additional \$10B to \$55B.

2yr Treasury Intraday Yields: March 19, 2014



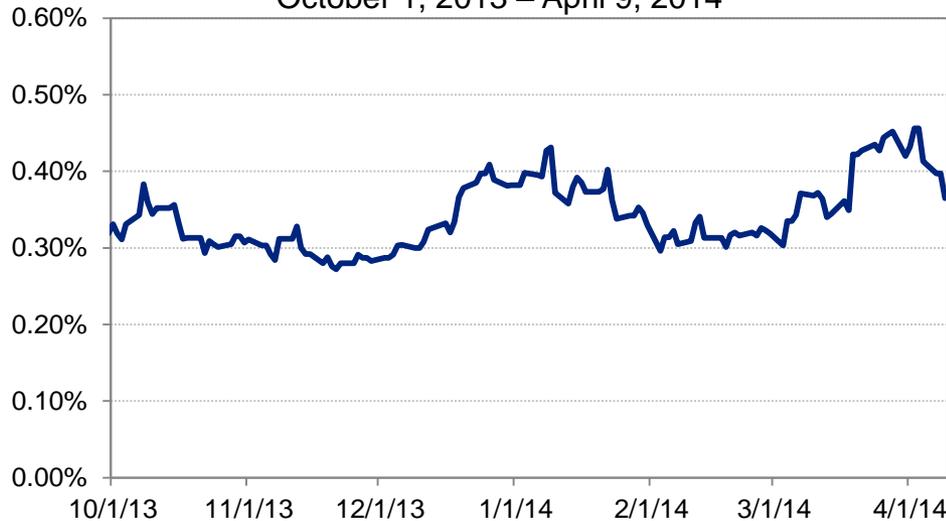
Source: Bloomberg, Federal Reserve

Yields Trend Higher On Economic News and Fed Comments

2-Year Treasury Yield
January 1, 2011 – April 9, 2014



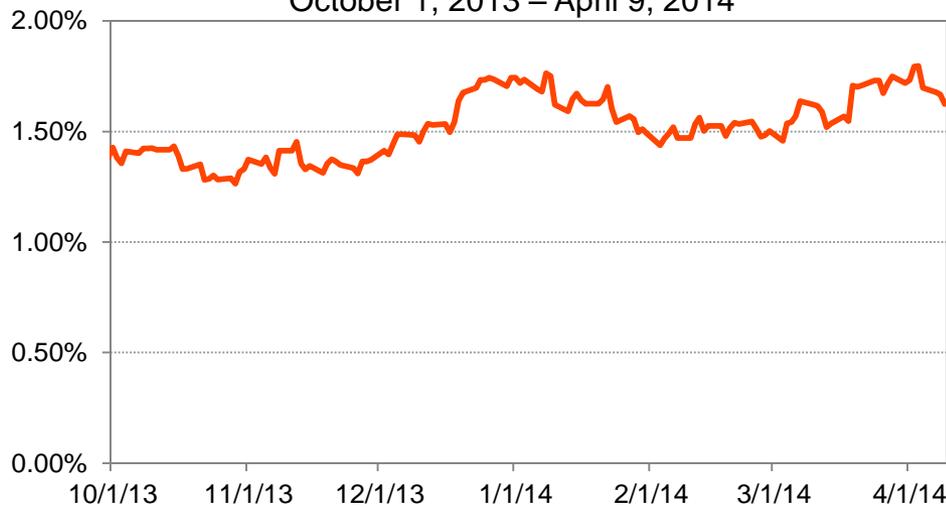
2-Year Treasury Yield
October 1, 2013 – April 9, 2014



5-Year Treasury Yield
January 1, 2011 – April 9, 2014



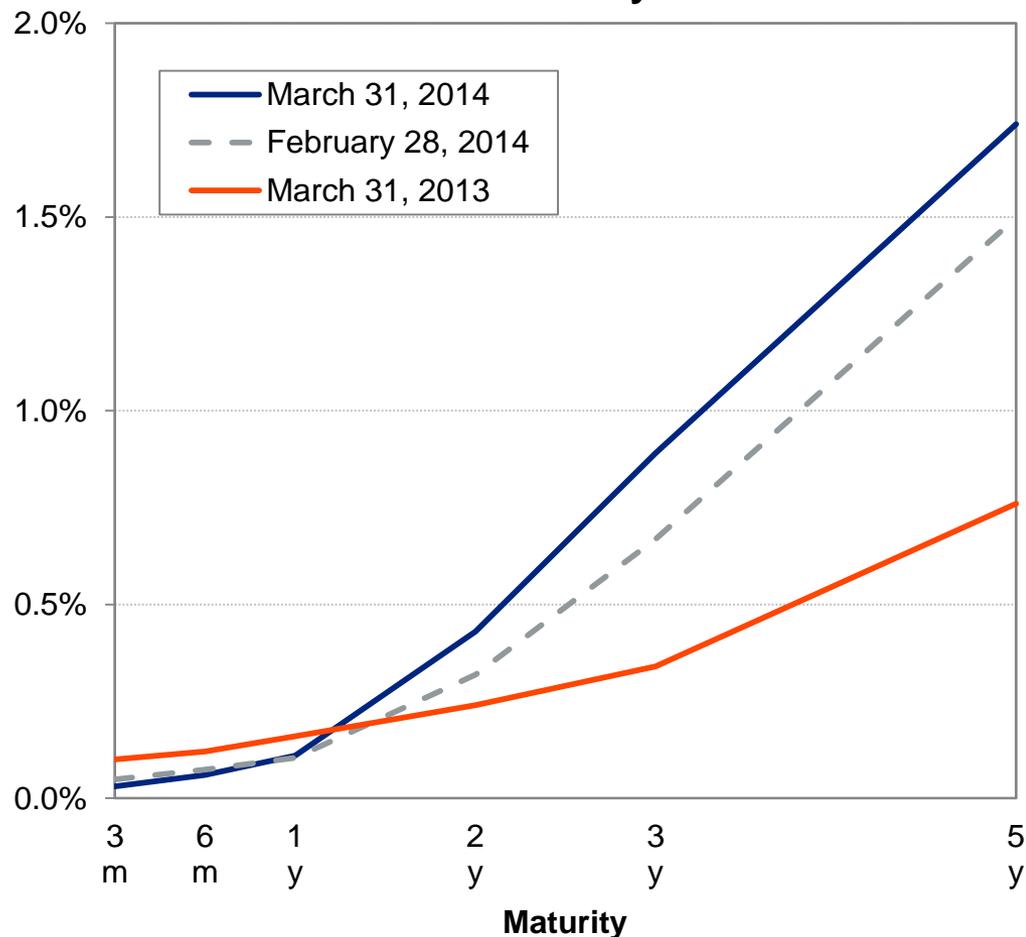
5-Year Treasury Yield
October 1, 2013 – April 9, 2014



Yield Curve Steepens

- The yield curve steepened as yields increased in all maturities except those under one year and securely anchored by the Fed Funds target rate.

U.S. Treasury Curves

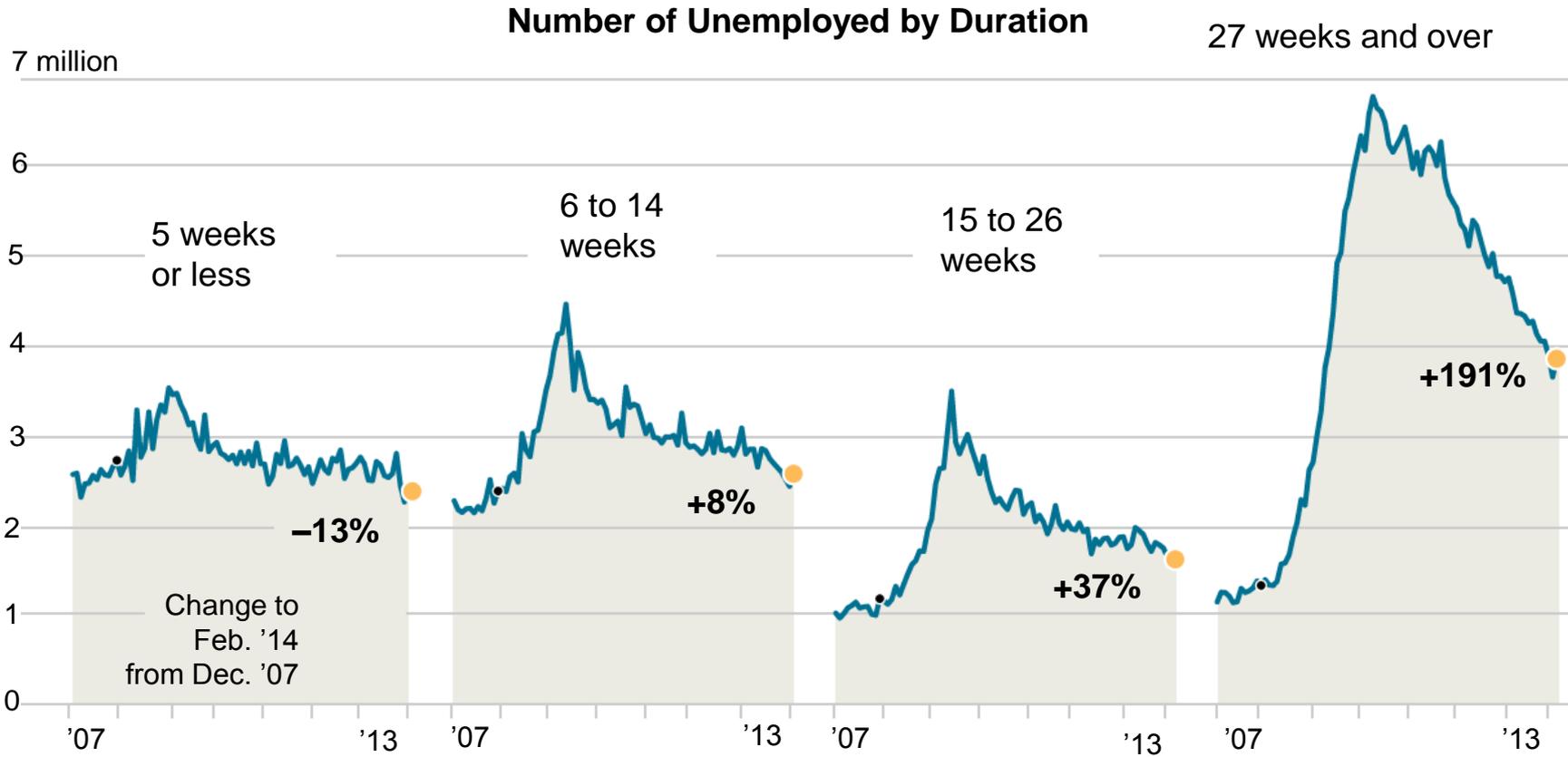


	3/31/13	2/28/14	3/31/14
3-Mo.	0.10%	0.05%	0.03%
6-Mo.	0.12%	0.07%	0.06%
1-Yr.	0.16%	0.10%	0.11%
2-Yr.	0.24%	0.32%	0.43%
3-Yr.	0.34%	0.67%	0.89%
5-Yr.	0.76%	1.50%	1.74%
10-Yr.	1.88%	2.63%	2.74%
30-Yr.	3.09%	3.56%	3.57%

Source: Bloomberg

Persistent Long-Term Unemployment

- While short-term unemployment has fallen to its prerecession level, long-term unemployment remains more than twice as high as it was in 2007.
- The high level of the long-term unemployed contributed to the Fed's decision to remove the 6.5% threshold on raising the Fed Funds target rate.



Source: Bureau of Labor Statistics and NY Times

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