



# Town of Fountain Hills Quarterly Investment Review Quarter Ended September 30, 2015



**The PFM Group**  
Financial & Investment Advisors

1820 East Ray Road  
Chandler, AZ 85225  
855-885-9621  
[brantl@pfm.com](mailto:brantl@pfm.com)/[woop@pfm.com](http://woop@pfm.com)

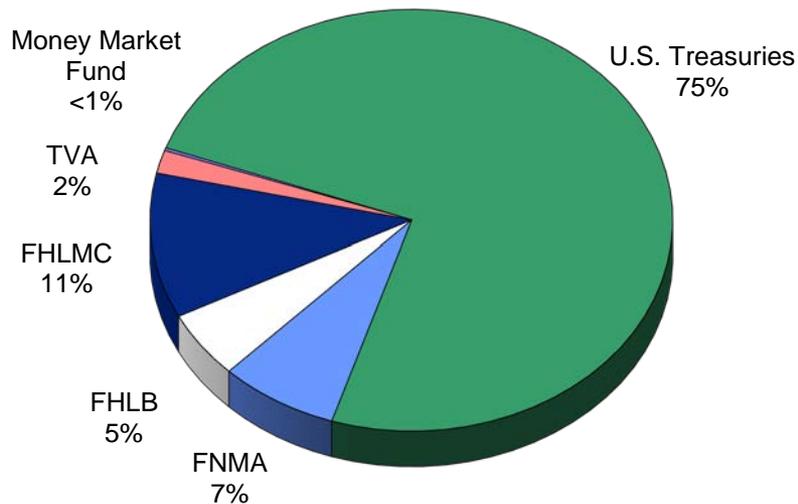
# Third Quarter 2015 Strategy and Recap

- Treasury yields fluctuated in response to evolving economic conditions, tracking:
  - Strength of global economy,
  - Slowdown in China and emerging market economies,
  - Persistent low inflation environment, and
  - Expectations for a Fed rate hike.
- Low inflation and tepid economic data, both in the U.S. and abroad, pushed longer-term yields lower. Yields on securities with maturities of two years or less, the part of the curve that is most dependent on Federal Reserve policy, moved up in advance of the September FOMC meeting, but quickly reversed after the “no hike” decision.
- The end result was that the quarter ended with generally lower yields and a flatter yield curve than at the beginning of the quarter.
- During the third quarter PFMAM moved the portfolio’s duration to be modestly shorter than its benchmark in anticipation of a Fed rate hike sometime before the end of this year. A shorter duration is more conservative and helps mitigate the impact that rising rates have on portfolio market values.

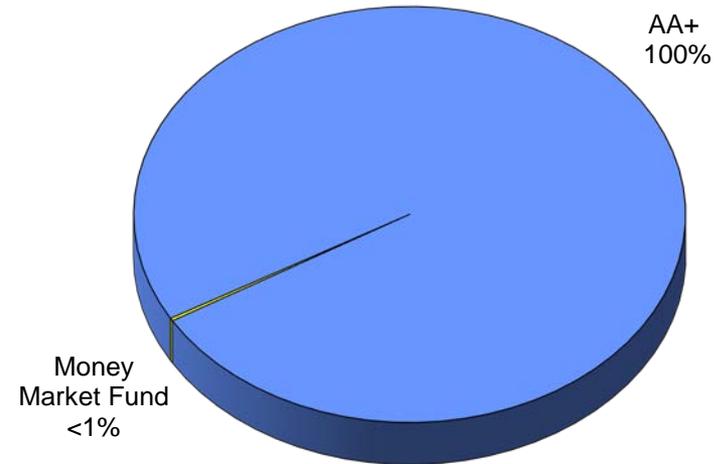
# Portfolio Composition and Credit Quality Characteristics

Security Type <sup>1</sup>	September 30, 2015	% of Portfolio	% Change From Prior Quarter	Permitted by Policy
<b>U.S. Treasuries</b>	<b>\$11,450,658.62</b>	<b>75%</b>	-2%	<b>100%</b>
<b>Federal Agencies</b>	<b>\$3,908,937.91</b>	<b>25%</b>	+2%	<b>100%</b>
<i>FNMA</i>	\$1,132,021.10	7%	-	-
<i>FHLB</i>	\$796,724.37	5%	-	-
<i>FHLMC</i>	\$1,707,880.09	11%	-	-
<i>TVA</i>	\$272,312.35	2%	+2%	-
<b>Money Market Fund</b>	<b>\$33,217.48</b>	<b>&lt;1%</b>	-	-
<b>Total</b>	<b>\$15,392,814.34</b>	<b>100%</b>		

**Portfolio Composition**



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

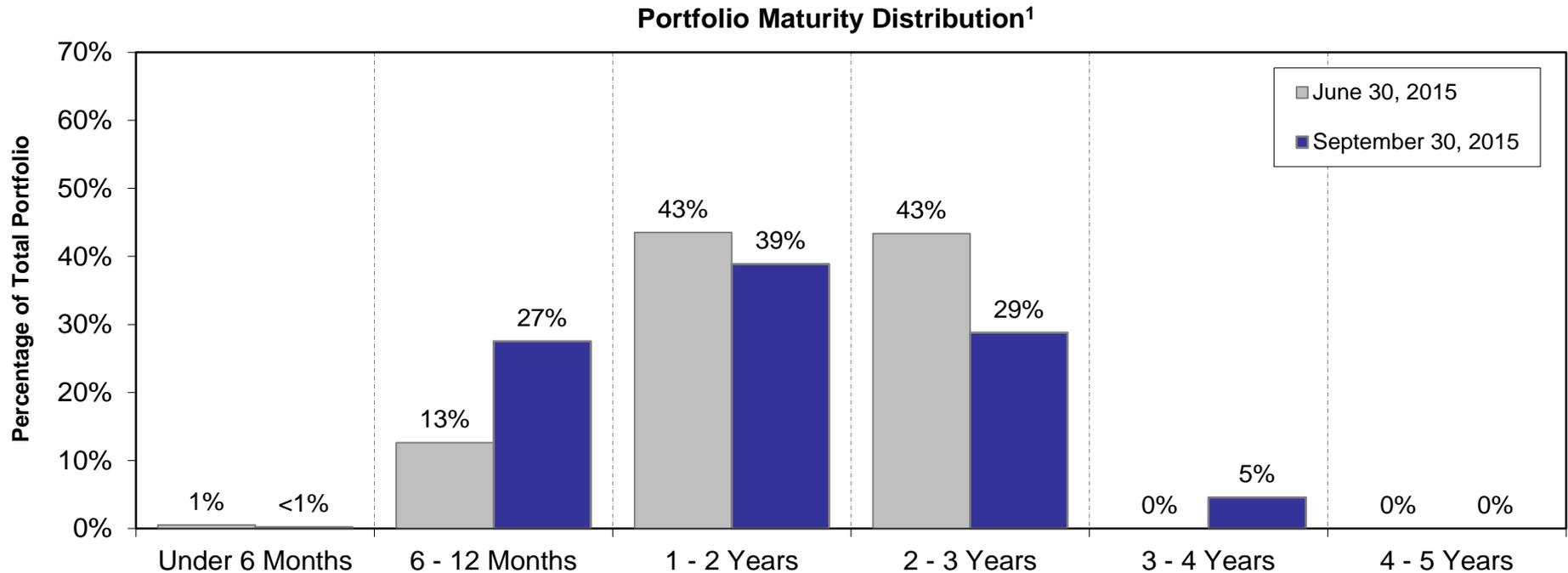


1. End of quarter trade-date market values of portfolio holdings, including accrued interest.

2. Ratings by Standard and Poor's.

# Portfolio Maturity Distribution

Maturity Distribution <sup>1</sup>	September 30, 2015	June 30, 2015
Under 6 Months	\$33,217.81	\$84,300.48
6 - 12 Months	\$4,240,212.73	\$1,937,592.45
1 - 2 Years	\$5,983,499.38	\$6,673,255.07
2 - 3 Years	\$4,432,310.57	\$6,648,519.29
3 - 4 Years	\$703,573.85	\$0.00
4 - 5 Years	\$0.00	\$0.00
<b>Totals</b>	<b>\$15,392,814.34</b>	<b>\$15,343,667.29</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. Includes accrued interest.

# Individual Portfolio Yield Summary

## Core Funds

## Liquid Funds

Date	Market Value <sup>1</sup>	Core Funds		Liquid Funds	
		Portfolio Yield (Cost)	1-3 Year Treasury/Agency Index Yield <sup>2</sup>	AZ-LGIP Pool 7 <sup>3</sup>	Wells Fargo MMF Yield <sup>4</sup>
Oct-14	\$15,233,264	0.58%	0.52%	0.06%	0.01%
Nov-14	\$15,243,198	0.58%	0.50%	0.07%	0.01%
Dec-14	\$15,225,956	0.61%	0.68%	0.08%	0.01%
Jan-15	\$15,288,391	0.61%	0.47%	0.08%	0.01%
Feb-15	\$15,251,169	0.66%	0.63%	0.08%	0.01%
Mar-15	\$15,297,198	0.71%	0.57%	0.09%	0.01%
Apr-15	\$15,288,916	0.72%	0.59%	0.11%	0.01%
May-15	\$15,298,473	0.74%	0.61%	0.08%	0.01%
Jun-15	\$15,320,962	0.74%	0.64%	0.09%	0.01%
Jul-15	\$15,314,600	0.76%	0.67%	0.09%	0.01%
Aug-15	\$15,345,933	0.77%	0.75%	0.11%	0.01%
Sep-15	\$15,358,979	0.77%	0.64%	0.11%	0.01%

1. Excludes accrued interest and includes balance in the custody account MMF.

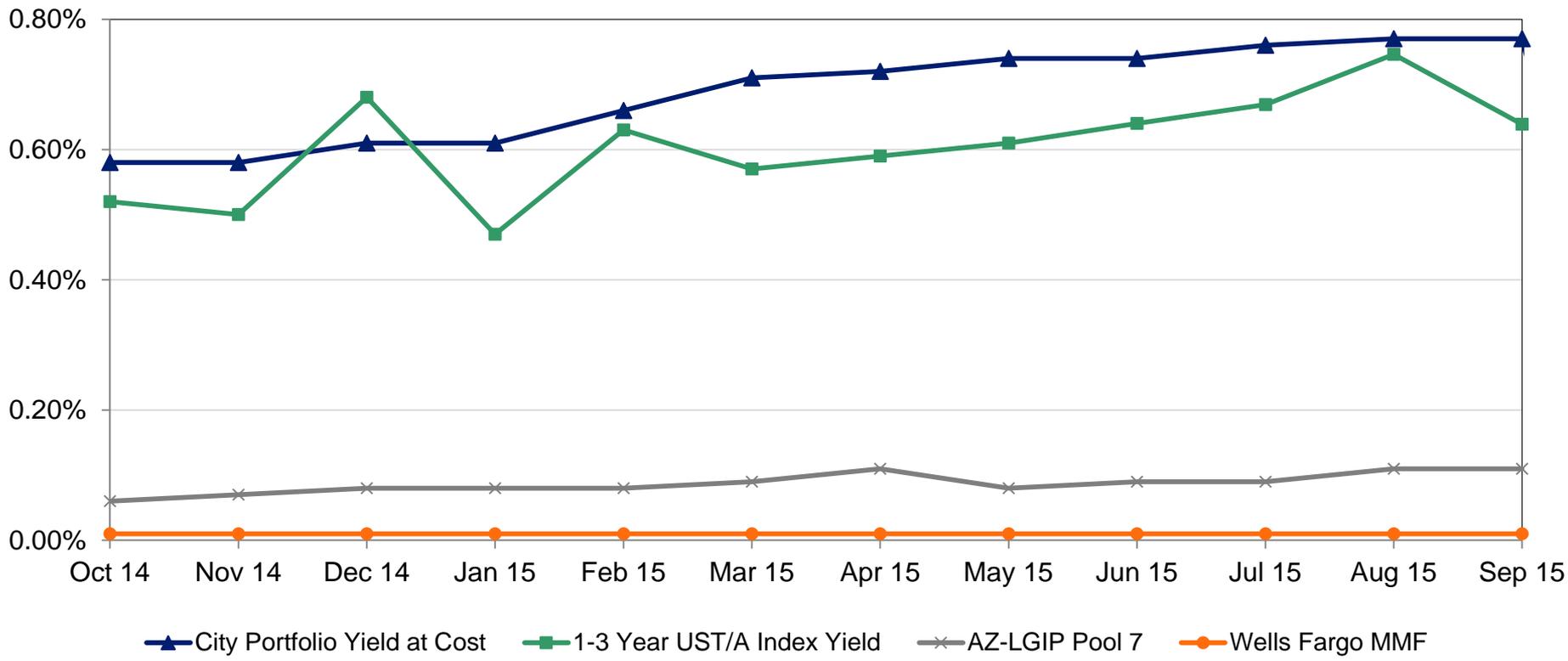
2. Rate represents the Merrill Lynch 1-3 Year U.S. Treasury/Agency Index month-end yield (G1A0). Source: Bloomberg.

3. Monthly Apportionment Yields. Source: Office of the Arizona State Treasurer.

4. Rate represents the Wells Fargo Advantage Government Money Market Service Fund.

# Individual Portfolio Yield Summary (Continued)

Comparison of Combined Portfolio Yield to Various Benchmarks<sup>1,2,3</sup>



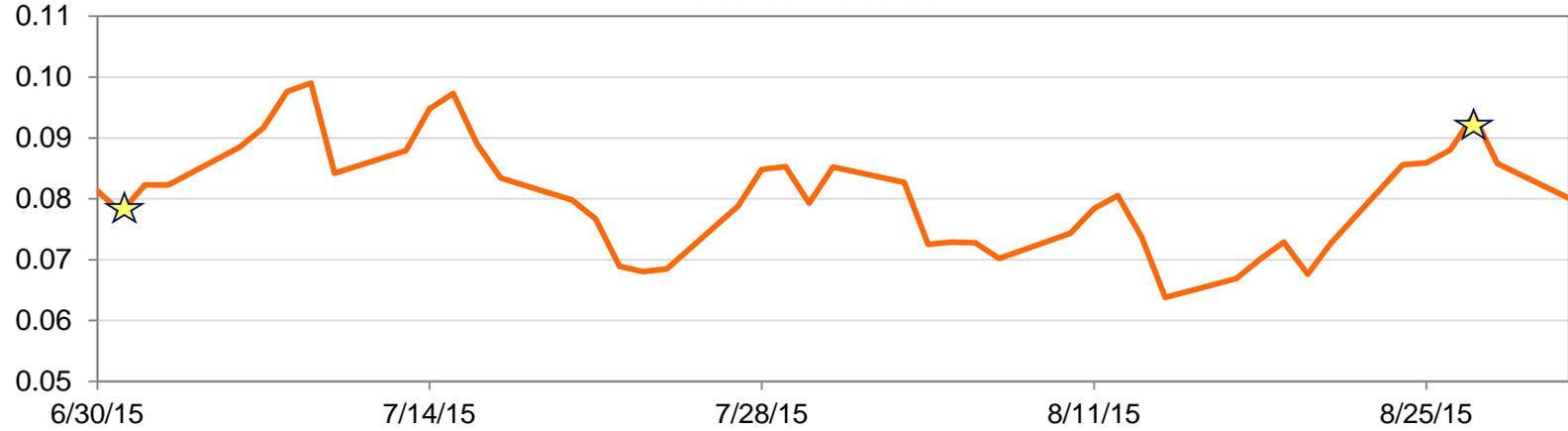
1. Rate represents the Merrill Lynch 1-3 Year U.S. Treasury/Agency Index month-end yield (G1A0). Source: Bloomberg.  
 2. Monthly Apportionment Yields. Source: Office of the Arizona State Treasurer.  
 3. Rate represents the Wells Fargo Advantage Government Money Market Service Fund.

# Capitalized on Changing Spread Relationships

- We prefer Treasuries when spreads are narrow and Agency securities when spreads widen to ensure that the Town is compensated for the risk of investing in any non-Treasury security.
- The following transactions extended duration by 1.37 years and will generate over \$6,500 in incremental earnings over the life of the securities.

Trade Date	Trade Type	Security	Maturity	Par Value	Yield
<b>7/1/15</b>	<b>Buy</b>	<b>U.S. Treasury Notes</b>	<b>7/31/18</b>	<b>\$650,000</b>	<b>1.11%</b>
7/1/15	Sell	FNMA Notes	3/30/16	\$610,000	0.29%
<b>8/27/15</b>	<b>Buy</b>	<b>FNMA Notes</b>	<b>10/19/18</b>	<b>\$700,000</b>	<b>1.18%</b>
8/26/15	Sell	U.S. Treasury Notes	7/31/18	\$650,000	1.03%

**3-Year Treasury-Agency Yield Spread**  
6/30/15 – 8/31/15



Source: Bloomberg

# Tennessee Valley Authority Purchase

- The Tennessee Valley Authority is a Federal Agency providing regional utilities support to the Tennessee Valley. Its bonds are secured by the power revenue generated by the Authority.
- The purchase:
  - Diversifies Town's government issuers.
  - Takes advantage of limited issuance with an attractive yield.
  - Maintains duration.

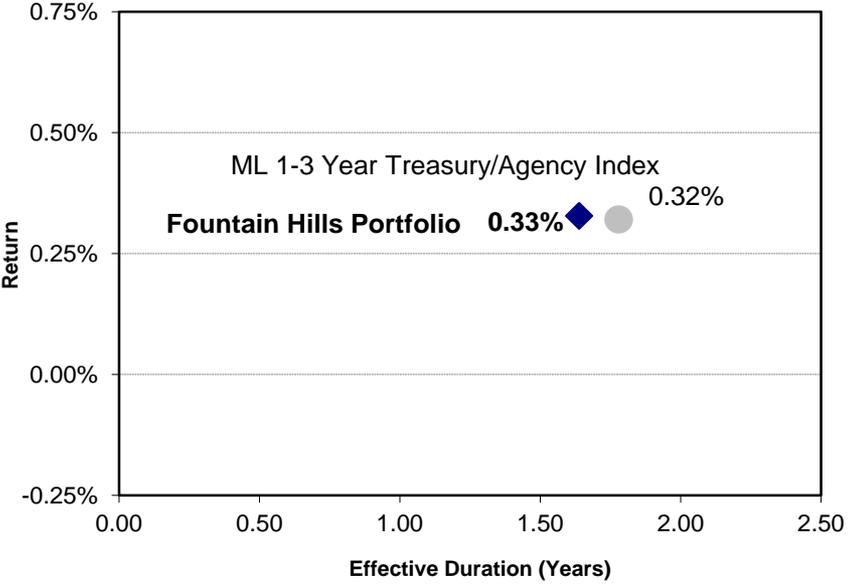


Trade Date	Par Value	Maturity	Yield	Spread over Comparable Treasury
8/18/15	\$240,000	12/15/17	1.01%	+0.30%

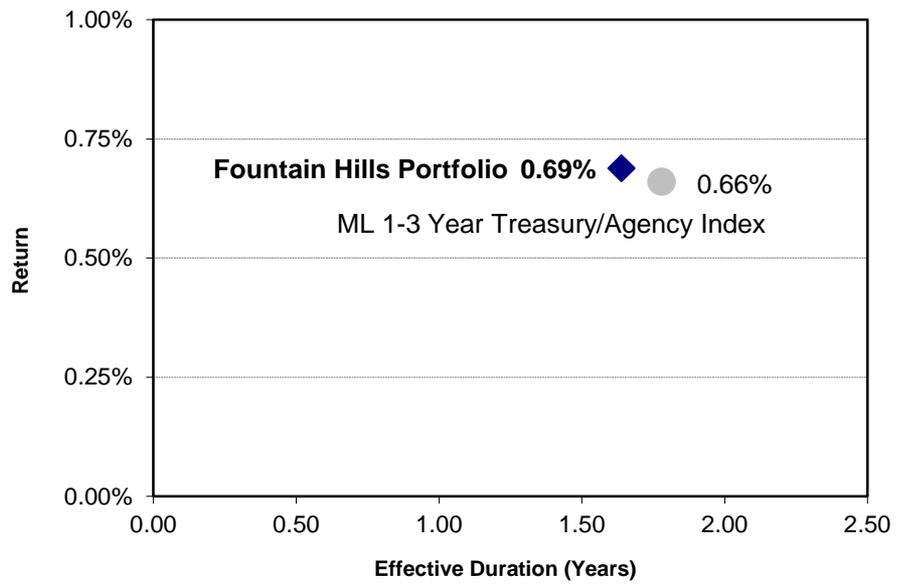
# Portfolio Performance

Total Return <sup>1,2,3,4</sup>	Quarter Ended September 30, 2015	Past 12 Months	Past 2 Years	Past 3 Years	Since Inception
<b>Fountain Hills Portfolio</b>	<b>0.33%</b>	<b>1.11%</b>	<b>0.80%</b>	<b>0.64%</b>	<b>0.69%</b>
ML 1-3 Year Treasury/Agency Index	0.32%	1.17%	0.84%	0.69%	0.66%
Effective Duration	September 30, 2015	June 30, 2015	Yields	September 30, 2015	June 30, 2015
<b>Fountain Hills Portfolio</b>	<b>1.64</b>	<b>1.78</b>	Yield at Market	0.58%	0.62%
ML 1-3 Year Treasury/Agency Index	1.77	1.78	Yield on Cost	0.77%	0.74%

**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 December 31, 2011.

# Fourth Quarter Investment Strategy

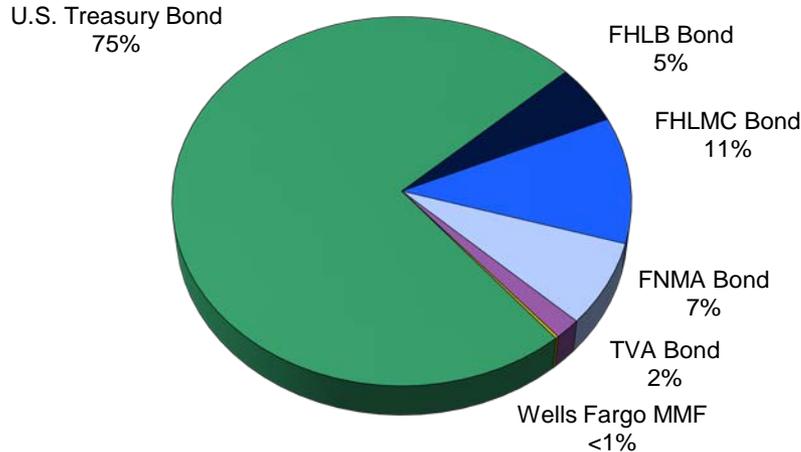
- We expect the U.S. economy to continue to expand, but at a slightly slower pace.
- The FOMC continues to monitor economic progress towards its dual objectives of full employment and price stability. It recently added an acknowledgement that global economic instability has the potential to affect Fed policy.
- We started the quarter with the portfolio's duration generally shorter and more conservative than the benchmark's as the potential for a Fed rate hike over the next few months remains strong.
- We will continue to monitor the spread relationship between Treasuries and comparable maturity Federal Agencies, adding to the Agency sector when attractive issues are identified, and reducing exposure when the benefit diminishes.

# 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
U.S. Treasury Bond	\$11,413,093	\$11,450,659	610	74.39%	100%	0.76%
FHLB Bond	\$795,706	\$796,724	390	5.18%	100%	0.58%
FHLMC Bond	\$1,702,800	\$1,707,880	498	11.10%	100%	0.70%
FNMA Bond	\$1,126,715	\$1,132,021	831	7.34%	100%	1.01%
TVA Bond	\$271,780	\$272,312	807	1.77%	100%	1.01%
Wells Fargo MMF	\$33,218	\$33,218	1	0.22%	N/A	0.01%
Total including cash	\$15,343,312	\$15,392,814	601	100.00%		0.77%
Total without cash	\$15,310,094	\$15,359,597				0.77%

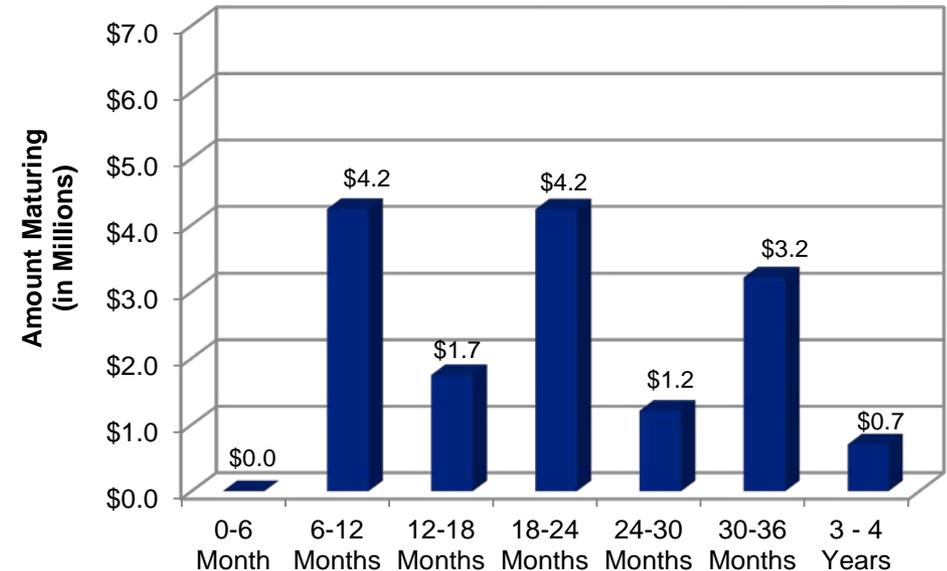
Summary by Issuer	Book Value	% of Portfolio
U.S. Treasury	\$11,413,093	74.38%
FHLB	\$795,706	5.19%
FHLMC	\$1,702,800	11.10%
FNMA	\$1,126,715	7.34%
TVA Bond	\$271,780	1.77%
Wells Fargo	\$33,218	0.22%
<b>Total</b>	<b>\$15,343,312</b>	<b>100%</b>

### Issuer Distribution



Weighted Average Maturity (in years)	1.66
Duration Allowed by Policy	5.00
Current Portfolio Duration Including Cash	1.63
Current Portfolio Duration Without Cash	1.64

### Maturity Distribution<sup>2</sup>



1. Market values of portfolio holdings include accrued interest.  
 2. Excludes Money Market Balance.



## Managed Account Detail of Securities Held

For the Month Ending **September 30, 2015**

### 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 06/02/2014 0.375% 05/31/2016	912828WM8	825,000.00	AA+	Aaa	06/02/14	06/03/14	824,871.09	0.38	1,039.70	824,956.94	825,676.50
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	3,901.32	484,932.37	485,409.15
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	4,106.66	510,597.91	510,957.00
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	6,159.99	765,216.26	766,435.50
US TREASURY NOTES DTD 08/31/2011 1.000% 08/31/2016	912828RF9	285,000.00	AA+	Aaa	02/27/14	03/03/14	288,595.90	0.49	242.72	286,325.15	286,592.01
US TREASURY NOTES DTD 11/30/2011 0.875% 11/30/2016	912828RU6	400,000.00	AA+	Aaa	12/03/13	12/04/13	403,578.13	0.57	1,176.23	401,400.45	402,026.00
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	1,323.26	451,323.38	452,279.25
US TREASURY NOTES DTD 01/03/2012 0.875% 12/31/2016	912828RX0	100,000.00	AA+	Aaa	12/05/14	12/09/14	100,375.00	0.69	221.13	100,227.72	100,501.30
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	525,602.77	528,828.30
US TREASURY NOTES DTD 03/31/2012 1.000% 03/31/2017	912828SM3	650,000.00	AA+	Aaa	10/02/14	10/06/14	653,173.83	0.80	17.76	651,921.10	654,739.80
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	1,732.84	822,441.58	825,612.15
US TREASURY NOTES DTD 07/02/2012 0.750% 06/30/2017	912828TB6	550,000.00	AA+	Aaa	10/30/14	11/03/14	549,441.41	0.79	1,042.46	549,632.06	551,510.85
US TREASURY NOTES DTD 07/31/2012 0.500% 07/31/2017	912828TG5	50,000.00	AA+	Aaa	02/06/15	02/10/15	49,582.03	0.84	42.12	49,689.59	49,907.55
US TREASURY NOTES DTD 07/31/2012 0.500% 07/31/2017	912828TG5	130,000.00	AA+	Aaa	07/01/14	07/07/14	128,197.26	0.96	109.51	128,917.06	129,759.63



## Managed Account Detail of Securities Held

For the Month Ending **September 30, 2015**

### 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 07/31/2012 0.500% 07/31/2017	912828TG5	700,000.00	AA+	Aaa	02/02/15	02/04/15	697,785.16	0.63	589.67	698,367.03	698,705.70
US TREASURY NOTES DTD 09/30/2010 1.875% 09/30/2017	912828PA2	625,000.00	AA+	Aaa	09/02/14	09/04/14	640,673.83	1.04	32.02	635,251.59	640,120.63
US TREASURY NOTES DTD 12/31/2012 0.750% 12/31/2017	912828UE8	300,000.00	AA+	Aaa	12/01/14	12/03/14	298,535.15	0.91	568.61	298,926.19	300,125.10
US TREASURY NOTES DTD 04/01/2013 0.750% 03/31/2018	912828UU2	950,000.00	AA+	Aaa	02/26/15	02/27/15	941,613.28	1.04	19.47	943,197.84	948,639.60
US TREASURY NOTES DTD 04/01/2013 0.750% 03/31/2018	912828UU2	1,100,000.00	AA+	Aaa	03/26/15	03/27/15	1,092,007.81	1.00	22.54	1,093,354.75	1,098,424.80
US TREASURY NOTES DTD 04/30/2013 0.625% 04/30/2018	912828UZ1	275,000.00	AA+	Aaa	04/28/15	04/30/15	272,787.11	0.90	719.26	273,092.35	273,589.25
US TREASURY NOTES DTD 04/30/2013 0.625% 04/30/2018	912828UZ1	900,000.00	AA+	Aaa	05/28/15	05/29/15	891,281.25	0.96	2,353.94	892,283.55	895,383.00
<b>Security Type Sub-Total</b>		<b>11,365,000.00</b>					<b>11,505,179.88</b>	<b>0.76</b>	<b>25,435.55</b>	<b>11,387,657.64</b>	<b>11,425,223.07</b>
<b>Federal Agency Bond / Note</b>											
FHLMC REFERENCE NOTE DTD 11/21/2014 0.400% 05/27/2016	3134G5RF4	500,000.00	AA+	Aaa	11/19/14	11/21/14	499,850.00	0.42	688.89	499,935.08	500,218.50
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	170,840.08	171,361.19
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	256,280.17	257,041.79
FHLB NOTES DTD 08/07/2014 0.500% 09/28/2016	3130A2T97	420,000.00	AA+	Aaa	08/06/14	08/07/14	419,055.00	0.61	17.50	419,560.76	420,320.04
FHLB NOTES DTD 11/17/2014 0.625% 11/23/2016	3130A3J70	375,000.00	AA+	Aaa	01/21/15	01/22/15	375,471.59	0.56	833.33	375,294.74	375,553.50
FHLMC REFERENCE NOTE DTD 01/16/2015 0.500% 01/27/2017	3137EADU0	415,000.00	AA+	Aaa	01/15/15	01/16/15	414,273.75	0.59	368.89	414,526.24	414,920.32

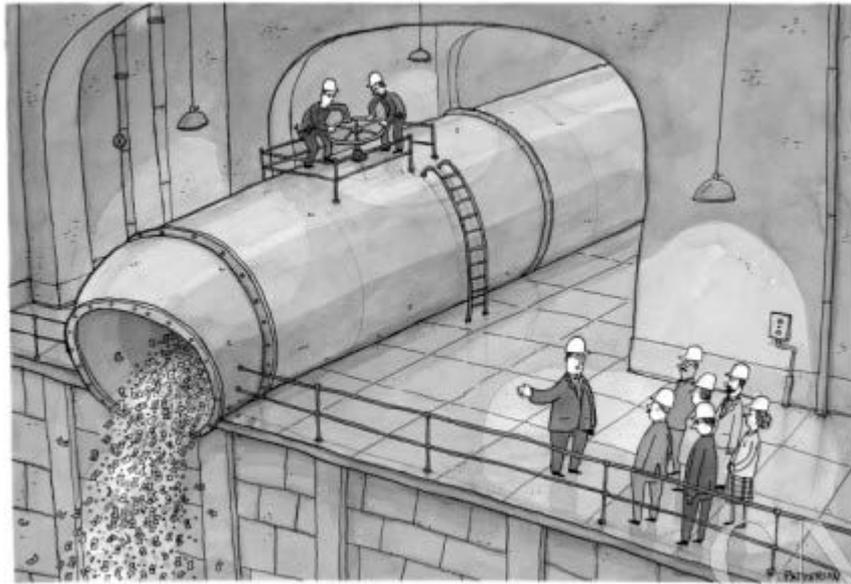


## Managed Account Detail of Securities Held

For the Month Ending **September 30, 2015**

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<b>Federal Agency Bond / Note</b>											
FREDDIE MAC GLOBAL NOTES DTD 06/25/2012 1.000% 07/28/2017	3137EADJ5	350,000.00	AA+	Aaa	03/19/15	03/20/15	351,190.00	0.85	612.50	350,924.52	352,367.40
FREDDIE MAC GLOBAL NOTES DTD 06/25/2012 1.000% 07/28/2017	3137EADJ5	435,000.00	AA+	Aaa	08/12/14	08/14/14	434,970.86	1.00	761.25	434,982.18	437,942.34
TENNESSEE VALLEY AUTHORITY NOTES DTD 12/22/1997 6.250% 12/15/2017	880591CU4	240,000.00	AA+	Aaa	08/18/15	08/19/15	268,794.24	1.01	4,416.67	267,363.51	267,895.68
FNMA BENCHMARK NOTE DTD 09/01/2015 1.125% 10/19/2018	3135G0E58	700,000.00	AA+	Aaa	08/27/15	09/01/15	698,866.00	1.18	656.25	698,894.28	702,917.60
<b>Security Type Sub-Total</b>		<b>3,860,000.00</b>					<b>3,893,808.90</b>	<b>0.79</b>	<b>8,399.55</b>	<b>3,888,601.56</b>	<b>3,900,538.36</b>
<b>Managed Account Sub-Total</b>		<b>15,225,000.00</b>					<b>15,398,988.78</b>	<b>0.77</b>	<b>33,835.10</b>	<b>15,276,259.20</b>	<b>15,325,761.43</b>
<b>Securities Sub-Total</b>		<b>\$15,225,000.00</b>					<b>\$15,398,988.78</b>	<b>0.77%</b>	<b>\$33,835.10</b>	<b>\$15,276,259.20</b>	<b>\$15,325,761.43</b>
<b>Accrued Interest</b>											<b>\$33,835.10</b>
<b>Total Investments</b>											<b>\$15,359,596.53</b>

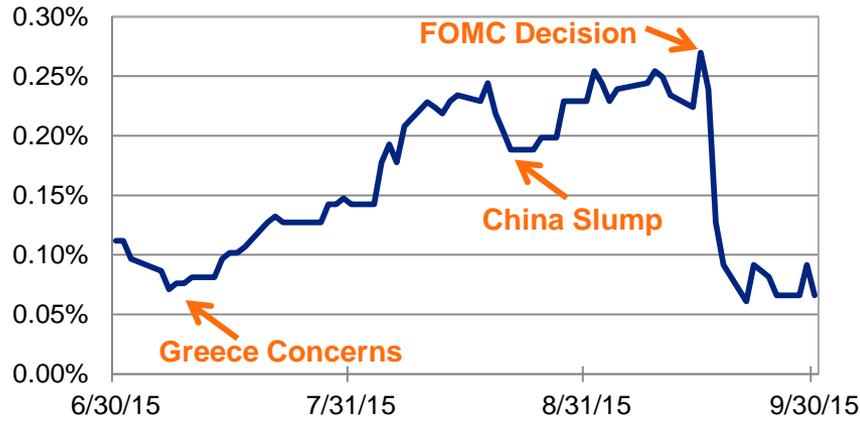


*"And this is where we adjust the interest rate."* COLLECTION

# Economic Update

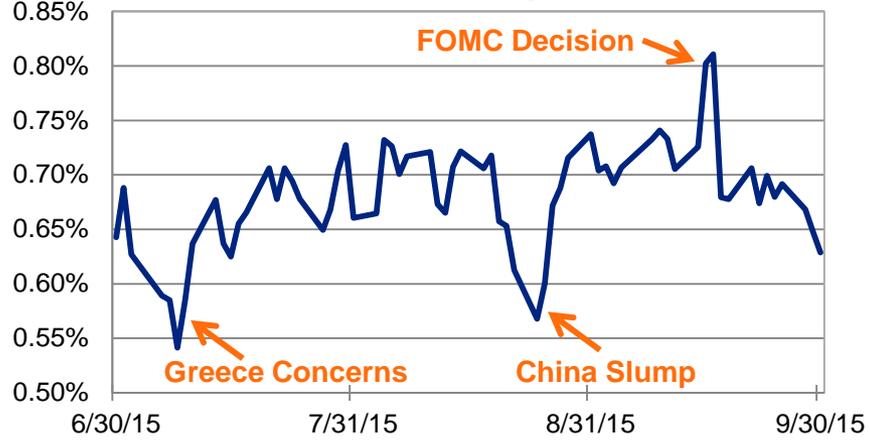
# Yields Update

**U.S. 6 Month Treasury Yield**

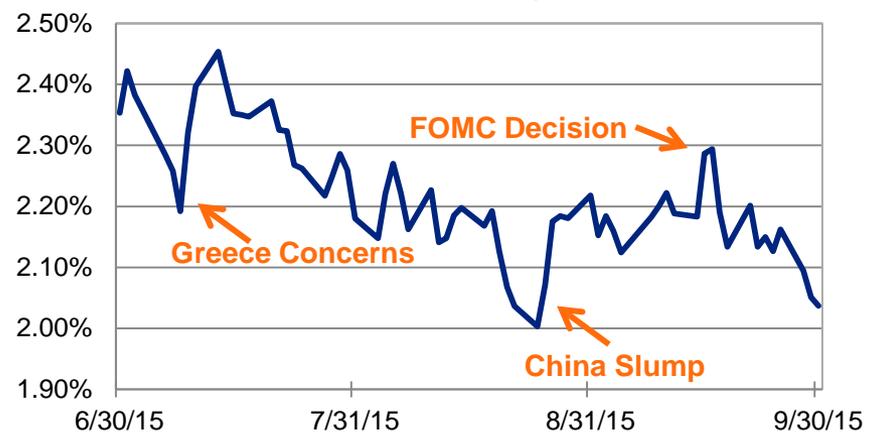


- The three major headlines throughout the quarter—Greece debt woes, China growth scare, and FOMC’s “no hike” decision—impacted the yield curve differently.
- Short- and intermediate-maturities were most impacted by changing FOMC expectations while longer maturities were driven by slowing global growth and inflation expectations.

**U.S. 2 Year Treasury Yield**



**U.S. 10 Year Treasury Yield**



Source: Bloomberg.

# FOMC Statement Highlights



- Economic activity has been expanding at a moderate pace. Household spending and business fixed investment have been increasing at solid rates in recent months, and the housing sector has improved further... ***The pace of job gains slowed and the unemployment rate held steady.***
  - ***Inflation has continued to run below the Committee's longer-run objective, partly reflecting declines in energy prices*** and in prices of non-energy imports... The Committee continues to see the risks to the outlook for economic activity and the labor market as nearly ***balanced but is monitoring global economic and financial developments.***
- 
- The current 0 – 0.25% target range for the federal funds rate remains appropriate ...In determining whether it will be appropriate to raise the target range ***at its next meeting***, the Committee will assess progress - ***both realized and expected*** - toward its objective of maximum employment at 2% inflation
  - Committee anticipates that it will be **appropriate to raise the target range for the federal funds rate** when it has seen further improvements in the labor market and is ***reasonably confident that inflation will move back to its 2% objective over the medium term.***

Source: Federal Reserve.

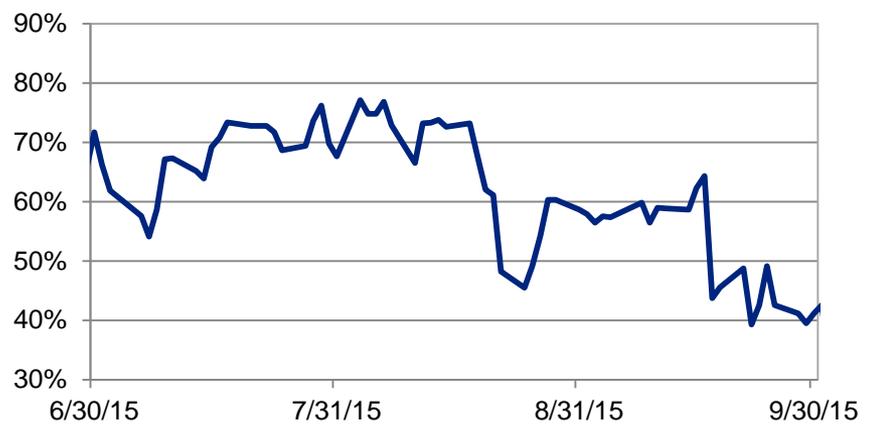
# Outlook for Fed Funds Target Rate

**Probability of September Rate Hike**

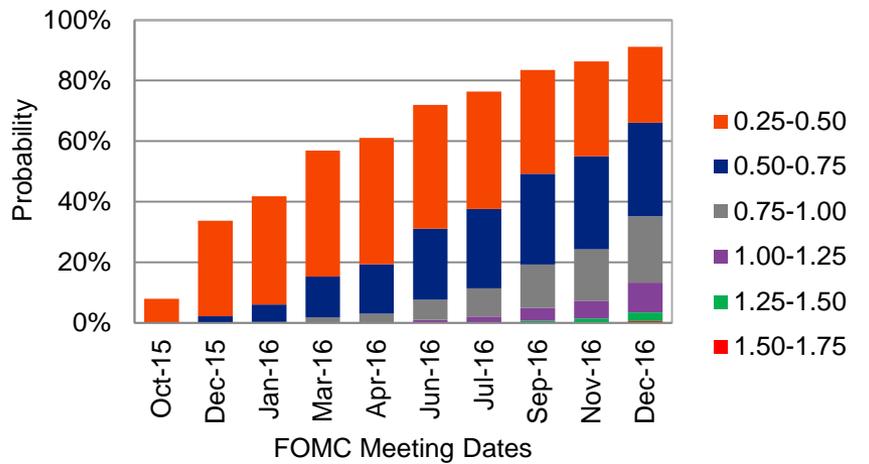


- Market expectations for a September hike fluctuated as participants digested the impact that deteriorating economic data would have on the FOMC's view of progress towards its goals.
- While investors are torn on the timing of an initial rate hike, the expectations for subsequent hikes remains tempered.

**Probability of December Rate Hike**



**Current Outlook for Fed Funds Target Range**

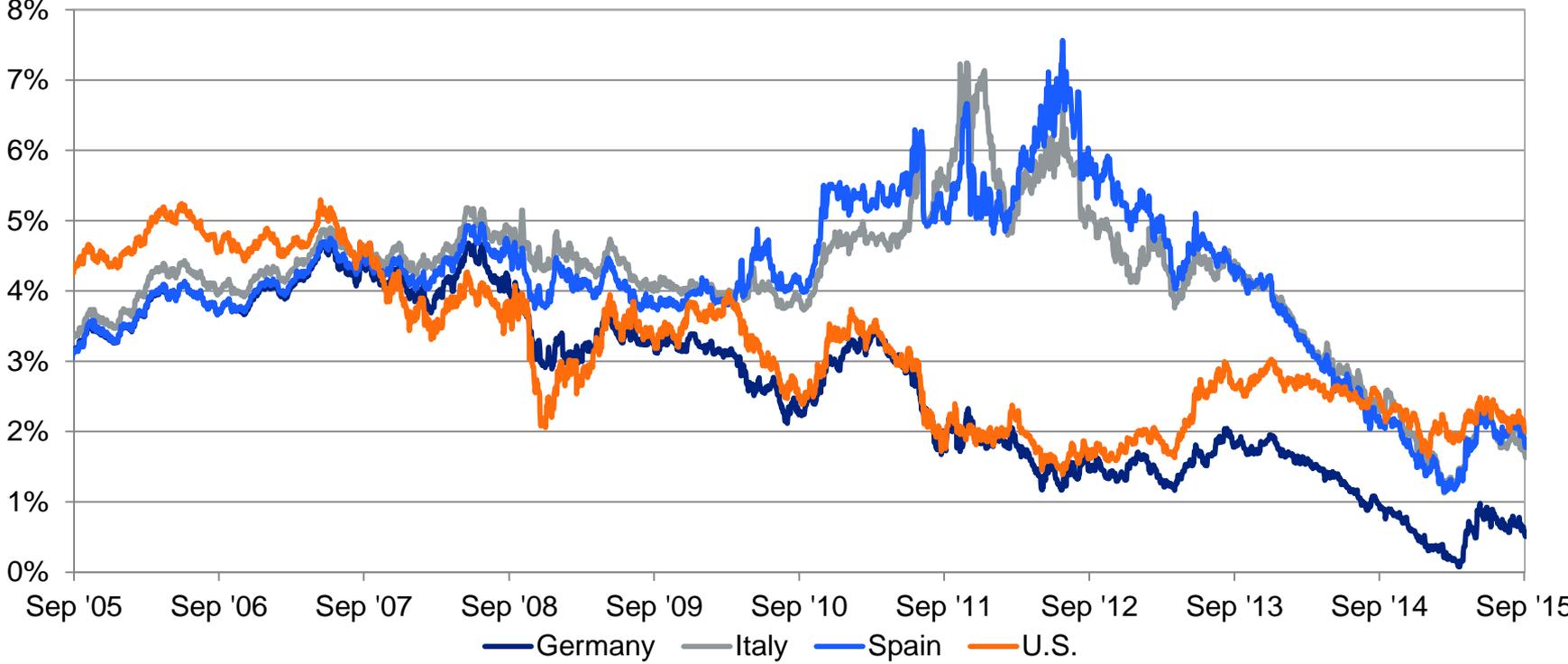


Source: Bloomberg, "Current Outlook" as of 10/7/15.

# Global Rate Environment

- Global yields declined through September as the Federal Reserve kept their benchmark interest rate unchanged and September's weaker-than-expected jobs report fueled prospect of rates to remain low.
- Volatility has remained high as global growth prospects continue to show signs of slowdown and indecision over when and whether the Federal Reserve will raise rates persists.

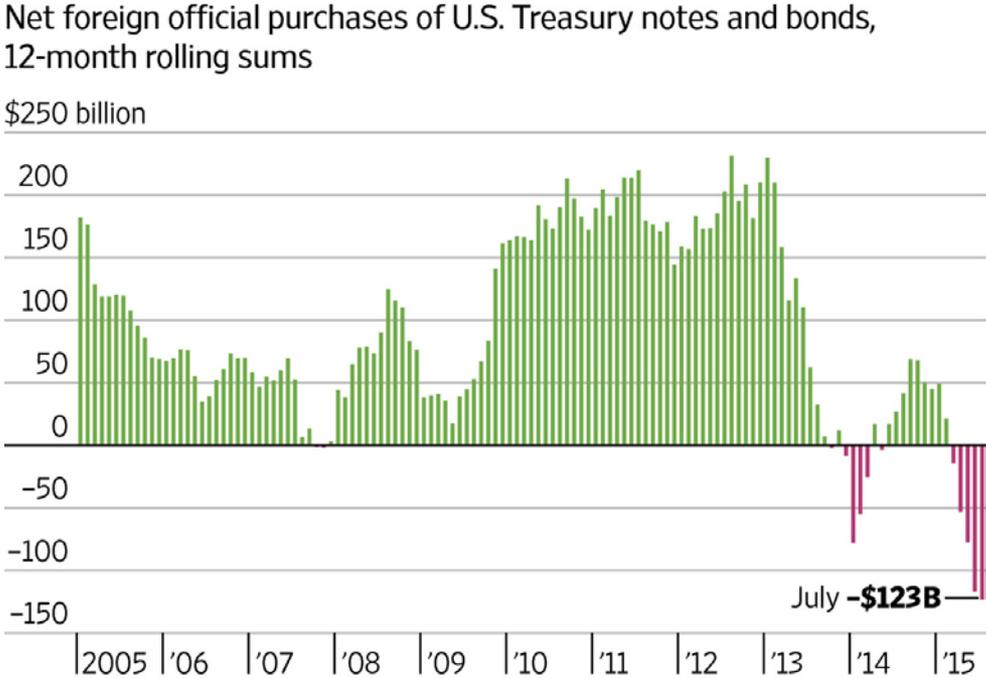
**Sovereign Bond Yields (10-Yr Maturities)**



Source: Bloomberg.

# U.S. Government Debt Sell-Off

- Foreign net sales of U.S. Treasury notes and bonds reached \$123 billion in July, the biggest decline since 1978 (first data collected).
- The emerging-market slowdown has hit the global economy as central banks of foreign nations including China, Russia, Brazil, and Taiwan sell U.S. Treasury securities at the fastest pace ever.
- Emerging-market countries typically use their trade surpluses and commodity revenues to buy up U.S. debt, favored for liquidity and stability.
- As global growth weakens and commodity prices slump, central banks sell off their foreign exchange reserves to raise cash.
- These sales could accompany a further decline in bond yields by underscoring the depth of economic problems hitting emerging regions.



Source: Deutsche Bank

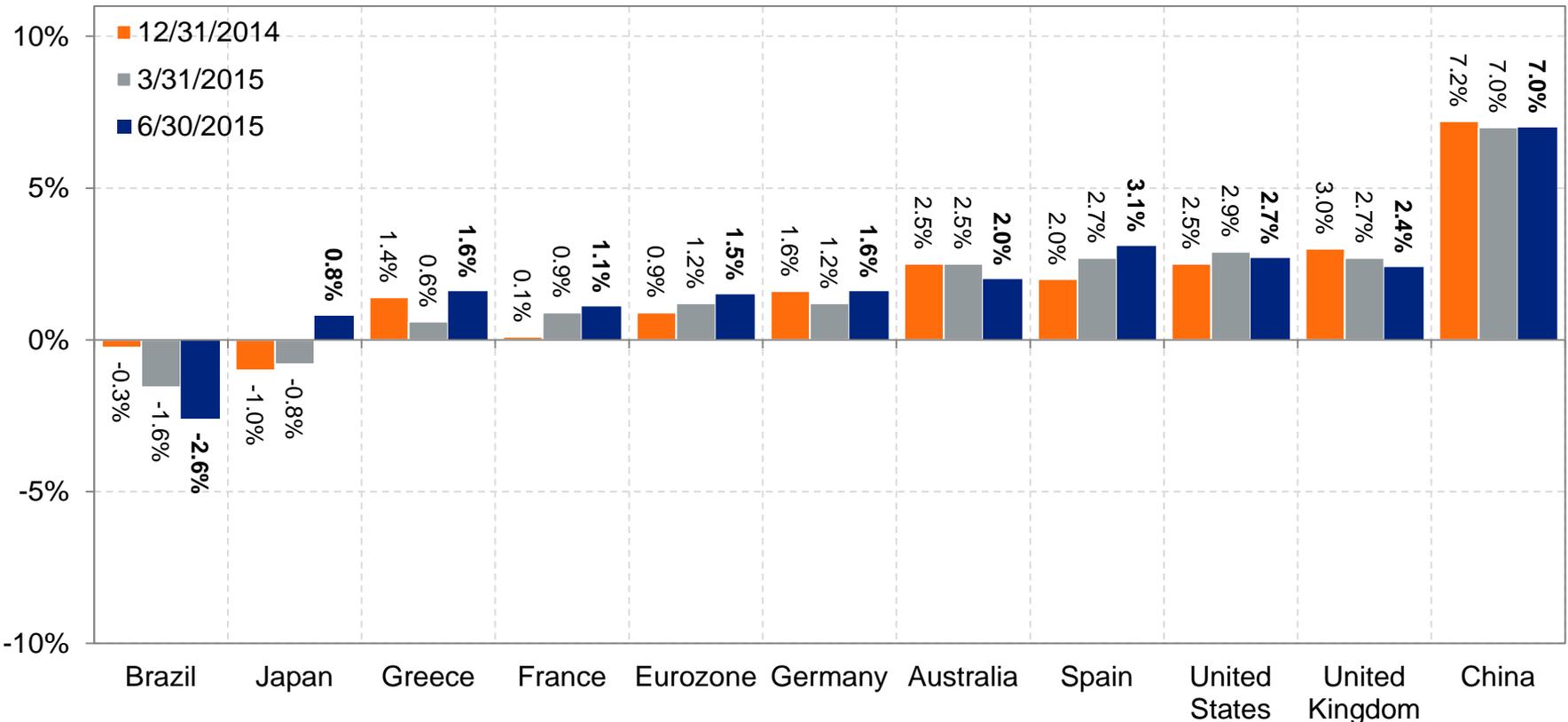
THE WALL STREET JOURNAL.

Source: The Wall Street Journal.

# IMF Expects Less Global Growth

- Global growth in 2015 is projected to be 3.1%, the weakest expansion since the financial crisis.
- Contributing factors to include China's deceleration, disharmony in Europe, and vulnerability of emerging economies (they will transmit and amplify economic shock rather than cushion against them).

GDP of Select Nations



Source: Bloomberg.

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