

Town of Fountain Hills

Quarterly Investment Review

Quarter Ended March 31, 2013

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Portfolio Summary

Total Portfolio Value	March 31, 2013	December 31, 2012
Market Value	**$15,143,539.10**	$15,127,981.66
Amortized Cost	**$15,101,882.30**	$15,083,880.50

- The portfolio complies with the Arizona Revised Statues and the Fountain Hills investment policy. The portfolio is well diversified among U.S. Treasury and Federal Agency securities and among issuers.
- The U.S. economy showed signs of recovery during the quarter as unemployment fell, home prices rose, and the equity markets reached new highs.
- The Federal Sequester, debt ceiling limit, rising energy prices, and the reemergence of the European crisis in Cyprus tempered the positive data.
- Despite sharp volatility, interest rates generally ended the quarter where they began.
- The Fed continued to hold its target rate at 0.00%-0.25%, anchoring short-term rates near their historic low levels. In addition, the Fed continued its quantitative easing program, purchasing long-term bonds in an effort to keep long-term rates low to encourage borrowing
- We continued to manage the portfolio with a duration target near that of the benchmark's duration. A longer duration strategy allows for investment in longer-term, 2 to 5 year investments. Longer-term investments benefit the portfolio with higher initial yields and through price appreciation from roll down. .

Portfolio Summary- Continued

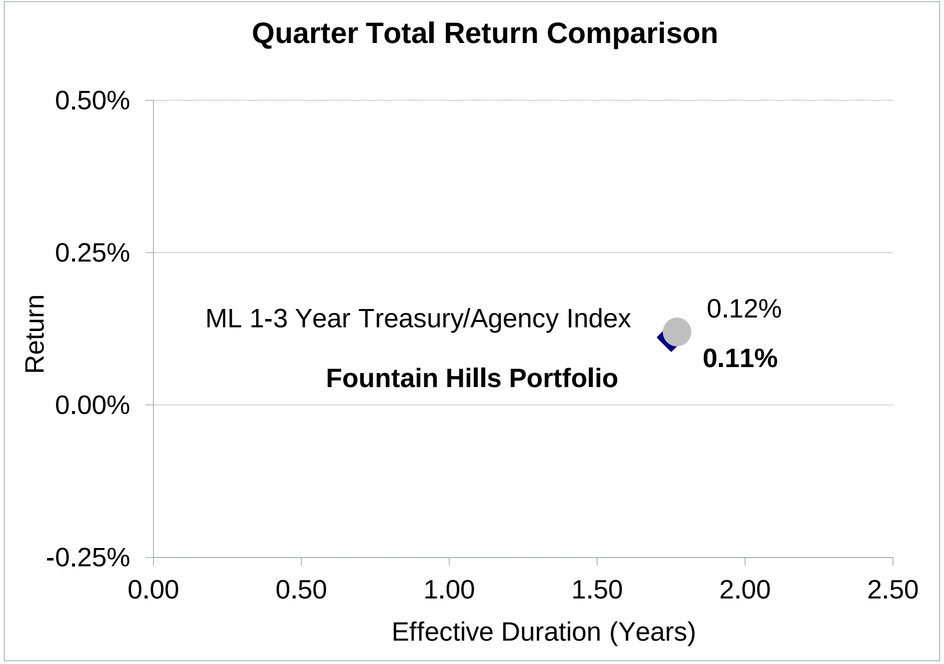
- The investment environment will continue to be challenging as opposing economic forces split the focus of investors.
  - Strong corporate earnings, strong equity markets, and modest recoveries in growth and employment.
  - Effects of the Sequester, Eurozone weakness, conflict in Asia, rising commodity prices.
- We expect the Fed to continue to keep the target rate near zero and maintain its stimulus measures. This will continue to put downward presser on short- and long-term interest rates.
- We will continue to employ the following active management strategies:
  - Invest funds in the steepest areas of the yield curve to take advantage of appreciation as they “roll down,” while ensuring the Town’s cash flow needs continue to be met.
  - Evaluate the spread between the Treasury and Agency sectors at different maturities to determine where there is more value.
  - Manage the portfolio’s duration near that of the benchmark.
- Our strategy will remain flexible and may change in response to changes in interest rates, economic data, market outlook, or as specific opportunities arise.

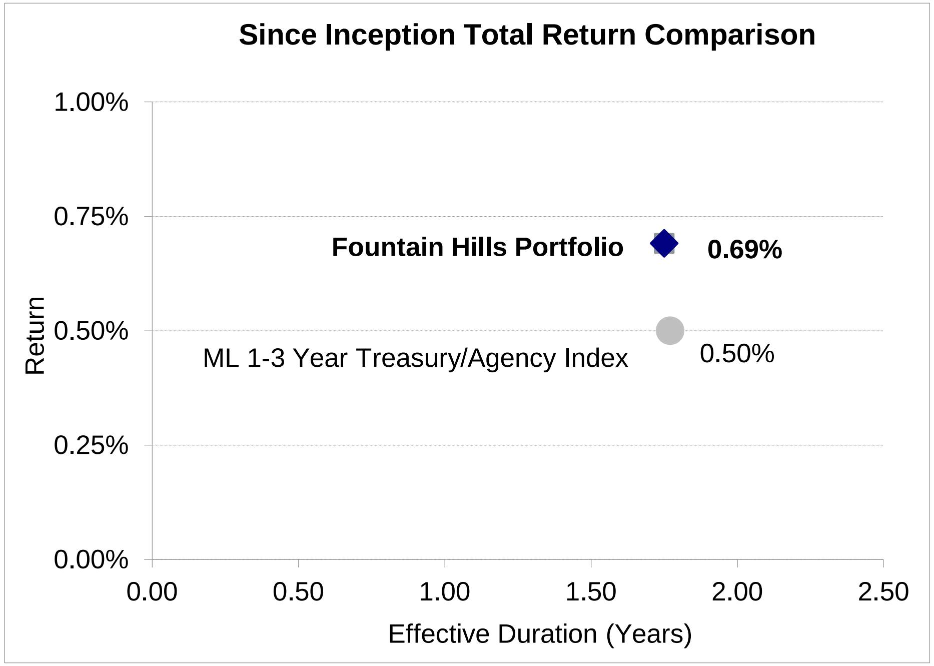
Operating Portfolio Performance

Total Return[1,2,3,4,5]	Quarter Ended March 31, 2013	Past 6 Months	Past 12 Months	Since Inception
Fountain Hills Portfolio	**0.11%**	**0.21%**	**0.65%**	**0.69%**
ML 1-3 Year Treasury/Agency Index	0.12%	0.19%	0.64%	0.50%

Effective Duration[5]	March 31, 2013	December 31, 2012
Fountain Hills Portfolio	**1.75**	**1.77**
ML 1-3 Year Treasury/Agency Index	1.76	1.77

Yields[5]	March 31, 2013	December 31, 2012
Yield at Market	0.26%	0.26%
Yield on Cost	0.46%	0.46%





1. Performance on trade date basis, gross (i.e., before fees), in accordance with the CFA Institute's Global Investment Performance Standards (GIPS).

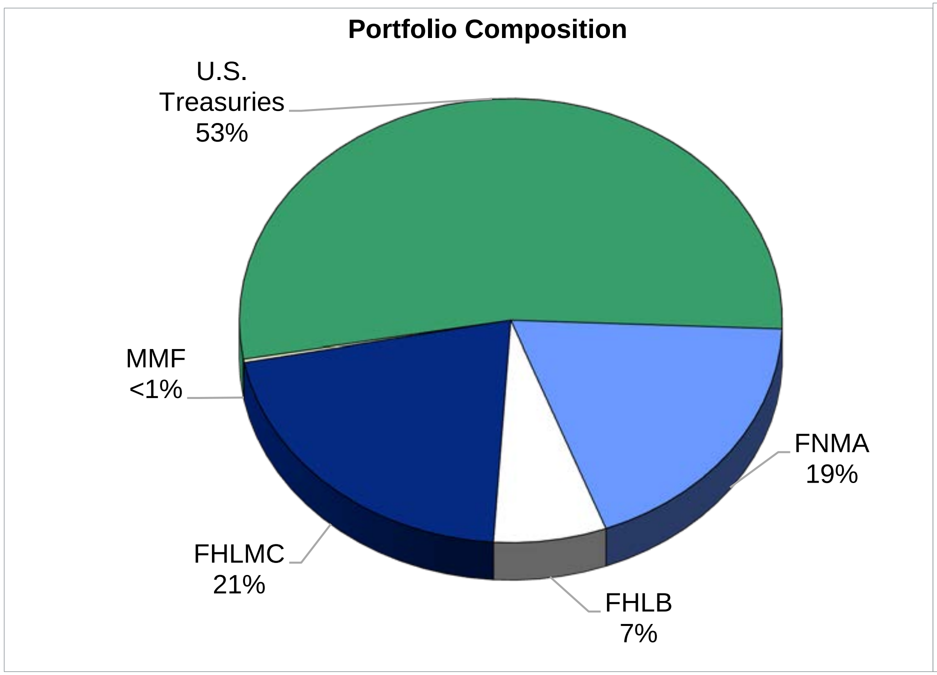
2. Merrill Lynch Indices provided by Bloomberg Financial Markets.

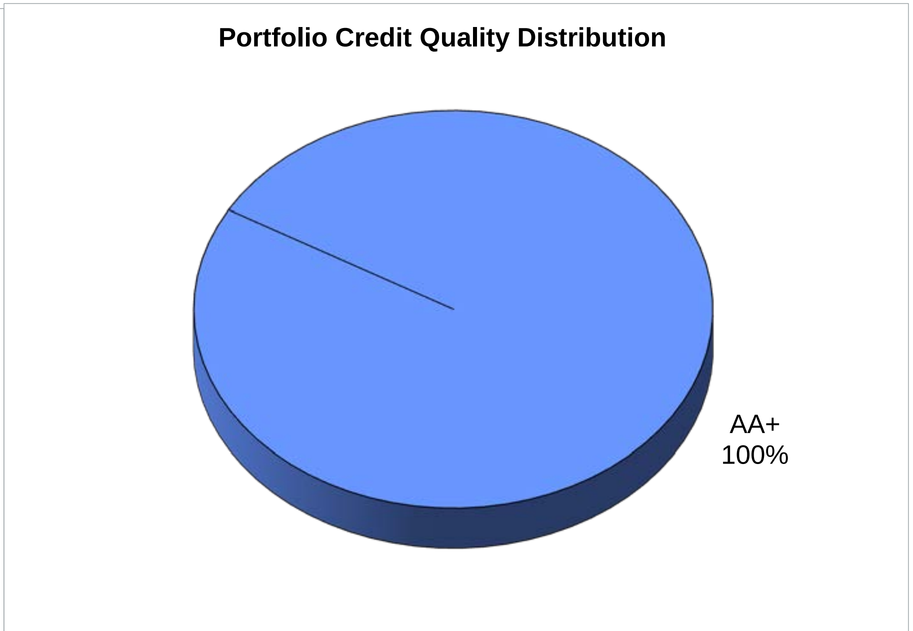
3. Quarterly returns are presented on an unannualized basis. Performance numbers for periods greater than one year are presented on an annualized basis.

4. Inception date is 12/31/2011.

Portfolio Composition and Credit Quality Characteristics

Security Type[1]	March 31, 2013	% of Portfolio	December 31, 2012	% of Portfolio	Permitted by Policy
U.S. Treasuries	**$8,087,009.35**	**53.4%**	$7,478,015.93	49.4%	**100%**
Federal Agencies	**$7,019,856.14**	**46.4%**	$7,577,106.46	*50.1%*	**100%**
FNMA	*$2,827,930.60*	*18.7%*	*$3,380,466.74*	*22.3%*	-
FHLB	*$1,018,193.92*	*6.7%*	*$1,018,359.42*	*6.7%*	-
FHLMC	*$3,173,731.62*	*21.0%*	*$3,178,280.30*	*21.0%*	-
MMF	**$36,673.61**	**0.2%**	$72,859.27	0.5%	
Totals	**$15,143,539.10**	**100.0%**	$15,127,981.66	100.0%	





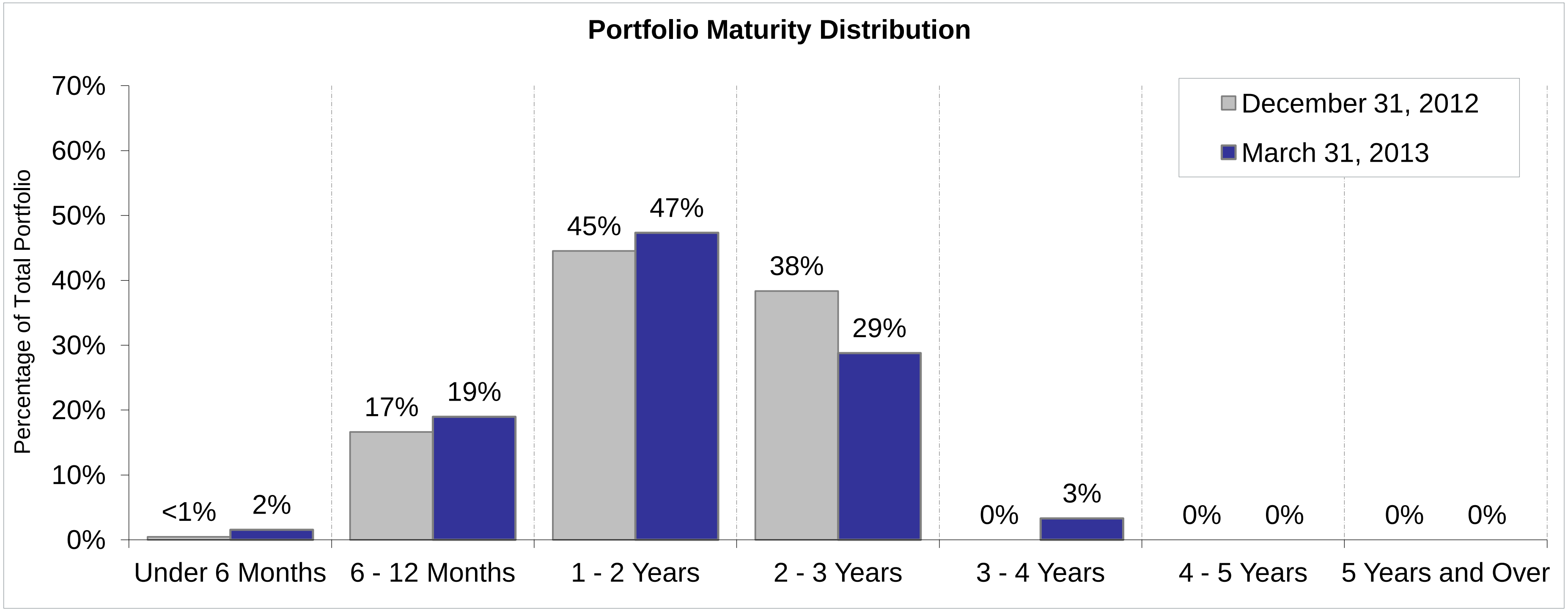
Ratings by Standard & Poor's

Notes:

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

Portfolio Maturity Distribution

Maturity Distribution[1]	March 31, 2013	December 31, 2012
Under 6 Months	**$237,530.65**	$72,859.27
6 - 12 Months	**$2,874,012.07**	$2,514,935.75
1 - 2 Years	**$7,167,794.74**	$6,735,586.02
2 - 3 Years	**$4,361,722.51**	$5,804,600.62
3 - 4 Years	**$502,479.13**	$0.00
4 - 5 Years	**$0.00**	$0.00
5 Years and Over	**$0.00**	$0.00
Totals	**$15,143,539.10**	$15,127,981.66



Continuation of Extended Duration Strategy

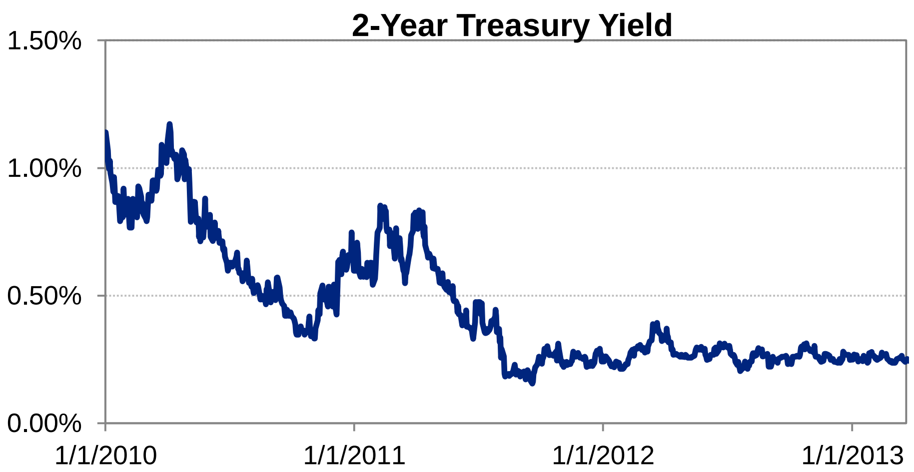
- As economic forecasts point to an accommodative Fed until at least mid-2015, meaning interest rates will likely remain low for the next 1 to 2 years, we continue to utilize an extended duration strategy.
- Below are duration extension trades executed during the quarter.

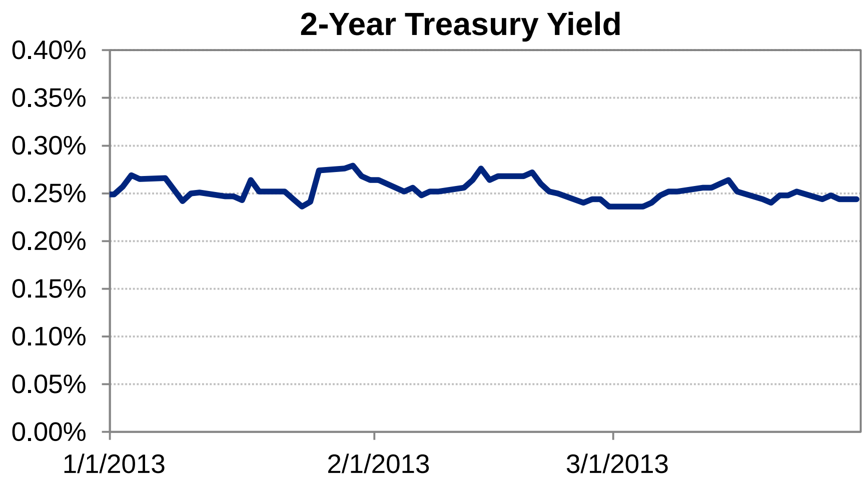
Trade Date	Trade Type	Security	Par	Maturity	Yield	Gain on Sale
1/30/13	Sell	Fannie Mae Notes	600,000	9/23/13	0.15%	$1,050
1/30/13	**Buy**	**U.S. Treasury Notes**	**575,000**	**1/31/16**	**0.44%**	**-**
3/12/13	Sell	Fannie Mae Notes	200,000	9/23/13	0.16%	$280
3/12/13	**Buy**	**Fannie Mae Notes**	**300,000**	**3/30/16**	**0.48%**	**-**
3/27/13	Sell	Fannie Mae Notes	500,000	9/23/13	0.14%	$696
3/27/13	**Buy**	**U.S. Treasury Notes**	**475,000**	**4/30/16**	**0.38%**	**-**

Economic Update

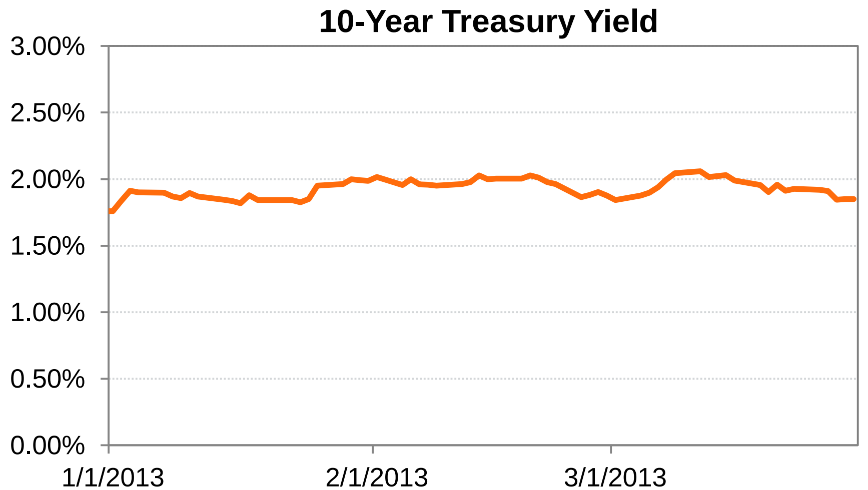
Interest Rates Are Low and Trading in Narrow Range

- **In the shorter end…**





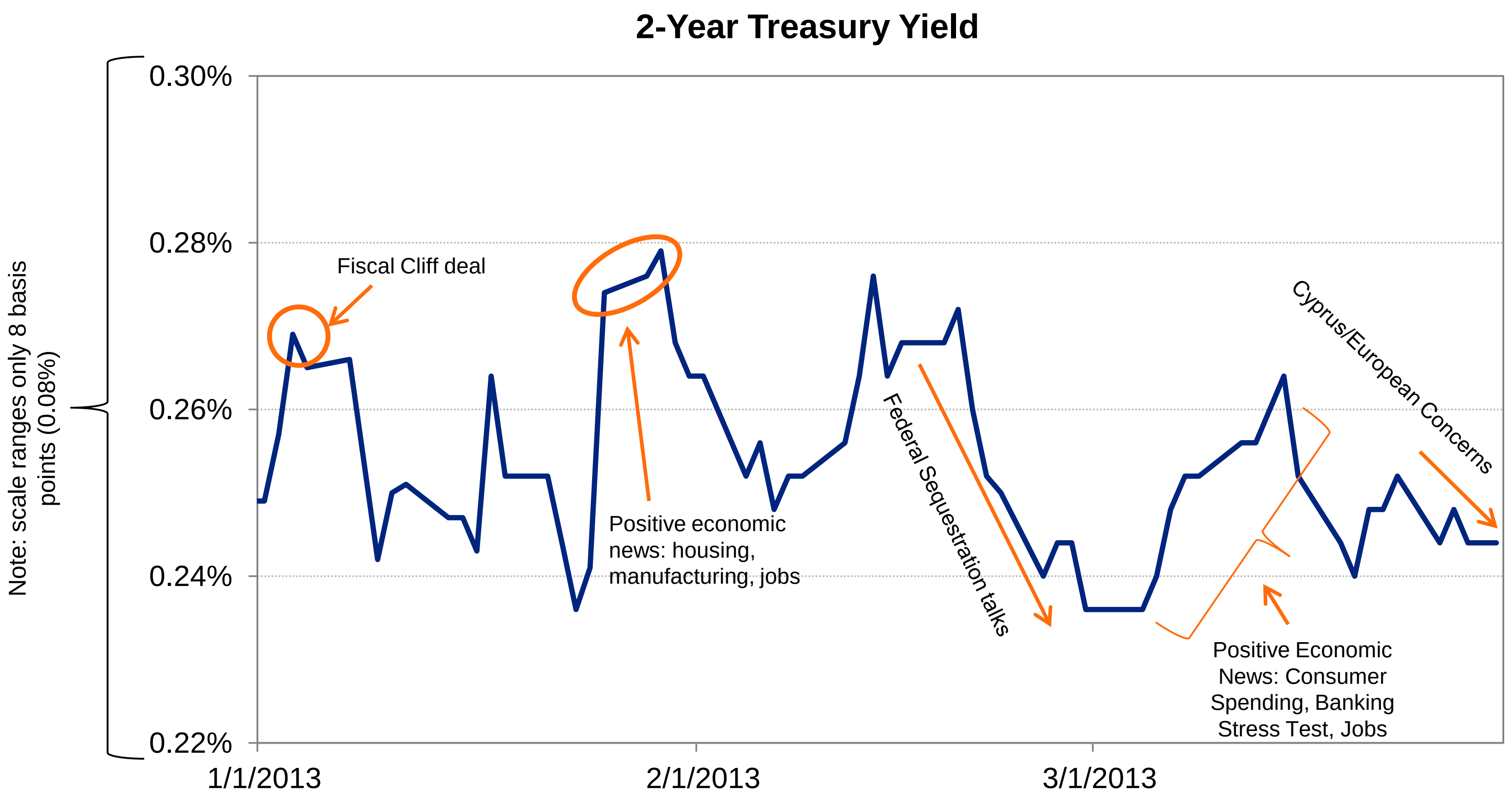
- **And in the longer end….**



Source: Bloomberg

First Quarter Market Movers

- First Quarter market movement was provoked by a mix of positive economic news and fiscal policy concerns; both domestically and abroad.



Source: Bloomberg

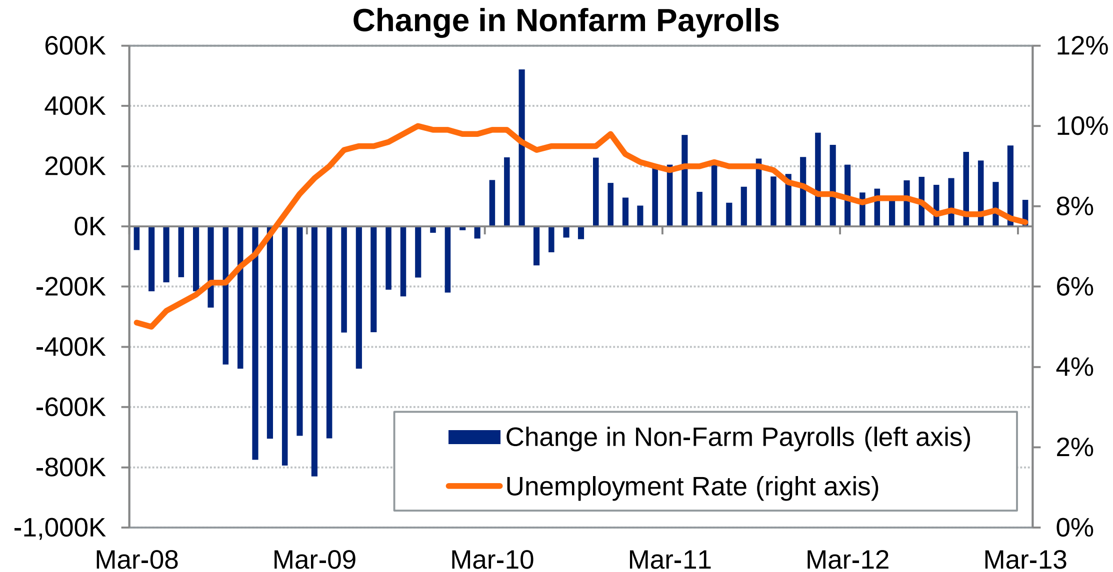
March Jobs Report A Big Surprise to Downside

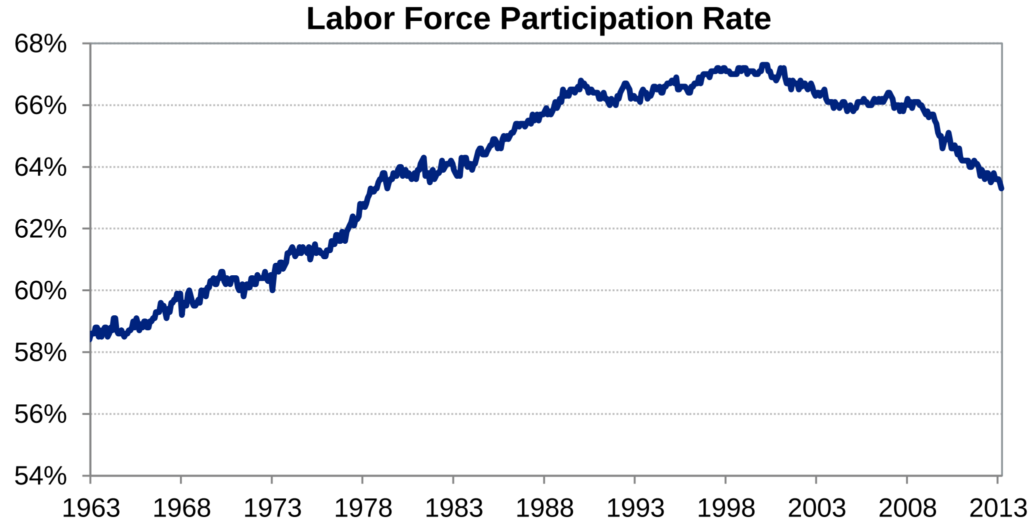
- After adding an average of 189,000 jobs a month for the past 8 months, economists were taken by surprise when it was reported only 88,000 jobs were added in March.

- Expectations has been for approximately 190,000.

- Additional disappointment came when it was reported the unemployment rate moved down to 7.6% only as a result of people leaving the labor market.

- The Labor participation rate is at its lowest level since 1979.

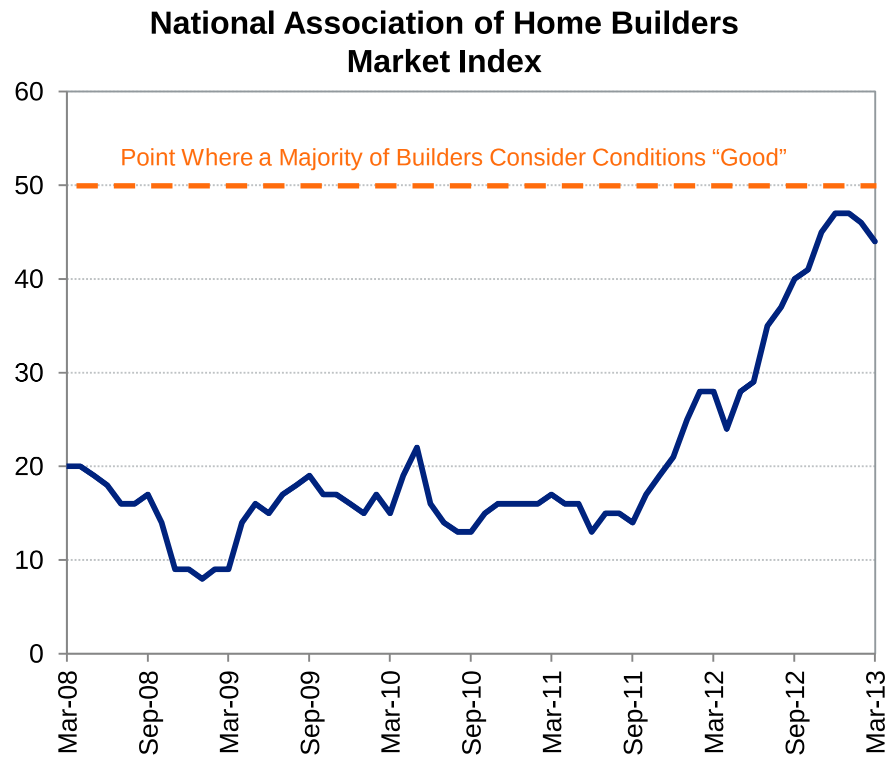


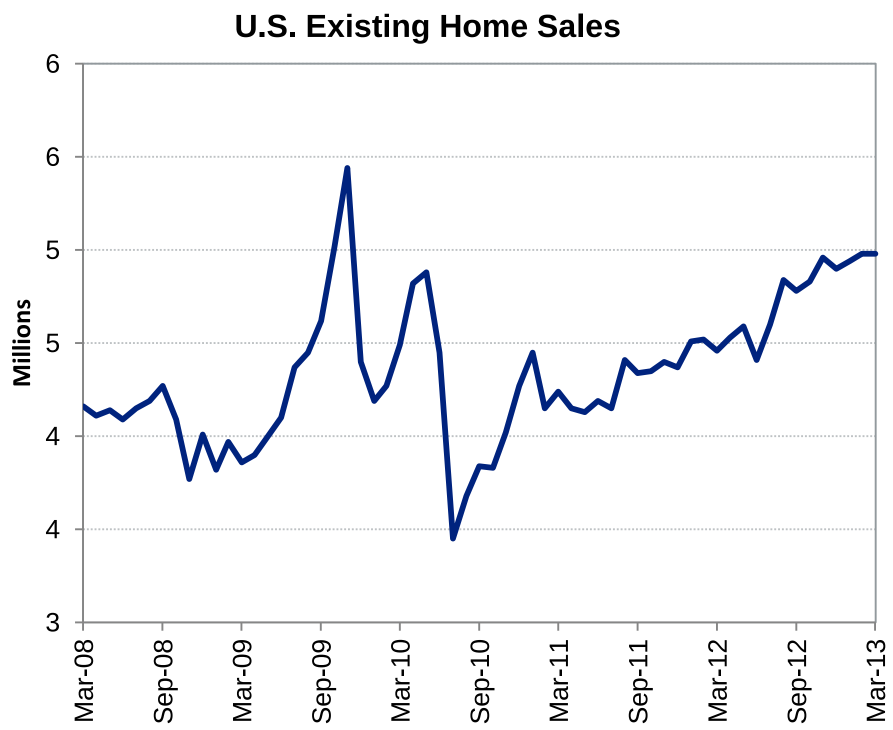


Source: Bloomberg

Housing Market Continues to Rebound

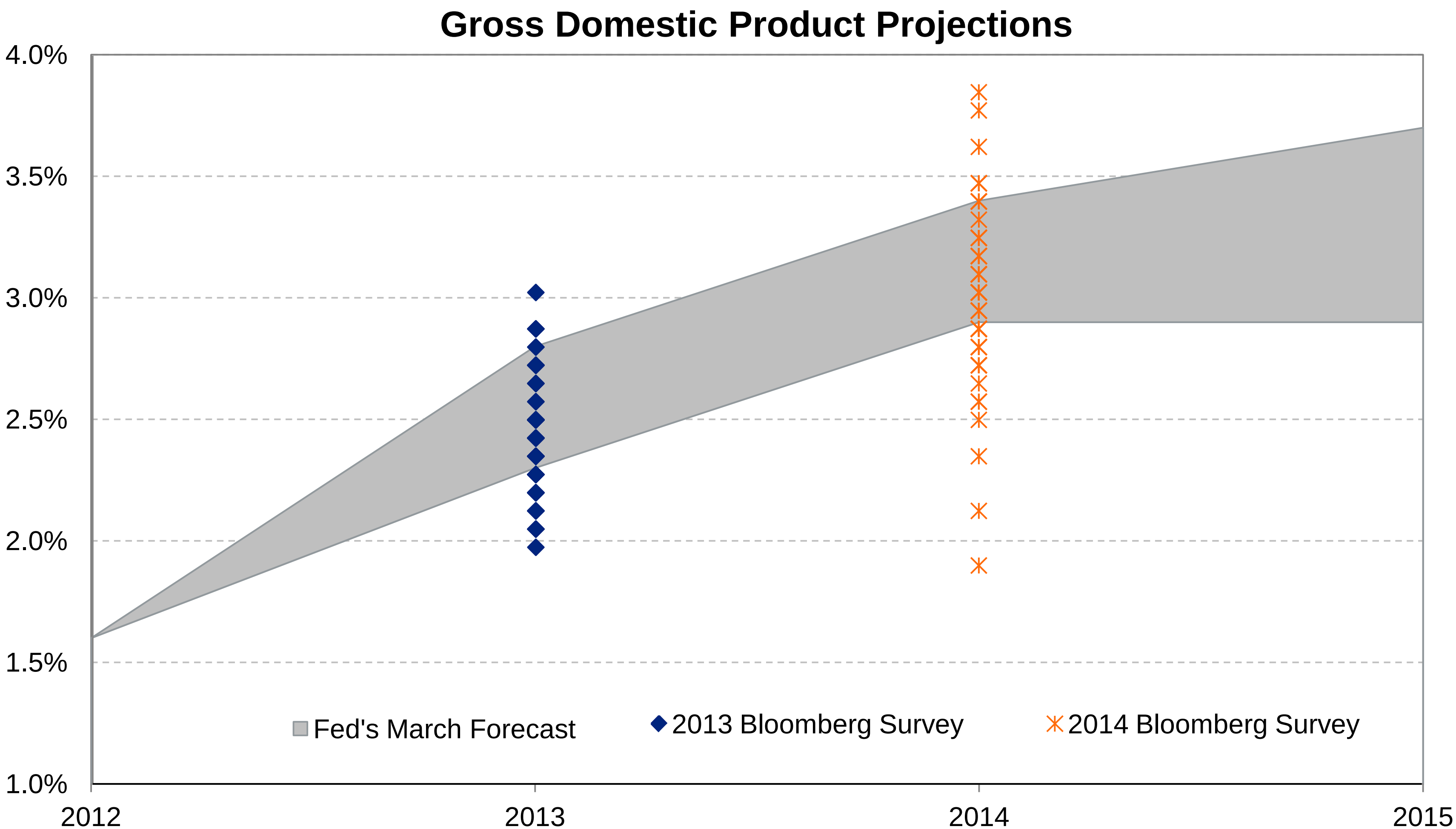
- The housing market continues to show signs of steady improvement; a positive indication of the direction of economic growth.
- Home Builder Confidence and Existing Home Sales continue to improve from their recession lows.





Source: National Association of Home Builders; National Association of Realtors

Fed Forecasts Gradual Improvement



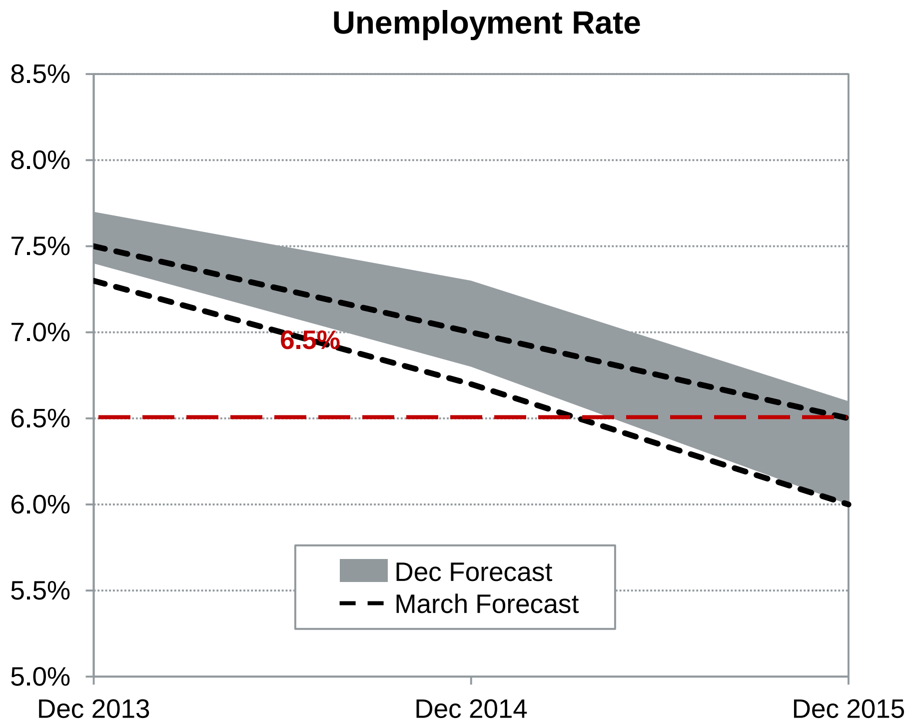
1. Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents, March 2013
2. Estimates are the 'central tendency' which excludes the three highest and three lowest projections in each year

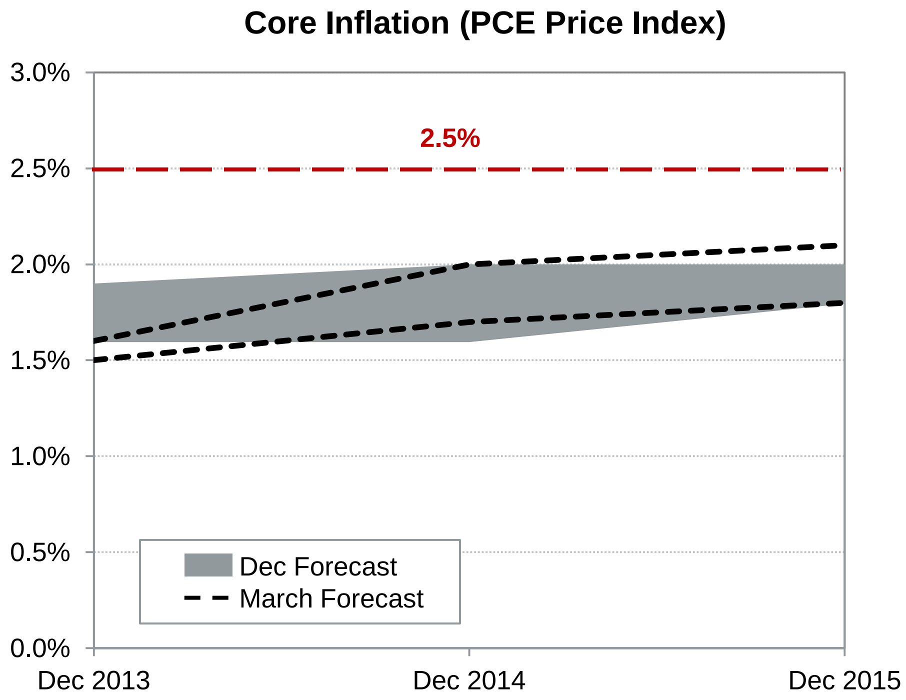
Monetary Policy

- Monetary policy: easy money
  - Fed Funds Rate = 0%
  - QE1: $1.25 trillion in mortgage backed securities and $175 million in US agency debt
  - QE2: $600 billion in long term Treasuries
  - QE3: $40 billion per month in mortgage backed securities
  - QE4: $40 billion per month US treasuries and $45 billion per month mortgage backed securities
  - “Operation Twist:” $267 billion, selling short term treasuries, buying long term treasuries

Forecasts Still Indicate No Rate Movement Until 2015

- The Fed has stated they will keep the target rate at 0% to 0.25%, anchoring short-term rates, until the unemployment rate is at or below 6.5% and maximum inflation levels remain below 2.5%.



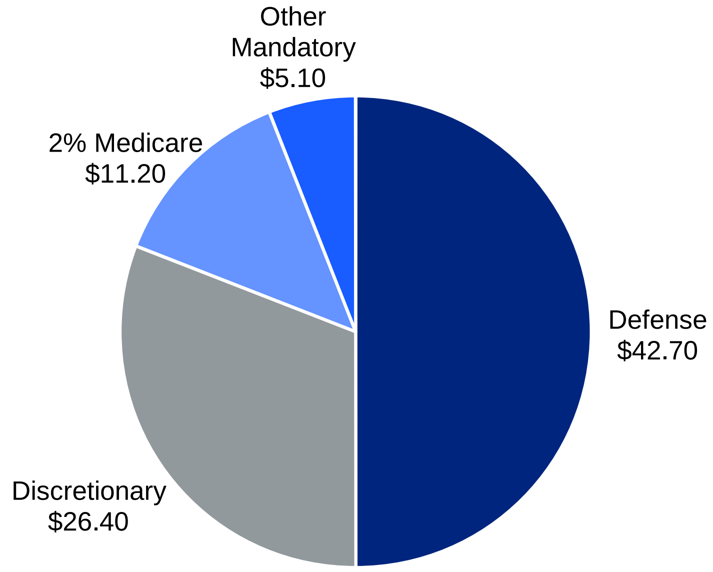


Source: FOMC; Represents the central tendency which excludes the three highest and three lowest projections for each year.

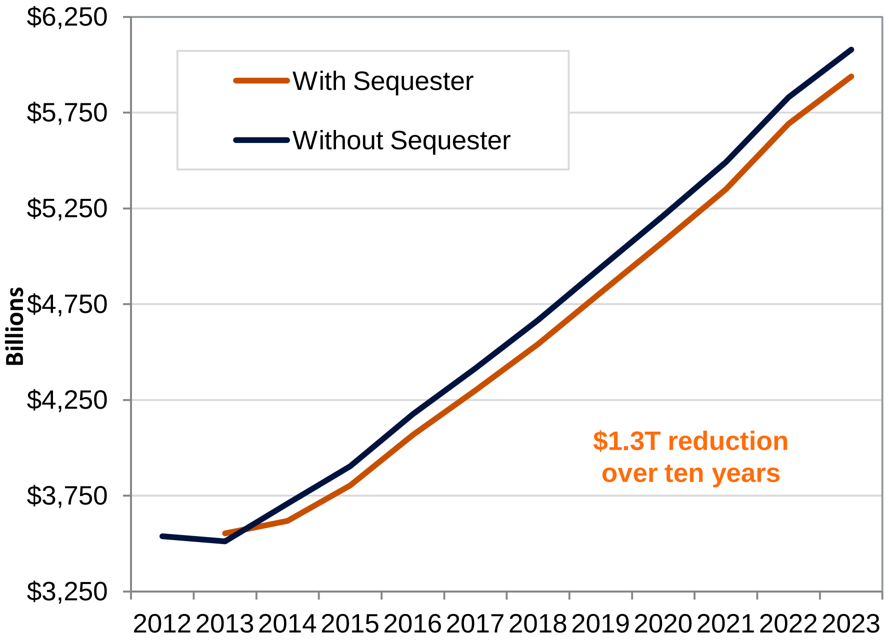
Impact of the Sequester

- Failure to produce legislation that would advert the impending sequestration of federal spending will negatively impact an already fragile economy.
- The longer term economic impact of reduced government spending is still uncertain.

Breakdown of FY 2013 Sequester
Total: $85.3 billion



Federal Spending and Sequestration
2013 to 2023



Source: Bipartisan Policy Center; George Mason University: Mercatus Center; Congressional Budget Office, Budget and Economic Outlook, February 2013. Aggregate reduction total includes estimated savings from debt service.

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