Town of Fountain Hills

Quarterly Investment Review

Quarter Ended December 31, 2013

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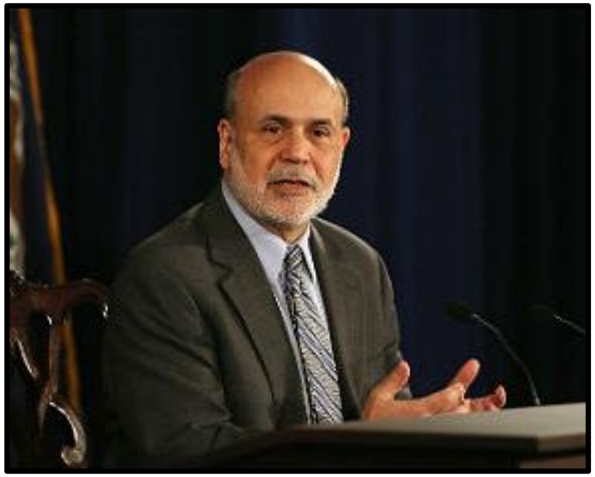
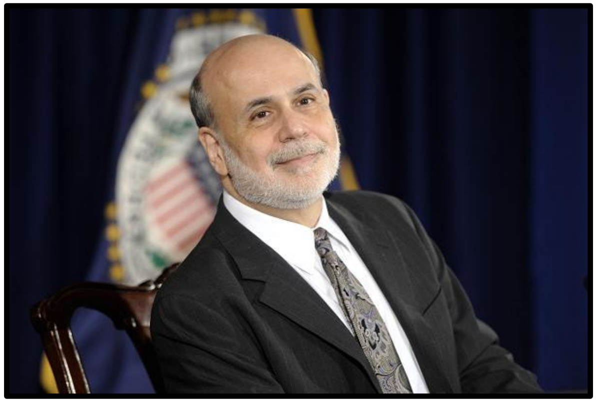
"Taper Talk" Reverses . . . Again



FOMC Press Conference: September 18, 2013

*"In evaluating whether a modest reduction in the pace of asset purchases would be appropriate at this meeting, however, **the Committee concluded that the economic data do not yet provide sufficient confirmation of its baseline outlook** . . . the extent of the effects of restrictive fiscal policy policies remain unclear, and **upcoming fiscal debates may involve additional risks to financial markets and the broader economy".***



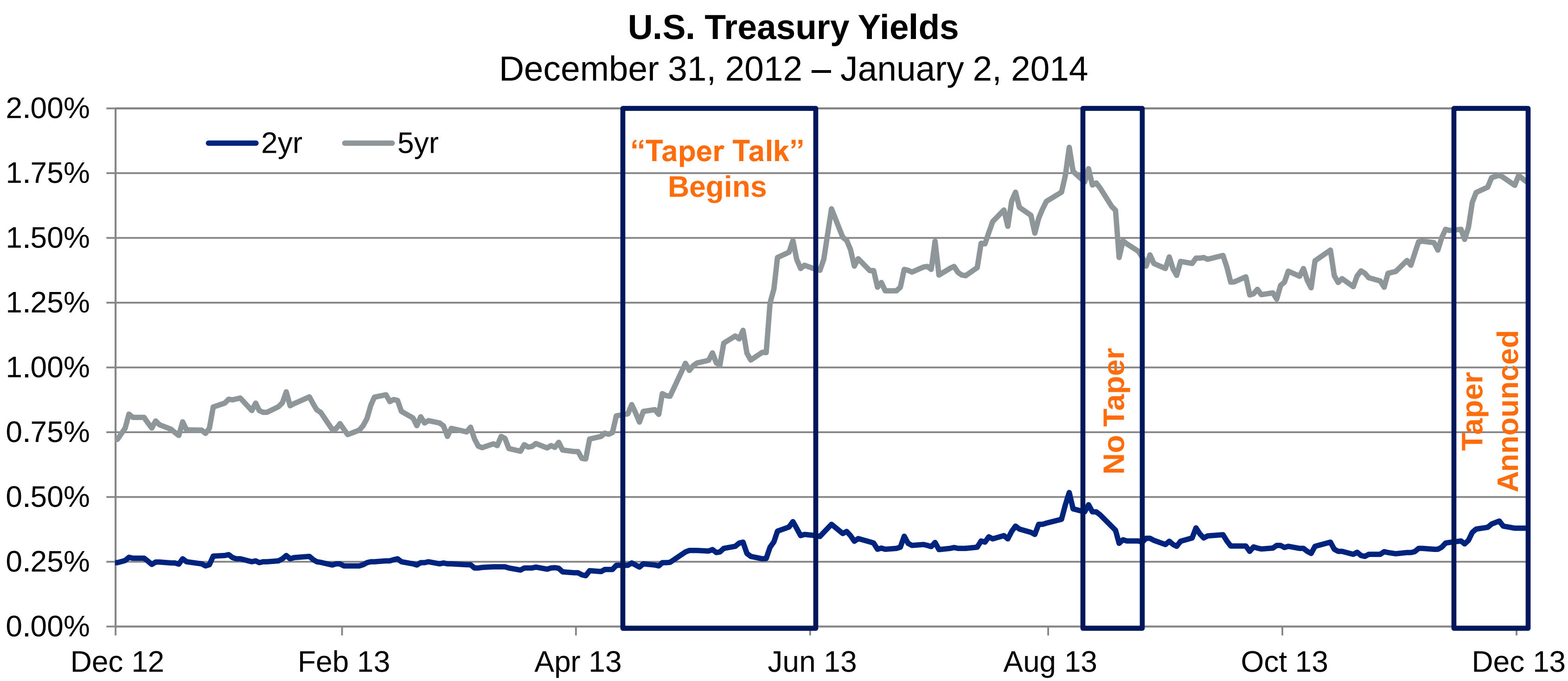
FOMC Statement: December 18, 2013

*"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%".***

Source: Federal Reserve

Market Impact of FOMC Taper

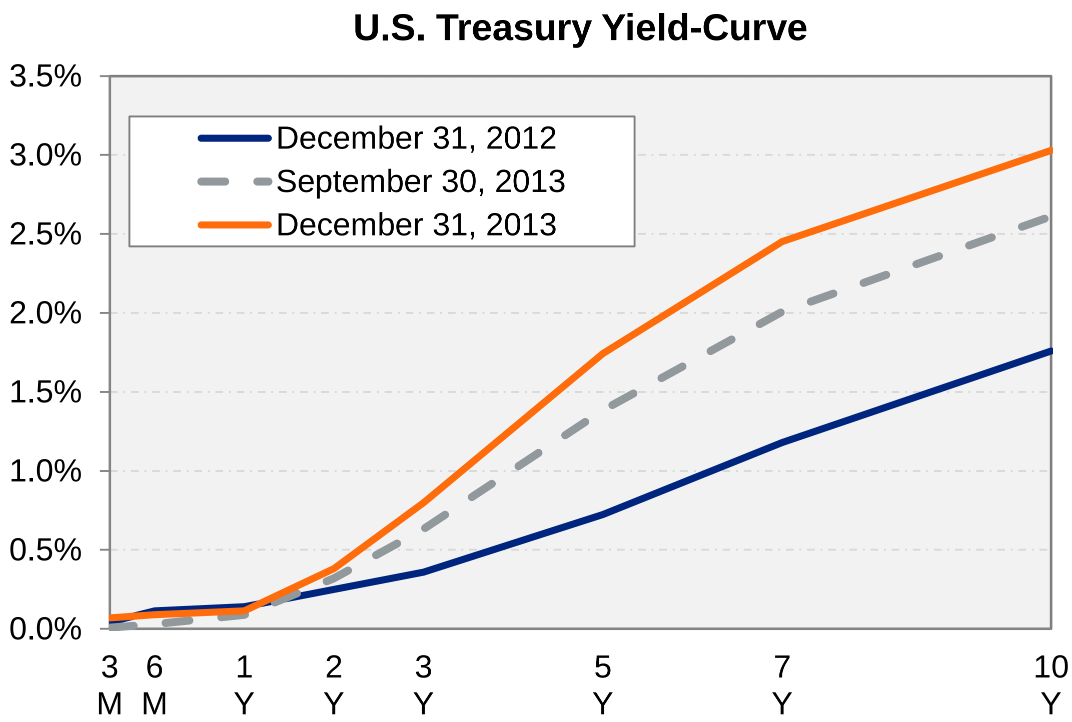
- FOMC announced it would begin to reduce its monthly asset purchases by $10B per month. A sizable interest rate hike was avoided as market participants largely anticipated a taper in the coming months.
- The FOMC reaffirmed their commitment to a near-zero Fed Funds Rate, further anchoring yields for shorter maturities.



Source: Bloomberg

Long-Term Rates Rose and the Yield-Curve Steepened

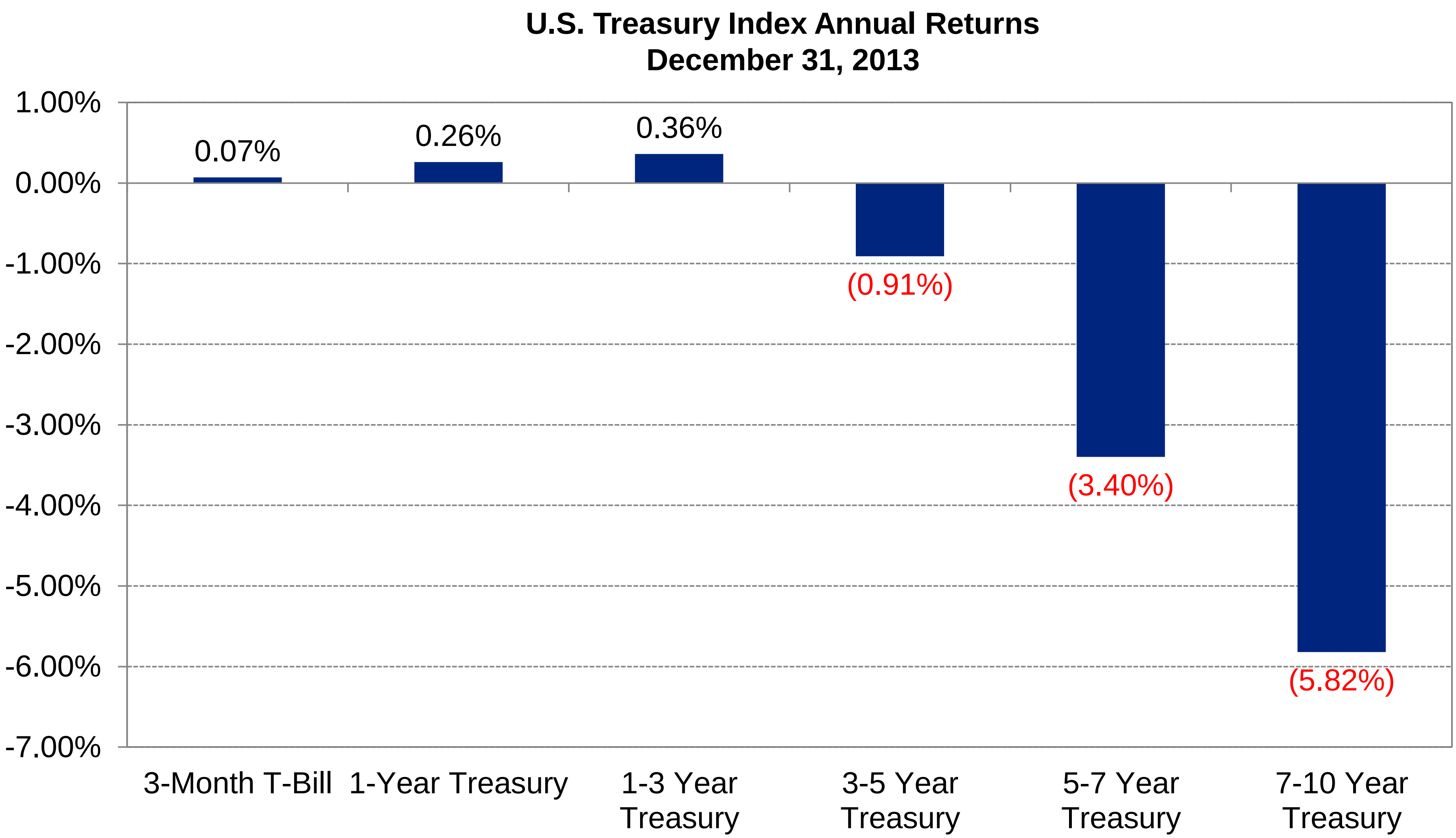
- Interest rates on maturities 2 years and longer rose moderately at the end of the quarter on strong economic data and the Fed's decision to begin tapering its bond purchase program.
- Over the course of the year, the yield on the 2-year Treasury moved 0.13% higher, and the yield on the 5-year Treasury moved 1.02% higher.



	12/31/12	9/30/13	12/31/13
3-Mo.	0.04%	0.01%	0.07%
6-Mo.	0.11%	0.03%	0.09%
1-Yr.	0.14%	0.09%	0.11%
2-Yr.	0.25%	0.32%	0.38%
3-Yr.	0.36%	0.63%	0.80%
5-Yr.	0.72%	1.38%	1.74%
10-Yr.	1.76%	2.61%	3.03%

Source: Bloomberg

Rising Rates Negatively Impacted Longer Strategies



Sources: Bloomberg; BofA Merrill Lynch Indices

Fourth Quarter 2013 Strategy

- Our investment strategy was based on the view that interest rates would eventually rise in anticipation of a tapering of the Federal Reserve's large-scale bond purchase program, after being surprised by no such action in Q3.

- Yields drifted modestly lower in October and November, then jumped sharply December in expectation of the Fed's tapering of bond purchases.

- Our shorter-duration strategy was the right one, but the magnitude of the yield increases in December dampened all fixed-income returns for the quarter.

- The key components of our strategy included:

  – Maintaining a defensive posture by positioning portfolio's duration shorter than the benchmark.

  – General caution toward investments with optionality (callables) that could underperform if rates spike upward and make duration management more challenging.

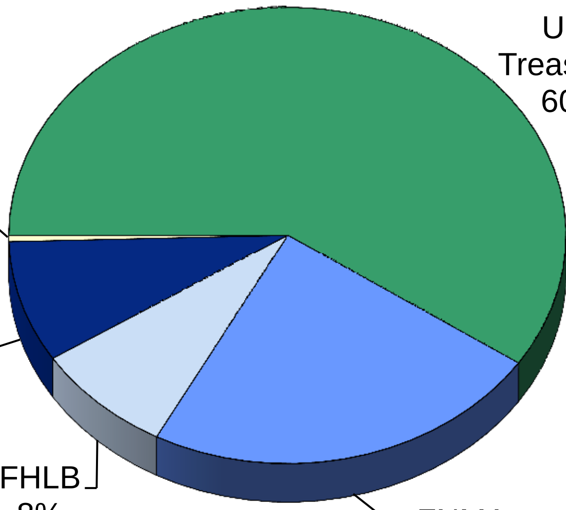
  – Maintaining a more laddered maturity distribution, in recognition of the steepening yield-curve.

  – Carefully monitoring yield spread relationships, which continued to compress across all sectors. In some sectors and maturities, spreads were so narrow as to diminish any value in holding them.

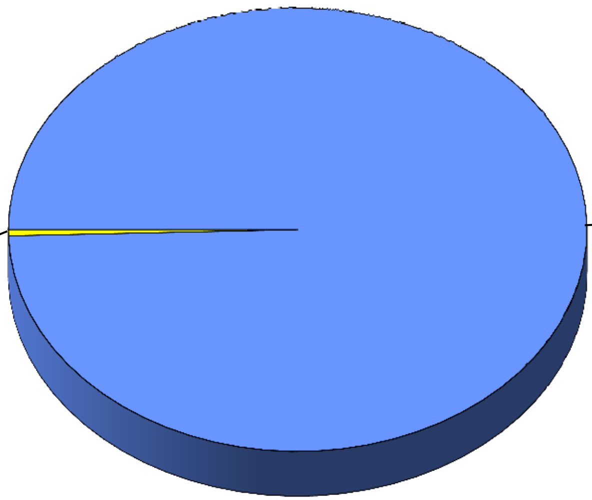
Portfolio Composition and Credit Quality Characteristics

Security Type[1]	December 31, 2013	% of Portfolio	% Change From Prior Quarter	Permitted by Policy
U.S. Treasuries	**$9,017,992.26**	**60%**	-1%	**100%**
Federal Agencies	**$6,082,987.17**	**40%**	+1%	**100%**
FNMA	*$3,540,315.71*	*23%*	*+2%*	-
FHLB	*$1,235,861.81*	*8%*	*-1%*	-
FHLMC	*$1,306,809.65*	*9%*	-	-
Money Market Fund	**$67,726.71**	**< 1%**	-	
Totals	**$15,168,706.14**	**100%**		

Portfolio Composition



Portfolio Credit Quality Distribution

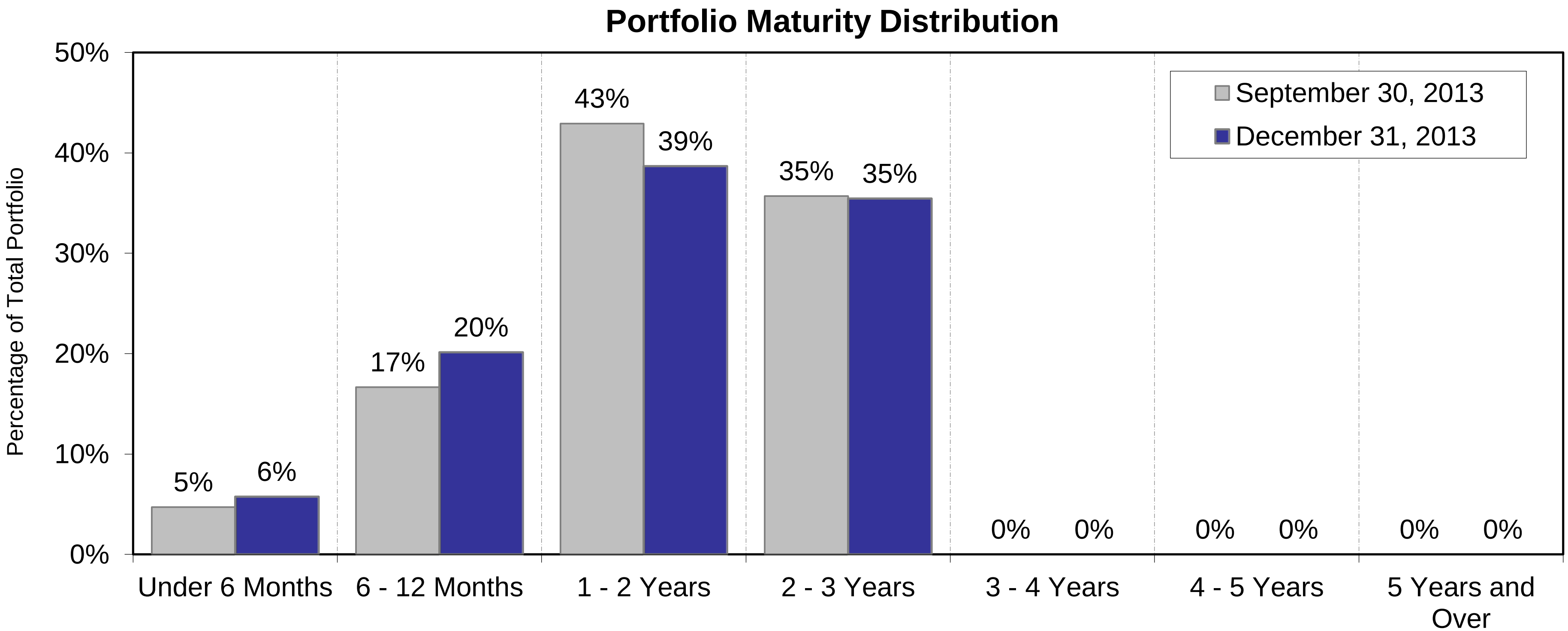


Ratings by Standard & Poor's

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

Portfolio Maturity Distribution

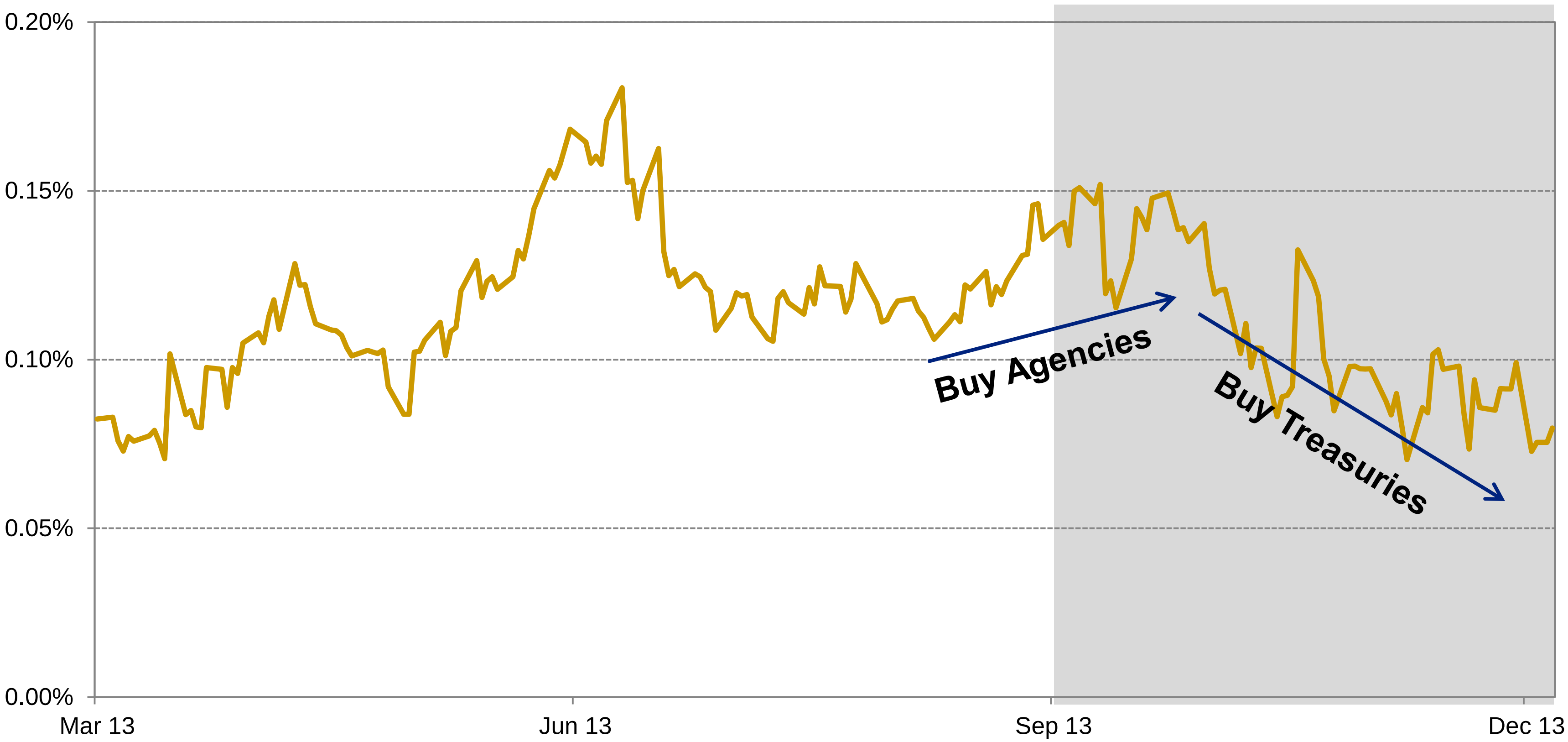
Maturity Distribution	December 31, 2013	September 30, 2013
Under 6 Months	**$872,771.84**	$714,804.14
6 - 12 Months	**$3,053,982.45**	$2,525,550.36
1 - 2 Years	**$5,866,127.89**	$6,506,932.96
2 - 3 Years	**$5,375,823.96**	$5,412,061.72
3 - 4 Years	**$0.00**	$0.00
4 - 5 Years	**$0.00**	$0.00
5 Years and Over	**$0.00**	$0.00
Totals	**$15,168,706.14**	$15,159,349.18



Significant Yield Spread Movement In Fourth Quarter

- When spreads are wide we prefer Agencies. When spreads narrow, the Treasury sector offers value as investors are not being adequately compensated for taking on risk in other sectors.

3-Year Treasury-Agency Yield Spread
Second Quarter 2013 - Fourth Quarter 2013

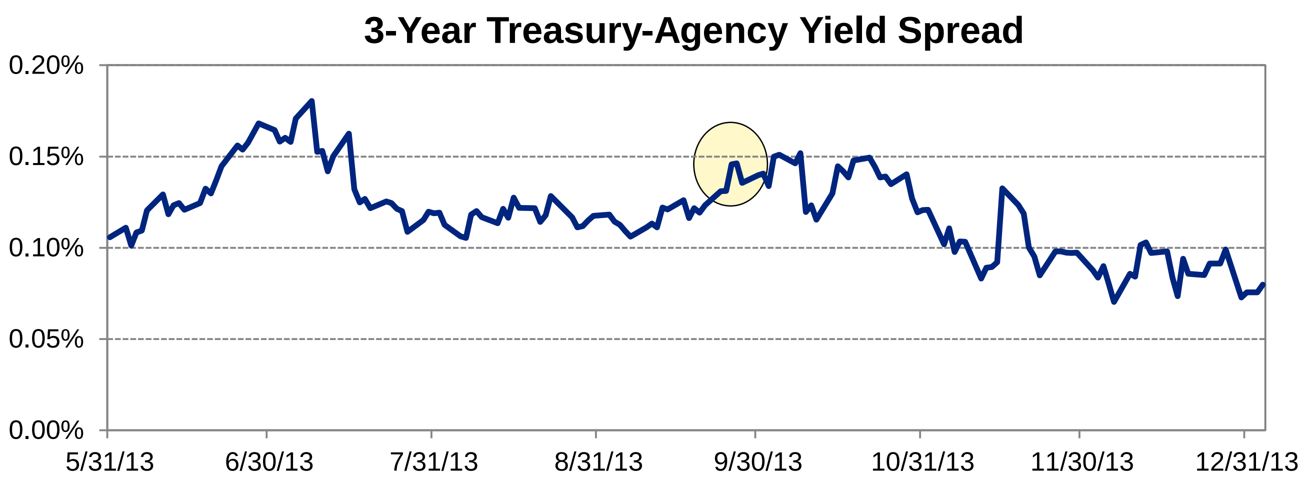


Source: Bloomberg

Agencies Offer Value Early in Q4

- Spread between Treasuries and Agencies were very wide early October ~0.12%.
- Added 3-year Agency to the portfolio.
  - Extended portfolio's duration closer to that of the benchmark.
  - Sold shorter-maturing Treasury note with little appreciation value left and invested funds in steepest part of yield-curve to capitalize on "roll down."

Date	Transaction	Security	Maturity	Par	Yield	Gain/Loss from Sale
10/1/2013	**Buy**	**FNMA Note**	**9/28/2016**	**$170,000**	**0.75%**	**-**
10/1/2013	**Buy**	**FNMA Note**	**9/28/2016**	**$225,000**	**0.74%**	**-**
10/1/2013	Sell	US Treasury	3/15/2014	$425,000	0.06%	$584



Source: Bloomberg

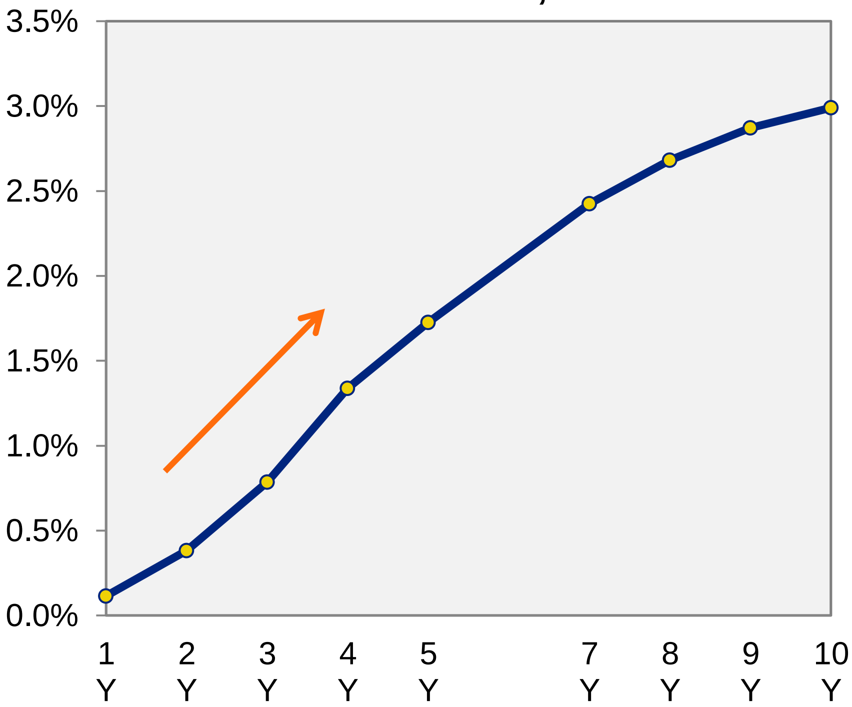
Capitalizing on the Steep Yield-Curve

- We continue to purchase intermediate-term investments that are well-positioned on the yield-curve to benefit from roll down.
- The majority of investments purchased during the fourth quarter were in the 3-year maturity range where the yield-curve has been steepest.

Intermediate-Term Purchases

Date	Security	Maturity	Par	Yield
10/1/2013	FNMA Note	9/28/2016	$170,000	0.75%
10/1/2013	FNMA Note	9/28/2016	$225,000	0.74%
10/31/2013	US Treasury	11/30/2016	$450,000	0.62%
12/3/2013	US Treasury	11/30/2016	$775,000	0.57%

U.S. Treasury Curve
December 31, 2013

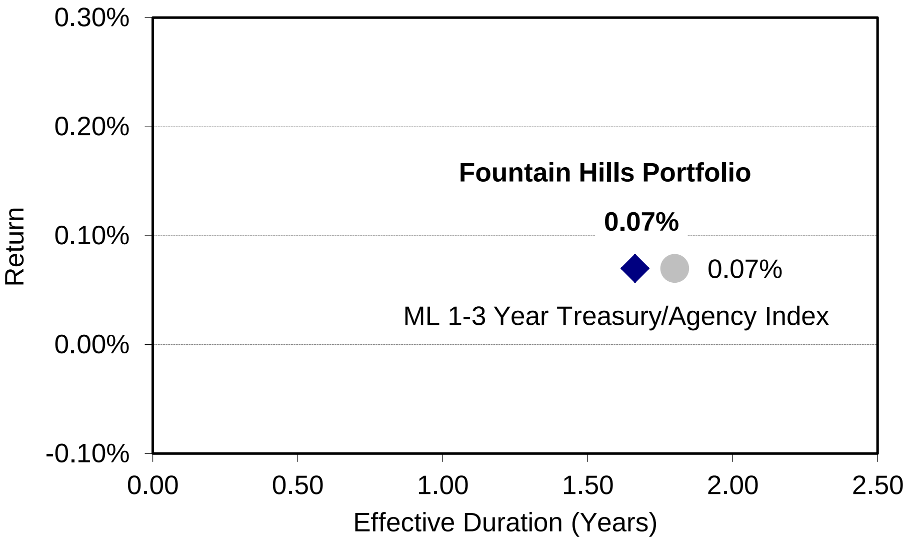


Source: Bloomberg

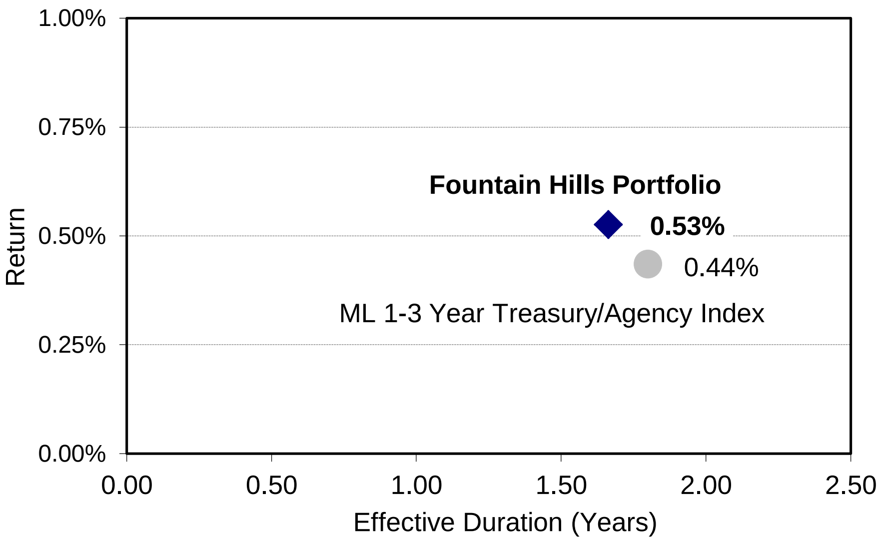
Portfolio Performance

Total Return[1,2,3,4]	Quarter Ended December 31, 2013	Past 6 Months	Past 12 Months	Since Inception	
Fountain Hills Portfolio	**0.07%**	**0.34%**	**0.30%**	**0.53%**	
ML 1-3 Year Treasury/Agency Index	0.07%	0.37%	0.36%	0.44%	
Effective Duration	**December 31, 2013**	September 30, 2013	**Yields**	**December 31, 2013**	September 30, 2013
Fountain Hills Portfolio	**1.66**	**1.64**	Yield at Market	0.37%	0.31%
ML 1-3 Year Treasury/Agency Index	1.80	1.80	Yield on Cost	0.49%	0.47%

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 2014 Investment Strategy

- If rates rise as the Fed withdraws its extraordinary monetary stimulus, negative returns on longer maturities may become unavoidable for short periods. However, over the long-term, the portfolio will be positioned to generate higher earnings in the future.
  - Active duration management will be a critical aspect of our strategy in 2014 to mitigate the effects of rate normalization and to maximize relative performance.
  - The steep yield-curve will continue to offer enhanced earning potential.
- Treasury yields will likely be range bound due to the unevenness of the economic recovery .
- Agency yield spreads have little value in most shorter maturities under 1 year.
- Agency yields spreads have little value in most shorter maturities, so the search for value will need to encompass a wider net amongst the universe of high quality investments.
- The “supranational” sector offers the Town another high-quality sector with which to diversify its portfolio.
- As always, we seek to maximize portfolio value through careful and prudent active management.
- Our strategy will remain flexible and may change in response to changes in interest rates, emerging economic data, or our market outlook.

Supranationals – World of Opportunity

- Supranational organizations are international financial institutions that are generally established by agreements among nations, with member nations contributing capital and participating in management.

- Investment in sector opens up an additional asset class—an alternative to the shrinking quantity of U.S. Agencies.
- Can enhance portfolio diversification
- Adds an element of global exposure, but not currency risk
- Desirable characteristics that may include:
  - High ratings, with many of the largest issuers rated AAA
  - Active secondary markets with generally good liquidity
  - Availability in a wide range of maturities
  - Often a modest yield advantage over traditional U.S. Agencies
- Allowable investment for the Town::
  - Arizona Revised Statutes 35-323. *6. Obligations issued or guaranteed by the United States or any of the senior debt of its agencies, sponsored agencies, corporations, sponsored corporations or instrumentalities.*

Largest AAA-rated Supranationals in the BofA Merrill Lynch U.S. Corporate, Government & Mortgage Index

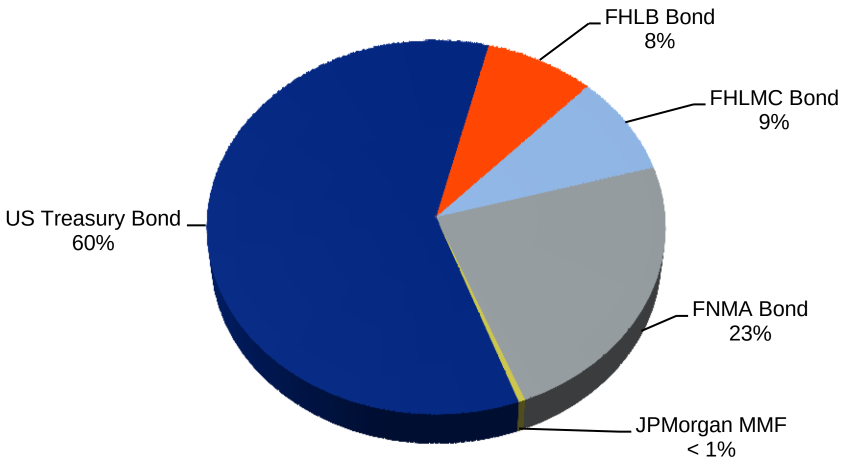
Organization	Rating	U.S. Participant
European Investment Bank	AAA	No
International Bank for Reconstruction and Development (The World Bank)	AAA	Yes
Asian Development Bank	AAA	Yes
Inter-American Development Bank	AAA	Yes
African Development Bank	AAA	Yes

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	$9,019,615	$9,017,992	690	59.45%	100%	0.44%
FHLB Bond	$1,234,162	$1,235,862	307	8.15%	100%	0.50%
FHLMC Bond	$1,303,583	$1,306,810	424	8.62%	100%	0.49%
FNMA Bond	$3,533,074	$3,540,316	607	23.34%	100%	0.63%
JPMorgan MMF	$67,727	$67,727	1	0.45%	N/A	0.01%
Total including cash	$15,158,161	$15,168,706	613	100.00%		0.49%
Total without cash	$15,090,434	$15,100,979				0.49%

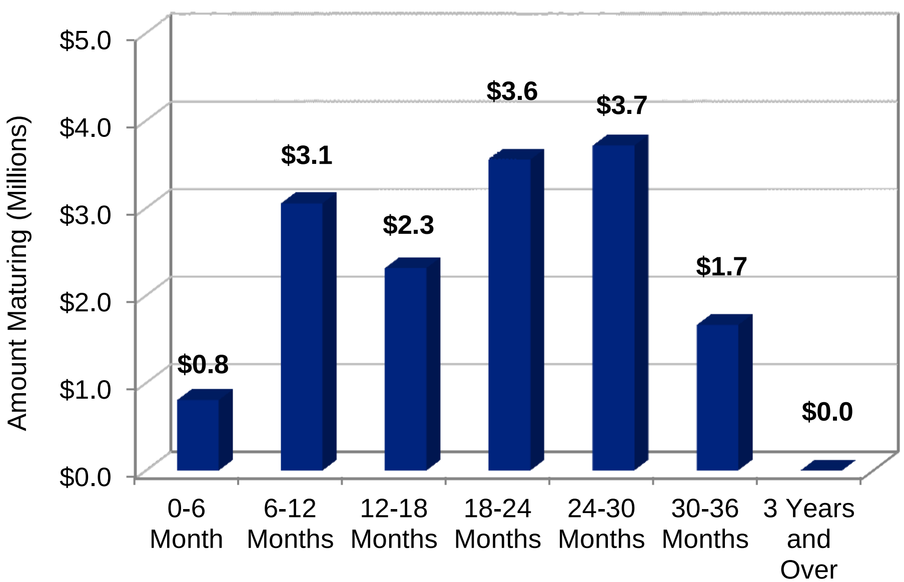
Summary by Issuer	Book Value	% of Portfolio
US Treasury	$9,019,615	59.5%
FHLB	$1,234,162	8.1%
FHLMC	$1,303,583	8.6%
FNMA	$3,533,074	23.3%
JPMorgan	$67,727	0.4%
Total / Average	$15,158,161	100%

Issuer Distribution



Weighted Average Maturity (in years)	1.68
Duration Allowed by Policy	5.00
Current Portfolio Duration Including Cash	1.66
Current Portfolio Duration Without Cash	1.66

Maturity Distribution



[1]*Market values of portfolio holdings include accrued interest.*

Disclaimer

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Managed Account Detail of Securities Held

TOWN OF FOUNTAIN HILLS, OPERATING FUNDS

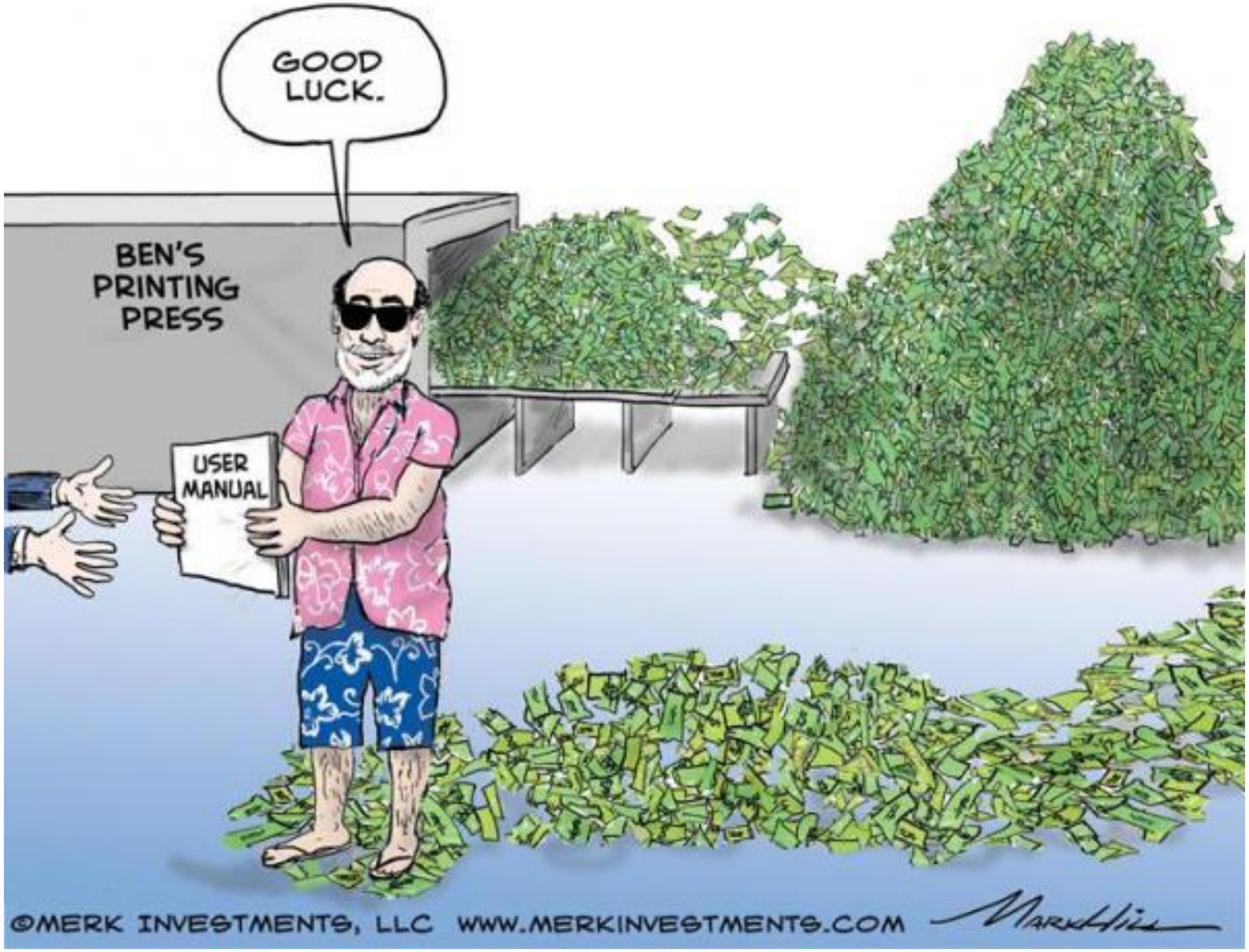
Security Type/Description Dated Date/Coupon/Maturity	CUSIP	Par	S&P Rating	Moody's Rating	Trade Date	Settle Date	Original Cost	YTM at Cost	Accrued Interest	Amortized Cost	Market Value
U.S. Treasury Bond / Note											
US TREASURY NOTES DTD 12/15/2011 0.250% 12/15/2014	912828RV4	725,000.00	AA+	Aaa	01/05/12	01/06/12	722,167.97	0.38	84.65	724,078.25	725,594.50
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	2,353.94	254,980.70	255,566.50
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	708.22	748,520.51	750,527.25
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	335.64	299,594.60	300,621.00
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	1,118.78	999,653.36	1,002,070.00
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	3,295.52	459,453.20	460,494.00
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	3,844.77	536,747.43	537,243.00
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	755.49	637,199.98	637,084.96
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	773.63	651,836.49	652,375.00
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	962.50	118,717.51	118,773.38
US TREASURY NOTES DTD 05/02/2011 2.000% 04/30/2016	912828QF0	475,000.00	AA+	Aaa	03/27/13	03/28/13	498,638.67	0.38	1,627.07	492,833.59	491,402.23
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	42.65	508,069.38	506,765.63
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	44.89	535,296.29	533,437.50
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	67.33	800,627.41	800,156.25

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 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	346.15	453,293.51	451,441.35
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	596.15	781,755.50	777,482.33
Security Type Sub-Total		**8,805,000.00**					**9,074,171.28**	**0.44**	**16,957.38**	**9,002,657.71**	**9,001,034.88**
Federal Agency Bond / Note											
FEDERAL HOME LOAN BANK GLOBAL NOTES DTD 04/15/2011 1.375% 05/28/2014	313373JR4	800,000.00	AA+	Aaa	10/03/11	10/03/11	816,896.00	0.57	1,008.33	802,617.01	804,036.80
FNMA NOTES DTD 07/18/2011 0.875% 08/28/2014	3135G0BY8	750,000.00	AA+	Aaa	10/03/11	10/03/11	754,860.00	0.65	2,242.19	751,128.59	753,527.25
FNMA GLOBAL NOTES DTD 10/26/2009 2.625% 11/20/2014	31398AZV7	700,000.00	AA+	Aaa	10/03/11	10/03/11	741,846.00	0.69	2,092.71	711,935.31	715,309.70
FREDDIE MAC GLOBAL NOTES DTD 10/06/2011 0.750% 11/25/2014	3137EACY3	850,000.00	AA+	Aaa	05/31/12	06/01/12	855,202.00	0.50	637.50	851,892.61	854,493.95
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	550.94	429,986.04	430,265.74
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	768.75	450,284.05	450,909.45
FANNIE MAE GLOBAL NOTES DTD 11/16/2012 0.375% 12/21/2015	3135G0SB0	375,000.00	AA+	Aaa	11/14/12	11/16/12	374,126.25	0.45	39.06	374,442.14	374,426.25
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	379.17	300,104.14	299,677.50
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	459,621.83	459,505.50
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	497,679.48	499,462.50
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	548.96	172,307.30	172,427.26

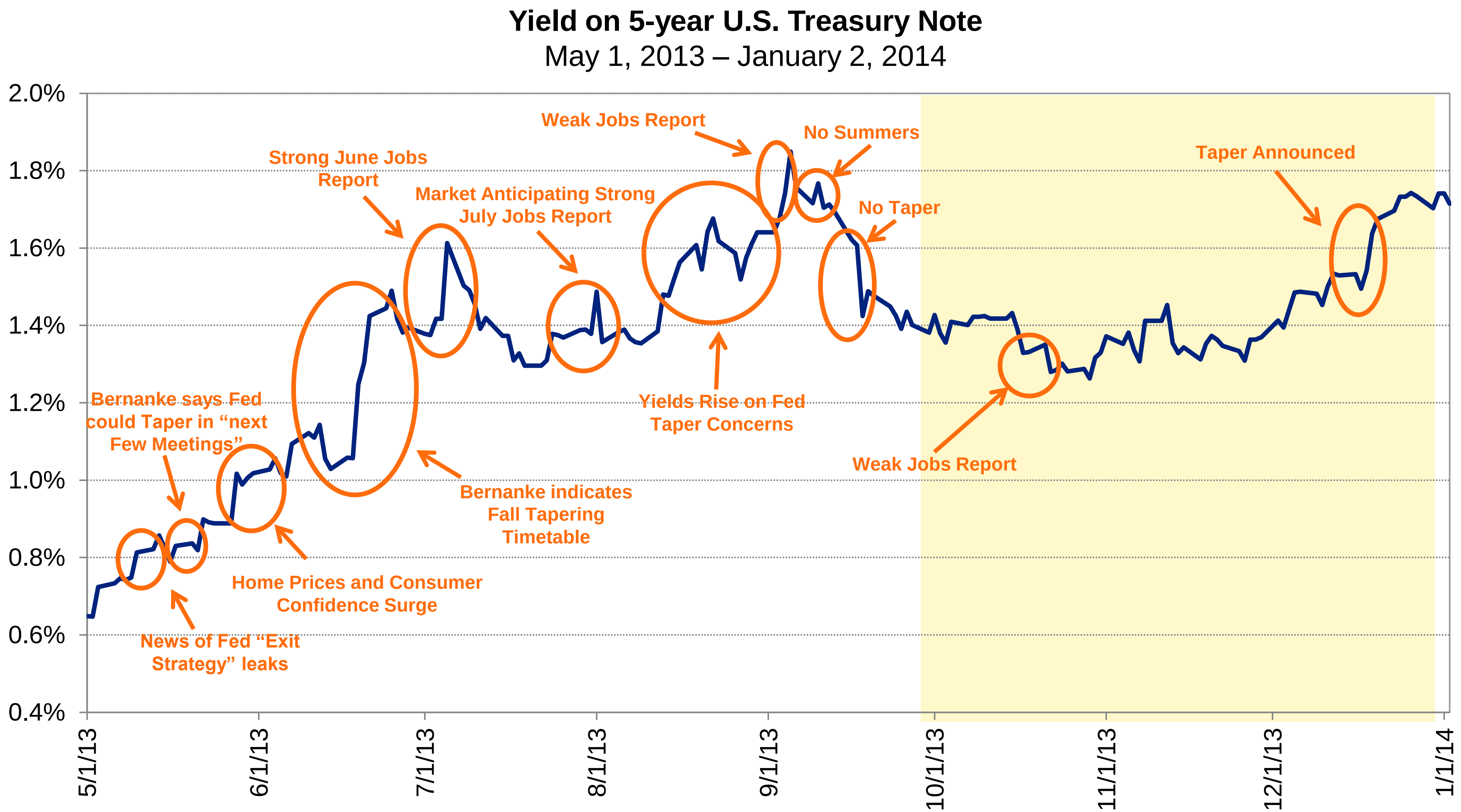
TOWN OF FOUNTAIN HILLS, OPERATING FUNDS

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
Federal Agency Bond / Note											
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	823.44	258,516.24	258,640.89
Security Type Sub-Total		**6,040,000.00**					**6,111,727.26**	**0.57**	**10,304.38**	**6,060,514.74**	**6,072,682.79**
Managed Account Sub-Total		**14,845,000.00**					**15,185,898.54**	**0.49**	**27,261.76**	**15,063,172.45**	**15,073,717.67**
Securities Sub-Total		**$14,845,000.00**					**$15,185,898.54**	**0.49%**	**$27,261.76**	**$15,063,172.45**	**$15,073,717.67**
Accrued Interest											**$27,261.76**
Total Investments											**$15,100,979.43**



Economic Update

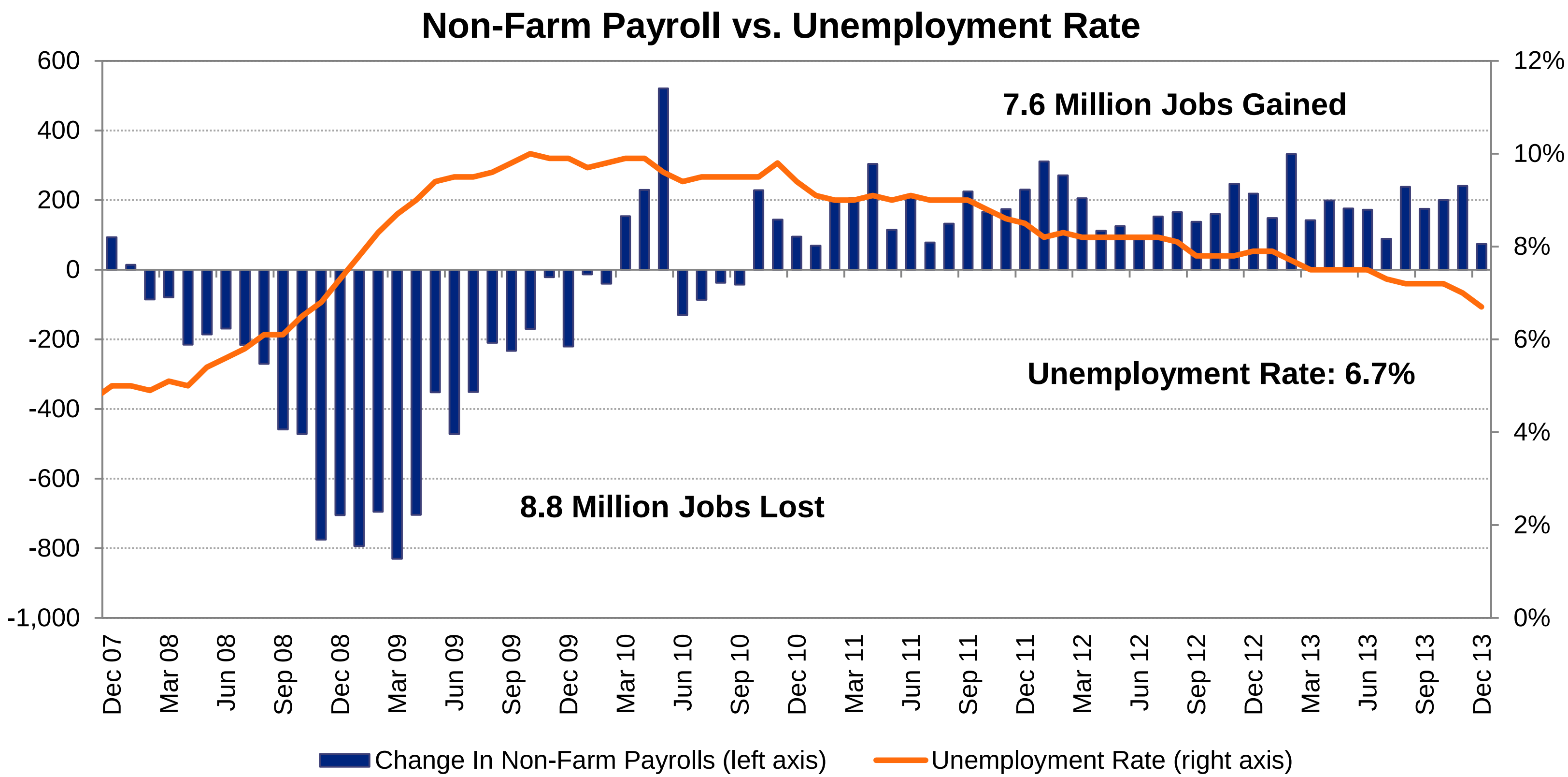
Recent Market Movers



Source: Bloomberg

Labor Market Generally Strengthening

- While December's job report showed a mere 74,000 jobs were added, the pace of job growth remains encouraging. The U.S. averaged 182,000 jobs per month in 2013.
- The Unemployment Rate fell to 6.7% as people left the work force.



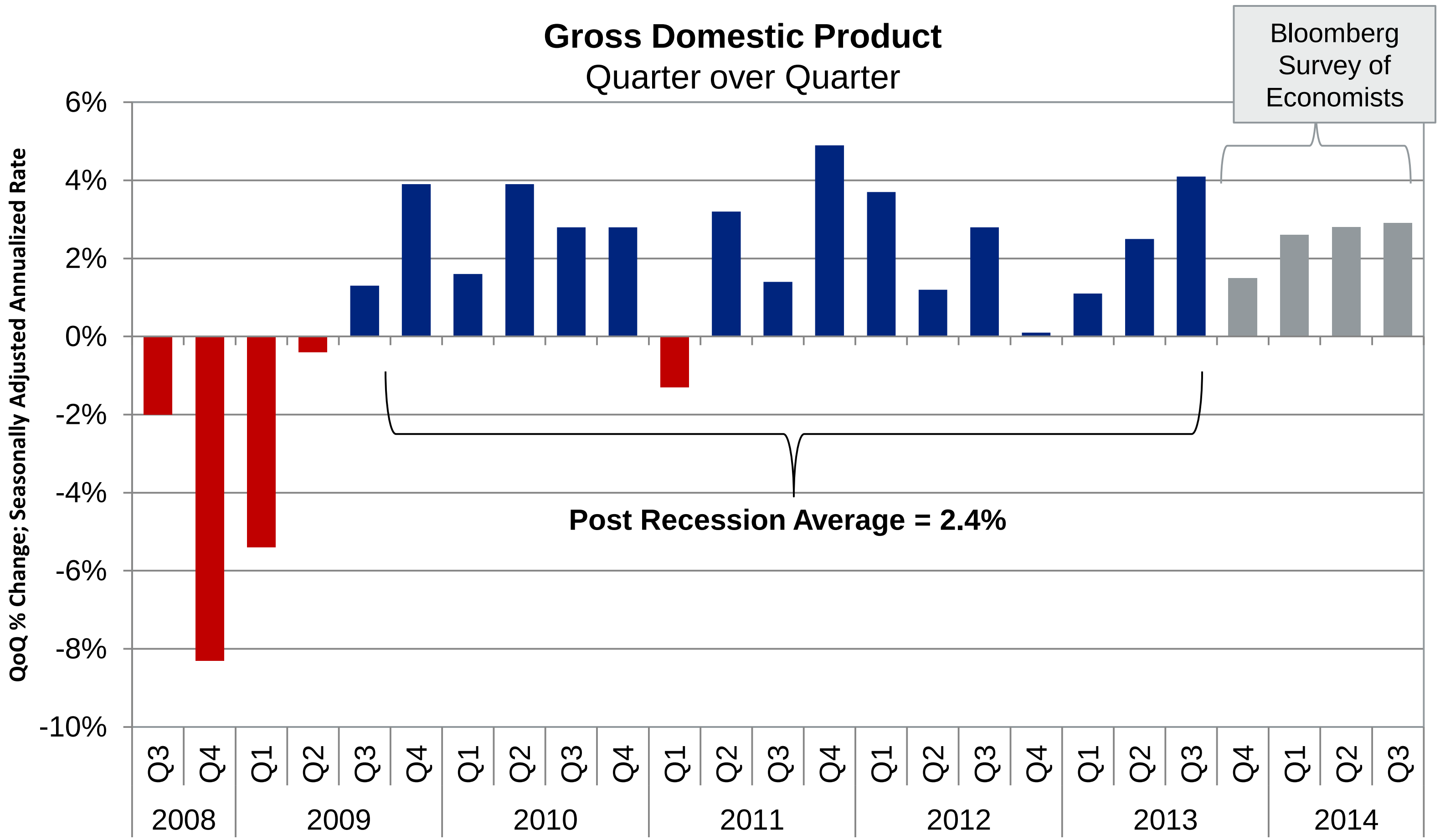
Source: Bureau of Labor Statistics

Employment Report Surprises Economist/Market

5-Year U.S. Treasury Yields
January 8, 2013 – January 10, 2013

Economic Growth Remains Moderate

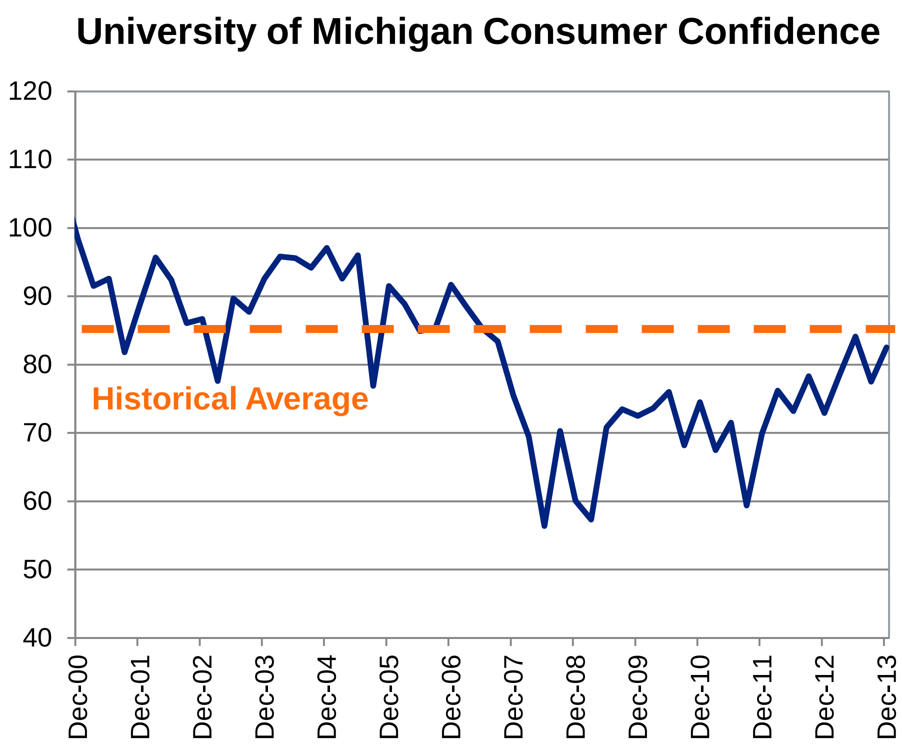
- Q3 GDP was restated to show that the economy grew at a 4.1% annualized pace; a significant increase from the prior reading of 3.6%.
- The latest release showed a significant contribution from Consumer Spending.

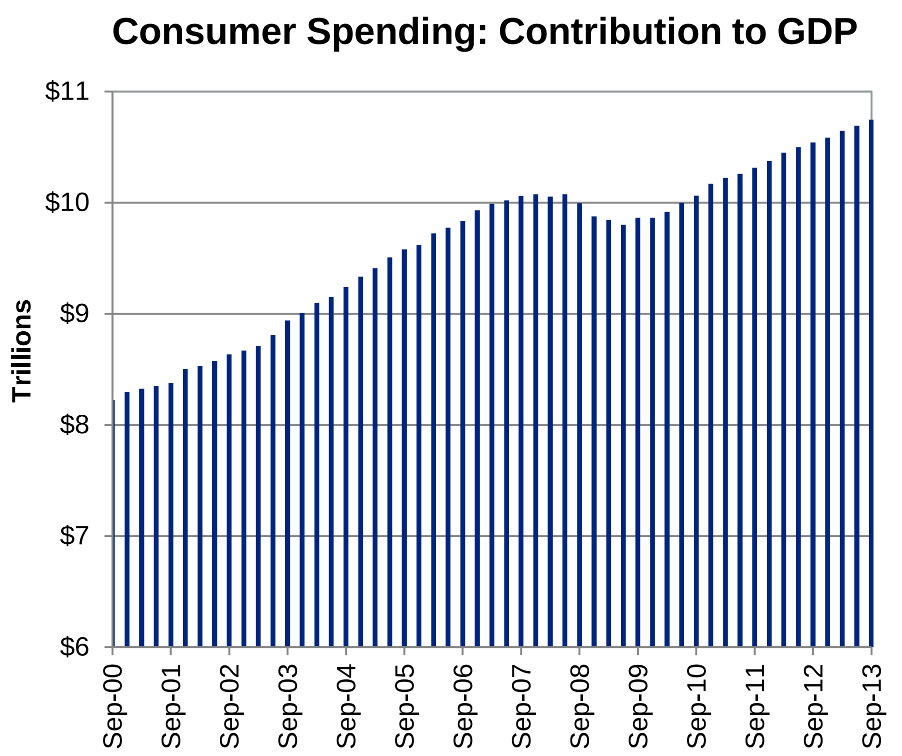


Source: Bureau Of Economic Analysis

Consumers Continue to Support Growth

- The Q3 GDP reading portrayed a significant contribution from the consumer sector. As Consumer Confidence has rebounded from its depths during the height of the recession, so has spending.
- Consumer behavior offers a vital indication on the general direction of economic growth.





Source: Bureau of Economic Analysis, Bloomberg.

Looking Into 2014

Market Events:

- Accelerated economic growth
- Janet Yellen takes over as FOMC Chairperson
- Fed bond purchases likely to cease by year end, while Fed Funds rate remains near 0%
- Fannie and Freddie's portfolios will continue to shrink

Interest Rate Reaction:

- Yield-curve steepens with longer-term rates rising as Fed continues to taper while holding overnight rate at zero
- Spreads between Treasuries and Agencies will likely remain narrow

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