



## **Annual Investment Committee Report**

### **To the City Commission for the Fiscal Year Ending September 30, 2006**

The purpose of this report is to inform the City Commission on how the City invested its idle funds and why the funds were invested in certain securities. This report will highlight each quarter and will provide a brief synopsis as to what economic developments were taking place and how it influenced our decision to invest in certain securities.

#### **The Economy – First Quarter Ending December 31, 2005**

As the first quarter of fiscal year 2005-06 drew to a close, Fed Chairman Alan Greenspan was about to retire and turn monetary control over to the new Fed Chairman, Ben Bernanke. Ben Bernanke was inheriting an economy with the largest economic imbalance in American history. Through Alan Greenspan's economic influence, globalization and information technology transformed the world economy as trade and capital flows accelerated with China, India and the former Soviet Union.

Greenspan facilitated the development of globalization by maintaining a loose monetary policy which benefited emerging economies but also added substantially to America's trade imbalance. Loose monetary policy and cheap money did not result in traditional inflation, but into rising asset prices instead – first equities and then housing. By consumers borrowing against capital gains on their homes, households have been able to consume more than they earn. Robust consumer spending has boosted economic growth at the cost of a negative personal savings rate, a growing burden of household debt and a huge current account deficit. When rising home-prices flatten out, and therefore the room for further equity withdrawal dries up, consumer spending will stumble. Given that consumer spending and residential construction have accounted for 90% of economic growth in recent years, it is hard to see how this can occur without a sharp slowdown.

#### **The City:**

**Given that interest rates were expected to continue increasing at quarter point increments for the next several quarters, the City's investments were concentrated in the twelve to eighteen month range. Investment purchases of callable securities were scaled back and Commercial Paper and U.S. Treasury securities were purchased. The benefit to the City's portfolio was to limit the City's exposure to additional security extension risk and increase the diversity of the portfolio security mix.**

**FIRST QUARTER ENDING 12/31/05**

**INVESTMENT PORTFOLIO BY SECURITY TYPE**

	<u>Par Value</u>	<u>Market Value</u>	<u>% of Portfolio</u>
Agency Securities	\$ 61,000,000	\$ 59,681,050	43.0%
State Board of Adm.	2,364,000	2,364,000	2.0%
Money Market Funds	39,051,000	39,051,000	28.0%
Certificates of Deposit	2,421,000	2,421,000	2.0%
Florida Municipal Inv. Pool	3,271,257	3,271,257	2.0%
U.S. Treasury Securities	11,000,000	10,833,589	8.0%
Commercial Paper	19,000,000	19,000,000	14.0%
Repurchase Agreements	1,227,875	1,227,875	1.0%
Totals	<u>\$ 139,335,132</u>	<u>\$ 137,849,771</u>	<u>100.0%</u>

**The Economy – Second Quarter Ending March 31, 2006**

By the completion of the second quarter (January – March 2006), the Federal Reserve Board was still expressing concern about inflation but was somewhat perplexed as to what action to take going forward. After fifteen consecutive rate increases, American monetary policy was no longer loose and the housing sector was beginning to feel the pinch. The rest of the economy however, seemed to shrug off the higher rate environment and continued to surge ahead. Both labor and product markets tightened, global growth was looking ever stronger, commodity prices were soaring, the dollar was falling, and America's inflation was on the rise. The market perception was that over the next few months, the Fed would worry more about inflation versus slower growth and rates would continue to rise. Since higher interest rates take some time to show their full effect, prudence would suggest a pause, otherwise the central bankers risk slowing demand too sharply.

Energy price were up sharply, unemployment fell to 4.7%, hourly earnings rose almost 4% over the past year and firms were operating at the tightest level since 2000. Optimists stated that, because profits were fat, firms need not pass higher costs on to consumers. But economists pointed out, that companies have already raised prices by 3.1% in the past year and that the trend is expected to continue as inflationary pressures continue to build. By the close of the quarter the market perception was that there was a better than 50/50 chance that the Fed would continue raising rates going forward.

**The City:**

Given the Federal Reserve Board's propensity to raise short-term rates over the next several quarters, the City's investment strategy remained unchanged from the previous quarter. Additional short-term callable securities were postponed, Commercial Paper and Money Market funds were increased slightly and Certificates of Deposit were decreased. This approach benefited the City in two ways: first, purchasing additional Commercial Paper increased portfolio diversity and secondly, portfolio returns were improved by adding to higher yielding Money Market funds in anticipation of investing in higher coupon rated Treasuries just over the horizon.

**SECOND QUARTER ENDING 03/31/06**

**INVESTMENT PORTFOLIO BY SECURITY TYPE**

	<u>Par Value</u>	<u>Market Value</u>	<u>% of Portfolio</u>
Agency Securities	\$ 60,000,000	\$ 58,515,923	40.0%
State Board of Adm.	2,364,000	2,364,000	2.0%
Money Market Funds	45,051,000	45,051,000	32.0%
Certificates of Deposit	1,633,000	1,633,000	1.0%
Florida Municipal Inv. Pool	3,184,088	3,184,088	2.0%
U.S. Treasury Securities	11,000,000	10,780,850	8.0%
Commercial Paper	20,000,000	20,000,000	14.0%
Repurchase Agreements	1,227,875	1,227,875	1.0%
Totals	<u>\$ 144,459,963</u>	<u>\$ 142,756,736</u>	<u>100.0%</u>

**The Economy – Third Quarter Ending June 30, 2006**

The third quarter (April - June 2006) ended with the announcement that corporate America continued to rake in record earnings in spite of rising interest rates. A miraculous corporate accomplishment considering energy and other raw material cost continued to skyrocket. Thanks to technology-driven increases in productivity, booming global demand for cheaper American products due to the falling dollar and debt-light corporate balance sheets this trend should continue at least in the short-run.

American businesses reported a 28.5% increase over the same period last year making it the 15<sup>th</sup> straight quarter of double-digit year-over-year increases which means that profits have doubled over the past four years. With such a rosy corporate picture, the only unknown was the war raging in the Middle East and how it would impact not only America but the world economy. The inflationary impact of the Middle East crises was anticipated to be around the 3% to 3.5% range by year-end with most of the increase tied to higher energy prices. Increased fuel and energy prices would impact economic growth as household purchasing power eroded. With the Fed raising rates by two .25% increases the growing consensus among most analyst was that there would be a better than 50/50 chance that the Fed would finally pause.

**The City:**

Given the economic and interest rate environment, increasing the overall return of the portfolio became more achievable as the Fed continued to increase rates over time. Some Agency Securities were called but the majority remained in the portfolio until maturity which reduced the opportunity for earlier re-investment at higher rates. Fortunately, the portfolio weighted average maturity continued to fall as securities matured. The benefit to the City, by continuing to postpone the purchase of callable securities, was to diminish additional security extension risk. This also provided an opportunity for the City to further diversify the portfolio by phasing-in purchases of shorter-term U.S. Treasury securities and Commercial Paper at higher coupons rates as the yield curve increased.

**THIRD QUARTER ENDING 06/30/06**

**INVESTMENT PORTFOLIO BY SECURITY TYPE**

	<u>Par Value</u>	<u>Market Value</u>	<u>% of Portfolio</u>
Agency Securities	\$ 54,000,000	\$ 52,430,373	38.0%
State Board of Adm.	2,364,000	2,364,000	2.0%
Money Market Funds	47,415,000	47,415,000	32.0%
Certificates of Deposit	1,534,000	1,534,000	1.0%
Florida Municipal Inv. Pool	3,291,998	3,291,998	2.0%
U.S. Treasury Securities	11,000,000	10,767,730	8.0%
Commercial Paper	22,000,000	22,000,000	16.0%
Repurchase Agreements	1,227,875	1,227,875	1.0%
Totals	<u>\$ 142,832,873</u>	<u>\$ 141,030,976</u>	<u>100.0%</u>

**The Economy – Fourth Quarter Ending September 30, 2006**

Heading into the final quarter of fiscal year 2005-06, it looked as though America's housing sector was headed south. By virtually every measure, America's housing market was in trouble as home sales and residential construction tumbled, unsold homes soared and according to some statistics, home prices started to slide. But America's consumer continued to spend as their spirits were buoyed by falling gas prices and low unemployment statistics. The Fed remained uncertain about long-term inflation but was pleased as to the short-term inflationary outlook and therefore chose to maintain short-term rates at 5.25% over the past two Fed meetings. That trend was expected to continue at least through the first quarter of fiscal year 2006-07 and possibly through the fall of 2007.

**The City:**

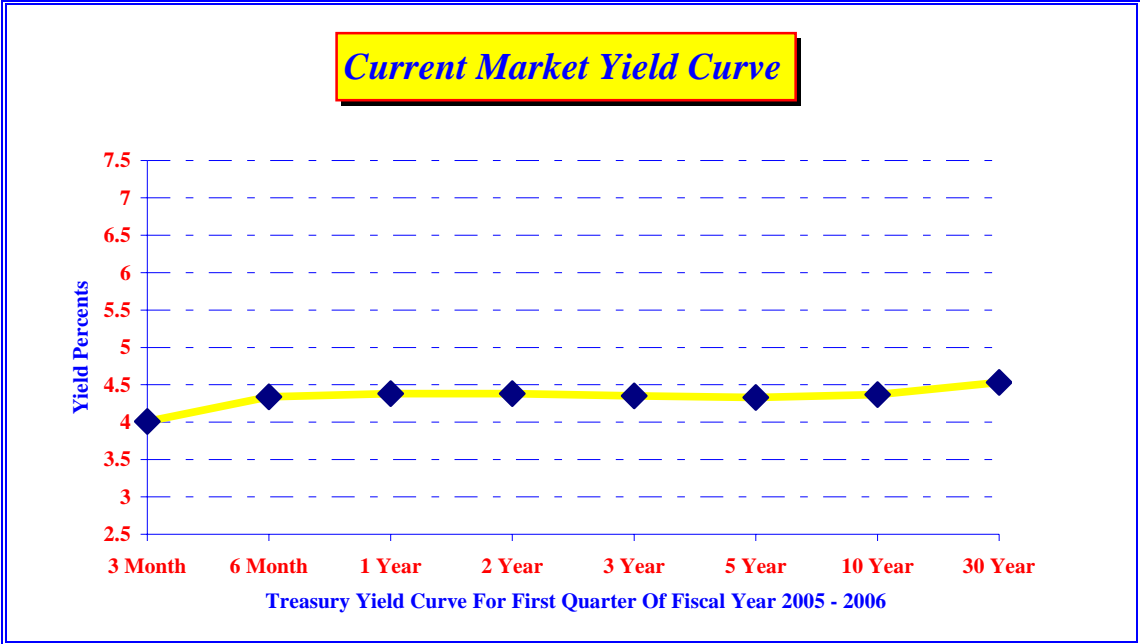
Since short-term rates were expected to hold at 5.25% for some time, several callable securities were placed into the portfolio to take advantage of higher yields. This approach will be repeated over the next year and modified as market conditions dictate or the Fed changes direction. Also, liquidity in Money Markets will be temporarily increased and be reduced only when yields in short-term Treasuries momentarily offered investment opportunities at higher yields. The benefit to the City was to shorten maturities and add diversity to the portfolio at higher yields.

**FOURTH QUARTER ENDING 09/30/06**

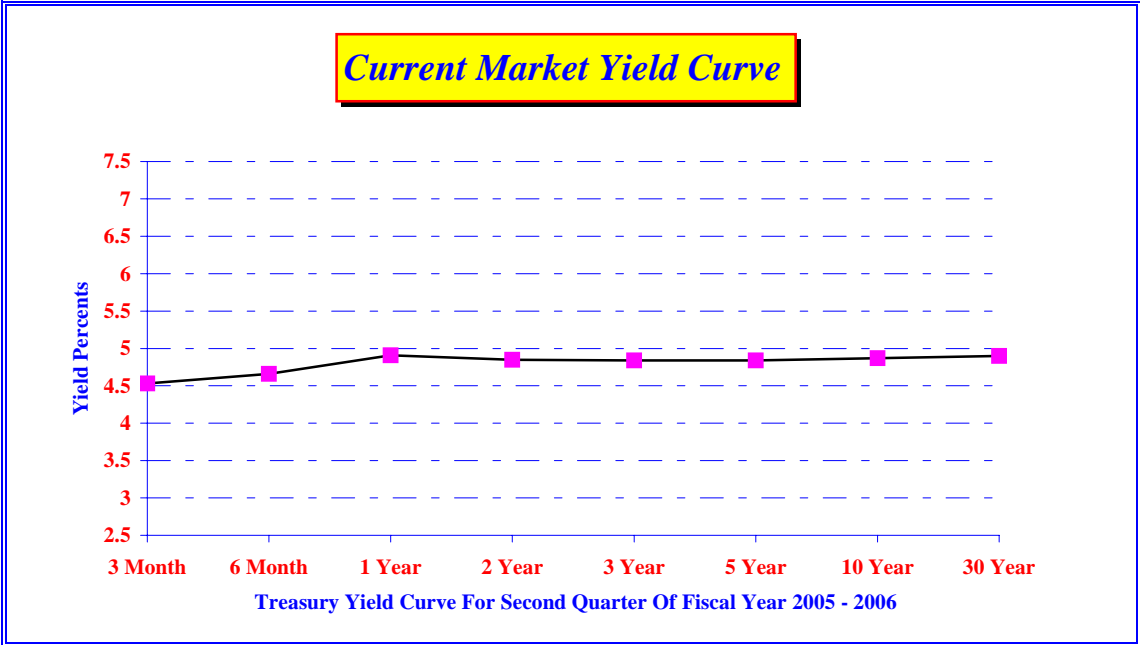
**INVESTMENT PORTFOLIO BY SECURITY TYPE**

	<u>Par Value</u>	<u>Market Value</u>	<u>% of Portfolio</u>
Agency Securities	\$ 57,662,211	\$ 56,676,890	43.0%
State Board of Adm.	16,687,000	16,687,000	12.0%
Money Market Funds	45,051,000	45,051,000	33.0%
Certificates of Deposit	1,435,000	1,435,000	1.0%
Florida Municipal Inv. Pool	3,379,648	3,379,648	2.0%
U.S. Treasury Securities	10,000,000	9,857,456	7.0%
Commercial Paper	1,000,000	1,000,000	1.0%
Repurchase Agreements	1,227,875	1,227,875	1.0%
Totals	<u>\$ 136,442,734</u>	<u>\$ 135,314,869</u>	<u>100.0%</u>

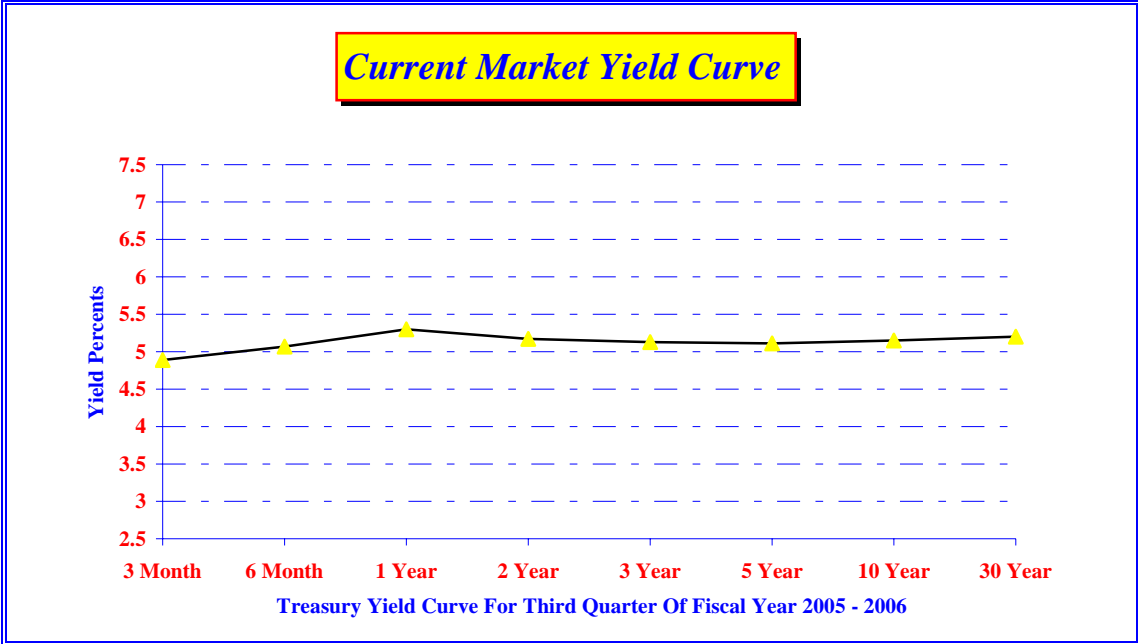
**FIRST QUARTER 12/31/05**



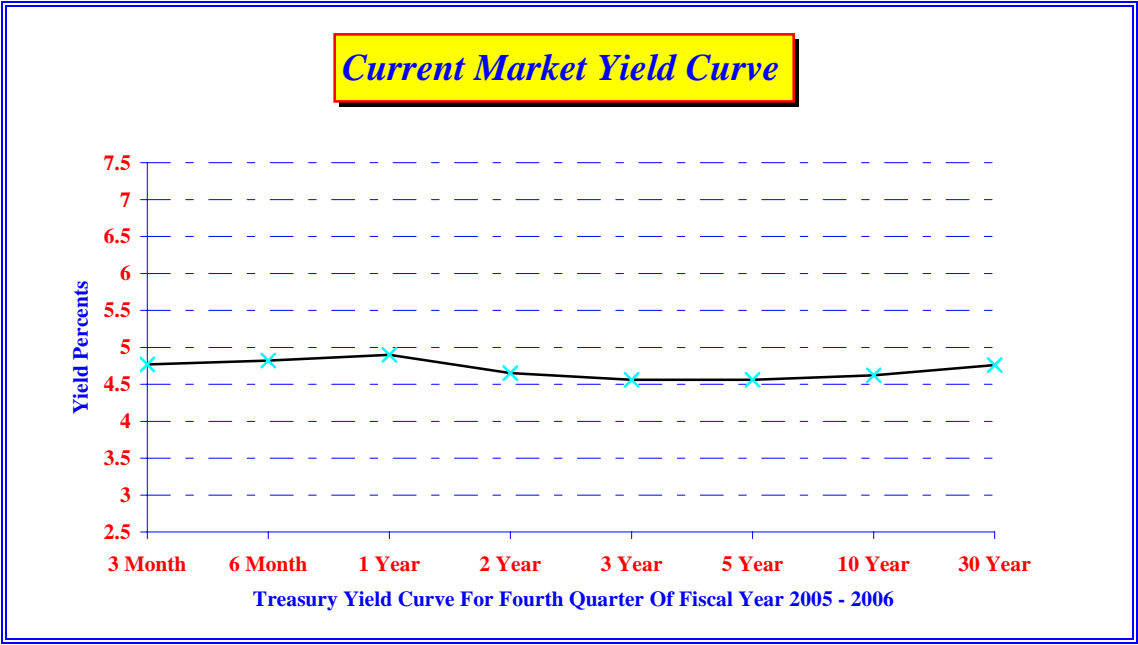
**SECOND QUARTER 03/31/06**



**THIRD QUARTER 06/30/06**



**FOURTH QUARTER 09/30/06**



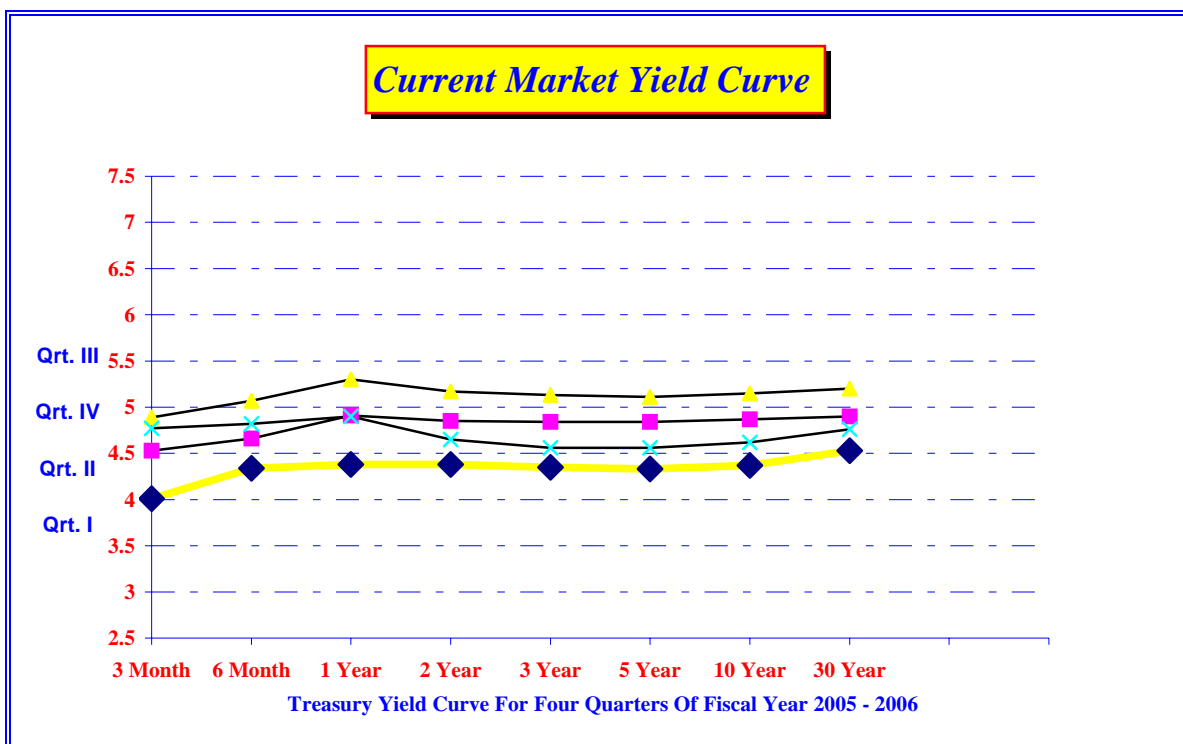
### FOUR QUARTERS OF FISCAL YEAR 2005 - 2006

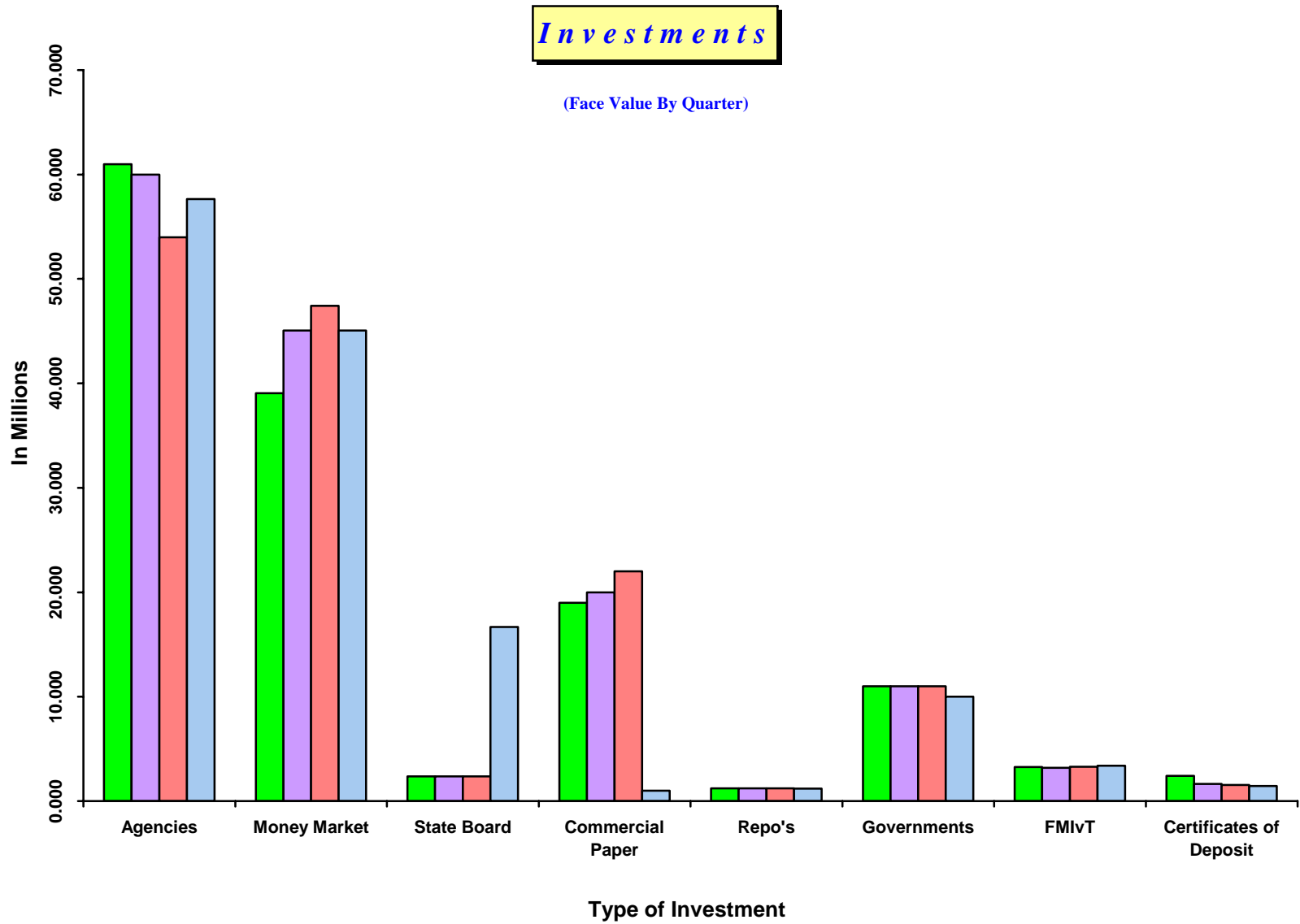
*(Source: Wall St. Journal)*

**Treasury Yield Changes By Quarter For Fiscal Year 2005 - 2006**

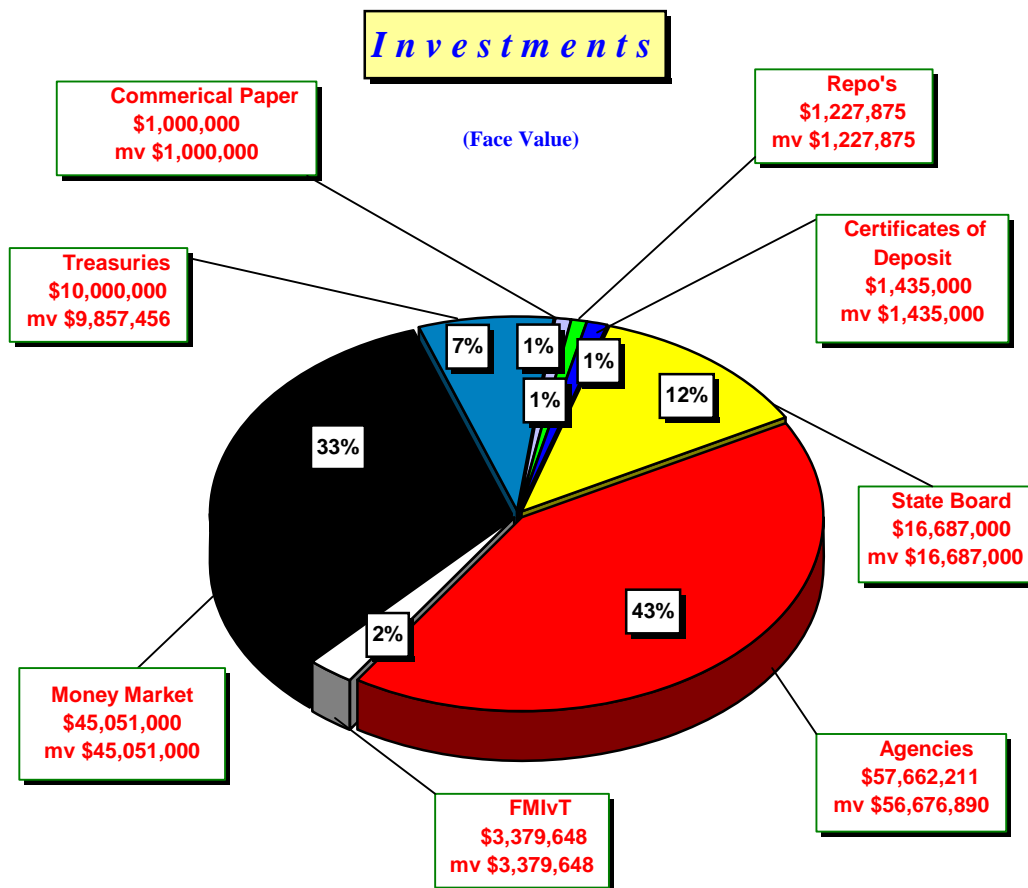
	12/31/2005	3/31/2006	6/30/2006	9/30/2006
<b>3 Month</b>	4.01%	4.53%	4.89%	4.77%
<b>6 Month</b>	4.34%	4.66%	5.07%	4.82%
<b>1 Yr.</b>	4.38%	4.91%	5.30%	4.90%
<b>2 Yr.</b>	4.38%	4.85%	5.17%	4.65%
<b>3 Yr.</b>	4.35%	4.84%	5.13%	4.56%
<b>5 Yr.</b>	4.33%	4.84%	5.11%	4.56%
<b>10 Yr.</b>	4.37%	4.87%	5.15%	4.62%
<b>30 Yr.</b>	4.53%	4.90%	5.20%	4.76%

### FOUR QUARTERS OF FISCAL YEAR 2005 - 2006





	<u>1st. Qtr.</u>	<u>2nd. Qtr.</u>	<u>3rd. Qtr.</u>	<u>4th. Qtr.</u>
<b>Total Portfolio Weighted Average Maturity</b>	1.36 Yrs.	1.19 Yrs.	1.04 Yrs.	1.00 Yrs.
<b>Weighted Average Maturity W/O SBA &amp; MM</b>	2.33 Yrs.	2.12 Yrs.	2.02 Yrs.	1.66 Yrs.



Total Investment - \$136,442,734  
 Market Value - \$135,314,869  
 Total Portfolio Weighted Avg. Maturity - 1.0 Years  
 CD'S & Agency Bond Weighted Avg. Maturity - 1.66 Years

### INVESTMENT PORTFOLIO BY SECURITY TYPE

	<u>Par Value</u>	<u>Market Value</u>	<u>% of Portfolio</u>
Agency Securities	\$ 57,662,211	\$ 56,676,890	43.0%
State Board of Adm.	16,687,000	16,687,000	12.0%
Money Market Funds	45,051,000	45,051,000	33.0%
Certificates of Deposit	1,435,000	1,435,000	1.0%
Florida Municipal Inv. Pool	3,379,648	3,379,648	2.0%
U.S. Treasury Securities	10,000,000	9,857,456	7.0%
Commercial Paper	1,000,000	1,000,000	1.0%
Repurchase Agreements	1,227,875	1,227,875	1.0%
<b>Totals</b>	<b>\$ 136,442,734</b>	<b>\$ 135,314,869</b>	<b>100.0%</b>

## **Investment Policy**

The City Commission adopted resolution NO. 01R-1397 on September 4, 2001, authorizing the Finance Director to invest surplus funds, as delegated by the City Manager. Quarterly reports are submitted to the investment committee, which consists of the City Manager, Finance Director, Cash and Investment Manager and the City Auditor and Clerk.

## **Performance Measurements**

- 1) 3.974% Target rate based on U.S. Treasury Market Securities at 09/30/2006.
- 2) 4.39% Annualized rate of return based on portfolio Investment at 09/30/2006.
- 3) 3.624% Annualized rate of return based on the Treasury, Agency and C.D. portion of the portfolio at 09/30/2005.
- 4) 4.892% Rate of return based on Lehman Brothers 1-3 Year Index for U.S. Governments maturing in December 2007, which is the duration equivalent of the portfolio's weighted average maturity.

## **Authorized Investment Institution and Dealers**

### **Bank –**

- 1) Wachovia Bank, N.A.
- 2) Fifth Third Bank
- 3) Bank of America
- 4) Liberty Savings Bank

### **Region Firms -**

- 1) Sun Trust Equitable Securities Corp.
- 2) Vining Sparks Securities
- 3) Shay Financial Services, Inc.
- 4) Brookstreet Securities Corp.
- 5) Sovereign Securities Corporation, LLC

### **Primary Dealers –**

- 1) Morgan Stanley Dean Witter, Inc.
- 2) Paine Webber Incorporated
- 3) Solomon Smith Barney, Inc.
- 4) Prudential Securities, Incorporated