

City of Sarasota

Quarterly Investment Committee Report Quarter Ending December 31, 2006

Economic Developments

With emerging economies gaining momentum, the balance of global growth will change in 2007. Firing on all cylinders, the world economy powered ahead in 2006 at its fastest pace for over 30 years. But already, heading into 2007, the engine is rattling, the pace is dropping and the road ahead looks a lot bumpier.

The good news is that a crash in 2007 is unlikely. The global economy should still manage to grow at a speed that, though not quite as furious as that of the past few years, still outpaces any year in the 1990's. Yet the risks will be higher, and in some key markets it will be a struggle to keep control.

Start with China. Its economy expanded by some 10.7% in 2006, the sort of growth rate normally associated with small countries rebounding from the ravages of war or natural disaster. On the face of it, such astonishing growth is an unambiguously good thing in a country where poverty is still widespread. But it may be storing up problems for future years. Investment is surging but it is unclear how much of this is commercially sound. Overcapacity is rife: as new factories spring up by the day, output of many products is running far ahead of demand, depressing prices and profits and ultimately risking a sharp rise in bad debts as companies struggle to meet loan repayments.

The government is alert to the danger, but its policy levers are crude and have so far proved ineffective at slowing the economy down. Besides, how serious is it about applying the brakes? A humming economy feels good – which is what China's leaders want as they prepare for the Communist Party's 17th

Congress towards the end of 2007. The smart money is on an abrupt slowdown only in 2009, after the 2008 Beijing Olympics. By that reckoning, 2007 should see growth yet again close to 10%, even as the dodgy loans continue to pile up.

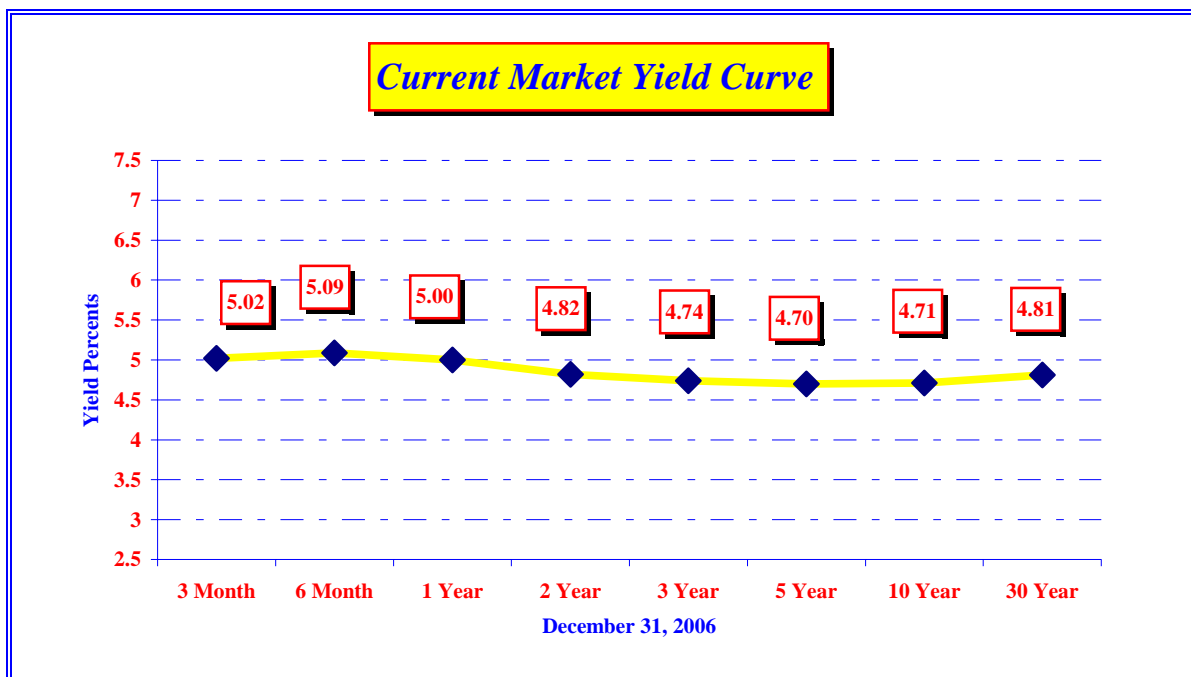
It is a rather different story in the United States, the world's largest economy. Two years of steady interest-rate rises are catching up with America's serial borrowers, and spending in 2007 looks set to be a lot softer than in the past few years. So soft, in fact, that some economists, while predicting a slowdown, are whispering "recession" to their personal fund managers. House prices, which for so long fuelled America's consumer boom, are falling in some metropolitan areas, making it hard for consumers to take out second mortgages and use their homes to fund the purchases of goods and services. But time and again, the Cassandras who predicted trouble – whether a crash in house prices, a collapse in consumer spending or a dollar crisis – were proved wrong. At last, in 2006, the pessimists got one prediction right. The housing boom abruptly ended, dragging down the pace of overall economic growth to well below its trend rate in the second half of the year. The housing slump will last into 2007. Nationally, average house prices will fall slightly. As a result, the economy will be weak, particularly at the beginning of the year.

However, the housing correction will not have calamitous consequences. The odds are against a recession in 2007. Rather than slashing interest rates to stave off a slump, America's central bankers will worry more that inflation is too high.

continued on page 4)

(Source: U.S. Treasury - Daily Treasury Yield Curve)
 Treasury Yield Changes During the Fourth Quarter of 2006

	12/31/2006	9/30/2006	BP Change
3 Month	5.02%	4.77%	0.25%
6 Month	5.09%	4.82%	0.27%
1 Yr.	5.00%	4.90%	0.10%
2 Yr.	4.82%	4.65%	0.17%
3 Yr.	4.74%	4.56%	0.18%
5 Yr.	4.70%	4.56%	0.14%
10 Yr.	4.71%	4.62%	0.09%
30 Yr.	4.81%	4.76%	0.05%



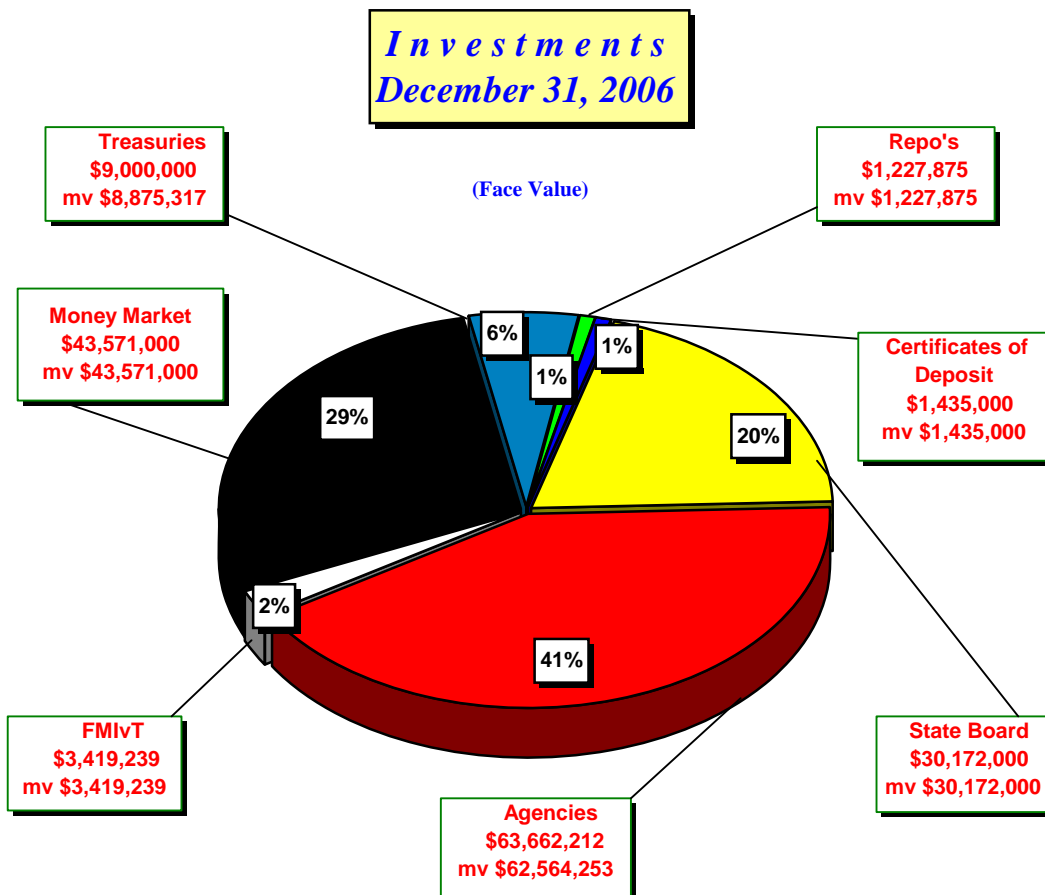
Interest Revenue vs Budgetary Expectation

General Operating Fund

	<u>12/31/06</u>	<u>03/31/07</u>	<u>06/30/07</u>	<u>09/30/07</u>
Interest Revenue	\$346,378	\$000,000	\$000,000	\$000,000
Budgetary Expectation	<u>312,500</u>	<u>312,500</u>	<u>312,500</u>	<u>312,500</u>
Excess (Shortfall)	\$ <u>33,878</u>	\$ <u>(312,500)</u>	\$ <u>(312,500)</u>	\$ <u>(312,500)</u>

Water & Sewer Operating Fund

	<u>12/31/06</u>	<u>03/31/07</u>	<u>06/30/07</u>	<u>09/30/07</u>
Interest Revenue	\$ 50,263	\$ 00,000	\$ 00,000	\$ 00,000
Budgetary Expectation	<u>31,250</u>	<u>31,250</u>	<u>31,250</u>	<u>31,250</u>
Excess (Shortfall)	\$ <u>19,013</u>	\$ <u>(31,250)</u>	\$ <u>(31,250)</u>	\$ <u>(31,250)</u>



Total Investment - \$152,487,326

Market Value - \$151,264,684

Total Portfolio Weighted Avg. Maturity - 1.0 Years

CD'S & Agency Bond Weighted Avg. Maturity - 1.76 Years

(continued from page 1)

In 2006, as the stocks of unsold houses soared, builders cut back sharply after a multi-year construction binge. The pace of residential building fell by a fifth, enough to drag overall output growth down by a full percentage point. But there was little effect elsewhere in the economy. Consumers did not take fright. A sudden plunge in fuel costs fattened their wallets and buoyed their spirits. Jobs were plentiful. The unemployment rate was merely 4.6% in September. Wages were rising at their fastest pace in five years.

In 2007 the mix will shift. The slump in construction will eventually ease, as builders work off their excess stock of new houses. Consumer, in contrast, will gradually slow their rate of spending in response to weaker house prices. The household saving rate, currently a negative 0.5%, will inch up. The rate of loan delinquencies will rise, albeit from an extremely low level. But a broad credit crunch looks unlikely. Most household balance sheets are strong enough to withstand a modest drop in housing prices. With consumer spending slower, but not stagnant, overall economic growth will be a little over 2% - below its potential but not exactly a slump.

Whether America dips into recession or not depends to a large extent on the actions of the Federal Reserve Board and Ben Bernanke, its chairman. He will come under pressure to cut interest rates sharply to cushion the impact of slower growth. But prudent central bankers focus on inflation rather than on growth, and with all the price signals flashing red the Fed may not have much room for maneuver.

Other global economies, such as Japan's will have another good year, although rising interest rates will mean the stellar performance of 2006 will be difficult to repeat. The Euro zone will look less impressive, laboring under higher interest rates, a sales-tax increase in Germany and weaker American demand for European exports. Instead, it will be the emerging world that delivers the economic goods. Eastern Europe and the former Soviet Union; India

and the rest of emerging Asia; the Middle East, Latin America and even Africa – all will perform well. Collectively, the emerging world will expand by an impressive 7.5% in 2007, according to forecasts, helping to offset a more sluggish 2.3% for the developed economies.

Accidents could happen. Watch for signs that rising interest rates in Japan and Europe may destabilize emerging-market currencies, or their equity and bond markets – havens for the rich world when borrowing was cheap and risks seemed low. And if China starts to wobble, commodities exporters will wobble too. But, for all the risks, emerging markets will ensure that the world economy moves along fairly briskly for another year.

INVESTMENT STRATEGY

The December quarter closed with Fed Chairman Bernanke indicating that the Fed was satisfied with the current pace of growth. Interest rates are expected to remain in a fairly narrow band. Some economists have predicted that the Fed may ease rates but with inflation being the focal point of concern for the Fed it's unlikely that any cuts will materialize in the near future. Therefore, with underlying technical statistics indicating that a potential acceleration in inflation may materialize, continuing to stay short going forward may be prudent. Therefore, maturities of U.S. Treasuries and Agency Securities will be temporarily shortened until economic indicators shed more light on which direction the Fed's moves interest rates. During the interim, Commercial Paper in the thirty to ninety day range with a rating of A1, P1 or better will be purchased for the purpose of diversity. Overnight liquidity increase during the quarter but will be reduced as investment opportunities develop going forward. Short-term (3-12 months) will remain at 10% to 12% or approximately \$15 to \$18 million. The medium term range (12-24 months) will targeted at approximately 65% or \$99 million of the portfolio. Long-term range (2-5 years) will continue to be reduced as call options are exercised; agencies securities mature or are sold.

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) 4.10% Target rate based on U.S. Treasury Market Securities on 12/31/2006.
- 2) 5.39% Rate of return based on Lehman Brothers 1-3 Yr. Index for U.S. Governments maturing in September 2008, which is the duration equivalent of the portfolio's weighted average maturity.
- 3) 4.29% Annualized rate of return based on portfolio Investments on 12/31/06.
- 4) 3.93% Annualized rate of return based on Treasury, Agency and C. D. portion of the portfolio on 12/31/2006.

Authorized Investment Institution and Dealers:

Bank -

- 1) Wachovia Bank, NA

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

Periodical publications used as source documents for articles appearing in December report.

1. The Wall Street Journal
2. The Economist Magazine
3. U. S. News Magazine