

City of Sarasota

Quarterly Investment Committee Report

Quarter Ending December 31, 2007

Economic Developments

It is not hard to worry about the world economy. America is either in, or perilously close to, recession, and other rich economies are weakening as the credit crunch tightens. In its new forecast, the International Monetary Fund expects global growth to slow from 4.9% last year to 4.1%: rich countries will manage only 1.8%. But that could prove optimistic. Since this slowdown came from a financial bust, the outlook is particularly uncertain. Nobody knows what financial calamities lurk under the surface or by how much credit will shrink. But one thing is clear. By adopting very different stances to the threat, policymakers are not helping to assuage the uncertainty.

In America politicians and central bankers are focusing on policy stimulus. The Federal Reserve has cut short-term interest rate by 1.25 percentage points in recent weeks, to 3%. Financial markets expect another half-point cut at or before the Fed's next meeting on March 18th. President Bush recently signed into law a package of tax rebates and temporary investment incentives worth \$152 billion, or just over 1% of GDP.

One reason for this frenetic activity is undoubtedly politics. The prospect of elections in November explains why a fiscal stimulus plan was agreed upon in record time. But there are two better reasons. There is, simply, the short-term need to respond to the downturn: employment is falling, consumer spending flagging and credit conditions tightening. But there is another rationale: both the Fed and the Treasury believe that by giving a stimulus now, they will minimize the odds of a nasty financial crisis and deep recession later. This is their insurance policy.

That logic is now being echoed in another – unlikely – corner of Washington, D.C. The

International Monetary Fund, long a fierce advocate of budget discipline, has applauded America's action and is urging other countries to draw up their fiscal plans in case the global outlook darkens. In addition to America, countries that make up a quarter of global GDP, the fund reckons, have the scope to cut taxes or boost spending. To reduce the odds of calamity, they should start contingency planning now.

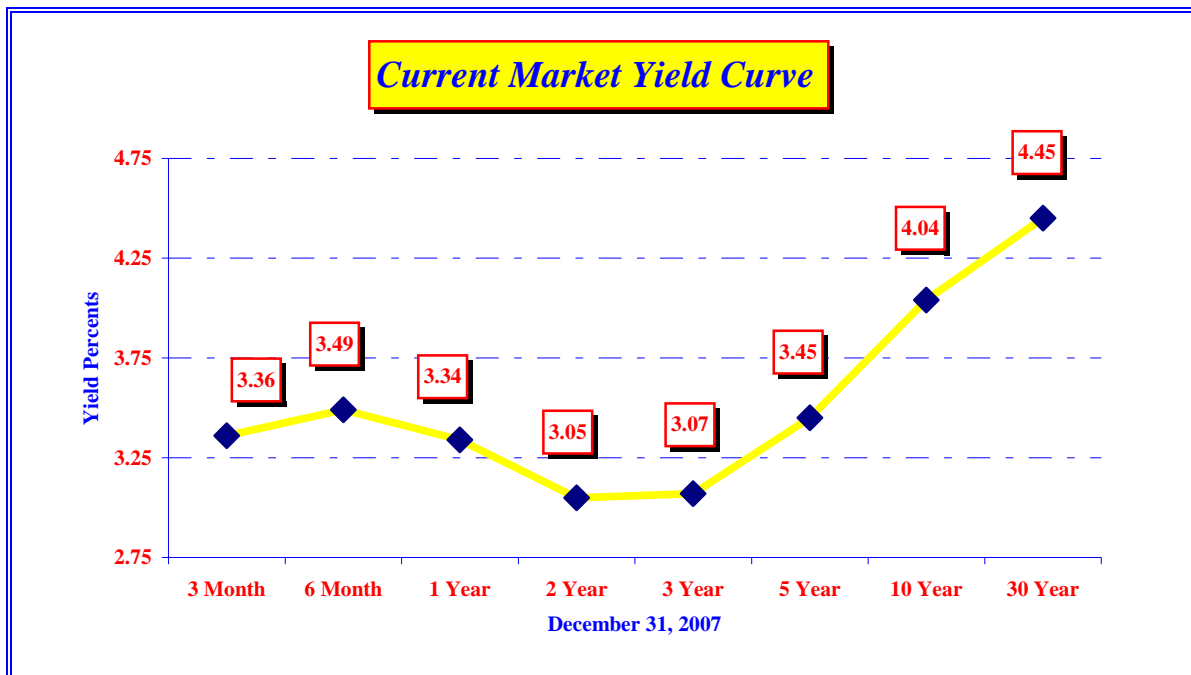
Few outside America, however, accept this logic or share the urgency. Britain and Canada have cut interest rates in recent month, but by much less than the fed. Canada has cut taxes recently, but is loath to do more. The European Central Bank has stood pat on interest rates, and has roundly criticized the idea of fiscal stimulus. In emerging economies, too, the call for budget loosening seems to be falling on deaf ears, although high commodity prices and better economic management mean that countries such as China, Russia and even Mexico have plenty of room to loosen their budgets.

This skepticism is partly justified by the economic fundamentals. With domestic demand booming, many big emerging economies are, rightly, more worried about overheating and inflation than they are about a dire downturn. The latest evidence suggests China's domestic demand is accelerating. Slower exports may be just what is needed to bring its growth back to a more sustainable pace. Although Europe's economies are more vulnerable than the U.S. economy, demand – at least so far – has weakened much less than in America, and the inflationary risks are much higher. The world economy can and should slow from its recent torrid pace. Global growth of 4% is hardly recessionary.

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(Source: U.S. Treasury - Daily Treasury Yield Curve)
 Treasury Yield Changes During the Fourth Quarter of 2007

	12/31/2007	9/30/2007	BP Change
3 Month	3.36%	3.92%	-0.56%
6 Month	3.49%	4.15%	-0.66%
1 Yr.	3.34%	4.11%	-0.77%
2 Yr.	3.05%	4.02%	-0.97%
3 Yr.	3.07%	4.05%	-0.98%
5 Yr.	3.45%	4.24%	-0.79%
10 Yr.	4.04%	4.56%	-0.52%
30 Yr.	4.45%	4.79%	-0.34%



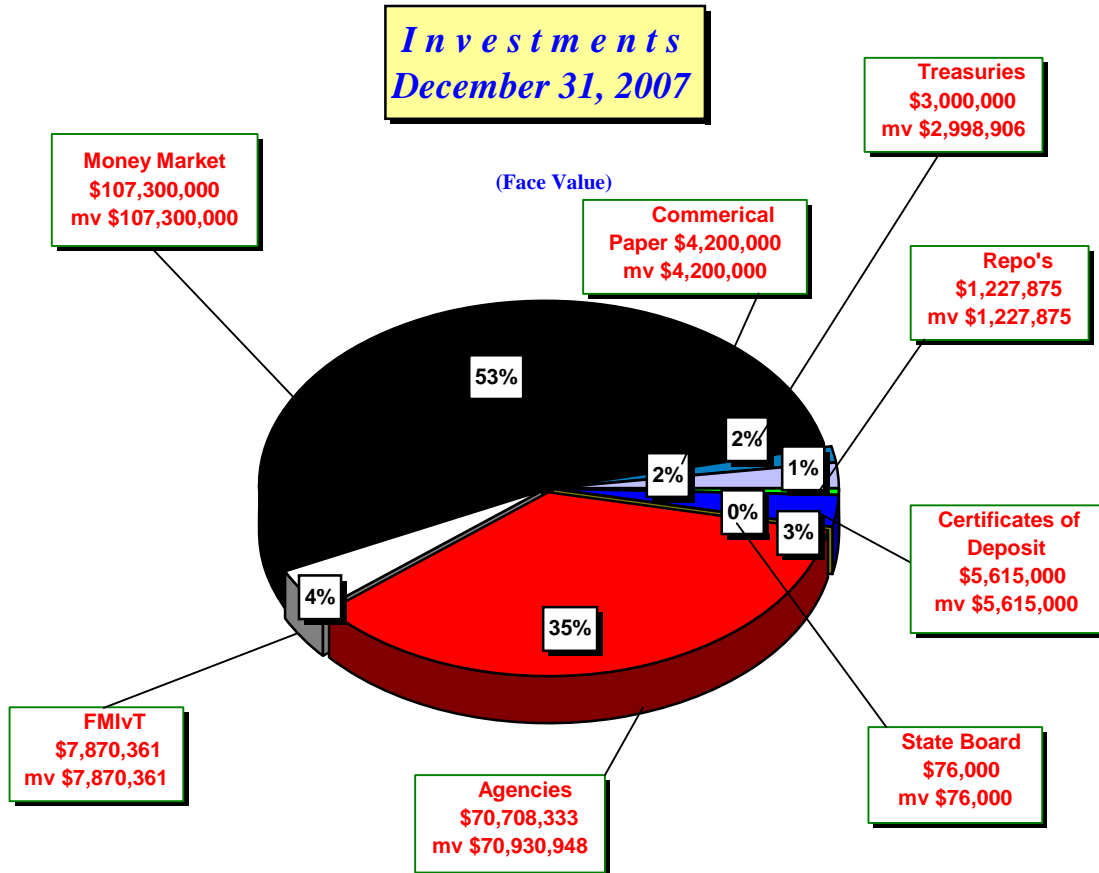
Interest Revenue vs Budgetary Expectation

General Operating Fund

	<u>12/31/07</u>	<u>03/31/08</u>	<u>06/30/08</u>	<u>09/30/08</u>
Interest Revenue	\$380,501	\$000,000	\$000,000	\$000,000
Budgetary Expectation	<u>447,500</u>	<u>447,500</u>	<u>447,500</u>	<u>447,500</u>
Excess (Shortfall)	<u>\$(66,999)</u>	<u>\$(447,500)</u>	<u>\$(447,500)</u>	<u>\$(447,500)</u>

Water & Sewer Operating Fund

	<u>12/31/07</u>	<u>03/31/08</u>	<u>06/30/08</u>	<u>09/30/08</u>
Interest Revenue	\$ 16,141	\$ 00,000	\$ 00,000	\$ 00,000
Budgetary Expectation	<u>25,000</u>	<u>25,000</u>	<u>25,000</u>	<u>25,000</u>
Excess (Shortfall)	<u>\$(8,859)</u>	<u>\$(25,000)</u>	<u>\$(25,000)</u>	<u>\$(25,000)</u>



Total Investment - \$199,997,569

Market Value - \$200,219,090

Total Portfolio Weighted Avg. Maturity - 1.21 Years

CD'S & Agency Bond Weighted Avg. Maturity - 2.74 Years

(continued from page 1)

History adds to the skeptics' case. The record of Keynesian – style fiscal stimulus is chequered. Too often politicians have failed to counter a downturn and added to the public debt instead. Furthermore, policymakers' responsibility is to their own citizens: it makes no sense for countries to overheat their economies to “make up” for America's weakness.

But the worry here is not weakness, but the risk of a nasty global economic downturn where emerging countries as well as rich ones slow far below their potential. People outside America are aware that things could get nasty. At a recent gathering of G7 officials in Tokyo, Peer Steinbrück, Germany's finance minister, gave warning that the total losses from the sub prime mess could reach \$400 billion. If house prices fall much further, everyone knows that losses will be greater still, and the odds of a financial calamity – and a deep recession – will rise. But for all the international hand wringing about this fatal risk, nobody is doing much about it. The main insurance policy is America's stimulus.

That is unwise. Lower interest rates are a blunt tool for warding off financial-market crises. If the source of calamity lies with tumbling house prices or weaknesses in particular financial institutions, such as monoline insurers, then targeted remedies are important. Market solutions, such as Warren Buffett's recent offer to reinsure municipal bonds, may prove enough. But America's housing market may yet justify dusting off Depression-era institutions, such as the Home Owners' Loan Corporation, which bought and refinanced distressed mortgages. In Europe regulations could do more to force banks to own up to their losses.

More worryingly, if the world leaves the Fed to provide risk insurance for everyone, America's interest rates will almost certainly be too loose for too long – just as they were in 2001 – 2004. Excessively low American rates would raise the odds of new asset bubbles and

impede the rebalancing of the global economy. The world would be better off if risk management were not down to one country.

The IMF'S call for contingency planning is surely right. True, history suggests that monetary loosening and targeted help to deal with systemic risks in the markets have often worked better than fiscal stimulus. But many countries have unusual scope to use their governments' coffers. If it comes to it, they should do so. Countries from China to Canada have the wherewithal to counter a sharp slowdown themselves. They should not rely on America to do it for them.

INVESTMENT STRATEGY

The Fed's concerns about inflation have been replaced by the ever increasing prospects of a potential recession. The Fed's must balance the two going forward to avoid a potential repeat of stagflation which has not been seen since the 1970's. Consumer prices are up 0.4% since January and 4.3% from a year ago reaching a sixteen year high. The dollar continues to fall against most currencies raising the cost of imports and adding to inflation. The possibility for lower rates going forward is very real. Therefore, maturities of three years for U.S. Treasuries and Agency Securities with twelve to twenty four month call features will continue to be added to the portfolio to lock in existing yields. Due to the possibility of rates increasing caused by inflationary pressures coupled with the current credit crunch, longer term maturities are not advised. Certificates of Deposit in the 90 to 180 day range will also be purchased for the purpose of portfolio diversity. Commercial Paper with a rating of A1 P1 will remain on hold as the sub-prime issue continues to unwind. Overnight liquidity will be decrease during the quarter as investment opportunities develop going forward. Short-term (3-12 months) will be set at 10% or approximately \$20 million while the medium term range (12-36 months) remains at approximately 65% or \$130 million of the portfolio. Long-term range (3-5 years) will continue to be reduced.

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:

Actual Rate of Return

- 1) 4.27% Annualized rate of return based on portfolio Investments on 12/31/07.
- 2) 4.37% Annualized rate of return based on Treasury, Agency and C. D. portion of the portfolio on 12/31/2007.

Benchmarks

- 1) 2.55% Target rate based on U.S. Treasury Market Securities on 12/31/2007.
- 2) 4.37% Rate of return based on Lehman Brothers 1-3 Yr. Index for U.S. Governments Securities.

Authorized Investment Institution and Dealers:

Bank -

- 1) Wachovia Bank, NA

Region Firms -

- 1) Sun Trust Robinson Humphrey, Inc.
- 2) Vining Sparks Securities
- 3) Shay Financial Services, Inc.
- 4) Mutual Securities Inc.
- 5) Sovereign Securities Corporation, LLC

Primary Dealers -

- 1) Morgan Stanley, Inc.
- 2) UBS Financial Services Inc.
- 3) Citigroup Global Market Inc.
- 4) Prudential Securities

Periodical publications used as source documents for articles appearing in December 2007 report.

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