

City of Sarasota

Quarterly Investment Committee Report

Quarter Ending September 30, 2007

Economic Developments

In economic terms, the first few years of the 21st century have been a roaring success. Between 2003 and 2006, global GDP at market exchange rates grew by 3.5% a year. At purchasing-power parities, according to the IMF, it surged ahead at just under 5% a year. That is its best run for more than three decades.

The great fear is that this locomotive is about to slow in the rich economies, and that this slowdown will be passed on to emerging markets. In America growth is already fading. In Britain and the Euro zone it may also be scaled down, partly by weakening exports and partly by tighter credit conditions. Japan's economy has stuttered all on its own.

The great hope is that the fast-growing emerging economies, notably China, are strong enough to come to the rescue. This year for the first time China alone will contribute more to global GDP growth than America, even if the American economy does not slow. In the first half of this year overall American growth contributed less to world GDP growth than did the increase in Indian and Chinese consumer spending, measured at market exchange rates.

That Asian resilience is about to be tested. After a good second quarter in America, with GDP growing at an annualized 3.8%, the news in the third quarter has been gloomier. Its housing market has gone from bad to worse, with slow sales of existing homes and falling prices. House-builders and lenders are eaten up by gloom. By this August the number of new homes started had fallen to an annual rate of 1.3m, 42% below the peak. New-home sales in August were 8.3% lower than in July and a whopping 21% down from a year ago.

Builders have slashed prices to get new properties off their hands – the median price fell by 7.5% in the year to August. But they still had more than eight months worth of sales on their books.

Weak construction activity has been dragging down the economy for a year or more and will keep doing so for a while yet. On top of that, weak house prices will hurt consumer spending. As the experts have indicated, estimating by how much is an inexact business even if one knew how far home prices would drop. This week the IMF cut its July forecast of growth in 2008 by almost a full percentage point, to 1.9%. The Fed's half-point cut in mid-September showed that the central bank is worried about the effect of the housing market on growth – but also that it hopes speedy action will limit the extent to which that infects the broader economy.

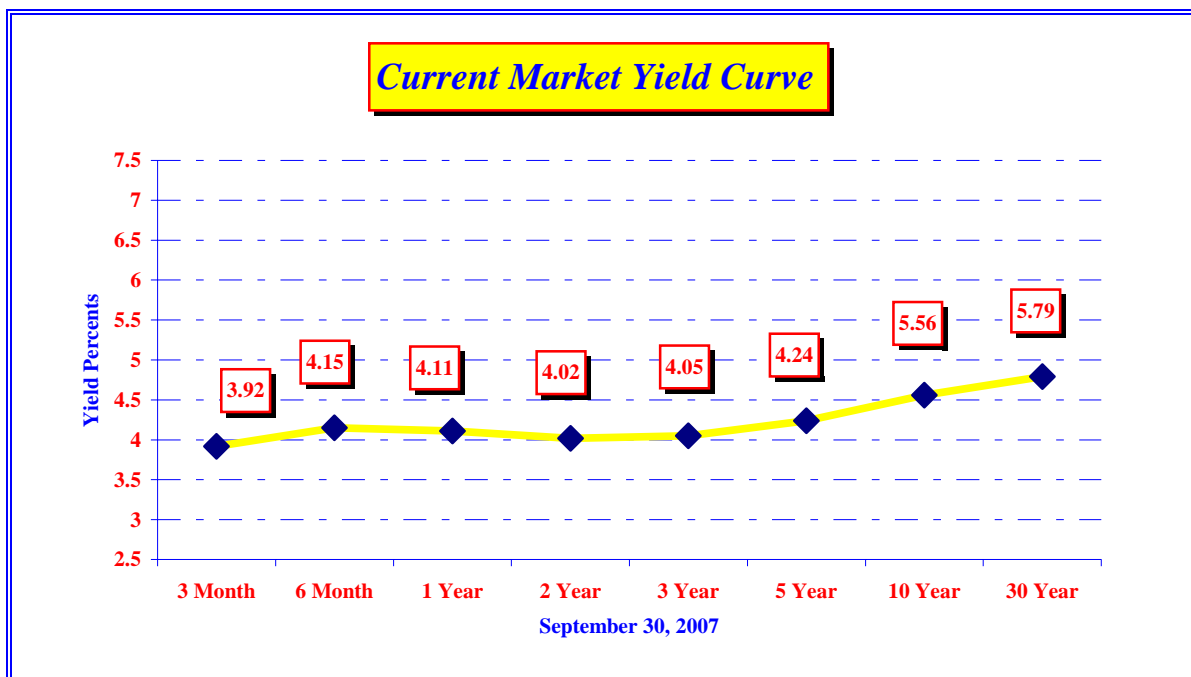
Until the credit squeeze, Europeans could afford to take a relaxed view of an American slowdown. The direct effects of the housing downturn would have been confined to the United States, and the possible knock-on effects on trade did not look so bad. Exports to America account for only 2-3% of the euro zone's GDP. Euro-zone exports to Asia, Central and Eastern Europe and oil-exporting countries have been growing apace.

The threat now is that the malaise in the credit and currency markets will worsen and be transmitted from the new world to the old. Granted, the European Economy still looks strong – German unemployment fell to a 14-year low last month – but the credit upheaval has clouded Europe's prospects, prompting

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

	9/30/2007	6/30/2007	BP Change
3 Month	3.92%	4.82%	-0.90%
6 Month	4.15%	4.93%	-0.78%
1 Yr.	4.11%	4.91%	-0.80%
2 Yr.	4.02%	4.87%	-0.85%
3 Yr.	4.05%	4.89%	-0.84%
5 Yr.	4.24%	4.92%	-0.68%
10 Yr.	4.56%	5.03%	-0.47%
30 Yr.	4.79%	5.12%	-0.33%



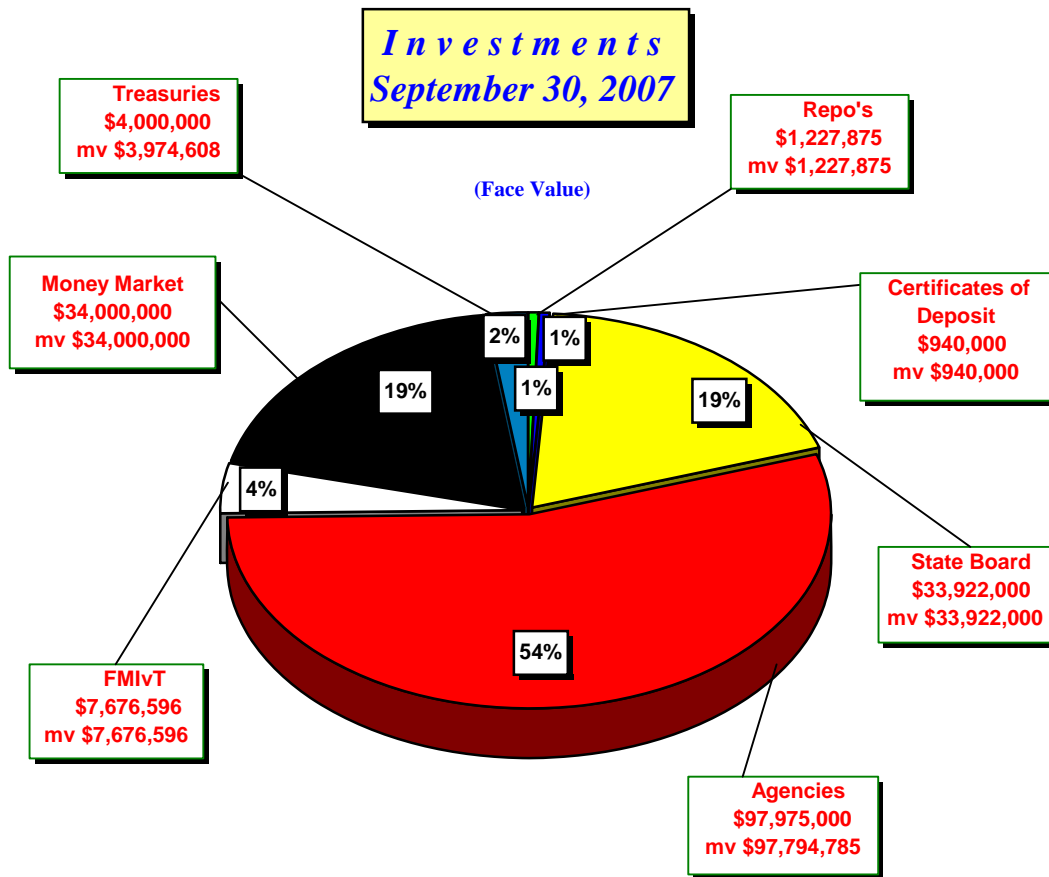
Interest Revenue vs Budgetary Expectation

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	\$503,272	\$381,283	\$375,065
Budgetary Expectation	<u>320,000</u>	<u>320,000</u>	<u>320,000</u>	<u>320,000</u>
Excess (Shortfall)	<u>\$26,378</u>	<u>\$183,272</u>	<u>\$61,283</u>	<u>\$55,065</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	\$ 53,325	\$ 28,490	\$ 58,078
Budgetary Expectation	<u>37,500</u>	<u>37,500</u>	<u>37,500</u>	<u>37,500</u>
Excess (Shortfall)	<u>\$ 12,763</u>	<u>\$15,825</u>	<u>\$(9,010)</u>	<u>\$20,578</u>



Total Investment - \$179,741,471

Market Value - \$179,535,864

Total Portfolio Weighted Avg. Maturity - 1.45 Years

CD'S & Agency Bond Weighted Avg. Maturity - 2.25 Years

(continued from page 1)

the IMF to cut its forecast of euro-zone growth next year by 0.4 percentage points, to 2.1%.

The Fed's rate cut, and with the prospect of more to come, have sent the dollar tumbling to below \$1.40 to the euro, the lowest since the single currency was established in 1999. For America, that may be no bad thing. A weaker dollar will rebalance America's economy towards exports and away from consumption, and dent its huge current-account deficit. But a stronger euro will not help the euro zone's export.

Worse, worries about the exposure of some of Europe's banks to American sub-prime-mortgage debt continue to infect European interest rates. Money market rates in America seem to be settling down, helped by the Fed's rate cut. European banks, however, were still reluctant to lend to one another.

That, plus the rising euro, should have much the same effect on the Euro zone as an increase in official interest rates, which helps to explain the postponement of an expected rate rise by the ECB. In Britain, too, money-market rates have been high and the Bank of England's first credit-conditions index, published late last month, suggested some tightening. Those countries where home prices have climbed most – Britain, Ireland and Spain – look most vulnerable.

Politicians, banks and businesses are urging the central banks in Britain and the Euro zone to keep growth going by cutting interest rates. But the bankers should not be in too much of a hurry.

One reason is that China is more robust than many think – and correspondingly less vulnerable to a slowing rich world. Its inflation rate is high, which some fear could yet cause a hard landing for its economy. Others point to the fragility of its overvalued stock market. Yet inflation is high because of food prices, rather than because of overheating, and therefore cannot be cured by a rate hike. Similarly, the Chinese economy is relatively immune to changes in

the value of shares. China exports a lot, yet

domestic demand will still account for three-quarters of its growth this year. Even without the stiff breeze of exports at its bank, China's economy would still advance at 9%.

A second reason not to rush into rate cuts is that the credit squeeze, if not the liquidity crisis, is in some ways necessary. Over the past few years risks of many kinds had been under-priced. Some repricing has already gone on: the spreads between low-grade and high-grade corporate debt have widened; and mortgage lenders are distinguishing more carefully between different kinds of borrowers. There is more still to do, unraveling devilishly complicated packages of debt and derivatives. Easing policy quickly could smooth this, but it could distort it too.

INVESTMENT STRATEGY

The Fed indicated satisfaction with the pace of economic growth as the September quarter came to a close. However, interest rates were expected to come under mounting pressure due to the development of the sub-prime market crises which may force the Fed to lower rates sooner rather than later. Therefore, longer maturities of U.S. Treasuries and Agency Securities with twelve month call features will continue to be added to the portfolio to lock in existing yields. Certificates of Deposit in the 90 to 180 day range will be purchased over the next quarter for portfolio diversity. Commercial Paper with a rating of A1 P1 will be temporarily placed on hold as the sub-prime issue develops. Overnight liquidity will continue to be decreased during the quarter as investment opportunities develop going forward. Short-term (3-12 months) will be set at 12% to 15% or approximately \$27 million. The medium term range (12-36 months) will continue to be targeted at approximately 65% or \$117 million of the portfolio. Long-term range (3-5 years) will continue to be reduced as call options are exercised and

agencies securities are sold or mature over time.

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) 5.25% Annualized rate of return based on portfolio Investments on 09/30/07.
- 2) 4.87% Annualized rate of return based on Treasury, Agency and C. D. portion of the portfolio on 09/30/2007.

Benchmarks

- 1) 3.40% Target rate based on U.S. Treasury Market Securities on 09/30/2007.
- 2) 4.27% 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 September 2007 report.

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