Agenda Item #2
August 19, 2013

TO: Financial Commission

FROM: Russell J. Morreale, Staff Liaison

SUBJECT: Investment Portfolio Update

RECOMMENDATION:

Accept the presentation of Investment Performance through June 30, 2013

BACKGROUND

The Financial Commission periodically reviews quarterly updates of the City's investment portfolio performance as a precursor to its delivery to City Council.

DISCUSSION

The attached report presents an update through June 30, 2013, as well as an interim reporting as of March 31, 2013, bringing the Commission up to date on the latest quarter of reporting. The portfolio presentation will be provided by the City's investment consultant, PFM, as a basis for discussion and questions. In this presentation PFM will provide a market update and illustrate the investments in place and made to date as well as a discussion of a forward looking posture.

Attachments:

1. Investment Portfolio – City Report
2. Second Quarter 2013 Review of Portfolio
3. First Quarter 2013 Review of Portfolio

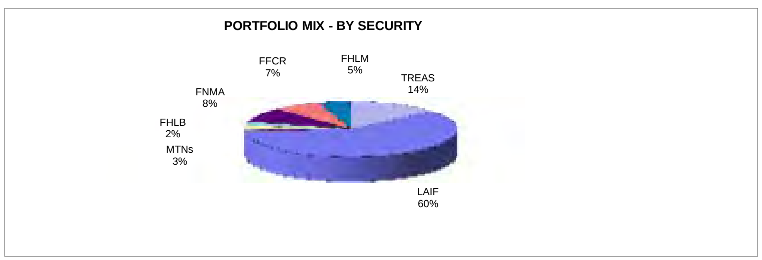
Attachment 1

Investment Portfolio – City Report

ATTACHMENT 1
Citywide Holdings and Investment Ladder
June 30, 2013

30-Jun-13

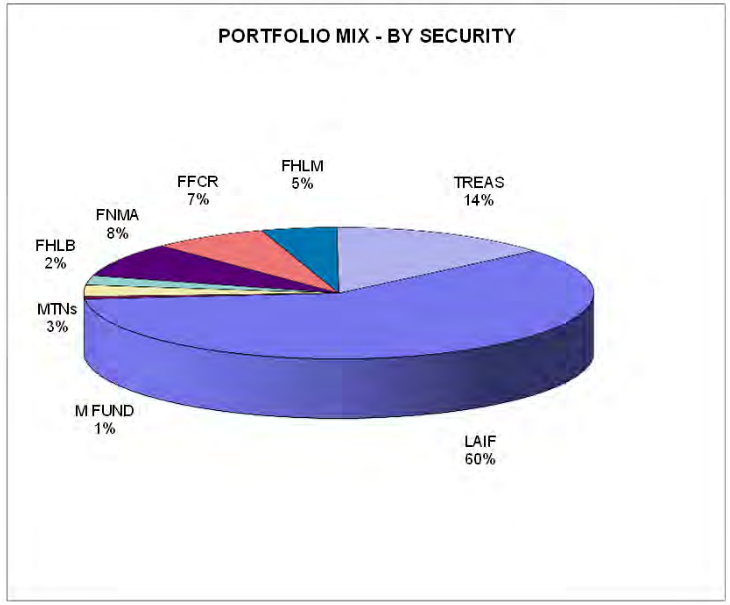
Month	2013					2014					2015					2016					
		YTM	Sec	Call Date	Amount		YTM	Sec	Call Date	Amount		YTM	Sec	Call Date	Amount		YTM	Sec	Call Date	Amount	
LAIF		0.24%			31,262,016																
MMKT		0.01%			358,573																
Jan																1/15/2016	0.36%	UT		300,000	
Feb																					
Mar											7/2/2015	0.61%	FNMA		900,000	4/25/2016	0.55%	FNMA	10/25/13	650,000	Cash
																					Surplus
Apr																					
																4/11/2016	0.56%	Wmart		800,000	
May																					
																5/13/2016	0.41%	FHLMC		500,000	
Jun																5/13/2016	0.72%	FHLMC		2,000,000	
																6/24/2016	0.77%	FHLB		1,200,000	
Jul											7/15/2015	0.38%	UT		750,000						
											7/15/2015	0.40%	UT		1,000,000						Period
																					of
Aug											8/7/2015	0.51%	FNMA	08/07/13	1,150,000						Cash
											8/27/2015	0.53%	FNMA	08/27/13	1,000,000						Deficiency
Sep																					
	9/15/2013	1.06%	UT		500,000																
Oct	10/15/2013	1.10%	UT		750,000	10/15/2014	0.49%	UT		1,700,000	10/9/2015	0.78%	CP GE		650,000						
Nov						11/10/2014	0.67%	FFCB		1,000,000	11/16/2015	0.45%	FFCB		1,600,000						
Dec	12/15/2013	1.19%	UT		750,000	12/31/2014	0.53%	UT		1,600,000	12/21/2015	0.40%	FNMA		750,000						Cash
											12/28/2015	0.41%	FFCB		1,250,000						Surplus
Total					$2,000,000					$4,300,000					$9,050,000					$5,450,000	
Count/Percent	3			0	13.03%	3			0	28.01%	9			2	58.96%	6			1	35.50%	
Avg YTM/Days		1.12%			117		0.56%			506		0.50%			810		0.56%			1,027	
Total Face Value					$ 2,000,000					$ 6,300,000					$ 15,350,000					$ 20,800,000	



		No of Inv	Ladder Yield	Spread Over LAIF	%	Avg Mat	# of Callables	Face Value
LAIF		1	0.240%	0.000%	60%	0		31,262,016
$ Mkt Fund		0	0.010%	-0.230%	1%	0		358,573
2010		0	0.000%		0%	0	0	0
2013		3	1.117%	0.877%	4%	4	0	2,000,000
2014		3	0.563%	0.323%	8%	42	0	4,300,000
2015		9	0.497%	0.257%	17%	140	2	9,050,000
2016		6	0.562%	0.322%	10%	107	1	5,450,000
		22	0.38%	0.44%	100%	293	3	$52,420,589
							3%	

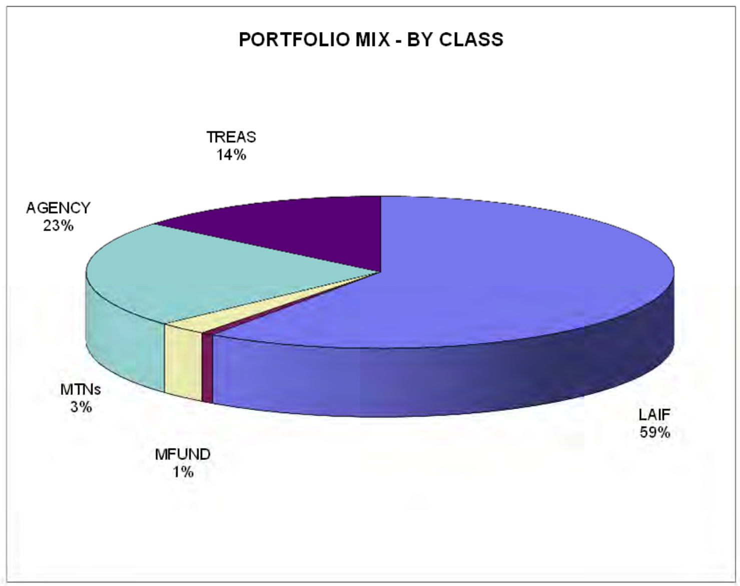
ATTACHMENT 1a
Portfolio Mix Charts - June 30, 2013

		Face Value	Callables
LAIF	59.6%	31,262,016	
M FUND	0.7%	358,573	
MTNs	2.8%	1,450,000	
FHLB	2.3%	1,200,000	
FNMA	8.5%	4,450,000	2,800,000
FFCR	7.3%	3,850,000	
FHLM	4.8%	2,500,000	
TREAS	14.0%	7,350,000	
	100%	**52,420,589**	**2,800,000**
Callables			**5%**



		Face Value	Mkt Value
LAIF	60%	31,262,016	
MFUND	1%	358,573	
MTNs	3%	1,450,000	
AGENCY	23%	12,000,000	
TREAS	14%	7,350,000	
	100%	**52,420,589**	

MTNs	1,450,000	1,444,040
TREAS	19,350,000	19,361,573
Accrued Interest		19,508
	20,800,000	**20,825,121**
Margin Over (Under) Par		**25,121**



Attachment 2

Second Quarter 2013 Review of Portfolio

City of Los Altos

Second Quarter 2013 Review of Portfolio
August 19, 2013

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Attachment 2

Second Quarter 2013 Recap

- During the second quarter, interest rates experienced their largest increase since the fourth quarter of 2010. The increase in interest rates was largely due to the Federal Reserve's May and June meetings, which revealed their bond purchases could be tapered beginning in September.
- Total returns, which take into account interest income as well as the change in market value of a portfolio, were negative for the second quarter for investments with durations longer than 1-year.
- Treasuries had higher returns than other sectors because, in addition to Treasury yields rising, spreads (yield difference) between Treasuries and Agencies or corporates also increased causing Agency and corporate yields to rise more (prices fall more).
- Active investment management strategies we used during the quarter were as follows:
  - Reinvested matured U.S. Treasury and corporate notes into the Federal Agency and corporate sector as the incremental yields within these sectors offered value over U.S. Treasuries.
  - Captured opportunities in yield and spread movements through strategic extensions into the 2- and 3-year area of the curve.

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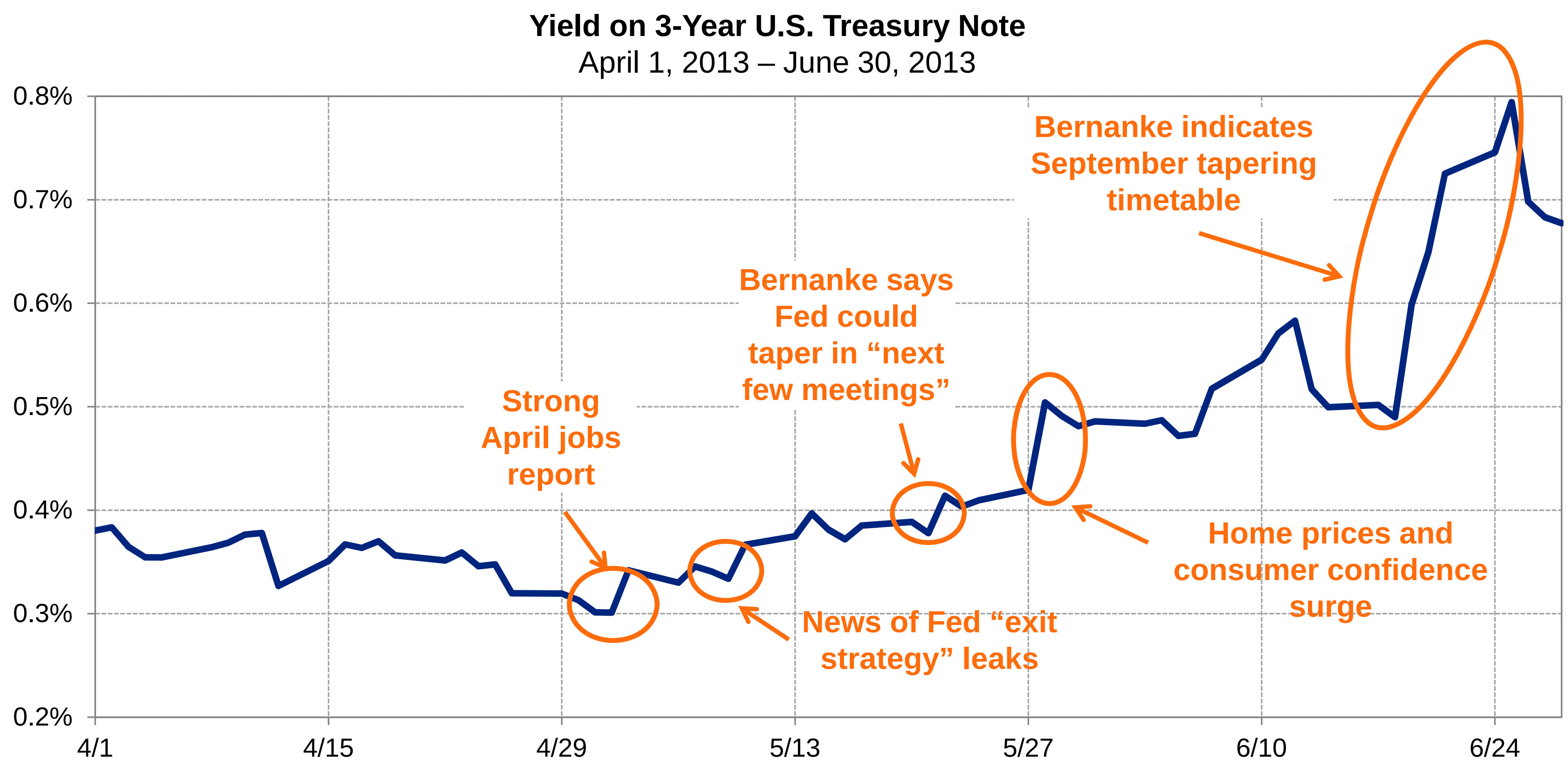
Interest Rates on the Rise

- Interest rates surged on a combination of positive economic news and the Federal Reserve's announcements that they would consider tapering their purchases of long-term Treasuries and mortgage-backed securities sooner than expected.



Source: Bloomberg

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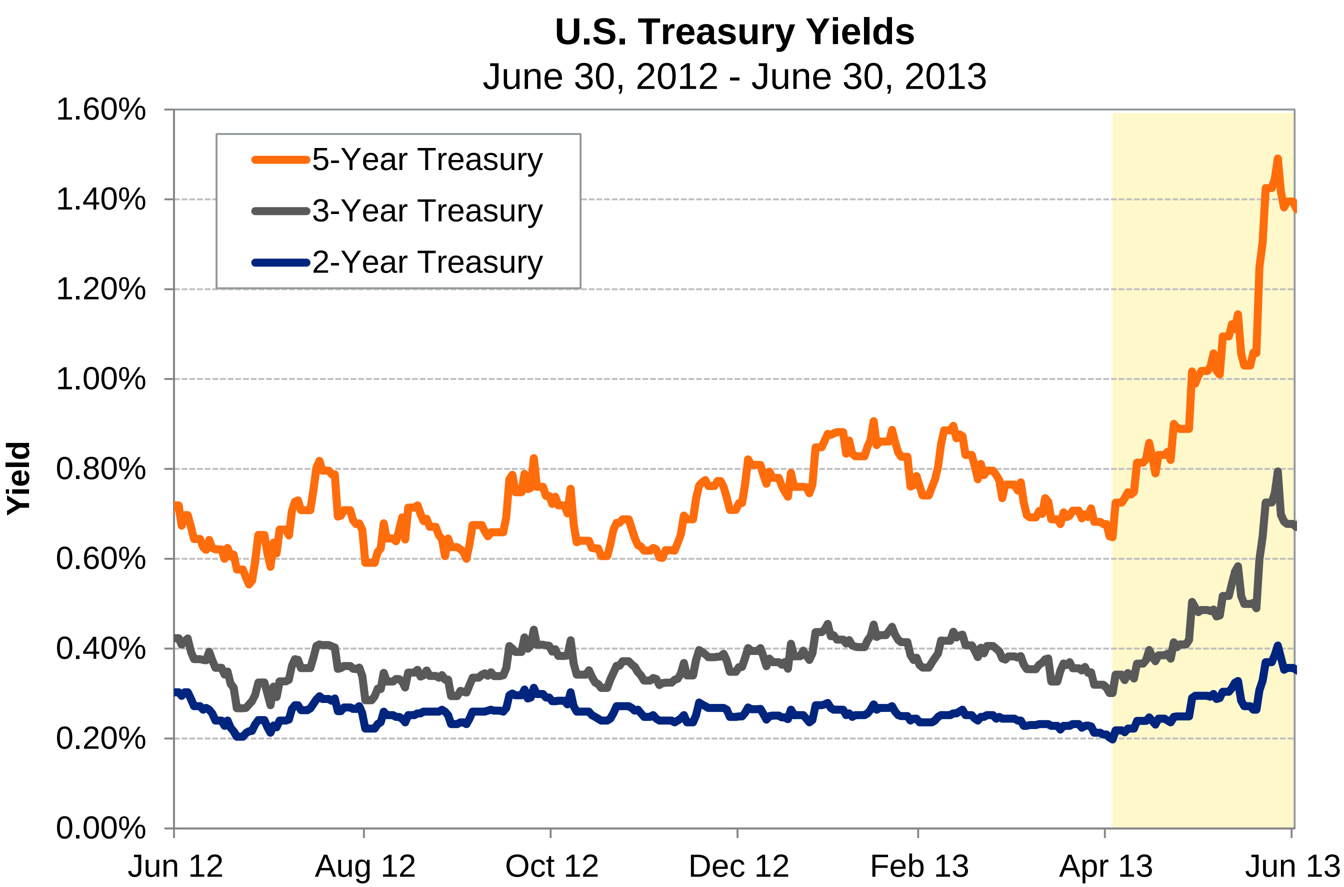
Longer-Term Rates Broke Out of Range

- The increase in rates following Fed Chairman Bernanke's comments and positive economic releases impacted longer-term maturities more significantly than shorter-term maturities.
- The yield on 5-year U.S. Treasury securities increased by 75 basis points in less than two months.



Source: Bloomberg

	5/2/13	6/30/13	Change
2 Year	0.20%	0.36%	+0.16%
3 Year	0.29%	0.68%	+0.39%
5 Year	0.65%	1.40%	+0.75%

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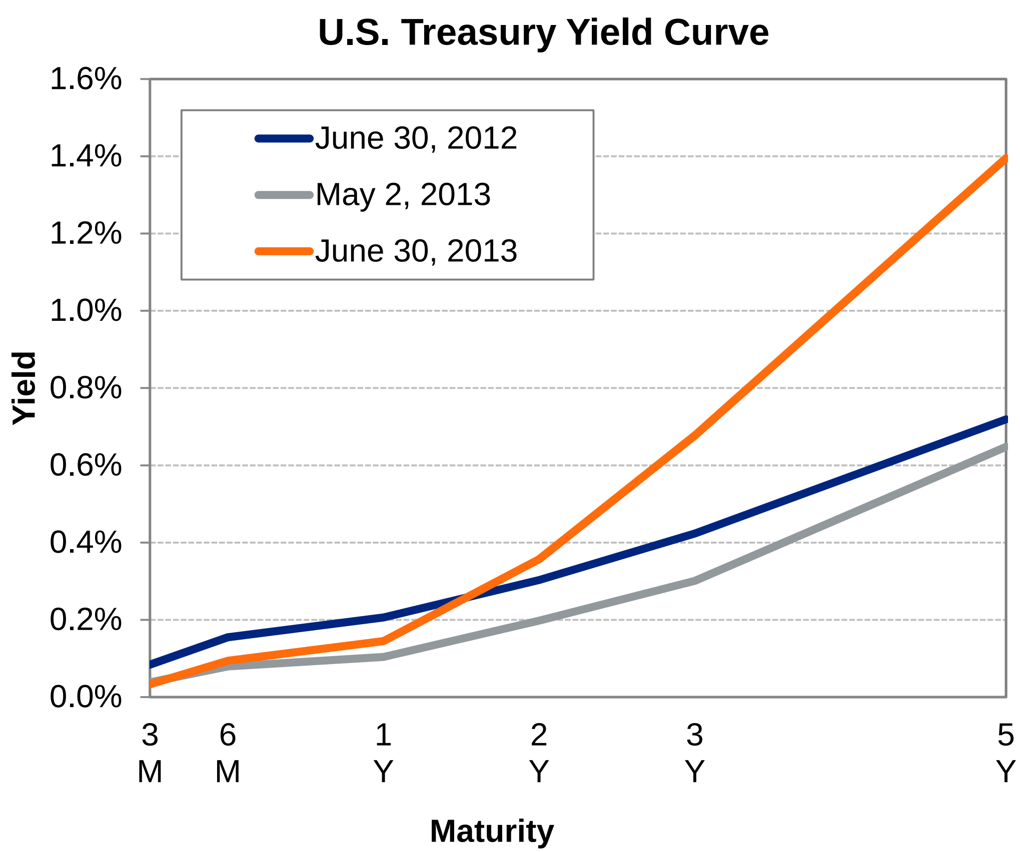
Yield Curve Steepens in Mid-2013

- The recent increase in rates, especially in the 3- to 5-year maturity range, steepened the yield curve.



Source: *Bloomberg*

	6/30/12	5/2/13	6/30/13
3 Month	0.08%	0.04%	0.03%
6 Month	0.16%	0.08%	0.09%
1 Year	0.21%	0.10%	0.15%
2 Year	0.30%	0.20%	0.36%
3 Year	0.40%	0.29%	0.68%
5 Year	0.72%	0.65%	1.40%

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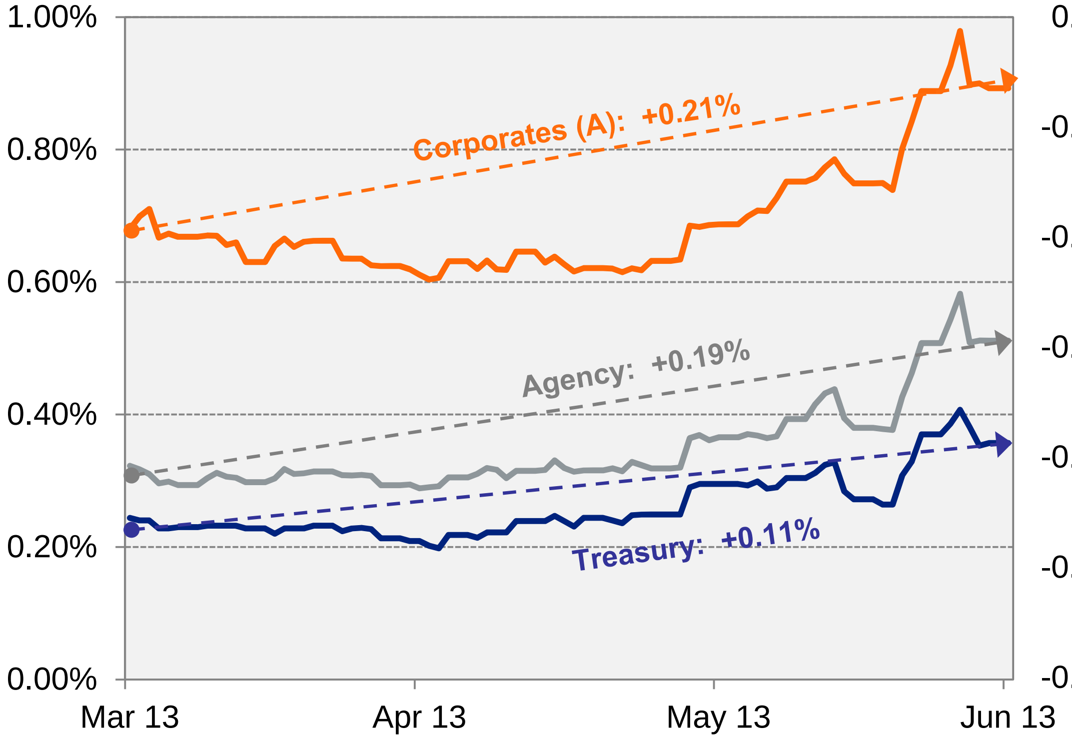
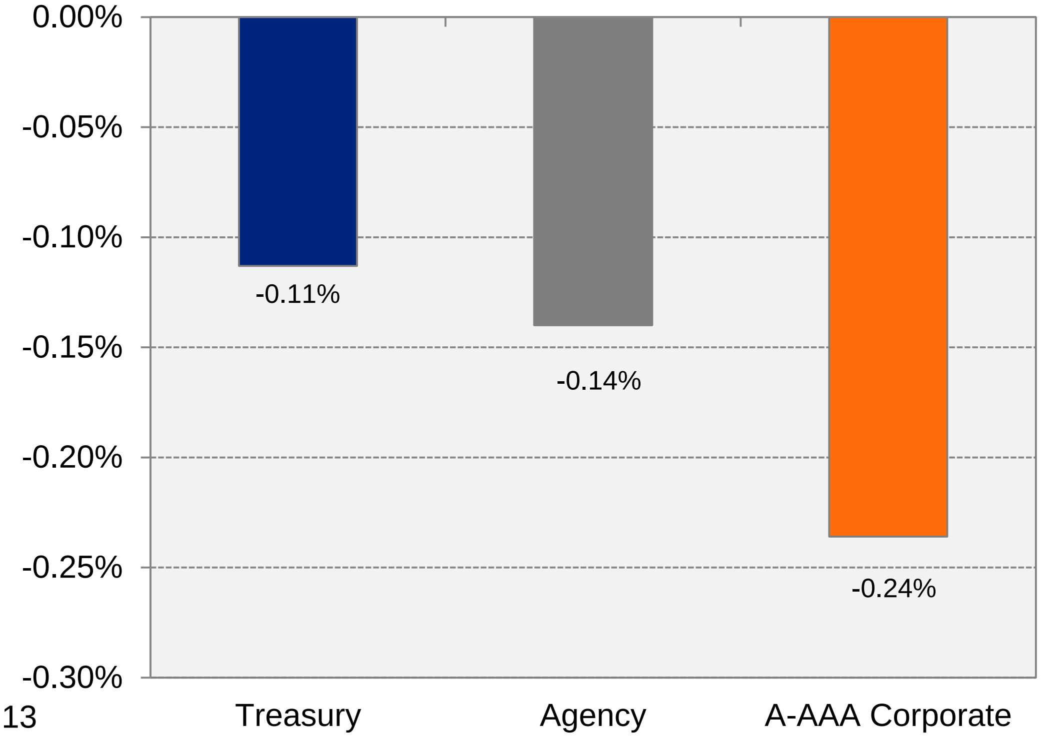
Spreads Also Widened, Causing Treasuries to Outperform

- As interest rates rose, yield spreads also widened on Federal Agencies, corporates and mortgage-backed securities. As a result, Treasuries outperformed other sectors.
  - – Spreads have reversed since the beginning of the third quarter.

Comparison of 2-year Yields
March 31, 2013 – June 30, 2013



1-3 Year Index Total Returns (Sector)
March 31, 2013 – June 30, 2013



Source: Bloomberg, BofA Merrill Lynch Bond Indices

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Returns Were Depressed Across All Sectors and Maturities

	As of 6/30/2013		Returns for Periods ended 6/30/2013		
	Duration	**Yield**	**3 Month**	**1 Year**	**3 Years**
1-3 Year Indices					
U.S. Treasury	1.89	0.37%	(0.10%)	0.33%	0.82%
Federal Agency	1.80	0.48%	(0.13%)	0.34%	0.97%
U.S. Corporates, A-AAA rated	1.99	1.20%	(0.22%)	2.16%	2.63%
Agency MBS (0 to 3 years)	1.69	1.67%	(1.00%)	(0.40%)	1.75%
Municipals	1.77	0.70%	(0.16%)	0.62%	1.27%
1-5 Year Indices					
U.S. Treasury	2.72	0.66%	(0.67%)	(0.03%)	1.44%
Federal Agency	2.61	0.81%	(0.74%)	0.01%	1.28%
U.S. Corporates, A-AAA rated	2.91	1.70%	(1.09%)	2.19%	3.40%
Agency MBS (0 to 5 years)	3.06	2.66%	(1.37%)	(0.60%)	2.46%
Municipals	2.51	1.04%	(0.61%)	0.53%	1.86%
Master Indices (Maturities 1 Year or Greater)					
U.S. Treasury	5.78	1.40%	(2.21%)	(2.00%)	3.03%
Federal Agency	4.01	1.34%	(1.97%)	(0.90%)	2.12%
U.S. Corporates, A-AAA rated	6.57	2.96%	(3.12%)	0.89%	5.08%
Agency MBS	4.61	2.96%	(1.92%)	(1.15%)	2.52%
Municipals	7.81	3.21%	(3.33%)	0.10%	4.66%

Return for periods greater than one year are annualized.

Source: BofA Merrill Lynch Bond Indices

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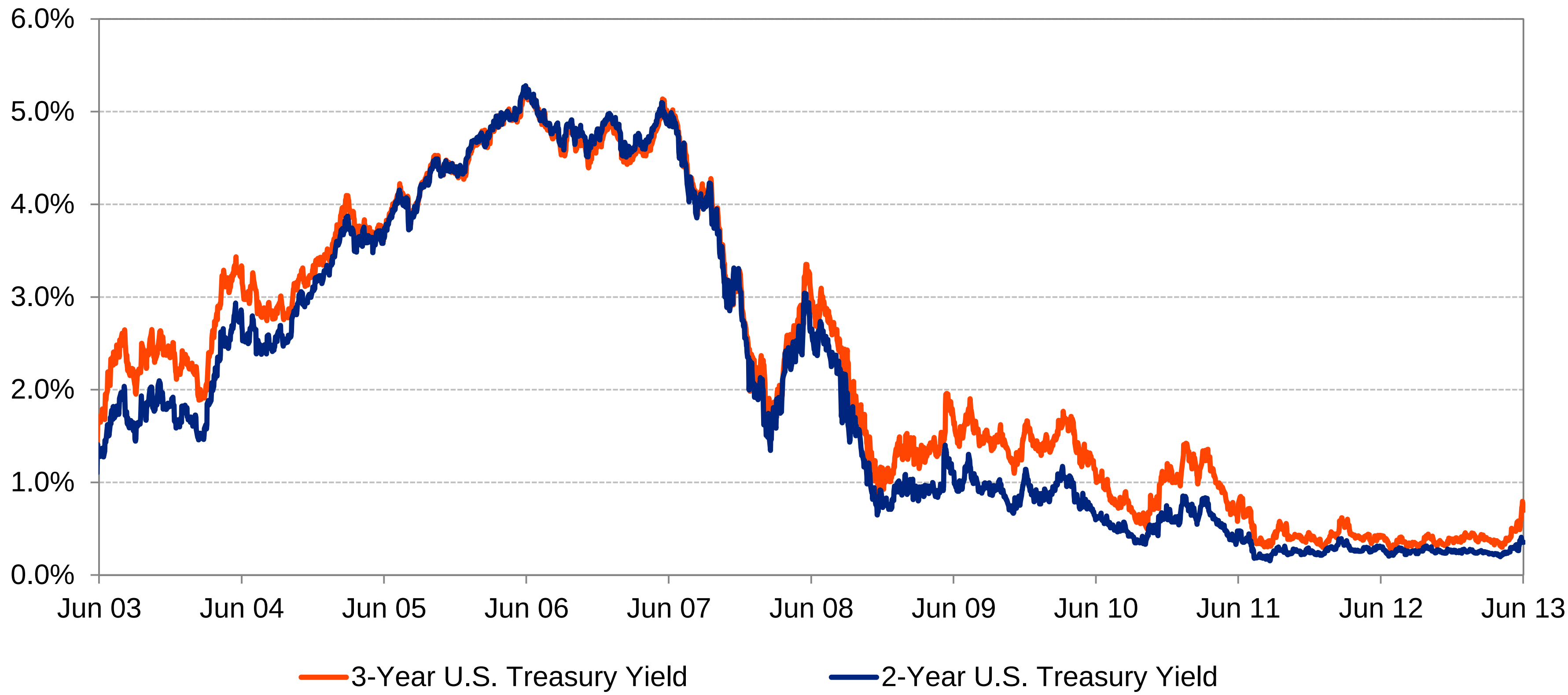
Interest Rates Remain Low by Historical Standards

- While interest rates have risen recently, they still remain low by historical standards and thus have a long way to go until they normalize.

2-Year and 3-Year Treasury Yield
June 2003 – June 2013



Source: Bloomberg

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Portfolio Generated Strong Returns

- The rise in interest rates in May and June caused the fair value of the City's portfolio to decrease in value more than the amount the portfolio earned in interest for the quarter, generating negative returns for the first time since 2010. We continue to monitor yield changes for opportunities to enhance the return through higher yields.

Total Returns
for Periods ending June 30, 2013

	Duration (years)	Past Quarter	Past Year	Past 2 Years	Since Inception
City of Los Altos	**1.97**	**-0.17%**	**0.23%**	**0.46%**	**0.74%**
Merrill Lynch 1 Year U.S. Treasury Index	0.91	0.04%	0.31%	0.29%	0.36%
Merrill Lynch 1-3 Year U.S. Treasury Index	1.81	-0.11%	0.33%	0.56%	0.82%

Notes:
- *Performance on trade-date basis, gross (i.e., before fees) in accordance with the CFA Institute's Global Investment Performance Standards (GIPS).*
- *Merrill Lynch Indices provided by Bloomberg Financial Markets.*
- *Inception date is third quarter 2010.*
- *Return calculation excludes LAIF*

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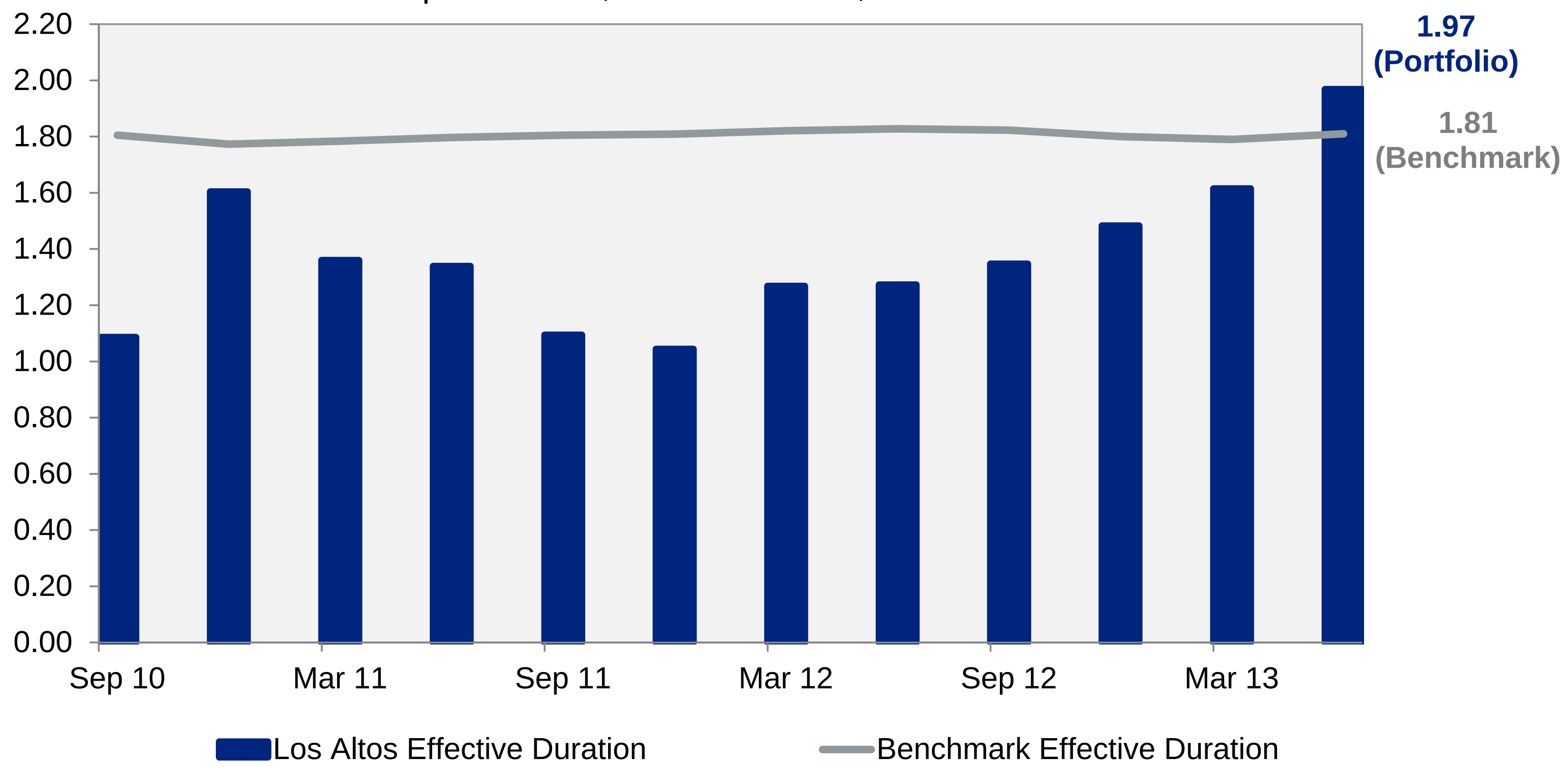
Portfolio Duration Near Benchmark Duration

- The recent rise in interest rates allowed us to extend portfolio duration to its target duration, while at the same time enhance the portfolio with additional yield. The portfolio duration generally changes when we purchase or swap securities.

City of Los Altos Duration vs. 1-3 Year Treasury Benchmark Duration
September 30, 2010 - June 30, 2013



Source: Bloomberg

Second Quarter Total Return Detail

- Although the portfolio's total return was -0.17% during the second quarter, the portfolio's total return, minus unrealized gains/losses, was 0.15% for the same time period.

Calculating Return in Dollars

	Ending Market Value + Accrued Interest		$21,204,695
-	Beginning Market Value + Accrued Interest	-	$18,236,389
+	Distributions	+	$0
-	Contributions	-	$3,000,000
	= Total Return		**-$31,693**

Components of Dollar Return

Realized Gain/Loss:		$0	**Realized Return**
Net Interest Income:	+	$26,566	
Realized Dollar Return:		**$26,566** →	**+0.15%**
Unrealized Gain/Loss:	-	$58,269	
Total Return		**-$31,693**	

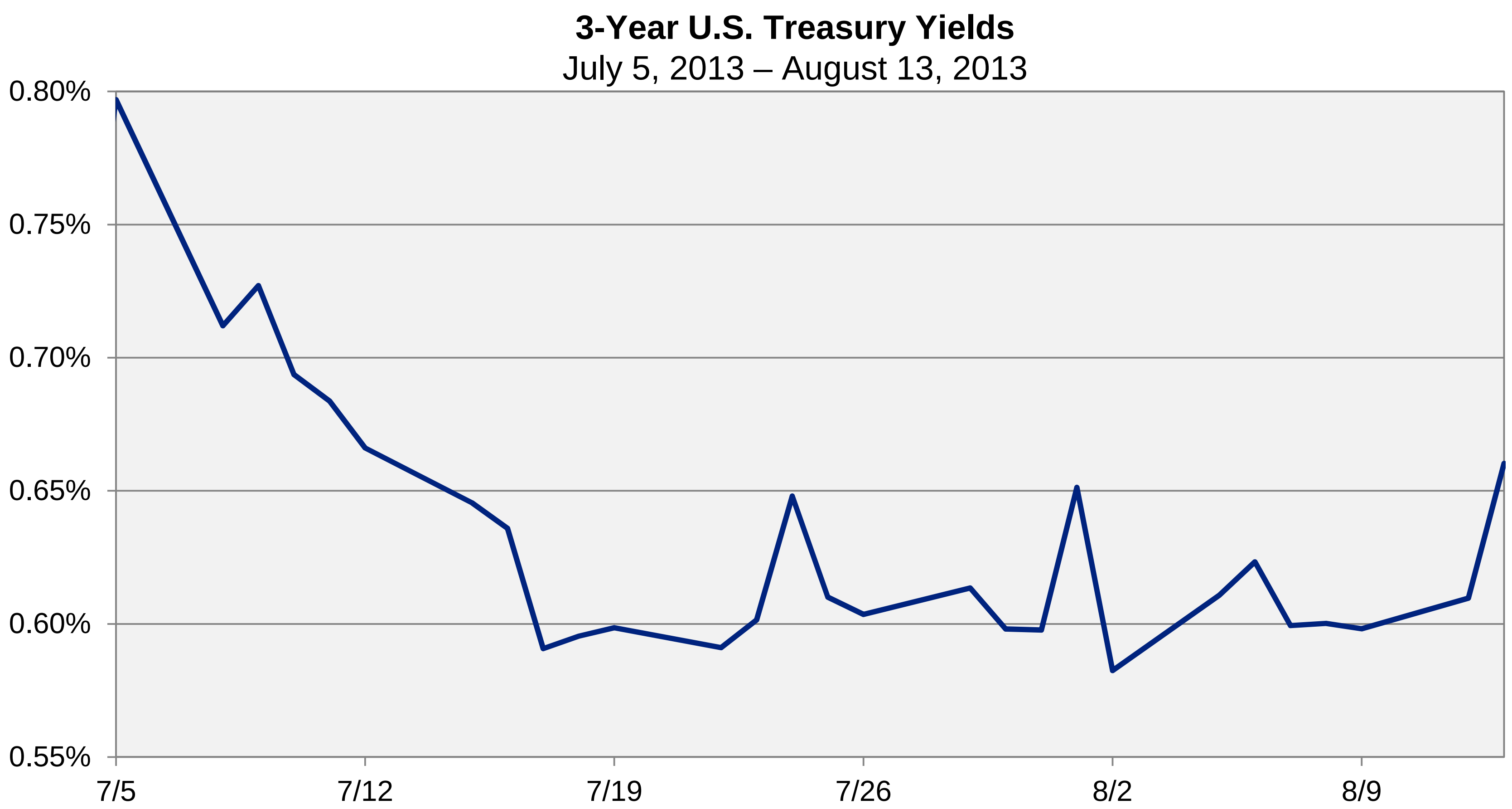
Calculating Average Balance

	Beginning Market Value + Accrued Interest		$18,236,389
-	Time-Weighted Distributions	-	$0
+	Time- Weighted Contributions	+	$131,868
	= Time Weighted Average Balance		**$18,368,257**

$$\textbf{Total Return} = \frac{-\$31,693}{\$18,368,257} = -0.17\%$$

Treasury Yields Retreat After Quarter-end

- Yields have fallen since the end of the quarter, which has boosted the portfolio's total return.



Source: Bloomberg

Portfolio Holdings in Compliance with California Code and City's Investment Policy

Security Type	Market Value as of June 30, 2013	Percent of Portfolio	Permitted by Policy	In Compliance
U.S. Treasury	$7,417,303	14%	100%	✓
Federal Agencies	$11,961,453	23%	100%	✓
Corporate Notes	$1,446,366	3%	30%	✓
LAIF	$31,262,016	60%	100%	✓
Money Market Fund	$379,573	<1%	20%	✓
Total	$52,466,711			

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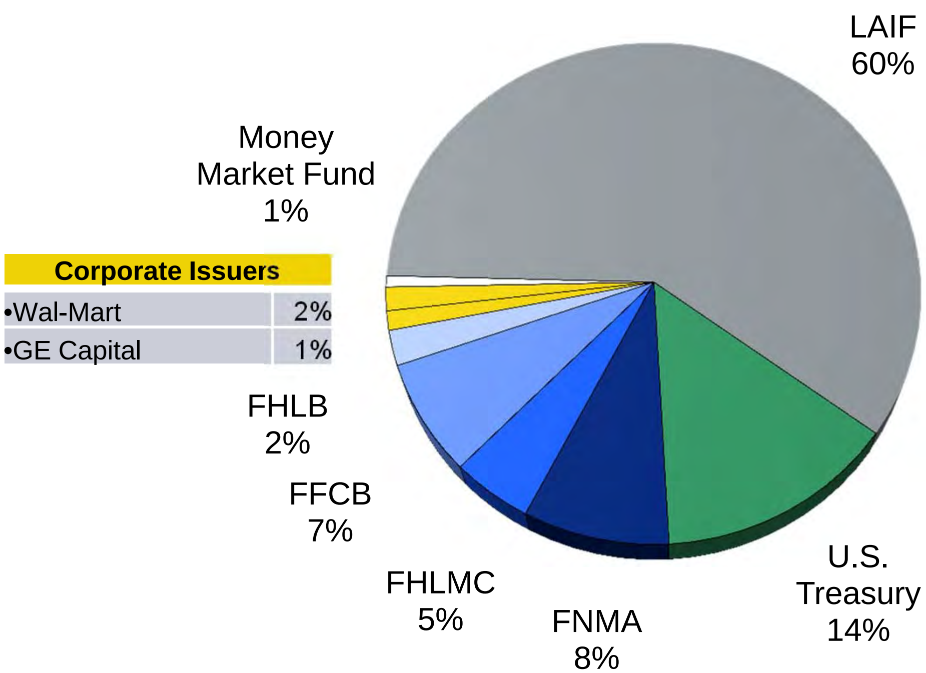
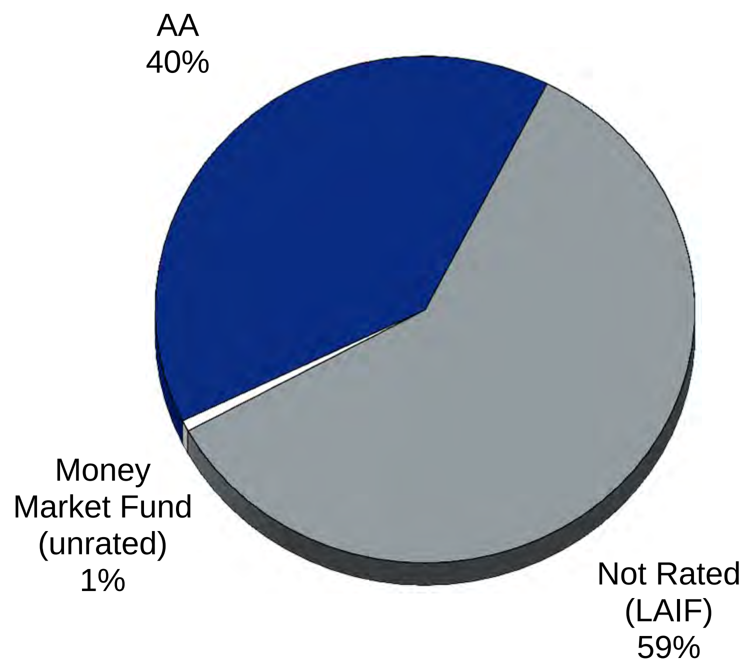
City's Holdings Maintain Highest Credit Quality

- The portfolio has excellent credit quality: 98% of the portfolio (excluding LAIF) is invested in securities rated in S&P's second highest ratings category, AA.
- The City's portfolio continues to be well diversified by both sector and issuer.

Issuer Distribution



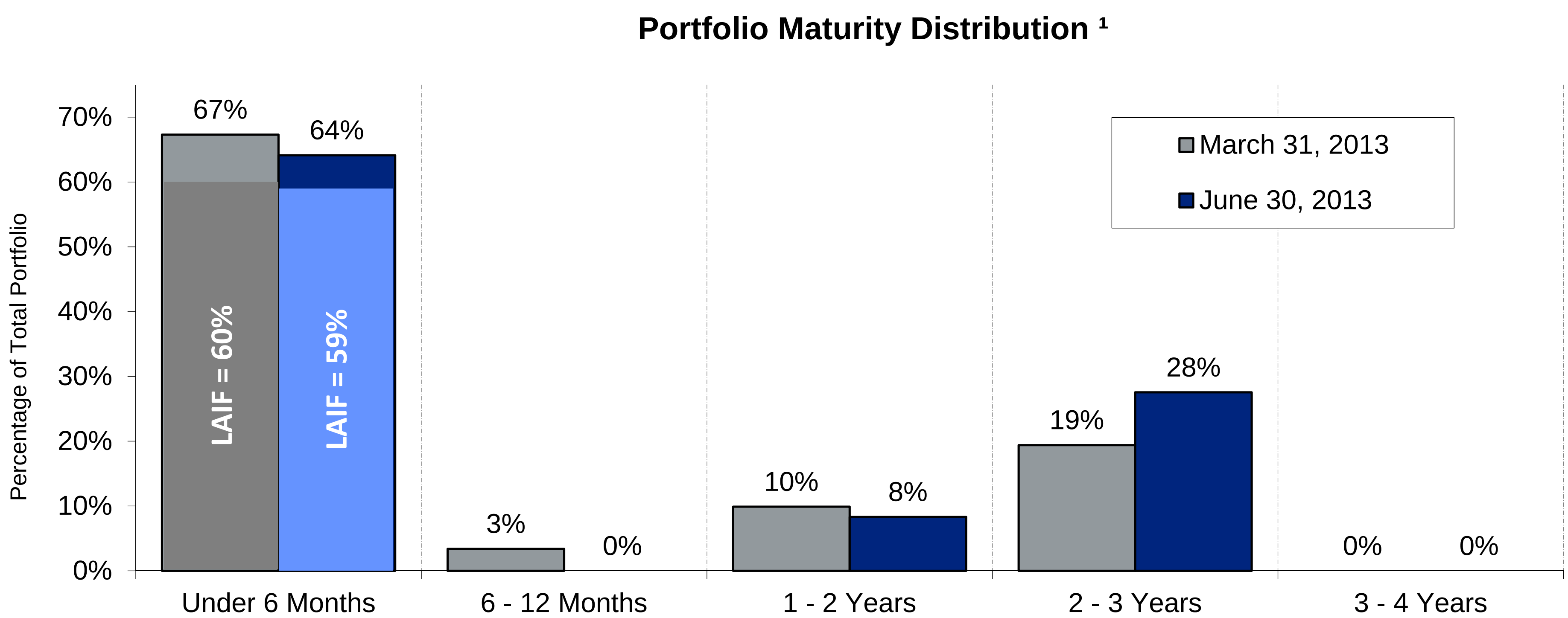
Credit Quality



Notes:
- *As of June 30, 2013*
- *Standard & Poor's Ratings*

Portfolio Holdings Are Diversified by Maturity

- We have continued to selectively invest in the 2- and 3-year range to expose the portfolio to higher yields and modestly.



Note: Callable securities in portfolio are included in the maturity distribution analysis to their stated maturity date, although they may be called prior to maturity.

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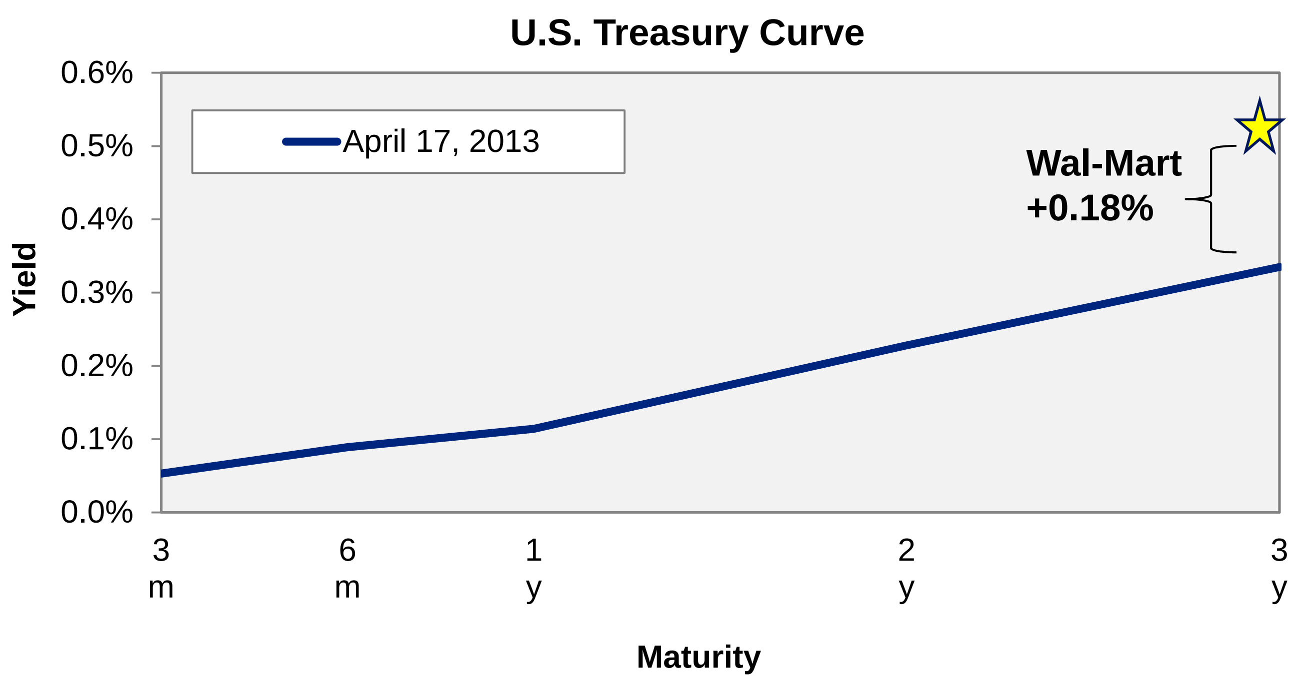
Strategy—Increase Allocation to Non-Financial Corporates

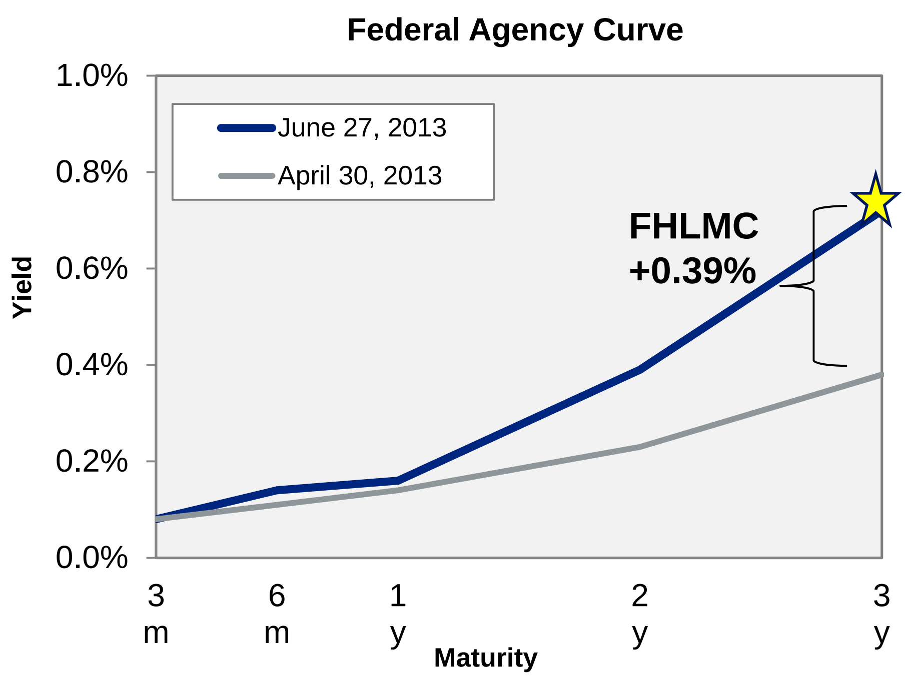
- We strategically increased the portfolio's holdings of non-financial corporates as the yield difference between U.S. Treasury securities and non-financial corporate obligations widened.
- The new investment will enhance portfolio yield and have the potential to increase in value through "roll-down."
  - Wal-Mart Stores.—Maturity: 4/11/16 Yield to Maturity: **0.52%**

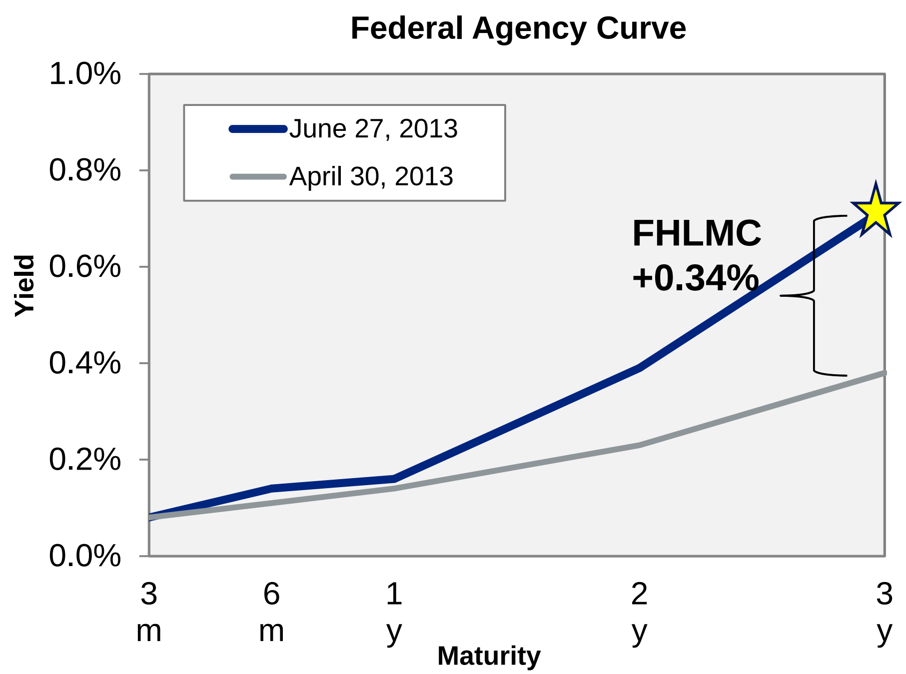


Source: Bloomberg

Strategy—Extend Duration After Rate Increase

- The rate increase that began in May presented a buying opportunity within the Federal Agency sector.
- The steepening in the yield curve increased the potential for "roll-down" return in longer-term securities.
- We made the following purchases after rates increased:
  - June 27, 2013: FHLMC—Maturity: 6/24/16 Yield to Maturity: **0.77%**
  - June 27, 2013: FHLMC—Maturity: 5/13/16 Yield to Maturity: **0.72%**





Source: Bloomberg

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Third Quarter Investment Strategy

- The economic outlook continues to strengthen, however, headwinds to recovery still remain.

Positive	Challenges
– Modest GDP growth	– Sequester and debt ceiling
– Decreasing unemployment	– Manufacturing sector weakness
– Housing sector momentum	– On-going European crisis
– Strong corporate earnings	– Rising energy prices

- The Fed may begin to decrease its quantitative easing programs by the end of the year.
- Treasuries have risen to a new higher trading range. Additionally, we expect higher volatility in the bond market in the coming quarter.
  - This new environment should generate relative value opportunities in callable and non-callable Agencies, due to favorable pricing and overall higher interest rates.
- Corporate and municipal bonds are expected to remain the primary generators of excess return as the fundamentals of financial companies and local governments continue their positive trend.
- We will look to for value within floating rate notes and negotiable certificate of deposit sectors.
- We will focus on safety of principal and appropriate liquidity more than ever in this new and challenging environment while maximizing value through careful and prudent active management.
- Our strategy will remain appropriately flexible and may change in response to changes in interest rates, economic data, market outlook or as specific opportunities arise.

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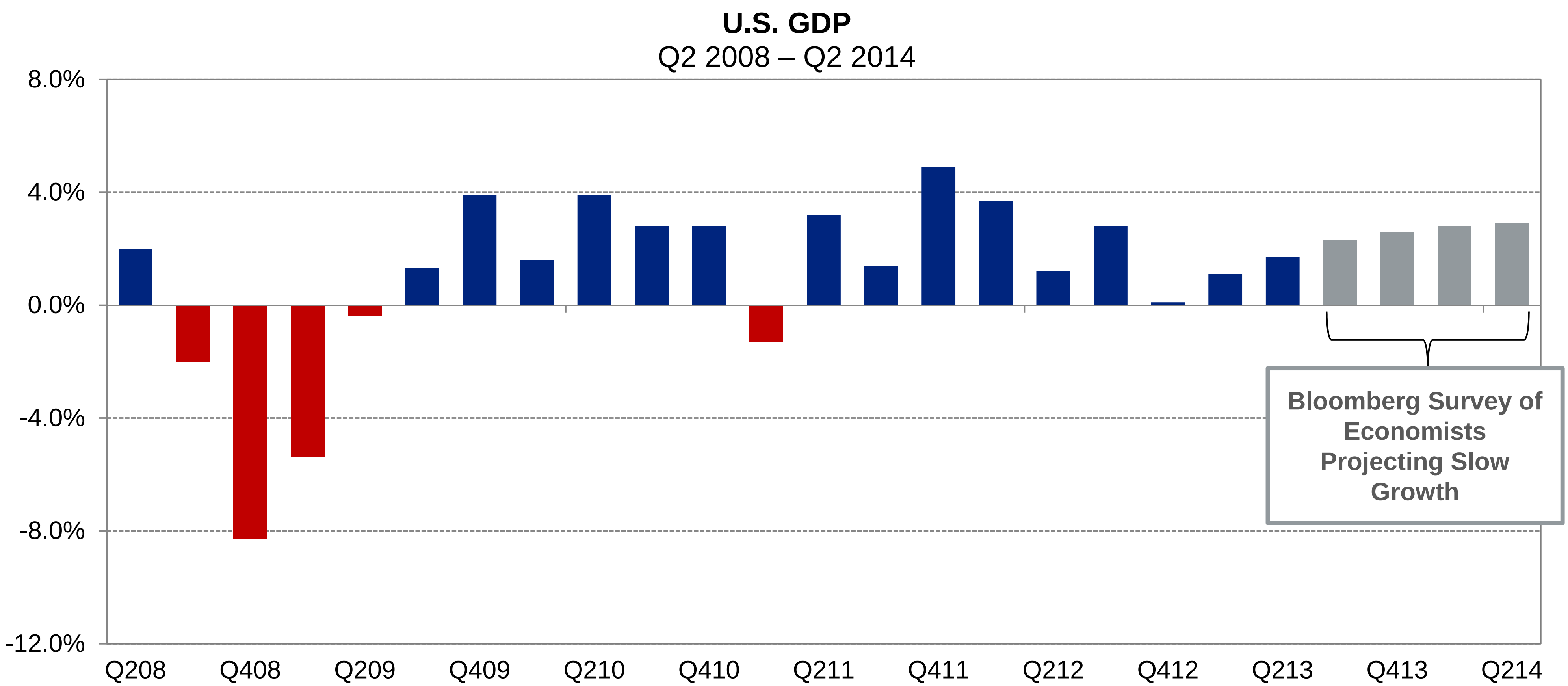
U.S. Economic Growth Remains Moderate

- GDP grew at 1.7% in the second quarter, beating economists’ expectations. The positive second quarter news was offset by the downward revision of first quarter GDP from 1.8% to 1.1%.



Source: Bloomberg

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Outline of July FOMC Meeting

- The Federal Reserve Open Market Committee (FOMC) met July 31, making a slight change to its assessment of overall U.S. economic conditions:
  - **Prior Language:** *"Information received since the Federal Open Market Committee met in May suggests that economic activity has been expanding at a* ***moderate pace****."*
  - **Current Language:** *"Information received since the Federal Open Market Committee met in June suggests that economic activity expanded at a* ***modest pace*** *during the first half of the year."*
- The statement likely reflects some disappointment with the pace of economic recovery.
- The FOMC kept their assessment of inflation as "below" the committee's long run objective. They further added that inflation persistently below 2% posed risks to economic performance.
- The FOMC went on to state that the committee "reaffirmed its view" regarding accommodative monetary policy for a considerable time after the economy strengthens.

Source: Bloomberg, Federal Open Market's Committee.

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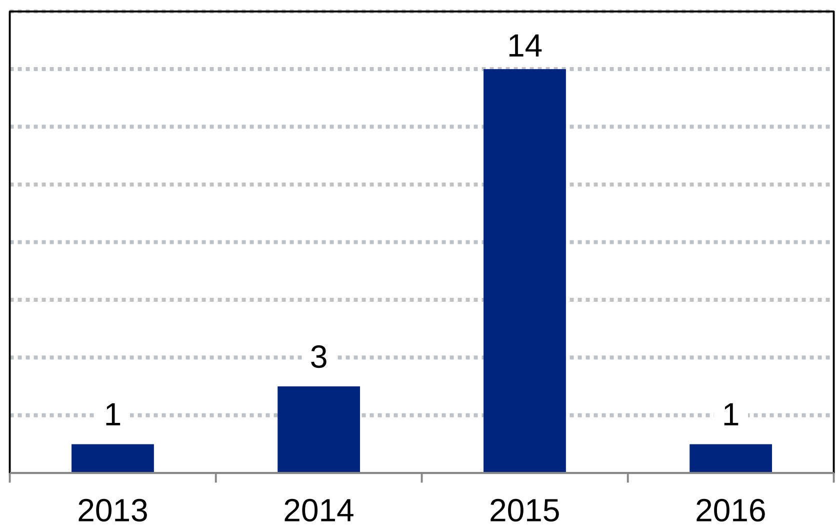
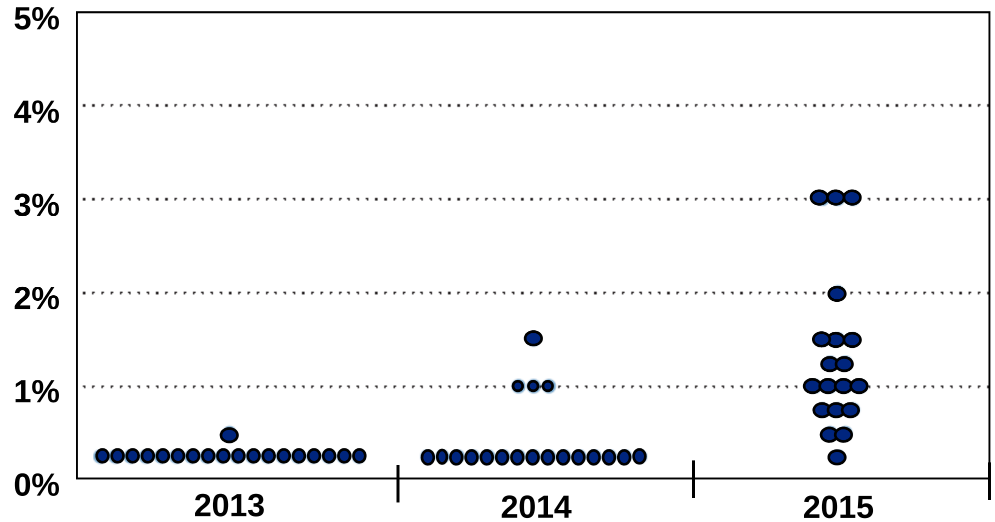
Fed Rate Guidance Indicates Continued Low Rates Through At Least 2015

- Since unemployment remains at uncomfortably high levels, and inflation remains at low levels, the Federal Reserve is still expected to keep interest rates low until 2015. However, in the Fed's June release they indicated that bond purchases are likely to taper near the end of 2013.

FOMC Participant Votes on Appropriate Timing of Policy Firming
as of June 19, 2013



Targeted Federal Funds Rate at Year-End FOMC Participant Forecasts
as of June 19, 2013



Individual FOMC participant's judgment of the appropriate level of the target federal funds rate at the end of the specified calendar year.

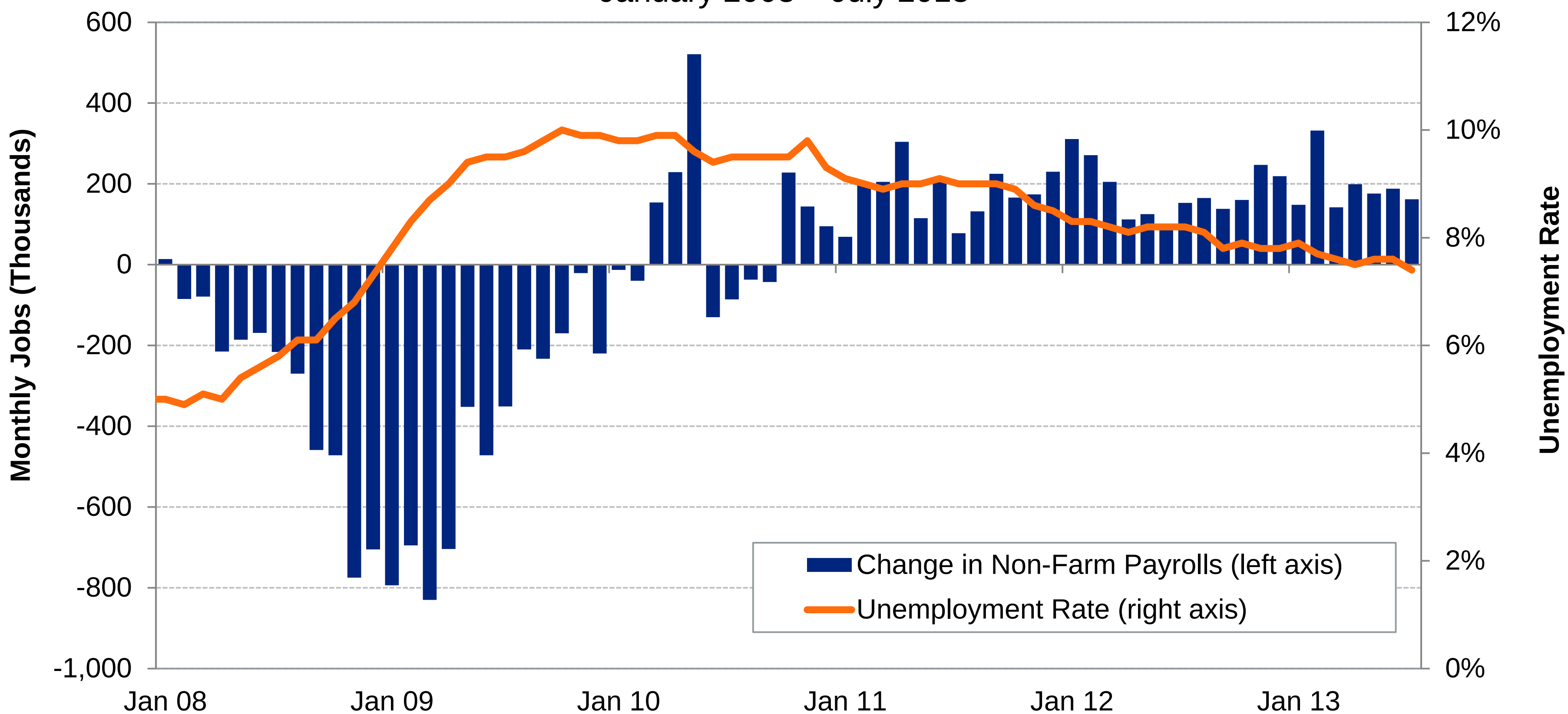
Source: Federal Reserve Open Market Committee.

Job Market Continues Slow Improvement

- Over the past year, the unemployment rate has decreased from 8.2% to 7.4%, and the economy has added an average of 190,000 jobs per month.
- Part of the decrease in unemployment is attributed to the continued decline of the labor force participation rate, which is currently 63.4% — just 0.1% higher than the lowest level in over 30 years.

Change in Nonfarm Payrolls vs. Unemployment Rate

January 2008 – July 2013

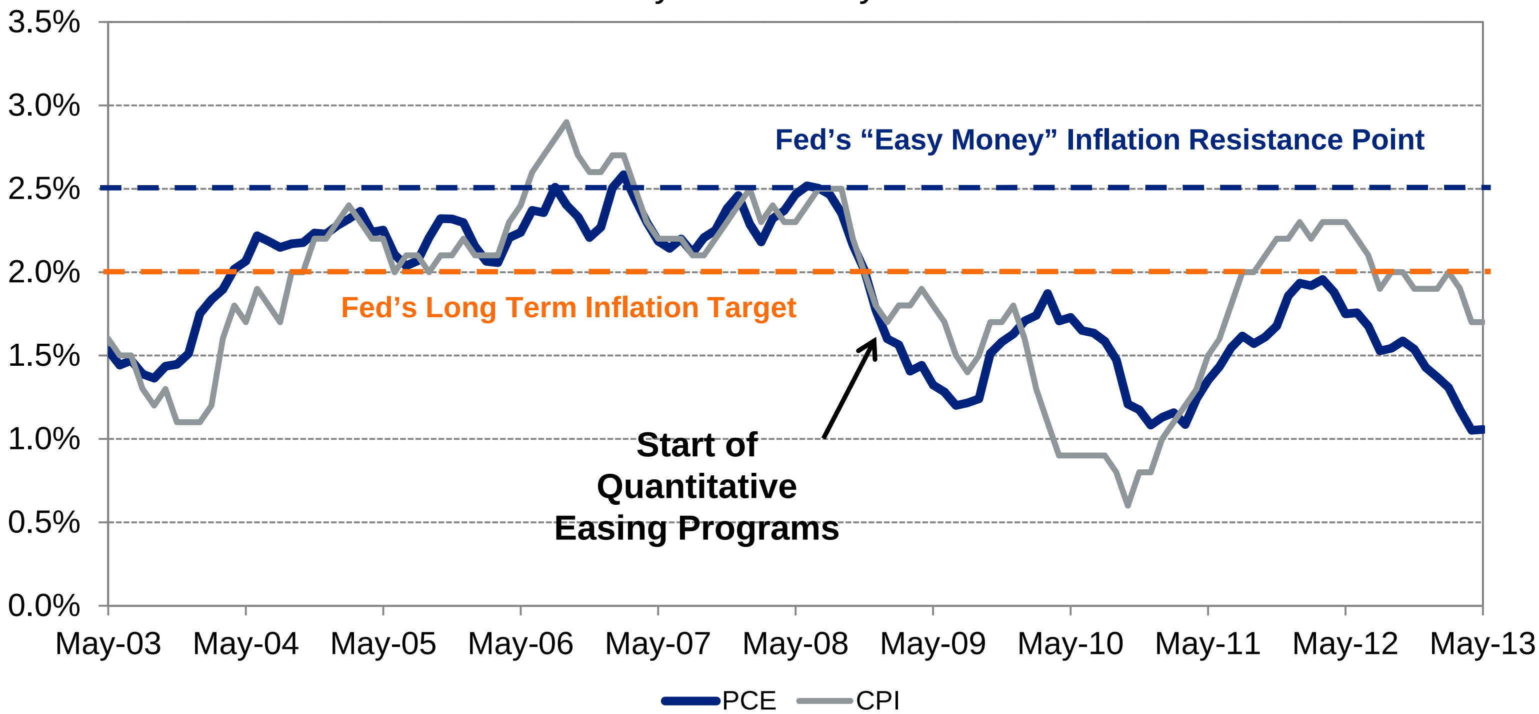


Source: Bloomberg

Inflation Far From Near

- Personal Consumption Expenditures (PCE) and Consumer Price Index (CPI) are the two most commonly utilized measures of inflation. Both readings seem to confirm that inflation is not an imminent concern.
- When considering monetary policy, the FOMC's primary focus is PCE.

PCE and CPI Inflation
May 2003 – May 2013



Source: Bureau of Economic analysis, Bureau of Labor Statistics, Bloomberg.

Attachment 3

First Quarter 2013 Review of Portfolio

City of Los Altos

Investment Performance Review
First Quarter 2013

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Attachment 3

Summary

- In the first quarter of 2013, investors flocked to relatively riskier assets (such as corporate bonds and equities) as loose global monetary policy fueled a search for additional yield.
- The U.S. housing market continued to strengthen, and the unemployment rate fell to 7.6%.
- The domestic economy has continued to experience moderate growth, but some economists believe that the federal budget cuts that went into effect March 1 (also known as the sequestration) may lead to slower growth for the second half of the year.

Economic Snapshot

- Housing starts have averaged more than 900,000 a year in the first quarter, up more than 25% over 2012 but still much lower than in the boom years. Home sales and housing prices are also significantly above recession levels.
- According to the U.S. Commerce Department, consumer spending rose 0.7% in February—a fourth straight increase that was due in part to higher gas prices. Meanwhile, personal income grew by 1.1% in February after a big downturn in the prior month. Both numbers were slightly above expectations.
- U.S. gross domestic product (GDP) grew by 0.4% in the fourth quarter of 2012, while forecasts for first-quarter growth are in the 2%-3% range.
- Euro-zone economies struggled with recession and political uncertainty. The banking crisis in Cyprus, Italy's difficulties creating a new government, and weakness in many European economies pushed the euro lower against the U.S. dollar and supported U.S. Treasury prices. Once again, heightened concerns about the euro zone caused a flight to quality late in the quarter.

Interest Rates

- Interest rates rose modestly during the quarter across longer-term maturities, while the flight to quality stemming from euro-zone fears counteracted the move higher.
- The markets shrugged off the start of the federal budget sequestration as they did the "fiscal cliff" in December, but if the economy feels growing stress from budget cuts in the coming months, interest rates may be pushed toward recent lows.
- The Federal Reserve (Fed) remained committed to keeping short-term rates at record-low levels, pegging short-term rates near zero. The Fed also continued to buy $45 billion in Treasuries each month in addition to its monthly purchases of $40 billion in Agency mortgage-backed securities (MBS).

Sector Performance

- High-quality corporate bonds continued to perform well for the quarter, as spreads narrowed to post-credit-crisis lows. Security selection has been important, as certain corporate sectors (such as Financials) performed particularly well.
- After incurring losses in the fourth quarter of 2012 due to concerns that their tax-exempt status might be curtailed, municipal bonds roared back to life in the first quarter of 2013. These securities, along with corporate bonds, were the top performers for the quarter.
- Supply scarcity and historically tight spreads resulted in Agencies contributing little or no additional performance when compared with similar-maturity Treasuries.
- MBS recovered somewhat after their fourth-quarter underperformance, bolstered by the upturn in housing values and expectations that the Fed's buying program would continue for the foreseeable future.

The views expressed within this material constitute the perspective and judgment of PFM Asset Management LLC (PFMAM) at the time of distribution and are subject to change. Information is obtained from sources generally believed to be reliable and available to the public; however, PFMAM cannot guarantee its accuracy, completeness, or suitability. This material is for general information purposes only and is not intended to provide specific advice or recommendation. The information contained in this report is not an offer to purchase or sell any securities.

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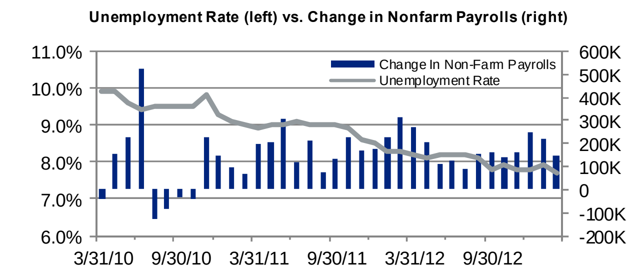
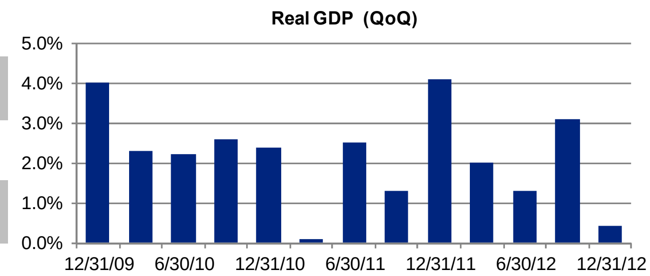
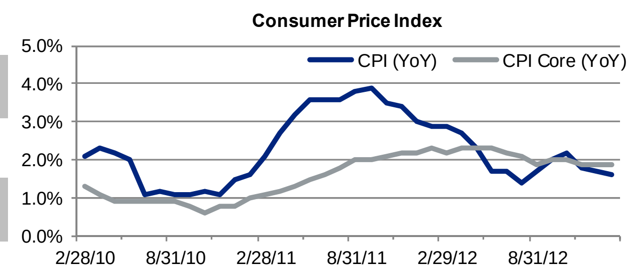
Economic Snapshot

Labor Market		Latest	Dec 2012	Mar 2012
Unemployment Rate	Mar'13	7.6%	7.8%	8.2%
Change In Non-Farm Payrolls	Mar'13	88,000	219,000	205,000
Average Hourly Earnings (YoY)	Mar'13	1.8%	2.1%	2.1%
Personal Income (YoY)	Feb'13	2.6%	7.1%	3.2%
Initial Jobless Claims (week)	Mar 29	385,000	372,000	368,000
Growth				
Real GDP (QoQ SAAR)	2012Q4	0.4%	3.1%[1]	2.0%[2]
GDP Personal Consumption (QoQ SAAR)	2012Q4	1.8%	1.6%[1]	2.4%[2]
Retail Sales (YoY)	Feb'13	4.6%	4.8%	6.3%
ISM Manufacturing Survey (month)	Mar'13	51.3	50.2	53.3
Existing Home Sales (month)	Feb'13	4.98 mil.	4.90 mil.	4.46 mil.
Inflation / Prices				
Personal Consumption Expenditures (YoY)	Feb'13	1.3%	1.5%	2.2%
Consumer Price Index (YoY)	Feb'13	2.0%	1.7%	2.7%
Consumer Price Index Core (YoY)	Feb'13	1.7%	1.3%	2.8%
Crude Oil Futures (WTI, per barrel)	Mar 31	$97.23	$91.82	$103.02
Gold Futures (oz)	Mar 31	$1,595	$1,676	$1,669







1. Data as of Third Quarter 2012 *2. Data as of First Quarter 2012*

Note: YoY = year over year, QoQ = quarter over quarter, SAAR = seasonally adjusted annual rate, WTI = West Texas Intermediate crude oil

Source: Bloomberg

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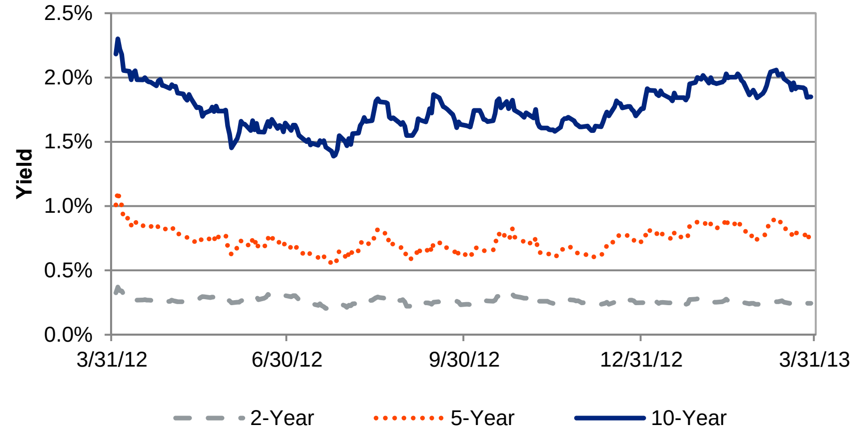
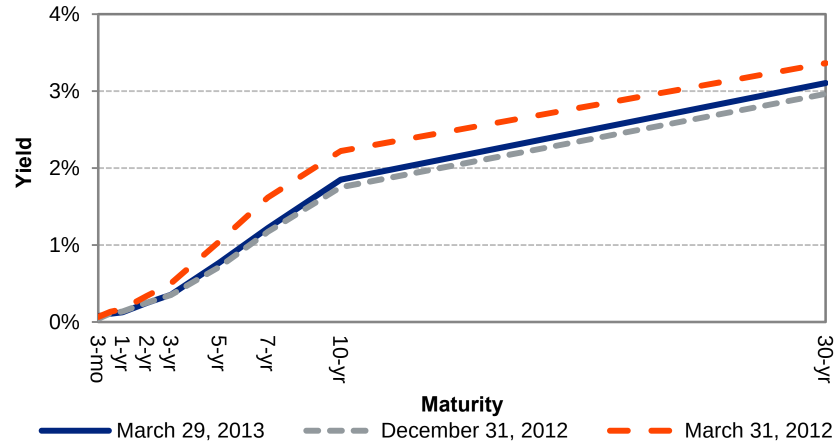
Interest Rate Overview

U.S. Treasury Note Yields



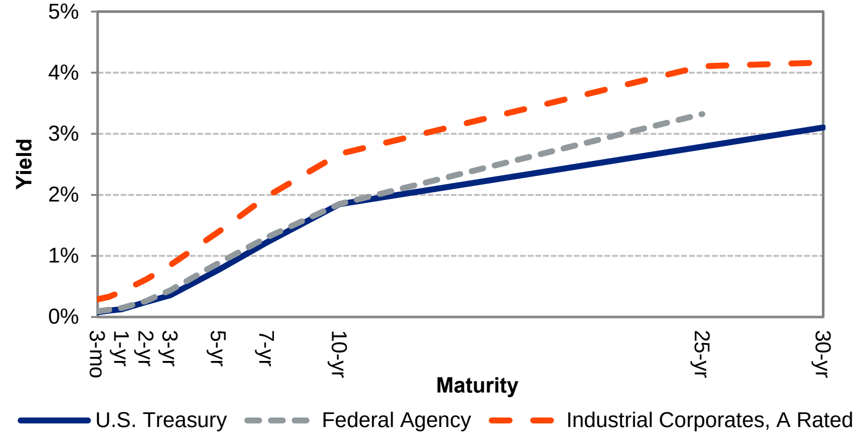
U.S. Treasury Note Yield Curve



U.S. Treasury Yields

Maturity	3/31/13	12/31/12	Change over Quarter	3/31/12	Change over Year
3-month	0.07%	0.09%	(0.02%)	0.11%	(0.04%)
1-year	0.13%	0.14%	(0.01%)	0.22%	(0.09%)
2-year	0.28%	0.27%	0.00%	0.35%	(0.07%)
5-year	0.79%	0.74%	0.05%	1.07%	(0.28%)
10-year	1.93%	1.81%	0.12%	2.28%	(0.35%)
30-year	3.10%	2.94%	0.16%	3.33%	(0.23%)

Yield Curves as of 3/31/2013



Source: Bloomberg

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B of A Merrill Lynch Index Returns

	As of 3/31/2013		Returns for Periods ended 3/31/2013		
	Duration	Yield	3 Month	1 Year	3 Years
1-3 Year Indices					
U.S. Treasury	1.87	0.25%	0.12%	0.64%	1.24%
Federal Agency	1.71	0.32%	0.11%	0.67%	1.37%
U.S. Corporates, A-AAA rated	1.99	0.90%	0.44%	2.75%	2.93%
Agency MBS (0 to 3 years)	1.81	1.29%	0.01%	1.19%	2.84%
Municipals	1.82	0.51%	0.45%	1.05%	1.63%
1-5 Year Indices					
U.S. Treasury	2.73	0.39%	0.15%	1.26%	2.36%
Federal Agency	2.38	0.47%	0.14%	1.19%	2.04%
U.S. Corporates, A-AAA rated	2.86	1.18%	0.58%	4.05%	4.23%
Agency MBS (0 to 5 years)	2.81	1.96%	(0.03%)	1.88%	3.82%
Municipals	2.55	0.71%	0.65%	1.68%	2.48%
Master Indices					
U.S. Treasury	5.95	1.01%	(0.26%)	3.23%	5.41%
Federal Agency	3.82	0.89%	0.05%	2.51%	3.72%
U.S. Corporates, A-AAA rated	6.79	2.39%	(0.18%)	6.88%	7.45%
Agency MBS	3.23	2.02%	(0.07%)	1.91%	4.17%
Municipals	7.51	2.62%	0.52%	5.61%	6.56%

Returns for periods greater than one year are annualized

Source: Bloomberg

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Portfolio Summary

Total Portfolio Value	March 31, 2013
Market Value	**$17,710,576.76**
Amortized Cost	**$17,663,648.80**

PORTFOLIO RECAP

- Interest rates for short maturity Treasuries (3 years or less) barely budged during the quarter as the Federal Reserve's near-zero interest rate policy on overnight lending continued to anchor the front end of the yield curve. Yields on 2-year Treasury Notes started the quarter at 0.25%, fluctuated no higher than 0.29% and no lower than 0.23%, before ending the quarter at 0.24% for a net change of -1 basis point (-0.01%).
- Strong retail sales and housing data initially led to a rise in rates of 20-25 basis points for 5- to-10 year Treasury notes. The 10-year Treasury note breached 2% for the first time in a year. By late March, however, unfolding developments in Europe triggered demand for safe assets and reversed the trend toward higher rates. Five-year Treasury notes, which began the year at 0.72%, climbed as high as 0.91%, but fell back to 0.78% by the end of the quarter.
- Index returns for the first quarter for various 1-3 year sectors were as follows: Treasuries 0.12%, Agencies 0.11%, Corporates (AA or better) 0.35%, Municipals 0.40%, and MBS 0.01%
- Returns for Federal Agency notes essentially mirrored those for Treasuries for the first quarter. Callable Federal Agencies slightly underperformed fixed-maturity bullets (by 3 basis points). The best opportunities to enhance fixed-income returns came from credit spread products, such as municipal bonds and corporate notes.
    - Corporate notes also had a strong quarter, especially those in the single-A rated category. Superior performance came from both higher income and capital appreciation. Since corporate note yields are higher than those of similar maturity Treasuries and Agencies, they produced higher income. At the same time, strong investor demand caused corporate yield spreads to continue to narrow, which led to capital appreciation. That demand reflects, in part, the Federal Reserve's success at pushing investors out of cash and into riskier parts of the capital markets, such as corporates and equities.
- The U.S. Treasury Department announced that it will begin issuing floating rate Treasury notes in November. These notes will have an adjustable coupon (on an as yet unspecified reference interest rate). Floating-rate Treasuries may offer value to investors who seek both a high degree of safety and protection from rising rates.
-

Portfolio Summary

PORTFOLIO STRATEGY

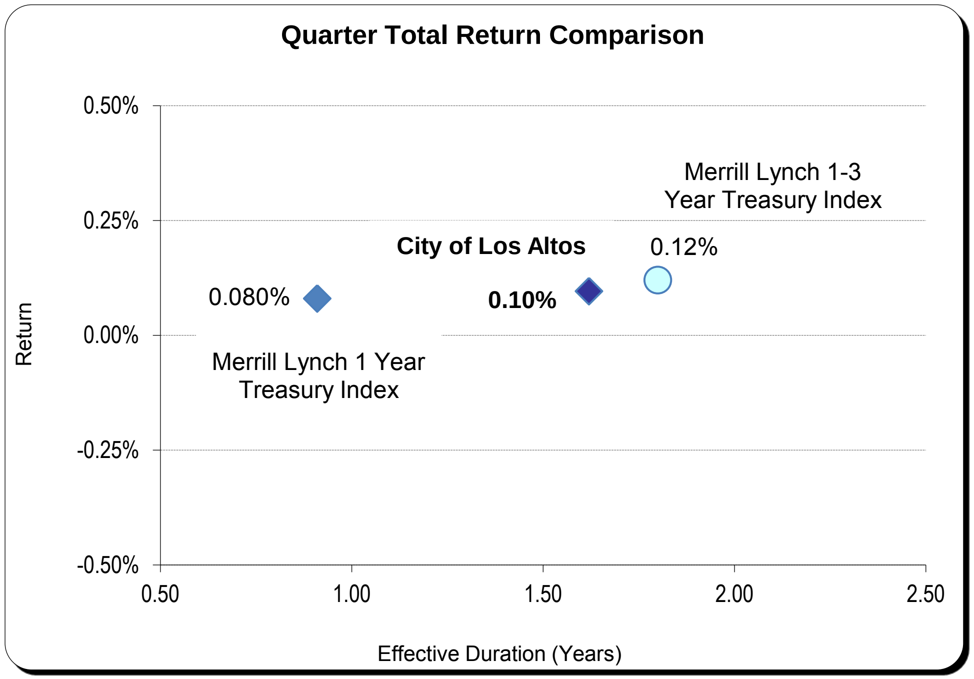
- Since U.S. GDP continues to track below its potential, employment gains are at a level that barely keeps pace with population growth, and inflation remains tame, the Federal Reserve is expected to continue its current posture of accommodative monetary policy, including a continuation of monthly purchases of Treasuries and Federal Agency MBS through 2013.
- U.S. Treasuries are expected to remain in their current yield ranges in the second quarter as they continue to benefit from strong demand from three sources: (1) the Fed's ongoing $45 billion monthly purchase program of longer-term maturities, (2) investors seeking safety from the economic and fiscal problems across much of Europe, and (3) export-oriented countries, particularly those in Asia, that invest foreign-exchange reserves accumulated from their positive balances of trade with the U.S. into U.S. dollar-denominated assets.
- Both Treasuries and Federal Agency securities will continue to benefit from "roll-down" in a stable, range-bound market. (Roll-down is the natural tendency of bonds to appreciate as time passes and their maturity shortens.) Shorter maturities are tethered by the Fed's near-zero interest rate policy, which is expected to remain in place for the foreseeable future. At current, very narrow yield spreads, Federal Agencies offer little value over Treasuries, especially in maturities under 3 years.
- We will continue to add value to the portfolio by combining a bottom-up approach of analyzing the credit characteristics and value of individual issuers and securities, with a top-down approach of capitalizing on macro-level trends in the market and through sector selection that seeks to capture value in all sectors allowed by the City's investment policy.
- Corporate bonds are likely to continue to be the investment of choice for fixed-income investors seeking enhanced return. In particular, yield spreads on the debt of financial companies are still well above their pre-credit-crisis levels and have further room for spread narrowing, which would add to return. Although bank holding companies remain exposed to potential ratings downgrades, increased capital levels, several years of deleveraging, and high cash balances have led to stronger balance sheet fundamentals across much of the corporate landscape.
- With a strengthening economy will come higher tax receipts that should improve the fiscal situation for state and local governments. Governments at all levels are benefiting from today's very low borrowing rates, which has resulted in reduced debt service burdens. Municipal bonds added value in the past quarter, and we intend to continue with our proven strategy of increasing our allocations to the sector through careful issue selection.
- We will continue to focus on safety of principal and appropriate liquidity, while maximizing value through careful, prudent active management. Our strategy will remain flexible and may change in response to changes in interest rates, economic data, market outlook or specific opportunities that arise.

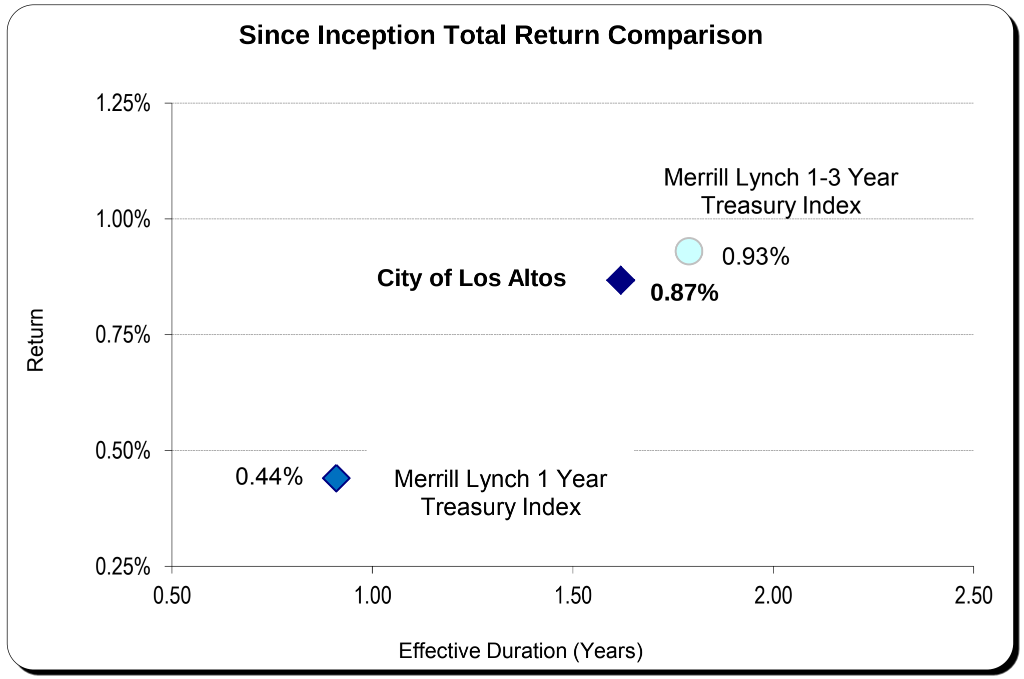
Portfolio Performance

Total Return[1,2,3,4]	Quarter Ended 3/31/2013	Past 12 Months	Past 2 Years	Since Inception
City of Los Altos	**0.10%**	**0.62%**	**0.89%**	**0.87%**
Merrill Lynch 1-3 Year Treasury Index	0.12%	0.64%	1.03%	0.93%
Merrill Lynch 1 Year Treasury Index	0.08%	0.32%	0.36%	0.44%

Effective Duration[4]	March 31, 2013	December 31, 2012
City of Los Altos	**1.62**	**1.48**
Merrill Lynch 1-3 Year Treasury Index	1.79	1.80
Merrill Lynch 1 Year Treasury Index	0.91	0.91

Yields[4]	March 31, 2013	December 31, 2012
Yield on Cost	**0.68%**	0.68%
ML 1-3 Year Yield on Cost	**0.25%**	0.25%





Notes:

1. Performance on trade date basis, gross (i.e., before fees), in accordance with the CFA Institute's Global Investment Performance Standards (GIPS).

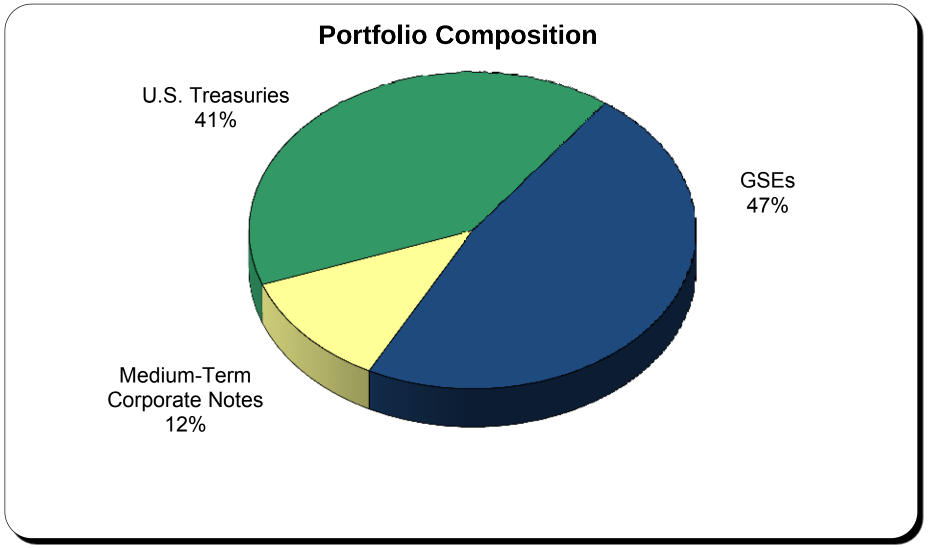
2. Merrill Lynch Indices provided by Bloomberg Financial Markets.

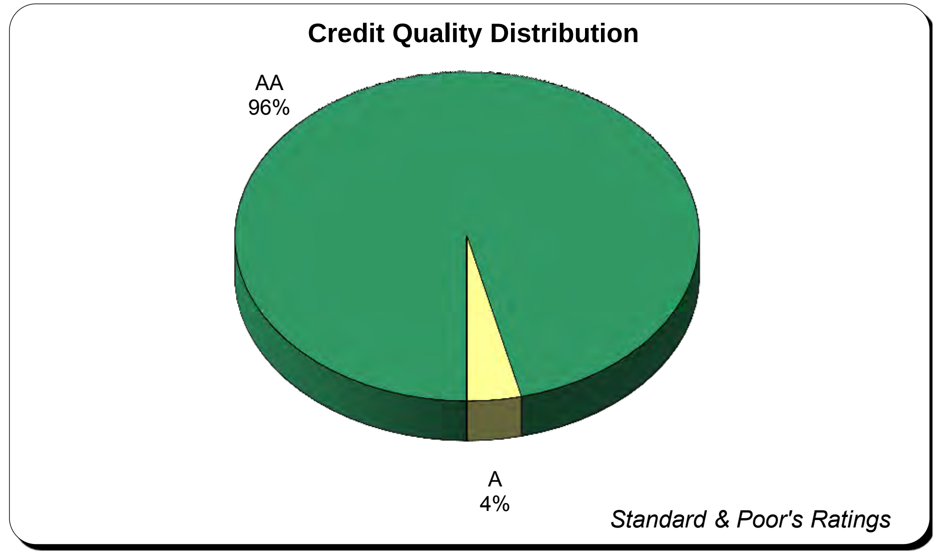
3. Quarterly returns are presented on an unannualized basis. Performance numbers for periods greater than 1 year are presented on an annualized basis.

4. Inception date is 6/30/2010

Portfolio Composition and Credit Quality Characteristics

Security Type[1]	March 31, 2013	% of Portfolio	December 31, 2012	% of Portfolio	Permitted by Policy
U.S. Treasuries	**$7,200,909.69**	**41%**	$7,399,134.71	40.6%	**100%**
Federal Agencies	**$8,424,541.53**	**48%**	$7,933,274.27	45.0%	**100%**
Medium-Term Corporate Notes	**$2,085,125.54**	**12%**	$2,082,589.89	11.4%	**30%**
Money Market Fund	**$0.00**	**<0.1%**	$803,935.65	4.4%	**20%**
Totals	**$17,710,576.76**	**100%**	$18,218,934.52	100.0%	





Notes:

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

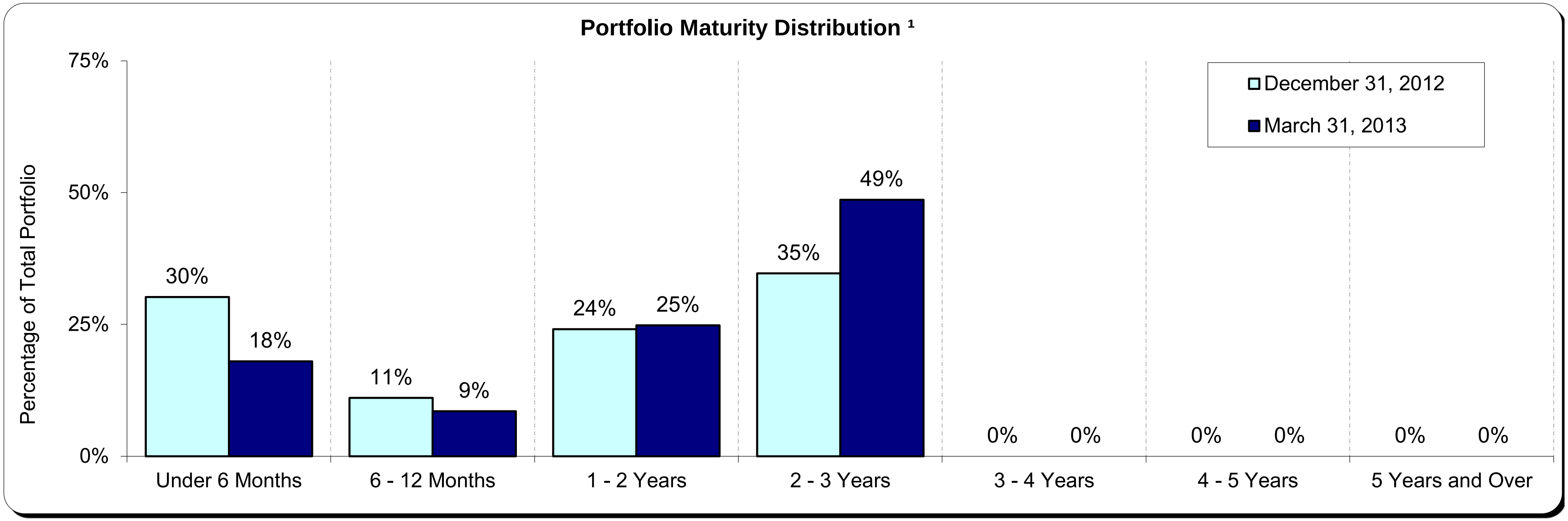
2. Government sponsored enterprises including, but not limited to Fannie Mae, Freddie Mac, Federal Home Loan Bank system and Federal Farm Credit Banks.

3. Debt guaranteed under the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program and backed by the full faith and credit of the United States.

4. Excludes LAIF

Portfolio Maturity Distribution

Maturity Distribution[1]	March 31, 2013	December 31, 2012
Under 6 Months	**$3,190,111.15**	$5,502,622.55
6 - 12 Months	**$1,508,101.02**	$2,010,192.56
1 - 2 Years	**$4,395,926.59**	$4,391,798.95
2 - 3 Years	**$8,616,438.00**	$6,314,320.46
3 - 4 Years	**$0.00**	$0.00
4 - 5 Years	**$0.00**	$0.00
5 Years and Over	**$0.00**	$0.00
Totals	**$17,710,576.76**	$18,218,934.52



Notes:

1. Callable securities, if any, in portfolio are included in the maturity distribution analysis to their stated maturity date, although they may be called prior to maturity.

2. Excludes LAIF

Managed Account Detail of Securities Held

CITY OF LOS ALTOS INVESTMENT PORTFOLIO

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 06/15/2010 1.125% 06/15/2013	912828NH9	500,000.00	AA+	Aaa	04/07/11	04/08/11	502,031.25	0.94	1,653.50	500,193.05	501,054.50
US TREASURY NOTES DTD 09/15/2010 0.750% 09/15/2013	912828NY2	500,000.00	AA+	Aaa	04/07/11	04/08/11	496,289.06	1.06	173.23	499,301.36	501,426.00
US TREASURY NOTES DTD 10/15/2010 0.500% 10/15/2013	912828PB0	750,000.00	AA+	Aaa	04/07/11	04/08/11	738,808.59	1.10	1,730.77	747,582.32	751,552.50
US TREASURY NOTES DTD 12/15/2010 0.750% 12/15/2013	912828PL8	750,000.00	AA+	Aaa	04/07/11	04/08/11	741,328.13	1.19	1,653.50	747,696.08	753,164.25
US TREASURY NOTES DTD 10/17/2011 0.500% 10/15/2014	912828RL6	1,700,000.00	AA+	Aaa	03/23/12	03/26/12	1,700,531.25	0.49	3,923.08	1,700,321.01	1,707,172.30
US TREASURY NOTES DTD 12/31/2009 2.625% 12/31/2014	912828ME7	1,600,000.00	AA+	Aaa	03/23/12	03/26/12	1,691,937.50	0.53	10,558.01	1,658,323.38	1,666,563.20
US TREASURY N/B DTD 07/16/2012 0.250% 07/15/2015	912828TD2	1,000,000.00	AA+	Aaa	08/20/12	08/22/12	995,625.00	0.40	524.86	996,537.42	999,219.00
US TREASURY NOTES DTD 01/15/2013 0.375% 01/15/2016	912828UG3	300,000.00	AA+	Aaa	01/15/13	01/17/13	300,128.91	0.36	236.19	300,120.15	300,304.80
Security Type Sub-Total		**7,100,000.00**					**7,166,679.69**	**0.69**	**20,453.14**	**7,150,074.77**	**7,180,456.55**
Federal Agency Bond / Note											
FNMA GLOBAL NOTES DTD 05/21/2010 1.500% 06/26/2013	31398AT44	750,000.00	AA+	Aaa	11/17/10	11/19/10	763,807.50	0.78	2,968.75	751,263.04	752,517.75
FEDERAL FARM CREDIT BANK BONDS DTD 11/10/2011 0.600% 11/10/2014	31331KQ86	1,000,000.00	AA+	Aaa	11/14/11	11/16/11	998,030.00	0.67	2,350.00	998,933.28	1,005,360.00
FANNIE MAE GLOBAL NOTES DTD 05/21/2012 0.500% 07/02/2015	3135G0LN1	900,000.00	AA+	Aaa	05/24/12	05/25/12	896,958.00	0.61	1,112.50	897,785.44	902,793.60
FNMA NOTES (CALLABLE) DTD 08/07/2012 0.500% 08/07/2015	3135G0NG4	1,150,000.00	AA+	Aaa	08/06/12	08/08/12	1,149,712.50	0.51	862.50	1,149,774.24	1,149,956.30
FANNIE MAE (CALLABLE) NOTES DTD 08/27/2012 0.520% 08/27/2015	3135G0NS8	1,000,000.00	AA+	Aaa	08/20/12	08/27/12	999,650.00	0.53	491.11	999,718.92	1,000,915.00

Managed Account Detail of Securities Held

CITY OF LOS ALTOS INVESTMENT PORTFOLIO

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											
FEDERAL FARM CREDIT BANK BONDS DTD 12/27/2012 0.430% 11/16/2015	3133ECBJ2	1,600,000.00	AA+	Aaa	12/19/12	12/27/12	1,599,264.00	0.45	1,796.44	1,599,329.82	1,600,912.00
FANNIE MAE GLOBAL NOTES DTD 11/16/2012 0.375% 12/21/2015	3135G0SB0	750,000.00	AA+	Aaa	01/15/13	01/17/13	749,415.00	0.40	781.25	749,455.94	749,113.50
FEDERAL FARM CREDIT BANK BONDS DTD 12/28/2012 0.440% 12/28/2015	3133ECBD5	1,250,000.00	AA+	Aaa	01/15/13	01/17/13	1,251,122.50	0.41	1,420.83	1,251,044.71	1,251,190.00
Security Type Sub-Total		**8,400,000.00**					**8,407,959.50**	**0.53**	**11,783.38**	**8,397,305.39**	**8,412,758.15**
Corporate Note											
BANK OF NEW YORK MELLON GLOBAL NOTES DTD 03/27/2008 4.500% 04/01/2013	06406HBJ7	650,000.00	A+	Aa3	11/17/10	11/19/10	701,018.50	1.13	14,625.00	650,000.00	650,000.00
WAL MART STORES INC GLOBAL NOTES DTD 04/15/2008 4.250% 04/15/2013	931142CL5	750,000.00	AA	Aa2	11/17/10	11/19/10	809,482.50	0.91	14,697.92	750,970.03	750,994.50
GENERAL ELECTRIC CO NOTES DTD 10/09/2012 0.850% 10/09/2015	369604BE2	650,000.00	AA+	Aa3	10/19/12	10/24/12	651,287.00	0.78	2,639.72	651,099.45	652,168.40
Security Type Sub-Total		**2,050,000.00**					**2,161,788.00**	**0.94**	**31,962.64**	**2,052,069.48**	**2,053,162.90**
Managed Account Sub-Total		**17,550,000.00**					**17,736,427.19**	**0.64**	**64,199.16**	**17,599,449.64**	**17,646,377.60**
Securities Sub-Total		**$17,550,000.00**					**$17,736,427.19**	**0.64%**	**$64,199.16**	**$17,599,449.64**	**$17,646,377.60**
Accrued Interest											**$64,199.16**
Total Investments											**$17,710,576.76**