Economic Update & Investment Options: 
The New Normal

September 29, 2010

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Economic Growth Sluggish

- Second quarter GDP was revised downward to a 1.6% annualized rate from the prior estimate of 2.4%. The revision was primarily due to a wider trade deficit and a smaller gain in inventories. Business investment and consumer spending remained level.

Gross Domestic Product Growth
First Quarter 2005 – Second Quarter 2010

Source: U.S. Department of Commerce – Bureau of Economic Analysis and Bloomberg Survey of Economists median forecasts
The Federal Open Market Committee has repeatedly stated that it will keep short-term rates low “for an extended period” of time.

After the end of the previous two recessions it took 2.6 years on average before the Fed started to increase the Federal Funds target rate. In the year following the first increase, the Fed raised its target rate an average of 2.50%.

Source: Bloomberg
Non-Farm Payrolls Decline, But Exceed Expectations

- Non-farm payrolls dropped by 54,000 in August, exceeding expectations for a 90,000 decrease. Private payrolls were a positive surprise as well, jumping up 67,000 instead of the anticipated 40,000.

Source: Bloomberg
Interest Rates Remain Near Historic Lows

- During the current year, yields have plunged to historic lows, with the 2-year U.S Treasury yield recently falling as far as 0.45%
  - Since January, 2-year Treasury yields have fluctuated between 1.18% and 0.47%

### 2-Year U.S. Treasury Yields
January 1, 2000 – September 15, 2010

Source: Bloomberg
Interest Rate Forecasts Vary Widely

- Economists’ forecasts for interest rates vary widely due to the uncertain nature of the economy

Source: Bloomberg
Treasury Yields Near All-Time Lows; Best Relative Value in Intermediate-Term Maturities

U.S. Treasury Yield Curve
High, Low, Average & Current
September 15, 2000 – September 15, 2010

Source: Bloomberg
Yield Curve is Steep

- The spread between 2 and 10-year Treasury Notes has been near historic highs for the past several months

Source: Bloomberg
Steep Yield Curve Presents Investment Opportunities

- Longer-term investments are attractive because of the steep yield curve, which provides the following benefits:
  - Additional yield
  - Potential for market value appreciation as investments “roll down the yield curve”

### U.S. Treasury Yield Curve

<table>
<thead>
<tr>
<th>Maturity</th>
<th>9/15/2009</th>
<th>9/15/2010</th>
<th>Change Over Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 month</td>
<td>0.13%</td>
<td>0.14%</td>
<td>+0.01%</td>
</tr>
<tr>
<td>6 month</td>
<td>0.20%</td>
<td>0.18%</td>
<td>-0.02%</td>
</tr>
<tr>
<td>1 year</td>
<td>0.36%</td>
<td>0.23%</td>
<td>-0.13%</td>
</tr>
<tr>
<td>2 year</td>
<td>0.94%</td>
<td>0.47%</td>
<td>-0.47%</td>
</tr>
<tr>
<td>3 year</td>
<td>1.50%</td>
<td>0.74%</td>
<td>-0.76%</td>
</tr>
<tr>
<td>5 year</td>
<td>2.40%</td>
<td>1.40%</td>
<td>-1.00%</td>
</tr>
<tr>
<td>10 year</td>
<td>3.45%</td>
<td>2.67%</td>
<td>-0.78%</td>
</tr>
<tr>
<td>30 year</td>
<td>4.27%</td>
<td>3.82%</td>
<td>-0.45%</td>
</tr>
</tbody>
</table>

Source: Bloomberg
Longer-Term Portfolios Outperform Over Time

- A recommended strategy realizes higher returns while meeting cash flow and liquidity needs

<table>
<thead>
<tr>
<th>Merrill Lynch Index</th>
<th>Duration</th>
<th>Overall Return</th>
<th>Cumulative Value of $12,000,000</th>
<th>Quarters With Negative Returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>3-Month Treasury Bill</td>
<td>0.25</td>
<td>2.69%</td>
<td>$15,655,385</td>
<td>0 out of 40</td>
</tr>
<tr>
<td>6-Month Treasury Bill</td>
<td>0.48</td>
<td>3.10%</td>
<td>$16,285,839</td>
<td>0 out of 40</td>
</tr>
<tr>
<td>1 Year Treasury Index</td>
<td>0.99</td>
<td>3.53%</td>
<td>$16,985,509</td>
<td>3 out of 40</td>
</tr>
<tr>
<td><strong>1-3 Year Treasury Index</strong></td>
<td><strong>1.89</strong></td>
<td><strong>4.36%</strong></td>
<td><strong>$18,398,120</strong></td>
<td><strong>4 out of 40</strong></td>
</tr>
<tr>
<td>1-5 Year Treasury Index</td>
<td>2.63</td>
<td>4.96%</td>
<td>$19,476,805</td>
<td>10 out of 40</td>
</tr>
<tr>
<td>3-5 Year Treasury Index</td>
<td>3.85</td>
<td>6.12%</td>
<td>$21,745,366</td>
<td>14 out of 40</td>
</tr>
<tr>
<td>1-10 Year Treasury Index</td>
<td>3.98</td>
<td>5.56%</td>
<td>$20,625,839</td>
<td>11 out of 40</td>
</tr>
</tbody>
</table>

*Source: Bloomberg – Merrill Lynch Global Indices*
Recent Federal Reserve Activity

• Research paper released on July 29th:
  – In his research paper, St. Louis Federal Reserve President James Bullard states that “quantitative easing program offers the best tool to avoid a Japanese-style, deflationary outcome within the next several years

• August 10th FOMC statement:
  – The Federal Open Market Committee stated that economic data released since its June meeting showed that the pace of recovery for the jobs and the economy has slowed. The FOMC re-stated its pledge to maintain the Federal Funds target rate between 0.00% and 0.25% for “an extended period.”

• Chairman Bernanke at the Jackson Hole Symposium on August 27th:
  – “For a sustained expansion to take hold, growth in...consumer spending and business fixed investment must ultimately take the lead...that critical handoff appears to be under way.”
  – The prospects for household spending depend to a significant extent on how the jobs situation evolves.”

• September 21st FOMC statement:
  – The Federal Reserve states that it is willing to ease monetary policy further to spur growth and support prices while refraining from expanding its holdings of securities
Fed Funds Target Remains 0.00% – 0.25%

- While Fed easing remains, the recent uptick in some money market rates provides opportunities
  - Effective Fed Funds rate is about 20 basis points (0.20%)
  - LIBOR rates have fallen after sharp rise
  - Market expects no increase in Fed Funds until the end of 2011 or later

Source: Bloomberg
Money Market & Repo Rates Have Improved Modestly

- Rates are 5 – 10 basis points higher than at year-end
- Longer-maturity Commercial Paper and negotiable CDs have some relative value

Source: Bloomberg
U.S. Equity Markets

- Domestic stocks are little changed on the year after April's peak
- Strong corporate earnings have supported higher valuations throughout the year

Source: Bloomberg
Indicative Investment Rates – Money Markets

**Historical Monthly Yields**

- **PFM Funds - Prime Series**
- **Illinois Funds MM Fund**
- **ISDLAF+ Liquid Class**
- **ISDLAF+ MAX Class**

*Source: Bloomberg*
Indicative Investment Rates – Short Term

Short-Term Investment Comparisons
(as of 9/22/10)

Source: Bloomberg
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