OFFICE OF THE TREASURER-TAX COLLECTOR

HALL OF FINANCE & RECORDS
12 CIVIC CENTER PLAZA, SUITE G76
POST OFFICE BOX 4515
SANTA ANA, CA 92701
http://tax.ocgov.com/treas/

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TO: Board of Supervisors
Thomas G. Mauk, County Executive Officer
Treasury Oversight Committee
Treasurer's Advisory Committee
Participants

FROM: John M. W. Moorlach, C.P.A., CFP®
Treasurer-Tax Collector

SUBJECT: Treasurer's Management Report for January 31, 2005

Attached please find the Treasurer's Management Report for the County of Orange for the month and quarter ended January 31, 2005. The information provided herein, including all charts, tables, graphs and numerical representations, is provided to readers solely as a general overview of the economic and market conditions which the Treasurer utilizes in making investment decisions. In addition, a complete version of this report is also available for download at our website **http://tax.ocgov.com/treas/**

TREASURER'S REPORT

In order to assist you in reading this report, please note that the current balances reflect the investments recorded in the portfolios for each particular fund for the period ending January 31. Each money market fund has an average maturity of less than ninety days, with a net asset value (NAV) falling within the range of $0.9950 and $1.0050. The extended fund will have an average maturity of up to 549 days and a fluctuating NAV. All investments are marked to the market at the end of the reporting period due to the narrow valuation range prescribed by the Pools' Investment Policy Statement.

The reports reflect the par value (face value), the book value (cost to the County of the investment) and market value (the price of each security at the close of the market on the last trading day of the month). Market values are derived from the Bloomberg Professional Service, a premier provider of instant access to real-time and historical financial data. The difference between the market value and book value is the unrealized gain or (loss). The Detail Transaction Report Section is provided in compliance with California Government Code Section 53607, which requires that the Treasurer file such a report with the Board of Supervisors, from whom his investment authority has been delegated.

APPORTIONMENT OF COMMINGLED POOL INTEREST EARNINGS

We have prepared a forecast for the timing of the County Pool's December 2004 and January 2005 interest apportionments. We anticipate posting the December 2004 and January 2005 interest apportionments to participants' cash accounts in the County general ledger by approximately February 22 and March 17, 2005 respectively.

CREDIT WATCH NEGATIVE AND APPROVED ELIGIBILITY LIST

In the month of January, there was one change to the Treasurer's approved eligibility list:

1) **Gillette Company** was deleted

TRACS FINANCIAL REPORT REVIEW

On August 30, 2004 Jeffery Flynn, of TRACS Financial LLC, released a thorough report on how money is managed by municipalities around the country, titled "A Review of State and Local Government Investment Pools."

It was a candid review of how states manage their investment pools and the factors that affect their yields. There was a "wide disparity of yields. Differences can exist either because of the rating or non rating of a pool which dictates different maturity parameters (amongst other factors), by the composition of the portfolio which may have riskier securities than others, and of course the fee structure which is taken right off the top of the portfolio yield."

Orange County is rated by two of the three major rating agencies. With these ratings comes a more restrictive range of investment strategies. We have a traditional money market composition in our portfolio, as can be seen by the accompanying graphs in this report. And we have a relatively low expense ratio, which was reduced by ten percent effective January 1 of this year.

How did Orange County stack up? As of July 31, 2004, if we were a rated state pool, we would have tied for second place with our net yield of 1.27%. Only one state had a better yield, utilizing similar investment strategies, than our county. "The average yield for rated State Pools is 1.19%." Consequently, we were in the benchmark range and added 8 basis points of value. For an average balance of $5 billion, this means we earned an additional $4 million in interest revenue.

The report also reviewed Local Government Investment Pools (LGIPs). These are investment pools available to municipalities in a state that are not managed by the State Treasurer. California has several of these available alternatives. "The average yield for rated LGIPs comes in at 1.04%."

Put in another manner, had we turned over our investment responsibilities to an outside LGIP, it would have resulted in a 23 basis point lost opportunity cost, or $11.5 million annually. Accordingly, it is very easy to claim that our department pays for itself.

A most interesting conclusion in the report mirrors the Treasurer's philosophy. "We remain steadfast that rated funds and pools offer the greatest degree of safety because it requires adherence to the 90 day maturity provisions."

AUTHORIZATION TO TRADE

As a result of our recent reorganization, we have added three managers to our "Authorization to Trade Letter" which is a directive sent to all broker/dealers with whom we trade. The additions are: Gary Cowan, Assistant Treasurer-Tax Collector; Paul Gorman, Deputy Treasurer; John Byerly, Assistant Financial Analyst. We anticipate that all investment trading will continue to be transacted by Judy Jacobson (Investment Officer), Paul Cocking (Assistant Investment Officer), or Julia Xue (Financial Analyst.). John Moorlach continues to be authorized to trade, but has not transacted a trade, nor plans to except for an emergency, due to internal control concerns."

ECONOMIC OBSERVATIONS

There actually used to be a certain amount of suspense heading into the next meeting of the Federal Open Market Committee (FOMC). But those days are long gone. As expected, the FOMC continued to remove the accommodative monetary policy (historically low interest rates) by raising interest rates another 25 basis points on February 2, 2005.

In this "steady as she goes" environment, the data flow has become almost boring—an endless mix of upside and downside surprises that aren't large enough or consistent enough to mean anything.

Lately, the mix has tilted to the soft side. For example:

- Several Purchasing Managers' surveys edged down.
- Consumer spending indicators were soft.
- Vehicle sales fell sharply.
- January's new jobs growth was below expectations.
- Consumer Confidence has started to wane.
- Largest trade deficit on record.
- The gross domestic product for the 4th quarter dropped to 3.1%.
- Productivity has slowed more than expected.

The last bullet holds the insight that may be the dominant theme. Lower productivity results in higher unit labor costs. The FOMC is concerned that any up trend in costs may exert upward pressure on inflation. Accordingly, the FOMC is prepared to maintain its "measured" path of rate increases for quite some time. Both the Treasurer's Investment Committee and the financial markets are mindful of this possibility.

INTEREST RATE PROJECTION

The Treasurer's Investment Committee is maintaining a 2.0 percent interest forecast for fiscal 2004-2005.

Please call if you have any questions.