MINUTES OF THE INVESTMENT ADVISORY COMMITTEE
February 17, 2004

I. CALL TO ORDER AND ROLL CALL

Chair Brown called the Investment Advisory Committee Meeting of February 17, 2004 to order at 1:30 p.m. in the Town Council Chambers. In attendance were: Chair Stephen L. Brown, Dr. Michael Andrews, Edward L. Hennessy, Jr., Jane Skittone, Finance Director, Cheryl Somers, Assistant Finance Director, and Betty Cotton, Finance Secretary.

Also present for a portion of the meeting were: Greg Coleman with Atlanta Capital Management Company, Darlene Malaney and Carol Whitaker with The Florida League of Cities.

II. PLEDGE OF ALLEGIANCE

Chair Brown led the pledge of allegiance.

III. APPROVAL OF AGENDA

Mr. Hennessey moved to approve the agenda, Dr. Andrews seconded, motion carried.

IV. COMMUNICATIONS FROM CITIZENS (3 MINUTE LIMIT PLEASE)

No citizens attended.

V. APPROVAL OF MINUTES FROM DECEMBER 15, 2003 MEETING

Chair Brown had some comments on the minutes. On page 2 in the first paragraph, "From October to November, the balance for that year to date was a negative $90,000 or 3.3% which would be $104,269 for the Florida League of Cities investment for that time period that it's been invested in." He could not understand that sentence.

Ms. Skittone said she thinks the $90,000 came from October. The Florida League of Cities had a negative $119,000 and then in November had a positive $28,000 which would make for a negative $90,000.

Chair Brown asked what is the $104,000 then? How does negative $90,000 get to be $104,000?

Ms. Skittone said in the month of November, the total was around $104,000. She can't remember what we were talking about at the time but the total monthly earnings for the month of November was $103,544.

Dr. Andrews said he thought the discussion was about two sets of financials at that particular point of time.

Ms. Skittone said right, we had one through September and we had one for October and November.

Chair Brown said he doesn't think it matters a great deal but if somebody could take a look at that and see if that could be rationalized a little bit. On page 12 of the minutes, in the fourth paragraph, the word "prereserves" should be reserves. And on page 26, in the third paragraph, "In his own company, they used swaps ***extensively*** not excessively…"

He asked if anyone else had any comments on the minutes? If not, he asked for motion to approve them with the adjustments?

Mr. Hennessey moved to approved, Dr. Andrews seconded, motion passed.

VI. STATUS REPORT REGARDING INVESTMENT RETURNS THROUGH JANUARY 31, 2004 AND ADDITIONAL INVESTMENT REPORTING INFORMATION

Chair Brown asked Ms. Skittone and Ms. Somers to lead this discussion.

Ms. Skittone said these are the reports that they included in the packet and that Ms. Somers just handed out. In the report titled Investment Balances/Income as of January 31, 2004, as you noticed earlier, we had $115,000,000 in total investments. As of the end of January, the total earnings for the fiscal year to date are $532,184. In the report titled FMIvT Net Total Return, the net total return from inception of the Florida Municipal Investment Trust is $403,458 with a blended year to date return through December of 2.07%. When you compare that with the SBA, the blended annualized year to date return for the SBA would have been 1.36%. The footnote at the bottom Life-to-Date through January 04 shows that the Florida Municipal Investment Trust generated $180,241 in income over the SBA. If we had left all our money in the SBA, we would have had $180,000 less than we now have.

Chair Brown asked does everyone follow those numbers? These are very helpful numbers and they do bring clarity to the policy and the comparison. He said the committee, Dr. Andrews in particular, had suggested the need for rates of return and dollar differences, etc. He thinks this does the job. It doesn't do it through January because all the numbers needed are not available yet. It's pretty clear January was a good month and would have improved, if anything, the comparative results. He asked Ms. Skittone if she would agree with that?

Ms. Skittone replied yes.

Ms. Skittone stated the other report included in their package was a list of all the participants and their balances by portfolio.

Chair Brown asked if that was the original package that was sent out?

Ms. Skittone said correct. That was through December 31. Then, in the 1 – 3 year bond fund, the Town of Palm Beach through December had 10.83% invested of the total. In the high quality bond fund, we had 3.49%. Those percentages will have changed because we did make additional distributions to this fund in January and there is one more in February to make for those additional monies.

Chair Brown asked if anyone on the committee had any concern about the percentage in each of these two funds?

Dr. Andrews said we end up as number three in scale in both funds. One of the things he does not have real good clarity on is the FMIT Insurance Trust. If you would take that out, our numbers kind of go up quite a bit. He did some rough calculations and it looks like we have about 5.3% of the total amount of money in both funds. He is concerned if we go over the 5%. He doesn't know if we need to look for additional investments. What percentage of the fund do we feel most comfortable with? He thinks that is something we should address.

Ms. Skittone said we did discuss that very early on but we didn't really come to any conclusions at the time on what our limit should be.

Dr. Andrews said if we added more money, we obviously are going to be above the 5%. He suggested asking our guests for clarity on what that insurance trust is because that has so much of the money. What is that?

Darlene Malaney said the League of Cities administers several trusts. Actually, the investment trust that you are in was established originally for investment of this insurance trust. The League of Cities operates almost like an independent insurance company out of Orlando and we provide insurance to all the cities in Florida. All cities are eligible to participate in our program. So that's really our largest program that helps the League do the things it does on behalf of the cities. That's the large number that you see there.

FMIvT is Florida Municipal Investment Insurance Trust. Sometimes you will also see, depending on where the market is, another acronym, FMLC, Florida Municipal Loan Council. We have a large amount in our bond proceeds and from time to time, we administer a bond program. We've issued over 500 million in debt. Currently all the bond proceeds that we manage on behalf of cities through that program are in another portfolio through the FMIT in a cash fund very similar to the SBA. Bond proceeds need to be very conservative and shorter term investments, so when the bond market started to go down over the summer, all that money was moved into the enhanced capital portfolio. We are starting to recommend that cities that have draw schedules, if they don't need money for twelve months out to the three years, that money is going to start showing in this 1 – 3 year bond portfolio. So your percentages will once again go down as far as the overall percentage of the fund because we have about 260 million in bond proceeds right now. We issue about 50 million twice a year. We manage that money until the cities spend it down. So your percentages in there will fluctuate. A large part of that bond proceeds money is in the 1 – 3 year bond portfolio. The intermediate portfolio kind of stays the same unless we have new members come in but your fluctuation and percentages will change or your percentage will fluctuate in that 1 – 3 year. Does that help?

Dr. Andrews said you mentioned that there are a number of cities that are in your trust? Are they duplicates of some of the cities?

Ms. Malaney said some of them are. A lot of cities use a number of our programs. So really through the overall investment trust, you are only seeing two of our eight portfolios here. We also manage pension money and we do define benefit plans that are administered through our longer term bond fund. So there's a lot of cities indirectly through the leagues programs, our insurance trust, our loan program, and our pension program, that have balances in the FMIvT as a whole. So you may not see their names spelled out directly but indirectly there's a lot of cities in there. On the loan program, we've done over fifty cities. In the FMIvT, we have hundreds of cities under the insurance trust.

Dr. Andrews said that to me would represent fairly stable money?

Ms. Malaney replied yes.

He was concerned if that money could go in and out. The other trust that you mentioned because it's shorter term money could go in and out and that's not showing in these numbers.

Ms. Malaney said right. In the cash fund, definitely, that money is going in and out because it's a really short term portfolio. In the 1 – 3 year based on moves in the market, people may be changing their outside allocation but for the most part, these two funds don't fluctuate a whole lot. They've grown a lot recently and as our bond program has been more and more successful, these funds are growing rapidly. But the money is not going to fluctuate in these two funds near as much as they would in our cash portfolio, definitely not our insurance trust and definitely not our pension trust which are not in these two portfolios. Those are long term investments for them and they're not moving money in and out of there very often.

Dr. Andrews asked so you have other municipalities that are using 1 – 3 high quality bond funds as a short term money market fund like the SBA?

Ms. Malaney said no sir. We have a portfolio that's not listed here that is a cash fund. It's a new fund actually since you came in, it opened in April of last year. It's the enhanced cash portfolio. Prior to last summer, we had a lot of bond proceeds in the 1 – 3 year. When you came in the fund, your percentage was probably down at that time compared to what it is now. When the bond market was getting a little more volatile over the summer, we moved a lot of the bond money that was in the 1 – 3 year that you're in into our new cash fund. We are about to start moving some of that money back.

Dr. Andrews asked if it would behoove the Town of Palm Beach to look at your short term fund as an alternative to the SBA? He said he does not know what the rates are.

Ms. Malaney said their rates now are right on top of the SBA as of Friday, the daily rate on the SBA was 1.16 on a 30 day average, we've trailed them a little bit recently. The benefits would be diversification. It is a AAA rated fund, the SBA is not. The portfolio is also not managed for daily cash like the SBA. We allow redemptions twice a month in that fund. The manager on that fund is Bank of America. That fund was originally established for the State Treasurer's Office. They were looking for an alternative to the SBA, looking for something where they can go out a little bit further than the SBA saying that maybe instead of about 90 days, we have the ability to go out 120 days. It's an institutional fund meaning that the majority of cities in Florida don't have the assets backing them up to access that fund on their own. We are allowing cities into an institutional fund based on economies of scale. I didn't bring a lot of information about the dynamics of that fund but I can provide that. If you would like to speak with the investment manager, we can do that as well.

Dr. Andrews said he didn't know if the League would be interested in the Town looking at that?

Ms. Skittone said it's an option but up until this point, they have trailed the SBA so we didn't.

Dr. Andrews said he was not aware of that.

Ms. Malaney said historically since we've opened the fund, because we are like a member of their fund, since we've allowed it to the cities, it has slightly trailed in a rising and more normal rate environment because it has been around longer than we've been in it. The underlying fund managed by Bank of America has had a positive over the SBA upwards of 30 basis points in a more normal rate environment than we've been in.

Chair Brown said certainly another thing a future committee would have to look at if it considered that would be the fact that we have already put a fair amount of money out with your 1 – 3 year intermediate funds which do not have instant liquidity and the SBA does. It's probably worthwhile that some portion of our assets have instant liquidity.

Ms. Malaney encouraged that the Town keep money needed daily in the SBA. Really their enhanced cash is between the SBA and the 1 – 3 year in a way because it's not managed for daily liquidity. The managers know that and they can make a little bit longer investments and just eke out that little bit more basis points here and there.

Chair Brown thanked Ms. Malaney and asked Dr. Andrews if that is okay in answer to his question.

Dr. Andrews said that's fine. He was just concerned about adding a percentage in 1 – 3 of 10% since that has never been addressed by the committee. Maybe that is something to look at in the future if that number fluctuates. How often do we get these particular numbers?

Ms. Malaney said they can provide them monthly.

Chair Brown said the committee might as well look at them.

Chair Brown thanked Ms. Malaney.

Chair Brown asked Ms. Skittone and Ms. Somers if they had more to report.

Ms. Skittone said she thinks that's it unless you have any other comments you'd like to make on the reports. It was our intention to keep supplying the Town Council the Investment Balances/Income Report**.** I don't know if this detailed information is important to them but I would think it would be important to the future committee.

Chair Brown said if you could find some way of summarizing the key findings from this long sheet for the Town Council regarding a comparison of the rates of return and the life-to-date additional earnings, I think that's really all they want to know. I doesn't think they really need to see all this detail. Maybe they do but they can ask for it if they do. But I do think they want to know what the bottom line is.

Ms. Skittone said that can certainly be added.

Chair Brown asked the committee members for other questions for Ms. Skittone or Ms. Somers on the updated reports or the reports we received with the material?

Dr. Andrews said there was discussion at the last committee meeting the idea of getting some type of a blended yield to compare against what the SBA percentages are.

Ms. Skittone said we tried to provide that in FMIvT Net Total Return Breakdown report.

Chair Brown said if you look down at the next to last block on the long sheet, there is a blended annualized year-to-date return of 2.07%. The blended annualized return on the SBA is shown on the next block down in the last line of 1.36%. So the 2.07% is the blended return from the Florida League investments.

Dr. Andrews said he was just wondering if in the future we could have the blended yield on this report. It just looks like we are missing it. If we had it, it would make it easier to compare.

Chair Brown said maybe we could combine the two ideas. As I mentioned, I agree that the blended yields are very important and I think the additional earnings in dollars is something also that's understandable to the Town Council. Maybe if we could combine this report with those two additions, then you would have it all in one small report.

Ms. Skittone asked do you think that should fit in it's own little box or be added to one of the others?

Chair Brown said he thinks it would be better if you could highlight it in another box sort of a summary box and he thinks that would be the one that would get the most attention.

Ms. Somers asked would you also on a monthly basis like to see the life-to-date dollar totals for each of the funds or just in summary?

Chair Brown replied sure, I think we're looking for what's the blended returns vs the SBA and what are the dollar earnings.

Ms. Skittone asked do you recommend seeing the report of all participants and their balances by portfolio at the future quarterly meetings or would you like that included in a monthly report?

Dr. Andrews said quarterly would be fine as long as its available. You will get it on a monthly basis?

Ms. Skittone said yes.

Dr. Andrews said if there if some reason the committee was interested, they could ask for it.

Chair Brown asked if there is anything else for Ms. Skittone or Ms. Somers.

Dr. Andrews said he had one question, from an administrative standpoint, ease of using the Florida League vs the SBA. Do you have any comments on that?

Ms. Somers said it has not been that much more work. We have the reconciliation process down and the reporting format set so it's quite easy.

VII. PRESENTATION BY FLORIDA LEAGUE OF CITIES REGARDING INVESTMENTS

Chair Brown officially welcomed Darlene Malaney, Greg Coleman, and Carol Whitaker.

Ms. Malaney said thank you for having us. I wanted to address briefly an e-mail that I received from Ms. Somers requesting a number of items from them ahead of time for this meeting. A lot of numbers you saw from these spreadsheets, she requested and our analyst provided to her at that time. Other items that she requested, Mr. Coleman will address specifically. Those were the extent that realized losses relate to credit problems or concerns, the reasons for realized and unrealized gains and losses, if you would like an illustration of walking you through a scenario of exactly how that happens in the portfolio as well as his economic forecast, where the portfolios have been and where he sees them going. He provided me with a memo specifically outlining the reasons for the gains and losses and how that works. It's in my car, I apologize, I will provide you with a copy of that after the meeting.

Mr. Coleman said thank you, it's good to be here. Before you is kind of a smorgasbord of what I thought both addresses the memo from Ms. Somers as well as cliff notes regarding the economy and interest rates and maybe a format from how we look at the markets and what determines whether we want to be a little bit shorter in maturity in the benchmark or a little bit longer. I would be delighted to answer any questions as we go along or at the end.

I do have an example on the booking of a gain and loss. Prior to working at Atlanta Capital, I spent almost twenty years in the banking industry and the investment portfolio. So I got reasonably familiar with book losses vs total rate return so we can talk about that or not at your pleasure. I really just have two slides on the economy. I can summarize by saying that we think the economic outlook is pretty strong as it relates to GDP for a couple of reasons, one of which you can see on page 1. This plots where we are in monetary policy by the fed funds rate vs inflation so, said differently, unbalance over time usually the short term interest rate that the federal reserve sets is 1.5 to 2.0% higher than inflation. So if inflation was running 1%, you'd expect short term interest rates be about 2.5%. Inflation is running about 1% and short term interest rates, as you know from your monthly analyses of the SBA returns is also 1%. For a number of probably good reasons, the economy is in regular session and so we had a much easier monetary policy. Alan Greenspan has recently said that eventually we'll have to get to a more neutral position, meaning, closer to our long run average of about 2%. You can see currently we are at about 0. Now, in the short run, that's pretty good for the economy. In fact, the last two and a half quarters have been pretty strong as it relates to total output.

The next chart shows unemployment of the U.S., Florida, and Palm Beach County, and although it's never as low as you want it to be, it's a lot lower than it was. We've had GDP in the third quarter of 8%, the fourth quarter of 4% and likely 4% for the foreseeable future to borrow a line from Chairman Greenspan. Consequently, the tax cut increased government spending. Low interest rates have led to a more robust economy and we look for that to continue. We also look for that ultimately to raise interest rates somewhat. We think all rates will rise but none too much if I can borrow from Kipling. The short rates will rise a little bit more than long rates. Because inflation will likely remain pretty low, we think rates will be a little higher than now but not materially higher. I can go into a lot more detail of why we think that but I think those are the broad strokes.

On page 3 is a summary of the performance. This is how The League does it on total rate of return. You can see for the quarter in the year particularly in the short term they were pretty good numbers relative to short term interest rates but the halcyon days of the terrific bond market returns are over. You can see in the 3, 5 and 7 year numbers on the short and the intermediate are 7 and 8%, numbers that we more likely associate with equity returns over time not bond market returns. We think that's pretty much over and the coupon will return maybe a little bit less. The bond glory days are largely past. There were really two stories. One – the terrific returns for the bond market and then last year the terrific returns for the corporate market. Relative to all other bond sectors, ironically or interestingly the lower the quality both in stocks and in bonds, the higher the relative return. So on page 4, the heading "Corporates Have Experienced Outsized Returns", there are two charts to just give you a flavor. It affects you less so because in the intermediate and short term, we really are limited to corporate bonds to less than 5%. But nonetheless, it's been a good run for the bond market as I mentioned it has been particularly a good run for the sectors. The chart at the top shows what we call excess returns which compares the major bond sectors with treasuries for the same maturity. So we just subtract the two. For example, when you look on the far left, mortgages matched up for maturity outperformed treasuries over this 15 month period by a little over a half of 1%, asset backed securities a little less than 1.75%. Corporate bonds outperformed maturity for maturity by almost 8%. I mentioned that the lower the quality the higher the out performance, that's all corporate bonds. Since a third of the bond market is BBB rated, you can see that they almost returned 14% over this period. This is the Lehman aggregate. The Lehman aggregate is the rough equivalent of the S&P 500 for stocks. When we say the bond market, we mean the Lehman aggregate. Those are longer benchmarks certainly than the intermediate funds that you are in and that we manage for the League in the 1 – 3 and the intermediate but this will give you a flavor for what's happened. We don't think the outsize returns for corporates are going to continue since they've rallied so much and we also think that the bond run is largely over.

If you go the next page, it just plots the last 20 years of the yield to maturity on the bond market, the Lehman aggregate. We say they are related to inflation. If yields went down, you'd expect inflation to go down. The core CPI is a little over 1% right now and the yield to maturity on the broad bond market is less than 4%. We were bragging about a 2% rate of return in the 1 – 3 but nonetheless it's followed it down. The bond market over the last 20 years has compounded at almost 10%. To put it in perspective, your stock portfolios over those times for that period in the S&P is just over 12%. So that's about as close as bonds get to stocks over that long a period with a lot less fluctuation.

One of the things that we do when we are trying to determine how bold relative to our maturity benchmarks or how defensive we want to get is just to compare if rates go up and down 1%, what happens? And then, we try to assess how confident are we that we'll have the direction right. The chart on the next page shows if you had a long term treasury bond and rates went up 1%, the value of the bond would go down 15% roughly. If rates fell 1%, the long term would rise to 1.15%. If rates go up 1%, the coupon will not offset the price decline. In the shorter term, and this is just a 1 year treasury but it's roughly analagous or more similar to the 1 – 3 that we have. You do get strength from a couple of things in terms of the short-term portfolio. If rates rise 1%, the value of the portfolio instantaneously would go down 1%. If your coupon is 2% on the portfolio, you'd have 1% loss in price, a 2% gain in coupon so you'd still net 1% positive return. We think that's pretty strong particularly if we don't think rates are going to go up 1% tomorrow and they may not go up 1% at all.

That can help mitigate, it doesn't happen month to month, so if you want to look over time at what you can expect, then the last year is a pretty good example.

Looking back at history on the next page, the Florida League has not been around for 20 years so as a proxy, we use the benchmark that is the Merrill Lynch 1 – 3, it's pretty close for purposes of explanation. It would be probably conservative so I feel comfortable sharing this with you. Over the 254 rolling 12-month period, you can see in almost three quarters of the time, in the short term you'd outperform a money market return, not always but 1 in 4 you would. If you extend that to a longer time say rolling 36 month periods, 96% of the time you would have outperformed money market returns and you always had positive returns.

Dr. Andrews asked if either fund had 12 month rolling negative numbers?

Mr. Coleman said no.

Ms. Malaney said we've never had a negative calendar year since inception but as far as the rolling, I'd have to check on that.

Mr. Coleman said if we would have been around in 94, the intermediate probably would have been negative. They will check that. If we ran the Lehman intermediate for the 20 years, you would find some 12 month periods that were negative. He doesn't think they have had any but they will check that.

Mr. Coleman said so taking the page with the rolling periods, how would that relate to what we might expect going forward and you can sort of roll your own forecast and decide. My marketing department did not like this page because it's such a busy page and there's lots of numbers but I said I was speaking to the Finance Department and the Investment Advisory Committee and I assured them it was just fine. So this is actually how we view our forecast when we look at the intermediate and the short. First we start with the unchanged scenario. These are numbers that are obviously our best guess but who knows what the right number is. Certainly since Chairman Greenspan has said we can remain accommodative for the foreseeable future, we thought unchanged would give the heaviest weight. If yield to maturity portfolio starts at 2.17% and rates never change, you'd earn about 2.17% over the period. What if rates rise? In fact, we do get a 25 basis point rise sometime during the year. The yield to maturity at the end of the period, of course, would be higher but the rate of return would fall because of the price of the bond, the value of the portfolio would go down. It would still be 1.83 but it would still be lower than if rates were unchanged. What if you rise 50 basis points? Which may sort of be realistic sometime in August or September if the fed tightens, you'd earn about 1.5% and if you went up a full 1% throughout the year, you'd end up with less than a 1% return but still substantially positive. On the downside, we think rates falling 100 basis points is less likely than rates rising for the reasons that we talked about but nonetheless its possible that if oil goes to $50 a barrel, and we end up having a stalled recovery and the fed has to ease again, you would see the returns would go up even further, 2.62, 3.06 for that period. I don't mean to provide a sense of false precision here when you have weighted averages to 2.03, it sounds so exact, but if you weighted those, that's what you would come up with.

Dr. Andrews asked your numbers on the weighted average, is that based on the year?

Mr. Coleman said correct. The calendar for the last three quarters of 2003 were probably sort of realistic. Some months were higher, some months were lower.

The next page shows the same thing for the intermediate. The case in point, if rates do go up 100 basis points, you'd be pretty close to break even for the year. It shows up as –10. It'd be close to marginal return if it went up 100 basis points. If it fell 50 basis points, you'd have a stronger return and if the probabilities played out like we have there, you'd earn between 2.75 and 3%. Obviously, rates are likely to go higher still and faster, those numbers would fall down but that's how we view things.

On the next page, we took a crack at what the SBA might return under the same set of probabilities. We took their ending yield and a little estimate of what it's working it's way down toward on a steady state case. We get to 1.12, not too far from the 1.16 that Darlene mentioned. We think we are in the ball park and you can see the returns even at up 50 basis points in yield, the SBA in all money market accounts would rise up as their portfolio rolls over and they have no price decline but that still would be a little bit less than what you'd earn against the benchmark 1-3 or being in the FMIvT portfolio.

I might while I'm thinking about it, answer the question on credit quality about what percent if any book losses taken were the result of credit quality, the answer to that is zero.

The League may make you feel better about the 5% plus commitment that you have in the FMIvT, it is rated by Fitch. We are on the phone with them a lot. They do the ratings and they look at each holding and in order to maintain a AAA rating in this portfolio, they basically limit the amount of A rated securities you can have to 4.99%. So we have a few corporate bonds in there and none of which were sold and none of which we are worried about. It's much less concentrated in corporates than other short term portfolios might be. That's my set of prepared remarks as it relates to where we think rates are going and the performance for the year end of December 31.

Mr. Hennessy asked what are you forecasting for inflation?

Mr. Coleman said we think that inflation on a run rate at the end of the year will be just under 2. The consensus in the market place is about 1.5 or maybe a little bit less. We think it's going to be higher than that. The big offset is really the China effect. Because of NAFTA and China and the relationship that they have, this is somewhat an oversimplification, but they may be bidding up the prices of copper and a lot of other hard goods around the world, you apply a dollar an hour labor to it, you spit it back out and it shows up in the shelves of WalMart. If WalMart were a country, it would be China's fifth largest trading partner. So day in and day out even though they import almost as much as they export except to the US, that drives prices down and we sort of grew up when 2% was a good inflation number. I think it keeps it below that number. We are looking for around 2% by year end but you can't find it in the data yet. Just about every measure you look at, whether you want to use Chairman Greenspan's personal consumption expenditure deflator or the CPI wizard, it's hard to get a number that's above 1% in the last quarter.

Chair Brown said one thing that I was a little surprised by when we first started seeing the results as you know was the extensive realized losses. I guess I don't mind realized gains as much but I was surprised to see how many realized losses there were particularly in the 1 – 3 year bond fund where you have very short term maturities. I certainly understand the unrealized gains and losses that's just the function of interest rates and I believe we were told in our last conversation by phone at the last meeting that there was a combination of getting better rates over the lifetime of the investments and also better liquidity. I don't know how much you weigh those two factors but at least from our point of view, the liquidity issue is not very big because we have all this money in SBA. That would certainly be our first place to go for liquid funds. All things being equal which of course they never are but if they were equal or even marginal, I think we'd be happier with fewer realized capital losses. I know there's nothing we can do about the unrealized but I think it just exaggerates the short term fluctuations. That is really the only down side that we have in the investments in the Florida League. I'm not suggesting you shouldn't do it if it's very clear that this is to our advantage but there is a disadvantage in my point of view in terms of increasing the fluctuations in short time periods.

Mr. Coleman said that's an excellent point. It's generally not the liquidity. There's a number of reasons. By and large, it's yield enhancement. If I have five minutes left, I have an example that exaggerates for emphasis but it shows you day in and day out why we think it's generally a good idea to do that.

Chair Brown said that would be perfect.

Mr. Coleman said he has updated this analysis for today's market rates. Basically, I want to show you at least what we are thinking about when we do what I call portfolio improvement swaps which is the realized losses that were realized that were not part of pay downs which I'll get to in a second. If you go to page 3 that shows the yield curve and it's a money market example but the same would be true with 2 year notes. This was the way the yield curve looked on February 9th and at 98 basis points would be T Bills and the little star would be discount notes. The portfolio manager can invest in T Bills at 98 basis points almost 1% and Fannie Maes at 1.03% which is sort of a normal relationship in the short term. So for 5 basis points on page 4, you might as well take the 6 month T Bill because you are only getting 5 basis points in T Bills, you can really sell on a dime. So if you did that, you'd spend a dollar price of roughly 99.52 and you'd spend $9,951,000. If you go to page 5, we are going to pretend that we were surprised by Fed fund interest rate hike of 50 basis points right after our portfolio manager Greenspan bought the T Bills. The market is in a little disarray when that happens, yield spreads tend to widen so you can see the before down below and the after up above. If everybody with me so far? Now we could buy and sell treasury bills at 1.48% and we could buy Fannie Mae or Freddie Mac discount notes at 1.68%. That's 20 basis points relative pick up but to do that I don't have any cash, I've got to sell the thing that I just bought, haven't even digested my lunch yet, and now I'm looking at a 50 basis point loss, so what should we do? Well let's look at the buy/hold decision over the next six months on page 6. If I hold the security, my $9,951,000, I'll take no losses, I'll get no questions from boards like yourself, and I'll earn $48,000. I get my $10,000,000 at maturity. I could do the swap and my $9,951,000 that I just spent at 9:00 a.m., I immediately get back not $9,951,000 but a loss of $24,000 at 9:20 a.m. because I'm selling it at a higher yield than I bought it at 1.48%. But I'm able to buy and here's the big but, since the discount notes that I'm buying yield 1.68%, it enables me to get a face value at maturity not of $10,000,000 but of $10,009,000. So the difference in terminal wealth at the end of the six months, in the hold it's $0, and it's almost $10,000 on the transaction. In deference to my marketing department, I've a better graphic on page 7 that shows the two things. On page 7, you put out $9,951,000, you don't do anything, day 180 you get $10,000,000 back. The graphic on page 8 shows if you go ahead and do the swap, buy at 98% at $9,951,000, sell it and get less money back $9,920,000. Fully invest the $9,920,000 at maturity you get $10,020,000.

I looked at the Swaps for the nine months ending December 31 that we did for you. Sometimes they were just old 2 year and new 2 year treasury, etc., but oftentimes, they were sell the treasury, buy an asset back security, pick up 1%, pick up 75 basis points, extend a few months and pick up 50 basis points. We are not always selling treasuries, there's a certain amount of transaction and set up costs that you have to go through anyway. We want to make sure that it makes sense.

Chair Brown asked why would you sell the 2 year treasuries for other 2 year treasuries?

Mr. Coleman said you would do that for two reasons. One – you are almost always picking up yield and the quarter ending December 31, we did a few of those. We owned the current one, we have a new auction and we have an auction every month, and the new 2 year treasuries are a little bit more liquid than the old 2 year treasuries. It's easier to lend out. You can pick up 3 or 4 basis points, you can do that every single month so the variations at the end of the year could be 35 or 40 basis points that you've picked up by doing those transactions. At the end of the day, the terminal wealth of the fund, if you got in on March 03 and you get out in March 06, I would submit to you that it's higher because of that.

Dr. Andrews said I think that's why it's important that you've told us on a 12 month rolling basis you haven't had the losses. On active portfolio management on relatively short term investments, you're going to be able to take care of the fluctuations and hopefully as you said the little pieces will add up to a big piece later on.

Mr. Coleman said yes. If you get a period like 1994 when all rates rise and even though you are buying new bonds at higher yields, on a total rate of return basis, we are going to count in the losses whether we realize them or not as part of the performance and you'd under perform something that was just cash. But in periods of stable declining or even slightly rising rates, you can normally do that. It's interesting, I looked at the realized losses and we own a fair amount of asset back securities and CMO's already AAA but they pay down quite a bit. Because rates have been so high and have been falling, most of what we've purchased has been at a slight premium. And just even the fact that those pay downs, where we don't control them, we count them into the yield, we are assuming we are going to get 5 or 6% paid back of this particular security. And we buy a 4.5% coupon at a slight premium, let's say, we get a pay down that's going to show. We paid 101.5 for it but when you pay off your car loan, you don't pay it off at a premium, you pay it on the par, we get par back so it reduces that coupon yield a little bit. It shows up as a realized loss on the portfolio. We are not surprised that the money is coming back, we want it to come back but the math is such that the reason you got the little higher coupon is because you are going to get some pay downs. Particularly in the intermediate, we have months of positive realized gains and losses, negative gains and losses, even negative months of returns, doesn't happen very often but it can. Because we are out there a little bit longer at the year and a half level, we think it's a good investment for municipalities once they've satisfied their operating needs because you're getting that extra 100 extra basis points day in day out on the yield and that generally can cover the operations month to month.

Dr. Andrews said our fiscal year goes from October to September and the way the piece of paper here that we report to the Town, we start out in October with just a huge glitz. What we are trying to say if I am interpreting correctly is that over that yearly period of time, we are going to look a lot better and I think that the Chairman mentioned each month we've consistently improved.

Mr. Coleman said you're absolutely right. January was about 30 basis points again, which as the Chairman should know, would have only added to the lead so to speak. Hopefully, we have that in the bank now. We can draw on that a little bit as we go through. I can see that October, November of each year, we are going to keep our fingers crossed.

Dr. Andrews said I just had another question. You mentioned in normal bond markets you believe that possibly toward the end of this year, there's going to be an interest rate increase, I assume the bond market would be at least on some type of short term disarray. Would you assume that?

Mr. Coleman said yes.

Dr. Andrews asked would you kind of wait and buy into that?

Mr. Coleman the way it would work long before we read Greenspan's tea leaves, there will be some surprise that says, my goodness, they are doing it sooner than we thought or bigger than we thought, one or the two. And then we'll assess the market's reaction to that and say rates have risen 1%, he only just said he might raise rates, he hasn't even raised them yet and now we are outside the bands of normalcy. Now we want to take some even shorter maturity than we normally would, we'll lengthen that a little bit and maybe we'll dollar average into it. So that'll be the plan.

Mr. Coleman asked if there are other questions? He thanked the committee and staff.

Chair Brown thanked Mr. Coleman and Ms. Malaney.

Dr. Andrews said he has one question. We had somewhat of an issue at the last meeting of trying to coordinate the reporting segments. Did that every get straightened out? Do we get it on a monthly basis now?

Ms. Somers said all of the new information that we've shown you, we can get on a monthly basis from them.

Chair Brown asked for other questions.

VIII. UPDATE ON THE STATUS OF A PERMANENT INVESTMENT ADVISORY COMMITTEE

Chair Brown said I did have a little conversation with Ms. Skittone this morning and as I understand it, this committee was appointed for a certain period of time and that period of time is actually up March 1. So we are essentially almost out of business in our initial assignment. This new ordinance will create a new committee. It would not be an extension of the old committee. That's an important distinction and we would sunset and there would be a new sunrise with a new membership which of course any of us could apply for if we so wished. Is that correct?

Ms. Skittone said correct.

Dr. Andrews said we would actually have to put in an application?

Ms. Skittone said yes you would and I just happen to have your old applications and a copy of a new one for you if you want. Fill out a new one because you are going to want to put on the new application that your were a member of this original committee.

Chair Brown asked Ms. Skittone to cover what happens next. This has been approved once on first reading. It goes back March 9th for a second reading. On approval of the second reading, they start advertising for membership.

Ms. Skittone said correct and the Council will not vote on that membership until May because they want the applicant's information thirty days prior to the Council meeting.

Chair Brown said the disadvantage to that for those of us who are not permanent residents, it's going to be a long time before we can attend a meeting in person.

Ms. Skittone said the first meeting probably won't be until the fall.

Chair Brown asked Ms. Skittone is there anything you want to highlight?

Ms. Skittone said the only change in the committee from the way it currently stands is that it will have five members and it will have at least four meetings per year. We did not really say that they would be specific quarterly meetings but we thought that we could fit in four somehow throughout the course of the year.

Dr. Andrews asked is there a tenure for the committee members or is it also staggered?

Ms. Skittone said it's a staggered term. There will be three members that will have a three year term to start and the two members will have a two year term to start. Then they will be staggered thereafter. How it gets decided who will have the three year term, I don't have an answer yet.

Dr. Andrews asked can you give us an idea of how the Town goes about selecting the members for the committee?

Mr. Hennessy added or finding the members for the committee?

Ms. Skittone said she has prepared a news release that will be sent out March 9th right after the approval of the ordinance and that news release usually gets faxed not only to the papers but to the Civic Associations, The Citizens Association, and many relevant associations.

Mr. Hennessy asked if the specifications are going to be the same as the last? He said he did not meet the specs.

Ms. Skittone said you don't have to be a permanent resident of the Town, just a resident.

Mr. Hennessy said it wasn't just the residency, they were looking for investment bankers.

Ms. Skittone said it states fixed income investment experience.

Dr. Andrews asked if the applicants get reviewed by you before they get to the Town?

Ms. Skittone said the Town Council will take your applications, maybe make some phone calls, I'm not really sure what they do, and review the applications and hopefully pick the top five candidates out of a base of applicants.

Dr. Andrews said so your input is independent of the Town Council?

Ms. Skittone said correct. But there were five or six applicants the last time. Some were not qualified at all.

Chair Brown asked is there anything else on this subject?

Ms. Skittone said there is one other thing. At the Town Council meeting on March 9th, we would like to invite the three of you to attend because the Mayor would like to do a presentation to you for your service on this initial committee. That usually is the first thing on the agenda so it would be March 9th, Tuesday at 9:30 a.m.

She said Peter Elwell, the Town Manager, wanted to express our sincere thanks to you and we have enjoyed working with you and hopefully we can work with you more in the future.

IX. ANY OTHER MATTERS

Chair Brown asked are there any other subjects to come before the committee?

Mr. Hennessy said he is very concerned about inflation. You've got falling dollar value and already you see it in the price of fuel at the gasoline pump. If it continues on, you are going to see a slow down in the economy because our economy does run on the price of oil. And the hugh inflation we are running and the new budget that's been proposed, you have to have an impact somewhere.

Chair Brown said I don't disagree with you and I think that's right but I guess I'm not sure at this point that we would necessarily make changes.

Mr. Hennessy said if we don't get nominated to the new committee, those people should be aware of it.

Chair Brown said right, he agrees it is a problem. Of course, if it slows down the economy, that will be somewhat an offset on the effect on interest rates. I think it is more likely that interest rates will go up than down. I don't know if these probabilities will even capture enough of that.

Dr. Andrews said I think we have some more money that's going to go into the Florida League of Cities.

Ms. Skittone said right, the excess bond monies that we had.

Chair Brown said and we are going to split it the same proportion that we split the other?

Ms. Skittone said yes, and we 4.8 million left to go in.

Ms. Somers said 2.4 million has already gone in and then another 2.4 million at the end of this month.

Chair Brown said when we started in this committee, the reserves were a little less than $100,000,000. Now they are $115,000,000. That's a pretty good jump and I just wondered what the outlook was for the funds.

Ms. Skittone said it will probably always hover around $100,000,000 unless we start spending a lot of the capital.

Ms. Somers said the difference between the balance now and the balance when we started is the bond proceeds, that $18,000,000, that we took out of the Guaranteed Investment Contract (GIC) and put it in SBA.

Chair Brown said oh yeah, that's because the money didn't get spent, right? But is it going to get spent sometime.

Ms. Somers said right.

Dr. Andrews said you don't have any anticipated problems from a cash flow standpoint for the SBA? Have you had to take any money out of the Florida League?

Ms. Somers said no.

Dr. Andrews said I think we are just going to look better on that the longer we go unless toward the end of the year we get that big increase in rates.

Chair Brown said if we get a big sudden increase in rates, it'll look back for a short period of time but that big sudden increase in rates will help our SBA investments. I guess the way I look at it is we've kind of got a balanced portfolio now whereas before we had it all in one type of investment.

Dr. Andrews said the best thing we did as a committee was to get a little more balance with a little more change for an up side. If we had to get again the number, are we saying that so far this year the difference has been?

Chair Brown said $180,000.

Dr. Andrews said I just wondered since we are getting evaluated on this October to date how we had done. The Town Council might say this committee was instrumental in bringing in $75,000 or $100,000.

Chair Brown said well we could do that but there's no reason we can't also mention the life to date.

Ms. Skittone said life to date is this committee really.

Dr. Andrews said the Town Council seems to be getting these year to date.

Ms. Skittone said we could do year to date as well as life to date.

Chair Brown said let's do both.

Chair Brown said he would like first of all to thank our committee members. I think they have been very industrious and hopefully successful in adding some value to the Town. I would also like to thank Ms. Skittone, Ms. Somers and Ms. Cotton for your help and assistance in working with us. It has been a lot of fun. I think we've all enjoyed it and I hope you have.

They replied, yes we have, thank you.

X. ADJOURNMENT

Chair Brown said now unless there is anything else, I will entertain a motion to adjourn. Mr. Hennessy made a motion to adjourn. Dr. Andrews seconded. Motion passed.