

Prince William County, Virginia

INVESTMENT PERFORMANCE REPORT

THIRD QUARTER -- FISCAL YEAR 2009

Quarter ended March 31, 2009

May 13, 2009

**This Investment Performance Report was reviewed and accepted by the County's
Investment Oversight Committee on
May 13, 2009**

INVESTMENT OVERSIGHT COMMITTEE
For the Quarter ended March 31, 2009

Chairman

Christopher E. Martino, Director of Finance

Standing Members

William B. Hoffman, Assistant Director of Finance

Appointed by the County Executive

Thomas Bruun, Public Works Director

Victor Evans, At Risk Y&F Services Manager

Melissa S. Peacor, Assistant County Executive

Citizen Members Appointed by the Board of County Supervisors

Mr. Bill Brogdon

Mr. Todd Hewitt

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I. INTRODUCTION

This is the FY 2009 third quarter report of the County's investment management program. Prince William County's Principles of Sound Financial Management and the Investment Policy adopted by the Board of County Supervisors requires the County's investment program meet four criteria, shown here in order of their importance:

- Legality *"Investment instruments shall, at a minimum, be limited to security, issuers and maturities in compliance with the Code of Virginia (1950) as amended."*
- Safety *"The next objective is the preservation of capital and the protection of investment principal. The County will employ mechanisms to control risks and diversify its investments regarding specific security types or individual financial institutions."*
- Liquidity *"The investment portfolio will remain sufficiently liquid to enable the County to meet operating requirements which might be reasonably anticipated."*
- Yield *"The County will maximize yield on the portfolio but will avoid unreasonable investment risk to preserve the purchasing power of the portfolio."*

In keeping with these principles, the Finance Department continued to invest the County's funds only in allowable, safe securities and to structure the maturity of the investment portfolio to assure liquidity. Short-term needs (six months or less) are being met by investments in certificates of deposit and money market funds, and funds not required for specific short-term needs are invested primarily in U.S. Agency securities and corporate and municipal bonds. These purchases are made so investments will mature in the future to provide for expected cash flow needs.

Throughout this report, investment income dollar amounts and percentages are presented on a total return basis, which includes the impact of adjusting investments to market value. Total return is made up of two primary components. The first is the earnings/yield income component that is the result of coupon interest rates, principal value invested and the time period of the investments being measured. That component of the total return is fairly stable and moves slowly as new investments are added to the portfolio or investments are removed from the portfolio as securities mature. The second component of total return is determined by the change in market value of the securities over the period being measured. This portion of the total return can be volatile given changes in the economic environment, Federal Reserve Board (FRB) rate policies, and significant geo-political events, but does not affect the cash flow of investments. The combination of both earnings yield and market value changes create the total return that is used in preparing this report. The accounting for investments at "Fair Value" on a total return basis is required by generally accepted accounting principles.

The total return yields on investments for the third quarter of FY 2009, were as follows:

	<u>FY 2009</u>	<u>FY 2008</u>
General Portfolio.....	2.20%	5.87%
Restricted Portfolio.....	0.89%	4.29%
Total Investment Portfolio.....	2.05%	5.59%

The third quarter FY 2009 total return of 2.20% on the general portfolio investments reflects a 367 basis point decline from the third quarter return of FY 2008 of 5.87%. The decrease was primarily due to a freefall in short-term rates over the past 12 months and negative mark-to-market adjustments. The third quarter total return on the restricted portfolio was down 340 basis points from 4.29% in FY 2008 to 0.89% in FY 2009. The short-term nature of the restricted portfolio results in rapid adjustments to short-term rate movements and very little in the way of mark-to-market adjustments. Rapid fed funds rate cuts over the last year was the primary cause of the decline. The third quarter total return on the total portfolio fell by 354 basis points from 5.59% to 2.05%. The changes in the total returns of all three components of the portfolio are driven by market volatility and the Fed Funds rate. More recently, however, rotating mispriced spreads between treasuries and various other segments of the debt market has resulted in increased volatility which can play havoc with day-to-day valuation levels.

During the third quarter of FY 2009, the County's General Portfolio purchased \$375 million in U.S. Agency, Corporate, and Municipal securities and Bank CDs with an average yield to maturity of 3.29% and has maintained an average combined balance of \$354.3 million in money market funds, repurchase agreements and CDs. During the same period, the County had called, sold, or matured \$362 million in securities with an average return to call/sale/maturity of 7.12%. Securities sold in the marketplace totaled \$146 million with a weighted average yield to sale of 10.1%. Gains on sales totaled \$2.5 million during the quarter.

II. TOTAL INVESTMENT PORTFOLIO STRUCTURE

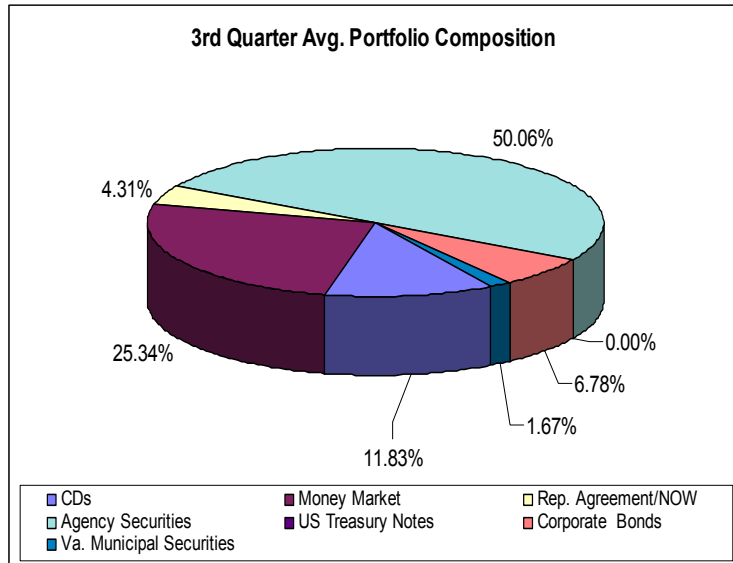
The County's total investment portfolio is divided into two components: (a) the general portfolio and (b) the restricted portfolio. The "**general portfolio**" is all funds with the exception of restricted capital project funds that contain bond proceeds, escrows and certain self-insurance funds. All general fund interest income is earned from securities in this general portfolio. The "**restricted portfolio**" is all other funds; mostly capital project funds that contain not-yet-spent bond proceeds, bond reserve and escrow funds, and the funds of the County's self-insurance pools. The term "**total investment portfolio**" refers to the sum of these two components.

III. EXCEPTIONS TO INVESTMENT POLICY

In accordance with Section 60-17 of the Investment Policy, specific exceptions to the policy investment guidelines are to be included as part of this report. There were no exceptions to the Investment Policy during the reporting period.

IV. INVESTMENT PERFORMANCE

A. Summary of General Portfolio Composition during the Third Quarter of FY 2009 - Investments held by the County are diversified to control the risk of loss resulting from over-concentration of assets in a specific security or class of securities. The portfolio



composition chart to the left shows the average percentage of the general portfolio assets at market value by investment type. The following table reflects the policy guidelines for each type of security. Securities held in the restricted portfolio are subject to trust agreements and other investment limitations that control the risk of loss and, therefore, are not included within this chart.

Balance at 03/31/09 Investment Category	Investment Guidelines		Actual
	Lower	Upper	
U.S. Govt. and Agency	33.00%	100.0%	49.76%
Va. Municipal Securities	-	100.0%	4.09%
Corporate Bonds	0.0%	20.0%	9.78%
Bankers Acceptance	0.0%	40.0%	0.00%
Certificates of Deposit	0.0%	40.0%	11.64%
Commercial Paper	0.0%	35.0%	0.00%
Money Market Funds	0.0%	60.0%	24.73%
Total			100.00%

* For policy purposes US Treasury Notes and Bills, US Agency securities, and Repurchase Agreements are combined to meet the 33% lower limit in the investment guidelines.

B. Average Invested Cash Balances – The average invested cash balance of the General Portfolio, during the third quarter of FY 2009, increased by approximately \$38.7 million to \$854.1 million in comparison to the average balance over the same period one year ago. The increase of the average cash balances in the general portfolio is attributable to the slowdown in construction expenditures resulting in construction draw reimbursements exceeding current construction demands on the General Fund.

AVERAGE INVESTED CASH BALANCES						
Unamortized Book Value in Millions of Dollars						
General Portfolio	FY2009/Q3	FY2008/Q3	Change	FY2009/YTD	FY2008/YTD	Change
Low	\$816.8	\$785.4	\$31.4	\$739.9	\$693.7	\$46.2
High	897.8	848.9	48.9	932.3	883.4	48.9
Average	854.1	815.4	38.7	823.8	758.3	65.5
Total Portfolio	FY2009/Q3	FY2008/Q3	Change	FY2009/YTD	FY2008/YTD	Change
Low	\$922.4	\$947.9	(\$25.5)	\$907.7	\$931.7	(\$24.0)
High	1,023.1	1,040.0	(16.9)	1,066.6	1,087.4	(20.80)
Average	967.6	990.5	(22.9)	978.6	998.8	(20.20)

The average cash balance of the total portfolio decreased approximately \$22.9 million to \$967.6 million in the third quarter of FY 2009 compared to the average balance over the same period one year ago. *The decrease in the Total Portfolio is the result of reduction in the Restricted Portfolio from a slowdown in the velocity of the County's issuance of new debt relative to reimbursement draws against the Restricted Portfolio.*

- C. Investment Income** – The total return investment income on the Total Portfolio decreased to \$28.97 million year-to-date for the third quarter of FY 2009 compared to \$46.63 million for the same period last year. This represents a 37.9% reduction in total return. *The decrease is the result of lower short-term interest rates and a 2.3% reduction in the average comparative size of the Total Portfolio.* The General Portfolio and Restricted Portfolio saw total return reductions of 31.2% and 68.5% respectively over the same period in the prior year.

INVESTMENT INCOME /TOTAL RETURN			
Millions of Dollars			
	FY2009/YTD	FY2008/YTD	Change
General Portfolio	\$ 26.32	\$ 38.23	-31.2%
Restricted Portfolio	2.65	8.40	-68.5%
Total Portfolio	\$ 28.97	\$ 46.63	-37.9%

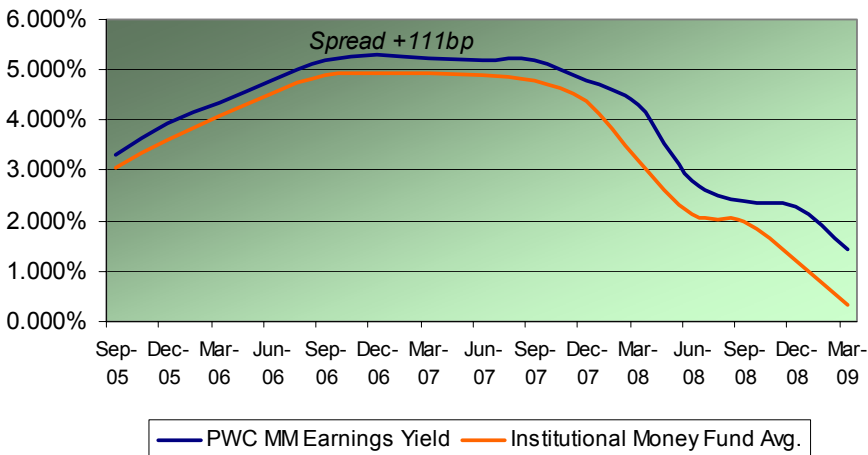
- D. Comparative Total Return (YTD)** – For the third quarter of FY 2009, Prince William County's total return on investment for the general portfolio YTD was 4.26%. This represents a decrease of 228 basis points from the same period in FY 2008. The average

COMPARATIVE INVESTMENT YIELDS			
Total Return on Investment for the General Portfolio			
	FY2009/YTD	FY2008/YTD	BP Change
Prince William County Total Return Earnings	4.260%	6.544%	-228
Institutional MM Fund Avg.	1.230%	4.120%	-289
Lehman 1-3 Yr. Govt. Index	5.477%	10.324%	-485
Virginia LGIP	2.030%	4.700%	-267
90 Day T-Bills	0.681%	3.330%	-265
1 Year T-Bills	1.230%	3.428%	-220
2 Year T-Notes	1.493%	3.303%	-181

rate of return on Institutional Money Market Fund Average and the 90-day T-Bill for FY 2009 YTD were 1.23% and .68% respectively. These two indices are often used as a basis of comparison for short-term investment performance. *Despite lower returns, the County's General Portfolio exceeded both of these performance measures by a wide margin on a YTD basis. The General Portfolio performance was affected by the sharp downdraft in short-term interest rates. Fed Fund rate reductions to below 0.5% and continued credit concerns were largely responsible for the rate declines.*

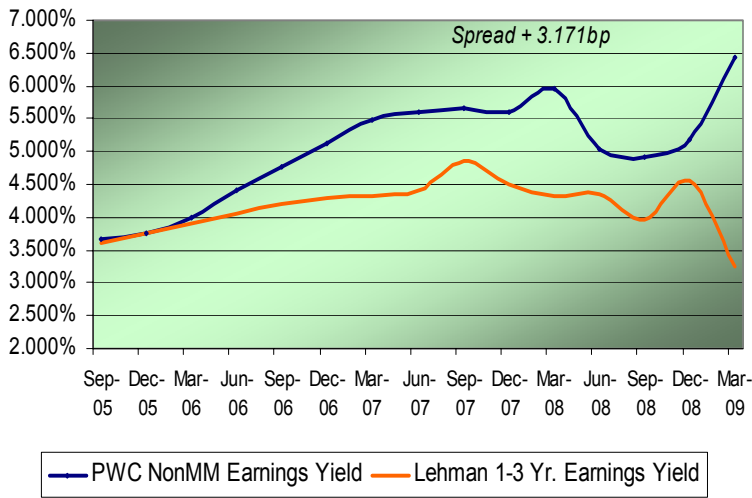
The chart below shows the last fifteen quarters of the County's short-term security performance in the General Portfolio compared with the Institutional Money Fund Average. The County Money Market funds continue to outperform the Institutional Money Fund Average. The

PWC MM Accounts vs MM Benchmark

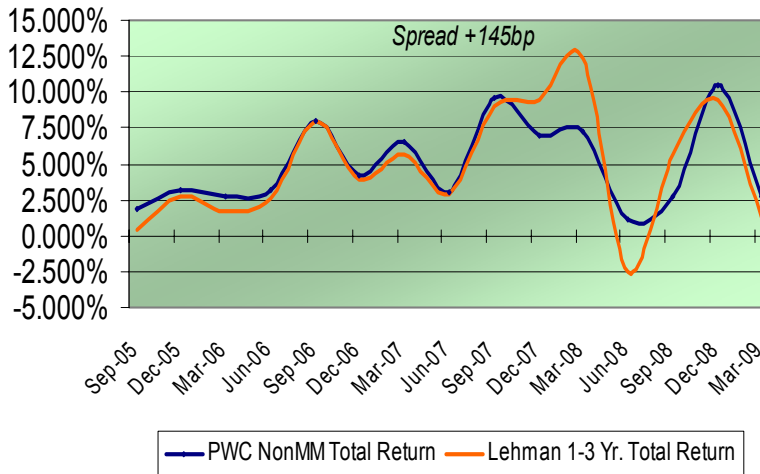


positive spread has widened dramatically primarily because of the movement of sizeable blocks of funds into FDIC-insured and collateralized CDs at attractive rates locked in for terms from one month to one year.

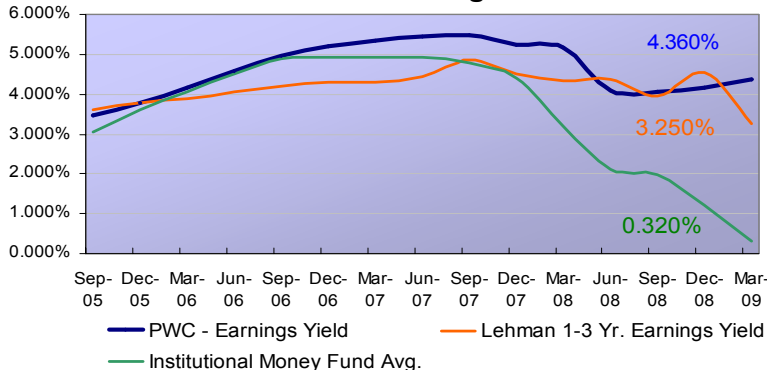
**PWC Non MM vs Lehman Benchmark
Earnings Yield (6.421% vs 3.250%)**



**Total Return
PWC Non MM (2.74%) vs Lehman Benchmark**



**PWC General Portfolio Earnings Yield vs
Benchmarks' Earnings Yields**



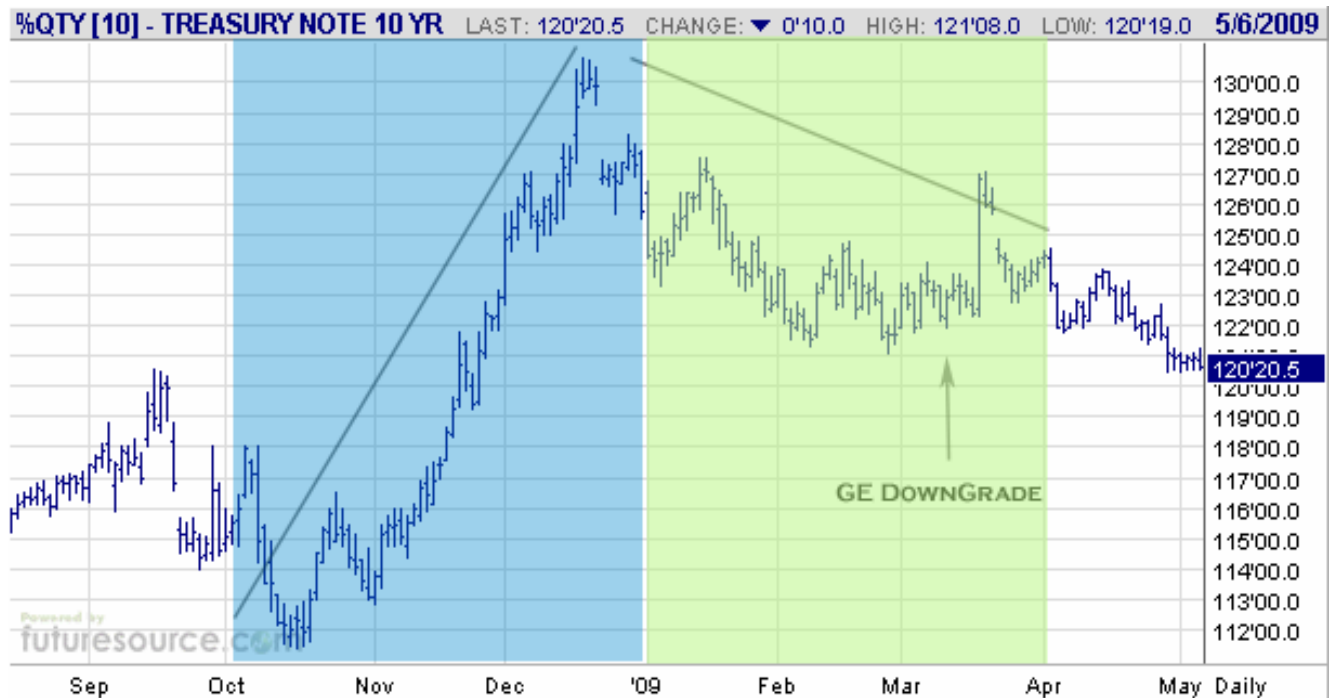
The County's Non-MM investments, on an earnings yield basis, are currently outperforming the Lehman 1-3 Year Treasury Index. For the quarter ended March 31, 2009 the favorable spread ballooned to 317 basis points. The primary reason for the increase was the realization of \$2.5 million in gains on sales which acted to supplement the portfolio's book yield during the period. Absent the gains on sales, the Non MM Earnings Yield would have been approximately 4.4%.

The County's Non-MM total return for the third quarter was 145 basis points over the Lehman benchmark. The outperformance by PWC is due primarily to gains on sales of securities and narrowing spreads between agency and government securities.

Earnings yield for the quarter of 4.360% exceeded the Money Fund benchmark by 404 basis points and the Lehman benchmark by 111 basis points.

E. Average Maturity of the Portfolio - The average days to maturity of the total portfolio were 1,189 days and 1,297 days as of March 31, 2009, and March 31, 2008, respectively. The average number of days to maturity of the general portfolio was 1,308 days as of March 31, 2009 and 1,547 days as of March 31, 2008. *The days to maturity for the total portfolio decreased over that from one-year ago largely as a result of a general portfolio investment strategy to shorten the portfolio's duration as rates fell.* The general portfolio has average days to maturity of 337 days on a callable life basis and the total portfolio has average days to maturity of 98 days on a callable life basis.

F. Comparison of Market Value to Amortized Cost of the Total Investment Portfolio – The market value of the total investment portfolio on March 31, 2009, was \$910,132,957. The amortized cost of \$911,040,958 exceeds the market value by \$908,001 or 0.099%. The difference represents a market value loss as a result of slightly higher interest rates during the quarter and a widening of spread relationships on selected corporate securities. Mark-to-market results from quarter to quarter have everything to do with the movement of interest rates. The highlighted area of the 10-year treasury futures contract chart shows FY second and third quarters. For nearly the entire second quarter the 10-year treasury was rising which, in large part, was the reason for such a large mark-to-market gain last quarter. Conversely, for the third quarter prices fell modestly which accounts for the bulk of the negative market value adjustment.



V. ECONOMIC AND INTEREST RATE OUTLOOK

A. In the Fed's three meetings year-to-date no new action on the interest rate front has been forthcoming or expected. The Fed funds target rate remains between 0% and .25%. The traditional short-term rate tool of the Fed has been augmented by the ability of the Treasury to affect the long end of the rate curve through purchases of mortgage-backed bonds, agency notes, and treasury securities. The TARP, the stimulus bill, and various other administration endeavors (not to minimize the Chrysler \$8 billion in previous government loans that won't be repaid in the bankruptcy arrangement) will result in an enormous increase in government spending, government debt, and the budget deficit. This will not be a benign governmental expansion and the vast majority of economists are expecting various consequences from this action ranging from moderate inflation growth in the intermediate term to hyper-inflation over that period to currency devaluation or some combination thereof.

In the meantime, first quarter GDP came in well under expectations at a mind-numbing -6.1% small comfort from the previous quarter's 6.3% decline. In fact, the last time back-to-back GDP declines exceeded 12.4% was in 1958 – 51 years ago. Unemployment, too, is bringing in successively bad numbers now standing at 8.5% with new unemployment claims running over 600,000 per week (450,000 per week is considered a typical recessionary level).

While much of the economic data still paints a negative picture, there are signs that the pall may be lifting a bit. The equity markets have managed, for the moment, to begin to show a slight mood enhancement. Yes, prices have been rising lately, but it is the general sentiment that feels like it is turning. The fear of total economic collapse has largely disappeared either because of or in spite of (take your pick) government intervention. Caution is still pervasive in our markets and rightly so, but abject terror is largely a memory of last fall.

While the economy continues to flounder, there are some steady movements higher in gold and silver, both used as monetary proxies and as safe havens in troubled times. Those trends, unless reversed, may indicate a continued and growing fear in the world economy, a concern about the future value of the dollar, or both. The play-out of the stimulus package funding and the auto industry shenanigans should provide day-to-day volatility over the near term but at decidedly lower levels than we experienced in late 2008. The long term concern remains how such an enormous government spending package will impact the economy, interest rates and inflation when the economy does recover, and will the Fed be able to reign in the money supply at that tipping point.

National housing market data continues to be negative, although the past twelve months in Prince William County has seen long-awaited increased sales volume and prices in the County ticked higher in March. With the Federal Tax Credit of up to \$8,000 for first-time home buyers now available, there are now far more fundamental factors in favor of local price declines halting, if not reversing, than the alternative – particularly in lower price brackets. One would not have to go very far out on a limb to call the real estate market turn right now.

VI. INVESTMENT STRATEGY

The County's current investment strategy properly addresses the requirements of legality, safety and liquidity by investing in a diversified portfolio with respect to specific security types, financial institutions and sufficient liquidity to meet reasonably anticipated operating requirements. The County seeks to match its cash flow needs to the maturity structure of the portfolio in order to maximize yield. The current investment strategy attempts to:

- (1) avoid the premature sale of investments to meet day-to-day operating requirements;
- (2) avoid holding large sums of cash that earn lower-than-average money market rates in favor of investing in longer-term securities when interest rates are higher; and
- (3) maintain higher balances in money market funds and short-term investments when longer-term interest rates are not favorable.

That having been said, the volatility of the markets has created some irrational and unsustainable dislocations in various sectors of the fixed income markets. Relative spreads on agencies, municipals, and corporates to governments moved extremely wide and then proceeded to narrow. Even within those categories, counter-trend volatility was apparent (GE bond yields widened to treasuries in the midst of a generally narrowing spread on corporates to treasuries). The CD market, as well, is exhibiting quite a differential in rates between banks making rate comparison pay off handsomely. The current strategy is to continue to utilize laddered CDs, selected corporates, occasional Virginia municipals, and agency securities to fill the short end of the yield curve. We continue to expect many of our agency securities to be called as their call dates approach. The redeployment of those funds will take market spreads into consideration given the market turmoil. As the credit markets begin to move back to some level of normality, and we believe it is moving that way, we will assess the advisability of returning to a more familiar investment allocation. In the meantime, the current portfolio mix provides a nice diversification of asset type and duration.

One last note on portfolio strategy is this; given the recent inclination of the government to print or borrow trillions of dollars, it is our view that these greenbacks will ultimately come home to roost in the form of a highly-inflated currency. Current state law prohibits investing in the hard assets that would be a first choice of a prudent investor looking for inflation protection, and we cannot choose to flee into alternative currencies that might not be subject to the governmental monetary cloning that is occurring here. We can however utilize Treasury Inflation Protected Securities (TIPS) to gain some level of protection. To that end we have begun to slowly add these securities to our portfolio in small increments with the intention of continuing to build this position at each 10-year TIPS auction. Our first purchase of TIPS was settled in April in the par amount of \$3.0 million and will be reflected in next quarter's report.

The County's portfolio currently contains no direct investments in commercial paper, asset-backed commercial paper, or mortgage backed securities.

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Portfolio Composition - March 31, 2009

GENERAL PORTFOLIO

Security Type	----- Amortized Cost Basis-----		-----Mkt. Value Basis-----		-----Difference-----	
U.S. Gov't & Agency Securities						
Agency Securities	\$378,555,623	46.36%	\$379,330,297	46.50%	\$774,674	
Repurchase & NOW	27,821,670	3.41%	27,821,670	3.41%	\$0	0.00%
Treasury Notes	0	0.00%	0	0.00%	0	0.00%
Subtotal	406,377,293	49.76%	407,151,967	49.91%	774,674	0.19%
Corporate and Municipal Securities						
Virginia Municipal Bonds	33,382,390	4.09%	33,865,320	4.15%	482,930	1.45%
Corporate Bonds	79,834,514	9.78%	77,778,768	9.53%	(2,055,745)	-2.58%
Subtotal	113,216,903	13.86%	111,644,088	13.68%	(1,572,815)	-1.39%
Certificates of Deposit & BAs						
CDs	95,069,074	11.64%	95,069,074	11.65%	0	0.00%
Subtotal	95,069,074	11.64%	95,069,074	11.65%	0	0.00%
Commercial Paper						
Commercial Paper	0	0.00%	0	0.00%	0	0.00%
Subtotal	0	0.00%	0	0.00%	0	0.00%
Money Market Funds						
JP Morgan	12,363	0.00%	12,363	0.00%	0	0.00%
Dreyfus Gov't Fund	0	0.00%	0	0.00%	0	0.00%
Wells Fargo Sweep	15,185,163	1.86%	15,185,163	1.86%	0	0.00%
PFM Fund (formerly Commonwealth)	17,897,490	2.19%	17,897,490	2.19%	0	0.00%
Federated Investors	3,319	0.00%	3,319	0.00%	0	0.00%
Virginia LGIP	168,880,157	20.68%	168,880,157	20.70%	0	0.00%
Subtotal	201,978,491	24.73%	201,978,491	24.76%	0	0.00%
TOTAL GENERAL PORTFOLIO	\$816,641,761	100.00%	\$815,843,620	100.00%	(798,141)	-0.10%

RESTRICTED PORTFOLIO

Security Type	----- Amortized Cost Basis-----		-----Mkt. Value Basis-----		-----Difference-----	
U.S. Gov't & Agency Securities						
Agency Notes	\$8,340,877	8.83%	\$8,435,263	8.94%	\$94,386	1.13%
Treasury Notes		0.00%		0.00%	0	0.00%
Subtotal	8,340,877	8.83%	8,435,263	8.94%	94,386	1.13%
Corporate Securities						
Corporate Bonds	4,119,716	4.36%	3,915,470	4.15%	(204,246)	-4.96%
Commercial Paper	0	0.00%	0	0.00%	0	0.00%
Subtotal	4,119,716	4.36%	3,915,470	4.15%	(204,246)	-4.96%
Money Market Funds						
All Money Market Funds	81,956,111	86.80%	81,956,111	86.90%	0	0.00%
Subtotal	81,956,111	86.80%	81,956,111	86.90%	0	0.00%
TOTAL RESTRICTED PORTFOLIO	\$94,416,704	100.00%	\$94,306,843	100.00%	(109,861)	-0.12%

TOTAL PORTFOLIO

	----- Amortized Cost Basis-----	---Mkt. Value Basis---	-----Difference-----
TOTAL PORTFOLIO	\$911,058,465	\$910,150,464	(908,001)

**Investment Statistics
FY 2006 through FY 2009**

Statistics	Fiscal Year 2006		Fiscal Year 2007		Fiscal Year 2008		Fiscal Year 2009					
	Amount	Change	Amount	Change	Amount	Change	Q1	Q2	Q3	Q4	YTD	Pro-Rated Change
							Amount	Amount	Amount	Amount	Amount	Amount
Earnings (millions) - Total Portfolio	\$29.1	\$22.0	\$48.4	\$19.3	\$51.1	\$2.7	\$6.6	\$17.5	\$4.9		\$29.0	(\$12.5)
Earnings (millions) - General Portfolio	\$21.0	\$16.1	\$35.7	\$14.7	\$41.5	\$5.8	\$5.2	\$16.4	\$4.7		\$26.3	(\$6.4)
Earnings (millions) - General Fund	\$12.6	\$9.4	\$21.1	\$8.5	\$24.2	\$3.1	\$2.9	\$9.3	\$2.7		\$15.0	(\$4.2)
General Fund Participation as a Percent of Total Portfolio Earnings	43.3%	-1.6%	43.6%	0.3%	47.3%	3.7%	44.7%	53.4%	56.1%		51.9%	4.6%
General Fund Participation as a Percent of General Portfolio Earnings	59.9%	-4.7%	59.1%	-0.8%	57.7%	-1.4%	56.3%	57.0%	57.9%		56.6%	-1.1%
Average Portfolio Composition (millions)												
Government Securities	\$377.5	\$161.9	\$353.0	(\$24.5)	\$439.1	\$86.1	\$533.5	\$588.1	\$435.4		\$519.2	\$80.1
Corporate Bonds	0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.6	\$61.1		\$20.6	\$20.6
Commercial Paper	0.0	(\$0.5)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0		\$0.0	\$0.0
Certificates of Deposit	0.0	\$0.0	\$0.0	\$0.0	\$15.0	\$15.0	\$3.8	\$64.4	\$101.1		\$56.4	\$41.4
Money Market	373.2	\$29.2	\$489.7	\$116.5	\$454.7	(\$35.0)	\$407.2	\$266.6	\$319.0		\$331.7	(\$123.0)
Repurchase Agreements	57.5	\$10.0	\$70.7	\$13.2	\$64.1	(\$6.6)	\$40.5	\$57.7	\$36.7		\$45.0	(\$19.1)
Municipal Obligations	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$3.0	\$14.3		\$5.8	\$5.8
Average Cash Invested - Total Portfolio	\$808.2	\$200.6	\$913.4	\$105.2	\$972.9	\$59.5	\$985.0	\$980.4	\$967.6		\$978.7	\$5.8
Portfolio Range (millions)												
High	\$904.7	\$236.2	\$1,057.3	\$152.6	\$1,087.4	\$30.1	\$999.9	\$1,060.5	\$1,023.1		\$1,060.5	(\$26.9)
Low	\$730.3	\$162.7	\$831.7	\$101.4	\$870.8	\$39.1	\$955.1	\$894.6	\$922.4		\$894.6	\$23.8
Comparative Investment Yields												
PWC Total Return (General Portfolio)	3.4%	2.3%	5.3%	1.9%	5.4%	0.1%	2.6%	7.9%	2.2%		4.3%	-1.2%
PWC Earnings Yield (General Portfolio)	4.0%	1.3%	5.2%	1.2%	5.0%	-0.2%	4.1%	4.2%	4.4%		4.2%	-0.8%
Institutionsl Money Funds	3.8%	3.1%	4.9%	1.1%	3.6%	-1.3%	2.0%	1.2%	0.3%		1.2%	-2.4%
Lehman 1-3yr Gvt Index	1.9%	1.6%	5.1%	-0.2%	7.1%	2.0%	5.6%	9.5%	1.3%		5.5%	-1.6%
U.S. Treasury Bills (90-Day)	4.1%	3.2%	5.0%	0.9%	2.9%	-2.1%	1.5%	0.3%	0.2%		0.7%	-2.2%
U.S. Treasury Notes (2 Year)	4.5%	2.6%	4.8%	0.3%	3.1%	-1.7%	2.4%	1.2%	0.9%		1.5%	-1.6%

GLOSSARY OF TERMS

A

Accreted Value	Zero Coupon Bonds are issued at a discount and mature at Par (\$1,000). The value of the bond increases mathematically by a slight amount every day during the life of the bond. The mathematical value of the bond on a given day is its accreted value (or accumulated value to date). Note that the accreted value may be higher or lower than the market value of the bond.
Accrued Interest	Accrued interest is the amount of interest that has been earned since the last interest date. When a bond trades, the buyer pays the seller the accrued interest - a pro rata portion of the next interest payment, which will be paid to the buyer of the bond.
Agency Bonds	Agency bonds are issued by United States agencies, and are generally thought to be very safe investments in terms of default risk. Examples of well known agencies that issue bonds are Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mac"), Federal National Mortgage Association (FNMA or "Fannie Mae"), the Federal Home Loan Bank and the Federal Farm Credit Administration.
Alternative Minimum Tax (AMT)	In addition to calculating regular income tax, taxpayers are also required to calculate tax liability using the AMT method. The taxpayer then pays the higher of the tax calculated by the two methods. Some municipal bonds are subject to AMT, meaning that if you pay AMT, the interest earned on these bonds is taxable under the AMT calculation. Other municipal bonds are not subject to AMT, meaning that even if you pay taxes using the AMT method, interest from non-AMT municipals will not be taxable. Please consult your tax advisor for complete details, and how you might be affected by buying municipal bonds that are subject to AMT.

B

Bank Qualified Basis Point	See Investment Grade
Bearer Bonds	A basis point is simply 1/100th of one percent. One basis point on a \$1,000,000 bond is equal to \$100.
Bond	Bearer bonds are unregistered bonds which are payable to the bearer. Bonds are no longer issued in bearer form, but there are some older bearer bonds that are still in circulation.
Bond Ladder	A bond is a debt instrument in which the issuer promises to pay to the bondholder principal and interest according to the terms and conditions of the bond.
Book Entry	(Laddered Portfolio) A bond ladder is a portfolio of bonds that have staggered maturities. For example, rather than invest \$100,000 in a 5 year bond, an investor might choose to invest in 4 blocks of \$25,000 maturing in 2, 4, 6, and 8 years. This enables the investor to diversify in terms of default risk and reinvestment risk.
	Most bonds are issued in book entry form, which means that there is no physical bond certificate. Bond ownership is evidenced by a trade confirmation issued by the broker/dealer, and by the monthly statements that the brokerage firm provides.

Bullet A bond that is not able to be redeemed prior to maturity is said to be non-callable. A slang term for a non-callable bond is a “bullet”. A bullet is usually more expensive than a callable bond (in that the interest rate is lower), since the investor is protected against the possibility of the bond being called when market interest rates fall.

C

Call Date When a bond is issued, the issuer may have the option to call (redeem) the bond on specified dates and prices prior to maturity. The list of dates on which a specified bond can be called is shown in a call schedule. The call price on callable Agency securities is nearly always 100.

Call Protection Call protection refers to the amount of time from the current date until a bond can be called. For example, if the first call on a bond is in 3 years from now, a buyer will have 3 years of call protection, and they are assured that they can own the bond for at least 3 years.

Call Risk Call risk refers to the risk that a bond may be called when the investor does not want it to be called. Bonds are often called when interest rates decline, so investors in the bond get their cash back and have to reinvest it at the lower rates. Call risk can be eliminated by buying non-callable bonds, however non-callable bonds will likely carry lower yields than callables.

Call Schedule A call schedule is a list of the dates that a bond can be called, together with the corresponding price for each call date.

Callable If a bond can be called (redeemed) prior to maturity, the bond is said to be callable. If a bond can not be called prior to maturity, it is said to be non-callable. A slang term for a non-callable bond is a “bullet”.

Certificates of Participation Certificates of Participation (COPs) are a type of municipal bond that are often used to finance capital improvement projects or equipment. The COPs represent participation in lease payments made by the municipality for the project or equipment.

Corporate Bond Corporate bonds represent debt of corporations. The bonds are fully taxable, and they are issued in maturities ranging from less than one year to about 30 years (although there are a few corporate bonds that mature in more than 30 years). They typically pay interest twice a year. Corporate bonds can be quite safe when they are issued by strong companies, or they can have significant risk of default when issued by weak companies. Two rating agencies, Moody's and Standard & Poors rate bonds as to the risk of default.

Coupon A coupon is the stated interest rate for a bond. Most bonds have a fixed coupon that does not change during the life of the bond. Most bonds have two coupon payments per year. For example, a bond with a 5.0% coupon will pay \$25 twice per year, for total interest of \$50 which is 5.0% of the face value of the bond (almost all bonds have a face value of \$1,000).

Credit Ratings In order to help us assess the credit worthiness of a bond issuer, there are agencies that study the financial strength of bond issuers, and assign credit ratings. The three major rating agencies are Moody’s Investors Service, Standard & Poors and Fitch Ratings. These agencies assign ratings to bond issues so that investors can determine the credit worthiness of an issue without having to do the financial analysis on their own.

Current Yield Current yield is the rate of return an investor will get, without taking into account the value of the premium or discount of the purchase price. It is calculated by dividing the coupon by the price. The current yield is not a good indication of your return on investment. Yield to maturity and yield to call take into account the value of the discount or premium paid for the bond, and as such they offer a much better indication of the value of the bond.

CUSIP A CUSIP number identifies a company or issuer and the type of security. CUSIP stands for Committee on Uniform Securities Identification Procedures.

D

Dated Date	The dated date is the date the bond is issued and starts to accrue interest.
Default	A term that denotes the failure to pay the principal or interest on a financial obligation (such as a bond). Clearly, purchasing a bond in default is an extremely risky investment.
Delivery	Bonds are issued in several different delivery forms. The most popular forms of delivery are Book Entry and Registered. Some older bonds in circulation were issued in bearer form (see bearer bonds).
Discount Bond	Bonds mature at a par value, which is almost always \$1,000. A premium bond is any bond that is currently trading at a price above par. A discount bond is a bond trading at a price lower than par.

E

Escrowed to Maturity (ETM)	Sometimes an issuer desires to pay off a bond in order to remove the debt from its books. However, the bond may not be callable, and the issuer can not redeem the bonds at its discretion. In this case the issuer may deposit sufficient funds with a trustee into an escrow account so that the trustee can use the funds to pay all interest and principal as they come due.
Extraordinary Redemption	Some municipal bonds are issued with an extraordinary redemption provision which gives the issuer the right to call the bonds under certain circumstances. The circumstances could range from natural disasters to cancelled projects to almost anything else.

F

First Coupon Date	Bonds typically pay interest twice per year on coupon payment dates. The first coupon date is the date on which the very first interest payment will be made for a bond. It is relevant because bonds often have a longer or shorter than normal first payment period. Once the first coupon payment has been made, the bond will likely pay every 6 months after that.
Fitch Ratings	A leading global rating agency providing independent, timely and prospective credit opinions.

G

General Obligation Bonds	The interest and principal payments for a municipal bond are typically either guaranteed by the issuer or by the revenue from a specific project. If the issuer guarantees the repayment of principal and interest, the bonds are known as a general obligation (often referred to as G.O.) of the issuer.
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H

High Yield Bonds	High Yield Bonds are typically corporate bonds that are rated below investment grade by the major rating services. These bonds pay much higher interest than investment grade bonds, but there is usually a substantial risk of default, which is why they are often referred to as “junk bonds” (see junk bonds).
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I

Industry Group	Corporations are often grouped by the industry to which they belong. A few industry groups are Financial Services, Industrials and Transportation.
Insured Bonds	Some municipal bonds are insured as to principal and interest by large bond insurance firms. The insurance firms are generally large with considerable financial strength. Therefore, any bond that is insured by one of the major insurers will carry a top credit rating from the major rating services, regardless of the issuer’s credit strength.
Interest	Interest is the money the issuer pays to the bondholder at specified times throughout the life of the bond. The stated interest

Interest Payment Dates	rate of a bond is usually referred to as the coupon rate. Most bonds pay interest semi-annually (twice per year). The interest payment dates are usually the same month and day as the maturity date of the bond, and the six month anniversary. For example, a bond with a stated interest rate (coupon) of 5.0% and a maturity of 02/15/2005 will pay \$25 every February 15 (the same month and day as the maturity date) and \$25 every August 15 (the 6 month anniversary). Note that each payment is half of the stated interest rate of 5% (\$50) per year per \$1,000 bond.
Investment Grade	The major credit rating services rate bonds as to their credit worthiness. Bonds that are rated at or above "Baa" by Moody's or "BBB" by S&P are said to be investment grade bonds.
Issue Description	This is the name of the issuer of the bond, and sometimes a brief description of the purpose of the bond. Think of this as the bond's name.
Issuer	The issuer is the entity that issues a bond. It could be the name of a company in the case of a corporate bond, or the name of the state, city, or county in the case of a municipal bond. The U.S. government is the issuer of Treasury bonds.

J

Junk Bonds	The major credit rating services rate bonds as to their credit worthiness. Bonds rated lower than these ratings are said to be high yield "junk" bonds.
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L

Listed	Most corporate bonds trade over-the-counter - that is to say that they do not trade on an exchange. There are a small number of bonds that do trade on the New York Stock Exchange (NYSE), and these bonds are said to be "listed" on the exchange.
Long Bond	The U.S. government currently issues new Treasury notes in maturities of two, five and ten years. Treasury bonds cover terms of more than ten years and are currently issued only in maturities of 30 years. The 30 year bond is called the long bond, and it is considered one of the benchmark indicators of interest rates.

M

Maturity Date	The maturity date of a bond is the date on which the bond will be repaid. Note that many bonds have features such as puts and calls which may cause the principal to be repaid on an earlier date.
Moody's Investors Service	A leading provider of independent credit ratings, research and financial information to the capital markets.
Municipal Bonds	Municipal bonds are issued by state, county, or city governments. They are generally exempt from federal tax, and are generally state tax-free for residents of the state in which they are issued. (This is not true for all states. Please see the discussion on states below for more information.) It should also be noted that though interest is tax-exempt, any capital gains are taxed at the appropriate levels.

N

Non-Callable Bond	If a bond can be called (redeemed) prior to maturity, the bond is said to be callable. If a bond can not be called prior to maturity, it is said to be non-callable.
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O

Original-Issue Discount (OID) Some bonds are issued at a discount to the Par value. In the case of a municipal bond, the accretion of value from the original issue discount price to Par is considered tax-free income. Throughout the life of the bond, the cost basis of the bond will increase based on a formula known as constant yield to maturity (CYM). This means that if you buy a bond with an OID priced at 96, and sell it 5 years later at 98, you will not incur a capital gain as long as the accreted value of the bond based on CYM is 98 or greater

P

Par Value Par value, also known as Face value, is the value of the bond at maturity. Almost all bonds have a \$1,000 par value. Bond prices are almost always quoted as a percentage of par, so you will hear prices such as 99 or 101.5. These refer to the percentage of \$1,000, and mean \$990 and \$1,015 per bond respectively.

Pay Frequency The pay frequency refers to the frequency that the bond pays interest. The most common pay frequency is semi-annually (twice per year), but bonds can also pay interest monthly, quarterly, annually, or at maturity.

Physical Bonds are issued in several different delivery forms. The most popular forms of delivery are Book Entry and Registered. There are also some older bonds in circulation that were issued in bearer form. In the case of book entry bonds, there is no physical bond certificate created. Bearer bonds and registered bonds are both issued with physical bond certificates that can be delivered to the bondholder, so they are said to be physical bonds.

Premium Bond Bonds mature at a par value, which is almost always \$1,000. A premium bond is any bond that is currently trading at a price above par. A discount bond is a bond trading at a price lower than par.

Pre-Refunded Sometimes an issuer desires to pay off a bond in order to remove the debt from its books. However, the bond may not be immediately callable, and the issuer can not redeem the bonds at its discretion. In this case the issuer may deposit sufficient funds with a trustee into an escrow account so that the trustee can use the funds to pay all interest and principal on a specified call date in the future. In this case, the bond is said to be pre-refunded, and the pre-refunded date should be viewed as the date that the bond will be redeemed.

Price Almost all bonds have a \$1,000 par value. Bond prices are almost always quoted as a percentage of par, so you will hear prices such as 99 or 101.5. These refer to the percentage of \$1,000, and mean \$990 and \$1,015 per bond respectively. The price of a bond moves higher and lower throughout the life of a bond based on movements in general market rates, the maturity of the bond, changes to credit ratings, and other factors.

Principal The principal is the cost per bond multiplied by the number of bonds in a transaction. Note that the price of a bond is quoted as a percentage of \$1,000 (Par). So if you purchase 10 bonds that are priced at 99.0, the price is $10 \times (99\% \text{ of } 1,000) = \$9,900$. (To convert a bond price to principal, simply move the decimal one place to the right.)

Purpose Most municipal bonds are issued for a specific purpose. Some common purposes of issuing bonds are to pay for housing, education, healthcare, and transportation.

Put Bonds Put bonds are issued with an option that entitles bondholders to force the issuer to buy back the bonds on specific dates (put the bonds back to the issuer).

Q

Quantity The quantity refers to the number of bonds being offered. Note that bonds typically have a \$1,000 par value, so 50 bonds means \$50,000 of par value. The current actual price may be more or less than par. In some cases the bond offering may be for a minimum number of bonds as well. This means that you can not buy fewer bonds than the minimum designated in the offering.

R

Ratings See **Credit Rating**

Redemption When the principal of the bond is paid off, the bond is said to be redeemed. Bonds can be redeemed at maturity, or on a call date or put date.

Registered Bonds Registered bonds are bonds that are issued as a physical certificate, and the owner is registered with the bond trustee. If the bond is lost, the registered owner can get the certificate replaced by paying a small fee.

Revenue Bonds The interest and principal payments for municipal bonds are typically either guaranteed by the issuer or by the revenue from a specific project. If they are guaranteed by a specific project, the bondholder is relying on revenue from the project to pay principal and interest, and the bonds are known as revenue bonds.

S

Secondary Market Bonds which have been issued and then trade subsequent to the original issue are said to be trading in the secondary market.

Settlement Date When a bond trade takes place, the buyer and seller agree on a date when the buyer will pay for the bonds and the seller will deliver the bonds. For municipal bonds and corporate bonds, the settlement date is typically 3 business days after the trade date. For Treasury and zero coupon bonds the settlement date is typically the next business day after the trade.

Sinking Fund Some municipal or corporate bonds are issued with a sinking fund provision, which could be optional or mandatory. In the case of a sinking fund the issuer pays off the principal of the bond over time, for example 10% of the principal in each of the last 10 years of the life of the bond. If the sinking fund is mandatory the issuer must make these payments each year.

Spread The spread of a bond refers to the difference between the yield of the bond and the yield of a Treasury bond with a comparable maturity. Since the Treasury yield is considered risk-free, the spread reflects the risk premium of the bond. The spread is expressed in basis points (1/100th of 1 percent.).

Standard & Poors State A global leader in credit ratings and credit risk analysis. The state in which the bond was issued. This is important for tax purposes since in some states interest earned from municipal bonds is exempt from state tax for investors who live in the state where the bond was issued. State will only appear on queries for municipal bonds.

STRIPS A Zero Coupon Treasury Security which stands for Separate Trading of Registered Interest and Principal of Securities (Refer to Zero Coupon Bonds).

T

Tax Status Municipal bonds are generally free of federal tax, and are generally not subject to alternative minimum tax (AMT). However, some municipal bonds are subject to federal income tax (tax status = "taxable"), and some are subject to AMT (tax status = "Subject to Alt min tax").

Taxable Equivalent Yield The taxable equivalent yield (TEY) is a calculated value that calculates the pre-tax yield an investor would need to get so that after paying tax, the after tax yield would be equal to the tax-free yield on a municipal bond.

Treasury Bills The U.S. government issues Treasury Bills, Treasury notes, and Treasury bonds. Treasury bills are issued in 3 month, 6 month and 1 year maturities, and they are sold at a discount to par. The bonds do not pay period interest, and the return an investor receives is based on the amount that the purchase price is discounted from par.

Treasury Bonds and Notes Treasury notes and bonds are issued by the U.S. government in maturities of two, five, ten and 30 years. They all pay interest semi-annually. The issues that mature in ten years or less are called notes, and the 30 year issue is called a bond. The most recently issued 30 year bond is called "the long bond".

Y

Yield See Yield to maturity, yield to call, and current yield.

Yield to Call Some bonds can be called (redeemed) by the issuer on specified dates throughout the life of the bond. Based on the current price of a bond, the yield to all calls should be calculated, and the investor should note the lowest yield to call and the yield to maturity. This will give the investor their worst case scenario.

Yield to Maturity Yield to maturity is the calculated return on investment that an investor will get if they hold the bond to maturity. It takes into account the present value of all future cash flows, as well as any premium or discount to par that the investor pays.

Z

Zero Coupon Bonds Zero Coupon Bonds are bonds that do not pay interest during the life of the bond. They are bought at a discount to the maturity value. For example, you might pay \$700 today to get back \$1,000 in 5 years. The difference between what you pay now and what you receive in the future is your return. Zero Coupon Bonds are similar in concept to savings bonds.