

# Palm Beach County School District

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Investment Performance Review  
Quarter Ended December 31, 2006



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**Table of Contents**

**Tab I.**

Section A Market Review

Section B Investment Portfolio Summary & Performance

Section C Asset Allocation Chart

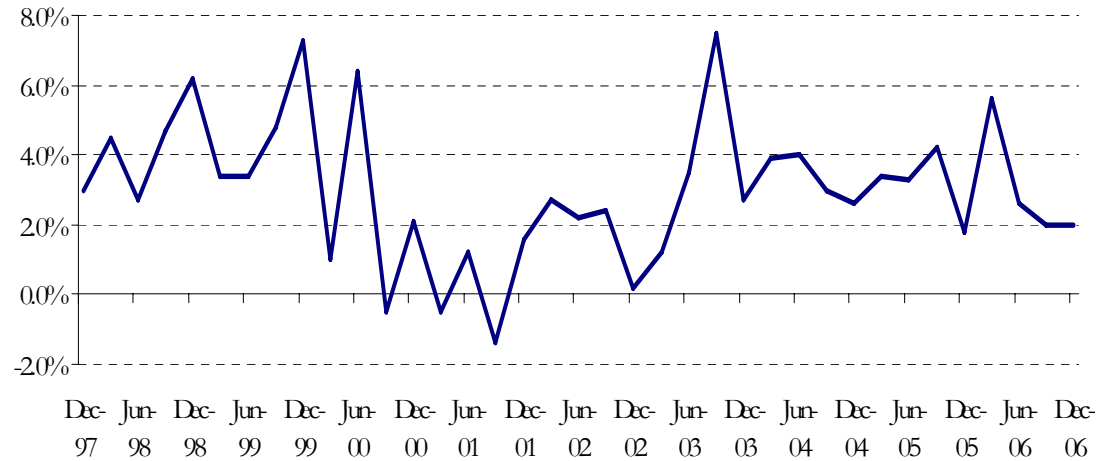
**Tab II.** December 31, 2006 PFM Month-End Statement

This material is based on information obtained from sources generally believed to be reliable and available to the public, however PFM Asset Management LLC cannot guarantee its accuracy, completeness or suitability. This material is for general information purposes only and is not intended to provide specific advice or recommendation. The information contained in this report is not an offer to purchase or sell any securities.

**MARKET REVIEW**

**The Economy: Soft Landing is Once Again in Range**

**Annualized GDP In Constant Dollars (Quarterly Change)  
December 1997 – December 2006**



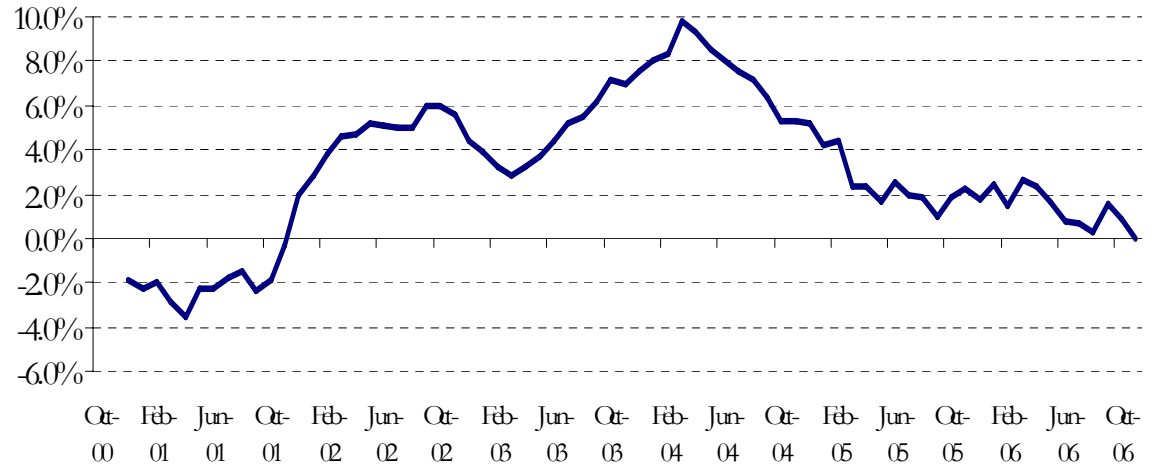
**Outlook is for 2-3% Growth in Next Several Quarters**

- 2nd and 3rd quarters averaged 2-3%
- Modest holiday season sales growth
- Weak housing
- Strong business investment and government spending

**Leading Economic Indicators Have Risen in 3 of the Last 5 Months**

- Stock prices, capital outlays show strength
- Housing and interest rates are a drag

**Leading Economic Indicators  
December 2000 – November 2006**

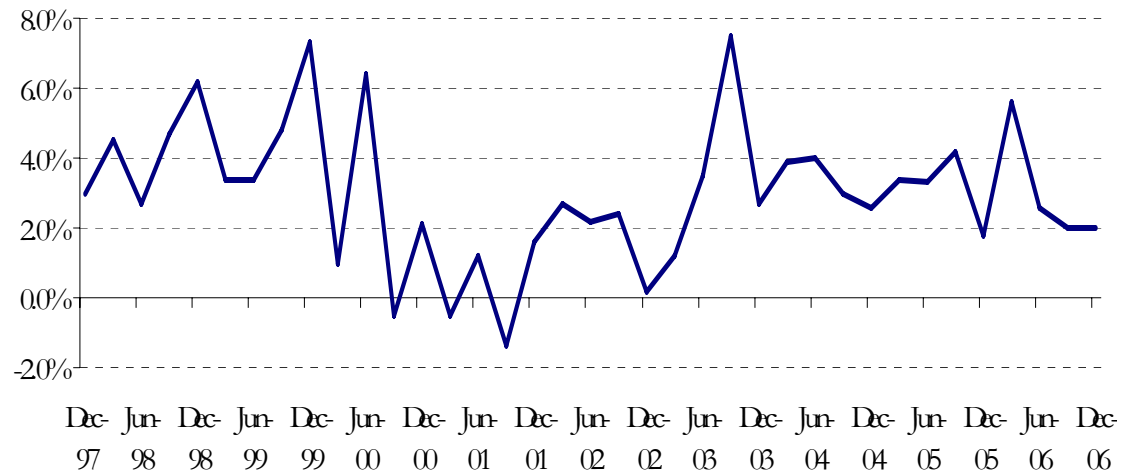


Source: Bloomberg

**Bottom of Housing Downturn is Uncertain**

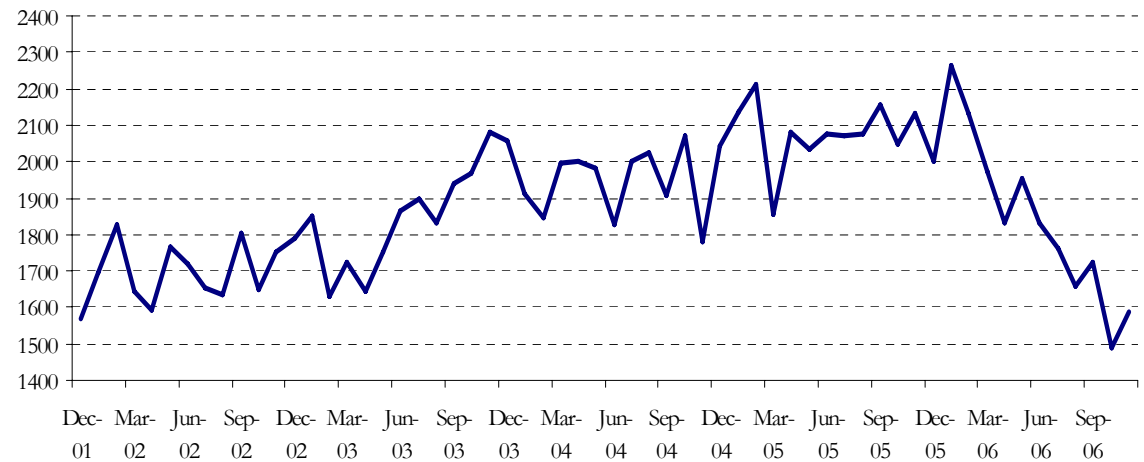
- Existing home sales in forth quarter remain weak
- Average prices below those of a year ago

**Annualized Existing Home Sales (in Millions)  
December 2001 – November 2006**



- Housing starts rebounded after October drop to lowest since 2000

**Housing Starts (in Thousands)  
December 2001 – November 2006**

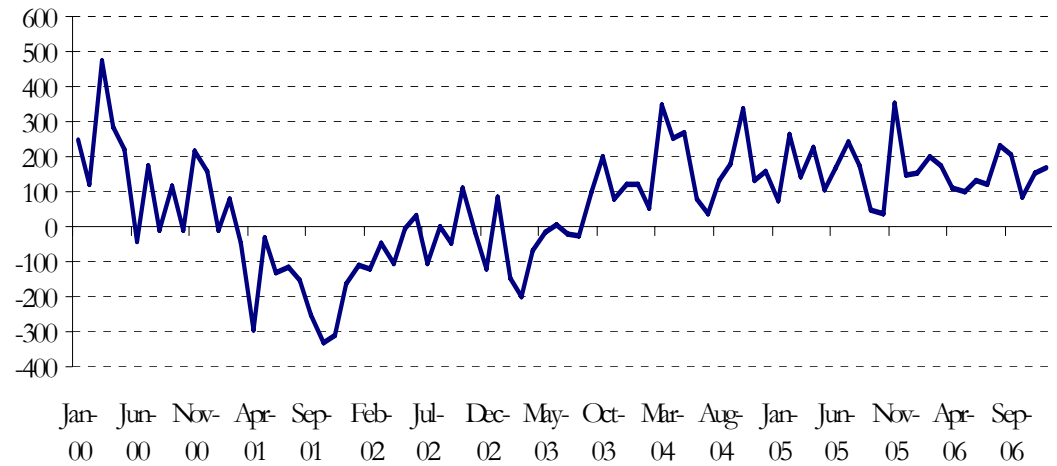


Source: Bloomberg

Recent Employment Reports Are Somewhat Stronger

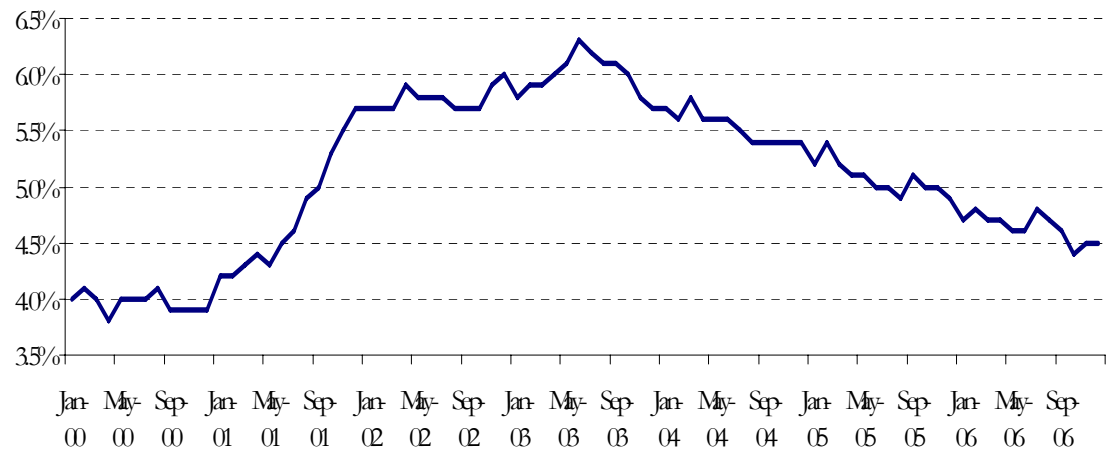
- Job growth averaged 160,000 jobs per month in the last six months

**Change in Non-Farm Payrolls (in thousands)**  
January 2000 – December 2006



- Unemployment rate at 4.5% in December
- Hourly earnings growing at 4.2% year-over-year
- Work week stable

**Unemployment Rate**  
January 2000 – December 2006

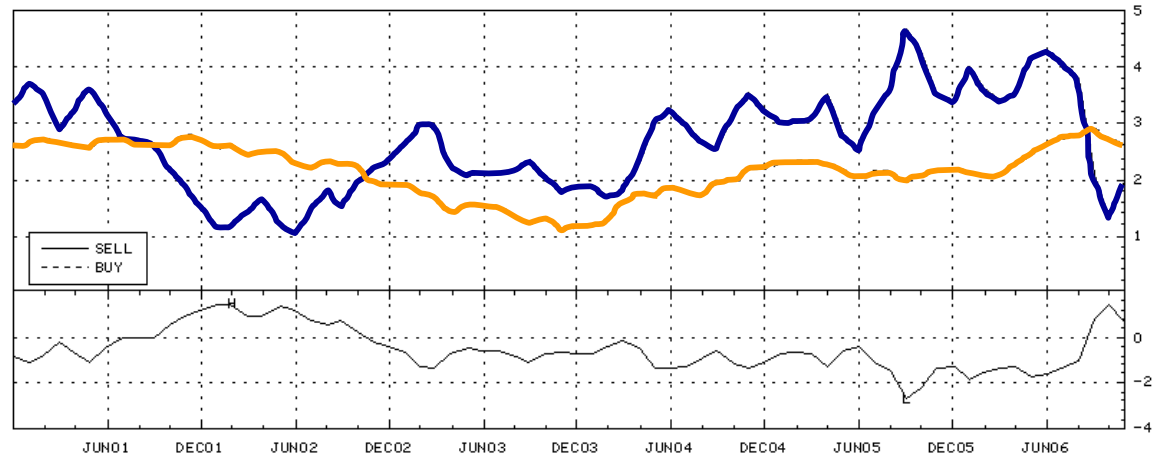


Source: Bloomberg

**Inflation Measures are Moving in the Right Direction**

- Core CPI +2.6% year-over-year
- Overall CPI (+2.0% year over) reflects energy price fluctuations

**Consumer Prices (Year-Over-Year)  
December 2000 – November 2000**



**Crude Oil Future Contract, Near Month  
January 2005 – December 2006**

- Oil Prices recently fell to lowest levels a year
- But hourly earnings recently ticked up to +4.2% over last year

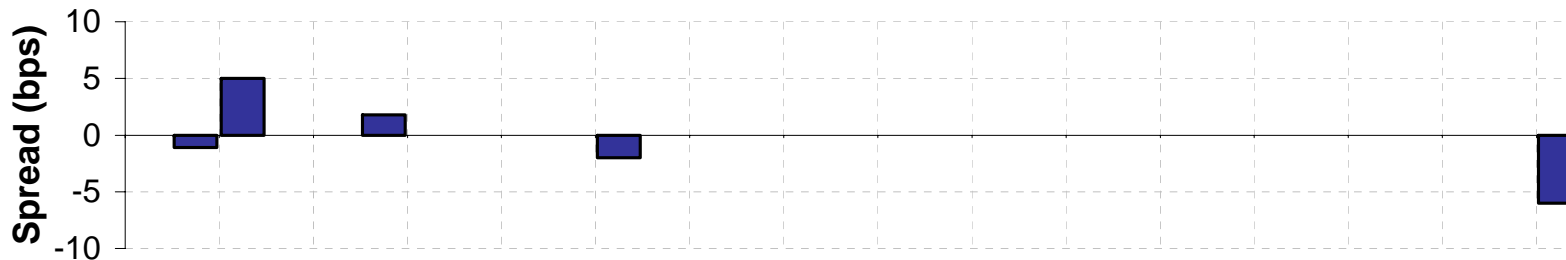
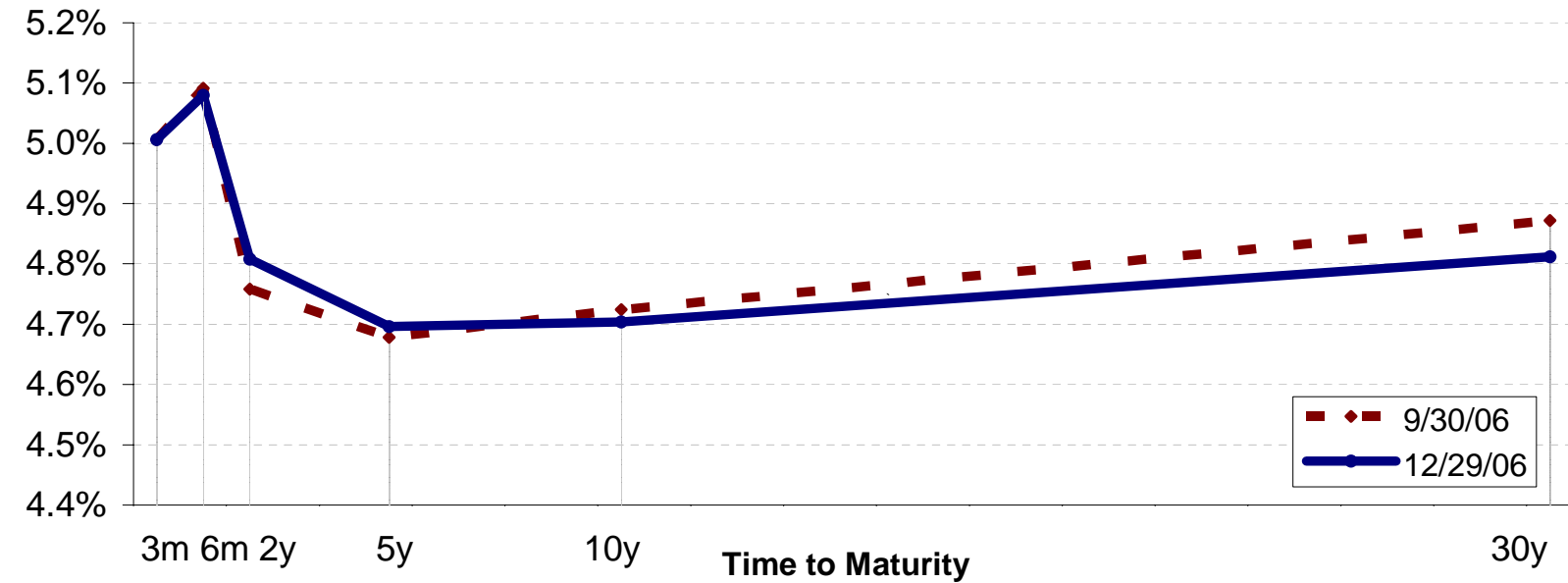


Source: Bloomberg

Yield Curve Remains Inverted

- Market experts lower Fed Fund rate in next 3-6 months

U.S. Treasury Yield Curve  
September 30, 2006 vs. December 29, 2006



Source: Bloomberg

**Federal Funds Futures Contracts Now Call For Steady Rates Through 1st Quarter 2007**

- FOMC left overnight rate unchanged on December 12
- Next Meeting: January 31

**Fed Funds Futures Contracts for June 2007  
June 1, 2006 – December 29, 2006**



Source: Bloomberg



Investment Portfolio Portfolio Summary<sup>1</sup>

Total Portfolio Value <sup>2</sup>	December 31, 2006	September 30, 2006
Market Value	\$84,527,587.32	\$84,653,135.87
Amortized Cost	\$84,838,707.92	\$84,985,449.30

**PORTFOLIO STRATEGY**

- Economic growth continued its downward trend during the fourth quarter with annualized GDP expected to be 1.75%-2.0% during the fourth quarter of 2006, following 5.6%, 2.6% and 2.0% growth for the first three quarters. Primarily as a result of the continued decline in the housing market. Housing did experience a slight increase towards the end of the quarter largely due to lower mortgage rates and incentives from homebuilders.
- The ISM index for Manufacturing posted a rate of 49.5 in November, the first non-expansion monthly figure (50 is considered the breakeven for expansion) since April of 2003, suggesting a slowdown in manufacturing.
- The FOMC maintained the Federal Funds rate at 5.25% during the quarter but maintaining concern for inflationary risk. As recent as December 12<sup>th</sup> Fed Member Fisher commented “the risk of unacceptably high inflation still outweighs the risk of substandard growth.” Many market participants do not agree with this assessment and several are predicting the FOMC will lower rates possibly as early as spring of 2007.
- The labor market remains a bright spot with the economy adding 407,000 jobs during the quarter, continuing the positive growth trend since September 2003, and an unemployment rate of 4.50%, the lowest since June 2001.
- The District’s Investment portfolio return of 1.09% was 18 basis points higher than the Merrill Lynch 1-3 Year U.S. Treasury Note Index benchmark return of 0.91%, considerably outperforming the benchmark for the quarter. PFM’s dynamic investment strategy has resulted in the portfolio outperforming the benchmark by 52 basis points for the last 12 months.
- Interest rates ended the quarter relatively stable with the three-month to two-year federal agency maturities experiencing a 5 and 6 basis points increase, respectively. PFM executed selective extension trades for the portfolio as periodic volatility provided the opportunity to lock in rates in anticipation of declines in interest rates as suggested by the current inverted yield curve and forward yield curves.

Notes:

- In order to comply with GASB accrual accounting reporting requirements; forward settling trades are included in the m
- End of quarter trade-date market values of portfolio holdings, including accrued interest.

**PORTFOLIO STRATEGY**

- The slow economic growth of the second half of 2006 is expected to continue into 2007. There is considerable debate regarding whether the Housing market has reached the bottom and how fast this industry will rebound. Consumers once flush with equity cash which fueled the economy through early 2006 are now worried about declining home values which has slowed spending.
- The U.S. leading economic indicator index, which attempts to signal the direction of the economy for the preceding three to six months - barely rose 0.1% in November.
- PFM will look to increase allocation to U.S. Treasuries during the first quarter of 2007 while spreads to Federal Agency securities remain narrow.
- Forward yield curves suggest further declines in interest rates, and PFM will continue to identify longer term securities to extend portfolio duration as opportunities arise from any upward moves in interest rates.

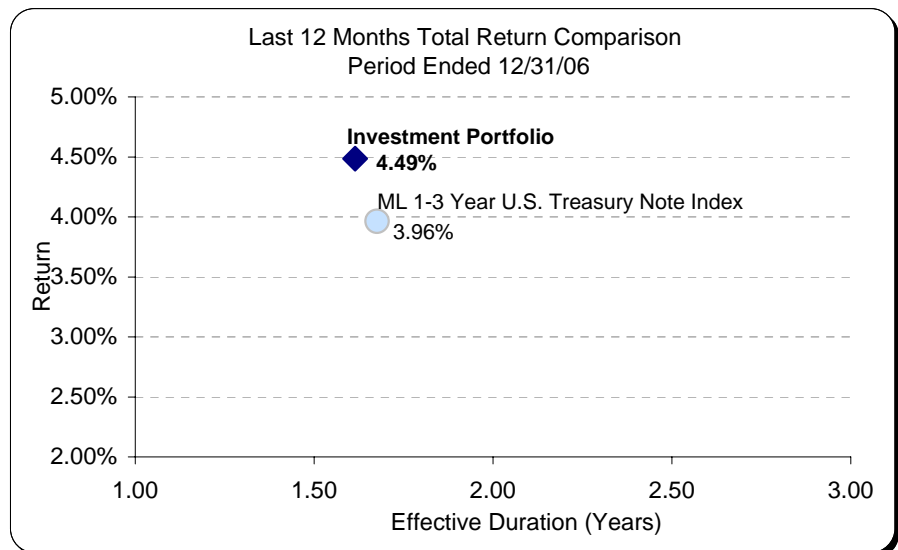
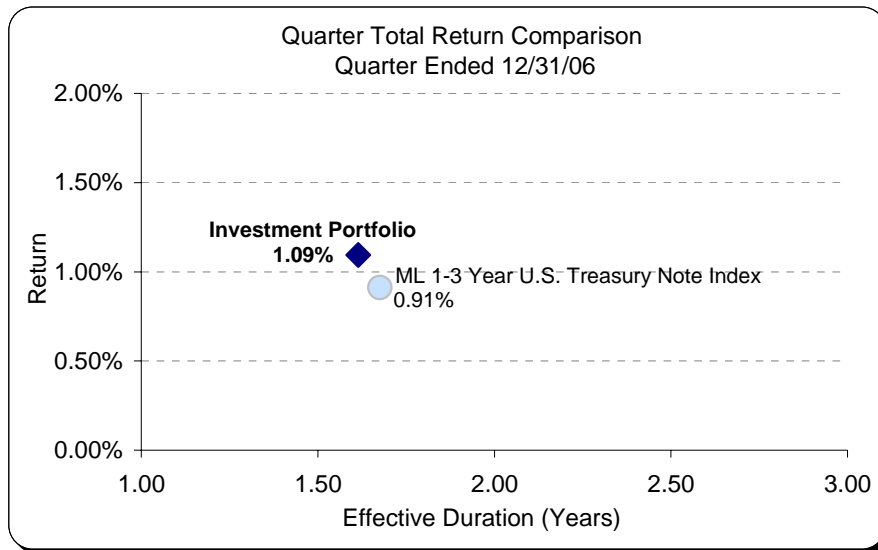
Federal Agency Security Yield Curve Analysis  
September 30, 2006 - December 29, 2006



Investment Portfolio Performance

Total Return <sup>1,2,3,4,5,6</sup>	Quarterly Return December 31, 2006	Annualized Quarter	Last 12 Months	Last 24 Months	Since Inception on 12/31/98
<b>Investment Portfolio</b>	<b>1.09%</b>	<b>4.41%</b>	<b>4.49%</b>	<b>3.20%</b>	<b>4.33%</b>
Merrill Lynch 1-3 Year U.S. Treasury Note Index	0.91%	3.66%	3.96%	2.81%	4.16%

<u>Effective Duration (Years)<sup>4</sup></u>	<u>December 31, 2006</u>	<u>September 30, 2006</u>	<u>Yields</u>	<u>December 31, 2006</u>	<u>September 30, 2006</u>
<b>Investment Portfolio</b>	<b>1.61</b>	<b>1.61</b>	Yield at Market	<b>5.02%</b>	5.05%
ML 1-3 Year U.S. Treasury Note Index	1.68	1.71	Yield at Cost	<b>4.72%</b>	4.67%

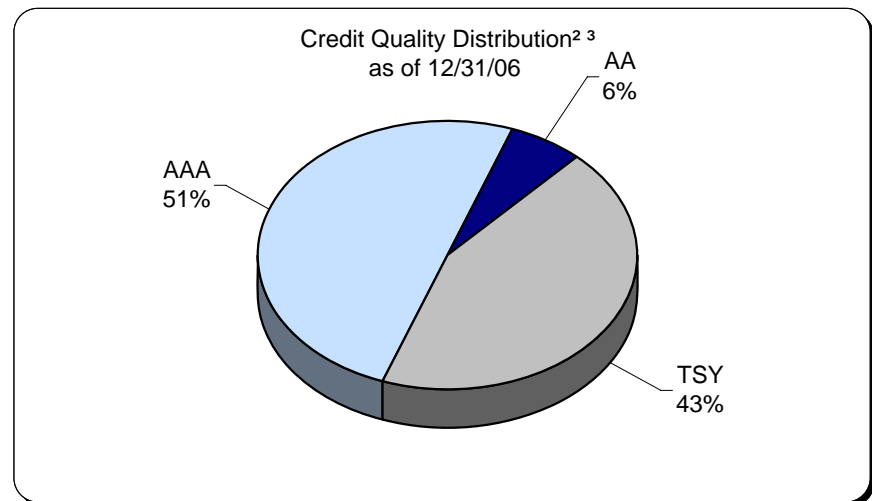
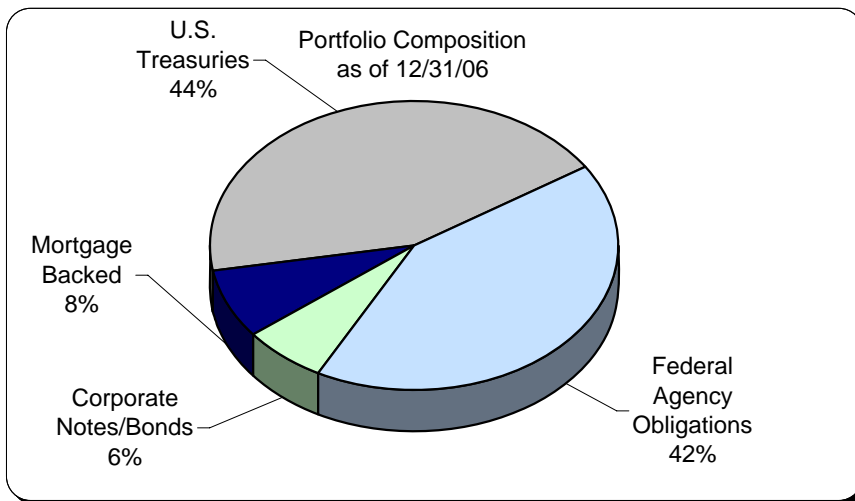


Notes:

1. Performance on trade date basis, gross (i.e., before fees), is in accordance with The CFA Institute's Global Investment Performance Standards (GIPS).
2. Merrill Lynch Indices provided by Bloomberg Financial Markets.
3. Quarterly returns are presented on both an unannualized and annualized basis. The annualized return assumes the quarterly return is compounded at the same rate for four quarters and is presented for reference only. The actual annual return will be the result of chaining the most recent four quarterly returns.
4. Excludes money market fund/cash in performance and duration computations.
5. Returns presented for 12 months or longer are presented on an annual basis.
6. Past performance is not indicative of future results.

Investment Portfolio Portfolio Composition and Credit Quality Characteristics

<u>Security Type<sup>1</sup></u>	<u>December 31, 2006</u>	<u>% of Portfolio</u>	<u>September 30, 2006</u>	<u>% of Portfolio</u>
U.S. Treasuries	\$36,769,090.44	43.5%	\$34,203,810.23	40.4%
Federal Agencies	35,591,126.21	42.1%	37,981,411.71	44.9%
Commercial Paper	0.00	0.0%	0.00	0.0%
Certificates of Deposit	0.00	0.0%	0.00	0.0%
Bankers Acceptances	0.00	0.0%	0.00	0.0%
Repurchase Agreements	0.00	0.0%	0.00	0.0%
Municipal Obligations	0.00	0.0%	0.00	0.0%
Corporate Notes/Bonds	5,479,395.45	6.5%	5,414,192.85	6.4%
Mortgage Backed	6,687,975.22	7.9%	7,053,721.08	8.3%
Money Market Fund/Cash	0.00	0.0%	0.00	0.0%
<b>Totals</b>	<b>\$84,527,587.32</b>	<b>100.0%</b>	<b>\$84,653,135.87</b>	<b>100.0%</b>

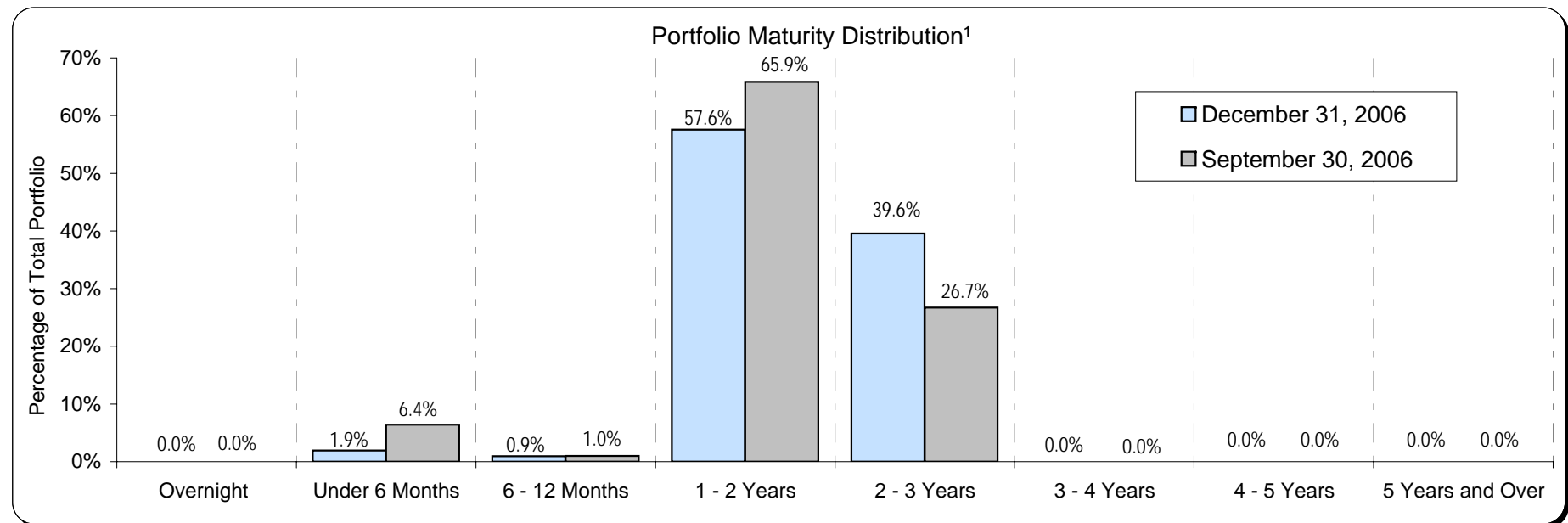


Notes:

1. End of quarter trade-date market values of portfolio holdings, including accrued interest.
2. Credit rating of securities held in portfolio, exclusive of money market fund/LGIP.
3. A rating of "TSY" indicates the security is an obligation of, or explicitly guaranteed by the U. S. Government.

Investment Portfolio Maturity Distribution

<u>Maturity Distribution<sup>1</sup></u>	<u>December 31, 2006</u>	<u>September 30, 2006</u>
Overnight (Money Market Fund)	\$0.00	\$0.00
Under 6 Months	1,624,798.50	5,439,031.06
6 - 12 Months	784,061.30	850,721.08
1 - 2 Years	48,655,360.52	55,759,573.76
2 - 3 Years	33,463,367.00	22,603,809.97
3 - 4 Years	0.00	0.00
4 - 5 Years	0.00	0.00
5 Years and Over	0.00	0.00
<b>Totals</b>	<b>\$84,527,587.32</b>	<b>\$84,653,135.87</b>



Notes:

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

Trade Analysis for October 10, 2006

Transaction Date: October 10, 2006

Transaction	Security	Par Value	Price	Yield at Market	Benefit	Gain/Loss	Additional Earnings
Sold	U.S. Treasury Notes (12/31/07)	\$2,455,000.00	\$99.3984	4.882%		(13,939.57)	
Purchased	FHLB Global Notes (8/28/08)	\$2,535,000.00	\$100.0500	5.468%	0.586%		17,862.99
Total Estimated Benefit from Transaction to Original Maturity							\$17,862.99
<b>Total Estimated Benefit from Transactions</b>							<b>\$17,862.99</b>

**Transaction Commentary:**

In accordance with Section III. Investment Objectives, of the District's Investment Policy, from time to time, securities may be traded for other similar securities to improve yield, maturity, or credit risk. For these transactions, a loss may be incurred for accounting purposes, provided any of the following occurs with respect to the replacement security: 1) The yield has been increased, 2) the maturity has been reduced, or lengthened, 3) or the quality of the investment has been improved.

The transactions presented were executed in accordance with Section III Investment Objectives of the District's Investment Policy to 1) Increase Yield as part of PFM's overall active management strategy for the District's investment portfolio, which should also increase the portfolio's total return. The performance of this portfolio should be evaluated based on the total return versus the District's 1-3 Year U.S. Treasury Index benchmark. PFM calculates the total return of the District's investment portfolio in a manner consistent with the CFA Institute's Global Investment Performance Standards.

Notes:

1. The total estimated benefit from the transaction is based on the net of the benefit in yield and the gain or loss on the transaction. The benefit is calculated on a 30/360 day basis until the earlier of: 1) original maturity of the sold security, or 2) new maturity of the purchased security. Total purchase may not equal to proceeds from sold securities as a result of additional income included in purchase or from a portion of maturity not reinvested. Calculations based on lesser amount sold or reinvested.

Trade Analysis for November 3, 2006

Transaction Date: November 3, 2006

Transaction	Security	Par Value	Price	Yield at Market	Benefit	Gain/Loss	Additional Earnings
Sold	U.S. Treasury Notes (1/31/08)	\$1,800,000.00	\$99.4648	4.819%		(3,259.19)	
Purchased	FHLB Disc Notes (12/21/06)	\$1,969,000.00	\$99.3153	5.135%	0.316%		7,173.20
Total Estimated Benefit from Transaction to Original Maturity							\$7,173.20

Transaction	Security	Par Value	Price	Yield at Market	Benefit	Gain/Loss	Additional Earnings
Sold	U.S. Treasury Notes (2/15/08)	\$3,070,000.00	\$98.2148	4.823%		(44,600.96)	
Purchased	U.S. Treasury Notes (8/15/09)	\$2,550,000.00	\$100.7930	4.566%	-0.257%		(8,537.75)
Total Estimated Benefit from Transaction to Original Maturity							(\$8,537.75)

Transaction	Security	Par Value	Price	Yield at Market	Benefit	Gain/Loss	Additional Earnings
Sold	U.S. Treasury Notes (2/15/08)	\$4,045,000.00	\$97.7773	4.804%		(4,689.89)	
Purchased	U.S. Treasury Notes (10/31/08)	\$4,250,000.00	\$100.4453	4.638%	-0.166%		(8,747.76)
Total Estimated Benefit from Transaction to Original Maturity							(\$8,747.76)

<b>Total Estimated Benefit from Transactions</b>							<b>(\$10,112.32)</b>
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The transactions presented were executed in accordance with Section III Investment Objectives of the District's Investment Policy to 2) lengthen the maturity as part of PFM's overall active management strategy for the District's investment portfolio, which should also increase the portfolio's total return. The performance of this portfolio should be evaluated based on the total return versus the District's 1-3 Year U.S. Treasury Index benchmark. PFM calculates the total return of the District's investment portfolio in a manner consistent with the CFA Institute's Global Investment Performance Standards.

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Trade Analysis for November 13, 2006

Transaction Date: November 13, 2006

Transaction	Security	Par Value	Price	Yield at Market	Benefit	Gain/Loss	Additional Earnings	
Sold	FHLB Disc Notes (12/1/06)	\$1,969,000.00	\$99.7425	5.235%		(14.76)		
Sold	FHLB Tap Notes (2/15/08)	\$2,000,000.00	\$97.9369	5.088%		(26,201.30)		
Purchased	U.S. Treasury Notes (8/15/09)	\$3,700,000.00	\$100.5547	4.655%	-0.506%		(11,612.51)	
Total Estimated Benefit from Transaction to Original Maturity							(11,612.51)	
<b>Total Estimated Benefit from Transactions</b>							<b>(\$11,612.51)</b>	

**Transaction Commentary:**

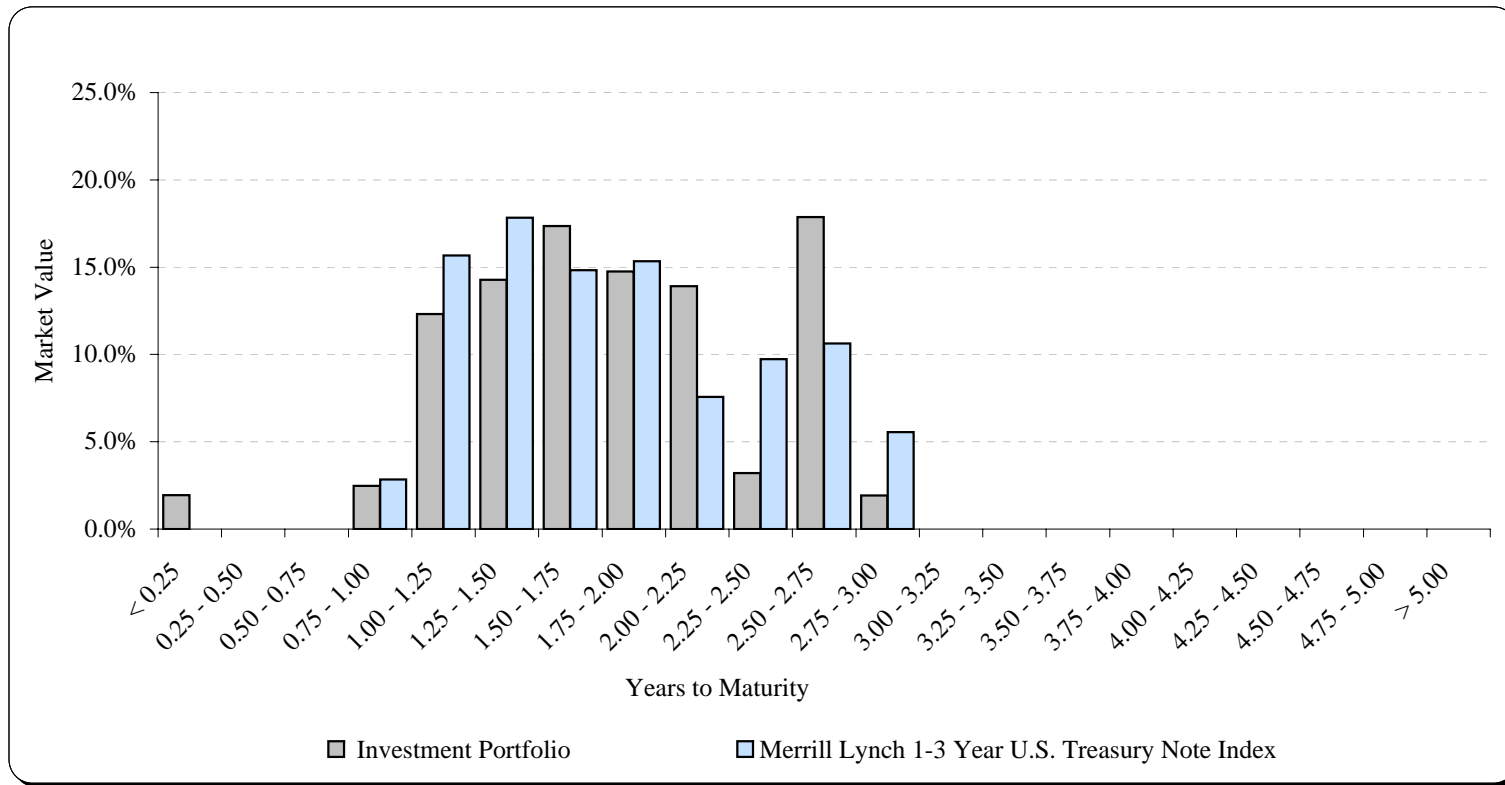
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Investment Portfolio Maturity Distribution versus the Benchmark<sup>1</sup>

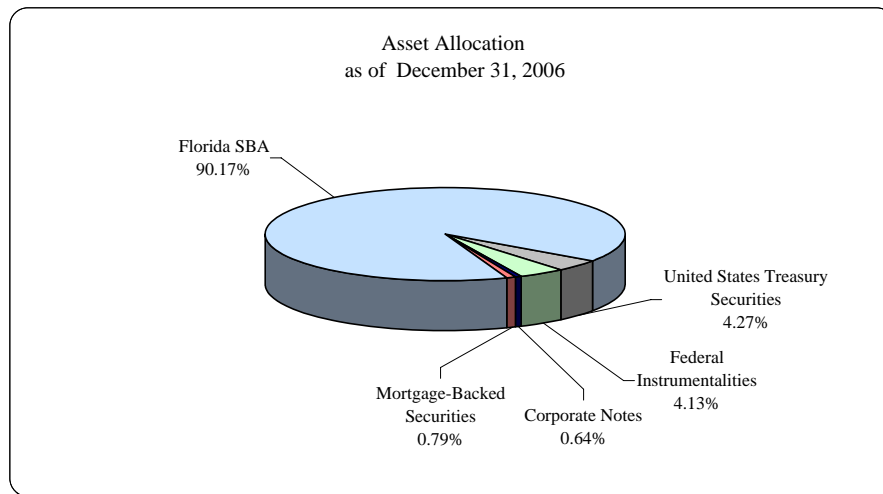


Notes:

1. Due to the nature of the security, Mortgage-Backed Securities are represented based on their average life maturity rather than their final maturity.



Security Type	December 31, 2006	Notes	Permitted by Policy
Florida SBA	90.17%		100%
United States Treasury Securities	4.27%		100%
United States Government Agency Securities	0.00%		50%
Federal Instrumentalities	4.13%	1	80%
Certificates of Deposit	0.00%		25%
Repurchase Agreements	0.00%		50%
Commercial Paper	0.00%		35%
Corporate Notes	0.64%		15%
Mortgage-Backed Securities	0.79%	1	25%
Bankers' Acceptances	0.00%		35%
State and/or Local Government Debt	0.00%		20%
Fixed Income Money Market Mutual Funds	0.00%		50%
Intergovernmental Investment Pool	0.00%		0%



Individual Issuer Breakdown	December 31, 2006	Notes	Permitted by Policy
General National Mortgage Association (GNMA)	0.00%		25%
US Export-Import Bank (Ex-Im)	0.00%		25%
Farmer Home Administration (FHDA)	0.00%		25%
Federal Financing Bank	0.00%		25%
Federal Housing Administration (FHA)	0.00%		25%
General Services Administration	0.00%		25%
New Communities Act Debentures	0.00%		25%
US Public Housing Notes & Bonds	0.00%		25%
US Dept. of Housing and Urban Development	0.00%		25%
Federal Farm Credit Bank (FFCB)	0.72%		50%
Federal Home Loan Bank (FHLB)	1.24%		50%
Federal National Mortgage Association (FNMA)	1.91%		50%
Federal Home Loan Mortgage Corporation (FHLMC)	1.05%		50%
Student Loan Marketing Association (SLMA)	0.00%		50%

Individual Issuer Breakdown	December 31, 2006	Notes	Permitted by Policy
CD - Bank A	0.00%		15%
CD - Bank B	0.00%		15%
Fully collateralized Repo - A	0.00%		25%
Fully collateralized Repo - B	0.00%		25%
CP A	0.00%		10%
CP B	0.00%		10%
CP C	0.00%		10%
CP D	0.00%		10%
CP E	0.00%		10%
Wells Fargo	0.47%		10%
Bank of America	0.17%		10%
Corporate Notes C	0.00%		10%
Corporate Notes D	0.00%		5%
Corporate Notes E	0.00%		10%
BA Bank A	0.00%		20%
BA Bank B	0.00%		25%
Municipal Notes/Bonds	0.00%		20%
Money Market Fund A	0.00%		0%

Notes:

- 1. The combined total of Federal Instrumentalities and Mortgage Backed Securities can not be more than 80%. The combined total as of December 31, 2006 is 4.92%.
- \* No Bond Proceeds.