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INVESTMENT QUARTERLY

A message from Clerk Bock



Sharon R. Bock

The July 2005 issue of *Investment Quarterly* announced that the Kennedy School of Government had published an article co-authored by Ben Finkelstein and Felicia Landerman, the Clerk & Comptroller's Investment Manager. The article proposed "suitability" as the appropriate measurement standard for the performance of a public fund. Suitability means many things. First, the investment portfolio must be liquid, meaning that funds

are available to pay obligations as they come due. Second, the portfolio must maintain an appropriate risk level given investment objectives and policy constraints. Third, investments must be legal in terms of being authorized by state statute and by county ordinance. Finally, the portfolio should earn a competitive market rate of return.

Finkelstein has written *The Politics of Public Fund Investing*, a book that is the first comprehensive resource ever available to stewards of public funds. It approaches public fund management from a unique perspective, providing the reader with techniques, standards and procedures to move from an investment policy to a plan to build a politically correct portfolio that is safe and diversified while optimizing income. The author acknowledges Landerman for writing the Foreword to the book, in addition to being part of an "outstanding group of practitioners and scholars who acted as an advisory board for this book." Finkelstein describes this group as "motivated by an interest in advancing the best practices" in the field of public fund investing.

For the next Investment Policy Committee meeting scheduled for May 18, I have invited Mr. Finkelstein to share his experiences with public fund managers nationwide as he researched the best practices in the industry. The Clerk & Comptroller's office seeks to apply these best practices as we pursue our vision: "To be the world-class leader in customer service, employee satisfaction and standards of excellence."

Clerk & Comptroller Sharon R. Bock holds a Juris Doctorate and earned insurance and securities licenses Series 7, 63, and 65.



SHARON R. BOCK
Clerk & Comptroller
Palm Beach County

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INVESTMENT POLICY COMMITTEE MEETING

Thursday, May 18, at 2 p.m.

Palm Beach County Government Center,
12th Floor

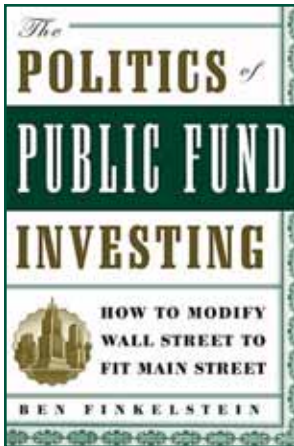
Guest Speaker: Ben Finkelstein, author
of *The Politics of Public Fund Investing*

For more information, contact Felicia Landerman at
(561) 355-4412 or flanderm@co.palm-beach.fl.us.

When It Comes To Public Fund Investing, Main Street Is Not Wall Street

The Politics of Public Fund Investing: How to Modify Wall Street to Fit Main Street, by Ben Finkelstein, is the first book to seriously undertake public fund investing from a Main Street rather than a Wall Street perspective.

In his new book, Finkelstein provides a practical framework for creating



successful public fund investment portfolios. Whether overseeing the monies for a local school district, city, or county, public fund managers face different

political pressures and priorities for their portfolios than their colleagues on Wall Street. "Strange things happen when we try to apply traditional money-management techniques to Main Street," says Finkelstein, a senior managing director of public funds for Stanford Group Company with two decades of experience in the field.

"Investing public funds isn't simply about economics. Politics and election cycles also matter, and they give notions of safety and expectations of income a different twist." According to Finkelstein, public fund managers

must learn how to optimize income while balancing the safety of the principal and providing for adequate liquidity in case of unexpected fiscal needs. Unlike Wall Street fund

"A fresh and thought-provoking look at public sector investment strategies."

– Kent Rock, President
Association of Public Treasurers

managers, public fund managers must often justify their investment decisions to elected officials and answer citizens' critiques. Ultimately, a successful public fund manager will both increase income for public goods and services, and help reduce taxes.

A unique textbook to address the specific investing issues related to public funds, the book explains:

- The key differences between Wall Street and Main Street, including which methods of the former are unsuited to the latter – and why.
- How to create and use an investment plan to differentiate between what is "legal" in terms of investment policy and what is "suitable" in terms of the objectives of public fund stakeholders.
- A new approach for managing, measuring, and monitoring public fund performance.
- A four-step process for building a "politically correct" portfolio that preserves principal while optimizing income at levels of risk stakeholders can accept.

The book also provides fund professionals with a technical toolkit designed specifically for investing public funds providing the reader with strategies to successfully incorporate politics into the quantitative side of public fund management.

A vital resource for anyone who manages, supervises or audits a public funds, *The Politics of Public Fund Investing* also provides valuable insights for interested citizens and government officials.

ABOUT THE AUTHOR:

Ben Finkelstein is senior managing director of public funds for Stanford Group Company. He has spent more than a decade developing training programs specifically for public fund investment professionals and supervisors. He is a nationally recognized consultant, lecturer, and published author in the public funds investment community. Finkelstein holds the Chartered Financial Analyst designation and is an active member in the Houston Society of Financial Analysts as well as the CFA institute.

Ben Finkelstein will share his experiences and best practices in the field of public fund investing at the Investment Policy Committee meeting on May 18. The public is welcome to attend. For more information, contact Felicia Landerman at (561) 355-4412.

Quarter-end Results

By Felicia Landerman



Felicia Landerman

As of March 31, 2006, the consolidated portfolio managed by the Clerk & Comptroller was \$2.125 billion, and the overall book yield was 4.49 percent. This far exceeded the Investment Policy Committee's benchmark, which is the 48-month moving average of the two-year Constant Maturity Treasury Index yield of 2.72 percent.

In the January issue of *Investment Quarterly*, new strategies were laid out by which the Clerk & Comptroller would implement a plan to diversify the county's credit exposures and to allow the portfolio to benefit from a broader range of security types. During the most recent quarter, this plan commenced with portfolio additions that included US Treasury notes, GNMA mortgage structures, AAA-rated corporate notes and Small Business Administration (SBA) mortgage pools. In addition, the Investment Policy Committee recently approved increasing the maximum allowable percentage of Collateralized

Mortgage Obligations (CMO's) in order to improve portfolio performance and flexibility. Value in this sector will be a primary focus in the coming months. The Clerk & Comptroller continues to seek opportunities in these diversified sectors with a focus on limiting overall duration volatility and credit risk.

Dynamic cash flow analysis and optimization models continue to be utilized in order to measure fluctuations in future cash flows given shocked interest rate scenarios and to determine optimal sector selections to enhance portfolio performance.

Since the beginning of the current fiscal year, the portfolio's overall par value has increased from \$1.622 billion to \$2.125 billion. Concentration in Government Sponsored Enterprises (GSE's) has fallen from approximately 90 percent to approximately 65 percent, minimizing credit exposure while maximizing diversification of investments. The book yield has risen from 4.25 percent to 4.49 percent. By continuing to implement new strategies and utilizing analytic tools, the Clerk & Comptroller's office will continue to provide solid returns while further limiting interest rate and credit exposures.

Felicia Landerman, who holds a Master's Degree in Business Administration and a Series 7 Securities License, is a Certified Treasury Professional and the Investment Manager for the Clerk & Comptroller, Palm Beach County.

"Since the beginning of the current fiscal year, the portfolio's overall par value has increased from \$1.622 billion to \$2.125 billion."

-- Felicia Landerman

CMO's: Collateralized Mortgage Obligations

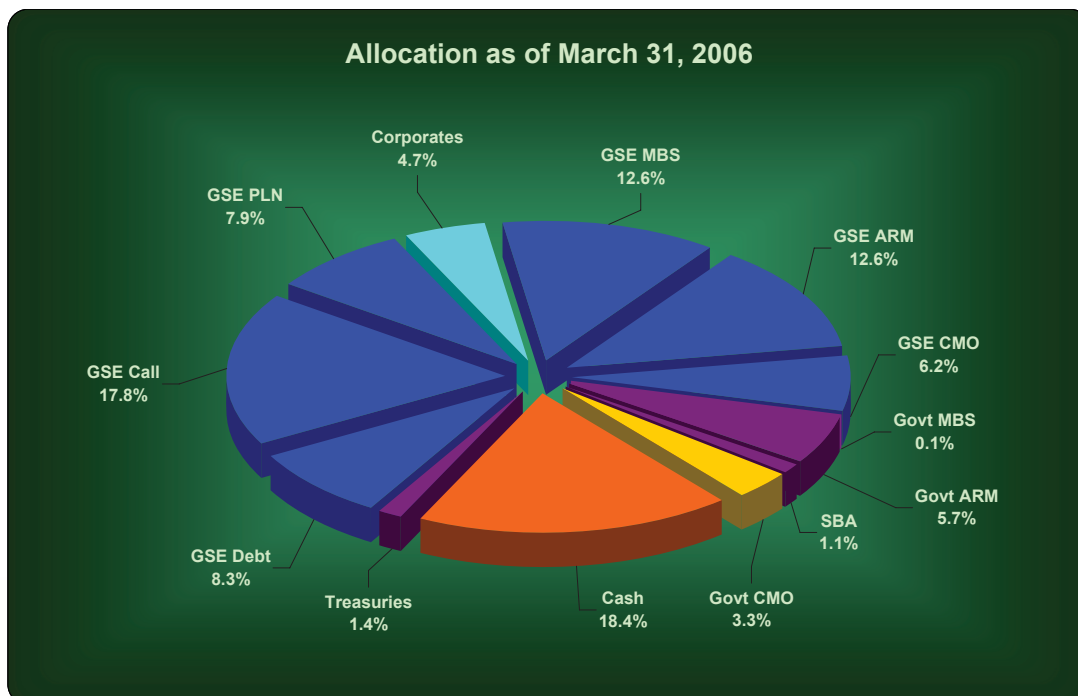
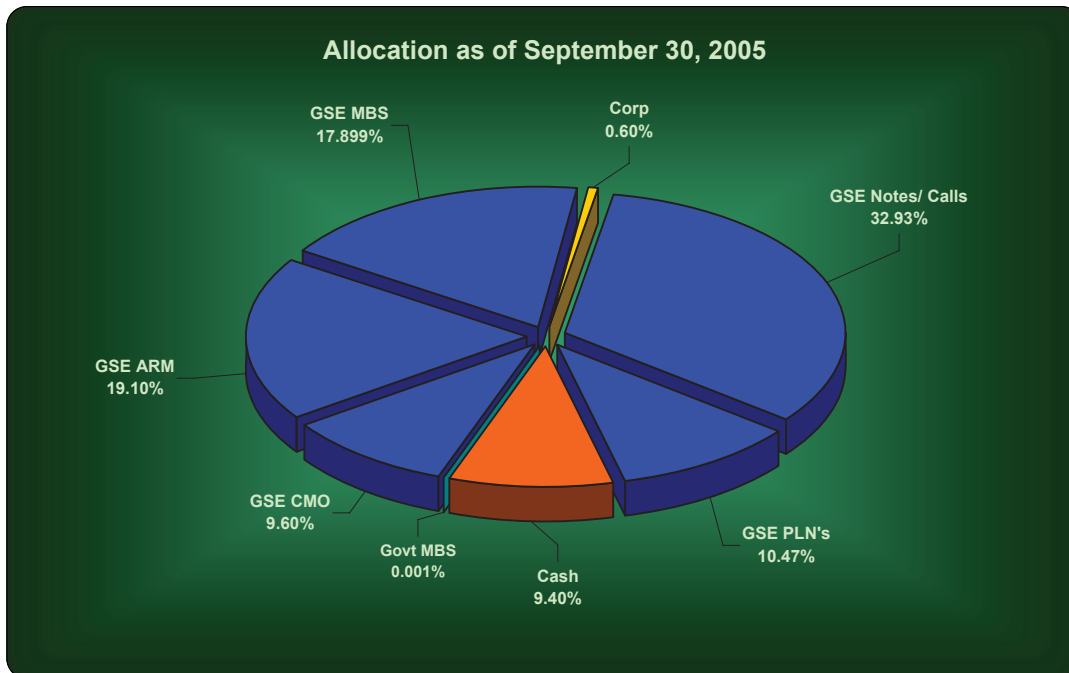
As of March 31, 2006, \$200mm or 9.5 percent of the county's \$2.12 billion consolidated portfolio was invested in Collateralized Mortgage Obligations (CMO). In April, the Board of County Commissioners amended the investment policy to increase the allowable percentage limitation of CMO's from 10 percent to 20 percent.

CMO's are securities based on or "collateralized" by home mortgages. These mortgages have been sold to an intermediary, then pooled, bundled, and divided into tranches or categories that dictate the manner in which principal and interest payments are passed through to the investor. These pass-through securities may offer predictability of cash flows and stability of returns. Because CMO's are made up of many different pools of mortgages originated in different parts of the country, the risk of default is diversified. In addition, CMO bonds are highly rated because of their AAA backing by Government Sponsored Enterprises (GSE's), as well as their full faith and credit backing by the Government National Mortgage Association (GNMA).

CMO's allow the Clerk & Comptroller's office additional flexibility to maximize investment earnings without taking on additional credit risk.

Portfolio Allocations

Since the end of Fiscal Year 2005, the Clerk & Comptroller's Office has further diversified investments into U.S. Government Treasuries, AAA Corporate paper, Government-Backed CMO's & Small Business Administration bonds.



**Portfolio Balance as of March 31, 2006:
\$2,125,000,000**

INVESTMENT QUARTERLY

Economic Update - Second Quarter FY 2006

A Bull-Headed Economy

By Arnfield P. Cudal



Arnfield P. Cudal

Despite a tenuous 2006 start, the U.S. economy expanded this first quarter with a healthy dose of economic activity and a burgeoning workforce. Buoyed by hopes that the Federal Reserve (Fed) might take a respite after its 14th consecutive rate-hiking campaign, the economy flourished. The Fed, however, monitoring the economy's rate of expansion with incessant concerns for

inflation, raised the short-term lending rate for the 15th time, another 25 basis points from 4.50 percent to 4.75 percent. The effect of short-term rate hikes that banks charge each other on overnight loans ripples to other rates lifting equity, home improvement, and other consumer loans. The commercial bank prime lending rate moved in tandem to the overnight lending rate increasing from 7.5 percent to 7.75 percent. Likewise, short-term savings and checking account rates also climbed.

Markets typically contract in response to rate hikes. Higher rates increase borrowing costs and the price of consumer loans. Consumer spending slows and business investment expansion is averted or postponed. Because rate increases have lasted for almost two years, economists sense that the Fed has neared the end of its rate-hiking cycle and has become more optimistic about the economy's strength and resilience. The stock market, as though trying to take advantage of the last of the lower rates, rallied to finish the quarter at its highest point since 2001. With investor exuberance running high and an over-heating economy in tow, the Fed, with equal determination, maintained its choke-hold monitoring of the economy. Investors realize that any signs of a welling up in inflation will make more rate hikes imminent.

The Fed's tough approach to monetary policy has analysts paring profit outlooks through the end of the year. Corporate investment spending remains tenuous as executives tread uncertain economic and geopolitical waters. While most corporations riding the wave of market exuberance are expected to churn respectable gains through the end of the year, some Blue-Chip companies like General Motors, are struggling to reconcile burgeoning costs with tepid earnings. Employment, manufacturing, and production gains are projected to remain steady. Although a positive February service-sector report lifted company stocks higher, high fuel costs and a looming trade deficit have weighed down the economy. Uncertainty over inflation, volatile fuel costs, and an expanding global market economy will test a company's mettle by its ability to remain profitable in spite of higher rates, costs, and increased competition.

The Commerce Department confirmed that sales of new homes fell for the fourth month in a row nationwide. With housing appreciation reaching its zenith in 2005, economists are watching, with almost masochistic anticipation, the oft-discussed and unpredictable harmful effect of a protracted decline in housing prices. Alarmists contending that an accelerated housing price decline will be kin to the Tech-stock crash of 2000 have incited anxiety and trepidation among investors. The National Association of Realtors reported that 28 percent of home sales in 2005 were by investors - implying that higher rates and declining prices will significantly affect buying activity and consequently reduce prices. Higher loan rates coupled with an erosion of equity brought on by declining home prices deal a double-whammy blow to equity lending activity, equity-driven consumer spending, and personal wealth. Yet, despite a declining housing market, rising energy costs, and a looming deficit being the economy's Achilles heel, the U.S. economy continues its bull-headed ascent, churning a hefty and unrestrained 4.75 percent Gross Domestic Product in the first quarter.

Arnfield Cudal holds a Master's Degree in Business Administration and is the Investment Analyst for the Clerk & Comptroller, Palm Beach County.

Investment Policy Committee Members

The Honorable Burt Aaronson
County Commissioner
Chair

James J. Derba
Investor
Vice-Chair

Richard Roberts
Director
Office of Financial Management
& Budget

Jim Davis, representing
The Honorable Ric L. Bradshaw
Sheriff

Richard Miller, Esq.
Edwards & Angell

Stephen Freilich
Treasurer
South Florida Water
Management District

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Investment Policy Committee (IPC) Member Profile

James L. Davis



Appointed July 2005

Education Bachelor's degree, Accounting
Florida A&M University, 1975

Organization: Palm Beach County Sheriff's Office

Title: Director, Department of Administrative Services

Background: Director Davis began his professional career at Indian River Community College where he was hired in 1975 as a Staff Accountant. He moved to Palm Beach County in 1977 and was hired as a Public Accounts Auditor with the State of Florida, Office of the Auditor General.

He began his career at the Palm Beach County Sheriff's Office in 1979 when he was hired as the Accounting Supervisor. He was promoted to Assistant Director, Department of Administrative Services in November 1999, and Director in July 2005.

Director Davis provides executive level management of the agency's Administrative Services Department, which encompasses Accounting, Budget, Purchasing, and Risk Management/Occupational Health & Safety Units.

Director Davis is a native Floridian. He is married and has two children.

"Nearly all men can stand adversity, but if you want to test a man's character, give him power."

-- Abraham Lincoln