

The Public Interest

An objective resource for state, county, & local government investment pools.

June 2006

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State of Mind

An op-ed by author Jeff Flynn

It has been over a year ago since we issued some warnings about the potential maturity risks of non-rated California County Pools. In April 2005 we were commissioned to write a report regarding these risk issues only to be un-commissioned a month later because of opposition by some Treasurers as to what this report and the results might have produced. This week, we received the yield information on the San Diego County Pool which ranked at the bottom of all national pools we track each month. Given that all pools which are using a \$1 NAV are supposed to have a 2a-7 like maturity focus in spirit, we suspect that there may be some County Pools deeply underwater. In fact, a pool with a WAM greater than 90 days is not intended to be a \$1 NAV pool but is rather a short term bond fund, or at least an “Ultrashort” and these funds generally have floating rate NAVs in the real world of mutual funds, as San Diego does according to their S&P data.

Meanwhile, LAIF, which is also a longer term pool and more of a short duration bond fund, has lagged behind all AAA rated pools and money funds which have to maintain a 60 day portfolio WAM. So if a rated 2a-7 type pool has outperformed all non rated pools, and given the far lower degree of maturity risk for the schools and taxpayers, why do so many California County Treasurers carry such maturity risk and especially in a 2 year tightening cycle? When rates are falling, even a monkey can look like a skilled money manager and that maturity extension can generally outperform the shorter WAM pools, but why take that risk? Or maybe, create a rated 2a-7 for one pool and offer a longer duration fund when rates warrant. Just spin off the longer term option, but to remain in a 1-2 year WAM during 18 consecutive Fed rate hikes suggests concerns and has created lower returns.

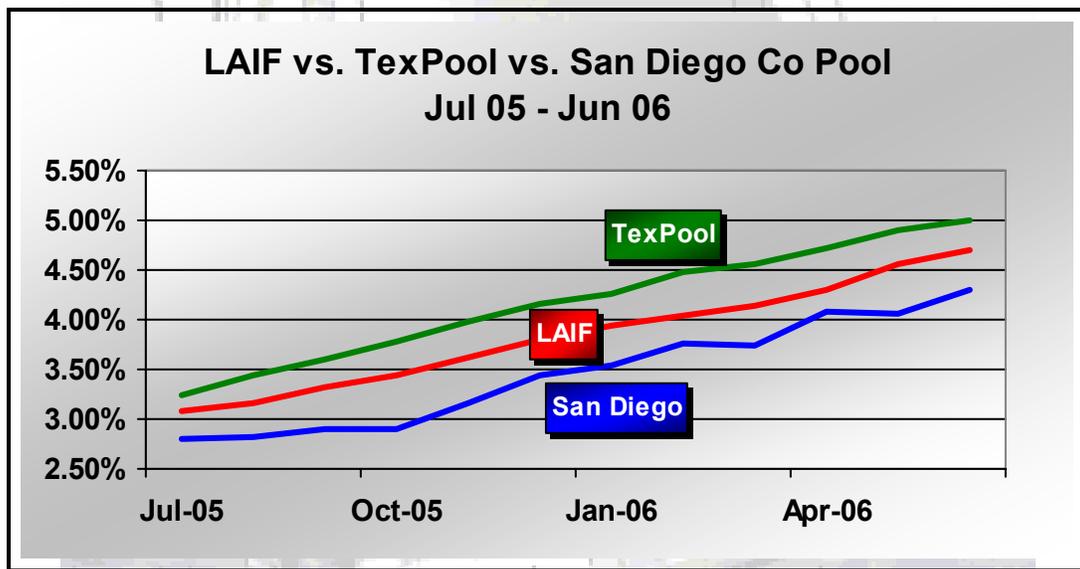
San Diego County Pool folks were out hitting the street last week with requests for their county area municipalities to ante up and place some new money with the pool. We can only guess that a recent withdrawal of \$500MM probably depleted a large piece

of the demand liquidity portion of the pool and that they would like to get some new money to work, especially now that Fed rates might have peaked. Their yield for June fell to about 4.30% while top AAA rated Pool yields are around 5.23%. The only way to maintain that “buck” or minimize a variable NAV reduction when losses occur is to reduce the amortized earnings of the pool. We saw this with another non rated State Pool in Idaho as they faced massive paper losses promoted by certain brokerage input urging mortgage backed structured notes as we recall.

Meanwhile, those County Pools like Orange County, Marin, and others who have chosen the rated route have been outperforming LAIF and sleeping like babies - no fear of having one member of their pool suddenly liquidate and force a breaking of the buck. So we do not mind telling some that we told them so; we were doing it to help keep them out of trouble for what my 20 years of experience was telling us was coming. For the handful of other county Treasurers who had the same benevolent intentions and support for objective research, thanks. Some folks HAVE learned from the past.

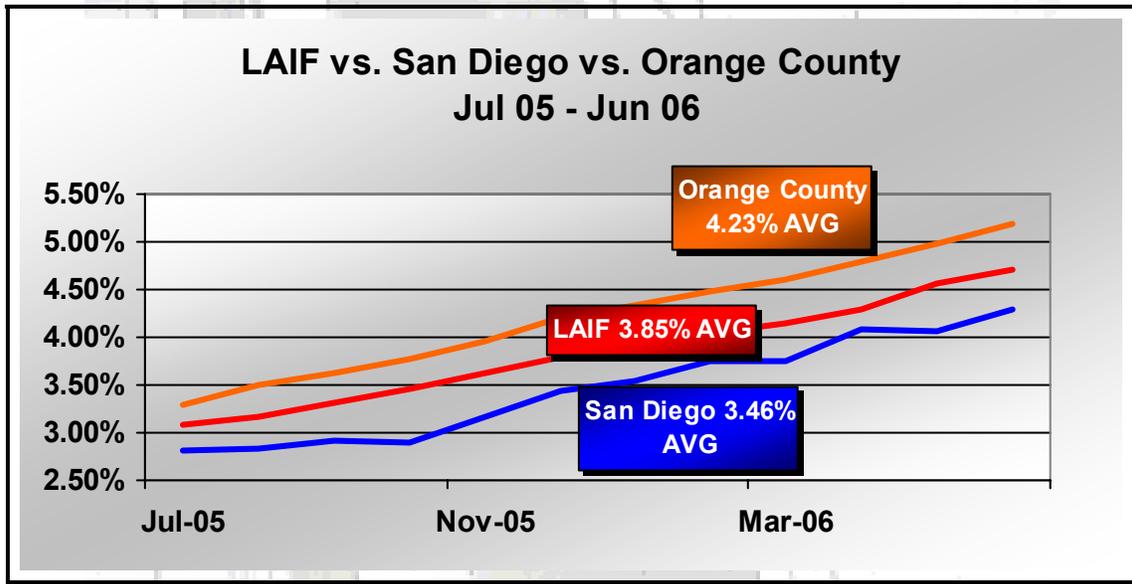
California Yield Review

TRACS Financial does extensive research on all US pools, LGIPs, and money market funds. Our articles and research are used and published nationwide so we have all of the data on these investments. A State Pool like TexPool is AAA rated and therefore has a 2a-7 60-day WAM parameter. They do not buy commercial paper and have 75%+ in repo, so they are a good benchmark for conservative. Below are the yields of this TexPool versus LAIF and the San Diego County Pool over the past year. LAIF and other non rated pools with longer WAMs have lower yields because they may have to use some of their yield to support their \$1NAV.

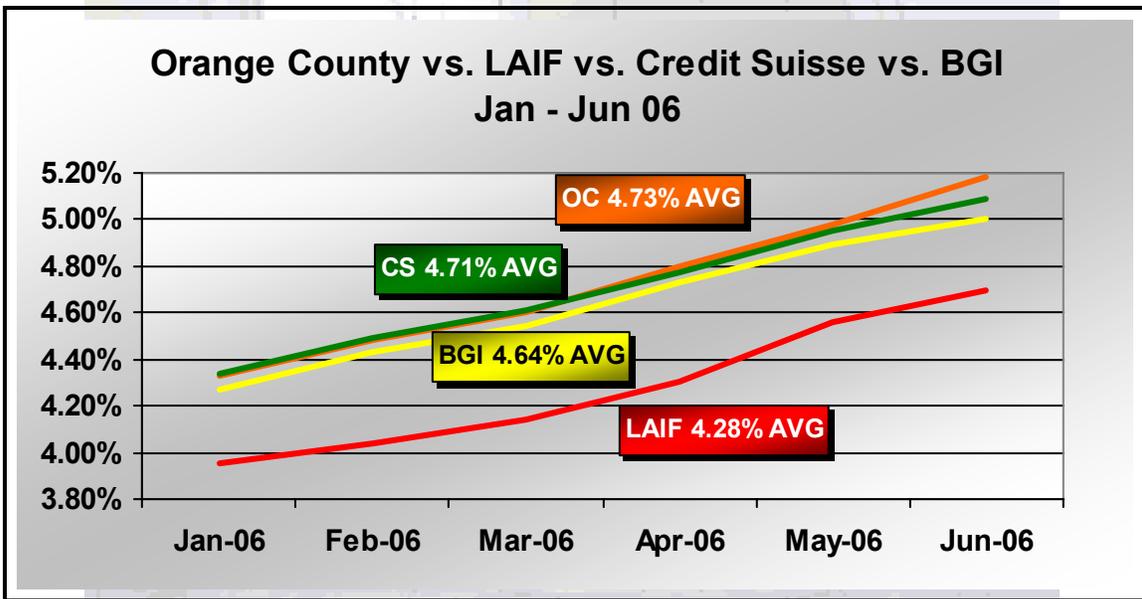


Some California County Treasurers have AAA ratings on their pools but the majority of California County Pools are not rated; they seem to want the ability to get far out on the curve, maybe as a way to “beat” the State Pool? But we recall asking the Treasury manager of the TOP ranked Pool in the US, Connecticut, whether they saw their rating and subsequent 2a-7 maturity restrictions as a detriment? Hal Johnson, now retired

replied, “Well, we have the knowledge of how to use maturity, but by having a 60 day WAM target, everybody knows where everybody is”, to paraphrase. Obviously, Orange County’s Pool has far outperformed both the LAIF pool and the San Diego Pool, both which have kept a longer term WAM over the past year and despite consecutive Fed rate hikes.



The AAA rated Orange County Pool yield over the past year outperformed the yields of two top ranked AAA money market funds found on the iMoneyNet website, Barclays, and Credit Suisse, both of which are 2a-7 type money funds. All three type investments with their 60 day portfolio WAM structures blew away the yield of LAIF over the past 6 months and with 5 Fed rate hikes.



By the Numbers

- Orange County California Pool ranks in the TOP 6 in the nation.
- Walla Walla County Washington also leads many other counties.
- Connecticut and Texas maintain their top national standing among the nation's State pools.
- Note that LAIF is ranked in the 3rd Quartile below. Also, other LGIPs like PFM appear to have cut fees, raising yields to go after some of that LAIF money.
- MOST POOLS IN THE 1ST QUARTILE ARE 2A-7 TYPE AAA RATED 2a7 type pools and even a non rated pool like that of Walla Walla has maintained a 2a-7 like portfolio WAM.

	As of 6/30/2006		
	Daily	7 Day	Monthly
1st Quartile	5.29%		
Connecticut Short Term Investment Fund	5.29%		
Texas TexPool Prime	5.28%		
Texas TexStar	5.27%		
Texas TexPool	5.24%		
Texas LOGIC	5.22%		
Orange County Investment Pool		5.18%	
Top Prime Money Market Fund Composite~	5.18%		
Florida SBA LGIP			5.17%
Texas CLASS	5.17%		
Montana Short Term Investment Pool	5.16%		
Virginia State Non-Arb Program SNAP		5.16%	
Illinois Funds Prime Fund	5.15%		
Iowa Schls Joint Invest Trust Diversified+	5.15%		
Walla Walla County Investment Pool		5.13%	
Colorado ColoTrust Plus+	5.11%		
Virginia LGIP		5.10%	
Georgia Fund 1			5.06%
Michigan CLASS^	5.06%		
New Jersey Cash Management Fund			5.06%
Pennsylvania INVEST Daily		5.05%	
Virginia PFM Commonwealth Cash Reserve Fund Prime		5.05%	
2nd Quartile	5.04%		
Iowa IPASeducation		5.04%	
Wisconsin CLASS^	5.04%		
California PFM Asset Mgmt Program		5.02%	
Virginia PFM Commonwealth Cash Reserve Fund Fed		5.02%	
Colorado CSAFE	5.01%		
Illinois Metro Inv Convenience Fund	5.00%		
Utah Public Treasurers Investment Fund			5.00%
Colorado ColoTrust Prime	4.99%		
Pennsylvania INVEST Community Pool		4.98%	
Washington LGIP			4.98%
Kansas Municipal Investment Pool	4.96%		
Louisiana Asset Management Pool		4.95%	

Alaska Municipal League Invest Pool	4.94%	
Texas LoneStar Liq Corp		4.94%
Texas LoneStar Liq Fund		4.94%
Indiana Invest CLASS^	4.93%	
New Jersey PFM Asset & Rebate Mgmt Program	4.93%	
Pennsylvania PFM PLGIT I CLASS	4.93%	
West Virginia Cash Liquidity Pool		4.93%
Texas LoneStar Liq Plus		4.92%
Michigan PFM Sch Dist Liquid Asset Fund Plus – Max	4.91%	
Wisconsin LGIP		4.91%
Missouri PFM Securities Invest Program Mon Mkt	4.90%	
Pennsylvania PFM PLGIT PLUS CLASS	4.90%	
Pennsylvania Sch District Liquid Asset Fund Max~	4.90%	
New York Liquid Asset Fund Max	4.89%	
Pennsylvania PFM PLGIT ARM	4.89%	
West Virginia Govt Money Market Pool		4.89%
Wyoming WYO-STAR LGIP		4.89%
Minnesota PFM SchI Dist Liq Asset Fund – Max	4.88%	
New York CLASS^	4.86%	
Minnesota Muni MMF (4M) – Plus	4.85%	
Illinois Sch Dist Liquid Asset Fund Plus - Max*	4.84%	
Connecticut CLASS PLUS^	4.83%	
Minnesota PFM Assc of Govts Inv for Counties	4.83%	
Oregon State Pool		4.83%
Maine CLASS^	4.82%	
New Mexico LGIP Overnight Pool	4.80%	
Wyoming Secured Investment Program (WYOSIP)	4.80%	
	Median	
	3rd Quartile	4.79%
California LAIF		4.79%
Wyoming Government Investment Fund		4.79%
Minnesota Muni MMF (4M)	4.78%	
Pennsylvania PFM PLGIT CLASS		4.78%
Nebraska PFM Sch Dist Liquidity Asset Fund Plus		4.76%
Rhode Island CLASS^	4.76%	
New Jersey CLASS^	4.74%	
Oklahoma Pub Schools Liq Asset Pool	4.74%	
Wisconsin Investment Series	4.70%	
New York Liquid Asset Fund Liq	4.67%	
Connecticut CLASS^	4.66%	
Illinois Sch Dist Liquid Asset Fund Plus - Liq*		4.65%
Michigan PFM Sch Dist Liquid Asset Fund Plus – Liq		4.65%
Iowa Schls Joint Invest Trust Diversified	4.64%	
Illinois Funds Money Market Fund	4.63%	
Kentucky Govt Org's Liq Fund (GOLF)*	4.63%	
Illinois Institutional Investors Trust (IIIT) b		4.61%
Nebraska Public Agency Investment Trust		4.60%
Iowa IPAIT Diversified		4.58%
Pennsylvania Sch District Liquid Asset Fund Liq~	4.58%	

South Dakota Pub Funds Invest Trust Gen Cash	4.58%	
4th Quartile	4.54%	
New Hampshire Public Dep Invest Pool^	4.53%	
Illinois Park Dist Liquid Asset Fund Plus		4.51%
Wisconsin Investment Series Cash Management	4.38%	
Idaho LGIP		4.36%
San Diego County Investment Pool		4.30%
Minnesota PFM Schl Dist Liq Asset Fund – Liq		4.28%

**as of 6/28, ~as of 6/29, ^estimate*

Again, if a pool is not ranked in the TOP 10 or Q1, it can only be because of several issues: fees, management, and maturity risk. **Note: the 7 day yield on the California PFM pool was 5.02% as of June 30. The yield for the same exact type pool for Minnesota schools was the lowest in the nation, 4.28%, -75 basis points lower. LGIPs and non-rated county investment pools have far less scrutiny and oversight relative to 2a-7 rated pools and SEC registered money market funds. GASB 40 is almost worthless as a risk avoidance regulation and is not really being enforced.**

NOTE\$ with Interest

CASE STUDY: The Evolution of Money Market Funds

We began tracking national pool yields and money funds back when Fed funds were at 1% and one day while looking thru the money fund section of Barron’s Magazine, we noticed that some of the fund yields were as low as .25% (that is ¼ point)! We also knew that since Fed funds and repo had been at 1% for so long that the difference between yield and repo had to be fees or what is called the gross expense ratio. The same thing applies to Pools and LGIPs.

We can look at a simple exercise as a way to determine what fees are actually being charged and a pool or fund may say their “ratio” is X number of beeps but they may also be subtracting additional fees out of their gross yield, (maybe they should disclose “total fees off gross yield”). Pool yields should be somewhere around the repo rate and obviously they should lag in an upward rate scenario such as we have had. If you look at the pools in our 1st quartile, you will see some month end daily yields from 5.17%- 5.06% and we would expect the pools with longer WAMs might explain the lower yields since maturities coming due take longer to become available for reinvestment.

iMoneyNet did an extensive report on LGIP fees last year, but mutual fund companies have gone thru some painful introspection and evolution over the past couple of years regarding fees. Money market funds used to charge 17-25 basis points back in the early 2000’s when yields were at 6.5% and yield differences were less noticeable. When Funds went to 1% for two years, the massive fees being charged was shocking. Some companies, while able to charge as much as 25 beeps, decided to begin waiving some part of these fees so as to not be earning more in fees than they were paying in yield. With that, some found “fast money” coming to their doors so some players chose to continue those fee waivers. The new “institutional” based money fund expense ratio soon became 8-10 basis points and is where it remains today. Many others chose to not

get in that cutting game and instead kept fees at 12-17 basis points citing the cost of exceptional services, whatever that might be on a daily money fund.

Pools in some states like Texas have experienced the same evolution with TexPool setting the bar at 5 beeps, followed by a couple others at 7-12 basis points; those being Prime type LGIPs able to cover their fees with higher yielding CP rather than TexPool which is Government. In other states where there is no low fee state pool to set the bar, some LGIPs have the apparent ability to charge what ever the market will bear. Competition definitely creates better yields and we think the 10 basis point fee days are here to stay, but believe me, they are not as excited as the investors.

Economic Review, Forecast, & Strategy

This will be short and sweet. TRACS issued our first **GREEN LIGHT BUY** signal on 9-12 month maturities in over two years this past Tuesday (6/12) when it appeared clear that corporate earning guidance was starting to come in to the low side for the first time in 4 years. Utility stocks also broke up thru their 200 day moving average and the 10 year T Notes inverted sharply to Fed funds. With oil prices north of \$75 dollars and representing a massive tax on the US consumers, and home equity ATMs running dry; if they raise Fed rates again on August 8th, we would be dumb struck.

We are now in a portfolio WAM target of 135 days, obviously longer than pool's 60 day parameters. Finally cash managers might be able to pick up some yield without the massive paper loss risks they have had for the past 2 years. Our proprietary cash flow based WADM (6 month avg) BETA target is .75. $135 \text{ days} / 180 \text{ days} = .75$ with 1:0 being a perfect balance so we are still somewhat defensive, but moving 25% of the portfolio out to 9-12 month paper does not bother us too much. We just do not want cash managers to buy 3 year quarterly callables if we think the Fed may actually cut rates in Feb '07, as we do. The brokers would love that since they will see that money come back for more of the same.

Your Municipalities

They have been beat up over the past 2 years. We have heard many stories that some brokers are leaving the business because they have buried their book so deeply in old 2-3 year agency step ups and callables that they cannot sell anything anymore. We think it is a good time for County Treasurers to hold seminars and meetings discussing things like investing with an inverted yield curve, show them what things they can do with short term maturities that might help them pick up a little yield over your Pool yield. In our experience, if you help them and offer some constructive input, you will probably help improve earnings, mitigate maturity risk and get more of their assets. We know that the banks are not offering management services which would promote their loss of deposits and the brokers are only selling long term new issue maturities which most cash managers are tired of because they are all underwater.

We requested June 30 County Pool yields from all county Treasurers and only received about 5 replies. We cannot therefore provide an average yield for either rated or non rated pools but the yields we received on several non rated pools were in the same approximate yield area as the San Diego County Pool.

Note: We provide shareholder services for a Credit Suisse Prime money market fund. If you have an interest in comparing LGIPs to registered money market funds, and what our shareholder services provide, please contact Jeff Flynn for a personal call or meeting, or e-mail jeff@tracsfinancial.com.

These reports, proprietary market research, investment portfolio management, and asset allocation services are also available thru a quarterly subscription service at just \$395.

For information regarding a subscription, e-mail us at info@tracsfinancial.com or contact Jeff Flynn at our Park City UT offices 435.649.8277.

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WADM™ is a TRACS Financial proprietary portfolio management concept component and is an estimate of the cash flow based weighted average maturity disbursement time frame which reflects an average time period under which cash flows could be depleted within a period of time. WADM will fluctuate during that period so the portfolio WAM will need to be monitored in accordance with that fluctuation.

BETA is a measurement of the portfolio interest rate risk with 1: being a perfect balance between portfolio WAM and the cash flow based WADM.

GASB 40 risk reporting, which is intended to monitor this portfolio risk relative to cash flow needs, is completely addressed by this approach.

TRACS Financial receives compensation directly from the money market and mutual fund companies with whom we have shareholder service agreements, fees that are paid out of the company's gross expense ratio.