

## Exhibit B

### Investment Portfolio Review Quarter Ending December 31, 2009

#### OVERVIEW

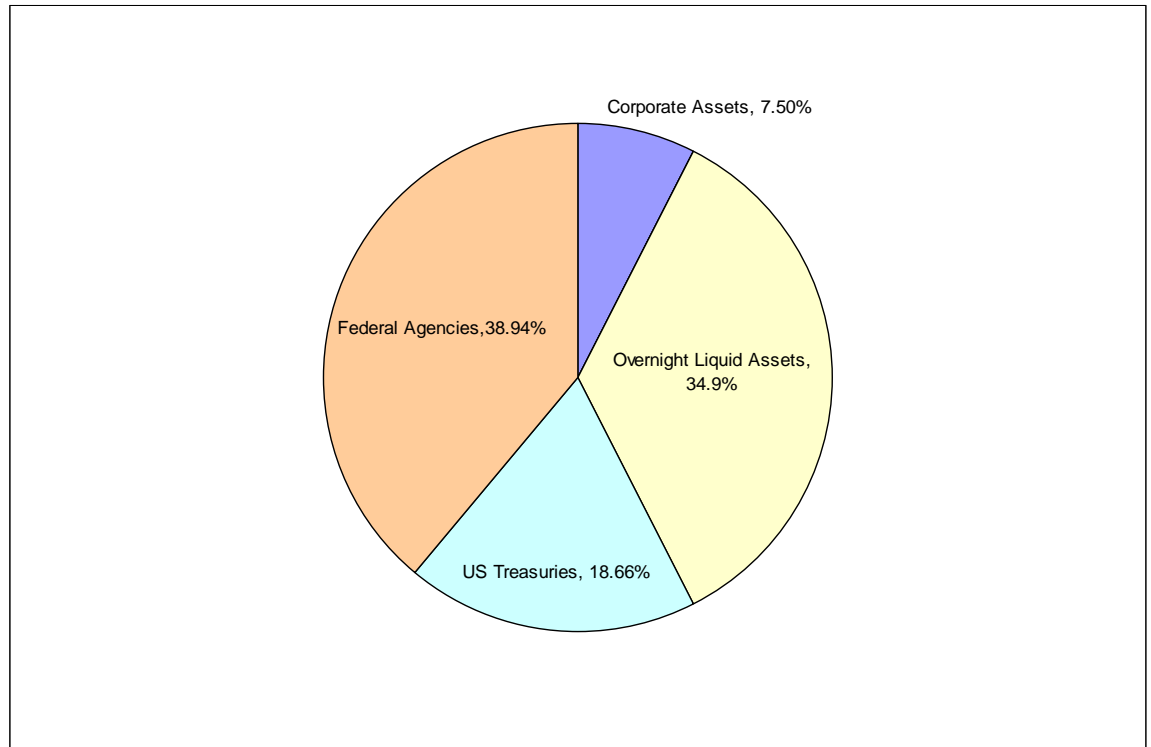
During the October to December quarter all sectors of the fixed income markets reflected continued downward pressure. Despite the continued gains in the stock markets many regional and smaller banks are still under pressure to deleverage which continues to be a factor in the 18 additional banks that have failed since our last report. In the U.S., 140 banks failed during the 2009 calendar year. Recent reports have shown that 369 banks had significantly high troubled asset ratios at the end of September, up from 297 in June. Unemployment levels as of November were 12.3% in California and 10.0% nationally. The national unemployment rate has remained high, with the September rate at 10.2%. This continued high rate and duration (average of 28.5 wks) of unemployment, coupled with ongoing housing foreclosures and larger banks maintaining artificially high levels of liquidity have continued the trend of investor flight to the safety of U.S. Treasury securities and accompanying low short term yields. The following indicators reflect key aspects of the County's investment portfolio in light of the above noted conditions:

1. Market Access – The U.S. Treasury continues to issue substantial amounts of debt instruments. This is due to continued efforts to stimulate the economy by providing funding for many larger investment banks (bailouts) and military funding requirements. Access to U.S. Treasuries is plentiful, but the continued investor appetite for safe havens to store funds in the short term has continued to force yields down on short term bonds. Investors continue to be wary of any negative economic news and prefer the safety of U.S. Treasuries to any potential gains in other markets. This flight to safety is clearly reflected in the current yields of the 3 Month Treasury Bill, which is an anemic 0.03% and in the 2 year, which rallied above 1.00% at the end of the calendar year, only to settle back to its current yield of 0.90%. It has also been reflected in the county's portfolio, which despite a marked increase in duration has also experienced a significant decrease in yield.

During the quarter, the majority of County investment purchases continue to be in U.S. Treasury and Agency markets, with some additional investments in shorter term, highly rated (AA or better) Corporate bonds and highly rated (A1, P1), short term Commercial paper. In addition, the Treasurer continued to keep a high level of overnight liquid assets, reflecting the need to maintain increased levels of available cash to ensure our ability to meet any cash flow needs.

The Monterey County Treasurer's portfolio consists of several different types of fixed income investments, all of which are authorized by the State of California Government Code 53601.

The portfolio asset spread is noted in the pie chart below:



2. Credit Risk – Approximately 92.5% of the investment portfolio is comprised of U.S. Treasuries, Federal Agency securities and other liquid funds. All of those assets have an investment grade rating. U.S. Treasuries are not specifically rated, but are considered the safest of all investments. The corporate debt (7.50%) is rated in the higher levels of investment grade. All federal agency securities have AAA ratings or they are guaranteed by the U.S. Treasury.
3. Liquidity Risk – Liquidity risk, as measured by the ability of the county’s treasury to meet withdrawal demands on invested assets, was adequately managed during the October to December quarter. This is due to a short portfolio maturity of 210 days and the large percentage (34.9%) of assets held in immediately available funds.

## **PORTFOLIO CHARACTERISTICS**

	<b><u>September 30, 2009</u></b>	<b><u>December 31, 2009</u></b>
Total Assets	\$998,400,290	\$1,138,270,786
Market Value	\$998,332,731	\$1,131,982,412
Days to Maturity	107	210
Yield	1.14%	0.75%
Estimated Earnings	\$ 2,859,145.49	\$ 1,944,833.82

## **FUTURE STRATEGY**

The U.S. Treasury has continued a policy of heavy borrowing for stimulus programs, military funding and other additional needs. We continue to believe this policy may lead to higher interest rates in the future. In order to mitigate the risk of incurring market value losses if/when yields begin to rise, the Treasurer will maintain a ladder of rolling asset maturities that ensure the safety and continued liquidity of the overall portfolio in any market environment.

In the near term (next 12 months), the Treasurer believes short term yields will remain extremely low and will not begin to rise until we see ongoing improvement in the unemployment rate. U.S. Treasuries continue to remain a safe haven for investors, but there has been increased interest in the length of time it will take for short term rates to go up given the less than expected increase in unemployment rate and announcements by the Treasury Secretary that the recession very likely has ended. The Fed has also stated that they have seen modest growth in this reporting period which has increased speculation that rates may begin to rise earlier than previously expected. The Treasurer's rolling investment ladder will access the short term Treasury and Agency market with expected yields over the next 90 days of less than one-half percent. In our efforts to continue to provide the safest vehicles for Treasury investments, the Treasurer will maintain a portfolio weighted with U.S. Treasuries, Federal Agency securities, and highly liquid funds.

Finally, the Treasurer continues to aggressively pursue recovery of the defaulted Lehman Brothers and Washington Mutual bonds (\$24.375 million). Monterey County and other impacted public agencies continue to pursue recovery of all funds lost through a combination of legislative & litigious actions. Our efforts to recover all funds lost in the Lehman collapse are being pursued on both fronts while the recovery of the outstanding Washington Mutual principal (\$14.375 million) continues through litigation against the firm and their respective accounting contractors.