

OFFICE OF THE TREASURER-TAX COLLECTOR



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June 7, 2007

TO: Board of Supervisors
Thomas G. Mauk, County Executive Officer
Treasury Oversight Committee
Treasurer's Advisory Committee
Participants

FROM: Chriss W. Street 
Treasurer-Tax Collector

SUBJECT: Treasurer's Management Report for May 31, 2007

Attached please find the Treasurer's Management Report for the County of Orange for the month ended May 2007. The information provided herein, including all charts, tables, graphs and numerical representations, is provided to readers solely as a general overview of the economic and market conditions which the Treasurer utilizes in making investment decisions. In addition, a complete version of this report is also available for download at our website www.ttc.ocgov.com.

TREASURER'S REPORT

In order to assist you in reading this report, please note that the current balances reflect the investments recorded in the portfolios for each particular fund for the period ending May 31. Each money market fund has an average maturity of less than ninety days, with a net asset value (NAV) falling within the range of \$0.9950 and \$1.0050. The extended fund will have an average maturity of up to 549 days and a fluctuating NAV. All investments are marked to the market at the end of the reporting period due to the narrow valuation range prescribed by the Pools' Investment Policy Statement.

The reports reflect the par value (face value), the book value (cost to the County of the investment) and market value (the price of each security at the close of the market on the last trading day of the month). Market values are derived from the Bloomberg Professional Service, a premier provider of instant access to real-time and historical financial data. The difference between the market value and book value is the unrealized gain or (loss). The Detail Transaction Report Section is provided in compliance with California Government Code Section 53607, which requires that the Treasurer file such a report with the Board of Supervisors, from whom his investment authority has been delegated.

APPORTIONMENT OF COMMINGLED POOL INTEREST EARNINGS

We have prepared a forecast for the timing of the County Investment Pool's March and April 2007 interest apportionments. We anticipate posting the March and April 2007 interest apportionments to participants' cash accounts in the County general ledger by approximately June 11 and June 25, 2007, respectively.

CHANGES IN ELIGIBLE CREDITS

In the month of May, there was one change to the Treasurer's approved eligibility list.

The following was removed from the CP/ MTN Eligibility list:

1) The Coca-Cola Company

Please see the attached reports detailing the reasons the above actions were taken by the Treasurer.

CREDIT RATINGS OBSERVATIONS

Moody's Rating Methodology Changes

As a result of recent changes in the rating methodologies used by Moody's Investment Services, many of the Treasurer-Tax Collector (TTC) approved investment issuers that have European parents have received one to two notch credit upgrades in the month of May. Moody's stated that the motivation in taking this action was to take into account all external sources of financial support. While the change caused a stir among analysts, we agree that some countries will have banks that are so large or so important to a country's financial system and economy, that they will enjoy a significant advantage in seeking external financial support as compared with smaller rivals.

Coca-Cola Enterprises Downgrade

Coca-Cola Enterprises, Inc. was downgraded to A3/P-2 this month as the company's 2006 financial metrics did not meet Moody's expectations. The TTC Research Team removed that issuer from our Eligibility List in April 2005, preferring to retain the stronger Consumer, Non-Cyclical/Beverage companies, Coca-Cola Company, PepsiCo, Inc. and Anheuser-Busch Companies as approved investments.

Coca-Cola Co. Credit Watch Negative

Later in May, Moody's also placed the ratings of Coca-Cola Co. on review for possible downgrade following the announcement that the company intends to acquire Glaceau for \$4.1 billion. We believe that a one notch downgrade to A1 is likely. The new Moody's rating will be consistent with the current Standard and Poor's and Fitch A+ ratings and will remain acceptable under the Treasurer's Investment Policy Statement (IPS). To comply with the IPS restrictions regarding Credit Watch Negative, we removed the name until Moody's review is resolved. (See CHANGES IN ELIGIBLE CREDITS above)

Sallie Mae Corp. Acquisition and Downgrade Presents Opportunity

In April, Moody's, Standard and Poor's, and Fitch all placed Sallie Mae Corp. (SLM) on Credit Watch with negative implications. On June 1, Standard and Poor's downgraded SLM to BBB+/A-2 and kept the ratings on Credit Watch with negative implications. The credit watch action was initially placed in response to the merger agreement with an investor group led by JC Flowers and Company. Standard and Poor's June 1 action was in response to the announcement that the transaction will result in increased financial risks. If the transaction is completed as expected, the counterparty credit ratings of the merged company are expected to fall below investment grade. The Treasurer's Office has not had Sallie Mae approved and sees little adverse credit implications for any of our eligible investments.

The TTC believes this news presents our funds with investment opportunity, as the yield spreads related to other potential finance company targets widened substantially. The TTC purchased a one year Medium Term Note issued by CIT Group, Inc., a US finance company with over \$80 billion in assets. We believe that CIT's management is committed to keeping its ratings high, since it depends on unsecured funding and will not follow in Sallie Mae's footsteps. This, and other material differences from Sallie, bolsters our opinion that a positive spread return equal to Libor plus 21 basis points is a great return on a fundamentally strong credit issuer. To further mitigate the risk of future events, this note matures in just one year.

MARKET OBSERVATIONS

Corporate profits remain near record highs, global inflation is stubbornly stuck above central banks' preferred range and the US consumer hangs tough; that about sums up May 2007. The Dow Jones Industrial Average is up 9% for the year (Exhibit: 1) as we enter what is normally referred to as the summer investment doldrums. Mergers and acquisitions are occurring at a record pace as Wachovia agreed to purchase A. G. Edwards for \$6.8 billion. Exports continue to gain momentum and manufacturing seems to be rebounding. The bond market responded to this improved economy and merger fever by driving rates to 5% across the curve. Most Wall Street economists threw in the towel on their expectation for the Fed to cut interest for the remainder of the year.

It is remarkable how quickly market sentiment has changed from an expectation of a recessionary "hard landing" for the US economy, to the Fed will be on hold for the year. In March, the interest rate futures market was pricing in an 83% probability of the Fed reducing rates on June 28th. The TTC has consistently predicted that the economy would remain strong through and then suffer a hard landing towards the end of 2007. We have benefited our investors by keeping our maturities short and expect to lock in longer maturities now that rates have moved up aggressively. The market is not there yet, but with the 2 year Treasury trading in a range 30-40 bps either side of 4.80% (Exhibit: 2), 5% is fairly priced. Consequently, we are selectively extending the duration of our portfolios on interest rate backups.

The Treasurer's Office appreciates your continued confidence and looks forward to providing you exemplary portfolio and cash management services in the future.

ORANGE COUNTY TREASURER-TAX COLLECTOR
EXECUTIVE SUMMARY
June 1, 2006 - May 31, 2007

| PERIOD ENDING - MONTH / YEAR | MONTH END MARKET VALUE | EARNINGS FOR MONTH | AVERAGE YIELD FOR MONTH | MONTH END WAM |
|--|-------------------------|-----------------------|-------------------------|--------------------|
| <i>Current Month - May 2007</i> | | | | |
| County Pool - Money Market Fund | \$ 2,038,485,187 | \$ 9,453,530 | 5.38% | 56 |
| Educational Pool - Money Market Fund | \$ 2,253,481,882 | \$ 11,347,317 | 5.35% | 55 |
| Extended Fund | \$ 2,269,898,637 | \$ 9,010,127 | 5.11% | 422 |
| <i>April 2007</i> | | | | |
| County Pool - Money Market Fund | \$ 2,310,098,771 | \$ 11,096,800 | 5.38% | 51 |
| Educational Pool - Money Market Fund | \$ 2,584,211,525 | \$ 10,202,892 | 5.36% | 53 |
| Extended Fund | \$ 2,037,558,524 | \$ 9,230,167 | 5.25% | 463 |
| <i>March 2007</i> | | | | |
| County Pool - Money Market Fund | \$ 1,800,423,404 | \$ 7,762,592 | 5.30% | 58 |
| Educational Pool - Money Market Fund | \$ 2,156,514,102 | \$ 9,805,516 | 5.29% | 50 |
| Extended Fund | \$ 2,257,154,399 | \$ 9,622,420 | 4.99% | 444 |
| <i>February 2007</i> | | | | |
| County Pool - Money Market Fund | \$ 1,707,506,698 | \$ 6,691,832 | 5.40% | 69 |
| Educational Pool - Money Market Fund | \$ 2,273,724,523 | \$ 8,707,709 | 5.35% | 56 |
| Extended Fund | \$ 2,278,912,413 | \$ 9,587,935 | 5.43% | 441 |
| <i>January 2007</i> | | | | |
| County Pool - Money Market Fund | \$ 1,702,220,169 | \$ 9,037,751 | 5.38% | 51 |
| Educational Pool - Money Market Fund | \$ 2,171,852,117 | \$ 9,951,822 | 5.31% | 40 |
| Extended Fund | \$ 2,250,742,762 | \$ 9,239,897 | 4.92% | 447 |
| <i>December 2006</i> | | | | |
| County Pool - Money Market Fund | \$ 2,459,854,086 | \$ 11,628,814 | 5.38% | 44 |
| Educational Pool - Money Market Fund | \$ 2,364,291,301 | \$ 9,283,335 | 5.37% | 42 |
| Extended Fund | \$ 1,997,281,928 | \$ 8,257,453 | 4.92% | 453 |
| <i>November 2006</i> | | | | |
| County Pool - Money Market Fund | \$ 1,834,087,894 | \$ 7,897,248 | 5.39% | 61 |
| Educational Pool - Money Market Fund | \$ 1,913,967,546 | \$ 8,281,668 | 5.36% | 62 |
| Extended Fund | \$ 1,971,569,719 | \$ 8,216,199 | 4.99% | 457 |
| <i>October 2006</i> | | | | |
| County Pool - Money Market Fund | \$ 1,792,188,272 | \$ 7,569,048 | 5.39% | 57 |
| Educational Pool - Money Market Fund | \$ 1,923,791,277 | \$ 9,185,841 | 5.35% | 60 |
| Extended Fund | \$ 1,944,745,354 | \$ 7,841,267 | 4.80% | 483 |
| <i>September 2006</i> | | | | |
| County Pool - Money Market Fund | \$ 1,615,083,076 | \$ 7,236,374 | 5.41% | 60 |
| Educational Pool - Money Market Fund | \$ 1,948,311,050 | \$ 8,808,477 | 5.40% | 66 |
| Extended Fund | \$ 1,903,965,350 | \$ 7,429,388 | 4.78% | 454 |
| <i>August 2006</i> | | | | |
| County Pool - Money Market Fund | \$ 1,614,920,265 | \$ 6,811,792 | 5.40% | 63 |
| Educational Pool - Money Market Fund | \$ 2,035,802,849 | \$ 9,180,864 | 5.38% | 64 |
| Extended Fund | \$ 1,895,848,400 | \$ 7,712,637 | 4.60% | 414 |
| <i>July 2006</i> | | | | |
| County Pool - Money Market Fund | \$ 1,584,726,279 | \$ 7,778,613 | 5.29% | 57 |
| Educational Pool - Money Market Fund | \$ 2,135,846,766 | \$ 8,849,641 | 5.24% | 50 |
| Extended Fund | \$ 1,777,440,895 | \$ 6,516,407 | 4.45% | 376 |
| <i>June 2006</i> | | | | |
| County Pool - Money Market Fund | \$ 1,802,431,285 | \$ 7,644,477 | 5.18% | 55 |
| Educational Pool - Money Market Fund | \$ 1,877,538,725 | \$ 8,917,379 | 5.09% | 50 |
| Extended Fund | \$ 1,695,053,655 | \$ 6,274,458 | 4.48% | 335 |
| CUMULATIVE BALANCES - 12 MONTHS | AVERAGE BALANCES | TOTAL EARNINGS | AVERAGE YIELD | AVERAGE WAM |
| <i>June 1, 2006 - May 30, 2007</i> | | | | |
| County Pool - Money Market Fund | \$ 1,855,168,782 | \$ 100,608,870 | 5.36% | 57 |
| Educational Pool - Money Market Fund | \$ 2,136,611,139 | \$ 112,522,461 | 5.32% | 54 |
| Extended Fund | \$ 2,023,347,670 | \$ 98,938,355 | 4.89% | 432 |