



# ZONE 7 WATER AGENCY

## Investment Performance Review For the Quarter Ended September 30, 2022

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# Agenda

- Market Update
- Account Summary
- Portfolio Review

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# Market Update

## Current Market Themes



- ▶ The U.S. economy is characterized by:
  - ▶ Persistent high inflation
  - ▶ A deteriorating housing market
  - ▶ Continued personal consumption that is impacting household savings and balance sheets
  - ▶ Worsening economic outlook that is propped up by a strong labor market



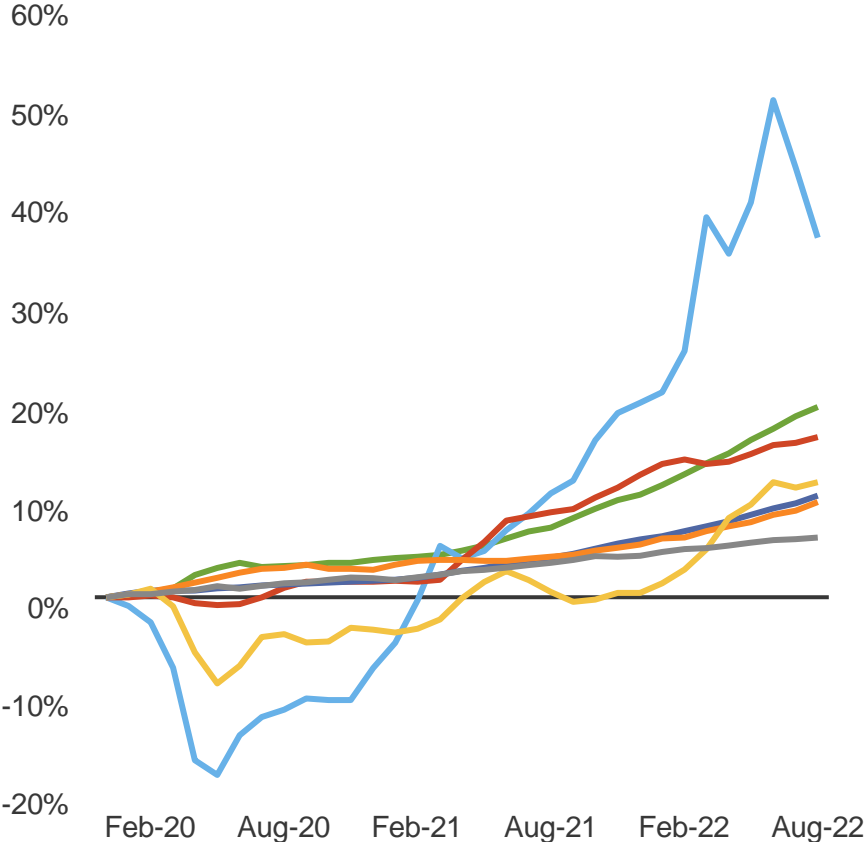
- ▶ The Federal Reserve has committed to a heavy-handed policy
  - ▶ Expectations have shifted from a soft landing to a moderate/hard landing, with increased recession risks
  - ▶ Short-term fed funds rate projected to reach 4.25% to 4.50% by year end
  - ▶ Increased pace of quantitative tightening



- ▶ Rapidly rising rates negatively impacting valuations and inducing market volatility
  - ▶ Yields across curve reached their highest levels in 14 years
  - ▶ Treasury yield curve remains inverted
  - ▶ Elevated volatility across all major asset classes

## Headline Inflation Remains Elevated Despite Recent Reduction in Energy Prices

**Price Change of Major CPI Components**  
Since December 2019



CPI Component	12-mo. Change	Weight <sup>1</sup>	Contribution to YoY CPI
Energy	23.8%	8.8%	1.7%
Food	11.4%	13.5%	1.5%
Goods	7.1%	21.2%	1.5%
Transportation	11.3%	5.9%	0.6%
Shelter	6.2%	32.2%	2.1%
Medical Services	5.6%	6.8%	0.4%
Other Services <sup>2</sup>	3.4%	11.6%	0.4%

*Detail may not add to total due to rounding.*

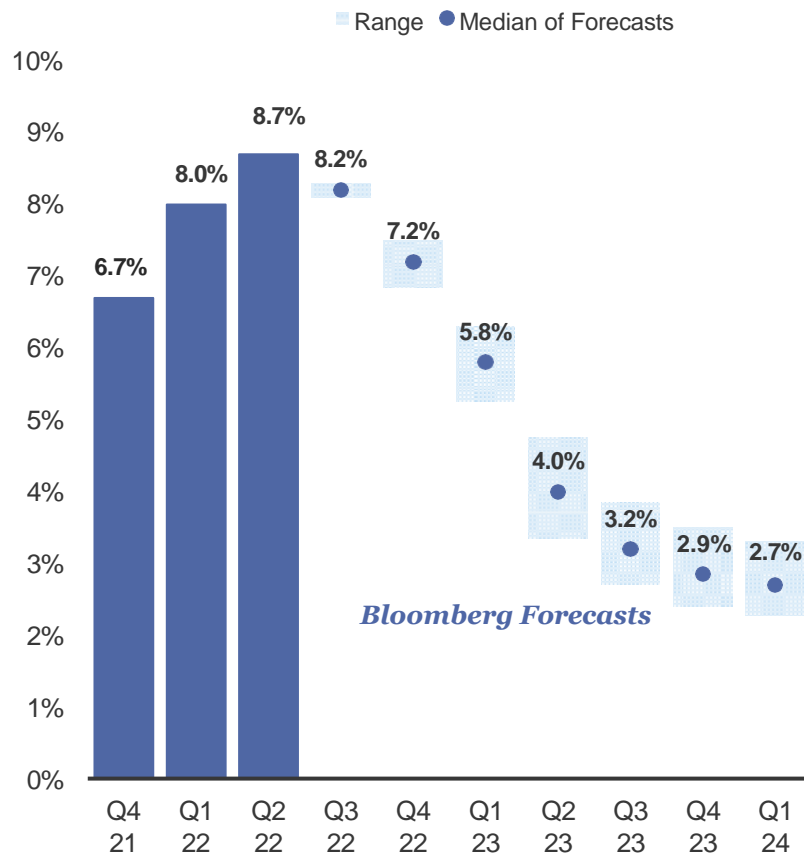
Source: Bloomberg, Bureau of Labor Statistics as of August 2022.

<sup>1</sup>Index weights are as of July 2022 as they are published on a one-month lag.

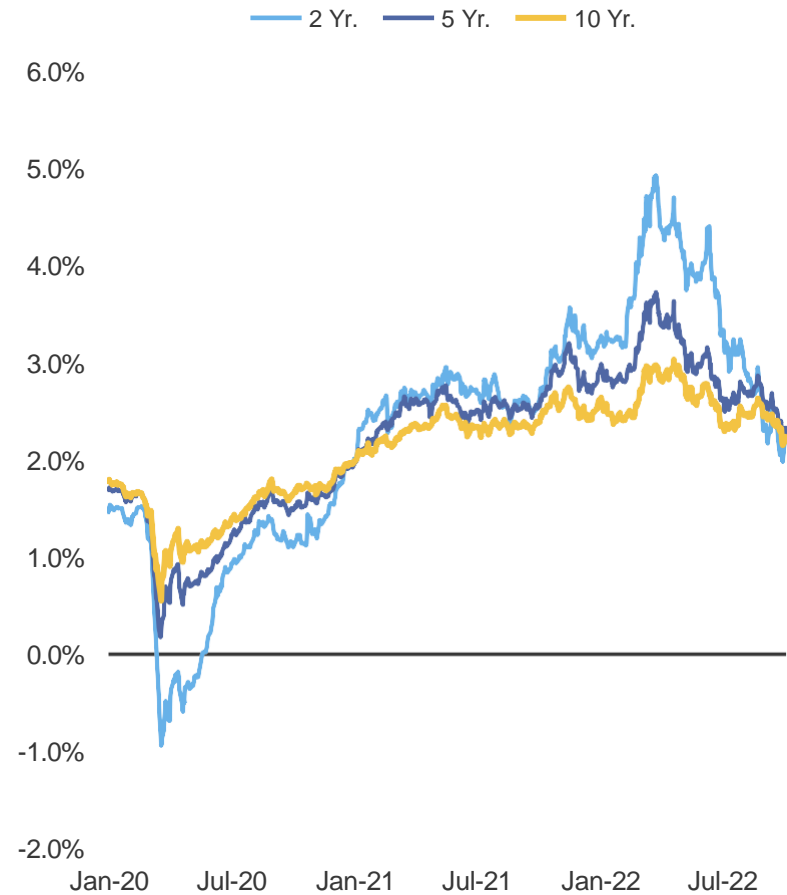
<sup>2</sup>Other services is a weighted blend of Water/Sewer/Trash, Household Operations, Recreation, Education, Communication Services, and Other Personal Services.

## Economist and Market Expectations Point to Slowly Moderating Inflation

### U.S. Inflation Forecasts Annualized Rate



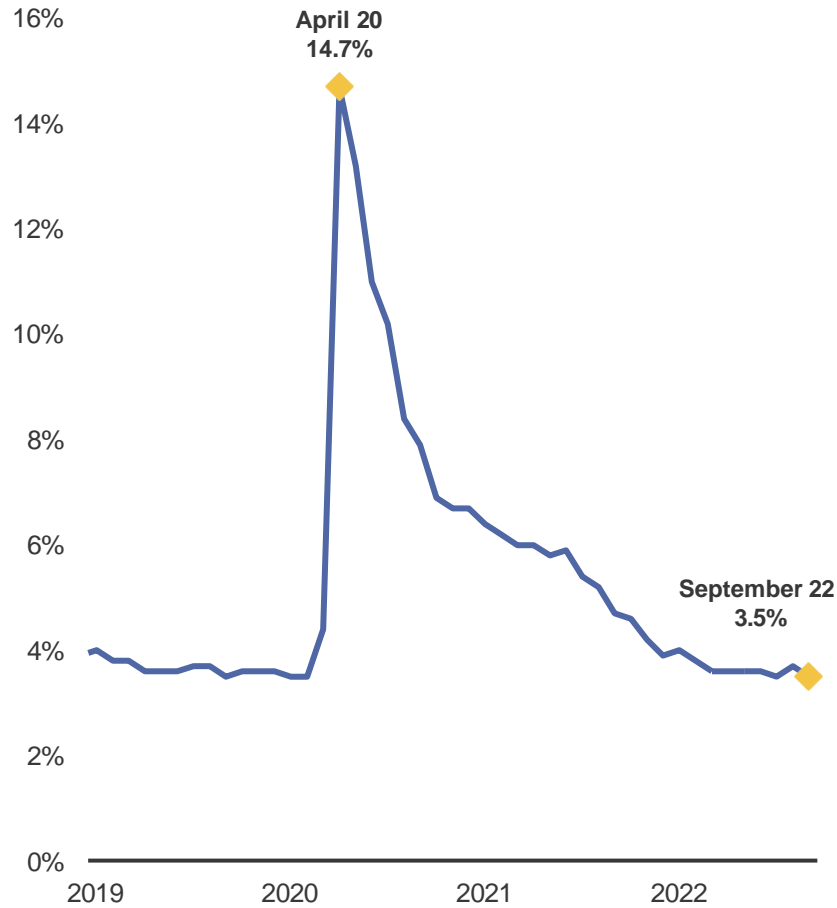
### Breakeven Inflation Rates



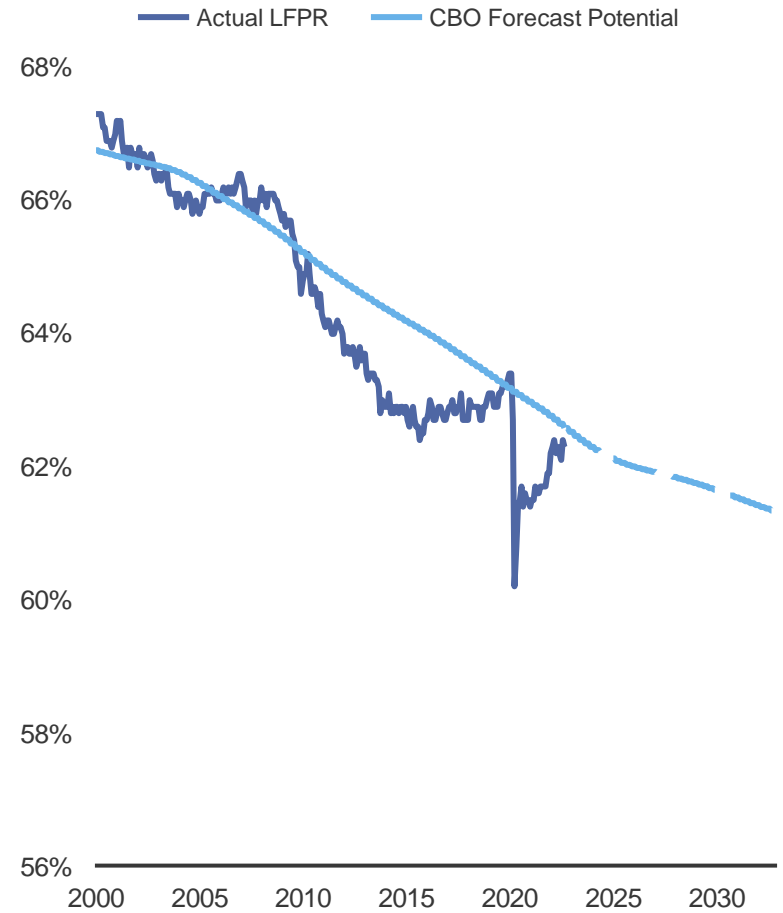
Source: Bloomberg, data as of September 30, 2022.

### Labor Force Continues to Recover

#### Unemployment Rate



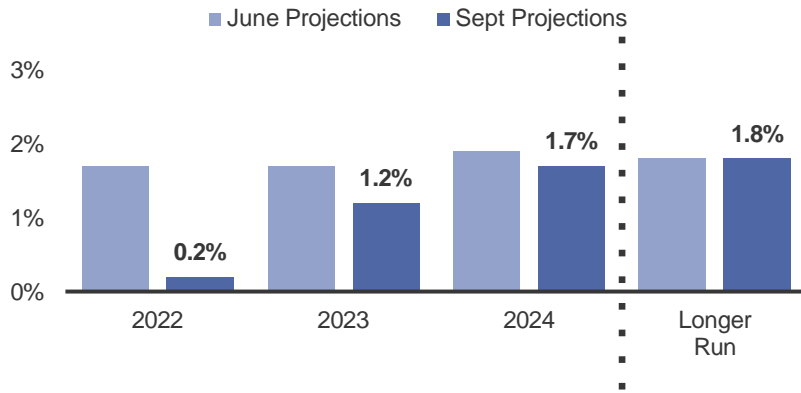
#### Labor Force Participation Rate



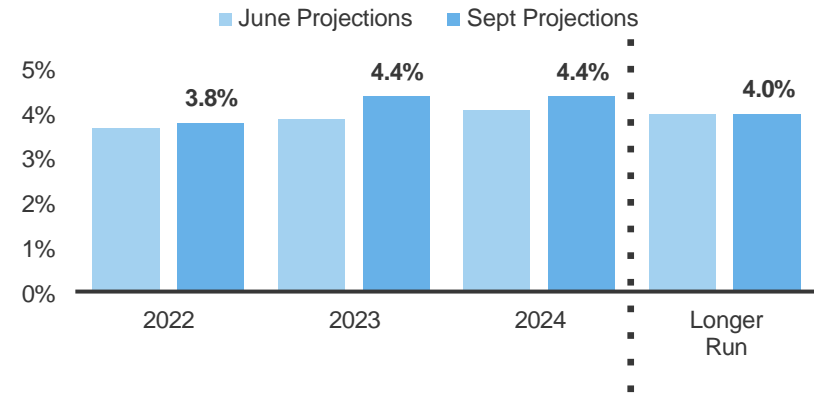
Source: Congressional Budget Office September 2022 economic projections, Bureau of Labor Statistics. Bloomberg, as of September 2022. Data is seasonally adjusted.

## Fed's Projections Reflect Weaker Economic Growth and Extended Timeline for Tighter Policy

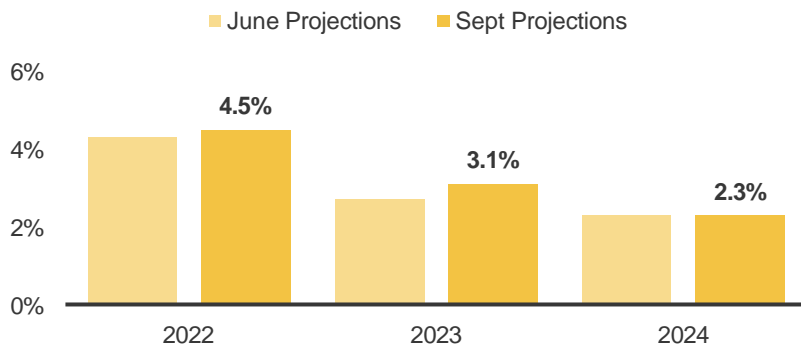
### Change in Real GDP



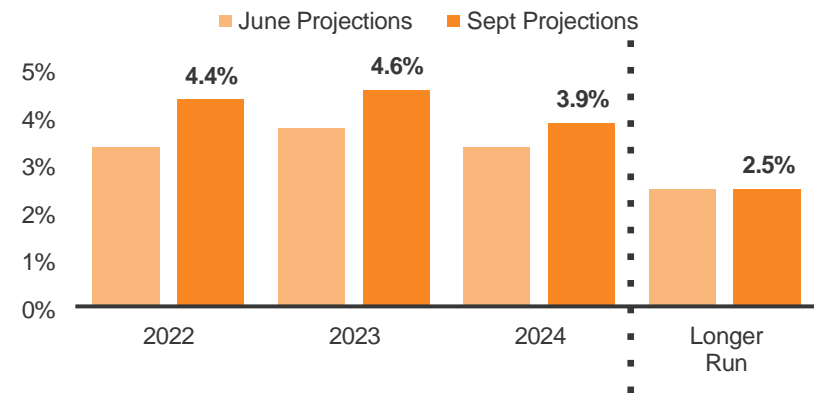
### Unemployment Rate



### Core PCE Inflation



### Federal Funds Rate

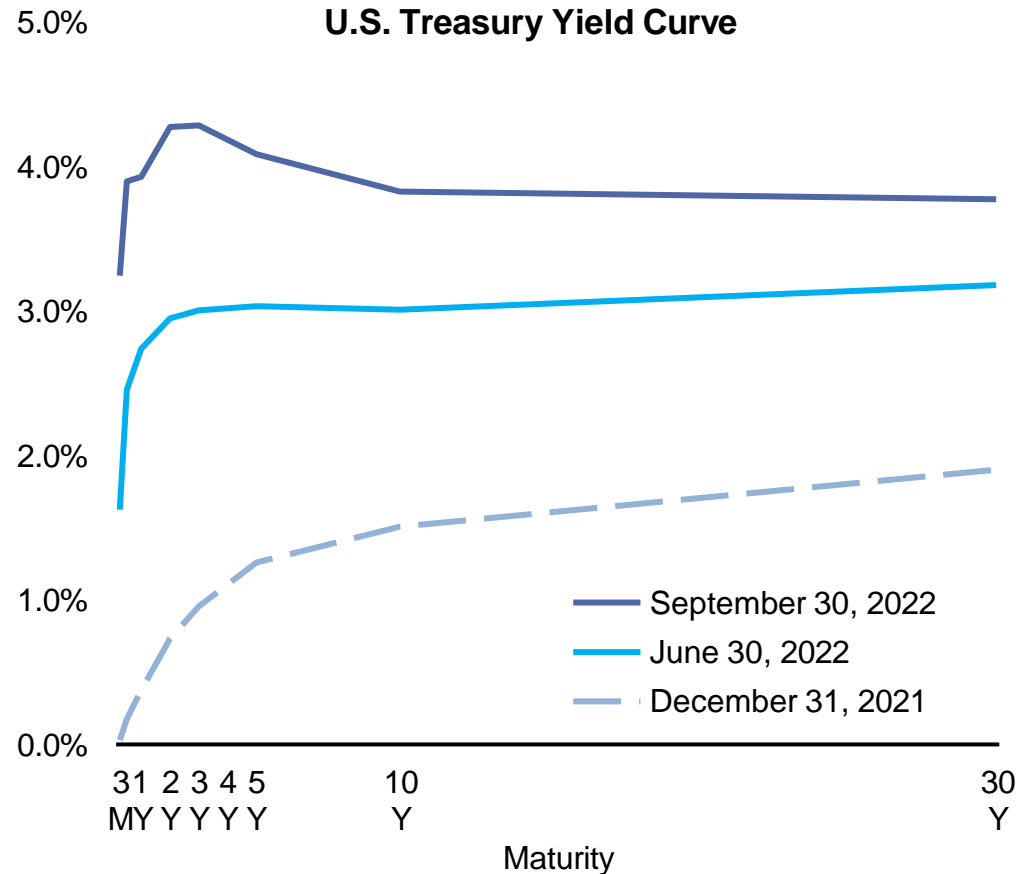


Source: Federal Reserve, latest economic projections as of September 2022.



### Treasury Yields Move Higher Across the Curve; Inversion Steepens Over the Quarter

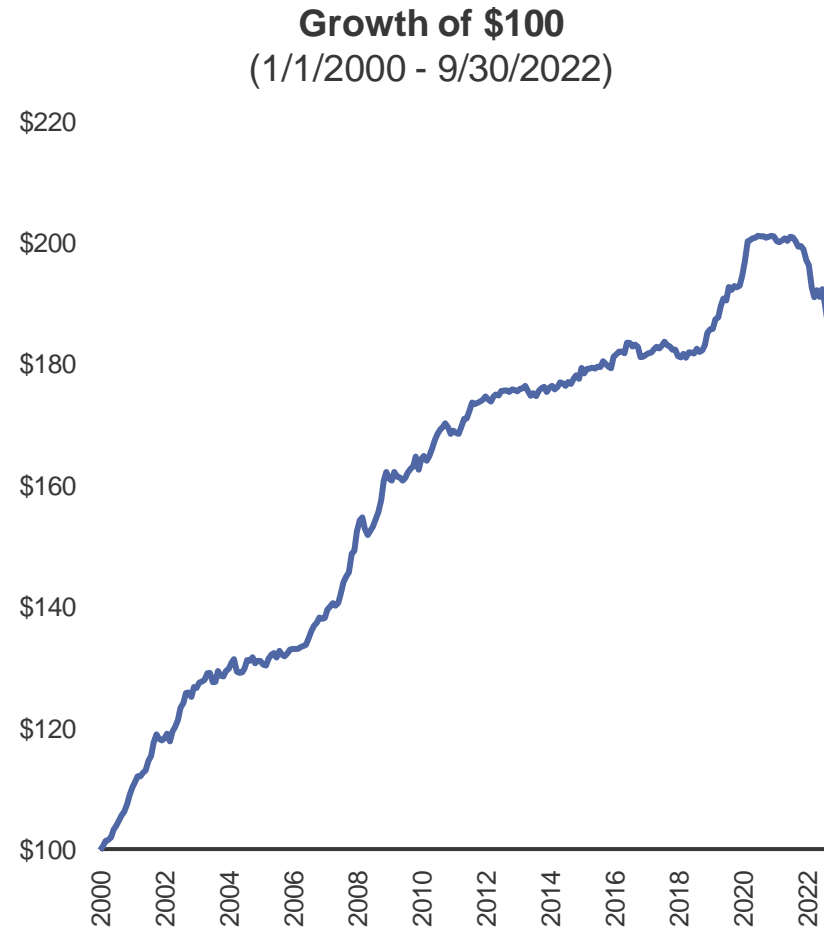
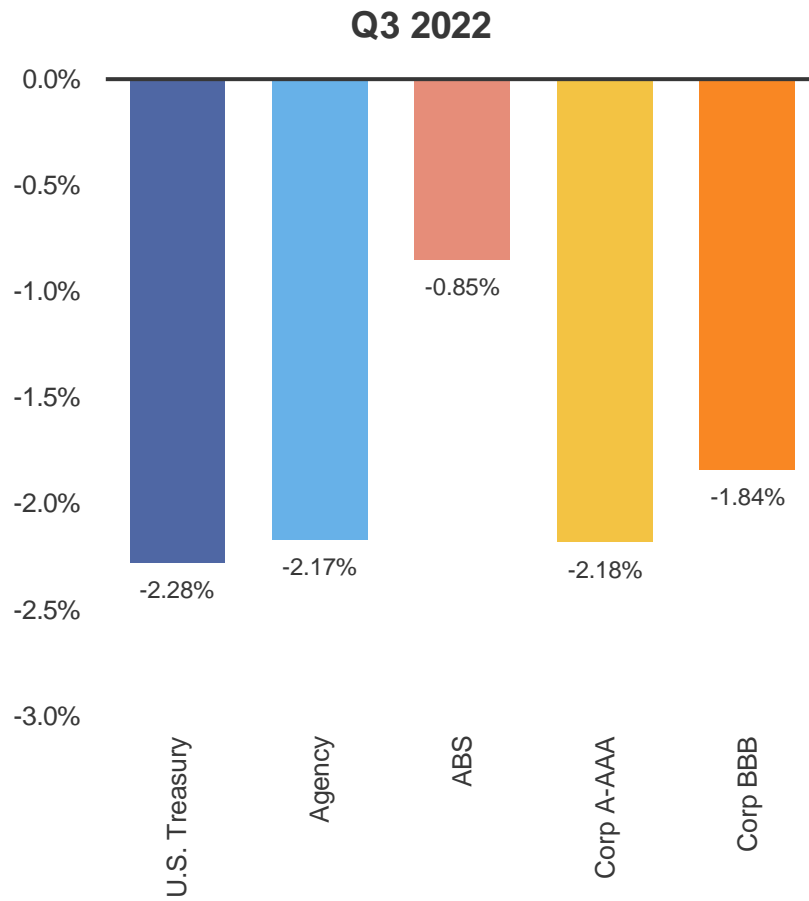
	3Q2022 09/30/22	2Q2022 06/30/22	QoQ Change
3-month	3.25%	1.63%	+1.62%
1-year	3.93%	2.74%	+1.19%
2-year	4.28%	2.95%	+1.33%
3-year	4.29%	3.01%	+1.28%
5-year	4.09%	3.04%	+1.05%
10-year	3.83%	3.01%	+0.82%
30-year	3.78%	3.18%	+0.60%



Source: Bloomberg, as of September 2022.

## Fixed Income Returns in Q3 2022

### 1-5 Year Indices



Source: ICE BofAML Indices. ABS indices are 0-5 year, based on weighted average life. As of September 30, 2022.  
Right Chart: 1-5 Year Treasury (GVQ0 Index).

## Fixed Income Sector Commentary – 3Q 2022

- ▶ **U.S. Treasury** securities posted negative absolute returns during Q3 as interest rates continue to ascend to levels not seen in over 14 years.
- ▶ **Federal agency** bullet spreads remained mostly unchanged in the low single-digits and the sector remained largely stagnant on light issuance. Conversely, the rapid rise in rates and volatility prompted a widening in spreads for callable federal agencies.
- ▶ **Supranational** yield spreads widened slightly in the longer-end of the curve while issuance has consistently lagged projections this year. Unattractive funding levels compounded by liquidity pressures resulted in minimal activity in the sector. New issues at attractive concessions to secondary inventory were the lone avenue to new exposure.
- ▶ **Investment-Grade Corporates** were a strong performer for much of the quarter as spreads tightened. Increases to allocations in the sector over recent months played a significant role in the strong performance relative to benchmarks.
- ▶ **Asset-Backed** yield spreads lagged the comparative narrowing in other sectors but remained relatively elevated in relation to high quality corporate notes. Although elevated relative to corporates, spreads tightened throughout the quarter and the sector generated attractive excess returns, with automobile collateral besting credit card structures.
- ▶ **Mortgage-Backed Securities** have been a staggering underperformer so far this year. Soaring mortgage rates combined with record high housing prices caused refinancing and new purchases to grind to a halt. Heightened volatility and concerns about an economic slowdown continued to weigh on the sector, while the looming Fed balance sheet reduction compounded the gloomy outlook.
- ▶ **Taxable Municipals** were another sector that generated positive excess returns in Q3. New issuance was generally lackluster with deals being heavily oversubscribed, pressuring spreads lower.
- ▶ **Commercial Paper and CDs** have been subject to a rapidly changing backdrop influenced by the Fed's aggressive series of rate hikes. Fixed-rate credit spreads widened during the quarter and the short-term credit curve remains steep.

### Fixed Income Sector Outlook – 4Q 2022

Sector	Our Investment Preferences
COMMERCIAL PAPER / CD	
TREASURIES	
T-Bill	
T-Note	
FEDERAL AGENCIES	
Bullets	
Callables	
SUPRANATIONALS	
CORPORATES	
Financials	
Industrials	
SECURITIZED	
Asset-Backed	
Agency Mortgage-Backed	
Agency CMBS	
MUNICIPALS	

● Current outlook

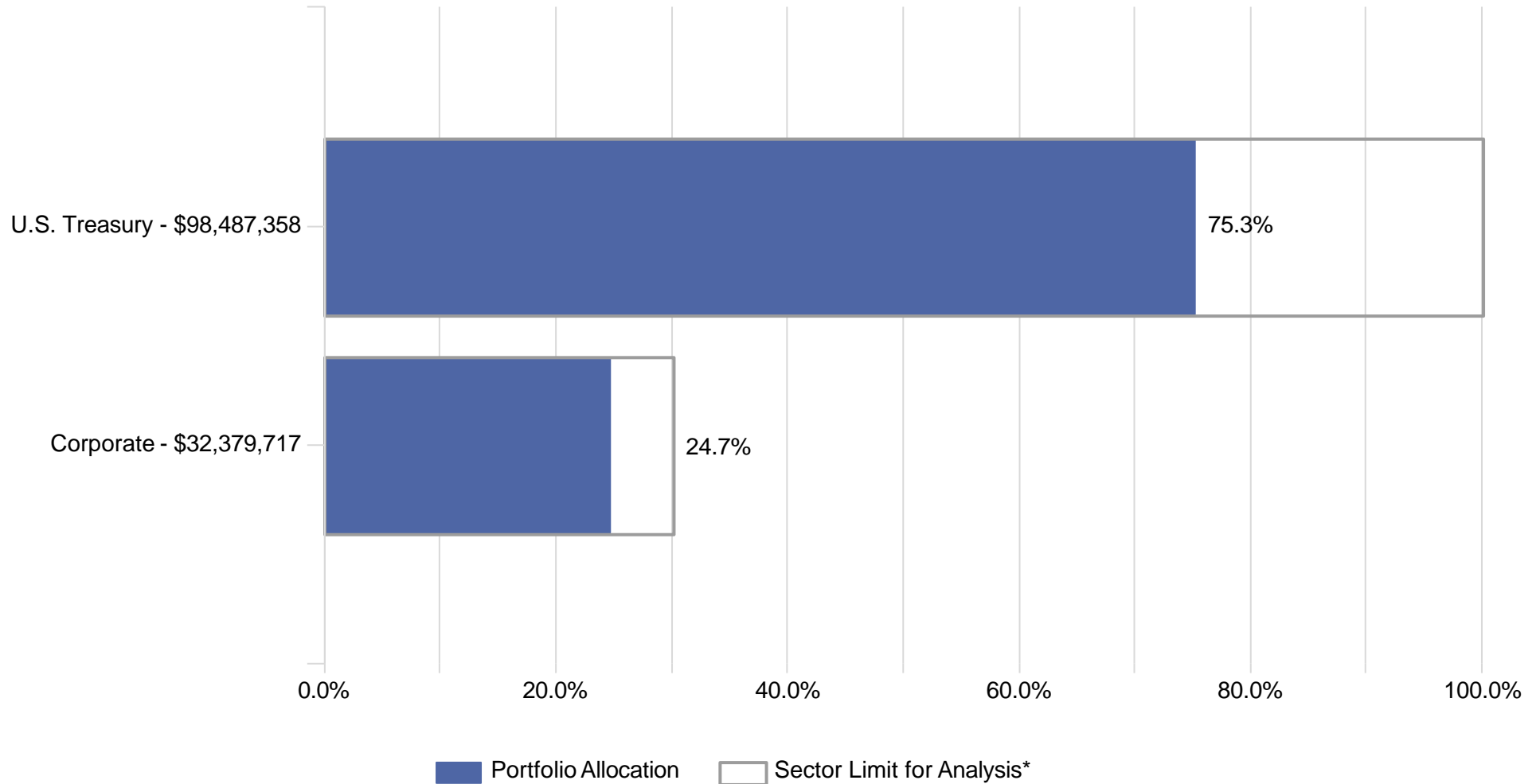
○ Outlook one quarter ago



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# Account Summary

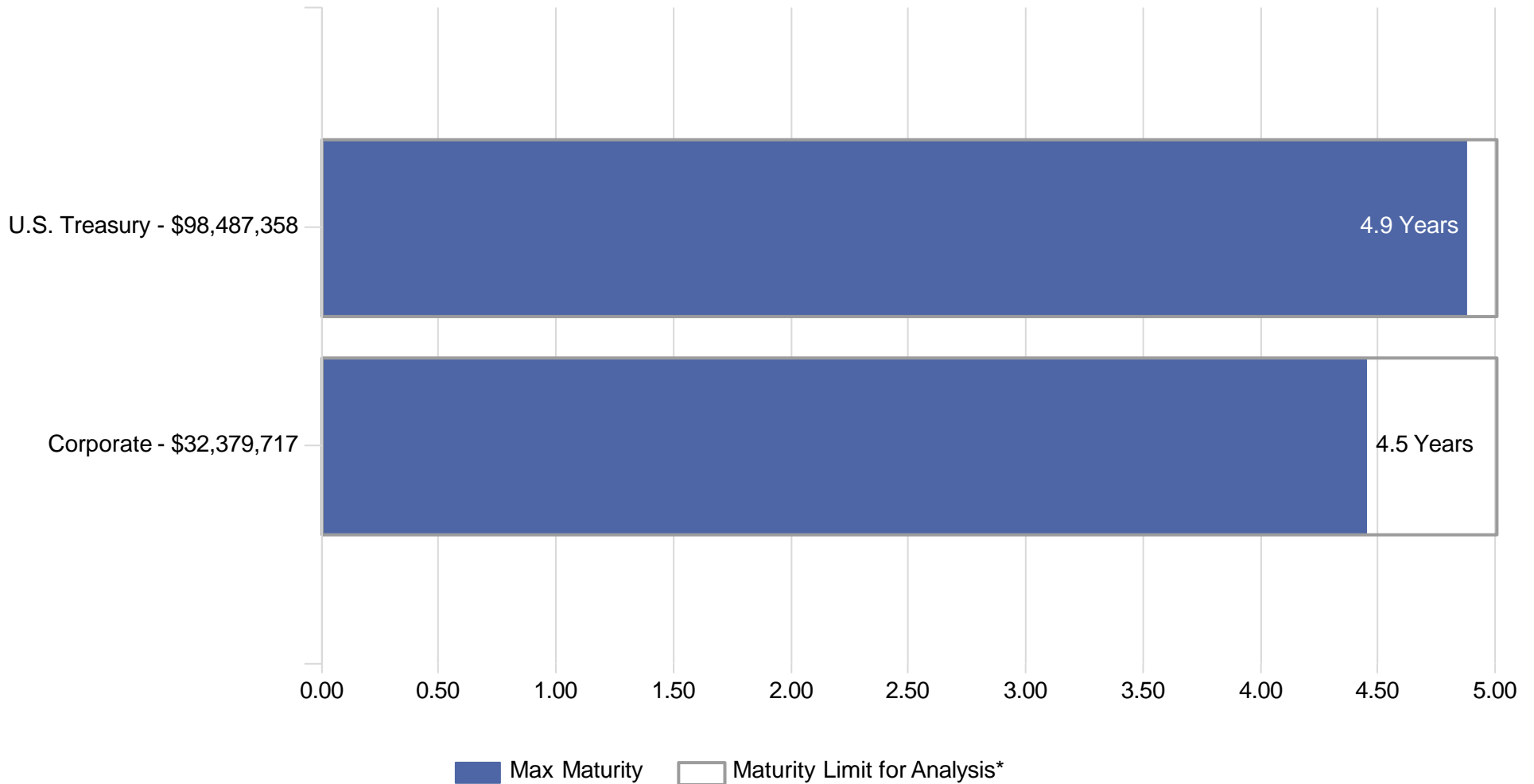
### Sector Allocation Analytics



*For informational/analytical purposes only and is not provided for compliance assurance. Includes accrued interest.*

*\*Sector Limit for Analysis is as derived from our interpretation of your most recent Investment Policy as provided.*

### Max Maturity Analytics



For informational/analytical purposes only and is not provided for compliance assurance. Includes accrued interest and excludes balances invested in overnight funds.

\*Maturity Limit for Analysis is derived from our interpretation of your most recent Investment Policy as provided.

Mortgage-backed securities and asset-backed securities, if any, limit is based on weighted average life, if applicable. Callable securities, if any, limit is based on maturity date.

## Certificate of Compliance

During the reporting period for the quarter ended September 30, 2022, the account(s) managed by PFM Asset Management ("PFMAM") were in compliance with the applicable investment policy and guidelines as furnished to PFMAM.

Acknowledged : *PFM Asset Management LLC*

*Note: Pre- and post-trade compliance for the account(s) managed by PFM Asset Management is provided via Bloomberg Asset and Investment Management ("AIM").*



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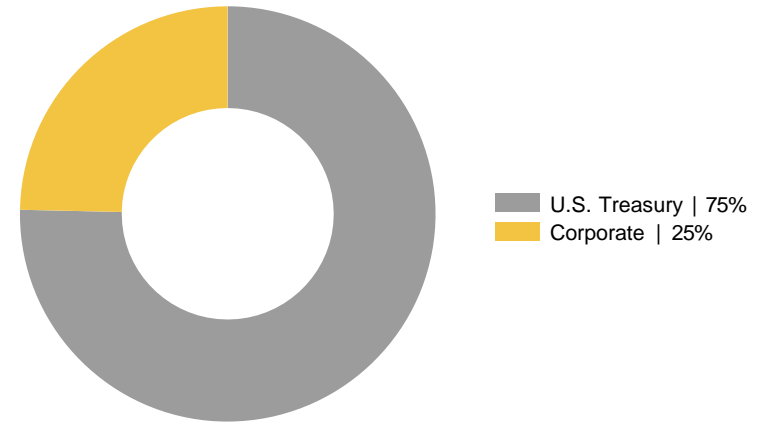
# Portfolio Review: ZONE 7 WATER AGENCY

## Portfolio Snapshot - ZONE 7 WATER AGENCY<sup>1</sup>

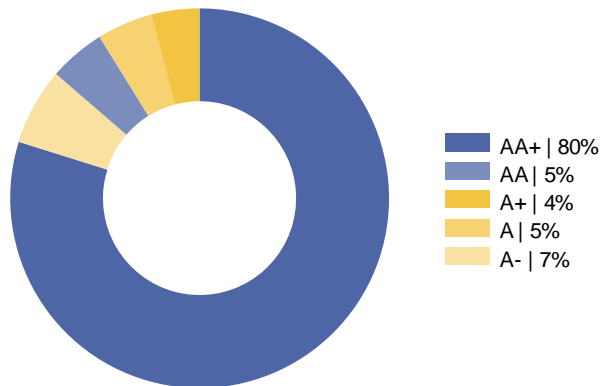
### Portfolio Statistics

<b>Total Market Value</b>	\$131,164,292.09
<i>Securities Sub-Total</i>	\$130,475,195.28
<i>Accrued Interest</i>	\$391,879.76
<i>Cash</i>	\$297,217.05
<b>Portfolio Effective Duration</b>	2.37 years
<b>Benchmark Effective Duration</b>	2.48 years
<b>Yield At Cost</b>	1.84%
<b>Yield At Market</b>	4.25%
<b>Portfolio Credit Quality</b>	AA

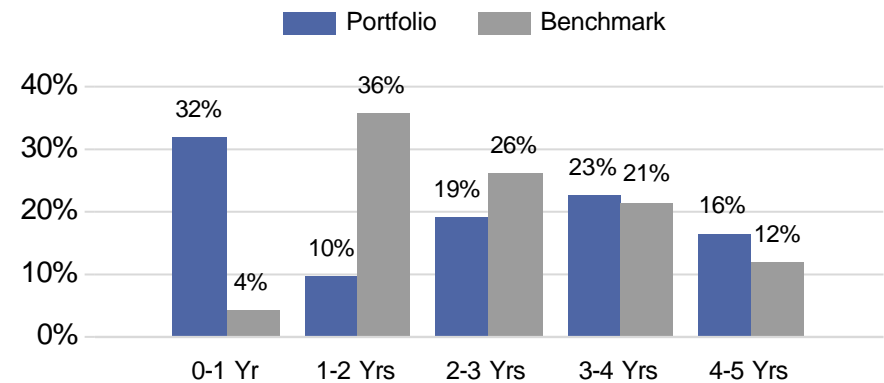
### Sector Allocation



### Credit Quality - S&P

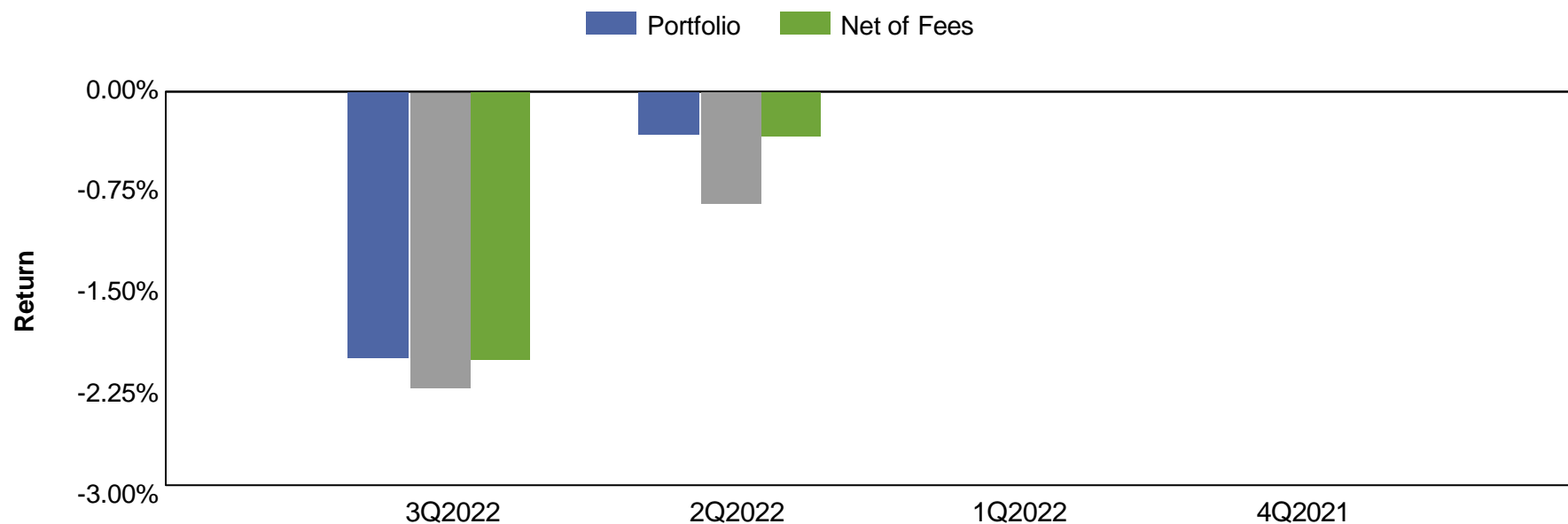


### Duration Distribution



<sup>1</sup> Yield and duration calculations exclude cash and cash equivalents. Sector allocation includes market values and accrued interest. The portfolio's benchmark is the ICE BofAML 1-5 Year U.S. Treasury Index. Source: Bloomberg. An average of each security's credit rating was assigned a numeric value and adjusted for its relative weighting in the portfolio.

### Portfolio Performance



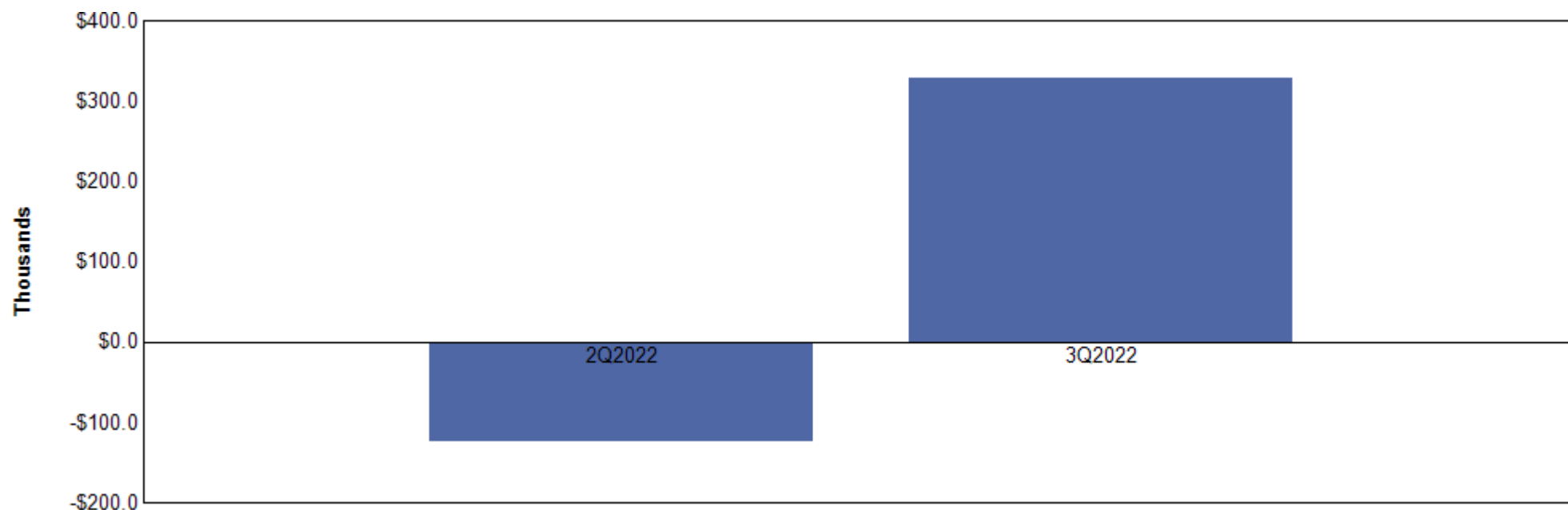
Market Value Basis Earnings	3Q2022	2Q2022	1Q2022	4Q2021
Interest Earned <sup>1</sup>	\$438,910	\$313,977	-	-
Change in Market Value	(\$3,047,237)	(\$782,470)	-	-
<b>Total Dollar Return</b>	<b>(\$2,608,327)</b>	<b>(\$468,493)</b>	-	-
<b>Total Return<sup>2</sup></b>				
Portfolio	-1.95%	-0.34%	-	-
Benchmark <sup>3</sup>	-2.28%	-0.81%	-	-
<b>Basis Point Fee</b>	<b>0.02%</b>	<b>0.02%</b>	-	-
<b>Net of Fee Return</b>	<b>-1.97%</b>	<b>0.36%</b>	-	-

1. Interest earned calculated as the ending accrued interest less beginning accrued interest, plus net interest activity.

2. Returns are presented on a periodic basis.

3. The portfolio's benchmark is the ICE BofAML 1-5 Year U.S. Treasury Index. Source: Bloomberg.

### Accrual Basis Earnings - ZONE 7 WATER AGENCY



Accrual Basis Earnings	4Q2021	1Q2022	2Q2022	3Q2022
Interest Earned <sup>1</sup>	-	-	\$313,977	\$438,910
Realized Gains / (Losses) <sup>2</sup>	-	-	(\$488,730)	(\$289,978)
Change in Amortized Cost	-	-	\$49,423	\$178,675
<b>Total Earnings</b>	-	-	<b>(\$125,331)</b>	<b>\$327,607</b>

1. Interest earned calculated as the ending accrued interest less beginning accrued interest, plus net interest activity.

2. Realized gains / (losses) are shown on an amortized cost basis.

## Important Disclosures

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It is not possible to invest directly in an index. The index returns shown throughout this material do not represent the results of actual trading of investor assets. Third-party providers maintain the indices shown and calculate the index levels and performance shown or discussed. Index returns do not reflect payment of any sales charges or fees an investor would pay to purchase the securities they represent. The imposition of these fees and charges would cause investment performance to be lower than the performance shown.

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- Market values that include accrued interest are derived from closing bid prices as of the last business day of the month as supplied by Refinitiv, Bloomberg, or Telerate. Where prices are not available from generally recognized sources, the securities are priced using a yield-based matrix system to arrive at an estimated market value.
- In accordance with generally accepted accounting principles, information is presented on a trade date basis; forward settling purchases are included in the monthly balances, and forward settling sales are excluded.
- Performance is presented in accordance with the CFA Institute's Global Investment Performance Standards (GIPS). Unless otherwise noted, performance is shown gross of fees. Quarterly returns are presented on an unannualized basis. Returns for periods greater than one year are presented on an annualized basis. Past performance is not indicative of future returns.
- Bank of America/Merrill Lynch Indices provided by Bloomberg Financial Markets.
- Money market fund/cash balances are included in performance and duration computations.
- Standard & Poor's is the source of the credit ratings. Distribution of credit rating is exclusive of money market fund/LGIP holdings.
- Callable securities in the portfolio are included in the maturity distribution analysis to their stated maturity date, although, they may be called prior to maturity.
- MBS maturities are represented by expected average life.

## Glossary

- **Accrued Interest:** Interest that is due on a bond or other fixed income security since the last interest payment was made.
- **Agencies:** Federal agency securities and/or Government-sponsored enterprises.
- **Amortized Cost:** The original cost of the principal of the security is adjusted for the amount of the periodic reduction of any discount or premium from the purchase date until the date of the report. Discount or premium with respect to short-term securities (those with less than one year to maturity at time of issuance) is amortized on a straight line basis. Such discount or premium with respect to longer-term securities is amortized using the constant yield basis.
- **Asset-Backed Security:** A financial instrument collateralized by an underlying pool of assets – usually ones that generate a cash flow from debt, such as loans, leases, credit card balances, and receivables.
- **Bankers' Acceptance:** A draft or bill of exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill as well as the insurer.
- **Commercial Paper:** An unsecured obligation issued by a corporation or bank to finance its short-term credit needs, such as accounts receivable and inventory.
- **Contribution to Total Return:** The weight of each individual security multiplied by its return, then summed for each sector to determine how much each sector added or subtracted from the overall portfolio performance.
- **Effective Duration:** A measure of the sensitivity of a security's price to a change in interest rates, stated in years.
- **Effective Yield:** The total yield an investor receives in relation to the nominal yield or coupon of a bond. Effective yield takes into account the power of compounding on investment returns, while nominal yield does not.
- **FDIC:** Federal Deposit Insurance Corporation. A federal agency that insures bank deposits to a specified amount.
- **Interest Rate:** Interest per year divided by principal amount and expressed as a percentage.
- **Market Value:** The value that would be received or paid for an investment in an orderly transaction between market participants at the measurement date.
- **Maturity:** The date upon which the principal or stated value of an investment becomes due and payable.
- **Negotiable Certificates of Deposit:** A CD with a very large denomination, usually \$1 million or more, that can be traded in secondary markets.
- **Par Value:** The nominal dollar face amount of a security.
- **Pass-through Security:** A security representing pooled debt obligations that passes income from debtors to its shareholders. The most common type is the mortgage-backed security.

## Glossary

- **Repurchase Agreements:** A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date.
- **Settle Date:** The date on which the transaction is settled and monies/securities are exchanged. If the settle date of the transaction (i.e., coupon payments and maturity proceeds) occurs on a non-business day, the funds are exchanged on the next business day.
- **Supranational:** A multinational union or association in which member countries cede authority and sovereignty on at least some internal matters to the group, whose decisions are binding on its members.
- **Trade Date:** The date on which the transaction occurred; however, the final consummation of the security transaction and payment has not yet taken place.
- **Unsettled Trade:** A trade which has been executed; however, the final consummation of the security transaction and payment has not yet taken place.
- **U.S. Treasury:** The department of the U.S. government that issues Treasury securities.
- **Yield:** The rate of return based on the current market value, the annual interest receipts, maturity value, and the time period remaining until maturity, stated as a percentage on an annualized basis.
- **YTM at Cost:** The yield to maturity at cost is the expected rate of return based on the original cost, the annual interest receipts, maturity value, and the time period from purchase date to maturity, stated as a percentage on an annualized basis.
- **YTM at Market:** The yield to maturity at market is the rate of return based on the current market value, the annual interest receipts, maturity value, and the time period remaining until maturity, stated as a percentage on an annualized basis.