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October 8, 2004

TO: Board of Supervisors
James D. Ruth, County Executive Officer
Treasury Oversight Committee
Treasurer's Advisory Committee
Participants

FROM: John M. W. Moorlach, C.P.A., CFP®
Treasurer-Tax Collector

SUBJECT: Treasurer's Management Report for September 30, 2004

Attached please find the Treasurer's Management Report for the County of Orange for the month ended September 30, 2004. 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 **http://www.oc.ca.gov/treas/**.

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 September 30. 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 Pool's September 2004 interest apportionment. We anticipate posting the September interest apportionment to participants' cash accounts in the County general ledger by approximately October 27, 2004.

CREDIT WATCH NEGATIVE AND APPROVED ELIGIBILITY LIST

In the month of September, there were four changes to the Treasurer's approved eligibility list:

1) **Caterpillar Financial Services Corp** was added
2) **Household Finance Corp** was added
3) **Royal Bank of Canada** was removed
4) **Strong Heritage Money Fund** was removed

ECONOMIC OBSERVATIONS

The price of crude oil has been the main focus of the financial markets for the last few weeks. In the Gulf of Mexico, Hurricane Ivan took out a third of the country's oil capacity and about 20 percent of natural gas capacity. This supply disruption has pushed crude oil prices past $50 per barrel and could reach $60 according to some doomsayers.

Higher oil prices do pose a bit of a quandary for Federal Open Market Committee (FOMC) officials. Will a dampening effect on growth cause FOMC members to cease tightening at the December meeting? Or will the impact on inflation be the more serious issue? With inflation comfortably under control, growth is likely to take the biggest hit. As a result, the prospects that December will end up being a temporary stopping point in the tightening process have increased.

At the Kansas City Federal Reserve's Annual Economic Luncheon, Federal Reserve Governor Edward M. Gramlich made a strong case for a steadfast continuation of gradual tightening. Governor Gramlich explains that, "Oil shocks have serious effects on the economy because they immediately raise prices for an important production input—oil—and important consumer goods—gasoline and heating oil. They are also likely to pushup prices in other energy markets. These price increases are significant enough that they typically show up as temporary bursts in the overall rate of inflation. They may even get passed through to continuing rates of inflation if they become incorporated into price- and wage-setting behavior. Increases in oil prices also reduce consumer-spending power, in much the same way as when a new excise tax is passed along by oil producers. To the extent that these producers are foreign, there should be a corresponding drop in domestic demand. Even if the oil producers are domestic, a drop in domestic demand could still occur if the producers do not spend as much of their new income as consumers would have or if they do not recycle their profits to shareholders."

In the past, any decision to stop the "measured" pace of interest rate tightening has been driven by the performance of the job market. The latest change in nonfarm payrolls, an increase of 96,000 for the month of September, puts some pressure on the Fed to pause. There is no doubt that consumer attitudes and business spending plus hiring have cooled as oil prices have climbed. Once again, the "wait and see" attitude appears to be infectious.

The FOMC increased interest rates by 25 basis points at their September 21 meeting. This action was built into the markets but the Treasurer's Investment Committee (TIC) was divided on the results. The financial community is leaning toward another rate increase at the next meeting on November 10. The TIC remains mixed on the outcome.

INTEREST RATE FORECAST

The estimated interest rate forecast for the fiscal year 2004-2005 is increased to 1.75 percent.

Please call if you have any questions.