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December 10, 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 November 30, 2007

Attached please find the Treasurer's Management Report for the County of Orange for the month ended November 30, 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 October 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 October and November 2007 interest apportionments. We anticipate posting the October and November 2007 interest apportionments to participants' cash accounts in the County general ledger by approximately December 17 and January 25, 2007 respectively.

CHANGES IN ELIGIBLE CREDITS

In the month of November, there were no changes to the Treasurer's approved eligibility list of issuers.

On November 30, however, Moody's placed Beta, CC (USA), Dorada, Five, Tango and Whistlejacket on review for possible downgrade. This announcement including the pressures that mounted in November prompted the December 5th removal of all Structured Investment Vehicle issuers. Please see the attached report.

Developments with Structured Investment Vehicles

Since my report to the Board of Supervisors regarding the actions my office has taken relative to the placing of certain structured investment vehicles on credit watch, there have been a number of responses and statements which have both misstated the current situation and attempted to link our investment pools with the problems confronting the public investment pools in Florida.

First, let me state unequivocally that the situation in Florida is in no manner similar to what I discussed with the Board last Tuesday. My office has provided the Board of Supervisors with a detailed analysis of the situation in Florida and how it, in no manner, is similar to what was discussed on Tuesday. A copy of this *Special Investment Report on Structured Investment Vehicles* can be found on our website at the following link http://www.ttc.ocgov.com/treas/PDF/SIV/siv.htm.

Second, let me state unequivocally that our investment pool is strong, safe and in no risk of imploding or breaching its fiduciary obligations to its members or the public. The structure of these investments, the security underlying these investments and the relatively small percentage of total investment pool funds in these vehicles preclude and prevent the County of Orange from defaulting on its financial obligations.

Third, the best evidence of the fluidity of the current economic environment is demonstrated by the fact that in the short period of time between my report last Tuesday and the close of business last Thursday, the bank sponsoring Tango Finance Corp. has announced its plan to move the vehicle's underlying assets directly onto their balance sheet. The incorporation of this vehicle, representing approximately $7.6 billion in assets, onto the banks current balance sheet should reduce the vehicles on credit watch in our portfolio by approximately thirty five percent (35%). Such a substantive and significant reduction in such a short period of time speaks to both the underlying stability of the assets securing the investment vehicles and the soundness of our policy of responding cautiously and conservatively to movements in the market.

In early September 2007, Moody's, in response to growing concerns regarding the subprime investment market, changed its methodology for valuation of structured investment vehicles, significantly increasing the stress testing used to rate those investment vehicles. Each and every one of the structured investment vehicles that our pool was invested in sustained its viability in light of the additional stress placed upon it via the new investment analysis. These results gave us continued confidence in the suitability and viability of our investment in these vehicles.

The results of this September review were incorporated into a special report attached to our September 2007 Treasurer's Management Report to the Board of Supervisors issued on October 10th. The report authored by our Senior Financial Analyst, along with all the other financial information discussed, is available on our website. Our analysis has been ongoing. Additional scrutiny of our eligible asset-backed issuers in April 2007 confirmed that our approved issuers had negligible exposure to subprime US residential mortgages. Updated reviews were repeated in June and as noted above, in September.

Based upon the Moody's review, coupled with our own internal analysis, my office had three options. The first was to sell off the vehicles at a substantial discount. The second was to write down the investments. The third was to continue to closely monitor the situation.

The first option was rejected as an overreaction to market fluctuations. The vehicles were still performing pursuant to their obligations and the underlying assets securing the structured investment vehicles were still highly rated. None of the rating services had alerted the investing public as to any problems with the general credit quality of the underlying assets. There was no reason to sell off the vehicles realizing what would have been an unnecessary loss.

The second option was rejected for essentially the same reasons. Our investment staff was monitoring the vehicles and the underlying assets while, at the same time, talking with the managers of the various vehicles as well as independent analysts from various brokerage houses and rating services. As such, we took the third option and continued to monitor the situation closely. At the time of the publication of our October report published on November 9th, there had been no changes in the ratings of the structured investment vehicle debt held by the investment pool.

On November 8, 2007 Moody's announced another review of structured investment vehicles. It must be noted that this announcement simply identified that Moody's was performing another analysis similar to the one done in September, the results of which were that our investments were stable and performing as anticipated. It must also be noted that on the date of the announcement, Moody's did not downgrade any of these vehicles and did not identify any senior note ratings as being in jeopardy.

Again, the Treasurer's Office was faced with two choices: they could react to an announcement that a review was taking place or they could wait for the results of that review. Seeing no need to panic or act prematurely, my office chose to wait for the results of the Moody's review.

On November 30, 2007 Moody's identified a number of structured investment vehicles that they were placing on credit watch. My office received the information mid-day Friday and immediately began to review the information conveyed by Moody's in light of our participation in the specific vehicles identified. After a review of the situation and in consultation with our analysts and advisors, it was decided that the most prudent method for dealing with the situation was to write down those investments by approximately three percent. That was done late Friday afternoon November 30th.

It is important to note that neither Fitch nor Standard and Poor's, the other two prominent rating services, has put these investment vehicles on credit watch at this time. We have included in this month's report two articles on this subject published by Standard & Poor's dated December 10, 2007. While Moody's has put them on credit watch, they have not downgraded their ratings of these vehicles or their underlying assets. Most importantly, all of these vehicles are performing as anticipated and none have defaulted.

At the time that the identified structured investment vehicles were placed on credit watch, Moody's announced that they would review their evaluation in a week. On December 5, 2007, Moody's announced that they were going to stay that review for another week. And so, as of the date of this report, no vehicles have been downgraded, no vehicles have defaulted and one investment vehicle, representing approximately thirty five percent of our total participation, has restructured itself in a manner designed to protect senior debt holders.

Under generally accepted accounting practices, our office was under no obligation to write down the SIV investments put on credit watch by Moody's. The write down was implemented as part of our conservative accounting methodology so as to continue to provide the Board of Supervisors and the public with as transparent, realistic and current financial information as is possible.

Over the weekend, it was decided that the write down, while only on paper and not, in any manner, impacting either liquidity or receivables, was a significant enough transaction so as to necessitate informing the Board in a timely but not worrisome manner. As such, it was decided that we would request time before the Board at its next meeting, which was Tuesday. Less than 48 hours of business time elapsed between the time my office received the information from Moody's, analyzed it, and prepared and presented our report to the Board.

Finally, it must be emphasized that at this time the investment pool has suffered no loss as a result of some structured investment vehicles being put on credit watch. It must also be considered that these underlying assets continue to perform well and continue to be highly rated. And, third, it must be realized that before our investments suffer any loss, the capital notes, which also support the investment vehicles and are subordinate to our investment, need to be called and exhausted. This has not happened and we believe there is sufficient cushion within those capital notes to protect out investment funds.

In sum, the Treasurer’s Office has continued its ongoing dialogue with vehicle management and heightened its attention to evolving developments in the asset-backed sector, with a special focus on subprime beginning in April of 2007. We provided an analysis of these investment vehicles to the Board of Supervisors in our September report and have been monitoring those vehicles since early this summer. It was our feeling that, short of any specific action taken by the market, or those who make and/or monitor the market, there was no reason to either take any action in regard to the holdings or provide a report to the Board that would be nothing more than speculation or conjecture.

When the market did make a move, albeit one involving the technical monitoring of certain investment vehicles as opposed to a substantive revaluation of those investment vehicles, we immediately reviewed the situation, took conservative, appropriate action and informed the Board of Supervisors at the first opportunity.

In these fluctuating economic times, this office will continue to closely monitor all financial trends and activities, take any and all appropriate action to protect the funds under our supervision and inform both the Board and the public at the earliest opportunity.

CREDIT OBSERVATIONS

Structured Investment Vehicles have received much attention over the last few months. Unfortunately, this asset class that once represented over $350 billion of the fixed income markets has been significantly mischaracterized. County approved Structured Investment Vehicle issuers are distinctly different from those garnering headlines. “Headline” SIVs are generally small and sponsored by “independents” with strong hedge fund ties. Unfortunately, the media has used those poorly performing issuers to paint the whole industry with a broad-brush.

Issues that set apart the County’s approved Structured Investment Vehicles:

Investment management

The TTC only considered for approval those SIVs with the most conservative investment management style. SIVs found in the market can be separated into two investment approaches. Older SIVs generally had a nice balance between corporate and asset-backed securities with predominately non-US assets overall. These older SIVs’ largest asset type is extremely solid, AA-rated commercial bank debt and they have an insignificant amount of US subprime debt. This is in contrast to the newer approach which heavily favors US assets, asset-backed in particular, with large exposures to two sectors that have been hardest hit by the markets: US residential and ABS CDO sectors.

The older, conservative investment managers have strong commercial bank ties. They have substantial reputational risk, which has been a great motivator for these issuers to repay all debt holders. The County benefits from continuing dialogue with top management of the SIVs we own.

Structural support

- **Subordinated debt** at par generally accounts for 6% to 8% of outstanding senior debt. This investment provides a cushion to senior note investors in the event asset values deteriorate. An often reported figure by the media is Capital NAV. Newspaper articles mischaracterize a "50% capital NAV" as saying half of the value of the assets has eroded. In reality a "50% capital NAV" is saying half of the subordinated debt is still providing a cushion to senior debt holders.
- So-called SIV-Lites lacked much of the support that traditional SIVs enjoyed. In contrast to that subset, **committed liquidity** adds another 6% to 8% of protection for senior debt holders against further market price deterioration. Through the market turbulence, committed liquidity has always remained available.

Asset quality

While SIV portfolios' market value has been affected, it should be emphasized that the credit quality of the underlying assets has performed well. They are still predominately, very highly rated with 80-90% of assets rated AA and above. On a security specific level, it is our understanding that there is substantial over-collateralization, further protecting investors.

While subprime US residential mortgage jitters seem to be responsible for an about-face in investor sentiment, that price dislocation has now affected the pricing of assets from every sector of the US and global economies. To widely varying degrees, this has had an effect on all Structured Investment Vehicles.

While the markets are currently under liquidity pressures, the County's Structured Investment Vehicle holdings are clearly the best of the sector. Structured Investment Vehicles have provided exposure to a diversified portfolio of high quality assets, in turn helping the County to diversify away from the US residential market. Now, investment managers are making substantial progress towards restructuring their vehicles to meet new investor expectations. We will continue our ongoing dialogue and convey any new developments.

MARKET OBSERVATIONS

November has posed many challenges for global financial markets. The Dow Jones Industrial average had one of its worst months this year as market participants continue to believe the United States economy is falling into recession. Turmoil in the credit markets resulted in many bond investors continuing to move toward the safety of US Treasuries as they forecast multiple Federal Open Market Committee rate cuts over the next few months. Even central banks of foreign countries have begun announcing either a pause in their rate tightening regimes or outright cuts. Much has been said about the decoupling of the global economy from the hegemony of the United States. This should go down as the shortest decoupling in history!

Currently, the biggest problem facing the world economy is a pronounced lack of liquidity in the credit markets. This can be attributed to several factors; however we shall focus on two which are of particular importance. First is a slow start in the United States to the winter shopping season. Consumer spending seems to have picked up of late and, while not great, it appears to be a reflection of consumers' diminished sense of confidence in the economy The slower than normal shopping season has been attributed to the banks hoarding cash and their unwillingness to lend to each other. Currently, retailers are enticing shoppers with heavy price reductions, hoping to reduce inventories which will reduce bank debt. This in turn will help alleviate some of the cash crunch currently affecting banks.

The second factor was started by the implosion of the subprime lending market, which caused banks to write down massive amounts of securities they were holding on their balance sheets. The housing market and its contagion still have a way to go before any kind of resolution can be expected. This will continue to cause banks to divert cash from their lending programs, and instead retain it against future uncertainties.

This has spilled over into the world's financial system as investors have become increasingly fearful of investing in anything other than the safest securities. As more investors move away from riskier assets, companies who formerly could depend on easy access to the credit markets are now finding it increasingly difficult (if not impossible) to secure funding. This in turn imperils formerly strong companies and increases the concern in the marketplace, creating a downward spiral in asset prices. As banks grapple with these issues, they are being forced to take assets back onto their balance sheets. This will cause them to conserve cash and continue to restrict lending practices.

There are two main options for solving this dilemma - cutting rates and deleveraging. In the first scenario, central banks would have to act in concert as they began a massive global rate-cutting scheme. The outcome of this could mean intensifying inflation risk or creating another asset bubble which may be more difficult to cure than the current property-induced bubble. The other scenario is for central bankers to work closely with the banking industry to allow a slow deleveraging and gradual restoration of a healthy lending environment. What is actually occurring is a combination of the two. Several central banks have recently cut short term rates, causing commercial banks to work feverishly to assess how much they will have to take back on their balance sheets. Over the next several weeks, additional restructuring options should be announced which should provide more clarity on the situation.

In fact, this is what is occurring with some of the Structured Investment Vehicles in which Orange County's investment pool is invested. Rabobank, the largest Dutch lender, recently announced it will take on $7.6 billion of assets from its Tango Finance Ltd. structured investment vehicle to avoid a fire sale of its assets. We believe the restructuring is good news for the structured investment vehicle market and anticipate more managers moving toward improving liquidity support and decreasing levered structures to allow the traditional investor-base to become active again. The recent market volatility has not substantially changed our strategy. We expect to continue selectively extending the duration of the portfolios when opportunities present themselves.

The Treasurer's Office appreciates your continued confidence as well as the opportunity to provide you exemplary portfolio and cash management services in the future.

Please call with any questions.

ORANGE COUNTY TREASURER-TAX COLLECTOR
EXECUTIVE SUMMARY
December 1, 2006 - November 30, 2007

PERIOD ENDING - MONTH / YEAR	MONTH END MARKET VALUE	EARNINGS FOR MONTH	AVERAGE YIELD FOR MONTH	MONTH END WAM
Current Month - November 2007				
County Pool - Money Market Fund	$ 1,982,354,313	$ 7,788,881	5.05%	33
Educational Pool - Money Market Fund	$ 1,609,274,201	$ 6,711,960	5.00%	37
Extended Fund	$ 2,331,861,281	$ 10,381,129	5.35%	477
October 2007				
County Pool - Money Market Fund	$ 1,782,577,124	$ 6,883,821	5.35%	38
Educational Pool - Money Market Fund	$ 1,694,769,373	$ 7,831,908	5.22%	43
Extended Fund	$ 2,402,836,096	$ 11,058,084	5.28%	484
September 2007				
County Pool - Money Market Fund	$ 1,432,086,153	$ 6,660,098	5.41%	45
Educational Pool - Money Market Fund	$ 1,819,448,968	$ 7,855,956	5.37%	48
Extended Fund	$ 2,540,343,321	$ 10,875,629	5.24%	468
August 2007				
County Pool - Money Market Fund	$ 1,504,259,141	$ 7,099,764	5.43%	52
Educational Pool - Money Market Fund	$ 1,838,089,922	$ 8,360,457	5.40%	54
Extended Fund	$ 2,562,116,542	$ 10,926,380	5.16%	462
July 2007				
County Pool - Money Market Fund	$ 1,591,863,228	$ 8,124,200	5.40%	51
Educational Pool - Money Market Fund	$ 1,955,074,669	$ 8,736,819	5.38%	58
Extended Fund	$ 2,498,650,022	$ 10,525,066	5.16%	479
June 2007				
County Pool - Money Market Fund	$ 1,877,130,515	$ 8,120,941	5.40%	54
Educational Pool - Money Market Fund	$ 1,796,807,395	$ 9,202,118	5.37%	58
Extended Fund	$ 2,360,816,509	$ 10,541,871	5.29%	496
May 2007				
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
April 2007				
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
March 2007				
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
February 2007				
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
January 2007				
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
December 2006				
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
CUMULATIVE BALANCES - 12 MONTHS	AVERAGE BALANCES	TOTAL EARNINGS	AVERAGE YIELD	AVERAGE WAM
December 1, 2006 - November 30, 2007				
County Pool - Money Market Fund	$ 1,849,071,566	$ 100,349,023	5.36%	50
Educational Pool - Money Market Fund	$ 2,043,128,332	$ 107,997,809	5.32%	50
Extended Fund	$ 2,315,681,036	$ 119,256,157	5.17%	461