

City of Albuquerque, New Mexico
Annual Investment Report
For the Year Ended June 30, 2006

City of Albuquerque Investment Philosophy

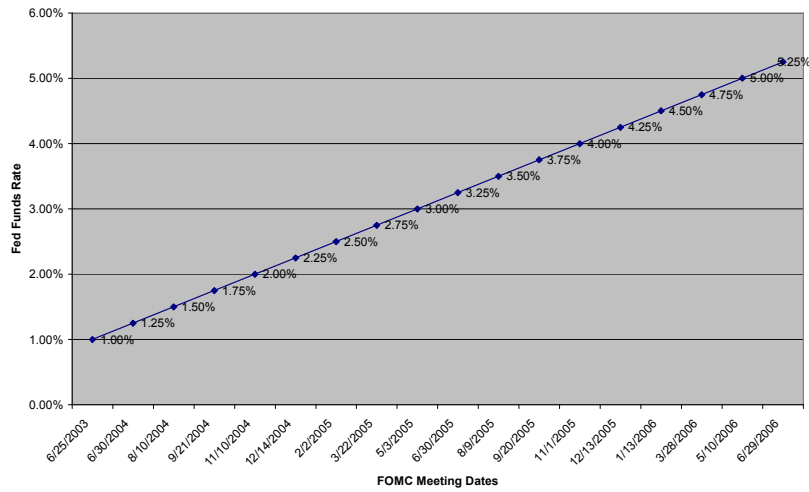
The City seeks to balance three primary objectives for its cash portfolio – maintaining sufficient liquidity to meet financial obligations, earning a market rate of return (subject to permitted investment constraints), and diversifying investments among asset classes to ensure safety of principal. The liquidity goal is achieved by matching investment maturities with the expected timing of obligations. Attainment of a market return is measured by benchmarking the portfolio against a relevant index, such as an appropriate Treasury yield. Finally, diversification (safety) is accomplished through implementation of a strategic asset allocation, derived from modern portfolio theory concepts.

The City consolidates cash from various sources into an internal investment pool, known as fund 920. The City's investment strategy is guided by its investment policy. The policy mandates allowable fixed income asset classes into which City Treasury may invest excess cash. These allowable classes, derived primarily from Section 6-10-10 NMSA 1978, are U.S. Treasuries, U.S. agency securities, as well as repurchase agreements, money market funds, and CDs fully collateralized by U.S. Treasury or agency securities.

Market Review & Portfolio Status

During the year the Federal Reserve continued its assertive anti-inflation campaign that it began in June 2004. On June 30, 2004 the Fed raised the rate it charges to member banks for overnight loans, known as the Fed Funds rate, by 25 basis points to 1.25%. By the start of this fiscal year – July 1, 2005 – the Funds rate had risen to 3.25%. On June 30, 2006, the most recent increase to the Funds rate took it to its current level of 5.25%.

Fed Funds Tightening Campaign

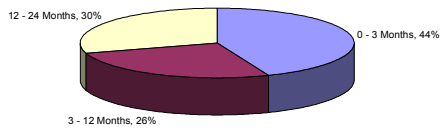


Sensing that a change in Fed policy was imminent in mid-2003 when Fed Funds reached a historic low of 1.00% and the economy was recovering strongly from its doldrums of 2000-2002, the City began to shorten the duration of its portfolio. This was accomplished by a focus on investing maturities in the overnight repurchase agreement (repo) market. As the yield curve began to flatten this strategy became particularly important.

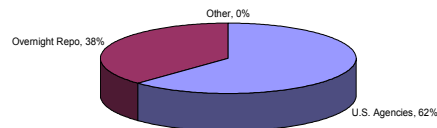
At July 1, 2005 the duration of the City’s portfolio – consisting primarily of intermediate-term agency securities and overnight repo investments – was 0.62 years. By contrast, in an environment of neutral or stimulative Fed policy and a “normal” upwardly-sloping yield curve, the City’s portfolio duration will fluctuate between 1.0 and 1.5. For instance, at June 30, 2004 the portfolio duration was 1.24. Asset class composition at July 1, 2005 was 62% U.S. agencies and 38% overnight repo. The maturity distribution at the time was:

0 – 3 months:	44%
3 – 12 months:	26%
12 – 24 months:	30%

Fund 920 Maturities Distribution
July 1, 2005

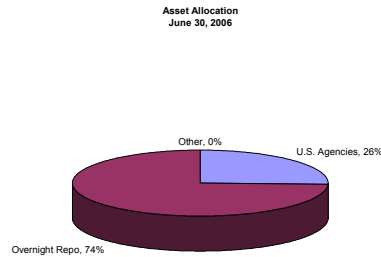
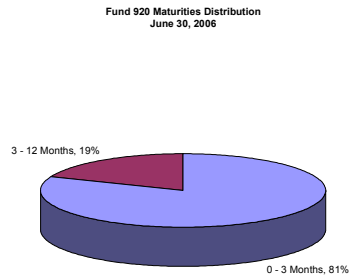


Asset Allocation
July 1, 2005



By June 30, 2006 portfolio duration had decreased to 0.11 years, as the maturing agency securities were rolled into the overnight markets. At fiscal year-end the portfolio was weighted 75% overnight repo and 25% agencies. As such, the maturity distribution was:

0 – 3 months: 81%
3 – 12 months: 19%

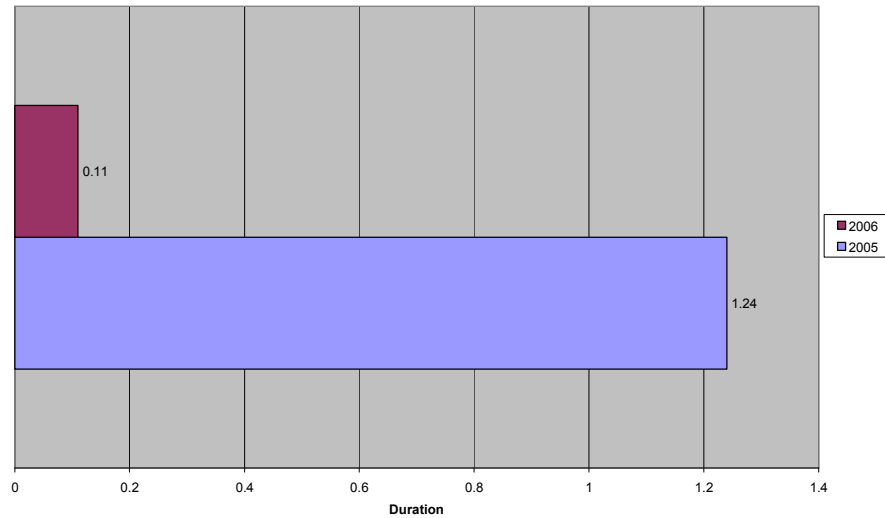


Discussion of Duration

Duration is preferred over weighted-average maturity of the portfolio as a measure of a fixed income portfolio's "life," because it measures the portfolio's sensitivity to changes in market interest rates. The higher the duration, the more the market value of the portfolio will change as interest rates change. Unlike the maturity measure, duration accounts for differences in bond coupons, i.e., for a given maturity a lower coupon bond will have a greater sensitivity to rate changes – therefore a higher duration. In addition, the duration of a coupon bond will always be less than its maturity.

As an example of the impact of duration on portfolio value, consider the City portfolio market value of \$736.4 million at June 30, 2006. Assume that immediately all short-term market rates increased by 1%, or 100 basis points. If the portfolio had been managed to retain the June 30, 2004 duration of 1.24, the value of the portfolio would have dropped by 1.24%, or \$9.1 million. By shortening portfolio duration to the June 3, 2006 level of 0.11, such a rate shock would result in a portfolio decline of only 0.11%, or \$0.8 million.

Portfolio Duration Management
Fiscal Year 2006



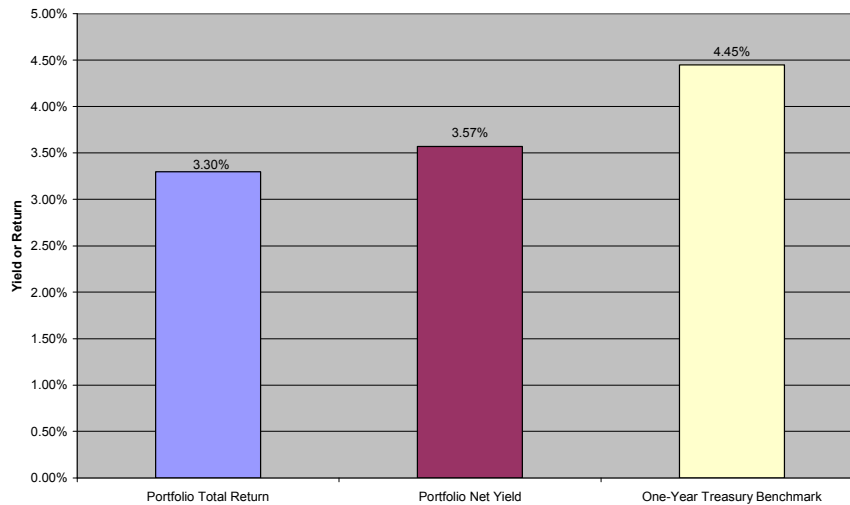
Of course, the keys to managing portfolio duration are to accurately forecast interest rate changes and to adjust the portfolio accordingly. Because the City has a “buy-and-hold” philosophy and rarely sells positions prior to maturity, portfolio performance may temporarily lag behind the benchmark rate of return. This occurred during fiscal 2006, as discussed below.

Portfolio Performance

For the year ended June 30, 2006 the portfolio’s net yield was 3.57%. In contrast, the time-weighted one-year Treasury benchmark yield was 4.45%. By the end of the fiscal year recessionary fears drove the benchmark yield down to parity with overnight rates. We expect the portfolio yield to exceed the benchmark in fiscal year 2007.

Another measure of performance – not currently benchmarked by the City – is Total Return. Whereas yield measures focus on income received as a proportion of the amount invested, total return takes into account unrealized gains and losses on holdings resulting from market interest rate changes. Since short and intermediate term rates rose throughout the year, the City’s agency holdings declined in value. Therefore, total return for the year lagged portfolio yield at 3.30%.

Portfolio Performance
July 1, 2005 - June 30, 2006



Portfolio Strategy for FY 2007

Initially the City intends to take advantage of the inverted yield curve and invest available cash in overnight repurchase agreements. We expect this strategy to provide reasonable returns – in excess of the benchmark – while maintaining liquidity to meet obligations and ensuring safety through principal stabilization. Current economic forecasts call for the Fed to most likely ease the Funds rate early in calendar year 2007. At that time we expect the curve to begin to normalize and credit spreads to widen, so that the strategic asset allocation discussed earlier becomes prudent.

The optimal strategic asset allocation can be derived from modern portfolio theory (MPT), derived primarily from the work of Nobel laureate Harry Markowitz. Using MPT and historical data, we can assign each allowable asset class an expected return, volatility (standard deviation), and a measure of its movement relative to the other classes under consideration (covariance). Applying Markowitz's formula yields a "frontier" of portfolios that will provide the optimal return for a given level of contemplated risk, or the least risk for a desired level of return. Adding a risk-free asset such as the 90-day Treasury bill to this computation yields the optimal portfolio of the given asset classes. This is the approach the City will employ to diversify its investment portfolio in the coming year.