LOCAL GOVERNMENT NEWS REPORT

March 2010

INTEREST RATES

The average annualized yield for February was 0.55%. The rate for February was as follows:

February 1st – 28th	0.55%

CREDIT MARKET UPDATE

Credit markets held steady during February in spite of mostly negative macro-economic news although there is some argument that the weather hurt economic performance in late January and February. On the fip side, performance was helped by the release of corporate earnings results for the 4th quarter of last year and by expectations for continued low short-term U.S. Treasury rates.

The average yield on debt in the Barclay's Index of US IG Corporate debt increased 4bps to 1.73% above treasury yields during the month. Over the trailing 3 months, this index's yield spread over Treasury yields has declined 33bps indicating price improvement relative to US Treasuries. For February, the total return (price change and coupon payment) of the index was +0.36% or -0.5% less than the total return of U.S. Treasuries.

As mentioned last month, "Earnings Season" or disclosure of last quarter's results has been generally positive, although a few weak spots remain. The year-over-year comparison was relatively easy considering the state of economic activity in late 2008. Nonetheless, improved overall earnings in the 4th quarter created some positive momentum for the credit markets. Based on reports thus far, 4th quarter revenues for S&P500 companies increased y/y after four consecutive quarters of y/y declines.

The U.S. Treasury curve is at historically steep levels meaning that the difference in yields between longer-term and shorter-term yields on US Treasuries is fluctuating around historical wides. The U.S. dollar and the pricing on short-term U.S. Treasury debt has benefitted so far this year from worries over sovereign default risk. At the end of February, the difference between 2-year and 10-year treasuries was 2.80%. Although this yield differential declined 6bps in February, it remained 10bps higher year-to-date and 80bps wider y/y. Much of the relatively large difference in yields between short-term and longer-term treasuries is driven by the fact that the market is operating in a period of unprecedented accommodative monetary policy and stimulative fiscal policy. The target Fed Funds rate, which is currently 0.25%, anchors short-term rates and is expected to remain unchanged in the near future. The real Fed Funds rate (Fed Funds rate minus inflation rate) remains negative has been negative longer than at any other points in history. Alternatively, longer term rates have been driven higher relative to short-term rates as the market attempts to price in the effects of new treasury supply from high levels of deficit spending and consequential deteriorating fiscal picture.

The economy is showing nascent signs of stabilization as seen in 4th quarter corporate earnings results as well as in recent economic data. The Federal Reserve, through press releases or public testimony by members such as Federal Reserve Chairman Ben Bernanke, continues to adapt by gradually scaling back or eliminating programs intended to provide liquidity to the market.

On February 10, Chairman Bernanke testified before Congress on the Federal Reserve's Exit Strategy and its plan for dealing with potential inflation from an improving economy. Chairman Bernanke described the economy in cautiously optimistic terms but continued to say the federal funds rate would likely be low for an

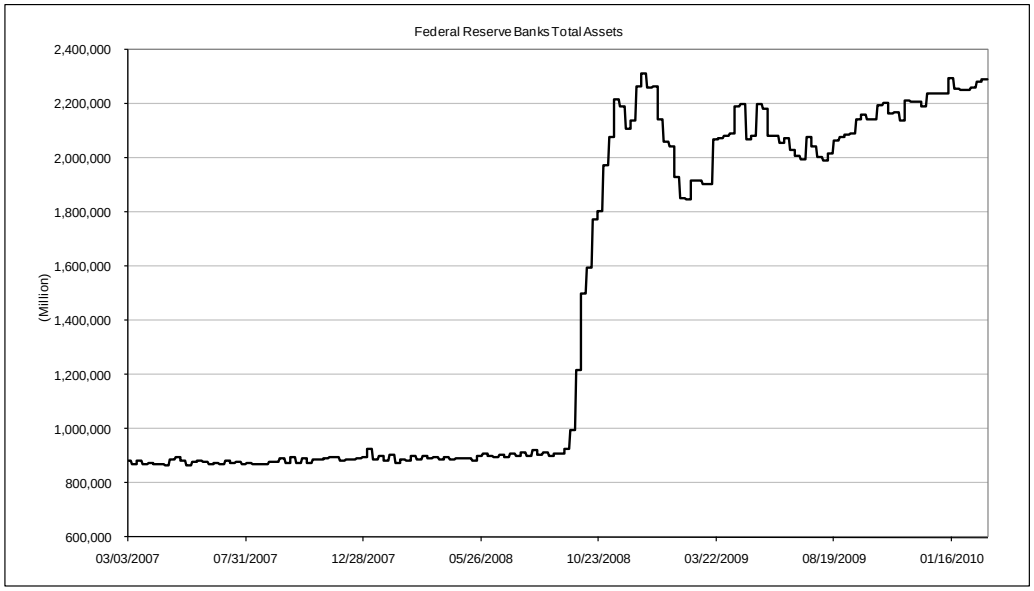
Continued on Page 2

extended period. He noted that the Fed was developing the capacity to carry out reverse repurchase agreements with the GSEs (FNMA, FHLMC, GNMA) to remove liquidity from the markets. Chairman Bernanke also noted that private demand growth was "moderate," with consumer spending having recently "picked up," while business equipment and software spending had "risen significantly". However, the jobs market "remains quite weak," and highlighted the increasing incidence of long-term unemployment, which was of concern because of its "long-term implications for workers' skills and wages". In our view, Chairman Bernanke's testimony reinforced the market's expectation of a low and stable Fed Funds rate for at least the next 6-8 months.

To counteract the effect of dwindling liquidity during the market crisis, the Fed instituted or increased multiple programs to provide liquidity to both financial and non-financial institutions in the US and abroad. These programs were funded with the Federal Reserve's balance sheet. Use of many of the Federal Reserve's lending facilities has declined sharply as financial conditions have improved. Some facilities were closed over the course of 2009, and most other facilities expired at the beginning of February. The only facilities still in operation that offer credit to multiple institutions, other than the regular discount window, are the TAF (the auction facility for depository institutions) and the Term Asset-Backed Securities Loan Facility (TALF), which has supported the market for asset-backed securities, such as those that are backed by auto loans, credit card loans, small business loans, and student loans. The Federal Reserve has announced that the final TAF auction will be conducted on March 8, and the TALF is scheduled to close on March 31 for loans backed by all types of collateral except newly issued commercial mortgage-backed securities (CMBS) and on June 30 for loans backed by newly issued CMBS.

In a sign of further normalization of Fed operations, the Fed reduced the maximum term of loans available from its discount window to 28 days from 90 days in January and then on February 18, increased the cost 25bps to 75bps. Significant hurdles remain for the Fed to fully pull away from market support and unwind the unprecedented growth in its balance sheet.

The Federal Reserve initiated a program to purchase $1.25 Trillion in agency MBS and $175B in GSE direct obligations in January 2009. This program has been purchasing an average of $10 billion per month in agency MBS and will end on March 31. The large monthly purchases have helped to support mortgage pricing and keep mortgage rates low. It remains to be seen how the market will adapt to the loss of such large regular purchases. On a longer term basis, the Federal Reserve's balance sheet has grown to over $2.2 trillion from approximately $900 billion pre-crisis. Purchases of these assets represent a significant amount of liquidity injected into the market that will likely be inflationary if not removed.



Questions regarding this update can be directed to Tom Lofton, Senior Credit Analyst, at (503) 378-4155, or via e-mail at tom.lofton@ost.state.or.us.

2010 OREGON SHORT-TERM FUND (OSTF) BOARD MEETINGS

The Oregon Short-Term Fund Board will be presenting at the OMFOA/OACTFO Spring Conference in Sunriver, on March 9, 2010 at 1:30 – 3:00 pm. Following are details of the presentation:

Oregon Short-Term Fund Board - Oregon Short-Term Fund: Year in Review and What's Next
- Perrin Lim & Tom Lofton, Office of the Oregon State Treasurer; Deanne Woodring, Davidson Fixed Income Management; Doug Goe, Orrick Herrington & Sutcliffe LLP
Our panel representing the State Treasurer's Office and members of the Oregon Short-Term Fund Board will cover a number of topics including an update and future strategic direction for the Oregon Short-Term Fund; a review of the roles of the members of the Board; and an update on local government investment pools throughout the nation, and what we can learn from their experiences in these turbulent investing times.

In addition to the presentation at the OMFOA/OACTFO Spring Conference, the next Oregon Short-Term Fund Board meeting is scheduled for April 29, 2010 at 10:00 am.

Investment policies needing to be reviewed should be sent to Oregon State Treasury at least four weeks prior to the meeting date. If you have any questions, please contact Heidi Rawe at (503) 373-1029.

ORS 294.810 LIMITATION INCREASE - EFFECTIVE: IMMEDIATELY

The limitation in ORS 294.810 has been **increased** from $42,523,092 to **$43,136,592**. This increase of 1.44% is in proportion to the Consumer Price Index in the 2nd half of 2009 for All Urban Consumers of the Portland, Oregon, Standard Metropolitan Statistical Area, as compiled by the U.S. Department of Labor, Bureau of Labor Statistics.

CPI adjustments for Local Gov't Balance Limitation

Period Start	Period End	Portland CPI	Semi-Annual		LGP Balance Limitation
1/1/2003	6/30/2003	186.0	1.09%		$ 36,610,104
7/1/2003	12/31/2003	186.5	0.27%		$ 36,708,519
1/1/2004	6/30/2004	189.8	1.71%		$ 37,337,705
7/1/2004	12/31/2004	192.5	1.42%		$ 37,868,853
1/1/2005	6/30/2005	194.5	1.04%		$ 38,262,295
7/1/2005	12/31/2005	197.5	1.54%		$ 38,852,459
1/1/2006	6/30/2006	199.8	1.16%		$ 39,304,918
7/1/2006	12/31/2006	202.5	1.35%		$ 39,836,066
1/1/2007	6/30/2007	206.7	2.05%		$ 40,653,049
7/1/2007	12/31/2007	210.5	1.84%		$ 41,401,967
1/1/2008	6/30/2008	214.6	1.98%		$ 42,220,131
7/1/2008	12/31/2008	216.2	.72%		$ 42,523,082
1/1/2009	6/30/2009	214.1	-.95%		$ 42,523,082
7/1/2009	12/31/2009	217.2	1.44%		$ 43,136,592

ORS 294.810 (2) provides that the $30 million limitation shall increase in proportion to the increase occurring after 9/9/95 in the CPI for all urban consumers of the Portland, Oregon area.

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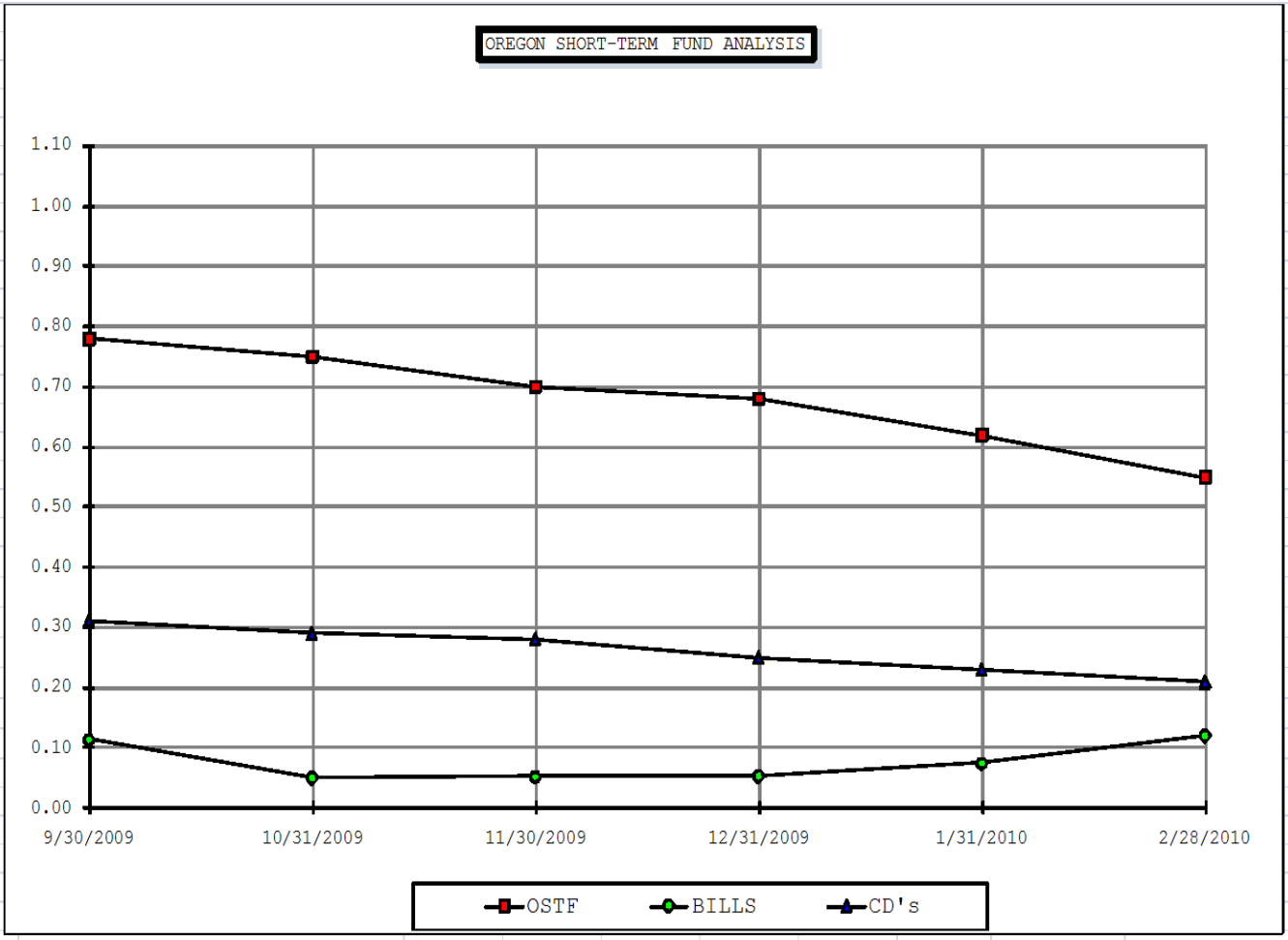

Oregon Short-Term Fund Analysis as of February 28, 2010

	9/30/2009	10/31/2009	11/30/2009	12/31/2009	1/31/2010	2/28/2010
LGIP AV DOLLARS INVESTED (MM)	3,979	3,766	5,119	5,505	5,173	5,122
STATE AGENCY AV DOLLARS INVESTED (MM)	6,422	6,081	5,791	5,628	5,677	5,588
TOTAL OSTF AV DOLLARS INVESTED (MM)	10,401	9,847	10,910	11,133	10,850	10,709
OST ANNUAL YIELD (ACT/ACT)	0.78	0.75	0.70	0.68	0.62	0.55
3-MO UST BILLS (BOND EQ YLD)	0.11	0.05	0.05	0.05	0.07	0.12
3-MO JUMBO CDS (ACT/360)	0.31	0.29	0.28	0.25	0.23	0.21

NOTE: The OST ANNUAL YIELD represents the average annualized yield paid to accountholders during the month. Since interest accrues to accounts on a daily basis and the rate paid changes during the month, this average rate is not the exact rate earned by each account.

3-MO UST BILLS yield is the yield for the Treasury Bill Issue maturing closest to 3 months from monthend. 3-MO JUMBO CDS is the highest posted rate received by the Treasury from Oregon banks as of monthend. Consequently, whereas the yield on UST Bills should normally be lower than CD rates, the fact that the quotes are up to a week different in time may result in an apparent reversal of this situation.

This material is available in alternative format and media upon request.