

USAFA Endowment, Inc.

April 2, 2011

MEMORANDUM

To: USAFA Endowment Directors

From: Investment Committee

Bart Holaday

Terry Drabant

Bill Wecker

Subject: Investment policy

The USAFA Endowment investment policy was described to the Board, and approved by the Board, at our first face-to-face Board meeting on January 25, 2008. There has been no change to that policy.

The purpose of this memorandum is to again describe the USAFA Endowment investment policy for the benefit of new Board members. Also, in keeping with the USAFA Endowment policy of transparency, this memorandum will be made available to donors.

No Fees, No deductions. The USAFA Endowment investment policy is importantly determined by the more fundamental USAFA Endowment policy that donor funds are used only for the purpose the donor intended, with no fees, no deductions, and all investment gains accruing to the donor fund. There are strong implications of this fundamental policy.

First, it means that each donor fund managed by the USAFA Endowment must be accounted for separately. This separate accounting allows us to show donors that our pledge (no fees, no deductions and all investment gains accruing to the fund) is scrupulously adhered to. Our accounting system is designed to accomplish all this.

The Investments. With the advice and counsel of Vanguard Institutional Investment advisors, the USAFA Endowment Investment Committee has selected four highly diversified Vanguard funds.¹

1. Vanguard Prime Money Market Fund
2. Vanguard Total Bond Market Index Fund
3. Vanguard Total (US) Stock Market Fund
4. Vanguard Total International Stock Market Fund

The “investment holdings” of each of our donor funds are placed in one or more of the

four Vanguard investment funds.^{2,3}

Our basic investment strategy is to match the maturity of the investment fund to the timing of the disbursements from the donor fund. By doing so, we make it highly likely that the donor fund will be able to disburse more money than the original donation, as the following examples will illustrate.

At one extreme, donor funds expected to be disbursed in the near term are held in the Money Market fund, with small investment gains, but virtually no risk of investment loss. At the other extreme, donor funds expected to be held for a very long period, such as the Founders Operating Fund and the Jannetta Lectureship Fund, are held primarily in a diversified portfolio of stocks and bonds consisting of

1. Total Bond Market Index Fund (average maturity approximately 5 years) (20%)
2. Total (US) Stock Market Fund (42.5 %)
3. Total International Stock Market Fund (37.5%)

in the proportions indicated.⁴ The proportions comprising the diversified portfolio were determined in consultation with Vanguard Institutional Investment advisors. In the very long term, investment losses in such a diversified portfolio are unlikely, while the potential gains are substantial.

The “holdings report”. We have developed a management tool that the investment committee uses on a regular basis to review the holdings of each of our donor funds, assess the near term disbursement requirements for the donor funds, and adjust, as appropriate, the investment holdings for each of the donor funds.

Performance. Our conservative investment strategy, in combination with the Endowment’s “no fees, no deductions” policy, is designed to make it highly likely that our donor funds will each be able to disburse more money than was originally donated. Our investment performance to date bears this out: All of our funds have investment gains. None have losses.

¹ The Board Chairman has appointed an Investment Committee, which is composed of the Chairman, the Vice Chairman and the Treasurer. The Investment Committee has established a fiduciary relationship with the Institutional Investments arm of the Vanguard Group, and with the Academy Bank in Colorado Springs.

² There is a fifth possibility, the Academy Bank, which is used mainly for check-writing.

³ There is a small cost of \$2 charged by Vanguard for liquidating stock. (\$2 total, not \$2 per share.) Otherwise, the movement of money into, out of, or between these investment funds is costless.

⁴ We do not currently hold an “endowment”, as that term is defined by the Colorado UPMIFA law, but if we do in the future, it is likely that such an “endowment” will be held primarily in the diversified portfolio. The Uniform Prudent Management of Institutional Funds Act (UPMIFA) is the law of Colorado and Delaware (and most other states) relating to “endowment” funds as they are defined in the Act.