

POTOMAC VALLEY SWIMMING

Treasurer's Report and Recommendations Regarding PVS Investments

December , 2009

Following the discussions at the past two Board meetings, numerous emails, and continuing on-deck and off-line conversations, I have refined my previous proposals and present them below. The essence of the effort has not changed, but I have changed the emphasis in order to address some of the concerns raised over the past two months. The recommended actions are not very dramatic, but the subject matter does not surface very often, so we need to understand how these proposed changes will affect PVS in the short term as well as the long term. I have tried to identify all the relevant issues below. If you have questions or comments, please address them to me in advance of the December 14 meeting and I will try to respond and provide additional information as required.

The proposals below are divided into two sections:

- I. Proposed Changes in the Management of PVS Assets
- II. Proposed Changes to the PVS Investment Policy

These are organized into two sections for logical reasons. If the changes in section I are adopted, then most of the changes proposed in section II will follow logically. We can focus our discussion and actions on the concepts in section I and then the section II proposals will become housekeeping items, as necessary.

I. Proposed Changes in the Management of PVS Assets

PVS currently has about \$600,000 in investable assets. This is \$50,000 more than the amount designated in FY 2009. Currently, these funds are invested as follows:

Cash	\$ 50,000
CDs	455,000
RBC Fixed Income	42,000
RBC Equities	53,000
Total	\$ 600,000

During FY '09, the equities provided a negative return on investment, following the direction of the markets. The remaining investments in fixed income and CDs provided \$21,325 of income on invested assets of approximately \$497,000, for a return of about 4.3% after fees. During this same time period, the professionally managed fixed income assets of USA Swimming returned 8% after fees. By not utilizing the professional managers chosen by USA-S, PVS left over \$18,000 on the table.

The current FY will be more challenging for fixed income investments than last year and, unless things change dramatically next year, FY 2011 will be even more challenging. Based on current CD rates, the return to PVS will drop from 4.3% in FY 08 to about 3.2% for FY 10. I expect the return at USA-S to drop this FY as well, but not to the same extent due to a much smaller pool of CDs. The return on all fixed rate investments is declining in general right now, but the interest rates for CDs have fallen dramatically due to the ability of banks to borrow from the government for an interest rate that is near zero. Now is not the best time to be overly invested in CDs as opposed to other secure fixed rate investments.

RBC v. First Western

RBC Dain Raucher was the previous investment advisor for USA-S. First Western took over the account during the summer of '08 after a competition to select a manager, beating out RBC and Wachovia among others. PVS has stayed with RBC pending a review and decision whether to follow USA-S.

I recommend that PVS follow the lead of USA-S and move its account to First Western. While RBC has done a credible job and while their fee structure is similar to that of First Western (RBS fees of 1.6% during FY 09 v. 1.5% at FW), the fact is that our account at RBC is no longer a professionally managed account. The previous account manager left the company and the instruction to "mirror" the investments of USA-S is a moot point since that account left as well. At First Western, PVS will benefit from the same level of attention and active management as USA-S with its \$13 million account.

Investment Account at First Western

The recommendation from the advisors at First Western is that LSCs with up to \$100,000 to invest should focus on CDs. From \$100,000 to \$250,000, these accounts also should include life cycle funds that diversify the portfolio and provide a greater return. At \$250,000, FW recommends that LSCs follow the investment portfolio allocation of USA-S, but this is dependent on the investment policy of the LSC. For example, USA-S allocates their portfolio 60/40 for equities and fixed income. PVS could designate a different ratio. However, the advisors at FW will select the specific investments.

My recommendation is that PVS designate First Western as its investment advisor and, over the next year or so, transfer approximately \$500,000 to First Western for them to manage. I also recommend that PVS accept the 60/40 split between equities and fixed income

investments that is followed by USA-S. This will leave \$100,000 for PVS to invest in CDs locally. Following this move, PVS should monitor the performance of FW and assess the needs of PVS in order to determine the amount of invested assets that should be placed with FW for active management and the amount that should be kept in CDs as cash reserves. An annual review should be performed with special attention paid to the cash reserve position and projected expenses for the coming year.

Risk Assessment

Investing is all about risk assessment. The least risky investment is cash or near cash because you can't lose your principle (invested amount) if it is in cash or near cash, such as CDs. Currently, PVS is approximately 95% invested in cash. While this is safe, it does not produce the level of income that is available elsewhere. Compared to the investment strategy of USA-S, PVS gives up 3% or more of return each year just on fixed income investments. First Western, and USA-S, use an assortment of fixed income investments to produce a return that is much higher while it is almost as safe as cash. The risk of investment in these bonds and similar fixed income instruments is that the value of the principle can drop. However, the return will be higher as compensation for the acceptance of higher risk. When properly managed, the risk actually is very slight and the investor benefits from greater returns.

The first element of risk management is to assess the investor's needs for the invested funds. Based on recent operating history, the designation of \$600,000 by PVS as investable funds is quite safe. At no time in the past few years has the available cash bank balance dropped below \$100,000 and, even if a larger need appeared, the proposed \$100,000 in CDs would be available. Since the cash needs of PVS are very predictable, we are on solid footing if we designate \$500,000 as long term investable assets.

If PVS accepts the concept that \$600,000 is available for investment, then the next decision is how to invest this amount. I propose that we leave this to the professionals at First Western for \$500,000 of this amount and allow them to advise us on investments that are consistent with the approach being used by USA-S and with our investment policies. They use a very thorough and very rigorous process to select managers and specific investments that are acceptable within the guidelines they have been given by USA-S. It is our good fortune, with only \$600,000 to invest, that we are able to share the management skills and results from a \$13,000,000 account that produces over \$130,000 per year for FW in fees, as compared to our projected fees of just \$7500.

Recommendations and Motions

As Treasurer, I have worked with the CFO at USA-S, met with the account manager at First Western, engaged in a drawn-out process of working up an LSC investment plan, and met with other LSC Treasurers and the USA-S Investment Committee. Based on my analysis and

after evaluating the alternatives, I am recommending that PVS take the following actions in regard to its investable assets:

1. Open an investment account with First Western.
2. Advise FW that we are investing in coordination with the policies and procedures of USA-S except as modified specifically by PVS in writing where the PVS policy differs from that of USA-S.
3. Fund the account at FW with the proceeds of the RBC account, which we will close, plus \$50,000 from cash reserves.
4. Add additional amounts to the new FW account over the next year until the total investment at FW totals \$500,000. This may require early termination of some CDs that may also include a small interest penalty. The exact timing and amounts to be determined by the Treasurer and Controller.

II. Proposed Changes to the PVS Investment Policy

If PVS decides to use the professional investment managers at First Western, this decision will require several changes to the PVS Investment Policy Statement. The current statement was written without provisions for outside money managers, but the necessary changes are relatively minor:

1. In the Definition section, “Mutual Funds” needs to be expanded to include all investment funds whether mutual funds, equities, fixed income or alternative investments.
2. In the Investment Guidelines section, “4. Mutual Funds” needs to be expanded to include a full range of investment funds.
3. In the Fund Allocation Guidelines section, “3. Mutual Funds” and “4. Certificates of Deposit” can be combined into one guideline. It will need limits on both the split between fixed income and equity investments and the percentage that will be limited to certificates of deposit.

After any management changes are adopted, the Treasurer and Controller will return with specific language to modify the Investment Policy Statement at the next Board Meeting.

