

GRINNELL COLLEGE



**Annual Report
of the
Investment Committee
Year Ended June 30, 2006**



Introduction

We are pleased to present this more detailed annual review of the College's investment activities. It has been a unique and especially active year for the Investment Committee. A series of unrelated events created a critical juncture in our investment history—the need to reallocate nearly one-half of the endowment portfolio. The Committee met frequently, including a two-day retreat in New York, and developed both strategic and tactical responses. The core investment strategy, to seek long-term real growth via meaningful allocations to value-oriented yet opportunistic mandates, was reaffirmed. At the same time, objectives were established to expand the portfolio's reach with respect to geography, sector and market capitalization. An extended search process followed which resulted in the addition of several new managers. We are pleased with the current collection of managers and their complementary investment processes. Details are provided in the pages that follow.

In the spirit of transparency, this report will also be available via the College's website. Other documents available include the audited financial statements and Form 990.

Please accept our thanks for your confidence and support during this significant transition year.

Henry Cornell '76
Chairman

David Clay
Treasurer

Investment Committee

Henry Cornell '76 - Chairman

George Shott - Vice Chairman

David Braman '75

Florence Fearington

Clinton Korver '89

Fred Little '53

Susan Holden McCurry '71

Russell Allen '68 - ex officio

Investment Office

David Clay - Treasurer

Karen Voss - Associate Treasurer

DeNeil Moes - Treasury Operations Assistant

Paige Carlson '05 - Investment Analyst

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(Dollars in thousands)

Section 1: Highlights

- Investment assets totaled \$1.545 billion of which endowment funds represent \$1.472 billion
 - Plant funds declined by \$13.3 million as facilities project expenditures exceeded \$35.7 million
- Endowment spending totaled \$49.2 million of which \$16.1 million was allocated to the Capital Reserve Fund
- Reallocated more than \$600 million within endowment funds
 - Concluded relationships with two marketable equity managers
 - Retained four new marketable equity managers with aggregate commitments of \$450 million
 - Committed \$50 million to a global macro manager/strategy
 - Increased allocation to credit-based alternatives by \$15.5 million
 - Approved \$88 million in non-marketable alternatives commitments across strategies (buyout, distressed and venture capital)
- Reallocation resulted in increased portfolio breadth with respect to manager, geography, sector and market capitalization
- Endowment funds continued to grow on both a nominal and real basis
 - Performance exceeded S&P 500 for all periods reported with lower volatility
 - One and three year performance was modest as compared to other endowments
 - Five and ten year performance was amongst the highest of all endowments
 - Performance continued to be positively impacted by allocations to alternative strategies

Section 2: Investment Assets

The Investment Committee shall be responsible for maintaining a policy of prudent investment in stocks, bonds, real estate, mutual funds, non-marketable securities such as private placements and limited partnerships, and other similar financial and trust instruments or interests.

- Excerpt from Article VII of the By-laws

The Treasurer of the College is charged with implementing and administering this policy subject to the direction of the Investment Committee.

- Excerpt from Investment Policy, approved October 2003

Market Value

	June 30, 2006	June 30, 2005
Endowment Funds	\$1,471,804	\$1,390,545
Plant Funds	60,224	73,506
Annuity Funds	13,199	13,640
Total	\$1,545,227	\$1,477,691

Additions and Withdrawals

	Endowment	Plant	Annuity	Total
Balance June 30, 2005	\$1,390,545	\$73,506	\$13,640	\$1,477,691
Investment return	127,807	2,426	690	130,923
Gifts	767	3,963	28	4,758
Distributions				
Endowment spending	(49,155)	16,056		(33,099)
Capital projects		(35,728)		(35,728)
Payments to beneficiaries			(890)	(890)
Other	1,840		(268)	1,572
Balance June 30, 2006	\$1,471,804	\$60,224	\$13,199	\$1,545,227

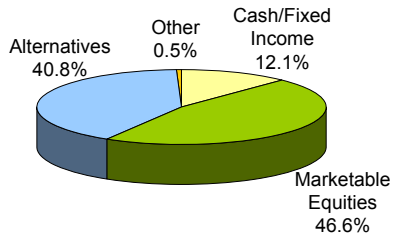
Section 3: Endowment Funds

The College intends that its endowment shall be invested to ensure long term growth of its capital rather than to maximize annual income or short term returns all designed to provide predictable and stable financial support for the College's mission as a fine liberal arts college. Total return is expected to preserve or enhance the real purchasing power of the endowment into perpetuity.

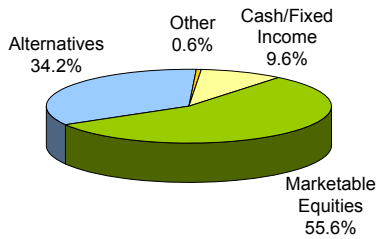
- Excerpt from Investment Policy, approved October 2003

Asset Allocation by Manager Mandate

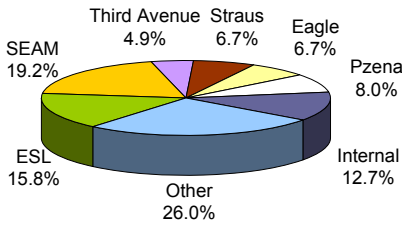
June 30, 2006
\$1,471,804



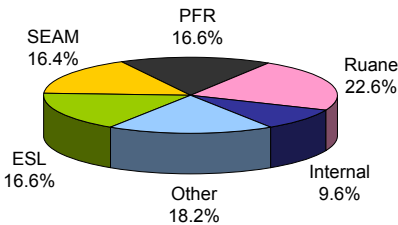
June 30, 2005
\$1,390,545



Manager Mix



June 30, 2006
\$1,471,804



June 30, 2005
\$1,390,545

Manager Relationships and Vehicles*

	Relationships	Vehicles
Cash/Fixed Income	Internal	Internal
Marketable Equities	5	6
Alternatives	17	30
Other	Internal	Internal
Total	22	36

*excludes direct co-investments

Performance

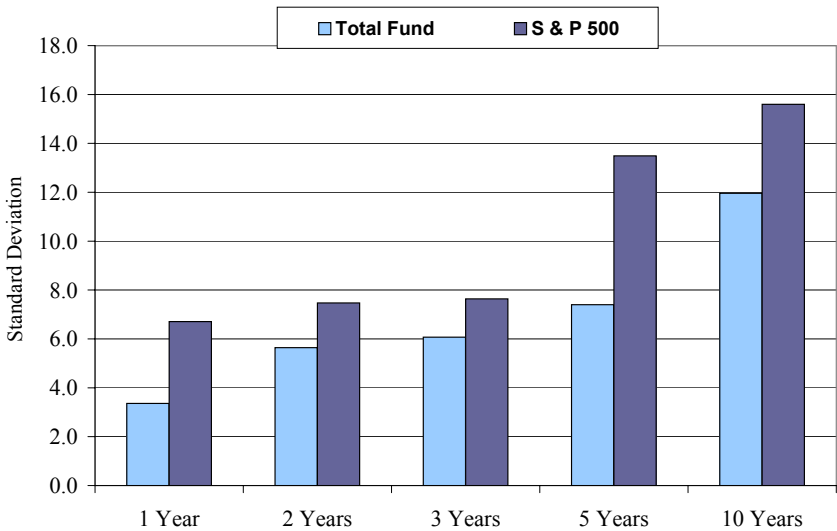
Rates of Return (%)

Asset Class	1 Year	2 Years	3 Years	5 Years	10 Years
Total Fund	9.3	10.0	13.3	11.5	13.7
Cash/Fixed Income	3.4	2.7	2.0	2.9	n/a
Marketable Equities	7.1	5.1	9.8	8.3	13.1
Alternatives	12.9	25.4	25.9	15.4	n/a

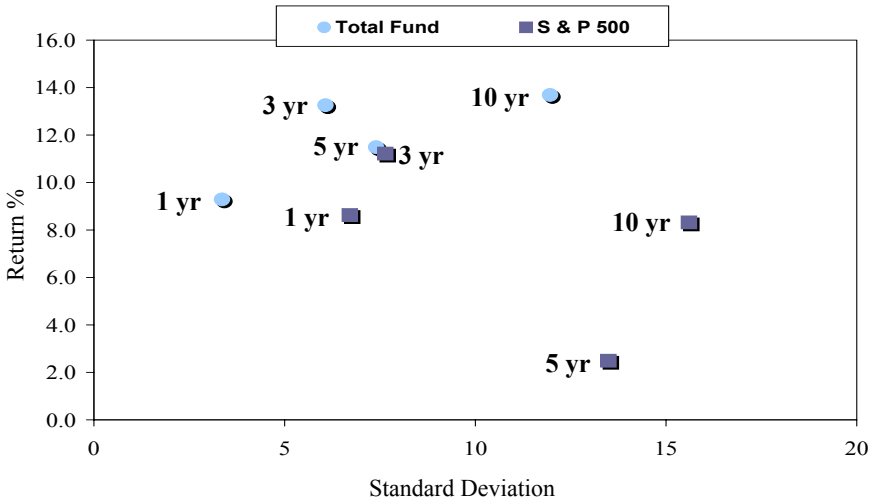
Benchmarks

LB Govt 1-3 Year	1.9	2.0	1.5	3.2	4.9
S & P 500	8.6	7.5	11.2	2.5	8.3
MSCI World	16.9	13.4	16.9	5.7	6.9

Risk



Risk vs. Return



Sharpe Ratio

	1 Year	2 Years	3 Years	5 Years	10 Years
Total Fund	1.5	1.2	1.8	1.3	0.8
S & P 500	0.7	0.6	1.1	0.0	0.3

The Sharpe ratio is a “measure of the excess return relative to the total variability of the portfolio” (*The Theory and Practice of Investment Management*, ed. Harry Markowitz)

$$\frac{\text{Portfolio return} - \text{Risk-free rate}}{\text{Standard deviation of portfolio's return}}$$

Asset Class Analysis

Cash/Fixed Income

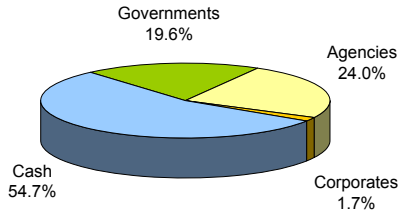
Marketable Equities

Alternatives

Other

Cash/Fixed Income

Asset Allocation



\$178,247

Performance

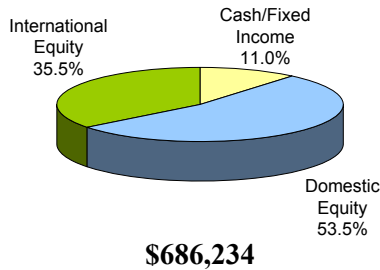
	Rates of Return (%)			
	1 Year	2 Years	3 Years	5 Years
Cash/Fixed Income	3.4	2.7	2.0	2.9
Cash	3.9	2.9	2.2	2.0
Fixed Income	3.3	2.6	2.0	3.1
LB Govt 1-3 Year	1.9	2.0	1.5	3.2

Portfolio Characteristics (excluding cash)

Fixed Income	Portfolio	LB Govt 1-3 Year Index
Average Duration	0.8	1.7
Average Coupon	3.8	4.1
Average Years to Maturity	0.9	1.9
Average Yield to Maturity	5.3	5.3
Average Quality	AAA/Aaa	TSY

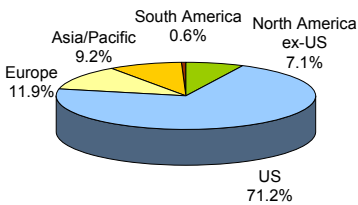
Marketable Equities

Asset Allocation



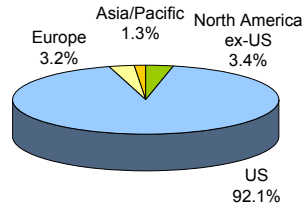
Region

FY 2006



\$686,234

FY 2005

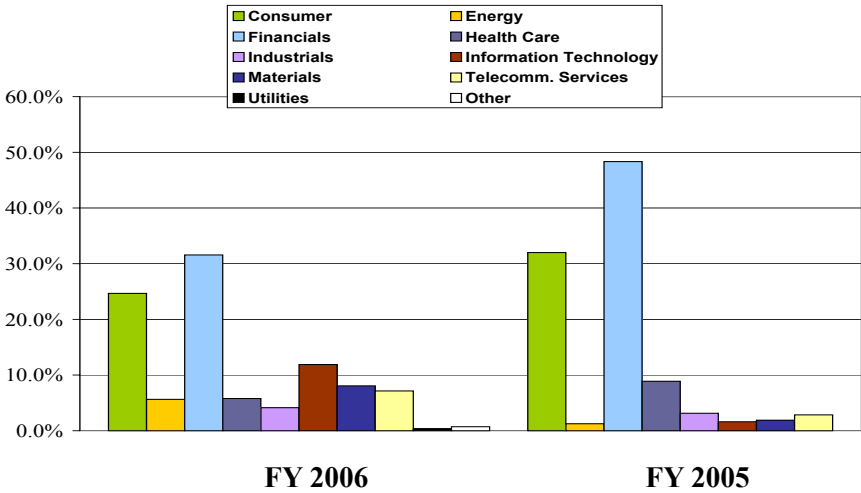


\$773,495

Other Portfolio Characteristics

	FY 2006	FY 2005
Equities Held	141	64
Top Five Holdings as % of Marketable Equities	14.3%	34.8%

Equity Sectors



excludes cash/fixed income

Performance

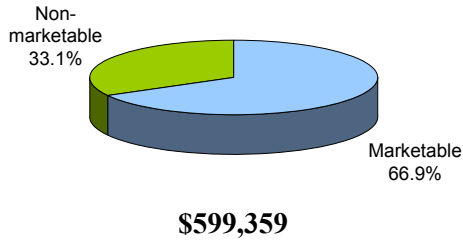
Performance

Rates of Return (%)

	1 Year	2 Years	3 Years	5 Years	10 Years
Total Equities	7.1	5.1	9.8	8.3	13.1
Benchmarks					
S & P 500	8.6	7.5	11.2	2.5	8.3
MSCI World	16.9	13.4	16.9	5.7	6.9

Alternatives

Asset Allocation



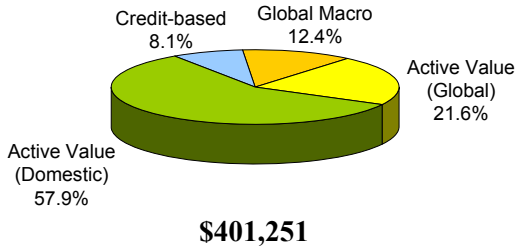
Performance

	Rates of Return (%)			
	1 Year	2 Years	3 Years	5 Years
Alternatives	12.9	25.4	25.9	15.4
Marketable	4.2	24.1	27.9	n/a
Non-marketable	32.5	30.4	25.5	14.6
Benchmarks				
S&P 500	8.6	7.5	11.2	2.5
Cambridge Private Equity Index*	21.2	25.5	24.8	11.8
Cambridge Venture Capital Index*	11.3	12.7	9.5	-7.7

*preliminary

Marketable Alternatives

Asset Allocation by Strategy

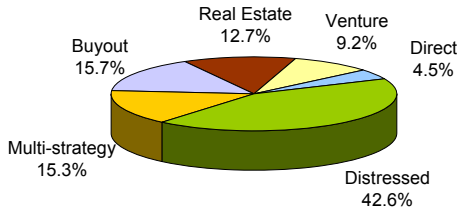


Performance

	Rates of Return (%)			
	1 Year	2 Years	3 Years	5 Years
Marketable Alternatives	4.2	24.1	27.9	n/a
Active Value (Domestic)	0.6	22.6	26.9	n/a
Active Value (Global)	13.2	n/a	n/a	n/a
Credit-based	20.0	n/a	n/a	n/a
Global Macro	n/a	n/a	n/a	n/a

Non-marketable Alternatives

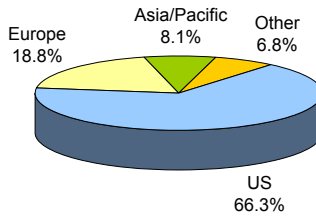
Asset Allocation by Strategy



\$196,854*

*excludes distributed securities

Region (as of December 31, 2005)



\$189,275*

*excludes distributed securities

Performance

Investment	Commitment	Market Value	IRR%	Multiple
Direct	\$10,625	\$8,759	2.32	1.10
Distressed	125,000	83,947	24.47	1.40
Multi-strategy	47,500	30,125	19.10	1.41
Buyout	85,000	30,985	20.41	1.56
Real Estate	70,000	24,986	27.62	1.39
Venture	75,613	18,052	-3.66	0.92
Total	\$413,738	\$196,854	18.27	1.37

Other

Adjusted Valuation

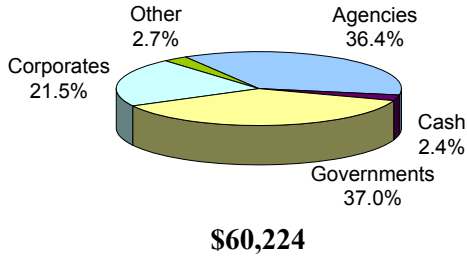
	Market Value
Marketable Equities	\$2,842
Non-marketable Alternatives	
Direct	3,537
Partnerships	258
Oil and Real Estate	1,204
Subtotal	\$4,999
Student Endowment	122
Total	\$7,963

Section 4: Plant Funds

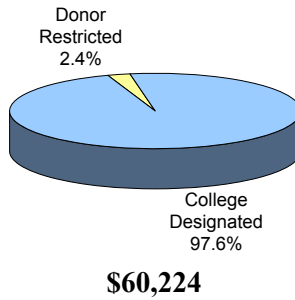
Operating funds, designated within the current, plant, loan and agency fund groups, consist of the financial resources available to satisfy the College's daily cash requirements (including capital project commitments). These funds shall be invested to provide safety of principal, maintain liquidity to match expected liabilities, and generate a reasonable return.

- Excerpt from the Investment Policy, approved October 2003

Asset Allocation



Funds by Source



Performance

	Rates of Return (%)			
	1 Year	2 Years	3 Years	5 Years
Plant Funds	4.2	3.1	2.2	3.4
LB Govt 1-3 Year	1.9	2.0	1.5	3.2

Portfolio Characteristics (excluding cash)

Fixed Income	Portfolio	LB Govt 1-3 Year Index
Average Duration	1.0	1.7
Average Coupon	4.1	4.1
Average Years to Maturity	1.1	1.9
Average Yield to Maturity	5.4	5.3
Average Quality	AA+/Aa1	TSY

Outstanding Facility Debt

\$50 Million Variable Rate Demand Revenue Bonds

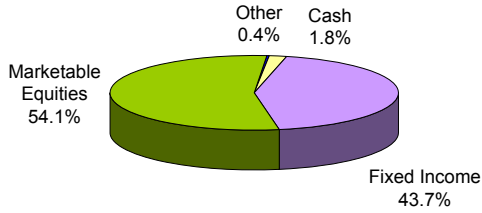
Issuer	Iowa Higher Education Loan Authority
Issue Date	December 13, 2001
Maturity Date (Bullet)	December 1, 2011
Interest Rates (Weekly)	
Average Since Inception	1.72%
Rate as of June 30, 2006	3.97%

Section 5: Annuity and Life Income Funds

Annuity funds represent assets transferred to the College subject to life income interests and for which it serves as trustee. These funds shall be invested to preserve and protect these assets by earning a total return appropriate to each trust or vehicle's time horizon, distribution requirements and risk tolerance.

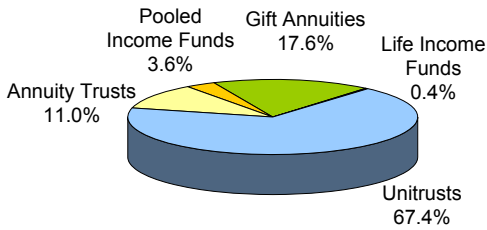
- Excerpt from Investment Policy, approved October 2003

Asset Allocation



\$13,199

Trust Distribution



\$13,199

Type of Trust	Number of Agreements
Life Income Funds	1
Unitrusts	30
Annuity Trusts	5
Pooled Income Funds	48
Gift Annuities	64
Total	148

GRINNELL COLLEGE



FOR MORE INFORMATION CONTACT:

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