

# ucfocus

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*an associated ministry of the United Church of Christ*

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## Product Focus

### *The UCF Fixed-Income Fund*

[Editor's Note: The first of a four-part series, this article describes the nature of the assets backing shares held in the UCF Fixed-Income Fund and how they are managed. Subsequent articles will discuss the make-up of the UCF Equity Fund, UCF Balanced Fund and UCF Cash & Equivalent Fund.]

The United Church Foundation now manages over \$200 million in fixed-income securities, primarily government and corporate bonds. These are the actual assets that back-up the participation units held by hundreds of local UCC churches and other denominational ministries who have invested in the UCF Fixed-Income Fund and the UCF Balanced Fund.

"The objective of our fixed-income investment program," says George Doty, the UCF's Chief Investment Officer, "is to achieve a rate of return over a long period of time [that is] at least equal to the rate that could be earned by investing in a mutual fund that tracked the Lehman Brothers Government/Credit Bond Index."

This quarter's performance figures, shown on the last page, demonstrate that this objective has been successfully achieved in four of the five time-periods reported. Over the past five years (ended 6/30/01), the time period typically used to measure investment performance, the rate of return on the UCF Fixed-Income Fund averaged 7.5% per year on a compound basis, while the rate of return on the Lehman Brothers Government/Credit Bond Index averaged 7.4% per year. The ten-year record is even more favorable: 8.3% for UCF vs. 7.9% for the Index.

Since the UCF Fixed-Income Fund outperformed its Index, (unlike a managed portfolio, is not burdened by real world operating costs), the reader might wonder, how are such results achieved without incurring undue investment risks?

The UCF holds a broadly diversified portfolio of fixed-income securities. We own U.S. Government bonds, notes and bills; we own bonds

and other obligations of U.S. corporations across a broad range of industries; and we own U.S. dollar denominated fixed-income obligations of foreign governments, foreign corporations and international agencies. The portfolio is also broadly diversified in terms of the maturity of the assets we own, and we concentrate on buying obligations of high quality issuers.

The weighting of the many types of obligations we own in our portfolio tends to vary over time with their availability in the market and with the judgment of our investment staff on their relative attractiveness. At the present time, approximately 39% of our fixed-income portfolio is invested in U.S. Government and agency securities, 43% in obligations of U.S.

corporations and 6% in dollar-denominated obligations of non-U.S. issuers, with the remainder held in cash and equivalent securities. But these numbers change over time.

In her article on page 3, Andrée Prindiville, the UCF's Senior Investment Manager for Fixed-Income Investments describes, in much greater

detail the way we select and manage this portfolio of fixed income securities. As indicated in her article, the UCF fixed-income portfolio is well structured to continue to provide a relatively stable stream of income in the future and should generate the total returns needed to meet or exceed our long-term goals.

Remember also that performance is enhanced by the cost-savings that economies of-scale make possible. Because the UCF's investment managers are the same professionals who manage the assets of the Pension Boards of the UCC, management costs to UCF participants for information gathering, research, analysis, trading, and administration are but a small fraction of what they would be without this fortuitous collaboration. ■



## Shareholder activism and the power of the proxy



Amy Muska O'Brien  
Director of Corporate  
Social Responsibility

Through their products, internal management practices, and public policy positions, corporations clearly have wide impact on people and the planet. Many institutional investors – like the United Church Foundation – try to continuously monitor and influence the Corporate Social Responsibility (CSR) performance of the companies in their holdings.

The Office of CSR utilizes several socially responsible investment (SRI) “tools” in order to encourage superior CSR performance. One SRI approach, described in the previous issue of UCFocus, is the practice of social screening - avoiding investment in objectionable companies or industries. However, the majority of our work emphasizes the SRI strategy of shareholder activism, because we believe that our strongest leverage lies in the fact that we are stockholders with voice and responsibility.

Actions investors can take to influence a company include: dialoguing with management to encourage more responsible levels of corporate citizenship;

filing shareholder proposals on CSR issues; and, actively voting proxy statements each year in a manner that supports the CSR efforts of other SRI proponents.

Constructive dialogue with the company, leading to corporate change, is the objective of filing a shareholder proposal. The shareholder proposal process is utilized when initial attempts at company dialogue prove unfruitful. The SEC governs a process by which a shareholder or group of shareholders has a right to introduce formal proposals (a recommendation that a company take a particular action), have it circulated to and voted on by all company shareholders, and present it in person at the company annual meetings. To be eligible, an investor must hold at least \$2,000 worth of stock for one year.

All investors have the opportunity to support shareholder proposals through voting their proxy statements in advance of or at the company annual meeting. Failure to cast a supporting vote is equivalent to voting with management’s recommendation, which is usually against the proposal.

Religious institutional investors file the majority of social shareholder proposals each year. In order to coordinate

their efforts, many religious institutional investors collaborate through the Interfaith Center on Corporate Responsibility ([www.iccr.org](http://www.iccr.org)), of which the Office of CSR is a member.

Approximately 260 CSR-related shareholder resolutions were filed with 170 companies in 2001. The leading topic was the environment, with proposals asking companies to endorse the CERES Principles, obtain power from clean, renewable sources, and report on its greenhouse gas footprint and emission reduction plans. Proposals asking companies to improve, monitor, or report on their global labor standards comprise the second largest grouping.

In 2001 the UCF cast its proxy votes in support of numerous shareholder resolutions brought by SRI proponents. The proxy voting process allows the UCF to advocate for corporate change across a wide range of social and environmental issues.

The Office of CSR is currently developing its shareholder activism plan for 2002. While tracking and voting all social issue shareholder proposals will continue, an increased emphasis will be placed on company dialogues and filing of shareholder resolutions on priority CSR topics. ■

## Understanding UCF’s privacy statement

The United Church Foundation (UCF) respects its participants’ privacy and considers protecting that privacy part of its fiduciary responsibility. Here’s a brief description of the confidential information we maintain, how we protect it, and what is done and not done with it.

The UCF maintains the names, addresses and account balances of its participants in a confidential and secure computer environment that is accessible only to select UCF staff in New York City, and then, only on a need-to-know basis. For security purposes, this network is a standalone system. It is not interconnected for access via the Internet nor is it accessible from outside UCF offices by other means.

Within UCF offices, assigned user IDs and passwords are required to access the contents of this record keeping system. Misuse of this information for any unauthorized purpose is cause for dismissal.

Names of nearby participating churches might be shared with a church that is considering participation in the UCF, as a business reference. UCC Planned Giving Associates and other UCC Conference officials may also request a list of participating churches within that conference. Divulging any other information in the system to unauthorized persons is considered misuse,

and is strictly and expressly forbidden. The UCF does not exchange information about the balances in a participant’s account with anyone, either within or outside the United Church of Christ.



The UCF also maintains separate mailing lists of the names and addresses of certain individuals from the churches and church related institutions it serves. These individuals tend to be members of the investment and/or finance committees of these churches and agencies, or other individuals interested in the asset management services provided by the UCF. This mailing list is used to widen the circle of individuals who receive the quarterly newsletter, UCFocus, and other publications prepared and distributed by UCF from time to time. It is not shared,

exchanged or sold to anyone for any purpose.

The contents of the UCF computerized record keeping system and/or the UCF mailing lists are confidential and UCF proprietary, and are used only for the internal administration, account maintenance, and marketing purposes for which they were created.

If you have any questions about the UCF, please contact: United Church Foundation, 475 Riverside Dr., 1020; New York, NY 10115; (212) 870-2582; toll free: (877) 806-4989; [info@ucfoundation.org](mailto:info@ucfoundation.org). ■

## The UCF Approach to the Fixed Income Market

Our stated objective, as mentioned elsewhere in this newsletter, is to at least equal to the return of our benchmark, which is the Lehman Brothers Government/Credit Bond Index.

To begin with, we analyze the Index in terms of its structure, composition and quality and then determine how we can best allocate the assets within the portfolio to achieve this objective.

Generally the first thing we do is analyze the macro-economic environment and develop a view on the level and direction of interest rates. We look at economic indicators such as the level of economic growth, the level of inflation and the expected future level of inflation. These three variables are key in determining the level of interest rates.

After we have developed this view, we structure the portfolio to capitalize on our outlook by adjusting the average maturity of the portfolio. For example, if we believe interest rates are poised to decline, we would lengthen the maturity of the portfolio versus that of the Index. If interest rates did decline, our portfolio would outperform the Index, all things being equal. Alternatively, if we feel interest rates are likely to move higher, we will shorten the relative maturity of the portfolio. Generally speaking, we remain fairly close to the Index and tilt the portfolio only *slightly* to capitalize on our interest rate outlook. This strategy insulates us from the impact of large movements in the level of interest rates.

In addition to structuring of portfolio in terms of maturity relative to the Lehman Brothers Government/Credit portfolio, we look at the structure of the Index in terms of its allocation to the various asset classes. The major asset classes within the Lehman Brothers Government/Credit Index are U. S. Government and agency debt, and corporate and non-corporate debt. The non-corporate component consists of U. S. dollar denominated sovereign debt, supernationals, foreign agencies and foreign local government debt. At this point we analyze the various segments of the market from a micro-economic prospective. We decide which segment of the market may out perform the Index i.e., government/agency debt or some other components of the Credit Index. Again, generally we do not stray too far from the allocation within the Index, but slightly overweight/underweight a specific asset class or company. It is at this point that we focus on micro-economic aspects of the economy. If for example, the economy is coming out of a slowdown and growth is poised to pick-up, we may overweight cyclical companies. Alternatively, if we feel the economy is entering a slowing phase, we would overweight more defensive industries and companies.

Our mandate is to consistently provide a rate of return above that of our benchmark Index. We believe that an actively managed, high quality portfolio, with limited interest rate and credit risk is the appropriate strategy to fulfill this goal. ■



Andree Prindiville  
Senior Investment Officer  
Fixed-Income Investments

## Does the change to daily valuation of the accounts affect my church's transactions in the Common Investment Funds?

Yes. An explanation of how transactions were recorded prior to daily valuation will help explain the effect the change has on the account. Previously, transactions (for all funds except the Cash & Equivalent fund) took place only on the first day of each month and were valued at the market value at the close of business on the last business day of the preceding month. Income was calculated monthly and credited to each account based on the number of units owned at month-end. On the first day of the next quarter, units were purchased for income earned during the quarter for reinvested accounts and checks were issued for all other accounts. Investment Activity reports showed a monthly income amount. Since income was accrued into each account on a monthly basis, the unit value represented the value of the account excluding income.

With the change to daily valuation on April 1<sup>st</sup>, the daily unit value includes an accrual for income (less an accrual for

expenses). Because the unit value includes income, a participant withdrawing money from an account receives the full value of the account, which includes accrued income. However, the income portion per unit is not separately calculated on a daily basis. When a participant adds money to an account, the participant is, in effect, purchasing the accrued income to date since at the end of the quarter it will receive the income distribution.

On the last day of each quarter an income distribution is declared and the income per unit is calculated. Income is credited to each account based on the number of units held on the date of declaration. As in the past, any reinvestment of income is done on the next business day and units purchased with the unit value at the close of business of the day preceding the purchase of units. ■

Q & A

# Performance

Returns as of June 30, 2001

*UCF returns are presented net of fees*

## Annualized Averages

	Year to Date	One Year	Three Years	Five Years	Ten Years	Current Yield*	Unit Value	Market Value
<b>UCF Equity Fund</b> (includes 6.0% international equity) <i>S&amp;P 500 Index</i>	-8.4% -6.7%	-14.6% -14.8%	4.0% 3.9%	13.8% 14.5%	14.8% 15.1%	1.3%	\$9.71030	\$347.9M
<b>UCF Fixed-Income Fund</b> <i>Lehman Brothers Government/Credit Index (LBGC)</i>	3.8% 3.5%	11.1% 11.1%	5.2% 6.0%	7.5% 7.4%	8.3% 7.9%	6.5%	\$4.24030	\$212.2M
<b>UCF Balanced Fund</b> (64.0% Equity, 36.0% Fixed-Income) <i>Composite Index: S&amp;P 500 (50%)/LBGC (50%)</i>	-1.5% -1.4%	-5.2% -2.2%	4.5% 5.3%	11.0% 11.2%	11.6% 11.4%	3.2%	\$7.25062	\$292.5M
<b>UCF Cash &amp; Equivalent Fund</b> (annualized) <i>Lipper Money Market Funds Index (annualized)</i>	5.7% 4.8%	6.1% 5.5%	5.4% 5.2%	N/A —	N/A —	3.6%	\$1.00000	\$ 3.7M
<i>Consumer Price Index (annualized)</i> also known as Inflation	3.8%	3.1%	3.0%	2.6%	2.7%			

*\*Yield represents income only*

## Sector Analysis

US Equity Portfolio				Fixed-Income Portfolio			
Sector Distribution % of Portfolio				Sector Distribution % of Portfolio			
Sector	UCF 6/30/01	S&P 500 6/30/01	UCF 3/31/01	Sector	UCF 6/30/01	LBGC* 6/30/01	UCF 3/31/01
Consumer Non-Durables	7.1	5.2	7.4	Treasury	24.8	40.0	23.0
Consumer Health Care	12.0	12.9	15.1	Agency	8.9	17.3	9.7
Media & Services	6.1	6.6	4.5	Mortgage-Backed	3.7	0.0	3.3
Retail Stores	6.8	6.5	6.3	Asset-Backed	2.3	0.0	1.2
Consumer Durables	1.1	1.6	0.9	Industrials	19.0	20.0	17.5
Technology	18.8	19.2	21.0	Electric/Gas	6.1	3.3	5.1
Capital Equipment	10.4	9.7	6.6	Telephone	0.0	0.0	0.0
Financial	17.3	17.9	17.8	Finance	14.7	14.4	16.7
Energy	6.6	6.6	6.5	International	8.4	5.0	7.8
Resources	2.5	2.6	2.1	Taxable Municipal	1.7	0.0	1.8
Transportation	0.8	0.7	0.7	Cash	10.1	0.0	13.1
Communications	6.6	5.6	6.8	Other	0.0	0.0	0.8
Utility	3.5	3.7	4.0				
Miscellaneous	0.4	1.3	0.3				

*\*Lehman Brothers Government/Credit Index (LBGC)*



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