

*Empowering
Ministry Through
Proven Asset
Management*

ucfocus

The Quarterly Newsletter of the United Church Foundation — An associated ministry of the United Church of Christ

WHAT IS THE “PRUDENT INVESTOR RULE?”

by Rev. Nelson R. Murphy, Director of Education and Marketing

The new “Prudent Investor Act (Rule)” updates trust investment law by recognizing the changes that have occurred in investment practices in recent years. The act was developed and proposed by the National Conference of Commissioners on Uniform State Laws in 1994, and has since been adopted by state legislatures across the country.¹

Under the previous “Prudent Man Rule” first established in 1830 by Massachusetts Judge Samuel Putnam, the measure of a fiduciary’s duty with regard to managing money for the benefit of others was identifiable roughly by answering the question “What would a prudent man do?” Judge Putnam wrote:

“All that can be required of a trustee to invest, is, that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion, and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.”

Russell P. Pennoyer comments, “That rule, as modified and narrowed by state legislatures and courts, has guided trustees for over 150 years. But the certainty and protection it provides trustees increasingly

has come at the expense of investment performance. For example, the rule evolved to prohibit entire categories of investments and to protect trustees who ignore the impact of inflation or deliver mediocre investment results so long as they invest in ‘prudent’ securities.”²

The effect of the new “Prudent Investor Rule” is to remedy this flaw, but it also ratchets-up the standard for prudence to which trustees can now be held accountable.³ It removes much of the common law restriction that was previously placed upon the investment authority of trustees. The principles of modern portfolio theory may now be used to guide risk management, placement and asset allocation decisions. Modern portfolio theory describes a broadly accepted body of empirical and theoretical knowledge pertaining to the overall behavior of capital markets.

Instead of using a “prudent [but otherwise ordinary] person” as the benchmark, the acceptable standard is now better described by asking, “What would a prudent investor (presumably an expert investor) do?”

The new Prudent Investor Rule contains these basic principles:

1. Trustees may have a duty, as well as the authority, to delegate as prudent investors would.
2. Risk and return are so directly related that trustees have a duty to analyze and make conscious decisions concerning the levels of risk appropriate to the purpose of the trust. (Continued on Page 2)

NEW TELEPHONE NUMBERS FOR STAFF

While our toll-free number remains unchanged (877-806-4894), the direct numbers for reaching United Church Foundation staff have recently changed. Feel free to use the toll-free number to reach the Foundation, and then ask whoever answers to transfer your call. Alternately, you may use the following numbers to reach staff directly:

UCF Main Number	212-729-2600
UCF Fax Line	212-729-2601
UCF Toll-Free Number	877-806-4989
Mr. Don Hart, Executive Vice-President	212-729-2610
Rev. Nelson R. Murphy, Director of Ed. & Mktg.	212-729-2620
Mr. Steve Millian, Director of Administration	212-729-2614
Mr. Brad York, Account Representative	212-870-2616
Ms. Amy Muska O’Brien, Director CSR Ministry	212-729-2750
Ms. Doreen Forrest, Executive Sect. to Don Hart	212-729-2612
Ms. Michele Hamilton, Accountant	212-729-2618
Mr. Patrick Jourdain, Executive Sect. to Nelson Murphy	212-729-2622

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Toll-free: 877-806-4989 • **Phone:** 212-729-2600
Fax: 212-729-2601 • **e-mail:** info@ucfoundation.org
website: www.ucfoundation.org
 475 Riverside Drive, Suite 1020, NY, NY 10115



NEW GUIDELINES CREATED FOR CORPORATE GOVERNANCE ISSUES

by Amy Muska O'Brien, Director of Corporate Social Responsibility (CSR)



How much compensation should corporate chief executive officers receive? How many "independent" directors – those with no employment, financial, or personal ties to the company – should a company's board of directors include? Should the same firm that conducts a company's audit also provide other consulting services? When is a stock option plan considered "excessive?"

All of these questions are embedded within the realm of "corporate governance," a key focus for the Corporate Social Responsibility Ministry of the United Church Foundation. Each year publicly held corporations face many shareholder proposals on corporate governance matters, many more than on social or environmental issues. So far in 2002, investors have filed approximately 450 proposals on corporate governance matters, compared to approximately 260 on social concerns. Furthermore, voting on routine management proposals – like the proposed board slate and/or stock option plans – provides an opportunity to advocate for better corporate governance practices.

Early in 2002, the CSR Ministry worked hard to develop new proxy-voting guidelines for the multiple sub-issues associated with corporate governance. By analyzing the corporate governance principles and proxy-voting guidelines used by others in the

investment community, we identified best practices across a wide range of issues. Institutional investors included in the analysis were the United Methodist Church, the Episcopal Church, several state pension systems (California, Wisconsin and Florida), and well-known members of the social investment community such as Domini Social Investments, Walden Asset Management, and Trillium Asset Management.

Since this was undertaken to benefit participants in both the United Church Foundation (UCF) and the Pension Boards (PB), a Corporate Governance Working Group (CGWG) was formed as a joint committee with three UCF Directors and three PB Trustees. The CGWG met on August 6, 2002 to review, refine and ultimately recommend these new proxy-voting guidelines to the Investment Committees of their respective boards.

On September 27th, 2002, the Investment Committees of both the UCF and the PB approved the CGWG's recommendations. Their guidelines cover four main categories: board independence and leadership, shareowner rights, executive compensation/stock option plans, and corporate actions. A copy of these recommendations has been posted on our website, at: <http://www.ucfoundation.org/corporategovernance.htm> or may be requested by calling toll-free (877) 806-4989. They enable making better use of the "power of the proxy" to encourage better corporate governance from the companies owned by the UCF. 🍀

WHAT IS THE "PRUDENT INVESTOR RULE?" (CONTINUED FROM PAGE 1)

3. Diversification is fundamental to risk minimization and is therefore ordinarily required of trustees.
4. The fiduciary's duty of impartiality requires a conscious balancing of current income and growth.
5. Evaluating the performance of the whole portfolio replaces measuring the performance of individual investments in it, singly.
6. Trustees have a duty to avoid fees, transaction costs, and other expenses that are not justified by the objectives of the investment program.

In Summary

The Prudent Investor Rule is directed at trustees of private trusts (including charitable trusts). But it may well influence the investment duties of foundation trustees also. The laws governing investments by charitable corporations and trusts are converging and should eventually settle on a single standard. Board members would be well advised to use the new Prudent Investor Rule as a guide when investing a charitable corporation's funds, rather than ignore it and hope they are acting prudently. This warning should be taken seriously given that "by imposing a very high standard of care the new rule makes it easier to establish trustee liability."⁴

To learn more about how the fiduciary responsibility of trustees has changed under the terms of the new Prudent Investor Rule, go to our website, <http://www.ucfoundation.org/prudentmanact.htm>. You will find some commentary on the six points identified above, as well as some other web and printed references you may wish to consult. 🍀

¹As of July 2000, the following states had enacted the Uniform Prudent Investor Act: AL, AZ, AK, CA, CO, CT, DC, HI, ID, IN, IA, KS, ME, MS, MD, MI, MN, NE, NH, NJ, NM, NC, ND, OH, OK, OR, PA, RI, UT, VT, VA, WA, WV, WY. If your state is not listed, check with local authorities to see if the Uniform Prudent Investor Act has been adopted.

²See "A Matter of Trust, A prudent approach to an important rule change," by Russell P. Pennoyer, *Journal of Philanthropy*, November, 1999. This article reviews the book noted in the next footnote, and is available on the web at: <http://www.philanthropyroundtable.org/magazines/1999-11/pennoyer.html>

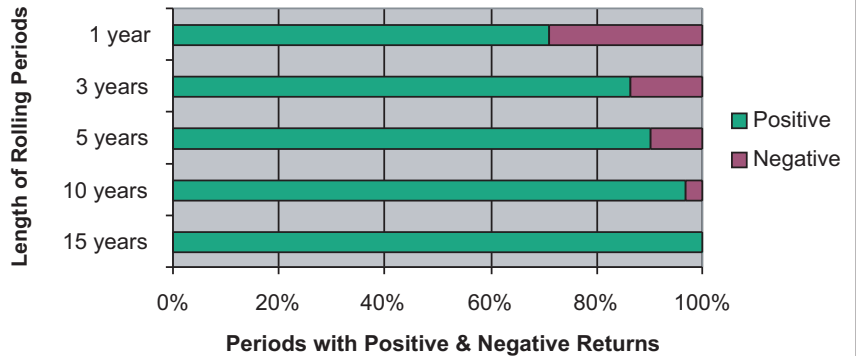
³See *Investing and Managing Trusts under the New Prudent Investor Rule: A Guide for Trustees, Investment Advisors, and Lawyers*; by John Train and Thomas A. Melfe; Harvard Business School Press

⁴Train & Melfe, footnote #3, above.

THE IMPORTANCE OF LONG-TERM INVESTING

Historically, long-term investors who have stayed in the stock market through the occasional (and inevitable) periods of declining equity prices have been rewarded for their patience. To illustrate this, consider the performance of stocks in rolling annual periods of 1, 3, 5, 10, and 15 years duration since January 1, 1926. During these 76 years (1926-2002), the longer stocks are held, the lower the risk of losing money.

S&P 500 Performance - Rolling Annual Periods



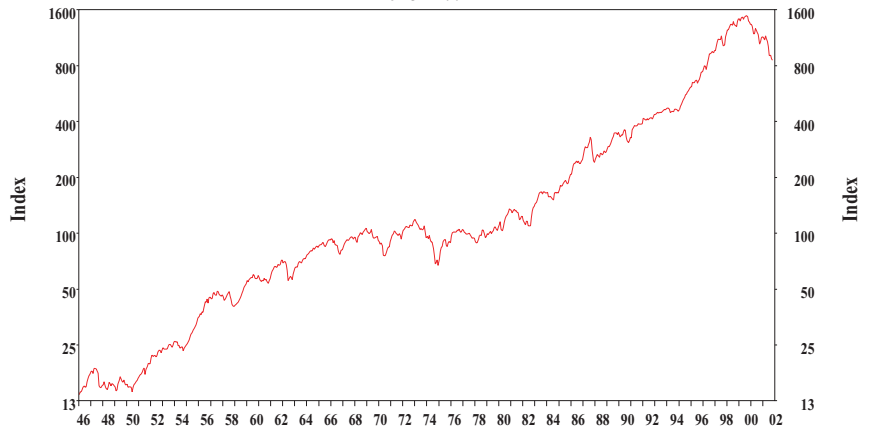
Here's how the Wall Street Journal described this data:

"Economists and financial advisers have long explained that profitable investing is a long-term affair. According to Ibbotson Associates, a financial consultancy in Chicago, an analysis of the S&P 500 over the past 76 years showed a 29% chance that an investor would lose money if he invested for only one year. The risk dropped to 10% over a five-year period, to 3% over a 10-year period, and to 0% over 15 years." — "The Great Retirement Scare," WSJ, August 2, 2002, p. A8

Time is on Your Side

Here's another way to visualize how stock values have changed over the long-term. The chart below depicts the S&P 500 Index from 1945 to the present, a period of nearly 57 years. It is graphed on a logarithmic scale to more accurately depict growth over time proportionally. The impressive upward sweep of stock prices in the U.S. over this extended period of time is instructive for the investment of church endowments where the expected time horizon is virtually infinite. While there are no guarantees that future results will replicate past experience, the long-term trend shown certainly encourages optimism about holding a broadly diversified portfolio of stocks over many decades.

Standard & Poor's 500
1945 - 2002



EMPLOYEE FOCUS

Brad York's is the friendly voice who usually answers the United Church Foundation's (UCF) Toll-Free Helpline (877-806-4989). Brad joined the UCF on a temporary basis in July of 2001, and was hired full-time the following year. Graduating recently from Arizona State University with a Masters Degree in Musical Theater Performance, Brad is a baritone soloist at nearby Riverside Church and is an active member of the Screen Actors Guild. In addition to music, Brad studied Broadcast Journalism and Mass Communications at Linfield College in Oregon, and has worked at a variety of other sales and customer service jobs. ➡

PERFORMANCE & ANALYSIS

INVESTMENT PERFORMANCE

SEPTEMBER 30, 2002

For more performance information, please visit our website: <http://www.ucfoundation.org/Fund Performance page.htm>

AVERAGE TOTAL RATES OF RETURNS	ANNUALIZED							
<i>Returns on UCF funds are presented net of fees⁽¹⁾</i>	Year to Date	1 Year	3 Years	5 Years	10 Years	Current Yield	Unit Value	Market Value
UCF Equity Fund – includes 10.7% international equity <i>S&P 500 Index</i>	-27.3% -28.2%	-20.0% -20.5%	-10.0% -12.9%	-1.2% -1.6%	9.0% 9.0%	1.9%	\$6.5797	\$273M
UCF Fixed-Income Fund⁽²⁾ <i>Lehman Brothers Government/Credit Bond Index (LBGC)</i>	10.6% 9.1%	8.6% 9.2%	9.1% 9.7%	7.5% 7.9%	7.5% 7.4%	5.3%	\$4.4634	\$160M
UCF Balanced Fund – (61.5% Equity, 38.5% Fixed Income) <i>Composite Index: S&P 500/LBGC (55/45)⁽³⁾</i>	-15.5% -12.8%	-10.4% -7.7%	-4.6% -2.5%	1.8% 3.0%	7.8% 8.2%	3.2%	\$5.7700	\$240M
UCF Cash & Equivalent Fund (annualized) <i>Lipper Money Market Funds Index (annualized)</i> <i>Consumer Price Index (Inflation) (annualized)</i>	1.5% 1.4%	1.6% 1.6%	4.0% 4.0%	N/A —	N/A —	1.5%	\$1.0000	\$4.3M

NOTES:

- (1) Actual fees since 10/1/94. Estimated fees prior to that date.
 (2) Prior to 10/1/94, these funds were respectively the equity and fixed-

income segments of the UCF Balanced Fund.

- (3) Until 3/31/01, the Policy Index was 50% S&P 500/50% LBGC and after that date it is 55%/45% respectively.

SECTOR DISTRIBUTION ANALYSIS

UCF Equity Fund				UCF Fixed-Income Fund			
Sector	Sector Distribution (% of Portfolio)			Sector	Sector Distribution (% of Portfolio)		
	UCF 9/30/02	S&P 9/30/02	UCF 6/30/02		UCF 9/30/02	LBGC* 9/30/02	Difference
Consumer Staples	9.2	7.5	8.7	Treasury	34.7	36.4	-1.7
Consumer Health Care	15.6	15.3	13.7	Agency	14.6	19.4	-4.8
Media & Services	5.0	5.3	5.2	Mtge-Backed	2.6	0.0	2.6
Retail Stores	8.1	8.1	8.0	Total Government	51.9	55.8	-3.9
Consumer Durables	0.9	1.8	1.1	Asset-Backed	2.0	0.0	2.0
Information Technology	13.8	13.2	14.0	Industrials	14.5	19.7	-5.2
Industrials	9.5	7.9	11.0	Electric/Gas	3.4	3.9	-0.5
Financials	19.8	20.6	19.4	Finance	14.0	15.1	-1.1
Energy	6.6	6.1	7.2	International	6.9	5.5	1.4
Materials	2.8	2.7	3.0	Taxable Munis	1.7	0.0	1.7
Transportation	1.9	1.8	1.0	Cash	5.6	0.0	5.6
Telecommunications Services	3.8	3.6	4.7	Total Credit	48.1	44.2	3.9
Utilities	2.9	2.9	2.9	Total Portfolio	100.0	100.0	
Miscellaneous	0.1	3.0	0.1				

*Lehman Brothers U.S. Government/Credit Bond Index



475 Riverside Drive, Suite 1020
New York, NY 10115



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