Spring 2003 • Vol. III, No. 3

Empowering Ministry Through Proven Asset Management

ucfocus

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

Investment Risk vs. Return Potential

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

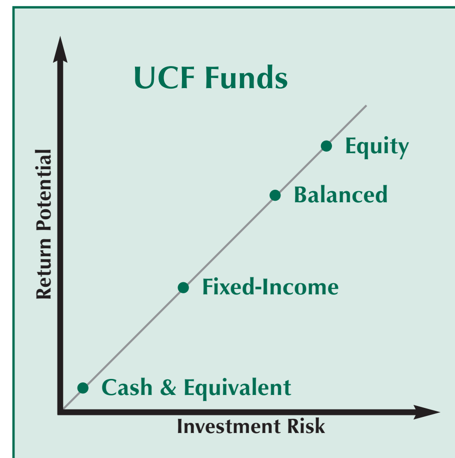
To say the least, investors are not happy when the market value of their investments fall below the price they paid for them. This leads people to ask, "Is it really necessary to risk such losses in order to get higher returns?" Unfortunately, the answer is yes. (The Q & A article on page three explains why.) For the purposes of this discussion, we shall define investment risk simply as the possibility that an investment's return might go down instead of up.

Someone once compared financial investing to mountain climbing. The higher you wish to climb up a mountain, the more risk to your safety there will be. Similarly, the higher the level of return you hope to obtain from your investments, the more risk you must be willing to take.

The relative risk of the four types of investments offered in the United Church Foundation's Common Investment Funds is summarized below.

• Money-market investments (cash), generally involve the lowest level of risk, and also offer the lowest level of potential return of the types of investments offered by the Foundation. The returns on money market funds closely follow prevailing short-term interest rates, which are primarily driven by government effort to control the economy.

• Fixed-income investments (bonds) generally involve higher risk than money market instruments, but lower risk than balanced funds or equities because they amount to loaning money to an issuer who promises to repay it with interest when the bond matures. The potential return from buying bonds is usually much less than the potential return from equity investments.



• Balanced funds usually hold both equities and fixed-income securities to offset the risk of one type with the other since they often tend to move in opposite directions. For example, when stocks prices decline, bonds often go up in value.

• Equity (stock) investments typically involve the highest risk of the types of investments offered by the Foundation, and have the highest potential for return. The sky is the limit for how high the value of a company's stock could rise, but it can also fall dramatically.

Historically speaking, riskier investments have shown a much higher potential for return than less risky investments. A long-term study completed recently by the London Business School, focused on the "real returns" for US stocks, bonds and cash over the last 102 years, from 1900 through 2002. "Real return" means, of course, how much investors really earned after inflation.

During that 102-year period, stocks averaged 6.3% in real return per year, while bonds delivered only 1.9%. The real return from cash was 1.0%. Looked at another way, stocks outperformed bonds more than three-fold and outperformed cash more than six-fold.

During the great bull market from 1980 through 1999, the real return of stocks (12.6%) was twice as high as the real return of bonds (6.4%) and four-times greater than the real return of cash (2.8%).

During the last three years (2000 through 2002), the dramatic turnaround in real return for stocks (-16.4%) and bonds (11.4%) illustrates just how punishing short-term investment risk can be upon assets allocated in the way that historically has proven to deliver greater long-term returns.

Remembering that past performance does not necessarily predict future returns, the following generalities are instructive

(Continued on Page 2)

Inside This Issue:

2 Does Social Responsibility Reduce Economic Risk?

3 Market Trends

3 Q&A: Investment Risk

4 Investment Performance

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

UNITED CHURCH FOUNDATION

Does Social Responsibility Reduce Economic Risk?

by Amy Muska-O'Brien, Director UCC Corporate Social Responsibility Ministry

The UCC's Corporate Social Responsibility Ministry joined with other large institutional investors to sound the alarm recently about the economic consequences of global warming and climate change caused by excessive hydrocarbon emissions (greenhouse gases). In addition to co-filing with oil and auto companies, we helped develop shareholder proposals specific to the electric utility industry. Power plants in the United States are responsible for forty percent of the country's, and ten percent of the world's, total carbon dioxide emissions. They are also major emitters of sulfur dioxide, nitrogen oxides, and mercury—all significant public health concerns.

What are the potential economic risks involved for shareholders in continuing this practice? The shareholder proposals we filed at several electric utilities this year asked management to report on the economic risk of these emissions if perpetuated indefinitely at current levels. We also asked management to evaluate the potential economic benefits of substantially reducing emission levels. These shareholder proposals describe how the growing scientific consensus around climate change will result in increased regulation in the future. This will have a detrimental impact on emissions-intensive industries like electric utilities. Developments at the international, national and state level confirm this. A recent report from the Yale School of Forestry and Environmental Studies describes how increased regulation of electric utilities in the future creates a significant business risk for those companies.

Proponents of this shareholder proposal—initially filed with the five largest emitters of carbon dioxide—believe that an "information deficit" exists for investors, leaving them unable to assess their economic risk properly or to adequately evaluate long-term shareholder value. Taking early action to reduce emissions and prepare for the tougher standards to come would position companies well, over against their peers, and especially so as consumer preferences for cleaner forms of energy emerge. Conversely, inaction and opposition to emissions control efforts expose companies to reputation and brand damage, regulatory and litigation risk, as well as uncalculated economic risk.

Recently, Institutional Shareholder Services, the largest investment advisory service to institutional investors nationwide, issued a recommendation in favor of our shareholder proposal at American Electric Power (AEP) stating, "the requested report will help shareholders assess financial risk related to greenhouse gas emissions." The shareholder proposal achieved the support of nearly 27 percent of the votes cast at the 2003 annual meeting—the highest vote ever for a global warming-related shareholder resolution. The Foundation is also a co-filer of an identical proposal at Southern Company, meeting May 28th, and anticipates a similar positive response.

These results from our shareholder activism efforts demonstrate that the business case for determining the potentially negative impact of harmful social and environmental practices is gradually becoming more and more self-evident to shareholders. Onward!

(Continued from Page 1)

when comparing the investment risk vs. return-potential for different types of securities.

- Investing in fewer securities is riskier than holding many securities that cover a broader range of market segments in the economy.
- Investing in smaller companies can be riskier than investing in larger, more established companies.
- Investing in any particular industry, currency or part of the world can be riskier than investing across many industries, currencies or regions.

The four Common Investment Funds of the United Church Foundation provide participants with a broadly diversified means for mitigating investment risk when holding investment securities for the long-term. The funds offered include a wide range of high-quality securities issued by governmental agencies and large corporations. Their activities involve every segment of the economy, and accurately reflect its overall strength. If there is such a thing as "average market risk," UCF Common Investment Funds come very close to approximating it, as is evident from the way their total returns so closely track comparable benchmark indexes, quarter after quarter.

Employee Focus

David L. Kniffin, CFA
(Certified Financial Analyst),
Chief Equity Officer

The Common Investment Funds of the United Church Foundation are managed on a day to day basis by the team of professional investment managers who work for The Pension Boards—United Church of Christ. The profiles of all our investment managers appear on the web at **www.ucfoundation.org.** Click on "Staff" and then on "Investment Managers."

David L. Kniffin, CFA (Certified Financial Analyst), Chief Equity Officer, has been with The Pension Boards—UCC for nine years. He has 29 years of investment experience with brokerage and insurance firms. David holds a B.A. in Economics from Yale University, and an M.B.A. from the Wharton School of Business, University of Pennsylvania.

MARKET TRENDS *(EXCERPTS FROM THE UCF 2002 ANNUAL REPORT)*

by George Doty, UCF Chief Investment Officer

Are the recent trends in stock prices and interest rates likely to continue into the foreseeable future, or might we reasonably expect a change in relative returns on these two major asset classes?

We believe there is reason to expect a change.

Over the short-term, as the last half-dozen years dramatically illustrate, stock prices sometimes reflect wild swings in optimism or pessimism. The severe bear market of the last three years is basically the mirror image of the rampaging bull market of the late 1990's. Certainly the recent recession, the likelihood of war, accounting irregularities, corporate malfeasance and the like all contributed to the severity of the decline. But the fact is that the speculative frenzy of the late 1990's was destined to end in great disappointment.

As we look forward, we believe that most, though not all, of the excesses of the late 1990's have now been worked off. Stock prices are still somewhat high in relation to corporate earnings and other measures, but more reasonable valuations can now be achieved if prices simply advance somewhat less rapidly than earnings over the near-term future.

Looking beyond the near-term, it is important to remember that our economy is strong. Indeed, with the recent surge in the development of new technologies and the very strong reactions we have seen to evidence of corporate malfeasance, one can argue that our economy is stronger now than it has been in some time. That strength bodes well for stock prices once the excesses of the late 1990's have been fully reversed, and it suggests that over the long-run, stock returns in the future should approximate the long-term returns of the past.

With short-term interest rates at or near record low levels, we can be confident that any further declines will be minimal. Indeed, if economic growth picks up this year as we expect, short-term interest rates should begin to increase.

The outlook for long-term interest rates, however, is not quite so obvious. Having declined from the 14% to 17% range back in 1980 and 1981 to the 4% to 7% range today for high quality bonds, it is safe to say that the bulk of any decline in rates has taken place. On the other hand, interest rate levels today on long-term bonds have only returned to the point where they are roughly in line with historical levels. The rates of 1980 and 1981 were clearly an aberration.

Given this situation, our best judgment is that long-term interest rates will remain within today's 4% to 7% range plus or minus about a percentage point. Yields over the long-term are largely a reflection of economic growth and inflation, and as already noted, our economy is strong and inflation remains under reasonably good control. As with common stock returns, bond returns in the future should approximate the long-term returns of the past.

[Editor's note: Each Participant will automatically receive a copy of the 2002 Annual Report in the next week or so. If you would like to request a copy for yourself, please contact us at info@ucfoundation.org, or call us (toll free) at 877-806-4989.]

Q&A

Why are financial investments always subject to risk?

The real value inherent in money can only be increased when it is put to work generating profits from the sale of products and services. Buyers' opinions about what they are willing to spend their money on change continually, as does the cost of the resources needed to generate the products and services buyers' want. Therefore, there is risk inherent in any investment activity due to the unpredictability of changing circumstances.

Investment risk varies, and is measured by the rate of change in market value over time. That is to say, an investment that experiences wide swings in market value over short periods of time is considered to be higher in risk than an investment which typically experiences a narrower, less volatile range of changes in value over the same period of time. For example, day-to-day changes in stock prices are typically greater than day-to-day changes in bond prices, which are considerably less extreme. For this and other reasons related to their intrinsic differences, bonds are considered less risky than stocks.

But all forms of investing involve some amount of risk in the comprehensive sense of possibly losing real (inflation-adjusted) value over time. In 1974 and again in 1979-80, even supposedly "risk-free" 3-month U.S. Treasury bills lost value after inflation and taxes when the cost-price index (CPI) was rising in excess of 1% per month.

"More Money for Ministry -- Investing for Today and Tomorrow"

A new video for investment committees.

Learn how to:
Develop & Implement a Sound Investment Strategy.

Topics covered include:
- Time Horizon
- Risk and Return
- Asset Allocation
- Corporate Social Responsibility
- Selecting an Outside Manager
- What the UCF Offers

Workbook & CD-ROM included.
Contact us for your ***FREE*** copy.

INVESTMENT PERFORMANCE

MARCH 31, 2003

For more information on the Common Investment Funds offered by United Church Foundation, call toll-free (877) 806-4989 or visit our website at www.ucfoundation.org

AVERAGE TOTAL RATES OF RETURN	ANNUALIZED							
Returns on UCF funds are presented net of fees	Year to Date	1 Year	3 Years	5 Years	10 Years	Current Yield	Unit Value	Market Value
UCF Equity Fund – includes 9.2% international equity	**-3.2%**	**-24.7%**	**-11.8%**	**-2.9%**	**7.8%**	**1.8%**	**$6.8318**	**$340M**
S&P 500 Index	*-3.2%*	*- 24.8%*	*- 16.2%*	*- 3.8%*	*8.5%*			
UCF Fixed-Income Fund	**1.5%**	**13.9%**	**9.3%**	**7.0%**	**7.0%**	**5.2%**	**$4.4713**	**$166M**
Lehman Brothers Government/Credit Bond Index (LBGC)	*1.7%*	*13.4%*	*10.1%*	*7.6%*	*7.3%*			
UCF Balanced Fund – (61.7% Equity, 38.3% Fixed Income)	**-1.5%**	**-13.1%**	**-6.2%**	**0.2%**	**7.0%**	**3.1%**	**$5.8869**	**$217M**
Strategy Index (See Note)	*-1.4%*	*-13.0%*	*-7.1%*	*0.3%*	*7.5%*			
UCF Cash & Equivalent Fund (annualized)	**1.1%**	**1.4%**	**3.2%**	**N/A**	**N/A**	**1.0%**	**$1.0000**	**$4.7M**
Lipper Money Market Funds Index (annualized)	*0.8%*	*1.2%*	*3.3%*	—	—			
Consumer Price Index (Inflation) (annualized)	*4.8%*	*2.9%*	*2.4%*	*2.6%*	*2.5%*			

NOTE: The Strategy Index represents the actual allocation to Fixed-Income and Equity in the Balanced Fund applied to the LBGC and S&P 500.

SECTOR DISTRIBUTION ANALYSIS

UCF Equity Fund

Sector	Sector Distribution (% of Portfolio) UCF 3/31/03	S&P 3/31/03	UCF 12/31/02
Consumer Staples	7.7	6.9	7.0
Consumer Health Care	16.3	15.6	14.9
Media	4.7	4.1	4.1
Services	1.2	1.5	1.4
Retail Stores	7.9	7.9	7.5
Consumer Durables	1.0	1.5	1.6
Information Technology	17.1	15.3	14.8
Industrials	8.0	7.9	7.8
Financials	19.5	19.8	20.5
Energy	5.8	6.2	6.0
Materials	2.7	2.7	2.8
Transportation	1.6	1.7	1.7
Telecommunications Services	3.6	3.7	4.2
Utilities	2.8	2.9	2.9
Miscellaneous	0.1	2.4	2.8

UCF Fixed-Income Fund

Sector	Sector Distribution (% of Portfolio) UCF 3/31/03	LBGC* 3/31/03	Difference
Treasury	29.0	36.1	-7.1
Agency	16.6	20.2	-3.6
Mtge-Backed	3.6	0.0	3.6
Total Government	49.2	56.3	-7.1
Asset-Backed	2.5	0.0	2.5
Industrials	17.6	19.7	-2.1
Electric/Gas	3.3	3.3	0.0
Finance	15.0	15.2	-0.2
International	7.0	5.5	1.5
Taxable Munis	1.3	0.0	1.3
Cash	4.1	0.0	4.1
Total Credit	50.8	43.7	7.1
Total Portfolio	100.0	100.0	

Lehman Brothers U.S. Government/Credit Bond Index

475 Riverside Drive, Suite 1020
New York, NY 10115

Non-Profit Org.
US Postage
PAID
Permit #252
Caldwell, NJ