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Empowering Ministry Through Proven Asset Management

ucfocus

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

UCF Board Adopts Five-Year Plan

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

The Board of Directors of the United Church Foundation completed a 15-month strategic planning process at its fall meeting in September by adopting a comprehensive 5-year plan entitled, "More Money For Ministry 2004-2008."

The planning process resulted in a "Mission Statement," a "Vision Statement," six "Guiding Principles" articulating our core values, and eight specific "Goals" with several "Strategies" identified for achieving each goal.

Look for our new Mission and Vision Statements elsewhere in this issue. The Guiding Principles articulate our core values within the following six categories:

1. Theological Foundation
2. Leadership
3. Constituent-Driven
4. Stewardship
5. Professionalism
6. Innovation

For example, under the fourth category above, one of the guiding principles is to "maintain the highest standards of financial integrity and accountability."

The eight goal areas established and toward which the Foundation will direct its efforts over the next five years are as follows:

1. **Customer Service –** Provide excellent services that respond to existing and new participants' needs and expectations.
2. **Growth –** Double assets under management through an increase in both the number of participants and account values.
3. **Education –** Provide educational materials to existing and potential participants that will help them make informed investment decisions.
4. **Marketing/Communications –** Develop marketing materials that communicate effectively with all parts of the UCC and result in increased participation in the Foundation.
5. **Financial Development –** Assist the Financial Development Ministry of the UCC raise funding for the mission and ministry of the UCC.
6. **Investments/Product Mix –** Provide investment options that meet the needs of our constituency.
7. **Corporate Responsibility –** Become a leader in the faith-based investment community in holding corporations accountable to their stakeholders for social and corporate governance responsibility.
8. **Capacity (People, Technology, Board) –** Maintain a staff and Board of Directors that are well trained, service oriented and demonstrate satisfaction in their four respective roles.

The members of the UCF board and staff are excited about this new strategic plan and the clarity of focus it gives to what we do on your behalf. We are grateful for the contributions made toward its completion by many colleagues. We feel confident that as these goals are realized, among other things, our constituent and asset base will grow, our costs per participant will decline, and the savings can be passed along in better investment returns.

Copies of the new UCF strategic plan have already been sent to all participants. The document is also posted on our website at www.ucfoundation.org. Additional copies are available upon request, either by email (info@ucfoundation.org) or by calling Doreen Forrest at 877-806-4989 x2612 toll-free. We invite you to obtain your own copy and give us the benefit of your opinion and/or your suggestions to help us improve the value of the Foundation's services to your organization.

Mission Statement

*The **United Church Foundation** strengthens the Church's ministries through the faithful stewardship of resources by offering all parts of the United Church of Christ sound financial management services.*

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United Church Foundation

Expanded CSR Ministry Integral to New UCF Strategic Plan

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

Expansion of the important role played by the Corporate Social Responsibility (CSR) Ministry in the United Church of Christ is an integral part of the United Church Foundation's (UCF) new Strategic Plan. UCF participants already benefit from the work done by the denomination's CSR Ministry. But the new Strategic Plan calls for an even greater involvement with the denomination's CSR Ministry in the future.

Currently, the three expressions of the CSR Ministry in the UCC are:

1. Monitoring compliance of investments made with social screening policy;
2. Engaging in a variety of proactive shareholder actions; and
3. Participating in the broader faith-based socially responsible investing arena.

These three activities bring the church's combined financial clout to bear on many important social issues, the basic reason for having a CSR Ministry in the first place.

One of the four pledges made in the UCF's new Vision Statement is that "[t]he Foundation will be a leader and a role model in advancing action for corporate responsibility," and one of the UCF's new goals is to "[b]ecome a leader in the faith-based investment community in holding corporations accountable to their stakeholders for social and corporate governance responsibility."

Toward achieving this goal, the UCF Board adopted the following three strategies:

1. Expand the Foundation's active shareowner approach with portfolio companies for those social and corporate governance issues of highest priority to the Foundation's stakeholders;
2. Provide Foundation stakeholders with more frequent updates on corporate dialogues, shareholder resolutions the Foundation has filed, and other activities in which the Foundation is engaged; and
3. Develop relevant CSR-related resources for clergy and local church leaders for use within the Foundation's overall financial management education function.

The first strategy above involves expanding the existing CSR Committee to foster a greater role for the boards of directors of the four Covenanted Ministries and other UCF stakeholders in guiding and prioritizing CSR initiatives. An expanded CSR Committee will help focus CSR work on the issues that truly reflect the denomination's social priorities.

The second strategy above involves providing UCF participants with more timely information about CSR dialogues currently underway with corporate managers, about shareholder resolution co-filings and about the UCF's proxy ballot voting decisions. The objective is to make all of this available on the web far enough in advance of annual corporate board meetings so investors across the UCC can make use of it while considering how to vote their own proxy ballots from these companies.

The third strategy above involves producing new and better CSR interpretive materials. One of the most frequent requests the CSR Ministry receives is for such resources. Those who champion the principles of faith-based socially responsible investing within their congregations need more and better material to support their cause. By providing these resources, the CSR Ministry helps the UCF fulfill its commitment to promote socially responsible investing in the local settings of the church.

The UCF Strategic Plan thus confirms the central role to be played by the CSR Ministry as the organization seeks to "strengthen the Church's ministries through the faithful stewardship of resources..."

EMPLOYEE FOCUS

Mr. Andrew Russell recently joined the Fixed-Income Investments team at The Pension Boards-United Church of Christ as the new Senior Portfolio Manager. He fills the position vacated when Mr. David Schiffman was promoted to become the Chief Fixed-Income Officer of the team. The Investment Department of The Pension Boards-UCC manages most of the assets held in the Common Investment Funds offered by the United Church Foundation.

Andy comes to us from FT Interactive Data, where he was a director in the portfolio analysis group. Prior to that he was a vice-president in the fixed-income group at Chase Asset Management where he managed four fixed-income mutual funds, as well as a portion of The Chase Manhattan Corporation retirement plan's bond portfolio.

A graduate of the University of Vermont, Andy moved to the New York City area in 1990. He grew up in the Second Congregational Church of Bennington, VT, during the ministry of the Rev. Thomas D. Steffen, now Pastor Emeritus of the church. Andy considers it a privilege to be part of The Pension Boards-UCC investment team. We are glad to welcome one of our own into this position.

Andrew Russell
Senior Portfolio Manager

The Outlook for 2004 and Beyond

by George Doty, UCF Chief Investment Officer

The recession of 2002 officially ended in November of last year. The stock market measured by the S&P 500 reached its low in October of last year or March of this year depending on whether you look at daily or monthly data. Interest rates measured by the yield on the 10-year Treasury Note reached their low point in June of this year. The very difficult period that began in the year 2000 appears now to have ended, but where do we go from here?

The Economy

Looking first at the economy, we believe that the year ahead will be a relatively good one, with growth only a bit below average, yet continuing throughout the year. Business and consumer confidence are growing, government policy has been extremely stimulative, and the benefits of the technological innovations of the 1990's and even earlier will continue to spread throughout the economy in terms of product and process improvements, higher real wages and improved corporate profits. The unemployment rate should break below the 6% level and head gradually toward 5.5% as the year progresses, and corporate profits should expand at a 10% to 15% rate.

Beyond next year, we expect continued growth but at a more moderate pace than that to which we became accustomed during the last couple of decades. Our country is in a very different place today than it was 20 years ago.

Then, inflation was very high but declining. Today, it is very low and the Federal Reserve has taken extraordinary steps to see to it that it declines no farther. Then, our deficit on current account transactions with the rest of the world was relatively low. Today, it has expanded to levels that historically have led to rising interest rates and a declining currency on international exchange markets. Then, investment funds were pouring into the country. Today, these funds are headed increasingly to other destinations. Then, federal, state and local government budget deficits were very large, but on the verge of improving. Today, demands for defense and for programs of all sorts at all levels of government seem destined to perpetuate the large budget deficits that currently exist.

These differences do not imply that disaster lies ahead: not at all. They do suggest, however, that the economic environment of the present decade is likely to be quite different than that of the 1990's. Growth is likely to be somewhat less rapid; gains in employment will probably not be as strong; inflation is likely to trend upward, not downward; the dollar is likely to trend downward on international exchange markets, not upward; and corporate profits will likely grow in line with the economy, but no better.

Interest Rates

As the economy continues to expand through the end of this year and next, we would expect to see interest rates rise and bond prices decline, particularly at the long end of the market, but not by a great deal. Inflation in our view should remain relatively low, and as a result, any rise in rates or decline in bond prices should not be substantial.

Looking beyond 2004, the economic environment described above should keep interest rates, measured by the 10-year Treasury Note, within a range of about 3% to 4% on the low side and 5% to 6% on the high side. Total returns on well-diversified bond portfolios should fall within or modestly above this range.

Common Stock Returns

We would expect common stock prices to move higher over the coming year, but in our judgment, the bulk of the move in prices for the current cycle is behind us. We would also expect corporate dividends to increase as companies now paying dividends increase their payout ratios, and as companies not currently paying dividends begin to do so.

Over the longer term, we would repeat the view that we have often expressed over the last few years. Stock returns should be positive, and will probably exceed the total return on bonds. However, stock returns are not likely to match the average return of about 10% per year achieved over the last 77 years.

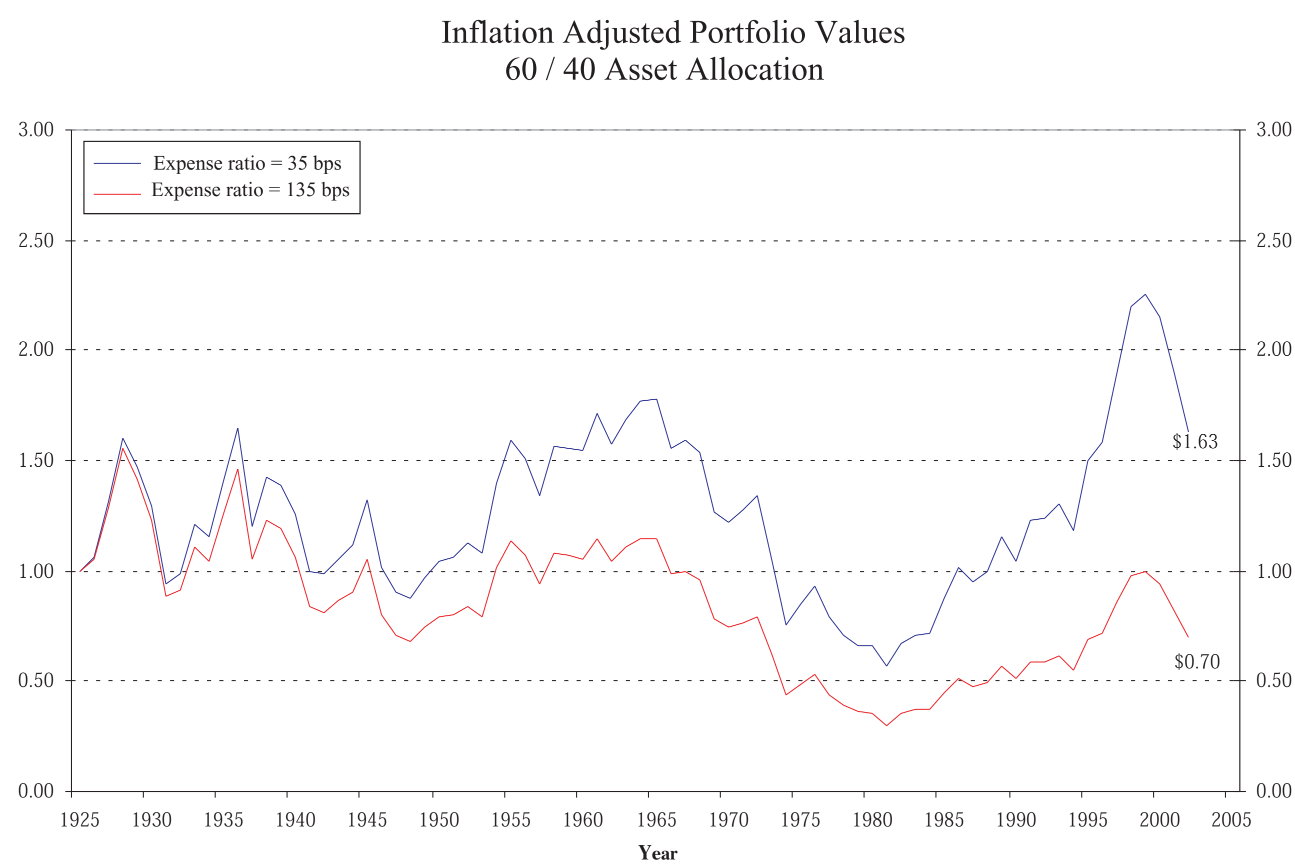
FOCUS ON THE FUTURE

Vision Statement

*Guided by United Church of Christ principles and beliefs, the **United Church Foundation** will be recognized as the preferred provider of financial services to all parts of the Church. The Foundation will increase its constituent base and assets under management by providing a comprehensive array of prudent investment products and quality educational materials supported by dynamic leadership, skilled staff and the use of technology. The Foundation will offer its products at a cost that is well below the industry average. The Foundation will be a leader and a role model in advancing action for corporate responsibility.*

Q&A

How much difference does lower cost make over a long period of time?



This graph illustrates the inflation adjusted results that would have been achieved over the last 76 years if $1 had been invested in a hypothetical balanced fund carrying 60% of its assets in stocks and 40% of its assets in bonds, where the assets performed as well as their respective indexes, and where 5% of the 5-year trailing average balance was withdrawn each year.

The blue line reflects the impact of a 35-basis point (0.35%) annual expense ratio, comparable to that charged by the United Church Foundation. The red line reflects the impact of a 135-basis point (1.35%) annual expense ratio, comparable to the average cost of owning a no-load balanced mutual fund. After 76 years, the lower cost (blue line) investment program ended up more than twice as large as the higher cost (red line) investment program ($1.63 vs. $0.70, or 138% more).

Equally dramatic is the difference in the total amount withdrawn over the years from each investment. If the original investment made in 1926 had been $100,000, the lower cost investment (blue line) would have generated $448,723 for the organization's use over the intervening 77 years, compared to only $311,986 generated by the higher cost investment (red line), or 44% more. (Cummulative dollar amounts are inflation adjusted. Actual dollar amounts are much higher.)

For long-term investments, lower-costs make an extremely significant impact on overall performance, other things being equal.

Do Lower Costs Result in Lower Performance?

Remember the old line, *"You get what you pay for?"* Some believe that this time-honored rule also applies to what they spend for investment management services. They conclude that by paying higher costs they are more likely to obtain higher investment returns.

But when it comes to paying for investment management services, higher costs do not necessarily result in higher performance. In fact, most of the time, the opposite is true. A number of studies have shown that lower cost mutual funds have historically outperformed higher cost funds.

The Morningstar fund data in Table 1 below provides average returns realized over the five-year period ending 6/30/2003 by equal-sized groups (quartiles) of mutual funds categorized by market segment and ordered by average expense ratio. It illustrates how higher fund expense ratios actually resulted in lower fund returns in all but one of the seven categories shown, and how even the highest cost small-cap funds—those in the third and fourth quartile—returned less than those in the first and second quartiles. These figures illustrate the premise that the more a fund costs to operate, the less shareholders get back in financial returns.

In another study, an investment research firm looked at how stock market returns were divided between investors and fund managers in the top twenty mutual fund families in this country. The results were astonishing. The fund family with the lowest costs delivered 96.7% of their gross returns to investors during the five-year period that ended 12/31/2001. The fund family with the highest costs delivered only 84.2% of their gross returns to investors, and kept the rest, 12.5%!

According to an article published by the Vanguard Group, the predictive value of ten different fund metrics were evaluated by The Financial Research Corp. Factors like a fund's past performance, its Morningstar rating, its alpha and beta ratios of risk and volatility were evaluated. The study found that a fund's expense ratio was the most reliable predictor of its future performance, with low-cost funds delivering above-average performances in all of the periods examined. The article concluded, "A fund's expense ratio is a valuable predictor of its performance because it is one of the few performance factors that is known in advance."

The UCF's current 35-basis point (0.35%) expense ratio is about one-fourth of the 1.39% average expense ratio for comparable equity funds and about one-third of the 1.11% average expense ratio for comparable bond funds. This makes the UCF's Common Investment Funds among the lowest cost investment vehicles available to churches, all the more remarkable considering that they are also actively managed portfolios holding socially responsible securities. So if a low expense ratio "is a valuable predictor of [future] performance" then UCF funds ought to perform very well indeed.

Table 1

Average Expense Ratios and Average Five-Year Returns

Stock Fund Category	Average Expense Ratio	Average Five-Year Return
Large Cap Stocks		
(*Quartile*) 1	0.64%	-0.73%
2	1.12%	-1.05%
3	1.57%	-1.83%
4	2.22%	-2.86%
Mid Cap Stocks		
1	0.85%	1.81%
2	1.27%	1.42%
3	1.70%	-0.30%
4	2.32%	-1.63%
Small Cap Stocks		
1	0.88%	1.08%
2	1.31%	1.55%
3	1.71%	1.10%
4	2.53%	-1.23%
International Stocks		
1	0.89%	-0.67%
2	1.44%	-1.66%
3	1.94%	-2.63%
4	2.56%	-3.43%

Bond Fund Category	Average Expense Ratio	Average Five-Year Return
High Yield Bonds		
(*Quartile*) 1	0.70%	-0.26%
2	1.00%	-0.73%
3	1.46%	-2.14%
4	1.94%	-2.55%
Short-Term Corp. /Gov't Bonds		
1	0.43%	6.50%
2	0.72%	6.00%
3	0.96%	5.88%
4	1.61%	5.48%
Intermediate-Term Corp./Gov't Bonds		
1	0.57%	8.29%
2	0.89%	6.72%
3	1.23%	6.37%
4	1.76%	5.91%

INVESTMENT PERFORMANCE

SEPTEMBER 30, 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 9.3% international equity	**15.5%**	**24.9%**	**-8.0%**	**1.4%**	**9.0%**	**1.7%**	**$8.0860**	**$315.7M**
S&P 500 Index	*14.7%*	*24.4%*	*- 10.2%*	*1.0%*	*10.0%*			
UCF Fixed-Income Fund	**4.1%**	**5.2%**	**8.9%**	**6.2%**	**6.4%**	**4.9%**	**$4.4914**	**$187M**
Lehman Brothers Government/Credit Bond Index (LBGC)	*4.7%*	*6.5%*	*9.6%*	*6.7%*	*7.0%*			
UCF Balanced Fund – (63.0% Equity, 37.0% Fixed Income)	**10.8%**	**16.4%**	**-3.1%**	**2.9%**	**7.8%**	**2.9%**	**$6.5406**	**$269.8M**
Strategy Index (See Note)	*10.3%*	*16.5%*	*-0.7%*	*3.9%*	*8.6%*			
UCF Cash & Equivalent Fund (annualized)	**0.9%**	**1.0%**	**2.3%**	**N/A**	**N/A**	**0.7%**	**$1.0000**	**$3.9M**
Lipper Money Market Funds Index (annualized)	*0.7%*	*0.8%*	*2.4%*	—	—			
Consumer Price Index (Inflation) (annualized)	*2.5%*	*2.4%*	*2.2%*	*2.5%*	*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	UCF 9/30/03	S&P 9/30/03	UCF 6/30/03
	Sector Distribution (% of Portfolio)		
Consumer Staples	6.6	6.3	6.9
Consumer Health Care	14.2	13.8	15.4
Media	4.7	4.0	5.1
Services	1.7	1.7	1.5
Retail Stores	7.9	7.9	7.8
Consumer Durables	1.2	1.6	1.1
Information Technology	18.4	17.0	17.1
Industrials	8.3	8.1	7.8
Financials	20.8	20.7	20.6
Energy	5.6	5.7	5.5
Materials	2.8	2.8	2.7
Transportation	1.6	1.6	1.6
Telecommunications Services	3.5	3.4	3.8
Utilities	2.8	2.9	3.2
Miscellaneous	0.1	2.6	0.0

UCF Fixed-Income Fund

Sector	UCF 9/30/03	LBGC* 9/30/03	Difference
	Sector Distribution (% of Portfolio)		
Treasury	22.6	37.1	-14.5
Agency	16.1	19.4	-3.3
Mtge-Backed	3.7	0.0	3.7
Total Government	42.4	56.5	-14.1
Asset-Backed	2.2	0.0	2.2
Industrials	18.8	21.2	-2.4
Electric/Gas	5.8	3.2	2.6
Finance	18.0	13.1	4.9
International	7.8	6.0	1.8
Taxable Munis	1.5	0.0	1.5
Cash	3.5	0.0	3.5
Total Credit	57.6	43.5	14.1
Total Portfolio	100.0	100.0	

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

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