

*Empowering
Ministry Through
Proven Asset
Management*

ucf focus

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

WILL RISING INTEREST RATES HURT OUR CHURCH'S INVESTMENTS?

Interest rates have started to rise, and further increases are likely. Generally, rising interest rates result in lower prices for bonds, and net asset values of bond funds decline. However, the impact of this short-term decline is mitigated substantially over time by the higher returns received on income reinvested in the fund. Thus the impact of rising interest rates on long-term investments in the UCF Fixed-Income Fund becomes less significant over time.

Conversely, falling interest rates cause bond prices to rise, which boosts short-term returns as we saw in 2002, but the new lower interest rates translate into lower returns on reinvested earnings over time. Thus, the income reinvested compounds at lower yields, reversing the short-term benefit generated by the initial increase in the rate of return.

Interest rate changes in and of themselves are neither good nor bad for bond funds. Rather, they are both good and bad. While

changes in interest rates can have a dramatic effect on a bond fund's net asset value initially, reinvested earnings smooth out average returns for total-return investors who sit tight and let the impact of the changes run their course.

The table below illustrates the impact over time of three hypothetical interest rate-change scenarios on a bond maturing in seven years, with a yield to maturity of 4% and a duration of 5.8.

Change in yield	12-Month Return			Annualized Returns		
	Year 1	Year 2	Year 3	3 Years	5 Years	7 Years
1. 4% to 2%	8.8%	8.0%	2.0%	6.2%	4.5%	3.8%
2. Unchanged	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
3. 4% to 6%	-0.8%	0.4%	6.0%	1.8%	3.5%	4.2%

Data source: The Vanguard Group

1. Interest rates decline by one percentage point a year over the next two years from 4% to 2%. Result: bond price rises. In the next 12 months, the combination

of the bond's interest income and rising price would produce a total return of 8.8%. Over time, however, as the bond's interest payments are reinvested at 2%, the bond's long-term return would decline. After seven years, the bond and its reinvested earnings would have produced an annualized return of 3.8%.

2. Interest rates hold steady at 4%. Result: the bond produces a steady annual total return of 4%, whether held for one year or seven.

3. Interest rates rise from 4% to 6% by one percentage point per year. Result: bond price declines. In the next 12 months, the bond's total return would be -0.8%. But

when earnings are reinvested at higher yields, the long-term returns rise. After seven years, the bond would have produced an annualized return of 4.2%, outpacing the returns earned in both the steady and declining-rate environments.

In all three scenarios, longer-term annualized returns are comparable to the bond's initial yield to maturity of 4%, accounting for both the income that a bond will provide and the expected change in its price as it approaches maturity.

Thus, when interest rates rise, the resulting decline in bond values is generally recovered over time by the higher yields earned on the reinvested income. Therefore, UCF participants should not let rising interest rate concerns overshadow their appreciation for the benefits of holding bonds, which include relative price stability, predictable earnings, and asset class diversification.

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ACH Speeds Cash to Your Bank Account

Electronic Funds Transfers (EFT) make it easy to receive payments and other withdrawals from the United Church Foundation. They are deposited directly into your checking account using the Automated Clearing House (ACH) banking system.

Consider these advantages:

- 1) Convenience.** Direct deposits represent less hassle compared to paper checks, which might sit for days before being deposited.
- 2) Security.** Mailed checks risk being stolen; not ACH deposits.

- 3) Speed.** Funds are available the same day with an ACH transfer; deposited checks are placed on hold for days until they clear.
- 4) Peace of Mind.** ACH transfers are easier, safer, and faster.

Many UCF participants already use this new service. If you have not signed up yet, get another application form and send it in today. They are available on our website at www.ucfoundation.org/ACHapp/achapp.pdf or by calling our toll free information line, 877-806-4989. ➤

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UNITED CHURCH
 FOUNDATION

SHAREHOLDER RESOLUTIONS SEEK CORPORATE CHANGES



Amy Muska-O'Brien

[Editor's note: Amy Muska-O'Brien returned from maternity leave July 12th. During her absence, the Foundation's collaborative work in Corporate Social Responsibility has continued apace.]

Shareholder groups filed 1,148 proposals during this year's annual meeting proxy season. Last year 1,082 shareholder proposals were filed. The UCF's shareholder proposals yielded a number of successes during the 2004 shareholder season. We participated in global warming/climate change co-filings at American Electric Power, the Southern Company, ExxonMobil, Unocal Corporation, Ford Motor Company and General Motors.

American Electric Power and Southern Company agreed to report on their greenhouse gas emissions and the associated risks. A summary of the resolution, along with a commitment to comply with its terms,

appeared in the company's proxy statement at its 2004 annual meeting. Independent Board Committees will evaluate the business risks associated with their present level of CO2 emissions in the face of rising regulatory standards and controls.

Our ExxonMobil shareholder proposal asking the company to respond to rising regulatory, competitive and public pressure to significantly develop renewable energy sources was challenged at the SEC.

However, a resolution filed by Christian Brothers Investment Services (CBIS) asking the company to justify its position on the science of climate change with peer-reviewed data, appeared on the ballot at the company's May 26 meeting. It received 8.8% of the vote, a good result for a first year resolution.

The resolution filed at Unocal asked the company to explore a strategy for renewable energy, support legislation that promotes a transition to renewable energy, and to set and report on firm targets for emissions reductions in its products and operations. It received 6.2% of the vote.

The resolution at Ford Motor Company asking the company to produce a report on

reducing green house gas emissions received 6% of the vote at the company's annual meeting on May 13th. The resolution at General Motors received 6.2% of the vote at the company's annual meeting on June 2nd.

The UCF's participation in human/labor rights shareholder activism campaign was noted at YUM! Brands, the parent company of Taco Bell, and at Wal-Mart. Support for the second-year shareholder

proposal at YUM! Brands calling for a report on the social and environmental sustainability of the company's operations remained high. The

resolution received 33% of the vote.

Wal-Mart has agreed to continue to meet with filers about the company's effort to "prepare a sustainability report, which includes the company's policies and practices related to social, environmental and economic sustainability and a summary of long-term plans to integrate sustainability objectives throughout company operations."

Institutional Shareholder Services, the largest investment advisory service to institutional investors nationwide, issued a recommendation in favor of the shareholder proposal at

Wal-Mart. The resolution received 13% of the vote at the June annual meeting, a strong showing considering that the company's founding family holds 40% of the stock.

Most of the shareholder activism efforts of the UCF are conducted collaboratively with peers at the Interfaith Center on Corporate Responsibility (www.iccr.org). For thirty years the ICCR has been a leader of the corporate social responsibility movement. ICCR's 275 faith-based institutional investor membership includes national denominations, religious communities, hospital corporations, and socially responsible mutual fund companies.

When in agreement on an issue, ICCR members work together to prepare a proposal that speaks for each co-filer. One of the larger institutions usually writes a first draft and then smaller co-filers suggest needed changes or improvements. Following the spring corporate annual meeting "high season," ICCR members meet to evaluate results and plan the following year's work.

Votes cast by the UCF on the proposals it received this year are posted on our website at www.ucfoundation.org. Click on the "Corporate Social Responsibility" link. ➤

Management
Concessions
Won at AEP,
Southern Co.

EMPLOYEE FOCUS

MILLY HERNANDEZ; UCF ACCOUNT REPRESENTATIVE

If you have called the United Church Foundation information line recently, you probably have already met Milly Hernandez. Born in the Dominican Republic, Milly has lived in New York City for the last 18 years. She graduated from the Aquinas Girls High School (Dominican Sisters) in 1997 and from the State

University of New York (SUNY) at Binghamton in 2002 with two BA degrees, one in English and one in Sociology. While studying at SUNY Binghamton, she also became a US Citizen.

Milly spent her last college semester studying in London, and then backpacked solo through Europe for three weeks. Before joining the UCF earlier this year, Milly did public opinion research at

Baruch College in New York City. Before that, Milly worked for Greenpath Debt Solutions, a non-profit debt consolidation service in New York City. Milly has three sisters and lives near the Cloisters Art Museum at the northern tip of Manhattan. Smart, ambitious and hardworking — we are delighted to have Milly on our staff. ➤



Milly Hernandez

STOCK AND BOND RETURNS ENTER TRANSITION PERIOD

by Catherine Waterworth, Chief Investment Officer



When one compares stock and bond returns in the 1980's and 1990's to long-term historical averages, one can only conclude that we have just

come through an extraordinary period of above average returns. Stocks in the last two decades of the 20th century averaged a return of around 18% compared to a long-term average of about 10%. Bonds during this period returned on average about 12% compared to a long-term average of about 6%. What gave rise to these spectacular returns? Two decades ago, inflation was very high, stock prices were very low and bond yields were at record highs. This set the stage for one of the greatest bull markets for both stocks and bonds in history.

The stage setting we now have is relatively low inflation at

around 2%, stock prices that are somewhat high relative to earnings and short-term interest rates at historical lows. The market is in a transition phase that will likely result in more "normal" or average levels of returns. Long-term interest rates have already begun to rise. Ten-year U.S. Treasury yields have risen by approximately 1.7% from the low they reached in June 2002 to about 4.8% currently. It is reasonable to expect that interest rates, especially short-term interest rates, will trend higher as the Federal Reserve adjusts monetary policy to keep inflationary pressures under control. Assuming the Federal Reserve is successful in keeping inflation between 2% and 3%, bond returns could average 4% to 6%.

It is unreasonable to expect that stocks, which have emerged

from the bear market that began in 2000 and have returned over 40% since October 2002, will continue at that pace. Historical returns have been around 9% – 10% and have shown a lot of volatility around the average. As we mentioned, stock prices relative to earnings are somewhat high. Given this higher starting valuation, it is reasonable to expect stocks on average to return in the 6% to 9% range with continued volatility.

As returns revert to these lower averages, spending power will not grow as much or as fast as in the past. It will take more invested assets to offset lower returns in order to end up with the same amount of income earned in the previous higher return environment. Participants should keep this in mind when adjusting their spending policies in the years ahead. ➤

Q & A

WHAT IS "MARKET TIMING" AND WHY IS IT BAD?

You may have heard about the "market timing" scandals that have rocked the mutual fund industry in recent months and the damage to individual investors these scandals have caused. You may also have wondered if your interests in the UCF's Common Investment Funds could have been compromised by "market timers" to your disadvantage, as has happened at some other mutual funds.

The answer is, no, nothing harmful like that has happened to UCF participants. But let's take a closer look at market timing. Exactly what is it and why is it bad?

One form of "market timing" is also called "time zone arbitrage" because it involves exploiting the price differentials that occurs when stocks are traded in the different time zones around the world. When the US stock market closes at 4:00 pm Eastern time, Asian and European markets have already been closed for many hours. The closing prices achieved elsewhere do not accurately reflect market values because of trading later in the day in the

US markets.

For example, international mutual funds which calculate their net asset values based on the previous day's closing price in Tokyo or London, may open again the next business day only to find that the true net asset value of their shares has been significantly affected by trading that occurred in the US while their markets were closed. This is especially true if the US market experiences a sharp rally, because a big rally will all but guarantee that foreign markets will surge upon opening the next day.

The time-zone arbitrage form of market timing exploits this momentary differential in prices in different parts of the world by buying and selling large positions quickly, before the effects of trading elsewhere are fully reflected in the next calculation of a fund's net asset value. It is bad because it works against the interests of long-term investors who miss out on potential gains, and must absorb the additional trading costs caused by fast in and out trades that dilute a fund's overall profit.

The United Church Foundation

offers no opportunity for participants to engage in the "time-zone arbitrage" form of market timing. However, there is another form of "market timing" that UCF participants could unwisely exercise, which we highly discourage. This takes the form of trying to guess which direction the stock and/or bond markets are going to move, and then transferring assets frequently from one asset class to another, trying to improve performance by "buying low and selling high." This may seem like the intuitive thing to do, but it is demonstrably a loser's game.

This form of market timing is bad because it assumes that an investor can correctly ascertain in advance when an asset is priced low and when it is priced high.

Who can always anticipate correctly the direction the markets are going to move in next? Such prognostication is extremely speculative and is notoriously difficult if not impossible to get right on a regular basis. Even experienced market-timers who work at this task full-time are often unsuccessful and miss out on unexpected upswings in

market values.

Consider the S&P 500 Index, a benchmark for stock market performance used by many funds, including the UCF Equity Fund. During the great bull market from 1975 to 1998, the Index posted a 17.1% average annual gain. However, if a market timer missed the 40 best days, less than 1% of the 6,237 trading days in that 23-year period, the annual rate of return would have been diminished by nearly 40% to 10.3%.

A much better investment strategy involves establishing an appropriate allocation of assets between stocks and bonds, one that is appropriate for your organization's tolerance of risk and its time horizon. Either rebalance the portfolio periodically to restore the asset allocation to the original level, or use a balanced fund that holds both stocks and bonds and maintains the desired ratio between them automatically. This is the prudent way to manage a long-term endowment or other trust fund, as it avoids market timing considerations altogether. ➤

PERFORMANCE & ANALYSIS

INVESTMENT PERFORMANCE

JUNE 30, 2004

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							
<i>Returns on UCF funds are presented net of fees</i>	Year to Date	1 Year	3 Years	5 Years	10 Years	Current Yield	Unit Value	Market Value
UCF Equity Fund – includes 9.8% international equity <i>Standard & Poors 500 Index (S&P)</i>	3.6% 3.5%	20.1% 19.1%	0.0% -0.7%	-1.5% -2.2%	11.2% 11.8%	1.6%	\$9.2923	\$382.5M
UCF Fixed-Income Fund <i>Lehman Brothers Government/Credit Bond Index (LBGC)</i>	-0.4% -0.2%	-1.0% -0.7%	6.0% 6.7%	6.4% 7.1%	7.2% 7.4%	4.4%	\$4.3467	\$197.3M
UCF Balanced Fund – (65.2 Equity; 34.8% Fixed-Income) <i>Strategy Index (See Note)</i>	2.3% 2.2%	12.1% 11.6%	1.9% 1.8%	1.3% 1.3%	9.2% 9.6%	2.6%	\$7.0759	\$314.4M
UCF Cash & Equivalent Fund <i>Lipper Money Market Funds Index</i> <i>Consumer Price Index (Inflation) (annualized)</i>	0.8% 0.9%	0.8% 0.8%	1.2% 1.6%	N/A —	N/A —	1.0%	\$1.0000	\$3.2M

Note: Balanced Fund only holds units of the UCF's Equity and Fixed-Income Funds. The "Strategy Index" represents the actual allocation percentages of these funds applied to the LBGC and S&P Indices.

SECTOR DISTRIBUTION ANALYSIS

UCF Equity Fund				UCF Fixed-Income Fund			
Sector	Sector Distribution (% of Portfolio)			Sector	Sector Distribution (% of Portfolio)		
	UCF 6/30/04	S&P 6/30/04	UCF 3/31/03		UCF 6/30/04	LBGC* 6/30/04	Difference
Consumer Staples	6.8	6.4	6.6	Treasury	14.7	39.6	-24.9
Consumer Health Care	14.0	13.3	13.9	Agency	19.5	19.2	0.3
Media	4.4	3.7	4.6	Mtge-Backed	2.0	0.0	2.0
Services	2.1	1.9	2.0	Total Government	36.2	58.8	-22.6
Retail Stores	7.6	7.5	7.9	Asset-Backed	13.4	0.0	13.4
Consumer Durables	1.6	1.7	1.6	Industrial	21.2	19.1	2.1
Information Technology	17.2	16.6	16.7	Electric/Gas	2.6	3.2	-0.6
Industrials	8.4	8.5	8.0	Finance	15.1	12.6	2.5
Financials	20.4	20.2	21.5	International	3.2	6.3	-3.1
Energy	6.1	6.4	5.9	Taxable Munis	0.8	0.0	0.8
Materials	3.1	3.0	3.1	Cash	7.5	0.0	7.5
Transportation	1.7	1.6	1.6	Total Credit	63.8	41.2	22.6
Telecommunications Services	3.7	3.4	3.7	Total Portfolio	100.0	100.0	
Utilities	2.9	2.8	2.9				
Miscellaneous	0.2	3.1	0.1				

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

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