

INVESTOR
STORIES

Legacy Fund Demonstrates the Value of Long-Term Investing



At the turn of the last century, the predecessor bodies of the United Church of Christ faced a new problem. Life expectancies were increasing, and older clergy were no longer “dying with their boots on.” Poorly paid for most of their careers, many of these tireless servants of the church (and their spouses) were reaching old age with stars in their crown, but nothing in the bank.

The National Council of the Congregational Churches addressed the problem by ambitiously raising a \$5 million endowment: the Pilgrim Memorial Fund (PMF), with income to be distributed to support retired clergy and their widows. To manage the Fund, a separate corporation was created that over the years became the United Church Foundation.

According to *A Book of Remembrance*, published in 1930 and naming the original donors, the idea for establishing the PMF was strongly advanced as early as 1908, when “... a group of devoted, courageous and far-seeing men... made an historic appeal to the Congregational Churches of the United States, in behalf of an endowment fund for the Annuity Fund for Congregational Ministers. In commemoration of the three hundredth anniversary of the landing of the Pilgrims, this Fund was to be called the Pilgrim Memorial Fund.”

The recommendation “was adopted unanimously and with great enthusiasm,” with its

objective “to provide Old Age Pensions for Congregational Ministers” (Pilgrim Memorial Fund brochure, 1918). When the campaign report was completed at the end of 1929, a net total of \$4,956,000 had been raised after expenses of \$517,505. By that time, over \$2 million in PMF earnings had been distributed to faithful clergy and their widows. Over the last 90+ years, the Pilgrim Memorial Fund has grown to more than \$40 million and continues to provide support to UCC clergy.

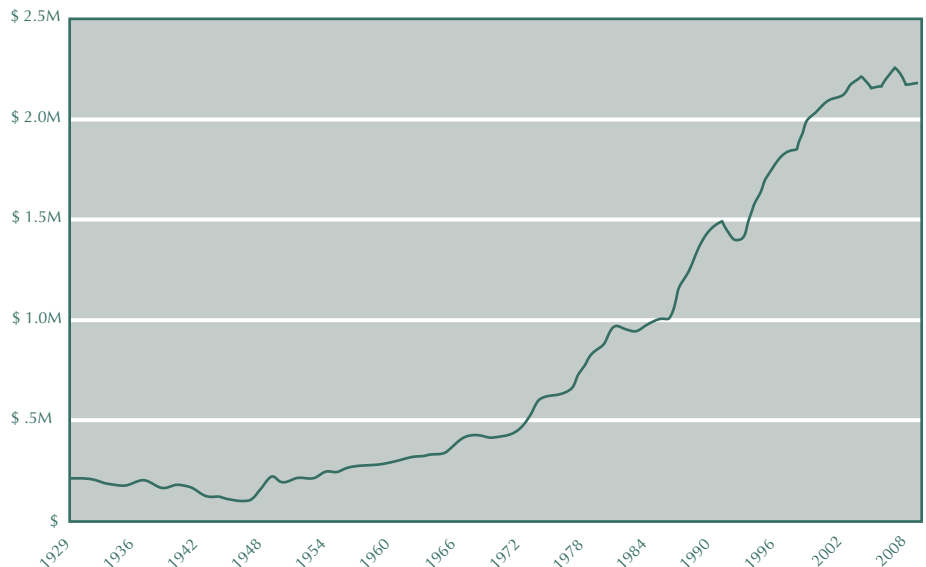
The graph below shows how payouts from the PMF have increased over time as the Fund has grown. Originally invested only in fixed-income securities which netted little capital growth, the Fund’s portfolio has been augmented with a broadly diversified common stock component over the last 50 years. The graph illustrates the value of maintaining a well-diversified portfolio, given the relentless diminishment in real buying power caused by inflation over time.

At such a challenging moment in our nation’s economic history, we are wise to recall that long-term funds — like endowments — can weather the occasional storms in the market. History clearly shows us that over time, investments in well-chosen, balanced portfolios like those offered by the United Church Foundation, will recover and continue to grow, supporting ministry for generations to come.

If you’d like to know more about the family of funds offered by the United Church Foundation, visit us online at ucfoundation.org.

Pilgrim Memorial Fund Annual Payouts, 1929-2009

From \$5 million in 1929 the Fund has grown to nearly \$40 million.



Fourth Quarter Ends on a Challenging Note

Ramifications from the bursting of the housing bubble and ensuing credit crunch accelerated in the fourth quarter, and resulted in the US stock market ending the year with its third worst calendar year return in the last century. The S&P 500 Index returned -21.94% in the fourth quarter, dropping 2008's return deep into bear market territory with a -37% annual return.

Compared with other bear markets, the speed and breadth of the decline is surprising. Losses were widespread, affecting domestic equities of all sizes and in all sectors, foreign equities, commodities, real estate and many types of bonds. The MSCI EAFE Index, a proxy for developed non-US markets, fell 19.92% in the fourth quarter, returning -43.09% in 2008. Oil, which had reached a historic high of more than \$147 a barrel in mid-July, ended the year just under \$45 a barrel. Home prices declined 18% for the 12 months ended October 2008 as measured by the Case/Shiller Index. US Treasuries proved to be one of the few safe havens in 2008, and Barclays Government/Credit Index ended the year in positive territory with a 5.70% rate of return — aided by aggressive Federal Reserve action to address the credit crisis which brought Treasury short-term yields to essentially 0% and longer term yields to historic lows. However, dissecting the Index's return shows that only government securities had positive returns for the year, as the corporate sector registered a -4.94% return in 2008.

Returns on the Foundation's Funds reflect the startling volatility in the fourth quarter and pressure on the financial markets from panicked investor selling. The Domestic Core Equity Fund returned -22.27% in the final quarter and -37.43% for the year, falling short of the S&P 500 Index when fees are deducted from performance. The Small Cap Equity Fund fell 27.40% in the final quarter, pulling down the return for the year to -39.40%. The Fund underperformed the -26.12% and -33.79% returns for the Russell 2000 Index for the fourth quarter and for the year, respectively, due primarily to the underperformance of the small cap value manager whose sector and issue selection negatively impacted performance. A larger weighting to the energy sector in the third quarter and issue selection within sectors hurt the results. The International Equity Fund returned -22.92% in the fourth quarter and -44.60% for the year. Although the Fund's emerging market holdings outperformed the EAFE Index for the year, the flight to quality in the fourth quarter resulted in these holdings dragging down performance in this period.

The Fixed-Income Fund returned 3.27% in the final quarter, resulting in a return of 1.48% for 2008, underperforming its benchmark. The Fund's managers had begun to underweight Treasuries and reduce interest rate exposure as it appeared that the Federal Reserve would have to raise interest rates as inflation fears rose along with commodity prices. However, the massive flight to quality driven by panic in the credit markets undermined the portfolio's positioning relative to the benchmark.

Given the struggles some of our equity managers faced as well as the out-performance of US domestic equities compared to



non-US equity markets, the Total Equity Fund's return of -23.19% for the quarter and -39.66% for the year fell short of the return for the S&P 500. The Conservative Balanced Fund recorded returns of -6.31% for the final quarter and -14.68% for the year, while the Moderate Balanced Fund returned -12.28% in the fourth quarter and -24.54% for the year. The Aggressive Balanced Fund returned -16.31% and -30.53% for the last quarter and 2008, respectively. All of the Balanced Funds underperformed their respective policy indices due to the underperformance of the Total Equity Fund and the Fixed-Income Fund versus their relative benchmarks as well as a modest overweighting of equities earlier in the year.

What led to the sharp declines in the final quarter? In the wake of de-leveraging by financial institutions and hedge funds, the Lehman Brothers collapse, and the collateral damage from this largest bankruptcy in history, lending dried up around the world as lenders grew increasingly fearful that their money wouldn't be returned. This loss of trust in the financial system exacted a heavy toll on the global economy, consumers and investors. US economic growth rapidly decelerated into negative territory as tighter credit conditions, falling home and equity values and rising unemployment affected consumer spending. The unemployment rate, which dipped as low as 4.8% early in 2008, rose sharply to 7.2% in December, when the National Bureau of Economic Research officially declared that the US had entered into a recession in December 2007.

Have we experienced the worst yet? When will the economy move to firmer footing? Unfortunately, no one knows for certain. The equity markets have rebounded somewhat from the low in November, and the S&P 500 through year-end is up 20% from its low in late November. Volatility has begun to retreat from the high level experienced in 2008, and rates at which banks lend to each other are declining — all positive signs that market conditions are becoming less strained. The economy will continue to face headwinds as long as home prices are declining and ►

While I-told-you-so announcements sometimes rub people the wrong way, socially responsible investors (SRIs) find them sadly apt as they recap the investment climate of 2008. SRIs, through the shareholder resolution process, predicted much of the destabilization that came to pass in the markets in the last year. Resolutions regarding corporate governance and social and environmental improvements, if heeded, may have prevented some of the damage.

SRIs have long held the belief that the chairman of a company's board of directors should not also be the chief executive officer. The oversight that a chair should provide is better done through a second party, external to the day-to-day decisions of a business, who will create and maintain appropriate guardrails around corporate policy. Without suggesting a causal relationship between a dual CEO/Chair role and the recent corporate collapses, one must note with interest that Richard Fuld of Lehman Brothers and James Cayne of Bear Stearns both served as CEO/Chairman at the time of investment banks' demises. And although Bernard Madoff's firm was not publicly held, he too served in this dual capacity.

In addition to pursuing best practices regarding board composition, investors associated with the Interfaith Center on Corporate Responsibility (ICCR) began calling for a more rational approach to mortgage lending almost a decade ago. Resolutions suggesting transparency and board committee-level oversight on how companies were lending to subprime borrowers went relatively unheeded. These resolutions foresaw the risks that no- and low-income lending brought to the marketplace and to shareholders.

And as far back as 1992, ICCR members sent shareholder resolutions to Ford Motor Company and General Motors requesting the companies explore the creation of fuel efficient automotive fleets. Since that time, shareholders have called again and again



for these companies to evaluate their "carbon burdens" — total carbon dioxide emissions associated with a manufacturer's fleet due in part to the poor fuel efficiency of its products — against the rest of the automotive industry. Again and again, corporate representatives maintained that sales data for fuel inefficient vehicles proved that fuel efficiency did not drive consumers. In 2008, a period of skyrocketing fuel prices and resulting losses in the SUV-heavy domestic auto industry revealed that previous sales data should not have been the determining factors when considering a more efficient fleet.

We will never know whether any of the crises of 2008 would have been avoided if investors' calls for more transparency and improvements were acted on by corporations. This year, however, demonstrated socially responsible investors' foresight into the issues that most affected the markets, and the Foundation will continue to engage in active shareholding to build both better returns and a better world.

Fourth Quarter Ends on a Challenging Note (cont'd.)

unemployment continues to rise, and consumer spending will remain anemic as consumers reduce consumption and increase their savings to repair their strained balance sheets. Expectations for corporate profits look more reasonable but still may be a tad optimistic. A big unknown but potential positive in the outlook is how government stimulus being shaped by the incoming Obama administration will play out.

Most economists do not see substantial recovery until the second half of 2009 at the earliest, and many see the economy remaining weak throughout 2009. However, financial markets

look ahead and usually recover six to nine months before the economy does.

As we have said many times in the past, turning points in the economy and the market are difficult to forecast and are mostly only recognized in hindsight. In past bear markets, years of sharp negative returns were often followed by years of strong returns. Although there are still a number of issues that need to be worked out to restore fully functional financial markets, it would not be surprising to see a meaningful rally in equity prices and better corporate bond performance at some point in 2009.

Making a Plan: Building a sound investment policy

The Bernie Madoff debacle brought home the wisdom of all those axioms your parents and grandparents impressed on you long ago — Nothing ventured, nothing gained. Don't put all your eggs in one basket. Don't buy a pig in a poke. If it seems too good to be true, it probably is.

Turns out all that boring-at-the-time advice would have served Mr. Madoff's investors well: take some calculated risks but spread your risk out, insist on transparency from the people in charge of your money, and be realistic about your expectations.

Every investor — whether an individual or an organization — needs a plan for their investments: a policy that spells out the investor's goals and risk tolerance, the types of investments and managers they consider acceptable, and their general return objectives.

Set your goals

A church investing its endowment generally has one overarching goal: to provide money for ministry while continuing to grow the endowment to benefit future generations. Where an individual invests with a time-specific goal like retirement, a church invests its endowment in perpetuity. Gifts made by members long gone continue to support the ministry today, and contemporary investors bear an obligation to both their predecessors and their successors to maintain and develop the endowment as a ministry tool.

A church's goals might include long-term growth, stability, social responsibility, and a competitive return that permits a spending policy of three to five percent a year.¹ When a church begins to develop or review its investment policy, goal-setting should be the first step from which all other elements of the policy grow.

Consider your risk tolerance

Once upon a time, the risk-averse kept their money in bonds and clipped coupons. While high-grade bonds offered no real

growth potential, they were largely protected from market fluctuations and guaranteed a return on which an investor could depend. But trustees of an endowment can't rest on their laurels — they must ensure an endowment's viability for years to come. They must take some risk.

Generally speaking, the more risk one is willing to take, the higher one's potential for significant gains — and losses — over long periods of time. While bonds typically represent a lower risk investment, they also offer a lower long-term return

on investment than stocks (equities). A "safe" investment, however, can actually be risky to a long-term investor: the failure to take advantage of market growth potential can leave an endowment diminished over time. A well-balanced portfolio includes a mix of stocks that provide the potential for growth, along with bonds that can temper stocks' potential for volatility.

In developing an investment policy, a church must consider how much risk they are willing to take to accomplish their goals. While opinions may vary widely, churches often find that investments like the United Church Foundation's Balanced Funds balance an appropriate level of risk with the potential for return, while diversification within the portfolio helps to smooth out some of the sharper changes in market values. With conservative, moderate or aggressive options, the Foundation's balanced funds appeal to the range of risk tolerances among UCC investors.

Determine acceptable investments and appropriate management

For most churches, mutual fund-type investments remain the ideal vehicle for an endowment: funds can be selected to suit the church's needs and offer professional management that removes the burden of direct investment selection from the church's investment or endowment committee. In creating an investment policy, however, a church needs to spell out the types of investments it considers appropriate. Will the church hold single issues of stocks or

KEY POINTS

Every church needs an investment policy — a plan that spells out how the endowment will be invested so that the assets will continue to support important ministries. In creating a policy —

- **Establish your investment goals**
Do you seek growth? income? stability? return? social responsibility?
- **Consider your tolerance for risk**
Realize that higher returns generally require greater risk
- **Choose appropriate investment types and management resources**
Clearly state the vehicles and managers that will be acceptable, and those that will not
- **Determine your return objectives**
Set reasonable expectations based on investment choices
- **Insist on transparency**
Expect transparency from managers and offer the same to the congregation

bonds? What about international stocks? real estate? or so-called alternative investments like hedge funds? What types of investments or industries is the church unwilling to consider?

A professional manager or fund can assist a church as they consider the wide array of investment options. So the investment policy should include a list of acceptable sources of investment management. May a church committee internally manage the portfolio, choosing which individual stocks and bonds the church will hold? Or must an outside, professional manager be employed? Does the church want to identify a sole management resource like the United Church Foundation, or may the outside manager be an individual broker?

Once the investment and management decisions have been made, the church must decide how it will evaluate the manager's performance. How and when will the investment committee communicate with the manager? What criteria will be used to determine if the manager has performed to the church's satisfaction? What process will be used if the church decides to move part or all of its funds to another manager? And perhaps even more importantly, how will the committee communicate its work and progress to the church to maintain faith and transparency with the congregation the endowment is meant to serve?

Establish return objectives

As we've seen in the past few months, investment management success can be derailed by unforeseen market events. Ironically, when the economy turns down and giving slows, churches often look for more income from their endowments. But return objectives must be balanced by a realistic view of conditions and a prudent degree of risk that positions the endowment for continued long-term growth. In other words, return expectations must be reasonable. Mr. Madoff's clients believed they could achieve steady 9-10% returns every year no matter what — generally not a very likely scenario.

If a church is taking too little risk, the endowment is unlikely to provide adequate money for the ministries it is meant to serve, and the real value of the endowment could decline because of inflation. On the other hand, a church should not expect to be able to spend more than three to five percent of its endowment every year to avoid diminishing the portfolio's value over time. With established return objectives, a church can evaluate and adjust its portfolio to achieve a level of performance that is consistent with the church's risk tolerance and goals.

So as your church develops or reviews its investment policy, recall Mama's wisdom. Take appropriate risks, but don't put all your eggs in one basket. Insist on transparency, both from yourself and others. If an investment or manager or return seems too good to be true, know that it probably is. And when it comes to endowments, remember: Rome wasn't built in a day.

¹For more on spending policies, see the third quarter 2008 edition of *UCFocus*.

AVERAGE TOTAL RATES OF RETURN		ANNUALIZED							
<i>Returns on UCF funds are presented net of fees</i>		Quarter	One Year	Three Years	Five Years	Ten Years	Current Yield	Unit Value	Market Value
MANAGED FUNDS	Fixed-Income Fund	3.27%	1.48%	4.19%	3.71%	4.89%	5.1%	\$4.2831	\$210.0M
	Barclay's Government Credit Bond Index (BGC)	6.42%	5.70%	5.56%	4.64%	5.64%			
	Domestic Core Equity Fund <i>(Inception 10/01/05)</i>	-22.27%	-37.43%	-7.30%	N/A	N/A	3.2%	\$7.3555	\$191.3M
	S&P 500 Index	-21.94%	-37.00%	-8.36%					
	Small Cap Equity Fund <i>(Inception 10/01/05)</i>	-27.40%	-39.40%	-9.16%	N/A	N/A	0.8%	\$6.9669	\$47.7M
	Russell 2000 Index	-26.12%	-33.79%	-8.29%					
	International Equity Fund <i>(Inception 10/01/05)</i>	-22.92%	-44.60%	-8.09%	N/A	N/A	5.0%	\$7.3466	\$71.4M
	EAFE Index	-19.96%	-43.38%	-7.35%					
	Cash & Equivalent Fund <i>(annualized)</i>	0.73%	1.91%	4.03%	N/A	N/A	0.8%	\$1.0000	\$13.2M
	Lipper Money Market Funds Index <i>(annualized)</i>	0.43%	2.41%	3.88%					
FUNDS OF FUNDS	Total Equity Fund <i>(61.3% Domestic Large Cap, 15.5% Domestic Small Cap, 23.2% International)</i>	-23.19%	-39.66%	-7.99%	-4.00%	-4.11%	3.2%	\$7.3631	\$306.5M
	S&P 500 Index	-21.94%	-37.00%	-8.36%	-2.19%	-1.39%			
	Conservative Balanced Fund <i>(Inception 01/01/06)</i> <i>(35.8% Equity, 64.2% Fixed-Income)</i>	-6.31%	-14.68%	N/A	N/A	N/A	4.4%	\$8.8368	\$1.3M
	Policy Index (35% S&P 500, 65% BGC)	-4.09%	-11.17%						
	Moderate Balanced Fund <i>(60.4% Equity, 39.6% Fixed-Income)</i>	-12.28%	-24.54%	-3.48%	0.24%	1.13%	4.0%	\$6.2526	\$295.0M
	Policy Index (60% S&P 500, 40% BGC)	-11.21%	-21.91%	-2.71%	0.72%	1.70%			
	Aggressive Balanced Fund <i>(Inception 01/01/06)</i> <i>(75.4% Equity, 24.6% Fixed-Income)</i>	-16.31%	-30.53%	N/A	N/A	N/A	3.7%	\$7.8065	\$7.4M
	Policy Index (75% S&P 500, 25% BGC)	-15.33%	-27.86%						



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