

Selecting the right investments for your endowment

The world of investment alternatives has exploded in the last decade or two. With the popularity of mutual funds, new U.S. Treasury instruments, indexed investing and online trading (just to mention a few), many of those entrusted with the management of endowment funds feel overwhelmed by the array of options — and increasingly concerned about the best strategies for their organizations. To make good choices, organizations need to assess their unique concerns and needs, then compare the most appropriate investment alternatives for their situation.

The United Church Foundation can help.

Consideration 1: Endowments can live for centuries

Across the United Church of Christ, many churches and organizations are reaping the benefits of contributions made 50, 100, even 200 years ago — evidence that an endowment lives as a legacy not only to members' faithfulness, but to the church or organization's importance in the life of its community: past, present and future. Because of the indefinite — and therefore *very* long-term — nature of an endowment, the investment strategy created for an endowment must be considered differently from the strategy an individual would employ.

When an individual creates an investment portfolio, s/he is generally building toward retirement: able to assume more risk for greater growth during the early earning years, reducing risk as retirement approaches, and investing primarily for income as retirement arrives and continues. But because an endowment usually has no financial “end time” for which to plan, most organizations choose a *growth*-oriented investment strategy — and the stock market, on average, has increased at an annual rate of more than 11% since 1925. An investment strategy adopted for an endowment, therefore, need not concern itself greatly with month-to-month — even year-to-year — market volatility, as its time horizon remains indefinite.

Consideration 2: Good stewardship claims a high priority

The old adage, “spend the interest, never the principal,” no longer applies to most modern investors. Inflation eats away at the value of “principal” invested in a bank or fixed-rate savings instrument, while the opportunity to make significant gains in portfolio value is lost when investments are selected only with an eye to risk avoidance or cash return (known as *yield* from dividends and interest). As Jesus' Parable of the Good and Faithful Servants¹ illustrates, good stewardship includes the selection of investments that makes the most of the gifts with which we have been entrusted, even when investing involves some risk.

When determining how to invest endowment funds and other long-term savings, an organization must consider a number of variables: its return requirements, risk tolerance, liquidity concerns, management and transaction costs, and more. The array of available investment options, however, can overwhelm even the most savvy investor. Fortunately, most of the investments considered by churches to be appropriate for endowments can be grouped into just a few categories.

¹ Matthew 25:14-30, also known as the Parable of the Talents.

Comparing Alternatives for Investment

Although many options exist in the investment world, most churches and related organizations choose from the following categories. The chart below outlines the major features and characteristics of these different investment and management alternatives. As part of its ministry to the United Church of Christ, the United Church Foundation works with UCC organizations as they consider the issues related to their individual investment strategies, and as they develop investment policies to guide future decision-making.

INVESTMENT TYPE	BANK INSTRUMENTS	DEDICATED PORTFOLIO	PUBLIC MUTUAL FUNDS	UNITED CHURCH FOUNDATION COMMON INVESTMENT FUNDS
<p>FEATURES</p>	<p>Most local banks offer a range of savings choices.</p> <p>Interest rates vary depending on the amount invested and the length of time funds are committed.</p> <p><i>Certificates of Deposit (CD)</i> <i>Money Market Accounts</i> <i>Interest-bearing Checking</i> <i>Passbook Savings</i></p>	<p>With the advice of a broker, investment consultant or committee, a portfolio is constructed in accordance with the organization's objectives and limitations.</p> <p><i>Equity (stock)</i> Investors become "owners" of a company, and are often paid a percentage of profits (dividends) for each share.</p> <p><i>Fixed Income (bonds, debt)</i> Investors become creditors (lenders) to a company or government, and are paid interest on their "loan."</p>	<p>Instead of purchasing individual stocks and/or bonds, investors purchase shares/units in a very large, professionally managed portfolio and share in the growth or decline of the overall portfolio. Most mutual funds are part of a "fund family" that offers investors a selection of options among which they may distribute and shift their investments.</p>	<p>The UCF's Common Investment Funds function similarly to mutual funds, but are available only to organizations associated with the United Church of Christ. Actively managed for Total Return by a team of investment professionals, the funds offer broad diversification in a conservative style.</p> <p><i>UCF Equity Fund</i> Primarily invested in the stock of large U.S. corporations, the Equity Fund reflects the S&P500 with the addition of a small international portfolio (currently less than 10% of the total portfolio).</p> <p><i>UCF Fixed-Income Fund</i> Managed for Total Return, this fund owns U.S. Treasury and agency notes, as well as quality corporate and foreign bonds.</p> <p><i>UCF Balanced Fund</i> Owning shares in both the Equity and Fixed-Income funds, the Balanced Fund gives investors a position in both "sides" of the market.</p> <p><i>UCF Cash & Equivalent Fund (C&E)</i> For short-term needs, this fund invests in money markets, commercial paper and the like.</p>

TIME HORIZON & LIQUIDITY	<p>Short-term.</p> <p>Liquid (with the exception of long-term CDs).</p>	<p>Generally long-term (five years or more).</p> <p>Publicly-traded investments are liquid.</p>	<p>Generally long-term (five years or more).</p> <p>Public funds are liquid.</p>	<p>Long-term (C&E: short-term)</p> <p>Funds are available, if needed, on the first of the month (C&E: funds available at any time).</p>
COST	<p>Fees vary, though some accounts are free.</p>	<p>Varies; usually \pm 1-2% annually of the market value of the portfolio.</p>	<p>Varies widely; usually 1-5%, 12b-1 costs, and various transaction fees for changes, checks, etc.</p>	<p>Annual: currently .20% (20 basis points) of market value, charged monthly against investment income.</p>
ADVANTAGES	<p>Funds can usually be withdrawn quickly (liquidity).</p> <p>Some accounts offer checking privileges.</p> <p>CDs and some other accounts are available at no cost.</p> <p>Insured by the FDIC up to \$100,000.</p>	<p>Investors may select exactly the companies and/or industries in which they want to invest, and the manner in which they want assets to be allocated.</p> <p>Equity investments offer a hedge against inflation.</p>	<p>A huge number of funds are available, with everything from broadly diversified to highly specific options.</p> <p>Funds are valued daily, and most values are published in newspapers.</p> <p>Funds and their managers are often reviewed by the financial media.</p> <p>Equity investments offer a hedge against inflation.</p> <p>Investors are insured by the Securities Investors Protection Corporation (SIPC) against errors and fraud.</p>	<p>Investors may shift money freely among UCF funds.</p> <p>UCF funds are managed according to social responsibility guidelines.</p> <p>Withdrawals from an account may be made monthly.</p> <p>Additional investments may be made at any time.</p> <p>Equity investments offer a hedge against inflation.</p> <p>Investors are insured against errors and fraud.</p>
DRAWBACKS	<p>Rates are generally low, with no growth potential (except compounding).</p> <p>No inflation hedge.</p> <p>Penalties incurred when funds are withdrawn early (CDs).</p>	<p>Unless an organization has a large amount to invest, the portfolio may not be well-diversified.</p> <p>Performance is dependent on the skill and expertise of the individual portfolio manager or committee.</p> <p>Management by an internal committee or group member may lead to conflicts, including conflicts of interest.</p>	<p>Selection and monitoring of appropriate funds can create a challenge for organizations and investment committees.</p> <p>Transaction fees can raise the overall cost of investment in a mutual fund.</p>	<p>At present, funds are valued monthly, limiting withdrawals to the first of each month.</p>
RISK & REWARD	<p>Very low risk with commensurate returns. Principal value can be eroded by inflation.</p>	<p>Equities tend to be more volatile than fixed-income investments, but generally offer higher returns. The quality of portfolio management, individual investment selection and diversification play major roles in overall risk and reward potential.</p>	<p>Depending on the fund type, mutual funds generally offer investors good diversification, which mitigates risk. The skill of the fund manager plays a major role in a particular fund's overall risk and reward potential.</p>	<p>Equities offer greater opportunity for return, but are also more volatile than fixed-income investments. The UCF funds are broadly diversified and conservatively managed, with dual goals of capital preservation and growth.</p>

Consideration 3: Investment selection makes a big difference

When carefully selected, equities (stocks) perform well over the long-term, tending to grow in value — even more quickly when income is reinvested. An organization can invest in a well-diversified manner, then enjoy the fruits of its investment in the marketplace by claiming a portion of the increase in value (the capital gain) as income available for mission and ministry. With a Total Return-based Spending Policy in place, most investors see spendable income increase over time while their portfolios continue to grow. As the chart below illustrates, a diversified portfolio of well-chosen investments that includes equities can both protect an endowment against the effects of inflation and provide more money for ministry over the long term.

Bank Certificate of Deposit							
Bal ance on...	Principal on Jan 1	Average Annual Return ²	Principal on Dec 31	Income Withdrawn ³	Rate of Inflation ⁴	Inflation-Adjusted Income	Inflation-Adjusted Principal
01-Jan-90	100,000	5.3%	105,300	5,300	3.1%	5,136	96,900
01-Jan-91	100,000	5.3%	105,300	5,300	3.1%	4,976	93,896
01-Jan-92	100,000	5.3%	105,300	5,300	3.1%	4,822	90,985
01-Jan-93	100,000	5.3%	105,300	5,300	3.1%	4,673	88,165
01-Jan-94	100,000	5.3%	105,300	5,300	3.1%	4,528	85,432
01-Jan-95	100,000	5.3%	105,300	5,300	3.1%	4,388	82,783
01-Jan-96	100,000	5.3%	105,300	5,300	3.1%	4,252	80,217
01-Jan-97	100,000	5.3%	105,300	5,300	3.1%	4,120	77,730
01-Jan-98	100,000	5.3%	105,300	5,300	3.1%	3,992	75,321
01-Jan-99	100,000	5.3%	105,300	5,300	3.1%	3,868	72,986
01-Jan-00	\$ 100,000		TOTAL	\$ 53,000	Total	\$ 44,754	\$ 72,986

United Church Foundation Balanced Fund							
Bal ance on...	Principal on Jan 1	Total Return	Principal on Dec 31	Income Withdrawn ³	Rate of Inflation ⁴	Inflation-Adjusted Income	Inflation-Adjusted Principal
01-Jan-90	100,000	-0.07%	99,930	4,997	3.1%	4,842	91,991
01-Jan-91	94,934	26.27%	119,873	5,495	3.1%	5,132	108,172
01-Jan-92	114,377	10.83%	126,765	5,776	3.1%	5,278	111,256
01-Jan-93	120,988	10.90%	134,176	6,347	3.1%	5,656	114,278
01-Jan-94	127,829	-3.48%	123,381	6,405	3.1%	5,538	101,220
01-Jan-95	116,975	26.99%	148,547	6,768	3.1%	5,682	119,720
01-Jan-96	141,779	13.76%	161,287	7,220	3.1%	5,890	126,592
01-Jan-97	154,067	21.79%	187,638	8,291	3.1%	6,609	143,642
01-Jan-98	179,347	19.64%	214,571	9,392	3.1%	7,294	160,107
01-Jan-99	205,179	11.36%	228,488	10,512	3.1%	7,951	165,380
01-Jan-00	\$ 217,976		TOTAL	\$ 71,203	TOTAL	\$ 59,873	\$ 165,380

Let the United Church Foundation assist your organization

Through its Common Investment Funds, the United Church Foundation offers proven, professional investment management to the churches and related organizations of the United Church of Christ — at very low cost and with no minimum investment. Investors maintain control over their assets, able to make deposit to accounts, withdraw funds as needed, or move assets among the Foundation's funds.

The Foundation also serves UCC organizations by providing educational materials, conducting workshops, facilitating discussions, and meeting with designated groups and church members in response to specific questions or needs. In cooperation with other groups within the United Church of Christ, the United Church Foundation can also help churches develop formal investment and endowment policies that will guide both present and future generations of church leaders.

Jesus' parable of The Good and Faithful Servants illustrates God's call to invest wisely and well, to maximize the potential of the money entrusted to us for the benefit of God's work in the world.

Make the most of your organization's gifts — call the United Church Foundation today.

² Historic average compounded return of long-term government bonds (1925-1998). Source: Ibbotson Associates. Because long-term bonds and Certificates of Deposit (CDs) both earn income at a fixed rate, the long-term bond rate has been used here for the sake of illustration.

³ Assumes reinvestment and withdrawal of 5% of the 3-year year-end average market value.

⁴ Historic average rate of inflation (1925-1998). Source: Ibbotson Associates. "Inflation-adjusted principal" reflects value net of income.