

Understanding the benefits of Total Return

For generations investors have been taught,

Spend the interest.

Never touch the principal.

When savings were invested primarily in banks, such a philosophy worked well. Even as the American stock market was born and more and more investments moved from banks to “the market,” the accepted wisdom still made sense.

But here at the dawn of the 21st century, investing has changed. Banks no longer offer the best — or even the safest — returns. And the most significant gains in the stock and bond markets are often not in cash distributions. Even an investment return as high as 25% often yields less than 2% in cash to an investor — not much spending power for a church or organization seeking to make an impact in its community.

But a Total Return policy for your investments can help.

Good stewardship requires a wise investment strategy

As Jesus’ parable of The Good and Faithful Servants¹ clearly teaches, caring for the gifts God has entrusted to us means more than simply keeping those gifts safe from possible danger. When considering how to invest the gift of an endowment, a church or organization must consider opportunities that, while perhaps involving some risk, nevertheless offer a reasonable expectation of growth. Even with its occasional volatility, the stock market continues to offer investors the greatest opportunities for significant returns on their investments. Consider this:

*If someone had invested \$1 for you back in 1925,
how much do you think your investment would now be worth?²*

If your benefactor had invested that dollar in long-term government bonds, your portfolio would be worth about \$44. Long-term bonds have earned an average annual return of 5.3% since 1925 — somewhat above the average inflation rate of 3.1%.

However, if that dollar had been invested in the stock of large companies, your investment would be worth \$2,351 — an average annual return of 11.2%!

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

² Figures as of year-end 1998, assuming income reinvestment and compounding. 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; had CDs been available since 1925, the results would have been similar.

Total Return Investment Policy

Maximizing a portfolio's growth potential

How did that \$1 invested in stocks become worth an extra \$2,300 over fixed-income investments? From the increase in the value over time, thanks to income compounding and capital gain. A Total Return Investment Policy permits assets to be invested without regard to direct cash distributions such as dividends or interest, keeping the focus on growth in the overall value of the portfolio.

You can easily see the advantage of a Total Return Investment Policy — the modern standard for the investment industry — when you consider Microsoft Corporation. Microsoft has never paid a dividend, though thousands of investors have become wealthy thanks to the significant increase in value that the corporation's stock saw in the 1990s. Many investors — believing they should spend only “interest” or other cash distributions (known as *yield*) — chose not to invest in Microsoft and paid a high cost in lost opportunity! Other corporations have begun to consider following Microsoft's example, decreasing or eliminating dividend payments as investors seek the advantages of overall portfolio growth.

But a Total Return Investment Policy offers additional benefits to churches and other organizations. Unencumbered by the limits of cash-return investing, organizations can invest in a manner that is more diversified and often more profitable. A more diversified portfolio tends to enjoy greater stability and ongoing growth potential, as its investments include an array of companies and industries representing all facets of the economic and business cycles.

The Equity, Fixed-Income and Balanced Funds of the United Church Foundation are all invested for Total Return — each portfolio managed to achieve the greatest possible return whether from income or capital gain. Over a long period of time, such a policy will generate *more* growth and income.

But to take full advantage of a Total Return Investment Policy, many organizations couple their investment strategy with a Total Return-based Spending Policy. As part of its service to the United Church of Christ, the Foundation assists UCC churches and organizations in considering the best investment strategies and policies for their endowments and other assets.

Spending Policy based on Total Return

Freeing more money for ministry

To benefit fully from a Total Return Investment Policy, investors often adopt a Spending Policy based on Total Return, which considers capital gain a part of total income. Because the only way to enjoy the spending benefit of a stock's increase in value (the capital gain) is to sell the stock, a Total Return-based Spending Policy establishes a set of guidelines that allows a church or organization periodically to sell a small percentage of its total portfolio, while protecting the investment's overall value.

Different from spending the “principal,” withdrawing a portion of the portfolio to take advantage of the capital gain increases the spending power of the investment while maintaining the value of the original principal (inflation-adjusted) (*see chart at left*). To ensure that the value of the portfolio does not erode over time, despite inflation and the inevitable down cycles of the market, a Total Return-based Spending Policy generally calculates an annual redemption (or sale) rate of three to six percent against a three- to five-year “rolling average” of the portfolio's total market value.³ Even with such a spending policy in place, most well-balanced portfolios continue to increase in value over time. And as the portfolio value grows, the spending amount available each year will continue to grow as well.

Pooled investments, like mutual funds or the Foundation's Common Investment Funds, are especially well-suited to a Total Return-based Spending Policy, as redemptions are made from units (or shares) of the *entire* portfolio rather than from the liquidation of particular issues of stocks or bonds. Churches and organizations that invest with the Foundation may withdraw funds from their accounts on either a regular basis or as needed, simply by sending a letter of instruction.

Coupled with a Total Return Investment Policy, a Spending Policy based on Total Return allows an organization's portfolio to remain well-diversified and positioned for continuing growth, while generating more cash from investments to enhance mission and ministry.

³ The appropriate percentage varies depending on the mix of equity and fixed-income investments.

Comparing Income Alternatives

The following chart compares an investment of \$100,000 in the United Church Foundation Balanced Fund: first, with income (yield) withdrawn as earned rather than reinvested; second, with income reinvested and drawn according to a Total Return-based Spending Policy that permits an annual redemption of five percent (5%) of the three-year average market value.

| UCF Balanced Fund: income received | | | | | |
|------------------------------------|---------------------|------------------|-----------------|-----------------|----------------------|
| Bal ance on... | Pr incipal on Jan 1 | Change in Val ue | Cur rent Yiel d | Income Received | Pr incipal on Dec 31 |
| 01-Jan-90 | 100,000 | -5.67% | 5.6% | 5,600 | 94,330 |
| 01-Jan-91 | 94,330 | 19.87% | 6.4% | 6,037 | 113,073 |
| 01-Jan-92 | 113,073 | 5.33% | 5.5% | 6,219 | 119,100 |
| 01-Jan-93 | 119,100 | 5.90% | 5.0% | 5,955 | 126,127 |
| 01-Jan-94 | 126,127 | -8.08% | 4.6% | 5,802 | 115,936 |
| 01-Jan-95 | 115,936 | 21.69% | 5.3% | 6,145 | 141,083 |
| 01-Jan-96 | 141,083 | 9.26% | 4.5% | 6,349 | 154,147 |
| 01-Jan-97 | 154,147 | 17.49% | 4.3% | 6,628 | 181,107 |
| 01-Jan-98 | 181,107 | 15.74% | 3.9% | 7,063 | 209,613 |
| 01-Jan-99 | 209,613 | 7.86% | 3.5% | 7,336 | 226,089 |
| 01-Jan-00 | \$ 218,752 | | TOTAL | \$ 63,134 | |

| UCF Balanced Fund: reinvestment, 5% spending policy | | | | |
|---|---------------------|--------------|----------------------|------------------|
| Bal ance on... | Pr incipal on Jan 1 | Total Return | Pr incipal on Dec 31 | Income Withdrawn |
| 01-Jan-90 | 100,000 | -0.07% | 99,930 | 4,997 |
| 01-Jan-91 | 94,934 | 26.27% | 119,873 | 5,495 |
| 01-Jan-92 | 114,377 | 10.83% | 126,765 | 5,776 |
| 01-Jan-93 | 120,988 | 10.90% | 134,176 | 6,347 |
| 01-Jan-94 | 127,829 | -3.48% | 123,381 | 6,405 |
| 01-Jan-95 | 116,975 | 26.99% | 148,547 | 6,768 |
| 01-Jan-96 | 141,779 | 13.76% | 161,287 | 7,220 |
| 01-Jan-97 | 154,067 | 21.79% | 187,638 | 8,291 |
| 01-Jan-98 | 179,347 | 19.64% | 214,571 | 9,392 |
| 01-Jan-99 | 205,179 | 11.36% | 228,488 | 10,512 |
| 01-Jan-00 | \$ 217,976 | | TOTAL | \$ 71,203 |

Call the United Church Foundation for more information

Making the move to Total Return usually involves a series of informational meetings: with investment and endowment committee members, with the congregation's governing body, and perhaps with the congregation itself. In most UCC churches, a vote by the congregation is needed to approve the necessary changes to existing policies or to authorize new policies.

The United Church Foundation can help by providing educational materials and sample policies, by conducting workshops and facilitating discussions, and by meeting with designated groups and church members. The Foundation can also help churches develop formal investment policies that will guide 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 church's gifts — call the United Church Foundation today.