



THE  
**ELCA**  
FOUNDATION

# ELCA ENDOWMENT FUND POOLED TRUST — FUND A

THIRD QUARTER 2007 REPORT

## Purpose-driven endowment funds

### The Rev. Rodger Prois

*Director of Mission Advancement*  
ELCA World Hunger Appeal

Do you remember how or why your endowment fund was created? In my experience it is often because someone had made a gift, usually through a bequest, to a congregation. The leadership of the congregation then identified individuals who were willing to serve on a board or committee to determine how those funds were to be deposited and distributed.

Today, many congregational leaders are realizing that a mission endowment fund could be a great service to their active members. A congregational mission endowment fund offers members a unique opportunity to make gifts in support of their local congregational ministries and, at the same time, retain some ability to advise how the endowment funds are used.

Recently, I worked with a few congregations that are moving to this next step. They are thinking through the giving history of the congregation, establishing an endowment fund with a defined purpose and encouraging people to give based on identified benevolent goals. This process allows the endowment committee to develop an open process for funding ministries that invites donors or their heirs to be part of the deciding body. These congregations not only are receiving gifts, they are spreading the story of each ministry as well.

One congregation in America's heartland has, as part of its DNA, a compassion for the hungry of the world. For decades it participated in the local food pantry, served free community meals and held fundraisers for the ELCA World Hunger Appeal. Its endowment group observed this pattern

and decided these ministries would receive distributions from its mission endowment fund, assuring it of financial support for years to come. The group informed the congregation of this decision and the people responded, connecting with Jesus' admonition to "go and do likewise."

Encourage your endowment team to lift up the "why" of your fund. Your ELCA Foundation Regional Gift Planner is willing and ready to help you think through this. Our nationwide network of knowledgeable staff can also share with you many types of ministries within your own area or throughout the church, which will give purpose to your work. To locate an ELCA Foundation Regional Gift Planner near you, see Page 7.

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## Fund A — Third quarter 2007 performance

**To help you understand the “drivers” of Fund A’s overall performance return, every quarter we provide you with market context for each asset class within Fund A.**

### SAILING THROUGH UNCERTAINTY

**Heather H. Williamson, CFA**

*Senior Investment Manager, ELCA Board of Pensions*

During the third quarter, Fund A returned 2.6 percent versus its benchmark return of 2.2 percent. Fund A also remains ahead of its benchmark in the one-, three- and five-year periods (gross of fees). Year-to-date in 2007, each asset category within Fund A has been positive (with the exception of real estate securities), but a great deal of volatility has been experienced on a month-to-month basis.

Most people prefer certainty over uncertainty, particularly when the assets are invested to support critical mission. However, much of our certainty “barometer” is driven by our emotions rather than by what we know to be true. This may explain why many of us have felt increasingly uneasy in response to recent market fluctuations. During the third quarter many areas of the market eroded as consumer confidence declined, the dollar devalued, oil prices rose and remained high, residential real estate continued to slow and credit markets experienced turmoil. Meanwhile, the Federal Reserve Board decided to cut short-term interest rates by 0.5 percent in September, just a month after restating that inflation was a primary risk. In light of these events, I find it helpful to anchor myself to what I know rather than what I assume or feel.

This balance between certainty (what we know) and uncertainty (as an emotional response to what we don’t know) reminds me of sailing. As a teenager, I was lucky to have friends who frequently took me sailing. I found sailing to be relaxing and yet thrilling. You need a few rudimentary things in order to sail. You need a boat, some working knowledge of the physics of sailing and wind (but

not too much!). Even with these basic elements, a lot of uncertainty is involved. Wind is rarely steady, and it comes in gusts, surging you forward, or leaves you languid for periods of time. There is nothing more thrilling and unnerving than watching for a gust of wind and feeling the boat pull forward, then heel to the side as it cuts through the water.

Fortunately, sailors have both knowledge and tools to help them keep the boat upright and moving forward. A heavy keel ensures the boat will not tip, and wind gusts can be anticipated by watching “tell-tales” on the sails or ripples on the water. A good sailor can watch these signs and — while the ultimate outcome is unknown — set her sail and riggings to anticipate the most likely strength and direction of the wind.

Investing mission endowment funds is similar. No one knows where the markets are headed, or how thousands of small global economic signals will combine to cause specific market reactions. Luckily, the ELCA Foundation and ELCA Board of Pensions have developed some great tools. We are here to provide the vehicle (Fund A) and ballast (professional knowledge) needed to prudently invest endowment assets on your organization’s behalf. We invest based on core beliefs and learnings that have withstood the tests of time.

Investing is like sailing: no one can predict a good or bad day, and the wind is rarely steady or in one direction. In managing Fund A, we focus on what can be reasonably predicted and controlled. Fund A is designed to support your long-term goals of investing for mission — while we watch the water and tell-tales on your behalf.



## FUND A PORTFOLIO MARKET VALUE

As of Sept. 30, 2007, Fund A had investments of approximately \$349 million:

- \$175 million in the U.S. equity component
- \$68 million in the investment-grade, fixed-income component
- \$34 million in the high-yield, fixed-income component
- \$54 million in the non-U.S. equity component
- \$17 million in real estate securities
- \$1 million accruals and other

### FUND A PERFORMANCE AS OF SEPT. 30, 2007

		THIRD QUARTER (%)	ONE YEAR (%)	FIVE YEARS (%)
Total Fund A <sup>1</sup>		2.6	14.8	14.1
Fund A benchmark <i>(Russell 3000 Index 50%, MSCI All Country World (Ex-U.S.) Index 15%, Citigroup High-Yield Cash-Pay Capped Index 10%, Citigroup Broad Investment Grade Index 20%, Dow Jones Wilshire Real Estate Securities Index 5%)</i>		2.2	14.2	14.0
EQUITIES	Fund A U.S. equity portfolio <sup>1</sup>	2.3	16.8	16.1
	U.S. equity benchmark <i>(Russell 3000 Index)</i>	1.6	16.5	16.2
	Fund A non-U.S. equity portfolio <sup>1</sup>	4.8	33.0	N/A <sup>2</sup>
	Non-U.S. equity benchmark <i>(MSCI All Country World (Ex-U.S.) Index)</i>	4.6	30.5	25.8
HIGH-YIELD	Fund A high-yield portfolio <sup>1</sup>	1.1	8.2	N/A <sup>2</sup>
	High-yield benchmark <i>(Citigroup High-Yield Cash-Pay Capped Index)</i>	0.6	7.5	12.5
FIXED-INCOME	Fund A fixed-income portfolio <sup>1</sup>	2.9	5.4	4.6
	Fixed-income benchmark <i>(Citigroup Broad Investment Grade Index)</i>	3.0	5.3	4.2
REAL ESTATE SECURITIES	Fund A real estate securities portfolio <sup>1</sup>	2.1	4.5	N/A <sup>2</sup>
	Real estate securities benchmark <i>(Dow Jones Wilshire Real Estate Securities Index)</i>	1.4	3.8	22.1

1. All returns are before the deduction of fees. Fees are  $\frac{1}{12}$  of 1 percent per month. All returns for periods greater than one year are annualized. Past performance does not guarantee future results.

2. This portfolio became a component of Fund A less than five years ago, so a five-year return is unavailable.



## U.S. EQUITIES MARKET REVIEW

**Steve Dixon, CFA**

*Senior Investment Analyst, ELCA Board of Pensions*

The U.S. equity component of Fund A returned 2.3 percent during the third quarter, well ahead of the benchmark return of 1.6 percent. The primary contributor to the U.S. equity component's outperformance was its allocation to large-cap growth stocks, which returned 6.9 percent (compared to 4.2 percent for the large-cap Russell 1000 Growth Index).

U.S. equities languished early in the third quarter amid accelerated residential mortgage foreclosures and a significant reduction in market liquidity. Attempting to increase market liquidity, the Federal Reserve Board unexpectedly reduced the discount rate in mid-August. The Federal Reserve's action was well received by U.S. equity investors. One month later, the Federal Reserve lowered the Federal Funds Target Rate and cut the discount rate again. U.S. equity prices surged nearly 3 percent on news of the short-term interest rate reductions.

## NON-U.S. EQUITIES MARKET REVIEW

**Josh Stieler, CFA**

*Senior Investment Analyst, ELCA Board of Pensions*

Fund A's non-U.S. equity component returned 4.8 percent in the third quarter, outperforming the benchmark return of 4.6 percent. The growth manager delivered strong results, offsetting slight underperformance by the core and value managers.

During the quarter emerging markets continued to outperform, returning 14.5 percent versus 2.7 percent for developed markets. China and India led the way, returning 41.9 percent and 20.2 percent, respectively. While value stocks slightly outperformed in the emerging markets, growth stocks continued to surpass value stocks in developed markets.

After a relatively stable second quarter, volatility returned for both developed and emerging markets in the third quarter. In August, concerns over tightening of global credit and the U.S. housing market drove equity prices lower. Markets recovered in September, reacting positively to the U.S. Federal Reserve Board's short-term interest rate cut.

Meanwhile, a weak U.S. dollar significantly benefited Fund A's U.S.-dollar-based participants. Dollar-based returns were 4.4 percent above local currency returns, representing the largest quarterly differential since 2005.

## FIXED-INCOME MARKET REVIEW

**Mark Haney, CFA**

*Senior Investment Manager, ELCA Board of Pensions*

For the third quarter, Fund A's fixed-income portfolio slightly underperformed its benchmark, returning 2.9 percent versus the benchmark return of 3.0 percent.

In a surprising move, the Federal Reserve Board responded to the mounting credit crisis by lowering the Federal Funds interest rate by 0.5 percent on Sept. 18, the first time it has moved more than 0.25 percent in five years. The effects of the rapidly slowing housing market first became evident in the sub-prime debt markets. Then all credit markets became affected, from high-yield to money markets, resulting in wider spreads and increased volatility across the board. The Federal Reserve's decisive move to lower rates was followed by strengthening markets for both debt and equities. However, housing and certain mortgage markets continue to struggle.

The Federal Reserve's interest rate cut caused a strong move in Treasury rates. The two-year rate was 0.8 percent lower by quarter's end, and the 30-year was lower by 0.3 percent. For the quarter, government bonds, returning 3.7 percent, performed best due to a high demand for quality. The mortgage sector, made up largely of high-quality agency mortgage pass-through bonds, followed with a 2.9 percent return. Meanwhile, the corporate sector returned 2.3 percent.



## REAL ESTATE SECURITIES MARKET REVIEW

**David Quello, CFA**

*Investment Manager, ELCA Board of Pensions*

Fund A's real estate securities component returned 2.1 percent for the quarter, compared to the benchmark return of 1.4 percent. The portfolio outperformed its benchmark largely due to good security selection (though performance was partially offset by an overweight in the office sector, which underperformed the overall index).

Real estate securities experienced a volatile quarter as the index fell over 7 percent in July and rebounded sharply in August and September, resulting in a slightly positive return for the quarter. Retail properties had the highest returns, while the office and hotel sectors lagged the index. Underlying real estate fundamentals remain quite solid for most property types, and future prospects for the real estate securities market should be closely tied to U.S. economic growth.

## HIGH-YIELD MARKET REVIEW

**Mark Haney, CFA**

*Senior Investment Manager, ELCA Board of Pensions*

For the third quarter, the high-yield bond component of Fund A returned 1.1 percent, outperforming its benchmark return of 0.6 percent.

The sub-prime mortgage and credit crunch took a huge toll on the high-yield market in the third quarter. By the end of the quarter, investors required a risk premium almost a full percentage point higher than was necessary when the quarter began. Though interest rates rallied, high yield returned only 0.6 percent (as measured by the Citigroup High-Yield Cash-Pay Capped Index), compared to the return on government securities of 3.7 percent. High-yield valuations are now much closer to historical averages, with a risk premium, or spread, over Treasuries of 4.3 percent versus the long-term average of 4.6 percent.

Industry segments performed within a narrow range. Not surprisingly, the stand-out industry was home builders, down 13.9 percent for the quarter.

## ELCA FOUNDATION PARTNERSHIP WITH ELCA BOARD OF PENSIONS

The ELCA Board of Pensions serves as investment adviser for the ELCA Foundation's two main investment funds — the ELCA Endowment Fund Pooled Trust and the Charitable Gift Annuity Reserve.

Attractive long-term investment returns allow congregations and beneficiary ministries to further their mission efforts. The Board of Pensions, as the ELCA's lifetime source of health, retirement and other benefits and related services, supports the ELCA Foundation's efforts to help strengthen the mission and benevolence of this church.

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## SOCIAL PURPOSE INVESTING IN FUND A

Fund A — a social purpose fund — is managed by the ELCA Foundation’s investment adviser, the Board of Pensions, in a manner designed to achieve attractive long-term returns for Fund A investors while considering the corporate social responsibility work of the ELCA.

### Fund A’s social purpose program uses three strategies

The overarching investment goal for Fund A is to achieve economic success for investors while considering the corporate social responsibility work of the ELCA. The Board of Pensions uses a three-pronged approach for addressing social and corporate governance issues:

- 1 Positive social investments** — These investments positively benefit communities while earning acceptable returns for Fund A investors.
- 2 Shareholder advocacy** — The Board of Pensions votes proxies, initiates shareholder resolutions and engages in corporate dialogue to motivate corporate leaders to act in the best interests of shareholders (i.e., Fund A investors).
- 3 Social screening** — Social screening prohibits new investments in certain companies whose business practices don’t meet the ELCA’s corporate social criteria.

### Fund A supports positive change

Positive social investing provides a proactive way for Fund A investors to receive market-rate returns on investments that channel capital to underserved markets. Typical investments may include securitized loans to promote community development, sustainable forestry, women- and minority-owned businesses and renewable energy.

### Shareholder advocacy supports shareholders

Through shareholder advocacy the Board of Pensions works to motivate corporate leaders to act in the best interests of shareholders. These shareholder advocacy efforts include three components:

- **Proxy voting** — The Board of Pensions takes seriously its fiduciary responsibility to vote proxies. All proxy voting decisions are made solely in the best interests of investors and for the purpose of maximizing the economic value of the company involved.

- **Dialogues** — Dialogue involves meeting face to face with corporate leaders. This method of interacting with companies is effective because it helps corporate decision makers understand why a proposed change has been requested. The Board of Pensions works in cooperation with other areas of this church to engage companies in dialogue.
- **Shareholder resolutions** — If a company does not respond favorably to dialogue, the Board of Pensions may file a shareholder resolution. Shareholder resolutions appear on proxy ballots prior to a corporation’s annual meeting, giving every shareholder the opportunity to vote on a proposed change.

These efforts reflect a fiduciary responsibility to maximize value for Fund A investors.

### Social screens support church values

Each year, investment managers for screened portfolios receive a list of companies that may not be purchased for the fund due to business practices that conflict with the ELCA’s corporate social criteria. Companies may appear on the list if they engage in aspects of these businesses:

- harmful products or services like tobacco, distilled alcohol, pornography or gambling
- those that research and develop nuclear, biological or chemical weapons; or manage U.S. government-owned facilities for such weapons
- those with significant toxic waste releases, hazardous waste sites, and environmental penalties or liabilities; and major producers of toxic chemicals

In collaboration with its social criteria consultant — KLD Research & Analytics Inc. — the Board of Pensions researches and evaluates thousands of companies in the process of determining which companies should appear on the list.



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The ELCA Foundation Regional Gift Planners are located in regional offices throughout the country. Call (800) 638-3522, ext. 2970 or visit [www.elca.org/fo](http://www.elca.org/fo) to find out more about how:

- your congregation or other ministry can establish an account in the Endowment Fund Pooled Trust
- you or a friend can leave a legacy for ministry
- you can establish contact with the Regional Gift Planner nearest you



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