



**ELCA Foundation**  
Evangelical Lutheran Church in America

# ELCA ENDOWMENT FUND POOLED TRUST — FUND A

SECOND QUARTER 2010 REPORT

## Changes to Endowment Fund Pooled Trust Fund A Strategic Asset Allocation go into effect this year

### Bonalynn Wallach

*Manager for Investments, ELCA Foundation*

The Endowment Fund Pooled Trust Fund A (Fund A) undergoes a formal strategic asset allocation (SAA) review every three years. The ELCA Board of Pensions (Fund A's investment advisor) and ELCA Foundation staff collaborated on the most recent analysis and recommendation. At the March 2010 ELCA Endowment Fund Board of Trustees meeting, a recommendation was presented and approved to change the SAA of Fund A, based on potential enhancements and further diversification. Implementation of the new asset allocation is targeted for the second half of 2010.

Based on the analysis, the recommendation further diversifies the fund by expanding the asset allocation to

include alternative equities and inflation-indexed bonds and increasing the exposure to non-U.S. equities and global real estate. To achieve this asset allocation, reductions will occur in the current U.S. equity and U.S. investment-grade bond holdings. The new allocation modestly improves the long-term potential return while lowering the long-term potential risk profile of Fund A and is consistent with meeting the objectives of Fund A as stated in the most recent disclosure statement.

These allocations were developed using the Board of Pensions' forward-looking asset class assumptions, Fund A's investment objectives, assumed constraints and magnitude of change from the current asset allocation.

The following chart shows the current and new Fund A asset allocation:

(continued on Page 4)

ASSET	CURRENT FUND A ALLOCATION (%)	NEW FUND A ALLOCATION (%)	SHIFT (%)
U.S. Stocks	50	30	-20
U.S. Bonds	20	15	-5
Non-U.S. Stocks	15	25	10
Inflation Indexed Bonds	0	5	5
High Yield Bonds	10	10	0
Global Real Estate Securities	5	10	5
Alternative Equities	0	5	5

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## Fund A — Second quarter 2010 performance

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

### MARKET COMMENTARY

**Heather H. Williamson, CFA**

*Senior Investment Manager, ELCA Board of Pensions*

### So many distractions; so little time

It was a very jittery quarter in the capital markets. The steady upward double-digit rise in the global stock markets that began in March 2009 ended abruptly during the second quarter of 2010 when volatility and a very healthy correction (defined as a stock market decline of roughly 10%) entered our consciousness.

Over the last several months, we have written that while a U.S. economic recovery seemed apparent, its sustainability, let alone future growth drivers have not been easy to spot. Debt crises tend to be particularly problematic to unwind. It is an exceedingly long process to make debt go away. It is somewhat easier to transfer the debt, and that is exactly what has happened. Private debt (that of both individuals and corporations) has been transferred to sovereign entities (e.g., the U.S. government). When a nation finds itself in crisis (e.g., Greece), further shifts occur — typically to other relatively more stable nations. Eventually, balance sheets should be normalized and debt burdens should come down, but it should be no surprise that this process has not played out fully at this time and as it does, there may be additional volatility like we’ve recently experienced.

The upward movements in the stock markets that began in March 2009 could not have been predicted with any more precision than the more recent downward movement. While fiduciary responsibilities over mission assets are crucial, we should not be lulled into thinking that we have any control or predictive power over the capital markets. Thoughtful investors constantly review the landscape, test assumptions and make changes where needed, but not for change’s sake.

While it is easy to be distracted by the capital market gyrations and feel like action is needed, in reality, we believe the most successful investors over the long term select an asset allocation that is appropriate for their time horizon and risk tolerance and remain exposed to a diverse set of asset categories. In this way, when markets turn quickly and unpredictably, asset class exposures are consistently maintained to take advantage of those that are moving upward while managing the magnitude of declines in those asset classes that may be falling.

The Endowment Fund Pooled Trust Fund A, with its objective of striving to provide for a stable, quarterly stream of distributions that grow over time approximately in line with long-term expected inflation, through diversification across and within asset classes and periodic rebalancing, may provide you the ability to grow your endowment and support mission, even in unpredictable environments.

### FUND A – SECOND QUARTER 2010 SUMMARY

As the global stock markets took a step back, so did Fund A, as it is designed to generally reflect the asset categories in which it is invested. U.S. and non-U.S. stock markets have decreased by 5% to 6% in the year-to-date period, while the investment-grade and high-yield bond markets have moved up by 4% to 5%.

During the second quarter, Fund A saw negative absolute returns with the Fund returning -7.56%, lagging the benchmark return of -7.09% gross of fees.



## FUND A PORTFOLIO MARKET VALUE<sup>1</sup>

As of June 30, 2010, Fund A had investments of approximately \$323.7 million:

- \$157.2 million in the U.S. equity component
- \$69.3 million in the investment-grade, fixed-income component

- \$34.7 million in the high-yield, fixed-income component
- \$45.6 million in the non-U.S. equity component
- \$16.8 million in global real estate securities

## FUND A INVESTMENT PORTFOLIO PERFORMANCE AS OF JUNE 30, 2010

		SECOND QUARTER (%)	YEAR-TO-DATE (%)	ONE YEAR (%)	FIVE YEARS (%)	10 YEARS (%)
Total Fund A <sup>2</sup>		-7.56	-3.49	16.31	2.87	3.11
Fund A benchmark <i>(Dow Jones Total Stock Market Index<sup>3</sup> 50%, MSCI All Country World (ex-U.S.) Index 15%, Citigroup High-Yield Cash-Pay Capped Index 10%, Custom Citigroup Index<sup>4</sup> 20%, Wilshire U.S. Real Estate Securities Index/Wilshire Ex-U.S. Real Estate Securities Index<sup>5</sup> 5%)</i>		-7.09	-2.98	16.21	2.29	2.14
EQUITIES	Fund A U.S. equity portfolio <sup>2</sup>	-11.75	-6.45	15.72	-0.06	0.24
	U.S. equity benchmark <i>(Total Stock Market Index<sup>3</sup>)</i>	-11.12	-5.64	16.13	-0.34	-0.85
	Fund A non-U.S. equity portfolio <sup>2</sup>	-12.91	-11.29	11.13	4.28	N/A <sup>6</sup>
	Non-U.S. equity benchmark <i>(MSCI All Country World (Ex-U.S.) Index)</i>	-12.45	-11.06	10.43	3.38	1.92
HIGH-YIELD	Fund A high-yield portfolio <sup>2</sup>	0.14	3.80	20.58	7.61	N/A <sup>6</sup>
	High-yield benchmark <i>(Citigroup High-Yield Cash-Pay Capped Index)</i>	0.23	4.05	24.67	6.43	7.31
FIXED-INCOME	Fund A fixed-income portfolio <sup>2</sup>	3.55	5.44	11.35	5.82	6.62
	Fixed-income benchmark <i>(Custom Citigroup Index<sup>4</sup>)</i>	3.47	5.19	9.71	5.87	6.66
GLOBAL REAL ESTATE SECURITIES	Fund A global real estate securities portfolio <sup>2</sup>	-6.79	-0.27	40.27	0.85	N/A <sup>6</sup>
	Real estate securities benchmark <i>(Wilshire U.S. Real Estate Securities Index and Wilshire Ex-U.S. Real Estate Securities Index<sup>5</sup>)</i>	-6.14	0.04	39.51	-0.99	9.82

NOTE: Past performance does not guarantee future results.

1. Total market value of Fund A is \$324.9 million. This total includes accrual, liabilities, deposits between monthly valuation dates and operating cash on which a total fee of one-twelfth of 1% is deducted monthly from each account.
2. Returns are before the deduction of fees.
3. The U.S. equity benchmark changed from the Russell 3000 to the Dow Jones Total Stock Market Index in November 2007.

4. The fixed-income benchmark changed from the Citigroup Broad Investment Grade to the Custom Citigroup Index in October 2007.
5. The Global Real Estate Securities Benchmark is a composite of 60% Wilshire U.S. Real Estate Securities Index and 40% Wilshire Ex-U.S. Real Estate Securities Index.
6. This portfolio became a component of Fund A less than 10 years ago, so a 10-year return is unavailable.



## U.S. EQUITIES MARKET REVIEW

**Josh Stieler, CFA**

*Assistant Investment Manager, ELCA Board of Pensions*

Fund A's U.S. equity component returned -11.8% in the second quarter, underperforming the benchmark return of -11.1%. Weak relative returns by the large-cap growth and large-cap value managers drove the underperformance.

Risk aversion returned to the markets as stocks fell sharply during the quarter. Although corporate earnings and balance sheets look generally strong, macro factors drove investor behavior. A number of issues are weighing on the market, including sovereign debt concerns in Europe, uncertainty around financial market regulation, the growth rate of the Chinese economy and the fallout from the oil spill in the Gulf of Mexico. This weakness in the equity markets drove up prices in areas typically seen as safe havens, such as gold and Treasury bonds.

Large-cap stocks trailed small- and mid-cap stocks for the quarter. Style was not a major driver of returns for the quarter.

## NON-U.S. EQUITIES MARKET REVIEW

**Josh Stieler, CFA**

*Assistant Investment Manager, ELCA Board of Pensions*

Funds A's non-U.S. equity component returned -13.0% for the quarter, compared to -12.5% for the benchmark. Negative relative returns by the value manager more than offset strength in the growth portfolio.

International equity markets suffered the same slide in investor confidence experienced in the U.S. markets.

### Changes to Endowment Fund ... (continued from Page 1)

Exposures of inflation-indexed bonds and alternative equities are obtained through investing in the Board of Pensions' Inflation-Indexed Bond Pool and Social Purpose Alternative Equity Pool. The addition of both new asset classes maintains the social purpose nature of the investments. Inflation-indexed bonds are issued by the

Europe continued to deal with the ramifications of sovereign debt concerns in a number of countries, including Greece, Spain and Portugal. Newly enacted austerity measures in these countries partially address the fiscal issues but threaten the already weak economic recovery by reducing government spending. Emerging markets continued to outperform developed markets, although returns were negative. A fall in non-gold commodity prices and concerns over the sustainability of China's growth rate drove the emerging market weakness.

Currency had a major impact on returns for U.S. investors. Dollar-based returns trailed local currency returns by almost 3% for the quarter, with the bulk of the impact coming from the strengthening of the dollar relative to the Euro.

## GLOBAL REAL ESTATE SECURITIES MARKET REVIEW

**David Quello, CFA**

*Associate Senior Investment Manager, ELCA Board of Pensions*

Fund A's real estate securities component returned -6.93% for the quarter, compared to the custom benchmark return of -6.14%. The month of May signaled a reversal of the equity market rally that began in March 2009. U.S. and Asian real estate securities significantly outperformed Europe due to concerns over sovereign debt levels in many of the European countries.

Defensive property types including apartments, healthcare and storage outperformed hotels, office, retail and industrial, as concerns about global economic growth renewed. The portfolio underperformed the benchmark during the quarter due to poor stock selection in the United States and overweighted investments in the United Kingdom.

U.S. Treasury and are therefore unaffected by screening activities. Alternative equities are not screened for social restrictions, although up to 50% of the portfolio may be allocated to positive social investments. These investments may include investments such as community banks, sustainable timber, and women- and minority-owned businesses.



## FIXED-INCOME MARKET REVIEW

**Mark Haney, CFA**

*Senior Investment Manager, ELCA Board of Pensions*

Fund A's fixed-income portfolio outperformed its benchmark, returning 3.55%, versus the benchmark return of 3.47% for the quarter.

As in the equity markets, most of the quarter was one of correction for all but the government segment of the fixed-income markets. Though Treasury rates dropped across the curve — 10-year Treasuries dropped by nearly .90%, to under 3.0% — risk premiums rose for non-government bonds. Much of the negative news came out of Europe, where rumors of bailouts for countries like Greece and Spain weighed on the Euro and sovereign credits. Housing and unemployment continued to have difficulty making any serious improvement, convincing the Federal Reserve to keep its Fed Funds rate near 0%.

With the flight to quality, Treasuries lead performance, contributing 4.36% to fixed income's 3.66% return for the quarter, as measured by the Citigroup US Broad Investment-grade Index. The credit sector returned 3.33%; mortgage and asset-backed sectors trailed with returns of 3.13% and 2.55%, respectively.

## HIGH-YIELD MARKET REVIEW

**Mark Haney, CFA**

*Senior Investment Manager, ELCA Board of Pensions*

The high-yield bond component of Fund A returned 0.14% for the quarter, underperforming its benchmark, the Citigroup High-Yield Cash-Pay Capped Index. The underperformance was largely due to a reversal of sector and credit positions that had been positive contributors in earlier quarters.

High-yield bonds were able to eke out a slight positive return of 0.23% for the quarter. However, with defaults continuing to decrease and yields now in excess of 9%, high-yield bonds appear to be poised to hold their own in the third quarter.

The highest rated BB-rated companies, returning 0.91% during the quarter, saved the asset class from negative territory; single-B and CCC-rated bonds returned -0.26% and -0.91%, respectively. Among the best-performing industries were airlines and pharmaceuticals, returning 3.90% and 3.92%, respectively; among the worst were technology and broadband with returns of -3.70% and -2.94%.

## ELCA FOUNDATION PARTNERSHIP WITH ELCA BOARD OF PENSIONS

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

Long-term projected investment returns should allow congregations and beneficiary ministries to further their mission efforts. The Board of Pensions, as the ELCA's 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 advisor for the ELCA Endowment Fund Pooled Trust — Fund A, the ELCA Board of Pensions. Fund A seeks to achieve attractive long-term returns while investing in ways that are compatible with the social policies of the ELCA.

### Fund A's social purpose program

The Board of Pensions uses a three-pronged approach to social purpose investing:

- 1 Positive social investments<sup>1</sup>** — making investments in pursuit of market-rate returns for participants, while channeling capital to underserved markets.
- 2 Shareholder advocacy** — acting as fiduciaries on behalf of participants to positively influence decisions made by the companies in which the Board of Pensions is invested.
- 3 Social screening<sup>2</sup>** — Avoiding new investments in companies whose business practices conflict with the ELCA's social criteria screens.

### Fund A supports positive change

Where applicable, the Board of Pensions' social purpose fund managers seek and invest in activities that they believe will positively benefit the community while achieving acceptable returns for participants. Managers look for investments which may include the following: community development, affordable housing, sustainable forestry, women- and minority-owned businesses, and clean energy and the environment.

### Shareholder advocacy supports shareholders

Through shareholder advocacy the Board of Pensions (in coordination with other shareholders where appropriate)

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

- 1 Dialogues** — Dialogue may involve meeting face-to-face with corporate leaders to discuss why specific changes have been proposed. This tactic has been proven to be particularly effective.
- 2 Shareholder resolutions** — Shareholder resolutions appear on proxy ballots prior to a corporation's annual meeting, giving every shareholder the opportunity to vote on a proposed change.
- 3 Proxy voting** — All proxy voting decisions are made solely in the best interests of participants and for the purpose of enhancing shareholder value of the company involved.

### Screening investments according to church values

Each year, investment managers for screened portfolios receive a list of companies that may not be considered for future investment due to business practices that conflict with the ELCA's social criteria screens.<sup>2</sup> Social criteria screens include: alcohol, community economic development<sup>3</sup>, environmental<sup>3</sup>, gambling, military weapons, pornography and tobacco.

The process of developing the ELCA's social criteria screens involves multiple sources. ELCA social statements (adopted by an ELCA Churchwide Assembly), social messages (adopted by the ELCA Church Council), and social policy resolutions (adopted by either Church Council or Churchwide Assembly) express scriptural and confessional understandings related to contemporary social issues and serve as the basis for social criteria screen development. All social criteria screens must be approved by the ELCA Church Council.

1. Consist mainly of investment-grade, fixed-income and alternative assets.
2. Due to practical implementation realities, not all portfolios in the social purpose funds are screened. Unscreened portfolios include real estate, alternative real assets and commingled assets.
3. Indicates positive social investment screen. Environmental screen is both positive and negative.

## ABOUT FUND A

You should carefully consider the investment objectives, risks, charges and expenses of any fund before investing in it. Fund A is subject to risk. Past performance cannot be used to predict future performance. The ELCA Board of Pensions' funds, in which Fund A is invested, are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Fund assets are invested in multiple sectors of the market. Some sectors, and therefore the funds, may perform below expectations and lose money over short or extended periods.



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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/foundation](http://www.elca.org/foundation) 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



**ELCA Foundation**  
Evangelical Lutheran Church in America

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