



ELCA Foundation
Evangelical Lutheran Church in America

ELCA ENDOWMENT FUND POOLED TRUST — FUND A

THIRD QUARTER 2010 REPORT

Endowment fund distributions

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ELCA congregations, synods and related ministries establish endowment funds to provide a dependable level of annual support for mission and ministry now and into the future. Their success depends on the preservation of their endowment’s purchasing power over time through prudent investing and sustainable distributions.

How endowment funds have changed over time

Historically, many endowment fund distributions were made based on income earned from investments such as CDs, bonds, dividend-generating stocks and money market accounts. When interest rates were high, these investments made significant distributions based on income. As interest rates dropped, so did their distributions, and ministry objectives went unmet.

Endowment investors responded to the perils of “interest rate risk” by establishing balanced portfolios of diversified investments, including equities and income-producing assets. In any given year, actual investment returns might vary significantly from the expected average annual investment return.

In response to performance variability, “smoothing” formulas were employed to help reduce annual volatility of distributed funds. Fund A’s smoothing process uses a

five-year look back of unit values. We average those values and determine a distribution rate per unit. This process is designed to help reduce the potential for significant fluctuations in the distribution amount each year.

We strive to reach a balance between meeting current needs for distributions that support ministry and long-term needs for sustainable distributions. In recent years, participants have seen the standard distribution rate decline. This decline is the result of careful analysis and strategic planning to fulfill the long-term sustainability objectives of the Fund and preserve your endowment’s purchasing power for the future.

HOW ARE ANNUAL DISTRIBUTIONS DETERMINED?

Annual distributions from endowments invested in Fund A are determined by a distribution rate policy approved by the Board of Trustees of the Endowment Fund of the ELCA. The target distribution rate for endowments managed through the ELCA Foundation takes into account current market conditions, rates of return assumptions for each of the various asset classes held by the fund in its investment portfolio, expenses, interest rates and inflationary pressures. For 2010, the distribution rate is 4.25%.

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Fund A — Third 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 REVIEW

Kurt A. Kreienbrink, CFA

Corporate Governance Analyst, ELCA Board of Pensions

The numbers behind the quarterly numbers

Quarterly equity numbers were boosted by one of the best Septembers ever. For example, the S&P 500 Index was up 11.3% in the third quarter. This upward movement is especially interesting when you consider September is typically noted for being one of the equity market’s worst months. Additionally, the fixed-income market delivered solid returns during the quarter. For the quarter, bonds, as measured by the Citigroup Broad Investment-Grade Bond Index, returned 2.4%.

Not necessarily a smooth ride

While strong returns like these are always welcome, these quarterly numbers don’t tell the whole story. The quarter didn’t follow a direct route or smooth upward ride. The individual monthly returns for the S&P 500 during July, August and September were 7.0%, -4.5% and 8.9%, respectively. These are some pretty significant upward and downward moves. It’s also interesting to contrast the quarterly return of 11.3% for the third quarter to the return of -11.4% in the second quarter. It clearly has been a bumpy and uneven ride so far in 2010, but it also appears we are headed in the right direction — given the S&P 500 has returned 3.9% year-to-date, as of September 30.

Uncertainty and market fluctuations

You may have seen or heard in September this year that the official arbiter of economic turning points (the National Bureau of Economic Research) declared the recession had ended and the recovery began in June 2009. While the recovery has begun, the overall recovery in the United States, and globally, remains fragile and inconsistent. The gross domestic product, while still positive, has been on a downward trend, and jobless claims and unemployment have shown some improvement at times, but remain at elevated levels. Uncertainty remains, and talk of a double-dip recession has not been silenced. The good news is the Federal Reserve and other government entities around the globe stand ready to take additional action if needed to support the economic recovery.

Uneven economic recoveries such as the one we are experiencing can lead to uneven markets and continued uncertainty, which is why diversification both across and within various asset classes such as stocks, bonds and cash is important in long-term investing. During uneven market recoveries, it’s also important to be patient and stay the course.

Investors who attempt to time the markets occasionally may be able to move funds in time to more conservative investments and miss a downward movement in the markets. However, it’s extremely difficult to correctly move funds before a downward movement and be back in the market soon enough to take advantage of potential upward movements like we saw during this quarter. The Board of Pensions avoids short-term market timing strategies, which are more risky and can lead to higher portfolio turnover and trading costs.

FUND A – THIRD QUARTER 2010 SUMMARY

During the third quarter, Fund A saw positive absolute returns with the Fund returning 9.91%, lagging the benchmark return of 10.26% gross of fees.



FUND A PORTFOLIO MARKET VALUE¹

As of September 30, 2010, Fund A had investments of approximately \$359.5 million:

- \$175.8 million in the U.S. equity component
- \$70.9 million in the investment-grade, fixed-income component

- \$36.9 million in the high-yield, fixed-income component
- \$56.1 million in the non-U.S. equity component
- \$19.8 million in real estate securities

FUND A INVESTMENT PORTFOLIO PERFORMANCE AS OF SEPTEMBER 30, 2010

		THIRD QUARTER (%)	YEAR-TO-DATE (%)	ONE YEAR (%)	FIVE YEARS (%)	10 YEARS (%)
Total Fund A ²		9.91	6.08	10.84	3.80	3.91
Fund A benchmark <i>(Dow Jones Total Stock Market Index³ 50%, MSCI All Country World (ex-U.S.) Index 15%, Citigroup High-Yield Cash-Pay Capped Index 10%, Custom Citigroup Index⁴ 20%, Wilshire U.S. Real Estate Securities Index/Wilshire Ex-U.S. Real Estate Securities Index⁵ 5%)</i>		10.26	6.97	11.66	3.59	2.99
EQUITIES	Fund A U.S. equity portfolio ²	10.82	3.67	9.83	0.75	1.15
	U.S. equity benchmark <i>(Total Stock Market Index³)</i>	11.51	5.22	11.33	1.06	0.17
	Fund A non-U.S. equity portfolio ²	17.49	4.23	8.35	5.06	N/A ⁶
	Non-U.S. equity benchmark <i>(MSCI All Country World (Ex-U.S.) Index)</i>	16.58	3.69	7.56	4.26	4.38
HIGH-YIELD	Fund A high-yield portfolio ²	6.46	10.51	16.44	8.64	N/A ⁶
	High-yield benchmark <i>(Citigroup High-Yield Cash-Pay Capped Index)</i>	6.12	10.41	16.64	7.51	7.80
FIXED-INCOME	Fund A fixed-income portfolio ²	2.40	7.97	8.47	6.46	6.55
	Fixed-income benchmark <i>(Custom Citigroup Index⁴)</i>	2.40	7.71	7.96	6.52	6.59
GLOBAL REAL ESTATE SECURITIES	Fund A global real estate securities portfolio ²	17.70	17.39	24.20	3.37	N/A ⁶
	Real estate securities benchmark <i>(Wilshire U.S. Real Estate Securities Index and Wilshire Ex-U.S. Real Estate Securities Index⁵)</i>	17.57	17.61	24.47	1.52	10.65

NOTE: Past performance does not guarantee future results.

1. Total market value of Fund A is \$359.3 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 10.8% in the third quarter, underperforming the benchmark return of 11.5%. Weak relative returns by the large-cap growth and large-cap value managers drove the underperformance.

Markets rebounded strongly in the third quarter, posting their biggest gains since third quarter 2009. While fears of a double-dip recession have eased, economic growth and unemployment numbers have not impressed. In response, the Federal Reserve has hinted at further policy action aimed at boosting growth and employment. Corporate earnings are showing continued strength due to cost-cutting measures and productivity gains. Gains were broad-based as all sectors rose in the quarter. Capital goods stocks led the way with a gain of over 18%. Financials lagged the overall market yet still rose almost 6%.

Capitalization was not a major driver for the quarter as both large- and small-cap stocks rose just over 11%. However, smaller stocks have dramatically outperformed year-to-date. Growth stocks outperformed value by almost 3%.

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 17.4%, outperforming the 16.6% benchmark return. Strong relative returns were driven primarily by outperformance in the growth portfolio.

International equity returns rebounded strongly in the third quarter. Markets put aside, at least temporarily, fears of sovereign credit risk as governmental policies address some of the near-term concerns. As the prospects for growth remain sluggish in developed markets, investors continue to look to emerging markets as a source of growth. For the quarter, emerging markets again outperformed developed markets, pushing the year-to-date performance to almost 11%, compared to just over 1% in developed nations. Japan lagged in developed markets, due in large part to the strengthening yen, which hurts exports.

Currency again had a major impact on returns for U.S. investors. The dollar weakened significantly versus major currencies and, as a result, dollar-based returns outperformed local currency returns by almost 8% for the quarter. Style was not a major driver of returns in developed markets while growth stocks outperformed value in emerging markets.

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 17.6% in the third quarter, compared to the custom benchmark return of 17.6%. The third quarter exhibited extraordinarily strong performance for REITs across the globe, in contrast to the weak performance in the second quarter. Europe significantly outperformed the United States and Asia, although all three regions performed well during the quarter. The property types that performed the best globally included diversified and retail, while hotels lagged. The portfolio performed in line with the benchmark during the quarter.



FIXED-INCOME MARKET REVIEW

Mark Haney, CFA

Senior Investment Manager, ELCA Board of Pensions

For the third quarter of 2010, Fund A's fixed-income portfolio returned 2.4%; the benchmark also returned 2.4%.

The search for yield returned to the fixed-income markets as the third quarter began; though treasuries continued their rally, demand returned in force for credit. While treasuries returned a respectable 2.68%, beating the 2.36% return of the Citigroup Broad Investment-Grade Index, credit, corporate bonds returned 4.51%. Mortgages (except for non-agencies which have lagged until recently) finally ran out of steam eking out only a slightly positive return of 0.52%. Housing and unemployment continued to have difficulty making any serious improvement.

The Federal Reserve kept its Fed Funds rate near 0.0% but made an incremental change in its balance sheet policy that helped boost treasuries; the decision to reinvest principle payments from its substantial agency mortgage-backed securities portfolio into treasuries will maintain the size of its balance sheet, which helped reassure the market.

HIGH-YIELD MARKET REVIEW

Mark Haney, CFA

Senior Investment Manager, ELCA Board of Pensions

For the third quarter of 2010, the high-yield bond component of Fund A returned 6.46%, outperforming its benchmark, the Citigroup High-Yield Cash-Pay Capped Index by 0.34%. Individual credit selection was the primary reason for the outperformance.

Demand returned to the high-yield market in July pushing prices higher and delivering a solid 6.12% return for the quarter as measured by the Citigroup High-Yield Cash-Pay Capped Index. Risk premiums narrowed but ended the quarter well above historical averages suggesting the rally may have room to run. Defaults continued to decline, as well, to a rate of about 0.5% according to Moody's.

Investors were selective during the quarter however, becoming less enthusiastic about the lowest rated (CCC) companies. BB-rated bonds were bid up the most returning 6.56% for the quarter and single-B bonds followed with a 6.49% return. CCC-rated bonds lagged at 5.47%. Diversified Telecommunications was the best performing industry returning 8.59% with autos and finance coming in behind, posting returns of 7.74% and 7.76% respectively. Gaming came in last with a still-respectable 4.07% return.

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.

THE ELCA FOUNDATION



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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 investments¹** — 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 screening²** — 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.² Social criteria screens include: alcohol, community economic development³, environmental³, 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 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 Chicago office or a regional gift planner nearest you



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Evangelical Lutheran Church in America

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