



**ELCA Foundation**  
Evangelical Lutheran Church in America

# ELCA ENDOWMENT FUND POOLED TRUST — FUND A

FIRST QUARTER 2011 REPORT

## Update — New Fund A strategic asset allocation

### **Bonalynn Wallach**

*Manager for Investments, Evangelical Lutheran Church in America*

As communicated in the Fourth Quarter 2010 Report, the plan to include Alternative Equities as part of Fund A's asset allocation was not implemented due to uncertainties around tax reporting, disclosures and potential liabilities for Fund A participants. The Endowment Fund of the ELCA Board of Trustees at its March 2011 meeting approved a new strategic asset allocation using traditional asset classes in publicly traded markets. The new allocation will attempt to further diversify Fund A with the inclusion of Inflation Indexed Bonds, as well as a more balanced allocation between U.S. and non-U.S. Stock. Decreases in U.S. Stocks of 15% and U.S. Bonds of 5% are accompanied by increases to non-U.S. Stocks of 10% and Global Real Estate and Inflation Indexed Bonds, each at 5% respectively.

As the market capitalization of global stocks and bonds is evolving, there are an increasing percentage of investable securities available in the non-U.S. vs. U.S. sectors. Reducing the U.S. stock and increasing the non-U.S. stock target asset allocation provides the ability to benefit from this change while reducing our expected long-term risk. Inflation Indexed Bonds will be managed by the ELCA Board of Pensions' Internal Fixed Income team and the remaining asset class managers will be unchanged. Modeling indicates that this allocation should marginally improve the long-term projected return while lowering the long-term projected risk profile of the Fund. The chart below shows the current and new asset allocations.

The new asset allocation was developed with careful consideration to factors such as the Fund's investment objectives and the projected impact on the distribution rate. Implementation began in April and will continue through July in a four-step process to ensure a smooth transition.

### STRATEGIC ASSET ALLOCATION FOR FUND A

ASSET CLASS	CURRENT ALLOCATION (%)	NEW ALLOCATION (%)	SHIFT (%)
U.S. Stocks	50	35	-15
Non-U.S. Stocks (Emerging markets component 20% – 25%)	15	25	10
U.S. Bonds	20	15	-5
Inflation Indexed Bonds	0	5	5
Alternative Fixed Income	10	10	0
Global Real Estate Securities	5	10	5

## INSIDE

First quarter 2011 market review .....	2	Global real estate securities market review .....	4
Fund A market value .....	3	High-yield market review .....	5
Fund A performance chart .....	3	Fixed-income market review .....	5
U.S. equities market review .....	4	Social purpose investing in Fund A .....	6
Non-U.S. equities market review .....	4	ELCA Foundation Regional Gift Planners list .....	7



## Fund A — First quarter 2010 performance

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

### MARKET REVIEW

**Kurt A. Kreienbrink, CFA**

*Corporate Governance Analyst, ELCA Board of Pensions*

#### **Solid quarterly performance in spite of the headlines**

If all a person did during the quarter was read the news headlines, it might be hard to figure out how the markets could have performed as well as they did, considering the horrific earthquake, tsunami and nuclear disaster in Japan, the continued fighting and instability in the Middle East, ongoing issues surrounding debt levels in some European countries and the U.S., higher oil and gas prices. Unfortunately the media seems to prefer to stress the negatives, but there were also a significant number of positive developments for the markets, including:

- improving economic growth in the U.S. as evidenced by Gross Domestic Product (GDP) improving for three consecutive quarters.
- the unemployment rate which peaked at 10.1% in October of 2009, while still elevated, has fallen to 8.6% in March of 2011.
- corporate profits have been steadily improving, and as a result increases in dividends and share buybacks are occurring.

#### **Will headlines become headwinds or tailwinds?**

While nobody knows for sure at this point, it is possible that some of the recent negative headlines simply create near-term uncertainty and volatility, but do not seriously disrupt the ongoing economic recovery in the U.S or abroad. For example:

- Ben Bernanke, chairman of the Federal Reserve Board, has said previously that higher oil prices were unlikely to steal much from growth or spark broader inflation, as long as they are not sustained.
- While a noticeable component of global GDP, Japan’s contribution to global GDP is under 10%, so the overall impact to the global economy may be somewhat limited. Furthermore, the short-term impact of the events in Japan are certainly a negative, but longer-term there could be a boost to the global economy from rebuilding efforts.
- The economic health of certain European countries continues to be a near term issue, but at the same time countries are implementing longer-term measures to control their spending and cut their deficits.

No one knows if some of these near-term issues will become more serious or if current actions are successful in stabilizing or even improving the economic situation. Because of this uncertainty, the Board of Pensions will continue to periodically rebalance the assets in the Fund and focus on its long-term investment objective in order to help manage risk in the Fund.

### STRONG START TO THE YEAR

For the first quarter, the S&P 500 Index was up 5.9%, building on its strong performance in 2010. The fixed-income market, as measured by the Citigroup Broad Investment-Grade Bond Index, returned 0.4% for the quarter.

**NOTE:** Past performance does not guarantee future results.



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

As of March 31, 2011, Fund A had investments of approximately \$409.3 million:

- \$209.2 million in the U.S. equity component
- \$78.2 million in the investment-grade, fixed-income component

- \$39.7 million in the high-yield, fixed-income component
- \$61.3 million in the non-U.S. equity component
- \$20.9 million in real estate securities

### FUND A INVESTMENT PORTFOLIO PERFORMANCE AS OF MARCH 31, 2011

		YEAR-TO-DATE (%)	ONE YEAR (%)	FIVE YEARS (%)	10 YEARS (%)
Total Fund A <sup>2</sup>		4.45	14.03	4.76	5.89
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>		4.41	14.85	4.61	5.56
EQUITIES	Fund A U.S. equity portfolio <sup>2</sup>	6.66	16.70	2.89	4.47
	U.S. equity benchmark <i>(Total Stock Market Index<sup>3</sup>)</i>	6.37	17.73	3.10	4.21
	Fund A non-U.S. equity portfolio <sup>2</sup>	2.94	13.02	3.97	N/A <sup>6</sup>
	Non-U.S. equity benchmark <i>(MSCI All Country World (Ex-U.S.) Index)</i>	3.41	13.15	3.59	7.44
HIGH-YIELD	Fund A high-yield portfolio <sup>2</sup>	3.55	13.51	9.24	N/A <sup>6</sup>
	High-yield benchmark <i>(Citigroup High-Yield Cash-Pay Capped Index)</i>	3.91	14.06	8.31	8.35
FIXED-INCOME	Fund A fixed-income portfolio <sup>2</sup>	0.54	5.40	6.32	5.70
	Fixed-income benchmark <i>(Custom Citigroup Index<sup>4</sup>)</i>	0.49	5.33	6.40	5.77
GLOBAL REAL ESTATE SECURITIES	Fund A global real estate securities portfolio <sup>2</sup>	4.11	23.65	2.17	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>	4.63	24.80	0.52	11.45

NOTE: Past performance does not guarantee future results.

1. Total market value of Fund A is \$409.5 million, including deposits between monthly valuation dates and operating cash on which a total fee of 1/2 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 6.6% in the first quarter, outperforming the benchmark return of 6.4%. Outperformance was driven by the large-cap growth manager and small/mid-cap value manager.

The U.S. equity market continued its strong performance in the face of rising geopolitical uncertainty and the devastating series of disasters in Japan. Strong corporate profits fueled investor optimism despite the macroeconomic concerns. Among S&P 500 stocks, earnings rose 40% and, in a sign that the earnings recovery is more than just a cost cutting story, revenues grew 10%. While unemployment remains high by historical standards, hiring is increasing and initial jobless claims are falling. However, rising oil prices remain a key threat to the economic recovery.

All sectors rose during the quarter. Energy stocks, buoyed by rising oil prices, led all sectors with a return of 17%. The more defensive sectors, such as consumer staples and utilities, trailed the overall market. Small-cap stocks outperformed large cap stocks for the quarter. Growth stocks outperformed value in small-cap stocks while style was not a major driver of returns in the large-cap space.

## 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 2.9%, trailing the benchmark return of 3.4%. All managers underperformed the benchmark for the quarter, with the value and growth managers accounting for the majority of the underperformance.

International equity markets rose during the first quarter yet lagged the U.S. market. The major headline was the devastating earthquake and tsunami in Japan and the resulting nuclear crisis. This series of events, projected to be among the most expensive natural disasters in history, will have a lasting impact on Japan. The Japanese Yen rose following the earthquake, as Japanese investors repatriated foreign investments to help cover the costs of the recovery.

The rising Yen further hampers economic activity as Japan is an export-driven economy. Compounding the volatility in the market is the continued instability in the Middle East. While these countries represent a small portion of the world's equity value, they represent a significant portion of the world's oil supply.

In developed markets, European stocks led the broader market. The dollar weakened versus major currencies and, as a result, dollar-based returns outperformed local currency returns by over 2% for the quarter. Value stocks led growth stocks by a wide margin in both developed and 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 4.11% in the first quarter, compared to the custom benchmark return of 4.63%. During the quarter, real estate securities returns varied across the globe. Europe and the U.S. significantly outperformed Asia, due to the earthquake and tsunami in Japan, as well as some policy tightening by some Asian Pacific countries. The property types that performed the best globally included industrial and office properties, while hotels lagged. The portfolio underperformed the benchmark during the quarter largely due to stock selection in Japan and an overweight to Brazil.



## HIGH-YIELD MARKET REVIEW

**Mark Haney, CFA**

*Senior Investment Manager, ELCA Board of Pensions*

For the first quarter of 2011, the high-yield bond component of Fund A returned 3.55%, underperforming its benchmark, the Citigroup High-Yield Cash-Pay Capped Index by 0.36%. Individual credit selection added value and quality positioning detracted as our manager's more conservative view of the market went generally unrewarded.

Demand continued to be strong in the first quarter of 2011 helping the high-yield index to post a solid 3.91% return. The continued strength in credit metrics pushed the global default rate down to 2.6% by quarter's end, down from 3.1% at year-end 2010, according to Moody's.

The appetite for risk continued as well; the riskiest CCC-rated credits returned 5.29%, while the highest quality BB bonds returned just 3.48%.

## FIXED-INCOME MARKET REVIEW

**Mark Haney, CFA**

*Senior Investment Manager, ELCA Board of Pensions*

Fund A's fixed-income portfolio slightly outperformed its benchmark, returning 0.54%, versus the benchmark return of 0.49%. An overweighting of the credit sector and security selection within the credit and mortgage sectors were primary reasons for the outperformance.

Interest rates continued to rise during the first quarter of 2011, as economic indicators strengthened. Household spending and business investment continued to expand and conditions in the labor market appear to be improving. However, central banks are becoming more concerned about inflation with the rapid rise in commodity prices. At the same time, the market is trying to sort out sovereign credit concerns and continuing weakness in the domestic housing sector. Overall, bonds returned 0.36% for the quarter with the government sector posting a -0.11% return due to the rise in interest rates. Spread sectors remained relatively strong, however, lead by credit with a return of 0.82% and mortgage-backed securities at 0.61%; asset-backed securities returned 0.56% for the quarter.

The Federal Open Market Committee kept the Fed Funds rate near 0%, acknowledging the continued strength of the economy and increasing inflation fears abroad, but on balance continuing to feel longer-term inflation expectations are stable.

## 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)

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 target asset allocations, 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, as well as the fund, may perform below expectations and lose money over short or extended periods.

Neither the ELCA Board of Pensions nor its funds are subject to registration, regulation or reporting under the Investment Company Act of 1940, the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940 or state securities laws. Members, therefore, will not be afforded the protections of those provisions of those laws and related regulations.

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.



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The ELCA Foundation regional gift planners are located in regional offices throughout the country. Call (800) 638-3522 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 Chicago office or a regional gift planner nearest you



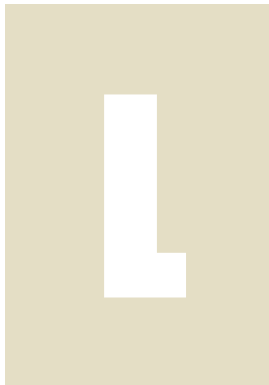
**ELCA Foundation**  
Evangelical Lutheran Church in America

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