



**ELCA Foundation**  
Evangelical Lutheran Church in America

# ELCA ENDOWMENT FUND POOLED TRUST — FUND A

SECOND QUARTER 2011 REPORT

## Investment and Expenditure

**Laura L. Knitt, JD**

*Associate General Counsel, ELCA Office of the Secretary*

Most states have enacted the Uniform Prudent Management of Institutional Funds Act (UPMIFA). This statute governs how charitable institutions make investment decisions, spend from endowment funds and follow or modify donor restrictions on endowment assets. This article addresses investment and spending decisions.

UPMIFA requires investment “in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.” Among the requirements are appropriate and reasonable investment costs, as well as consideration of the effects of inflation, overall resources of the institution and its charitable purposes, risk and return suitable to the fund and the institution, and diversification of assets unless special circumstances dictate otherwise.

Expenditure provisions under UPMIFA are only applicable to endowment funds, as defined in the statute. Such funds can be appropriated or accumulated “as the institution determines to be prudent for the uses, benefits, purposes and duration for which the endowment fund is established.” Seven criteria guide annual expenditure decisions:

- 1 duration and preservation of the endowment
- 2 purposes of the institution and the endowment

- 3 general economic conditions
- 4 effect of inflation or deflation
- 5 expected total return from income and appreciation of investments
- 6 other resources of the institution
- 7 investment policy of the institution

Although UPMIFA does not require adhering to an old Uniform Management of Institutional Funds Act (UMIFA) rule about not spending below “historic dollar value,” compliance with accounting standards of the Financial Accounting Standards Board (FASB) requires that “historic dollar value” continue to be tracked.

Fund A’s investment and distribution structure is designed specifically for endowments, with UPMIFA compliance included as a decision-making factor. For a Fund A participant — with the investment decision made — the next thing to think about is whether and how much to spend from an endowment fund. The Endowment Fund of the ELCA’s annual distribution amount, currently 4.25% of a five-year rolling average and integrated into the Fund A accounting system, is a reasonable choice.

More information about UPMIFA is available at [www.upmifa.org](http://www.upmifa.org).

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## Fund A — Second Quarter 2011 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 — KEEPING PERSPECTIVE

**Kurt A. Kreienbrink, CFA**

*Senior Corporate Governance Analyst,  
ELCA Board of Pensions*

#### Up Slightly, but Quite a Journey

For the second quarter, the S&P 500 Index was up slightly, rising 0.1%, while the fixed-income market, as measured by the Citigroup Broad Investment-Grade Bond Index, returned 2.3%.

As the quarter was unfolding, I was starting to get the feeling that this year was looking a lot like 2010, so I decided to look back at what transpired in the equity markets (as measured by the S&P 500) during the first couple quarters in 2010. Much like last year, where the market was up 5.4%, the first quarter this year was up 5.9%. And while the second quarter this year ended flat, compared to down 11.4% last year, there was plenty of volatility during the quarter which probably is what left me wondering if we were repeating 2010. April was up about 3.0%, May was down 1.1% and June ended down 1.7%. However, during June, the market was down nearly 6.0% from the end of May before rallying in the second half of June to close down only 1.7%.

#### Why the Continued Volatility?

While it’s impossible to say for sure what the cause is, there continue to be a number of potential drivers and some are probably becoming quite familiar since they just don’t seem to go away.

Potential negative drivers:

- Ongoing uncertainty in Greece and other European countries with debt issues, as well as debt issues concerning the U.S. debt ceiling

- Elevated jobless numbers in the United States and high levels of unemployment
- Higher food and energy prices (however, energy prices have begun moderating)

Potential positive drivers:

- Continued low levels of the federal funds rate
- Corporate profits have steadily improved and there have been significant increases in dividends and share buybacks
- While short-term impacts of the devastating events in Japan have certainly been a negative, there are already signs of a boost to the global economy from rebuilding in Japan

#### Keeping Perspective

I have to admit that at times I probably spend too much time thinking about short-term drivers of the markets, and that’s probably what caused me to feel like 2011 was looking an awful lot like 2010. This “here we go again” feeling can occur when we focus more on the short term than the long term. But at times like this it’s important to keep things in perspective by taking a step back and considering a longer term view. For example, even with all the negative headlines we’ve seen over recent quarters and years, did you realize that as of the end of June, the equity market (as measured by the S&P 500) is up over 95% from its low point on March 9, 2009?

While looking back a little over two years is not considered a long-term view, it’s good to see progress can be made even during a time of ongoing challenges. Keeping a long-term perspective (typically 10 or more years) and maintaining a diversified portfolio can go a long way to navigating the rough spots we are certain to encounter in the world of investing.

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

As of June 30, 2011, Fund A had investments of approximately \$409.6 million:

- \$174.9 million in the U.S. equity component
- \$71.0 million in the investment-grade, fixed-income component

- \$40.3 million in the high-yield, fixed-income component
- \$81.6 million in the non-U.S. equity component
- \$31.5 million in real estate securities
- \$10.2 million in inflation indexed bonds

See Fund A Investment Portfolio Performance chart on Page 3.



## FUND A INVESTMENT PORTFOLIO PERFORMANCE AS OF JUNE 30, 2011

		SECOND QUARTER (%)	YEAR-TO-DATE (%)	ONE YEAR (%)	FIVE YEARS (%)	10 YEARS (%)
Total Fund A <sup>2</sup>		0.53	5.00	24.00	5.27	5.51
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>		0.76	5.21	24.56	5.02	5.12
EQUITIES	Fund A U.S. equity portfolio <sup>2</sup>	-0.61	6.01	31.43	3.47	3.81
	U.S. equity benchmark <i>(Total Stock Market Index<sup>3</sup>)</i>	-0.01	6.36	32.44	3.51	3.52
	Fund A non-U.S. equity portfolio <sup>2</sup>	0.47	3.42	30.37	4.04	N/A <sup>6</sup>
	Non-U.S. equity benchmark <i>(MSCI All Country World (Ex-U.S.) Index)</i>	0.38	3.80	29.73	3.67	7.50
HIGH-YIELD	Fund A high-yield portfolio <sup>2</sup>	0.74	4.32	14.19	9.43	N/A <sup>6</sup>
	High-yield benchmark <i>(Citigroup High-Yield Cash-Pay Capped Index)</i>	0.84	4.78	14.76	8.59	8.63
FIXED-INCOME	Fund A fixed-income portfolio <sup>2</sup>	2.33	2.88	4.16	6.82	5.90
	Fixed-income benchmark <i>(Custom Citigroup Index<sup>4</sup>)</i>	2.30	2.81	4.14	6.90	5.96
GLOBAL REAL ESTATE SECURITIES	Fund A global real estate securities portfolio <sup>2</sup>	4.43	8.72	38.53	3.11	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>	4.02	8.84	38.31	1.55	10.72
INFLATION INDEXED	Inflation indexed bond portfolio	N/A <sup>7</sup>	N/A <sup>7</sup>	N/A <sup>7</sup>	N/A <sup>7</sup>	N/A <sup>7</sup>
	Inflation indexed benchmark <i>(Citigroup U.S. Inflation-Linked Securities Index)</i>	3.65	5.75	7.81	6.93	6.95

- NOTES:
- On August, 1, 2011, Fund A and its benchmark completed its transition to the new strategic asset allocation. Please refer to the first quarter newsletter for details.
  - Past performance does not guarantee future results.

1. Total market value of Fund A is \$412.6 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.
7. In June 2011, Inflation Indexed Bonds were added as a component to Fund A's asset allocation. The June 2011 one-month return was 0.77%.



## U.S. EQUITIES MARKET REVIEW

**Josh Stieler, CFA**

*Investment Manager, ELCA Board of Pensions*

Fund A's U.S. equity component returned -0.61% in the second quarter, underperforming the benchmark return of -0.01%. Underperformance was driven primarily by the large-cap growth manager.

The U.S. equity market reversed its trend of quarterly gains in the face of disappointing economic data and uncertainty surrounding government debt, both at home and abroad. Despite a strong start to the quarter, investors became more defensive as the economic recovery showed signs of slowing. Strength in corporate profits counterbalanced these concerns, although companies continue to hoard cash amid economic and fiscal uncertainty. Heading into the third quarter, markets are keeping a close eye on Congress and its decisions on the U.S. debt limit.

The more defensive sectors, such as health care, utilities, and consumer staples led the overall market while financials continue to lag. Large-cap stocks outperformed small-cap stocks for the quarter, while growth stocks outperformed value stocks.

## NON-U.S. EQUITIES MARKET REVIEW

**Josh Stieler, CFA**

*Investment Manager, ELCA Board of Pensions*

Funds A's non-U.S. equity component returned 0.47%, ahead of the benchmark return of 0.38%. Underperformance by the value manager offset much of the positive relative returns for the other non-U.S. equity managers.

International markets continued to grapple with a tenuous debt situation in Europe as several smaller nations in the Euro zone struggle with debt levels and austerity measures. Greece looks to have avoided default, at least for the time being, with the passage of austerity measures and assistance from other EU nations, particularly Germany. However, a longer term solution remains to be found. Disruptions continue as a result of

the earthquake in Japan, although supply chains are recovering. Emerging markets continue to serve as the world's growth engine, yet emerging market returns (in U.S. dollar terms) trailed developed for the quarter.

The U.S. dollar continued to fall against foreign currencies, boosting dollar based returns by 2%. Growth stocks outperformed value stocks in both developed and emerging markets.

## FIXED-INCOME MARKET REVIEW

**Mark Haney, CFA**

*Senior Investment Manager, ELCA Board of Pensions*

For the quarter, Fund A's fixed-income portfolio slightly outperformed its custom benchmark, returning 2.33%, versus the benchmark return of 2.30%. An overweighting of the credit sector was again a positive contributor, as was security selection within the credit and mortgage sectors.

With the epic budget confrontations in Washington and continuing debt issues in Europe, interest rates generally dropped during the quarter. However, the consequences of a potential default by the U.S. government if the debt ceiling is not raised, as well as concerns over rising inflation warrant caution. For the time being, yields on government bonds remain incredibly low — virtually 0% on short dated bills and the 10-year note yielding 3.16% at quarter's end. Overall, as measured by the Citigroup U.S. Broad Investment-Grade Index, bonds returned 2.29% for the quarter. Expectations of strong corporate earnings for the quarter propelled the credit sector into the lead with a return of 2.38%, followed by the mortgage-backed securities sector with a 2.34% return; government bonds returned 2.2% and asset-backed securities lagged at 1.99%.

There was little change in the Federal Reserve's Federal Open Market Committee statements during the quarter and the Fed Funds rate remains near 0%. The committee acknowledged the economic recovery, though continuing at a moderate pace, is proceeding somewhat slower than expected and vowed to act as needed to best foster maximum employment and price stability.



## GLOBAL REAL ESTATE SECURITIES MARKET REVIEW

**Greg Zick, CFA**

*Assistant Investment Manager, ELCA Board of Pensions*

Fund A's global real estate securities component returned 4.43% in the first quarter, compared to the custom benchmark return of 4.02%. During the quarter, real estate securities returns varied across the globe. Europe significantly outperformed the United States and Asia, lead by the United Kingdom. The property types that performed the best globally included residential and retail, while health care and self-storage contributed negative returns. Relative to the benchmark, the portfolio benefited from stock selection in the United States, Japan, Germany, and Singapore. An overweight to Germany detracted from performance.

## HIGH-YIELD MARKET REVIEW

**Mark Haney, CFA**

*Senior Investment Manager, ELCA Board of Pensions*

For the quarter, the high-yield bond component of Fund A returned 0.74%, underperforming its benchmark, the Citigroup High-Yield Cash-Pay Capped Index, which returned 0.84%. Individual credit selection added value, but quality positioning and sector exposure were reasons for the underperformance.

Over-supply and debt concerns in the United States and Europe finally caught up with the high-yield market in June. High-yield mutual funds saw \$6.1 billion in outflows during the month at the same time traders were working to reduce inventories. The appetite for risk turned into a flight to quality as well with CCC-rated bonds returning only 0.24%, while BB-rated bonds returned 1.37%. The good news was that defaults continued to fall, ending the quarter at just 1.7%, compared with a long-term average of more than double that amount.

Industry segments varied widely with broadband returning 4.88% and paper/forest products losing -4.42%.

## 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

For more information contact:

**David Novak**

The ELCA Foundation  
8765 West Higgins Road  
Chicago, IL 60631

Phone: (800) 638-3522

Fax: (773) 380-2775

Email: [david.novak@elca.org](mailto:david.novak@elca.org)

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



## 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 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 the 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 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.



## ELCA FOUNDATION REGIONAL GIFT PLANNERS

**Alice L. Benson**

Metropolitan Washington,  
D.C. Synod  
(301) 963-6570  
[alice.benson@elca.org](mailto:alice.benson@elca.org)

**Pr. Robert C. Buschkemper**

Southeastern, Western and  
Northeastern Iowa Synods  
(402) 502-0735  
[buschkemper@cox.net](mailto:buschkemper@cox.net)

**William R. Elmstrom**

Southwestern and  
Northwestern Minnesota  
Synods  
(320) 839-3326  
[elmstrom@wat.midco.net](mailto:elmstrom@wat.midco.net)

**Pr. Gregory A. Kramer**

Central and Northeastern  
Pennsylvania Synods  
(570) 374-2044  
[kramerga@ptd.net](mailto:kramerga@ptd.net)

**Brenda J. Moore**

Minneapolis and St. Paul  
Area Synods  
(507) 934-4614  
[brenda.moore@elca.org](mailto:brenda.moore@elca.org)

**Kurt Osborne**

South Dakota Synod  
(605) 274-6012  
[osborne@augie.edu](mailto:osborne@augie.edu)

**Joyce C. Palmer**

Central States Synod  
Arkansas-Oklahoma Synod  
(816) 204-5181  
[jcpalmer49@aol.com](mailto:jcpalmer49@aol.com)

**Christine A. Post-Duncan**

North Carolina Synod,  
South Carolina Synod and  
Southeastern Synod  
(828) 439-8977  
[christine.postduncan@elca.org](mailto:christine.postduncan@elca.org)

**Jim L. Schade**

South Dakota Synod  
(605) 274-4011  
[schade@augie.edu](mailto:schade@augie.edu)

**Gregory T. Shepherd**

Southwest California and  
Pacifica Synods  
(909) 910-6823  
[gregory.shepherd@elca.org](mailto:gregory.shepherd@elca.org)

**Pr. George L. Sims**

Virginia Synod  
(540) 667-8609  
[director@plan2giv.org](mailto:director@plan2giv.org)

**Craig Stirtz**

Nebraska Synod  
(402) 342-5728  
[cstirtz@lpgs.org](mailto:cstirtz@lpgs.org)

**Pr. Paul H. Summer**

Florida-Bahamas Synod  
(386) 852-0511  
[paul.summer@elca.org](mailto:paul.summer@elca.org)

**Pr. Larry G. Westfield**

Wisconsin  
(262) 224-9574  
[larry.westfield@elca.org](mailto:larry.westfield@elca.org)

**David R. Whitenack**

Delaware-Maryland Synod  
(717) 571-6554  
(800) 652-9416  
[david.whitenack@elca.org](mailto:david.whitenack@elca.org)

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

The ELCA Foundation  
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