

INVESTOR
STORIES

Inaugural Investor Conference Offers Education & More



United Church Funds is pleased to announce its inaugural national investor conference, *Investing Responsibly in Uncertain Times*, to be held October 22-23 in Chicago. Designed for the women and men who steward endowment assets, the conference offers both current UCF clients and prospective investors a unique opportunity to develop confidence and knowledge as they pursue their important role. From the Friday night reception to the Saturday afternoon closing, participants will build their skills with plenary sessions and a selection of workshops led by recognized investment experts.

While the final agenda and list of speakers will be released this summer, participants can begin to consider their choices of three workshops from a selection of nine topics —

- Asset Allocation, Risk Tolerance & Time Horizon
- Understanding Alternative Investments
- The UCF Family of Funds
- Effective Investment Committees
- UPMIFA & Fiduciary Responsibility
- Corporate Social Responsibility at UCF
- Refining Endowment, Investment & Spending Policies
- Building Endowments (Planned Giving & Fundraising)
- Investing with the UCC Cornerstone Fund

The conference will feature a keynote address by Rick Mattoon, an economic advisor and senior economist of the Federal Reserve Bank of Chicago, along with a presentation by UCF Chief Investment Officer Catherine Waterworth. Former UCC General Minister & President John Thomas will also speak, addressing the theological implications of investing in the contemporary marketplace.

The event begins on Friday evening with a reception, dinner and keynote address, followed by a post-dinner opportunity to network with other UCC lay leaders and UCF staff members. On Saturday, the first plenary begins at 8:30am, followed by two workshop sessions and lunch with a keynote speaker. The afternoon brings another workshop opportunity and the closing plenary, with the conference ending at 4:00pm in time for evening flights home.

Sponsored by United Church Funds, *Investing Responsibly in Uncertain Times* costs just \$195 per person, which includes the conference and meeting materials, one hotel night at the Crowne Plaza Hotel at O'Hare Airport (with free shuttle service), and all meals. Participants who would like to spend the weekend in Chicago can add additional hotel nights for just \$99/night including breakfast.

Space is limited for this inaugural conference, and online registration will begin in July. Ready to reserve your place? Call United Church Funds at 212-729-2622.



Investing Responsibly in Challenging Times

A United Church Funds Investor Conference
October 22-23, 2010 • Chicago

Economic Engagement to End the Israeli Occupation

In 2006, United Church Funds helped to create the Ecumenical Action Group for a Just Peace in Israel-Palestine — a task force comprising over 20 denominational executives and lay leaders who collaborate in engaging US and multi-national corporations, seeking to end profit-making from the Israeli Occupation of the Palestinian Territories. Over the last several years, the group has met with Caterpillar, Motorola, Hewlett-Packard, United Technologies and related corporations, encouraging positive change in their business practices in Israel and Palestine and sponsoring shareholder resolutions when discussions bear little fruit.

In February 2010, a group of 13 people representing five main-line denominations and one Roman Catholic order traveled to the region seeking a range of on-the-ground dialogues with US corporations and members of their supply chains. The goal: to ensure corporate executives — many of whom fly in only to attend business meetings in Tel Aviv — gain a deeper understanding of the impact of their activities and practices on the people who live in the West Bank.

Despite early expressions of willingness to meet the group in Jerusalem and environs, Caterpillar and Motorola executives ultimately declined the group's invitation to meet. Proctor & Gamble, however, facilitated a meeting with Avgol, a P&G supplier whose manufacturing facility lies in the Barkan Industrial Zone — essentially an industrial settlement on land well within the West Bank and near the Israeli Ariel settlement (a highly developed planned community of about 20,000). Despite hosting his guests well, the CEO of Avgol indicated the cost to move his facility into Israel proper would be prohibitive. Israeli industrial zones, built on occupied land, offer significant incentives to business owners and enjoy easy access to workers from nearby settlements. Although many Israeli industrial zone business owners hire Palestinian workers, most of these workers are employed in low-level jobs (often in janitorial or other cleaning work) and many are contract workers rather than employees with the benefits enjoyed by Israeli workers. Because most Palestinians

have few employment options, work in settlement and industrial zones remains one of their few means of earning a living.

Hewlett-Packard (HP) also responded to the invitation of the Ecumenical Action Group, sending an Israeli marketing staffer from the Tel Aviv area to meet with the delegation just outside Bethlehem — a suburb of Jerusalem in which the staffer had never traveled. Hewlett-Packard's EDS subsidiary supplies the Israeli Defense Force with the technology required by checkpoint hand scanners that evaluate each Palestinian worker wishing to leave the West Bank (or sometimes simply leave a walled-in city within the West Bank). Following reasoning used by Caterpillar and other corporations profiting from the Occupation, the HP representative claimed that HP does not determine how its products and services are used by customers. But similar claims made 20 years ago in South Africa are currently being challenged in US courts, posing a threat to shareholders of companies who profited from the apartheid regime.

At both the beginning and end of the trip, the delegation met with representatives from the US State Department, who helped clarify some of the work the US government is doing to assist the Palestinian Authority and people as they seek to build a sustainable economy while under Occupation. But the group was again reminded that State Department staff only pursue the policies of the President and US government — real change in the situation in Israel and Palestine requires ongoing engagement with Congressional representatives, many of whom hear only from well-organized and well-funded lobbyists who play down the life-altering injustices occurring daily and at nearly every turn in Palestinian society. United Church Funds remains engaged in fulfilling its obligation to the United Church of Christ as voted in the General Synod resolution adopted in 2005, using economic leverage to promote peace in the Middle East.

UCF Moves Closer to Offering Alternatives

At its March meeting, United Church Funds' board of directors selected a manager for its alternatives portfolio, moving UCF closer to opening these new investment options in the final quarter of 2010. Initially, UCF will use a "fund of hedge funds" approach, offering both an alternatives fund and an alternatives balanced fund to qualified investors. These investments will be subject to a unique set of rules, including a mandatory commitment of one year. If your church or organization is interested in alternatives, keep an eye out for additional information in the coming months.

Recovery Continues in First Quarter

Returns in the first quarter of 2010 ended strong across most asset classes, as the global economy continued to show signs of improvement. Despite a slow start to the year — with equity returns negative in January and February — the market came back in full force in March amid renewed optimism on the sustainability of the economic recovery.

Talk of a potential “double dip” recession — voiced by some economists during the second half of 2009 — receded, replaced by questions of whether the current recovery clearly underway will see the V-shaped recovery (characterized by robust growth) that has typically followed recessions, or perhaps more likely, will see an extended period of positive yet below-average growth. The rationale for the latter: \$700 billion in unprecedented US federal government stimulus spending on programs such as the Troubled Asset Relief Program (TARP), which could provide a headwind to longer-term growth as it is withdrawn and a larger federal deficit remains. Total federal government debt increased in 2009 to more than \$13 trillion from \$10 trillion in 2007, increasing the deficit to more than \$2.5 trillion from \$163 billion in 2007.

Nonetheless, the quarter was marked by improving economic data. In March, it was announced that fourth quarter 2009 gross domestic product (GDP) grew at an above-average 5.6%. A large part of the growth came from companies spending on replenishing their inventory from low levels that they held during the recession as demand dried up. While sharp spikes in inventory are generally not a sustainable contributor to ongoing growth, the pickup in corporate spending does point to increased end demand, which is positive. The unemployment rate, which peaked at year-end 2009 at 10%, ended the first-quarter at a still-weak but improved 9.7%. Employers added 162,000 jobs to payroll in March — the most in three years — after jobs declined by 36,000 in February. In addition, the ISM purchasing managers’ survey for March proved surprisingly strong at 59.6%, its highest since July 2004. In its March meeting, the Federal Reserve Board kept the federal funds rate at the current, historically low target level of 0 to 0.25%, and in its meeting “minutes” reiterated plans to maintain this low level for an “extended period” to facilitate continued economic recovery.

The following summarizes global stock and bond market returns in the first quarter 2010, as represented by the major indexes —

US Large Cap Equity	S&P 500 Index	5.39%
US Small Cap Equity	Russell 2000 Index	8.85%
Int’l Developed Market Equity	MSCI EAFE Index	0.87%
Int’l Emerging Market Equity	MSCI Emerging Market Index	2.41%
US Fixed Income	Barclays US Government /Credit Index	1.55%



US stocks delivered their fourth consecutive quarterly gain and the strongest first-quarter return since 1999, with small cap stocks extending into 2010 last year’s outperformance versus large cap stocks. Smaller companies, which tend to be more sensitive to economic cycles, often outperform in periods directly following recessions as economic growth picks up. US equities across the board outperformed international stock markets. Escalating debt problems and concerns over the solvency of Greece dampened returns in Europe. Among emerging markets, China’s decision to tighten monetary policy by raising the RMB reserve requirement ratio for depository financial institutions by 0.5% curbed investor exuberance. A strengthening US dollar also dampened international equity returns, as a rising dollar reduces the returns US investors in foreign stocks receive when foreign proceeds are exchanged back into dollars. Bonds delivered a solid return, as spreads incrementally narrowed further and companies took advantage of investor demand with significant new issuance.

United Church Funds remains cautiously optimistic that the market will continue to improve, despite some volatility as the US economy recovers. As always, our managers will work to seek the best returns possible in these still uncertain times.

Hedge Funds, An Alternative Investment

Imagine you're buying a new car. You've done your research, chosen a well-rated brand and selected the model that will give you the best investment for your money. But when you buy the car, you decide to purchase the extended warranty as well. Some would say you were "hedging your bet" — seeking a positive outcome no matter the circumstances. That's what hedge fund managers do — in fact, the name *hedge fund* actually comes from the phrase "hedging your bets."

In 1949, skilled stock picker Alfred Winslow Jones established the first hedge fund, envisioning an investment structure that would enable investors to earn a positive return regardless of fluctuations in the overall stock market. So Mr. Jones "hedged" his portfolio, buying shares of stock he believed would rise in price (like a traditional investor), and shorting shares of stock he believed would fall in value.¹ Provided his stock picks were correct, Mr. Jones would make money regardless of how the overall market performed. If the market dropped, the profits from his short positions would offset the losses from his long positions (those traditional purchases). If the market went up, the profits from his long positions would offset the losses from his short positions.

While hedge funds have evolved since the 1940s, Mr. Jones' original concept remains central to modern hedge fund management. Today, hedge funds are segmented according to the different investment strategies that they employ, but share the common goal of targeting a specific return goal regardless of market conditions.

Hedge Funds vs. Traditional Mutual Funds

A traditional mutual fund manager buys a stock with the expectation that the shares will rise in value, based on the manager's analysis of the stock relative to the company's financial health and growth prospects. Hedge fund managers, on the other hand, enjoy greater flexibility. As described above, a hedge fund manager may buy one stock to hold while shorting another that appears to be overvalued. Or s/he may use derivatives like *put options*, which provide downside protection

on particular stocks. Perhaps a hedge fund manager owns Bank of America stock, believing the bank has stabilized and become profitable again since the recession. The manager is concerned, however, that new financial regulatory legislation could have an adverse effect on the profitability of large banks — so the manager purchases a *put option* on the portfolio's investment in Bank of America. The put option is basically insurance that permits the manager to sell the Bank of America stock at a price close to the current level should the stock drop. For a premium (the cost of the put option), the manager is able to limit the portfolio's losses if the stock goes down, while profiting if the price rises since the portfolio already owns the stock.

In general, hedge funds share several characteristics —

- *Unlisted*
Hedge funds represent private pools of money, rather than investments listed on an exchange.
- *Unregulated*
Hedge funds remain largely unregulated and lack transparency in investment positions and reporting requirements.
- *Flexible*
Investment managers use a variety of tools to profit in both rising and falling markets.
- *Leveraged*
Investment managers may borrow money to add to their positions, which can enhance returns when used prudently.

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- *Illiquid*
Investors commit to lock-up periods on their investment (usually one or more years from the time of investment), and infrequent redemption periods may require advance notice.
- *Expensive*
Investment managers usually charge a base management fee (typically 1.5-2.0%) plus a performance incentive fee (typically 15-20% of the fund's profit above a specified level).

KEY POINTS

- The name *hedge fund* derives from the phrase "hedging your bets." Hedge fund managers seek to profit in both rising and falling markets.
- Hedge fund managers enjoy freedoms unavailable to traditional managers, including the opportunity to sell short, to use leverage (or borrowed funds), and to operate with minimal regulation and transparency.
- Institutional investors choose hedge funds to improve returns and reduce overall portfolio risk.

¹ To short a stock, an investor borrows shares (often from an owner holding the shares in a long-term portfolio), then sells those borrowed shares with the expectation of repurchasing them later at a lower price to repay the lender. If the stock price falls, the investor profits (pocketing the difference between the original price and the new lower price the investor pays to repay the shares to the lender). However, if the stock appreciates, the investor faces a loss (owing the difference between the original price and the new higher price the investor pays to repay the shares to the lender).

Why hedge funds?

Institutional investors (like churches) and high net worth individuals generally choose to invest in hedge funds for two primary reasons: 1) hedge funds typically offer lower volatility (lower risk) and can add diversification to an investor's portfolio, and 2) hedge funds aim to provide enhanced risk-adjusted returns over time. Because hedge funds rely on mechanisms such as selling short, derivatives and leverage, they are often mistakenly considered more risky investments. A well-run hedge fund, however, actually reduces risk within the portfolio by employing hedging techniques that neutralize different market conditions.

Unfortunately, a number of hedge funds have publicly "blown up" in the last few years. Besides cases of outright fraud, many failed hedge funds share a common problem: the overuse of leverage. Leverage, or buying on margin (borrowing) to add to an investment position, is a double-edged sword: when an investment goes up, leverage increases return; but if the investment goes down, leverage magnifies losses. A manager utilizing leverage to increase investment in a specified stock must ensure the hedge fund has enough extra cash on hand to meet margin calls (or provide additional collateral) if the leveraged stock falls in value. Because irresponsible or unskilled hedge fund managers can get into trouble with leverage, choosing the right hedge fund manager is as important as making the decision to invest in hedge funds in the first place.

Of course, the last few years have seen unprecedented financial turmoil, and both financial markets and market participants have come under scrutiny. The prosecution of Bernard Madoff brought out of the woodwork other rogue hedge fund managers driven by high fees, extravagant life styles and relentless greed — at the expense of innocent investors. Nonetheless, by many accounts, hedge funds emerged from the 2008-2009 financial crisis with renewed attention and increased investment due to the potential benefits of portfolio diversification and risk reduction.

In 2008, for example, the S&P 500 Index fell 37% while the HFRX Aggregate Index (a broad hedge fund index) was down only 17%. Although one might argue that hedge funds should have hedged their risks more effectively (any many did), the dire financial conditions that swept the global economy led to investor panic and an unprecedented contraction in liquidity that impacted nearly every asset class except US Treasuries. And in order to stabilize the financial system in 2008, the US government enacted temporary restrictions on short-selling which affected the ability of hedge fund managers to fully "hedge" their portfolios. Nevertheless, hedge funds sizably outperformed the broad equity market in 2008 — and where the traditional 60%/40% equity/bond portfolio included a hedge fund allocation as a portion of equity, the portfolio's overall negative return in 2008 was likely reduced.

For years, large institutional investors like major US foundations and university endowments have used hedge funds and other alternative investments (including real estate trusts, commodities and venture capital) to reduce risk, diversify portfolios and improve potential returns. The inclusion of hedge funds in asset allocation decision-making — for both large and small institutions — is likely to grow in the coming years as investors better understand hedge fund strategies and acknowledge benefits these strategies bring to a portfolio over the long term.

ADVANTAGES

- Absolute return oriented, to profit in both bull and bear markets
- Higher risk-adjusted returns relative to traditional asset classes thanks to flexible investment approach, prudent use of leverage and hedging strategies employed
- May provide low correlation with traditional asset classes. Hedge fund investment returns often do not move in lock-step with other investments, such as stocks or bonds.
- Most underlying hedge fund investment positions are liquid and marketable

DISADVANTAGES

- Higher fee than traditional mutual fund investments
- Investor lock-up periods or restrictions on withdrawals
- Lack of regulation and transparency in positions and reporting

A Range of Strategies

As the hedge fund industry has evolved, hedge funds are now typically classified according to the strategies they employ —

- *Long/Short Equity*
Long equity positions are hedged with short sales of stocks or stock market index options. The overall portfolio may hold a long or short bias depending on the investment manager's view of the market.
- *Market Neutral*
Long and short positions completely offset each other to create a neutral portfolio that eliminates market risk, with excess return generated by individual stock selection.
- *Global Macro*
Attempts to capitalize on global macroeconomic changes or trends using various hedged strategies.
- *Managed Futures*
Primarily uses the futures market, taking long and short positions in futures to capitalize on changes or trends in global macro-economic conditions.
- *Merger Arbitrage*
An event-driven strategy that attempts to exploit pricing inefficiencies between merging companies.
- *Distressed Securities*
Typically specializes in the debt securities of companies trading at discounts to their value because of (potential) bankruptcy.
- *Convertible Arbitrage*
Attempts to exploit pricing inefficiencies between convertible securities and the corresponding stocks.

Sources: *The Economist Guide to Hedge Funds*, Philip Coggan, 2008
Summit Strategies, consultant to United Church Funds



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INVESTMENT
PERFORMANCE
MARCH 31, 2010

AVERAGE TOTAL RATES OF RETURNS		ANNUALIZED								
<i>Returns on UCF funds are presented net of fees</i>		Quarter	Year to Date	One Year	Three Years	Five Years	Ten Years	Current Yield	Unit Value	Market Value
MANAGED FUNDS	Fixed-Income Fund	1.97%	1.97%	13.91%	6.67%	5.58%	6.11%	4.56%	\$4.5673	\$250.2M
	Barclays Capital Gov't Credit Bond Index (BCGC)	1.55%	1.55%	7.51%	5.84%	5.17%	6.22%			
	Domestic Core Equity Fund *	5.05%	5.05%	50.11%	-4.67%	N/A	N/A	1.96%	\$9.3297	\$211.8M
	S&P 500 Index	5.39%	5.39%	49.77%	-4.17%					
	Small Cap Equity Fund *	8.28%	8.28%	51.81%	-6.93%	N/A	N/A	0.51%	\$8.9312	\$67.6M
	Russell 2000 Index	8.85%	8.85%	62.77%	-3.99%					
	International Equity Fund *	2.26%	2.26%	64.32%	-4.63%	N/A	N/A	2.71%	\$10.4806	\$90.4M
	EAFE Index	0.87%	0.87%	54.44%	-7.02%					
	Cash & Equivalent Fund (annualized)	0.01%	0.01%	0.05%	2.45%	N/A	N/A	0.00%	\$1.0000	\$5.5M
	Lipper Money Market Funds Index (annualized)	0.01%	0.01%	0.11%	2.06%					
FUNDS OF FUNDS	Total Equity Fund (57.3% Domestic Core Equity, 18.3% Small Cap Equity and 24.5% International Equity)	4.83%	4.83%	53.80%	-5.09%	1.36%	-0.60%	1.88%	\$9.6335	\$367.4M
	Policy Index: 55% S&P 500, 20% Russell 2000, 20% EAFE, 5% MSCI Emerging Markets Net	5.01%	5.01%	54.99%	-4.37%	2.59%	0.14%			
	Conservative Balanced Fund ** (36.8% Equity, 63.2% Fixed-Income)	2.98%	2.98%	27.11%	2.86%	N/A	N/A	3.57%	\$10.1887	\$4.0M
	Policy Index: 35% Equity Policy, 65% BCGC	2.84%	2.84%	22.66%	2.70%					
	Moderate Balanced Fund (61.1% Equity, 38.9% Fixed-Income)	3.63%	3.63%	36.18%	-0.26%	3.46%	2.09%	2.92%	\$7.5747	\$345.5M
	Policy Index: 60% Equity Policy, 40% BCGC	3.71%	3.71%	34.42%	0.16%	4.01%	2.75%			
	Aggressive Balanced Fund ** (75.4% Equity, 24.6% Fixed-Income)	4.09%	4.09%	42.70%	-2.15%	N/A	N/A	2.54%	\$9.7427	\$9.1M
Policy Index: 75% Equity Policy, 25% BCGC	4.21%	4.21%	41.88%	-1.47%						

*Inception 10/01/05 **Inception 01/01/06