ALA Endowment Trustees

Report to Council

Saturday January 25, 2014

Philadelphia *(Long-Term Investment Fund)*

Rod Hersberger – Senior Trustee

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<u>Endowment Performance</u>

At the end of 2013, the value of the Endowment stood at $37,288,932. This value is as improvement of $14,000,000 or 61% from the recessionary depth of $23,421,000 in 2008.

2013 was a banner year for equities in the United States and Western Europe. While remaining within the investment policy guidelines, the Trustees have over-weighted equities compared to other assets classes. Consequently, ALA's long-term investment returned

16.7% last year. The Endowment's performance has been relatively robust since 2008.

As you know, the Fed has kept interest low for several years, so most fixed income investments have struggled and compare poorly with equities. Corporate bonds did somewhat better than government securities. Hybrids like convertible securities did rather well and real estate investment trusts performed better than fixed income, but not nearly as well as equities.

Even though the equity sector performed spectacularly, it is important for an endowment like ours to maintain a balanced portfolio. Someday interest rates will rise and equities will decline. Those of you who follow markets know that major equity indexes returned 25% or more in 2013. Because ALA maintains a balanced portfolio, terrible years like 2008 could have been far worse. In that year, equity indexes plunged by a third or more while ALA's endowment value dropped only 24%. We won't have a benchmark comparison for 2013 from NACUBO and others until mid-year. However, if you look at longer terms of 3, 5, and 10 years, ALA's total returns compare favorably with comparison indexes.

Trustee Activities and Process

The Trustees are all experienced, recognized leaders in the field, but are relatively new to the Trustee role. Prior to our September meeting in Chicago, our advisors from Merrill Lynch put together a very useful and informative webcast about investing and the roles and responsibilities of being a Trustee. Since the webcast had voice interaction for all participants, it allowed for lively interaction.   When we got together in person a few days later, we continued the orientation and learning experience by giving the investment policy a thorough review

Gradually, over the years, the Trustees have diversified the asset classes in which we invest Association funds. In the world of wealth management, it is well accepted that investing in a broadly diverse set of asset classes will, over time, result in superior returns with less risk. As the Association's capital has grown and the knowledge base of the Trustees has grown more sophisticated, we have broadened the asset classes in which we invest.

Part of this diversification is considering active vs. passive management. By passive management, we mean investments like ETFs that follow a well know index like the Standard & Poor 500 or the Russell 3000. By active management, we mean that managers will select individual stocks within something like the S&P 500.

While not ignoring the performance of individual managers over defined periods of time, the Trustees are now more focused on asset class investments – large cap, small cap, convertibles, REITs and so forth.

Starting last year, the Trustees are holding their February meeting in New York. While we have excellent advisors at Merrill Lynch, I wanted the Trustees to have access to different talent and expertise that is only found in New York. These New York sessions are not sales pitches, but an opportunity to evaluate both macro-economic conditions as well as different asset classes that might be appropriate for our size of endowment.

What Lies Ahead

If consumer spending remains level or improves and corporate earnings are strong, the equity markets may not have topped out yet. Unemployment remains stubbornly high. Many corporations have found ways to increase profit without adding to payroll costs.

In Janet Yellin, the Fed has a new chief. Quantitative easing is winding down, but if the Fed keeps interest rates low, there is little reason for fixed income to perform much better in 2014.

Developing markets are somewhat uneven, so it is difficult to predict whether investments in that sector will keep pace with equity markets in the US and Western Europe. In any event a well-balanced, diversified portfolio will serve ALA well as it has in the past.