

**2009-2010 ALA CD#16.1  
2010 ALA Annual Conference**

**ALA Endowment Trustees  
Report to Council  
Sunday – June 27, 2010  
Chicago, IL**

This report provides information regarding the performance of the ALA Long Term Investment Fund (LTI) i.e. the Endowment Fund. It is provided as a supplement to the oral report given by the Senior Trustee of the Endowment Trustees. This report also provides information on the general condition of the financial markets, the performance of the individual portfolio managers and other issues that impact the Endowment fund that are viewed as important to the membership. This report will be placed on the Treasurer's web page after this Annual Conference.

**Attachments**

Attached for your review are charts (Exhibits #1-5) detailing the value of the portfolio, the allocation of the assets by type, investment style and manager. Also included is a historical review, manager investment style/benchmark comparisons and other pertinent information related to the management of the Endowment Fund.

**Volatility at its Best and Worst**

The Trustees preface their commentary here by reminding the membership that "Volatility" is a fact of life. It is an aspect of the market that increases as uncertainty and risk increase. It is something that must be dealt with everyday and is influenced by events from around the world.

*First Quarter* - Last year at this time when the Trustees reported to you, we talked about the "Tale of Two Quarters." Coming out of the financial crisis of 2008 the first quarter of 2009 was very volatile on the downside reaching a market low on March 9, 2009. Since that time, beginning with the second quarter, volatility worked in our favor moving the market up and producing a gain in the portfolio during 2009 of \$5.2 million or 23.4%. Volatility continued to work in our favor during the first quarter of 2010 as the portfolio produced a gain of \$1.2 million or

4.5%. Despite the strong start things changed again. Just the opposite of what happened in 2010.

*Second Quarter* – Through 4-30-10 the portfolio reflected a gain of \$1.7 million or 6.3%, which compared favorably to its index of 5.4%. However, in May the market began to lose the faith it placed in its assessment of the economies general strength. What caused the change? After a blistering 14 month rally, investors began to suffer from buyers' fatigue. The cheap buying bonanza realized by bargain hunters due to the stock market free fall in 2008, which cut broad market values in half, was over as the market was now viewed as slightly fair to over priced. There are now lingering doubts about whether or not the underlying strength of the US economy justified the market's ascent in the past year. This is particularly true in view of the fact that this seems to be a jobless recovery. Other significant impacts include the following:

- The end of government stimulus programs
- Lack of a consumer lead rebound
- Continued de-leveraging by consumers
- Euro Zone debt concerns rise
- Housing still unsettled
- Financial reform up for debate
- Calls for a "Double Dip" recession getting louder

The result was a significant negative impact in most asset categories during the month of May. This was never any clearer than on May 6<sup>th</sup> when European debt fears greased the skids for a violent market sell off – now known as the "Flash Crash." Major indexes plunged as much as 650 points or 9.2 % in a ten minute period. Although the market recovered during the remainder of the trading session, it sent chills throughout the financial markets. For the rest of the month through today volatility has ruled the day.

As noted earlier, the volatility pattern is just the opposite of last year at this time and so is the result. Regardless, volatility is here to stay.

### **Endowment Fund Performance**

For the five months ended 5-31-10 the value in the ALA Endowment fund increased by \$235,648 from \$28.7 million to \$28.9 million - see exhibit #1. This resulted in a return of 1.1% compared to the portfolio's benchmark, which recorded a loss of -0.1%.

As we can see from exhibit #3, most of the portfolio managers performed at a level that was less than their benchmarks. Their results were as follows:

***Alliance Bernstein*** – Core manager – reported a loss of -1.2% compared to its benchmark of -1.5%. Alliance is the portfolio's equity stabilizer with equity holdings split between growth and value categories. Holdings are currently split 60/40 in favor of growth. The firm makes investment decisions based on long-term secular market themes, along with some catalysts to provide support and short term cyclical changes in the economy. The portfolio is currently overweight in information technology, energy and materials, while underweight in consumer staples and financials. The portfolio was helped to date by holdings in Cummins, Estee Lauder, VMware, Inc. and hurt by Cameco Corporation, Red Hat and Qualcomm.

### ***Institutional Discretionary Portfolio's - IDP***

The IDP is an investment vehicle designed to provide exposure to a diversified portfolio of large cap growth, large cap value and international common stocks consisting of a blend of investment manager/styles, mutual funds and exchange traded funds (ETF's). These portfolios provide for a greater degree of diversification as the risks are not limited to just one manager and help to tamp down volatility. These portfolios are adjusted/allocated among the components of the portfolio based on expected market conditions.

Large Cap Growth manager – reported a loss of -2.3% compared to its benchmark which lost -2.3%. This represents the results of two managers as Marsico was replaced in April 2010.

Large Cap Value manager – reported a small gain of 0.6% compared to its benchmark (S&P/Citigroup Value) of -1.0 %.

International manager – reported a loss of -12.0% compared to its benchmark (MSCI EAFE) of -11.0%.

***NFJ*** – Small Cap manager – reported a gain of 4.6% compared to its benchmark (Russell 2000 Value) with a gain of 7.8. NFJ is a value contrarian style investor who concentrates on out of favor, dividend paying, low multiple small cap companies and has low adherence to their benchmark. As such they typically provide more downside risk protection. Exposure to the mining and materials industry, along with gas utilities and financials hurt the performance of the portfolio. Holdings included Lamgold, Ennis Inc. and Bank of Hawaii. The losses were mitigated by exposure to consumer staples and disretionnaires. The

holdings included Del Monte, Teleflex, Lubrizol Corporation and Phillip Van Heusen.

***Heitman and Invesco*** – REIT managers – reported gains of 11.0% and 8.9% respectively compared to their benchmark (Wilshire Real Estate Securities) which reflected a gain of 11.1%. Heitman benefited from overweighting in the regional retail and diversified sectors while being underweight in the office and healthcare sectors. Overweighting in the industrial sector detracted from performance. Invesco performance was helped by overweighting in the lodging sector while underperformance was more the result of modest weightings in shopping center, regional mall and office sectors.

***The Endowment Fund*** – Alternative Manager – reported a gain of 4.5%, which is more than its benchmark of 3.3%. Note that the Endowment Fund is a fund of funds hedge fund manager and reports on a 30 day lag. As such the results you are seeing now is as of April 30, 2010. This asset class gives the portfolio access to areas of investment that ordinarily would not be available to us, while at the same time provide additional stability from a volatility standpoint.

***PIMCO*** – Fixed Income manager – reported a gain of 5.4% to its benchmark (ML US Bond Market) which returned 3.9%. The portfolio benefited from growing investor confidence in a sustainable economic recovery. The corporate sector lead performance and the portfolio's exposure to the bonds of financial companies added to performance. Also helping was exposure to Asian currencies and plays on falling European interest rates.

Despite the signs of a stronger than expected economic recovery in the US, Pimco believes that over the long haul than the US and other developed countries will experience below trend growth. Management believes that deflationary pressures will likely persist in the developed world. Pimco calls this situation the “New Normal.”

***Lord Abbett*** – Convertible Bond manager and new to the portfolio since the Midwinter Meeting – reported a gain of 10.6% slightly less than its benchmark return of 12.3%. Convertible securities are hybrids in that they are fixed income securities with the ability to be converted into equities provided certain market conditions are met. Thus they have the benefits of both worlds with the potential to generate additional gains.

***Ariel Capital*** – SRI manager – reported a gain of 1.4% compared to its primary benchmark (Russell 1000 Midcap Value) of 5.6%. Because of Ariel's unique

standing in the investment community in that they are an SRI fund that compares itself to a more industry standard benchmark i.e. non-SRI (Russell 1000 Value), we have also provided two SRI specific indices, the Domini 400 and the KLD Social Select. These performance measurers reflected returns during the period of -1.6% and -2.2% respectively. Ariel's performance suffered in May, down -9.6% and was hurt by overweighting in consumer discretionaries and healthcare and no exposure to utilities.

### **New Manager - Institutional Discretionary Portfolio (Growth)**

As the Trustees move forward and examine opportunity to improve the portfolio's performance and reduce volatility, manager options are examined. The Trustees have been monitoring and reviewing the performance of the portfolio's large cap growth manager – Marsico. It was determined that for the level of risk incurred, the results over an extended period time suggested a change was necessary. Although Marsico has had a good reputation and has had favorable good results, they also run a concentrated portfolio i.e. approximately 30 stocks. It was felt that by moving to the IDP product that the large cap growth space could generate better returns and minimize the risk/volatility. The chance of a handful of holdings blowing up and negatively impacting the entire asset category are minimized.

### **Asset Allocation and Rebalancing**

See exhibit #5 for details on the asset allocation strategy and current allocation. The practice of rebalancing is based on an assessment of the prevailing risks and opportunities in the market. The Trustees', in conjunction with its investment advisor, continually monitor the portfolio and look for new opportunities to boost performance at appropriate levels of risk.

It should be noted that using asset allocation strategies is the foundation for generating excess investment earning. This is value added by "Active Management." This is accomplished by the following:

1. Overweighting an asset category which is undervalued or out of favor
2. Underweighting an asset category which is overvalued or in –favor
3. Interviewing and selecting managers that add value over their benchmarks
4. Rebalancing asset categories over time as appropriate

Based on the prevailing and expected future market conditions the Trustees are continuing their strategy of maintaining the current balance between equities and fixed income and reviewing other asset classes that will reduce risk and enhance

performance. Many believe that the foundation has been laid for some significant long-term gains in equities due to the de-leveraging or revaluation that is taking place in the market.

### **Acknowledgements**

On behalf of the Trustees I would like to thank the ALA Finance staff who assists the Endowment Trustees in carrying out our duties. We continue to be especially well served by Greg Calloway, Keith Brown and Elaine Klimek of the ALA financial staff. They have been very dependable, reliable and thorough in assisting the Trustees in our financial oversight responsibilities.

Respectfully submitted,

Dan Bradbury – Chair (2012)

John Vitali – Trustee (2010)

Robert Walton – Trustee (2011)

Rod Hersberger – ALA Treasurer, Ex Officio (2010)