2010-2011 ALA CD#16
2011 ALA Midwinter Meeting

ALA Endowment Trustees
Report to Council
Sunday, January 9, 2011
San Diego, CA

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 Chair of the ALA 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 Midwinter Meeting.

Note: Due to the early scheduling of this year's Midwinter Meeting, much of the detailed analysis will be focused on the eleven month results ending 11-30-10.

Attachments

Attached for your review are charts (Exhibits #1- 4) 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, as well as, other pertinent information related to the management of the Endowment Fund.

Financial Year in Review - 2010

After the trauma of the financial meltdown of 2008 and the degree of persistent volatility in the markets in 2009, expectations for 2010 were all over the board. The economy expanded at a much slower rate than is normally expected in a post recession recovery. Unemployment, which started the year at 9.7%, moved in the wrong direction as it increased during the year to nearly 10.0%. Even though it was clear that the economy was recovering, it was just as clear that it was in the form of a jobless recovery i.e. no job growth. In view of the amount of stimulus dollars that were made available to address the issue, the results were disappointing. However, despite the jobless recovery, corporate America has never done better. The cash balances for American corporations reached a 50 year high. Most of the profitability realized during the year were the result of labor cost savings and other cost cutting efforts but no organic growth.

Endowment Fund Performance

As noted above we do not have the detailed analysis for the twelve month period ending 12-31-10. However, we are in a position to report on some preliminary information. The Trustees are happy to report that the value of the endowment at 12-31-10 was $31,668,000. This is a gain of approximately $3.0

million (10.4%) compared to last year. The estimated gross return for the ALA portfolio was 12.2% for 2010.

For the eleven months ended 11-30-10, the value of the ALA Endowment fund increased by $2.2 million from $28.7 million to $30.9 million - see exhibit #1 and exhibit #3. This resulted in a return of 8.0% compared to the portfolio's benchmark of 8.1%. As we can see from exhibit #3, all of the portfolio managers reported positive results. Additionally, comparisons to their respective benchmarks were also positive with a few exceptions. Their results were as follows:

Alliance Bernstein – Core manager – reported a gain of 20.1% compared to its benchmark of 7.9%. Alliance is the portfolio's equity stabilizer with holdings in the growth and value categories. Holdings are currently spilt 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 Amazon, Juniper Net, Netflix Inc. Red Hat and Qualcomm.

Institutional Discretionary Portfolio (IDP)/(Marsico) – Large Cap Growth manager – reported a gain of 8.5% compared to its benchmark of 10.6%. For the year this is a combination of the results between Marsico, a growth manager that runs a concentrated portfolio and the IDP growth portfolio, which is a combination i.e. exposure to a blend of investment managers/styles, mutual funds and exchange traded funds (ETF's).

Institutional Discretionary Portfolio (IDP)/(Blackrock) – Large Cap Value manager – This is the combined results of the Institutional Discretionary Portfolio (IDP) and Blackrock. The IDP has been in place (managed) since October. The combined efforts resulted in a gain of 8.6% compared to its benchmark (S&P/Citigroup Value) of 7.1%. The new manager was hired because the Trustees felt that the overall performance of Blackrock was good, but a better investing alternative was available in this asset category and carried much less risk.

NFJ – Small Cap manager – reported a gain of 11.9% compared to its benchmark (Russell 2000 Value) which gained 15.0%. NFJ has performed very well in all types of market conditions, which is contrary to how small cap stock managers typically perform in volatile markets. This asset category typically performs well coming out of a recession. It is also one of the first categories to be negatively impacted at the onset of a recession. Since August 24th small caps have been running hard and have easily outperformed large caps.

As a value contrarian style investor who concentrates on out of favor, low multiple small cap companies, NFJ provides downside risk protection. The portfolio is currently underweight its index in financials and overweigh in industrials, materials, utilities and consumer staples. The portfolio continues to be helped by holdings of Lubrizol Corporation, Brinks, Ennis, Inc. and Phillips-Van Heusen Corporation.

Institutional Discretionary Portfolio (IDP) International/(Lazard) – International manager – reported a gain of 2.8% compared to its benchmark (MSCI EAFE) of 0.3%, which is a 34.5% gain. As stated this time last year, there are 38 stock markets in developed and emerging countries around the world but all reported positive gains this year instead of losses. Lazard is by nature a defensive manager in a volatile asset class, which is why they were hired. As such they protect on the down side but won't realize as much of the markets rise when things turn positive. This is the nature of Lazard's investing style and explains why they have lagged the turnaround that occurred in 2009.

Invesco – REIT manager – reported a gain of 19.4% compared to its benchmark (Wilshire Real Estate Securities) which also reported a gain of 22.3%. This asset category continues to spin off a significant amount of interest to the benefit of the association. All this is being accomplished in the shadow of a struggling residential housing market. Commercial real estate, which was forecast to be the second shoe to drop in real estate, has rebounded nicely. The portfolio is currently overweight in retail property, office space, apartments and diversified properties. The best performing holdings were Simon Property Group, Vornado REIT, Camden Property and Boston Properties.

Blackrock – SRI manager – reported a gain of 8.0% compared to its primary benchmark (KLD Domini 400) of 5.6%. The Blackrock SRI manager applies the same process for investing as its non-SRI portfolios – quantitative models and fundamental research, growth/momentum and valuation. At this point the portfolio is still underweight financials, prefers energy to materials, overweight consumer discretionary and healthcare.

Ariel Capital – SRI manager – reported a gain of 10.5% compared to its primary benchmark (Russell 1000 Midcap Value) of 16.0% and the standard SRI index (KLD Domini 400) of 5.6%. Ariel is an SRI fund that compares itself to a more industry standard benchmark i.e. non-SRI Ariel's performance was helped by holdings in media and consumer discretionary stocks.

Lord Abbett – Convertible Bond manager – reported a gain of 7.6% compared to its benchmark return of 4.6%. 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. The portfolio is currently overweight health care, consumer discretionaries and materials.

Neuberger Berman – Intermediate Bond manager – reported a gain of 1.5% compared to its benchmark return of 1.3%. Neuberger seeks total returns with lower volatility than longer maturity bond strategies. The taxable fixed income sector delivered good absolute performance as interest rates continued to test their cyclical lows. Credit sensitive sectors mostly outperformed Treasuries. High

yield issues were up strongly and fared better than investment grade bonds. Treasuries and corporates made up the bulk of the portfolio.
The Endowment Fund – Fund of Funds Hedge Fund Manager – reported a gain of 6.3%, which is more than its benchmark of 4.1%. 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 October 31, 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 10.4% compared to its benchmark (ML US Bond Market) which returned 8.0%. Pimco has been very good at making investment decisions based on where they think interests are headed. They continue to overweight government and AA securities with maturities in the 1-5 year range. Because of the expectation of higher rates in the future and its potential impact on the performance of this asset category, the Trustees have been reducing their position in PIMCO and reallocating those dollars into other asset classes when possible.

Asset Allocation and Rebalancing
Exhibit #4 provides details on the current asset allocation and strategy. 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. Since the Annual Conference the Trustees have made the following moves to enhance performance:

- Reduced fixed income bonds (Pimco) by $3.3 million and fixed income convertibles bonds (Neuberger Berman) by $1.5 million

- Reallocated $300,000 to REIT (Invesco)
- Reallocated $1.5 million to global fixed income bonds (Templeton)

- Reallocated $1.5 million to global fixed income bonds (Oppenheimer)
- Reallocated $750,000 to real assets (Pimco)
- Reallocated $750,000 to real assets (Hartford)
- Reallocated $600,000 to large cap growth (IDP)
- Reallocated $300,000 to large cap core (Alliance)

- Liquidated Blackrock SRI and reallocated $247,000 to SRI mutual fund Ariel

As you can see from the above information the Trustees have underweighted the portfolio's holdings in fixed income securities.

<u>Outlook for 2011</u>

As the Trustees have stated over the years, predicting the future is unwise and full of risk. 2011 will be no different. However, by looking at available information the Trustees are confident that the portfolio is well positioned to take advantage of the current financial environment and protect the corpus while adding value. 2010 closed out in a much more positively than many expected. Many analysts now expect the market for 2011 to end with a positive gain although with some bumps along the way. As stated earlier the current economic recovery is weaker than most post recession recoveries. The economy is expected to grow at about 3.0% - 3.5% during the year. In view of the severity of the most recent economic decline i.e. "The Great Recession," this level of growth is considered to be a weak recovery.

In many professional views the cyclical bull market that began in March 2009 is not yet over. Our own Investment Advisor's technical analysts are forecasting higher equity prices and mediocre returns from fixed income securities. The recently passed tax package has revised economic forecasts upward. The tax package is expected to add approximately $100.0 billion in net new stimulus during the year. This should add an additional 0.5% to GDP.

Unfortunately the tax package also adds about $400.0 billion to the budget deficit over the next two years. This likely means higher Treasury supply and will push 10 year Treasury yields higher. The percentage of institutional investors forecasting higher inflation is now at a six year high. As such, pro-growth and pro-inflation strategies and resources are being put in play.

Capital expenditures and corporate spending in the US are expected to be stronger than consumer spending, which is still being hurt by high unemployment. Meanwhile global GDP is expected to grow about 4.3%. Growth in Europe, excluding Germany, and Japan are expected to be sluggish, while Asia and emerging markets will grow at a robust 6.4%. Note that emerging markets account for about 75% of the expected global growth.

Portfolio Manager Changes

During the year the Trustees continually monitor the financial landscape and performance of its managers. This monitoring resulted in the following changes at the Trustees November meeting in Chicago:

1. Templeton Global Bond
2. Templeton Global Total Return
3. Oppenheimer International Bond
4. Pimco Commodity Real Return
5. Hartford Global Real Asset[1]

These managers represent portfolio exposure to global fixed income and real assets in the form of mutual funds. The expectation of growth and higher inflation makes the necessity for holding real assets a must. Additionally, fixed income pricing around the world are presenting excellent opportunities not available in the US bond market i.e. high yielding international bonds and the potential benefit of non-dollar investments. The addition of these managers expands the reach of the portfolio and allows for performance in all market conditions. This lineup makes asset allocation all the more important and flexible.

An additional move made by the Trustees during their December conference call was to consolidate the holdings of the SRI manager's. Based on a number of metrics and factors i.e. performance, community activism etc. the holdings of Blackrock were liquidated and moved into Ariel Investments. It should also be noted that Ariel[2] recently joined the Bank of America/Merrill Lynch investment platform. This will allows Merrill Lunch to advise upon the fund, provide performance & valuation of the fund (rather than the estimates) and to include the performance of that fund in the overall ALA composite performance.

Spending Policy Change

For the better part of the year the Trustees have been examining ways to increase the amount of funds that could be made available for scholarships, awards, program initiatives and other projects. To this end the Trustees, along with the ALA finance staff, are in the process of performing some financial modeling. It is our hope and expectation that this exercise will point us to a payout rate that will increase the current level of spending, while minimizing the impact on the portfolio's total return. It is our intent to report back to you on this subject in the spring or at the latest at Annual conference in New Orleans.

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[1] Managed by Wellington in their Diversified Inflation Hedge style

[2] When initially hired at the direction of the Executive Board for an SRI mutual fund, Ariel was a mutual fund holding outside of the Merrill Lynch platform

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 (2013)
Robert Walton – Trustee (2011)
James Neal – ALA Treasurer, Ex Officio (2013)