

**2012 ALA CD#16  
2012 ALA Midwinter Meeting**

**ALA Endowment Trustees  
Report to Council  
Sunday - January 22, 2012  
Dallas, TX**

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 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.

**Attachments**

Attached for your review are charts (Exhibits 1- 10) 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.

**Endowment Fund Performance**

*Background: The Investing Environment in 2011* - Since the financial meltdown of 2008 - 2009, volatility has been the watch word for the Trustees and most other investors. This was particularly true for the investing environment in 2011. In terms of volatility there has been no other year like 2011. Investing in this market was like watching volatility on steroids. Any news – good or bad – impacted the market in ways no investor could have ever imagined or predicted. From the Arab Spring Uprisings that began in January, the Japanese Tsunami and nuclear disaster in March, the never ending European sovereign debt crisis, to the handling of the U.S. debt ceiling debate and where for the first the credit rating of U.S. government

debt was downgraded from AAA to AA+. This and much, much more helped to define volatility during the year. An example of volatilities impact is the S&P 500 which was up as much as 8.4% in April and down as much as -13.2% in early October and ended the year at 0.0%.

As we entered 2011 the general thinking among the market prognosticators was to allocate more or most of your assets outside of the U.S., particularly to large multi-nationals. For the U.S. markets the results were mixed with a slight gain of 5.5% in the Dow Jones Industrial Average, a miniscule loss (flat) of 0.003% in the S&P 500 and a loss of 1.8% in the NASDAQ Composite. U.S. corporations reported record profits and price to earnings ratios for stocks dropped to their lowest levels in recent memory. Due to the issues mentioned earlier that caused the resultant volatility, the markets positive fundamentals were drowned out. Despite the issues in the U.S., when there was any sign of trouble in the world the U.S. was once again viewed as a safe haven i.e. the place to be (Treasurys).

Working with the mind-set that the U.S. is still a safe haven in times of trouble and uncertainty, equity markets in the rest of the world were bound to struggle. The results were a near disaster with most major foreign markets reporting double digit losses. Exhibits 3-5 illustrates the impact volatility had on the markets at different times during the year, particularly the 3<sup>rd</sup> quarter (7/1/11 – 9/30/11). Remember, the results in the 1<sup>st</sup> quarter were probably the strongest quarterly market results since 1998.

*Endowment Fund Performance* - The Trustees can report that the value of the endowment at 12-31-11 was \$30.1 million. This represents a decline of \$722,587 (1.6%) from \$31.7 million last year - see exhibit #2. The loss in the portfolio of 1.6% compares to its benchmark which returned a gain of 2.6%. As we can see from exhibit #7, with the exception of the Invesco the REIT manager, most of the equity managers sustained losses which closely correlated with the general decline in equity markets around the world. This was particularly true for the core manager<sup>1</sup> where Alliance was out of sync with the market for much of the year.

The performance of the fixed income managers held up much better, particularly for those managers who invested exclusively in bonds (Treasurys and corporates). Note that two of the managers invest in a hybrid of securities. Lord Abbett invests in fixed income securities that can be

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<sup>1</sup> Reflects the combined results of Alliance (10.5 months) and the London Company (1.5 months)

converted into equities under certain conditions. The Global Bonds/Real Assets category managers invest real assets i.e. real estate, commodities etc. In both cases equities and real assets suffered declines during the year. Both Neuberger Berman and Pimco benefited from the faltering equity markets as Treasury bonds took off, particularly after the credit rating of U.S. government debt to AA+ on August 5<sup>th</sup>. The combination of price gains and interest payments boosted the return for long-term Treasuries to 29.9% in 2011, with the bulk of the gain (16.6%) coming after the downgrade. As the equity markets declined, investors didn't seem to mind the fact that they were getting miniscule interest rate returns for their investments. In this case, the security of lower returns trumped fear of being in the equity market. Note that bonds tend to perform better than other assets classes, such as equities, during periods of sluggish economic growth and low inflation.

### **Outlook for 2012**

As the new-year begins, the old watchword "Volatility" is still expected to be with us. The economy is still sputtering along as it tries to find its footing, but signs are pointing up. The European debt crisis is no closer to resolution that before as political leaders seem to want to take the slow death approach to a solution. Prior sovereign debt crises were always solved by a combination of currency devaluation, higher growth and aggressive monetary easing. Europe today is taking the path of most resistance: no growth, no devaluation and significant austerity for its citizens. Also to be considered is the upcoming presidential election which all but ensures another year of partisan brinksmanship. These along with the unknown events that have yet to be heaped upon us, makes for a challenging investing environment.

Higher volatility creates more risk for the portfolio which can obviously be devastating. However, it can also create more opportunities. There are signs that there is life in the U.S. economy, but at the same time Europe and Asia are showing signs of slowing down. Remember, the things that drive markets up are general economic growth i.e. spending and future expectations for corporate earnings growth. Given today's environment investors expect that the tension between fundamental stock market strength and macroeconomic worries are natural and as such should continue to serve as a template for the next 12 months.

Despite current state of uncertainty related to future events, the Trustees feel confident that the portfolio is well positioned to take advantage of the current financial environment to protect the corpus and still add value to the portfolio.

In order to diversify the risk that's inherent in today's market a more global view i.e. large U.S. companies with global reach, having a multi-segmented<sup>2</sup> approach to asset allocation and exposure to real assets. This would include eliminating excessive home country<sup>3</sup> bias and more exposure outside the U.S., including emerging markets. Exploiting today's scarcity themes related to Growth, Quality and Yield i.e. large multinational dividend growers gain market share in the secular growth story of the emerging market consumer. Finally, although the Trustees want to limit the number of managers in the portfolio, using a multi-asset manager helps raise the prospects of meeting our absolute return goals.

### **Portfolio Manager Changes**

Since our report at the Fall Meeting there have a number of developments related to our portfolio managers. As a result there were two manager changes – Invesco REIT and the London Company.

As you are aware, ALA participates in the Merrill Lynch Consults program. In addition to the wide array of services provided to help manage the Trustees manage the portfolio i.e. consulting, advisory, custodian services etc.; we are also afforded access to another level of managers that we wouldn't normally have access to due to size of our portfolio.

Invesco recently made the decision not to continue their participation in the Merrill Lynch program due to the low minimum initial investment requirements for investors as compared to what they would charge investors if they invested directly with Invesco. Fortunately, Invesco offers a mutual fund alternative that is run by the same managers. As a result, we were able to maintain our relationship with Invesco, as well as, the positive cash flow that has been generated by REIT's.

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<sup>2</sup> Using multiple managers with different investing styles

<sup>3</sup> US based large multi-nationals are receiving a greater percentage of their earnings from outside the US, particularly emerging markets. As such they are not primarily dependent on the US market.

At our Fall Meeting in early November the Trustees followed up on their review of Alliance, which had been trailing their benchmark for a number of quarters in 2011. Alliance, as the core manager, acts as the portfolio's equity stabilizer with holdings in the growth and value categories. They make their investment decisions based on their outlook for long-term secular themes that they have identified as adding value in the future. Although their long-term results are generally good, they are prone to be ahead of the market and as such will lag their benchmark for extended periods. Typically, they will make up for the lag in results by outperforming at some point. However, the Trustees felt that the level of tracking error for Alliance to their benchmark was too high and that the portfolio needed a manager that tracked a little closer to the benchmark. As such the decision was made to hire the London Company.

The London Company is a portfolio manager that focuses on securities that generate above average dividend yields. Their investment objective is to provide a conservative, high income with growth characteristics focused on capital preservation and total return. The portfolio manager seeks to identify companies with sustainable high cash returns on capital and above average free cash flow. This style has generally provided a higher yield with less downside and lower volatility. As such, they should generate above average absolute returns and have less participation in down markets.

### **New Endowment – IRRT**

The Trustees will be recommending to the ALA Executive Board the establishment of a new IRRT endowment. At our Fall Meeting in November the Trustees review a proposal submitted by the leadership of the IRRT. As a result of a multi-year fundraising effort and reaching the minimum requirement of \$25,000, IRRT requested the establishment of a new endowment. The proposed IRRT endowment will provide necessary funds to support IRRT activities and initiatives that encourage international collaboration, raise the visibility of international opportunities, and promote a global dialogue about librarianship, by providing ongoing support for:

1. International speakers invited to present at ALA conferences in the form of travel grants.
2. ALA members to initiate or participate in international projects in the form of seed money or travel grants.

3. Publication of materials that raises awareness about international opportunities for librarians.
4. ALA members to collaborate with IFLA and library associations in other countries to provide developmental and educational opportunities for librarians by providing travel grants, seed money, and/or funds for promotional materials.

The Trustees recognize the importance and the focus on our international membership and welcome the opportunity to strengthen this relationship within the Association. This request will be presented to the ALA Executive Board for final review and approval.

Finally, it should be noted that although this request is outside of the regular ALA budget process, the Trustees considered the request due to the fact the funds were coming from an ongoing fundraising effort or a donor gift. All other requests to establish an endowment must come through the regular budget process.

### **Changes to Starting a New Endowment**

As noted above, to start new endowment today the minimum amount needed is \$25,000. The Trustees have been reviewing this level funding for some time and have conclude that due to the relatively small amount of income that is generated, as well as, the administrative cost, that a change needed to be made. As such, the Trustees will be recommending at this Midwinter Meeting that the minimum to start an endowment be increased to \$50,000. This change will also apply to existing funds in the endowment (8).

Understanding the issues involved the Trustees felt that it was more than appropriate to allow those funds under \$50,000 time to evaluate their situation and plan for the future. As such, the Trustees are also recommending that endowments currently under \$50,000 be given five year to consider how best to address the new requirement and up to ten years to reach the new requirement.

### **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) – 2<sup>nd</sup> Term  
John Vitali – Trustee (2013) – 2<sup>nd</sup> Term  
Robert Walton – Trustee (2014) – 2<sup>nd</sup> Term  
James Neal – ALA Treasurer, Ex Officio (2013)

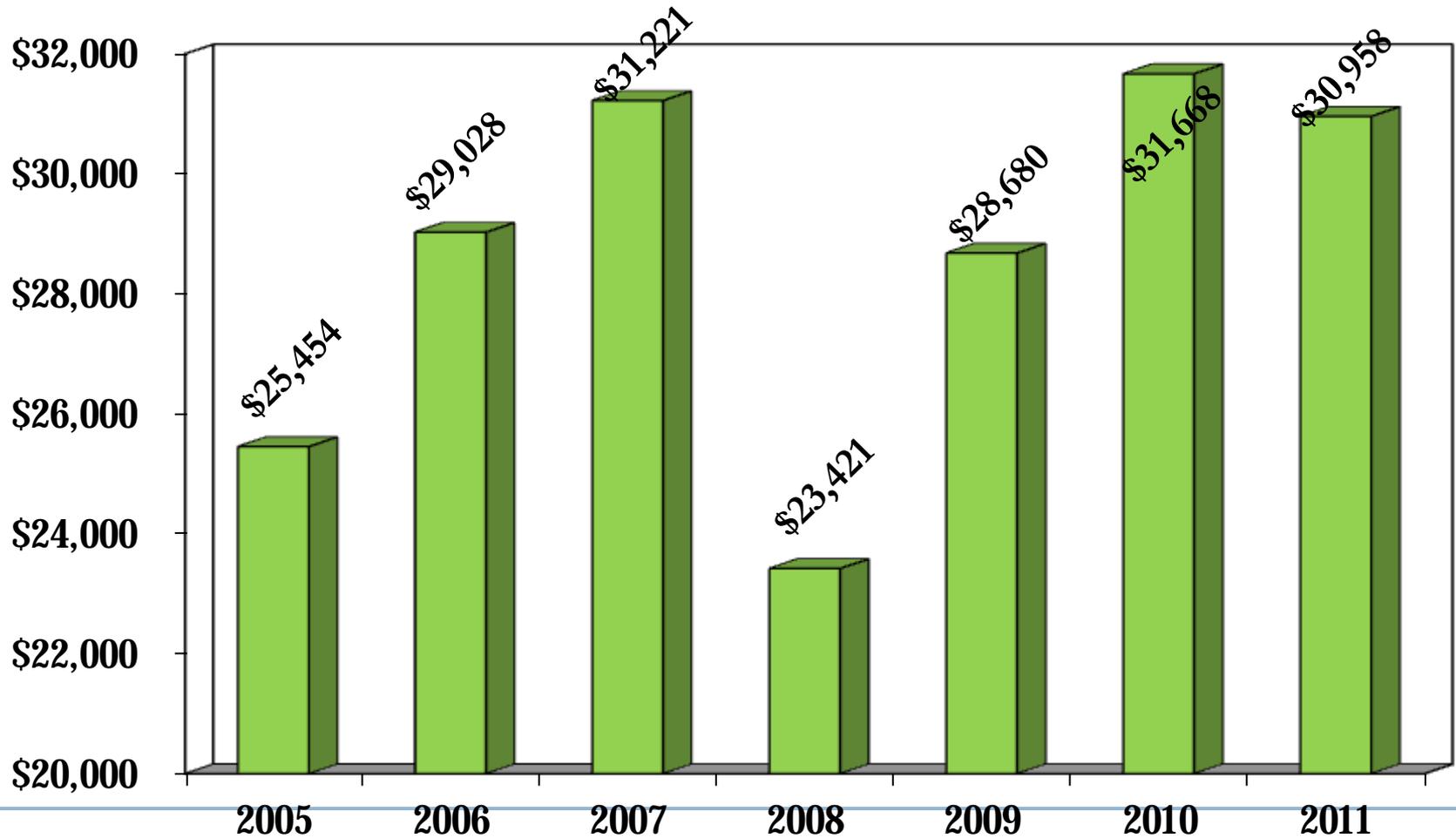
# Issues Affecting the Market

- § The slow resolution of the European sovereign debt.
- § Volatility was extreme throughout the year.
- § Bad news of any type seemed to affect the market as evidenced by the ten day period in August where the market fell by 10%.
- § Legislative gridlock in Washington becoming more problematic.
- § Economic growth in China and India showing signs of slowing down.
- § European banks still viewed as undercapitalized.
- § Fiscal and monetary authorities in the West have limited tools to address the situation.

# Market Value @ 12-31-11

Exhibit #2

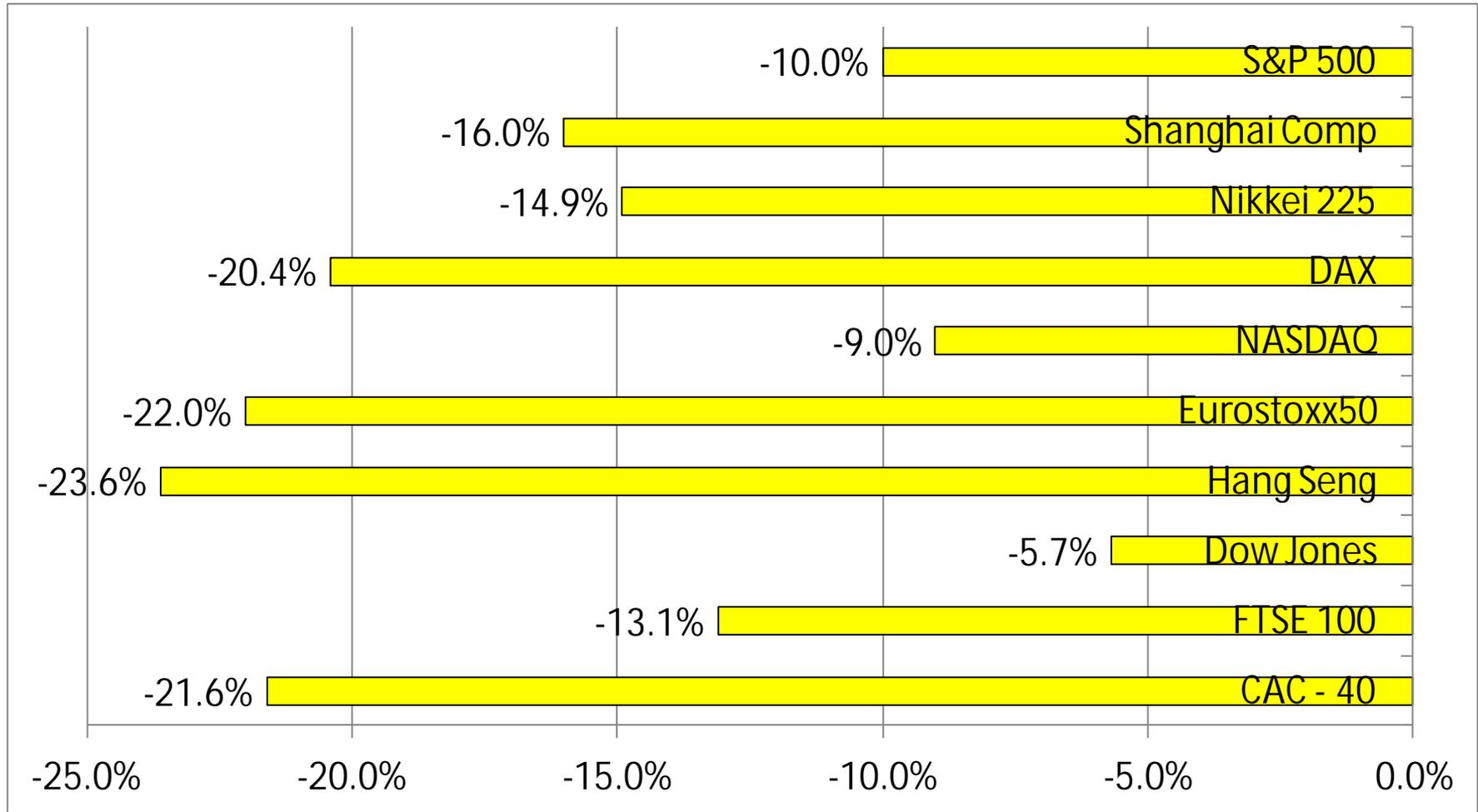
\$30,958,282



# World Market Performance

Exhibit #3

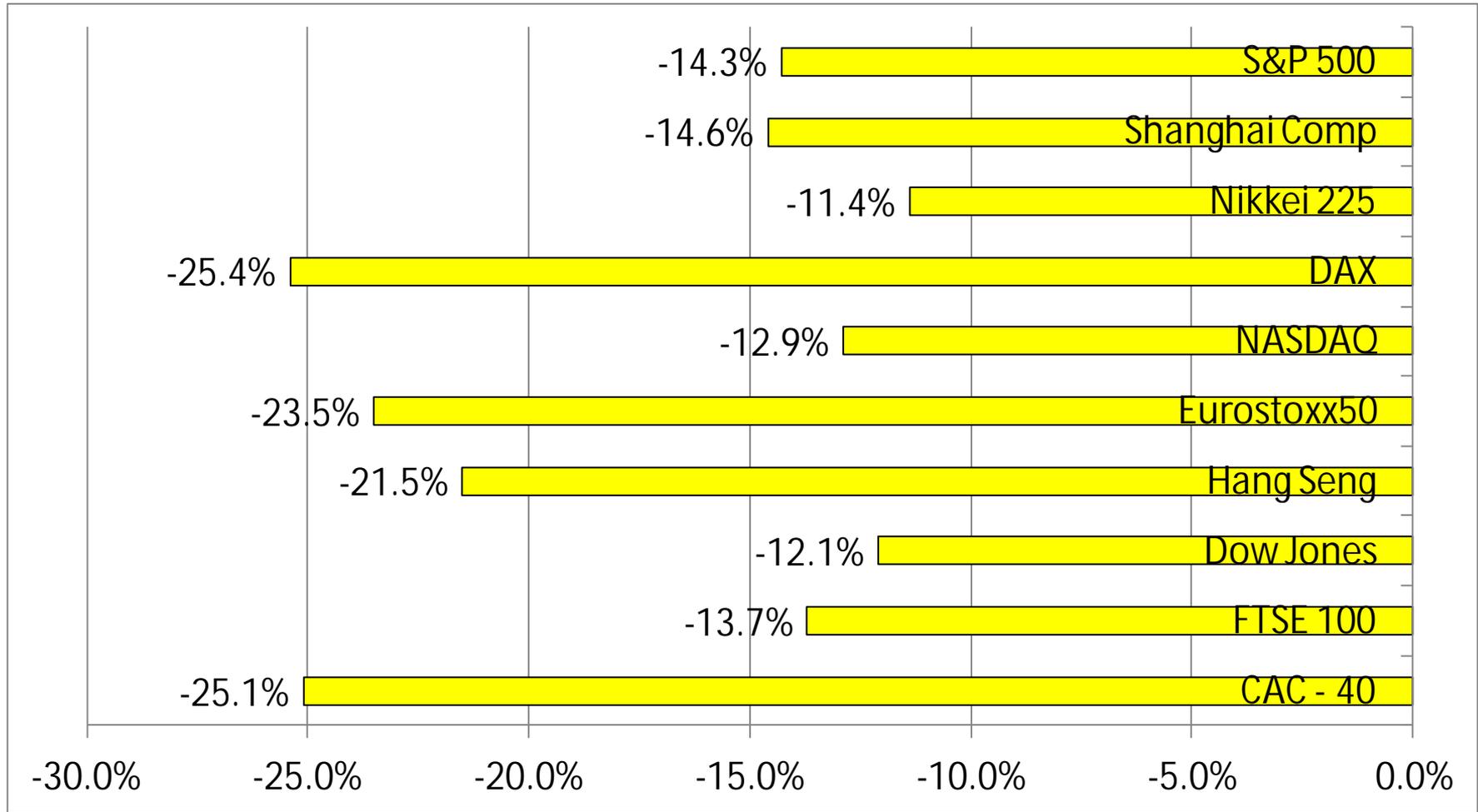
- Market Returns Nine Months 9-30-11



# World Market Performance\*

Exhibit #4

- Market Returns for Three Months July - September

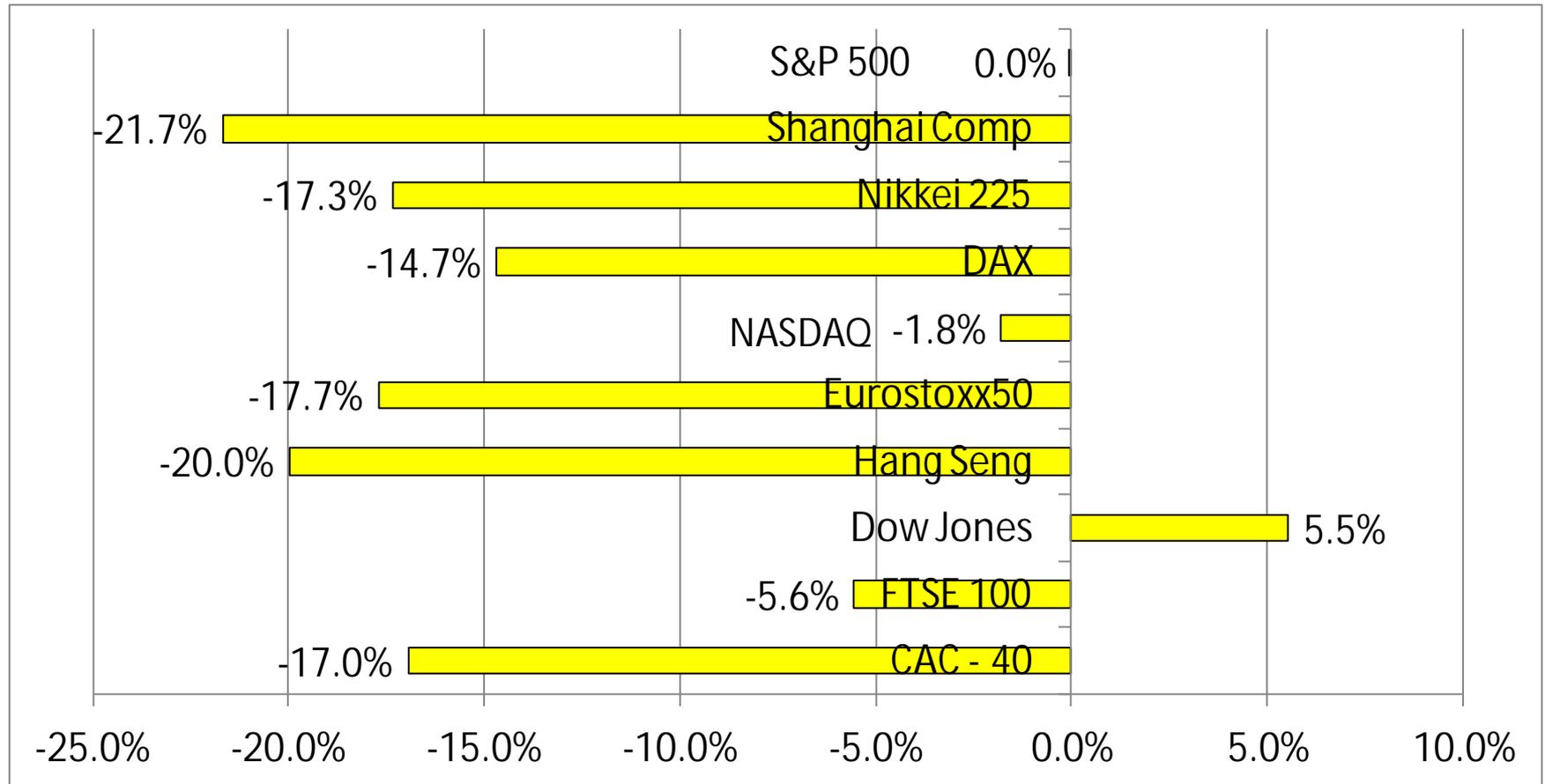


\*Three months 7/1/11 to 9-30-11

# World Market Performance

Exhibit #5

- Market Returns Calendar Year 2011

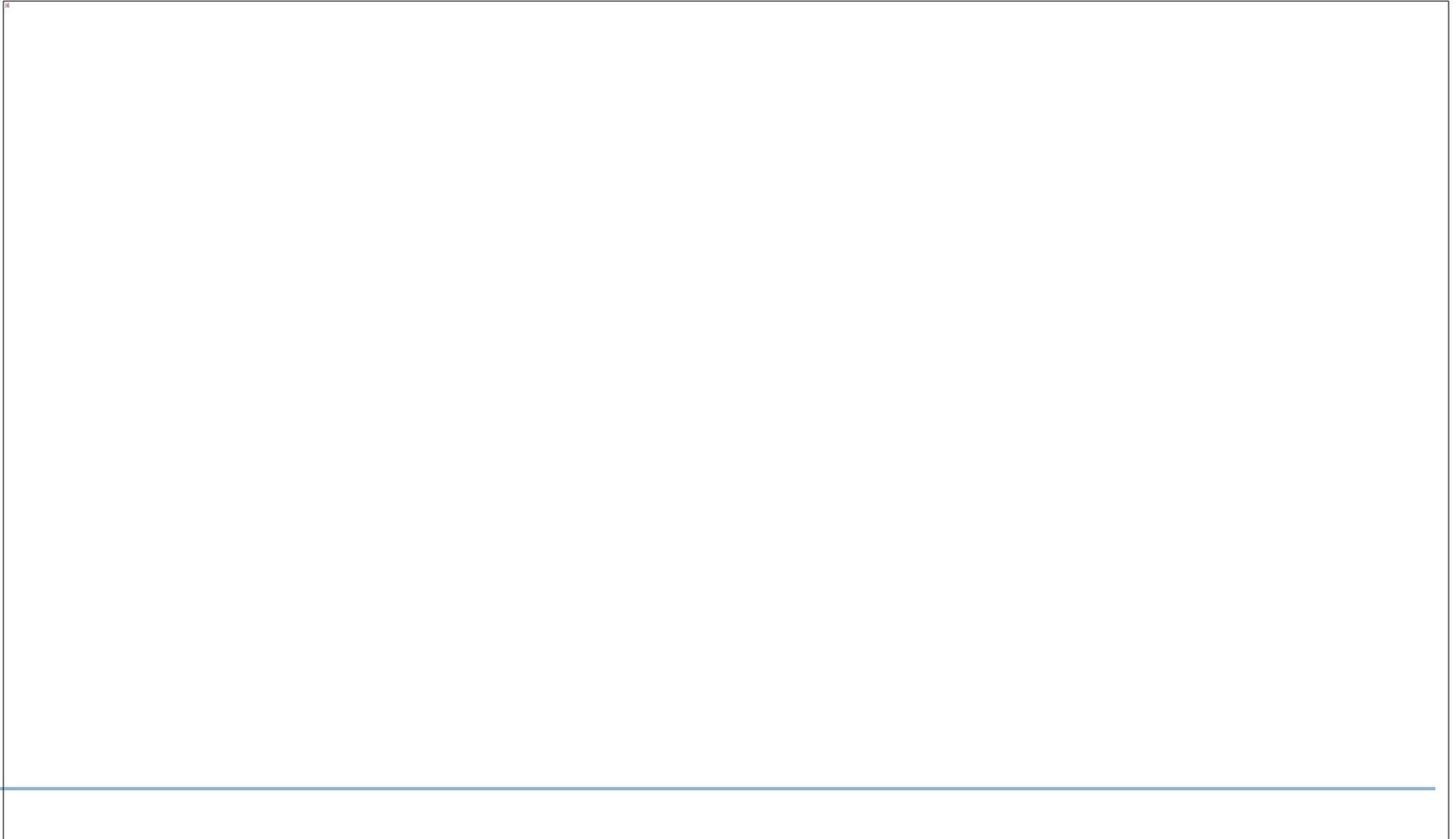


# Endowment Fund Manager

Exhibit #6

## Allocation & Style @ 12-31-11

\$30,958,282



# Performance Gains

Exhibit #7

## Calendar Year Ending-12/31/11

| <u>Managers</u>        | <u>Market Value</u> | <u>% of Portfolio</u> | <u>Returns</u> | <u>Index</u> |
|------------------------|---------------------|-----------------------|----------------|--------------|
| London – Core          | \$ 4,122,115        | 13.3%                 | -6.1%          | 2.1%         |
| IDP – Large Cap Growth | \$ 4,310,592        | 13.9%                 | -0.6%          | 2.6%         |
| IDP – Large Cap Value  | \$ 3,056,366        | 9.9%                  | -1.1%          | 0.4%         |
| NFJ – Small Cap Value  | \$ 1,490,768        | 4.8%                  | -0.6%          | -5.5%        |
| Ariel Capital - SRI    | \$ 514,584          | 1.7%                  | -7.3%          | -1.4%        |
| IDP - International    | \$ 1,822,783        | 5.9%                  | -12.0%         | -11.7%       |
| Endowment Fund         | \$ 3,339,372        | 10.8%                 | -1.0%          | -2.5%        |
| Invesco - REIT         | <u>\$ 1,581,990</u> | <u>5.1%</u>           | 7.9%           | 8.3%         |
| Total Equity           | \$20,238,570        | 65.0%                 |                |              |

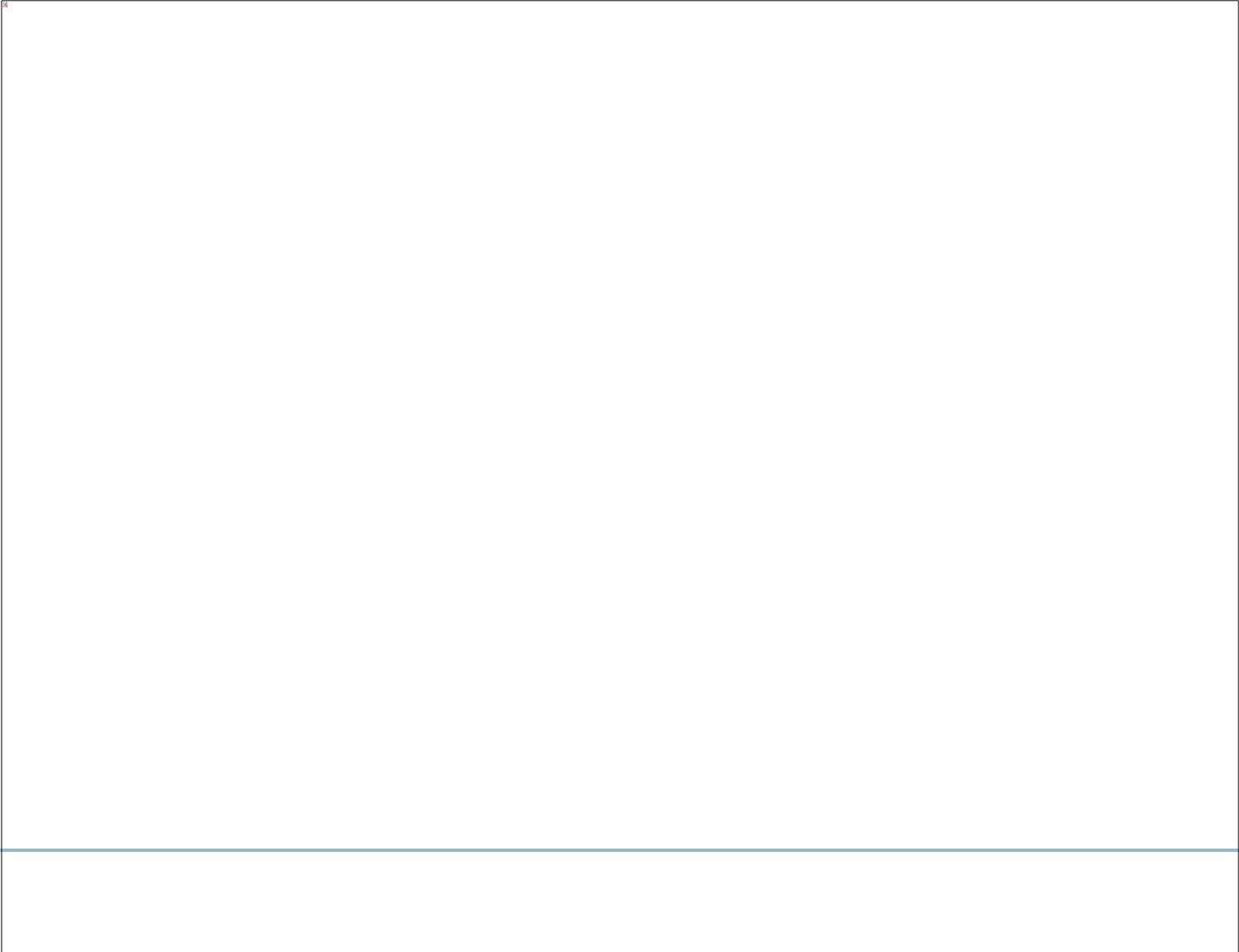
# Performance Gains

Exhibit #8

## Calendar Year Ending-12/31/11 (Con't)

| <u>Managers</u>           | <u>Market Value</u> | <u>% of Portfolio</u> | <u>Returns</u> | <u>Index</u> |
|---------------------------|---------------------|-----------------------|----------------|--------------|
| Neuberger - Intermediate  | \$ 1,620,677        | 5.2%                  | 5.6%           | 5.9%         |
| Lord Abbett – Conv. Bonds | \$ 815,910          | 2.6%                  | -8.1%          | -5.5%        |
| Global Bonds              | \$ 2,999,430        | 9.7%                  | 0.7%           | 5.6%         |
| Real Assets               | \$ 1,417,205        | 4.6%                  | -8.7%          | -13.4%       |
| Pimco - Bonds             | <u>\$ 3,866,490</u> | <u>12.5%</u>          | 5.2%           | 7.8%         |
| Total Fixed Income        | \$10,719,712        | 34.6%                 |                |              |
| Total Portfolio           | \$30,958,282        | 100.00%               | -1.8%          | 2.6%         |

# Asset Allocation Strategy



# Manager Composite Performance

@ 12/31/11

| <u>Managers</u>               | <u>1 Year</u> | <u>Benchmark</u> | <u>3 Year</u> | <u>Benchmark</u> | <u>5 Year</u> | <u>Benchmark</u> |
|-------------------------------|---------------|------------------|---------------|------------------|---------------|------------------|
| London Company - Core         | 16.3%         | 2.1%             | 20.6%         | 14.1%            | 6.1%          | (0.3%)           |
| IDP - Large Cap Growth        | (0.6%)        | 2.6%             | NA            | NA               | NA            | NA               |
| IDP - Large Cap Value         | (1.1%)        | 0.4%             | 12.7%         | 11.6%            | NA            | NA               |
| NFJ - Small Cap Value         | (0.6%)        | (5.5%)           | 13.3%         | 12.4%            | 2.5%          | (1.9%)           |
| Ariel Capital - SRI           | (7.3%)        | (1.4%)           | 21.8%         | 18.2%            | 1.1%          | 0%               |
| IDP - International           | (12.1%)       | (11.7%)          | 20.6%         | 21.2%            | NA            | NA               |
| Invesco - REIT                | 7.9%          | 8.7%             | 6.2%          | 5.4%             | (0.5%)        | (1.4%)           |
| Neuberger - Intermediate      | 5.6%          | 5.9%             | 6.4%          | 4.7%             | 5.8%          | 5.6%             |
| Lord Abbett - Conv Bonds      | (8.1%)        | (5.5%)           | 9.9%          | 17.7%            | 2.4%          | 3.7%             |
| Global Bond & Real Assets     | 0.7%          | 5.6%             | NA            | NA               | NA            | NA               |
| PIMCO - Bonds                 | 5.2%          | 7.8%             | 9.0%          | 6.9%             | 7.5%          | 6.4%             |
| Endowment Fund - Alternatives | (1.0%)        | (2.5%)           | 2.2%          | 0.6%             | 3.3%          | 1.5%             |
| ALA Endowment                 | (1.8%)        | 2.6%             | 5.7%          | 4.9%             | 5.1%          | 4.7%             |

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# Nothing Creates Wealth Like Investing

**The last “Secular” bull market ran from 1983 – 2007  
where high returns were realized**

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