Endowment Trustees Report
- Information Session -
(Long-Term Investment Fund)

Kate Nevins – Trustee
Saturday – June 29, 2013
This report provides information regarding the performance of the ALA Long Term Investment Fund (LTI) AKA the Endowment Fund. It is provided as a supplement to the oral report given by Trustee Kate Nevins of the ALA Endowment Trustees. Specific items will include 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 1-8) detailing issues impacting the general market, the value of the portfolio, world market performance, manager performance & allocation and other pertinent information related to the management of the Endowment Fund.

Endowment Fund Performance

*The Investing Environment in 2013* – The first quarter of 2013 was very similar to the first quarter of 2010, 2011 and 2012 – where the results were strong and looked very favorable for a full year of solid gains. This is evidenced by the fact that the endowment realized a first quarter return of 8.4%, which are usually good results for an entire year. However, once again something happened along the way to upset the high expectations for the remainder of the year:

- Federal Reserve hints of winding down $85.0 billion monthly bond buying program
- Unexpected slowdown in economic activity in China
- Over reaction by investors to any perceived bad news of any type, particularly economic i.e. jobs report, housing starts, consumer confidence etc.
These events amplified the market’s volatility and uncertainty which caused investors raced to the exits in search of safety and protecting gains generated to date - once again over reacting.

Performance - The Trustees can report that the value of the endowment at 5-31-12 is $34.9 million. This represents an YTD increase of $2.3 million from $32.6 million in December - see exhibit 2. The gain in the portfolio reflects a return of 8.4% and compares favorably to its benchmark which reported a gain of 8.5%. As we can see from exhibits 4 and 5, the individual manager results held up relatively well in view of the recent market jitters.

All of the equity managers with the exception of IDP - International delivered solid results. As the Federal Reserve continued its bond buying activities in an effort to provide liquidity to the economy, interest rates were suppressed forcing investors into the equity market. This played well into the strategies of the managers. IDP-International, a conservative manager\(^1\), was negatively impacted by being underweight Japan, which has finally come out of its two decade old doldrums. The portfolio’s core holdings – large cap growth, value and core managers – all performed well and benefited from investors search for returns. Ariel reported strong results by sticking to its philosophy of investing within its circle of competence and sticking with the firms that it believes in.

On the fixed income side all of the managers met or beat their respective benchmarks. This is exceptional results in view of the fact that the market has generally turned against the bond market since the end of March – see benchmark results. The convertible bond manager – Lord Abbett – benefitted the most by converting many of its bond holdings into equity positions. Global bonds have also performed particularly well YTD, far outpacing their benchmark. Pimco, the portfolio’s primary bond manager, reported the only negative fixed income results. Pimco saw its performance hurt by a rally in the Treasury market where prices rose and yields fell. The expectation for higher inflation resulting from the Federal Reserve’s bond buying program has not come to fruition.

**Remaining 2013 Year End Outlook**

As the first quarter came to a close, the Trustees and ALA’s Investment Advisor Merrill Lynch took a critical look at financial, economic and

\(^1\) Operates in a fashion that will not capture most upside returns or downside declines
political landscape to determine what if any issues may have an impact the portfolio. The review pointed to a number of issues that will likely hit the performance of the economy by year-end. They are as follows:

- The Federal Reserve’s bond buying program
- Uncertainty on the strength of the US economy
- Slowdown in Chinese economic activity
- Improved housing market

The biggest impact on the market today is the recent (6/19/13) signal sent by the Federal Reserve Chairman Ben Bernanke when he laid out an exit strategy from the current bond buying program - $85 billion per month – started in September 2012. Since the September announcement stocks have performed very well as interest rates were kept at extremely low levels and investors headed into stocks in search of yield. Since the hinted end of the buying program, the financial markets have responded badly with multiple days of triple digit losses. It should be noted that tapering purchases from current levels is predicated on a strengthening economy and lower unemployment. Additionally, tapering is not expected to occur until later this year or early 2014.

The above mentioned realities are just now being fully priced into the market and will definitely have an impact on returns. The direction those returns take will depend on how investors react and or over react to the news.

**Asset Allocation Changes**

The Trustees continue to be strong advocates of the idea that asset allocation is the key to generating excess returns in the portfolio, while at the same time working to protect the corpus. After the critical review of the markets as highlighted in the 2013 market outlook for the remainder of the year, the Trustees put in place a tactical recommendation designed to take advantage of the market environment expected based on the Federal Reserve’s action to help the market. There is a strong belief among the Trustees and its Investment Advisor that in view of a steadily improving economy, equities are a less risky proposition going forward compared to bonds. Many in the industry call this the “Great Rotation.” As a result, since February the Trustees have taken steps to reduce the portfolio’s exposure to fixed income

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2 As of 6/26/13 there were 14 triple digit moves up and down in 18 trading sessions.
holdings. As such, there have been regularly planned reductions toward the policy minimum of 25%. In view of the market’s reaction i.e. multiple triple digit declines, to the Federal Reserve’s hint at slowing down its bond purchasing program here during the month of June, this was a good move. The reductions in the portfolio’s fixed income holdings were reallocated to the small cap manager Principal/Goldman SMID and the IDP – International manager.

Despite current state of uncertainty related to future events, the Trustees feel confident that the portfolio is very well positioned to take advantage of the current financial environment to protect the corpus and still add value to the portfolio. Changes to the portfolio will be made as circumstances dictate.

**Proposed Fossil Fuel Resolution – CD#16.2/EBD #13.8**

At the request of the Chair of the Budget Analysis and Review Committee (BARC), the Endowment Trustees reviewed the financial impact to ALA of a proposed (draft) resolution to divest any fossil fuel holdings in the Endowment fund and invest in renewable energy initiatives. Enlisting the help of our investment advisor (Merrill Lynch), the Trustees critically reviewed and analyzed the question at hand. In the process of addressing the question it was clear that in addition to considering the financial impact to ALA, consideration also needed to be given to the Trustees ability to carry out its fiduciary responsibility and optimally manage the portfolio to the benefit of the Association.

In addressing the question of the financial impact, the Trustees have determined that the proposed resolution would have reduced the value of the endowment by $1.2 million over a three year period. In consideration of this and the other qualitative issues raised, the Trustees at this time do not support implementing the proposed resolution. The full report and its findings are attached as document CD #16.2/EBD #13.8.

**Portfolio Manager Changes**

For the last four quarters the Trustees have been monitoring the performance of its long time (5/03) small cap manager NFJ/Allianz. During that time NFJ/Allianz has outperformed its benchmark 70% of the time. NFJ/Allianz’s performance failed to meet expectations on two levels: 1). performance over the last few quarters has significantly underperformed its benchmark and 2.)
to remain an active participant in the Merrill Lynch Consult’s program, a manager must beat its benchmark 85% of the time. Taking these factors into consideration in March the Trustee took the action to hire a new manager – Principal/Goldman SMID. In this instance the Trustees decided to follow a mutual fund strategy by replacing NFJ/Allinaz with two mutual funds which have lower historical risk profiles and higher performance compared to their benchmark.

Endowment Trustee Investment Panel Discussion

On February 20, 2013 Trustee Jim Neal and Columbia University/Butler Library played host to the Endowment Trustees first ever “Investment Discussion” panel. New York City is viewed in many corners of the world as the financial capital of the world. If nothing else it is clearly a center for some of the world’s best financial and investing minds. Trustees felt that it was important to take advantage of such an available resource and avail themselves of the opportunity to hear a different voice on the subject of investing. To this end the Trustees extended invitations to five of the industry’s leading investment professionals. Moderated by Dr. Bruce Greenwald of Columbia University they were as follows:

Stewart Massey – Massey Quick Investments
Savita Subramanian – BOA Merrill Lynch
Maziar Minovi – Goldman Sachs
Zane Brown – Lord Abbett

As expected, the interactions were challenging, fast paced, and very informative. As a result of the knowledge gained the Trustees feel they are in a better position to help grow and protect the assets of the Endowment fund.

Trustee Changes

Robert Walton – Chief Executive of the Claremont University Consortium recently submitted his resignation to the university to pursue another career opportunity as Vice President for Finance and Administration at Vassar College. He is also resigning from his current ALA activities and responsibilities with the Endowment Trustees and the Budget Analysis and Review Committee. He has successfully served two terms (5 years) with the Trustees. In this capacity he has provided the Trustees with invaluable investing insights and a different perspective resulting from his service on
many other investment committees of various sizes. His drive to maximize returns in the portfolio for the benefit of the Association will be missed and we wish him well and much success in his new endeavor.

Siobhan A. Reardon - President and Director of the Free Library of Philadelphia, has been elected to serve as the ALA’s newest Endowment Trustee. Ms. Reardon’s three-year term officially begins at the conclusion of this Annual Conference on July 2, 2013. This term will end at the conclusion of the 2016 ALA Annual Conference in Orlando, FL. In keeping with a previously established practice for newly elected Trustees, she began in an unofficial non-voting capacity immediately upon notification of her selection in March.

Ms. Reardon has been actively involved in library service for close to twenty-five years. She has also been a business professional in all aspects of business management – planning, budgeting, marketing, strategic planning, government relations, technology implementation and investing – for thirty-five years. She is currently the President and Director of the Free Library of Philadelphia and holds an M.L.I.S in Information Science from the Palmer School of Library Science, a Master of Arts degree in International Political Economy & Development from Fordham University and a Bachelor of Arts degree in Political Science from SUNY College at Purchase.

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

John Vitali – Chair (2013) – 2nd Term
Robert Walton – Trustee (2014) – 2nd Term
Kate Nevins – Trustee (2015) – 1st Term
Rod Hersberger – Trustee (2015) – 1st Term
James Neal – ALA Treasurer, Ex Officio (2013)
Issues Impacting the Market

➢ First half results following the same pattern as each of the last three years – strong 1st quarter following by market stumble i.e. “Spring Swoon”
➢ Federal Reserve signals the possible end to bond purchases, which has provided sustained liquidity to the economy
➢ In the 1st quarter the market grew at an annualized pace of 2.5%* after just 0.4% in 4th quarter of 2012
➢ Cutbacks in Federal spending expected to mute 1st quarter market growth for remainder of the year
➢ Public sector spending declined at a rate of 4.1%, continuing a three year retrenchment since the federal stimulus program started winding down

*Revised down to 1.8% by the Commerce Department on June 25, 2013
Market Value @ 5-31-13
$34,951,042

*YTD 5 months ending 5-31-13
Manager and Asset Allocation

Exhibit #3

- Pimco Bonds $2,887,338
- Ariel SRI $743,222
- Endowment Fund Alternatives $3,068,653
- London Company Core $5,389,445
- Global Bond/RE $3,092,042
- Lord Abbett Convertible $1,014,443
- Corporate Fixed income $1,776,590
- Invesco REIT $1,972,100
- IDP International $3,441,214
- IDP Large Cap Growth $5,411,675
- Principal/Goldman Small Cap Value $2,868,454
- IDP Large Cap Value $3,285,866
# Performance Gains

## Five Months Ending - 5/31/13

<table>
<thead>
<tr>
<th>Managers</th>
<th>Market Value</th>
<th>% of Portfolio</th>
<th>Returns</th>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>London – Large Cap Core</td>
<td>$5,389,445</td>
<td>15.4%</td>
<td>16.6%</td>
<td>16.9%</td>
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<tr>
<td>IDP – Large Cap Growth</td>
<td>$5,411,675</td>
<td>15.5%</td>
<td>12.2%</td>
<td>14.0%</td>
</tr>
<tr>
<td>IDP – Large Cap Value</td>
<td>$3,285,866</td>
<td>9.4%</td>
<td>16.7%</td>
<td>16.9%</td>
</tr>
<tr>
<td>Principal/Goldman SMID – Small Cap Value</td>
<td>$2,868,454</td>
<td>8.2%</td>
<td>4.2%</td>
<td>3.8%</td>
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<tr>
<td>Ariel Capital - SRI</td>
<td>$743,222</td>
<td>2.1%</td>
<td>21.0%</td>
<td>17.5%</td>
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<tr>
<td>IDP - International</td>
<td>$3,441,214</td>
<td>9.8%</td>
<td>5.3%</td>
<td>8.4%</td>
</tr>
<tr>
<td>Endowment Fund</td>
<td>$3,068,653</td>
<td>8.8%</td>
<td>5.4%</td>
<td>4.1%</td>
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<tr>
<td>Invesco - REIT</td>
<td>$1,972,100</td>
<td>5.6%</td>
<td>6.9%</td>
<td>8.2%</td>
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<tr>
<td>Total Equity</td>
<td>$26,180,629</td>
<td>74.9%</td>
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## Performance Gains

### Five Months Ending 5/31/13 (Cont’t)

<table>
<thead>
<tr>
<th>Managers</th>
<th>Market Value</th>
<th>% of Portfolio</th>
<th>Returns</th>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Fixed Income</td>
<td>$ 1,776,590</td>
<td>5.1%</td>
<td>1.9%</td>
<td>(1.0%)</td>
</tr>
<tr>
<td>Lord Abbett – Conv. Bonds</td>
<td>$ 1,014,443</td>
<td>2.9%</td>
<td>12.3%</td>
<td>11.1%</td>
</tr>
<tr>
<td>Global Bonds</td>
<td>$ 3,092,042</td>
<td>8.8%</td>
<td>1.6%</td>
<td>(3.4%)</td>
</tr>
<tr>
<td>Pimco - Bonds</td>
<td>$ 2,887,338</td>
<td>8.3%</td>
<td>(1.0)%</td>
<td>(1.0%)</td>
</tr>
<tr>
<td>Total Fixed Income</td>
<td>$ 8,770,413</td>
<td>25.1%</td>
<td></td>
<td></td>
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<tr>
<td>Total Portfolio</td>
<td>$ 34,951,042</td>
<td>100.0%</td>
<td>8.4%</td>
<td>8.5%</td>
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</table>
# Manager Composite Performance

@ 3/31/13*

<table>
<thead>
<tr>
<th>Managers</th>
<th>1 Year</th>
<th>Benchmark</th>
<th>3 Year</th>
<th>Benchmark</th>
<th>5 Year</th>
<th>Benchmark</th>
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</thead>
<tbody>
<tr>
<td>IDP - Large Cap Growth</td>
<td>7.3%</td>
<td>10.1%</td>
<td>9.2%</td>
<td>13.1%</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>London Company - Core</td>
<td>17.0%</td>
<td>18.8%</td>
<td>18.1%</td>
<td>12.7%</td>
<td>11.7%</td>
<td>4.9%</td>
</tr>
<tr>
<td>IDP - Large Cap Value</td>
<td>15.7%</td>
<td>18.8%</td>
<td>11.0%</td>
<td>12.7%</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Ariel Capital - SRI</td>
<td>18.6%</td>
<td>21.5%</td>
<td>12.6%</td>
<td>15.0%</td>
<td>10.2%</td>
<td>8.5%</td>
</tr>
<tr>
<td>Principal - Small Cap Value</td>
<td>19.6%</td>
<td>16.3%</td>
<td>18.2%</td>
<td>13.5%</td>
<td>10.5%</td>
<td>8.2%</td>
</tr>
<tr>
<td>Goldman SMID - Small Cap</td>
<td>16.3%</td>
<td>16.3%</td>
<td>14.1%</td>
<td>13.5%</td>
<td>11.3%</td>
<td>8.2%</td>
</tr>
<tr>
<td>IDP - International</td>
<td>7.6%</td>
<td>11.3%</td>
<td>5.3%</td>
<td>5.0%</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Invesco - REIT</td>
<td>16.3%</td>
<td>16.3%</td>
<td>14.1%</td>
<td>13.5%</td>
<td>11.3%</td>
<td>8.2%</td>
</tr>
<tr>
<td>PIMCO - Bonds</td>
<td>5.5%</td>
<td>4.0%</td>
<td>5.8%</td>
<td>5.7%</td>
<td>6.7%</td>
<td>5.5%</td>
</tr>
<tr>
<td>Corporate Fixed Income</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Lord Abbott - Conv Bonds</td>
<td>10.6%</td>
<td>9.9%</td>
<td>6.2%</td>
<td>7.0%</td>
<td>5.7%</td>
<td>2.3%</td>
</tr>
<tr>
<td>Global Bond &amp; Real Assets</td>
<td>0.7%</td>
<td>5.6%</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Endowment Fund - Alternatives</td>
<td>2.0%</td>
<td>4.8%</td>
<td>1.9%</td>
<td>2.1%</td>
<td>-0.4%</td>
<td>-0.2%</td>
</tr>
</tbody>
</table>

*Data generated quarterly*
<table>
<thead>
<tr>
<th>ASSET ALLOCATION STRATEGY</th>
<th>POLICY GUIDELINES @ 3-31-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic Large/Medium Cap Stocks</td>
<td>Min</td>
</tr>
<tr>
<td>London Company - Core</td>
<td>30%</td>
</tr>
<tr>
<td>IDP - Large Cap Value</td>
<td></td>
</tr>
<tr>
<td>IDP - Large Cap Growth</td>
<td></td>
</tr>
<tr>
<td>Ariel - SRI</td>
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</tr>
<tr>
<td>Domestic Small/Medium Cap Stocks</td>
<td>0%</td>
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<tr>
<td>Principal/Goldman SMID</td>
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</tr>
<tr>
<td>Alternative Investments</td>
<td>0%</td>
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<tr>
<td>Endowment Fund</td>
<td></td>
</tr>
<tr>
<td>International Equity</td>
<td>5%</td>
</tr>
<tr>
<td>IDP - International</td>
<td></td>
</tr>
<tr>
<td>Real Estate Investment Trust (REIT)</td>
<td>5%</td>
</tr>
<tr>
<td>Invesco</td>
<td></td>
</tr>
<tr>
<td>Investment Grade Fixed Income</td>
<td>20%</td>
</tr>
<tr>
<td>Global Fixed Income</td>
<td></td>
</tr>
<tr>
<td>Corporate Fixed Income</td>
<td></td>
</tr>
<tr>
<td>Lord Abbett</td>
<td></td>
</tr>
<tr>
<td>PIMCO - Bonds</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Portfolio Concerns Going Forward

- The general economy is expected to expand at a tepid 2.0% i.e. growth trajectory is shallow
- The current recovery is likely to remain choppy through the summer
- Investors and the market may overreact to the possible end to Federal Reserve bond purchases
- Slowing economic growth in China
- The collapse of commodity prices
- Austerity induced recession in Europe
- By historical standards this recovery is below trend. Is this the new normal?
TO: Budget Analysis and Review Committee (BARC)

FROM: Endowment Trustees

RE: Divesting fossil fuel holdings in the ALA Endowment Fund

CONTACT PERSON:

John Vitali – Senior Trustee, ALA Endowment Trustee’s

DATE: May 22, 2013

ACTION REQUESTED/INFORMATION/REPORT:

Information Report

ACTION REQUESTED BY:

BARC at the request of the ALA Council to address Resolve #2 which

“Directs its Endowment Trustees to divest all holdings in the fossil fuel industry and invest in renewable energy initiatives”

EXECUTIVE SUMMARY:

The Endowment Trustees strongly believe that the proposed resolution and similar resolutions i.e. screening, will severely limit the Trustees’ primary responsibility of maximizing investment returns. Additionally, it impacts how the investments are managed both short-term and long-term. As such, the Endowment Trustees’ unanimously oppose the proposed resolution for the following reasons:

• It has a negative financial impact on the Association through the General Fund, on the Divisions and on the Round Tables to carry out their programs.
• It will limit investment choices.
• It works against the strength and “Best Practices” built into the investment policy, which protects the organization.
• It might limit the recruitment of strong/qualified Trustee candidates.
BACKGROUND:

At the 2013 Midwinter Meeting in Seattle, the ALA Council discussed a proposed resolution requesting that the ALA Endowment Trustees divest any and all fossil fuel industry holdings in the ALA Endowment Fund and to invest in renewable energy initiatives. This resolution was forwarded to BARC to determine the financial impact on the ALA Endowment fund if such a request was carried out. In order to determine the impact involved the BARC Chair – Clara Bohrer - requested from the Senior Endowment Trustee – John Vitali – and the Endowment Trustees, to review the Council request and prepare a report on the financial implications of divesting fossil fuel holdings from the portfolio, as well as, investing in renewable energy initiatives.

After reviewing the request from Council the Endowment Trustees discussed and analyzed how the proposal would impact:

- The financial performance of the endowment portfolio
- The general risk profile of the endowment
- How the endowment is managed
- How the Trustees carry out their responsibilities

The Trustees solicited the assistance of its investment advisor Merrill Lynch. Merrill Lynch provided to the Trustees for their review a study titled “Do the Investment Math: Building a Carbon-Free Portfolio.” from the Aperio Group, an investment management firm that specializes in customized indexing strategies such as Socially Responsible Investing (SRI), sin free and carbon free portfolios. Note that the Trustees recognized that there was a potential “conflict of interest” in using the findings in the study as the basis for evaluating ALA’s portfolio. In this instance the conflict being that the author of the report specializes in the development of customized SRI portfolio’s, which has a built in bias toward SRI portfolios. The following were some of the key findings.

**Fossil fuel related holdings are a significant component of the Russell 3000 index**

- 20% of the Russell 3000 (an index that broadly represents the US stock market) consists of energy, utilities and materials sectors
- 13% of the Russell 3000 consists of fossil fuel related mining, oil services and utilities - source: gofossilfree.org.
- As of 2/28/13 two of the top five holdings in the Russell 3000 were Exxon Mobil (#1) and Chevron (#4)
The Aperio Group study indicates that divestiture will increase risk

- The study looked at 2 divestiture methods:
  - Exclude a small sample of companies that have been identified as particularly harmful by climate change advocates, namely the “Filthy Fifteen”. 13 of these companies are publicly traded stock and were excluded.
  - Exclude a more comprehensive list of what they classified as “Oil, Gas & Consumable Fuels” (the study did not identify which stocks)
- While both divestiture methods will increase risk, the first exclusion had less impact because it excludes a smaller number of holdings. Aperio indicated that over long term holding periods that the risk would be relatively minor for both.

Calendar year volatility will be increased significantly

The Aperio study focused on long term performance and risk, including rolling 10 year periods which understate annual risks. The year to year variation in the returns posted by fossil fuel specific companies as a group can be very dramatic. As an example, during the 10 year period between 2/28/03 – 2/28/13, excluding energy and utilities from the S&P 500 would have had the following impact:

- Reduced returns in 7 out of 10 years
- Reduced cumulative overall returns by 10%

Investing in renewable energy would add significant risk to the ALA portfolio

Merrill Lynch identified ten (10) exchange traded funds (ETF’s) that invest in clean/alternative/renewable energy. They noted that the choices are very limited, are extremely small³, have short track records⁴ and are relatively expensive. A review of these investments reveals much higher risk:

- Performance of these renewable energy investments was dramatically less than the Russell 3000 or the energy sector. The average 3 year annualized performance as of 12/31/12 for these funds was -22.2% vs. +11.2% for the Russell 3000 and +9.6% for the S&P Energy ETF
- The downside capture ratio for the funds was roughly twice the Russell 3000, i.e. market declines are approximately twice that of the market
- The underlying investments are generally not profitable, a sign of a speculative investment

The endowment trustees believe that this type of investment is more appropriately suited for alternative investments.

Endowment Fund Financial Impact of Divestiture – A review of ALA’s portfolio, which includes twelve managers – see attached – was conducted to identify if any of the managers held

³ Only 1 had more than $100 million in assets
⁴ Typically 3 years, only 1 has been in existence for 7 years
any of the “Filthy Fifteen” holdings in their individual portfolios. As of 2/28/13 ALA’s portfolio was found to contain three (3) holdings of the “Filthy Fifteen” (15). These holdings were Dominion Resources, Duke Energy and Edison International. Extrapolating out the findings in the Aperio Group study to the ALA portfolio, it is reasonable to conclude that on a short term basis divesting these holdings from the ALA portfolio would have little or no significant negative impact on returns realized in the portfolio as the tracking error to the index is very low. However, as stated earlier, the longer term impact could be significant. The ALA portfolio is actively managed and a screened portfolio will prevent the portfolio managers from positioning their respective portfolios from benefit during those times when the screened industry/asset class outperforms the index. We have found that year to year variances in asset classes like energy, materials utilities etc. can be significant in terms of outperforming the index and other asset classes. See impact above on the S&P 500 in study shortcomings. This is a clear indication that the ALA’s portfolio would be sacrificing returns if the portfolio was screened.

While it is difficult if not impossible to accurately predict future behavior in the market, extrapolating out the future cost of divestment for a particular type of investment is equally challenging. However, based on the resolution as proposed we can say with confidence that if this action had been in place over the last three years the ALA endowment fund would now be $1.2 million less in value than it is today.

**Trustee Identified Qualitative Findings** - There are other considerations that the Trustees feel are as important as the financial considerations in the management of the Endowment fund. This relates to having available as many tools as possible to profitably manage the portfolio. The Trustees start with the following premise as stated in the ALA investment policy – page 4:

*To achieve the maximum rate of return, within established risk parameters, over the long term that would significantly contribute to the cash flow needs of the Long-Term Investment fund for scholarships & awards, on-going operations, special initiatives and capital projects in support of the American Library Association.*

By restricting or screening out specific holdings that may benefit the portfolio, the Trustees feel that the portfolio will be hampered in the following ways:

- Dividend yield of the portfolio would decline and inflation sensitivity would be reduced if energy and utility stocks were excluded
- It will reduce the effectiveness of sector rotation strategies which investment managers use to add value or manage risk
- Restricts the use of safe havens asset classes during recessions i.e. utilities, mandating investments in renewable energy stocks adds an element of speculation and increased volatility to the portfolio
- It limits the opportunity to diversify the assets in order to reduce the risk of wide swing in year to year market value
- It would prohibit the use of commingled investments such as exchange traded funds (ETF’s) or institutional mutual funds
• Introduces a degree of subjectivity in determining what specific stocks are to be excluded and which are acceptable.

Summary/Conclusion: At this time the Endowment Trustees do not support the proposal to divest fossil fuel holdings from the ALA’s endowment fund and invest in renewable energy initiatives. Given the current marketplace, serious data suggest that such a divestment would ultimately harm the fund’s ability to fulfill its time-honored mandate. That is, to appreciate the corpus of the fund in such a way as to support scholarships, awards and ALA operations. Evidence against the proposal is as follows:

- Year to year fluctuations in performance among asset categories
  - Missed opportunities
- Reduces Trustee flexibility
  - Limits the tools available for investing
- Investing in renewable energy initiative
  - Increases the risk profile of the portfolio
  - Is very expensive
  - Renewable funds have short track records
  - Performance of this asset class has been poor