

**ALA Endowment Trustees
Report to Council
Saturday - June 29, 2013
Chicago, IL**

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 manager¹, 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 losses². 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

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)