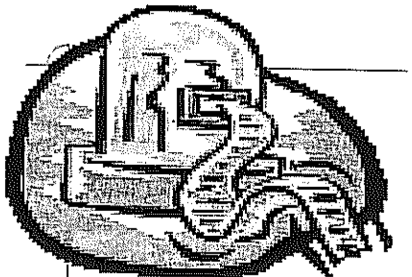
2005 - 06 CD #16.1
(2006 ALA Annual Conference)
2005 - 06 ET #6.2
2005 - 06 EBD #13.3



Endowment Trustees Report to Council

(Long-Term Investment Fund)

Annual Conference New Orleans, Louisiana

Rick Schwieterman - Senior Trustee
Sunday – June 25, 2006

ALA ENDOWMENT TRUSTEES
REPORT TO COUNCIL
SUNDAY JUNE 25, 2006
New Orleans, LA

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 Annual Conference at http://www.ala.org/treasurer.

Attachments

Attached for your review are charts (Exhibits #1- 12) 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.

Financial Review 1st Quarter 2006

Amid the hope during the quarter that the Federal Reserve Board would stop its long running interest rate increase program, the market began the year with some relative strength. As a result this ended up being the best first quarter results for US stocks in several years. Gains were realized in most major stock indexes due to the conventional wisdom that says stocks should do well once the Fed stops raising rates. The S&P 500 surged 3.7% during the quarter, which nearly matched its total return for all of 2005. The Dow Jones Industrial Average returned 3.7%. It is interesting to note that the bigger gains did not come in the areas expected - large cap blue chip type stocks. These stocks were touted as the asset category that would lead the market. A recent survey by the Russell Investment Group found that this is still the prevailing wisdom with 70% still bullish on large cap growth stocks. Small caps continued to lead the market forward as they have for the last few years. The Russell 2000 returned 13.9% and ended at a new record high of 765. Investors were also still willing to take on unprecedented risk as dollars continued to pour into emerging market stocks. This resulted in double-digit returns (12.3%) for the category. Over the last 12 months Latin American stocks have climbed a staggering 77.5%. REIT's and international stocks also continued to surprise the market with the Wilshire REIT index returning 15.4% and the EAFE index returning 9.5%. Fixed income markets fared less than expected as bond yields rose across the yield curve, which in turn reduced prices.

Second Quarter Happenings - Despite the solid results of the first quarter many market strategists were predicting a slowdown. Back on April 9, 2006 Robert Doll – President and Chief Investment Officer of Merrill Lynch, noted that it had been four years since there was a correction of 10% or more. Liz Ann Sonders – Chief Investment Strategist at Charles Schwab, agreed and stated, "we're overdue for a more than typical correction." Typically the market will experience a correction of 10% or more every 21 months.

As the first quarter was ending the majority of market strategists began expressing concern about the sustainability of the gains. Since the end of the first quarter the Federal Reserve hinted that its rate hike program might not be at its end as many had expected. This caused a negative reaction in the market, which adversely impacted equities. Since then there have been a number of missteps by the Fed Chairman during testimony to Congress (4/27/06), the International Monetary conference (6/5/06) and private interviews with the business media (Maria Bartiromo), which have been interpreted as flip flops on the direction of the Fed's next move. This has resulted in a sustained and prolonged adjustment downward in the value of equities held by portfolio managers. This is particularly true for the month of May and June. As a result the value in the portfolio at 5-31-06 was $25,931,304. Despite the downturn most of our portfolio managers are viewing the current situation as a buying opportunity.

Note: Historically speaking the second and third quarters in the second year of a presidential term are the worst periods for stock market performance. According to Standard and Poor's dating back to 1945 the S&P 500 has registered losses of –2.0% in the second quarter and –2.2% in the third quarter during the second year of a presidential term.

Endowment Fund Performance

For the three months ended 3-31-06 the value in the ALA Endowment fund increased by approximately $1.1 million from $25.4 million to $26.5 million - see exhibit #2 & #4. This resulted in a return of 4.3% compared to the portfolio's benchmark of 3.6%. Performance on an individual basis resulted in most of the managers being within striking distance of their respective benchmarks – see Exhibit #5. Alliance Bernstein, the core equity manager, returned 4.5% for the quarter compared to its index of 4.2%. As the year progresses investors are expected to move more investment dollars into large cap blue chip stocks, particularly the growth segment. In view of the moderate performance of the stocks in the S&P 500 individual stock picks will continue to be a key. Although Alliance maintains a balance between growth stocks and value stocks, value carried the day. Another solid performer during the quarter for many of the same reasons behind Alliance's performance was Marsico, the large cap growth manager. Marsico returned 3.2% compared to their benchmark of 3.1%. Marsico's results are definitely due to stock picking as they run a limited portfolio of 25 – 30 stocks. Gulf, a long time performer for ALA, realized a gain of 3.8% compared to its benchmark of 5.9%. Gulf's style as a large cap value manager is to identify candidates whose intrinsic value is less than that reflected in its stock price and holds for 3-5 years. As will be highlighted later, Gulf's performance has not kept pace with its index since its merger with Oppenheimer, Inc. in 2004. NFJ, the small cap manager, had a strong quarter returning 10.3% but still under performed its index results of 13.5%. The international markets continue to perform well, particularly in Germany and France. Despite being a defensive manager Lazard returned 8.0% compared to its index of 9.5%. The index benefited from the results realized from exposure in the emerging market, particularly in Latin America. Credit Suisse, the fixed income (bonds) manager, had a return of -.04% compared to its index which returned -0.6%. This portion of the portfolio should closely match the performance of the benchmark. Credit Suisse continues to position the portfolio to benefit from the anticipated end of the Federal Reserves interest rate hikes.

For additional information on the performance of the portfolio and its managers please see exhibits #9 and #10. These exhibits highlight the 1, 3 and 5 year performance of each as of 3-31-06.

Socially Responsible Investing (SRI) - Ariel

During the first quarter Ariel reported a return of 1.9% compared to its chosen benchmark – the Russell Mid Cap Value – of 7.6%. Ariel's return compares much more favorably to the more traditional SRI indexes the Domini 400 and KLD Social Select at 3.8% and 3.4% respectively. Although they have a good long term record their recent performance has lagged. We are reminded by our investment advisor that portfolio's run in cycles with different styles coming in and out of favor with the market. Their long term record suggests that while performance is lagging now they may well make up the shortfall in the not too distant future. Their current performance continues to be hurt by the fact that they do not invest in the energy sector, as well as, technology where they do not have the expertise. As such we will continue to monitor their performance and make adjustments as necessary.

In addition to ALA's SRI position with Ariel, the Trustees continue to review additional options which will further enhance the portfolio from an SRI perspective. Recently, a number institutional investment money managers ie Merrill Lynch etc. have begun offering portfolio's managed from an SRI perspective. We will continue to investigate these options, as well as, other SRI funds as to their appropriateness for our portfolio.

Asset Allocation and Rebalancing

See exhibit #7 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.

Based on prevailing market conditions the portfolio has benefited from an over weighting in small cap stocks and international stocks. There has also been an under-weighting of the large cap value portion of the portfolio and a corresponding increase in the large cap growth portion. The weighting in the fixed income portion of the portfolio continues to increase as the Federal Reserve has sustained its program of interest rates hikes, as well as, the anticipation of the expected end of these rate increases. On June 20th during a regularly scheduled conference call of the Trustees, the weighting for the international manager – Lazard – was reduced by 2% and added to the fixed income manager – Credit Suisse. This had the effect of bringing each manager more in line with their respective asset allocation targets and reducing expected volatility.

Note: The Trustees meet on a monthly basis via telephone, with ALA staff and Merrill Lynch – ALA's Investment Advisor – to review the Endowments' investment performance, asset allocation and other matters. As a result of this practice and asset allocation decisions made by the Trustees' during the course of the year, based on prevailing market conditions.

Future Outlook in 2006

Just as the calendar year 2005 ended showing signs of fatigue the market began the year with new vitality. Major indexes were showing gains of 3.5% or more in late March in anticipation of a pause in the Federal Reserve Bank's interest rate hike program. Capital spending continues to be good. Corporate cash flows continue to be steady which has prompted a number of dividend payments and stock buyback programs. Unfortunately the markets good fortune was not sustainable as uncertainty on the direction of interest rates caused a great deal of anxiety, as well as, high energy costs. This has impacted housing activity that continues to slow down. This of course has a direct/indirect impact on consumer's ability and willingness to spend. Consumer spending and residential investment have been the driving forces behind our economic growth over the past three years having accounted for 80% of real gross domestic product. As a result the economy should slow this year in conjunction with this activity. If the Fed continues to raise rates beyond the 5% level the landing will likely be somewhat rougher than the much hoped for soft landing. Inflation data and the Fed's willingness to keep it under control will be a key to watch. Unfortunately the outlook seems to change daily. This risk is best managed by maintaining the best practices' asset allocation strategy, which is a part of the investment policy approved by the Executive Board.

Manager Changes

The Trustees met in Chicago on April 26, 2006 for their Spring meeting. The primarily objective was to review alternatives (interview candidates) for the disappointing performance to the portfolio's large cap value manager - Gulf Investment. The Trustees listened to three presentations by managers of the large cap value asset category. After reviewing their presentations, previous financial performance and input from our investment advisor, the Trustees chose Merrill Lynch Investment Managers (MLIM) as the new large cap value manager. Their 1, 3 and 5 year results were superior to Gulf Investment.

MLIM is currently a division of Merrill Lynch & Company. This will change as a result of the Blackrock merger – see below. As of 12-31-05 MLIM had over 500 investment professionals in 17 countries with $539.0 billion in assets under management. They have $15.5 billion under management in the large cap value asset category and are headed by Robert Doll, who is the Senior Portfolio Manager, President and CIO.

Merrill Lynch - Blackrock Merger

On February 15, 2006 Merrill Lynch & Company announced an agreement to merge Merrill Lynch's investment management business – Merrill Lynch Investment Managers (MLIM) and Blackrock to create a new independent company. This company will be one of the world's largest asset management firms with nearly $1.0 trillion in assets under management. Merrill Lynch will have a 49.8% stake (investment) in the new combined company and a 45.0% voting interest. The new company will operate under the Blackrock name and be governed by a board of directors with a majority of independent members. Mr. Laurence Fink, CEO of Blackrock, will serve as Chairman and CEO of the combined company along with Robert Doll, President and CIO of MLIM, will become a Vice Chairman and CIO of Global Equities. The transaction has been approved by the

Board's of Directors of both companies and is expected to close in the third quarter of 2006.

Special Note – The Trustees questioned ALA's Investment Advisor – Merrill Lynch – on any potential conflicts of interest as a result of the pending merger with Blackrock. Just as MLIM, the new large cap value manager, had to meet specific criteria to participate in the Merrill Lynch Consults program as will the new entity. All participants in the Consults program are held to the same standard including, one or more affiliates of Merrill Lynch, and as such have no advantage over any other participant in the Consults program. The new Blackrock entity is now being vetted for continued participation in the program. The final resolution is that there is no conflict with the Investment Advisor or as a participant in the Consults program.

Sara Jaffarian Donation

As a result of the hard work of Joan Claffey – Director of the Development Office – the Trustees are happy to announce the receipt of a gift in the amount of $160,000 for the establishment of the Sara Jaffarian School Library Program Award from Ms. Sara Jaffarian. This donation will go into the long-term investment fund as part of the Cultural Communities Fund, where it will be eligible to receive a 3 to 1 match from the NEH. This award, which is restricted to an elementary or middle school library, will recognize exemplary programs in humanities for elementary and middle school libraries that serve children K-8. Beginning in 2007 this fund will seek to make an annual award of $4,000 and a plaque to the winner. Representatives from AASL and the Public Programs office will evaluate and select a winner.

As always the Trustees continue to encourage the ALA membership to keep ALA and the Endowment fund in mind with respect to their estate planning and donating options.

Merrill Lynch Investment Advisor Fees

Investment Advisor fees have been a continuing source of conversation among ALA's members. As such the Trustees have been ever vigilante in its efforts to make sure that we are receiving the best package of products and services[1] from our investment advisor Merrill Lynch, while keeping the fees that we pay competitive. In 2003, the Trustees retained Merrill Lynch as its Investment Advisor at a lower fee structure as a result of the outcome of an RFP process. In Exhibit #10

[1] Money Manager Fee, Custodian Fee, Transaction Fee and Consulting Fee.

we have highlighted the fees that the fund has paid over the last five years. As you can see, the fee rate has been reduced significantly and is now at a level that is among the best in the industry at .73%. The contract rate is .77% and is paid quarterly at the beginning of the quarter. The rates illustrated in Exhibit #10 show variances due the timing of quarterly payments and when donations are received and fund transfers are made ie the Huron Plaza deposit in 2003. This fee rate also compares very favorably with the average cost of a mutual fund of 1.3%. Index funds come in at about .3% - .7% and by design do not outperform the market. As the Trustees have stated in the past active portfolio management is strongly preferred and adds more value to the portfolio over the long term than passive management as with index funds.

Executive Board Actions

On April 7 – 9, 2006 the Executive Board held their Spring meeting in Chicago. A number of actions were taken during this meeting that impacts the Trustees. Effective July 1, 2006 the following actions will take affect:

- The name of the Endowment Trustees will be changed to the Long Tem Investment Fund Trustees.
- The Long Term Investment Fund Trustees shall be appointed for three years and may be reappointed for a second, but not third, consecutive full term. This term limit applies to all current and future Trustees.
- Each year, the Senior Trustee (Chair) of the Long Term Investment Fund Trustees be appointed for a one-year term by the ALA President-Elect.

Note – It is the understanding of the Trustees that the action regarding the name change will receive further consideration and that the original name may be retained. Additionally, that the LTI fund may continue to be recognized as the Endowment fund.

New Trustee Appointment

The ALA Endowment Trustees are pleased to announce and welcome the newest Trustee Daniel J. Bradbury, who was elected at the 2006 Executive Board Spring meeting in Chicago to serve a three year term. His term officially begins at the conclusion of the 2006 ALA Annual Conference in New Orleans and ends at the conclusion of the 2009 ALA Annual Conference in Chicago.

Dan comes to the Trustees with a strong business background and a wealth of investing experience, all with the backdrop of a lifetime (40 years) of library service in varying capacities. His most recent direct involvement with libraries was as Director of the Kansas City Missouri Public Library. This library system directly served 240,000 residents and provided extended service to a metropolitan area of 1.5 million residents. Since 1994 he has served on the Board of directors of the Public School Retirement System of Kansas City, which has a fiduciary responsibility for $760,000 million in assets. He is currently the vice president of Gossage Sager Associates, which is an executive search firm specializing in the library market. He holds an M.L.A. degree from Emporia State University in Emporia, Kan., and a B.A. degree in English from the University of Missouri at Kansas City. Since his election in April 2006 he has been participating in the monthly Trustee meetings and Trustee business in a non-voting capacity, including the April 2006 meeting in Chicago.

We welcome Dan and look forward to utilizing his experience and insights in addressing the issues that face the Long-Term Investment Fund.

Acknowledgements

As this is my last report as Senior Trustee and member of the ALA Endowment Trustees I would like to share a few personal thoughts:

- Maintain a "Best Practices" investment policy as approved by the Executive Board, particularly a well disciplined investment allocation strategy.

- Preserve the integrity of policy 8.5.1 approved by Council. It reflects the fiduciary expectations of the membership.

On a more personal note I have found it to be a privilege to serve as an Endowment Trustee. I am not a librarian but it has been a way to contribute my time to the library community. Thank you….

And a special "thank you" to the ALA Finance staff who assist the Endowment Trustees in carrying out our duties. We continue to be well served specially 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,

Rick Schwieterman – Senior Trustee (2006)

<u>Trustees Effective July 1, 2006</u>

Robert Newlen – Trustee (2008)
Carla Stoffle – Trustee (2007)
Dan Bradbury – Incoming Trustee (2009)
Teri Switzer – ALA Treasurer, Ex Officio (2007)

Exhibit #1

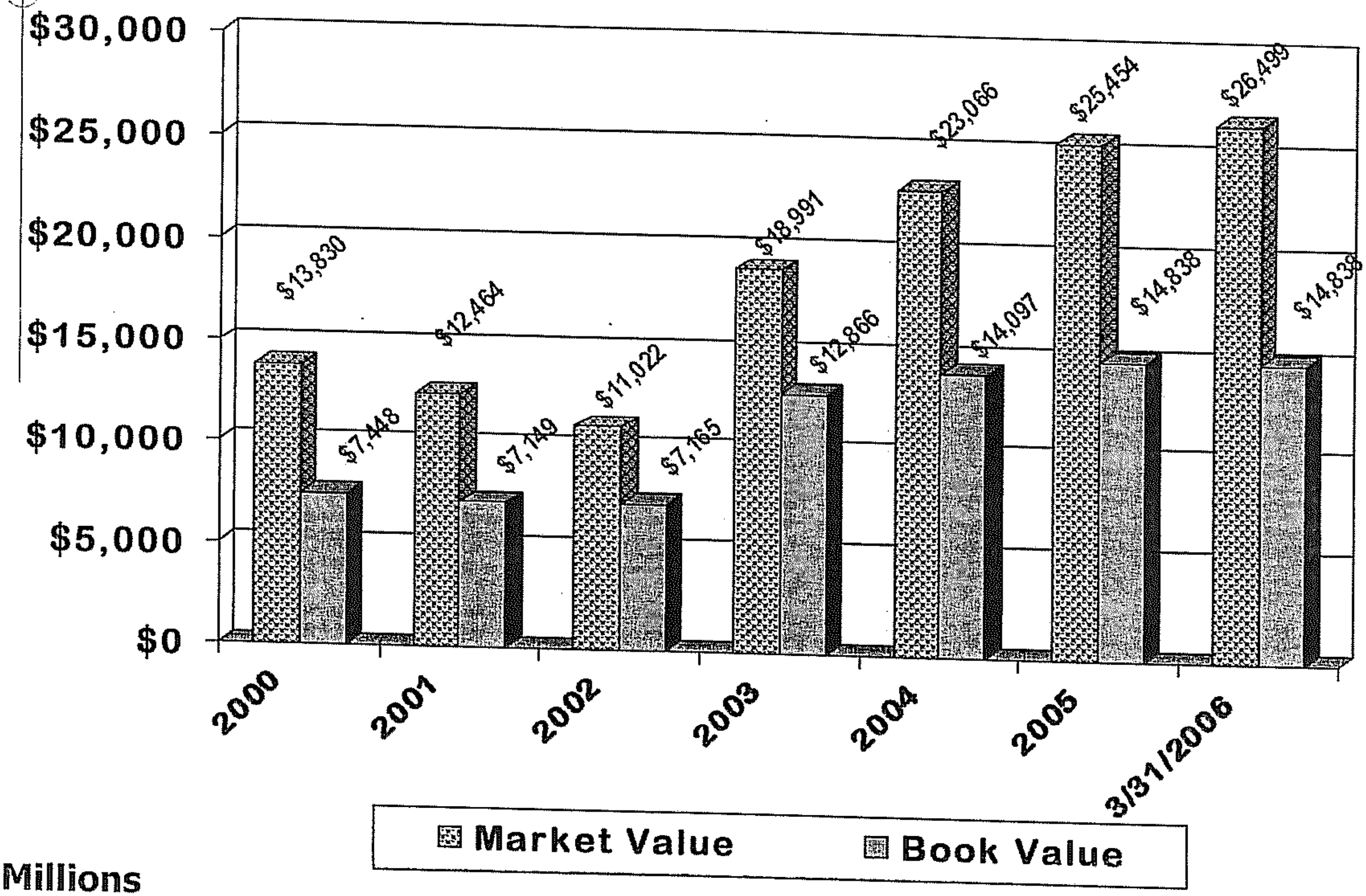
Salient Points

- Interest rates increases expected to continue in second and third quarters of 2006
- New Fed Chairman – Ben Bernanke – began term 1/31/06
- History suggests that the market will experience a cyclical decline during the second year (2006) of a two term President to reach a four cycle low
- Growing concerns of a slowing U.S. economy
- Global equities still look like the preferred investment arena, particularly the emerging markets which are more risky.
- Concerns regarding the inverted yield curve between short and long term bonds.
- Ever changing outlook on the future by market prognosticators.

Exhibit #2

Market and Book Value Since 2000 @ 3-31-06

($000's)



*Millions

Exhibit #3

Division Market Value Since 2000
@ 3-31-06

($000's)

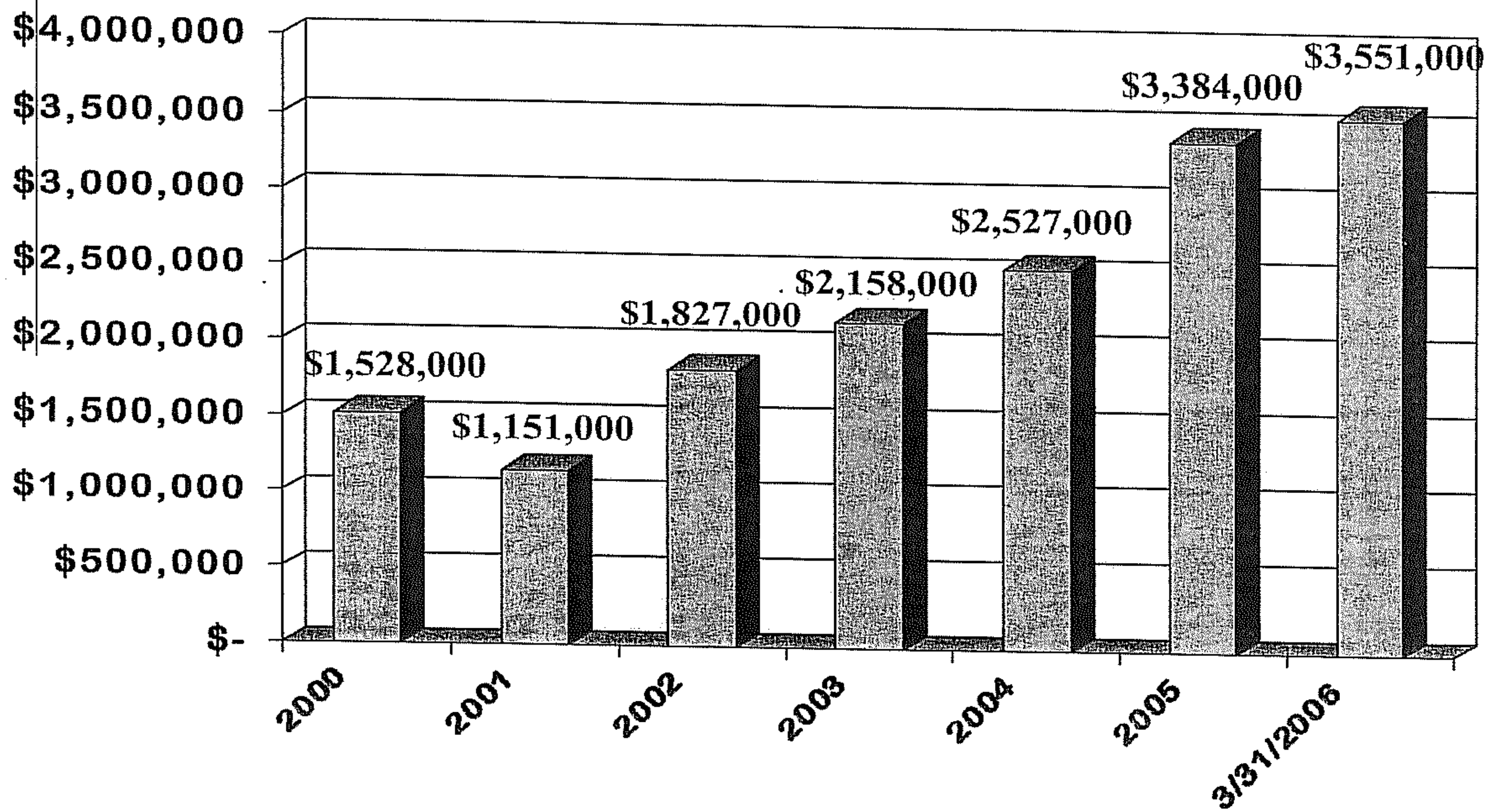
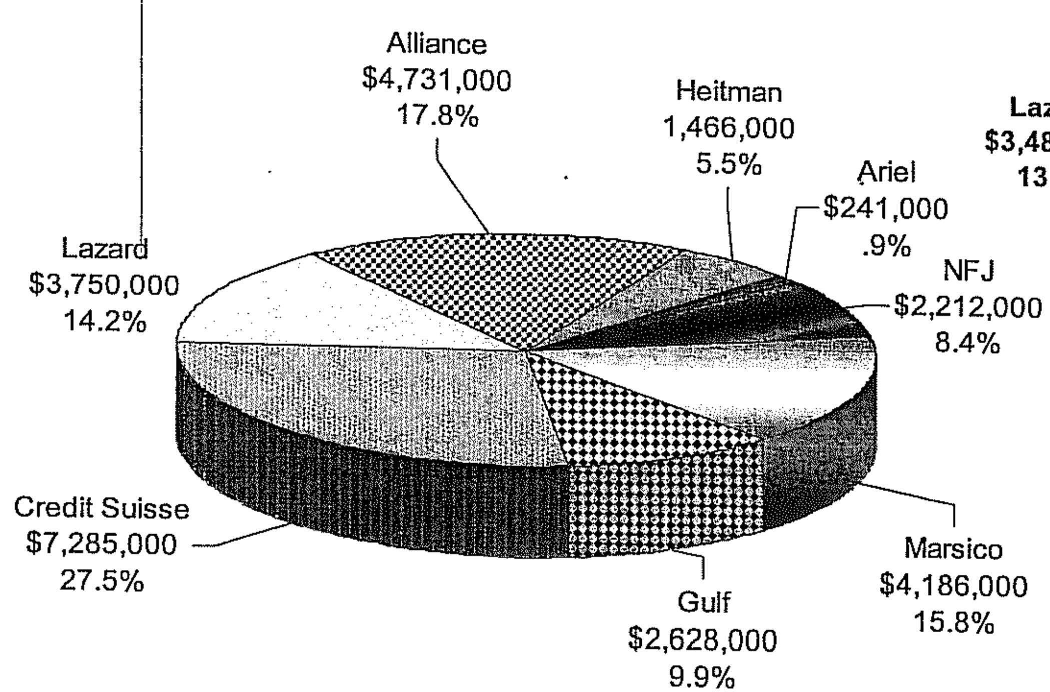


Exhibit #4

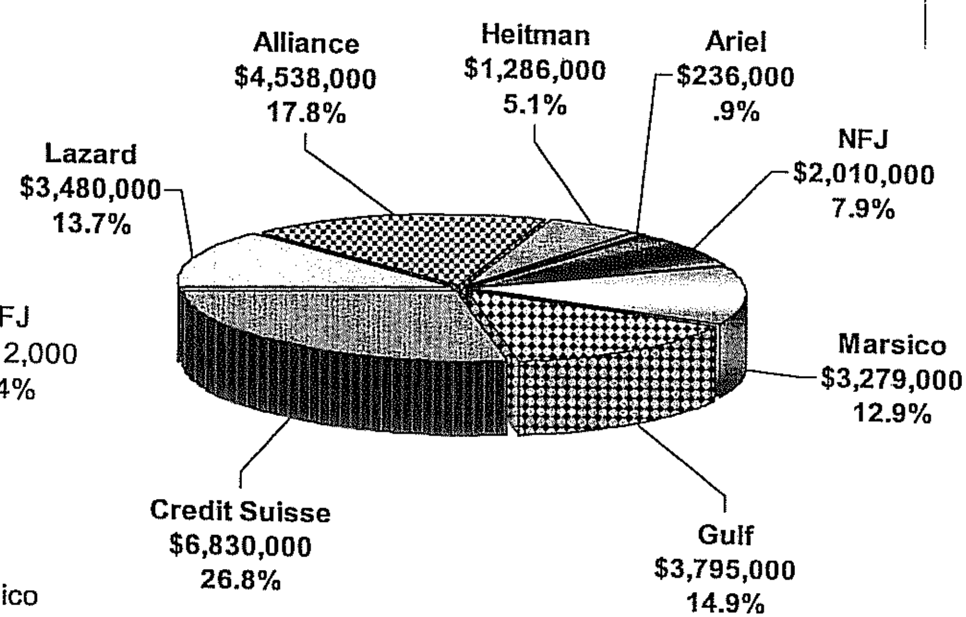
Endowment Fund
Manager Allocation

$26,499,000



3/31/06

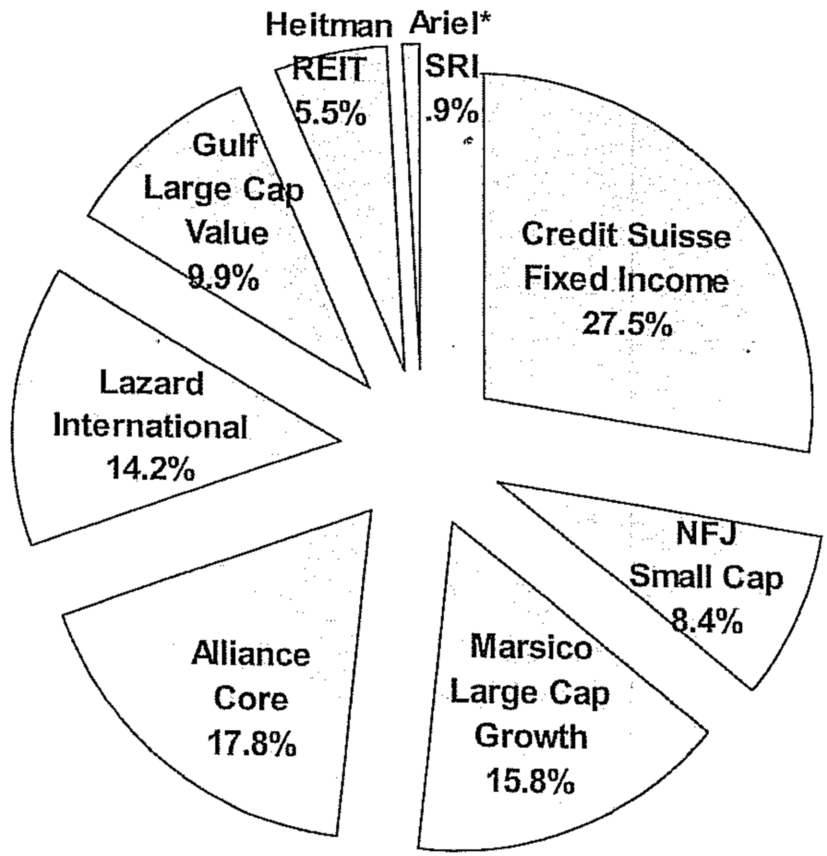
$25,454,000



12/31/05

Exhibit #5

Allocation and Investment Style by Manager

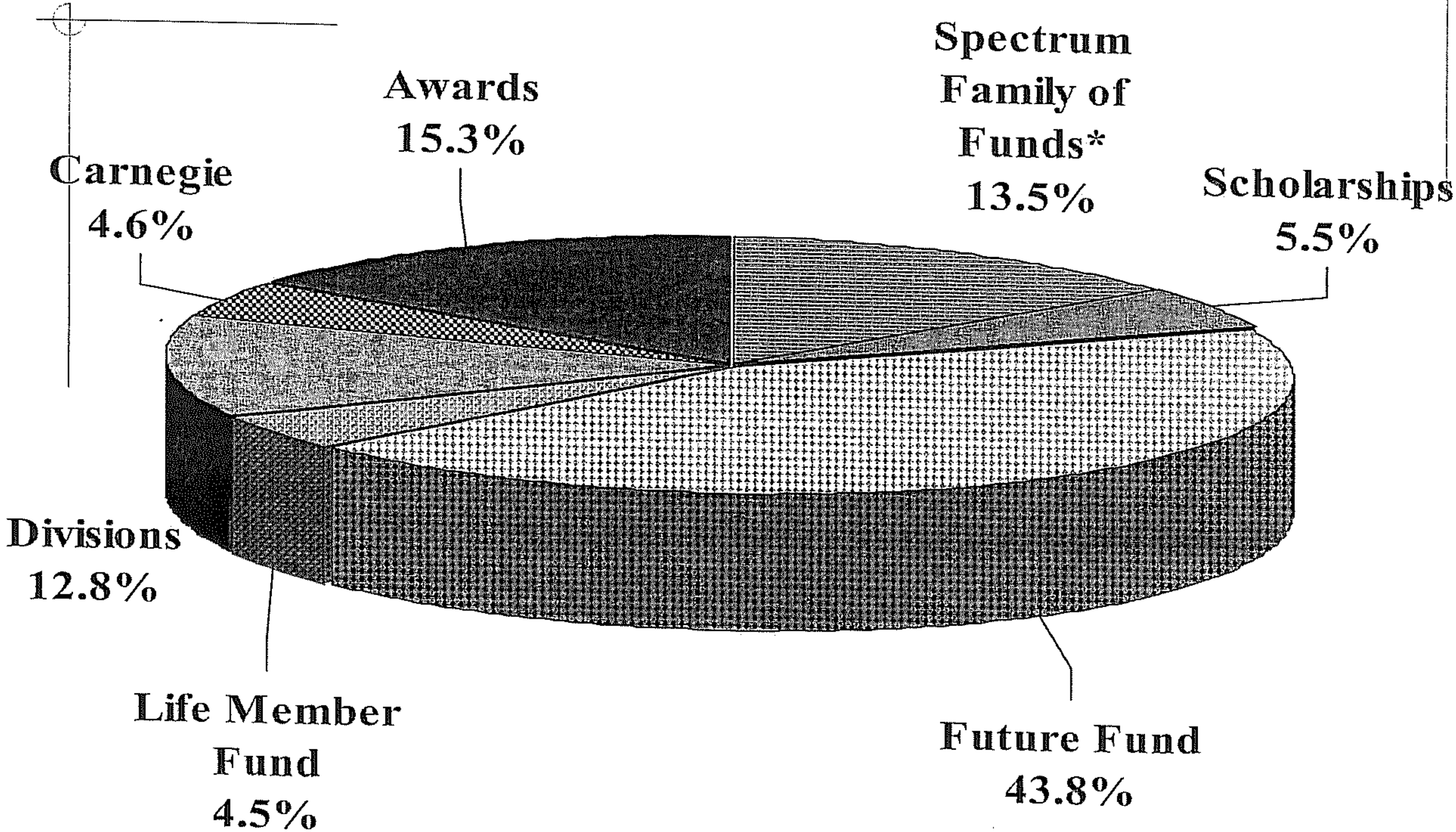


*SRI mutual fund manager

3-31-06

Exhibit #6

Endowment Fund By Type @ 3-31-06



*Spectrum, Turock, Teeple, Giles, Gordon & Leo Albert

Exhibit #7

Asset Allocation Strategy

ASSET ALLOCATION STRATEGY		POLICY GUIDELINES @ 3-31-06			
		Min	Target	Actual	Max
	12/31/2005				
Domestic Large/Medium Cap Stocks	46%	40%	45%	45%	50%
Alliance Bernstein - Core	18%			18%	
Ariel Captial*	1%			1%	
Marsico - Large Cap Growth	13%			16%	
Gulf - Large Cap Value	15%			10%	
Domestic Small/Medium Cap Stocks	8%	0%	5%	8%	10%
NFJ - Small Cap Value	8%			8%	
International Equity	14%	5%	10%	14%	15%
Lazard - International	14%			14%	
Real Estate Investment Trust (REIT)	5%	5%	10%	6%	15%
Heitman	5%			6%	
Investment Grade Fixed Income	27%	22.5%	30%	27%	37.5%
Credit Suisse - Bonds	27%			27%	
Cash and Cash Equivalents	0%	0%	0%	0%	5%
	100%			100%	

***Part of the Core asset category**

Exhibit #8

Performance – 1st Quarter (Returns)

	31-Mar-06		
Managers	**Market Value**	**Returns*** **	**Index*** **
Alliance	$ 4,731,113	4.5%	4.2%
Marsico	$ 4,185,988	3.2%	3.1%
Gulf	$ 2,628,565	3.8%	5.9%
NFJ	$ 2,211,902	10.3%	13.5%
Lazard	$ 3,750,185	8.0%	9.5%
Heitman	$ 1,465,993	14.3%	15.4%
Credit Suisse	$ 7,284,596	-0.4%	-0.6%
Merrill Lynch	**$ 26,258,342**		
Ariel Capital	$ 240,939	1.9%	7.6%/3.8%/3.4%*
Composite	**$ 26,499,281**	4.3%	3.6%**

*Returns for Russell Mid Cap value – Ariel Mgt choice, KLD Social Select and Domini 400 Social respectively

**These returns are unaudited. Composite benchmark is 55% Russell 3000, 10% MSCI EAFE and 35% ML Domestic Master

***Actual returns are net of expenses and Index returns incur no expenses

Exhibit #9

Long-Term Investment Manager Performance @ 3-31-06

	1 Year	3 Year	5 Year
Alliance Bernstein	22.3%	24.1%	7.8%
Marsico	17.8%	19.1%	6.8%
Gulf	25.1%	30.0%	15.1%
NFJ	24.7%	29.2%	19.3%
Lazard	19.1%	25.0%	9.1%
Heitman	39.0%	33.9%	23.6%
Credit Suisse	2.0%	2.9%	4.9%
ALA Portfolio	14.6%	15.6%	6.6%

Exhibit #10

Long-Term Investment Manager Performance – SRI @ 3-31-06

	1 Year	3 Year	5 Year
Ariel Capital Appreciation	7.7%	18.7%	9.7%
Russell 1000 Mid Cap Value*	20.3%	29.2%	14.7%
Domini 400 Social Index**	11.8%	16.1%	3.8%
KLD Social Select Index***	12.0%	NA	NA

*Investment Industry Specific Index - this is Ariel's choice to measure their performance

**Most commonly known SRI index in the industry - equivalent to S&P 500

***SRI Investment Industry Specific Index - KLD developed an asset category specific index, which tracks the Russell 1000

Exhibit #11

Value Added by Active Management of ALA Endowment Assets

-Raj Bhatia, C.I.M.A.
January 13, 2006

For Calendar Year 2005, the net Investment Earnings of the ALA Endowment Fund have amounted to **$1,624,995**. (See Note 1 below)

A typical Asset allocation for Endowments calls for keeping 60% in Equity and 40% in Fixed Income securities. This strategy if deployed by ALA using Index funds would have returned 4.0% or Investment Earnings of **$923,990**. (See Note 2 below)

ALA policy guidelines call for an Active Asset Allocation Strategy.
This Strategy is implemented by the Endowment Trustees with input from the staff of ALA and Investment Management Consultant from Merrill Lynch Consulting and Advisory Services. The strategy calls for:

a) Overweighting within guidelines, an Asset Category which is undervalued or out of favor.
b) Underweighting within guidelines, and Asset Category which is overvalued or in favor.
c) Interviewing and selecting Managers that add value over and above their benchmarks.
d) Rebalancing the different Asset Categories over time.

By implementing this strategy, The Endowment Fund had Net Investment Earnings of **$1,624,995.**

The difference between following an Active Asset Allocation and Manager Selection strategy versus following a Passive Index Investment Strategy has resulted in excess Investment earnings of **$701,005** for calendar year 2005. (See Note 3 below)

Note 1:

Dec 05 Composite Value	$	25,442,854
Dec 04 Composite Value	$	23,065,541
Net Contributions	$	752,318
Investment Earnings	$	1,624,995

Note 2:

Average Value of the A/C	$	23,099,770
2004 60% S&P Index and 40% US Bond Index Return		4.0%
Index Investment Earnings	$	923,990

Note 3:

Investment Earnings	$	1,624,995
Index Investment Earnings	$	923,990
Active Allocation Earnings	$	701,005

Exhibit #12

Merrill Lynch Investment Advisor Fees

	2001	2002	2003*	2004	2005
Portfolio Value	$12,187,026	$11,619,977	$18,038,696	$20,958,687	$25,212,173
Total Fees @ Fiscal YE	$149,477	$131,256	$110,725	$157,289	$183,759
Fee Rate	1.23%	1.11%	.61%	.75%	.73%

*New contractual fee structure of .77 basis points after RFP process

**Fee excludes Ariel which has an expense ratio of 1.14%