INVESTOR EDUCATION SERIES

UNITED CHURCH FUNDS

Making a Plan: Building a Sound Investment Policy

The Bernie Madoff debacle brought home the wisdom of all those axioms your parents and grandparents impressed on you long ago — Nothing ventured, nothing gained. Don't put all your eggs in one basket. Don't buy a pig in a poke. If it seems too good to be true, it probably is.

Turns out all that boring-at-the-time advice would have served Mr. Madoff's investors well: take some calculated risks but spread your risk out, insist on transparency from the people in charge of your money, and be realistic about your expectations.

Every investor — whether an individual or an organization — needs a plan for their investments: a policy that spells out the investor's goals and risk tolerance, the types of investments and managers they consider acceptable, and their general return objectives.

KEY POINTS

Every church needs an investment policy – a plan that spells out how the endowment will be invested so that the assets will continue to support important ministries. In creating a policy –

- **Establish your investment goals**
  Do you seek growth? income? stability? return? social responsibility?
- **Consider your tolerance for risk**
  Realize that higher returns generally require greater risk
- **Choose appropriate investment types and management resources**
  Clearly state the vehicles and managers that will be acceptable, and those that will not
- **Determine your return objectives**
  Set reasonable expectations based on investment choices
- **Insist on transparency**
  Expect transparency from managers and offer the same to the congregation

Set your goals

A church investing its endowment generally has one overarching goal: to provide money for ministry while continuing to grow the endowment to benefit future generations. Where an individual invests with a time-specific goal like retirement, a church invests its endowment in perpetuity. Gifts made by members long gone continue to support the ministry today, and contemporary investors bear an obligation to both their predecessors and their successors to maintain and develop the endowment as a ministry tool.

A church's goals might include long-term growth, stability, social responsibility, and a competitive return that permits a spending policy of three to five percent a year.

When a church begins to develop or review its investment policy, goal-setting should be the first step from which all other elements of the policy grow.

Consider your risk tolerance

Once upon a time, the risk-averse kept their money in bonds and clipped coupons. While high-grade bonds offered no real growth potential, they were largely protected from market fluctuations and guaranteed a return on which an investor could depend. But trustees of an endowment can't rest on their laurels — they must ensure an endowment's viability for years to come. They must take some risk.

Generally speaking, the more risk one is willing to take, the higher one's potential for significant gains — and losses — over long periods of time. While bonds typically represent a lower risk investment, they also offer a lower long-term return on investment than stocks (equities). A "safe" investment, however, can actually be risky to a long-term investor: the failure to take advantage of market growth potential can leave an endowment diminished over time. A well-balanced portfolio includes a mix of stocks that provide the potential for growth, along with bonds that can temper stocks' potential for volatility.

In developing an investment policy, a church must consider how much risk they are willing to take to accomplish their goals. While opinions may vary widely, churches often find that investments like UCF's Balanced Funds balance an appropriate level of risk with the potential for return, while diversification within the portfolio helps to smooth out some of the sharper changes in market values.

With conservative, moderate or aggressive options, UCF's balanced funds appeal to the range of risk tolerances among UCC investors.

Determine acceptable investments and appropriate management

For most churches, mutual fund type investments remain the ideal vehicle for an endowment: funds can be selected to suit the church's needs and offer professional management that removes the burden of direct investment selection from the church's investment or endowment committee. In creating an investment policy, however, a church needs to spell out the types of investments it considers appropriate. Will the church hold single issues of stocks or bonds? What about international stocks? real estate? or so called alternative investments like hedge funds? What types of investments or industries is the church unwilling to consider?

A professional manager or fund can assist a church as they consider the wide array of investment options. So the investment policy should include a list of acceptable sources of investment management. May a church committee internally manage the portfolio, choosing which individual stocks and bonds the church will hold? Or must an outside, professional manager be employed? Does the church want to identify a sole management resource like United Church Funds, or may the outside manager be an individual broker?

Once the investment and management decisions have been made, the church must decide how it will evaluate the manager's performance. How and when will the investment committee communicate with the manager? What criteria will be used to determine if the manager has performed to the church's satisfaction? What process will be used if the church decides to move part or all of its funds to another manager? And perhaps even more importantly, how will the committee communicate its work and progress to the church to maintain faith and transparency with the congregation the endowment is meant to serve?

Establish return objectives

As we've seen in the past few months, investment management success can be derailed by unforeseen market events. Ironically, when the economy turns down and giving slows, churches often look for more income from their endowments. But return objectives must be balanced by a realistic view of conditions and a prudent degree of risk that positions the endowment for continued long-term growth. In other words, return expectations must be reasonable. Mr. Madoff's clients believed they could achieve steady 9-10% returns every year no matter what — generally not a very likely scenario.

If a church is taking too little risk, the endowment is unlikely to provide adequate money for the ministries it is meant to serve, and the real value of the endowment could decline because of inflation. On the other hand, a church should not expect to be able to spend more than three to five percent of its endowment every year to avoid diminishing the portfolio's value over time. With established return objectives, a church can evaluate and adjust its portfolio to achieve a level of performance that is consistent with the church's risk tolerance and goals.

So as your church develops or reviews its investment policy, recall Mama's wisdom. Take appropriate risks, but don't put all your eggs in one basket. Insist on transparency, both from yourself and others. If an investment or manager or return seems too good to be true, know that it probably is. And when it comes to endowments, remember: Rome wasn't built in a day.

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