



January 12, 2018

Dear Partners in Ministry,

Enclosed is the 2017 4<sup>th</sup> quarter statement for your account(s) at the United Methodist Foundation of Northern Illinois. Net of all fees, the returns of the three fund models are:

	4 <sup>th</sup> Qtr 2017	Year to Date	Last 1 Year <sup>†</sup>	Last 3 Years <sup>†</sup>	Last 5 Years <sup>†</sup>	Inception to Date <sup>†</sup>
Aggressive Fund	4.45%	17.88%	17.88%	7.54%	8.12%	5.19%
benchmark*	4.93%	20.91%	20.91%	8.30%	9.67%	6.14%
Moderate Fund	3.30%	13.01%	13.01%	5.33%	6.13%	5.10%
benchmark*	3.59%	15.80%	15.80%	6.59%	7.66%	5.40%
Conservative Fund	2.00%	8.62%	8.62%	3.40%	3.94%	5.06%
benchmark*	2.26%	10.69%	10.69%	4.82%	5.48%	4.90%

\*"Benchmark" is a blend of benchmarks for stocks and fixed income, relative to allocations. †Rates of return (1+ years) are annualized. Inception dates are: Aggressive Fund: 7/30/08; Moderate Fund: 6/29/08; Conservative Fund: 7/1/08

**Market Commentary from Investnet | PMC**

Writing for Investnet’s 2017 4th quarter “Economic and Market Overview,” Brandon Thomas, Chief Investment Officer, Investnet | PMC, summarizes the consensus economic outlook for the short- to intermediate-term and possible impact on stock prices:

“The consensus among economists is that the recently passed tax reform package is likely to provide a significant short- to intermediate-term boost to the economy. The \$1.5 trillion, 10-year tax cut will benefit corporations significantly, which will see a permanent reduction in their tax rate ... Economists expect the tax cuts to act like fiscal stimulus, increasing GDP growth by as much as 0.5% per year. A fear among analysts is that annual growth increasing to 3% at a time when the economy is at or very near full employment may result in overheating ... Market analysts have been raising estimates for corporate earnings for 2018, but it is quite possible that the market has already discounted higher earnings ... In addition, despite the lack of obvious bubbles, most market watchers expect stock prices to be more volatile in 2018 than in 2017, as valuations are more extended, and volatility remains near multiyear lows.”<sup>1</sup>

One important lesson to learn for healthy investing is to not equate *volatility* with *risk*. No one knows how 2018 will play out in the stock market, but should there be increased volatility, it will be important to stick with sound strategies, as provided by the Foundation, rather than making emotional decisions triggered by volatility. The world’s most famous investor, Warren Buffett, wrote in Berkshire Hathaway’s 2014 shareholder letter, “Volatility is far from synonymous with risk. Popular formulas that equate the two terms lead students, investors and CEOs astray.”<sup>2</sup>



### Update on Impact Investing

For nearly three years the Foundation's Investment Committee, Board of Directors, and investment consultant have researched, discussed, and reviewed many aspects of investing the Foundation's portfolios through "impact"-oriented strategies, including evaluating investment advisors that provide such strategies. At the Foundation's June 2016 annual meeting, held in the midst of annual conference in St. Charles, Envestnet Co-Founder and Executive Vice President James Lumberg shared a presentation about impact investing. I also highlighted the shift to impact investing during my presentation at the Foundation's 2017 annual meeting in June. On December 19, 2016, the Foundation integrated Envestnet | PMC's "Impact Quantitative Large Cap Core Portfolio" as a portion of the large cap sleeve of the Foundation's three model portfolios: Conservative, Moderate, and Aggressive. For 2017 this impact portfolio returned 23.59% versus 21.69%, its benchmark return (Russell 1000).

After considerable analysis and deliberation, **the Foundation decided at the December 2017 Board meeting to adopt the impact methodology** for the stock allocations of all three model portfolios.

### What is Impact Investing?

Envestnet | PMC's Impact Quantitative Portfolios "track traditional market indexes with an explicit focus on companies with high sustainability ratings and/or environmental, social, and governance priorities [ESG]."<sup>3</sup> Envestnet | PMC uses several ESG factors from Sustainalytics, a global leader in ESG and corporate governance research and ratings, to construct the portfolios, "**excluding [companies] with high carbon footprints and ESG controversies.**"<sup>4</sup>

The result of the impact investment methodology is to go beyond the "clean hands" approach most commonly associated with socially responsible investing (SRI), i.e. screening out the so-called "sin" stocks: alcoholic beverages, tobacco products, gambling enterprises, pornography, weapons, and private prisons. In addition to *screening out* the "bad" companies, impact investing *screens in* the "good" companies. Some of the ESG characteristics relate to lower carbon footprint compared to peers, usage of renewable energy technologies, human rights records, gender and racial diversity in the workplace and the boardroom, LGBTQ rights, and equitable compensation and benefits.

Through partnership with Glass, Lewis & Co., **the Foundation influences companies as shareholders to do good and align with our values** with proxy voting and constant and active corporate engagement.<sup>5</sup>

**Impact / ESG investing is the approach most aligned with the "Investment Ethics" enumerated by The United Methodist Church in Resolution 4071 of the 2016 Book of Resolutions of the UMC.**<sup>6</sup>

### What effect does this have on our investments with the Foundation?

This is an important question. First, there is **no increase in fees**. Second, **asset allocation and sector diversification remain essentially unchanged**. The portfolios still invest according to the proven strategies of optimizing diversification across asset classes like domestic and international stocks (large, mid, and small cap), emerging markets, and domestic and international bonds. The portfolios still target the sector allocations of their underlying benchmark indexes, for example, such as the Russell 1000 and S&P Small Cap 600.

Diversification is the bedrock of risk management. **The portfolios are essentially unchanged in their strategies of diversification.**

You will notice a one-time effect of this change to impact / ESG investing on your final 2017 statement in the categories of “Gains/Loss” and “Change in Market Value.” Because the portfolios were realigned with the new approach, the higher than normal trading to do that realignment caused substantial realized gains in the month of December, offset by the “Change in Market Value.” In a month without such a broad-based portfolio realignment you would have seen modest gains/loss and a higher “Change in Market Value” because stocks did go up for the month of December. For example, the Aggressive Fund (85% stocks) increased about 0.88% for December, whereas the Russell 1000 index (100% stocks) increased about 0.95%. **There are no tax consequences for charitable accounts.**

For a simplified understanding, simply take the difference between the beginning balance and the ending balance (and back out the effect of additions and withdrawals), and that’s your investment return for December or the fourth quarter or whatever statement you are looking at.

### **The Bottom Line**

The Foundation’s investments are now even more **deeply and closely aligned with the “Investment Ethics” of Resolution 4071** and place our Foundation in a select group of similar foundations.

Over the long haul, in theory and according to research and backtesting, “good” companies collectively outperform “bad” and “average” companies collectively because they are managed more sustainably. In the end, through impact / ESG investing we are not sacrificing our time-tested principles of healthy investment management through broad asset allocation, sector diversification, and passive management. And we gain the confidence of knowing that your and our investment dollars—a significant portion of God’s blessings for our collective life—are working the most good they can in the world according to our highest ethical standards.

### **New Website!**

We are very close to rolling out the new website for you to access your account and download statements at your convenience. **Please send to me the contact info for the “ONE” person in your church / organization that will be the point person for this access.** Thank you.

Respectfully,



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- 1 <http://www.investpmc.com/insights/commentaries/economic-and-market-overview-forth-quarter-2017>
  - 2 <http://www.berkshirehathaway.com/letters/2014ltr.pdf>
  - 3 <http://www.envestnet.com/content/docs/impact-quantitative-portfolios>
  - 4 [http://www.envestnet.com/sites/default/files/documents/PMC-FS-ImpactQP\\_FINAL.pdf](http://www.envestnet.com/sites/default/files/documents/PMC-FS-ImpactQP_FINAL.pdf)
  - 5 <http://www.glasslewis.com/company-overview/>
  - 6 <http://www.umc.org/what-we-believe/investment-ethics1>

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