

# The National Christian Foundation

## Investment Strategy Report

March 31, 2009

### Global Market Overview

The NCF investment management team's defensive portfolio construction enabled the investment pools to outperform their benchmarks by a wide margin during the 1<sup>st</sup> quarter of 2009. This outperformance, in combination with strong relative performances in 2008, has produced investment results that are dramatically better than benchmark results during the last 12 months, 36 months and since inception.

The first quarter of 2009 was a tale of two stock markets. From January 1<sup>st</sup> to March 9<sup>th</sup>, the Standard & Poor's 500 Index tumbled 25% to a new 12-year low. But from March 9<sup>th</sup> through the end of the quarter, the S&P 500 jumped 18%, en route to a 29% rally...so far. Clearly, high volatility continues to buffet the equity markets.

After the dust had settled at the end of the quarter, the S&P 500 had produced a total return of minus 11.0% - its sixth consecutive quarterly loss. International markets also performed poorly during the quarter, with the MSCI EAFE Index down 14.0%. Most fixed-income indices also delivered negative returns. Relatively speaking, commodities performed well during the quarter, with the Reuters/Jefferies CRB Index down only 4.0%, while gold actually gained 4.2%.

In such an environment, it is important to note the performance of our allocation to hedge funds. Both of our fund of fund managers produced positive returns for the quarter of 3.36% and 2.28%, respectively. We were especially pleased that these allocations delivered positive absolute returns, not merely excellent relative returns.

### NCF Portfolio Modifications

The primary goal of NCF's investment pools is capital preservation. With that objective in mind, we are continually monitoring our allocations, watching for opportunities to improve the pools by reducing risk or by increasing anticipated risk-adjusted returns. With the incredible declines and volatility of the last 18 months, it may be helpful to review some of our recent changes.

In the third quarter of 2007, we began repositioning our portfolios toward a more defensive stance. Our initial modification was to reduce our allocation to long-only equities by eliminating our holdings in real estate investment trusts (REITs). REITs, as measured by the Bloomberg Diversified REIT Index, have now lost more than 60% percent of their value since we eliminated this allocation. We also reduced our exposure to other sectors of the US stock market and, in particular, greatly reduced our investments in finance companies such as banks and brokerage firms. Each of these former allocations has declined by at least 40% since we reduced our exposure with the finance sector faring even worse. From September of 2007 through the March of 2009, the KBW Index of large bank stocks plummeted 71%.

Net-net, the best equity investment of the last several months has been no investment. The same could be said for the corporate bond market. Beginning in 2007, we reduced our holdings of corporate debt in all pools by liquidating our investments in the bonds of finance companies. We reallocated most of the proceeds into the short end of the Treasury market. As a result of our light exposure to corporate credit and heavy exposure to short-term Treasury securities, our fixed income portfolios performed very well.

During the first two months of 2009, we maintained our defensive positioning in both our equity and fixed income portfolios. At the same time however, we continued modifying our portfolio allocations for the sake of maximizing our investment returns relative to the risks that we are taking. Specifically, we eliminated our allocation to an historically volatile small-cap manager. We also trimmed our allocation to large-cap international equities, with the intention of reallocating the proceeds to the beaten-down emerging-market sector. Because of the severe selloff of the last several months we believe that emerging markets offer better risk/reward potential than traditional large-cap international stocks.

## **NCF Portfolio Additions**

Although we maintained our defensive positioning throughout most of the first quarter, we increased our exposure to equities in late February and early March. We implemented this reallocation to equities by investing in a value stock mutual fund, a natural resource ETF and an emerging market stock ETF. All three positions produced very strong results during the quarter, both in absolute terms and relative to the S&P 500 Index.

During the first quarter of 2009 we also initiated a new allocation to the commodity sector. Specifically, we invested in three ETFs that hold one or more commodities. One of these ETFs holds only gold; one holds various agricultural commodities; and one holds a diversified basket of commodities that includes energy, base metals, precious metals and agricultural commodities.

Generally speaking, the commodity sector exhibits equity-like volatility...for better or worse. But based on historical inter-market relationships, the commodity sector tends to exhibit a low or negative correlation with equities over a complete market cycle. Therefore, commodity exposure within a portfolio tends to offset or dampen the volatility of the equity exposure. And we witnessed this exact phenomenon during the first quarter of this year as commodities exhibited a very low – or even inverse – correlation with the stock market.

It is important to note, however, that the commodity allocation within the NCF pools does not merely serve to dampen overall portfolio volatility. Rather, we initiated this allocation as a way to hedge the portfolios against adverse monetary trends - specifically, inflation. Commodity prices tend to respond quickly to inflationary trends – meaning that rising inflation tends to produce rising commodity prices.

Additionally, we believe that the commodity sector offers a compelling tactical investment opportunity, which is an investor's way of saying, "at the moment, commodities appear to be inexpensive." In the second half of 2008, commodity prices collapsed as part of a broad response to the credit crisis. That left the prices of many commodities below the cost of marginal production. From a pure investment perspective, such price levels arguably offer an excellent entry point for new investment and effectively provide some margin of safety. In other words, even if our expectation of future inflation proves incorrect, we may nonetheless do reasonably well with our commodity investments based on current prices. Please see the pie charts in the quarterly investment performance report for details of the percentage allocations to the various asset classes in each of our pools.

## **Conclusion**

We are committed to creating an investment environment with choices for NCF donors that focus primarily on capital preservation. We hate losing money! But in order to have a reasonable chance of protecting and preserving longer term funds, it is necessary to have investments that can grow at a rate greater than long-term inflation. Therefore, we have equity allocations that sometimes, in years like 2008, lose value. We will continue to do our best to strike the right balance between the need for safety and the need for future growth.

In that regard, also, we will undoubtedly be making additional portfolio changes from time to time. We will describe all such changes in our quarterly performance reports and in future editions of this Global Investment Strategy report. Therefore, please check our website periodically to watch for upcoming reports. Thank you, as always, for allowing the National Christian Foundation to help support you in your charitable giving.

### ***Additional Information***

This Investment Strategy Report is part of a more complete performance report that is available on-line in the "Forms & Reports" section of the NCF website: [www.nationalchristianfoundation.com](http://www.nationalchristianfoundation.com).