

2018 REPORT OF THE FUUSN BOARD OF INVESTMENT

Introduction

The Board of Investment has taken a cautious approach to managing the Endowment over the last year following nine years of strong performance by both stocks and bonds and we are pleased with the results. In addition to our core responsibility we have been working hard to streamline the management of the funds entrusted to us (General Endowment, Restricted Endowments and other funds) and to improve transparency and communication with both the Finance Committee and the Board of Trustees. We have also worked closely with the Financial Oversight Committee on new – and needed – policies governing withdrawals and loans from the Endowment.

As the Society's annual meeting is at the very beginning of June this annual report had to be prepared before the end of May. We will, therefore, refer throughout to the eleven months ending April 30th, 2018. A supplement to this report with numbers updated through the end of the fiscal year will be distributed as soon as practical after the end of May.

Overview of Financial Markets

Financial markets continued to do very well in the first seven months of the period as the nearly nine year rally in both stocks and bonds continued. Equity valuations were already high while bond yields were close to multi-decade lows, but economic fundamentals remained very positive, allowing investors to ignore the increased political uncertainty. Not only was the US economy continuing to grow at a steady pace, bringing unemployment down a notch further from the already low level it had reached at the end 2016 but the global economy was also shifting into higher gear. As a result, corporate earnings worldwide continued to grow, supporting rising stock prices. At the same time inflation remained notably absent. This ensured that interest rates remained low, an additional positive for stocks and also supportive for bonds.

The rally came to a halt in February as volatility returned to the markets. With stock market valuations already so high it became harder for investors to ignore a host of concerns, even though both economic growth and corporate earnings remained strong. Interest rates began to come under more pressure as inflation started to reappear and the Federal Reserve began to quicken the pace of rate hikes. US government policy also increasingly became a source of worry. With the massive tax cuts targeted at

corporations and the wealthy coupled with increased spending the US embarked on a risky policy of adding fiscal stimulus to an already strong economy. This led almost immediately to a jump in government borrowing, pushing up long term interest rates. The size of the stimulus also increased concern about the inflation that was starting to reappear, leading to higher short term interest rates. Rising rates are a clear negative for stock markets and they reacted accordingly.

In addition, the administration's threats of protectionism and trade wars, which most had previously written off as just bluffing, began to seem real with the imposition of tariffs on imported steel and aluminum. Growth in the US and global economies is heavily dependent on trade, and the biggest companies, such as those found in the S&P 500, are especially globalized. As the administration continued to alternately threaten and cajole the US's trading partners around the globe stock markets reacted to every escalation and de-escalation. As if that weren't enough the war of words with North Korea, the US's withdrawal from the Iran nuclear agreement and the risk that the ongoing Syrian civil war could trigger a broader conflict are all making investors nervous. And finally, there is new concern over emerging markets, highlighted by sharply falling currencies in Argentina and Turkey. Emerging markets governments generally have solid fiscal positions, but their private companies have borrowed heavily in US Dollar, which could become a real problem.

Over the eleven months from May 31, 2017 to April 30, 2018 one-month US Treasury rates rose from 0.86% to 1.65% while the benchmark ten-year rate rose from 2.21% to 2.95% (it later crossed the symbolic 3% threshold). During the same period the S&P 500 (a broader measure than the better-known Dow Jones index) gained .

The bottom line is that the current environment of solid growth and low inflation is no longer enough to keep investors from worrying about growing economic and political uncertainty. The long rally appears to be over. We expect markets to remain volatile and have positioned our portfolio accordingly.

Investment Activity

During the year we continued to reduce the level of risk in the portfolio by selling stocks and buying bonds. This brought our equity weighting down to 65% (not including real estate funds) while our bond weighing increased to 25%. We also retained a larger than usual cash position. We sold our holdings of the Walden Social Equity Fund and used the proceeds to increase our holdings of the TIAA-CREF Social Choice Fund. Our analysis revealed that the two funds held substantially identical portfolios yet the TIAA-CREF fund

charges much lower fees. We also disposed of our holding of the Vanguard Short-Term Corporate Bond Index Fund. As markets have become more volatile we need our bond holdings to be less correlated to equities and at times of market stress corporate bonds behave much more like equities than do government bonds. We remain cautious about the near to medium term outlook for financial markets and plan to keep our defensive stance. We have, however, just invested in two new sustainable funds, the Brown Advisory Sustainable Growth Fund and the Pax Elevate Global Women's Leadership Fund. We continue to investigate other sustainable funds that could be added to the portfolio.

Our investment philosophy remains the same. We begin by selecting the investment weighting by asset class, varying the relative weighting of stocks and bonds according to our expectations for the markets. Within these asset classes we utilize index funds whenever possible to minimize the expense ratio and maximize return. Where possible, we use sustainable funds that also meet our criteria of having low expenses. We do not invest in individual stocks and we strive to keep turnover low to keep costs down.

Please see the Appendix 1 for details on how the endowment was invested at the end of April.

Performance of FUUSN's Portfolio

FUUSN's portfolio suffered somewhat from our cautious investment strategy as the multi-year rally continued, which we had not expected, but has held its value in the more volatile time since the end of January. The total return for the eleven month period was 8.6%, compared to 8.2% for the composite benchmark that we use to measure the performance of our endowment. This benchmark is a mix of the S&P500 (40%), Wilshire 4500 (20%), Barclays Aggregate Bond (20%), and MSCI EAFE (20%) indices. In order these indices represent large US stocks, medium and small US stocks, US and international bonds and non-US developed country stocks. This is in line with the typical allocation of our portfolio. By comparison the Unitarian Universalist Association Common Endowment Fund gained 8.2% for the year ending April 30th.

The key driver of performance was our steady move out of equities and into bonds. We now have 70% in equities (including real estate) compared to 80% for the above mentioned benchmark.

The Society's total endowment as of April 30, 2018 stood at \$1,968,474. Of these funds \$1,760,495 is in the General Endowment and two unrestricted funds, while \$207,584 is in funds that are restricted for specific purposes. In addition, the Board of Investment held \$167,792 in funds set aside by the Board of Trustees and the Finance Committee (see Appendix 2 for details).

Update on Endowment Withdrawal and Lending Policies

The Board of Investment and the Financial Oversight Committee worked together during the course of the year to write new policies governing the annual draw from the endowment to support the Society's operations and any potential loans from the endowment for the same purpose. As noted in last year's report, the existing endowment withdrawal policy was simply too conservative to be workable. This left us with essentially no withdrawal policy at all. There was also no policy governing loans from the endowment, something which became an issue in 2017 when it looked like a loan would be necessary. The two committees jointly presented the proposed new policies to the Society's Board of Trustees, which approved them in December.

The new withdrawal policy aims to keep the monetary value of the Endowment's annual contribution to operations relatively stable while adjusting it according to the Endowment's performance. The previous year's withdrawal, adjusted for inflation, is weighted at 70% of the annual withdrawal. The average value of the endowment over the four quarters of the previous calendar year is weighted at 30%. This policy is first being applied with the 2019 budget and is being used to determine the amount to be withdrawn from both the General Endowment and the Restricted Endowment.

The new loan policy protects the Endowment by setting a maximum loan value of 5% of the Endowment and establishing a maximum five year repayment period. No interest is to be charged as the only loans that are allowed are to the Society itself. There are currently no loans outstanding nor are any planned.

General Endowment

The total contribution from the General Endowment to operations for FY2018 was \$77,090, which represented a payout of 4.7% of the value of the General Endowment as of December 31, 2016. In FY2019, under the new spending policy, the contribution will be \$80,861, 4.6% of the value of the endowment as of December 31, 2017.

Restricted Endowments

During the year the Board of Investment completed a review of all of the restricted endowment funds based largely on a summary document that was compiled in the early 1980s. Some of these funds can be used for the Society's general operating expenses while others can only be spent on the purpose specified

by the donor. In most cases we are not allowed to spend the principal, but some funds can be spent in full, as long as they are used for the designated purpose.

This review enabled the Board of Investment to free up additional funds to support operations. In 2018 we disbursed \$6,370.22 from the restricted endowments, compared to nothing at all in the previous several years. This included full payout of the Tucker Music Fund, whose principal was available to be spent on music, so not all of this amount will be recurring.

The Restricted Endowments are managed together with the General Endowment. For details see Appendix 2.

Other Funds Held by the Board of Investment

In addition to the Endowment the Board of Investment holds several funds entrusted to it by the Finance Committee and the Board of Trustees which are not part of the Endowment and not intended to be held for the long term. At the end of 2017 we set up a separate account at Fidelity to hold these funds. This enables us to keep track of them separately from the Endowment and to invest them more appropriately, in shorter term investments with an emphasis on capital protection, rather than growth. It is also now our policy to transfer the amount of the annual draw on the General Endowment to this account at the beginning of the fiscal year. As of April 30, 2018, these funds totaled \$167,792.25 and include the following:

- A \$35,000 legacy that was received in April and is being held in this account pending instructions from the Board of Trustees. The Board of Investment has recommended that it be set aside as a Board Designated Endowment Fund to be managed as part of the Endowment.
- A \$50,000 operating reserve saved from an operating surplus several years ago that the Board of Investment is holding for the Finance Committee. The Committee has notified the Board that it plans to draw the \$50,000 during this fiscal year.
- The Building Reserve Fund (\$72,000), set aside to cover repairs and improvements that are not covered by the operating budget, and the Sabbatical Reserve (\$10,000) to cover the costs of a n interim minister in the event of a ministerial sabbatical or departure. The Society makes a contribution every year to the Building and Sabbatical Reserve funds in anticipation of future expenses.

In July, at the direction of the Board of Trustees and the remaining members of the Women's Alliance, the Board of Investment cleared out three non-endowment funds it was holding: the Cell Tower Reserve, the Ministerial Intern Fund and the Roof Maintenance Fund. This raised \$50,627 which was used to complete the accessibility project and landscaping improvements at the front of the building.

As noted in last year's annual report, the Board of Investment is very concerned at how little now remains of the non-Endowment funds that had been set aside for the maintenance and improvement of our building. The improvements to accessibility and landscaping were a very important enhancement to the building but there are now no funds to undertake any more major projects

Legacies and the Endowment

We have been informed by the Financial Oversight Committee that only the donor can legally designate a gift as part of the permanent endowment. In the absence of explicit instructions, it is up to the Board of Trustees to decide how the money can be used. The Trustees cannot add these funds to the permanent endowment, but they can direct that the funds be managed as part of the endowment. One of the proposed by-law changes to be considered at the 2018 annual meeting addresses this question. **The Board of Investment recommends very strongly that any member of the Society who is considering a legacy gift include explicit instructions that it be directed to the General Endowment.**

Sustainability

The Board of Investment has long had a policy of dividing its stock market portfolio between passive index funds – which keep costs down - and actively managed sustainable funds, which help us to better align our investment portfolio with our UU values. A well-managed sustainable fund can also improve the long term value of our portfolio by delivering more stable performance, due to its inherent bias towards owning higher quality, less risky, companies and its lower correlation to the overall market. One quarter of the Endowment is currently invested in sustainable funds and we continue to look for new sustainable funds with a strong track record and a reasonable level of fees.

A key priority for us over the next year is to come up with a policy for the Endowment on sustainable investing. We look forward to continuing our dialogue with the Social Action Committee on this topic and we hope to have a resolution to present to the 2019 annual meeting of the Society.

Urban Larson, Chair

David Griswold

Devon Welles

Appendix 1: Holdings of the Board of Investment as of April 30, 2018

| FIDELITY ENDOWMENT ACCOUNT | | | | |
|---|---------------------|---------------|-----------------------|---------------|
| | May 31, 2017 | | April 30, 2018 | |
| CASH (Fidelity Government Money Market): | \$ 83,573 | 4.1% | \$ 113,612 | 5.8% |
| EQUITIES | | | | |
| Vanguard International Equity Index Funds FTSE Emerging Mkts ETF | \$ 82,268 | 4.0% | \$ 95,865 | 4.9% |
| Vanguard FTSE Developed Market ETF | \$ 299,066 | 14.5% | \$ 278,710 | 14.2% |
| Vanguard Scottsdale Funds Vanguard Russell 2000 Growth Index Fund ETF | \$ 78,733 | 3.8% | \$ 57,293 | 2.9% |
| Vanguard Scottsdale Funds Vanguard Russell 2000 Value Index Fund ETF | \$ 117,991 | 5.7% | \$ 91,171 | 4.6% |
| Vanguard Admiral Funds Inc S&P Midcap 400 Value Fund ETF | \$ 141,054 | 6.9% | \$ 100,437 | 5.1% |
| Vanguard Admiral Funds Inc S&P Midcap 400 Growth Index Fund ETF | \$ 80,834 | 3.9% | \$ 55,682 | 2.8% |
| Vanguard Admiral Funds Inc S&P 500 Value Index Fund ETF | \$ 152,431 | 7.4% | \$ 154,604 | 7.9% |
| TIAA-CREF Social Choice Fund | \$ 249,473 | 12.1% | \$ 392,328 | 19.9% |
| Walden Social Equity Fund | \$ 161,866 | 7.9% | | |
| Parnassus Endeavor Fund | \$ 65,342 | 3.2% | \$ 70,154 | 3.6% |
| TOTAL EQUITIES: | \$ 1,429,058 | 69.5% | \$ 1,296,242 | 65.9% |
| BONDS | | | | |
| Payden Global Fixed Income Fund | \$ 100,556 | 4.9% | \$ 101,759 | 5.2% |
| Fidelity Capital and Income Fund | \$ 143,600 | 7.0% | \$ 150,134 | 7.6% |
| Vanguard Scottsdale Short-Term Bond Index Fund | \$ 40,315 | 2.0% | | |
| Fidelity Inflation-Protected Bond Index Fund | \$ 52,334 | 2.5% | \$ 94,598 | 4.8% |
| Fidelity High Income Fund | \$ 72,715 | 3.5% | \$ 75,078 | 3.8% |
| Fidelity Total Bond Fund | | | \$ 59,838 | 3.0% |
| TOTAL BONDS: | \$ 409,520 | 19.9% | \$ 481,407 | 24.5% |
| REAL ESTATE | | | | |
| Fidelity International Real Estate Fund (FIREX) | \$ 24,445 | 1.2% | \$ 17,560 | 0.9% |
| Fidelity Real Estate Investment (FRESX) | \$ 60,697 | 3.0% | \$ 59,653 | 3.0% |
| TOTAL REAL ESTATE: | \$ 85,142 | 4.1% | \$ 77,213 | 3.9% |
| OTHER | | | | |
| US Treasury Bill due 4-15-18 | \$49,805 | 2.4% | | |
| TOTAL OTHER: | \$ 49,805 | 2.4% | | |
| TOTAL HELD IN FIDELITY ENDOWMENT ACCOUNT | \$ 2,057,098 | 100.0% | \$ 1,968,474 | 100.0% |
| FIDELITY OPERATING ACCOUNT (opened November, 2017) | | | | |
| | | | April 30, 2018 | |
| CASH (Fidelity Government Money Market): | | | \$ 635 | 0.4% |
| BONDS | | | | |
| US Treasury Bill due 8-16-18 | | | \$ 35,802 | 21.4% |
| US Treasury Bill due 10-11-18 | | | \$ 49,559 | 29.6% |
| Baird Core Plus Bond Fund | | | \$ 10,269 | 6.1% |
| Fidelity Total Bond Fund | | | \$ 71,527 | 42.8% |
| TOTAL BONDS: | | | \$ 167,157 | 100.0% |
| TOTAL HELD IN FIDELITY OPERATING ACCOUNT | | | \$ 167,792 | |
| TOTAL HELD BY BOARD OF INVESTMENT | \$ 2,057,098 | | \$ 2,135,631 | |

Appendix 2: Summary by Endowment Fund

| Summary by Fund | | | | | | |
|--|-----------------------------------|---------------------|-------------------------|---------------------|-------------------------|-------------------------|
| ENDOWMENT | | | | | | |
| <i>Fund</i> | <i>Purpose</i> | May-17 | | Apr-18 | | Spend Principal? |
| | | Total Value | Percent of Total | Total Value | Percent of Total | |
| General Endowment | Unrestricted | \$ 1,669,015 | 81.1% | \$ 1,742,115 | 88.5% | No |
| Holt | General Purposes | \$ 6,562 | 0.3% | \$ 6,271 | 0.3% | No |
| Whitmore | General Purposes | \$ 12,670 | 0.6% | \$ 12,109 | 0.6% | No |
| Total Unrestricted: | | \$ 1,688,248 | 82.1% | \$ 1,760,495 | 89.4% | |
| Little | Minister's Discretionary | \$ 4,320 | 0.2% | \$ 4,314 | 0.2% | No |
| Total Minister's Discretionary Funds: | | \$ 4,320 | 0.2% | \$ 4,320 | 0.2% | |
| Allen | Flowers | \$ 4,814 | 0.2% | \$ 4,914 | 0.2% | Yes |
| Brigham-Fischer | Organ | \$ 3,945 | 0.2% | \$ 4,110 | 0.2% | Yes |
| Howard | Music | \$ 1,472 | 0.1% | \$ 1,471 | 0.1% | No |
| Jaynes | Guest Ministers, Outside Speakers | \$ 6,691 | 0.3% | \$ 6,683 | 0.3% | No |
| Lipton | Music | \$ 43,919 | 2.1% | \$ 43,868 | 2.2% | No |
| C.J. Teixeira | Sheet Music | \$ 2,872 | 0.1% | \$ 2,869 | 0.1% | No |
| N.A. Teixeira | Wayside Pulpit | \$ 11,065 | 0.5% | \$ 11,528 | 0.6% | No |
| Tucker | Music | \$ 1,000 | 0.0% | \$ - | 0.0% | Yes |
| Total Designated for Specific Operational Expenses: | | \$ 75,779 | 3.7% | \$ 75,443 | 3.8% | |
| Best | Building | \$ 12,521 | 0.6% | \$ 11,946 | 0.6% | No |
| Haskell | Memorial Windows | \$ 44,205 | 2.1% | \$ 46,052 | 2.3% | Yes |
| Memorial | Memorial Plaques (also Building) | \$ 17,612 | 0.9% | \$ 17,612 | 0.9% | No |
| Peppard-Lovett | Lovett Window | \$ 35,015 | 1.7% | \$ 36,477 | 1.9% | No |
| Tyler | Building | \$ 16,491 | 0.8% | \$ 15,734 | 0.8% | No |
| Total Designated for Building: | | \$ 125,845 | 6.1% | \$ 127,821 | 6.5% | |
| Total Restricted Funds | | \$ 205,944 | 17.9% | \$ 207,584 | 10.5% | |
| Total Endowment | | \$ 1,894,192 | 100.0% | \$ 1,968,474 | 100.0% | |
| Owed to Operations | | \$ 3,690 | 0.2% | \$ - | - | |
| Operating Reserve | Held for Finance Committee | \$ 49,795 | 2.4% | \$ 50,000 | 2.4% | |
| Total Owed to Operations | | \$ 53,485 | 2.6% | \$ 50,000 | 2.6% | |
| Legacy Gift | Endowment? | | | \$ 35,761 | | |
| Building Reserve | Building | \$ 58,794 | 2.9% | \$ 71,527 | 2.9% | |
| Sabbatical Reserve | Ministry | | | \$ 10,269 | | |
| Cell Tower | Building | \$ 7,164 | 0.3% | \$ - | - | |
| Roof Maintenance | Building | \$ 21,049 | 1.0% | \$ - | - | |
| Total Board Directed Funds: | | \$ 87,008 | 4.2% | \$ 117,558 | 4.2% | |
| Ministerial Intern | Ministerial Intern | \$ 22,414 | 1.1% | \$ - | - | |
| Total Women's Alliance Directed Funds: | | \$ 22,414 | 1.1% | \$ - | - | |
| Miscellaneous Cash | | | | \$ 235 | | |
| Total Non-Endowment Funds | | \$ 162,907 | | \$ 167,792 | | |
| TOTAL HELD BY THE BOARD OF INVESTMENT | | \$ 2,057,098 | | \$ 2,135,631 | | |