



The Episcopal Church in
BROOKLYN · QUEENS · NASSAU · SUFFOLK
The Diocese of Long Island

To: Investors in the Investment Fund of the Diocese of Long Island
Date: January 6, 2009
From: The Investment Committee
Subject: The Current State of the Investment Fund

The global retreat of common stock, real estate and hedge fund values has severely eroded the market value of virtually every personal and institutional portfolio. All of us, whether as individuals or as stewards of the wealth of others, are deeply concerned by these regrettable developments in the financial marketplace and worry about our ability to fund the current and future cash requirements of our budgets and other spending objectives. Our Committee decided that the anxieties and intense concerns being stimulated by the current economic and financial environment created an obligation to give our investors a special stewardship report.

This report has two principal objectives:

- A. To demonstrate our early and continuing awareness of troubles on the horizon and our focused attention on the responsibilities with which we are charged: identifying an investment policy that appropriately balances capital preservation and total return objectives; allocating capital to a diversified set of asset categories; selecting skilled investment managers for each asset category; and diligently monitoring each investment manager's performance against realistic benchmarks.
- B. To discuss the implications of recent performance on current and future dividend distributions to the Fund's shareholders.

A. Investment Policy & Management

- a. Our Committee has been increasingly alert to financial market risks since July of 2007, when signs of market weakness traceable to sub-prime mortgage foreclosures and derivative securities pricing problems first began to affect the performance of the Diocesan Investment Fund's portfolio.
- b. In addition to our schedule of regular quarterly meetings, at which we review investment performance in the most recent calendar quarter

The Right Reverend Orris G. Walker, Jr., D.Min., D.D., D.C.L., L.H.D.

36 Cathedral Avenue, P.O. Box 510, Garden City, NY 11530 • 516-248-4800 or 718-345-4800 FAX: 516-248-1616

www.dioceselongisland.org

and discuss our team of investment managers, we have held three special meetings in the past eighteen months.

- c. At the August 2007 meeting we concluded a comprehensive review of the Fund's investment guidelines and our team of managers.
- d. In September 2007 we recommended to the Trustees an increase in international equity and REIT exposure and a realignment of our network of managers, terminating a U.S. equity manager, an international specialist and one of our hedge fund managers and hiring replacements selected after the Committee interviewed a battery of candidates recommended by our consultant, Evaluation Associates, Inc. (EAI).
- e. At the March 2008 meeting we again reviewed the Fund's investment guidelines and asset allocation ranges and, in recognition of the November 2007 decision to increase international equity exposure, interviewed three international managers screened by EAI. The Committee recommended Globeflex Capital to the Trustees.
- f. At the May 2008 meeting we formally adopted a revised Summary of Investment Policy and Guidelines and discussed hedge fund systemic risk, concluding that our exposure was limited, particularly because our hedge fund exposure is to funds-of-hedge funds with no leverage at the FoHF level.
- g. At the August 2008 meeting we interviewed our primary fixed income manager, reviewed an asset allocation and risk budgeting analysis prepared by EAI, and discussed an EAI report on candidates to replace the fixed income manager. The Committee decided to recommend Pacific Investment Management Co. (PIMCO) to the Trustees.
- h. The November 2008 meeting was dominated by discussion of the sharp worldwide fall of stock and real estate prices since the August meeting. After lengthy discussion the Committee affirmed its intention to maintain its current equity exposure, concluding that past market declines of similar magnitude had been followed by significant jumps in stock prices. The Committee remained confident that the Fund's investment guidelines were consistent with reasonable capital market expectations.
- i. The Committee also decided to allocate \$2 million of the \$4 million in its money market account to its current international managers, since that asset class was furthest below the midpoint of its guideline range, and to meet again in January to review the Fund's 2008 performance, to evaluate the market environment at that time, and to consider its options for allocation of the remaining \$2 million in the money market account.

- j. The Committee recently compared the market's fall in the past eighteen months to periods of dramatic market retreat in the twentieth century and noted similarities between the market's current situation and the Panic of 1907 and the stagflation of 1973-74, where the market recovered to its former level in about two years. In late November the equity market gave indications that a bottom was near or might have been reached. From that date through the year end, the S&P 500 Stock Index and EAFE, an international stock market index, rose by 15% and 17%, respectively. The Committee is not interpreting this encouraging news as a prediction of sustained or rapid recovery in 2009 and 2010. Caution and clear thinking, not optimistic cheerfulness will be our guides as we enter the New Year.

B. Dividend Distributions

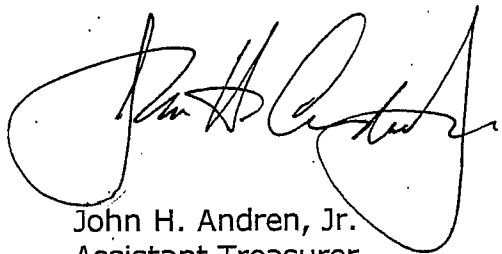
- a. As described above, the ongoing turmoil in the financial markets has had a severe impact on the Investment Fund. That the Fund is down less, on average, than many other funds is small comfort.
- b. The impact on your investment in the Fund is two-fold: the value of the shares is down; the payout of the Fund is reduced, simply because the payout is based on the value of shares in the Fund.
- c. Whether the markets have reached bottom, and when they will recover, can't be known with any certainty, other than that it will be known when it happens. A recent article in the Wall Street Journal reported on the Journal's economic forecasting survey. On average, the economists surveyed expect the economic downturn to conclude in June of 2009, but anticipate that pain in the labor markets will extend into 2010.
- d. In past periods of economic stress the stock market has typically rebounded in anticipation of the economic recovery. If we see a similar outcome this time around, our dividend payout will bottom out sooner and begin growing again.
- e. In light of all of this, the Trustees are assuming, for budget purposes, that there will be no growth in the Fund's share value through 2009. The reduction in the dividend payout from the Fund is, in the short term, tempered by the 36-month rolling average of the Fund's share value that is the basis for the calculation. Two years of good performance are still in the average, but as each month goes by, the old months drop out and are replaced by the recent, and lower-valued, months.
- f. The Trustees have taken no action to change the payout rate, as the income generated by the Fund does not rise or fall in lockstep with the

value of the shares. Certainly this bears close watching. As circumstances warrant the Trustees will keep you informed.

- g. We are aware that some parishes build an expected payment from the Investment Fund into their annual budgets and may not have a reliable replacement for this source of operating cash. Surrendering a few of their shares in the Investment Fund is a no-cost option that they may wish to consider. Ms. Baietto, the diocesan Deputy for Finance and Administration, can assist in arranging this transaction.

We will welcome any comments or questions, whether by phone or by e-mail.

Respectfully submitted,



John H. Andren, Jr.
Assistant Treasurer
Trustees of the Estate

Tel: (212) 410-9234
E-mail: andren17@earthlink.com



William A. Dreher
Chairman
Investment Committee

Tel: (212) 946-2828
E-mail: wdreher@comp-strat.com