
How will MMBB work for us through the recession?

A CANDID DISCUSSION WITH MMBB'S FINANCIAL LEADERS

2008 was a tumultuous year for the global economy. Stock markets declined dramatically. Individual investors—including MMBB members—saw their investments decrease in value. Many people approaching retirement began rethinking their plans.

MMBB's annual report seeks to respond to these trends. We thought you would want to know how MMBB is facing the current challenges as well as how we are taking advantage of the opportunities.

To explore those issues, MMBB brought together four people who lead our investment strategy: MMBB Executive Director Sumner M. Grant, Finance Committee Chair William Cobb, Chief Investment Officer Candace Cox and Evaluation Associates International Principal Ellen Petrino.

This blue ribbon panel addresses three major issues. What are the causes of the economic downturn? How is MMBB responding to this investment climate? What options do MMBB members have?

We hope you find this discussion interesting and illuminating. We know you will find MMBB's professional investment leaders thoughtful, intelligent and insightful.

Harold Leibovitz
Communications Director



Candace Cox

Candace Cox, MMBB's chief investment officer, is leading the initiative to expand MMBB's investment capability. She has built a distinguished career in the management of institutional assets. She is perhaps best known as principal investment officer for the City of New York's nine pension funds. Ms. Cox has extensive investment experience in the not-for-profit sector, including the American Red Cross, the American Heart Association and the Financial Women's Association. She has also held senior investment positions in the private sector during a career spanning over twenty years.

William L. Cobb

William L. Cobb Jr. is executive vice president and chief investment officer of The Church Pension Fund, a six-billion-dollar plan for clergy of the Episcopal Church. A former vice chairman of J. P. Morgan Investment Management, Mr. Cobb is a graduate of Northwestern University and has an M.B.A. from the University of Chicago. His service on MMBB's Board of Managers began in 2000, at which time he was elected to the Finance Committee. He became chair of the committee in May 2008.

Rev. Dr. Sumner M. Grant

The Rev. Dr. Sumner M. Grant has been executive director of The Ministers and Missionaries Benefit Board (MMBB) since 1998. He served as executive director and treasurer of American Baptist Churches of New York State. He has also been a pastor in New Hampshire and Maine. A graduate of Gordon-Conwell Theological Seminary (B.D., summa cum laude) and Gordon College (B.A.), Dr. Grant completed the Advanced Management Program at Harvard University's School of Business Administration. In 2002, he received an honorary doctor of divinity degree from Franklin College.

Ellen Petrino

Ellen Petrino is a founder, principal and senior consultant at Evaluation Associates International (EAI). She brings more than 30 years of investment and consulting experience to her work with MMBB, which she has served since 2002. She has special expertise in asset-allocation modeling, defined-contribution plan outsourcing and performance analysis. Before founding EAI, Ms. Petrino was a vice-president at Paine Webber Jackson & Curtis. She has a B.A. from Mount Holyoke College and an M.B.A. from the New York University Stern School of Business.

MMBB: Sumner, perhaps you can start off our conversation by providing some perspective on what you're seeing and hearing from our members.

SUMNER GRANT: I've attended several annuitant luncheons recently. Our members are very aware of what's going on. They are very forgiving and wonderful people as long as we're straight with them. So I've tried to be as straight with them as I possibly can be. A couple of times they've actually stopped the meeting and prayed for me and for MMBB, which has been a humbling thing.

I also assure them that our endowment allows us to provide emergency assistance to our members. Because of the 5% decline in the annuity payout value, we anticipate that more people may need help with medical bills, heat or other immediate needs. So I urge them, if they are experiencing hurt in any way, please let us know because it's very important to us that we have the opportunity to support them in their emergency.

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ELLEN PETRINO: Is that a loan program?

SUMNER GRANT: These are not loans. The funds for these emergency grants come from our endowment. We draw from the endowment at a rate of about 5% annually based on a 12-quarter rolling average of the endowment's asset value. We offer grants for medical assistance, support for medical premiums in retirement, premium assistance for pastors who have lost their jobs, scholarships for the children of widows and deceased clergy, and other financial emergencies.

MMBB: So how did the U.S. economy get into this situation?

WILLIAM COBB: I think you'd probably have to go back more than a year ago. It was the summer of 2007 when the first shoes started to fall. That's when the leveraged loan market began to seize up. For the most part, the real economy was pretty much unaffected until well into 2008. Things really began to unravel in September 2008, starting with the Lehman Brothers collapse. Up until that point,

the economy wasn't strong, but neither was it particularly weak. Even though credit markets were relatively tight, business was still functioning.

ELLEN PETRINO: It was the Lehman bankruptcy that caused the flight out of money market funds. Once people began fleeing out of money market funds, there was no money available to buy the commercial paper that corporations use to fund their operations. To me, that was the catalyst for the downturn. That's when the economic reports started coming in negative.

CANDACE COX: The beginning of the recession has now been tagged at December of '07. That means we're 15 months and counting into this recession. The average length of a recession is about 13 months. So we're already beyond the historical average length of recessions. From that perspective, this recession has been going on for a long time.

MMBB: This does seem qualitatively different than other recessions in my lifetime.

CANDACE COX: For one thing, it's global. We are a lot more integrated globally. So we're feeling it not only in the U.S. but around the world. Another difference is the severity of fourth-quarter events.

WILLIAM COBB: This economy, like most economies, lives on credit. And by that I don't mean consumer debt. I mean that every company from triple-B to triple-A never has enough cash in their bank account to fund their day-to-day operating needs. They regularly borrow from banks or issue commercial paper to fund these working capital needs. But the speed with which everything fell apart in the fourth quarter of 2008, that's what got people's attention.

MMBB: Did the free market let us down, or was it just the banking sector?

WILLIAM COBB: Since the beginning of man we've always had economic cycles, and we've always had financial panics. We just have. They used to be common in the 1800s and early 1900s.

It also stems from human emotion. Humans run the investment business and they run the gamut from being greedy at one point to very fearful at the other. Now the fear has come to the fore. Everybody's pointing the finger at somebody else, but there are so many places to lay blame, you hardly know where to start or where to stop. Congress would say it's these greedy bankers, but it was also Congress that put in place the regulation or lack thereof. The President didn't oversee the enforcement of the regulations that were in place. There's no institution out there without some responsibility—including individual investors.

SUMNER GRANT: One of the things that I say to our members is that we're all to blame. Even we who are members of MMBB are to blame because we all like the market uptick. We like to see our accounts increase in value; we hate to see them decline in value. So we accept what's going on in the marketplace on the upside and we protest when the market slides.

ELLEN PETRINO: On the investor side, we had trouble understanding what CMOs [collateralized mortgage obligations] were and then all these other structures, but everybody was buying them. They thought they understood them.

WILLIAM COBB: Some of it too, I think, was interest rates were kept too low for too long a period of time. Monetary policy was punishing people who were doing the right thing by being frugal.

SUMNER GRANT: That's a great point.

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- WILLIAM COBB:** So you were somehow encouraged by a whole host of people and institutions to say, "Well, gee, if somebody can loan me 90% of what I need to buy a second home, and I'm convinced by my neighbor that the price of second homes only goes up, why wouldn't I want to do that?" And they did that all with leverage. And the banks were happy to do that because they thought housing was a free lunch too, and the price would only go up.
- CANDACE COX:** It wasn't only people being greedy. I think people were trying to be as responsible as they could be to look after themselves. As we've moved from defined benefit pension plans to defined contribution plans, people are now aware they have to provide for their own retirement and so have been seeking ways to build their wealth.
- MMBB:** To what extent was this foreseeable?
- CANDACE COX:** I think you could look at certain elements, such as the dramatic rise in real estate prices for the last 10 to 15 years, and might have predicted that at some point prices would decline. What was tougher to predict was the impact of the packaging of these mortgages and selling them with very high credit ratings. People buying these packages of mortgages did not realize that what they thought was a high credit rating really wasn't.
- MMBB:** So, in other words, these mortgages that were being packaged and sold were not as creditworthy as labeled?
- ELLEN PETRINO:** Yes. Someone got the notion that by averaging a whole pool of below-average credit quality mortgages, you could turn them into an above-average credit quality instrument.
- MMBB:** So the people doing the packaging argued that the whole is greater than the sum of its parts?
- ELLEN PETRINO:** Standard mortgage underwriting practices were relaxed in 2004. It now appears that even bond managers didn't realize how much the standards for underwriting had relaxed.



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- CANDACE COX:** You could've foreseen, after five straight years of very, very nice returns, maybe 2008 will be a negative year. But negative by how much? You might have said 6%, 8%, 10%. Nobody would have said 40%.
- MMBB:** What do you think is the biggest threat to the economy or the stock market now, given where we are?
- WILLIAM COBB:** I think a lot of it's confidence. And that's sort of a scary thing because you can't make confidence happen.
- ELLEN PETRINO:** Yes, that illusive tipping point.
- WILLIAM COBB:** Once people begin to be fearful, it's hard to turn the switch. Getting out of a serious recession requires people to have some confidence. You may start to build confidence when a couple who's been saving money to buy a house takes advantage of the lower prices and does so.
- SUMNER GRANT:** Where is the money going? There's money on the sidelines. Where is it?
- WILLIAM COBB:** One place it's going is into treasury bills and treasury securities.
- ELLEN PETRINO:** And it's back into money market funds.
- WILLIAM COBB:** I'm sure there are people who took cash out of the bank and it's sitting somewhere in their basement.
- SUMNER GRANT:** It is global, too. There are countries that are not investing in our markets at this point.
- ELLEN PETRINO:** The United States is still a very large, stable economy in comparison to the rest of the world. The euro and the yen are both weakening, so the dollar is still the world's major currency.

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MMBB: Are there aspects of this that are hopeful?

CANDACE COX: For one thing, lending standards are not going to be as lax as they were. The housing situation where you could get a mortgage with virtually no money down—that's not going to happen again.

SUMNER GRANT: Businesses are being forced now to take a hard look at the bottom line. And I think in some ways that is hopeful, because when the market begins to swing back up again, we'll see businesses that are more streamlined. I know that's happening with us at MMBB. We're wringing every bit of value out of every dollar that we have.

CANDACE COX: I think that the interest in alternative fuels could be a positive outcome for a variety of reasons. Anytime that there's financial stress in this country, there's always a huge component that is foreign oil-driven. To the extent that interest in alternative fuels increases, that can be a positive.

MMBB: How about individual actions? Are we going to become a nation of savers, rather than a nation of spenders? Is that good or bad?

WILLIAM COBB: That's the paradox. On the one hand, people have been overconsuming and undersaving for 20 to 30 years. But the more people save, the less they spend—and the less the economy's going to grow. We now have a savings rate that is higher than the savings rate in Japan. If you had said 10 years ago that was going to happen, people would've laughed at you.

MMBB: What are some of the actions that MMBB has taken to mitigate the impact of the financial downturn?

CANDACE COX: During this stressful time we have done exactly what good financial theory and practice would dictate. We maintained our diversified portfolio. In addition, we chose to obtain some of our equity exposure through hedge funds. While hedge funds also took a hit, they declined less than the equity markets as a whole did. Those were two really big actions in our portfolio.

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“ WE ARE LONG-TERM INVESTORS. ”

ELLEN PETRINO: The diversification took place over time.

CANDACE COX: These are things that we would do no matter what the markets were doing, and we'll continue to do these things going forward as the markets recover. We'll continue to be diligent. We'll continue to monitor and contain costs. We'll continue to seek the highest quality investment management that we can find. And we'll continue to make good and reasoned judgments on risk and return trade-offs.

SUMNER GRANT: Putting it in context, we are long-term investors.

WILLIAM COBB: Nor do you try to time the market, knowing that very few people have ever been consistently successful at that.

CANDACE COX: Quite to the contrary, we rebalance—effectively rebalance—continually, so that the downturn has provided opportunities for us to acquire assets at lower prices than we would have been able to as recently as a year or two ago.

ELLEN PETRINO: One way MMBB took advantage of investment opportunities created by this downturn is the purchase of distressed debt. Some of this debt is “money-good,” but, because the credit markets are frozen, nobody is buying. We believe that the prices now are artificially low.

WILLIAM COBB: Not to disagree with anything on diversification, but diversification was never intended to protect you in an environment where the market's down 40% and 50%. It can help you in a three- to five-year period when returns are sluggish, but not in a free fall like we've had in the last six months,

MMBB: **How does the downturn in the market change our investment strategy?**

CANDACE COX: It doesn't. We adhere to the asset allocation and policies that have been carefully developed over the years by our Finance Committee. We evolve over time to take advantage of opportunities, but we don't overreact to market volatility. We don't attempt to time the market—no one can do that consistently. In fact, our rebalancing protocols are designed to take advantage of buying opportunities in markets like this.

MMBB: When you say rebalancing, what do you mean?

CANDACE COX: Let's say you have two asset classes, and you have allocated 50% of your money to one and 50% to the other, and one rises in value and the other one falls. You'll no longer be at your target weights. So what you would do is effectively to withdraw from the asset class that has performed well and funnel those funds into the asset class that has not.

MMBB: It sounds like the old saying, "Sell high and buy low."

CANDACE COX: It's not more complicated than that.

MMBB: What can MMBB members do to reduce some of the worst effects of the recession or to take advantage of them?

WILLIAM COBB: I would say don't panic. Selling when the market's down is never a good thing.

ELLEN PETRINO: That's exactly right.

SUMNER GRANT: MMBB is well-diversified and well-managed by a talented group of people. We have nearly a 100-year history of weathering these storms. And we'll weather this one as well. So people can trust us. I sincerely believe that.

MMBB: For people who are retiring in the next couple of years—what do we say to them?

SUMNER GRANT: One of the things that we can say is that each situation is different. You can't generalize. Secondly, whether you're retiring 10 years from now or next year, you need to determine how much income you need. Once you have estimated how much you need, contact one of our member service representatives to work out a projection of your annuity income. If it appears as though the income you will receive is sufficient to pay your expenses, then yes, you can comfortably contemplate retiring.

CANDACE COX: People might want to be flexible on their retirement date. If they look at their projection and they make their estimated monthly expenditure list, and if those two numbers are not pretty close, they might want to rethink when they retire or rethink that list of expenditures.

SUMNER GRANT: Or rethink saving more or pulling assets from other places.

MMBB: When you look ahead in the next five years, what do you see?

WILLIAM COBB: I'll go back to what I said earlier. We've always had recessions and stock market declines, and we've always had stock market recoveries. And it will happen again. It's just a matter of when. When you look at 10- to 20-year cycles, the stock market has only been at these levels a few times in history. And every time it's been a good time to buy.