# American Radio Relay League

**Treasurer's Report**
**Rick Niswander, K7GM**
**For the quarter ending June 30, 2013**

Thanks in large part to a poor June, overall returns in the second quarter of 2013 were effectively flat with stocks eking out a small gain that was almost offset by losses in the bond market.

As shown below, the small overall stock market gains in April and May were reduced by June losses and the small April/May bond market loss was doubled in June.

| | Apr + May | June | 2nd Quarter |
|---|---|---|---|
| Total Return Indices: | | | |
| US stock – Russell 3000 (broad market) | 3.99% | (1.30%) | 2.69% |
| Foreign stock – FTSE All World ex-US | 1.48% | (4.27%) | (2.79%) |
| Bonds – Barclays US Aggregate Bond | (0.77%) | (1.55%) | (2.32%) |
| Vanguard Money Market | 0.0067% | 0.0033% | 0.01% |
| | | | |
| Blended Return (45% US, 5% intl, 45% bonds, 5% money market) | 1.52% | (1.50%) | 0.03% |

The June swoon was largely in response to comments from Fed Chairman Ben Bernanke that the Fed bond buying program (that pushes liquidity into the economy) might be coming to an end. Those comments sent stock and bond markets into a tizzy. While it can be argued that the market over-reacted to Fed statements, the damage was done, particularly for bonds where 10-year treasury yields went from 2.13% on June 1 to 2.49% on June 30. In fact, since the first of May, the yield on 10-year treasuries jumped from 1.63% to 2.49%. Since prices move opposite of rates, bond prices were down 2.3% for the quarter. In the bond world, that is a significant move for one quarter.

For stocks, a strong US market in the first quarter was followed by a small second quarter increase. Foreign stocks were negative in the second quarter and almost flat for the first half of 2013. Foreign stocks have not kept pace with the US market in part because of the strength of the US dollar – a stronger dollar means that foreign returns are translated into fewer dollars.

The following chart illustrates the percentage change in various market and portfolio indicators for the first and second quarter of 2013, the first half of 2013, the last four quarters (third and fourth quarters of 2012 plus the first and second quarters of 2013) as well as calendar year 2012.

| | Q1<br>2013 | Q2<br>2013 | First<br>Half<br>2013 | Last 4<br>Qtrs | Calendar<br>Year<br>2012 |
|---|---|---|---|---|---|
| Popular Stock Market Price Indices | | | | | |
| Dow Jones Industrials | 11.25% | 2.27% | 13.78% | 15.76% | 7.26% |
| NASDAQ | 8.21% | 4.15% | 12.71% | 15.95% | 15.91% |
| S&P 500 | 10.03% | 2.36% | 12.63% | 17.92% | 13.41% |
| | | | | | |
| Total Return Indices: | | | | | |
| US stock – Russell 3000 (broad market) | 11.07% | 2.69% | 14.06% | 21.46% | 16.42% |
| Foreign stock – FTSE All World ex-US | 3.08% | (2.79%) | 0.20% | 14.43% | 17.80% |
| Bonds – Barclays US Aggregate Bond | (0.12%) | (2.32%) | (2.44%) | (0.69%) | 4.22% |
| Vanguard Money Market | 0.01% | 0.01% | 0.02% | 0.04% | 0.04% |
| | | | | | |
| Portfolio Benchmark (total return) | 5.08% | 0.03% | 5.24% | 10.07% | 10.18% |
| Actual Portfolio Return (total return) | 5.60% | 0.23% | 5.85% | 10.25% | 10.93% |

The stock market price indices above (first three lines of numbers) are based solely on stock price changes without regard to dividends. These price indices are the ones quoted in the popular press ("the Dow Jones Industrial Average went up 1.2% today"). The total return indices (fourth and fifth lines for stocks) reflect both prices and dividends. These total return indices are the ones against which our portfolio is measured.

To illustrate the difference between a price index and a total return index, assume a stock price is $100 at the beginning of a quarter, is $110 at the end of the quarter, and the company pays a $5 dividend in the middle of the quarter. The price index will increase by 10% (the $10 stock price increase divided by the base of $100). The total return index will increase by 15% (the $10 price increase plus the $5 dividend is a total increase of $15 divided by the $100 base). Because the total return index takes dividends into account while the price index does not, the total return index will always be greater than a price index for the same basket of securities.

**<u>ARRL Portfolio Analysis</u>**

As noted in Appendix A, the portfolio ended the second quarter of 2013 at $19,825,656. Contributions of $925,667 were added to the portfolio during the quarter (most of it around the 10th of June) and no transfers were made to the general operating accounts. Consistent with prior years, a transfer of $300,000 to $500,000 will likely be made from portfolio to operating in the third quarter. The total portfolio return (interest, dividends, realized and unrealized gains and losses) was $33,665 for the second quarter.

For the first half of 2013, the portfolio increased about $2.1 million, about half of the increase coming from portfolio returns and the other half from contributions.

The top of Appendix B provides detail concerning the dispersion of investment portfolio assets across investment classes. The composition of the investment portfolio conforms to the asset allocation policy.

The rest of Appendix B provides detail on the total portfolio return with respect to the portfolio benchmark. The portfolio benchmark is a blend of total return indices in proportions consistent with the asset allocation policy. The benchmark proportions are 45% broad domestic stock, 5% international stock, 45% bonds, and 5% money market.

For the second quarter, the total return benchmark increased by a miniscule 0.03% while the actual return was a slightly-less-miniscule 0.18%. Actual total return also exceeded the portfolio benchmark for the first quarter, the most recent 4 quarters, and for calendar year 2012.

When comparing benchmark return to actual return, variability from quarter-to-quarter or year-to-year should be expected. Comparisons should be made with caution and only over a three-to-five year time horizon.

## **Bonds**

Our bond portfolio consists of a collection of individual bonds (about 82% of the bond portfolio) and short-term bond funds (about 18%). Individual bonds are held to maturity and, when one matures, the proceeds are re-invested in another bond with a maturity of about 5 years. This creates a "ladder" of bonds each with an initial maturity of about 5 years. Obviously, actual time-to-maturity of each individual bond decreases as time goes by. As you all know, interest rates are very low. So, when a bond we purchased 5 years ago matures, we reinvest it from a five-year-old interest rate into a current interest rate. As a result, interest income will drop considerably.

An example of this effect comes from a series of transactions around the end of January. At that time $300K of bonds issued by British Telecom and Prudential Financial matured and we were repaid. The two bond issues had a stated interest rate of 5.15% (it was just happenstance that the rate was the same on both).

The proceeds were reinvested into five-year bonds of three different companies with similar credit quality. The new yields ranged from 1.3% to 1.5%. So, instead of receiving a bit over $15,000 a year we will now earn slightly more than $4,000 a year. All told, we will have about $1.2 million of bonds which will mature in 2013. We will face a very similar outcome to the above as those bonds mature.

The only way to compensate (at least partially) for the reduction in interest rates for the bond portfolio is to either reduce credit quality or increase the term of the bonds. Neither alternative is prudent or sensible.

## **Preferred Stock**

In the 2013 second quarter the preferred stock portfolio decreased from $586K to $459K (after a first quarter drop from $720K to $586K). The reductions occurred because some securities were redeemed by the issuer, not because I purposefully sold them. These securities carry a relatively-high interest rate and I expect issuers will continue to unilaterally redeem these holdings to reduce their costs.

I have noted in earlier reports that these investments are priced similar to long term bonds so they will fall in value as interest rates rise. Unlike individual bonds, their price will not recover because preferred stock generally does not have a maturity. I have also noted that it is my intention to sell all the preferred stock in an orderly fashion, and it still is. However, interest rates have remained low and I anticipate they will remain low for a considerable portion of the year (notwithstanding the second quarter bump up). Thus, except for issuer-initiated redemptions, the pace of disposition will slow until rates start to rise.

## Appendix A

**American Radio Relay League** Page 1
**Portfolio Flow** de K7GM

| | Investment Portfolio Fair Value |
|---|---|
| **Balance, December 31, 2012** | 17,724,259 |
| Additions from contributions | 149,589 |
| Subtractions | 0 |
| Total Return (see note) | 992,476 |
| **Balance, March 31, 2013** | 18,866,324 |
| | |
| **Balance, March 31, 2013** | 18,866,324 |
| Additions from contributions | 925,667 |
| Subtractions | 0 |
| Total Return (see note) | 33,665 |
| **Balance, June 30, 2013** | 19,825,656 |

Note: Total Return represents portfolio increases from interest and dividends plus or minus realized gains and losses as well as the change in unrealized gains and losses.

**Appendix B**

**American Radio Relay League**
**Portfolio Composition as of June 30, 2013**

de K7GM

| | Fair Value | Percentage | Cost |
|---|---|---|---|
| Investment Portfolio | | | |
| Stock (of which $1,579,268 is international) | 10,245,570 | 51.7% | 8,605,351 |
| Preferred | 459,420 | 2.3% | 457,752 |
| Bond | 8,300,770 | 41.9% | 8,352,337 |
| Cash | 819,896 | 4.1% | 819,896 |
| Total Investment Portfolio | 19,825,656 | 100.0% | 18,235,336 |

**American Radio Relay League**
**Portfolio Return and Total Return Metrics**

| | 2013 1st Quarter | 2013 2nd Quarter | 2013 First Half | Last 4 Quarters (Q312 to Q213) | Calendar Year 2012 |
|---|---|---|---|---|---|
| Applicable Total Return Indices | | | | | |
| US Stock - Russell 3000 TR | 11.07% | 2.69% | 14.06% | 21.46% | 16.42% |
| Foreign Stock - FTSE AW Ex US TR | 3.08% | -2.79% | 0.20% | 14.43% | 17.80% |
| Bonds - Barclays US Agg Bond TR | -0.12% | -2.32% | -2.44% | -0.69% | 4.22% |
| VG Prime Money Market | 0.01% | 0.01% | 0.02% | 0.04% | 0.04% |
| Benchmark Blended Total Return (45% us, 5% intl, 45% bonds, 5% mmkt) | 5.08% | 0.03% | 5.24% | 10.07% | 10.18% |
| Benchmark Bended Total Return (above) | 5.08% | 0.03% | 5.24% | 10.07% | 10.18% |
| Actual Total Return | | | | | |
| In Percent | 5.60% | 0.18% | 5.79% | 10.25% | 10.93% |
| In Dollars (from page 1) | 992,476 | 33,665 | 1,026,141 | 1,737,344 | 1,769,299 |

Notes:

Returns for greater than one quarter will be different than the sum of the quarterly returns because of compounding

The Russell 3000 Index is a measure of the total US stock market.
The FTSE index measures the World (AW) stock market, minus the US market
The Barclays index measures the aggregate US bond market
The Vanguard Prime Money Market is a proxy for the overall US money market

The Benchmark Blended Total Return is calculated from the above indexes in the proportions noted. It represents the expected return on the portfolio.

The Actual Total Return is calculated based on the dollar amount of Total Return (see page 1) relative to the original principal amount for the period calculated. If there are significant increases or decreases to the investment portfolio in the applicable period, the calculated Actual Total Return is adjusted accordingly.