Short Term Investment Pool (STIP)

The Short Term Investment Pool (STIP) is a cash investment pool established in fiscal 1976 by the Regents, in which all University fund groups participate, including retirement and endowment funds as well as campus endowment funds. Cash to meet payrolls, operating expenses, and construction funds of all the campuses and teaching hospitals of the University are the major funds invested in STIP until expended. Retirement and endowment funds awaiting permanent investment are also invested in STIP until transferred. STIP participants are able to maximize returns on their short-term cash balances by taking advantage of the economies of scale of investing in a large cash pool.

INVESTMENT OBJECTIVE

The basic investment objective of STIP is to maximize returns consistent with safety of principal, liquidity, and cash-flow requirements. STIP investments[1] managed by the Office of the CIO include a broad spectrum of high-quality money-market and fixed-income instruments with a maximum maturity of five-and-a-half years. Investment maturities are structured to ensure an adequate flow of funds to meet the University's cash needs as well as to provide the liquidity needed to facilitate asset class rebalancing and other major liquidity events.

In September 2009, the Regents authorized a change in the investment guidelines for STIP, effective October 2009. As the liquidity requirements of the University have changed, due in part to the financial status of the State of California, an increased level of liquidity is now maintained in the STIP portfolio. Accordingly, to reflect the fact that there are now implicitly two components of the portfolio—a very short-term liquid portion and a somewhat longer portion—the policy benchmark has been changed to one that combines both components. The new benchmark is the weighted average of the income return on a constant maturity two-year U.S. Treasury Note and the return on the 30-day U.S. Treasury Bills. The weights are set at the actual average weights of the bond and cash equivalent components of the pool, rebalanced monthly. This change allows the managers to continue managing STIP consistent with the fund's guidelines, while allowing for volatility in the amount of cash equivalents needed at any given time.

INVESTMENT STRATEGY AND RETURNS

STIP is managed as a highly liquid portfolio, using maturity distribution strategies to maximize returns in different yield-curve environments. Select swapping strategies are employed to take advantage of disparities in the market to improve quality and yield, while maintaining liquidity.

[1] Although not managed by the Office of the Chief Investment Officer, Mortgage Origination Program (MOP) loans are an allowable investment under the current STIP guidelines.

STIP Annualized Income Return[2]
June 30, 2013

	1-Year	5-Year	10-Year	10-Year Cumulative
STIP	2.09%	2.70%	3.41%	39.85%
Policy Benchmark[3]	0.18	0.66	2.07	22.78
Inflation[4]	1.75	1.31	2.43	27.14

[2] STIP returns are net of (after) investment management costs which are automatically deducted from income. The distribution return (net of all expenses and other program activities) was 2.09%, 2.65%, and 3.37% for the one-, five-, and 10-year periods, respectively.

[3] The STIP Policy Benchmark is a weighted average of the income return on a constant maturity two-year Treasury Note and the return on U.S. 30-day Treasury Bills. The weight is the average of the actual weights of the bond and cash equivalent components of the pool, rebalanced monthly. This benchmark was effective October 1, 2009.

[4] Inflation as measured by the Consumer Price Index.

STIP has achieved attractive returns over the long term. Over the last 10 years, the average annual income return was 3.41%, compared to the policy benchmark return of 2.07%.

For the fiscal year ended June 30, 2013, the amortized book value of the STIP investments was approximately $9.2 billion. STIP's income return was 2.09% versus the policy benchmark income return of 0.18%. The weighted average maturity of the fund was 2.2 years.

It has been five years after the Lehman Brothers bankruptcy, which triggered the worst financial crisis since the Great Depression and ushered in a period of volatility unlike any before it. The scope and size of government intervention was unprecedented. The U.S. government provided an enormous backstop to the financial system and injected huge amounts of stimulus into the economy. Since then, there have been a number of regulatory reforms to the market, including those stemming from the implementation of the Dodd-Frank Wall Street Reform and Consumer Act.

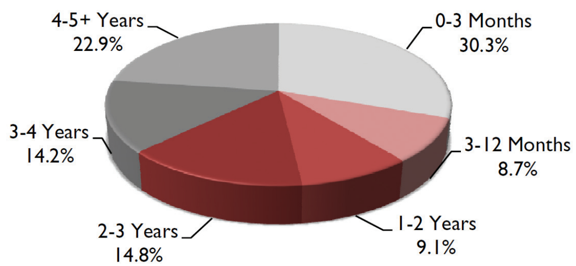
At the September 2013 meeting, the Federal Reserve Board's Federal Open Market Committee (FOMC) shocked the markets by deciding not to slow its large-scale asset purchase program of buying bonds at an $85 billion monthly pace. Chairman Ben Bernanke stated that the FOMC decided to delay tapering as it wants to see more economic data given the downside risks created by higher mortgage rates and the evolving U.S. fiscal debate, and that monetary policy will remain extremely accommodative. The FOMC also decided to keep the target for the federal funds rate at 0–0.25%.

The Federal funds rate has been near zero (0–0.25%) since December 2008. With the record level of low interest rates since the financial crisis, short-term yields remain

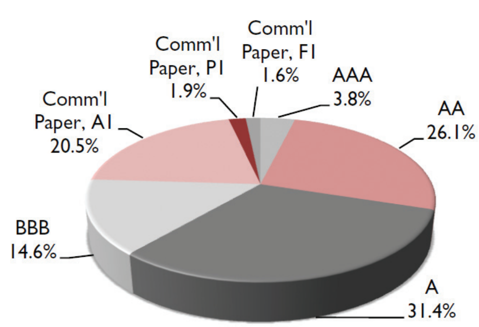
pressured as the front end of the yield curve is anchored to the Fed's zero interest rate policy. During the year, the yield curve steepened and credit spreads have narrowed. As of October 4, 2013, the three-month U.S. Treasury bill yield was 0.02%, the two-year U.S. Treasury Note yield was 0.33% and the five-year U.S. Treasury Note yield was 1.41%.

With Treasury yields remaining at historic lows, credit spreads remain attractive and continue to offer excellent yield enhancement opportunities for the portfolio, especially as high-grade corporate credit fundamentals remain positive. We continue to take advantage of the dislocations in the market to selectively add high quality credit spread products at attractive levels to lock in higher yields. At all times, the STIP's primary investment objective remained the safety of principal with the focus on maintaining liquidity and managing the risk in the portfolio. The high quality of the STIP portfolio, with its highly liquid investments, provided the needed liquidity to meet the University's cash needs.

STIP Maturity Distribution
June 30, 2013
Weighted Average Maturity = 2.2 years

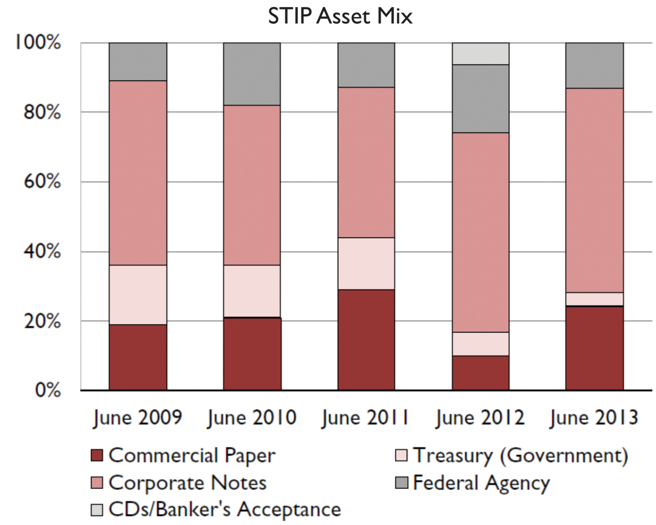


STIP Quality Mix
June 30, 2013



Average Long-Term Credit Rating[5] = A- (S&P Rating)
Commercial paper must have a rating of at least A-1, P-1, D-1, or F-1.

[5] BBB- and higher = Investment grade



UNIVERSITY PROGRAMS UTILIZING STIP

In fiscal year 1985, the Regents authorized the University of California Mortgage Origination Program, funded by the legally available cash balances in the unrestricted portion of STIP. The MOP provides first deed-of-trust, variable-rate mortgage loans with up to 40-year terms to eligible members of the University's faculty and staff. In November 2001, the Regents approved interest-only mortgage loans under the MOP. Graduated payment mortgages, which offer a reduced interest rate during the initial years of the loan, were approved for the MOP by the Regents in May 2007. These loans totaled $161.1 million at June 30, 2013.

In March 1999, the Regents authorized the use of the legally available cash balances in the unrestricted portion of STIP to provide liquidity support for the University's Commercial Paper Program. At the July 2008 meeting, the Regents authorized the President to increase the program from $550 million to $2 billion. The STIP also provides working capital advances to the medical centers.

Subsequent to the creation of the TRIP portfolio, in November 2008, the Regents authorized the President to utilize up to 40% of the combined outstanding balances from the combined STIP and TRIP investment portfolios as liquidity support for the Commercial Paper Program, the medical centers' working capital borrowings, and the MOP loans. In November 2009, the Regents revised the internal limits and liquidity support options for the Commercial Paper Program.

In March 2011, the Regents authorized the President to utilize borrowing from STIP, restructuring of University debt, and other internal or external sources to fund the gap between scheduled pension contributions from the University and employees and the required funding amount.