

## One hundred and thirty-third fiscal year

Berkeley  
Davis  
Irvine  
Los Angeles  
Merced  
Riverside  
San Diego  
San Francisco  
Santa Barbara  
Santa Cruz



The image is a collage of financial data, likely from a stock market ticker or a financial report. It features a large, semi-transparent watermark that reads "University of California" diagonally across the center. Overlaid on the bottom left is the text "2000-2001" in a large, bold, yellow font. The background is filled with various financial figures, including stock prices, company names, and percentages, arranged in a grid-like pattern. Some of the visible text includes "Company Security", "Net Chg", "Vol", "Pct Chg", and "Volume". The data points are scattered and partially obscured by the watermark and the "2000-2001" text.



THE REGENTS OF THE UNIVERSITY OF CALIFORNIA  
as of June 2001

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Sherry L. Lansing, Vice Chairperson	David H. Russ, Treasurer and Vice President for Investments

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Chand Viswanathan	Gayle Binion
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John J. Moores	



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The Treasurer of The Regents is responsible for managing the investments and cash for the University of California System, which includes ten campuses, five teaching hospitals and three national laboratories. The Treasurer's Office carries out these activities under the policies established by the Investment Committee of The Regents of the University of California.

The investment funds managed consist of the University's retirement, defined contribution and endowment funds, as well as the system's cash assets. At June 30, 2001, the Treasurer's Office managed \$55.5 billion in total assets as outlined below.

## TOTAL FUNDS UNDER MANAGEMENT

June 30, 2001  
(\$ in billions)

UC Retirement Plan (UCRP)	\$38.7
DC Funds	6.4
Endowment Funds	5.1
Short Term Investment Pool (STIP) <sup>1</sup>	5.3
<b>Total Funds</b>	<b>\$55.5</b>

The Treasurer's investment management staff includes 20 investment professionals with an average of 15 years of investment experience.

## INVESTMENT OBJECTIVE

The major investment objective for all funds under management is to maximize long-term total real returns (adjusted for inflation) while assuming appropriate levels of risk. Because the purpose of each fund is unique, The Regents has established specific objectives for each fund, along with the overall goal of exceeding the median return of our peer institutions and the rate of inflation.

## INVESTMENT PHILOSOPHY/STRATEGY

Historically, portfolio asset allocation has favored equity investments over fixed income securities due to the expectation that equities will provide higher total returns over the long term. This emphasis on equity investing has resulted in substantial growth in both the endowment and retirement funds managed on behalf of The Regents. Through the 1990s the fundamental basis of The Regents' equity investment philosophy has been to invest selectively in firms with a global emphasis.

In March 2000 The Regents adopted a new asset allocation plan for the University of California Retirement Plan and the General Endowment Pool. The new plan maintains a 65% neutral equity weight and a 35% neutral fixed income weight with the dual objectives of increasing portfolio diversification while decreasing portfolio risk. The

major portion of the U.S. equity and fixed income assets are actively managed internally by the professional staff.

For all asset classes, security selection has been made in companies and industries with superior long-term total return prospects through application of original in-depth research to identify secular themes. Investment opportunities have also been sought through premier venture capital partnerships and select buyout funds.

## FISCAL YEAR 2001 IN REVIEW

Fiscal year 2001 was a difficult year for investors, with a severe contraction in capital spending on technology and telecommunications equipment and rapidly rising energy prices leading to a significant slowdown in global economic growth. Corporate profits suffered their worst decline in over a decade.

Equity markets, where valuations were priced for a continuation of increasing growth rates, reacted severely. The NASDAQ Index declined 45.5% in the fiscal year, nearly reversing last year's 48% gain. The S&P 500 and Russell 3000 indices fell 15.8% and 15.0%, respectively. In comparison, the decline in values of The Regents' General Endowment Pool (GEP) and UC Retirement Plan (UCRP) were 6.9% and 5.6% respectively, demonstrating the protection provided by multiple-asset class diversification across these portfolios.

Following three years of extraordinary gains, private equity markets also suffered from the revaluation of equities. The long-term prospects for this asset class are viewed as attractive, although activity will remain subdued for some time, and future gains will be more modest than in the recent period.

Conversely, global bond markets performed very well in the fiscal year, with The Salomon Large Pension Fund Index returning 11.8% and the Lehman Aggregate Index 11.2%. At the beginning of FY 2001, short-term interest rates were greater than long-term interest rates, a condition described as an inverted yield curve. The two-year U.S. Treasury note yielded 6.35%, while the thirty-year Treasury bond yielded 5.90%. In past business cycles an inversion in the yield curve has been a harbinger of a potential recession in the future. As the year progressed, the yield curve steepened to the normal upwardly sloping shape with long-term rates higher than short-term rates.

Despite an aggressive response to the weakening economy by the Federal Reserve, which lowered short-term interest rates by 300 basis points between December 31 and June 30, real U.S. GDP growth fell to 1.2% in fiscal 2001 from 5.2% in fiscal 2000.





## MESSAGE FROM THE TREASURER



Fiscal Year 2001 was a time of transition for The Treasurer's Office. The focus of investment activity during the year centered on implementing The Regents' new Asset Allocation Strategy for the GEP, UCRP and 403(b) funds. This comprehensive plan required converting a portion of the actively managed U.S. equity assets to passively managed U.S. and International tobacco-free equity index funds. Index funds aim to match the returns on strategic benchmarks and thus reduce the risk of under-performing the policy benchmark. At the same time, the fixed income assets were rebalanced to reflect the change in benchmarks for the GEP, UCRP, and 403(b) bond portfolios. By year-end, The Treasurer's Office had completed the conversion to the new plan and all portfolios were in compliance with the new portfolio and policy guidelines.

DeWitt Bowman was named Interim Treasurer in the fall of 2000. Mr. Bowman ably guided the office and oversaw The Regents' assets while a search was conducted for a permanent Treasurer. Close to the year-end, June 1, 2001, I was appointed as the fifth Treasurer of The Regents.

Fiscal Year 2001 was a difficult year for institutional investment returns. The negative returns for Fiscal Year 2001 followed a period of phenomenal economic expansion and investment growth from 1991 to 2000. As investment professionals, we have been expecting a period where the exuberant returns of the 1990s would be tempered by an environment of single digit or negative returns. As evidenced by this recent performance period, investment return and risk go hand in hand. The emphasis should be placed on the long-term horizon of the assets managed on behalf of The Regents. As you read the following tables, note that the 5-year, 10-year, and 20-year returns *include* the past fiscal year's returns. The University of California has enjoyed a long tradition of adding value to its investment portfolios over and above the appropriate benchmarks. As the Treasurer of The Regents, I hope to assist The Regents in maintaining their historical track record and achieving their investment goals in the future.

Looking ahead, we anticipate establishing new programs to preserve and protect the financial well-being of The Regents' investment portfolios. The concept of risk management has reentered the mainstream of investment management best practices. We will be introducing rigorous portfolio risk management processes to the Treasurer's Office in FY 2002 to manage and control investment risk. This year we updated the appearance of the Treasurer's Annual Report. Next year we will continue this process by introducing a new format that will be both informative and educational.

I am pleased to serve The Regents, faculty, staff and students of the University of California. I look forward to the many challenges ahead.

Sincerely,

David H. Russ  
Treasurer and Vice President For Investments  
October 2001



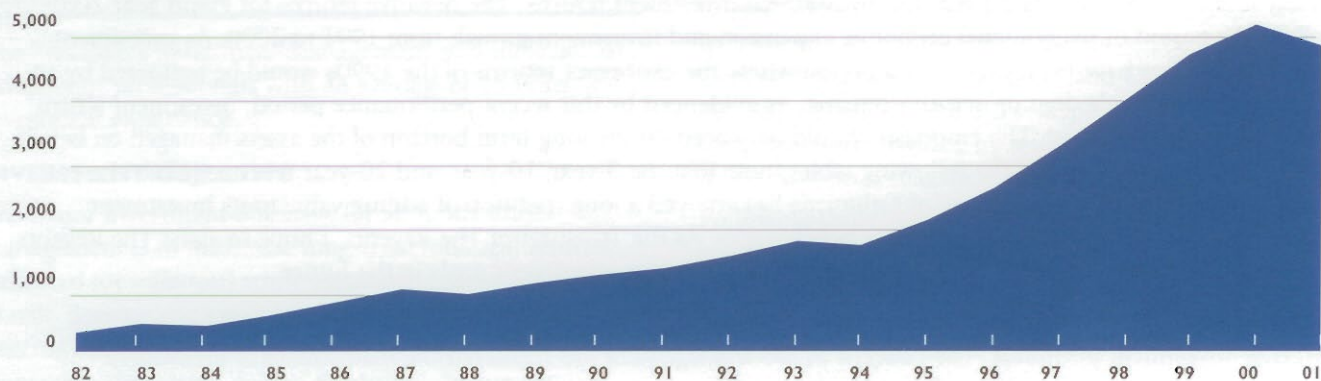
# The Regents' Endowment Funds

## GENERAL ENDOWMENT POOL (GEP) Summary of Investments<sup>1</sup> (\$ in thousands)

GENERAL ENDOWMENT POOL	June 30, 2001			June 30, 2000 <sup>2</sup>	
	Cost	Market Value	% of Pool	Market Value	% of Pool
<b>EQUITIES</b>					
U.S. Equity	\$ 1,820,085	\$ 2,382,532	50.7 %	\$ 3,030,488	59.8%
Non-U.S. Equity	357,772	292,371	6.2 %	50,368	1.0%
Private Equity	153,986	170,360	3.6 %	318,551	6.3%
<b>TOTAL EQUITIES</b>	<b>\$ 2,331,843</b>	<b>\$ 2,845,263</b>	<b>60.5 %</b>	<b>\$ 3,399,407</b>	<b>67.1%</b>
FIXED-INCOME SECURITIES	\$ 1,721,787	\$ 1,745,730	37.1 %	\$ 1,588,009	31.4%
STIP PARTICIPATION	\$ 111,736	\$ 111,736	2.4 %	\$ 76,458	1.5%
<b>TOTAL GENERAL ENDOWMENT POOL</b>	<b>\$ 4,165,366</b>	<b>\$ 4,702,729</b>	<b>100.0 %</b>	<b>\$ 5,063,874</b>	<b>100.0%</b>
<b>OTHER ENDOWMENT FUNDS</b>	<b>\$ 208,810</b>	<b>\$ 384,000</b>		<b>\$ 386,437</b>	
<b>TOTAL GEP AND OTHER ENDOWMENT FUNDS</b>	<b>\$ 4,374,176</b>	<b>\$ 5,086,729</b>		<b>\$ 5,450,311</b>	

## GEP Market Values (Fiscal Periods Ending June 30)

\$6,000 (in millions)



## General Endowment Pool

Established in 1933, and unitized in 1958, the General Endowment Pool (GEP) is The Regents' primary investment vehicle for endowed gift funds. GEP is comprised of over 5,000 individual endowments that support the University's mission. GEP is a balanced portfolio of equities and fixed-income securities in which all endowment funds participate, unless payout needs require otherwise.

The June 30, 2001 market value of GEP was \$4.7 billion, or \$17.76 per share, versus \$5.1 billion, or \$19.72 per share, at the end of fiscal 2000. Total GEP net investment income for the year was \$164.8 million, or \$0.63 per share, versus \$147.1 million, or \$0.56 per share, at the end of fiscal 2000.

## SPENDING POLICY

The Regents has long believed that a total return investment philosophy aimed at achieving real (after inflation) asset growth would be able to generate growing annual payouts to support donors' designated programs. In October 1998, The Regents adopted a long-term spending rate of 4.75% of a 60-month (5-year) moving average of GEP's market value. The Regents will review the payout rate each year in the context of GEP's investment returns, inflation and the University's programmatic needs, in conjunction with prudent preservation of principal and prudent increases in the payout amount.

<sup>1</sup> For fiscal 2000 and fiscal 2001, the cash portion of the various portfolios excludes the unrealized market appreciation or depreciation of STIP investments, accounts receivable and accounts payable, and the investments in the security lending collateral pool. Therefore, the balances differ from the University's Annual Financial Report.

<sup>2</sup> For fiscal 2000, the equity figures have been reallocated to reflect The Regents' new asset allocation plan adopted in March 2000, as detailed by the June 30, 2001 figures.



## INVESTMENT OBJECTIVE

The overall investment objective for all funds under management is to maximize real, long-term total returns (income plus capital appreciation adjusted for inflation), while assuming appropriate levels of risk.

For GEP, the primary goal is to generate growth of principal and a growing payout stream to ensure that future funding for endowment-supported activities can be maintained.

## INVESTMENT STRATEGY

In order to continue to achieve these investment objectives, The Regents adopted the following asset allocation policy in March 2000:

Asset Class	Target	Minimum	Maximum
U.S. Equity	53%	48%	58%
Non-U.S. Equity	7%	5%	9%
Private Equity	5%	3%	7%
Fixed Income	35%	30%	40%

The asset allocation changes, along with the establishment of new benchmarks and portfolio guidelines, were designed to reduce risk and broaden portfolio diversification. The new benchmarks for the individual asset classes are: Russell 3000 Tobacco-Free for U.S. Equity; MSCI ACWI-ex-US for Non-U.S. Equity; Russell 3000 Tobacco-Free +3% for Private Equity; and Salomon Large Pension Fund (LPF) for Fixed Income. The total fund benchmark is a target-weighted average of the individual asset class benchmarks.

Within the U.S. Equity asset class, approximately 70% of the fund is actively managed by the Treasurer's Office, which targets investments primarily in the common stocks of high-quality global companies with reasonable valuations that have the ability to grow their earnings and dividends at a higher rate than market averages. The remaining 30% is invested in a Russell 3000 Tobacco-Free Index fund managed by State Street Global Advisors, which is intended to mirror the returns of the broad U.S. stock market.

In the Non-U.S. Equity category, 85% is invested in a MSCI EAFE Tobacco-Free Index fund managed by State Street Global Advisors, designed to mirror the returns of the broad developed foreign stock markets. The remaining 15% is invested in two emerging markets net asset value or "NAV" funds, to gain exposure to the developing foreign markets.

For Private Equity, the Treasurer's Office seeks opportunities through recognized top-tier venture capital partnerships and select buyout funds.

For Fixed Income investments, the Treasurer's Office analyzes relative value among the core benchmark sectors of Governments, Corporates, and Mortgage-backed securities and overweights those sectors and securities offering attractive real returns, while maintaining a risk level commensurate with the benchmark index.

## RETURNS

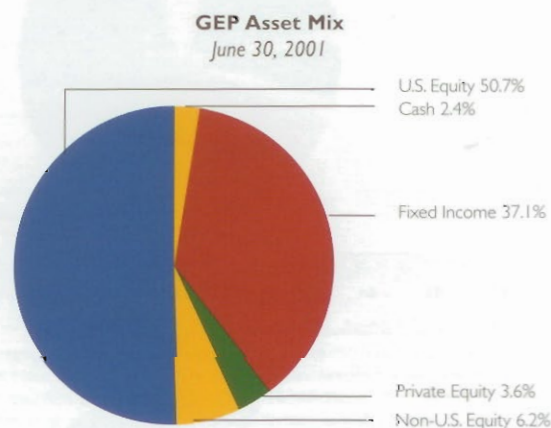
Throughout the years, GEP has exceeded its fund objectives. As illustrated in Table I on page 6, GEP has also consistently performed well vs. its peers and policy benchmarks. GEP's total return for the fiscal year was (6.9%), impacted by weak global equity markets. For the past 20 years, however, GEP's compound annual total return was a strong 15% vs. 12.4% for the CRA Median<sup>1</sup> and 14.5% for its benchmark.

During that time, payout distributions grew at an average annual rate of 7.8%—well above annualized inflation of 3.1%. GEP's five-year average annual turnover rate was 17.1%

Chart I on page 6 illustrates the cumulative total returns for GEP for the past 20 years relative to the CRA Balanced Fund Median and inflation. Table II on page 8 provides a detailed illustration of the performance of an endowed gift to GEP for the past 20 years.

## ASSET MIX

The following represents GEP's asset mix at June 30, 2001.



## EQUITY INVESTMENTS

The equity portion of GEP consists primarily of domestic and foreign common stocks, with a modest exposure to private equity. Total equities represented 60.5% of GEP at year-end, with a market value of \$2.8 billion.

<sup>1</sup> Capital Resource Advisors (CRA), measures investment returns on approximately 5,500 portfolios, with \$364 billion in assets. These are gross returns and are before any investment management fees, which would be approximately 0.50% of average annual market value. For periods longer than ten years, the Treasurer's Office uses the linked median, which is the compounded return of the annual universe median during a given time period.

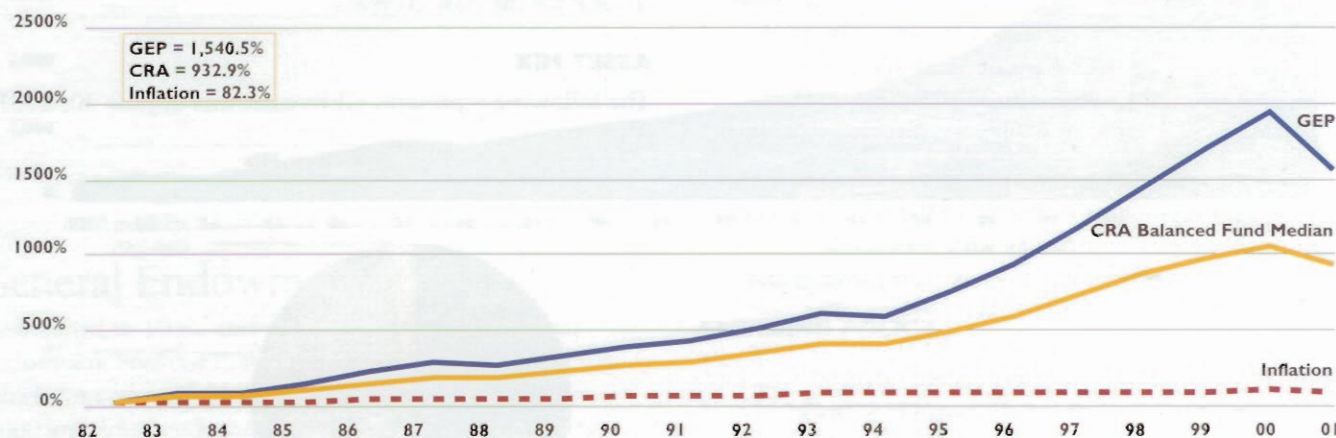


# The Regents' Endowment Funds

**Table I**  
**GEP Annualized Total Returns<sup>1</sup> versus Peers<sup>2</sup>, Benchmarks and Inflation**  
June 30, 2001

Total Fund	1-Year	5-Year	10-Year	20-Year	20-Year Cumulative
<b>GEP</b>	<b>(6.9)%</b>	<b>13.3%</b>	<b>14.1%</b>	<b>15.0%</b>	<b>1540.5%</b>
CRA Balanced Fund Median	0.2	10.7	12.2	12.4	932.9
Policy Benchmark <sup>3</sup>	(5.9)	12.7	13.3	14.5	1408.0
Inflation <sup>4</sup>	2.5	1.8	2.1	3.1	82.3
<b>U.S. Equity</b>					
<b>GEP</b>	<b>(14.9)%</b>	<b>13.4%</b>	<b>14.8%</b>	<b>15.1%</b>	<b>1565.4</b>
Policy Benchmark <sup>5</sup>	(14.1)	14.7	15.2	15.4	1654.3
<b>Non-U.S. Equity</b>					
<b>GEP</b>	<b>(34.0)%</b>	<b>(2.8)%</b>	<b>5.4%</b>	<b>N/A</b>	<b>N/A</b>
Policy Benchmark <sup>6</sup>	(23.6)	N/M	N/M	N/A	N/A
<b>Private Equity</b>					
<b>GEP</b>	<b>(29.0)%</b>	<b>46.1%</b>	<b>57.1%</b>	<b>N/A</b>	<b>N/A</b>
Policy Benchmark <sup>7</sup>	(11.5)	19.9	20.6	N/A	N/A
<b>Fixed Income Securities</b>					
<b>GEP</b>	<b>10.7%</b>	<b>10.0%</b>	<b>10.7%</b>	<b>13.5%</b>	<b>1152.2%</b>
Policy Benchmark <sup>8</sup>	11.8	8.4	9.4	12.2	907.0

**Chart I**  
**GEP Cumulative Total Returns: Fiscal 1982-2001**  
Fiscal Periods Ending June 30



<sup>1</sup> GEP's total returns are based on unit values calculated by UCOP Endowment and Investment Accounting and are net of (after) investment management and administrative expenses of 0.04% of average annual market value, which are automatically deducted from income. The asset class returns reflect investment returns. The performance of The Regents' total return investment portfolio is calculated by QED, according to the standard recommended by the Bank Administration Institute (BAI), which uses a time-weighted methodology that essentially neutralizes the effect of contributions and withdrawals so as to measure only the return on assets. These calculations comply with the Association for Investment Management and Research (AIMR) standards, which require time-weighted rates of return using realized and unrealized gains plus income. Performance is reconciled to the Treasurer's Office internal calculations.

<sup>2</sup> Capital Resource Advisors (CRA), measures investment returns on approximately 5,500 portfolios, with \$364 billion in assets. These are gross returns and are before any investment management fees, which would be approximately 0.50% of average annual market value. For periods longer than ten years, the Treasurer's Office uses the linked median, which is the compounded return of the annual universe median during a given time period.

<sup>3</sup> New: 53% Russell 3000 Tobacco-Free (TF), 35% SB LPF, 7% MSCI AC World ex US, 5% Russell 3000 TF + 3%; Historical: 65% S&P 500 and 35% LB LT G/C.

<sup>4</sup> Inflation as measured by the GDP deflator.

<sup>5</sup> New: Russell 3000 TF; Historical: S&P 500.

<sup>6</sup> MSCI AC World ex US, since November 2000.

<sup>7</sup> New: Russell 3000 TF + 3%; Historical: S&P 500 + 5%.

<sup>8</sup> New: SB LPF; Historical: LB LTG/C.



Implementation of The Regents' new asset allocation policy required several changes to the equity portfolio during the fiscal year. Investments to Russell 3000 and MSCI EAFE Tobacco-Free indices were made in November 2000, and the Russell 3000 replaced the S&P 500 as the U.S. Equity benchmark in order to enhance the fund's diversification. In addition, exchange-traded index funds are sometimes used to maintain equity exposure until attractive individual securities are identified for long-term holdings.

U.S. Equity represented 50.7% of the fund at year-end, with a market value of \$2.4 billion. In a difficult year for the U.S. stock markets, GEP's U.S. Equity returns declined by 14.9%, trailing the benchmark return of (14.1%). Over the longer-term, however, GEP's U.S. Equity returns of 14.8% and 15.1% for the 10 and 20 year periods compare favorably. The portfolio's five-year average annual turnover rate was 16.1%.

The following are the 10 largest equity holdings and sector breakdown of the active portion of the U.S. Equity portfolio:

<b>Largest Equity Holdings</b>	<b>Major Sector Allocations</b>	<b>% of Total</b>
American International Group	Technology	17%
AOL Time Warner	Financial Services	16%
General Electric	Health Care	15%
Sysco	Consumer Disc.	12%
SPDR Trust (S&P 500)	Utilities	9%
Exxon Mobil	Consumer Staples	7%
Marsh & McLennan	Multi-Sector Cos.	6%
Automatic Data Processing	Integrated Oils	4%
American Home Products	Producer Durables	3%
Pharmacia	Other Energy	3%

Non-U.S. Equity represented 6.2% of GEP at year-end, with a market value of \$292 million. The developed foreign equity markets fared worse than the U.S. as the global economy slowed, with GEP's Non-U.S. Equities declining 34.0%. The longer-term returns for this asset class represent the emerging markets NAV funds only, so comparisons are not yet meaningful.

Private Equity represented 3.6% of GEP at year-end with a market value of \$170 million. Returns for this asset class suffered more than the public equity markets as the excessive valuations achieved during the internet boom were largely reversed. Over the past 5 and 10 years, however, GEP's private equity returns of 46.1% and 57.1% have been very rewarding. Longer-term, this category should provide attractive returns, although likely more modest than those of the previous few years.

#### **FIXED-INCOME INVESTMENTS**

At year-end, Fixed-Income Investments constituted 37.1% of the portfolio, with a market value of \$1.7 billion. In

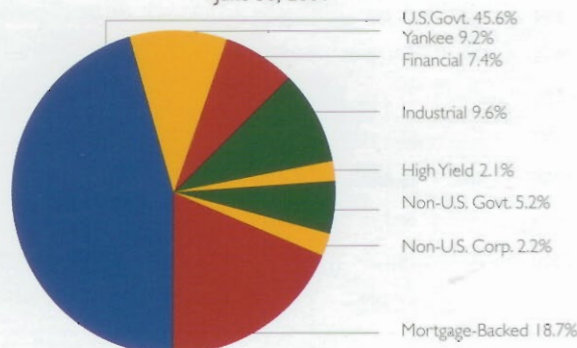
accordance with The Regents' new asset allocation policy, the Salomon Large Pension Fund Index replaced the longer-duration Lehman Long-Term Government/Credit Index as the portfolio's policy benchmark. In response, the fund's duration was shortened from 10.3 years to 8.5 years during the fiscal year, which will reduce the portfolio's volatility over the long-term. Other major changes were an increase in the portfolio's mortgage-backed allocation and a reduction in foreign holdings.

GEP's fixed-income investments returned an attractive 10.7% during the year, below the benchmark return of 11.8%. Over the long-term however, GEP's fixed income returns of 10.7% and 13.5% for the 10 and 20 year periods have consistently exceeded the benchmark. The portfolio's five-year average annual turnover rate was 15.4%.

The weighted average maturity of the bond portfolio at year-end was approximately 17 years, and the average credit quality was AA, with more than 86% of fixed-income securities rated A or higher. The following pie charts illustrate the sector mix and quality breakdown of the GEP bond portfolio.

**GEP Fixed-Income Sector Mix**

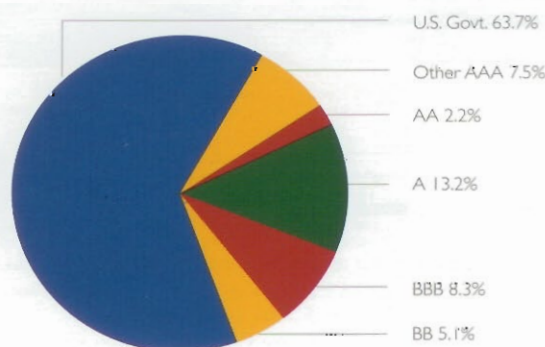
June 30, 2001



**GEP Fixed-Income Quality Mix**

June 30, 2001

(BBB and higher = investment grade) Average Quality = AA





# The Regents' Endowment Funds

**Table II**  
**Example of GEP Investment Performance Fiscal 1982-2001**

In order to endow a scholarship fund, a donor made a \$100,000 cash gift to the University at the end of fiscal 1981, which then entered GEP on the first day of fiscal 1982. The gift purchased 38,536 shares, or units, in the pool based on a unit price of \$2.595. GEP and the gift have performed as follows.

Fiscal Year Ending 6/30	Per Share Performance			Endowment Gift Performance				
	Market Value	Payout	% Change Payout	Market Value	Payout	Yield on Beg. Book	Total Return (1)	Inflation (GDP Deflator)
Enter Pool 7/1/81	2.595			100,000				
1982	2.277	0.1730	7.9%	87,746	6,667	6.7%	-5.59%	6.7%
1983	3.263	0.1813	4.8%	125,742	6,987	7.0%	52.41%	4.5%
1984	2.942	0.1769	-2.4%	113,372	6,817	6.8%	-4.63%	3.8%
1985	3.801	0.1925	8.8%	146,474	7,418	7.4%	36.70%	3.5%
1986	4.986	0.1941	0.8%	192,139	7,480	7.5%	37.37%	2.6%
1987	5.937	0.1965	1.2%	228,786	7,572	7.6%	23.60%	3.1%
1988	5.346	0.2259	15.0%	206,012	8,705	8.7%	-6.13%	3.5%
1989	5.968	0.2522	11.6%	229,981	9,719	9.7%	16.84%	4.5%
1990	6.521	0.2933	16.3%	251,291	11,303	11.3%	14.43%	4.2%
1991	6.824	0.3157	7.6%	262,963	12,165	12.2%	9.86%	4.1%
1992	7.576	0.3203	1.5%	291,946	12,343	12.3%	15.91%	2.9%
1993	8.410	0.3489 (2)	8.9%	324,085	13,445	13.4%	15.91%	2.6%
1994	7.883	0.3299	-5.4%	303,771	12,713	12.7%	-2.51%	2.3%
1995	9.518	0.3435	4.1%	366,786	13,237	13.2%	25.64%	2.4%
1996	11.215	0.3507	2.2%	432,167	13,530	13.5%	21.80%	1.9%
1997	13.461	0.4090	16.5%	518,728	15,761	15.8%	24.20%	2.0%
1998	15.698	0.4795	17.2%	604,933	18,478	18.5%	20.47%	1.0%
1999	17.731	0.5406 (3)	12.7%	682,706	20,831	20.8%	16.67%	1.2%
2000	19.722	0.6254 (3)	15.7%	756,888	24,080	24.1%	14.70%	2.1%
2001	17.759	0.7145 (3)	14.2%	678,210	27,421	27.4%	-6.92%	2.5%

## Compound Annual Total Return for 20 years (Fiscal 1982-2001)

(Capital Appreciation plus Income)

15.0%

## Compound Annualized Growth Rate for 20 years (Fiscal 1982-2001)

Payout Per Share

7.8%

Inflation (GDP Deflator)

3.1%

<sup>1</sup> GEP's total returns are based on unit values calculated by UCOP Endowment and Investment Accounting and are net of (after) investment management and administrative expenses of 0.04% of average annual market value, which are automatically deducted from income. The performance of The Regents' total return investment portfolio is calculated by QED, according to the standard recommended by the Bank Administration Institute (BAI), which uses a time-weighted methodology that essentially neutralizes the effect of contributions and withdrawals so as to measure only the returns on assets. These calculations comply with the Association for Investment Management and Research (AIMR) standards, which require time-weighted rates of return using realized and unrealized gains plus income. Performance is reconciled to the Treasurer's Office own internal calculations.

<sup>2</sup> Payout per share in fiscal 1993 is approximately \$0.0133 higher than normal as a result of an accounting policy change to distribute equity accruals. Without the change, payout per share would have been \$0.3356, or \$14,882 for the \$100,000 gift.

<sup>3</sup> The payout for fiscals 1999 and 2000 were 4.35% and the payout for fiscal 2001 was 4.45% of a 60-month moving average of GEP's market value.



## ASSET DESIGNATION BY CAMPUS AND PURPOSE

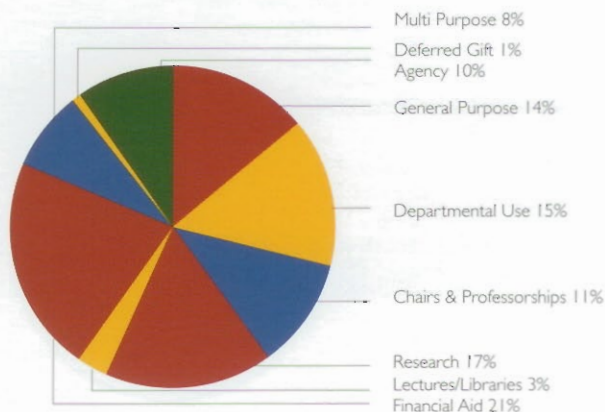
A donor has two avenues for making a gift to or establishing an endowment at the University: either directly to The Regents for a specific campus and/or purpose, or directly to a campus through its Foundation. The campus foundation trustees have discretion in their choice of investment managers and may use the Treasurer's Office or external investment managers.

The Regents' endowment pools include assets that were gifted directly to The Regents, as well as foundation assets where the Treasurer was retained as the investment manager. Chart III (below) illustrates the breakdown of GEP's assets among the campuses. Not surprisingly, a higher proportion of the assets is dedicated to the older campuses, which have a more established alumni and donor base. Development efforts at the younger campuses aim to leverage the growth of their alumni base, as well as cultivate donors.

Fundraising efforts provide critically needed monies to support the goals of the University. As illustrated above in Chart II, more than half of GEP's assets support departmental use (15%), financial aid (21%) and research (17%).

More detailed information on fundraising results may be found in the University's Annual Report on Private Support published by the Office of University and External Relations.

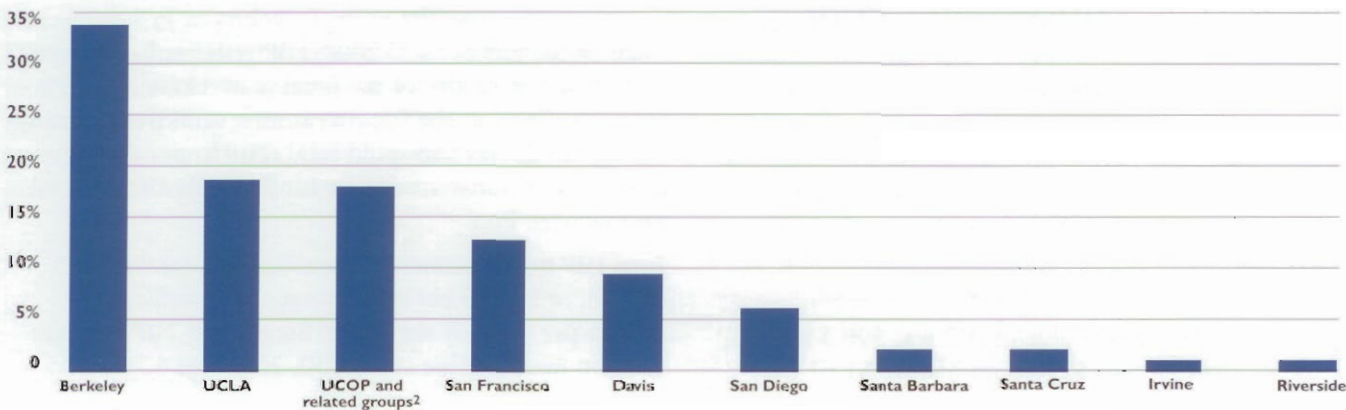
**Chart II**  
**GEP Assets Designated by Purpose<sup>1</sup>**  
June 30, 2001



## OTHER ENDOWMENT FUNDS

At June 30, 2001, The Regents had \$384 million of separately managed endowment funds (including approximately \$136 million where The Regents are the beneficiaries, but not the trustees). The separately managed funds were established to achieve specified payout requirements for donor and agency monies, as well as to comply with the terms of gift agreements in which donors required funds to be invested separately (e.g., no commingling of funds) and/or placed restrictions on the investment options (e.g., only U.S. Treasury bonds).

**Chart III**  
**GEP Assets Designated by Campus**  
June 30, 2001



<sup>1</sup> 71 % of GEP assets are restricted as to purpose.

<sup>2</sup> UCOP = UCOP-administered programs and multi-campus gifts.

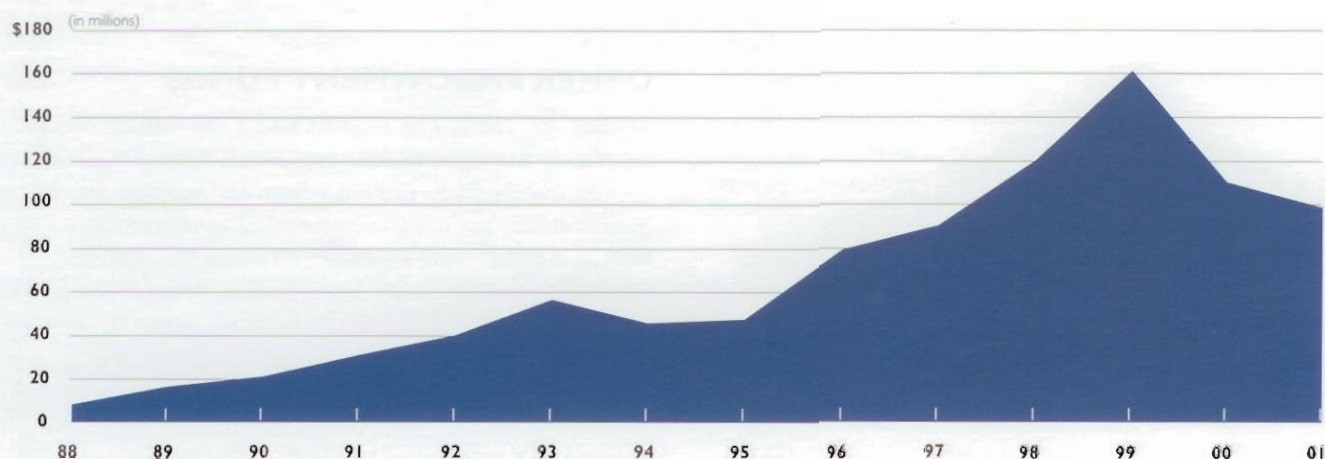


## The Regents' Endowment Funds

### High Income Pool (HIP) Summary of Investments<sup>1</sup> (*\$ in thousands*)

	June 30, 2001			June 30, 2000	
	Cost	Market Value	% of Pool	Market Value	% of Pool
<b>HIGH INCOME ENDOWMENT POOL</b>					
EQUITIES	\$12,594	\$12,807	13.0%	\$13,701	12.4%
FIXED-INCOME SECURITIES	\$85,233	\$85,250	86.6%	\$92,820	83.9%
STIP PARTICIPATION	\$399	\$399	0.4%	\$4,097	3.7%
<b>TOTAL HIGH INCOME ENDOWMENT POOL</b>	<b>\$98,226</b>	<b>\$98,456</b>	<b>100.0%</b>	<b>\$110,618</b>	<b>100%</b>

### HIP Market Values (Fiscal Periods Ending June 30)



## High Income Endowment Pool

The High Income Endowment Pool (HIP) was established in May 1987 to accommodate endowments with high payout requirements and deferred gift giving programs with high contractual payout obligations. As such, HIP is a balanced portfolio comprised primarily of fixed-income securities, along with select higher-yielding equities. The General Endowment Pool (GEP) remains The Regents' primary investment vehicle for endowed gift funds.

The June 30, 2001 market value of HIP was \$98.5 million, or \$1.69 per share, versus \$110.6 million, or \$1.61 per

share, at the end of fiscal 2000. HIP generated a strong total return of 12.1% for the fiscal year. However, HIP assets declined in the fiscal year as several participating agency funds have adopted total return spending policies and transferred their funds to the UC General Endowment Pool.

Total HIP net investment income for the year was \$6.5 million, or \$0.113 per share, versus \$7.9 million, or \$0.105 per share, at the end of fiscal 2000. HIP's current yield on market value at June 30, 2001 was 6.7%.

<sup>1</sup> For fiscal 2000 and fiscal 2001, the cash portion of the various portfolios excludes the unrealized market appreciation or depreciation of STIP investments, accounts receivable and accounts payable and the investments in the security lending collateral pool. Therefore, the balances differ from the University's Annual Financial Report.



## SPENDING POLICY

Although The Regents adopted a total return spending policy for GEP during fiscal 1999, the income only payout spending policy is being maintained for HIP given the nature of the gifts and their required payouts.

## INVESTMENT OBJECTIVE

The overall investment objective for all funds under management is to maximize real, long-term total returns (income plus capital appreciation adjusted for inflation), while assuming appropriate levels of risk.

For HIP, the primary goal is to produce a relatively high and stable level of current income sufficient to meet the needs of the specific funds, with moderate growth of income and preservation of capital.

## INVESTMENT STRATEGY

In order to achieve these higher income goals, The Regents' asset allocation strategy for HIP calls for the majority of assets to be invested in fixed-income securities. The Treasurer's Office targets those fixed-income securities and equities that will provide a high level of current income and can also generate moderate growth. The Treasurer's Office may vary the asset mix to maintain a relatively high level of income.

## RETURNS

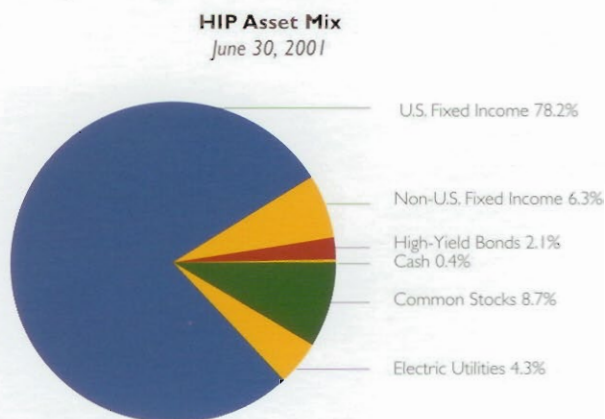
During its 14-year history, HIP has performed well versus its peers and benchmark, as illustrated in Table III on page 12.

Chart IV on page 12 illustrates HIP's cumulative total returns versus the CRA Bond Fund Median and inflation since inception.

Table IV on page 13 provides a detailed illustration of the performance of an endowed gift to HIP since inception. During that time, HIP has generated a compound annual total return of 11.6%, and payout distributions have grown at an average annual rate of 3.6%, exceeding average inflation of 2.7%. HIP's five-year average annual turnover rate was 19.8%

## ASSET MIX

The following chart represents HIP's asset mix at June 30, 2001.



## FIXED-INCOME INVESTMENTS

At year-end, fixed-income investments were 86.6% of HIP, with \$85.3 million in market value. HIP's fixed-income investments returned 11.3% during the year, outperforming the CRA Bond Only Median return of 10.9%.

U.S. Government bonds constituted 50.6% of the fixed-income investments at year-end, while high-grade industrial bonds represented 11.4%, financial bonds 13.7%, Yankee bonds 9.4%, high-yield bonds 2.4%, foreign bonds 7.1%, and mortgage-backed securities 5.4%. The weighted average maturity of the bond portfolio at year-end was approximately 20 years, and the average quality was AA, with 85% of the portfolio rated A or higher.

## EQUITY INVESTMENTS

The equity portion of HIP constituted 13.0% of the fund at year-end, with a market value of \$12.8 million. HIP's equity portfolio was comprised primarily of utilities and REITS. HIP's common stocks performed very well during the fiscal year due to their defensive nature and emphasis on income, returning 17.7%.

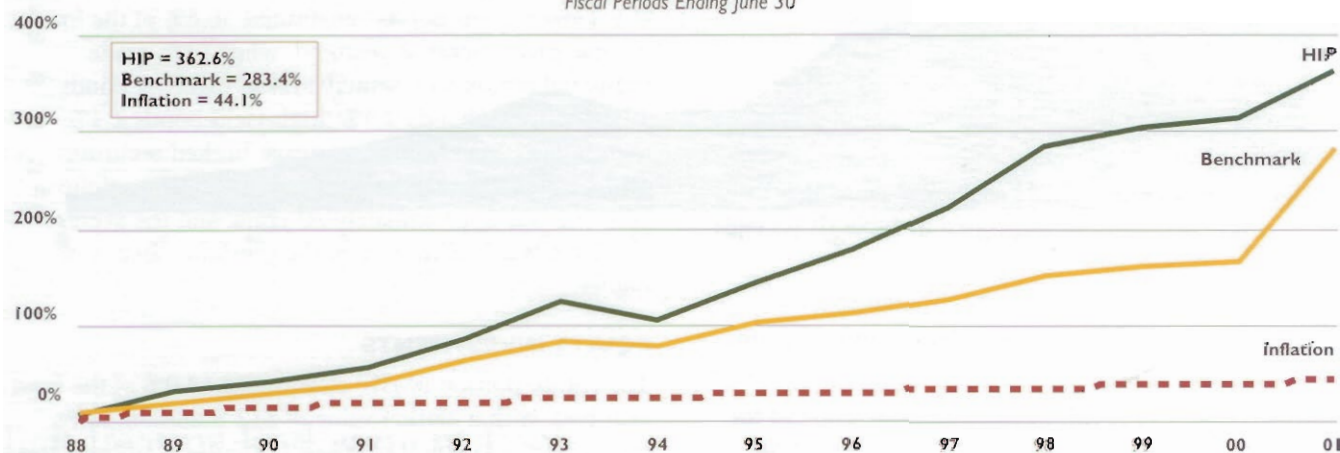


# The Regents' Endowment Funds

**Table III**  
**HIP Annualized Performance versus Peers, Benchmark and Inflation**  
*June 30, 2001*

	Annualized Total Returns				
	1-Year	5-Years	10-Years	14-Years	14-Year Cumulative (HIP Inception)
<b>Total Fund</b>					
<b>HIP<sup>1</sup></b>	<b>12.1%</b>	<b>11.0%</b>	<b>11.8%</b>	<b>11.6%</b>	<b>362.6%</b>
Policy Benchmark <sup>2</sup>	17.2	9.3	10.0	10.1	283.4
CRA Bond Only Median <sup>3</sup>	10.9	7.5	8.0	8.0	196.3
Inflation <sup>4</sup>	2.5	1.8	2.1	2.7	44.1
<b>Yields</b>					
	1-Year	5-Years	10-Years	14-Years (HIP Inception)	
<b>HIP Total Fund</b>	<b>6.7%</b>	<b>6.3%</b>	<b>6.7%</b>	<b>7.0%</b>	
5-Year U.S. Treasury Notes	5.3	5.6	5.9	6.6	

**Chart IV**  
**HIP Cumulative Total Returns: Since Inception**  
*Fiscal Periods Ending June 30*



<sup>1</sup> HIP's total returns are based on unit values calculated by UCOP Endowment and Investment Accounting and are net of (after) investment management and administrative expenses of 0.04% of average annual market value, which are automatically deducted from income. The performance of The Regents' total return investment portfolio is calculated by QED, according to the standard recommended by the Bank Administration Institute (BAI), which uses a time-weighted methodology that essentially neutralizes the effect of contributions and withdrawals so as to measure only the returns on assets. These calculations comply with the Association for Investment Management and Research (AIMR) standards, which require time-weighted rates of return using realized and unrealized gains plus income. Performance is reconciled to the Treasurer's Office own internal calculations.

<sup>2</sup> 80% LB LT G/C; 20% S&P Electric, Utilities.

<sup>3</sup> Capital Resource Advisors (CRA), measures investment returns on approximately 5,500 portfolios, with \$364 billion in assets. These are gross returns and are before any investment management fees, which would be approximately 0.50% of average annual market value. For periods longer than ten years, the Treasurer's Office uses the linked median, which is the compounded return of the annual universe median during a given time period.

<sup>4</sup> Inflation as measured by the GDP deflator.





**Table IV**  
**Example of HIP Investment Performance Fiscal 1988-2001**

In order to endow a scholarship fund, a donor made a \$100,000 cash gift to the University at the end of fiscal 1987, which then entered HIP on the first day of fiscal 1988, purchasing 103,149 shares, or units, in the pool based on a unit price of \$0.969. HIP and the gift have performed as follows.

Fiscal Year Ending 6/30	Per Share Performance			Endowment Gift Performance			Annual Total Return (1)	Inflation (GDP Deflator)
	Market Value	Payout	% Change Payout	Market Value	Payout	Yield on Beg. Book		
Enter Pool 7/1/1987	\$0.969			\$100,000				
1988	0.952	\$0.0718		98,233	\$7,403	7.4%	5.99%	3.5%
1989	1.059	0.0761	6.1%	109,250	7,855	7.9%	20.20%	4.5%
1990	1.069	0.0839	10.2%	110,243	8,657	8.7%	8.99%	4.2%
1991	1.080	0.0848	1.0%	111,450	8,743	8.7%	9.47%	4.1%
1992	1.197	0.0833	-1.8%	123,432	8,588	8.6%	18.96%	2.9%
1993	1.358	0.0923 (2)	10.8%	140,087	9,518	9.5%	21.98%	2.6%
1994	1.160	0.0888	-3.8%	119,667	9,154	9.2%	-8.64%	2.3%
1995	1.284	0.0869	-2.1%	132,487	8,964	9.0%	19.03%	2.4%
1996	1.374	0.0893	2.7%	141,774	9,209	9.2%	14.21%	1.9%
1997	1.494	0.0946	6.0%	154,084	9,758	9.8%	16.06%	2.0%
1998	1.699	0.0962	1.8%	175,209	9,933	9.9%	20.58%	1.0%
1999	1.674	0.0982	1.9%	168,358	10,126	10.1%	4.41%	1.2%
2000	1.615	0.1050	7.0%	166,624	10,831	10.8%	3.04%	2.1%
2001	1.694	0.1130	8.4%	174,735	11,655	11.7%	12.13%	2.5%

**Compound Annual Total Return for 14 years (Fiscal 1988-2001)**

(Capital Appreciation plus Income) 11.6%

**Compound Annualized Growth Rate for 14 years (Fiscal 1988-2001)**

Payout Per Share 3.6%

Inflation (GDP Deflator) 2.7%

<sup>1</sup> HIP's total returns are based on unit values calculated by UCOP Endowment and Investment Accounting and are net of (after) investment management and administrative expenses of 0.04% of average annual market value, which are automatically deducted from income. The performance of The Regents' total return investment portfolio is calculated by QED, according to the standard recommended by the Bank Administration Institute (BAI), which uses a time-weighted methodology that essentially neutralizes the effect of contributions and withdrawals so as to measure only the returns on assets. These calculations comply with the Association for Investment Management and Research (AIMR) standards, which require time-weighted rates of return using realized and unrealized gains plus income. Performance is reconciled to the Treasurer's Office internal calculations.

<sup>2</sup> Payout per share in fiscal 1993 is approximately \$0.0019 higher than normal as a result of an accounting policy change to distribute equity accruals. Without the change, payout per share would have been \$0.0904, or \$9,325 for the \$100,000 gift.



## The Regents' Endowment Funds

### Short Term Investment Pool

The Short Term Investment Pool (STIP) is a cash investment pool established in fiscal 1976 by The Regents and is available to all University groups, including retirement and endowment funds. STIP allows fund participants to maximize the returns on their short-term cash balances by taking advantage of the economies of scale of investing in a larger pool and investing in a broader range of maturities.

STIP consists primarily of current funds slated for payroll, operating and construction expenses for all the campuses and teaching hospitals of the University. In addition, funds awaiting permanent investment are invested in STIP to earn maximum daily interest until transferred.

#### INVESTMENT OBJECTIVE

STIP's investment objective is to maximize returns consistent with safety of principal, liquidity and cash-flow requirements. STIP's investments encompass a broad spectrum of high-quality money-market and fixed-income instruments with a maximum maturity of five years. The Treasurer's Office structures investment maturities to ensure an adequate flow of funds to meet the University's cash requirements.

#### INVESTMENT STRATEGY

The Treasurer's Office manages STIP as a highly liquid portfolio, using maturity distribution strategies to maximize returns in different yield-curve environments. The Treasurer's Office also employs select swapping strategies by taking advantage of disparities in the market to improve quality and yield, while maintaining liquidity.

#### YIELDS

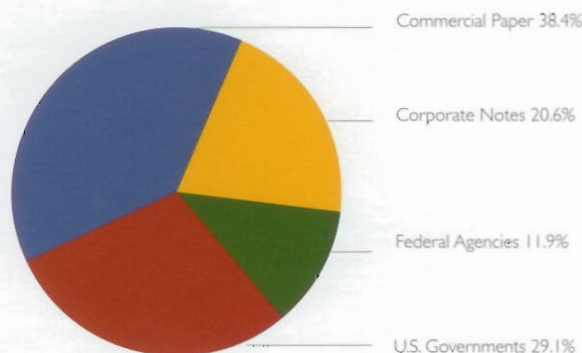
STIP has achieved very attractive returns over the years as illustrated in Table V on page 15. For fiscal 2001, STIP's yield of 6.2% outperformed 3-month U.S. Treasury Bills at 5.3%. During the past 20 years, the average yield on STIP was 8.0%, compared to 6.6% for 3-month U.S. Treasury Bills.

With the yield curve inversion and the high degree of liquidity required to effect The Regents' new asset allocation plan, shorter-dated securities were emphasized for the earlier part of the fiscal year, capturing very attractive yields for the portfolio. As the curve disinverted, maturities were extended to lock in yields. While the portfolio continues to maintain a large percentage of U.S. Treasuries, select high-quality spread products at historical wide spreads have been added to enhance STIP's yield.

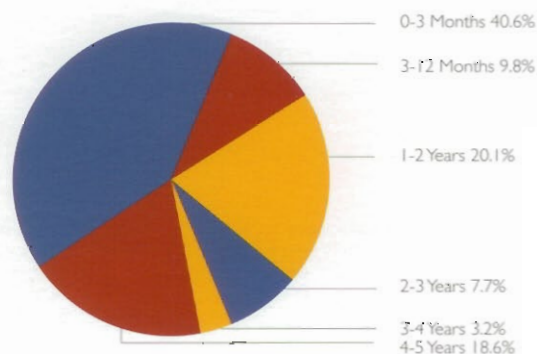
#### ASSET MIX

STIP totaled \$7.0 billion at June 30, 2001, compared to \$7.2 billion at the end of fiscal 2000. STIP's asset mix and maturity distribution as of June 30, 2001 are illustrated below.


**STIP Asset Mix**  
June 30, 2001



**STIP Maturity Distribution**  
June 30, 2001  
(Average Maturity = 1.5 years)







**Table V**  
**STIP Annualized Yields<sup>1</sup>**  
*June 30, 2001*

	1-Year	5-Years	10-Years	20-Years	20-Year Cumulative
<b>STIP<sup>1</sup></b>	<b>6.2</b>	<b>6.2</b>	<b>6.3</b>	<b>8.0</b>	<b>363.7</b>
3-Month U.S. Treasury Bills	5.3	5.2	4.8	6.6	259.0
Inflation <sup>2</sup>	2.5	1.8	2.1	3.1	82.3

#### UNIVERSITY PROGRAMS UTILIZING STIP

In fiscal 1985, The Regents authorized the University of California Mortgage Origination Program, which provides first deed of trust mortgage loans to eligible members of the University's faculty and staff. These loans totaled \$386.7 million at June 30, 2001, and were funded by the legally available cash balances in the unrestricted portion of STIP. 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 Commercial Paper Program.

<sup>1</sup> STIP's annualized yields are net of (after) investment management and administrative expenses of 1.5% of average annual income for the fiscal year, which are automatically deducted from income.

<sup>2</sup> Inflation as measured by the GDP deflator.



# University of California Retirement System

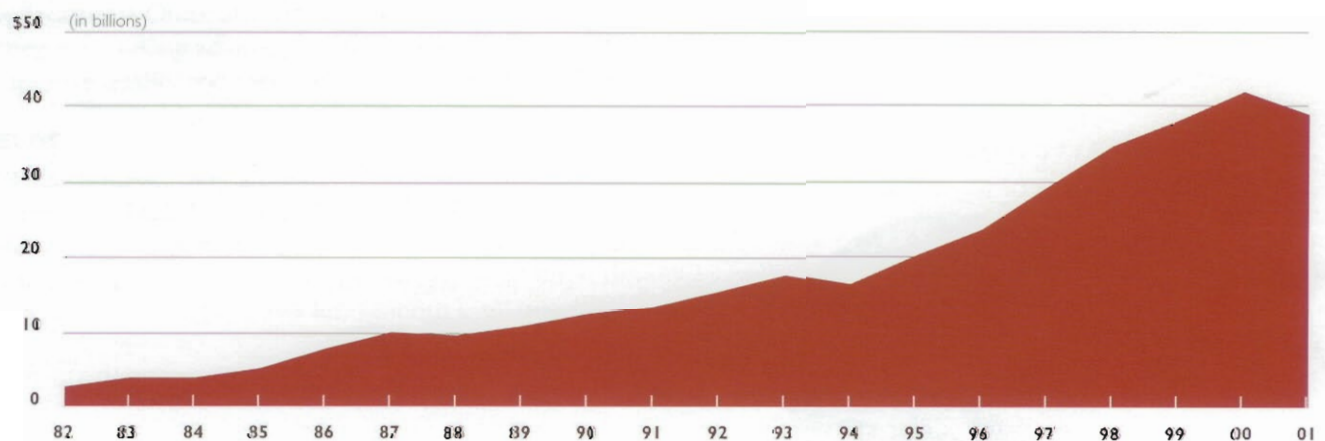
## UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM Summary of Investments<sup>1</sup> (\$ in thousands)

UC RETIREMENT PLAN (UCRP)	June 30, 2001			June 30, 2000 <sup>2</sup>	
	Cost	Market Value	% of UCRP	Market Value	% of UCRP
<b>EQUITIES</b>					
U.S. Equity	\$ 13,951,479	\$ 19,953,399	51.5%	\$ 23,942,656	57.1%
Non-U.S. Equity	\$ 2,938,469	\$ 2,474,151	6.4%	\$ 462,310	1.1%
Private Equity	\$ 755,782	\$ 802,929	2.1%	\$ 1,510,144	3.6%
<b>TOTAL EQUITIES</b>	<b>\$ 17,645,730</b>	<b>\$ 23,230,479</b>	<b>60.0%</b>	<b>\$ 25,915,110</b>	<b>61.8%</b>
<b>FIXED INCOME SECURITIES</b>	<b>\$ 13,642,424</b>	<b>\$ 14,281,066</b>	<b>36.9%</b>	<b>\$ 13,541,194</b>	<b>32.3%</b>
<b>STIP PARTICIPATION<sup>3</sup></b>	<b>\$ 1,187,698</b>	<b>\$ 1,187,698</b>	<b>3.1%</b>	<b>\$ 2,457,735</b>	<b>5.9%</b>
<b>TOTAL UCRP</b>	<b>\$ 32,475,852</b>	<b>\$ 38,699,243</b>	<b>100.0%</b>	<b>\$ 41,914,039</b>	<b>100.0%</b>

DEFINED CONTRIBUTION (DC) FUNDS	June 30, 2001			June 30, 2000	
	Cost	Market Value	% of DC	Market Value	% of DC
<b>TOTAL RETURN FUNDS</b>					
EQUITY FUND	\$ 2,597,297	\$ 3,008,396	46.6%	\$ 3,494,339	50.3%
BOND FUND	\$ 631,413	\$ 642,299	10.0%	\$ 523,363	7.5%
<b>INTEREST INCOME FUNDS</b>					
SAVINGS FUND	\$ 2,372,636	\$ 2,372,636	36.8%	\$ 2,568,262	37.0%
ICC FUND	\$ 299,769	\$ 299,769	4.6%	\$ 261,032	3.7%
MONEY MARKET FUND	\$ 131,425	\$ 131,425	2.0%	\$ 102,962	1.5%
<b>TOTAL DC FUNDS<sup>4</sup></b>	<b>\$ 6,032,540</b>	<b>\$ 6,454,525</b>	<b>100.0%</b>	<b>\$ 6,949,958</b>	<b>100.0%</b>

### UCRP Market Values (Fiscal Periods Ending June 30)



<sup>1</sup> For fiscal 2000 and fiscal 2001, the cash portion of the various portfolios excludes the unrealized market appreciation or depreciation of STIP investments, accounts receivable and accounts payable and the investments in the security lending collateral pool. Therefore, the balances differ from the University's Annual Financial Report.

<sup>2</sup> For fiscal 2000, the equity figures have been reallocated to reflect The Regent's new asset allocation plan adopted in March 2000, as detailed by the June 30, 2001 figures.

<sup>3</sup> UCRP's STIP investments include assets associated with the UC PERS Voluntary Early Retirement Incentive Program totaling \$95.8 million in fiscal 2000 and \$84.7 million in fiscal 2001.

<sup>4</sup> Total DC Funds excludes the Multi-Asset Fund, which totaled \$587.9 million at June 30, 2001, and is invested in and reported as part of the Equity, Bond, Savings and Money Market Funds.





## Retirement Plan

The largest pool of assets managed by the Treasurer's Office is the University of California Retirement Plan (UCRP), created in 1961. UCRP is a defined benefit plan, whereby retirement benefits are a function of the employee's age, average income and length of service. With the plan in surplus, The Regents suspended both employee and employer contributions to UCRP in 1990, but redirected the mandatory employee contributions (less than 2% of annual salary for most employees) to the newly established Defined Contribution Plan.

UCRP is a balanced portfolio of equities and fixed-income securities, which at June 30, 2001 totaled \$38.7 billion, versus \$41.9 billion at the end of fiscal 2000.

### INVESTMENT OBJECTIVE

The overall investment objective for all funds under management is to maximize real, long-term total returns (income plus capital appreciation adjusted for inflation), while assuming appropriate levels of risk.

UCRP's specific objective is to ensure its ability to meet its obligation to beneficiaries by earning sufficient returns over the long term that meet or exceed the actuarial rate of return of 7.5%.

### INVESTMENT STRATEGY

In order to continue to achieve these investment objectives, The Regents' adopted the following asset allocation policy in March 2000:

Asset Class	Target	Minimum	Maximum
U.S. Equity	53%	48%	58%
Non-U.S. Equity	7%	5%	9%
Private Equity	5%	3%	7%
Fixed Income	35%	30%	40%

The asset allocation changes, along with the establishment of new benchmarks and portfolio guidelines, were designed to reduce risk and broaden portfolio diversification. The new benchmarks for the individual asset classes are: Russell 3000 Tobacco-Free for U.S. Equity; MSCI ACWI-ex-US for Non-U.S. Equity; Russell 3000 Tobacco-Free +3% for Private Equity; and Salomon Large Pension Fund (LPF) for Fixed Income. The total fund benchmark is a target-weighted average of the individual asset class benchmarks.

Within the U.S. Equity asset class, approximately 70% of the fund is managed actively by the Treasurer's Office, which targets equity investments primarily in the common stocks of high quality global companies with reasonable valuations that have the ability to grow their earnings and dividends at a higher rate than market averages. The remaining 30% is invested in a Russell 3000 Tobacco-Free Index fund managed by State Street Global Advisors, which is intended to mirror the returns of the broad U.S. stock market.

In the Non-U.S. Equity category, 85% is invested in a MSCI EAFE Tobacco-Free Index fund managed by State Street Global Advisors, designed to mirror the returns of the broad developed foreign stock markets. The remaining 15% is invested in three emerging markets net asset value or "NAV" funds, to gain exposure to the developing foreign markets.

For Private Equity, the Treasurer's Office seeks opportunities through recognized top-tier venture capital partnerships and select buyout funds.

For Fixed Income investments, the Treasurer's Office analyzes relative value among the core benchmark sectors of Governments, Corporates, and Mortgage-backed securities and overweights those sectors and securities offering attractive real returns, while maintaining a risk level commensurate with the benchmark index.

### RETURNS

UCRP has exceeded its investment objectives over the long-term. It has also performed very well versus its policy benchmarks and peers. As illustrated in Table VI on page 18, UCRP has a proven history of above-median investment performance when compared to the CRA universe of balanced funds<sup>1</sup>. UCRP returned (5.6%) in the fiscal year, impacted by weak global equity markets. However, UCRP's annualized total return for the past 20 years through June 30, 2001 was a strong 14.6% versus 12.4% for the CRA Balanced Fund Median, and 14.5% for its benchmark.

Chart VI on page 18 illustrates the cumulative total returns for UCRP for the past 20 years relative to the CRA Balanced Fund Median and inflation.

UCRP's five-year average annual turnover rate was 17.6%.

<sup>1</sup> Capital Resource Advisors (CRA), measures investment returns on approximately 5,500 portfolios, with \$364 billion in assets. These are gross returns and are before any investment management fees, which would be approximately 0.50% of average annual market value. For periods longer than ten years, the Treasurer's Office uses the linked median, which is the compounded return of the annual universe median during a given time period.

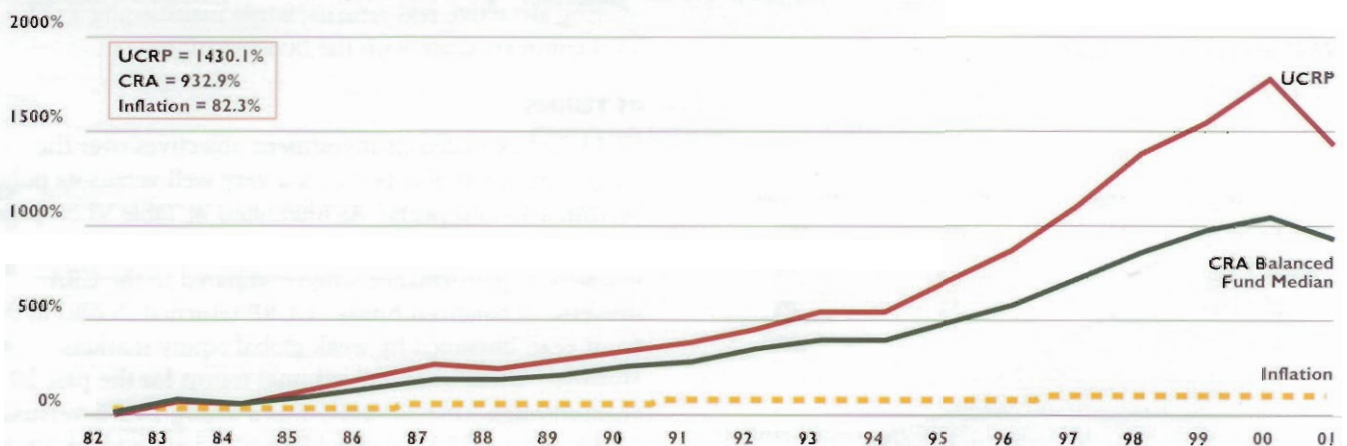


# University of California Retirement System

**Table VI**  
**UCRP Annualized Total Returns<sup>1</sup> versus Peers<sup>2</sup>, Benchmarks and Inflation**  
June 30, 2001

Total Fund	1-Year	5-Year	10-Year	20-Year	20-Year Cumulative
<b>UCRP</b>	<b>(5.6)%</b>	<b>12.9%</b>	<b>13.9%</b>	<b>14.6%</b>	<b>1430.1%</b>
CRA Balanced Fund Median	0.2	10.7	12.2	12.4	932.9
Policy Benchmark <sup>3</sup>	(5.9)	12.7	13.3	14.5	1408.0
Inflation <sup>4</sup>	2.5	1.8	2.1	3.1	82.3
<b>U.S. Equity</b>					
<b>UCRP</b>	<b>(13.5)%</b>	<b>13.5%</b>	<b>14.7%</b>	<b>15.0%</b>	<b>1536.7%</b>
Policy Benchmark <sup>5</sup>	(14.1)	14.7	15.2	15.4	1654.3
<b>Non-U.S. Equity</b>					
<b>UCRP</b>	<b>(33.1)%</b>	<b>(3.9)%</b>	<b>6.4%</b>	<b>N/A</b>	<b>N/A</b>
Policy Benchmark <sup>6</sup>	(23.6)	N/M	N/M	N/A	N/A
<b>Private Equity</b>					
<b>UCRP</b>	<b>(28.8)%</b>	<b>44.3%</b>	<b>49.5%</b>	<b>N/A</b>	<b>N/A</b>
Policy Benchmark <sup>7</sup>	(11.5)	19.9	20.6	N/A	N/A
<b>Fixed-Income Securities</b>					
<b>UCRP</b>	<b>10.8%</b>	<b>10.6%</b>	<b>11.3%</b>	<b>12.7%</b>	<b>982.2%</b>
Policy Benchmark <sup>8</sup>	11.8	8.4	9.4	12.2	907.0

**Chart VI**  
**UCRP Cumulative Total Returns: Fiscal 1982-2001**  
June 30, 2001



<sup>1</sup> UCRP's total returns are net of (after) investment management and administrative expenses of 0.04% of average annual market value. The asset class returns reflect investment returns. The performance of The Regents' total return investment portfolio is calculated by QED, according to the standard recommended by the Bank Administration Institute (BAI), which uses a time-weighted methodology that essentially neutralizes the effect of contributions and withdrawals so as to measure only the return on assets. These calculations comply with the Association for Investment Management and Research (AIMR) standards, which require time-weighted rates of return using realized and unrealized gains plus income. Performance is reconciled to the Treasurer's Office internal calculations.

<sup>2</sup> Capital Resource Advisors (CRA), measures investment returns on approximately 5,500 portfolios, with \$364 billion in assets. These returns are gross returns and are before any investment management fees, which would be approximately 0.50% of average annual market value. For periods longer than ten years, the Treasurer's Office uses the linked median, which is the compounded return of the annual universe median during a given time period.

<sup>3</sup> New: 53% Russell 3000 Tobacco-Free(TF), 35% SB LPF, 7% MSCI AC World ex US, 5% Russell 3000 TF + 3%; Historical: 65% S&P 500 and 35% LB LT G/C.

<sup>4</sup> Inflation as measured by the GDP deflator.

<sup>5</sup> New: Russell 3000 TF; Historical: S&P 500.

<sup>6</sup> MSCI AC World ex US, since November 2000.

<sup>7</sup> New: Russell 3000 TF + 3%; Historical: S&P 500 + 5%.

<sup>8</sup> New: SB LPF; Historical: LB LTG/C.

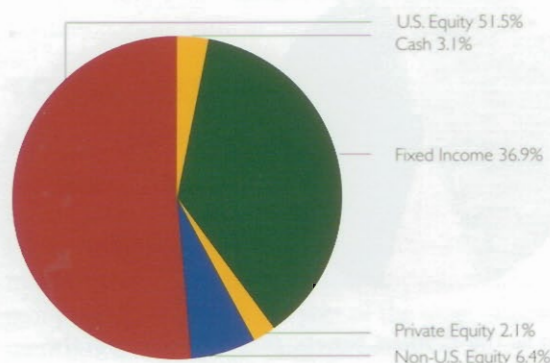




## ASSET MIX

The following chart illustrates UCRP's asset mix at June 30, 2001.

**UCRP Asset Mix**  
June 30, 2001



## EQUITY INVESTMENTS

The equity portion of UCRP consists primarily of domestic and foreign common stocks, along with a modest exposure to private equity. Total Equities represented 60% of UCRP at year-end, with a market value of \$23.2 billion.

Implementation of The Regents' new asset allocation policy required several changes to the equity portfolio during the fiscal year. Investments to Russell 3000 and MSCI EAFE Tobacco-Free indices were made in November 2000, and the Russell 3000 replaced the S&P 500 as the U.S. Equity benchmark in order to enhance the fund's diversification. In addition, exchange-traded index funds are sometimes used to maintain equity exposure until attractive individual securities are identified for long-term holdings.

U.S. Equity represented 51.5% of the fund at year-end, with a market value of \$19.9 billion. In a difficult year for the U.S. stock markets, UCRP's U.S. Equity returns declined by 13.5%, outperforming the benchmark return of (14.1%). Over the longer-term, UCRP's U.S. Equity returns of 14.7% and 15.0% for the 10 and 20 year periods also compare favorably. The portfolio's five-year average annual turnover rate was 16.7%.

The following are the 10 largest equity holdings and sector breakdown of the active U.S. Equity portfolio:

### Largest Equity Holdings

General Electric
AOL Time Warner
American International Group
Exxon Mobil
Sysco
American Home Products
SPDR Trust (S&P 500)
Automatic Data Processing
Marsh & McLennan
Microsoft

### Major Sector Allocations

Major Sector Allocations	% of Total
Technology	18%
Health Care	15%
Financial Services	14%
Consumer Discret.	13%
Utilities	8%
Consumer Staples	7%
Multi-Sector Cos.	7%
Integrated Oils	5%
Producer Durables	3%
Other Energy	2%

Non-U.S. Equity represented 6.4% of UCRP at year-end, with a market value of \$2.5 billion. The developed foreign equity markets fared worse than the U.S. as the global economy slowed, with UCRP's Non-U.S. Equities declining 33.1%. The longer-term returns for this asset class represent the emerging markets net asset value or "NAV" funds only, so comparisons are not yet meaningful.

Private Equity represented 2.1% of UCRP at year-end with a market value of \$802 million. Returns for this asset class suffered more than the public equity markets as the excessive valuations achieved during the internet boom were largely reversed. Over the past 5 and 10 years, however, UCRP's private equity returns of 44.3% and 49.5% have been very rewarding. Longer-term this category should provide attractive returns, although likely more modest than those of the previous few years.

## FIXED-INCOME INVESTMENTS

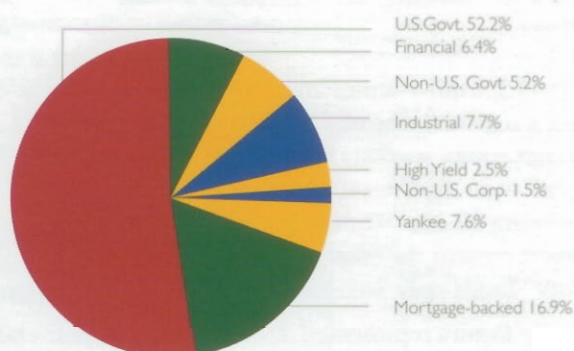
At year-end, Fixed-Income Investments constituted 36.9% of the portfolio, with a market value of \$14.3 billion. In accordance with The Regents' new asset allocation policy, the Salomon Large Pension Fund Index replaced the longer-duration Lehman Long-Term Government/Credit Index as the fund's benchmark. In response, the fund's duration was shortened from 11.4 years to 8.8 years during the fiscal year, which will reduce the portfolio's volatility over the long-term. Other major changes were an increase in the portfolio's mortgage-backed allocation and a reduction in foreign holdings.

UCRP's fixed-income investments returned an attractive 10.8% during the year, but below the benchmark return of 11.8%. Over the long-term, UCRP's fixed income returns of 11.3% and 12.7% for the 10 and 20 year periods have consistently exceeded the benchmark. The portfolio's five-year average turnover rate was 16.5%.

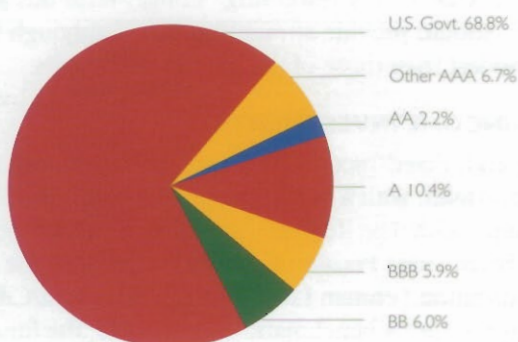


The weighted average maturity of the portfolio at the end of the year was approximately 15 years, and the average credit quality was AA, with more than 88% of the fixed-income securities rated A or higher. The following pie charts illustrate the sector mix and quality breakdown of the UCRP bond portfolio.

**UCRP Fixed-Income Sector Mix**  
June 30, 2001

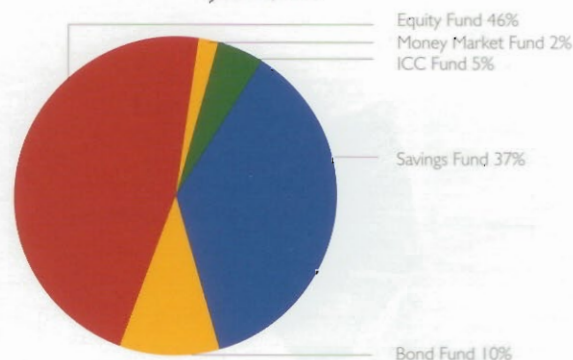


**UCRP Fixed-Income Quality Mix**  
June 30, 2001  
(BBB and higher = investment grade)



## Defined Contribution Funds

**Total DC Assets by Fund<sup>1</sup>**  
June 30, 2001



In addition to the defined benefit program (UCRP), the University offers three defined contribution plans to provide its employees with supplemental retirement benefits—the mandatory Defined Contribution Plan (DC Plan), the Tax-Deferred 403(b) Plan and the Defined Contribution Plan After-Tax Account. These programs differ from UCRP in that the benefits received by participants are based on the employee's contributions to the plans and the returns earned on those contributions over time.

When investing their defined contribution funds, employees may choose among six University Defined Contribution (DC) Funds managed internally by the Treasurer's Office or numerous external funds. The six University-managed funds include three total return funds—the Equity Fund, Bond Fund and Multi-Asset Fund—and three interest income funds—the Savings Fund, Insurance Company Contract (ICC) Fund and Money Market Fund.

### INTERNALLY MANAGED UC FUNDS

University-managed funds offer employees the opportunity to achieve excellent, long-term investment performance by investing in one or more funds of their choice. These funds represent diversified portfolios of high-quality, growth-oriented global stocks and bonds, as well as more conservative interest income funds with attractive above market yields. As Table VII on page 22 illustrates, these funds consistently rank above average in performance comparisons. In addition, the University-managed funds are extremely low cost relative to external fund options: Annual expenses are only 0.15% of average annual market value, compared to the industry average of 1.4%<sup>2</sup>.

<sup>1</sup> Includes balances invested for the Multi-Asset Fund, which at 6/30/01 totaled \$587.9 million and consisted of 37% in the Savings Fund, 34% in the Equity Fund, 20% in the Bond Fund and 9% in the Money Market Fund.

<sup>2</sup> Source: Principia Plus© for Mutual Funds July 2000, Morningstar, Inc. Although gathered from reliable sources, data completeness and accuracy cannot be guaranteed.





As part of the asset allocation policy adopted by The Regents in March 2000, certain changes were made to the asset profiles and benchmarks for the University-managed Equity and Bond Funds. These were intended to reduce volatility and broaden portfolio diversification. These changes were implemented during the fiscal year and are discussed more fully in the sections below.

## TOTAL RETURN FUNDS

### EQUITY FUND

The largest of the University-managed DC funds is the Equity Fund, established in August 1967. The Equity Fund is a total return fund with the primary objective of maximizing long-term capital appreciation with a moderate level of risk. As part of the asset allocation policy mentioned above, The Regents has adopted an asset mix for the Equity Fund similar to the equity portion of the UC Retirement Plan.

At June 30, 2001, the total market value of the Equity Fund was \$3.0 billion. The portfolio consisted of 80.7% U.S. Equity, 11.3% Non-U.S. Equity, 5.2% Private Equity and 2.8% cash.

While the Treasurer's Office continues to manage the majority of the Equity Fund, allocations to a Russell 3000 Tobacco-free Index fund and an MSCI EAFE Tobacco-free Index fund were made in November 2000. These were intended to mirror the returns of the broad U.S. and foreign stock markets. The Russell 3000 replaced the S&P 500 as the fund's U.S. Equity benchmark.

The Treasurer manages the active portfolio as a diversified portfolio of primarily high quality, reasonably-priced large-cap, growth-oriented global companies with above average earnings prospects.

For the fiscal year, the Equity Fund's return of (16.3%) was below its policy benchmark return of (15.4%). This was largely due to the fund's underweighting in small cap stocks and its exposure to private equity, which lagged public equity market returns after several years of exceptional performance. As shown in Table VII on page 22, the fund's long-term returns of 13.6%, 14.6%, and 14.8% for the 5, 10, and 20 year periods compare favorably to the market and to the Morningstar Domestic Equity Funds Average. The Equity Fund's five-year average annual turnover rate was 12.8%.

### BOND FUND

The Bond Fund is a total return fund established by The Regents in January 1978. The primary objective of the Bond Fund is to maximize real (adjusted for inflation) long-term total return through a combination of interest income and price appreciation, subject to maturity and quality constraints. The Treasurer's Office invests the Bond Fund in a diversified portfolio of primarily high-quality, global debt securities for which an attractive real return greater than the expected rate of inflation is achievable.

The major changes to the bond fund mandated by the new asset allocation policy were the adoption of the Lehman Aggregate Index as the fund's policy benchmark and guidelines limiting the fund's duration and exposure to foreign and high yield bonds in order to reduce volatility over the long-term. As such, over the course of the fiscal year, the fund's duration was reduced from 10.5 years to 5.8 years. Other major changes were a reduction in the fund's foreign bond holdings and an increase in its allocation to mortgage-backed securities.

At June 30, 2001, the total market value of the Bond Fund was \$642.3 million. U.S. Treasury securities constituted 27.9% of the fund, while high-grade industrial bonds represented 14.7%, financial bonds 6.7%, Yankee bonds 7.3%, high-yield bonds 1.2%, mortgage-backed securities 37.1%, and asset backed securities 5.1%. The weighted average maturity of the portfolio at year-end was approximately 10 years, and 89.9% of the portfolio was rated A or better. The five-year average annual turnover rate for the Bond Fund was 25.4%.

In fiscal 2001, the Bond Fund returned 11.6%, outperforming both its benchmark and the Morningstar Taxable Bond Funds Average. As shown in Table VII on page 22, the Bond Fund's returns of 10.7%, 11.2%, and 13.6% for the 5, 10, and 20 year periods have also consistently exceeded those of its Morningstar peers and its benchmarks.

### MULTI-ASSET FUND

In September 1990, the University Administration established the Multi-Asset Fund as an investment option. The Multi-Asset Fund is not a managed fund, per se, but is a combination of four existing University-managed funds, whereby contributions are invested according to a fixed percentage: 30% in the Equity Fund, 20% in the Bond Fund, 40% in the Savings Fund and 10% in the Money Market Fund. As such, the Fund invests in a conservative blend of 70% fixed-income assets and 30% equity assets. Although employee contributions enter the Multi-Asset Fund in a fixed percentage, the Multi-Asset Fund is not



# University of California Retirement System

**Table VII**  
**University-Managed Defined Contribution Funds**  
**Annualized Total Returns and Yields<sup>1</sup>**  
*June 30, 2001*

	1-Year	5-Years	10-Years	20-Years
<b>Total Return Funds</b>				
<b>Equity Fund</b>	<b>(16.3)%</b>	<b>13.6%</b>	<b>14.6%</b>	<b>14.8%</b>
Policy Benchmark <sup>2</sup>	(15.4)	14.3	15.0	14.0
Morningstar Domestic Equity Funds Average <sup>3</sup>	(9.4)	11.5	13.4	N/A
<b>Bond Fund</b>	<b>11.6%</b>	<b>10.7%</b>	<b>11.2%</b>	<b>13.6%</b>
Policy Benchmark <sup>4</sup>	11.2	8.3	9.4	12.2
Morningstar Taxable Bond Funds Average <sup>3</sup>	6.0	5.7	7.0	N/A
<b>Multi-Asset Fund<sup>5</sup></b>	<b>(2.0)%</b>	<b>9.7%</b>	<b>10.1</b>	<b>N/A</b>
Policy Benchmark <sup>6</sup>	0.6	8.7	8.9	N/A
<b>Interest Income Funds</b>				
<b>Savings Fund</b>	<b>6.0%</b>	<b>6.1%</b>	<b>6.6%</b>	<b>8.4%</b>
2-Year U.S. Treasury Notes	5.2	5.6	5.6	7.7
<b>ICC Fund</b>	<b>6.9%</b>	<b>7.2%</b>	<b>7.7%</b>	<b>N/A</b>
5-Year U.S. Treasury Notes	5.3	5.6	5.9	N/A
<b>Money Market Fund</b>	<b>6.1%</b>	<b>5.7%</b>	<b>5.2%</b>	<b>N/A</b>
3-Month U.S. Treasury Bills	5.3	5.2	4.8	N/A
Inflation <sup>7</sup>	2.5	1.8	2.1	3.1

rebalanced. The actual mix of the Multi-Asset Fund will vary over time as the market values of the component funds fluctuate at different rates.

The market value of the Multi-Asset Fund at June 30, 2001 was \$587.9 million, and the actual asset mix was 33.7% Equity Fund, 20.1% Bond Fund, 37.1% Savings Fund and 9.1% Money Market Fund.

The Multi-Asset Fund's returns are a function of the performance of its component funds.

## INTEREST INCOME FUNDS

### SAVINGS FUND

The Savings Fund, the second largest DC fund, is an interest income fund created in July 1967. The investment objective of the Savings Fund is to maximize interest income returns, while protecting principal, in order to

provide a safe, low-risk investment with attractive and stable returns. As such, the Savings Fund invests 100% in government, government-guaranteed and government agency securities of up to five years in maturity. The Treasurer's Office maximizes returns by altering the Fund's maturity structure in different yield curve environments.

The Savings Fund totaled \$2.4 billion at June 30, 2001, and was invested 100% in AAA-rated U.S. Treasury and federal agency securities. The weighted average maturity of the Savings Fund was 1.5 years at June 30, 2001.

The Savings Fund has historically provided a yield greater than that of 2-year U.S. Treasury Notes. In fiscal 2001, the Savings Fund generated a yield of 6.0%, exceeding the 5.2% yield on 2-year U.S. Treasury Notes. And, during the past 20 years the Savings Fund generated an average yield of 8.4% versus 7.7% on 2-year U.S. Treasury Notes.

<sup>1</sup> All returns and yields for the University-managed funds are net of (after) investment expenses of 0.15% and are based on unit values for the Equity, Bond and Multi-Asset Funds and on interest factors for the Savings, ICC and Money Market Funds. The Treasurer's Office calculates returns and yields by dividing the new unit value or interest factor by the previous unit value or interest factor supplied by UC Human Resources and Benefits. The Treasurer's Office compares these results to the gross investment returns calculated by the QED. QED's calculations comply with the Association for Investment Management and Research (AIMR) standards, which require time-weighted rates of return using realized and unrealized gains plus income.

<sup>2</sup> New: 80% Russell 3000 Tobacco-Free (TF), 15% MSCI ACWI ex-U.S.; 5% Russell 3000 TF + 3%. Historical: S&P 500.

<sup>3</sup> Source: Principia Plus® for Mutual Funds, July 2001, Morningstar, Inc. Although gathered from reliable sources, data completeness and accuracy cannot be guaranteed. Morningstar is the leading investment information and services provider. [800-735-0700; <http://www.morningstar.net>]

<sup>4</sup> New: Lehman Aggregate; Historical: LB LTG/C.

<sup>5</sup> Contributions to the Multi-Asset Fund are invested 40% Savings Fund, 30% Equity Fund, 20% Bond Fund and 10% Money Market Fund. The fund is not rebalanced.

<sup>6</sup> The Market Index Mix consists of 40% 2-Year U.S. Treasury Notes, 30% Russell 3000 TF, 20% Lehman Aggregate, and 10% 3-Month U.S. Treasury Bills.

<sup>7</sup> Inflation as measured by the GDP deflator.





### **INSURANCE COMPANY CONTRACT FUND**

The Regents approved the Insurance Company Contract (ICC) Fund as an investment option in September 1985. The investment objective of the ICC Fund is to maximize interest income while protecting principal. The Treasurer's Office invests contributions to the ICC Fund in insurance company contracts offered by select, highly rated, financially sound insurance companies. Under such contracts, the insurance companies guarantee a fixed annual rate of interest for a specified time period and the repayment of principal at the end of that time period. The contracts are backed by the assets of the insurance companies, and ICC Fund participants receive the blended rate of all contracts in the fund. The Treasurer's Office uses staggered maturities to systematically manage the reinvestment of maturing contracts and to provide return stability.

At June 30, 2001, the ICC Fund totaled \$299.8 million, with a weighted average maturity of 3.8 years.

Since inception, the ICC Fund has generated yields that have exceeded those of 5-year U.S. Treasury Notes by a comfortable margin. In fiscal 2001, the ICC Fund generated a 6.9% yield versus 5.3% on 5-year U.S. Treasury Notes and during the past 10 years 7.7% compared to 5.9% on 5-year U.S. Treasury Notes.

### **MONEY MARKET FUND**

The Regents approved the Money Market Fund as an investment option in September 1985 on the recommendation of the University Administration. The Fund's investment objective is to maximize interest income while protecting principal. The Treasurer's Office invests the Money Market Fund in a diversified portfolio of high-quality, short-term securities. The weighted average maturity of the Fund may not exceed 90 days and no individual maturity may exceed 13 months.


The Money Market Fund totaled \$131.4 million at June 30, 2001 and had a weighted average maturity of 75.0 days. The portfolio was invested 87% in commercial paper and 13% in federal agencies.

The Money Market Fund's yields compare favorably to those of 3-month U.S. Treasury Bills. In fiscal 2001, the Money Market Fund generated a 6.1% yield compared to 5.3% on 3-month U.S. Treasury Bills. During the past 10 years, the Money Market Fund generated an average yield of 5.2% compared to 4.8% on 3-month U.S. Treasury Bills.

### **FOR FURTHER INFORMATION**

For more information on the University-managed funds, please refer to *"Retirement Investment Funds", December 2000*, or log on to our website (<http://www.ucop.edu/treasurer>)





## Investment Operations and Banking and Treasury Services

### Investment Operations

The Investment Operations unit is responsible for all investment portfolio operations, including investment accounting and reporting, as well as the central management of all cash services for the University.

The Investment Operations group consists of a Director and Supervisor with an average of 17 years experience in banking and/or investment operations and six analysts with an average of 14 years experience in investment accounting and operations.

#### INVESTMENT ACCOUNTING

- Track all investment security transactions (foreign and domestic) from origination to settlement.
- Monitor and collect all investment income.
- Reconcile all investment assets with the master custodians daily.
- Monitor all transactions and holdings and reconcile all custodial records to in-house-investment databases.
- Calculate, analyze and report investment performance.
- Coordinate incoming gifts with campuses and/or donors and monitor and report receipt of security and cash gifts.
- Review and upgrade portfolio accounting systems on an ongoing basis in order to remain current with industry standards.
- Provide the UCOP Corporate Accounting Office with investment accounting entries for input into the general ledger.

#### INVESTMENT REPORTING

The investment group provides the following reports:

- All required reports to The Regents' Committee on Investments.
- Performance reports on the various portfolios and separately invested funds.
- All required governmental and other regulatory agency reports.
- The Treasurer's Annual Report.
- The Retirement Investment Funds Brochure

#### CASH MANAGEMENT

- Sweep all depository accounts daily and transfer funds to the University's main accounts.
- Provide UCOP funds to cover all checks and electronic fund transfers for vendor and payroll account
- Provide the Corporate Accounting Office with accounting entries for input into the general ledger for all cash and STIP transactions.

### Banking and Treasury Services

The Treasurer's Office manages all Regental banking services and bank accounts used within the UC system. As such, the Banking and Treasury Services unit of the Office of the Treasurer is responsible for the management and central oversight of all banking and related service facilities for the UC system including all campuses and laboratories under the authority of The Regents' Committee on Finance. This group is comprised of five professionals with an average of 14 years experience each: the Chief Treasury Officer, an Assistant Director, Senior Manager, Senior Analyst, and a Banking Specialist. This unit is responsible for the following:

- Provide oversight, expertise, and leadership system-wide with respect to banking and related services in administration of UC funds. Recommend policies and services that promote "best practices" for all UC organizations.
- Manage banking and related vendor relationships to ensure optimal pricing, consistently high levels of service, and state-of-the-art services.
- Support clients (campuses, hospitals, labs, and other UC departments) in their needs and in support of their goals by maintaining high levels of customer focus, and by being responsive and effective in matching organizational needs with appropriate service providers.
- Fulfill the duties of the Treasurer as directed in the UC Bylaws with respect to:
  1. Vendor selection for banking, credit card and related services;
  2. Bank account administration and control;
  3. Bank system oversight;
  4. Contract negotiation and execution for services used in the administration of UC funds.



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June 2001

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Treasurer and Vice President for Investments

MELVIN L. STANTON

The Assistant Treasurer

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Managing Director for Public Equity Investments

RANDOLPH E. WEDDING

Managing Director for Fixed Income Investments

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KIM B. EVANS  
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SANDRA SALAS  
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