



# INVESTMENT PERFORMANCE SUMMARY

Prepared for

*The Campus Foundations of the  
University of California*

Fourth Quarter 2002



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## MARKET COMMENTARY

- GEP returned 5.2% in the second quarter of fiscal year 2003, as world equity markets rebounded from their worst quarter since 1987. However, lagging returns in Private Equity markets led GEP to underperform its benchmark.
- GEP's U.S. Equity portfolio returned 8.3% in the quarter, outperforming the benchmark return by 18 basis points.
- Foreign markets outperformed the U.S. in the quarter, as the US \$ declined vs. major world currencies. GEP's foreign equities returned 7.2%, outperforming its benchmark by 29 basis points due to relative strength in emerging markets.
- GEP's bonds returned 1.5% in the quarter, as a sharp improvement in corporate bonds was offset by a small rise in U.S. Treasury yields. GEP's bonds trailed the benchmark by 23 basis points, as its corporate bond sector lagged the index counterpart after a long period of strong outperformance.
- Private Equity markets did not participate in the rally in public equities, returning (8.9%) vs. 8.9% for the benchmark (Russell 3000 +3%).
- HIP returned 1.7% for the quarter vs. 2.3% for its benchmark, as its equity holdings lagged due to their more defensive nature.
- STIP produced an attractive yield of 4.0% in the quarter vs. 1.4% on 3-month Treasury Bills, due to its longer average maturity of approximately two years and corporate holdings.

## MARKET OUTLOOK

- Although equity markets rebounded strongly in the quarter, many of the risks facing investors, such as possible military action against Iraq, rising budget deficits at all levels of government, and a weakening economic environment, remain unresolved. Resolution of some of these issues should set up a better environment for equity markets as the year progresses. While interest rates will eventually begin to rise, modest inflation and general risk aversion among investors should keep yields low.

## STRATEGY

- Rebalancing to bring GEP's equity weighting closer to the 65% target was undertaken early in the quarter through the sale of \$135 million in fixed income assets and reinvestment in The Regents' Russell 3000 Tobacco-Free Index fund managed by State Street Global Advisors. Effective in mid-November, all internal active equities were transferred to the same fund in order to implement The Regents' decision to have the assets managed externally. Over the next several months, external managers will be selected for a range of equity strategies to complete the diversification strategy.
- Fixed income markets were essentially flat in the quarter, with a considerable improvement in corporate bond spreads offset by a small rise in U.S. Treasury yields. Activity focused on taking profits in government bonds and select corporates to fund equities and swapping to improve quality and market position within market sectors. Net sales were \$126 million.
- Private Equity markets remained quiet, with drawdowns of \$1.4 million in the quarter.



## GENERAL ENDOWMENT POOL (GEP)



## GENERAL ENDOWMENT POOL (GEP)

December 31, 2002

### I. Asset Allocation

	Assets (\$M)	Actual %	Policy Target % <sup>1</sup>	Variance	Policy Range	Range Compliance
U.S. Equity	\$2,212	56%	53%	3%	48-58%	Yes
Fixed Income	1,404	35%	35%	0%	30-40%	Yes
Non-U.S. Equity	246	6%	7%	-1%	5-9%	Yes
Private Equity <sup>2</sup>	122	3%	5%	-2%	3-7%	Yes
<b>Total Assets</b>	<b>\$3,984</b>	<b>100%</b>	<b>100%</b>			

### II. Investment Performance

	Market Value (\$M)	Total Returns			Annualized Total Returns	
		Fourth Quarter	Fiscal Year	Calendar YTD	Five Years	Ten Years
<b>GEP Total Fund</b>	<b>\$3,984</b>	<b>5.2%</b>	<b>-3.8%</b>	<b>-11.7%</b>	<b>3.6%</b>	<b>10.0%</b>
Policy Benchmark <sup>3</sup>		<b>6.0%</b>	<b>-4.0%</b>	<b>-9.7%</b>	<b>3.0%</b>	<b>9.6%</b>
Variance to Benchmark		<b>-0.8%</b>	<b>+0.2%</b>	<b>-2.0%</b>	<b>+0.6%</b>	<b>+0.4%</b>
<b>U.S. EQUITY<sup>4</sup></b>	<b>\$2,212</b>	<b>8.3%</b>	<b>-11.0%</b>	<b>-26.0%</b>	<b>-1.3%</b>	<b>8.3%</b>
Policy Benchmark <sup>5</sup>		<b>8.1%</b>	<b>-10.6%</b>	<b>-21.7%</b>	<b>-0.3%</b>	<b>9.5%</b>
Variance to Benchmark		<b>+0.2%</b>	<b>-0.4%</b>	<b>-4.3%</b>	<b>-1.0%</b>	<b>-1.2%</b>
Core Index Portfolio	\$705	8.0%	-10.7%	-21.6%	NA	NA
Transitional Portfolio <sup>6</sup>	\$1,507	8.4%	-11.3%	-27.5%	-1.8%	8.0%
<b>FIXED INCOME<sup>7</sup></b>	<b>\$1,404</b>	<b>1.5%</b>	<b>9.5%</b>	<b>14.4%</b>	<b>7.7%</b>	<b>10.1%</b>
Policy Benchmark <sup>8</sup>		<b>1.8%</b>	<b>8.6%</b>	<b>12.5%</b>	<b>7.8%</b>	<b>8.9%</b>
Variance to Benchmark		<b>-0.3%</b>	<b>+0.9%</b>	<b>+1.9%</b>	<b>-0.1%</b>	<b>+1.2%</b>
<b>NON-U.S. EQUITY<sup>4</sup></b>	<b>\$246</b>	<b>7.2%</b>	<b>-13.4%</b>	<b>-14.4%</b>	<b>-8.4%</b>	<b>1.0%</b>
Policy Benchmark <sup>9</sup>		<b>6.9%</b>	<b>-13.8%</b>	<b>-14.7%</b>	<b>-7.7%</b>	<b>-0.5%</b>
Variance to Benchmark		<b>+0.3%</b>	<b>+0.4%</b>	<b>+0.3%</b>	<b>-0.7%</b>	<b>+1.5%</b>
Index Portfolio	\$214	6.6%	-14.4%	-15.5%	NA	NA
Emerging Markets	\$32	10.7%	-6.3%	-6.5%	-3.8%	3.5%
<b>PRIVATE EQUITY<sup>2</sup></b>	<b>\$122</b>	<b>-8.9%</b>	<b>-13.3%</b>	<b>-17.7%</b>	<b>25.0%</b>	<b>28.2%</b>
Policy Benchmark <sup>10</sup>		<b>8.9%</b>	<b>-9.3%</b>	<b>-19.3%</b>	<b>3.7%</b>	<b>14.4%</b>
Variance to Benchmark		<b>-17.8%</b>	<b>-4.0%</b>	<b>+1.6%</b>	<b>+21.3%</b>	<b>+13.8%</b>

1. Changes to this target policy approved by The Regents in May 2002 are not reflected and not yet implemented.

2. Private Equity total assets include a small percentage of real estate, less than 0.2% of the total portfolio.

3. Policy Benchmark consists of 53% Russell 3000 TF, 7% MSCI ACWI ex US, 5% Russell 3000 TF + 3%, 35% SB LPF linked to 65% S&P 500, 35% LB LT G/C.

4. For 5 and 10 year periods returns were reclassified to match current asset classes.

5. Policy Benchmark consists of Russell 3000 TF linked to S&P 500.

6. Market Value is as of 12/31/02. Returns reflect performance over the entire period during which the portfolio was part actively-managed and part passively-managed.

7. Fixed income securities are 100% internally managed.

8. Policy Benchmark consists of SB Large Pension Fund linked to LB LT G/C.

9. Policy Benchmark consists of MSCI ACWI ex US.

10. Policy Benchmark consists of Russell 3000 TF + 3% linked to S&P 500 + 5%



## GEP

### III. GEP Asset Allocation Plan Guideline Compliance: Exceptions

#### Private Equity Sector Allocation

	Assets (\$M)	% of P.E. Portfolio	Policy Target %	Variance	Policy Range	Range Compliance
Venture Cap.	\$29	27%	65%	-38%	45-70%	No
Buyouts	52	49%	35%	14%	25-50%	Yes
Non-U.S.	26	24%	0%	24%	0-10%	No
<b>Total Assets</b>	<b>\$107</b>	<b>100%</b>	<b>100%</b>			

#### **Venture Capital**

Weakness in Venture Capital over the past year has caused this segment to fall below the lower end of its allowable range.

#### **Non-U.S. Private Equity**

Non-U.S. private equity will not be emphasized going forward. This exposure is expected to decline over time as the other segments in the private equity portfolio grow.



## High Income Endowment Pool (HIP)



## HIGH INCOME ENDOWMENT POOL (HIP) December 31, 2002

### I. Asset Allocation

	Assets (\$M)	% of Portfolio
U.S. Equity	<b>\$8</b>	9%
Fixed Income	<b>81</b>	91%
<b>Total Assets</b>	<b>\$89</b>	<b>100%</b>

### II. Investment Performance

		Total Returns			Annualized Total Returns	
		Market Value (\$M)	Fourth Quarter	Fiscal Year	Calendar YTD	Five Years
<b>HIP Total Fund</b>	<b>\$89</b>	<b>1.7%</b>	<b>9.1%</b>	<b>11.8%</b>	<b>8.2%</b>	<b>10.6%</b>
Policy Benchmark <sup>1</sup>		<b>2.3%</b>	<b>6.3%</b>	<b>8.6%</b>	<b>7.1%</b>	<b>8.6%</b>
Variance to Benchmark		<b>-0.6%</b>	<b>+2.8%</b>	<b>+3.2%</b>	<b>+1.1%</b>	<b>+2.0%</b>
U.S. Equity	<b>\$8</b>	<b>2.5%</b>	<b>-12.4%</b>	<b>-19.0%</b>	<b>3.7%</b>	<b>9.7%</b>
Fixed Income	<b>\$81</b>	<b>1.7%</b>	<b>12.3%</b>	<b>16.7%</b>	<b>8.4%</b>	<b>10.3%</b>

### III. Guideline Compliance: No Exceptions

1. Policy Benchmark consists of 80% LB LT G/C and 20% S&P Electric Utilities.



## SHORT TERM INVESTMENT POOL (STIP)



## SHORT TERM INVESTMENT POOL (STIP)

December 31, 2002

- I. **Asset Allocation** - invests in approved fixed income investments with a maximum maturity of five years

	Assets (\$M)	% of Portfolio
U.S. Governments	\$1,136	16%
Corporate Notes	2,105	29%
Commercial Paper	2,851	39%
Certificate of Deposit	150	2%
Federal Agencies	1,040	14%
<b>Total Assets</b>	<b>\$7,282</b>	<b>100%</b>

- II. **Investment Performance**

	Market Value (\$M)	Total Returns			Annualized Total Returns	
		Fourth Quarter	Fiscal Year	Calendar YTD	Five Years	Ten Years
<b>STIP</b>	<b>\$7,282</b>	<b>4.0%</b>	<b>4.1%</b>	<b>4.5%</b>	<b>5.7%</b>	<b>6.0%</b>
3-Month U.S. Treasury Bills		<b>1.4%</b>	<b>1.5%</b>	<b>1.6%</b>	<b>4.2%</b>	<b>4.5%</b>
Variance to Benchmark		<b>+2.6%</b>	<b>+2.6%</b>	<b>+2.9%</b>	<b>+1.5%</b>	<b>+1.5%</b>

- II. **Guideline Compliance:** No Exceptions