# UNIVERSITY OF CALIFORNIA

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# Treasurer's Annual Report

ONE HUNDRED and THIRTY-SECOND FISCAL YEAR **1999-2000**

# THE REGENTS OF THE UNIVERSITY OF CALIFORNIA
## AS OF OCTOBER 2000

# UNIVERSITY OF CALIFORNIA
# TREASURER'S ANNUAL REPORT

**TABLE OF CONTENTS**

# TREASURER'S LETTER

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, 2000, the Treasurer's Office managed $58.1 billion in total assets as outlined below.

**TOTAL FUNDS UNDER MANAGEMENT**
**June 30, 2000**
*($ in billions)*

| | |
|---|---|
| UC Retirement Plan (UCRP) | $41.9 |
| DC Funds | 6.6 |
| Endowment Funds | 5.5 |
| Short Term Investment Pool (STIP)[1] | 4.1 |
| Total Funds | $58.1 |

The Treasurer's investment management staff includes 16 senior investment professionals with an average of 18 years of investment experience.

## INVESTMENT OBJECTIVE

The overall investment objective for all funds under management is to maximize real long-term total returns 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 beating the median return of our peers and exceeding inflation.

## INVESTMENT PHILOSOPHY/STRATEGY

The fundamental basis of the Regents' investment philosophy has been to invest strategically in a select group of securities with a global emphasis while taking a long-term perspective in regard to asset allocation decisions and individual security selection.

Historically asset allocation has emphasized equity over fixed income securities to take advantage of the greater long-term total return from this asset class which has resulted in substantial growth in the endowment funds and enabled the value of UCRP assets to substantially exceed actuarial funding level assumptions.

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, buyout funds, and select public and private emerging markets funds.

In recognition of the increasingly volatile nature of the securities' markets, however, The Regents initiated an asset allocation and strategy study by Wilshire Associates, which was completed and adopted in March 2000. While retaining the major portion of the equity and fixed income assets under the active management of the staff which has proven successful in the past, core portions of equity securities will be invested in index funds to more closely replicate the performance of growing U.S. and world economies while increasing diversification.

1 The Short Term Investment Pool excludes the cash invested for, and reported as, part of the UCRP, DC and Endowment funds.

## FISCAL YEAR 2000 IN REVIEW

Fiscal year 2000 saw the continued expansion of the global economy, led by very robust real GDP growth of 6% in the U.S. As central bankers in the world's major economies tightened interest rates to stem inflation pressures, signs that economies were peaking emerged later in the year, and investors embraced the prospect of a "soft landing" and the end of the tightening cycle. The combination of higher interest rates, moderating earnings growth, and extreme valuations in several sectors led to more modest common stock and bond market returns than seen in the past few years. However, the Internet boom of the past two years produced extraordinary private equity returns for some investors. The Regents' funds benefited from this trend, as well as performing very well compared to their benchmarks in all asset classes and continued to meet their objectives.

The disparity in performance between the "new and old economy" stocks continued for the first part of the fiscal year. Thus, extreme valuations in technology and telecommunications stocks, along with the expansion of the global economy, eventually led to a broadening in market participation. The traditionally more defensive areas of the market such as electric utilities, financial services, and REITS came into favor. Energy stocks also performed very well as oil prices rose beyond expectations. Due to the earlier momentum in internet-related stocks, NASDAQ still outperformed the other indices by a wide margin for the year, with returns of 47.6% vs. 6% for the S&P 500 and a decline of 4.7% for the Dow. However, the gap continues to narrow quickly, with NASDAQ down over 8% for the calendar year-to-date through mid-September.

As productivity gains curtailed wage inflation pressures and growth began to moderate, thirty-year U.S. Treasury bond yields peaked at 6.75% in January 2000 and ended the fiscal year almost unchanged from a year ago at 5.90%. The major story in bonds was the inversion of the yield curve and the buyback of longer-term U.S. Treasury debt with surplus budget funds. This phenomenon was not unique to the U.S., as better growth, demand for long duration assets, and more responsible fiscal policies benefited long-term government debt around the world. In contrast, excess supply and declining credit quality translated to wider spreads and underperformance for corporate and government agency bonds.

The attractive environment of healthy growth and high real yields underpinned by technology investment, strong productivity gains, and moderate inflation continued to attract investment flows into the U.S., leading to ongoing strength of the U.S. dollar.

## MESSAGE FROM THE TREASURER

In the U.S., growth now appears headed towards a more moderate and sustainable, but still healthy pace. This, along with moderating global activity, is allowing the Federal Reserve to stay on the sidelines but still remain watchful of inflation pressures. Despite this friendly backdrop, financial markets are currently grappling with extreme valuations in some sectors, along with the growth and inflation/deflation risks from the continuing rise in oil prices and extreme weakness in the Euro. The potential impact of the upcoming U.S. presidential election on the budget surplus, health care sector, and regulatory issue is also dampening investor enthusiasm. As such, the major stock indices may remain under pressure, and stock selection will be key to superior performance. Fixed income markets should have a generally positive bias, but remain in a relatively narrow range.

The allocation and investment changes required by the augmented strategy as reviewed and adopted by The Regents in March 2000 will be reflected in next year's Annual Report. Implementation has required development of new systems, skills, and relationships, but the resulting changes should serve the needs of the retirement and endowment funds well over the coming years. The Treasurer's Office looks forward to the challenges of the years ahead.

After 29 years of service with the University, including five as Treasurer, Patricia Small resigned in August 2000 to pursue other challenges and opportunities. During her tenure, she helped to establish a strong record of safety and outstanding performance for the University's investments, as assets grew from less than one billion dollars to $58 billion. The Treasurer's Office will miss her dedication

DeWitt Bowman
Interim Treasurer and Vice President
For Investments
October, 2000

# THE REGENTS' ENDOWMENT FUNDS

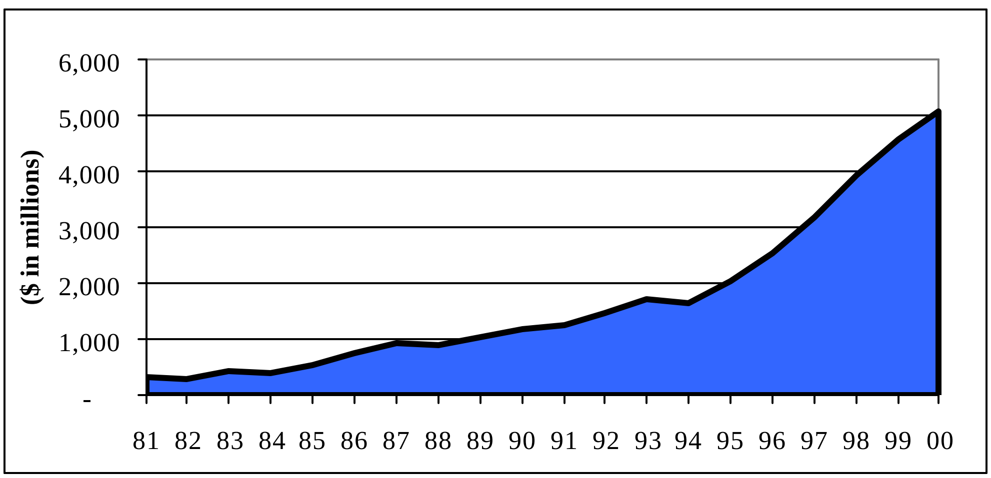
## Summary of Investments[1]

*($ in thousands)*

| | June 30, 2000 | | | June 30, 1999 | |
|---|---|---|---|---|---|
| **GENERAL ENDOWMENT POOL** | Cost | Market Value | % of Pool | Market Value | % of Pool |
| EQUITIES | | | | | |
| Common Stock | $1,253,341 | $2,919,064 | 57.6% | $2,903,470 | 63.4% |
| Alternative Equities[2] | 241,305 | 480,343 | 9.5% | 221,658 | 3.7% |
| Total Equities | $1,494,646 | $3,399,407 | 67.1% | $3,125,128 | 68.3% |
| FIXED-INCOME SECURITIES | $1,571,427 | $1,588,009 | 31.4% | $1,377,999 | 30.1% |
| STIP PARTICIPATION | $76,458 | $76,458 | 1.5% | $74,557 | 1.6% |
| **TOTAL GENERAL ENDOWMENT POOL** | **$3,142,531** | **$5,063,874** | **100.0%** | **$4,577,684** | **100.0%** |
| **HIGH INCOME ENDOWMENT POOL** | | | | | |
| EQUITIES | $14,605 | $13,701 | 12.4% | $42,098 | 26.1% |
| FIXED-INCOME SECURITIES | $94,056 | $92,820 | 83.9% | $113,948 | 70.6% |
| STIP PARTICIPATION | $4,097 | $4,097 | 3.7% | $5,280 | 3.3% |
| **TOTAL HIGH INCOME ENDOWMENT POOL** | **$112,758** | **$110,618** | **100.0%** | **$161,326** | **100%** |
| **OTHER ENDOWMENT FUNDS** | **$251,847** | **$386,437** | | **$474,156** | |
| **TOTAL REGENTS' ENDOWMENT FUNDS** | **$3,507,047** | **$5,560,929** | | **$5,213,166** | |

## GEP Market Values

*(Fiscal Periods Ending June 30)*




(1) For fiscal 1999 and fiscal 2000, the cash portion of the various portfolios excludes the unrealized market appreciation or depreciation of STIP investments and the investments in the security lending collateral pool. Therefore, the balances differ from the University's Annual Financial Report.

(2) Alternative equities include investments in premier private equity funds, select public equity funds and a minor amount of real estate.

# THE REGENTS' ENDOWMENT FUNDS: 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 a balanced portfolio of equities and fixed-income securities in which all endowment funds participate, unless payout needs require otherwise.

The June 30, 2000 market value of GEP was $5.1 billion, or $19.72 per share, up from $4.6 billion, or $17.73 per share, at the end of fiscal 1999. Total GEP net investment income for the year was $146.4 million, or $0.56 per share, up from $136.8 million, or $0.54 per share, at the end of fiscal 1999. The total return for GEP for the fiscal year was 14.7%.

## 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 target 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.

## 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 achieve these investment objectives, The Regents' asset allocation strategy for GEP is to invest 65% in equities and 35% in fixed income securities.

The Treasurer's Office targets equity investments primarily in the common stocks of global companies that have the ability to grow their earnings and dividends at a higher rate than market averages, and fixed-income investments in high-quality, longer-term, global debt securities with attractive real returns. In addition, the Treasurer invests a modest portion of the equity portfolio in alternative equities, which include premier private equity funds and select public equity funds.

## Returns

Throughout the years, GEP has performed extremely well versus its peers. As illustrated in Table I on page 4, GEP has consistently performed well above the median returns of the CRA Balanced Fund universe.[2] GEP's excellent return record is driven by a commitment to quality issues, which has led GEP to perform very well versus its peers. GEP's compound annual total return for the past 20 years was a strong 16.2% versus 13.1% for the CRA Balanced Fund Median.[1]

During that time, payout distributions grew at an average annual rate of 7.4%—well above annualized inflation of 3.4%.

Chart I on page 4 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 6 provides a detailed illustration of the performance of an endowed gift to GEP for the past 20 years.

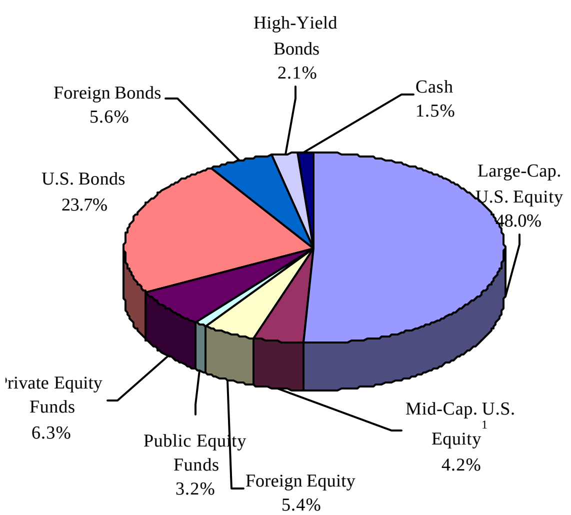
2 Capital Resource Advisors (CRA), formerly SEI, measures investment returns on approximately 5,500 portfolios, with $364 billion in assets.

## Asset Mix

At June 30, 2000, the portfolio consisted of 67.1% equities, 31.4% fixed-income securities and 1.5% cash. The five-year average annual turnover rate at the end of fiscal 2000 was 12.4%.

**GEP Asset Mix**[1]

*June 30, 2000*




1 Mid-Cap. stocks have a market capitalization of approximately $10 billion or less.

## Equity Investments

The equity portion of GEP consists primarily of domestic and foreign common stocks, with a modest exposure to alternative equity. Common stocks represented 57.6% of GEP at year-end, with a market value of $2.9 billion. GEP's common stocks returned 9.8% during the year, higher than the CRA Equity Only Median return of 8.6%. For the past 5, 10, 15 and 20 years, GEP's common stocks have performed ahead of the CRA Equity Only Median.

Alternative equities constituted 9.5% of the total portfolio at year-end, with a market value of $480.3 million. Alternative equities include premier private equity and select public equity funds and a minor amount of real estate. During the past fiscal year, alternative equities performed well above the major equity indices, as is evident with the fiscal year return of 163.2%.

**GEP 10 LARGEST EQUITY HOLDINGS**

*(June 30, 2000)*

General Electric Co.

Hewlett Packard Co.

Time Warner Inc.

Exxon Mobil Corp.

Marsh & McLennan Cos.

Ericsson (LM) Tel-Adr.

American Home Products Corp.

Cisco Systems Inc.

Merck & Co.

Worldcom Inc.

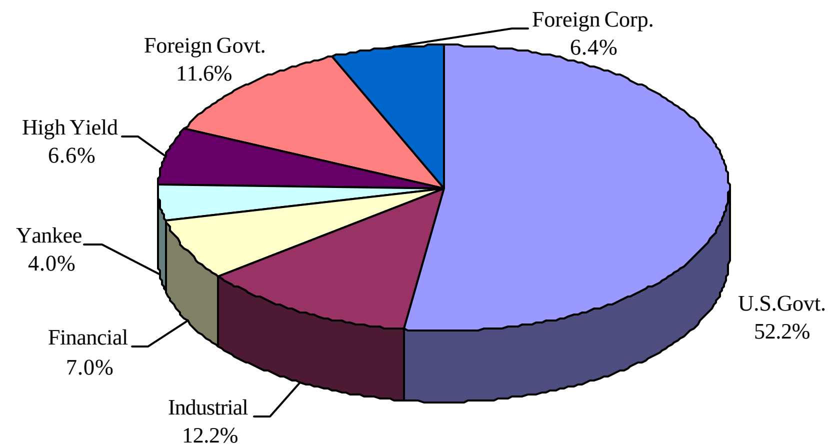
## Fixed-Income Investments

At year-end, fixed-income investments constituted 31.4% of the portfolio, with a market value of $1.6 billion. GEP's fixed-income securities returned 4.0% during the year, modestly underperforming the CRA Bond Only Median return of 4.4%. However, for the past 5, 10, 15 and 20 years, GEP's fixed-income securities have outperformed the CRA Bond Only Median by a wide margin.

The weighted average maturity of the bond portfolio at year-end was approximately 20 years, and the average credit quality was AA, with more than 85% 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, 2000*

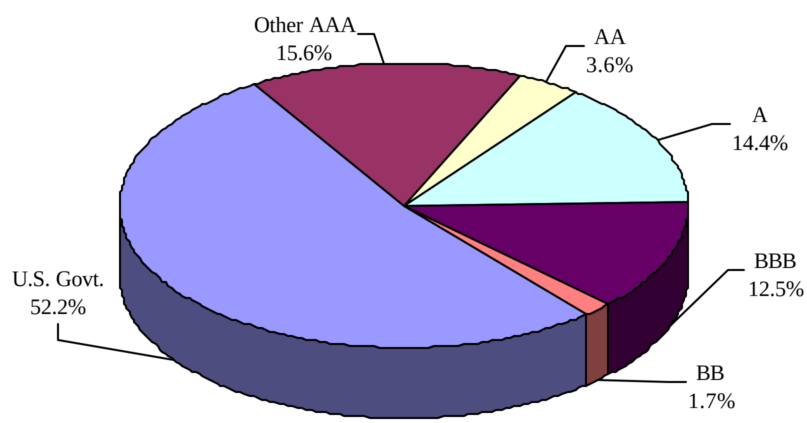



**GEP Fixed-Income Quality Mix**

*June 30, 2000*

*(BBB and higher = investment grade)*

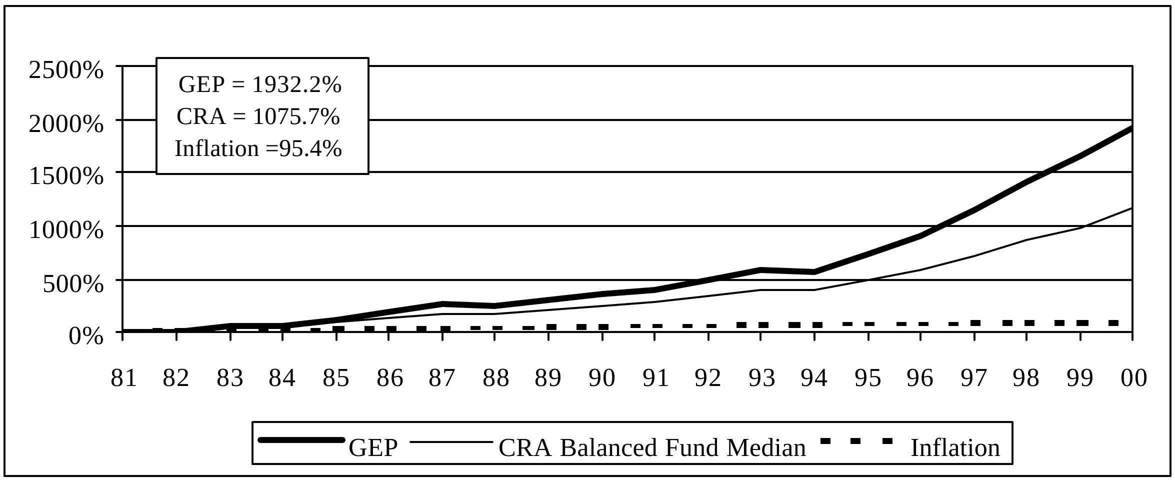
*Average Quality = AA*



## Table I
## GEP Annualized Total Returns versus Peers and Inflation
*June 30, 2000*

| | 1-Year | 5-Year | 10-Year | 15-Year | 20-Year | 20-Year Cumulative |
|---|---|---|---|---|---|---|
| **Total Fund** | | | | | | |
| **GEP**[1] | **14.7%** | **19.5%** | **16.0%** | **16.1%** | **16.2%** | **1932.2%** |
| *CRA Balanced Fund Median*[2] | *6.8* | *15.0* | *13.5* | *12.7* | *13.1* | *1075.7* |
| *Inflation*[3] | *2.1* | *1.6* | *2.2* | *2.7* | *3.4* | *95.4* |
| | | | | | | |
| **Common Stocks** | | | | | | |
| **GEP**[1] | **9.8%** | **22.4%** | **17.7%** | **17.3%** | **17.0%** | **2210.5%** |
| *CRA Equity Only Median*[2] | *8.6* | *22.2* | *16.8* | *16.3* | *16.1* | *1892.7* |
| | | | | | | |
| **Fixed Income Securities** | | | | | | |
| **GEP**[1] | **4.0%** | **9.6%** | **10.7%** | **11.8%** | **12.7%** | **985.3%** |
| *CRA Bond Only Median*[2] | *4.4* | *6.1* | *8.0* | *8.3* | *9.3* | *487.6* |

## Chart I
## GEP Cumulative Total Returns: Fiscal 1981-2000
*Fiscal Periods Ending June 30*




(1) 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 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.

(2) Capital Resource Advisors (CRA), formerly SEI, 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.

(3) Inflation as measured by the GDP deflator.

## Table II
## Example of GEP Investment Performance Fiscal 1981-2000

In order to endow a scholarship fund, a donor made a $100,000 cash gift to the University at the end of fiscal 1980, which then entered GEP on the first day of fiscal 1981, purchasing 41,580 shares, or units, in the pool based on a unit price of $2.405. GEP and the gift have performed as follows.

| | Per Share Performance | | | | Endowment Gift Performance | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Fiscal Year Ending 6/30 | Market Value | Payout | | % Change Payout | Market Value | Payout | Yield on Beg. Book | Annual Total Return (1) | Inflation (GDP Deflator) |
| Enter Pool | | | | | | | | | |
| 7/1/80 | 2.405 | | | | 100,000 | | | | |
| 1981 | 2.595 | 0.1604 | | | 107,900 | 6,669 | 6.7% | 14.80% | 7.7% |
| 1982 | 2.277 | 0.1730 | | 7.9% | 94,678 | 7,193 | 7.2% | -5.59% | 7.1% |
| 1983 | 3.263 | 0.1813 | | 4.8% | 135,676 | 7,538 | 7.5% | 52.41% | 4.0% |
| 1984 | 2.942 | 0.1769 | | -2.4% | 122,328 | 7,356 | 7.4% | -4.63% | 4.5% |
| 1985 | 3.801 | 0.1925 | | 8.8% | 158,046 | 8,004 | 8.0% | 36.70% | 3.7% |
| 1986 | 4.986 | 0.1941 | | 0.8% | 207,318 | 8,071 | 8.1% | 37.37% | 2.7% |
| 1987 | 5.937 | 0.1965 | | 1.2% | 246,861 | 8,170 | 8.2% | 23.60% | 3.1% |
| 1988 | 5.346 | 0.2259 | | 15.0% | 222,287 | 9,393 | 9.4% | -6.13% | 3.7% |
| 1989 | 5.968 | 0.2522 | | 11.6% | 248,150 | 10,486 | 10.5% | 16.84% | 4.8% |
| 1990 | 6.521 | 0.2933 | | 16.3% | 271,143 | 12,195 | 12.2% | 14.43% | 4.3% |
| 1991 | 6.824 | 0.3157 | | 7.6% | 283,737 | 13,126 | 13.1% | 9.86% | 4.0% |
| 1992 | 7.576 | 0.3203 | | 1.5% | 315,010 | 13,318 | 13.3% | 15.91% | 3.0% |
| 1993 | 8.410 | 0.3489 | (2) | 8.9% | 349,688 | 14,507 | 14.5% | 15.91% | 2.2% |
| 1994 | 7.883 | 0.3299 | | -5.4% | 327,770 | 13,717 | 13.7% | -2.51% | 2.0% |
| 1995 | 9.518 | 0.3435 | | 4.1% | 395,763 | 14,283 | 14.3% | 25.64% | 1.7% |
| 1996 | 11.215 | 0.3511 | | 2.2% | 466,309 | 14,599 | 14.6% | 21.80% | 2.1% |
| 1997 | 13.461 | 0.4090 | | 16.5% | 559,709 | 17,006 | 17.0% | 24.20% | 2.7% |
| 1998 | 15.698 | 0.4795 | | 17.2% | 652,723 | 19,938 | 19.9% | 20.47% | 1.0% |
| 1999 | 17.731 | 0.5406 | (3) | 12.7% | 736,641 | 22,476 | 22.5% | 16.67% | 1.2% |
| 2000 | 19.722 | 0.6254 | (3) | 15.7% | 816,684 | 25,983 | 26.0% | 14.70% | 2.1% |

**Compound Annual Total Return for 20 years (Fiscal 1981-2000)**
**(Capital Appreciation plus Income)** **16.2%**

**Compound Annualized Growth Rate for 20 years (Fiscal 1981-2000)**

**Payout Per Share** **7.4%**
**Inflation (GDP Deflator)** **3.4%**

(1) 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.

(2) 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.

(3) The payout for fiscals 1999 and 2000 were 4.35% 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 II (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 below in Chart III, almost half of GEP's assets support departmental use (13%), financial aid (18%) and research (15%).

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 Campus**

*June 30, 2000*

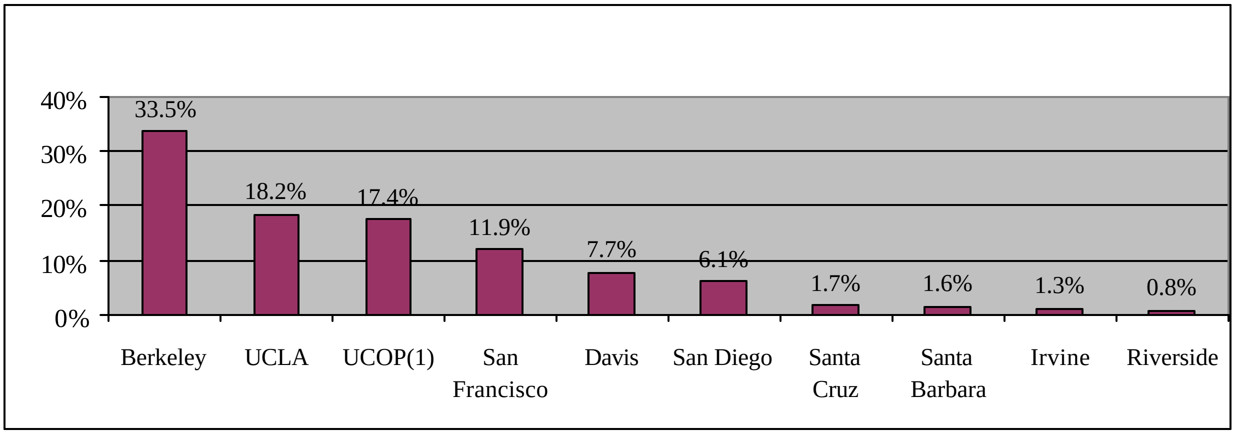
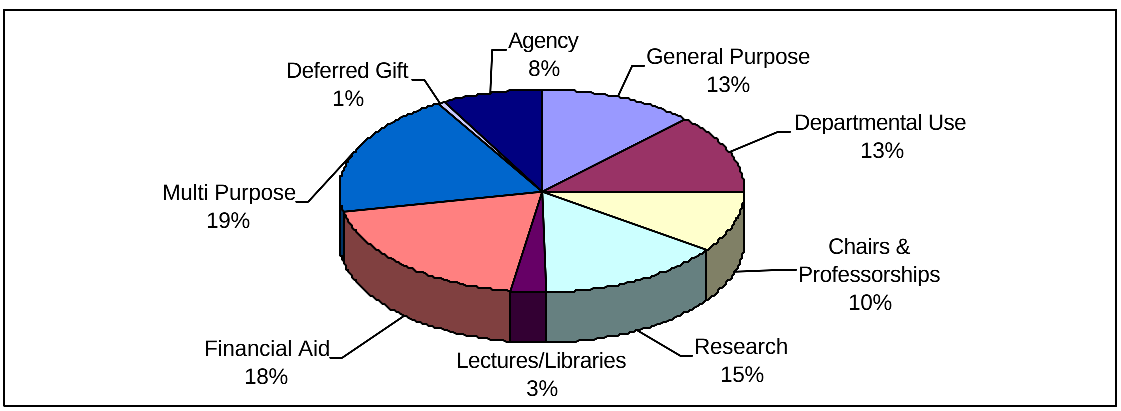



**Chart III**

**GEP Assets Designated by Purpose[2]**

*June 30, 2000*

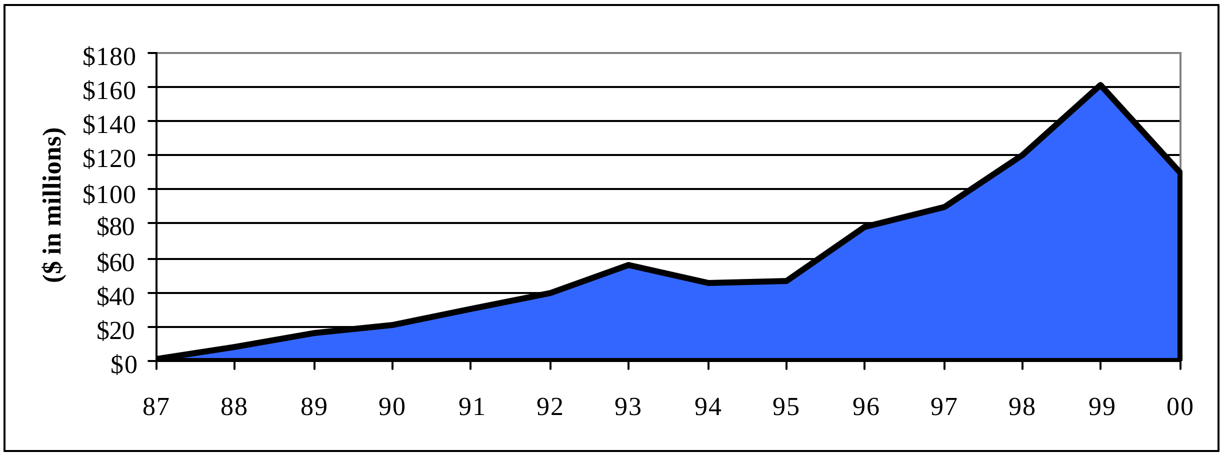



1 UCOP = UCOP-administered programs and multi-campus gifts.
2 71 % of GEP assets are restricted as to purpose.

# HIGH INCOME ENDOWMENT POOL

**HIP Market Values**

*(Fiscal Periods Ending June 30)*




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 endowment investment vehicle.

The June 30, 2000 market value of HIP was $110.6 million, or $1.61 per share, down from $161.3 million, or $1.67 per share, at the end of fiscal 1999. Total HIP net investment income for the year was $7.9 million, or $0.105 per share, down from $8.2 million, or $0.098 per share, at the end of fiscal 1999. HIP's current yield at June 30, 2000 was 7.1% on market value. HIP generated a total return of 3.0% for the fiscal year. 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.

## 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 13-year history, HIP has performed extremely well versus its peers. As illustrated in Table III on page 11, HIP has outperformed its benchmark during the last 5 and 10 years, as well as from inception.

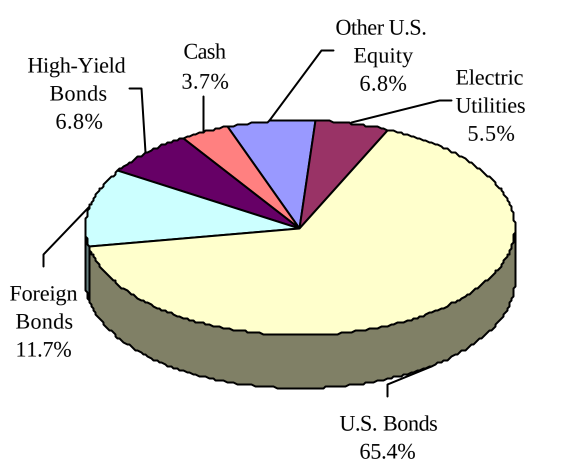
Chart IV also on page 11, illustrates HIP's cumulative total returns versus the CRA Bond Fund Median and inflation since inception.

Table IV on page 12 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 11.5%, and payout distributions have grown at an average annual rate of 3.2%, exceeding average inflation of 2.7%.

### Asset Mix

HIP's historic asset mix has been approximately 50-80% fixed-income securities, with the remainder primarily in higher-yielding equities. At June 30, 2000, HIP consisted of 83.9% fixed-income securities, 12.4% equities and 3.7% cash. The five-year average annual turnover rate was 14.0%.

**HIP Asset Mix**
*June 30, 2000*




### Fixed-Income Investments

At year-end, fixed-income investments were 83.9% of HIP, with $92.8 million in market value. HIP's fixed-income investments returned 4.1% during the year, modestly underperforming the CRA Bond Only Median's return of 4.4%.

U.S. Government bonds constituted 48.0% of the fixed-income investments at year-end, while high-grade industrial bonds represented 17.2%, financial bonds 10.8%, Yankee bonds 2.0%, high-yield bonds 8.1% and foreign bonds 13.9%. The weighted average maturity of the bond portfolio at year-end was approximately 21 years, and the average quality was AA, with 85.2% of the portfolio rated A or higher.

### Equity Investments

The equity portion of HIP constituted 12.4% of the fund at year-end, with a market value of $13.7 million. HIP's equity portfolio was comprised primarily of electric utilities and REITS, along with select convertible preferred issues that offer attractive current yields. HIP's common stocks returned 1.8% during the year versus -9.3% for the S&P 500 Electric Utilities.

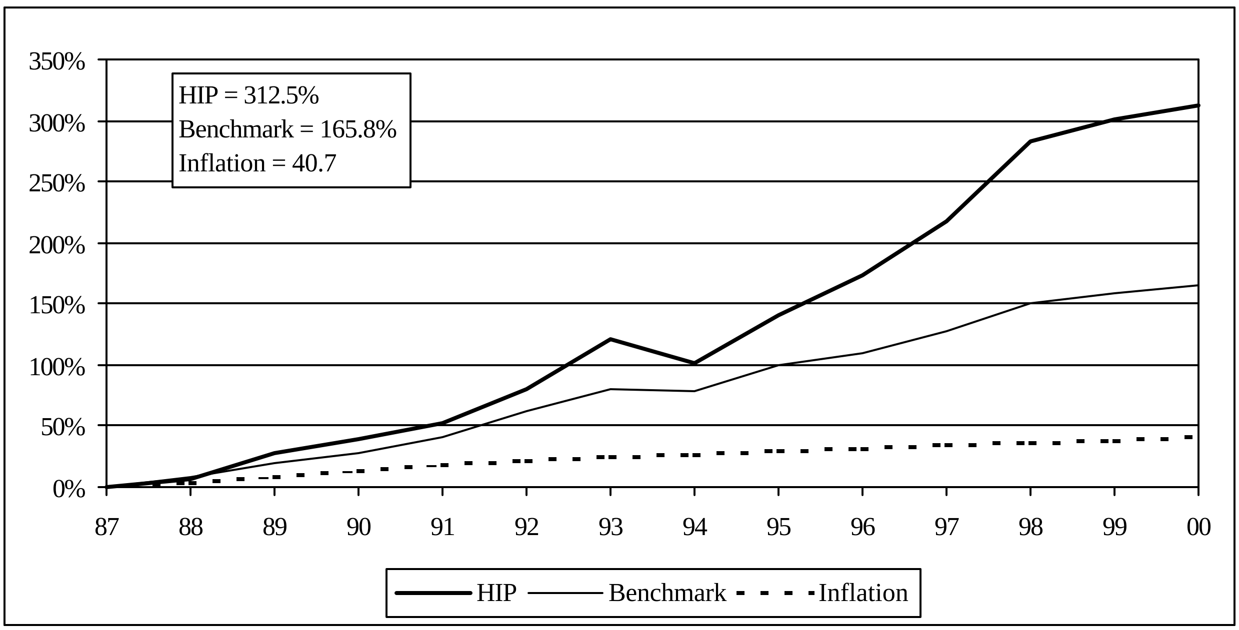
## OTHER ENDOWMENT FUNDS

At June 30, 2000, The Regents had $386 million of separately managed endowment funds (including approximately $133 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).

## Table III
## HIP Annualized Performance versus Peers and Inflation
*June 30, 2000*

| | Annualized 1-Year | Total 5-Years | Returns 10-Years | 13-Year Cumulative (HIP Inception) |
|---|---|---|---|---|
| **Total Fund** | | | | |
| **HIP[1]** | **3.0%** | **11.5%** | **11.5%** | **312.5%** |
| *Benchmark[2]* | *(0.4)* | *7.3* | *9.3* | *165.8* |
| *Inflation[3]* | *2.1* | *1.6* | *2.2* | *40.7* |
| | **1-Year** | **Annualized 5-Years** | **Yields 10-Years** | **13-Year Cumulative** |
| **HIP Total Fund** | **6.6%** | **5.6%** | **5.3%** | **148.2%** |
| *5-Year U.S. Treasury Notes* | *5.8* | *5.8* | *6.2* | *132.5* |

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




(1) 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.

(2) 60% LB LT G/C, 40% S&P Electric Utilities.

(3) Inflation as measured by the GDP deflator.

## Table IV
## Example of HIP Investment Performance Fiscal 1988-2000

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.

| | Per Share Performance | | | Endowment Gift Performance | | | Annual | Inflation |
|---|---|---|---|---|---|---|---|---|
| Fiscal Year Ending 6/30 | Market Value | Payout | % Change Payout | Market Value | Payout | Yield on Beg. Book | Total Return (1) | (GDP Deflator) |
| Enter Pool | | | | | | | | |
| 7/1/1987 | $0.969 | | | $100,000 | | | | |
| 1988 | 0.952 | $0.0718 | | 98,233 | $7,403 | 7.4% | 5.99% | 3.7% |
| 1989 | 1.059 | 0.0761 | 6.1 | 109,250 | 7,855 | 7.9% | 20.20% | 4.8% |
| 1990 | 1.069 | 0.0839 | 10.2% | 110,243 | 8,657 | 8.7% | 8.99% | 4.3% |
| 1991 | 1.080 | 0.0848 | 1.0% | 111,450 | 8,743 | 8.7% | 9.47% | 4.0% |
| 1992 | 1.197 | 0.0833 | -1.8% | 123,432 | 8,588 | 8.6% | 18.96% | 3.0% |
| 1993 | 1.358 | 0.0923 (2) | 10.8% | 140,087 | 9,518 | 9.5% | 21.98% | 2.2% |
| 1994 | 1.160 | 0.0888 | -3.8% | 119,667 | 9,154 | 9.2% | -8.64% | 2.0% |
| 1995 | 1.284 | 0.0869 | -2.1% | 132,487 | 8,964 | 9.0% | 19.03% | 1.7% |
| 1996 | 1.374 | 0.0893 | 2.7% | 141,774 | 9,209 | 9.2% | 14.21% | 2.1% |
| 1997 | 1.494 | 0.0946 | 6.0% | 154,084 | 9,758 | 9.8% | 16.06% | 2.7% |
| 1998 | 1.699 | 0.0963 | 1.8% | 175,209 | 9,933 | 9.9% | 20.58% | 1.0% |
| 1999 | 1.632 | 0.0982 | 1.9% | 168,358 | 10,126 | 10.1% | 4.36% | 1.2% |
| 2000 | 1.615 | 0.1050 | 7.0% | 166,624 | 10,831 | 10.8% | 3.00% | 2.1% |

**Compound Annual Total Return for 13 years (Fiscal 1988-2000)**

**(Capital Appreciation plus Income)** **11.5%**

**Compound Annualized Growth Rate for 13 years (Fiscal 1988-2000)**

**Market Value Per Share (after payouts)** **4.0%**

**Payout Per Share** **3.2%**

**Inflation (GDP Deflator)** **2.7%**

(1) 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.

(2) 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.

# 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 in one of the long-term pools are invested in STIP to earn maximum daily interest until transferred.

## Investment Objective

STIP's basic 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 2000, STIP's yield of 6.0% outperformed 3-month U.S. Treasury Bills at 5.4%. During the past 20 years, the average yield on STIP was 8.3%, compared to 8.1% for 2-year U.S. Treasury Notes and 6.9% for 3-month U.S. Treasury Bills.

The yield curve inverted in the second half of the fiscal year and remains inverted. Since July 1, 1999, the Federal Reserve tightened interest rates five times for a total of 150 basis points in an effort to slow demand and curb inflation. At June 30, 2000, the yield on 3-month U.S. Treasury Bills was approximately 110 basis points higher than one year ago, while yields on 2-year and 5-year U.S Treasury Notes increased 83 and 53 basis points, respectively, during the fiscal year.

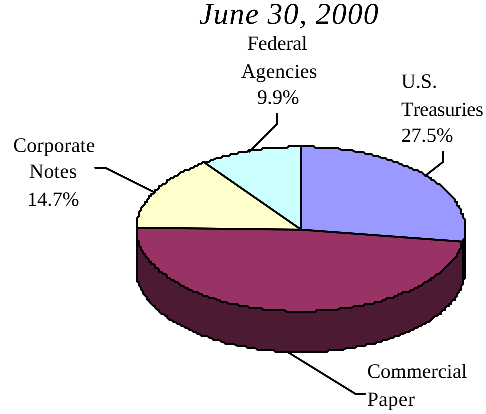
With the yield curve inversion and the high degree of liquidity required to effect the Regents' new asset allocation plan, shorter-dated securities were emphasized, capturing very attractive yields for the portfolio. While the portfolio continues to maintain a large percentage of U.S. Treasuries, select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

## Asset Mix

STIP totaled $7.2 billion at June 30, 2000, compared to $5.2 billion at the end of fiscal 1999. The portfolio consisted of 27.5% U.S. Treasury securities, 9.9% Federal agency securities, 47.9% prime commercial paper and 14.7% short-term corporate notes. The weighted average maturity of the portfolio at year-end was 1.3 years.

**STIP Asset Mix**

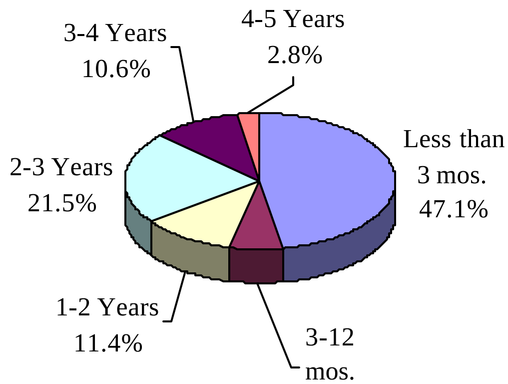
*June 30, 2000*



**STIP Maturity Distribution**

*June 30, 2000*

*(Average Maturity = 1.4 years)*




## 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 $297.2 million at June 30, 2000, 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.

**Table V**

**STIP Annualized Yields[1]**

*June 30, 2000*

| | 1-Year | 5-Years | 10-Years | 15-Years | 20-Years | 20-Year Cumulative |
|---|---|---|---|---|---|---|
| **STIP[1]** | **6.0%** | **6.2%** | **6.5%** | **7.1%** | **8.3%** | **392.3%** |
| *2-Year U.S. Treasury Notes* | *6.1* | *5.8* | *5.8* | *6.6* | *8.1* | *374.1* |
| *3-Month U.S. Treasury Bills* | *5.4* | *5.2* | *5.0* | *5.7* | *6.9* | *283.8* |
| *Inflation[2]* | *2.1* | *1.6* | *2.2* | *2.7* | *3.4* | *95.4* |

1 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.

2 Inflation as measured by the GDP deflator.

# UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM

## Summary of Investments[1]

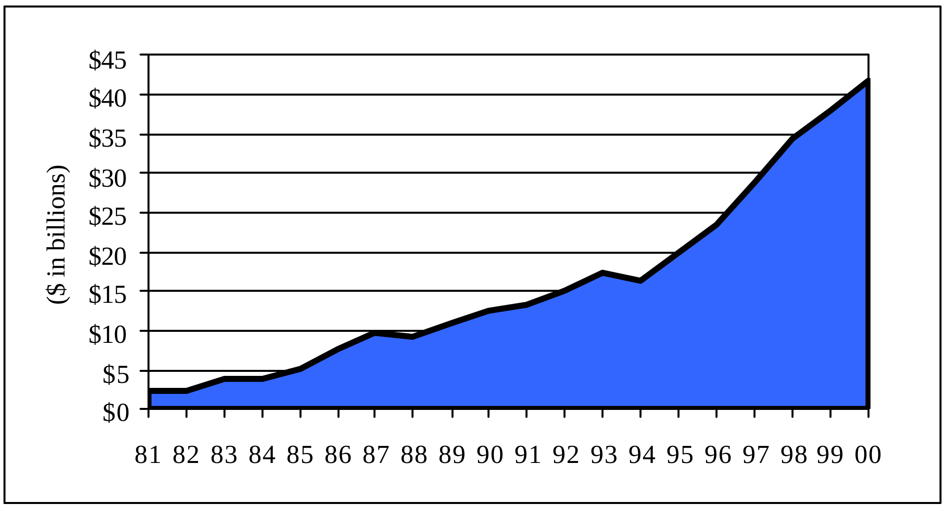
*($ in thousands)*

| | June 30, 2000 | | | June 30, 1999 | |
|---|---|---|---|---|---|
| **UC RETIRMENT PLAN (UCRP)** | Cost | Market Value | % of UCRP | Market Value | % of UCRP |
| EQUITIES | | | | | |
| Common Stock | $8,392,845 | $23,379,494 | 55.8% | $22,548,442 | 59.5% |
| Alternative Equities[2] | $1,313,199 | $2,535,616 | 6.0% | $1,300,110 | 3.4% |
| Total Equities | $9,706,044 | $25,915,110 | 61.8% | $23,848,552 | 62.9% |
| FIXED INCOME SECURITIES | $13,012,389 | $13,541,194 | 32.3% | $13,305,540 | 35.1% |
| STIP PARTICIPATION[3] | $2,457,735 | $2,457,735 | 5.9% | $775,958 | 2.0% |
| **TOTAL UCRP** | **$25,176,168** | **$41,914,039** | **100.0%** | **$37,930,050** | **100.0%** |

| | June 30, 2000 | | | June 30, 1999 | |
|---|---|---|---|---|---|
| **DEFINED CONTRIBUTION (DC) FUNDS** | Cost | Market Value | % of DC Funds | Market Value | % of DC Funds |
| TOTAL RETURN FUNDS | | | | | |
| EQUITY FUND | $1,938,287 | $3,494,339 | 50.3% | $2,795,469 | 48.0% |
| BOND FUND | $503,172 | $523,363 | 7.5% | $553,750 | 9.5% |
| INTEREST INCOME FUNDS | | | | | |
| SAVINGS FUND | $2,568,262 | $2,568,262 | 37.0% | $2,141,663 | 36.8% |
| ICC FUND | $261,032 | $261,032 | 3.7% | $238,780 | 4.1% |
| MONEY MARKET FUND | $102,962 | $102,962 | 1.5% | $91,392 | 1.6% |
| TOTAL DC FUNDS[4] | $5,373,715 | $6,949,958 | 100.0% | $5,821,054 | 100.0% |

## UCRP Market Values

*(Fiscal Periods Ending June 30)*




(1) For fiscal 1999 and fiscal 2000, the cash portion of the various portfolios excludes the unrealized market appreciation or depreciation of STIP investments and the investments in the security lending collateral pool. Therefore, the balances differ from the University's Annual Financial Report.

(2) Alternative equities include premier private equity funds and select public equity funds.

(3) UCRP's STIP investments include assets associated with the UC PERS Voluntary Early Retirement Incentive Program totaling $95.8 million in fiscal 2000 and $83.1 million in fiscal 1999.

(4) Total DC Funds excludes the Multi-Asset Fund, which totaled $562.7 million at June 30, 2000, and is invested in and reported as part of the Equity, Bond, Savings and Money Market Funds.

# UNIVERSITY OF CALIFORNIA 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, 2000 totaled $41.9 billion, up from $37.9 billion at the end of fiscal 1999.

## 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 achieve these investment objectives, The Regents' asset allocation strategy for UCRP is to invest 65% in equities and 35%in fixed income securities.

The Treasurer's Office targets equity investments primarily in the common stocks of global companies that have the ability to grow their earnings and dividends at a higher rate than market averages, and fixed-income investments in higher-quality, longer-term, global debt securities with attractive real returns. In addition, the Treasurer's Office invests a modest portion of the equity portfolio in alternative equities, which include premier private equity and select public equity funds.

## Returns

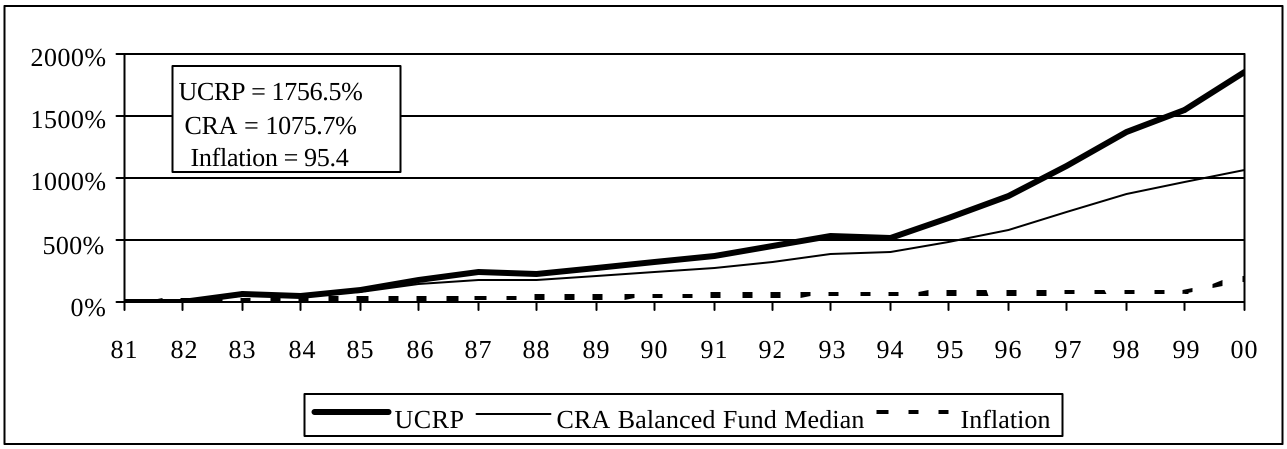
UCRP has performed extremely well over the years versus its peers. As illustrated in Table VI on page 18, UCRP has a proven history of above-median investment performance when compared to the CRA universe of balanced funds. UCRP's excellent return record is driven by a commitment to quality issues, which has led UCRP to perform very well versus its peers. UCRP's annualized total return for the past 20 years through June 30, 2000 was a strong 15.7% versus 13.1% for the CRA Balanced Fund Median. UCRP also outperformed the Wilshire Large Pension Plan Median for the last five-year period, the longest period for which data is available, at 18.7% versus 16.5%.

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.

## Table VI
## UCRP Annualized Total Returns versus Peers and Inflation
*June 30, 2000*

| | 1-Year | 5-Years | 10-Years | 15-Years | 20-Years | 20-Year Cumulative |
|---|---|---|---|---|---|---|
| **Total Fund** | | | | | | |
| **UCRP**[1] | **12.8%** | **18.7%** | **15.6%** | **15.7%** | **15.7%** | **1856.5%** |
| *CRA Balanced Fund Median*[2] | *6.8* | *15.0* | *13.5* | *12.7* | *13.1* | *1175.7* |
| *Wilshire Large Pension Plan Median*[3] | *12.8* | *16.5* | *N/A* | *N/A* | *N/A* | *N/A* |
| *Inflation*[4] | *2.1* | *1.6* | *2.2* | *2.7* | *3.4* | *195.4* |
| **Common Stocks** | | | | | | |
| **UCRP**[1] | **11.4%** | **22.2%** | **17.4%** | **17.1%** | **16.8%** | **2247.4%** |
| *CRA Equity Only Median*[2] | *8.6* | *22.2* | *16.8* | *16.3* | *16.1* | *1992.7* |
| **Fixed-Income Securities** | | | | | | |
| **UCRP**[1] | **4.3%** | **10.1%** | **11.3%** | **11.7%** | **12.6%** | **1080.9%** |
| *CRA Bond Only Median*[2] | *4.4* | *6.1* | *8.0* | *8.3* | *9.3* | *587.6* |

## Chart VI
## UCRP Cumulative Total Returns: Fiscal 1981-2000
*June 30, 2000*




(1) 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 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.

(2) Capital Resource Advisors (CRA), formerly SEI, 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.

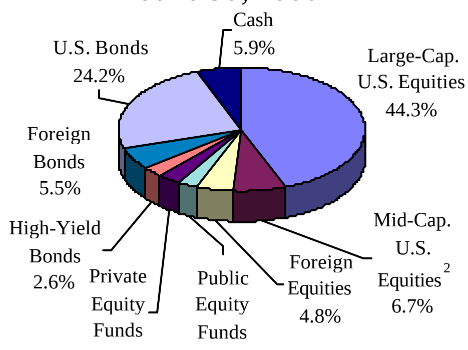
(3) The Wilshire Large Pension Plan Index measures investment returns on a universe of 26 pension plans greater than $10 billion, of which seven are corporate and 19 are public (including UCRP).

(4) Inflation as measured by the GDP deflator.

## Asset Mix

At June 30, 2000, UCRP consisted of 61.8% equities, 32.3% fixed-income securities and 5.9% cash[1]. The five-year average annual turnover rate at the end of fiscal 2000 was 12.9%.

**UCRP Asset Mix**[3]
*June 30, 2000*




## Equity Investments

The equity portion of UCRP consists primarily of domestic and foreign common stocks, with a modest exposure to alternative equities. Common stocks represented 55.8% of UCRP at year-end, with a market value of $23.4 billion. UCRP's common stocks returned 11.4% during the year, outperforming the CRA Equity Only Median return of 8.6% by a wide margin. For the past 10, 15 and 20 years, UCRP's common stocks have outpaced the CRA Equity Only Median.

**UCRP 10 LARGEST EQUITY HOLDINGS**
(June 30, 2000)

Hewlett Packard Co.
General Electric Co.
Marsh & McClennan Cos.
Time Warner Inc.
American Home Products Corp.
Exxon Mobil Corp.
Automatic Data Processing
Ericsson (LM) Tel-Adr.
Merck & Co., Inc.
Cisco Systems Inc.

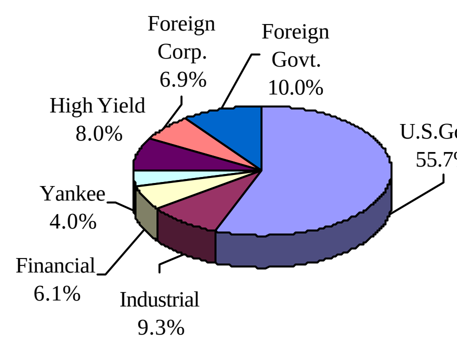
Alternative equities constituted 6.0% of the total portfolio at year-end, with a market value of $2.5 billion. Alternative equities include premier private equity funds and select public equity funds. During the past fiscal year, alternative equities performed well above the major equity indices, returning 138.6%, led by extraordinary Venture Capital results.

## Fixed-Income Investments

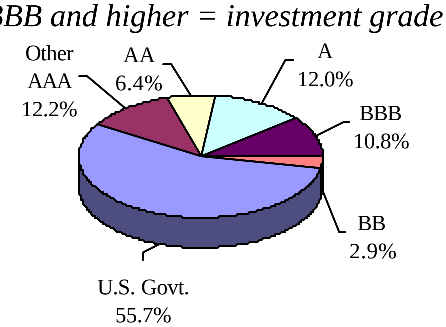
At year-end, fixed-income investments constituted 32.3% of the portfolio, with a market value of $13.5 billion. UCRP's fixed-income securities returned 4.3% during the year, in line with the CRA Bond Only Median return of 4.4%. For the past 5, 10, 15 and 20 years, UCRP's fixed-income securities have outperformed the CRA Bond Only Median by a wide margin.

The weighted average maturity of the portfolio at the end of the year was approximately 18 years, and the average credit quality was AA, with more than 86% 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, 2000*




**UCRP Fixed-Income Quality Mix**
*June 30, 2000*
*(BBB and higher = investment grade*

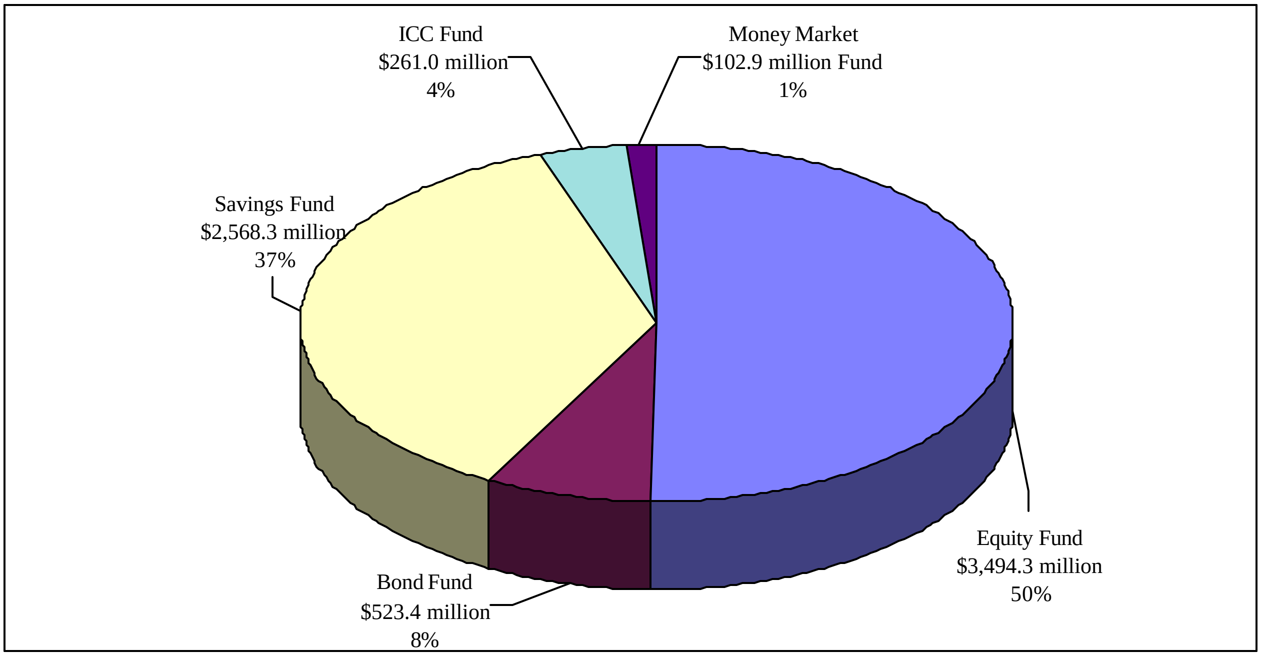



1 High cash balance due to transition to new asset allocation strategy.
2 Mid-Cap. stocks have a market capitalization of approximately $10 billion or less.

# DEFINED CONTRIBUTION FUNDS

**Total DC Assets by Fund[1]**

*June 30, 2000*




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.

## INTERNALLY MANAGED UC FUNDS

The 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 25 illustrates, these funds consistently rank above average in performance comparisons. In addition, the University-managed funds are extremely low cost relative to external fund

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.

options: Annual expenses are only 0.15% of average annual market value, compared to the industry average of 1.4%[2].

1 At 6/30/00, the Multi-Asset fund totaled $562.7 million and consisted of 33% in the Savings Fund, 41% in the Equity Fund, 18% in the Bond Fund and 8% in the Money Market Fund.

2 Source: *Principia PlusÓ for Mutual Funds*, July 2000, Morningstar, Inc. Although gathered from reliable sources, data completeness and accuracy cannot be guaranteed.

## 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. The Treasurer's Office invests the Equity Fund in a diversified portfolio primarily of high-quality, large-cap, growth-oriented, global companies, with a modest representation in alternative equities, including premier private equity funds and select public equity funds.

At June 30, 2000, the total market value of the Equity Fund was $3.5 billion. The portfolio consisted of 66.6% domestic common stocks, 10.8% foreign common stocks, 13.5% alternative equities and 9.1% cash[2]. The five-year average annual turnover rate for the Equity Fund was 10.8% as of June 30, 2000.

For the fiscal year, the Equity Fund's return of 21.1% was significantly above the S&P 500 return of 7.3% and the Morningstar Domestic Equity Funds Average of 18.3%. Moreover, the risk profile of the Equity Fund, with a five-year average beta of 0.96, was lower than that of the market as represented by the S&P 500. This lower risk has helped performance in down markets. In addition, the Equity Fund's longer-term performance compares very favorably to the market, and to the Morningstar Domestic Equity Funds Average.

### *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 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 primarily of high-quality, global debt securities for which an attractive real return greater than the expected rate of inflation is achievable.

At June 30, 2000, the total market value of the Bond Fund was $523.4 million. U.S. Treasury securities constituted 49.7% of the Fund, while high-grade industrial bonds represented 15.7%, financial bonds 6.9%, Yankee bonds 3.5%, high-yield bonds 6.1% and foreign bonds 18.2%. The weighted average maturity of the portfolio at year-end was approximately 19 years, and 87.5% of the portfolio was rated A or better. The five-year average annual turnover rate for the Bond Fund was 13.2% as of June 30, 2000.

In fiscal 2000, the Bond Fund returned 3.0%, matching the return on the Morningstar Taxable Bond Funds Average. Over the long-term, the Bond Fund's returns have exceeded those of its peers, recording an annualized return of 11.9% for the past 15 years versus 8.1% for the Morningstar Taxable Bond Funds Average.

### *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 an extremely 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 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, 2000 was $562.7 million, and the actual asset mix was 41.0% Equity Fund, 17.6% Bond Fund, 33.3% Savings Fund and 8.1% Money Market Fund.

The Multi-Asset Fund's returns are a function of the performance of its component funds, which has been excellent over the years.

## 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 $2.6 billion at June 30, 2000, and was invested 100% in AAA-rated U.S. Treasury and federal agency securities. The weighted average maturity of the Savings Fund was 2.1 years at June 30, 2000.

The Savings Fund has historically provided a yield greater than that of 2-year U.S. Treasury Notes. In fiscal 2000, the Savings Fund generated a yield of 6.0%, just under the 6.1% yield on 2-year U.S. Treasury Notes. However, during the past 15 years the Savings Fund generated an average yield of 7.7% versus 6.6% on 2-year U.S. Treasury Notes.

### *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, 2000, the ICC Fund totaled $261.0 million, with a weighted average maturity of 4.4 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 2000, the ICC Fund generated a 7.0% yield versus 5.8% on 5-year U.S. Treasury Notes and during the past 10 years 7.9% compared to 6.2% on 5-year U.S. Treasury Note

### *Money Market Fund*

The Regents approved the Money Market Fund as an investment option in September 1985 on the recommendation of the University Administration. Initially, the Treasurer's Office invested the assets in STIP, but then created a separate money market fund in February 1989. 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 $102.9 million at June 30, 2000 and had a weighted average maturity of 62.0 days. The portfolio was invested 100% in commercial paper.

The Money Market Fund's yields compare favorably to those of 3-month U.S. Treasury Bills. In fiscal 2000, the Money Market Fund generated a 5.8% yield compared to 5.4% on 3-month U.S. Treasury Bills. During the past 10 years, the Money Market Fund generated an average yield of 5.4% compared to 5.0% on 3-month U.S. Treasury Bills.

## For Further Information

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

**Table VII**
**University-Managed Defined Contribution Funds**
**Annualized Total Returns and Yields[1]**
*June 30, 2000*

| | 1-Year | 5-Years | 10-Years | 15-Years | 20-Years |
|---|---|---|---|---|---|
| **Total Return Funds** | | | | | |
| **Equity Fund** | **21.1%** | **22.7%** | **17.7%** | **17.4%** | **17.0%** |
| *S&P 500* | *7.3* | *23.8* | *17.8* | *17.6* | *17.4* |
| *Morningstar Domestic Equity Funds Average[2]* | *18.3* | *18.2* | *14.8* | *14.6* | *N/A* |
| **Bond Fund** | **3.0%** | **10.1%** | **11.1%** | **11.9%** | **12.5%** |
| *Lehman Long-Term G/C/Y* | *4.6* | *6.8* | *9.2* | *10.3* | *10.9* |
| *Morningstar Taxable Bond Funds Average[2]* | *3.0* | *5.5* | *7.4* | *8.1* | *N/A* |
| **Multi-Asset Fund[3]** | **11.2%** | **12.7%** | **N/A** | **N/A** | **N/A** |
| *Market Index Mix[4]* | *6.4* | *11.4* | *N/A* | *N/A* | *N/A* |
| **Interest Income Funds** | | | | | |
| **Savings Fund** | **6.0%** | **6.2%** | **6.9%** | **7.7%** | **8.6%** |
| *2-Year U.S. Treasury Notes* | *6.1* | *5.8* | *5.8* | *6.6* | *8.1* |
| **ICC Fund** | **7.0%** | **7.4%** | **7.9%** | **N/A** | **N/A** |
| *5-Year U.S. Treasury Notes* | *5.8* | *5.8* | *6.2* | *N/A* | *N/A* |
| **Money Market Fund** | **5.8%** | **5.6%** | **5.4%** | **N/A** | **N/A** |
| *3-Month U.S. Treasury Bills* | *5.4* | *5.2* | *5.0* | *N/A* | *N/A* |
| *Inflation[5]* | *2.1* | *1.6* | *2.2* | *2.7* | *3.4* |

1 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.

2 Source: *Principia Plus© for Mutual Funds*, July 2000, 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]

3 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.

4 The Market Index Mix consists of 30% S&P 500, 20% Lehman Long-Term G/C/Y, 40% 2-Year U.S. Treasury Notes and 10% 3-Month U.S. Treasury Bills.

5 Inflation as measured by the GDP deflator.

## TREASURY OPERATIONS

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

The Treasury Operations group consists of two managers with an average of 20 years experience in banking and/or investment operations and six analysts with an average of 18 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.

### *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.

### *Cash Management*

- Sweep all depository accounts daily and transfer funds to the University's main account.
- Provide funds to cover all checks and electronic fund transfers for vendor and payroll account

## 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. This group is comprised of three professionals: a Manager and two Associates with an average of 15 years experience each, and are responsible for the following:

- Promote best practices in the areas of depository and disbursement banking, lockboxing, credit card processing, travel and procurement cards and other financial and banking services.
- Select and manage Regental bank accounts; open and close accounts as needed and monitor all bank account signatories.
- Manage banking and other related vendor relationships.
- Negotiate all banking and related service contracts and pricing and monitor billings for these services.
- Review and upgrade cash management systems to meet industry standards.
- Advise campuses and labs of new financial services and technologies.
- Serve as office of record for all banking and related service contracts, and all bank accounts and associated signatories.

## OFFICE OF THE TREASURER

OCTOBER 2000

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| | NELSON S. CHIU | JEFFREY S. DONAHUE |
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| ADMINISTRATIVE STAFF | GAYLE TAPSCOTT, *OFFICE MANAGER* | |
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