Treasurer's Annual Report

One hundred and thirty-eighth fiscal year

University of California • 2005-2006

The Regents of the University of California

June 2006

The University of California is governed by The Regents, a 26-member board, as established under Article IX, Section 9 of the California Constitution. The Treasurer of The Regents is responsible for managing the investments and cash for the University of California System. The Treasurer's Office carries out these activities under the policies established by the Investment Committee of The Regents of the University of California.

Officers of The Regents

The Honorable Arnold Schwarzenegger, **President**
Gerald L. Parsky, **Chairman**
George Marcus, **Vice Chairman**
James E. Holst, **General Counsel and Vice President for Legal Affairs**
Leigh Trivette, **Secretary**
Marie N. Berggren, **Acting Treasurer**

Ex Officio Regents

The Honorable Arnold Schwarzenegger, **Governor of California**
Cruz M. Bustamante, **Lieutenant Governor**
Fabian Núñez, **Speaker of the Assembly**
Jack O'Connell, **State Superintendent of Public Instruction**
Richard E. Rominger, **President of the Alumni Associations of the University of California**
Eric G. Juline, **Vice President of the Alumni Associations of the University of California**
Robert C. Dynes, **President of the University of California**

Appointed Regents

Richard C. Blum
Russell Gould
Judith L. Hopkinson
Eddie R. Island
Odessa P. Johnson
Joanne C. Kozberg
Sherry L. Lansing
David S. Lee
Monica C. Lozano
George M. Marcus
John J. Moores
Gerald L. Parsky
Norman J. Pattiz
Peter Preuss
Adam Rosenthal
Frederick Ruiz
Tom Sayles
Leslie Tang Schilling
Paul Wachter

Faculty Representatives

John B. Oakley
Michael T. Brown **(03/14/06- 06/30/2006)**
Clifford Brunk **(07/01/05- 03/13/2006)**

Regents-Designate

Jefferson Coombs
Maria C. Ledesma
Stephen Schreiner

Committee on Investments

Richard C. Blum
David S. Lee, **Chair (07/01/05- 02/28/2006)**
Norman J. Pattiz
Peter Preuss
Adam Rosenthal
Paul Wachter, **Chair (03/01/06- 06/30/2006)**

Ex Officio Members:
The Honorable Arnold Schwarzenegger
Robert C. Dynes
Gerald L. Parsky

Advisory Members:
Stephen Schreiner
John B. Oakley

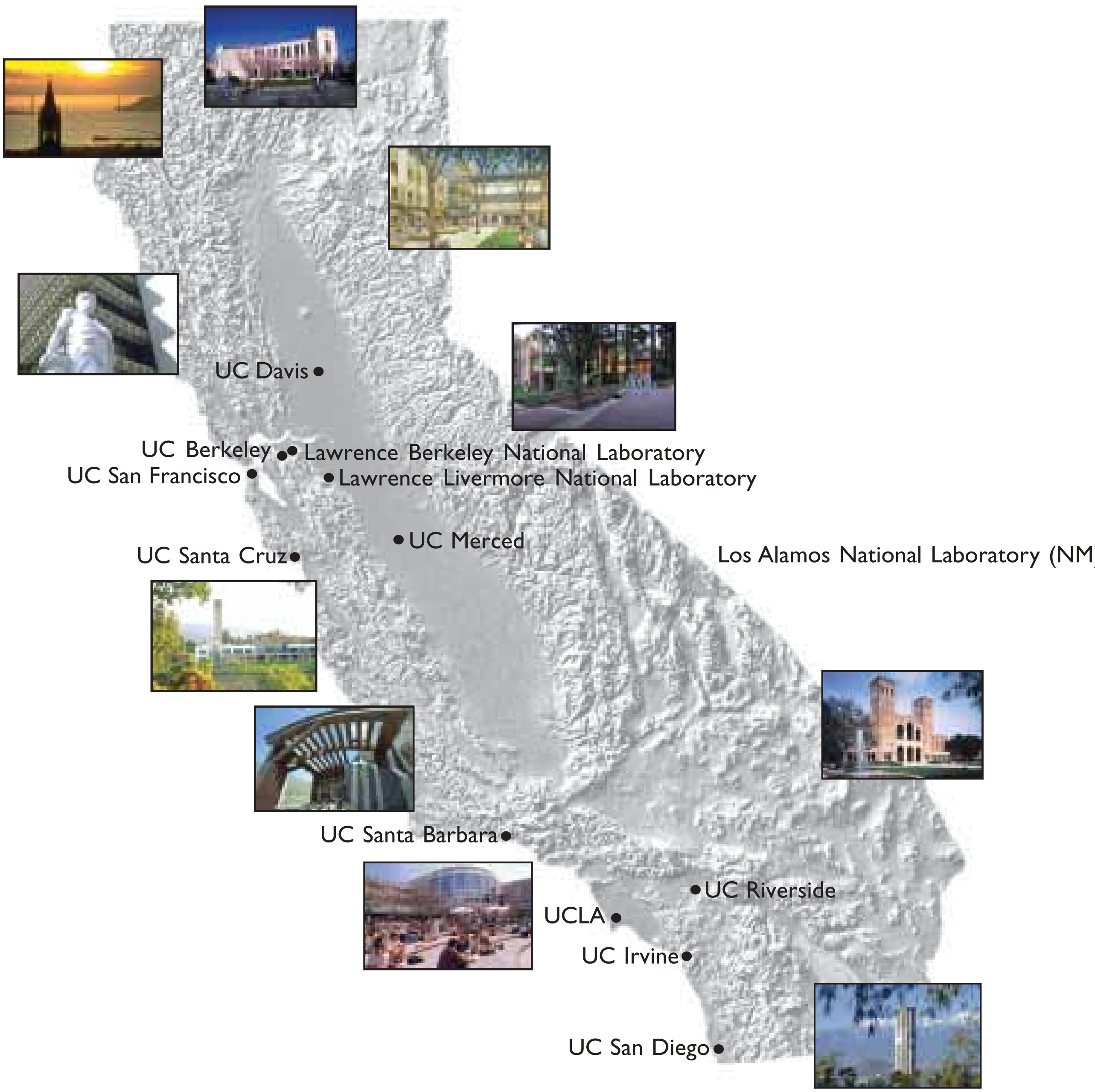
Mission Statement

The Office of the Treasurer of The Regents manages the University of California's retirement, endowment and cash assets under the policies, guidelines, and performance benchmarks established by The Regents. The Office's mission is to implement those policies and guidelines by selecting, executing, and monitoring investment strategies designed to add value over the benchmarks within a risk controlled framework. The Office adheres to high ethical as well as professional standards in serving the financial management needs of its constituency.

The University of California

The University of California, founded in 1868, is a system of 10 campuses with a mission of teaching, research and public service. With over 208,000 graduate and undergraduate students, UC is the world's premier public university. UC has three law schools, five medical schools and the nation's largest continuing education program. The University also manages three national laboratories that are engaged in energy and environmental research. Its Natural Reserve System manages approximately 130,000 acres of natural habitats for research, teaching and outreach activities.

Campuses and National Laboratories



TREASURER'S ANNUAL REPORT FISCAL 2005-2006

Table of Contents & Summary

FISCAL YEAR 2006 IN REVIEW

Global equity markets overcame rising interest rates and soaring oil prices to record positive results for the fiscal year, while bonds experienced modest negative returns. Foreign developed and emerging stock markets were especially strong, as the MSCI World ex U.S. (Net) Index gained 26.9% and the MSCI Emerging Market (Net) Index 35.5% vs. 9.7% for the Russell 3000. U.S. real GDP grew 3.5%, matching last year, while headline Consumer Price inflation accelerated to 4.3% from 2.5% in June 2005, largely due to oil prices. Core CPI's rise to 2.6% from 2.0% was more gradual, but significant enough to prompt the Fed to continue to raise short term interest rates throughout the year. Fed Funds closed the year at 5.25%, and Treasury yields rose across all maturities, resulting in a negative 3.4% total return for the Citigroup LPF (Large Pension Fund) Bond Index and negative 0.8% for The Lehman Aggregate Bond Index.

The yield curve remained very flat, with yields around 5.1% from two to 30 years. The European Central Bank also raised interest rates from 2.0% to 3.0% during the fiscal year, and Japan ended its decade-long zero-interest rate policy by raising rates to 0.25% in July. More recently, continued weakness in housing activity and moderation in several other U.S. economic indicators prompted the Fed to pause tightening monetary policy at its August meeting. Treasury yields have fallen to just below 5%, and U.S. equity markets are approaching their May highs, bolstered by strong earnings and the prospects for a more friendly Fed.

Ultimately, the restrictive effect of 17 Fed moves, balanced against rising wages and high resource utilization rates will determine whether or not the Fed has come to the end of its tightening cycle. As has been the case the past several years, geopolitical tensions have potential to impact upcoming elections and the global economy.

In June 2006 the Board of Regents appointed Marie N. Berggren as Chief Investment Officer and Vice President - Investments, Office of the President and Acting Treasurer of The Regents. Marie served as Interim Treasurer and Interim Vice President for Investments during this past fiscal year.

MESSAGE FROM THE CHIEF INVESTMENT OFFICER

All Regents assets grew by $3.2 billion over the previous fiscal year to $66.5 billion, reflecting a total return of 7.13%. This return outperformed the total entity benchmark by 0.22%. We are pleased to report that the University of California Retirement Plan (UCRP), the General Endowment Pool (GEP), and the Short Term Investment Pool (STIP) all produced positive returns for the fiscal year: UCRP 7.10%, GEP 11.57%, and STIP 4.20%, respectively.

The UCRP grew by $1.4 billion over the fiscal year, net of all payments to beneficiaries and expenses. In fact, the UCRP paid out benefits of $1.4 billion to UC retirees for the year. The UCRP's funding status is determined by a combination of three elements: investment policy, funding policy (contributions to the fund), and benefit policy (what is paid out). While the funded status of the UCRP has allowed for the temporary suspension of contributions, studies have indicated an increased likelihood of required contributions in the near term. The Board of Regents is currently evaluating this possibility.

The value of assets of the 18 Core Funds available within the University's Retirement Savings Program (the DC Plan, 403(b) Plan and 457(b) Plan) rose by $707 million during the past year. Performance of the individual UC-Managed funds is available beginning on page 31 of this report. Primary asset class funds include seven broad-based asset class funds. Specialized asset class funds include small cap U.S. equity, emerging market equity, REITs and socially-responsible investments. These Core Funds provide investment options that are easy to understand and that offer an appropriate range of asset class choices. In July 2005 the University transitioned its Retirement Savings Program's recordkeeping to an external provider, Fidelity Investments Institutional Services Company (FITSCo). Our Office continues to work jointly with Human Resources and Benefits to facilitate enhancements to both the financial education and recordkeeping services provided to participants by FITSCo.

The Treasurer's Office continues to diversify its holdings to provide for the long-term needs of the University, its programs and employees. For many years the Regents had similar strategic asset allocations for the pension plan (UCRP) and endowment (GEP). Recognizing the differences between the two (primarily that endowments have a longer investing horizon and can afford to invest in less liquid, potentially higher returning assets), the asset allocations for these two portfolios have become differentiated.

The Treasurer and The Regents' consultant recommended a new asset allocation for the GEP which was approved by The

Regents in September 2005, modified in May 2006, and implemented throughout the past year. There is now less emphasis on traditional equity and bonds and more weight in alternatives, including an increased commitment to private equity and real estate. The goal is to achieve a portfolio with higher expected return and lower market volatility. The Office has increased staffing to handle the increased allocation to Alternative Investments - see our "Investing In Depth" section on pages 12-13 to learn more about these asset classes.

We added a senior member to our Real Estate group and have worked with The Regents to further refine our Real Estate strategy in relation to the current real estate environment.

The Treasurer and The Regents' consultant also recommended a new asset allocation for the UCRP which was approved by The Regents in November 2005 and implemented in the first half of 2006. The overall proportion of equity was increased slightly, but Non-U.S. Equity was increased substantially, and U.S. Equity reduced. Core Fixed Income was reduced substantially, in order to diversify into three new fixed income classes: Non-U.S. Dollar Debt, High Yield Debt, and Emerging Market Debt.

In August 2005, The Regents adopted a conflict of interest policy which separated the responsibilities for developing and approving policy versus selecting investment strategies and managers. The Regents' responsibilities center on approving policy, asset allocation, benchmarks, and risk budgets and guidelines, while the Treasurer is responsible for all aspects of implementation, including the development of processes and procedures and the selection of investment products. The Regents determine the amount of risk that is appropriate for each fund, and the Treasurer must ensure that risk is kept within these parameters. The Treasurer is charged with presenting an annual review of policies and guidelines and recommending any changes. Compliance with this policy ensures the continuance of sound investment practice and the protection against real or perceived conflict of interest, especially with regard to the selection of individual investments or investment managers.

I am extremely pleased to serve The Regents, faculty, staff and students of the University of California.

Sincerely,

Marie N. Berggren
Chief Investment Officer and Vice President - Investments, Office of the President and Acting Treasurer of The Regents University of California, October 2006

LOOKING FORWARD

UCRP In December 2005, the Department of Energy (DOE) awarded the management and operating contract for Los Alamos National Laboratory (LANL) to Los Alamos Security, LLC (LANS). The RFP required LANS to operate and manage the laboratory as a separate corporate entity. The new contract began June 1, 2006. As part of the transition process to the new management team, and consistent with the requirements set forth in the University's contract with DOE, UC is required to transfer assets and liabilities attributable to the benefits of LANL employees who continue employment with LANS and participate in the new corporate defined benefit plan. Assets will be transferred from UCRP when both plans have obtained the necessary approvals. Retired members and inactive members of the UCRP-LANL Plan will remain in the UC-sponsored plan, and their benefits will be paid from the related trust.

The actuarial accrued liability for those members electing to participate in the LANS Plan has been estimated by The Regents' actuary, The Segal Company, to be in excess of $1 billion. This future transfer will require Regental approval and will not reduce the ability of the UCRP to meet its obligations to its members.

GEP In response to requests from several UC Foundations who would like to increase their portfolios' allocation to alternative investments, the Office has created three new programs: Private Equity Vintage Year Program, Real Estate Vintage Year Program and Absolute Unitized Program. All three programs will begin in January 2007. The UC Foundations may elect to participate in any or all of the programs. The benefits the UC Foundations receive by partnering with our Office include access to mangers which impose high minimum investment amounts, lower fees than those charged by fund of funds and elimination of time spent on paper work related to manager searches and monitoring.

INVESTMENT MANAGEMENT OVERVIEW

The investment funds managed by the Treasurer of The Regents consist of the University's retirement, defined contribution and endowment funds, as well as the system's cash assets. At June 30, 2006, the Treasurer's Office managed over $66 billion in total assets as outlined below.

TOTAL FUNDS UNDER MANAGEMENT[1]
June 30, 2006
($ in billions)

University of California Retirement Plan (UCRP)	$43.4
Defined Contribution Plan Funds	9.4
Endowment Funds	6.4
Short Term Investment Pool (STIP)[2]	7.3
Total Funds	$66.5

The Treasurer's Office investment management staff includes 24 investment professionals with an average of 17 years of investment experience.

INVESTMENT OBJECTIVES & PHILOSOPHY

The investment objective for all funds under management is to maximize long-term total real returns while assuming appropriate levels of risk. Because the purpose of each fund is unique, The Regents has established the following specific objectives for each fund, along with the overall goal of exceeding the policy benchmark return and the rate of inflation:

Retirement Funds: for the University of California Retirement Plan, produce a real return to meet obligations to beneficiaries and to meet or exceed the actuarial rate of return; for the University-Managed Defined Contribution Funds, meet stated investment objectives for each fund.

Endowed Funds: to ensure that future funding for endowment-supported activities be maintained in perpetuity both by generating a growing payout stream and by growth of principal.

1 Market values include accrued income.

2 The Short Term Investment Pool excludes the cash invested for, and reported as part of, the UCRP, Defined Contribution and Endowment Funds.

ASSET ALLOCATION

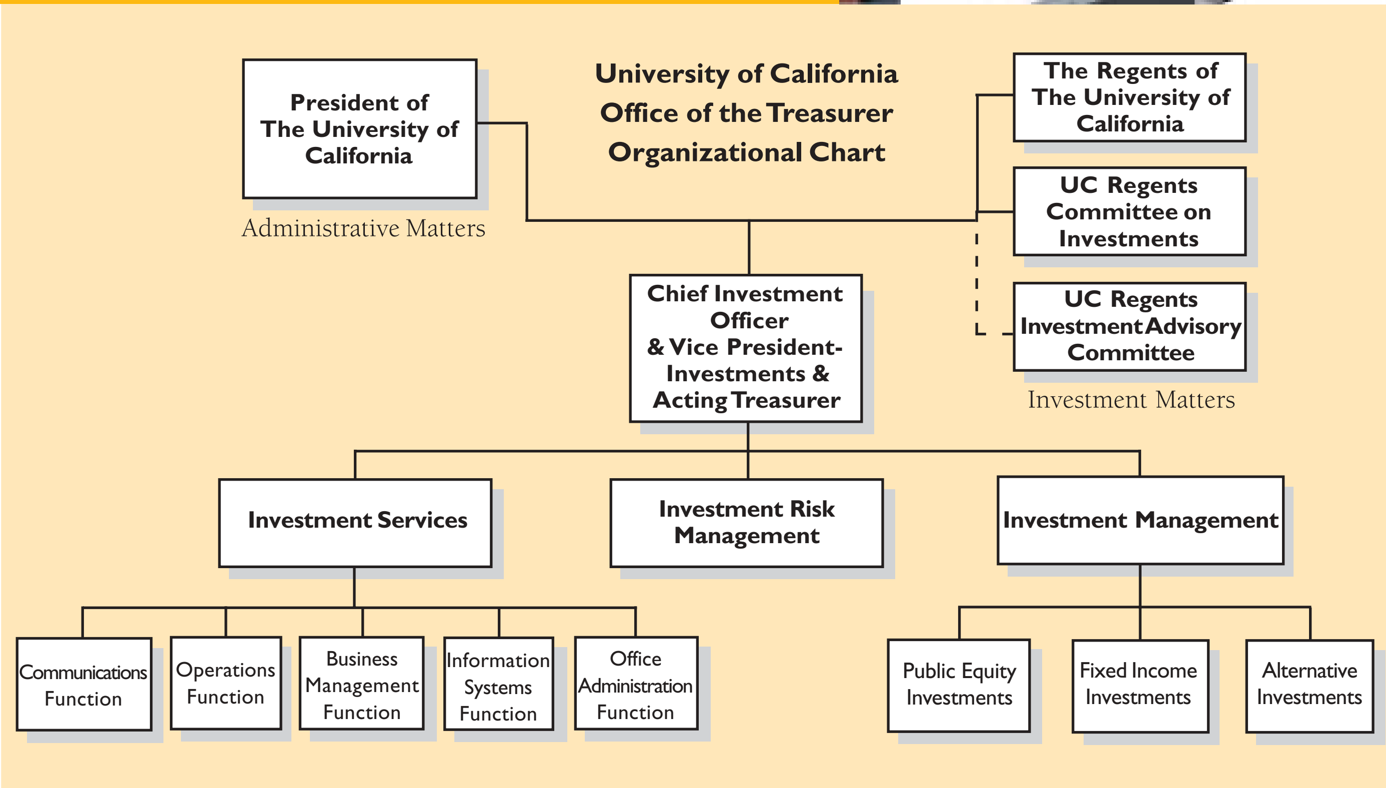
Asset allocation is the primary determinant of long-term investment returns. UC funds are diversified among global equities, fixed-income securities, and other non-marketable investments, within a Regental target allocation (see pages 17, 26 and 32.) Historically, portfolio asset allocation has favored equity investments over fixed-income securities due to the expectation that equities will provide higher total returns over the long term, albeit with greater year-to-year volatility.

The asset allocations for UCRP and GEP are developed as follows: First, expected return and risk for each asset class is estimated using an equilibrium framework and current prices. Second, a set of efficient portfolios is developed, consistent with those assumptions. Third, the assets and liabilities (pension benefits or endowment spending) are modeled under alternative economic scenarios and different efficient portfolio mixes. Fourth, the Regents chooses a portfolio allocation consistent with its risk tolerance, one which maximizes the probability of meeting scheduled payments over time.

The Portfolio Management Group meets weekly to review asset allocation, portfolio performance, and market conditions. Asset allocation rebalancing is required when asset class weights move out of the allowable range. The Treasurer decides on the timing and extent of the rebalancing, within The Regents' policy, based on market conditions.

PUBLIC EQUITY INVESTING

The Regents' Public Equity investment strategy utilizes both active and passive management. The Treasurer's Office has an internal team of experienced investment professionals selecting multiple equity strategies; selecting the external managers to implement these strategies; and monitoring those external managers on an ongoing basis. As of June 30, 2006, approximately 42 percent of domestic equity assets and 34 percent of non-U.S. equity assets are managed in active strategies by 39 external managers. The combined assets in each of the domestic and the non-U.S. asset classes are monitored under guidelines established within the investment policy statement for each asset class. Each asset class is controlled according to a risk budget framework set by The Regents. The passive/active allocation is controlled subject to both the risk budget and by the opportunities to add value to the benchmark for each asset class.



FIXED INCOME INVESTING

Within the primary goal of maximizing total return over a long-term horizon, the members of the Treasurer's Office Fixed Income Team take an active approach to managing the portfolios, focusing on safety of principal, credit quality, liquidity and efficient use of risk. They start with a "top-down" approach to evaluate the global macroeconomic environment, including analysis of business cycles, monetary and fiscal policies, and political backdrops, in order to assign appropriate sector weights and duration exposure among the three core sectors of Government, Credit and Collateralized bonds. This is coupled with a "bottom-up" approach to individual security selection. Each portfolio manager utilizes a variety of proprietary and industry-developed analytical tools best suited for the particular sector, emphasizing rigorous analysis of such factors as yield curve exposures, portfolio duration and convexity, credit fundamentals, relative value and position weights.

The portfolio managers closely monitor current and prospective investments on a daily basis. New opportunities are identified, and existing positions are adjusted as appropriate. The team, along with representatives from the Risk Management Group, meet monthly to review performance, portfolio exposures and current economic assumptions. Potential new products and strategies are also presented at these sessions before seeking the Treasurer's approval. This combination of rigorous fundamental and quantitative analysis within an active risk management framework has produced a history of successful returns for The Regents' fixed income funds.

The Regents includes inflation-indexed bonds (TIPS) in its overall asset allocation to achieve the objective of maximizing long-term total real returns. The low correlation of TIPS returns with other asset classes also increases portfolio diversification. The Treasurer's Office inflation-indexed bond investment strategy utilizes passive management techniques. The objective of this strategy is to replicate the performance of the U.S. TIPS market.

The fixed income investments also include allocations to emerging markets, U.S. domestic high yield and foreign government bonds. The allocations are intended to improve the risk/reward profile of fixed income and the overall asset allocation. These funds are managed both internally and externally.

The Treasurer's Office also manages the Short Term Investment Pool (STIP) for the benefit of numerous University groups. The STIP portfolio managers participate in the Fixed Income process with the Team as outlined above, but place a greater emphasis on generating current income in the execution of two major mandates.

The first is to insure that the daily liquidity needs of the University are met by investing an appropriate portion of total assets in short-term money market instruments at attractive yields relative to the desired quality. The second is to maximize the interest income paid to participants by investing the remaining funds not required for immediate expenditure in a variety of government and corporate bonds with maturities up to five and one-half years. The maturity restrictions and emphasis on quality assets help minimize the price volatility of the overall portfolio. The STIP has achieved an impressive long-term record of above-market interest income returns.

PRIVATE EQUITY INVESTING

The Regents of the University of California recognize the benefits of including private equity investments as an integral part of the diversified asset pool of the Treasurer's investment program. The long-term strategic objective of the private equity program is to develop and maintain adequate exposure to a select group of buyout and venture capital investments in order to reduce the overall risk of the Regents' portfolio through added diversification and to generate attractive long-term rates of return. Indeed, long term return expectations for private equity as an asset class stand several hundred basis points above public market indices.

The Regents has been a long standing investor in the asset class. The Regents began the private equity program in the 1970's, initially investing directly in a number of private companies and, starting in 1979, emphasizing investments in established west coast venture capital funds which primarily focused on early-stage investments in technology. The Regents' participation in venture capital was based on an early insight into the importance of technology industries to the State of California, the unique position the University holds within the state, and the University's unique contributions to and benefits derived from these industries. As one of the first investors in Silicon Valley, The Regents has formed long-standing relationships with some of the premier venture capital groups and have built a reputation as an active and sophisticated partner. Since 2002, the private equity program has also been diversifying its private equity investment strategy to include buyout funds and select new relationships.

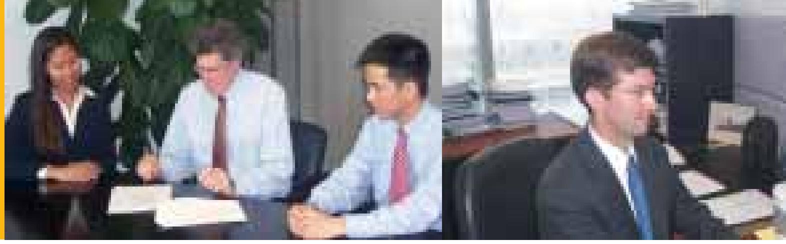
The process of successfully investing in private equity is resource intensive and requires a high degree of specialized expertise. Consequently, The Regents' private equity program continuously strives to incorporate "best-practices" from across the investment world and to attract professionals who contribute a positive impact both on decisions and processes used by the team. In addition, since it is extremely difficult to "time" the private equity market, the private equity team is focused on building a strategically consistent portfolio of select partnerships to generate superior investment performance over long cycles. The team dedicates careful attention to identifying managers with a superior track record in selecting technologies, companies and industries with the highest potential for value creation. In addition to active portfolio management and oversight, the team works with its private equity consultant to review potential investment opportunities on a periodic basis.

ABSOLUTE RETURN INVESTING

The Absolute Return (AR) investments offer risk-return attributes that are not readily available through traditional equity and fixed income investments because they are designed to protect capital and provide positive returns irrespective of overall equity and fixed income market performance. The AR strategies are designed to achieve this by selling instruments short, in addition to positions owned long, to hedge out much of the market risk. AR investments typically have low correlation with other asset classes and increase the overall portfolio diversification and reduce risk. AR includes long/short equity, merger arbitrage, event-driven and other strategies. An AR portfolio might be net long, net short or neutral relative to the underlying investment market. Currently, AR strategies are used in the General Endowment Pool (GEP) solely.

Strategy and manager selection are the important drivers of the Absolute Return allocation. The Treasurer's Office is focusing on a subset of available strategies to achieve diversification benefits and preservation of capital. The Office has also been able to invest with established and accomplished managers, including some that are no longer open to new investors. As of this writing, the target allocation to AR strategies is 15% of the GEP. The Alternative Investments Team works with a consultant that specializes in AR strategies.

Another critical element of the AR program is ongoing monitoring of the investments. Investments typically offer quarterly liquidity, which permits rebalancing toward strategies with a favorable outlook or redeeming from managers



that are no longer suitable investments. The Treasurer's Office has regular contact with the investment managers to review adherence to the expected investment style, personnel turnover, performance and other issues to ensure the appropriate investments and allocations for the program.

REAL ESTATE INVESTING

In May 2003, The Regents approved a 5% allocation to real estate for UCRP and GEP, funded from existing equity and bond allocations. Adding real estate investments to these portfolios is expected to provide long-term risk-adjusted total returns between those of U.S. equities and bonds; diversification benefits given real estate's low correlation with other asset classes; protection against unanticipated inflation; and a high proportion of the total return derived from current income.

The real estate investment program began during fiscal year 2004-2005. The program utilizes a combined public and private market strategy. The dual strategy seeks to reduce risk within the real estate allocation, offers opportunities for increased liquidity and broader diversification (across investments, time and geography) and enables the Treasurer to actively tilt overall real estate exposure toward public or private investments depending on relative valuations.

The public strategy employs the use of external managers who specialize in publicly-traded real estate securities, such as real estate investment trusts (REITs). The private strategy is accomplished through investing in limited liability investment vehicles, such as limited partnerships sponsored by experienced real estate investment firms with demonstrated expertise and superior performance. The Real Estate Investment Team, along with a real estate consultant, reviews and recommends managers of publicly-traded investments and sponsors of private investments, screens investment opportunities, negotiates investment agreements and monitors performance. To date, staff has allocated \$880 million (including \$178.6 million invested to date) to 14 funds and managers expect to fully invest this allocation within the next 18 to 24 months.

RISK MANAGEMENT

Investors perceive risk as the possibility of a loss, which they accept in order to achieve their investment goals. Thus investors accept risk to earn returns. In modern investment theory and practice, risk refers to the inherent uncertainty of outcomes and is measured by the volatility of asset returns. Because risk is an essential aspect of investing, risk management does not eliminate or necessarily reduce risk, but balances risk and expected return. As Benjamin Graham said, "The essence of investment management is the management of risks, not the management of returns."

The primary objective of the Risk Management Team is to ensure that the Treasurer's Office investment and operational activities do not expose the University to potential or unexpected losses beyond The Regents' risk tolerance levels. This process involves three steps: 1) to identify risks and the range of possible losses; 2) to implement policies, guidelines and controls on the investment process to maintain the probability of loss within acceptable limits; and 3) to integrate risk monitoring, measurement, and analysis into all aspects of the investment process.

At the portfolio level, both quantitative and qualitative aspects of risk are monitored or measured to ensure that risk levels are proportional to return expectations, and that risk is taken intentionally and diversified optimally. At the plan level, risk management focuses on the adequacy of assets to pay promised benefits or to support spending policies. Other key components of the risk management process include scenario analysis, stress testing key assumptions, and optimization of risk and expected return. A key element of modern - and traditional - risk management is diversification across asset classes, strategies, and securities.

Risk exposures are continually monitored, compared to targets, and altered when appropriate. Pension plan risk factors include asset volatility, inflation and interest rates. Equity risk factors include economic activity, market risk preferences, style factors (e.g., relative value, capitalization size) and industry membership. Fixed Income risk factors include interest rate volatility, term structure, credit quality, mortgage prepayments, currency and liquidity. Private Equity and Real Estate risk factors include local economic activity, industry fundamentals and business risk. Absolute Return risk factors include the equity and fixed income factors defined above, and the degree to which they are offsetting, hedged or diversified.

Risk measurement is the first step in a process known as risk budgeting (detailed on page 14). Risk budgeting involves two additional steps: 1) determining the overall amount of risk required to meet a given investment objective and 2) budgeting or allocating it in an optimal manner. Optimal use of risk means constructing a fund so that, at the margin, the contribution to expected return of each sector, portfolio, or asset class is proportional to its estimated contribution to risk. This process is being implemented in the Treasurer's Office and integrated into the asset allocation and rebalancing process.

OPERATIONS

Supporting the management of the portfolios is an experienced Operations staff consisting of a Director, Assistant Director, and Supervisor with an average of 18 years experience in banking and/or investment operations and seven analysts with an average of 13 years experience in investment accounting and operations. This unit is responsible for investment accounting and reporting, as well as the central management of all cash services for the University.

In addition to tracking and monitoring all investment security transactions and holdings, the Investment Operations staff verifies and analyzes the returns prepared by the Custodian Bank (State Street Corporation), prepares performance and holdings reports, and provides investment accounting entries for input into the UCOP Endowment and Investment Accounting general ledger.

The management of the portfolios is also supported by state-of-the-art information systems and a well-established custodial relationship with State Street Corporation, a leading industry provider, ensuring sound safekeeping and recording of assets. In addition, State Street Corporation has been the official book of record for the investment portfolios since June 2002. Among other functions, State Street provides independent calculations of the monthly performance data that is reported for the various portfolios and for all of the UC Campus Foundations.

A WORD ABOUT BENCHMARKS

The primary objective of a performance report is to answer the question: what happened to our investments during the last quarter or year? But investors, fiduciaries, and other interested parties should immediately ask two more questions: what happened to our investments *relative to our investment goals* and objectives, and *how much risk was taken* to achieve those returns? Finding meaningful answers to these questions requires the selection of, and comparison of performance to, a diversified basket of similar securities of similar risk known as a *benchmark*.

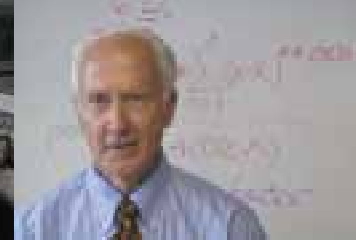
While an investor may state that his or her long-term *goal* is to preserve purchasing power and increase assets by 5% in real terms, an investment *program* is best articulated in terms of an asset allocation. An asset allocation is the formal policy describing investments in terms of broad asset classes. A policy could be as simple as stating the percentage of assets to be invested in equities, fixed income, and cash equivalents, or it could be more detailed, e.g., further segmentation of equity into U.S. stocks, non-U.S. stocks, and private equity.

Once a policy allocation is set, the natural (and best) benchmark is the market index that most closely represents the asset class, such as the Russell 3000 Index for U.S. stocks or the Citigroup Large Pension Fund Index for U.S. bonds. Market indexes are also good benchmarks in that they represent the investor's "opportunity cost," i.e. an institutional investor can earn the index return via a low cost passively managed portfolio.

A policy benchmark for a *fund* can be a blend of indexes, each weighted by the percentage it represents in the asset allocation, e.g., 65% Russell 3000 + 35% Citigroup LPF. Additionally, although targets may be set for the percentages of assets in each category, it is customary to allow for a range around each target, to avoid frequent and costly rebalancing, and to allow for tactical deviations from policy when market conditions warrant (see range example on page 17).

When compared to its policy benchmark, a fund's investment performance reveals at least two things. First, whether the fund added value by allocating assets differently than the policy percentages. And second, whether the investments chosen within each asset class added value over their class benchmarks. This information is referred to as *performance attribution,* and it can be derived for each component of the total fund to understand further where and how value was added.

It is also natural to ask, how did the fund perform relative to those funds of peer institutions? The answer is not so straightforward, mainly because other institutions may utilize asset allocations that differ from their peers' and thus are expected to perform differently. This is especially true in the case of endowments and foundations. Before comparing performance, compare the asset allocation policies and designated benchmarks.

SENIOR MANAGEMENT

MARIE N. BERGGREN, MS

Chief Investment Officer and Vice President for Investments and Acting Treasurer

Ms. Berggren is responsible for overseeing the University of California investment portfolio. Prior to joining the Treasurer's Office in 2002, Ms. Berggren was Executive Vice President/Department Head of Venture Capital Investments for Bank One Corporation. While employed at Bank One and its predecessor organization, First Chicago Corporation, she was the Senior Vice President and Department Head of the Corporation's Mergers and Acquisitions activity. Prior to that she was the Managing Director of Public Equities and Director of Research for First Chicago Investment Advisors (the predecessor to Brinson Partners). Ms. Berggren earned her MS in Management from Stanford University Graduate School of Business and a BA in Economics from the College of New Rochelle.

MELVIN L. STANTON, MBA

The Assistant Treasurer

Mr. Stanton, along with the Treasurer, is responsible for the overall management of the Treasurer's Office. Prior to joining the Treasurer's Office in 1989, Mr. Stanton had more than 13 years experience as a financial executive in portfolio management and securities trading, including Director of Sales for Midland Montagu Securities, Inc., San Francisco; First Vice President and Manager with Crocker National Bank, San Francisco; and Vice President and Regional Sales Manager with Bankers Trust Company, Los Angeles. Mr. Stanton received his MBA and BS degrees from California State University, Northridge.

RANDOLPH E. WEDDING, MBA

Managing Director – Fixed Income Investments

Mr. Wedding is responsible for the strategic focus and management of the long- and short-term fixed-income portfolios. Prior to joining the Treasurer's Office in 1998, Mr. Wedding was Manager of Currency Options and Derivatives Trading for Bank of America, NT&SA, New York; Managing Director, Commodities and Derivative Sales for Bear Stearns & Co., New York; and Principal, Manager of Fixed-Income Derivative Sales for Morgan Stanley & Co., New York. Mr. Wedding began his career with Wells Fargo Bank, responsible for the Bank's Fixed Income Portfolio. Mr. Wedding earned his MBA in Finance from the University of California, Berkeley and BA in Mathematics from the University of California, San Diego.

JESSE L. PHILLIPS, CFA, MBA, MA

Managing Director – Investment Risk Management

Mr. Phillips is responsible for integrating risk monitoring, measurement, and management into all aspects of the investment process. Prior to joining the Treasurer's Office in 2002, Mr. Phillips worked at Northrop Gruman for 11 years, first as Corporate M&A Analyst and then as Manager, Risk Analysis and Research in the Treasury department. Mr. Phillips also worked as Corporate Planning Analyst with Florida Power & Light Company and as Senior Financial Analyst with Storer Communications, Inc., both in Miami Florida. Mr. Phillips earned his BA degree in Mathematics/Economics and MA in Applied Mathematics from the University of California, Los Angeles and his MBA in Finance from the University of Miami. Mr. Phillips is a CPA (Florida) and holds the CFA designation.

ROBERT B. BLAGDEN, MBA

Managing Director – Public Equity Investments

Mr. Blagden is responsible for overseeing all externally managed funds and activities with overall responsibility for executing an investment strategy that generates optimal total return relative to risk taken. Prior to joining the Treasurer's Office in 2003, Mr. Blagden had more than 35 years experience as a financial executive, including most recently serving as Director of Investments overseeing endowment assets of the Ludwig Institute for Cancer Research. Previous to this position, Mr. Blagden served as Managing Director, Public Equity for the Stanford Management Company, when the company was established in 1991. He served as Associate Treasurer in the Treasurer's Office of Stanford University from 1982-1991. Prior corporate planning and finance positions held at Kaiser Cement Corporation between 1968 and 1982 included management of pension and profit sharing assets. Mr. Blagden received his MBA, Finance degree from Stanford University Graduate School of Business and his BA in Statistical Psychology from Dartmouth College.

Alternative Investments "101"

BENEFITS OF ALTERNATIVE INVESTMENTS

Alternative Investments (AI) is a broad label used to describe asset classes and investments other than traditional equity or fixed income. Alternative Investments can include private equity; hedge funds; managed futures and other derivatives; foreign exchange investments; real estate; commodities, including natural resources and agriculture; and art, wine, antiques and other fine collectibles.

AI have become increasingly recognized as an instrument of diversification alongside traditional investments and are now considered to be a necessary investment category for many institutional and private investors.

Research shows that effective reduction of risk in an investment portfolio comes with investing in assets that do not exhibit the same pattern of performance. A low correlation between returns on different asset classes indicates that the performance of those assets is not closely related. Because the performance of AI strategies tends not to be highly correlated with that of traditional equity and fixed income markets, investing in AI can be a means of diversifying a pool of assets and lowering the overall portfolio risk (volatility). Lower portfolio volatility can result in higher risk-adjusted returns—that is, the size of return achieved given the level of risk assumed.

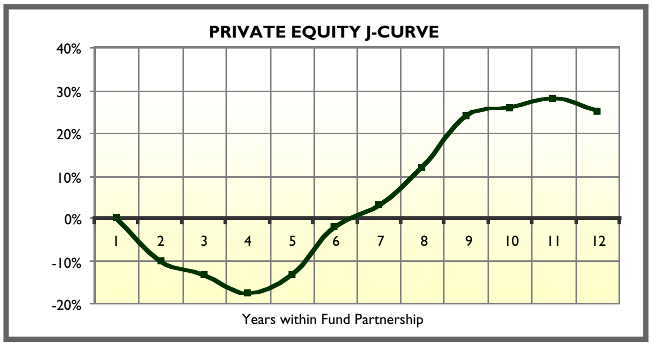
The University of California is among the growing number of institutions that have added Alternative Investments to their portfolios or increased and expanded upon existing allocations. The UC AI portfolio currently includes private equity, hedge funds and real estate.

PRIVATE EQUITY

Google. eBay. Genentech. Cisco Systems. All are examples of successful private equity investments that ultimately resulted in companies with multi-billion dollar valuations. Venture capital is a form of private equity whereby capital is invested into high risk opportunities that may lead to high returns. Venture capital investments are typically companies that have yet to generate revenue, or who wish to accelerate their growth trajectory through the use of capital and strategic advice from venture capital investors, who also act as advisors to their portfolio companies. One of the earliest moments in the history of venture capital dates back to 1959 when General Georges Doriot's American Research and Development Corporation invested $70,000 into a company called Digital Equipment Corporation. Thirteen years later, the $70,000 investment had a market value of $37 million. This example illustrates the long-term nature of the asset class and the potential return on investment.

Other common forms of private equity include growth capital, leveraged buyouts, distressed situations and mezzanine investing. At UC, the private equity program generally invests via commingled funds. Commitments are made to fund managers who, in turn, invest the capital into opportunities where their strategy dictates. While each strategy has different risks and returns, UC takes a programmatic approach to investing by diversifying its commitments across managers based on stage, style, and industry focus. The UC private equity team conducts detailed due diligence on existing and prospective fund managers with potential to deliver attractive risk-adjusted returns over time.

For diversification purposes, private equity firms often invest in a portfolio of companies and structure these investments through a fund partnership or other commingled investment vehicle. It is important to understand that investing in the private equity asset class requires patience and a long-term perspective. For example, in the early years of an investment portfolio, funds will generate low or negative investment returns (due to management fees and any early impairment in the portfolio). However, it is expected that, over five or six years, these investments will mature and increase in value, which should generate positive investment returns for the fund overall. This shift in investment returns is often referred to as the J-curve (chart below). Investment performance is usually measured both on a time-weighted basis (the net internal rate of return) and in terms of the ratio of capital returned to the original capital committed (the investment multiple).



HEDGE FUNDS

Unfortunately, when most people hear the term "hedge funds" they think of Long Term Capital Management, the firm that received a multi-billion dollar bailout to avoid a collapse in the financial markets in 1998. Or, they think of

ALTERNATIVE INVESTMENTS TEAM

Front row left to right: Thomas Lurquin, Private Equity Investment Officer; Marie Berggren, Chief Investment Officer; Gloria Gil, Real Estate Director; and William Chu, Private Equity Investment Officer. ***Back row left to right:*** Elizabeth Agbayani, Executive Assistant; Lynda Choi, Absolute Return Investment Officer; Ruth Welch, Administrative Analyst; Leslie Watson, Analyst; and Rebecca Stafford, Sr. Investment Analyst.

George Soros, the billionaire hedge fund manager who was dubbed "the man who broke the Bank of England" when he sold short more than $10 billion of British Pounds in 1992. Why? Because the media has written thousands of articles about the hedge fund industry and sensationalistic stories are the ones most people remember reading. In fact, most hedge fund managers want to avoid the spotlight, preferring to target consistent returns of 10% to 15% annually. Many have built stable, institutional investment platforms to appeal to endowments, foundations and pension funds. Here is how our office sees hedge funds.

Hedge funds are similar to mutual funds, in that they are pools of assets jointly managed by a portfolio manager who makes investment decisions for the fund. However, unlike mutual funds, hedge funds are structured as private partnerships, which permits them to short securities, use derivatives (like options, futures and swaps), and incur leverage. Access to this wide variety of investment tools enables investment managers to hedge their portfolios and to target attractive returns in up or down markets. Hedge funds generally charge an annual fee of 1% to 2% of assets, plus 10% to 20% of net profits. This performance-based compensation aligns the portfolio managers' incentive with that of fund investors. The great flexibility of hedge fund portfolios and the higher fees that fund managers are able to charge investors has attracted much talent among investment professionals from other industries.

The General Endowment Pool began investing in hedge funds in April 2003. The portfolio is designed to target consistent, positive returns annually, rather than being benchmarked to an equity index. The portfolio should exhibit low volatility and low correlation to bonds, equity and real estate strategies. Selected managers are those that value capital preservation and take calculated risks, not speculative ones. This is why the University of California's hedge fund program is called an "Absolute Return Program."

REAL ESTATE

The real estate industry experienced a significant transformation during the past twenty years, becoming a much more stable and mature asset class. Before the 1990s, limited accurate information existed on property performance or market conditions, even in the United States. Since then, there has been a striking increase in the amount and quality of information available to the investment community about real estate markets worldwide. There is also improved regulatory oversight and discipline in the real estate lending community, which resulted in a more measured pace of development.

These shifts were driven in part by the increased depth of debt and equity markets for real estate, which were far less robust before the 1990s. Market participants demand timely, comprehensive information to permit accurate valuation of potential deals. The real estate investment universe includes the acquisition or development of properties in the various real estate sectors, which include office, industrial, retail, hospitality and residential properties. UC began investing in real estate in October 2004. UC executes its real estate investment strategy through commingled funds run by investment managers specializing in real estate and invests directly in properties or real estate operating companies.

Fund strategies range through a spectrum of risk and return levels and include:

HIGH RETURN FUNDS: Invest in new developments or properties that require major repositioning, redevelopment or financial restructuring. Emphasis on growth in value. Usually structured as private investment vehicles.

ENHANCED FUNDS: Invest in moderately impaired assets with correctable flaws. Emphasis on growth in income and value. Usually structured as private investment vehicles.

CORE FUNDS: Acquire investment grade, income-producing properties that are in good physical condition and have stabilized occupancy levels with creditworthy tenants. Emphasis on stable income and modest value growth. Usually structured as private investment vehicles.

PUBLIC EQUITY FUNDS: Invest in publicly-traded Real Estate Investment Trusts (REITs) and other public real estate companies. Emphasis on stable income and modest value growth. Usually structured as mutual funds.

"In today's competitive investment environment, alternative investments present the opportunity to generate superior risk-adjusted returns for our program."

Marie Berggren, Chief Investment Officer

Risk Budgeting

How Risk Budgeting is used in the Office of the Treasurer of The Regents of the University of California

Six years ago, the former Regents' consultant proposed, and the Regents adopted, a new investment policy for the pension plan and General Endowment Pool. Among other things, this policy included a simple *risk control* for US Equity: a requirement that 30% of the equity allocation be managed passively.

In 2004, the new consultant proposed, and the Regents adopted, a different approach to *risk management* that was *not* based on percentage limits. A simple example can illustrate the benefits of the new approach. Suppose we constrain the percentage of capital allocated to active strategies: how much risk do we actually end up with? The answer is: it depends. Suppose we hire only traditional, concentrated, fundamental managers. We will certainly have higher risk than if we hire enhanced indexed managers. Rather than ask 'how much active management do we want?' a better question is: 'how much active risk do we want?'

At this point, one might ask, why do we want any risk[1] at all? We use the term "active risk" as a measure of how "different" the portfolio is from the benchmark. To be precise, it is a measure of the likely range of active returns around the benchmark. Active risk results from any difference in the individual securities and weighting of securities between a portfolio and benchmark, for example, over- or under-weighting securities, industries, sectors, countries, regions, currencies, styles, capitalization size, etc.

Of course, portfolio managers take active risk – i.e., they have exposures different than the benchmark – to earn positive active returns. And all else equal, expected active return is a function of active risk (the size of the differences). Thus risk (difference from benchmark) is the "input" to the investment process, and should be carefully measured and managed. If we can measure, in some sense, the potential return impact of each of these decisions, then we can begin to manage risk. In addition, if we understand how much risk is contributed by different parts of a portfolio, we can build a better diversified portfolio.

Now, managing investments has always been about managing risk, and this has traditionally been done by investment guidelines and constraints. For example, there may be limits on individual security weights, or the absolute weight of a sector, or a limit on non-core investment in "risky" sectors, such as high yield bonds or emerging market stocks. Why is this approach inefficient? These constraints help us *limit* risk (they are crude, but sometimes effective, risk controls). But they do not help us to *manage* risk. When we apply these constraints, we can't be sure how much risk we will have – any more than we know how much risk results from a 50% allocation to active strategies. Do we have too much or too little risk? The latter could be as much of a problem as the former if the risk we take is not commensurate with our expectations for higher returns.

In addition, constraints don't account for the actual contribution to risk of different positions, nor do they account for volatility, correlations, or implicit hedges. Most importantly, constraints cannot be combined or traded off against each other.

Instead of trying to control or limit risk through constraints, why not manage our exposures to the underlying risk factors directly? The size of a position is only one of the determinants of risk, the other two being the volatility of the risk factors and their correlation with each other. In order to measure and budget risk, we use a common framework and

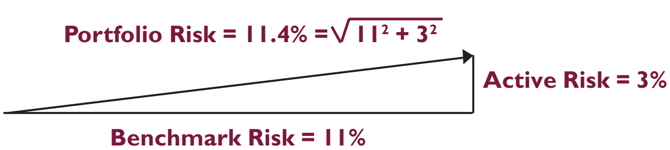
1. Active risk (also called Tracking Error) is defined as the volatility of active returns (active return is the difference between the portfolio and benchmark return).
2. The Regents' Investment Policy contains a risk budget for each marketable asset class. These budgets are derived from a combination of return expectations and opportunities for active management.

uniform metric to evaluate all active decisions. We use industry standard statistical models to provide the information that allows us to trade off one type of risk for another, based on our expectation for return.

For example, by examining simulated portfolios, we can determine that being underweight in duration by one year translates into twice the tracking error of a two percent allocation to high yield bonds, or that an overweight in technology stocks of one percent adds twice the volatility as an equal overweight in financial stocks (values are for illustrative purposes only).

The active risk budget for the UCRP is 3% annualized tracking error. An interpretation of this level is that in every 2 out of 3 years, the expected active return will be within +/-3% of the performance benchmark. This level of active risk is consistent with: the historical volatility of UCRP; other pension plans' active risk; reasonable budgets for the risk of the asset classes[2] which comprise the fund; and the investment objectives of the fund (modest value added). This budget for risk allows flexibility in allocating risk across a multitude of investment decisions, from over or under weighting different asset classes, tilting the portfolio to various equity styles or sectors, and choosing individual managers who will themselves allocate risk across their portfolios. The active risk budget for the GEP is higher, at 4.5% tracking error, as its investment objectives are correspondingly higher.

It is important to remember that, because risk measures do not "add," this level of active risk adds only a negligible amount of total volatility to the fund (that is, over benchmark volatility). Risk measures add when squared, and actually are similar to the Pythagorean theorem illustrated below. With benchmark volatility of about 11%, an active risk budget of 3% results in portfolio volatility of 11.4%: only 40 basis points additional volatility.



In summary, we manage active risk by setting a budget for risk (the investment "plan"). All organizations set budgets for key inputs and expenses and in investment firms, the inputs are people, ideas, and willingness to take risk. Then we measure risk and compare realized risk to our budgets (plan).

After measuring, we analyze the variance between plan and actual, and recommend changes if needed. Just as performance attribution is essential to highlight those decisions which added to - or subtracted from - portfolio value, so risk attribution indicates the risk contribution by various elements in the portfolio. By linking expected return to risk, we can use risk more efficiently and ensure that our risk exposures are intentional and that the expected return is commensurate with the risk. This is the essence of the process now being implemented in the Treasurer's Office.

"The great investor
Benjamin Graham said,
'The essence of investing is the
management of risk,
not the management of return.'
The tools of modern
investment management,
including the risk budgeting process,
help us focus our decision making
on those strategies which have
the best risk-adjusted expected returns."

Marie Berggren, Chief Investment Officer

General Endowment Pool (GEP)

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 4,350 individual endowments that support the University's mission. GEP is a balanced portfolio of equities, fixed-income securities and alternative investments in which all endowment funds participate, unless payout needs require otherwise.

GENERAL ENDOWMENT POOL (GEP)
Summary of Investments[1]
($ in thousands)

	June 30, 2006		June 30, 2005	
GENERAL ENDOWMENT POOL	Market Value	% of Pool	Market Value	% of Pool
EQUITIES				
U.S. Equity	$ 2,115,884	36.8%	$ 2,115,168	40.6%
Non-U.S. Equity-Developed	$ 1,239,797	21.6%	$ 995,696	19.1%
Non-U.S. Equity-Emerging Market	$ 295,032	5.1%	$ 224,406	4.3%
TOTAL EQUITIES	$ 3,650,713	63.5%	$ 3,335,270	64.0%
FIXED-INCOME SECURITIES				
Bonds	$ 1,024,630	17.8%	$ 1,033,084	19.8%
TIPS	$ 246,381	4.3%	$ 256,982	4.9%
TOTAL FIXED-INCOME SECURITIES	$ 1,271,011	22.1%	$ 1,290,066	24.7%
ALTERNATIVE ASSETS				
Private Equity	$ 206,256	3.6%	$ 118,291	2.3%
Absolute Return	$ 518,693	9.0%	$ 450,368	8.6%
Real Estate	$ 90,958	1.6%	$ 6,920	0.1%
TOTAL ALTERNATIVES	$ 815,907	14.2%	$ 575,579	11.0%
LIQUIDITY PORTFOLIO	$ 9,849	0.2%	$ 9,288	0.2%
TOTAL GENERAL ENDOWMENT POOL	$ 5,747,480	100.0%	$ 5,210,203	100.0%
OTHER ENDOWMENT FUNDS	$ 533,450		$ 518,342	
TOTAL GEP AND OTHER ENDOWMENT FUNDS	$ 6,280,930		$ 5,728,545	

The June 30, 2006 market value of GEP was $5.7 billion, or $20.81 per share, versus $5.2 billion, or $19.09 per share, at the end of fiscal 2005. Total GEP net investment income for the year was $130.3 million, or $0.48 per share, versus $127.6 million, or $0.47 per share, for fiscal 2005. In addition, $77.8 million was withdrawn to fund the Total Return Payout.

SPENDING POLICY

The Regents adopted a total return investment philosophy aimed at achieving real asset growth in order to generate growing annual payouts to support donors' designated programs. In October 1998, The Regents adopted a long-term spending rate range of 4.35% to 4.75% of a 60-month (5-year) moving average of GEP's market value. The Regents reviews 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. In May 2005, The Regents adopted a rate of 4.65% for expenditure in the 2005-2006 fiscal year.

INVESTMENT OBJECTIVE

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

The primary goal for GEP is to ensure that future funding for endowment-supported activities be maintained both by generating a growing payout stream and by growth of principal.

[1] For fiscal 2006 and fiscal 2005, 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.

GENERAL ENDOWMENT POOL (GEP) POLICY ASSET ALLOCATION

as of June 30

	2002	2003	2004	2005	2006
MARKET VALUE (in millions)	$4,199	$4,385	$4,782	$5,210	$5,747
ANNUAL TOTAL RETURN	(9.51)%	5.36%	14.65%	10.31%	11.54%
ANNUAL TOTAL RISK[1]	8.72	12.51	5.79	6.23	6.22
ASSET ALLOCATION:					
PUBLIC EQUITY	59.79%	63.76%	65.66%	64.01%	63.52%
PUBLIC FIXED INCOME	36.28	30.86	26.63	24.76	22.11
ALL ALTERNATIVES	3.40	4.71	7.39	11.05	14.20
LIQUIDITY	0.53	0.67	0.32	0.18	0.17

INVESTMENT STRATEGY

In order to continue to achieve these investment objectives, The Regents adopted the following asset allocation policy in March 2005[2]:

Asset Class	Current Policy	Min.	Max.
Public Equity	63%	47%	73%
Public Fixed Income	25%	13%	35%
All Alternatives*	12%	2%	30%
Liquidity	0%	0%	10%

*including, but not limited to: Real Estate, Private Equity, and Absolute Return Strategies

The asset allocation benchmarks and portfolio guidelines are designed to manage risk and ensure portfolio diversification. The benchmarks for the individual asset classes are: Russell 3000 Tobacco Free (TF) Index for U.S. Equity; MSCI World Index ex-U.S. TF (Net) Index for Non-U.S. Equity-Developed Markets; MSCI Emerging Markets (Net) Index for Non-U.S. Equity-Emerging Markets; Lehman Aggregate Index for Fixed Income; Lehman TIPS Index for TIPS; 91-Day Treasury Bill + 2% for Absolute Return; and NCREIF Property Index for Private Real Estate and the Dow Jones-Wilshire REIT Index for Public Real Estate. The total fund benchmark is a policy-weighted average of the individual asset class benchmarks.

The Regents' Public Equity investment strategy utilizes both active and passive management. The Treasurer's Office has an internal team of experienced investment professionals selecting multiple equity strategies; selecting the external managers to implement these strategies; and monitoring those external managers on an ongoing basis. As of June 30, 2006, approximately 44 percent of domestic equity assets and 48 percent of non-U.S. equity assets are managed in active strategies by 39 external managers. The combined assets in each of the domestic and the non-U.S. asset classes are monitored under guidelines established within the investment policy statement for each asset class. Each asset class is controlled according to a risk budget framework set by The Regents. The passive/active allocation is controlled subject to both the risk budget and by the opportunities to add value to the benchmark for each asset class.

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.

For TIPS, the Treasurer's Office seeks to maximize long-term total real returns and increase portfolio diversification, given TIPS' low correlation with other asset classes.

For Absolute Return, investments include long/short equity, arbitrage, event-driven and other strategies.

For Real Estate, the Treasurer's Office seeks investments which provide long-term risk-adjusted total returns between those of U.S. equities and bonds; diversification benefits given real estate's low correlation with other asset classes; protection against unanticipated inflation; and a high proportion of the total return derived from current income. The Real Estate program began implementation in fiscal year 2004-2005.

[1] Annual Total Risk is defined as the standard deviation of monthly total return over the 12 month period ended June 30.

[2] See "Message from the Chief Investment Officer" (pages 4-5) for information on revised allocation approved by The Regents in September 2005.

RETURNS

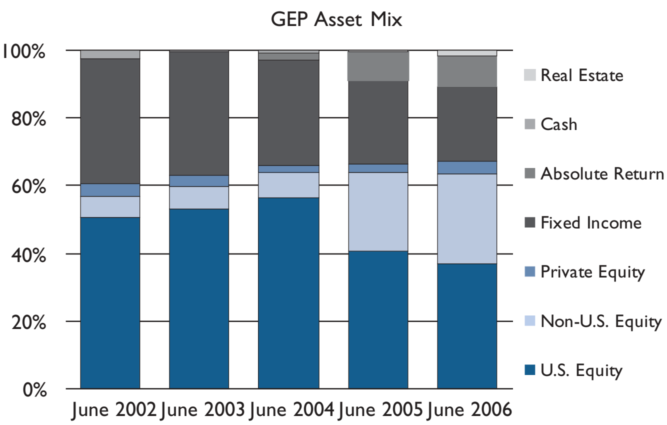
Throughout the years, GEP has exceeded its fund objectives. As illustrated in the table on page 19, GEP has consistently performed well vs. its policy benchmarks.

GEP returned 11.57% for the fiscal year. For the past 10 years, GEP's compound annual total return was a strong 9.63% vs. 9.39% for its benchmark. During that time, payout distributions grew at an average annual rate of 8.4%—well above annualized inflation of 2.6%.

The cumulative Total Returns Chart below illustrates the returns for GEP for the past 10 years relative to the policy benchmark and inflation.

ASSET MIX

The following represents GEP's asset mix as of each of the past five fiscal year ends.



EQUITY INVESTMENTS

The equity portion of GEP consists of U.S. and Non-U.S. common stocks. Total equities represented 63.5% of GEP at year-end, with a market value of $3.6 billion.

U.S. Equity represented 36.8% of the fund at year-end, with a market value of $2.1 billion. GEP's U.S. Equity assets returned 9.33% for the fiscal year and 7.61% for the 10-year period.

Total Non-U.S. equity represented 26.7% of GEP at year-end with a market value of $1.5 billion. Non-U.S. Equity-Developed Markets represented 21.6% with a market value of $1.2 billion and Non-U.S. Equity-Emerging Markets represented 5.1% with a market value of $295 million. GEP's Non-U.S. Equities-Developed Markets gained 26.53% and Non-U.S. Equity-Emerging Markets gained 34.83% in the fiscal year. The longer-term returns for this asset class represent the emerging markets funds only, so comparisons are not yet meaningful.

ALTERNATIVE INVESTMENTS

Private Equity represented 3.6% of GEP at year-end with a market value of $206 million. GEP returns for this asset class in the fiscal year were 10.02%. Over the long term, GEP's private equity returns have been an important contributor to total fund return.

Absolute Return represented 9.0% of GEP at year-end and returned 10.92% in the fiscal year, strongly outperforming the benchmark return of 6.68%.

Real Estate represented 1.6% of GEP at year-end and returned 19.85% in the fiscal year, below the benchmark return of 20.19%.

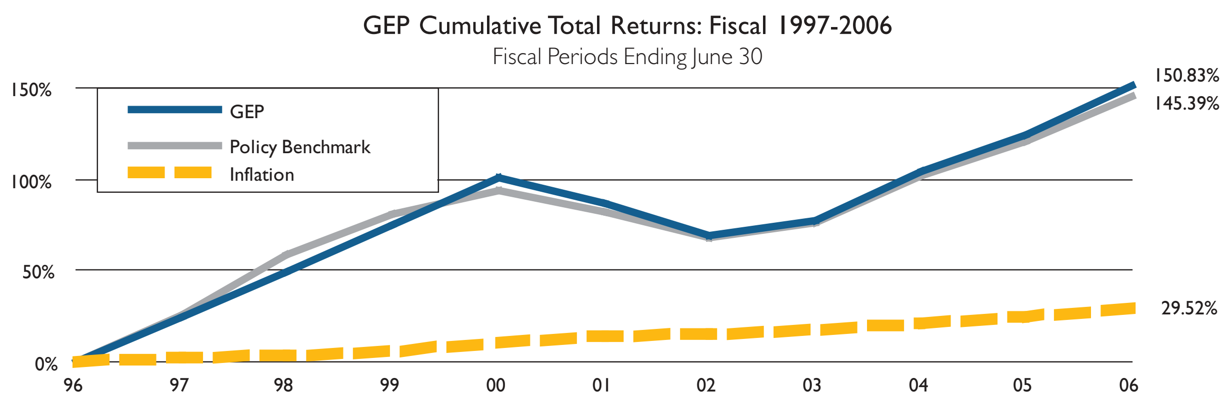
FIXED-INCOME INVESTMENTS

At year-end, Fixed Income constituted 22.1% of the portfolio, with a market value of $1.3 billion.

GEP's fixed-income investments returned (1.16)% during the year, outperforming the benchmark return of (1.64)%. GEP's fixed income return of 8.35% for the 10-year period exceeded the benchmark returns of 7.40%.

GEP's TIPS, represented 4.3% of total assets on June 30, 2006.

The weighted average maturity of the bond portfolio at year-end was approximately 9 years, the average duration 4.8 years, and the average credit quality was AA, with more than 86% of fixed-income securities rated A or higher.



GEP ANNUALIZED TOTAL RETURNS[1] VERSUS BENCHMARKS AND INFLATION

June 30, 2006

	1-Year	5-Year	10-Year	10-Year Cumulative	Benchmark Description[2]
TOTAL FUND					
GEP	11.57%	6.11%	9.63%	150.83%	Total Fund Policy Benchmark: A blend of the indexes described in detail below, each weighted by the percentage it represents in the asset allocation. Adjustments have been made to reflect that the actual investment in Private Equity and Real Estate are below policy weights. Annual index returns assume monthly rebalancing.
Policy Benchmark	11.04	6.18	9.39	145.39	
Inflation	4.32	2.65	2.62	29.52	Inflation: Consumer Price Index.
U.S. EQUITY					
GEP	9.33%	2.27%	7.61%	108.20%	U.S. Equity Policy Benchmark: Russell 3000 TF Index; Historical: S&P 500 Index.
Policy Benchmark	9.44	3.41	8.90	134.54	
NON-U.S. EQUITY-DEVELOPED					
GEP	26.53%	10.27%	N/A	N/A	Non-U.S. Policy Benchmark: MSCI World ex US (Net) Index.
Policy Benchmark	26.88	10.40	N/A	N/A	
NON-U.S. EQUITY-EMERGING MARKET					
GEP	34.83%	19.86%	8.89%	134.31%	Non-U.S. Policy Benchmark: MSCI Emerging Markets (Net) Index.
Policy Benchmark	35.47	21.30	6.55	88.65	
FIXED INCOME					
GEP	(1.16)%	6.77%	8.35%	122.99%	Fixed Income Policy Benchmark: Lehman Aggregate Bond Index. Historical: Citigroup LPF; LB LT G/C Index.
Policy Benchmark	(1.64)	6.37	7.40	104.26	
TIPS					
GEP	(1.58)%	N/A	N/A	N/A	TIPS Policy Benchmark: Lehman TIPS Index.
Policy Benchmark	(1.64)	N/A	N/A	N/A	
PRIVATE EQUITY[3]					
GEP	10.02%	7.05%	24.91%	824.65%	
ABSOLUTE RETURN					
GEP	10.92%	N/A	N/A	N/A	Absolute Return Policy Benchmark: 91-Day TBills + 2%.
Policy Benchmark	6.68	N/A	N/A	N/A	
REAL ESTATE					
GEP	19.85%	N/A	N/A	N/A	Real Estate Policy Benchmark: NCREIF Property Index (private real estate): Dow Jones-Wilshire REIT Index (public real estate).
Policy Benchmark	20.19	N/A	N/A	N/A	

[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 0.09% 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 State Street Bank, 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 CFA Institute's standards, which require time-weighted rates of return using realized and unrealized gains plus income. Performance calculations are reconciled by the Treasurer's Office.

[2] Historical benchmark information is available online at http://www.ucop.edu/treasurer/invinfo/Benchmarks.html.

[3] From July 2004 through December 2004 the Private Equity Benchmark was the Russell 3000 TF Index +3% (lagged by three months). Beginning January 2005 the Benchmark is the actual performance.

ASSET DESIGNATION BY CAMPUS AND PURPOSE

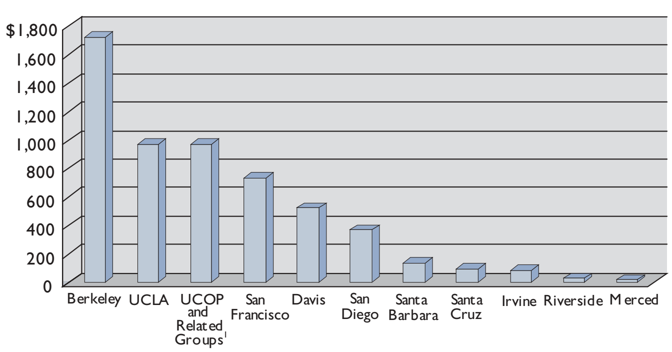
A donor has two avenues for making a gift to or establishing an endowment at the University: directly to The Regents for a specific campus and/or purpose or directly to a campus through its Foundation. The campus foundation trustees have discretion in their choice of investment managers and may use the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

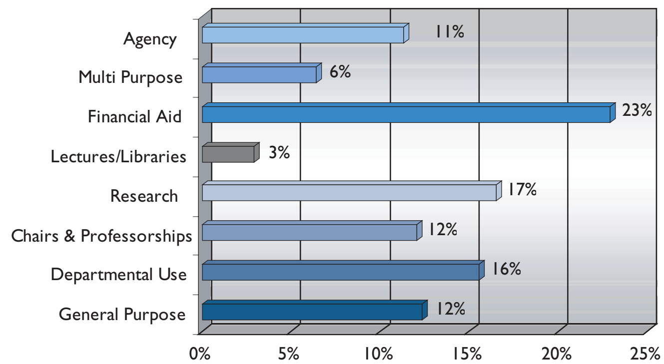
Fundraising efforts provide critically needed monies to support the goals of the University. As illustrated by the chart at the right, more than half of GEP's assets support financial aid (23%), research (17%) and departmental use (16%).

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.

GEP Assets Designated by Campus
(in millions)
June 30, 2006



GEP Assets Designated by Purpose
June 30, 2006



HIGH INCOME POOL (HIP)

The High Income Pool (HIP) was established in May 1987 to accommodate endowments and deferred gift giving programs with high contractual payout obligations. Although The Regents' adopted a total return spending policy for The General Endowment Pool (GEP) in 1998, the income only spending policy was maintained for HIP. As the campus foundations have adopted a total return spending policy, they have moved most of their assets out of HIP into GEP. The GEP is The Regents' primary investment vehicle for endowed gift funds. As of June 30, 2006, $56 million is invested in HIP. The HIP assets are reported as part of "Other Endowment Funds" market value (see GEP Summary of Investments table on page 16).

SEPARATELY MANAGED ENDOWMENT FUNDS

At June 30, 2006, The Regents had $311 million invested in separately managed endowment funds (including approximately $217 million where The Regents is the beneficiary, but not the trustee). 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).

[1] UCOP = UCOP-administered programs and multi-campus gifts.



CHARITABLE ASSET MANAGEMENT POOLS

The Charitable Asset Management (CAM) Pools are used by The Regents of the University of California and the Campus Foundations for the investment of split-interest gifts, including charitable remainder trusts, pooled income funds and charitable gift annuities. The investment of these funds is directed by the Treasurer of The Regents; the administration of these funds is handled by the Charitable Asset Management group of State Street Global Advisors, Boston and San Francisco. The pools were created in November 2003.

INVESTMENT OBJECTIVES

The CAM Russell 3000 TF Index Pool seeks to provide investment results that correspond to the total return (i.e. the combination of price changes and income) performance of a broad base of stocks publicly traded in the United States. The CAM EAFE International TF Index Pool seeks to provide investment results that correspond to the total return performance of Non-U.S. developed country stocks. The CAM Fixed Income Pool seeks to outperform the Lehman Aggregate Index and consistently have higher current income. The Funds' policy benchmarks are the Russell 3000 TF Index, MSCI EAFE + Canada TF Index and the Lehman Aggregate Index, respectively.

RETURNS

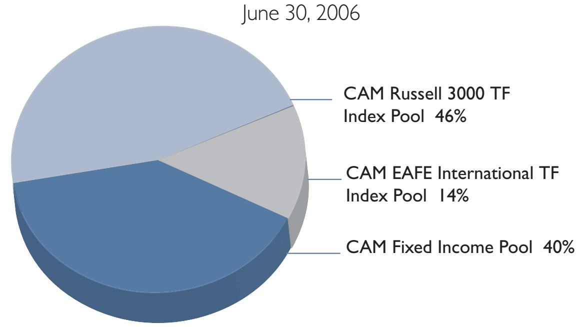
1-year performance ending June 30, 2006 follows:

Fund/Policy Benchmark	Return
CAM Russell 3000 TF Index Pool	9.48%
Russell 3000 TF Index	9.44%
CAM EAFE International TF Index Pool	27.32%
MSCI EAFE + Canada TF Index	26.88%
CAM Fixed Income Pool	(0.49)%
Lehman Aggregate Index	(0.81)%

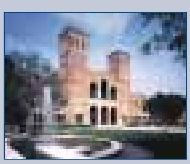
At fiscal year end CAM assets totaled $130 million, with CAM Russell 3000 Tobacco Free (TF) Index Pool's market value at $60 million, The CAM EAFE International TF Index Pool's market value at $18 million, and the CAM Fixed Income Pool's market value at $52 million.

Total CAM Assets by Pool

June 30, 2006



WAYS OF GIVING TO THE UNIVERSITY



CHARITABLE REMAINDER UNITRUST

This trust pays the income beneficiary a percentage (at least 5%) of its net asset value each year. The trust is revalued annually. An income tax charitable deduction is allowed for the value of the remainder interest of the trust. Minimum gift is $100,000; additional contributions are accepted at anytime.

CHARITABLE REMAINDER ANNUITY TRUST

This plan pays a fixed amount (at least 5% of initial value of transferred property) to the donor or designated beneficiary for life. A charitable contribution deduction is allowed for the value of the trust's remainder interest. Minimum gift is $100,000; additional contributions are not accepted.

CHARITABLE GIFT ANNUITY

This annuity plan pays a fixed annuity for the life of the income beneficiary. The rate is based on the age of the income beneficiary on the date of gift, and part of each payment is usually tax-exempt. The amount of the charitable contribution deduction is basically the difference between the value of the gift and the value of the annuity. Minimum gift of $10,000.

DEFERRED PAYMENT GIFT ANNUITY

This plan pays a fixed amount, but the first payment is deferred for a year or more from the date of gift--usually timed to coincide with retirement or other plans. The donor is able to make gift now and use the income tax charitable deduction while in a higher tax bracket, deferring annuity payments until the income is needed more. Each payment may be tax-free depending on the donor's life expectancy and appreciation in gift assets. The charitable contribution is face value of the gift less actuarial value of the deferred annuity. Minimum donation is $10,000.

POOLED INCOME FUNDS

These funds are donations from many donors, combined for investment purposes. There are two pooled income funds operated by the The Regents and are open to donors to any campus or university program. These funds pay the donor or designated beneficiary a pro rata share of the particular pool's earnings each year for life. Income is taxed as ordinary income and a charitable deduction is allowed for the value of the remainder interest. Minimum gift is $5,000; additional contributions of $1,000 or more are accepted.

LIFE INCOME OPTIONS WITH APPRECIATED SECURITIES

Donors to charitable remainder trusts and pooled income funds may make gifts using appreciated property without having to incur capital gains taxes. The trust can sell those assets and purchase other higher yielding assets, also without capital gains taxes. Capital gains on donations to gift annuities are usually distributed over the annuitant's life expectancy.

Additional information on giving to the University is available at http://www.universityofcalifornia.edu/giving/welcome.html.

UC DAVIS MEDICAL INVESTIGATION OF NEURODEVELOPMENTAL DISORDERS (M.I.N.D.) INSTITUTE - PARENT INSPIRED, SCIENCE DRIVEN

The University of California at Davis Health System is home to a major initiative in the pursuit of early diagnosis, preventions, treatments and cures for neurodevelopmental disorders such as autism. In 1998, dedicated families concerned about autism turned their hope for answers into a house of dreams — the UC Davis M.I.N.D. (Medical Investigation of Neurodevelopmental Disorders) Institute. Since that time, the Institute has transformed its initial inspiration into significant contributions to the science of autism, fragile X syndrome, learning disabilities and other neurodevelopmental disorders that can limit a child's lifelong potential.

Autism is a neurodevelopmental disorder — meaning that it is something that goes wrong during the growth of the brain — and usually appears by age three. Autism has no cure. Children express their symptoms in varied ways and in varying degrees. The common denominators are that they all have trouble communicating meaningfully with others, have difficulty forming social relationships and are often preoccupied with a narrowly-focused range of activities like rocking or continuously repeating words or expressions.

Autism affects approximately 1 in 166 children in our nation. The prevalence of autism, including the full range of diagnoses identified as autism spectrum disorders, is rising at an alarming rate. The California Department of Developmental Services reports that autism cases have increased four-fold over the past decade. According to the California Department of Education, between 1992-2003 and 2002-2003, there was ten-fold growth in the number of children with autism enrolled in California schools. While the reason for this increase is not yet known, it is unlikely that such a phenomenal rise can be solely explained by improved or changed diagnostic practices.

The M.I.N.D. Institute is an international, multidisciplinary research organization committed to understanding the causes, development of better treatments and ultimately cures for neurodevelopmental disorders. At the Institute, a collaboration of families, scientists, physicians, educators and clinicians work to unlock the mysteries of the mind. The Institute attracts the world's leading scientists in the areas of neurophysiology, molecular biology, immunology, epidemiology, psychology and developmental pediatrics. Together, they utilize advanced biomedical technology and the research infrastructure of the University of California, Davis, to make daily lives easier and find long-term answers for those affected by neurodevelopmental disorders.

The M.I.N.D. Institute's unique multidisciplinary approach is already achieving significant outcomes. Research teams are identifying:

- Key differences in the immune systems of children with autism
- Biological and behavioral markers of autism that can lead to earlier detection and targeted interventions
- New medical guidelines for screening patients for fragile X syndrome – the most common cause of inherited mental impairment
- Interactions among genetic susceptibility, environmental exposures and neurodevelopment
- The neural structures and connective patterns that underlie cognitive functions
- New treatments that reduce or eliminate challenges for children with neurodevelopmental disorders

In 2006, M.I.N.D. Institute autism researchers published two major findings. One connected the mercury-based preservative thimerosal with disruptions in antigen-presenting cells known as dendritic cells obtained from mice. This research provided the first evidence that dendritic cells show unprecedented sensitivity to thimerosal, leaving the immune system vulnerable to external influences.

Another study revealed that the brains of males with autism have fewer neurons in the amygdala. This was the first neuroanatomical study to quantify a key difference in the part of the brain responsible for emotion and memory and to help narrow the search for where autism exists.

The Institute is also currently funding two on-going, large-scale, long-term research projects. The Autism Phenome Project is a longitudinal study that will eventually involve 1,800 children – 900 with autism, 450 with developmental delay and 450 who are typically developing. All participants undergo thorough medical evaluations in addition to analyses of their immune systems, brain structures and functions, genetics, environmental exposures and blood proteins. The outcomes will identify the distinct biological and behavioral patterns that define subtypes of the disorder.

The house that collaboration built:
The M.I.N.D. Institute UC Davis Health System
Established 1998

Another project – CHARGE (Childhood Autism Risks from Genetics and the Environment) – is a study of 1,000 to 2,000 children with autism, children with developmental delay or learning disability (but not autism) and typically developing children. The goal is to find out how genes and the environment interact and contribute to differing patterns of development. All participants are evaluated for a broad array of exposures and types of susceptibility.

Both of these comprehensive initiatives will shorten the time it takes to discover causes of autism, identify prevention strategies and develop maximally effective treatments.

As with most research programs, the costs are great and resources are limited. Funding is critical to the Institute's stability and for enhancing and leveraging research and clinical capabilities. The Institute received original donations totaling more than $9.6 million to help kick-off financing for endowed chairs, research and clinical programs. At June 30, 2006, the Treasurer's Office managed assets in excess of $10.5 million for the M.I.N.D. Institute, held within the General Endowment Pool (GEP) and other smaller endowment funds.

UC Davis faculty associated with the M.I.N.D. Institute research program currently receive $19 million in funding from the National Institutes of Health, other government sources and private donors. However, projected funding to fully execute just one comprehensive autism research project such as the Autism Phenome Project exceeds $30 million for 10 years. In addition to the financial costs to fund research programs and the overwhelming emotional and social costs of caring for a child with autism, educational interventions for dealing with social and learning issues can cost school districts up to $100,000 per child for one year, depending on the need.

Since its founding, endowments have helped support the meaningful work accomplished at the UC Davis M.I.N.D. Institute. These endowments also help the Institute continue to increase international collaboration in neurodevelopmental research and share its research and clinical findings with a worldwide community of autism scientists. Ultimately, the institute's leaders aim to build a special school on the Institute's grounds in order to bring their groundbreaking research into K-12 classrooms.

For families of children with autism the Institute represents hope. The Institute is founded on the belief that collaboration works, and that has proven to be true. Revolutionary programs in the study of neurodevelopmental disorders have positioned the M.I.N.D. Institute and UC Davis as leaders in modern scientific discovery. The Institute's impact is felt globally, affecting millions of individuals worldwide. And for the 1 in 20 Americans who struggle with neurodevelopmental disorders, the work of the M.I.N.D. Institute is truly much more than "science-as-usual."

"The smart investment is on hope. And hope is at the M.I.N.D. Institute."

The M.I.N.D. Institute is the only institution where scientists, clinicians, educators, parents and even community volunteers work together to fight neurodevelopmental disorders.

We wish to acknowledge the help of the UC Davis M.I.N.D. Institute. For more information on The M.I.N.D. Institute visit their website at http://www.ucdmc.ucdavis.edu/mindinstitute/.

Short Term Investment Pool (STIP)

The Short Term Investment Pool (STIP) is a cash investment pool established in fiscal 1976 by The Regents and is available to all University fund groups, including retirement and endowment funds as well as campus foundations. The STIP allows fund participants to maximize 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. The 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, pension, endowment, and defined contribution funds awaiting permanent investment are invested in the STIP to earn maximum daily interest until transferred.

INVESTMENT OBJECTIVE

The STIP's investment objective is to maximize returns consistent with safety of principal, liquidity and cash-flow requirements. The STIP's investments include a broad spectrum of high-quality money-market and fixed-income instruments with a maximum maturity of five- and a half 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 the 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.

RETURNS

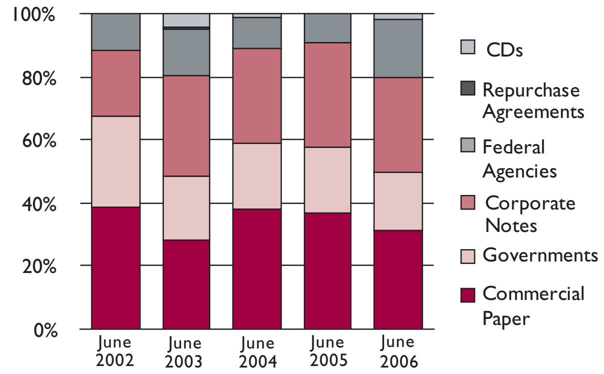
The STIP has achieved very attractive returns over the years. During the past 10 years, the average income return on the STIP was 5.07%, compared to 4.28% for 2-Year U.S. Treasury Note income return. For fiscal 2006, the STIP's income return of 4.20% trailed the 2-Year U.S. Treasury Note income return of 4.35%.

During the year, the STIP continued to provide liquidity to facilitate asset class rebalancing, in-flows and out-flows associated with University financing and other material liquidity events. During this period, selective high quality credit spread products were added to enhance the portfolio's yield. The average maturity of the portfolio was shortened as the yield curve continued to flatten and eventually inverted in the second half of the fiscal year.

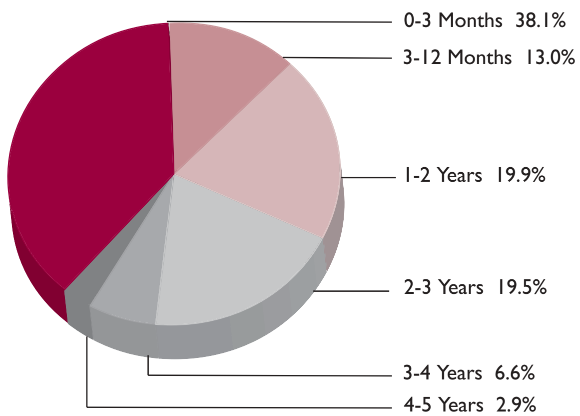
ASSET MIX

The STIP totaled $8.0 billion at June 30, 2006, compared to $7.4 billion at the end of fiscal 2005. The STIP's asset mix at each of the past five fiscal year-ends and maturity distribution and quality mix as of June 30, 2006 follow.

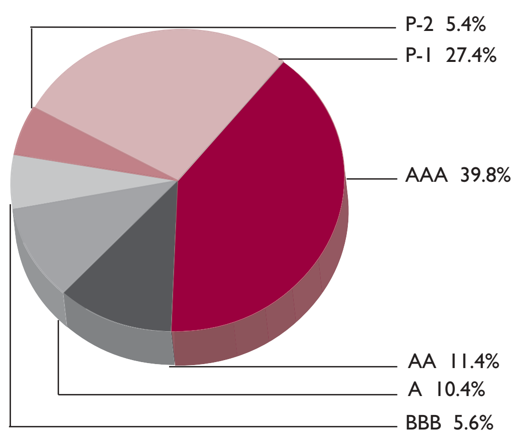
STIP Asset Mix



STIP Maturity Distribution
June 30, 2006 Average Maturity = 1.2 years



STIP Quality Mix
June 30, 2006 Average Quality = AA
(BBB and higher = investment grade)



CHOOSING TO UTILIZE UC-MANAGED POOLS

As of June 30, 2006, the Treasurer's Office manages $938 million for the campus foundations and support groups. A donor has two avenues for making a gift to or establishing an endowment at the University of California: 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 Treasurer's Office has worked with the UC San Diego Foundation since 1989, helping it manage the campus' private assets to promote and advance the university's mission.

Photograph by Erik Matwijkow, UCSD Biomedical Library.

"The UC Treasurer's Office works closely with our foundation to help the campus community meet its financial obligations. The Treasurer's Office staff is experienced and knowledgeable and offers expert insight on investment products and services tailored to our campus' needs such as the Vintage Fund. More importantly, the Treasurer's Office is sensitive to the campus-donor relationship and its impact on a university. By understanding this relationship they bring a unique perspective to managing endowment assets. We recognize the value of the investment products available to us and the special partnership we have developed. Most of all, we acknowledge the Office's continuous effort at improving the cost-effective investment programs we have benefited from over the years".

John A. Woods
Interim Vice Chancellor, External Relations
University of California, San Diego

STIP ANNUALIZED INCOME RETURN[1]

June 30, 2006

	1-Year	5-Year	10-Year	10-Year Cumulative
STIP[1]	4.20%	4.01%	5.07%	64.02%
2-Yr U.S. Treasury Note Inc.	4.35	2.86	4.28	52.06
Inflation[2]	4.32	2.65	2.62	29.52

[1] STIP's returns are net of (after) investment management costs and administrative expenses (1.5% of average annual income for the fiscal year) which are automatically deducted from income.

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

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 $246.5 million at June 30, 2006 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 University's Commercial Paper Program. The STIP also provides working capital advances to the medical centers.

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 salary 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 to the newly established Defined Contribution Plan.

UNIVERSITY OF CALIFORNIA RETIREMENT PLAN

Summary of Investments[1]
($ in thousands)

	June 30, 2006		June 30, 2005	
UC RETIREMENT PLAN (UCRP)	Market Value	% of UCRP	Market Value	% of UCRP
EQUITIES				
U.S. Equity	$ 21,539,288	49.6%	$ 23,807,926	56.7%
Non-U.S. Equity-Developed	$ 7,662,445	17.7%	$ 3,244,124	7.7%
Non-U.S. Equity-Emerging Markets	$ 940,606	2.2%	$ 389,917	0.9%
TOTAL EQUITIES	$ 30,142,339	69.5%	$ 27,441,967	65.3%
FIXED INCOME SECURITIES				
US Core Fixed Income	$ 6,534,992	15.1%	$ 11,315,750	27.0%
High Yield Bond	$ 648,873	1.5%	N/A	N/A
Non USD Fixed Income	$ 1,353,381	3.1%	N/A	N/A
Emerging Market Debt	$ 859,682	2.0%	N/A	N/A
TIPS	$ 2,747,744	6.3%	$ 2,507,205	6.0%
TOTAL FIXED INCOME	$ 12,144,672	28.0%	$ 13,822,955	33.0%
ALTERNATIVE ASSETS				
Private Equity	$ 822,138	1.9%	$ 613,689	1.5%
Real Estate	$ 230,305	0.5%	$ 63,124	0.1%
TOTAL ALTERNATIVE ASSETS	$ 1,052,443	2.4%	$ 676,813	1.6%
LIQUIDITY PORTFOLIO	$ 47,683	0.1%	$ 28,666	0.1%
TOTAL UCRP	$ 43,387,137	100.0%	$ 41,970,401	100.0%

UCRP is a balanced portfolio of equities and fixed-income securities, which at June 30, 2006 totaled $43.4 billion, versus $42.0 billion at the end of fiscal 2005.

INVESTMENT OBJECTIVE

The overall investment objective for all UCRP assets 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 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 July 2005:

Asset Class	Current Policy	Policy Range
U.S. Equity	49%	60-80% Combined Equity
Non-U.S. Equity-Dev.	18%	
Non-U.S. Equity-Emrg.	3%	
Core U.S. Fixed Income	13%	18-38% Combined Fixed Income
High Yield Bond	3%	
Non-U.S. Fixed Income	3%	
Emrg. Mkt. Debt	3%	
TIPS	6%	
Private Equity	2%	2-12% Combined Alternatives
Real Estate	0%	
Liquidity	0%	0 - 10%

The benchmarks for the individual asset classes are: Russell 3000 Tobacco Free (TF) Index for U.S. Equity; MSCI World ex-U.S. (Net) Index (TF) for Non-U.S. Equity-Developed; MSCI Emerging Markets (Net) Index for Non-U.S. Equity-Emerging Markets; Citigroup Large Pension Fund (LPF) Index for U.S. Core Fixed Income; Merrill Lynch High Yield Cash Pay Index for High Yield Bond;

[1] For fiscal 2005 and fiscal 2006, 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. UCRP's STIP investments include assets associated with the UC PERS Voluntary Early Retirement Incentive Program totaling $78.2 million in fiscal 2005 and $77.9 million in fiscal 2006.

UNIVERSITY OF CALIFORNIA RETIREMENT PLAN (UCRP) FUNDED STATUS

as of June 30

	2002	2003	2004	2005	2006
MARKET VALUE (in millions)	$34,292	$35,241	$39,289	$41,970	$43,387
TOTAL RETURN	(9.20)%	5.6%	14.34%	10.30%	7.10%
ANNUAL TOTAL RISK[1]	8.68	12.37	6.04	6.28	5.65
TOTAL CONTRIBUTIONS[2] (in millions) AND INVESTMENT ACTIVITY	$(3,457)	$1,900	$5,006	$3,985	$2,979
TOTAL PAYMENTS AND[3] (in millions) EXPENSES	(970)	(1,015)	(1,145)	(1,315)	(1,474)
SURPLUS ASSETS[4] (in millions)	$11,500	$8,500	$6,300	$3,800	$1,700
FUNDED RATIO[5]	138.4%	125.7%	117.9%	110.3%	104.1%

Citigroup World Government Bond Index ex-U.S. for Non-U.S. Fixed Income; JP Morgan Emerging Market Bond Plus Index for Emerging Market Debt; Lehman TIPS for TIPS; and NCREIF Property Index for Private Real Estate and the Dow Jones-Wilshire REIT Index for Public Real Estate. The total fund benchmark is a policy-weighted average of the individual asset class benchmarks.

The Regents' Public Equity investment strategy utilizes both active and passive management. The Treasurer's Office has an internal team of experienced investment professionals selecting multiple equity strategies; selecting the external managers to implement these strategies; and monitoring those external managers on an ongoing basis. As of June 30, 2006, approximately 42 percent of domestic equity assets and 31 percent of non-U.S. equity assets are managed in active strategies by 39 external managers.

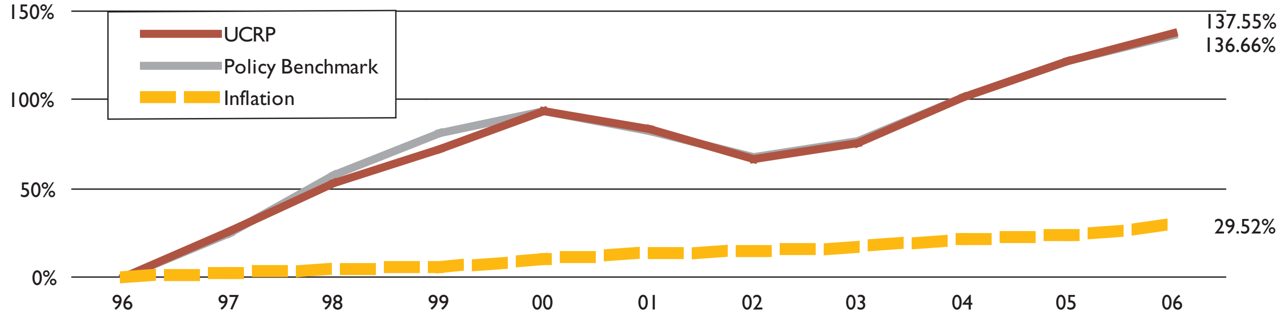
The combined assets in each of the domestic and the non-U.S. asset classes are monitored under guidelines established within the investment policy statement for each asset class. Each asset class is controlled according to a risk budget framework set by The Regents. The passive/active allocation is controlled subject to both the risk budget and by the opportunities to add value to the benchmark for each asset class.

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.

UCRP Cumulative Total Returns: Fiscal 1997-2006

Fiscal Periods Ending June 30



[1]Annual Total Risk is defined as the standard deviation of monthly total return over the 12 month period ended June 30.

[2]Total Contributions and Investment Activity include employer and member contributions (which have been negligible over this period), investment income and realized and unrealized gains and losses.

[3]Total Payments and Expenses include retirement, cost-of-living adjustments, lump sum cashouts, survivor, disability and death payments, member withdrawals and administrative and other expenses.

[4]Surplus assets are calculated as the difference of actuarial (or smoothed) assets and actuarial liabilities, neither of which are shown in the table above.

[5]The Funded Ratio is the ratio of actuarial assets and acturial liabilities.

For TIPS, the Treasurer's Office seeks to maximize long-term total real returns and increase portfolio diversification, given TIPS' low correlation with other asset classes.

For Real Estate, the Treasurer's Office seeks investments which provide long-term risk-adjusted total returns between those of U.S. equities and bonds; diversification benefits given real estate's low correlation with other asset classes; protection against unanticipated inflation; and a high proportion of the total return derived from current income. The Real Estate program began implementation in fiscal year 2004-2005.

The cumulative Total Returns Chart on page 27 illustrates the returns for UCRP for the past 10 years relative to the policy benchmark and inflation.

UCRP FUNDED STATUS

The University of California Retirement Plan costs are funded by a combination of investment earnings, employee member and employer contributions. Since 1990, the University's contribution rate to the UCRP has been zero. In addition, since 1990, most of the required employee member contributions to the UCRP are being redirected to the separate defined contribution plan maintained by the University.

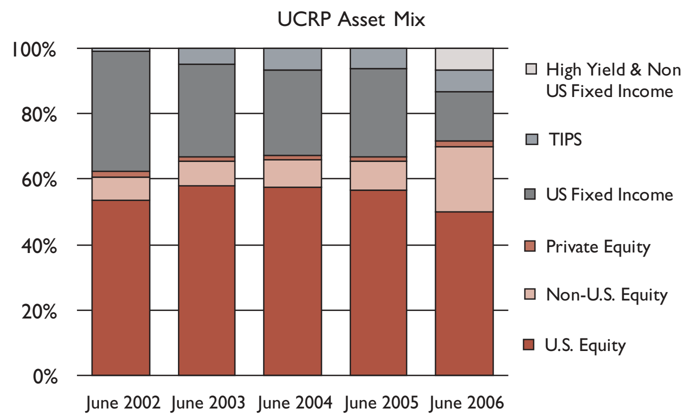
In 2006, The Regents updated the funding policy for UCRP to provide for a targeted funding level of 100 percent over the long term, and for University and UCRP member contributions at rates necessary to maintain that level within a range of 95 percent to 110 percent. The University will implement a multi-year contribution strategy under which shared employer and employee contribution rates will increase gradually over time to 16 percent of covered compensation, based upon UCRP's current normal cost. The Regents have authorized the initial resumption of shared employer and employee contributions beginning July 1, 2007, gradually increasing over future years toward the normal cost, subject to funding and completion of the budget process.

RETURNS

UCRP has exceeded its investment objectives over the long-term. It has also performed well versus its policy benchmarks. UCRP returned 7.10% in the fiscal year vs. its benchmark return of 6.84%. UCRP's annualized total return for the past 10 years through June 30, 2006 was 9.04%, outperforming its benchmark at 9.00%.

ASSET MIX

The following illustrates UCRP's asset mix at each of the past five fiscal year ends.



EQUITY INVESTMENTS

The equity portion of UCRP consists of U.S. and Non-U.S. common stocks. Total Equities represented 69.5% of UCRP at year-end, with a market value of $30.1 billion.

U.S. Equity represented 49.6% of the fund at year-end, with a market value of $21.5 billion. UCRP's U.S. Equity assets returned 9.30% for the fiscal year and 7.74% for the 10-year period.

Total Non-U.S. Equity represented 19.9% of UCRP at year-end, with a market value of $8.6 billion. Non-US Equity-Developed Markets represented 17.7% with a market value of $7.6 billion and Non-U.S. Equity-Emerging Markets represented 2.2% with a market value of $940 million. UCRP's Non-U.S. Equity-Developed grew 26.50% and Non-U.S. Equity-Emerging Markets grew 31.33% in the fiscal year. The longer-term returns for this asset class represent the emerging markets funds only, so comparisons are not yet meaningful.

ALTERNATIVE INVESTMENTS

Private Equity represented 1.9% of UCRP at year-end with a market value of $822 million. UCRP returns for this asset class in the fiscal year were 16.05%. Over the long term, UCRP's private equity returns have been an important contributor to total fund return.

Real Estate represented 0.5% of UCRP at year-end and returned 17.56% in the fiscal year, below the benchmark return of 20.19%.

FIXED-INCOME INVESTMENTS

At year-end, Fixed-Income investments constituted 28.0% of the portfolio, with a market value of $12.1 billion.

Within total fixed income, UCRP's US Core Fixed Income investments returned (2.71)% during the year, exceeding the

UCRP ANNUALIZED TOTAL RETURNS[1] VERSUS BENCHMARKS AND INFLATION

June 30, 2006

	1-Year	5-Year	10-Year	10-Year Cumulative	Benchmark Description[2]
TOTAL FUND					
UCRP	7.10%	5.34%	9.04%	137.55%	Total Fund Policy Benchmark: A blend of the indexes described in detail below, each weighted by the percentage it represents in the asset allocation. Adjustments have been made to reflect that the actual investment in Private Equity is below policy weight. Annual index returns assume monthly rebalancing.
Policy Benchmark	6.84	5.41	9.00	136.66	
Inflation	4.32	2.65	2.62	29.52	Inflation: Consumer Price Index.
U.S. EQUITY					
UCRP	9.30%	2.33%	7.74%	110.69%	U.S. Equity Policy Benchmark: Russell 3000 TF Index; Historical: S&P 500 Index.
Policy Benchmark	9.44	3.41	8.90	134.54	
NON-U.S. EQUITY-DEVELOPED					
UCRP	26.50%	10.26%	N/A	N/A	Non-U.S. Equity-Developed Policy Benchmark: MSCI World ex U.S. (Net) Index TF; Historical: MSCI EMF (Net) Index.
Policy Benchmark	26.89	10.40	N/A	N/A	
NON-U.S. EQUITY-EMERGING MARKETS					
UCRP	31.33%	20.34%	8.83%	133.18%	Non-U.S. Equity-Emerging Markets Policy Benchmark: MSCI Emerging Market Free (Net) Index; Historical: MSCI EMF (Net) Index.
Policy Benchmark	35.47	21.30	6.55	88.65	
US CORE FIXED INCOME					
UCRP	(2.71)%	6.41%	8.49%	125.86%	US Fixed Income Policy Benchmark: Citigroup Large Pension Fund Index; Historical: LB LTG/C Index.
Policy Benchmark	(3.43)	5.98	7.21	100.54	
TIPS					
UCRP	(1.59)%	N/A	N/A	N/A	
Policy Benchmark	(1.64)	N/A	N/A	N/A	TIPS Policy Benchmark: Lehman TIPS Index.
PRIVATE EQUITY[3]					
UCRP	16.05%	6.03%	23.90%	752.49%	
REAL ESTATE					
UCRP	17.56%	N/A	N/A	N/A	Real Estate Policy Benchmark: NCREIF Property Index (private real estate): Dow Jones-Wilshire REIT Index (public real estate).
Policy Benchmark	20.19	N/A	N/A	N/A	

benchmark return of (3.43)%. Over the long-term, UCRP's US Fixed Income returns of 6.41% and 8.49% for the 5- and 10-year periods have exceeded the benchmark.

Three new asset classes were added to UCRP's Fixed Income portfolio during the fiscal year—High Yield, Non-US, and Emerging Markets. Their first full year of performance will be detailed in next year's Annual Report, but their performance-to-date is reflected in the Total Fund's cumulative results in the table above.

UCRP's TIPS, represented 6.3% of total assets on June 30, 2006.

The weighted average maturity of the portfolio at the end of the year was approximately 9.6 years, the weighted average duration 7.5 years, and the average credit quality was AA, with more than 82% of the fixed-income securities rated A or higher.

[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 State Street Bank, 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 CFA Institute's standards, which require time-weighted rates of return using realized and unrealized gains plus income. Performance is reconciled by the Treasurer's Office.

[2] Historical benchmark information is available online at http://www.ucop.edu/treasurer/invinfo/Benchmarks.html.

[3] From July 2004 through December 2004 the Private Equity Benchmark was the Russell 3000 TF Index +3% (lagged by three months). Beginning January 2005 the Benchmark is the actual performance.

[4] Includes balances invested for the Balanced Growth Fund, which at 6/30/06 totaled $1,008 million and consisted of 65% in the Equity Fund, 30% in the Bond Fund, and 5% in the TIPS Fund.

UC-Managed Defined Contribution Funds

In addition to the defined benefit program (UCRP), the University offers defined contribution plans to provide employees with supplemental retirement benefits—the mandatory Defined Contribution Plan (DC Plan), the Tax-Deferred 403(b) Plan, the 457(b) Deferred Compensation 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 and that each participant chooses a mix of asset classes (funds) consistent with his or her own investment objectives and risk tolerance.

UNIVERSITY-MANAGED DEFINED CONTRIBUTION (DC) FUNDS[1]

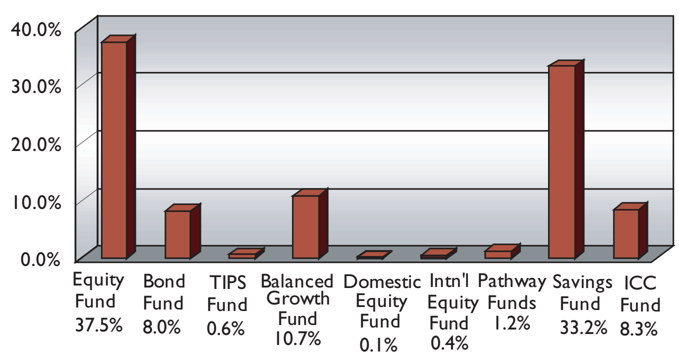
Summary of Investments[2]
($ in thousands)

	June 30, 2006		June 30, 2005	
DEFINED CONTRIBUTION (DC) FUNDS	Market Value	% of DC	Market Value	% of DC
TOTAL RETURN FUNDS				
EQUITY FUND	$ 3,524,432	37.5%	$ 3,275,347	37.1%
BOND FUND	$ 754,538	8.0%	$ 791,707	9.0%
TIPS FUND	$ 51,897	0.6%	$ 56,756	0.6%
BALANCED GROWTH FUND	$ 1,008,261	10.7%	$ 904,359	10.3%
DOMESTIC EQUITY INDEX FUND	$ 6,522	0.1%	N/A	N/A
INTERNATIONAL EQUITY INDEX FUND	$ 33,555	0.4%	N/A	N/A
PATHWAY INCOME FUND[3]	$ 9,178	0.1%	N/A	N/A
PATHWAY FUND 2010[3]	$ 32,256	0.3%	N/A	N/A
PATHWAY FUND 2020[3]	$ 37,092	0.4%	N/A	N/A
PATHWAY FUND 2030[3]	$ 21,155	0.2%	N/A	N/A
PATHWAY FUND 2040[3]	$ 7,969	0.1%	N/A	N/A
PATHWAY FUND 2050[3]	$ 4,850	0.0%	N/A	N/A
INTEREST INCOME FUNDS				
SAVINGS FUND	$ 3,140,301	33.3%	$ 3,091,580	35.0%
ICC FUND	$ 781,702	8.3%	$ 706,183	8.0%
TOTAL UC MANAGED DC FUNDS	$ 9,413,708	100.0%	$ 8,825,932	100.0%

As of June 30, 2006, total assets in the UC managed defined contribution plans were $9.4 billion vs. $8.8 billion on June 30, 2005.

When investing their defined contribution funds, employees may choose among eighteen CORE Funds[4] under the direction of UC's Office of the Treasurer which are managed internally by the Treasurer's Office or selected external funds.

Total UC-Managed Defined Contribution Plan Assets by Fund
June 30, 2006



[1] New funds inception 7/1/05.

[2] For fiscal 2005 and fiscal 2006, 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.

[3] The Pathway Funds are funds of funds and include some assets managed by DFA and Vanguard.

[4] UC Core Funds are under the direction of UC's Office of the Treasurer. The UC Treasurer manages each fund, or selects the fund's investment manager. The UC Core Funds also include three mutual funds managed by Vanguard and one managed by DFA. Information on the specific investment objectives, strategies, returns and risks associated with the UC Core Funds is available to plan participants on FITSCo's NetBenefits website.

UNIVERSITY-MANAGED DEFINED CONTRIBUTION FUNDS[1]

June 30, 2006

	1-Year	5-Year	10-Year	Benchmark Description
TOTAL RETURN FUNDS				
Equity Fund	12.07%	3.55%	8.44%	Equity Fund Policy Benchmark: 85% less the actual Private Equity weight from the prior month end times the Russell 3000 TF Index, 15% MSCI ACWI ex US (Net) Index and the actual Private Equity weight of the previous month end; Historical: S&P 500 Index.
Policy Benchmark	12.08	4.56	9.32	
Morningstar Domestic Equity Funds Median[2]	9.32	3.67	7.74	
Bond Fund	(0.41)%	5.61%	8.11%	Bond Fund Policy Benchmark: Lehman Aggregate Index; Historical: LB LTG/C Index.
Policy Benchmark	(0.81)	4.97	6.64	
Morningstar Taxable Bond Funds Median[2]	0.13	4.40	5.14	
TIPS Fund (started 4/1/04)	(1.59)%	NA	NA	
Policy Benchmark	(1.64)%	NA	NA	TIPS Fund Policy Benchmark: Lehman TIPS Index.
Balanced Growth Fund (started 4/1/04)	7.55%	NA	NA	Balanced Growth Fund Policy Benchmark: 65% policy benchmark for Equity Fund, 30% policy benchmark for Bond Fund and 5% policy benchmark for TIPS Fund.
Policy Benchmark	7.45%	NA	NA	
Domestic Equity Index Fund (started 7/1/05)	6.47%	NA	NA	Domestic Equity Index Fund Policy Benchmark: Russell 3000 Tobacco Free Index.
Policy Benchmark	6.57%	NA	NA	
International Equity Index Fund (started 7/1/05)	25.52%	NA	NA	
Policy Benchmark	25.29%	NA	NA	International Equity Index Fund Policy Benchmark: MSCI EAFE + Canada Tobacco Free Index.
UC Pathway 2010 (started 7/1/05)	6.18%	NA	NA	UC Pathway 2010 Fund Policy Benchmark: Blend of benchmarks of underlying UC Core Funds based on holdings percentages.
Policy Benchmark	6.05%	NA	NA	
UC Pathway 2020 (started 7/1/05)	7.84%	NA	NA	UC Pathway 2020 Fund Policy Benchmark: Blend of benchmarks of underlying UC Core Funds based on holdings percentages.
Policy Benchmark	7.66%	NA	NA	
UC Pathway 2030 (started 7/1/05)	10.42%	NA	NA	UC Pathway 2030 Fund Policy Benchmark: Blend of benchmarks of underlying UC Core Funds based on holdings percentages.
Policy Benchmark	10.27%	NA	NA	
UC Pathway 2040 (started 7/1/05)	11.03%	NA	NA	UC Pathway 2040 Fund Policy Benchmark: Blend of benchmarks of underlying UC Core Funds based on holdings percentages.
Policy Benchmark	10.80%	NA	NA	
UC Pathway 2050 (started 7/1/05)	11.73%	NA	NA	UC Pathway 2050 Fund Policy Benchmark: Blend of benchmarks of underlying UC Core Funds based on holdings percentages.
Policy Benchmark	11.58%	NA	NA	
UC Pathway Income (started 7/1/05)	3.60%	NA	NA	UC Pathway Income Fund Policy Benchmark: Blend of benchmarks of underlying UC Core Funds based on holdings percentages.
Policy Benchmark	3.82%	NA	NA	
INTEREST INCOME FUNDS				
Savings Fund	3.84%	4.40%	5.25%	Savings Fund Policy Benchmark: 2-Year U.S. Treasury Note Income Return.
Policy Benchmark	4.35	2.86	4.28	
ICC Fund	5.07%	5.79%	6.51%	ICC Fund Policy Benchmark: 5-Year U.S. Treasury Note Income Return.
Policy Benchmark	4.41	3.72	4.81	
Inflation	4.32%	2.65%	2.62%	Inflation: Consumer Price Index.

[1] All returns for the University-managed funds are net of (after) investment expenses of 0.15% and are based on unit values for the Total Return Funds and on yields and interest factors for the Interest Income 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 State Street Bank. State Street Bank'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: Morningstar, Inc. Although gathered from reliable sources, data completeness and accuracy cannot be guaranteed.

INTERNALLY MANAGED UC FUNDS

The nine University-managed investment choices include total return funds—the Equity Fund, Bond Fund, TIPS Fund, Balanced Growth Fund, Domestic Equity Index Fund, International Index Fund, and the UC Pathway Funds—and interest income funds—the Savings Fund and Insurance Company Contract (ICC) Fund. University-managed funds offer employees the opportunity to achieve attractive, 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 shown on page 31, these funds rank above average in performance comparisons for most time periods. In addition, the University-managed funds are extremely low cost relative to external fund options: Annual expenses are only 0.15%[1] of average annual market value, compared to the industry average of 1.4%[2].

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 following asset allocation policy for the Equity Fund has been in effect since March 2000:

Asset Class	Policy	Minimum	Maximum
U.S. Equity	80%	75%	85%
Non-U.S. Equity	15%	10%	20%
Private Equity	5%	3%	7%

At June 30, 2006, the total market value of the Equity Fund was $3.5 billion. The portfolio consisted of 82.9% U.S. Equity, 15.7% Non-U.S. Equity and 1.3% Private Equity.

At June 30, 2006 the U.S. equity is invested in a Russell 3000 Tobacco Free (TF) Index fund managed by State Street Global Advisors. Non-U.S. Equity is invested in a MSCI EAFE + Canada Tobacco Free Index fund (also managed by State Street Global Advisors). The private equity is invested in venture capital partnerships and buyout funds.

For the fiscal year, the Equity Fund's return of 12.07% almost equaled its policy benchmark return of 12.08%, yet outperformed its peers, as measured by the Morningstar Domestic Equity Funds Median. The Equity Fund's longer-term returns are shown on page 31.

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 of primarily high-quality, debt securities.

At June 30, 2006, the total market value of the Bond Fund was $754 million. U.S. Treasury securities constituted 11.2% of the fund, U.S. Agency 19.5%, high-grade industrials 10.0%, financial bonds 7.9%, high yield 1.8%, utility bonds 4.1%, mortgage-backed securities 43.2% of the fund, Sovereigns 0.2% and cash 2.1%. The weighted average maturity of the portfolio at year-end was approximately 8.1 years, the weighted average duration 4.8 years, and 86% of the portfolio was rated A or better.

In fiscal 2006, the Bond Fund returned (0.41)%, outperforming its benchmark. As shown on page 31, the Bond Fund's long-term returns of 5.61% and 8.11% for the 5- and 10-year periods have exceeded those of its Morningstar peers and its benchmark by healthy margins.

BALANCED GROWTH FUND

The Balanced Growth Fund seeks to provide long-term growth and income through a balanced portfolio of equity and fixed income securities held within UC-managed funds. The market value of the Balanced Growth Fund at June 30, 2006 was $1.0 billion.

Contributions are invested according to a fixed ratio: 65% Equity Fund, 30% Bond Fund and 5% TIPS Fund. The Balanced Growth Fund's returns are a function of the performance of its component funds.

The Fund is rebalanced periodically. This will prevent the three component funds from growing outside their allocation percentages. The Treasurer's Office manages the component funds according to the investment objectives and strategies of those funds.

[1] Total expenses are comprised of approximately 0.03% for investment management, 0.02% for investor education and 0.10% for accounting, audit, legal and recordkeeping services.

[2] Source: Morningstar, Inc. Although gathered from reliable sources, data completeness and accuracy cannot be guaranteed.

TIPS FUND

The TIPS (Treasury Inflation-Protected Securities) Fund, started April 1, 2004, seeks to provide long-term total return and inflation protection consistent with an investment in U.S. Government inflation-indexed securities.

The Fund invests in inflation-protected securities issued by the U.S. Government. Inflation-indexed securities are designed to protect future purchasing power. The principal value is adjusted for changes in inflation, and interest is paid on the inflation-adjusted principal.

The market value of the TIPS Fund at June 30, 2006 was $52 million and returned (1.59)% for the fiscal year.

DOMESTIC EQUITY INDEX FUND

The Domestic Equity Index Fund, started July 1, 2005, seeks to provide investment results approximating the total return performance of securities included in the Russell 3000 Index. The Fund is invested in the Russell 3000 Tobacco Free (TF) Index Fund, composed of shares of 3,000 U.S. companies as determined by market capitalization. The portfolio of securities represents approximately 98% of the investable U.S. equity market. The TF version excludes tobacco companies.

At June 30, 2006, the market value of the Domestic Equity Index Fund was $6.5 million and returned 6.47% for the fiscal year.

INTERNATIONAL EQUITY INDEX FUND

The International Equity Index Fund is invested in a MSCI EAFE + Canada Tobacco Free (TF) Index Fund. Started on July 1, 2005, the International Equity Index Fund seeks to provide investment results approximating the total return performance of the securities included in the MSCI + Canada Index.

The Morgan Stanley Capital International Europe, Australia, and Far East Index is designed to measure the performance of stock markets in those regions. The TF version excludes tobacco companies.

The market value of the International Equity Index Fund at June 30, 2006, was $33.5 million and returned 25.52% for the fiscal year.

UC PATHWAY FUNDS

The UC Pathway Funds are a simple yet diversified, one-stop-shopping approach to saving for retirement. Established on July 1, 2005, the UC Pathway Funds are lifecycle funds managed to adjust the level of risk as the investor approaches a target retirement date of 2010, 2020, 2030, 2040 and 2050. The investment objective of these Funds is to maximize long-term capital appreciation. For those participants near or in retirement, the UC Pathway Income Fund seeks to maximize income.

Each Pathway Fund is diversified across several asset classes by investing in a variety of Core Funds[1] at varying percentage levels. Over time, the amount invested in stock funds is gradually reduced, while the amount invested in bond and short-term funds is increased.

At June 30, 2006, the market values and fiscal year returns for the UC Pathway Funds were as follows: 2010, $32.3 million and returned 6.18%; 2020, $37.1 million and returned 7.84%; 2030, $21.1 million and returned 10.42%; 2040, $8.0 million and returned 11.03%; 2050, $4.8 million and returned 11.73%; and UC Pathway Income, $9.2 million and returned 3.60%.

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 $3.1 billion at June 30, 2006, 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, 2006.

[1] UC Core Funds are under the direction of UC's Office of the Treasurer. The UC Treasurer manages each fund, or selects the fund's investment manager. Information on the specific investment objectives, strategies, returns and risks associated with the UC Core Funds is available to plan participants on FITSCo's NetBenefits website.

The Savings Fund has historically provided an income return greater than that of 2-Year U.S. Treasury Note income. In fiscal 2006, the Savings Fund generated an income return of 3.84%. During the past 10 years the Savings Fund generated an average income return of 5.25% versus 4.28% on 2-Year U.S. Treasury Note income.

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 return 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 Fund may also invest in government and government agency securities and cash during periods in which maturing contracts expire and available contracts are not deemed attractive by the portfolio manager. ICC Fund participants receive the blended interest rate of all contracts in the fund. The Fund strives to exceed the returns of 5-Year U.S. Treasury Notes and to outpace inflation.

At June 30, 2006, the ICC Fund totaled $782 million, with a weighted average maturity of 3.9 years. Since inception, the ICC Fund has generated income returns that have exceeded those of 5-Year U.S. Treasury Note income by a comfortable margin. In fiscal 2006, the ICC Fund generated a 5.07% income return versus 4.41% on 5-Year U.S. Treasury Note income and during the past 10 years generated a 6.51% income return compared to 4.81% on 5-Year U.S. Treasury Note income.

RETIREE PROFILE

Sandra Norberg graduated from the University of California Davis with a degree in International Relations, but she didn't have to travel far to find her career - it was literally in her backyard! It isn't unusual for early career choices to hinge on a simple fact such as an easy commute. For Sandra, the terrain was familiar because the University of California San Francisco (UCSF) was already her neighborhood community. She started out as a casual employee, but truly enjoyed her work and soon realized how important it was to become a career employee and made that transition within a year and a half. She found her niche in the Benefits Department serving as one of two Principal Benefits Coordinators for the campus.

She found great joy in helping others gain awareness and appreciation of the range of benefits available to them within the UC system. Expertise gained from her work was put to good use building her own plans for the future. She acknowledges that she wasn't aware of the University of California Retirement Plan (UCRP) when she first started, but she quickly realized the beauty of having a pension. Eventually, she started a supplemental 403(b) Plan account and admits, in hindsight, that she should have started it even sooner.

Sandra took advantage of the classes and seminars on investing provided through UCSF's Benefits Department and met with a financial planner based on campus. And now in retirement, she and her husband continue to utilize an outside counselor to help them with their total financial picture and their budget. "The secret of my retirement planning success was my willingness to make a lot of little (and some big) sacrifices knowing that they would be worth it in the long run." She warns others, "Avoid developing a false sense of security and make sure you always have some thing to fall back on." In her case it was real estate. Her contributions to the 403(b) balanced nicely against her real estate investments. Her choices mirror the advice of retirement planners: Start saving early and don't put all your eggs in one basket - diversify.

Time flies when you are having fun. Life has its challenges, but a supportive spouse and good friends can ease the rough spots. "I really enjoyed the sense of community at the University. Not just among my peers at UCSF, but throughout the entire system. My co-workers have always been very supportive." She advises all employees to get involved with committees, activities, etc. at UC. "You'll have fun and make a contribution as well." Her proudest accomplishment was co-chairing the committee which ultimately delivered all day orientations for new employees. It took several years of hard work, but Sandra feels it was worth every minute.

When it came time to retire, she opted to take a monthly payout rather than a lump sum payment and felt that this choice would help insulate her from the volatility of the market. She is very comfortable and confident with the management of the UCRP and with the management of her UC Funds within her 403(b) Plan.

She may have stopped going into work at UCSF every day, but she still feels a part of the UC community. She left her position at a time when her work was going well and she felt upbeat about her contribution. She deems her retirement a success, but warns that the best laid retirement plans don't necessarily go exactly as initially imagined. Her goal of retiring at 50 was modified to a more realistic 60 and she never dreamed that her mother would need care. Yet, her original dreams remain intact. She is working part-time at the Ferry Plaza Farmer's Market surrounded by fabulous food, traveling the world and studying French and Italian. And, she serves on the Board of the UCSF Retirees Association.

Sandra Norberg

Retired

Principal Benefits Coordinator

27 years with the University of California San Francisco

We wish to acknowledge the help of the UCOP Human Resources staff in preparing this information.

This *Treasurer's Annual Report 2005-2006* is unaudited, however these investments are included in the following audited financial statements of the University of California: *The University of California Annual Financial Report 2005-2006* (available on the internet at www.ucop.edu/ucophome/busfin/reports.html), *The University of California Defined Contribution Plan and Tax-Deferred 403(b) Plan 2005-2006*, and *The University of California Retirement Plan 2005-2006* (both available on the internet at http://atyourservice.ucop.edu/forms_pubs/categorical/annual_reports.html).

INTERNET LINKS OF INTEREST

<u>UC-Managed Funds</u>

UCRP Benefit Information: http://atyourservice.ucop.edu/

UC Retirement Savings Program including 403(b), 457(b) and DC Plan Information:
https://netbenefits.fidelity.com/

GEP Investment Policy: http://www.ucop.edu/treasurer/invpol/GEP%20policy.pdf

UCRP Investment Policy: http://www.ucop.edu/treasurer/invpol/UCRP%20policy.pdf

<u>Regents' Committee on Investments/Investment Advisory Committee</u>

Schedule and Agendas: www.universityofcalifornia.edu/regents/meeting.html

<u>UC News</u>

UC Newsroom: http://www.universityofcalifornia.edu/news/welcome.html

UC Human Resources and Benefits News: http://atyourservice.ucop.edu/

UC Office of the Treasurer News: http://www.ucop.edu/treasurer/updates/welcome.html

You may contact us in writing at the University of California, Office of the Treasurer,
1111 Broadway, Suite 1400, Oakland, CA 94607-4007

www.ucop.edu/treasurer Email treas.regents@ucop.edu

Office of the Treasurer

June 2006

Marie N. Berggren, MS – **Chief Investment Officer and Vice President for Investments and Acting Treasurer**
Melvin L. Stanton, MBA – **The Assistant Treasurer**
Randolph E. Wedding, MBA – **Managing Director – Fixed Income Investments**
Jesse L. Phillips, CFA, MBA, MA – **Managing Director – Investment Risk Management**
Robert B. Blagden, MBA – **Managing Director – Public Equity Investments**

ALTERNATIVE INVESTMENTS

Private Equity

William Chu, BS	Investment Officer
Thomas Lurquin, Ph.D.	Investment Officer
Leslie Watson, BA	Analyst

Absolute Return

Lynda Choi, MBA	Investment Officer
Rebecca Stafford, MA	Senior Investment Analyst

Real Assets

Gloria Gil, BS, CRE	Director

PUBLIC EQUITY INVESTMENTS

Steven Algert, CFA, MPPM	Investment Officer
Burton Yuen, MBA	Investment Officer
David Hughes, CFA, MBA	Senior Investment Analyst

FIXED INCOME INVESTMENTS

Linda Fried, BA	Senior Portfolio Manager, Credit Sector
David Schroeder, BA	Senior Portfolio Manager, Governments Sector
Satish Swamy, CFA, MBA	Senior Portfolio Manager, Collateralized Sector
Alice Yee, MBA	Senior Portfolio Manager, Short-Term Securities
Aaron Staines, BA	Junior Portfolio Manager
Kim Evans, MBA	Senior Portfolio Manager and Head of Credit Analysis
Omar Sanders, CFA, MBA	Investment Officer, Credit Sector

INVESTMENT RISK MANAGEMENT

Aileen Liu, MS	Associate Director
Michael John, BS	Analyst
Anson Wong, BA	Analyst

OPERATIONS

Robert Yastishak, **Director**	Brian Hagland	Marjan Shomali	Allen Woo
Paula Ferreira, **Supervisor**	Jan Kehoe, **Assistant Director**	Michael Strach	
Floyd Gazaway, Jr.	Khaleelah Muhammad	Pu Wang-Fackler	

INFORMATION TECHNOLOGY

Michael Comstock, **Manager**

COMMUNICATIONS

Susan Rossi, **Director**	Alison Johnson

BUSINESS MANAGEMENT

Nelson Chiu, **Manager**

ADMINISTRATION

Gayle Tapscott, **Manager**	William Byrd	Claudia Green	Ruth Welch
Gay Adams	Kristina Chow	Joyce Lewis	
Elizabeth Agbayani	Milkah Cunningham	Barbaretta Morris	