

U T I M C O

THE UNIVERSITY OF TEXAS INVESTMENT MANAGEMENT COMPANY
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1999 Annual Report

Building

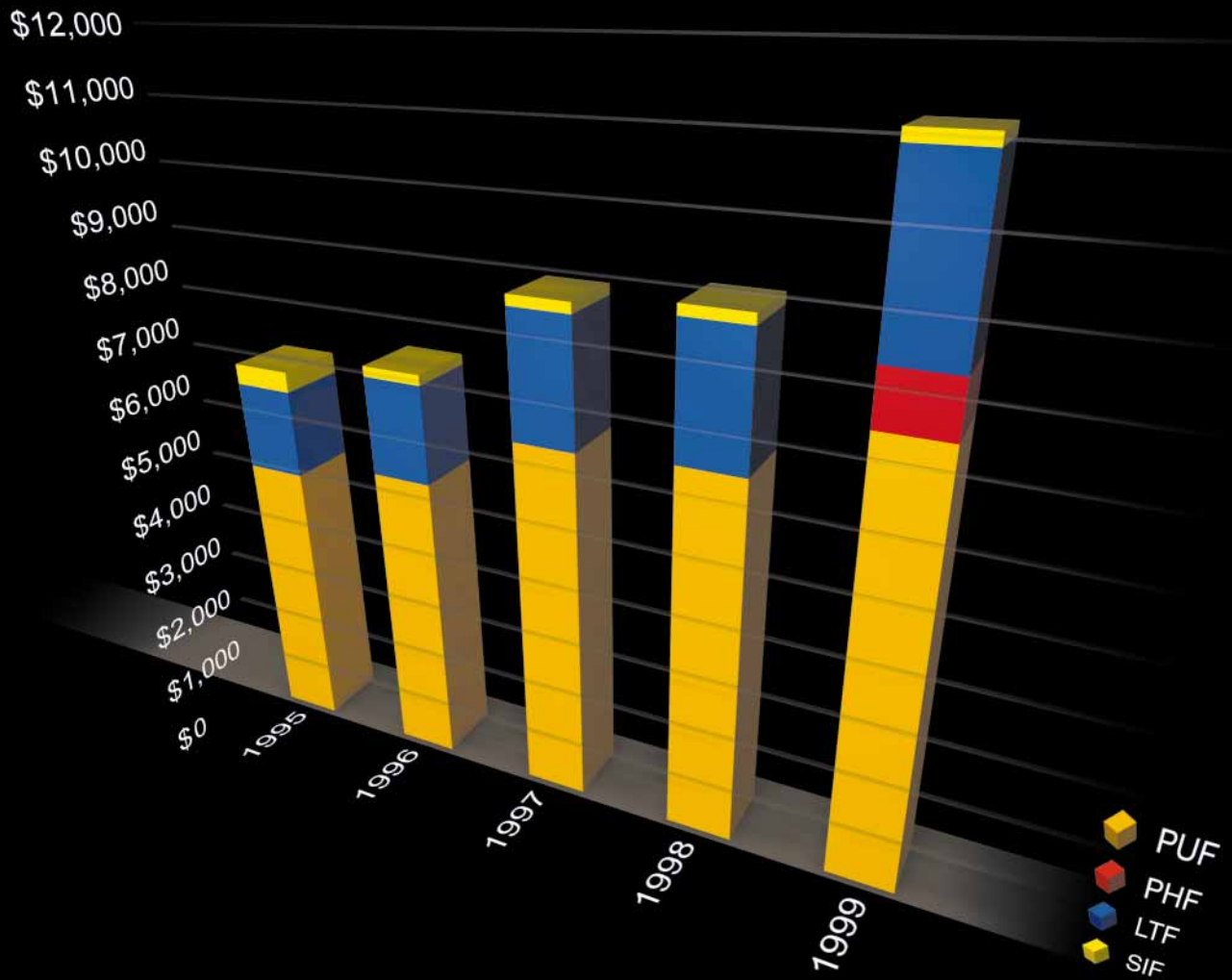
MOMENTUM



Growth in Value

Years Ended August 31,

(in millions)



Endowment Funds

The UT Board is fiduciary for four major endowment fund groups with a combined value equal to \$11,123.4 million.



ENDOWMENT FUNDS

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Endowment Funds

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Building

MOMENTUM

in excess of \$13 Billion.

Endowment Funds Overview

As of August 31, 1999, the UT Board is fiduciary for four major endowment fund groups with a combined value equal to \$11,123.4 million. The UT System and other institutional beneficiaries of the endowment funds managed by UTIMCO provide educational and health care services to the citizens of the State of Texas. The ability of these institutions to provide quality services throughout the next century will depend on the maintenance of long-term financial equilibrium by these institutions. Maintenance of such equilibrium requires, among other financial objectives, the preservation of endowment purchasing power. Endowment funds are permanent funds by their nature with the result that endowment purchasing power must be preserved in perpetuity. The endowment must provide to future generations the same level of economic support for scholarships, teaching, research and other educational programs as it provides today.

Investment Objectives

Measured quantitatively, the preservation of endowment purchasing power requires the simultaneous achievement of two contradictory objectives:

- increase the amount of the annual distribution to endowment beneficiaries at a rate at least equal to the rate of inflation, and
- increase the market value of the endowment fund (after the annual distribution) at a rate at least equal to the rate of inflation.

These objectives are contradictory because higher rates of annual distributions require larger annual withdrawals from the endowment fund. Larger withdrawals reduce the endowment fund's ability to grow over time.

Factors Affecting an Endowment Fund's Purchasing Power

The maintenance of endowment purchasing power is affected by four major factors: a) fund investment return, b) fund expenses, c) the rate of inflation, and d) fund distributions. UTIMCO attempts to preserve endowment purchasing power by distributing from the endowment no more than the *average* expected annual investment return *after* expenses and inflation.

a) Fund Investment Return

The investment returns and accompanying risk generated by the endowment funds are determined largely by the allocation of fund assets to different classes of investments. The Endowment Policy Portfolio is an efficient optimized mix of the multiple asset classes that produces the highest return with the lowest risk profile. The current expected risk of the Endowment Policy Portfolio is 11.24% (as measured by standard deviation).

The neutral asset allocation underlying the Endowment Policy Portfolio as of August 31, 1999 was the following:

Asset Class	Neutral Weight	Range	Return Index
Cash and Equivalents	0%	0.0%-5.0%	ML 90 Day T-Bill Ave. Yield
U.S. Equities: Med/Large Capitalization	30%	10%-40%	S&P 500 Index
U.S. Equities: Small Capitalization	10%	5%-15%	Russell 2000 Index
Non-U.S. Equities: Established Markets	12%	5%-20%	FT Actuaries World (ex-U.S.) Index
Non-U.S. Equities: Emerging Markets	3%	0%-10%	MSCI-Emerging Mkts. Free
Alternative Assets: Marketable	7%	0%-10%	ML 90 Day T-Bills + 7%
Alternative Assets: Nonmarketable	18%	5%-25%	17%
U.S. Fixed Income	15%	13%-25%	Lehman Brothers Aggregate Index
Non-U.S. Fixed Income	5%	0%-7%	Salomon Non-U.S. WGBI Unhedged
TOTAL FUND ASSETS	100%		POLICY PORTFOLIO INDEX





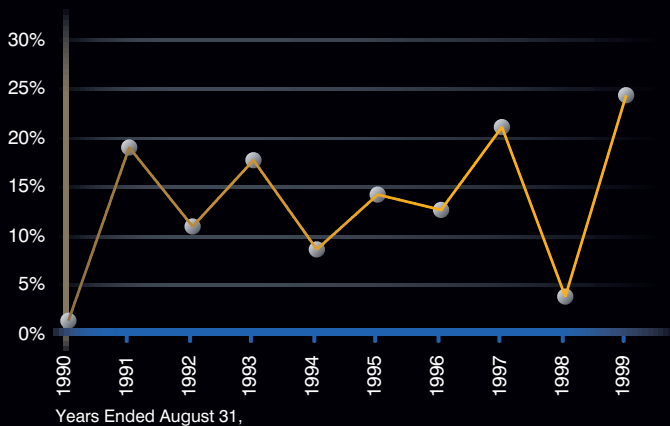
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The expected average annual return for an endowment fund is the weighted average index return for each of the asset classes comprising the Endowment Policy Portfolio.

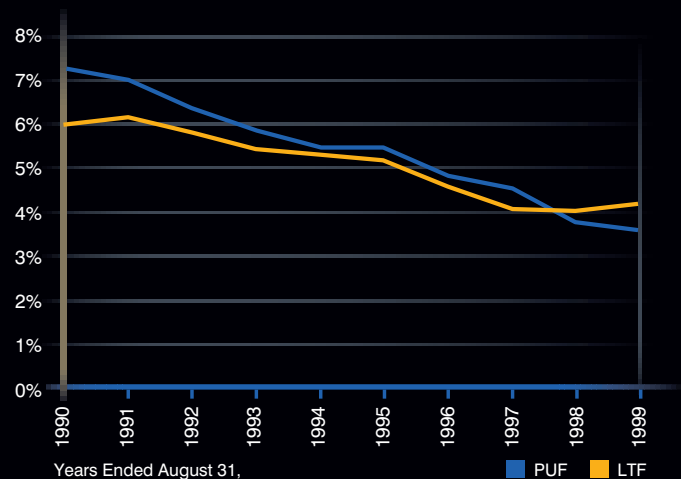
The actual average annual return of the Endowment Policy Portfolio over the last 10 fiscal years was 13.25% and was quite volatile as presented below:

Endowment Policy Portfolio Returns



Historically, fund investment returns for any given year have varied significantly from the expected average annual investment return. Consequently, UTIMCO's distribution policy for the LTF uses a smoothing formula to reduce annual volatility in spending and to maintain spending on a sustainable basis. The historical distribution rates for the PUF and LTF are presented below:

Historical Distribution Rates



b) Fund Expenses

UTIMCO incurs expenses associated with strategy and analysis, portfolio management, custody and safekeeping, accounting and other investment related functions. These expenses are allocated to the endowment funds in proportion to their asset values and certain activity levels. Fund expenses are paid from fund assets except for the PUF.

c) Rate of Inflation

Inflation erodes the value of endowment funds by reducing fund purchasing power over time. Investors have no control over the rate of inflation. UTIMCO must invest fund assets so as to maximize the risk adjusted real return on investment. Inflation is cyclical resulting in periods of increasing and decreasing fund purchasing power. The long-term average annual rate of inflation since 1926 is approximately 3.5% with a range of (10.3%) to 18.1%.

d) Fund Distributions (Spending)

Annual distribution, or spending, from endowment funds (except for the PUF and SIFs) is controllable by UTIMCO (as approved by the UT Board). The key to preservation of endowment purchasing power over the long-term is control of spending through a target distribution rate. This target rate should not exceed the endowment's average annual investment return after fund expenses and inflation. The target distribution rate for endowments managed to the Endowment Policy Portfolio is currently 4.5% of the fund's asset value. Distributions are increased annually at the rate of inflation provided that the distribution rate remains within a range of 3.5% to 5.5% of fund asset value.

Combining these four factors, the higher the fund investment return and the lower the rates of fund expenses, inflation and spending, the greater the ability to increase the purchasing power of the endowment assets and the spending stream over time. Preservation of endowment purchasing power over the long run is currently targeted by UTIMCO using the following expected long-term annual rates for the Endowment Policy Portfolio.

	Expected Annual Average
Rate of Investment Return	9.35%
Less:	
Expense Rate	0.35%
Inflation Rate	3.50%
Distribution Rate	4.50%
Increase in Purchasing Power	1.00%