Fiscal Year 2013 Returns

The Permanent University Fund (the “PUF”) and the General Endowment Fund (the “GEF”) – together the “Endowments” – had investment gains of 8.8% and 9.0%, respectively, for the fiscal year ended August 31, 2013 (“2013”). While the PUF and the GEF have similar investment strategies and implementations, oil and gas revenues going into the PUF caused its returns to slightly trail the GEF due to the time-lag associated with putting that cash to work.

PUF assets totaled $14.9 billion and GEF assets totaled $7.4 billion at fiscal year-end. This represents all-time peaks for the Endowments. Combined with the other funds managed by UTIMCO, namely the Intermediate Term Fund, and the Short Term and Debt Proceeds Funds, UTIMCO’s assets under management totaled $30 billion, also an all-time peak.

The Endowments’ actual returns exceeded the Policy Portfolio Benchmark by 1.3% for the PUF and 1.5% for the GEF. As a reminder, the Policy Portfolio Benchmark represents the returns that would result without UTIMCO staff, or said precisely, the investment returns that would be realized if each asset class was at its Policy Portfolio target weight and generated that asset class’ average returns.

Over the past five years, the Endowments actual returns have outperformed the Policy Portfolio Benchmark by an average of 2.1% per year, resulting in $428 million per year of additional resources for the UT and A&M Systems. In 2013 alone, $286 million of additional resources was generated.

UTIMCO analyzes other top endowments in order to identify “best practices”. Over the last few years, the Endowments’ investment returns have lagged other large endowments primarily due to the Endowments’ lower risk profile. The Endowments’ risk-adjusted returns are in the middle of the pack. UTIMCO staff, the UTIMCO Board (“Board”) and The University of Texas System Board of Regents (the “Regents”) have all concurred with having a less-risky portfolio, particularly given global economic uncertainties. While it is the case that risk has been rewarded over the past few years, there is agreement that the necessity to protect principal supersedes the desire for higher investment returns.

Investment Strategy

Readers of previous Annual Report letters may observe that this part of the annual letter has remained – and will remain again this year – consistent. That is because as a long-term investor our investment strategy remains relatively constant, while our implementation is flexible in order to capitalize on capital market opportunities.

Our core investment principles, and therefore strategy, include beliefs that:

• A diversified portfolio produces the best risk-adjusted returns. Therefore, we invest across all asset classes, capital structures, investment styles and geographies. One method of diversification is across investment styles, as manifest in our More Correlated and Constrained (“MCC”, or long-only), Less Correlated and Constrained (“LCC”, or hedge fund) and Private Investment exposures.

• Skill matters when investing. Therefore we continue to partner with the best investment managers around the globe. In fact, staff spends the majority of its time identifying, diligencing, structuring and monitoring external investment managers.

### Combined PUF and GEF Asset Allocation

<table>
<thead>
<tr>
<th>Asset Group</th>
<th>Asset Class</th>
<th>More Correlated &amp; Constrained</th>
<th>Less Correlated &amp; Constrained</th>
<th>Private Investments</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Income</td>
<td>Investment Grade</td>
<td>$1,559 (7.0%)</td>
<td>$648 (2.9%)</td>
<td>$0.0%</td>
<td>$2,207 (9.9%)</td>
</tr>
<tr>
<td></td>
<td>Credit-Related</td>
<td>23 (0.1%)</td>
<td>1,114 (5.0%)</td>
<td>1,062 (4.8%)</td>
<td>2,199 (9.9%)</td>
</tr>
<tr>
<td>Fixed Income Total</td>
<td></td>
<td>1,582 (7.1%)</td>
<td>1,762 (7.9%)</td>
<td>1,062 (4.8%)</td>
<td>4,406 (19.8%)</td>
</tr>
<tr>
<td>Real Assets</td>
<td>Real Estate</td>
<td>550 (2.5%)</td>
<td>114 (0.5%)</td>
<td>748 (3.3%)</td>
<td>1,412 (6.3%)</td>
</tr>
<tr>
<td></td>
<td>Natural Resources</td>
<td>2,140 (9.6%)</td>
<td>6 (0.0%)</td>
<td>1,061 (4.8%)</td>
<td>3,207 (14.4%)</td>
</tr>
<tr>
<td>Real Assets Total</td>
<td></td>
<td>2,690 (12.1%)</td>
<td>120 (0.5%)</td>
<td>1,809 (8.1%)</td>
<td>4,619 (20.7%)</td>
</tr>
<tr>
<td>Equity</td>
<td>Developed Country</td>
<td>3,238 (14.6%)</td>
<td>4,338 (19.5%)</td>
<td>2,492 (11.2%)</td>
<td>10,068 (45.3%)</td>
</tr>
<tr>
<td></td>
<td>Emerging Markets</td>
<td>2,143 (9.6%)</td>
<td>419 (1.9%)</td>
<td>594 (2.7%)</td>
<td>3,156 (14.2%)</td>
</tr>
<tr>
<td>Equity Total</td>
<td></td>
<td>5,381 (24.2%)</td>
<td>4,757 (21.4%)</td>
<td>3,086 (13.9%)</td>
<td>13,224 (59.5%)</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$9,653 (43.4%)</td>
<td>$6,639 (29.8%)</td>
<td>$5,957 (26.8%)</td>
<td>$22,249 (100.0%)</td>
</tr>
</tbody>
</table>
• A bias toward value is prudent, providing a margin of safety.

• Capital markets are subject to the same supply and demand imbalances at various times as other markets. Therefore, we look to take advantage of favorable imbalances in our investment decisions. For example, across many developed countries, particularly in Europe, capital demand exceeds capital supply in many assets classes, including real estate, where the bifurcation between core and non-core pricing is at historic highs.

• Emerging markets will continue to grow in the long term, albeit likely at lower rates than experienced over the past few decades. While economic growth creates demand for capital, we base our decision to provide capital on current asset pricing and expected returns. Emerging market investments present additional risks such as political and currency uncertainties, for which we must believe we will be compensated.

• Equity will outperform fixed income over the long term. Therefore we have an “equity orientation”. We also recognize, however, that during certain periods fixed income can present attractive risk-adjusted returns. We also retain a certain fixed income “cushion” to ensure liquidity to meet distribution and other short-term obligations.

• Real assets – real estate and natural resources – present attractive investment opportunities in an environment of monetary ease, as well as a “third leg” of diversification with stock and bonds. Attractive returns may be generated in real estate given the large amount of debt used to acquire assets, and in natural resources given the long-term demand dynamics and the capital intensive nature of the value-add supply chain.

• As an “in-perpetuity” investor our long-term horizon enables us to prudently assume reasonable levels of illiquidity risk. We are mindful of the uncertainty of being rewarded for expending illiquidity risk, so we work to be thoughtful and deliberate in our private commitments.

Every year we engage in a thorough review of our Investment Policies (“Policy”) with our Board and the Regents. This year we updated our five year investment strategy plan to continue increasing exposure in Real Assets and Private Investments.

Tactical Allocation and Portfolio Positioning

During 2013, although actual investment performance beat the Policy Portfolio by 1.3% in the PUF and 1.5% in the GEF, tactical allocation detracted .9%, or 90 basis points. Tactical allocation refers to staff’s positioning of investments in specific asset classes over or under Policy targets, but always within specified ranges.

Given concerns with the global economic environment, the portfolio was slightly under target in Developed Country and Emerging Market Equity. The underweight in Emerging Market equity proved prescient but the underweight in Developed Country equity detracted from performance.

The largest tactical detractor from investment returns in 2013 was the approximately 4% of the portfolio invested in gold. The investment was made a number of years ago and enhanced returns in prior years. The investment was made, and continues, as a hedge against excessive central bank monetary easing. If global growth improves, facilitating central banks removal of liquidity from capital markets, the gold investment may not yield attractive returns, but under this scenario the vast majority of the investment portfolio should produce more than adequate returns.

For the most part, the portfolio is invested close to target and undergoes only modest, incremental changes over the course of the year.

Highlights of the portfolio positioning include:

• Approximately 7% of the portfolio is invested in MCC Investment Grade Fixed Income. This part of the portfolio provides liquidity and diversification.

• The MCC Natural Resources portfolio includes the gold position, with the remainder evenly divided between broad commodity trading strategies and natural resources related public equities. MCC Real Estate brings core real estate exposure to the overall portfolio through investments with REIT investment managers. Each of the broad commodities, natural resources related public equity and REIT positions comprise approximately 2.5% of the overall Endowment portfolio.

• MCC Developed Country Public Equity exposure includes external managers focused on high-quality global companies as well as external managers who invest in mid and small capitalization companies. This exposure represents approximately 15% of the total Endowments.
In fact, UTIMCO staff focuses the vast majority of its effort on partnering with “best in class” managers in order to deliver this level of value added returns. One set of metrics underscoring this is that staff participated in over 1,075 meeting with prospective investment managers and over 1,350 meetings with existing managers during the year. These meetings are in addition to the materials that were reviewed and analyzed on existing and new investments, as well as the basic market research that is conducted on an ongoing basis.

- The MCC Investment Grade Fixed Income portfolio outperformed its benchmark by 3.1% as the market experienced an average loss of (3.4%) and our portfolio was down (.3%). This level of outperformance is stellar in this area of the capital markets.
- The MCC Real Estate active managers produced a 9.1% return, outperforming their benchmark by 3.2%, a very strong showing.
- The MCC Natural Resources portfolio was down (1.0%) versus a benchmark decline of (3.5%) as our public equity managers substantially outperformed their market averages.
- The MCC Developed Country Public Equity portfolio generated returns of 24.6%, far in excess of the market average 17.6%. Staff has focused on this part of the book over the past few years and is pleased that the results are so positive.
- The MCC Emerging Markets Public Equity portfolio was up 1.3%, also besting its benchmark return of .5%. Staff continues to focus on this portfolio and is pleased with the progress that has been made given that in previous years actual returns have lagged the market average.
- The LCC portfolio posted an 11.5% return, far in excess of the 6.1% average fund of fund benchmark. This portfolio continues to generate top or second decile returns relative to its peers.
- Private Investments generated returns of 13.3%, outpacing the market average return of 13.2%. And given the more conservative nature of our portfolio with such a large portion in less-risky, shorter-lived credit related investments, this outperformance is all the more impressive.

2013 Market Recap and 2014 Outlook
Central banks and centrally planned economies continue to dominate global capital markets, skewing their purely economic functioning.
The United States Federal Reserve talked of tapering, although none has yet transpired, while the federal government lurches from crisis to crisis without a pragmatic, realistic focus on long-term fiscal policy. Japan is easing mightily with uncertain implications, and structural reforms have yet to be adequately enacted. Europe is not dead but may not be fully alive either.

China’s new regime is dealing with a legacy of non-market directed over-investments. India is, as usual, navigating volatility not altogether unrelated to the country’s volatile governance. Russia remains resource rich and rule of law challenged. Brazil continues to combat inflation while debating the optimal level of government entitlements and redistribution.

Due to the fear of tapering, U.S. and Global Barclay’s bond indices were down -2.5% and -3.4%, respectively. Overall, commodities prices fell 10.6%, while spot oil prices rose 11.6%. Fueled with low cost capital, developed country equity markets posted strong gains during the 2013 fiscal year as both the S&P 500 and the EAFE rose 18.7%. Emerging market public equities were flat after being up over 12.5% at mid-year.

Our view for the past few years remains our view for the next few years, summarized in the headline “Long Workout, Long March”.

Growth areas exist, even in a Long Workout: U.S. energy and information technology’s global transformation are two examples. Certainly austerity is part of the equation, which provides more investment warnings than opportunities. Good assets being sold by stressed sellers at compelling discounts is another example of a Long Workout investment opportunity. Given the public nature of the debt, monetization may also be a dynamic and therefore an investment consideration.

Long Marches are messy and hard and never linear. Growth requires capital, and if it is invested with the right partners in the right structures and at the right prices, then attractive risk-adjusted returns should be earned. Perhaps the biggest single variable in country selection is whether the government has some record of commitment to free capital markets, governed by consistent laws and adjudicated when necessary in independent courts – and will continue to do so into the future.

Importantly, UTIMCO takes a “bottom-up” approach with the objective of “making one good investment at a time”. Our comprehensive and consistent engagement with investors across global capital markets helps position us to take advantage of opportunities as they present themselves.

**Board and Staff**

The Board and staff are the keys to UTIMCO’s investment success.

We are grateful for Paul Foster and Printice Gary’s service on the UTIMCO Board. Paul Foster’s leadership as Chairman was strong, steady, and thoughtful, and we wish him well as he assumes the Chairmanship of the Regents. We welcome Jeff Hildebrand and Robert Stillwell to our Board, and we appreciate Morris Foster agreeing to Chair the Board.

We are grateful for the open communications we have with our colleagues at the UT and A&M Systems and their respective institutions. In addition, we appreciate the oversight, direction and support we receive from the Regents.

We cannot express enough our gratitude to the UTIMCO staff, who has worked together now for a number of years to continuously enhance results. Senior investment staff is fully in place, seasoned, and integrated. Improvements in manager identification, investment structuring, and economic alignment efforts are being implemented. A major project to enhance information technology is underway. We have a great group of people who tirelessly apply their extraordinary skills to increase the resources available to the public institutions we serve. We couldn’t ask for a better team to be part of.

We are pleased to have had a positive year of investment returns. We believe we are prepared for whatever the markets may offer, and we are committed to doing our best, each and every day.

Bruce Zimmerman
Chief Executive Officer and
Chief Investment Officer

Cathy Iberg
President and Deputy
Chief Investment Officer
UTIMCO SENIOR MANAGEMENT As of August 31, 2013

BRUCE ZIMMERMAN – CEO and Chief Investment Officer
CATHY IBERG – President and Deputy CIO
LINDEL EAKMAN – Managing Director – Private Markets Investments
MARK WARNER – Managing Director – Natural Resources Investments
MARK SHOBERG – Managing Director – Real Estate Investments
SUSAN CHEN – Managing Director – Public Markets Investments
RYAN RUEBSAHM – Managing Director – Marketable Alternative Investments

UTIMCO BOARD OF DIRECTORS As of August 31, 2013

PAUL L. FOSTER (CHAIRMAN) – Chairman – Board of Regents, The University of Texas System; Executive Chairman – Western Refining, Inc., El Paso, Texas; Former Executive Committee, Former Chair and Member – El Paso Regional Economic Development Corporation; Former Chair – El Paso Chapter of the American Red Cross; Member – Texas Economic Development Corporation; Member – Advisory Board, Hankamer School of Business at Baylor University; Member – Executive Committee of the Paso del Norte Group; Former Member – Texas Higher Education Coordinating Board; Member – Bank of the West Board of Directors and Chairman of the Nomination and Governance Committee; Member – National Petroleum Club; Member – Governor’s Business Council; Former Member – Young Presidents’ Organization; Member – World Presidents’ Organization; Member – Business Advisory Council, University of Texas at El Paso; Former Member – Greater El Paso Chamber of Commerce Board of Directors; Board Member – American Fuel & Petrochemical Manufacturers; Chairman – Western Refining Logistics, LP; Chairman – Northern Tier Energy, GP LLC

ARDON E. MOORE (VICE CHAIRMAN) – Member – UTIMCO Compensation Committee; Member – UTIMCO Risk Committee; President and CEO – Lee M. Bass, Inc.; Member – The University of Texas Development Board; President – Fort Worth Zoological Association; Past President – All Saint’s Episcopal School of Fort Worth; Past Trustee – Texas Water Foundation; Past Trustee – Stanford Business School Trust; Past Trustee – Cook Children’s Hospital Foundation Board; Member – Advisory Council, The University of Texas McCombs School of Business

FRANCISCO G. CIGARROA, M.D. (VICE CHAIRMAN FOR POLICY) – Chancellor – The University of Texas System; Past President – The University of Texas Health Science Center at San Antonio; Member – Institute of Medicine of The National Academies; Fellow – American College of Surgery; Diplomate – American Board of Surgery; Member – American Medical Association; Member – Texas Medical Association; Trustee – Yale Corporation; Past President – Texas Academy of Medicine, Engineering, and Science of Texas (TAMEST); Member – Council of University Presidents and Chancellors; Member – President’s Advisory Commission on Educational Excellence for Hispanics

KYLE BASS – Member – UTIMCO Compensation Committee; Member – UTIMCO Policy Committee; Member – UTIMCO Risk Committee; Managing Partner – Hayman Capital Management, L.P.; Founding Member – Serengeti Asset Management Advisory Board; Director – Troops First Foundation; Former Director – ABS Credit Derivatives Users Association; Former Managing Director – Legg Mason, Inc.; Former Senior Managing Director – Bear, Sterns & Co.

MORRIS FOSTER – Member – UTIMCO Risk Committee; Member – UTIMCO Policy Committee; Member – Board of Regents, The Texas A&M University System; Past Chairman – Board of Regents, The Texas A&M University System; Chairman – Stagecoach Properties, Inc.; Director – First State Bank of Central Texas; Director – Tidewater, Inc.; Former President – ExxonMobil Production Company; Member – Board of Scott & White Medical Institute
UZIEL YOELI – Senior Director – Portfolio Risk Management
JOAN MOELLER – Senior Managing Director – Accounting, Finance and Administration
ANNA CECILIA GONZALEZ – General Counsel and Chief Compliance Officer
UCHE ABALOGU – Chief Technology Officer
FIDUCIARY COUNSEL – Andrews Kurth, LLP, Austin, Texas
INDEPENDENT AUDITORS – Deloitte & Touche LLP

PRINTICE L. GARY – Chair – UTIMCO Policy Committee; Member – UTIMCO Audit and Ethics Committee; Former Member – Board of Regents, The University of Texas System; CEO and Managing Partner – Carleton Residential Properties; Former Division Partner – Trammell Crow Residential; Member – Board of the Southwestern Medical Foundation; Member – Board of the National Equity Fund; Former Trustee – Carleton College

R. STEVEN HICKS – Chair – UTIMCO Compensation Committee; Member – UTIMCO Audit and Ethics Committee; Member – UTIMCO Policy Committee; Vice Chairman – Board of Regents, The University of Texas System; Chairman – Board of Regents, The University of Texas System - Academic Affairs Committee; Member – Board of Regents, The University of Texas System - Audit, Compliance and Management Committee; Member – Board of Regents, The University of Texas System - Facilities Planning and Construction Committee; Member – Board of Regents, The University of Texas System - Technology Transfer and Research Committee; Chairman – Capstar Partners, LLC; Member – Gentiva Health Services

CHARLES W. TATE – Chair – UTIMCO Risk Committee; Member – UTIMCO Audit and Ethics Committee; Chairman & Founding Partner – Capital Royalty L.P.; Former Partner and Member of Management Committee – Hicks, Muse, Tate & Furst Incorporated; Former Managing Director – Morgan Stanley & Co. Incorporated; Inductee – 2002-2003 University of Texas McCombs School of Business Hall of Fame; Member – University of Texas Business Productivity Committee - Chairman; Technology Commercialization Sub-committee; Chairman – External Advisory Committee of The University of Texas Department of Biomedical Engineering; Member – The University of Texas Development Board; Member – The University of Texas System Chancellor’s Technology Commercialization Advisory Cabinet; Co-Vice Chair – The University of Texas “Campaign for Texas”; Member – The University Cancer Foundation Board of Visitors & Executive Committee for The University of Texas M.D. Anderson Cancer Center; Member – The Robert A. Welch Foundation Board of Directors; Member – Industry & Community Affiliates Committee of The Academy of Medicine, Engineering & Science of Texas; Recipient – 2007 University of Texas Distinguished Alumnus Award; Member – Board of Overseers of the Columbia University Graduate School of Business

JAMES P. WILSON – Chair – UTIMCO Audit and Ethics Committee; Member – UTIMCO Compensation Committee; Managing Director – Rock Hill Capital Group; Former Member and Past Vice Chairman – Board of Regents, The Texas A&M University System; Past Chair – 12th Man Foundation Board of Trustees; Member – Board for Lease of University Lands; Past Member – Mays Business School Development Council; Past Member – Board of Directors, Fort Bend Education Foundation; Former Managing Partner – RSTW Partners; Past Member – Board of Directors, Texas Growth Fund