

ANNUAL REPORT

2011



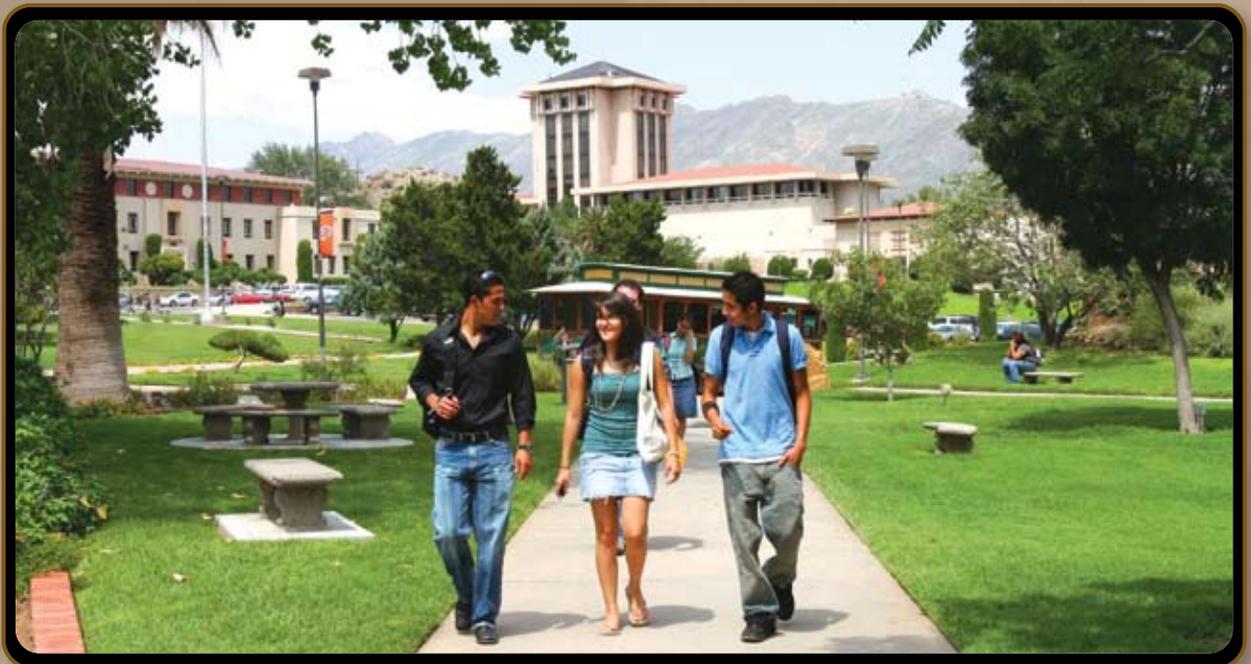


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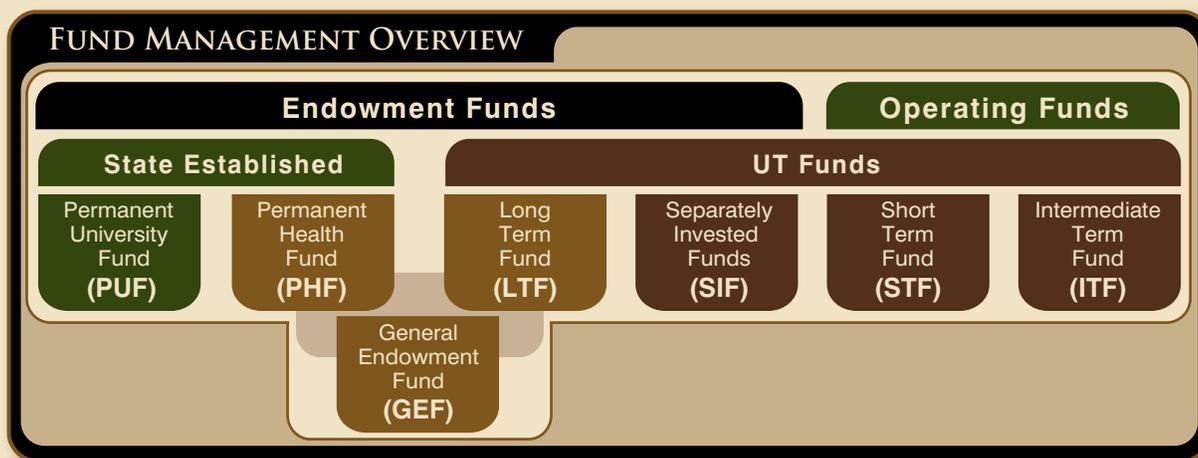
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FUND MANAGEMENT OVERVIEW

The University of Texas Investment Management Company (UTIMCO) manages the investment assets under the fiduciary care of the Board of Regents of The University of Texas System (UT Board). UTIMCO is governed by a nine member Board of Directors - three Regents of the UT Board, four outside directors with experience in investment management appointed by the UT Board, the Chancellor of The University of Texas System (UT System), and one director nominated by the Board of Regents of Texas A&M University System (A&M Board). The UT Board has delegated the day-to-day investment management responsibilities of the funds to UTIMCO, subject to

compliance with UT Board approved investment policies. The UTIMCO staff includes approximately 55 specialists in various investment disciplines, as well as risk management, compliance, legal, accounting, finance and information technology.

UTIMCO invests the endowment and operating assets entrusted to its management primarily through external investment managers in accordance with the approved Investment Policies. These external investment managers are then combined into internal "mutual funds", each with distinct time horizons and unique risk and return characteristics.



ENDOWMENT FUNDS

UTIMCO manages four major endowment funds under the fiduciary care of the UT Board. These four endowment funds, with a combined market value of \$19.9 billion, are the Permanent University Fund (PUF), the Permanent Health Fund (PHF), the Long Term Fund (LTF), and the Separately Invested Funds (SIF). Two of the endowment funds, the PHF and the LTF, are invested in shares of the General Endowment Fund (GEF), a broadly diversified pooled investment fund managed by UTIMCO. The GEF was created to increase efficiencies in managing investments, reduce costs, and streamline reporting.

Representing a permanent legacy, endowment funds provide the means to create a margin of excellence in higher education for UT and Texas A&M System's institutions. Since endowment funds are permanent funds by their nature, they must provide

for the economic needs of today while remaining intact to provide the same level of economic support for future generations, not just the next ten to twenty years, but hundreds of years in the future. The trade-off between preserving assets for tomorrow and supporting the educational and health care needs of today creates the need for a delicate balancing act in managing the endowment funds.

Balancing the competing needs of current beneficiaries, future beneficiaries and donors is the motivating force behind UTIMCO's efforts to achieve the following two primary objectives:

1. Provide for current beneficiaries by increasing annual distributions at a rate at least equal to the current rate of inflation so that real purchasing power is maintained, and



2. Provide for future beneficiaries by increasing the market value of endowment assets so that future distributions to future beneficiaries will buy the same or better level of goods and services received by today's beneficiaries (before adding any current contributions and after deducting current distributions).

Four factors affect an endowment fund's ability to meet the competing needs of current and future beneficiaries. These factors are a) fund distributions, b) the rate of inflation, c) fund investment return, and d) fund expenses.

a) Endowment Fund Distributions (Spending).

The UT Board determines the annual distributions from the endowments. 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 funds' average annual investment return minus fund expenses and inflation over the long-term. The UT Board has approved two distinct forms of distribution or spending policies. One is the so-called "constant growth" spending policy, and the other is the "percent of assets" spending policy.

The PHF and LTF utilize the constant growth spending policy. The PHF and LTF distributions are increased annually at the average rate of inflation for the three preceding years, provided that the distribution rate remains within a range of 3.5% and 5.5% of fund asset value. The constant growth spending policy uses a smoothing formula to reduce annual volatility in spending and to maintain spending on a sustainable basis.

The PUF utilizes the percent of assets spending policy. The PUF's annual distributions are based on a distribution rate of 4.75% of the PUF's three-year average net asset value. This policy has been chosen for the PUF because it is best for endowments in which the current distribution is small relative to the

total budget, and where long-term growth of the fund is the key objective, which are the characteristics of the PUF and its beneficiaries.

b) Inflation. Inflation erodes the economic value of an endowment fund by reducing the endowment's purchasing power over time. Endowment assets must be invested so as to maximize the total return after inflation. The long-term expected rate of inflation is 3.0%.

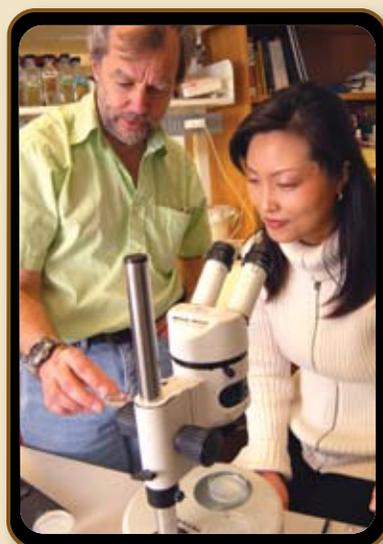
c) Investment Returns. Investment returns generated by the endowment funds are determined primarily by the allocation of fund assets to different asset classes and types of investments, and by the ability of the UTIMCO staff to add value by earning returns greater than those generally available from each asset category. UTIMCO draws on years of investment experience and expertise to determine the best allocations to different categories of assets in order to achieve the returns necessary to meet objectives while endeavoring to protect endowment assets from severe losses in adverse market environments. Once allocation decisions are made, UTIMCO focuses on earning the highest returns possible within each asset category while maintaining strict risk control through a quantitative risk budgeting process and qualitative judgments. **Figure A** shows the investment returns earned for periods ended August 31, 2011, which are a result of these asset allocation decisions and risk budgeting processes.

UTIMCO's strategy is to invest the assets of the PUF and GEF in broadly diversified portfolios of equity, fixed income and real assets across global markets using a long-term investment horizon. In order to earn above market returns, UTIMCO also focuses on a number of different investment categories characterized by complex, illiquid, and mispriced securities where proprietary information and sophisticated investment strategies offer the opportunity for value-added returns. These asset categories have an additional important advantage. Because these assets typically provide returns which

FIG. A INVESTMENT RETURNS

| Endowment Funds | (in millions) Net Asset Value August 31, 2011 | Annual Returns for Periods Ended August 31, 2011 | | | |
|------------------------------|---|--|----------------|---------------|--------------|
| | | One Year | Three Years | Five Years | Ten Years |
| Permanent University Fund | \$12,688 | 14.62% | 4.08% | 4.68% | 7.05% |
| General Endowment Fund: | | | | | |
| Permanent Health Fund | 993 | 14.76% | 3.97% | 4.73% | 7.14% |
| Long Term Fund | 6,057 | 14.77% | 3.97% | 4.73% | 7.16% |
| Separately Invested Funds | 128 | N/A | N/A | N/A | N/A |
| Total Endowment Funds | \$19,866 | | | | |

have a low correlation with those of the more traditional exchange-traded equities and fixed income securities (“More Correlated and Constrained”) in the PUF and GEF portfolios, they offer the additional advantage of diversifying and, therefore, reducing the overall risk level. These investments include hedge funds (“Less Correlated and Constrained”) and Private Investments, including venture capital, buy-out, growth, real estate and natural resources-related opportunities.



the PUF and GEF. Equity values can fluctuate in response to the activities of individual companies as well as to general market conditions. Bond prices can fluctuate based on changes in interest rates and the credit quality of the issuers. Real assets prices respond to inflation expectations and specific market supply and demand factors. Investments in non-U.S. securities can involve political and macroeconomic risk in addition to typical individual company risks. An additional element of risk in non-U.S. investments is the currency risk, as

To properly diversify the PUF and GEF assets, UTIMCO invests in a broad variety of asset categories. Asset allocation policy recommendations to the UT Board are developed through careful asset allocation reviews with the UTIMCO Board in which potential returns for each asset category and investment type are balanced against the contribution to total portfolio risk by each category. An asset allocation review is undertaken by the UTIMCO staff, the UTIMCO Board and the UT Board every year.

the returns on those investments must be converted to U.S. dollars for use here. Private investments (and, to some extent hedge funds) also have an element of liquidity risk, due to the fact that some of these investments cannot be easily converted to cash at short notice. Hedge funds also often entail leverage risk.

While the allocations in **Figure B** indicate the actual asset allocation as of August 31, 2011, UTIMCO repositions the allocations to each asset category and investment type from time to time in response to changes in the investment outlook, within the ranges specified in the investment policies adopted by the UT Board.

All these risks are carefully monitored by both the UTIMCO staff and the UTIMCO Board. It is essential that some risk must be assumed in order to earn the levels of real returns necessary to meet the long term goals of the PUF and GEF. However, it is particularly important to carefully weigh each element of risk against the reward – expected future returns. The quantitative process used at UTIMCO to evaluate risks and rewards is known as risk budgeting. The UTIMCO staff is charged with carefully budgeting risks so that the risk assumed in the aggregate does not exceed the risk limits set by the UT Board. Risks are monitored daily and

While the UTIMCO staff works diligently to earn the highest investment returns possible while maintaining risk at acceptable levels, there are still risks associated with the investments held in

FIG. B COMBINED PUF AND GEF ASSET ALLOCATION

as of August 31, 2011
(\$ in millions)

| Asset Group | Asset Class | More Correlated & Constrained | | Less Correlated & Constrained | | Private Investments | | Grand Total | |
|---------------------------|-------------------|-------------------------------|--------------|-------------------------------|--------------|---------------------|--------------|-----------------|----------------------------|
| | | \$ | % | \$ | % | \$ | % | \$ | % |
| Fixed Income | Investment Grade | \$ 2,151 | 10.9% | \$ 559 | 2.8% | \$ – | 0.0% | \$ 2,710 | 13.7% |
| | Credit-Related | 20 | 0.1% | 868 | 4.4% | 1,319 | 6.7% | 2,207 | 11.2% |
| Fixed Income Total | | 2,171 | 11.0% | 1,427 | 7.2% | 1,319 | 6.7% | 4,917 | 24.9% |
| Real Assets | Real Estate | 447 | 2.3% | 124 | 0.6% | 265 | 1.3% | 836 | 4.2% |
| | Natural Resources | 2,493 | 12.6% | 11 | 0.1% | 519 | 2.6% | 3,023 | 15.3% |
| Real Assets Total | | 2,940 | 14.9% | 135 | 0.7% | 784 | 3.9% | 3,859 | 19.5% |
| Equity | Developed Country | 1,725 | 8.7% | 3,779 | 19.2% | 2,366 | 12.0% | 7,870 | 39.9% |
| | Emerging Markets | 1,844 | 9.4% | 503 | 2.5% | 455 | 2.3% | 2,802 | 14.2% |
| Equity Total | | 3,569 | 18.1% | 4,282 | 21.7% | 2,821 | 14.3% | 10,672 | 54.1% |
| Grand Total | | \$ 8,680 | 44.0% | \$ 5,844 | 29.6% | \$ 4,924 | 24.9% | \$19,448 | 98.5%^(A) |

(A) Grand total asset allocation percentage as of August 31, 2011 is less than 100% due to the hedging of certain long equity exposures within the portfolio.



FIG. C ASSET ALLOCATION COMPARISON

| | Endowment Funds Peer Group May 31, 2011 | Combined PUF and GEF Actual Allocation August 31, 2011 ^(A) |
|---------------------|---|---|
| Fixed Income | 9.9% | 11.0% |
| Equity | 28.6% | 18.1% |
| Real Estate | 7.8% | 2.3% |
| Natural Resources | 10.1% | 12.6% |
| Hedge Funds | 19.6% | 29.6% |
| Private Investments | 24.0% | 24.9% |

(A) Grand total asset allocation percentage as of August 31, 2011 is less than 100% due to the hedging of certain long equity exposures within the portfolio.

Source: Cambridge Associates, Inc.

monthly by UTIMCO staff and quarterly by the UTIMCO Board.

Figure C indicates how the current strategic allocation of the PUF and GEF compares with a peer group of endowment funds which is comprised of endowment funds with portfolios greater than \$2.5 billion and staffs utilizing private investments and hedge funds.

Expenses. UTIMCO incurs expenses associated with analysis, portfolio management, custody and safekeeping, accounting, and other investment

related services. Investment fees and other fees paid to external managers are, by far, the largest component of expenses. The majority of external investment manager fees are netted against the PUF's and GEF's asset value or capital, with the remainder being paid from fund assets.

Endowments require investment management in accordance with long-term investment objectives because of the perpetual nature of the funds. Recognizing that the investment environment will only become more challenging in the future, UTIMCO will meet the challenge by maintaining a specialized and experienced investment staff focused on adding value within a well-structured and disciplined asset allocation and risk control process.

UTIMCO's management of \$27 billion of assets, including both endowment and operating funds, provides for exceptional economies of scale in the investment of the assets. The ratio of UTIMCO's management fee to assets under management was .067% for the year ended August 31, 2011.

FUND OVERVIEWS

LTF

Totalling \$6.1 billion, the LTF is a pooled UT System investment fund for the collective investment of over 9,800 privately raised endowments and other long-term funds benefiting the 15 institutions of the UT System. Most gifts given to fund endowments are commingled in the LTF and tracked with unit accounting much

like a large mutual fund. Each endowment or account purchases units at the LTF's market value per unit. Cash distributions are paid quarterly, on a per unit basis, directly to the UT System institution of record. Distributions from the LTF fund scholarships, teaching, and research across the UT System.

FIG. D LONG TERM FUND FINANCIAL HIGHLIGHTS

| Years Ended August 31, | 2007 | 2008 | 2009 | 2010 | (in millions) 2011 |
|------------------------------------|---------|---------|---------|---------|-----------------------|
| Beginning Net Asset Value | \$4,441 | \$5,333 | \$5,285 | \$4,517 | \$5,130 |
| Contributions (Net of Withdrawals) | 363 | 355 | 192 | 290 | 439 |
| Distributions (Payout) | (199) | (217) | (236) | (253) | (282) |
| Net Investment Return | 728 | (186) | (724) | 576 | 770 |
| Ending Net Asset Value | \$5,333 | \$5,285 | \$4,517 | \$5,130 | \$6,057 |

FIG. E OWNERSHIP OF LONG TERM FUND

| August 31, 2011 | Accounts | (in millions) Value |
|---|--------------|------------------------|
| UT System Administration | 140 | \$29 |
| UT Arlington | 479 | 77 |
| UT Austin | 4,694 | 2,615 |
| UT Dallas | 217 | 220 |
| UT El Paso | 591 | 136 |
| UT Pan American | 103 | 31 |
| UT Brownsville | 107 | 8 |
| UT Permian Basin | 105 | 17 |
| UT San Antonio | 326 | 69 |
| UT Tyler | 223 | 67 |
| UT Southwestern Medical Center | 474 | 772 |
| UT Medical Branch at Galveston | 686 | 417 |
| UT Health Science Center at Houston | 420 | 145 |
| UT Health Science Center at San Antonio | 365 | 168 |
| UT MD Anderson Cancer Center | 440 | 391 |
| UT Health Science Center at Tyler | 40 | 11 |
| Other Accounts | 444 | 884 |
| Total | 9,854 | \$6,057 |

PHF

Totaling \$1.0 billion, the PHF is a pooled UT System investment fund for the collective investment of state endowment funds for health-related institutions of higher education, created

with proceeds from state tobacco litigation. Distributions from the PHF fund programs that benefit medical research and health education.

FIG. F PERMANENT HEALTH FUND FINANCIAL HIGHLIGHTS

| Years Ended August 31, | 2007 | 2008 | 2009 | 2010 | (in millions) 2011 |
|------------------------------------|----------------|----------------|--------------|--------------|-----------------------|
| Beginning Net Asset Value | \$987 | \$1,100 | \$1,026 | \$842 | \$905 |
| Contributions (Net of Withdrawals) | - | - | - | - | - |
| Distributions (Payout) | (41) | (42) | (43) | (44) | (45) |
| Net Investment Return | 154 | (32) | (141) | 107 | 133 |
| Ending Net Asset Value | \$1,100 | \$1,026 | \$842 | \$905 | \$993 |

FIG. G PERMANENT HEALTH FUND OWNERSHIP ALLOCATION

| August 31, 2011 | (in millions) Value |
|--|------------------------|
| Permanent Health Fund for Higher Education | \$424 |
| UT Health Science Center at San Antonio | 242 |
| UT MD Anderson Cancer Center at Houston | 121 |
| UT Southwestern Medical Center | 61 |
| UT Medical Branch at Galveston | 30 |
| UT Health Science Center at Houston | 30 |
| UT Health Science Center at Tyler | 30 |
| UT El Paso | 30 |
| Regional Academic Health Center | 25 |
| Total | \$993 |



THE UTIMCO TEAM

**PUF**

Totaling \$12.7 billion, the PUF is a public endowment contributing to the support of 18 institutions and 6 agencies in the UT System and The Texas A&M University System (TAMU System).

The Texas Constitution of 1876 established the PUF through the appropriation of land grants previously designated to The University of Texas, as well as an additional one million acres. Another state grant of one million acres was made in 1883.

PUF Lands, which today consist of more than 2.1 million acres located primarily in 19 counties in West Texas, are managed by the UT System under the direction of the UT Board. In administering PUF Lands, the UT System's mission is to generate income and apply intensive conservation measures to maintain and/or improve the productivity of the lands for the benefit of the PUF. In keeping with this purpose, the lands are managed to produce two streams of income: one from oil, gas, and mineral interests, and the other from surface interests such as grazing.

Surface acreage of the sparsely populated PUF Lands has been leased primarily for grazing and easements for power lines and pipelines. As mandated by the Constitution, all surface lease income is deposited in the Available University Fund (AUF). Mineral income generated by PUF Lands consists primarily of bonuses and rentals from the periodic sale of mineral leases, and royalties on gross revenues from oil, gas, and sulphur production. The Constitution requires that all income from the sale of PUF Lands and leasing of mineral interests be retained within the PUF and invested in PUF Investments.

Distributions from PUF Investments to the AUF are allocated two-thirds for the benefit of eligible institutions of the UT System and one-third for the benefit of eligible institutions of the TAMU System. PUF distributions paid to the AUF are expended by each university system to fund two major programs as follows:

PUF BENEFICIARIES**THE UNIVERSITY OF TEXAS SYSTEM**

- UT Arlington
- UT Austin
- UT Dallas
- UT El Paso
- UT Permian Basin
- UT San Antonio
- UT Tyler
- UT Southwestern Medical Center
- UT Medical Branch at Galveston
- UT Health Science Center at Houston
- UT Health Science Center at San Antonio
- UT MD Anderson Cancer Center
- UT Health Science Center at Tyler

THE TEXAS A&M UNIVERSITY SYSTEM

- Prairie View A&M University
- Tarleton State University
- Texas A&M University
 - Texas A&M at Galveston
- The Texas A&M Health Science Center
- Texas Agricultural Experiment Station
- Texas Agricultural Extension Service –
 - Texas Cooperative Extension
- Texas Engineering Experiment Station
- Texas Engineering Extension Service
- Texas Forest Service
- Texas Transportation Institute



Debt Service on PUF Bonds Issued to Fund Capital Expenditures

The Constitution authorizes the UT Board and the A&M Board to issue bonds (PUF bonds) payable from their respective interests in PUF distributions. PUF Bonds are issued to finance construction and renovation projects, major library acquisitions, and educational and research equipment at the 18 eligible campuses and six agencies of the UT and TAMU Systems. The UT Board and the A&M Board are constitutionally authorized to issue bonds secured by each system's interest in PUF distributions in an amount not to exceed 20% and 10%, respectively, of the book value of PUF assets at the time of issuance. The \$1,714.2 million of outstanding UT System PUF bonds were rated AAA, Aaa and AAA by Fitch Ratings, Moody's Investors Service, Inc., and Standard & Poor's Inc., respectively, as of fiscal year end. The \$644.2

million of outstanding TAMU System PUF bonds were rated AAA, Aaa and AAA by Fitch Ratings, Moody's Investors Service and Standard & Poor's Inc., respectively, as of the fiscal year end.

Academic Excellence Programs

PUF distributions, after payment of debt service on PUF bonds, are used to fund academic excellence programs at UT Austin, Texas A&M University, and Prairie View A&M University. Expenditures for excellence programs encompass library enhancements, specialized science and engineering equipment, student counseling services, graduate student fellowships, and National Merit and other scholarships. In combination, these activities enhance the universities' competitive posture as they seek to attract the best scholars in fulfilling their roles as world-class academic and research universities.

FIG. H PERMANENT UNIVERSITY FUND FINANCIAL HIGHLIGHTS

| Years Ended August 31, | 2007 | 2008 | 2009 | 2010 | (in millions) 2011 |
|---------------------------------|-----------------|-----------------|----------------|-----------------|-----------------------|
| Beginning Net Asset Value | \$10,313 | \$11,743 | \$11,359 | \$9,674 | \$10,725 |
| PUF Lands Mineral Contributions | 273 | 458 | 340 | 338 | 896 |
| Distributions to AUF | (401) | (449) | (531) | (516) | (506) |
| Net Investment Return | 1,558 | (393) | (1,494) | 1,229 | 1,573 |
| Ending Net Asset Value | \$11,743 | \$11,359 | \$9,674 | \$10,725 | \$12,688 |

OPERATING FUNDS

Operating funds are used primarily to fund UT System institutions' short-term operating needs as well as medium-term institutional needs associated with capital programs, financial reserves, and endowment matching funds. The UT System institutions have two investment fund options, the Short Term Fund

(STF) and the Intermediate Term Fund (ITF). The ITF was established February 1, 2006, to improve the efficiency of operating funds management and to improve investment returns on UT System operating reserves. As of August 31, 2011, operating funds of UT System institutions amounted to \$6.8 billion.



LETTER FROM THE EXECUTIVE MANAGEMENT OF UTIMCO

Fiscal Year 2011 Returns

The Permanent University Fund (the “PUF”) and the General Endowment Fund (the “GEF”) – together the “Endowments” – had investment gains of 14.62% and 14.74%, respectively, for the fiscal year ending August 31, 2011. PUF assets totaled \$12.7 billion and GEF assets totaled \$7.1 billion at fiscal year-end. This represents all-time peaks for the Endowments.

As noted in last year’s Annual Report, the previous peak for Endowment assets occurred in October 2007 - coinciding with the peak in the public equity markets. Since then, adjusting for contributions and distributions in order to reflect only investment returns, the Endowments’ assets are at 101 cents on the dollar, as compared to public equity markets which are at 85 cents on the dollar.

The Endowments’ actual returns were 2.63%, or 263 basis points, in excess of the Policy Portfolio Benchmark, thus producing \$461 million of additional assets for the UT and A&M Systems. As a reminder, the Policy Portfolio Benchmark represents the returns that would result without UTIMCO staff: namely the returns from investing at each asset class’ target weight and receiving the market average returns for each asset class. The outperformance in 2011 is due almost exclusively to the active management on the part of external investment managers, as tactical allocations – which reduced the risk of the overall portfolio – had very little effect (positive 6 basis points) on investment returns.

For the twelve months ending June 30, 2011, the twenty largest university endowments had returns ranging from 11.7 % to 24.5%. The best returning five endowments produced 23.0%-24.5%, the bottom five endowments produced 11.7%-18.9%, and the middle ten, which include UTIMCO, produced 20.0%-22.4% returns. Importantly, for the three year period ending June 30, 2011, UTIMCO ranked 6th among the twenty largest endowments.

The Intermediate Term Fund (the “ITF”) returned 11.39% for the fiscal year. Actual performance was 2.33% better than the Policy Portfolio Benchmark, producing \$99 million of additional assets for the fifteen institutions comprising the UT System. Thus, in total UTIMCO staff added \$560 million of additional assets to the Funds it manages.

Investment Strategy

UTIMCO’s investment strategy remains both constant and flexible, which we believe is appropriate for our long-term mandate.

We believe that when it comes to investing, skill matters. Therefore, we continue to rely on ‘best in class’ external investment managers. This is evident across all investment styles: long only, hedge funds and private equity.

We believe that a diversified portfolio produces the best risk-adjusted returns so we invest across asset classes, investment styles, geographies and other metrics of differentiation.

We believe that equities will outperform fixed income over the long-term, particularly in areas with solid economic growth, so we retain an “equity orientation”. However, we also recognize that during certain periods of time fixed income can provide extremely attractive risk-reward opportunities so we are not rigid in our implementation of an “equity oriented” investment strategy. In fact, as of August 31, 2011, 24.9% of the Endowments’ assets were invested in fixed income securities and 19.5% were invested in real assets (albeit, often in the form of equity).

We have a bias towards value and welcome a margin of safety in our investments. We also believe in the growth prospects of many emerging markets, but are mindful of valuations and the political and economic risks in these areas. Said another way, as long as we invest at the right price we are always happy to benefit from the positive effects of growth.

We believe that as an “in-perpetuity” investor our long-term horizon allows us to assume prudent levels of illiquidity as long as we are appropriately compensated. That said, we are ever mindful of maintaining safe levels of liquidity from which to meet our obligations.

We believe that our portfolio will benefit from continuing to add exposure to real assets – natural resources and real estate – both from the attractive risk-reward opportunities of the individual investments as well as from their portfolio diversifying and hedging of potential inflation characteristics. We continue to phase implementation of these strategies in the portfolio.

This year, as we do every year, we engaged in a thorough review of our Investment Policies with the UTIMCO Board of Directors and the Board of Regents of The University of Texas System, both of which helped shape and ultimately affirmed the Funds' investment strategies. This year's process included a strategy offsite meeting which proved very informative and beneficial.

Tactical Allocation and Portfolio Positioning

Over the course of the fiscal year, tactical asset allocation added six basis points of return, but more importantly it served to reduce the portfolio's risk as the Endowments' averaged 91% of the risk of the Policy Portfolio.

Under-weights to Emerging Markets Equity and over-weights to Natural Resources and Private Investments (which were highly concentrated in credit related opportunities) positively contributed to the tactical investment outperformance. An under-weight to Developed Country Equity, and an over-weight to Investment Grade Fixed Income, however offset some of the tactical asset allocation gross gains, as we maintained a defensive position throughout the year.

The long-only ("More Correlated and Constrained" or "MCC") Investment Grade Fixed Income allocation of 10.9% of total assets at fiscal year-end is slightly lower than last year's 13.1%, although we maintain a defensive positioning and continue to have 'dry powder'. While this may cost some in the short term, we believe that maintaining the flexibility to take advantage of opportunities as they arise and ample liquidity from which to meet our obligations will benefit the Endowments in the long term.

MCC Credit Related Fixed Income declined from 1.3% of total assets at fiscal year-end 2010 to 0.1% at fiscal year-end 2011. During the continued rally in these markets during the past twelve months, we harvested 20% gains.

MCC Real Estate assets also declined from 3.0% of total assets at fiscal year-end 2010 to 2.3% at fiscal year-end 2011. Again, the continuing rally in these markets, coupled with our concern about the underlying fundamentals in the real estate markets, led us to monetize some of our gains.

MCC Natural Resources assets increased from 8.1% of total assets at fiscal year-end 2010 to 12.6% at fiscal year-end 2011. A substantial portion of this increase is attributable to a position in gold we laddered into during fiscal years 2010 and 2011. We allocated assets to gold as a hedge for our overall

portfolio against weakening currencies, particularly the U.S. dollar, Euro and Yen. To date, this tactical position has produced strong returns. The majority of our MCC Natural Resources portfolio remains allocated to active, long-only natural resources-related public equities as well as a diversified portfolio of actively managed commodity futures.

MCC Developed Country Public Equity assets were reduced from 12.4% of total assets to 8.7% of assets during the fiscal year. We remain underweight in public equities as a result of our shift to credit-related assets and our gold position. The Developed Country Public Equity exposure we do have is generally comprised of managers who invest in high-quality, global companies as well as managers who typically invest in midcap companies that have a unique, defensible niche.

MCC Emerging Market Public Equity assets remained constant, ending fiscal year 2011 at 9.4%. Our portfolio consists of a diversified set of managers, with some investing globally across all emerging markets, some investing across emerging regions such as in Asia or the Middle East and Africa, and others investing in specific countries such as Brazil, China and Russia.

Hedge Funds ("Less Correlated and Constrained" or "LCC" managers) remain the single largest allocation, although this slightly decreased from 30.3% at the end of fiscal year 2010 to 29.6% at the end of fiscal year 2011. UTIMCO has a diversified portfolio of approximately forty LCC managers employing a wide variety of investment strategies including long/short equities, distressed securities, global macro, relative value and other approaches. Our largest ten managers represent approximately 60% of our LCC portfolio. All but two of these managers have been in our portfolio for over five years. One of the other two is a manager that is headed by individuals that departed from organizations with which we have had a long term relationship. The final manager is one we have known for over a decade and which had been closed to new investments until three and a half years ago. Our LCC managers utilize modest levels of leverage, provide substantial transparency, practice strong risk management and generally approach investing with a value bias based on superior fundamental research.

Lastly, UTIMCO's Private Investments increased from 22.4% of total assets at fiscal year-end 2010 to 24.9% at fiscal year-end 2011. The composition of this portfolio is important. Approximately one-quarter of the total Private Investments are in credit-related strategies that have shorter lives, employ less leverage,



and much have more downside protection than traditional buyout-oriented private equity. Another fifteen percent of the private portfolio is comprised of venture capital investments. The remaining half of our private portfolio is distributed across natural resources, real estate, small and mid-cap buyout and growth capital – primarily in emerging markets which is where the majority of global GDP growth came from over the past year. Growth in this half of the portfolio was the primary source of growth in the overall Private Investment portfolio.

During the fiscal year, UTIMCO received \$820 million in distributions from the Private Investment portfolio, sent \$1,075 million of capital to our general partners and made 28 new commitments totaling \$1,413 million in Private Investments.

One tactical activity that bears particular mention is staff's efforts to protect the Endowments from severe drawdown should dramatic scenarios unfold. For example, in the event of a sovereign default, high U.S. inflation, or the severe slowing of emerging market growth – to name a few such dramatic events – staff forecasts that the Endowments' returns would be insufficient given the investment objectives.

To protect against such scenarios, "insurance", in the form of financial options have been purchased. The maximum loss of such activities is known: it is the cost of the option. This cost would be realized should these scenarios not unfold, however, if the scenarios do not come about the Endowments' returns should remain sufficient to meet the investment objectives. Should one or more of these dramatic scenarios unfold, the 'insurance' would help offset the losses likely to be incurred in the overall portfolio.

While there is no "free lunch" the current cost of such "insurance" has been determined to be acceptable given the severe undesirable consequences of not having the "insurance" in place. This activity has been fully vetted with the UTIMCO Board and the UT System Board of Regents, and is carefully monitored and reported in detail.

Active Management

The efforts of our external investment managers in buying and selling securities to produce investment returns that exceed their markets' averages is referred to as "active management". These efforts generated approximately 2.68% or 268 basis points of "value-add" or approximately \$550 million of additional assets for the Endowments and ITF during the fiscal year.

Our active long-only, or MCC, Investment Grade Fixed Income managers underperformed their market averages, or benchmarks, by 0.08% or 8 basis points. Our long-only Credit Related Fixed Income managers generated investment returns of 20.2% vs. the market average of 9.2%.

MCC Real Estate managers generated an 8.7% return versus their market average of 15.5% and the Natural Resources managers delivered 35.5% returns, significantly outpacing their market average of 25.1%.

During fiscal year 2011, our MCC Developed Country Public Equity managers delivered 15.5% returns, exceeding their market average or benchmark returns of 14.5%. And our MCC Emerging Market Public Equity managers produced returns of 9.3%, besting their benchmark returns of 9.1%.

LCC managers continue to outperform the market average, posting returns of 7.5% versus the average hedge fund of fund return of 3.0%.

Private Investment managers produced a 23.3% return, versus a market average 20.0% return. Of particular note, over five years ago the Private Investment staff determined that UTIMCO's venture capital portfolio was not world class. The staff undertook an effort to identify the best area for venture capital investment at that time and concluded that social media would provide attractive returns. Staff then identified the best firms in this area to partner with – no small feat given that neither the area nor the firms were yet proven. The fruits of these efforts began to be realized this year as gains in this part of the portfolio alone exceeded \$280 million.

FY 2011 Market Overview and FY 2012 Market Outlook

Public equity markets and natural resources were exceptionally strong in the first half of the fiscal year, posting gains of 25%-30%, depending on the market. These markets stalled, however, in the spring and then fell 10%-20%, over the summer.

Fixed Income markets, conversely, were fairly soft in the first half of the year but rallied strongly in the second half of the year.

For the full fiscal year, fixed income markets rose 9%, natural resources rallied 25%, developed country public equities returned 14.5% and emerging market public equities rose 9.1%. Thus the Endowments' returns approximated developed country public equity returns, although the Endowments exhibit substantially lower volatility due to their diversification and defensive positioning.

Two years ago and again last year we wrote:

“Our base case for most developed countries is a slow, subpar economic recovery as global assets are rebalanced. At the same time, many developing countries around the world have good prospects for growth and development.

Global excess capacity retards inflation and, together with limited credit supply or demand, deflation concerns are understandable. The vast amounts of monetary stimulus governments have injected, however, cause concerns about inflation and currency devaluation over the longer term.”

Continuing with last year’s musings:

“The reality is that no one knows what the next fiscal year will bring in the capital markets. And while the future can never be known with certainty, the future looks particularly uncertain to us at this time.

The developed world labors under historically high debt levels, a need to bring consumption back in line with production and excess capacity. Emerging countries will need to rely more on domestic consumption than exports to the developed world to power continued growth.

Unprecedented levels of government monetary and fiscal stimulus will have implications that cannot yet be certain and the role of governments in the economy continues to evolve differentially – and often in unexpected ways – across the globe.

In this context, capital markets – always volatile – are likely to be even more so, particularly over shorter time periods as emotional euphoria and despair rear their ever present heads.

Our mantra is to remain long-term investors: focused on value, cognizant of manic market

swings and patiently investing in opportunities that will protect our capital and produce attractive returns over the longer term. We continue to view capital markets as global and we continue to consider the full spectrum of asset classes, investment vehicles and approaches. We remain committed to partnering with best-in-class investment managers and to having a diversified portfolio.

Given the uncertainty and headwinds, we do remain defensive, liquid and flexible. We do believe that the stresses and changes will present attractive opportunities to those that are patient, flexible and ready to move quickly when the situations arise.”

Board and Staff

The UTIMCO staff and Board are the keys to investment success. Along with the Board of Regents, and the UT System and its fifteen institutions’ staffs, it is this team of people that produce the returns that provide additional resources for the state’s educational and health well being.

We are grateful for Erle Nye’s many years on the UTIMCO Board, which concluded this past year, as well as for Janiece Longoria’s service which also ended this year. We welcome Steve Hicks and Jim Wilson to our 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.

Lastly, we cannot express enough appreciation for all of our colleagues at UTIMCO. We have a great group of people who tirelessly apply their extraordinary skills to enhance the resources available to the public institutions that we serve.

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

As always, we welcome your inquiries and input.



Bruce Zimmerman
Chief Executive Officer and
Chief Investment Officer



Cathy Iberg
President and Deputy
Chief Investment Officer



UTIMCO BOARD OF DIRECTORS As of August 31, 2011

PAUL L. FOSTER (CHAIRMAN)

Vice Chairman – Board of Regents, The University of Texas System; **Executive Chairman** – Western Refining, Inc., El Paso, Texas; **Chairman and CEO** – Vomaris, Inc.; **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 Council; **Member** – Governor's Business Council; **Former Member** – Young Presidents' Organization; **Member** – World Presidents' Organization; **Member** – Business Advisory Council, University of Texas at El Paso; **Member** – Greater El Paso Chamber of Commerce Board of Directors

J. PHILIP FERGUSON (VICE CHAIRMAN)

Chair – UTIMCO Compensation Committee; **Member** – UTIMCO Policy Committee; **Member** – UTIMCO Risk Committee; **Former Chief Investment Officer** – AIM Capital Management, Inc.; **Member** – Fund Advisory Committee, The MBA Investment Fund, The University of Texas at Austin; **Member** – Board of Directors of ABM Industries, Inc. (NYSE: ABM); **Member** – Audit Committee of ABM Industries, Inc.; **Member** – Governance Committee of ABM Industries, Inc.; **Member** – Investment Committee, Museum of Fine Arts, Houston; **Member** – Development Board, UT Health Science Center at Houston; **Chair** – UT School of Nursing at Houston, Advisory Council; **Member** – Chancellor's Advisory Council, Texas Christian University; **Former Trustee** – Houston Ballet; **Former Director** – Memorial Hermann Foundation; **Trustee** – Memorial Endowment Fund, St. John the Divine Episcopal Church; **Former Member** – Board of Governors of the Investment Adviser Association

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; **Alumni Fellow** – Yale Corporation; **President** – Texas Academy of Medicine, Engineering, and Science of Texas (TAMEST); **Member** – Council of University Presidents and Chancellors; **Member** – President's Advisory Commission on Education Excellence for Hispanics

KYLE BASS

Member – UTIMCO Compensation Committee; **Member** – UTIMCO Policy Committee; **Member** – UTIMCO Risk Committee; **Principal** – Hayman Capital Management, L.P.; **Founding Member** – Serengeti Asset Management Advisory Board; **Board Member** – Troops First Foundation; **Board Member** – Texas Rangers Foundation; **Member** – Advisory Council of the Comeback America Initiative; **Former Director** – ABS Credit Derivatives Users Association; **Former Senior Managing Director** – Bear, Sterns & Co.; **Former Managing Director** – Legg Mason, Inc.



PAUL L. FOSTER

J. PHILIP FERGUSON

FRANCISCO G. CIGARROA

KYLE BASS

PRINTICE L. GARY

Chair – UTIMCO Policy Committee; **Member** – UTIMCO Audit and Ethics Committee; **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 Audit and Ethics Committee; **Member** – UTIMCO Compensation Committee; **Vice Chairman** – Board of Regents, The University of Texas System; **Chair** – Board of Regents, The University of Texas System - Academic Affairs Committee; **Vice Chair** – Board of Regents, The University of Texas System-Technology Transfer and Research Committee; **Member** – Board of Regents, The University of Texas System - Facilities Planning and Construction Committee; **Member** – Board of Regents, The University of Texas System - Athletics Liaison; **Chairman** – Capstar Partners, LLC; **Board Chairman** – Austin Recovery

ARDON E. MOORE

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; **Trustee** – Cook Children’s Hospital, Fort Worth; **Past President** – All Saint’s Episcopal School of Fort Worth; **Past Trustee** – Texas Water Foundation; **Trustee** – Stanford Business School Trust; **Member** – Advisory Council, The University of Texas McCombs School of Business

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; **Member** – The University Cancer Foundation Board of Visitors & Strategic Advisory Committee for The University of Texas MD Anderson Cancer Center; **Chairman** – The University of Texas MD Anderson Cancer Center - Center for Global Oncology Advisory Group; **Member** – The University of Texas MD Anderson Cancer Center - “Making Cancer History” Campaign Cabinet; **Co-Vice Chair** – The University of Texas “Campaign for Texas”; **Member** – The University of Texas Development Board; **Chairman** – External Advisory Committee of The University of Texas Department of Biomedical Engineering; **Recipient** – 2007 University of Texas Distinguished Alumnus Award; **Member** – McCombs School of Business Hall of Fame; **Member** – Board of Overseers of the Columbia University Graduate School of Business; **Member** – Cancer Prevention & Research Institute of Texas - Oversight Committee; **Member** – Cancer Prevention & Research Institute of Texas - Executive Committee; **Chairman** – Cancer Prevention & Research Institute of Texas - Economic Development & Commercialization Subcommittee; **Member** – The Robert A. Welch Foundation Board of Directors; **Member** – Industry & Community Affiliates Committee of The Academy of Medicine, Engineering & Science of Texas

JAMES P. WILSON

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



PRINTICE L. GARY R. STEVEN HICKS ARDON E. MOORE CHARLES W. TATE JAMES P. WILSON

THE UNIVERSITY OF TEXAS SYSTEM BOARD OF REGENTS

As of August 31, 2011

OFFICERS

Wm. Eugene "Gene" Powell - Chairman
 Paul L. Foster - Vice Chairman
 R. Steven "Steve" Hicks - Vice Chairman
 James D. Dannenbaum - Vice Chairman

MEMBERS

Terms Expire February 1, 2013*

James D. Dannenbaum
 Paul L. Foster
 Printice L. Gary

Terms Expire February 1, 2015*

R. Steven "Steve" Hicks
 Wm. Eugene "Gene" Powell
 Robert L. Stillwell

Terms Expire February 1, 2017*

Alex M. Cranberg
 Wallace L. Hall, Jr.
 Brenda Pejovich

STUDENT REGENT

Term Expires May 31, 2012*

John Davis Rutkauskas

*Each Regent's term expires when a successor has been appointed, qualified, and taken the oath of office.
 The Student Regent serves a one-year term.

Francie A. Frederick – General Counsel to the Board of Regents

THE UNIVERSITY OF TEXAS SYSTEM EXECUTIVE OFFICERS

As of August 31, 2011

Francisco G. Cigarroa, M.D. – Chancellor
 Scott C. Kelley – Executive Vice Chancellor for Business Affairs
 David B. Prior – Executive Vice Chancellor for Academic Affairs
 Kenneth I. Shine – Executive Vice Chancellor for Health Affairs
 Barry D. Burgdorf – Vice Chancellor and General Counsel
 Barry McBee – Vice Chancellor and Chief Governmental Relations Officer
 Randa S. Safady – Vice Chancellor for External Relations
 William H. Shute – Vice Chancellor for Federal Relations
 Amy Shaw Thomas – Vice Chancellor and Counsel for Health Affairs
 Sandra K. Woodley – Vice Chancellor for Strategic Initiatives

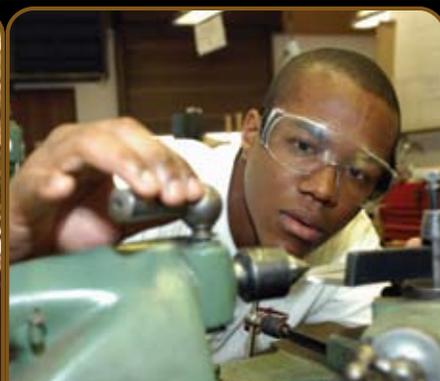
UTIMCO SENIOR MANAGEMENT

As of August 31, 2011

Bruce Zimmerman – CEO and Chief Investment Officer
 Cathy Iberg – President and Deputy Chief Investment Officer
 Joan Moeller – Senior Managing Director – Accounting, Finance and Administration
 Anna Cecilia Gonzalez – General Counsel and Chief Compliance Officer
 Lindel Eakman – Managing Director – Private Investments
 Mark Warner – Managing Director – Natural Resources Investments
 Mark Shoberg – Senior Director – Real Estate Investments
 Uziel Yoeli – Senior Director – Portfolio Risk Management
 Susan Chen – Senior Director – Public Markets Investments
 Ryan Ruebsahm – Senior Director – Marketable Alternative Investments

FIDUCIARY COUNSEL – Andrews Kurth, LLP, Austin, Texas

INDEPENDENT AUDITORS – Deloitte & Touche LLP



FREQUENTLY ASKED QUESTIONS

LTF DISTRIBUTIONS

1. What is the spending (distribution) policy of the LTF?

The LTF utilizes what is often called a “constant growth” spending policy in determining annual distributions. Under a constant growth spending policy, distributions in a year are equal to the distribution in the prior year (in dollars) plus an increase to offset actual inflation in that particular year. Thus, distributions grow at a steady rate equal to the rate of inflation, which provides a stable stream of “real” resources to the beneficiaries of the endowments in the LTF. The constant growth spending policy is particularly suited to endowments in which current distributions are large relative to the total budget for the program being served by the endowment, as is the case for many of the endowments in the LTF. An unfortunate effect of the constant growth spending policy is that the volatility of financial markets, which is typically much greater than the volatility of inflation, is transferred to the value of the endowment funds from which distributions are made. To moderate potential negative effects on the value of endowments, which could endanger the ability of the endowments to meet the needs of future beneficiaries, a smoothing formula is used to calculate the inflation rate at which distributions are increased year to year and limits are placed on the distributions to protect the endowments under the most adverse capital market environments.

2. How is the LTF distribution rate determined?

Distributions are increased annually at the three year average rate of inflation, provided that the distributions remain within a range of 3.5% and 5.5% of the three year average net asset value of the LTF. All calculations are done on a per-share (or per-unit) basis, to adjust for flows into and out of the LTF. For example, the 2011 distribution rate of \$.3172 per unit was increased to \$.3215 for fiscal year 2012 because the average three year increase of the consumer price index was 1.4%. Distributions based on the new rate of \$.3215 were equal to 5.33% of the three year per-unit asset value of the LTF, within the allowable range of 3.5% to 5.5%, up from the 5.05% payout in 2011. The long-term target distribution rate for the LTF is 4.75%.

3. Who determines the distribution rate for the LTF?

Final authority over the distribution rate rests with the UT Board. Following the Spending Policy established by the UTIMCO Board, UTIMCO staff recommends the annual distribution rate to the UTIMCO Board. Upon approval by the UTIMCO Board, the rate is recommended to the UT Board.

4. What is the current payout of the LTF?

The payout for the LTF for the fiscal year ended August 31, 2011, was \$.3172 per unit. The UT Board has approved a payout rate of \$.3215 per unit for the fiscal year ending August 31, 2012. The 2011 payout or distribution rate amounted to 5.12% of the LTF’s twelve-quarter average net asset value.

5. How does the distribution rate convert into dollars distributed to the individual endowment beneficiary?

All endowments which invest in the LTF purchase units based on the LTF’s market value per unit as of the date of purchase. The endowment beneficiary receives distributions on the last day of each fiscal quarter from the LTF based on the number of units owned at that time multiplied by the current distribution rate.

6. How has the distribution policy in the past affected the internal growth of the LTF?

The LTF’s investment and distribution policy has been positioned to balance the needs of present and future beneficiaries by distributing only a portion of the market value of the endowment each year. Reinvested earnings, the difference between the total returns and the distribution rates over time, provide the cushion to support the endowments’ educational programs in the future, while still meeting the needs of current beneficiaries.

UTIMCO adheres to the constant growth distribution philosophy. Distributions rates are targeted at 4.75%. In years when investment markets are strong, excess returns are held within the LTF. These excess returns are used to maintain a constant distribution stream for beneficiaries in years, such as fiscal years 2008 and 2009, when investment returns fell below the targeted distribution rate.

FIG. I ENDOWMENT MARKET VALUES AFTER SPENDING



Source: Cambridge Associates, LLC

Assumptions: Begin with \$100 million in 1926. Spend 4%, 5%, and 6% of average beginning market value of the previous four quarters. Asset allocation consists of 70% U.S. equity (performance measured by Ibbotson Yearbook, Large Company Stocks 1926-68; S&P 500 1969-present) and 30% U.S. bonds (performance measured by CA Corp Bond Series [derived from Salomon yields] 1926-68; Salomon High Grade Corporate Bond Total Rate of Return Index, Red SB Book 1969-79; SSB High Grade AAA/AA Corporate 10+ Year Index 1980-present), rebalanced quarterly. Management fees have been disregarded.

7. What effect does the target distribution (spending) rate have on an endowment's value in the long term?

One of the two objectives required to preserve the purchasing power of the endowment is to increase the market value of the endowment (after the annual distribution) at a rate at least equal to the rate of inflation. Over the long term, a higher spending rate will produce a lower long term endowment market value when compared to a lower spending rate. The effect that the distribution (spending) rate will have

on the endowment's value is shown graphically in Figure I.

8. How does the current distribution rate of the LTF compare to other colleges and universities?

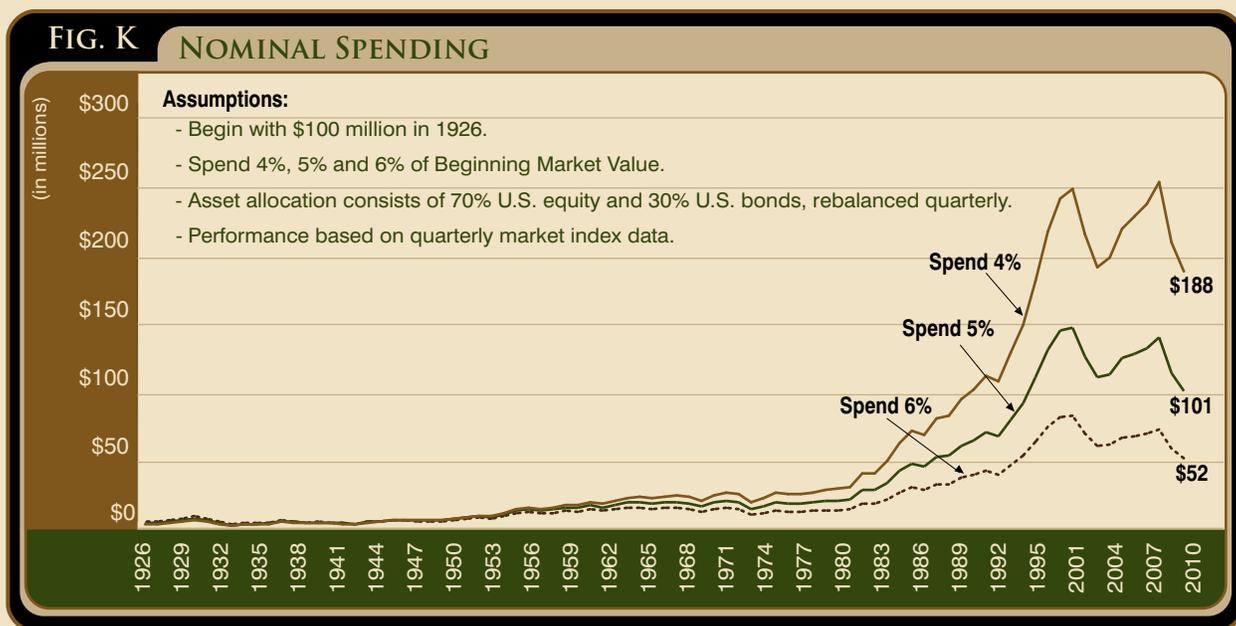
The LTF's distributions, when compared to the 2010 NACUBO-Commonfund Study of Endowments, are near the distribution rates for large endowment funds (Figure J).

FIG. J SPENDING RATE COMPARISON

| As of June 30, | 2006 | 2007 | 2008 | 2009 | 2010 |
|-------------------------------------|------|------|------|------|------|
| LTF | 4.6% | 4.4% | 3.9% | 4.1% | 5.7% |
| Endowments Greater than \$1 Billion | 4.6% | 4.4% | 4.2% | 4.6% | 5.6% |
| Public | 4.5% | 4.5% | 4.2% | 4.2% | 4.1% |
| Independent | 4.8% | 4.7% | 4.4% | 4.5% | 4.8% |

Source: 2006-2007 NACUBO Endowment Study; 2008-2010 NACUBO-Commonfund Study of Endowments 2010.





Assumptions: Begin with \$100 million in 1926. Spend 4%, 5%, and 6% of average beginning market value of the previous four quarters. Asset allocation consists of 70% U.S. equity (performance measured by Ibbotson Yearbook, Large Company Stocks 1926-68; S&P 500 1969-present) and 30% U.S. bonds (performance measured by CA Corp Bond Series [derived from Salomon yields] 1926-68; Salomon High Grade Corporate Bond Total Rate of Return Index, Red SB Book 1969-79; SSB High Grade AAA/AA Corporate 10+ Year Index 1980-present), rebalanced quarterly. Management fees have been disregarded.

9. What effect does the target distribution (spending) rate have on the amount of the distribution (the dollar payout) paid to the endowment beneficiaries in the long term?

One of the two objectives required to preserve the purchasing power of the endowment is to increase the amount of the annual distribution to endowment beneficiaries at a rate at least equal to the rate of inflation. Over the long term, a higher spending rate will produce a lower spending amount because the endowment's ability to grow has been compromised by the higher spending rate. The effect the distribution (spending) rate has on the dollar payout is shown graphically in **Figure K**.

OPERATIONS

10. How and when are LTF units purchased and redeemed?

Units are purchased on quarterly buy-in dates of March 1, June 1, September 1, and December 1. Funds wired to UTIMCO prior to a quarterly purchase date are immediately invested in a money market account until LTF units can be purchased. Interest earned on the money market account during the interim period is distributed to the UT System institution of record.

11. What are the expenses of the GEF and LTF?

UTIMCO's large asset base allows for economies of scale in the management of the endowment funds. UTIMCO incurs expenses associated with strategy and analysis, portfolio management, custody and safekeeping, accounting and other investment related functions. The GEF was created as the investment vehicle in which the LTF and PHF could get cost effective exposure to a well diversified investment portfolio. Both the LTF and PHF pay the same fee for every unit of GEF owned by these Funds. However, there are additional expenses which differ for the LTF and PHF. Therefore, the total fee paid by each unit of the LTF includes LTF expenses plus a portion of the GEF expenses. The UTIMCO fee for 2011 fiscal year was 0.08% of LTF average net assets; fees and expenses paid to external managers (which do not directly net fees against the net asset value or capital), and other service providers totaled 0.24% of LTF average net assets. These fees and expenses do not include fees incurred and charged by the general partners in partnership investments, fees charged by mutual fund managers, and fees charged by hedge fund managers as these types of fees are netted directly against returns for those investments in accordance with standard industry practice.

The LTF is also assessed an annual administrative fee on behalf of the UT System and UT System institutions for the support of endowment administration and management, and an annual fee to cover costs associated with UT System personnel in their oversight responsibilities of UTIMCO. The endowment management and administration and oversight fees for 2011 were 0.21% of LTF average net assets.

12. How does compensation for UTIMCO staff members compare to other endowments?

Compensation for top UTIMCO staff members is a combination of base salary and performance-based incentive compensation. Base salaries are set at the median level for similar job functions in a universe of endowments, foundations, and private investment management firms constructed by our compensation consultant, Mercer. Performance-based incentive compensation is based on investment performance and qualitative performance goals. Investment performance includes UTIMCO's performance and asset class performance. UTIMCO's investment performance is measured by comparing the endowment funds' (the PUF and the GEF) and

the Intermediate Term Fund's net investment return relative to their respective policy portfolio returns. Asset class performance is measured by comparing asset class net investment returns relative to approved performance indices for each staff member's specific area of responsibility. Qualitative performance goals may be based on leadership, implementation of operational goals, management of key strategic projects, and effective utilization of human and financial resources. All elements of staff compensation at UTIMCO are defined in the UTIMCO Compensation Program that was approved by the UTIMCO Board and the UT Board.

13. What types of reporting and services are available to obtain periodic information about the Fund?

UTIMCO provides a variety of reports and services, including an annual report. Individual donor statements are available to UT System institutions via UTIMCO's website at www.utimco.org. UT System institutions may also obtain daily individual account information via the Component Reporting Information System (CRIS), also accessed through the UTIMCO website.

FIG. L LTF RATIO OF EXPENSES TO AVERAGE NET ASSETS

| Years Ended August 31, | 2007 | 2008 | 2009 | 2010 | 2011 |
|--|--------------|--------------|--------------|--------------|--------------|
| UTIMCO Management | 0.08% | 0.08% | 0.11% | 0.06% | 0.08% |
| External Investment Managers ¹ | 0.16% | 0.11% | 0.16% | 0.22% | 0.20% |
| Other Service Providers Fees | 0.04% | 0.07% | 0.01% | 0.03% | 0.04% |
| Total Investment Fees and Expenses | 0.28% | 0.26% | 0.28% | 0.31% | 0.32% |
| UT System Administrative Fees ² | 0.08% | 0.19% | 0.27% | 0.25% | 0.21% |
| Total | 0.36% | 0.45% | 0.55% | 0.56% | 0.53% |

(1) Fees incurred by the general partners in private investments, fees incurred by mutual fund managers, and fees charged by hedge fund managers are not included in these totals. Fees incurred by partnerships, mutuals funds and hedge funds are netted directly against returns for those investments in accordance with standard industry practice.

(2) During the fiscal year ended August 31, 2008, the UT System administrative fee assessed on behalf of the UT System and UT System institutions for the support of endowment administration and management was increased from .08% to .20% of a rolling twelve quarter average net asset value of the LTF. The change in the ratios between 2008 and 2009 are reflective of the expense ratios being calculated on a five-quarter average net asset value of the LTF, and the fee assessment being calculated on a twelve-quarter average net asset value of the LTF.



FREQUENTLY USED TERMS

Asset Allocation – Asset allocation is the long-term strategy for investing funds into various asset classes based on investment goals, time horizon, and risk tolerance. It is the primary determinant of investment return, and is defined by the investment policy for each fund.

Asset Class – Asset class refers to a set of related investment vehicles that have similar risk and return characteristics. Different types of asset classes would include domestic equities, international equities, fixed income, hedge funds, commodities, and private investments.

Benchmark Returns – Benchmark returns are the returns for a specific index defined in the investment policy statement as the performance measurement standard for a particular asset class. The most commonly used benchmarks are market indexes such as the S&P 500 Index for common stocks and the Barclay's Capital Aggregate Bond Index for bonds.

Book Value of an Endowment – The book value of an endowment represents all contributions, reinvested income and any realized gains or losses attributable to the sale of an investment held in the endowment.

Downside Risk – A risk metric that distinguishes between “good” and “bad” returns by assigning risk only to those returns below a return specified by an investor. Downside risk is considered a more effective risk measure than standard deviation (volatility) for two important reasons: 1) it is investor specific, and 2) it identifies return distributions that have higher probabilities for negative (“left tail”) market events. Downside risk is also referred to as downside deviation or target semi-deviation.

Endowment Policy Portfolio – The endowment policy portfolio is the hypothetical portfolio consisting of each asset category weighted at the neutral asset class allocation outlined in the investment policy of each fund.

Endowment Policy Portfolio Return – The endowment policy portfolio return is the benchmark return for the endowment policy portfolio and is calculated by summing the neutrally weighted index return (percentage weight for the asset class multiplied by the benchmark return for the asset class) for the various asset classes in the endowment portfolio for the period.

Expected Returns – Expected returns are best estimates of what returns might be over some future time period. Expected returns are based on projection models of different possible scenarios. Each scenario is assigned a probability of occurrence. The result of weighting each scenario by its probability of occurrence is the expected return.

Expected Risk – Expected risk is the projected variability in future returns. A common measure of risk is standard deviation.

Hedge Funds – Hedge fund investments are broadly defined to include non-traditional investment strategies whereby the majority of the underlying securities are traded on public exchanges or are otherwise readily marketable. These types of investments can include: (1) global long/short strategies that attempt to exploit profits from security selection skills by taking long positions in securities that are expected to advance and short positions in securities where returns are expected to lag or decline; (2) arbitrage strategies which attempt to exploit pricing discrepancies between closely related securities, utilizing a variety of different tactics; and (3) event driven strategies that attempt to exploit pricing discrepancies that often exist during discreet events such as bankruptcies, mergers, takeovers, spin-offs and recapitalizations in equity and debt securities.

Investment Return – Investment return is the change in investment value during the period, including both realized and unrealized capital appreciation and income, expressed as a percentage of the market value at the beginning of the period. Investment return is also known as total return.

Less Correlated and Constrained Investments

Less correlated and constrained investments are investment mandates that exhibit lower levels of beta exposure to the underlying assets being traded, may be across Asset Classes, may have higher levels of short exposure and leverage, may not have underlying security transparency, are more likely to be in publicly traded securities and may entail lock-ups

Long Position – A long position is a bet that prices will rise. For example, you have a long position when you buy a stock and benefit from prices rising. A long position is the opposite of a short position.

Market Value – Market value is the value of an investment determined by prevailing prices for that investment in an actively traded market including the investment.

More Correlated and Constrained – More correlated and constrained investments are investment mandates that exhibit higher levels of beta exposure to the underlying assets being traded, tend to be in a single asset class, have lower levels of short exposure and leverage, have more underlying security transparency, are more likely to be in publicly traded securities and are less likely to entail lock-ups.

Net Investment Return – Net investment return is total return after deduction of investment management fees and expenses.

Private Investments – Private investments consist of investments in the equity securities of private businesses including real estate. Private investments are held either through limited partnerships or as direct ownership interests. The private equity category also includes mezzanine and opportunistic investments.

Purchasing Power – The primary objective of the endowment funds is to preserve the purchasing power of the endowment over the long-term. This essentially means to increase the market value of the endowments over time by at a rate at least equal to the rate of inflation after all expenses and distributions and to increase annual distributions at a rate at least equal to the rate of inflation.

Realized Gain or Loss – Realized gain or loss represents any gain or loss attributable to the sale or disposition of an investment.

Short position – A short position is a bet that prices will fall. For example, a short position in a stock will benefit from the stock price falling. Short positions are obtained by borrowing securities from another party, selling them and then repurchasing them at a later date, at a lower price, to return the shares to the original owner. The investor making the short sale pockets the difference between the price at which the shares were sold and the price at which the shares were repurchased to return to the original owner. A short position is the opposite of a long position.

Standard Deviation – Standard deviation is a measure of the variability of investment returns. It is the most commonly used measure of risk.

Total Return – Total return is the change in investment value during the period, including both realized and unrealized capital appreciation and income, expressed as a percentage of the market value at the beginning of the period. Total return is also known as investment return.

Unrealized Gain or Loss – Unrealized gain or loss represents the difference between the market value and book value of an investment.

Value-Added – Value-added is a measure of the increase in dollar value of endowment funds due to actual investment performance exceeding the performance of the policy portfolio.



1 Sum of the market value of the investment holdings for the endowment at the beginning of the year (September 1, 2010).

2 Funds received from donors or matching funds. Contributions may be received in the form of cash, securities, real estate, mineral interests, and other assets. Contributions are reported at market value on the contribution date.

3 Funds that are withdrawn from the endowment. Because most endowments are perpetual, withdrawals are minimal. Those made are normally due to an administrative adjustment or if the endowment is a term endowment.

4 Total funds distributed to the institution to support the purposes of the endowment. In some instances, the distributions are not received in cash but are automatically reinvested into the endowment principal. Distributions (payout) are derived from the LTF units held by the endowment and any separately invested assets.

The LTF distributions are determined by the number of units held and payout in cents per unit.

The separately invested assets receive income, which may include interest, dividends, and real estate income that is also distributed to the institution.

5 Average Market Value is derived from the sum of the endowment's market value for the five quarters ended August 31, 2011 divided by five.

6 Summary of information presented in the body of the Endowment Report for years 2007 through 2011.

7 Sum of the book value of the investment holdings held at the end of the year. The book value also represents all contributions, reinvested income and any realized gains (losses) attributable to the sale of an investment. The difference between market value and book value is unrealized gains and losses.

8 Reinvestment of distributions into the endowment principal which becomes a permanent part of the endowment.

9 Represents the component of the LTF distributions derived from LTF income (interest and dividends) and any income from separately invested assets. Separately invested assets are individual investment holdings of the endowment such as real estate, stocks, bonds, and mineral interests. Expenses, if any, on the separately invested accounts, are deducted from income.

10 Represents any gains or losses attributable to the sale of an investment. Also includes the portion of distributions attributable to realized gains of the LTF.

11 Amount of growth or decline in the market value of the endowment that is not attributable to realized gains or income.

12 Beginning market value, plus contributions, reinvested income and total investment return, less withdrawals and cash distributions to the endowment. This value will also comprise the sum of the market value of the investment holdings for the endowment at the end of the year.

13 Total cash distributions divided by the average market value.

14 LTF payout was 31.72¢ per unit for the year ended August 31, 2011.

15 Number of LTF units held by the endowment at the end of the year.

16 Endowment's investment in the LTF. It is the number of LTF units held by the endowment multiplied by the LTF market value per unit at the end of the year.



DONOR ENDOWED SCHOLARSHIP

I. ENDOWMENT REPORT FOR PERIOD ENDED AUGUST 31, 2011

| | | | | |
|----------|--|-----------|---------------------|-----------|
| 1 | Beginning Market Value (September 1, 2010) | | \$227,956.13 | |
| 2 | Contributions Received | | -- | |
| 3 | Withdrawals | | -- | |
| | Income Reinvested | | -- | 8 |
| | Investment Return: | | | |
| | Income | | \$ 1,441.36 | 9 |
| | Net Realized Gains (Losses) on Investments | 10 | 10,399.40 | |
| | Net Increase (Decrease) in Market Value of Investments | | <u>21,050.05</u> | 11 |
| | Total Investment Return | | 32,890.81 | |
| 4 | Cash Distributions to Endowment Income Account | | <u>(11,840.76)</u> | |
| | Ending Market Value (August 31, 2011) | | <u>\$249,006.18</u> | 12 |

| | LONG TERM FUND | OTHER | TOTAL | |
|----------|--|--------------|-------|------------------|
| 4 | Total Cash Distributions | \$ 11,840.76 | -- | \$ 11,840.76 |
| 5 | Average Market Value For Period Ended August 31, 2011 (1) | | | \$245,692.00 |
| | Annual Yield (Total Cash Distributions as a % of Average Market Value) | | | 4.82% 13 |
| | Current Long Term Fund Annual Payout in Cents Per Unit | | | 31.72¢ 14 |

II. FIVE YEAR INVESTMENT HISTORY

| YEAR ENDED 8/31 | NET CONTRIBUTIONS (WITHDRAWALS) | INCOME REINVESTED | INVESTMENT DISTRIBUTIONS | INVESTMENT RETURN | TOTAL MARKET VALUE | TOTAL BOOK VALUE | LTF MARKET VALUE | LONG TERM FUND UNITS |
|-----------------|---------------------------------|-------------------|--------------------------|-------------------|--------------------|------------------|------------------|----------------------|
| 2007 | -- | -- | (10,612.40) | 38,934.82 | 279,977.78 | 100,000.00 | 279,977.78 | 37,315.00 |
| 2008 | -- | 48.58 | (10,930.52) | (8,748.93) | 260,346.91 | 100,048.58 | 260,346.91 | 37,321.48 |
| 2009 | -- | 52.71 | (11,288.32) | (36,124.12) | 212,987.18 | 100,101.29 | 212,987.18 | 37,329.04 |
| 2010 | -- | -- | (11,567.62) | 26,536.57 | 227,956.13 | 100,101.29 | 227,956.13 | 37,329.04 |
| 2011 | -- | -- | (11,840.76) | 32,890.81 | 249,006.18 | 100,101.29 | 249,006.18 | 37,329.04 |

(1) Five quarter average.





DONOR ENDOWED SCHOLARSHIP

III. ENDOWMENT AND LONG TERM FUND PERFORMANCE FOR THE PERIOD ENDED AUGUST 31, 2011

| | <u>ENDOWMENT TOTAL RETURN</u> | <u>LONG TERM FUND TOTAL RETURN (NET OF FEES)</u> |
|------------------------------------|-----------------------------------|--|
| 17 One Year | 14.50% | 14.77% |
| 18 Three Years (Annualized) | 3.72% | 3.97% |
| Five Years (Annualized) | 4.52% | 4.73% |
| Ten Years (Annualized) | 6.99% | 7.16% |

IV. SCHEDULE OF INVESTMENTS AS OF AUGUST 31, 2011

| | <u>PAR/SHARES</u> | <u>BOOK VALUE (\$)</u> | <u>MARKET VALUE (\$)</u> |
|--------------------------|-------------------|------------------------|--------------------------|
| COMMINGLED FUNDS: | | | |
| LONG TERM FUND UNITS | 37,329.04 | 100,101.29 | 249,006.18 |
| TOTAL INVESTMENTS | <u>37,329.04</u> | <u>100,101.29</u> | <u>249,006.18</u> |

17 Computes the change in the endowment's investment value, including both capital appreciation (realized and unrealized gains and losses) and income, expressed as a percentage of the endowment's market value at the beginning of the year (September 1, 2010).

18 Endowment's total return is calculated individually for the twelve month periods ended August 31, 2007, 2008, 2009, 2010, and 2011 and the results are geometrically linked to provide a five year annualized return. The total return computes the change in the endowment's investment value, including both capital appreciation (realized and unrealized gains and losses) and income, expressed as a percentage of the endowment's market value at the beginning of the period.

19 Computes the change in the LTF value (at the Fund level) and includes both capital appreciation (realized and unrealized gains and losses) and income, expressed as a percentage of the LTF market value at the beginning of the period.

20 Endowment's total return is calculated individually for the twelve month periods ended August 31, 2009, 2010, and 2011 and the results are geometrically linked to provide a three year annualized return. The total return computes the change in the endowment's investment value, including both capital appreciation (realized and unrealized gains and losses) and income, expressed as a percentage of the endowment's market value at the beginning of the year.

21 Endowment's total return is calculated individually for the twelve month periods ended August 31, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010, and 2011 and the results are geometrically linked to provide a ten year annualized return. The total return computes the change in the endowment's investment value, including both capital appreciation (realized and unrealized gains and losses) and income, expressed as a percentage of the endowment's market value at the beginning of the period.





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