Treasurer's Annual Report

One hundred and thirty-seventh fiscal year

University of California • 2004–2005

The Regents of the University of California

June 2005

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

Officers of The Regents

The Honorable Arnold Schwarzenegger, **President**
Gerald L. Parsky, **Chairman**
Richard C. Blum, **Vice Chairman**
James E. Holst, **General Counsel and Vice President for Legal Affairs**
Leigh Trivette, **Secretary**
David H. Russ, **Treasurer and Vice President for Investments**

Ex Officio Regents

The Honorable Arnold Schwarzenegger, **Governor of California**
Cruz M. Bustamante, **Lieutenant Governor**
Fabian Núñez, **Speaker of the Assembly**
Jack O'Connell, **State Superintendent of Public Instruction**
Mark F. Ornellas, **President of the Alumni Associations of the University of California**
Gary D. Novack, **Vice President of the Alumni Associations of the University of California**
Robert C. Dynes, **President of the University of California**

Appointed Regents

Jodi Anderson, **Student Regent**
Richard C. Blum
Judith L. Hopkinson
Odessa P. Johnson
Joanne C. Kozberg
Sherry L. Lansing
David S. Lee
Monica C. Lozano
George M. Marcus
John J. Moores
Gerald L. Parsky
Norman J. Pattiz
Peter Preuss
Fred Ruiz
Tom Sayles
Paul Wachter

Faculty Representatives

George Blumenthal
Clifford Brunk

Regents-Designate

Eric Juline
Richard E. Rominger

Committee on Investments

Jodi Anderson, **Student Regent**
Richard C. Blum
David S. Lee, **Chair**
Mark F. Ornellas
Norman J. Pattiz, **Vice Chair**
Peter Preuss
Paul Wachter

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

Advisory Member:
George Blumenthal

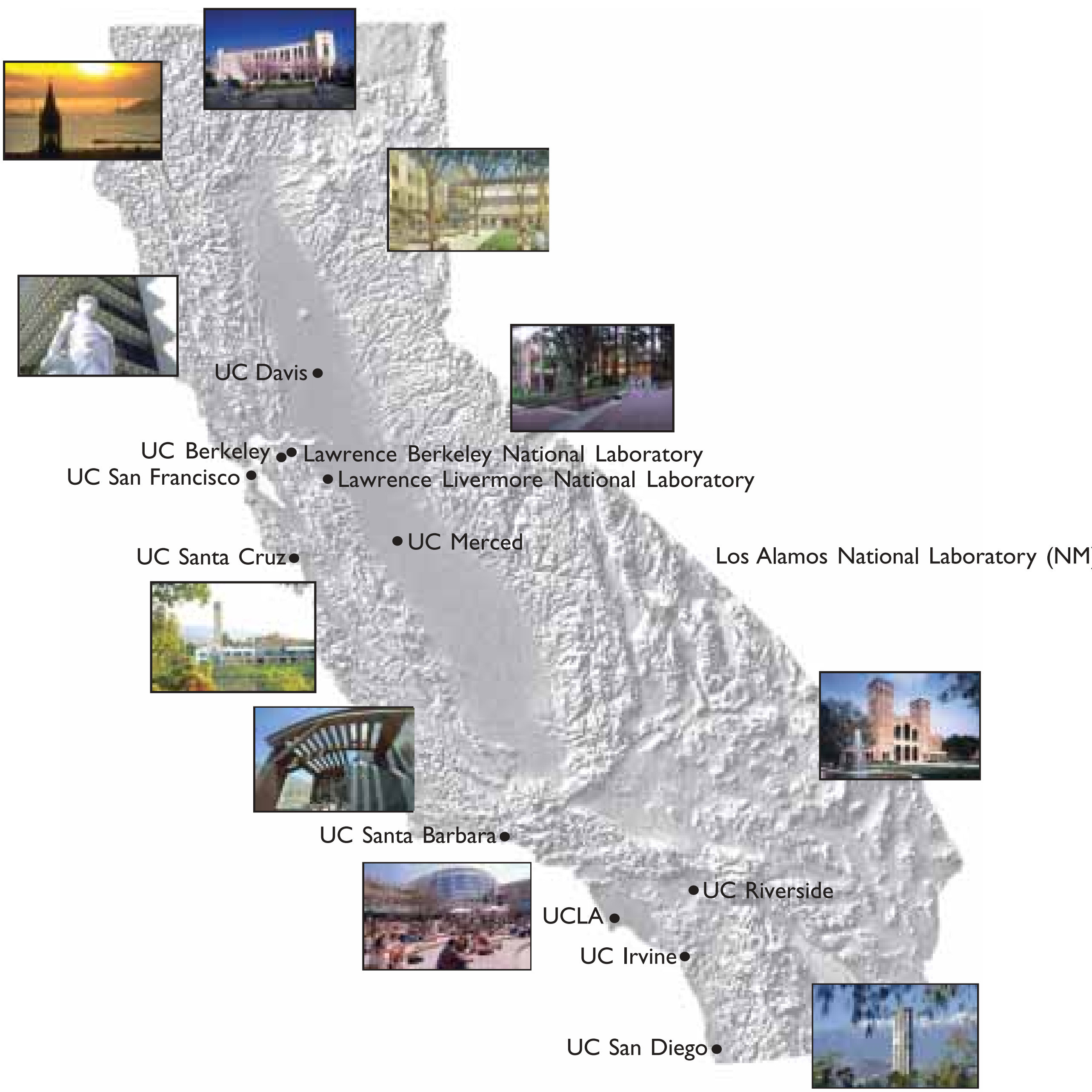
Mission Statement

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

The University of California

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

Campuses and National Laboratories



Treasurer's Annual Report Fiscal 2004-2005

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FISCAL YEAR 2005 IN REVIEW

Global equity and fixed income markets recorded positive results in the fiscal year, as the world economy continued to perform well, and inflation overall remained contained. Enthusiasm was tempered, however, by a steady rise in crude oil prices to a current high near $68/barrel. U.S. real GDP grew 3.4%, slightly trailing last year, while headline Consumer Price inflation moderated to a 2.5% rate from 3.3% in June 2004. Foreign stock markets led the way, as the MSCI All Country World ex U.S. (Net) Index gained 16.5% vs. 8.1% for the Russell 3000. Private equity markets outperformed domestic public equities for the second straight year, as merger activity continued at a strong pace.

The Fed raised short term interest rates at a steady pace, and Fed Funds closed the year at 3.25%. Ten-year U.S. Treasury yields, however, fell to 3.9% from 4.5% at 6/30/04, prompting a positive return of 11.49% for the Citigroup LPF (Large Pension Fund) Bond Index and 6.8% for The Lehman Aggregate Bond Index. The positive performance of longer-dated bond maturities in the face of rising short-term rates has been a puzzle to many observers, who attribute this to strong demand for long duration securities from pension funds, foreign buyers, and the Federal Reserve's credibility in fighting inflation.

The strength of the U.S. economy leaves the Fed firmly on a path to raise short-term interest rates to at least 4% by calendar year-end. However, financial markets are currently grappling with two major issues—the potential effects of the continued rise in oil prices on the global economy—exacerbated by recent supply shocks—and the debate over the current state of the housing market and consumer debt in the U.S. Reflecting these concerns, along with ongoing global political tensions, stock prices and bond yields have retreated from their recent highs.

The Board of Regents appointed Marie N. Berggren as Interim Treasurer and Interim Vice President for Investments, effective July 8, 2005. Marie temporarily replaces David H. Russ who left UC to assume the position of chief investment officer at Dartmouth College. Marie served as UC's Managing Director of Alternative Investments for the last three years. Prior to joining UC in April 2002, Marie held several executive positions with Bank One Corporation, including executive vice president of venture capital investments, senior vice president of portfolio risk management and venture investments, senior vice president for corporate mergers and acquisitions, and vice president for corporate strategy. She also spent 14 years in numerous management positions with First Chicago Investment Advisors (which subsequently became Brinson Partners).

MESSAGE FROM THE TREASURER

All Regents assets grew by $4.3 billion over the previous fiscal year to $63.3 billion, reflecting a total return of 9.09%. This return outperformed the total entity benchmark by 0.57%. We are pleased to report that the University of California Retirement Plan (UCRP), the General Endowment Pool (GEP), and the Short Term Investment Pool (STIP) all produced positive returns for the fiscal year: UCRP 10.30%, GEP 10.31%, and STIP 3.57%.

The UCRP grew by $2.7 billion over the fiscal year, net of all payments to beneficiaries and expenses. In fact, the UCRP paid out benefits of $1.3 billion to UC retirees for the year. As of June 30, 2005, the UCRP's estimated funded ratio was 110% on an actuarial basis. It is important to note that the UCRP's funding status is determined by a combination of two elements, both of which may fluctuate: 1) the value of the investment portfolio, and 2) the expected value of the liabilities (payment obligation). While the funded status of the UCRP has allowed for the temporary suspension of contributions, studies have shown an increased likelihood of required contributions within the next few years.

The University's 403(b) and DC Plan funds' total returns for the year were as follows: Equity Fund 10.26%, Bond Fund 6.78%, Savings Fund 3.79%, ICC Fund 5.09%, Balanced Growth Fund 9.23% and TIPS Fund 9.13%. UC successfully launched the 457(b) Deferred Compensation Plan this past Fall and completed a transition to a new master recordkeeper in July 2005. Our Office worked jointly with Human Resources and Benefits to facilitate these enhancements, along with creating a set of Core Funds (see description at far right) providing investment options that are easy to understand and that offer an appropriate range of asset class choices for use within the expanded Plans.

The Treasurer's Office continues to diversify its holdings to provide for the long-term needs of the University, its programs and employees. For many years the Regents had similar

strategic asset allocations for the pension (UCRP) and endowment (GEP). Recognizing the differences between the two (primarily that endowments have a longer investing horizon and can afford to invest in less liquid, potentially higher returning assets), the Treasurer and consultant recommended a new asset allocation for the GEP which was approved by The Regents in September 2005. Although the overall mix of equity, bonds, and alternatives is not appreciably different from the current mix, there will be less emphasis on traditional equity and bonds, and more weight in alternatives. There will continue to be a focus on less liquid assets, and we will increase commitments to private equity and real estate. The planned result is to achieve a portfolio with higher expected return and lower market volatility than the current strategy.

One of the principal accomplishments of the past year was the articulation of a governance framework for the pension and endowment, resulting in The Regents' adoption of an Investment Policy Statement (IPS) for the UCRP and also one for the GEP. These two documents - available on the Treasurer's website - do more than consolidate all The Regents' investment policies in one coherent framework. The IPS identifies the various types of investment risk faced in the management of pension and endowment assets, and assigns accountability for the management of those risks. It delineates the roles and responsibilities of The Regents' Committee on Investments and the Treasurer. The essence of investment governance is to balance flexibility in implementing Policy with the requirement to manage and control risk. Use of risk budgeting is an integral part of the Policy, and the Treasurer allocates the risk budget across asset classes in order to optimize the risk-return tradeoff. In addition, guidelines were included for the appropriate uses of derivative securities in the funds. This year's report includes an in-depth look at our approach to Risk Management.

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

Sincerely,

Marie N. Berggren
Interim Treasurer of The Regents and
Interim Vice President for Investments
University of California, October 2005

LOOKING FORWARD

During the coming year the portion of Public Equity assets that is managed actively will be increased by the External Management Team both by adding additional assets to existing managed portfolios and by funding new strategies, when such changes offer a more attractive reward/risk tradeoff in the context of the future composite portfolio than the existing composite portfolio.

The Alternative Investments Group will add to the Absolute Return assets as the allocation increased from 5% to 10% as part of the overall asset allocation changes within the GEP.

As mentioned in the Message at left, the Office worked jointly with Human Resources and Benefits to create a set of 18 Core Funds for use within the UC Retirement Savings Program Plans in July 2005. The Pre-Mixed Investment Options include the six UC Pathway Funds (a series of lifecycle funds) and the UC Balanced Growth Fund. The Primary Asset Class funds include seven broad-based asset class UC funds. The Specialized Asset Class funds offer small cap, emerging markets, REITs and socially-responsible investments.

The Office will continue to collaborate with the University's Office of Human Resources and Benefits to enhance the UC Retirement Savings Program by selecting an investment education provider. An RFP will be posted this Fall and a provider selected in early 2006.

The University of California and CalPERS sponsored legislation introduced by Senator Joseph Simitian (SB 439) concerning the public disclosure of investment information. Effective January 1, 2006, the bill will enable the University and other public investment systems in California to maintain access to top-tier, high-performing alternative investments. The Treasurer played an active role in developing this legislation and in generating support for its passage.

INVESTMENT MANAGEMENT OVERVIEW

The investment funds managed by the Treasurer of The Regents consist of the University's retirement, defined contribution and endowment funds, as well as the system's cash assets. At June 30, 2005, the Treasurer's Office managed over $63 billion in total assets as outlined below.

TOTAL FUNDS UNDER MANAGEMENT[1]
June 30, 2005
($ in billions)

University of California Retirement Plan (UCRP)	$41.9
Defined Contribution Plan Funds	8.8
Endowment Funds	5.9
Short Term Investment Pool (STIP)[2]	6.7
Total Funds	$63.3

The Treasurer's Office investment management staff includes 21 investment professionals with an average of 17 years of investment experience.

INVESTMENT OBJECTIVES & PHILOSOPHY

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

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

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

[1] Market values include accrued income.

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

ASSET ALLOCATION

Asset allocation is the primary determinant of long-term investment returns. UC funds are diversified among global equities and fixed-income securities, within a Regental target allocation (see pages 14, 25 and 28.) Historically, portfolio asset allocation has favored equity investments over fixed-income securities due to the expectation that equities will provide higher total returns over the long term. This emphasis on equity investing has resulted in substantial growth in both the endowment and retirement funds managed on behalf of The Regents.

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

PUBLIC EQUITY INVESTING

Historically, The Regents' Public Equity investment strategy utilized both active and passive management. In the process of implementing the November 2002 Regents-approved changes to the U.S. equity strategy, the internally managed U.S. common stock was transferred into a Russell 3000 Tobacco Free Index fund. The Treasurer's Office has an internal team of experienced investment professionals selecting multiple U.S. equity strategies; selecting the external managers to implement these strategies; and monitoring those external managers on an ongoing basis. As of June 30, 2005 approximately 30 percent of domestic equity assets had been transferred from the passive Russell 3000 index fund to active managers. Approximately 50 percent of non-U.S. equity had been transferred from the passive MSCI World ex U.S. index fund to developed markets' active managers as of June 30, 2005. The combined assets in each of the domestic and the non-U.S. asset classes are monitored under guidelines established within the investment policy statement for each asset class. Each asset class is controlled according to a risk budget framework set by The Regents. The passive/active allocation is controlled subject to both the risk budget and by the opportunities to add value to the benchmark for each asset class.

FIXED INCOME INVESTING

Within the primary goal of maximizing total return over a long-term horizon, the members of the Treasurer's Office Fixed Income Team take an active approach to managing the portfolios, focusing on safety of principal, credit quality, liquidity and efficient use of risk. They start with a "top-down" approach to evaluate the global macroeconomic environment, including analysis of busi-

ness cycles, monetary and fiscal policies, and political backdrops, in order to assign appropriate sector weights and duration exposure among the three core sectors of Government, Credit and Collateralized bonds. This is coupled with a "bottom-up" approach to individual security selection. Each portfolio manager utilizes a variety of proprietary and industry-developed analytical tools best suited for the particular sector, emphasizing rigorous analysis of such factors as yield curve exposures, portfolio duration and convexity, credit fundamentals, relative value and position weights.

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

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

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

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

PRIVATE EQUITY INVESTING

The Regents includes private equity investments such as venture capital and leveraged buyout partnerships in its overall asset allocation to increase portfolio diversification and reduce risk due to the low correlation of private equity with other asset classes. Adding to its attraction, long-term return expectations for private equity are generally at least 300 basis points greater than those of the public equity markets.

Manager selection is key to this asset class, and the Treasurer's Office Alternative Investments Team has a strong competitive advantage and many years of successful experience. The University is seen as a sophisticated, long-term investor in the private equity arena, achieving above average returns over the past 25 years. The University has long standing relationships with many top-tier private equity groups and continues to build new relationships with premier firms. The objective is to build a well-diversified portfolio of top tier U.S. partnerships. The Team works with a private equity consultant to review private equity investment opportunities. The Team actively monitors investments through regular meetings with the general partners.

ABSOLUTE RETURN INVESTING

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

Strategy and manager selection are the important drivers of the Absolute Return allocation. The Treasurer's Office is focusing on a subset of available strategies to achieve diversification benefits and preservation of capital. The Office has also been able to invest with established and accomplished managers, including some that are no longer open to new investors. As of this writing, the allocation to AR strategies is approximately 10%. The Alternative Investments Team works with a consultant that specializes in AR strategies.

Another critical element of the AR program is ongoing monitoring of the investments. Investments typically offer quarterly liquidity, which permits rebalancing toward strategies with a favorable outlook or redeeming from managers that are no longer suitable investments. The Treasurer's Office has regular contact with the investment managers to review adherence to the expected investment style, personnel turnover, performance and other issues to ensure the appropriate investments and allocations for the program.

REAL ESTATE INVESTING

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

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

The public strategy will employ the use of external managers who specialize in publicly-traded real estate securities, such as real estate investment trusts (REITs). The private strategy will be accomplished through investing in limited liability investment vehicles, such as limited partnerships sponsored by experienced real estate investment firms with demonstrated expertise and superior performance. The Real Estate Investment Team, along with a real estate consultant, will review and recommend managers of publicly-traded investments and sponsors of private investments and screen investment opportunities. Upon completion of due diligence and subsequent investment selection, the Team will negotiate investment agreements and monitor performance.

RISK MANAGEMENT

Investors perceive risk as the possibility of a loss which is accepted in order to achieve some investment goal. Thus investors accept risk to earn returns. In modern investment theory and practice, risk refers to this uncertainty of outcomes and is measured by the volatility of asset returns. Because risk is an essential aspect of investing, risk management is not about eliminating or necessarily reducing risk, but balancing risk and expected return. As Benjamin Graham said, "The essence of investment management is the management of risks, not the management of returns."

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

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

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

Risk measurement is the first step in a process known as risk budgeting. Risk budgeting involves two additional steps: 1) determining the overall amount of risk required to meet a given investment objective and 2) budgeting or allocating it in an optimal manner. Optimal use of risk means constructing a fund so that, at the

margin, the contribution to expected return of each sector, portfolio, or asset class is proportional to its estimated contribution to risk. This process is being implemented in the Treasurer's Office over the next fiscal year and being integrated into the asset allocation and rebalancing process.

OPERATIONS

Supporting the management of the portfolios is an experienced Operations staff consisting of a Director, Assistant Director, and Supervisor with an average of 17 years experience in banking and/or investment operations and seven analysts with an average of 12 years experience in investment accounting and operations. This unit is responsible for investment accounting and reporting, as well as the central management of all cash services for the University.

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

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

A WORD ABOUT BENCHMARKS

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

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

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

A policy benchmark for a *fund* can be a blend of indexes, each weighted by the percentage it represents in the asset allocation, e.g., 65% Russell 3000 + 35% Citigroup LPF. Additionally, although targets may be set for the percentages of assets in each category, it is customary to allow for a range around each target, to avoid frequent and costly rebalancing, and to allow for tactical deviations from policy when market conditions warrant (see range example on page 14).

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

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

SENIOR MANAGEMENT

Effective July 8, 2005 Mr. Russ left the University of California for a position as Chief Investment Officer at Dartmouth College and The Board of Regents named Marie N. Berggren (see biography below) as Interim Treasurer and Interim Vice President for Investments.

DAVID H. RUSS, MA
Treasurer and Vice President for Investments

Mr. Russ is responsible for overseeing the University of California investment portfolio. Mr. Russ brings over 19 years of investment management experience to the Treasurer's Office. Prior to joining the Treasurer's Office in 2001, Mr. Russ served as Managing Director-Public Markets for the University of Texas Investment Management Company. Mr. Russ also served as the Director of Investment Management and Portfolio Manager for Pacific Telesis Group (now SBC Communications) and as Senior Portfolio Manager for the Stanford Management Company. Mr. Russ received his Master of Administration in Finance and Accounting from the University of California, Davis, and his BA degree in Genetics from the University of California, Berkeley.

MELVIN L. STANTON, MBA
The Assistant Treasurer

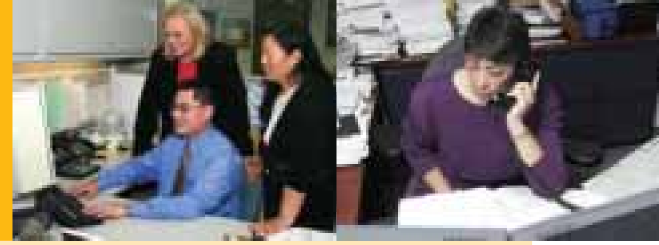
Mr. Stanton, along with the Treasurer, is responsible for the overall management of the Treasurer's Office. Prior to joining the Treasurer's Office in 1989, Mr. Stanton had more than 13 years experience as a financial executive in portfolio management and securities trading, including Director of Sales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

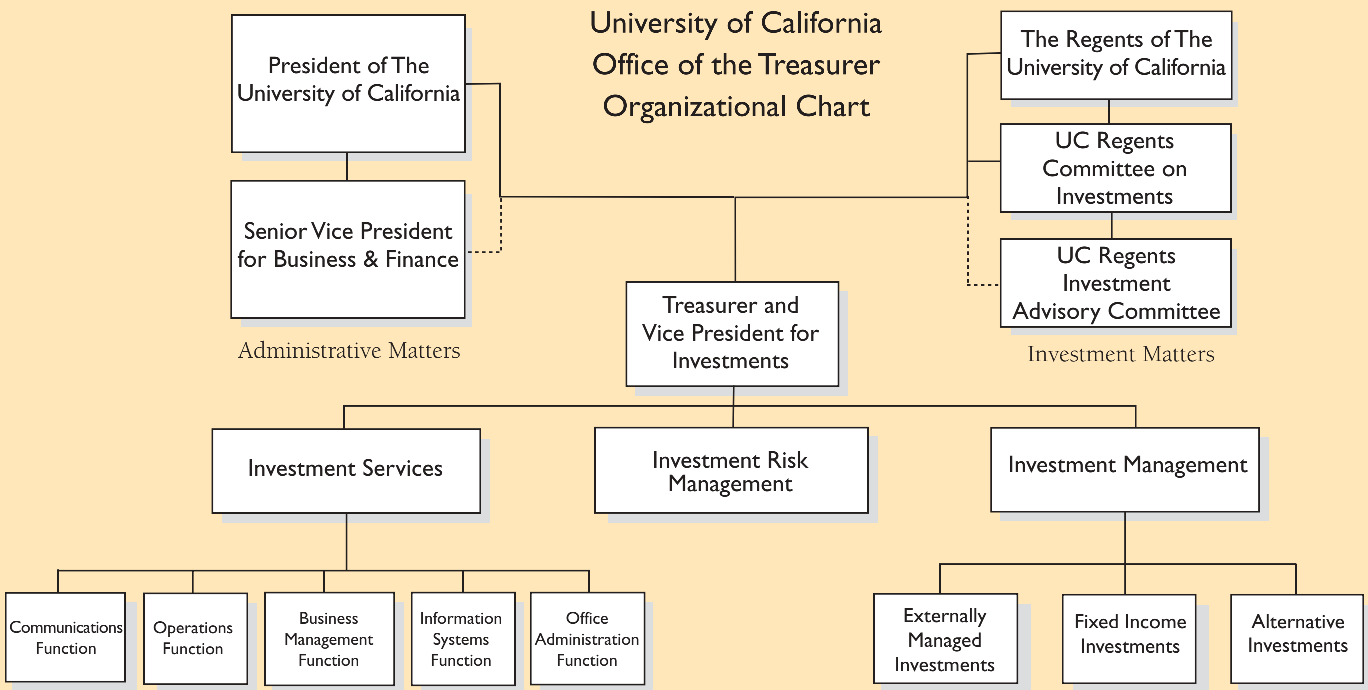
RANDOLPH E. WEDDING, MBA
Managing Director – Fixed Income Investments

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

MARIE N. BERGGREN, MS
Managing Director – Alternative Investments

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





JESSE L. PHILLIPS, CFA, MBA, MA

Managing Director – Investment Risk Management

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

ROBERT B. BLAGDEN, MBA

Managing Director – Externally Managed Investments

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

Investing In *Depth*

Insight into the Office of the Treasurer's approach to managing risk in the pension portfolio.

WHAT IS "RISK MANAGEMENT?"

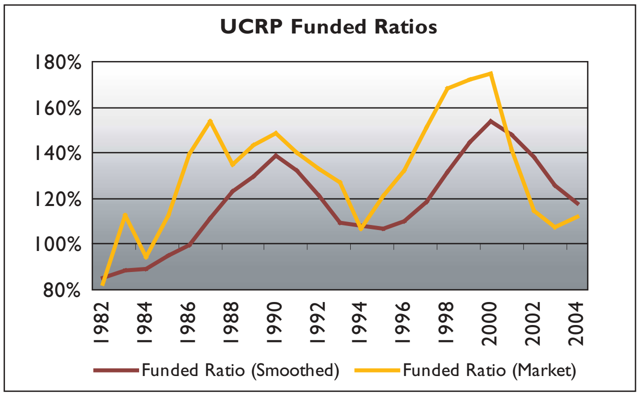
All investment portfolios—endowments, individual retirement accounts, savings earmarked for a down payment on a home—have a more or less specific investment objective. A Defined Benefit (DB) pension plan, such as the UCRP, has a well-defined objective: to pay the retiree benefits which are promised to employees by an employer.

In some ways, managing risk for a pension plan is similar to managing risk for any investment portfolio: establishing measurement and monitoring processes to ensure that its investment policies and strategies are being implemented effectively in order to increase the probability of success and to limit losses to an acceptable level.

For the individual portfolios that make up the pension fund, the focus is on whether they have outperformed their benchmarks, and how much risk they have taken in order to do so. Monitoring portfolios on a daily and monthly basis, and ensuring that guidelines are being followed and risk budgets are not exceeded, is one side of risk management, and this process is appropriate for any portfolio. Yet pension risk management has an additional component. This is due to the contractual nature of the pension promise, and the requirement to make payments according to a defined schedule.

THE FUNDED RATIO

The ratio of the plan's assets relative to its liabilities is called the Funded Ratio (FR). It is a critical measure of the financial strength of a plan, and changes in its level are closely watched. A Funded Ratio of 110% means that there are 10% more assets than liabilities at that point in time. Similarly, a Funded Ratio of 90% means that there are 10% fewer assets than liabilities. The difference of assets and liabilities is called its Surplus, or Deficit if negative. While an under-funded, or Deficit, plan can continue to pay benefits for some time, a *goal* of pension plan management is to maintain or exceed full funding — a FR of 100%. Thus both the Funded Ratio and its volatility are key measures of risk.



Although the UCRP Funded Ratio rose with the equity market "bubble" of 1995-1999, it declined over the next three years, and at June 2005 is in the range of 110%-115%.

PENSION FUND MATH

Pension "math" is quite simple: Assets grow (or decline) with investment returns. They are increased by contributions and decreased by paying benefits. Liabilities (almost) always increase, because each year, existing employees earn more "retirement benefits." Liabilities are decreased by paying benefits, and may increase or decrease with changes in plan design, changes in actuarial assumptions, or changes in demographics. But mostly, liabilities grow.

NOTE: Funded Ratio (Smoothed) uses the smoothed or Actuarial value of assets in the numerator. The Funded Ratio (Market) uses the actual market value of assets in the numerator.

Pension Fund Math

	Beginning Assets
+	Contributions
+/-	Investment Earnings
-	Benefit Payments
	Ending Assets

	Beginning Liabilities
+	Normal Cost
+	Interest Cost
-	Benefit Payments
+/-	Changes in Actuarial Assumptions
+/-	Changes in Actuarial Experience
+/-	Changes in Plan Design
	Ending Liabilities

Assets/Liabilities = Funded Ratio

Assets - Liabilities = Surplus (Deficit)

A careful examination of the equations on the chalkboard above shows that an employer has little control over many of the variables which are fixed (at least in the short run) by the plan provisions. The fiduciaries can increase the amount of risk, through the asset allocation, in hopes of earning higher returns over the long run, but capital markets are unpredictable. The one variable the employer and plan members control is the amount of contributions which flow into the fund.

A PENSION MANAGER'S TOOLS

Leaving aside plan design (which is outside the scope of the Treasurer's Office), the two levers for managing a pension plan are (a) to establish and implement a Funding Policy, which determines who will make what contributions to the plan's assets, and (b) to establish and implement an Investment Policy, the key elements of which are to determine the appropriate level of capital market risk, and to determine the asset allocation most likely to maximize returns within that risk budget.

FUNDING POLICY

Since 1990, there have been no contributions to the assets by the University or its employees under The Regents' current Funding Policy. However, each year the Plan's financial health is re-assessed: the Plan's Actuary estimates the size of the accrued liability and calculates the level of contribution, called the "normal cost", which is the amount sufficient to maintain the plan's funded ratio, assuming a constant expected rate of return on plan assets. This required contribution is roughly 16% of University payroll for individuals covered by UCRP. Each year, if this level of contribution is not made (or if the assets' rate of return is below their long term expected rate), the plan's Surplus is diminished. However, the forecast growth in assets resulting from Investment Policy alone is not expected to match the forecast growth in liabilities. In the most recent actuarial valuation [July 2005], the Plan's Actuary states "It is expected that the Plan's surplus will run out in the next few years."

INVESTMENT POLICY

Developing an asset allocation strategy requires balancing risk and return. The simplest and lowest risk investment strategy is probably the most expensive one. This strategy is to buy a series of zero coupon Treasury nominal and inflation protected bonds whose maturity date and amount match the dates and amounts of estimated future payments. This strategy is called the "liability hedging strategy" because it protects the value of the assets from changes in interest rates (and thus changes in the value of the liabilities). However, because the rate of return on such a bond portfolio is lower than other riskier assets, the contributions required to maintain full funding of the plan's liabilities would be higher than under a strategy incorporating assets with more risk. To lower the cost – i.e., annual contributions – one must accept risk. Investing in assets with more risk (chiefly equities) not only results in greater asset volatility but also greater surplus volatility. Thus the trade-off of risk and expected return is the essence of pension fund management and of pension risk management.

> "In modern investment practice,
> risk is the raw material used to
> generate expected returns.
> But increasing risk too much
> in the hope of avoiding contributions
> may not be prudent."
>
> Jesse Phillips, Managing Director

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

	June 30, 2005		June 30, 2004	
GENERAL ENDOWMENT POOL	Market Value	% of Pool	Market Value	% of Pool
EQUITIES				
U.S. Equity	$ 2,115,168	40.6%	$ 2,609,207	54.6%
Non-U.S. Equity-Developed	$ 995,696	19.1%	$ 463,754	9.7%
Non-U.S. Equity-Emerging Market	$ 224,406	4.3%	$ 67,224	1.4%
TOTAL EQUITIES	$ 3,335,270	64.0%	$ 3,243,198	65.7%
FIXED-INCOME SECURITIES				
Bonds	$ 1,033,084	19.8%	$ 1,273,472	26.6%
TIPS	$ 256,982	4.9%	$ 0	0.0%
TOTAL FIXED-INCOME SECURITIES	$ 1,290,066	24.8%	$ 1,273,472	26.6%
ABSOLUTE RETURN	$ 450,368	8.6%	$ 250,253	5.2%
PRIVATE EQUITY	$ 118,291	2.3%	$ 103,013	2.2%
REAL ESTATE	$ 6,920	0.1%	$ 0	0.0%
LIQUIDITY PORTFOLIO	$ 9,288	0.2%	$ 15,350	0.3%
TOTAL GENERAL ENDOWMENT POOL	$ 5,210,203	100.0%	$ 4,782,273	100.0%
OTHER ENDOWMENT FUNDS	$ 518,342		$ 375,587	
TOTAL GEP AND OTHER ENDOWMENT FUNDS	$ 5,728,545		$ 5,157,860	

Established in 1933, and unitized in 1958, the General Endowment Pool (GEP) is The Regents' primary investment vehicle for endowed gift funds. GEP is comprised of over 4,350 individual endowments that support the University's mission. GEP is a balanced portfolio of equities and fixed-income securities in which all endowment funds participate, unless payout needs require otherwise.

The June 30, 2005 market value of GEP was $5.2 billion, or $19.09 per share, versus $4.8 billion, or $17.76 per share, at the end of fiscal 2004. Total GEP net investment income for the year was $127.6 million, or $0.47 per share, versus $121.8 million, or $0.44 per share, for fiscal 2004. In addition, $73.4 million was withdrawn to fund the Total Return Payout.

SPENDING POLICY

The Regents adopted a total return investment philosophy aimed at achieving real asset growth in order to generate growing annual payouts to support donors' designated programs. In October 1998, The Regents adopted a long-term spending rate range of 4.35% to 4.75% of a 60-month (5-year) moving average of GEP's market value. The Regents reviews the payout rate each year in the context of GEP's investment returns, inflation and the University's programmatic needs, in conjunction with prudent preservation of principal and prudent increases in the payout amount. In May 2004, The Regents adopted a rate of 4.60% for expenditure in the 2004-2005 fiscal year.

INVESTMENT OBJECTIVE

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

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

INVESTMENT STRATEGY

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

Asset Class	Long-term Policy	Current Policy	Min.	Max.
Public Equity	52%	63%	40%	73%
Public Fixed Income	28%	30%	5%	40%
All Alternatives*	20%	7%	2%	40%
Liquidity	0%	0%	0%	10%

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

The asset allocation benchmarks and portfolio guidelines are designed to manage risk and ensure portfolio diversification. The benchmarks for the individual asset classes are: Russell 3000 Tobacco Free (TF) Index for U.S. Equity; MSCI World Index ex-U.S. (Net) Index for Non-

[1] For fiscal 2005 and fiscal 2004, the cash portion of the various portfolios excludes the unrealized market appreciation or depreciation of STIP investments, accounts receivable and accounts payable, and the investments in the security lending collateral pool. Therefore, the balances differ from the University's Annual Financial Report.

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

U.S. Equity-Developed Markets; MSCI Emerging Markets Free (Net) Index for Non-U.S. Equity-Emerging Markets; Citigroup Large Pension Fund (LPF) Index for Fixed Income; 91-Day Treasury Bill + 4.5% for Absolute Return; and NCREIF Property Index for Private Real Estate and the Wilshire REIT Index for Public Real Estate. The total fund benchmark is a policy-weighted average of the individual asset class benchmarks.

Historically, The Regents' Public Equity investment strategy utilized both active and passive management. In the process of implementing the November 2002 Regents-approved changes to the U.S. equity strategy, the internally managed U.S. common stock was transferred into a Russell 3000 Tobacco Free Index fund. As of June 30, 2005 approximately 30 percent of domestic equity assets had been transferred from the passive Russell 3000 index fund to active managers. Approximately 50 percent of non-U.S. equity had been transferred from the passive MSCI World ex U.S. index fund to developed markets' active managers as of June 30, 2005. The combined assets in each of the domestic and the non-U.S. asset classes are monitored under guidelines established within the investment policy statement for each asset class. Each asset class is controlled according to a risk budget framework set by The Regents. The passive/active allocation is controlled subject to both the risk budget and by the opportunities to add value to the benchmark for each asset class.

For Private Equity, the Treasurer's Office seeks opportunities through recognized top-tier venture capital partnerships and select buyout funds.

For Fixed-Income investments, the Treasurer's Office analyzes relative value among the core benchmark sectors of Governments, Corporates, and Mortgage-backed securities and overweights those sectors and securities offering attractive real returns, while maintaining a risk level commensurate with the benchmark index.

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

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

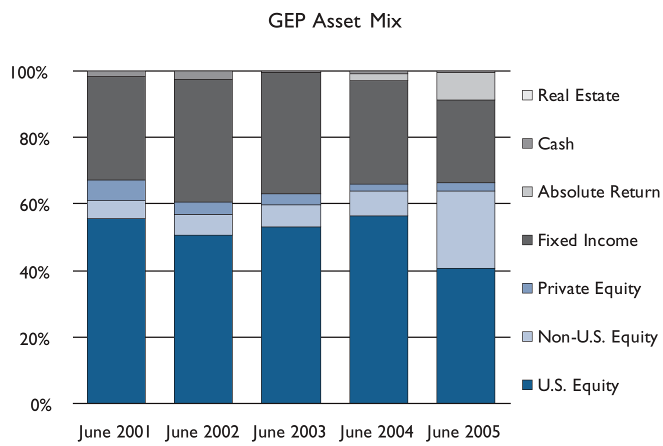
RETURNS

Throughout the years, GEP has exceeded its fund objectives. As illustrated in the table on page 17, GEP has consistently performed well vs. its policy benchmarks. All asset classes contributed positively to the GEP's total return of 10.31% for the fiscal year. For the past 10 years, GEP's compound annual total return was a strong 10.59% vs. 10.05% for its benchmark. During that time, payout distributions grew at an average annual rate of 8.4%—well above annualized inflation of 2.5%.

The cumulative Total Returns Chart on page 16 illustrates the returns for GEP for the past 10 years relative to the policy benchmark and inflation.

ASSET MIX

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



EQUITY INVESTMENTS

The equity portion of GEP consists primarily of U.S. and Non-U.S. common stocks, with a modest exposure to private equity. Total equities represented 66.3% of GEP at year-end, with a market value of $3.4 billion.

U.S. Equity represented 40.6% of the fund at year-end, with a market value of $2.1 billion. GEP's U.S. Equity assets returned 8.21% for the fiscal year outperforming the benchmark by 0.41%. GEP's U.S. Equity return of 9.07% for the 10-year period underperformed the benchmark return of 10.44%.

Non-U.S. Equity-Developed Markets represented 19.1% of GEP at year-end, with a market value of $995 million. GEP's Non-U.S. Equities-Developed Markets gained 14.62% in the fiscal year, outperforming the benchmark return gain of 14.55%. Non-U.S. Equity-Emerging Markets represented 4.3% of GEP at year-end, with a market value of $224 million. Non-U.S. Equity-

Emerging Markets gained 36.93% outperforming the benchmark returns of 34.38%. For the 10-year period, the class outperformed the benchmark by 2.76%.

ALTERNATIVE INVESTMENTS

Private Equity represented 2.3% of GEP at year-end with a market value of $118 million. GEP returns for this asset class in the fiscal year were 55.54%. Over the long term, GEP's private equity returns have been an important contributor to total fund return.

Absolute Return represented 8.6% of GEP at year-end and returned 5.26% in the fiscal year, below the benchmark return of 6.56%.

REAL ESTATE INVESTMENTS

The Real Estate program was implemented this fiscal year, 2004-2005. Real Estate investments represented less than 1% of GEP at year-end with a market value of $6.92 million. GEP returns for this asset class are not available for the fiscal year.

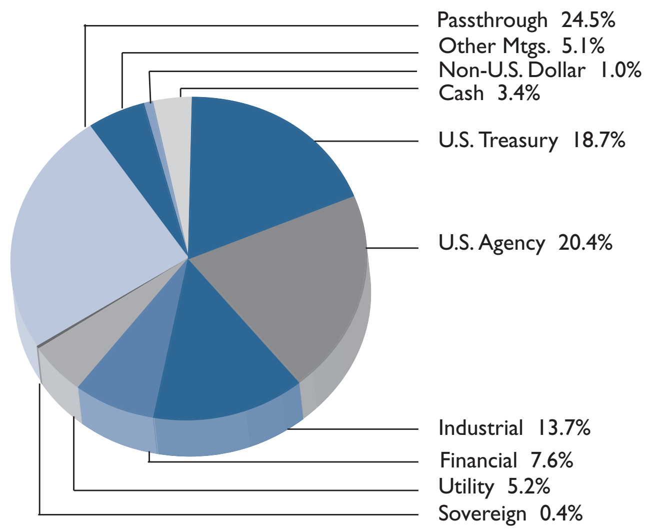
FIXED-INCOME INVESTMENTS

At year-end, Fixed Income constituted 24.8% of the portfolio, with a market value of $1.3 billion.

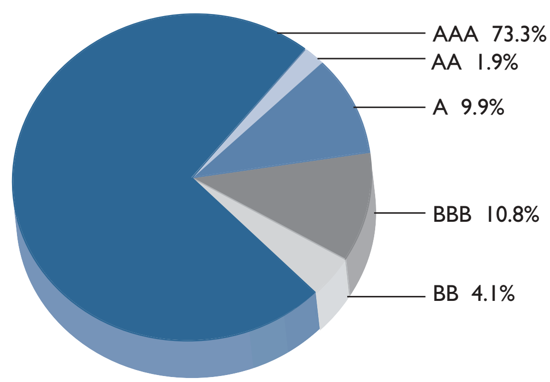
GEP's fixed-income investments returned 11.28% during the year, just underperforming the benchmark return of 11.49%. GEP's fixed income return of 9.41% for the 10-year period exceeded the benchmark returns of 7.98%.

The weighted average maturity of the bond portfolio at year-end was approximately 12 years, the average duration 7.1 years, and the average credit quality was AA, with more than 85% of fixed-income securities rated A or higher. The following pie charts illustrate the sector mix and quality breakdown of the GEP bond portfolio.

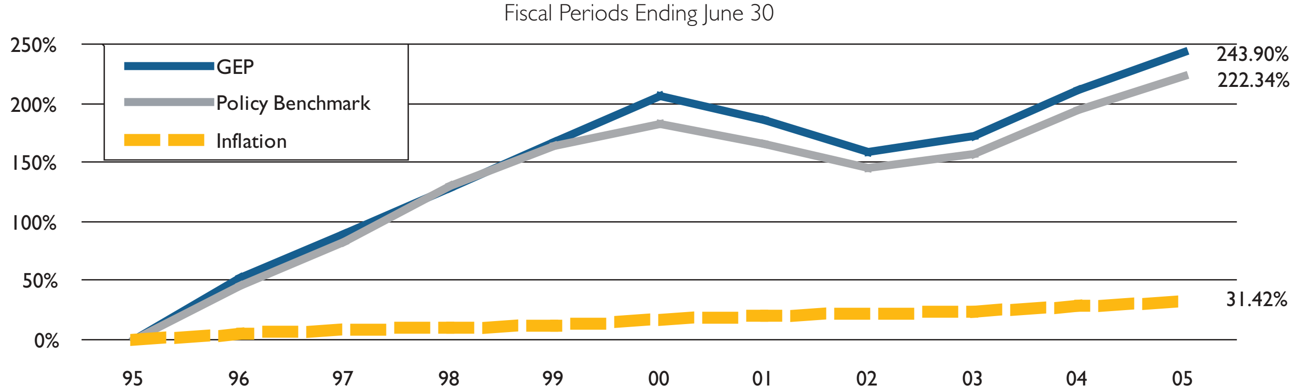
GEP Fixed Income Sector Mix
June 30, 2005



GEP Fixed Income Quality Mix
June 30, 2005
(BBB and higher = investment grade) Average Quality = AA



GEP Cumulative Total Returns: Fiscal 1996-2005
Fiscal Periods Ending June 30



GEP ANNUALIZED TOTAL RETURNS[1] VERSUS BENCHMARKS AND INFLATION

June 30, 2005

	1-Year	5-Year	10-Year	10-Year Cumulative	Benchmark Description[2]
TOTAL FUND					
GEP	10.31%	2.34%	10.59%	243.90%	Total Fund Policy Benchmark: A blend of the indexes described in detail below, each weighted by the percentage it represents in the asset allocation. Adjustments have been made to reflect that the actual investment in Private Equity and Real Estate are below policy weights. Annual index returns assume monthly rebalancing. Inflation: Consumer Price Index.
Policy Benchmark	9.45	2.71	10.05	222.34	
Inflation	2.52	2.44	2.46	31.42	
U.S. EQUITY					
GEP	8.21%	(2.74)%	9.07%	140.66%	U.S. Equity Policy Benchmark: Russell 3000 TF Index; Historical: S&P 500 Index.
Policy Benchmark	7.80	(1.47)	10.44	170.16	
NON-U.S. EQUITY-DEVELOPED					
GEP	14.62%	N/A	N/A	N/A	Non-U.S. Policy Benchmark: MSCI World ex US (Net) Index; Historical: MSCI EMF (Net) Index.
Policy Benchmark	14.55	N/A	N/A	N/A	
NON-U.S. EQUITY-EMERGING MARKET					
GEP	36.93%	6.20%	6.97%	96.12%	Non-U.S. Policy Benchmark: MSCI Emerging Markets Free (Net) Index; Historical: MSCI EMF (Net) Index.
Policy Benchmark	34.38	7.54	4.21	51.05	
FIXED INCOME					
GEP	11.28%	9.21%	9.41%	156.59%	Fixed Income Policy Benchmark: Citigroup Large Pension Fund Index. Historical: LB LT G/C Index.
Policy Benchmark	11.49	9.13	7.98	115.48	
PRIVATE EQUITY					
GEP	55.54%	(1.92)%	29.13%	1189.04%	Private Equity Policy Benchmark: Russell 3000 TF Index +3% (lagged by 3 months); Historical: S&P 500 Index +5%
Policy Benchmark	10.09	(1.77)	11.46	239.50	
ABSOLUTE RETURN					
GEP	5.26%	N/A	N/A	N/A	Absolute Return Policy Benchmark: 91-Day TBills + 4.5%.
Policy Benchmark	6.56	N/A	N/A	N/A	

[1] GEP's total returns are based on unit values calculated by UCOP Endowment and Investment Accounting and are net of (after) investment management and administrative expenses of 0.09% of average annual market value, which are automatically deducted from income. The asset class returns reflect investment returns. The performance of The Regents' total return investment portfolio is calculated by State Street Bank, according to the standard recommended by the Bank Administration Institute (BAI), which uses a time-weighted methodology that essentially neutralizes the effect of contributions and withdrawals so as to measure only the return on assets. These calculations comply with the CFA Institute's standards, which require time-weighted rates of return using realized and unrealized gains plus income. Performance calculations are reconciled by the Treasurer's Office.

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

Note: The TIPS program and the Real Estate program began implementation in fiscal year 2004-2005. Performance less than one year not shown. The TIPS Policy Benchmark is the LB TIPS Index. The Real Estate Policy Benchmark is the NCREIF Property Index for private real estate and the Wilshire REIT Index for public real estate.

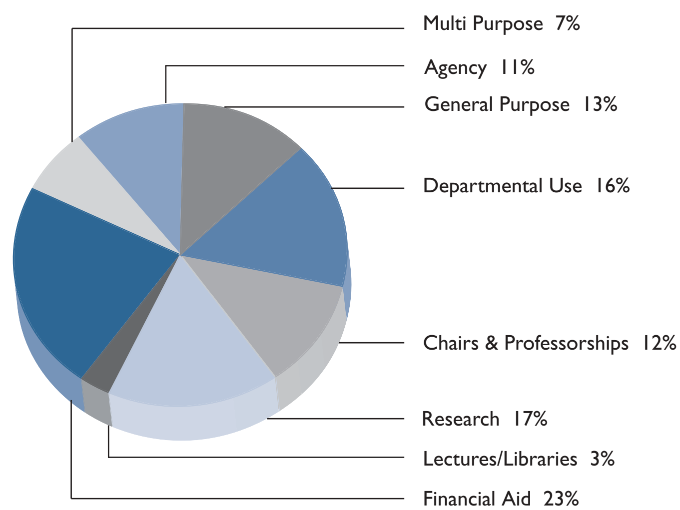
ASSET DESIGNATION BY CAMPUS AND PURPOSE

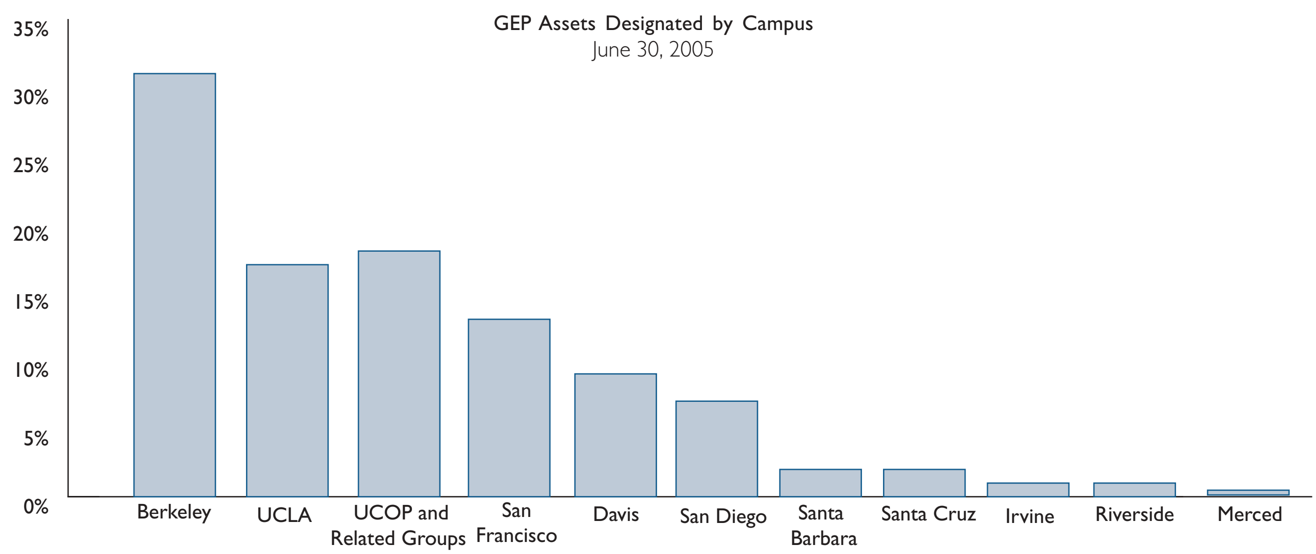
A donor has two avenues for making a gift to or establishing an endowment at the University: directly to The Regents for a specific campus and/or purpose or directly to a campus through its Foundation. The campus foundation trustees have discretion in their choice of investment managers and may use the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

The Regents' endowment pools include assets that were gifted directly to The Regents, as well as foundation assets where the Treasurer was retained as the investment manager. The chart below illustrates the breakdown of GEP's assets among the campuses. Not surprisingly, a higher proportion of the assets is dedicated to the older campuses, which have a more established alumni and donor base.

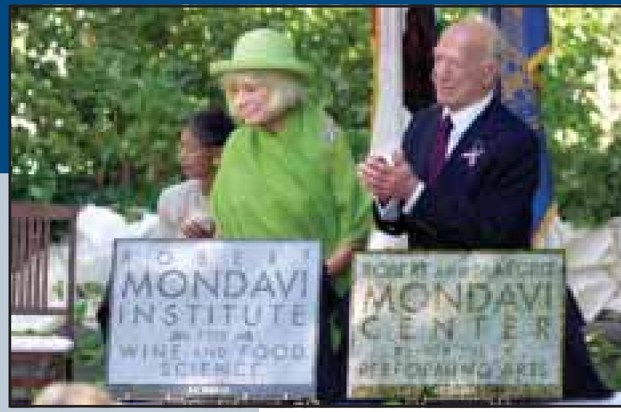
Fundraising efforts provide critically needed monies to support the goals of the University. As illustrated by the chart at the right, more than half of GEP's assets support financial aid (23%), research (17%) and departmental use (16%).

More detailed information on fundraising results may be found in the University's *Annual Report on Private Support* published by the Office of University and External Relations.





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



Robert and Margrit Mondavi
Legendary Napa Valley
wine makers

ROBERT MONDAVI INSTITUTE FOR WINE AND FOOD SCIENCE

Amid California's cloudy economic climate, there is a bright spot—the wine industry. In 2004 the wine industry made an annual impact on California's economy of over $45 billion, according to an April 2005 Wine Institute press release. California's wine industry is also responsible for more than 200,000 jobs and continues to preserve agriculture land and the family farm. "California's wine industry is a major contributor to the economic vitality of California."

The University of California at Davis is a consistent contributor to California's wine industry through new research technologies and in producing some of the brightest minds in wine making. UC Davis is host to the world-renowned department of Viticulture (vine cultivation) and Enology (wine study). These specialized fields of study are found at few institutions, and even more unique, are combined within a single department. UC Davis also houses the department of Food Science and Technology, the apparent associé (associate) to the department of Viticulture and Enology. Currently residing in buildings nearly 50 years old, the departments of Viticulture and Enology and Food Science and Technology will soon intermingle in the new Robert Mondavi Institute for Wine and Food Science.

This new Institute seeks to form partnerships with the world's best teaching facilities to open opportunities for UC students and faculty to influence the wine and food industries worldwide. More importantly, the modern facilities and centralized location of departments will provide new opportunities for synergy in research. The institute has an opportunity to establish itself as a global innovator in university-based teaching and research for wine and food programs.

The vision for the Institute will soon come to fruition due in large part to Robert and Margrit Mondavi, the distinguished Napa Valley family wine makers credited with the development of California's wine industry, and now recognized as UC Davis's most generous benefactors, having given a gift in the amount of $35 million ($10 million earmarked for the Center for Performing Arts). This gift will help place the University at the forefront of educational centers in wine and food science and the arts. It is also one way the Mondavis hope to fulfill their dream of enhancing the quality of life through wine, food and the arts. The Institute promises to benefit not only the UC community, but also the state of California, US and international wine and food industries.

In addition to the Mondavis' donation, the University plans to raise an additional $12 million and anticipates receiving another $35.5 million in state support. Thus far, other generous donors including the Anheuser-Busch Foundation and Diane Disney Miller have contributed more than $3 million. At 2004-2005 fiscal year-end, the Treasurer's Office, on behalf of The UC Davis foundation, managed assets valued at more than $27 million for the Robert Mondavi Institute for Wine and Food Science. These resources will help fund a 75,000 square-foot academic building with classrooms, laboratories, offices and public education spaces, home to the departments of Viticulture and Enology and Food Science and Technology. Plans also include a 36,000 square-foot teaching and research winery; a 13,000 square-foot food production plant, including processing labs for dairy foods, fruits and vegetables; a brewery and packaging and processing technologies; and a 75 guest-room hotel and conference center to accommodate the thousands of anticipated visitors each year—all strategically located at the "front door" to the UC Davis campus.

The Institute for Wine and Food Science, partnered with the Center for Performing Arts, is the quintessential cultural benchmark. This new cultural center at UC Davis does more than ensure the finest research and teaching in new technologies for wine and food, it also positions the University as a global leader in evolving the partnership between wine, food and the arts.

"UC Davis has been a true partner in building the international reputation of the California wine industry...We are greatly honored to support UC Davis with new facilities that ensure its position as the world's leading educational center for viticulture, enology and food science."

Robert Mondavi

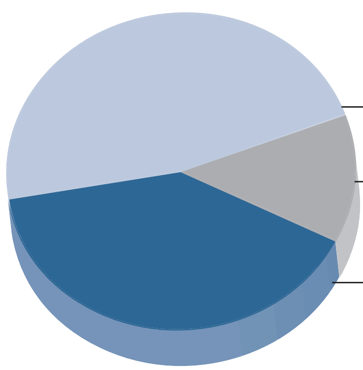
We wish to acknowledge the help of the UC Davis Public Communications Department and Campus Foundation. For more information on The Robert Mondavi Institute for Wine and Food Science visit their website at http://www.news.ucdavis.edu/mondavi/. Photograph courtesy of Neil Michael/Axiom.

Charitable Asset Management Pools

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

At fiscal year end CAM assets totaled $126 million, with CAM Russell 3000 Tobacco Free (TF) Index Pool's market value at $59 million, The CAM EAFE International TF Index Pool's market value at $17 million, and the CAM Fixed Income Pool's market value at $50 million.

Total CAM Assets by Pool
June 30, 2005



INVESTMENT OBJECTIVES

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

RETURNS

1-year performance ending June 30, 2005 follows:

Fund/Policy Benchmark	Return
CAM Russell 3000 TF Index Pool	7.77%
Russell 3000 TF Index	7.80%
CAM EAFE International TF Index Pool	14.77%
MSCI EAFE + Canada TF Index	14.41%
CAM Fixed Income Pool	7.16%
Lehman Aggregate Index	6.80%

HIGH INCOME POOL (HIP)

The High Income Pool (HIP) was established in May 1987 to accommodate endowments and deferred gift giving programs with high contractual payout obligations. Although The Regents' adopted a total return spending policy for The General Endowment Pool (GEP) in 1998, the income only spending policy was maintained for HIP. As the campus foundations have adopted a total return spending policy, they have moved most of their assets out of HIP into GEP. The GEP is The Regents' primary investment vehicle for endowed gift funds. As of June 30, 2005 only $69 Million are invested in HIP. The HIP investment information is included as part of "Other Endowments".

SEPARATELY MANAGED ENDOWMENT FUNDS

At June 30, 2005, The Regents had $233 million invested in separately managed endowment funds (including approximately $195 million where The Regents is the beneficiary, but not the trustee). The separately managed funds were established to achieve specified payout requirements for donor and agency monies, as well as to comply with the terms of gift agreements in which donors required funds to be invested separately (e.g., no commingling of funds) and/or placed restrictions on the investment options (e.g., only U.S. Treasury bonds).

THE ANDREW W. MELLON FOUNDATION

Nierenberg Hall and Annex
Scripps Institution of
Oceanography

The University of California (UC) has earned a reputation as a high-achieving public institution by offering top academic programs. The cornerstone of this reputation lies with the expert faculty and staff that lead the teaching and research programs. One of the ways in which the University is able to maintain such standards in public education is its funding support—commonly in the form of endowments. This support helps fund professorships and fellowships that attract leading educators and the Andrew W. Mellon Foundation is one organization that provides such funding.

The man for whom the Andrew W. Mellon Foundation is named was born in Western Pennsylvania in 1855. At an early age, Andrew worked alongside his father and brother managing the family bank, which soon became the prime financial agent in the transformation of western Pennsylvania into one of the richest industrial regions in the United States. By 1914 Mellon was one of the richest men in the United States.

Mellon also served as Secretary of the Treasury, appointed by Warren Harding. He was hailed as the greatest Treasury Secretary since Alexander Hamilton. Mellon served as an American Ambassador to Britain as well. An accomplished art collector— Mellon amassed what is said to be the greatest collection of his generation (over 21 masterpieces). Even more impressive, Mellon bestowed over $10 million during his lifetime, mostly to educational and charitable institutions. His most famous gift was one of money and pictures to establish the National Gallery of Art in Washington DC. Unfortunately, Andrew Mellon did not live to see the opening of the National Gallery. He died in 1937.

In 1969, the Avalon foundation (founded by his daughter Ailsa in 1940) and the Old Dominion Foundation (founded by his son Paul in 1941) merged to form the Andrew W. Mellon Foundation. The Foundation directly and indirectly supports a wide range of initiatives aimed at strengthening selective (by invitation only) research universities in the United States, with particular emphasis on the humanities and "humanistic" social sciences. The Foundation's interests in this area include (but are not limited to) doctoral education, post-doctoral fellowships, faculty research support, and discipline-related projects. Grants also support research on the economics, sociology, and history of higher education, and improving access to resources for the study of science and society.

Institutions and programs supported by Mellon dollars are often leaders in fields of Foundation activity, but may also be promising newcomers, or in a position to demonstrate new ways of overcoming obstacles to achieving program and grantee goals. The Foundation directs most of its grantmaking to a few program areas—Higher Education and Scholarship, Conservation and the Environment, Museums and Art Conservation, and Performing Arts—in order to focus on a limited number of important objectives.

All nine UC campuses operating at June 30, 2005, have received awards under these programs. Individual campuses, at their discretion, may choose to invest the awards with campus investment programs, or within UC's General Endowment Pool (GEP). To date, the largest contribution awarded to UC by the Mellon Foundation was an appropriation of $1.2 million to the Oceanography Research Endowment for use by the Scripps Institution of Oceanography located on the San Diego campus. In July 1991, an initial cash payment in the amount of $200,000 was transferred to The Regents for management by the Treasurer's Office. As of June 30, 2005, the Mellon Foundation Endowment for the Scripps Institution of Oceanography has grown to more than $2.6 million.

The benefits of UC study are far-reaching and impact every corner of society. UC Supporters like the Andrew Mellon Foundation help sustain the University's excellence in teaching and research. It is through grant and endowment support that first-rate faculty is available to lead the academic programs which merit the University's distinction as a globally respected institution of advanced study.

Three major divisions of Scripps are headquartered in Nierenberg Hall:

The Physical Oceanography Research Division,

The Climate Research Division, and

The California Space Institute

We wish to acknowledge the help of The Andrew W. Mellon Foundation, the Communications Office at the Scripps Institution of Oceanography at UC San Diego and the University of California's Office of the President Department of Endowment and Investment Accounting. For more information on The Mellon Foundation visit their website at http://www.mellon.org. For more information on The Scripps Institution of Oceanography visit their website at http://sio.ucsd.edu. Photograph courtesy of Scripps Institution of Oceanography.

Short Term Investment Pool (STIP)

The Short Term Investment Pool (STIP) is a cash investment pool established in fiscal 1976 by The Regents and is available to all University fund groups, including retirement and endowment funds as well as campus foundations. The STIP allows fund participants to maximize returns on their short-term cash balances by taking advantage of the economies of scale of investing in a larger pool and investing in a broader range of maturities. The STIP consists primarily of current funds slated for payroll, operating and construction expenses for all the campuses and teaching hospitals of the University. In addition, pension, endowment, and defined contribution funds awaiting permanent investment are invested in the STIP to earn maximum daily interest until transferred.

INVESTMENT OBJECTIVE

The STIP's investment objective is to maximize returns consistent with safety of principal, liquidity and cash-flow requirements. The STIP's investments include a broad spectrum of high-quality money-market and fixed-income instruments with a maximum maturity of five- and a half years. The Treasurer's Office structures investment maturities to ensure an adequate flow of funds to meet the University's cash requirements.

INVESTMENT STRATEGY

The Treasurer's Office manages the STIP as a highly liquid portfolio, using maturity distribution strategies to maximize returns in different yield-curve environments. The Treasurer's Office also employs select swapping strategies by taking advantage of disparities in the market to improve quality and yield, while maintaining liquidity.

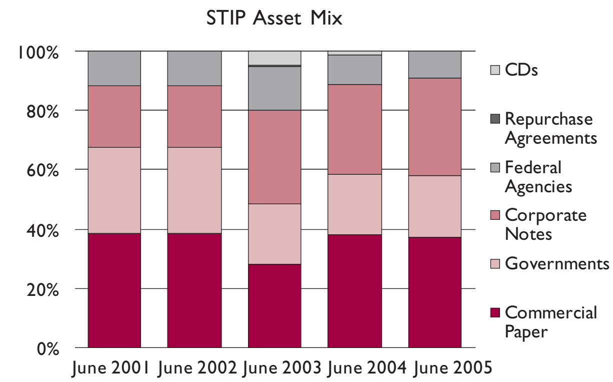
RETURNS

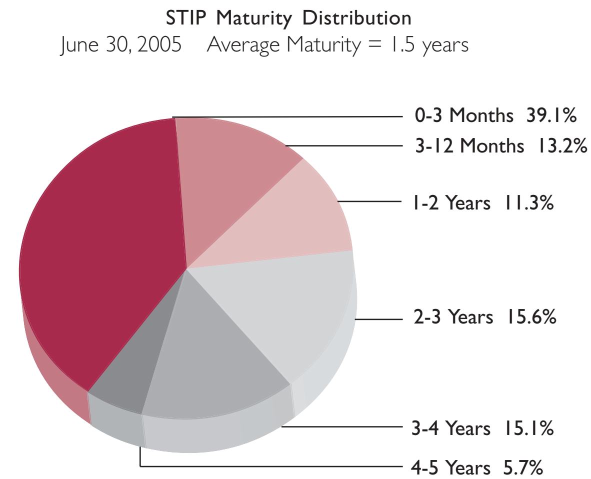
The STIP has achieved very attractive returns over the years. For fiscal 2005, the STIP's income return of 3.57% exceeded the 2-Year U.S. Treasury Note income return of 2.99%. During the past 10 years, the average income return on the STIP was 5.31%, compared to 4.42% for 2-Year U.S. Treasury Note income return.

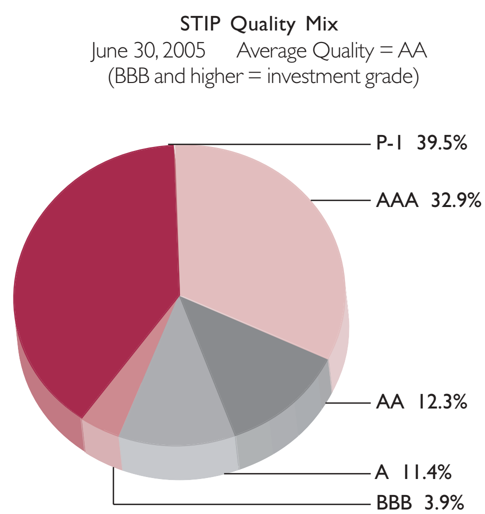
During the year, the STIP periodically provided liquidity to facilitate asset class rebalancing, in-flows and out-flows associated with University financing and other material liquidity events. During this period, selective high quality credit spread products were added to enhance the portfolio's yield. The average maturity of the portfolio was shortened due to the shortening of the yield curve and with the expectation of higher interest rates going forward.

ASSET MIX

The STIP totaled $7.7 billion at June 30, 2005, compared to $7.4 billion at the end of fiscal 2004. The STIP's asset mix at each of the past five fiscal year-ends and maturity distribution and quality mix as of June 30, 2005 follow.







CHOOSING TO UTILIZE UC-MANAGED POOLS

As of June 30, 2005, the Treasurer's Office manages $1,032 million for the campus foundations and support groups. A donor has two avenues for making a gift to or establishing an endowment at the University of California: either directly to The Regents for a specific campus and/or purpose, or directly to a campus through its Foundation. The campus foundation trustees have discretion in their choice of investment managers and may use the Treasurer's Office or external investment managers.

The Treasurer's Office has a long history of working with the UC Berkeley's Foundation, helping it manage the campus' private assets to promote and advance the university's mission.

"As chair of the Investment Committee of the UC Berkeley Foundation for the past five years, I am pleased to say that as we manage our campus' General Endowment Pool, we have benefited greatly from our collegial and productive relationship with the Office of the Treasurer. On behalf of the members of the UC Berkeley Foundation's Investment Committee, I would like to underscore that the Treasurer has been a strong partner in helping us to achieve our goals -- by providing such services as pooled investment vehicles and educational investment forums. Above all else, we value the open and candid line of communication we enjoy with the Treasurer's Office."

Robert B. Beim BA '65, MBA
Managing Director, Woodside Asset Management
Chair, Investment Committee
UC Berkeley Foundation

STIP ANNUALIZED INCOME RETURN[1]

June 30, 2005

	1-Year	5-Year	10-Year	10-Year Cumulative
STIP[1]	3.57%	4.40%	5.31%	67.72%
2-Yr U.S. Treasury Note Inc.	2.99	3.06	4.42	53.64
Inflation[2]	2.52	2.44	2.46	31.42

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

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

UNIVERSITY PROGRAMS UTILIZING STIP

In fiscal 1985, The Regents authorized the University of California Mortgage Origination Program, which provides first deed of trust mortgage loans to eligible members of the University's faculty and staff. These loans totaled $98.5 million at June 30, 2005 and were funded by the legally available cash balances in the unrestricted portion of STIP. In March 1999, The Regents authorized the use of the legally available cash balances in the unrestricted portion of STIP to provide liquidity support for the University's Commercial Paper Program. The STIP also provides working capital advances to the medical centers.

UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM

Summary of Investments[1]
($ in thousands)

	June 30, 2005		June 30, 2004	
UC RETIREMENT PLAN (UCRP)	Market Value	% of UCRP	Market Value	% of UCRP
EQUITIES				
U.S. Equity	$ 23,807,926	56.7%	$ 22,539,391	57.4%
Non-U.S. Equity	$ 3,634,041	8.6%	$ 3,253,511	8.3%
TOTAL EQUITIES	$ 27,441,967	65.3%	$ 25,792,902	65.7%
FIXED INCOME SECURITIES				
Bonds	$ 11,315,750	27.0%	$ 10,382,678	26.4%
TIPS	$ 2,507,205	6.0%	$ 2,527,050	6.4%
TOTAL FIXED INCOME	$ 13,822,955	33.0%	$ 12,909,728	32.8%
PRIVATE EQUITY	$ 613,689	1.5%	$ 561,583	1.4%
REAL ESTATE	$ $63,124	0.1%	$ 0	0.0%
LIQUIDITY PORTFOLIO	$ 28,666	0.1%	$ 25,159	0.1%
TOTAL UCRP	$ 41,970,401	100.0%	$ 39,289,372	100.0%

	June 30, 2005		June 30, 2004	
DEFINED CONTRIBUTION (DC) FUNDS	Market Value	% of DC	Market Value	% of DC
TOTAL RETURN FUNDS				
EQUITY FUND	$ 3,863,180	43.8%	$ 3,362,496	42.6%
BOND FUND	$ 1,062,967	12.0%	$ 941,111	11.9%
TIPS FUND	$ 101,973	1.2%	$ 49,241	0.7%
INTEREST INCOME FUNDS				
SAVINGS FUND	$ 3,091,580	35.0%	$ 2,943,607	37.3%
ICC FUND	$ 706,183	8.0%	$ 587,530	7.5%
TOTAL DC FUNDS[2]	$ 8,825,883	100.0%	$ 7,883,985	100.0%

The largest pool of assets managed by the Treasurer's Office is the University of California Retirement Plan (UCRP), created in 1961. UCRP is a defined benefit plan, whereby retirement benefits are a function of the employee's age, average salary and length of service. With the plan in surplus, The Regents suspended both employee and employer contributions to UCRP in 1990, but redirected the mandatory employee contributions to the newly established Defined Contribution Plan.

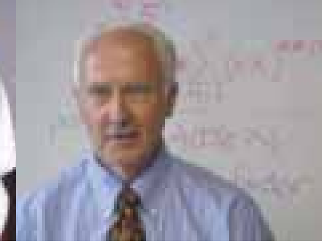
UCRP is a balanced portfolio of equities and fixed-income securities, which at June 30, 2005 totaled $42.0 billion, versus $39.3 billion at the end of fiscal 2004.

INVESTMENT OBJECTIVE

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

[1] For fiscal 2004 and fiscal 2005, the cash portion of the various portfolios excludes the unrealized market appreciation or depreciation of STIP investments, accounts receivable and accounts payable and the investments in the security lending collateral pool. Therefore, the balances differ from the University's Annual Financial Report. UCRP's STIP investments include assets associated with the UC PERS Voluntary Early Retirement Incentive Program totaling $76.2 million in fiscal 2004 and $78.2 million in fiscal 2005.

[2] Total DC Funds excludes the Balanced Growth Fund (started 4/1/04), which totaled $904 million at June 30, 2005, and is invested in and reported as part of the Equity, Bond, and TIPS Funds.



UCRP's specific objective is to ensure its ability to meet its obligation to beneficiaries by earning returns over the long term that meet or exceed the actuarial rate of return of 7.5%.

INVESTMENT STRATEGY

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

Asset Class	Long-term Policy	Current Policy	Min.	Max.
U.S. Equity	50%	56%	53%	73%
Non-U.S. Equity	7%	7%		
Private Equity	5%	2%	1%	7%
Fixed Income	28%	30%	25%	45%
TIPS	5%	5%		
Real Estate	5%	0%	0%	7%

The benchmarks for the individual asset classes are: Russell 3000 Tobacco Free (TF) Index for U.S. Equity; MSCI All Country World (Net) Index ex-U.S. for Non-U.S. Equity; Citigroup Large Pension Fund (LPF) Index for Fixed Income; Lehman TIPS for TIPS; and NCREIF Property Index for Private Real Estate and the Wilshire REIT Index for Public Real Estate. The total fund benchmark is a policy-weighted average of the individual asset class benchmarks.

Historically, The Regents' Public Equity investment strategy utilized both active and passive management. In the process of implementing the November 2002 Regents-approved changes to the U.S. equity strategy, the internally managed U.S. common stock was transferred into a Russell 3000 Tobacco Free Index fund. As of June 30, 2005 approximately 30 percent of domestic equity assets had been transferred from the passive Russell 3000 index fund to active managers. Approximately 50 percent of non-U.S. equity had been transferred from the passive MSCI World ex U.S. index fund to developed markets' active managers as of June 30, 2005. The combined assets in each of the domestic and the non-U.S. asset classes are monitored under guidelines established within the investment policy statement for each asset class. Each asset class is controlled according to a risk budget framework set by The Regents. The passive/active allocation is controlled subject to both the risk budget and by the opportunities to add value to the benchmark for each asset class.

For Private Equity, the Treasurer's Office seeks opportunities through recognized top-tier venture capital partnerships and select buyout funds.

For Fixed Income investments, the Treasurer's Office analyzes relative value among the core benchmark sectors of Governments, Corporates, and Mortgage-backed securities and overweights those sectors and securities offering attractive real returns, while maintaining a risk level commensurate with the benchmark index.

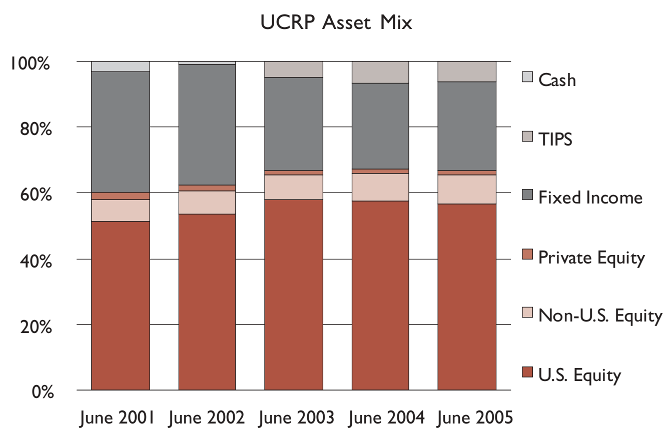
For Real Estate, the Treasurer's Office seeks investments which provide long-term risk-adjusted total returns between those of U.S. equities and bonds; diversification benefits given real estate's low correlation with other asset classes; protection against unanticipated inflation; and a high proportion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

RETURNS

UCRP has exceeded its investment objectives over the long-term. It has also performed well versus its policy benchmarks. All asset classes contributed positively to UCRP's return of 10.30% in the fiscal year. UCRP's annualized total return for the past 10 years through June 30, 2005 was 10.40%, outperforming its benchmark at 10.08%. The cumulative Total Returns Chart on page 26 illustrates the returns for UCRP for the past 10 years relative to the policy benchmark and inflation.

ASSET MIX

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



EQUITY INVESTMENTS

Total Equities represented 66.8% of UCRP at year-end, with a market value of $28.1 billion.

U.S. Equity represented 56.7% of the fund at year-end, with a market value of $23.8 billion. A majority of UCRP's U.S. Equity assets were indexed for the fiscal year and returned 8.11%, outperforming the benchmark return of 7.80%. UCRP's U.S. Equity return of 9.19% for the 10-year period underperformed the benchmark return of 10.44%.

Non-U.S. Equity represented 8.6% of UCRP at year-end, with a market value of $3.6 billion. UCRP's Non-U.S. Equities grew 16.62% in the fiscal year, outperforming the benchmark return of 16.47%. The longer-term returns for this asset class represent the emerging markets funds only, so comparisons are not yet meaningful.

ALTERNATIVE INVESTMENTS

Private Equity represented 1.5% of UCRP at year-end with a market value of $614 million. UCRP returns for this asset class in the fiscal year were 46.02%. Over the long term, UCRP's private equity returns have been an important contributor to total fund return.

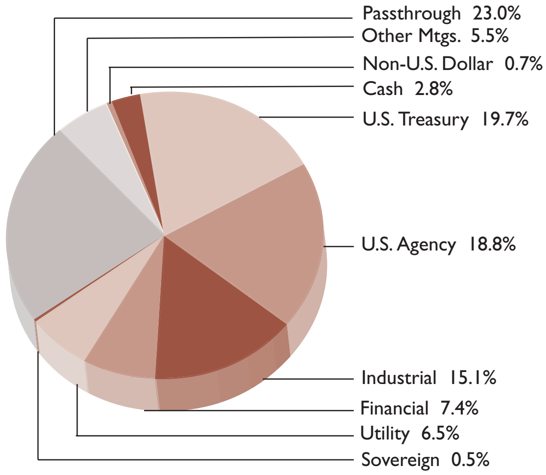
FIXED-INCOME INVESTMENTS

At year-end, Fixed-Income investments constituted 33.0% of the portfolio, with a market value of $13.8 billion.

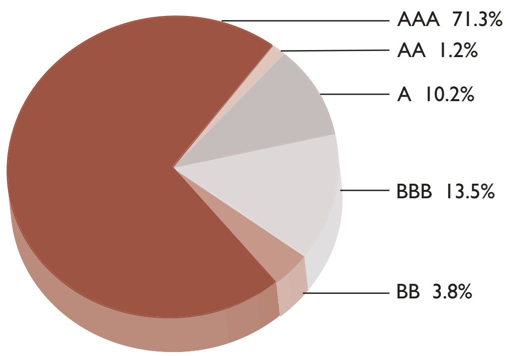
Within total fixed income, UCRP's bond investments returned 11.35% during the year, slightly below the benchmark return of 11.49%. Over the long-term, UCRP's bond returns of 9.22% and 9.65% for the 5- and 10-year periods have exceeded the benchmark. UCRP's TIPS, which represented 6% of total assets on June 30, 2005, outperformed the benchmark by 0.05% for the fiscal year.

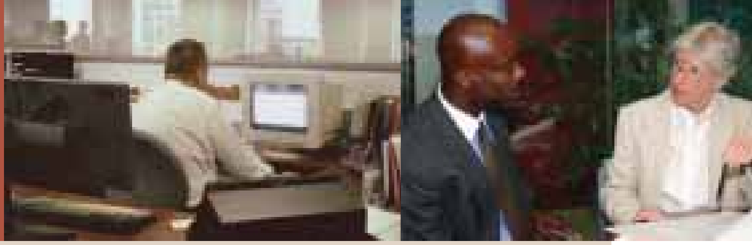
The weighted average maturity of the portfolio at the end of the year was approximately 11.7 years, the weighted average duration 7.1 years, and the average credit quality was AA, with more than 82% of the fixed-income securities rated A or higher. The following pie charts illustrate the sector mix and quality breakdown of the UCRP bond portfolio.

UCRP Fixed-Income Sector Mix
June 30, 2005



UCRP Fixed-Income Quality Mix
June 30, 2005
(BBB and higher = investment grade)





UCRP ANNUALIZED TOTAL RETURNS[1] VERSUS BENCHMARKS AND INFLATION

June 30, 2005

	1-Year	5-Year	10-Year	10-Year Cumulative	Benchmark Description[2]
TOTAL FUND					
UCRP	10.30%	2.73%	10.40%	239.17%	Total Fund Policy Benchmark: A blend of the indexes described in detail below, each weighted by the percentage it represents in the asset allocation. Adjustments have been made to reflect that the actual investment in Private Equity is below policy weight. Annual index returns assume monthly rebalancing.
Policy Benchmark	9.82	2.77	10.08	223.09	
Inflation	2.52	2.44	2.46	31.42	Inflation: Consumer Price Index.
U.S. EQUITY					
UCRP	8.11%	(2.36)%	9.19%	141.43%	U.S. Equity Policy Benchmark: Russell 3000 TF Index; Historical: S&P 500 Index.
Policy Benchmark	7.80	(1.47)	10.44	170.16	
NON-U.S. EQUITY					
UCRP	16.62%	(1.95)%	2.58%	28.46%	Non-U.S. Equity Policy Benchmark: MSCI AC World ex U.S. (Net) Index; Historical: MSCI EMF (Net) Index.
Policy Benchmark	16.47	0.61	0.80	8.31	
PRIVATE EQUITY[3]					
UCRP	46.02%	(3.84)%	28.24%	1103.45%	
FIXED-INCOME SECURITIES					
UCRP (Bonds)	11.35%	9.22%	9.65%	150.12%	Fixed Income Policy Benchmark: Citigroup Large Pension Fund Index; Historical: LB LTG/C Index.
Policy Benchmark	11.49	9.13	7.98	115.48	
TIPS					
UCRP	9.38%	N/A	N/A	N/A	
Policy Benchmark	9.33	N/A	N/A	N/A	TIPS Policy Benchmark: Lehman TIPS Index.

[1] UCRP's total returns are net of (after) investment management and administrative expenses of 0.04% of average annual market value. The asset class returns reflect investment returns. The performance of The Regents' total return investment portfolio is calculated by State Street Bank, according to the standard recommended by the Bank Administration Institute (BAI), which uses a time-weighted methodology that essentially neutralizes the effect of contributions and withdrawals so as to measure only the return on assets. These calculations comply with the CFA Institute's standards, which require time-weighted rates of return using realized and unrealized gains plus income. Performance is reconciled by the Treasurer's Office.

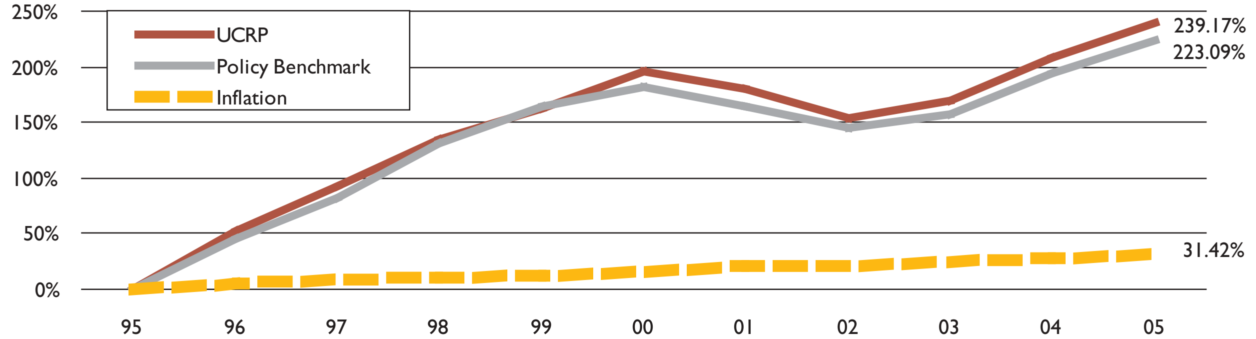
[2] Historical benchmark information is available online at http://www.ucop.edu/treasurer/invinfo/Benchmarks.html.

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

[4] Includes balances invested for the Balanced Growth Fund, which at 6/30/05 totaled $904 million and consisted of 65% in the Equity Fund, 30% in the Bond Fund, and 5% in the TIPS Fund.

UCRP Cumulative Total Returns: Fiscal 1996-2005

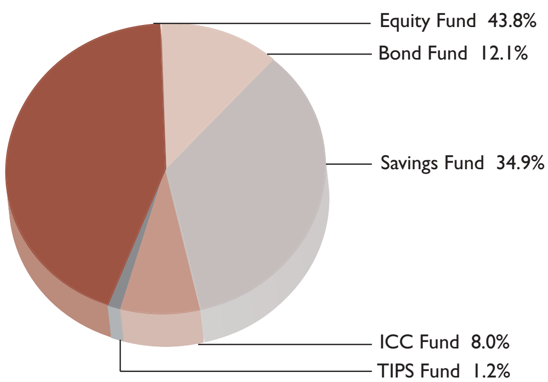
Fiscal Periods Ending June 30



In addition to the defined benefit program (UCRP), the University offers defined contribution plans to provide employees with supplemental retirement benefits—the mandatory Defined Contribution Plan (DC Plan), the Tax-Deferred 403(b) Plan, the Tax-Deferred 457(b) Plan (new as of October 1, 2004), and the Defined Contribution Plan After-Tax Account. These programs differ from UCRP in that the benefits received by participants are based on the em-ployee's contributions to the plans and the returns earned on those contributions over time and that each participant chooses a mix of asset classes (funds) consistent with his or her own investment objectives and risk tolerance. As of June 30, 2005, total assets in the defined contribution plans were $8.8 billion vs. $7.8 billion on June 30, 2004.

When investing their defined contribution funds, employees may choose among six University Defined Contribution (DC) Funds managed internally by the Treasurer's Office or selected external funds.

Total UC-Managed Defined Contribution Plan Assets by Fund[4]
June 30, 2005



INTERNALLY MANAGED UC FUNDS

The six University-managed funds include four total return funds—the Equity Fund, Bond Fund, TIPS Fund and Balanced Growth Fund—and two interest income funds—the Savings Fund and Insurance Company Contract (ICC) Fund. University-managed funds offer employees the opportunity to achieve attractive, long-term investment performance by investing in one or more funds of their choice. These funds represent diversified portfolios of high-quality, growth-oriented global stocks and bonds, as well as more conservative interest income funds with attractive above market yields. As shown on page 29, these funds rank above average in performance comparisons for most time periods. In addition, the University-managed funds are extremely low cost relative to external fund options: Annual expenses are only 0.15%[1] of average annual market value, compared to the industry average of 1.4%.[2]

TOTAL RETURN FUNDS

EQUITY FUND

The largest of the University-managed DC funds is the Equity Fund, established in August 1967. The Equity Fund is a total return fund with the primary objective of maximizing long-term capital appreciation with a moderate level of risk. The Regents adopted the following asset allocation policy for the Equity Fund in March 2000:

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

At June 30, 2005, the total market value of the Equity Fund was $3.9 billion. The portfolio consisted of 82.7% U.S. Equity, 15.4% Non-U.S. Equity, 1.8% Private Equity and 0.1% cash.

At June 30, 2005 the U.S. equity is invested in a Russell 3000 Tobacco Free (TF) Index fund managed by State Street Global Advisors. Non-U.S. equity is invested in a MSCI EAFE + Canada Tobacco Free Index fund (also managed by State Street Global Advisors) and in Emerging Markets funds. The private equity is invested in venture capital partnerships and buyout funds.

For the fiscal year, the Equity Fund's return of 10.26% outperformed its policy benchmark return of 9.17% and its peers, as measured by the Morningstar Domestic Equity Funds Median. The Equity Fund's longer-term returns are shown on page 29.

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

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

UNIVERSITY-MANAGED DEFINED CONTRIBUTION FUNDS RETURNS[1]

June 30, 2005

	1-Year	5-Year	10-Year	Benchmark Description
Equity Fund	10.26%	(2.33)%	9.47%	Equity Fund Policy Benchmark: 85% less the actual Private Equity weight from the prior month end times the Russell 3000 TF Index, 15% MSCI ACWI ex US (Net) Index and the actual Private Equity weight of the previous month end times the Russell 3000 TF Index +3% (lagged by 3 months); Historical: S&P 500 Index.
Policy Benchmark	9.17	(1.17)	10.61	
Morningstar Domestic Equity Funds Median[2]	7.25	0.14	8.94	
Bond Fund	6.78%	8.04%	9.05%	Bond Fund Policy Benchmark: Lehman Aggregate Index; Historical: LB LTG/C Index.
Policy Benchmark	6.80	7.41	7.12	
Morningstar Taxable Bond Funds Median[2]	6.10	6.15	5.65	
TIPS Fund (started 4/1/04)	9.13%	NA	NA	
Policy Benchmark	9.33%	NA	NA	TIPS Fund Policy Benchmark: Lehman TIPS Index.
Balanced Growth Fund (started 4/1/04)	9.23%	NA	NA	Balanced Growth Fund Policy Benchmark: 65% policy benchmark for Equity Fund, 30% policy benchmark for Bond Fund and 5% policy benchmark for TIPS Fund.
Policy Benchmark	8.59%	NA	NA	
Savings Fund	3.79%	4.82%	5.50%	Savings Fund Policy Benchmark: 2-Year U.S. Treasury Note Income Return.
Policy Benchmark	2.99	3.06	4.42	
ICC Fund	5.09%	6.16%	6.79%	ICC Fund Policy Benchmark: 5-Year U.S. Treasury Note Income Return.
Policy Benchmark	3.72	4.02	4.97	
Inflation	2.52%	2.44%	2.46%	Inflation: Consumer Price Index.

BOND FUND

The Bond Fund is a total return fund established by The Regents in January 1978. The primary objective of the Bond Fund is to maximize real long-term total return through a combination of interest income and price appreciation, subject to maturity and quality constraints. The Treasurer's Office invests the Bond Fund in a diversified portfolio of primarily high-quality, debt securities.

At June 30, 2005, the total market value of the Bond Fund was $1.1 billion. U.S. Treasury securities constituted 9.2%of the fund, U.S. Agency 23.8%, high-grade industrials 11.8%, financial bonds 7.6%, utility bonds 5.1%, mortgage-backed securities 40.3% of the fund, Sovereigns 0.6% and cash 1.6%. The weighted average maturity of the portfolio at year-end was approximately 7.9 years, the weighted average duration 4.4 years, and 87% of the portfolio was rated A or better.

In fiscal 2005, the Bond Fund returned 6.78%, slightly underperforming its benchmark, yet outperforming the Morningstar Taxable Bond Funds Median. As shown above, the Bond Fund's long-term returns of 8.04% and 9.05% for the 5- and 10-year periods have exceeded those of its Morningstar peers and its benchmark by healthy margins.

[1] All returns and yields for the University-managed funds are net of (after) investment expenses of 0.15% and are based on unit values for the Equity, Bond and Multi-Asset Funds and on interest factors for the Savings, ICC and Money Market Funds. The Treasurer's Office calculates returns and yields by dividing the new unit value or interest factor by the previous unit value or interest factor supplied by UC Human Resources and Benefits. The Treasurer's Office compares these results to the gross investment returns calculated by State Street Bank. State Street Bank's calculations comply with the Association for Investment Management and Research (AIMR) standards, which require time-weighted rates of return using realized and unrealized gains plus income.

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

BALANCED GROWTH FUND

The Balanced Growth Fund seeks to provide long-term growth and income through a balanced portfolio of equity and fixed income securities held within UC-managed funds. The market value of the Balanced Growth Fund at June 30, 2005 was $904 million.

Contributions are invested according to a fixed ratio: 65% Equity Fund, 30% Bond Fund and 5% TIPS Fund (see below). The fund's asset allocation mix is more aggressive and deemed more suitable to long-term retirement goals than used in its predecessor, the Multi-Asset Fund which was closed March 31, 2004. The Balanced Growth Fund's returns are a function of the performance of its component funds and are likely to closely mirror the performance of the University of California Retirement Plan (UCRP).

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

TIPS FUND

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

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

The market value of the TIPS Fund at June 30, 2005 was $101 million.

INTEREST INCOME FUNDS

SAVINGS FUND

The Savings Fund, the second largest DC fund, is an interest income fund created in July 1967. The investment objective of the Savings Fund is to maximize interest income returns, while protecting principal, in order to provide a safe, low-risk investment with attractive and stable returns. As such, the Savings Fund invests 100% in government, government-guaranteed and government agency securities of up to five years in maturity. The Treasurer's Office maximizes returns by altering the Fund's maturity structure in different yield curve environments.

The Savings Fund totaled $3.1 billion at June 30, 2005, and was invested 100% in AAA-rated U.S. Treasury and federal agency securities. The weighted average maturity of the Savings Fund was 1.5 years at June 30, 2005.

The Savings Fund has historically provided an income return greater than that of 2-year U.S. Treasury Note income. In fiscal 2005, the Savings Fund generated an income return of 3.79%, exceeding the 2.99% income return on 2-year U.S. Treasury Notes. During the past 10 years the Savings Fund generated an average income return of 5.50% versus 4.42% on 2-year U.S. Treasury Note income.

INSURANCE COMPANY CONTRACT FUND

The Regents approved the Insurance Company Contract (ICC) Fund as an investment option in September 1985. The investment objective of the ICC Fund is to maximize interest income return while protecting principal. The Treasurer's Office invests contributions to the ICC Fund in insurance company contracts offered by select, highly rated, financially sound insurance companies. Under such contracts, the insurance companies guarantee a fixed annual rate of interest for a specified time period and the repayment of principal at the end of that time period. The contracts are backed by the assets of the insurance companies, and ICC Fund participants receive the blended rate of all contracts in the fund. The Treasurer's Office uses staggered maturities to systematically manage the reinvestment of maturing contracts and to provide return stability.

At June 30, 2005, the ICC Fund totaled $706 million, with a weighted average maturity of 3.7 years. Since inception, the ICC Fund has generated income returns that have exceeded those of 5-year U.S. Treasury Note income by a comfortable margin. In fiscal 2005, the ICC Fund generated a 5.09% income return versus 3.72% on 5-year U.S. Treasury Note income and during the past 10 years generated a 6.79% income return compared to 4.97% on 5-year U.S. Treasury Note income.

RETIREE PROFILE

Hugh Pates' 23 1/2 year career at the University of California San Diego was launched by his being in the right place at the right time. His wife had been hired as the Assistant Resident Dean at Revelle College at UCSD. They lived on campus and Hugh was finishing his doctorate. He recalls, "One day the Provost, Paul Saltman Ph.D, asked if I would be interested in doing some counseling for students during the evening hours. That part time experience became a full time job after I completed my studies. For me, it was a match made in heaven."

Like most young people in their first job, Hugh wasn't initially aware of all the benefits available to him as a UC employee, but he learned of them over time. When the government introduced IRA plans and then the University introduced a 403(b) plan, he was ready to plan for his retirement and began making monthly contributions to both an IRA and a 403(b) account. Open to learning, he credits many sources which helped him along the way. He attended retirement seminars and benefits fairs sponsored by UCSD and read about the financial markets and investment opportunities. Early on in his career a co-worker encouraged him to invest in San Diego real estate. He also gained insight from a financial advisor, and he credits his wife of 37 years with providing conservative and cautious advice about the utilization of their assets.

Hugh had two dreams for his career: 1) to find each day rewarding and enjoyable at work; and 2) to be able to retire early in order to devote more time to his family and to travel. As for the first dream, Hugh enjoyed his daily contact, interactions and experiences with UCSD students. "I also had the privilege of working with and for some of the most caring, gracious and devoted people in my life's experience," he reminisces. As for his second dream, his regular contributions to his IRA and 403(b), along with his real estate investments and the UC's VERIP III (Voluntary Early Retirement Incentive Program) provided income Hugh felt was sufficient to sustain him and his family for the rest of his life. Hugh retired at 58, opting to receive a monthly distribution citing, "I had more faith in the University than any other investment I could make with a lump sum payout."

Retirement is busy and rewarding with Hugh's activities benefiting both his family and the community. He has served as President of the UCSD Retirement Association, Board Member and Chair of the Council of the University of California Retirees Association, Board Member and President of the San Diego Psychological Association, Board Member of the California Psychological Association, Member of the Citizens Review Board, President of University City Community Association, and he devotes one day a week in consultation with Geriatric Patients in Skilled Nursing Facilities. In addition, he attends many of his grandchildren's varied activities and takes them to events in and around San Diego. He is a cofounder of the UC Retirees Travel group and together, the group has taken journeys through the Panama Canal, down the Danube River, into the Scandinavian Countries and Russia and most recently, toured Australia, New Zealand and Fiji.

Hugh is currently planning for a family reunion next summer and notes that there are still several countries he has not yet been able to visit. What is his secret to tackling such an active agenda? "I believe being involved in a regular exercise program which has allowed me to be very healthy, having great friends and family with whom to enjoy my time, and having a positive attitude about life and its challenges, has allowed me to live a very happy and productive life in retirement," he replies.

His advice to current UC employees is straightforward, "Invest as much as possible in your 403(b) plan, enjoy the opportunities to interact with the students, and take as much advantage as possible of the wonderful educational and cultural activities offered by each campus."

Hugh Pates, Ph.D.

San Diego, CA

Retired

Clinical Psychologist

23 1/2 years with the University of California San Diego

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

This *Treasurer's Annual Report 2004-2005* is unaudited, however these investments are included in the following audited financial statements of the University of California: *The University of California Annual Financial Report 2004-2005* (available on the internet at www.ucop.edu/ucophome/busfin/reports.html), *The University of California Defined Contribution Plan and Tax-Deferred 403(b) Plan 2004-2005*, and *The University of California Retirement Plan 2004-2005* (both available on the internet at http://atyourservice.ucop.edu/forms_pubs/categorical/annual_reports.html).

INTERNET LINKS OF INTEREST

UC-Managed Funds

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

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

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

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

Regents' Committee on Investments/Investment Advisory Committee

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

UC News

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

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

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

You may contact us in writing at the University of California, Office of the Treasurer,
P.O. Box 24000, Oakland, CA 94623-1000

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

OFFICE OF THE TREASURER

June 2005

Effective July 8, 2005 Mr. Russ left the University of California for a position as Chief Investment Officer at Dartmouth College and The Board of Regents named Marie N. Berggren as Interim Treasurer and Interim Vice President for Investments.

David H. Russ, MA – **Treasurer and Vice President for Investments**
Melvin L. Stanton, MBA – **The Assistant Treasurer**
Randolph E. Wedding, MBA – **Managing Director – Fixed Income Investments**
Marie N. Berggren, MS – **Managing Director – Alternative Investments**
Jesse L. Phillips, CFA, MBA, MA – **Managing Director – Investment Risk Management**
Robert B. Blagden, MBA – **Managing Director – Externally-Managed Investments**

ALTERNATIVE INVESTMENTS

Private Equity

Neetesh Kumar, MBA, MS	Investment Officer
Brett Johnson, MBA	Investment Officer
Leslie Watson, BA	Analyst

Absolute Return

Lynda Choi, MBA	Investment Officer

EXTERNALLY-MANAGED INVESTMENTS

Steven Algert, CFA, MPPM	Investment Officer
Burton Yuen, MBA	Investment Officer

FIXED INCOME INVESTMENTS

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

INVESTMENT RISK MANAGEMENT

Aileen Liu, MS	Assistant Director
Alicia Boice, CFA, BS	Analyst
Michael John, BS	Analyst

OPERATIONS

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

INFORMATION SYSTEMS

Michael Comstock

COMMUNICATIONS

Susan Rossi, **Director**	Alison Johnson

BUSINESS MANAGEMENT

Nelson Chiu, **Manager**	William Byrd

ADMINISTRATIVE STAFF

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