Office of the Treasurer
Investment Performance
Quarter Ended June 30, 2009

Executive Summary

Market Commentary

- U.S. equity markets strengthened across the board in the second quarter as investors sought riskier assets. Equities and lower quality credit issues rallied while Treasuries retreated. After dropping to historic lows on March 9, markets rallied strongly in the second quarter, partially recouping losses since the start of the fiscal year. While the economy clearly continued to slow, and unemployment climbed close to double digits, investors were cheered by indicators that the *pace of the decline* in key sectors of the economy has begun to moderate. However, in the last month of the quarter, it was evident that a significant level of uncertainty still remained. The market did not make much headway in June, as investors awaited the release of quarterly earnings for additional evidence that the next stage of the recovery, based on company fundamentals, may be underway.

Equity and Fixed Income Market Performance

- The second quarter marked one of the best returns for the U.S. equity broad market since 4Q 1998. The Dow Jones Industrial Average climbed 12.0%, the S&P 500 gained 15.9%, and the Russell 3000 advanced 16.8%. Despite the sharp quarterly rally, markets were still down significantly from year earlier levels. The Dow, S&P 500, and Russell 3000 declined -23.0%, -26.2%, and -26.6%, respectively for the fiscal year ended June 30, 2009. The recent rally was also fueled by a belief that the global economy would be supported by emerging market infrastructure-driven growth. Emerging Markets were the dominant driver of returns this quarter. MSCI Emerging Markets soared 34.7% while MSCI World ex US gained 25.9% over the quarter. However, global markets were also down significantly over the full fiscal year, with Emerging and Developed markets down -28.1% and -31.6% respectively.

- Within fixed income markets, U.S. fixed income rose for the quarter, and had positive performance for the fiscal year as investors sought Treasuries as a safe haven at the peak of the credit crisis. Credit access improved as it became increasingly easier for financial institutions to shore up balance sheets, a clear reversal from the ‘frozen credit’ conditions at the start of the credit crisis. The Barclay’s Capital Aggregate rose 1.8% for the quarter, and 6.1% for the fiscal year. Riskier credit issues performed best over the quarter, with the Merrill Lynch High Yield Cash Pay index soaring 22.6% for the quarter, though it was still down -3.6% for the fiscal year. In global credit markets, the JPM Global Diversified Emerging Market Index climbed 11.4% for the quarter and gained 4.0% for the fiscal year, while the Citigroup Non-U.S. World Government Bond Index rose 5.4% for the quarter and 3.5% for the fiscal year.

UC Fund Performance

- The aggregate of all managed funds had a strong double digit return of 10.04% for the quarter compared to 10.29% for the benchmark. For the full Fiscal Year the entity declined -14.66%, ahead of the policy benchmark by 9 bps. For the FYTD, the retirement plan was down -18.81%, ahead of the policy benchmark return of -18.86%. For UCRP, the asset allocation decision to underweight equities and overweight fixed income benefited the portfolio during the fiscal year. The UCRP portfolio had a strong double-digit return of 13.38% for the quarter, while the benchmark returned 13.94%. The returns relative to the benchmark were distorted by the use of Treasury Bills + 4.5% as

the benchmark for the Absolute Returns portfolio for several months, rather than a more relevant hedge fund benchmark (the HFRX). Using the HFRX benchmark for the entire year would have produced a positive relative return of 72 bps. The GEP portfolio returned 10.65% behind the policy benchmark by -53 bps. For the FYTD, the portfolio fell -17.74%, underperforming the benchmark by -3.75%, primarily due to Absolute Return underperformance. As in the case of UCRP, the relative return was distorted by the Treasury Bills + 4.5% benchmark. Using the HFRX benchmark for the entire year would have produced a *positive* relative return of 119 bps.

- STIP continued to significantly outperform its benchmark. For the QTD, STIP gained 0.82% versus the benchmark return of 0.22%. STIP more than doubled the U.S. 2-Year Treasury benchmark for the FYTD, gaining 3.67% versus 1.55% for the benchmark. The TRIP portfolio lagged the benchmark QTD by -1.37%; however, the portfolio has outperformed for the period since its inception. From August 2008 through June 2009 TRIP returned -1.55%, significantly ahead of the benchmark return of -3.02%.

Quarterly Market Overview

As fear dissipated, the overall tenor grew positive for most of the quarter and the markets with higher risk and higher spreads (within credit markets) outperformed. In the second quarter, sectors that were previously hurt the most severely led the market rally. Financials saw the broadest price rebound followed by technology, producer and consumer durables, especially autos. (See Attachment 1-A for market summary returns.)

- U.S. Equity Markets saw the sharpest quarterly rally in over a decade.
  - U.S. equity large core indices such as the Dow Jones Industrial Average rose 12.0%, the S&P 500 climbed 15.9%; and the Russell 3000 soared 16.8% over the quarter.
  - Within the core Russell 3000 index, growth and value performed identically for the quarter. Both the Russell 3000 Growth and Value indices returned 16.8%.
  - Smaller cap stocks dominated large caps over the quarter. The Russell Midcap and Russell 2000 indices returned 20.8% and 20.7% respectively, while the Russell 1000 Index returned 16.5%. Megacaps, comprised of the 200 largest securities, lagged the most gaining 14.9% for the quarter. However, earlier in the year as investors fled riskier assets at the height of the liquidity crisis, smaller capitalization and higher beta stocks underperformed, offsetting the relative edge to smaller caps from the most recent quarter. The Russell 1000 fell -26.7% for the fiscal year while the Russell 2000 index fell -25.0%.
  - Financial stocks, particularly the banking sector, led the market higher this quarter. The Russell Financial Services sector gained 27.6% while banking stocks soared 37.3%. Technology, fueled by a belief that productivity improvements would help sustain the rally, gained 21.1%. Sectors reliant on future growth in manufacturing, such as producer durables, were winners. The GM bankruptcy and subsequent government rescue signaled a turning tide, which in its wake helped create a spectacular 81.2% rally in the automobile sector as the market discounted the possibility that the entire sector was in danger of collapse.

- Non-U.S. Developed also rallied strongly over the quarter, up 25.9%.

  - The equity markets of Non-U.S. Developed Countries in *local currency terms*, rose 17.4% for the quarter, while foreign currencies gained 8.5%.
  - In short, the equity markets in foreign developed countries performed very similarly as the U.S. equity market, but the flight away from the U.S. dollar during the quarter caused overseas markets to outpace the U.S. market during the quarter.
  - Country returns were tightly distributed, with almost all countries advancing by 20-30%. Ireland, which is bogged down by severe debt problems, gained just 6.50%. Over the fiscal year, Ireland was by far the worst performing developed market, plunging -81.1% from peak levels.
  - Singapore was the best performing equity market for the quarter among developed countries, rising 43.1%.
  - Among major countries, Japan and the United Kingdom gained 22.9% and 24.9%, respectively. Both countries slightly underperformed the broader Non-U.S. developed market index.
  - All ten Global Industrial Classification industry sectors recorded at least double digit gains during the quarter as economically sensitive sectors, particularly those that were beaten down the most severely during the fierce decline in the last six months of 2008, recording the largest gains.
    - Financials soared 41.2% and Materials gained 29.6% during the quarter.
    - Meanwhile, defensive sectors lagged the broader index, while still obtaining strong gains.
    - Health Care, Utilities, and Consumer Staples rose 11.0%, 14.7%, and 19.6% for the quarter.

- Emerging markets soared 34.8% for the quarter, outpacing both U.S. and Non-U.S. developed markets.

  - Emerging market currencies rallied sharply during the quarter, surging 10.9%. The U.S. dollar fell during the quarter, partially due to investor's willingness to increase risk, but also due to concerns about the fast-rising U.S. government debt.
  - Country returns showed some differentiation, though every market gained over 10%.
    - Hungary, which previously plunged roughly 75% peak-to-trough, shot up 69.7% for the quarter.
    - India soared 59.8% during the quarter, boosted in part by election results that were encouraging to investors.
    - Turkey, Indonesia, and Thailand each gained between 54% and 57%.
    - The countries that most significantly lagged the benchmark during the quarter were smaller equity markets, although even the 'lagging' countries had hefty double digit gains including Peru (11.0%), Israel (16.0%), and Morocco (19.9%).
    - Among larger countries, Brazil outpaced the emerging market index with a gain of 41.0%, Russia slightly outperformed the index with a gain of 37.8%, and China performed right in line with the index by gaining 35.3%. Larger emerging markets that trailed the index during the quarter included South Africa, up 31.3%, and Korea, which gained 25.1%.
  - Sector returns in emerging markets exhibited more variation than country returns during the quarter. Sector returns in emerging markets were linked to their economic sensitivity and the degree to which they plunged during the severe decline in the second half of 2008, though the link was stronger in U.S. and Non-U.S. developed markets.

    - Financials and Consumer Discretionary were the best performing sectors in emerging markets, up 47.4% and 47.3%, respectively, for the quarter.
    - Energy, Materials, and Industrials, which also share extra sensitivity to the economy, gained 35% to 36% each, slightly outperforming the broader index.
    - Health Care, which returned 15.7%, was the sector that lagged the most. Other sectors that trailed the broader index included Telecommunications -23.0%; Technology -23.5%; Consumer Staples -29.5%; and Utilities -33.3%.

- Core Fixed Income recorded modest gains in the quarter as U.S. Treasury yields rose on heavy supply and a lessening of risk aversion, while credit markets had one of their strongest rallies in history. The Citi LPF Index rose 0.93%, and the Barclay's Aggregate Index gained 1.78%. For the fiscal year, the LPF gained 7.34% and the Barclay's Aggregate 6.05%.

  – Governments: U.S. Treasury yields rose, and the yield curve steepened in Q2 as Treasury gross coupon issuance totaled a hefty $500 Billion during the quarter. In March, the Federal Reserve announced they would purchase $300 Billion in Treasury securities as part of an increase in their quantitative easing program. The flight to quality bid for Treasuries diminished during the quarter as the equity markets improved and investors became more comfortable with the riskier sectors of the bond markets. 2 yr. Treasury yields rose 31 bps to yield 1.11% while 10 yr. Treasury yields rose 87 bps to yield 3.53% at quarter end. The Citigroup LPF Government sector returned -5.66% for the quarter.

  – Credit Sectors were strong across the board in the quarter, as investors took advantage of attractive yields and a perception that the worst of the global financial crisis was past. Investors from other asset classes, such as equities and absolute return strategies, were also active buyers of corporate bonds, enhancing the markets' technicals. In investment grade credit, the Citi LPF Credit Index returned 10.67%, and the Barclay's Aggregate Credit Index 8.81%. Emerging Markets debt was similar, with returns of 11.42% for the JPM EMBIG Diversified Index. For the fiscal year, which encompasses perhaps the worst period for credit markets in history, results were mixed, with positive returns of 3.97% for investment grade and 3.45% for EM.

  – Mortgage-backed securities were up modestly for the quarter under very light trading: the Citigroup LPF Collateral sector gained 0.45%. The government finally announced details of the TALF and PPIP programs causing spreads to narrow in the CMBS sector. For the FY, MBS sector had strong returns (9.37%) coming mainly from strong government buying of mortgage pass-throughs. Delinquencies in all residential mortgage sectors continue to increase.

  – TIPS outperformed same maturity Treasuries in Q2 as commodity prices rose and investors became concerned about the inflationary impact of the ever increasing U.S. current account deficit. Breakeven inflation rates rose across the TIPS curve with shorter term TIPS performing the best. Treasury yields rose 80 bps to end the quarter at 4.33%. For the quarter, the Barclay's U.S. TIPS index returned 0.66%, outperforming similar duration Treasuries by 5.27%.

- The High Yield market experienced one of its strongest rallies in history in the quarter, soaring 22.55%, led largely by buyers of low dollar-priced issues, as well as successful debt exchanges by several distressed issuers. The High Yield market also benefited from a very positive technical situation created by strong mutual fund inflows. Despite the rally, high yield still recorded negative absolute returns for the fiscal year, down -3.63%.

Second Quarter Plan Performance

The overall UC Entity performance was strong this quarter, gaining 10.04%, compared to the policy benchmark return of 10.29%. For the Fiscal Year to Date the entity was down -14.66%, ahead of the benchmark by .09%.

- While overall market conditions were challenging, in both the UCRP and GEP plans, returns for the quarter were impacted by an overweight in Private Equity, which reflected continued write-downs carried over from first quarter. For UCRP, an underweight to non-U.S. Equity, which rallied strongly in the second quarter, further detracted. For GEP, a modest emerging market underweight detracted, as emerging market equity was the strongest performing asset class over the quarter.

- The return of each Plan and the corresponding policy benchmark is detailed in Attachment 2 and discussed below.

  - The UCRP portfolio return was 13.38% compared to the Policy Benchmark return of 13.94% for quarter end and -18.81% versus -18.86% respectively for the fiscal YTD period.
  - The GEP portfolio return was 10.65% compared to the Policy Benchmark return of 11.18% and -17.74% versus -13.99% respectively for the fiscal YTD period.
    - The divergence in relative returns between the two portfolios, particularly over the FYTD period, is primarily due to differences in their exposure to Absolute Returns, which outperformed its benchmark this quarter, but lagged significantly over the FYTD. The underperformance resulted from the use of a Treasury Bill + 4.5% benchmark return when a relevant hedge fund index would have produced a positive related return. The benchmark for Absolute Returns was changed effective March 1, 2009 from Treasury Bills + 4.5% to an HFRX (Hedge Fund Research Tradable Index) proxy. GEP has a far larger exposure to absolute returns, with an ending weight of 23.4% at the end of June, compared to UCRP's weight of 5.9%.
    - GEP also ended the quarter with a modestly higher active exposure to Private Equity, which also detracted from relative performance. (See Attachment 3.)
  - The STIP portfolio returned 0.82% for the quarter, exceeding its benchmark by 0.60%.
    - This was mainly due to consistently maintaining its high credit quality philosophy and avoiding investments in short-term asset backed securities (ABS) and paper issued by structured investment vehicles (SIVs).

- Returns were hurt this quarter from **under**weighting non-U.S. Equities, as investors returned to riskier assets over most of the quarter. The overweight to Private Equity, which reflected significant write-downs carried over from the first quarter, also detracted from active returns.

Plan Level Risk

As of quarter end, the VIX index is still above the 'normal' level of 20-25 before the credit crisis. The market has significantly trimmed the index to levels that are a fraction of the peak reading of 80 reached in November.

- The market has significantly adjusted the price of buying S&P 500 protection through options, as proxied by the VIX moving to a third of the level in the fourth quarter, yet still above long term averages (see Attachment 1-B).

- Despite the high level of uncertainty and systemic risk in the financial system, total plan level active decisions (relative to our policy benchmarks) were diversified and moderate in size.

- Aggregate tracking errors continue to remain below the overall budgeted risk (3% annualized volatility) for both UCRP and GEP, as global market risk levels have moderated.

- UCRP's total forecast risk based on current portfolio valuations decreased from prior quarter levels to 19.64% with an active risk of 1.11%. GEP's total forecast risk decreased to 16.81% with an active risk of 2.02%.

Quarterly Asset Class Review

The following is a summary of the core asset class performance underlying UCRP's returns.

- **Public Equity Portfolios:** Total Public Equities advanced 21.12% over the quarter. Since March, the extreme level of fear among investors in reentering the equity market has been dissipating. Investors have begun to discern increasing opportunities across countries, sectors, and stocks. Emerging markets were the highest returning asset class among equities, followed by Non-U.S. markets, then U.S. stocks. (See Attachment 4.)

  - Non-U.S. Developed: The total portfolio (including active and passive) rose 25.37% for the quarter, versus the benchmark return of 25.93%.

    Active Non-U.S. Developed Equity: Active managers returned 23.40%, behind the benchmark return by -2.53%. For the fiscal year, active managers returned -30.11%, outperforming the benchmark return of -31.69% by 1.58%.

    - An emphasis on managers whose companies have lower debt and more stable sales and earnings held back returns during the quarter, though they helped during the fiscal year.
    - An underweight to financials detracted from performance during the quarter, but boosted returns over the fiscal year.
    - An underweight to Canada of -5% had an adverse effect on returns as the Canadian equity market outperformed the broader index by 3.9% for the quarter, although the underweight was beneficial in the fiscal year period as financials, materials, and natural resources lagged.

  - Emerging Market Equity: This portfolio surged 35.63% during the quarter, outpacing the benchmark by 0.90%.

    - An underweight of 3.4% to Brazil held down returns, as Brazil gained 41.0% and topped the benchmark return by 6.2%.
    - An overweight of 2.5% in Turkey boosted returns, as Turkey rocketed 57.2% during the quarter, topping the benchmark by 22.4%.
    - An overweight of 3.3% to Consumer Discretionary added to returns, as the sector gained 47.4% during the quarter, outpacing the benchmark by 12.6%.
    - An underweight of -2.5% to financials hurt returns, as the sector gained 47.3% during the quarter, handily beating the benchmark by 12.5%.

  - Total U.S. Equity: Total U.S. Equities gained 16.99%, outperforming its benchmark by 0.16%. Active U.S. Equity portfolio of outside managers outperformed its benchmark by 0.81%.

    - Within sectors a nearly 4% overweight to technology, and an overweight to selected financial sectors helped boost returns, as both sectors led the market higher.

- The market's renewed emphasis on company fundamentals benefited the returns among our U.S. active equity managers.
- In aggregate, our active manager's smaller cap orientation relative to benchmark and emphasis on positive earnings growth contributed to the positive net performance as securities exhibiting higher volatility and greater prospects for growth in a recovering economy rallied most.

Fixed Income Portfolios

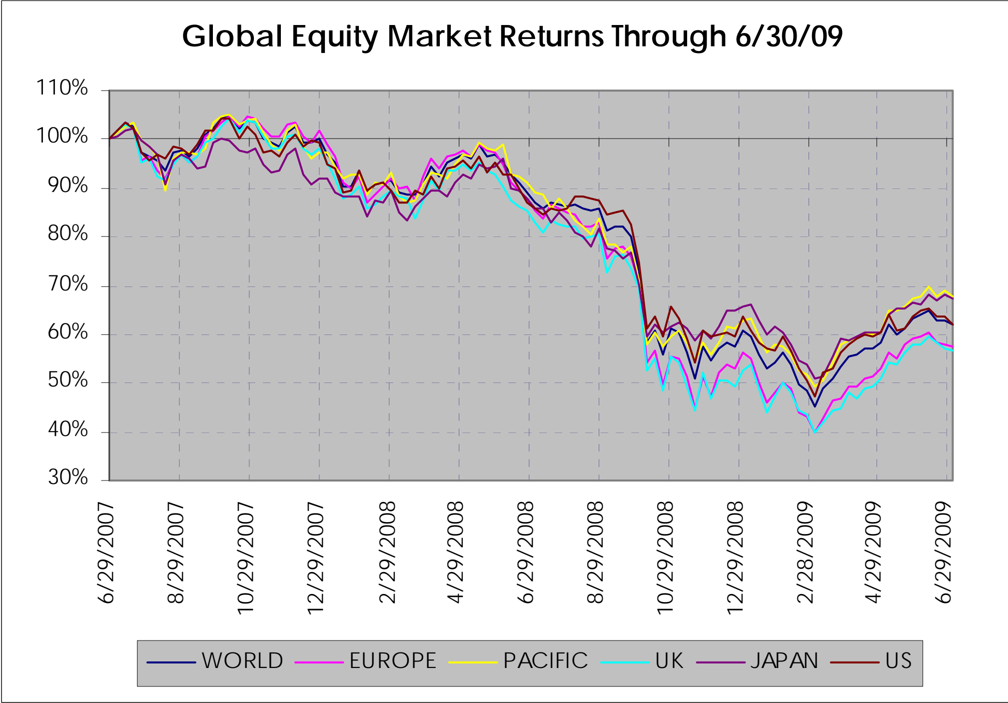
- **Core U.S. Fixed Income Portfolio**: The actively managed UCRP Core Fixed Income portfolio had a strong quarter, returning 3.40% and outperforming the benchmark return by 2.47%. Performance was led by strong relative gains in the Government and Credit sectors. Mortgage returns were flat versus a small gain for the benchmark. For the fiscal year, the fund regained nearly all of the underperformance suffered in the earlier months, returning 7.14% versus 7.34% for the benchmark. (See Attachment 5.)
  - **Government Sector**: The UCRP Government Bond Portfolio returned -3.71%, outperforming its benchmark by 1.95% due primarily to overweights in TIPS, 10 yr maturity STRIPS and REFCORP zeros and GSE subordinated debt. For the year ended June 2009, the UCRP Government Bond Portfolio returned 8.96%, outperforming its benchmark by 1.57%.
  - **Credit Sector**: UCRP Credit returned 13.80% in the quarter, outperforming the benchmark by 313 basis points, due primarily to security selection in financials and underweights in the lowest-yielding segments of the markets such as Sovereigns and Supranationals. For the full fiscal year, the credit portfolio underperformed the benchmark by 117 basis points, due mainly to its holdings in subordinated financial paper and other higher beta issues, which underperformed during the period of severe risk aversion earlier in the year.
  - **Mortgage Sector**: UCRP Collateral was flat, modestly underperforming the benchmark. For the full FY, the portfolio matched the strong performance of the sector, returning 9.28% versus 9.37% for the index. Liquidity improved across all sectors helping prices to move higher and spreads to narrow as appetite for risk increased significantly. The government was a big buyer during the year of mortgage securities and also provided financing to leveraged investors under the TALF and PPIP programs.
  - **High Yield Debt**:
    - The UCRP High Yield portfolio, which focuses more on the broader high yield market, soared 19.53%, but could not keep pace with the torrid rally in the lower quality, more distressed issues, particularly in autos, financials, and gaming, lagging the Merrill Lynch High Yield Cash Pay Index by -3.02%.
    - For the fiscal year, the portfolio outperformed in the early part of the year, due to its emphasis on high quality names, but lagged more recently during the market rally. FYTD returns were -4.35% versus -3.63% for the benchmark.
  - **Emerging Market Debt**: Emerging Market debt also had a very strong quarter, led by a rebound in several of the weaker countries, as the direst expectations for the global economy receded. For the fiscal year, Emerging Market had positive absolute returns similar to investment grade credit.
    - The UCRP Emerging Market portfolio returned 9.56% versus 11.42% for the benchmark in the quarter. Similar to the results in High Yield, UCRP suffered from not owning several of the lower quality names that rallied strongly. For the fiscal year, the portfolio returned 3.15% versus 3.95%, lagging the benchmark by -80 basis points, primarily due to the recent results.

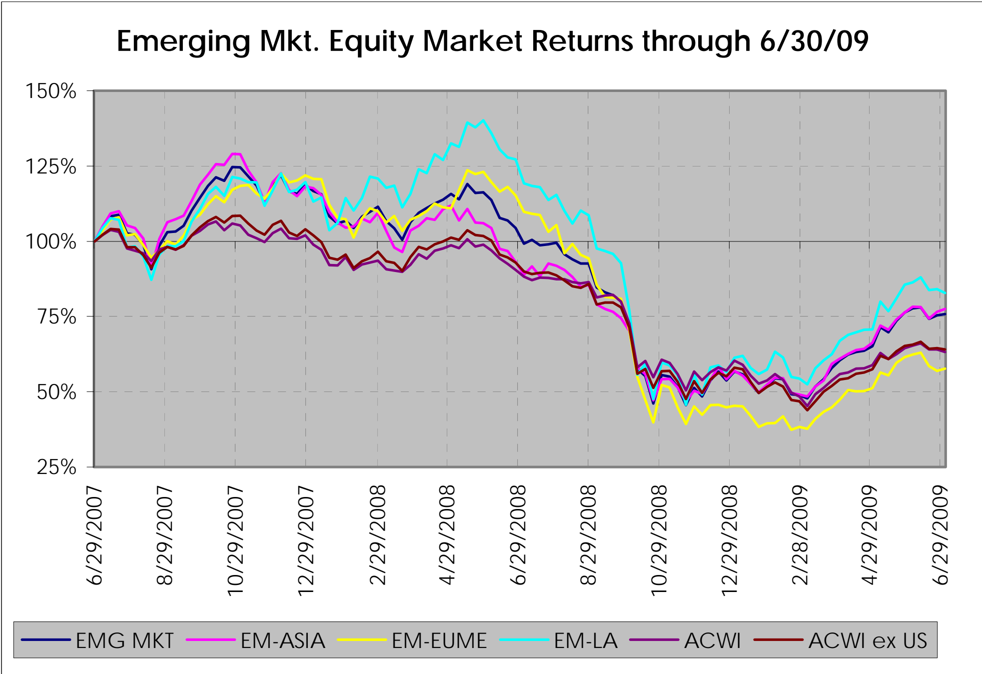
- **<u>Alternative Assets</u>:** Absolute Returns saw gains over the quarter as global markets recovered, while non-marketable alternatives, including Private Equity and Real Estate, continued to see write-downs this quarter, a carry over from March valuations. Private Equity declined -3.29%, Private Real Estate declined -15.52%, and Absolute Returns gained 5.84%. Tradable REITs had a strong rally, gaining 34.65% for the quarter relative to the index return of 35.48%. A full discussion of Alternatives appears in Attachment 6.

Market Indices Performance Report
Quarter Ended June 30, 2009

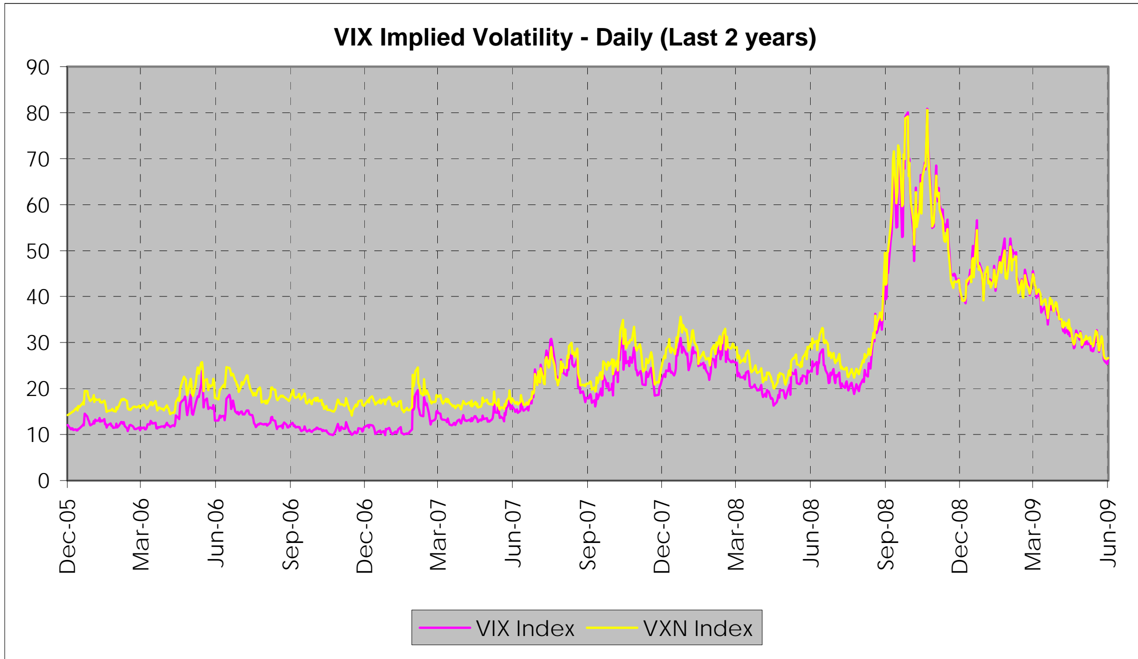
Market Indices Performance Report			
Periods Ending 06/30/2009			
		QTD (%)	FYTD (%)
US Equity			
	S&P 500	15.93	-26.22
	Russell 3000	16.82	-26.82
	Dow Jones Industrial Average	11.96	-22.97
Non-US Equity			
	MSCI World ex-US	25.86	-31.62
	MSCI Emerging Markets	34.73	-28.07
US Fixed Income			
	Barclays Capital Aggregate	1.78	6.05
	Citigroup Large Pension Fund	0.93	7.34
	Barclays Capital TIPS	0.66	-1.11
	Merrill Lynch High Yield US Corporate	22.55	-3.63
Non-US Fixed Income			
	Citigroup World Government Bond Index ex-US	5.44	3.53
	JP Morgan Emerging Market Global Diversified	11.42	2.10
Real Estate			
	NAREIT all share Price Index	27.48	-40.63
Cash Equivalents			
	91 Day Treasury Bill	0.05	0.95
	Consumer Price Index	0.83	-1.98

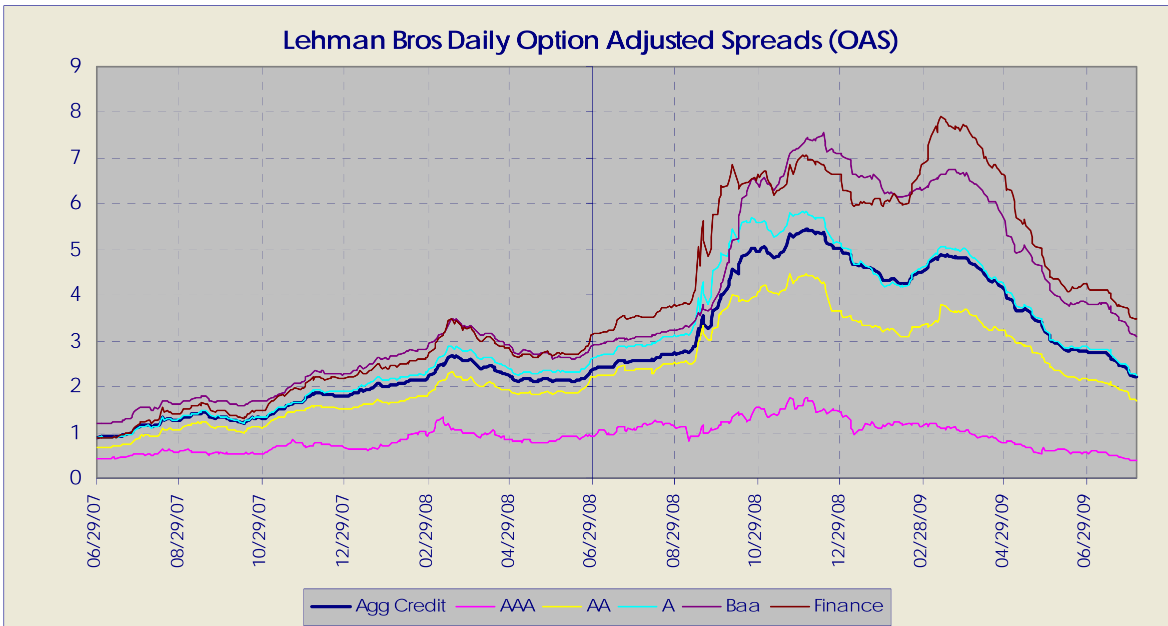
Global Equity Market Returns
Quarter Ended June 30, 2009





Risk Trends
Quarter Ended June 30, 2009





Investment Performance Report
Quarter Ended June 30, 2009

Quarterly Investment Performance Report			
Periods Ending 6/30/2009			
UC Entity		Total Return	
	Market Value ($M)	QTD	Fiscal YTD
UCRP	**$ 32,309**	13.38%	-18.81%
Policy Benchmark		13.94%	-18.86%
Variance to Benchmark		-0.56%	0.05%
GEP	**$ 5,186**	10.65%	-17.74%
Policy Benchmark		11.18%	-13.99%
Variance to Benchmark		-0.53%	-3.75%
STIP	**$ 6,567**	0.82%	3.67%
Policy Benchmark		0.22%	1.55%
Variance to Benchmark		0.60%	2.12%
TRIP	**$ 1,452**	9.18%	N/A
Policy Benchmark		10.55%	N/A
Variance to Benchmark		-1.37%	N/A
Total Assets[1]	**$ 54,679**	10.04%	-14.66%
Entity Benchmark		10.29%	-14.75%
Variance to Benchmark		-0.25%	0.09%
1) Excludes 403(b), 457(b) & DC Plans			

UCRP Quarterly Asset Class Performance Attribution
Quarter Ended June 30, 2009

UCRP	Total Contribution (%)	Within Asset Class Return (%)	Asset Allocation (%)
US Equity	0.01	0.05	-0.05
Non US Equity	-0.26	-0.11	-0.16
Emg. Mkt Equity	-0.08	0.03	-0.11
Global Equity	-0.03	0.00	-0.03
Core Fixed Income	0.22	0.29	-0.07
High Yield Debt	-0.06	-0.08	0.02
Emg. Mkt Debt	-0.02	-0.05	0.03
Non-US Debt	0.03	-0.01	0.04
TIPS	0.01	0.01	0.00
Absolute Return	-0.02	0.09	-0.12
Private Equity	-0.29	0.00	-0.29
Real Estate	-0.03	-0.01	-0.02
Other	-0.04	0.01	-0.02
TOTAL	**-0.56**	**0.22**	**-0.78**

- Asset allocation was the primary detractor of returns for the quarter, as the market turned sharply positive, the overweight to private equity and underweight to non-U.S. equity contributed to the shortfall relative to benchmark.
- Core Fixed Income added the most value to the total plan return this quarter, primarily driven by strong relative performance within the asset class.
- Private Equity detracted the most from the total plan due to an overweight relative to the policy allocation. Write downs taken in the fourth quarter are now impacting the overall portfolio.
- Overall, value added due to security selection was relatively strong, adding 0.22% to relative return primarily from Core Fixed Income and Absolute Returns outperforming their respective benchmarks.

GEP Quarterly Asset Class Performance Attribution
Quarter Ended June 30, 2009

GEP	Total Contribution	Within Asset Class Return	Asset Allocation
US Equity	0.00	0.06	-0.06
Non US Equity	-0.22	-0.13	-0.09
Emg. Mkt Equity	-0.13	0.05	-0.18
Global Equity	-0.04	0.00	-0.05
Core Fixed Income	-0.03	0.02	-0.05
High Yield Debt	-0.14	-0.12	-0.02
Emg. Mkt Debt	-0.05	-0.05	0.01
Non-US Debt	-0.01	-0.01	-0.01
TIPS	-0.01	0.01	-0.02
Absolute Return	0.55	0.59	-0.04
Private Equity	-0.37	0.00	-0.37
Real Estate	-0.02	-0.10	0.08
Other	-0.06	0.00	-0.04
TOTAL	**-0.53**	**0.32**	**-0.84**

- The overweight to private equity was a key detractor due to write-downs in the March quarter which are reflected in our lagged quarterly valuations.
- Non-U.S. Equity underweights contributed negatively to asset allocation, as non-U.S. Equity and emerging markets outperformed U.S. Equity markets.
- Absolute Returns contributed positively as superior returns relative to the new HFRX Tradable index benefitted the overall portfolio.
- Overall contributions within asset classes was positive, primarily due to absolute returns as well as value added from U.S. Equity and Emerging Market managers this quarter.

Public Equity Review
Period Ended June 30, 2009

Public Equity	Total Return		Benchmark Return		Excess Return	
	Quarter (%)	FYTD (%)	Quarter (%)	FYTD (%)	Quarter (%)	FYTD (%)
US Equity UCRP	16.99	-26.82	16.83	-26.82	0.16	0
US Equity GEP	17.18	-26.45	16.83	-26.82	0.35	0.37
Non-US Developed Equity UCRP	25.37	-30.87	25.93	-31.69	-0.56	0.82
Non-US Developed Equity GEP	25.11	-30.41	25.93	-31.69	-0.82	1.28
Emg. Mkt. Equity UCRP	35.63	-29.45	34.73	-28.07	0.90	-1.38
Emg. Mkt. Equity GEP	36.01	-30.42	34.73	-28.07	1.28	-2.35

Review of U.S. Public Equity Portfolios

- Within financials, active managers were slightly overweight key financials including securities and financial services which helped. As a whole, financials led the market rally.
- The aggregate smaller cap tilt helped relative performance as smaller caps outperformed over the market rally.
- Growth and value styles performed very similarly during the quarter.
- Overall, active managers slightly outperformed during the quarter.

Review of Non U.S. Developed Public Equity Portfolios

- The Non-U.S. developed market was up 25.37% for the quarter.
- In aggregate, the international managers underperformed the benchmark
- Managers were **under**weight Canada by 5%, which **out**performed the benchmark by 3% during the quarter, detracting from returns.
- Managers were **under**weight financial sector stocks by 4%, which **out**performed the benchmark by 15% during the quarter, further detracting from returns.
- Managers were **under**weight Japan by 3%, which **under**performed the benchmark by 5% during the quarter, boosting returns.

Review of Emerging Market Equity Portfolios

- Emerging Market countries continued to experience a large dispersion in returns this quarter, with country returns ranging from 11% to 70%. Hence, country selection has continued to be an important driver of returns. Our active managers outperformed the benchmark primarily from aggregate country allocations and an overweight to consumer discretionary.
- Managers were **under**weight Brazil by 3.4%, which outperformed the benchmark by 6% during the quarter, detracting from returns.
- Managers were **over**weight Turkey by 2.5%, which **out**performed the benchmark by 22%, during the quarter, boosting returns.
- Managers were **over**weight consumer discretionary stocks by 3.3%, which **out**performed the benchmark by 13% during the quarter, further boosting returns.
- Managers were **under**weight financial stocks by 2.5%, which **out**performed the benchmark by 13% during the quarter, detracting from returns.

Looking Forward

- **Emphasis on Higher Quality Companies with Greater Free Cash Flow and Low Debt**
  - The current global recession is likely to be long and deep. As a result, we believe the best investment strategy right now is to emphasize companies that will be able to survive.
  - The investment implications of our assessment has led us over the past several quarters to tilt the equity portfolio as a whole toward managers whose companies have the following risk and factor exposures:
    - Less debt-equity.
    - Higher free cash flow.
    - Higher cash yield.
    - Higher return on equity.
    - More stable revenues and earnings.
    - Strong brands and franchises.
    - Less expensive companies (lower valuations).

- **Greater Use of Macroeconomic Factors in Portfolio Construction**
  - Under normal market conditions, relative valuation, momentum, and fundamental factors tend to be the primary sources of excess returns, and macroeconomic factors don't add much.
  - When markets and economies are experiencing fundamental, significant change, macroeconomic factors can add more value than they otherwise would.

- **Less Dollar Exposure**
  - As we expected, the dollar has rallied somewhat thus far in 2009. But over the intermediate term, we expect dollar weakness due to:
    - Very large government deficits.
    - Printing money in very large volume.
    - Potential for deflation, hyperinflation, or stagflation.
    - Large trade deficits.
    - High consumer debt.
    - Weak U.S. economy.
    - Economies, policies, and debt levels are better overseas.

- **Greater Emphasis on Emerging Markets**
  - The emerging markets have the most favorable long-term investment potential as compared to U.S. and international equities.
  - The investment implications for this assessment will result in placing a greater emphasis on emerging markets, over the long term.

- **International Small Cap**
  - UC does not have a dedicated international small manager (Note: We do have such exposure through all-cap international managers and through passive strategies).
  - Active managers in international small cap have earned relatively high excess returns.
  - When the economic environment improves, we may include an investment in an international small manager. For the time being, we're satisfied that our international all-cap managers can provide exposure to smaller companies on a tactical basis.

Fixed Income Review
Period Ended June 30, 2009

Core Fixed Income	Total Return		Benchmark Return		Excess Return	
	Quarter (%)	FYTD (%)	Quarter (%)	FYTD (%)	Quarter (%)	FYTD (%)
UCRP	3.40	7.14	0.93	7.34	2.47	-0.20
Government	-3.71	8.96	-5.66	7.39	1.95	1.57
Corporate	13.80	2.80	10.67	3.97	3.13	-1.17
Mortgage	.03	9.28	.45	9.37	-0.42	-0.09
GEP	2.05	4.54	1.78	6.05	0.27	-1.51
Government	-.58	7.44	-2.21	6.63	1.63	0.81
Corporate	11.44	1.14	8.81	4.08	2.63	-2.94
Mortgage	-1.09	5.11	1.68	7.06	-2.77	-1.95
403b Bond Fund	2.76	6.89	1.78	6.05	0.98	0.84
Other Fixed Income						
High Yield Debt	19.53	-4.35	22.55	-3.63	-3.02	-0.72
Emerging Market Debt	9.56	3.15	11.42	3.95	-1.86	-0.80
STIP	0.82	3.67	0.22	1.55	0.66	2.12
403b Savings Fund	0.82	3.52	0.22	1.55	0.60	1.97

Review of Fixed Income Portfolio

- Core Fixed Income significantly outperformed the benchmark. UCRP's performance was particularly strong due to outperformance in Government and Credit.
- The portfolios' asset allocation (underweight Governments and overweight Credit) added 100 bps to performance, as investors began to increase risk exposures and U.S. Treasuries lost some of their safe haven status.
- The high yield and emerging market portfolios underperformed as our focus on the better credits in those sectors subtracted from performance.

Review of Core Government Portfolio

- The UCRP Government sector outperformed its benchmark by 1.95% in the quarter.
- The main contributors to outperformance were overweights in TIPS, 10 yr maturity STRIPS, REFCORP zeros, and GSE subordinated debt.
- The Core portfolios' underweight to the Government sector, given the belief that the rally in Treasuries was overextended and better opportunities lay outside the sector, contributed to overall performance.

Review of Core Credit Portfolio

- UCRP Credit returned 13.80% in the quarter, outperforming the benchmark by 313 basis points.
- Security selection in financials, cable, and aerospace contributed positively to performance.
- Underweights in the lowest-yielding segments of the markets, such as Sovereigns and Supranationals, also helped, as investors avoided these in favor of higher beta securities.
- The strong rally experienced in the last several months has taken spreads on several sectors back to pre-Lehman levels.

Review of Core Mortgage Sector
- The UCRP Mortgage Sector modestly underperformed its benchmark.
- GEP was negatively impacted by a markdown of one large position due to rising delinquencies.
- Positively, government programs are contributing to spread narrowing in several of the collateral sectors.

Review of High Yield Portfolio
- The High Yield markets experienced an historic rally in the quarter, led primarily by the lowest quality names. Investors were encouraged that several distressed companies were able to accomplish debt exchanges to extend maturities and forestall liquidity crises.
- Overall, the UCRP High Yield returned near 20%, however the portfolio underperformed the benchmark by -3.02%.
- The UCRP High Yield portfolio, which was moderately tilted towards higher quality issues, could not keep pace with the rally in the more distressed segments of the high yield market, such as gaming and autos.

Review of Emerging Market Debt
- Emerging Markets debt also performed well this quarter, with returns of 11.4% similar to high grade. The UC Emerging Markets portfolio underperformed the benchmark by -1.86%, primarily due to underweights in several weak countries that bounced back strongly from last quarter's weakness.

Review of STIP Portfolio
- STIP / 403b Savings Fund materially outperformed the benchmark due to:
  - Effective yield curve positioning;
  - Opportunities caused by attractive spreads on high quality corporates;
  - Maintaining consistent high credit quality philosophy.

Looking Forward

- Confidence in the ability to stem the global financial crisis is in the process of being restored, and recent economic data are suggesting the direst predictions for the global economy may have been averted.
- We have seen a massive rally in credit markets over the past four months as increased confidence prompted investors to put some of the mountain of cash built up in money market funds during the financial crisis – earning less than one percent – to work.
- At this point, investors will be looking for greater confirmation of this trend in the form of a bottoming of the declines in housing and employment indicators. The consumer still faces several headwinds to recovery.
- In this light, in credit we are maintaining underweights in those credits most exposed to consumer spending, as well as some of the most economically sensitive sectors, as spreads have narrowed considerably. We will look for high quality names in these sectors to gradually add exposure as the scope of the recovery becomes clearer.
- Financial spreads remain somewhat wide historically, but we believe a premium is warranted in light of ongoing funding and capital pressures. Therefore, we are maintaining a near-market weight, which was achieved at wider spreads.

- We will look for new issuance opportunities in the highest quality sectors, as recent underperformance has resulted in more attractive relative values.
- The underweight to Governments will be gradually reduced, as the sector has become more attractive on a relative value basis.
- Liquidity is slowly returning to the non-agency MBS market. In the second half of March, we were able to sell some holdings at prices exceeding our marks. As liquidity increases, we anticipate restructuring the MBS portfolio to reflect our new benchmark (Barclays Aggregate).

Absolute Returns Review
Period Ended June 30, 2009

Absolute Returns	Quarter (%)	FYTD (%)	3 Year Rolling (Annualized) (%)
UC AR Portfolio	5.8	-13.0	1.4
HFRX AR and MD Blended Index	3.3	-18.0	-3.0
HFRI Fund of Funds	5.2	-15.3	-1.1
S&P 500	15.9	-26.3	-8.2
Barclays Aggregate Bond Index	1.8	6.1	6.4

Second Quarter Strategy Exposure Review

- The UC Absolute Return (UC AR) portfolio generated a return of 5.8% in the second quarter. In comparison, the HFRX AR and MD Blended Index return was 3.3%, the HFRI Fund of Funds Index return was 5.2% and the S&P 500 return was 15.9%.
- 90% of UC AR managers were profitable during the quarter. Given the massive rally in the equity and credit markets, long-biased managers outperformed market neutral and short-biased managers during the quarter.
- Long-biased credit managers provided outsized returns during the quarter.
  - The S&P Leveraged Loan Index and Barclays High Yield Credit Bond Index advanced 19.8% and 23.1%, respectively. The quarterly increases for both indices were the highest on record.
  - High yield mutual funds had $16.9 billion of inflows in the first six months of the year versus $4.8 billion in all of 2008. These flows helped push yields back to pre-Lehman Brother-default levels.
  - New issuance in the second quarter was $46.5 billion, the fourth highest quarter on record.
  - In the first half of 2009, the volume of "amend to exchange" transactions was three times as high as in all of 2008. These transactions typically involve borrowers paying steep fees and accepting higher interest rates in order to delay the repayment of outstanding debts. This provided another tail-wind for the bond market during the quarter but could lead to liquidity problems in the future. Please see the "Looking Forward" section below.
- Long/short equity managers continued to perform well in the second quarter.
  - All but one of UC AR's long/short equity managers had positive performance.
  - Long-biased managers focused on the natural resources sector and developing Asia provided outsized returns.
  - In certain sectors such as technology and healthcare, fundamental analysis began to take hold once again in the equity markets, allowing managers to generate positive spreads between their long and short positions through stock picking.
  - In other sectors including financials and consumer retail, highly levered, low quality companies outperformed.
- Event-driven strategies including merger-arbitrage and value equity performed well during the quarter.
  - Average deal spreads tightened significantly as the markets became more confident that buyers could obtain credit to close announced deals.

  - Many of our event-driven managers profited from preferred for common equity swaps by large financial institutions. These trades, including equity swaps by Bank of America and Citigroup, provided 20-35% returns in a matter of a few weeks.
- The largest detractors were a short-biased credit fund and managed futures exposure.
  - UC AR's worst performing strategy was a small allocation to a short-biased high yield credit manager. While this manager was able to add value through credit selection, the manager was not able to overcome the massive run up in the credit markets. In order to manage risk, UC significantly reduced exposure to this strategy in the first quarter when credit spreads reached all time highs.
  - Our managed futures managers lost money during the quarter. These strategies tend to outperform when volatility explodes and are expected to struggle when volatility declines.
  - The Real Assets portfolio was up 3.8% in the second quarter, primarily as a result of exposure to commodities managers who benefitted from an improving macro picture.

Looking Forward

- Until there is more clarity on the global economic outlook, we will continue to favor managers that employ a highly liquid and active trading strategy. These managers should be able to generate attractive returns regardless of market direction.

- We continue to add new strategies to diversify the portfolio. During the quarter, we added managers focused on technology and health care, fixed income global macro, and global event-driven strategies.

- We continue to search for creative ways to expand our partnerships with our managers. During the quarter, we allocated capital to another customized product. This product allows UC the flexibility to invest opportunistically in a wider range of strategies without subjecting the portfolio to lock-ups and redemption penalties. In addition, UC is working with existing and new managers to better align our interests and, in many cases, to reduce fees.

- Without material improvements in the global economy and availability of new credit, it is likely that a large number of forced restructurings and defaults will continue to occur in the next few years. While many companies were able to source temporary relief in the first half of 2009, the payments of debts have only been delayed for a few years. In the mean time, the company is forced to use more and more cashflow to support fees and higher interest payments. This type of environment should provide compelling opportunities for long-biased distressed strategies in the months ahead.

- We are continuing to build out the Real Assets portfolio, which has generated positive returns to date.

Real Estate Review
Period Ended June 30, 2009

Real Estate	Total Return		Benchmark Return		Excess Return	
	Quarter (%)	FYTD (%)	Quarter (%)	FYTD (%)	Quarter (%)	FYTD (%)
UCRP Private Real Estate	-15.5	-40.36	-15.2	-37.52	-0.4	-2.84
GEP Private Real Estate	-10.7	-38.56	-8.8	-33.06	-1.9	-5.50
UCRP Public Real Estate	34.65	-19.41*	35.5	36.58*	-.83	17.17
GEP Public Real Estate	34.67	-19.37*	35.5	36.58*	-.81	17.21

*Inception date for Public Real Estate was September 1, 2008. Fiscal YTD results reflect 10 months for both portfolio and benchmark.

<u>Review of Private Real Estate Portfolio</u>

- The UCRP Private Real Estate return for the quarter was -15.5%, as compared to the policy benchmark of -15.2% for the same period.
- The GEP Private Real Estate return for the quarter was -10.7%, as compared to the policy benchmark of -8.8% for the same period.
- The open-end funds in the UCRP and GEP portfolios utilize greater leverage than do the funds included in the NFI Open-End Diversified Core Equity Index (a component of both the UCRP and GEP benchmarks). This resulted in greater volatility of the UCRP and GEP Private Real Estate returns relative to the benchmark return for the quarter.
- One reason that greater leverage is employed is that relative to the ODCE index, the UCRP and GEP open-end portfolios hold a higher proportion of investments in new development.
- The UCRP and GEP open-end portfolios also hold a higher concentration of investments in non-traditional property types such as hotels and self-storage properties, which tend to be more cyclical and are currently experiencing a deeper downturn than other real estate sectors.
- Both open- and closed-end funds continue to mark their holdings to market based on lowered expectations for income and disposition prices due to the economic downturn.
- Major operational challenges the managers are facing include weakening occupancy, declining rents, and increasing landlord concessions.
- Credit markets remained largely frozen as lenders continued to delever. Debt for commercial real estate is scarce and expensive.
- Most advisors are not closing on new assets at this time. Capital calls for investments in the Private Real Estate portfolio primarily reflect capital needs for existing assets (including paying down outstanding debt).
- The pace of distributions from the investments in the Private Real Estate portfolio continues to be slow since most advisors are not selling properties at this time. In addition, if there is available capital from gains or income, most advisors are electing not to distribute these funds in order to preserve liquidity.

Public Real Estate Performance

- The UCRP Public Real Estate return for the quarter was 34.65%, as compared to the policy benchmark of 35.5% for the same period.
- The GEP Public Real Estate return for the quarter was 34.67% as compared to the policy benchmark of 35.5% for the same period.
- The performance of both the UCRP and GEP Public Real Estate portfolio was on par with that of the benchmark in the current quarter.
- Real estate securities both globally and in the U.S. rallied very strongly during the quarter after experiencing a severe downturn during the prior two quarters. A high volume of successful secondary offerings by over-leveraged companies buoyed investor confidence in their ability to survive.

Looking Forward

- The outlook for the commercial real estate sector remains negative as the recessionary environment continues to weaken real estate fundamentals (rent levels, occupancy and property values). Because real estate decisions are sticky, the impact of an economic downturn on real estate general lags the timing of the downturn itself, and likewise a real estate recovery generally lags the overall economic recovery.
- Private Real Estate returns are expected to be weak at least through 2009 as advisors continue to mark-to-market their investments. In some cases part or all of these "temporary impairments" will become permanent as lenders force borrowers to infuse more equity or give back assets. This process of deleveraging is expected to create attractive investment opportunities as assets are shaken loose from the current stalemate between debt- and equity-holders.
- The UC separate account program is well-positioned to take advantage of these opportunities as they come to market. There are also an increasing number of commingled funds on offer that are targeted at particular niches of distress.
- With the overall outlook for commercial real estate still negative, some volatility is expected in the public market for the near- to mid-term. Nonetheless, this dislocation is expected to result in attractive investment opportunities, and UC plans to deploy additional capital to public real estate strategies.

Private Equity Review
Period Ended June 30, 2009

Private Equity	Quarter (%)	FYTD (%)
Private Equity – UCRP	-3.29	-20.75
Private Equity – GEP	-4.41	-19.12
Total Buyouts	-3.30	-22.33
Total Venture Capital	-2.81	-16.86

Private Equity Returns

- The second quarter returns for Private Equity continued to be primarily affected by the application of FASB 157 (Fair Market Value accounting of illiquid securities) in an environment of depressed public markets. All Private Equity funds now carry out extensive quarterly analysis on public and private comparables to value the holdings in their portfolios. Due to the scarcity of private transactions in the last 9 months, funds marked-to-market their portfolios based on lower public company comparables. Staff expects continued volatility in quarter to quarter valuation changes. Given the recent implementation of FASB 157, this volatility in valuations is a significant change in the long history of the program where more conservative valuation methodologies prevailed.

Review of the Buyout Portfolio

- The Large and Mega buyouts segment was the most significantly affected by mark to market accounting, primarily due to the high level of leverage applied to some of the recent very large transactions consummated in recent years. The UC Regents portfolio is tactically underweight Large and Mega buyouts, which performed significantly worse than Small and Mid Market buyouts. This has been a significant contributor toward positive relative performance to many other Private Equity investors which have had larger allocations to the large segment of the buyout market.
- Capital calls declined 38% in the second quarter of 2009 versus the second quarter of 2008 due to slow investment pace. The investment pace is expected to accelerate as soon as economic uncertainty is reduced, and buyers and sellers can come to agreement on pricing.
- Distributions for the UC Private Equity portfolio continued to be weak with a 54% year over year decline for the second quarter. However, June distributions were up sharply versus prior months as a result of significant public stock distributions. Should public markets continue to hold up, staff expects private equity funds to take advantage of public offerings in the coming months and quarters, generating potential additional liquidity.
  - Given the strong public market performance during the quarter, the UC took the opportunity to liquidate most of the public stocks in its distribution portfolio.

Review of the Venture Portfolio

- Venture funds continued to use the severity of the economic environment to take a disciplined look at companies in their portfolios and instructed management teams to pare down their expenses and cash burn positions aggressively. In addition, many funds created additional buffers in capital reserves for their most promising companies by ceasing to support the poorest performing companies in their portfolios earlier than usual.
- Companies that require a financing round in 2009 or 2010 are expected to see significant pressures on valuations as follow-on investors are aggressively down-pricing later stage rounds for most companies.

- The exit markets continued to be challenged, thereby creating little liquidity for our venture portfolio. The last quarter saw a continued retrenchment by large public companies which had been an active acquirer of venture backed companies. IPO exits were also very scarce.

Commitment Pacing and Other Activity

- The UC Regents continues to prudently manage the pacing of new commitments in 2009 with only $197 million in commitments in the first half of 2009.
- The secondary market did not generate the activity level that was expected as a result of strengthening public equity markets and improved liquidity for institutions. In addition, buyers and sellers continued to hold very different views of the worth of stakes in private equity funds. The UC, however, successfully closed one secondary transaction in the second quarter of 2009.

Looking Forward

- Private Equity returns are expected to be weak into 2009 as funds continue to mark-to-market their portfolios as a result of declining earnings due to the current economic softness. Further multiple compression is not expected at this point, unless public markets suffer from another period of acute stress similar to that in Q4 2008, and Q1 2009.
- Debt financing available for private transactions continues to be scarce, and, where available, typically commands more onerous terms than in recent years. This situation is driving purchase multiples lower for new transactions, when they take place.
- The UC Regents will continue to pursue attractive secondary transactions, but expects fewer opportunities in the market due to improved liquidity positions of potential sellers.
- Fundraising continues to be extremely challenging for Private Equity as investors continue to struggle with allocation constraints and liquidity concerns. Terms are clearly starting to move more favorably to the Limited Partners.
- The UC Regents is finding increased capacity and access to the best private equity managers, creating an opportunity to enhance the portfolio long-term.