Investment Performance Review
Quarter Ended June 30, 2012

I. EXECUTIVE SUMMARY

- **<u>Markets were challenged by Macro uncertainties in the June Fiscal Year</u>**
  - U.S. stocks ended the year in positive territory as the S&P 500 gained 5.45% and the Russell 3000, 3.84%. In contrast, international equity markets as represented by the MSCI International Equity Index sustained double digit losses of -14.13%, weighed by heightened risks from Greek and Spanish debt insolvency. Overall, the MSCI World Index declined -4.41% for the fiscal year.
  - The marked divergence between U.S. and International equity markets was most pronounced in the first half of the fiscal year as peripheral European debt concerns caused double digit losses for the International Equity market. In contrast, signs of stabilization in U.S. unemployment and housing helped dampen losses stemming from an overseas slowdown, benefitting U.S. returns. July through December, the MSCI International Equity Index declined -16.16% and the S&P 500 sustained a far smaller loss, -3.69%. (See Attachments IA – IB for market performance.)
  - Returns in the second half of the year were mixed, with U.S. markets continuing to outperform. In the March quarter, global equity markets soared higher with the MSCI International Equity Index gaining 10.37% on the heels of accommodative ECB LTRO (Longer-Term Refinancing Operation) while the S&P 500 advanced 12.59% on Federal Reserve policy statements. However, by the end of the June quarter, International Equity markets fell -7.20%, as heightened concerns of a potential Greek and Spanish default re-emerged in April, while the S&P 500 experienced a more modest loss of -2.75, tempered by accommodative Fed policy.
  - Investors seeking safety from the sovereign debt crisis in Europe poured into U.S. Fixed Income, including Treasuries. Over the fiscal year, fixed income, particularly treasuries were the best performing asset class. The Barclays Aggregate gained 7.47% while the Barclays Long Government Bond index soared 31.42%. The Barclays Long Credit Index gained 19.19% as investors sought higher yielding debt securities over cash and equities.
  - Volatility remained low despite a high degree of global macro uncertainty over the year based on the VIX index (a measure of the S&P's volatility tied to futures markets). Over the fiscal year, the VIX averaged in the 20s, well below the peak levels reached during the height of the U.S. financial crisis, when the index breached 80. (See Attachment IC for volatility measures.)
- **<u>Plan portfolios generated strong excess return (Alpha) in the quarter</u>.**
  - Operating in a challenging market that continued to be tested by uncertainties triggered by the global deleveraging crisis, the UC Treasurer's Office closed the year with strong relative returns for UCRP, GEP, TRIP and STIP. For the FYTD period, the UC Retirement Plan gained 0.37%, 0.96% ahead of policy, and GEP fell -0.36%, 2.12% ahead of policy. TRIP gained 6.71% ahead of policy by 0.95% and STIP gained 2.44%, well ahead of the 0.20% policy benchmark. (See Attachment II for portfolio performance.)
  - For the fiscal year ended June 30, manager selection was the key driver for returns. Total asset selection contributed 0.99% to UCRP's relative performance and 2.20% to GEP's relative performance. Most asset classes, including public equity and absolute returns, demonstrated positive relative performance.
  - In a year of modest sideways returns for risk assets, several of our portfolios managed double digit gains including TIPS, Absolute Return Cross-Asset Class, and Real Estate. The portfolio's

asset allocation policy modestly detracted from overall performance, given our underweight to Core Fixed Income and TIPS, as economic uncertainties and accommodative central bank policies drove yields lower.

- **<u>All three equity portfolios outperformed over the fiscal year</u>.**
  - The composite U.S. Equity Portfolio across both UCRP and GEP gained 3.76% for the fiscal year, while the Non-U.S. Developed Markets Portfolio and the Emerging Markets Equity Portfolio returned –13.65% and –13.69%, respectively. Concerns surrounding European debt and banking persisted through the year and reduced investor appetite for non-U.S. equities. U.S. equities managed to edge up higher as banks at home have done much more to clean up their balance sheets and higher economic growth was better.
  - After a two year period in which stocks traded more on economic news and policy activism and less on their individual business performance, stocks began trading a bit more on their business results beginning in early 2012. Good fundamentals among specific companies helped the actively managed portion of all three equity portfolios to outperform during the fiscal year.
- **<u>The fixed income portfolios delivered significantly positive value add to the plan total returns</u>.**
  - Fixed Income securities generated the strongest portfolio total returns over the fiscal year. Within the UC managed plans, although Core Fixed Income for UCRP and GEP lagged its benchmark (7.06% versus the benchmark return of 7.47%), two of the three core sectors, Governments and Credit, outperformed for the fiscal year. Core Credit delivered a double digit return of 10.31%, beating the policy return by 0.77% while the Core Government sector added over 8.5%. Both industry allocation and security selection played a role in the outperformance. Collateral securities lagged due to losses associated with legacy non-agency residential mortgage-backed securities positions.
  - High Yield for UCRP and GEP returned 7.51%, beating the benchmark by 0.89%. Security selection and some well-timed purchases during a period when markets were in risk-off mode helped the internally managed High Yield portfolios generate a 9.61% return for the fiscal year, beating the policy return by 2.44%. That performance was above the 95th percentile of the Mercer U.S. Fixed High Yield Manager Universe for the 12 months ended June.
- **<u>Alternatives achieved strong relative returns although not all achieved positive total returns.</u>**
  - During the year, the Absolute Return portfolio made strong headway relative to its peer policy benchmark, outperforming by 732 bps. However, on an absolute basis, the portfolio declined -2.00% over the fiscal year. The majority of hedge fund strategies were challenged by the market risk on risk off environment and high asset correlations which were most pronounced in the first half of the fiscal year. Subsequently, hedge fund managers allocated risk cautiously as global macro concerns remained elevated, making it difficult to fully recoup losses.
  - The private equity portfolio had a solid return for the fiscal year with nearly 900 bps of outperformance relative to the entity return for both the UCRP and GEP. The strongest performance in the portfolio was driven by the co-investment portfolio which generated 19.9% returns for the fiscal year.
  - The Cross-Asset Class Strategy closed the fiscal year with strong total and active returns. The fiscal year return for the strategy was 11.12%, delivering significant value added in a year that was flat for the policy benchmark. This strong performance was primarily driven by a significant allocation to a core manager whose portfolio reflects a balanced risk exposure across a diverse set of potential macroeconomic regimes.

II. MARKET OVERVIEW

PUBLIC EQUITY MARKET OVERVIEW

U.S. Equity Markets edged up 3.84% for the fiscal year but declined -3.15% during the quarter based on the Russell 3000 Index. After incurring a double digit decline in the first quarter of the fiscal year, U.S. equities stormed back with double digit gains in both the second and third quarters. Stocks ebbed back and forth during the latest quarter with an overall downward trend as investors gauged the seriousness of a slowdown in global economic growth and evaluated whether the policy activism in Europe would be sufficient to save the Euro, recapitalize their banks, and restore economic growth.

- For the fiscal year, defensive sectors performed well while cyclical sectors generally posted negative returns. Consumer Staples, Telecom, and Utilities all gained between 13.2% and 13.4% for the fiscal year. Energy and Materials were the worst performers over the past twelve months, declining -9.8% and -7.0%, respectively.
- Growth style investing with a 5.1% gain edged value investing (+2.6%) over the fiscal year, but trailed slightly in the latest quarter. During the quarter, value stocks fell -2.3% while growth lost -4.0%.
- Large stocks outperformed small stocks during the fiscal year, while their returns were similar over the past quarter. Over the past twelve months, large stocks gained 4.4% while small stocks fell -2.1%. Over the past quarter, large and small returns declined -3.1% and -3.5%, respectively.

Non-U.S. Developed Markets substantially trailed the U.S. equity markets for the fiscal year and the June quarter. Over the past three and twelve months, Non-U.S. Developed Markets lost -7.20% and -14.13%, respectively. Currency negatively impacted returns as evidenced by the -5.5% loss in local currency for the quarter and -9.5% for the year.

- Foreign developed markets performed poorly relative to the U.S. for several reasons. First, much of Europe has fallen into recession, while the U.S. has posted decent economic growth. Second, investors remain concerned that policy actions in Europe have not been sufficient to reduce government debts and restore economic growth. Third, interest rates in the most troubled European countries remain high, causing investors to worry about whether governments can service their debts.
- Countries at the epicenter of the Euro crisis incurred substantial declines during the fiscal year. Greece plunged -68.5%; Portugal fell -41.4%, while Spain and Italy lost -35.8% and -33.6%, respectively.
- Germany underperformed during the fiscal year, losing -24.1%, as investors worried about very slow growth in Europe's largest economy and whether Germany had the resources to backstop the debt of Europe's most troubled countries.
- Several countries that had previously been relatively immune to the movements in other foreign equity markets declined slightly more than the overall market this fiscal year. Canada and Sweden had losses of -16% over the past twelve months. Canada's currency had remained strong in the past several years, but that reversed this fiscal year as it fell -4.7% versus the dollar.
- Among sector returns, defensive sectors generally outperformed, but not uniformly. Consumer Staples and Health Care inched up 2.8% and 0.5%. The worst performing industry was Materials (-26.8%), followed by Technology (-19.45%) and Utilities (-17.8%) and Financials (-17.6%).

Emerging Markets also substantially trailed the U.S. equity markets over the fiscal year and during the latest quarter. Over the past three and twelve months, Emerging Markets lost -8.89% and -15.95%, respectively. Countries tied to peripheral Europe fared the worst over the period, while larger core emerging markets also experienced significant declines.

- Countries in Eastern Europe performed poorly over the past twelve months on European debt contagion concerns. Hungary, Poland, and the Czech Republic lost -38.3%, -30.2%, and -26.4%, respectively. Russia, also performed poorly, falling -25.6%, as global economic growth slowed considerably, which led to falling commodity prices. Russia's stock market often moves in the same direction and similar magnitude as commodity prices.
- Among larger emerging market countries, internal growth concerns as well as the economic slow-down in Euro-zone countries dampened returns to China and Korea, whose economies rely heavily on exports to Europe. Both China and Korea fell virtually in lock step with the overall index, declining -16.0% and -14.5%, respectively, during the fiscal year.
- Risk averse investors reallocated to defensive sectors, which generally outperformed, but not uniformly. Consumer Staples edged up 4.1% and Telecom fell just -3.4%. But Technology, a cyclical sector, significantly outperformed, falling just -1.9%. Energy, Materials, and Industrials, three sectors with extra dependence on global economic growth, performed poorly, losing -27.6%, -25.2%, and -23.4%, respectively.

FIXED INCOME MARKET OVERVIEW

Core Fixed Income

- For the full fiscal year Core Fixed Income returns were strong as historically low returns to cash and uncertainty surrounding global growth prospects drew investors to fixed income securities. The Barclays Capital Aggregate returned 7.47%.
- Credit sector demand was particularly strong, in an environment of negative real cash yields, and investor aversion to volatile risk assets. In addition to falling Treasury yields, investment grade bonds benefitted from strong demand relative to supply and that supply-demand imbalance was particularly acute in the longer maturities. The long maturity (10-year and longer) credit sector climbed 19.19% for the fiscal year.
- The U.S. Government securities sector, particularly 10-year and longer dated maturities, benefitted from the sharp drop in interest rates to record lows in the second quarter, returning 10.32 % for the final three months of the fiscal year. The Federal Reserve Board's extension of Operation Twist in which the Fed eases monetary conditions by purchasing long Treasury bonds to keep yields low was an important boost to performance. For the full fiscal year, the Long Government sector was the strongest performer in the Barclays Aggregate as a whole, soaring 31.42%.

TIPS

- TIPS had the best return for all major fixed income classes in the fiscal year ending June. The Barclays' TIPS index return of 11.66% outperformed the Treasury Index return of 9.04% and bettered HY, EM and Core Credit returns as well. The sharp fall in Treasury yields drove the returns.
- For the quarter, the TIPS index returned 3.15%, while the Treasury Index was up 2.83%. Interestingly, although TIPS real yields actually declined 20-30 basis points less than the yields of nominal Treasury bonds of the same maturity over the quarter, the price of the TIPS index slightly outperformed the Treasury index. This is due to the higher duration or interest rate sensitivity of the TIPS index.

Emerging Markets Debt

- The JPMorgan Emerging Market index hedged to the U.S. dollar gained 9.77% for year. As the European debt crisis reemerged in the June quarter, risk among peripheral debt markets increased, and EM Debt spreads widened 30 bps, closing the quarter at 360 bps over Treasuries. The geographic variance in returns were correlated with risk stemming from the European debt crisis, with the worst

returns recorded in Emerging Europe and better returns produced by Asian and Latin American markets.

- The local currency benchmark, the JPMorgan GBI-EM Global Diversified Index (unhedged, in U.S. dollars) posted a negative return of -1.69% for the fiscal year, due primarily to currency movement as the U.S. Dollar rallied as a relative safe haven against most currencies, including emerging market currencies.
- May was a difficult month for all risky assets but the markets managed to turn around in June, after the announcement of the Spanish bank bailout and most notably after the EU summit on June 29, when European leaders announced plans for direct recapitalization of banks from the new European Stability Mechanism (ESM). The resulting rally in emerging markets and other global assets left the index 2.33% up for the day, making June 29 the strongest daily return since May 2010 and the 10th best day in the history of the JPM GBI-EM Global Diversified Index.

High Yield Market

- The BAML (Bank of America Merrill Lynch) High Yield Cash Pay Index returned 1.85% in the June Quarter and 6.60% for the fiscal year. The market experienced significant volatility during the period with strong returns in April (1.03%) and June (2.02%), and weak performance in May returning (-1.16%). Strong corporate earnings were the main driver of returns early in the quarter, with over 80% of S&P 500 companies reporting better than expected earnings.
- Typically, returns on High Yield are not highly correlated with Government sector returns which is one of the attractive features of the asset class as it provides higher expected return and diversification to a fixed income portfolio. When High Yield as a whole does well, normally the most volatile, riskiest securities lead the way higher and High Yield outperforms blue-chip investment grade corporate securities. In the June quarter, that relationship was reversed as the highest rated and least volatile securities benefited from the big drop in Treasury yields.
- The High Yield sector continues to benefit from strong mutual fund inflows and attractive yields versus higher quality alternatives. In addition, the default rate of High Yield issuers included in the benchmark index was low at 2.6% versus the long-term average default rate of 4.14%. The low default rate means that investors get to keep more of the high coupon income associated with the asset class.

III. UC PLAN PERFORMANCE (Attachment IIA - IIE)

UC Entity ended the quarter with $71.6 billion in assets, gaining 1.15% for the fiscal year, 118 bps ahead of the policy, slightly below the peak level of assets ($75.5 billion) reached as of 10/31/07. (See Attribution table in Attachments IIC-IID.)

UCRP with a market value of $1.4 billion, increased 0.37% compared to the Policy Benchmark return of -0.59%.

- Nearly all core asset classes added value through positive asset and manager selection as fundamentals improved over the year and correlations across individual securities notably declined. The long only asset classes (U.S., Non-U.S., and Emerging Market Equity) and the Absolute Return Diversified and Cross-Asset Class fund portfolios added the most value through stock selection.
- Asset allocation across the aggregate portfolio was mixed. The overweights to real estate and cross asset class strategy, both contributed double digit gains for the year, but were offset by the underweight to Treasuries and Fixed Income. Treasuries were one of the best performing asset classes for the fiscal year as investors sought a safe haven from European debt uncertainties.

GEP had an ending market value of $6.5 billion, declining -0.36% compared to the Policy Benchmark return of -2.48% for the quarter

- As in the UCRP, nearly all core asset classes contributed to positive asset and manager selection as fundamentals improved over the year and correlations across individual securities notably declined. However, given the significantly larger exposure to absolute returns, stock selection added 220 bps to overall return as the Absolute Return fund had outsized returns relative to the HFRX composite benchmark.
- Asset allocation across the aggregate portfolio detracted 8 bps. The overweights to real estate and cross asset class strategy, both contributed double digit gains for the year, but were offset by the underweight to Treasuries and Fixed Income.

STIP ended the fiscal year with $7.0 billion, for a return of 2.44%, exceeding its benchmark by 2.24%. Returns benefitted from effective yield curve positioning and attractive spreads on high quality corporate securities purchased in early 2009 as credit markets began to rally. Securities Lending income continues to add incremental yield to the portfolio.

TRIP had an ending market value of $4.3 billion, gaining 6.71%, 0.95% ahead of policy benchmark returns.

- TRIP continues to meet the Regents' objective of delivering more yield and return to the University's operating portfolio with less risk. The fixed income's active returns were very strong within TRIP over the fiscal year with all sectors adding value.
- Security selection was the primary driver of returns for the year, as the active core credit portfolio returned 10.78%, 124 bps ahead of the policy benchmark. High Yield, which is internally managed, added 23 bps.
- At year end TRIP was 56% exposed to core fixed income, 34% in equities and REITs, and 10% in high yield debt.

IV. ASSET CLASS PERFORMANCE

Public Equity Portfolio Asset Class Performance (Attachment III)

The U.S. Equity Portfolio* gained 3.76% for the fiscal year while the Russell 3000 Tobacco Free index returned 3.41%, an outperformance of 0.35%. The Active U.S. Equity portfolio returned 3.59%, outperforming the index by 0.18%.

- Although managers were underweight utilities and mega cap stocks and those two groups both earned double digit returns, active managers were able to slightly outperform for two reasons. First, an overweight to technology added 0.12% to returns as technology outperformed the broader market by 6.1% for the year. Second, good stock selection in the technology, health care, telecom, and materials sectors added to returns.
- Managers overcame obstacles to slightly outperform for the year. For example, utilities returned a strong 13.2% over the past twelve months, despite being expensive relative to other sectors and to the overall market. Managers underweighted utilities, which detracted -0.12% from excess returns. Returns were also held back by an underweight to mega cap stocks, which returned 10.7% for the year. Active managers sometimes think they don't have differentiated insights into the very largest stocks, so they often underweight them.

Non-U.S. Developed Equity Portfolio* returned -13.65% during the fiscal year an outperformance of 0.93% relative to the MSCI World ex U.S. tobacco-free index. Active managers returned -13.22%, outperforming the index by 1.32%. Active managers solidly outperformed as country, sector, and stock selection all contributed positively to excess returns.

- Sectors most exposed to the slowdown in global growth suffered the most, with Materials falling -27.7%. Active managers were underweight Materials, which contributed 0.30% to returns. Sectors and countries most exposed to the sovereign debt crisis also performed poorly. Spain and Financials, for example, declined -32.1% and -17.4%, during the year. Managers were underweight both, which contributed another 0.39% to returns.
- Defensive segments of the market such as mega cap stocks outperformed during the year. Active managers were underweight the largest stocks, which detracted 0.38% from returns. An overweight to technology also hurt, detracting 0.37% from returns. However, very good stock selection, particularly in technology, Germany, Japan, and the U.K. enabled the portfolio to solidly outperform.

Emerging Markets Portfolio* returned -13.69% during the fiscal year while the MSCI Emerging Markets index returned -15.95%, an outperformance of 2.26%. A majority of the decline occurred due to currency weakness as emerging market stocks fell just -6.6%, but their currencies lost -9.4%.

- Managers strongly outperformed during the year as stock selection was particularly strong as stock selection was positive in virtually every country and sector this year.
- Countries with less exposure to the global economy, such as Indonesia, Mexico, Thailand, and Turkey, tended to outperform. Active managers were overweight all four of these countries, which added 0.63% to returns.
- Defensive sectors tended to outperform, while cyclical sectors performed poorly during the year. Consumer Staples outperformed by 24.1% for the year while Materials underperformed by 11.2%. Active managers were overweight Consumer Staples and underweight Materials, which contributed 0.48% and 0.36% to returns, respectively.

*Combined UCRP and GEP.

Fixed Income Portfolio Asset Class Performance (Attachment IV)

Fixed Income Core gained 7.13% for the fiscal year to date, lagging -0.34% behind the policy benchmark. Fixed income core investments delivered significant gains, in a period of flat to declining risk assets.

- UCRP and GEP Core fixed income underperformed for the fiscal year as excess return in the Credit and Government sectors was more than offset by underperformance in the collateralized/MBS (Mortgage Backed Securities) sector. In both cases, that underperformance was due to legacy non-agency RMBS (Residential Mortgage Backed Securities) positions and the weaker performance in GEP reflects a relatively higher proportion of non-agencies. The non-agency holdings were the subject of an intensive review in FY 2011-2012, which resulted in sales that reduced these positions materially. Those holdings that remain are expected to deliver very strong returns over the next 12 months.
- TRIP Core fixed income performance was very good. Its performance was unimpeded by non-agencies as they were not considered an investable asset class as of the 8/1/2008 portfolio inception date. In fact, TRIP collateral had the best relative performance of the three core sectors, beating its benchmark by 1.81%.

High Yield Portfolio demonstrated strong performance as investors preferred high yield as a risk asset to equities. The portfolio gained 7.51% for the year, across the two plans, 89 bps ahead of policy.

- High Yield (UCRP & GEP combined), consisting of internally and externally managed portfolios, returned 7.51%, beating the benchmark by 0.89%. Security selection and some well-timed purchases during a market selloff helped the internally managed High Yield portfolios to a 9.61% return for the fiscal year, beating the policy return by nearly 3% in the fiscal year ending June.
- Both internal and external managers demonstrated strong security selection which drove the outperformance for the fiscal year. The external managers posted a 7.14% fiscal year return while internally managed portfolio returned 9.58% relative to the policy return of 6.62%.

Emerging Market Debt Portfolio (UCRP & GEP combined) returned 6.91% for the full fiscal year in line with the policy benchmark return of 6.93%.

- The EM Debt portfolio is comprised of an internally managed dollar-denominated fund and two external local currency debt funds in a 2/3 to 1/3 ratio. The hard currency benchmark, JPM EMBIG-D, posted a robust 9.77% return for the fiscal year while the local currency benchmark, JPM GBI-EM GD, returned -1.69%.
- The hard currency EM markets benefitted from strong inflows by investors looking for additional yield in what were considered safer markets than many developed European countries. However, returns varied greatly by region. Latin America was particularly favored, returning over 13%, while Europe lagged at 5.8%. In the local currency markets, however, broad-based dollar strength during the past 12 months overwhelmed the gains achieved from a lowering of interest rates in many countries, leading to negative overall returns.

STIP

- For the second quarter and the full fiscal year, STIP had returns of 0.58% and 2.44%, generating outperformance of 0.53% and 2.24%, respectively. The benchmark two-year Treasury income return averaged 0.20% for the year reflecting the Fed's ongoing attempts to revive the economy with extremely low rates. STIP has averaged a maturity of less than two years but has maintained an income return above 2% by investing in high quality short term corporate securities in addition to Treasuries and money market securities such as commercial paper.

- STIP continues to experience net inflows that average approximately $20-40 million each business day. As a result, despite material transfers of monies into TRIP by STIP stakeholders, the STIP balance as of quarter-end and fiscal year-end was still a robust $7.9 billion.

TRIP

- TRIP Core Fixed Income and High Yield generated strong returns with the asset class contributing 0.88% of the TRIP total portfolio fiscal year outperformance of 0.94%. TRIP Core Fixed income gained 10.24%, ahead of the policy by 1.21%, while TRIP High Yield added 9.60%, 2.41% ahead of the policy return of 7.19%. Industry allocation and security selection drove the Credit Portfolio returns while High Yield's excess return was primarily due to security selection alone.

Alternative Investments Asset Class Performance (Attachments V- IX)

Alternative Investments in aggregate added significant value to the Retirement and Endowment plans based on superior security selection relative to policy. Private Equity and Cross-Asset Class also delivered strong absolute returns, in a year when global risk assets were flat to negative.

Private Equity returned 8.93% in UCRP and 8.79% in GEP over the fiscal year. (See Attachment V.)

- Fiscal year returns are reflective of a robust M&A market, IPO market, and improving portfolio company operating metrics. In addition, the private equity valuations benefitted from the strong March quarter 2012 public equity markets. However, investor appetite in the IPO market has recently slowed dramatically, and many companies with planned IPO's have not been able to complete their offerings.
- Distributions for the fiscal year were strong with $576 million in distributions versus $509 million for the prior year. Capital calls were above historical trends with $810 million called versus $644 million in the prior year.

The Absolute Return (AR) Diversified Portfolio declined -2.00%, however, well ahead of the HFRX Absolute Return and Market Directional Blended Index return of -9.32. (See Attachment VI.)

- The primary contributors to the UC AR portfolio during the fiscal year were emerging markets and relative value strategies. The positive contribution from emerging markets was primarily due to manager selection as most of the relevant emerging market indices for both hedge funds and the public markets were down during the period. The contribution from relative value strategies was driven chiefly from mortgage arbitrage strategies which have been the rare strong performer throughout the period.
- The largest detractors to performance during the fiscal year were equity hedge and event driven strategies. Equity hedge and event driven managers who more actively adjusted net exposures in response to exogenous macro factors generally underperformed those who held net exposures more constant as they found themselves cutting risk at inopportune times limiting participation in any subsequent rallies.

Cross-Asset Class ("CAC") strategies delivered strong absolute and relative performance. The fund gained 11.12%, nearly 12% ahead of the policy return. The Cross Asset Class benchmark is based on a weighted average of the UCRP and GEP's policy return. (See Attachment VII.)

- The strategy's strong 11.96% of excess return over policy over the fiscal year-to-date was primarily driven by a sizeable allocation to a core manager known for balancing risk allocations across four key macroeconomic scenarios, determined by inflation and growth outlooks. In the first half of the fiscal

year, the manager's performance had been heavily driven by strong returns in U.S. and sovereign debt of the strongest EU countries.

- In a low growth, deflationary environment, sovereign debt as well as gold, proved to be positive hedges as European debt uncertainties roiled the markets.

Real Assets returned 1.15% in UCRP and -1.09% in GEP for relative returns of -0.50% and -2.53%, respectively. (See Attachment VIII.)

- Returns for the Real Assets program were negatively impacted during the fiscal year by the Commodity and Timberland Portfolios while the Energy and Infrastructure Portfolios delivered accretive results.
- The Commodity Portfolio trailed its benchmark, the S&P GSCI Reduced Energy Index, by 316 basis points due to heightened volatility in the energy sector and poor relative performance in the agriculture sector. Since its inception, the Commodity Portfolio has generated positive alpha of 212 basis points. The Timberland Portfolio was flat for the fiscal year due to continued weak timber demand from the U.S. housing market.

Private Real Estate Portfolio continued a robust recovery, with UCRP gaining 14.68% and GEP adding 12.54%. The UCRP portfolio was 1.09% ahead of policy, while the GEP portfolio lagged the benchmark by -1.05%. (See Attachment IX.)

- The Private Real Estate Portfolio, which was marked down to reflect conservative valuations during the financial crisis, achieved steady gains over the fiscal year as the real estate market showed signs of stabilization. For the fiscal year, UCRP returned 14.68%, ahead of the benchmark by 1.09%, while the GEP underperformed, returning 12.54%, which is -1.05% short of the benchmark. The UCRP outperformed the policy benchmark materially, driven by the appreciation of one large asset in the separate account portfolio. The GEP did not have exposure to that transaction and lagged the benchmark slightly.

Public Real Estate portfolio returned 1.74 % in UCRP and 1.64% in GEP during the quarter, outperforming the policy benchmark by 0.25% and 0.15%, respectively. In the fiscal year to date, the portfolio significantly outperformed the benchmark, exceeding it by 4.00% in UCRP and 3.40% in GEP.

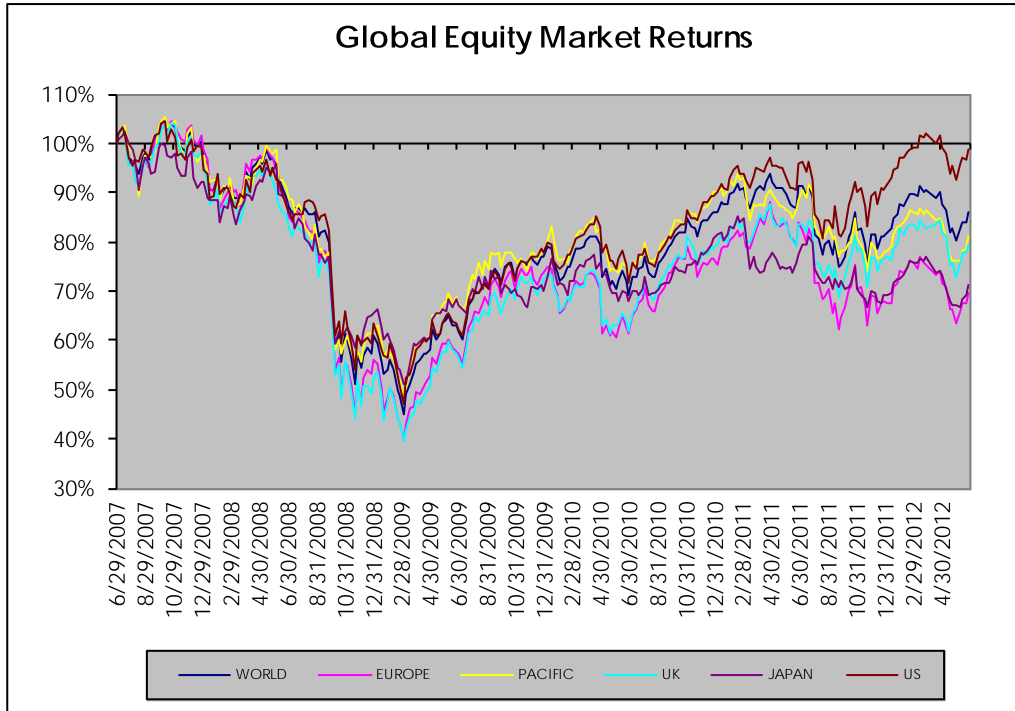
- Stock selection was slightly positive, with relative strength in the U.S. and Western European holdings. Regional allocation was negative, with an over-allocation to Latin America, which lagged other regions during the quarter. As of quarter-end, the portfolio remained overweight to Latin America, as well as Australia, Hong Kong, China, Singapore and the UK.

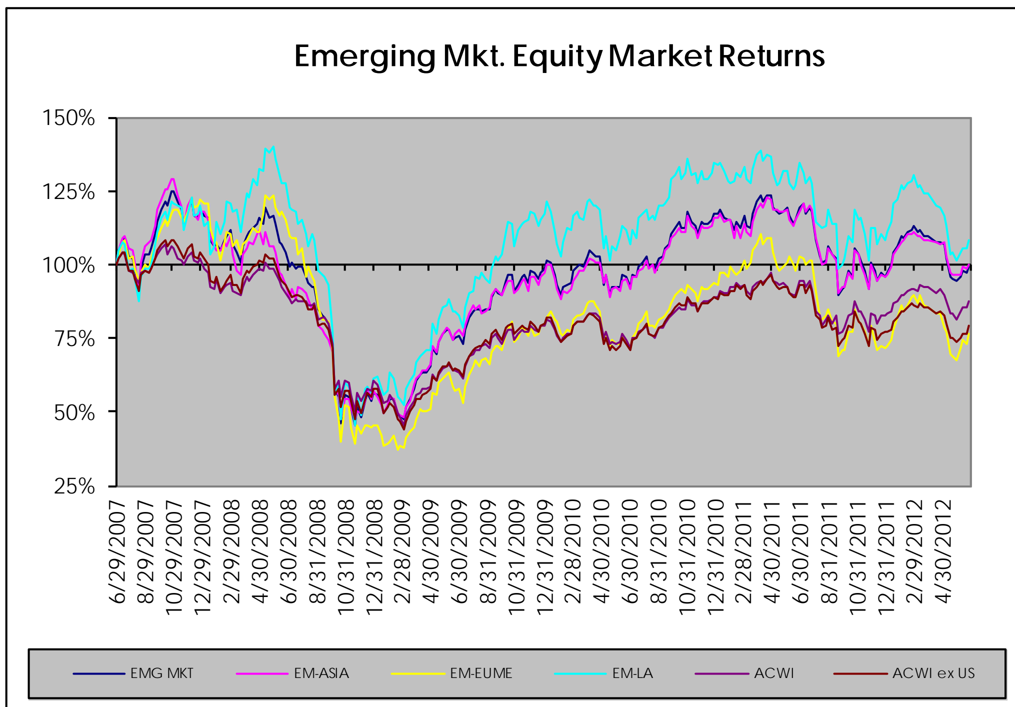
In summary, the fiscal year saw equity markets retrace back to beginning of year levels, after making new highs at mid-year. The uncertainty in global markets, particularly in peripheral Europe has challenged risk assets throughout the year. The potential for a recovery has already been observed in certain sectors, such as Real Estate as the U.S. housing sector has showed signs of stabilizing. The Treasurer's Office will remain vigilant in assessing new opportunities as they arise.

Market Indices Performance Report
Period Ended June 30, 2012

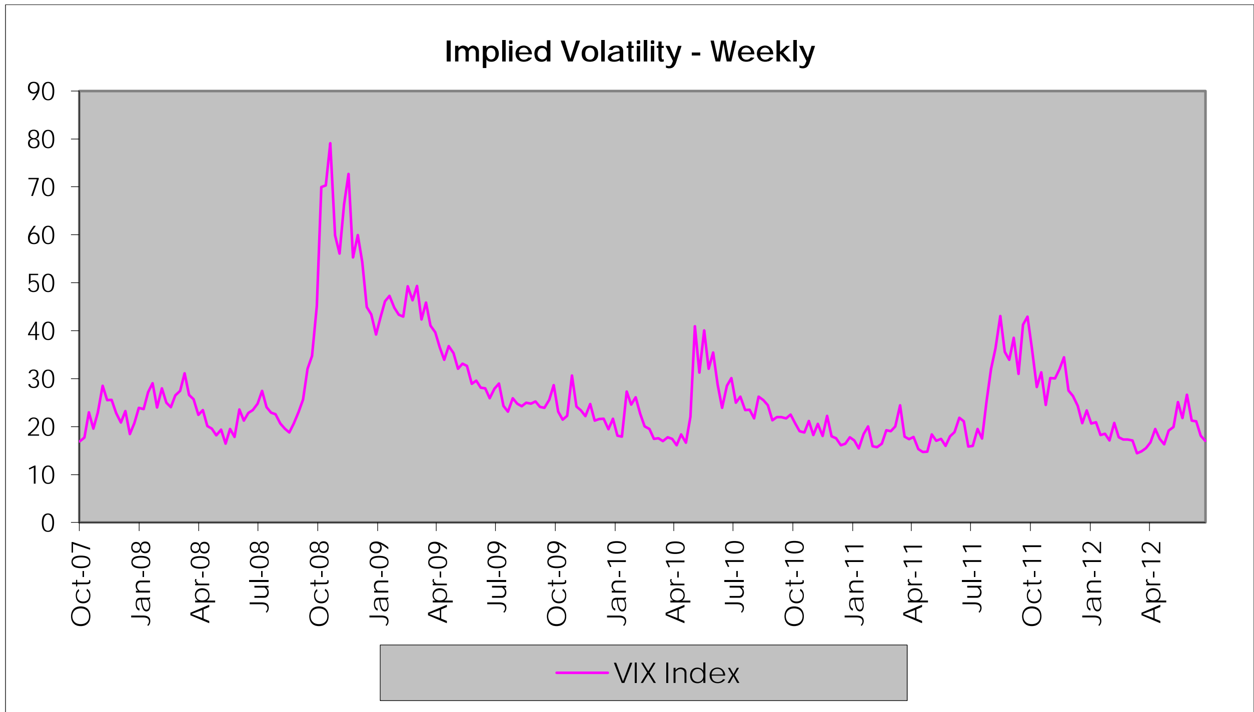
Market Indices Performance Report			
Period Ended 6/30/2012		Returns	
		Quarter (%)	Jul 1 - June 30 FYTD (%)
US Equity			
	S&P 500	-2.75	5.45
	Russell 3000	-3.15	3.84
	Dow Jones Industrial Average	-1.85	6.63
Non-US Equity			
	MSCI World ex-US	-7.2	-14.13
	MSCI Emerging Markets	-8.89	-15.95
US Fixed Income			
	Barclays Capital Aggregate	2.06	7.47
	Barclays Capital TIPS	3.15	11.66
	B of A ML High Yield US Corporate	1.88	6.62
Non-US Fixed Income			
	JP Morgan Emerging Market Global Diversified	-1.21	-1.69
Real Estate			
	FTSE EPRA NAREIT Global	1.49	1.13
Cash Equivalents			
	91 Day Treasury Bill	0.03	0.05
	Consumer Price Index	0.04	1.66

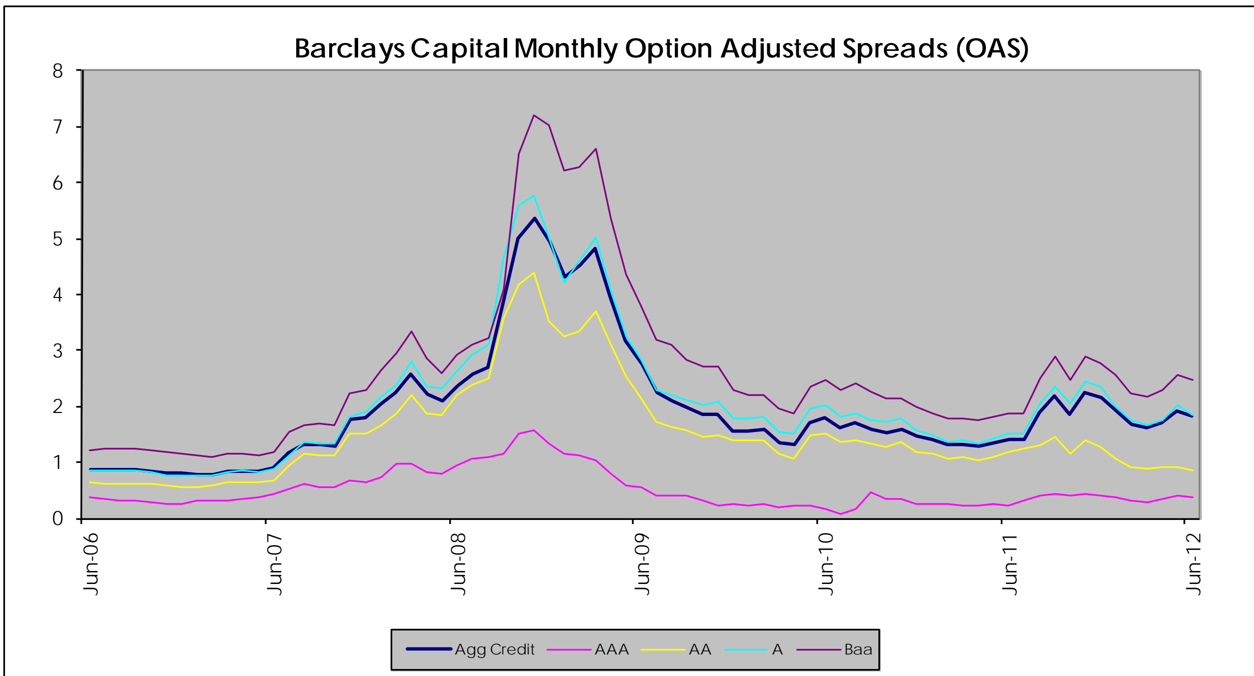
Global Equity Market Returns
Period Ended June 30, 2012





Risk Trends
Period Ended June 30, 2012





Monthly Investment Performance Report
Period Ended 06/30/2012

UC Entity		Return	
	Market Value ($M)	Recent Quarter	Fiscal YTD
UCRP	**$41,376**	-1.94%	0.37%
Policy Benchmark		-2.05%	-0.59%
Variance to Benchmark		*+0.11%*	*+0.96%*
GEP	**$6,526**	-2.03%	-0.36%
Policy Benchmark		-2.07%	-2.48%
Variance to Benchmark		*+0.04%*	*+2.12%*
STIP	**$7,929**	0.58%	2.44%
Policy Benchmark		0.05%	0.20%
Variance to Benchmark		*+0.53%*	*+2.24%*
TRIP	**$4,342**	0.66%	6.71%
Policy Benchmark		0.45%	5.76%
Variance to Benchmark		*+0.21%*	*+0.95%*
Total Assets	**$71,597**	-1.36%	1.15%
Entity Benchmark		-1.52%	-0.03%
Variance to Benchmark		*+0.16%*	*+1.18%*

UCRP, GEP, and TRIP Asset Class Performance: Period Ended June 30, 2012

		Total Return		Excess Return	
UC RETIREMENT PLAN	**Market Value ($000)**	**Quarter**	**FYTD**	**Quarter**	**FYTD**
	$41,376	-1.94%	0.37%	*+0.11%*	*+0.96%*
EQUITIES					
U.S. Equity	$10,718	-3.38%	3.80%	*-0.12%*	*+0.39%*
Non-U.S. Equity-Developed	$7,705	-7.06%	-13.71%	*+0.22%*	*+0.83%*
Non-U.S. Equity-Emerg. Mkt	$2,636	-7.97%	-13.76%	*+0.92%*	*+2.19%*
Global Equity	$797	-5.67%	-6.84%	*+0.01%*	*+0.07%*
FIXED-INCOME SECURITIES					
Core Fixed Income	$4,989	2.08%	7.13%	*+0.02%*	*-0.34%*
High Yield Bond	$1,273	1.97%	7.42%	*+0.09%*	*+0.80%*
Emerging Market Debt	$1,048	1.26%	6.77%	*-0.21%*	*-0.16%*
TIPS	$2,664	3.25%	11.82%	*+0.10%*	*+0.16%*
ALTERNATIVE ASSETS					
Private Equity	$3,303	4.32%	8.93%	*N/A*	*N/A*
Absolute Return-Diversified	$2,482	-1.86%	-2.00%	*+0.48%*	*+7.33%*
Absolute Return-Cross Asset Class	$903	-0.28%	11.04%	*+1.77%*	*+11.63%*
Real Assets	$535	-0.42%	1.15%	*+0.01%*	*-0.50%*
Public Real Estate	$193	1.74%	5.13%	*+0.25%*	*+4.00%*
Private Real Estate	$2,018	4.87%	14.68%	*+2.32%*	*+1.09%*

		Total Return		Excess Return	
GENERAL ENDOWMENT POOL	**Market Value ($000)**	**Quarter**	**FYTD**	**Quarter**	**FYTD**
	$6,526	-2.03%	-0.36%	*+0.04%*	*+2.12%*
EQUITIES					
U.S. Equity	$1,249	-3.39%	3.53%	*-0.13%*	*+0.12%*
Non-U.S. Equity-Developed	$1,002	-7.06%	-13.46%	*+0.25%*	*+1.12%*
Non-U.S. Equity-Emerg. Mkt	$360	-7.77%	-13.15%	*+1.12%*	*+2.80%*
Global Equity	$111	-5.67%	-6.84%	*+0.01%*	*+0.07%*
FIXED-INCOME SECURITIES					
Core Fixed Income	$366	1.54%	6.19%	*-0.52%*	*-1.28%*
High Yield Bond	$208	2.02%	7.88%	*+0.14%*	*+1.26%*
Emerging Market Debt	$191	1.39%	7.61%	*-0.08%*	*+0.68%*
TIPS	$169	3.12%	11.76%	*-0.03%*	*+0.10%*
ALTERNATIVE ASSETS					
Private Equity	$619	4.32%	8.79%	*N/A*	*N/A*
Absolute Return-Diversified	$1,548	-1.86%	-2.00%	*+0.47%*	*+7.32%*
Absolute Return-Cross Asset Class	$149	-0.04%	11.73%	*+2.03%*	*+14.21%*
Real Assets	$117	-1.52%	-1.09%	*-0.87%*	*-2.53%*
Public Real Estate	$28	1.64%	4.53%	*+0.15%*	*+3.40%*
Private Real Estate	$404	2.01%	12.54%	*-0.54%*	*-1.05%*

		Total Return		Excess Return	
TOTAL RETURN INVESTMENT POOL	**Market Value ($000)**	**Quarter**	**FYTD**	**Quarter**	**FYTD**
	$4,342	0.66%	6.71%	*0.21%*	*0.95%*
EQUITIES					
U.S. Equity	658	-3.07%	3.91%	*0.19%*	*0.50%*
Non-U.S. Equity-Developed	659	-5.16%	-8.65%	*0.03%*	*-0.19%*
FIXED-INCOME SECURITIES					
Core Fixed Income	2,369	2.67%	10.24%	*0.32%*	*1.21%*
High Yield Bond	432	2.14%	9.60%	*0.11%*	*2.41%*
ALTERNATIVE ASSETS					
REITS	224	3.47%	12.50%	*-0.15%*	-

UCRP Asset Class Performance Attribution
Period Ended June 30, 2012

UCRP FYTD Attribution (July 1, 2011 – June 30, 2012)	Asset Allocation %	Within Asset Class Return %	Total
EQUITY			
US Equity	0.03	0.10	0.13
Non-US Equity	(0.01)	0.18	0.17
Emerging Market Equity	(0.03)	0.14	0.11
Global Equity	0.00	0.00	0.01
FIXED INCOME			
Core Fixed Income	(0.14)	(0.04)	(0.18)
High Yield Debt	0.02	0.02	0.04
Emg Mkt Debt	(0.00)	(0.00)	(0.01)
TIPS	(0.10)	0.01	(0.09)
ALTERNATIVES			
Private Equity	0.04	0.00	0.04
Abs Return - Diversified	(0.01)	0.46	0.45
Abs Return - CAC	0.08	0.05	0.13
Real Assets	(0.01)	(0.01)	(0.01)
Real Estate	0.06	0.06	0.12
Other	0.04	0.00	0.04
TOTAL	**(0.02)**	**0.99**	**0.96**

GEP Asset Class Performance Attribution
Period Ended June 30, 2012

GEP FYTD Attribution (July 1, 2011 – June 30, 2012)	Total Contribution %	Within Asset Class Return %	Asset Allocation %
EQUITY			
US Equity	0.01	0.02	0.04
Non-US Equity	(0.03)	0.19	0.16
Emerging Market Equity	(0.02)	0.16	0.14
Global Equity	(0.00)	0.00	(0.00)
FIXED INCOME			
Core Fixed Income	(0.11)	(0.08)	(0.19)
High Yield Debt	0.01	0.04	0.04
Emg Mkt Debt	(0.01)	0.02	0.01
TIPS	(0.10)	0.00	(0.09)
ALTERNATIVES			
Private Equity	0.03	0.00	0.03
Abs Return - Diversified	(0.05)	1.82	1.77
Abs Return - CAC	0.10	0.10	0.20
Real Assets	(0.00)	(0.03)	(0.03)
Real Estate	0.04	(0.05)	(0.00)
Other	0.04	0.00	0.04
TOTAL	**(0.08)**	**2.20**	**2.12**

TRIP Asset Class Performance Attribution
Period Ended June 30, 2012

TRIP FYTD Attribution (July 1, 2011 – June 30, 2012)	Asset Allocation %	Within Asset Class Return %	Total
EQUITY			
US Equity	(0.02)	0.07	0.05
Non-U.S. Equity	0.05	(0.03)	0.02
FIXED INCOME			
Core FI – Govt.	(0.00)	0.01	0.01
Core FI - Credit	0.02	0.53	0.55
Core FI - Collateral	0.00	0.09	0.09
High Yield Debt	(0.00)	0.23	0.23
ALTERNATIVES			
REIT	(0.01)	(0.00)	(0.01)
TOTAL	**0.04**	**0.90**	**0.94**

PUBLIC EQUITY

Period Ended June 30, 2012

Public Equity Returns	Total Return		Excess Return	
	Quarter (%)	FYTD (%)	Quarter (%)	FYTD (%)
US Equity – Combined (UCRP & GEP)	-3.38	3.76	-0.12	0.35
US Equity - UCRP	-3.38	3.80	-0.12	0.39
US Equity - GEP	-3.39	3.53	-0.13	0.12
Non-US Developed - Combined (UCRP & GEP)	-7.05	-13.65	0.26	0.93
Non-US Developed Equity - UCRP	-7.06	-13.71	0.25	0.87
Non-US Developed Equity – GEP	-7.06	-13.46	0.25	1.12
Emg. Mkt. Equity - Combine (UCRP & GEP)	-7.94	-13.69	0.95	2.26
Emg. Mkt. Equity - UCRP	-7.97	-13.76	0.92	2.19
Emg. Mkt. Equity - GEP	-7.77	-13.15	1.12	2.80

HIGHLIGHTS OF THE PUBLIC EQUITY ASSET CLASS

- After a two year period in which stocks traded more on economic news and policy activism and less on their individual business performance, in January 2012 stocks began trading more on their business results. That helped the actively managed portion of all three equity portfolios to outperform during the fiscal year.
- Corporate earnings were positive during the fiscal year while stocks in most markets declined. As a result, equity valuations are cheaper than they have been in some time. Two years ago the price-earnings ratios of the U.S., Non-U.S. Developed Markets, and Emerging Markets were 15.4, 16.6 and 14.6, respectively. Now they are 14.4, 13.0, and 11.3.
- The U.S. Equity portfolio has a tilt toward the Technology sector as companies seek to innovate and enhance productivity and due to high consumer demand for electronics.
- The Non-U.S. Developed Markets portfolio has a strong tilt away from Financials due to the sovereign debt problems plaguing European governments and banks. The portfolio also has a tilt away from Australia and Canada, due to the high valuation of their currencies, high real estate prices, and high exposure to energy. The portfolio has a positive tilt toward Technology and toward companies doing additional business with Emerging Markets.
- The Emerging Markets portfolio has a tilt away from large multi-national emerging market companies that rely more on exports, due to weak economic growth in developed markets. The portfolio has a positive tilt toward local demand as well as emerging market countries that trade with each other. The portfolio also has a solid tilt toward Consumer Staples and Consumer Discretionary, due to strong wage growth, low unemployment, and rising living standards in most emerging countries. We think the growth of emerging market consumers will persist for some time; hence, we took steps to increase these tilts during the year.

PUBLIC EQUITY PORTFOLIO REVIEW

The U.S. Equity Portfolio* gained 3.76% for the fiscal year while the Russell 3000 Tobacco Free index returned 3.41%, an outperformance of 0.35%. The Active U.S. Equity portfolio returned 3.59%, outperforming the index by 0.18%. For the quarter, the portfolio declined -3.38% while the index fell -3.26%, an underperformance of 0.12%. The active U.S. Equity portfolio fell -3.77% during the quarter, an underperformance of 0.51%.

- An overweight to the Technology sector of 2.5% boosted returns as the sector returned 9.6% during the fiscal year, outperforming the broader market by 6.2%.
- An underweight to the Utilities sector of 1.3% hurt returns as Utilities returned 13.2% during the fiscal year, outperforming the benchmark by 9.8%.
- An underweight to mega cap stocks (the largest 50 companies) of 3.8% hurt returns as mega cap stocks returned 10.7% during the fiscal year, outperforming the benchmark by 7.3%.
- Security selection enabled the active portfolio to slightly outperform for the fiscal year despite being underweight mega cap and utility stocks.

Non-U.S. Developed Equity Portfolio* returned -13.65% during the fiscal year while the MSCI World ex-U.S. index fell -14.58%, an outperformance of 0.93%. Active managers returned -13.22%, outperforming the index by 1.32%. In the latest quarter, both the overall portfolio and the active portfolio returned -7.05% while the index fell -7.28%, an outperformance of 0.23%.

- An underweight of 2.2% to Materials helped during the fiscal year as the sector returned -27.7%, underperforming the index by 13.2%. A slowdown in global economic growth pushed commodity prices down, putting pressure on their revenues and profits.
- An underweight to Financials of 5.4% added to returns as the European debt crisis continued to roil European banks. The sector underperformed the index by 3.7% over the fiscal year. Active managers continue to underweight European banks, especially those in Spain and Italy due to the worrisome level of sovereign debt in both countries.
- An underweight to Spain of 1.2% helped returns during the fiscal year. Spain declined -32.1% over the past twelve months, underperforming the benchmark by 17.6%.
- An underweight to Canada of 3.7% helped returns during the fiscal year as Canada returned -18.2%, underperforming the benchmark by 3.7%.
- An underweight to Japan of 1.2% hurt returns during the fiscal year as Japan declined -7.2%, outperforming the benchmark by 7.3%.

Emerging Markets Portfolio* returned -13.69% during the fiscal year while the MSCI Emerging Markets index returned -15.95%, an outperformance of 2.26%. Active managers returned -12.38%, outperforming the index by 3.57% for the fiscal year. In the quarter, the Emerging Markets Portfolio declined -7.94% while the index lost -8.89%, an outperformance of 0.95%. The active portfolio fell -7.40%, an outperformance of 1.49% for the quarter.

- An overweight to Brazil of 2.0% hurt returns during the fiscal year as Brazil declined -26.7%, underperforming the benchmark by 10.8%.
- An overweight to Thailand of 2.7% benefitted returns in the fiscal year as Thailand gained 9.1%, beating the benchmark by 25.1%.

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*Combined UCRP and GEP.

- An overweight to Turkey of 2.6% was additive to returns during the fiscal year as Turkey edged up 0.9%, outperforming the index by 16.9%.
- An underweight to Materials of 4.1% helped returns as the sector sank -30.0% during the fiscal year, outperforming the benchmark by 14.1%.
- An overweight to Consumer Staples of 2.5% had a positive impact on returns as the sector edged up 2.0% over the past twelve months, outperforming the index by 18.0%.
- An overweight to Consumer Discretionary of 2.5% detracted slightly from returns as the sector lost 17.6% during the fiscal year, underperforming the index by 1.6%.
- An overweight to Health Care of 0.7% was additive to returns as the sector outperformed the benchmark by 5.8% over the fiscal year.

LOOKING FORWARD

- In all three active portfolios – U.S., Non-U.S. Developed Markets, and Emerging Markets – we expect to further increase our allocation to active managers that are particularly different than their benchmarks. These managers should do well in an environment where a company's stock price moves more in tandem with their specific business results rather than economic news.
- In the emerging markets portfolio, during the year we hired a manager that focuses on smaller stocks which are not widely researched by Wall Street. We also hired a manager that invests exclusively in Brazil, which was our first allocation to a country specific manager. We are also evaluating managers that focus solely on China.

  Country specific managers tend to have considerably more resources dedicated to their country than globally diversified managers. Hence, country managers may be better at identifying emerging companies, secular trends, political, legislative and social developments, and inflection and turning points, than globally diversified managers. Further, and of considerable importance, China managers have access to "A" shares, which are very often priced significantly differently than "H" shares, which managers outside of China are normally restricted to. We have applied for a "QFII" registration which would allow us to invest in China based managers that in turn can invest in "A" shares.

  For these reasons, we expect to earn meaningfully larger excess returns by investing in a China based manager that can invest in the "A" shares market than we can earn by investing in globally diversified emerging market managers that can invest only in "H" shares.
- A strategy paper on GEP' new Opportunistic Equity initiative will be completed and presented to the Committee on Investments in September 2012. Manager research and analysis on this initiative has begun, and will continue through the next two quarters. Portfolio construction and implementation are scheduled to take place toward the end of the calendar year or early next year.

FIXED INCOME

Period Ended June 30, 2012

Fixed Income Returns	Total Return		Excess Return	
	Quarter (%)	FYTD (%)	Quarter (%)	FYTD (%)
Core FI - Combined (UCRP & GEP)	2.04	7.06	-0.02	-0.41
UCRP – Core FI	2.08	7.13	0.02	-0.34
GEP – Core FI	1.54	6.19	-0.52	-1.28
High Yield Debt - Combined (UCRP & GEP)	1.98	7.51	0.10	0.89
Emg. Mkt. Debt - Combined (UCRP & GEP)	1.28	6.91	-0.19	-0.02
STIP	0.58	2.44	0.53	2.24
TRIP-Core FI	2.67	10.24	0.32	1.21

FIXED INCOME HIGHLIGHTS

- The Entity-level Fixed Income asset class, including all active fixed income under management, outperformed by 0.18% in the quarter ending June 30, 2012, and by 0.85% for the full fiscal year, adding over $220 million in market value versus index performance. STIP, TRIP and High Yield were the major contributors to the outperformance. For the last five years, Fixed Income has outperformed by 0.85% per annum. In dollar terms, active management has added a cumulative $1 billion in value during that period.
- The internally-managed High Yield portfolios returned 9.61% beating their benchmark by a combined 2.44% in the fiscal year ending June. That performance was above the 95th percentile of the Mercer U.S. Fixed High Yield Manager Universe for the 12 months ending June.
- For the quarter ending June, TRIP Core Fixed Income outperformed by 0.32%. For the full fiscal year, TRIP returned 10.24% to its stakeholders, exceeding its benchmark by 1.21%. Since its inception date of 8/1/08, TRIP Core has returned 9.16% per annum, outperforming by an average of 0.93%.

FIXED INCOME PORTFOLIO REVIEW

Fixed Income Core Portfolios

- UCRP and GEP Core fixed income underperformed for the fiscal year as excess return in the Credit and Government sectors was more than offset by underperformance in the collateralized/MBS (Mortgage Backed Securities) sector. In both cases, that underperformance was due to legacy non-agency RMBS (Residential Mortgage Backed Securities) positions and the weaker performance in GEP reflects a relatively higher proportion of non-agencies. The non-agency holdings were the subject of an intensive review in FY 2011-2012 which resulted in a number of sales, reducing these positions materially. Those holdings that remain are expected to deliver very strong returns over the next 12 months.
- TRIP Core fixed income performance was very good as noted above. Its performance was unimpeded by non-agencies as they were not considered an investable asset class as of the 8/1/2008 portfolio inception date. In fact, TRIP collateral had the best relative performance of the three core sectors, beating its benchmark by 1.81%.

High Yield Portfolio

- UCRP High Yield returned 1.97% in Q1 and GEP returned 2.02%, beating the benchmark return of 1.85% by 0.12% and 0.17%. For the full fiscal year UCRP and GEP returns were 7.42% and 7.88% respectively, versus the benchmark return of 6.60%. In contrast to TRIP High Yield which is 100% managed internally, UCRP and GEP include both internally and externally managed portfolios. External managers for UCRP/GEP combined posted a 7.14% fiscal year return while internally managed high yield returned 9.58 % for UCRP/GEP combined. TRIP High Yield returned 9.60%
- Over the course of the fiscal year, high yield spreads actually widened 100 bps but that widening was completely offset by a 100 bps drop in Treasury yields. As a result, the yield on the benchmark BAML Cash Pay High Yield was unchanged on the fiscal year at 7.25%.

Emerging Market Debt Portfolio

- UCRP/GEP combined EM Debt returned 1.28% in the quarter and 6.91% for the full fiscal year. The full year return was in line with the benchmark return of 6.93%. GEP's EM Debt gained 5.15%. The Emerging Market portfolios are comprised of an internally managed dollar-denominated fund and two external local currency debt funds in a 2/3 to 1/3 ratio. The hard currency benchmark, JPM EMBIG-D, posted a robust 9.77% return for the fiscal year while the local currency benchmark, JPM GBI-EM GD, returned -1.69% due to broad-based dollar strength during the last 12 months.

STIP

- For Q2 and the fiscal year, STIP had returns of 0.58% and 2.44%, generating outperformance of 0.53% and 2.24%, respectively.
- STIP continues to experience net inflows that average approximately $20 million each business day. As a result, despite ongoing transfers of monies into TRIP, the STIP balance as of quarter-end was $7.9 billion.

LOOKING FORWARD

As of June 2012, U.S. economy growth has decelerated. Q2 job growth averaged 73,000 per month down from the 225,000 average of Q1 and consumer spending has dropped sharply. Treasury yields have declined in a bull flattener move with long yields falling farther than short yields and the probability of QE3 has risen commensurately. Despite the economic slowdown, risky assets ended the quarter on a strong note with equities and spread product rallying in June.

- The good liquidity and demand for spread product provide an opportunity to perform some housecleaning on the investment grade and High Yield portfolios although an overweight to Credit in the Core portfolios and a favorable view of High Yield and Emerging Markets debt continues. We continue to favor credits that have the majority of their earnings generated outside of the Euro-zone.
- Spread product is favored in other sectors as well and in particular CMBS (Commercial Mortgage-Backed Securities) as they represent good value and a logical next step for buyers of yield in the collateralized sector.
- In the Government bond sector, yield curve flattening is anticipated but there is no active duration position. Forecasting the next move in interest rates is very difficult currently but the yield curve should exhibit a flattening trend if rates fall or trend sideways.

Emerging Market Debt Portfolio

- UCRP EM Debt returned 5.23%, in line with the benchmark return of 5.07%. GEP's EM Debt gained 5.15%. The fund is currently comprised primarily of an internally managed fund and an external local currency debt fund.
- The internally-managed EM portfolio had a strong return of 4.61%, outperforming the USD hedged EM benchmark by 36 bps in the quarter. The externally managed Local Currency EM fund had a very strong absolute return of 7.73% but underperformed its benchmark by 0.57%. The local currency EM market had the highest benchmark returns of any of the fixed income asset classes at 8.30%.
- Country allocations were unchanged in Q1 and included an overweight to Latin America and Asia and underweight to Europe and the Middle East.

STIP

- For Q1 and FYTD, STIP had returns of 0.59% and 1.84%, generating outperformance of 0.54% and 1.69%, respectively.
- STIP continues to experience net inflows that average approximately $20 million each business day. As a result, despite ongoing transfers of monies into TRIP, the STIP balance as of quarter-end was $7.7 billion.

LOOKING FORWARD

As of March 2012, U.S. economy growth has accelerated mildly, still fueled by Fed largesse and at a pace well below those of past post-recession recoveries. Nonetheless, business investment has turned up, lifting job growth as well. While the unemployment rate remains unsatisfactorily high, its gradual reduction along with earnings growth has lifted consumer consumption. Improving economic fundamentals in the U.S. bode well for the risky assets but continuing challenges in the Euro-zone mean that any significant rally among equities or narrowing of yield spreads is unlikely to occur in a straight-line fashion.

- We have lengthened the duration of the Government portfolios so that it is on a par with benchmark duration. We have also neutralized the active yield curve exposure. We view interest rates as range bound at present.
- We are maintaining an overweight to Credit in the Core portfolios and a favorable view of High Yield and Emerging Markets debt, as the outlook for spread products should continue to be supported by low money market and treasury yields, as well as the large demand from mutual fund flows. We favor higher-quality credits that have strong balance sheets and the majority of their earnings generated outside of the Euro-zone.
- We have reduced our modest overweight in U.S. Financials as spreads have narrowed versus industrial credits. Moody's quixotic attempt to capture the changing business models of large banks in their credit ratings could lead to multiple notch downgrades of several large global banks, an event that may not be fully priced in to spreads. Thus we are cautious at present in that sector. The risk of contagion from stressed European banks diminished as the ECB supplied plentiful cheap long-term liquidity to the banking system. We anticipate more of the same if needed.

PRIVATE EQUITY

Period Ended June 30, 2012

Private Equity Returns	Total Return	
	Quarter (%)	FYTD (%)
Private Equity - UCRP & GEP	4.32	8.91
Buyouts - UCRP & GEP	4.16	
Venture Capital - UCRP & GEP	3.95	

PRIVATE EQUITY HIGHLIGHTS

- The private equity portfolio had a solid return for the fiscal year with nearly 900 bps of outperformance relative to the entity return for both the UCRP and GEP. The strongest performance in the portfolio was driven by the co-investment portfolio which generated 19.9% returns for the fiscal year. The buyout and venture capital portfolios also delivered strong performance over the fiscal year. Returns for the quarter were 4.32% for both the UCRP and GEP portfolios.
- Co-investment activity was robust during the fiscal year, five transactions were completed and one transaction has been approved and is expected to close within thirty days. While the co-investment portfolio is still young and small relative to the overall PE portfolio, it is already contributing materially to returns.
- The UC made 17 new fund commitments during the fiscal year representing $700 million of new commitments. Buyout funds represented 64% of the new commitments while venture capital accounted for 23%. Co-investments accounted for 8% of the commitments for the 2012 fiscal year.
- Staff continues to pursue a secondary purchase strategy for select funds, but due to pricing pressures, has had limited opportunities to transact in the past year. As a result of the current market conditions, the team is actively reviewing a sales strategy for non-core funds in the portfolio with a focus on enhancing future returns.
- Capital calls and distributions continued to remain strong during the fiscal year, up 26% and 15%, respectively, from the prior year.

PRIVATE EQUITY PORTFOLIO REVIEW

- Fiscal year returns are reflective of a robust M&A market, IPO market, and improving portfolio company operating metrics. In addition, the private equity valuations benefitted from the strong first quarter 2012 public equity markets. However, investor appetite in the IPO market has recently slowed dramatically, and many companies with planned IPO's have not been able to complete their offerings.
- Distributions for FY 2012 were strong with $576 million in distributions versus $509 million for the prior year. Capital calls were above historical trends with $810 million called versus $644 million in the prior year.

Commitment Pacing and Other Activity

- The private equity portfolio tracked to its strategic commitment pace with $700 million of new commitments for the fiscal year. The second quarter of 2012 was a particularly robust period for new commitments with $283 million committed versus $75 million for the prior quarter.
- Staff has been focused on the European market after strategically avoiding significant commitments to European funds from 2008 to 2010. Staff recently committed to two European funds and expects to make an additional European fund commitment during the second half of the year.
- The UC continues to pursue its strategy of seeking attractive co-investments. During fiscal year 2012, staff sourced twenty-two transactions and completed five transactions. In addition, there is one co-investment that is approved and expected to close in the next thirty days. The strategic target for the year was to complete five to six transactions.

LOOKING FORWARD

- Staff is seeking to increase co-investment activity in the portfolio and is targeting more than eight transactions per year going forward.
- Staff is completing a review of non-core holdings and will seek to sell a portfolio of assets if able to execute a transaction that enhances long-term returns.
- Distributions should continue to be strong given the maturation of the PE portfolio and the robust M&A environment. The M&A market continued to remain strong through the second quarter of 2012. However, the IPO market has continued to face headwinds recently and is not expected to be as favorable in the near term.
- The fundraising market continues to be strong with a slight increase in the amount of capital raised by funds during the second quarter of 2012 versus the second quarter of 2011.
- Investment activity is expected to remain strong as debt continues to be available at attractive terms with favorable covenants.
- Calendar year 2012 commitments are expected to be between $650 million and $750 million. The team is planning to deploy $250 million to $350 million of capital for the remainder of the calendar year.

ABSOLUTE RETURN

Period Ended June 30, 2012

Absolute Return - Div	Total Return	
	Quarter (%)	FYTD (%)
UC AR Portfolio	-1.86	-2.00
HFRX AR and MD Blended Index	-2.33	-9.32
HFRI Fund of Funds	-2.26	-4.40
S&P 500	-2.75	5.45
Barclays Aggregate Bond Index	2.06	7.47

ABSOLUTE RETURN HIGHLIGHTS

- During the quarter, the UC AR portfolio posted a loss of -1.85%, outperforming its HFRX benchmark by 48 basis points. For comparative purposes, the HFRI Fund of Funds Index lost -2.21% over the same period.
- During the fiscal year, the UC AR portfolio posted a loss of -1.99%, outperforming its HFRX benchmark by 733 basis points. For comparative purposes, the HFRI Fund of Funds Index lost -4.40% over the same period.
- The hedge fund industry continues to adjust to the increased regulatory and compliance requirements including registering with the SEC, and preparing to file Form PF with the SEC.
- In the first half of 2012, 464 hedge funds closed their doors, with liquidations up a quarter on the year before. However, the closures were still outweighed by 608 launches during the period.
- The hedge fund industry ended the fiscal year with $2.10 TN of assets.
- Capacity is becoming more of a concern as more managers are starting to return capital or hard close to new capital.

ABSOLUTE RETURN PORTFOLIO REVIEW

- The primary contributors to the UC AR portfolio during the fiscal year were emerging markets and relative value strategies.
  - The positive contribution from emerging markets was primarily due to manager selection as most of the emerging market indices for both hedge funds and the public markets were down for the fiscal year.
  - New sub-strategy additions within the relative value strategy helped generate a positive contribution for the year.
- Global macro and equity market neutral strategies also contributed positively to performance.
  - While global macro strategies were able to generate modest returns during the fiscal year, they were not immune to the volatile “risk on” and “risk off” market which was driven by increasing government interventions intended to combat rising systemic financial sector and sovereign risks.

  - Equity market neutral strategies were able to harvest alpha from the occasional emergence of dispersion of equity returns. These low beta strategies were less whipsawed by the volatile markets.
- The largest detractors to performance during the fiscal year were equity hedge and event driven strategies.
  - Within equity hedge, a single manager with large exposure to commodities generated a large portion of the strategy's loss. This was a challenging space, with the S&P GSCI Index down -11% during the year, the HFRX energy/basic materials index down -14%, and the HFRI energy/basic materials index down -20%.
  - During the two months of August and September, the AR portfolio suffered its biggest drawdown since 2008. Managers who went into August with a high net exposure only to cut their net exposure before the fourth quarter missed the rally that ensued.
  - Managers who refrained from overly managing their net exposure fared better during the year.
- For the quarter, relative value arbitrage and emerging markets strategies were the largest positive contributors to performance, while equity hedge strategies detracted the most.

LOOKING FORWARD

- As global uncertainties still dominate investor sentiment, we will continue to focus on finding managers who have demonstrated the ability to navigate through volatile markets and find areas of uncorrelated opportunities.
- We will also direct more assets towards our smaller managers as industry inflows continue to find their way to the largest managers.

Cross-Asset Class

Period Ended June 30, 2012

Absolute Return - CAC	Total Return		Excess Return	
	Quarter (%)	FYTD (%)	Quarter (%)	FYTD (%)
AR CAC - Combined (UCRP & GEP)	-0.25	11.12	1.81	11.96

CROSS-ASSET CLASS HIGHLIGHTS

- The Cross-Asset Class closed the fiscal year with strong total and active returns. The fiscal year return for the strategy was 11.14%, delivering significant value added in a year that was flat for the policy benchmark. This strong performance was primarily driven by a significant allocation to a core manager whose portfolio reflects a balanced risk exposure across a diverse set of macroeconomic regimes.
- The focus on offering risk diversification across economic regimes was the best ammunition for a period challenged by heightened market uncertainty within the Euro-zone. The flexibility of the cross asset class mandate was also beneficial in allowing managers to apply tactical overlays within a shifting market environment.
- At the end of the fiscal year, we have completed funding our core strategic partners. Over the course of the year, we have engaged our managers in periodic discussion of tactical allocation recommendations, as the uncertainties surrounding the Euro-zone continued to percolate. Our early discussions were launched by a roundtable discussion at the start of 2012 reviewing potential scenarios and portfolio positioning.
- As of June 30, Cross Asset Class Absolute Return has $1.05 billion under management within the UC Retirement (UCRP) and Endowment (GEP) plans, accounting for 2.1% and 2.3% of each plan's respective allocation.

CROSS-ASSET CLASS PORTFOLIO REVIEW

- The strategy's strong 11.83% of excess return over policy over the fiscal year-to-date was primarily driven by a sizeable allocation to a core manager known for balancing risk allocations across four key macroeconomic scenarios, determined by inflation and growth outlooks. In the first half of the fiscal year, the manager's performance had been heavily driven by strong returns in U.S. and sovereign debt of the strongest EU countries. In a low growth, deflationary environment, sovereign debt as well as gold, proved to be positive hedges as European debt uncertainties roiled the markets. In the final June quarter, our risk parity manager's balanced portfolio dominated once again as uncertainties in Europe, particularly Greece and Spain triggered a pull back in risk assets.
- The year has also helped confirm that in the event of a growth rally, we have Strategic Partners in place who would benefit from a rise in risk assets. Risk assets rallied at the start of the calendar year, on the heels of supportive central bank policies before stalling again in May. Within a growth rally, two of our recently hired strategic partners demonstrated stronger performance in their growth strategies and tactical overlays, which helped sustain the outperformance. For example, a number of our strategic partners favored high yield credit and selected regional equity markets.

- Strategic Partners have also shown innovation in facing market challenges. As the markets continued to show unevenness and sharp reversals, a newly introduced tactical strategy was launched by a manager. The low beta equity strategy aims to deliver well over half the beta of the global equity market, while incurring half the market volatility. This strategy did especially well as a substitute for a pure equity allocation within the strategic partner's portfolio as markets reacted to European debt uncertainties.
- Over the fiscal year, strong performance was generated by net positive exposures to high quality sovereign and U.S. government debt, including TIPs (Treasury Inflation Protection bonds), given sustained negative real yields, currency swaps favoring 'safe' currencies relative to Euros, as well as long positions in gold. These are assets that are positioned to perform well in deflationary and lower growth scenarios, and provided the most significant overall gains to the portfolio over the full fiscal year.

LOOKING FORWARD

- We completed funding for our core Strategic Partners last quarter, and continue to explore supplementing the portfolio with satellite strategies. We will be completing our funding on a loan modification fund, which specifically targets enhancing the loan profile of high yielding distressed, as well as re-performing loans, and selling them at a premium, through work-outs or refinancing.
- Given a modest overweight in the Cross Asset Class portfolio in mid-June, we have trimmed the short term allocation back to the 2.0% tactical policy weight as of July 1. At the July 9 Regents meeting, the Committee on Investments agreed to increase the long-term policy allocation for Cross Asset class within the Endowment (GEP) portfolio to 5%. The long term allocation within the UC Retirement Plan remains at 2%.
- For the existing portfolio, we continue to reallocate assets among our core strategic partners, reducing our exposure to a risk parity manager. As of July 1, the manager was further reduced by $100 million as we reduced our overall Cross Asset Class allocation to target. Risk balanced strategies remain our largest allocation. We believe we can continue to benefit from strategies that are equally weighted across key relative growth macro scenarios as global growth uncertainties continue to dominate the financial market landscape.
- Staff continues to evaluate the merits of incubating strategies which take advantage of current market dislocations and strategies providing diversification and risk control. These additions would be more modest satellite allocations framing our key strategic partnerships. Given the smaller capital commitments individually, the CAC satellite strategies may be a testing ground for potentially larger scale application within the aggregate plans.

REAL ASSETS

Period Ended June 30, 2012

Real Assets Returns	Total Return		Excess Return	
	Quarter (%)	FYTD (%)	Quarter (%)	FYTD (%)
Real Assets - Combined (UCRP & GEP)	-0.62	0.74	0.03	-0.70
Real Assets - UCRP	-0.42	1.15	0.01	-0.50
Real Assets - GEP	-1.52	-1.09	-0.87	-2.53

REAL ASSETS HIGHLIGHTS

- The Real Assets composite increased by 0.74% for the fiscal year. Returns were negatively impacted by the Commodity portfolio, which was down -13.16% for the fiscal year and the Timber portfolio, which was down -0.18% for the fiscal year. The Energy and Infrastructure portfolios added value during the fiscal year with gains of 9.47% and 6.54% respectively.
- For the quarter ending June, the Real Assets composite returned -0.62%. Returns were weighed down by the Commodity portfolio, which returned -9.63% versus -9.80% for the GSCI Reduced Energy Index.
- Ten new investments were closed during the fiscal year, bringing the portfolio to a net asset value of $652 million with $534 million in unfunded capital commitments and a total exposure of $1,186 million. The portfolio is now comprised of 26 investments.
- Investment activity was strong during the fiscal year with net cash outflows of $249.0 million as a result of both capital calls made by existing managers and new investments. As the portfolio is still in its build up phase, this level of activity is consistent with the strategic plan.
- Since inception on April 1, 2010, the Real Assets composite has generated an annualized return of 14.91%, which has been accretive to entity level returns. The Real Asset portfolio's returns have been broad based with all of the underlying portfolios demonstrating strong positive returns since inception.

REAL ASSETS PORTFOLIO REVIEW

- The Real Assets composite increased by 0.74% for the fiscal year. Returns were negatively impacted by the Commodity and Timber portfolios while the Energy and Infrastructure portfolios were accretive.
- At 22% of the Real Assets composite, the Commodity portfolio returned -13.16% for the fiscal year, which underperformed the S&P GSCI Reduced Energy Index return of -10.0% by 316 basis points. This underperformance was driven by two of the portfolio's four managers which suffered from volatile markets amidst deteriorating economic fundamentals. Since its August 2010 inception, the portfolio continues to deliver positive alpha with a return of 6.25% versus 4.13% for the portfolio benchmark.

- The Energy portfolio currently comprises 25% of the Real Assets composite. It was a positive contributor to overall performance for the fiscal year with a return of 9.47%. The portfolio saw strong returns in its more mature investments during the year, which was offset by the J-Curve of newer commitments. Since January 2010, the Energy portfolio has generated an annualized return of 21.73%. Four new investments were added to the portfolio during the fiscal year, including two co-investments.
- The Infrastructure portfolio was a positive contributor for the fiscal year with a 6.54% return. The portfolio currently represents 22% of the overall Real Assets portfolio and saw positive returns among each of its managers during the period. Staff completed three new investments in this portfolio during the quarter including a midstream energy focused strategy and two investments focused on the energy, transport, and water/waste industries.
- The Timberland portfolio had a fiscal year return of -0.18% which was predominately driven by a lower return in the portfolio's domestic holdings. The portfolio is still in the build up phase and remains heavily dominated by one asset that has an attractive long-term return profile, but a low current cash yield, particularly in the early years. The portfolio currently represents 21% of the overall Real Assets portfolio. This allocation is expected to decrease further over time as Staff focuses on opportunities across other segments of the portfolio.
- The UC has committed to three Opportunistic investment strategies, but only two have drawn capital to date. This portfolio currently represents 10% of the Real Assets portfolio, but we expect two of these managers to continue to call capital throughout the second half of 2012.
- Investment activity was strong during the fiscal year with net cash outflows of $249.0 million as a result of both capital calls made by existing managers and new investments. This level of activity was slightly lower than the previous fiscal year, which realized $313.0 million in net cash outflows. Cash outflows should continue at this pace over the next few years. Since the portfolio is still in the early stages of the J-curve, the portfolio's cash distributions are expected to be lower than the long-term expectation.

LOOKING FORWARD

- Staff is currently conducting due diligence on a number of new opportunities, including an oil and gas strategy, a European infrastructure fund, an agriculture fund, and an international timberland opportunity.
- The secondary market has become generally less attractive over the last twelve months relative to primary opportunities; however, Staff is continuing to actively pursue secondary opportunities on a select basis. Staff is currently evaluating two secondary opportunities that are in the pipeline within the energy and infrastructure sectors.
- Staff continues to take a measured and constructive approach in evaluating new opportunities. Areas of particular interest include the midstream energy sector, metals and mining, international timberland, and royalty-based strategies.

REAL ESTATE

Period Ended June 30, 2012

Real Estate Returns	Total Return		Excess Return	
	Quarter (%)	FYTD (%)	Quarter (%)	FYTD (%)
Private Real Estate - UCRP	4.87	14.68	2.32	1.09
Private Real Estate - GEP	2.01	12.54	-0.54	-1.05
Public Real Estate - UCRP	1.74	5.13	0.25	4.00
Public Real Estate – GEP	1.64	4.53	0.15	3.40

REAL ESTATE HIGHLIGHTS

- Two additional acquisitions were made for the separate account portfolio during the fourth fiscal quarter – one stable multi-family property and one portfolio of two value-added multi-family properties – with an aggregate net value of $36 million (which is not yet reflected in the portfolio net asset value). In addition, subsequent to quarter-end purchase and sale agreements were entered for a two office properties and one multi-family asset.
- The office tower brought to market for sale received attractive offers and a purchase and sale agreement was entered with a prospective buyer. The transaction is scheduled to close during the first quarter of the new fiscal year. A sales contract was also entered for a student housing property, and that transaction is also scheduled to close by quarter-end.

PORTFOLIO REVIEW

- The **Private Real Estate Portfolio** continued its steady recovery during the fourth fiscal quarter, with UCRP gaining 4.87% and GEP adding 2.01%. The UCRP portfolio exceeded the benchmark by 2.32%, while the GEP portfolio slightly underperformed the benchmark by 0.54%. For the fiscal year, UCRP returned 14.68%, ahead of the benchmark by 1.09%, while the GEP underperformed, returning 12.54%, which is -1.05% short of the benchmark.
- Core investments continued to report steady income and appreciation, performing in line with the benchmark during the quarter and moderately outperforming for the fiscal year; they were among the biggest contributors to total return during the period. Value added investments materially outperformed the benchmark, recording strong appreciation due to improved valuation metrics as well as strong offers received on a large asset for sale in the separate account portfolio, resulting in its value being written up.
- In contrast, opportunistic investment lagged the benchmark in terms of total return, reporting negative income, though the appreciation materially exceeded the benchmark in both the quarter and the fiscal year ended June. This is expected, as while assets are in the execution phase of their business plan, income will not be a primary component of return.
- The Separate Account composite, taken alone, underperformed the benchmark in terms of income, with operating income falling short of budget on several properties. However, the composite materially outperformed in terms of appreciation, primarily attributed to the aforementioned positive valuation change on one large holding that is for sale and received attractive offers.

- In general, returns for Private Real Estate continued to trend positive, but to a more moderate degree. There remains a more positive outlook than a year ago, but valuation gains moderated in the face of European uncertainty and its potential global impact.
- The **Public Real Estate portfolio** returned 1.74 % in UCRP and 1.64% in GEP during the quarter, outperforming the policy benchmark by 0.25% and 0.15%, respectively. In the fiscal year to date, the portfolio significantly outperformed the benchmark, exceeding it by 4.00% in UCRP and 3.40% in GEP.
- In the active portfolio, stock selection was slightly positive, with relative strength in the U.S. and Western European holdings. Regional allocation was negative, with an over-allocation to Latin America, which lagged other regions during the quarter. As of quarter-end, the portfolio manager remained overweight to Latin America, as well as Australia, Hong Kong, China, Singapore and the UK. By property type, the portfolio is overweight to retail, industrial and hotels.

LOOKING FORWARD

- The existing portfolio is constructed with the flexibility to reposition or adjust the strategy in changing market conditions. More than 50% of UC's investment commitments are to structures that provide some degree of liquidity (i.e. separate accounts, open-end funds, and REITS).
- There is currently $585 million in unfunded commitments in the Private Real Estate portfolio (including separate accounts and commingled funds), available to invest into lower pricing in a post-correction market.
- Committed capital continues to be deployed by the separate account managers, who report an increasingly robust pipeline of opportunities. Additional separate account managers and strategies are under consideration for addition to the portfolio.
- Opportunities presented by dislocation and distress in the credit markets are under review, with interest especially in debt-to-own strategies, certain types of loan origination, as well as acquisition and servicing of large loan portfolios.
- Also of interest are European strategies that capitalize on the bank distress there, and Asian and Latin American funds well-positioned to benefit from growth and development in those regions.