The University of Texas System

LONG TERM FUND







Annual Report

Year Ended August 31, 1997

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Pictured on Front Cover

Karen Gonzalez was enraptured by the artistic treasures of Florence when she participated in a University of Texas honors class taught in Italy. So much so, that this Plan II major decided to focus her studies in art history when she returned to The University of Texas at Austin. Gonzalez, a native of Edmond, Oklahoma, is grateful to the Dedman Merit Scholars Program for giving her the financial freedom to make the trip. She is shown on the cover with a work by Joan Miró in U. T. Austin's Archer M. Huntington Art Gallery, where Gonzalez is interning to learn the art of curatorship.

Prepared by The University of Texas Investment Management Company (UTIMCO)

Fiscal year 1997 was a very successful year for the Long Term Fund (the "Fund"). Above average investment returns combined with a benign inflation environment enabled the Fund to easily achieve its primary investment objective of preserving purchasing power. The University of Texas Investment Management Company ("UTIMCO") continues to improve the Fund's efficiency by diversifying its equity exposure into U.S. and non-U.S. small capitalization and alternative equities.

UTIMCO is also pleased to report that the 5-year program to adjust the Fund's spending rate downward to a sustainable long term equilibrium level is complete. As a result, UTIMCO has recommended that the U. T. Board of Regents increase the annual distribution rate on each underlying Fund endowment by 2.8% or the average rate of inflation for the three year period ending August 31, 1997.

The investment environment in the future will continue to be a challenge as the securities markets evolve on a global basis. UTIMCO looks forward to providing continued growth in distributions to the Fund's 4,400 endowments so generously donated by the many friends of The University of Texas System.

Donald L. Evans
Chairman
Board of Regents
The University of Texas System

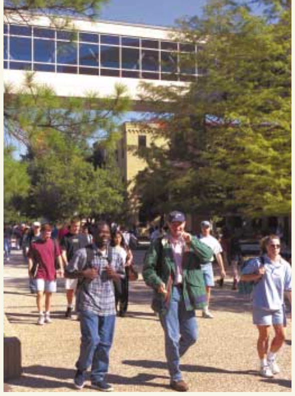
Thomas O. Hicks
Chairman
Board of Directors
The University of Texas Investment Management Company

Regent
The University of Texas System

The Long Term Fund (the "Fund") was established on February 9, 1995, by the Board of Regents of The University of Texas System (the "Board"). It replaced the Common Trust Fund originally established by the Board in 1932. The Fund serves as a pooled fund for the collective investment of approximately 4,400 privately raised endowments and other long term funds of the 15 component institutions comprising The University of Texas System (the "U. T. System"). It also provides for greater diversification of security holdings than would be possible if each participant's account was managed separately. The Fund is structured as a mutual fund in which each endowment or account purchases units at the Fund's market value per unit. Cash distributions are paid quarterly, on a per unit basis, directly to the component institution of record.

Fiduciary responsibility for the Fund rests with the Board. The day-to-day operational responsibilities of the Fund are delegated to The University of Texas Investment Management Company ("UTIMCO"). UTIMCO is a 501(c)(3) organization formed in March 1996 to invest endowment and other assets of the Board. UTIMCO is governed by a board of directors consisting of three U. T. System regents, the Chancellor of the U. T. System, and five outside directors with experience in investment management. UTIMCO's governance structure is designed both to preserve ultimate regental control of investments for fiduciary purposes and to increase the level of investment expertise in the governance of investments. Day-to-day management of funds is delegated to UTIMCO's employees, who provide a full range of investment management services. UTIMCO employs investment managers and contracts with unaffiliated investment managers in order to enhance the Fund's return and risk characteristics. UTIMCO manages investments in excess of $10 billion which includes the $6.4 billion Permanent University Fund, and other assets supporting the teaching, research, and health care missions of The University of Texas System component institutions.

The 15 component institutions supported by the Fund consist of nine general academic institutions and six health-related institutions, with an enrollment base of approximately 147,000 students as of the 1997 Fall semester. Maintenance and enhancement of the academic quality of the institutions will require continued support from the private sector and achievement of Fund investment objectives.



U. T. at Arlington
Mall Area

U. T. at Austin
U. T. Tower

U. T. at Brownsville
Gorgas Hall

U. T. at Dallas
Eugene McDermott Library

U. T. at El Paso
Undergraduate Learning Center

U. T. Health Center at Tyler
Hospital & Outpatient Clinic Towers

U. T. Health Science Center at Houston
University Center Tower

U. T. Health Science Center at San Antonio
Fountain Courtyard

U. T. M.D. Anderson Cancer Center at Houston
R. Lee Clark Clinic Building

U. T. Medical Branch at Galveston
R. Waverly Smith Pavilion

U. T. - Pan American
Science Building

U. T. of the Permian Basin
Mesa Building

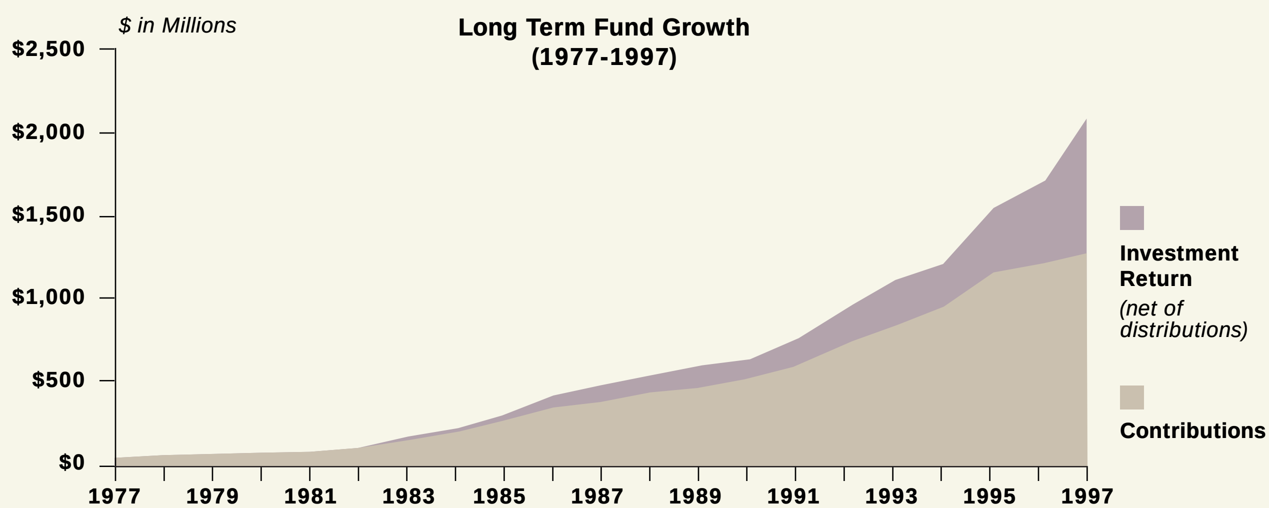
U. T. at San Antonio
College of Business

U. T. Southwestern Medical Center at Dallas
Seay Biomedical Building

U. T. at Tyler
Administration Building

The Fund's net assets have continued to grow over the years, reaching $2,125.0 million at August 31, 1997. The five-year period illustrated below summarizes the substantial growth in the Fund's net assets over the last five years. New contributions and investment return after expenses and distributions produced 46% and 54% of five-year asset growth, respectively.

(in millions)	Years ended August 31, 1993	1994	1995	1996	1997
Beginning Net Assets	$ 958.8	$1,128.0	1,226.3	$1,558.8	$1,712.1
Net Contributions	106.5	111.9	202.3	54.1	66.1
Investment Return	121.2	51.3	203.4	182.3	433.8
Expenses	(2.0)	(2.1)	(2.8)	(3.7)	(4.5)
Distributions (Payout)	(56.5)	(62.8)	(68.5)	(76.4)	(79.1)
Distribution of Gain on Participant Withdrawals	0.0	0.0	(1.9)	(3.0)	(3.4)
Ending Net Assets	$1,128.0	$1,226.3	$1,558.8	$1,712.1	$2,125.0



QUESTION: What are the major factors in meeting the primary investment objectives of the Fund?

ANSWER: The Fund's ability to meet its primary investment objectives depends on two important factors:

1. Investment return which is primarily determined by how the Fund allocates its investment assets among different investment classes.

2. The Fund's spending rate which should not exceed the average net investment return after expenses and inflation. An equilibrium spending rate is required to preserve the purchasing power of the Fund's assets through time.

	Average Annual Rate (1)
Investment Return	8.5%
Expenses	(0.5%)
Inflation	(3.5%)
Net Return After Inflation	4.5%
Spending Rate	(4.5%)
Net Change in Purchasing Power	0.0%

(1) based on market indices data 1901 - 1996

The Dedman Merit Scholars Program Endowment—a $10 million program established at The University of Texas at Austin in 1986 by alumnus Robert Dedman and his wife Nancy, provides scholarships to U. T. Austin's National Merit Scholars, and to a select group of undergraduate students in the College of Liberal Arts. Last year, more than 700 Dedman Merit Scholars received awards through the program. Allison Bloom, a senior in the Plan II program who is majoring in both English and Radio-Television-Film, wants to make movies. Her interests, however, lie behind the scenes, and the Miami native's ambition is to be among the first women to win an Oscar for Best Original Screenplay. She was inspired by her literature studies and fascination with narrative, which she dreams of translating into film. Bloom says she couldn't have been a film major without the support of the Dedman scholarship program because of the cost of equipment, supplies, and film.

Investment Objectives

The majority of the accounts invested in the Fund are endowments which are perpetual in nature. As a result, they require investment management with long term fund investment horizons. The Fund's investment objectives follow the principles of endowment fund management. The primary investment objectives of the Fund are to preserve the purchasing power of the Fund's assets and its annual distributions by earning an average total return after inflation of 5.5% over rolling ten-year periods or longer. Growth of the Fund is required to preserve its purchasing power and is essential for providing growth in the distributions remitted to the component institutions. The Fund's secondary objectives are to generate a fund return in excess of the Policy Portfolio benchmark, and the average median return of the universe of the college and university endowments as reported annually by Cambridge Associates, Inc. and the National Association of College and University Business Officers ("NACUBO") over five-year periods or longer. The policy portfolio is a composite of asset class return indices weighted to reflect the Fund's neutral asset allocation policy.

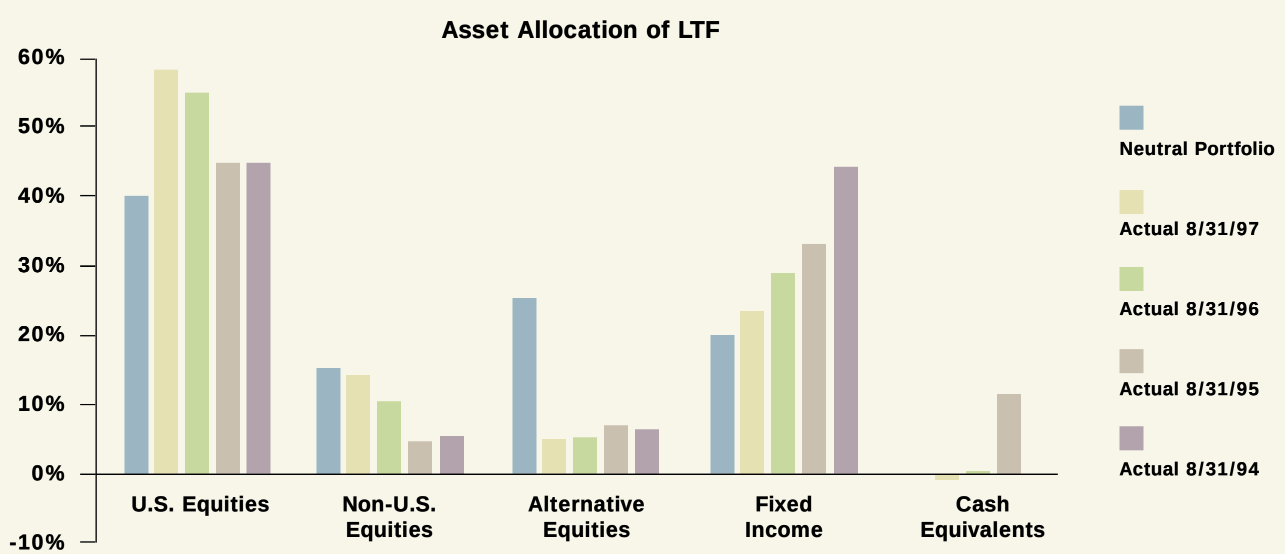
Asset Allocation

The Fund's ability to meet its investment objectives depends primarily upon the allocation of its assets among different investment classes. Asset allocation is the primary determinant of investment performance.

In establishing an asset allocation policy, it is recognized that the Fund's return risk profile can be enhanced by diversifying its investments across different types of assets whose returns are not closely correlated.

The Board in February of 1995 approved a long term equity allocation goal to be achieved in five years. The long term policy contains neutral allocations of 20%, 55%, and 25% to fixed income, equities, and alternative equities, respectively.

Specific asset allocations may be changed from time to time based on the economic and investment outlook. The Board adopted a total return investment strategy for the Fund in late 1993 with the amendment to the Texas Uniform Management of Institutional Funds Act. This Act allowed governing boards of public institutions of higher education to appropriate for expenditure the realized appreciation of an endowment fund. Since each account owns an undivided interest based on the number of units it holds, the Fund's realized appreciation is also available for expenditure. Prior to the amendment of the law, only income (defined primarily as interest and dividends) could be distributed to meet the distribution provisions established for the Fund.



The distribution policy of the Fund in the past forced an emphasis on fixed-income securities. The relatively low exposure to equities resulted in a lower return than the Fund's peers over the last ten years. The chart on the bottom of page 6 represents the asset allocation of the Fund for the previous four years ending with August 31, 1997, versus the neutral policy portfolio for the Fund.

The chart below compares the policy neutral return for the portfolio and the actual returns for the Fund by asset class for the year ended August 31, 1997. The Fund slightly underperformed its benchmark return by 0.17% The Fund was substantially overweighted in domestic equities and underweighted in alternative equities compared to its neutral allocation. The substantial overweighting in domestic equities will remain until the rebalancing to the alternative equity asset classes is complete.

	Actual Portfolio Asset Allocation 8/31/97	Neutral Policy Asset Allocation	Portfolio Total Return	Benchmark Return
Equities:				
U.S. Equities:				
Medium/Large Cap Stocks	46.75%	30.00%	38.12%	40.63%
Small Cap Stocks	11.39%	10.00%	25.01%	28.95%
Non-U.S. Equities:				
Established Markets	11.38%	12.00%	13.55%	9.11%
Emerging Markets	2.95%	3.00%	22.06%	2.54%
Alternative Equities:				
Liquid	0.00%	5.00%	0.00%	10.69%
Illiquid	4.40%	15.00%	14.28%	47.63%
Inflation Hedging Assets	.41%	5.00%	35.29%	7.45%
Fixed Income:				
U.S. (Domestic)	23.19%	15.00%	10.99%	9.99%
Foreign	0.00%	5.00%	0.00%	1.66%
Cash and Cash Equivalents	(.47%)	0.00%	N.M.	N.M.
TOTAL FUND	100.00%	100.00%	25.15%	25.32%

N.M. - Not Meaningful

QUESTION: Why is the Fund's neutral asset allocation heavily weighted toward equities?

ANSWER: Historical data has shown an asset allocation of 70-80% to equity securities is required in order to provide an expected average investment return in excess of 8.5%. Although there is a higher volatility (standard deviation) associated with an equity oriented portfolio, endowment funds can absorb this risk due to their perpetual nature.

U.S. Stock/ U.S. Bond Ratio	Average Annual Compound Return (%)	Standard Deviation (%)
0/100	5.2	9.8
10/90	5.8	9.9
20/80	6.4	10.3
30/70	6.9	11.0
40/60	7.4	12.0
50/50	7.9	13.1
60/40	8.3	14.4
70/30	8.7	15.9
80/20	9.1	17.4
90/10	9.4	19.0
100/0	9.7	20.6

FUND REVIEW - Overall

The Fund achieved a total return of 25.1% for the year ended August 31, 1997. The Fund achieved its primary investment objective of preserving the purchasing power of the Fund's principal by posting a net real return of 22.7% before distributions of 4.1%. The following chart shows the calculation of the Fund's real growth for the current year as well as for the three, five and ten year periods ending August 31, 1997.

Long Term Fund Real Growth

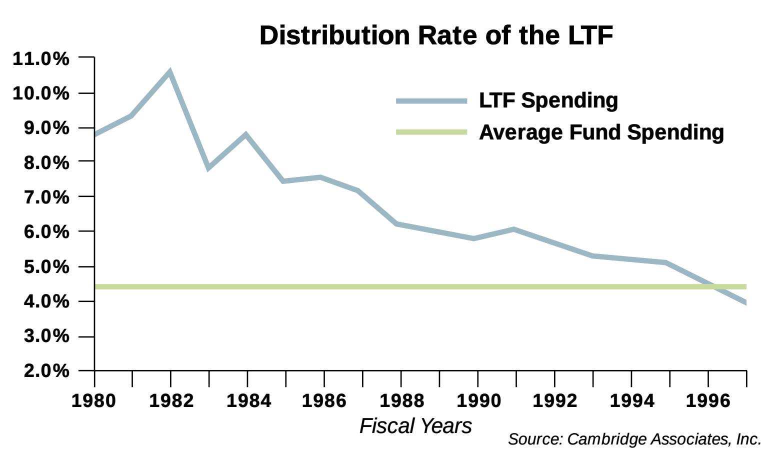
	One Year	Three Years	Five Years	Ten Years
Total Return	25.1%	17.4%	13.6%	11.5%
Fund Expenses	(.2%)	(.2%)	(.2%)	(.2%)
Net Total Return	24.9%	17.2%	13.4%	11.3%
Inflation	(2.2%)	(2.6%)	(2.7%)	(3.5%)
Net Real Return	22.7%	14.6%	10.7%	7.8%
Distributions	(4.1%)	(4.6%)	(4.8%)	(5.4%)
Net Real Growth	18.6%	10.0%	5.9%	2.4%

A secondary objective of the Fund is to generate a fund return in excess of the average median return of the universe of the college and university endowments as reported annually by NACUBO. Shown in the chart below is a comparison of the Fund to other colleges and universities that reported returns for the period ended June 30, 1997 to Cambridge Associates, Inc. This information is shown for the one, three and five years ended June 30, 1997. The improvement shown in the three year period return is a result of the asset allocation changes made by the Fund.

	One year ended June 30, 1997	Three years ended June 30, 1997	Five years ended June 30, 1997
Fund Total Return	20.0%	17.9%	13.4%
Median Return of the Universe	20.5%	17.9%	14.5%
Fund Rank compared to the Universe	65/119	58/118	89/115
% Ranking	55.0%	49.0%	77.0%

QUESTION: How has the distribution policy in the past affected the internal growth of the Fund?

ANSWER: The Fund's historical distribution rates have been quite generous compared to endowment distribution rates of other major colleges and universities. These historically high distributions have affected the internal growth of the Fund. The average distribution rate established by other colleges and universities is 4.5%-5% of the endowment's market value. In order to bring the Fund into equilibrium and in line with other colleges and universities, the distribution rate was frozen in 1992. The chart to the right reflects the downward trend of the distribution rate for the Fund to the norm of other colleges and universities. Now that the Fund has reached the norm, effective for the fiscal year beginning September 1, 1997, the distribution rate will increase from $.175 per unit to $.18 per unit.



Source: Cambridge Associates, Inc.

Through generous corporate and foundation support, The University of Texas Health Science Center at San Antonio has become an international leader in imaging. Shown here is the Positron Emission Tomography (PET) Scanner, which helps researchers "map" the human brain. Dr. Helen Mayberg of the Health Science Center's Research Imaging Center, is administering a radio-labeled tracer used to identify brain abnormalities in a patient with severe depression. Endowment funds provide critical support to Health Science Center faculty, as well as to students in the schools of medicine, dentistry, nursing, allied health sciences and graduate biomedical sciences.

The Health Science Center is celebrating its 25th anniversary this year, and much of the progress in research is directly attributable to endowed positions and scholarship endowments.

Performance - Against Market Benchmark

Another measurement of performance is to compare the Fund's asset class performance against performance of market indices. The following table reflects the historical performance by asset class and a comparison against relevant market benchmarks:

	Years ended August 31,			
	One Year	Two Years	Three Years	Five Years
Long Term Fund	25.1%	18.2%	17.4%	13.6%

For the year, the LTF's investment assets produced a total return of 25.1% versus a return for the neutral policy portfolio of 25.3%. Performance attributable to the underweighting in the alternative asset class was offset to a large degree by the overweighting in U.S. Equities.

Performance - By Asset Class

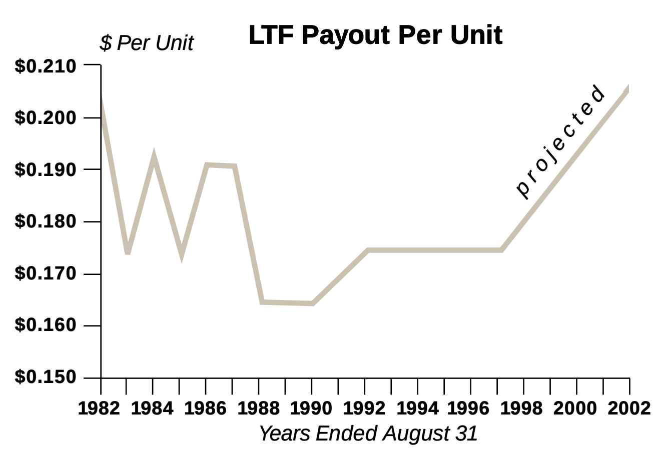
FIXED INCOME-Performance

	One Year	Two Years	Three Years	Five Years	Seven Years
Fixed Income-Internal	11.0%	7.7%	9.5%	7.8%	9.9%
Benchmark: Salomon Brothers Broad Investment Grade Bond Index	10.0%	7.0%	8.4%	6.9%	8.9%

During the year, the Fund continued to reposition its assets into equity securities. $50 million was transferred from the fixed income portfolio to equities to reduce the Fund's exposure to fixed income securities. The fixed income portfolio comprised 28.7% of the beginning of the year's market value and ended the year at 23.2%. The average portfolio quality rating at August 31, 1997 was Aa2. The total return for the fixed income portfolio was 11% compared to 10% for its benchmark, the Salomon Brothers Broad Investment Grade Bond Index. The outperformance of the portfolio versus its benchmark was primarily attributable to the fact that it had a higher income component with a longer modified duration than the benchmark.

QUESTION: How does the Fund's distribution rate convert into dollars distributed to the individual endowment beneficiary?

ANSWER: All endowments which invest in the Fund purchase units based on the Fund's market value price per unit as of the date of purchase. The endowment beneficiary receives distributions quarterly from the Fund based on the number of units owned multiplied by the current distribution rate. The distribution rate is increased each year by an average consumer price index. This formula continues so long as the distribution % is between 3.5% and 5.5% of the Fund's market value. Therefore, the dollars distributed are inflation adjusted in order to maintain their purchasing power. The chart to the right presents the per unit distribution rate and the projected increases based on an inflation rate of 3.5%.



Dalia Galicia, who first learned English when she entered kindergarten, still speaks Spanish at home in Mission, Texas, with her parents, who came to the United States from Mexico two months before Dalia was born. Today, the talented young graduate of the South Texas High School for Health Profession in Mercedes, Texas, is enrolled in both the Honors Studies Program and Premedical Honors College at The University of Texas-Pan American. Her dream is to practice general and family medicine in her native Rio Grande Valley. With the support of her parents, who already have helped her three older brothers finish college, and the financial assistance she gets from a Mary Jones Endowed Scholarship at U. T. Pan American, Dalia says her goal is definitely within reach. "When I was accepted into the Premedical Honors College, a program U. T. Pan American offers in cooperation with Baylor College of Medicine, I knew I had taken a huge step toward fulfilling my dreams", she said.

U.S. EQUITIES-Performance

	One Year	Two Years	Three Years	Five Years	Seven Years
Total Domestic Equities	**36.6%**	**26.7%**	**24.3%**	**18.0%**	**16.8%**
Benchmarks:					
Russell 3000 Index	**38.4%**	**27.4%**	**25.5%**	**19.6%**	**19.2%**
S&P 500 Index	**40.6%**	**29.2%**	**26.6%**	**19.7%**	**19.0%**

U.S. equities markets posted another excellent year on a fiscal year basis, with the S&P 500 Index returning 40.6%, compared to 18.7% for the previous fiscal year. Both years surpassed the long term historical average for the market of 9-10%.

The Fund's U.S. equity portfolios which utilize both active and passive investment strategies generated a total return for the year of 36.6%. During the year, $42.5 million was transferred from the U.S. equity portfolios, a majority of which was allocated to non-U.S. equity portfolios. The LTF's U.S. equities exposure totaled $1.2 billion and represented 58.1% of the LTF's investment assets at fiscal year end. The U.S. equity portion of the LTF consists of the following investment portfolios:

S&P 500 Index	**18.9%**
Large Cap Growth	**10.5%**
Equity Income/Value	**9.0%**
Mid-Cap Index	**8.3%**
Small Cap Equities	**11.4%**
Total	**58.1%**

The Fund's domestic equity portfolios provide for different management styles in order to diversify its equity exposure.

NON-U.S. EQUITIES-Performance

	One Year	Two Years	Three Years	Five Years	Seven Years
Non-U.S. Equities- Established Markets(1)	**12.7%**	**11.1%**	**7.2%**	*	*
Established Markets- Small Cap(2)	*	*	*	*	*
Emerging Markets(3)	**22.1%**	*	*	*	*
Total Non-U.S. Equities	**15.1%**	**12.3%**	**8.3%**	*	*
Benchmarks:					
Financial Times Actuaries World Index (excluding U.S.)(1)	**9.1%**	**8.7%**	**5.7%**	**10.7%**	**7.6%**
MSCI EAFE Net(2)	**9.1%**	**8.5%**	**5.7%**	**10.7%**	**7.4%**
MSCI Emerging Markets(3)	**2.5%**	**2.1%**	**(5.0%)**	**10.8%**	**12.0%**

*** Funded during the Fiscal Year**

The (number) correlates to the respective benchmark for the performance return.

Non-U.S. equities in general performed well over this reporting cycle. The LTF's total return attributable to non-U.S. equities for the year was 15.1%. The LTF's non-U.S. equities totaled $304.5 million and represented 14.3% of the LTF's investment assets at fiscal year end. The Fund's non-U.S. equity portfolios provide for different management styles in order to diversify its equity exposure. The Fund currently has exposure to established markets (7.7%), non-U.S. small cap (3.7%), and emerging markets (3.0%).

Jack Waymire, Ph.D., the Levit Family Professor in Neurosciences in the Department of Neurobiology and Anatomy, U. T. Health Science Center at Houston, studies the biochemistry of the synthesis of neurotransmitters in nervous tissue, believed to be an important factor in Parkinson's disease. Dr. Waymire is pictured preparing a protein sample using high pressure liquid chromatography - a technique which enables scientists to purify and analyze biological substances.

Max and Milton Levit established the Levit Family Professorship in the Neurosciences in March 1997, to support research of the basic biological mechanisms of normal and abnormal brain function, in honor of their mother who suffered with Alzheimer's disease. Dr. Jack Waymire was appointed in September 1997 as the first holder of this new endowment.

ALTERNATIVE EQUITIES-Performance

	One Year	Two Years	Three Years	Five Years	Seven Years
Total Alternative Equities	**16.3%**	**15.2%**	**21.5%**	**21.5%**	**14.3%**
S&P 500 Index +5%	**45.6%**	**34.2%**	**31.6%**	**24.7%**	**24.0%**

The alternative equities portfolio return reflects the large amount of capital invested in this asset class during the year. It takes several years before the alternative equity portfolio will realize returns from new investments. The LTF's alternative equities totaled $102.3 million and represented 4.8% of the LTF's investment assets at fiscal year end.

The alternative equities portfolio was comprised of the following asset mix as of August 31, 1997:

Oil and Gas	**8.6%**
Venture Capital	**23.4%**
Buyouts/Special Equities	**60.2%**
Mezzanine	**7.8%**
TOTAL	**100.0%**

Distributions

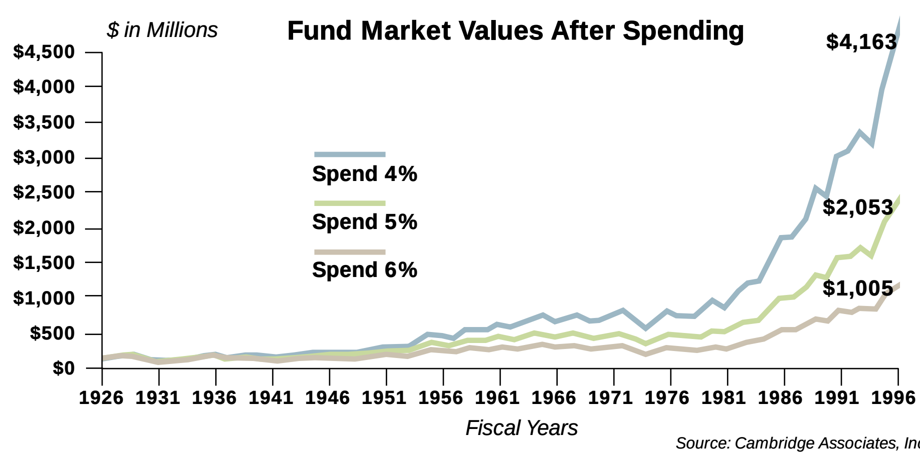
The distributions of the Fund are based on a distribution policy which balances the needs and interests of present beneficiaries with those of the future. The Fund's distribution policy objectives are to:

- *provide a predictable, stable stream of distributions over time*
- *ensure that the inflation adjusted value of the distributions is maintained over the long term*
- *ensure that the inflation adjusted value of Fund assets after distributions is maintained over the long term*

Many donors who establish endowments make their gifts through bequests or otherwise expect them to stand as one-time gifts to the institution. Thus, there may not be further contributions to ensure that a particular endowment will continue to provide the same level of real economic support as prices rise. Furthermore, many endowments support faculty salary supplements that are integral parts of faculty compensation. An unexpected decline in the distribution from the endowment would cause considerable difficulties for the component institutions that the Fund supports. Recognizing these factors, UTIMCO, as directed by its Board of Directors, does not distribute to the component institutions all earnings, including capital gains, from the endowment for the given period. Instead, it remits a fixed amount to each endowment based on the number of units the endowment holds in the Fund. This fixed amount is determined annually based on a formula which conforms to the distribution policy objectives on the left margin.

QUESTION: What impact does the distribution (spending) rate have on the endowment's value?

ANSWER: The impact that the distribution (spending) rate will have on the endowment's value is shown graphically in the chart to the right. The dollar value of the endowment is adversely affected by the larger spending rate. This example assumes an initial endowment value of $100 million in 1926 with a constant asset allocation of 70% to stocks and 30% to bonds. Performance in these sectors is based on quarterly market indices.



Source: Cambridge Associates, Inc.

One of the oldest buildings on the University of Texas at Arlington's campus, Ransom Hall, is the sight of a new computer learning center. Recently renovated and equipped with 372 state-of-the-art computers, the center provides students, faculty and staff access to the latest computer equipment and distance education programs. Endowment funds which support quality educational and research opportunities result in a successful blend of high-tech and high-touch education. The University of Texas at Arlington's new computer complex is accessible twenty-four hours a day, seven days a week.

D i s t r i b u t i o n s (cont.)

The current policy holds distributions constant at $.175 per unit until the distribution stream reaches a base distribution equal to 4.5% of the Fund's market value (12-quarter average.) At that point, the distribution rate will be adjusted each year by the consumer price index (inflation) subject to a maximum distribution of 5.5% of the Fund's average market value and a minimum distribution of 3.5% of the Fund's average market value. This type of distribution formula will enhance the Fund's ability to meet its objectives. The purpose of establishing a maximum and minimum perimeter is to stabilize the distribution stream.

At fiscal year end, the distribution rate was 4.5% of the Fund's average market value (12-quarter average). The distribution amount for the fiscal year beginning September 1, 1997 will be adjusted to $.180 per unit of ownership in the LTF. The distribution amount of $.175 was adjusted by the average consumer price index for the prior 3 years.

D i s t r i b u t i o n P o l i c y - *I l l u s t r a t e d*

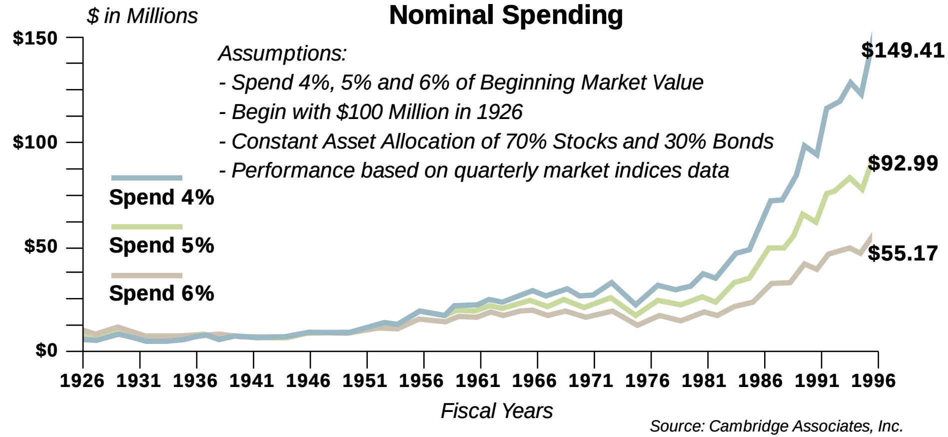
To illustrate the distribution policy objectives, assume that a donor contributes $1,000,000 to create an endowment. Also assume that the Fund actually earns (income plus price appreciation) 11.5% for the year after the costs of management, and the average consumer price index (inflation) is 5%. The Fund retains the 7% component of the total earnings of 11.5% and remits 4.5% or $45,000 to the institutions. In effect, the market value of the endowment is now $1,070,000. The following year the Fund will remit 1.05% of $45,000 and the component will receive $47,250. The distribution amount was adjusted by the average consumer price index of 5%. In this way, the investment value continues to grow over time as does the absolute amount of the distribution.

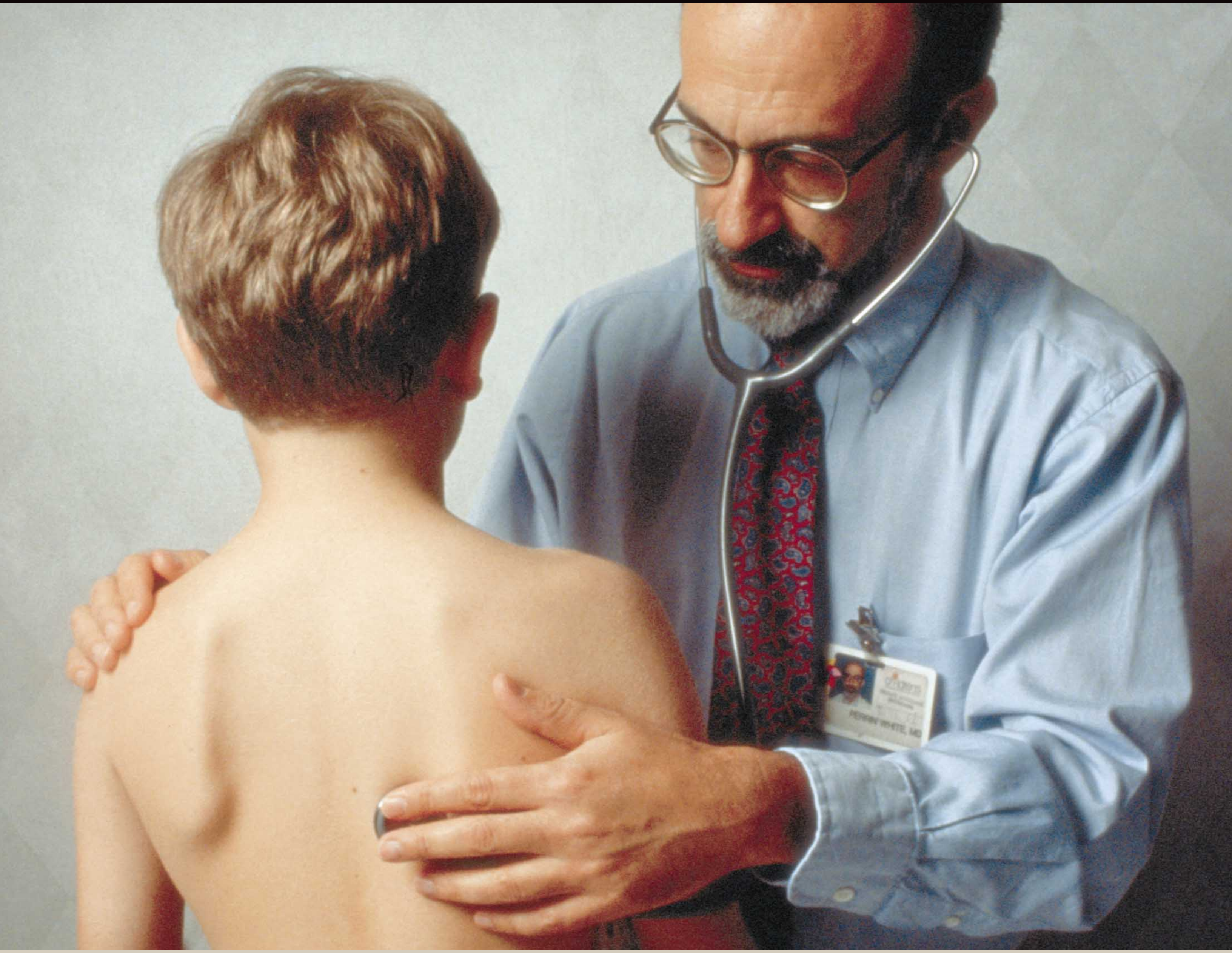
C o n c l u s i o n

Increasingly, the margin for excellence in higher education is dependent upon the preservation and enhancement of the endowment assets which require a long term investment outlook. The Board continues to reposition the Fund to meet the investment challenges of the next century and to increase the financial support to the Fund's beneficiaries.

QUESTION: What impact does the Fund's distribution rate have on the amount of the distribution (the dollar payout) paid to the institution?

ANSWER: The impact the distribution rate (or spending rate) has on the dollar payout can be shown graphically in the chart to the right. Dollar payout amounts over time are greater if the distribution rate, as a percentage of market, is smaller. This is because the market value of the Fund has been able to increase at a greater rate due to the lower distribution rate.





The Audre Newman Rapoport Distinguished Chair in Pediatric Endocrinology was established in 1994 by Bernard and Audre Rapoport for the benefit of U. T. Southwestern Medical Center at Dallas. The former Chairman of the Board of Regents of the University of Texas System and his wife have always worked to enhance the quality of life for people around the world. This gift, now supporting the work of Dr. Perrin White, an internationally recognized authority on hormone disorders adversely affecting growth and sexual development, will benefit thousands of children. Dr. White joined the U. T. Southwestern faculty as a professor of pediatrics in 1994.

The Bernard and Audre Rapoport Foundation is dedicated to "ameliorating the quality of life for all who inhabit the earth".

Financial Statement and Financial Highlights

LONG TERM FUND

Year Ended August 31, 1997

Participants in the 1996 School of Allied Health Sciences (U. T. Medical Branch at Galveston) 5-K Fun Run took part in a first-of-its-kind event when they ran or walked over the Galveston Bay Causeway, for a worthy cause…scholarships for UTMB students pursuing careers in every academic discipline from occupational therapy to medical technology.

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Touche LLP

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
The University of Texas Investment Management Company
Austin, Texas

We have audited the accompanying statement of assets and liabilities of The University of Texas System Long Term Fund (the "Fund") as of August 31, 1997, the comparison summary of investments as of August 31, 1997 and 1996, and the related statements of operations and changes in net assets and financial highlights for each of the two years in the period ended August 31, 1997. These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and per unit data based on our audit.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of August 31, 1997, by correspondence with the custodian. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of the Fund as of August 31, 1997, the comparative investments as of August 31, 1997 and 1996, the results of its operations, the changes in its net assets and the financial highlights for each of the two years in the period ended August 31, 1997 in conformity with generally accepted accounting principles.

The unaudited information on page 20 was not audited by us and, accordingly, we express no opinion or other form of assurance on it.

Deloitte & Touche LLP

October 31, 1997

Years Ended August 31,	1997	1996	1995 (unaudited)	1994 (unaudited)	1993 (unaudited)
Selected Per Unit Data					
Net Asset Value, Beginning of Period	$ 3.897	$ 3.661	$ 3.336	$ 3.375	$ 3.181
Income from Investment Operations					
Net Investment Income	0.143	0.148	0.166	0.167	0.176
Net Realized and Unrealized Gain (Loss) on Investments	0.807	0.263	0.334	(0.031)	0.193
Total Income from Investment Operations	0.950	0.411	0.500	0.136	0.369
Less Distributions					
From Net Investment Income and Income Reserve Account	0.175	0.175	0.175	0.175	0.175
Total Distributions	0.175	0.175	0.175	0.175	0.175
Net Asset Value, End of Period	$ 4.672	$ 3.897	$ 3.661	$ 3.336	$ 3.375
Ratios and Supplemental Data					
Net Assets, End of Period (in thousands)	$2,124,977	$1,712,134	$1,558,799	$1,226,266	$1,128,034
Ratio of Expenses to Average Net Assets	0.235%	0.225%	0.212%	0.182%	0.196%
Ratio of Net Investment Income to Average Net Assets	3.336%	3.864%	4.867%	5.085%	5.445%
Ratio of Distributions to Average Net Assets (5-quarter average)	4.098%	4.589%	5.187%	5.304%	5.423%
Ratio of Distributions to Average Net Assets (12-quarter average) (unaudited)	4.462%	4.906%			

The accompanying notes are an integral part of these financial statements.

Comparison Summary of Investments

August 31, 1997 and 1996
(in thousands)

	1997		1996	
	VALUE	COST	VALUE	COST
Debt Securities				
U.S. Government Obligations (Direct)	$ 134,814	$ 129,669	$ 65,355	$ 62,063
U.S. Government Obligations (Guaranteed)	1,948	1,805	2,351	2,191
U.S. Government Agencies (Non-Guaranteed)	70,995	68,096	79,845	78,109
Foreign Government Obligations	14,910	14,526	23,813	23,920
Municipal and County Bonds	17,600	17,033	19,725	20,088
Corporate Bonds	170,996	163,002	281,024	278,685
Total Debt Securities	411,263	394,131	472,113	465,056
Preferred Stock	788	541	540	541
Equity Securities				
Convertible Preferred Stock	-	-	314	286
Common Stock	630,283	442,749	426,751	352,107
Limited Partnerships and Other	93,031	88,133	68,270	60,856
Index Funds	737,095	488,371	626,440	516,168
Commingled Funds	142,079	130,521	51,797	51,551
Total Equity Securities	1,602,488	1,149,774	1,173,572	980,968
Cash and Cash Equivalents				
Money Markets	133,952	133,952	63,844	63,844
Total Investments	$2,148,491	$1,678,398	$1,710,069	$1,510,409

The accompanying notes are an integral part of these financial statements.

Statement of Assets and Liabilities

August 31, 1997 (in thousands)	
Assets	
Investment in Securities, at Value (Cost $1,678,398)	$2,148,491
Receivable for Investments Sold	4,913
Accrued Income Receivable	8,435
Total Assets	2,161,839
Liabilities	
Payable to Participants	12,415
Payable for Investments Purchased	23,539
Other Payables and Accrued Expenses	908
Total Liabilities	36,862
Net Assets	$2,124,977
Net Assets Consist Of:	
Participant Contributions (Net of Withdrawals)	$1,298,201
Undistributed Net Investment Income	5,337
Accumulated Undistributed Net Realized Gain on Investments	351,345
Net Unrealized Appreciation	470,094
Net Assets for 454,803,889 Units	$2,124,977
Net Asset Value Per Unit	$ 4.672

The accompanying notes are an integral part of these financial statements.

August 31, 1997 and 1996
(in thousands)

	1997	1996
Investment Income		
Interest	$ 44,477	$ 48,207
Dividend	23,748	19,723
Other	728	180
Total Investment Income	68,953	68,110
Expenses		
Internal Fee for Management and Educational Purposes	1,985	1,692
Investment Counseling Fees	1,835	1,462
Internal Administrative Fee	300	300
Consultation Fees	128	30
Custodial Fees and Expenses	231	240
Miscellaneous Expenses	61	23
Total Expenses	4,540	3,747
Net Investment Income	64,413	64,363
Realized and Unrealized Gain on Investments		
Net Realized Gain on Investment Securities	94,442	56,783
Change in Net Unrealized Appreciation on Investment Securities	270,435	57,617
Net Gain on Investments	364,877	114,400
Net Increase in Net Assets Resulting from Operations	$ 429,290	$ 178,763
Net Assets		
Beginning of Period	1,712,134	1,558,799
Participant Contributions (including reinvestments of $5,738 and $7,996 for the years ended August 31, 1997 and 1996, respectively)	77,519	75,114
Participant Withdrawals:		
Cost	(11,397)	(21,073)
Gain	(3,438)	(3,029)
Distributions to Participants:		
Net Investment Income	(64,413)	(64,363)
Income Reserve	(14,718)	(12,077)
End of Period	$2,124,977	$1,712,134

The accompanying notes are an integral part of these financial statements.

Note 1 - Organization

The Long Term Fund (the "Fund") is a pooled fund established for the collective investment of private endowments and other long term funds supporting various programs and purposes of the 15 institutions comprising The University of Texas System. The Fund was formerly known as the Common Trust Fund. The Long Term Fund was established February 9, 1995, by the Board of Regents of The University of Texas System (the "U. T. System") to succeed the Common Trust Fund pooled investment fund. Fiduciary responsibility for the Fund rests with the Board of Regents. The day-to-day operational responsibilities of the Fund are delegated to The University of Texas Investment Management Company ("UTIMCO"), pursuant to an investment management agreement with The Board of Regents.

The accompanying financial statements follow the form and content of investment company financial statements and related disclosures in accordance with generally accepted accounting principles. The principles followed will differ from the principles applied in governmental and fund accounting. The annual combined financial statements of The University of Texas System are prepared in accordance with Texas Comptroller of Public Accounts' Annual Financial Reporting Requirements and include information related to the Long Term Fund. The accompanying financial statements do not purport to represent information in compliance with governmental accounting principles nor in accordance with Texas Comptroller of Public Accounts' Annual Financial Reporting Requirements.

Note 2 - Significant Accounting Policies

(A) Security Valuation - Investments are primarily valued on the basis of market valuations provided by independent pricing services.

Fixed income securities held directly by the Fund are valued based upon prices supplied by Merrill Lynch Securities Pricing Service and other major fixed income pricing services, external broker quotes and internal matrices.

Equity security market values are based on the New York Stock Exchange Composite closing prices, if available. If not available, the market value is based on the closing price on the primary exchange on which the security is traded (if a closing price is not available, the average of the last reported bid and ask price is used).

Limited partnerships and other are valued based on a fair valuation determined as specified by policies established by the UTIMCO Board of Directors.

Securities held by the Fund in index funds are generally valued as follows:

> *Stocks traded on security exchanges are valued at closing market prices on the valuation date.*
>
> *Stocks traded on the over-the-counter market are valued at the last reported bid price, except for National Market System OTC stocks which are valued at their closing market prices.*
>
> *Fixed income securities are valued based upon bid quotations obtained from major market makers or security exchanges.*

Commingled funds are valued based on the net asset value per share provided by the investment company.

(B) Foreign Currency Translation - The accounting records of the Fund are maintained in U.S. dollars. Purchases and sales of securities of foreign entities and the related income receipts, and expense payments are translated into U.S. dollars at the exchange rate on the dates of the transactions.

Investment income includes net realized and unrealized currency gains and losses recognized between accrual and payment dates.

(C) Investment Income - Interest income is accrued as earned. Dividend income is recorded on the ex-dividend date. Dividend and interest income is recorded net of foreign taxes where recovery of such taxes is not assured. Bonds are amortized over the life of the security using the interest method, which is a method of amortizing discounts or premiums that results in constant rates of interest.

(D) Security Transactions - Security transactions are recorded on a trade date basis for most securities. Index fund transactions are recorded on a settle date basis due to trading practices which impose restrictions in acquiring per unit information on trade date. Gains and losses on securities sold are determined on the basis of average cost. A loss is recognized if there is an impairment in the value of the security that is determined to be other than temporary.

(E) Distributions to Unitholders - Cash distributions to unitholders are paid quarterly based on a per-unit payout established by the Board of Regents. For the years ended August 31, 1997 and 1996, the quarterly rate was $.04375 per unit which equates to a yearly rate of $.175 per unit. The unaudited ratio of distributions to average net assets (12-quarter average) was 4.462% as of August 31, 1997. The investment policy provides that when the ratio reaches 4.5%, the payout will be adjusted by the average consumer price index of the prior 36 months including August 31, 1997. Therefore, beginning September 1, 1997, the yearly payout has been increased to $.180 per unit.

(F) Fund Valuation - Valuation of the Fund's units occurs on a quarterly basis. Unit values are determined by dividing the value of the Fund's net assets by the number of units outstanding on the valuation date.

(G) Purchases and Redemption of Units - The value of participating units, upon admission to the Fund, is based upon the market value of net assets held as of the valuation date. Any purchase amount will be assigned a whole number of units in the Fund to avoid fractional units. Any fractional amount of purchase funds which exceeds the market value of the units assigned will be transferred to the Fund but no units will be issued. Redemptions from the Fund will also be made at the market value price per unit at the valuation date at the time of the withdrawal. There are no transaction costs incurred by participants for the purchase or redemption of units.

(H) Participants' Net Assets - All participants in the Fund have a proportionate undivided interest in the Fund's net assets.

(I) Federal Income Taxes - The Fund is not subject to federal income tax.

(J) Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Note 3 - Acquisitions and Dispositions of Investments

Acquisitions and dispositions (including sales, maturities and prepayments) of securities, other than short-term securities, totaled $748,133,608 and $745,037,018, respectively. Net realized gains on investments for the year ended August 31, 1997 and 1996, were $94,441,798 and $56,782,541, respectively. The realized gains for August 31, 1997 included $42,680,869 of reinvested capital gains earned on the index funds and mutual funds and $51,956 of currency exchange losses. Included in realized gains for the year ended August 31, 1996, was $18,948,278 of index and mutual funds reinvested capital gains and $14,310 of currency exchange losses. The components of the acquisitions and dispositions for the year ended August 31, 1997 are as follows:

	Acquisitions	Dispositions
	(in thousands)	
U.S. Government Obligations (Direct)	$ 78,638	$ 11,158
U.S. Government Obligations (Guaranteed)	-	387
U.S. Government Agencies (Non-Guaranteed)	-	10,146
Foreign Government Obligations	-	10,063
Municipal and County Bonds	-	3,021
Corporate Bonds	-	118,972
Convertible Preferred Stock	113	8
Common Stock	462,779	409,720
Limited Partnerships and Other	37,596	17,390
Index Funds	90,038	160,111
Commingled Funds	78,970	4,061
	$748,134	$745,037

Note 4 - Investment, Management, and Custodial Fees and Expenses

The Fund was assessed a quarterly internal fee by U. T. System for management and educational purposes based on .025% of the Fund's net assets on the last day of each quarter for the years ended August 31, 1997 and 1996. Additionally, an internal administrative fee of $300,000 was charged to the Fund by U. T. System for the years ended August 31, 1997 and 1996, respectively.

The Fund incurs investment counseling fees from various external managers of the Fund. The fees, generally assessed quarterly, are based on a percentage of the market value of investments held by each individual investment manager and currently range from .01% to 1.0%.

Custodial fees and expenses are assessed quarterly by the financial institution which holds the Fund's assets. Fees are based on number of accounts, market value of the Fund, and transaction activity in accordance with the contractual agreement with the institution. Additional fees are assessed for performance measurement and online communication services per the contractual agreement.

Note 5 - Index Funds

The index funds consist of the Equity Index Fund B Lendable, which is solely owned, and the Mid Cap Index Fund B Lendable, which is majority-owned, by the Permanent University Fund and the Long Term Fund. Also included in the index funds are twenty-one MSCI Equity Index Fund B international funds which are invested in Europe, Australia and the Far East. The market values of the funds are as follows:

	August 31, 1997	August 31, 1996
Equity Index Fund B Lendable	$400,162,613	$326,336,534
Mid Cap Index Fund B Lendable	177,480,193	169,391,882
MSCI Equity Index Fund B	159,452,171	130,711,862
	$737,094,977	$626,440,278

Note 6 - Commingled Funds

The commingled funds consist of investments in the Emerging Markets Series, a foreign fund which is a part of the Templeton Institutional Funds, Inc., an open-end, diversified management investment company. Also included in the commingled funds is an investment in the Capital Guardian International (Non-US) Small Capitalization Fund for Tax Exempt Trusts which is a fund established within the Capital Guardian Common Trust Fund which is a part of the Capital Guardian Trust Company, a California state chartered bank. In addition, an investment in The MBA Investment Fund, L.L.C., which is a limited liability company is also included. The market values of the funds are as follows:

	August 31, 1997	August 31, 1996
Emerging Markets Series	$ 62,594,712	$51,282,379
Small Capitalization Fund	78,760,118	-
MBA Investment Fund, L.L.C.	724,117	514,881
	$142,078,947	$51,797,260

Note 7 - Securities Lending

The Fund loaned securities to certain brokers who paid the Fund negotiated lenders' fees. These fees are included in investment income. The Fund receives qualified securities and/or cash as collateral against the loaned securities. The collateral when received will have a market value of 102% of loaned securities of United States issuers and a market value of 105% for loaned securities of non-United States issuers. If the market value of the collateral held in connection with loans of securities of United States issuers is less than 100% at the close of trading on any business day, the borrower is required to deliver additional collateral by the close of the next business day to equal 102% of the market value. For non-United States issuers, the collateral should remain at 105% of the market value of the loaned securities at the close of any business day. If it falls below 105%, the borrower must deliver additional collateral by the close of the following business day. At year end, the value of securities loaned of United States issuers and the value of collateral held amounted to $110,019,304 and $111,933,970, respectively. There were no non-United States issuers loaned during the years ended August 31, 1997 and 1996.

Note 8 - Commitments

The Fund had unfunded contractual commitments for limited partnerships and other assets of $128,306,554 as of August 31, 1997.

Note 9 - Restatement

Ratios and Selected Per Unit Data in the Financial Highlights have been restated for years ending August 31, 1993 through 1996 to conform with the 1997 presentation.

The University of Texas System

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U T I M C O

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