

Financial Statements

The University of Texas System

General Endowment Fund

*Years Ended August 31, 2006 and 2005*

# The University of Texas System General Endowment Fund

## Financial Statements

Years Ended August 31, 2006 and 2005

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## Report of Independent Auditors

The Board of Regents of The University of Texas System  
The Board of Directors of The University of Texas Investment Management Company

We have audited the accompanying financial statements of The University of Texas General Endowment Fund (the "Fund") as of and for the years ended August 31, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

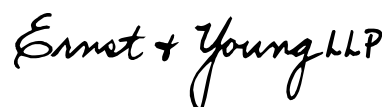
We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. 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.

As discussed in Note 1, the financial statements present only The University of Texas General Endowment Fund and do not purport to, and do not, present fairly the fiduciary net assets of The University of Texas Investment Management Company nor The University of Texas System as of August 31, 2006 and 2005 and the changes in its fiduciary net assets for the years then ended in conformity with accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net assets of The University of Texas General Endowment Fund as of August 31, 2006 and 2005, and the changes in the fiduciary net assets for the years then ended, in conformity with accounting principles generally accepted in the United States.

Management's discussion and analysis on pages 2 through 4 is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the financial statements of The University of Texas General Endowment Fund. The supplemental schedules are presented for purposes of additional analysis and are not a required part of the financial statements. The supplemental schedules as of August 31, 2006, 2005, 2004 and 2003 and for the years then ended have been subjected to the audit procedures applied in the audits of the financial statements and, in our opinion, based on our audits, are fairly stated in relation to the financial statements taken as a whole. The Fund's financial statements for the year ended August 31, 2002, which are not presented with the accompanying financial statements, were audited by other auditors whose report thereon dated October 18, 2002, expressed an unqualified opinion on the financial statements. Their report on the 2002 supplemental schedules stated that, in their opinion, such information was fairly stated in all material respects in relation to the financial statements taken as a whole.



October 27, 2006

**THE UNIVERSITY OF TEXAS SYSTEM  
GENERAL ENDOWMENT FUND**

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**MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)**

Our discussion and analysis of The University of Texas System General Endowment Fund's (Fund) financial performance provides an overview of its activities for the fiscal year ended August 31, 2006. This discussion was prepared by The University of Texas Investment Management Company (UTIMCO) and should be read in conjunction with the Fund's financial statements and notes. The Fund is an internal UT System mutual fund for the pooled investment of the Permanent Health Fund (PHF) and The University of Texas System Long Term Fund (LTF). The Fund was created to allow the PHF and LTF to benefit from their identical investment objectives by providing greater efficiencies and cost savings than was possible when the investments of the PHF and LTF were managed separately. The Texas Constitution and various state statutes designate The University of Texas System Board of Regents (UT Board) as the fiduciary for the management of certain public endowment and operating funds. The UT Board has entered into an Investment Management Services Agreement delegating investment management responsibility for all investments to UTIMCO.

The purpose of the MD&A is to provide an objective and easily readable analysis of the Fund's financial statements based upon currently known facts, decisions or conditions.

**Financial Highlights**

- The Fund's fiduciary net assets, after contributions and withdrawals, increased by \$501.0 million from \$4,926.8 million to \$5,427.8 million or approximately 10.2% for the year ended August 31, 2006, compared to an increase of \$719.2 million or approximately 17.1% for the year ended August 31, 2005. The change in net fiduciary net assets from year to year is mainly attributable to the following:
  1. The PHF and LTF redeemed and purchased Fund units resulting in a net reduction in contributions of \$54.2 million for the year ended August 31, 2006, compared to a net reduction in contributions for the year ended August 31, 2005 of \$71.9 million.
  2. The Fund posted a net investment return of 11.10% for the fiscal year ended August 31, 2006. Investments in real estate investment trusts, private market investment funds and global equities were the leading contributors to the 2006 return. For the fiscal year ended August 31, 2005, the commodities, private market investment funds and global equity asset classes were the leading performers contributing to a net investment return of 18.82%.
  3. The Fund allocates its net investment income and its realized gain or loss to the PHF and LTF monthly based on their ownership of Fund units at month end. The distributed net investment income and realized gain amounts increase the cost basis of the units of the Fund, and any distributed realized losses reduce the cost basis of the units in the Fund. Since the distribution is proportional to the percentage ownership by the PHF and LTF, no additional units are purchased.

# THE UNIVERSITY OF TEXAS SYSTEM GENERAL ENDOWMENT FUND

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## Use of Financial Statements and Notes

The Fund's financial statements were prepared in accordance with standards issued by the Governmental Accounting Standards Board (GASB). Two financial statements are required under GASB: the Statement of Fiduciary Net Assets and the Statement of Changes in Fiduciary Net Assets.

The notes to the financial statements contain supplemental information that is essential for the fair presentation of the financial statements.

## Statements of Fiduciary Net Assets

The Statements of Fiduciary Net Assets present assets, liabilities, and net assets of the Fund as of the end of the fiscal year. These statements, along with all of the Fund's financial statements, are prepared using the accrual basis of accounting, whereby Fund investment income is recognized when earned and Fund expenses are recognized when incurred.

The Fund invests in a broad mix of investments and is actively managed to its benchmark, the Endowment Policy Portfolio. The Endowment Policy Portfolio is the index or benchmark for the endowment funds that UTIMCO manages. The return of the Endowment Policy Portfolio is the sum of the weighted benchmark returns for each asset class that comprise it. UTIMCO allocates the Fund's assets to internally and externally managed portfolios in accordance with approved asset allocation policies, and attempts to supplement the original endowment corpus by increasing purchasing power over time. In doing so, UTIMCO increases the endowment resources available to fund the teaching, research, and health care programs specified by the various donors.

The following summarizes the Statements of Fiduciary Net Assets (in millions):

<b>Assets</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Investments	\$ 5,560.3	\$ 5,002.9	\$ 4,207.6
Other Assets	626.8	656.2	469.1
<b>Total Assets</b>	<b>6,187.1</b>	<b>5,659.1</b>	<b>4,676.7</b>
<b>Total Liabilities</b>	<b>759.3</b>	<b>732.3</b>	<b>469.1</b>
<b>Net Assets Held in Trust</b>	<b>\$ 5,427.8</b>	<b>\$ 4,926.8</b>	<b>\$ 4,207.6</b>

## Statements of Changes in Fiduciary Net Assets

Changes in fiduciary net assets as presented on the Statements of Changes in Fiduciary Net Assets are based on activity of the Fund. The purpose of these statements is to present additions to the Fund resulting from net investment income and participant contributions and to present deductions from the Fund resulting from participant distributions.

The net increase in investments of the Fund was \$453.8 million during the year ended August 31, 2006 compared to the net increase in of investments of \$689.8 million for the year ended August 31, 2005. Expenses totaled \$38.2 million, \$23.1 million, and \$10.7 million, respectively, for the years ended August 31, 2006, 2005, and 2004.

# THE UNIVERSITY OF TEXAS SYSTEM GENERAL ENDOWMENT FUND

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The net increase in fiduciary net assets totaled \$501.0 million for the fiscal year ended August 31, 2006 compared to a net increase in fiduciary net assets totaling \$719.2 million for the fiscal year ended August 31, 2005.

The following summarizes the Statements of Changes in Fiduciary Net Assets (in millions):

	2006	2005	2004
Investment Income	\$ 593.3	\$ 814.2	\$ 560.2
Less Investment Expenses	(38.2)	(23.1)	(10.7)
Net Investment Income	555.1	791.1	549.5
Participant Contributions	273.9	139.2	308.9
Total Additions	829.0	930.3	858.4
Participant Withdrawals	328.0	211.1	235.6
Total Deductions	328.0	211.1	235.6
Change in Fiduciary Net Assets	501.0	719.2	622.8
Net Assets Held in Trust, Beginning of Period	4,926.8	4,207.6	3,584.8
Net Assets Held in Trust, End of Period	\$ 5,427.8	\$ 4,926.8	\$ 4,207.6

## Contacting UTIMCO

The above financial highlights are designed to provide a general overview of the Fund's investment results and insight into the following financial statements. Additional information may be found on our website and inquiries may be directed to UTIMCO via [www.utimco.org](http://www.utimco.org).

**THE UNIVERSITY OF TEXAS SYSTEM  
GENERAL ENDOWMENT FUND**

**Statements of Fiduciary Net Assets**

August 31, 2006 and 2005

(Dollars in thousands, except per unit amounts)

<b>Assets</b>	<b>2006</b>	<b>2005</b>
Investments		
Equity Securities	\$ 806,951	\$ 963,605
Preferred Stock	2,771	2,808
Purchased Options	25,853	10,867
Debt Securities	1,070,164	880,521
Convertible Securities	16	4,022
Investment Funds	3,126,170	2,619,756
Cash and Cash Equivalents	528,367	521,304
<b>Total Investments</b>	<b>5,560,292</b>	<b>5,002,883</b>
Collateral for Securities Loaned, at Fair Value	471,382	494,069
Deposit with Brokers for Derivative Contracts	56,937	30,429
Deposit with Brokers for Securities Sold Short	4,030	-
Swaps, at Fair Value	2,579	6,477
Unrealized Gains on Foreign Currency Exchange Contracts	6,688	5,591
Receivables		
Investment Securities Sold	70,576	109,587
Accrued Income	13,754	10,099
Other	865	-
<b>Total Receivables</b>	<b>85,195</b>	<b>119,686</b>
<b>Total Assets</b>	<b>6,187,103</b>	<b>5,659,135</b>
<b>Liabilities</b>		
Payable to Participants	2,092	1,547
Payable Upon Return of Securities Loaned	471,382	494,069
Written Options, at Fair Value	41,531	19,152
Swaps, at Fair Value	11,628	7,048
Securities Sold Short, at Fair Value	4,569	-
Unrealized Losses on Foreign Currency Exchange Contracts	9,837	4,525
Payables		
Investment Securities Purchased	210,687	197,646
Other	7,622	8,351
<b>Total Payables</b>	<b>218,309</b>	<b>205,997</b>
<b>Total Liabilities</b>	<b>759,348</b>	<b>732,338</b>
<b>Net Assets Held in Trust</b>	<b>\$ 5,427,755</b>	<b>\$ 4,926,797</b>
<b>Number of Units:</b>		
Permanent Health Fund (PHF)	6,359,817	6,628,710
The University of Texas System Long Term Fund (LTF)	28,623,092	28,652,350
<b>Total</b>	<b>34,982,909</b>	<b>35,281,060</b>
<b>Net Asset Value Held in Trust Per Unit</b>	<b>\$ 155.154</b>	<b>\$ 139.644</b>

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

**THE UNIVERSITY OF TEXAS SYSTEM  
GENERAL ENDOWMENT FUND**

**Statements of Changes in Fiduciary Net Assets**

*Years Ended August 31, 2006 and 2005*

*(in thousands)*

	<u>2006</u>	<u>2005</u>
<b>Additions</b>		
Investment Income		
Net Increase in Investments	\$ 453,778	\$ 689,817
Interest	76,993	54,685
Dividends	28,590	41,765
Income Distributions from Private Market Investment Funds	10,742	14,740
Securities Lending Income	22,253	12,527
Other	961	648
Total Investment Income	<u>593,317</u>	<u>814,182</u>
Less Investment Expenses		
Investment Management	15,398	10,031
Securities Lending Fees	21,035	11,157
Consulting Fees	385	405
Custodial Fees and Expenses	798	884
Legal Fees	243	317
Analytical and Risk Measurement Fees	255	276
Other Expenses	80	54
Total Investment Expenses	<u>38,194</u>	<u>23,124</u>
Net Investment Income	555,123	791,058
Participant Contributions	273,830	139,205
<b>Total Additions</b>	<u>828,953</u>	<u>930,263</u>
<b>Deductions</b>		
Participant Withdrawals	327,995	211,110
<b>Total Deductions</b>	<u>327,995</u>	<u>211,110</u>
<b>Change in Fiduciary Net Assets</b>	500,958	719,153
Net Assets Held in Trust, Beginning of Period	4,926,797	4,207,644
<b>Net Assets Held in Trust, End of Period</b>	<u>\$ 5,427,755</u>	<u>\$ 4,926,797</u>

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



# THE UNIVERSITY OF TEXAS SYSTEM

## GENERAL ENDOWMENT FUND

### *Notes to Financial Statements*

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#### **Note 1 – Organization and Basis of Presentation**

The University of Texas System General Endowment Fund (Fund), created March 1, 2001, is a pooled fund established for the collective investment of long-term funds under the control and management of the Board of Regents of The University of Texas System (Board of Regents). The Fund is organized as a mutual fund and has two participants, the Permanent Health Fund (PHF) and The University of Texas System Long Term Fund (LTF). The PHF and LTF initially purchased units of the Fund on March 1, 2001, in exchange for the contribution of their investment assets. The Fund provides for greater diversification of investments than would be possible if each account were managed separately.

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 Services Agreement with the Board of Regents.

The activities of the Fund are accounted for as a fiduciary fund. The financial statements of the Fund use an economic resources management focus and the accrual basis of accounting, whereby revenues are recorded when earned and expenses are recorded when a liability is incurred regardless of the timing of cash flows. The Fund is subject to the pronouncements of the Governmental Accounting Standards Board (GASB).

The annual combined financial statements of UT System are prepared in accordance with the Texas Comptroller of Public Accounts' Annual Financial Reporting Requirements and include information related to the Fund. The accompanying financial statements may differ in presentation from the 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 pricing 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).

Private market investment funds and other equity securities are valued using the equity method of accounting using the partnership's capital account balance at the closest available reporting period (usually June 30), as communicated by the general partner, adjusted for contributions and withdrawals subsequent to the last available reporting period. In the rare case no ascertainable value is available, the private market investment funds are valued at cost.

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

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Securities held by the Fund in index funds and exchange traded 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.

Marketable alternative, U.S. equity, non-U.S. developed equity, emerging market and fixed income investment funds and certain other investment funds are valued using the equity method of accounting based on net asset value information provided by the investment company.

(B) ***Foreign Currency Translation*** -- The accounting records of the Fund are maintained in U.S. dollars. Investments in securities are valued at the daily rates of exchange on the valuation date. 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. The Fund does not isolate that portion of the results of the change in fiduciary net assets resulting from changes in foreign exchange rates on investments from fluctuations arising from changes in market prices of securities held. Such fluctuations are included with the net increase in investments.

(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. Investment income includes net realized and unrealized currency gains and losses recognized between accrual and payment dates on dividend and interest transactions. Premiums and discounts on bonds are not amortized.

(D) ***Security Transactions*** -- Security transactions are recorded on a trade date basis. 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 Participants*** -- The Fund, for accounting purposes, allocates its net investment income and realized gain or loss to the PHF and LTF monthly, based on their ownership of Fund units at month end. The allocated investment income and realized gain amounts increase the cost basis of the units of the Fund, and any allocated realized losses reduce the cost basis of the units of the Fund. Since the allocation is proportional to the percentage ownership by the PHF and LTF, no additional units are purchased.

(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. 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.

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

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(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 accounting principles generally accepted in the United States of America 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.

(K) **Derivative Applications** -- Derivative securities are financial instruments whose value is derived, in whole or part, from the value of any one or more underlying securities or assets, or index of securities or assets, such as stocks, bonds, commodities, or currencies. The Fund from time to time uses various derivative applications, as allowed under Board of Regent approved investment policy guidelines. These derivative applications are utilized in compliance with a derivative investment policy established by the UTIMCO Board of Directors, and by guidelines established in contracts with external investment managers. Futures contracts are valued at closing market prices on valuation date. Written options and swaps are valued by using independent broker quotes or using models with externally verifiable model inputs. Derivative applications included under these policies and contracts include futures, forwards, swaps and all forms of options. Derivative applications in the Fund are used to achieve the following objectives:

- implement investment strategies in a low cost and efficient manner,
- alter the Fund's market (systematic) exposure without trading the underlying cash market securities,
- construct portfolios with risk and return characteristics that could not be created with cash market securities,
- hedge and control risks so that the Fund's risk/return profile is more closely aligned with the Fund's targeted risk/return profile, and
- facilitate transition trading.

Through the use of derivative applications, the complex risks that are bound together in traditional cash market investments can be separated and managed independently. The primary intent of the Fund's investment in derivative securities is to hedge its risk or to implement investment strategies more effectively and at a lower cost than would be possible in the cash market.

*Options Written* -- When the Fund writes an option, an amount equal to the premium received by the Fund is recorded as a liability and is subsequently adjusted to the current fair value of the option written. Premiums received from writing options that expire unexercised are treated by the Fund on the expiration date as realized gains from investments. The difference between the premium and the amount paid on effecting a closing purchase transaction, including brokerage commissions, is also treated as a realized gain, or, if the premium is less than the amount paid for the closing purchase transaction, as a realized loss. If a call option is exercised, the premium is added to the proceeds from the sale of the underlying security or currency in determining whether the Fund has realized a gain or loss. If a put option is exercised, the premium reduces the cost basis of the securities purchased by the Fund. The Fund as writer of an option bears the market risk of an unfavorable change in the price of the security underlying the written option.

# THE UNIVERSITY OF TEXAS SYSTEM

## GENERAL ENDOWMENT FUND

### *Notes to Financial Statements (cont.)*

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Options are marked to market on a daily basis, and are included as a liability on the statements of fiduciary net assets.

*Swaps* -- Swaps are agreements between two parties to exchange periodic payments on the notional value of the contract multiplied by a stated fixed interest rate versus a stated floating interest rate, or on a commodity sector return versus a specified cost per contract. Swaps are marked to market on a daily basis, and are included at fair value in the statements of fiduciary net assets. Cash flows occur when a swap is opened, when it resets, if or when it is prematurely terminated by both parties to the agreement, and when it reaches maturity. The frequency of the resets is defined by the term sheet of the particular swap agreement, and varies from instrument to instrument.

*Futures Contracts* -- The Fund enters into futures contracts to facilitate various trading strategies, primarily as a tool to increase or decrease market exposure to various asset classes. Upon entering into a futures contract, initial margin deposit requirements are satisfied by the segregation of specific securities as collateral for the account of the broker (the Fund's agent in acquiring the futures position). During the period the futures positions are open, the contracts are marked to market daily; that is, they are valued at the close of business each day, and a gain or loss is recorded between the value of the contracts that day and on the previous day. The daily gain or loss is referred to as the daily variation margin which is settled in cash with the broker each morning for the amount of the previous day's mark to market. The amount that is settled in cash with the broker each morning is the carrying and fair value of the futures contracts, and is included as an other receivable or other payable on the statements of fiduciary net assets. The Fund executes such contracts either on major exchanges or with major international financial institutions and minimizes market and credit risk associated with these contracts through the managers' various trading and credit monitoring techniques.

*Foreign Currency Contracts* -- The Fund enters into forward foreign currency exchange contracts to hedge against foreign currency exchange rate risks on its non-U.S. dollar denominated investment securities and to facilitate trading strategies primarily as a tool to increase or decrease market exposure to various foreign currencies. When entering into a forward foreign currency contract, the Fund agrees to receive or deliver a fixed quantity of foreign currency for an agreed-upon price on an agreed future date. These contracts are valued daily and the Fund's net equity therein, representing unrealized gain or loss on the contracts as measured by the difference between the forward foreign exchange rates at the dates of entry into the contracts and the forward rates at the reporting date, is included in the statements of fiduciary net assets. Realized and unrealized gains and losses are included in the statements of changes in fiduciary net assets. These instruments involve market and/or credit risk in excess of the amount recognized in the statements of fiduciary net assets. Risks arise from the possible inability of counterparties to meet the terms of their contracts and from movement in currency and securities values and interest rates.

(L) *Securities Sold Short* -- The Fund may sell securities it does not own in anticipation of a decline in the fair value of that security. When the Fund sells a security short, it must borrow the security sold short and deliver it to the broker-dealer through which it made the short sale as collateral for its obligation to deliver the security upon conclusion of the sale. The Deposit with Broker for Securities Sold Short was \$4,030,234 as of August 31, 2006. The market value of securities sold short as of August 31, 2006 was \$4,568,973. The Fund must pay dividends or interest on the securities sold short. Until the Fund covers its short sales, it is exposed to market risk to the extent

# THE UNIVERSITY OF TEXAS SYSTEM

## GENERAL ENDOWMENT FUND

*Notes to Financial Statements (cont.)*

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that subsequent market fluctuations may require purchasing securities sold short at prices which may be significantly higher than the market value reflected in the statement of fiduciary net assets.

(M) **Cash and Cash Equivalents** -- Cash and Cash Equivalents consist of money markets, foreign currencies and other overnight funds. A portion of the Fund's cash and cash equivalents are maintained to support the notional value of futures contracts held (see Note 8). Cash and cash equivalents are an integral part of the Fund's investment activities, and as such are included in the investments balance on the statement of fiduciary net assets.

(N) **Reclassifications** -- Certain items in the 2005 financial statements and related notes have been reclassified to conform with 2006 classification.

### Note 3 – Investment Risk

The investment risk disclosure that follows relates to the Fund's investments before securities lending transactions and the investment of cash collateral. Disclosures relating to securities lending are provided in Note 4.

#### (A) **Credit Risk**

Article VII, Section 11b of the Texas Constitution authorizes the Board of Regents, subject to procedures and restrictions it establishes, to invest the Permanent University Fund (the "PUF") in any kind of investment and in amounts it considers appropriate, provided that it adheres to the prudent investor standard. This standard provides that the Board of Regents, in making investments, may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment that prudent investors, exercising reasonable care, skill and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all of the assets of the fund rather than a single investment. Pursuant to Section 51.0031(c) of the Texas Education Code, the Board of Regents has elected the PUF prudent investor standard to govern its management of the Fund.

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). The Fund's investment policy limits investments in U.S. Domestic bonds and non-dollar denominated bond investments to those that are rated investment grade, Baa3 or better by Moody's Investor Services, BBB- or better, by Standard & Poor's Corporation, or BBB- or better, by Fitch Investors Service at the time of acquisition. This requirement does not apply to investment managers that are authorized by the terms of an investment advisory agreement to invest in below investment grade bonds. Per GASB Statement No. 40 (GASB 40), *Deposit and Investment Risk Disclosures, an amendment to GASB Statement No. 3*, unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. GASB 40 also provides that securities with split ratings, or a different rating assignment between NRSROs, are disclosed using the rating indicative of the greatest degree of risk. The following table presents each applicable investment type grouped by rating as of August 31, 2006 and 2005.

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

Investment Type	August 31,		Rating
	2006	2005	
<b>Investments, at Fair Value:</b>			
U.S. Government Guaranteed	\$ 488,621,082	\$ 410,926,435	Exempt from Disclosure
U.S. Government Non-Guaranteed:			
U.S. Agency	14,753,501	41,600,824	AAA
U.S. Agency	-	3,486,600	A
U.S. Agency Asset Backed	<u>165,335,521</u>	<u>189,909,004</u>	AAA
Total U.S. Government Non-Guaranteed	<u>180,089,022</u>	<u>234,996,428</u>	
Total U.S. Government	<u>668,710,104</u>	<u>645,922,863</u>	
Corporate Obligations:			
Domestic	32,549,255	26,227,562	AAA
Domestic	5,259,513	3,987,292	AA
Domestic	17,274,534	26,568,844	A
Domestic	22,175,891	18,283,032	BAA/BBB
Domestic	-	5,738,898	BBB
Domestic	148,706	4,023,428	BAA
Domestic	3,429,835	5,715,758	BA/BB
Domestic	282,258	2,325,452	BB
Domestic	798,730	237,670	BA
Domestic	5,815,053	2,865,309	B
Domestic	171,688	299,038	CAA
Domestic	-	277,212	CA
Domestic	117,588	-	CCC
Domestic	10,518	1,530,659	Rating Withdrawn
Commercial Paper	101,990,653	30,260,619	P
Commercial Paper	125,635,303	-	A
Foreign	5,162,532	7,389,342	AAA
Foreign	3,361,173	2,161,106	AA
Foreign	8,317,931	5,736,190	A
Foreign	7,068,373	2,533,357	BAA/BBB
Foreign	-	216,227	BBB
Foreign	-	358,133	BAA
Foreign	-	99,225	BA/BB
Foreign	-	28,710	B
Total Corporate Obligations	<u>339,569,534</u>	<u>146,863,063</u>	
Foreign Government and Provincial Obligations	37,106,962	55,025,083	AAA
Foreign Government and Provincial Obligations	11,827,719	11,543,947	AA
Foreign Government and Provincial Obligations	3,640,494	1,563,171	A
Foreign Government and Provincial Obligations	1,918,085	4,528,262	BAA/BBB
Foreign Government and Provincial Obligations	-	211,300	BAA
Foreign Government and Provincial Obligations	1,468,500	3,789,780	BA
Foreign Government and Provincial Obligations	-	<u>573,976</u>	B
Total Foreign Government and Provincial Obligations	<u>55,961,760</u>	<u>77,235,519</u>	
Other Debt Securities	1,598,754	4,205,197	AAA
Other Debt Securities	586,557	1,189,058	AA
Other Debt Securities	-	1,196,629	A
Other Debt Securities	<u>3,737,606</u>	<u>3,908,654</u>	BAA/BBB
Total Other Debt Securities	<u>5,922,917</u>	<u>10,499,538</u>	
Total Debt Securities	<u>\$ 1,070,164,315</u>	<u>\$ 880,520,983</u>	
Other Investment Funds - Debt	\$ 35,725,669	\$ 1,073,218	AAA
Other Investment Funds - Debt	51,724,323	-	AA
Other Investment Funds - Debt	<u>4,388,793</u>	<u>11,808,257</u>	BB
Total Other Investment Funds - Debt	<u>\$ 91,838,785</u>	<u>\$ 12,881,475</u>	
Cash and Cash Equivalents - Money Market Funds	\$ 521,860,064	\$ 510,611,287	AAA
Cash and Cash Equivalents - Other	6,506,854	10,692,712	Exempt from Disclosure
Total Cash and Cash Equivalents	<u>\$ 528,366,918</u>	<u>\$ 521,303,999</u>	
<b>Deposit with Brokers for Derivative Contracts:</b>			
U.S. Government Guaranteed	\$ 44,052,195	\$ 26,536,568	Exempt from Disclosure
Cash	<u>12,884,683</u>	<u>3,892,797</u>	Exempt from Disclosure
	<u>\$ 56,936,878</u>	<u>\$ 30,429,365</u>	
<b>Deposit with Broker for Securities Sold Short:</b>			
Cash	\$ 4,030,234	\$ -	Exempt from Disclosure
	<u>\$ 4,030,234</u>	<u>\$ -</u>	

# THE UNIVERSITY OF TEXAS SYSTEM

## GENERAL ENDOWMENT FUND

*Notes to Financial Statements (cont.)*

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### *(B) Concentrations of Credit Risk*

The Fund's investment policy statement contains the limitation that no more than 5% of the market value of domestic fixed income securities may be invested in corporate or municipal bonds of a single issuer. The Fund does not hold any direct investments in any one issuer that represents five percent or more of total investments.

### *(C) Custodial Credit Risk*

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Fund will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Fund will not be able to recover the value of its investment or collateral securities that are in the possession of another party. Texas State Statutes and the Fund's investment policy statements do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments. As of August 31, 2006 and 2005, the Fund does not have any investments that are exposed to custodial credit risk.

### *(D) Interest Rate Risk*

Interest rate risk is the risk that changes in market interest rates will adversely affect the value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its value to changes in market interest rates. Interest rate risk inherent in the Fund is measured by monitoring the modified duration of the overall investment portfolio. Modified duration estimates the sensitivity of the Fund's investments to changes in interest rates. The Fund has no specific policy statement limitations with respect to its overall modified duration. The following table summarizes the Fund's modified duration by investment type at August 31, 2006 and 2005.

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

Investment Type	August 31,			
	2006		2005	
	Value	Modified Duration	Value	Modified Duration
<b>Investments in Securities:</b>				
U.S. Government Guaranteed:				
U.S. Treasury Bonds and Notes	\$ 123,394,180	7.28	\$ 113,343,204	6.47
U.S. Treasury Strips	2,924,111	5.00	3,650,520	6.00
U.S. Treasury Bills	4,977,641	0.04	7,027,898	0.15
U.S. Treasury Inflation Protected	355,036,247	7.91	284,511,840	8.03
U.S. Agency Asset Backed	<u>2,288,903</u>	5.88	<u>2,392,973</u>	2.34
Total U.S. Government Guaranteed	<u>488,621,082</u>	7.65	<u>410,926,435</u>	7.42
U.S. Government Non-Guaranteed:				
U.S. Agency	14,753,501	3.05	45,087,424	5.21
U.S. Agency Asset Backed	<u>165,335,521</u>	5.46	<u>189,909,004</u>	3.39
Total U.S. Government Non-Guaranteed	<u>180,089,022</u>	5.26	<u>234,996,428</u>	3.74
Total U.S. Government	<u>668,710,104</u>	7.00	<u>645,922,863</u>	6.08
Corporate Obligations:				
Domestic	88,305,907	4.41	98,080,155	5.06
Commercial Paper	227,353,618	0.07	30,260,618	0.23
Foreign	<u>23,910,009</u>	11.18	<u>18,522,290</u>	6.80
Total Corporate Obligations	<u>339,569,534</u>	1.98	<u>146,863,063</u>	4.28
Foreign Government and Provincial Obligations	<u>55,961,760</u>	6.52	<u>77,235,519</u>	8.69
Other Debt Securities	<u>5,922,917</u>	12.30	<u>10,499,538</u>	11.31
Total Debt Securities	<u>1,070,164,315</u>	5.41	<u>880,520,983</u>	5.90
Other Investment Funds - Debt	<u>91,838,784</u>	3.77	<u>12,881,475</u>	5.97
Cash and Cash Equivalents:				
Money Market Funds	521,860,064	0.08	510,611,287	0.08
Other	<u>6,506,854</u>	-	<u>10,692,712</u>	-
Total Cash and Cash Equivalents	<u>528,366,918</u>	0.08	<u>521,303,999</u>	0.08
Total	<u>\$ 1,690,370,017</u>	3.66	<u>\$ 1,414,706,457</u>	3.76
<b>Deposit with Brokers for Derivative Contracts:</b>				
U.S. Government Guaranteed:				
U.S. Treasury Bonds and Notes	\$ -	-	\$ 110,176	0.41
U.S. Treasury Bills	42,900,178	0.15	25,280,888	0.21
U.S. Treasury Inflation Protected	<u>1,152,017</u>	0.36	<u>1,145,504</u>	1.33
Total U.S. Government Guaranteed	<u>44,052,195</u>	0.16	<u>26,536,568</u>	0.26
Cash	<u>12,884,683</u>	-	<u>3,892,797</u>	-
Total Deposit with Brokers for Derivative Contracts	<u>\$ 56,936,878</u>	0.11	<u>\$ 30,429,365</u>	0.22
<b>Deposit with Broker for Securities Sold Short:</b>				
Cash	<u>\$ 4,030,234</u>	-	<u>\$ -</u>	-

**(E) Investments with Fair Values That Are Highly Sensitive to Interest Rate Changes**

In accordance with the Fund's investment policy statement, the Fund may invest in various mortgage backed securities, such as collateralized mortgage backed obligations. The Fund also may invest in investments that have floating rates with periodic coupon changes in market rates, zero coupon bonds and stripped Treasury and Agency securities created from coupon securities. As of August 31, 2006 and 2005, the Fund's investments include the following investments that are highly sensitive to interest rate changes:

Collateralized mortgage obligations which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will



# THE UNIVERSITY OF TEXAS SYSTEM

## GENERAL ENDOWMENT FUND

### *Notes to Financial Statements (cont.)*

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affect the fair value of these securities. These securities amounted to \$36,102,174 and \$50,062,056 as of August 31, 2006 and 2005, respectively.

Mortgage backed securities which are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows will affect the fair value of these securities. These securities amounted to \$152,326,777 and \$97,192,500 as of August 31, 2006 and 2005, respectively.

Asset backed securities which are backed by home equity loans, auto loans, equipment loans and credit card receivables. Prepayments by the obligees of the underlying assets in periods of decreasing interest rates could reduce or eliminate the stream of income that would have been received. These securities amounted to \$13,242,548 and \$11,047,555, as of August 31, 2006 and 2005, respectively.

Step-up notes that grant the issuer the option to call the note on certain specified dates. At each call date, should the issuer not call the note, the coupon rate of the note increases (steps up) by an amount specified at the inception of the note. The call feature embedded within a step-up note causes the fair value of the instrument to be considered highly sensitive to interest rate changes. These securities amounted to \$1,983,815 and \$4,967,598 as of August 31, 2006 and 2005, respectively.

#### *(F) Foreign Currency Risk*

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of the Fund's non-U.S. dollar investments. The Fund's investment policy statement limits investments in non-U.S. denominated bonds to 50% of the Fund's total fixed income exposure. The following table summarizes the Fund's exposure to non-U.S. dollar investments at August 31, 2006 and 2005:

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

Investment Type	August 31,	
	2006	2005
<b>Foreign Common Stock:</b>		
Australian Dollar	\$ 8,534,198	\$ 10,124,785
Canadian Dollar	37,669,008	36,684,222
Swiss Franc	5,094,521	7,802,018
Danish Krone	1,870,287	2,446,779
Euro	22,362,906	61,022,142
UK Pound	27,234,609	21,563,653
Hong Kong Dollar	11,269,939	3,920,523
Japanese Yen	122,721,691	104,257,087
South Korean Won	3,365,746	1,609,388
New Zealand Dollars	363,707	-
Norwegian Krone	2,919,601	9,780,475
Swedish Krona	3,551,759	4,338,954
Singapore Dollar	5,736,852	5,665,952
Total Foreign Common Stock	<u>252,694,824</u>	<u>269,215,978</u>
<b>Other - Equity Securities</b>		
Canadian Dollar	26	-
<b>Foreign Government and Provincial Obligations:</b>		
Australian Dollar	-	445,031
Canadian Dollar	127,064	432,652
Danish Krone	499,411	508,675
Euro	44,776,200	57,153,201
Japanese Yen	2,199,641	-
New Zealand Dollar	336,342	810,244
Polish Zloty	1,822,456	1,563,171
UK Pound	-	5,420,008
Total Foreign Government and Provincial Obligations	<u>49,761,114</u>	<u>66,332,982</u>
<b>Corporate Obligations:</b>		
Euro	10,959,086	7,644,464
UK Pound	766,612	752,506
Japanese Yen	1,716,000	-
Total Corporate Obligations	<u>13,441,698</u>	<u>8,396,970</u>
<b>Purchased Options:</b>		
Canadian Dollar	36,275	676,961
Euro	511,229	36,207
UK Pound	77,456	-
Japanese Yen	1,686,811	-
Total Purchased Options	<u>2,311,771</u>	<u>713,168</u>
<b>Private Market Investment Funds:</b>		
Euro	57,393,661	49,292,741
UK Pound	2,729,729	4,367,073
Total Private Market Investment Funds	<u>60,123,390</u>	<u>53,659,814</u>
<b>Cash and Cash Equivalents:</b>		
Australian Dollar	90,778	63,237
Canadian Dollar	689,056	3,422,722
Swiss Franc	48,778	43,231
Danish Krone	17,437	23,105
Euro	1,031,350	1,425,974
UK Pound	507,356	(36,249)
Hong Kong Dollar	119,521	11,058
Japanese Yen	5,241,463	12,035,227
Mexican New Peso	-	-
Norwegian Krone	40,489	5,225
New Zealand Dollar	280,192	8,229
Polish Zloty	202,922	89,959
Swedish Krona	135,494	4,885
Singapore Dollar	111,956	29,906
New Taiwan Dollar	331	332
Total Cash and Cash Equivalents	<u>8,517,123</u>	<u>17,126,841</u>
Total	<u>\$ 386,849,946</u>	<u>\$ 415,445,753</u>

# THE UNIVERSITY OF TEXAS SYSTEM

## GENERAL ENDOWMENT FUND

Notes to Financial Statements (cont.)

### Note 4 – Securities Lending

In accordance with the prudent investor investment standards, the Fund loans securities to certain brokers who pay the Fund negotiated lenders' fees. These fees are included in investment income and related expenses are included in investment expenses. 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 U.S. issuers and a market value of 105% for loaned securities of non-U.S. issuers. If the market value of the collateral held in connection with loans of securities of U.S. 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-U.S. 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. The value of securities loaned and the value of collateral held are as follows at August 31, 2006 and 2005:

Securities on Loan	2006 Value	2005 Value	Type of Collateral	2006 Value of Collateral	2005 Value of Collateral
U.S. Government	\$337,257,794	\$365,710,122	Cash	\$343,142,005	\$369,426,991
Foreign Government	12,120,643	18,437,869	Cash	12,724,861	19,305,472
Corporate Bonds	4,778,573	4,949,974	Cash	4,898,370	5,084,750
Common Stock	106,120,368	96,373,309	Cash	110,616,706	100,251,659
<b>Total</b>	<b>\$460,277,378</b>	<b>\$485,471,274</b>	<b>Total</b>	<b>\$471,381,942</b>	<b>\$494,068,872</b>
U.S. Government	\$ 22,439,309	\$ 7,564,102	Non-Cash	\$ 22,923,741	\$ 7,824,389
Common Stock	757,036	736,292	Non-Cash	772,367	761,628
<b>Total</b>	<b>\$ 23,196,345</b>	<b>\$ 8,300,394</b>	<b>Total</b>	<b>\$ 23,696,108</b>	<b>\$ 8,586,017</b>

Cash received as collateral for securities lending activities is invested and reinvested in a commingled pool managed exclusively for the benefit of the Fund, the Permanent University Fund, the Intermediate Term Fund and other Board of Regent accounts that participate in securities lending activities. The pool is managed in accordance with investment guidelines established in the securities lending contract between the Fund and its securities lending agent. The maturities of the investments in the pool do not necessarily match the term of the loans, rather the pool is managed to maintain a maximum dollar weighted average maturity of 60 days and an overnight liquidity of 20 percent. Lending income is earned if the returns on those investments exceed the rebate paid to borrowers of the securities. The income remaining after the borrower rebates is then shared with the lending agent on a contractually negotiated split. If the investment of the cash collateral does not provide a return exceeding the rebate or if the investment incurs a loss of principal, the payment of the shortfall to the borrower would come from the Fund and the securities lending agent in the same proportion as the split of income.

The Fund's pro-rata share of collateral pool investments, rating by NRSRO, and weighted average maturity as of August 31, 2006 and 2005, is shown in the following table.

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

Description	August 31,					
	2006			2005		
	Fair Value	Rating	Weighted Average Maturity In Days	Fair Value	Rating	Weighted Average Maturity In Days
		No Rating			No Rating	
Repurchase Agreements	\$ 171,613,892	Available	14	\$ 232,820,580	Available	1
Commercial Paper	204,992,614	P	26	200,108,779	P	36
Floating Rate Notes	26,903,120	AAA		4,522,477	AAA	
Floating Rate Notes	<u>19,323,207</u>	AA		<u>50,608,154</u>	AA	
Total Floating Rate Notes	<u>46,226,327</u>		69	<u>55,130,631</u>		37
Certificates of Deposit	58,979,172	P	67	7,441,140	P	50
Asset Backed Securities	845,390	AAA	11	282,026	AAA	168
Other Receivables/Payables	<u>(11,275,453)</u>	Not Rated	-	<u>(1,714,284)</u>	Not Rated	-
Total Collateral Pool Investment	<u>\$ 471,381,942</u>		31	<u>\$ 494,068,872</u>		20

Collateral pool investments are uninsured, and are held by the securities lending agent, in its name, on behalf of the Fund, except for the investments in repurchase agreements which are held in the securities lending agent's name by a third party custodian not affiliated with the Fund or the borrower of the associated loaned securities. Therefore, the collateral pool is not exposed to custodial credit risk because the pool investments are not held by counterparties to the lending transactions or a counterparties trust department or agent.

Cash collateral is recorded as an asset with an equal and offsetting liability to return the collateral on the statements of fiduciary net assets. Investments received as collateral for securities lending activities are not recorded as assets because the investments remain under the control of the transferor, except in the event of default.

In the event of default, where the borrower is unable to return the securities loaned, the Fund has authorized the securities lending agent to seize the collateral held. The collateral is then used to replace the borrowed securities where possible. Due to some market conditions, it is possible that the original securities cannot be replaced. If the collateral is insufficient to replace the securities, the securities lending agent has indemnified the Fund from any loss due to borrower default.

As of August 31, 2006 and 2005, the Fund had no credit risk exposure to borrowers because the amounts the Fund owed to borrowers exceeded the amounts the borrowers owed the Fund.

There were no significant violations of legal or contractual provisions, no borrower or securities lending agent default losses, and no recoveries of prior period losses during the years ended August 31, 2006 and 2005.

**Note 5 – Investment Funds**

Investment funds include exchange traded funds, index funds, SEC regulated mutual funds and externally managed funds, limited partnerships, and corporate structures which are generally unrated and may be unregulated. The composition of investment funds at August 31, 2006 and 2005 is summarized in the table below as they are classified within the asset mix of the Fund.

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

	August 31,	
	2006	2005
Marketable Alternatives:		
Absolute Return Strategies	\$957,363,306	\$767,923,000
Directional Equity	455,192,610	428,609,676
Total Marketable Alternatives	<u>1,412,555,916</u>	<u>1,196,532,676</u>
Private Markets	586,501,102	493,180,684
Public Markets:		
U.S. Equity:		
Private Placements	373,228,158	208,036,046
Exchange Traded Funds	187,232,146	91,403,952
Index Funds	-	243,388,656
Total U.S. Equity	<u>560,460,304</u>	<u>542,828,654</u>
Non-U.S. Developed Equity:		
Private Placements	175,306,690	25,979,312
Exchange Traded Funds	-	10,485,739
Index Funds	-	187,152,260
Total Non-U.S. Developed Equity	<u>175,306,690</u>	<u>223,617,311</u>
Emerging Markets:		
Private Placements	197,565,210	23,264,465
Exchange Traded Funds	11,312,673	27,803,275
Publicly Traded Mutual Funds	90,629,502	69,955,152
Index Funds	-	29,692,702
Total Emerging Markets	<u>299,507,385</u>	<u>150,715,594</u>
Fixed Income:		
Private Placements	86,282,693	-
Publicly Traded Mutual Funds	5,556,091	12,881,475
Total Fixed Income	<u>91,838,784</u>	<u>12,881,475</u>
Total Investment Funds	<u>\$3,126,170,181</u>	<u>\$2,619,756,394</u>

Marketable alternatives funds are invested in private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These investment managers may invest in both long and short securities and may utilize leverage in their portfolios. The funds invested may be subject to a lock-up restriction of one or more years before the investment may be withdrawn from the manager without significant penalty. There are certain risks associated with these private placements, some of which include investment manager risk, market risk, and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Private markets funds are invested in limited partnerships with external investment managers or general partners who invest primarily in private equity securities. These investments are domestic and international, are illiquid and may not be realized for a period of several years after the investments are made. There are certain risks associated with these investments, some of which are liquidity risk, market risk, event risk, and investment manager risk. The Fund has committed \$537,430,747 of future funding to various private market investments as of August 31, 2006.

Public market funds are invested in exchange traded funds, index funds, and private placements with external investment managers who invest in equity and fixed income securities of both domestic and international issuers. These funds are characterized as public market funds based on individual risk/return characteristics and their relationship to the overall asset mix of the Fund. Some of these investment managers may invest in both long and short securities and may utilize modest leverage in their portfolios. There are certain risks associated with these investments, some of which are

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

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investment manager risk, market risk, and liquidity risk, as well as the risk of utilizing leverage in the portfolios.

Marketable alternative, private market, and public market funds include investments in private placement vehicles that are subject to risk which could result in the loss of invested capital. The risks include the following:

- *Non-regulation risk* -- Some of these funds are not registered with the Securities Exchange Commission, and therefore are not subject to regulatory controls.
- *Key personnel risk* -- The success of certain funds is substantially dependent on key investment managers and the loss of those individuals may adversely impact the fund's performance.
- *Liquidity risk* -- Many of the Fund's investment funds may impose lockup periods which would cause the Fund to incur penalties to redeem its units or prevent the Fund from redeeming its shares until a certain period of time has elapsed.
- *Limited transparency* -- As private placement investment vehicles, these funds may not disclose the holdings of their portfolios.
- *Investment strategy risk* -- These funds often employ sophisticated investment strategies and may use leverage which could result in the loss of invested capital.

**Note 6 – Written Options**

During the year, the Fund wrote call options on Treasury note, commodity, and domestic and international equity index and exchange traded fund futures. Transactions in call options written during the year ended August 31, 2006 were as follows:

	<b>Contracts</b>	<b>Premiums Received</b>
Call Options Outstanding at August 31, 2005	793,182	\$ 2,707,781
Options Written	1,163,673	4,347,219
Options Expired	(256,526)	(2,954,187)
Options Exercised	(980)	(164,148)
Options terminated in closing purchase transactions	(11,976)	(399,534)
Call Options Outstanding at August 31, 2006	<u>1,687,373</u>	<u>\$ 3,537,131</u>

As of August 31, 2006, an amount of \$26,232,821 is included on the statement of fiduciary net assets as options written, at fair value. The Fund recognized losses of \$26,016,771 on call options written for the year ended August 31, 2006.

During the year ended August 31, 2005, the Fund wrote call options on Treasury note, commodity, and domestic and international equity index and exchange traded fund futures. Transactions in call options written during the year ended August 31, 2005, were as follows:

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

	<u>Contracts</u>	<u>Premiums Received</u>
Call Options Outstanding at August 31, 2004	75	\$ 40,735
Options Written	794,139	3,040,599
Options Expired	(957)	(332,818)
Options Exercised	(75)	(40,735)
Call Options Outstanding at August 31, 2005	<u>793,182</u>	<u>\$ 2,707,781</u>

As of August 31, 2005 an amount of \$16,824,170 is included on the statement of fiduciary net assets as written options at fair value. The Fund recognized losses in the amount of \$13,784,662 on call options written for the year ended August 31, 2005.

During the year ended August 31, 2006, the Fund wrote put options on Treasury note, commodity, and domestic and international equity index and exchange traded fund futures. Transactions in put options written during the year ended August 31, 2006, were as follows:

	<u>Contracts</u>	<u>Premiums Received</u>
Put Options Outstanding at August 31, 2005	662,365	\$ 185,726
Options Written	1,306,304	5,566,095
Options Expired	(145,241)	(633,568)
Options Exercised	(127,931)	(311,587)
Options terminated in closing purchase transactions	(84,712)	(2,767,402)
Put Options Outstanding at August 31, 2006	<u>1,610,785</u>	<u>\$ 2,039,264</u>

As of August 31, 2006, an amount of \$15,297,808 is included on the statement of fiduciary net assets as written options at fair value. The Fund recognized gains in the amount of \$13,868,529 on put options written for the year ended August 31, 2006.

The Fund also wrote put options on Treasury note and domestic and international equity index futures during the year ended August 31, 2005. Transactions in put options written during the year ended August 31, 2005, were as follows:

	<u>Contracts</u>	<u>Premiums Received</u>
Put Options Outstanding at August 31, 2004	-	\$ -
Options Written	752,351	845,288
Options Expired	(89,596)	(547,632)
Options Exercised	(390)	(111,930)
Put Options Outstanding at August 31, 2005	<u>662,365</u>	<u>\$ 185,726</u>

As of August 31, 2005, an amount of \$2,327,984 is included on the statement of fiduciary net assets as written options at fair value. The Fund recognized gains in the amount of \$1,595,143 on put options written for the year ended August 31, 2005.

**Note 7 – Swaps**

During the fiscal year ended August 31, 2006, the Fund entered into interest rate, credit default and commodity swap contracts. The following discloses the notional amount, the coupon rate, and the fair values of the outstanding swap contracts as of August 31, 2006:

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

Currency	Coupon	Notional Value	Maturity Date	Fair Value at August 31, 2006	
				Assets	Liabilities
<b>Interest Rate</b>					
<b>Australian Dollar</b>					
	6.000%	\$ 1,000,000	6/20/2009	\$ -	\$ 3,451
	6.000%	18,700,000	6/15/2010	-	117,590
	6.000%	10,700,000	6/15/2015	93,426	-
<b>UK Pound</b>					
	4.250%	2,800,000	6/12/2036	191,708	-
	4.500%	10,300,000	9/15/2017	22,521	-
	5.000%	-	9/7/2006	-	5,706
	5.000%	-	9/8/2006	-	31,956
	5.000%	1,500,000	6/15/2008	-	5,842
	5.000%	27,600,000	9/15/2010	-	236,383
	5.000%	1,300,000	9/15/2015	-	10,039
	5.000%	500,000	6/18/2034	72,207	-
<b>Canadian Dollar</b>					
	5.000%	700,000	6/15/2015	24,836	-
	5.500%	-	8/24/2006	-	61,683
<b>Euro</b>					
	2.103%	2,000,000	10/15/2010	2,782	-
	2.146%	400,000	10/15/2010	1,868	-
	4.000%	2,390,000	6/17/2010	-	31,103
	4.000%	10,050,000	6/16/2014	-	98,703
	4.500%	7,600,000	6/17/2015	-	415,551
	5.000%	1,100,000	6/16/2014	106,927	-
	5.000%	300,000	6/17/2015	30,862	-
	6.000%	1,200,000	3/15/2032	156,376	-
	6.000%	1,500,000	6/18/2034	275,841	-
<b>Japanese Yen</b>					
	0.800%	400,000,000	3/30/2012	86,859	-
	1.000%	-	9/18/2008	4,081	-
	2.000%	-	9/4/2006	-	98,489
	2.000%	1,000,000,000	6/20/2010	-	104,070
	2.000%	270,000,000	6/15/2012	-	89,814
	2.000%	875,000,000	12/20/2013	-	594,356
	2.000%	4,110,000,000	12/15/2015	-	568,758
	2.500%	830,000,000	12/15/2035	-	82,882
	5.000%	2,000,000,000	3/18/2008	38,067	-
<b>South Korean Won</b>					
	4.765%	1,050,700,000	2/3/2009	4,644	-
	4.800%	2,508,300,000	2/1/2009	13,252	-
	4.965%	525,400,000	2/3/2011	7,288	-
	4.990%	650,500,000	2/1/2011	9,721	-
	5.000%	543,300,000	2/1/2011	8,349	-
<b>U.S. Dollar</b>					
	4.000%	5,300,000	12/15/2008	-	149,941
	5.000%	29,600,000	12/15/2007	-	72,447
	5.000%	5,400,000	12/20/2008	-	13,891
	5.000%	30,000,000	6/18/2009	-	4,794
	5.000%	5,700,000	12/20/2011	41,254	-
	5.000%	18,700,000	12/20/2013	235,743	-
	5.000%	25,400,000	12/20/2016	550,898	-
	5.000%	200,000	12/20/2026	9,616	-
	5.000%	3,700,000	12/20/2036	-	219,080
	5.500%	2,200,000	12/16/2014	13,286	-
				<u>2,002,412</u>	<u>3,016,529</u>



**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

<u>Currency</u>	<u>Coupon</u>	<u>Notional Value</u>	<u>Maturity Date</u>	<u>Fair Value at August 31, 2006</u>	
				<u>Assets</u>	<u>Liabilities</u>
<b>Commodity</b>					
<b>U.S. Dollar</b>					
	TBILL + 23 Basis Points	\$ 12,770,000	9/26/2006	\$ -	\$ 764,382
	TBILL + 27 Basis Points	31,710,000	9/26/2006	-	1,899,084
				<u>-</u>	<u>2,663,466</u>
<b>Credit Default</b>					
<b>U.S. Dollar</b>					
	0.410%	500,000	6/20/2007	<u>965</u>	<u>-</u>
				<u>965</u>	<u>-</u>
<b>Structured</b>					
<b>U.S. Dollar</b>					
	Emerging	14,000,000	4/7/2007	-	315,099
	Emerging	17,500,000	4/13/2007	-	301,977
	Emerging	14,000,000	4/20/2007	-	175,599
	Emerging	17,500,000	4/27/2007	-	177,459
	Emerging	17,500,000	5/4/2007	-	339,780
	Emerging	8,750,000	5/11/2007	-	204,488
	Emerging	26,250,000	5/18/2007	-	560,775
	Emerging	15,750,000	5/25/2007	-	968,733
	Emerging	26,250,000	6/4/2007	-	2,126,401
	TOPIX	14,000,000	5/4/2007	-	768,238
	TOPIX	11,550,000	4/7/2007	44,799	-
	TOPIX	8,750,000	4/8/2007	172,083	-
	TOPIX	17,500,000	4/9/2007	358,902	-
	TOPIX	4,200,000	4/15/2007	-	9,635
				<u>575,784</u>	<u>5,948,184</u>
				<u>\$ 2,579,161</u>	<u>\$ 11,628,179</u>
<b>Total</b>					

The following discloses the notional amount, the coupon rate, and the fair values of the outstanding swap contracts as of August 31, 2005:

<u>Currency</u>	<u>Coupon</u>	<u>Notional Value</u>	<u>Maturity Date</u>	<u>Fair Value at August 31, 2005</u>	
				<u>Assets</u>	<u>Liabilities</u>
<b>Interest Rate</b>					
<b>Australian</b>					
	6.000%	\$ 4,800,000	6/15/2015	\$ -	\$ 131,074
	6.000%	8,400,000	8/15/2010	142,210	-
	6.000%	5,900,000	6/15/2015	-	160,492
	6.000%	10,300,000	6/15/2015	174,376	-
<b>UK Pound</b>					
	5.000%	900,000	6/18/2034	92,067	-
	5.000%	500,000	6/15/2008	10,391	-
	5.000%	1,000,000	6/15/2008	20,782	-
	5.000%	2,000,000	9/15/2010	94,387	-
	5.000%	5,400,000	9/15/2010	254,846	-
	5.000%	200,000	9/15/2015	-	15,545
	5.000%	1,300,000	9/15/2015	-	101,044
	5.000%	10,100,000	9/15/2010	476,657	-
	5.000%	100,000	9/15/2015	-	7,773
	5.000%	200,000	9/15/2010	9,439	-
	5.000%	4,300,000	9/15/2010	202,933	-
	5.000%	1,000,000	6/18/2034	-	103,077
<b>Canadian</b>					
	5.500%	2,100,000	12/16/2014	-	68,777
	6.000%	700,000	12/16/2019	15,380	-
	5.500%	2,000,000	12/16/2014	-	65,298
	4.500%	300,000	6/15/2025	-	188

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

				<u>Fair Value at August 31, 2005</u>	
<u>Currency</u>	<u>Coupon</u>	<u>Notional Value</u>	<u>Maturity Date</u>	<u>Assets</u>	<u>Liabilities</u>
<b>Interest Rate</b>					
<b>Euro</b>					
	6.000%	\$ 3,600,000	3/15/2032	\$ 594,854	\$ -
	4.000%	800,000	6/17/2010	58,474	-
	4.000%	1,600,000	6/17/2010	116,966	-
	5.000%	1,100,000	6/16/2014	199,438	-
	4.000%	3,190,000	6/17/2010	-	233,164
	5.000%	300,000	6/17/2015	56,528	-
	4.000%	19,550,000	6/16/2014	-	1,694,416
	4.500%	400,000	6/17/2015	-	54,647
	4.500%	800,000	6/17/2015	-	109,294
	4.500%	700,000	6/17/2015	-	95,632
	4.500%	5,700,000	6/17/2015	-	778,716
	4.000%	2,100,000	12/15/2014	-	167,138
	4.000%	200,000	12/15/2014	-	15,918
<b>Japanese Yen</b>					
	0.800%	400,000,000	3/30/2012	24,626	-
	2.000%	545,000,000	12/20/2013	-	323,317
	2.000%	270,000,000	6/15/2012	-	170,101
	1.000%	400,000,000	3/20/2009	25,476	-
<b>U.S. Dollar</b>					
	3.000%	35,700,000	6/15/2006	-	289,378
	3.000%	5,000,000	6/15/2006	-	40,529
	5.500%	1,000,000	12/16/2014	33,214	-
	5.500%	2,300,000	12/16/2014	76,393	-
	5.000%	19,600,000	12/15/2015	-	809,072
	5.000%	7,600,000	12/15/2015	-	313,722
	5.000%	2,400,000	12/15/2015	-	99,070
	5.000%	4,300,000	12/15/2015	-	177,500
	5.000%	5,200,000	12/15/2015	-	214,652
	5.000%	700,000	12/15/2015	-	28,895
	5.000%	2,500,000	12/15/2015	-	103,198
	5.000%	1,400,000	12/15/2015	-	57,791
	5.000%	300,000	12/15/2015	-	12,384
	6.000%	200,000	12/15/2025	-	8,328
	4.000%	1,200,000	12/15/2010	17,088	-
	4.000%	1,500,000	12/15/2010	21,360	-
	4.000%	11,500,000	12/15/2010	163,763	-
	4.000%	1,600,000	12/15/2010	22,784	-
	4.000%	12,400,000	12/15/2010	162,178	-
	4.000%	2,500,000	12/15/2007	12,114	-
	4.000%	200,000	12/15/2007	-	969
	4.000%	100,000	12/15/2007	-	485
	5.000%	16,100,000	12/15/2012	-	581,863
	5.000%	400,000	12/15/2012	-	14,456
	4.000%	20,300,000	12/15/2007	98,365	-
	4.000%	3,900,000	12/15/2010	55,537	-
				3,232,626	7,047,903
<b>Credit Default</b>					
<b>U.S. Dollar</b>					
	3.500%	1,000,000	6/20/2006	16,268	-
<b>Commodity</b>					
<b>U.S. Dollar</b>					
	TBill + 36.5 Basis Points	24,990,395	9/23/2005	944,637	-
	TBill + 45 Basis Points	60,400,000	9/23/2005	2,283,120	-
				3,227,757	-
<b>Total</b>				\$ 6,476,651	\$ 7,047,903

**THE UNIVERSITY OF TEXAS SYSTEM**

**GENERAL ENDOWMENT FUND**

*Notes to Financial Statements (cont.)*

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**Note 8 – Futures Contracts**

During the years ended August 31, 2006 and 2005, the asset classes that used futures include domestic and foreign equities, domestic and foreign debt, and commodities. The Fund had \$44,736,566 and \$30,429,365 on deposit with a broker for collateral as margin for the futures contracts as of August 31, 2006 and 2005, respectively. Short futures were used by internal managers and may be used by a limited number of external managers of the Fund to hedge the Fund's interest rate or country risk associated with security positions. The amount of net realized losses on the futures contracts was \$5,835,002 for the year ended August 31, 2006. The amount of net realized gains on the futures contracts was \$47,597,850 for the year ended August 31, 2005.

The following discloses the name, number of contracts, notional value, and the carrying and fair values at August 31, 2006 for futures contracts:

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

Contract	Number of Contracts	Expiration	Notional Value at August 31, 2006		Carrying and Fair Value at August 31, 2006	
			Long	Short	Assets	Liabilities
<b>Domestic Fixed Income</b>						
U.S. 5 Year Treasury Notes	179	Dec-06	\$ 18,814,578	\$ -	\$ 27,969	\$ -
U.S. 10 Year Treasury Notes	126	Sep-06	-	13,535,156	-	37,407
U.S. 10 Year Treasury Notes	287	Dec-06	30,816,625	-	36,878	-
U.S. Treasury Bond	74	Sep-06	8,190,875	-	27,750	-
U.S. Treasury Bond	45	Sep-06	-	4,980,938	-	16,875
			<u>57,822,078</u>	<u>18,516,094</u>	<u>92,597</u>	<u>54,282</u>
<b>Domestic Equity</b>						
Dow Jones Index	240	Sep-06	27,338,400	-	2,400	-
Russell 2000 Index Mini	7,751	Sep-06	-	559,389,670	347,802	-
Russell 2000 Index Mini	1,140	Dec-06	-	82,957,800	-	-
S&P 500 Index	2,501	Sep-06	<u>816,326,400</u>	<u>-</u>	<u>332,799</u>	<u>-</u>
			<u>843,664,800</u>	<u>642,347,470</u>	<u>683,001</u>	<u>-</u>
<b>Commodities</b>						
Goldman Sachs Commodities	1,462	Sep-06	<u>170,323,000</u>	<u>-</u>	<u>657,900</u>	<u>-</u>
<b>Foreign Fixed Income</b>						
90 Day Euro Dollar	157	Sep-06	37,132,462	-	4,906	-
90 Day Euro Dollar	56	Dec-06	13,251,700	-	4,900	-
90 Day Euro Dollar	162	Mar-07	38,387,925	-	18,225	-
90 Day Euro Dollar	13	Jun-07	3,085,063	-	1,463	-
90 Day Euro Dollar	43	Sep-07	10,217,338	-	5,375	-
90 Day Euro Dollar	23	Dec-07	5,468,825	-	2,875	-
90 Day Euro Dollar	12	Mar-08	2,853,750	-	1,500	-
90 Day Euro Dollar	20	Sep-08	4,754,000	-	2,000	-
90 Day Euro Dollar	20	Dec-08	4,752,000	-	2,000	-
90 Day Euro Dollar	20	Mar-09	4,750,250	-	1,750	-
90 Day Euro Dollar	20	Jun-09	4,748,250	-	1,500	-
Japan 10 Year Bond	17	Sep-06	19,564,824	-	138,354	-
Japan 10 Year Bond	26	Dec-06	29,836,222	-	135,437	-
UK Long Gilt	3	Dec-06	-	628,679	-	2,531
Euro-Bund	63	Sep-06	9,537,665	-	21,851	-
Euro-Bund	9	Dec-06	<u>1,354,690</u>	<u>-</u>	<u>32,731</u>	<u>-</u>
			<u>189,694,964</u>	<u>628,679</u>	<u>374,867</u>	<u>2,531</u>
<b>Foreign Equity</b>						
Amsterdam Index	4	Sep-06	480,685	-	-	-
CAC 40 Index	17	Sep-06	1,124,383	-	-	-
DAX Index	3	Sep-06	562,678	-	-	-
DJ Euro Stoxx 50	811	Sep-06	39,552,393	-	-	183,784
FTSE 100 Index	812	Sep-06	91,182,261	-	-	689,575
FTSE/JSE Top 40	75	Sep-06	2,092,406	-	-	62,872
Hang Seng Index	2	Sep-06	223,461	-	-	23
IBEX 35 Index	3	Sep-06	466,924	-	-	-
MSCI Singapore Index	147	Sep-06	5,548,722	-	26,430	-
MSCI Taiwan Index	121	Sep-06	3,329,920	-	27,830	-
OMX Index	26	Sep-06	356,763	-	-	-
S&P/MIB Index	2	Sep-06	486,713	-	-	-
SPI 200 Index	6	Sep-06	584,650	-	-	-
Topix Index	16	Sep-06	<u>2,229,782</u>	<u>-</u>	<u>-</u>	<u>5,161</u>
			<u>148,221,741</u>	<u>-</u>	<u>54,260</u>	<u>941,415</u>
<b>Total</b>			<u>\$ 1,409,726,583</u>	<u>\$ 661,492,243</u>	<u>\$ 1,862,625</u>	<u>\$ 998,228</u>

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Notes to Financial Statements (cont.)*

The following discloses the name, number of contracts, notional value, and the carrying and fair values at August 31, 2005 for futures contracts:

Contract	Number of Contracts	Expiration	Notional Value at August 31, 2005		Carrying and Fair Value at August 31, 2005		
			Long	Short	Assets	Liabilities	
<b>Domestic Fixed Income</b>							
U.S. 5 Year Treasury Notes	314	Dec-05	\$ 34,029,750	\$ -	\$ 97,187	\$ -	
U.S. 10 Year Treasury Notes	33	Sep-05	-	3,726,422	3,609	-	
U.S. 10 Year Treasury Notes	87	Dec-05	-	9,750,797	-	43,500	
U.S. Treasury Bond	78	Sep-05	9,233,250	-	53,625	-	
U.S. Treasury Bond	7	Dec-05	826,219	-	4,813	-	
			<u>44,089,219</u>	<u>13,477,219</u>	<u>159,234</u>	<u>43,500</u>	
<b>Domestic Equity</b>							
Dow Jones Index	116	Sep-05	12,182,320	-	100,920	-	
Russell 2000 Index Mini	4,178	Sep-05	-	278,756,160	-	5,556,740	
S&P 500 Index	676	Sep-05	206,416,600	-	2,162,558	-	
S&P 500 Index	660	Dec-05	202,587,000	-	2,112,695	-	
S&P 500 Emini	16	Sep-05	-	977,200	-	-	
S&P Midcap 400 Index Mini	30	Sep-05	2,140,500	-	36,300	-	
S&P Midcap 400 Index Mini	404	Sep-05	-	28,825,400	-	488,840	
			<u>423,326,420</u>	<u>308,558,760</u>	<u>4,412,473</u>	<u>6,045,580</u>	
<b>Commodities</b>							
Goldman Sachs Commodities	1,542	Sep-05	<u>178,910,550</u>	<u>-</u>	<u>-</u>	<u>1,117,950</u>	
<b>Foreign Fixed Income</b>							
90 Day Euro Dollar	59	Mar-06	14,143,038	-	22,863	-	
90 Day Euro Dollar	116	Dec-05	27,816,800	-	37,700	-	
Euro-Bund	217	Sep-05	33,079,460	-	127,801	-	
Euro-Bund	137	Dec-05	20,609,629	-	80,684	-	
Japan 10 Year Bond	21	Sep-05	26,382,510	-	25,640	-	
Japan 10 Year Bond	5	Dec-05	6,267,150	-	6,105	-	
			<u>128,298,587</u>	<u>-</u>	<u>300,793</u>	<u>-</u>	
<b>Foreign Equity</b>							
Amsterdam Index	49	Sep-05	4,698,076	-	-	-	
DJ Euro Stoxx 50	1,075	Sep-05	43,232,302	-	364,833	-	
FTSE 100 Index	791	Sep-05	75,329,479	-	449,107	-	
FTSE/JSE TOP 40	395	Sep-05	8,522,672	-	58,419	-	
Hang Seng Index	25	Sep-05	2,395,733	-	-	811	
IBEX Index	34	Sep-05	-	4,194,244	-	-	
MSCI Singapore Index	123	Sep-05	3,937,577	-	-	7,341	
MSCI Taiwan Index	396	Sep-05	9,939,600	-	-	-	
S&P/MIB Index	23	Sep-05	-	4,741,533	-	-	
S&P/TSE 60 Index	44	Sep-05	-	4,447,033	-	-	
SPI 200 Index	91	Sep-05	-	7,585,657	-	-	
Topix Index	191	Sep-05	21,835,200	-	-	23,168	
			<u>169,890,639</u>	<u>20,968,467</u>	<u>872,359</u>	<u>31,320</u>	
<b>Total</b>			<u>\$ 944,515,415</u>	<u>\$ 343,004,446</u>	<u>\$ 5,744,859</u>	<u>\$ 7,238,350</u>	

**Note 9 – Foreign Currency Exchange Contracts**

The tables below summarize by currency the contractual amounts of the Fund's foreign currency exchange contracts at August 31, 2006 and 2005. Foreign currency amounts are translated at exchange rates as of August 31, 2006 and 2005. The "Net Buy" amounts represent the U.S. dollar equivalent of net commitments to purchase foreign currencies, and the "Net Sell" amounts represent the U.S. dollar equivalent of net commitments to sell foreign currencies.

# THE UNIVERSITY OF TEXAS SYSTEM

## GENERAL ENDOWMENT FUND

Notes to Financial Statements (cont.)

Currency	Net Buy	Net Sell	Unrealized Gains on Foreign Currency Exchange Contracts	Unrealized Losses on Foreign Currency Exchange Contracts
	August 31, 2006	August 31, 2006	August 31, 2006	August 31, 2006
Australian Dollar	\$ 7,335,810	\$ —	\$ 172,056	\$ 37,731
Canadian Dollar	—	2,061,562	170,308	241,809
Chilean Peso	151,827	—	259	—
Chinese Yuan Renminbi	15,891,505	—	104,402	385,580
Czech Koruna	288,193	—	5,234	40,392
Danish Krone	359,473	—	782	2,936
Euro	532,473	—	1,119,389	501,200
Hungarian Forint	—	238,479	21,719	49,674
Indian Rupee	33,568	—	63	—
Japanese Yen	145,383,916	—	1,309,018	6,354,240
Mexican New Peso	3,992,230	—	196,593	250,635
New Taiwan Dollar	4,789,576	—	60,441	218,574
New Zealand Dollar	—	2,488,478	172,424	173,579
Norwegian Krone	332,120	—	215	16,273
Polish Zloty	327,629	—	35,332	126,140
New Russian Rubel	197,840	—	1,168	—
Singapore Dollar	6,641,938	—	56,585	372
Slovak Koruna	—	—	3,066	2,567
South African Comm Rand	1,536,353	—	63,059	268,198
South Korean Won	3,403,298	—	58,324	145,663
Swedish Krona	3,765,825	—	23,516	35,411
Swiss Franc	7,529,615	—	68,994	275,521
UK Pound	103,262,718	—	3,044,667	710,653
	<u>\$ 305,755,907</u>	<u>\$ 4,788,519</u>	<u>\$ 6,687,614</u>	<u>\$ 9,837,148</u>

Currency	Net Buy	Net Sell	Unrealized Gains on Foreign Currency Exchange Contracts	Unrealized Losses on Foreign Currency Exchange Contracts
	August 31, 2005	August 31, 2005	August 31, 2005	August 31, 2005
Australian Dollar	\$ 11,241,773	\$ —	\$ 72,978	\$ 102,864
Canadian Dollar	—	23,732,307	81,342	332,138
Chilean Peso	111,304	—	2,000	—
Chinese Yuan Renminbi	12,789,467	—	204	194,111
Czech Koruna	1,187,246	—	24,505	3,025
Euro	—	21,244,159	1,946,523	513,153
Hong Kong Dollar	2,506,473	—	143	599
Hungarian Forint	555,182	—	25,750	9,867
Indonesian Rupian	245,708	—	17,708	—
Japanese Yen	72,666,052	—	422,677	1,612,192
Mexican New Peso	4,482,342	—	101,162	15,319
New Taiwan Dollar	11,379,386	—	16,260	390,498
New Zealand Dollar	—	1,591,028	19,089	30,727
Norwegian Krone	—	6,405,779	25,632	40,379
Polish Zloty	144,004	—	198,238	18,817
New Russian Rubel	109,589	—	67	1,252
Singapore Dollar	2,041,585	—	45,933	47,622
Slovak Koruna	255,405	—	29	3,073
South African Comm Rand	2,983,209	—	96,999	6,745
South Korean Won	5,783,992	—	45,879	178,385
Swedish Krona	2,318,017	—	97,340	101,185
Swiss Franc	3,916,327	—	12,360	216,336
UK Pound	87,366,371	—	2,338,351	706,883
	<u>\$ 222,083,432</u>	<u>\$ 52,973,273</u>	<u>\$ 5,591,169</u>	<u>\$ 4,525,170</u>

**Note 10 – Purchase Commitment**

Effective November 10, 2005, UTIMCO, as investment manager of the funds under the control and management of the Board of Regents, entered into a security purchase agreement with the Board of Regents. The agreement commits the funds under management, including the Fund, to purchase up to \$1,285,000,000 in UT System flexible rate notes in the event of a failed remarketing of such notes.

**Note 11 – Fees and Expenses**

The Fund incurs investment management 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 0.01% to 0.9%. In addition to quarterly investment management fees, the Fund may pay annual performance-based management fees for investment performance in excess of certain defined benchmarks as provided for in the managers' contracts. In addition, the Fund incurs consulting fees for investment planning and oversight services with regard to private market and marketable alternative investments.

Custodial fees and expenses are assessed by the financial institution which holds the Fund's assets. Fees are based on the 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 on-line communication services per the contractual agreement.

The Fund incurs legal fees associated with the review of investment manager agreements and with due diligence efforts undertaken as part of hiring new investment managers.

Analytical and risk measurement fees are also incurred to implement and maintain a sophisticated risk measurement system for the Fund.

The Fund incurs other expenses related to its operations primarily consisting of audit fees, printing and graphic expenses, and consultation fees.

**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Supplemental Schedules*

**Comparison Summary of Investments**  
*August 31, 2006 and 2005*  
*(in thousands)*

	2006		2005	
	Value	% of Total	Value	% of Total
<b>Equity Securities</b>				
Domestic Common Stock	\$ 509,099	9.16%	\$ 638,244	12.75%
Foreign Common Stock	296,420	5.32%	321,974	6.44%
Other	1,432	0.03%	3,387	0.07%
<b>Total Equity Securities</b>	<u>806,951</u>	<u>14.51%</u>	<u>963,605</u>	<u>19.26%</u>
<b>Preferred Stock</b>				
Domestic Preferred Stock	<u>2,771</u>	<u>0.05%</u>	<u>2,808</u>	<u>0.06%</u>
<b>Debt Securities</b>				
U.S. Government Obligations	668,710	12.03%	645,923	12.91%
Corporate Obligations	339,570	6.11%	146,863	2.94%
Foreign Government and Provincial Obligations	55,962	1.01%	77,236	1.54%
Other	5,922	0.11%	10,499	0.21%
<b>Total Debt Securities</b>	<u>1,070,164</u>	<u>19.26%</u>	<u>880,521</u>	<u>17.60%</u>
<b>Purchased Options</b>	<u>25,853</u>	<u>0.46%</u>	<u>10,867</u>	<u>0.22%</u>
<b>Convertible Securities</b>	<u>16</u>	<u>0.00%</u>	<u>4,022</u>	<u>0.08%</u>
<b>Investment Funds</b>				
Absolute Return Strategies	957,363	17.22%	767,923	15.35%
Directional Equity	455,193	8.18%	428,610	8.57%
Private Markets	586,501	10.55%	493,181	9.86%
U.S. Equity	560,460	10.08%	542,829	10.85%
Non-U.S. Developed Equity	175,307	3.15%	223,617	4.47%
Emerging Markets	299,507	5.39%	150,715	3.01%
Fixed Income	91,839	1.65%	12,881	0.25%
<b>Total Investment Funds</b>	<u>3,126,170</u>	<u>56.22%</u>	<u>2,619,756</u>	<u>52.36%</u>
<b>Cash and Cash Equivalents</b>				
Money Market Funds Maintained to Back Futures Contracts	355,490	6.39%	401,342	8.02%
Money Market Funds – Other	172,877	3.11%	119,962	2.40%
<b>Total Cash and Cash Equivalents</b>	<u>528,367</u>	<u>9.50%</u>	<u>521,304</u>	<u>10.42%</u>
<b>Total Investment in Securities</b>	<u>\$ 5,560,292</u>	<u>100.00%</u>	<u>\$ 5,002,883</u>	<u>100.00%</u>



**THE UNIVERSITY OF TEXAS SYSTEM**  
**GENERAL ENDOWMENT FUND**  
*Supplemental Schedules (cont.)*

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**Financial Highlights**  
*Years Ended August 31,*

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>Selected Per Unit Data</b>					
Net Asset Value, Beginning of Period	\$ 139.644	\$ 117.595	\$ 102.539	\$ 90.932	\$ 97.811
Income from Investment Operations					
Net Investment Income	2.846	2.826	2.247	1.972	1.895
Net Realized and Unrealized Gain (Loss) on Investments	12.664	19.223	12.809	9.635	(8.774)
Total Income (Loss) from Investment Operations	15.510	22.049	15.056	11.607	(6.879)
Net Asset Value, End of Period	<u>\$ 155.154</u>	<u>\$ 139.644</u>	<u>\$ 117.595</u>	<u>\$ 102.539</u>	<u>\$ 90.932</u>
<b>Ratios and Supplemental Data</b>					
Net Assets, End of Period (in thousands)	\$5,427,755	\$4,926,797	\$4,207,644	\$3,584,765	\$3,293,194
Ratio of Expenses to Average Net Assets	0.33%	0.26%	0.24%	0.17%	0.20%
Ratio of Net Investment Income to Average Net Assets	1.96%	2.20%	2.02%	2.12%	2.00%