

# **PERMANENT HEALTH FUND**

## **FINANCIAL STATEMENTS**

**Year Ended August 31, 2000 and for the  
Period from Inception (August 30, 1999) to  
August 31, 1999**

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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 statements of assets and liabilities, and the comparison summary of investment in securities of the Permanent Health Fund (Fund) as of August 31, 2000 and 1999, the related statements of operations and changes in net assets for the year ended August 31, 2000, and for the period from inception (August 30, 1999) to August 31, 1999, and the financial highlights for the year ended August 31, 2000. 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 financial highlights based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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, 2000 and 1999, 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 and the comparative investment in securities of the Fund as of August 31, 2000 and 1999, the results of its operations and the changes in its net assets for the year ended August 31, 2000, and for the period from inception (August 30, 1999) to August 31, 1999, and the financial highlights for the year ended August 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Deloitte &amp; Touche LLP". The signature is written in a cursive, flowing style.

October 27, 2000

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Deloitte  
Touche  
Tohmatsu

# PERMANENT HEALTH FUND

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## Financial Highlights

Year Ended August 31, 2000

### Selected Per Unit Data

|  |                        |
|--|------------------------|
| Net Asset Value, Beginning of Period                                     | \$ <u>1.000</u>        |
| Income from Investment Operations  |                        |
| Net Investment Income  | 0.030                  |
| Net Realized and Unrealized Gain<br>on Investments                       | <u>0.128</u>           |
| Total Income from Investment Operations                                  | <u>0.158</u>           |
| Less Distributions   |                        |
| From Net Investment Income and<br>Undistributed Net Investment<br>Income | 0.030                  |
| From Net Realized Gain   | <u>0.015</u>           |
| Total Distributions  | <u>0.045</u>           |
| Net Asset Value, End of Period   | <u><u>\$ 1.113</u></u> |

### Ratios and Supplemental Data

|   |             |
|---|-------------|
| Net Assets, End of Period<br>(in thousands)             | \$1,016,587 |
| Ratio of Expenses to Average Net<br>Assets              | 0.20%       |
| Ratio of Net Investment Income to<br>Average Net Assets | 2.87%       |
| Ratio of Distributions to Average Net<br>Assets         | 4.28%       |

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

# PERMANENT HEALTH FUND

## Comparison Summary of Investment in Securities, at Value

August 31, 2000 and 1999

(in thousands)

|  | <u>2000</u>         | <u>1999</u>       |
|--|---------------------|-------------------|
| <b>Debt Securities</b>   |                     |                   |
| U.S. Government Obligations (Direct and Guaranteed)                            | \$ 79,696           | \$ -              |
| U.S. Government Agencies (Non-Guaranteed)                                      | 32,758              | -                 |
| Foreign Government and Provincial Obligations<br>(U.S. Dollar Denominated)     | 96                  | -                 |
| Foreign Government and Provincial Obligations<br>(Non-U.S. Dollar Denominated) | 8,346               | -                 |
| Municipal and County Bonds   | 3,235               | -                 |
| Corporate Bonds  | 70,318              | -                 |
| Foreign Corporate Bonds  | 5,057               | -                 |
| Commercial Paper   | <u>1,028</u>        | <u>-</u>          |
| <b>Total Debt Securities</b>   | <u>200,534</u>      | <u>-</u>          |
| <b>Preferred Stock</b>   |                     |                   |
| Domestic Preferred Stock   | 1,956               | -                 |
| Foreign Preferred Stock  | <u>192</u>          | <u>-</u>          |
| <b>Total Preferred Stock</b>   | <u>2,148</u>        | <u>-</u>          |
| <b>Equity Securities</b>   |                     |                   |
| Domestic Common Stock  | 155,180             | -                 |
| Foreign Common Stock   | 27,804              | -                 |
| Commingled Funds   | 189,768             | -                 |
| Limited Partnerships   | 7,889               | -                 |
| Index Funds  | <u>356,000</u>      | <u>86,251</u>     |
| <b>Total Equity Securities</b>   | <u>736,641</u>      | <u>86,251</u>     |
| <b>Cash and Cash Equivalents</b>   |                     |                   |
| Money Markets  | <u>117,112</u>      | <u>890,000</u>    |
| <b>Total Investment in Securities</b>  | <u>\$ 1,056,435</u> | <u>\$ 976,251</u> |

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

# PERMANENT HEALTH FUND

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## Statements of Assets and Liabilities

August 31, 2000 and 1999

(in thousands)

| <b>Assets</b>  | <b>2000</b>                | <b>1999</b>              |
|--|----------------------------|--------------------------|
| Investment in Securities, at Value (Cost \$997,012 and \$976,256, respectively)  | \$ 1,056,435               | \$ 976,251               |
| Collateral for Securities Loaned, at Value   | 39,604                     | -                        |
| Deposit with Broker for Futures Contracts  | 6,354                      | -                        |
| Unrealized Gains on Foreign Currency Exchange Contracts  | 976                        | -                        |
| Receivables  |                            |                          |
| Investment Securities Sold   | 9,552                      | -                        |
| Accrued Income   | 2,767                      | 258                      |
| Other  | 650                        | -                        |
| <b>Total Assets</b>  | <b><u>1,116,338</u></b>    | <b><u>976,509</u></b>    |
| <b>Liabilities</b>   |                            |                          |
| Payable Upon Return of Securities Loaned   | 39,604                     | -                        |
| Unrealized Losses on Foreign Currency Exchange Contracts   | 822                        | -                        |
| Payables   |                            |                          |
| Investment Securities Purchased  | 58,366                     | 86,256                   |
| Other  | 959                        | -                        |
| <b>Total Liabilities</b>   | <b><u>99,751</u></b>       | <b><u>86,256</u></b>     |
| <b>Net Assets</b>  | <b><u>\$ 1,016,587</u></b> | <b><u>\$ 890,253</u></b> |
| <b>Net Assets Consist Of:</b>  |                            |                          |
| Participant Contributions (Net of Withdrawals)   | \$ 915,000                 | \$ 890,000               |
| Undistributed Net Investment Income  | -                          | 258                      |
| Accumulated Undistributed Net Realized Gain on Investments<br>including Foreign Currency Transactions                              | 41,921                     | -                        |
| Net Unrealized Appreciation (Depreciation) of Investments including<br>Translation of Assets and Liabilities in Foreign Currencies | <u>59,666</u>              | <u>(5)</u>               |
| <b>Net Assets for 913,765,506 and 890,000,000 Units, respectively</b>  | <b><u>\$ 1,016,587</u></b> | <b><u>\$ 890,253</u></b> |
| <b>Net Asset Value Per Unit</b>  | <b><u>\$ 1.113</u></b>     | <b><u>\$ 1.000</u></b>   |

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

## PERMANENT HEALTH FUND

### Statements of Operations and Changes in Net Assets

Year Ended August 31, 2000 and for the Period from Inception (August 30, 1999) to August 31, 1999  
(in thousands)

|   | <u>2000</u>         | <u>1999</u>       |
|---|---------------------|-------------------|
| <b>Investment Income</b>  |                     |                   |
| Interest  | \$ 22,204           | \$ 258            |
| Dividend  | 6,814               | -                 |
| Income Distributions from Limited Partnerships  | 23                  | -                 |
| Other   | <u>178</u>          | <u>-</u>          |
| <b>Total Investment Income</b>  | <u>29,219</u>       | <u>258</u>        |
| <b>Expenses</b>   |                     |                   |
| Investment Management Fees  | 1,248               | -                 |
| UTIMCO Management Fee   | 440                 | -                 |
| Custodial Fees and Expenses   | 202                 | -                 |
| Dividends on Securities Sold Short  | 33                  | -                 |
| Other Expenses  | <u>18</u>           | <u>-</u>          |
| <b>Total Expenses</b>   | <u>1,941</u>        | <u>-</u>          |
| <b>Net Investment Income</b>  | <u>27,278</u>       | <u>258</u>        |
| <b>Realized and Unrealized Gain (Loss) on Investments</b>   |                     |                   |
| Net Realized Gain on Investment Securities and Foreign Currency Related Transactions                          | 55,025              | -                 |
| Net Unrealized Appreciation (Depreciation) on Investment Securities and Foreign Currency Related Transactions | <u>59,671</u>       | <u>(5)</u>        |
| <b>Net Gain (Loss) on Investments</b>   | <u>114,696</u>      | <u>(5)</u>        |
| <b>Net Increase in Net Assets Resulting from Operations</b>   | \$ 141,974          | \$ 253            |
| <b>Net Assets</b>   |                     |                   |
| Beginning of Period   | 890,253             | -                 |
| Participant Contributions   | 25,000              | 890,000           |
| Distributions to Participants:  |                     |                   |
| Net Investment Income   | (27,278)            | -                 |
| Undistributed Net Investment Income   | (258)               | -                 |
| Net Realized Appreciation   | <u>(13,104)</u>     | <u>-</u>          |
| End of Period   | <u>\$ 1,016,587</u> | <u>\$ 890,253</u> |

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

# PERMANENT HEALTH FUND

## *Notes to Financial Statements*

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### **Note 1 – Organization**

The Permanent Health Fund (Fund) is an internal University of Texas System mutual fund for the pooled investment of state endowment funds for health-related institutions of higher education, created August 30, 1999, with proceeds from state tobacco litigation. The distributions from the Fund endowments support programs that benefit medical research, health education, public health, nursing, and treatment programs at health-related institutions of higher education.

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 accompanying financial statements follow the form and content of investment company financial statements and related disclosures in accordance with accounting principles generally accepted in the United States of America. 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 Permanent Health Fund. The accompanying financial statements may differ in presentation from governmental accounting principles or 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).

Limited Partnerships 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.

## PERMANENT HEALTH FUND

### Notes to Financial Statements (cont.)

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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. Investments in securities and securities sold short 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 operations 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 realized and unrealized gain or loss from 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 for most securities. International index fund transactions are recorded on a settle date basis due to trading practices which impose restrictions in acquiring per unit information on the 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 Participants** -- Cash distributions to participants are paid quarterly based on a per unit payout established by the Board of Regents. For the year ended August 31, 2000 the quarterly rate was \$.01125 per unit which equates to a yearly rate of \$.045 per unit. The investment policy provides that the annual payout will be adjusted by the average consumer price index of the prior 36 months including August 31 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. There was not a distribution for the period ended August 31, 1999.

(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.

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



## PERMANENT HEALTH FUND

### Notes to Financial Statements (cont.)

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- (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) **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 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 statement of assets and liabilities. Realized and unrealized gains and losses are included in the statements of operations. These instruments involve market and/or credit risk in excess of the amount recognized in the statement of assets and liabilities. 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) **Cash and Cash Equivalents** -- Cash and Cash Equivalents consist of money markets and other overnight funds.
- (M) **Recently Issued Accounting Standards** -- In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 standardizes the accounting for derivative instruments, by requiring an entity to recognize those items as assets or liabilities in the Statements of Assets and Liabilities and measure them at fair value. This statement is effective for fiscal years beginning after June 15, 2000. The Fund's financial statements are not expected to change as a result of the adoption of SFAS No. 133. The Fund currently accounts for its derivative instruments at fair value.

### Note 3 – Acquisitions and Dispositions of Investments

Acquisitions and dispositions (including sales, maturities and prepayments) of securities, other than short-term securities, and the associated net realized gains are as follows for the year ended August 31, 2000 and for the period ended August 31, 1999:

|                                   | <u>2000</u>      | <u>1999</u>   |
|-----------------------------------|------------------|---------------|
| Acquisitions                      | \$ 3,040,196,480 | \$ 86,255,500 |
| Dispositions                      | (2,284,624,969)  | -             |
| Net Realized Gains on Investments | 55,024,845       | -             |

The net realized gains on investments included \$12,601,425 of reinvested capital gains earned on the

## **PERMANENT HEALTH FUND**

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

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index and mutual funds for the year ended August 31, 2000. Also included in net realized gains were \$3,565,484 of currency exchange losses for the year ended August 31, 2000.

#### **Note 4 – Fees and Expenses**

The fund is assessed a management fee by UTIMCO to cover the costs of managing the Fund and providing day-to-day operations. The fee assessed for the year ended August 31, 2000, was \$439,627. There was no management fee assessed for the period ended August 31, 1999.

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 1.0%. 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 manager's contract.

Custodial fees and expenses are assessed quarterly 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 other fees related to its operations primarily consisting of audit fees, printing and graphic expenses, legal and consultation fees.

#### **Note 5 – Index Funds**

The index funds, managed by the same investment manager, consist of several funds with different investment objectives, as follows:

*The Equity Index Fund B Ex-Tobacco* is a portfolio of common stocks with the objective of approximating as closely as practicable the capitalization weighted total rate of return of the segment of the U.S. market for publicly traded common stocks represented by the larger capitalized companies. The criterion for selection of investments is the S&P 500 Index, excluding the stocks of companies engaged in the production or manufacture of tobacco-related products.

*The Equity Index Fund B Lendable* is a portfolio of common stocks with the objective of approximating as closely as practicable the capitalization weighted total return of that segment of the U.S. market for publicly traded common stocks represented by the larger capitalized markets.

*The Mid-Cap Index Fund B Lendable* is a portfolio of common stocks with the objective of approximating as closely as practicable the capitalization weighted total rate of return of the segment of the United States and Canadian markets for publicly traded common stocks represented by the medium capitalized companies. The fund tracks the S&P 400 Index.

## PERMANENT HEALTH FUND

### Notes to Financial Statements (cont.)

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The EAFE Equity Index Fund B Ex-Tobacco is managed to replicate the Morgan Stanley Capital International Europe, Australia and Far East Index (EAFE), excluding the stocks of companies engaged in the production or manufacture of tobacco-related products. Individual index funds are established to represent each country within the EAFE index. The fund is a commingled 'superfund' comprised of the individual EAFE Index country funds managed in their appropriate capitalization weights.

The Russell 2000 Index Fund B's objective is approximating as closely as practicable the capitalization weighted total return of the segment of the U.S. market for publicly traded common stocks represented by the Russell 2000 Index.

When deemed appropriate, a portion of the index funds may be invested in futures contracts for the purpose of acting as a temporary substitute for investment in common stocks.

The Equity Index Fund B Ex-Tobacco is majority-owned by the Fund. The Mid-Cap Index Fund B Lendable and the Russell 2000 Index Fund B are majority-owned by the Permanent Health Fund, the Permanent University Fund, and The University of Texas System Long Term Fund. The market values of the Fund's interests in the index funds are as follows:

|                                     | <b>August 31,<br/>2000</b> | <b>August 31,<br/>1999</b> |
|-------------------------------------|----------------------------|----------------------------|
| Equity Index Fund B Ex-Tobacco      | \$ 141,345,964             | \$ -                       |
| Equity Index Fund B Lendable        | -                          | 86,251,045                 |
| Mid-Cap Index Fund B Lendable       | 77,623,056                 | -                          |
| EAFE Equity Index Fund B Ex-Tobacco | 86,534,718                 | -                          |
| Russell 2000 Index Fund B           | <u>50,496,376</u>          | <u>-</u>                   |
|                                     | <u>\$ 356,000,114</u>      | <u>\$ 86,251,045</u>       |

### Note 6 – Commingled Funds

The commingled funds consist of investments in other entities in which the Fund has an ownership percentage or shares. The investment vehicles include shares and limited partnerships. The market values of the commingled funds consist of the following at August 31, 2000:

|   |                       |
|---|-----------------------|
| Merger Arbitrage and Special Situation Funds  | \$ 53,438,633         |
| Emerging Market Mutual Funds                  | 48,839,671            |
| Hedge Fund                                    | 40,012,736            |
| Small Capitalization International Stock Fund | 38,866,923            |
| Small Capitalization Fund                     | <u>8,609,737</u>      |
|   | <u>\$ 189,767,700</u> |

## PERMANENT HEALTH FUND

### Notes to Financial Statements (cont.)

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The merger arbitrage and special situation funds invest in merger arbitrage, corporate restructuring, distressed investments, distressed convertibles and liquidations. The hedge fund invests long and short with a low net exposure to market risk.

#### 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.

The value of securities loaned and the value of collateral held are as follows at August 31, 2000:

| <b>Securities<br/>on Loan</b> | <b>Value</b>         | <b>Type of<br/>Collateral</b> | <b>Value<br/>of Collateral</b> |
|-------------------------------|----------------------|-------------------------------|--------------------------------|
| U.S. Government               | \$ 38,046,975        | Cash                          | \$ 38,603,170                  |
| Common Stock                  | <u>967,874</u>       | Cash                          | <u>1,000,755</u>               |
| <b>Total</b>                  | <u>\$ 39,014,849</u> | <b>Total</b>                  | <u>\$ 39,603,925</u>           |
| U.S. Government               | <u>\$ 139,403</u>    | Non-Cash                      | <u>\$ 278,737</u>              |

Cash received as collateral for securities lending activities is recorded as an asset with an equal and offsetting liability to return the collateral. 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.

#### Note 8 – Commitments

The Fund had unfunded contractual commitments for Limited Partnerships of \$31,170,277 as of August 31, 2000.

#### Note 9 – Securities Sold Short

In connection with the Fund's market neutral trading strategies, the Fund may sell a security 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 Fund

## PERMANENT HEALTH FUND

### Notes to Financial Statements (cont.)

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 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 assets and liabilities. The Fund has a policy of reviewing, as considered necessary, the credit standing of the broker selected by the manager for the account under management. The Fund did not have any securities sold short at August 31, 2000 or 1999.

#### Note 10 – Futures Contracts

During the year ended August 31, 2000, the Fund's activities included trading in derivatives such as futures contracts. Futures contracts are used to facilitate various trading strategies, primarily as a tool to increase or decrease market exposure to various asset classes of the Fund. The asset classes that used futures during the year include domestic and foreign equities, domestic and foreign debt and commodities. Commodity index exposure was obtained through the Goldman Sachs Commodity Index (GSCI). The GSCI is a composite index of commodity sector returns, representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities. The Fund had \$6,354,242 on deposit with a broker for collateral as margin for the futures contracts as of August 31, 2000. It is the intention of the Fund not to utilize leverage when entering into these contracts, and to maintain cash balances that when combined with the collateral deposit with a broker exceed the notional value of the futures contracts held. Futures 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 difference is referred to as the daily variation margin which is settled in cash with the broker each morning for the amount of the previous days' mark to market. The amount that is settled in cash with the broker on each morning is the carrying and fair values of the futures contracts. The amount of net realized gain on the futures contracts was \$12,160,707 for the year ended August 31, 2000. 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 manager's various trading and credit monitoring techniques.

The following discloses the notional, carrying and fair values at August 31, 2000 and the average carrying and fair values for the year ended August 31, 2000 for futures contracts:

|                         | Notional Value at<br>August 31, 2000 |              | Carrying and Fair Value<br>at<br>August 31, 2000 |             | Average Carrying<br>and Fair Value<br>for the Year Ended<br>August 31, 2000 |             |
|-------------------------|--------------------------------------|--------------|--|-------------|---|-------------|
|                         | Long                                 | Short        | Assets   | Liabilities | Assets  | Liabilities |
| Equity Futures          | \$ 55,902,887                        | \$ 5,923,574 | \$ 669,340                                       | \$ 46,603   | \$ 261,472  | \$ 264,744  |
| Commodity<br>Futures    | 37,690,988                           | -            | -  | 69,413      | 240,115   | 172,613     |
| Fixed Income<br>Futures | 15,954,259                           | -            | 73,403   | 1           | 25,912  | 23,439      |

## PERMANENT HEALTH FUND

### Notes to Financial Statements (cont.)

#### Note 11 – Purchased Options

During the year ended August 31, 2000, the Fund invested in over-the-counter traded put options as a tool to facilitate various trading strategies. These options are contracts that allow the holder of the option to sell a financial instrument at a specified price and within a specified period of time. Purchased options have no off-balance sheet risk as the Fund's market risk is limited to its investment in the option. Market risk is substantially dependent upon the value of the underlying financial instruments and is affected by market forces such as volatility and changes in interest rates. The contractual amounts do not represent the amounts exchanged by the parties to the option and, thus, are not a measure of the Fund's exposure to credit or market risk. Contractual amounts are not included in the statement of assets and liabilities and generally exceed the cash requirements of the option. Credit risk is minimized by using only primary dealers as designated by the Federal Reserve Bank.

During the year ended August 31, 2000, the Fund recognized losses of \$79,086 on purchased options. The average carrying and fair value of purchased options was \$139,913 for the year ended August 31, 2000. At August 31, 2000, the Fund did not hold any options.

#### Note 12 – Foreign Currency Exchange Contracts

The tables below summarize by currency the contractual amounts of the Fund's foreign currency exchange contracts at August 31, 2000. Foreign currency amounts are translated at exchange rates as of August 31, 2000. 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.

| Currency           | Net Buy<br>August 31, 2000 | Net Sell<br>August 31, 2000 | Unrealized Gains<br>on Foreign<br>Currency<br>Exchange<br>Contracts | Unrealized Losses<br>on Foreign<br>Currency<br>Exchange<br>Contracts |
|--------------------|----------------------------|-----------------------------|---|--|
|                    |                            |                             | August 31, 2000   | August 31, 2000  |
| Australian Dollar  | \$ -                       | \$ 1,057,063                | \$ 48,505   | \$ 19,478  |
| Canadian Dollar    | 2,458,414                  | -                           | 19,455  | 9,066  |
| Euro Currency      | 5,826,138                  | -                           | 207,943   | 210,494  |
| Japanese Yen       | 7,342,300                  | -                           | 207,383   | 13,933   |
| New Zealand Dollar | -                          | 2,796,531                   | 205,367   | 54,543   |
| Norwegian Krone    | 4,809,893                  | -                           | 37,648  | 157,793  |
| Singapore Dollar   | 1,809,095                  | -                           | 22,409  | 2,446  |
| Swedish Krona      | -                          | 5,001,403                   | 109,133   | 24,747   |
| UK Pound           | 1,989,665                  | -                           | 61,998  | 143,439  |
| Various            | 985,337                    | -                           | 55,810  | 186,535  |
|                    | <u>\$ 25,220,842</u>       | <u>\$ 8,854,997</u>         | <u>\$ 975,651</u>   | <u>\$ 822,474</u>  |