



# 2018 ANNUAL REPORT



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## UTIMCO AT A GLANCE

- Created March 1996
- Manages the investment assets under the fiduciary care of the U.T. System Board of Regents
- \$45 billion under management
- Governed by a nine-member board consisting of at least three members of the U.T. System Board of Regents, four members appointed by the U.T. System Board of Regents, three of which must have substantial background and expertise in investments, and two members appointed by the Texas A&M System Board of Regents, one of which must have a substantial background and expertise in investments
- Day-to-day management responsibility for the investment assets is delegated to UTIMCO investment team
- Diversified portfolio includes US and global equities, fixed income investments, real estate, private equity, venture capital, and hedge funds



## OUR MISSION

We generate superior long-term investment returns to support the University of Texas and Texas A&M University systems as they provide world-class teaching, push the boundaries of discovery, and achieve excellence in patient healthcare for the people of Texas and beyond.



## TOTAL ENDOWMENT RESULTS

For the year ended August 31, 2018, the Permanent University Fund (PUF) returned +9.2% and the General Endowment Fund (GEF) returned +9.6%, resulting in a combined Total Endowments performance of +9.3%. The value added by the active management decisions of the UTIMCO team was +1.2% over the Endowments' Benchmark Policy Portfolio return of +8.1%.

Over this same period, the total value of the Endowments grew from \$29.3 billion to \$32.3 billion, an increase of \$3.0 billion. Total assets managed by UTIMCO grew by \$3.8 billion to end the year at \$45.1 billion. At present, the Total Endowment assets managed by UTIMCO rank second in size relative to all other endowments in America.

## MARKET CONDITIONS

This period marked the ninth consecutive year of an equity market expansion and is now the second longest bull market period without a significant downward correction in equity market history. The US stock market bottomed on March 9, 2009 and has since gone up a cumulative 329%, leading to total returns of 423% including dividends. Despite relatively slow GDP growth and limited productivity advances in the US, stock markets have moved steadily upwards, supported initially by low valuations and accommodative monetary policy.

Following the "Great Financial Crisis" central banks globally, led by the US Federal Reserve, drew short-term interest rates down to near zero and went on to use previously untested monetary policies designed to avoid a potential depression. The intended impact of these policies was to spread out the potential negative implications over a longer period of time. To date, the policy has worked and is just now being carefully reversed as economic and financial market conditions have improved.

Figure 1

### Economic and Financial Condition Indicators<sup>1</sup>

	Then	Now	Total Change	Annualized
<b>S&amp;P 500</b>				
Price	676.5	2,901.5	+328.9%	11.2%
Price/Earnings Ratio (Forward/Trailing)	11.2/11.1	18.0/21.1	+7.7/+10.0	
Volatility	38.5	11.4	-27.1%	
US UNEMPLOYMENT (%)	8.3	3.9	-4.4%	
10-YEAR TREASURY-NOTE YIELD (%)	2.9	2.9	+0.0%	
GROSS DOMESTIC PRODUCT GROWTH YEAR OVER YEAR (%)	-3.3	2.9	+6.2%	
INFLATION YEAR OVER YEAR (%)	0.2	2.5	+2.5%	
FEDERAL FUNDS RATE (%)	0.25	2.00	+1.8%	
SIZE OF FEDERAL BALANCE SHEETS (\$, TRILLIONS)	\$1.9	\$4.2	\$2.3	

<sup>1</sup> Source: Bloomberg  
Then refers to 3/31/2009, now refers to 8/31/2018





## ASSET ALLOCATION

The Endowments' goals are to produce attractive long-term returns within a sound and well diversified asset allocation structure, professionally and prudently implemented at all times. In order to achieve these goals over time, three complementary investment portfolios are simultaneously maintained.

- A Global Equity portfolio designed to capture the increase in the value of companies driven by the revenue growth and improved corporate profits that generally accompany periods of positive Gross Domestic Product (GDP) growth and moderate inflation.
- A Stable Value portfolio intended to provide diversification against deflationary conditions (e.g., typical recessions) which see slowing GDP growth and falling profits that generally result in a decline in equity values.
- A Real Return portfolio intended to provide diversification against the wealth-eroding effects on asset values that result from periods where inflation exceeds expectations.

Set out in Figure 2 on the next page is the endowments' current asset allocation to the various components of each of the three strategies.



Figure 2

### Endowments Asset Allocation as of August 31,

	2018		2017	
<b>GLOBAL EQUITY</b>				
US PUBLIC EQUITY	\$3,510.9	10.9%	\$2,592.1	8.9%
<b>NON-US PUBLIC EQUITY</b>				
EAFE + Canada	2,517.5	7.8%	1,960.8	6.7%
Emerging Markets	3,246.8	10.0%	3,132.8	10.7%
<b>TOTAL NON-US PUBLIC EQUITY</b>	<b>5,764.3</b>	<b>17.8%</b>	<b>5,093.6</b>	<b>17.4%</b>
<b>DIRECTIONAL HEDGE FUNDS</b>	<b>4,538.2</b>	<b>14.0%</b>	<b>4,935.7</b>	<b>16.9%</b>
<b>PRIVATE EQUITY</b>				
Private Equity	2,567.6	8.0%	2,379.3	8.1%
Venture Capital	1,966.4	6.1%	1,557.7	5.3%
Emerging Markets	1,717.2	5.3%	1,470.8	5.0%
Credit	560.6	1.7%	701.1	2.4%
<b>TOTAL PRIVATE EQUITY</b>	<b>6,811.8</b>	<b>21.1%</b>	<b>6,108.9</b>	<b>20.8%</b>
<b>TOTAL GLOBAL EQUITY</b>	<b>20,625.2</b>	<b>63.8%</b>	<b>18,730.3</b>	<b>64.0%</b>
<b>STABLE VALUE</b>				
US Fixed Income (Investment Grade)	1,148.6	3.5%	766.3	2.6%
Non-US Fixed Income	828.4	2.6%	803.9	2.7%
Emerging Markets Sovereign Debt	406.2	1.2%	472.1	1.6%
Stable Value Hedge Funds	1,330.4	4.1%	1,248.3	4.3%
Cash	1,130.8	3.5%	1,025.8	3.5%
<b>TOTAL STABLE VALUE</b>	<b>4,844.4</b>	<b>14.9%</b>	<b>4,316.4</b>	<b>14.7%</b>
<b>REAL RETURN</b>				
Inflation Linked Bonds	18.7	0.1%	14.4	0.0%
Gold	501.2	1.6%	695.5	2.4%
Commodities	321.0	1.0%	39.5	0.1%
Natural Resources	2,933.4	9.1%	2,771.1	9.5%
Infrastructure	554.5	1.7%	560.0	1.9%
Public Real Estate	21.0	0.1%	21.5	0.1%
Private Real Estate	2,476.4	7.7%	2,133.2	7.3%
<b>TOTAL REAL RETURN</b>	<b>6,826.2</b>	<b>21.3%</b>	<b>6,235.2</b>	<b>21.3%</b>
<b>TOTAL ENDOWMENTS</b>	<b>\$32,295.8</b>	<b>100.0%</b>	<b>\$29,281.9</b>	<b>100.0%</b>

# INVESTMENT PHILOSOPHY- CREATING LONG-TERM RETURNS

The Endowments are managed as long-term investment funds with a time horizon exceeding that of most other investors. They have consistent sources of funding with relatively low and reasonably predictable short-term funding requirements. As a result, the Endowments are able to assume significant equity risk as well as higher levels of illiquidity than the typical investor. These two factors alone should typically produce higher long-term returns relative to most other funds. When combined with effective risk systems and risk management, attractive and consistent results have been achieved.

In addition, other factors are key to creating superior risk-adjusted long-term returns.

### The Risk-Free Rate

The returns available to an investor without taking incremental risk have declined meaningfully over the past 20+ years. Using the 10 Year US Treasury Bond as a proxy, this rate has fallen from 6.9% in 1996, to cycle lows below 1.5% in 2016, to 2.9% in 2018. When taking inflation into account the deterioration is even more pronounced. Assuming that most investors are trying to earn returns of 5% in excess of inflation, risk-free government bonds are simply no longer helpful in achieving an investor's return goals. However, the 10 Year US Treasury Bond yield has increased to roughly 2.99% recently in response to the Federal Reserve's steady increases in the Fed Funds Rate over the course of 2018.

Figure 3

## Annualized Returns

(Periods Ending August 31, 2018)

	TEN YEARS		TWENTY YEARS	
	Endowments	Policy Benchmark	Endowments	Policy Benchmark
<b>Return</b>	<b>6.43%</b>	<b>4.87%</b>	<b>7.41%</b>	<b>6.33%</b>
<b>Volatility</b>	<b>7.69%</b>	<b>8.58%</b>	<b>7.74%</b>	<b>7.95%</b>
<b>Sharpe Ratio<sup>1</sup></b>	<b>0.83</b>	<b>0.57</b>	<b>0.96</b>	<b>0.80</b>

<sup>1</sup>Sharpe Ratio is the average return earned in excess of the risk free rate per unit of volatility or total risk.

### Creating "Alpha" (Returns that Exceed Passive Benchmarks)

To achieve this consistently requires both skill and the assumption that markets are not completely efficient, or that their efficiency varies over time and across market cycles. Over the past one and five year periods UTIMCO's portfolios have produced the results shown in Figure 4 versus passive or competing benchmarks.

### Aligning Costs

To achieve cost alignment, UTIMCO seeks to negotiate fees with external managers that are below market and where the manager's incentives are aligned with our own. Recently, UTIMCO has been collaborating with its key investor relationships to assure that the Endowments receive either a high return or a substantial portion

Figure 4

## Investments Returns by Portfolio

	ONE YEAR			FIVE YEARS		
	Return	Benchmark	Over/(Under)	Return	Benchmark	Over/(Under)
<b>GLOBAL EQUITY</b>						
Public Equity	7.9%	8.2%	(0.3%)	10.2%	8.3%	1.9%
Directional Hedge Funds	5.4%	4.0%	1.4%	5.7%	3.5%	2.2%
Private Equity	18.1%	14.9%	3.2%	13.1%	11.8%	1.3%
<b>TOTAL GLOBAL EQUITY</b>	<b>10.0%</b>	<b>9.4%</b>	<b>0.6%</b>	<b>9.1%</b>	<b>7.9%</b>	<b>1.2%</b>
<b>STABLE VALUE</b>						
Global Fixed Income	(2.7%)	(1.4%)	(1.3%)	1.7%	1.3%	0.4%
Stable Value Hedge Funds	5.4%	4.0%	1.4%	3.5%	3.5%	0.0%
Cash	1.5%	1.5%	0.0%	0.5%	0.5%	0.0%
<b>TOTAL STABLE VALUE</b>	<b>(0.2%)</b>	<b>0.8%</b>	<b>(1.0%)</b>	<b>1.4%</b>	<b>2.3%</b>	<b>(0.9%)</b>
<b>REAL RETURN</b>						
Gold	(9.2%)	(9.1%)	(0.1%)	(2.9%)	(2.9%)	0.0%
Commodities	1.8%	0.5%	1.3%	(8.4%)	(8.0%)	(0.4%)
Natural Resources	10.8%	14.9%	(4.1%)	11.9%	11.8%	0.1%
Infrastructure	26.2%	14.9%	11.3%	15.9%	11.8%	4.1%
Public Real Estate	4.5%	5.5%	(1.0%)	6.3%	7.0%	(0.7%)
Private Real Estate	21.3%	14.9%	6.4%	17.9%	11.8%	6.1%
<b>TOTAL REAL RETURN</b>	<b>13.8%</b>	<b>11.6%</b>	<b>2.2%</b>	<b>7.3%</b>	<b>7.0%</b>	<b>1.0%</b>
<b>TOTAL ENDOWMENTS</b>	<b>9.3%</b>	<b>8.8%</b>	<b>0.5%</b>	<b>8.1%</b>	<b>7.1%</b>	<b>1.0%</b>



of any excess return over a properly constructed passive benchmark. Attractive co-investment opportunities are also developed with key investment relationships which add to returns and lower costs. Co-Investments currently represent 5.5% of the Endowments' assets and have generated returns of 17.8% since the inception of the program.

## INVESTMENT PHILOSOPHY- RISK MANAGEMENT

Managing risk is central to the execution of any investment process and is a priority for the UTIMCO team. This is done primarily by focusing on longer-term outcomes rather than short-term results; prudent and effective diversification; a

series of risk systems that monitor economic and market conditions; and professional collaboration with both the UTIMCO Board of Directors and a global network of investment organizations. Most importantly, UTIMCO maintains an organization of high character and professional investment personnel dedicated to integrity and transparency. The objective of our risk management processes is not to avoid any and all risk, but rather to manage through various environments effectively by assuring that UTIMCO is always the "strong hand" in the market. This allows us to not only weather the inevitable and unpredictable financial storms, but also to take advantage of the unique investment opportunities that those "bad times" often produce.

Markets gyrate through repeating but difficult to anticipate patterns as they work their way through

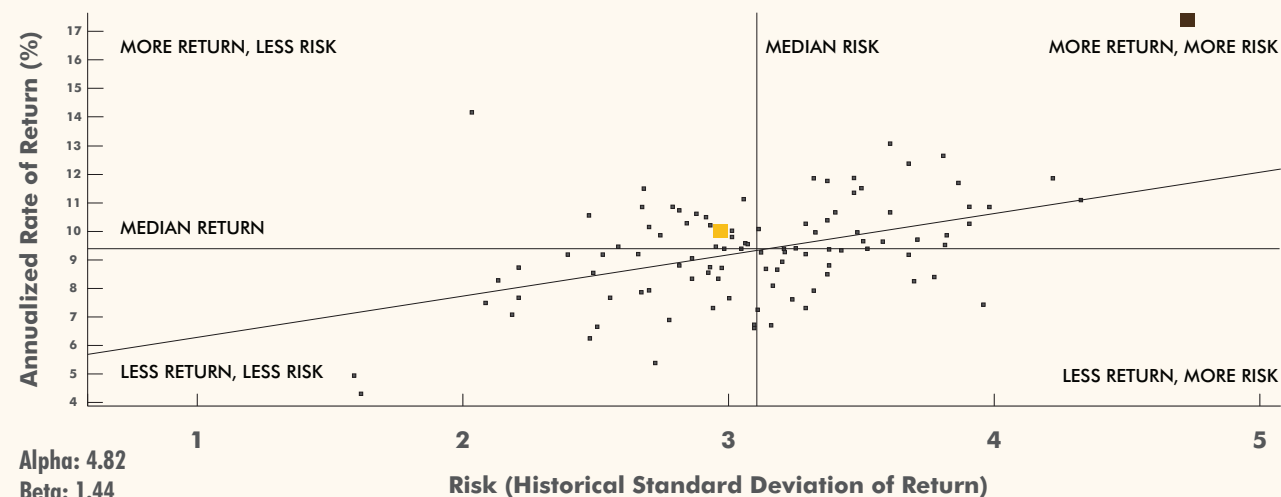
both short and longer-term cycles. Short-term cycles are driven primarily by business conditions and are comprised of corrections, recoveries and expansions. At this time, equity markets are generally in expansion having reclaimed their previous peaks. Longer-term cycles are generally driven by debt levels. The amount of debt in the economy has risen substantially over the past several decades and is likely to be less of a stimulus to economic activity going forward. In fact, at some point, deleveraging is likely although the pace has, so far, been slow. Should interest rates rise meaningfully, deleveraging would likely be accelerated, and economic conditions would likely deteriorate.

Bear markets are generally the result of one of the following five factors: recessions, commodity disruptions, Federal Reserve policies, global geopolitical events and/or excessive valuations. At the present time, valuations are above historical norms while other conditions remain generally benign. Whenever the next cyclical "bear market" occurs, the Endowments will likely decline in a range between -16% and -36%, with a baseline outcome of approximately -23%.

Over the past three years, UTIMCO has taken less risk than 61% of other similar funds while producing a three-year return exceeding the peer median and a passive benchmark.

**Figure 5**  
**Trust Universe Comparison Service**  
**Risk vs Total Returns of Master Trusts -**  
**Foundation & Endowment**

3 Years Ending September 30, 2018



	Risk Value	Risk Rank	Return Value	Return Rank
■ GEF TOTAL FUND	2.98	61	9.83	38
■ S&P 500	4.75	2	17.31	1
MEDIAN	3.11		9.32	

## FUTURE OUTLOOK

Short-term investment returns are largely driven by variations in economic conditions relative to what markets are currently pricing in. Today economic and financial market conditions are strong but valuations are also relatively high across most markets. This combination means that future endowment returns are likely to be lower and that results in the 4% to 7% range are a reasonable baseline expectation until better valuations are ultimately restored either through a typical bear market decline, or an extended period of lower than normal market returns. Whatever the future holds, UTIMCO will manage through the process using sound investment practices and with experienced,



dedicated and high character investors. And as better investment opportunities arise, UTIMCO will be prepared to participate in them.

Thank you for your continued dedication to the important work that these endowments support.

Sincerely Yours,

Britt Harris  
President, CEO and Chief Investment Officer

# UTIMCO BOARD OF DIRECTORS



**Jeffery D. Hildebrand**  
Chairman



**Ray Rothrock**  
Vice Chairman



**R. Steven Hicks**  
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**J. Kyle Bass**



**Robert Gauntt**



**Janet Handley**



**Ray Nixon**



**Clifton L. Thomas, Jr.**



**James Conrad Weaver**

**Jeffery D. Hildebrand** **Vice Chairman:** Board of Regents, The University of Texas System / **Chairman:** Board of Regents, The University of Texas System - Finance and Planning Committee; University Lands Advisory Board / **Member:** Board of Regents, The University of Texas System - Facilities Planning and Construction Committee; Board of Regents, The University of Texas System - Health Affairs Committee / **Founder, Chairman and Chief Executive Officer:** Hilcorp Energy Company / **Recipient:** 2005 Distinguished Engineering Graduate Award, The University of Texas at Austin; 2013 Petroleum & Geosystems Engineering Distinguished Alumnus Award, The University of Texas at Austin / **Board Member:** Central Houston, Inc.; Houston Livestock Show and Rodeo; Houston Police Foundation; The Hildebrand Foundation; Baker Institute of Public Policy - Rice University

**Ray Rothrock** **Chair:** UTIMCO Compensation Committee / **Member:** UTIMCO Risk Committee; Forbes Midas List; Corporation for the Massachusetts Institute of Technology / **CEO:** RedSeal, Inc. / **Partner Emeritus:** Venrock / **Chairman:** Transatomic Power / **Distinguished Alumnus:** Texas A&M University / **Past Chairman:** National Venture Capital Association / **Board Member:** Check Point Software Technology (NASDAQ: CHKP); Several Private Companies including Roku, Team8, Shape Security, CTERA, Unbound Tech, and Tri Alpha Energy; Nuclear Innovation Alliance / **Speaker:** Nuclear energy, climate change and energy policy in general / **Co-Executive Producer:** Documentary, Pandora's Promise / **Advisor:** BreakThrough Institute

**R. Steven Hicks** **Chair:** UTIMCO Policy Committee / **Member:** Board of Regents, The University of Texas System; Board of Regents, The University of Texas System - Academic Affairs Committee; Board of Regents, The University of Texas System - Audit, Compliance, and Management Review Committee; Board of Regents, The University of Texas System - Health Affairs Committee / **Former Vice Chairman:** Board of Regents, The University of Texas System / **Chairman:** Board of Regents, The University of Texas System - Facilities Planning and Construction Committee / **Executive Chairman:** Capstar Partners, LLC

**J. Kyle Bass** **Chair:** UTIMCO Risk Committee / **Member:** UTIMCO Compensation Committee; Advisory Group for the Center of Asset Management at the Darden School of Business at the University of Virginia / **Principal:** Hayman Capital Management, L.P. / **Board Member:** Troops First Foundation; Texas Department of Public Safety Foundation / **Expert Witness:** U.S. House of Representatives, U.S. Senate and Financial Crisis Inquiry Commission / **Former Managing Director:** Legg Mason, Inc. / **Former Senior Managing Director:** Bear Stearns & Co.

**Robert Gauntt** **Member:** UTIMCO Compensation Committee; UTIMCO Risk Committee; The University of Texas Chancellor's Council Executive Committee; Pro-Vision Charter School; Hope for Africa Advisory Group / **Founding Partner:** Avalon Advisors, LLC / **Former Chairman:** Investment Committee and Risk Management Committee of the Teacher Retirement System of Texas Board of Trustees / **Former Member:** McCombs School of Business Advisory Council; Texas Growth Fund Board; Endowment Committee at River Oaks Baptist School / **Letterman:** The University of Texas at Austin - 1983 NCAA Division I National Championship Baseball Team

**Janet Handley** **Chair:** UTIMCO Audit and Ethics Committee / **Member:** UTIMCO Policy Committee; A&M Legacy Society; Texas Wall Street Women; Greater Texas Foundation - Investment Committee / **Former Vice President for Investments:** Texas A&M Foundation / **Investment Committee Advisor:** Society of Petroleum Engineers / **Former Member:** Venture Capital Advisory Council - Commonfund Capital

**Ray Nixon** **Member:** UTIMCO Compensation Committee; UTIMCO Policy Committee; McCombs School of Business Advisory Council / **Executive Director and Portfolio Manager:** Barrow, Hanley, Mewhinney & Strauss / **Trustee:** UT Southwestern Foundation / **Inductee:** The University of Texas McCombs School of Business Hall of Fame / **Board Member:** East West Ministries; Dallas Seminary Foundation / **Chairman:** Texas Health Resources Endowment Investment Committee / **Former Board Member:** CFA Society of Dallas-Fort Worth; CFA Society of DDFW Strategic Advisory Board

**Clifton L. Thomas, Jr.** **Member:** UTIMCO Audit and Ethics Committee; UTIMCO Policy Committee; Board of Regents, The Texas A&M University System - Committee on Buildings & Physical Plant; St. Joseph High School Board of Directors / **Member, Past Chairman and Former Vice Chairman:** Board of Regents, The Texas A&M University System / **Chair:** Board of Regents, The Texas A&M University System - Committee on Audit / **President, Owner, CEO:** C.L. Thomas, Inc.; Speedy Stop Food Stores; Thomas Fuels / **Owner, Chairman and Board Member:** Pilot Thomas Logistics / **Liaison Board Member:** 12th Man Foundation / **Former Board Member:** Guadalupe-Blanco River Authority; DeTar Hospital System; Wells Fargo Bank

**James Conrad "Rad" Weaver** **Member:** UTIMCO Audit and Ethics Committee; UTIMCO Risk Committee; Board of Regents, The University of Texas System - Academic Affairs Committee; Board of Regents, The University of Texas System - Audit, Compliance, and Risk Management Committee; Board of Regents, The University of Texas System - Facilities Planning and Construction Committee; Board of Regents, The University of Texas System - Finance and Planning Committee / **CEO:** McCombs Partners / **Chair:** San Antonio Chamber of Commerce / **Director:** San Antonio Branch of the Federal Reserve Bank of Dallas / **Board Member:** Cox Enterprises; Southern Towing Company; Circuit of the Americas; Allegiance Ambulance; General LED



FROM LEFT TO RIGHT: Melynda Shepherd, Scott Slayton, Uziel Yoeli, Patrick Pace, Susan Chen, Britt Harris, Joan Moeller, Ryan Ruebsahm, J. Russell Kampfe, Anna Cecilia Gonzalez, Richard Hall, Ken Standley, Edward Lewis, Uche Abalogu

## UTIMCO SENIOR MANAGEMENT

- Britt Harris**, President, CEO and Chief Investment Officer
- Richard Hall**, Deputy Chief Investment Officer
- Uche Abalogu**, Chief Technology Officer
- Susan Chen**, Managing Director - Public Equity
- Anna Cecilia Gonzalez**, Corporate Counsel and Chief Compliance Officer
- J. Russell Kampfe**, Managing Director - Fixed Income
- Edward Lewis**, Managing Director - Real Return
- Joan Moeller**, Senior Managing Director and Chief Operating Officer
- Patrick Pace**, Senior Director - Private Equity
- Ryan Ruebsahm**, Managing Director - Hedge Funds
- Melynda Shepherd**, Senior Director - Human Resources
- Scott Slayton**, Managing Director - Tactical Asset Allocation
- Ken Standley**, Chief of Staff
- Uziel Yoeli**, Managing Director - Risk Management



**Fiduciary Counsel**, Orrick Herrington & Sutcliffe LLP  
**Independent Auditors**, Deloitte & Touche LLP