RICKS

FILE COPY

The University of Texas Investment Management Company

U T I M C O

THE UNIVERSITY OF TEXAS
INVESTMENT MANAGEMENT COMPANY

Presentation Materials Board of Directors Meeting

June 10, 1996

k:\users\oam\utimco\bodcov.doc

UTIMCO

BOARD OF DIRECTORS MEETING

June 10, 1996

AGENDA

- issue mandate vs authority/discretion

1:00 p.m. - 1:05 p.m.	Call to Order/Approval of Minutes of April 17, 1996 Meeting (Tab 1)
1:05 p.m. - 1:30 p.m.	UTIMCO Governance and Compliance Process (2)
1:30 p.m. - 2:00 p.m.	1997 Legislative Issues - Amendment of Constitution (3)
2:00 p.m. - 2:05 p.m.	Review of Investment Performance (4)
2:05 p.m. - 2:20 p.m.	LTF Risk Management - Value at Risk (5)
2:20 p.m. - 3:00 p.m.	Consideration of Divestiture of Tobacco Holdings (6)
3:00 p.m. - 3:15 p.m.	Break
3:15 p.m. - 3:45 p.m.	Equities - Presentation by Fayez Sarofim & Co.- Mr. Ralph Thomas (7)
3:45 p.m. - 4:30 p.m.	Private Investments - Presentation by Beacon Group (8)
4:30 p.m. - 4:45 p.m.	Fixed Income - Discussion of Short Term Fund Management (9)
4:45 p.m. - 4:55 p.m.	Report of Audit Committee
4:55 p.m. - 5:00 p.m.	Appointment of Compensation Committee
5:00 p.m.	Adjournment

- minor items
- consideration of divestiture
- 15 minutes [illegible]

Next Scheduled Meeting: Friday, August 30, 1996

K:\USERS\OAM\UTIMCO\AGENDA.DOC

which falls below investment grade after date of purchase. Mr. Hicks then inquired if there should be a program to invest in high yield or distressed securities. Mr. Holland required that the in-house staff is too thinly staffed and have no analytical training for such a specialized sector. Mr. Ricks added that the Asset Management Committee has approved a 10% allocation from the LTF to invest in publicly traded alternative assets which included high-yield bonds. However, the asset class was unfunded as the staff was concentrating on diversifying into international and emerging market equity asset classes first.

Long Term Fund

(No presentation of the Long Term Fund fixed income portfolio occurred because of time constraints.)

Short/Intermediate Term Fund

Mr. Ricks then asked Mr. Kampfe to review activity in the $1.2 billion S/ITF. Mr. Kampfe reviewed the S/ITF 2nd quarter summary for the Board. He noted the Fund's slightly bullish outlook for the months ahead, particularly due to yields reaching their highest levels over the past 9-12 months. He indicated that if the market showed some ability to stabilize at the current higher yields, the Fund would become significantly more bullish with significant purchases of securities in the 3-5 year maturity area. The most significant change in S/ITF assets for the quarter was a $124.2 million net contribution by Fund participants. The only question concerning the was from Mr. Fisher who asked if the staff understood how to account for CMOs. Mr. Kampfe responded that the staff had been investing in CMOs for over ten years and were confident of their understanding. Mr. Kampfe concluded by reviewing the Fund summary and holdings.

Short Term Fund

Mr. Ricks reported that the only external fixed income management was in the management of short term funds. Goldman Sachs Asset Management was engaged in 1988 to manage the $600 million Short Term Fund. The original fee was 30 bps which was renegotiated down in 1993 to 18bps. With the formation of the S/ITF, Fidelity was hired to manage the approximately $100 million liquidity portion of the Fund also for 18 basis points.

Mrs. Montgomery remarked that she believed an 18 basis point fee for short term fixed income management appeared high. Mr. Ricks replied that the fee included custody and, in the case of Goldman Sachs, use of the Goldman Sachs trading and reporting system by each of the component institutions. Management's review had indicated that the major money funds all charged 18-20 basis points. The money fund structure and the prohibition against "preferential dividends" effectively "precluded" the funds from providing fee discounts to larger customers. As a result, the question was whether management could invest the short term funds for less than the $1.25 million currently paid on an annual basis. This issue was to be examined by the staff following completion of the custodian consolidation process at the end of the fiscal year. The Board agreed as a group that Mr. Ricks should express his concern over the fee and ask the firm what they might offer in terms of a fee reduction.

Equities:

Background

Mr. Ricks reported that prior to 1985, the equity portfolio was 100% actively and internally managed as a single U.S. large cap portfolio. In 1985, following the formation of the Office of Asset Management, 30% of the asset class was allocated to seven external managers. In 1993, following Mr. Ricks's appointment as chief investment officer, the equity asset class was restructured to increase diversification. Approximately 50% of the asset class was indexed through Wells Fargo/Nikko. The balance was actively managed through two internally managed portfolios(20%) and 30% with external managers. Mr. Ricks stated that the majority of the external managers were terminated as part of the restructuring. In addition, a minority manager program was established and overall portfolio management expenses were reduced by 25%.

Mr. Ricks also stated that a major objective was to evaluate the current equity management program in light of the new asset allocation program for the LTF and the excessive number of managers brought on since 1993. He wanted to first recruit a Vice President - Equities in order to assist in the process. In response to questions regarding compensation, Mr. Ricks responded that his market research indicated that he could expect to pay $150,000 plus a 25% bonus. This would be a critical recruitment as equities would be the growth vehicle in the future.

U.S. Domestic Equities

Presentation by Austin Calvert & Flavin

Representatives of the firm reviewed their investment style for the $114 million combined equity portfolios which they characterized as relative value with a growth bias. The firm uses a top down approach to assess the market environment and a bottom up approach to research potential stocks. The firm evaluates equities on both absolute and relative measures and attempts to fit them to a model portfolio. The firm then presented its overview of the stock market, expressing concern about current valuations and making comparisons versus the Japanese stock market prior to its major correction. The firm stated that it would like the flexibility to hold more cash but would abide by Mr. Ricks's instructions to keep cash at minimum levels.

Presentation by Kempner Capital Management

Representatives of KCM stated that their objective was to create real returns and to achieve long term returns by conserving principal. It concentrated on overlooked stocks paying high yields. In particular, stocks of companies with high cash flows but where the whole industry or the company may be depressed for the wrong reasons. Since they don't buy stocks that don't conform to their discipline, they will build cash in up markets which was the reverse of most institutional investors. As a result, they will achieve most of returns in up markets but not runaway markets. He pointed out that the UT portfolios had not seen a downturn. Mr. Allen inquired about the firm's cash level which was reported to be at 30%.

Emerging Markets

Mr. Ricks reported that the Board LTF asset allocation program contained a 3% allocation to emerging markets. The staff had delayed funding the allocation until it believed the timing was appropriate for funding. The staff had proposed funding at the last meeting when the UTIMCO Board approved funding at the 1.5% level or approximately $20 million with Templeton Investment Counsel. The Board had deferred funding the remaining 1.5% in order to obtain the input of the new UTIMCO Board members. Mr. Ricks reported that due to new contributions and appreciation, the 3% allocation now represented $50.8 million for an incremental funding requirement of $30 million. He reviewed an updated comparison of the return and risk performance for the original five finalists and recommended that the balance of the funding be committed to Templeton. The general consensus of the Board was that diversification away from the U.S. equity markets made sense and that the current level of 1.5% did not represent a sufficient exposure to the asset class to impact returns.

By motion duly made, seconded and carried by a unanimous vote, the Board of Directors approved the full funding of the 3% emerging markets allocation.

Private Investments:

Thayer Equity Investors III, L.P.

The Thayer principals (Fred Malek, Paul Stern and Rick Rickertsen) made a brief presentation to the board, citing their individual credentials and accomplishments and discussing their proposed investment strategy (all of which are contained in the staff's Thayer Equity Investors III, L.P. Due Diligence Review and Recommendation).

During the presentation, Mr. Allen expressed reservations as to the achievability of the principals' quantitative measure of partnership value added: a 25% or more improvement in cash flow for each portfolio investment in its first year. Mr. Malek, citing hotels in general and Ritz-Carlton in particular, stated that increases in cash flow of this magnitude are possible but conceded that some businesses cannot be expected to produce that result in such a short time period.

After the presentation, Mr. Evans asked the principals their response to a particular hypothetical transaction, with a purchase price of $300 million to $500 million, requiring $75 million in equity. The principals replied that they see similar transactions in the current market and cite CB Commercial and Ritz-Carlton as two such successful transactions in their track record.

Mr. Hicks asked the principals whether they can work together for a prolonged period. Mr. Stern replied that his long friendship with Mr. Malek, the stresses of fundraising over the past year and the fact that their spouses are friends all point toward long-term compatibility.

Mr. Hicks asked what Thayer Capital's partnership governance procedures are, particularly with regard to investment decision making. Mr. Malek replied that all three Thayer Capital principals are equal partners and each investment requires unanimous approval of the partners.

The Thayer principals then left the board room and the UTIMCO board discussed the merits of the investment. The staff, in summarizing the investment for the board prior to the discussion, emphasized the level of experience and ability of both Mr. Malek and Mr. Stern and stated that Mr. Rickertsen's involvement was likely to mitigate any friction which might be expected to develop between the other two partners.

Mr. Fisher stated that in his opinion the business reputation of one of the principals led him to believe that as a partnership Thayer would be short-lived. Mr. Hicks agreed with the staff that the Thayer principals could produce attractive returns in the current partnership but also agreed with Mr. Fisher that it was unlikely they would stay together long enough to raise and invest a second partnership.

After a short further discussion of UTIMCO policy on partnership continuity, the Board, by motion duly made, seconded and carried by a unanimous vote , approved a commitment of $20 million subject to further due diligence prior to closing. In voting affirmatively, Mr. Fisher expressed reservations as to whether the Thayer principals could maintain their partnership over more than one fund.

(Note: as a result of further due-diligence, the indicative commitment of $20 million was withdrawn in favor of observing the general partners' performance in the fund over the next three years.)

At this point in time, Mr. Allen left the meeting.

Wand Equity Portfolio II, L.P.

Prior to the presentation, Mr. Hicks recused himself from consideration of Wand, citing his 32 year business history with its principals.

The Wand principals (Bruce Schnitzer and David Callard) then made a brief presentation to the board, citing their individual credentials and accomplishments and discussing their proposed investment strategy (all of which are contained in the staff's Wand Equity Portfolio II, L.P. Due Diligence Review and Recommendation).

The Wand principals then left the board room and the UTIMCO board discussed the merits of the investment. The staff, in summarizing the investment for the board prior to the discussion, emphasized the value remaining in the initial Wand fund's software and business services investments, which should result in superior returns at the point they are eventually realized. The staff noted that investing with the Wand principals over the next 18 months or so is an interim step on a partnership by partnership (i.e., investment by investment) basis, to be followed by the raising of a conventional fund in which the staff would propose to participate. The staff also noted that the relationship between the Wand principals and the staff is expected to be unusually close, with Wand serving to introduce the staff to a number of co-investment opportunities on an unpromoted basis.

The staff outlined certain key items on the term sheet not yet agreed to by the parties and proposed the following position on each: all interim investments prior to the raising of the fund should be aggregated for purposes of determining payback; the request of the Wand principals to vary the amounts invested by the general partners for each investment amounts to cherrypicking and should be denied in favor of a fixed ratio; the Wand proposal to share only 25% of transaction fees with the limited partners is at the low end of the acceptable range and should be negotiated up; and the terms under which each of the partnerships can be extended should be altered to require a vote of the limited partners. Finally, the staff proposed imposing the same promoted interest hurdle rate for Wand II as for the staff's incentive compensation program: 500 basis points over the S&P 500 on a dollar-weighted, time-weighted basis.

After some discussion of the staff's proposed promoted interest hurdle rate computation, the board by motion duly made, seconded and carried by a unanimous vote (Mr. Hicks abstaining) unanimously approved a commitment of up to 20% of the club/fund amount representing $13.125 million initially and then up to $30 million assuming an ultimate fund size of $150 million. Mr. Evans summarized the board's particular concerns in approving this investment: that the Wand agreement should prohibit cherrypicking on the part of the principals investing as general partners, that all investments should be aggregated for purposes of determining payback and that the computation of the promoted interest be done on the most advantageous terms to U. T.'s interest as possible.

Financial Report--March 1996

Mr. Ricks then presented the Corporation's balance sheet (unaudited) as of March 31, 1996, the Corporation s statement of revenue, expenses and changes in fund balance (unaudited) for the period of March 1, 1996 through March 31, 1996, and the Corporation's statement of cash flows (unaudited) for the period March 1, 1996 through March 31, 1996. He stated that there was nothing to report concerning the Corporation's first month of operations as operations had proceeded as expected.

Fiscal Year 1996--97 Budget Parameters

Mr. Ricks stated that the U.T. System, as part of its budget planning for fiscal year 1996-97, had requested the amount of investment management fees to be charged beginning September 1, 1996. Mr. Ricks added that this was difficult given UTIMCO's existence for one month. Given the need for a number, he had submitted a 5% increase over the annualized fee amount for the second half of fiscal year 1996. The Board indicated that these budget parameters were acceptable. Mr. Ricks stated that a detailed budget would be submitted for approval at the August meeting.

Meeting Date

Mr. Ricks stated that the next meeting dates needed to be scheduled. He was instructed to telephone directors for mutually convenient dates for the remainder of the calendar year.

There being no further business to come before the Board of Directors, the meeting was adjourned.

____
Secretary

APPROVED:

____

Governance + Compliance
Power:
· first cut at [illegible] for vote · to
· provide a summary
overview of director liability
· discuss compliance structure
delegation of authority

Material to be distributed at the meeting

, permit of directors and employees

Education Code

Chapter 66. Permanent University Fund

Section 66.08 Investment Management

(i) The corporation may not enter into an agreement or transaction with a:

1. director, officer or employee of the corporation acting in other than an official capacity on behalf of the corporation;

2. business entity in which a director, officer or employee of the corporation has an interest;

3. former director or [,] ~~officer~~ [~~or employee~~] of the corporation on or before the first [~~second~~] anniversary of the date the person ceased to be a director, officer or employee of the corporation; or

policy

4. business entity in which a former director or [,] ~~officer~~ [~~or employee~~] of the corporation has an interest on or before the first [~~second~~] anniversary of the date the person ceased to be a director or [,] ~~officer~~ [~~or employee~~] of the corporation.

(j) An agreement or transaction entered into in violation of Subsection (i) is void

(k) For purposes of this section, a person has an interest in a business entity if:

1. the person owns five percent or more of the voting stock or shares of the business entity;

2. the person owns five percent or more of the fair market value of the business entity:

3. [~~money received by the person from the business entity exceeds five percent of the person's gross income for the preceding calendar year~~]

Education Code

Chapter 66. Permanent University Fund

Sec. 66.02 Available University Fund

The dividends, interest and other income from the permanent university fund shall constitute the available university fund. All accrued income derived from the permanent university fund shall be deposited in the State Treasury to the credit of the available university fund once a month by the fund's bank custodian [~~within five days after receipt by any state officer, agent or employee~~].

Sec. 66.07 Investment Securities and Proceeds

Add Section 66.07 to read as follows:

a) All securities owned or taken as collateral by the fund may be held in trust in a bank or trust company designated by the board;

b) Securities purchased or sold by the fund or taken or released as collateral by the fund may be delivered to or from the bank or trust company designated by the board in accordance with normal and recognized practices of the securities and banking industries;

c) All net cash proceeds from investment transaction of the fund shall be received and held in trust by the bank or trust company designated by the board and be fully invested as determined and directed by the board;

d) In this section, "fund" means the permanent university fund and 'board' means the board of regents of The University of Texas System.

State of Texas Constitution

Article VII, Education

Section 11a. <u>Investment of Permanent University Fund</u>
Paragraph 3

<u>"Annual distributions from the Permanent University Fund in an amount equal to 5% of the average market value of the Permanent University Fund for the previous twelve fiscal quarters,</u> [~~The interest, dividends and other income accruing from the investments of the Permanent University Fund~~,] except the portion thereof which is appropriated by the operation of Section 18 of Article VII for the payment of principal and interest thereunder, shall be subject to appropriation by the Legislature to accomplish the purposes declared in Section 10 of Article VII of this Constitution."

- convert to an equilibrium based spending formula from the existing income only requirement
- improve the probability of achieving endowment objectives of preserving purchasing power of <u>both</u>

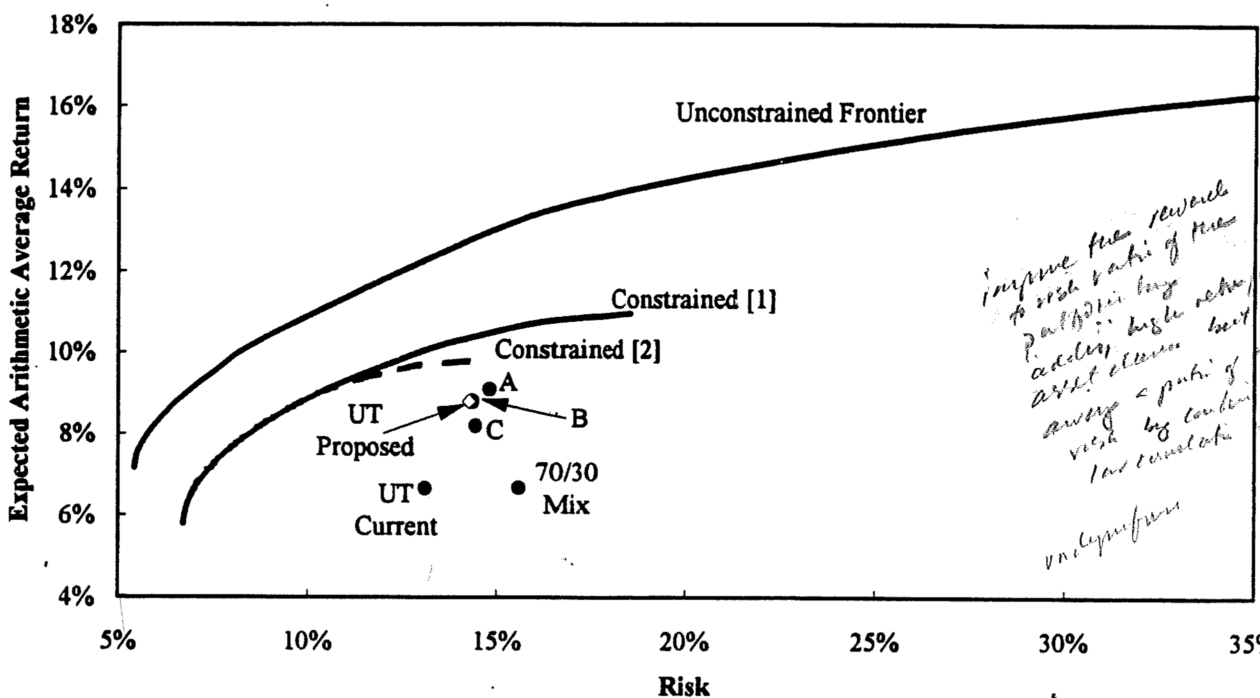
THE UNIVERSITY OF TEXAS INVESTMENT MANAGEMENT COMPANY
PERFORMANCE SUMMARY
APRIL 30, 1996

	Periods Ended April 30, 1996								Fiscal Year To Date
	One Month	Three Months	Six Months	One Year	Two Years	Three Years	Five Years	Seven Years	Eight Months Ended April 30, 1996
Permanent University Fund	0.9	1.5	7.6	20.1	14.9	11.4	11.4	10.9	9.8
Fixed Income-Internal(1)	(0.9)	(4.1)	(0.2)	9.8	9.0	6.6	9.2	10.1	2.8
Equities-Fayez Sarofim(2)	0.9	3.2	13.7	32.5	27.6	19.1	14.9	16.3	21.6
Equities-Holland Timmins(2)	1.1	3.7	11.9	21.1	19.6	13.8	-	-	16.5
Equities-Austin Calvert(2)	1.2	4.3	15.5	24.7	19.4	14.8	-	-	14.9
Equities-Kempner(2)	0.8	2.3	11.0	19.9	16.6	12.8	-	-	11.9
Equities-Greg Cox(2)	0.9	3.1	16.0	30.9	20.0	16.2	-	-	19.4
Equities-Wells Fargo S&P(2)	1.5	3.4	13.7	30.3	23.7	17.1	-	-	18.5
Equities-Wells Fargo Mid Cap(3)	3.1	7.9	13.9	30.0	19.6	17.2	-	-	13.9
Equities-HUB Managers(4)	10.5	17.8	19.1	39.2	23.9	-	-	-	15.4
Equities-Schroder Wertheim(5)	7.4	15.0	23.8	33.4	18.8	-	-	-	18.0
Total Domestic Equities	2.3	5.5	14.6	29.1	21.3	15.9	13.5	11.8	16.9
International Equities-Boatmen's(6)	2.8	5.4	13.3	12.0	8.4	11.2	-	-	12.5
Total Equities	2.4	5.5	14.4	27.2	19.8	15.3	13.2	11.5	16.4
Private Investments(7)	3.5	20.3	23.6	67.3	31.2	31.5	17.2	12.7	18.5
Long Term Fund	1.7	5.2	9.3	20.9	15.5	12.0	15.7	11.1	11.3
Fixed Income-Internal(1)	(0.7)	(3.4)	0.4	10.0	8.8	6.5	9.4	10.2	3.2
Equities-Fayez Sarofim(2)	0.9	3.5	13.8	32.5	27.2	18.8	-	-	21.4
Equities-Holland Timmins(2)	1.1	3.8	11.7	20.6	19.1	13.4	-	-	16.1
Equities-Austin Calvert(2)	1.2	4.4	15.5	24.7	19.4	14.6	-	-	14.9
Equities-Kempner(2)	0.9	2.4	11.0	20.2	16.7	12.5	-	-	12.0
Equities-Greg Cox(2)	0.9	3.1	16.4	31.4	20.2	16.5	-	-	19.8
Equities-Wells Fargo S&P(2)	1.5	3.4	13.8	30.4	23.7	17.3	-	-	18.5
Equities-Wells Fargo Mid Cap(3)	3.1	7.9	13.9	30.0	19.6	17.2	-	-	13.9
Equities-HUB Managers(4)	10.5	17.9	19.2	39.7	24.2	-	-	-	15.3
Equities-Bankers Trust(4)	13.3	22.4	27.2	-	-	-	-	-	-
Equities-MBA Investments(2)	2.6	7.0	7.0	-	-	-	-	-	-
Equities-Artisan Partners(5)	5.5	13.9	18.5	-	-	-	-	-	-
Equities-Schroder Wertheim(5)	7.1	14.9	23.4	32.2	17.8	-	-	-	17.4
Total Domestic Equities	2.8	6.3	15.4	30.1	21.8	16.2	13.5	11.5	18.0
International Equities-Boatmen's(6)	2.8	5.4	13.0	12.0	8.4	11.2	-	-	12.3
International Equities-Templeton(6)	3.0	2.6	-	-	-	-	-	-	-
Total Foreign Equities	2.8	4.9	12.4	-	-	-	-	-	11.8
Total Equities	2.8	6.1	15.0	28.2	20.3	15.3	13.0	11.2	17.3
Private Investments(7)	1.6	8.0	9.2	35.9	22.8	26.8	-	-	6.6
Short/Intermediate Term Fund(8)	0.0	(0.5)	1.8	6.2	5.8	4.5	-	-	3.1
Short Term Fund(9)	0.4	1.3	2.7	5.6	5.4	4.6	4.5	-	3.7
Index Benchmarks:									
1. Salomon Broad Bond Index	(0.7)	(3.1)	0.4	8.6	7.9	5.5	8.2	9.3	2.7
2. S&P 500 Index	1.5	3.4	13.8	30.2	23.7	17.2	14.9	14.6	18.1
3. S&P Mid Cap Index	3.1	7.8	13.9	29.8	19.4	16.1	16.6	16.7	13.7
4. Wilshire Small Cap Growth Index	7.5	15.7	20.7	40.2	26.1	23.2	20.0	15.5	17.1
5. Wilshire Small Cap Value Index	(0.3)	2.1	8.3	23.6	16.0	12.0	18.8	14.0	11.1
6. World ex U.S. Index	3.2	5.2	13.7	11.8	8.3	11.0	8.6	4.9	12.6
7. S&P 500 Index +5%	6.5	8.4	18.8	35.2	28.7	22.2	19.9	19.6	23.1
8. Composite Index	0.0	(0.3)	2.0	6.9	6.4	4.8	-	-	3.4
9. Donoghue's Institutional Average	0.4	1.2	2.6	5.5	5.1	4.4	4.3	-	3.5
10. Consumer Price Index	0.4	1.0	1.6	2.8	2.9	2.7	2.9	3.4	2.1

expect to see performance [illegible]

THE UNIVERSITY OF TEXAS SYSTEM
LONG TERM
Efficient Frontier Analysis

Expressed a desire to review asset allocation at the August meeting; at the time it was indicated that it was important for Board to define the risk tolerance for the fund prior to constructing asset allocation



improve the reward to risk ratio of the portfolio by adding higher return/higher risk asset classes but diversifying away a portion of the incremental risk by combining assets w/ low correlation

[illegible]

Asset Class	School A Allocation	School B Allocation	School C Allocation	UT Current Allocation	UT Proposed Allocation
Domestic Common Stocks	30.4%	19.2%	28.7%	41.4%	25.0%
Small Cap	7.6	4.8	7.4	3.4	10.0
International Equity	15.0	12.3	14.1	3.9	12.0
Emerging Markets	5.0	4.1	5.2	0.0	3.0
Marketable Alternative Assets	2.0	16.6	1.7	0.0	10.0
Non-Marketable Alternative Assets	12.0	12.8	8.9	5.0	10.0
Real Estate	7.0	6.0	12.0	0.0	5.0
Oil & Gas	6.0	1.6	0.6	1.4	5.0
Domestic Fixed Income	10.0	22.6	19.3	44.9	15.0
International Fixed Income	5.0	0.0	2.5	0.0	5.0
Expected Compound Return	8.1%	7.9%	7.3%	5.9%	7.9%
Expected Arithmetic Average Return	9.1	8.8	8.2	$\boxed{6.7}$	8.8
Expected Risk	14.8	14.4	14.4	$\boxed{13.1}$	14.3
Return/Risk	0.61	0.61	0.57	$\boxed{0.51}$	0.62

still a low return/risk ratio

-6.4 - 19.8 　　 -23.1
-19.5 - 32.9 　　 -37.4
-32.6 - 46.0 　　 -51.7

[1] The constrained curve limits emerging markets, absolute returns investments, venture capital, real estate, and oil & gas to 10% each.
[2] The second constrained curve holds the above limitations, and maintains a floor of 20% on domestic fixed income.
Note: Totals may not add due to rounding.

5/2/96

based on averages
to capture risk
and the 7 year spread
- to identify risks
- to evaluate and manage

Capital At Risk Summary Report

University of Texas - Assets as of Feb 26, 1996

Total Risk => The Maximum Loss that will occur over the next year with 99% confidence

	Total Risk	Market Value Modeled	Total Fund MV	% Modeled	Risk as % of MV Modeled
Total Portfolio	(270,875,877)	1,632,578,762	1,705,013,180	96%	(16.6%)

99% certainty that the fund will not suffer a cumulative loss over the next 12 mos of 16.6% or $270 million.

Absolute Risk => The risk of those assets in isolation

Incremental Risk => The change to the total portfolio risk if those assets are removed

• 3 years - based on vol on equity
• private investments use Russell 2000

Risk Type Detail

	Incremental Risk	Absolute Risk	Market Value	Total Exposure	Incr as % of Exp	Abs as % of Exp	Incr as % of MV	Abs as % of MV
Equity	(209,348,729)	(234,307,945)	1,086,864,887	1,085,891,396	(19.3%)	(21.6%)	(19.3%)	(21.6%)
Currency	(706,584)	(31,423,473)	0	179,105,500	(0.4%)	(17.5%)	N/A	N/A
Interest Rate	(35,167,501)	(52,043,426)	545,713,874	604,537,203	(5.8%)	(8.6%)	(6.4%)	(9.5%)

315

risk reduction
target asset allocation
not manager select

- decompose securities into risk components - eq, curr, int.

Investment in Tobacco Companies

- in May - State of Texas joined 90 other States in suing tobacco industry to seek recovery of $ medical payments for tobacco-related illnesses.
- asked Board to consider divestiture decision on a legal [illegible]

Consideration of Divestiture

UTIMCO
THE UNIVERSITY OF TEXAS
INVESTMENT MANAGEMENT COMPANY

U.T. SYSTEM
TOBACCO HOLDINGS AS OF APRIL 30, 1996
(number of shares rounded to nearest even number)

e.n. Limit

Fund	Phillip Morris	UST Inc.	Am Brands	Universal Corp	Loews	Total
PUF						
Fayez Sarofim	80,000	0	0	0	0	
Kempner Capital	7,900	0	0	0	0	
Greg Cox	74,100	0	0	0	0	
Holland Timmins	168,600	330,700	0	0	0	
Active	330,600	330,700	0	0	0	
Indexed	111,571	25,856	24,337	25,743	15,777	
LTF						
Fayez Sarofim	13,500	0	0	0	0	
Kempner Capital	2,100	0	0	0	0	
Greg Cox	27,700	0	0	0	0	
Holland Timmins	56,100	128,700	0	0	0	
Active	99,400	128,700	0	0	0	
Indexed	54,161	12,552	11,814	9,388	7,659	
Total Shares	**595,732**	**497,808**	**36,151**	**35,131**	**23,436**	
Price Per Share	**$77.00**	**$32.00**	**$51.50**	**$24.00**	**$76.25**	
Total Value	**$45,871,364**	**$15,929,856**	**$1,861,777**	**$843,144**	**$1,786,995**	**$66,293,136**
	70%	25%		5%		
	75% active	25% active				

Review of Litigation (cont.)

1960-1980s

- *1966: Health warning required on all cigarette products and advertising*
  - *strengthened legal defense that smokers were aware of danger*
- *1984: federal court ruled PM, Lorillard and Liggett liable for lung cancer in individual suit filed on behalf of Rose Cipilone*
- *1988: Cipilone overturned on appeal*
  - *end of suits pursued on behalf of individuals*

Review of Litigation (cont.)

3rd wave initiated in early 1994 based on new evidence that industry mfg have suppressed studies, manipulated addictive properties of nicotine

1990s - *New tactics to circumvent difficulty in proving individual causation*

- *Class Action Suits*
  - *largest is Castano vs. American Tobacco Co.*
    - *filed 1994 on behalf of all 50 million smokers "addicted" to nicotine*
    - *65 law firms pledging to spend $100k annually*
    - *focus not on harmful effects of smoking*
      - *on addictive properties of nicotine and industry concealment of supporting data*

Review of Litigation (cont.)

· States are seeking independent status to sue the industry separate from smokers individual claims!
· if goes, will not have to overcome defense that plaintiffs ignored warning labels
- novel argument which must survive a more conservative and precedent oriented appellate court

State Medicaid Suits

most visible legal threat remaining to industry -
10 states have filed including Texas and more expected -
· imp - built on untested legal theories!

- State of Mississippi files suit to recover Medicaid costs incurred in treating tobacco related illness
- State of Florida passes legislation allowing statistical evidence to be used as evidence
  - designed to eliminate the individual assumption of risk defense
- Seven other states (including Texas on 5/96) follow
  - complicated by state excise taxes

still must prove that health costs were directly related
· how to argue that health costs exceed the amount that state collects on excise taxes

THE UNIVERSITY OF TEXAS INVESTMENT MANAGEMENT COMPANY

FDA Regulation of Tobacco

- FDA argues that effects of nicotine qualify it as a drug
  - jurisdiction would allow FDA to:
    - ban tobacco outright
    - limit levels of tar and nicotine in cigarettes

based on flexibility of statute giving
- allow tobacco to remain on market even if not proven safe + effective
- allow FDA more leeway in regulating a certain segment of drugs
- drugs => total ban

- taking tactic that cig + smokeless are medical devices rather than drugs
- proposed regulation in 3 areas - limiting access, limiting advertising + promotion, education + awareness 150 mil

- Industry disputing FDA claim to jurisdiction
  - filed suit in NC seeking a permanent injunction preventing FDA from taking any action against industry
  - since early 1950s courts have ruled that FDA has no jurisdiction over drugs or devices unless a therapeutic benefit is being represented

conclusions

- Jurisdiction requires President to enact legislation
  - FDA would prefer to have new legislation drawn up by Congress than risk a challenge in court
  - will require Presidential initiative won't be forthcoming during this election year

Review of Historical Equity Performance

- *Tobacco industry has outperformed the S&P500 Index*
  - *by 750% since 1970*
  - *by 125% since 1984 (in 9 of last 12 years)*
- *Price multiples historically have moved with the litigation environment*
  - *poor performance during periods of high profile litigation*
  - *market has not paid for exceptional relative earnings growth*
  - *tobacco investments acquired in the face of litigation have performed exceptionally well*

Outlook

- *Litigation risk overdiscounted*
- *Several avenues to resolution of litigation*
  - *New tactics have no precedent of success at appellate level*
  - *decertification of Castano should lead to similar decertifications at State level*
  - *settlement of Medicaid recovery suits through increase and dedication of excise taxes for Medicaid*
    - *PM expected to pay $14 billion in excise taxes and $4.5 billion in income taxes in 1996*

difficult for State to effectively argue that it should be reimbursed for damages caused by cigarettes that it allowed to be sold and profited from

- 50 State excise tax collected 5.2 BN 7.0 BN
- programs are ...
- increase in taxes earmarked method
- 9 states
↑ prices 15%
↓ volume consumption 6%

- milk the CE

THE UNIVERSITY OF TEXAS INVESTMENT MANAGEMENT COMPANY

Outlook (cont)

- *Industry agreement/ compromise with FDA*
  - *support efforts to reduce underage smoking*

to but ban on advertising + reduction in year smoking [illegible] - capital availability - 5-6% decline in share value -

- *Strong fundamental industry growth prospects versus S&P500 Index will continue*

expect P/E to return to historical 80-85% relative valuation vs S&P 500 · 115-130 10S

- *Tobacco stocks rated strong buys, buys or holds*
  - *Goldman Sachs, Merrill Lynch, Salomon Bros., Smith Barney, Lehman Bros., Bernstein*
  - *Internal staff*
  - *Fayez Sarofim, Kempner Capital Management*

release litigation risk would allow RJR to spin off Nabisco -

- UST - relative normalized multiple - 438

UTIMCO

THE UNIVERSITY OF TEXAS INVESTMENT MANAGEMENT COMPANY

Recommendation

- ***No divestiture based on current risk adjusted return expectations***

Fayez Sarofim & Co.
Two Houston Center, Suite 2097
Houston, Texas 77010
(713) 654-4484

Founded:	1958
Employee Ownership:	90% of firm owned by current, active employees.
Assets Under Management:	$28 billion
Tax Exempt	$24 billion
Company Characteristics:	U.S. based multinational companies with above average growth rates in earnings and dividends.
Portfolio Structure:	Top down analysis identifies trends or themes to select industry concentration. Fundamental analysis to implement sector decision with an emphasis on larger companies.
Portfolio Characteristics:	versus S&P: P/E =, 5 yr. EPS >, 5 yr. div growth >, ROE >
Portfolio Distribution:	Concentrated industry sector bets, diversified within sectors.
Number of Companies:	40 - 55 (Universe of 400 companies closely watched)
Cash Holdings:	fully invested, unless unusual market circumstances warrant.
Ave. Annual Turnover:	5% - 15%
Research:	Primary: 80% internally generated fundamental research. Source: Government agencies, outside consultants, Wall Street, clients

Key Investment Personnel:

Fayez Sarofim	Russell B. Hawkins
Ralph B. Thomas	James A. Reynolds, III
Raye G. White	Russell M. Frankel
William K. McGee, Jr.	Nancy V. Daniel
Charles E. Sheedy	

Private Investments Commitment Activity
By Date of Approval

	1995	1996					1997	1998	1999
	Total	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	**Total**	**Total**	**Total**	**Total**
The Woodlands/Essex Venture Fund III, L.P.	**$5.0**								
Austin Ventures IV, L.P.	**$5.0**								
Rice Partners II, L.P.	**$25.0**								
Citicorp Mezzanine Partners, L.P.	**$25.0**								
Clayton, Dubilier & Rice Fund V, L.P.	**$20.0**								
Carlyle Partners II, L.P.	**$10.0**								
KB Mezzanine Partners II, L.P.	**$25.0**								
Wingate Partners II, L.P.	**$15.0**								
Morgenthaler Ventures IV, L.P.	**$15.0**								
SCF III, L.P.	**$20.0**								
North American Fund II, L.P.	**$15.0**								
PMI Mezzanine Fund, L.P.	**$25.0**								
Asian Corporate Finance Fund, L.P.	**$20.0**								
Technologies for Information & Entertainment III, L.P	**$10.0**								
Texas Growth Fund II	**$10.0**								
VS&A Communications Partners II, L.P.	**$30.0**								
Information Technology Partners, L.P.*	**$10.0**								
Cortec Group		$20.0							
Ampersand Ventures			$15.0						
Energy Arrow E. TX Pinnacle Reef Play			$2.0						
3i			$20.0						
CVC European Equity Partners L.P.			$30.0						
CWB Capital Partners Fund II			$30.0						
Willis Stein & Partners, L.P.			$20.0						
Atlantic Medical Partners			$10.0						
Brentwood Associates			$20.0						
Wand Partners				$30.0					
Beacon Group					*$15.0*				
*KKR***					*$50.0*				
	$285.0	$20.0	$147.0	$30.0	$65.0	**$262.0**	**$220.0**	**$173.0**	**$126.0**

*name change from New Horizon Partners, L.P.

**subject to further due diligience

CONFIDENTIAL

See Due Diligence Memorandum for

Beacon Group Focus Value Fund, L.P.

UTIMCO
MONEY FUND BALANCES
30-Apr-96

	LTF	SITF	STF	SIF	TOTAL
GSAM/FINANCIAL SQUARE					
Operating Funds					
U.T. System Administration	-	-	216.8	-	**216.8**
UT Arlington	-	-	8.4	-	**8.4**
UT Austin	-	-	98.3	-	**98.3**
UT Dallas	-	-	5.4	-	**5.4**
UT El Paso	-	-	8.2	-	**8.2**
UT Pan American	-	-	3.5	-	**3.5**
UT Brownsville	-	-	4.8	-	**4.8**
UT Permian Basin	-	-	0.4	-	**0.4**
UT San Antonio	-	-	11.5	-	**11.5**
UT Tyler	-	-	1.8	-	**1.8**
UTSWMC- Dallas	-	-	33.5	-	**33.5**
UTMB Galveston	-	-	154.4	-	**154.4**
UTHSC-Houston	-	-	29.4	-	**29.4**
UTHSC-San Antonio	-	-	6.7	-	**6.7**
UT M.D. Anderson	-	-	64.1	-	**64.1**
UTHC- Tyler	-	-	14.6	-	**14.6**
Endowment Funds					
Long Term Fund	111.9	-	-	-	**111.9**
Separately Invested Funds	-	-	-	2.1	**2.1**
sub-total	111.9	0	661.8	2.1	**775.8**

MONEY FUND BALANCES

30-Apr-96

(cont.)

	LTF	SITF	STF	SIF	TOTAL
FIDELITY MONEY MARKET					
Short/Intermediate Term Fund	-	101.7	-	-	**101.7**
sub-total	0	101.7	0	0	**101.7**
TOTAL	**111.9**	**101.7**	**661.8**	**2.1**	**877.5**

University of Texas Client Profile

University of Texas is a significant investor in the Financial Square Prime Obligations Fund, as well as a heavy consumer of operational services.

Goldman Sachs

Investment:	Financial Square Prime Obligations Fund
Fund description	A1-P1 rated securities only, which include US gov't secs, obligations of US banks and US companies, cp and repo
Average balance	$435 million
Average number of transactions per day	23
Number of sub-accounts	1 Primary system account (Austin) 16 Sub-accounts (Campuses)
Number of wire addresses	98 Destinations
Number of redemptions [05/01/95 - 05/01/96]	4,937
Number of purchases [05/01/95 - 05/01/96]	2,609
Number of exchanges [05/01/95 - 05/01/96]	816
Number of wires [05/01/95 - 05/01/96]	4,937
Total number of transactions [05/01/95 - 05/01/96]	8,362
Number of client service calls [05/01/95 - 05/01/96]	778
*Average service level [05/01/95 - 05/01/96]	95%
Accuracy of wire transfers [05/01/95 - 05/01/96]	100%

* GSAM tracks all client calls, but also has a separate tracking system to ensure that our top 10 clients - which includes UT - calls are answered within 18 seconds.

Institutional Money Market Funds

Fund Family	Total Size 12/31/95 ($Bil)	Prime Fund 3/31/96 ($Bil)	Fee (bps)	Internal PrimeFund 3/31/96 ($Bil)	Fee (bps)
Federated	29	3.9	20	-	-
Fidelity	26	1.1	18	6.4	18
Dreyfus	21	2.3	20	5.0	20
Goldman Sachs	18	5.0	18	3.1	18
Provident	16	7.2	18	2.6	18

Efficient and Cost-Effective Cash Management Alternatives

FS Prime, a separate pooled account, and a University of Texas proprietary fund, each have different revenue, expense and service dynamics.

	FS Prime Obligations Fund	Separately Managed Account	University of Texas Proprietary Fund
Determinants of Gross Yield:			
– Weighted Average Maturity	Maximum flexibility	Limited by size and cash flows	Limited by size and cash flows
Determinants of Expense:			
150,000 – Management Fees – Fund Administration Fees	17 BPs net Included in "Management Fees"	Negotiated: 10 to 15 BPs Separate: 2 to 5 BPs	Negotiated: 10 to 15 BPs Separate: 5 to 20 BPs
121,000 80,000 – Custody and Fund Accounting – Shareholder Servicing/Accounting	Included in "Other" 4 BPs (included in "Fund Administration")	Separate: 2 to 5 BPs Separate: $400,000 (5 BPs)	Separate: $115,000 (2 BPs) Separate: $400,000 (5 BPs)
50,000 – Other (e.g., audit, outside counsel)	1.5 BPs gross; 1 BPs net	Separate: $75,000 to $150,000 (1 to 2.5 BPs)	Separate: $130,000 (6 BPs)
400,000 – 5.7 bps realized – **Impact on Gross Yield**	All inclusive, capped @ 18 BPs	Range: 21 to 33 BPs	Range: 25 to 35 BPs Lipper Avg.: 39 BPs
Management Issues			
– Regulatory Oversight	• 1940 Act provides standards for management, accounting and risk management	• Subject to local regulatory oversight	• 1940 Act provides standards for management, accounting and risk management
– Special Operational Services	• Available	• Depends on choice of custodian	• Available
– Electronic Access (e.g. SMART)	• Available	• Depends on choice of custodian	• Available

Goldman Sachs