ANNUAL REPORT

2019

UTIMCO 1996

210 West 7th Street, Suite 1700, Austin, TX 78701
512.225.1600 • utimco.org

UTIMCO AT A GLANCE

- Created March 1996
- Manages the investment assets under the fiduciary care of the U.T. System Board of Regents
- $47.7 billion under management as of August 31, 2019
- 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, 2019, the Permanent University Fund (PUF) and the General Endowment Fund (GEF) returned +4.5%. The value added by the active management decisions of the UTIMCO team was +0.1% over the Endowments' Benchmark Policy Portfolio returns of +4.4%. Over the last 10 years, the Endowments have grown at an annualized rate of +8.4% which exceeded the benchmark return by +1.3% annually.

During the year, the total value of the Endowments grew from $32.3 billion to $35.5 billion, an increase of $3.2 billion, and total assets managed by UTIMCO grew by $2.6 billion to end the year at $47.7 billion. Over the last ten years the Endowments have increased in value by $20.4 billion from there starting value of $15.1 billion in August 2009. Over that same 10 year period totals asset managed increased by $27.2 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 tenth consecutive year of an equity market expansion and is now the 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 333%, leading to total returns of 439% 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 Bank (the "Fed"), 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. In 2018, the Fed began raising rates which led to a sharp equity market decline in the fourth quarter of 2018 with the S&P 500 narrowly missing the 20% decline

Rich Hall
Deputy Chief Investment Officer

Figure 1

Economic and Financial Condition Indicators[1]

	Then	Now	Total Change	Annualized
S&P 500				
Price	676.5	2,926.5	+332.6%	15.0%
Price/Earnings Ratio (Forward/Trailing)	11.2/11.1	17.7/19.3	+6.5/+8.2	
Volatility	38.5	15.4	23.1%	
US UNEMPLOYMENT (%)	8.3	3.7	-4.6%	
10-YEAR TREASURY-NOTE YIELD (%)	2.9	1.5	-1.4%	
GROSS DOMESTIC PRODUCT GROWTH YEAR OVER YEAR (%)	0.6	4.3	+3.7%	
INFLATION YEAR OVER YEAR (%)	0.2	1.7	+1.5%	
FEDERAL FUNDS RATE (%)	0.25	2.25	+2.0%	
SIZE OF FEDERAL BALANCE SHEETS ($, TRILLIONS)	$1.9	$3.7	$1.9	

[1] Source: Bloomberg
Then refers to 3/9/2009, now refers to 8/31/2019

Joan Moeller
Senior Managing Director and Chief Operating Officer

which typically represents a bear market. The Fed reversed this trend in 2019 and equity markets rallied strongly. The Fiscal Year straddled both of these periods which led to moderate investment returns for the funds managed by UTIMCO.

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,

	2019		2018	
GLOBAL EQUITY				
Public Equity	$10,830.5	30.5%	$9,911.3	30.7%
Directional Hedge Funds	4,221.0	11.9%	4,538.2	14.1%
Private Equity	7,531.4	21.2%	6,811.8	21.1%
TOTAL GLOBAL EQUITY	22,582.9	63.6%	21,261.3	65.9%
STABLE VALUE				
Global Fixed Income	3,266.8	9.2%	2,286.4	7.1%
Stable Value Hedge Funds	2,621.2	7.4%	1,330.4	4.1%
Cash and Other Assets/Liabilities	397.0	1.1%	614.3	1.9%
TOTAL STABLE VALUE	6,285.0	17.7%	4,231.1	13.1%
REAL RETURN				
Gold and Commodities	490.6	1.4%	818.2	2.5%
Natural Resources	2,522.1	7.1%	2,933.4	9.1%
Infrastructure	799.8	2.3%	554.5	1.7%
Real Estate	2,791.3	7.9%	2,497.3	7.7%
TOTAL REAL RETURN	6,603.8	18.7%	6,803.4	21.0%
TOTAL ENDOWMENTS	$35,471.7	100.0%	$32,295.8	100.0%

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 rose from a low of 1.3% in 2016 to 1.9% today. 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. Today, the US 10 year rate is 1.9% versus annual inflation of 1.7%.

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.

Figure 3

Annualized Returns

(Periods Ending August 31, 2019)

	TEN YEARS		TWENTY YEARS	
	Endowments	Policy Benchmark	Endowments	Policy Benchmark
Return	8.41%	7.10%	6.72%	5.44%
Volatility	5.33%	6.20%	7.63%	7.75%
Sharpe Ratio[1]	1.57	1.14	0.88	0.70

[1]Sharpe Ratio is the average return earned in excess of the risk free rate per unit of votality or total risk.

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 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.

Figure 4

Investments Returns by Portfolio

	ONE YEAR			FIVE YEARS		
	Return	Benchmark	Over/(Under)	Return	Benchmark	Over/(Under)
GLOBAL EQUITY						
Public Equity	1.6%	(1.3%)	2.9%	6.0%	4.0%	2.0%
Directional Hedge Funds	3.8%	0.4%	3.4%	4.1%	2.1%	2.0%
Private Equity	11.3%	11.9%	(0.6%)	11.8%	10.5%	1.3%
TOTAL GLOBAL EQUITY	5.2%	3.8%	1.4%	6.8%	5.7%	1.1%
STABLE VALUE						
Global Fixed Income	8.8%	10.7%	(1.9%)	2.3%	2.2%	0.1%
Stable Value Hedge Funds	6.1%	2.2%	3.9%	3.8%	2.5%	1.3%
Cash	2.4%	2.4%	0.0%	0.9%	0.9%	0.0%
TOTAL STABLE VALUE	6.2%	6.8%	(0.6%)	1.8%	2.3%	(0.5%)
REAL RETURN						
Gold	26.5%	26.6%	(0.1%)	3.4%	3.4%	0.0%
Natural Resources	(9.6%)	(5.3%)	(4.3%)	4.2%	6.9%	(2.7%)
Infrastructure	3.6%	9.6%	(6.0%)	13.4%	10.1%	3.3%
Public Real Estate	4.5%	8.1%	(3.6%)	3.6%	4.9%	(1.3%)
Private Real Estate	8.5%	6.6%	1.9%	15.3%	9.5%	5.8%
TOTAL REAL RETURN	1.2%	3.7%	(2.5%)	5.1%	4.9%	0.2%
TOTAL ENDOWMENTS	4.5%	4.4%	0.1%	6.1%	5.2%	0.9%

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.

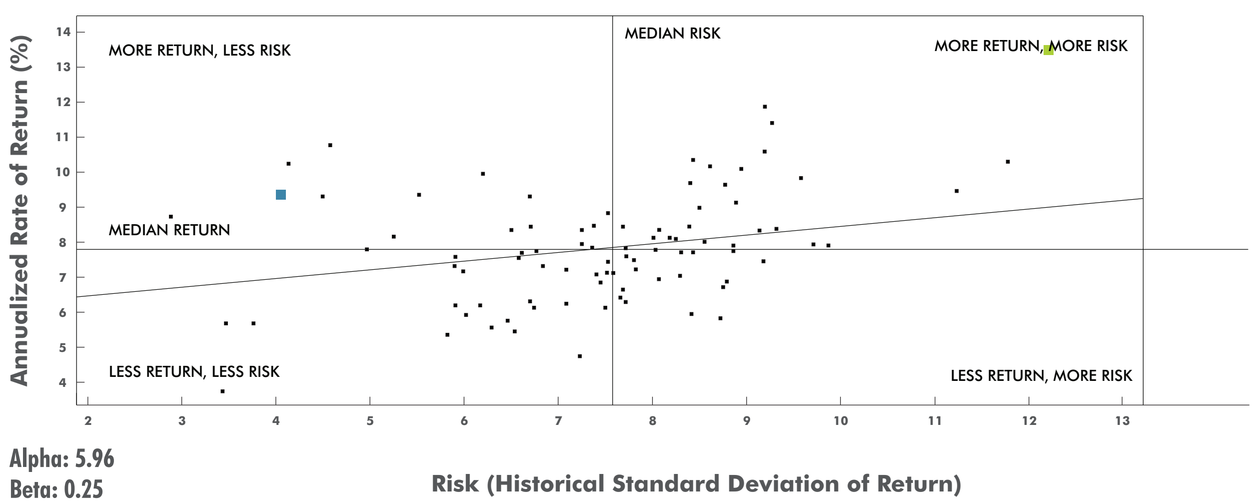
The objective of our risk management processes is not to avoid any and all risk, but rather to manage through various environments effectively by assuring that UTIMCO is always the “strong hand” in the market. This allows us to not only weather the inevitable and unpredictable financial storms, but also 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.

Figure 5

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

3 Years Ending September 30, 2019



Alpha: 5.96
Beta: 0.25
R-Squared: 0.08

	Risk Value	Risk Rank	Return Value	Return Rank
GEF TOTAL FUND	4.09	94	9.25	20
S&P 500	12.25	1	13.39	1
MEDIAN	7.58		7.79	

Bear markets are generally the result of one of the following five factors: recessions, commodity disruptions, Fed policies, global geopolitical events and/or excessive valuations. The US stock market came close to a bear market (typically a decline of 20% from its peak) in December 2018 in response to the Fed’s series of rate increases during the course of the year. It has rebounded during the course of 2019 in response to rate reductions by the Fed. 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 94% of other similar funds while producing a three-year return exceeding the peer median and a passive benchmark.

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 Chariman

R. Steven Hicks
Vice Chairman for Policy

Janiece Longoria

Robert Gauntt

Janet Handley

Ray Nixon

Clifton L. Thomas, Jr.

James Conrad Weaver

Jeffery D. Hildebrand **Former Member and Vice Chairman:** Board of Regents, The University of Texas System / **Founder and Chairman:** 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; Texas Oil & Gas Association Distinguished Service Award / **Board Member:** Central Houston, Inc.; Houston Livestock Show and Rodeo; Houston Police Foundation; The Hildebrand Foundation / **Commissioner:** Texas Parks & Wildlife Commission

Ray Rothrock **Chair:** UTIMCO Compensation Committee; UTIMCO Cybersecurity Committee / **Member:** UTIMCO Risk Committee; Forbes Midas List; Corporation for the Massachusetts Institute of Technology, Nuclear Threat Initiative / **CEO:** RedSeal, Inc. / **Partner Emeritus:** Venrock / **Recipient:** 2016 Texas A&M University Distinguished Alumnus Award / **Past Chairman:** National Venture Capital Association; Texas A&M Foundation / **Board Member:** Check Point Software Technology (NASDAQ: CHKP); Roku (NASDAQ: ROKU); Several Private Companies including Team8, Shape Security, CTERA, Unbound Tech, and Tri Alpha Energy; BreakThrough Institute / **Speaker:** Cyber Security, Venture Capital, Nuclear energy, Climate Change & Energy Policy in general / **Co-Executive Producer:** *Pandora's Promise* and *Chasing the Moon* Documentaries / **Advisor:** Nuclear Energy Advisory Committee (DOE)

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

Janiece Longoria **Member:** UTIMCO Risk Committee; UTIMCO Cybersecurity Committee; Board of Regents, The University of Texas System - Academic Affairs Committee; Board of Regents, The University of Texas System - Finance and Planning Committee; System Review and Structure Task Force / **Vice Chairman:** Board of Regents, The University of Texas System / **Chairman:** Board of Regents, The University of Texas System - Health Affairs Committee / **Board Member:** Federal Reserve Bank of Dallas, Houston Division; Superior Energy Services, Inc.; M.D. Anderson Services Corporation / **Founder:** Center for Women in Law at The University of Texas School of Law / **Recipient:** The University of Texas Distinguished Alumnus Award; The University of Texas President's Citation Award; The University of Texas School of Law Distinguished Alumnus Award; Houston Port Bureau Maritime Person of the Year for 2017 / **Chairman:** Port Houston, 2013 to January 31, 2019 / **Commissioner:** Port Houston, 2002 to January 31, 2019

Robert Gauntt **Chair:** UTIMCO Risk Committee / **Member:** UTIMCO Compensation Committee; UTIMCO Cybersecurity Committee; The University of Texas Chancellor's Council Executive Committee; Ascend Mission Academy - Africa; RBI Austin / **Founding Partner:** Avalon Advisors, LLC (2001-2018); Capital Creek Partners (2019-Present) / **Former Chairman:** Investment Committee and Risk Management Committee of the Teacher Retirement System of Texas Board of Trustees / **Former Member:** The University of Texas at Austin McCombs School of Business Advisory Council; Texas Growth Fund Board; Endowment Committee at River Oaks Baptist School and Provision School Houston / **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; UTIMCO Compensation 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

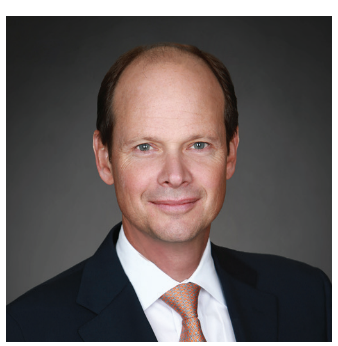
Ray Nixon **Member:** UTIMCO Compensation Committee; UTIMCO Policy Committee; The University of Texas at Austin McCombs School of Business Advisory Council; UT Southwestern Foundation Investment Committee / **Chairman:** Nixon Capital; Texas Health Resources Endowment Investment Committee / **Trustee:** UT Southwestern Foundation - Investment Committee / **Inductee:** The University of Texas McCombs School of Business Hall of Fame / **Board Member:** Dallas Seminary Foundation / **Former Board Member:** Salvation Army; East West Ministries; Presbyterian Foundation; Dallas Police & Fire Pension Plan; Susan G. Komen Investments; CFA Society of DFW 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 Finance; 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 Academic and Student Affairs / **President, Owner, CEO:** C.L. Thomas, Inc.; Speedy Stop Food Stores; Thomas Fuels / **Owner, Chairman and Board Member:** Pilot Thomas Logistics / **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 - 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; University Lands Advisory Board / **Vice Chairman:** Board of Regents, The University of Texas System / **Chairman:** Board of Regents, The University of Texas System - Academic Affairs Committee / **CEO:** McCombs Partners / **Board Member:** Cox Enterprises; KB Homes; Circuit of the Americas; Allegiance Ambulance; General LED

UTIMCO LEADERSHIP TEAM

Britt Harris
President, CEO and
Chief Investment Officer



Rich Hall
Deputy Chief Investment
Officer

Joan Moeller
Senior Managing Director
and Chief Operating Officer

Ken Standley
Chief of Staff

Susan Chen
Managing Director –
Public Equity

Anna Cecilia Gonzalez
Corporate Counsel and
Chief Compliance Officer

Michael Dean
Senior Director –
Human Resources

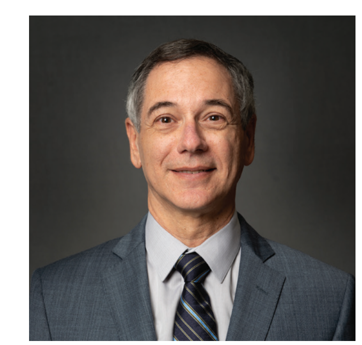
J. Russell Kampfe
Managing Director –
Fixed Income

Edward Lewis
Managing Director –
Real Return

Patrick Pace
Managing Director –
Private Equity

Ryan Ruebsahm
Managing Director –
Hedge Funds

Scott Slayton
Managing Director -
Tactical Asset Allocation



Uziel Yoeli
Managing Director –
Risk Management

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