

ENDOWMENT FUND ANNUAL REPORT

JUNE 30, 2006



University of Maine System

ANNUAL ENDOWMENT REPORT

The Endowment funds of the University of Maine System are subject to the restrictions of gift instruments requiring that the principal be invested and current expenditures be funded from related income and appreciation.

Management

The following persons meet quarterly to provide oversight of the Endowment and to make portfolio management and investment management decisions for the fund:

- Board of Trustees Investment Committee
- Investment Consultant – New England Pension Consultants – Cambridge, MA
- Joanne Yestranski - CFO & Treasurer, UMS
- Tracy Elliott – Director of Finance & Controller, UMS
- Peter Small – Institutional Research Analyst, UMS

Governing Policy

A formal investment policy governs the Endowment Investment Process. The Investment Policy details:

- Total return and risk objectives
- Spending Policy
- Permitted and Excluded Investments
- Asset Allocation guidelines with defined targets and permissible ranges
- Evaluation benchmarks by asset class and for the portfolio as a whole
- Risk and Diversification requirements by asset class
- Use of Derivatives
- Performance Standards and Evaluation
- Responsibilities of all parties concerned

The Investment Policy established by the Investment Committee targets a long run minimum return objective of 9.0%. The spending policy for FY06 has been set at 5.0%.

FY 2006 Performance

The Endowment Fund did very well in FY06, returning 10.0% net of fees, ***ranking in the 40th percentile of the total fund universe*** tracked by the System's investment consultant. The assets in the plan totaled \$107.8 million, an increase of \$7.1 million over the prior year-end figure.

The plan's 5-year annualized return of 6.6% ranks it in the top 32% of all funds, while the risk taken by the fund in the 5 year period was in the 20th percentile. This return compares to an S&P 500 return of 2.5% and a Lehman Brothers Aggregate return of 5.0% over the 5 year period.

Diversification

The Endowment fund is well diversified by style and asset class, as well as internationally. The fund is diversified amongst 12 different asset classes and is managed by 11 different investment managers. The size of the fund permits fuller diversification (which enhances risk adjusted returns) as well as access to attractive asset classes/managers that smaller funds don't have access to. Additionally, larger investments benefit from reduced investment manager, consultant and custodial fees.

As of June 30, 2006, about 41% (\$44.2 million) of the fund was invested in **Domestic Equities**, which is further segmented into Passively Managed, Large Cap, and Small/MidCap investment categories. Within the Large Cap and Small/MidCap categories, the investments are further diversified into growth and value styles.

Roughly 16% of the fund is invested in **international stocks**, to provide diversification benefits and to pursue attractive equity investments worldwide.

Approximately 24% of the assets were invested in **fixed income** strategies with 16% in a Multi-Strategy Bond fund (invests in the most attractive fixed income sectors worldwide), 4% in High-Yield bonds (tactical position to benefit from high income payments and improving economy), and 4% in cash.

About 19% of the fund was invested in **alternative strategies**, with 7% in Market Neutral investments (to improve stability of return), 8% in a Global Absolute Return strategy (which seeks to invest in those asset classes worldwide which offer the best relative value), and 4% in Timber (which provides greater diversification as historically timberland has been negatively correlated with traditional assets).

The Investment Committee chose an emerging markets equity manager to achieve an approximate 3% portfolio allocation during FY2007.

The following endowment fund information is provided for fiscal year ended June 30, 2006 and includes information for the UMS **and** amounts held for affiliated organizations.

	<u>(Unaudited)</u>
Total Endowment at Market Value - June 30, 2006	<u>\$107,819,635</u>
Total Endowment at Market Value - June 30, 2005	<u>\$100,688,916</u>

The FY06 increase of **\$7,130,719** is comprised of:

Inflows:

Gifts (UMS and UMS affiliated organizations)	\$1,711,091
Charitable Gift Annuities (Net of Annuitant Payments)	234,893
Increase in Corpus for Unspent Earnings	502,490
Investment Returns:	
Income	4,396,930
Net Appreciation	6,562,346
Fees/Expenses	<u>(803,349)</u>
	12,604,401

Outflows:

5.00% Spending for Scholarships & Operations	(4,642,767)
Endowment Forwarded to Foundations at Donors' Request	<u>(830,915)</u>
	<u>(5,473,682)</u>

Net Inflows and Outflows: \$7,130,719

Attachment I reports the total returns for the Pooled Endowment fund on a net of fees basis and the fund's growth for the past 5 years, as well as the asset allocation for the fiscal years ended June 30, 2005 and 2006.

**UNIVERSITY OF MAINE SYSTEM
POOLED ENDOWMENT FUND
AS OF JUNE 30, 2006**

The following tables present the System's Pooled Endowment Fund asset allocation for the fiscal years ended June 30, 2005 and June 30, 2006, the growth of the Endowment, and the total return figures **net of fees** since FY02.

June 30, 2005

Total Pooled Endowment: \$100,689 (000's)		
		% of Total
Domestic Equities	\$ 47,378	47%
Int'l Equities	15,020	15%
Multi Strategy Bond	17,617	17%
High Yield Bond	5,865	6%
Market Neutral	6,945	7%
Global Absol. Return	7,721	8%
Timber	-	0%
Cash	143	0%
Total	\$ 100,689	100%

June 30, 2006

Total Pooled Endowment: \$107,820 (000's)		
		% of Total
Domestic Equities	\$ 44,215	41%
Int'l Equities	17,577	16%
Multi Strategy Bond	17,120	16%
High Yield Bond	4,217	4%
Market Neutral	7,941	7%
Global Absol. Return	8,626	8%
Timber	3,745	4%
Cash	4,379	4%
Total	\$ 107,820	100%

