

# Report from the Stanford Management Company

The Stanford Management Company (SMC) was established in 1991 to manage Stanford's financial assets. SMC is a division of the University with oversight by a Board of Directors appointed by the University Board of Trustees. The SMC board consists of investment and real estate professionals, the University president, the University chief financial officer, the chairman of the Board of Trustees and the CEO of SMC. The Board approves SMC asset allocation targets, oversees the hiring of external asset managers and evaluates the performance of SMC investments and professionals. SMC oversees approximately \$21.6 billion of endowment and trust assets, temporarily invested expendable funds and commercial real estate investments.

The majority of the University's endowment assets are invested through the Merged Pool (MP), which is a diversified portfolio of actively managed financial and real estate assets valued at approximately \$18.8 billion as of June 30, 2007. MP performance measurements are calculated on the 12 months ended June 30, 2007, to facilitate the comparison of returns with results of other endowments and foundations. The following discussion of endowment performance relates solely to investments in the MP. The MP generated a 23.4% investment return for the 12 months ended June 30, 2007. Over the past 10 years, the MP achieved an annualized rate of return of 15.1%, growing from \$4.3 billion to \$18.8 billion. This investment performance places Stanford in the top 5% of all reporting university and college endowments during this period, according to the consulting firm Cambridge Associates.

The MP portfolio is constructed on a foundation of modern portfolio theory and strategic asset allocation. The portfolio is designed to optimize long-term returns, create consistent annual payouts to the University's operating budget and preserve purchasing power for future generations of Stanford faculty and students.

SMC, with assistance from the Board of Directors, actively manages the MP, selecting third-party managers to deploy the MP's capital. Stanford University's brand and SMC's reputation as a stable long-term source of capital enable SMC to gain access to the best third-party managers in the world. Within each asset class, we endeavor to place capital with a diversified set of managers across geographies and investment strategies. We seek to benefit from drivers of economic growth through a broadly diversified and hedged portfolio that is less subject to drawdown than the more concentrated portfolio of the late 1990's. SMC also seeks to add value through effective risk management, tactical portfolio rebalancing and opportunistic investment tilts.

**STANFORD MP ASSET ALLOCATION** Given the perpetual nature of the University, SMC's investment horizon is long-term. Our objective is to generate optimal total return relative to an appropriate level of risk for Stanford. Each June, SMC and the Board reevaluate portfolio asset allocation targets, as well as expected risk, return and correlation

among asset classes. This annual review takes into account current market conditions and historical characteristics of each asset class. The strategic asset allocation targets for the MP as of June 30, 2007, are listed below:

**LONG-TERM POLICY TARGETS**

ASSET CLASS	STRATEGIC ALLOCATION
Public Equity	37%
Real Estate	16%
Private Equity	12%
Natural Resources	7%
Absolute Return	18%
Fixed Income	10%

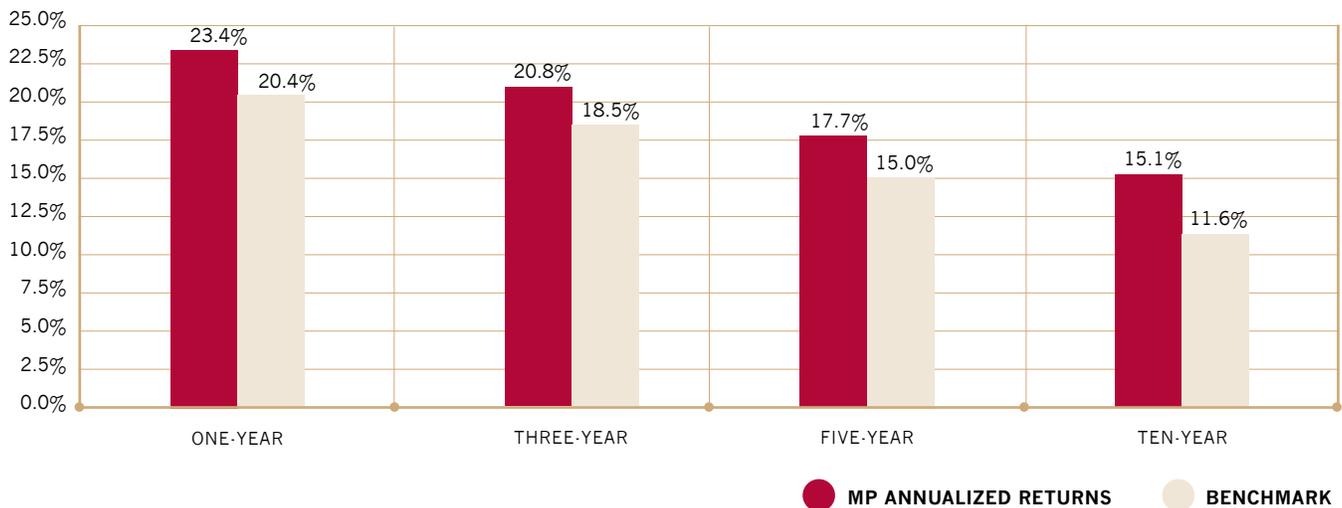
**STANFORD MP PERFORMANCE COMPARED TO INFLATION** The table below outlines annualized returns for various periods ending June 30, 2007. Stanford's objective is to return a minimum of 6.75% over the rate of inflation as measured by the DGP Deflator. If this real return target is achieved over time, the value of the MP, net of annual payouts to support operating activities, will be maintained. Over the past one-, three-, five- and 10-year periods, Stanford's annualized real return has substantially exceeded the 6.75% target.

**MP PERFORMANCE COMPARED TO INFLATION**

	ONE-YEAR	THREE-YEAR	FIVE-YEAR	TEN-YEAR
Nominal Endowment Return	23.4%	20.8%	17.7%	15.1%
GDP Deflator	3.1%	3.1%	2.8%	2.3%
Real Endowment Return	20.3%	17.7%	14.9%	12.8%

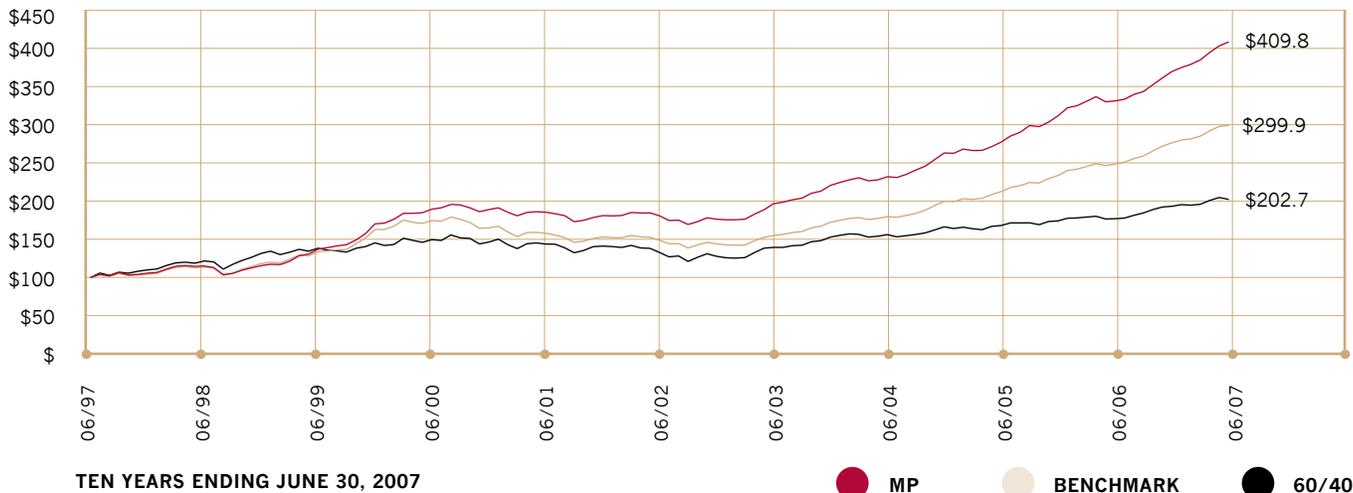
**STANFORD MP PERFORMANCE COMPARED TO BENCHMARKS** SMC evaluates the performance of investment managers by comparing their returns to benchmarks that are appropriate for each individual asset class. The SMC Board reviews asset class benchmarks on an annual basis to ensure comparability. SMC compares overall MP performance to the composite benchmark return, which represents a blend of the benchmark returns for each asset class weighted by the strategic allocations above. In the table below, actual performance, net of management fees, is compared to the composite benchmark for periods ended June 30, 2007.

**STANFORD MP VS. STANFORD COMPOSITE BENCHMARK**



SMC's effectiveness in implementing its investment strategies through top-level manager selection has resulted in consistent and long-term outperformance over the composite benchmark. This has added an excess of \$4.8 billion to the value of the MP over this 10-year period. The cumulative return chart below compares the growth of \$100 in Stanford's MP, a composite benchmark portfolio, and a 60% stock / 40% bond portfolio over the past 10 years:

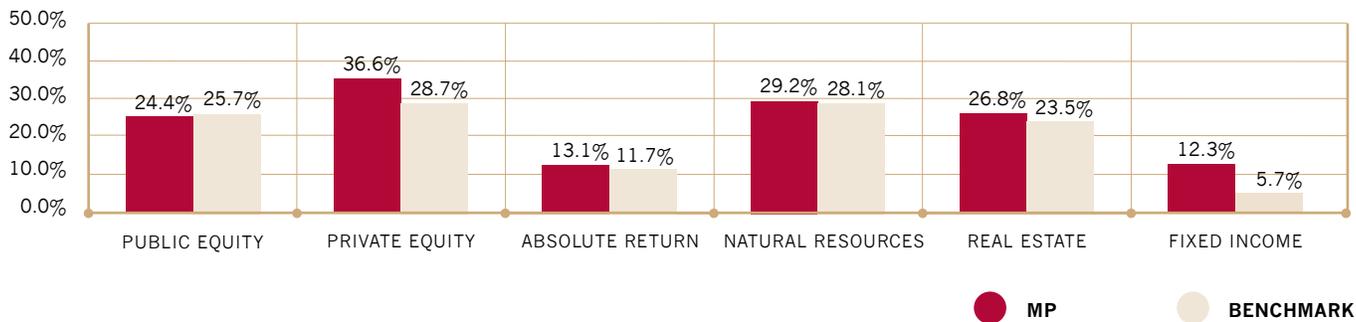
**STANFORD MP VS. STANFORD COMPOSITE BENCHMARK VS. PASSIVE 60% EQUITY/40% BOND COMPOSITE**



Relative one-year performance of the MP versus the benchmark was strong with overall portfolio excess return of 3.0% over the benchmark. This excess return was driven by outperformance in a number of asset classes, especially Private Equity and Real Estate. Total return in all asset classes was strong for the year as all asset classes exhibited double-digit annual returns.

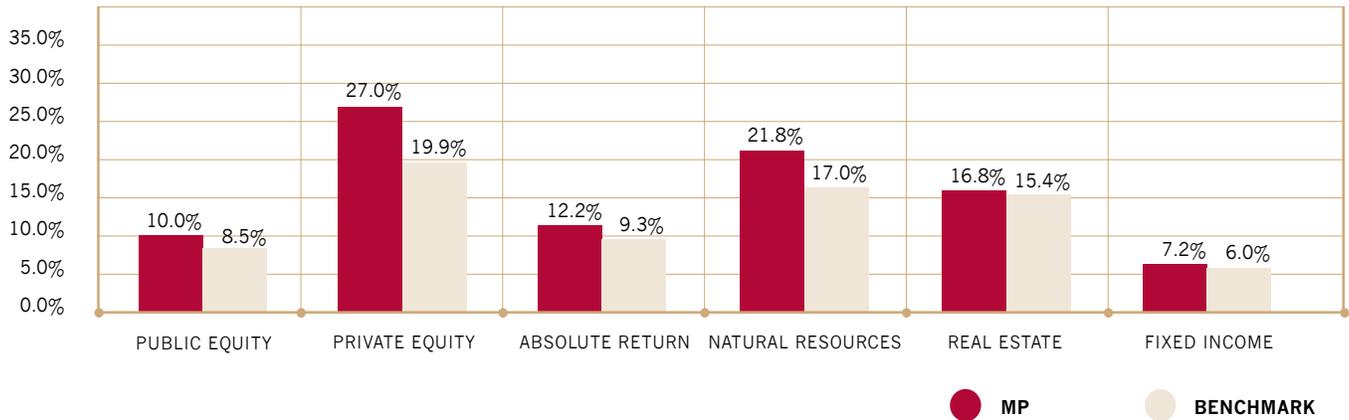
**INDIVIDUAL ASSET CLASS PERFORMANCE** The performance of individual asset classes for the 12 months ended June 30, 2007, relative to each asset class benchmark, is illustrated in the graph below:

**STANFORD MP ONE-YEAR ASSET CLASS RETURNS VS. BENCHMARK**



As outlined below, the results of 10-year asset class returns, relative to benchmark, illustrate the value of SMC's ability to shift investment styles/strategies and identify outstanding managers in each asset class:

**STANFORD MP TEN-YEAR ANNUALIZED ASSET CLASS RETURNS VS. BENCHMARK**



The year ending June 2007 was the fourth of an extraordinary series of years during which global economic expansion and abundant liquidity from a variety of sources combined to lift virtually all markets. Public equity markets in the United States and abroad benefited from an extended economic expansion. Real estate and private equity markets performance was fueled by attractive financing conditions. Natural Resources investments, particularly in energy, surged as economic growth and political uncertainty drove commodity prices higher. Finally, the Absolute Return portfolio experienced strong performance from multi-strategy hedge funds, which are able to allocate capital opportunistically across all asset classes.

The year ending June 2007 was also a pivotal year as SMC initiated an organizational transformation focused on long-term performance sustainability. After substantial turnover in the year ending June 2006, the organization was re-staffed and significant effort was spent on refining business processes. In 2008, we will focus on the ongoing task of portfolio improvement, while looking to strengthen risk management.

While the Stanford Management Company will continue to navigate through changes and developments in the investment environment, we remain committed to protect and grow the endowment of the University. We are pleased that the MP has continued to deliver solid performance, demonstrated by a 23.4% annual return. Moreover, the MP's three-year and five-year annualized returns remained strong at 20.8% and 17.7%, respectively. Our goal is to pursue consistent and strong, risk-adjusted returns and to administer dependable and growing financial support to the University's legacy of providing the highest quality education possible and setting a new standard of excellence.

JOHN F. POWERS  
 President and Chief Executive Officer  
 Stanford Management Company