

# 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 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, evaluates the performance of SMC investments and professionals, and oversees management of significant portions of endowment, trust assets and expendable funds for the University and the Hospitals.

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 \$19.7 billion as of June 30, 2012. To facilitate the comparison of returns with results of other endowments and foundations, MP performance measurements are calculated on the 12 months ending June 30, 2012. The following discussion of endowment performance relates solely to investments in the MP. The MP realized a 1.0% investment gain for the 12 months ending June 30, 2012. Over the past 10 years, the MP achieved an annualized rate of return of 9.7%, growing from \$7.5 billion to \$19.7 billion.

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 its 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 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, 2012 are listed below:

**LONG-TERM POLICY TARGETS**

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%

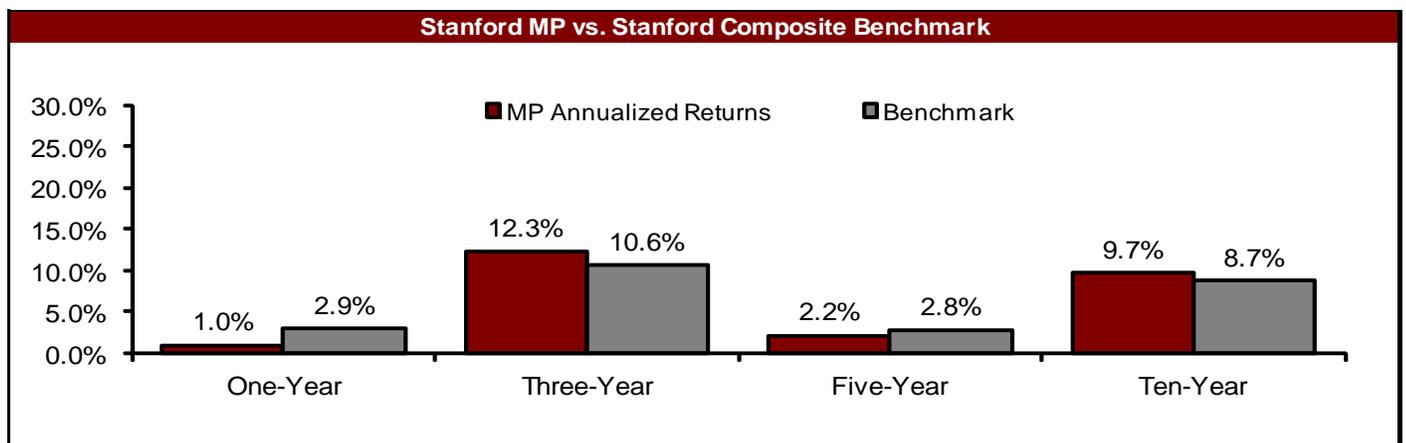
**STANFORD MP PERFORMANCE COMPARED TO INFLATION** The table below outlines annualized returns for various periods ending June 30, 2012.

**MP PERFORMANCE COMPARED TO INFLATION**

MP Performance Compared to Inflation				
	One-Year	Three-Year	Five-Year	Ten-Year
Nominal Endowment Return	1.0%	12.3%	2.2%	9.7%
GDP Deflator	1.7%	1.7%	1.6%	2.3%
Real Endowment Return	-0.7%	10.6%	0.6%	7.4%

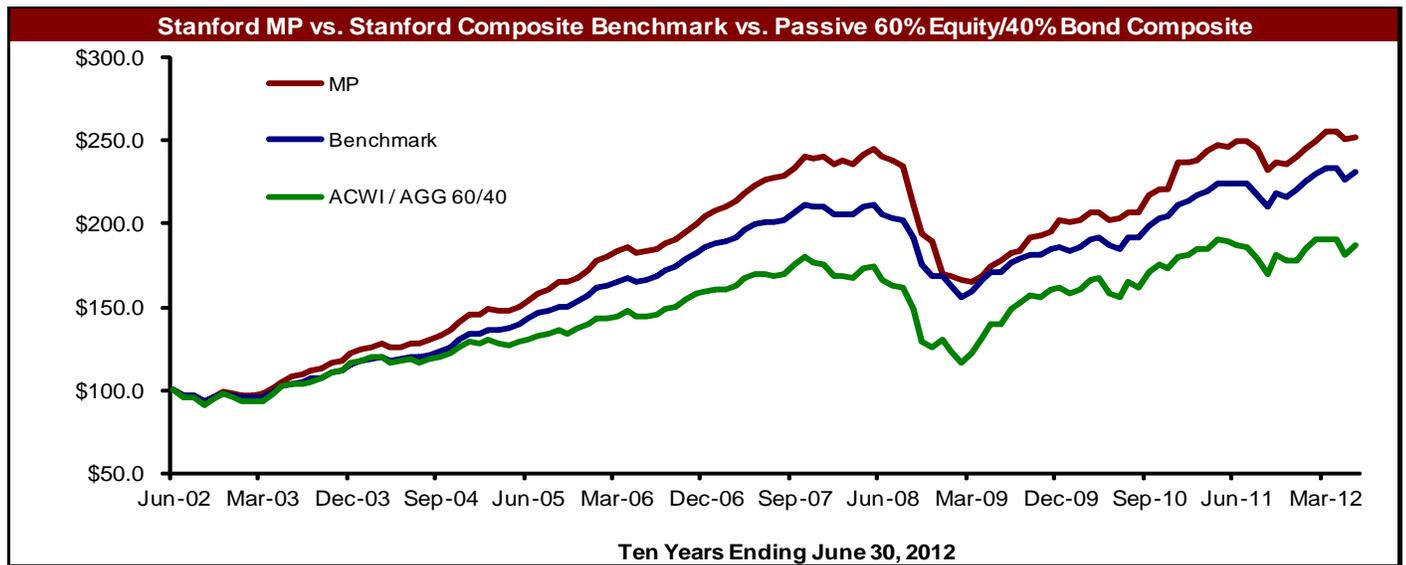
**STANFORD MP PERFORMANCE COMPARED TO BENCHMARKS** SMC evaluates the performance of investment managers by comparing their returns to benchmarks that are appropriate for each individual asset class. The SMC Board reviews asset class benchmarks on an annual basis to ensure comparability. SMC reviews overall MP performance against 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, 2012.

**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 \$1.6 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:

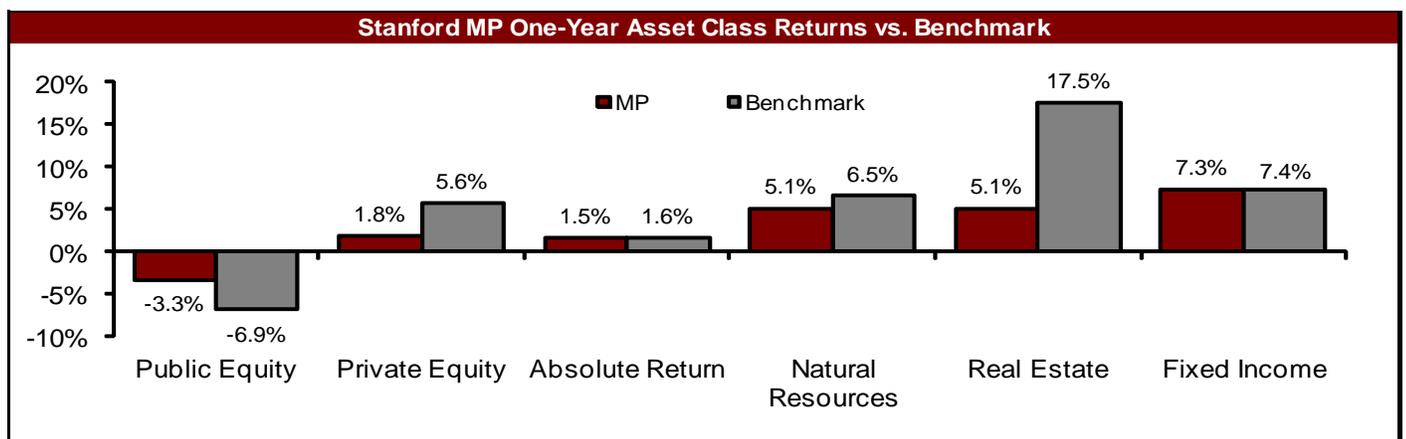
**STANFORD MP VS. STANFORD COMPOSITE BENCHMARK & PASSIVE 60%EQUITY/40%BOND COMPOSITE**



The relative one-year performance of the MP versus the benchmark was -1.9%.

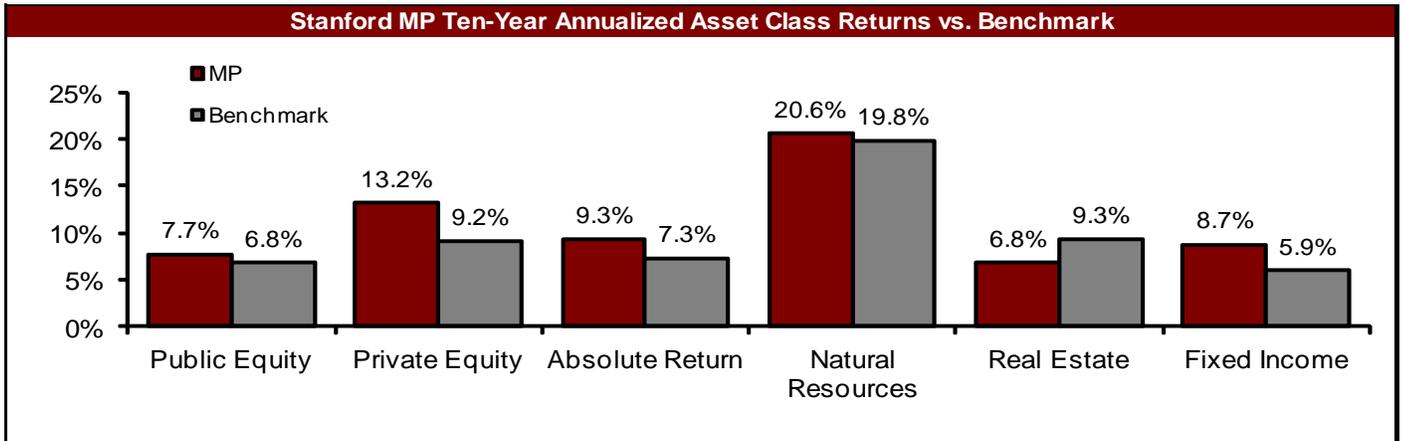
**INDIVIDUAL ASSET CLASS PERFORMANCE** The performance of individual asset classes for the 12 months ended June 30, 2012, relative to each asset class benchmark, is illustrated in the graph below:

**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 ASSET CLASS RETURNS VS. BENCHMARK



In the 12 months through June 30, 2012, the Merged Pool returns were 1.0%. During the same period, the MSCI ACWI Index returned -6.0%, the Barclays Aggregate returned 7.5%, and a 60/40 equity/fixed income mix would have returned -0.6%. We continue to exist in an environment where powerful drivers of financial asset returns are central bank actions. Even in this low interest rate environment, with its mix of excess liquidity and deleveraging we remain cautious. We believe there is a good chance for significant continued volatility (triggered by European banking crisis, China hard landing, or geopolitical flare-up), and have positioned the portfolio to preserve flexibility and optionality to respond with strength in a crisis.

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