



University of Illinois First Quarter 2013 Investment Update Board Report

May 2013

Reported to the Board of Trustees
May 29, 2013

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Market Overview and Total University Assets

Capital Markets Review

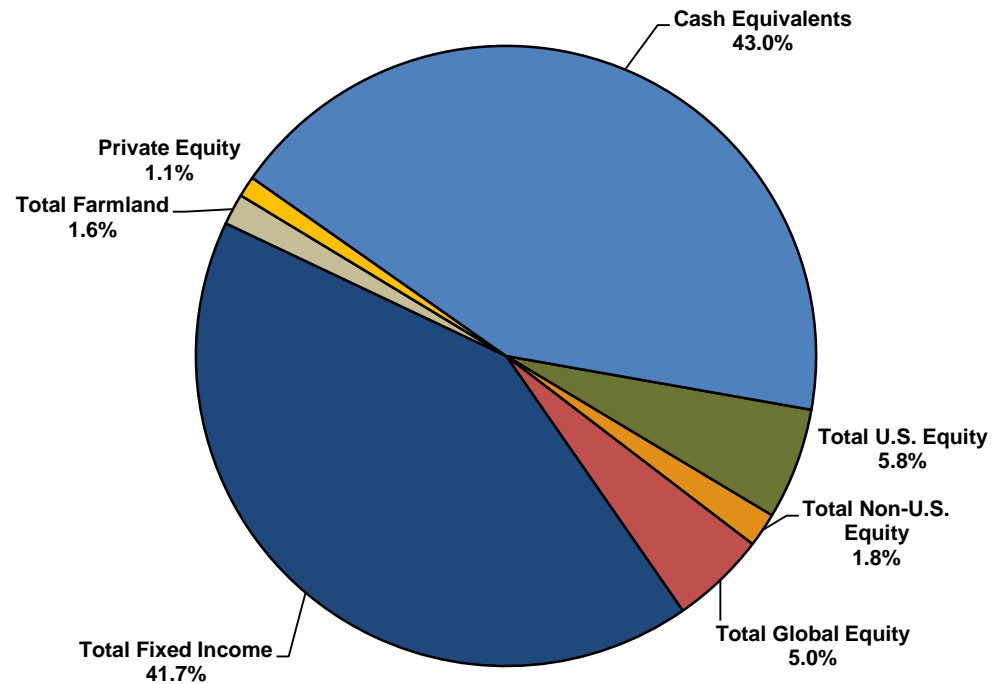
March 31, 2013

	First Quarter	One Year	Three Years	Five Years	Ten Years
DJ U.S. Total Stock Market Index	11.1	14.5	13.1	6.5	9.4
MSCI All Country World ex-U.S. Index	3.2	8.4	4.4	-0.4	10.9
MSCI All Country World Index	6.5	10.6	7.8	2.1	9.4
Barclays Capital Aggregate Bond Index	-0.1	3.8	5.5	5.5	5.0
HFR Fund of Funds Index	3.4	4.8	2.1	-0.2	3.9
NCREIF ODCE Index	2.7	10.8	15.1	-0.8	6.8
NCREIF Cornbelt Index	0.0	24.9	15.3	14.8	--

- Financial markets surged during the first quarter of 2013 as the Dow Jones U.S. Total Stock Market Index reached double digit returns, fueled by positive economic data in the U.S. and the U.S. fiscal cliff deal that was reached at the beginning of the quarter.
- Performance based on capitalization and style was mixed, with mid-cap value stocks performing best, while large-cap growth stocks were the worst performing sector during the quarter.
- U.S. equities outperformed Non-U.S. equities during the first quarter. Emerging Markets were the weakest performing region, while outside the U.S., Japan was the strongest performing region.
- Long duration bonds underperformed intermediate and short duration bonds as the yield curve rose during the quarter. High yield bonds gained 3.9%, as investors sought yield in a low interest rate environment.

Total University Assets: March 31, 2013

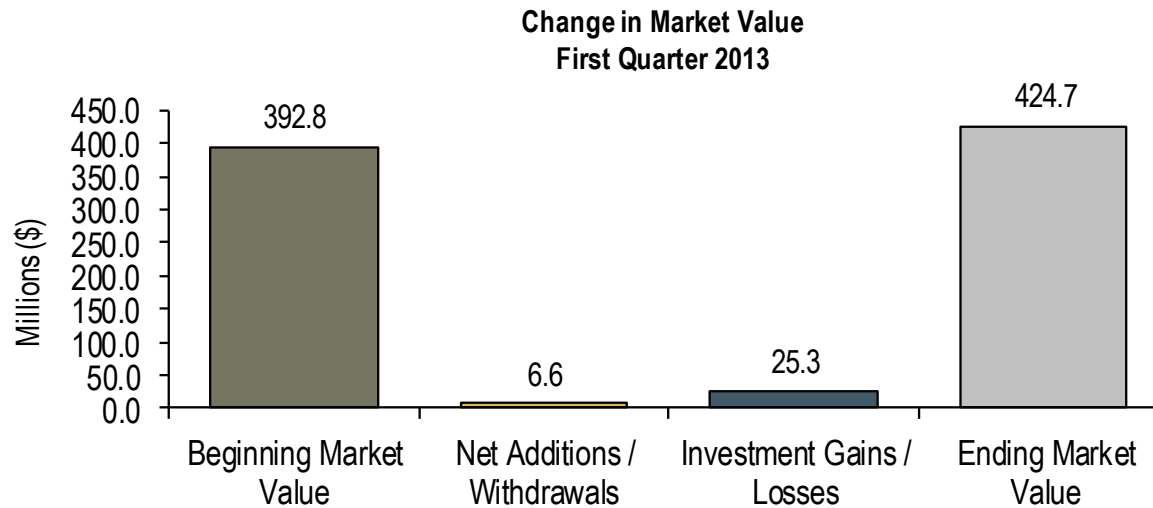
University Of Illinois Endowment & Operating Assets
\$2.25 Billion as of 3/31/2013





Endowment Fund Update: March 31, 2013

Total Fund Asset Growth: Endowment Pool



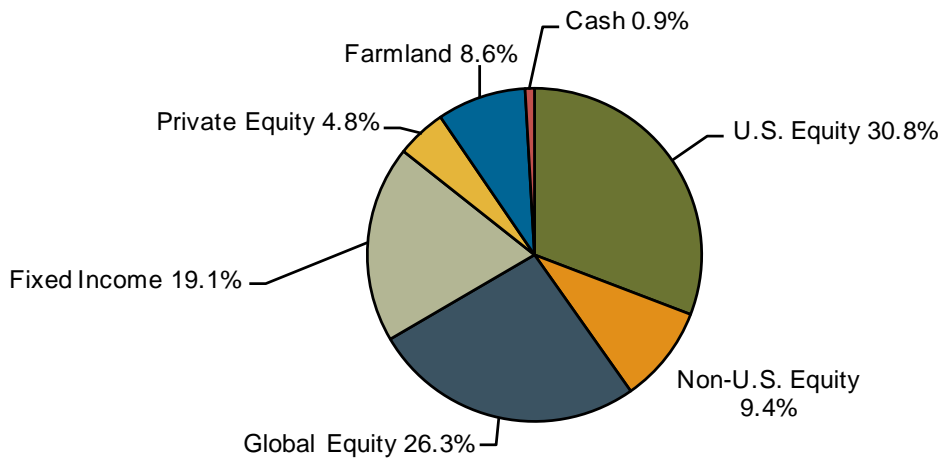
- During the first quarter, Endowment fund assets increased by approximately \$31.9 million from \$392.8 million to \$424.7 million.
- This increase was the net result of investment gains and positive fund flows. For this period, net inflows were approximately \$6.6 million and the absolute return of 6.3% in Endowment assets resulted in investment gains of \$25.3 million.

Market Value and Asset Allocation: Endowment Pool

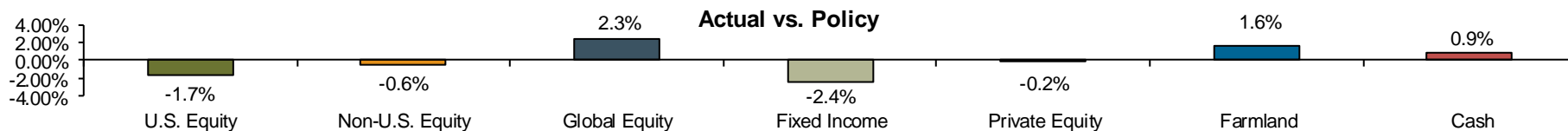
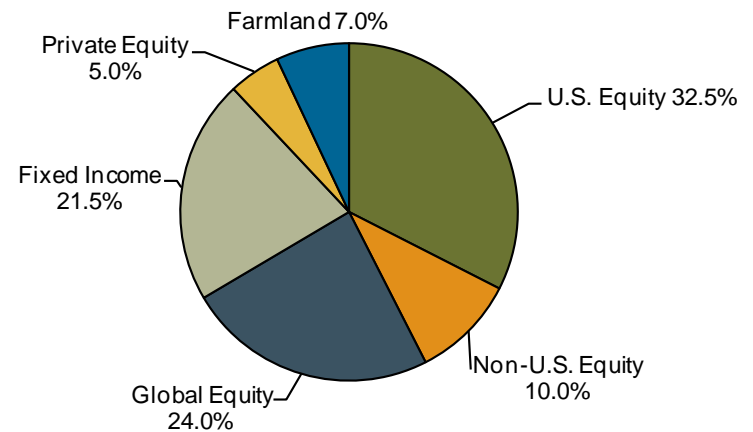
March 31, 2013

Total Fund
\$424,671,473

Actual Allocation



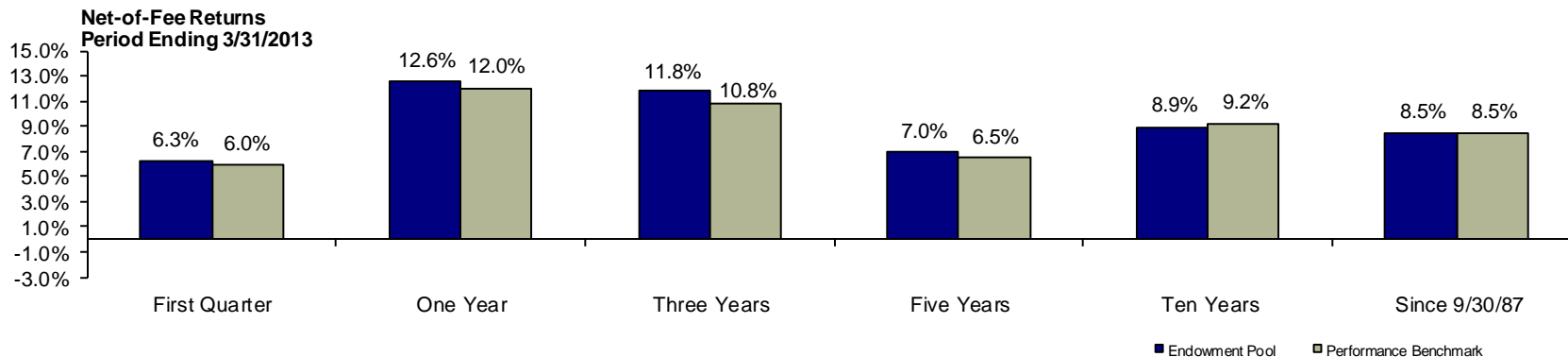
Interim Policy Allocation*



*Long Term Policy Allocations: US Equity 14%, Non-US Equity 10%, Global Equity 24%, Private Equity 8%, Hedge Funds 10%, Fixed Income 20%, Farmland 7%, and Core Real Estate 7%

Total Fund Performance: Endowment Pool

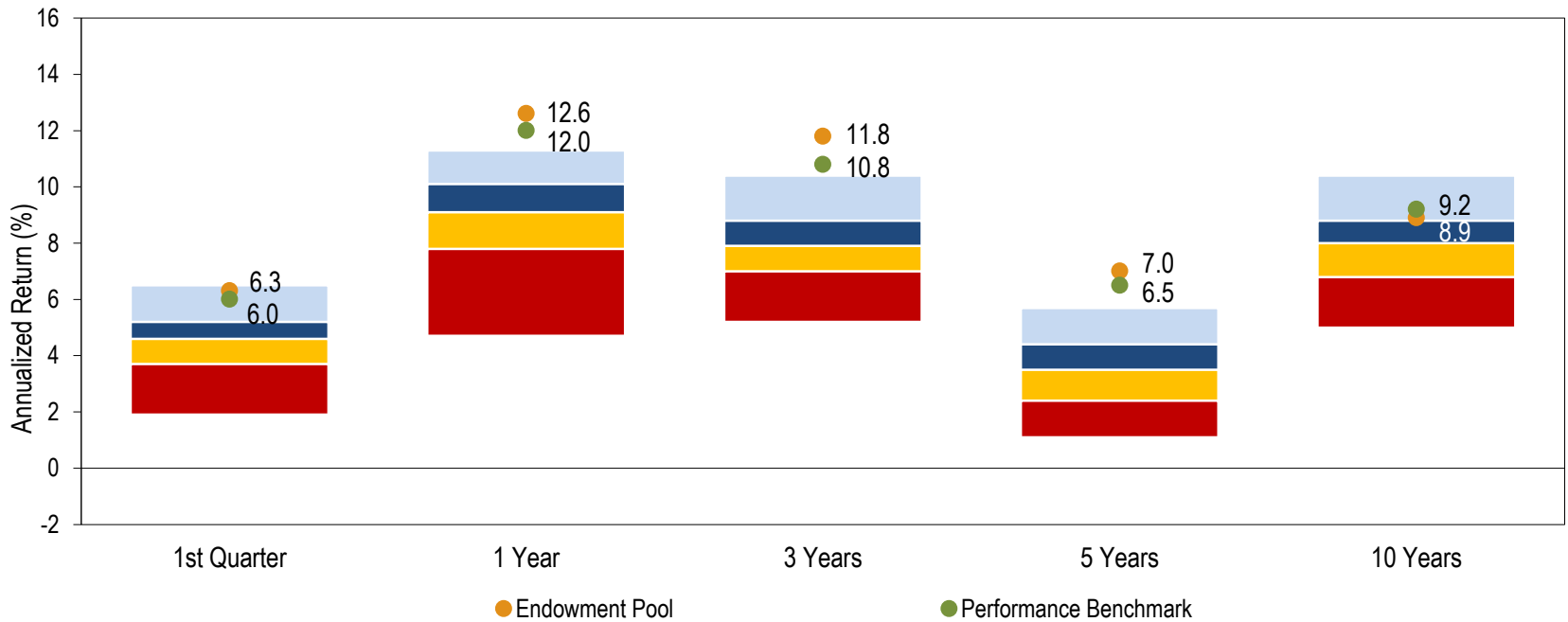
March 31, 2013



- For the first quarter, the Endowment Pool gained 6.3 percentage points and outperformed the performance benchmark by 30 basis points. The U.S. Equity asset class outpaced the Dow Jones U.S. Total Stock Market Index, returning 12.1 percent for the quarter, 1.0% above the benchmark. During this same time period the Pool's Non-U.S. equity component also outperformed, beating the MSCI All Country World ex-U.S. Index by 1.5 percentage points. In the Endowment's fixed income investments, Western and JP Morgan both outpaced their benchmarks, leading to overall fixed income outperformance of 0.6 percentage points over the asset class benchmark during the first quarter. The Endowment's recently funded Global Equity allocation matched its benchmark.
- Over the trailing one-year period, the Endowment Pool gained 12.6 percentage points and outperformed its benchmark by 60 basis points. Strong performance from Western, which added 3.9 percentage points of relative value was offset by poor relative performance from Private Equity and GMO.

Peer Rankings: Endowment Pool

March 31, 2013



Returns/Ranks	1st Quarter		1 Year		3 Years		5 Years		10 Years	
	Return	Rank	Return	Rank	Return	Rank	Return	Rank	Return	Rank
Endowment Pool	6.3	7	12.6	3	11.8	3	7.0	1	8.9	25
Benchmark	6.0	11	12.0	4	10.8	4	6.5	2	9.2	19

- Over the trailing one-, three- and five-year time periods, the returns of the University of Illinois' Endowment Pool have ranked in the top 5% of the BNY Mellon Endowment Fund and Foundation Universe returns.

Asset Class Performance

March 31, 2013

	First Quarter	One Year	Three Years	Five Years	Ten Years	Inception
Endowment Pool	6.3	12.6	11.8	7.0	8.9	8.5
Performance Benchmark	6.0	12.0	10.8	6.5	9.2	8.5
Total U.S. Equity	12.1	15.7	13.4	7.5	9.3	8.8
Dow Jones U.S. Total Stock Market Index	11.1	14.5	13.1	6.5	9.4	8.9
Total Non-U.S. Equity	4.7	11.5	4.7	-0.3	10.2	5.6
MSCI All Country World ex-U.S. Index	3.2	8.4	4.4	-0.4	10.9	5.7
Total Global Equity	6.5	--	--	--	--	16.6
MSCI All Country World Index	6.5	--	--	--	--	17.1
Total Fixed Income	0.5	6.6	8.7	8.7	6.1	7.9
Barclays Aggregate Bond Index	-0.1	3.8	5.5	5.5	5.0	7.3
Total Private Equity⁽¹⁾	0.9	4.5	8.7	2.0	--	-1.2
Private Equity Benchmark	11.9	17.9	16.5	9.7	--	9.9
Total Farmland⁽²⁾	0.0	21.9	24.9	18.3	--	15.7
NCREIF Cornbelt Index	0.0	24.9	15.3	14.8	--	12.8

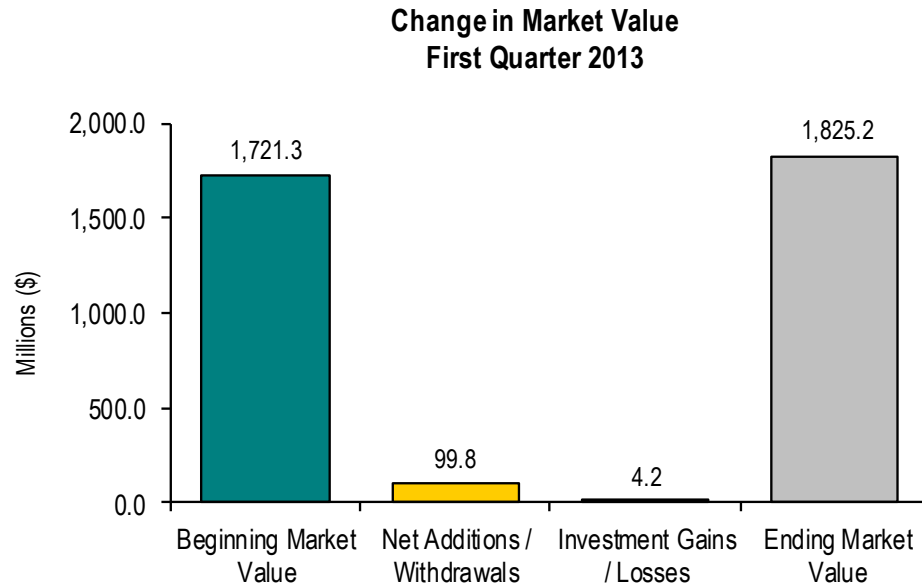
(1) The combined Adams Street Partners IRR at 12/31/2012 was 6.4%.

(2) Farmland is valued annually on June 30th. As such, the one year return reflected above is the one-year return for Farmland as of June 30th, 2012.



Operating Pool Update: March 31, 2013

Total Fund Asset Growth: Operating Pool

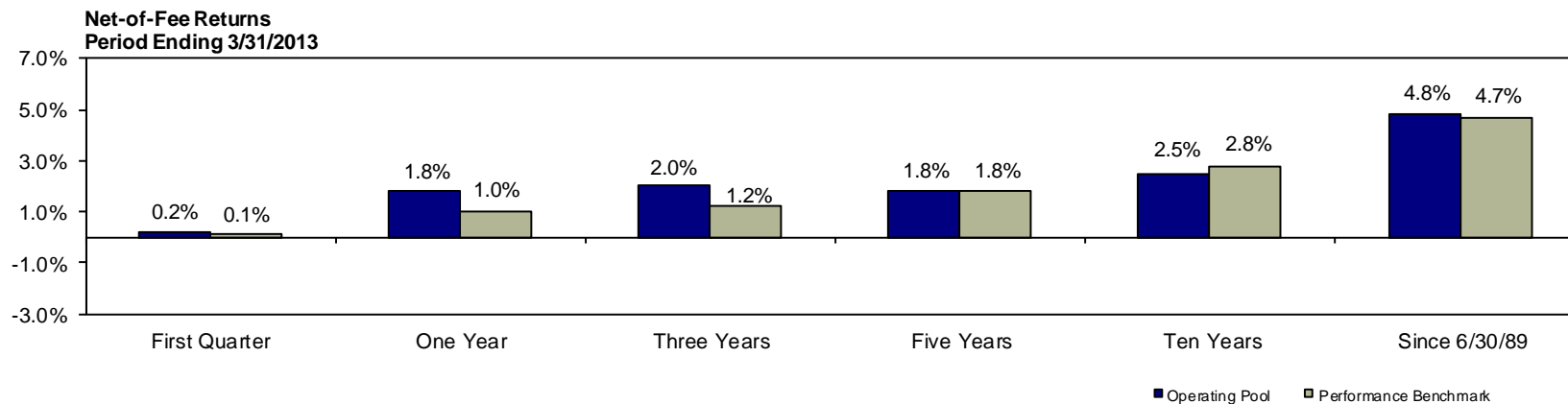


- During the first quarter, the Operating Pool assets increased by approximately \$104.0 million from \$1.72 billion to \$1.83 billion. This increase was the result of approximately \$99.8 million in net inflows and \$4.2 million in investment gains.

Total Fund Performance: Operating Pool

March 31, 2013

Total Fund
\$1,825,238,769



- The Operating Pool returned 20 basis points during the first quarter, beating the benchmark return for this time period by 10 basis points. Western Asset Management drove portfolio outperformance, outpacing its benchmark by 180 basis points with a 2.0 percent return during the quarter. Positive absolute and relative returns from Galliard and IR+M also had a positive effect.

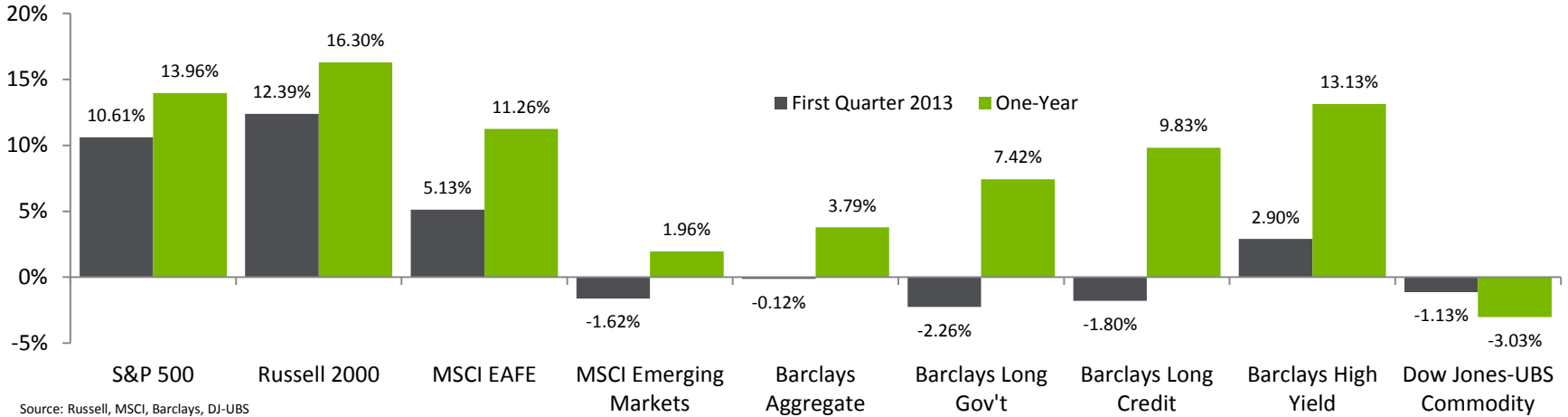
Appendix:

Market Environment

Market Highlights

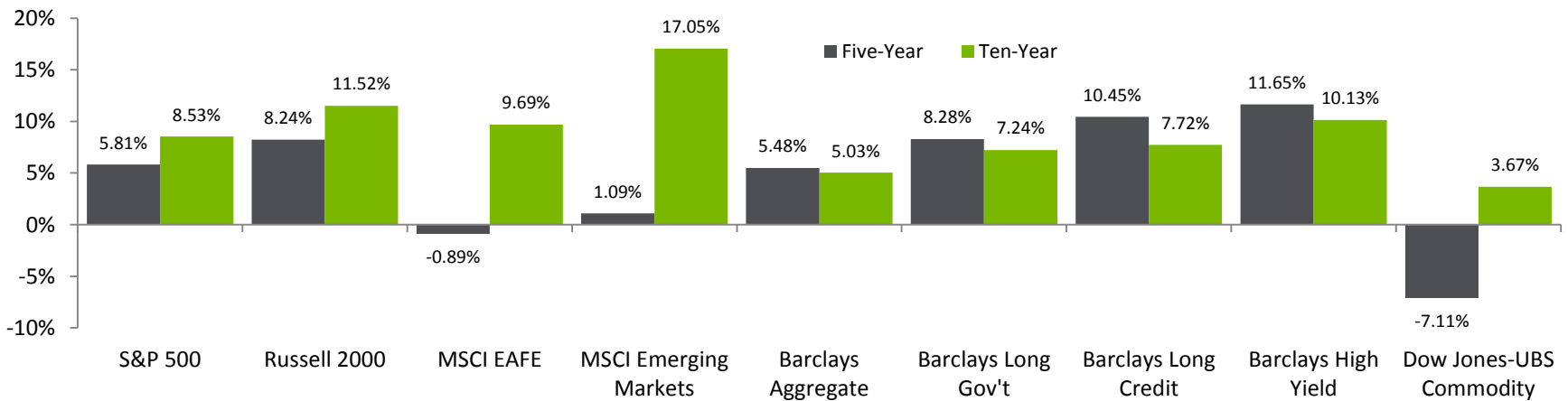
SHORT TERM RETURNS

AS OF 03/31/2013



LONG TERM ANNUALIZED RETURNS

AS OF 03/31/2013



Market Highlights

Returns of the Major Capital Markets						
			Periods Ending 03/31/2013			
	First Quarter	Year-to-Date	1-Year	3-Year ¹	5-Year ¹	10-Year ¹
Equity						
MSCI All Country World IMI	6.90%	6.90%	10.95%	8.13%	2.58%	9.87%
MSCI All Country World	6.50%	6.50%	10.55%	7.78%	2.06%	9.36%
Dow Jones U.S. Total Stock Market	11.07%	11.07%	14.49%	13.08%	6.48%	9.43%
Russell 3000	11.07%	11.07%	14.57%	12.97%	6.32%	9.15%
S&P 500	10.61%	10.61%	13.96%	12.68%	5.81%	8.53%
Russell 2000	12.39%	12.39%	16.30%	13.45%	8.24%	11.52%
MSCI All Country World ex-U.S. IMI	3.57%	3.57%	8.62%	4.71%	-0.03%	11.33%
MSCI All Country World ex-U.S.	3.17%	3.17%	8.36%	4.41%	-0.39%	10.93%
MSCI EAFE	5.13%	5.13%	11.26%	5.00%	-0.89%	9.69%
MSCI EAFE (100% Hedged)	8.79%	8.79%	13.27%	1.59%	-1.75%	5.22%
MSCI EAFE (Local Currency)	9.67%	9.67%	16.73%	4.34%	0.74%	7.46%
MSCI Emerging Markets	-1.62%	-1.62%	1.96%	3.27%	1.09%	17.05%
Fixed Income						
Barclays Global Aggregate	-2.10%	-2.10%	1.25%	4.52%	3.65%	5.47%
Barclays Aggregate	-0.12%	-0.12%	3.79%	5.54%	5.48%	5.03%
Barclays Long Gov't	-2.26%	-2.26%	7.42%	12.39%	8.28%	7.24%
Barclays Long Credit	-1.80%	-1.80%	9.83%	12.05%	10.45%	7.72%
Barclays Long Gov't/Credit	-1.98%	-1.98%	8.94%	12.31%	9.55%	7.52%
Barclays US TIPS	-0.37%	-0.37%	5.67%	8.56%	5.88%	6.32%
Barclays High Yield	2.90%	2.90%	13.13%	11.24%	11.65%	10.13%
SSB Non-U.S. WGBI	-3.83%	-3.83%	-2.16%	3.33%	2.28%	5.58%
JP Morgan EMBI Global (Emerging Markets)	-2.30%	-2.30%	10.44%	10.55%	9.81%	10.59%
Commodities						
Dow Jones-UBS Commodity	-1.13%	-1.13%	-3.03%	1.42%	-7.11%	3.67%
Goldman Sachs Commodity	0.55%	0.55%	-4.96%	3.04%	-9.74%	2.34%
Hedge Funds						
HFR I Fund-Weighted Composite ²	3.81%	3.81%	5.46%	4.05%	3.02%	6.99%
HFR I Fund of Funds ²	3.36%	3.36%	4.78%	2.10%	-0.24%	3.85%
Real Estate						
NAREIT U.S. Equity REITS	8.19%	8.19%	15.29%	17.17%	6.83%	12.44%
NCREIF ODCE ³	2.69%	2.69%	10.79%	15.13%	-0.84%	6.80%
Private Equity						
Thomson Reuters VentureXpert ⁴	3.75%	9.11%	13.49%	13.63%	4.47%	12.54%
Infrastructure						
Macquarie Global Infrastructure - North America	12.00%	12.00%	16.68%	16.37%	7.28%	13.47%

MSCI Indices and NCREIF ODCE show net returns.

MSCI EAFE (100% Hedged) shows price return.

All other indices show total returns.

¹ Periods are annualized.

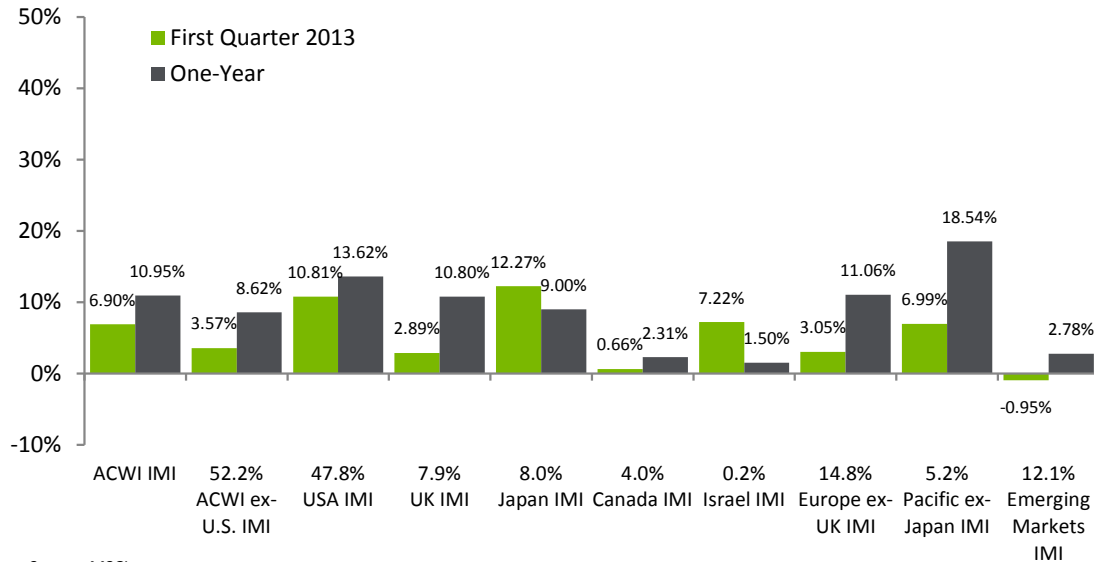
² Latest 5 months of HFR data are estimated by HFR and may change in the future.

³ First quarter results are preliminary.

⁴ Benchmark is as of 09/30/2012.

Global Equity Markets

**GLOBAL MSCI IMI INDEX RETURNS
AS OF 03/31/2013**

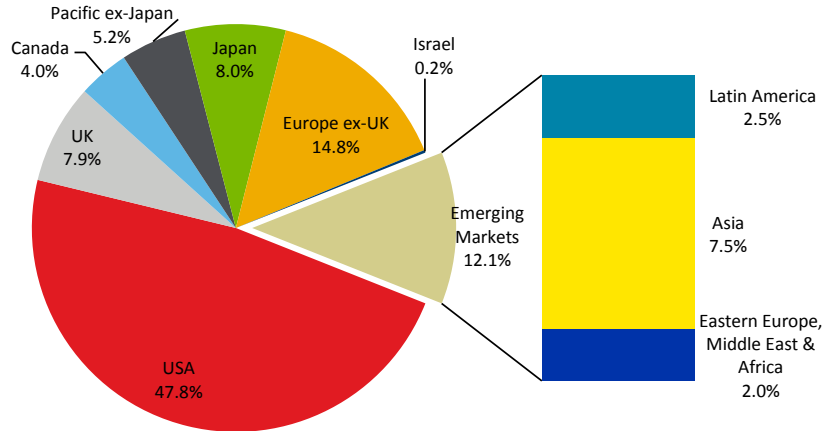


Source: MSCI

- Equity markets posted positive returns during the quarter despite Eurozone worries resulting from an Italian election in which no party claimed a majority, corruption allegations in Spain, and a Cypriot bailout. Equity markets were pushed higher by positive U.S. economic data and the U.S. fiscal cliff deal that was reached at the beginning of the quarter.
- Japan proved to be the best performing region as investors were pleased with the Prime Minister's ongoing pressure to increase the money supply. The worst performing region was Emerging Markets.

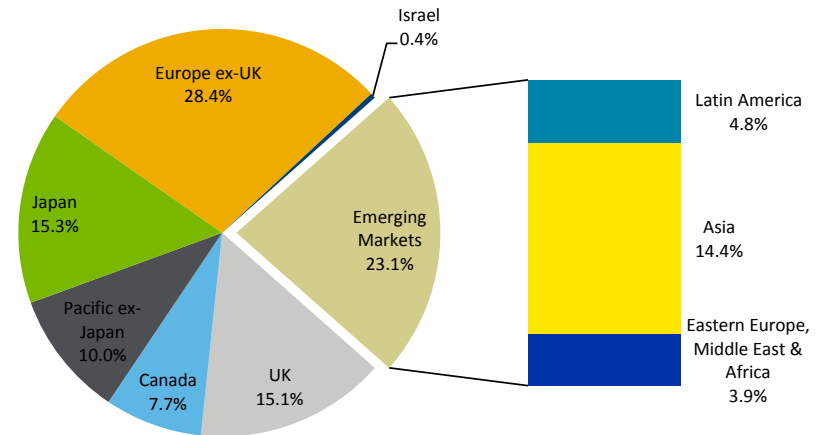
Global Equity Markets

MSCI ALL COUNTRY WORLD IMI INDEX
GEOGRAPHIC ALLOCATION AS OF 03/31/2013



Source: MSCI

MSCI ALL COUNTRY WORLD EX-U.S. IMI INDEX
GEOGRAPHIC ALLOCATION AS OF 03/31/2013

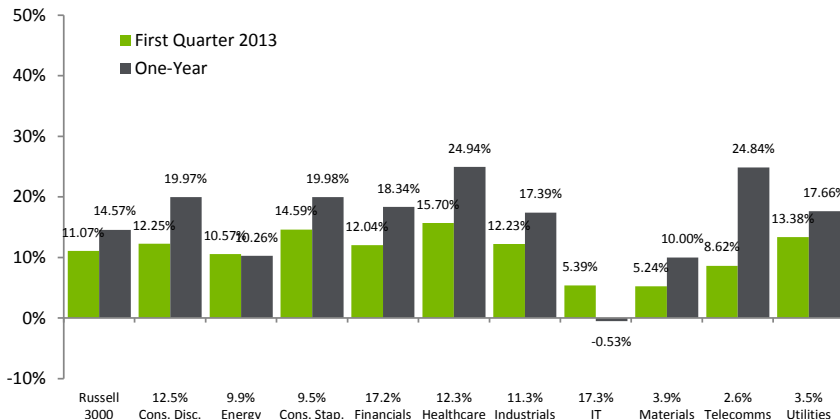


Source: MSCI

- The two exhibits on this slide illustrate the percentage that each country/region represents of the global equity market as measured by the MSCI All Country World IMI Index and the MSCI All Country World ex-U.S. IMI Index.

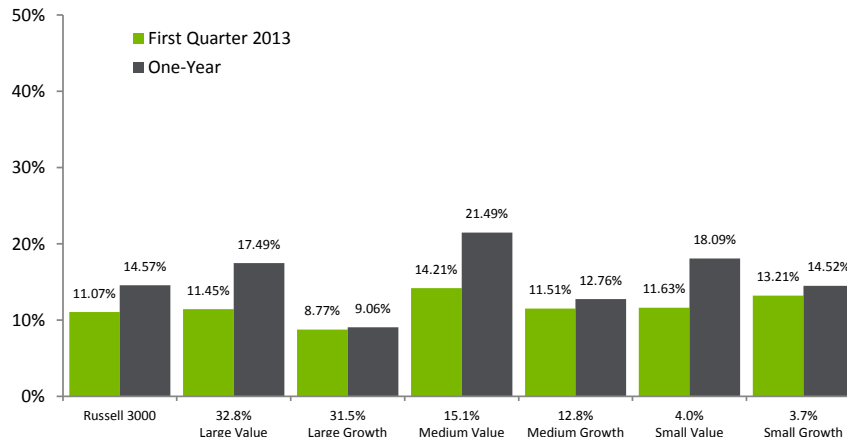
U.S. Equity Markets

**RUSSELL GICS SECTOR RETURNS
AS OF 03/31/2013**



Source: Russell Indexes

**RUSSELL STYLE RETURNS
AS OF 03/31/2013**

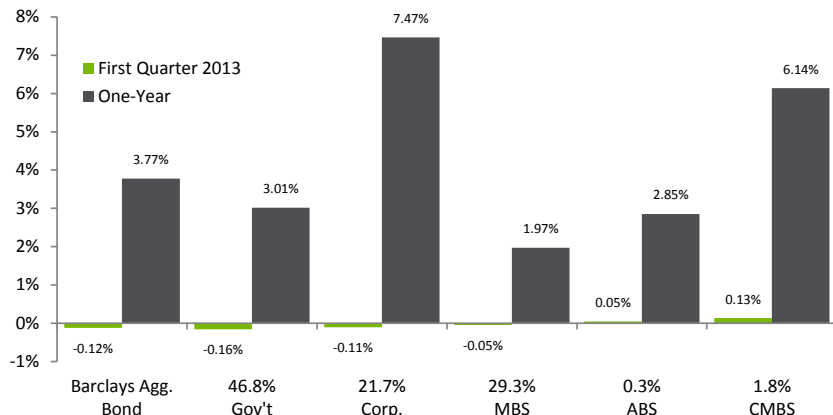


Source: Russell Indexes

- 2013 started strong for U.S. equities as Congress acted to delay negotiations regarding the debt ceiling. The rally continued through the second half of the quarter as fourth quarter earnings proved to be strong with roughly three-fourths of companies meeting or beating expectations.
- The Russell 3000 rose 11.07% during the quarter and returned 14.57% over the one-year period.
- The Healthcare, Consumer Staples, Utilities, Consumer Discretionary, and Industrial sectors were the best performing sectors during the first quarter, posting returns of 15.70%, 14.59%, 13.38%, 12.25%, and 12.23%, respectively. The Materials and Information Technology sectors were the worst performing areas, producing returns of 5.24% and 5.39%, respectively, during the first quarter.
- Overall, mid cap outperformed both small cap and large cap during the first quarter. Value outperformed growth in the large and mid cap sectors but growth prevailed amongst small cap stocks during the quarter.

U.S. Fixed Income Markets

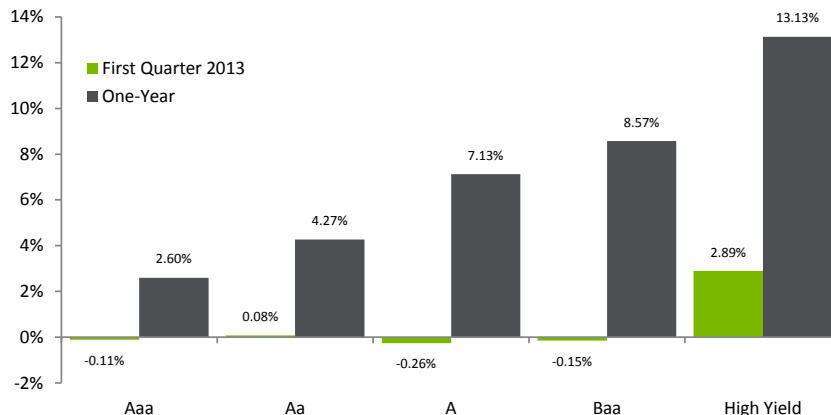
BARCLAYS AGGREGATE RETURNS BY SECTOR
AS OF 03/31/2013



Source: Barclays Live

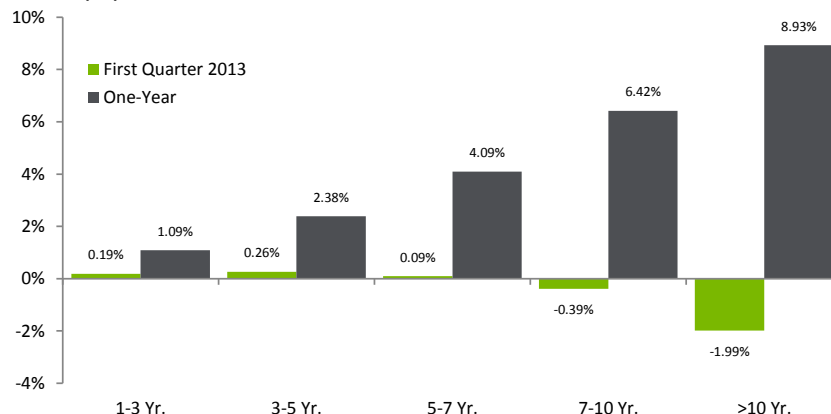
- The Barclays Aggregate Bond Index returned -0.12% in the first quarter.
- Commercial mortgage-backed securities and asset-backed securities were the strongest performing sectors, returning 0.13% and 0.05%, respectively, over the course of the first quarter.
- In the investment grade market, higher quality bonds outperformed lower quality bonds during the first quarter.
- High yield bonds outperformed investment grade bonds as investors sought yield in a low interest rate environment.
- From a maturity perspective, shorter term bonds outperformed, with the 1-3 yr. and 3-5 yr. posting positive returns of 0.19% and 0.26%, respectively, during the first quarter.

BARCLAYS AGGREGATE RETURNS BY QUALITY AND HIGH YIELD RETURNS
AS OF 03/31/2013



Source: Barclays Live

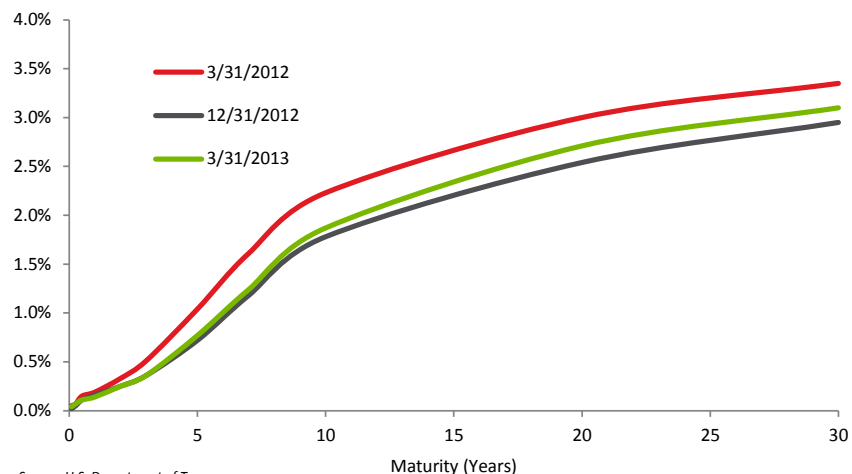
BARCLAYS AGGREGATE RETURNS BY MATURITY
AS OF 03/31/2013



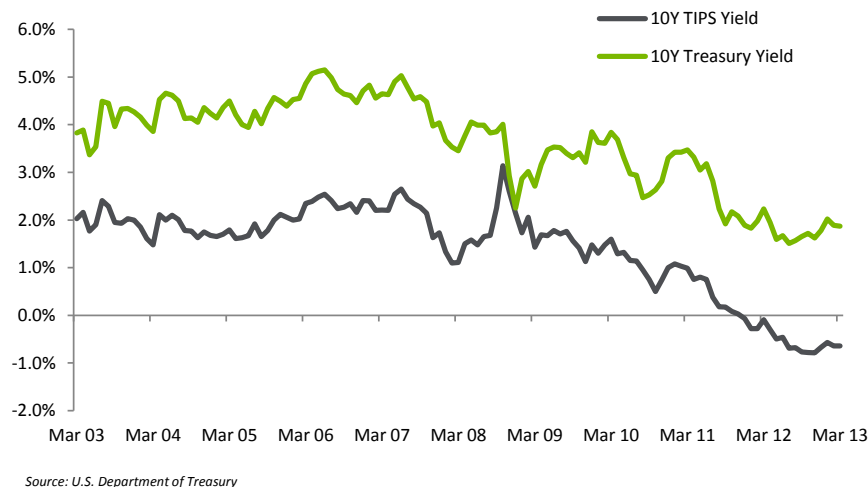
Source: Barclays Live

U.S. Fixed Income Markets

U.S. TREASURY YIELD CURVE



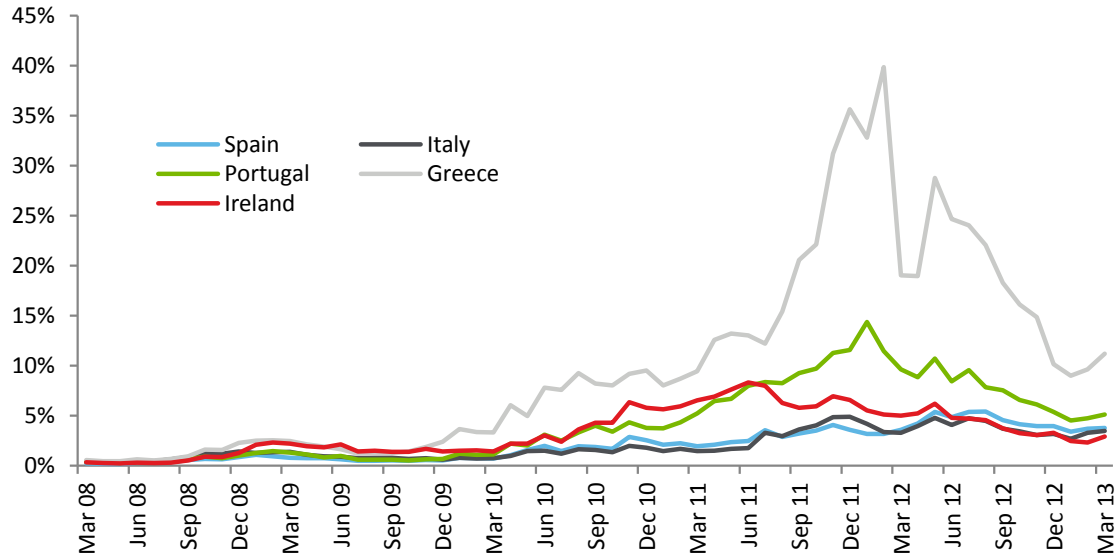
U.S. 10-YEAR TREASURY AND TIPS YIELDS



- The Treasury yield curve steepened during the quarter; both the intermediate (1 to 10 years) and the long-term segments of the yield curve rose.
- The 10-year U.S. Treasury yield ended the quarter at a yield of 1.87%, roughly 9 basis points higher than its level at the beginning of the quarter.
- 10-year TIPS yields remained in negative territory, but rose by 3 basis points to -0.64% over the quarter.

European Fixed Income Markets

**EUROZONE PERIPHERAL BOND SPREADS
(10-YEAR SPREADS OVER GERMAN BUNDS)**



Source: DataStream

- Cyprus was one of the focal points of the Eurozone debt crisis during the quarter as issues arose around the terms of the losses that depositors should face in the country's bailout. By the end of the quarter, Cyprus re-opened its banks after accepting €10 billion of financial aid under the condition that Cypriot bank depositors with deposits over €100,000 would bear significant losses.

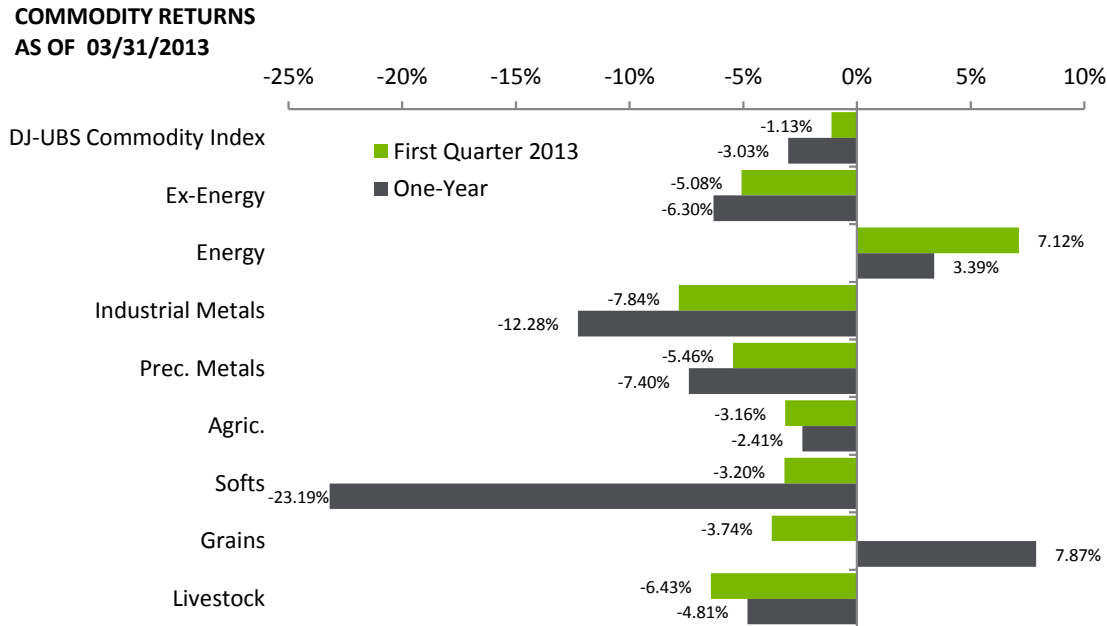
Credit Spreads

Spread (bps)	3/31/2013	12/31/2012	3/31/2012	Quarterly Change (bps)	1-Year Change (bps)
U.S. Aggregate	56	53	64	2	-8
Long Gov't	4	4	5	0	-1
Long Credit	183	180	198	3	-15
Long Gov't/Credit	113	109	114	3	-1
MBS	58	50	52	8	6
CMBS	133	124	221	9	-89
ABS	49	43	65	6	-16
Corporate	139	141	176	-2	-37
High Yield	457	511	576	-54	-119
Global Emerging Markets	287	293	359	-6	-72

Source: Barclays Live

- Credit spreads rose modestly across most markets during the quarter with the exceptions of Long Government, Corporate, High Yield, and Global Emerging Markets.
- The High Yield segment experienced the largest drop in spreads during both the quarter and the one-year period.
- Credit spreads across most segments as of March 31, 2013 were lower relative to a year prior with the exception of MBS, which rose by 6 bps.

Commodities

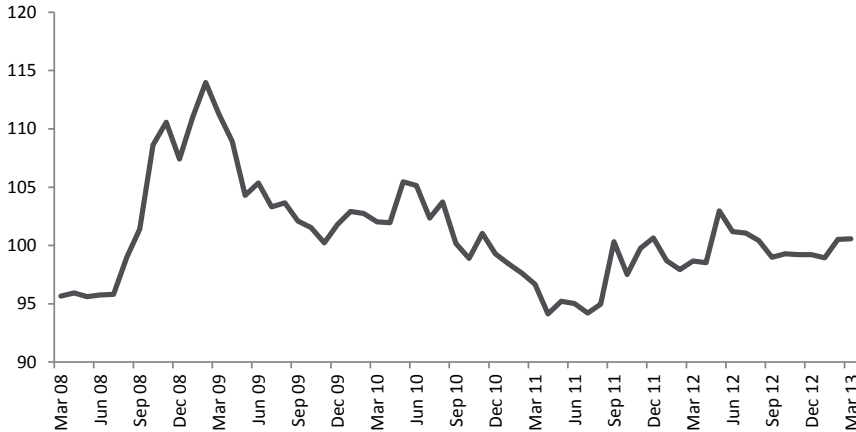


Source: Dow Jones-UBS

- Driven by negative returns across most market sectors, the Dow Jones-UBS Commodity Index decreased by 1.13% during the first quarter.
- The strongest and only positive performing segment of the market was Energy with a return of 7.12% during the quarter.
- Industrial Metals and Livestock were the worst performing sectors of the market during the first quarter with returns of -7.84% and -6.43%, respectively.

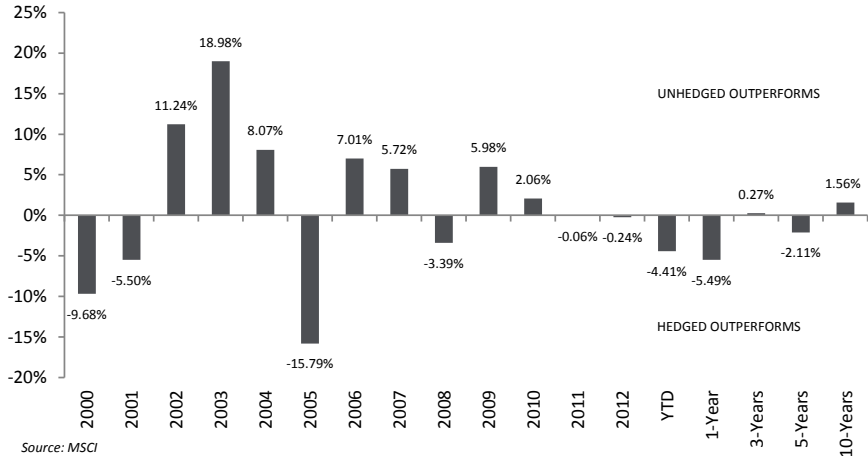
Currency

**TRADE WEIGHTED U.S. DOLLAR INDEX
(1997 = 100)**



Source: Federal Reserve

**DIFFERENCE BETWEEN MSCI EAFE UNHEDGED AND HEDGED INDICES
AS OF 03/31/2013**

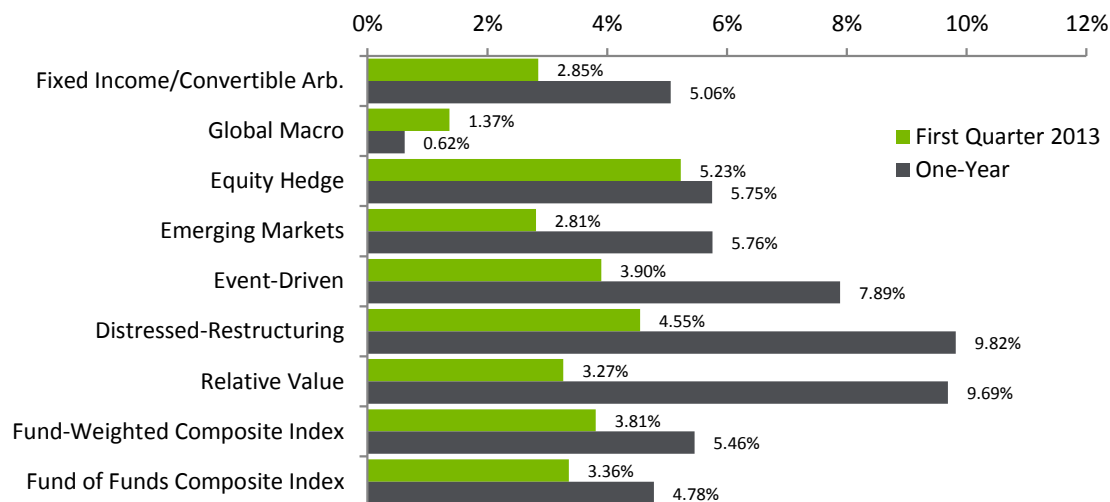


Source: MSCI

- As measured through the broad trade weighted U.S. dollar index, the U.S. dollar appreciated during the quarter and the one year period.
- The MSCI EAFE Unhedged Index significantly underperformed the MSCI EAFE 100% Hedged Index during the year-to-date period reflecting the appreciation of the U.S. dollar. The Unhedged index underperformed the Hedged index during the trailing 1 and 5 year periods.

Hedge Fund Markets Overview

HEDGE FUND PERFORMANCE AS OF 03/31/2013



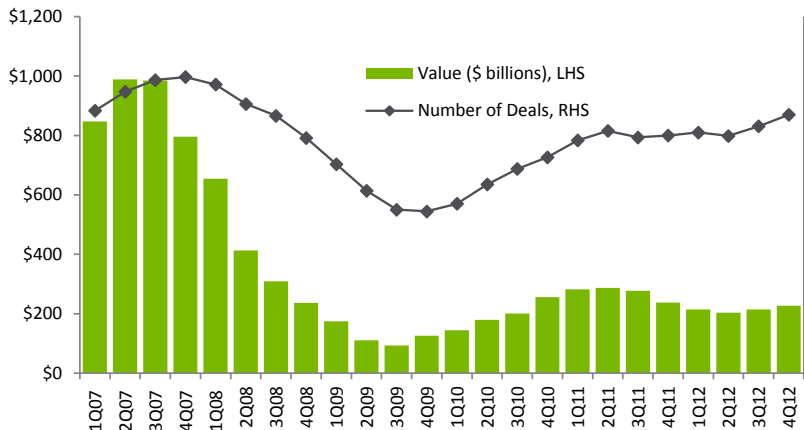
Note: Latest 5 months of HFR data are estimated by HFR and may change in the future.

Source: HFR

- All major hedge fund strategies types posted positive returns in the first quarter and one-year period. The HFRI Fund-Weighted Composite Index and the HFRI Fund of Funds Composite Index produced returns of 3.87% and 3.46%, respectively, during the first quarter.
- Equity Hedge and Distressed-Restructuring strategies were the strongest performers during the quarter gaining 5.29% and 4.37%, respectively.

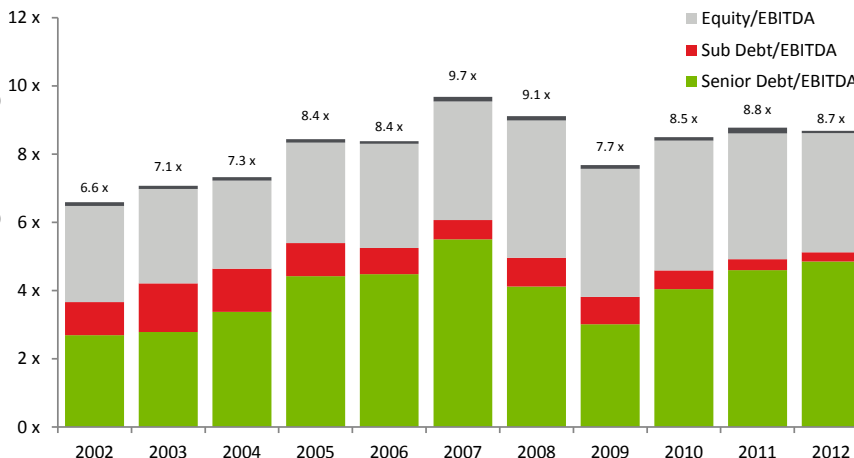
Private Equity Market Overview – Q4 2012

**LTM GLOBAL SPONSOR M&A DEAL VOLUME AND VALUE
(TRAILING 12 MONTH DATA)**



Source: ThomsonOne

PURCHASE PRICE MULTIPLES

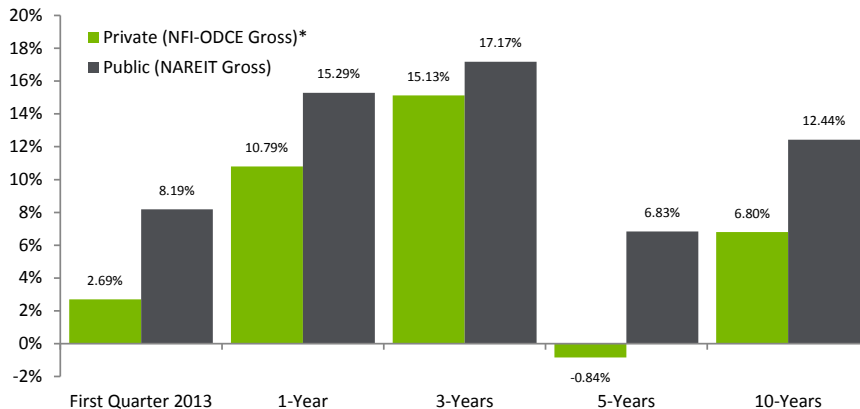


Source: S&P

- **Fundraising:** \$265 billion was raised in 2012, which is flat with 2011. This is a healthy but not excessive levels and is the well below the peak pre-crisis levels (\$490B). Dry powder available to invest is significant (\$789B) but decreasing and resides primarily within large cap and mega funds.
- **Buyout:** The number and value of deals completed is trending up but is 33.5% below the ten year average. Some mega deals are getting done although small and middle market deals comprise bulk of the number of deals. Purchase price multiples remained relatively steady for last three years; European and US large cap prices are above their 10 year average while middle market is at its 10 year average. Europe activity remains slow due to economic uncertainty.
- **Venture capital:** \$25.5 billion was invested in new deals, lagging the solid \$29 billion in 2011. Pre money valuations stabilized with exception of series B valuations which increased 34% to levels not seen since 2007. Exit activity was slightly lower than 2011 due to reduced M&A activity and poor performance of consumer technology IPO's.
- **Mezzanine:** U.S. mezzanine lenders are getting squeezed out of larger transactions due to robust and less expensive high yield market. In smaller deals mezzanine is facing competition from senior lenders who are beginning to provide higher levels of leverage.
- **Distressed Debt:** Investment activity remains low due to high refinance activity and continued low high yield default rates; looking forward to 2013-2014 attractive opportunities exist primarily in mid to lower cap market and in Europe where bulk of troubled situations have yet to be resolved.
- **Secondaries:** \$20 billion raised which is the highest level since 2008. \$24 billion of deals was completed, the second highest level for this strategy. Purchase prices for buyout funds increased to 90% of value due to improving valuations, increased expected liquidity and higher levels of capital raised. Venture pricing fell to 69% of value, but is largely contingent on the specific fund being priced. Solid activity expected in 2013 but smaller transactions and lesser quality assets.
- **Infrastructure:** \$23.2 billion raised, 5% greater than 2011. Infrastructure debt funds are being raised to replace the void left by the banks. Activity plateaued at lower levels due debt availability and increased regulation in Europe.

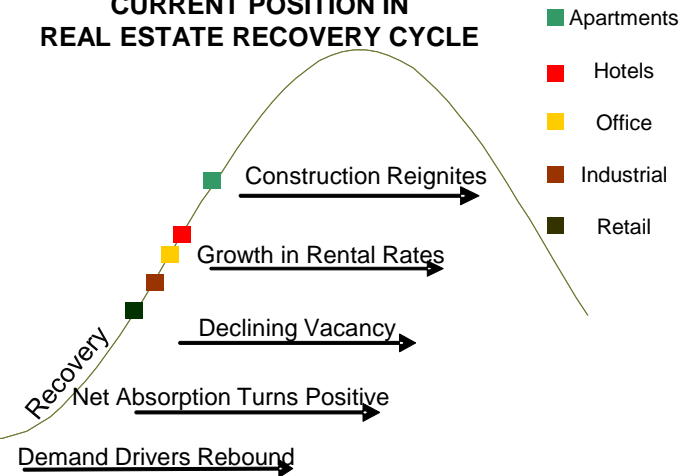
U.S. Commercial Real Estate Markets

PRIVATE VS. PUBLIC REAL ESTATE RETURNS
AS OF 03/31/2013



*First quarter returns are preliminary
Sources: NCREIF, NAREIT

CURRENT POSITION IN
REAL ESTATE RECOVERY CYCLE



2013 U.S. Real Estate Outlook:

- U.S. economy expected to remain in slow-growth mode for much of 2013, though still strong enough to support continued measured improvements in real estate fundamentals
- New supply expected to become more noticeable in 2013, first in apartments with some uptick in industrial as well; other new property type deliveries are still well restrained
- Current low interest rate environment continues to support price recovery/growth
 - Relative value of Real Estate versus other asset classes remains attractive
- Core rebound is mature and returns are expected to continue to moderate (consensus NPI forecast range is 6–9%...generally in line with long-term average)
 - Still solid investment option for long term investors seeking diversification and yield
 - Consider debt plays as a substitute for Core returns (also good alternative for fixed income)
- Non Core opportunities remain in the sector's sweet spot, with above average return potential
 - Distress, recapitalization, lease up, repositioning, even some development attractive
- Headwinds remain, both domestic and global, thus don't discount the potential for above average volatility in the sector to continue