

# The University of Houston System Non-Endowed Investments



FISCAL YEAR 2008

MAY 31, 2008

## Market Overview

Bond yields were much higher in May. Bond yields have risen (up to around 4% on the 10-year Treasury, the highest level since January 2008) as higher inflation expectations outweighed economic growth worries. Investors are attempting to ascertain the consequences of financial market volatility, a housing-led economic slowdown and an end to Federal Reserve interest rate cuts. The broader fixed income market, as measured by the Lehman Aggregate Bond Index, returned -0.7% and -0.6% for the month and quarter, respectively, ending May.

## Inflation & Interest Rates

The Consumer Price Index for All Urban Consumers (CPI-U) increased 0.8% in May. The core CPI, which excludes food and energy, rose 0.2% after a 0.1% uptick in April. The consensus had projected a 0.2% rise. Year-on-year, the core rate was unchanged at up 2.3%. The Federal Open Market Committee (FOMC) did not meet formally during May; their next meeting is scheduled for June 25. The Fed's most recent statements follow the consensus that they may be at the end of their easing cycle. The Fed's target for Fed Funds stands at 2.0%. The market nearly universally expects that the Funds rate will not change in June. Most economists are expecting rates to rise. The debate is whether it will be late 2008 or in 2009.

## Total Cash and Short-Term Investments

As of May 31, 2008, total non-endowed funds for UH System have a market value of \$267.0 million *excluding the \$59.5 million (market value) invested in the endowment fund*. The increase of \$31.5 million in May as compared to the month ending April 2008 is due mainly to our issuance of short term commercial paper to reimburse the System for funds expended for ongoing capital projects.

## Investment Allocation

The current allocation of the non-endow fund is 46% to the cash pool consisting of money market funds, 36% to the liquidity pool consisting of fixed income, and 18% to the core pool which is invested in the endowment. The target allocation is 40%, 40%, and 20% to the cash, liquidity, and core pools, respectively.

## Investment Performance

The money market funds are yielding 2.45% annualized, which outperformed the Merrill Lynch 91-Day Treasury Bill Index of 0.36% annualized. The Enhanced Cash Portfolio underperformed the Merrill Lynch 1-5 year Government/Credit Index return by 6 basis points for May. It also underperformed the benchmark for the quarter by 5 basis points last month. The first graph below compares the longer term returns of the fixed income portfolio to its benchmark. The second graph shows the asset allocation of the portfolio for the most recent and prior quarter.

