



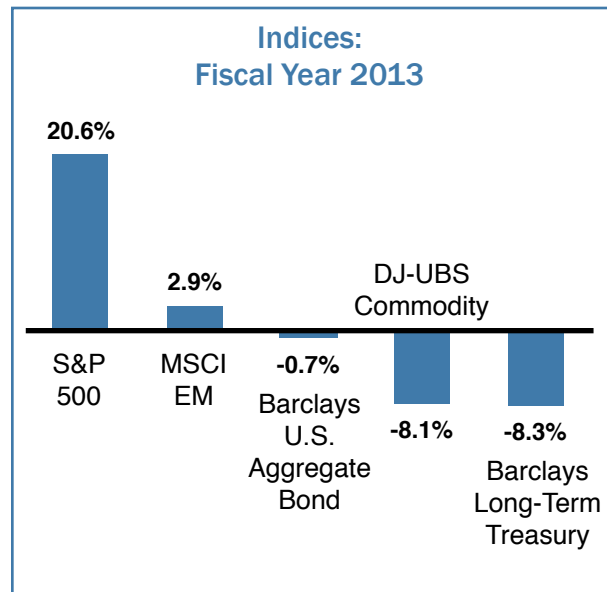
THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL ANNUAL ENDOWMENT REPORT FOR FISCAL YEAR ENDING JUNE 30, 2013

FISCAL 2013 FINANCIAL MARKET OVERVIEW

In stark contrast to FY 2012, the fiscal year ended June 30, 2013, saw equity markets, particularly those in the U.S., deliver strong performance as improved macroeconomic data and solid corporate profits drove markets higher. The S&P 500 Index of large capitalization U.S. stocks returned 20.6 percent for the year with domestic small cap stocks (as measured by the Russell 2000 Index) faring even better with a 24.2 percent return. While developed country international equities produced solid gains, they trailed the U.S. market with the MSCI EAFE Index finishing the year up 18.6 percent.

Despite the strong gains in developed equity markets, emerging market equities struggled with the MSCI Emerging Markets Index returning a modest 2.9 percent for the year as concerns surrounding a slowing of the Chinese economy roiled markets. In turn, these concerns regarding Chinese growth also led to a weaker outlook for commodities leading to an 8.1 percent loss for the Dow Jones-UBS Commodity Index. The sharp drop in commodities prices hit equity values in Brazil and Russia particularly hard.

Unlike developed world equities, fixed income markets experienced a sharp decline during the fiscal year, particularly in the last quarter, following comments by U.S. Federal Reserve Chairman Ben Bernanke indicating a possible slowing (often referred to as tapering) of the \$85-billion-per-month pace of bond purchases under its quantitative easing (QE) program. While Bernanke’s comments shook markets across the board and led to increased volatility across asset classes, fixed income markets were



hit particularly hard. The decline in fixed income markets was generally broad-based with U.S. Government securities and corporate credit suffering sharp reversals alongside structured credit markets as well. For the year, the Barclays Long-Term Treasury Index lost 8.3 percent. High yield securities proved resilient, however, with the Barclays U.S. Corporate High Yield Index returning 9.5 percent for FY 2013.

FISCAL 2013 INVESTMENT FUND PERFORMANCE

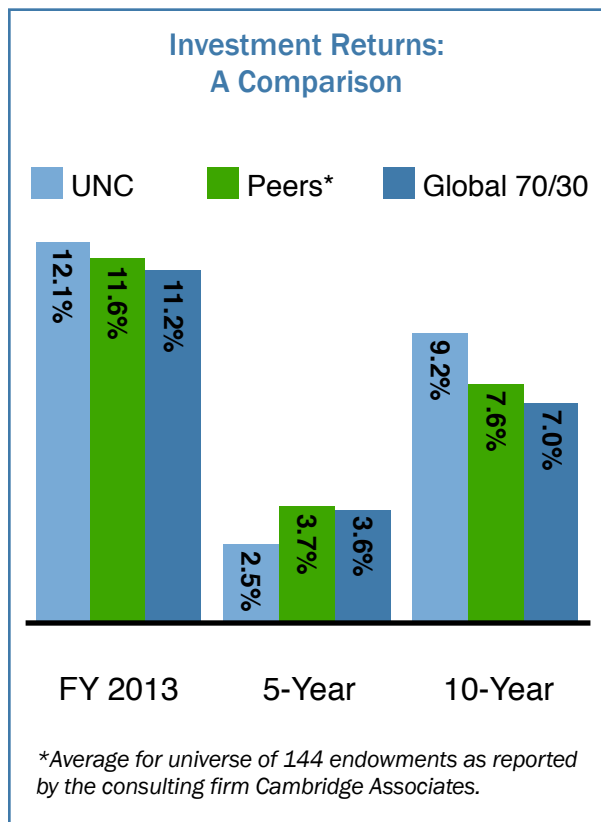
Benefitting from the strong returns experienced by both public and private equity markets, the UNC Investment Fund (the “Investment Fund”) posted a healthy 12.1 percent return for the 12-month period ended June 30, 2013. The Investment Fund’s primary objective is to maintain the purchasing power of its underlying funds after accounting for spending distributions

and inflation over the long term. Returns in excess of 8.5 percent are deemed to have achieved this target. In addition to contributing to the Investment Fund’s long-term return objective, the FY 2013 return of 12.1 percent exceeded the Investment Fund’s primary benchmark, the Strategic Investment Policy Portfolio Index (SIPP), as well as the more traditional Global 70/30 Index (consisting of 70 percent MSCI All Country World Index and 30 percent Barclays Aggregate Bond Index), which recorded 10.4 percent and 11.2 percent returns for the year, respectively. Relative to other endowments, the Investment Fund’s return beat the 11.6 percent median return of the 144 constituent institutions in the Cambridge Associates College & University universe of endowment funds.

With the exception of June, the Investment Fund generated a positive return in each month of the fiscal year. Also, each of the Investment Fund’s seven primary asset classes produced a positive return for the year with five of seven outperforming their respective benchmarks. Long Biased Equity, the portfolio’s largest allocation, was the Investment Fund’s top performing asset class in FY 2013 with a 19.6 percent return for the year. Energy & Natural Resources was the Investment Fund’s biggest relative out-performer, beating its SIPP benchmark by almost 10 percentage points (10 percent vs. 0.1 percent benchmark return). Fixed Income was also a strong relative performer in FY 2013, returning nearly 7 percent despite the slide in fixed income markets in the last two months of the fiscal year.

LONGER-TERM PERFORMANCE

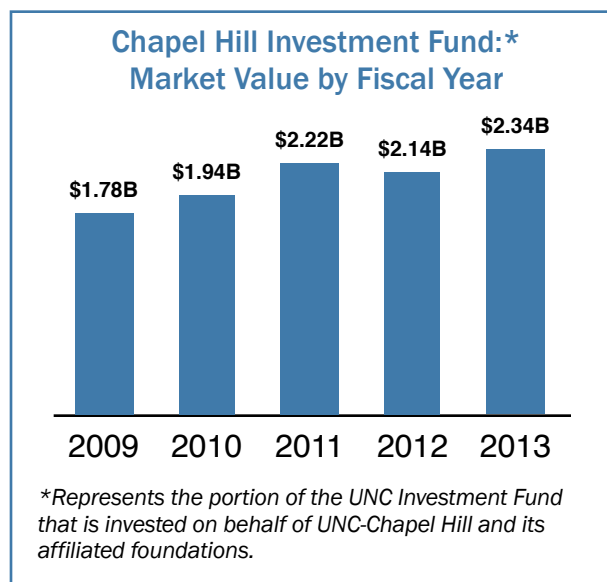
For the three-year period ended June 30, 2013, the Investment Fund generated a 9.7 percent annualized return, achieving the Fund’s primary return objective of exceeding the sum of the spending rate plus inflation over the period. The Fund’s 2.5 percent five-year return, however, fell short of reaching the long-term return objective, reflecting the impact of the global financial crisis in FY 2009. These returns compare to the 9.9 percent and 3.6 percent returns earned on the Global 70/30 Index for the three- and five-year periods, respectively.



Over the long term, the Investment Fund’s 10-year annualized performance of 9.2 percent not only achieves its long-term objective, but also ranks in the top-quartile of the Cambridge Associates College & University universe of endowment funds. Additionally, the Investment Fund’s 10-year return exceeds both the SIPP benchmark and the Global 70/30 Index, which returned 8.7 percent and 7 percent, respectively. During this period, each of the Investment Fund’s asset classes generated a positive return and, with the exception of Real Estate, exceeded their benchmark return.

FISCAL 2013 CHAPEL HILL INVESTMENT FUND MARKET VALUE

The University of North Carolina at Chapel Hill Foundation Investment Fund (“Chapel Hill Investment Fund”) represents the portion of the UNC Investment Fund* that is invested on behalf of UNC-Chapel Hill and its affiliated foundations. During FY 2013, the market value of the Chapel Hill Investment Fund increased by \$198.9 million, from \$2.14 billion at the beginning of the fiscal year to \$2.34 billion at June 30, 2013. The \$198.9 million increase resulted from a positive net investment return of



\$262.9 million plus \$59.1 million in net contributions to the Investment Fund less the annual endowment spending distribution of \$123.1 million. Over the past five years, the market value of the Chapel Hill Investment Fund has increased from \$2.23 billion at June 30, 2008, to \$2.34 billion at June 30, 2013. During this five-year period, \$571.1 million was distributed from the Chapel Hill Investment Fund in support of University programs.

**Note: The UNC Investment Fund is managed by UNC Management Company, Inc. The Management Company provides investment management services to UNC-Chapel Hill, to the UNC system and its other constituent institutions, and to affiliated foundations and endowments that support UNC-Chapel Hill or other UNC system schools.*

INVESTMENT OBJECTIVE

The Investment Fund employs a multi-asset class, multi-strategy investment approach to provide broad diversification, consistent returns and growth in spending and market value. This investment process is overseen by the Chapel Hill Investment Fund's Board of Directors ("CHIF Board"), which met three times in FY 2013 to review the Investment Fund's results and investment strategies.

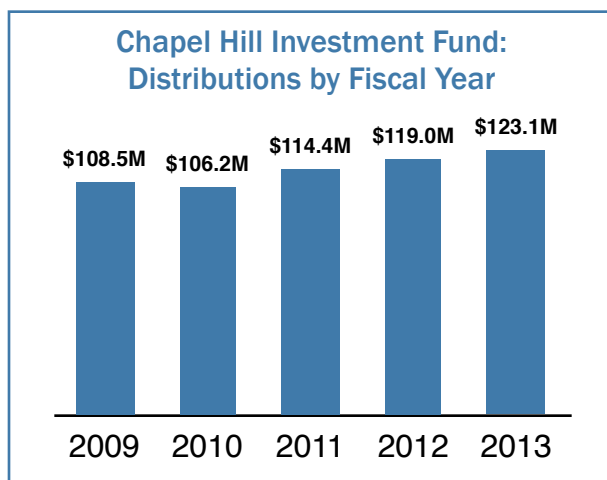
The Investment Fund's primary long-term investment goal is to provide an increasing stream of spending support in perpetuity while

simultaneously ensuring that the underlying value of the invested gift grows at a rate at least equal to inflation. This rather straightforward goal, however, creates an ongoing conflict between maximizing current spending and protecting the corpus of the gift from inflation. A dollar spent today cannot be reinvested to generate additional dollars tomorrow, and losses within the corpus impair the ability of the funds to earn returns sufficient to meet future spending needs. Our investment strategy must manage the delicate balance between protecting the corpus, which favors a more conservative investment strategy, and growing the value of the assets over time, which favors a more aggressive investment strategy, all within the context of widely varying financial market environments. Pairing the uncertainty of the financial markets with the need to generate a predictable and growing stream of spending to support endowed programs illustrates the underlying nature of our challenge.

Given the extensive diversification within the Investment Fund's portfolio, the quarter-to-quarter and year-to-year investment returns generated have been significantly less volatile than equity market returns and most other college and university endowment fund portfolios. A distinguishing feature of this low volatility is that the Investment Fund tends to lag behind traditional equity oriented benchmarks, as well as other endowment funds, in very strong up markets. On the other hand, the Investment Fund tends to significantly outperform traditional fund benchmarks, as well as other endowment funds, in down markets. Over reasonably long periods of time, this pattern of returns has served participants in the Investment Fund very well, as the Fund has produced competitive rates of return with lower levels of volatility and more downside protection than most institutional funds.

DISTRIBUTION POLICY

One of the distinguishing aspects of the Chapel Hill Investment Fund is the use of a "constant growth" spending rule. Under this spending rule, the annual per-unit distribution from the Investment Fund is ordinarily increased by the inflation rate (CPI) from year-to-year. This constant growth spending approach is designed to meet the stated objective of providing a predictable and growing stream of spending to support the



underlying endowed programs. Also by utilizing the constant growth approach, there is an increased likelihood that funds made available to support programs continually grow regardless of the financial market environment in a given year. Each year, however, the CHIF Board reviews the distribution rate and can make discretionary adjustments for the upcoming fiscal year.

In May 2013, the Board voted for a modest 1.8 percent increase in the per-unit distribution rate for fiscal year 2014. The resulting FY 2014 distribution rate amounts to 5.4 percent of the June 30, 2013, market value. Over the past three years, the distribution rate has grown at an annualized rate of 1.9 percent, which is slightly below the annualized CPI increase of 2.3 percent over the same period. To sustain the current distribution policy, the Investment Fund must achieve its long-term return objective of generating a real rate of return of at least 5.5 percent (5.5 percent plus CPI).

INVESTMENT OUTLOOK

While the economic backdrop has marginally improved from last year, uncertainty continues to linger requiring investors to exercise caution. Economic reports in the U.S. continue to paint a mixed picture but tend to point toward the continuation of modest growth with employment, housing statistics and auto sales improving, albeit at a modest pace. Economic data from Europe is also showing signs of improvement as business and consumer sentiment rise. The Federal Reserve and other central banks across the globe, particularly in Japan and Europe, have reiterated their stance

that monetary policy will continue to be accommodative for the foreseeable future.

It is unclear when the Fed will slow its bond purchase program, but it is likely to maintain interest rates near zero well into 2015. Winding down the bond purchase program would remove an important source of liquidity that has been fueling the demand for financial assets and driving U.S. and global stock indexes to record levels.

While a high degree of uncertainty as to the impact of a reduction in QE exists given a lack of precedence, without this support we believe fundamental factors will ultimately return as a significant driver of asset values in the “post QE” era, and we are optimistic the Investment Fund’s underlying investments will perform well as fundamental market drivers return. Additionally, we have confidence that these investments will provide downside protection as overall uncertainty persists and with it the potential for increased market volatility.

SUMMARY

The Investment Fund remains committed to its long-term goal of providing a predictable stream of distributions to support the University in perpetuity on an inflation-adjusted basis. For the 10-year period ending June 30, 2013, with an annualized return of 9.2 percent, we have been successful in delivering on this objective. The Investment Fund’s FY 2013 return of 12.1 percent contributed to this success.

Going forward, in order for the Investment Fund to continue to meet its long-term return objective, we maintain our conviction in managing a portfolio appropriately diversified across asset classes and underlying investment managers. We also strive to structure the portfolio in a way that allows it to participate in market rallies while protecting capital during market downturns.

Copies of the annual report for the UNC-Chapel Hill Foundation Investment Fund are available from:

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