



UNIVERSITY OF
ALBERTA

**INVESTMENT COMMITTEE
REPORT TO THE BOARD OF
GOVERNORS**

For the Year Ended March 31, 2006

UNIVERSITY OF ALBERTA

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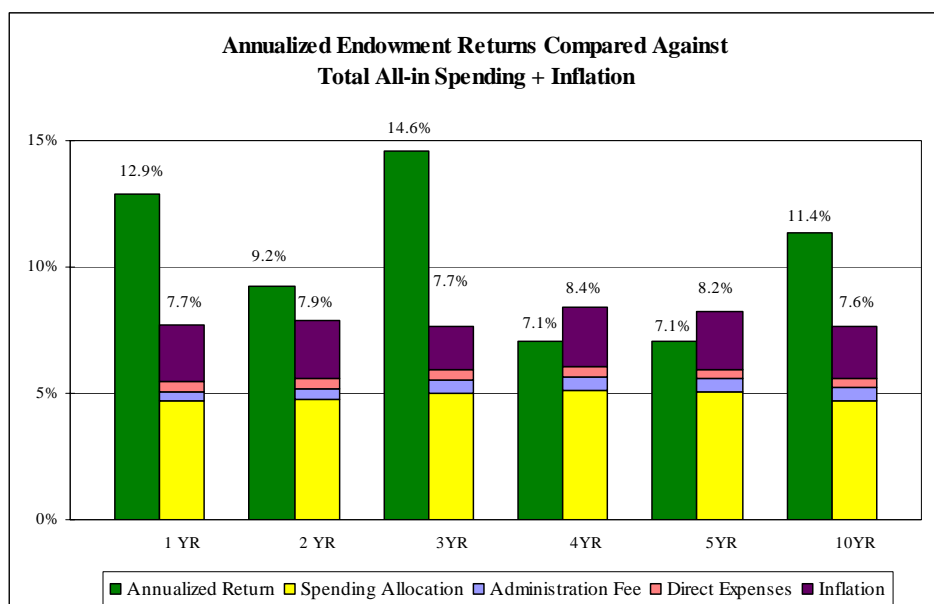
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The investment assets of the University of Alberta that are under the governance of the Investment Committee had a total market value of \$995 million (2005 - \$963 million) as of March 31, 2006. Of this amount, \$645 million (2005 - \$586 million) relates to endowments, while the remaining \$350 million (2005 - \$377 million) relates to non-endowed funds.

Endowment Funds - Key Points

- The market value of the endowments increased by \$59 million to \$645 million. The increase was comprised of investment earnings of \$72 million and new donations of \$22 million, less spending allocations and administrative expenses of \$35 million.

- The Unitized Endowment Pool (UEP) investment portfolio posted an absolute return of 12.9% for the year ending March 31, 2006. This return exceeds the primary goal of maintaining the real value of the UEP's assets, as the spending allocation, administrative fees, direct expenses plus inflation totaled 7.7% for fiscal 2006. The UEP's returns are ahead of this target over the long-term as well with a 10-year annualized return of 11.4% against a total expenses plus inflation measure of 7.6%. The excess of endowment market values over contributions indexed for inflation grew by 23% from \$112 million in fiscal 2005 to \$138 by the end of fiscal 2006.



- The investment policy approved by the Board of Governors in June 2005 mandates an externally managed, well diversified portfolio of equity, fixed income and alternative investment strategies. The Investment Committee will continue to focus on a diversified approach with an emphasis on equities. The management structure of the UEP did not add value in fiscal 2006 as the portfolio return of 12.9% lagged the benchmark return of 14.2%. Over the long-term however, the investment managers have added value. For the 10 years ending March 31, 2006, the UEP has returned 11.4% annualized, against the benchmark return of 9.6% for a 10-year annualized added value of 1.8%.
- The Investment Committee continues to implement the portfolio structure contained in the Investment Policy that was approved by the Board of Governors in June 2005.
 - The University terminated the active Canadian nominal bond mandate with Legg Mason Canada Inc. as of December 13, 2005. Legg Mason had underperformed their benchmark over the past four years and the Investment Committee decided that the UEP required a different solution for this portion of its actively managed Canadian nominal bond portfolio. The money allocated to Legg Mason has been temporarily added to the UEP's existing Scotia Capital Universe Index product with TD Quantitative Capital. A full review of the UEP's fixed income structure is currently underway and will be completed in the fall of 2006.

- JP Morgan Asset Management was retained for an active currency overlay mandate. The UEP has a significant exposure to foreign currency associated with its 50% benchmark allocation to foreign equities; primarily the US Dollar, Euro, Japanese Yen and the Pound Sterling. The exposure to foreign currency was not being managed and represented a risk for which the University was not being compensated. Using a system of forward contracts, JP Morgan will seek to hedge the UEP against periods when the Canadian Dollar appreciates, while still participating in the gains associated with periods when the Canadian Dollar depreciates. The primary focus for this mandate will be risk management and downside protection, with a secondary objective of return enhancement. The University of Alberta is phasing this mandate in over a period of twelve months. The mandate began on October 31, 2005 with a notional principal of \$30 million and will increase by \$30 million each month until the mandate reaches the notional principal target that is equal to the University's exposure to foreign equities (\$360 million).
- As well, the Investment Committee plans to research and fund other alternative investment strategies such as Private Equity.

Non-Endowed Funds - Key Points

The non-endowed funds have decreased by \$26 million to \$350 million. The funds were mainly invested in high quality, liquid money market products (\$168 million), bonds with duration of less than 5 years (\$78 million), and the UEP (\$96 million). The decline in total non-endowed funds is attributable to the University's capital construction program. During the fiscal year ending March 31, 2005, the University had received restricted capital funding that was not spent until the fiscal year ending March 31, 2006.

Governance and Compliance

The Board has delegated to the Investment Committee responsibility and authority to make decisions on behalf of the Board in the Committee's defined area of responsibility except to the extent that such authority has been specifically limited by the Board in the Terms of Reference for the Committee. The Investment Committee meets regularly as part of its governance responsibility for oversight and implementation of the investment policy. The Investment Committee:

- Reviews and recommends to the Board, investment objectives and policies for the Endowment and Non-Endowed funds.
- Approves investment manager mandates, appointments and terminations.
- Monitors compliance to the investment policy and investment manager mandates.
- Addresses and resolves any identified non-compliance matters.

Management provides the Investment Committee with quarterly reports on endowment investment performance. The Investment Committee forwards to the Board an annual investment review. The Investment Committee retains the services of independent external consultants that specialize in evaluating fund performance on a quarterly basis. Specialized consultants are retained from time to time to assist with governance matters, asset-liability studies and manager searches.

The Investment Committee monitors compliance with the approved investment policy, investment manager mandates and related legal aspects on a regular basis. All non-compliance issues have been immaterial and have not resulted in any losses. All have been resolved and there is nothing material to report.

Endowment Funds

Endowments consist of the Unitized Endowment Pool (UEP) and a small number of other endowed funds managed outside the UEP. Endowment investments are comprised of Canadian, U.S. and International equities, Canadian government and corporate bonds, mortgages, real estate, alternative investment funds and money market instruments.

Investment Policy

The primary endowment investment policy objective is to maintain the real capital value of the endowment while providing an appropriate level of spending. This requires returns which meet or exceed the all in spending policy rate plus inflation over time within an acceptable level of risk.

Portfolio diversification is used to help ensure that the endowment investment objectives are met. Diversification is achieved through the following strategies:

- The asset mix policy that has established allocations to fixed income products for income and to equities and alternative assets for growth.
- The allocation within equities between Canada, the United States of America and other international capital markets diversifies market specific risk.
- The allocation of funds amongst different fund managers diversifies manager style risk. Please refer to Appendix 1 for details.
- The allocation of funds between both active and passive investment strategies controls active management risk.

UEP Endowment Asset Mix as at March 31, 2006

	Policy Range Min.-Max. %	2006 Actual Asset Mix	2005 Actual Asset Mix
Fixed Income			
Money Market Securities	-5 - 10	2.4%	2.1%
Bonds, Debentures, Real Return Bonds	20 - 40	26.2%	28.1%
Total	20 - 40	28.6%	30.2%
Equity			
Canadian Equity	10 - 20	14.8%	15.3%
Foreign Equity	40 - 60	53.6%	51.4%
Alternative Assets	0 - 10	3.0%	3.1%
Total	60 - 80	71.4%	69.8%

Investment Performance

Measuring Performance of Endowment Funds

The returns of individual asset classes in the Fund are measured against established market benchmarks, such as the Scotia Capital (SC) Universe Bond Index, the Scotia Capital Real Return Bond Index, the S&P/TSX Composite Index capped at 10%, and the Morgan Stanley Capital International World Index. The total fund return is measured against the return of benchmark asset mix policy. The difference between the endowment's return and the benchmark return reflects the value added by strategic and investment policy allocation decisions together with active management by our investment managers. Please refer to Appendix 3 for details. The benchmark return for the endowment pool is calculated from the asset mix and the benchmark indices as outlined in the adjacent table.

UEP Investment Policy Benchmark

91-Day Treasury Bill Return	0%
Scotia Capital Universe Bond Index	20%
Scotia Capital Real Return Bond Index	10%
S&P/TSX Composite Index ^(Cap 10)	15%
MSCI World Index	55%
	<u>100%</u>

The performance is also measured against that of other funds through participation in Russell/Mellon Analytical Services Canadian Trust Universe, the Canadian Association of University Business Officers (CAUBO), and the National Association of College and University Business Officers (NACUBO) endowment survey. The Investment Committee uses these universes as reference points to monitor whether or not the University's endowment investments have achieved competitive rates of return.

Annual Endowment Fund Performance to March 31, 2006

The main objective of the endowment investment policy is the preservation of capital. Past performance has accomplished this objective. In Fiscal 2006, the real value of the endowments increased by 5.2%, comprised of the 12.9% return less the 5.0% spending allocation, less the 0.50% administrative fee and less inflation of 2.2%.

As shown in the adjacent graph, the market value of the endowments currently exceeds the cumulative endowment contributions indexed for inflation by \$138 million. This represents a 23% increase over the \$112 million from 2005. The current year's position is consistent with the Board's policy objective of providing stable funding over time in real terms to current and future generations.

The University's endowment investments returned 12.9% for the year ending March 31, 2006.

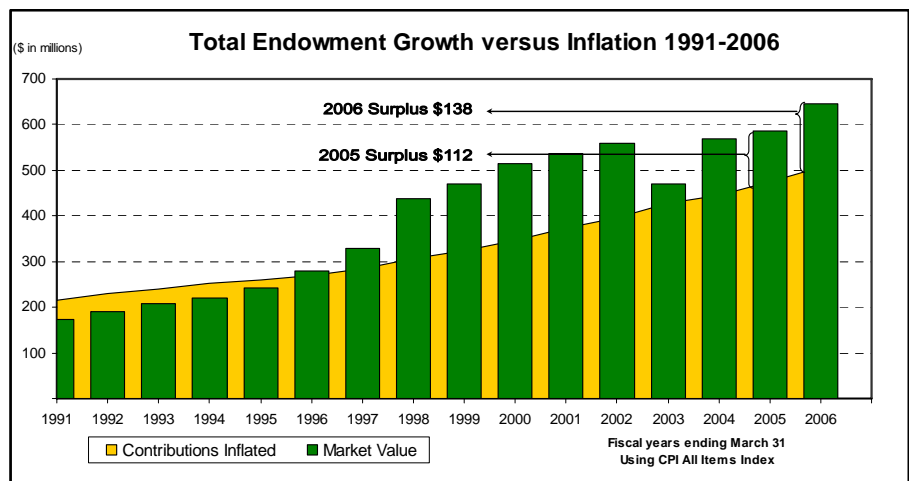
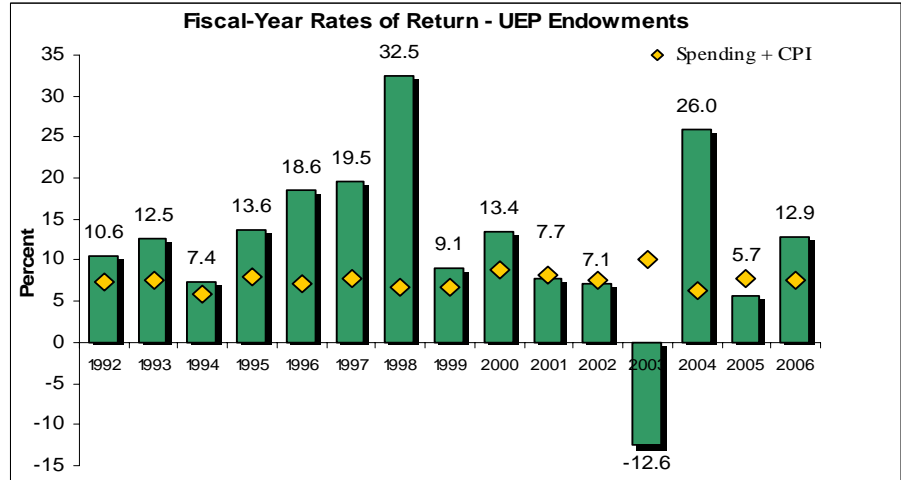
This return lagged the benchmark return of 14.2%. Three main economic events drove capital market returns in fiscal 2006: escalating commodity prices, the appreciation of the Canadian Dollar against most major world currencies, and the rebound of the Japanese economy.

For a second consecutive year, commodity prices grew rapidly. The commodity that garnered the most attention, especially in Canada, was crude oil. Due to strong commodity prices, the Energy (50.5%) and Materials (33.6%) sectors paced the Canadian market which posted a strong overall return of 28.4%.

After years of recession, the Japanese economy finally appeared to begin its recovery in fiscal 2006. The MSCI Japan reported a one-year gain of 32.5% and the economy posted consecutive quarters of growth for the first time since the early 1990's.

The University tends towards hiring more conservative, lower volatility managers. Accordingly, many of the endowment's managers took defensive positions in fiscal 2006 and shied away from highly cyclical equity sectors such as Industrials and Materials. The end result of 12.9% generated by the endowments' managers did not capture all of the bull market and generally underperformed their respective benchmarks.

The U.S. dollar continued to depreciate against the Canadian Dollar in fiscal 2006, falling 3.5% for the year ending March 31, 2006. Other world currencies such as the Euro (-9.7%), the UK Pound (-11.2%) and the Japanese Yen (-12.0%) depreciated against the Canadian dollar as well. This appreciation of the Canadian dollar detracted from the absolute performance of the endowments as 53.6% of the endowments' assets were



denominated in foreign currencies as of fiscal year-end and the active currency overlay mandate has not yet been fully implemented.

In the Russell/Mellon Analytical Services Canadian Trust Universe (RMCTU), which is composed of Canadian institutional pensions, endowments, and foundations, the median fund returned 14.9%. Within this universe the endowment's investment performance was ranked in the 88th percentile. The Canadian dollar appreciation affected the University's portfolio more severely than it did the RMCTU median. This is because the RMCTU is heavily influenced by pension plans, many of which have higher fixed income and lower foreign equity exposure than the UEP. To illustrate this point, the asset mix of the median RMCTU fund as of March 31, 2006 was 61.0% equities and 39.0% fixed income and cash. This asset mix is substantially different than the UEP's target allocation of 70.0% to equities and 30.0% to fixed income. As well, the median RMCTU portfolio had a global equity allocation of only 33.2% while the UEP's foreign equity exposure was 53.6%. Canadian equity returns as measured by the S&P/TSX Composite Index returned 28.4% while global equities as measured by the MSCI World Index returned 14.3%. The fourth quartile ranking in the RMCTU is largely attributable to our relatively heavier weighting to the poorer performing global equity asset class. On a five-year basis the endowment returned 7.1% versus an RMCTU median return of 7.6%. The relative underperformance of the UEP reflects the relative out-performance of Canadian equities and fixed income versus Global equities for the past five years.

The University of Alberta participates in benchmark studies sponsored by the Canadian Association of University Business Officers (CAUBO) and the USA's National Association of College and University Business Officers (NACUBO). The most recent published data from these organizations is for the periods ending December 31, 2004 and June 30, 2005 respectively. The University of Alberta has performed well versus the other 19 Canadian universities with assets greater than \$100 million. The University's return of 10.2% for the one year ending December 31, 2004 ranks in the second quartile of the CAUBO survey, but the 10 year return of 12.6% is ranked first overall. The University's returns remain in the first quartile for the 5yr and 10yr periods surveyed in the NACUBO study and is ranked 47th overall of 747 Canadian & U.S. universities for its 10 year annualized return of 11.6% as of June 30, 2005.

Annual Performance - UEP Endowments

Relative to Asset Class Benchmarks	Years Ending March 31				
	2006	2005	2004	2003	2002
	%	%	%	%	%
Short Term	3.0	2.3	2.7	2.7	3.7
<i>91Day Treasury Bill</i>	2.8	2.2	3.0	2.7	3.1
Fixed Income (non-RRB)	4.4	4.7	10.9	9.2	4.9
<i>SC Universe Bond Index</i>	4.9	5.0	10.8	9.2	5.1
Fixed Income (Real Return Bonds)	11.7	10.7	15.0		
<i>SC RRB Index</i>	11.8	10.7	15.3		
Canadian Equity	25.5	20.5	34.3	-15.6	13.9
<i>S&P/TSX Composite Index (Cap 10)</i>	28.4	13.9	37.7	-17.6	5.2
Foreign Equity Total	12.9	1.5	35.7	-30.7	3.0
<i>MSCI World Index</i>	14.3	2.3	29.2	-29.8	-3.1
Non-North American Equity	17.9	4.9	52.3	-30.9	2.6
<i>MSCI EAFE Index</i>	20.4	6.3	41.3	-29.0	-7.3
U.S. Equity	6.7	-2.4	18.6	-30.7	4.0
<i>Standard and Poors 500 Index</i>	7.7	-1.8	20.7	-30.6	1.4
Absolute Return Strategies	7.2				
<i>US T-Bills +6.0%</i>	8.5				
Total Fund	12.9	5.7	26.0	-12.6	7.1
Benchmark Return	14.2	5.5	25.2	-12.7	2.6
CTU Median	14.9	8.2	24.5	-10.6	5.4
CPI Index	2.2	2.3	0.7	4.3	1.8

Annualized Return - UEP Endowments

Relative to Asset Class Benchmarks	Year Ending March 31					
	1YR	2YR	3YR	4YR	5YR	10YR
	%	%	%	%	%	%
Short Term Yield	3.1	2.7	2.7	2.7	2.9	3.8
<i>91-day Treasury Bill Yield</i>	2.8	2.5	2.7	2.7	2.9	3.7
Fixed Income (non-RRB)	4.4	4.6	6.6	7.2	6.8	7.0
<i>SC Universe Bond Index</i>	4.9	4.9	6.9	7.4	7.0	7.7
Fixed Income (Real Return Bonds)	11.7	11.2	12.4			
<i>SC RRB Index</i>	11.8	11.2	12.6			
Canadian Equity	25.5	23.0	26.6	14.4	14.3	17.9
<i>S&P/TSX Composite Index (Cap 10)</i>	28.4	21.0	26.3	13.5	11.8	13.4
Foreign Equity Total	12.9	7.1	15.9	1.9	2.1	12.5
<i>MSCI World Index</i>	14.3	8.1	14.7	1.5	0.6	7.7
Non-North American Equity	17.9	11.22	23.5	6.8	5.9	
<i>MSCI EAFE Index</i>	20.4	13.2	21.9	6.5	3.6	
U.S. Equity	6.7	2.1	7.3	-3.8	0.5	10.4
<i>Standard and Poors 500 Index</i>	7.7	2.9	8.5	-3.0	-2.1	7.3
Absolute Return Strategies	7.2					
<i>US T-Bills +6.0%</i>	8.5					
Total Fund	12.9	9.2	14.6	7.1	7.1	11.4
Benchmark Return	14.2	9.8	14.7	7.1	6.2	9.6
CTU Median	14.9	11.3	15.5	8.3	7.6	9.2
CPI Index	2.2	2.3	1.7	2.4	2.3	2.1

Spending Policy

On April 1, 2004 the University implemented a Board of Governors approved long-term strategy to shift the endowment's spending model to a sustainable inflation indexed model subject to a spending rate maximum of 6.0% of market value and a minimum spending rate of 4.0% of market value. The move was required given that the effective rate of spending at the time significantly exceeded the long-term real return expectation of 5.0%. Under this strategy, the shift will occur gradually to limit the impact of spending allocation reductions on the programs being supported. The spending policy during the transition period will remain based on the 36-month averaging rule. For the year ending March 31, 2006, \$30.5 million was made available from the Endowments to support program spending. During the fiscal year ending March 31, 2005, the administrative fee was reduced from 0.75% to 0.50%. The spending allocation will be gradually reduced from 5.0% to 4.25% over a 4-year period commencing in the current fiscal year ending March 31, 2007. It had been forecast that this new spending policy would result in year-over-year declines in the spending allocation of approximately 3.0% in each of the 6 years in the transition period. The 3-year annualized return of 14.6% for the period year ending March 31, 2006 has had a positive impact on the forecasted year-over-year declines. The actual decline in the spending allocation for the fiscal year ending March 31, 2007 is 0.6%. Future investment returns will continue to impact these forecast reductions in the spending allocation.

Costs

The Administrative Fee totaled \$2.4 million for fiscal 2006, representing 0.4% of average market value of the fund. The Administrative Fee supports central indirect expenses associated with the programs supported by the Endowments. Direct expenses were \$2.5 million during the same period or 0.4% of the average market value of the fund. These expenses represent manager fees, custodial fees and other direct costs associated with the management of the endowment assets.

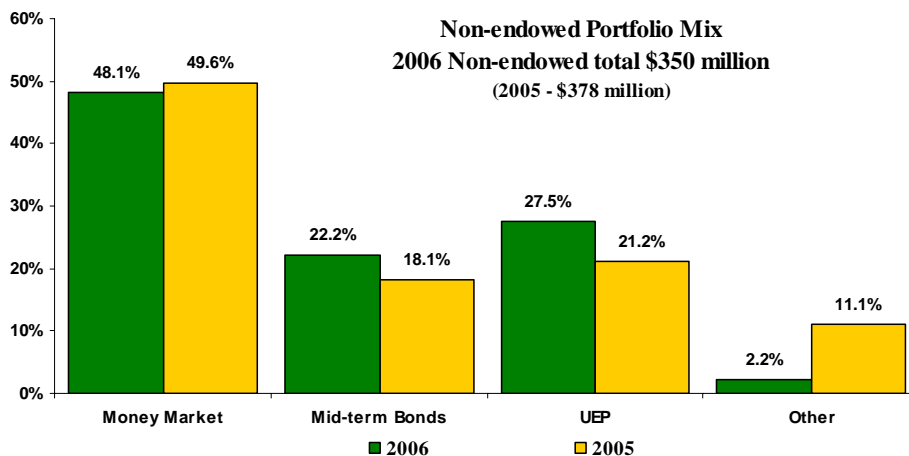
Non-Endowed Funds

The Non-endowed Investment Pool (NEIP) represents the University's operating, capital, and restricted funds, of which \$168 million (2005 - \$200 million) is held in money market instruments while the remaining \$182 million (2005 - \$178 million) is invested in bonds and equities.

The investment policy approved by the Board of Governors in June 2005 identified that only a portion of non-endowed funds are required for short-term cash flow management, with the remainder being available for medium to long-term investment strategies. The policy objective of the short and mid-term funds is to earn the highest return possible on

investments that ensure the security of the invested capital. The short and mid-term fixed income investments are currently managed internally, using a buy and hold to maturity strategy. Yield curve analysis, duration management, and credit quality are taken into account in the pre-trade fixed income analysis.

The return on the non-endowed funds was 5.7% for the year. Cash and cash equivalent money market funds comprised 48.1% or \$168 million of the non-endowed funds at the end of the fiscal year. These funds provided a return of 3.0%, which exceeded the benchmark Scotia Capital 91 day T-Bill return of 2.8%.



Internally managed mid-term bonds with duration under 5 years comprise 22.2% or \$77 million of the non-endowed funds; these bonds provided a return of 2.7%, which exceeded the benchmark Scotia Capital Short Term Bond index return of 2.5%.

At March 31, 2006 \$96 million or 27.5% of the non-endowed funds was invested in the UEP, which returned 12.9% for the year.

Going Forward

The Investment Committee is currently reviewing the Fixed Income portfolio. A long-term solution is required for the funds that were previously managed by Legg Mason Canada Inc. The committee is researching a number of different options to determine a solution that offers the correct combination of return enhancement and risk mitigation.

The Investment Committee will also begin work on identifying suitable private equity fund of funds managers. The primary objective of this asset class is to enhance the returns of the endowment assets by identifying general partners with a demonstrated long-term ability to generate superior returns. Given the very long-term nature of such investments, the due diligence component of the search process will be of primary importance.

Management is currently searching for a short-term money market manager. Money market investing has been managed internally for over 20 years and management has generally been able to add value over the benchmark through corporate commercial paper products which offer a yield superior to T-Bills. From a return perspective, the past two years have slightly bettered the Scotia 91-day T-bill index. Although the University's return has exceeded the 91-day T-bill rate of return, the University's portfolio is exclusively corporate paper and therefore more risky than the index. Retaining a money market manager would allow the University to enhance returns by taking advantage of longer term (greater than 90 days) money market investments, lower risk through access to higher-rated products, while maintaining the necessary liquidity of the portfolio to meet operating needs.

Board of Governors Investment Committee established October 1997.
Investment Committee Membership for the period June 2005 to June 2006:

Bob Kamp, Chair (external member)	Jim Edwards (ex-officio)
Ken Bancroft (external member)	Dr. Eric Newell (ex-officio)
Fred Barth (external member)	Dr. Indira Samarasekera (ex-officio)
Barbara Belch (external member)	
Jim Drinkwater (external member)	
Lynne Duncan (external member)	
Louise Hayes (board member)	
Allister McPherson (external member)	
Gerard Protti (board member)	

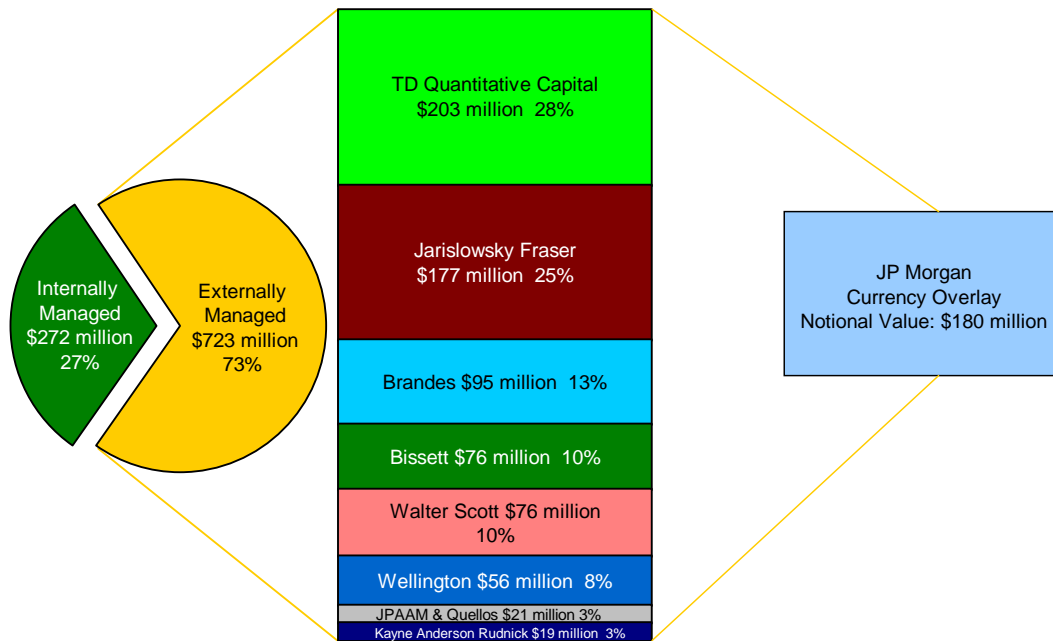
Prepared for Board Investment Committee
By Financial Services - Treasury

Appendix 1 - Investment Manager Structure

The University retains the services of ten external fund managers for the bond, equity and absolute return components of the endowment investment portfolio.

Investment Management Structure

Total Investment Assets of \$995 Million at March 31, 2006



Bissett Investment Management has an active Canadian equity mandate. Bissett’s approach is to identify companies that have good growth potential and are presently trading at reasonable prices. Bissett has been managing funds on behalf of the University since November 1998.

Brandes Investment Partners has an active international equity mandate that includes Europe, Australia, the Far East, and emerging markets. Brandes’ style is that of a value manager, in which undervalued companies are identified and investments are made for future growth. Brandes has been a fund manager for the University since November 1998.

Jarislowsky Fraser Ltd. has an active, balanced mandate that includes bonds, Canadian equities and international equities. Jarislowsky Fraser’s equity style can be described as a hybrid value/growth style that focuses on a company’s long-term fundamentals rather than on short-term events. Their fixed income style includes interest rate anticipation, yield curve management and sector rotation. Jarislowsky Fraser has been a fund manager for the University for more than 20 years.

JP Morgan Alternative Asset Management has an absolute return strategy mandate. The University of Alberta has invested in JPMAAM's Multi-Strategy Fund Ltd. which operates a hedge fund of funds product. The Multi-Strategy Fund invests in approximately 30 individual strategy funds run by managers outside of JPMAAM. These different strategies seek to capitalize on market inefficiencies and include relative value, opportunistic/macro, long/short equities, merger arbitrage/event driven, distressed securities and dedicated short selling strategies. JPMAAM selects well-established hedge fund managers with assets under management greater than \$50 million. JP Morgan Alternative Asset Management's mandate was funded on January 1, 2005.

JP Morgan Asset Management has an active currency overlay mandate. JP Morgan uses both quantitative and qualitative measures to actively track seventeen different currency pairs. The manager uses a series of currency forward contracts to either increase or decrease the university's exposure to a certain currency, in the context of a strategic hedge ratio of 50% that is based on the UEP's actual exposure associated with its foreign equity holdings. The primary goal of the mandate is to manage the UEP's underlying currency risk exposure, with a secondary goal of return enhancement. The long-term objective for this mandate is to generate a 1.0% excess return over that of the strategic hedge ratio with a target tracking error of 2.0%. The mandate commenced on October 31, 2005 and will be fully implemented by October 31, 2006.

Kayne Anderson Rudnick Investment Management LLC, has an active US small-mid cap equity mandate. Kayne Anderson Rudnick invests in high quality companies at a reasonable price, seeking to identify the next generation of blue chip companies through bottom up fundamental research focused on companies with an S&P rating of A- or better. Kayne Anderson Rudnick's mandate was funded on December 1, 2003.

Quellos Capital Management has an absolute return strategy mandate. The University has invested in Quellos Strategic Partners II Ltd. which operates a hedge fund of funds product. Quellos Strategic Partners II invests in approximately 40 individual strategy funds run by managers outside of Quellos. These different strategies seek to generate a return by capitalizing on market inefficiencies and include relative value, event driven and hedged directional strategies. Quellos excludes certain strategies from their fund of funds, such as commodity trading and global macro. As well, Quellos seeks to identify and invest with new fund managers at an early stage to establish a long-term competitive advantage. Quellos Capital Management's mandate was funded on January 1, 2005.

TD Quantitative Capital has a passive U.S. equity S&P500 index mandate, a Scotia Capital Universe bond index mandate, and a Scotia Capital Real Return bond index mandate. The University has been using the services of TD Quantitative Capital since 1996.

Walter Scott & Partners Limited has an active international equity mandate that includes Europe, Australia, and the Far East. Walter Scott seeks to invest in companies capable of sustaining an internal rate of return growth above 20% per annum. Walter Scott's mandate was funded on July 1, 2003.

Wellington Management Company LLP has an active core United States equity mandate for large corporations. Wellington's style uses a balanced process that takes both top down and bottom up analysis into account in sector weighting and security selection. Both growth and value considerations are taken into account in the buy and sell discipline. Wellington has been managing funds on behalf of the University since July 2001.

Appendix 2 - Investment Performance by Asset Class

Balanced Manager Performance

Jarislowsky Fraser's total return for the year of 8.9% trailed their benchmark return of 14.0%. Jarislowsky Fraser invests in more defensive, non-cyclical stocks. They generally avoid stocks in cyclical sectors such as Materials and Industrials while overweighting sectors such as Health Care and Consumer Staples. The underweight cyclical sectors were amongst the strongest performers in most capital markets this past year, while the overweight defensive sectors were amongst the weakest performers, accounting for the majority of Jarislowsky Fraser's underperformance. Jarislowsky Fraser was able to partially mitigate the underperformance through their exposure to Canadian oil stocks which performed very well and which the manager views as non-cyclical. Throughout the year, Jarislowsky Fraser has been actively increasing the allocation to International Equities while reducing the allocation to Canadian Fixed Income. This strategic asset shift has added value to the portfolio.

Individual Asset Class Performance

Fixed Income

Fixed income includes publicly traded Canadian bonds, a Canadian bond index pool, real return bonds, and privately issued mortgages. During fiscal 2006, the University of Alberta removed its allocation to the Legg Mason Active Bond Fund. Those funds were temporarily added to the existing allocation to the TD Emerald Canadian Bond Index Fund. Currently 39.9% of the fixed income allocation is in the TD Emerald Canadian Index bond fund. The TD Emerald Real Return Bond Fund accounts for another 37.4%. Jarislowsky Fraser manages 20.6% of the bond portfolio, while the remaining 2.1% was managed internally. The overall fixed income portfolio returned 7.0% which trailed the fixed income benchmark return of 7.1%. However, the University's return exceeded the Russell Mellon Canadian Trust Universe (RMCTU) median of 5.7%.

Top 10 Canadian Fixed Income Holdings

Company	Market Value (\$ millions)	% of CDN Bonds	% of Portfolio
Gov't of Canada RRB 4.00% 01-DEC-2031	10.93	5.7%	1.5%
Gov't of Canada RRB 4.25% 01-DEC-2021	9.34	4.9%	1.3%
Gov't of Canada RRB 4.25% 01-DEC-2026	9.11	4.8%	1.2%
Gov't of Canada RRB 3.00% 01-DEC-2036	7.49	3.9%	1.0%
Gov't of Canada 5.50% 01-JUN-2010	4.06	2.1%	0.5%
Gov't of Canada 8.00% 01-JUN-2023	3.43	1.8%	0.5%
Gov't of Canada 5.25% 01-JUN-2013	3.12	1.6%	0.4%
Gov't of Canada 5.75% 01-JUN-2033	2.79	1.5%	0.4%
Gov't of Canada 6.00% 01-JUN-2011	2.41	1.3%	0.3%
Gov't of Canada 4.25% 01-SEP-2009	2.31	1.2%	0.3%

Bonds

Canadian bond rates of return for the endowments were 4.4% for the fiscal year. This return trails both the Scotia Capital (SC) Bond Universe return of 4.9% and the RMCTU median of 5.7%. The Bank of Canada consistently tightened its monetary policy in response to fears of inflation in the Canadian economy brought on by high energy prices. Demand for long-term bonds remained robust as a flattening yield curve and compressed corporate credit spreads meant there was little opportunity for excess returns in the market.

Legg Mason's return to their termination date of December 13, 2005 was 4.1% which trailed the SC Bond Index at that time. After four years of continual underperformance, the Investment Committee decided that an alternative approach was needed for active Canadian bond management.

Jarislowsky Fraser underperformed the benchmark at 3.7%. Jarislowsky Fraser underestimated the Canadian demand for long-term bonds despite a rise in short-term interest rates. The manager had begun the year with a short duration strategy which hampered returns. The manager further noted that spread compression in the Canadian corporate bond market has limited their long-term bond purchasing opportunities.

The TD Emerald Canadian Bond Index Fund is indexed to the SC Bond Universe and provided a near benchmark return of 5.2%. The slight excess return can be attributed to the timing of the reallocation of the Legg Mason funds.

Real Return Bonds

Real return bonds are bonds that pay a rate of return that is adjusted for inflation. Unlike regular (nominal) bonds, this feature ensures that purchasing power is maintained regardless of the future rate of inflation. The real return bond fund investment strategy is to invest in Canadian issued bonds that are selected and weighted mathematically to approximate the overall risk and return characteristics of the Scotia Capital Real Return Bond Index. The fund invests in federal and provincial real return bonds and debentures with a minimum A credit rating requirement for the purchase of individual securities. For the year ending March 31, 2006 the real return bonds returned 11.7 % nearly matching the Scotia Capital Real Return Bond Index return of 11.8%. The index is long in duration, which accounts for a substantial portion of its performance this past year. Demand for real return bonds continues to exceed supply resulting in further yield compression, which also contributed to this year's return.

Canadian Equity Component

The Canadian equity portfolio returned 25.5% for the period compared to a return of 28.5% for the Canadian equity benchmark S&P/TSX Composite Index and 26.8% for the RMCTU median. Both Canadian equity managers began reducing their allocation to the Energy sector during the fiscal year which detracted from returns relative to the benchmark.

Both stock selection and sector allocation detracted from Jarislowsky Fraser's returns for the fiscal year. The manager was underweight both the Materials and Industrials sectors which were the Canadian markets fourth and second best performing sectors respectively. Additionally, Jarislowsky Fraser underperformed in six of the eight sectors they were invested in, including Energy and Financials which composed more than half of the portfolio at fiscal year-end. As a whole, Jarislowsky Fraser's Canadian Equity portfolio returned 23.5%, trailing the benchmark by 5.0%.

For fiscal 2006, Bissett returned 25.5%, trailing the benchmark by 3.0%. As mentioned, Bissett began to trim its Energy sector positions in fiscal 2006 and ended the year with a portfolio weight of 22.3% versus 27.9% for the index. However, Bissett managed to add value in the Energy sector through stock selection so the net effect was a positive 1.9% for the year. Two factors drove Bissett's underperformance. Bissett was substantially underweight the Materials sector. Bissett finished the year with a 2.9% allocation to Materials versus 15.4% for the index. Their performance in the Materials sector detracted 207 basis points from the overall return. Conversely, Bissett was substantially overweight the Consumer Staples sector with an ending allocation of 11.9% versus 3.1 for the index. The Consumer Staples sector was the poorest performing Canadian equity sector and Bissett's performance in this sector detracted 2.9% for the year.

The UEP's fund managers have a tentative outlook for the Canadian equity market going forward. The market has become increasingly concentrated with the Energy, Financials and Materials sectors comprising 75% of the market as of March 31, 2006. High commodity prices have resulted in strong stock market returns but they also have been the primary driver of inflation and Canadian dollar appreciation. The uncertainty for the Canadian markets comes from how the other sectors of the market, along with the Canadian consumer, will respond to

Top 10 Canadian Equity Holdings

Company	Market Value (\$ millions)	% of CDN Equities Portfolio	% of
Royal Bank of Canada	5.90	5.4%	0.8%
Manulife Financial Corp.	5.39	4.9%	0.7%
Bank of Nova Scotia	5.28	4.8%	0.7%
Nexen Inc.	4.72	4.3%	0.6%
Canadian National Railway Co.	3.75	3.4%	0.5%
Power Financial Corp	3.74	3.4%	0.5%
Encana Corp	3.18	2.9%	0.4%
Petro-Canada	3.08	2.8%	0.4%
Canadian Natural Resources Ltd.	2.92	2.7%	0.4%
Shell Canada Ltd.	2.89	2.6%	0.4%

sustained increases in interest rates, prices of retail commodities such as gasoline and natural gas, and the Canadian dollar.

Foreign Equity Component

The foreign equity component is comprised of U.S. equities and units in three Europe, Australasia, Far East, and emerging market (EAFE) funds. The endowment's foreign equity component posted a return of 12.9% compared to the benchmark Morgan Stanley Capital International Composite World Index which gained 14.4% for the year. The endowments also trailed the RMCTU median of 15.1%. These returns can be further broken down into their US and Non-North American components.

Top 10 Foreign Equity Holdings			
Company	Market Value (\$Cdn millions)	% of Foreign Equities	% of Portfolio
Johnson & Johnson	5.46	1.3%	0.7%
Microsoft	5.07	1.2%	0.7%
Proctor & Gamble	4.57	1.1%	0.6%
American International Group	3.47	0.8%	0.5%
Millea Holdings	3.45	0.8%	0.5%
Unilever	3.35	0.8%	0.5%
Woodside Petroleum	3.27	0.8%	0.4%
Pepsico Inc	3.13	0.8%	0.4%
BG Group	3.00	0.7%	0.4%
Nestle	2.87	0.7%	0.4%

Jarislowsky Fraser's foreign equity portfolio had a return of 6.3%, which trailed the benchmark. Jarislowsky Fraser's U.S. return was 2.1% trailed the S&P 500 return of 7.7%. On the EAFE side, Jarislowsky Fraser underperformed as well, posting a return of 11.5% against the MSCI EAFE benchmark return of 20.4%. The explanation for underperformance in both areas is similar. Jarislowsky Fraser invests in large capitalization, non-cyclical stocks that have steady historical earnings growth. Throughout fiscal 2006, small capitalization stocks out-performed large capitalization stocks and highly cyclical stocks out-performed non-cyclical. Additionally, with interest rates remaining historically low, speculative companies were in favour as they had ready access to inexpensive capital. The manager does not typically perform well in this kind of market environment.

The Non-North American (EAFE) equity mandate managed by Brandes Investment Partners had a return of 20.1%, which lagged the MSCI EAFE Index return of 20.4%. Brandes attributes the underperformance entirely to stock selection. Through their bottom-up approach, Brandes found many buying opportunities in Japan, which brought the portfolio to a market weighting in that region. However, Brandes' specific Japanese holdings underperformed the MSCI EAFE Japan return. As well, Brandes holds an above market weighting in the Diversified Telecommunications sector. The telecommunication services sector was the worst performing sector in the MSCI EAFE.

Walter Scott & Partners' EAFE mandate posted a return of 22.8% for fiscal 2006. Walter Scott has maintained an overweight position in Japanese stocks with the portfolio having a 44.6% allocation to Japan as of March 31, 2006. The manager focuses on companies that they view to have the potential to grow in excess of 20% per year. Walter Scott believes that China offers the highest growth potential but that there are too many risks associated with direct investment in China. Therefore, the manager looks mainly to Japanese companies that have significant business dealings in China. This strategy performed well during fiscal 2006 as the Japanese economy appears to have ended a recession that spanned more than a decade. Japan posted consecutive quarters of economic growth and many economic indicators such as housing prices and consumer spending were positive as well. The result was that the Japanese market was a top contributor to the MSCI EAFE with an index return of 32.5%. Correspondingly, Walter Scott's holdings performed well also.

The U.S. equity portfolio managed by Wellington Management posted a return of 7.0%. Wellington underperformed both the S&P 500 benchmark of 7.7% and the RMCTU median of 9.9%. Wellington was ahead of their benchmark for the majority of fiscal 2006 until giving back gains in February. Poor stock selection in the final quarter, notably in the Health Care sector, dragged returns down below those of the index. The U.S. Equity

market continued to favor more speculative mid- and small- cap stocks for most of the 2005 calendar year. Wellington focuses on large cap equities with 90% of the portfolio invested in names with market capitalizations of greater than \$6 billion. Wellington believes that going forward, higher interest rates, a slowing macroeconomic environment and improved growth of earnings of large capitalization companies will favor high quality large multi-national corporations.

The U.S small to mid-cap equity portfolio, managed by Kayne Anderson Rudnick, gained 13.9% for the fiscal year versus the benchmark Russell 2500 index return of 19.6%. Kayne Anderson Rudnick invests in high quality companies at a reasonable price, seeking to identify the next generation of blue chip companies through bottom up fundamental research focused on companies with an S&P rating of A- or better. Management attributes the underperformance to historically low yields and credit spreads in the U.S. market. This allows weak companies to continue to operate through debt financing. With the low credit spreads, investors are not willing to pay a premium for quality which has suppressed high quality stock returns. Kayne Anderson expects significant relative out-performance for their strategy when credit spreads widen to historical norms.

The S&P 500 Index portfolio managed by TD Quantitative Capital returned 7.8% for fiscal 2006 matching the S&P 500 benchmark return of 7.8%.

Alternative Asset Component

Both companies trailed their benchmark return of 8.5% (100% C\$ hedged US T-Bill +6%). Quellos Capital Management returned 6.9% for the fiscal year while JP Morgan Alternative Asset Management (JPMAAM) returned 7.5%.

JPMAAM saw positive contribution from both long/short equities and distressed securities strategies. However, relative value and short selling strategies did not perform as well. JPMAAM believes that increased capital market volatility will continue to have a positive impact on long/short equity strategies, while a healthy merger deal flow will provide opportunities for merger arbitrage, and structural opportunities in Asia are providing a positive outlook for relative value strategies. Widening credit spreads will create a challenging environment for distressed securities strategies.

For Quellos, the relative value segment of their portfolio was the weakest as well. A fundamental widening of credit spreads resulted in increased selling pressures forcing some of the underlying managers to liquidate positions at depressed prices. Another factor in the relative-value arena was the timing of the downgrade of Ford and GM to junk bond status. This too created selling pressure which negatively affected fixed-income related relative value strategies. On the positive side, the hedged-directional and event driven strategies consistently added value throughout the year. Quellos believes that future opportunities will be determined primarily by managers that employ fundamentally-based qualitative skills as returns for strategies that rely on financial engineering and quantitative tools are diminishing with the large inflow of new assets into these strategies.

Currency Overlay

The active currency overlay mandate by JP Morgan was established on October 31, 2005. The strategy will be phased in over a one year period in equal monthly increments of \$30 million. The target nominal asset value of \$360 million is based on the UEP's actual exposure to foreign currency. To date the strategic hedge ratio of 50% should have added value to overall performance as the Canadian Dollar has appreciated against most major currencies. However, the short-term negative impact of the implementation strategy and the 28 basis point underperformance of the active currency overlay program, have combined to detract 14 basis points from the UEP's total fiscal year return.

Appendix 3 - Long-Term Value Added

The graph below depicts the UEP’s return in excess of the benchmark return since inception. The benchmark has varied over time as changes have been made to the UEP’s investment policy. This graph demonstrates that active management strategies have successfully added value over the longer term. Active management strategies have, however, failed to add value over the past four years. Global interest rates during this period were at historically low levels, resulting in a reduced cost of capital and an increase in the risk tolerance of investors. Markets during the latter part of this period have favored smaller, more speculative companies that are highly levered as well as those in cyclical sectors such as commodities, energy and industrials. The UEP’s managers have tended to limit their exposure to these areas due to their historically volatile nature.

The yellow bars depict annual performance in relationship to the benchmark. The green line annualizes these amounts over a moving four-year period. The red line represents the cumulative value added since inception. The black diamond single point marks the ten-year annualized value added.

