

USMF FOUNDATION

SERVING THE UNIVERSITY SYSTEM OF MARYLAND

Quarterly Investment Report Period Ending September 30th, 2008

“If you can keep your head when all about you are losing theirs...” – Rudyard Kipling

Performance:	September	3 rd Quarter	Calendar Year 2008	3 year Ann. Return
USMF Endowment (preliminary)*	-7.0%	-10.8%	-15.3%	5.9%
S&P 500 Index	-8.9%	-8.4%	-19.3%	0.2%
MSCI EAFE Index	-14.5%	-20.6%	-29.3%	1.1%
80/20 Stocks/Bonds Portfolio	-7.4%	-6.8%	-15.5%	1.1%
HFR Equity Hedge Index	-7.5%	-12.0%	-15.3%	2.3%

* Private investments are marked as of June 30, 2008

The current events in the global financial markets are the most challenging of our lifetimes. The global financial system has been shaken to the core with numerous institutions facing solvency and liquidity crises. Investor confidence has evaporated from all parts of the globe, sending equities into free-fall and credit markets into cardiac arrest. As of this writing in early October, global equity markets suffered an eight-day crash with panic selling leading to the largest weekly decline on record. The domestic recession has arrived, with the rest of the world likely to follow, leaving the only question of how long and how deep. Faced with dismal results, the hedge fund industry will suffer substantial redemptions, resulting in continued downward pressure on securities prices. There is a high probability for heightened volatility in all markets for the near-term, with a bias to the downside.

In the face of these historic times, the good news is that governments around the world are now undertaking massive commitments to ensure the soundness of the financial system. The solutions will not work overnight, but ultimately a changed and healthier financial system will emerge. The slow-down will pass and the natural private sector cycle will run its course. For the patient long-term investor, today's environment will offer tremendous opportunities with significant margins of safety.

Portfolio Review

The results for the current fiscal year are disappointing but it is important to have a long-term view of the benefits of our strategy. One comparison that tells the tale is that from January 1, 2007 to September 30, 2008, the S&P 500 index declined 15% while the Endowment portfolio declined 2%. Another comparison of course are the three year annualized returns, noted above.

As a broad generalization, our managers' portfolios were pulled into the vortex of selling that rattled markets around the globe over the last several weeks. When constructing our portfolio several years ago, we believed that a high allocation to 'hedged' managers focused on delivering absolute returns would provide a cushion against severe market dislocations. During September, this approach did not offer the full protection we had hoped for. For most of our long/short equity managers, simply put, their longs traded down sharply while their shorts only fell modestly or even worse in some cases rallied. Market-based hedges failed to fully offset industry- or company-level trades especially in the energy and materials sectors. In the event-driven space, merger arb spreads broke down and now provide attractive levels so long as one assumes the 'highly confident' deals will still close. The usually lower-risk bank loan market traded down more than 10% over the past month. Relative value spreads in fixed income and convertible arbitrage blew out, producing historic losses for these strategies. Anything tied to the commodities markets suffered indiscriminate selling with most companies in this sector off by half or more since the selling began in mid July.

Our managers are starting to see significant investment opportunities with solid margins of safety. We still face persistent headwinds, and it is not clear when these will abate. However, a combination of factors over the next few months will yield compelling opportunities. First, securities prices have severely dislocated from the underlying company fundamentals in many sectors even after accounting for a global economic slowdown. Over time (we do not know how long), investors will identify these discounts and their buying will close the gap. Second, competition going forward is likely to decline as the hedge fund industry is forced to deal with large redemptions and poor returns. Many firms will be forced to close shop as they are well under their high-water marks and will have a hard time keeping let alone attracting new talent. Extremely good returns existed for those funds that were able to weather the 1987 crash. These factors bode well for calendar year 2009.

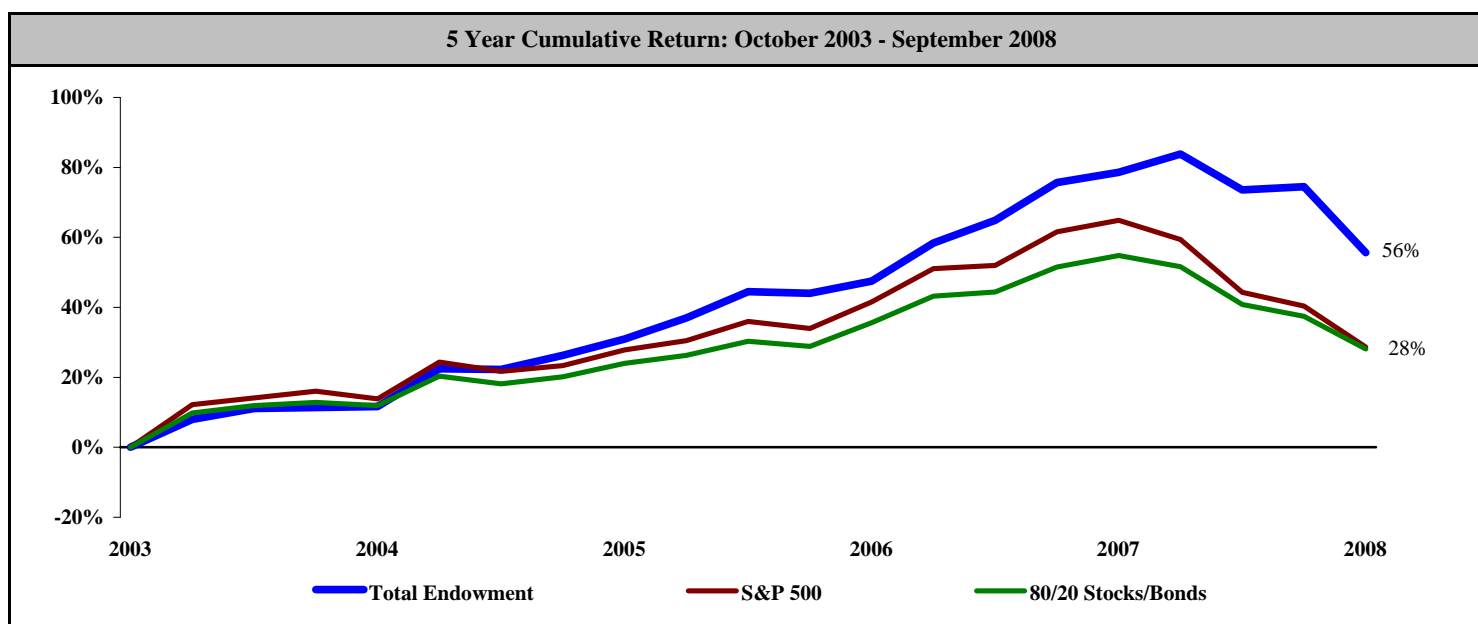
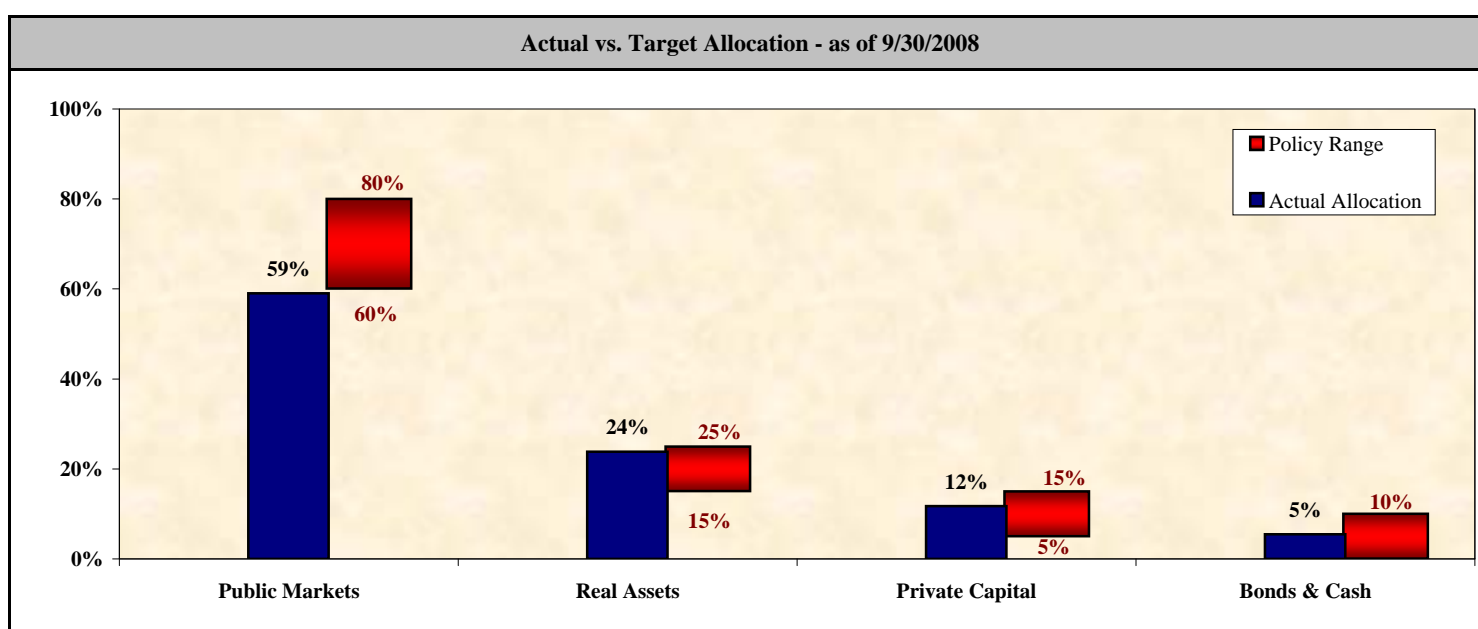
In the past several weeks, many of our managers have chosen to lower risk and raise cash. Some were in the more envious position of already having cash available and are waiting for the right pitches to deploy capital. A number of our multi-strategy funds have used this dislocation to rebalance out of equities and into credit, where there is a greater margin of safety and superior risk-adjusted opportunities. They are buying senior secured bank loans and over-collateralized first lien debt that will generate a high-teens unlevered return if held to maturity, yields normally associated with highly leveraged subordinated debt. This paper gapped down on average 10-15 points on low volume during the last several weeks. In some cases, they are bidding on and buying senior secured short-term maturity paper using 40% IRR assumptions, absurdly high. In merger arbitrage, our managers are conservatively positioned in higher probability short-duration deals, some of which are slated to close in the next three months and may generate very high annualized returns. Managers that specialize in emerging markets are seeing tremendous values in Asia, particularly in India and Hong Kong, where stock markets have suffered huge declines. During our correspondences with managers we are repeatedly hearing that on a risk-adjusted basis, this is the most attractive buying opportunity they have seen in their careers.

While we are disappointed with September's performance, we maintain confidence in the ability of our managers to identify profitable long-term opportunities. Our strategy of investing with the world's best managers has experienced a temporary and painful bump in the road, but it is not broken. We have confidence that the flexibility of our model and our managers will capture a large piece of today's opportunities. Please feel free to call if you questions, comments, advice, etc.

The University System of Maryland Foundation, Inc.

Endowment Portfolio Review - As of September 30, 2008

Performance - as of 9/30/2008					
Preliminary	FYTD 2009	CYTD 2008	3 Year Annualized	5 Year Annualized	10 Year Annualized
Total Endowment	-10.8%	-15.3%	5.9%	9.3%	6.7%
S&P 500 Index	-8.4%	-19.3%	0.2%	5.2%	3.1%
80/20 Stocks/Bonds	-6.8%	-15.5%	1.1%	5.1%	3.8%
Total Endowment ¹	\$766.7 million				



(1) Total Endowment Investment Pool includes \$741.3 million of Endowment assets and \$25.4 million from the Operating Fund.