

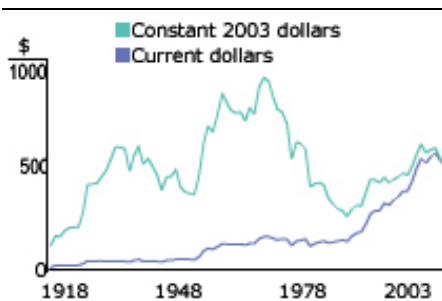


2003 Annual Report

TREASURER'S REPORT

The finance committee of the Fund's board of directors is responsible for the effective and prudent investment of the endowment, a task essential to assuring a stable source of funds for programs and the foundation's perpetuity. The committee determines the allocation of the endowment among asset classes and hires external managers, who do the actual investing. Day-to-day responsibility for the management of the endowment rests with the Fund's executive vice president and treasurer, who with the assistance of Cambridge Associates consultants is also responsible for researching policy questions to be addressed by the committee. The committee meets at least twice a year with the Fund's principal external investment managers, at which time it also deliberates investment issues affecting the management of the endowment and considers new undertakings.

The Commonwealth Fund's endowment, in millions, 1918-2003



The value of the endowment fell from \$501.7 million on June 30, 2002, to \$498.3 million on June 30, 2003, reflecting a return of 5.3 percent on the investment portfolio during the year combined with total spending (including programs, administration, investment management fees, and taxes) of \$30.8 million. In that 12-month period, the return of the Wilshire 5000 index of U.S. stocks was 1.3 percent; the return of the Lehman Aggregate Bond index was 10.4 percent; and the return of a benchmark portfolio weighting these two broad

market indexes according to the Fund's target allocations of stocks and bonds during the year was 5.2 percent. The Fund's overall investment performance exceeded the 2.6 return produced by the median balanced U.S. manager during the fiscal year.

The Fund's team of marketable equity (U.S. and international) managers produced a combined 12-month return of 5.0 percent, well above the Wilshire 5000's 1.3 percent, the median U.S. equity manager's -.1 percent, and the EAFE international stock index return of -6.1 percent. In a period of pronounced volatility in marketable equity markets, almost all of the foundation's equity managers produced very strong returns compared with their market benchmarks. The Fund's bond manager underperformed the Lehman Aggregate index (8.5 percent versus 10.4 percent), as a result of an early bet on U.S. economic recovery. Reflecting both depressed private equity market returns and the youth of most of the foundation's current venture capital and other private equity partnerships, this segment of the portfolio detracted from overall performance during the year.

The Fund's investment returns in 2002-03 continued to benefit from the significant restructuring of the management of the endowment that the foundation's finance committee began in early 2000. The restructuring has been aimed at reducing the risk of performance significantly divergent from that of the overall market or peer institutions and at streamlining the management structure.

The finance committee undertook further changes in the allocation of the endowment among asset classes during the year, principally increasing the overall equities allocation and establishing an additional inflation hedge through Treasury Inflation-Protected Securities (TIPS). The salient features of the Fund's current investment strategy are summarized in the accompanying figure. Key among these are an overall target

The Commonwealth Fund's endowment management strategy

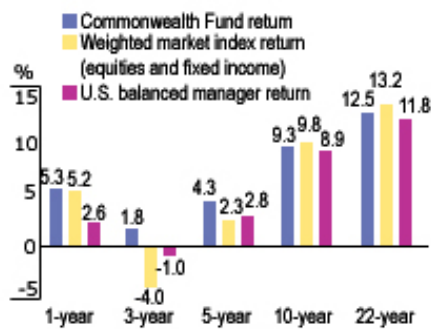
	Long-term target	Permissible range
Total endowment	100%	
ASSET CLASS		
Total Equity	80%	70-85%
U.S. equity marketable securities	35%	25-45%
Non-U.S. equity marketable securities	15%	10-20%
Marketable alternative securities	10%	5-15%
Non-marketable alternative equity	10%	5-15%
Inflation hedge	10%	5-15%
Fixed Income	20%	15-30%
MANAGER STYLE		
U.S. stock index (S&P 500) fund	10%	5-20%

commitment of 80 percent of the portfolio to equities (publicly traded and private) and 20 percent to fixed income securities; a 35 percent commitment to publicly traded U.S. equities, paired with a 15 percent commitment to international equities, including a 5 percent allocation to emerging markets; allocation of approximately 10 percent of the endowment to a passive S&P 500 index fund, to help control investment costs and assure adequate tracking of the market; satellite U.S. active large and small capitalization value and growth stock managers, with mandates to outperform their respective market bogeys; assignment of responsibility for 10 percent of the endowment to marketable alternative equity (hedge fund) managers; a 10 percent commitment to non-marketable alternative equities (venture capital and private equities); and a 10 percent allocation to inflation hedges, including real estate, oil and gas, and TIPS.

The finance committee periodically reviews asset class allocation targets and the permissible ranges of variation around them; except in very unusual circumstances, the portfolio is rebalanced when market forces or manager performance cause an allocation to diverge substantially from its target.

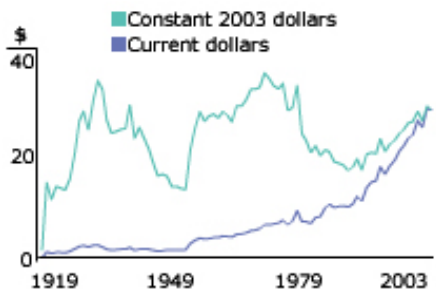
As shown in the figure, the Fund’s investment managers as a group outperformed the overall portfolio market benchmark and the median balanced U.S. manager over the three- and five-year periods ending June 30, 2003. For the last 10 years and over the almost 22 years since the foundation adopted a multiple manager system, the portfolio’s average annual return has exceeded that of the median U.S. balanced manager but fallen just short of the weighted benchmark index return.

The Commonwealth Fund endowment's investment returns



Three considerations determine the Fund’s annual spending policy: the aim of providing a reliable flow of funds for programs and planning; the objective of preserving the real

The Commonwealth Fund's annual spending, in millions, 1919-2003: Total spending of \$624.5 million over 84 years, or \$1.98 billion in constant 2003 dollars



(inflation-adjusted) value of the endowment and funds for programs; and the need to meet the Internal Revenue Service requirement of distributing at least 5 percent of the endowment for charitable purposes each year. While the Fund's endowment has performed comparatively well in the severe equities bear market that began in early 2000, the average annual return on the endowment during this downturn has been 1.2 percent annually. At the same time, the foundation's spending rate has exceeded 5.5 percent annually, and inflation has taken an additional 2.2 percent from the endowment's purchasing power each year. Most market seers predict continued low average investment returns for at least the next five years, as the market corrects for the excesses that occurred in the final stages of the 1982-2000 bull market in stocks.

During the year, the Fund's board of directors wrestled with the questions of what spending policy is most appropriate in the still-uncertain financial environment, and the appropriate mix of extramural grants and intramural activities—research, program development, and communications—for advancing the foundation's mission. Like most other institutions whose sole source of income is their endowment, the Fund has found it necessary to reduce its spending plans to adjust to the current market realities and will spend 10 percent less in 2003-04 than in the preceding fiscal year. Barring worse market conditions than now predicted, the foundation plans to maintain the resulting total spending level over the next five years, which will enable the continuation of all major grants programs.

After close examination, the board reaffirmed the Fund's value-added strategy of using a professional staff to, first, work closely with grantees to shape, execute, and communicate the results of projects and, second, conduct intramural research and communications programs that enable the foundation to

be an information resource for health care leaders and policymakers. The ability to maintain all grants programs and the intramural capacities that assure their effectiveness will enable the foundation to continue to fulfill a unique and highly productive role in American society.