



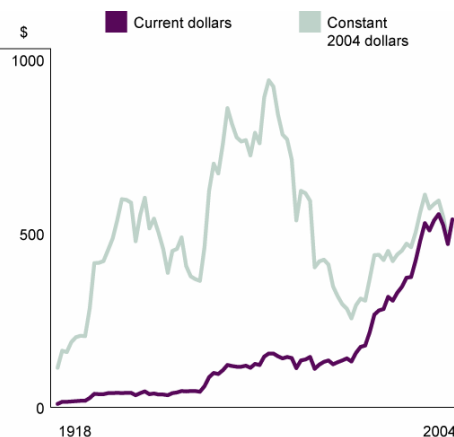
## 2004 Annual Report

### Treasurer's Report

The investment 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 COO/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 value of the endowment rose from \$498.3 million on June 30, 2003, to \$571.2 million on June 30, 2004, reflecting a return of 20.6 percent on the investment portfolio during the year combined with total spending (including programs, administration, investment management fees, and taxes) of \$27.98 million. In that 12-month period, the return of the Wilshire 5000 index of U.S. stocks was 21.2 percent; the return of the Lehman Aggregate Bond index was .3 percent; and the return of a benchmark portfolio weighting these two broad market indexes according to the Fund's target

**The Commonwealth Fund's endowment, in millions, 1918-2004**



allocations of stocks and bonds during the year was 16.0 percent. The Fund's overall investment performance exceeded not only that of the weighted market benchmarks, but also the 13.0 percent produced by the median U.S. balanced manager during the fiscal year.

The Fund's team of marketable equity (U.S. and international) managers produced a combined 12-month return of 23.5 percent, well above the Wilshire 5000's 21.2 percent and the median U.S. equity manager's 21.6 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 outperformed the Lehman Aggregate bond index (3.8 percent versus .3 percent), reflecting the ultimate payoff on an early bet on U.S. economic recovery. The foundation's private equities and real estate portfolios had particularly strong returns during the year, and its oil and gas portfolio benefited from the sale of Intrepid Energy North Sea, Ltd.—a holding which produced an average annual return of 20 percent over a seven-year investment period.

The Fund's investment returns in 2003–04 continued to benefit from the significant restructuring of the management of the endowment that the foundation's investment 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 investment committee undertook further changes in the allocation of the endowment among asset classes during the year, principally by decreasing the U.S. marketable equities allocation from 35 percent to 30 percent, increasing the energy allocation to 5 percent of the endowment, and establishing a commodities allocation of 3 percent of the endowment.

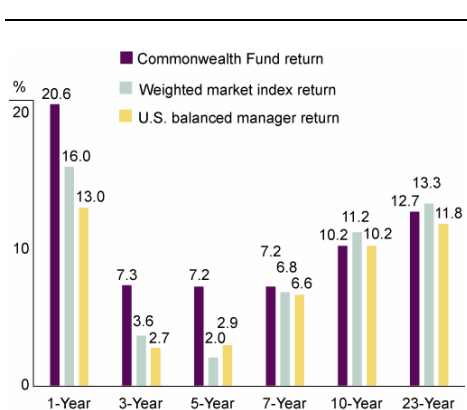
**The Commonwealth Fund's endowment management strategy**

	Long-term target	Permissible range
Total endowment	100%	
<b>Asset Class</b>		
Total Equity	80%	65-85%
U.S. equity marketable securities	30%	25-45%
Non-U.S. equity marketable securities	15%	10-20%
Marketable alternative equity	10%	0-20%
Non-marketable alternative equity	10%	0-10%
Inflation hedge	15%	5-15%
Fixed Income	20%	15-35%

The salient features of the Fund's current investment strategy are summarized in the accompanying figure. Key among these are an overall target commitment of 80 percent of the portfolio to equities (publicly traded and private) and 20 percent to fixed income securities; a 30 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 boogies; 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 15 percent allocation to inflation hedges, including real estate, oil and gas, and TIPS.

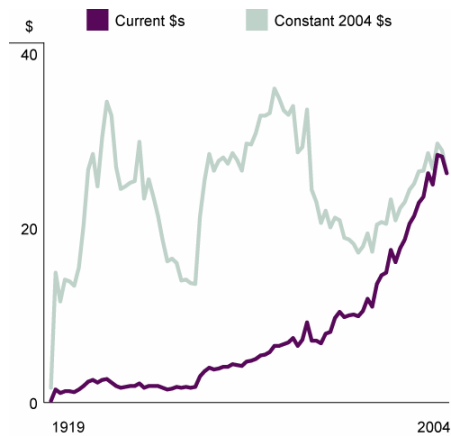
The investment committee periodically reviews asset class allocation targets and the permissible ranges of variation around them; except in very unusual circumstances, the portfolio is rebalanced when market forces or manager performance cause an allocation to diverge substantially from its target.

**The Commonwealth Fund endowment's average annual investment returns**



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-, five-, and seven-year periods ending June 30, 2004. For the last 10 years and over the almost 23 years since the foundation adopted a multiple manager system, the portfolio's average annual return has equaled or exceeded that of the median U.S. balanced manager but fallen just short of the weighted benchmark index return.

**The Commonwealth Fund's annual spending, in millions, 1919-2004: Total spending of \$650.8 million over 85 years, or \$2.05 billion in constant 2004 dollars**



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 (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 5.4 percent annually. At the same time, the foundation’s spending rate has exceeded 5.5 percent annually, and inflation has taken an additional 2.4 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.

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. After a reduction of 10 percent in 2003–04, it expects to maintain an essentially flat budget over the next five years. The Fund is fortunate in being able to maintain this level of spending, which allows continuation of all major grants programs.

In a constrained fiscal environment, the Fund remained extraordinarily productive over the last year, while achieving intramural cost savings that enabled staying well within the policy guideline set by the Board of Directors for the ratio of extramural (60 percent minimum) to intramural spending (40 percent maximum). The Fund’s shift from mail/paper to electronic distribution of the results of its work and that of grantees and a major upgrade of its Web site accounted for

much of the savings achieved on intramural costs. The foundation's ability to maintain all grants programs and the intramural capacities that assure their effectiveness will enable it to continue to fulfill a unique and highly productive role in American society.