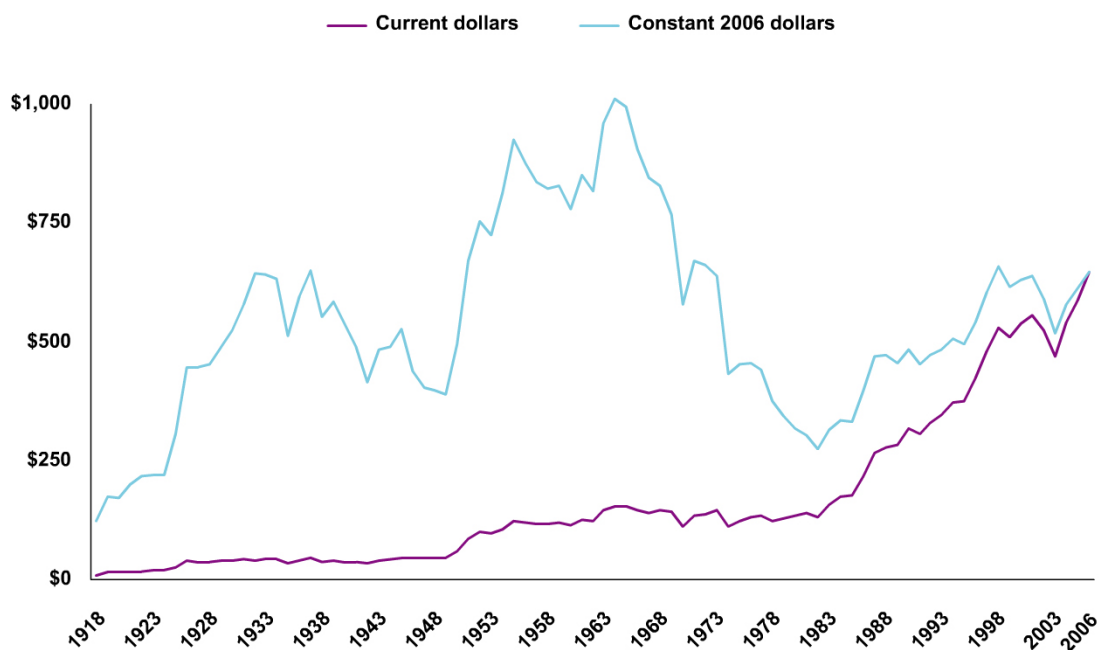


## 2006 Annual Report Treasurer's Report

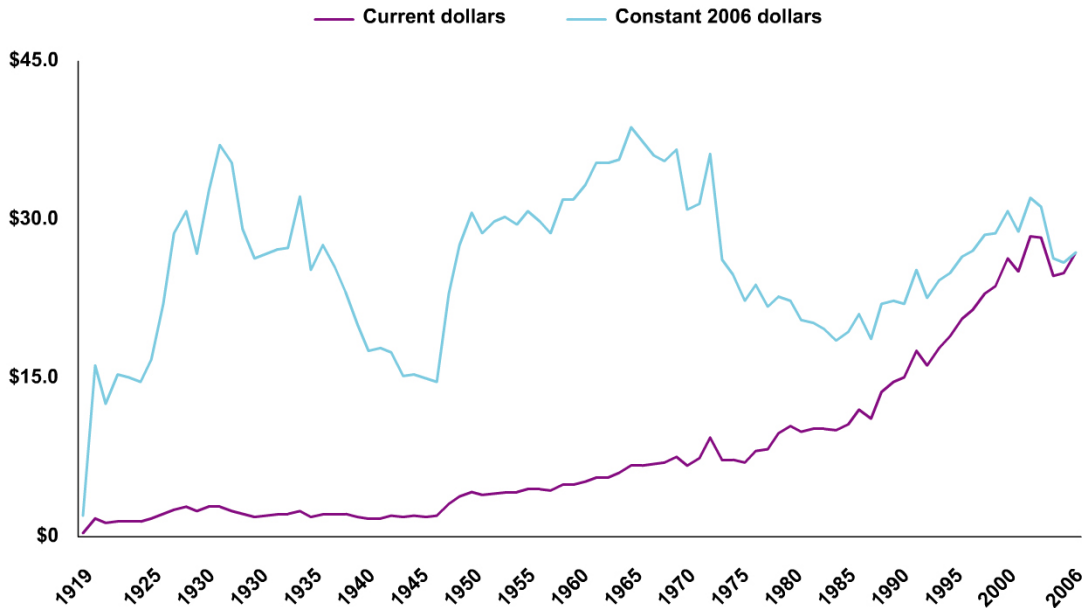
The investment committee of The Commonwealth Fund's board of directors is responsible for the effective and prudent investment of the endowment, a task essential to ensuring a stable source of funds for programs and the foundation's perpetuity. The committee determines the allocation of the endowment 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 three times a year to review the performance of the endowment and individual managers, reassess the allocation of the endowment among asset classes and managers and make changes as appropriate, deliberate investment issues affecting the management of the endowment, and consider new undertakings.

The value of the endowment rose from \$606.7 million on June 30, 2005, to \$667.8 million on June 30, 2006, reflecting a return of 15.4 percent on the investment portfolio during the year combined with total spending (including programs, administration, investment management fees, and taxes) of \$30.0 million. In that 12-month period, the return of the Wilshire 5000 index of U.S. stocks was 10.0 percent; the return of the Lehman Aggregate Bond index was -0.8 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 7.8 percent. The Fund's overall investment performance exceeded not only that of the weighted market benchmarks but also the 9.9 percent produced by the median U.S. balanced manager during the fiscal year.

### The Commonwealth Fund's endowment, in millions, 1918–2006.



**The Commonwealth Fund's annual spending, in millions,  
1919–2006: Total spending of \$701 million over 87 years,  
or \$2.26 billion in constant 2006 dollars.**



The Fund's team of marketable equity (U.S. and international) managers produced a combined 12-month return of 19.2 percent, well above the Wilshire 5000's 10.0 percent and the median U.S. equity manager's 9.3 percent. The foundation's energy, emerging markets equities, international equities, commodities, hedge fund, U.S. small capitalization growth stock, and venture capital/private equity managers produced very strong returns compared with their market benchmarks, and accounted for the overall superior equity team performance. The Fund's bond manager team (including a global fixed-income manager) outperformed the Lehman Aggregate bond index (1.6% vs. -0.8%) in 2005–06.

The Fund's investment returns in 2005–06 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 salient features of the Fund's current investment strategy are summarized in the accompanying table. 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 25 percent commitment to publicly traded U.S. equities, paired with a 20 percent commitment to international equities, including a 5 percent allocation to emerging markets; allocation of approximately 7 percent of the endowment to a passive S&P 500 index fund, to help control investment costs and ensure 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 15 percent allocation to inflation hedges, including real estate, oil and gas, and TIPS.

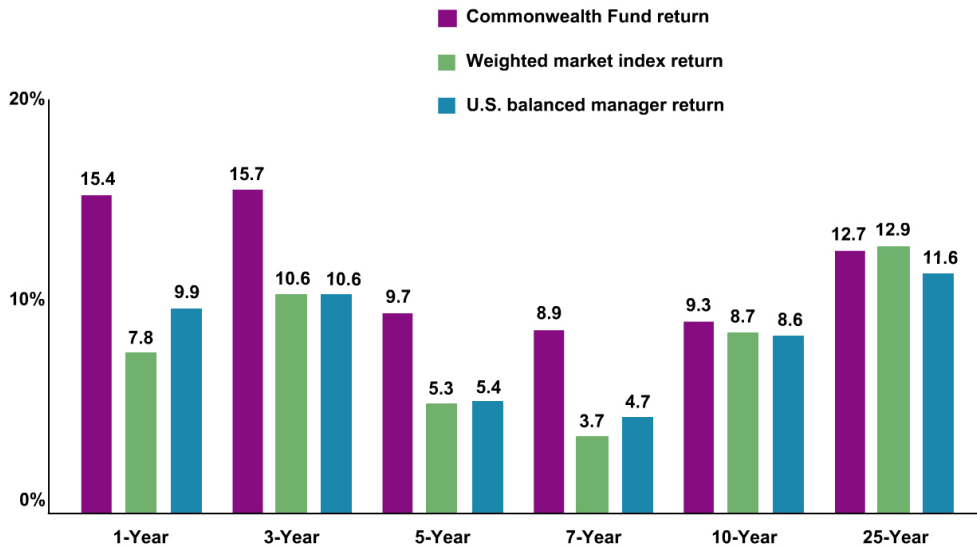
**The Commonwealth Fund’s endowment management strategy.**

	<b>Allocation on June 30, 2006</b>	<b>Long-term target</b>	<b>Permissible range</b>
Total endowment	100%	100%	
<b>Asset Class</b>			
Total Equity	82%	80%	65%–85%
U.S. equity marketable securities	25%	25%	20%–45%
Non-U.S. equity marketable securities	24%	20%	10%–25%
Marketable alternative equity	11%	10%	0–20%
Non-marketable alternative equity	4%	10%	0–15%
Inflation Hedges	18%	15%	5%–20%
Fixed Income	18%	20%	15%–35%

The investment committee devoted particular attention during the year to building up the foundation’s non-marketable alternative equities—venture capital and private equities—and non-marketable oil-and-gas and natural resources portfolios. New commitments to nine partnerships totaling \$41 million, following \$33 million in such commitments in the preceding year, have put the foundation well on the road to meeting the target allocations for these types of investments. The 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 by wide margins over the three-, five-, and seven-year periods ending June 30, 2006, and by a respectable margin over the last 10 years. Over the almost 25 years since the foundation adopted a multiple manager system, the portfolio’s average annual return has significantly exceeded that of the median U.S. balanced manager and equaled that of the weighted benchmark index return.

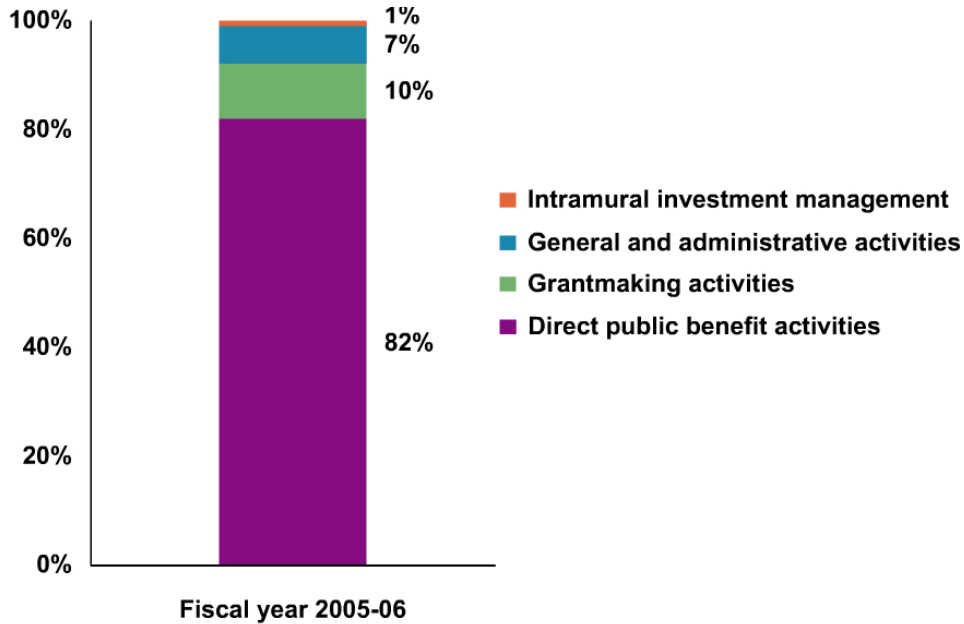
**The Commonwealth Fund endowment’s average annual investment returns, years ending June 30, 2006.**



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. Like most other institutions whose sole source of income is their endowment, the Fund found it necessary adjust spending plans to the realities of the severe bear equities market that began in early 2000—reducing its budget by 10 percent in 2003–04 and allowing only very modest increases through 2005–06. Heartened by the continuing recovery of the market value of the endowment and a comparatively strong average annual return of 7.8 percent since the bear market began, the Fund’s Board has approved a 5.6 percent increase in annual spending for the 2006–07 fiscal year, with the hope that comparable increases will be possible in coming years.

As a value-adding foundation, the Fund seeks to achieve an optimal balance between its grantmaking and intramural research and program management activities, while minimizing purely administrative costs. Recognizing that data on expenditures reported in the Internal Revenue Service 990PF annual tax return inadequately reflect the purpose of many expenditures, the analysis in the figure sorts out the foundation’s 2005–06 expenditures according to four categories recommended by the Foundation Financial Officers Group: direct public benefit activities (extramural grants and intramurally conducted programs such as research, communications, and fellowships); grantmaking activities, including grants management; general and administrative activities; and intramural investment management. In 2005–06, the Fund’s total direct public benefits activities accounted for 82 percent of its annual expenditures. Value-adding oversight of grants took up 10 percent of the Fund’s budget, and the intramural costs of managing the endowment, 1 percent. Appropriately defined, the Fund’s administrative costs amounted to 7 percent of its budget.

**The Fund’s total direct public benefit activities—including extramural grants and intramural research, communications, and programs conducted by the foundation—account for 82 percent of its annual expenditures. Value-adding oversight of grants takes up 10 percent of the Fund’s budget.**



In a still-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 to intramural spending. The Fund’s earlier shift to electronic distribution of the results of its work and that of grantees, along with continuous upgrading of its Web site, accounted for much of the savings achieved on intramural costs. The foundation’s ability to take on new initiatives while maintaining all grants programs and the intramural capacities that ensure their effectiveness will enable it to continue to fulfill a unique and highly productive role in American society.