Introduction

The Investment Office of The Ohio State University was established in September of 2008 to manage the long term financial assets of the University. The Investment Office is part of the Business and Finance Division of Ohio State with advisory oversight by the Investment Working Group (IWG), appointed by the SVP-Finance and CFO of the University. The IWG consists of investment professionals and the SVP-Finance & and CFO of the University. The IWG reviews asset allocation targets, strategic directions of investment decisions, and evaluates the performance of the Investment Office.

The Investment Office is tasked with the management of the Long Term Investment Pool (LTIP) which is a diversified portfolio of actively managed financial and real estate assets valued at approximately $2.37 Billion as of June 30, 2012. The LTIP contains three distinct pools of capital that are all managed in a commingled fashion as one pool:

University Endowment	$ 878.7MM
Foundation Endowment	$ 500.8MM
Long Term Operating Funds	$ 986.5MM
Total LTIP @ 6-30-12	$ 2,366.0MM

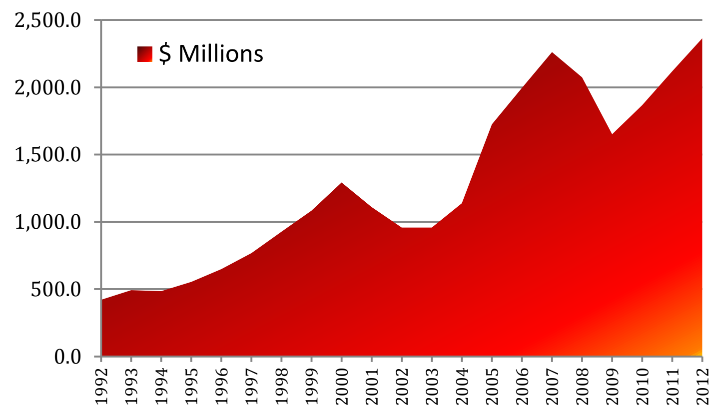
The return on the OSU LTIP for the fiscal year ending June 30, 2012 was essentially flat. The pool earned a net investment return of (0.1%) for the fiscal year. This was a disappointing outcome for us as we and all of the managers that we employ tried to navigate the choppy domestic and international markets. This return was very typical of institutional portfolios that were highly diversified and chose not to extend way out on the risk spectrum. It was also a very similar return to many of our brethren in the endowment and foundation space.

The markets over the last year were very skittish and highly sensitive to the macroeconomic winds in the U.S., Europe and Asia. As a result, international equity markets were down double digits for the fiscal year and the broad hedge fund industry posted total net returns of approximately -7.5%. With this as the backdrop, we were pleased that the endowment held its value while also providing the necessary support to the University that is essential.

This was also the first year that we did not exceed our Policy Benchmark Portfolio. We operate with a benchmark that is very driven toward positive numbers at all times. Our portfolio is highly diversified and has a global orientation so in a twelve month period when many investment strategies have muted or negative returns, it is difficult to beat that benchmark. Most of our peer institutions operated with benchmarks that ranged between +1.0% to -3.0%. Our benchmark for the fiscal year was +4.2% which was higher than all but five of the *actual returns* experienced by the group of the approximately 100 major universities that we follow.

The good news is endowments are perpetual investment vehicles and should not be scrutinized over short periods of time. Looking out over longer periods of time is essential to follow and execute a strategic plan that provides the University the level of funding it needs and deserves. To that end, our office completed its third full year of operations this year and the three year rolling performance was quite good given our stage of development.

For the three year period, the endowment was up an annualized 10.5% which exceeded the Policy Benchmark of 8.9% annualized for the comparable period. Over this first three year period of the Investment Office, we have focused on building growth as well as risk and liquidity management while we plant the seeds for future consistent returns to benefit Buckeye Nation. We believe that we are in a very good position as we move forward into the environment that we will face in FY 2013 and beyond.

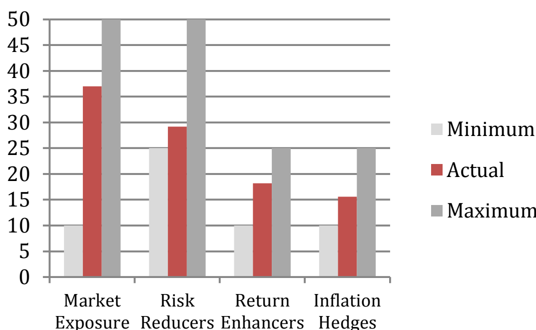


* The Investment Office began August 1, 2008 and became fully operational in March 1, 2009

Asset Allocation Model

Given the perpetual nature of the University, its mission and the investment pool itself, our investing horizon is long term. Our objective is to generate an optimal risk-adjusted total return such that we can fulfill our mission of consistently funding the University to help it achieve its goals. The asset allocation of the LTIP has now been in place for three full years after being adjusted at the end of FY 2009 in concert with the Board of Trustees and its Investment Committee. The underlying principles of the asset allocation model are to provide consistent positive returns to Ohio State which will, over time, provide exceptional long-term growth, capital appreciation, and liquidity.

The asset allocation (%) at June 30, 2012 is shown with the policy ranges in the chart below:



The nomenclature used applies to a customized model that was developed by staff and is broken down as follows:

Market Exposure (37.0%): Global Equities that include both long-only and long/short strategies. Range: 10 – 50%

Risk Reducers (29.2%): Fixed Income and Diversifying strategies that include credit, relative value and macro-focused managers. Range: 25 – 50%

Return Enhancers (18.2%): Private Capital invested in buyouts, venture capital, and opportunistic strategies. Range: 10 – 25%

Inflation Hedges (15.6%): Strategies that should perform well in an inflationary environment that include real estate, natural resources, and infrastructure. Range: 10 – 25%

At the end of FY 2012 (and all throughout the fiscal year) the Investment Office remained comfortably within the prescribed asset allocation bands that the Investment Policy, set by the Board of Trustees, dictates.

Historical Context

The Ohio State University, like other public universities, has historically received a large percentage of its funding from the state government. The State of Ohio has been a stalwart supporter of the university throughout the course of time and remains so today. Even so, with the pressure that every state budget is under, the amount of funding that OSU receives each year has declined.

Other sources of revenue, such as the draw off of the Endowment, have become increasingly important to the viability and success of the institution. Due to this and the overriding belief that we are called upon to be great stewards of the University's funds, our office is very focused on managing to appropriate levels of risk and return. Through successful portfolio management over an extended period of time, we can focus on the security of our corpus and the perpetual growth of the pool over decades, rather than months or even years.

Investment Return

Annualized for Periods Greater than One Year

	Ohio State	Policy Portfolio Benchmark	65/35 Stock/Bond Portfolio
1 Year	(0.1%)	4.2%	(1.3%)
3 Years	10.5%	8.9%	9.8%
10 Years	4.9%	N/M*	6.5%
20 Years	6.6%	N/M*	7.3%

* No policy portfolio benchmark existed prior to 2009

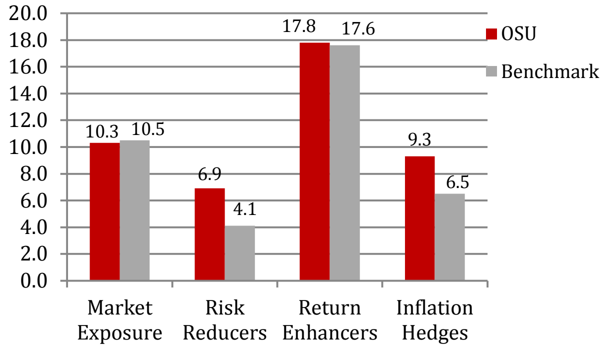
One of the goals of rebuilding the portfolio (coinciding with the inception of the Investment Office) was to reduce the risk and the volatility within the portfolio while still earning the same (or higher) returns. The long history of the LTIP is that it underperformed a 65% stock/35% bond portfolio. Our goal was to change that metric as well as to earn a consistently positive return which would allow our growth to compound over time.

Twenty years ago, the portfolio was 100% stocks and bonds. Those financial instruments were the predominant tools used to manage institutional monies in the 1990's and earlier. During the decade of the 2000's, it became much more common for assets known as "alternatives" to be used in portfolios in various ways to express certain investments or styles. Ohio State moved in and out of these areas in the early part of the last decade, but has focused on building a consistent and permanent allocation to alternatives since the Investment Office began. The office continues to embrace the utilization of buyouts, real estate, hedge funds, and natural resources.

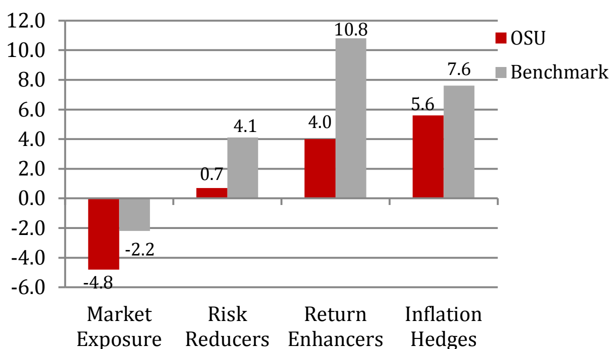
Concurrent with the evolution of the types and styles of investments used in the portfolio as well as moving toward a

different style of manager and different risk tolerance, the comparisons between the last three years and the earlier 10 and 20 year numbers are not very meaningful nor straightforward. Implementing an allocation model that incorporates longer term, less liquid strategies is complex and takes time and patience. The payoffs to the model will take time to be realized as the portfolio is built and strategies mature.

Three Year Performance vs. Policy Benchmarks (%)



Fiscal 2012 Performance vs. Policy Benchmarks (%)

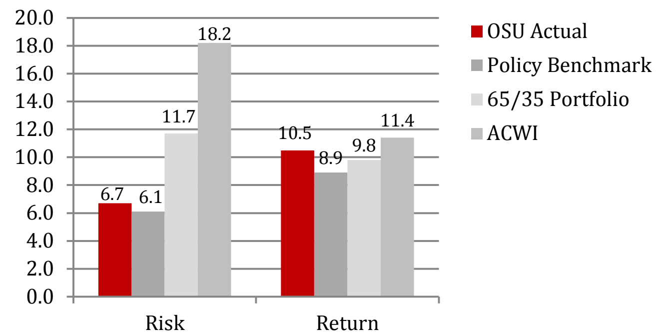


As stated earlier in this report, FY 2012 was disappointing with an effective net return of zero. It is a fair statement to say that very little worked well over those 12 months. We also were met by most of our endowment and foundation peers with meager to negative returns during that time period.

Since the inception of the Investment Office, we began to build a portfolio that would have an enduring asset allocation and perform well and reliably over the long term. The design was not to focus on opportunities that provide short term gains at the expense of long term stability, wealth creation and endowment growth. Rather, the LTIP is a permanent asset of the University and must be sustained over a perpetual time period.

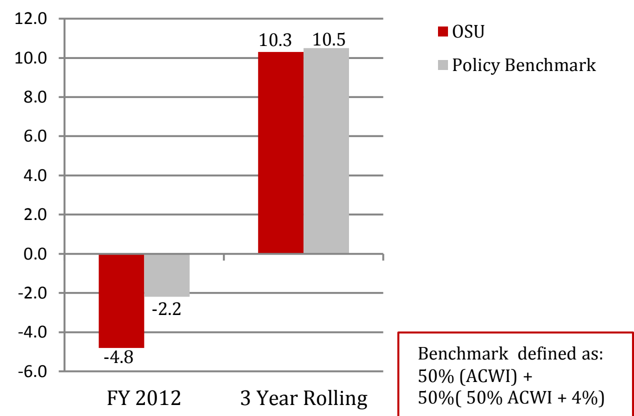
The benchmarks that your University uses are focused on always being positive. What that means is that in years where the market is positive, we strive to match or exceed the market performance with a lower overall risk profile. In years where the markets are negative, we hope to perform better than the markets. The latter case is generally what occurred in FY 2012, with international equity markets, credit markets, and energy markets having difficult years. Our policy benchmarks last year were largely positive and so, while we kept up with or exceeded many of the actual markets in which we invest, we did not exceed the 12 month benchmark returns. As a comparison, our policy benchmarks exceeded a market index set of benchmarks by 5.5% (which are used by many of our peer institutions).

Three Year Risk/Return Comparison (%)



Portfolio returns (for any time period) must be measured against the level of risk (defined here as standard deviation of returns) taken to achieve the return. As seen in the chart above, the OSU portfolio has been roughly half as volatile as a 65% equity/35% fixed income portfolio, one third as volatile as the ACWI equity index and just slightly more volatile than our portfolio policy benchmark. In comparison, we have outperformed our policy benchmark and the 65/35 portfolio over the three-year period. While we have not earned quite as much as the all-equity benchmark (ACWI), we have a much higher risk-adjusted return which has been our goal.

Market Exposure Performance vs. Policy Benchmark (%)

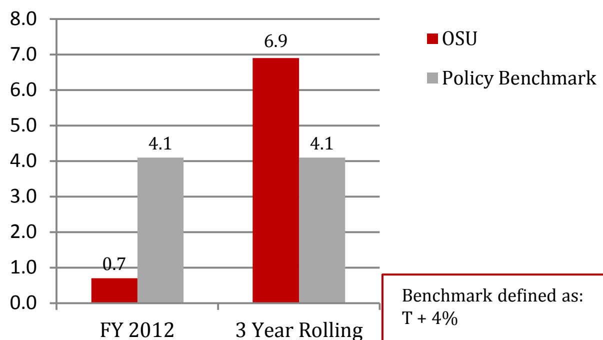


Last year was disappointing, but relative to the negative performance of the MSCI ACWI index (our core benchmark

which was down -6%), we did much better. Our Market Exposure bucket is comprised of long only equity managers and long/short equity managers giving us "global" equity exposure. For that reason, our performance will not look exactly like the S&P 500 or any other domestically-focused index.

Over the three years, we have tracked almost exactly to our policy benchmark but have done it with a lower risk profile that is approximately two-thirds that of the global equity markets. In order to have the desired level of risk control, we have had an approximate 50/50 mix of long only and long/short managers in our book. What we have found is that the continuous moves by central banks around the world to pump liquidity into the markets have made the long/short equity space much more difficult (especially on the shorting side) to navigate. What you will likely see in the portfolio during FY 2013 is a thoughtful reduction of long/short exposure and an increase in long only. This will hopefully serve to capture a bit more return. It will raise our risk levels a bit, but we believe that we will achieve a better balance while remaining focused upon risk control.

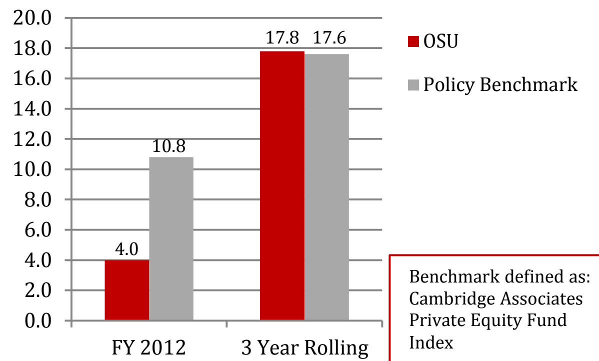
Risk Reducers Performance vs. Policy Benchmark (%)



The Risk Reducer bucket in our portfolio is designed to be the place that holds a high degree of liquidity as well as styles/strategies that will produce a steady, low risk return stream. Over the three-year time period that our office has been in place, it has accomplished exactly that goal. We have outperformed the policy benchmark by nearly 300 basis points which has not been easy in our low interest rate environment. We have mixed fixed income managers along with absolute return style hedge funds to achieve this return with very low volatility. Over the three years, we have adjusted the mix by reducing the amount of resident equity exposure here and by adding some more discrete styles such as global macro, mortgage-backed securities, and direct lending to augment the desired credit exposures.

During FY 2012, however, the markets were volatile and the fall of calendar 2011 was a hugely negative quarter for credit strategies of most types. We were not immune to that downdraft but survived it relatively well. During that quarter, there were several managers whose credit positions were hit by mark-to-market adjustments. Those were not realized losses but short-term performance was impacted during that period. We expect to see all of that bounce back in FY 2013, if it hasn't already done so.

Return Enhancers Performance vs. Policy Benchmark (%)



In this portfolio bucket there is a similar story to be told that distinguishes the difference between the one and three-year scenarios. In the fiscal year just completed, we underperformed our benchmark by a considerable amount. This part of our portfolio was slightly more than 50% private equity (largely buyouts and venture capital) and slightly less than 50% in distressed debt and other credit-related opportunities. We benchmark this against a 100% private equity benchmark.

The credit market issues mentioned in the prior section affected this part of the portfolio as well. The credit downdraft hit this book over the second half of 2011 while our benchmark was impacted to a much lesser extent. Private Equity over the last two years has bounced back nicely following the Global Financial Crisis of 2008-2009 ("GFC"). The vintage year exposures in private equity that have done particularly well are vintage years where Ohio State did not invest (early to mid-2000's). Those vintages are now being harvested, but OSU does not have any exposure from which to benefit. While we patiently build the illiquid piece of the portfolio, we have augmented the book with credit strategies that have done well but have now largely played out.

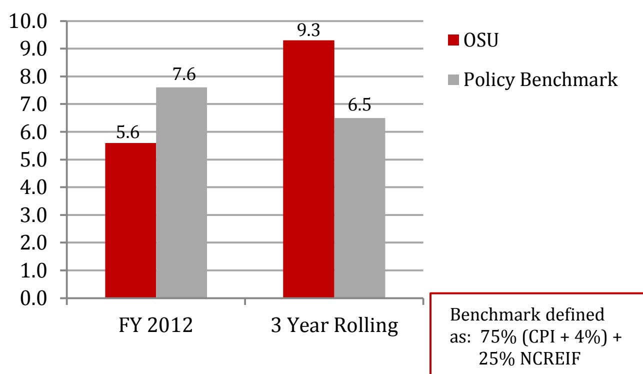
We have been diligently building the private equity side of the book over the last several years while working through the "J-Curve". This term refers to the fact that when one invests in private equity for the long run, one must pay fees and fund investments for several years before the results are seen. Over the entire 7-12 year life of a private investment, it is expected that the total return (measured by IRR and Multiple of Capital) will be higher than many liquid styles due to the operational improvements made by the investment partners and the ability to harvest gains at opportunistic times. OSU has committed to invest the

majority of its private equity over the last few years, resulting in a portfolio that is not seasoned. The majority of strategies are early in their investment periods. Therefore, contributions will far outweigh realized gains during this development stage. It is also important to note that annual performance on these illiquid strategies will not track an annual benchmark closely. Performance tends to be more uneven as it is dependent upon the time it takes to invest the capital and harvest returns. Longer term comparisons are generally more useful as the strategies have time to mature.

In FY 2012, we had the softness in the credit markets, the J-Curve disadvantage, and the lack of harvestable exposures in our private equity bucket. Over the three-year rolling scenario, our performance has kept pace with our benchmark which is very encouraging. As our private portfolio matures and we expand the strategy and vintage year diversification, we believe that we will see the benefits play out.

Another factor that should bode well for Ohio State is the fact that we never had a liquidity crisis during 2008-2009 as did some of our peer institutions. While we certainly do not wish any ill will on anyone else, we did benefit by not having to deal with those issues. Some institutions shied away from making illiquid investments then and still are making fewer private investments today. Due to the planning and good work of the financial side of this University and its Board of Trustees, we are able to build the portfolio with the future solidly in focus.

Inflation Hedges Performance vs. Policy Benchmark (%)



Again, we have the tale of two time periods between the twelve months just completed and the rolling three year scenario. This bucket, which is largely comprised of illiquid investments, has four distinct components today: real estate, natural resources, infrastructure, and commodities. Its desired goal is to provide additional diversification and to post strong performance if or when inflation rises. While inflation has not been a major concern for the past few years, we do believe that all of the global quantitative easing will eventually manifest itself in higher inflation. Even without inflation, we believe this bucket will have strong performance. However, due to the private nature of most of the investments, it too suffers the J-Curve effect while it is being built, and the fee drag precedes the realization of income and profits.

In FY 2012, two of the four categories performed quite well and two were disappointing. Our Natural Resources and Infrastructure investments were up 9.5% and 22.4%, respectively during the fiscal year. Over the three years, those two categories were also up 21.0% and 16.6% proving them to be resilient and profitable even while dealing with the J-Curve. The other two categories did not prove to work as well as Real Estate was up 2.1% for the one year and down -1.2% for the three years. Commodities were negative over both time periods (-12.9% and -3.8%, respectively for the one and three years) which bested the Dow Jones-AIG commodity index in FY 2012 but not over the three years.

We have already taken steps to reduce our commodity exposure by half until we see a more bullish economic environment develop. It is a difficult market for managers investing in commodities so we have reduced exposure and now employ just one manager in the space. We believe that the firm can still make money trading the markets but if we see differently we can reduce our exposure even further.

Real Estate has been a different issue with which to deal. A large percentage of our real estate exposure comes from legacy private investments made before the Investment Office began. They were accretive to profitability in FY 2012, but those investments, which are now past the J-Curve, have underperformed over the past three year period and since inception of the investment office. Since late 2008, we have been highly selective and targeted in our approach to investing in real estate. For example, one strategy was focused on farm and ranch land (agriculture), one focused on buying up specific distressed properties, and another focused on special situations that entail office and apartment properties, debt and student housing. We would hope to see our more mature real estate funds stabilize and improve over the next few years and the newer funds continue navigating the J-Curve.

The other, better performing pieces of Natural Resources and Infrastructure have a heavy interconnection. They revolve around the exploration, development, generation and transmission of oil & natural gas, power and water. We continue to believe that there are exceptional opportunities where we can be investors in this area which will benefit the University and do it in a responsible and ethical manner. These two have been our highest returning sectors of the portfolio and by investing here in a private, illiquid manner we can partner up with strong operating teams that match up well with the long term goals of the LTIP.

The Investment Process of OSU

The OSU Investment team is always on the lookout for new and interesting investment styles and strategies whereby we can invest the University's money wisely and with our long term goals in mind.

We utilize two internal teams to each manage a part of the portfolio that covers both the public markets and the alternative asset classes. One team covers the public markets in both equities and fixed income as well as the hedge fund universe. The other team covers the private markets ranging from private equity to real estate to natural resources and other illiquid strategies. While the two have very little overlap in the strategies and types of managers with whom they work, the entire investment office scrutinizes every manager that we add or delete from the portfolio. Everyone is aware of what is entering or leaving the portfolio and has a voice in that decision. Everyone is engaged and everyone is judged based upon how the entire portfolio performs; not just individual pieces.

Within our Investment Process there are several important factors that we consider:

* We consider the risk and reward of each investment and each manager to determine the fit within the existing context of the portfolio construction.

* We prefer a fundamental approach that is a repeatable and understandable process over a quantitative "black box" process" that we cannot dig into.

* We prefer to invest with smaller niche managers who excel at one or two strategies over larger firms who focus on asset gathering or who try to invest in every strategy possible.

* We utilize an opportunistic lens whereby we assess the relative merits of the potential new investment vs. all others currently held.

* We do not seek to "fill up a bucket" just to reach a specified asset percentage in our allocation. We must see a good opportunity as well as diversification benefits in order to invest.

Looking Forward

The time has flown by since the Global Financial Crisis erupted virtually upon the day that the Investment Office began. It has been four years (and counting) since the GFC. It has now been three full fiscal years (and counting) since the office was fully staffed and became fully operational.

While the investment performance of the University prior to the inception of the Investment Office had historically been lackluster, the Board of Trustees and Senior Management at Ohio State engaged in a bold financial move to propel the university and its endowment forward. The asset allocation model was changed, the investment team was built, and a new investment paradigm was instituted. The focus changed to managing risk and achieving strong risk-adjusted returns, which would reduce the volatility seen in past investment results and provide for a better platform to compound returns out into the future with a long term focus.

The seeds have been sown and the portfolio is much better positioned for the unknown environment into which we head. What is still required is patience to continue to build our long term, illiquid portfolio. We cannot predict the future as to what our leaders in Washington will do nor what course the central banks in other nations will follow. We will be vigilant and continue to seek opportunities where we can grow and profit in ways that will benefit Buckeyes today and out into the next century.

It is a pleasure to serve each of you and we thank you for your support.

Regards,

Jonathan D. Hook
Vice President & Chief Investment Officer

Subsequent Events

In late September 2012, the University entered into a 50-year lease with an Australian infrastructure firm by which OSU leased its parking facilities to this entity in return for an upfront payment of $483 Million. The funds received were placed into the LTIP for the express purpose of providing long term funding critical to the University's mission (supporting students, faculty and other purposes). This was one of the largest single inflows to a university investment pool in the history of the U.S.

The money was received two days prior to the end of September and has now been fully invested. When adding that amount to the pre-existing investment pool, Ohio State holds nearly $3 Billion in its LTIP. The increase in our pool has been estimated to raise us to #24 (out of nearly 800 colleges and universities) from #31 and to #6 out of all public universities. This was a significant transaction for many reasons. The most important is that we took an integral physical asset of the university (parking) and turned it into a financial asset that will help students and faculty alike into perpetuity.

This is good for all of Buckeye Nation!