DATE: January 15, 2004

FROM: Gary C. Schultz

TO: Members of the Board of Trustees

Re: Penn State Endowment

Below is the preliminary fourth quarter report on Penn State’s Endowment investments. These reviews are prepared for the Board of Trustees approximately two weeks following the end of each quarter, and are subject to possible revision.

The preliminary market value of Penn State’s Endowment, including similar funds, was approximately $1.05 billion as of December 31, 2003.

During 2003’s fourth quarter, Penn State’s Endowment earned 6.7% – due to investment value changes (excluding the impact of new gifts and spending), as shown below along with returns for the Standard & Poor’s 500 Index and the Lehman Aggregate Bond Index.

<table>
<thead>
<tr>
<th></th>
<th>4Q03</th>
<th>1-Year</th>
<th>5-Years</th>
<th>10-Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500 Index</td>
<td>12.2%</td>
<td>28.7%</td>
<td>-0.6%</td>
<td>11.1%</td>
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<tr>
<td>Lehman Agg. Bonds</td>
<td>0.3</td>
<td>4.1</td>
<td>6.6</td>
<td>6.9</td>
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<tr>
<td>Endowment (prelim.)</td>
<td>6.0 (6.7)</td>
<td>16.8 (16.6)</td>
<td>4.6 (4.4)</td>
<td>8.6</td>
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</tbody>
</table>

For calendar 2003, the S&P 500 rose 28.7% and the Nasdaq Price Index climbed 50.0%. While common stocks moved higher on encouraging economic and earnings news, a mid-year spike in interest rates held the Aggregate Bond Index to a 4.1% gain. We estimate the Penn State Endowment Pool earned 16.8% in 2003, compared with a -8.2% return posted in calendar 2002. Emphasizing our long-term focus, the Endowment’s 5- and 10-year annualized returns are compared above to the S&P 500 and Lehman Aggregate Bond Index.

As of December 31, approximately 49% of the endowment portfolio was invested in both domestic and foreign equities. In addition, the pool contained about 22% in alternative investments such as venture capital, private equity, oil & gas, and real estate. Our bond allocation was approximately 29%, primarily in short- to intermediate-term maturities.

The Penn State Investment Council (PSIC) met on December 12, 2003 and approved:

- An additional $4.5 million investment in Oaktree Capital Management, increasing the total commitment to $14.5 million
- A $10 million investment in Cumberland Benchmarked Partners, a long-biased hedge fund manager located in New York City

Arthur Miltenberger was elected “lead outside Council member” and will chair the Executive sessions following each Investment Council meeting, serving as the principal contact between outside and university members of PSIC. Arthur will also chair the nomination subcommittee.