SUFFOLK COUNTY LEGISLATURE

Gail Vizzini
Director

BUDGET REVIEW OFFICE

March 14, 2007

To: William J. Lindsay, Presiding Officer
and All Suffolk County Legislators

From: Gail Vizzini, Director
Budget Review Office

Subject: Vanderbilt Museum Endowment Trust Fund Annual Report for the period January 1, 2006 through December 31, 2006

The Budget Review Office is required to report annually to the Legislature on the status of the Vanderbilt Museum Endowment Trust Fund (Fund). During the ten-year period, January 1997 through December 2006[1], the portfolio's average annual total return was 8.8 percent. The disturbing fact is that during this same period of time the market value of the Fund decreased by $729,810, after distributions of $12 million to the Museum and fees of $463,423. This situation demonstrates our concern that the current market value of the Fund, $12.3 million as of March 5, 2007, may not be sufficient to support a long-term policy to distribute $1.2 million annually to the Museum without adversely impacting the Fund's investment objective to achieve capital appreciation to sustain the future income needs of the Museum.

The Budget Review Office recognizes that the Museum would not be able to meet its 2007 operating expenditures without the annual $1.2 million distribution. Therefore, the Legislature is faced with the difficult policy decision that requires balancing the current income needs of the Museum against the need to achieve capital appreciation to provide higher future income. We highlight this situation to encourage a positive dialogue between the Legislature, County Executive, Museum, and the Fund's investment manager to work together to develop a

[1] Fleet Bank began managing the Fund in December 1996 and then merged with Bank of America in September 2004, which is the Fund's current investment manager.

Mailing Address: P.O. Box 6100, Hauppauge, NY 11788-0099
(631) 853-4100 FAX: (631-853-5496 email: gail.vizzini@suffolkcountyny.gov

long-term plan to provide for the future income needs of the Museum and to mitigate depletion of the Fund.

Based upon the Fund's 8.8 percent average annual total return during the past 10 years ending December 31, 2006, a conservative distribution of 4 percent annually ($500,000 during 2007) would provide long term capital appreciation to meet the future income needs of the Museum. This policy would allow the Fund to grow an average of 4.8 percent annually. If this policy was adopted four years ago, we estimate that the current market value of the Fund would be $14.3 million, which would support a 4 percent distribution of $572,000.

Attached is the Budget Review Office annual review and report on the performance of the Vanderbilt Museum Endowment Trust Fund. The Fund provides income to assist the Museum with meeting a significant portion of its operating costs. The report includes a historical perspective of the Museum and a discussion of the performance of the Fund's investments.

The Executive Summary highlights our major concerns and findings, which are underscored below:

- During 2006, the market value of the Fund increased by $153,995, net of distributions to the Museum and fees. The year ending market value of the Fund was $12,673,778.
- The Fund's total return for 2006 was a gain of 11.39%.
- The Fund's performance over the past year has enabled it to provide the Museum with its annual $1.2 million distribution, which is the Museum's largest source of income.
- Providing an annual $1.2 million distribution adversely affects the Fund's ability to grow the principal in accordance with the Legislature's investment objectives; however the Museum would not be able to meet its operating expenditures without this distribution.
- The Budget Review Office is cautiously optimistic with the Fund's ability to maintain a market value above $12.2 million during 2007 while providing the Museum with the $1.2 million annual distribution.
- Current policy allows the Fund to continue disbursing $100,000 per month to the Museum as long as the corpus of the Fund does not go below the value of the original bequest of $8.2 million. Historically, the Fund has a $12.2 million threshold as the estimated minimum market value to support the Museums' monthly distributions. If the Fund falls below the recommended $12.2 million minimum market value during 2007, we will alert the Legislature and recommend a comprehensive review of the Fund.
- We recommended that the Legislature establish a minimum market value for the Fund to support the Museums' monthly distributions without

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adversely impacting the principal or the investment objectives. Without a policy to protect and grow the principal, inflation could erode the Fund's ability to provide sufficient future revenues to the Museum to meet its operating expenses.

- The 2006 distributions to the Museum exceeded its guaranteed fixed income of $1.2 million by $4,647.63. The overpayment, which was reconciled in January of 2007, resulted from authorized adjustments to the distribution to provide the Museum cash to meet its payroll requirements. Bank of America is instituting policies to ensure that this does not occur again.
- The County Attorney's Office is currently formalizing an agreement between the County and the Bank of America for investment management services, as directed by Resolution 1477-2006.
- The authorization for the $1.2 million annual distribution from the Fund expires December 31, 2007. A resolution will be necessary to continue the authorization beyond this date.

My staff and I are available should you have any questions regarding this report.

* * *

Attachments

cc: Angie Carpenter, Suffolk County Treasurer
Joseph Sawicki, Suffolk County Comptroller
Frederick Pollert, Deputy County Executive, Financial Affairs
Christine Malafi, Suffolk County Attorney
Ron Foley, Commissioner of Parks and Recreation
J. Lance Mallamo, Director, Vanderbilt Museum
Steven Gittleman, President, Vanderbilt Board of Trustees
Vinh Tran, Portfolio Manager, Bank of America
Bryan Amico, Philanthropic Service Officer, Bank of America

VANDERBILT MUSEUM ENDOWMENT TRUST FUND

ANNUAL REPORT

JANUARY 1, 2006 THROUGH DECEMBER 31, 2006

March 14, 2007

Gail Vizzini, Director
Budget Review Office
Suffolk County Legislature
Hauppauge, New York

Executive Summary and Recommendations

The Fund's performance over the past year has enabled it to provide the Museum with its annual $1.2 million distribution; however, the distribution adversely affects the Fund's ability to grow the principal in accordance with the Legislature's investment objectives. The Budget Review Office recognizes that the Museum would not be able to meet its operating expenditures without this distribution. During 2006, the market value of the Fund increased by $153,995, net distributions to the Museum and fees. The year ending market value of the Fund was $12,673,778. The Fund's total return; dividends and interest, as well as capital appreciation from stocks and bonds, during 2006 was 11.39%.

The Budget Review Office is cautiously optimistic with the Fund's ability to maintain a market value above $12.2 million during 2007. Our concern is based on the possibility of a market decline coupled with the $100,000 monthly distributions to the Museum and payment of annual fees.

The current policy allows the Fund to continue disbursing $100,000 per month to the Museum as long as the corpus of the Fund does not go below the value of the original bequest, $8.2 million. This policy allows the market value of the Fund to drop below $12.2 million, which is contrary to the investment objective to provide for future growth of income through long term capital growth. For the past two years, the Budget Review Office has recommended establishing a policy by which distributions from the Fund would be suspended from the principal account (realized capital gains from previous years) in the event that the market value goes below the established minimum account balance. However, we recognize that based upon the Museum's cash flow needs an automatic suspension of distributions would adversely impact the Museum's ability to meet its operating budget demands. As a preventative measure to address the depletion of the Fund's realized capital gains, if the market value falls below $12.2 million, we will alert the Legislature and recommend a comprehensive review to include:

- A report to the Legislature from the Fund's investment advisor on:

    - ✓ The Fund's status and ability to continue to supplement the Museum's income from the principal account.
    - ✓ Suggested modifications to the Fund's current investment management policy.
    - ✓ Recommendations for ensuring that the Fund is able to adhere to the Legislature's investment objectives of preserving the principal corpus of the fund, maintaining a high level of steady and predictable income, and increasing the Fund's future income through long-term capital growth.

- A report to the Legislature from the Museum on:

    - ✓ Its financial status and continued need to supplement its income through the use of realized capital gains distributions from the Fund.

The Budget Review Office recommends for the second year in a row that the Legislature consider establishing an estimated minimum market value of the Fund that is necessary to support the Museums' monthly distributions without adversely impacting the principal or the investment objectives. Without a policy to protect and grow the principal, the Fund's monthly distributions and payment of fees coupled with a possible market downturn and inflation could erode the Fund's ability to provide sufficient future revenues to the Museum.

- The minimum market value of the Fund can be adjusted based on information provided by the Fund's investment advisor, market projections and an accepted, objective economic indicator, such as the consumer price index (CPI) for the New York region, as reported by the U.S. Department of Labor, *Bureau of Labor Statistics*.

The Fund's 2007 investment policy was modified by Resolution No. 1477-2006, which:

- Extended the authorization to provide the Museum with $1.2 million annually, $100,000 each month, through December 31, 2007.

    - ✓ The 2006 distribution to the Museum exceeded the $1.2 million distribution authorized by Resolution 1306-2005 by $4,647.63. The overpayment was reconciled in January of 2007. The overage was related to authorized adjustments to the distribution schedule to provide cash for the Museum to meet its payroll. Bank of America is making policy changes to ensure that this does not occur again.

- Authorized the County Attorney to formalize an agreement with Bank of America for investment management services. Bank of America is currently managing the Fund as a result of its merger with Fleet Bank in September of 2004. An updated contract agreement has not been instituted since the merger.

    - ✓ The County Attorney's Office is currently formalizing an agreement between the County and Bank of America for investment management services, as directed by Resolution 1477-2006.

- Modified the investment guidelines to allow the investment advisor to maintain a 50/50 split between fixed securities and equities to range between 5-10% of the 50/50 split, as determined by market conditions.

- ✓ The portfolio’s 2006 year end market value of equities exceeded the guidelines as originally set forth in Resolution 933-1994, which allows up to 50 percent of the Fund’s assets to be invested in equities.

- ✓ The year-ending equity portfolio (individual stocks, mutual equity funds, and mutual real estate equity funds) represents 54.36% of the Fund’s market value.

- ✓ Favorable market conditions increased the Fund’s unrealized capital gains, which caused the Fund’s equities to exceed the authorized asset allocation policy.

- Extended the authorization from January 1, 2007 through December 31, 2007, to use realized capital gains in the Fund attributable to realized capital gains for a period of time prior to December 18, 2002 through December 31, 2006, for cash purposes only, as long as the corpus of the Fund does not go below the value of the original bequest, ($8.2 million) to augment income distributions.

  - ✓ The Budget Review Office, for the past several years, has expressed concern over the Museum’s dependence on the use of realized capital gains to augment its income.

Historical Information

William Kissam Vanderbilt II (1878-1944) referred to his 43-acre summer estate in Centerport, which overlooks the Northport Harbor and the Long Island Sound, as the “Eagle’s Nest”. Mr. Vanderbilt traveled extensively throughout the world collecting artifacts to develop his own personal museum at Eagles Nest. In Mr. Vanderbilt’s last will and testament, he recognized the potential for his vast estate to become a museum “for the use, education and enjoyment of the general public”.   Mr. Vanderbilt died in 1944 of a heart attack and his wife whom he married in Paris in September of 1927, Rosamund, died three years later in 1947 at “Eagle’s Nest”. She was the last Vanderbilt to live there.

In his last will and testament, Mr. Vanderbilt bequeathed his estate in Centerport, together with its real property, furnishings, exhibits, works of art, artifacts, memorabilia and certain moneys either to the State of New York, County of Suffolk or Town of Huntington. Suffolk County accepted the generous bequest in accordance with the terms of the agreement dated August 3, 1949.

The estate was opened as a public museum in 1950. The Museum includes a Spanish revival style mansion with a Memorial Wing constructed in 1936 to commemorate Mr. Vanderbilt’s only son who died in 1933 from an automobile accident in South Carolina, a planetarium, outbuildings as well as landscaped grounds.

The Vanderbilt planetarium was erected in 1971 for less than one million dollars on the site of the former Vanderbilt family tennis courts and was paid for from the Endowment Trust Fund. The planetarium is a 238-seat 60-foot diameter domed sky theatre with a central GOTO projector supplemented by dozens of perimeter slide projectors and a video projector.

In November of 1986, Local Law No. 35-1986, designated and renamed the museum "Suffolk County Vanderbilt Museum". The Suffolk County Vanderbilt Museum Commission evolved from the former Suffolk County Park Commission, which was established by resolution of the Board of Supervisors on June 27, 1949, and enlarged by resolution of the Board of Supervisors on December 28, 1959. The Commission is responsible for the management and control of the Suffolk County Vanderbilt Museum, pursuant to Local Law No. 1-1966. The Board of Trustees of the Suffolk County Vanderbilt Museum Commission has the sole power and control over the development, maintenance and operation of the Suffolk County Vanderbilt Museum and Planetarium and to conduct its programs and activities, subject only to the contractual conditions under which the county accepted the Vanderbilt bequest. The Board of Trustees is the appointing body with respect to all personnel engaged in the maintenance and operation of the programs and activities of the museum and planetarium, including the Director. The employees of the Museum are not employees of Suffolk County, but are employees of a privately endowed institution. The Suffolk County Legislature appoints fifteen members to the Commission for four-year terms of office to govern the Vanderbilt Museum.

The Legislature has the sole power and control over Museum property and the distribution of Trust Funds for its operation, care and perpetuation, subject only to the contractual conditions under which the County accepted the Vanderbilt bequest. Mr. Vanderbilt's bequest included $2 million to establish an endowment fund for the maintenance and care of the estate. In 1973, the Fund had an additional bequest of $6.2 million from the estate of Muriel Vanderbilt Adams, William K. Vanderbilt's daughter, raising the corpus of the Fund to $8.2 million. Today, distributions from the Fund partially defray the Museum's operating expenses.

The Museum's operating budget receives no funds from County real property taxes; however the County general fund assumes all debt service for the Museum's capital projects. Resolution No. 557-1998 authorized an annual distribution of $1.2 million in $100,000 monthly installments from the Fund to help defray operating expenses. Resolution No. 1477-2006 extends the current distribution policy through December 31, 2007. If the Legislature desires to continue the $1.2 million annual distribution to the Museum past 2007, the adoption of a resolution will be required by the end of this year.

Analysis of the Fund has shown that the volatility of the stock market and changing economic times has caused the Fund to fluctuate in value over the years. However, the Fund has been able to meet the financial demands of maintaining the Museum. As of December 31, 2006, the total account market value of the Fund was $12,673,778.

As indicated in correspondence from Stephen V. Malo, past Senior Vice President of Fleet Investment Services, dated November 14, 2002, "the necessary cash flow to the Museum ($1.2 million annually) is sustainable as long as assets of approximately $12.2 million remain available." Conversations with the Fund's current Portfolio Manager, Vinh Tran, indicate that the $12.2 million minimum market value continues to be a reasonable base figure to use for the account to be able to carry on its $100,000 monthly distributions to the Museum. Therefore, the Budget Review Office will continue to use $12.2 million as a base figure to notify the Legislature to review the account within the context of existing market conditions.

Term of Investment Management Services Contract

- Fleet Investment Services (Fleet) entered into a contractual agreement in 1996 with the Suffolk County Legislature to provide investment management services for the Vanderbilt Museum Endowment Trust Fund. The two year agreement included two options to renew for a period of two years for each renewal. In 2004, Fleet Investment Services was selected through an RFP. In September of 2004, Fleet merged with Bank of America, which is now the investment manager for the Endowment Trust Fund. An updated contract agreement has not been instituted since the merger.

- ✓ Resolution No. 1477-2006 authorizes the County Attorney to formalize an agreement with the Bank of America for investment management services. The County Attorney's Office is currently formalizing a one year agreement.

Investment Strategies

The current investment objectives are to preserve the principal corpus of the fund, maintain a high level of income that is steady and predictable and provide for future growth of income through long-term capital growth.

- Resolution 215-1987 restricts bond investments to investment grade, Baa or above, per Moody's Investors Service.

- The Fund's 2007 investment policy was set by Resolution No. 1477-2006, which authorizes the Vanderbilt Museum Trust Fund's Investment Advisor, Bank of America, to:

  - ✓ Utilize a total return concept, meaning investing for a comprehensive return, including interest and dividends earned on stocks and bonds, plus realized and unrealized gains and losses.

  - ✓ Provide a fixed annual income of $1.2 million, as requested by the Suffolk County Vanderbilt Museum, to be paid to the Suffolk County Vanderbilt Museum at $100,000 per month.

  - ✓ Use realized capital gains to augment the monthly income distribution to the Museum, as long as the corpus of the Fund does not go below the value of the original bequest ($8.2 million). Resolution No. 1477-2006 extends this authorization from January 1, 2007 through December 31, 2007.

  - ✓ Invest in a 50/50 split between fixed securities (bonds) and equities (stocks) to range between 5-10% of the 50/50 split, as determined by market conditions.

Performance

During 2006, the market value of the Fund increased by $153,995 from $12,519,783 at the beginning of January to its year-end amount of $12,673,778. The Fund's year-ending asset allocation is detailed in the following chart.

Year-Ending Asset Allocation

	2006	2005	Variance
Equities (Stocks)	$6,888,986	$6,310,880	$578,106
Bonds (Fixed Income)	$5,546,329	$6,113,089	($566,760)
Cash & Cash Equivalents (Money Market Fund)	$238,463	$95,813	$142,649
Total	**$12,673,778**	**$12,519,783**	**$153,995**

The Fund's total annual return is the income from investments, dividends and interest, as well as capital appreciation from stocks and bonds. The Fund's total return for 2006 was a gain of 11.39% compared to a gain of 7.15% in 2005, a gain of 7.02% in 2004, a gain of 12.82% in 2003, a loss of 6.32% in 2002 and a loss of 1.13% in 2001.

The Fund's stock portfolio, including stock mutual funds, posted a total return of 17.66% in 2006 after posting a gain of 8.49% in 2005, a gain of 12.29% in 2004, a gain of 25.04% in 2003, a loss of 30.13% in 2002 and a loss of 14.54% in 2001. The Fund's total return from equities this past year compared favorably to the three main equity indexes[1] Standard & Poor's 500 stock index[2] (13.6% gain), NASDAQ composite index[3] (9.5% gain) and the Dow Jones industrial average[4] (16.3% decline), as indicated in the charts that follow from the Wall Street Journal.

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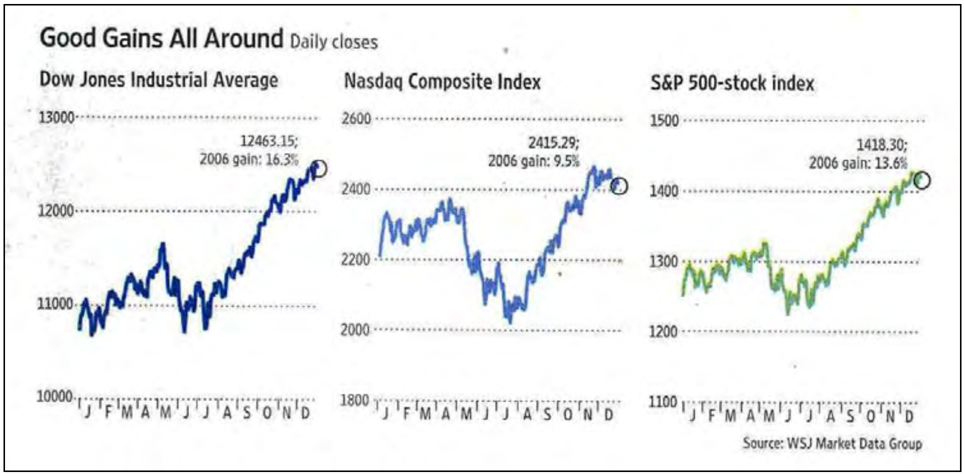
[1] Equity indexes are used as a benchmark to measure stock market performance.

[2] The Standard & Poor's (S&P) 500 is the average value of 500 different large companies; 400 industrial stocks, 60 transportation and utility company stocks, and 40 financial issues.

[3] The NASDAQ, National Association of Securities Dealers Automated Quotation service, is a market value weighted index that tracks the performance of common stocks listed on NASDAQ.

[4] The Dow Jones Industrial Average is a stock market performance indicator that is based on the prices of 30 actively traded blue chip stocks, primarily major industrial companies.



The Wall Street Journal January 2, 2007 PP. R1

From 2000 through most of 2002 the "bear market" had noticeable negative effects on the Fund. In 2003 and 2004, "The stock market posted back-to-back yearly gains for the first time since 1999."[5] Then in 2005, the stock market had below average returns. However, in 2006 the stock market had its best year since 2003. "Investors are approaching 2007 with a high degree of optimism – perhaps too high, some skeptics worry."[6] The optimists are describing the economy as "Goldilocks" or as not too hot and not too cold which they think is the perfect environment for stocks. "They believe Ben Bernanke[7] has stopped raising rates at just the right time, stifling inflation without sending the economy into recession."[8] Mr. Bernanke, the Chairman of the Federal Reserve Board[9], however is concerned about inflation and the possibility of having to raise the rates again. This coupled with long-term government bonds yielding less than short-term ones has pessimists forecasting a coming recession. "Lower long-term yields suggest investors expect rates to fall, and rates generally fall when the economy is weakening."[10] Forecasters are predicting that the start of the year will have market volatility that will be disappointing for investors but by the end of the year the market will be doing better and experiencing gains. Recent media coverage indicates that the stock market is being negatively affected by "concerns about a market correction"[11] and "worries over rising defaults in the

[5] Browning, E. S. "Bull Pedals Hard in Uphill Climb". The Wall Street Journal. 3 January 2005: PP. R1.

[6] Browning, E. S. "Stocks Take a Walk in the Clouds" The Wall Street Journal. 2 January 2007: PP. R1.

[7] Ben Bernanke replaced Alan Greenspan, after his 18½-year tenure as the Chairman of the Federal Reserve Board, on February 1, 2006.

[8] Browning, E. S. "Stocks Take a Walk in the Clouds". The Wall Street Journal. 2 January 2007: PP. R1

[9] The Federal Reserve Board is the independent body responsible for setting monetary policy, for overseeing the integrity of the banking system, for containing the risk that can arise in financial markets, and for ensuring a functioning payment system.

[10] Browning, E. S. "Stocks Take a Walk in the Clouds". The Wall Street Journal. 2 January 2007: PP. R1

[11] Bruno, Joe Bel. "Stocks Lower on Concerns of Correction". Newsday.com. 26 February 2007

subprime mortgage industry"[12]. In fact, Alan Greenspan, the former Chairman of the Federal Reserve Board, in an Associated Press article published on February 26, 2007, warns of a likely recession by year's end. Mr. Greenspan said the U.S. economy has been expanding since 2001 and that there are signs the current economic cycle is coming to an end. He further stated that "When you get this far away from a recession invariably forces build up for the next recession, and indeed we are beginning to see that sign." Overall, the stock market in 2007 should be approached with cautious optimism. Based upon our interpretation of this information, we do not anticipate that the equity portion of the portfolio in 2007 will approach the 17.66% total return it achieved in 2006.

The Fund's fixed income assets (individual bonds and bond mutual funds) posted a total return of 4.56% in 2006 after gaining 5.87% in 2005, 2.05% in 2004, 4.81% in 2003, 10.47% in 2002 and 9.74% in 2001. This component of the Fund's portfolio compares favorably to the 2006 Lehman Brothers Bond Indexes, Lehman Brothers Long Term Treasury Index (1.85%); Lehman Brothers U.S. Credit Index AA-rated segment (4.32%); Lehman Brothers Municipal Bond Index (4.84%); Lehman Brothers Intermediate-Term Treasury Index (3.51%) and the Lehman Brothers Mortgage-Backed Securities Index (5.22%).

The Fund's cash equivalents (money market account, treasury bills, and cash) represented 1.88% of the Fund's year-ending asset allocation. Treasury Bills are short-term government issued debt instruments that have maturities of one year or less. The money market account is a fund designed to provide safety of principal and current income by investing in securities that mature in one year or less, such as bank certificates of deposit, commercial paper and U.S. Treasury bills. Money market funds have the lowest risk of any type of mutual fund. The 2006 total return for the cash equivalents component of the Fund's portfolio was 4.81%. This total return compares favorably with the Merrill Lynch 91 Day T-Bill total return of 4.85%.

2006 Income & Remittances to the Museum

During 2006, a total of $1,204,647.63 was remitted to the Museum, which included the distribution of the Fund's December 2005 income in January 2006, as detailed in the chart that follows.

[12] Combined News Reports. "Mortgage defaults worry the market". Newsday.com. 25 February 2007

Distribution to Museum

2006	Income Account (Interest & Dividends)	Principal Account	Combined
January	$79,873	$20,127	$100,000.00
February*	$22,578	$77,422	$99,999.88*
March	$37,589	$62,411	$100,000.00
April	$31,941	$68,059	$100,000.00
May	$27,467	$72,533	$100,000.00
June	$33,682	$66,318	$100,000.00
July	$47,781	$52,219	$100,000.00
August	$35,433	$64,567	$100,000.00
September*	$27,149	$77,499	$104,647.75*
October	$30,876	$69,124	$100,000.00
November	$26,420	$73,580	$100,000.00
December	$27,509	$72,491	$100,000.00
Grand Total	**$428,298**	**$776,350**	**$1,204,647.63**
*Note: Bank of America adjusted the Fund in January 2007 to reconcile the under payment in February and the overpayment in September.			

The 2006 distribution to the Museum exceeded the amount authorized by Resolution 1306-2005. The Museum was provided with $4,647.63 more than its guaranteed fixed income of $1.2 million. The overage was related to authorized adjustments to the distribution schedule to allow for the Museum to meet its payroll requirements. The overpayment was reconciled in January 2007. Bank of America is aware of the distribution exceeding the authorized annual amount and is making policy changes to ensure that this does not occur again.

Resolution 1477-2006 continues the policy of using realized capital gains to augment the Museum's income as long as the corpus of the Fund does not go below the value of the original bequest ($8.2 million) and any unused funds are returned to the Fund for reinvestment. This authorization expires December 31, 2007. If the Legislature desires to continue the $1.2 million annual distribution to the Museum past 2007, the adoption of a resolution will be required by the end of this year.

The estimated income for the Fund in 2007 is $422,180, which is a yield of 3.33% of the market value. Using this 2007 estimated income level as an indication of the Fund's financial status in the coming year, it is estimated that the Fund will require a distribution of $777,820 from capital gains to augment income from interest and dividends to provide the guaranteed $1.2 million annual income to the Museum.

Advisory Fees

Investment management fees during 2006 totaled $22,210. The annual fee is 40 basis points (.40%), calculated on both principal value and accrued income, and taken quarterly. Resolution 682-1993 authorizes the use of capital gains to pay 50 percent of the investment management fees. A total of $11,105 in investment fees was paid during 2006 from the principal account (realized capital gains from previous years) and a total of $11,105 was paid from the Fund's income account. Bank of America does not receive any remuneration for the Fund's equity trades. However, a nominal commission is paid to an independent financial institution for equity market transactions.

Realized Capital Gains

Realized capital gains are the profitable difference between an investments market value and its initial purchase price. The Fund's 2006 year-ending market value includes $1,398,634 in unrealized capital gains, the difference between the market value of the Fund, $12,673,778, and its book value, $11,275,143.

In 1993, the Legislature first authorized the use of capital gains to pay for one half of the investment management fees (Resolution No. 682-1993). Since the inception of this policy through 2006, a total of $348,269 in realized capital gains has been used to pay investment fees.

In 1994, the Legislature first authorized using realized capital gains to augment distributions to the Museum and to provide a guaranteed annual income with the adoption of Resolution No. 933-1994. From 1995 through 2006 a total of $6,896,655 in realized capital gains has been remitted to the Museum.

In 2002, Resolution No. 929-2002 changed the long-standing policy of restricting capital gains distributions to a maximum of the realized capital gains accrued during the current calendar year (total return policy) to allow for distributions of capital gains realized during prior years to be distributed. Without this change the Fund would not have been able to provide the Museum with the $1.2 million income during each of the ensuing years.

For the past several years the Budget Review Office has expressed concern over the Museum's dependence on the use of realized capital gains to augment its income. Specifically, a prolonged market decline coupled with $100,000 monthly distributions and payment of fees could cause the Fund to fall below $12.2 million.

While the Museum continues to concentrate on its fund-raising efforts, its attempts to increase revenue from operations have not been sufficient to decrease its reliance on the use of realized capital gains from the Fund to supplement its income. The Museum also has taken measures to decrease its expenditures.

Allocation of Portfolio Assets

During the 2006, the market value of stock equities averaged 35.9% and the bond portfolio represented 7.7% of the Fund's total market value. Investments in bond, stock and real estate equity mutual funds represented the other major investment category, averaging 55.1% of the Fund's market value. As of December 31, 2006, stock mutual funds totaled $2.14 million and bond mutual funds totaled $4.77 million. The year-ending equity portfolio (individual stocks, mutual equity funds, and mutual real estate equity funds) represents 54.36% of the Fund's market value. The portfolio's allocation of assets exceeded the guidelines as originally set forth in Resolution 933-1994, which allows up to 50 percent of the Fund's assets to be invested in equities (i.e. corporate stock, mutual funds, real estate equity fund). Favorable market conditions increased the Fund's unrealized capital gains in equities to exceed the authorized asset allocation policy. Resolution 1477-2006 modified the investment guidelines for 2007 to allow the investment advisor to maintain a 50/50 split between fixed securities and equities to range between 5-10% of the 50/50 split, as determined by market conditions.

The Fund's asset allocation reflects the adopted investment objective to achieve greater growth through capital appreciation as well as provide a steady income from interest and dividends. The Fund's asset allocation as of December 31, 2006 is presented in the following table.

2006 Year-Ending Allocation of Fund Assets

Description	Market Value	% Of Portfolio	% Of Portfolio
Individual Stocks (Domestic & Foreign)	$4,744,442	37.44%	
Mutual Funds (Equity)	$2,144,544	16.92%	
Total Equities	**$6,888,986**		**54.36%**
Individual Bonds (Treasury Notes; Asset Backed Securities; Corporate Bonds)	$776,058	6.12%	
Mutual Funds-Fixed (Bond)	$4,770,271	37.64%	
Total Bonds	**$5,546,329**		**43.76%**
Short Term Investments (Money Market)	$238,463	1.88%	
Cash	$0	0.00%	
Total Other Investments	**$238,463**		**1.88%**
Total Portfolio	**$12,673,777.50**	**100.00%**	**100.00%**

Equities (Stocks)

The following table details the allocation of equities by category as a percent of the Fund's equities total market value.

Allocation of Equity (Common Stock) Portfolio by Industry

Category	Market Value 12/31/2006	% of Total Common Stocks
Basic Industry	$108,529	2.29%
Capital Goods	$435,367	9.18%
Communications	$373,663	7.88%
Consumer Cyclical	$142,368	3.00%
Consumer Staples	$406,197	8.56%
Energy	$455,196	9.59%
Finance	$1,047,219	22.07%
Health Care	$588,919	12.41%
Retailing	$195,757	4.13%
Technology	$788,040	16.61%
Transportation	$33,215	0.70%
Utilities	$169,970	3.58%
Total of Common Stocks	**$4,744,442**	**100%**

The majority of the common stock investments are "blue chip", large cap and Fortune 500 companies, which pay dividends. As of December 31, 2006, ninety (79 domestic and 11 foreign) of the Fund's one hundred and fourteen (102 domestic and 12 foreign) equity holdings generate dividends with a market yield of 1.77%, which is a decrease from last year's ending dividend yield of 1.84%. In addition to individual stocks, the Fund's year-end portfolio includes five stock mutual funds with a market value of $2.14 million. The market value for all of the Fund's equity investments is $6,888,986, which is 54.36% of the Fund's year-end market value.

Bank of America's investment policy restricts equity investments in any one company to a maximum of 3 to 5 percent of the total equity portfolio. This conservative investment policy protects the Fund by restricting exposure in any one company. As of the end of 2006, the largest stock holding in the Fund is ConocoPhillips, an international integrated energy company, with a market value of $172,680, which represented 3.6% of the equity portfolio, excluding stock mutual funds.

Fixed Income Investments (Bonds)

Fixed income investments, individual bonds and bond mutual funds, allow for diversification of the Fund's assets in a type of asset that provides a dependable income. However, the market value for bonds fluctuates with interest rates. The market value may be higher or lower than its book value dependent upon prevailing market interest rates and bond ratings. Generally, the market value of bonds decreases during times of rising interest rates, assuming investment grade bonds. Therefore, it is possible to experience a loss of principal when selling a bond prior to its maturity.

The December 31, 2006 market value of all bond investments is $5,546,329, which is 43.8% of the Fund's total market value. This portion of the portfolio includes individual corporate bonds and mutual bond funds. The year ending market value for the individual bonds is $776,058, which represented 6.1% of the Fund's total market value. The year ending market value of the mutual fund bonds is $4.8 million in three mutual bond funds, which represented 37.6% of the Fund's total market value. The mutual bond funds, yielding 5.2% of book value ($245,809 annually), are detailed in the following chart.

Mutual Funds - Fixed (Bond) 2006

	Yield at Market	Estimated Annual Income	Market Value	Original Cost	Variance
CMG Ultra Short Term Bond Fund	4.6%	$135,738	$2,973,889	$3,008,960	($35,071)
Columbia Core Bond Fund Class Z Shares	4.7%	$18,694	$399,243	$400,000	($757)
Columbia Conservative High Yield	6.5%	$91,377	$1,397,139	$1,427,309	($30,170)
Total		**$245,809**	**$4,770,271**	**$4,836,269**	**($65,998)**

Resolution 215-1987 restricts bond investments to investment grade, Baa or above, per Moody's Investors Service. This legislation structures the Fund's bond portfolio to provide income that is consistent with a reasonable level of risk. The weighted average maturity takes into account the proportional relevance of each bond. The weighted average maturity of the Fund's individual bond portfolio is 15.2 years with a yield of 1.15 percent of book value for a 2007-projected income of $55,521.

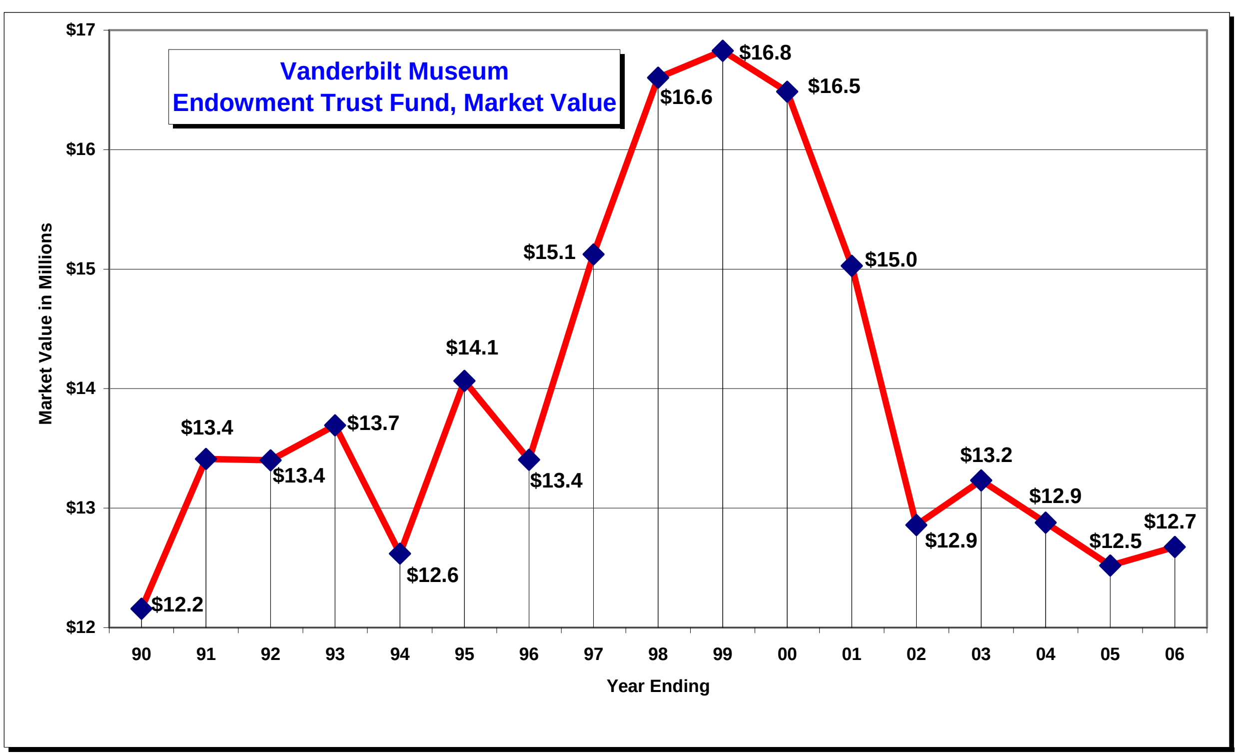
Summary Table and Graph

The following table summarizes the Fund's 2006 $153,995 net change (increase) in market value and the chart that follows plots the Fund's year-end market values during the period 1990-2006.

2006 Endowment Trust Fund Summary

Beginning Market Value			
Market Value December 31, 2005		$12,519,783	
Income			
Dividends	$423,571		
Interest	$76,122		
Other Income (Money Market interest & dividends)	$264	$499,957	
Distributions			
Income Remitted to the Museum	($428,298)		
Realized Capital Gains Remitted to the Museum	($776,350)		
Fees	($22,209)		
Foreign Taxes	$0	($1,226,857)	
Capital			
Capital Appreciation		$880,895	
Ending Market Value			
Market Value December 31, 2006		$12,673,778	
2006 Net Change in Market Value			$153,995

The following graph plots the Fund's market values for the past 17 years ending in December 31, 2006.



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