

ANNUAL REPORT AND FINANCIAL STATEMENTS

2007



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# CHAIRMAN'S STATEMENT

In June this year we opened Wellcome Collection, a transformation of the Wellcome Building, 183 Euston Road. This brings to life Sir Henry Wellcome's vision of a place where people could learn more about the development of medicine through the ages and across cultures. This new public space for London provides a unique mix of galleries, events, meeting, reading and eating places, as well as housing the Wellcome Library. It has been incredibly popular to date, with over 100,000 visitors in the first five months. There are two permanent galleries, *Medicine Man* and *Medicine Now*. *Medicine Man* has opened up a selection of extraordinary objects from Sir Henry Wellcome's collection to the public. *Medicine Now* explores the themes of the body, genomes, malaria, obesity and living with medical science through a range of exhibits from science and everyday life, as well as presenting artistic responses to these issues. Temporary exhibitions, such as *The Heart* and *Sleeping & Dreaming*, have also proved popular. Wellcome Collection provides a space to explore the big ideas around medicine, health and wellbeing and its opening has been a memorable highlight of the year.

## Investments

The Wellcome Trust's investment team, led by Danny Truell, has created a robust investment portfolio. Since flotation of Wellcome plc in 1986, the investment portfolio has delivered an annualised return of 16.2% and returns of 17.0% this year will allow us to increase our planned expenditure significantly. Anticipating downturns in the financial and economic markets, the Trust has sold over £3 billion of equities, principally in the UK, has largely avoided credit-based and highly leveraged strategies and now holds 53% of its portfolio in 'alternative' assets (hedge funds, buy-out funds, venture, property and emerging market equities). It remains well diversified with over 600 funds and managers. The net value of the Trust's investment asset base was £15.1 billion at 30 September 2007.

## Governance

This year has seen a number of changes to the Board of Governors of the Wellcome Trust. Professor Martin Bobrow came to the end of his term as Deputy Chairman and member of the Board of Governors. Professor Adrian Bird, a Board member since 2000, was appointed as his successor as Deputy Chairman. Professor Dame Jean Thomas's term as a Governor also came to an end in September.

Professor Sir Leszek Borysiewicz resigned his membership of the Board to take up the role of Chief Executive of the UK's Medical Research Council and Professor Ronald Plasterk resigned his membership of the Board to fulfill his new appointment as Minister of Education, Culture and Science in the Dutch Cabinet.

I would like to thank Martin, Jean, Borys and Ronald for the valuable contributions they have made to the Trust.

We have also made a number of new appointments to the Board. Professor Richard Hynes, Daniel K Ludwig Professor for Cancer Research at the Massachusetts Institute of Technology (MIT) and a Howard Hughes Medical Institute Investigator, was appointed in January 2007. Joining the Board in January 2008 are Professor Kay Davies and Professor Chris Fairburn from the University of Oxford, and Professor Peter Rigby, Chief Executive of The Institute of Cancer Research, London. Rod Kent, Chairman of Bradford & Bingley plc, will join the Board in February 2008.

I am pleased to welcome these new Governors to the Board.

## Grant making

By far the largest fraction of our funding is preserved for the support of investigator-led advancement of science to underpin future discovery and the application of knowledge. Much of this expenditure is through traditional project, programme and fellowship schemes. However, in recent years we have recognised that research funders have an increasing role to play in the choreography needed to bring the best teams together to work on the best ideas. To allow us to play a larger role in grant making we have made a number of new senior appointments, from academia, industry and the public sector, who will help in our grant making choreography and further encourage applications from the brightest researchers with the best ideas. Flexibility is key to ensuring the ideas of the research community are not constrained by the funding vehicles we provide. This year we have again used our Strategic Awards to provide the variable geometry that innovative projects often require.

Highlights of these awards include:

- A team led by Professor Linda Partridge was awarded a £5.9 million Strategic Award to examine the genomic and biochemical mechanisms of ageing and age-related disease.
- A £10.7 million Clinical Veterinary Research initiative to support training in clinical veterinary sciences to stimulate the uptake of research careers.
- The £7.7 million funding of the second phase of the Wellcome Trust Case Control Consortium, a large-scale whole genome study that aims to investigate the genetic contribution to common disease.

## Future challenges

When you look at the challenges facing the world today, encapsulated in the word 'sustainability', there is no doubt that man will be looking for increasingly technological solutions to sustain his future alongside the world's biodiversity. Sir Henry Wellcome demonstrated the importance of the power of scientific excellence combined with the capacity of industry to translate new discoveries for health benefit. The challenge of unmet clinical need on a global basis remains as great today as at any time since the establishment of the Wellcome Trust in 1936 on Sir Henry Wellcome's death. Today extensive programmes of biomedical science around the world are providing enormous opportunities to capitalise on new discoveries through translation to new products, treatments and devices. We need to evolve an improved culture for translation activities and provide the right environments that facilitate successful translation within our institutions. There is much to be done if we are to improve the lives of the newly born in Africa, the prevention of tropical diseases and HIV, and finally enhancing our ability to meet the global challenges presented by chronic disease. Through bringing scientific excellence and outstanding technology we can meet these future challenges as we partner the knowledge-based society with the world's industrial capacity.

Finally and most importantly I should like to thank Mark Walport and team for their focus on excellence, which continues to upgrade the contribution of the endowment.



Sir William Castell  
19 December 2007

# TRUSTEE'S REPORT

for the year ended 30 September 2007

## Objects

The objects of the Wellcome Trust (the "Trust"), as set out in its Constitution, are as follows:

- to protect, preserve and advance all or any aspects of the health and welfare of humankind and to advance and promote knowledge and education by engaging in, encouraging and supporting:
  - (a) research into any of the biosciences; and
  - (b) the discovery, invention, improvement, development and application of treatments, cures, diagnostics, and other medicinal agents, methods and processes that may in any way relieve illness, disease, disability or disorders of whatever nature in human beings or animal or plant life; and
- to advance and promote knowledge and education by engaging in, encouraging and supporting:
  - (a) research into the history of any of the biosciences; and
  - (b) the study and understanding of any of the biosciences or the history of any of the biosciences.

## Mission and Aims

The Trust's Strategic Plan for 2005–2010, *Making a Difference*, sets out the context and direction for the Wellcome Trust to achieve its overall mission to "foster and promote research with the aim of improving human and animal health" during this period. The Trust has six aims:

- **Advancing knowledge:** To support research to increase understanding of health and disease, and its societal context.
- **Using knowledge:** To support the development and use of knowledge to create health benefit.
- **Engaging society:** To engage with society to foster an informed climate within which biomedical research can flourish.
- **Developing people:** To foster a research community and individual researchers who can contribute to the advancement and use of knowledge.
- **Facilitating research:** To promote the best conditions for research and the use of knowledge.
- **Developing our organisation:** To use our resources efficiently and effectively.

The Strategic Plan and the *Wellcome Trust Annual Review 1 October 2006–30 September 2007*, which gives more detail of the achievements in the year, are available on request from the address on the inside back cover.

## Review of Activities

During the year the Trust delivered a wide range of activities to further its mission as it has continued to support the brightest scientists with the best ideas.

This review sets out major areas of funding during the year within the context of the Trust's aims. Impacts are often only seen some time after the expenditure is committed – and the direct link to health outcomes may be seen generations later. Where achievements are reported, they often reflect only the final result of many years of research from previous funding.

The charitable activities of the Trust, as detailed in note 6 to the Financial Statements, often cover more than one of the Trust's aims. More detail on all the Trust's activities and achievements, including those mentioned below, can be found in the Trust's *Annual Review*.

## Understanding health and disease, and societal context

A significant proportion of the funding to achieve this aim is supported by the Science Funding activity. The continuing support for excellent basic research also provides a platform from which to develop clinical research and use of knowledge to create health benefit. The Trust also supports research that addresses the wider societal and historical context of the biomedical sciences, to help understand the present and learn from the past.

The Trust continued to award substantial funds to research institutions, primarily UK universities, through its established project, programme and other ad hoc award schemes. Support was awarded through Science Funding activity for 50 programme grants (2006: 45) and 241 project grants (2006: 218).

Another indicator of success in meeting this aim was the publication of over 3,400 scientific papers that acknowledge funding by the Wellcome Trust in journals featuring in the PubMed database.

During the year the Trust announced a number of new targeted calls for proposals to encourage applications in strategic highlight areas which emerged from a series of Frontiers meetings held during the year.

In the area of history of medicine, which falls within the Medicine, Society and History activity, 12 project grants (2006: nine) and nine fellowships (2006: six) were awarded. History of medicine awards cover a wide range of topics and periods and during the year awards totalling £5.6 million (2006: £4.8 million) were made. New studentships and fellowships build on the history of medicine community's strong academic foundations, and much work is now disseminated to public audiences. During the year the Biomedical Ethics Programme was reviewed and relaunched, with £1.7 million of awards already made in 2007.

### Creation of health benefit

Significant health impacts can result from basic research funded by the Trust. In addition the Trust also supports research specifically aimed at driving forward the application of research to create health benefits.

To help bridge the gap between basic research and commercial application, £20 million (2006: £13 million) of awards were made through the Technology Transfer activity.

During the year the Trust awarded the first eight Strategic Translation Awards to support early stage drug discovery projects via the £91 million Seeding Drug Discovery initiative. Awards ranged from antibacterial compounds to combat MRSA to the development of new drugs for the treatment of obesity.

Several other Strategic Translation Awards were also made in the year. Dr Helen Lee and colleagues were awarded £7.6 million to develop rapid point-of-care diagnostics for a range of infectious diseases, suitable for use in developing countries.

Lord Ara Darzi of Imperial College London received £2.1 million to develop a novel, bio-inspired robotic surgical tool which would deliver a revolutionary approach to assisted minimally invasive surgery.

Dr Geraint Morgan, of the Open University, and Dr Liz Corbett, London School of Hygiene and Tropical Medicine, were awarded £1.3 million to produce a robust and rapid, field-deployable tuberculosis diagnostic to help halt the TB pandemic in the developing world.

### Global health

International awards continue to contribute to global health. During the year the Trust once again provided major funding support for research and capacity building activities in developing and restructuring countries. For example, the Trust has worked with the UK Department for International Development and the International Development Research Centre, Canada, to develop capacity building programmes in Kenya and Malawi through the £20 million Health Research Capacity Strengthening initiative. Awards under this initiative are expected to be made in the coming year.

Funding to the South African University of KwaZulu-Natal for the Africa Centre was renewed during the year, with an award of £16.8 million. The Centre brings together basic, clinical and translational researchers across a range of immunology, infectious disease and other disciplines.

Other Major Overseas Programmes in Africa and South East Asia also received additional funding during the year to continue to support the valuable research being performed.

### Partnerships

The Trust works in innovative funding partnerships where added benefit can be gained and sees this as a strategically important way to achieve its mission.

During the year a second phase of funding was awarded to the Structural Genomics Consortium, an international collaboration aiming to unravel the structures of proteins of medical relevance and place them in the public domain without restriction, with the ultimate aim of providing structural information to stimulate the development of new and improved drugs and other healthcare products. Two new industrial funding partners also joined the Consortium, which exceeded its phase 1 milestones.

Phase 1 construction of the Diamond synchrotron, funded by the Trust and the UK Government, was completed during the year and it became operational in January. The Diamond synchrotron produces pinpoint ultra-violet and X-ray beams of exceptional brightness. These highly focused light beams enable scientists and engineers to probe deep into the basic structure of matter and materials, answering fundamental questions about everything from the building blocks of life to the origin of our planet.

# TRUSTEE'S REPORT

## for the year ended 30 September 2007 (continued)

The joint Wellcome Trust and Howard Hughes Medical Institute (HHMI) Exchange Programme was launched, which enables Trust-funded postdoctoral researchers to carry out collaborative research by joining the laboratory of an HHMI investigator.

In addition a new four-year PhD scheme in partnership with the US National Institutes for Health was launched, which provides opportunities for the most promising postgraduate students to undertake international collaborative training.

### Engaging society

The Trust continues to engage society to foster an informed climate within which biomedical research can flourish. The Trust's approach to engaging the public with biomedical sciences draws on its unique resources, history and expertise to place biomedical science within a societal, historical and cultural context. This work takes place within the Medicine, Society and History activity.

Wellcome Collection, housed in the Wellcome Building, opened its doors to the public in June. Its three new galleries hold two permanent exhibitions, *Medicine Man* and *Medicine Now*, and one temporary exhibition. The exhibitions and other events form part of the Trust's aim to engage the public with science-related issues affecting their lives. In its first five months Wellcome Collection attracted over 100,000 visits from the public and received much positive media attention.

In addition to these direct activities, the Trust also awarded over £3.3 million (2006: £2.9 million) in grant funding for public engagement projects via the Engaging Science programme and as part of this launched a new Arts Awards scheme. A number of notable Strategic Awards were also made including £600,000 to Professor Francis Balkwell for the 'Centre of the Cell' – an interactive exhibition for young people in East London.

### Contributing to a long-term and vibrant research environment

In meeting the Trust's aims of advancing and using knowledge, whilst engaging with society, the Trust appreciates the absolute importance of both the people it supports and the research environment in which they work.

The most prestigious of the Trust's career support schemes are the Principal Research Fellowships (PRFs) which provide long-term support for basic and clinical researchers of international standing. During the year awards totalling £30 million were made (2006: £23 million) covering four new PRF awards, three renewal PRF awards and two PRF programme renewal awards. The Trust also awarded £39 million for Senior Research Fellowships (2006: £27 million).

Expanding its current PhD programme, the Trust has awarded funding for 31 PhD programmes at UK universities including 22 new or renewed programmes for basic scientists, seven for clinicians and two joint basic-clinical.

In addition the Trust announced the first 20 recipients of Sir Henry Wellcome Postdoctoral Fellowships, which enable the brightest and best newly qualified scientists to embark on independent research careers. £5 million was awarded in the year.

The Trust's Strategic Award scheme, launched in 2006, continued to support research and training programmes in areas of strategic importance. 14 major awards were made during the year and a total of £55.4 million was awarded through this scheme.

A team led by Professor Linda Partridge was awarded a £5.9 million Strategic Award to examine the biological mechanisms of ageing.

The Trust also announced a £10.7 million Clinical Veterinary Research initiative to support training in clinical veterinary sciences to stimulate the uptake of research careers. £3.7 million of this was awarded as a Strategic Award during the year.

The Trust has relaunched and expanded its fellowship schemes for researchers from developing countries. The Fellowships in Public Health and Tropical Medicine provide a career path for high-calibre researchers in developing countries, from an early stage in the development of their research careers through to establishing themselves as leading investigators at academic institutions in developing countries. The fellowships aim to build sustainable capacity in areas of research that have the potential for increasing health benefits for people and their livestock in developing countries.



The Trust awarded funding for the second phase of the Wellcome Trust Case Control Consortium, a large-scale whole genome study led by Peter Donnelly at the Wellcome Trust Centre for Human Genetics in Oxford, which aims to investigate the genetic contribution to common diseases. This work also included collaboration with the Wellcome Trust Sanger Institute. Major results from the first phase were published in *Science* and *Nature* during the year and gained considerable media attention.

The Trust continues its support of centres and infrastructure within the research environment. During 2006/07 the Trust also introduced a biennial competition to support major Capital Awards for science-based activities as well as an annual competition for projects in public engagement and medical history.

The Wellcome Library was also re-opened as part of Wellcome Collection and continued to take forward activities to preserve and make available key historical resources.

In the area of influencing policy, the Trust has worked with the Health and Safety Executive, the research community and other funders, to highlight the threat of the EU Physical Agents (Electromagnetic Fields) Directive to research and clinical practice conducted using magnetic resonance imaging. The Trust welcomed the European Commission's decision to postpone its implementation to allow time for 'substantive amendments'.

### **Wellcome Trust Sanger Institute and Wellcome Trust Genome Campus, Hinxton**

The aims of the Trust are furthered by the outstanding work undertaken at the Wellcome Trust Sanger Institute, in Hinxton. The Sanger Institute's principal activity is a programme of biomedical research based on large scale studies of gene function.

During the year the construction of an extension to accommodate the European Bioinformatics Institute (EBI) was completed on time and within budget. The informatics teams at the Sanger Institute have worked in partnership with the EBI, making a significant contribution to the publication of the pilot phase of the international ENCODE collaboration, which used cutting edge methods to define accurately the functional elements in 1% of the human genome.

A series of landmark papers have been published during the year in major scientific journals, which demonstrate how the Institute has matured from a sequencing centre to a world-leading genome centre with a focus on the genetics of natural and induced variation.

The Trust also funds a programme of Conferences, Retreats and Advanced Courses at the Wellcome Trust Conference Centre, Hinxton. A wide range of international events were also held during the year, including workshops in Latin America and Africa.

Examples include the large scale conferences on 'Molecular Biology of Hearing and Deafness' and 'Genomics of Common Diseases', a Hinxton Retreat on 'Malaria Parasite Diversity' and the Advanced Course on 'Functional Genomics and Systems Biology'.

### **Future Plans**

As indicated last year, most of the Trust's funding over the next few years will be to support a range of research from the fundamental to the translational. The Trust will continue to focus its support on the best and the brightest medical researchers at all career stages. Other priorities are to increase support for clinical research and training, and to continue promoting the use of knowledge arising from biomedical research to improve human and animal health in the UK and globally.

The Trust aims to strengthen its support for public health research in the UK, including as a partner in the UK Clinical Research Collaboration Centres of Excellence for Public Health initiative.

Through the Technology Transfer activity the Trust aims to deliver targeted calls for proposals in the current highlight areas of medical technologies and antibiotic resistance.

In partnership with the Department of Health, the Trust will take forward the new £100 million Health Innovation Challenge Fund to accelerate the development of innovative technologies, devices and clinical procedures of relevance to the National Health Service. The Trust has committed £50 million over five years towards this initiative.

# TRUSTEE'S REPORT

for the year ended 30 September 2007 (continued)

The Trust aims to continue to increase its international activities in line with its International Strategy. Alongside this the Trust continues to look for opportunities to work within partnerships to continue to take forward existing projects or explore new opportunities. One such opportunity to do both is the Health Research Capacity Strengthening initiative in Africa. A new initiative was launched during the year to develop North-South partnerships for strengthening research in African institutions, which will be taken forward over the coming year.

The Trust also plans to continue to support UK centres and Major Overseas Programmes as major centres of research excellence.

The new International Public Engagement programme will be taken forward, supporting a range of activities to engage relevant stakeholder groups with biomedical science in developing countries.

As part of the Trust strategy to engage society a broad and challenging programme of exhibitions and other activities at Wellcome Collection is planned. A new science education strategy will also be implemented with the aim of supporting the professional development of teachers and developing a programme of research. A strategy to help scientists to work more effectively with the broadcast media is also underway.

To increase access to Wellcome Library collections a major programme of systematic digitisation is planned over the next four years.

The new grants management system will go live in 2008, providing a modern approach to the grant-making process right from the initial enquiry through to payment and submission of end of grant reports.

The Trust will continue to work with the Medical Research Council, Cancer Research UK and University College London to progress the development of a new world-leading centre for medical research at a site near St Pancras.

## Financial Review

Figure 1: Summary financial information

	2007 £m	2006 £m
<b>Statement of financial activities</b>		
<b>Investment activities</b>		
Total return from investment activities	2,246	1,586
Costs of investment activities		
Management fees and other costs	(47)	(51)
Interest payable on bond liability	(26)	(5)
Interest payable on finance leases	(2)	(2)
<b>Net return on investments</b>	<b>2,171</b>	<b>1,528</b>
<b>Charitable activities</b>		
Charitable income	11	7
Other income	6	9
Charitable resources expended		
Grants	(359)	(325)
Direct	(114)	(119)
Allocated support	(47)	(40)
<b>Net charitable activities</b>	<b>(503)</b>	<b>(468)</b>
<b>Other activities</b>		
Governance	(2)	(2)
Actuarial gain/(loss) on pension schemes	16	(9)
<b>Net other activities</b>	<b>14</b>	<b>(11)</b>
<b>Net movement in fund</b>	<b>1,682</b>	<b>1,049</b>
<b>Summary of net assets</b>		
<b>Investment</b>		
Investment assets	15,666	13,941
Bond liability	(544)	(544)
<b>Net investment assets</b>	<b>15,122</b>	<b>13,397</b>
<b>Charitable</b>		
Tangible fixed assets	432	458
Other assets	21	18
	<b>453</b>	<b>476</b>
Grant liability	(1,040)	(1,017)
Finance lease creditor	(87)	(87)
Other charitable liabilities	(43)	(35)
	<b>(1,170)</b>	<b>(1,139)</b>
<b>Net charitable liabilities</b>	<b>(717)</b>	<b>(663)</b>
<b>Defined benefit pension scheme deficit</b>		
	<b>(40)</b>	<b>(51)</b>
<b>Net assets representing unrestricted funds including pension deficit</b>	<b>14,365</b>	<b>12,683</b>

## Investment activities

2006/07 was a year in which global economic growth remained strong, but excessive leverage and insufficient regard for risk created a crisis in credit markets, which caused major disruption in the final quarter. Over the year the US Dollar weakened by almost 9% against Sterling.

It was satisfying, therefore, that at the end of September 2007, the net value of the Trust's investment assets grew to £15,122 million. The total return from investment activities in the year was £2,171 million.

## Investment performance

Over each of the past five years, investment returns have exceeded £1 billion; cumulative gains exceeded £8 billion.

The independently calculated nominal performance return was 17.0% for the year to September 2007. At the year end, the one year 95% Value at Risk (VAR) was 9.4% compared with the Trust's targeted maximum of 15%, that is, there is a one in twenty year chance that the value of the portfolio would decline by £1.4 billion. VAR has been reduced by continuing diversification of the portfolio.

Positive Sterling returns were recorded in each quarter of the year, including the final quarter. Annual real returns (after inflation) have exceeded the Trust's 6% target over 3, 5 and 10 years. Since the flotation of Wellcome plc in 1986, annualised nominal returns have been 16.2%, exceeding both the global equity index (MSCI World) and the Trust's targeted return (6% real) by over 6% annualised (see figures 2 and 3).

### Figure 2: Total portfolio returns (Sterling)

#### Period to 30 September 2007

	Nominal return %	Consumer price index %	Real return %
Time weighted return			
1 year	17.0	1.8	15.2
3 year	17.6	2.2	15.4
5 year	15.7	1.8	13.9
10 year	7.9	1.5	6.4
Since Wellcome plc flotation	16.2	2.8	13.4

Especially strong returns were recorded in the Trust's Asian and emerging market equity strategies, in its equity long/short funds, in its buy-out funds and in its UK residential property assets. Positive Sterling returns were recorded in all asset classes except for Japanese long-only equity strategies.

The Trust continues to sell down its holdings in UK equities, especially its mid-cap and smaller stocks. At the end of September 2007, UK equities constituted 15.1% of total investment assets compared with 23.6% in September 2006 and 31.9% in September 2005.

Since March 2006, the Trust has sold over £3 billion of equities across its portfolio, reducing its long-only equity exposure to 51.1%.

Exposure to UK private equity buy-outs and to UK commercial property was also reduced, reflecting continued concern about high valuations and excess levels of leverage in these markets. The Trust continues to avoid investment in funds dependent on leverage, credit and infrastructure.

Weightings were increased in Asian and emerging market equities, equity long/short hedge funds, multi-strategy hedge funds, active currency funds, healthcare investments, venture capital funds and residential property. The Trust increased its commitment to distressed debt funds and added to its portfolio of directly held investments. After consideration, it chose not to make a firm offer as part of a consortium for Alliance Boots plc as a potential investment asset.

The Trust continues to focus on finding and securing capacity with the best managers across asset classes as well as extending its directly held investments so as to achieve its demanding return targets.

International performance comparisons are hampered by currency distortions and by the passive currency overlay employed by the Trust. In US Dollar terms, total investment returns were 27.6% in 2006/07 and have been 18.2% per annum since the flotation of Wellcome plc in 1986. Net investment assets were \$31.0 billion at the end of September 2007. The exchange rate applied to Euro, US Dollar and Japanese Yen denominated stocks were €1.43, \$2.04 and JP¥234.34 (2006: €1.47, \$1.87 and JP¥220.54).

# TRUSTEE'S REPORT

for the year ended 30 September 2007 (continued)

Figure 3: Total portfolio cumulative returns (Sterling)

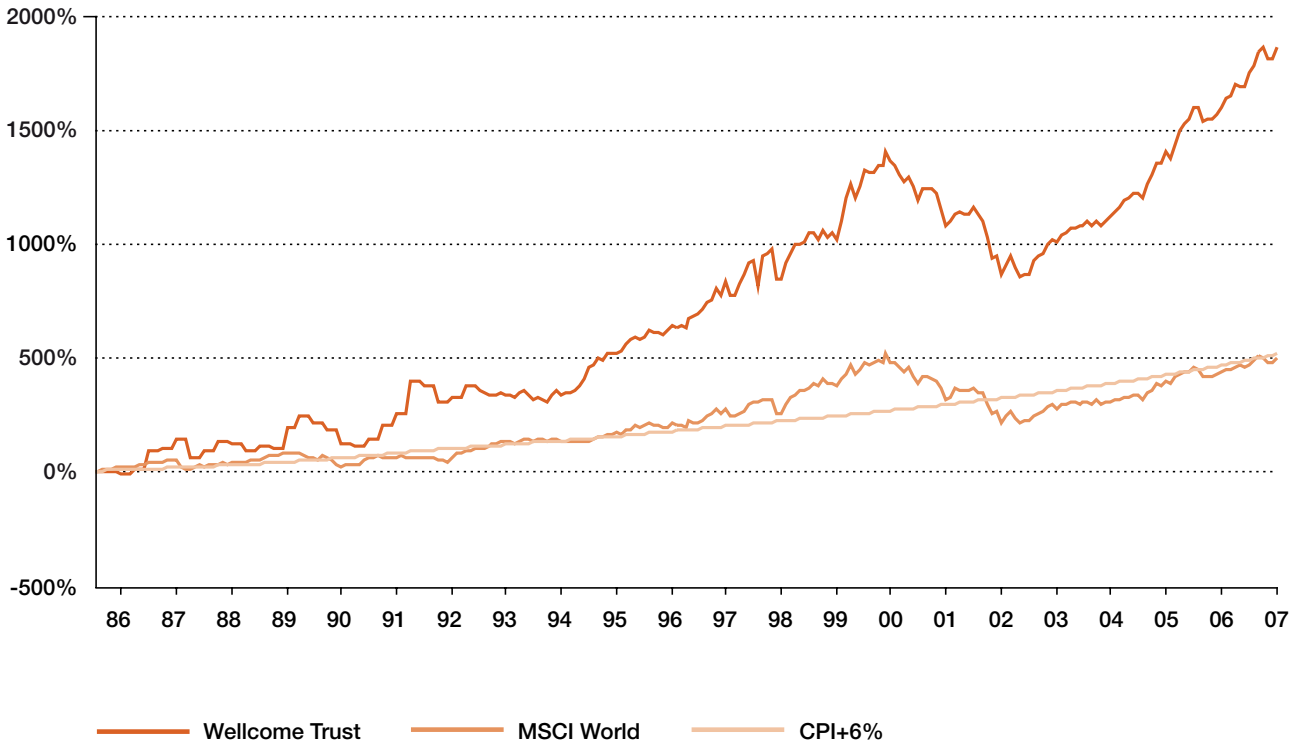
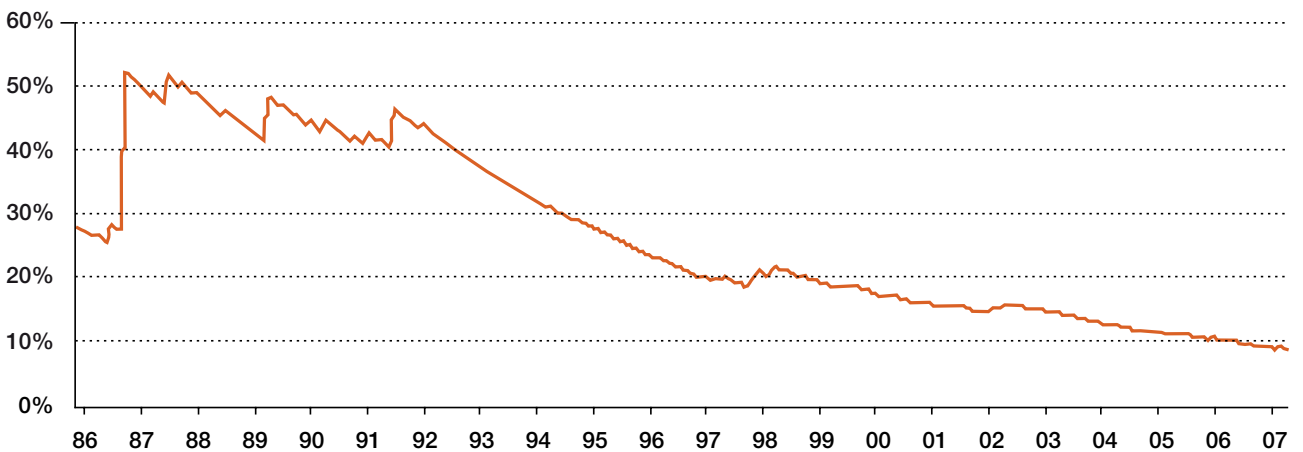


Figure 4: Volatility of returns exponentially weighted moving average (Sterling)



## Investment risk management

The volatility of the portfolio, as computed using an exponentially weighted moving average method with a decay factor of 0.97, has shown a significant decrease over the years, from a maximum of 52% in 1987 to about 9.2% in 2007 (see figure 4). Risk is an integral part of the portfolio management process and over the last 12 months the Trust has developed sophisticated risk tools to monitor and manage the risk in the portfolio. The impact of new investments is integrated into the risk model and evaluated in order to assess the impact on the portfolio.

## Investment assets

A number of investment beliefs drive the Trust's asset allocation in the deliberate absence of any pre-determined strategic benchmark:

- 1) Despite concerns about the use of excessive leverage and the mispricing of risk in some areas of the economic and financial markets, the Trust remains committed to investment in reawl assets.
- 2) In order to maximise investment returns from global economic activity, the portfolio should be very broadly diversified with no innate geographical bias.
- 3) The Trust seeks to utilise the advantages of its long-term investment horizon, its ability to tolerate high levels of short-term volatility, its AAA balance sheet and its real-time governance structure in its investment portfolio.
- 4) The best returns will be driven by investing through a principally outsourced structure in which the Trust aligns with the strongest partners.
- 5) The Trust is generally flexible as to the nature of the vehicles in which it invests, whether public companies or private partnerships.

Figure 5: Asset allocation

	Market value* £m	As at 30 Sept 2007 %	As at 30 Sept 2006 %	Change
<b>Equity and equity long/short</b>	<b>9,047</b>	<b>59.8</b>	<b>67.9</b>	<b>(8.1)</b>
<b>Long only equities</b>	<b>7,724</b>	<b>51.1</b>	<b>61.7</b>	<b>(10.6)</b>
UK	2,285	15.1	23.6	(8.5)
Europe	1,201	8.0	9.9	(1.9)
Global	948	6.3	6.3	(0.0)
US	1,125	7.4	8.6	(1.2)
Japan	442	2.9	3.9	(1.0)
Asia Pacific ex Japan	850	5.6	4.1	1.5
Emerging markets	873	5.8	5.3	0.5
<b>Equity long/short hedge funds</b>	<b>1,323</b>	<b>8.7</b>	<b>6.2</b>	<b>2.5</b>
<b>Bonds and cash</b>	<b>817</b>	<b>5.4</b>	<b>5.8</b>	<b>(0.4)</b>
<b>Absolute return and buy-outs</b>	<b>3,072</b>	<b>20.4</b>	<b>16.4</b>	<b>4.0</b>
Buy-out funds	1,201	8.0	7.7	0.3
Distressed – buy-out funds	193	1.3	0.7	0.6
Multi strategy hedge funds	1,070	7.1	5.3	1.8
Distressed – MS hedge funds	212	1.4	0.9	0.5
Active currency	396	2.6	1.8	0.8
<b>Healthcare and venture</b>	<b>980</b>	<b>6.4</b>	<b>5.1</b>	<b>1.3</b>
Healthcare equity	139	0.9	0.8	0.1
Venture capital funds	612	4.0	3.5	0.5
Healthcare hedge funds	138	0.9	0.4	0.5
Direct investments	91	0.6	0.4	0.2
<b>Property and infrastructure</b>	<b>1,791</b>	<b>11.9</b>	<b>8.7</b>	<b>3.2</b>
Commercial and other	527	3.5	4.4	(0.9)
Residential	1,264	8.4	4.3	4.1
<b>Currency overlay</b>	<b>(42)</b>	<b>(0.3)</b>	<b>0.3</b>	<b>(0.6)</b>
<b>Programme related investments</b>	<b>1</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Wellcome Trust Bond</b>	<b>(544)</b>	<b>(3.6)</b>	<b>(4.2)</b>	<b>0.6</b>
<b>Total</b>	<b>15,122</b>	<b>100.0</b>	<b>100.0</b>	

\* The Wellcome Trust Bond is stated at book value not market value.

# TRUSTEE'S REPORT

for the year ended 30 September 2007 (continued)

## Equities

The public equity element of the portfolio enjoyed another strong year, although, especially in £ terms, returns from different elements were very mixed, with losses in Japanese equities and small gains in US equities being overshadowed by gains in excess of 40% in Asian and emerging market equities. The decision to focus selling activity almost exclusively on UK and European equities permitted the Trust to continue to benefit from investors' enthusiasm for Asian assets.

### Figure 6: Public equity annual returns (Sterling)

Period to 30 September 2007

	Time weighted return public equities %
1 year	15.5
3 year	17.0
5 year	16.0
10 year	6.6
Since Wellcome plc flotation	9.6

### Figure 7: Equity allocation by manager strategies

	2007		2006	
	£m	Number of managers	£m	Number of managers
Total UK equity active	1,214	3	1,399	4
Total UK equity passive	1,071	2	1,649	2
Europe equity active	1,201	2	1,032	2
Europe equity passive	0	0	285	1
Global equity	948	3	971	3
US equity active	1,125	4	1,152	5
US equity passive	0	0	30	1
Japanese equity	442	4	521	4
Asia Pacific ex Japan	850	3	546	3
Emerging markets equity	873	4	634	4
Healthcare equity	139	2	107	1
<b>Total long only equities</b>	<b>7,863</b>	<b>27</b>	<b>8,326</b>	<b>30</b>

Progress continued to be made in reshaping the portfolio to allocate monies to talented managers. The amount of money managed passively declined from £2.0 billion in September 2006 to £1.1 billion in September 2007. Passive exposure to European stocks was sold. In the UK, the remaining passive exposure was shifted exclusively to FTSE100 stocks to reflect a view on the relative undervaluation of larger companies.

In 2007/08, it is expected that the UK bias will be eliminated, that the European manager structure will be significantly altered and that further attention will be paid to creating the best structure to maximise returns from Asia and emerging markets.

## Hedge funds

The Trust's commitment to hedge funds continued to grow over the year, rising to £3.1 billion, largely reflecting the commitment of new monies to existing managers, most of whom are generally closed to new investors, and who have a record of strong performance. The average investment in each individual fund rose from £39 million to £56 million.

The Trust's portfolio of hedge funds performed well in 2006/07; each part of the portfolio delivered double digit (net of fees) returns over the year.

Equity long/short funds performed most powerfully with almost half of the Trust's managers recording gains in excess of 20%. The portfolio remains well diversified with the average fund position being £41 million such that overall volatility is less than 5%. Emphasis is put on managers with strong skills in selling stock short.

Absolute return hedge funds also recorded gains in each of the four quarters, including the challenging final three months. The Trust continues to avoid funds that are highly dependent on leverage, that seek most of their returns from fixed-income markets and that are too dependent on quantitative strategies. Overall volatility was barely 3%.

The injection of new monies into distressed debt funds in the final quarter of 2006/07 reflected the Trust's confidence in the ability of its managers to benefit from the dislocation of credit markets and the re-pricing of risk. Historic volatility of less than 5% is expected to rise as opportunities become more widespread and performance of these funds remains strong.

The Trust's active currency programme, inaugurated in 2006, had a positive first full year; although individual manager results were mixed, overall volatility was less than 11%. The healthcare hedge fund programme also performed well with volatility of around 7%.

In October 2006, the Trust announced that it would be seeding up to \$550 million in funds, principally hedge funds, managed by New Smith Capital Partners and would take a financial interest in the group.

#### Figure 8: Hedge fund (net of fees) annual returns (US Dollars)

Period to 30 September 2007			
	1 year %	3 year %	5 year %
Distressed debt	12.2	12.3	17.3
Absolute return	14.8	12.2	10.8
Equity long/short	21.3	14.2	11.8
Healthcare	16.8	n/a	n/a
Active currency (£)	10.2	n/a	n/a

#### Figure 9: Hedge fund allocation by funds

	2007		2006	
	£m	Number of managers	£m	Number of managers
Distressed debt	212	7	119	6
Absolute return	1,070	10	605	10
Equity long/short	1,323	32	861	30
Healthcare	138	4	56	3
Active currency (£)	396	3	239	2
<b>Total</b>	<b>3,139</b>	<b>56</b>	<b>1,880</b>	<b>51</b>

## Private equity

The Trust remains a major investor in private equity, with investments in over 500 partnerships. The net asset value of drawn funds exceeded £2 billion for the first time, with outstanding commitments of £1.8 billion. Total (net of fee) annual returns have been in excess of 21%.

#### Figure 10: Private equity performance

##### Period to 30 September 2007

	Local currency %	Sterling %
Net IRRs (from 1994)*		
Buy-outs	14.3	12.5
Venture	66.5	66.3
Total private equity	21.5	19.4

\* The internal rate of return (IRR) is the annualised compounded rate of return on invested capital and is the most widely used measure of performance for private equity.

As indicated in last year's Report, the Trust had become concerned about the levels of debt and increasing prices for acquisitions in parts of the buy-out market. As a result, new commitments became more concentrated with the best managers. The majority of the increase in the number of funds is due to the absorption of a historic fund of funds relationship, which appeared as a single fund in previous years.

As credit market pricing becomes more realistic and weaker economic conditions offer more attractive acquisition opportunities, these concerns are likely to abate. Although the very strong returns of the past three years are likely to fall, the Trust is confident that its portfolio of buy-out funds can continue to deliver long-term returns at least in line with the annual 14% recorded since inception of the private equity portfolio in 1994.

# TRUSTEE'S REPORT

for the year ended 30 September 2007 (continued)

**Figure 11: Private equity investments by funds**

	2007		2006	
	£m	Number of funds	£m	Number of funds
Buy-outs	1,394	262	1,144	167
Venture	612	230	465	160
Direct	91	23	40	20
<b>Total</b>	<b>2,097</b>	<b>515</b>	<b>1,649</b>	<b>347</b>

In venture, realisations remained more subdued in 2006/07. However, since 1994, annual returns of 66% have justified the volatility of outcomes in individual funds. The Trust continues to have strong access to the best managers and increased its commitments in the period.

As investor demand has strengthened, as has been the case in buyouts for some time, the number and size of new venture funds has increased. The predictability and timing of future returns remains uncertain, but the Trust is comfortable with its commitment to this part of its portfolio, because of the potential for a higher level of expected return.

As the Trust's expertise grows, it continues to increase its portfolio of directly held long-term investments, especially in the area of healthcare. Its allocation remains driven by the appearance of attractive opportunities in which it can partner with other parties.

## Property and infrastructure

The Trust's property portfolio continued to produce strong returns over the year. Demand for property in South Kensington, London, the largest part of the property portfolio, remained extremely strong. The 36% gain in the value of the direct residential portfolio also reflects the added value created by active management of the portfolio.

**Figure 12: Property annual returns (Sterling)**

	Since inception				
	1 year	3 year	5 year	10 year	(1994)
Total property	16.4	18.5	17.4	15.3	14.1
Commercial property	3.9	14.0	15.8	12.3	11.4
Residential property	36.0	23.7	20.3	18.5	19.8
Indirect property funds					13.1*

\* IRR since 2000.

**Figure 13: Property allocation (Sterling)**

	2007	2006
	£m	£m
Residential property	1,264	697
Commercial property	309	299
Indirect property funds	217	155
<b>Total</b>	<b>1,791</b>	<b>1,151</b>

Significant gains were also made by the Trust's German residential property fund manager. The Trust's long time horizon, low long-term cost of borrowing and high tolerance for short-term price volatility make it a natural holder of residential property despite weaker short-term capital values. A significant investment was made in a Manhattan, New York, residential property fund and the Trust completed one of the largest ever UK residential property acquisitions towards the end of the year, adding principally to its holdings in London and the South-East.

As outlined in last year's Report, the Trust continued to take advantage of strong buyer demand and unsustainably low yields to reduce further its exposure to UK commercial property. It was not able to find infrastructure investments which offered to produce acceptable returns without using undue levels of leverage.

The sharp downturn in credit markets is likely to provide opportunities for the Trust to acquire further property assets at discounted prices in the coming year.

## Financial risk management

The Group is exposed to market price risk, credit risk, liquidity risk, currency risk and cash flow and interest rate risk arising from the financial instruments it holds. These risks are summarised in note 23 of the Financial Statements.





























































































































