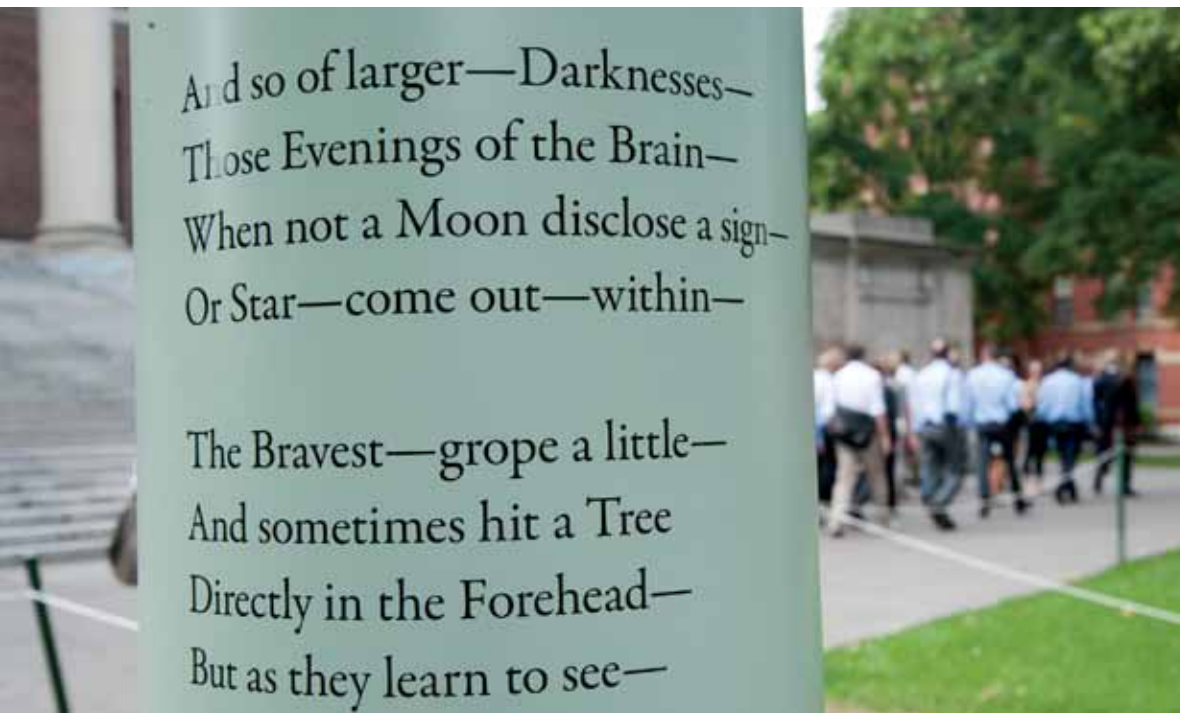


JOHN HARVARD'S JOURNAL



AS PART OF THE UNIVERSITY'S observance of the tenth anniversary of 9/11, the Mahindra Humanities Center erected eight "poetry posts" on the lawns between Massachusetts Hall and the Barker Center: slim green cylinders, about seven feet tall, each bearing the names of the 10 Harvard affiliates who died in the attacks, and a poem (or excerpt) meant to prompt reflection about loss and recovery. Among the texts were Martin Espada's "Alabanza: In Praise of Local 100," on the 43 members of Hotel Employees and Restaurant Employees Local 100 who perished in Windows on the World; Emily Dickinson's "We Grow Accustomed to the Dark"; an excerpt from Lucille

Clifton's "september song: a poem in 7 days"; Frank Bidart's "Curse"; and an excerpt from W. H. Auden's "September 1, 1939."

The list atop each pale olive pillar paid homage to the dead: David Alger '66; Paul Ambrose, M.P.H. '00; Anthony Demas, P.M.D. '80; Steven Lawrence Glick, M.B.A. '89; Edward R. Hennessy '88; Waleed Joseph Iskandar, M.B.A. '93; Andrew Keith Kates, M.B.A. '91; Michael B. Packer '76; Meta Waller, M.P.A. '82; and Steven Weinstein, S.M. '73.



For a report on the community commemorative service, see harvardmag.com/commemorating-9-11.

Better Endowed

HARVARD'S ENDOWMENT was valued at \$32 billion as of June 30, the end of fiscal year 2011—up 16 percent from \$27.6 billion at the end of fiscal 2010—according to Harvard Management Company's (HMC) annual report, released on September 22. HMC recorded an investment return of 21.4 percent on endowment and related assets—a strong performance following the 11.0 percent return in fiscal 2010 (and the -27.3 percent investment return during the

financial crises of fiscal 2009, when the endowment's value declined by \$11 billion).

According to Wilshire Associates Trust Universe Comparison Service—a standard measuring stick—large institutional investors achieved fiscal year 2011 median returns of 20 percent to 21 percent, reflecting the generally favorable market conditions. Results for similarly managed large university endowments reported at press time included Stanford's 22.4 percent investment return (and 19.5 percent endowment growth, to \$16.5 billion); Yale's 21.9

percent return (and 16.2 percent endowment growth, to \$19.4 billion); Princeton's 21.9 percent return (and 18.8 percent endowment growth, to \$17.1 billion, boosted by its capital campaign); and MIT's 17.9 percent return (and 16.5 percent endowment growth, to \$9.9 billion). The University of Virginia realized a 24.3 percent return, and apparently became the first school to recoup *all* of its losses from the 2008-2009 downturn—and then some.

The difference between the rate of investment return and the growth in the absolute value

of the endowment reflects the distribution of endowment funds to support University operations and for other purposes (perhaps \$1.4 billion in fiscal 2011, down from fiscal 2010's \$1.56 billion, fiscal 2009's \$1.66 billion, and fiscal 2008's \$1.63 billion), offset by endowment gifts received during the year (perhaps in line with the quarter-billion dollars received in fiscal 2010). Details will be disclosed in Harvard's annual financial report, published in October after this issue went to press (see harvard-magazine.com for details).

The fiscal 2011 investment return handily exceeded HMC's long-term goal of 8.25 percent annual gains. After distributions in support of University spending (the endowment now provides about one-third of operating revenues), this return, plus gifts, notably boosted the endowment. With inflation low, that 16 percent appreciation in the endowment represents vigorous real growth.

Is the endowment fully recovered? Hardly: its peak value was \$37.2 billion at the end of fiscal 2008. But it was "a successful year for HMC and the Harvard endowment," said president and chief executive officer Jane L. Mendillo in an interview. "The markets were good for most of the year and we were able to do well relative to the markets." As she wrote in HMC's annual report—citing the investment professionals' active management of the portfolio to satisfy growth, liquidity, and risk-management objectives—"We are pleased to report that our progress in fiscal year 2011 was significant along each of these dimensions."

With fiscal 2011 on the books, HMC's *annualized* investment return for the past five years rose to 5.5 percent from 4.7 percent last year, and for 10 years to 9.4 percent from the prior-year 7.0 percent. Part of the improvement reflects the strong fiscal 2011—and part the arithmetic of moving beyond fiscal 2001 (when investment returns were *negative* 2.7 percent, in the wake of the dot-com collapse). These rates of return look more like the long-term returns that HMC's investment strategy is designed to produce. The long-term performance shapes the Corporation's financial decisions as it determines a rate of distribution from the endowment to support University operations. For the current fis-

cal year, the Corporation authorized a 4 percent increase in the endowment distribution, following two years of declines. Its fiscal 2013 decision is not yet public.

ON A RELATIVE BASIS, HMC's 21.4 percent return (after all investment-management fees and HMC operating expenses) exceeded the 20.2 percent return calculated using market benchmarks for the assets in the "policy portfolio" (HMC's model for allocating assets among categories such as equities, bonds, real estate, and so on.) HMC also bested its benchmarks in fiscal 2010 (an 11.0 percent investment return versus 9.4 percent for the policy portfolio)—a welcome recovery from fiscal 2009, when HMC *trailed* its market benchmarks by 2.1 percentage points. In both 2010 and 2009, the University's portfolio fared less well than the median return of the Trust Universe Comparison Service, in part reflecting dissimilar asset allocations: TUCS funds are about half invested in public equities (versus one-third for HMC's policy portfolio), with only a few percent invested in real assets (typically almost one-quarter of HMC's allocation). Out-performing that metric for fiscal 2011 gives HMC at least public bragging rights:

Two overall observations: First, market returns were strong across the board during fiscal 2011. Second, for HMC, *all* asset classes produced positive returns—reflecting gains on real-estate assets, following punishing losses on commercial properties after the 2008-2009 financial crises.

In her letter, Mendillo highlighted the performance of certain segments. Investments in *domestic equities* yielded a 34.6 percent return—comfortably above market

indexes—but both *developed-market international equities* and *emerging-market equities* trailed their benchmarks, pulling down public-equity performance overall. (Each of these classes is assigned an 11 to 12 percent weight in the policy portfolio, summing to about one-third of typical endowment holdings.)

Private-equity investments now account for another 12 percent of the policy portfolio, and produced a 26.2 percent return, also behind the benchmark. Long term, HMC

Harvard Management Company 2011 Investment Performance

Asset Class	HMC Return	Benchmark Return	Difference
Public equities	28.3%	30.4%	(2.1)%
Private equity	26.2	28.7	(2.5)
Absolute return*	11.6	11.3	0.3
Real assets**	17.7	15.9	1.8
Fixed income	9.1	6.9	2.2
Total endowment	21.4	20.2	1.2

*Includes high-yield bonds

**Includes real estate, commodities, and natural resources

has done very well in this asset class, but Mendillo last year signaled a more restrained view, given both increased competition in the market and the inherent liquidity risks; accordingly, the policy-portfolio weighting for private equity has been trimmed (see below).

Returns on the "*absolute return*" category, 16 percent of the policy portfolio (consisting of both *high-yield fixed-income investments* and *hedge funds*) were 11.6 percent, fractionally above benchmark results.

Real assets (23 percent of the policy portfolio, consisting of *real estate* and *natural resources*, such as timber and agricultural land—each about 9 percent of the endowment assets—plus publicly traded *commodities*) produced positive returns of 17.7 percent, 1.8 points better than the benchmark, with gains in each segment.

Fixed-income returns (11 percent of policy-portfolio assets, *excluding* high-yield



Jane L. Mendillo

STEPHANIE MITCHELL/HARVARD NEWS OFFICE

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bonds, as noted) were led by results in the foreign-bond segment (up 21.7 percent).

IN CATEGORIZING THE YEAR, Mendillo cited HMC's confidence "that our portfolio...is well positioned to support Harvard's mission." That confidence follows changes in strategy, investments, and coordinated financial management with the administration that, as she wrote last year, "more closely aligned HMC with the University"—following the frightening period in late 2008 and early 2009 when long-term investments were out of sync with Harvard's urgent need for liquid resources.

"The much improved flexibility of the portfolio we are managing" that Mendillo cited last year shows up in symbolically significant tweaking of the policy portfolio. For fiscal 2012, it *increases* commitments to equities by 2 percentage points (to 48 percent of the assets), but does so with higher goals for public investments and a one-point *reduction* in private equities. The goals for absolute return, real assets, and fixed-income investments remain unchanged.

Meanwhile, the protective policy allocation to *cash* (2 percent in fiscal years 2009 and 2010, after HMC had for years boosted returns by *borrowing* up to 5 percent of its total holdings to invest more) has been eliminated. As Mendillo explained, "We've

made a lot of progress in risk management and...improved the liquidity of the portfolio enough" so that the specific cash allocation is no longer needed.

One sign of the portfolio's repositioning is that obligations to provide future funding to real-estate and private-equity investment managers (so-called capital commitments have been reduced further, to about \$5 billion (down from \$11 billion at the end of fiscal 2008). That level of future obligations to investors in illiquid asset classes (which also include the internally managed natural-resources holdings) appears to be comfortable as the asset managers put funds to work in the future. Mendillo noted, "We're about where we want them to be for the size of our portfolio."

Operationally, Mendillo highlighted some new skills on her staff: an in-house trader of Chinese equities; an in-house commodities-trading team; and a credit-markets group that pursues opportunities in publicly traded corporate debt (HMC has heretofore focused on U.S. Treasury and foreign govern-

Harvard Management Company Weight in Policy Portfolio

Asset Class	Fiscal Years 2010-2011	Fiscal Year 2012
Public equities	33%	36%
Private equity	13	12
Absolute return*	18	18
Real assets**	23	23
Fixed income	11	11
Cash	2	0
Total endowment	100	100

*Includes high-yield bonds

**Includes real estate, commodities, and natural resources

ment securities).

Consistent with the direction since she took charge in mid 2008, HMC continues to bring fund management in-house, citing gains in performance where it

can build expert teams (as in the natural-resources portfolio); better control over assets and knowledge of market conditions; and lower operating expenses. From a 70-30 external-internal mix of assets under management when she arrived, the proportion has shifted to perhaps 65-35 today.

DESPITE THE STRONG recent results, Mendillo took unusual pains to point out how very unpromising the external environment turned in the months following the end of the reporting period. During the July-September quarter, various stock-market indexes declined from 14 to 24 percent. Lower economic growth means also lessened demand for commercial office space, lower commodity prices, and so on.

Accordingly, Mendillo noted—specifically in her language about the portfolio's favorable long-term position relative to Harvard's needs—that it was "impacted by adverse markets." She amplified the warning in her concluding paragraphs, citing "exceptionally volatile" markets, "driven by concern and uncertainty related to the debt ceiling debate, the fate of the euro zone, the S&P [Standard & Poor's ratings service] downgrade of the U.S. Treasury securities, and indications of slowing growth in economies at home and abroad."

As she stressed in conversation, "I wanted to signal that these are volatile times with significant downward moves in the markets." Of the endowment's value overall, she noted, "We're not back to where we were"—making it imperative that everyone understand the external and University fiscal realities. Thus, the administration will likely practice continued budget discipline—as it pursues a large, endowment-bolstering capital campaign.



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