HARVARD MANAGEMENT COMPANY

Message from the CEO

OCTOBER 2020

Dear Members of the Harvard Community,

For the most recent fiscal year ended June 30, 2020, the return on the Harvard endowment was 7.3% and the value stood at $41.9 billion. The endowment also distributed $2 billion toward the University's operating budget, supporting financial aid, research funds, faculty chairs, and more.

Performance

Asset Class	Allocation	Return
Public Equity	18.9%	12.2%
Private Equity	23.0%	11.6%
Hedge Funds	36.4%	7.9%
Real Estate	7.1%	-0.5%
Natural Resources	2.6%	-6.2%
Bonds/TIPS	5.1%	8.2%
Other Real Assets	1.3%	-17.5%
Cash & Other	5.6%	---
Endowment	**100%**	**7.3%**

Fiscal year 2020 (FY20) was another year in which asset allocation (or risk level) played a major role in returns. Those who took the highest risks, generally speaking, garnered higher returns. Like FY19, it was also a year in which HMC's manager performance served to overcome its lower allocation to certain higher risk assets.

Having completed three full fiscal years of our transition of HMC's organization and portfolio, I am proud of the progress our team has made. To date, we have focused on a number of important efforts, most notably: significant restructuring of the organization, implementing our investment approach across the portfolio, rebuilding the public market side of the portfolio, building on the historically successful parts of the illiquid portfolio, and also dealing with significant illiquid portfolio issues. Additionally, we are in active conversations with the University regarding its risk tolerance to ensure that future investment decisions balance the need for endowment growth with the need for stable endowment revenue.

Portfolio Progress

In public markets, we have progressed more quickly than expected and have already begun running the long-term performance marathon over the last three fiscal years, despite still being in the restructuring period. By contrast, for illiquid markets, the situation is more complex. As previously mentioned, we are building upon a historically strong private equity portfolio, reducing other illiquid exposure, while also removing certain illiquid anchors. Not surprisingly, these changes take much longer and we will use the remaining two fiscal years of the restructuring period to work our way to the starting line.

Public Market Benchmark Relative Performance

In last year's report, I noted that our annualized benchmark outperformance in the public markets portion of the portfolio (public equities and hedge funds, in aggregate), during the two-year period of FY18 and FY19, was in excess of 2.25% annualized. We considered this to be very good, albeit not excellent. More importantly, it represented a positive step for HMC. It is worth noting again that we do not fixate on benchmarks, but they serve a unique role in this circumstance for a few reasons:

- Investments in public markets are ones on which we can have the most immediate performance impact over the three fiscal years of the HMC transition.
- Public investments represent more than half of the endowment portfolio.
- All relevant private market benchmarks are not yet available.

At the end of FY20, HMC's three-year public portfolio annualized outperformance now stands at 4.4%, reflecting excellent performance for that period. This represents another positive step forward for HMC and a strong affirmation of our early progress in effecting the turnaround. Furthermore, this strong manager performance has been critical in helping to offset HMC's lower exposure to venture capital, a high-risk/high-reward investment strategy.

Reducing Illiquid Portfolio Anchors

Last year's report also discussed the many illiquid portfolio anchors weighing down the overall portfolio and its performance. These legacy assets do not have a prospect of generating a return commensurate with the risk and illiquidity they entail and, in some cases, may not provide a return at all. As is evident from the performance chart above, outlining the performance of certain parts of the illiquid portfolio, these assets weighed materially on performance again this past fiscal year. However, the very positive news is that through sales and necessary write-downs we are working our way through these assets and are very pleased that they now represent a considerably smaller percentage of the portfolio — now just in the lower single digits. Our goal is to eventually remove them entirely from the portfolio, as opportunities present themselves, and we believe there is a chance of doing so over the next two fiscal years.

Risk Tolerance

Determining risk tolerance is the fundamental and critical question, yet to be answered. Our goal clearly is to maximize returns at the risk level determined by the University. Close followers of these letters will note that HMC's returns would have been materially higher in FY18, FY19, and FY20 with a higher risk level — in particular, with a higher venture capital allocation — consistent with that of some of our peers. Simply put, it is a tradeoff between higher returns and more long-term growth in the endowment versus having a less volatile University budget. This remains a critical and complex collaboration with the University, one that is well under way and will guide future portfolio construction.

Organizational Progress

Natural Resources (Agricultural) Joint Venture

As we recently announced, HMC spun-out its natural resources team into an independent firm, Solum Partners. We simultaneously sold roughly a 50% interest in a collection of agricultural assets to a third-party investor. Solum will manage this portfolio with both HMC and the third party serving as limited partners. The talented team of asset managers that have formed this new firm will also continue to manage — and ultimately liquidate — certain other HMC natural resource assets.

THERE WERE THREE MOTIVATIONS FOR THESE TRANSACTIONS:

- Continue to right-size our exposure to natural resources
- Retain and even build exposure to specific types of assets and platforms with the appropriate level of risk/return/liquidity for an endowment
- Ensure continued expert management of our natural resources portfolio

Because of the complexity of the assets and the jurisdictions involved, completing this transaction took over two years. We look forward to our continued partnership with the talented team at Solum.

Harvard Management Trusts and Gifts

Historically, the Trusts & Gifts (T&G) group at HMC has worked closely with the University's Planned Giving Program (estates, trusts, non-cash assets, annuities, and donor advised funds) to process, administer, and steward planned gifts and associated donors. We are proud of the T&G team's efforts and accomplishments, but after careful consideration, and in consultation with the University's leadership, we have determined that the structure of T&G needs to evolve in order to best serve and help grow the University's vast planned giving program. To this end, we have decided to outsource the gift administration, tax reporting, and some investment functions to a third-party vendor that will have many more resources and a broader platform with which to serve Harvard's donors. Donors will continue to have the option of investing their remainder trusts in Harvard's endowment.

Throughout and following the transition, HMC and the University will continue to consider the donors' and beneficiaries' interests as a key guiding principle in decision making, and HMC will remain a close advisor on investment strategy. At the same time, both Harvard and HMC also believe that Harvard's donors will be best served if the donor relations and legal structuring teams within T&G are more closely integrated with their counterparts at the University. The transition, both to a third-party vendor and to the University, will be jointly managed by HMC and Harvard over the next 12 months before fully migrating oversight of both efforts to the University. We believe that these changes will present new opportunities to strengthen and expand the planned giving program.

New Strategic Initiatives

Net-Zero Pledge

This past spring, Harvard University made a commitment for its endowment to be net-zero of greenhouse gas (GHG) emissions by 2050. HMC is mindful that we do not make this pledge in isolation. Achieving this goal requires governments to uphold their commitments to the Paris Agreement, the further development of GHG-reducing technologies, and the cooperation of others in the investment management industry. That said, we are not waiting for others to do their part in order to start to prepare ourselves. This decades-long commitment is in its infancy, but HMC has already begun work developing methodologies to assess our portfolio and measure our progress over the course of this significant endeavor.

Diversity and Inclusion

The topics of diversity and inclusion received significant attention this past year and will hopefully remain an issue of industry-wide focus moving forward. While the gender and racial diversity of our external managers is one that HMC has sought to improve in recent years, it is my strong view that diversity and inclusion efforts begin with our own team. We cannot expect more from our managers than we are willing to ask of ourselves. Currently, 55% of HMC's senior staff members, including myself, are either ethnic and racial minorities or women. All high-performing organizations must draw talent from the broadest possible pool and the diversity of our staff is one way to ensure that we meet that standard.

Along with our Board of Directors and members of the Harvard Corporation, we are exploring ways that we can institutionalize these initiatives to ensure that we continue to improve in the years to come.

In Closing

After three full fiscal years of hard work, we are beginning to see the benefits of the ongoing transition. The entire team is committed to maximizing the two remaining fiscal years to position both the organization and the endowment for long-term success. To be sure, there is much left for us to accomplish, but the early signs are encouraging and we remain confident in the direction we are headed.

Best regards,

N.P. "Narv" Narvekar
Chief Executive Officer