HARVARD MANAGEMENT COMPANY

Message from the CEO

OCTOBER 2022

Dear Members of the Harvard Community,

For the most recent fiscal year, which ended on June 30, 2022, the return on the Harvard endowment was -1.8% and the value stood at $50.9 billion. The endowment also distributed more than $2.1 billion toward the University's operating budget, which continues to represent more than one-third of annual operating revenue.

The disparity between fiscal year 2021 (FY21) and fiscal year 2022 (FY22) returns was stark and reinforces the necessity of focusing on long-term, risk adjusted returns. Among the headwinds we faced this past year, several market factors weighed negatively on performance.

- By far the most significant impact was the poor performance of global equity markets over the course of the year. The S&P 500, Nasdaq Composite, Nasdaq Small Cap, and the ACWI—benchmarks for domestic and global equities—declined by 11%, 23%, 27% and 16%, respectively.

In addition, two other less significant factors weighed upon performance:

- While our benchmark relative performance with respect to public equities, hedge funds, and private equities had been unusually strong over the past four fiscal years, FY22 was not a strong benchmark relative year. Notably, however, HMC's five-year benchmark relative performance—a far more important metric—remains very strong and reinforces the effective turnaround HMC has made.
- A number of institutional investors leaned into the conventional energy sector, through either equities or commodity futures, adding materially to their total return. HMC did not participate in these returns given the University's commitment to tackling the impacts of climate change, supporting sustainable solutions, and achieving our stated net zero goals.

Notably, the highest risk asset classes—i.e., the private portfolios of venture capital, buyout, and real estate—were the strongest performers. In fact, the more private assets an investor had in its portfolio in FY22, the stronger their performance. This is somewhat counterintuitive and may indicate that private managers have not yet marked their portfolios to reflect general market conditions. This phenomenon does make us cautious about forward-looking returns in private portfolios.

For example, the venture capital portion of HMC's private equity portfolio returned high single digits despite the deeply negative performance of relevant public equity indices. On the other hand, some venture managers have meaningful exposure to public companies, which declined with public markets. Accordingly, the performance of venture portfolios during FY22 was largely a function of the proportion of public companies held in those portfolios.

We expect that the end of the current calendar year might present meaningful adjustments to these valuations, as investment managers audit their portfolios. Under existing accounting conventions for venture portfolios, investment managers generally use the most recent round of financing to mark investments. This convention may slow the process of moving existing valuations to fair value. This circumstance is not unique to Harvard—other institutional investors with large private portfolios will almost certainly face the same dynamic.

Given this environment, we are particularly pleased that we were able to sell close to $1 billion of private equity funds in the secondary market during the summer of 2021—a time of significant ebullience—avoiding the discounts these funds would likely face today.

Harvard's Risk Tolerance

Harvard engaged in a years-long analysis of its risk tolerance to balance the desire for continued growth in the endowment with the University's steady reliance on annual distributions. In November 2021, the Corporation approved a proposal of the Harvard Finance Committee and the HMC Board to moderately increase the risk level of the portfolio. Noting how expensive the overall market was at the time, HMC decided to increase the portfolio risk level slowly over a multi-year period to avoid investing heavily at prevailing valuations. This increase will eventually make our risk level more consistent with that of various peers, although it will still be lower than some.

Net Zero Efforts

HMC is proud to be deeply engaged in the issue of sustainability. We are particularly excited about two efforts. First, HMC became the first U.S. endowment to make its own operations carbon neutral for FY22. Working with a third-party vendor, we measured our greenhouse gas emissions, sought opportunities to reduce future emissions, and secured offsets through carbon dioxide removal (CDR). Our goal continues to be mitigation of emissions wherever possible. For the emissions we cannot abate, our guiding principles for CDR are durability, additionality, quality carbon accounting and monitoring, and they may not result in harm to surrounding ecosystems and communities. Second, HMC has been an active investor in technology-driven climate transition investments. A more detailed report on our efforts for these important initiatives will be available in the 2023 Climate Report.

Diversity, Equity & Inclusion

For many years, HMC has worked to address the lack of gender and racial diversity in the financial industry—among our team, our universe of external managers, and portfolio investments.

We last reported on the diversity of our external managers in 2020. Since then, the percentage of diverse, active U.S.-based managers has grown. While we are pleased with our efforts to date, there is certainly more work to be done. HMC continues to actively seek out opportunities to invest with diverse managers and to maintain a staff that reflects those same principles.

In Closing

The disparity in performance between FY21 and FY22 serves to highlight both the value of the endowment to Harvard University during times of economic adversity, as well as the need to focus on long-term returns. We remain confident that the steps we have taken—and those still in process—to construct a portfolio that serves the University's long-term interests will allow Harvard to maintain and increase its critical support of students, faculty, and research for generations to come.

Best regards,

N.P. "Narv" Narvekar
Chief Executive Officer