Harvard Management Company

Message from the Chief Executive Officer

For the most recent fiscal year, which ended on June 30, 2023, the return on the Harvard endowment was 2.9% and the value stood at $50.7 billion. The endowment also made available more than $2.2 billion for the University's operating budget, supporting financial aid, faculty, research initiatives, and more.

PERFORMANCE

Fiscal year 2023 (FY23) was a year of generally muted returns for asset classes outside of public equities. While public markets were flat or negative during the first half of FY23, the dramatic equity rally during the second half of FY23 (i.e., the first six months of calendar year 2023) changed the picture meaningfully.

Index	FY22 Total Return	2022 July to December Return	2023 January to June Return	FY23 Total Return
ACWI	-15.8%	**2.3%**	**13.9%**	16.5%
S&P 500	-10.6%	**2.3%**	**16.9%**	19.6%
NASDAQ	-23.4%	**-4.7%**	**32.3%**	26.1%

As noted in the asset allocation chart below, Harvard Management Company (HMC) has limited long-only public equity exposure (11%) and, accordingly, the endowment's FY23 return does not reflect a significant impact from public equity movements. However, this portfolio construction also helps brace against significant swings in either direction, as it did last year when the FY22 return (-1.8%) was not meaningfully impacted by an overall double-digit public equity decline.

Asset Class	Allocation
Public Equity	11%
Private Equity	39%
Hedge Funds	31%
Real Estate	5%
Natural Resources	1%
Bonds/TIPS	6%
Other Real Assets	2%
Cash and Other	5%
ENDOWMENT	**100%**

Strong public equity returns are often outpaced by private equity and venture capital. However, the returns for these asset classes proved to be only slightly positive in private equity and mildly negative in venture capital/growth. While this outcome may seem counterintuitive, we anticipated a correction in those funds' performance in last year's annual letter, noting that their dramatic outperformance over public markets was likely due to a natural lag in how their assets are valued.

Put another way, in FY22 private managers did not reduce the value of their investments in a manner consistent with declining public equity markets. Accordingly, those private asset managers did not subsequently increase the value of their investments in the context of rising public equity markets in FY23. Given the continued slowdown in exits and financing rounds over the last year, it will likely take more time for private valuations to fully reflect current market conditions.

REFLECTIONS ON SIX FISCAL YEARS AT HMC

In FY21, HMC reported on the completion of our five-year restructuring of both the organization and the endowment portfolio one year ahead of schedule. We noted at the time that the swift, broad restructuring of HMC's operations and investment model allowed us to focus substantially all our time on the portfolio turnaround, which is now largely complete. We are fortunate to have maintained a 9.2% annualized return during that span.

There are three main components to endowment performance: risk level, asset allocation, and manager selection. We are particularly gratified by the second and third components outlined immediately below.

HMC's manager selection alpha is one of our proudest achievements. Over the course of the last six fiscal years, the alpha generated by HMC's manager selection has been very strong, greater than we would have anticipated. Although we are confident that HMC will continue to do very well, it is hard to imagine that the next six years of alpha production can be as strong as the previous six years.

Our approach to overall asset allocation is based on portfolio risk level. Accordingly, and as discussed in greater detail below, Harvard engaged in a deliberate process to analyze its risk tolerance. However, even before changing risk levels, HMC worked to optimize its asset allocation within the University's existing risk constraints. We moved swiftly in a risk-neutral manner to pivot from private real estate and agriculture/timber to private equities early during this period. We also built a portfolio of liquid uncorrelated funds within our overall hedge fund allocation. These decisions proved to be successful. Within the asset classes, we also diversified into biotech (both public and private markets) and significantly added to tech venture.

Looking back over many years, a main constraint on Harvard's endowment returns has been that the portfolio was structured to take less risk than what was likely prudent. The question of the amount of risk to take is not a simple one, as it must weigh, for example, budget stability against long-term growth in the endowment. HMC built an analytical risk framework and partnered closely with the University to help determine the University's risk tolerance. After several years of rigorous conversation and analysis, the University agreed to a measured increase in the portfolio's risk level, which HMC began implementing over the last two years.

While we are very pleased to have catalyzed this critical discussion and process, we note that we continue to operate, even after the risk increase, at a somewhat lower risk level than many peer endowments. Going forward, HMC will continue to work with the University to periodically review the appropriate long-term risk level and tolerance (similar to how many endowments periodically review their asset allocations with their investment committees and university constituents).

Ultimately, we believe that the measured increase in risk—carefully calibrated to ensure long-term endowment stability—and the improved asset allocation (versus when we started, six years ago) will continue to generate strong returns even if the manager selection alpha attenuates.

I would also like to highlight that HMC has started investing in innovation related to mitigating greenhouse gas emissions. While we have been early in investing in this area over the last few years, we believe that a decade from now it will be accretive to endowment performance. Innovation to reduce carbon emissions will be rewarded, as it is one of the most obvious needs in society today.

In addition to organizational structure and portfolio shifts, there were two other specific initiatives that we are proud to have incorporated into our operations: addressing gender and racial diversity in the financial industry and expanding our sustainable investing practices to meet the University's pledge to have the endowment net zero of greenhouse gas emissions by 2050.

HMC's focus on diversity looks at our own team, the leadership of our asset managers, and the companies in which those managers choose to invest. We aim to seek talent from the broadest possible pool of candidates and managers. In addition to actively seeking out more diverse managers for investment consideration, we collect data, where available, on the diversity of the managers' leadership, staff, and portfolio investments. The financial industry has a long way to go on this front, but we hope these steps can play a small role in addressing this challenge.

Nearly a decade ago, Harvard became the first U.S. higher education endowment to sign onto the U.N.-supported Principles for Responsible Investment. Along with that commitment, HMC formalized its Sustainable Investing Policy to ensure that we considered all environmental, social, and governance factors that could impact the value of our investments. More recently, Harvard became the first U.S. university to commit to making its endowment portfolio net zero of greenhouse gases by 2050 — in line with the timeline of the Paris Agreement. In addition to the groundbreaking work that entails, our own operations were net zero of carbon emissions for the second consecutive year. Doing so has not only allowed us to hold ourselves to the same standards we are asking of others, but also is in line with Harvard University's climate commitments. Our annual Climate Report will go into greater detail on the variety of efforts associated with our sustainable investing initiatives and progress toward the net zero pledge.

I am proud of our team's ability to adapt to this new structure and to proactively engage with new challenges. And we have done so while always keeping Harvard's mission front of mind, ensuring that the University has the financial resources to achieve academic excellence, expand opportunities for students and faculty, and foster diverse educational experiences. I am excited to see what we will accomplish together in the years ahead.

Best Regards,

N.P. "Narv" Narvekar
CHIEF EXECUTIVE OFFICER

September 2023