Harvard Management Company

Message from the Chief Executive Officer

Harvard's endowment generated a 9.6% return for fiscal year 2024 (FY24) and the value stood at $53.2 billion. The endowment distributed $2.4 billion toward the University's operating budget supporting financial aid, faculty, research initiatives, and more.

PERFORMANCE

The endowment delivered strong performance in FY24. The target return for Harvard's endowed funds is 8%, which accounts for roughly a 5% distribution and 3% growth to maintain purchasing power over time. The annualized return of 9.3% over the past seven years—which encompasses the full fiscal years since I joined Harvard Management Company (HMC)—has more than kept pace with that target.

While it is common practice—and seemingly straightforward—to compare endowment performance among peer institutions, such comparisons ignore the nuance of each institution's investment goals. Endowment portfolios are constructed to reflect the specific needs and risk tolerances of their respective institutions. Accordingly, portfolios may be more, or less, aggressive, and therefore benefit more, or less, from a particular market environment. With the University's reliance on endowment distributions to fund a substantial portion of its operations—over one-third when I arrived and now approaching 40%—the endowment's orientation toward strong investment returns has been tempered by the imperative for budgetary stability. We believe that has resulted in a lower tolerance for risk than many of our largest private university peers, which can cause lags in ebullient environments, but also provide protection during downturns.

The endowment performance of any institution must be understood in this context. In fact, the portfolio's performance is based on three sets of factors: portfolio risk level, asset allocation, and manager selection.

Portfolio risk

During my early days at HMC, we initiated a deep review of the University's risk tolerance to better inform both HMC and the University of the various financial considerations at play. In 2021, following thoughtful, rigorous analysis, a moderate increase in portfolio risk was approved. As discussed above, we believe the endowment's portfolio risk is still lower than that of many private university peers. Nevertheless, the moderate increase has bolstered returns and conversations with the University remain active to determine if future increases to risk tolerance are warranted.

Asset allocation

The University's tolerance for risk informs HMC's portfolio risk level and therefore HMC's asset allocation decisions, one of the most significant factors in the portfolio's long-term returns.

HMC's asset allocation has featured three interrelated portfolio moves over the last seven years. First, we reduced the exposure to real estate and natural resources from 25% of the endowment portfolio in FY18 to 6% today. This strategic reduction has had a positive and compounding impact on the University's endowment returns. It has also created room for the second major portfolio shift, which is our significant increase in private equities. Public equity returns are often outpaced by private equity—both buyouts and venture capital. However, in FY24, for the second year in a row, private equity returns lagged those of public equity markets. Readers will recall that in FY22, private managers did not reduce the value of their investments in a manner consistent with declining public equity markets at the time. As presaged in that year's letter, those private asset managers did not subsequently increase the value of their investments in the context of rising public equity markets in fiscal years 2023 and 2024. Finally, we increased the size

of the hedge fund portfolio as a means of limiting equity exposure (public and private, collectively) and, therefore, limiting portfolio risk.

Asset Class	Allocation
Public equities	14%
Hedge funds	32%
Private equity	39%
Real estate	5%
Bonds/TIPs	5%
Other real assets*	3%
Cash	3%
ENDOWMENT**	**100%**

** Natural Resources, now under 1% of allocation, is included among Other Real Assets.*
*** Rounding results in a total percentage greater than 100%.*

Manager selection

A significant positive factor in our returns has been HMC's strong manager selection. In FY24, HMC's public equity and hedge fund portfolios stood out for their strong performance. This is a particularly positive indicator, since HMC's hedge fund portfolio has less equity exposure than most hedge fund indices, yet still outperformed during a strong year for equities. Overall, significant alpha production over relevant benchmarks—a reflection of HMC's strength in its process of selecting managers—has reduced the drawbacks of a comparatively under-equitized and lower-risk portfolio.

IN CLOSING

The endowment's performance in FY24 was encouraging, less for its one-year return than for the trend it continues to reflect. The work HMC has undertaken to reposition the endowment for long-term success is clearly visible and the risk-adjusted returns to date show we are on the right track. This wouldn't be possible without a remarkable team, and I extend my gratitude to each and every member of HMC for their contributions, individually and collectively, to our progress.

I also thank the University's exceptional financial team, with whom we continue to work very closely. Ultimately, I extend my gratitude to the members of HMC's board. We benefit tremendously from their dedicated service and insightful leadership. At the close of this past fiscal year, we welcomed Tim Barakett '87, MBA '93, who had joined the board in 2022, as Chair of the HMC Board of Directors. Paul Finnegan '75, MBA '82, who joined the board in 2014 and had chaired the board for nine years, has been an invaluable contributor to HMC's successful turnaround and we are fortunate for his continued service on the board. Additionally, Michael Chae '90 joined as a director this past spring, bringing decades of asset management and investment expertise to the HMC board.

Twenty years ago, Harvard's endowment distributions accounted for 21% of the University's budget. Ten years later, it had grown to 31%. Now, it is approaching 40%. The ever-increasing reliance on this critical resource makes our work all the more important. We are motivated by the fact that our efforts directly support an institution that serves as a global leader in teaching, learning, research, and the groundbreaking advancements its community makes each day.

Best Regards,

N.P. "Narv" Narvekar
CHIEF EXECUTIVE OFFICER

October 2024