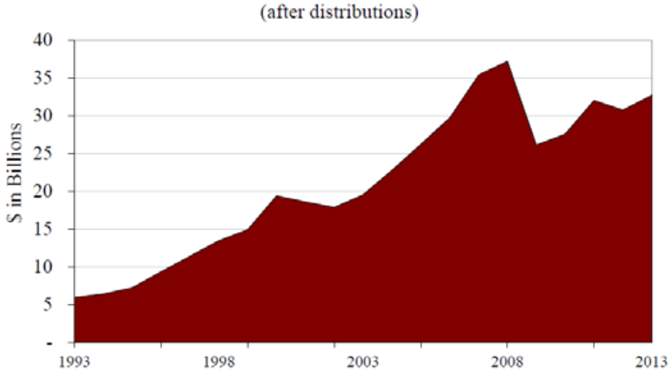
September 2013
Harvard Management Company Endowment Report
Message from the CEO

Introduction

For the fiscal year ended June 30, 2013 the return on the Harvard endowment was 11.3% and the endowment was valued at $32.7 billion. The return exceeded our benchmark by a healthy 223 basis points. As I mark my fifth anniversary as the chief executive of the Harvard Management Company, I am very proud of the internal and external managers we have in place and the results they have achieved. Thanks to this talented team we have made a strong recovery since the global economic downturn of 2008-2009, and our outperformance this year alone contributed about $600 million of additional value to the portfolio over and above the markets, net of all fees.

This also marks the fourth consecutive year in which HMC's return exceeded the Policy Portfolio benchmark. As we have noted previously, earning returns in excess of the markets as represented in the Policy Portfolio is not easily done and is not expected every year.

Total Value of the Endowment
(after distributions)



Over the last three years the average annual return on the Harvard endowment has been 10.5%, compared with the average annual return on the Policy Portfolio of 9.1%.

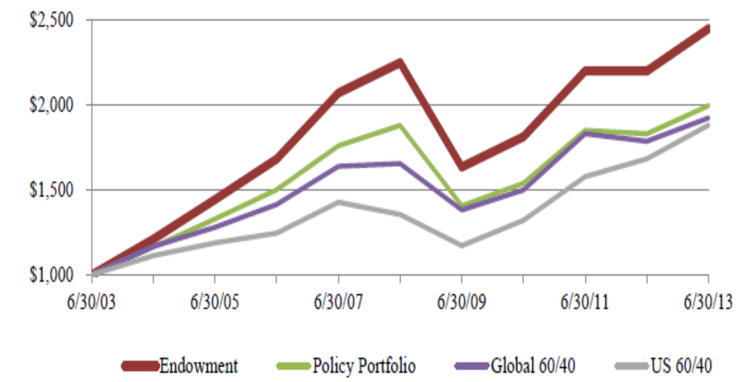
Investment Return
(Annualized for Periods Greater than One Year)

	HMC	Benchmark	Relative
1 year	11.3%	9.1%	2.2%
3 years	10.5%	9.1%	1.4%
10 years	9.4%	7.2%	2.2%
20 years	12.0%	9.1%	2.9%

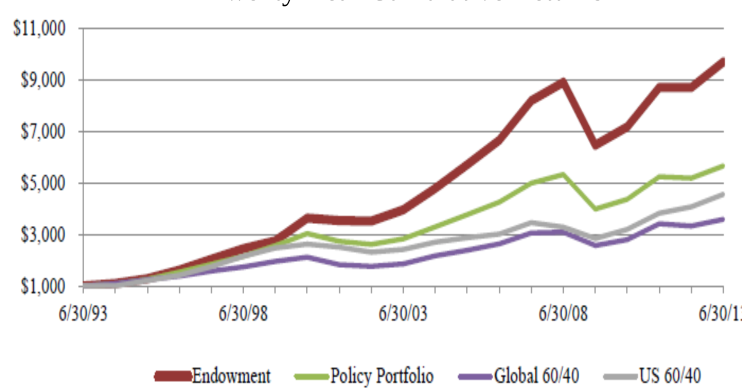
Longer term, the Harvard endowment under HMC's management has returned 9.4% over the last ten years and 12.0% over the last twenty years.

Growth of $1,000 Invested in Endowment vs. Policy Portfolio and 60/40 Portfolios

Ten Year Cumulative Returns



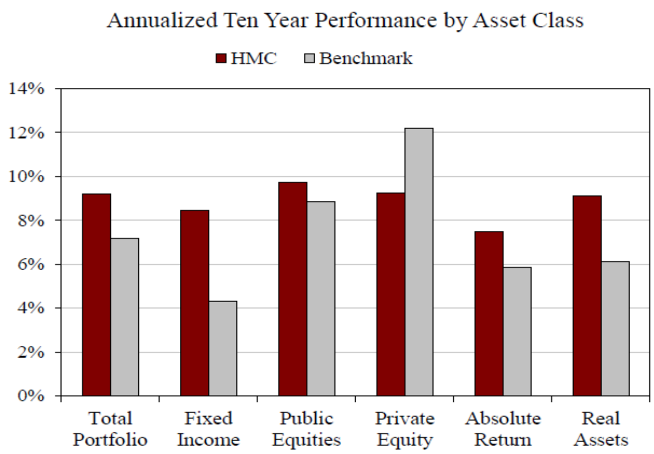
Twenty Year Cumulative Returns

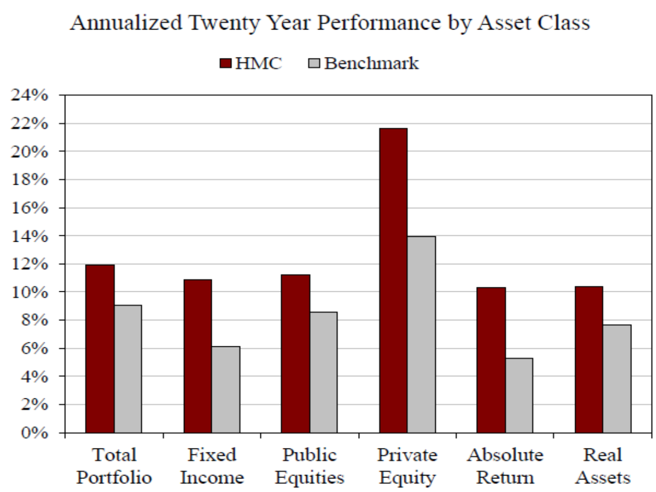


We continue to manage the Harvard endowment with three primary objectives: growth, sufficient liquidity and appropriate risk management. The aspirations of Harvard University, as well as the ongoing challenges presented by the markets, require that we be constantly attentive to all three. The entire team at HMC is attuned to these goals and aligned with our mission: to achieve strong, sustainable long-term investment returns in support of the outstanding institution that is Harvard.

Historical Context

HMC's sole focus for its nearly 40 year history has been the investment and stewardship of the endowment – the University's largest financial asset. The perpetual nature of the University creates an unusually long-term horizon for us as investors of the endowment portfolio. This perspective has encouraged us to be innovative as investment managers – from our early investments in venture capital and private equity in the 1970s and 1980s, to the development of our expertise in timberland and natural resources in the 1990s and 2000s, to our focused strategies in absolute return and public markets during the most recent decade.





As we maintain our focus on the long term, we are constantly aware that financial markets and investors are always evolving: correlations may change over time, previously inefficient markets may get crowded and less attractive, new areas for opportunity may develop.

In the five years since my return to HMC we have continued to evolve the Policy Portfolio. These changes in our Policy Portfolio allocations reflect our growth, liquidity and risk management objectives while allowing us to continue to maintain a high degree of diversification. Specifically, since 2008 we have: added to our Policy Portfolio allocation in equities (increasing growth potential), removed our negative allocation to cash (increasing liquidity), and reduced our allocation to fixed income following a 20 year bull market (managing risk). We have also replaced a portion of our publicly-traded commodities with more stable and attractive natural resources.

Purpose of the Policy Portfolio Benchmark

The Policy Portfolio is a theoretical target portfolio comprised of a mix of asset classes that is determined to be best equipped to meet Harvard's needs over time in terms of both potential return and risk. The Policy Portfolio provides HMC with a guide as to the actual allocation of the investment portfolio and also serves as a measuring stick against which we judge the success of our active management strategies. Each year the HMC Board and management team create the Policy Portfolio and review it for continued fit with the University's risk profile and our projections for expected returns in each asset class. Recent evolution of the Policy Portfolio is shown below:

Policy Portfolio	2008	2013
Domestic Equity	12%	11%
Foreign Equity	12	11
Emerging Markets	10	11
Private Equity	11	16
Total Equities	**45**	**49**
Absolute Return	**18**	**15**
Public Commodities	8	2
Natural Resources	9	13
Real Estate	9	10
Total Real Assets	**26**	**25**
Domestic Bonds	5	4
Foreign Bonds	3	2
Inflation-Indexed Bonds	7	3
Total Fixed Income	**15**	**9**
High-Yield	1	2
Cash	**-5**	**0**
TOTAL	**100%**	**100%**

Discussion of Fiscal Year 2013

During short-term periods, we expect to experience volatility in different regions and asset categories in our portfolio. Last year was a good example. The nominal returns on the broad markets in which we actively invest ranged from 20.6% for the S&P 500 to -8.0% for the Dow Jones Commodities Index. While any investor would welcome a circumstance in which all markets went up at the same time, we are diversified precisely because we know that is not likely to happen.

There was significant variation across regions in fiscal year 2013. US equities rebounded strongly as the US economy showed small but repeated signs of recovery and growth. Housing markets recovered from their lows, consumer confidence improved, and unemployment crept slowly but surely lower.

Outside of the US, markets responded positively in Europe and in developed foreign markets as the threat of a collapse of the European Union became less pronounced. However, emerging markets did not perform as well, on average gaining only 2% to 3% for the year. While the "risk-off" move by some market participants was quite acute toward the end of the fiscal year, we still believe strongly that emerging markets will be an important area for substantial growth. In fact, over the past two and half decades since emerging market indices first appeared, emerging markets equities have delivered an average annual return 400 basis points greater than the return on developed markets.

Fiscal 2013 Performance by Asset Class

	HMC	Benchmark	Relative
Public Equities	16.3%	14.5%	1.8%
Private Equity	11.0	10.6	0.4
Fixed Income	3.3	(3.4)	6.7
Absolute Return	13.2	6.8	6.4
Real Assets	7.0	7.2	(0.2)
Total Endowment	**11.3%**	**9.1%**	**2.2%**

We are pleased to note that our performance relative to the market was once again positive in most asset categories and in total. Multiple studies have shown that 80% of active asset managers underperform their markets, failing to add value for their investors over what would have been earned by a relevant index fund. The 223 basis points of excess return earned by HMC this year versus our Policy Portfolio puts our team in a small minority of successful active investment managers. In addition, HMC's nominal return of 11.3% puts us well ahead of the HFRI Fund of Funds Index (comprised of a large group of hedge fund managers), which returned 7.3% last year.

As in prior years, we would like to highlight a few areas within our portfolio for further discussion of our performance and management philosophy.

Public Equities

	HMC	Benchmark	Relative
Domestic Equity	26.6%	21.3%	5.3%
Foreign Equity	20.5	18.9	1.6
Emerging Markets	2.3	2.9	(0.6)
Total Public Equities	**16.3%**	**14.5%**	**1.8%**

Domestic Equity was a stand-out performer during the last fiscal year, on both a nominal and a relative basis. The US stock market continued a steep recovery as economic indicators improved. Our internal and external managers in domestic equity added value, on average, relative to the markets, some by a wide margin. Foreign equity also performed well, though not as well as US equity, driven by a somewhat improved outlook (or at least the perception that we have reached a bottom) for Japan and parts of Europe. Emerging markets underperformed expectations this fiscal year, with Brazil down 14%, India down 4% and China barely positive, up 1.8%. Notwithstanding, we remain convinced that over time emerging markets is an area that will deliver strong positive returns for a portfolio like ours that can withstand short-term volatility.

Private Equity

	HMC	Benchmark	Relative
Total Private Equity	**11.0%**	**10.6%**	**0.4%**

I would characterize our Private Equity performance this year as fair. Private Equity (which includes venture capital) returned 11.0% for the year, a strong nominal return, but well below the return on public market equity, and only slightly above our benchmark. When we invest in private equity, we lock up Harvard's money for multiple years. In exchange for that lock-up we expect to earn returns over time that are in excess of the public markets – an "illiquidity premium." Over the last ten years however, our private equity and public equity portfolios have delivered similar returns. While this asset class still presents unique opportunities for attractive returns, it has gotten much more crowded and there is less of an illiquidity premium. As a result, we are actively focused on honing our private equity strategy to maintain the highest concentration in the very best managers with the greatest potential to add value.

Fixed Income

	HMC	Benchmark	Relative
Domestic Bonds	2.7%	(1.6)%	4.3%
Foreign Bonds	2.3	(5.0)	7.3
Inflation-Indexed Bonds	1.9	(4.8)	6.7
Total Fixed Income	**3.3%**	**(3.4)%**	**6.7%**

For most of the year our portfolio was underweight relative to the Policy Portfolio in terms of its exposure to fixed income. This was a good thing, as fixed income returns were negative on a nominal basis. However, we had significant success in our internal fixed income active strategies during fiscal year 2013, leading to a very strong return relative to the fixed income markets for our portfolio. Internal fixed income trading has been a strength of HMC for many years. Our team's expertise in interest rates and relative value across global fixed income markets allows us to find mispriced opportunities in US and international bonds.

Absolute Return

	HMC	Benchmark	Relative
Total Absolute Return	**13.2%**	**6.8%**	**6.4%**

Our Absolute Return portfolio, comprised entirely of external managers, includes multi-strategy hedge funds, single strategy hedge funds, and some special situations. This portfolio is anchored by very strong and experienced managers who constantly improve their game to deliver above-industry returns. We have also added a collection of newer managers over the last several years with focused strategies in niche areas that are designed not to be correlated with public markets. Although the hedge fund world has become more crowded with both managers and investors, we are pleased with the current composition of this portfolio.

Real Assets

	HMC	Benchmark	Relative
Real Estate	10.6%	8.8%	1.8%
Natural Resources	5.1	7.6	(2.5)
Public Commodities	(4.1)	(3.0)	(1.1)
Total Real Assets	**7.0%**	**7.2%**	**(0.2)%**

We continue to favor well-chosen investments in Real Assets because of the long-term supply/demand imbalances in these markets, specialized expertise required to complete often-complicated deals, and the sometimes unique nature of the assets we can acquire. As an experienced investor in Real Assets we believe HMC can perform significantly better than the average investor over time. However, valuation changes and return realizations in these areas will be lumpy.

In Real Estate, our new investment strategy focused on direct deals performed exceptionally well, generating a return of 15.8%, while our legacy fund investments returned 5.3%. This speaks to the innovative yet disciplined nature of our new HMC real estate team, who have pursued and closed numerous promising property investments but also passed on deals that no longer fit our strategy.

Our Natural Resources portfolio returned 5.1% in the fiscal year, lagging its benchmark by 2.5%. However, we were pleased that this portfolio generated roughly $600 million of liquidity this past year, owing to sales of timberland properties at strong prices. Over the last ten years our Natural Resources portfolio has returned 12.2% per year, versus the market benchmark of 7.0%, demonstrating the continued potential of this investment area.

Organizational Update

HMC, like Harvard, prides itself on being a magnet for talent. We have added a number of promising new investment professionals to our team this past year, including a new Chief Risk Officer, Jake Xia. We now feel HMC is fully staffed on the investment front with highly experienced, high quality talent across the board.

We are also pleased to welcome Jameela Pedicini to the HMC team as our first Vice President of Sustainable Investing. As long-term investors we are acutely aware of the many factors that can impact the sustainability and growth of Harvard's endowment, including environmental, social and governance (ESG) considerations. As HMC's subject matter expert in this area, Jameela will work with HMC investment professionals and University officials to ensure that we are actively considering ESG issues while maintaining our singular focus on maximizing returns for the University.

Looking Ahead

The outlook for the world's economies and markets continues to be full of uncertainty. Questions abound about fiscal and monetary policy here and abroad, about how much "stimulus" is still needed, about the impact of new market regulations and participants, and about the prospects for economic growth across global markets in sometimes shaky political environments. There are many issues to be pondered and debated. However, looking beyond some of the shorter-term issues, which we are fortunate to be able to do, we are confident that there is plentiful opportunity for long-term investors like Harvard.

Harvard University has an immensely long and successful history in making a positive contribution to the world through higher education and research, and in recent years our role in supporting the University has become more meaningful. Our support is likely to become even more important in the coming years given the myriad challenges facing higher education. We at HMC come to work every day with one mission front of mind – achieving strong long-term investment returns that will enable this remarkable institution to continue to achieve its goals and maintain its excellence far into the future.

Sincerely,

Jane L. Mendillo
President and Chief Executive Officer