



## *Want to Invest Like Harvard?*

Harvard University has the world's largest endowment fund at \$33 billion in assets. Stands to reason that it would be run by some very bright people, utilizing the best consultants. Well all that brainpower has not helped the endowment fund performance over the 5 year period ending June 30, 2013. The endowment's annualized return over that period was 1.7%. That's right, 1.7%. A simple portfolio of 60% invested in S&P 500 stocks and 40% in corporate bonds would have returned more than 6% per year over the same time period.

### What Happened?

Harvard was one of the first endowments to invest in alternative investments. These include venture capital, private equity, timberland, and hedge funds. These investments typically have elevated expenses to pay for their special expertise. They can also be hard to value and are often not liquid. The theory is that the bright people running them will eventually justify their fees with above market returns. Over that last five years, that has simply not been the case.

As a result of substandard returns and the accompanying criticism, the current chief executive of the Harvard Management Company is stepping down. This is the fourth resignation in the last nine years. According to the Wall Street Journal, the current chief executive, Jane Mendillo, made about \$5 million in 2012. The paper suggests that she can make more in the private equity/hedge fund market, with far less criticism directed her way.

### The Portfolio Composition

According to the annual report of the Harvard Management Company in September 2013, the diverse assets of the portfolio are the culprit behind the recent underperformance. It has a benchmark of 11% of the portfolio in US stocks, 11% in foreign stocks, 11% in emerging market stocks, and 16% in private equity. This brings the total assets targeted to be in equities to 49%. For the past five years, foreign, emerging markets and pri-

vate equity have all underperformed US stocks.

Harvard allocates 15% of the portfolio to what they call absolute return. The majority of these assets are in hedge funds. As they state in the performance review for 2013, “The hedge fund world has become more crowded with managers and investors.” In other words, it’s becoming harder to generate good returns, given the high fee structure and lack of managers who can justify the elevated fees.

Total real assets comprised 25% of the fund benchmark. These include commodities, natural resources, and real estate. As noted in the performance report “valuation changes and return realization in these areas will be lumpy.” Over the past five years, they have likely been lumpy on the downside.

The final 11% is targeted to be in bonds. These include domestic, foreign, high yield, and inflation - indexed bonds.

### The Ivy Portfolio

Harvard trumpets the ten and twenty year return numbers in their report. At the height of the relative outperformance of this approach in early 2009, a book was published entitled The Ivy Portfolio. It discussed how individual investors could enjoy the same kinds of excellent returns using Exchange Traded Funds. How many individual investors restructured their portfolios at the wrong time?

It reminds us of a conversation we had with a friend in January 2000. He had recently moved all of his investments into technology oriented mutual funds. He said “you can’t fight this, it’s the wave of the future.”

Nothing is foolproof in investing. Whatever has done relatively well for a period of time is likely to underperform for a while. This phenomenon is called “regression to the mean.” That’s why individual investors so often struggle to build wealth. They are frequently chasing what’s worked well the past five years. Keep an approach that’s worked well over long periods of time, pay close attention to overall cost, rebalance at least annually, and diversify.