<u>Harvard CEO Says 8.1% Return Signals 'Deep Structural Problems'</u>

Harvard University's endowment reported an 8.1 percent annual investment gain, a lagging performance its new manager said was "a symptom of deep structural problems" that will take years to turn around.

N.P. "Narv" Narvekar, who took over as chief executive officer of Harvard Management Co. in December, said in a five- page letter published Tuesday that the problems "highlight the critical impact of culture, structure, and incentives in an investment organization."

The return for the fiscal year ended in June, the worst of almost 20 large endowments that have reported so far, illustrates the challenges Narvekar faces trying to turn around an organization that's churned through three CEOs in four years.

Harvard has trailed the performance of almost every Ivy League rival in the past decade. The fund lost 2 percent in its prior fiscal year, declining about $2 billion in value.

"Our performance is disappointing and not where it needs to be," Narvekar wrote. "Indeed, the opportunity to improve this is what attracted me to the leadership role of Harvard Management Company. The endowment's returns are a symptom of deep structural problems at HMC and the resultant significant issues in the portfolio."

In his first seven months, Narvekar wrote, he shifted responsibilities on the investing teams so that managers handled a variety of asset classes rather than take a "silo" approach.

Employees' compensation is now based on the performance of the entire portfolio, not the portion they happen to manage. He said he recruited new senior investment team members and created a new system for assessing the fund's risk.

Narvekar's letter echos the findings in an April 2015 internal report McKinsey & Co. prepared for Harvard Management, which found that employees were compensated using "easy-to-beat"

benchmarks. Top-paid managers had nevertheless been paid tens of millions of dollars in bonuses. Narvekar said in the letter that bonuses will now be paid over multiple years after a "five-year look back period."

The value of the world's biggest college fund rose 4 percent to $37.1 billion in the year ended June 30. Narvekar attributed its performance to gains in public equity, private and direct real estate investments.

College funds with more than $500 million had a median investment gain of 13.3 percent in the year through June 30, according to Wilshire Trust Universe Comparison Service. The S&P

500 Index returned 18 percent during that period. The Wilshire Bond Index returned 1.6 percent.

One of the best performances came from Grinnell College, a wealthy private school in Iowa, whose $1.8 billion endowment produced an 18.8 percent return. Dartmouth College, a member of the Ivy League, posted a gain of 14.6 percent in its $4.96 billion fund. Harvard and Dartmouth are the first two of the eight Ivies to release results.

Narvekar moved aggressively to restructure the organization after announcing in January a plan to cut the 230-person staff in half this year. Harvard shut down an internally managed equities team, spun out portfolio managers who do relative value trading and still plans to spin out a real estate team and credit trading portfolio, according to the letter.

The portfolio is also being overhauled, with more than $2 billion of private equity, venture capital and real estate funds unloaded in the secondary market, Bloomberg previously reported.

Harvard sought to also unload assets such as timberland in Uruguay and a dairy farm in New Zealand this year while writing down the natural resource portfolio, which was valued at $4 billion as of June 30, 2016.

“Narv and his team are making excellent progress in reorganizing HMC to ultimately improve investment performance,”

Paul Finnegan, chairman of the endowment’s board of directors, said in a statement. “The HMC board of directors is fully supportive of these efforts and the time required to reposition HMC so that it can perform up to our collective expectations.”

It’s going to take time, Narvekar warned several times in his letter.

“The HMC board of directors and I expect that it will take a number of years to reposition HMC in order to perform up to our expectations from that point forward,” Narvekar wrote.

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