October 2010

Harvard Management Company Endowment Report
Updated Message from the CEO

Introduction*

The year ended June 30, 2010 was a successful one for the Harvard endowment and for Harvard Management Company ("HMC"). We added value over our Policy Portfolio benchmark, strengthened our organization and more closely aligned HMC with the University. In comparison to one year ago, our portfolio and our organization are now significantly better positioned to continue to deliver strong long-term returns as well as actively manage our risks. It has been a productive year.

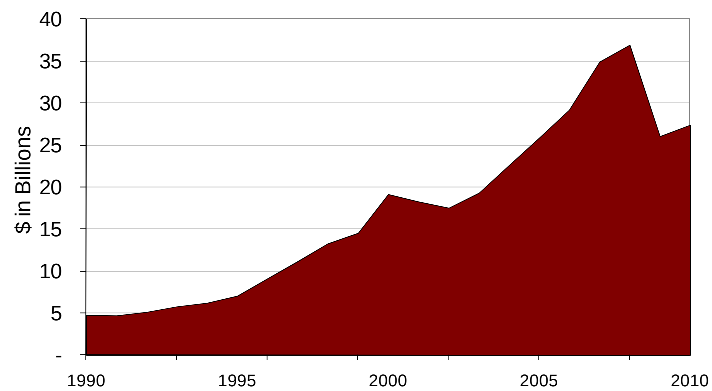
The endowment portfolio earned an investment return of 11.0% for the year and was valued at $27.6 billion as of June 30, 2010. The return for the year was 160 bps above the return that would have been earned by our Policy Portfolio benchmark.

In addition to HMC's financial results, we are pleased with the much improved flexibility of the portfolio we are managing today. We have attended closely over the last two years to liquidity, capital commitments and risk management, while pursuing innovative investment strategies, growing our base of talent and exploring cross-asset class opportunities.

Historical Context

Over the long term, HMC has produced excellent investment returns for the Harvard portfolio. The average annual return on the endowment over the last 20 years has been 11.9% per year. Over the more recent past, returns from the portfolio (and from the markets) have been more modest, averaging 7.0% over the last ten years and 4.7% over the last five years. This recent performance is weighed down substantially by the 2008-2009 global crisis, and it will take many years to recover these losses. However, as shown in the table, the returns earned by the Harvard endowment have been substantially better over 5, 10 and 20 years when compared with a simple 60/40 stock/bond portfolio or our Policy Portfolio. On average over the last ten years HMC has added 5.0% annually over and above the 60/40 portfolio, 3.3% over our Policy Portfolio and 3.6% over the TUCS median fund.

Total Value of the Endowment

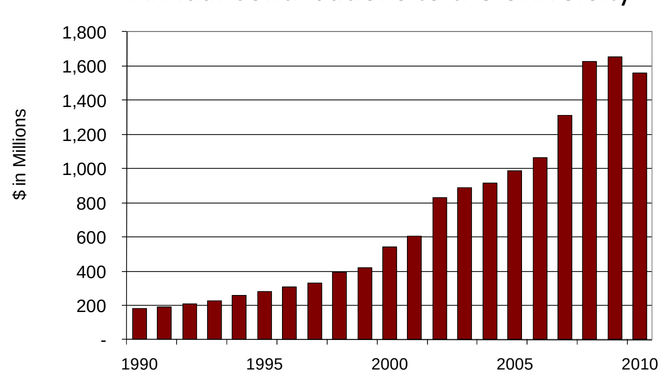


Historical Investment Return
Annualized for Periods Greater than One Year

	Harvard	Policy Portfolio Benchmark	60/40 Stock/Bond Portfolio *	TUCS Median **
1 year	11.0 %	9.4 %	12.6 %	13.3 %
5 years	4.7	3.0	2.1	3.1
10 years	7.0	3.7	2.0	3.4
20 years	11.9	9.3	7.8	8.2

* S&P 500 / CITI US BIG
** Trust Universe Comparison Service as compiled by Wilshire Associates

Annual Contributions to the University



* This updated report incorporates information from Harvard University's Financial Report for Fiscal Year 2010 dated October 15, 2010.

Fiscal Year 2010 Performance

After a tumultuous ride in fiscal year 2009, the markets in the beginning of fiscal 2010 reflected a return to normalization and a restoration of confidence, at least temporarily. The equity markets pursued a strong upward climb through the first months of our fiscal year, surprising to some, given high unemployment in the US and uncertain economic conditions. Bond markets were functioning fairly normally for the most part, with reasonable liquidity and persistently low rates. High yield spreads declined, indicating that the risk of default was lessening, resulting in strong returns for investors in that sector.

In the second half of the fiscal year, particularly in the June quarter, the positive sentiment began to reverse. As unease set in over the debt load in Greece, questions arose about the fate of the euro and fears of a double-dip recession took hold. Long rates on US Treasuries were pushed lower as investors sought safe haven investments. There were a number of peaks and valleys, but in the end the quarter was quite damaging to equity investors, as many markets sustained double-digit losses for the three month period ended June 30. Despite this volatility, for the full fiscal year, the S&P 500 earned 14.4%, emerging market equities earned 23.2% and foreign developed market equities earned 5.9%. The US Treasury market returned 6.7% while foreign bonds returned 3.0% for the year.

At HMC we began the year close to fully invested in the US and international equity markets, in line with our Policy Portfolio. We also began the year with a small positive cash allocation specifically set aside to take advantage of new opportunities. We were able to add new talent to our team and new investments to the portfolio, a few examples of which are noted below:

- During the September quarter, we hired an experienced equity team from a leading hedge fund to expand our internal platform.
- We added to some unique low-beta opportunities (i.e., investments with low correlation to public markets) in our absolute return portfolio.
- We committed new capital to our highest conviction managers in private equity and venture capital funds.
- We made several new real estate investments in sectors we judged to be well-positioned for recovery.

In the majority of individual asset classes our active management added value for the year compared with their relevant market benchmarks. Our return in US equities, at 17.1%, was about 2 percentage points over the US markets and the return in international developed equities, at 12.9%, was over 6 percentage points ahead. Our internal fixed income teams all added value over and above their market benchmarks. Private equity, absolute return and natural resources also generated positive returns relative to their market comparables.

Our emerging market equities and high yield returns were strong, at 17.6% and 19.6%, although they did not beat their benchmarks. Our real estate portfolio also underperformed its benchmark, as real estate values continued to correct downward during the year. Nevertheless, real estate is one of the areas we find most interesting in terms of current and future opportunities. As a result, we have added experienced leadership to our real estate team that will enable us to strengthen HMC's strategic position and allow us to make high-potential investments over the next several years.

Fiscal Year 2010 Performance

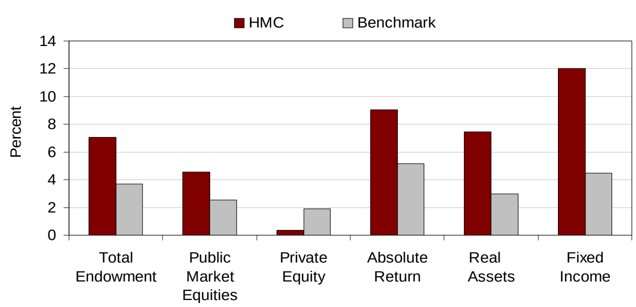
	HMC	Benchmark	Relative
Public Market Equities	15.8 %	15.2 %	0.6 %
Private Equity	16.2	13.3	2.9
Absolute Return*	15.2	12.3	2.9
Real Assets	(2.7)	(4.7)	2.0
Fixed Income	8.5	7.2	1.3
Total Endowment	11.0	9.4	1.6

* Absolute Return asset class includes High Yield

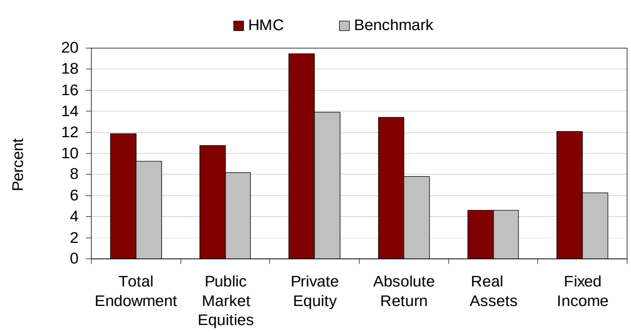
Another area where we are currently active is natural resources, a relatively new asset class that was pioneered by HMC. While nominal returns were relatively low this year, we outperformed the market benchmark significantly, as we have over time. We believe natural resources is a core strength in our portfolio, offering inflation protection, cash flow and long-term growth. At HMC we are well-equipped to recognize and negotiate good value in the natural resources arena, with an experienced in-house team, strong relationships with local operating partners around the world, and a track record of over a decade of transactions. The long-term return on our natural resources portfolio since inception is 13.3% annually.

In summary, with a few exceptions, our individual asset class strategies have been largely value-adding this year, and over the longer term. However, we can not afford to rest on past success. Each year new investment ideas and themes are explored in order to replace strategies that no longer provide attractive returns. We also need to be mindful that our portfolio, while large, still operates under liquidity constraints and spending demands that are greater than they were 5-10 years ago. The endowment now funds 35% of the total University budget. We need to continually tune our asset class strategies and our overall approach to managing the endowment in concert with changing market conditions and the University's evolving needs.

Annualized Ten Year Performance by Asset Class



Annualized Twenty Year Performance by Asset Class



In reporting to you on the various asset classes above, we are reminded of a question that has appeared in the headlines this year: Has the "endowment model"[†] run its course? Our answer to that question is No. We continue to believe that the creation of a diversified portfolio including significant exposure to a variety of alternative assets has been a major factor in HMC's long-term success. Can our strategies and insights be improved? Yes. We learned some specific lessons over the last two years about keeping control of our capital and being prepared for unexpected market conditions. We have made and continue to make adjustments, and recognize that we will constantly need to evolve to be able to seize on market opportunities, manage our risks and meet the needs of this amazing University. This, for many of us here at HMC, is the reason we come to work every day.

Secondary Markets for Illiquid Assets

At HMC we have been participants, recently and over time, in the secondary markets for private equity and real estate partnership interests, both as buyers and sellers. We have gained significant market intelligence, as well as liquidity, through this participation. As a result, we have been able to pursue a more active portfolio management strategy with regard to our partnership interests. When we are holding a partnership interest that is no longer core, or one that is core but is not sized correctly for our portfolio, we may look for a buyer who wants some of the position. Conversely, if we are interested in a geography or sector that is not currently represented in our portfolio we may look to be a buyer of another party's interest in an existing fund. Over the last few years the secondary market for partnership interests has grown substantially. Given our experience in these markets, and the increasingly active management we strive to pursue in all asset categories, we expect to continue to access the secondary markets from time to time.

Organizational Update

The reorientation of the HMC investment platform and organization that began in 2009 bore fruit this year in the form of improved investment performance. While the

[†] The term "endowment model" is often used to describe a theory and practice of investing, first used by major endowments including Harvard, Yale and others starting in the 1990's. The model is characterized by highly-diversified long-term portfolios that differ from a traditional stock/bond mix in that they include allocations to less-traditional and less-liquid asset categories, such as private equity and real estate, as well as absolute return strategies.

markets were helpful, there is no doubt that our portfolio and our company benefited from creative and talented new management in a number of key positions.

Investment management is now overseen by two senior executives, Stephen Blyth, the Head of Internal Management, and Andy Wiltshire, the Head of External Management. Stephen and Andy work closely with me and with each other on issues ranging from broadening and deepening our investment talent, evaluating current strategies to unlock competitive edge and allocating incremental capital to the best investment ideas. Stephen and Andy have collaborated on several joint investigations this year, in one example leading to an improved active commodities strategy, which we will be implementing in fiscal year 2011.

During the course of the last year we have also strategically focused our attention on key investment support areas. Bob Ettl, who joined HMC in late 2008 as our Chief Operating Officer, has significantly upgraded our operations and IT platforms throughout the company.

The environment for attracting investment talent and experience to HMC has been favorable over the last two years and we have taken advantage of this opportunity. Recognizing that staff will change over time, our approach is to continue to build depth in each of our teams and to install leadership that is not only extremely well-qualified, but is also committed to Harvard over the long term. HMC is well known for providing valuable experience and training which allows us to regularly hire best-in-class talent.

Risk Management

In March, Neil Mason joined us as our new Chief Risk Officer. Neil brings an increased level of experience and sophistication to our analytical functions, and will provide an improved level of risk management to our portfolio. Neil and I have put considerable time, thought and effort into this area, applying lessons learned from the 2008-2009 time period. We have reassessed and augmented our risk models with tougher downside scenarios, analysis of different types of leverage, and liquidity stress tests. Continuous improvement in risk management is critical in what remains an extremely volatile environment.

In addition, senior management at HMC has been working closely with the University this year, and I believe all would agree that we have achieved deeper understanding of appropriate risk parameters and better alignment of the endowment's risk/return profile with the University's goals and needs. A concrete example of how we are achieving this is the Financial Management Committee established in 2009, on which I serve along with Jim Rothenberg, the University's Treasurer. President Faust has charged this group with pursuing integrated risk and financial management across HMC and the University.

Cost of Management Study

In fiscal year 2010 we engaged a leading consulting firm to assess HMC's cost structure in managing the Harvard endowment, adding an independent, third-party view to our own internal data on this subject. The consulting firm compared HMC's costs to a representative group of asset managers in order to identify areas of best practice and opportunities for improvement. The study concluded that over the past five years, HMC's total operating costs as a percentage of assets under management have averaged less than 0.3% (including variable compensation), substantially less than that of hedge fund managers with customary 1.5-2% management fees and 20% incentive fees, or funds-of-funds managers with typical fees of 1% base and 5-10% incentive. Overall, the study assessed HMC's operating cost structure as significantly less expensive than the cost of equivalent external or outsourced management. This cost differential has saved Harvard over a billion dollars in management fees over the past decade.

We continue to be vigilant in our efforts to maintain our edge, both in our investment performance as well as in managing our business in the most cost effective manner. Through our hybrid model of internal and external management, and the pay-for-performance principles underlying our compensation system, we are able to achieve these goals while containing investment management costs.

Strengthening Competitive Advantage

Looking ahead to fiscal year 2011 and beyond, we agree with Federal Reserve Chairman Ben Bernanke that at this point there is "unusual uncertainty" in the outlook for the economy and for the markets. Profit margins are high but unemployment is also high. Governments have been helpful in starting the economic healing process, but they may be running out of new maneuvers. Stocks and bonds, ETFs and options, high quality and risk assets are picked up and dropped by herds of investors in increasingly choppy cycles.

This is a time when our internal trading platform is especially valuable. The signals that our portfolio managers can glean from being in the markets day after day help us to adjust strategies throughout the year. While we do not know what direction markets will take in fiscal year 2011, we are pleased to have a well-diversified portfolio with some room to move. We continue to comb the markets for interesting opportunities, and we continue to sharpen our edge as an investment organization.

While I am often asked about my target for internal versus external management, any shift in assets under management will be incremental and driven by the addition of new talent and strategies, not by any arbitrary target for allocating Harvard's endowment funds. My team and I do think that it makes sense to increase the share of internally managed assets under the right conditions, given the added agility and cost effectiveness of managing money this way.

In areas where we have had good long-term experience and where we have competitive strength, internal fixed income trading and natural resources for example, we have been increasing risk allocations and encouraging our teams to do more when they see good opportunities. As mentioned earlier in this report, we are increasingly confident that we can develop an edge in real estate and commodities, taking a few pages from the books we've developed around timberland investing and internal trading. The repositioning of our real estate portfolio will take several years, but it began in earnest this year with several new investments outside of the traditional LP fund structure. On the topic of limited partnerships, we also intend to continue to reduce uncalled capital commitments to real estate and private equity fund managers. Our uncalled capital commitments at the end of fiscal year 2010 were $6.6 billion, down from over $11 billion two years ago.

Private equity bears a mention of its own as we look to the future. Harvard has benefited from being an early participant in the private equity arena, and we have a strong team in this area and many important relationships with a number of the best private equity and venture capital investors in the world. However, the field of private equity has become more and more crowded – with capital, with managers and with investors – over the last decade. Our expectations for this asset class are that returns will be more muted going forward, and we are even more committed to holding our fire for the best-in-class opportunities. We will continue to have a meaningful level of exposure to this asset class over the long term, and we are making new commitments to fund strategies that we like, but we anticipate that the number of active relationships within our private equity and venture capital portfolio will be reduced, while the concentration will be increased in our highest conviction managers.

Manager Relationships

Harvard is in the enviable position of working with some of the finest external managers in the world. We are dedicated to finding the best-in-class managers in each asset class and to creating and fostering long-term partnerships with them. Over time, as the endowment grew, the number of external manager relationships in the portfolio increased, and we found, particularly in the wake of the financial crisis, that some of these relationships and strategies (as well as the fees and terms to which we were bound) were not well-aligned with our goals. We have been increasing manager concentration in the last couple of years, and the number of relationships in the Harvard portfolio has been reduced by about 20% as we focus on partnering with the best of the best and improving the terms under which we operate together, moving toward greater access to our capital and more reasonable fees.

Whether in public or private markets, we are continually aware that the market for good investment ideas is global, not local, and we are challenging ourselves to develop deeper understanding of, and more unique insights into, the world's higher-growth markets. I spent two weeks in China this summer, starting in Beijing and ending in Shanghai to better understand the pace of economic change as well as the potential risks in this important emerging market. My team and I continually meet with managers and market participants from geographies where we have significant capital at work as well as other key markets. And I must note that we find the Harvard network is a superb resource and we are increasingly coordinating with alumni and faculty contacts as we continue to pursue emerging international investments.

Conclusion

At HMC we understand that endowment management is a very specific form of investment management. Unlike a typical investment firm, our sole purpose is to provide resources for a single mission – to support the educational and research objectives of Harvard University. Our constant challenge is to stay ahead of the pack, to distinguish the really unique ideas from the common beliefs, and to find the investments that will pay off best for Harvard.

Most importantly, we strive to add value relative to the Policy Portfolio which is specifically constructed to generate strong, long-term risk-adjusted returns. In this context, a strong year or two (or a weak year or two) pales in comparison to the importance of maintaining a rigorous investment strategy that meets the needs and expectations of the University. Endowment management is a long-term game – we need to keep our eyes on the horizon twenty years out while making investment decisions today.

Fiscal year 2010 was an important and productive year for HMC and for the Harvard portfolio. Going forward we will continue to build on the success of HMC's strategy and strengthen our organization. We will continue to change – to evolve while not diluting our strengths, to adapt to a dynamic investment and economic landscape, and to position HMC for greater success in the future. We need to provide Harvard with the strength and financial support that it needs to fulfill its mission. I believe we are in an excellent position to do so.

Thank you for your attention and your support.

Jane L. Mendillo
President and Chief Executive Officer

Evolution of the Policy Portfolio

The Policy Portfolio is a theoretical portfolio allocated among asset classes in a mix that is judged to be most appropriate for the University from both the perspective of potential return and risk over the long term. The HMC Board and management team set the Policy Portfolio and review it annually for continued fit with the University's risk profile and our projections of long-term market returns, volatility and correlations. The Policy Portfolio provides HMC with a guide as to the actual allocation in the investment portfolio and also serves as a measuring stick against which we judge the success of our active investment management activities. As in any measure of investment performance, long-term results relative to the Policy Portfolio are most meaningful.

Long Term Policy Portfolio

	1995	2005	2010 *
Domestic Equities	38 %	15 %	11 %
Foreign Equities	15	10	11
Emerging Markets	5	5	11
Private Equities	12	13	13
Total Equity	**70**	**43**	**46**
Absolute Return	**0**	**12**	**16**
Commodities	6	13	14
Real Estate	7	10	9
Total Real Assets	**13**	**23**	**23**
Domestic Bonds	15	11	4
Foreign Bonds	5	5	2
High Yield	2	5	2
Inflation-Indexed Bonds	0	6	5
Total Fixed Income	**22**	**27**	**13**
Cash	**-5**	**-5**	**2**
TOTAL	**100**	**100**	**100**

* Unchanged for FY 2011