International Conference for Film, TV, Cable, Wireless, Broadband
Satellite, Advertising, Radio, Publishing, Print Media
Magazines, Newspapers and Marketing

BusinessWeek online

DECEMBER 27, 2004

2005 INVESTMENT OUTLOOK -- SMART STRATEGIES

How To Invest Like Harvard

There's "not much plain vanilla" in the university's portfolio

Just as most colleges look up to Harvard University, most investment managers look up to Harvard Management Co., the in-house firm that manages $27 billion for the university. Over the past decade, Harvard has posted a 15.9% annual return, vs. just 10.1% for the median large institutional fund. That feat has generated an extra $12.2 billion -- nearly as much as the entire endowment at Yale University, the second-wealthiest. Says James Swanson, chief investment strategist at MFS Investment Management: "They are the Mickey Mantles of the investing world."

Harvard Management has achieved this with a formula that bears little resemblance to that of the average investor. "There's not much plain vanilla in our portfolio," says Chief Executive Jack R. Meyer, who got the university to adopt a model portfolio soon after he arrived from the Rockefeller Foundation in 1990. Today it calls for investing just 15% of the fund into U.S. stocks, and 11% into conventional U.S. bonds, far less than is usual for individuals or most institutions.

Meyer's core strategy is diversification writ large. He and the 175 pros who work with him cast their net far and wide -- from private equities and hedge funds to real estate, commodities, and foreign stocks and bonds -- in their search for investments that don't move in step with each other. Harvard also puts just as much money into foreign and emerging stocks combined as it does into U.S. equities. And its bond portfolio covers the waterfront. "When I say bonds, I don't just mean conventional U.S. bonds," says Meyer. "But also foreign bonds, high-yield bonds, TIPS [Treasury inflation-protected securities], and emerging-market debt."

The diversification strategy doesn't preclude huge bets. Meyer's model portfolio calls for 13% in commodities -- along with hedge funds and the like, the second biggest class of investments on his menu. But about 77% of Harvard's allocation to commodities is invested in timber. "It's one of my favorite asset classes right now," says Meyer, "because if you have a little skill, you can buy timber today [and achieve] a 7.5%-to-8% annual real return, assuming flat real log prices." He has three professional lumberjacks on the payroll who select the forests he buys and help manage them.

Harvard's clout brings other advantages. It has achieved an eye-popping 28.7% annual return on private equity over the past five years. That's largely because it has access to some of the best private funds, including the fabled Kleiner Perkins, where it was the first institutional client. "Everybody would like to get into the Kleiner Perkins fund, but you can't get in [any longer]," says Meyer. Likewise, it has an entrée into the cream of hedge funds. It puts another 12% into those funds aiming to produce positive returns whether the stock market is up or down.

With his highly-paid pros -- two of his bond managers each earned more than $25 million last year -- Meyer can execute sophisticated transactions way beyond the scope of individuals. But can private investors draw any lessons from what Harvard does?

Meyer says they can, but should be guided by four key principles. First, "get diversified. Come up with a portfolio that looks a little like ours and covers a lot of asset classes." Second, "you want to keep your fees low." That means avoiding the most hyped but expensive funds, in favor of low-cost index funds.

Unlike Harvard, which is tax-exempt, individuals must also pay close attention to the taxes on their investments. "That isn't often done in individual investing," says Meyer, "but it affects what your portfolio should look like and how much turnover you want." And finally, invest for the long term. You never know, with such an approach you too could join the ranks of the crimson.

By William C. Symonds

Copyright 2000-2004, by The McGraw-Hill Companies Inc. All rights reserved.
Terms of Use Privacy Notice

BusinessWeek online
A Division of The McGraw-Hill Companies