

Lowly Analyst Free Newsletter

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The Market

The markets are in a short-term rally. Investor sentiment has turned bullish. The Hulbert Newsletter Sentiment Index, the [Investor Intelligence Bearish Index](#), the [American Association of Individual Investors' Sentiment Index](#), and the [CBOE Volatility Index \(VIX\)](#) all showed investors reached new highs of optimism.

The [Wilshire Total Market Index](#) rose [0.4% in June](#). Markets around the world declined especially in developing countries and Russia. Commodity prices, one of the indicators of economic revival, declined.

The World Bank lowered its [Economic Outlook](#) to a 2.9% decline for world, 3% for the US for 2009. For 2010 it sees a gain in world GDP of 2%, 1.8% for the US. The World Bank sees no inflation in the foreseeable future, but other forecasters are gradually worrying.

Markets usually go down in the summer. This argues for a bear market. Of course, this time it could be different.

Currencies. June, S Africa up 3.2%, British Pound 1.8%, Brazil, 1.5%, Australia 0.8%, US\$ 0.7%, China down 0.2%, India -0.7%, Euro -0.7%, Rubel -0.9%, Sweden -2%, Canada -6.2%

Asset Classes. June, Micro Cap up 3%, Sml Growth 3%, Lrg Growth 1%, Mid Growth 1%, Mid Val 0%, Sml Val 0%, Lrg Val down 1%.

Sectors: June, Biotech up 8%, Utilities 5%, Listed Private Equity 5%, Oil 4%, Intrnl Telecom 4%, Health Care 4%, Technology 3%, Semiconductors 3%, Transportation 1%, Software 1%, Clean Energy 1%, Consumer Goods 1%, Financial Srv down 2%, Intrntl Real Est -2%, DB Liquid Commodities -3%, US Real Est -4%, Gold -5%, Energy -6%, Ntrl Resorces -7%, Lumber -9%, Silver -14%.

Foreign Investments. June, China up 4%, Spain 3%, RAFI Dvlp Mrkts ex US S/M 3%, Australia 2%, Japan 1%, US 0%, United Kingdom down 2%, World ex US -2%, Emrg Mrkts -2%, Latin Am -2%, BRIC -3%, S Korea -3%, Brazil -3%, India -4%, Canada -7%, Russia -13%.

Fixed Income. June, Financial Preferreds up 6%, Hi Yld 3%, Preferreds 3%, Invst Grd Corp 3%, Buy/Write 2%, Intl Gvmt Infl Protected 2%, Intrmed 1%, Emrg Mrkt Gvmt 1%, 20+ Yr Treas 1%, Intrnatl Gvmt 1%, Barkleys Aggregate Bonds 0%. TIPS 0%, GNMA 0%, Ins Ntl Munis 0%.

Harvard University Investment System

1. Introduction

The [Harvard University Investment System \(HMC\)](#) returned an average of 13.8%/yr for the 10 yrs to June 2008, compared to the S&P 2.7%. This performance was clearly outstanding. Harvard can invest in many assets not available to individual small investors

We have [summary information](#) by asset class but detailed information only on \$0.7 Billion that Harvard manages itself The remainder is managed by others. During the last 5 years HMC has had different managers of various portfolios and of the total investment.

We look at the [emerging market](#) investments in detail since that is where we have the most information. Emerging market investments account for \$4.3B out of \$43B total. We have details on \$670M of that.

2. Returns

In each asset class Harvard, HMC, outperformed the benchmark (BMK). HMC did particularly well in bonds. In domestic bonds it outperformed the benchmark by 8.1%.

Average Annual Returns 5 Years Ending June 30, 2008

Asset	HMC	BMK	HMC-BMK
Domestic Equity	9.8%	8.2%	1.6%
Foreign Equity	17.7%	17.1%	0.6%
Emerging Market Equity	31.3%	30.2%	1.1%
Private Equity	23.6%	19.9%	3.7%
Domestic Bonds	12.5%	4.4%	8.1%
Foreign Bonds	12.8%	6.9%	5.9%
Inflation Protected Bonds	7.0%	6.2%	0.8%
High Yield Bonds	10.0%	7.6%	2.4%
Absolute Return	12.9%	9.6%	3.3%
Real Assets	24.8%	19.9%	4.9%

3. Asset Allocation

Like any good investor HMC starts out each year with a portfolio policy statement that determines its asset allocation. The asset allocation has evolved gradually over the years. Equity has decreased, [Fixed Income](#) has increased. [Emerging Markets](#), [Inflation Protected Bonds](#), Absolute Returns, Timber & Agricultural Lands were added. Domestic and Foreign Bond investments decreased because of investments in Absolute Returns and Inflation Protected Bonds. Real Assets increased substantially with the addition of Timber & Agricultural Lands.

All of these asset classes are available to individual small investors. Timber farms and agricultural land are

difficult to find. Some of the options are customized and not available to small investors.

Changes in Asset Allocation 1991 to 2008

Asset	1991	2008
Equity	69%	46%
Domestic Equity	39%	11%
Foreign Equity	18%	11%
Emerging Market Equity		11%
Private Equity	12%	13%
Fixed Income	23%	31%
Domestic Bond	15%	4%
Foreign Bonds	6%	2%
<u>Inflation Protected Bonds</u>		5%
High Yield Bonds	2%	2%
Absolute Return		18%
Real Asset	13%	26%
<u>Liquid Commodities</u>	6%	8%
Timber/Agricultural Land		9%
<u>Real Estate</u>	7%	9%
Leverage	-5%	-3%
	100%	100%

HMC usually is slightly on margin. In 2009 for the first time in years HMC is holding some cash. HMC is expecting a decline of its funds of 30% for the fiscal year ending in June 2009.

4. Holdings

Only a small part of the individual holdings is disclosed. These disclosures show that in Emerging Markets HMC primarily holds ETFs

Investments June 2008 in Million Dollars

Equity	Symbol	Area	\$M	% Hldg
iShares FTSE/Xinhua China	FXI	China	90	13.4%
China Mobile	CHL	China	16	2.4%
Morgan Stanley China	XCAF	China	3	0.4%
Baidu	BIDU	China	1	0.1%
iShares MSCI S Korea	EWY	S. Korea	49	7.3%
iPath MSCI India	INP	India	14	2.1%
iShares MSCI Malaysia	EWM	Malaysia	1	0.1%
Philippine Long Distance	PHI	Philippines	1	0.1%
iShares MSCI Brazil	EWZ	Brazil	119	17.7%
Petroleo Braisleiro	PBR	Brazil	2	0.3%
CIA Vale Do Rio Doce	VALE	Brazil	1	0.1%
Empresa Nacional De Elec	EOC	Chile	2	0.3%
iShares MSCI Chile	ECH	Chile	2	0.3%
Bancolumbia	CIB	Columbia	1	0.0%
iShares Mexico	EWW	Mexico	38	5.7%
America Movil	AMX	Mexico	1	0.1%
iShares S&P Latin Am	ILF	Latin Am	2	0.3%
iShares MSCI S Africa	EZA	S. Africa	45	6.7%
Market Vectors Russia	RSX	Russia	25	3.7%
Turkcell Iletisim Hizimet	TKC	Turkey	1	0.1%
Vanguard Emerging Market	VWO	Emrg Mkts	54	8.0%
iShares MSCI Emrg Mrkts	EEM	Emrg Mkts	205	30.5%
Total			673	100.0%

Asian investments are primarily invested in China and S. Korea; Latin American investments are primarily in Brazil.

There is a large investment in South Africa and in broadly diversified Emerging Market ETFs.

Investments by Area in Million Dollars

Area	\$M	% Hldg
Asia	175	26.0%
China	110	16.3%
South Korea	49	7.3%
India	14	2.1%
Other Asia	2	0.3%
Latin America	168	25.0%
Brazil	122	18.1%
Other Latin Am	46	6.8%
Russia	25	3.7%
South Africa	45	6.7%
Other Emerging Markets	260	38.6%
Emerging Market ETFs	673	100.0%

HMC also has separate investments in derivatives, not detailed here. HMC has about equal amounts of long and short derivatives of approximately 52B dollars. Most of these are custom derivatives not traded on an exchange. \$18B are long and short foreign currency contracts.

5. What We Can Learn from HMC

We should have a portfolio policy statement with allocations for equity, fixed income, and real assets. The portfolio policy statement should be reviewed annually and should gradually be adapted to changing economic conditions and your changing needs. The statement can evolve but it should not be changed radically from one year to the next. This portfolio policy statement should be reviewed by husband, wife, and other affected persons. It is this policy statement that enabled HMC to perform well despite turnover of its implementing managers.

A good way to invest is using broad ETFs that have large trading volume. If you deal in derivatives, you should have an equal amount in long and short term derivatives. Derivatives are very volatile and require much time to manage well. Right now you should have some cash to reduce volatility and for future investments.

6. Bottom Line

- Harvard is one of the most successful investors.
- HMC has a well-diversified portfolio.
- The portfolio changes slowly over the years.
- Individual Investors can duplicate HMC asset allocation.

If you have questions write to curtfey@curtfey.com