

2007

[IS THE IVORY TOWER SMARTER THAN WALL STREET?]

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By Suhas Kundapoor

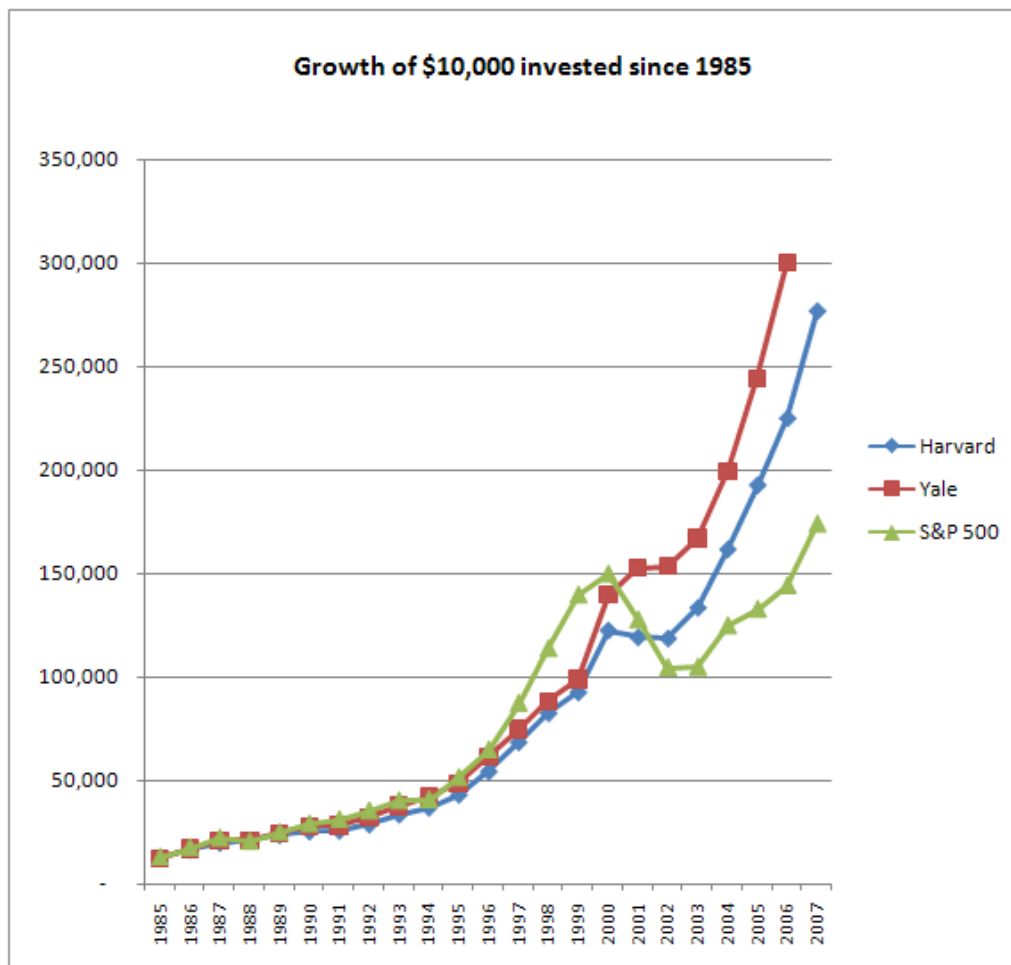
Is The Ivory Tower Smarter than Wall Street?

“Those who can, do: those who can't, teach”

The adage may be true in most circumstances however, one look at Yale’s and Harvard’s endowments track record might just change your mind.

In 1985 the Yale endowment was worth slightly more than \$1 billion. By June 30 of last year, it had reached \$18 billion ¹. Harvard Management Company the investment arm of Harvard’s endowment has realized returns of 15.92% since 1985 compared to 14.22% for the S&P 500. The Yale endowment did even better returning 17.14% over the same period ³.

Not only did Yale and Harvard outperform the S&P 500 but did that with lower volatility (9.65% and 10.26% compared to 14.89% for the S&P 500 ³). The single worst year for the S&P 500 was 2002 when it was down a staggering 17.99%. If you could invest in Harvard’s endowment the single worst year since 1985 would have been only down 2.7% and if Yale was managing your money the single worst year would have been down 0.2%! ³

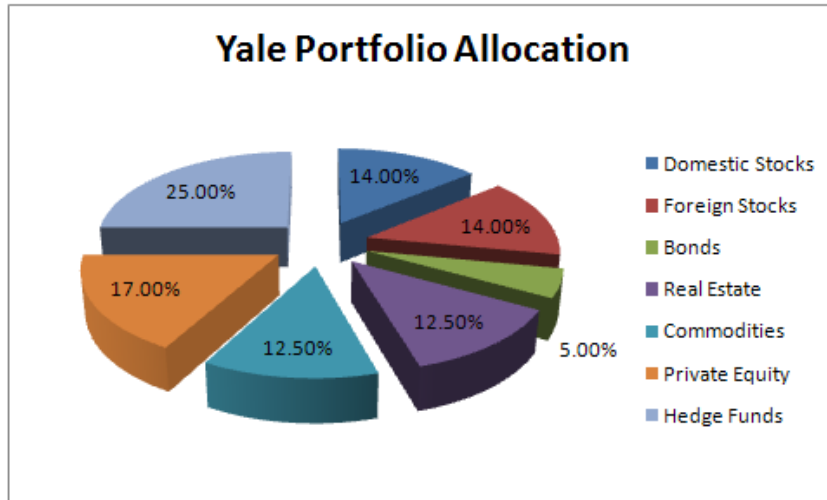


Source: Harvard-Yale Endowment Performance Versus the Buy-and-Hold and Timing Approaches by Mebane Faber

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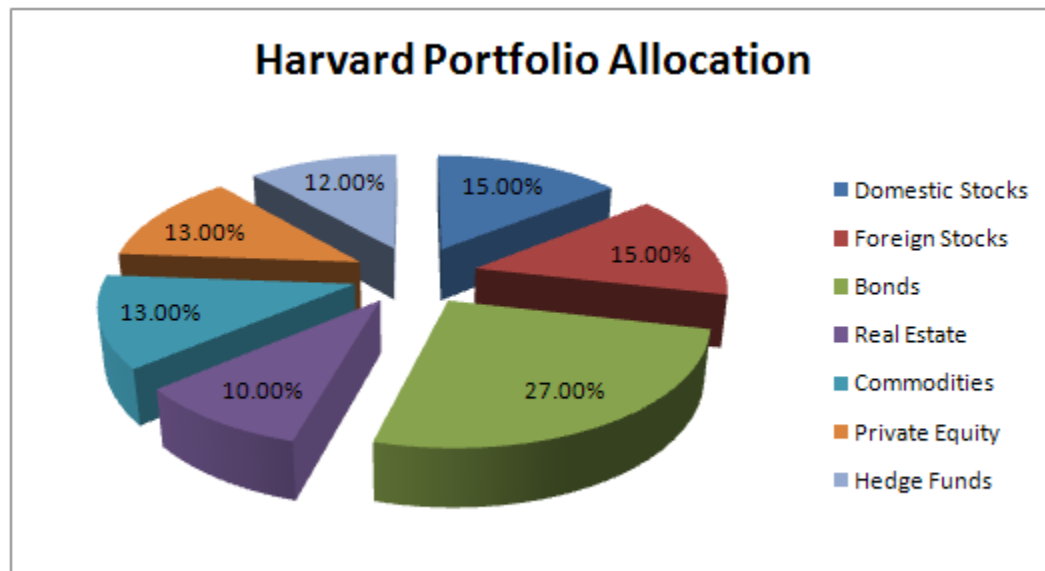
So the Ivory tower is smarter than Wall Street but how do they do it?

Digging a little deeper into Harvard's and Yale's portfolio gives us an interesting insight into their investment philosophies. Harvard's and Yale's portfolio allocation is very different from an average investor.



Source: Seeking Alpha, Learning From The Harvard & Yale Endowments By Mebane Faber

Yale invests 14% of its portfolio in foreign stocks while Harvard invests 15% of its portfolio in foreign stocks ². Harvard is actually run by Mohamed El-Erian, an emerging markets expert who has made large bets on emerging markets via companies like Infosys Technologies, one of the biggest computer-services companies in India.



Source: Seeking Alpha, Learning From The Harvard & Yale Endowments By Mebane Faber

Harvard and Yale invest only about 15% of their portfolio in domestic equities ². Compare this to an average U.S. investor, whose portfolio is primarily comprised of domestic equities and bonds.

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Harvard and Yale have outperformed Wall Street by ignoring conventions. The following are key stones of Yale's and Harvard's investment strategy.

1. Buy Equities

Harvard and Yale both have over 70% of their investments allocated to equities². Now equity does not necessarily mean listed stocks. Yale and Harvard investment managers follow a broad based definition for equities, wherein, it is any asset class where there is unlimited upside. This could mean investments in assets like timber, commodities, and real estate or could mean investments in regular domestic and international securities.

Both Yale and Harvard have long investment horizons and over these horizons equities almost always outperform bonds making equities an ideal investment.

2. Diversification

Diversification is the cornerstone of Yale's and Harvard's investment philosophy. Diversification is achieved by investing in uncorrelated asset classes such as real estate, international equities, and commodities. By doing so Harvard and Yale have reduced portfolio volatility and risk substantially.

The low volatility has meant that in its single worst year (2001) Harvard was only down 2.7% and Yale was only down 0.2% in its worst year which was all the way back in 1988. Yale has not lost money since!³ compare this to the S&P 500 which was down 17.99% in 2002 after falling almost 15% the year before³.

3. Buy assets classes where markets are not very efficient

Traditional investment philosophy directs investors to markets which are efficient and liquid. Markets that are not so are allocated a high risk premium and the average investor advised to stay clear.

David Swensen at Yale believes that mispricing of assets happen more often in markets that are relatively illiquid and inefficient like foreign equity and commodities, making it possible for investment managers to find bargains. Thus, both Harvard's and Yale's investment philosophy concentrate on finding investments that can be bought for less than their intrinsic value without emphasis on market liquidity or market efficiency.

4. Long term horizon, do not try to time markets

Warren Buffet once said his favorite investment horizon was "forever". Yale and Harvard both belong to this camp holding on to their portfolios for long periods of time. Both eschew market timing and believe that it is virtually impossible to time the markets in the short run.

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The secret of Yale's and Harvard's success is buying diverse asset classes in inefficient markets at below intrinsic prices and holding on to them for long periods of time.

What does all this mean to an average investor who cannot hope to match Harvard's or Yale's resources? People are not very different from College endowments; they look to generate income with long term capital gains.

An average investor may not be able to buy into private equity or hedge funds, however, they can follow in the steps of Harvard and Yale and create a diversified high growth portfolio by buying commodities based ETF's and international funds and other similar instruments with a long term holding period.

Following the four Harvard and Yale endowments keystones may just be tonic your portfolio needs.

(1 -Source: Financial Times, A great investor with a centuries-long horizon By John Authers, Published: June 8 2007

2-Source: Seeking Alpha, Learning from the Harvard & Yale Endowments by Mebane Faber, posted on: November 20, 2006

3-Source: Harvard-Yale Endowment Performance Versus the Buy-and-Hold and Timing Approaches by Mebane Faber, posted on: August 23, 2007)