

#### TITLE:

# A case study in using investment beliefs: Strategic tilting

AUTHOR: David Iverson

Head of Asset Allocation

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Outline

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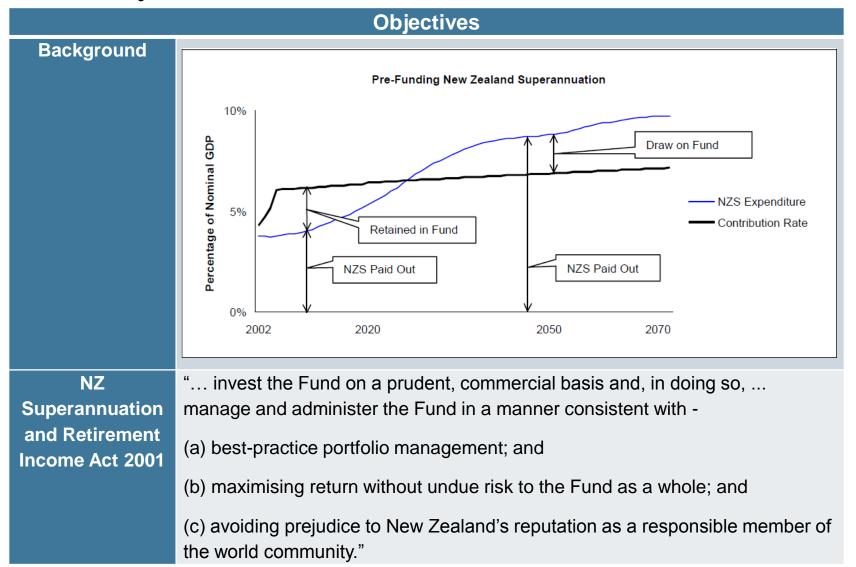
Who we are

- Our investment beliefs
- Developing investment beliefs
- Case study: application to strategic tilting



## Who We Are

#### **NZSF:** Objectives





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# Our investment beliefs



#### NZSF: Investment Beliefs and Endowment

Key Investment Beliefs		
Governance	Clear governance and decision-making structures will add value	
Asset allocation	Asset allocation is the key investment decision	
Investment strategy	Asset class expected returns are partly predictable and mean-revert	
	Some markets are more conducive to active return and some markets have identifiable life-cycles	
Asset selection	True skill in generating active returns consistently (i.e., pure alpha) is rare, which makes it hard to identify and capture	
Responsible	Responsible investors must have concern for environmental, social	
investing	and governance factors because they are material to long-term returns	
Endowment		

Our	Long-term
comparative advantages	Stable risk appetite
	Higher certainty in cash outflows
	Sovereign status



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# Developing investment beliefs



# 1. Understand the fundamentals of risk and return

- How to measure investment risk and how it relates to expected return
- How an asset is valued (stocks, bonds, etc)
- 2. Sound framework for how markets work
  - Good understanding for how a competitive financial market operates. Helps you with passive versus active management, and where to take active risk
  - Familiarity with decades of financial research on investment strategies
- 3. Investment beliefs must suit the fund
  - Fund horizon
  - Cash flow profile
  - Tax status



Our investment beliefs are informed by finance theory, and these beliefs form the basis for our strategies. For example:

### **Asset Allocation**

What we believe in	What we are not sure about
Asset allocation is key	The exact nature of risk premiums
	How portfolios should be constructed beyond mean variance, i.e. if and when 'fat-tail' matters





## **Market Efficiency**

#### What we believe in

Financial markets are by and large 'efficient':

- Risk and return are strongly related, i.e. 'beta' is a fair reward for systematic risk
- Manager skill ('alpha') is hard to find

Manager fees represent a clear hurdle for active management

#### What we are not sure about

Are there structural inefficiencies in the market? Examples:

- Are some markets (such as frontier markets) segmented?
- Do active manager incentives distort market pricing?





### **Dynamic Behaviour of Markets**

#### What we believe in

Risk and return characteristics of financial markets are dynamic

Empirical evidence suggests that market volatilities cluster and returns 'mean-revert' over time

#### What we are not sure about

To what extent are these dynamic changes predictable?

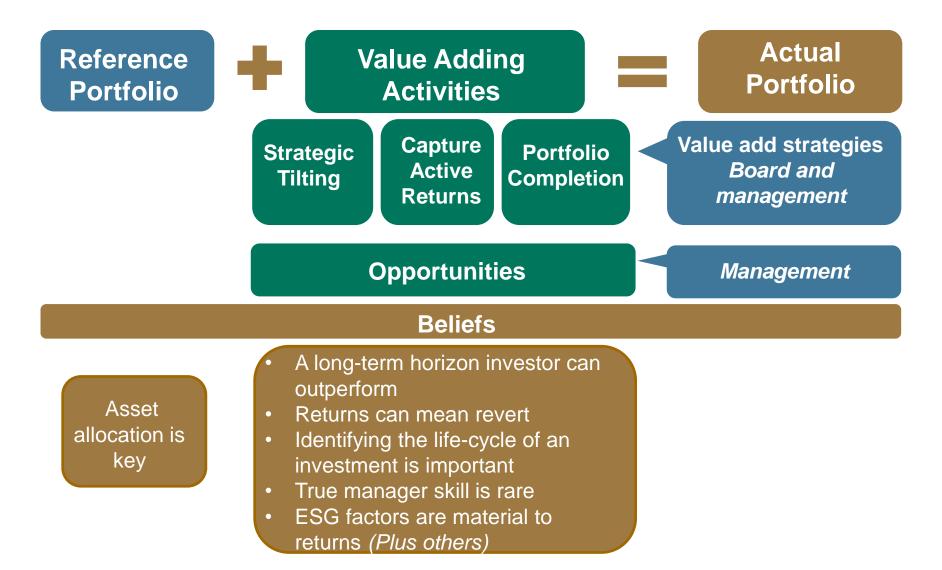
How long will it take for markets to mean-revert?



# Case study: application to strategic tilting



# Investment beliefs underpin all strategies





# **Tilting and investment beliefs**

#### **Investment beliefs**

- Asset class expected returns are partly predictable and mean-revert
- Long horizon investors with stable risk appetite can outperform short horizon investors

## Tilting philosophy

Mean reversion to fair value

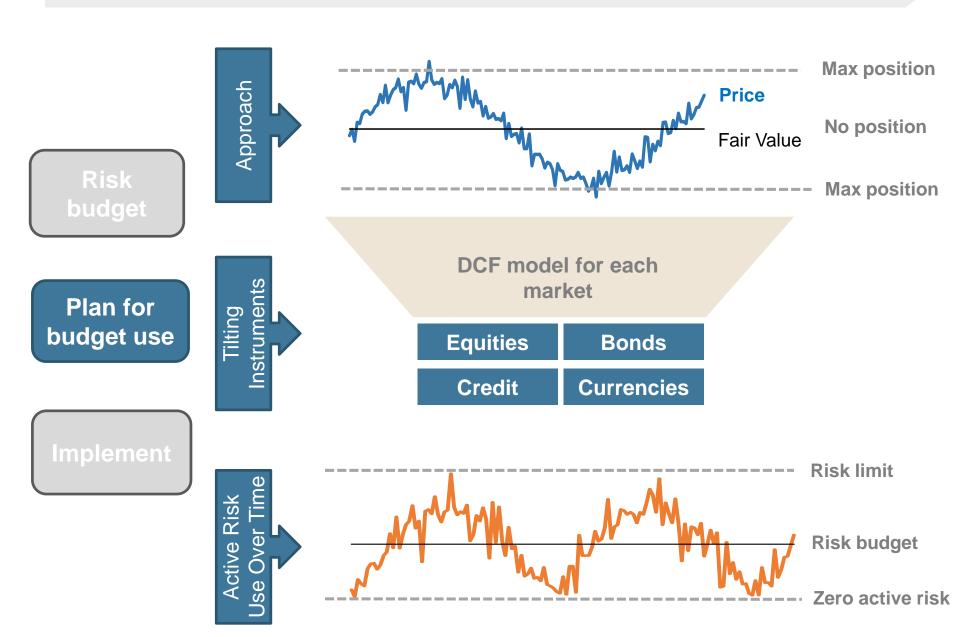
Long horizon focus

Disciplined approach to capital allocation



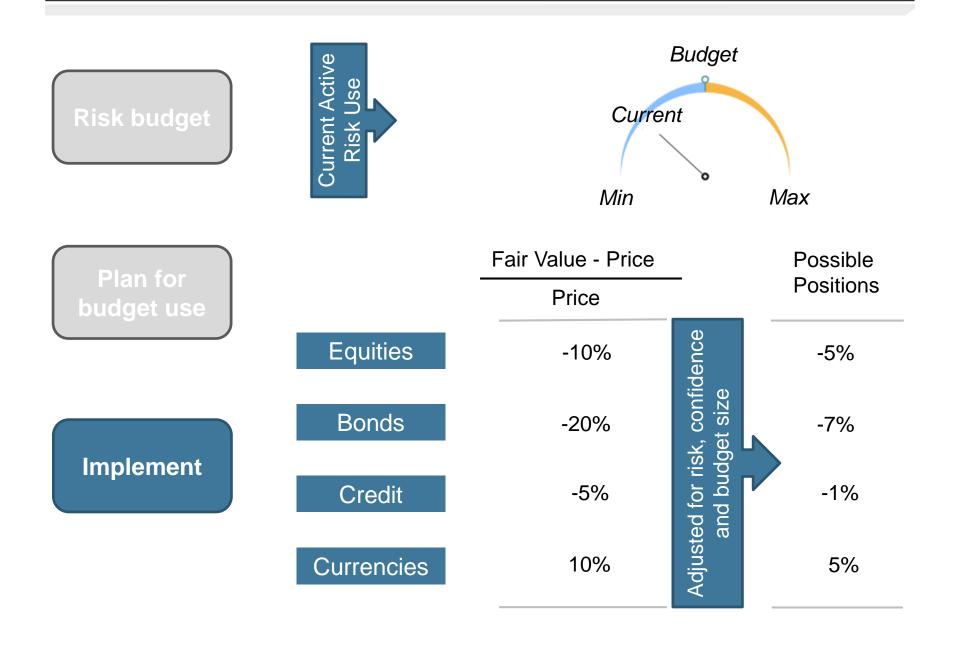
# Mean reversion and long horizon

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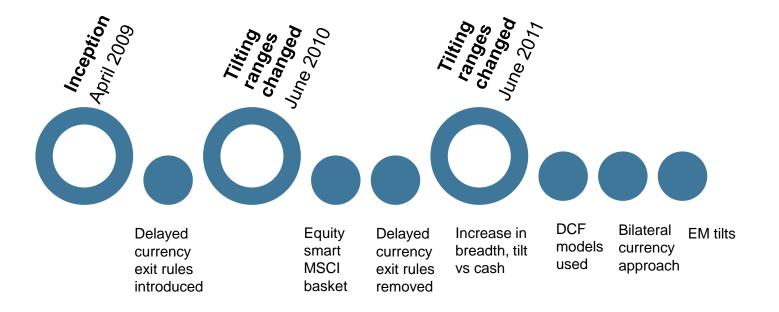
# **Discipline (capital allocation)**





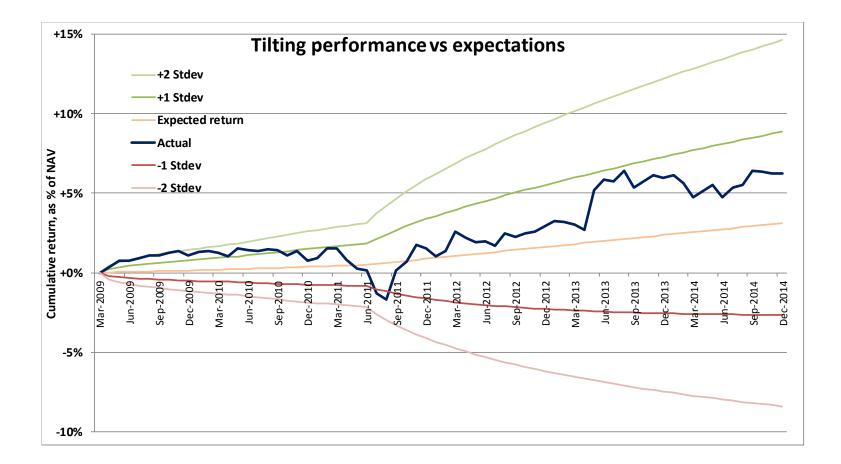
#### Approach has evolved, but investment philosophy has not

Evolution of the tilting strategy to better capture returns consistent with these philosophies





#### **Performance since inception**





# **Concluding comments**

# Developing investment beliefs

- 1. Understand the fundamentals of risk and return
- 2. Sound framework for how markets work
- 3. Investment beliefs must suit the fund

Investment beliefs underpin all investment strategies

https://www.nzsuperfund.co.nz/