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ADVENTURE CAPITALISM

FIONA MACKENZIE As the spiritual home of bungee jumping, New Zealand has long been a mecca for thrill seekers. Fiona Mackenzie injects that same spirit into her management of the island nation's US$20 billion sovereign wealth fund. She talks to **Atholl Simpson** about turning distance to your advantage, winning prizes for innovation and why fixed income makes up just 9% of her portfolio

When you think of New Zealand its formidable rugby team is likely to be your first association, while its role in the financial world probably won't register at all. So there must surely be some unique challenges when it comes to running a US$20 billion sovereign wealth fund from 'the bottom of the world'.

Some would consider her fund's relatively isolated location a hindrance, but Fiona Mackenzie, head of investments for the New Zealand Superannuation Fund (NZSF) couldn't disagree more: 'The fact we are further away means we have had to approach things a bit differently. I think the distance actually helps us. It gives us a bit of space to reflect and really focus on what is going to drive the portfolio and get away from some of the noise.

'We have turned that distance to our advantage.' Combined with this home-grown approach is a healthy dose of wider experience. Mackenzie has spent a large part of her career working abroad, honing her investment skills at groups such as Morgan Stanley in New York and San Francisco and for Crédit Suisse in London.

Her time abroad has proved instrumental to her understanding of global markets, she says, and reflects a strong outward-looking strand in the country's culture – it's commonplace for New Zealanders to travel. That time away from the homeland often gives these adventurous islanders a different take on things and encourages an appetite for new experiences.

'There are a lot of Kiwis that have spent around 10 years offshore and then returned to the homeland. Culturally we are not big believers in the "that's always the way we've done it" answer, we are always looking for a better way of doing things.

'We are not scared of innovation and I think in the world of investing that is pretty powerful,' says Mackenzie.

INVESTMENT FREEDOM

New Zealand-born Mackenzie has been working as NZSF's head of investments since she joined in September 2011. Returning home in 2009 after stints in the US, the UK and Sydney, Australia, she first worked at New Zealand's stock exchange NZX listings as head of markets before being appointed to the sovereign wealth fund.

NZSF was launched in 2003 to meet the country's future pension liabilities and now has about a third of its US$20 billion in assets under management run by external managers. The fund's first pension payment is not due until 2029/2030 and this relatively long time frame means it can deal more comfortably with short-term volatility.

'When you look at our investments, natural catastrophe re-insurance, for example, is a very lumpy asset class.

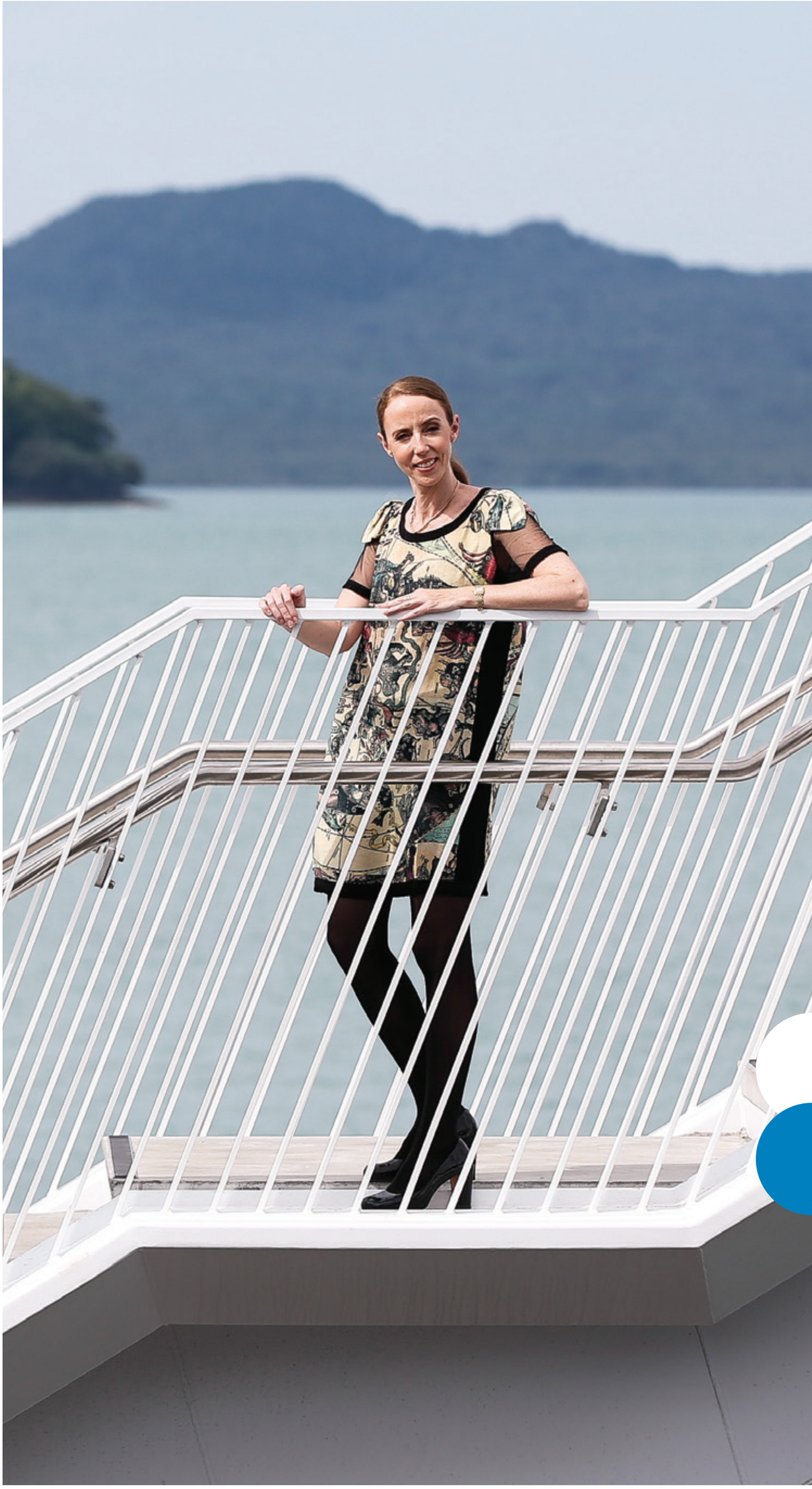
'Depending when those disasters happen, you can have big drawdowns one year and none for the next few. That unevenness is something our portfolio can weather reasonably well because we have that 20-year horizon.'

Another important fact about NZSF's set-up is there is no onus to comply with a particular asset allocation model. As Mackenzie says: 'We don't have to be in anything or we can be in everything.'

Her team have a reference portfolio which is an 80/20 division between equities and fixed income but they can steer away from these figures if they feel the opportunity is worth backing.

This is a large part of why the fund is heavily exposed to global equities, which currently account for 61% of its overall portfolio exposure, a significant part of which is run passively by BlackRock, institutional giant State Street Global Advisors and Northern Trust.

With only 10% of the portfolio invested in fixed income, investments such as natural catastrophelinked bonds, life settlements and holdings in timber act as a necessary diversifier.



MOVING INTO EMD

The most recent asset allocation change Mackenzie and her team have made to their portfolio is to increase exposure to emerging market sovereign debt.

'Our macro team looked at our portfolio and felt we were under-exposed on local currency EMD and that is an asset class we expect to keep growing in the long-term.'

Being located in the Pacific ocean, the overall health of the emerging markets has a strong effect on NZSF. China plays an important role in the fund's emerging market portfolio and part of this exposure is channelled through New Zealand's exports of timber and dairy products which go to China and also emerging Asia.

While emerging markets look attractive Mackenzie was keen to emphasise that they are still at the early stage of researching opportunities.

Real assets make up significant portion of the fund's emerging markets exposure, with real estate playing an important role in this portfolio through **Red Fort Capital's India Real Estate** fund and **GAW Capital's** China and south-east Asia-focused **Gateway Real Estate** fund.

'The aspect of emerging markets we really wanted to get exposure to was growth at a local consumer level, not just emerging markets going into developed markets and we felt that EMD was the best way to tap this,' says Mackenzie.

While there has been an investor trend of selling out of EMD to return to developed market bonds during the past year, she says she is not one to follow the herd.

'This is not unusual for us because we do have this long-term investment horizon so we tend to act as contrarian investors which can feel a bit uncomfortable at times.

'We really think much longer term than six or 12 months' time.'

'We tend to act as contrarian investors which can feel a bit uncomfortable at times'

‘If we were to spread ourselves across a huge number of managers we feel we’d be having these little civil conversations and not really getting to the meat of what’s driving the opportunity that manager is giving us access to’

CV FIONA MACKENZIE

Fiona Mackenzie joined the New Zealand Superannuation Fund (NZSF) in September 2011 and is currently its head of investments. During her career she has lived and worked in New York, San Francisco, London and Sydney.

She began her investment career in 1994 as a tax adviser with Deloitte in Auckland, New Zealand. She then moved overseas to work as a self-employed consultant in London before relocating to New York to work for Crédit Suisse, where she was a member of the product development team and then subsequently joined its CFO’s office. While in New York, she also worked for Morgan Stanley’s Institutional Equities division before relocating to San Francisco in 2007 to join the firm’s Asia ex-Japan equity desk. In 2009 she moved back to New Zealand where she worked for the stock exchange group NZX prior to joining the NZSF.

‘When you have periods of distress in financial markets, previously uncorrelated investments can start behaving in a very correlated way, so genuine diversifiers like these can be very attractive,’ says Mackenzie.

However, she insists she is not stretching her portfolio risk levels too far – on the contrary.

‘With that kind of duration and the fact we don’t have any redemption risk, if you go too low on your growth allocation you wouldn’t be hitting the fund’s mandate which is maximising returns without undue risks. We’d actually be way too conservative if we were more heavily invested in fixed income.’

ATTRACTING THE TALENT

New Zealand may be a relatively distant location but it’s still able to pull in stars from various realms. The Pacific island has recently staged large Hollywood productions such as Tom Cruise’s *The Last Samurai* and New Zealand-born director Peter Jackson’s *The Lord of The Rings* and *The Hobbit* trilogies thanks to a raft of government incentives and its stunning landscape.

‘It is a very small country at the bottom of the world but I think we punch well in excess of our weight,’ says Mackenzie.

But when it comes to external fund managers, does the location mean she misses out and ends up picking from a smaller pool closer to home?

‘Not really, I have been very pleasantly surprised with the willingness of our managers to travel to come and see us in New Zealand,’ says MacKenzie.

However, while a sovereign wealth fund based in New York can rely on managers knocking at the door for business, NZSF’s location is a contributing factor to why Mackenzie and her team focus on having fewer and deeper manager relationships.

‘If we were to spread ourselves across a huge number of managers we feel we’d be having these little civil conversations and not really getting to the meat of what’s driving the opportunity that manager is giving us access to.’

These manager relationships are not only based around their expertise, insists Mackenzie, as they will also tap them for broader advice on investments in other sectors. ‘Our managers are our eyes and ears on the world. We are only about 90 people sitting in New Zealand and our managers have enormous global teams. They provide us with a lot of breadth, depth and visibility on what is going on in the investment world.’

Among the longest-standing managers she continues to rely on are: **Bridgewater Associates**, founded by renowned US investor **Ray Dalio**; Chicago-based **LSV Asset Management**, which runs an emerging market equity mandate; **GMO Renewable Resources**, an alternative division of Jeremy Grantham’s GMO; and **Hancock Natural Resources** which both manage part of the fund’s domestic and US timber assets.

One of the most recent groups Mackenzie says she has added to her portfolio is **Sankaty Advisors**, the credit affiliate of $70 billion alternative investment group Bain Capital, through which she made a significant commitment to European distressed credit earlier in the year.

‘They help us think more broadly about what is going on in Europe but also in distressed credit and the big changes in Europe’s regulatory landscape that have impacted the financial services sector.

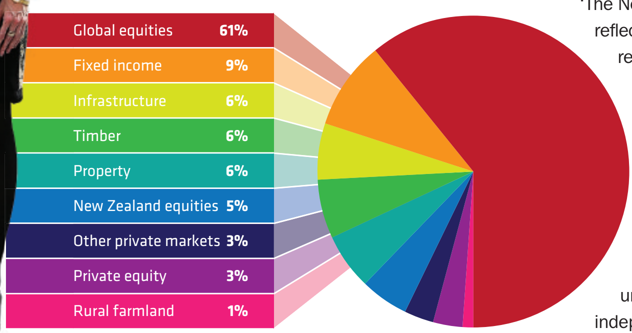
‘We also have a life settlement investment through **Apollo Management** in New York, and a natural catastrophe re-insurance mandate with **Leadenhall Capital Partners**.’

Mackenzie says they have also been buying up some timber assets as they got them at good prices. ‘Our infrastructure exposure has come down a little bit but we were buying in times of distress and bought some great assets. Over the last year though we have been trimming back our infrastructure exposure as we felt the market was ripe for selling.’

This paring back came from a successful joint venture by NZSF and infrastructure investment group Infratil who teamed up together in April 2010 to buy New Zealand fuel distributor Z Energy from Royal Dutch Shell. The two investors happily took profits when Z Energy completed its recent IPO.

NZSF ASSET ALLOCATION AT JUNE 2013

SOURCE: NZSF



PRIZE-WINNING INNOVATOR

The pension fund’s distinct approach boils down to the way the fund invests, says Mackenzie – an unrestricted and open asset allocation format complemented by flexible investment mandates with access to external investors. This stance saw NZSF named the most innovative sovereign fund at the 2012 aiCIO Industry Innovation Awards, beating the likes of the Singaporean fund GIC and Norges Bank Investment Management (NBIM) which runs Norway’s giant oil fund.

Mackenzie’s team selects managers from a shortlist of highly skilled managers they have compiled in-house but they are only included in the portfolio when it is clear they understand and embrace the pension fund’s investment approach with real enthusiasm.

‘The lights really start going on when we see that they really understand how we invest and how they can be a part of it.’

Tapping into the local manager talent also has its benefits. Since the start of the year, New Zealand’s equity market is experiencing its strongest growth in a decade, and Mackenzie uses three New Zealand specialists for the majority of her domestic exposure.

‘We draw on three managers, which are good in different ways: **Milford Asset Management**, **Devon Funds** and **AMP Capital Investors**.

‘The New Zealand market is still reflective of a small economy and relatively illiquid with pockets of inefficiency. Our research showed that active management is currently the best for this market.’

It’s this willingness to continually assess the most suitable direction for the long-term goals of the fund that underpin Mackenzie’s flexible and independent approach.