



**NZSUPERFUND**

*Te Kaitiaki Tāhua Penihana  
Kaumatua o Aotearoa*

TITLE:

# **A case study in using investment beliefs: *Strategic tilting***

AUTHOR:

**David Iverson**

Head of Asset Allocation

EVENT | PRESENTATION:

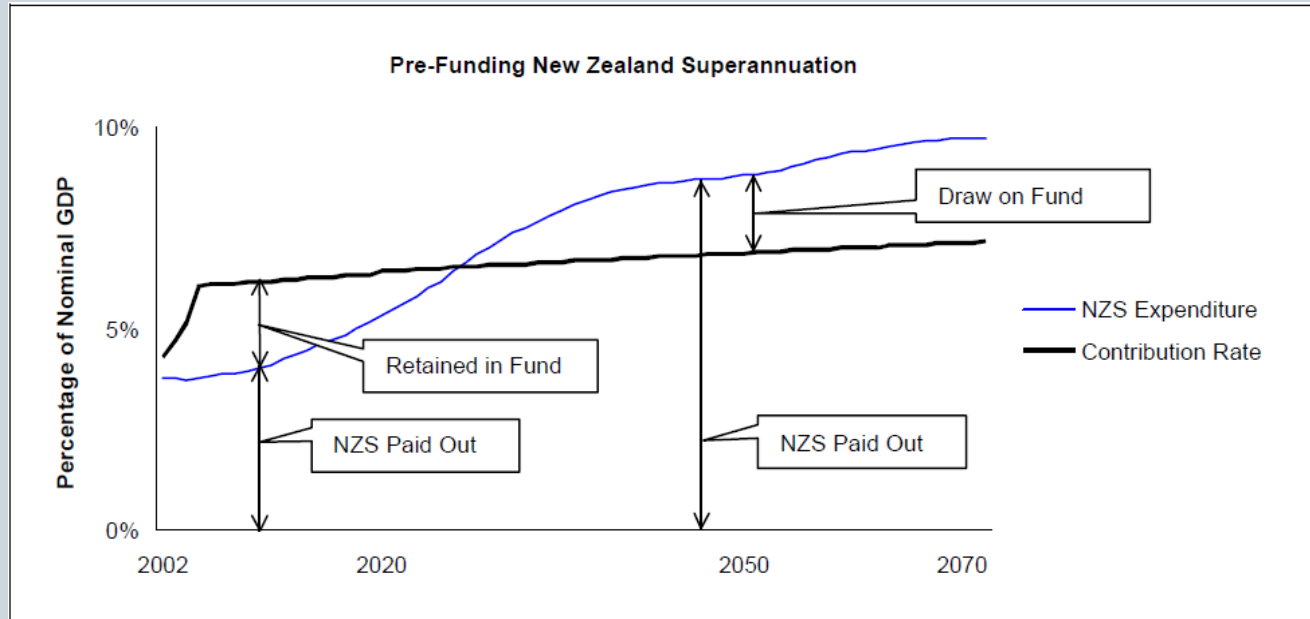
Global Investment Strategy Forum, October 2016

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

## NZSF: Objectives

### Objectives

#### Background



#### NZ Superannuation and Retirement Income Act 2001

“... invest the Fund on a prudent, commercial basis and, in doing so, ... manage and administer the Fund in a manner consistent with -

- (a) best-practice portfolio management; and
- (b) maximising return without undue risk to the Fund as a whole; and
- (c) avoiding prejudice to New Zealand’s reputation as a responsible member of the world community.”

# Our investment beliefs

## ***NZSF: Investment Beliefs and Endowment***

### **Key Investment Beliefs**

<b>Governance</b>	Clear governance and decision-making structures will add value
<b>Asset allocation</b>	Asset allocation is the key investment decision
<b>Investment strategy</b>	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
<b>Asset selection</b>	True skill in generating active returns consistently (i.e., pure alpha) is rare, which makes it hard to identify and capture
<b>Responsible investing</b>	Responsible investors must have concern for environmental, social and governance factors because they are material to long-term returns

### **Endowment**

<b>Our comparative advantages</b>	<ul style="list-style-type: none"> <li>Long-term</li> <li>Stable risk appetite</li> <li>Higher certainty in cash outflows</li> <li>Sovereign status</li> </ul>
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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

Asset allocation is key

### What we are not sure about

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

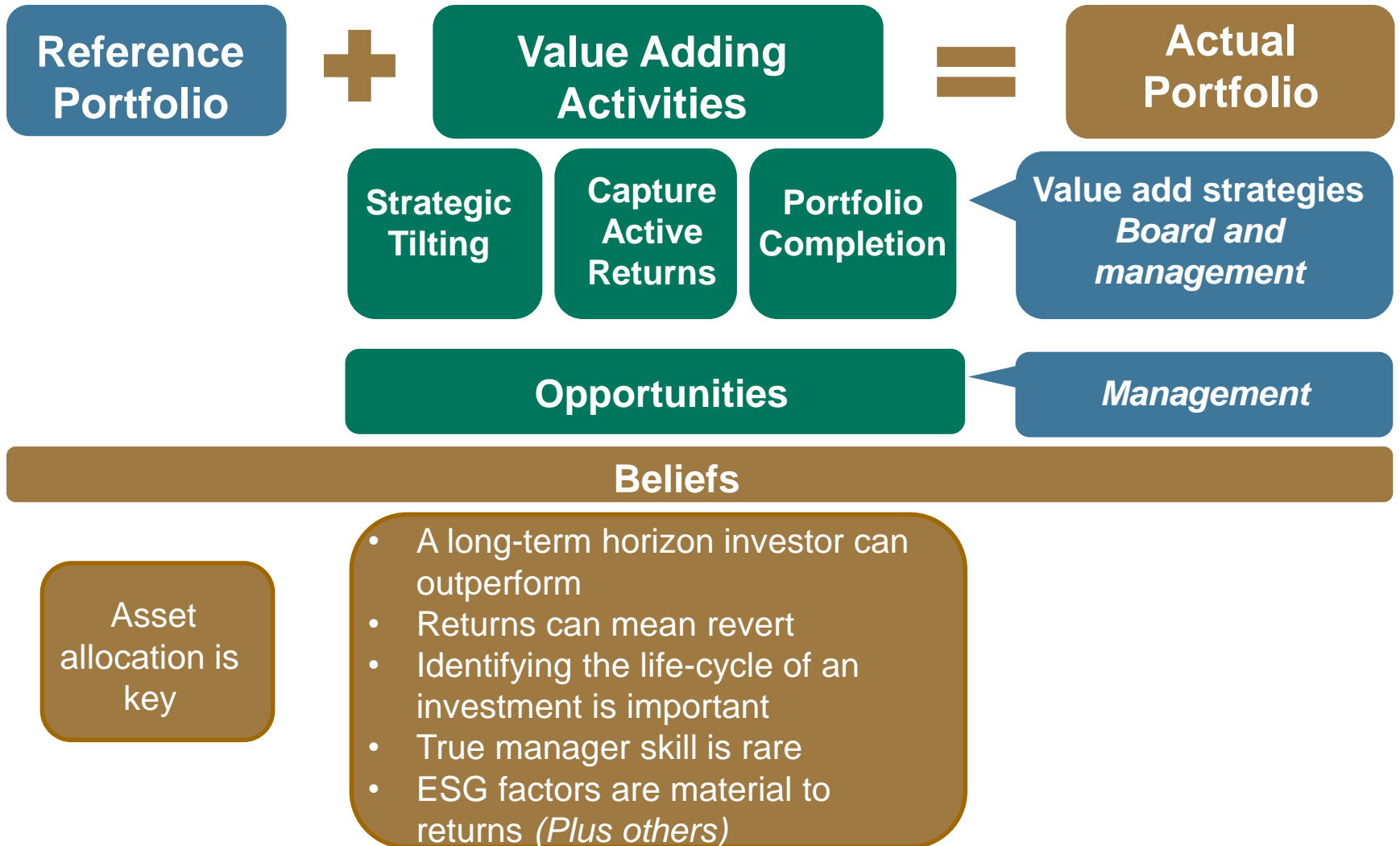
### What we are not sure about

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



## Investment beliefs

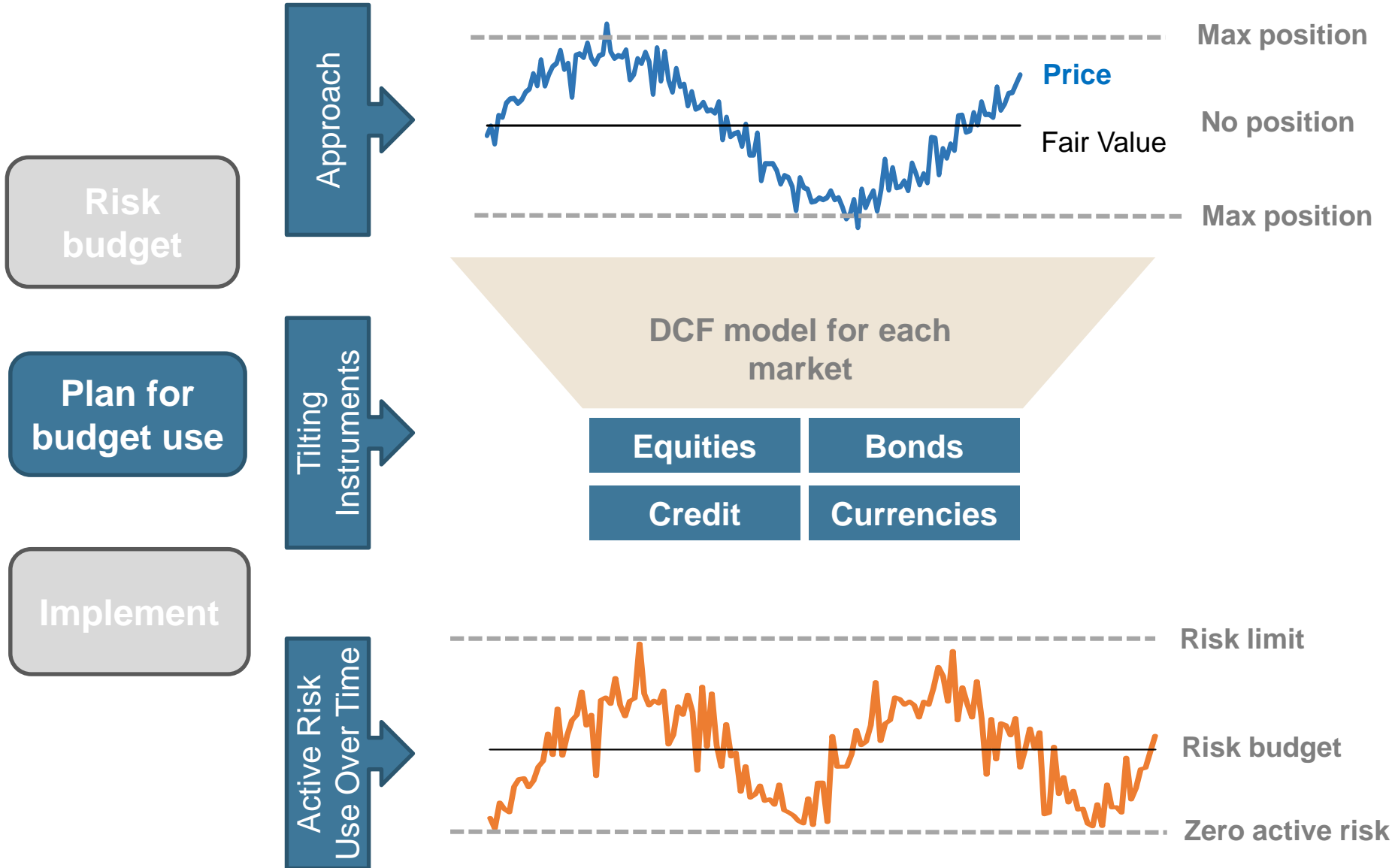
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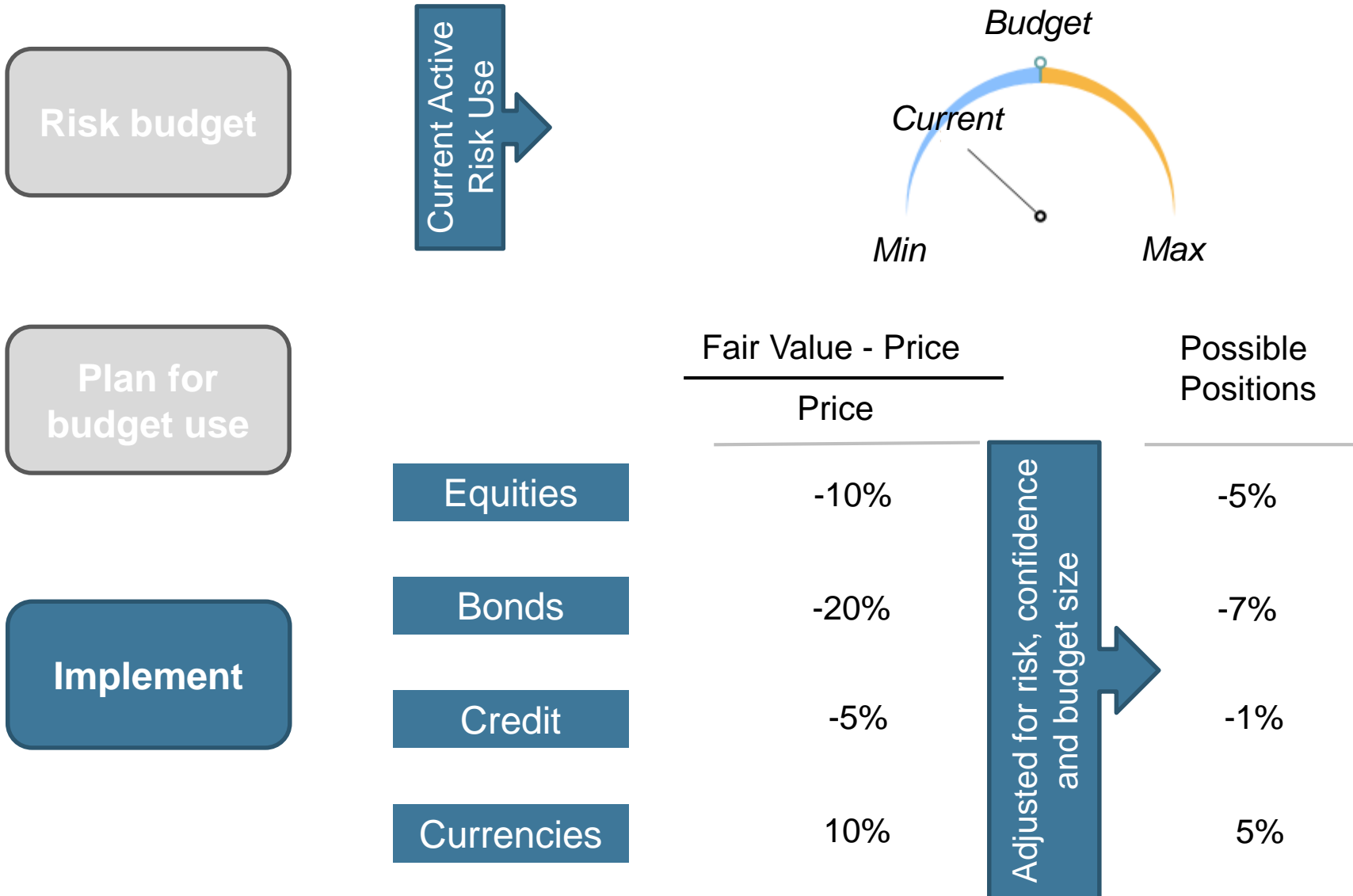
- Asset class expected returns are partly predictable and mean-revert
- Long horizon investors with stable risk appetite can outperform short horizon investors

## Tilting philosophy

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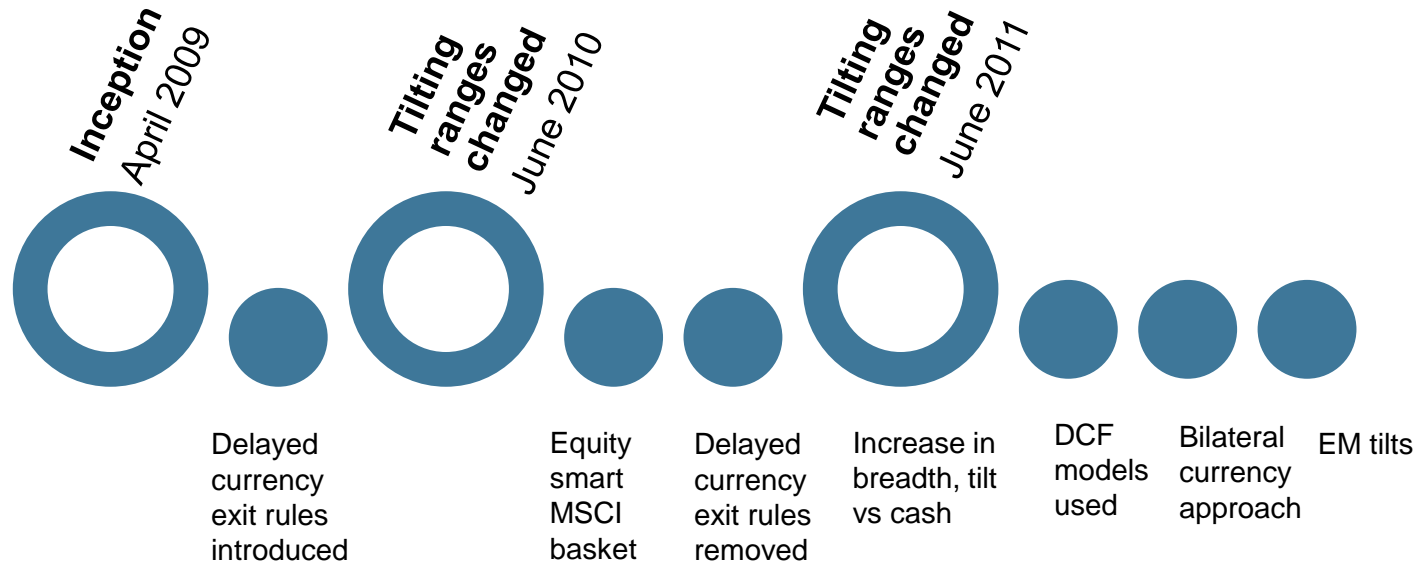
- Mean reversion to fair value
- Long horizon focus
- Disciplined approach to capital allocation





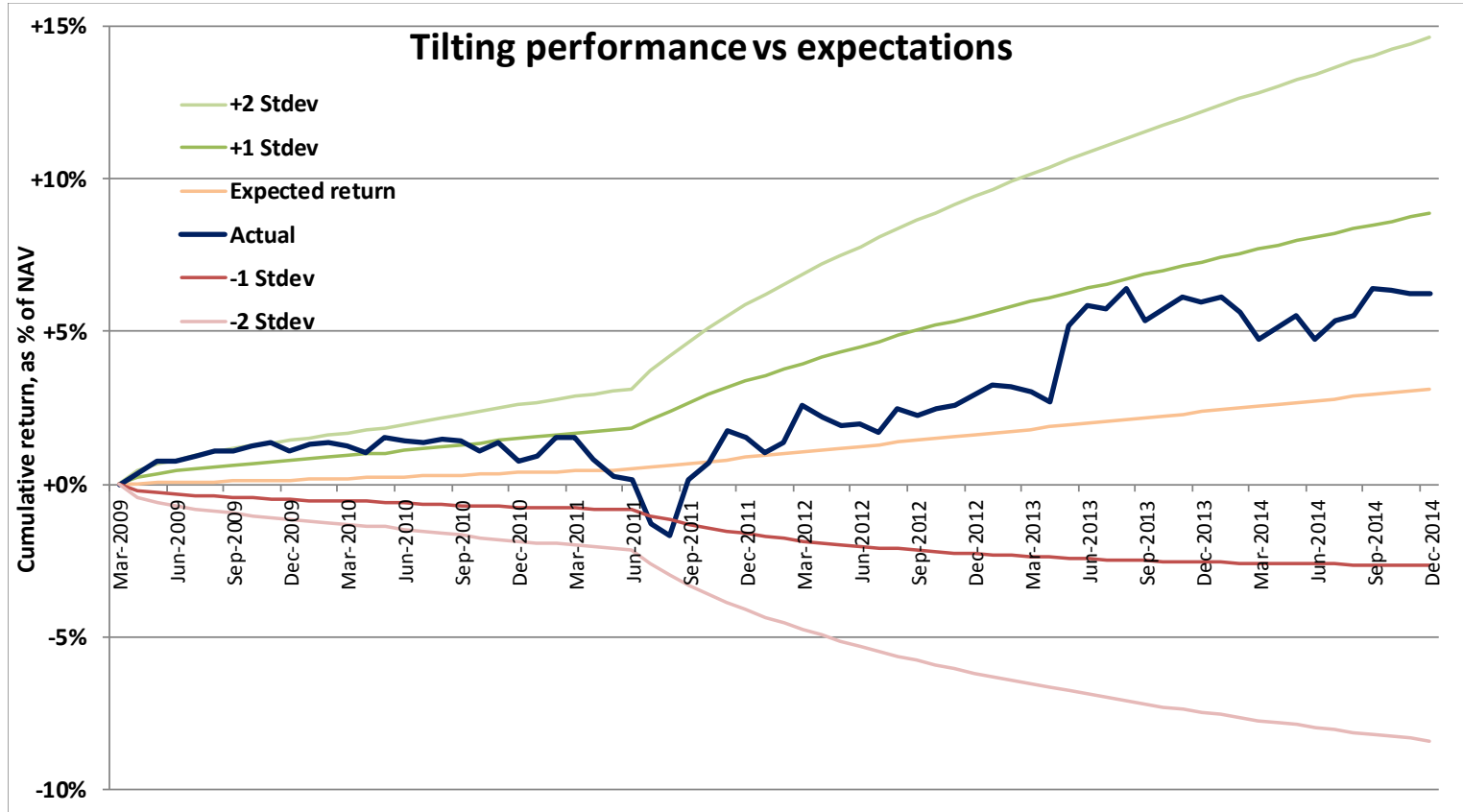
## Approach has evolved, but investment philosophy has not

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/>