



NZSUPERFUND

*Te Kaitiaki Tāhua Penihana
Kaumatua o Aotearoa*

TITLE:

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

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EVENT | PRESENTATION:

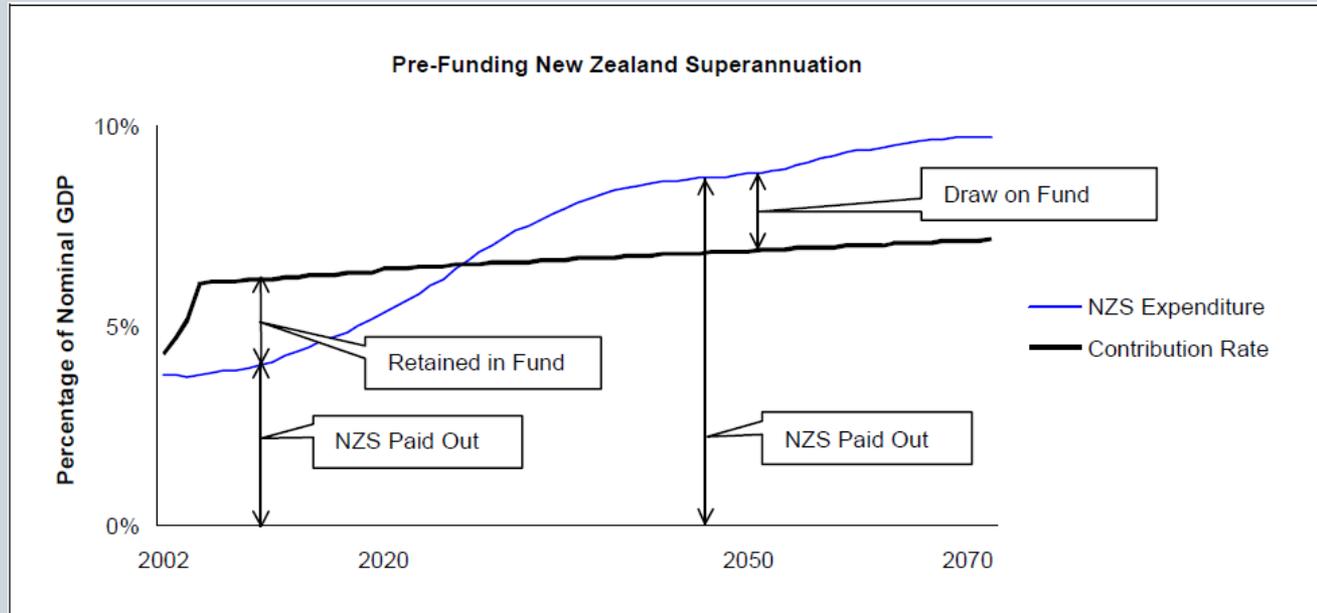
Global Investment Strategy Forum, October 2016

- 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

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 investing	Responsible investors must have concern for environmental, social and governance factors because they are material to long-term returns

Endowment

Our comparative advantages	<ul style="list-style-type: none"> Long-term 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

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

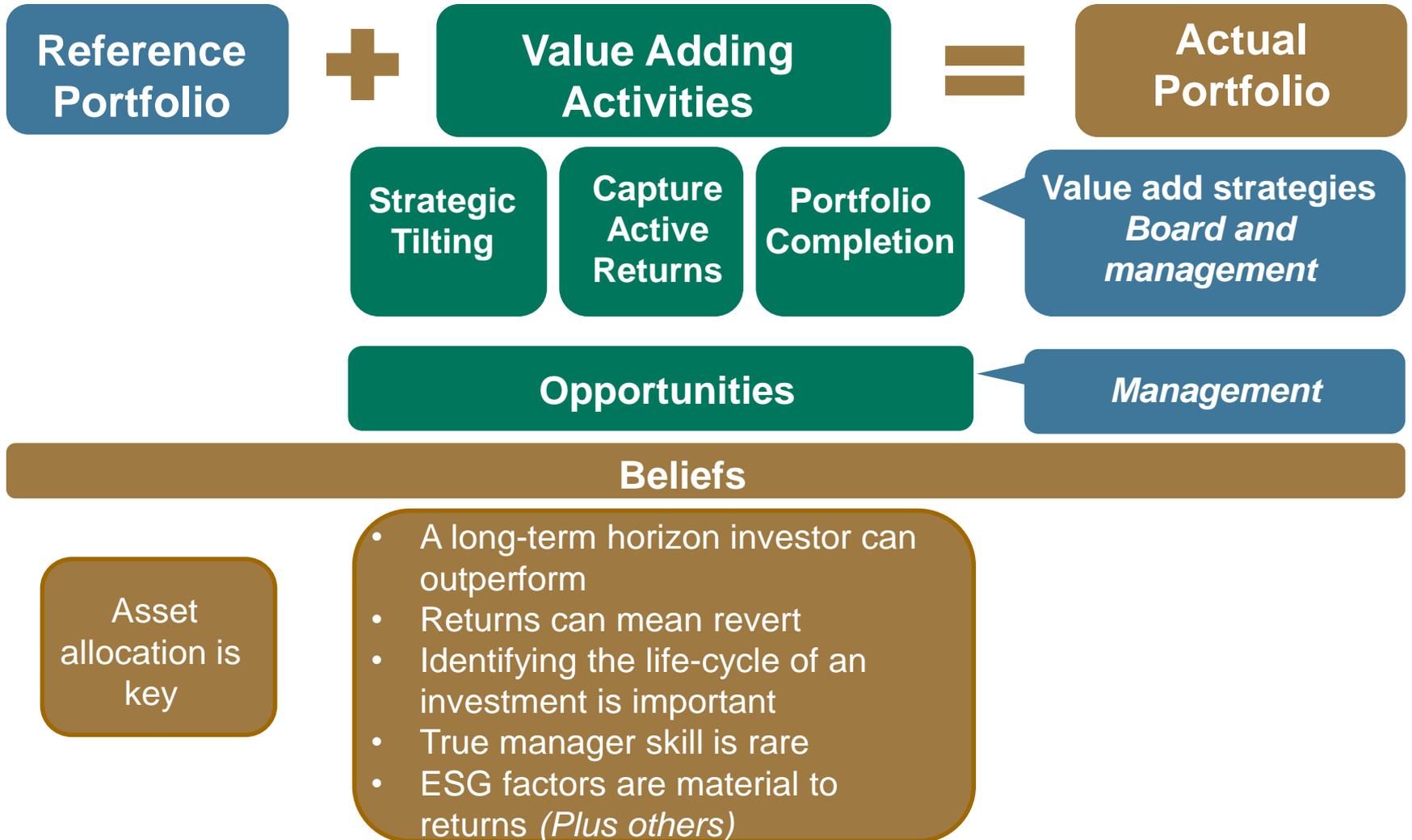
What we are not sure about

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

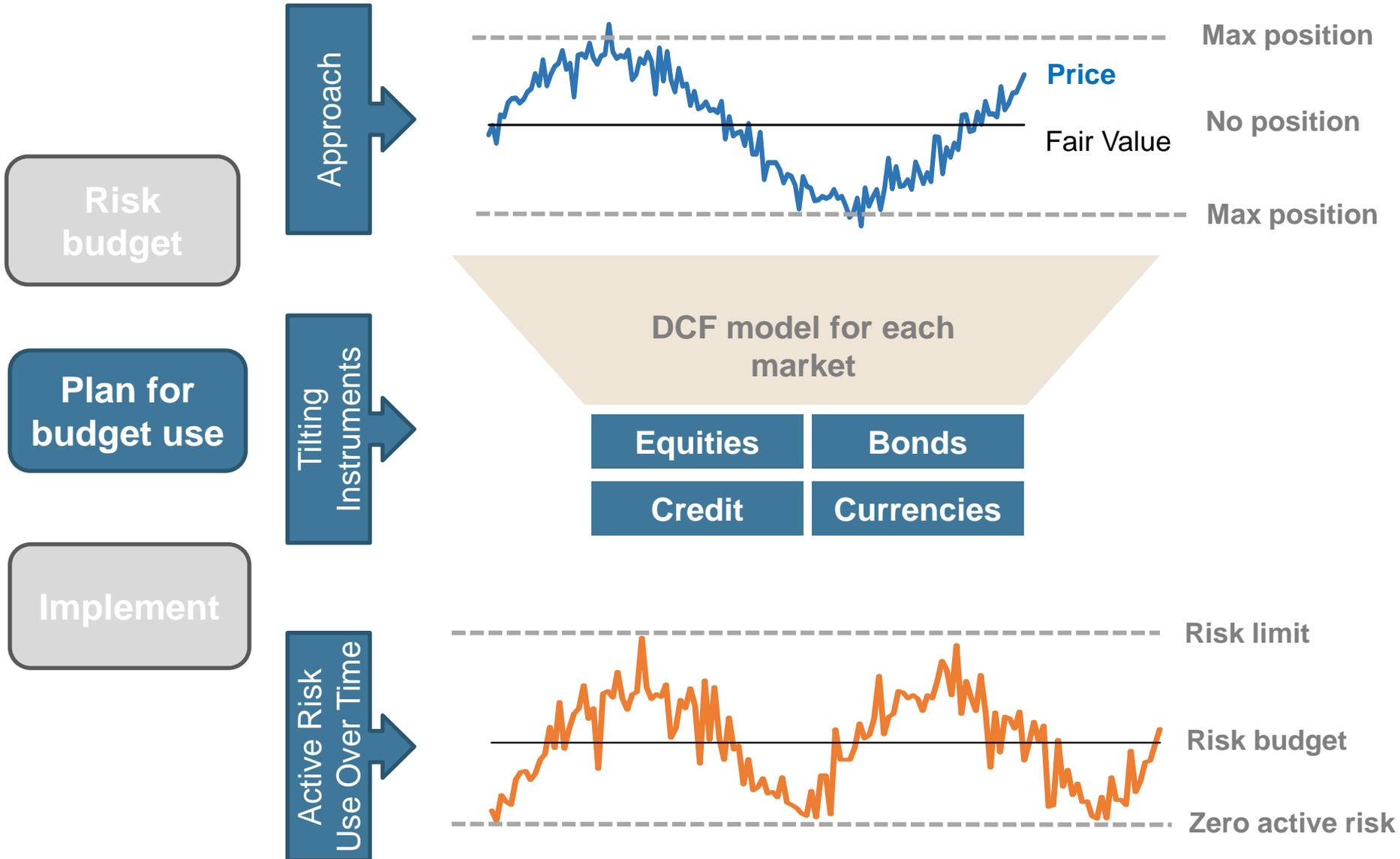


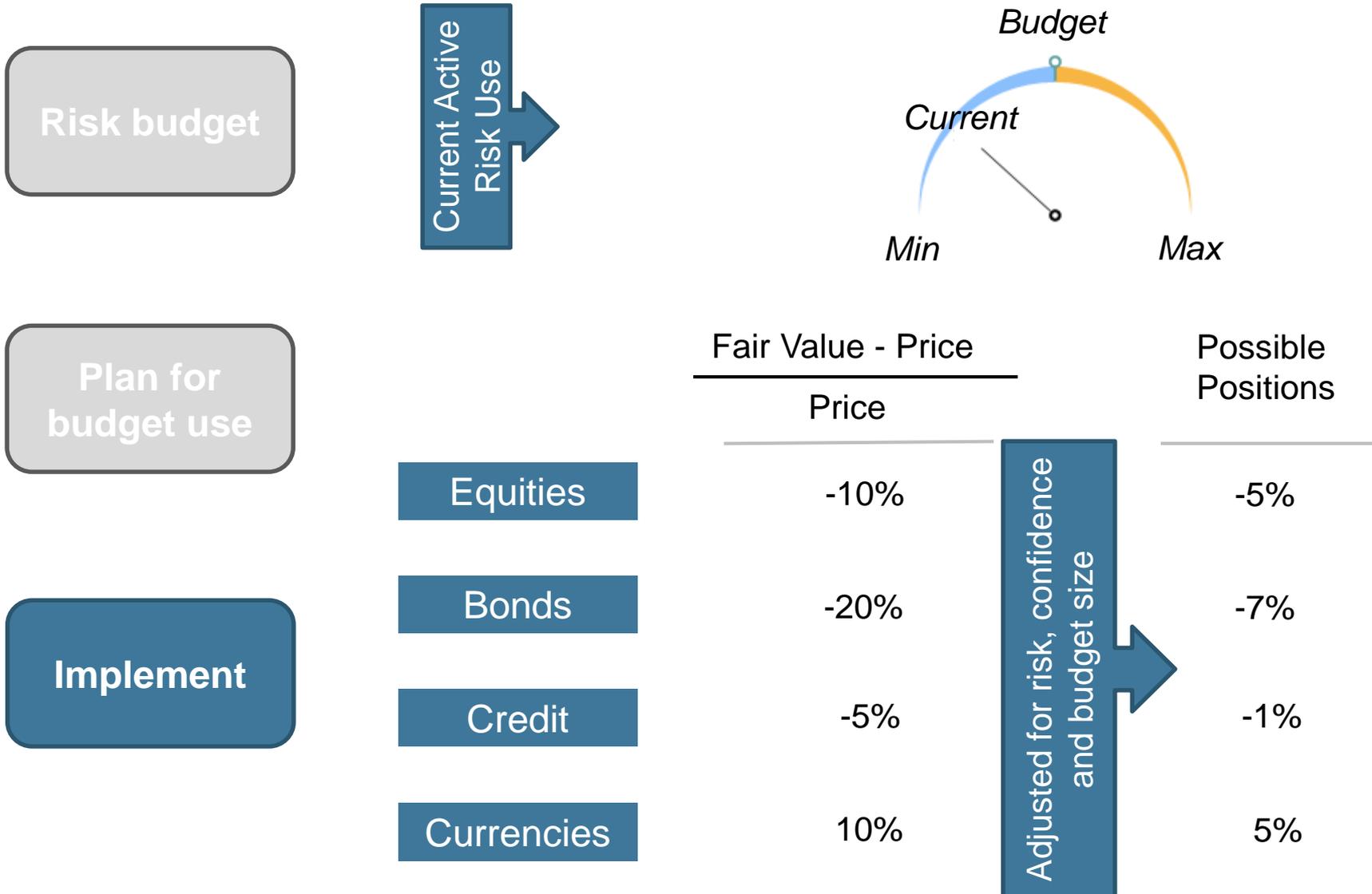
Investment beliefs

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

Tilting philosophy

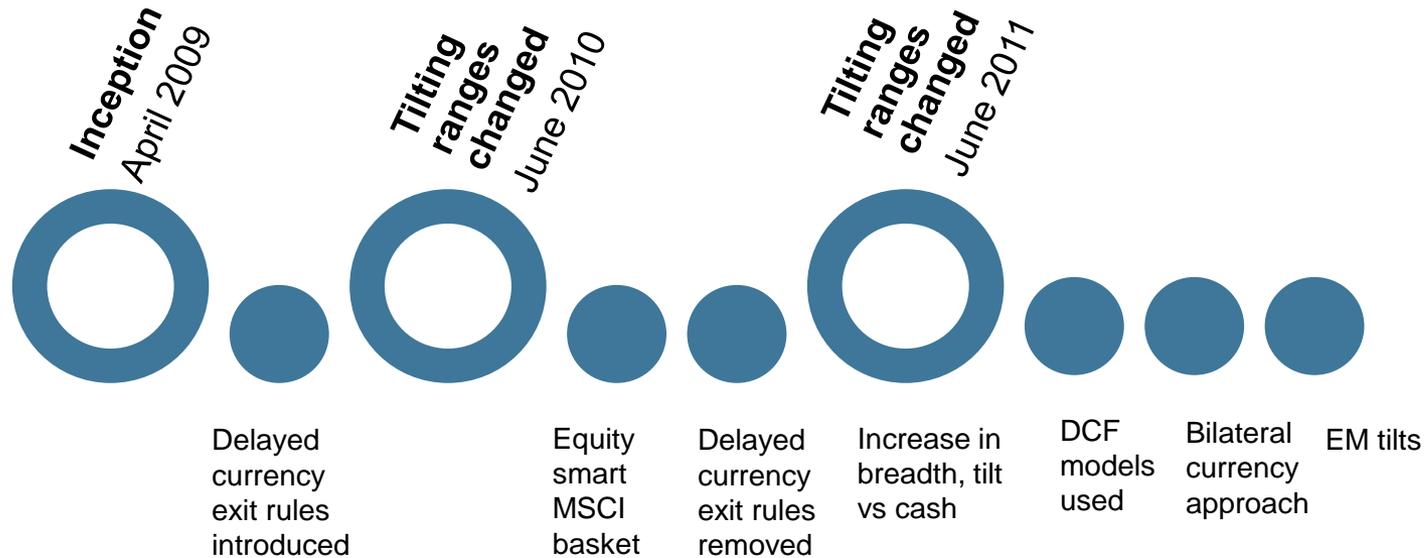
- Mean reversion to fair value
- Long horizon focus
- Disciplined approach to capital allocation



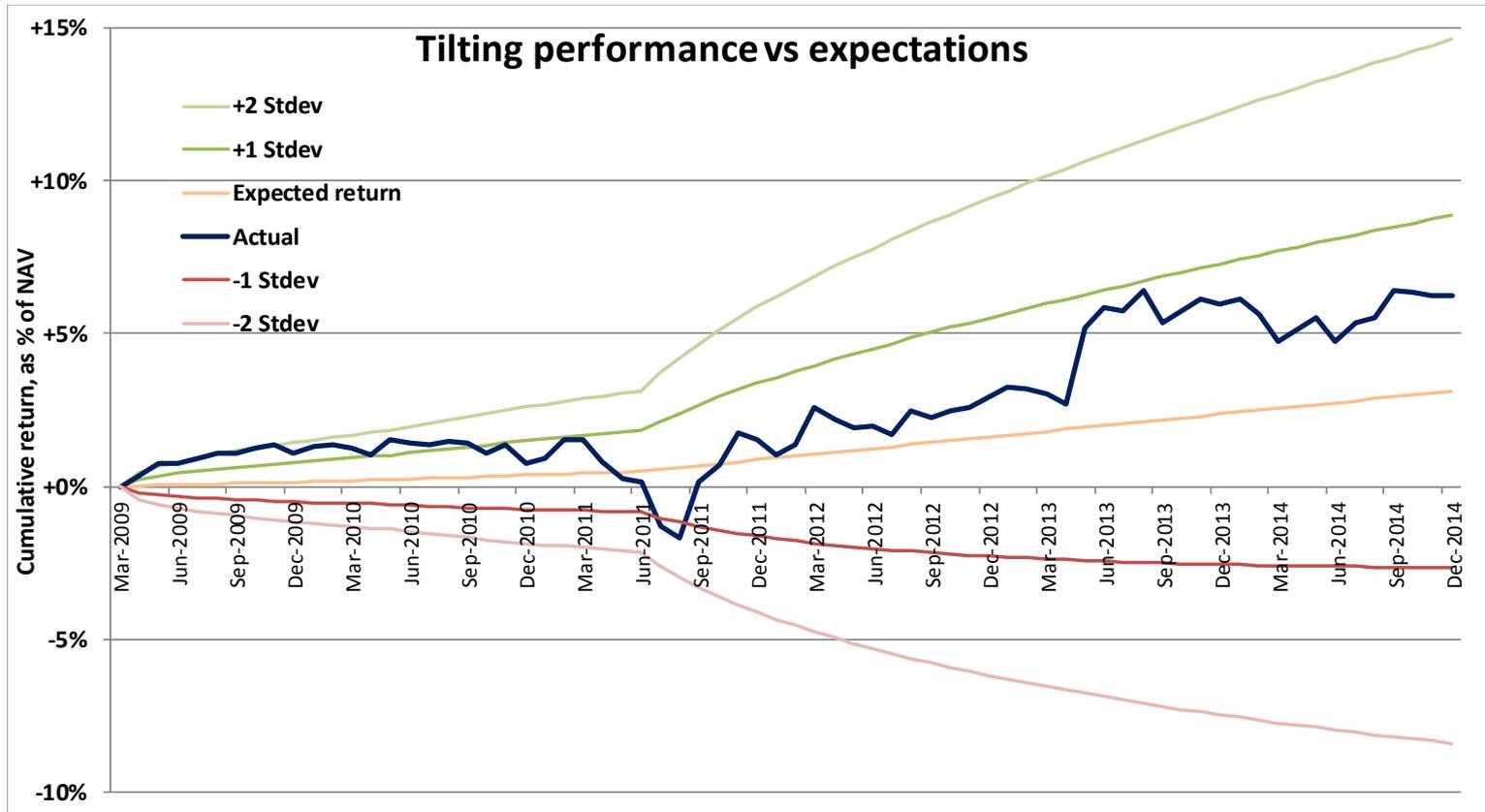


Approach has evolved, but investment philosophy has not

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

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