

Conference highlights

SPS - Local Authority Pension Fund – Investment Strategies – 15 November 2018 – London

This conference examined and debated specific investment opportunities and challenges facing Local Government Pension Scheme funds. Do get in touch with us if you would like to discuss any topic in more depth.

Session 1: Topical Issues

Accessing Private Markets: Current Status and Progress of the Industry

(Jim Strang, Hamilton Lane)

- Private equity is £2.5 trillion (albeit only c.2% of MSCI) but growing: shows its resilience in bad times;
- Deploying capital overhang is key: “keep the shark moving at least at equilibrium speed”;
- Every year there are more than 1,000 new potential investments arising, so don’t spread too thin;
- Funds can “lean” appropriately if they consider a downturn is coming.

Artificial Intelligence: Shaping the Future of Investing?

(Steve Smith, Capital Group)

- Machine Learning is a branch of AI, where machines learn to “think” from mass amounts of data;
- AI is being fuelled by a combination of lower costs, greater processing power, storage, and data;
- AI matters for global businesses, whether technology sector or not;
- Opportunities are mainly in areas such as image recognition, so the very pessimistic predictions on job losses are almost certainly unfounded.

Session 2: Income from Property and Infrastructure

Planning for Cash-Flow Negativity

(Niren Patel, Aviva)

- Driven by demographics and reduced asset yields
- Can achieve higher yields through illiquidity premium, with lower default risk too, eg infrastructure debt;
- By definition, more illiquid stocks pose deployment time challenges which need to be managed, eg by multi asset approach;
- Can compete with insurance company annuity purchasers as fundamentally different characteristics being sought vs constrained insurance requirements.

The changing role of real estate income in cashflow matching strategies

Ian Mason (AEW)

- Traditionally property lay on the risk/return spectrum between bonds & equities, but changing investor needs has led to a broader range of property strategies across the whole spectrum;
- Real estate strategies underpinned by need for stable sustainable cash flows;
- “When markets fall, with equities you lose your shirt, but with property you at least get to keep the wardrobe”!
- Selection of assets can reflect economic views eg through type and location of properties;
- Property is not a hedge against inflation, because of the great variety of lease increase terms.

Build to Rent: Helping to address the UK housing shortage whilst generating a sustainable Income

Angus Henderson (BMO)

- Residential investment sector value is greater than commercial sector;
- Over last 15 years, proportion of people buying their own homes has fallen from 40% to 30%, whereas private housing tenants increased from 10% to 20%;
- “Build to rent” implicitly has ESG characteristics (energy saving etc), to attract tenants as well as meeting regulations;
- There is alignment of interest between local authorities and this investment sector.

Session 3: Management of Assets

Improving cost transparency and Net Return: Big data in action!

Wolfram Klingler (XTP) & Dean Johnson (Sainsbury’s Group Pensions Investment Officer)

- There is increased demand for cost transparency from investors and regulators;
- In effect a performance fee is an option, so that the expected fee can be valued as a fixed fee equivalent;
- Can analyse investment cost data to identify inefficiencies;
- Watch out for private equity situations where the manager charges for say 10 years monitoring fees, but when company is sold before the end of the period, the manager still levies the outstanding years’ fees;
- This and other bad practices do go on and can cost pension funds but go unnoticed: eg rounding up in manager’s favour, excessive third party advisory costs, unnecessary counterparty risk by only going to one bank to seek FX quotes;
- These practices gave rise to conversations with some managers, greater understanding, and reimbursed fees.

Building an Investment Capability

Julian Cripps (RPMI RailPen)

- Railway Pension Scheme can trace its roots to 1853! Now unitised, 150 employers, £28 billion AUM;
- Default portfolio for different employers varying by covenant;
- People: Talent is the scarcest resource in the market: requires a combination of remuneration and being an attractive employer to the staff in a competitive market. Also, this takes time;
- Process: Need to very clear on who is responsible for what and by when;
- Technology & Data: Technology is relatively straightforward to buy in, but data not necessarily so: accounting data is not investment data!

Session 4: LGPS Perspectives

LGPS Current Issues

Douglas Green (Hymans Robertson)

- The actuarial valuation links the Fund's investment strategy with its need to pay the members' benefits;
- Funds need to work with Pools to obtain the necessary asset class building blocks for their chosen investment strategy;
- The LGPS is like an ocean liner ploughing through choppy waters at a stately pace: technical actuarial aspects are in the engine room below decks;
- De-risking / LDI / equity protection are unlikely to be appropriate for the whole ship for its unending journey (albeit may work for those employers who need to "pull into port", i.e. heading to cessation);
- Employer diversity may lead to different investment strategies: the administration of that is relatively straightforward, provided appropriate governance put in place.

What's on the Agenda

Panel session with Phil Triggs (Westminster), George Graham (South Yorkshire), Denise Le Gal (Brunel)

- Much discussion on how to find opportunities among current challenges;
- Funds almost need a corporate planning approach to developing their strategies, taking actuaries' calculated cashflows for current and future membership;
- Being close to full funding opens up new investment and funding opportunities which were not available when the main focus was clearing deficits;
- Are fee reductions real? We think so, and the use of the Transparency Code by managers will help demonstrate that.