Pensions

On The Record What is your European equities strategy?

Cheap and cheerful or approach with caution?

Frjálsi Pension Fund
Iceland
Hjörleifur Arnar Waagfjörð
Portfolio manager

- Invested assets: ISK123bn (€717m)
- Multi-employer professional pension fund
- Hybrid DB/DC
- Solvency ratio co-insurance department (second pillar): -1.1%
- Members: 45,000
- Date established: 1978

“Since the Central Bank of Iceland introduced currency restrictions in 2008, we have not been able to make new investments in foreign currencies with our domestic currency, the krónur. This, combined with the positive net inflows of krónur into the Frjálsi funds, has caused our allocations to foreign positions to shrink. Today they only make up 19% of our overall portfolio. Listed equities amount to about 20% of today's portfolio, of which around 14% are allocated to foreign ones.

The benchmark we use for our foreign equities strategy is the MSCI World index.

Our approach is to invest in equity markets indirectly, through funds, and use a top down approach to make tactical allocations. We use both global funds, which make up 10% of our overall foreign equity portfolio, and at least two or more regional funds in each part of the MSCI regions, such as North America, Europe and Asia. We have on average invested 8-10% of our foreign equity portfolio in emerging markets in recent years although those do not form part of the benchmark.

After the Icelandic banking crisis in 2008, the domestic stock market was down by around 95%. Exposure to the domestic stock market was limited after that at first but has since then been increasing.

With regard to the MSCI World, we are currently underweight European equities by around 4%. Through the funds we currently use to invest in equities, our European bias is more towards mid-cap and Scandinavian positions. Although we could reinvest directly in Spain and Italy, we still retain a sceptical view on their equities. The existence of sovereign risk increases the risk aversion in general, as it could have possible effects on corporate ratings, for example.

We are still cautious and wondering whether the worst of the crisis with regard to Italy and Spain is over.

Regarding the European financial sector, we remain as cautious as we are with Spanish and Italian equities and other high beta and risky positions although signs are that the situation is improving.

In terms of foreign equities, our strategy for this year is to continue to increase our exposure but in small steps only, as the situation slowly improves.

Our situation, of course, is affected by the currency restrictions, which we expect to continue for a while.”

PensPlan
Italy
Armin Weissenegger
Investment director

- Invested assets: €1.3bn
- Project that promotes and provides asset management services to pension funds in Italy's Trentino Alto-Adige South Tyrol region
- DC
- Members: 150,000

“Generally speaking in Italy, new pension funds have a multiple line system whereby the individual member chooses his preferred investment line. Our lines range from a conservative strategy with only 5% invested in equities to a riskier strategy with a 100% exposure to equities. All lines combined, we invest around 35% of our overall portfolio in equities, of which approximately two-thirds is in European equities.

As active managers we continuously work on our tactical equity exposure in order to gain a few additional basis points. Because of this approach, we have shifted over the last few years, particularly in 2007, 2009 and 2010, from European equities to global, with a focus on the US. However, during 2012 we returned to European equities.

As we aim to spread our allocations across the euro-zone we do not have a home bias – Italian equities make up 7-8% of our European equities portfolio. But with a bottom-up approach in trying to find the best companies, we do not overly concentrate on country weightings of benchmarks anyway.

Italian and Spanish equities have suffered severely in recent years due to their economies worsening. Italian equities have on average lost around two-thirds of their peak value from 2000. But in both countries the stock picking of individual names is more important than their respective country's economic output, and many – such as Italy's Campari and Spain's Inditex – have performed independently from the state's worsening credit rating. Luxury brands have also done well.

The banking sector and utilities have suffered much more as a result of the global financial crisis. I only expect a significant recovery of those stocks once the European debt crisis has been permanently solved although today investors are overweight financials again for the first time since 2007.

With regard to financials, you have to distinguish between the geographies. In the US, where the consolidation and merger process in the financial sector started a lot earlier, bank stocks look a lot more attractive and benefit from the property recovery.

In Europe, the fate of the banks, which hold a lot of domestic debt, is more closely interlinked with the fate of their respective domiciles, which is why many still trail their book value. There are of course exceptions such as Santander, which is much better rated than Spain. But in general I think we need to say goodbye to banks as producers of annual double-digit profit growth like in the late 1990s.”

Valida Pension
Austria
Walter Schmoiger
Head of asset management

- Invested assets: over €4bn
- Around 96% are DC plans, 4% DB plans
- All plans are fully funded
- Participants: over 203,000
- Date established: 1990 as ÖPAG Pensionskassen, 2010 as Valida Pension

“The average Valida pension plan currently has an allocation of about 12% to euro zone equities.

Valida decides on the overall equity allocation of the plans but does not make any country or sector allocations.

Country or sector strategies are left at the discretion of the fund manager, while we focus on the fund selection. As such our research is focused on the market in general.

We analyse the euro crisis as a driver of the general market performance but do not make dedicated allocations within the equity area based on our findings. Those are much more influential in our allocation to sovereign bonds.

We stayed out of peripheral bonds for some time. But we took the new Outright Monetary Transactions bond-buying programme by the European Central Bank (ECB) as a strong commitment of the ECB and the EU to save the euro zone from falling apart.

We honoured the efforts of these countries to bring their budgets and current account deficits to a more sustainable level, and as a result have now allocated funds to peripheral bonds again.

The financial sector in Europe has had always a strong involvement with the euro crisis, which was demonstrated by the strong correlation between peripheral spreads, especially Italian and Spanish ones, and the spreads of European bank bonds. As such the easing of the crisis had a very profound effect on bank debt.

This should be a good sign for bank equities as well although the amount of bad debt and the ongoing recession in Europe still pose some challenges.

Lately, some sentiment indicators, such as the German IFO and ZEW indices, have shown signs of improvement. This together with falling peripheral bond spreads gives hope to a general recovery in Europe and should be further positive for stocks.

Since last summer, Valida's proprietary systematic allocation model has been overweight in equities in general, not just in Europe. But should the recovery falter again, we could cut back on our equity exposure in a very timely manner.”

Interviews conducted by Nina Röhrbein