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# Taking ON THE future

INVESTORS ARE FACING the most challenging market environment in many years. Between that and the burgeoning challenge of how to provide retirement income for ageing members, superannuation funds are demanding more than ever from their fund managers and service providers.

Over the last 25 years, Australians have collectively amassed a \$2.3 trillion pool of retirement savings that is forecast by Deloitte to reach \$9 trillion by 2033. It's an impressive sum, but not enough. Roughly 80 per cent of Australians still retire on a full or part age pension. Innovation is needed if the ideal of a universal system to empower average workers to self-fund their retirement is ever to be achieved.

Especially in an era when world interest rates are hovering around record lows and asset prices are inflated from years of stimulatory global monetary policy, that is now being partially tapered, meaning the return outlook for the next 25 years is much more subdued.

"Our view is that we are going to be in a low-return world and...the chances of savers investing their way out of their self-funding problem are not that high," Macquarie Asset Management head Shemara Wikramanayake told the group's annual Research Insights Forum in Sydney on August 31, 2017.

## EXPLORING INSOURCING OPTION

An area of focus for Macquarie's super fund clients is to reduce the leakage from fees and costs. This is true despite average super fees having already fallen from 1.3 per cent to 1.03 per cent over the last decade, according to Rice Warner.

One of the ways some of the country's super funds are seeking to reduce their costs is bringing more of their investment management and advice capabilities in-house. This presents some challenges, the forum heard.

Macquarie quantitative equities portfolio manager Scot Thompson said many of the firm's institutional clients have already insourced some of their investment management or are thinking about it.

"People are thinking about this because

MACQUARIE INVESTMENT MANAGEMENT recently held its annual *Research Insights Forum* for institutional investors. Speakers at the event reflected on the **CHALLENGES investors face** and presented Macquarie's latest research and thinking to help overcome them.

By Mark Fenton-Jones

although the investment opportunity set is growing, they don't appear to be getting what they need," Thompson said. "But it's a balancing act."

While the cost benefits of insourcing might appear attractive, Thompson suggests institutions be mindful of the risks it brings, both competitive and regulatory. He suggested there might be an alternative where the client is able to access flexibility, control and reduced cost by engaging with an asset manager to build a multifactor core portfolio.

The benefit of a multifactor core portfolio is that it complements the active manager line-up. Building a portfolio of active managers may result in some unwanted risk exposures, which may lead to a result that's less than optimal. A multifactor approach can change the overall risk exposure by combining various smart-beta strategies.

"A multifactor portfolio can either be a total equity core solution or just a part of the portfolio that is too small at the moment to justify having a full-blown suite," Thompson explained. "Or maybe it's just a piece of that internal low-risk portfolio, but there are alternatives and people to help you work through those."

Thompson suggests that rather than bringing the core portfolio in-house, clients negotiate alternative management fee structures to reflect the size of their core portfolio or implement innovative fee structures, such as True Index products.

In developing multifactor solutions, Macquarie can assist clients in a range of ways to leverage their relationship, including quantitative research and technological solutions.

Those clients that are able to implement a flexible, low-cost core portfolio are then able to use their risk and fee budget to employ highly specialised managers that provide diversified sources of return, Thompson explained.

## BALANCING RISKS AND RETURNS

While keeping a tight rein on costs is critical, super funds also need to ensure they are managing risks and tapping new sources of returns.

Wikramanayake told the forum that even if the local super industry reduced its average investment fee from 1 per cent to 50 basis points, it would not make a material difference to the rate at which retirement savings are compounding. A holistic approach is required.

"In addition to focusing on fees and cost, we as an industry need to think much more about capital preservation and superior return for risk," she said.

Wikramanayake also noted the need for super funds to ensure their investment strategies reflect the risk profile of their ageing members.

"In a low-yield environment, sequencing risk becomes a much bigger issue if you have a big downturn in your savings pool," she said.



**SHEMARA WIKRAMANAYAKE**  
Head of Macquarie Asset Management

“It takes a long time to catch up so we need to be protecting capital a lot more in this world we are in, but we also need to be looking at how we can add more meaningful returns without stepping up risk.”

Macquarie executive director and head of fixed income research Dean Stewart told the forum that even in the current low-yield environment, bonds can play a major role in capital preservation.

“Protecting against sequencing risk is actually far more important, and more effective, from bonds in this low-yield environment,” he said.

Stewart noted that over the last three decades, the average super fund allocation to bonds has dropped from 40 per cent to 10 per cent. Despite this, he argued, the asset class still has an important role to play in portfolio construction.

“If we are trying to deliver something that is not going to give members a lot of surprises or shocks when they go to use that money, we need to be investing in things that move with the liability, and bonds are the asset class that goes up when retirement liabilities go up,” he said.

### INFRASTRUCTURE AS AN ASSET CLASS

Infrastructure is an alternative source of yield that has been an important contributor to the returns delivered by the super industry over the past two decades.

Macquarie executive director and Asia-Pacific co-head of infrastructure and real assets, Frank Kwok, told the forum that he expects the sentiment surrounding infrastructure to remain positive, despite the increase in valuations in recent years.



**SCOT THOMPSON**  
Macquarie quantitative equities portfolio manager

He is confident that continued demand from pension funds will fuel innovation in this asset class.

Macquarie was a pioneer of infrastructure investing, having taken a stake in more than 200 infrastructure companies through its infrastructure and real-assets division over the last 20 years, with more than one-quarter of those investments now realised.

As infrastructure as an investment class matures, pension funds are increasingly focused on the composition of their infrastructure allocation, determining what subsets of the asset class and respective return profile – infrastructure debt, super core, core or core-plus infrastructure – best fit their desired portfolio.

With increased demand for the asset class, sourcing good investments is even more critical. One of the ways Macquarie is sourcing infrastructure investments is by identifying captive infrastructure assets within large companies in sectors such as energy, transportation, resources and telecommunications. These companies are increasingly seeing the benefit of disposing of their infrastructure assets via long-term investors who value these assets at a lower cost of capital.

### BIG DATA

The impact of big data and machine learning on the investment landscape was also examined at the forum, which heard

from Björn Österberg, the chief investment officer and head of research of Stockholm-based Informed Portfolio Management (IPM).

“Machine learning is not new, I was experimenting with supervised and unsupervised neural networks back in the early ’90s,” Österberg said. “However, big data is new and is making new datasets for investment signals available.”

Österberg provided a fascinating example of how it is now possible to use satellite imagery data to measure economic activity directly, rather than having to wait and rely on official GDP data.

“New data vendors are emerging and making these new data sets available to investment markets,” he said. “From an investment perspective, knowing how to develop investment signals from these new data sets, and how to build portfolios to profit from those signals, is where the lion’s share of the value add remains.”

Australian investors can now access IPM’s systematic global macro strategy via the Macquarie Professional Series.

Taken together with the other innovations and insights that were detailed throughout the forum, Macquarie’s approach is to look for value and efficiencies in existing assets and processes, rather than dramatically replacing them. That way, their clients’ members will be on a surer footing to provide for their retirement when faced with the present low-return environment. ✕

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