Getting ahead in challenging markets

Ian Mizrahi, head of portfolio management, explains how pension funds can address key investment challenges by partnering with new generation asset managers, delivering access to a broader universe of investment opportunities, trading expertise and technological innovation

What are some of the key portfolio management challenges for pension schemes at present?
Pension managers and trustee boards are looking for new ways to manage their investment portfolios more effectively in a turbulent environment. Three of their key challenges are:

- How to access greater investment opportunities and diversification
- Adjusting portfolios quickly in changing market conditions
- Managing risk more effectively

Why is accessing a broader investment universe important and how can it be achieved?
Many traditional, single asset class investments have failed to deliver consistent positive returns over the last decade. Investors are looking for additional sources of value across a broader universe, such as commodities, emerging markets and derivatives, as well as the ability to go long and short and use options to reduce volatility and protect capital.

Pension funds have started to invest in these non-traditional assets classes, however, establishing the capabilities in-house may be challenging. It requires a combination of investment and trading expertise, a more complex risk management framework, ISDA (International Swaps and Derivatives Association) agreements, and legal and operational know-how to make it work.

We have developed a turn-key platform that allows our clients to invest across all asset classes in both cash and derivatives. Our clients can focus solely on making investment and asset allocations decisions across almost every market and instrument and we can take care of the implementation front to back.

Being able to act fast seems to have become more important in the current volatile markets. What trends are you seeing in the market to address this need?
There are a number of approaches depending on the asset composition of the scheme and size. Generally pension portfolios are built upon sub-advisory mandates and investments into third-party vehicles. This type of investment structure can require significant lead time to adjust.

To enable faster implementation of investment views, pension funds are increasingly using tactical asset allocation overlays which sit over the strategic portfolio but are composed of highly liquid investments, such as exchange traded futures and other derivatives. Such overlays enable managers to change the overall risk profile of their portfolios in minutes or hours depending on the portfolio size. If the pension scheme then wants to make a permanent reallocation between asset classes, the transition management can take place more slowly, adjusting the overlay and the main portfolio in tandem. This approach provides continuity in the overall asset allocation and avoids taking on unintended risks or trading costs.

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We have a successful track record delivering these solutions to our clients. Successful delivery relies on our experienced cross-asset investment team and a scalable platform. Look-through capabilities are also essential as they enable pension managers to access a consolidated, granular view of their portfolio across all investments including the overlay.

In this model, who makes the tactical asset allocation decisions?
This is entirely up to the pension scheme. Some of our clients manage the tactical asset allocation on a day-to-day basis, others prefer to focus on the strategic portfolio and rely on us to manage tactically. We can accommodate either approach.

Risk management is an important topic. What are some of the developments you are seeing in this area?
Given the significant volatility the markets have been experiencing, many of our clients are looking more actively at tail-risk hedging and principal protection strategies. Our team works with trustees and pension managers to develop customised solutions which meet their specific risk hedging needs. Once the solution is in place, our experienced investment managers implement the strategies front to back and provide detailed reporting based on the requirements of the trustees' mandate. For instance, we have worked with institutional clients on rolling option-based risk hedging strategies which protect their portfolios for market drops of more than 10%. The strategy has the additional benefit of diversifying the portfolio and enhancing returns during bear markets.

Any final comments on your approach?
Investment breadth, implementation speed and active downside risk management are key ingredients for enhancing investment value. There are significant challenges in developing some of these capabilities in-house. We offer flexible solutions that allow pension managers to access more investment opportunities globally, act quickly via tactical asset allocations, and reduce downside risk through our sophisticated investment and risk management platform.

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The asset management business of Barclays Capital

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