PPCmetrics

Investment & Actuarial Consulting, Controlling and Research.

www.ppcmetrics.ch

COUNTRY REPORT
SWITZERLAND

Shifting from fixed income

INVESTMENT STRATEGY
LUIGI SERENELLI

Swiss pension funds are rebalancing their portfolios but allocating to certain asset classes could prove challenging

KEY POINTS

- **Infrastructure looks set to gain in importance as an asset class**
- **Migros has increased its allocation to corporate bonds**
- **Pension funds are overweight equities**
- **The share of illiquid investments is expected to rise**

Investment strategies of Swiss pension are going through a makeover. The exposures to equities increase. Investments in infrastructure grow in importance. Fixed-income investments continue to decline, but still represent the largest part of the portfolios.

Swiss pension funds currently allocate about 34% of the assets to bonds, 31% to equities, 20% to real estate and almost 10% to alternative investments (see figure).

Persistently low interest rates prompted a decrease of the share of fixed-income investments "by a further 4 percentage points in the last five years, and of a good 7 percentage points over the last 10 years", says Heinz Rothacher, CEO of Complementa. This has freed up capital available for equities, foreign real estate and alternative investments. The share of alternative investments went up by 2.8 percentage points over the past 10 years, currently at 9.4%, slightly below the previous year's values, Rothacher explains. In the recent past, he says, pension funds have looked with interest at physical gold as a reserve currency.

The share of allocation in commodities is slightly down, currently at 1.2%, he says. Swiss pension funds have built up allocations in "private

"Individual pension funds have carried out a rebalancing between developed and emerging markets"

Hansruedi Scherer

equity, currently at 2.1%, private debt at 1.4% and infrastructure investments at 1.4%", Rothacher says.

Meanwhile, the share of hedge funds investments has steadily declined and is currently at 1.5%. The Pensionskasse of the city of Zurich (PKZH), for example, has decided to cut the exposure to hedge fund investments from 9% to 7%. At the same time, it has lifted its allocation in equities, corporate bonds, insurance-linked securities and real estate. It is investing in renewable energy infrastructure for the first time.

"Infrastructure investments will continue to gain in attractiveness in the future", as they are no longer classified as an alternative investment, Rothacher says. A new law allows pension funds to invest up to 10% of their assets in infrastructure, but the impact will be seen only next year. "The illiquid nature of the asset class creates a delay between the investment decision and the investment itself. This means that infrastructure investments can only become visible with a 12-month delay," he says.

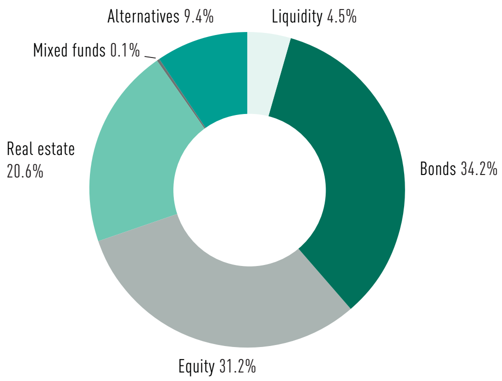
Core/satellite approach

Migros Pensionskasse divides its portfolio in equities, fixed-income and real estate. "Alternative investments do not constitute an asset class in themselves but are, depending on its underlying assets, allocated as a 'satellite' product to one of the three main asset classes," says Christoph Ryter, CEO of Migros Pensionskasse. Investing in infrastructure represents a possibility to diversify Migros's real estate portfolio. "We consider infrastructure investments, in particular brownfield projects, attractive due to the steady cash flows, which help us to meet our pension liabilities," he says.

The same is true for the pension funds' real estate portfolio itself, with its regular rental income. Most of the real estate portfolio at Migros consists of Swiss residential properties. "Volatility in this portfolio is very low, with stable cash flows. Our foreign real estate portfolio has somewhat higher risk exposure with a core allocation to logistics, residential properties and office, but also diversifying into other areas such as retail, student housing or others," says Ryter.

Migros has also invested with other

Swiss pension funds: 2020 asset allocation



Source: Complementa

pension funds in a green-energy infrastructure fund managed by Aquila. "This is a collective investment vehicle supported by the five pension funds and we will invest more in the future to expand the portfolio," Ryter says. The pension fund's allocation in fixed income instead was reduced to 33% from 40%. "Within fixed income, we increased the allocation to corporate bonds. Before we had more government bonds, now we have more credit risk in the portfolio, and this is something that changed continuously over the past 15 years," he says.

Sticking to strategies

Swiss pension funds have bravely held firm to their investment strategies over the past year, despite the COVID-19 crisis. They have been rewarded with positive results. "Strategic decisions are based on long-term factors and market fluctuations have hardly had any influence on the decisions, says Hansruedi Scherer, partner at actuarial consultancy PPCmetrics. Returns achieved on the equity markets have led to an increase in the funding ratios, which could lead to a more aggressive investment strategy, he says.

At the end of August, most pension funds had tactical overweight positions in equities, according to Scherer. "Mostly because of market drift and less because of positioning changes based on market forecast," he says. Some pension funds have reduced their equity overweight somewhat, but overall "we are still seeing an equity overweight", he says.

Migros has reduced equity allocations with the new strategy to 28% from 30%. The difference of 2% was allocated to gold, "which diversifies well against other asset classes", Ryter says.

Compenswiss is likely to increase allocation in equities to 26% next year, up from 24% last year, "as we can only slightly increase our equity portion", chief investment strategist Frank Juliano says. The remaining part of Compenswiss's portfolio consists of bonds, real estate and a small allocation in gold. The pension fund is evaluating the possibility of increasing allocations in other asset classes because of lacklustre returns on the bond side. "Currently, we are looking at private debt, and next year other segments will be looked at as well," he says.

Compenswiss is under liquidity constraints, limiting its scope for action. "As far as less-liquid investments are concerned, we have been sticking to real estate because it is more diversifying. We do not invest in private equity. Infrastructure remains challenging as it requires investment over a long period of time," Juliano says. Within equities, Scherer says, emerging markets are already at least market-weighted by most pension funds, so "we are not assuming a further increase".

On the other hand, he says, it is likely that even more pension funds will invest in emerging market bonds in the future. It is mostly large pension funds that invest in such assets at present. Pension funds have decided to tactically slightly underweight their exposures to emerging markets stocks because of lower returns so far this year than those of other stock markets. "Individual pension funds have carried out a rebalancing between developed and emerging markets," Scherer says.

Illiquidity premium

The share of illiquid alternative investments is expected to continue to rise. "The associated illiquidity premium represents an additional income that is often needed, especially in the context of low interest rates," he says. Investing in illiquid asset classes is expensive and complex, however. "Smaller pension funds could be disappointed by allocating in alternatives," he says.

Swiss pension funds have traditionally invested in real estate. In the Swiss market, Compenswiss holds only indirect real estate. "In order to further diversify the portfolio, we have been reviewing the investment process and have significantly developed foreign real estate indirect investments," Juliano says.

Compenswiss will continue investing in this asset class with core plus funds. "For real estate, we started with Europe, followed by Asia, and this year we have increased the allocation in foreign real estate with core plus funds and have invested in US real estate funds for the first time," he says.

"Also, in times of stress the goal is to stick to the strategy," Ryter says, adding that Migros reviews, on average, the investment strategy every four years. With the new strategic asset allocation it has increased investments in real assets, including real estate. "Due to the illiquidity of those assets the implementation will take some time, with a target of two years to implement," he says. The complexity of those assets from a fundamental, operational and legal perspective requires a detailed due diligence analysis before the investments and increasing monitoring efforts, he says.

We publish more than 40 articles on various topics per year.

Publicat-
ions

Our experts share their knowledge and opinions with the public.

Videos

Experience our conferences, which we organize several times per year.

Confe-
rences

PPCmetrics AG
Investment & Actuarial Consulting, Controlling, and Research.
Read more

Website