

ACHIEVING INVESTMENT EXCELLENCE

Theory and Practice of Investment Beliefs

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A Swiss Pensions Carveout event



Partner



- 1. The board as a source of return**
- 2. Investment beliefs – why it matters and works**
- 3. Working with beliefs: the case of a large Dutch pension fund**

1. The board as a source of return

The sources of prolonged below average performance of pension funds are basically a lack of board governance budget:

- knowledge, skills, behavior

So boards are key in the long term success or failure: they make the decisions.

Large research project to help trustees worldwide, ending in this book.



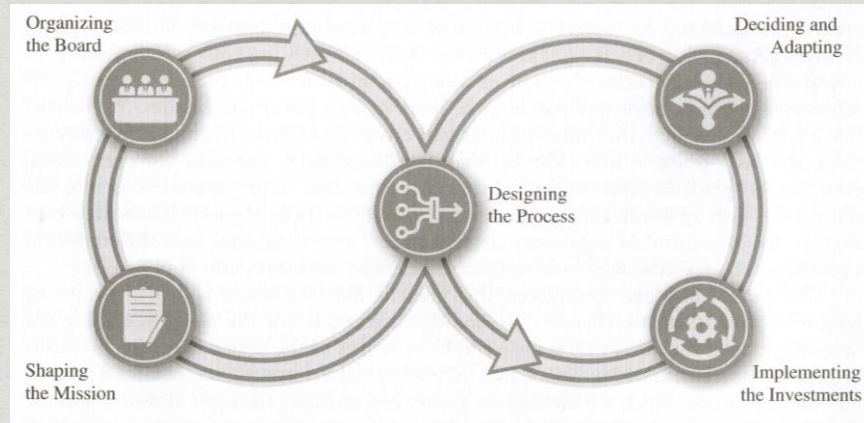
How to position beliefs?

How do we achieve with our investments what we want to achieve?

They help you to enhance effectiveness.

Provides guidance to key decisions:

- Designing the process
- Implementing the Investments
- Deciding and Adapting



2. Investment beliefs – why it matters and works



My lessons



All investment choices have assumptions.

These assumptions are **tested** at the worst possible times.

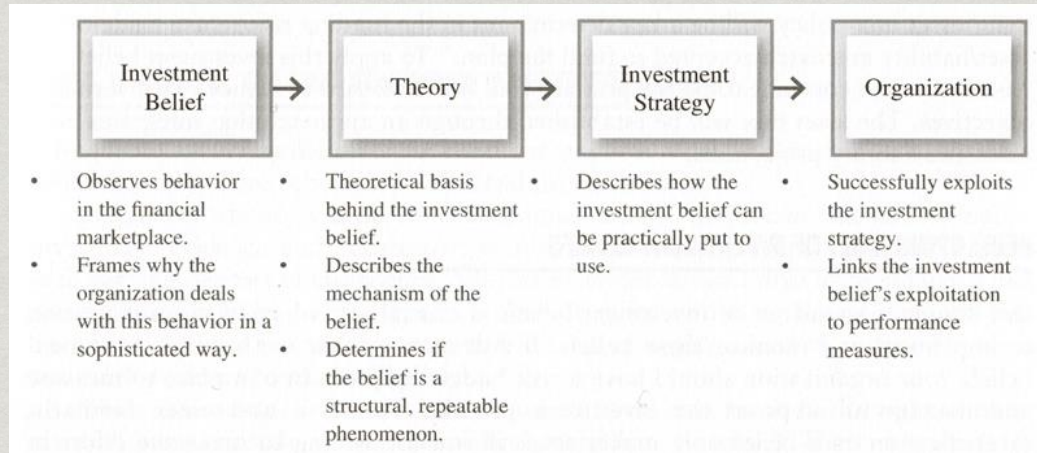
Good boards think through them **beforehand**.

And the way to do this is by formulating your **beliefs**.

Key questions

- * What are investment beliefs – why do we need them?
- * How do we link them to implementation?
- * When do we change them?
- * What mistakes should we avoid?

How it works



Starter set: 80% of the decisions

Belief 1: Strategic Asset Allocation is the most important choice in the investment process.

Belief 2: Active management does not pay off.

Belief 3: Costs determine net return.

Belief 4: There are only a select number of risk premiums worth pursuing.

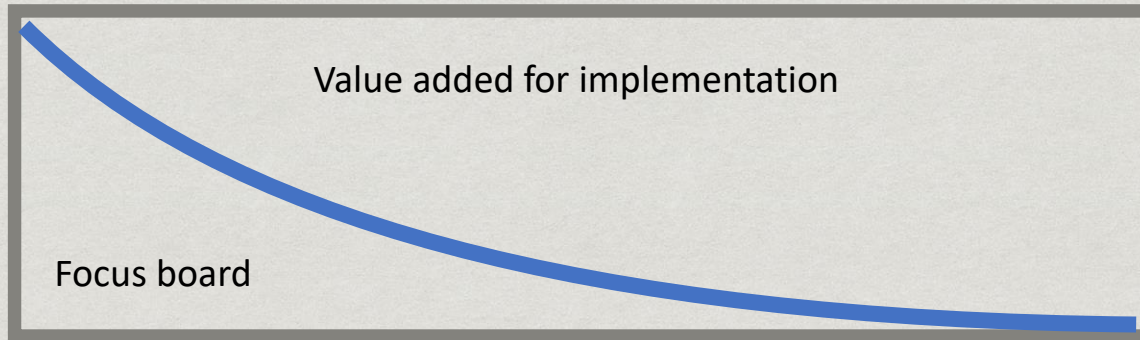
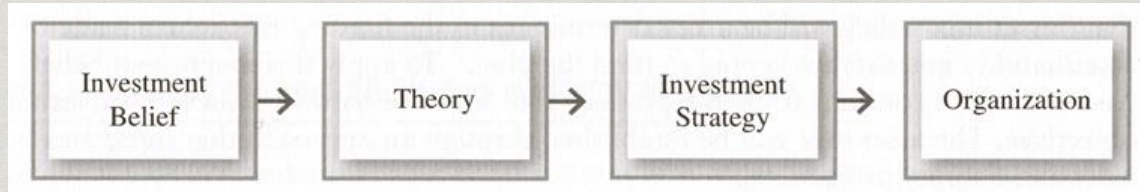
Belief 5: Simplicity pays off: we match governance and strategies.

Belief 6: We only invest if we agree on when to exit.

Belief 7: Sustainability is an opportunity, not a necessity.

Belief 8: Checking against procyclical behavior pays.

Linking beliefs to implementation



When to change them?

High	We are very confident about the evidence presented; new research will not provide new insights; we can assume that the true effect lies close to the estimated the effect.
Moderate	We are moderately confident in the evidence presented; the true effect is likely to be close to the estimated effect, but there is a possibility that it could be substantially different.
Low	We have limited confidence in the evidence presented: more studies or different methodology might well change the outcome.
Very low	We have very little confidence in evidence presented: any new research is very likely to change the outcome.



Not when results disappoint,
but when evidence changes

Mistakes to avoid

- * Beliefs that are copied from industry leaders.
- * Beliefs based on results
- * Too simplified beliefs
- * “I strongly believe in . . . ”: hope kicks in

3. Working with beliefs: the case of Dutch pension fund PFZW

The Challenge

2011...

1. Need for strategic redirection after the Great Financial Crisis
2. Many new people on the board and new roles
3. Lack of clarity on shared principles guiding investment decision making
4. Need for disciplined & collective guidance to the fiduciary manager (PGGM)

Process

1. Strong commitment of 6 key board members
2. Outside in views – many experts interviewed
3. Board takes the lead. Serious amount of board time committed
4. Collectively embraced by board



Framework

The principles laid down in the “investment framework” provide the basis for the strategic plans (2015 – 2020 and now 2020 – 2025). Three dimensions:

- How to achieve financial goals
- How to look at responsibility
- How to be in control

Every investment decision is guided by the same 5 criteria:

- Contribution to financial goals
- Contribution to sustainable / responsible investing
- Cost
- Controllability / complexity
- Communication / explainable

Outcomes

- Increased board comfort on the oversight of the investments – focus on forest
- Decision making on the basis of standardized documents
- Complexity of portfolio was reduced – e.g: exit hedge funds
- Investment cost has been significantly lowered, efficient implementation
- Discipline in how we think we can generate returns, e.g., not TAA, not active in public markets, etc.
- Basis for next steps in responsible investing

Ownership, maintenance, and review of investment beliefs

1. The beliefs have to be alive and kicking. This is not always easy
2. Ownership of the beliefs is in the hand of the board...
3. ...but board members come and go
4. Critical moments: do new members subscribe to the beliefs? Do you formally educate them?
5. Reviewing and maintenance are key. In the end, the beliefs are a set of working hypotheses that can and should be improved.

Practical Advice

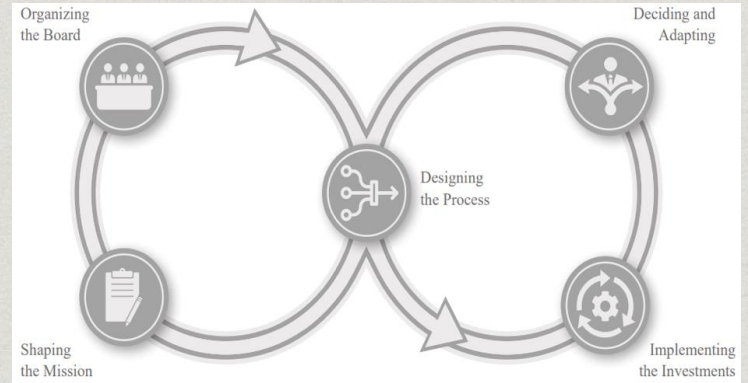
When to consider building (new) investment beliefs?

1. Leakage / Sub-optimal outcomes (cost, negative alpha)
2. Board / Investment Committee not does not feel in control the investment process / manager
3. Waste of board time on decision making, focus on trees, not on the forest
4. When you seriously want to move up the excellence ladder

As a smart investor, you have a huge interest in having a great board. It will improve the value chain and lengthen and deepen relations between boards and investors.

Summarizing our key take aways

- Investment beliefs invaluable tool to be a successful long-term investor.
- Good beliefs are owned by the board, shared and used daily
- Trustees to take ownership of the investment process
- When to change your beliefs?
- Do not try this at home: what to avoid



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