

## **MANDATEWIRE**

### **Swiss pension funds diversify investment portfolios in uncertain markets**

By Alexandra Tischendorf 8 June 2022

**Swiss pension funds are reviewing their long-term investment strategies as inflation and the war in Ukraine continue to test the resilience of their investment portfolios. However, schemes are coping surprisingly well with these challenges, says Alexandra Tischendorf, head of investment at WTW in Switzerland.**

On average, Swiss pension funds lost 7 per cent in the first phase of the pandemic in March 2020 but ended 2020 with a strong performance of around 4 per cent.

Two years later, markets are again suffering from shock losses, driven by the war in Ukraine and the build-up of problems for economic growth in a higher inflation environment. As a result, Swiss pension fund portfolios fell by almost 3.5 per cent in the first quarter of 2022.

However, most pension funds have reacted calmly to this development. They continue to follow the long-term trend of increasing real assets, equities and alternative investments in their portfolios.

In preparation for the current inflationary environment, we have witnessed investors reviewing their long-term investment strategies to ensure they are crisis-resistant. Specifically, investors continue to evaluate the size of their nominal assets and, if necessary, they are looking to tactically underweight them or shorten their duration.

As high inflation rates can also harm real assets at some point, we have a neutral stance on equities and real estate, and rather support investors reviewing their long-term direction paths.

#### **Pension assets double**

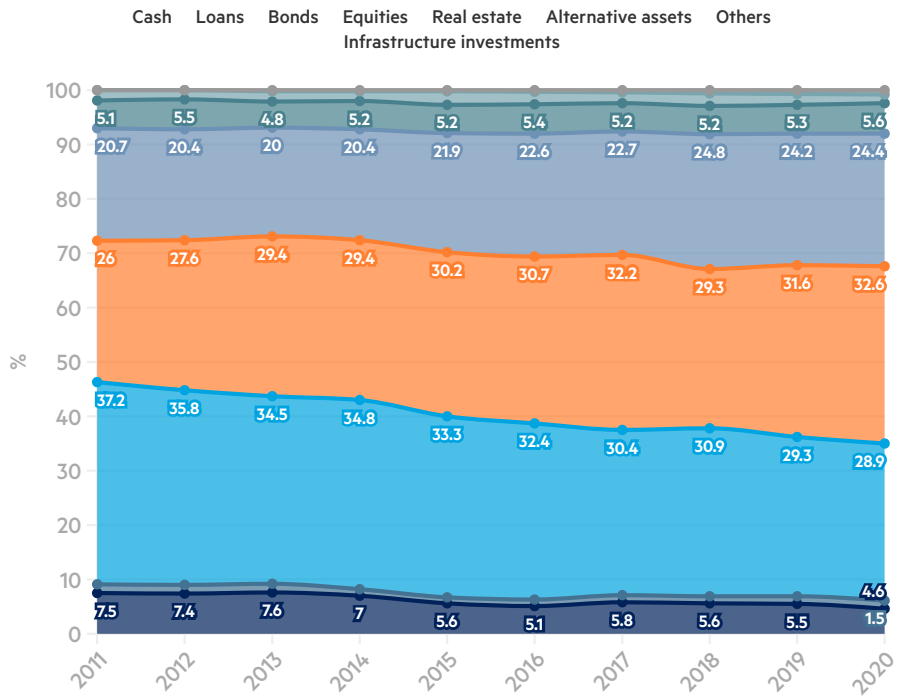
Swiss pension fund assets under management have grown significantly during the past 10 years.

According to the Global Pension Assets Study 2022 conducted by the Thinking Ahead Institute – a global, not-for-profit research and innovation hub – Swiss pension assets doubled to \$1.3tn (£1tn) in 2021, from \$666bn in 2011. This was an impressive annual growth rate of 6.7 per cent.

With growth in assets under management and the low interest rate environment, Swiss pension funds' asset allocation has also changed during the past decade.

According to OAK BV – the Supervisory Commission for Occupational Pensions in Switzerland – pension funds invested around 46 per cent of their assets in fixed income-related investments such as bonds and cash in 2011. This share dropped to 35 per cent at the end of 2020.

### Swiss pension funds' asset allocation



Source: OAK BV, Bericht finanzielle Lage der Vorsorgeeinrichtungen 2011 – 2020



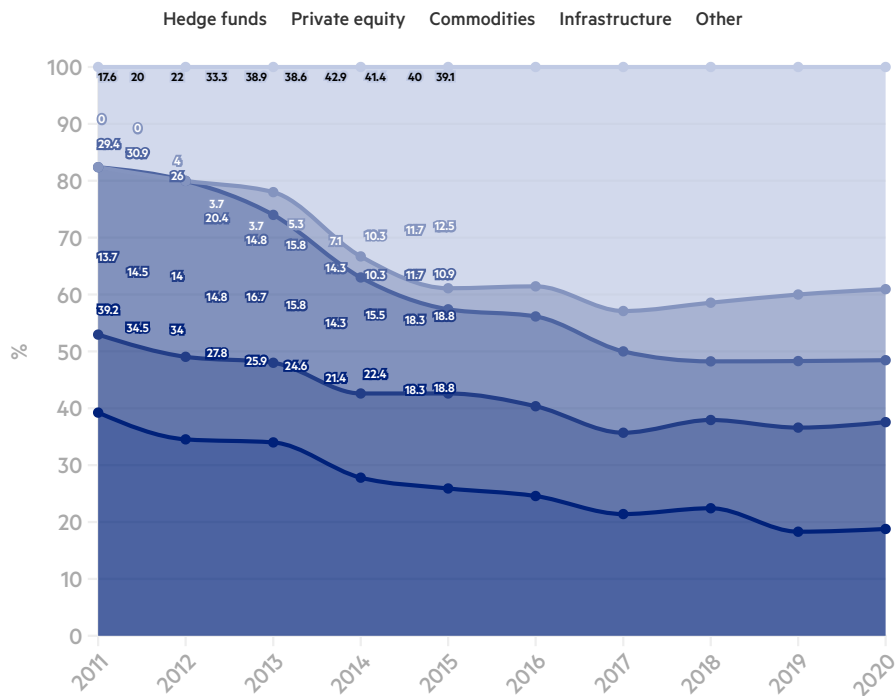
The search for returns led to a clear shift away from safe, partly negative-yielding (government) bonds towards equities, real estate and alternative investments.

The OAK BV report shows that Swiss pension funds reduced the share of domestic bonds drastically by a third to 18.7 per cent at the end of 2020, from around 28 per cent in 2011.

During the same time period, the share of equities rose to 32.6 per cent, from 26 per cent, while investments in real estate increased by 3.7 percentage points to 24.4 per cent.

Investors also hunted for higher returns and diversification in alternative asset classes.

## Swiss pension funds' alternative investments



Source: OAK BV, Bericht finanzielle Lage der Vorsorgeeinrichtungen 2011 – 2020

**MANDATEWIRE**

Demand for infrastructure investments, which were classified as alternative assets until 2019, and private market investments rose.

In comparison, the proportion of assets invested in insurance-linked securities, commodities and hedge funds declined. This is especially true for hedge funds, with their share of alternative assets falling by around 50 per cent as many hedge fund managers failed to deliver on their return promises.

### **Inflation protection in portfolios**

If we compare Switzerland with the average of the seven largest pension fund markets (US, Canada, UK, Netherlands, Japan, Australia and Switzerland) tracked by the Global Pension Assets Study 2022, a different picture emerges.

In aggregate, pension funds in these countries have reduced their equity investments to 45 per cent of total assets, from 60 per cent. This is entirely in favour of alternative investments, including real estate. The share of bonds, on the other hand, has remained the same.

But are these portfolios equipped to deal with the interest rate turnaround and the high-inflation environment?

For several months now, after 15 years of expansive monetary policy bringing real rates below 0 per cent, the inflation rate has been climbing upwards. Switzerland's annual inflation rate stood at 2.5 per cent in April, according to the Federal Statistical Office.

The conventional wisdom is that high inflation rates might be somewhat transitory, and that levels will settle below the upper bandwidth of the Swiss National Bank's defined target range of 0-2 per cent annual price increases in the medium term.

Since rising inflation is associated with a loss of purchasing power, as well as losses on many investments, we see pension funds re-examining their investment strategies and their implementation.

As investments with nominally fixed cash flows record the greatest losses in the event of an increase in inflation, we advise pension funds to reduce the duration of nominal values such as bonds and to scrutinise their overall share in the portfolio.

Higher interest rates only hurt bonds in the short to medium term, as the rise in interest rates causes a shock drop in market value due to a higher discounting of future cash flows.

In the long term, rising interest rates are making bonds attractive again as reinvestment can be made at higher rates.

The effect inflation might have on real assets is somewhat tricky to gauge as, depending on the level of inflation, real asset prices may rise or fall. Inflation protection is also limited, as rising values are also accompanied by significantly higher volatility.

With that in mind, we remain neutral on equities and real estate, and focus more on the long-term, sustainable orientation of investment strategies. This includes parameters such as diversification of risk premiums, sustainable investment considerations and enhanced risk management and governance.

*MandateWire Europe is a copyrighted publication. MandateWire Europe has agreed to make available its content for the sole use of the employees of the subscriber company. Accordingly, it is a violation of the copyright law for anyone to duplicate the content of MandateWire Europe for the use of any person, other than the employees of the subscriber company.*

An Information Service of MandateWire, a Financial Times Company.