Consultants Tell Managers to Stay Aware of Investor Goals

By Tim Sturrock April 25, 2014

Faced with more complicated markets and decreasing return potential, institutions are turning towards strategies like risk parity, dynamic asset allocation and liability driven investment (LDI) that are tailored to their specific needs. Managers looking to win institutional business need to understand how these approaches drive investments, experts say.

Institutions are particularly looking for products that can help them achieve specific goals, like reducing volatility, protecting returns or improving funding levels. In fact, investors' preference for these "outcome-based mandates" are expected to drive more than $3.4 trillion into these "next generation" strategies by 2018, **according to a study** from **Casey Quirk**.

"A manager has to be increasingly aware of the concerns and objectives of the plan sponsor, the orientation of the investment consultant, and how different investment consultants favor different kinds of strategies," said **Richard Charlton**, chairman of **NEPC**, speaking on the sidelines of the **Pension Bridge** **Conference** in San Francisco. He also spoke at a panel that discussed the three strategies.

Risk parity, he said, for example, focuses on risk factors over returns, and allocates to liquid, global asset classes often with a limited focus on alpha-seeking assets.

About 140 NEPC clients spanning corporate pensions, public pensions, and non-profits use the strategy and it appeals especially to clients that have negative cash flows and that are averse to large draw downs.

"Risk parity gives us a strategic asset allocation, it gives us a core position... It's not a panacea, but it's one of many tools," he said on the panel. "We and our clients really don't have much taste for the volatility that's inherent in some of the more traditional approaches to asset allocation."

And while risk-parity can have a more straight-forward definition, dynamic asset allocation, another strategy discussed at the panel, can mean different things for different types of institutions.

For a corporation, a dynamic asset allocation reduces volatility as funding status improves, but it can also create flexibility in a portfolio in the case of public pensions, endowments and foundations, said **Julia Bonafede**, president of **Wilshire Associates**, speaking on the panel.

“It can… mean a less-constrained, more tactical approach to allocating capital that typically involves shorter investment horizons,” she said. “At Wilshire, we advise our clients on long-term strategic asset allocations, but we believe there is opportunity within those long-term targets to look at those rebalancing ranges.”

Dynamic asset allocation can also complement a core risk parity approach, Charlton said.

Another popular strategy, LDI, which uses fixed income instruments to immunize liabilities, creates its own set of challenges, said panelist **Gretchen Tai**, CIO for the $35 billion pension of **Hewlett-Packard Company.**

She described periods of de-risking at HP’s pension as funding levels changed over the years following market turbulence, company restructuring and the acquisition of a company that had an underfunded pension.

“It does feel a bit like Sisyphus,” she said, referring to the figure in Greek mythology doomed to spend eternity pushing a boulder up a mountain only to have it fall down again.

In recent years, the pension has required discipline to invest in bonds and derivatives even when interest rates are expected to rise.

“The hardest part is to stick to it,” she said, adding that ultimately the pension reduced its volatility. “It’s a willingness to look like a fool. People say ‘my grandmother knows that interest rates are going to go up, so why are you increasing your interest rate hedge ratio?’”