futurefund

POSITION PAPER

Long term investing

We believe there are three main comparative advantages to being a long-term investor:

i. the ability to take on greater levels of market risk, on the assumption that a long-term investor is able to tolerate the shorter-term losses that come with the greater market risk exposure. The greater market risk ought to (albeit in practice it need not necessarily) be rewarded with higher long-term returns;

ii. the ability to accept capital being locked-up in assets or structures that are impossible and/or costly to sell out of within a short period of time. Such investments ought to (again, albeit in practice they need not necessarily) attract a premium return to compensate for this loss of liquidity; and

iii. the ability to be counter-cyclical, patient and opportunistic. The investor can use its long-term nature to reduce risk when prospective returns are unattractive and wait for more compelling opportunities to buy (or sell). At times of market stress when other investors are selling, the long-term investor is able to step in and provide liquidity to the markets in return for outsized forward-looking expected returns.

The balance between these three advantages is controllable. Many investors emphasise the first, by holding high and relatively fixed levels of equity exposure. Some funds are increasingly supplementing this by seeking to exploit the second advantage, by growing their private markets portfolios (such as property and infrastructure). The use of the third advantage is lower, often limited to a modest rebalancing strategy around the fixed strategic asset allocation.

Essentially having a high exposure to market risk (the first advantage) removes the ability to play meaningfully to the patient opportunistic capital approach, because there is no spare capital to invest in times of distress because it is already invested.

The Future Fund seeks to benefit from all three advantages:

i. we have a meaningful exposure to riskier assets, given the expected (but not guaranteed) higher long-term rewards for this risk;

ii. we search hard for opportunities to extract strong excess returns for locking our capital away in less liquid investments; and

iii. we seek to manage the portfolio risk dynamically to reflect substantial changes in conditions. While the portfolio strategy is under regular review and will be adjusted as the relative attractiveness of different sectors changes, meaningful changes to the Fund’s risk profile are only expected upon substantial changes in external conditions. One aim of this dynamic approach is to have capital ready to deploy into areas of market weakness.

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