Report on Active Management of the Norwegian Government Pension Fund – Global

One Practitioner's Perspective

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Outline

- Active Management Approach
- Governance Structure
- Factor Approach to Investing
- Anticipating Bubbles
- Concluding Remarks

Active Management Approach

- NBIM’s approach to active management is in line with practices of other leading long-term funds
- Level of active risk-taking is reasonable given fund size and prevailing risk measurement
- However, reluctance to undertake significant tactical asset allocation shifts (and increase in policy allocation to equities) may have impeded ability to reduce risk ahead of the crisis
- Active risk budget should help to set risk/return expectation and not viewed as hard limit

Governance Structure

- Current structure rests on a strict division of labour between MOF and NBIM on asset allocation and active management
- This is not necessarily a strength for it may place too much emphasis on the distinction between benchmark and active returns
- Ultimately, what matters is the overall fund performance
- Other highly respected funds employ different models that are no less successful

Factor Approach to Investing

- Report places great store on factor-based investing to the exclusion of other approaches
- Choice of factors is itself a form of active decision
- Factors are useful for construction of policy portfolios but active management need not be constrained to factor-based view of the world
- Over-reliance on factor models brings on risk of its own as testified by the debacle of quant equity strategies in Q2/Q3 2007
- Factor benchmarks may further complicate division of labour between MOF and NBIM

Anticipating Bubbles

- Traditional approach to asset allocation extols virtue of rebalancing and riding through cycles
- However, fund owners and managers generally over-estimate opportunity cost of being “under-invested” in bull markets
- It is useful to build in safety valve to de-risk the portfolio as valuation becomes over-stretched and latent risk surges
- Ability to acquire high quality assets at times of distress depends critically on having sufficient dry powder on hand

Concluding Remarks

- Active management can enhance returns and inform policy decisions while “pure indexation” carries hidden costs to organization and portfolio
- Current governance structure between asset owner and manager is not without shortcomings
- Factor models unlikely to offer panacea and strategy diversity needs to be emphasized
- Safety valves can help to reduce losses from stress events and enhance returns in long run