Quantitative Easing has destabilised the finances of pension plans and heightened the role of liquidity management

- *As quantitative easing reaches a point of diminishing returns, capital conservation and liquidity management have become paramount for Europe's pension plans*
- *Pension plans favour defensive equities, illiquid assets and emerging market assets*
- *Portfolios are moving to low-cost options and negotiating lower fees for active funds*

London, 2 December 2019 – As a crisis-era measure, Quantitative Easing ("QE") has worked. But its unintended side effects have undermined the financial viability of pension investors, according to a new report published today by CREATE-Research and the largest European asset manager, Amundi.

The report surveyed 153 pension plans with €1.88 trillion assets under management and 38 pension consultants with €1.4 trillion assets under advisement. It highlights the effects of QE on pension plans so far and how their approaches are likely to change as QE evolves into its next round.

QE has created an era of enduring low yields, inflated asset prices and unsustainable deficits. Pension plans are therefore adapting to this radically new financial environment by changing their asset allocation approaches and their business models. Below we outline the key findings from this year's survey.

QE has only worked as a crisis-era measure

There is no doubt that QE has delivered many benefits. Two thirds (67%) of respondents agree the stabilisation of financial markets after the Lehman collapse can be attributed to QE, and 58% cite that it has helped boost returns on risker assets. However, there are now strong concerns that QE is running out of steam in all the key regions where it has been undertaken since the crisis. According to one survey participant, *"problems in Europe and Japan are structural. QE can't fix them. It can only act like an anaesthetic before surgery."*

The overwhelming majority of respondents (nearly 80%) agree that QE has inexorably inflated global debt and sown the seeds of the next crisis. Two thirds of respondents agree that QE has overinflated pension liabilities via zero-bound interest rates, whilst half say governments have used QE as an excuse to backslide on growth-friendly supply-side reforms.

Capital preservation tops the agenda

Pension plans expect to go into the next recession with their finances weaker than ever - currently only one third (33%) have a positive cash flow and two fifth (40%) have a negative one. Accordingly, their risk appetite is diminishing, and capital preservation tops their agenda.

Three avenues have been identified to help pension plans avoid suffering a major portfolio loss in falling markets and conserve their capital. The first seeks greater time alignment between asset allocation and the maturity profile of pension liabilities, as cited by nearly 9 in every 10 respondents.

The second treats liquidity management as the primary risk management tool (62%) and the third is duration management (37%), with a focus on under-valued assets across the yield curve (37%).

Pension plans will favour global equities

Whilst QE lasts, the majority of respondents (58%) say they will favour equities. The asset class offers a defensive play, a good yield and reasonable total return at a time when pension plans are advancing in negative cash flow territory owing to ageing membership. Global equities, US equities, European equities and emerging market equities are preferred.

Periodic portfolio rebalancing will favour private market assets designed to deliver uncorrelated absolute returns. Topping the list will be infrastructure (51%), real estate (46%), alternative credit (44%) and private equity (42%). Their recent superior returns are one factor. The other is their valuations which are not marked-to-market and therefore shield portfolios from the volatility seen in public markets.

According to another survey participant *"infrastructure and real estate are good proxies for bonds",* highlighting the consensus that the risk-reward ratio offered by fixed income assets is perceived to be too risky, given the compressed credit curve and tighter spreads.

Pension plans are turning towards Emerging Market (EM) assets in order to capitalise on their long-term growth dynamics. Within the investment universe, EM equities are preferred (38%), followed closely by EM government bonds (36%) and EM investment-grade corporate bonds (33%).

Pension plans considering more low-cost options, raising share of passive funds

At a time when markets remain distorted, pension plans are taking the necessary steps to tackle implementation leakage: errors made by pension plans themselves in designing and implementing their portfolios that only become evident in hindsight.

Two thirds of respondents consider cost minimisation as a key source of outperformance. As such, they are raising the share of passive funds as a low-cost option in their core portfolio and negotiating lower fees for active funds.

As QE has side-lined much of the conventional investment wisdom, trustee boards are having to make big judgement calls without the normal navigational tools. Therefore, strong investment expertise on pension trustee boards (59%), a deep talent pool among professional staff (53%) and a nimble governance structure (44%) are seen as having a big impact on portfolio returns.

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Professor Amin Rajan of CREATE-Research, who led the project, said: *"Quantitative easing is currently at the point of diminishing returns and has undermined the finances of pension plans. So deeply is it now entrenched in investor psyche, QE will be very hard to unravel without huge market volatility."*

Pascal Blanqué, Group Chief Investment Officer at Amundi, highlights: *"Pension plans are facing a host of challenges in this post-QE environment. As volatility rises and markets fall, liquidity management has become paramount, as has capital preservation for pension investors."*

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[1] Source: IPE "Top 400 Asset Managers", published in June 2019, based on AuM at December 2018
[2] Amundi figures as of 30 September 2019
[3] Investment hubs: Boston, Dublin, London, Milan, Paris and Tokyo

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