



FUTURE FUND

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AustralianSuper

AUSTRALIANSUPER?

1. Largest Industry Super Fund;
2. \$25 billion in assets;
3. 1.2 million members; 100,000 contributing employers;
4. Over 80% of members invested in Balanced/Default plan;
5. Pure accumulation;
6. Average member aged below 40 years;
= investment horizon of 20 years +; and
7. Balance Plan objective CPI + 4% (net).

PORTFOLIO MANAGEMENT THEORY

When building a portfolio you typically identify the investors:

Objectives

- Return requirements
- Risk preference

Constraints

- Liquidity
- Time horizon
- Laws and regulations
- Taxes
- Unique preferences and circumstances

What Do We know About the Future Fund?

Objectives

- Return of at least CPI + 5% over rolling ten years;
- Maximising the return of the fund over the long term consistent with international best practice;
- Risk preference not specified (except being a long term investor);

Constraints

Liquidity

- No liquidity requirements (withdrawals) until 2020. No new cash flows after initial finding period;

Time Horizon

- Long term, withdrawals from 2020 at around 5-6% per annum;

Laws and Regulation

- Some additional constraints but not onerous – restricted to investing in financial assets;

Taxes

- Does not pay tax (Federal or State) but receives franking credits; and

Unique Preferences and Circumstances

- None as far as I know;

SUMMARY

- True long term investor;
- Very few constraints;
- No tax but franking credits; and
- No liquidity requirements.

(A great portfolio to manage!)

Implications for Investment Strategy

- i. Board can focus on the challenge of maximising returns;
- ii. Portfolio can have a meaningful bias toward growth assets;
- iii. Allocation to cash/fixed interest is likely to be quite low due to minimal liquidity requirements;
- iv. International assets will add to returns and assist diversification; and
- v. Unlisted long duration assets (especially where there is a liquidity premium) would be attractive.

1. Asset allocation (as always) will be the most important decision. It should be the major focus of the Fund;
2. Active vs Passive – Active management only if there is skill manager in selection;
3. Australian/Overseas Equity Allocation – Australia very small part of global markets but Future Fund receives franking credits;
4. Foreign Currency exposure – How much is required to achieve optimal diversification? Data is terribly unreliable; and
5. What is the Government's/public risk preference for negative returns (will influence how much diversification is needed).

FUNDS MANAGEMENT SECTOR IMPACT

- Currently over \$1 trillion invested in super;
- Also significant assets invested outside of super (eg. QIC, VFMC and insurance companies);
- Investment assets likely to grow at > 10% per annum for at least the next ten years; and
- Total investment funds could be around \$4 trillion by 2020.

The Future Fund will be around \$130-\$140 billion in 2020.

- i. Some of the best investment ideas are capacity constrained (especially in Australia) eg. small caps, long/short, private equity;
- ii. There is a broad inverse correlation between funds under management and a manager's ability to add value;
- iii. Passive management is relatively unconstrained; and
- iv. Fewer capacity constraints in international markets. Alpha seems easier to get.

- i. Funds management is already very profitable;
- ii. Many quality Australian fund managers are already closed;
- iii. Increasing proportion of funds are being placed offshore benefiting overseas managers; and
- iv. The Future Fund will (at the margin) add to the demand for fund management services (active or passive).