The Government Pension Fund – Seminar of Active Management
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Comments on *Evaluation of Active Management of the Norwegian Govenement Pension Fund - Global*

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Outline of comments

- *GPF –G: good deal for norwegian investor?*
- *Active management – my definition*
- *Active management – scope, benefits, costs*
- *Fund characteristics – size – horizon*
- *Ang, Goetzman and Schaefer proposals*
- *Conclusion*

Government Pension Fund - global

- *GPF-G managed by NBIM tremendous deal for Ola and Kari Nordmann:*
  - *Diversification*
  - *Risk-return trade-off*
  - *Costs*
  - *Information?*
- *For Owner/Fiduciary representative of the sponsor:*
  - *Performance good?*
  - *Information about strategies, risk exposures, capital allocation and risk budgeting not quite sufficient to make a fully informed evaluation.*

Active investment management

- *Harvest premium that can be earned from the investor's effort, expertise or competive advantage, in*
  - *Gathering & Processing information about markets/securities*
  - *Ability to bear and/or manage some or all types of systematic risk*
  - *Implementing and trading portfolios efficiently and at low cost*

Active investment management

- *The definition encompasses*
  - *Traditional security selection*
  - *Risk premiums timing*
  - *Dynamic systematic risk factor allocation*
  - *'Active' Ownership*
  - *Active benchmark replication*
  - *Liquity provision*
- *Internal or external mandates*
- *Each task not easy, requires substantial specialized ressources, induces operational risk*

Fund size and investment horizon

- Size:
  - Active managment only pays if trade does not fully make mispricing disappear. Limits size of position.
  - Most traditional security selection and HF strategies not fully scalable to GPF-F asset growth without loss of IR (as BR↑ , IC↓)
  - Organizational pressure and increased complexity
- Horizon:
  - Trully long term in principle
  - But quarterly report ’hot news” cycle & electoral cycle

Andrew & coauthors' proposals

- Liquid vs non liquid assets:
  - Trully investable benchmarks
  - Horizon (Liquidity) bucket portfolios
- Dynamic systematic risk factor allocation
  - Factor portfolio construction
  - Risk and Expectation determination
  - Top down passive allocation to systematic factor
- Scope for discretionary investment for NBIM
  - Risk factor timing
  - Limited traditional security selection

Final thoughts and issues

- As size increase further
  - more limited place for ’traditional active management
  - more focus on extracting premiums from liquidity provisions in
    - Active benchmark replication (a la DFA)
    - Portfolio Liquidity buckets – but if less frequent pricing monitoring needs to be structured more carefull.
  - Implementing basic benchmark portfolio at low cost
    - Investable liquid, float-based benchmark.
- Multiple systematic risk factor approach is the way forward – but difficult to implement.
- Keep it simple!