

Stay-at-home parent

Tapiola, with €8.1bn under management, ranks third among Finnish mutual pension funds.

In terms of returns last year, however, and indeed during the past decade, it takes top honour. The guiding principle of its investment strategy is to seek the highest possible returns at a risk level lower than the market. The rationale behind this objective is to ensure stable, predictable and solid returns in all market conditions.

Tapiola has an investment strategy that concentrates on asset allocation between conventional asset classes such as fixed income, equities, real estate and private equity. Tapiola will also invest in alternative investments like commodities if it feels it necessary at a given time. Some 85% of Tapiola's investments are managed in-house. "We analyse all potential investments thoroughly before making any final investment decision and typical holding periods are measured in years," says the firm.

Tapiola says its main focus has always been on risk management and an efficient allocation process. "To achieve this, our primary objective has been to develop an in-house asset allocation capacity. Our strategic allocation between the main asset classes, which is normally determined yearly, is based on the house view of the financial markets. Furthermore, tactical asset allocation between and within asset classes can be altered within limits throughout the year." It is this focus on asset allocation that has enabled Tapiola to achieve the highest return among large pension funds in Finland in the past decade.

EQUITY AVERSION

As the financial crisis loomed, Tapiola successfully reduced the share of its equity investments. At the end of 2007, the allocation between different asset classes was modified by reducing the share of equities in all investments below 30%. "The aim was to prepare for the uncertain market outlook for 2008. In early autumn 2008, when investment prospects weakened considerably in our view, we reduced the equity risk even further by selling a considerable number of foreign shares and equity index funds."

The profits from the sale went partly to premium loans to customers and partly to short-term money market investments. At the end 2008, the proportion of equities in Tapiola's portfolio was roughly 15%. This signalled something of a turning point. "During the first half of 2009, when market pessimism was deemed excessive in our view, we gradually increased the equity weightings in our portfolio. At the end of this review period, the proportion of equity investments in the portfolio stood at 22%."

CREDIT AVERSION

Equities were not the only asset class Tapiola did not like the look of during that period. "In fixed income, we had relatively small allocations to high yield and emerging markets debt at the beginning of 2008. This allocation was further reduced during the year, as was our allocation to investment-grade credit. When short rates rose in the autumn, both the allocation and duration of the money market portfolio were raised to an all-time high," it says.

As for its sovereign portfolio, Tapiola says its EMU periphery allocation was reduced because of a deteriorating fundamental outlook in certain countries and diminished secondary liquidity. "Allocation to credit was gradually increased from December

2008 through to the spring of 2009. This saw the investment-grade credit portfolio grow from roughly 15% of fixed income assets to over 30%. At the same time, we also increased our holdings in high yield and emerging markets bonds."

ESTATE AGENT

Tapiola's real estate portfolio, which accounts for some 12% of its overall assets, did better than its equity and fixed income equivalents. "Properties managed internally in prime locations yielded stable returns and we managed to avoid large write-offs." This positive return was however offset by negative returns from its listed real estate investments.

Returns from private equity were in line with the market, but these investments represent only 2% of Tapiola's total assets. "Of the various asset classes we invest in, fixed income yielded 8.2% during the period beating the local industry average by more than five percentage points. Although equity investments returned -31.1%, they easily outperformed the benchmark return of -39.3%. Real estate returned 1.9%, whereas our alternative investments returned 3.5%," Tapiola reveals.

Tapiola lost faith in some of its alternative asset classes and took decisive action to remedy any problems they were causing. "We held a small commodity position at the beginning of 2008. The position was successively closed in May 2008 with a return of 14.3%. Hedge funds, which represented less than 1% of all assets at the beginning of 2008 returned -10.3%. Not surprisingly, we have subsequently divested all our hedge funds. But that does not mean we will not consider them again in the future and as such we follow the hedge fund community closely to gain insight on latest developments in financial markets," it says.

LESS IS MORE

Although the returns for the whole scheme were negative during this period, Tapiola says the result may be considered extremely satisfactory in view of how the financial crisis has affected the global investment community. "By beating the local industry average by more than eight percentage points, we have clearly distinguished ourselves from the rest and demonstrated the ability to fulfil our objective to ensure a stable, predictable and solid return in all market conditions. The key issue in achieving this result was our investment strategy that concentrates on rigorous risk management, an efficient allocation process and in-house asset management capabilities. Our team of 30 investment professionals ensures that information is flowing freely across all asset classes, thereby enabling an efficient and flexible asset allocation process," Tapiola claims.

Furthermore, by managing the majority of its investments in-house, Tapiola claims it can monitor risks transparently and react quickly if needed. "In fixed income, only high yield and emerging market debt investments are outsourced. In equities, we manage stocks from geographical areas close to Finland in-house and invest in mutual funds for other regions. And we manage all our real estate portfolios - both direct and indirect - internally."

Despite the negative returns, by implementing the investment strategy presented above, Tapiola is happy it has maintained good solvency ratios and liquidity throughout the financial crisis.



Name of fund

Tapiola Pension (Tapiola Mutual Pension Insurance Company)

Type of fund

Multi-employer

Date established

1962

Fund structure

Defined benefit

Members

Active 265,000

Retirees 113,000

Market value of fund in €m

31 Dec 08 7,300

31 Dec 07 7,870

31 Dec 06 7,400

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