John Bennett:

Our next session, we'll look at trends in portfolio construction. Our panel led by Kirsten Temple, General Manager Investment Strategy at JANA Investment Advisors, is going to discuss how the approach to building multi-asset portfolios has evolved over time. Welcome, and over to you, Kirsten.

Kirsten Temple:

Thank you.

Thank you. Thank you for that introduction. So we've been through quite the rollercoaster ride in investment markets in recent years. First with the onset of COVID and the down markets we had there, then a strong recovery and then of course more recently, rising and what's turned out to be quite sticky inflation. And with that backdrop, we've had some people out there quite prominently making comments about it being quite the death of traditional portfolio construction, really quite a challenging environment for multi-asset investors going forward. So they were quite lucky to have two very skilled people in the industry to talk to us about what that means for us as long-term investors and what it means for portfolio construction.

So Anna Shelley, CIO of AMP and Tanya Branwhite, Head of Portfolio Construction at TCorp. So there are obviously a lot of challenges for us as investors today. Last year was a particularly challenging year, if you do look at it from that sense of traditional portfolio construction of both equities and bonds delivering negative returns in response to that real rise in interest rates over the year. It'd be great to hear from both of you with that backdrop of some calling it incredibly challenging environment on a forward looking basis for multi asset investors, how you are seeing the future environment and how it might be changing relative to that post GFC period where we had obviously much stronger returns from both equities and bonds.

Anna Shelley:

Yeah, well maybe I'll go first. I think it is really interesting because actually we've had this huge tailwind to investment returns over the last 30, 40 years, those factors that you mentioned in terms of falling interest rates, falling inflation. But also we've had globalization and we've had peace dividend even relative peace up until recently. So we've had a massive tailwind to investment returns over that period and we've had that bond equity negative correlation. But actually if you look back over 200 years, the more normal state of affairs is for bond equities to have a positive or perhaps a neutral correlation or zero correlation through that longer period.

But nevertheless, the most recent period is the period that our working lives have been spent in. So I'd probably characterize it as it's always portfolio construction. There's always challenges in markets, but perhaps there are some fundamental changes. And I think that that long-term tailwind, some of those factors are starting to become a headwind potentially. And we're seeing definitely some reversals. And then we've also got other new longer term factors. If I think about big government demographics is the other one. And I think one of the really interesting things since COVID is that disparity in the US where we've seen all those older baby boomer workers not return to the workforce. And yet, we haven't seen that here. So that's an interesting one as well. But obviously, if some of those trends persist longer, then I think it's definitely more challenging for investment returns and therefore, for portfolio construction I think as well.

Tanya Branwhite:

Perhaps if I'd add to that comment. I think the really interesting thing is that if you think about when you build a portfolio, you're having to think about how much risk that you're prepared to take or the client or the actual underlying portfolio, how much risk it's actually exposed to. And I think very much to Anna's comments, it's been very interesting because that continual decline against expectations of inflation has really allowed central banks to almost provide the constant put in terms of managing total investment risk. And I think that clearly, once inflation gets to a point where it's now rising and it's back on the agenda for central banks and societies more broadly, that constant put, and I that put as from an option context, that the markets always thought that central banks had our back in terms of any sort of risk event, that the central banks would be able to lead derisking. That of course has paid significant dividends.

And one of the things that I think is going to be really challenging going forward is that actually, if you think about those portfolios that had higher appetites for risk versus those portfolios that maybe didn't have quite as high appetite for risk, their returns actually through this period have not been that different. And so it really is going to be, I think much more challenging for those who have capital for particular objectives, and clearly in the context of Tcorp, where we're managing funds on behalf of the people of New South Wales and specifically for the New South Wales government and certain objectives, is how much risk those underlying stakeholders are prepared to take for those return objectives. And many of those return objectives of course are real return objectives, they're CPI.

And the other thing of course that wasn't just the challenge for last year, which was obviously negative returns born out of the equity risk and the term risk or we would call it the bond risk factor. Those two risk factors being highly correlated, to your point, it's actually also the fact that inflation was high. So if you had a real return objective, then very much, it wasn't just the negative returns, but the higher hurdle rate in terms of trying to meet that objective on behalf of the client was even more challenging.

Kirsten Temple:

Absolutely. And are you finding, so looking forward with some of those challenges, is it making a real change for how you think about building your portfolio looking forward versus how it has been? As you say, I guess we've felt a lot of investors have felt there's been that comfort that central banks liked a certain way and now there is definitely the view that has shifted. Does it change the way you think about taking risk?

Tanya Branwhite:

It doesn't change the way. Risk is inherently in our portfolio construction process, it is at its heart. And it's always really trying to make sure that you're appreciative of the underlying risk you have. I think we've always, certainly in the way in which the investment model at TCorp has evolved over the last four or five years, we've very much thought about diversifying not asset classes, but the actual underlying risks those asset classes are exposed to. And what it's done is it's intensified our understanding of the importance of that risk diversification. So it's probably put even greater emphasis on elements of our portfolio construction we're already focused on, but certainly it's reinvigorated the importance of that focus and made the search even more compelling and important.

Kirsten Temple:

Yes. We say it's a challenging environment now, but it probably always is a challenging in reality. Now, I should have mentioned earlier, we're obviously happy to take questions throughout this session. If anyone watching today has any questions I'd like to a ask of Tanya or Anna, or both. So Anna, with that discussion about risk and as Tanya's mentioned, having to think about how much risk you're willing to take to get that return. We've all been in the industry for some time, you've been in the industry longer than I have. For those who don't know, Anna and I used to work together some time ago. How would you characterize... I guess my observation would be that maybe the level of risk that's been taken throughout the post GC period is different to what it was previously, but how have portfolios evolved over time in the Australian market?

Anna Shelley:

Yeah. And it's fascinating because I think if I, back to sort of 25 years ago or so, whenever I started, I think the industry fund clients that we had at that time, they were all under a billion, some of them under 100 million. There were no internal investment teams, or one or two. There was one or two funds that had an internal team back in the day. So it's not just return prospects and asset classes and all that sort of thing that have changed, but it's also the nature of the market participants as well. But clearly, back in that day when I was an asset consultant and we used to act as the investment arm really of those super funds and we were still at that stage persuading some funds to come out of ye olde balanced fund into a specialist investment structure where you had specialists by sector. But even the sectors themselves much blunter much broader.

Whereas now, I'd say everyone's got to a finer level of asset allocation. It's not just Aussie equities versus global equities, it's every sub-sector within those markets and within bonds and regions and all of that sort of thing as well. So the asset allocation decision I think is, in some senses, that's become perhaps more complex. But it also gives you more tools and more levers.

And so in terms of the overarching risk, I think what you're trying to do there is make lots of many smaller bets, if you like, to control that risk and hopefully improve your risk return equation. But yeah, there's no doubt and particularly where you have real return objectives, I mean that's a major challenge and I think in the context of super funds, you've only got the tools that you've got and no new asset classes that. But well, there's always new things popping up and new sub-sectors maybe and specializations. But there's a pretty broad array that's already in the toolkit. But it's probably more about educating your stakeholders, your members, to the fact that the 10% per annum after tax, after fee returns that they've been used to are probably behind us.

Tanya Branwhite:

Yeah. Look, I think very much to Anna's point, I think that the finer detail of the opportunity set has certainly broadened. But I think really interestingly, certainly the way we think about the way we approach this is no matter what the label on the tin is, the underlying drivers of many of these same finer details are actually still very similar. And really what you're looking for is true diversification. I think one of the things that has really changed, like many other industries, is technology and data is an absolute core of the way in which I think asset allocation and portfolio construction is now really thinking about. And so I think the ability to bring data in to be looking at effectively what is a very complex opportunity set that portfolios are exposed to, but bring that into a data set that is really much more understandable.

I think going to Anna's point, if you're trying to make lots of small decisions around different pieces, the challenge of that is how do you know whether they're all working and in fact what is the correlation of those decisions? And so underlying data and I think a really robust infrastructure to manage that data has become a really critical element of our funds. And that I think also goes with the size of the pools of capital. That's not just ourselves, but think around the world. If you look at the retirement savings right around the world, we have very large pools of capital and very sophisticated investors who are very clear about some of their objectives. And so really marrying that up with the underlying portfolio and the data sets to better inform and also better evidence the outcomes of the decisions that you're making. I think they're some of the really key changes from an actual portfolio management perspective.

Kirsten Temple:

And just on that, so you're right, as you said, there's been a huge growth in assets that are savings for the demographic shift you mentioned earlier. I know all of us who need our retirement savings because we've got aging populations. Does that change the way markets operate as well? Do you factor that in as well when you're thinking about portfolio construction or is that too long term?

Tanya Branwhite:

I would certainly say markets are always changing. We talk about globalization. There's no doubt capital markets have globalized dramatically to the extent of the free flow of capital right around the world. So if you went back, say 10, 15, 20 years in an Australian context, the marginal investor from an Australian super fund or an Australian investor was really the, perhaps key drivers in many cases. Now I think at any point in time the marginal investor or the marginal purchaser or seller of an asset can be anywhere from around the globe. So I think that the markets have changed very much in that transition to a true globalized capital set of markets. And those pools of capital, I think informed by data and because of their size of being forced to look in every nook and cranny globally and in every asset class. To Anna's point, every little bit is really considered now I think by many investors constantly.

Kirsten Temple:

It sort of leads to that sort of you're thinking about drivers and what the drivers of return are and then that globalization of capital markets leading to greater synchronization as well of assets. It's kind of the element of how the market's behaving as opposed to what the fundamentals are as well.

So obviously, there's been this increasing complexity and our approach I suppose, always evolving as to how we build portfolios just as the markets are always evolving. There's been a lot of discussion in recent years about the total portfolio approach and obviously at TCorp, Tanya, you've implemented that approach. Could you talk us through what that means to you? I know it means slightly different things to different people as well, but I think people will be quite interested to hear TCorp's experience.

Tanya Branwhite:

Yeah. Perhaps total portfolio approach is given that name and it may actually be presented as a more complex approach to investing than it truly is. Total portfolio approach is really thinking about the whole outcome as opposed to dividing it into those various pieces and hoping when those pieces come together, that those pieces are the most optimal mix. So really it is what I would sort of call, it's both a top-down and a bottom-up approach of thinking about portfolio construction. And instead of thinking about a multi-asset portfolio as a series of individual portfolios and those who manage those individual asset classes, thinking about them as individual portfolios, it actually becomes that we're all working for the one portfolio. And that actually changes. In some cases it may really change and nuance the role that different asset classes or different investment play in a portfolio to deliver that objective.

And so this comes back to being able to make changes in a total portfolio context that better aligns that portfolio to the objectives of the underlying client. What do I mean by that? I'll give you a really good working example. If you think about allocating different asset class teams and they take that pool of capital and go away and do what they think is absolutely the best outcome, it may indeed be the best outcome if they are thinking about in their opportunity set. But let's just play for example, a scenario where a particular jurisdiction or a particular industry pervades a number of those asset classes and suddenly, all of those teams are actually investing capital in a narrow set of either jurisdictions or sectors or industries. Suddenly, you have an over concentration at the total portfolio. It may be that you've got a lot of assets in one particular location, you may have a lot of assets in one particular industry.

And so those individual teams may not be thinking about it in that way. They see these as great opportunities. But when you bring that together, the portfolio may be overly concentrated and then there may be other parts of diversification that you are under exposed to. So that's just an example.

Trying to bring that to a realistic sort of experience I think for the audience is what does a total portfolio mean? I'd say it's constant iteration and it's actually more of a mindset. It's a cultural approach where everyone is thinking about at the margin, if we make this decision, what impact is that going to have at the total portfolio level and is it going to improve in some element, whether it's a higher degree of confidence about the delivery of a return or increased diversification. So it's bringing something very different to the portfolio risk and return expected outcomes. It's everyone having that mindset as opposed to thinking about I have this pool of capital, I'm going to go and try the best possible returns I can, and not necessarily thinking how each of those teams are bringing that overall capital decision. Because at the end of the day, the client whether it be an individual retiree or a particular stakeholder, they actually get, as we call it, to eat that portfolio in total. They get the total portfolio outcome. And so we have to think very much in an alignment with that underlying client.

Kirsten Temple:

And so in adopting that approach find then, does it make a market difference to how those underlying asset classes end up being constructed in change? Have you seen greater concentration of portfolios or any other changes?

Tanya Branwhite:

I think the interesting thing is it allows you in that mindset to take a greater concentration of risk in a particular part of your portfolio. And so it may be that a particular opportunity, you maybe have an opportunity to invest a larger amount of capital. But in, let's just say sector or asset class portfolio mindset, they go, "Oh, that may be too much risk. So therefore, we'll just take this amount of capital," even if you had a greater opportunity to invest more capital. But at the total portfolio level, actually that individual investment is very well diversified at the total. And so with that in mind, what you end up with is perhaps empowering your teams to actually, if you see a great investment and you have an opportunity, then take that additional risk because you are not going to be judged on your part of the portfolio outcome. We're all going to be judged on the total portfolio outcome. And that does change mindset in the way in which you take risk and return decision making.

Kirsten Temple:

Yeah, that is, that's interesting. And Anna, so how would you contrast your approach to Tanya's?

Anna Shelley:

Firstly, I thought that was a really good articulation, particularly that emphasis on the cultural aspect of it and the mindset, right? And I would say what we try to do is obviously being a super funds, we are required by APRA to set a strategic asset allocation. Now, with the APRA performance test, we're held to a hard account against that strategic asset allocation. And there probably have been some changes therefore, off the back of that.

But what we would try to do is combine the best of both worlds. So notwithstanding the fact that we have to set a strategic asset allocation that it has to be within a certain band to meet the members' expectations of that product. So balanced has to be roughly 60 to 80% growth assets, for example. And so it can't ever be a growth fund or a defensive fund based on our outlook or our total portfolio view. But it's still quite a big band.

So you can still then look at your strategic asset allocation, you can look at your actual assets, as Tanya was annunciating, and then you can look through to the risk factors. And so we try and do that as well. So we look through to value bias for example, through the entire portfolio. Have we got too much risk? Are we too concentrated in particular views or particular bets? Or even as Tanya said, do we not have enough in a particular opportunity when you lift it up to that total portfolio level? So we do try and do that. I think one of the big changes has been the APRA performance test though, because you know live and die by your tracking error to that strategic asset allocation. You review it annually though. So I think perhaps one of the things we're seeing amongst super funds is a greater tendency to change and adjust your strategic asset allocation every year. And for some funds, maybe even more frequently than that.

Kirsten Temple:

Regulation has its place and helps in some ways that it can. And to be honest, it's not even just your future, your [inaudible 00:21:10] though. There's an element where you've communicated to members that that's the particular mix of that pre-mix option and they may be combining multiple options to get the outcome they want or other things as well. So there's an element of true label, I suppose, in a superannuation context as well.

We do have a few questions coming through from the audience, so I might first go to this one that was really sort of around ESG and just understanding how you think about. So the question is how are ESG factors influencing how you think about portfolio construction given that it's increasing importance to investors and members?

Tanya Branwhite:

So certainly, the ESG component or thinking of a total portfolio approach, again, total portfolio is very aligned with that because you're sort of thinking holistically about how that portfolio might be seeking to achieve whether it's a net zero 2050 objective or a particular climate risk objective. But you can again think about that. So all of the elements and characteristics of your underlying investments, if they can be diagnosed or there's a diagnostic and analytics can be brought to that, then you certainly have a much greater sense of understanding about how the portfolio at the total is sitting within a overall ESG context.

I think different investors and stakeholders have different objectives and so it's very important obviously to think about how the portfolio is meeting those objectives. I'd still say we're early in the journey of data and how we capture that data. So yes, I think there is still some challenges to come, but there is no doubt that it is certainly, we think about our portfolios as multi-dimensional. It's not just return, it's not just risk, it's liquidity. We have, in some cases, very explicit objectives and ESG very easily can fall into one of those dimensionalities of our portfolio construction. And its thinking and being aware of what the total portfolio itself looks like in an ESG objective.

Anna Shelley:

And perhaps just again from our perspective, I think it probably is that top down, bottom up. So again, similar sorts of things from the top down perspective. A lot of scenario analysis type stuff there with climate change and that. And of course, it's highly speculative. We are still in that phase where everybody needs more data. But then you marry that with sort of the bottom up where you've got your fundamental sort of ESG factors and risks and opportunities as well. But coming through from the asset level through the manager level and into your asset allocation, I guess.

Kirsten Temple:

It's challenging, isn't it? It's easy to find tangible examples of how you manage ESG risk when you go to that asset level versus at the whole of portfolio. Because as we know, the impacts or even just looking at climate change, we know that it's quite universal in its impact. But the level of impact on different assets is obviously so different, even within an asset class.

I'm always a bit reticent to ask a question like this, but it's been voted up so I feel like I should. A question is in relation to bitcoins and cryptocurrencies, just wondering if either of you have done any work on or maybe also more broadly on the digital asset complex and whether there's divers, well I suppose in relation to cryptocurrencies, whether there's diversification benefits from your perspective.

Tanya Branwhite:

Well perhaps have we seen diversification benefits in this behavior in last year? I would certainly sort of argue it probably hasn't. Look, I think a very simple case is that obviously, as capital markets evolve, opportunity and investment opportunities evolve. You should always have an open mind and you should always be investigating these opportunities as they begin to evolve.

I think one of the things though that has been really, and obviously came to the fore last year in terms of cryptocurrency was the degree in which the regulatory environment and oversight is still not caught up with that part of the investment. And we're fiduciaries on behalf of other people's capital. And so I suppose in that respect, if you're not really confident about how the environment in which any opportunity is overseen, the transparency of how it's managed and the transparency, particularly as we've seen in how certain assets are held in custody and the management of that custody, one has to be very cautious. So I certainly say that we've had interesting conversations at Tcorp. We've had presentation to us, but at no time has it appeared on our radar as an opportunity that we would be prepared to, as a fiduciary, invest in at this time.

Anna Shelley:

Yeah, spot on. And I think you've always got to be on top of trends and new technology and then how they might impact not just your own investments but the broader investing environment. So that's something you are always trying to keep up with. And we have private equity managers for example, and I'd expect that they would run those sorts of opportunities through their lens as opposed to me sitting a long way away from the actual knowledge and expertise and attempting to pick that.

But we did, we had a lot of advisor requests because we have that retail side of the business. The advisors weren't that keen on investing it, but they certainly wanted a lot of material on how to persuade their clients not to invest in it. So we did do quite a few white papers there and I think that was really helpful in an education sense as well for us because it made us get down deep into the nuts and bolts of it. So always good to look at all these new technologies and new opportunities. But whenever there's a trend, you've got to be a little bit careful.

Kirsten Temple:

I think the last year, it would've helped you a lot in giving paces to why not because obviously-

Anna Shelley:

I haven't had any witness since the-

Kirsten Temple:

No, they go through cycles. And obviously, the diversification argument that was being made quite strongly by some. As you'd expect there's been. Once there's more assets in something, it's more likely to behave more like other capital markets, ultimately, at the end of the day. And look, it's something that we think about more from the tokenization of assets. I think it's a very long run theme, but that might have some implications I suppose maybe more so than even the central bank digital currencies might have an impact on currency markets for example. I think from that lens is probably still quite a lot that we could learn about as well.

So I have another question here. So many institutional investors have been overweight, unlisted assets versus cash to have to gain that illiquidity premium. Do you think that trend of institutional investors investing more in private markets will continue?

Anna Shelley:

I don't see why not. If you think about how big our biggest funds are becoming, and particularly those funds that are sustained by really strong net inflows there, there's no reason why they can't invest a continuing very high percent in illiquid markets where that premium holds to and where the fundamentals of the assets stack up. I think perhaps more broadly, we are probably seeing some risk to underlying unlisted asset valuations just with bond yields rising. And so some of the more mainstream assets, say commercial property or that sort of stuff, I think there's still a bit of a question mark there as to how valuations pan out. But from the fund's perspective, particularly if you're like a Aussie super or someone like that, huge inflows, yeah, why not?

Tanya Branwhite:

Look, I think again it comes back to illiquid assets requiring illiquidity premium. So that's always sort of certainly something that you need to be very mindful of. I think the other thing is what is the role of illiquid assets in any portfolio? And it comes back to if they are bringing different risk and return opportunities to the portfolio beyond those that you can access through the liquid markets, then clearly they're very valuable. And in that mindset, if you're continuing to find those opportunities that can further diversify those underlying risk exposures, the risk factors as we call them, then clearly there's a good reason to hold those assets.

But I do think it's always important that you do consider the illiquidity premium that comes with those assets and the constraints it brings into your portfolio. It was interesting seeing last year just in terms of sometimes as we saw in the UK market at a certain point in time last year, that need for illiquidity and making sure that not only have you considered your illiquidity, but what is the liquidity that you may need. So illiquid assets clearly have a very important role. They can bring a very different set of characteristics than the listed market. But it's very important to think about portfolio construction in both your illiquidity and liquidity context and framework to ensure that you're not just going into illiquid assets because they seem to providing you with an extra level of return than what you might have expected.

Kirsten Temple:

I'd be interested in knowing, so in the context of the total portfolio approach and thinking about the drivers. Obviously, sometimes the use of illiquid assets can get a bit of a bad rap in portfolios because some would say they smooth returns a bit by being less volatile than the listed markets. And clearly, there are arguments the other way around that just say listed markets are just noise and the unlisted markets have it right. But how do you think about that when you're thinking about those underlying risk drivers? How do you think about that aspect of the volatility versus the true drivers of return?

Tanya Branwhite:

Yeah. Look, a great question and one that's very well debated within investment teams between the illiquid teams and obviously, those in the listed market. I think it comes back to in the end, if there is a lag in the recognition of a change of the circumstances of an asset, does that truly make the asset actually less risky? And I think this is very interesting when you think, for example, in the property market, two properties next to each other, one's an unlisted asset, one's a listed asset. Just because the listed asset gets marked every day, clearly there is a shorter term volatility that you're going to experience in a portfolio context. But those two assets, if they are absolutely mirror images of each other, one would say likely if they're managed in the same way, they actually are the same underlying risk.

And I think it also does then does require you to have that longer term context. Listed markets I don't believe are noise, but you have to accept that a volatility of a portfolio is going to be higher if you focus on a one year view in the listed exposures you have. But if you truly look forward, and certainly in my past and doing some research, if you truly look at the unlisted property versus listed property in an Australian context over the long term, their risk and return characteristics are fairly similar. It's just that you've got to be able to have that longer term context.

It was interesting through the COVID drawdown for example, many of our underlying stakeholders were very keen to get more regular marks of those unlisted assets and suddenly you were getting valuation movements more frequently. Did that mean the underlying asset had become more risky? No, it was always more risky. It was facing into a more uncertain environment and that was being recognized by more frequent marking of the valuations of those assets. So I think it's a little bit of a smoke and mirrors on this idea that an unlisted asset is truly less risky than a listed asset. I think it depends on the asset, depends on what it's exposed to.

Kirsten Temple:

No, very fair. And it's a vague reason of what modeling might tell you when it's using a volatility number versus the true risk that you're holding. We have the same sorts of debates at JANA as well.

So some more questions. So this is specifically to you Tanya. What were the structural and governance changes required internally to move to the TPA approach?

Tanya Branwhite:

Excellent question, whoever's asked that question. And I think that is one of the true elements from a total portfolio perspective because good governance really is about who owns what decisions, focusing on those decisions and setting the portfolio's objectives and risk tolerances really clearly. There is no doubt that our governance has evolved quite substantially over the last five or six years. The governance has evolved from the underlying client or stakeholder almost owning the very end portfolio all the time. And that of course, is really interesting because as we know markets evolve, opportunities come. And if indeed there is an end state where governance is at that very granular level, then that really does impede the ability of the portfolio to actually evolve and change depending on the opportunities or the environment.

So we've really taken our governance back to a really deep engagement with the clients and particularly around what we call the setting of the risk appetite. So our clients we work with very deeply around what their objectives are, try to really provide them with an understanding of what that risk experience would be for their portfolio and whether or not as a governance body they are able to withstand that volatility that we may face into portfolios, into investment markets at sometimes acute points in time.

Once we've done that and we've effectively been able to define that amount of risk, then effectively, we provide them with a guidance to what we would call a reference portfolio that sort of says at the limit of your edge of risk, these would be the exposures in asset class or what we call the risk factor terms and setting a range around those. And once we have done that, our objective and our management then has to sit effectively to both improve on the risk adjusted returns relative to that reference portfolio and that we would sit within the asset allocation bans set by that governance engagement.

And so it has provided a lot more accountability actually to us as an investment team, a lot more transparency in terms of how we report the decisions we make, but also I think a much greater degree of efficiency and an ability to act in the client's best interests in changing portfolios in response to either opportunities as they present themselves or to changing market environments that we have to encounter. Because if indeed that governance is slowed down, it may mean that the portfolios are overly exposed to a situation that's not advantageous to them or we miss an opportunity that would've been advantageous because of that governance control at that level. So I think it really has lifted us to a really good governance conversation to what really matters to the client and then really informing us as to what decisions we're going to make that are in the interest of the client within that risk and return objective and their sensitivities.

Kirsten Temple:

So you've obviously had the governance structure evolve to suit that. Do you think there are also certain organizational characteristics or a starting point that makes it possible to do that or that's really necessary to enable that sort of approach?

Tanya Branwhite:

Look, I think it's a good question. But to be honest, I don't think there is any investment environment or investment situation that I could think of where a total portfolio mindset. There are degrees to which you can adopt total portfolio. I would certainly say Tcorp, along with some of our other peer organizations, the Future Fund's always been very, very clear on they've always, they've grown up as an organization and evolved as an organization always with that total portfolio mindset. Many of the Canadian investors certainly have adopted it.

But I think it really does come back to that it is an interaction internally of your investment teams with absolute clarity about what your objective is, absolute clarity about what the decision you're making and its impact at the total portfolio level. And I think being willing to understand that you aren't always just driving for the highest level of returns across your whole portfolio and that perhaps there may be some really good investments that you might like to make as an investment team that actually don't benefit the total portfolio level. And those are hard and challenging conversations because it does then require a degree of the investment team acknowledging that there isn't complete independence at the very bottom level to make independent decisions of the total portfolio.

Kirsten Temple:

Yeah, it's challenging. So question for Anna. So given the recent market developments, do you still consider fixed income part of a liquid portfolio?

Anna Shelley:

Yes, absolutely. Yes, yes. I mean think if anything, so that question was probably very pertinent a year ago. And I think we saw an awful lot of superannuation funds really tone down their fixed income exposure. I think if anything, the new environment that we're going into, fixed income always has a place in my view. Admittedly, most funds are probably coming from quite low exposures and gradually coming back in. And of course, there's certainly a pretty good chance that rates are going to go higher from here. So there's definitely a place for it.

I think maybe the nature of the fixed income exposures has probably changed a bit over time. I think we've seen a lot of funds weighed pretty heavily into private debt, private credit, and there's some good reasons for that, not just in terms of the assets and hopefully an illiquidity premium as well, but also greater control over the covenants and the terms of that debt. So I think that trend is here to stay unless APRA introduces a new private debt benchmark, in which case who knows. But no, I think that's a good solid and increasing asset class, I think for many funds as an example.

Kirsten Temple:

It's interesting. As you say, I think as large rates came down really fixed interest portfolios changed enormously. Rates are obviously up higher now. And notwithstanding that we might have periods like last year where bonds and equities both do terribly at the same time as each other. Do you think that fixed income, like traditional fixed income, so government bonds and investment grade credit, whether they'll come back to being a more central role in portfolios?

Anna Shelley:

Yeah, it's interesting. Certainly, they're massive markets. And I think maybe the question at the moment is with inflation. Even if you have the view that... So our view would be that we think we're seeing signs that inflation has peaked. But we're not sure that it's going to come back down to the levels that the central banks might like it to come down to. So say it's even a little bit higher for longer than are bonds appropriately priced for that and potentially they're not, the traditional ones. So maybe there's a bit more losses to be born through that period.

But look, they're huge markets. I think there are always corners of the markets where you know can find interesting and diversifying sources of return. And there are of course, a lot of other global players who have mandated minimum requirements to fixed income. Our super funds don't have that. But of course, there's also other sort of influencing factors as well. The government's been talking about encouraging social investments. Some of them may supplant some of the fixed income investments that we might otherwise have had in traditional government bonds.

Kirsten Temple:

That might be the point where the liquidity question becomes particularly pertinent though.

Anna Shelley:

It will. We'll trade it all off.

Kirsten Temple:

So superannuation funds have obviously grown to and TCorp's also grown, I'm sure, to be quite large over time. There's a question here around the crowding whether that crowd's at the local market to some extent and changes the dynamics of the domestic market?

Tanya Branwhite:

I think to the extent that obviously the pools of capital have become very large. Quite clearly Australian institutional investors have increased, certainly their investments overseas and overseas investors have increased their investments in Australia. So to the extent that it's crowded out, that's the extent to which there's too much money chasing too little in the way of assets. That's always a conversation and always an issue to be considered. But at the end of the day, the price clears between the buyer and the seller.

So to the extent that is there too much money chasing that, I think this is in part why your liquid assets have become a much greater component, particularly given the horizon because instead of really relying on the liquid markets, large pools of institutional capital have diversified into the liquid markets, and that of course, has meant there's a more diverse opportunity set for that capital to invest in. So no, I don't think that's probably something to be overly concerned about.

Anna Shelley:

Look, I agree. I think our pools of capital are more global than they ever have been. The opportunities are global. It all comes down to valuation and opportunities. And if the valuation is wrong and the opportunity's not there, then they won't be there. But looking at the longer term trend, when I started, all the super funds we worked for had more than 35% in Australian equities. Clearly, that's come down quite a long way. And then funds like the Future Fund only have about 6% or so in Australian equities. There's that franking credit benefit that is still there. I think if we ever saw that go, then maybe we would see something a bit more like the New Zealand experience where it's nearly all offshore. And clearly, those pools of capital are still growing. So by their nature, that means they're looking then for bigger and bigger opportunities, which it does mean that the global market is the more relevant market. But there'll always be room for capital investment here in Australia, I think.

Kirsten Temple:

Obviously, as you mentioned earlier, the funds used to be really small compared to what we think of as being a small fund today. As you get larger, what are the implications of that for portfolio construction and where you can generate returns? Has that made a change? I mean obviously, there's the element of moving offshore from in and out of the Australian market. But do you see more need for passive exposure? Are there opportunities that become available or cease to be available?

Anna Shelley:

Yeah. And we're in an interesting spot because we're still quite a bit, well, we're probably what you call small now. I don't know. Medium at the very least in terms of size. So we still see a lot of the same opportunities I think that we would've seen if we were 30 billion or 50 billion, up to 100 billion, it's sort of the same sort of opportunity set really. Clearly, as you get bigger though, you sort of change where you might get your alpha or your bang for buck. Depends too on how you structure your internal team and where you think competitive advantage might be as a team. So if that's a total portfolio approach, there might be a much greater emphasis on, and it's probably not alpha, but on added value at that overarching asset allocation level. I think that naturally sort of happens as you get bigger and bigger. And some of the smaller markets, say Aussie small caps or long short Aussie equities, you're definitely going to get crowded out of some of those opportunities.

Tanya Branwhite:

Yep. I think Anna's covered it very well. There are just some opportunities that just are not meaningful, create greater complexity and operational risk. So you have to acknowledge that that's sort of the end and really just focus on those opportunities that are really going to be impactful to portfolio outcomes.

Kirsten Temple:

Well, I think we're out of time. So thank you so much for your time, Tanya and Anna. It's been really interesting and engaging. Great questions from the audience as well.