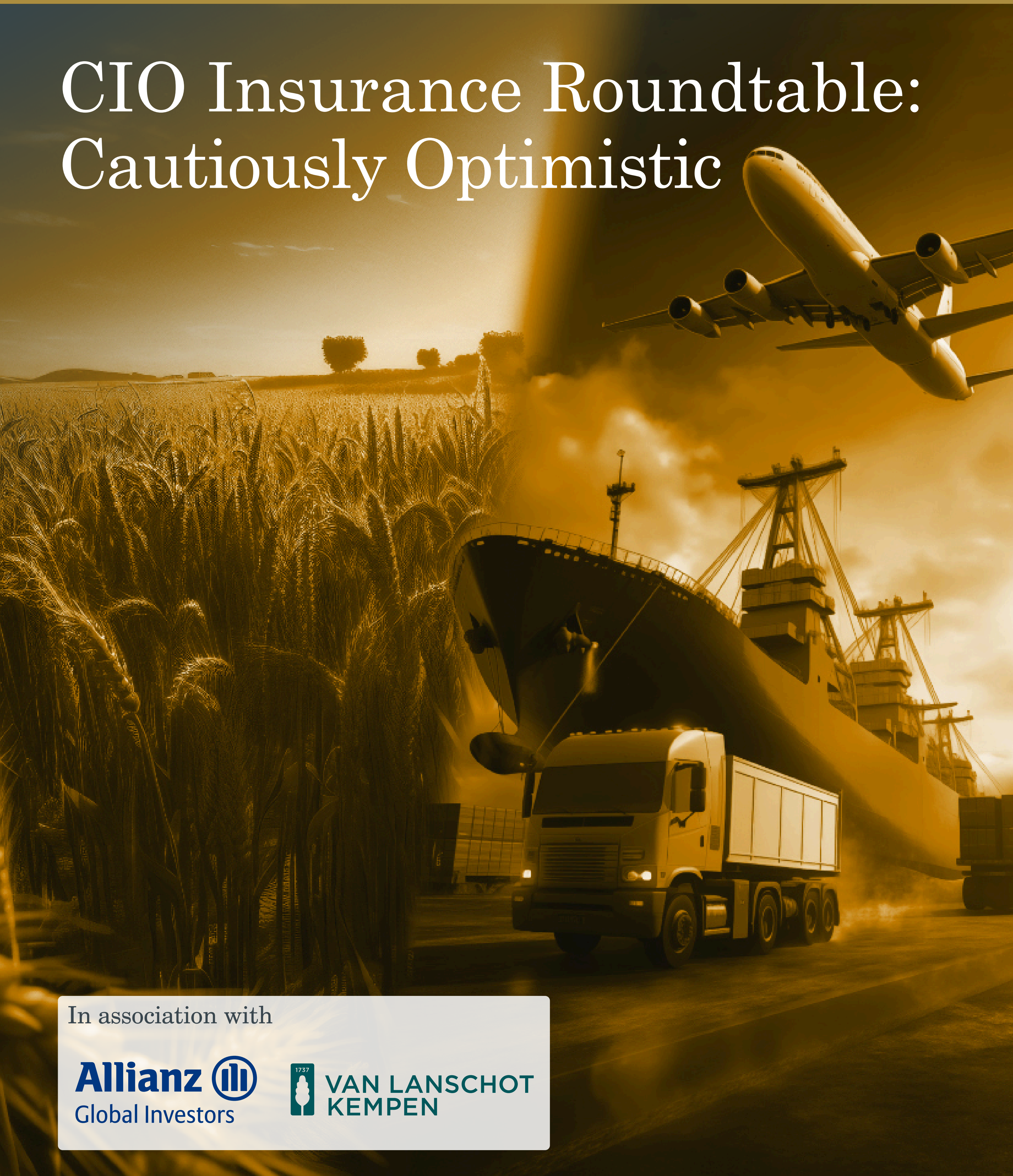
cio investment club

Roundtable #1

January 2024

# CIO Insurance Roundtable: Cautiously Optimistic



In association with

Allianz Global Investors

VAN LANSCHOT KEMPEN

# Roundtable sponsors

Thank you to our sponsors for this edition of the CIO Insurance Roundtable.

Allianz Global Investors

Van Lanschot Kempen

# Contents



sean.thompson@cioinvestmentclub.com
www.cioinvestmentclub.com
cio-investment-club

Design by Go Vicinity Creative

# CIO Insurance Roundtable: Cautiously Optimistic

## The cio investment club's CIO Insurance Roundtable took place in February 2024

**The worst of the economic turbulence appears to be behind us, with inflation falling and central bank rates set to follow suit over the coming 12 months. But uncertainties persist over the timing and depth of rate cuts and the geopolitical outlook. Our panel of five insurance chief investment officers and two fund managers discussed the risks and opportunities in constructing a portfolio in 2024.**

Panellists: David Devlin, director, strategic partnerships and research, Phoenix Group; Corrado Pistarino, CIO, Foresters Friendly Society; Todd Isaac, CIO, Hiscox; Ian Coulman, CIO, Pool Re; Gareth Russell, CIO Canopius; Mike McGill, director, portfolio manager, Allianz Global Investors; Samuel Berman, director of UK insurance business development, Allianz Global Investors; Richard Jacobs, managing director and lead portfolio manager of SDG Farmland Fund, Van Lanschot Kempen; and Chris Windeatt, director, distribution at Van Lanschot Kempen.

Moderator: Liz Pfeuti, Rhotic Media

Cautious optimism were the watchwords of the roundtable discussion, but most of the panellists also voiced lingering concerns either around inflation and monetary policies or the geopolitical risks of the coming year.

“There are some tailwinds,” says David Devlin, Director at Phoenix Group. “Inflation appears to have peaked and come in closer to target, so market expectations are that central banks may follow suit and reduce rates this year. I do see some headwinds, too. Each time I sit down at an annual conference, it seems we’ve gone through at least one 1-in-200-year shock since the last! In 2024, we could see supply shocks from further geopolitical disruption increasing inflation and further potential unrest as 50% of the world's adult population is going to the polls this year – let alone any potential impact of the outcome of the US Presidential Election.

“So, we must control what we can control. Our balance sheet is well hedged against changes in inflation and interest rates and in 2024 we will continue to add more private assets to our balance sheet. The latter will be selective as we consider how credit fundamentals are impacted by the macro picture. All said, we’re at an exciting juncture relative to a year ago, but on balance, I’m cautiously optimistic” says Devlin.

The risk that inflation may not be fully tamed was also a concern of Gareth Russell, CIO at Canopius. “The US economy is stronger than people think and while inflation will start to roll over in the first half, it is not dead. We may see another leg of inflation towards the end of the year and that will lead to another leg up in bond yields,” says Russell.

The other major risk raised by some panellists was geopolitical. “The increased level of conflict, whether it's in the Middle East or Russia or Ukraine, is a concern,” says Ian Coulman, CIO at Pool Re, the government-backed reinsurer for terrorist risk. Coulman adds migration from Africa to Europe and the rise of populist far right politics to his list of concerns. “You’ve got the likelihood of Trump getting re-elected and he’ll claim that he can come up with a solution to the Russia-Ukraine situation by placating Putin in some way or another. I don't think markets are really thinking about what that could mean,” Coulman says.

# Private opportunities

**Despite his concerns Coulman believes there are clear opportunities for portfolios in 2024, most notably in private markets.**

“If you go back five years or more, private markets meant locking up your money with no liquidity. But it has evolved significantly over the last couple of years,” Coulman says. “Part of this is probably the fallout from the global [financial] crisis, as there seems to be more secondary market activity. That has unintended consequences. As the secondary market develops, we're going to get price discovery of private assets, which is probably going to create more volatility. But it's still good because it will provide liquidity in private markets.”

Richard Jacobs, portfolio manager, Van Lanschot Kempen, also focusses on the opportunities in private markets: “We have gone from a long cycle of a rising tide lifting all boats – low interest rates, relatively low inflation, globalisation, which has been great for private equity. But going forward we will have to be more selective. Some markets, such as large cap private equity, have become overpriced. The liquidity in the secondary market really comes from a realisation that the values have become pushed. The first downgrades are yet to come, particularly for real estate. We have to be selective.”

Chris Windeatt, director, distribution at Van Lanschot Kempen, said farmland could combine a store of value with an added environmental dimension. ”We are seeing a lot of interest in Sustainable Farmland, particularly from institutional investors looking for both a strong financial return as well as making a positive impact on the world. Investing in Sustainable Farmland can help promote biodiversity and carbon sequestration and contributes to many of the United Nations’ Sustainable Development Goals,” says Windeatt.

Mike McGill, portfolio manager at Allianz Global Investors, adds: "What’s interesting is that our private market trade finance offering has been resonant with investors through quite different market regimes we’ve seen over the last 5 years. In a world of zero rates, it was the search for yield and income generation that appealed to investors. Then it was its defensive profile during covid uncertainty. Then in 2022, it was the ultra-short duration that made it outperform virtually all fixed income asset classes. And more recently, it’s the demonstrated resilience during big drawdowns in public risk assets seen during the onset of Russia/Ukraine war, gilts crisis, and the collapse of Credit Suisse, which was imperceptible if one looks at the monthly return profile of the strategy.”

Samuel Berman, director of UK insurance business development at Allianz Global, adds: ““Clients continue to seek relative value, especially amidst ongoing market volatility. They want to adapt swiftly while ensuring an appropriate margin level on their invested assets, particularly in the short term. However, there’s a noticeable cost of holding too much cash, in real terms. As a result, cash alternatives are gaining traction.”

*“Clients continue to seek relative value, especially amidst ongoing market volatility”*

# Credit duration and liquidity

**The desire to manage volatility in public markets is leading to increasing interest in private credit, according to Todd Isaac, CIO at Hiscox. “We want to earn a return that's commensurate with the risk we're taking. With public market spreads are extremely tight, the question is where do I want to take risk? I'm looking to diversify part of our corporate portfolio and going into private credit and other sectors, where I can avert some of the volatility,” says Issac.**


He adds: “Managing risk in private markets goes back to due diligence. I want managers that are deeply underwriting every holding and not just in a club deal. We are also looking at taking some of our cash on balance sheet and diversifying it into money market funds and cash plus strategies.”

Pool Re’s Coulman is also focussed on credit-driven strategies. "When we select our managers, we are looking for their ability to add value through the credit cycle. But we also have additional strategies, including, alternative risk premium, along with a variety of other fixed-income strategies, and an allocation to private markets,” says Coulman.

Pool Re’s private market holding are entirely with the venture capital managers that manage money for the British Business Bank’s National Security Strategic Investment Fund. Crucially, Pool Re’s unique status means it does not have the same liquidity needs. “Liquidity is important, but cash is not critical from a liquidity point of view. The portfolio is structured in

> *“Managing risk in private markets goes back to due diligence.”*

such a way that it can largely run off in the event of a claim. We can tell managers to stop investing, let the cash build up in the money market fund and into our bank account, and then make the necessary payments to our members.”

Pistarino also places the emphasis on credit as a key part of any insurance portfolio. "There are two obvious sources of risk premium that can be harvested by insurers:  credit and liquidity. When it comes to credit, we do not invest in spread duration, because investors are not compensated for the extra risk they take by positioning their portfolios on long-maturity assets. We are also not constrained by the regulatory framework to operate on that segment of the credit curve. Our credit positions are very much short term, across investment grade, high yield and private assets, where we invest in short-term self-liquidating positions like trade finance or in private loans whose expected repayment horizon is less than 3 years."

As a portfolio manager in Allianz Global trade finance team, Mike McGill naturally agreed that trade finance was a key opportunity for 2024.

"Trade finance is one of those markets that doesn't make news headlines, but it's just so big. It's linked to global trade and ongoing commerce. Our rough estimate is that the stock of trade finance is $2-3 trillion at any one time, mostly financed by banks. As an institutional asset class, it's quite a broad church. At the higher end of the risk-return spectrum, there are SME lending and commodity trade finance strategies, or on a more conservative basis, there's our Strategy, which is more akin to a diversified institutional credit portfolio targeting cash+ returns with low volatility and offering monthly liquidity.

"It used to be seen as an illiquid private credit allocation. But there is inherent liquidity in trade finance, because the underlying instruments are based on an obligor owing a counterparty money and paying in 60 days on average. You naturally see a portfolio of [instruments] churning out cash. People are more willing to say that they do not need access to cash daily – their access just needs to match their liquidity forecasting in a stress scenario. We see trade finance as a fixed-income alternative, or a cash plus allocation, that delivers a spread pick up. On a trailing five-year annualised basis, our strategy generated almost 3 times the level of annualised return with less volatility than 1-to-3-year sterling corporate credit."

> *Trade finance is one of those markets that doesn't make news headlines, but it's just so big.*

# Active ownership and sustainability

**Not all our insurance CIOs were focused on short-dated investment. As the UK's largest long-term savings and retirement business, Phoenix Group has an entirely different strategy.**

"Relative to others, we're focussed on longer dated private credit to back pensioners' long-dated annuity liabilities," says Devlin. "Our annuity book is run on a buy and maintain basis with any new asset classes only added where we have strong embedded capabilities in the people, technology and risk and control required for that asset class. When it comes to rates and inflation volatility, the last years have shown that no one truly knows what is going to happen. As such, we don't see either of these risks as rewarded and are accordingly closely hedged."

Jacobs identifies long duration investments as a stabilising force in volatile times, but he adds the dimension of active management. "What I keep hearing from strategists is that this cycle favours active management or active ownership. That's true for all asset classes when there are headwinds, like geopolitical risk and higher inflation or interest rates.

"But the question of active management also brings us to sustainability. I think that dimension is becoming very important. Our investors are looking to be in longer-term sustainable categories of the market, such as renewables or, in my case, regenerative agriculture. But investors also demand that their asset managers look at it more actively and ask ourselves: 'what can we change, what impact can we have through this investment?'" says Jacobs.

While the panellists were in broad consensus in their economic and market outlooks, there was no similar consensus for how to approach the challenge of sustainable investing.

True sustainable investing, for Isaac, means investing in companies with scale that are capable of enacting change and will play a role in transition. "If you want to invest in sustainable assets, you really should not exclude companies like Shell and BP," he says.

"Those are the companies that have to change and that have started to change. They are developing and producing sustainable energy, but the fossil fuel side is still part of the economy in transition. I am flying to the US in a month and I'm not going to be flying in an electric plane. We need fossil fuels to get us through the transition and we've got to be mindful that we can't shut down the industry that we need. At the same time, we can say that we don't want to keep supporting higher emission sectors that we possibly don't need."

Isaac was also sceptical about current metrics and ratings of sustainable investments. "The information that we receive from the sustainability side has room for improvement. I'm not a complete cynic. I don't think every company is manipulating things. But there is a percentage that are and there is certainly room for improvement."

> *everyone should start asking themselves: 'In what part of the market can I make an impact?'*

Coulman agrees sustainability rating systems have a long way to go. "We use an independent platform and when we consider scope three emissions, the coverage is about 4% – it's just very poor. But it is a transition. That's why for us it is important that the managers we use engage with companies as well.

"As asset owners or asset managers, the onus is on us to engage with companies to bring about that change. It's not going to happen overnight – it's evolutionary," says Coulman.

Pistarino, meanwhile, is sceptical even of engagement. "I've always been amazed by the idea of engaging with the likes of BP or Chevron. These businesses are based on digging out fossil fuels. What level of engagement can you get to steer them away from their own "raison d'être" and improve things materially, if that's your objective?

"When it comes to ESG investing, are we saying that there's a store of value somewhere, that is not being recognised and yet is in plain view and can be harvested by pointing in the direction of sustainability? In highly competitive financial and product markets, I do not believe that this is the case, I really don't.

"The economy works bottom-up, not top-down. Consumers have the last word. We delude ourselves when we think that asset allocators have this enormous power to steer the economy away from consumer preferences," he adds.

Jacobs, however, argues institutional investors do have real power and real responsibility. "The way to address this is not by saying it's just the responsibility of governments or corporates or consumers. It's all our responsibility. All of us here at the table every day make a choice about where we invest our capital, how we invest our capital and how we mitigate certain risks – and that gives us power. And with that power, we can do something," he says.

"I think there's a portion of your capital, maybe on the private side, where you have more ownership, and where you can set the agenda. For us, that means sustainable farmland. Healthy soils turn into healthy plants, healthy plants mean healthy food and a healthier society. In the end, that also means lower insurance costs for health.

"For other people it might be something else, but everyone should start asking themselves: 'In what part of the market can I make an impact?'"

# Insurance panellists

## Corrado Pistarino

Chief investment officer

Foresters Friendly Society

## David Devlin

Director, strategic partnerships and research

Phoenix

## Gareth Russell

Chief investment officer

canopius

## Ian Coulman

Chief investment officer

POOL Re
REINSURING TERRORISM RISK

## Todd Isaac

Chief investment officer

HISCOX

# Asset manager panellists

Allianz Global Investors is a leading active asset manager with over 600 investment professionals in over 20 offices worldwide and managing EUR 516 billion in assets. We invest for the long term and seek to generate value for clients every step of the way. We do this by being active – in how we partner with clients and anticipate their changing needs, and build solutions based on capabilities across public and private markets. Our focus on protecting and enhancing our clients' assets leads naturally to a commitment to sustainability to drive positive change. Our goal is to elevate the investment experience for clients, whatever their location or objectives.

## Mike McGill

Director, portfolio manager

Allianz Global Investors

## Samuel Berman

Director of UK insurance business development

Allianz Global Investors

At Van Lanschot Kempen Investment Management, we invest responsibly and with conviction. We are active managers who bring free thinking, resolve and originality to investment decisions. This helps us to reach hard-to-access asset classes that are often missed by our competitors.

As a leading manager, we look after large institutional portfolios for a range of European clients – taking great care to facilitate good outcomes for everyone invested. What's more, all clients benefit from our fiduciary expertise and investment infrastructure.

## Richard Jacobs

Managing director and lead portfolio manager of SDG Farmland Fund

## Chris Windeatt

Director, distribution