

30 October 2019

INSTITUTIONAL INVESTOR DIALOGUE

Frankfurt am Main, 8 October 2019
10:30 to 13:30 CET, Sonnemannstrasse 20

Participants

- Representatives of Abu Dhabi Investment Authority, Aegon Asset Management, Amundi, Assicurazioni Generali, Aviva Investors, AXA, BlackRock, Nordea Asset Management, Norges Bank Investment Management, PGGM, State Street Global Advisors, Union Investment and Zurich Insurance Group
- Members of the Governing Council of the ECB (or their alternates)
- ECB officials from the Directorates General Market Operations, Communications and Secretariat, as well as the ECB's Chief Compliance and Governance Officer

Summary

Outcome of the survey of participating investors

Based on the survey results, most participating investors thought that the ECB's purchases under the asset purchase programme were the most important element of the ECB's future monetary policy actions, followed by the path of interest rate adjustments.

Regarding the main risks that could lead to higher volatility in financial markets, most investors pointed to political uncertainty and geopolitical risks, including risks of protectionism. This was followed by uncertainty about the future monetary policy outlook of major central banks and a global economic slowdown.

If financial market volatility were to increase, investors expected that equities, credit and emerging market assets would be most affected. Some investors stated that global portfolios were overweight in risky assets owing to the lack of opportunities to invest in fixed income assets, which could exacerbate price movements in the event of shocks.

As regards the EUR/USD exchange rate, most investors replied that monetary policy decisions and related expectations would be the most important drivers over the next 12 months. In addition, political

and geopolitical uncertainty was becoming increasingly important, while macroeconomic fundamentals seemed to be declining in relative importance.

More than half of the participating investors stated that they were not planning any changes to their currency allocations. Of those planning some changes, most were considering increasing their allocation to the US dollar. For investors planning changes to their asset allocation, increasing the exposure to emerging Asia equities was the most popular choice. Compared with the May survey, there was more interest in investing in US bonds and equities.

Several investors highlighted continued strong demand for private and alternative investments to boost performance and also for diversification purposes. Within such investments, the previous trend decline in the attractiveness of real estate had come to a halt and it was currently viewed as the most attractive alternative asset class, followed by private debt. The reasons for the renewed strong interest in real estate were that it was seen as offering good returns, exceeding the returns on more traditional asset classes, and that it provided opportunities for value creation. For the same reasons its appeal had also increased among retail investors. A few respondents also mentioned that real estate offered better liquidity than other alternative investments.

About two-thirds of participating investors responded that there had been a further shift into other asset classes after bond yields had declined further into negative territory. Most of the remaining investors were considering changing their asset allocation in the future.

When asked about the share of active investments relative to passive investments, around one-third of investors stated that over the past three years they had made no significant changes. The number of investors responding that the share of passive investments had increased was, however, higher than the number of investors responding that it had decreased. This was mainly cost-related, but was also due to client disappointment with the performance of active portfolios.

Finally, the European Commission's report on an EU taxonomy for sustainable activities that was published in June was mostly seen as helping to deepen knowledge about companies' sustainability on the basis of individual business models and/or business lines and increasing pressure on all companies to provide regular and detailed disclosures.

Global investment trends

One investor provided an overview of prevailing global investment trends. There had been a long period of economic expansion, but the pace had been modest and had recently slowed. Central banks had responded to the slowdown and to low inflation rates by cutting their policy rates. Further monetary policy easing was expected in the future, even though an unprecedented number of government bond yields were below zero and corporate bond yields were close to all-time lows. Credit spreads were low despite increasing corporate leverage, which was said to increase vulnerability, as well as the probability of losses if corporate defaults were to increase.

Several institutional investors had reacted to this environment by increasing the share of private assets, which would result in an increase in illiquidity risk. One particular challenge cited was the lack of skills needed to manage these more complex types of investment.

As regards increased geopolitical risks, it was commented that the timing and market impact of such risks are difficult to predict, but an investor could mitigate them by having a strong balance sheet in risk-based capital terms, a well-diversified portfolio and robust risk management processes.

One investor highlighted the fact that private equities were not very different from traditional equity investments but were much less liquid. Both types of investment would be expected to come under pressure when the market turned. Some investors cited consumer risk and the need to retain flexibility and control over the investments as being specific challenges faced when diversifying into private assets.

Potential role of fintech and artificial intelligence as tools for institutional investors

One investor provided an overview of major technological developments, highlighting that they were not new concepts but their use and importance had soared in recent years in the financial industry and led to high efficiency gains. Asset managers said to have been leveraging technology in three ways. First, they had improved client connectivity by streamlining their interactions with investors and financial advisers. This had been very costly but had increased transparency by making more data available to investors online. Second, they had increased operational efficiency through automation, which had been particularly important in the current low-yield environment and had led to cost savings. Third, they had gradually incorporated “big data” as a forecasting tool in their investment processes.

These developments had not replaced portfolio managers’ decisions, as both human and machine-led inputs were being used side by side. However, they had led to different job profiles, with increased demand for staff with technological expertise who could help develop high-value IT tools for their companies and clients. As an example, one investor reported that the total number of people in the company had not changed significantly, but the composition of the staff had.

The implementation of these new technologies is expensive but they are vital in order for asset managers to remain competitive. The high cost of these technologies will likely lead to more consolidation in the asset management industry.

These developments could also lead to disintermediation, with clients and new fintech platforms having more information at their disposal more quickly and easily. One participant commented, however, that the existing regulatory requirements were expected to be a major barrier to new entrants. Another participant felt that disintermediation had already started but new technologies could help asset managers to reverse this trend.