Asian Investor

HD **Asset Owners: Q&A - Taking the first steps into alternatives - Gary Brader, group chief investment officer at QBE**

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Gary Brader is group chief investment officer of QBE, a Sydney-based general insurance firm with operations across 46 countries and dollars 31 billion in assets under management.

In addition to Australia, the firm has Asia-Pacific operations in Fiji, French Polynesia, Hong Kong, Indonesia, Macau, Malaysia, Papua New Guinea, the Philippines, Singapore, the Solomon Islands and Vanuatu.

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About one-third of its AUM is in Australian dollars, one-third in US dollars, 25% in sterling and euro, and the rest in currencies across countries including Asia, Canada, Latin America and New Zealand.

Brader took up the CIO role in January 2011, after previously acting as head of fixed income and having joined the group in 2003. Before that, he worked at Alliance Capital in London and spent 19 years on the investment side, including at Axa Investment Managers in London and Axa Australia.

Q Please outline your investment approach.

AWe form our return target from a bottom-up perspective. We conduct analysis of the future market context, likely slope and level of yield curve, likely path of interest rates and likely returns on a variety of asset classes. We then overlay the group's and divisional risk appetites and construct portfolios that optimise that risk appetite and deliver an acceptable return to the business.

Q When do you set the performance target and what is it this year?

A We set the performance target in Q3 for the following calendar year to enable our businesses to plan accordingly. The group is targeting a 2.25% return this calendar year.

Q That seems a pretty conservative target.

A It's a challenging environment to get returns unless one is prepared to move heavily into risk assets. We have a very conservative and liquid investment portfolio, we are moving to be less extremely vanilla, conservative and liquid.

Our risk asset allocation was 7% last year, and we are targeting 10% this year with a view to growing that to 15% in 2015. We're in the process of moving incrementally down the risk spectrum, but will end up in a place that's conservative compared to our peers.

Our global peer group of general, non-life insurers typically has 15-20% invested in risk assets.

Q What is your strategic asset allocation?

A Cash and money market securities generally account for around 25%; sovereign and semi-sovereign bonds 25%; corporate bonds about 40% (mostly floating-rate) - the figure was 47.3% last year and 41.7% in 2012; structured credit about 3% (this includes residential mortgage-backed securities, collateralised loan obligations AAA tranches); developed market equities 3%; property 2%; and 0.5% to 1% in each of emerging market debt and high yield.

Q How is your allocation changing?

A Last year we started investing in infrastructure debt. We gave two mandates to external managers to grow investment-grade-equivalent infrastructure debt. We're up to around 1% and are increasing that allocation.

Overall we target having 90% of our portfolio in fixed and 10% in risk assets.

We expect to grow our allocation to risk assets to be closer to that of our peer **group**. As the cycle matures, we expect to extend duration somewhat.

We're running short-duration strategies (less than a year) right now, but are likely to extend that once yield curves price in more meaningfully the likelihood of rate rises across the developed world.

Q How are you doing that?

A We have five categories of risk assets: equity; **property** (unlisted real **estate** investment trusts, no direct investment); EM debt (through mutual funds); high-yield and leveraged loans; and EM equity. The last three of these are new to our portfolio this year. We are aiming to have 1% (of the total) in each of those this year, and all those are being deployed to specialist conservative mutual fund managers.

Q Are you looking at alternatives?

A In addition to growing the allocation to risk assets modestly in 2014, we are planning to broaden it next year with a small alternatives allocation. This will be potentially 0.5% for the initial deployment, but we expect that to grow. This may include private equity, infrastructure equity and hedge funds - we're open-minded on what we might allocate to. We're looking at a couple of platforms to give us efficient access to a variety of managers, strategies and vehicles.

The key driver is that we're looking for uncorrelated risk to bring into the portfolio.

Social impact bonds is a new space we are interested in. These involve contracts where the government undertakes to pay for a successful social intervention that saves them money. This is happening in the UK in the prisons sector and in Australia with foster care.

The government shares some of the savings it makes from successful interventions with those investors. We would expect these to be part of our alternatives allocation, one that could be innovative and potentially transformative.

Q How big is QBE's investment team?

A We've got 60-odd investment staff across four countries - in Sydney, London, New York and Buenos Aires. The people in each location don't just manage local money - they all manage assets globally.

We have one team, one global remit.

By far the biggest part of the portfolio in Asia Pacific is in Australian dollars, then New Zealand dollars, then **Hong Kong** dollars, Singapore dollars and Malaysian ringgit. They account for the lion's share of regional business; the non-Australia and New Zealand part of our Asia-Pacific assets is dollars 1 billion of AUM.

Q To what extent do you use external managers?

A Around 95% of our money is managed in-house and 5% externally, but that will grow. All of our investment-grade fixed income and all our developed market equities are managed in house. Where we don't have in-house skill-sets or our likely allocations are not going to be of the scale to warrant buying that in-house skill-set, we'll **buy** external expertise.

Essentially anything that's not developed-market equities or investment-grade fixed income, we might look for external expertise.

Q How do you select managers?

A We used consultants to guide us in the early days with initial deployment - to help us in thinking about strategies and managers. But we have developed in-house expertise to own that process.

Q How do you manage your assets versus your liabilities?

A We run a strict currency match between assets and liabilities, and the term, if not the duration, of fixed income assets is similar to that of the liabilities. The short-duration profile of the asset book will likely extend towards that of the liabilities as global yield curves begin to normalise in the coming years.

Q What are you concerned about above all in the markets?

A I'm always a bit wary of **group**-think. It's fair to say we're less anxious on **China** than the consensus, though we're very wary of current elevated valuations in easily accessible and liquid asset classes generally - equities being one.

There was an interesting finding in Goldman Sachs Asset Management's recent survey of insurance asset allocations. Around 20% of respondents highlighted deflation as being a risk or concern over the next 12 months, and 3% had the same concern about inflation.

It wouldn't take much to really rattle forward curves in the bond market and by association all markets, if there were emerging signs that there wasn't quite as much spare capacity in say the skilled part of the US labour market as people were assuming. This could be deeply unsettling for markets.

It's a risk case - I think markets are very complacent about those kinds of risks.

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