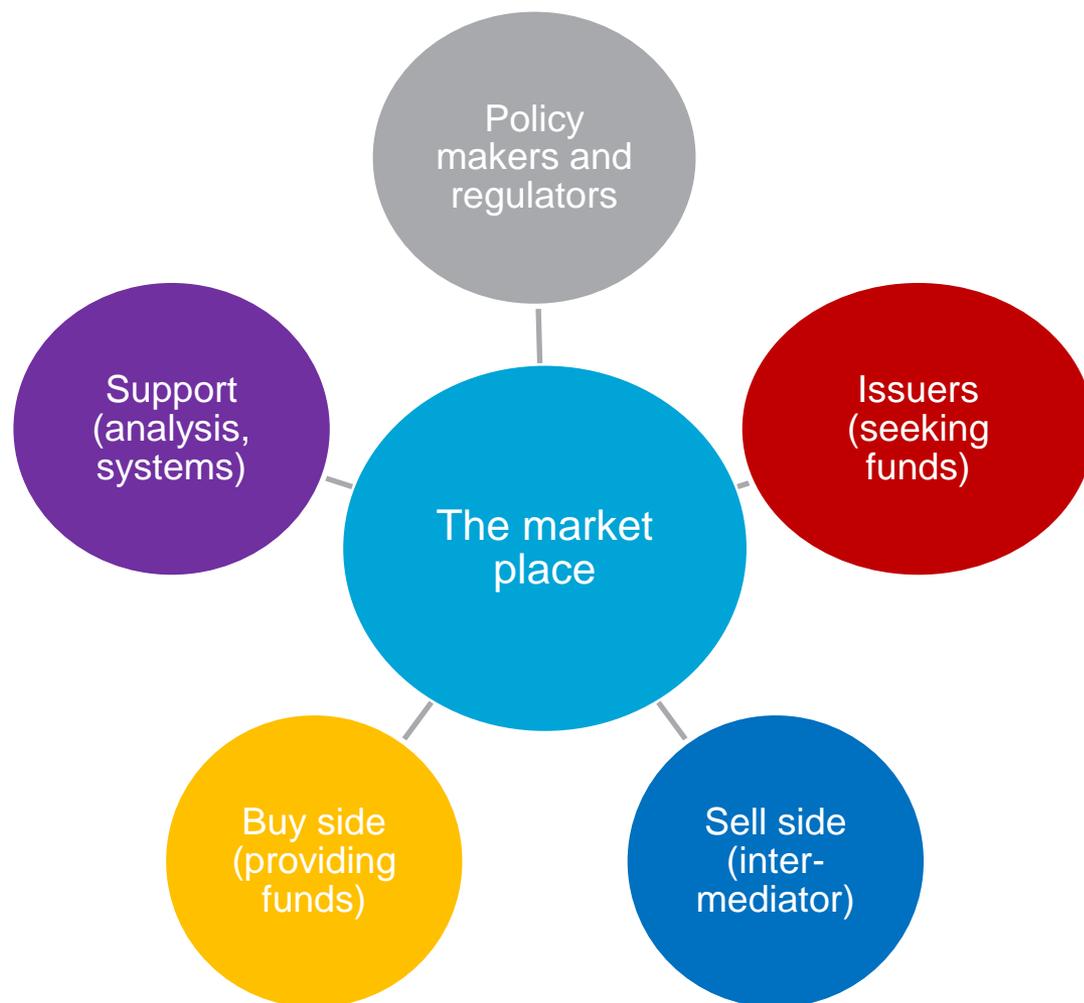


Financial markets, governance and Folketrygdfondet's management of the Government Pension Fund Norway

Thomas Ekeli, Chief Economist/Investment Strategy
BI, 7 October 2015



Financial market participants



Different perspectives

- Purpose & motivation
- Constraints (regulatory, political)
- Time horizon
- Recruitment
- Organizational culture

Ministry of Finance

GOVERNMENT PENSION FUND



NORWAY

MANAGED BY
FOLKETRYGDFONDET

No inflow or outflow
Returns added to the fund



200 bn NOK (2q15)

GLOBAL

MANAGED BY
NORGES BANK

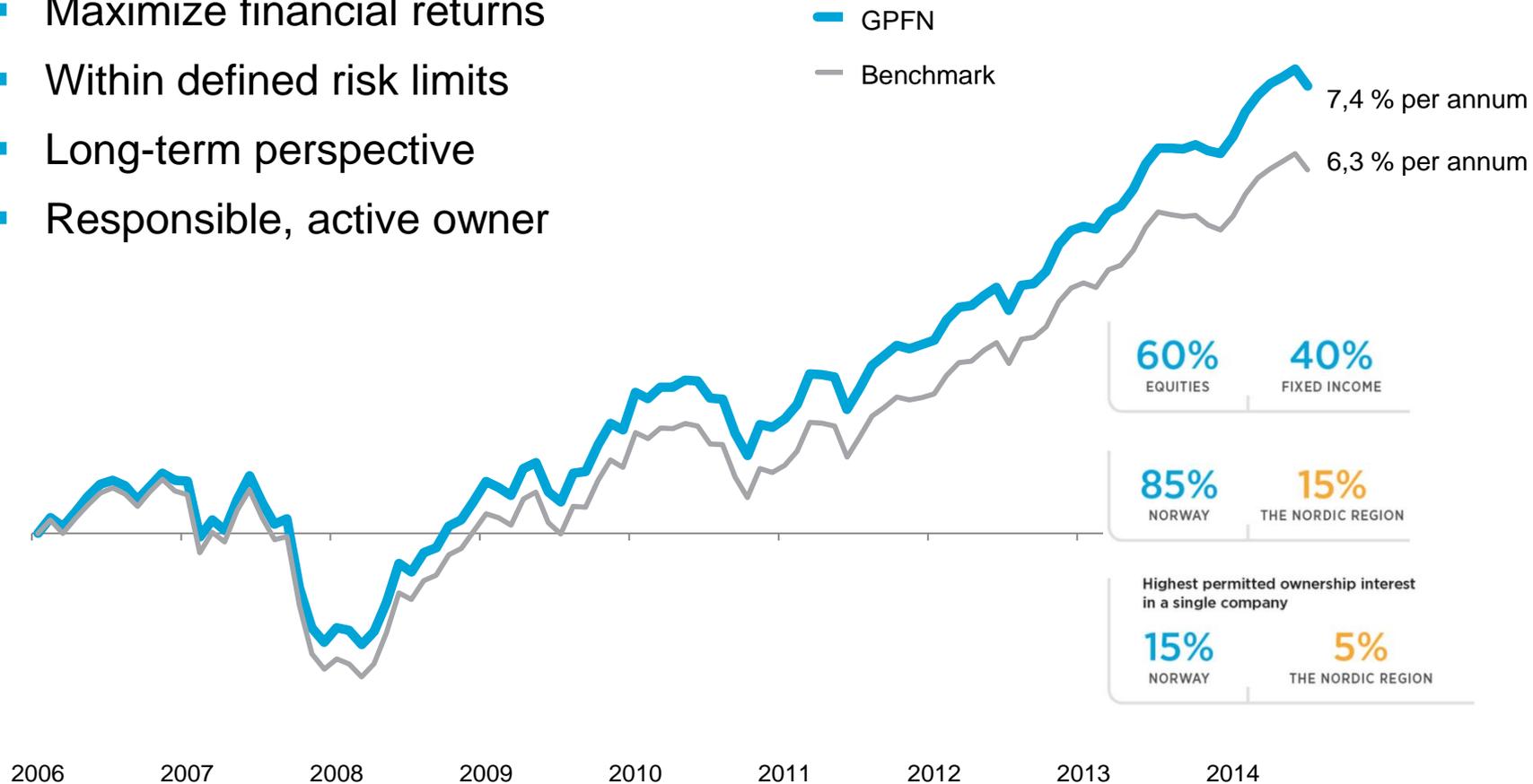
Fiscal guideline
Inflows from petroleum activities,
outflows to cover non-oil budget deficit



7 000 bn NOK (2q15)

Our mandate: Manage public assets

- Maximize financial returns
- Within defined risk limits
- Long-term perspective
- Responsible, active owner



The global rise of the sovereign investor

Motivation

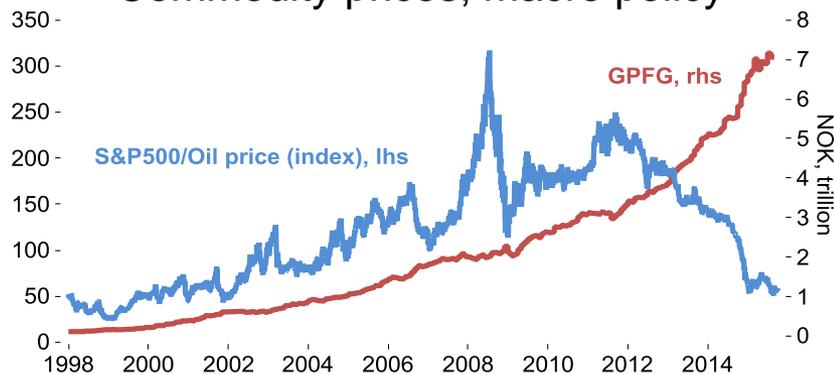
- Long-term wealth and tax smoothing
- Tool to support long-term policy

Design features

- Inflows, outflows, management
- Norway: Integrated with state budget, invested abroad, transparent

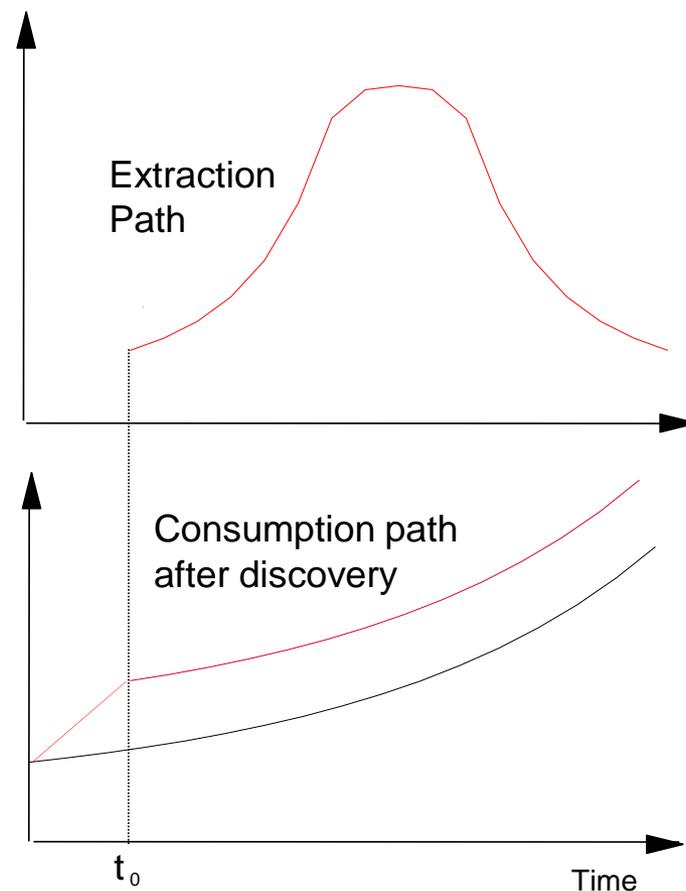
Rapid rise

- Commodity prices, macro policy



Source: Folketrygdfondet, Macrobond

Separating volatile resource revenues from spending via SWF



China illustrates economy links to markets (and sovereign asset management)

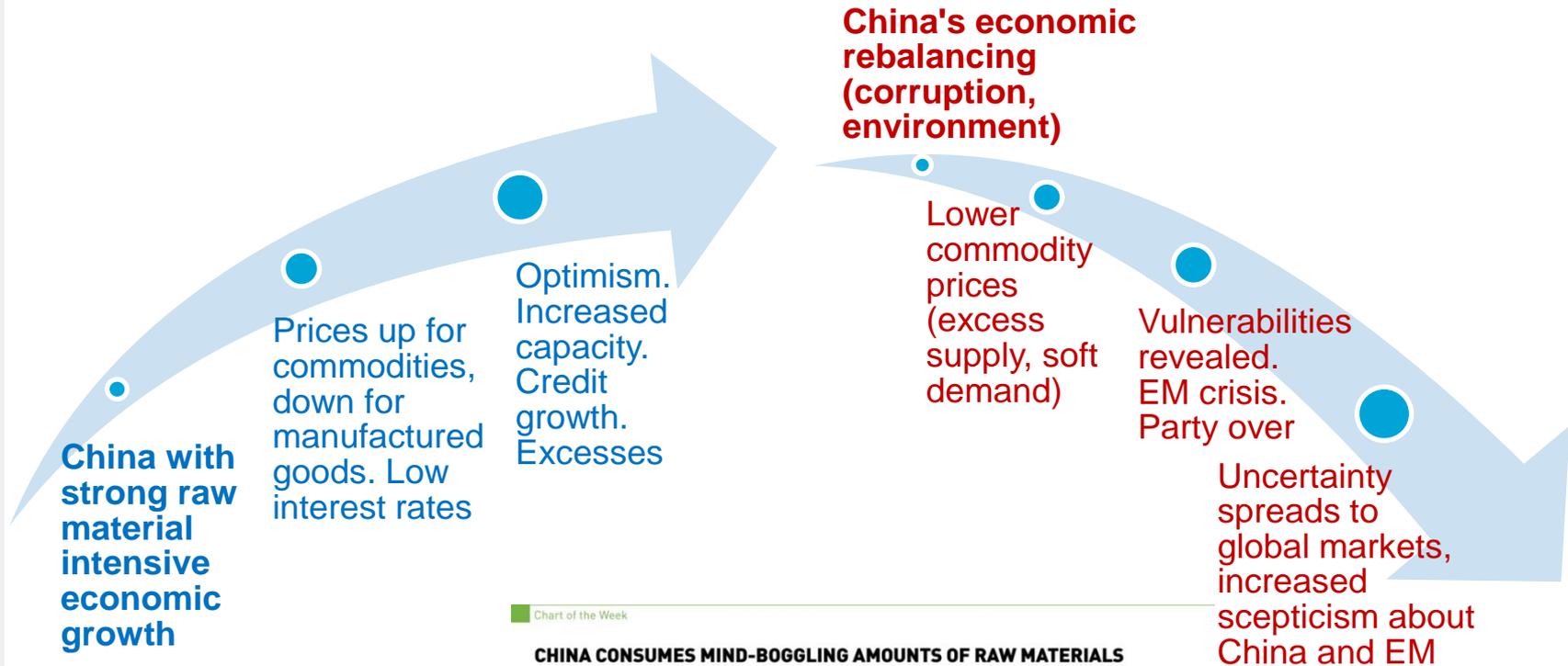
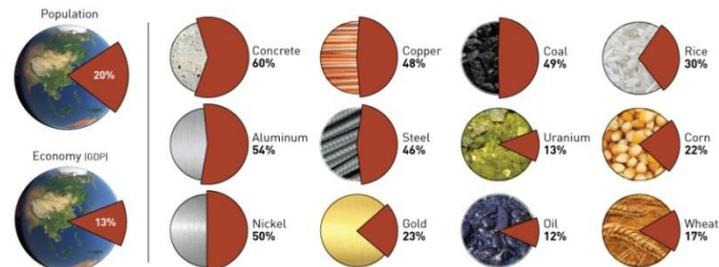


Chart of the Week

CHINA CONSUMES MIND-BOGGLING AMOUNTS OF RAW MATERIALS

...and that's why slowing growth may continue to cause headaches for commodity producers



Resource curse – both real and financial

Evidence

- Economic underperformance by resource rich countries
- Investment underperformance (financial and reputational)

Key issues

- Macroeconomic stability
 - Revenue volatility, Dutch disease, rent seeking
- Political governance
 - Conflict, corruption, weak institutions
- Investment governance
 - Inappropriate (pro-cyclical) risk taking
 - Misalignment of interest between owner and managers (and others)
 - Time inconsistency, myopia, asymmetric information, principal-agent risk

Developing the investment framework

- **Know thyself**
 - Beneficial owner, fund size, time horizon, risk bearing capacity, liquidity needs

- **Clarity on purpose, governance, strengths and weaknesses**
 - Clear lines of responsibility, accountability
 - Investment style, responsible investor, ownership role
 - Attracting talented and motivated individuals to contribute to a sound corporate culture

- **Beliefs: Efficiency of markets, diversification, type of investment risk**
 - View on how the market works, predictability/efficiency (who forecast China's rise, Asian crisis, LTCM, dotcom, Lehman, GFC, EMU crisis, CB rates & QE?)
 - Concept of risk. Time horizon. Factor exposures (structural and time-varying)

Long-term investing

Key issues

- **Nice in theory, difficult in practice**
 - Long verification horizon
 - Cyclical vs structural
 - Human behaviour
 - Principal-agent issues
(owner/manager, external managers, consultants)
- **Encourage owner to be long term**
 - Conversation, education
 - Institutionalize long-term investing
- **Encourage manager to be long term**
 - Owner's incentives to manager
 - Manager's corporate culture

Ex: CalPERS – pro-cyclical investment

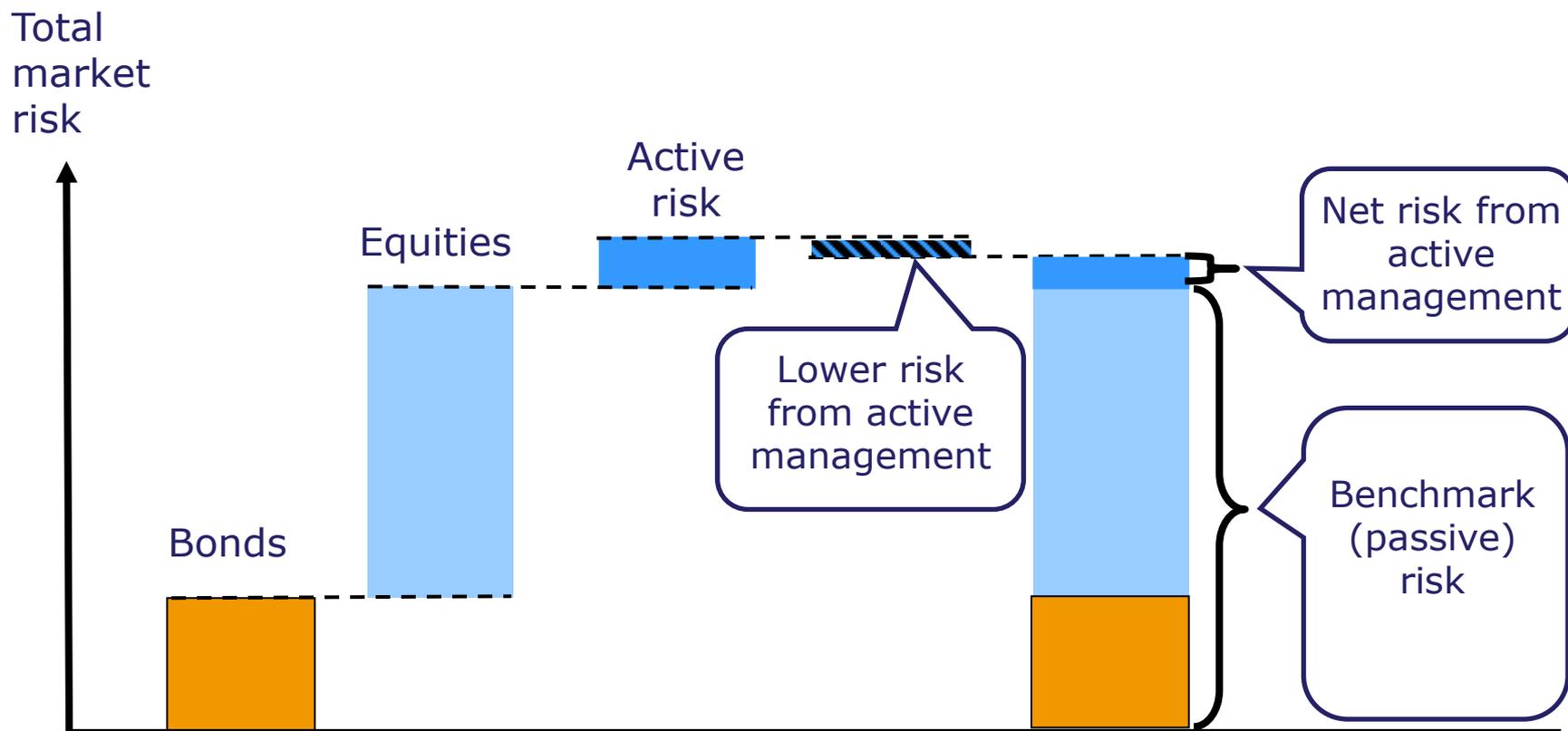
- Increased real estate share from 5% in 2005 to 9% in 2008
- Reduced equity share from 60% in 2007 to 44% in 2009
- Buying high+selling low=weaker returns

Source: Ang and Kjær (2011)

Ex: GPF 2008 – public debate

- Benchmark –19.9%, Alpha –3.4%
(subsequently recovered)
- Intense media attention on alpha
- Importance of ex-ante communication and conversation

Financial markets efficiency and the active/passive (alpha/beta) debate



Active/passive debate needs to be nuanced

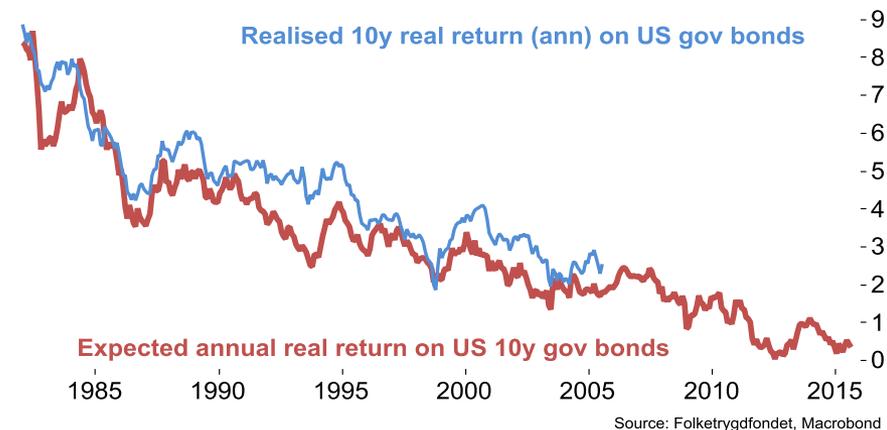
- Focus on low-cost and simple passive management has advantages, but:
 - Asset owner must take risk. "Safe and passive" is an illusion
 - Asset owner should take risk that is well remunerated after costs
 - Portfolio risk should reflect asset owner's characteristics
 - Asset owner should focus on strategy and delegate investment decisions & implementation
 - Manager needs the trust of the asset owner

- Folketrygdfondet is an active manager of the GPFN because:
 - Our characteristics, core values, investment philosophy and long experience provides a solid foundation to create excess risk-adjusted returns at low costs
 - Liquidity in the Norwegian financial market is variable and at times quite poor
 - Benchmark risk exposure not necessarily suitable for long-term investor
 - Interdependence between responsible investing and active investing

Folketrygdfondet's key sources of excess returns

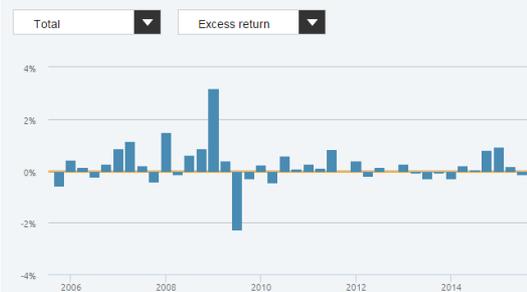
Our long-term perspective means we:

- Invest in quality companies
- Invest in less liquid assets
- Invest countercyclically
 - Risk premia and expected returns vary over time (see charts)



THE GOVERNMENT PENSION FUND NORWAY

Return/Excess return, quarterly

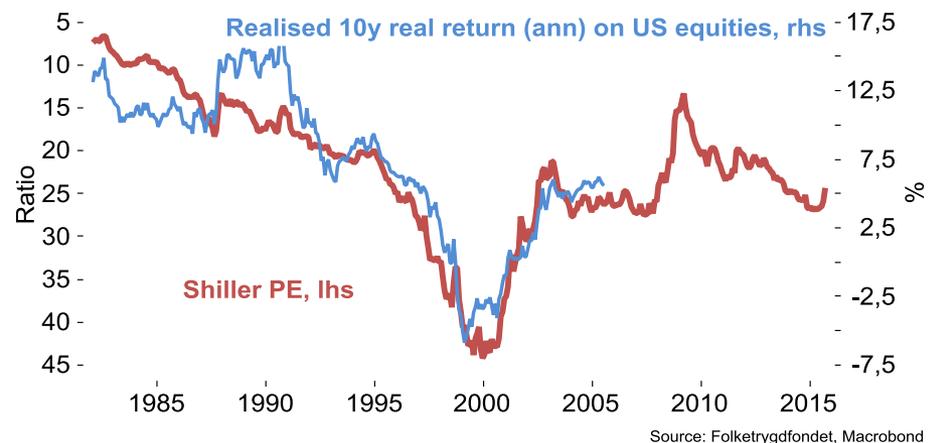


As of 30. June 2015

196 billion NOK

EXCESS RETURN:

last quarter	-0,1%
last 1 year	1,8%
last 3 years	0,6%
last 5 years	0,7%
last 10 years	1,1%



Thank you for your attention

