Finnish Pension Fund Turns to Alternatives

Stockholm (HedgeNordic) – Around $15 trillion of government-issued bonds, or one-fourth of the market, trade at negative yields worldwide, according to Deutsche Bank. As a result, Finnish employment pension company Ilmarinen Mutual Pension Insurance and other pension funds are increasingly turning to non-traditional asset classes in the pursuit of sufficient returns to cover liabilities.

Quoted by AMWatch, Ilmarinen's Chief Investment Officer, Mikko Mursula *(pictured)*, says that "the answer is, you need to be innovative and able to accept more, in some cases a lot more, illiquidity in your portfolio than before." Requiring a return of more than three percent to counterweigh the growth in the pension fund's liabilities, Ilmarinen has been allocating more capital to alternative assets to pump up pension returns. According to Mursula, it is "unrealistic" to expect good returns in fixed-income markets at the moment, pointing out that the best opportunities can be found in real estate and less liquid alternatives such as private debt.

Investing more money with private equity funds represents another viable alternative. "Every time we find opportunities there, we take money out mostly from our government bond portfolio," Mursula said in an interview. With the pool of negative-yielding debt worldwide expanding, pension funds are increasingly struggling to find suitable investment options in the current low-return environment. At the end of 2018, around 37.7 percent of Ilmarinen's €46.0 billion-investment portfolio was allocated to fixed-income investments. Equity-related investments accounted for 42.8 percent, with private equity investments constituting 8.2 percent of the overall portfolio.

Ilmarinen's allocation to hedge funds reached 4.3 percent at the end of last year, with the hedge fund portfolio returning 2.9 percent for the year. Whereas the pension fund's portfolio of listed equities lost 9.7 percent last year, its investments in private equity and non-listed equities returned 18 percent and 28.8 percent, respectively. Real estate investments, which accounted for 13.2 percent of the €46 billion-portfolio, generated a return of 6.0 percent last year. Mursula and his team plan to increase Ilmarinen's exposure to real estate assets to as much as 20 percent from approximately 13 percent at the end of June.

Corporate credit markets are starting to look expensive as well, according to Mursula. At the end of 2018, around 11 percent of Ilmarinen's portfolio was invested in public corporation bonds. "It is difficult to find investment opportunities from the listed credit market," says Mursula, adding that this is "why private credit has been growing in size in our asset allocations."

Ilmarinen relies on external managers to find the right assets in the private credit market. "When the environment gets challenging, good managers still perform well," says Ilmarinen's CIO. "Within the private debt markets, there are products and managers, and investment opportunities that will provide you a 2 percent – 3 percent return," says Mursula. "Then if you go to the riskier part of the market we are starting to see return levels of 10 percent – 12 percent."