ATP’s Smart Beta Approach

Stockholm (HedgeNordic) – ATP, Europe’s fourth-largest pension fund, runs an investment portfolio and a hedging portfolio, “with the hedging portfolio taking care of the guarantees that we have and the investment portfolio generating returns on top of the guaranties,” according to Christian Kjær *(pictured)*, Head of Liquid Markets at ATP. About one-third of ATP’s DKK 423 billion investment portfolio is invested in listed equities, with 68 percent of the listed equity portfolio invested globally and 32 percent in local Danish companies.

ATP relies on different approaches to invest in Danish listed companies and international companies. “We have three layers in the liquid equity exposure,” Christian Kjær tells HedgeNordic. “We have the Danish equity allocation run by a Danish fundamental stock-picking team that applies a deep fundamental research approach and an active ownership style to invest in local Danish listed companies,” starts Kjær. “We also have an emerging markets equity allocation achieved through cheap and efficient investing in futures, and then we have the global equities allocation achieved through a smart-beta approach.”

“We have a very long history of working with Danish companies and we see it is part of our obligation as a pension scheme in Denmark to engage with Danish companies.”

“Our active approach to investing in listed Danish companies is obviously very time consuming and people-intensive, as we need to be close to the companies,” explains Kjær. “We have a very long history of working with Danish companies and we see it is part of our obligation as a pension scheme in Denmark to engage with Danish companies,” he continues. “We believe it makes sense to have this approach in Denmark and lever our institutional power in the Danish equity market.” ATP finds little value in applying this time-consuming and labor-intensive investment approach to global equities.

“Globally, we have a different approach. We use futures to get exposure to emerging markets equities and then use a smart-beta approach for getting exposure to other global equities.”

“If we were to apply the same strategy to global equities, we would need to hire a lot more people and we would need offices around the globe to be able to access different companies or managers across the globe,” argues Kjær. “Globally, we have a different approach. We use futures to get exposure to emerging markets equities and then use a smart-beta approach for getting exposure to other global equities,” continues ATP’s Head of Liquid Markets. “Our emerging market exposure is very simple. It is the cheapest exposure possible with the highest possible liquidity, and in our view, we find that in the futures market.”

“On global equities, we have a smart-beta approach.”

“On global equities, we have a smart-beta approach,” says Kjær. “Instead of reading the annual reports of thousands of global companies and doing all the fundamental work our Danish team does, we use a systematic approach to invest in global equities,” he elaborates. “It is simply a way of trying to select the right equities without having hundreds of people employed, it is a very efficient and clean way to invest in global equities. We want to stay lean, which is one of the reasons why we have a quant approach for global equities."

ATP's Smart Beta Approach with an ESG Overlay

ATP's four-member team focused on global equities weight holdings based on four main factors: low risk, momentum, value, and quality. ATP also relies on an additional ESG factor to pick stocks for its systematically invested portfolio of foreign equities. "We use a fixed allocation to each factor, as we believe we are not able to time market factors," explains Christian Kjær. "The low-risk factor is an important component for the portfolio because we are constrained by a risk capacity, not as much a capital capacity, in the investment portfolio at ATP."

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"It is very much a low-risk/quality portfolio."

"Momentum and value come together and we try to have a balanced exposure between the two," elaborates Kjær, suggesting that momentum and value work as nemeses with one performing poorly if the other one is performing well and the other way around. "Finally, we recently added quality as a factor to give stronger defensive properties to our portfolio," says Kjær. "Since momentum and value cancel each other to some extent, and quality tends to balance out some of the value exposure, we do not have a lot of value exposure in the portfolio. It is very much a low-risk/quality portfolio."

Since 2018, Denmark's largest pension fund has also added an environmental factor to its quant-based approach to investing in global equities. "Before that, we had been using ESG on the restriction side by excluding certain stocks and industries from the portfolio," Kjær tells HedgeNordic. "But we decided to find a way to implement ESG investing in a more positive way, to use ESG data to improve our portfolio instead of keeping us out of struggle." Instead of relying on aggregate ESG ratings from MSCI, Sustainalytics and other providers, ATP opted to "drill further down and get into the rawest part of ESG datasets to find insightful indicators."

"We do not really believe in these aggregated ESG ratings. We took a different approach by looking further down into the datasets."

"We do not really believe in these aggregated ESG ratings, partly because it is quite hard to understand the main underlying drivers behind these ratings and partly because different providers tend to disagree quite a lot on ratings," explains Kjær. "We took a different approach by looking further down into the datasets," he continues. "Up until now, we have been focusing on the climate side by looking for CO2 efficient companies."

"We think we found some data points in the ESG dataset that gives a hint about which companies in the utility sector will improve the most going forward."

More importantly, ATP has been implementing the ESG factor in sectors where carbon emissions are a key problem, such as utilities. "We are looking at the sectors where improvements in CO2 emissions we would have the greatest impact on climate change mitigation," says Kjær. "We recently integrated a leading indicator for ESG efficiency improvements for utility companies," he continues. "We think we found some data points in the ESG dataset that gives a hint about which companies in the utility sector will improve the most going forward."

The Advantages of a Quant Approach

"I am a big believer in this quant approach to investing."

"I am a big believer in this quant approach to investing," Christian Kjær tells HedgeNordic. "Quant-based investing involves a scientific approach to investing. You have a hypothesis of how to select stocks, you can formulate a strategy and you are able to test how the strategy would have performed historically," explains Kjær. "When you go live, you can compare if the strategy performs as expected. If it doesn't, you can make some changes and improve the strategy."

"A systematic approach to investing is not dependent on one brilliant stock picker, who may decide to leave and shake up the entire approach to investing."

"Secondly, there is minimal key man risk here," continues Kjær. "A systematic approach to investing is not dependent on one brilliant stock picker, who may decide to leave and shake up the entire approach to investing," he adds. "For our systematically invested portfolio of global stocks, everything is put into code. If somebody leaves, the code is still here." And finally, a systematic approach to investing does not rely on a resources-intensive – time-consuming and people-intensive – process.