INVESTMENT

Ask the industry:

Imagine you have €1 billion (or equivalent value in local currency) of new capital to invest today for your pension fund/pension fund client. How would you allocate it, what opportunities would you avoid, and what factors would most influence your decisions?

Diversification remains, in our view, 'the only free lunch in investing', as observed by Harry Markowitz. With €1 billion of new capital, we would seek to build a diversified portfolio designed to perform across market cycles rather than rely on any single theme or region. We would combine passive exposure to core asset classes – equities and bonds – with active strategies that may offer less correlated returns, alongside selective private market allocations.

Within equities, we would remain constructive but diversify beyond US large caps (which are dominated by tech stocks) by including emerging markets and small-cap stocks. In fixed income, we would spread risk across government, corporate, investment-grade, high-yield, emerging market and inflation-linked debt. We would also consider liquid alternatives and private market strategies that add diversification, and access to return drivers less dependent on public markets.

We would seek to avoid concentration risk, stretched valuations and areas where expectations already appear fully priced. Our allocation decisions would be driven primarily by diversification, inflation protection and portfolio resilience – aiming to improve downside resilience through periods of sustained negative performance, whilst recognising that losses remain possible.

ORLA AHERNE, Mercer Ireland head of investment

If I had €1 billion to invest today for long-term pension commitments, the goal would not be to predict the next market winner. Instead, I would build a diversified all-weather portfolio: 20 per cent high-quality bonds and credit, 40 per cent listed equities across regions, 15 per cent private companies, 15 per cent real estate and infrastructure, and 10 per cent in liquid or strategic opportunities. I would avoid complicated, highly leveraged assets and fashionable themes whose valuations assume perfect outcomes. Decisions would be driven by expected risk-adjusted returns, liabilities, inflation sensitivity, liquidity, fees, governance, and sustainability. The priority would be resilience: preserving flexibility while compounding capital steadily enough to meet pension commitments across different economic and market environments.

MATTIAS MUNTER
Skandia pension economist and head of public affairs

There is a pension reform taking place in Finland. The reform allows us to increase our portfolio allocation to equities. Thus, additional new money would go to equity markets. But of course, depending on the prevailing market situation and valuation.

ANNIKA EKMAN
Ilmarinen CIO

If we were allocating €1billion of new pension capital today, artificial intelligence and digital infrastructure would be among the highest-conviction themes under consideration. Artificial intelligence has moved from a speculative theme to materially shaping markets, capital expenditure and the real economy. In our view, the AI revolution is real, substantial and still in its early stages. As the implications of AI stretch across asset classes, regions and sectors, it has the potential to create a wide set of winners and losers across portfolios. A Total Portfolio Approach is thus essential to assess the investment opportunity.

Much of the market debate has focused on the largest US hyperscalers, listed technology platforms and leading private AI laboratories. These businesses are clearly important to the theme, but their valuations already reflect a great deal of optimism. We think investors need to also consider opportunities beyond the largest and most visible beneficiaries. Value could accrue to chipmakers, cloud providers, data centre owners, AI labs, energy providers or a broader ecosystem of enabling technologies.

Data centres are a newer addition to the investment universe and represent the physical infrastructure required to house, power and cool the servers that train and run AI models. If AI adoption continues, demand for compute capacity should rise materially. Renewable energy has become an increasingly attractive indirect beneficiary of AI-driven infrastructure growth and would therefore rank highly among the areas we would consider for incremental allocations.

Listed data centre companies and infrastructure securities provide one route to access the trend, but a significant share of the opportunity is in private markets where we have invested through specialist funds, development platforms and direct co-investments. For an investor deploying substantial capital, private market opportunities can be particularly attractive because they provide access to parts of the value chain that are often unavailable in public markets.

However, if allocating a €1 billion portfolio today, we also need to remain alert to the risks. Some existing business models may face disruption, such as software and SaaS companies which are already under pressure around pricing power and competitive advantage as AI lowers the cost of producing software and automating white-collar workflows. Another important consideration is that transformative technologies rarely follow a straight line. As capital flows into a new theme, periods of exuberance, sharp corrections and excessive valuations are often part of the price discovery process.

For long-term investors, maintaining diversification, discipline around valuations and concentration risk will be just as important as identifying the opportunities themselves.

MARTIN DIETZ
L&G head of diversified strategies

Decisions on the strategic asset allocation are based on our long-term expectations for asset classes returns and the risk preferences of the fund participants. It would make sense to invest this unexpected €1 billion new capital in the same proportions, unless the current portfolio deviates from the portfolio deemed optimal. This is actually why we regularly rebalance the portfolio: market developments cause deviations from intended weights, rebalancing brings the portfolio back in line. Perhaps for a smaller fund a billion could make a difference (assuming the assets increase, but the liabilities remain the same). So, if a pension fund were to receive €1 billion of additional capital today, our starting point would not be to chase short-term opportunities. Rather than trying to predict short-term market movements, we focus on maintaining a resilient portfolio that can perform across different market environments.

CHARLES KALSHOVEN
APG macroeconomist and expert strategist