28 May 2019

INSTITUTIONAL INVESTOR DIALOGUE

Frankfurt am Main, 8 May 2019
10:30 to 13:30 CET, Sonnemannstrasse 20

Participants

- Representatives of Abu Dhabi Investment Authority, Aegon Asset Management, Amundi, Assicurazioni Generali, ATP, Aviva Investors, AXA, BlackRock, Mapfre, Nomura Asset Management UK, Nordea Asset Management, Norges Bank Investment Management, PGGM, Swiss Re, State Street Global Advisors and Union Investment
- Members of the Governing Council of the ECB (or their alternates)
- ECB officials from the Directorates General Market Operations, Communications and Secretariat as well as the ECB's Chief Compliance and Governance Officer

Summary

Outcome of the survey of participating investors

Most investors thought that the path of interest rate adjustments was the most crucial element of the ECB's future monetary policy actions, followed by the length of the asset purchase programme reinvestment period and operational details of the forthcoming targeted longer term refinancing operations (TLTRO-III).

Regarding the main drivers of medium-term financial market volatility, most investors pointed to political uncertainty and geopolitical risks. A possible deterioration of market liquidity and a global economic slowdown were also among the most common answers. In contrast to previous survey results, uncertainty about the future monetary policy outlook of major central banks was no longer among the top three expected drivers of volatility. If volatility were to surge, investors expected that the relatively riskier asset classes would be affected most strongly, namely equities, credit and emerging market assets.

As regards the EUR/USD exchange rate, most investors replied that monetary policy decisions and related expectations would be the most important drivers over the next 12 months. The most notable change from the previous survey was that political uncertainty and geopolitical risks were now expected to affect the EUR/USD exchange rate as strongly as macroeconomic fundamentals do. As examples of such risks that could influence the EUR/USD exchange rate in the short term, the participants mentioned Brexit, the EU-US trade talks and the upcoming EU parliamentary elections.

Regarding portfolio allocations, several investors mentioned that they did not plan any major changes in currencies or asset classes in the foreseeable future. For those investors that were planning changes, increasing exposure to emerging Asia equities was the most popular choice, but less so than a year ago. Several investors were planning to increase their fixed income exposure broadly across the globe. There was a noticeable decline in the number of respondents who planned to add more equities, in particular European equities.

Among alternative investments, increased allocation to infrastructure remained the most popular choice within this asset class, followed by private debt, private equity and real estate. However, the latter had been losing appeal over the past two years. One investor noted a general lack of alternative investments in an environment in which a substantial share of bonds traded at negative yields, whether issued by governments worldwide or investment-grade corporates. A debate followed on the root cause of the lack of structural reforms in some European countries.

Finally, half of the participating institutions indicated that they had already adopted the FX Global Code, a set of global principles of good practice in the foreign exchange market that was jointly developed by central banks and the private sector.

Global investment trends

One investor provided an overview of prevailing global investment trends. Global growth had moderated but the current expansion was expected to continue. Low inflation rates had persisted in the G7 countries and monetary policy had remained supportive with low official interest rates. However, economic policy uncertainty had risen to high levels while implied volatility in financial markets had stayed low from a historical perspective. This had led some investors to ask whether risk is underpriced, also in light of ongoing changes to market making.

Investors had remained cautious and, as a result, their cash holdings were at the highest level in a decade. But cash holdings had gradually started to fall as demand for spread assets and less liquid instruments had picked up. Flows were also returning to emerging market bonds, which offered a good opportunity for diversification, but this was less true of equities. In future, slower growth, longer cycles, lower rates and lower volatility could be expected. Under this scenario, leverage would be likely to increase as investors look for other ways to achieve their target returns.

Application of environmental, social and governance (ESG) criteria by institutional investors

Almost two-thirds of investors responded that a large majority (80-100%) of their investments already complied with some sort of ESG criteria. They used a combination of strategies, with the ESG integration approach said to be the most popular choice.

One investor provided a presentation on the trends and challenges for ESG investing. The ESG market had grown measurably over the past ten years, reflecting in part the growing attention paid by policymakers to ESG-related topics, most notably climate change. Central banks and institutional investors were also increasingly involved in promoting ESG investing. One participant mentioned that the environmental aspect was the most urgent one given the concerns about climate change. Millennials were also increasingly likely to request climate-related financial instruments. Europe was currently leading in this area but the trend had become increasingly global.

Over the past two years, new academic research had suggested that ESG investing could improve performance on a risk-adjusted basis, helping to lift demand from asset owners. One participant highlighted the difficulty of finding adequate supply to meet investment demand, while another mentioned that there were plenty of investment opportunities in ESG as there were still market inefficiencies that let investors achieve better returns. At some stage, when ESG becomes mainstream in the investment process, market inefficiencies are likely to disappear, reducing scope for higher returns.

Another participant expressed concern about how to incorporate the ESG approach into risk management systems due to the lack of data and taxonomy. Some participants mentioned that certification was one of the key elements, as the wide variety of products in the market could leave scope for greenwashing. Some participants suggested that a rating agency should be created with the aim of assigning scores to corporates based on the ESG criteria.