Balancing short-term opportunities with a long-term strategy

Spotting short-term investment opportunities can be a valuable tactic in a trustee's armoury, but how can this be effectively combined into a long-term investment strategy?

Summary

- Trustees can take a short-term view to benefit from a market trend, while still maintaining focus on their long-term strategic plan.
- Self-sufficiency or buyout goals has forced some DB investors to think more like short-term investors.
- The challenge investors face is finding short-term opportunity that can feed into a long-term strategy, without comprising the latter. To manage this, trustees should make sure they first have a solid long-term strategy in place of what they are targeting, eg buyout.
- Trustees should have a quick and early exit strategy in case a bubble is cleverly disguised as a short-term investment opportunity.

The past 18 months have been volatile for investors. By the end of March 2020, when the severity of Covid-19 had become abundantly clear, markets had fallen through the floor. The nosedive was as a result of a broad sell-off across sectors and asset classes, driven by investors' need for liquidity and security. The FTSE 100, for example, posted its biggest quarterly fall in more than three decades at the end of March, with shares losing a quarter of their value in the first three months of the year.

Fortunately for investors, markets were quick to recover as governments worldwide put in place aid measures and central banks cut interest rates and issued massive quantitative easing packages in the hope of propping up economies.

Scenarios like March 2020 can provide the opportunity for long-term investors like pension funds to increase allocations to assets that were already considered attractive strategic opportunities, but at favourable entry levels.

In such a situation, scheme trustees could take a short-term view to benefit from a market trend, while still maintaining focus on their long-term strategic plan.

Legal & General Retirement Institutional head of investment solutions, Sumit Mehta, says that short-term investment decisions matter when it comes to valuation relative to fundamentals.

"For long-term investors like us, we evaluate short-term valuations primarily in the context of what it means for long-term returns," she explains, "so an asset that might be considered expensive in the context of current markets, but if we believe that in the long term it still provides attractive risk-adjusted returns against our benchmarks, then we would buy it."

She continues: "For long-term investors who have liabilities to service, this evaluation additionally takes on a relative value nature, as not investing carries a penalty. We would evaluate the asset relative to similar opportunities. Examples of this are corporate credit and segments of property markets, which, while seem expensive in traditional value measures, still offer positive risk-adjusted returns in our opinion."

The challenge investors face is finding short-term opportunity that can feed into a long-term strategy, without comprising the latter.

Keeping an eye on the end goal

The difficulty involved in balancing short-term opportunity with long-term strategy should not be overstated. Cartwright director, Sam Roberts, says that in practice, the best way for trustees to go about such a feat would be to make sure they first have a solid long-term strategy in place.

"They need a clear idea of what they are targeting, such as buyout in 10 years' time, for example, their risk appetite, and the key building blocks required to achieve it," he says. "Trustees can then assess how much time they have left to be involved in shorter-term opportunities.

"For those that don't have the time, delegating to the investment consultant through pre-agreed triggers, or to the fund manager through an active fund, allows short-term opportunities to be taken in an effective way."

Having an investment sub-committee could allow extra time to be dedicated to investment issues for both the longer term, like ESG, and for the shorter term, like buying equities in March 2020, he adds.

Recognising how difficult identifying short-term opportunities can be, Charles Stanley head of fiduciary management, Bob Campion, advises trustees to ensure this duty is being managed by a dedicated team on an ongoing basis.

"It's very difficult for trustees – even at the largest pension schemes in the country – to make short-term investment decisions," he says. "But short-term or 'tactical' investing can improve performance and, more importantly, be a valuable technique for managing risk.

"The most sensible way for long-term investors like pension schemes to make tactical decisions is to employ a dedicated in-house investment team or fiduciary manager. That way short-term positions and market conditions can be monitored constantly, and the risks of tactical trading can be managed."

The need for continual monitoring is not necessary simply because of short-term opportunities potentially arising. Many DB schemes have evolved with new self-sufficiency or buyout timelines. This has forced DB investors to think differently, and more like short-term investors.

"This is due to the significant gains in the markets, as well as the rise in bond yields, resulting in over half of the UK DB schemes now being in surplus," explains Newton Investment Management head of UK institutional, Jenny Joe.

"For these schemes, the challenge is what to do next and some of these have illiquid assets that they no longer need and can't exit easily."

This can create new considerations throughout a scheme. While some investors may be increasingly inclined to behave like short-term investors, the idea may prove controversial for others.

It is the focus on strategic asset allocation, not short-term tactical decisions, that remains vital for Momentum Investment Solutions & Consulting partner, Peter Hall. He argues short-term distractions cannot be allowed to take away from long-term investment timeframes. A core tenet of long-term investing.

"We believe trustees should focus their time on strategic decisions rather than being distracted by the temptation of short-term trends," says Hall.

However, he continues, short-term trends can provide attractive entry or exit opportunities when it comes to implementing strategic asset allocation decisions: "The market stress observed across asset classes as a result of the Covid-19 crisis last year, for example, provided long-term investors with the opportunity to increase allocations to higher quality opportunities that have a long-term role in portfolios at very attractive prices."

Barings Real Estate head of European research and strategy, Paul Stewart, says many private sector DB plans are under-allocated to real and inflation-linked assets. With inflation on the rise, Stewart says in the near term there has been an increased appetite for higher return, cashflow-generating assets like real estate, adding: "This prevailing short-term trend has the potential to meet challenging DB scheme liabilities in the long run."

'Make sure you can sleep at night'

While short-term opportunities have a place in long-term strategic planning, there is a danger that something that looks like a good short-term opportunity could in fact be unsustainable.

Campion reiterates that trustees should make use of an experienced investment professional skilled in differentiating sectors or trends that they believe have good prospects.

"Bubbles can be difficult to identify until it's too late, but one of the key skill sets of any professional investor is a sell-discipline – the ability to exit a position once profits have been made," he says.

"Short-term or 'tactical' investing is certainly a valuable strategy to have in your armoury – but it isn't something trustees should attempt themselves."

More confident in the ability of trustees, Roberts says: "Bubbles are easy to spot after the event and you will always be able to find someone who thinks what you're doing is crazy – ignore them. Ask yourself – is what you're doing consistent with your objectives and mandate?"

Nevertheless, Roberts says that while trustees should have conviction in their views, they should be using diversification as protection, and have a quick and early exit strategy in case a bubble is cleverly disguised as a short-term investment opportunity.

"Always make sure you can sleep at night," he adds.

As Roberts explains, bubbles are clear in hindsight but in the moment the excitement of a potentially very profitable short-term opportunity arising can risk catching some long-term investors off guard.

Here, tried and tested investment processes and rigorous disciplines regarding valuations can prove their worth. Joe reflects: "We do not believe in chasing bubbles and to date Newton has avoided many of the popular trends such as crypto-currencies as our research team has not been able to gain sufficient comfort with the unregulated nature of these, the lack of a clear valuation methodology and the high volatility which currently make these unsuitable.

"We do, however, believe there are other opportunities that offer some interesting investment benefits and renewables and infrastructure are two such asset classes we have included in our portfolios."

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