



GEPF Thought Leadership Conference

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Navigating an Uncertain Environment

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High Macroeconomic Uncertainty

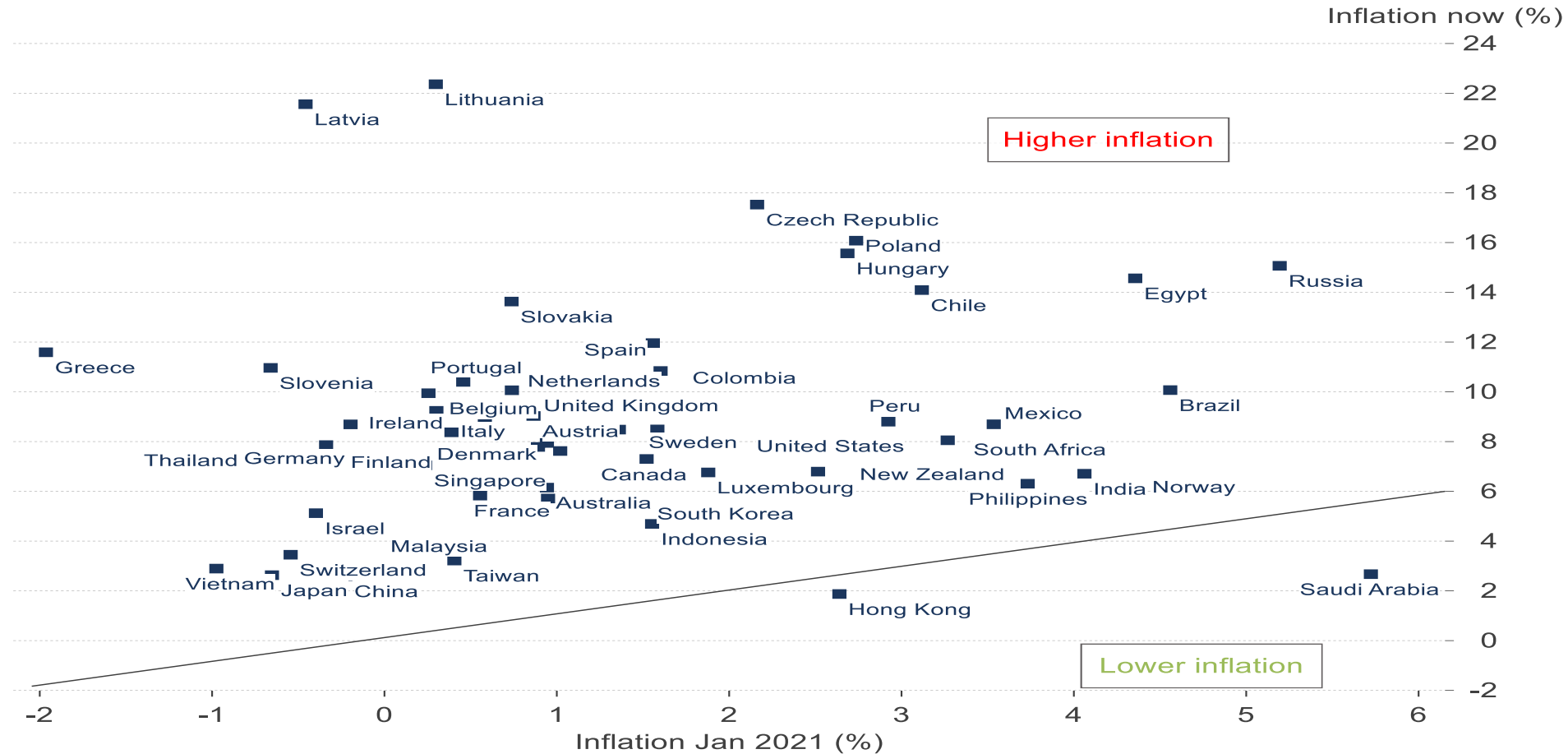
- A combination of global geopolitical and macroeconomic factors that have emerged over the last years make for a highly uncertain and potentially structurally different global market environment going forward:
 - **Geopolitical conflicts** leading to a spike in energy and commodity prices;
 - Post pandemic **global supply chain disruptions**;
 - **Reversal of decade long global policy of quantitative easing** and loose fiscal policy;
 - **Return of inflation** as a global phenomenon.

High Inflation – A global phenomenon

- Inflation readings are above central bank targets pretty much everywhere around the globe

Inflation today vs. Jan 2021

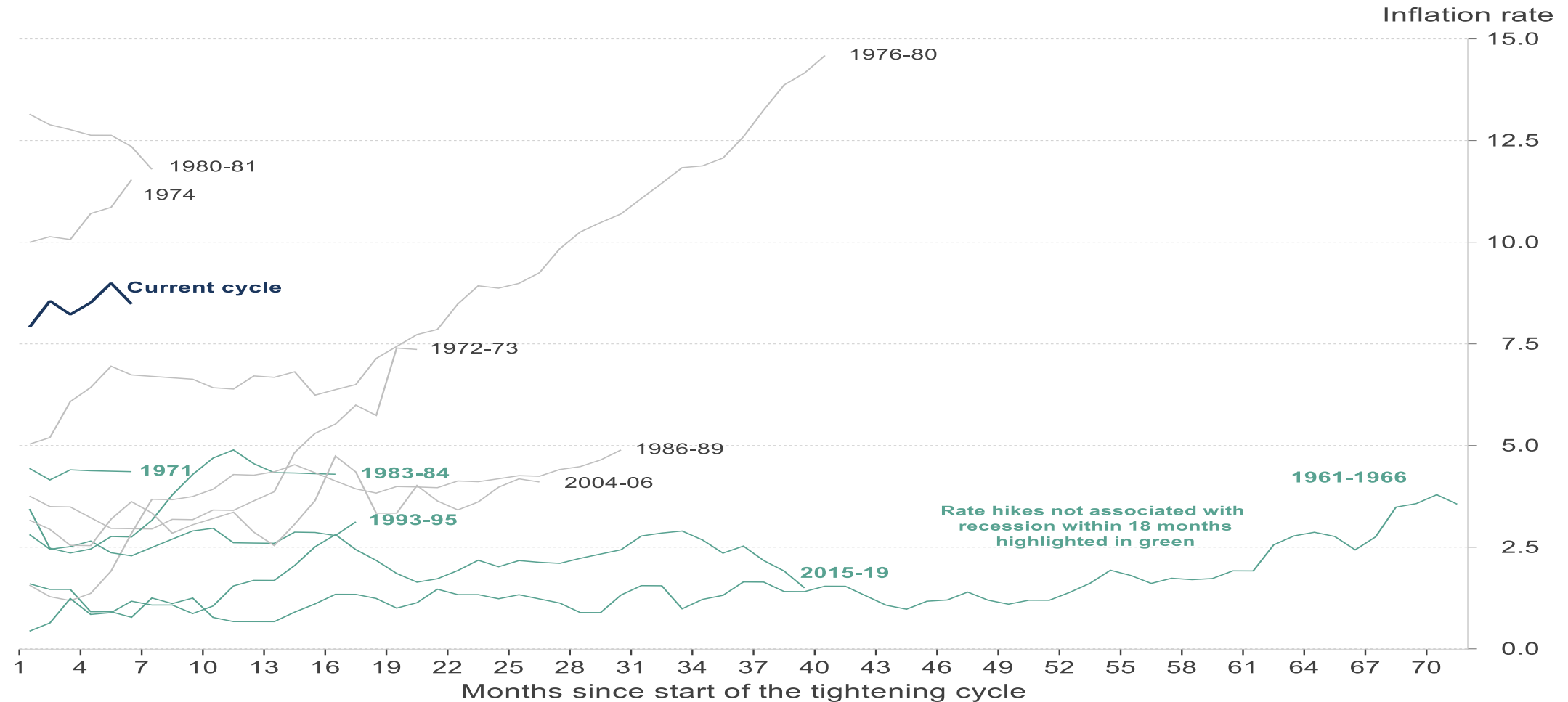
Source: National sources



US Recessions and FED tightening cycles

Monetary tightening vs inflation

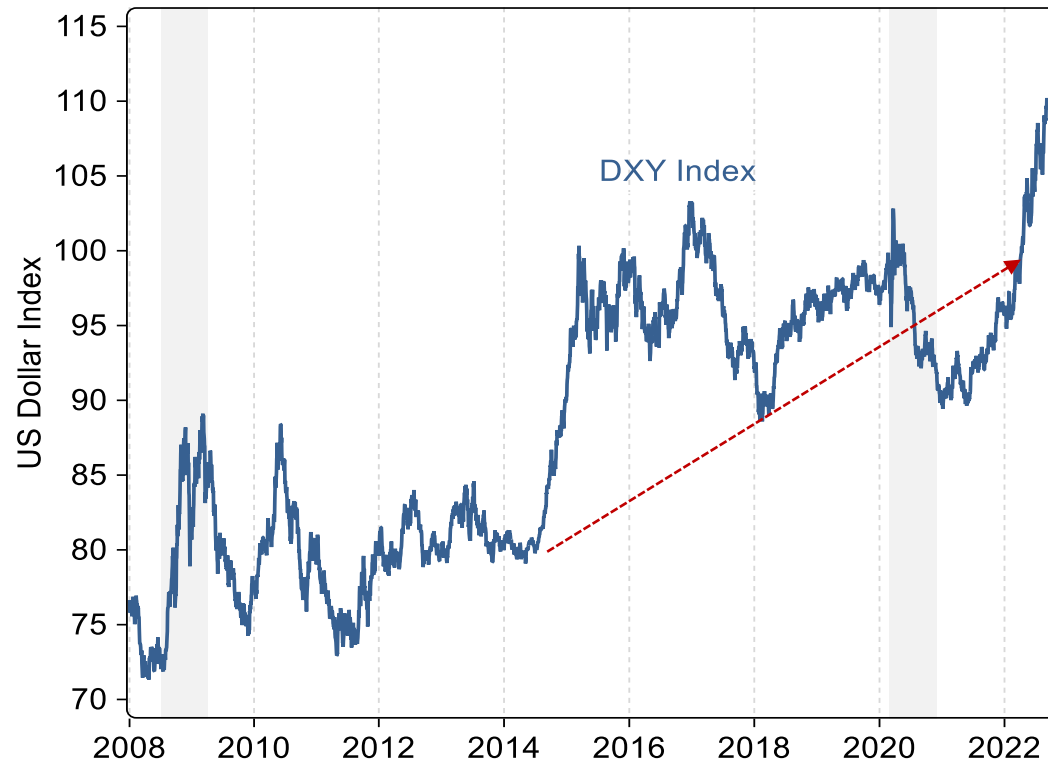
Change of US inflation rate during tightening cycles



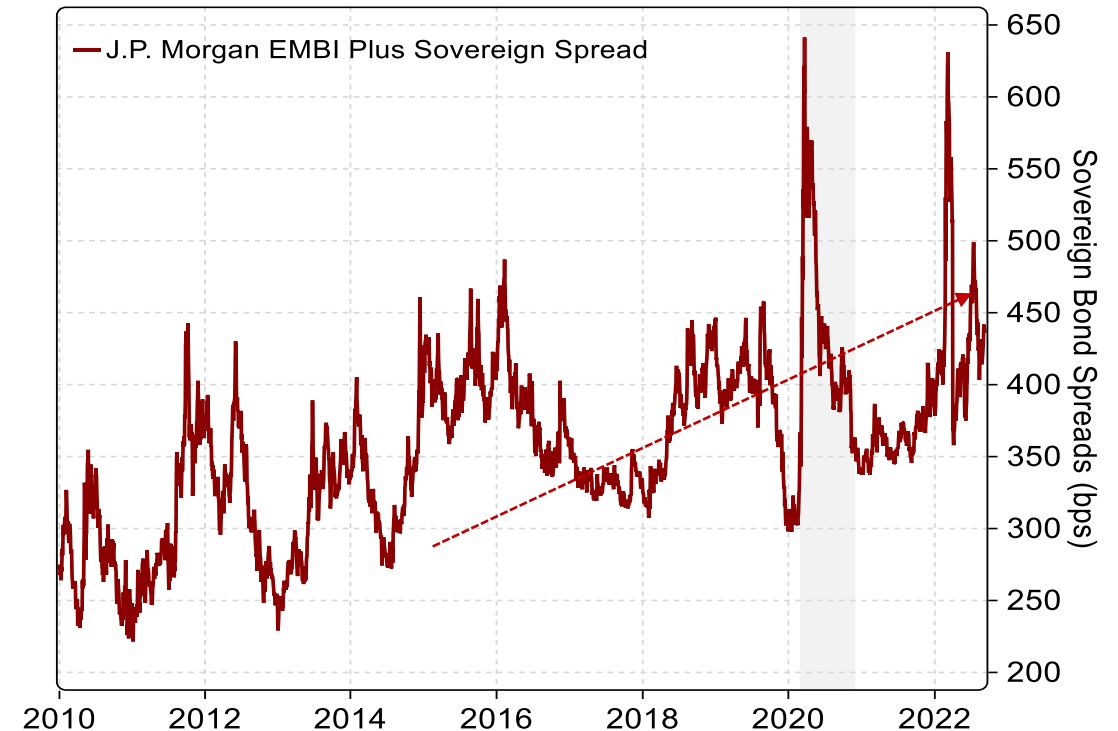
US Dollar and Emerging Market assets

- A tightening cycle in the US coupled with a slowdown in growth, negatively impacts emerging market economies and assets due to risk aversion, increase fiscal burden, and higher risks of default.

Trade-weighted Dollar Index



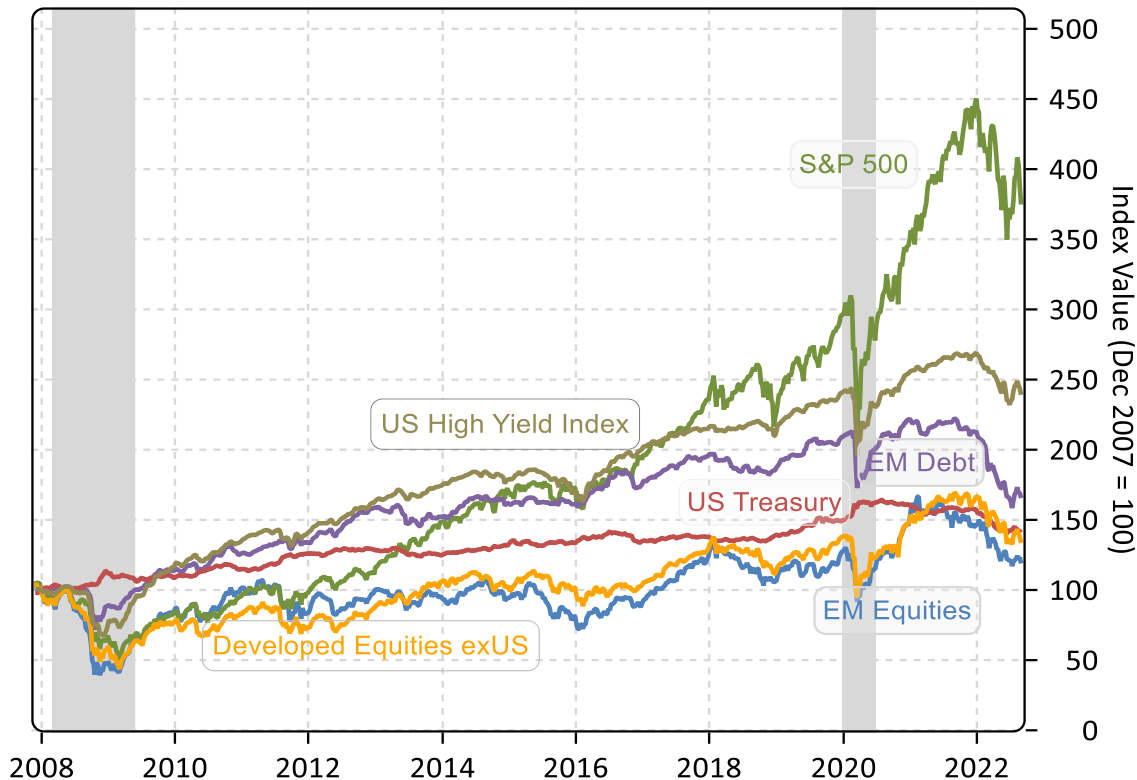
EM Sovereign Spreads (HC)



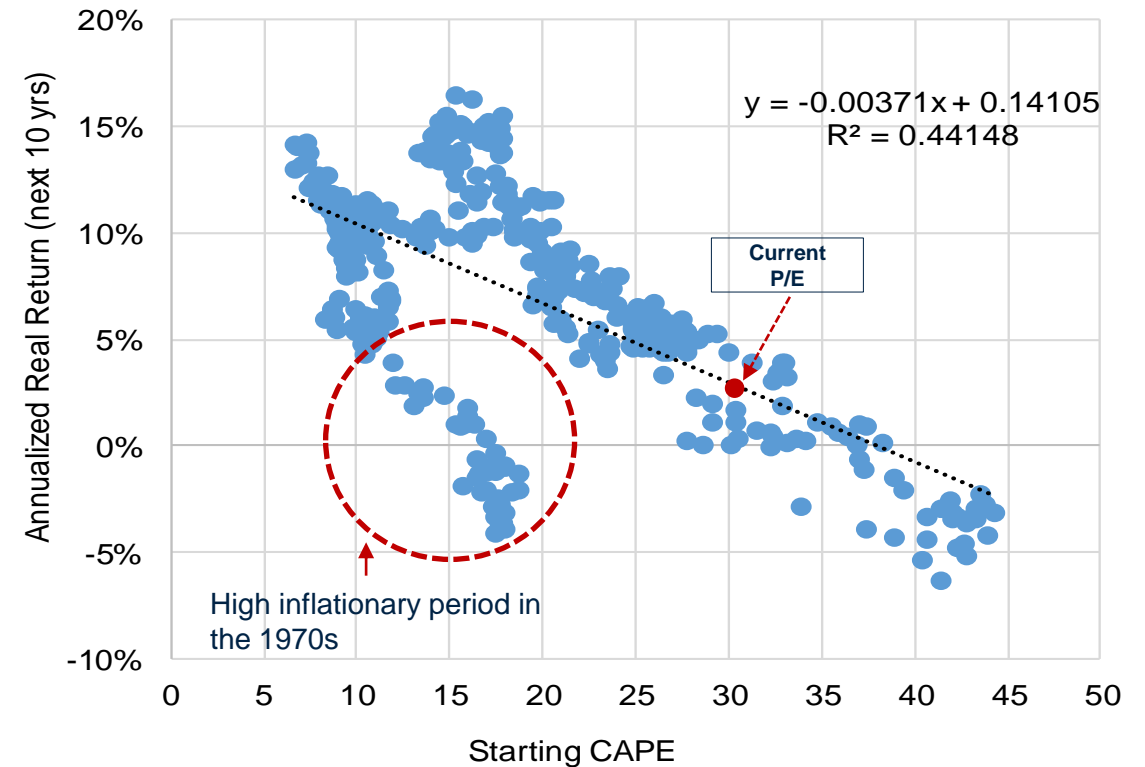
Long run-up in risk assets, modest correction thus far

- Risk assets, particularly in the US, have had a decade plus of extraordinary returns, imply rich valuations and low returns going forward; A persistent high inflation scenario poses additional significant risks;

Total Return Indices (USD, Unhedged)

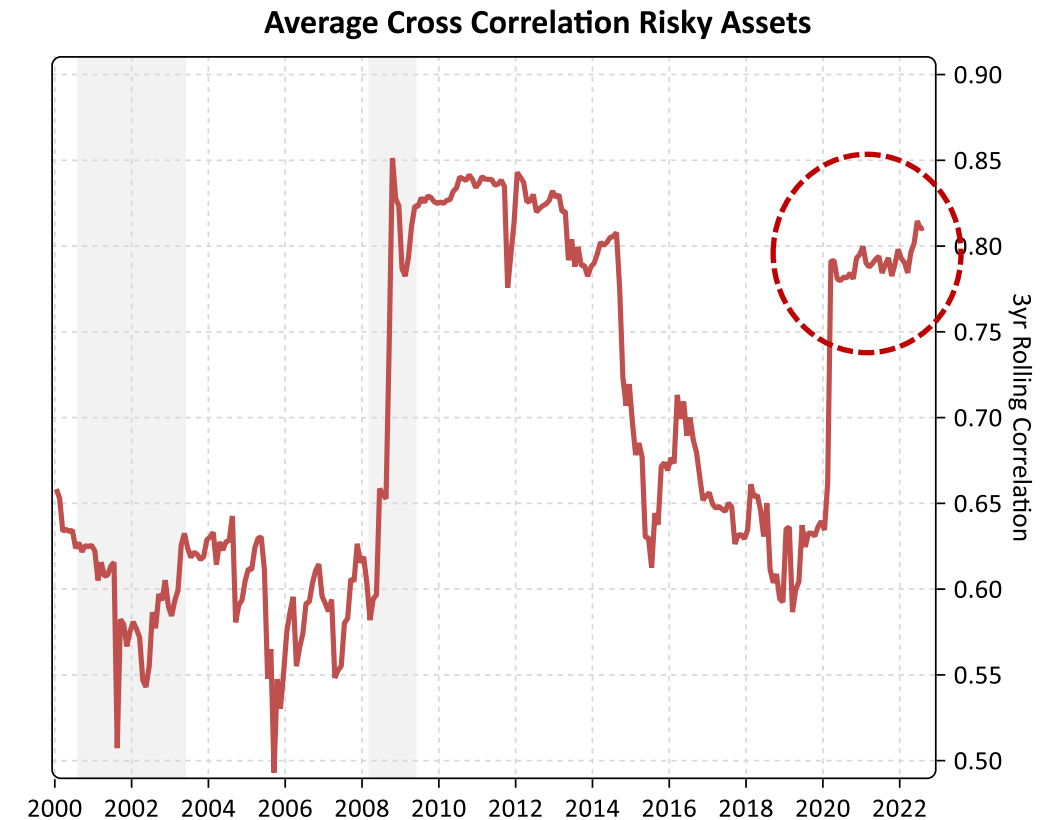
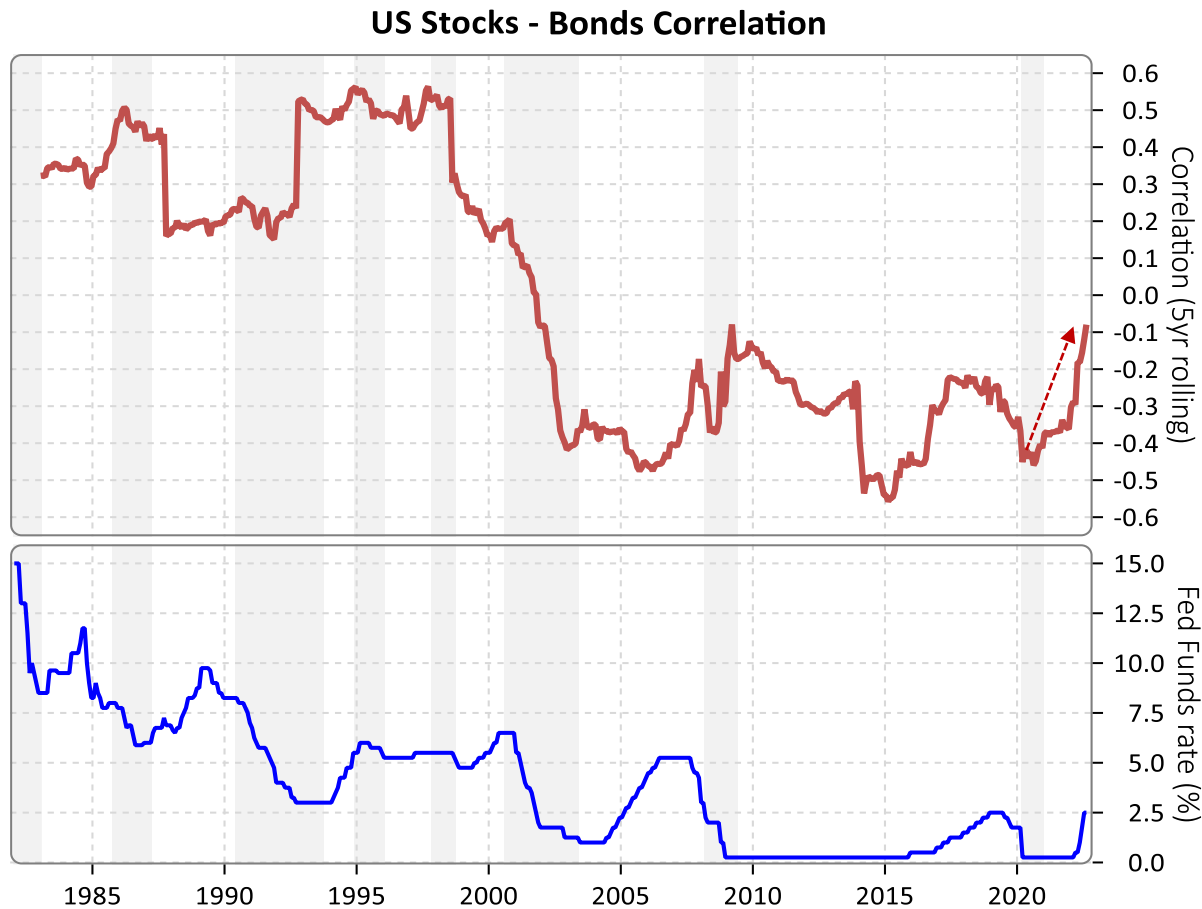


Starting CAPE and Subsequent 10yr Real return – Since 1970



A high inflationary world challenges the core tenet of stocks/bonds diversification

- Traditionally pension portfolios have been built around the idea of a negative correlation between stocks and bonds. That assumption may not hold in a high inflation/ low growth world.

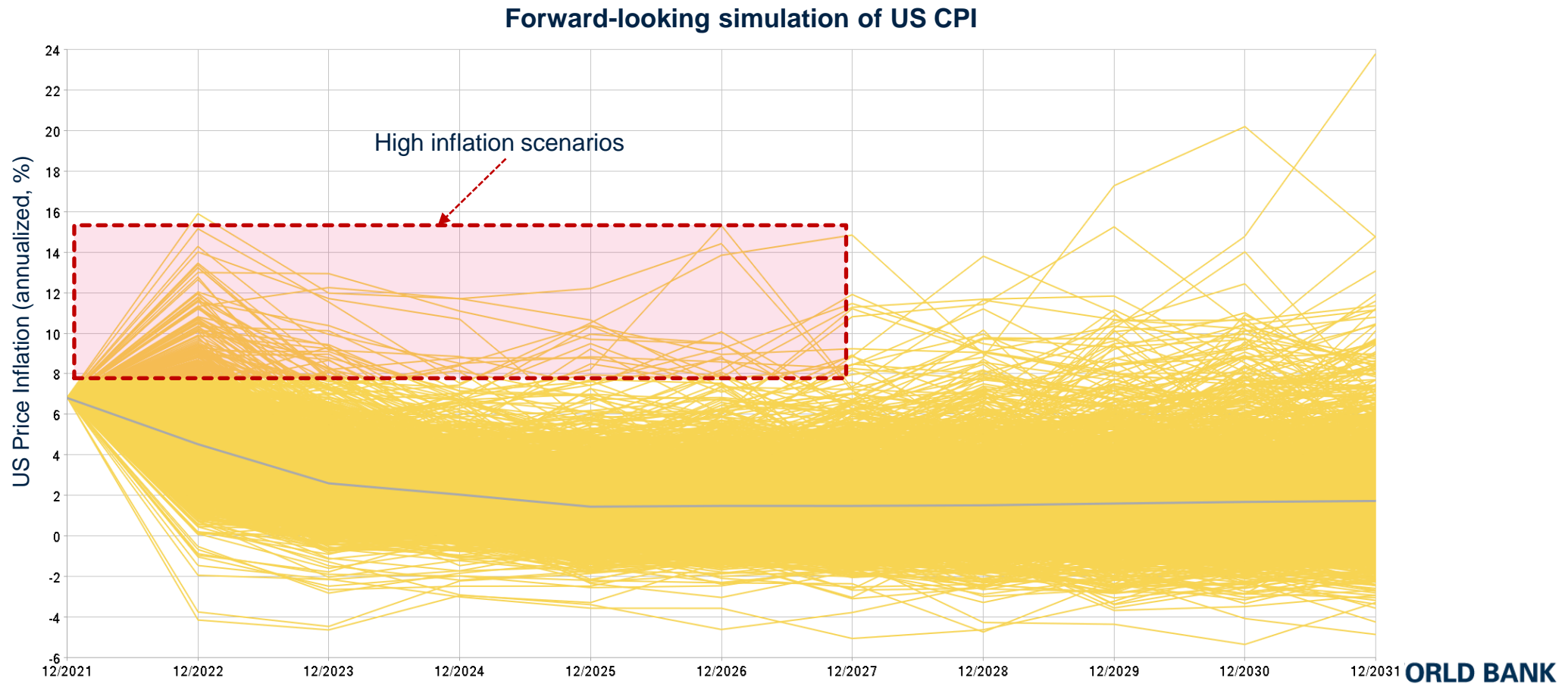


Pension Fund Challenges

- From a sustainability point of view, the current environment poses significant challenges particularly if the scenario that materializes is a stagflationary one, where **high inflation and weak economic growth persist for a prolonged period of time.**
- To the extent that pension benefits have embedded inflation indexation features, the **cost of meeting those promises may increase significantly in the short-term** particularly if asset returns fall short of expectations in real terms.
- A **deep understanding by the trustees of the long investment horizon and the risk tolerance embedded in the investment strategy** is a necessary pre-condition in navigating such uncertain environment and maintaining a clear focus on the long-term goals.
- Any potential changes to the investment strategy need to be properly understood and calibrated in that context.

Risk Management tools – Scenario Analysis

- Understanding what may happen with the portfolio and how each asset class may perform in a high inflation/low growth environment (both from a historical as well as forward-looking perspective) is critical.
- It is important for trustees to understand the potential implications for **fund returns, funding position, benefit levels, inflation indexation (if any), contribution requirements**.



Portfolio management tools

- From an asset allocation perspective, it might make sense in the current environment to emphasize certain aspects of sound portfolio management such as:
 - Re-assess the **liquidity management framework** of the fund and make sure that there is adequate liquidity to be able to meet payments and other commitments even in a highly stressed market context;
 - Undertake a **discipline rebalancing process** to make sure that the overall risk profile remains consistent with the risk tolerance parameters;
 - Seek **to increase the diversification of the portfolio** across a range of different risk factors, economic environments, and geographies;
 - Consider **overweighting on tactical basis the areas in the portfolio that offer reliable exposure to sustainable long-term cash flow in real terms** and that might be less sensitive to interest rate increases.

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