THE GLOBE AND MAIL

Pension funds tout rewards of active investing

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The active investing approach used by the Canada Pension Plan Investment Board appears to be paying off, adding nearly $50-billion to the fund's asset base over the past 12 years, according to an analysis by the Parliamentary Budget Office (PBO).

Since shifting away from a passive indexing strategy in 2006, the CPPIB has since invested heavily in alternative markets and private equity, building up large stakes in things such as office towers, toll highways and shopping centres around the world.

The CPPIB's own reporting suggests those kinds of assets are delivering higher long-term returns than can be found in public securities – a conclusion supported by the PBO report.

It estimated that the CPPIB's annual returns after fees since 2006 were 1.2 percentage points higher than a theoretical benchmark made up of global stocks and bonds, which contributed an extra $48.4-billion to the pension fund's total portfolio value of $392-billion, as of the end of the 2018-19 fiscal year.

“It's great to see Ottawa finally getting caught up on what is a world class story, that we've created pension delivery organizations that are the best in the world,” said Keith Ambachtsheer, a pension consultant and director emeritus of the International Centre for Pension Management at the University of Toronto.

Canada's largest pension funds have pioneered a style of investing in recent years by establishing in-house resources to invest directly in a vast range of assets and companies both public and private.

Whereas passive investing simply tries to match the overall market's performance while minimizing fees, the CPPIB and other Canadian pension funds try to identify individual investments that can beat the market over the long term.

CPPIB net assets

In billions of dollars; years show end of fiscal year

THE GLOBE AND MAIL, SOURCE: PBO / NOTE: PASSIVE PORTFOLIO USES ANNUALIZED RETURNS OF S&P GLOBAL LARGEMIDCAP INDEX AND FTSE TMX CANADIAN GOVERNMENTS NOMINAL BONDS INDEX×

Year	Active	Passive (70% equity, 30% fixed income)
2007-01-01	115.9	114.6
2008-01-01	122.7	115.1
2009-01-01	105.5	99.3
2010-01-01	127.6	124.9
2011-01-01	148.2	140.7
2012-01-01	161.6	150.8
2013-01-01	183.3	171.4
2014-01-01	219.1	209.7
2015-01-01	264.6	253.3
2016-01-01	278.9	255.0
2017-01-01	316.7	293.5
2018-01-01	356.1	320.4
2019-01-01	392.0	343.6

"Active management is not a low-cost approach," the CPPIB said in its latest annual report. "It increases complexity and resource requirements as we deal with additional sources of risk and return."

Investment profits need to first cover those higher costs in order to justify an active strategy.

The PBO's analysis compared the CPPIB's returns with three different passive portfolios based on different mixes of stocks and bonds. In all three scenarios the pension fund's portfolio, after accounting for fees, beat the passive benchmark over the past 12 years and, in most cases, with less volatility, the report said.

The PBO conducted the same analysis for the Public Sector Pension Investment Board, which slightly beat a market benchmark by 0.3 percentage points in excess returns a year after factoring out the higher cost of actively managed portfolios.

However, not everyone is convinced that Canada's big pension funds are doing as well as the numbers seem to indicate.

Having large allocations in private, illiquid assets can make the determination of market value a challenging, subjective exercise, according to Malcolm Hamilton, a retired actuary and senior fellow with the C.D. Howe Institute.

Publicly traded securities are subject to daily pricing in the open market. Private assets, such as toll roads, on the other hand, often require appraisals to approximate market value, Mr. Hamilton said.

"Appraised values are more stable than market values because appraisers make them so, not because the investments are less risky," he said.

"I think they're pulling our legs a bit when they confidently assert that they're consistently running well ahead of benchmarks."

The counterargument is that daily trading in securities such as stocks can involve a certain amount of market irrationality, with wild swings in prices often driven by emotion and sentiment.

Private assets, by contrast, are independently valued by some mix of objective valuation and an accounting of recent transactions of comparable assets, Mr. Ambachtsheer said.

"Returns based on private market valuation techniques may in fact reflect changes in economic value better than returns calculated using market values."

For the average investor, or even for professional fund managers, consistently beating the market after fees is a feat rarely achieved.

But Canada's mighty pension funds are no ordinary investors, Mr. Ambachtsheer pointed out.

They have the capability to influence the operations of the companies they invest in, he said, using Canadian Pacific Railway Ltd. as an example. Both the CPPIB and the Ontario Teachers' Pension Plan supported a change in leadership when activist investor Bill Ackman targeted the underperforming railway in 2012.

"It's more a story of engagement by long-term investors," Mr. Ambachtsheer said.

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