Allianz Global Investors

RiskMonitor

Risk Leaders
2017

Allianz Global Investors

Understand. Act.

The AllianzGI RiskMonitor assesses the impact of the current market environment on the sentiment, attitudes and behavior of institutional investors. In the second of three 2017 reports, we explore the qualities of a sub-group of investors that we call Risk Leaders. More adept at risk management, they set the standard for others to emulate.

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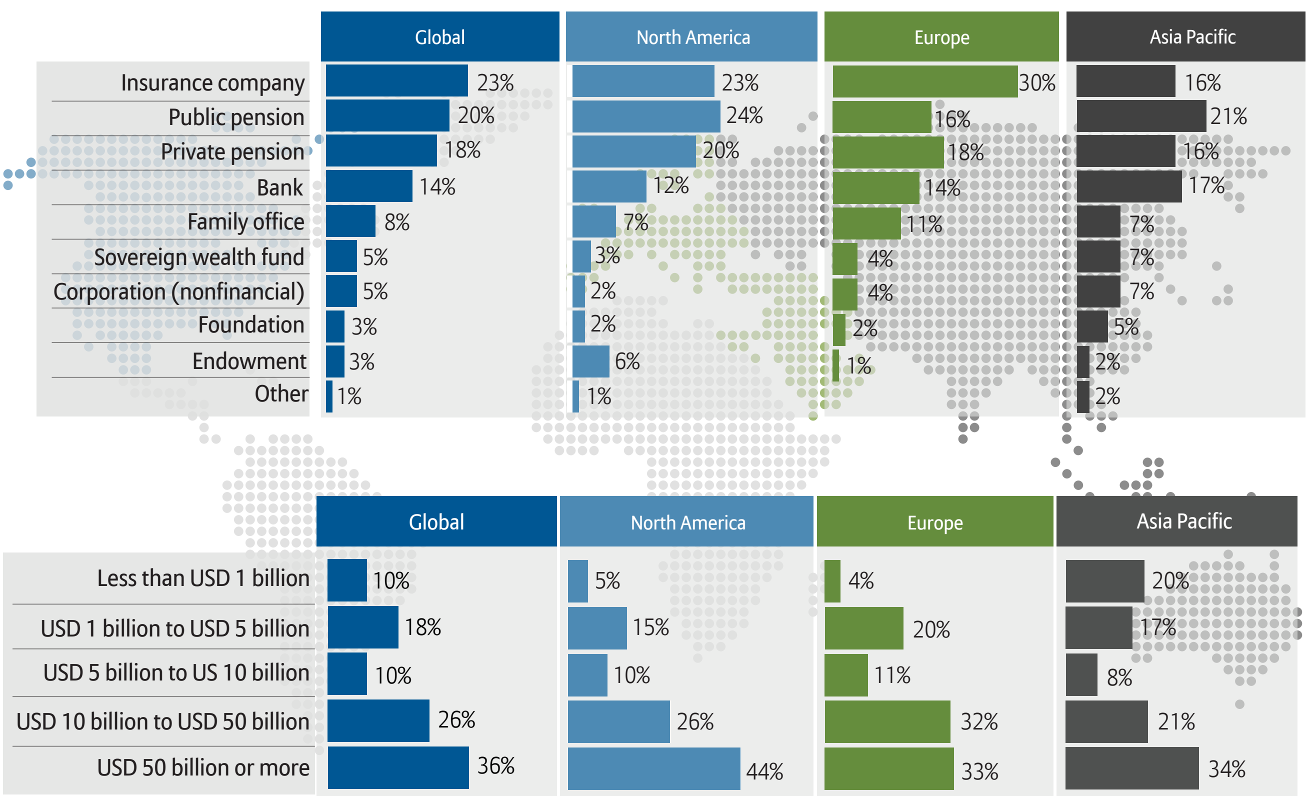
Methodology

This report is based on the fifth annual Allianz Global Investors RiskMonitor study. CoreData Research was commissioned by AllianzGI to conduct this study of institutional investors across North America, Europe and Asia Pacific to better understand attitudes towards risk, portfolio construction and asset allocation.

This paper focuses specifically on a group of investors we call Risk Leaders. These investors are setting the pace on risk management. We define them as those who responded 'Agree' or 'Strongly Agree' to three questions: 'Risk management is an integral part of our investment process and actively addressed on a systematic, ongoing basis', 'My organization has a strong risk management culture', and 'I am confident that our portfolio has appropriate downside protection for the next tail event.'

Respondents were drawn from a variety of 'asset owning' institutions: pension funds, foundations, endowments, sovereign wealth funds, family offices, banks and insurance companies.[1] The research was carried out via an extensive global survey during April and May 2017. The 755 institutional respondents were split evenly by region: 250 from Europe, 250 from North America and 255 from Asia Pacific. Our Risk Leaders comprise around one-fifth of global respondents.

2017 RiskMonitor respondents



[1] Bank and insurance respondents represent a broad mix with concentrations of professional buyers/gatekeepers, fund selectors, fund-of-funds (external manager appointments etc.), heads of research (influence in manager selection), portfolio specialists (those who build model portfolios using external managers). There is no retail participation in this study from financial advisors or internally focused portfolio managers.

Executive Summary

The institutional investors leading the charge on risk management have a holistic approach to risk. This is driven from the highest level of management at their organization. A greater percentage of investors identified as Risk Leaders say the senior executives within their organization are dedicated to supporting sound risk management practices.

In addition, they are more likely to incentivize good risk management throughout their organization. More Risk Leaders also pledge to invest more money into risk management in the coming year.

Our research shows that larger institutions are more likely to be Risk Leaders. This may be because they have greater resources to dedicate to risk management. Their size may also require them to have stronger safeguards in place.

Critically, these differences lead to a more confident investment outlook among Risk Leaders. A greater number of them are confident in their ability to achieve their expected returns and fewer have decreased their return expectations for the coming year.

Risk Leaders are also more likely to believe strongly in active management and more of them think active investing is worth the cost.

As a result of their confidence and a more holistic approach to risk, Risk Leaders feel better prepared for investment risks (72% vs 57% of the broader investor population).

More specifically, a greater number of Risk Leaders have changed their approach to risk management to protect against a tail risk event. This indicates their views on risk are being put into practice and they are driving change from within.

Risk Leaders' greater confidence also transfers into the realm of alternative assets. A greater number of Risk Leaders say they understand alternative assets and more of them are satisfied that these assets are fulfilling their intended role within their portfolio.

Background

The world of an institutional investor is far from simple. The global political and economic environment, the uncertain interest rate outlook and potential asset bubbles give them much to battle with – in addition to their day-to-day investment and organizational challenges.

Investors are concerned about the impact these macro-economic risks can have on their investments. As a result, they are focusing on how to protect their portfolios from potential downside risks. In an environment characterized by persistent low yields, potentially increased market volatility and greater geopolitical uncertainty, they face a conflict between managing the anticipated risks while also generating returns.

With risk sitting at the forefront of investor mindsets, we think it is relevant to isolate the impact investor attitudes to risk can have on their broader behavior and sentiment. We have identified a subset of investors within our respondents that we call Risk Leaders. Analysis of this group finds they differ from other investors across a number of areas – showing they are leading the charge when it comes to best practice in risk management.

Investors face numerous risks to performance

Geopolitical tensions (e.g. - Syrian war, North Korea, etc.)	**44%**
Global economic slowdown	**41%**
Rise in interest rates	**32%**
US politics	**31%**
New asset bubbles	**24%**

% Yes, Multiple answers allowed

Who are the Risk Leaders?

We surveyed 750+ institutional investors ...

... and identified ~150 "Risk Leaders" with unique characteristics

Risk leaders represent a fifth of our sample of institutional investors.

Risk Leaders 20%

80% Others

Risk leaders have key qualities in common

They make risk management an integral part of their investment processes

They have built a strong risk culture

They have implemented appropriate downside protection for the next tail-risk event

	Risk Leaders	Others
Public pension	25%	20%
Insurance company	21%	24%
Private pension	18%	18%
Bank	11%	15%
Family office	8%	8%
Sovereign wealth fund	6%	4%
Corporation (nonfinancial)	5%	4%
Foundation	3%	3%
Endowment	2%	3%
Other	1%	1%

Risk Leaders Others

Risk Leaders tend to belong to larger organizations with higher levels of assets under management. More than two in five (43% compared to 36% of others) have $50 billion or more in AuM.

	Risk Leaders	Others
Less than USD 1 billion	6%	10%
USD 1 billion to USD 5 billion	15%	18%
USD 5 billion to USD 10 billion	14%	9%
USD 10 billion to USD 50 billion	22%	27%
USD 50 billion or more	43%	36%

Leading from the top

Risk Leaders have a strong risk culture that starts at the highest levels of their organization. A significantly higher percentage of Risk Leaders say the senior management within their organization is dedicated to ensuring and supporting sound risk management practices (88% vs 62% of other investors).

This difference in leadership and risk culture is among the most significant variances observed between Risk Leaders and other investors across the globe. This shows that the focus on risk needs to be driven from the top, setting the tone for the rest of the organization. Furthermore, a greater number of Risk Leaders say there are organization-wide incentives to reward risk management across teams (48% vs 28% of others). This supports the idea of a more holistic view of risk and the way it is managed, rather than seeing risk as the responsibility of one part of the organization.

Risk Leaders are also more willing to invest in improving risk management. Within this group, 59% say their organization is putting more money towards investment risk management strategies this year (vs 41% of others).

A greater number of Risk Leaders (70% vs 55% of others) say their organization conducts independent risk analyses of their portfolios. While risk management is important at all levels of the organization, it is also key within specific investment areas and independent risk assessments help maintain objectivity.

Strong risk culture starting at the top

The regional view

Risk Management Culture

66%	71%
67%	61%

Risk management is an integral part of our investment process and actively addressed on a systematic, ongoing basis.

59%	67%
58%	53%

My organization has a strong risk management culture.

Global · North America · Europe · Asia Pacific

- Risk management is an integral part of investment process in more North American (71%) and European institutions (67%) than their Asia Pacific counterparts (61%).
- A greater number of North American investors (67% vs 58% in Europe and 53% in Asia Pacific) feel they have a strong risk management culture.

Risk Investment

45%	49%
41%	45%

My organization is putting more money towards investment risk management strategies in the coming year.

Global · North America · Europe · Asia Pacific

- More North American organizations (49%) are increasing their budget for investment risk management strategies in the coming year compared to their European (41%) and Asia Pacific (45%) peers.

Incentives

32%	38%
32%	27%

My organization has incentives to reward risk management across teams.

Global · North America · Europe · Asia Pacific

- Four in 10 (38%) North American institutions have incentives to reward risk management across teams (compared to only 27% in Asia Pacific and 32% in Europe).

Senior Management

67%	77%
61%	62%

The senior management at my organization are dedicated to ensuring and supporting sound risk management practices.

Global · North America · Europe · Asia Pacific

- North American institutions (77%) are also ahead when it comes to their senior management setting the right tone and ensuring sound risk management practices (61% in Europe and 62% in Asia Pacific).

How risk excellence translates into action

Investment decisions

One of the most significant findings of our research is that Risk Leaders exhibit a greater confidence in tackling the "risk-return conundrum" – finding the optimal balance between upside potential and downside protection. This is due to greater senior leadership and organizational buy-in for risk management, among other factors.

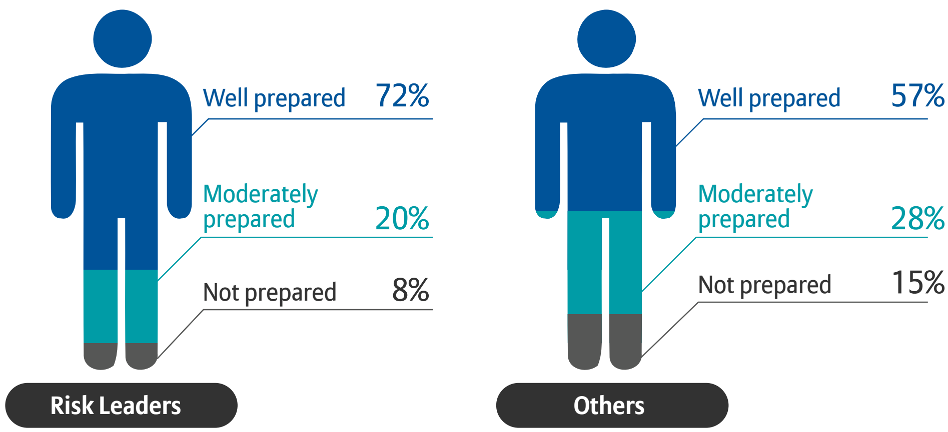
Critically, Risk Leaders are more confident in their ability to achieve their return expectations for the year: Fewer Risk Leaders have decreased their return expectations for the coming year (47% vs 53% of others). They are also less likely to be pessimistic about meeting their return objectives (60% vs 66% of others).

A higher number of Risk Leaders believe actively managed portfolios are worth the cost – 56% compared to 46% of others. In addition, they are more likely to think there is alpha to be found in today's markets.

More confident and proactive

With a more confident outlook, Risk Leaders feel more prepared to deal with investment risks in 2017. Almost three-quarters of them agree with this statement – compared to 57% of other investors.

Risk Leaders are more prepared to handle investment risks



Tail risk is now firmly on the radar for institutional investors, and Risk Leaders are more proactive in their efforts to mitigate it. Almost three in five (57% vs 47% of others) say their organization has changed its approach to risk management since the financial crisis.

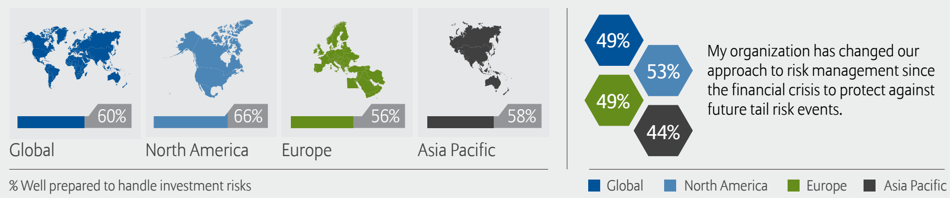
More recent events have also had an impact on Risk Leaders' attitude to risk management. More than three-fifths of them say the upheavals experienced over the past year have led to an increased focus on risk management within their institution.

Changes prompted by political events

% Agree	Risk Leaders	Others
My organization has changed our approach to risk management since the financial crisis to protect against future tail risk events.	57%	47%
Recent political events in the last 12 months have led to an increased focus on overall risk management in my institution.	63%	58%

The regional view

- Two-thirds of institutional investors in North America say they are well prepared to handle investment risks compared to 56% in Europe and 58% in Asia Pacific.
- North American institutional investors are slightly more likely to have changed their approach to risk management since the financial crisis (53% vs 49% in Europe and 44% in Asia Pacific).



Alternative assets

We have seen how Risk Leaders manage risk and the impact their decisions have on their investment sentiment. But what is the impact on their investment decisions? This group of investors is bullish on European and emerging market equites, but opinion is divided on the US. While nearly one-third of Risk Leaders are long US equities, a similar percentage plan to reduce their exposure to the US market. More broadly, these investors are less optimistic about the return prospects of various debt instruments, namely developed market sovereign debt and corporate debt, both investment grade and high yield.

Risk Leaders' asset class preferences

Go long/buy		Go short/sell	
European equities	41%	US equities / Sovereign debt: Developed market	32%
Emerging-market equities	34%	Corporate debt: High yield	30%
US equities	31%	Corporate debt: Investment grade	22%

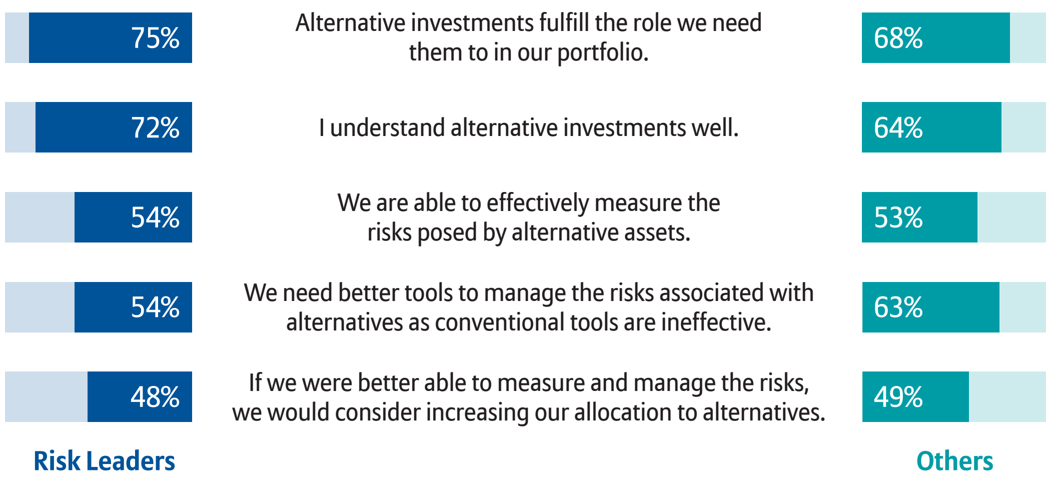
Risk Leaders' more proactive and holistic views on risk also translate into the realm of alternative assets. Overall they say they have a better understanding of these non-traditional asset classes and 72% say they understand them well – compared to 64% of other investors.

In addition, a slightly smaller percentage of Risk Leaders say they are hampered by a lack of understanding of alternative assets, compared to other investors.

Risk Leaders' greater grasp on alternatives may help them make use of these asset types more effectively. A greater number of Risk Leaders feel alternative investments fulfil the role they need them to in their portfolio (75% vs 68%).

A crucial element to taking full advantage of alternative assets is understanding their risk profile and how this can be managed. Risk Leaders feel they are better equipped to tackle the risks alternatives present. Fewer individuals in this group say they need better tools to manage the risks associated with alternatives (54% vs 63%).

Understanding more prevalent among Risk Leaders

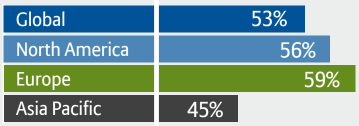


% Agree

The regional view

Measuring and Managing Risks

We need better tools to manage the risk associated with alternatives as conventional tools are ineffective.

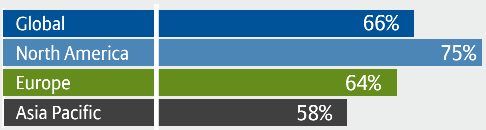


We are able to effectively measure the risk posed by alternative assets.

More European investors (59%) are seeking for better tools to manage risks than Asia-Pacific investors (45%).

Understanding Alternatives

I understand alternative investments well.



Understanding of alternatives is highest in North America (75%) and lowest in Asia Pacific (58%).

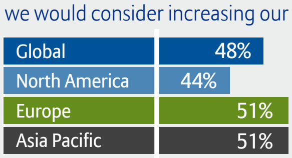
Alternatives' Role

Alternative investments fulfill the role we need them to in our portfolio.

Investors in North America are more likely to say alternatives fulfill the role they need them to (73%).

Increasing Allocation to Alternatives

If we were better able to measure and manage the risks, we would consider increasing our allocation to alternatives.



More Asia-Pacific and European investors (51%) admit they would consider a higher allocation to alternatives if they were better able to measure the risks. In contrast only 44% of North American investors agree with this.

In summary

Risk Leaders are spearheading change in the way risk is managed and considered among institutional investors. They prioritize risk management by investing more money in it and ensuring the right attitudes and behavior are cascaded through their whole institution.

Among this group, senior management leads from the top, providing strong and clear guidance of the way forward. Risk Leaders are more confident in their return targets and have greater faith in active management. They are also more confident in their grasp of alternative assets.

Risk Leaders and their attitudes to risk and investment can serve as solid examples for the broader industry as investors continue to grapple with the risk management challenge.

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