

8 May 2018

INSTITUTIONAL INVESTOR DIALOGUE

Frankfurt am Main, 11 April 2018
10:00 to 13:00 CET, Sonnemannstrasse 20

Participants

- Representatives of Abu Dhabi Investment Authority, Aegon Asset Management, Allianz SE, Amundi, ATP, Aviva Investors, AXA, BlackRock, Canada Pension Plan Investment Board, Mapfre, Nordea Asset Management, Singapore GIC, Swiss Re, State Street Global Advisors, Union Investment and Zurich Insurance Group
- 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

The survey covered investors' feedback on the ECB's non-standard monetary policy measures, perceived risks to financial markets and asset allocation strategies.

Regarding the impact of the ECB's asset purchase programme on asset prices, investors had diverging views about the relative importance of stock and flow effects. While these two effects were seen as having the strongest impact on asset prices, one of the investors stressed that the duration of the purchases was also relevant. As regards the ECB's future monetary policy actions, most investors were of the view that the path of future interest rate adjustments was the most crucial element from their perspective.

Regarding the main drivers of financial market volatility in the medium term, most investors pointed to the uncertainty about major central banks' future monetary policy actions and a possible deterioration of market liquidity. Uncertainty however, especially regarding the ECB, seemed to be less pronounced than it was a few months ago. Most participants furthermore agreed that investors may currently be too complacent about risks, in particular geopolitical ones. In addition, most investors expected equity

prices to be the main driver of volatility in financial markets in the medium term, followed by government bonds, while exchange rates and other asset classes were seen as less of a concern. As regards the EUR/USD exchange rate, most investors said that monetary policy decisions and related expectations, together with macroeconomic fundamentals, would be the most important factors over the next 12 months. Some investors stressed that they expected the recent phase of US dollar depreciation to be temporary. It was also noted that the Japanese yen had attracted renewed interest. One investor mentioned that they expected the yen to appreciate as domestic political support for Abenomics may have peaked.

As regards portfolio asset allocations, several investors mentioned that they did not plan any changes in the foreseeable future. Other investors continued to view equities across the globe as being more attractive than bonds. The most attractive regions, according to investors, were emerging Asia and Europe, while the appeal of US equities was diminishing, also as high US dollar hedging costs entailed decreasing US dollar exposures by foreign investors. One investor acknowledged that the increase in the US corporate sector's leverage had been in line with the advancing business cycle and pointed out that this had made the US economy more sensitive to interest rate changes.

Among alternative investments, real estate and infrastructure remained the most popular asset classes, although some investors pointed to the limited supply of those investment opportunities. Finally, crypto-assets were not seen by the participating investors as an attractive investment class.

Global investment trends

One investor provided an overview of prevailing global investment trends, which were still characterised by a search for yield. This explained the growing interest in illiquid asset classes. Real estate investments remained attractive but, in view of high valuations in some segments, investors were more prudent and selective. One investor noted that the trend towards private assets was not sustainable and that it was difficult to find investments with attractive risk-adjusted returns. These assets would also be very sensitive to market downturns. Environmental, social and governance criteria had also become more important, although the subjectivity of such criteria meant that they would have to be determined by end investors. Safety remained retail investors' most important investment criterion when making investment decisions, a factor that had dominated the industry since the global financial crisis.

Evidence was provided that suggested that market liquidity was continuing to deteriorate – for example, the decreasing inventories of primary dealers in US corporate bonds. At the same time, the outstanding amount of corporate bonds had been steadily increasing. Some investors however pointed out that technological innovation and the increased role of non-bank liquidity providers had countered the negative impact on liquidity. One investor noted that the illiquidity premium was shrinking and was wondering about the most appropriate level of illiquid assets in portfolios.

Market volatility and institutional investors' behaviour

One investor noted that asset price volatility tended to be mean-reverting. In his view, volatility had been artificially low, also because of central banks' asset purchase programmes, and it was expected to increase again as central bank stimulus had passed its peak. Another investor recalled that the period of increased volatility in February 2018 had mainly affected equity markets and that it could now be described as normal from a historical perspective. In contrast, bond and foreign exchange market volatilities remained comparatively low.

In this context, the importance of long-term institutional investors was also recalled as they held an estimated €80 trillion of assets. During the financial crisis long-term investors had sold less of their equity and credit portfolios than short-term investors. Participants discussed the relevance of "countercyclical investors" and considered that it was important to have market participants with different approaches. Some participants argued that Solvency II would penalise long-term investment strategies with its one-year calculation horizon for capital requirements.

One participant mentioned that volatility had arguably become an asset class in itself and that there was a feedback loop between volatility and developments in equity markets. This participant also remarked that not enough attention was being paid to developments in US macroeconomic policies and the risks they entailed for the global economy and the entire financial system. Going forward, the mix of high valuations and historically low volatility may lead to sizeable risks, and diversification would remain key, both for the investors' financial performance and global financial stability.