Management of the Government Pension Fund Global

Introductory statement by CEO Yngve Slyngstad before the Standing Committee on Finance and Economic Affairs of the Storting.

Please note that the text below may differ from the actual address.

I would like to thank the Chair of the Committee for the invitation to speak on the management of the Government Pension Fund Global (GPFG).

Chart: Total return of NOK 3 666 billion

The GPFG's market value stood at NOK 8 256 billion at end-2018. The year was marked by high volatility in terms of market value. At this time last year, the market value stood at NOK 8 000 billion, the lowest level recorded in 2018. The GPFG's market value increased again before suffering a broad market fall in autumn. Owing to good returns at the beginning of 2019, the market value of the GPFG is higher today. The GPFG has received total transfers of NOK 3 326 billion and generated a return of NOK 3 666 billion.

Chart: Trading volume and equity prices

The most important decision influencing expected return and risk is the allocation to equities in the overall portfolio. The equity allocation was last discussed and changed in 2017, when it was set at 70 percent. From November 2018 to January 2019, we bought equities for NOK 250 billion, and the equity share is 70 percent today.

A higher equity allocation results in a higher expected return, but also a higher risk of a fall in value. If investments were confined to government bonds, the long-term expected real return would have been close to 0 percent, and not the 3 percent that is applied in the fiscal rule. In the long-term, this would not have provided a good return - nor would it have secured our savings.

With the new equity allocation, the Ministry of Finance will also issue new rebalancing rules. We will now set the weight back to 70 percent in stocks already when we are 2 percentage points away from 70 percent. Even if this is a change from a broader band, there will still be substantial amounts traded in connection with portfolio rebalancing. At today's value, rebalancing will involve securities trading in the amount of about NOK 360 billion.

With the change in equity allocation, it was also natural to look at the framework for fixed-income investing. The Ministry is planning to reduce the number of markets in the benchmark index, with a reduction in government bond investments in emerging markets.

When we reduce bond investments in emerging markets, it will at the same time be important to maintain the diversification properties of emerging markets in the equity portfolio. A key feature of our management model is that the GFPG is invested worldwide, and emerging markets account for more than half of world GDP. GPFG equity investing is mainly performed by external managers. Their local insight has secured high returns, acceptable risk, responsible management and active management, which have delivered outstanding results over time.

Chart: Investment strategies

We use different investment strategies in managing the GPFG. First, we construct a long-term benchmark portfolio, which is adapted to the special features of the GPFG and is the basis for our investments. The benchmark portfolio should be assessed over a long time horizon. It includes investments in emerging bond markets and systematic risk factors in the equity investments.

Company investments is based on thorough analyses and has proven successful over time. The same applies to our enhanced indexing strategies, which ensure efficient market exposure.

The investment strategies are complementary and are used to varying degrees in different market segments. The goal is that combined and over time they provide a higher return than the benchmark indices against which the GPFG is measured. But it is not a goal for them to provide an excess return at the same time and under the same market conditions. The different investment strategies are parts of a whole that has delivered good results over time.

Chart: Return on environmental mandates

At the end of 2018, NOK 43.3 billion were invested in environmental equity mandates. The mandates have been managed both internally and externally since start-up in 2009. Today, they are all managed internally after termination of externally managed mandates in 2018 to reduce management costs.

Looking ahead, investments in so-called green bonds may account for a larger share of these investments. This type of investments involves low costs for us as managers.

The return on the environmental mandates has been somewhat weaker over time than on broader markets and our general equity investments.

Chart: How exclusions affect performance

GPFG returns are also influenced by decisions to exclude companies and sectors from the investment universe. Historically, product-based exclusions have entailed costs in the forms of weaker returns. Exclusions of companies and sectors reduce risk spread. As such, a high threshold for exclusions has been established.

The GPFG also engages in risk-based divestments, where we deem that a business is no longer sustainable in the long term. Such divestments are based on long-term financial risk and have improved returns.

The Ministry of Finance wished to remove from the GPFG companies classified as upstream companies by the index provider FTSE Russel. We do not know at present precisely which companies will be involved as the index provider is planning to implement sector changes. We assume that implementation will span a longer period.

Chart: Annual real estate investments

We invested a total of NOK 12.7 billion in unlisted real estate in 2018, bringing the total to NOK 246 billion, or 3 percent of the GPFG, at the end of 2018. Decisions relating to the size and composition of real estate investments within the mandate's limit of 7 percent have been delegated to Norges Bank. In 2018, Norges Bank decided to keep that allocation to unlisted real estate at around 3 percent, and introduced a simplified strategy for unlisted real estate in order to keep down costs.

Chart: Stable internal management costs

Total management costs measured as a share of GPFG capital have been low and relatively stable in recent years, despite building a portfolio of unlisted real estate investments and a higher allocation to equities.

We have realised substantial economies of scale and keep internal management costs below 0.05 percent of capital under management. That figure is very low compared with other investment funds, and partly reflects very low costs for internally managed active strategies, for which costs are nearly the same as for the internal index strategies. The scale of external management was reduced in 2018, and a new strategy for real estate was decided, partly with a view to reducing costs.

Chart: Public information is published on our website

All public information about the GPFG can be found on our webpages. In addition, we publish quarterly and annual report where we provide detailed information on responsible management, unlisted real estate investments, and return and risk. Our website also includes a wide range of publications, data and background information. Combined, this ensures a high degree of transparency about investment management.

We manage financial wealth for future generations in a secure, efficient, responsible and transparent manner. The goal of management is to deliver the highest possible return in the long term.