

Management of the Government Pension Fund Global

Introductory statement by Yngve Slyngstad, CEO of Norges Bank Investment Management, before the Storting's Standing Committee on Finance and Economic Affairs, 17 April 2011.

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

Chart 1: Performance

The Government Pension Fund Global (GPFG) returned -2.5 percent in 2011. This is the third weakest result in the Fund's history.

The year was marked by the sovereign debt crisis in southern Europe and growing financial market turbulence after summer. The Fund's equity portfolio returned -8.8 percent, primarily reflecting very weak equity markets in Europe and Asia. The Fund's fixed-income investments had a positive year, generating a 7.0 percent return. So far this year, returns have been favourable.

Chart 2: The Fund's market value

The Fund's current market value is NOK 3 446 billion. Since the previous hearing on 20 May 2011, it has increased by NOK 300 billion.

The annual real return on the Fund was about 2.5 percent from 1998 to the end of 2011. A positive first quarter now brings the annual return after inflation, tax and management costs to 2.8 percent.

Returns are primarily influenced by developments in equity markets in the long run. Return prospects are shrouded in considerable uncertainty.

Chart 3: Real return 1900-2011

Historically, equities have generated considerably higher returns than other investment alternatives.

Equity returns vary widely not only in the short run, but also across decades. The past decade has been weak, but Norges Bank is nonetheless of the view that it is important to maintain the allocation to equities in the Fund.

Chart 4: Inflows to the Fund

Transfers are made to the Fund on a monthly basis. In 2011, total transfers amounted to NOK 271 billion, the highest transfer since 2008.

The transfers are used to purchase equities and bonds. The distribution depends on market developments. In autumn 2011, following a decline in equity markets, the total amount transferred was used to buy equities, primarily in Europe. In some situations, assets are also sold.

In times of falling equity prices, the equity portion in the Fund will decline. In order to maintain the 60 percent equity portion in the portfolio, the Fund must be weighted back to the starting point through rebalancing transactions. This strategy implies that the Fund purchases equities when equity prices have fallen and sells equities when equity prices have risen sharply.

Chart 5: Rebalancing

Through the Fund's history, we have only rebalanced fully on two occasions. The first time was in the first quarter of 2003, with an equity purchase of NOK 4 billion. The second was in the first quarter of January 2009, when we bought equities for NOK 136 billion to rebalance the Fund, in addition to the equities bought using new transfers for a total of NOK 85 billion in the first half of 2009.

When equity prices fall and uncertainty is at a high level, it is challenging to buy equities and increase risk. Yet experience shows that it is precisely at such a juncture that it is profitable to buy. The rebalancing transactions in spring 2009 have alone contributed to increasing the annual return on the Fund by about a half percentage point since 1998.

In its role as an investment advisor, Norges Bank has now proposed the establishment of a rule for rebalancing when the equity portion exceeds 63 percent or falls below 57 percent. A rule will increase the probability that rebalancing is actually implemented when times are at their most challenging and risk seems highest.

The Fund's return will also depend on the markets in which we invest. So far, more than half of the Fund is invested in Europe.

Chart 6: Regional weights in equity markets

The portion of the Fund invested in European equities is large in relation to the size of that region, and a sound return on the Fund is therefore particularly dependent on market developments in Europe. Norges Bank has advised that the high European weight should be reduced.

Reducing the exposure to that region would imply an increase in investments in other areas of the world, not least in emerging markets. These are markets that will swing widely in periods. Moreover, investors' legal protection may be weaker and the investable area of the economy is smaller for financial investors.

Chart 7: Market size

On the basis of an overall evaluation, it is our opinion that it is appropriate for the Fund to increase its investments in emerging markets, now and over time.

Chart 8: The Fund's fixed-income portfolio

The long-term objective of investment management is to preserve the Fund's long-term international purchasing power. The bond portfolio should be based on market weights using each country's GDP. GDP-weighting will also better diversify risk across the world's economies.

Norges Bank has proposed to include emerging market sovereign bonds in the benchmark portfolio for bonds.

Chart 9: Yields of 10-year government inflation-linked bonds

Real yields on government 10-year bonds in advanced economies are currently negative, while real yields on corresponding bonds in emerging markets are considerably higher.

Initially, emerging markets will account for 7 percent of the Fund's bond holdings. When other major economies such as China, India, Brazil and Russia become more open to foreign investment, the portion will increase over time.

Chart 10: New benchmark index for bonds

The Fund operates with a long investment horizon. We should be able to tolerate wide swings in market value from one year to the next. This means that the Fund, to ensure sound returns over time, should first of all have a high equity portion.

Second, we should firmly maintain a strategy for rebalancing when markets have fallen. We will thus buy equities when risk seems high and the market value of the Fund has fallen. In the assessment of Norges Bank, this is best ensured by establishing a public rule for rebalancing.

Third, the Fund's investment strategy must be developed in pace with changes in the world economy. A larger portion of the Fund's portfolio now and in the years ahead should therefore be invested in emerging economies.

Thank you for your attention.