Senate Finance and Public Administration Legislation Committee
ANSWERS TO QUESTIONS ON NOTICE
BUDGET ESTIMATES 2013-2014

Finance and Deregulation Portfolio

Department/Agency: Future Fund
Outcome/Program:
Topic: Future Fund performance

Senator: Cormann
Question reference number: F39
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Question:

Senator CORMANN: Would you, on notice, be able to give us a list with a bit more science around this by asset class, where you essentially show us what the acceptable benchmark is and how you are performing against the acceptable benchmark? Take it on notice and give it some thought. It would be interesting. I note what you are saying in terms of your general performance in recent times, but the market has performed very well in recent times compared to what was happening previously. So I think it is of interest to the committee to be able to gauge to what extent in an overall sense the Future Fund has performed better or not as well as the market. If you could give that some thoughts, on notice, that would be great.

Mr Burgess: I might just add—and I appreciate the question—that one of the reasons we made the opening statement today was to focus on this balance between risk and return. I think your question about return is absolutely correct, but I would not hesitate to say that just looking at return is a danger. I think we have been asked previously why you did not just invest in cash. During the last three or four years if you had invested in cash there would have been a major opportunity, so you have had to take more risks to grasp that opportunity. We are saying that in the next stage of the investment cycle there is that search for yield—what we call 'reinvestment issue'—moving from cash into other asset classes and there has to be a careful forward-looking assessment of risk. So we look at it holistically. The question is a very good one. You have to look at both the return and the combinations of assets to get the right risk profile, and that is why we are focusing on that today.

Answer:

The Board's investment mandate from government emphasises not only the absolute return target of CPI+4.5 to 5.5% per annum, but also the long term nature of this objective and the importance of managing to an acceptable but not excessive level of risk.

It is important to consider progress and performance in light of these return, risk and long-term aspects of the objective and how these are reflected in the Board's investment strategy which prioritises a broadly diversified portfolio. As part of this strategy the portfolio is positioned at any one time for a range of possible future scenarios with different asset classes playing a variety of return seeking and risk mitigation roles. As such the Board combines asset classes to meet its total portfolio risk and return objectives and asset classes have generally performed in line with expectations.

The Board does monitor the total portfolio return against a policy benchmark index which reflects the mix of asset classes in the actual portfolio. It should be noted that the indices within the policy benchmark are imperfect measures given, for example, the specific strategies that are used, how these change and the varying degrees of maturity in asset classes (such as private equity returns will often be negative at the start but positive in the longer term).

The policy portfolio is detailed in the 2011-12 annual report and also provided below:

Category/sector	**Policy benchmark representative index**
Australian equities	ASX 200 (ex LPTs) Accumulation Index
Global developed market equities (ex Australia)	MSCI World ex-Australia (hedged)
Global developing markets	MSCI Emerging Markets (hedged)
Private equity	Cambridge Associates Private Equity Universe
Tangible assets (property and infrastructure and timberland)	CPI+5% pa
Debt	Barclays Capital Global Aggregate (ex Sovereign) Index, duration and currency hedged (50%); Barclays Global High Yield Index, duration and currency hedged (50%)
Alternatives	UBS Bank Bill Index plus 3% pa
Cash	UBS Bank Bill Index
Developed market currency	MSCI ex Aus weightings
Emerging markets currency	JP Morgan ELMI+ Index less UBS Bank Bill Index
Interest rate duration	An exposure (equally weighted between Australia and international) to 10 year zero coupon sovereign bonds

Over the five years to 30 June 2012 the actual portfolio outperformed the policy portfolio by 2.0% pa and over three years to that date it outperformed by 1.7% pa.