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How to boost investment return for long term savings

Alternative investments for institutional investors

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Important Notes

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(Alternative) Asset Management:

- Traditionally there is somewhat of a **divide** between the actuarial side of insurance companies, pension funds, etc. and the asset management.
- Caused by clear split of the balance sheet between **assets and liabilities**.
- Matching portfolios (mostly **LDI-management**) somewhat of a bridge between asset management and the actuarial practice but return drivers like equities and alternatives not focus for most actuarial professionals.

Increasing importance of alternatives for actuarial practice:

- The **move from DB to DC** across Europe causes for a less clear cut between liabilities and assets. Pension benefit directly dependent on returns.
- Increased **regulatory focus**, especially for more complex and illiquid products.
- **ESG and sustainability goals**.

What are alternatives?



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Classic versus alternative investments:

- There is not a clear distinction between “**classic**” and **alternative investments**.
- A distinction can be made between:
 - Public / private
 - Liquid / illiquid
 - Straight forward / more complex
 - Institutional / less institutional

For this presentation the following are considered classic investments:

- **Public assets** considered classic, meaning public equities and corporate bonds (both investment grade and high yield)
- **LDI-management** considered classic, including government bonds and more complex swap structures
- **Mortgages** considered classic, while being illiquid
- **Hedge funds** considered somewhat classic, while being complex
- **Real estate** generally considered classic, especially public REITs)

Note: this split is dependent on sector and country.

What can an alternative asset class bring to the investment portfolio?

Traditional variables

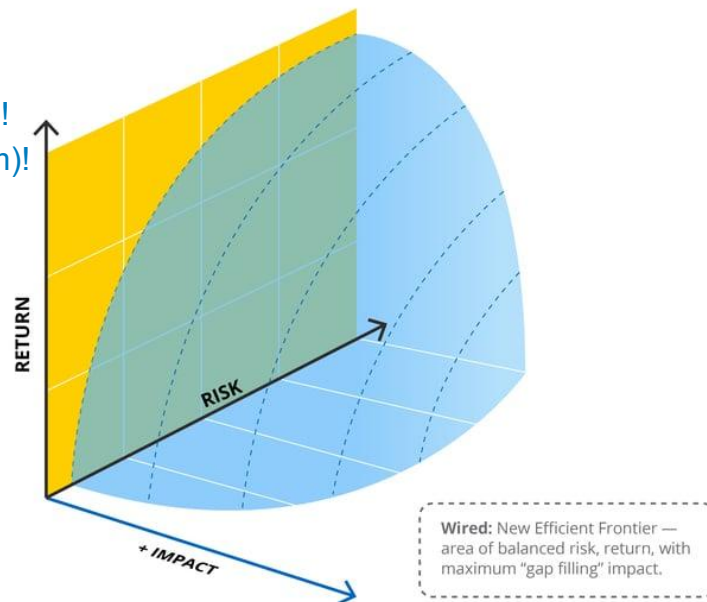
- Return
- Risk

Alternative variables

- Illiquidity → can be both negative and positive (premium)!
- Complexity → can be both negative and positive (premium)!
- ESG / Impact

Asset classes discussed:

- Private Equity
- Venture Capital
- Private Debt
- Farmland
- Crypto



What?

A collective term for all equity investments outside of the public markets.

This is a collective term (including different stages of companies, type of transactions).

Traditional variables

- **Return:** generally higher than public equities, although large range in returns depending on manager, vintage year etc. Illiquidity should give investors an additional risk premium. Be aware of J-curve.
- **Risk:** Tends to be lower and less correlated. Partially due to no noise from (irrational) public markets, but also the less frequent valuations, lagged response and smoothed returns.

Alternative variables

- **Illiquidity:** By structure much more illiquid than public equities. Provides premium
- **Complexity:** Investing process itself not necessarily complex, structured finance/secondaries can be. Governance, especially for smaller investors, can be costly. Internal or external resources needed for manager selection.
- **ESG:** Ambiguous. Asset class tends to have bad reputation. Also, potentially the asset class with the most “impact”, especially with early-stage (see next page) or growth equity.

What?

Early-stage private equity investing. Generally considered its own category due to specific characteristics.

Traditional variables

- **Return:** High, but large range between managers and investments. VC performance depicted by a few winners.
- **Risk:** Generally, one of the riskiest investment strategies, especially compared to public equities. Although low correlation with public markets.

Alternative variables

- **Illiquidity:** Comparable to regular private equity, illiquidity slightly increased due to longer investment horizon to IPO, smaller secondaries market.
- **Complexity:** Investment process more complex, companies that are invested in are not fully set up yet. Internal or external resources needed for manager selection, specialized knowledge for certain sectors (Healthcare, AI, etc).
- **ESG:** VC investing considered vital to impact investing due to the role in early-stage innovation.

What?

A collective term for all debt investments outside of bank lending.

Traditional variables

- **Return:** very dependent on structure of investment. Can be constructed to fit return/risk appetite of investor. Generally higher yield than traditional bonds.
- **Risk:** Can be structured to fit appetite. Decreases risk due to low correlation with traditional bonds.

Alternative variables

- **Illiquidity:** By structure more illiquid.
- **Complexity:** Can become very complex but does not have to be. In case of complexity there might be a complexity premium, completes the market.
- **ESG:** It fills the bank lending gap and can hence be an important part of an impact mandate. Tailored financing.

What?

Part of the broader “natural capital” asset class.

Traditional variables

- **Return:** Lower return objectives than other alternatives. Historical returns have been very high. Return drivers different than other investments.
- **Risk:** Low to medium risk profile, but large diversification compared to traditional assets and other alternatives.

Alternative variables

- **Illiquidity:** Asset class itself very illiquid, fund structure can increase liquidity.
- **Complexity:** Farmland funds are available, which makes institutional investing simple. Direct investing needs specific resources.
- **ESG:** can be considered an important factor for ESG investing investing in biodiversity.

What?

Digital assets (like Bitcoin or Ethereum) and their linked products (like stable coins)

Traditional variables

- **Return:** Has been incredibly high, although largest driver is speculation and not considered to be due to intrinsic value increase.
- **Risk:** 2x to 10x that of global equities, but low correlation with traditional assets could lead to diversification benefits. Correlation has been increasing steadily though.

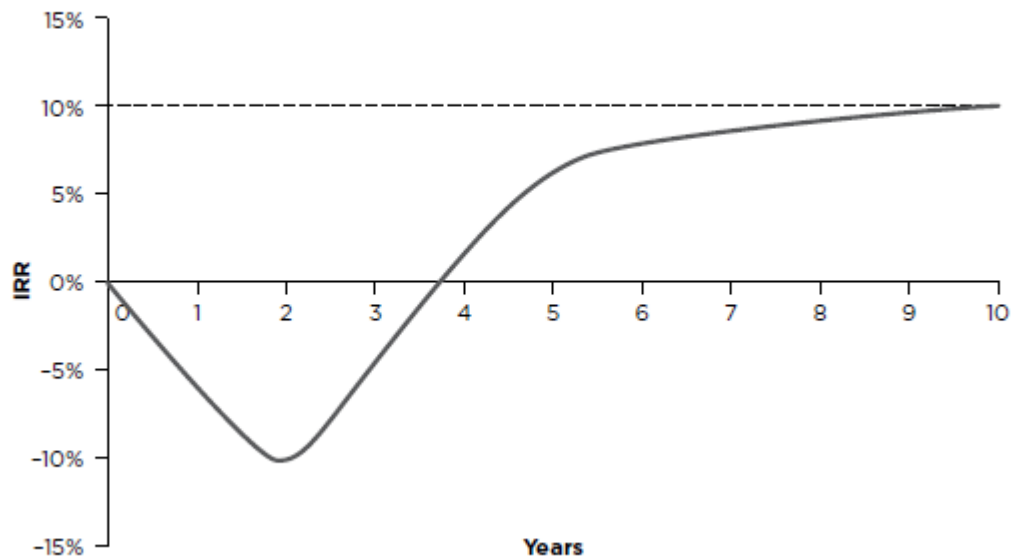
Alternative variables

- **Illiquidity:** Generally liquid, also increasingly in institutional trading vehicles. In times of crises liquidity can decrease rapidly.
- **Complexity:** Highly complex but more simple investment strategies (stablecoins, ETF's) have been developed in the last years.
- **ESG:** Especially Bitcoin is very high in energy consumption. Some argue it would increase the speed for innovation in green energy.

- When it comes to alternative investments, we need to **look further** than the traditions risk/return characteristics.
- Alternative investments can positively impact institutional portfolios and hence their **participants**.
- Illiquidity and complexity can be **positive drivers** for return.
- Alternative investments can be considered key to **impact investing**.
- Depending on scale of institutional investor and investment objective certain asset classes would fit the portfolio (or not!)

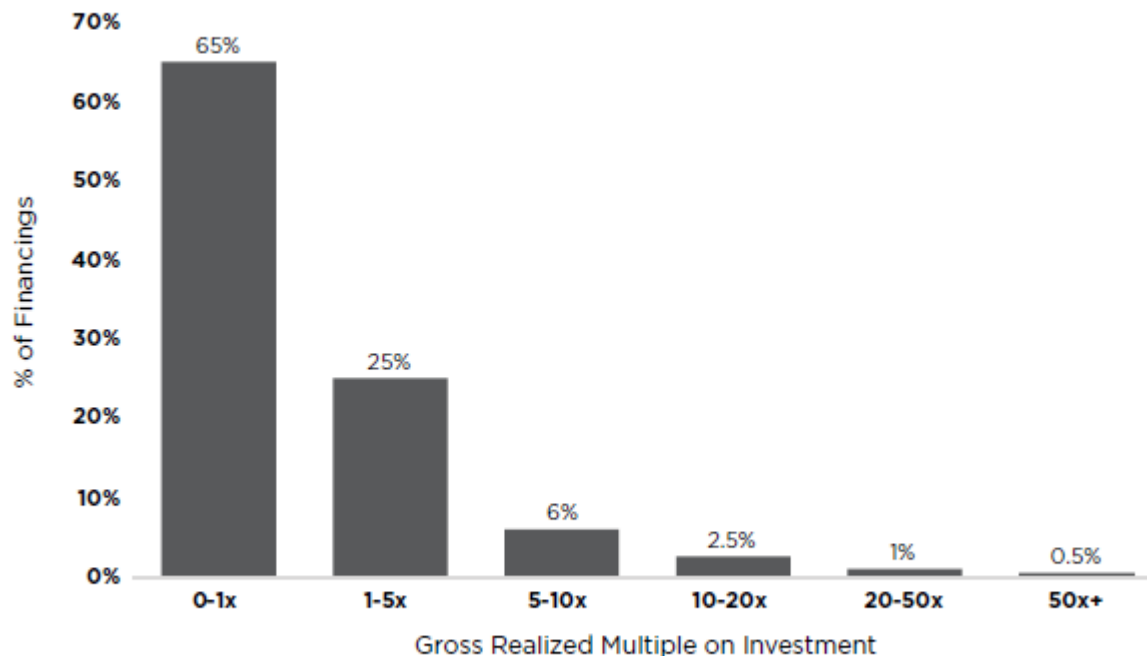
And many other investment classes can be considered as well: cat bonds, ESG focused infrastructure, etc etc..

EXHIBIT 2: Fund Standard J-Curve



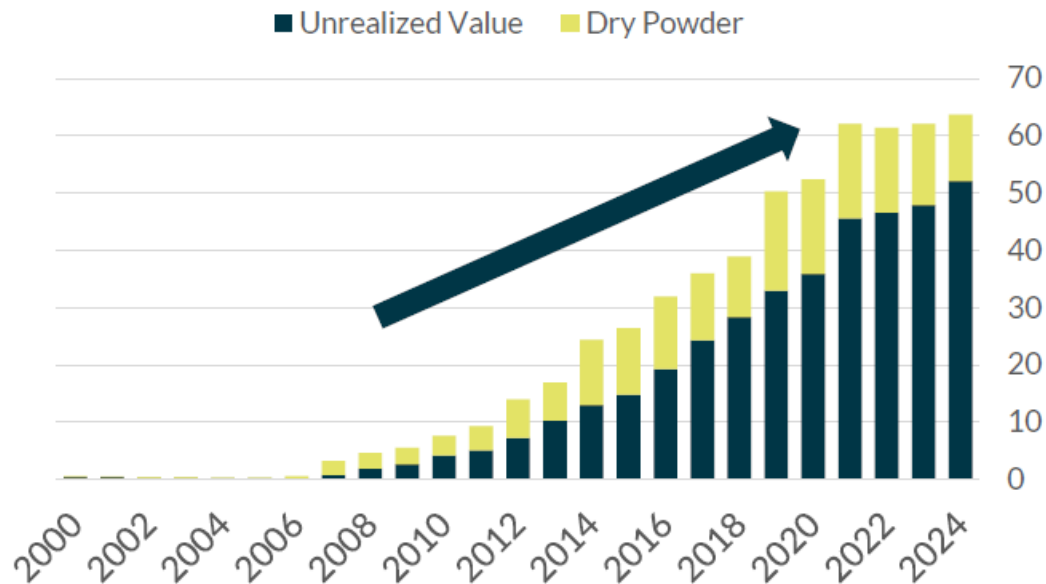
Source: CAIA Handbook

EXHIBIT 4: Distribution of early stage venture backed returns by % of Financings



Source: correlation ventures

Agriculture/Farmland strategy - AuM by date (USD bn)



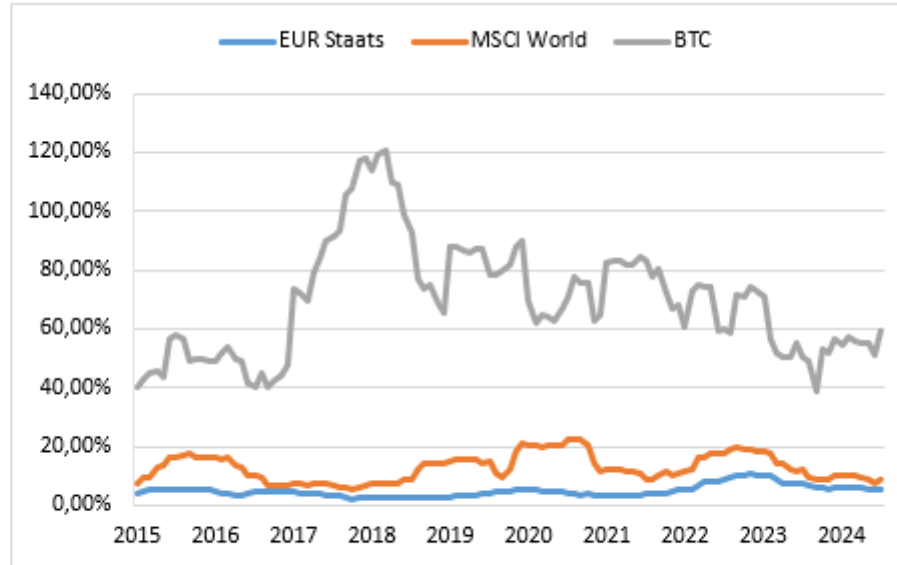
Source: Preqin

Some interesting graphs



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Figuur 6: Jaarlijkse volatiliteit van verschillende assetklassen (1-jaars rolling window van maandelijkse rendementen) (Sprenkels)



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