

# Perpetuality and Investment Strategies for the Long Term

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# Perpetuality

- In the world of popular culture, forever is...
- Now (Duke Nukem)
- Tomorrow (David Gray)
- Never (Cinema Bizarre)

# Perpetuality

- In the world of investment modelling, forever is...
- About 30 years
- Long-term investment strategy is set based on expected outcomes over 10-30 years
- However, it is recognized that the lifetime of the trust is effectively infinite
- Important to realise that even 10 years is a long time compared to the average period a trustee serves

# Asset allocation drivers

- General:
- Intergenerational equity
- Liquidity
- Diversification
- SRI issues
- Governance budget

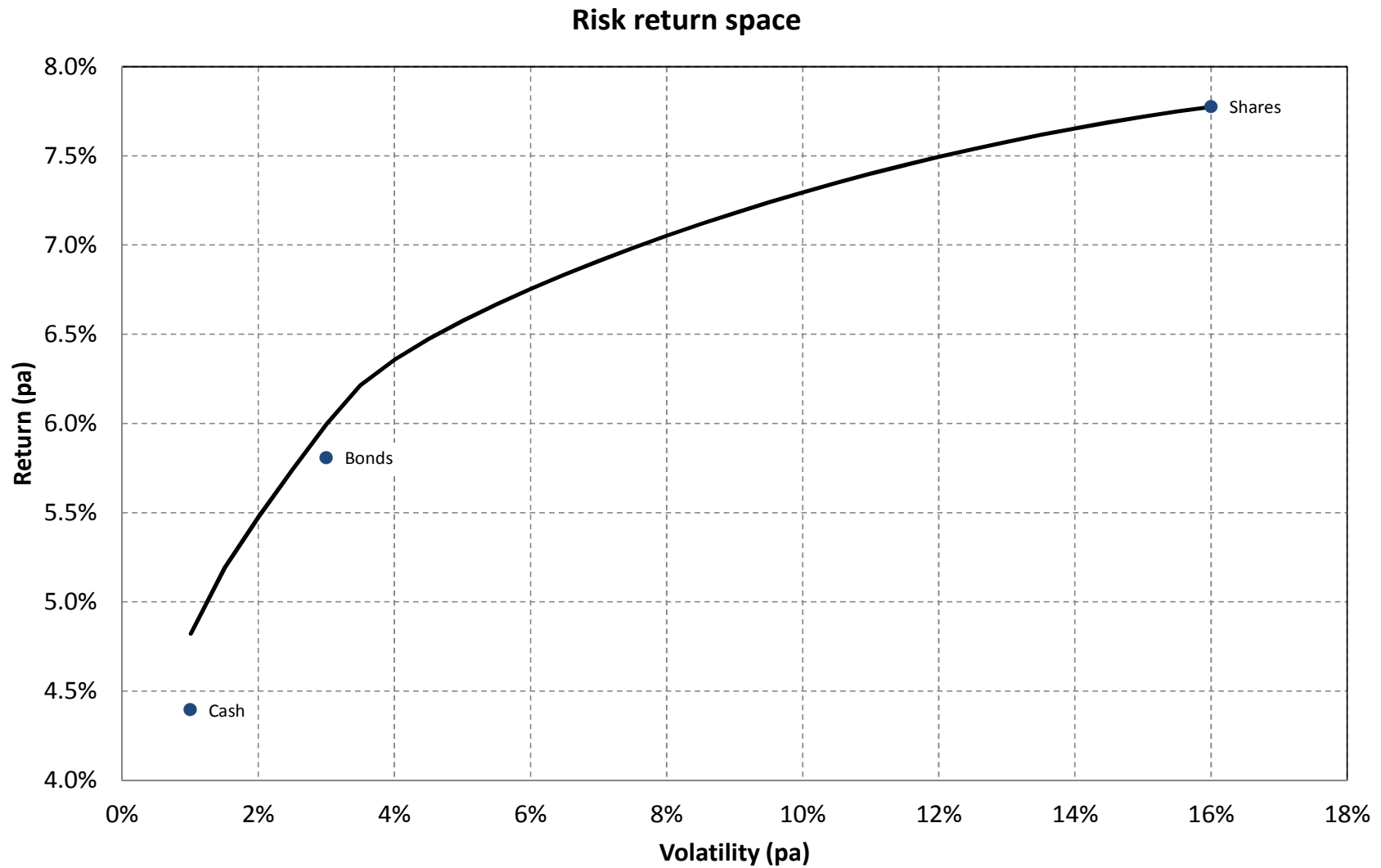
# Asset allocation drivers

- Specific:
- Distribution policy:
  - Trustees may or may not have flexibility on level of distributions
  - Ability to cut distributions if required
- Preservation of capital
- Inflation-proofing of capital and/or distributions
- Population growth
- Reserving policy
  - Ability to eat into reserves/capital

# Asset allocation - examples

- Two trusts:
- Initial capital \$100
- Trust A distributes 5% pa
- Trust B distributes 3% pa
- Also have objective to maintain real value of capital

# Asset allocation -examples

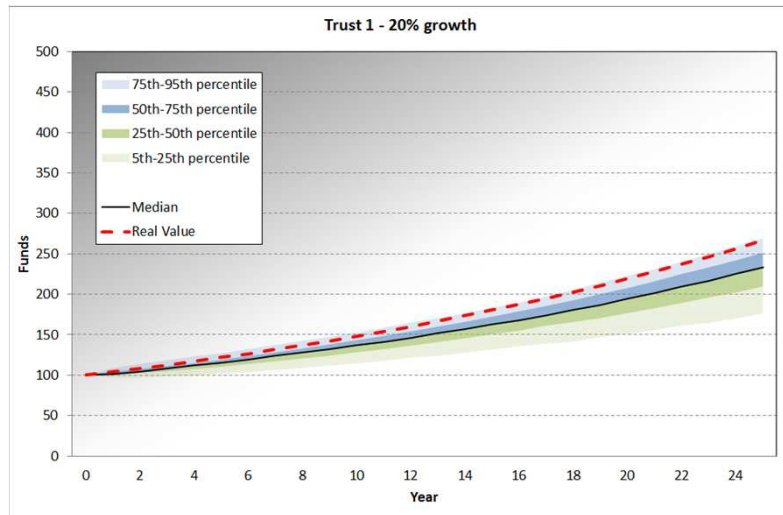


# Asset allocation - examples

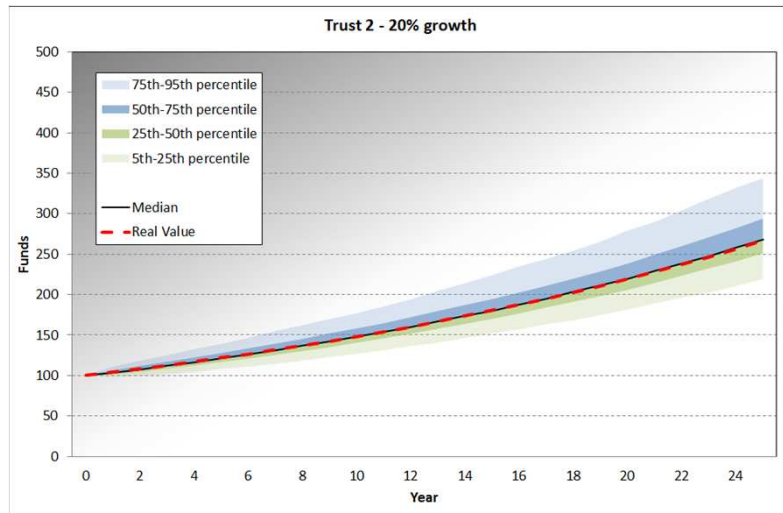
- Simulated future development of both trusts using various investment strategies

| Growth % | Income % |
|----------|----------|
| 20       | 80       |
| 40       | 60       |
| 60       | 40       |
| 80       | 20       |

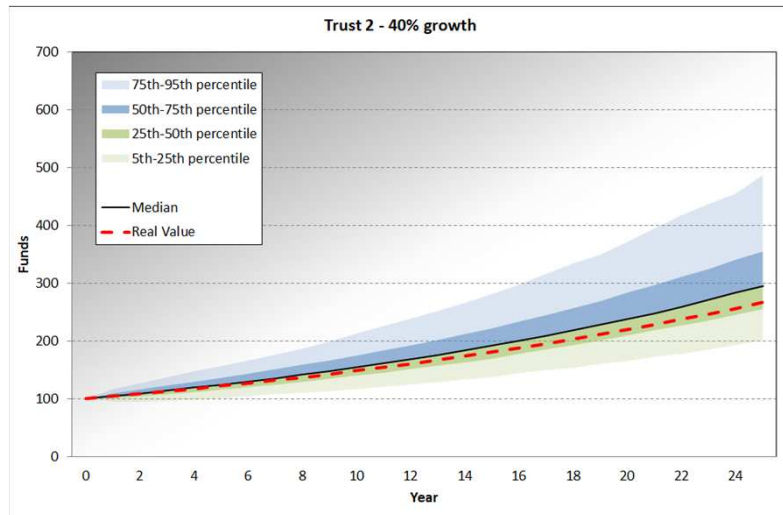
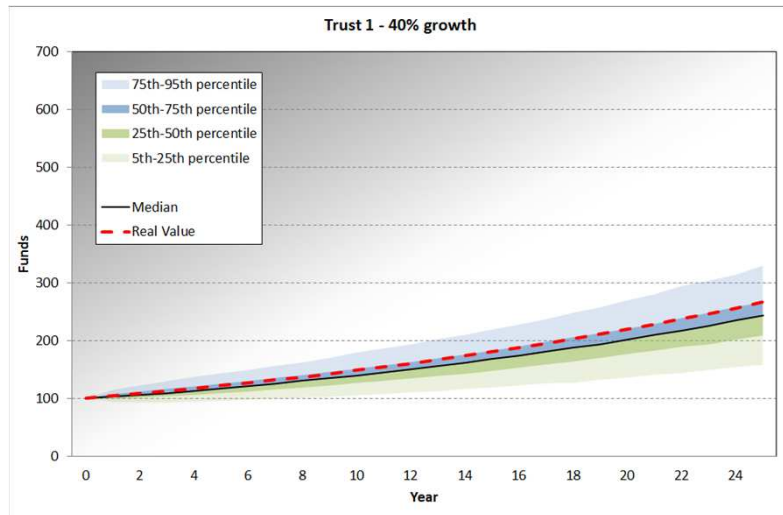
# Asset allocation - examples



- 20% growth assets
  - Trust 1 fails to keep up with the real value
  - Trust 2 median does match inflation

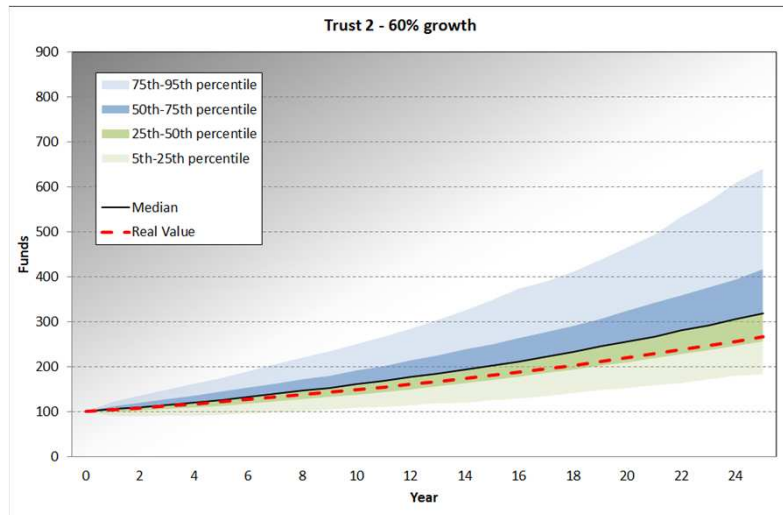
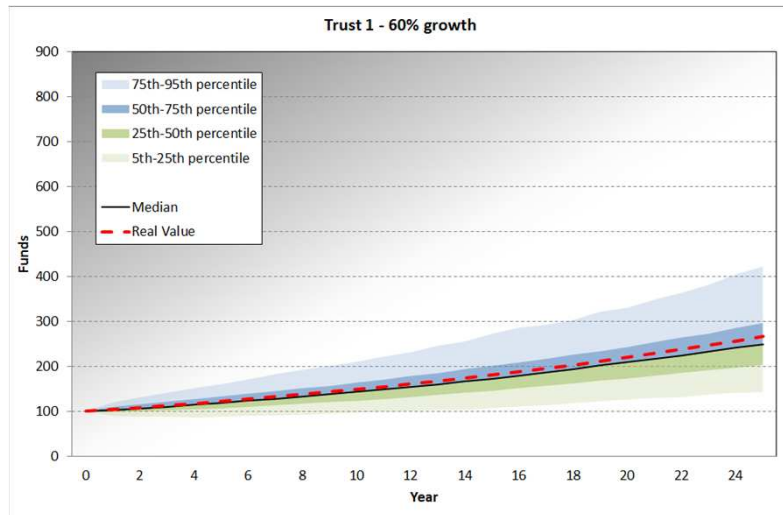


# Asset allocation - examples



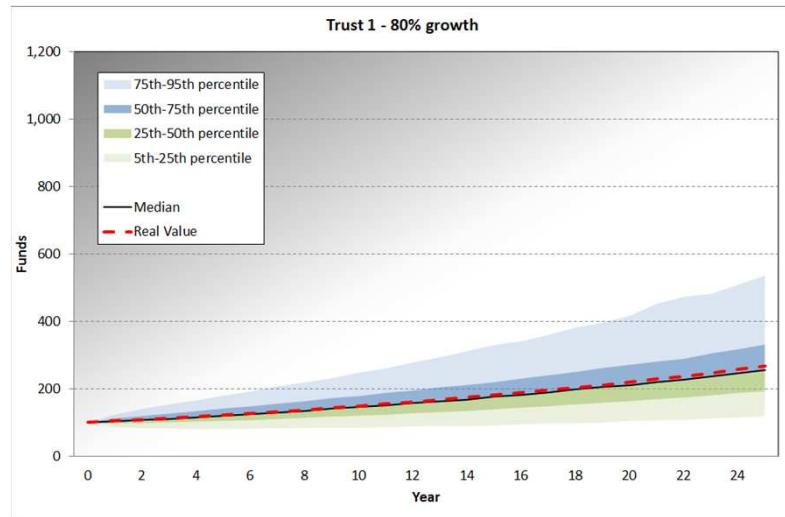
- 40% growth assets
  - Higher growth assets makes picture better for both trusts
  - But Trust 1 only matches real value in 25% of simulations

# Asset allocation - examples

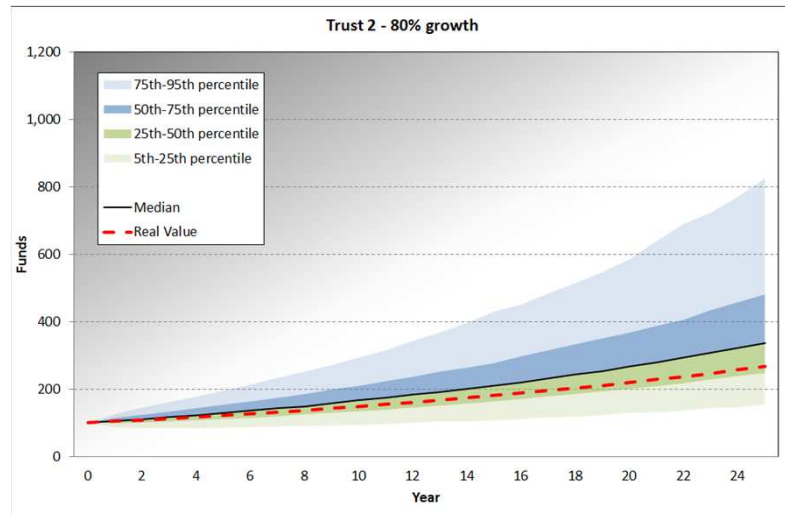


- 60% growth assets
  - Both trusts on average meet real value requirement
  - But Trust 2 more often (75% of the time)

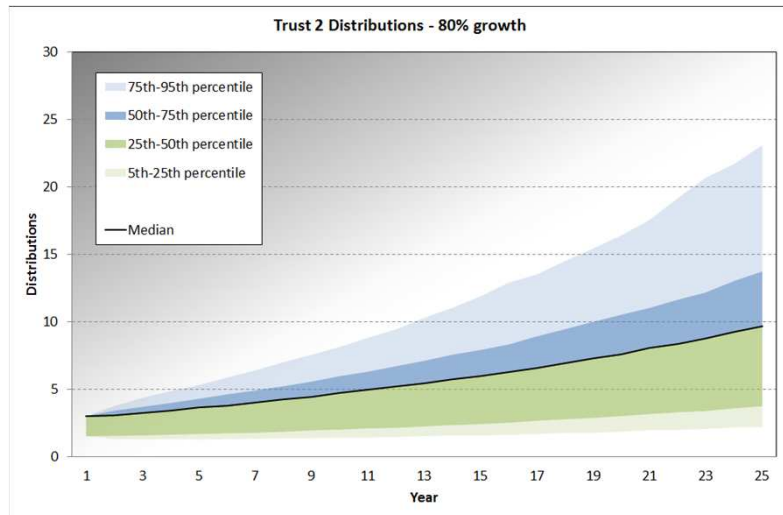
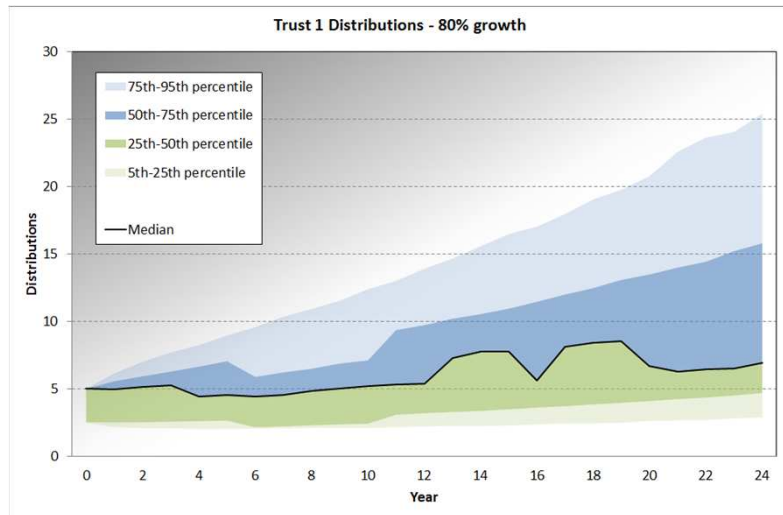
# Asset allocation - examples



- Similar picture to before at 80% growth assets



# Asset allocation - examples



- But when look at distributions for 80% growth assets
  - Trust 1 has much more volatility
  - Not assured of stability of distributions

# Asset allocation – summary

| Growth Assets % | Real Value Preserved ? |         | Distributions Stable ? |         |
|-----------------|------------------------|---------|------------------------|---------|
|                 | Trust 1                | Trust 2 | Trust 1                | Trust 2 |
| 20              | ✗                      | ✓       | ✓                      | ✓       |
| 40              | ✗                      | ✓       | ✓                      | ✓       |
| 60              | ✓                      | ✓       | ✓                      | ✓       |
| 80              | ✓                      | ✓       | ✗                      | ✓       |

- Trust 1 has to have higher growth exposure to meet real value preservation target
- But cannot have 80% growth as this leads to fluctuations in distributions
- Trust 2 can pretty much have any asset allocation

# Asset allocation – other issues

- Liquidity
- Alternative assets
- Currency hedging
- SRI considerations
- Implementation and monitoring

# Conclusions

- Flexibility of asset allocation depends on constraints imposed by distribution and other objectives
  - Trusts with high distribution requirements and limited ability to cut distributions need enough growth assets to maintain real capital, but cannot have too much because this will lead to large fluctuations in the distribution levels.
  - Trusts with lower distribution levels or greater flexibility in distributions have a wider range of choices.
  - The key is to determine distributions and flexibility to alter them at the outset