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# An Investment Letter for True Long-Term Investors

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This publication has been produced by the True North Institute which was founded by Stan Miranda in 2023. True North is an independent investment company which, in addition to its investment activities, performs deep research into the most fundamental areas affecting long-term investment returns. The results of such research are openly shared with the broader institutional investment community. The Institute's audience includes Chief Investment Officers of large and small institutional pools of capital. This includes sovereign wealth funds, pensions, insurance companies, foundations, endowments and family offices.

# True North Institute

# An Investment Letter For True Long-Term Investors: Q3 2024

*This is our second quarterly newsletter. The aim of this is to arm the Chair of Institutional Investors' Investment Committees and the Chief Investment Officer with possible agenda items to be addressed in the upcoming investment committee meeting. We assume this audience comprises mostly of true long-term investors and the topics for discussion are only those with long-term consequences, including near-term actions which could have long-term consequences.*

## Elephants in the Investment Committee Boardroom

Since our last quarterly newsletter, the wall of CIO worries has changed more than one would expect in such a short period of time. These are the issues coming up most with CIOs and investment committees for their upcoming meetings:

1) Future returns for public equity in light of current valuations and concentration

2) Geopolitical uncertainty (which we discuss below)

3) Long-term inflation and interest rate risks

4) lliquidity management: managing PE capital calls as distributions dry up

5) Alpha from public equities: active vs passive debate

6) Climate Change's impact on long-term asset values

7) Technological disruption – fears around AI and impact on cyber-security

The anxiety around private equity returns has migrated now to public equity returns with recent widely read views by the likes of Goldman Sachs, forecasting 3% p.a. for the next 10 years, and Bridgewater's recent publication which focuses on why US equities may drag down global equities returns as the US equity markets reach a ceiling on foreign capital inflows. Bridgewater asserts that the degree to which the US drags down global equity returns is a call on the degree to which AI and technology generally has a real bottom-line impact with US companies.

Goldman's piece expresses concern about the current high concentration of the stock market which they argue is a precursor to the largest companies underperforming and the equal weighted index outperforming the cap-weighted by 2 to 8% per annum. US corporate after-tax profits have grown from $1.8 trillion in 2020 to $3.4 trillion in 2023, which is an extraordinary leap by historical standards. This has corporate profits representing 12.3% of US GDP in 2023 compared to 5.5% in 2020.

All other major forecasters (JP Morgan, Blackrock, Schroders, Invesco, Vanguard and Morgan Stanley) forecast 10-year forward looking public equities total returns between 5.2% and 7.9% with an average expected return of 6.6%. At minimum, the concern raised by Goldman may just add ammunition to support the case for diversification of liquid assets beyond equities into credit, real estate and various hedge fund strategies.

# Long-Term Performance

As long-term institutional investors, we need to be obsessed with our asset allocation job. Long-term asset allocation decisions are driven mostly by long-term return expectations. Despite the impossibility of getting return estimates right within a narrow confidence interval, it is our job to try; hence the reason we publish this table below. Past performance of course is, to some extent, indicative of future returns, but forecasts from the likes of Partners Capital, JP Morgan and Harvard Management Company go deeper into the study of future risk-free rates, risk premia, illiquidity premia, capital flows and other drivers. Partners Capital's estimates are shown in the right-hand column in the table below and in the bar chart at the back of this letter which decomposes future returns into beta, illiquidity premia and security selection alpha.

The remainder of the table below shows updated long-term historical performance for each asset class to be compared against the forward-looking forecast from Partners Capital. Partners Capital's forecast generally does not differ significantly from a "consensus view" of the major forecasters such as JP Morgan, Investec, Schroders, KKR and others.

## Historical and Forecast Performance of Asset Classes and Overall Portfolios.

| Fiscal Years | | FYTD estimate | 3-Year Performance | 5-Year Performance | 10-Year Performance |
|---|---|---|---|---|---|
| | | *Sept 23 - Sept 24* | *Sept 21 - Sept 24* | *Sept 19 - Sept 24* | *Sept 14 - Sept 24* |
| TNI 12 Endowments | See note No 1 | 9.6% | 2.7% | 11.1% | 9.3% |
| NACUBO Cohort | (>$1B AUM) | 10.8% | 3.6% | 9.6% | 7.8% |

| Calendar Years (3) | Index Name | CYTD estimate | 3-Year Performance | 5-Year Performance | 10-Year Performance | 10-Year Forecast (2) |
|---|---|---|---|---|---|---|
| | | *Jan 24 - Sept 24* | *Sept 21 - Sept 24* | *Sept 19 - Sept 24* | *Sept 14 - Sept 24* | *2024-2034* |
| TNI 12 Endowments | (>$1B AUM) | 7.9% | 5.7% | 11.0% | 8.3% | 8.6% |
| 70/30 Equity/Bond Index | 70% MSCI ACWI / 30% Barclays US Treasury 5-10 Year | 9.6% | 3.4% | 8.3% | 7.3% | 6.3% |
| **Asset Class Returns** | | | | | | |
| Fixed Income | Barclays US Treasury 5-10 Yr | (6.5%) | (5.7%) | (2.4%) | 0.5% | 4.3% |
| Liquid Credit | Barclays Global Corporate BBB | (1.6%) | (2.8%) | 0.2% | 2.5% | 6.0% |
| Private Credit | State Street Private Debt | 12.4% | 9.9% | 10.1% | 9.2% | 8.5% |
| Public Equities | MSCI ACWI | 17.1% | 7.3% | 12.7% | 10.0% | 7.0% |
| Leveraged Buyouts | State Street Leveraged Buyouts | 9.5% | 8.7% | 14.5% | 12.9% | 10.0% |
| Venture Capital | State Street Venture Capital | 6.2% | (1.8%) | 14.7% | 13.9% | 11.5% |
| Hedge Funds | PivotPath Multi-Strategy Hedge Funds | 7.5% | 5.8% | 7.9% | 6.0% | 7.5% |
| Real Estate | Preqin Real Este Opportunities | (2.5%) | 7.4% | 7.3% | 9.0% | 9.5% |

**Notes:**
1. Includes reported results through 30 June 2023 and market index-based estimate for July 23 to Sept 24. Includes Brown, Columbia, Cornell, Dartmouth, Harvard, MIT, Notre Dame, U Penn, Princeton, Stanford, University of Virginia (UVIMCo) and Yale.
2. Partners Capital 10-Year forecast net returns (see bar chart at back). TNI 12 Endowments 10-yr forecast is based on FYE 2023 asset allocation of the top 12 endowments listed above and Partners Capital 10-year return forecasts. Assumes 60% buyout and 40% VC as per >$1B AUM cohort. Forecasts also based on Partners Capital 10-year forecasts for annual asset class returns (excluding potential manager outperformance)
3. Given not all Endowments have reported their 2024 numbers, we have taken the latest FY 2023 numbers and forecasted these to 2024 using relevant index returns based on the Endowments' asset allocation (numbers will be updated in our next quarterly newsletter with FY 2024 reported performance)

# Macro Debates Worth Having Today

The IC Chair can usefully guide macro discussion with their committee members by establishing what macro topics are worth debating in the investment committee boardroom. Valuable airtime can be wasted on attempts to forecast the unpredictable and discuss events that may not have any material long-term impact on investment performance. What macro-economic or major financial markets issues are worth discussing today?

**1)** Interest Rates
**2)** China decoupling from US debt
**3)** War in Middle East
**4)** US Elections
**5)** How to think about equities performance with the Mag 7

## 1. Interest Rates

Interest rates and inflation remain top of mind. We discussed these in our last letter by reminding you of what markets are pricing into interest rate futures, which showed the US 10-year 5 years from now at 4.7% and 10 years from now at 5.2%. The Fed cut the federal funds rate by 50 bps on September 18, 2024, lowering the target range to 4.75%–5.0%. This was the first rate cut since March 2020. Despite this, the US 10-year 5 years out is 4.6% and 10 years out is 5.1%, so virtually unchanged.

**10yr Government Bond Yields are expected to gradually increase over the next decade to c. 5% in US/ UK and c. 3% in Germany (22 Oct 2024).**
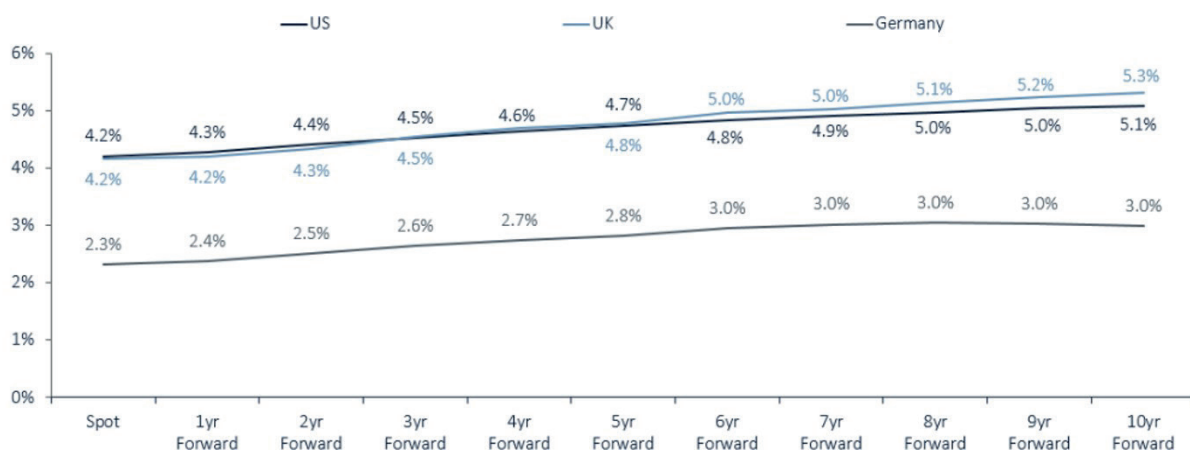


**Source:** Bloomberg

## 2. China decoupling from US debt

One of the biggest long-term macro issues we focus on is the relationship between China and the US as this has major implications for many industries and for the energy transition. The US has imposed a 100% tariff on Chinese-made EVs, along with tariffs on other goods including raw materials, components, and final products. The EU has imposed tariffs of up to 45.3% on Chinese-made EVs. The EU's tariffs are in response to concerns that Chinese manufacturers have received significant state subsidies. One argument we hear is that the US won't go too far on decoupling in part due to the role China plays in funding the US deficits. This should not be a discussion at all. China today holds 2.2% of US national debt, down from a peak of 5.9% in 2013. Foreign-owned US debt is 23% of the total and is decreasing in favour of domestic holders. And there are a lot of other foreign holders. The US does not need Chinese investors.

**At its peak in 2014, foreign-owned securities made up over a third of total US debt.**
Total US national debt, separated by ownership, adjusted for inflation, 2000–2024
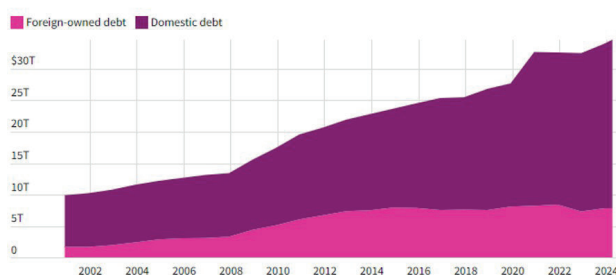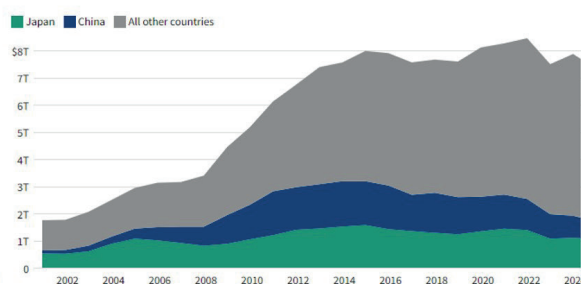


**Source:** Treasury Department
**Notes:** Domestic-owned debt includes domestic public debt and intragovernmental debt. From 2000 to 2023, annual totals are based on data from December, ehile the 2024 data is updated through April. Inflation adjusted to the 2023 calendar year.

**Japan and China have been the largest foreign holders of US debt for the last two decades.**
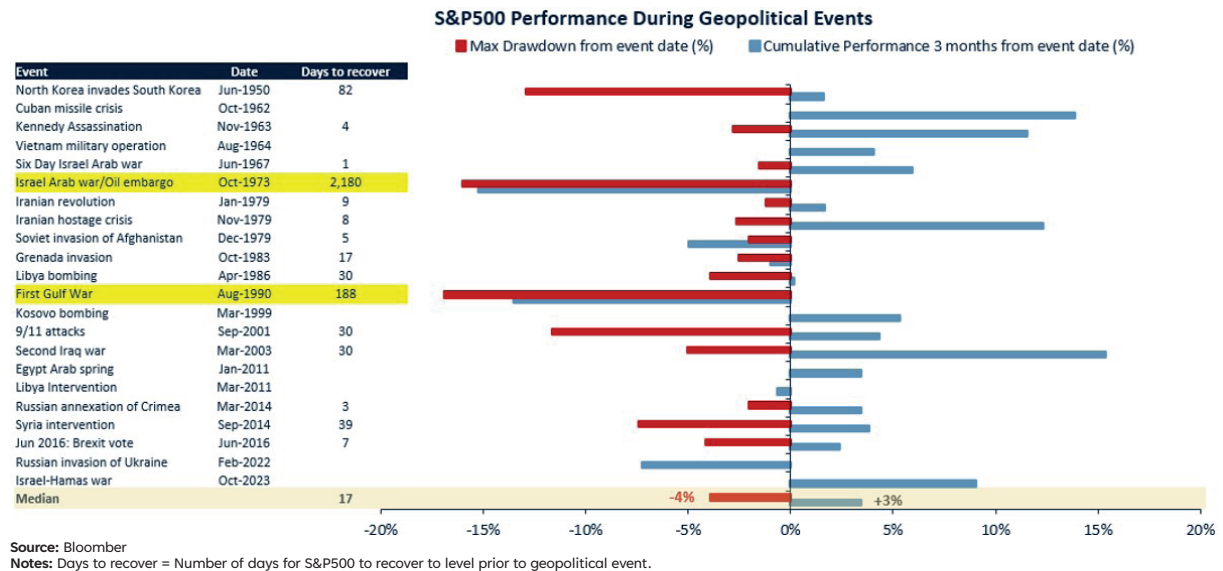Foreign-owned US debt, adjusted for inflation, December 2000–April 2024



**Source:** Treasury Department
**Notes:** From 2000 to 2023, annual totals are based on data from December, while the 2024 data is updated through April. Inflation adjusted to the 2023 calendar years.

## 3. The War in the Middle East

On Oct 1, Iran launched a ballistic missile attack on Israel seen as a significant escalation in the conflict in the Middle East. We are reminded that historically, major geopolitical events, despite their horrific human tragedy, do not generally leave an enduring impact on financial markets. Given the increasing scale of the tragic developments in the Middle East, we thought we should share the evidence we use to come to that conclusion below. This shows the maximum market drawdown following every significant geopolitical event (hot wars, not cold wars) since 1950 in the blue bars on the left and then the red bars on the right shows the cumulative market performance since the event (including the full drawdown) after three months. You can see the only major exception was the 1973 Israel/ Arab war which resulted in the oil crisis which did have a significant and lasting impact on markets, where markets only recovered six years later. This sudden price increase from $3 per barrel to $12 caused major economic disruptions worldwide, leading to inflation and recession in many countries.

**Geopolitical events can create high market volatility but often fail to leave and enduring significant impact on financial markets.**

### S&P500 Performance During Geopolitical Events

■ Max Drawdown from event date (%)  ■ Cumulative Performance 3 months from event date (%)

| Event | Date | Days to recover |
|---|---|---|
| North Korea invades South Korea | Jun-1950 | 82 |
| Cuban missile crisis | Oct-1962 | |
| Kennedy Assassination | Nov-1963 | 4 |
| Vietnam military operation | Aug-1964 | |
| Six Day Israel Arab war | Jun-1967 | 1 |
| Israel Arab war/Oil embargo | Oct-1973 | 2,180 |
| Iranian revolution | Jan-1979 | 9 |
| Iranian hostage crisis | Nov-1979 | 8 |
| Soviet invasion of Afghanistan | Dec-1979 | 5 |
| Grenada invasion | Oct-1983 | 17 |
| Libya bombing | Apr-1986 | 30 |
| First Gulf War | Aug-1990 | 188 |
| Kosovo bombing | Mar-1999 | |
| 9/11 attacks | Sep-2001 | 30 |
| Second Iraq war | Mar-2003 | 30 |
| Egypt Arab spring | Jan-2011 | |
| Libya Intervention | Mar-2011 | |
| Russian annexation of Crimea | Mar-2014 | 3 |
| Syria intervention | Sep-2014 | 39 |
| Jun 2016: Brexit vote | Jun-2016 | 7 |
| Russian invasion of Ukraine | Feb-2022 | |
| Israel-Hamas war | Oct-2023 | |
| Median | | 17 |

Median: -4%  +3%

(x-axis: -20%, -15%, -10%, -5%, 0%, 5%, 10%, 15%, 20%)

**Source:** Bloomber

**Notes:** Days to recover = Number of days for S&P500 to recover to level prior to geopolitical event.

Experts are divided on the risk of major escalation. Several believe it is a low probability given the strategic interests of key backers in the region (China and the US) but others, most notably BCA and Alpine Macro believe that a major escalation is only a matter of time.

**Oil market prices have responded calmly to the recent escalation of war in the Middle East. (grey shaded bars mark global recessions).** Chart is through to 31 October 2024, showing WTI crude at $67per barrel.

(Oil price chart, y-axis $20.00 to $160.00, x-axis years 1950 to 2020)

**Source:** Macrotrends
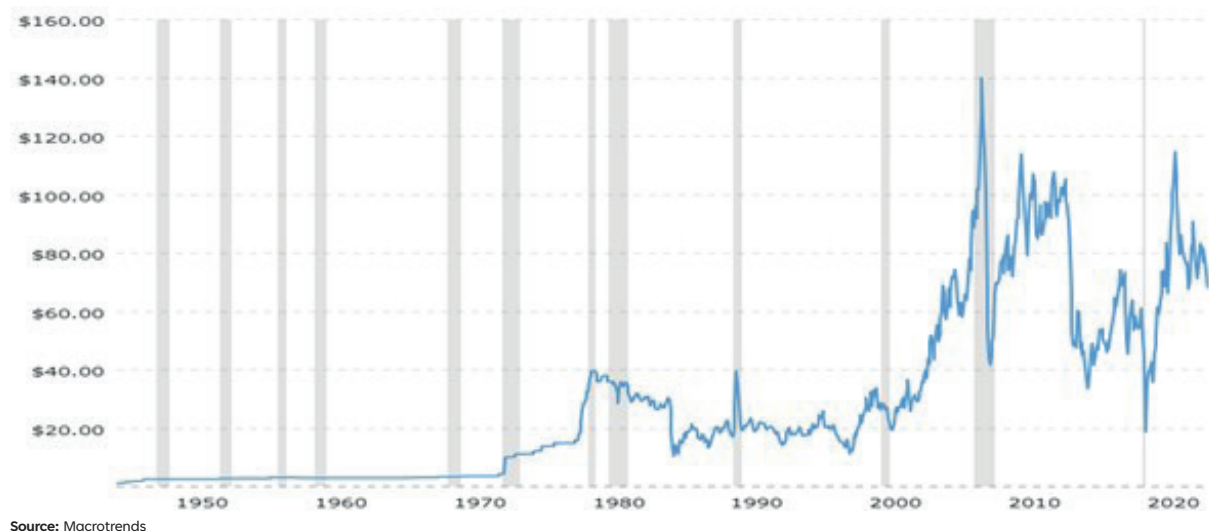
## 4. US Elections

Some elections can also change the relative attractiveness of different asset classes such as the current US election. In our last newsletter we shared research firm, BCA's estimated spending and deficits from a Trump vs Biden presidency. BCA updated this for Harris which showed no change for either the Democrat winner or Republican winner, with 2033 CBO forecasting an annual deficit of 7% of GDP by Harris and 8% from a Trump win, vs the current annual deficit of 6% of GDP. The major implication is for upward pressure on interest rates, slightly more so if Trump is elected. The current (30 Oct) 10-year yield is 4.25%. By the time you read this, you will see if the election mattered to financial markets as they discount the expected long-term effects of the different outcomes (including the Senate) on the deficit, rates and other long-term economic impact. We suspect you will see little movement.

## 5. What to do about the Mag7 in your equity portfolios?

Most active investors in public equities have underperformed the passive indices in the last two years, primarily due to the extreme outperformance of a handful of large companies in the indices, with a focus on the 7 companies shown below, who presently comprise 17% of the MSCI ACWI global equities index.

The standard market value-weighted MSCI ACWI in USD, that many of us benchmark equities' performance against, is up 19.2% YT September 2024, compared to the equal weighted index up 10.9%. You can see below, what drove that difference. We have noticed more active managers reporting both the underlined equal weighted and market weighted benchmarks against their portfolio performance, which is fine, if we know we have that underweight (vs the market weighted MSCI ACWI) rebalanced elsewhere in the portfolio.

### Magnificent Seven Stocks Performance.

| Company Name | Symbol | 2024 YTD Performance |
|---|---|---|
| Alphabet | (GOOGL) | +19.5% |
| Amazon | (AMZN) | +21.8% |
| Apple | (AAPL) | +17.5% |
| Meta Platforms | (META) | +62.9% |
| Microsoft | (MSFT) | +11.9% |
| Nvidia | (NVDA) | +136.3% |
| Tesla | (TSLA) | +3.8% |

Source: IBD Data as of Oct. 1

Those of us who underperformed due to an underweight, likely had that underweight as a consequence of our active managers not holding these securities as they generally find it easier to deliver security selection alpha choosing companies less followed and analysed. SWFs and large pensions with direct equity holdings, will generally not be underweight and will not have suffered, to the extent that they generally track closely to their indices.

Over the past decade, the top 10 stock's representation in MSCI ACWI has risen from c. 8% in 2013 to c. 20% in 2024. However, the rising concentration of index weight to the top 10 doesn't tell the full story. The volatility contribution from the top 10 stocks has risen by more than the capital weight, rising from c. 7% to c. 25% (based on Bloomberg's MAC3 Risk Model), mostly due to the change in names over this period. Previously, the top 10 represented a diverse group of stocks which spanned a variety of sectors and exhibited a range of market betas and value/growth characteristics. By comparison, today's top 10 stocks are almost all high beta, growth-biased and have overlapping industry risk, and above average correlations to the market and each other.

Two questions emerge for most of us. Will this concentration reverse in the near future? And how do we make sure this source of underperformance doesn't happen again? Some of the reasons it might reverse include regulation (break-ups), a manufacturing recovery, and/or a bursting of the prospects for artificial intelligence. Our long-term recommendation would be to closely monitor your portfolio's look-through exposure to the largest companies in the index and seek to have market weights for these positions to the extent that your active managers provide you with an underweight.

Modelling the holdings of a typical set of active equity managers suggests the average investor would only have about 10% in the Mag7 vs 17% for the index. Closing this gap can be achieved through public equity portfolio construction to include direct holdings of the Mag7 in an amount that fills the gap. For smaller portfolios, replacing any existing passive index exposure with the Vanguard MegaCap Growth ETF (ticker MGK in the US which has a 7bps TER) will move the portfolio in the right direction. With respect to timing your move back up to 17%, we would recommend a typical "averaging in" system back up to the 17% over a 24-to-36-month period or immediately after any material market mean reversion of the Mag7.

# Institutions Doing Interesting Big Things

The Teacher Retirement System of Texas is shifting ~$10 billion **away from private equity** due to diminishing returns and a slowdown in exits. This move, redirecting capital to public equities, reflects concerns over continued pressure on private equity performance.

In the same vein, CalPERS, Alaska Permanent Fund and Columbia University's endowment are **increasingly relying on public markets** to boost performance and liquidity amidst declines in private equity deal-making and distributions, which have fallen to their lowest level since the financial crisis.

New Private Markets just published this list of recent publicly announced commitments to sustainable investments, most of which are focused on climate investment. The most interesting is from CDPQ of Canada which has committed C$10B to transition investments, or companies with clear plans to abate 60% of their emissions by 2030 and 70% by 2035.

In 2022, CDPQ invested in electric utilities to help fund the phasing out of coal in favour of renewable energy. More recently, CPPIB of Canada agreed to acquire Allete Inc, a Minnesota-based utility owner for about US$3.9B alongside Global Infrastructure Partners.

**Recent major commitments to sustainable investing made by large US and EU Pensions.**

| LP | AUM | Description |
|---|---|---|
| CALSTRS | ~$350B | • 1% target allocation to climate & low-carbon themes private investments within its $350 billion portfolio<br>• This is part of a 5%, multi-strategy target allocation for Sustainable Investment & Stewardship Strategies, a long-standing program |
| NEW YORK STATE Common Retirement Fund | ~$270B | • $40 billion climate solutions investment target by 2035 to be invested across PE, debt, infrastructure and green bonds |
| CalPERS | ~$463B | • Created a $100 billion investment target by 2030 for climate solutions across asset classes |
| CDP Caisse de dépôt et placement du Québec | ~C$424B | • Created two climate buckets: C$10 billion "transition" fund for decarbonizing the highest-emitting industries, and a target to hold C$54 billion in "low carbon" or "green assets" by 2025 |
| BORDER TO COAST PENSIONS PARTNERSHIP | ~$70B | • $1.6 billion earmarked for private markets climate investments over the three-year period from 2022 |
| OREGON PERS | ~$94B | • OPERS' state treasurer has proposed a $6 billion allocation to "climate positive" and "climate solutions" investments across real assets and private equity |
| N | ~$210B | • NN Group, a Dutch pensions and insurance provider, has set a target to invest €6 billion into climate solutions by 2030 across real estate, infrastructure, private equity, and green bonds |
| PGGM | ~$250B | • Dutch asset manager, which invests on behalf of Pensioenfonds Zorg en Welzijn and other pension fund clients, has an 18% allocation to Sustainable Development Investments – opportunities aligned with the SDGs |
| USS | ~$110B | • The UK's Universities Superannuation Scheme has created a £2.5 billion five-year investment target for decarbonization solutions across private asset classes |

Source: New Private Markets

# Asset Allocation Trends

As implied in the section above, institutional investors are grappling most with long-term allocations to private equity and public equity, with dispersion of views taking each extreme position – i.e., there are advocates of cutting and adding to each, with less consensus than historically. This debate will stay on the table until major market value corrections emerge, suggesting more clarity on future returns. The one area we thought we should bring to readers' attention is the liquid credit vs equities allocation trade-off, which Howard Marks discusses in is his latest letter which we summarise below.

**Howard Marks advocates for increasing allocations to credit.** Howard Marks makes this case in his latest letter on the 22nd of October entitled "Ruminating on Asset Allocation". Howard commented that the models most often used to arrive at the optimal asset allocation require inputs regarding expected return, risk, and correlation. Most of these are based on history and thus of questionable relevance to the future. Correlation between asset classes is particularly difficult to predict. "It's often a case of garbage in, garbage out (but with the added comfort that comes from using mathematical models)" Howard declares. Howard further argues that investors should fundamentally consider only two asset classes: owning part of a business or lending to it, so ownership and debt. He emphasizes that the trade-offs between the two should be driven by achieving the right balance between offense and defence in the overall investment portfolio.
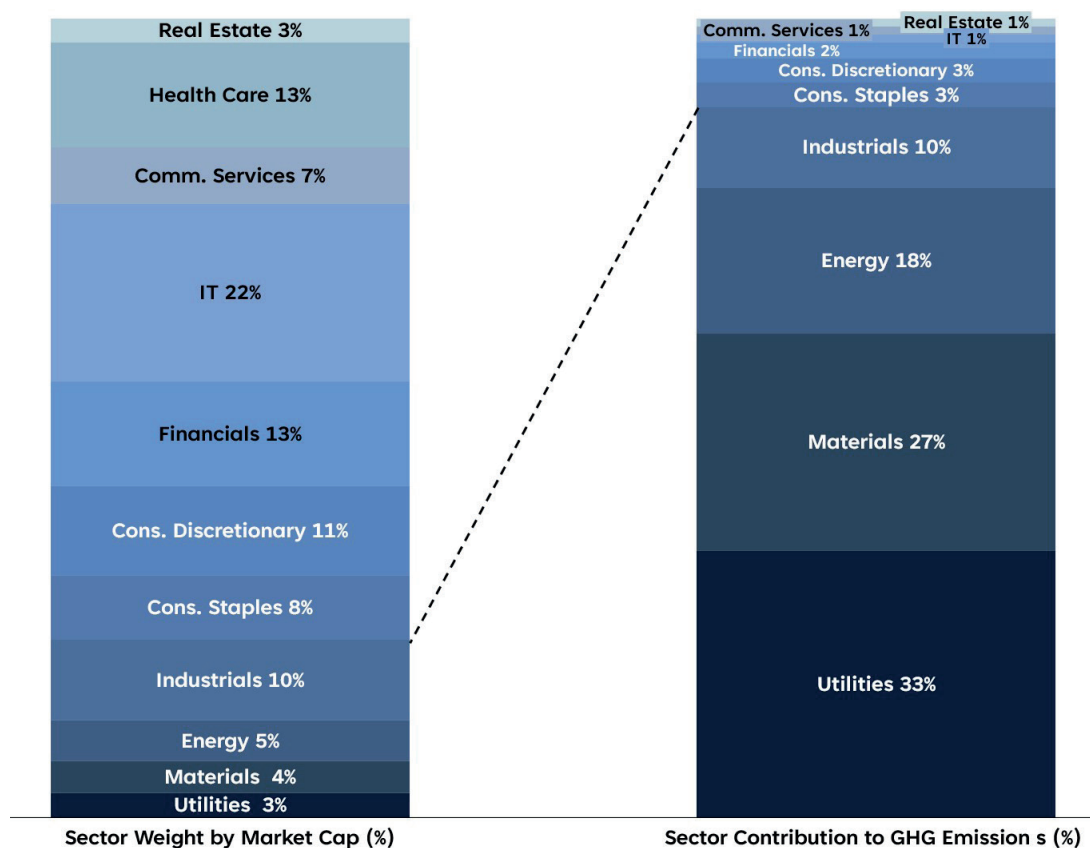
That being said, Howard then proposes that credit investments offer a more attractive option than equities in the current environment, due to their dependable returns and potential to mitigate uncertainty and volatility.  These returns, starting at roughly 7%

on public credit and 10% on private credit, are competitive with the historical returns on equities and capable of helping many investors toward their overall return targets. Because of their contractual nature, the returns from credit are likely to prove much more dependable than ownership returns.

# Sustainable Investing Corner

We have recently drafted a whitepaper to help institutional investors establish their own investment policy for investing in the energy transition which is posted on the True North Institute website this week here. The criticality of having such a policy is based on our observation that 25% of the global economy and equity market comprises companies with existential risks if the cost of carbon abatement or avoidance is accurately factored into their valuations.

**90% of public company emission (scope 1 & 2) are derived from five sectors (adding in the automotive sector) which account for 25% of the market.**

| Sector Weight by Market Cap (%) | Sector Contribution to GHG Emission s (%) |
|---|---|
| Real Estate 3% | Comm. Services 1% |
| Health Care 13% | Real Estate 1% / IT 1% |
| Comm. Services 7% | Financials 2% |
| IT 22% | Cons. Discretionary 3% |
| Financials 13% | Cons. Staples 3% |
| Cons. Discretionary 11% | Industrials 10% |
| Cons. Staples 8% | Energy 18% |
| Industrials 10% | Materials 27% |
| Energy 5% | Utilities 33% |
| Materials 4% | |
| Utilities 3% | |

Based on our meetings with a large swath of the world's asset managers over the years, it is our observation that very few managers have a sufficiently deep understanding of the various pathways that companies can take to decarbonise their businesses in terms of the future technological developments, economics and customer behaviour (e.g., paying green premiums) that will most impact the companies they own.

Other large institutional investors have made similar observations about this knowledge gap with asset managers deploying their capital. For example, the team that manages the £4B Cambridge University endowment have come to this same conclusion and have been doing something about it. In 2021, the University of Cambridge Investment management team developed the 6-week "net zero by 2038" Executive Education programme with the Cambridge Institute for Sustainability Leadership to be attended by the key investment team members of all of the endowment's asset managers. They have now run the programme for four cohorts through to 2024. But managers need to go much deeper than programmes like this can go, in understanding, in detail, the most shareholder value enhancing sector decarbonisation pathways for each of the companies they own.

In our whitepaper on institutional energy transition investment policy, we lay out four investment policy options that might be considered by any institutional investor and describe the pros and cons of each.

# Artifical Intelligence Corner

We move on from our last letter which laid out the four relevant dimensions to any examination of AI's impact on institutional investing: the macro-economic impacts of the evolving AI technology, the impact on overall portfolio management, impact on manager selection and AI investment opportunities. Since the last issue we have invested heavily in assembling all of the existing research we could find on this topic and summarise it here and in an upcoming whitepaper, which has been aided by AI in its drafting. Below we summarise some of the key findings.

**AI integration is no longer optional.** Once the domain of hedge funds and quantitative strategies, AI is now expanding into fundamental investment strategies. 91% of asset managers are either currently using or planning to use AI in their investment processes (Mercer). AI will no longer a niche tool, but is rapidly becoming a core component of most investment strategies, for asset managers and institutional asset owners.

**Existing systems may become obsolete.** Investment institutions are continuously accumulating more and more data all the time from underlying asset managers, the companies and assets we own, and from the external financial markets, including a growing base of third-party data providers. The pace at which we integrate and assimilate that data almost always lags behind the pace at which the universe of data is growing. The present technology toolkit for asset owners seeks to structure data in ways that it can be easily accessed and then produces reports that investors can use to make better alpha-generating decisions. The single biggest AI impact on institutional investors will be that AI can work with unstructured data, find its various uses and answer questions posed to an unstructured system. Existing systems may largely become obsolete and new AI technologies will replace them. **Implementation of AI becomes a major source of competitive advantage for asset owners and asset managers.**

**Data quality is paramount.** The most significant barrier to unlocking AI's full potential is data quality and availability. Investors must prioritize data governance and invest in robust data management systems to ensure data accuracy & consistency, generating reliable insights and mitigating risks associated with biased or incomplete data.

**Large Language Models (LLMs) function as "consensus engines."** These AIs are trained by processing billions of data points, learning to prioritise information based on how past training has sorted through data to arrive at conclusions. This process inherently averages out extreme or outlier perspectives, often leading to a safe but potentially uninspired consensus. While this may reduce risk, it also risks filtering out innovative or contrarian viewpoints, potentially yielding conclusions that lack depth or fresh insight. **In this way, AI "levels the playing field" for all investors and alpha will become even more elusive.**

**AI will accelerate the competitive race among third-party data providers with deep specialisation within industry sectors** (e.g., Evaluate Ltd in biotech, CB Insights in tech) as well as generalist investment data providers such as Bloomberg, Refinitiv, FactSet, Morningstar, S&P Global, Preqin, PitchBook, Albourne, et al. The race will accelerate on two dimensions – quantum of data with a high proportion being unique and novel, and the AI-driven intelligence and analysis provided on that data. This is not a source of competitive advantage or alpha for subscribers, but rather a critical component for staying in the race. Smaller institutional investors may not afford access to such data and AI tools.

**Unique proprietary data sources become the second key source of competitive advantage** after AI implementation. If generative AI levels the playing field and makes all publicly available information easily accessible to all, the role of truly proprietary and highly relevant data becomes a key focus for any asset manager and for asset owners. For equity managers, proprietary information has always come from deep fundamental research talking to customers, suppliers, distributors and competitors. For institutional investors, unique information is harder to find if we are focusing on the overall portfolio construction and risk management.

**Identifying AI-integrated asset managers is key.** Institutional investors should prioritize identifying asset managers who most effectively integrate AI into their investment processes. Three key attributes to look for in an AI-integrated asset manager are: (1) strategic use of third-party data sources combined with proprietary data sets to generate unique insights; (2) deep understanding of AI's technological advancements and their impact on various sectors, and (3) effective use of AI to automate research processes, freeing analysts to focus on higher-order skills, such as management assessment and identifying unique data sources.

**AI enhances and complements human expertise, rather than replacing it.** While AI enhances capabilities by expanding data sets, generating investment ideas, and identifying signals that might otherwise be missed, human judgment remains essential for interpretation, qualitative assessment and navigating ethical complexities.

**There will be many operational enhancements provided by AI** including automated trading and rebalancing, legal due diligence, compliance filings, AI-driven cyber security and automated portfolio risk management.

**Key action items for CIOs navigating the AI revolution:**

**1.** Adopt a strategic alpha-driven approach to AI integration: Identify key capabilities and pain points that AI can address.

**2.** Prioritize data privacy and security: Establish robust data governance frameworks and ensure compliance with relevant regulations.

**3.** Create a toolkit for assessing AI-integration of all asset managers, deployed in ongoing due diligence and manager monitoring processes.

**4.** Forge strategic relationships with third-party system and data providers and seek to overlay truly unique data sources on top.

**5.** Continuously monitor and adapt: Stay informed about the latest AI advancements and be prepared to adjust strategies and processes accordingly.

# Long-Term Return Forecasts



The 10-year forecasts for annual asset class returns in nominal USD & GBP terms are decomposed into the market return (risk-free rate plus risk premium), estimated illiquidity premium where relevant and the level of manager outperformance that we believe is achievable in each asset class.

Potential Manager Outperformance

Illiquidity Premium

Market Return

10yr breakeven inflation = 2.5%
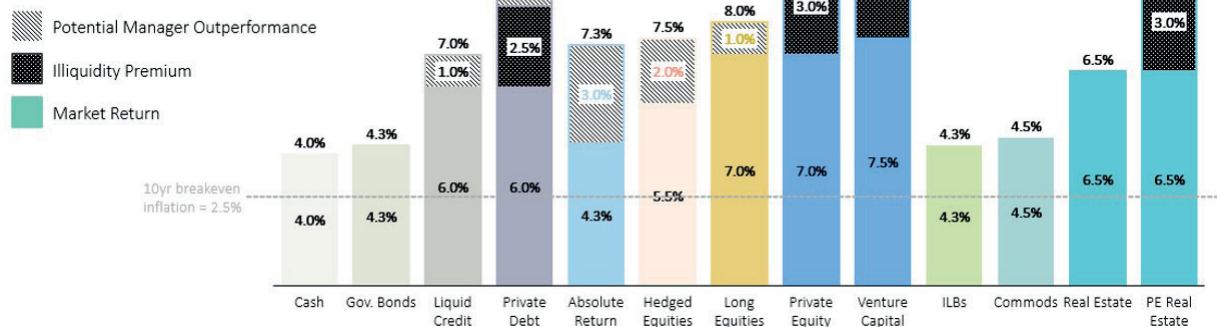
**Source:** Partners Capital Insights 2024

# Disclaimer

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