

# Universities Superannuation Scheme (“USS”)

## Investment Beliefs

### Introduction

The role of the **Investment Committee** in the investment governance process is to design an investment strategy which is consistent with the trustee’s broad objectives. Their role is then to oversee the implementation of this strategy by the **USS’s London Investment Office(LIO)** and to monitor progress.

The trustees’ broad objectives are set out in the statement of **Investment Principles**. The key elements are:

- a long term time horizon – the scheme is growing and with the employers’ covenants strong, there is less need to be concerned about short term volatility
- emphasis on the risk-reducing benefit of diversification – a fundamental investment principle
- emphasis on equities and alternative investments as the means by which the superior returns required by the objectives will be achieved.

1.1 In translating these principles into a workable investment strategy, there needs to be a common frame of reference. This should ensure that the trustees’ broad objectives are linked directly to the actions of the LIO. Since there is no certainty in investment, and since the past is not a helpful guide to the future, the frame of reference must consist of investment **beliefs** rather than investment **certainties**. Since they are not certainties, investment beliefs should be constantly monitored as a belief, no matter how strongly held, may be flawed. Formulation of these beliefs rests with the Investment Committee but ownership rests with the USS Board.

1.2 Not only do the Investment Committee’s investment beliefs provide a frame of reference on which the strategy may be designed, but they also provide guidance to the LIO. They are a discipline against which the LIO may benchmark its processes and the beliefs define how the LIO should operate.

## 2. **USS Investment Beliefs**

### **Market beliefs**

- 2.1 The most fundamental belief held by the Investment Committee is that excess return is available to those investors who take a long term view of investment. The rationale behind this belief is based on three connected behavioural observations:
- All other things being equal, shorter term investors favour investments that can be liquidated easily and where the price at which they can be sold does not vary greatly from day to day. This allows shorter term investors to meet their objectives. It follows that investments which are either illiquid and/or volatile in the short term should on average, be priced more cheaply to reflect these “undesirable” characteristics (the liquidity and volatility risk premia).
  - Most investors behave as though they are short term investors even when they are not. Thus, with the majority either being or behaving as though they are short term, the liquidity and volatility risk premia are non-trivial elements in the pricing of many investments.
  - Most investors exhibit the herd instinct and are most comfortable buying when others are buying (and the price is rising) and selling when others are selling (and the price is falling).

Taking a long term view allows an investor to harvest the liquidity and risk premia (since neither are significant risks to the long term investor). It also allows the investor to avoid investment fashions should they choose to be “contrarian”. The long term investor can in this way benefit from the occasional investment bubble and subsequent “reversion to the mean”.

The Investment Committee uses Asset-Liability Modelling (ALM) to help set its long term asset strategy. The inputs to this more quantitative ALM process support the long term investment principles, whilst also demonstrating the potential volatility of the strategy. This ensures that the Investment Committee is always aware of the short term risk implications of a longer term focus.

- 2.2 The Investment Committee believes that no investment market is perfectly efficient all the time. The presence of inefficiencies allows good active managers to have a better than 50% chance of outperforming over the long term. However, the Investment Committee also believes that the level of efficiency varies from market to market. In particular, it believes that some markets can become sufficiently efficient that passive management could be the most cost effective way of securing return from that market.

### **Style Beliefs**

- 2.3 The Investment Committee believes that diversification is a fundamental and necessary risk control mechanism. Diversification by market and by investment approach is a necessary part of any investment strategy. It follows that to ensure diversification it is essential to have a full understanding of the characteristics of any market in which the

USS is invested and of the style of management employed. These characteristics should be monitored to ensure that they remain unchanged.

- 2.4 The Investment Committee believes that having regard to responsible investment principles in the investment approach employed will in the long term lead to enhanced performance.

**Process Beliefs**

- 2.5 The Investment Committee believes that the main purpose of benchmarks is to guide investment decision making and is a measure to monitor success over the long term. Benchmarks should not drive or constrain decisions unduly.
- 2.6 The Investment Committee believes that the most cost effective way to implement the market and style beliefs is to use its LIO in house staff to manage the majority of the investments. The short term commercial pressure experienced by most third party providers makes it hard (if not impossible) for them to adopt the long term approaches which USS requires.
- 2.7 The Investment Committee believes that external managers should be employed to complement in house expertise and/or where in house management is not cost effective.
- 2.8 The Investment Committee believes that the reward structure for those managing the scheme's investments should support the delivery of the USS principles and objectives.