



THE ONLY CONSTANT IS CHANGE

New approaches and challenges characterize the evolving institutional investment universe.

BY STEPHEN N. POTTER

Markets often take us into unusual places. Strong global growth, a weak dollar, relatively low interest rates and an era of inconsistent regulation have all contributed to a period of unprecedented leverage, creative financial engineering and dynamic global growth. Large investors — whether institutions or wealthy individuals — continue to analyze their appetite for risk and their hunger for return-generating opportunities. These natural investor adaptations create new opportunities and threats. They force change. They make markets.

The Current Environment

The sub-prime crisis will, no doubt, lead to new regulation that will impact the financial industry globally, and will precipitate major changes in how investors frame risk. Risk avoidance has moved to the forefront for many. Conversely, those that can afford to take risk have many attractive buying opportunities ahead. Regardless, a series of new investment strategies is unfolding at an accelerated rate.

In Europe, pension schemes are being consolidated into new entities to gain scale, efficiency and consistent risk management and financially benefit from improved performance. Liability driven investing is prevalent in the Netherlands and the United Kingdom. Several large, established pension funds in the region have converted into commercial enterprises, leveraging their core competencies and buying other pension funds to gain scale, thereby converting themselves into multi-manager pension factories. The Danish government is considering legislation that would require pension funds to report on corporate social responsibility. Environmental, social and governance considerations are changing how companies act and invest.

Recently the opportunity to invest has been constrained

by supply and expected returns of traditional markets. There has been strong movement toward alternative asset classes, including commodities and infrastructure-type products, along with “alternative” alternative investments such as weather derivatives, carbon credits and intellectual property rights.

Coping with Change

These changes reinforce that the way we operated in the past is not the way we will operate in the future. I cannot predict if any of these developments will be sustainable investment trends, but they do represent dynamic change at an accelerated pace. As the global opportunity set continues to broaden, value creation (and destruction) opportunities abound — with regard to asset allocation, asset selection and in long or short positioning.

I am confident that there will be increased focus on investment advisors' abilities to adapt and apply new thinking and new theory. But fundamentally, successful investment programs will continue to be grounded in well-considered objectives, effective long-term asset allocation and a disciplined approach to risk management and program governance. ♦



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