CONCENTRATION IN EQUITY INVESTING

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'A journey of a thousand miles begins with a single step', Lao Tzu

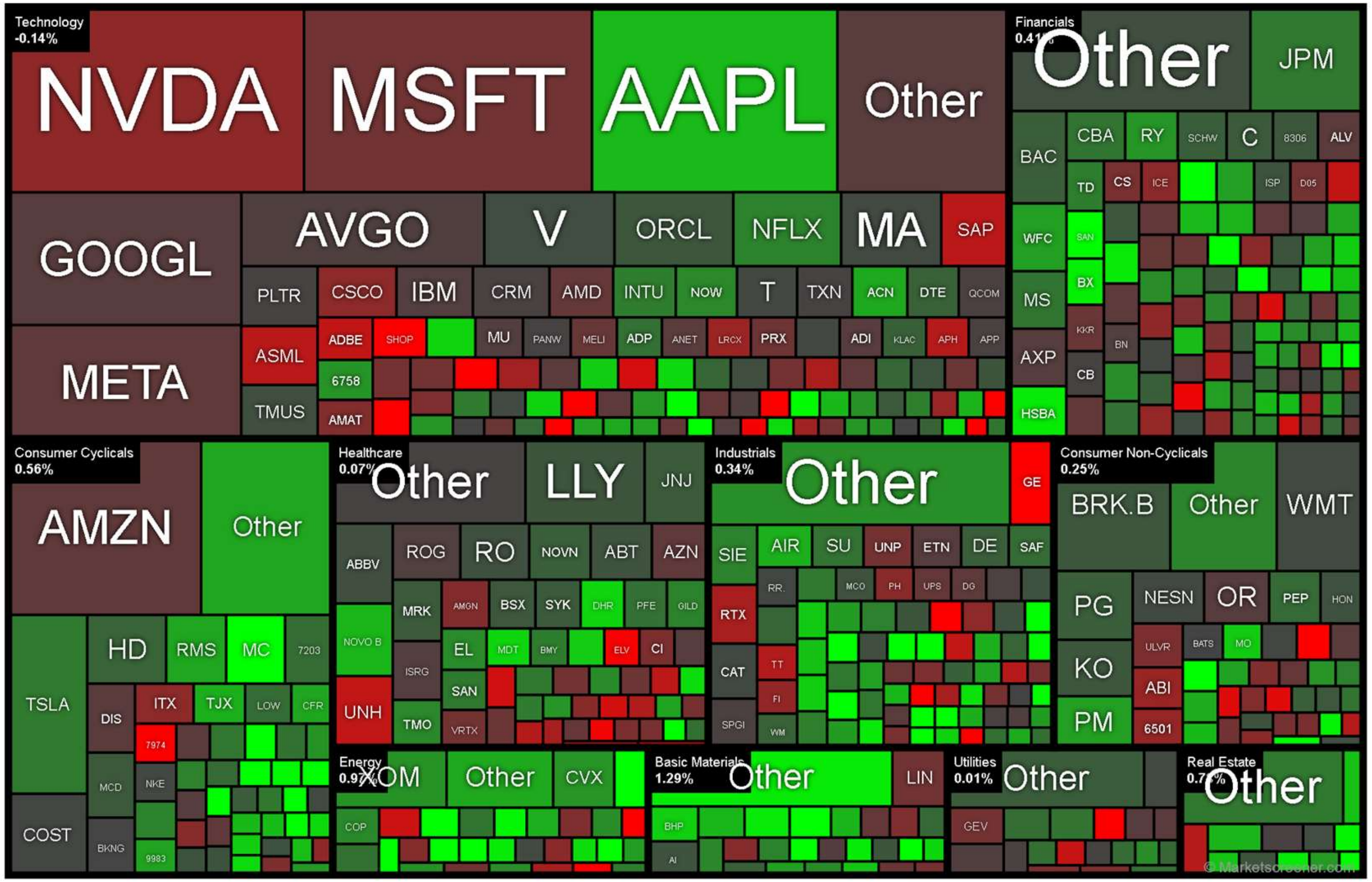
INTRODUCTION

- Passive investing still on the rise and remains very popular
- Increased focus on concentrated investing but not yet a huge trend
- Wide spread portfolio also means 'bad' companies in portfolio, financially and/or socially
- There is growing attention for increasing concentration in the number of holdings
  - Recent papers by Netspar, SPIL, Eumedion. Also FCLT
  - Idea fix: less diversification costs returns → is it less performance or increased risk? What risks?
  - Is it Alpha in a new guise?
  - Many investors express interest but cite barriers such as their size, costs, or limited supply
  - Investors are not 'real' stewards and too short-term focus: from transactional to relational (stewardship)
    - Eumedion (2025): "Asset owners may be expected to act as stewards of their investee companies and to know and understand these companies. An over-diversified equity portfolio does not align with this. This argues for more focus and concentration in the equity portfolio. "

WHAT IS CONCENTRATION?

- Concentration, concentrated or more concentrated?
- Concentration already exists in many portfolios in terms of weights →
- Passive investing can be on universes of 2000, 3000, 5000, but also 500 etc
- Passive investing can be market cap based or systematically, with tilts or screens on ESG/sustainability
- More concentrated portfolios mostly via active management:
  - 25, 40, 50, 75, 100, 200, 300, 500, 1000 names?
  - For part of equity portfolio or entire equity portfolio?
- Fear or pleasure:
  - FOMO? or, FBL (Fear of Buying the Losers) or,
  - JAL (Joy of Avoiding the Losers) or, JOFWAL (Joy of Owning Future's Winners and Avoiding the Losers), or
  - FOP (Fear of Peers)?

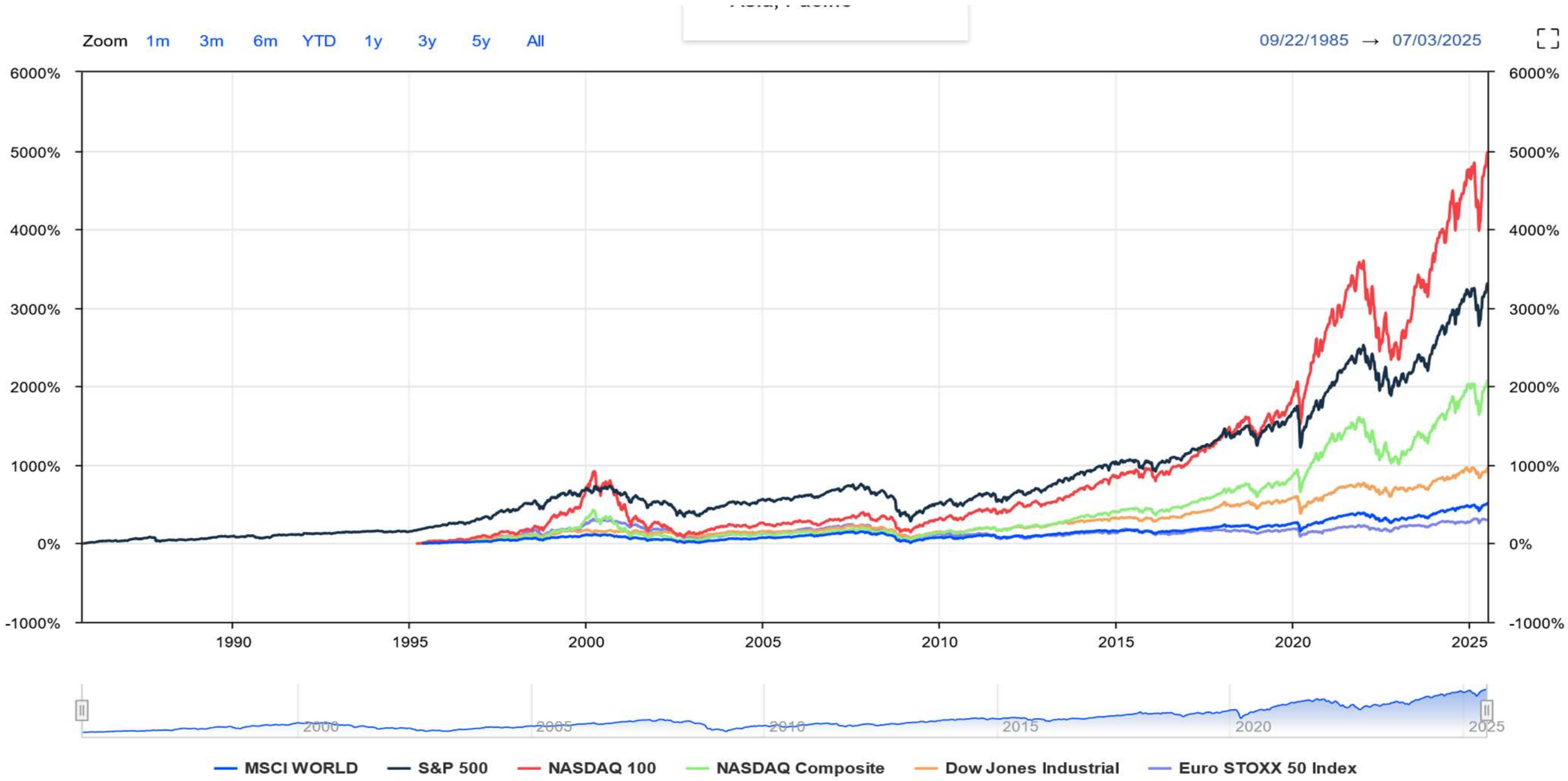
MSCI WORLD HEATMAP



Top 10: ~22,5%
Top 25:~32%
US: ~70%

Source: www.marketscreener.com

30-YEAR HORIZON



Source: www.marketscreener.com

WHY (MORE) CONCENTRATED INVESTING?

- Financially future-proof portfolio
  - Geopolitics/deglobalisation
  - (sustainability) transitions
- Long-term investing in line with liabilities: broad value creation
  - Long-term financial value creation is always intertwined with the direction of human development
  - That development direction is social/political, ("what do we want/what do we find acceptable or not"), ecological ("where are the limits of natural resources and the ecological system") and technological ("what can we do") driven
- Know what you own: understand and explain what you invest in, reduce reputational risk
- Socially responsible investing: from exclusions to inclusions, contributing to a better world
  - Integration of ESG with the aim of better risk-return profile
  - Preventing negative sustainability impact by avoiding sustainability underperforming companies (DNSH)
  - Stimulating sustainability by investing in sustainable companies and/or investing in companies in transition to (more) sustainability
  - Stewardship: deep stewardship is not possible with thousands of companies in portfolio
- A combination of the above drivers

TRANSITION

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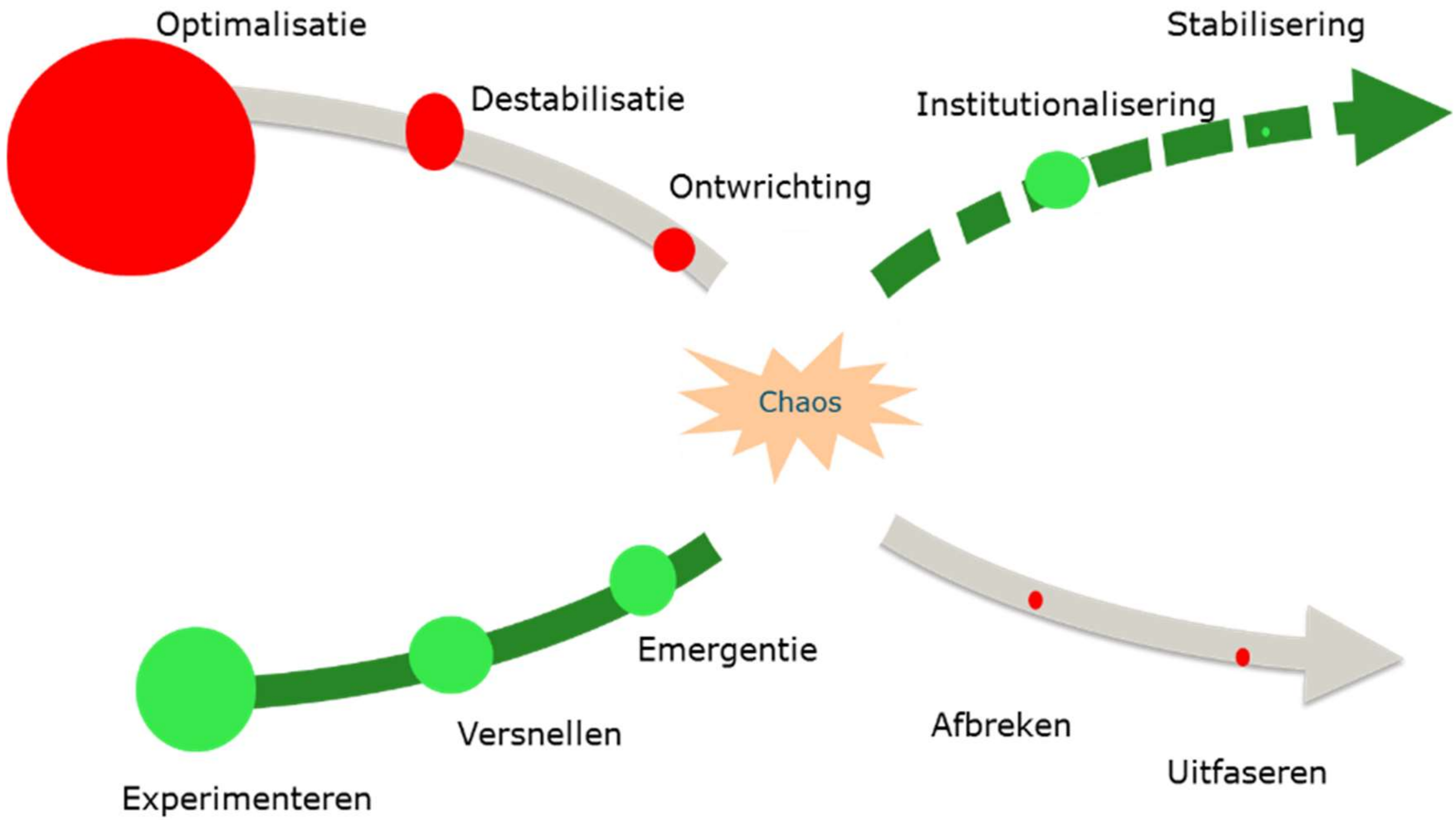
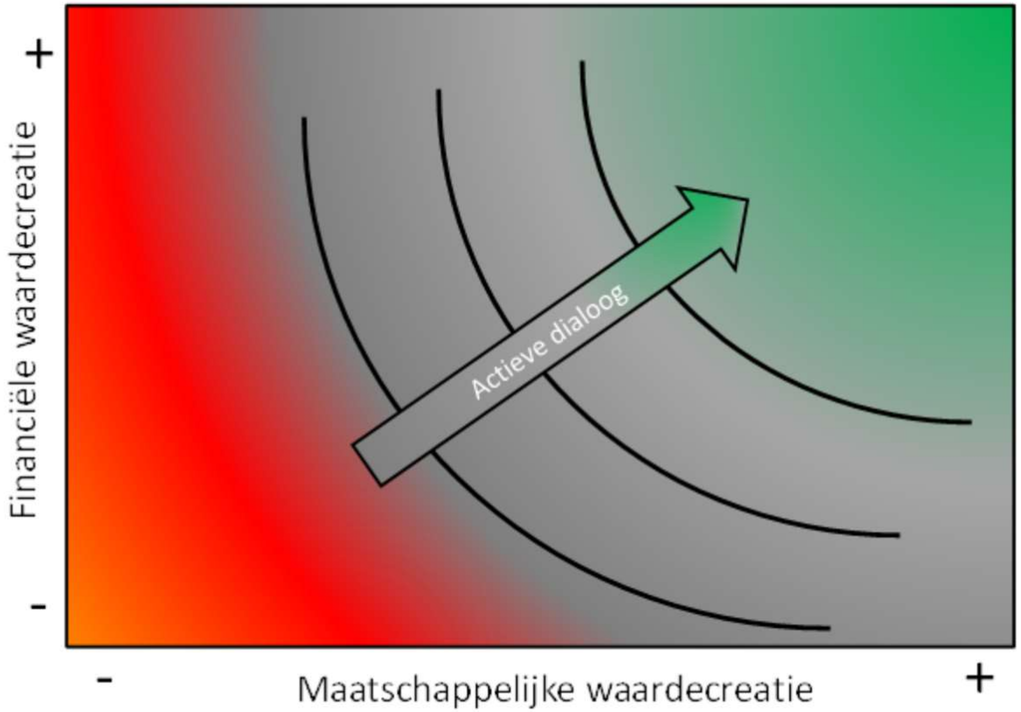


Brom: Loorback and Oxenaar (2018)

VALUE CREATION OF INVESTEE COMPANIES



SPIL WORKSHOP CONCENTRATED INVESTING, 2023

- Reasons for workshop: increasing number of pension funds are developing, or are interested in developing, more concentrated portfolios with a long-term focus. How to do this?
- Well-known examples: RailOV, PME, SPH, PNO, PostNL
- Working session pension trustees and investors:
  - what are the key principles?
  - how does portfolio construction take place in concrete terms?
  - how to integrate sustainability objectives?
  - how to effectively monitor and report?
  - how to remain a long-term investor?

HOW (MORE) CONCENTRATED INVESTING?

- Develop vision and objective for concentrated investing (CI)
  - Which return objective (relative, absolute, which horizon) and ESG/sustainability objective
  - First determine what you want to achieve, how you can manage it and then find the right instruments and *metrics*
- Walk through and ensure consistency in entire investment policy process (esp also on steps 4 and 5, overall governance and involving participants)
- Forms of implementation:
  - Internal/external/collaboration (importance of proximity/'partnering', cost, capacity)?
  - Core-statelite: passive overlay or hold TRS/options alongside CI?
  - One or multiple CI mandates (spread across styles/factors)?
  - Global or just Europe and/or US?
  - Buy and hold or active portfolio rotation?
  - With or without ESG/sustainability objectives and/or stewardship?
  - Diversification remains important: limits on sectors/regions/transitions, individual names, volatility, correlations

CI MONITORING, EVALUATION AND GOVERNANCE

- Continuous analysis required - on process, not just outcome
- Use absolute return and risk metrics, and possibly also relative metrics: e.g. on volatility, drawdown, required excess return over 10-year horizon
- Use real world metrics (such as GDP growth, CO_2 reduction, water savings)
- Split interim monitoring and evaluation
  - Report on a quarterly basis, at least once a year with pension board spread conversation (+ exception reporting)
  - Long-term evaluation (5-10 years) with board, with case discussions
- Do a pre-mortem:
  - What if returns are disappointing? Temporary bubbles?
  - What if preferences of participants change?
  - What if focus is lost or asset manager is taken over?
- Inform participants about vision, process and what to expect in terms of (relative) 'outliers'
- Actively involve directors through continuous education. Consistent vision necessary, also for new directors.

CONCLUSION

- Concentrated portfolios fit well into fiduciary mandate of pension funds
- Start with investment beliefs and vision of value creation process
- Then shift the conversation from 'why' to 'how’
  - Formulate clear goals and metrics
  - Redesign investment strategy iteratively: different implementation forms and 'concentrations' are possible
  - Compile your own metrics – avoid simple performance measurement against an index
  - Consider and design the the role of stewardship
  - Keep monitoring & evaluation separate
  - Embed in governance structure and continuous board involvement
  - Communicate proactively & ensure consistent process and narrative