

Low interest rates present a challenge

During 2019, Andra AP-fonden increased its strategic allocation to the rapidly growing market for green bonds. While contending with low interest rates, the Fund is also endeavouring to increase the exposure to sustainability within its other mandates.

“The central banks' bond purchases have reduced certain risk premiums”

The department for markets, exposure, currencies and fixed-income management handles the Fund's trading, hedges currency transactions and ensures that the actual allocations reflect the strategic portfolio adopted by the Board of Directors.

“Different assets give different returns at various times. To balance the effects of this in the portfolio, we adjust the net exposures with derivatives, such as different index futures for equities. This is far more cost effective than trading the underlying securities,” says Ole-Petter Langeland, Head of MEFIX.

The department also has three bond management mandates: one Swedish, one global and one green. In the Swedish and global mandates, there is focus on government bonds and organisations with high credit ratings, such as the European Investment Bank (EIB).

Flat yield curves

The economic development in developed countries, not least in Europe, with a succession of crises over several years – first the financial crisis and then the euro crisis – has resulted in a challenging position with a highly stimulative monetary policy.

“The central banks' bond purchases have reduced certain risk premiums and made yield curves much flatter than usual for low interest rates. This makes it more difficult to achieve returns, even by buying long maturities,” says Ole-Petter Langeland.

New sustainable bonds

While handling the low level of interest rates, the department is strongly focused on sustainability. Besides the increase in the Fund's strategic allocation to green bonds, there is also an ambition to increase the sustainable elements of the other mandates. The number of borrowers using the bond markets to finance sustainable projects outside the environmental sector is also increasing.

“There are now, for example, social bonds, equality bonds, and blue bonds to finance water projects. The bonds are often linked to the UN's Global Sustainable Development Goals. If the World Bank, for example, is borrowing, and we can choose between an ordinary bond and a sustainability bond, we will try to choose the sustainable bond,” says Ole-Petter Langeland.

Difficult valuation

For green bonds, there are reporting regulations that make it possible to quantify the positive environmental impact. For social bonds, this is more difficult. If the Spanish development bank ICO borrows funds to promote development in Andalusia, it will report on which projects were financed, with macroeconomic data for the region.

“But it's difficult to distinguish the projects effect from the general economic development in Spain. Follow-up is therefore not as profound and quantitative as for green bonds, but we still think that this is a better way of using the funds, provided that we get the same return,” says Ole-Petter Langeland.