Portfolios for long term investors: Norwegian Sovereign Wealth fund

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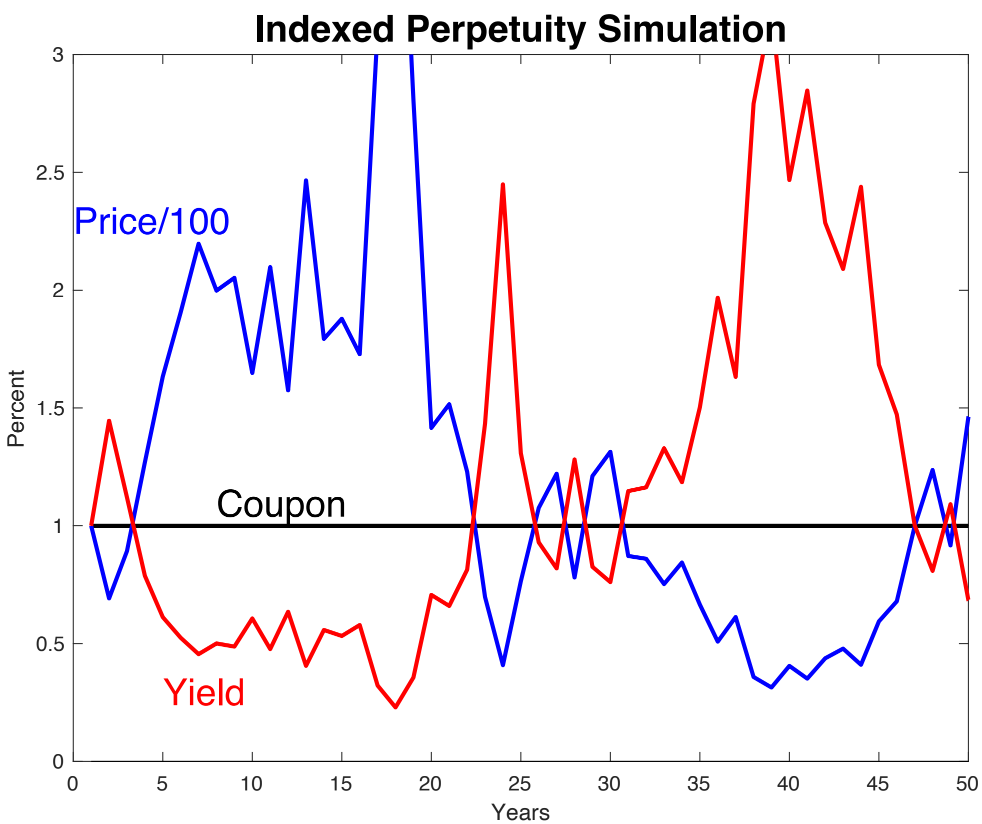
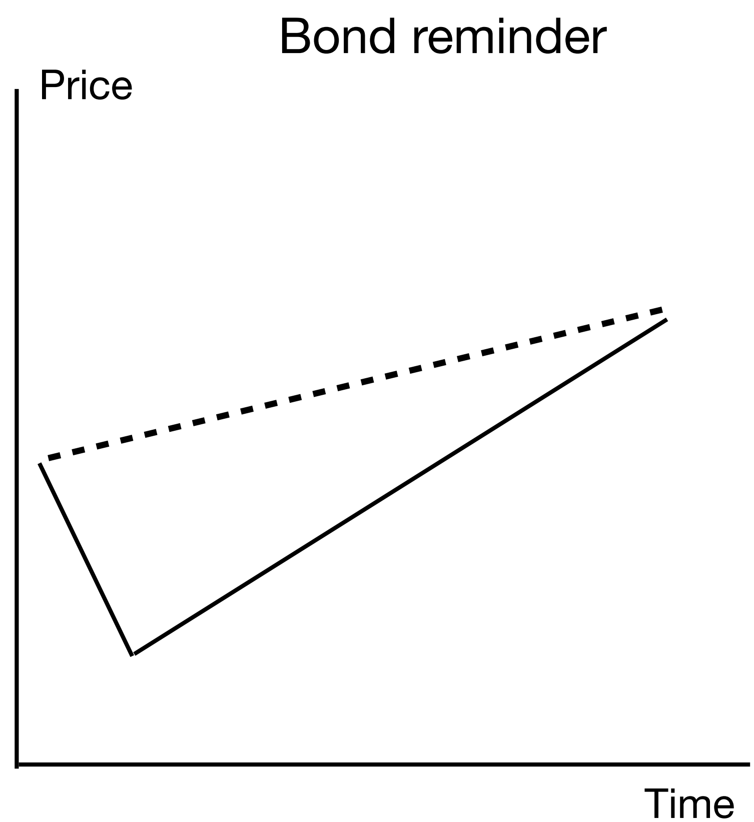
The parable of the indexed perpetuity

The optimal portfolio/payout for a long-term risk averse investor is:

- Hold indexed perpetuities, consume the coupons.
- Ignore price/portfolio value.

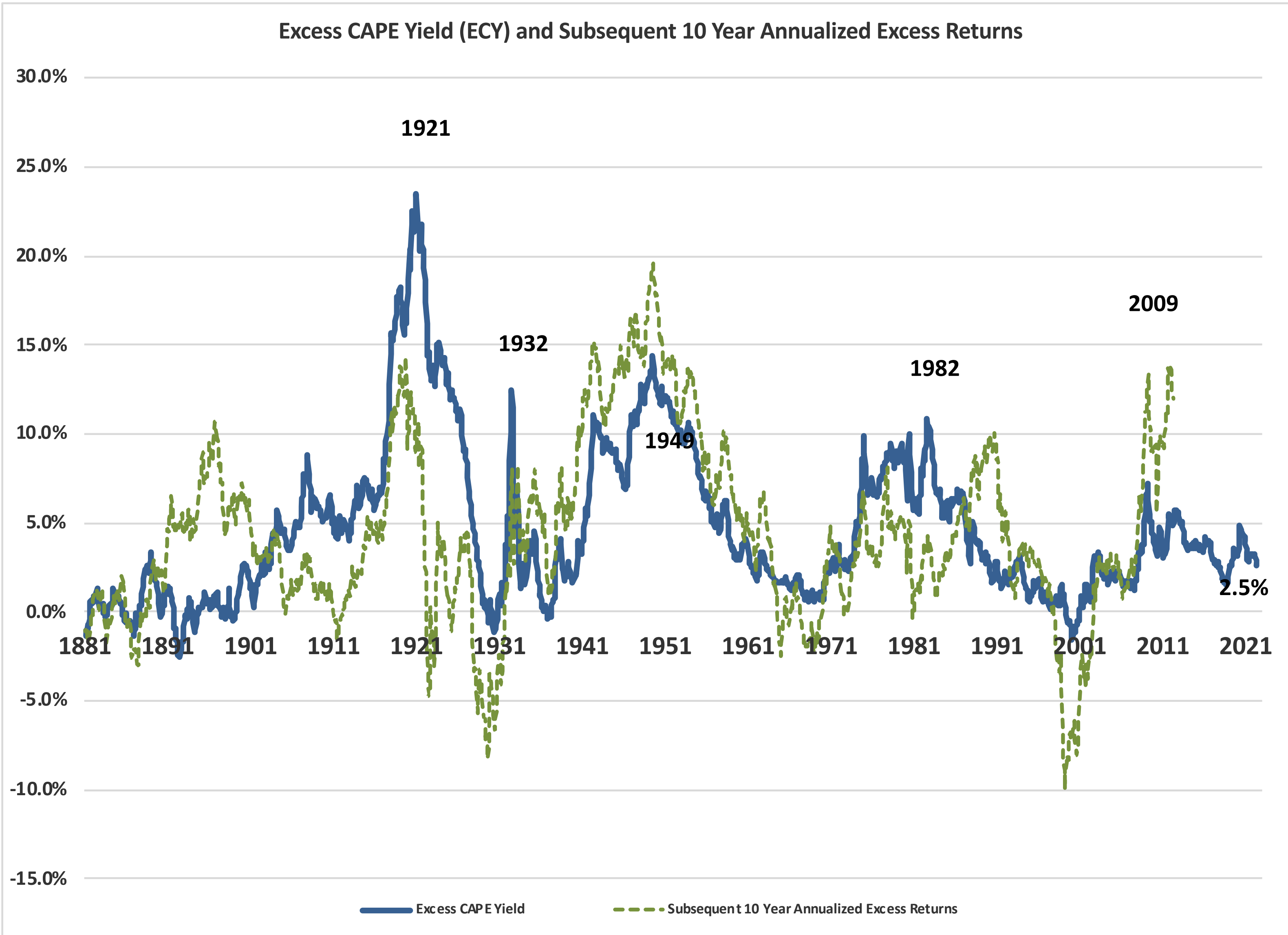
Lesson: Think about payoffs not one period returns.





Stocks are a bit like bonds

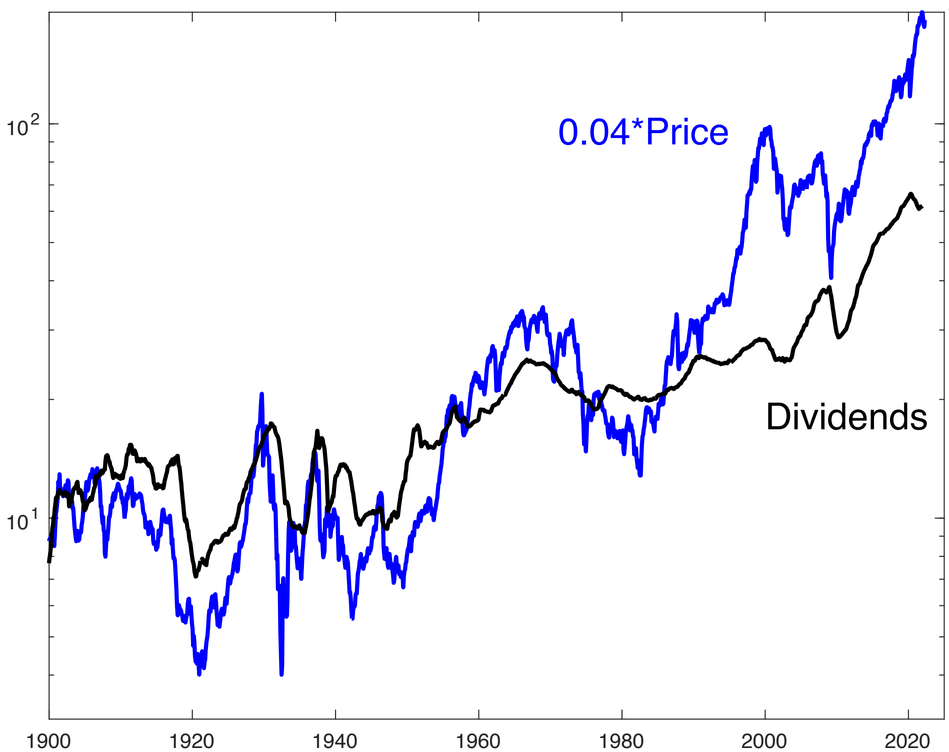
High price/dividend or earnings signals low returns, not higher dividends/earnings



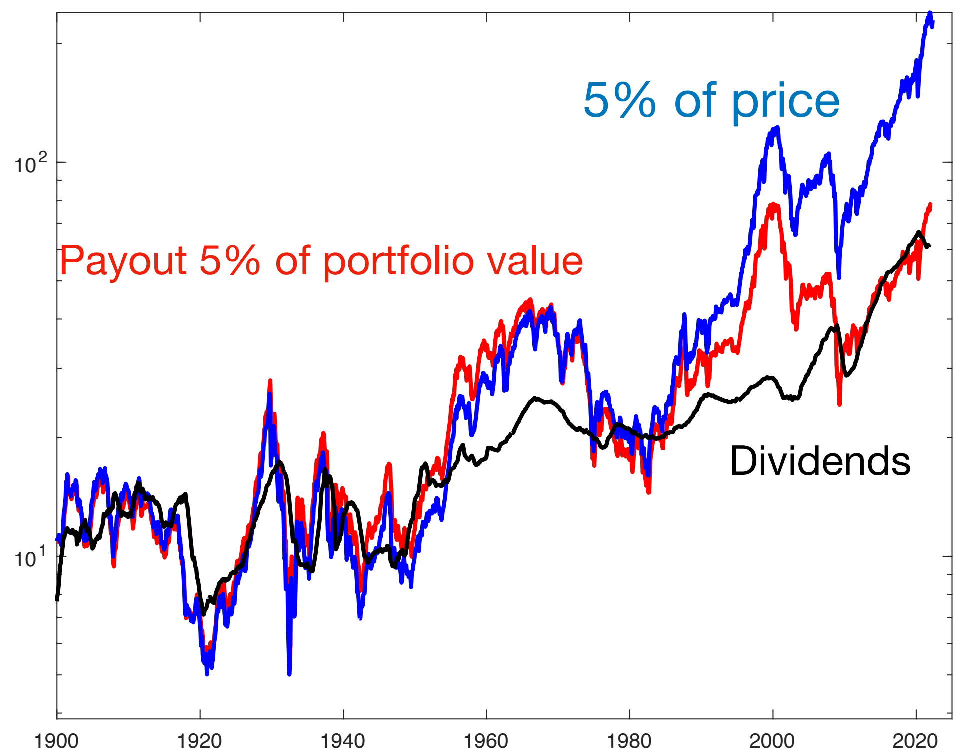
Source: Robert Shiller website

Paying out (consuming) dividends gives a smoother stream

Price and dividend is a bit like bond price and coupon

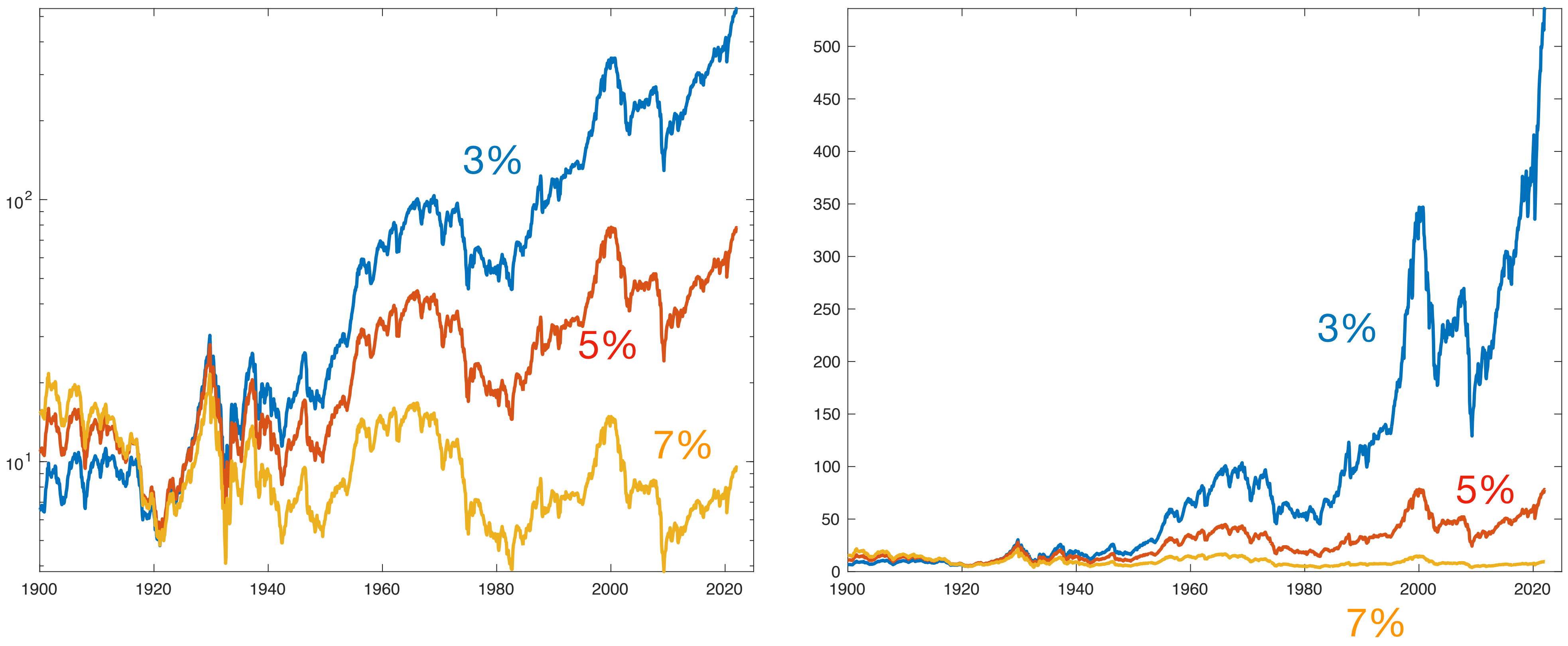


Simulation: Pay 5% of portfolio



- Shiller: "Buy stocks for the dividends" (properly measured).
- Practicalities: Dividends? Earnings? Repurchases? Payout more/less?
- But: Selling low/buying high.
- Market timing is more ephemeral than long run investing.
- Explain this? Smoothed value rules.

After 20 years, higher payouts mean much lower value.
(But if growth continues, they'll be far wealthier anyway).

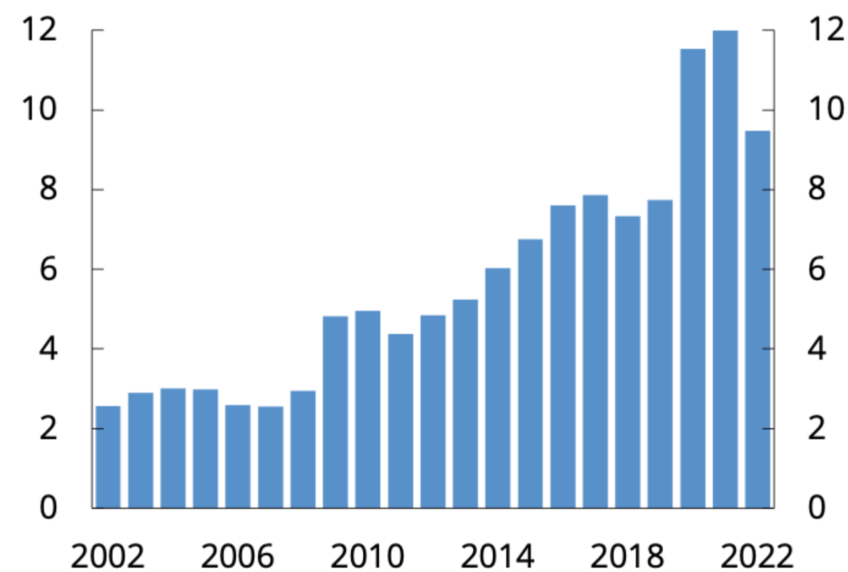


More portfolios for long term investors considerations

- *The average investor holds the market portfolio*. Without rebalancing. Any deviation is a financial zero sum game. If you are buying someone is selling. Why? Placebo / dinner with lions test.
- How are you different from average? What is your function in the market? A view of the world in which it makes sense for you to buy, other to sell.
- Smarter?

- Different liability/outside risk stream.
  1. Hedge outside income. Oil.
  2. Covid: larger payouts. When markets down! University endowments.
  3. Norway budget: large structural deficit financed by fund. Borrow, tax, or sell?
  4. To take asset market risk there must be a liability stream that can take risk. Dividends = overall economic growth. Which kinds of spending?

A. Structural non-oil fiscal deficit. Per cent of trend GDP for mainland Norway



- "Write insurance." Really?
- Don't pay for liquidity, trading value. Value tilt (but not duration)? Institutional finance, provide liquidity?
- Time to rethink basic purpose of the fund?