

# **INSTITUTE AND FACULTY OF ACTUARIES**

## **EXAMINATION**

23 September 2021 (am)

**Subject SA7 – Investment and Finance**

**Specialist Advanced**

Time allowed: Three hours and twenty minutes

<p>In addition to this paper you should have available the 2002 edition of the Formulae and Tables and your own electronic calculator.</p>
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If you encounter any issues during the examination please contact the Assessment Team on  
T. 0044 (0) 1865 268 873.

**1** Following a pandemic, a country's central bank has significantly increased its existing Quantitative Easing (QE) programme to re-inflate the economy. At the same time, it has loosened a policy of targeting an inflation rate of 2% p.a. and replaced it with an average inflation rate target where it will only react to average inflation increasing over a period of years.

- (i) Describe how effective these policy changes will be for improving economic growth. [6]
- (ii) Discuss how these changes could increase inequality within the country. [6]
- (iii) Describe the impact on fixed income markets and inflation. [5]
- (iv) Suggest the combined political and economic impact of the pandemic and the QE programme. [4]

[Total 21]

2

Sech is a specialist asset manager that is in the process of creating a new fund, Fund M, which will invest in a portfolio of 'social impact assets'. These are private market assets that are expected to have significant positive social impact. Sech's research team has completed a report on these assets. The report identified that most investors in these assets fall into one of the following two types:

- **return seekers:** investors who seek to maximise returns regardless of the projects being funded
- **impact maximisers:** investors who seek to maximise Environmental, Social and Governance (ESG) impact subject to a minimum level of return.

- (i) (a) State two examples of each investor type described above. [4]
- (b) Give a reason for each of the investor types to invest in social impact assets.
- (ii) Outline, for both investor types described above, the advantages and disadvantages of investing in Fund M. [5]

The research report concluded that the returns achieved by investing in social impact assets were highly dependent on two key elements: a) the asset class, and b) the nature of the positive ESG impact. Risk-adjusted returns for these assets also showed a large range of outcomes compared to risk-adjusted returns for traditional asset classes.

- (iii) Explain why the two elements above affect the returns achievable for social impact assets. [5]
- (iv) Explain why social impact assets may show the following when compared to traditional assets:
- (a) Higher returns
- (b) Materially different risk-adjusted returns. [9]

Sech's Marketing Director has proposed to include Fund M in the investable universe of multi-asset funds marketed by brokers, and to measure Fund M's performance against this universe of funds.

- (v) Outline the reasons why investors may prefer multi-asset funds, instead of using a balanced asset allocation approach to achieve specific investment goals. [5]

Sech's Chief Investment Officer (CIO) has made the following response to this proposal:

'Fund M is not a typical multi-asset fund and marketing it as such, as well as performing direct comparisons against other multi-asset funds, is not appropriate and does not meet investor needs'.

- (vi) Explain the CIO's response. [8]
- [Total 36]

- 3 (i) Discuss why investment psychology is important. [2]

In a developed economy, the stock market index has increased by 100% in the previous 6 months. When asked to comment on this return, an Investment Manager said 'it is a bubble' and then refrained from further comment.

- (ii) Explain the Investment Manager's response, with reference to a psychological perspective on this narrative using concepts such as *Nous* and *Logos*. [8]

In the months before a recent financial crisis in the country, the Investment Manager had been selling short the stock market during the latter stages of the boom that preceded the crisis, because they considered it to be a bubble. Their performance was very weak relative to other managers during the boom, and was marginally better than other managers during the crisis as markets sold off aggressively. The Investment Manager commented that they were glad to have stuck to their convictions because they were right all along and will again be right this time.

- (iii) Comment on the Investment Manager's response, with reference to a psychological perspective on their narrative using concepts such as *Nous* and *Logos*. [8]

[Total 18]

- 4 An Investment Consultant is working on a private credit manager selection exercise for a pension fund. The Chief Investment Officer of the pension fund has asked the consultant to include two managers who are not currently included in their manager research database. The managers have provided the following information:

	<i>Manager A</i>	<i>Manager B</i>
Ownership	Joint venture between two banks	Private partnership
Manager created	2017, through the merger of two existing managers that have existed since the 1970s	1997, formed by three founders who are still partners today
Total staff	3,000	250
Decision making	Lead Portfolio Manager	Investment Committee
Remuneration	Salary plus annual bonus	Salary plus share of profits
Assets under management	€400bn	£30bn
Back office	In house	Outsourced

- (i) Comment on the likely differences in culture between the two managers, A and B. [7]
- (ii) List TWELVE areas you would want additional information on, specifically in relation to the managers' private credit product and team. [6]

As a separate exercise, the CIO is conducting a review of how investment analysis is carried out by each of the pension fund's asset managers. The review will be carried out in two distinct parts, reviewing both the objective elements and the subjective elements of the investment decisions, and a similar approach will be used across all asset classes.

- (iii) Set out the factors that should be considered in the review of the investment analysis of:
  - (a) the objective elements, e.g. skillsets, competencies and processes.
  - (b) the subjective elements, e.g. different types of qualitative analyses.

[12]

[Total 25]

**END OF PAPER**