

The Star - How The EPF Stacks Up Against Other Funds

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BY almost any measure, the returns delivered by the Employees Provident Fund's (EPF) investment managers over the past decade would be considered as "supernormal" – or profits that consistently exceed initial, conservative expectations.

Last week, Malaysian research outfit IQI Holdings estimated that the average annual return for sovereign wealth funds (SWFs) globally last year was 4.2%. This essentially means that despite reporting a lower yield of 5.7% for 2016, the EPF has trumped the global average by a wide margin, said IQI's chief economist and investment strategist Shan Saeed to *Bernama*.

But it is worth noting that typically, with strong asset growth comes lower yields. In numerical terms, the EPF now needs to generate an income of RM6.5bil just to pay a 1% dividend rate, or triple the amount required a decade ago.

It is also worth considering the sheer scale of the EPF's growing investment assets relative to the size of Malaysia's capital markets and investable instruments.

For example, the total market capitalisation of stocks listed on Bursa Malaysia had remained steady at between RM1.65 trillion and RM1.7 trillion between 2013 and 2016. Over the same period, the EPF's investment assets grew by RM141bil from a combination of new deposits as well as income growth.

With more than RM30bil in fresh funds coming in every year to be invested somewhere, the fund has to somehow find a way to sustain its historical yields of above 5% in each of the past eight years.

Last week, during the EPF's full-year earnings presentation, its chief executive officer Datuk Shahril Ridza Ridzuan told reporters that the fund is keen on growing its exposure in other asset classes, as well as increasing its equity investments overseas.

"As with major asset managers globally, the current trend is to invest in illiquid assets with inherent value appreciation prospects

and an assured cash-flow generation. This is why the EPF, as well as sovereign funds such as Singapore's GIC, are actively seeking new opportunities globally in prime office space, utilities and logistics, among others," says one fund manager.

As at last year, 42% of the EPF's assets were invested in equities, which provide returns in terms of both capital appreciation and dividends. The largest portion of 51% is invested in fixed income – mostly in Malaysian government issuances – which offer a predictable rate of return and ensures that its invested capital is preserved.

The disparity becomes clearer after taking into account the fund's current total investment assets of RM731.11bil as at last year, which makes up about 42% of the market cap of all stocks on the Malaysian exchange and 70% of the total market cap of the component stocks in the FBM KLCI index.

The EPF is targeting a return of at least 2.5% nominal dividends on a yearly basis, and at least 2% real dividends on a rolling three-year basis. The fund has consistently outperformed this benchmark, with its rolling three-year dividend at 3.83%, or 183 basis points above the target.

On the other hand, its rolling three-year dividend stood at 4.05% in 2015 and 4.11% in 2014. This suggests that the fund's overall dividend-generation capability is diminishing due to a mix of a growing asset base, as well as the weak performance of local equities in recent years.

This begs the question: How has the EPF fared relative to its peers in the investing world?

In a reply to *StarBizWeek*, the fund says that the emphasis of its investment approach is first and foremost on ensuring the retirement well-being of its 6.83 million active and contributing members.

"The comparison of the performance between the EPF and that of other funds is not based on an 'apple-to-apple' comparison due to the differences in objectives, strategies, asset allocation and investment risk tolerance. The fund's strategies must be prudent, with

greater emphasis on preserving capital and providing long-term returns," it said.

Nevertheless, based on its asset base and income performance, the EPF seems to deliver the best returns among the balanced funds in Malaysia, which tend to invest in a mix of equities with debt and other asset classes.

The flagship Amanah Saham Bumiputera (ASB) scheme, which has total units of 144 billion priced at RM1 each, announced an income distribution of 7.25% for 2016. The smaller Amanah Saham Malaysia (ASM) scheme with 16.3 billion units on offer distributed a dividend of 6.3% for the same year.

Both the ASB and ASM schemes benchmark their investment performance to the three-month Kuala Lumpur Interbank Offered Rate (Klibor), which is the average interest rate in which term deposits are offered between prime banks.

The three-month Klibor stood at 3.43% as at Feb 24.

Given the EPF's massive investment assets, which equate to around US\$164bil, a fairer comparison may be made with global SWFs, which manage similar amounts or more.

GIC, which invests Singapore's Government reserves, reported an annualised 20-year real rate of return of 4% last year. The fund has investment assets of an estimated US\$350bil, according to data by the Sovereign Wealth Fund Institute.

Meanwhile, Norway's sovereign fund, the largest in the world with some US\$890bil in assets, delivered an annualised 5.8% return from 1998 to 2015 in dollar terms.

While this seems to prove that it is possible to achieve high yields despite holding assets worth hundreds of billions of dollars, SWFs and provident funds such as the EPF currently operate in an environment with excess liquidity, high volatility and uncertain economic headwinds.

As such, maintaining their historical returns will no doubt be a considerable challenge, as funds globally may be faced with an ever larger cash pile and lesser avenues to invest them in.