



# Strategic Asset Allocation

## Introduction

This section integrates net zero objectives into the asset allocation process, complementing traditional risk/return objectives.

Together with 'Governance and Strategy' and 'Objectives and Targets', it forms part of NZIF's lever of 'Setting internal direction and portfolio structure for alignment'.

Some recommended actions will be less relevant for asset managers not undertaking asset allocation for clients; but relevance can still exist for those involved in similar activities (e.g., portfolio optimisation).

Judgement is necessary to ensure portfolios are not over-exposed to specific risk factors and are well-diversified across regions, technologies, sectors, and not over-exposed to policy uncertainties.

## Core action points

NZIF recommends the following actions for investors using the framework and considers them core:

- ✓ Undertake scenario analysis to update capital market assumptions, asset-level risk/return expectations, and stress test portfolios.<sup>34</sup>
- ✓ Supplement standard financial objectives with portfolio-level net zero objectives.
- ✓ Update investment benchmarks, when possible and relevant, to ensure that climate-related objectives are specified in sufficient detail and performance objectives are clearly defined.
- ✓ Integrate net zero objectives into portfolio construction alongside standard indicators. Additional alignment objectives should ideally cover both decarbonisation and climate solutions.

## Advanced action points

NZIF recommends the following advanced actions. These may initially be difficult when beginning to update strategic asset allocation (when attention is likely to be placed on implementing core action points), but would likely prove beneficial over the long term:

- ✓ Consider different asset classes and investments when constructing portfolios, as well as the importance of primary issuances of corporate bonds given the role these have in driving real economy decarbonisation.
  - ✓ Integrate forward-looking non-financial climate metrics into asset valuation approaches.
  - ✓ Specify asset class variants using systematic approaches to increase climate solutions exposure (including nature-based solutions) and reduce carbon intensity (e.g., custom benchmarks, climate-tilted indices, climate-focused variants).
  - ✓ Review constraints to achieving alignment within the context of portfolio optimisation to understand if they are strictly necessary.
- ✓ Monitor achievement of alignment objectives, including portfolio carbon intensity and allocation to climate solutions.
  - ✓ Supplement standard financial objectives with material forward-looking non-financial metrics capturing some dimensions of alignment, such as:
    - Exposure to fossil fuel production or reserves.<sup>35</sup>
    - Percentage of material corporates within portfolio with methane emissions reduction commitments.<sup>36</sup>
    - Percentage of portfolio with net zero science-based targets.
    - Aggregate management indicators score.
    - Level of capex relating to relevant taxonomies.
    - Proportion of portfolio companies with clean energy commitments.
    - Percentage of corporates within portfolio with material deforestation related commitments to halt commodity driven deforestation and habitat conversion within their entire operations and supply base.<sup>37</sup>