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Five Questions Hospital and Healthcare Fiduciaries Should Ask

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Political uncertainty dominates the investment outlook as markets adjust to the new realities of Brexit and President Trump.

The search for returns is not getting any easier against a backdrop of record high U.S. equity prices, narrow credit spreads and low bond yields. Russell Investments expects more fiscal stimulus, more inflation pressures, and a total of two Fed rate increases this year. Hospitals and healthcare systems need to account for potentially higher borrowing costs and lower investment returns as they also consider the impact of what a changing political and policy landscape means to them.

With this environment in mind, we've created a list of the top five investment questions hospital and healthcare fiduciaries should be asking themselves.

1. Does the asset allocation strategy for each of your investment pools support the financial strategy of the entire enterprise?

Right now, healthcare systems are grappling with significant industry changes, such as the changing payer mix, infrastructure investments for electronic medical records and mergers and acquisitions. This often leaves very little time for busy CFOs to focus on their investment pools. Today's markets are volatile, and we may be late in the recovery cycle, which means now is not the time to put your investments on autopilot. Consider looking at your aggregate risk exposures, as well as the exposures within each individual investment pool. This will help in affirming that all investments are aligned with your organization's needs, allow you to diversify risk and return sources across your investment program, and better ensure that the investment strategy for each pool is appropriate for its objectives.

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2. What is your exposure to interest rate risk?

Rising interest rates impact your pension plan liabilities, the cost of debt and the returns earned on any long-term investments. If your pension plan is underfunded, rising rates may help improve funded status. Even though asset values (especially fixed-income assets) tend to fall in a rising rate environment, liability values tend to fall faster. In addition, the cost of debt issuance may rise, increasing the overall cost of borrowing for capital improvements or merger and acquisition activity. Keep in mind, too, that for funded status to improve, it's not enough for rates to rise. Rates need to rise more than the market has already priced in. That's why, historically, a bet on rising rates has been a losing bet more often than a winning one.

3. Do you have an extreme home country bias in your equity portfolio?

Although U.S. equity markets have done incredibly well for the past few years, U.S. equities are relatively expensive, and their profit growth may be, at best, in the mid-single digits in 2017. We believe that now is a good time for investors to think about adding geographic diversity to their portfolios in search of returns. Both Japan and Europe currently have better value, less political uncertainty and central banks that are likely to continue with supportive policies. Emerging markets are a bit more nuanced, as valuation across these economies remains attractive. However, they really need robust global growth without an aggressive Fed or strong U.S. dollar to do well. When shifting to a more market-neutral allocation within an equity portfolio, keep in mind the impact of currency on those shifts.

4. Are there return sources missing from your investment mix?

Many healthcare systems are conservatively invested. There is a heavy reliance on liability matching fixed income in pension plans, and a significant allocation to low risk, liquid assets in operating and insurance pools. In this volatile return environment, we believe that a diverse array of return sources is needed to continue to meet return objectives while minimizing risk. Consider taking a close look at your asset mix to see if there are additional return sources that could help improve the risk adjusted returns of your portfolio.

5. Does your investment policy statement and portfolio implementation structure allow for dynamic management?

The combination of low expected long term returns with market volatility means that investors may want to use that volatility in their favor. You can do this by incorporating investment strategies that may offer incremental returns, not taking uncompensated risks and ensuring that the investment portfolio is implemented efficiently. Taking advantage of volatility means that your investment policy statement (IPS), investment committee and service providers should be aligned with this effort. 2017 is a great time to have those conversations, to adjust your governing documents to allow for dynamic management and to ensure your team has the right skills and resources to implement your portfolio effectively. ■

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