Japan’s public pension fund, the world’s largest, will start investing in emerging market stocks as early as this quarter as it seeks to diversify assets and cover rising payouts.

The Government Pension Investment Fund, which oversees 108 trillion yen ($1.3 trillion), has decided on the managers who will handle the investments and is now in the process of setting up accounts in prospective markets, said Takahiro Mitani, president of the fund, known as GPIF. He declined to name the managers until investments are actually made or disclose the amount of the allocations.

“We expect to start investing in emerging market stocks by the end of this quarter or the beginning of the next quarter,” Mitani, 63, said in an interview in Tokyo today. “Because the markets are less liquid than the developed ones, we’ll likely begin with a small amount and then decide on whether to buy more depending on how it goes.”

The investments will be focused on markets included in the MSCI Emerging Markets Index (MXEF), which tracks 21 countries including Brazil, Russia, India, China, South Korea, Taiwan and South Africa, Mitani said. The gauge has gained 13 percent this year compared with an 8.6 percent increase in the MSCI World Index (MXWO) of developed stocks.

Higher Hurdle

GPIF doesn’t plan to begin investing in alternative assets such as hedge funds and real estate “any time soon,” Mitani said, citing AIJ Investment Advisors Co.’s incident where the Tokyo-based asset manager lost pension clients’ money.

“AIJ’s incident pushed the hurdle a bit higher for us to consider alternative investments,” said Mitani. “We can’t invest unless we know what exactly the investments are.”

GPIF, historically one of the biggest buyers of Japanese debt, held 72.8 trillion yen in domestic bonds, or 67 percent of its assets as of December, according to the fund’s latest quarterly financial statement. That compares with 12 trillion yen in Japanese stocks, or 11 percent, 9.1 trillion yen, or 8.4 percent, in foreign bonds and 10.9 trillion yen, or 10 percent, in overseas stocks, the report shows. The fund had a 0.58 percent return in the three months ended Dec. 31.

GPIF needs to raise about 8.87 trillion yen for payments this fiscal year, Mitani said, adding that it plans to sell assets, without elaborating. Payments are increasing as the first of Japan’s baby boomers are set to turn 65 in 2012, becoming eligible for pensions.

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