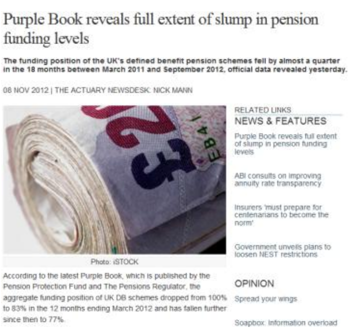
The Actuarial Profession
making financial sense of the future

Momentum Conference 2012
John Dewey, Managing Director, BlackRock

Investment
Tools, Techniques and Hot Topics

3 December 2012

A challenging environment for investors



Purple Book reveals full extent of slump in pension funding levels

The funding position of the UK's defined benefit pension schemes fell by almost a quarter in the 18 months between March 2011 and September 2012, official data revealed yesterday.

08 NOV 2012 | THE ACTUARY NEWSDESK: NICK MANN

Photo: iSTOCK

According to the latest Purple Book, which is published by the Pension Protection Fund and The Pensions Regulator, the aggregate funding position of UK DB schemes dropped from 100% to 83% in the 12 months ending March 2012 and has fallen further since then to 77%.

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Pensions need some 'regulatory relief'
Mark Cobley
08 Nov 2012

Insurers and pension funds in Europe are being held back from shifting their portfolios into higher-risk, higher-return investments by a gathering wave of post-crisis regulation, according to a report from consultants Greenwich Associates. Separately, another survey found that UK pension funds are continuing to reduce equity allocations.

Greenwich's report covered 663 institutional investors in Europe outside the UK, who were interviewed between March and May this year. It found the majority of them were "coming under increasing pressure", thanks to historically low interest-rates and the eurozone sovereign debt crisis.

With portfolios dominated by bonds, often domestic or eurozone government bonds, these investors have been hit hard. Greenwich picked out the examples of Belgium,

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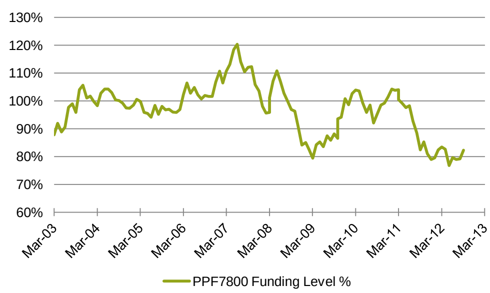
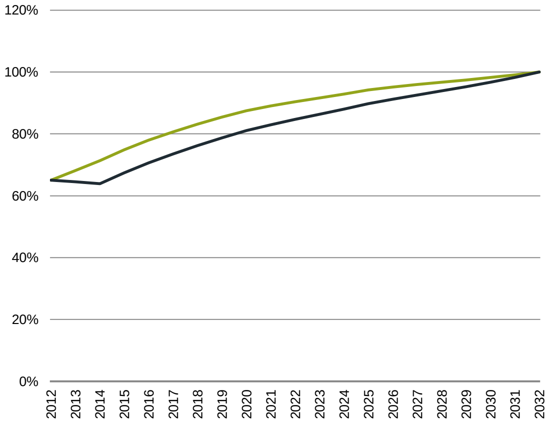


Source: The Actuary, Financial News, BlackRock, PPF

Why and how should a strategy evolve?

An evolving problem

- Assume you are targeting the correct return
- Does not go to plan – zero return
- What is the new required rate?
- – Implies higher risk, increased contributions, or extending the period to full funding.



Source: BlackRock/Bloomberg

2

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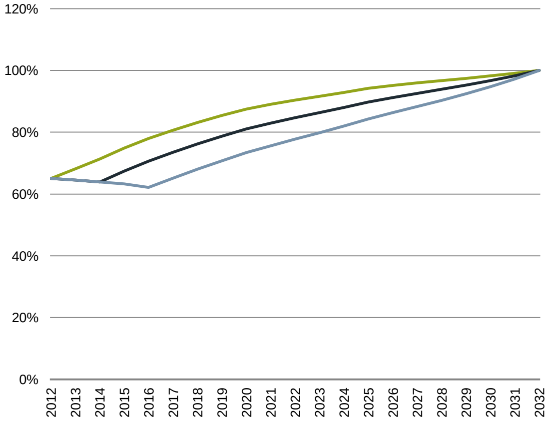

Source: BlackRock/Bloomberg

3

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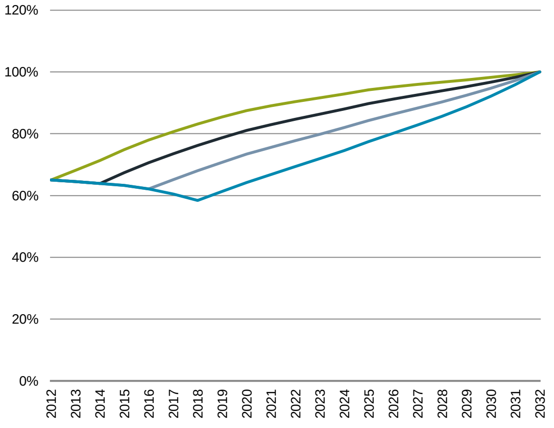

Source: BlackRock/Bloomberg

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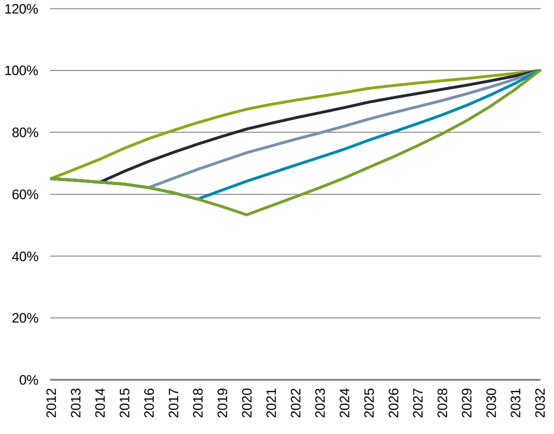


Source: BlackRock/Bloomberg

Why and how should a strategy evolve?

Cashflow profile

- For every year of zero return, the required rate of return increases
- This is due to reduced time as well as increasing size of liabilities
- Losses now disproportionally affect the required returns in subsequent years

Small problems can snowball

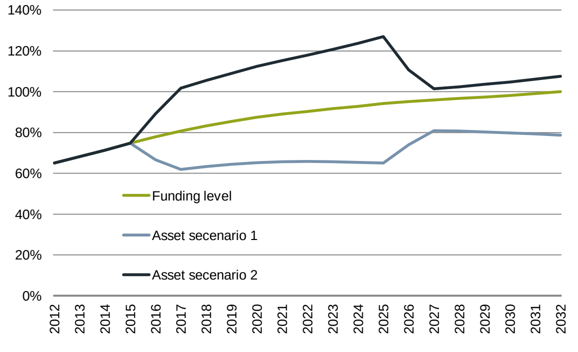
Source: BlackRock/Bloomberg

6

Why and how should a strategy evolve?

Cashflow profile

- Portfolio has two bad years (scenario 1), 15% below expected return, and 10% below expected return (years 4 and 5)
- This reverses in years 14 and 15, but Plan will not get back to full funding
- Reverse of the above example (scenario 2), now achieve full funding very quickly.
- How does a deficit feel compared with a surplus?
- How should a surplus or deficit change your view or approach?

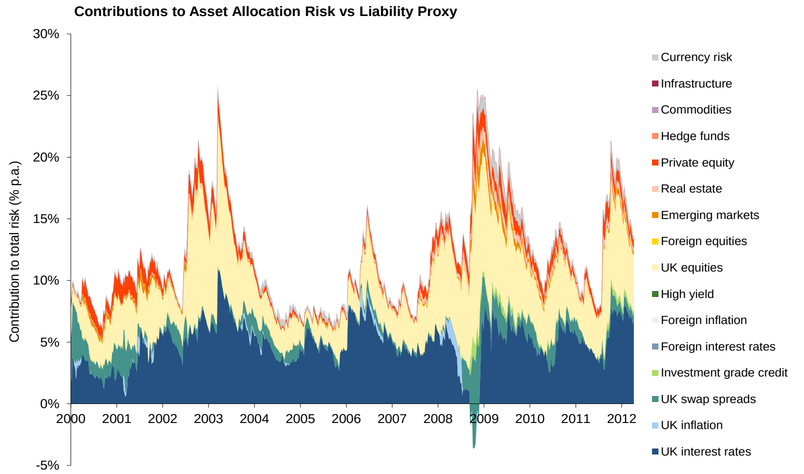


Kicking the can down the road may be dangerous

Source: BlackRock/Bloomberg

7

Volatility: threat or opportunity?

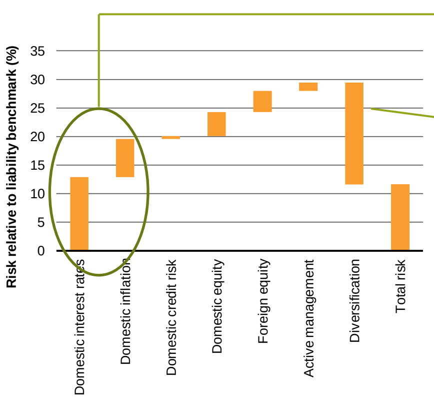


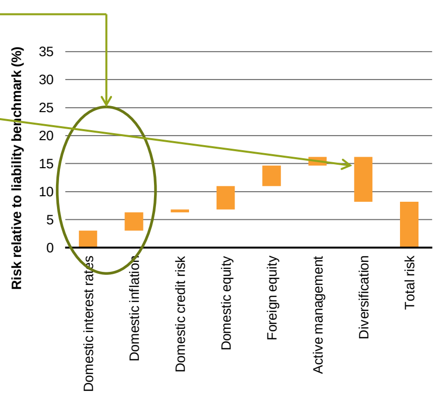
Source: Blackrock, Thomson Financial - Datastream (DJ UBS, FTSE Actuaries, FTSE EPRA/NAREIT, HFRI, HFRX, JP Morgan, MSCI, S&P, UBS) , Bloomberg (BofA Merrill Lynch)
Note: Contributions to risk are based on rolling 104 weeks of index return data with an 8 week half life; Proxies are used where the relevant asset data is unavailable

8

Opportunistic risk management

- Monitor funding level and adjust asset allocation as funding level triggers are achieved





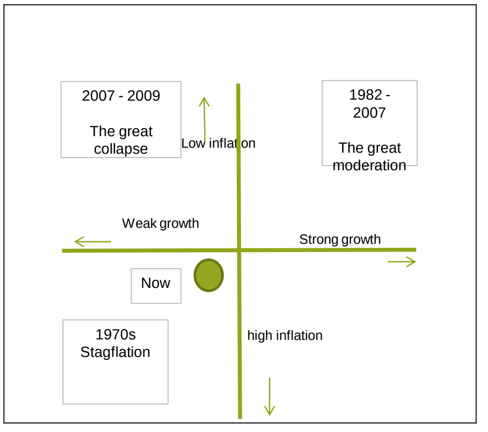
Source: BlackRock

9

The very big picture – the theme of our time

- There have been multi-year themes in the global economy
- These themes have had a profound impact on market returns
- We are struggling to define a new theme for our times

Regime Shifts In Financial Markets



Source: BlackRock

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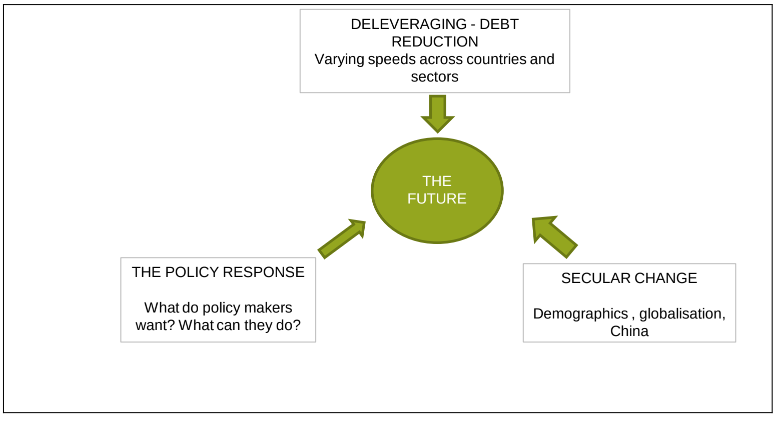
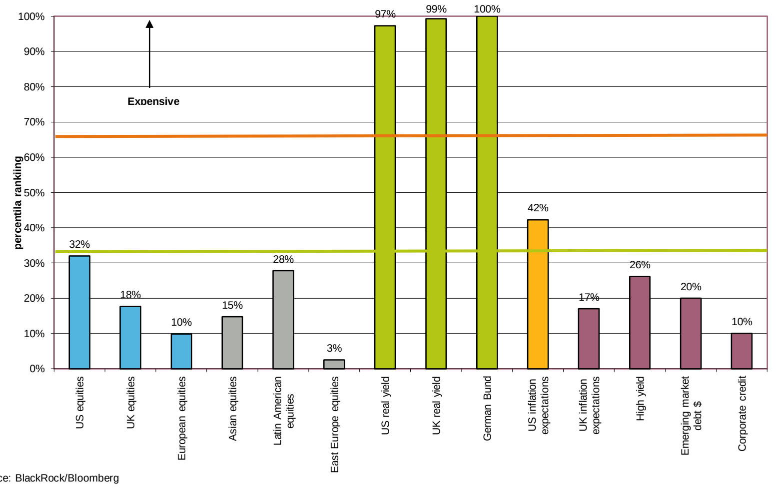
Multiple themes suggest a more complex and fragmented world



Source: BlackRock

11

Market valuation rankings (relative to own history)



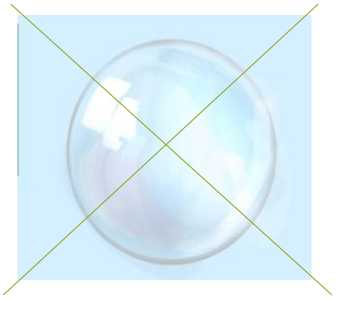
Source: BlackRock/Bloomberg

12

Government bond yields?

- Why are government bond yields so low?
- Dysfunctional economic environment – central banks have delivered low real rates
- Most likely catalyst for a bond bear market is higher policy rates - requires genuine cyclical recovery
- A good strategy must have more than a simple duration bet

Not a bond bubble



13

High risk premia or value traps? Digging into some themes

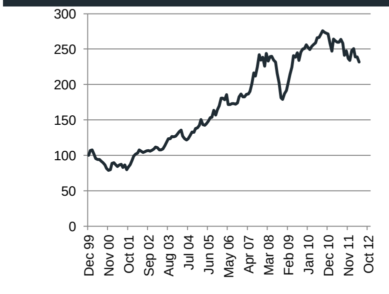
Lower risk	Strong corporate balance sheets	Corporate credit Financials credit High yield Higher yielding equities
Higher risk	Emerging market growth	Emerging market currencies – local currency debt Emerging market dollar debt Global equities
Short-term Risk Diversification	Bonds and equity inverse return correlation	Fixed income UK Property
Long term Return Diversification	Diversification from corporate sector performance	Oil, food, gold

Emerging equities - part of the solution not THE solution

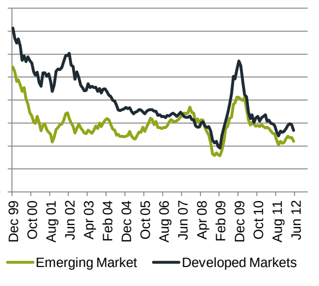
Why no outperformance from emerging equities?

- Valuations converge
- Greater integration into global equities

Outperformance of emerging Markets over developed markets



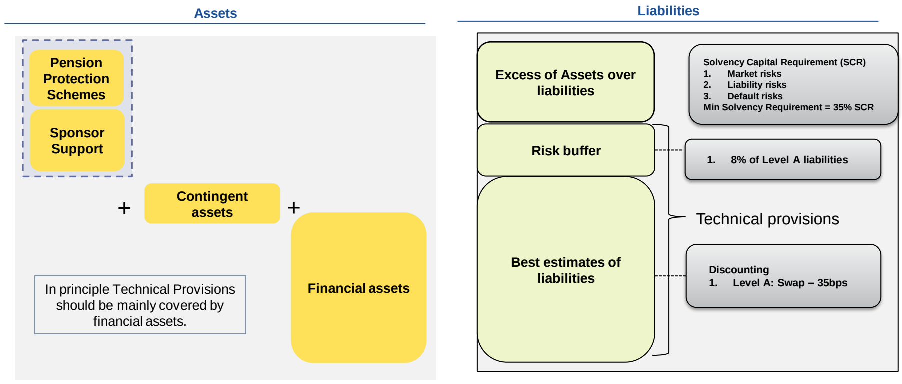
PE Multiples on Developed and Emerging Equities



Source: BlackRock/Bloomberg

IORP Directive and the holistic balance sheet

- Institutional Occupational Retirement Plans
- Objective: ensure level of security offered by all IORPS is similar



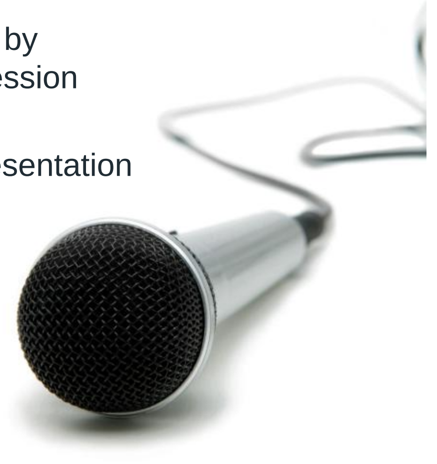
Where next?

- An asset only focus has failed
  - Liability focus and timescales are key
- Risk and the sources of risk should vary through time
  - A dynamic asset allocation
  - Funding level, risk allocation and return expectations
- Governance
  - Reacting to changing circumstances
  - Market themes
- Regulation
  - You can run but you can't hide

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.



18