

Annual Pensions Convention 2005 A6: Cleansing the Soul – a few investment myths exposed

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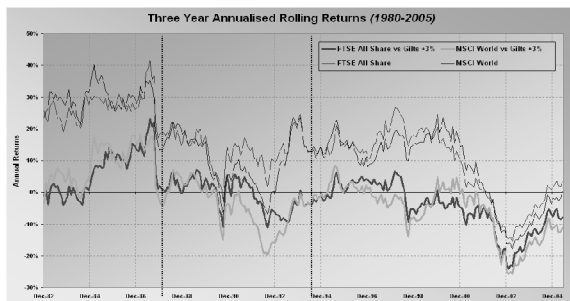
Agenda – some myths

- When is a bull market not a bull market
- High yield bonds are high risk
- Do strategic decisions override timing decisions
- Does decision delay have limited impact
- Research – torchlight or comfort blanket

Bull markets – to bull or not to bull...



Bull markets – is this the answer?



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Bull markets – key points for discussion

- Merits of a ubiquitous liability-driven filter
- Key part of Trustee Knowledge Understanding
- Monitoring
- Case for alternatives becomes stronger
 - Approaches
 - Asset classes
 - Analysis

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High yield bonds – basics

- Mainly US\$ based (but growing €/£ market)
- Shorter duration and higher default risk
- Substantial premium over governments
- Widely used in US pension plans
- (Un)judicious use of “junk” term is commonplace

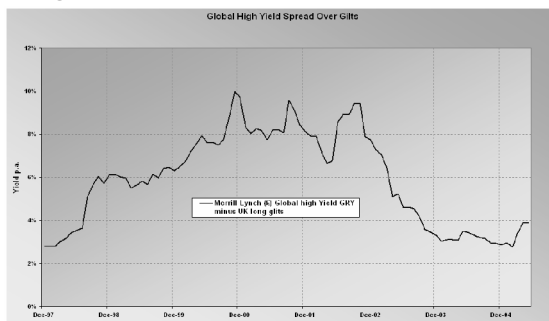
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High yield bonds – “risks”

- Non-payment/worsening yield gap
 - Manageable via active approach (as per Inv Grade bonds)
 - Bond: defined yield provided payment occurs and held to end
- Volatility
 - Relative to risk-free, volatility can be managed
 - Tactical mandate in and out of high yield
- Perception
 - Education (Ours and Trustees!)
 - Embryonic but rising interest
- Liquidity

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High yield bonds – a return history



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High yield bonds – key discussion points

- Merits of a ubiquitous a liability-driven filter
- More lateral thinking from advisors
- Less domination of perception over investment thesis
- Need to monitor timing
 - Mandate
 - Access
 - Managers

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Strategic/timing – anonymous anecdotes

- Strategic asset allocation is the most important decision
- "... advice focuses on strategic long-term split."
- "... a thorough strategic asset allocation study..."
- "... Even managers, whose remit usually involved tactical decisions, have not consistently delivered"
- "... timing the market is a dangerous activity, which Trustees should avoid..."

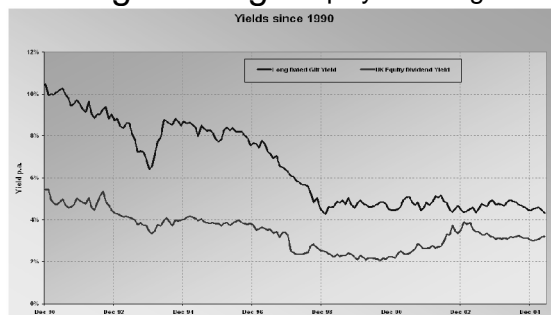
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Strategic/timing – Damascene conversion

- Investment is all about timing – what else is there
- I thought buying low and selling high was key
- Ignoring timing leads to scope for loss crystallisation
- Insurance is important but you don't need to take up the first quote you get, at the time you get it
- Historically, for managers, agency cost had a large impact
 - peer-group-benchmarked
 - In-house products only
 - AMC was not equal in each asset class

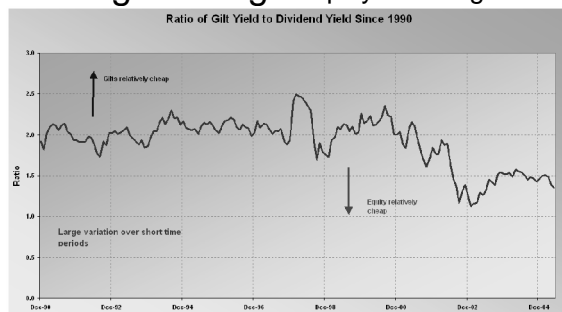
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Strategic/timing – Equity versus gilts



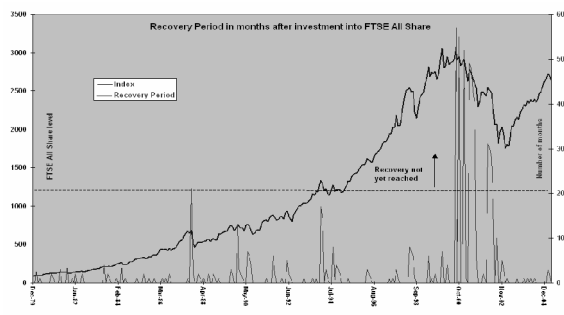
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Strategic/timing – Equity versus gilts



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Strategic/timing – Equity recovery period



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Strategic/timing – key discussion points

- Need/merits of striking a balance
- More “advice” from advisers
- Understand/tailor risk deployment better
- Case for alternatives becomes stronger
 - Phased switching
 - Market-based triggers
 - Alpha-generative liability-driven assets

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Decision delay – sources

- Advisory model requires Trustee decisions for all areas
- Infrequency of Trustee meetings
- Desire for thoroughness prolongs advisory process
- Behavioural inertia
- Commercial risk management by advisory firms
- Paperwork!

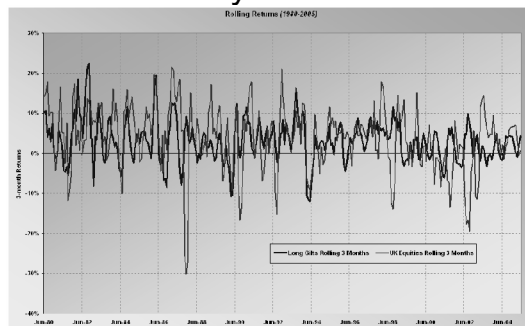
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Decision delay – solutions

- Alternative support models
- Faster, more pro-active advisory process
- Focus on efficiency not just thoroughness
- More selective (reduced) use of Stochastic ALM
- Deploy safe-houses in the manager roster
- More pro-active monitoring

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Decision delay – market movements



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Decision delay – key discussion points

- Which support models might work
- Prevalence of elongating the advisory process
- Re-check at point of investment
- Monitoring:
 - What do Scheme Actuaries want to see
 - What should Trustees be looking for

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Research – comfort blanket ...

- Research needs to be thorough for it be effective
- ...requires time and resource to be deployed
- ...data source should be sufficiently wide/deep
- ...but lots of manager meetings does not = quality
- ...which risk does “more quantity” really manage
- ... and what role for interpretational added-value

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Research – ... or torchlight

- Research needs to be efficient to be effective
- ... scarcity of resources can force better use (less is more!)
- ... focus on key client needs prioritises lines of questioning
- ... data source needs to be recent enough to be relevant
- ... quality not quantity
- ... must recognise risk of missing out (opportunity cost)

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Research – key discussion points

- How much is “less chance of being wrong” driving research processes
- Why are so many schemes/advisers spectators in so many asset classes
- Which takes precedence
 - Simplicity, Ease-of-understanding and perception; or
 - Investment thesis and financial impact
 - Parallel of medical profession

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Closing remarks

- Education, education, education
- Awareness of impact of agency on advisory firms
- Pro-activity/Innovation are necessary in our environment
- Work collaboratively with managers/Scheme Actuary
- Monitoring – investment is a process not an event
- Liability-driven filters are an effective management tool
- Trustees need support:
 - if not our community, then who
 - If not now, then when

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