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Current Issues in Pensions
Matt Johnson



Global Economics and Markets: Where next?

1 November 2012

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Agenda

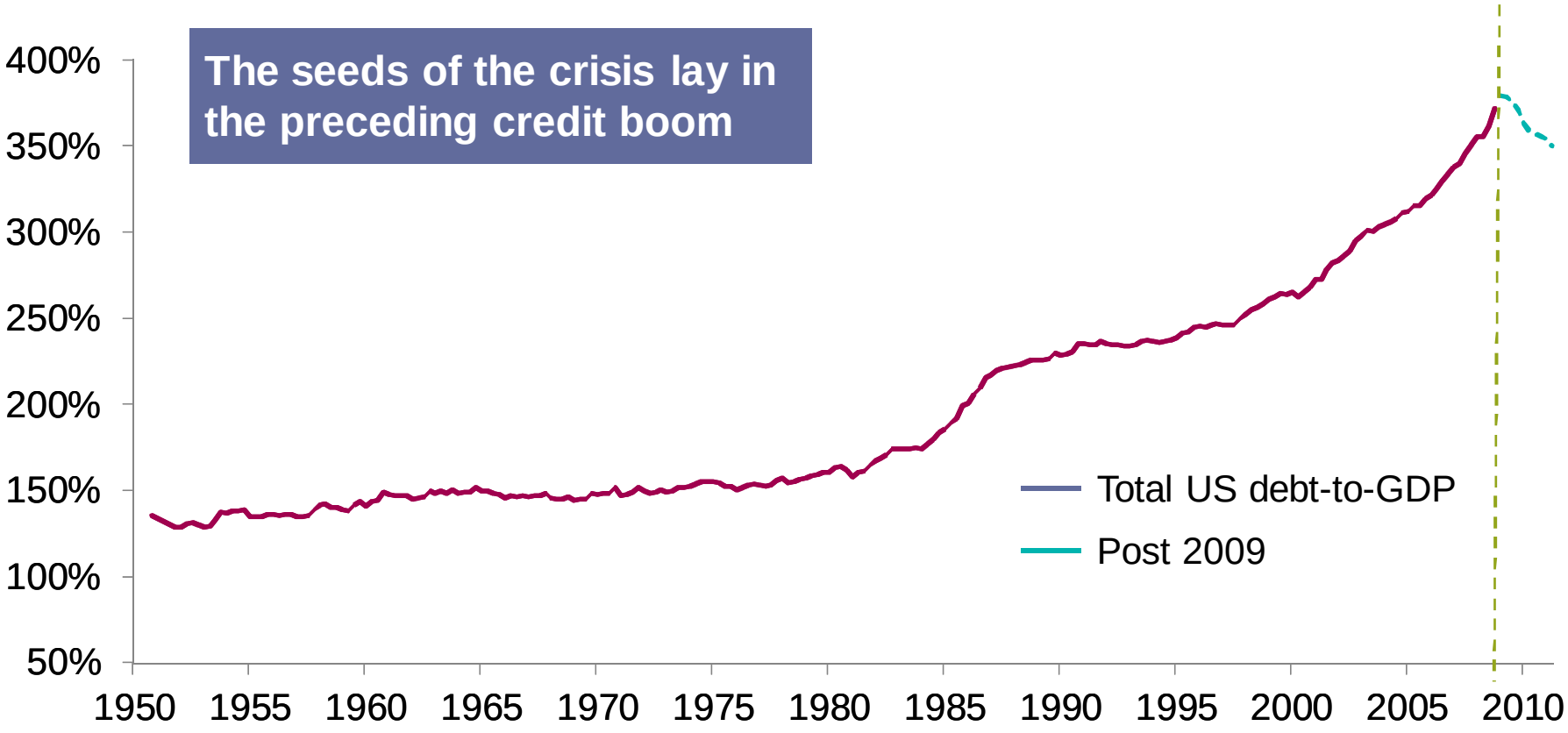
- Where have we come from?
- Where are we going?
- What's priced into markets?

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Where have we come from?

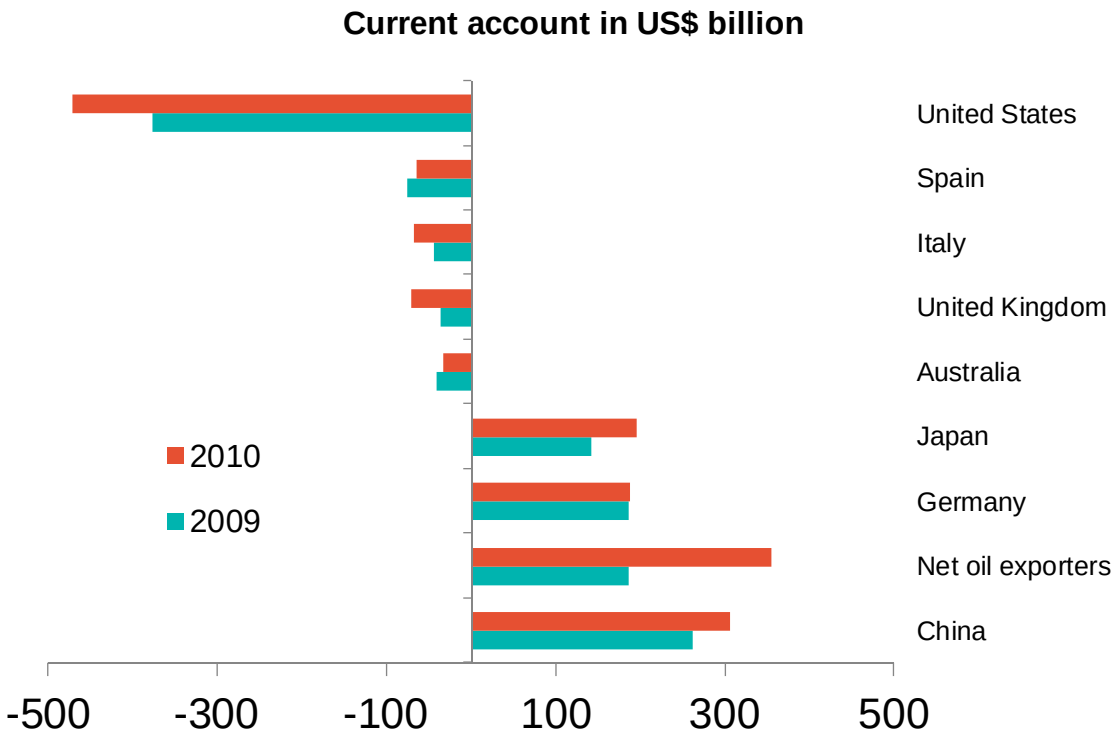
A debt-driven expansion



Source: Datastream, Towers Watson

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The borrowers and lenders

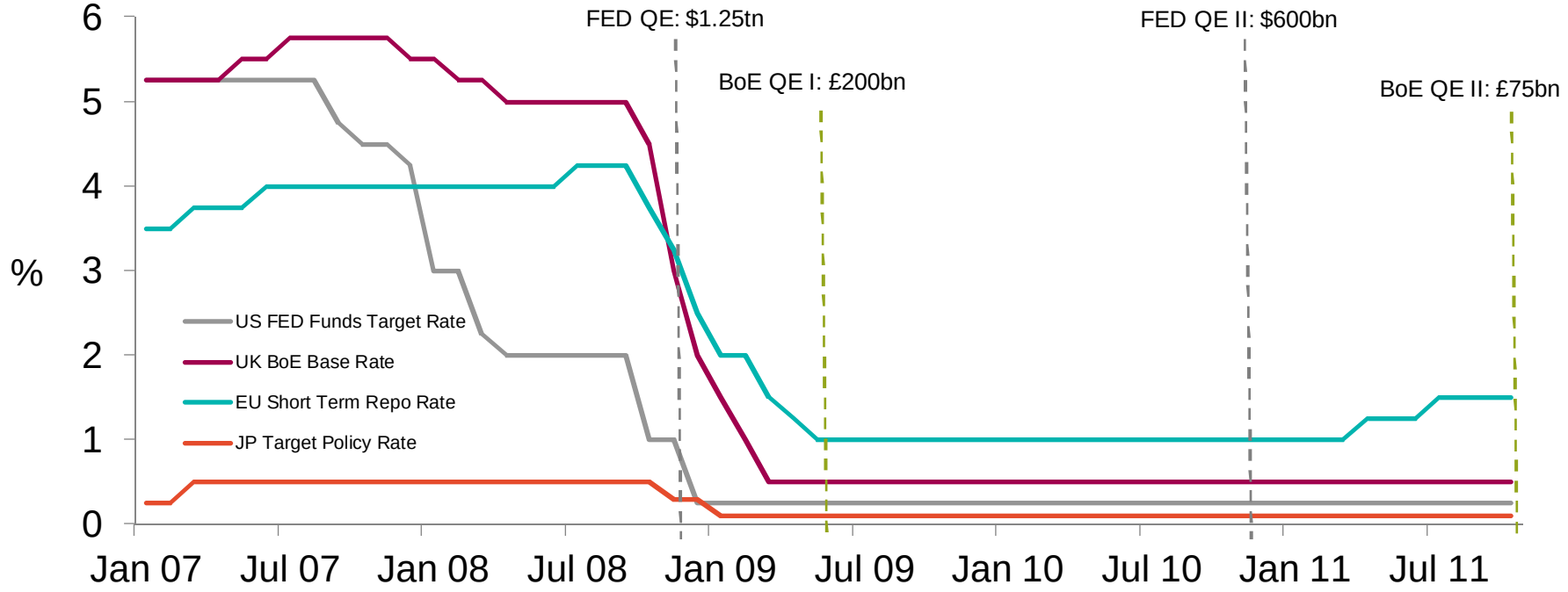


Rebalancing between debtor and creditor countries is required

Source: IMF WEO, Towers Watson

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Dealing with the fall out: Monetary policy

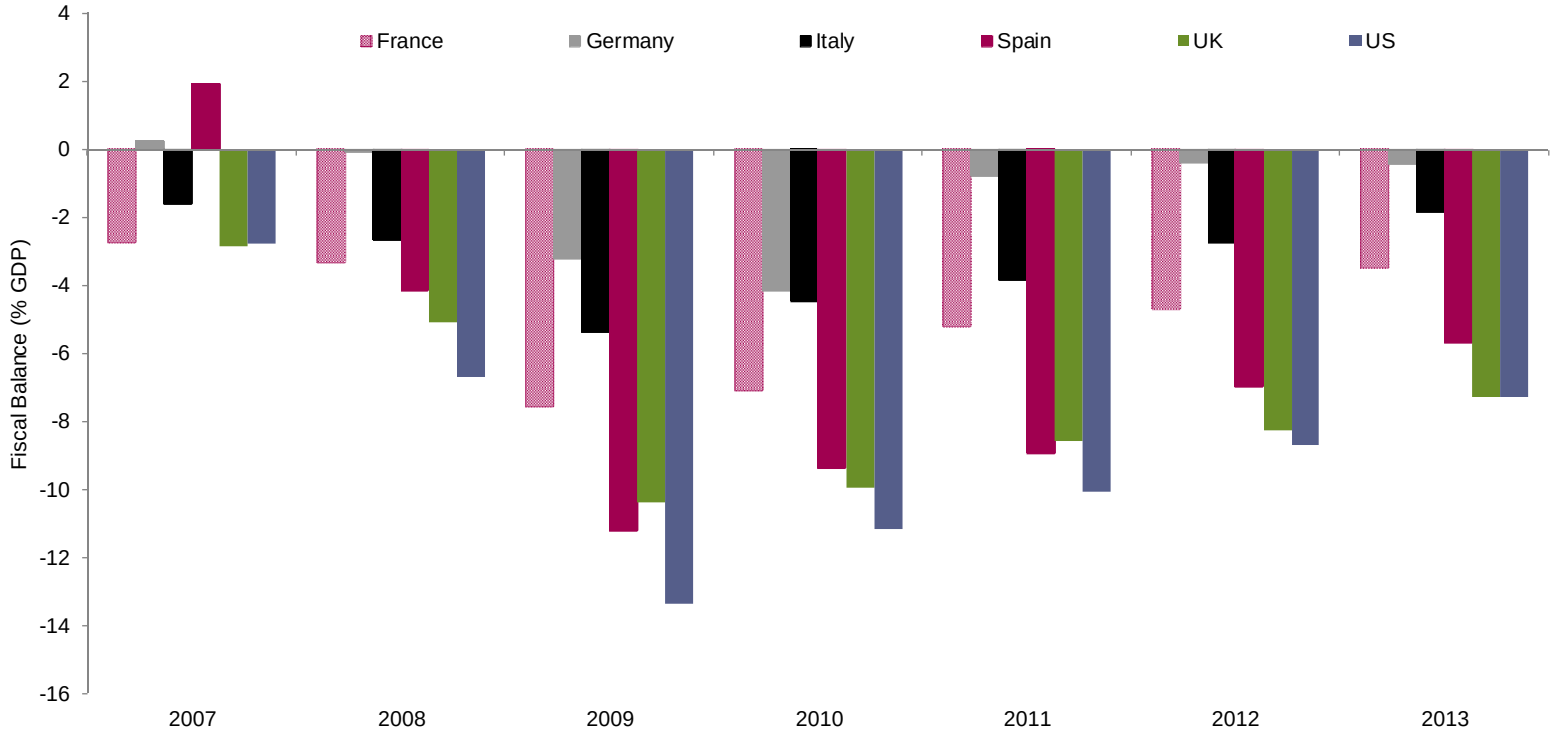


Traditional monetary tools exhausted and the only option left is more (and more) "unconventional" measures

Source: Datastream, Towers Watson

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Dealing with the fall out: Fiscal policy



Source: Datastream, Towers Watson

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Where are we going?

Future outlook

- Normal cyclical recovery
- Slow, bumpy recovery
- Recession

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What will determine which outcome wins

The sources of and speed of resolution of excessive indebtedness are critical at the current time

Has deleveraging finished?	Household Sector	Corporate Sector	Banking Sector	Government Sector
United States	No	Yes	Yes	No
Germany	Yes	Yes	Partial	Yes
United Kingdom	No	Yes	Partial	Partial
France	Yes	Yes	Partial	Partial
Italy	Yes	Yes	No	No
Spain	No	Partial	No	No

Source: Towers Watson

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Common tail risks

- US fiscal cliff
- Euro-zone
- Chinese “hard” landing

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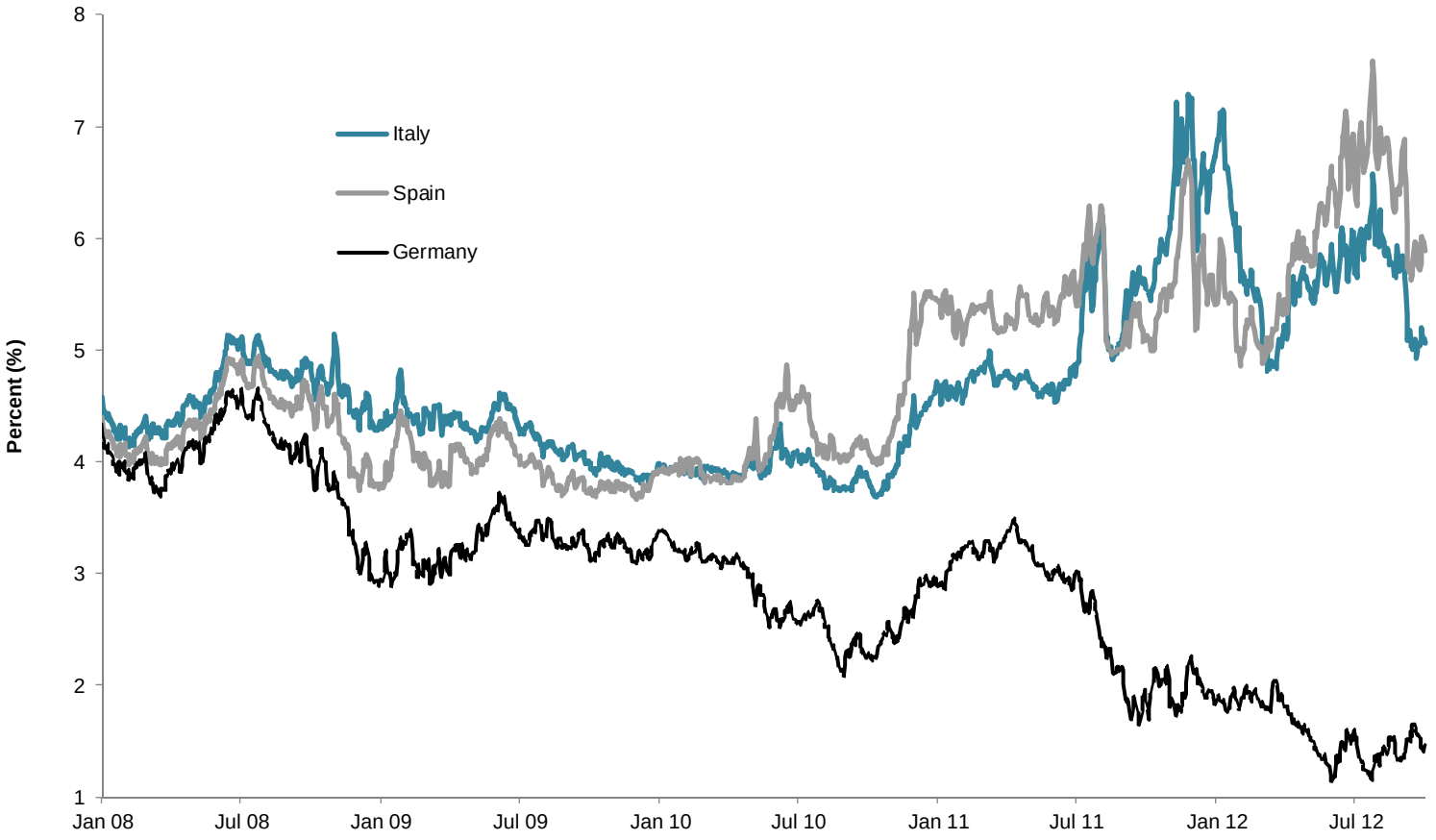
US fiscal cliff

Change in budget deficit	USD bns
Projected deficit for FY2012	1,130
Increases in Federal revenue due to expiry of tax cuts	*-390*
Decreases in Federal spending	*-100*
Total change in deficit (3.1% of GDP)	**-490**
Projected deficit for FY2013	640

(Source: CBO, Towers Watson)

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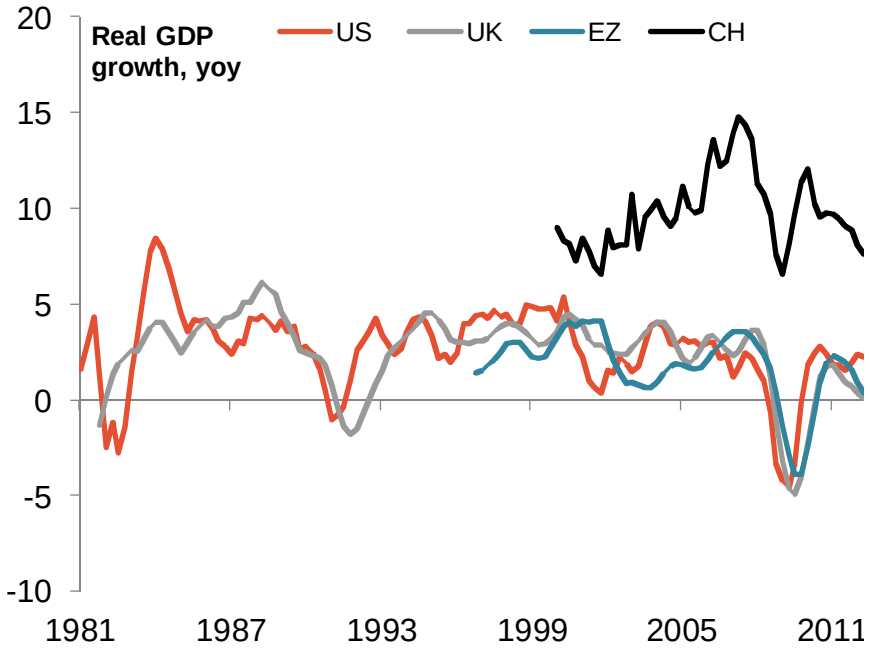
Euro-zone stresses



Source: Thomson

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China hard landing



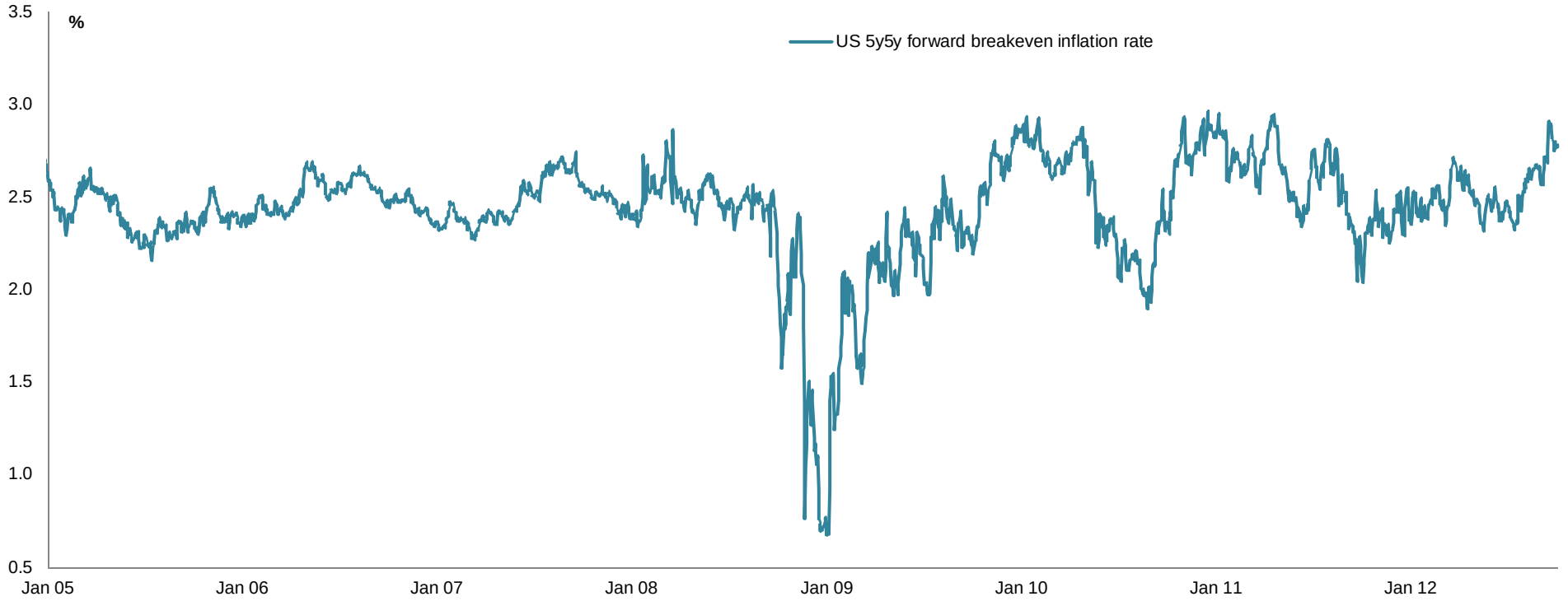
Source: Datastream, Towers Watson

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What's priced into markets?

Inflation

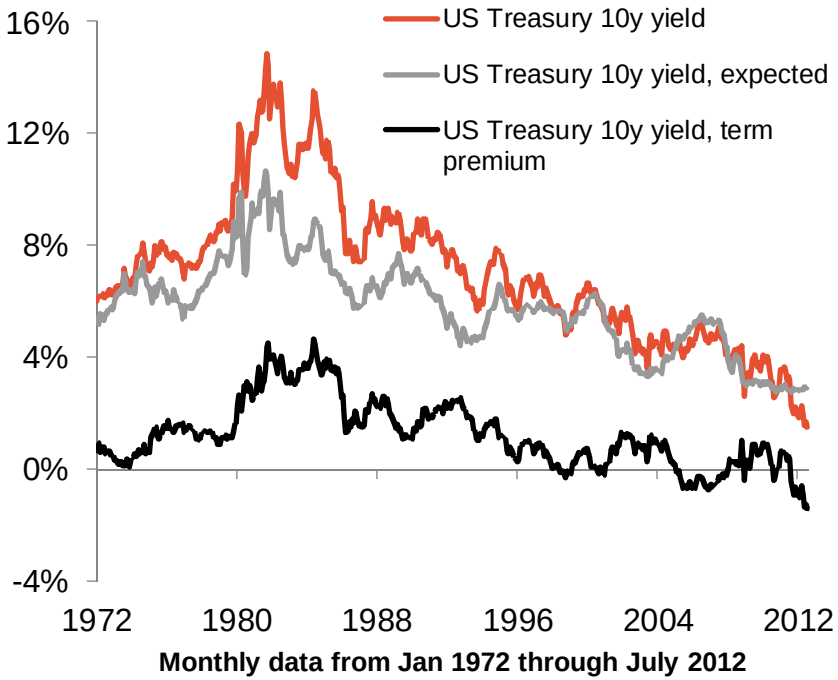


Source: Bloomberg LP

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Government bonds

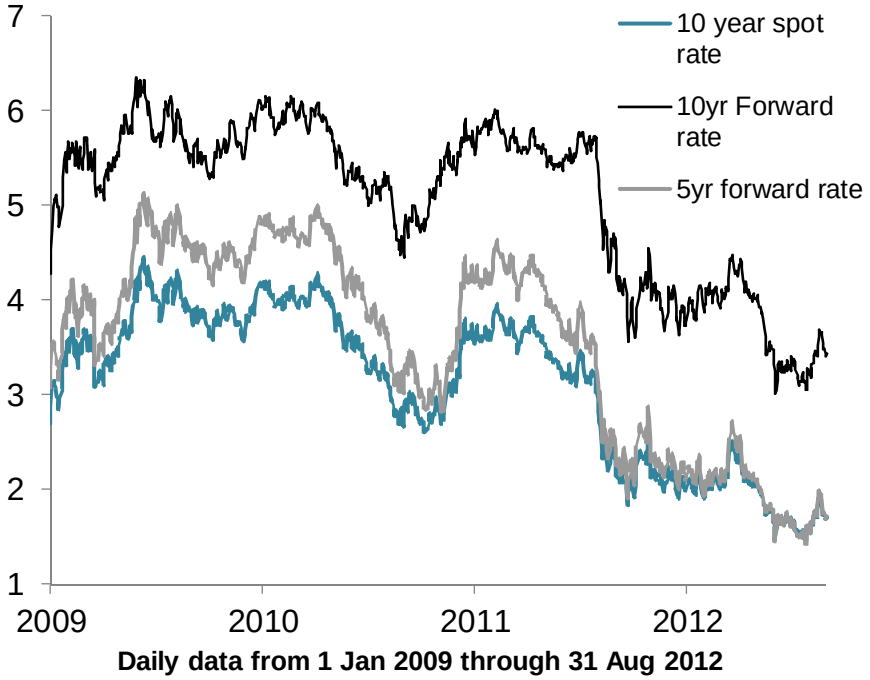
US treasuries remain highly unattractive



Monthly data from Jan 1972 through July 2012

Source: Federal Reserve, Towers Watson

Bond markets are pricing in a very weak economic environment, for a very long time



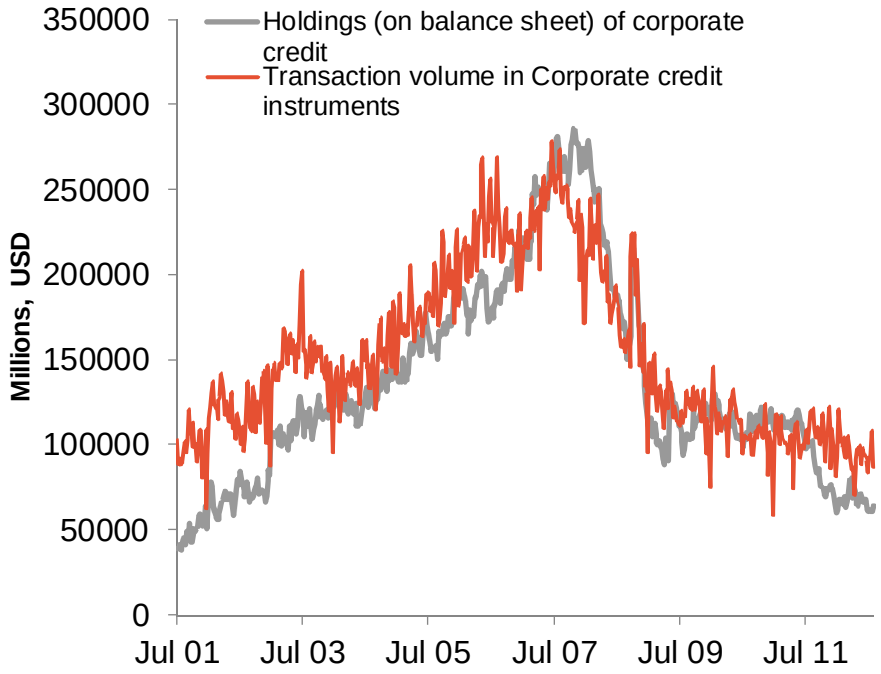
Daily data from 1 Jan 2009 through 31 Aug 2012

Source: Thomson, Towers Watson

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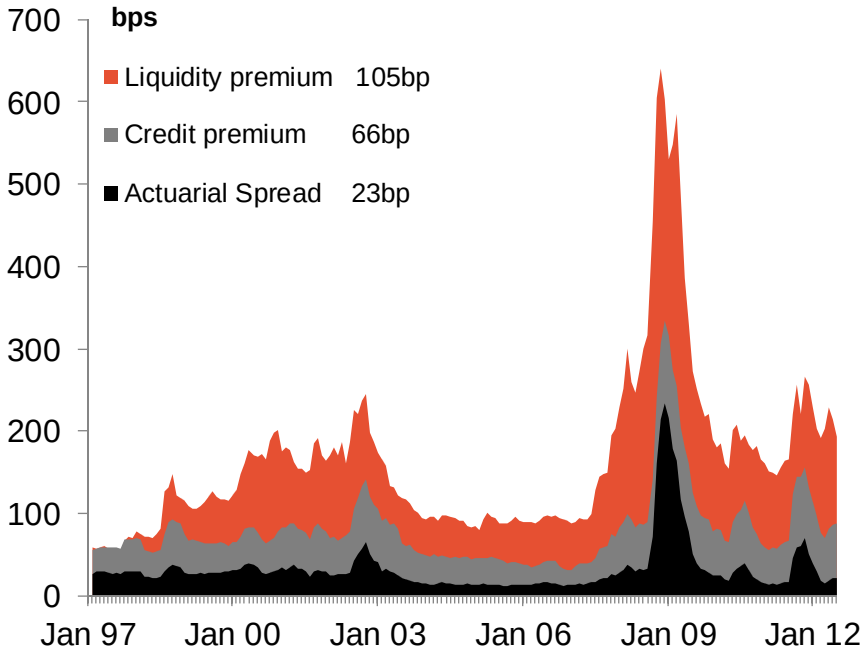
Corporate bonds

Investment banks (“Primary dealers”) are playing less of a role in corporate credit markets



Source: Federal Reserve Bank of New York

Decomposition of US corporate credit spreads

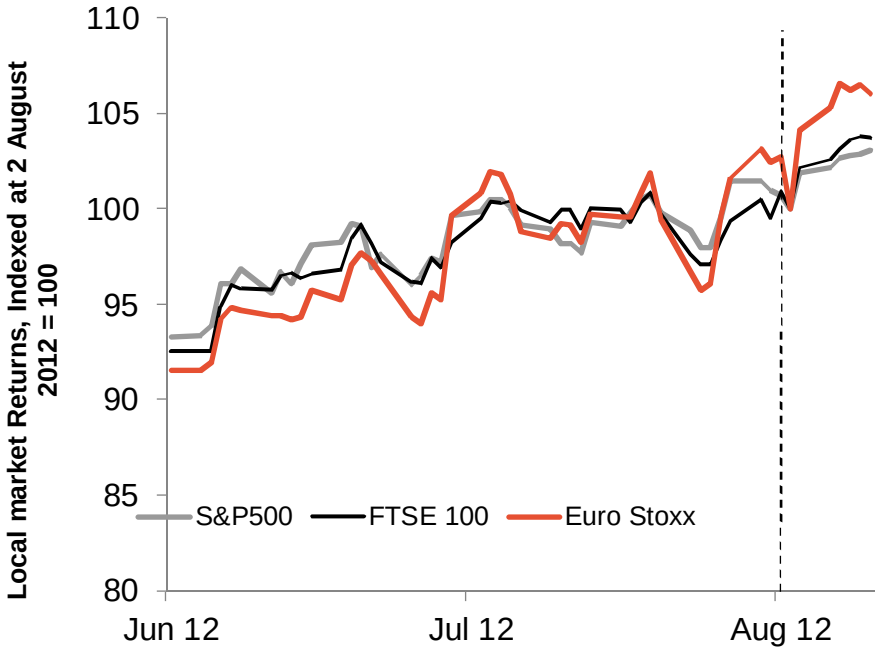


Source: Credit Suisse, Towers Watson

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Equities

In the short-term markets driven by perceived positive news from the European Central Bank



Source: Bloomberg LP, Towers Watson

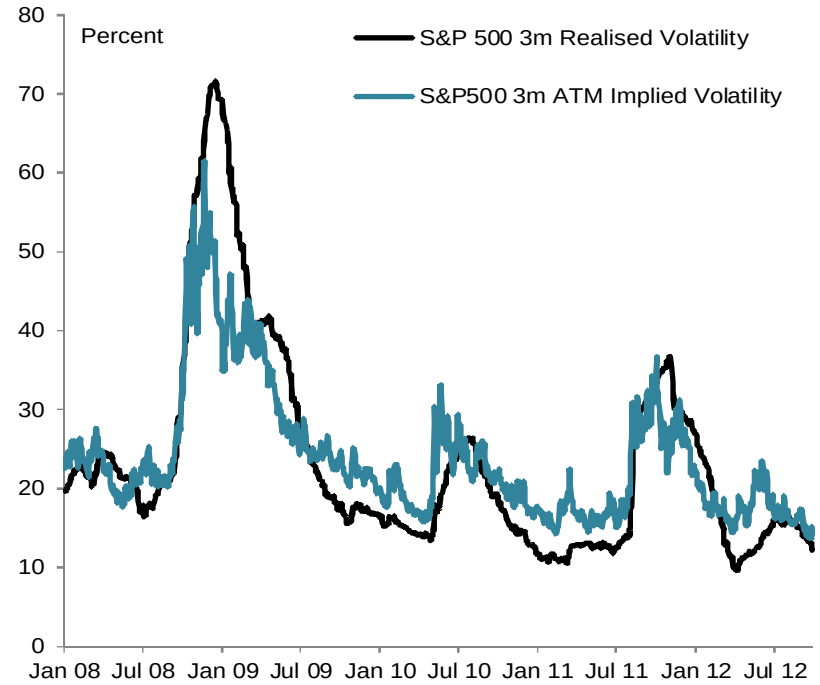
Our dividend discount model implies the US market is around neutrally price, whilst the Eurozone and UK markets reflect heightened uncertainty

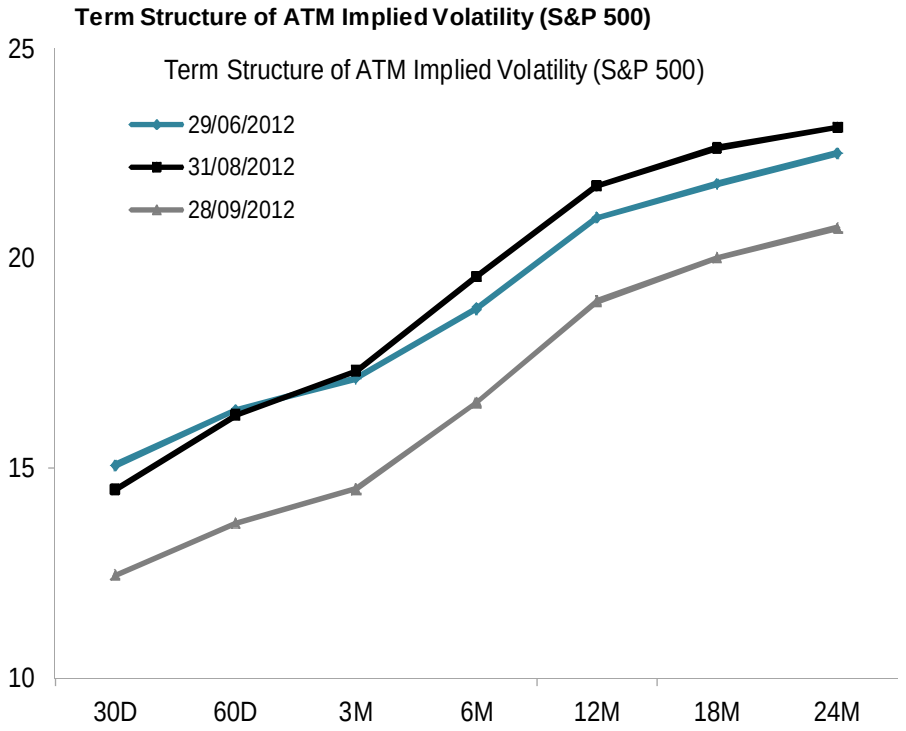
2-Stage DDM		US	Eurozone	UK
Discounted real sales growth	%	1.6	1.4	0.3
Average level	%	1.5-2	1.25-1.5	1.25-1.5
Discounted ERP (5yr geometric average)	%	4.0	5.3	4.5
Neutral ERP	%	4.0	4.3	4.3

Source: Thomson, Towers Watson

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Volatility





Source: Bloomberg

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Conclusions

Conclusions

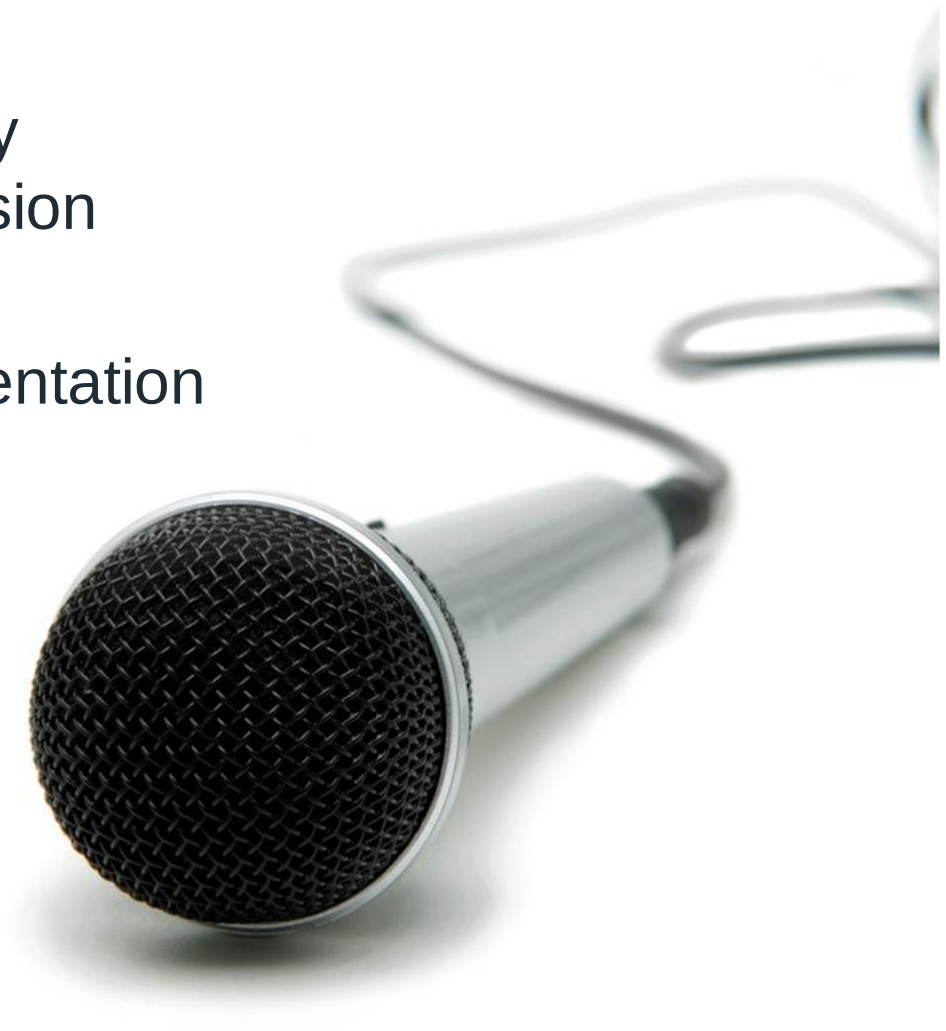
- No quick and easy way to resolve current imbalances
- But we will, although the “new normal” won’t feel like recovery
- Some material tail risks around this outlook
- Consensus around macro outlook developing
- Therefore much of this priced into markets
- Exception being bonds given central bank actions

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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.



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