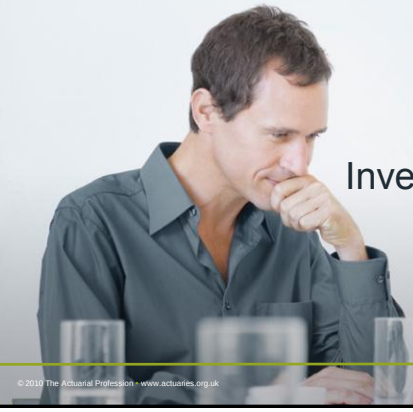
The Actuarial Profession
making financial sense of the future

Owen McCrossan FIA
Standard Life Investments



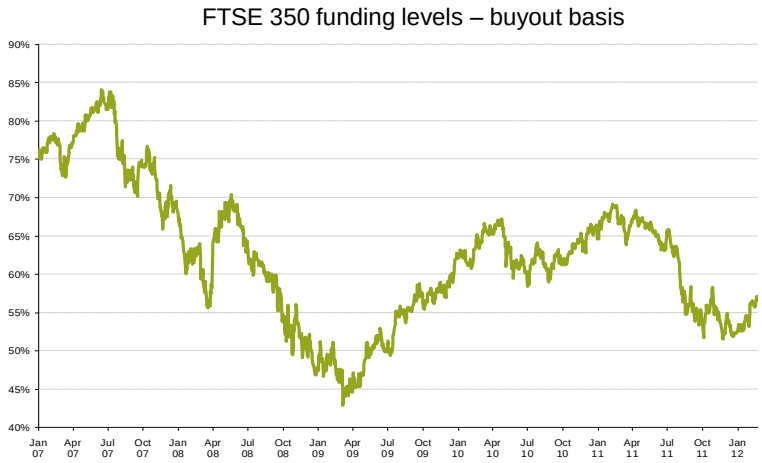
Investing in today's economic climate

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Agenda

- What happened
- What might happen from here
- What can we do to improve funding levels
  - Standard Life Pension Scheme response

Funding levels have been volatile



Source: AonHewitt Risk Tracker

2

Because both assets and liabilities effected by financial crisis (and not in the same way!)



Source: AonHewitt Risk Tracker

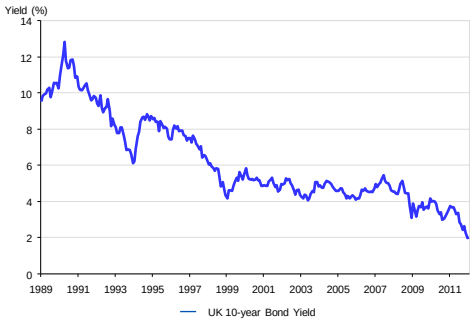
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Double whammy

Equity Market volatility



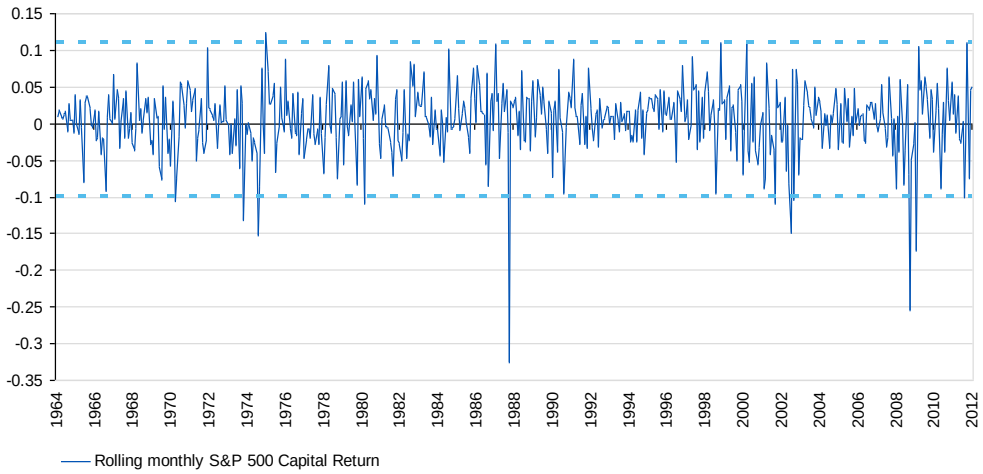
Bond markets - Historic fall in yields



Source: Bloomberg

4

Living through volatile times



Source: Datastream, Standard Life Investments

August 2011: 11th largest monthly decline → October: 3rd largest monthly gain

5

What might happen from here?

Lots of known unknowns!

1. The impact of QE on growth or inflation
2. The impact of deleveraging on economic activity
3. The extent of China's complex indebtedness
4. The degree of US fiscal tightening in 2013
5. The outlook for Middle Eastern politics

6

All policy responses have dangers

OECD governments could:

- cut spending and raise taxes (eg the UK)
- grow their way out of the problem (eg the US is still trying)
- enforced buying of government debt (eg Japan)
- default or restructure (eg Greece…..and others…..)
- inflate the debt away – is this the long term answer?

The time for easy solutions is long past

7

Political events in 2012/2013

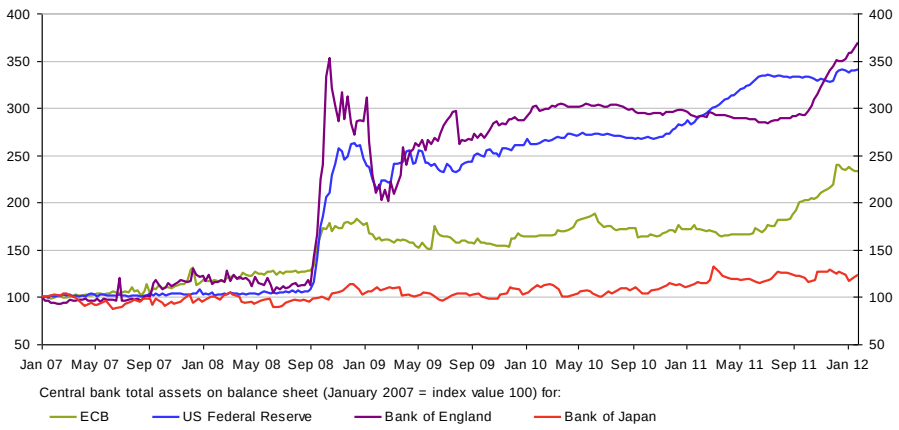
2012 Elections	
Russia	4th March
France	22nd April
Mexico	1st July
India	July
USA	6th November
South Korea	18th December
2013 Elections	
Italy	April
Japan	30th August
Germany	1st September
China - new Politburo Standing Committee in Autumn 2012, appointing new President and Premier in March 2013.	

Source: IFES Election Guide, Standard Life Investments

Another driver of market volatility

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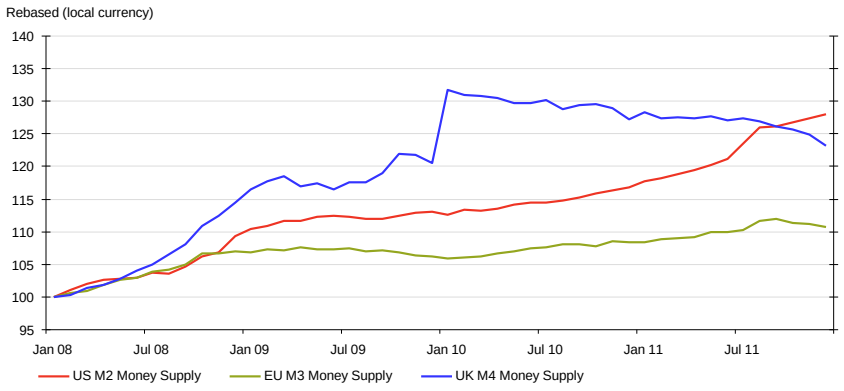
Governments are manipulating markets



Currencies reacting to monetary policy changes

9

US banking system is healthier than others



Some evidence of an upturn in US credit creation

10

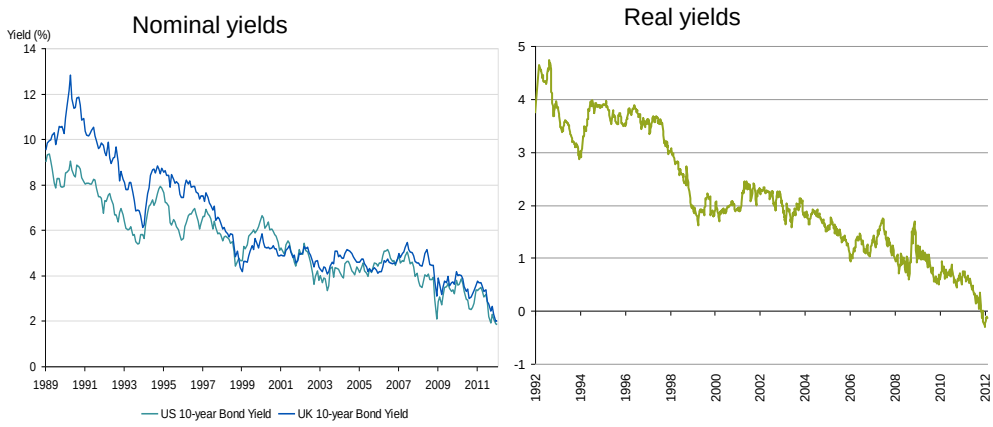
Europe: tackling the symptoms not the cause

- Good news – European politicians have got onto the front foot with a fiscal 'compact', Italy's structural reforms and the Greek PSI
- More good news - the ECB is becoming proactive, understanding its vital role to buy time by supporting the financial sector and key economies
- Bad news – EMU decisions remain 'necessary but not sufficient', with little progress on boosting future economic growth

We remain cautious on European assets

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Bonds are expensive

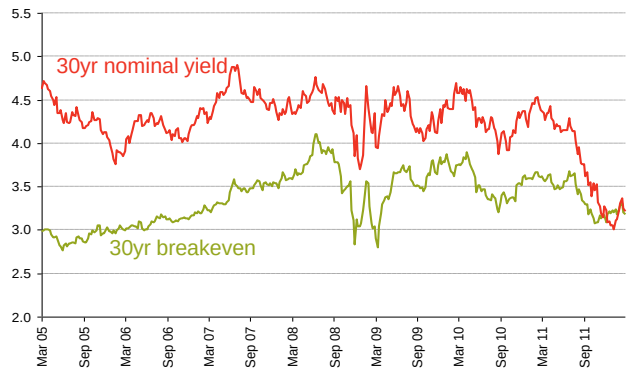


Source: Datastream

The House View has moved Very Light in core government bonds

12

But is inflation protection expensive?

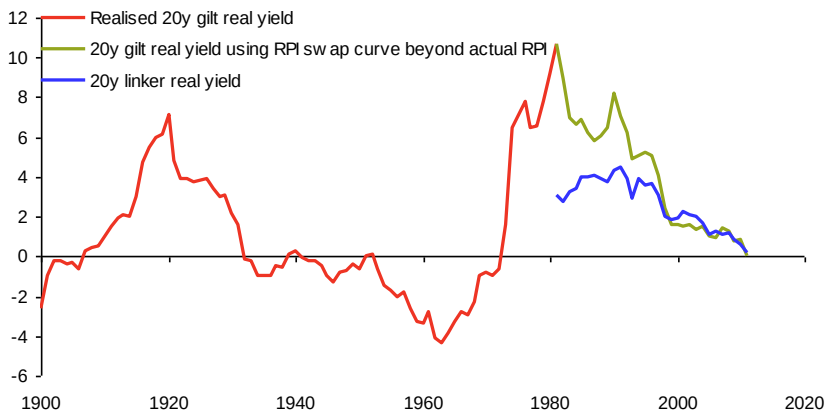


- 30yr RPI is priced at circa 3.0%
- Little or no risk premium built in
- Prefer inflation linked bonds to nominal bonds

Source: Bloomberg

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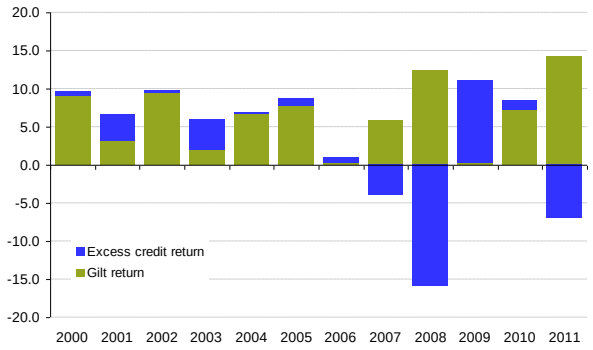
Real yields can stay negative for long times



Source: Barclays Capital

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Look for more diversification from bond portfolio

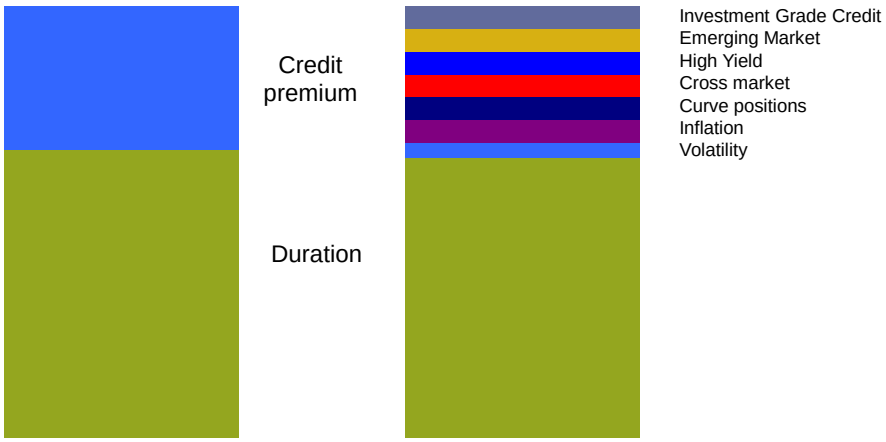


- Separate total return into
  - underlying interest rate
  - Credit risk
- Credit premium is a risk asset with volatility

Source: Bank of America Merrill Lynch

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Look for more diversification from bond portfolio



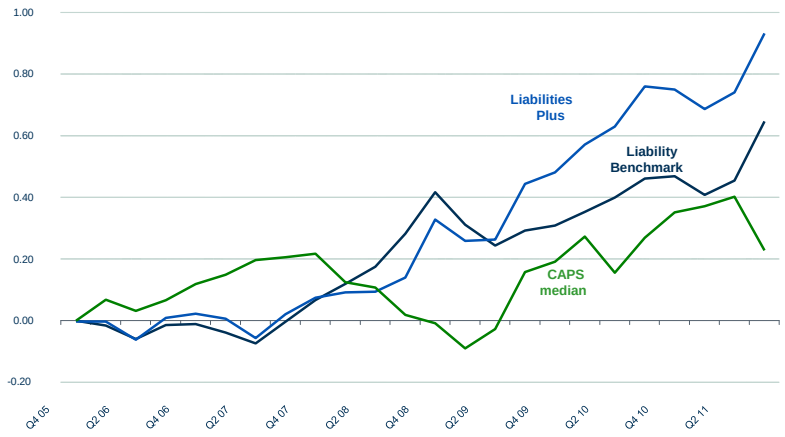
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What can we do?
The Standard Life Pension Scheme response

- Remove unrewarded risks as far as possible
- An absolute return approach provides a wider opportunity set to build truly diversified portfolios
- Taking longer term themes improves your chances

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The Standard Life Pension fund experience



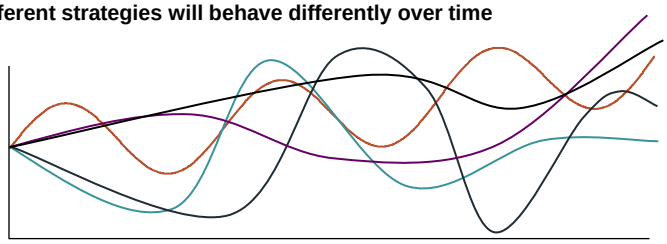
Source: Standard Life Investments and Towers Watson Statistics, 30 September 2011
* The average UK Institutional Pension Portfolio

Liabilities plus approach avoided the volatility in funding position

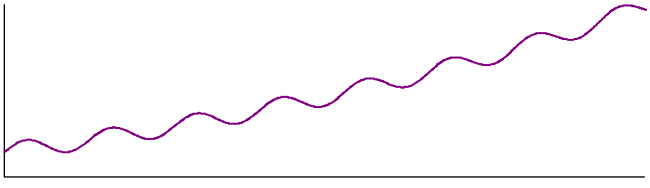
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Diversification through absolute return

Different strategies will behave differently over time



The challenge is to blend them to constrain risk

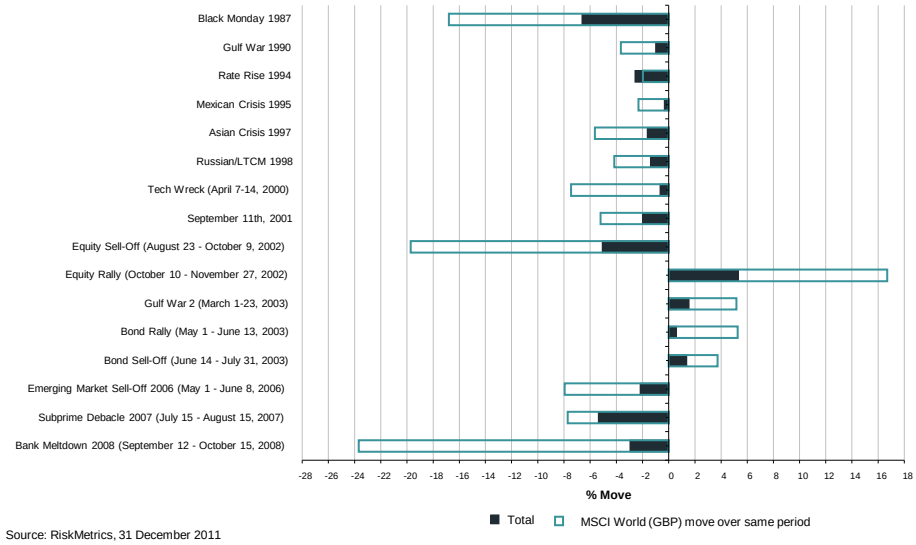


Wider opportunity set + longer time spans + creativity

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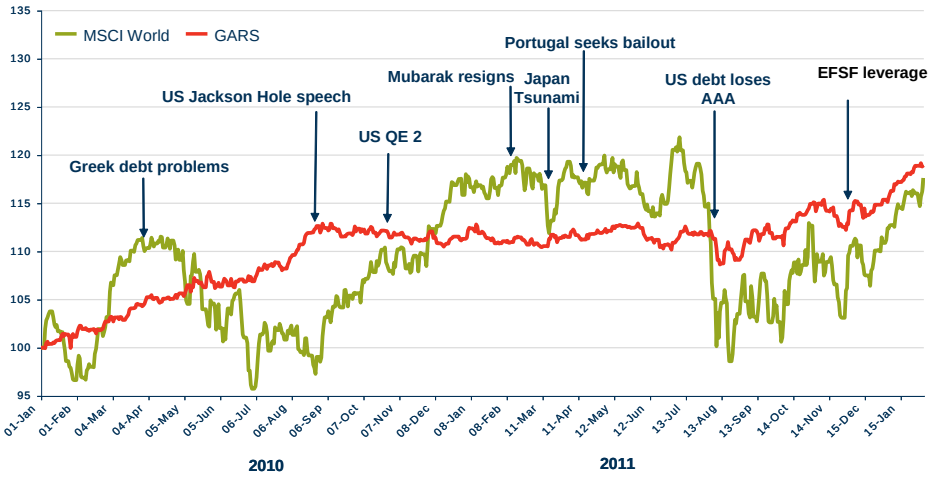
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Historical scenario analysis



Source: RiskMetrics, 31 December 2011

A portfolio that is prepared for the unexpected



Source: Standard Life Investments, gross £ performance GARS Fund vs. MSCI £ from 01 January 2010 to 03 February 2012

Conclusions

- Political upheaval and brinkmanship will lead to continued volatility in markets
- Interest rates will remain low for some time as developed economies continue to delever
- Achieving true diversification in portfolios is the key to controlling volatility
- An absolute return approach coupled with liability hedge provides a way for Trustees and sponsors to reduce risk and improve funding levels

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