

The Actuarial Profession
making financial sense of the future

Owen McCrossan FIA
Standard Life Investments



Investing in today's economic climate

© 2010 The Actuarial Profession - www.actuaries.org.uk

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

FTSE 350 funding levels – buyout basis



Source: AonHewitt Risk Tracker

2

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



Source: AonHewitt Risk Tracker

3

Double whammy

Equity Market volatility



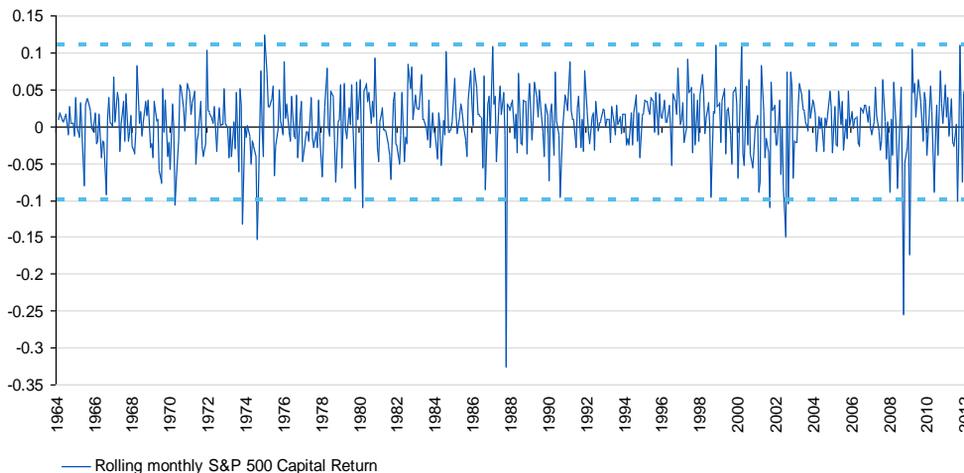
Bond markets - Historic fall in yields



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

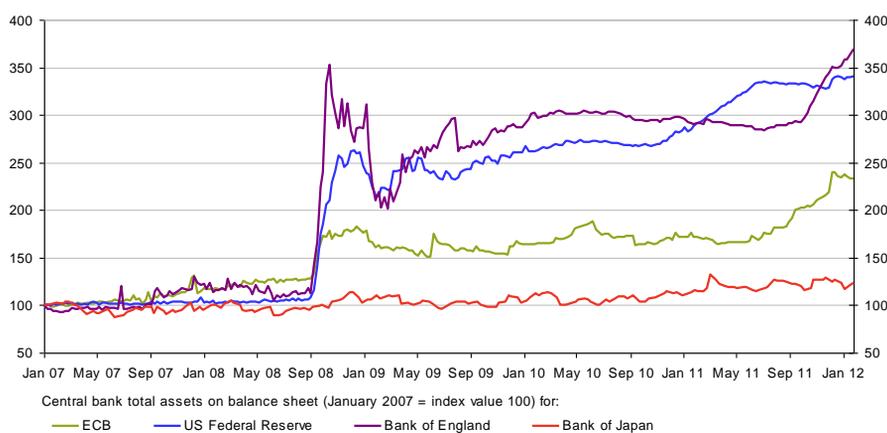
2012 Elections		
Russia		4th March
France		22nd April
Mexico		1st July
India		July
USA		6th November
South Korea		18th December
2013 Elections		
Italy		April
Japan		30th August
Germany		1st September
China - new Politburo Standing Committee in Autumn 2012, appointing new President and Premier in March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

Source: IFES Election Guide, Standard Life Investments

Another driver of market volatility

8

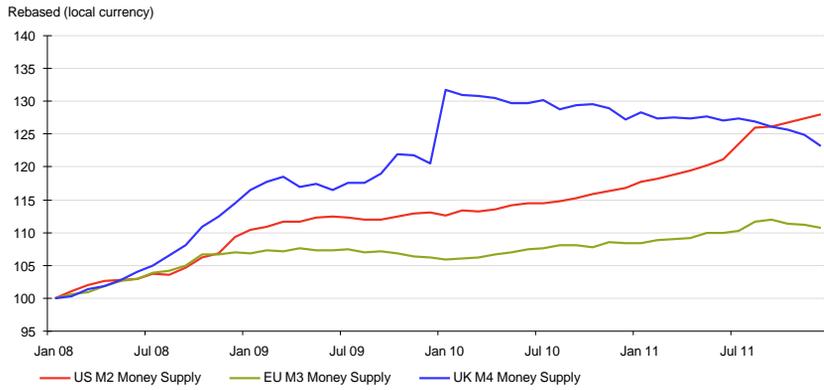
Governments are manipulating markets



Currencies reacting to monetary policy changes

9

US banking system is healthier than others



Some evidence of an upturn in US credit creation

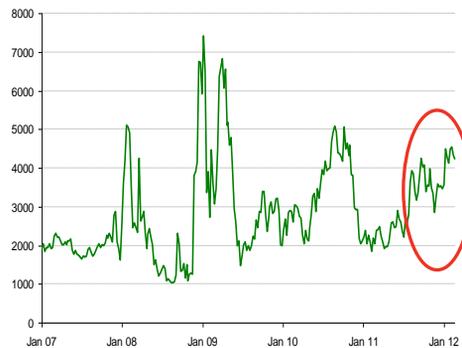
10

USA – Housing market

30yr Treasury yields vs mortgage rates



Mortgage refinancing index



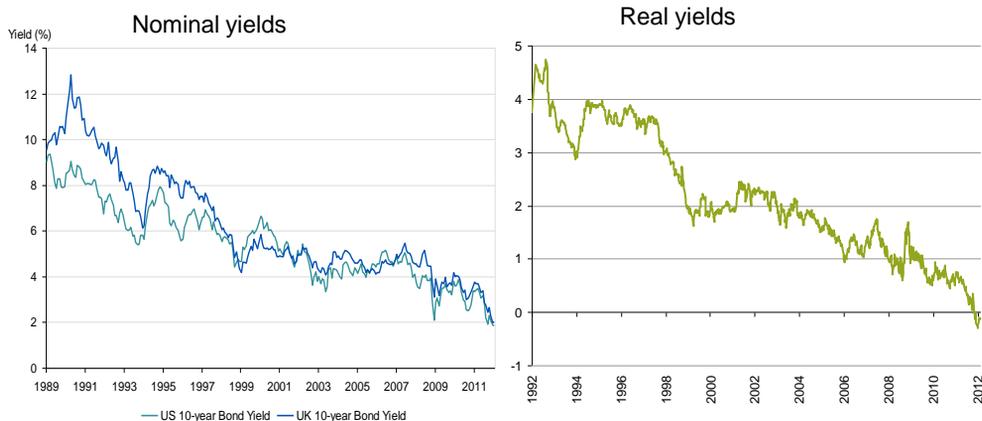
Europe: tackling the symptoms not the cause

- 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

12

Bonds are expensive



Source: Datastream

The House View has moved Very Light in core government bonds

13

But is inflation protection expensive?



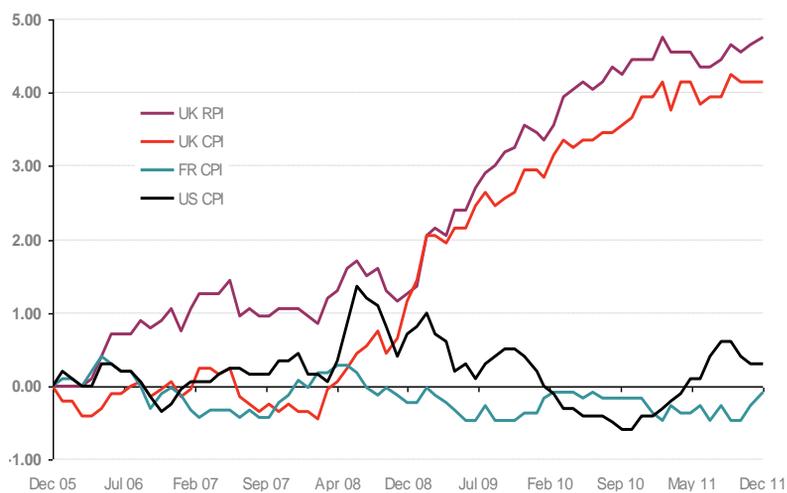
- 30yr RPI is priced at circa 3.0%
- Little or no risk premium built in
- Prefer inflation linked bonds to nominal bonds

Source: Bloomberg

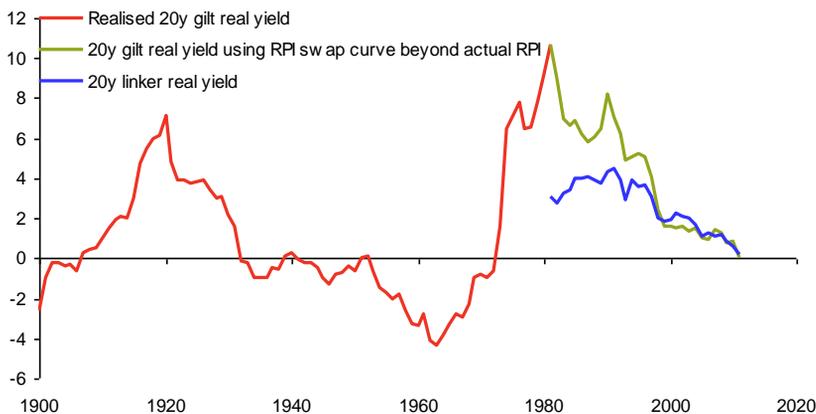
14

A persistent niggle with UK inflation

Cumulative differences between consensus forecasts and outturn for UK, US and France



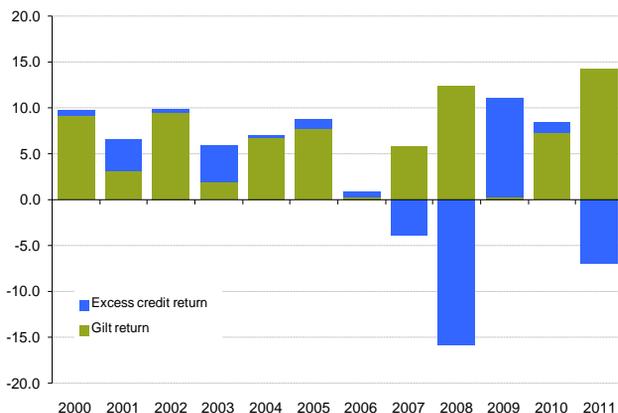
Real yields can stay negative for long times



Source: Barclays Capital

16

Look for more diversification from bond portfolio



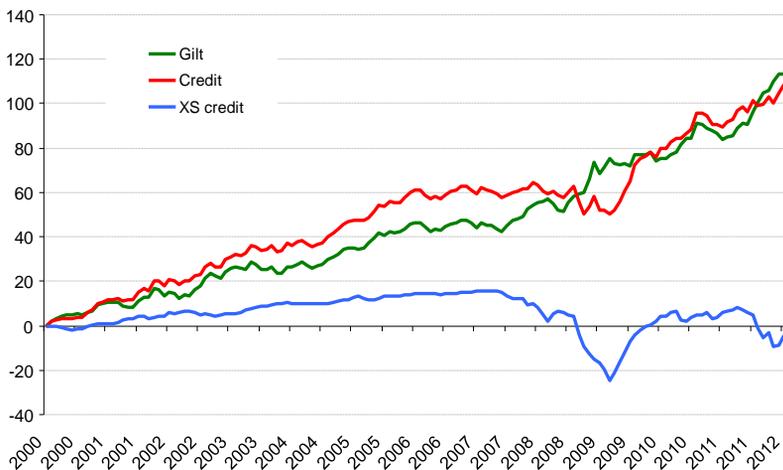
- Separate total return into
 - underlying interest rate
 - Credit risk

- Credit premium is a risk asset with volatility

Source: Bank of America Merrill Lynch

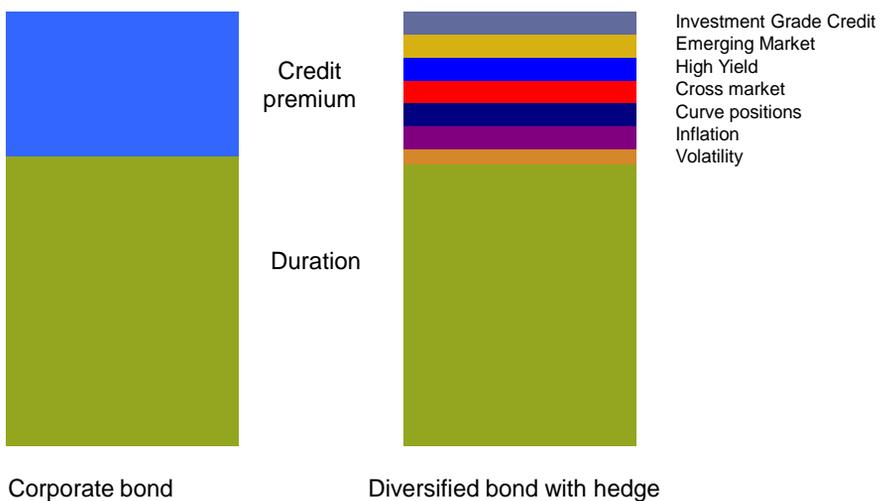
17

Look for more diversification from bond portfolio



Source: Bank of America Merrill Lynch

Look for more diversification from bond portfolio



What can we do?

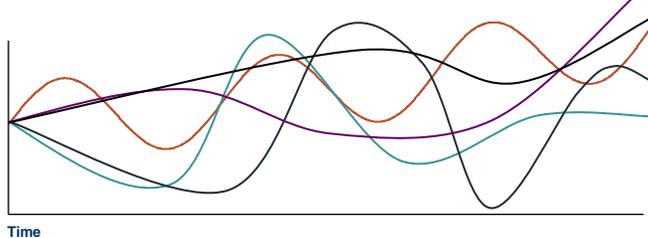
The Standard Life Pension Scheme response

- 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

20

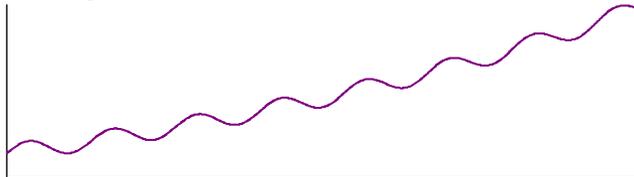
Diversification through absolute return

Different strategies will behave differently over time



Time

The challenge is to blend them to constrain risk



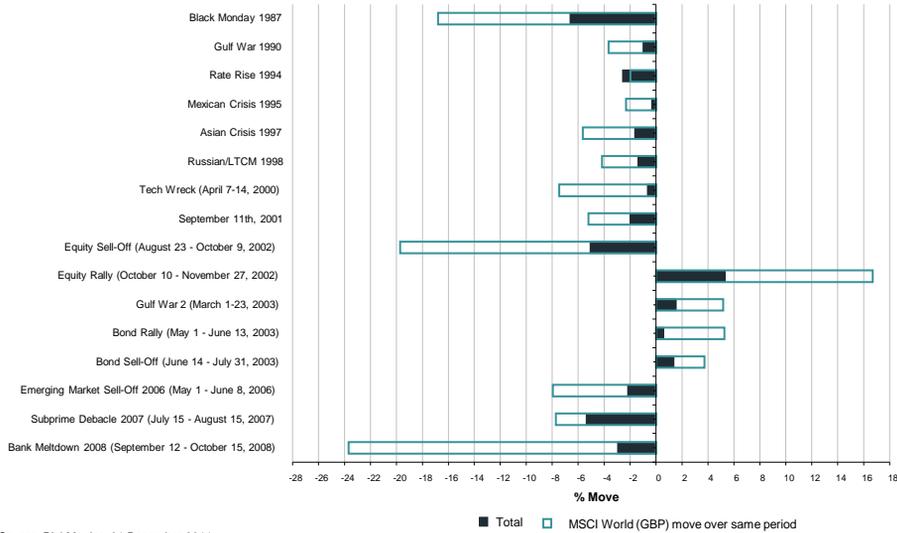
Time

Wider opportunity set + longer time spans + creativity

© 2010 The Actuarial Profession • www.actuaries.org.uk

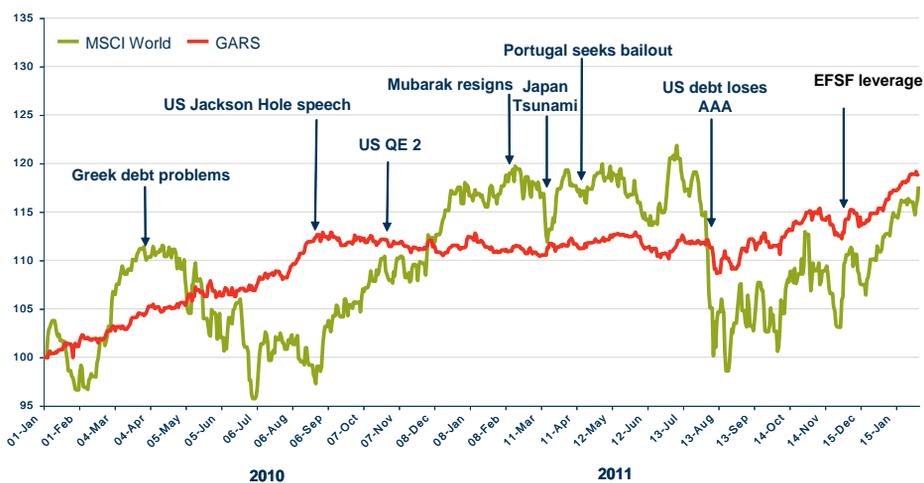
21

Historical scenario analysis



22

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

23

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

24

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
- Inflation should fall, but may be stickier on the way down with greater volatility
- 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

25

The information shown relates to the past. Past performance is not a guide to the future. The value of investment can go down as well as up.

Any data contained herein which is attributed to a third party ("Third Party Data") is the property of (a) third party supplier(s) (the "Owner") and is licensed for use by Standard Life**. Third Party Data may not be copied or distributed. Third Party Data is provided "as is" and is not warranted to be accurate, complete or timely. To the extent permitted by applicable law, none of the Owner Standard Life** or any other third party (including any third party involved in providing and/or compiling Third Party Data) shall have any liability for Third Party Data or for any use made of Third Party Data. Past performance is no guarantee of future results. Neither the Owner nor any other third party sponsors, endorses or promotes the fund or product to which Third Party Data relates.

**Standard Life means the relevant member of the Standard Life group, being Standard Life plc together with its subsidiaries, subsidiary undertakings and associated companies (whether direct or indirect) from time to time.*

Standard Life Investments Limited is registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL.
The Standard Life Investments group includes Standard Life Investments (Mutual Funds) Limited, SLTM Limited, Standard Life Investments (Corporate Funds) Limited, SL Capital Partners LLP and AIDA Capital Limited.

Standard Life Investments Limited is authorised and regulated by the Financial Services Authority.
Calls may be monitored and/or recorded to protect both you and us and help with our training.

www.standardlifeinvestments.com

© 2012 Standard Life, images reproduced under licence