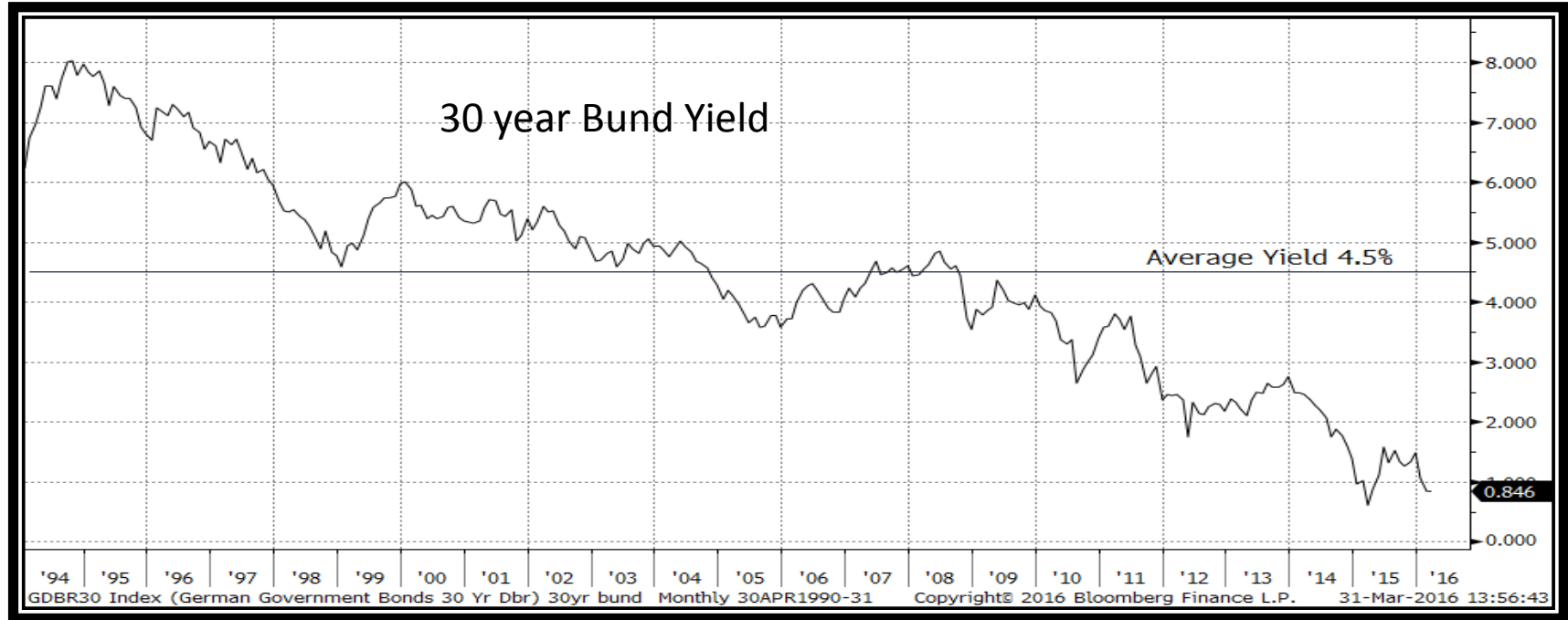


ARE BONDS THE ONLY ANSWER TO FUNDING PROBLEMS IN PENSION SCHEMES?

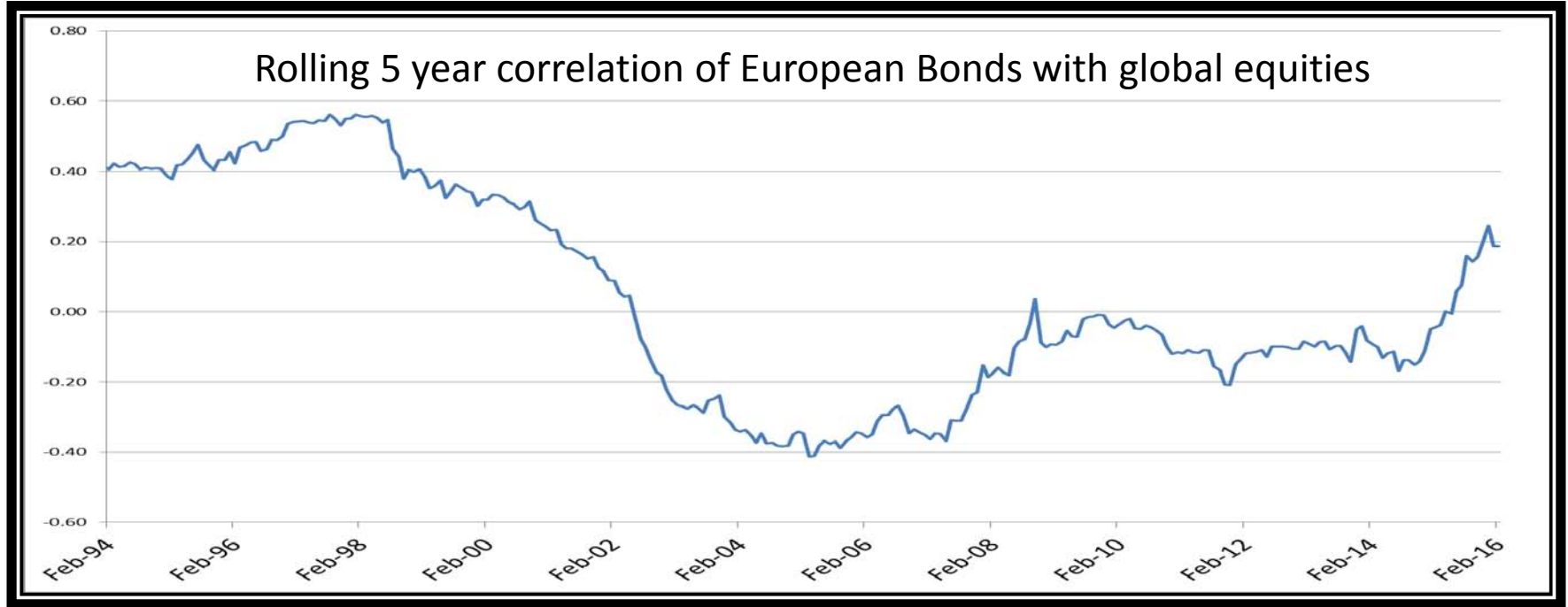
Pearse Mac Manus – Head of Fixed Income
Merrion Investment Managers

Why do investors hold bonds?



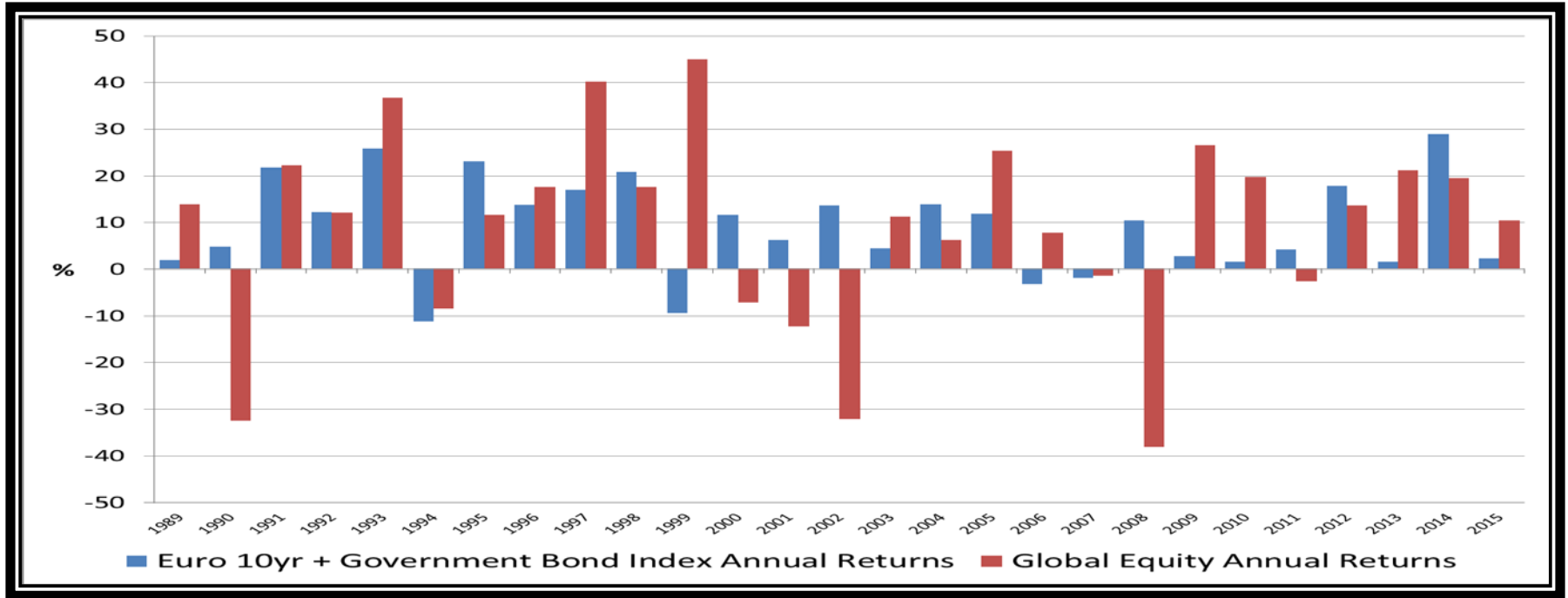
Income – average yield of 4.5% over last 20 years

Why do investors hold bonds?



Diversification– Bonds have exhibited a low correlation with equities over time

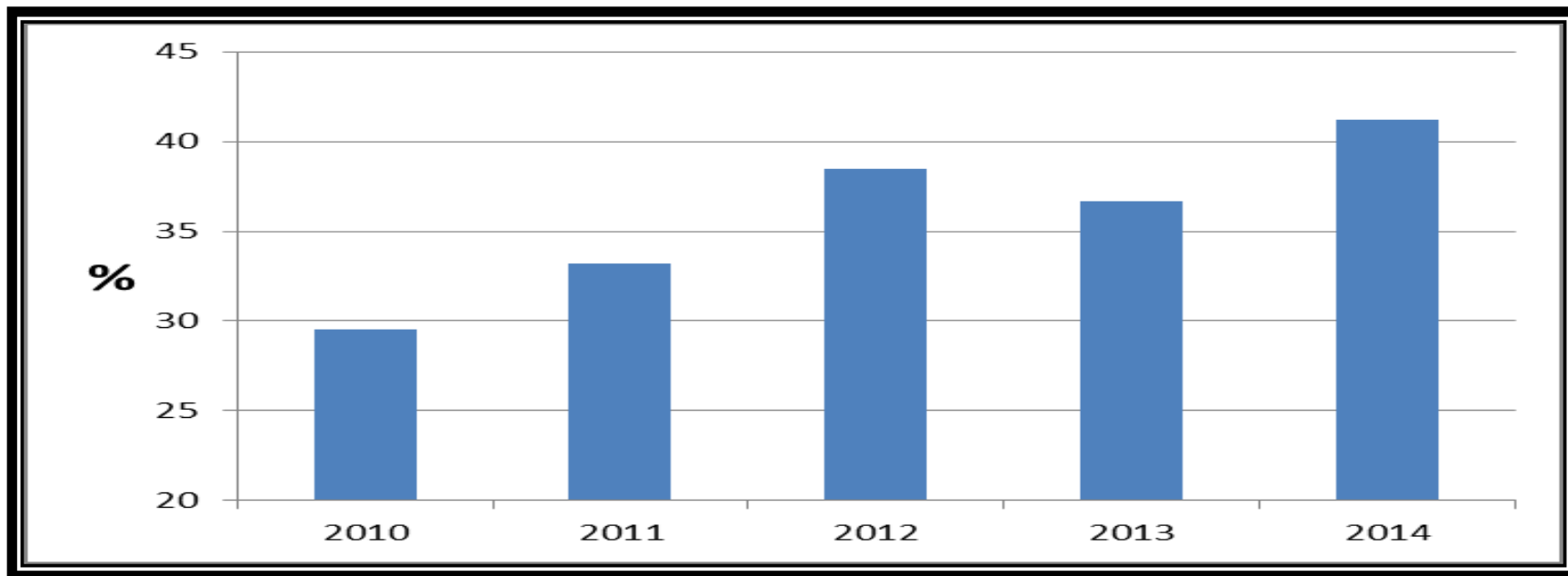
Why do investors hold bonds?



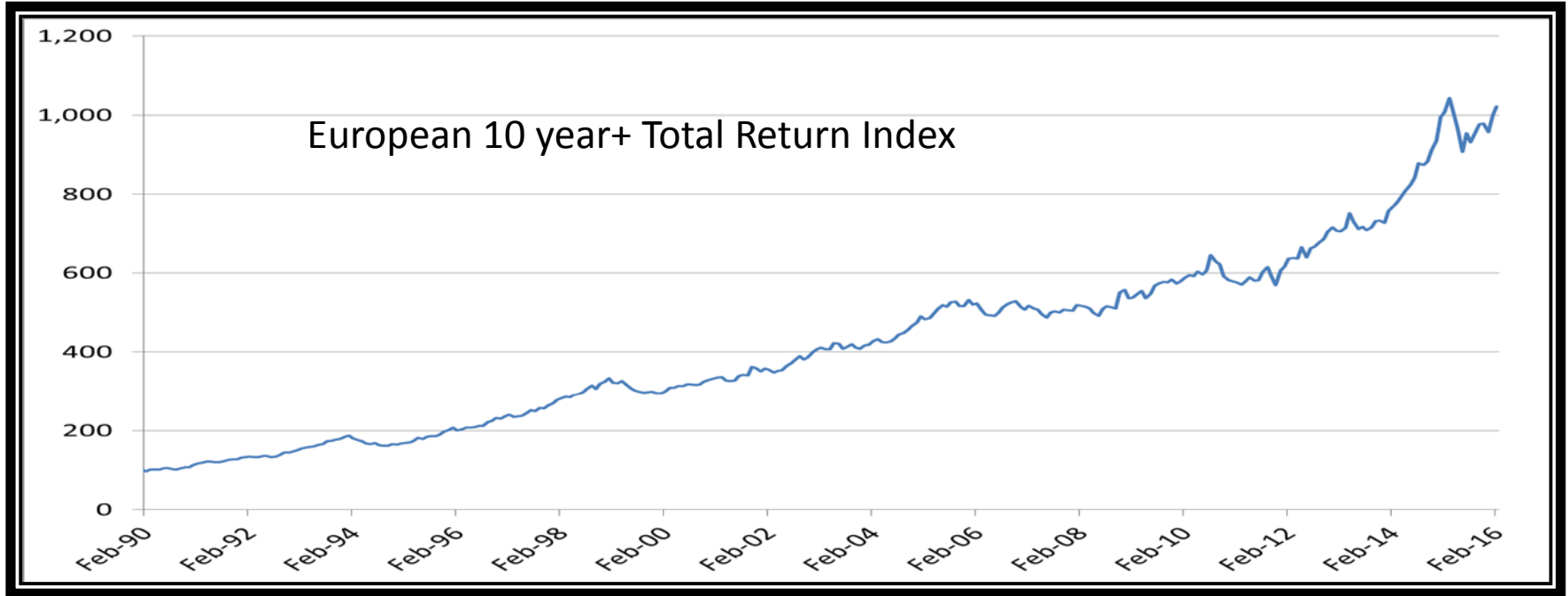
A counterbalance to riskier growth assets

How have allocations changed?

IRISH DEFINED BENEFIT BOND EXPOSURE



Returns have been very attractive



Annualised return of 9% over last 25 years

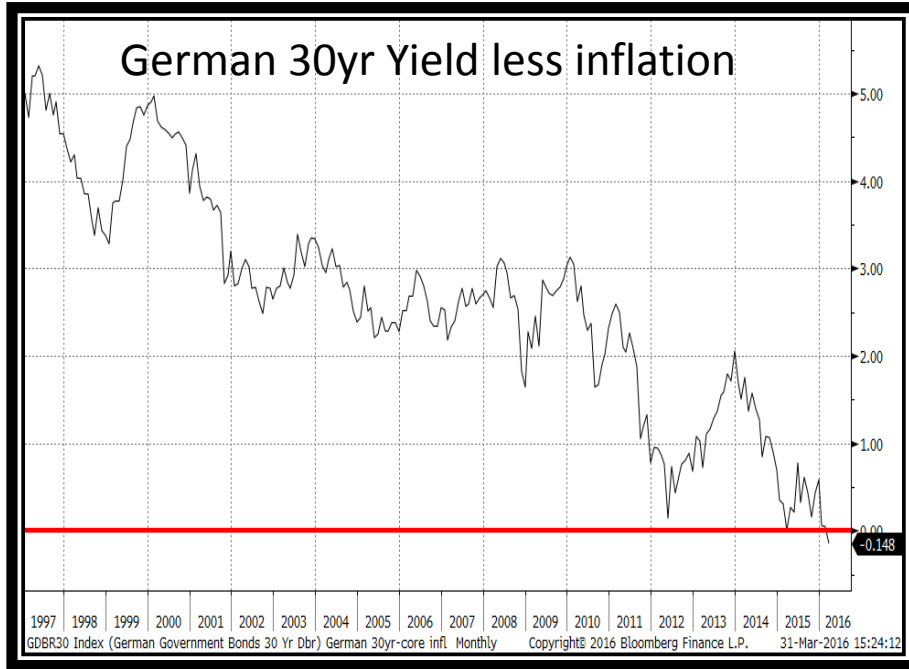
Should this change to reflect current market conditions?

Practical considerations - Regulatory pressure to increase bond allocations need to be challenged

Bonds are not a perfect hedge

- Liability is only an estimate – likely negative surprise
- Liability is long duration, linked to wage inflation
- Very long dated bonds are nominal, not real
- Inflation protected bonds are shorter duration, and not linked to wage inflation

Cost of hedging

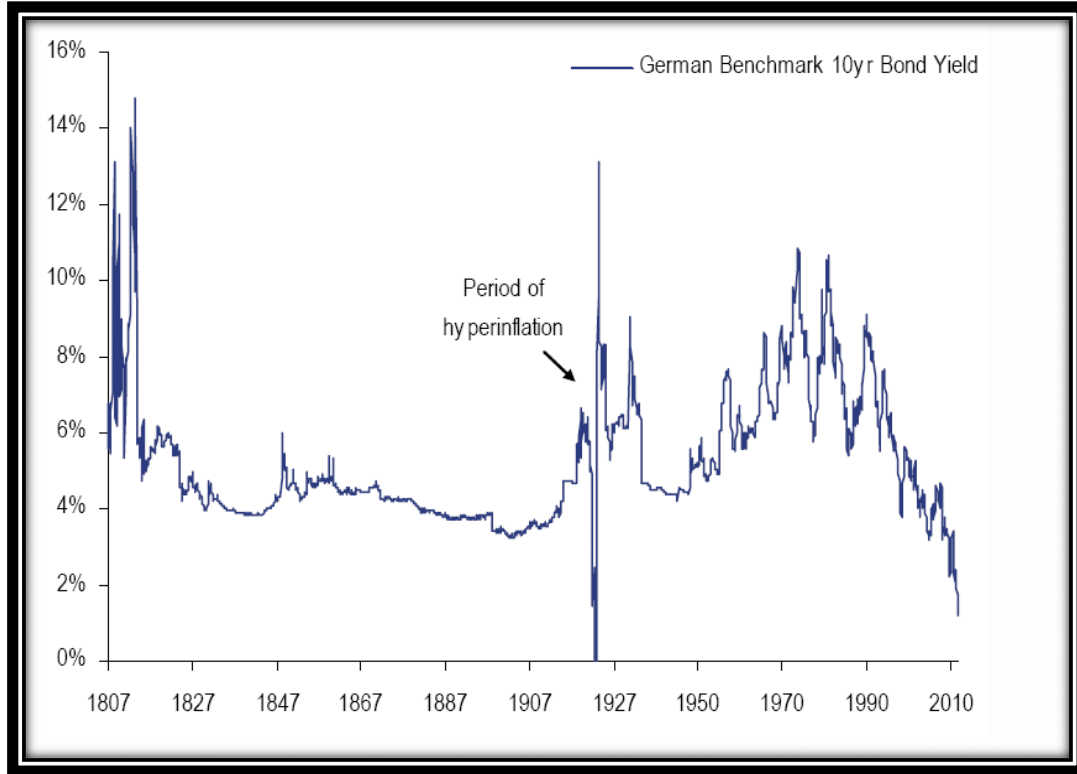


Should schemes in funding difficulty really increase exposure to an asset class offering negative real returns?

Are pension schemes not long term investors?

Source: Bloomberg, Eurostat

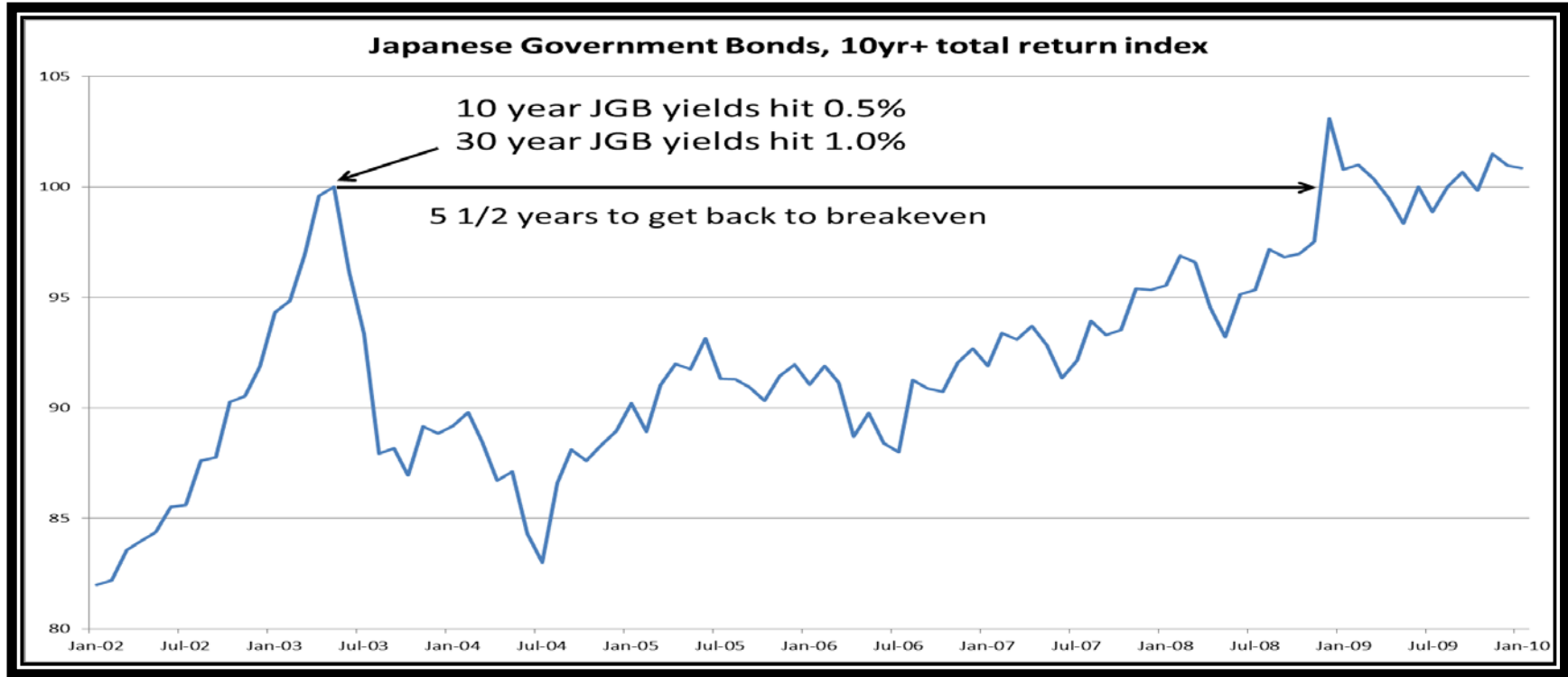
Cost of hedging



Source: Bank Of America Merrill Lynch

- Most expensive time in 200 years!
- The hedge isn't even perfect
- Any hedging surprise is likely to be negative

Is there a precedent in recent history?



What is the ideal solution?

- Bonds are an imperfect hedge - Scheme Assets not equal to scheme Liabilities
- Need something to pay for the hedging mismatch
- An allocation to another asset classes is required

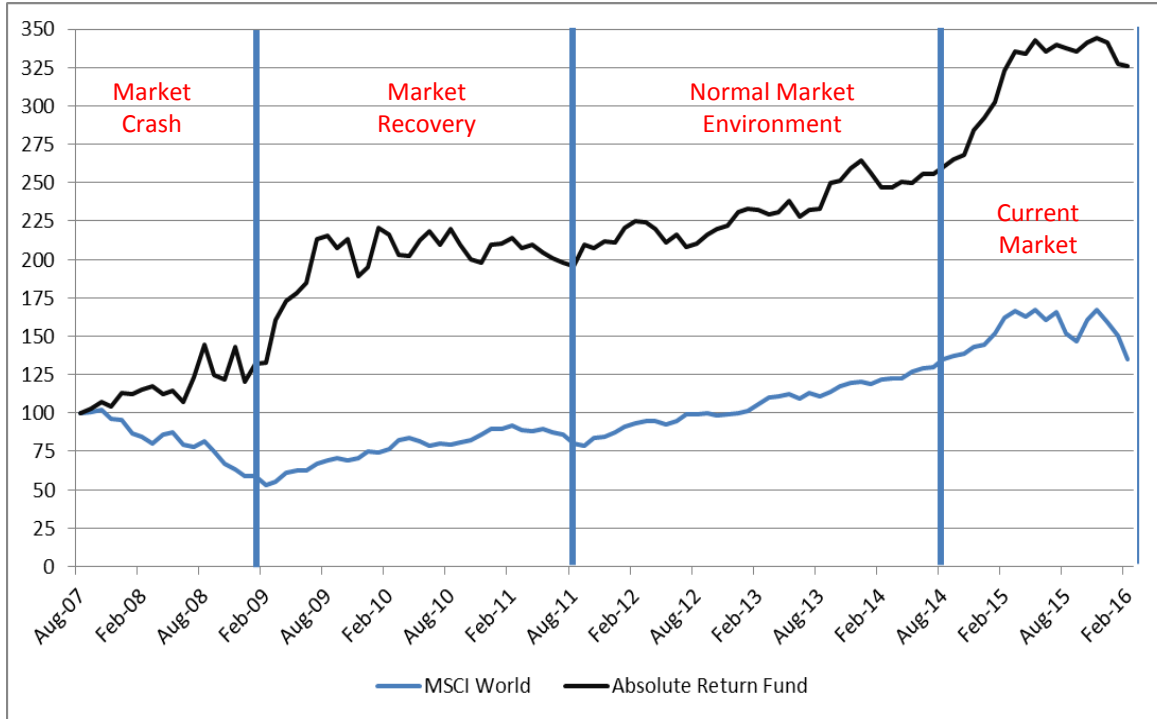
What is the ideal solution?

- Global Macro
- Equity Long-Short
- Quantitative Equity
- Equity Market Neutral
- Multi Strategy
- Systematic Macro
- Bond Long-Short
- Merger Arbitrage
- Tactical Asset Allocation
- Alternative Yield

What is the ideal solution?

- What characteristics do you need?
 - Protect against downside risks
 - Exhibit a low correlation with other asset classes
 - Ability to provide attractive real returns
- Is this wishful thinking?

Does such an asset exist?



RETURNS

- Absolute Return Fund: +15.0% p.a.
- MSCI World Index +5.2% p.a.
- BAML EMU 10yr + Index: 8.4%

STANDARD DEVIATION (5yr)

- Absolute Return Fund: 9.3%
- MSCI World Index: 11.4%
- BAML EMU 10yr + Index: 9.3%

CORRELATION OF ABSOLUTE RETURN FUND WITH:

- Equities: 0.25
- Bonds: 0.19
- Cash: 0.06
- Property: 0.22

Merrion Investment Managers

2nd Floor

Guild House

Guild Street

IFSC

Dublin 1

Phone: 353-1-670 2500

Fax: 353-1-670 2356

Warning: Past performance is not a reliable guide to future performance.

Warning: The value of your investment may go down as well as up.

Warning: This fund may be affected by changes in currency exchange rates.

Warning: If you invest in this fund you may lose some or all of the money you invest.

Merrion Capital Investment Managers (trading as Merrion Investment Managers) is regulated by the Central Bank of Ireland.