Hermes Commodities

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Hermes

BT Pension Scheme & Commodities

- An early adopter of commodities.
- Commodities is a significant asset class for the BT Pension Scheme.
- Demonstrated ability to outperform

Source: * Hermes as at end September 2009.

Commodities - Buying Process

Why Commodities?
- Diversification
- Inflation Protection
- Event Risk Insurance
- Positive Risk Premium

What?
- Index or Active
- Benchmark (DJ-UBS, GSCI, RICI)
- Collateral (Cash, Credit, TIPs)

How?
- Swaps
- Futures
- Exchange Traded
- Fund
- Equities
- Physical

Who?
- Fiduciary (Fund, Pension)
- Investment Bank
- Hedge Fund
- In House

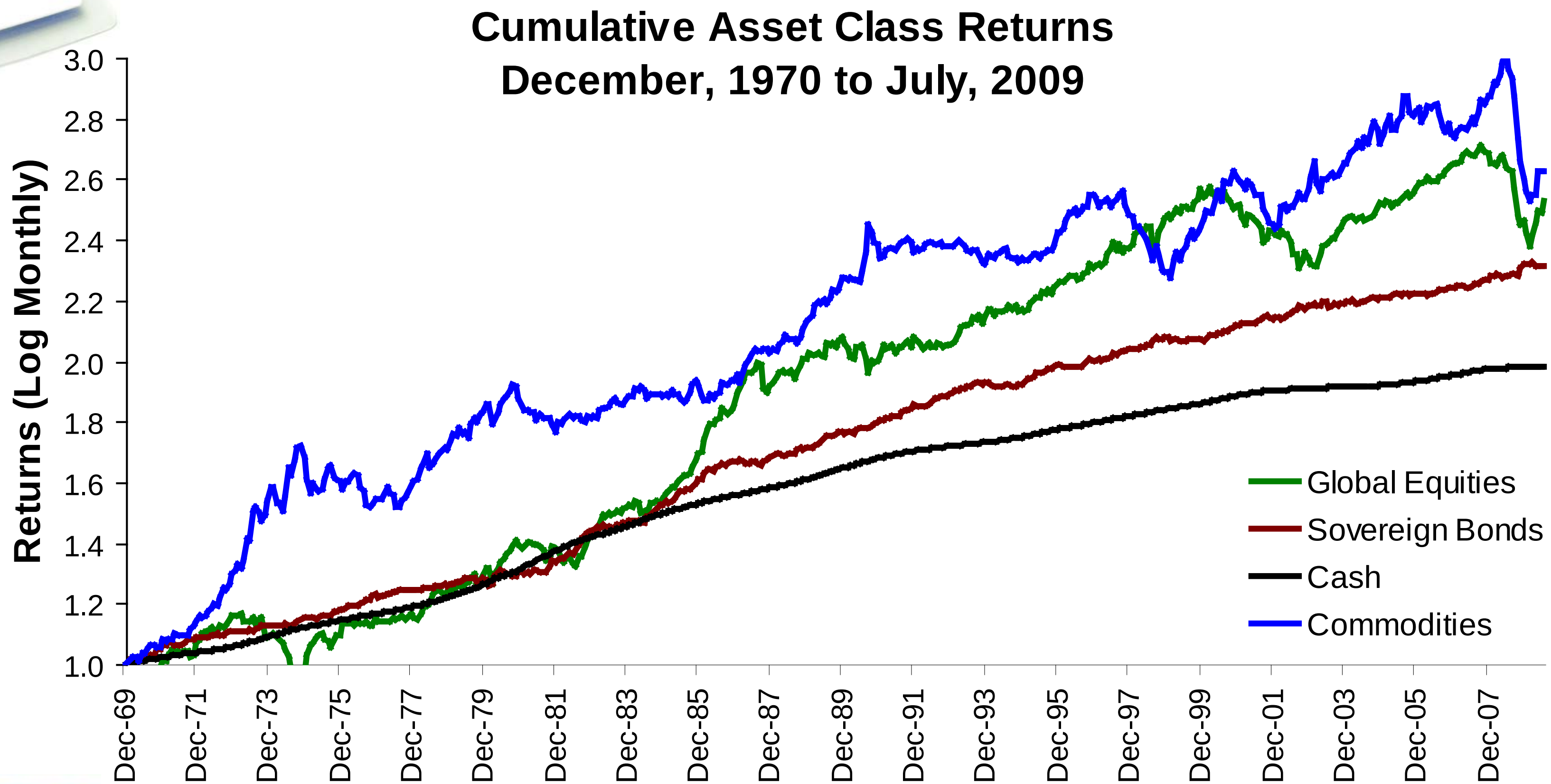
- Increasingly investors spending more time on how to gain exposure.

Why Invest In Commodities?

Why Invest In Commodities?

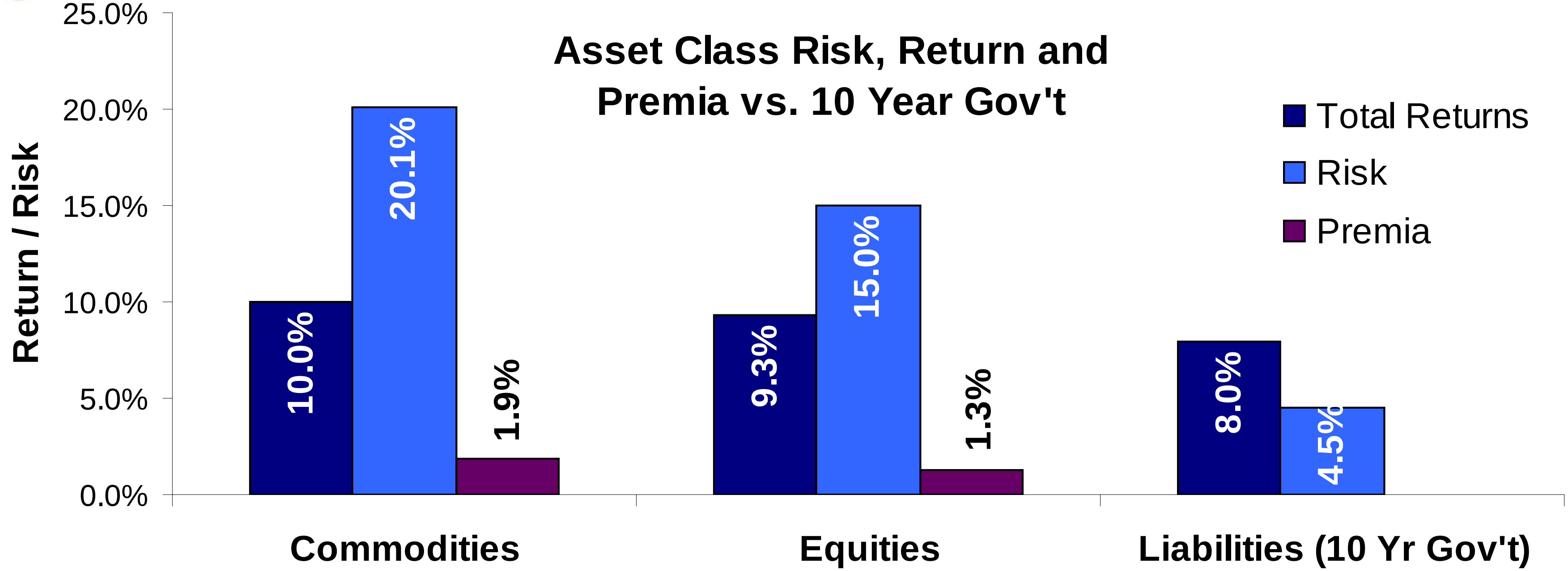
- A positive return over time
  - Similar return and risk profile to equities
  - A positive forward-looking risk premium
- Portfolio diversification
  - Low correlations with other asset classes
- Portfolio protection
  - Hedge against rising inflation
  - Hedge against event risk
- Liquid and transparent
  - More transparent & liquid than “traditional” alternative investments
  - No leverage required to gain benefits

Risk Return Profile of Commodities



Source: World Equities is the MSCI World Equity Index, Bonds is the Barclays 10 Year US Government Index, Cash is the Bloomberg 3 Month Treasury and Commodities is the Standard and Poor's GSCI Total Return Index.

Risk Return Profile - Since 1970



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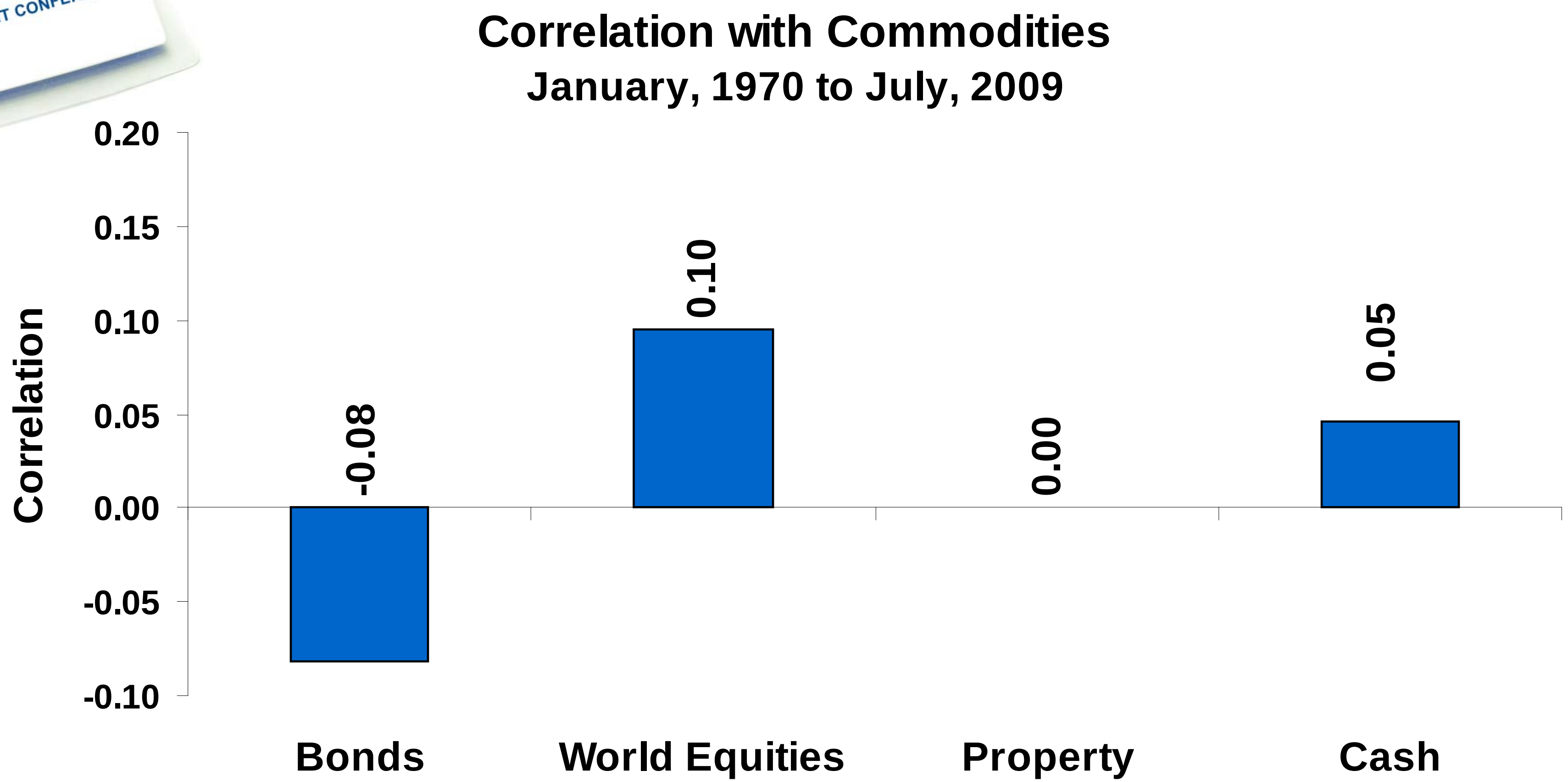
Commodity Market Returns Forward-Looking Expectations

- Spot Return
  - Price appreciation
  - Linked to GDP growth rates and producer price index (i.e. PPI)
- Collateral Return
  - Short-term cash rates
  - Linked to inflation (i.e. CPI)
- Roll Return
  - Analogous to yield that can be positive or negative
  - Linked to cost to maintain commodity exposure

$$E(R_{SPOT}) + E(R_{CASH}) + E(R_{ROLL}) - E(R_{10yUST}) = E(R_{Premium})$$

$$2.25\%_{[1.5,3.0]} + 3.5\%_{[2.0,4.5]} + 0\%_{[0,0.75]} - 5\% = 0.75\%_{[-1.5,3.25]}$$

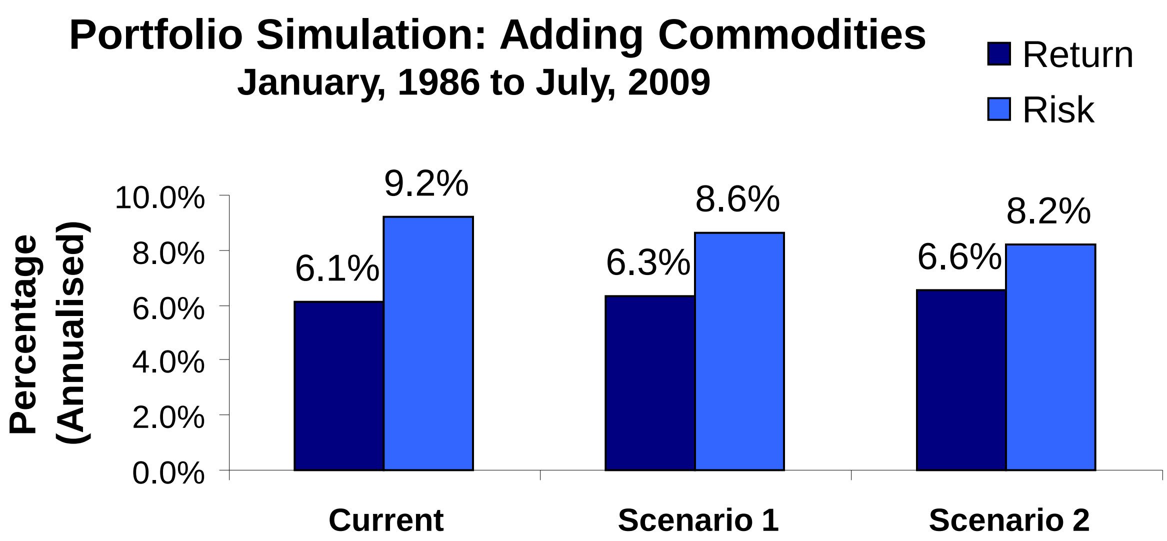
Commodity Correlation



Source: World Equities is the MSCI World Equity Index, Bonds is the Barclays 10 Year US Government Index, Cash is the Bloomberg 3 Month Treasury, Property is the UK IPD Property Index from 1986 and Commodities is the Standard and Poor's GSCI Total Return Index.

Adding Commodities to a Strategic Asset Allocation

	Current	Scenario 1	Scenario 2
Equity	60%	55%	50%
Bonds	30%	30%	30%
Property	10%	10%	10%
Commodities	0%	5%	10%



- Commodities though volatile can actually reduce overall portfolio risk

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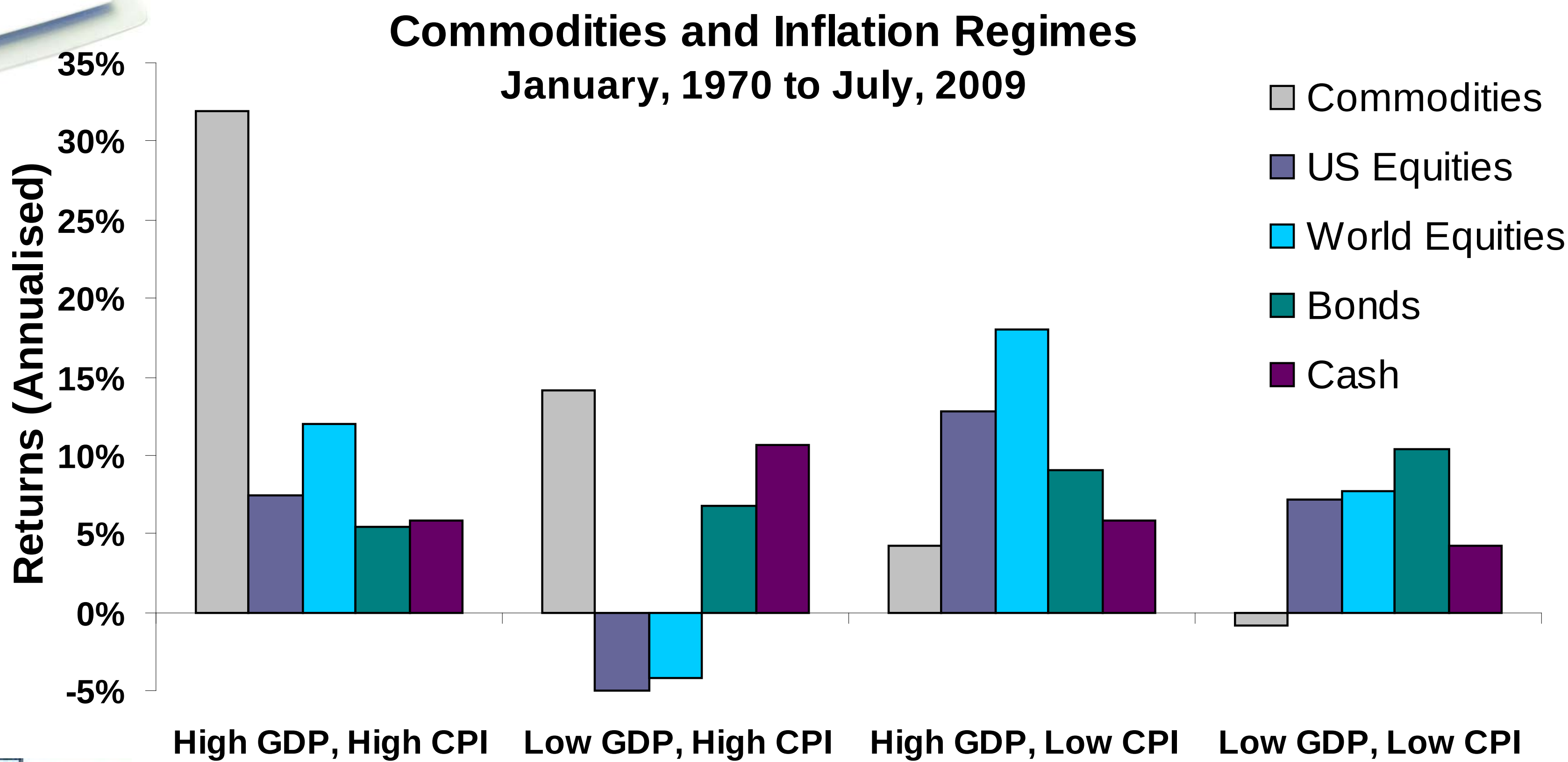
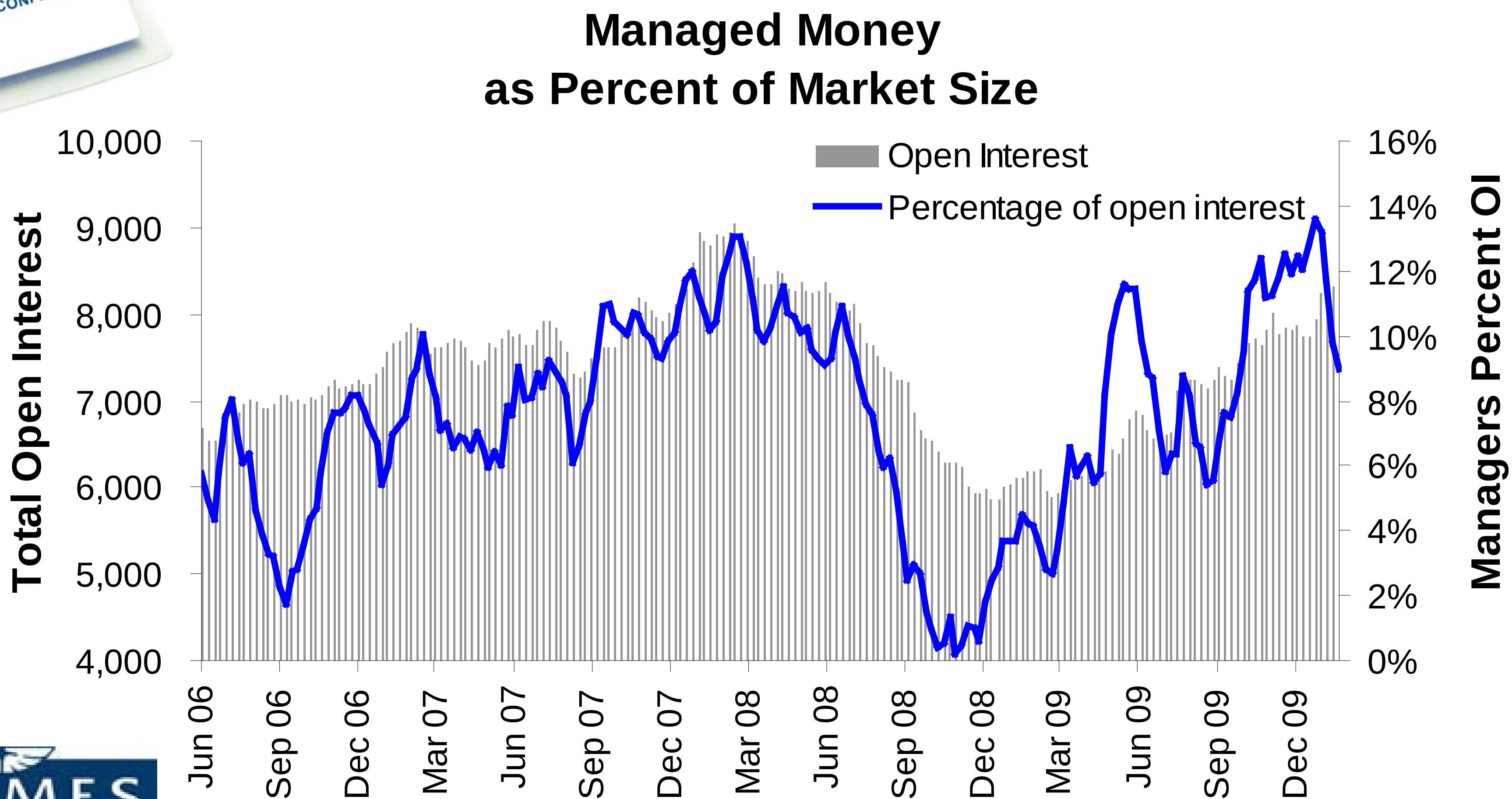
Commodities and Inflation Regimes



Source: World Equities is the MSCI World Equity Index, Bonds is the Barclays 10 Year US Government Index, Cash is the Bloomberg 3 Month Treasury, Property is the UK IPD Property Index from 1986, US Equities is Standard and Poor's and Commodities is the Standard and Poor's GSCI Total Return Index. "High GDP" for example is defined as above trend where the trend is the historical average. "Low GDP" is defined as below trend or the historical average.

Liquidity Providers - Market Capacity



Source: Hermes, CFTC and Barclays Capital.

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THANK YOU

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