



The Evolution of DC Investment

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Managing DC expectations.....



UK DC market so far

- UK DC assets expected to grow to £1,000 bn in 2019
 - Growth of approx 11% per annum
- Current size estimated at £370bn
- Trust and Contract structures
- 2012 – Auto enrolment for UK
- Focus on default fund design

Are there any ground rules for default funds?

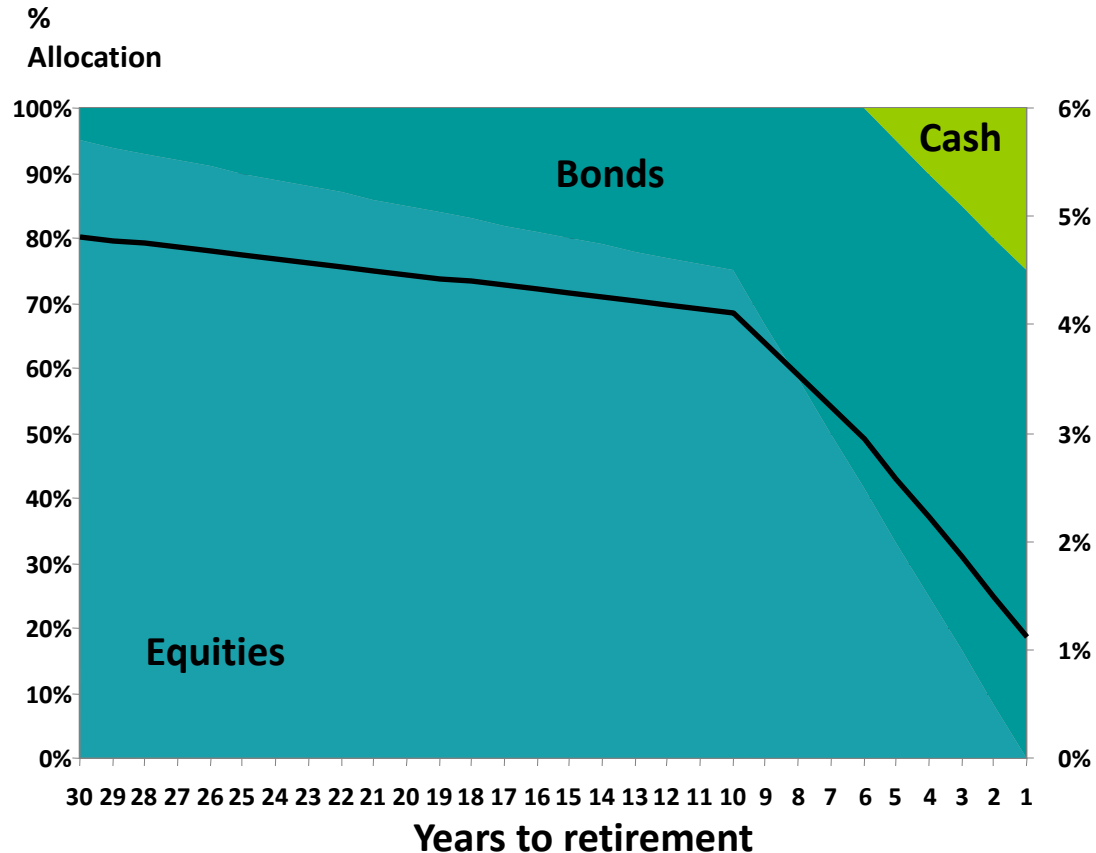
Investment Governance Group (a Govt/ Industry group sponsored by HMRC and DWP) has outlined 6 principles for Investment Governance of work-based DC pension schemes:

1. Clear roles and responsibilities for investment decision-making and governance
2. Effective decision-making
3. Appropriate investment options
4. Appropriate default strategy
5. Effective performance assessment
6. Clear and relevant communication with members

What this really means for trustees?

1. Consider the member's risk tolerance and profile
2. Understand the likely format and structure of their retirement benefits

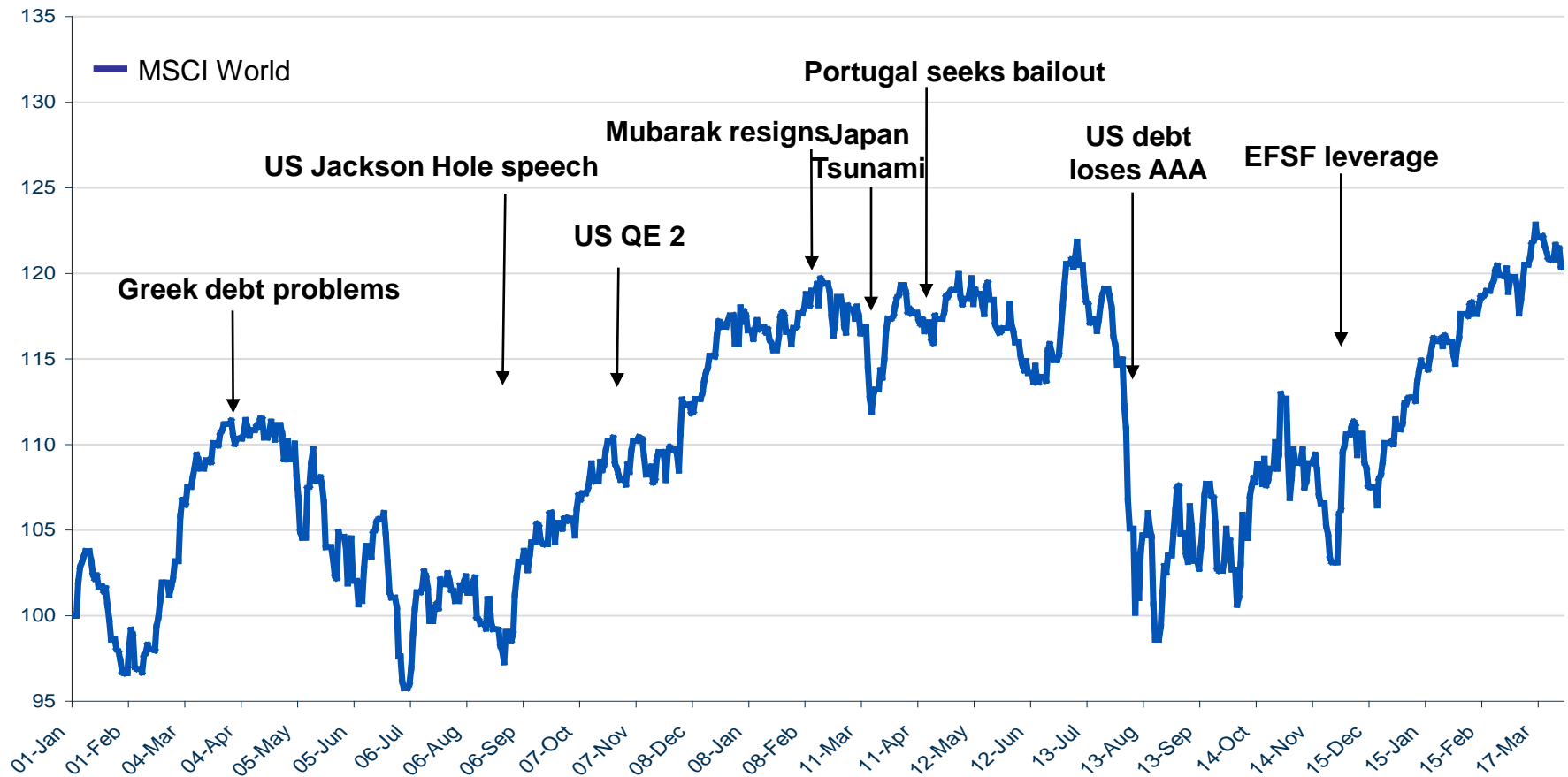
The common default strategy design



- 'Bolt on' to DB scheme?
- Often passive funds used
- Volatile journey for members
- Assumes 'cliff edge' retirement
- Reduces risk at retirement but also investment returns

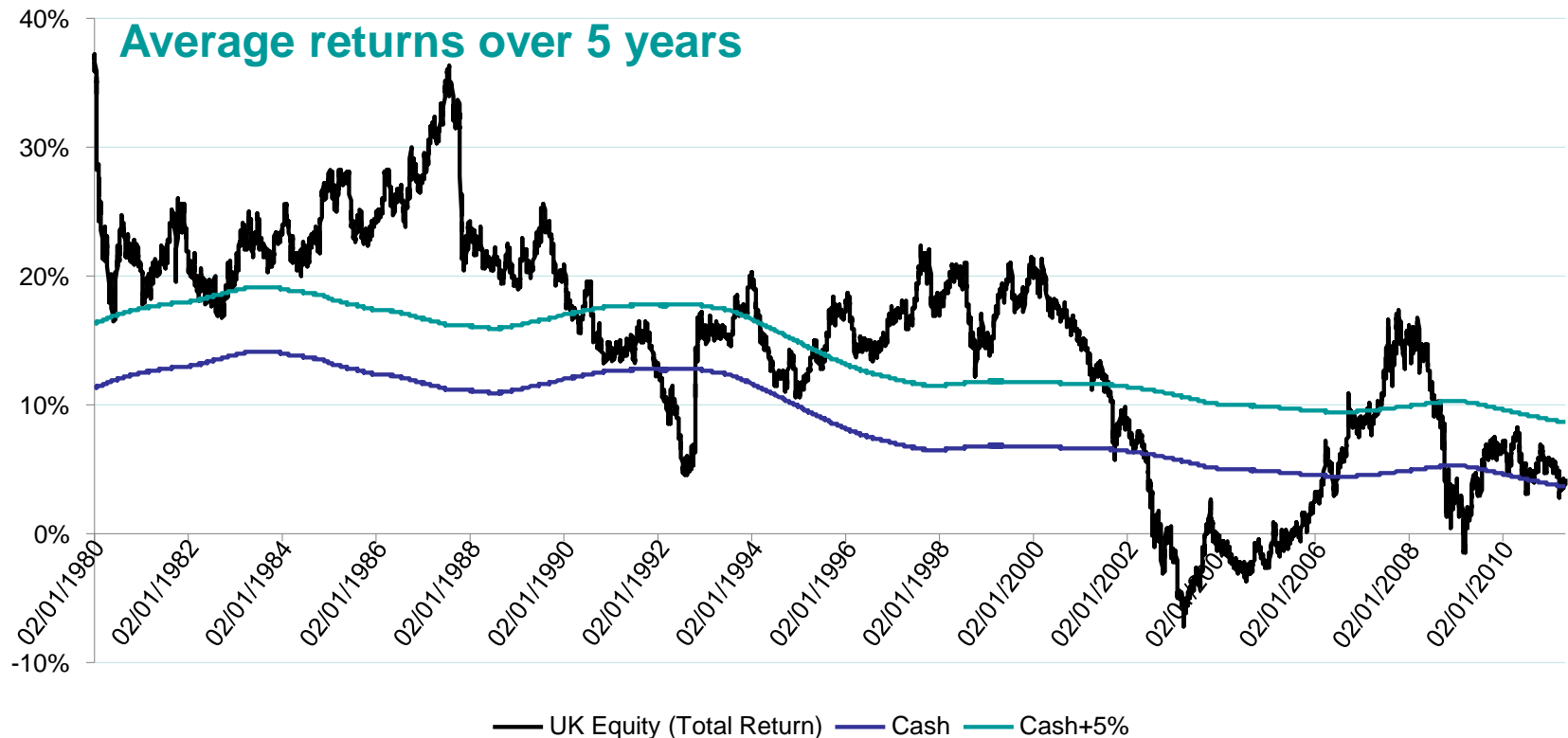
Set and forget ?

Considering the member's risk tolerance?



Source: Standard Life Investments, gross £ performance GARS Fund vs. MSCI £ from 01 January 2010 to 31 March 2012

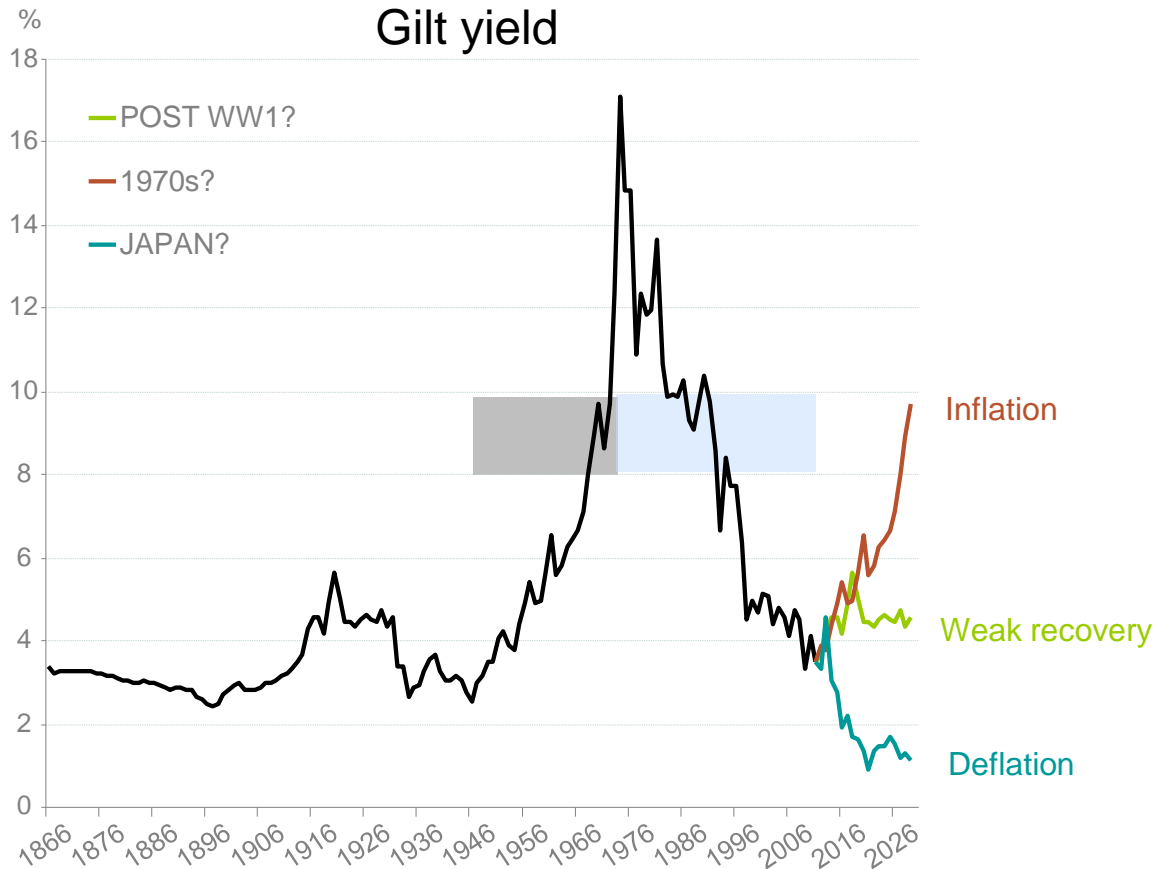
How reliable is equity investment?



- Some global equity markets have delivered negative returns over long periods, prompting a review of equity allocations
- Is there a more reliable way to deliver similar returns?

Source: Standard Life Investments

Bond yields bottoming out – which way next?



Source: Global Financial Data, Standard Life Investments

- Over 100 years UK bonds have outperformed cash by 0.4% on average
- However this hides periods of extreme volatility
- 1950-1980: Bonds underperformed cash by nearly 2%
- 1980-2011: Bonds outperformed cash by nearly 2%

Bonds cycles can be long and varied – bull market coming to an end?

Diversification in DC pension schemes

- **Historically pooled balanced funds**
 - A limited asset mix
- **Target Dated Funds**
 - Similar to life-cycle
- **Diversified growth funds**
 - Some more diversification
 - “Foul weather” correlation
 - Strategy subject to peer pressures
- **Absolute returns – true diversification**
 - Much more diversification
 - Cash benchmark means a wide opportunity set

More focus than ever on DC Investment solutions

Asset Allocation – the difficulty of choice...

Discrete Yearly Performance (%) by Market

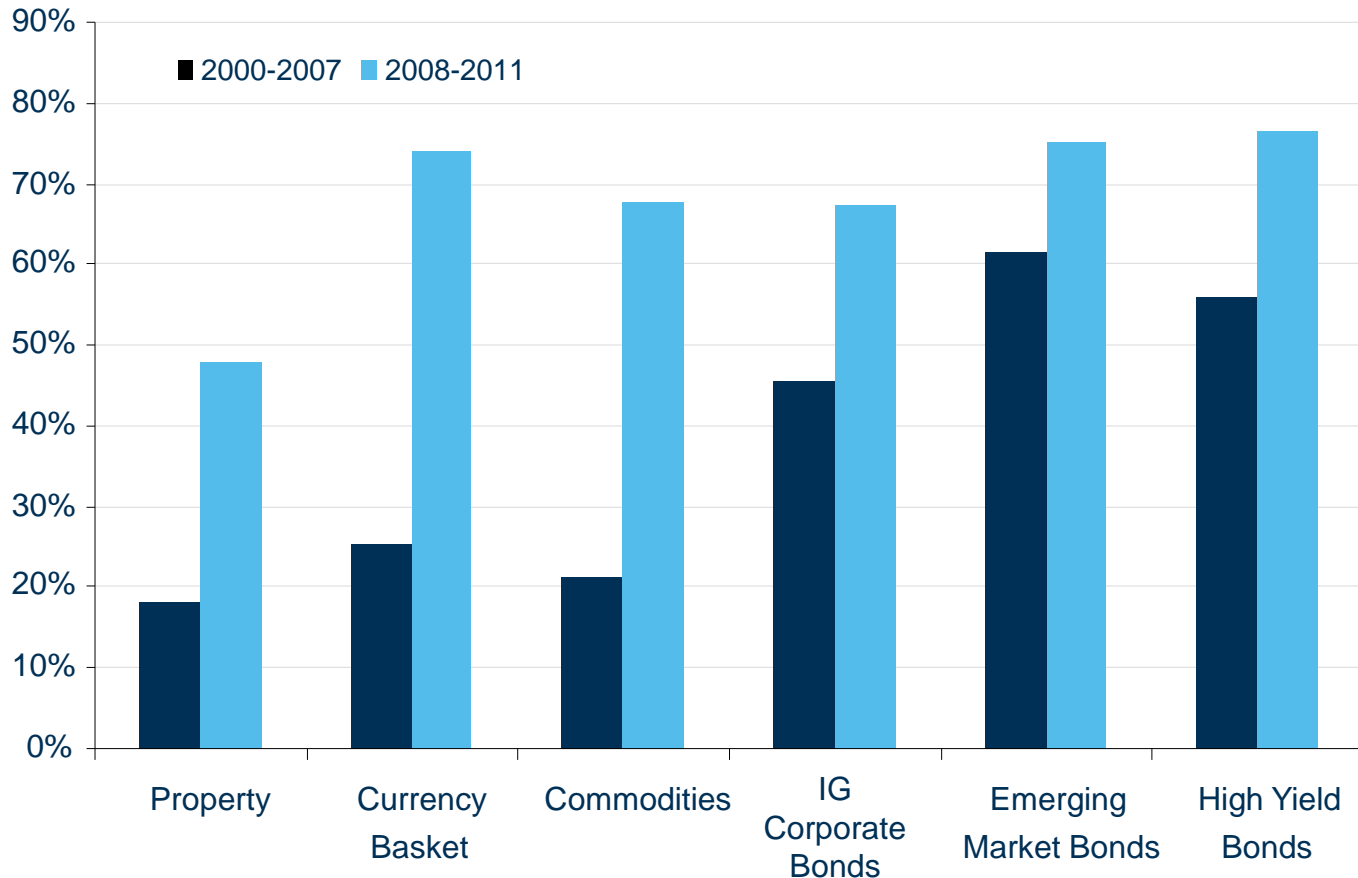
2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
10.51	7.06	10.45	40.88	18.89	50.46	22.87	37.43	12.81	59.39	22.94	15.57
10.39	6.65	10.14	40.54	17.44	40.49	20.13	32.21	-0.12	57.67	21.91	8.09
8.76	5.9	9.25	32.67	14.87	34.25	18.12	15.72	-1.85	52.72	19.23	7.6
6.91	3.05	-10.63	29.74	13.83	24.08	16.75	5.32	-2.14	44.22	18.68	3.39
1.72	1.62	-14.57	22.44	13.07	22.04	16.3	5.27	-12.77	30.12	17.47	2.87
1.59	0.2	-15.02	20.86	12.84	18.96	15.91	3.72	-22.53	20.09	16.9	-3.46
-1.93	-9.56	-18.74	17.55	8.11	18.83	1.57	1.85	-23.99	12.6	14.51	-12.73
-5.9	-13.29	-22.68	15.73	6.75	17.33	0.69	1.28	-29.93	8.09	14.49	-13.55
-22.39	-15.48	-27.04	11.24	6.6	13.46	0.57	-5.47	-31.15	2.18	7.8	-14.71
-25.13	-20.05	-27.77	5.12	4.83	8.78	-0.41	-5.75	-35.18	-1.16	7.2	-15.16
-25.26	-27.42	-29.58	2.1	3.39	7.93	-6.73	-17.92	-48.32	-5.28	5.75	-17.57

Global High Yield Bonds		UK Equities		UK Direct Property		
UK Investment Grade Bonds		European Equities		Asia Equities Ex Japan		Japan Equities
UK Gilts		UK Small Cap		Emerging Market Equities		US Equities

Source: Lipper Hindsight, total returns, in £ terms, 31 December 2011

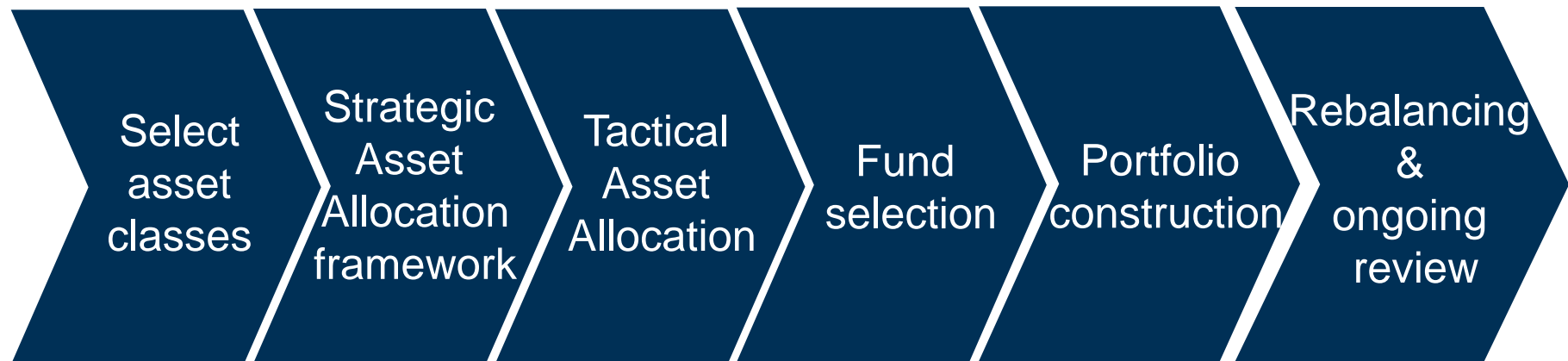
Finding diversity is increasingly difficult

Correlation of Global Equities with other market sectors



Source: IPD UK Monthly Property Index, All Property; Federal Reserve Trade-Weighted Exchange Value of US Dollar vs 6 Countries; Dow Jones UBS – Commodity Index; Barclays Capital Global Corporate Index, Excess Returns; Barclays Capital Emerging Markets Index, Excess Returns; Barclays Capital US High Yield Index, Excess Returns; Standard Life Investments, 31 December 2011

Putting in Place a Comprehensive Investment Process



Establishing a quantitative and qualitative decision framework

Conclusion

- Auto enrolment in the UK is bringing greater focus on governance from regulators
- Move away from historical 'set and forget' approach
- Increasing use of DGF & Absolute Return Strategies that bring dynamic Asset Allocation
- Essential characteristics in future - require schemes to be durable, fair and deliver good outcomes for the members

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Thank You
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