The Investment Conundrum

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The Equity Dilemma

Why invest in equities?

- Strong long-term growth potential
- Access to the equity risk premium
- High liquidity

However:

- Equities have had a very strong run since 2009
- Equities are volatile
- Pension schemes are already heavily exposed to equities

Timely to diversify from equities = “bank” gains

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The Bond Dilemma

Why invest in bonds?

- DB schemes need to manage risk and meet regulatory requirements
- DC schemes need to cater for members who may purchase annuities

However:

- Is now the time to increase government bond allocations / buy annuities?
- Impact on expected return on assets and cost of de-risking today

May have to live with higher risk than desired

May need to manage risk within bond portfolio

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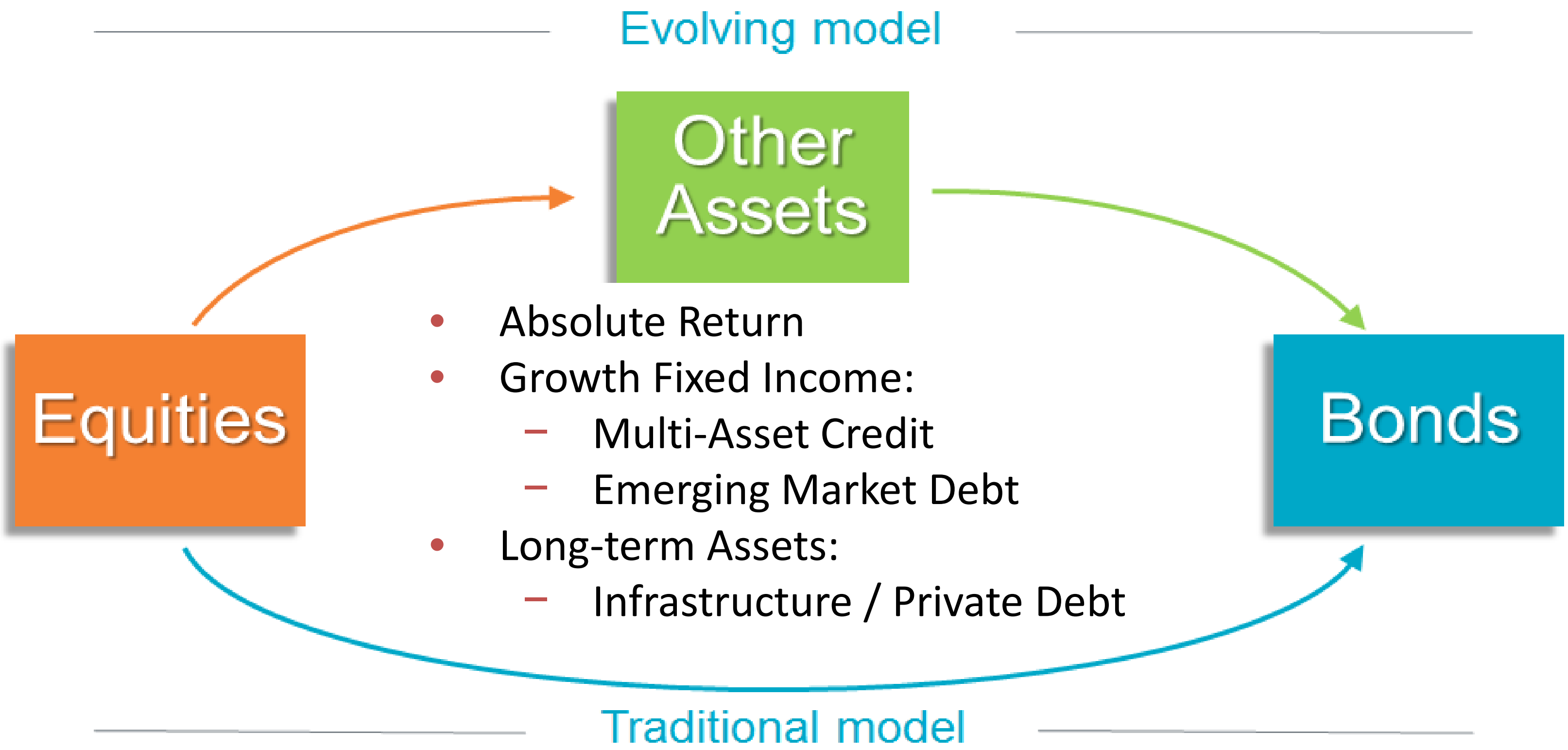
Derisking through Portfolio Diversification



- Absolute Return
- Growth Fixed Income:
  - Multi-Asset Credit
  - Emerging Market Debt
- Long-term Assets:
  - Infrastructure / Private Debt

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Managing Risk within Bond Portfolios

Three Key Imperatives:

1) **Matching Liabilities**
    - Schemes typically under-hedged relative to liabilities
    - Still makes sense to have a core allocation to long dated Eurozone bonds
    - BUT what about new money?
2) **Protecting against rising bond yields**
    - Consider lower duration for new allocations to Government bonds
    - Consider Absolute Return Bond strategies (Cash + 2-3%)
3) **Targeting higher yields**
    - Consider global government bonds
    - Consider global corporate (i.e. non Government) bonds

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Conclusion

- Most asset classes at fair value or looking expensive today
- Portfolio diversification is an essential risk management tool
- Need to adopt a more dynamic approach to investing
- Need to enhance governance to be able to move quickly

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