Impact of QE on DB schemes

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Agenda

- How has QE impacted the average DB scheme?
- What will happen from here?
- What can Trustees do to manage growing risks?

How has an 'average' scheme performed?

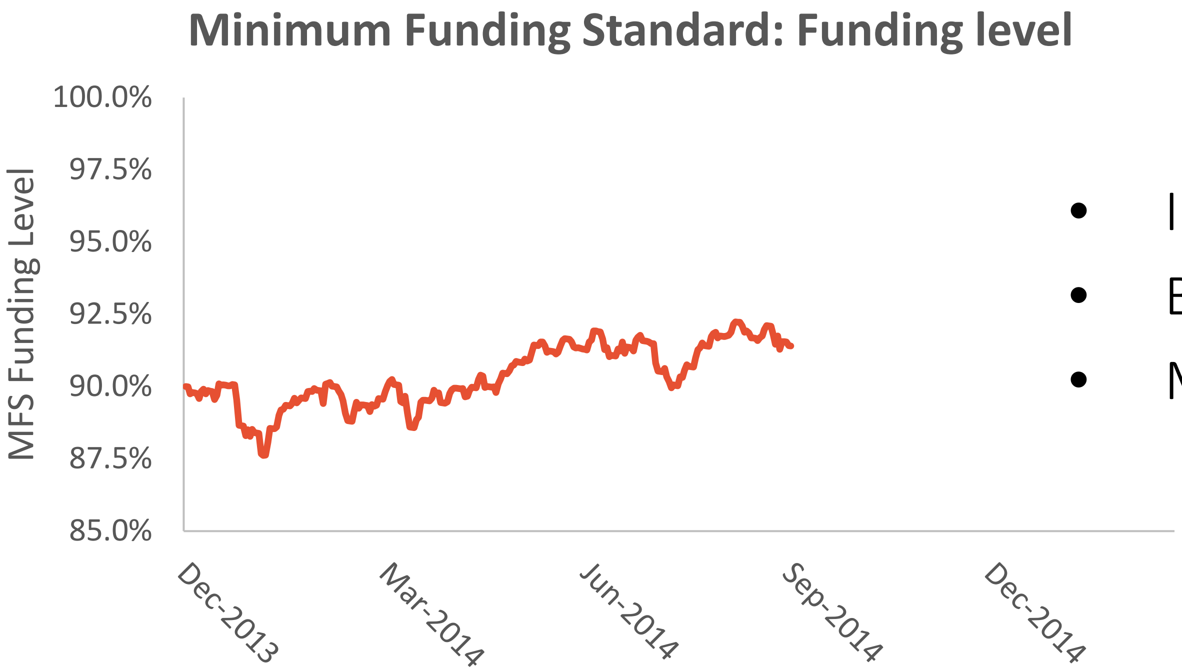
Funding proposal in place to 2023

50% return seeking / 50% matching bonds (Source: IAPF Survey)

90% funded on an MFS basis at the beginning of 2014

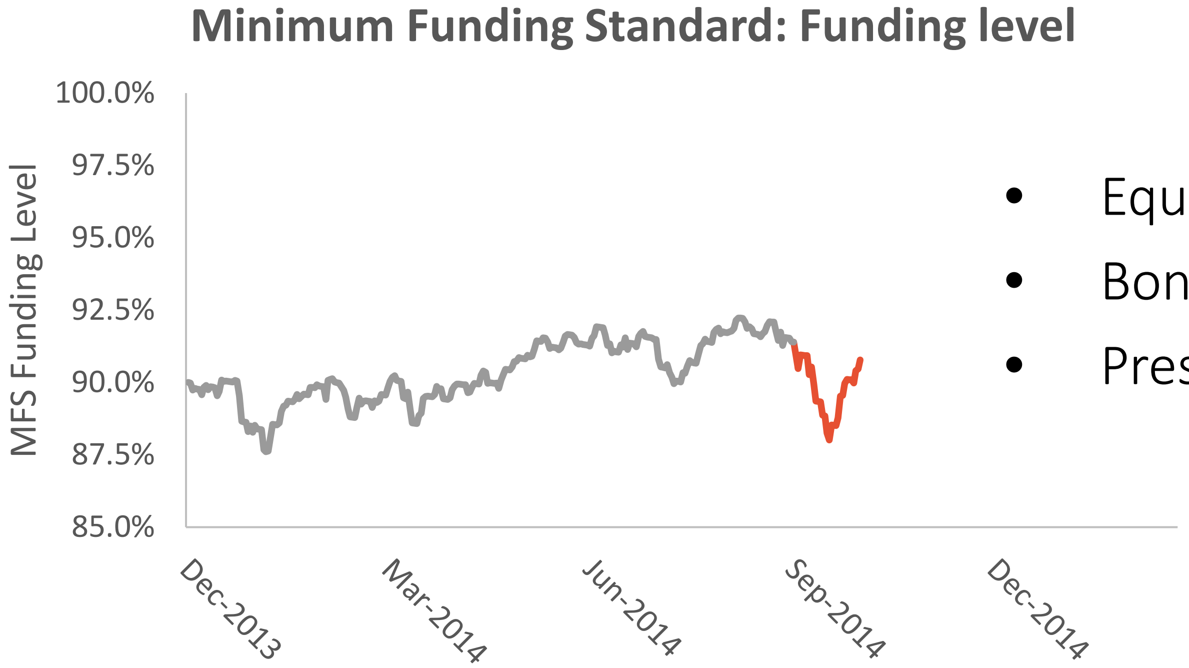
Average liability profile (Source: Pensions Authority)

2014 – a benign beginning



- Inflation falling
- Bond yields declining
- Modest equity returns

October – a word of warning



- Equities lose 7%, but recover
- Bond yields decline 0.2%
- Pressure for QE builds

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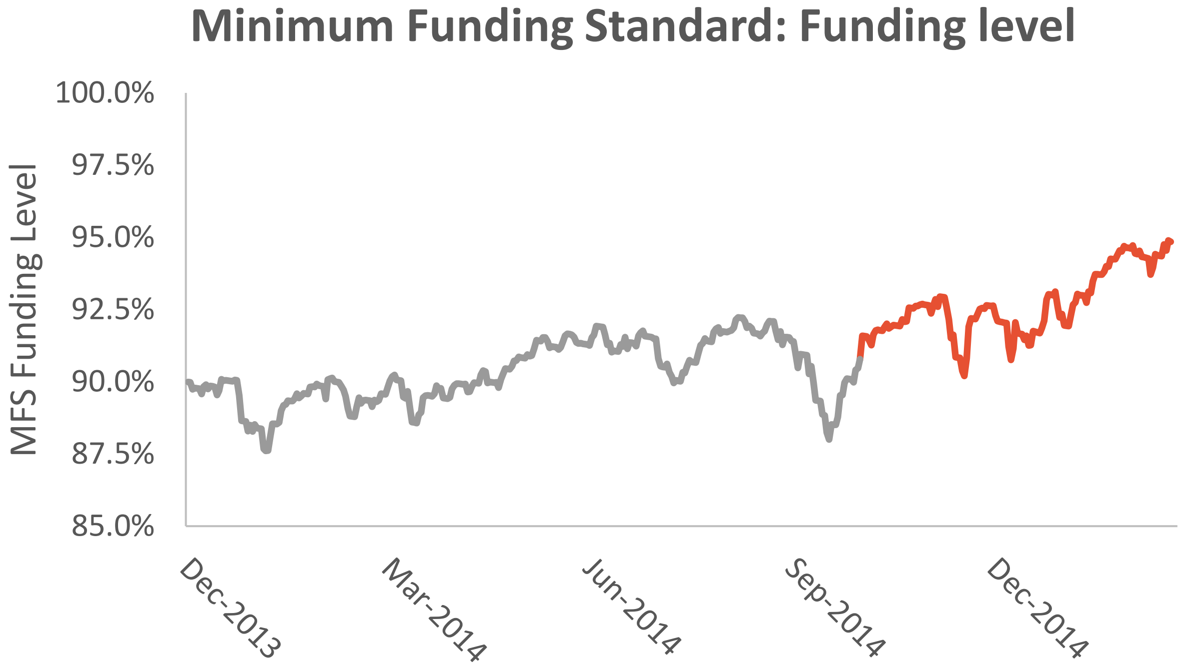
QE fuels the furnace



- Bond yields drop 1%
- Euro weakens by >15%
- Equities gain 8%

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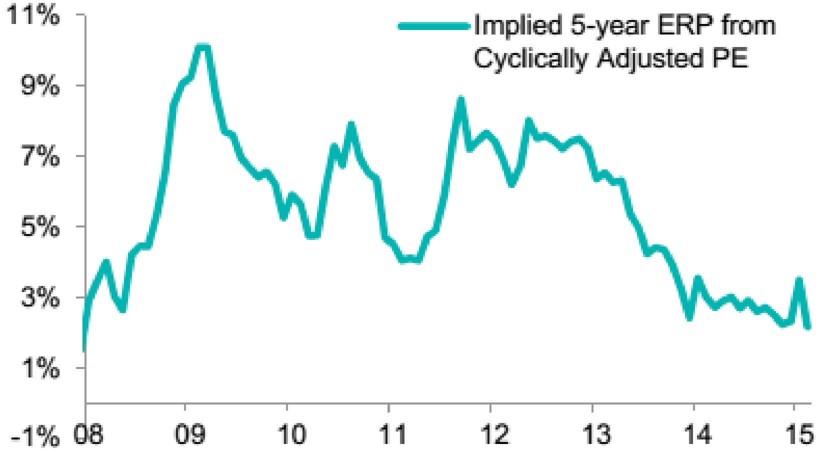
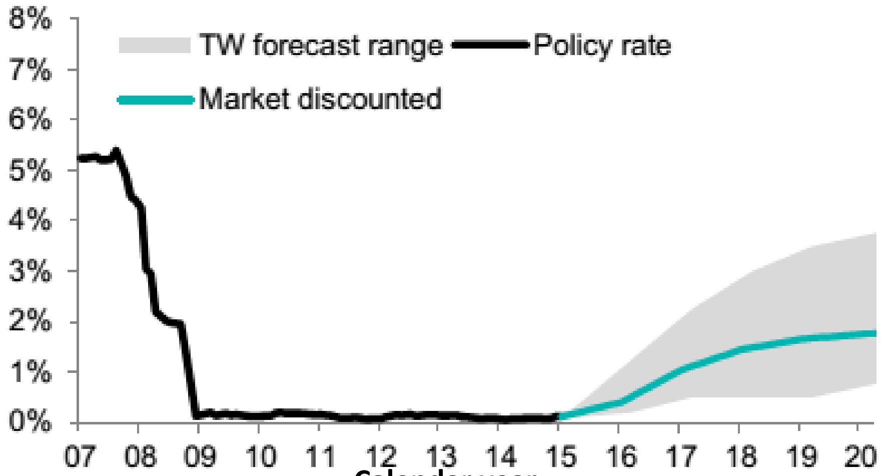
Equity & bond outlook



Calendar year

Source: Federal Reserve, European Central Bank, Bank of England, Bloomberg LP, Factset, Towers Watson



Calendar year

Source: Bloomberg LP, Federal Reserve, Towers Watson

Global equities looking increasingly expensive

Cash / bond yields expected to slowly recover

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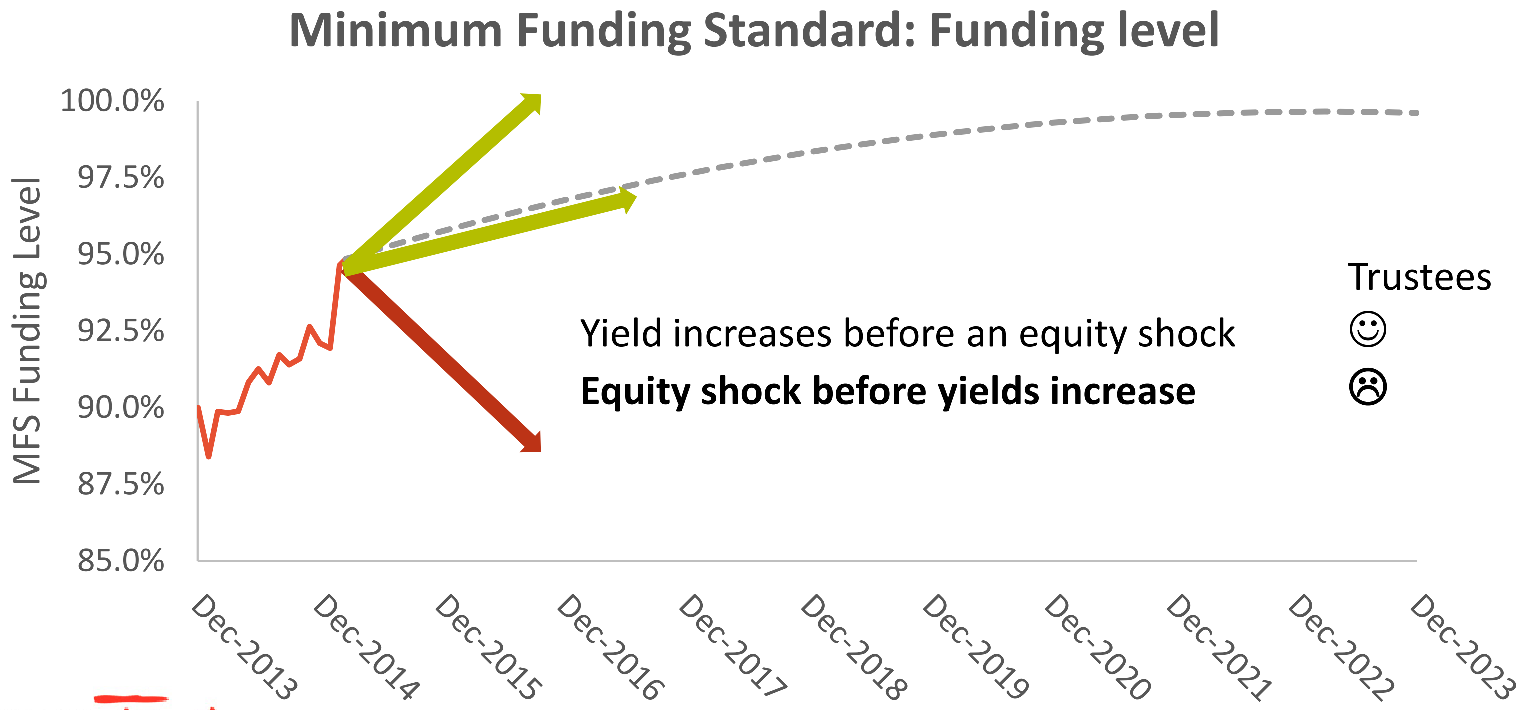
Where to from here?



	Trustees	Sponsor
Yield increases before an equity shock	☺	☺
Equity shock before yields increase	☹	☹

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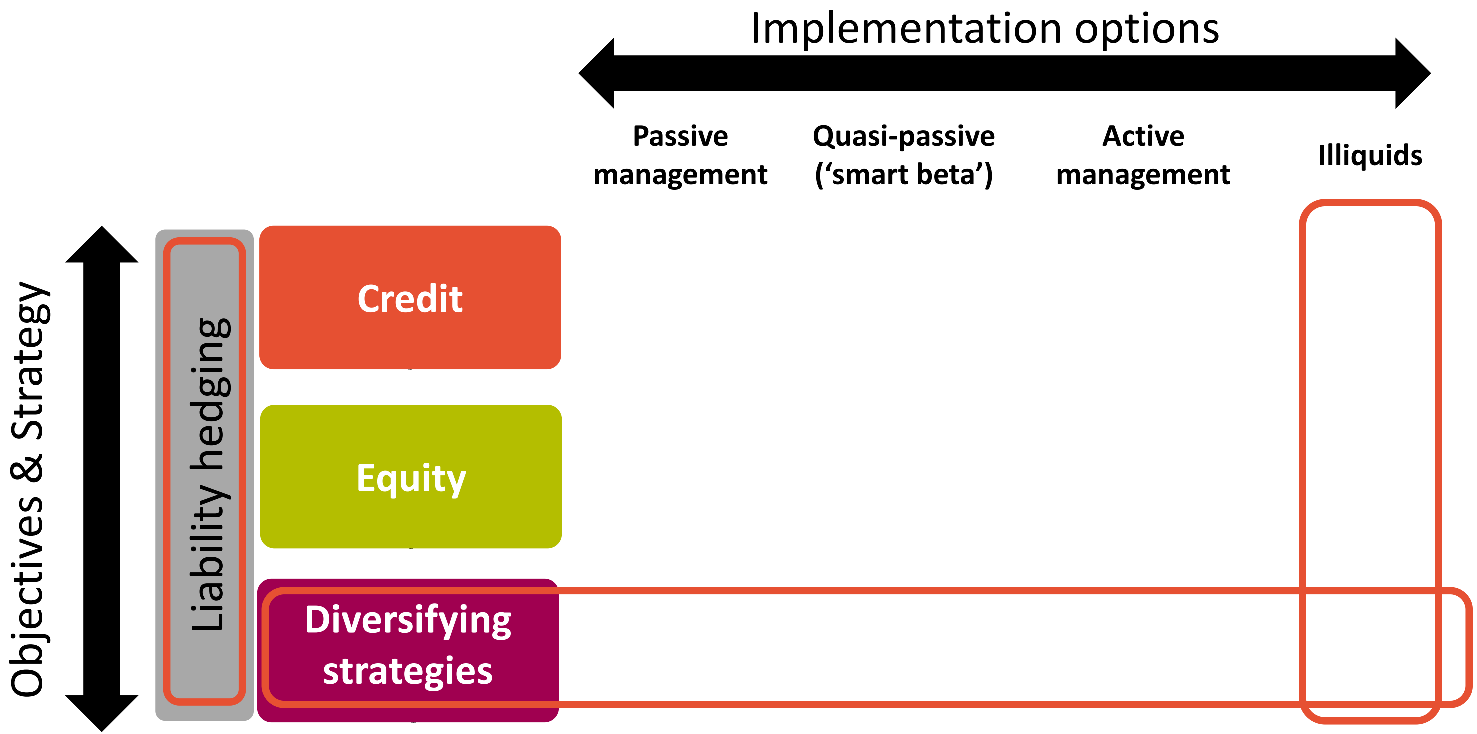
Trustee focus - Portfolio construction



Bonds - To hedge or not to hedge?

- Current bonds valuations aren’t everything
- Portfolio construction is key

Robust Portfolio Construction

Current market valuations

Liability hedging

Tail risk hedging

Covenant risk hedging

Diversifying strategies

- Genuine diversification
- Economic reward for bearing other risks
- Low correlation to equities & credit
- Low reliance on manager skill

Reinsurance

Trend

Volatility premium

Merger arbitrage

Carry premium

Cash + 3-4% target return

Equity sensitivity <0.2

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Secure income assets

- Assets providing contractual cashflows to meet liabilities

Renewable energy assets

Ground rents

Government bonds

Long-lease property

Social housing

Social infrastructure

Long-lease property

20 year plus leases

Inflation-linked

Investment grade tenants

Inflation + 4% target return

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Summary

- Funding levels are healthy…
- … but return expectations are low
- Scheme exposed to an equity shock
- Portfolio construction is key
- Selective opportunities in diversifying & illiquid strategies