Irish Association of Pension Funds

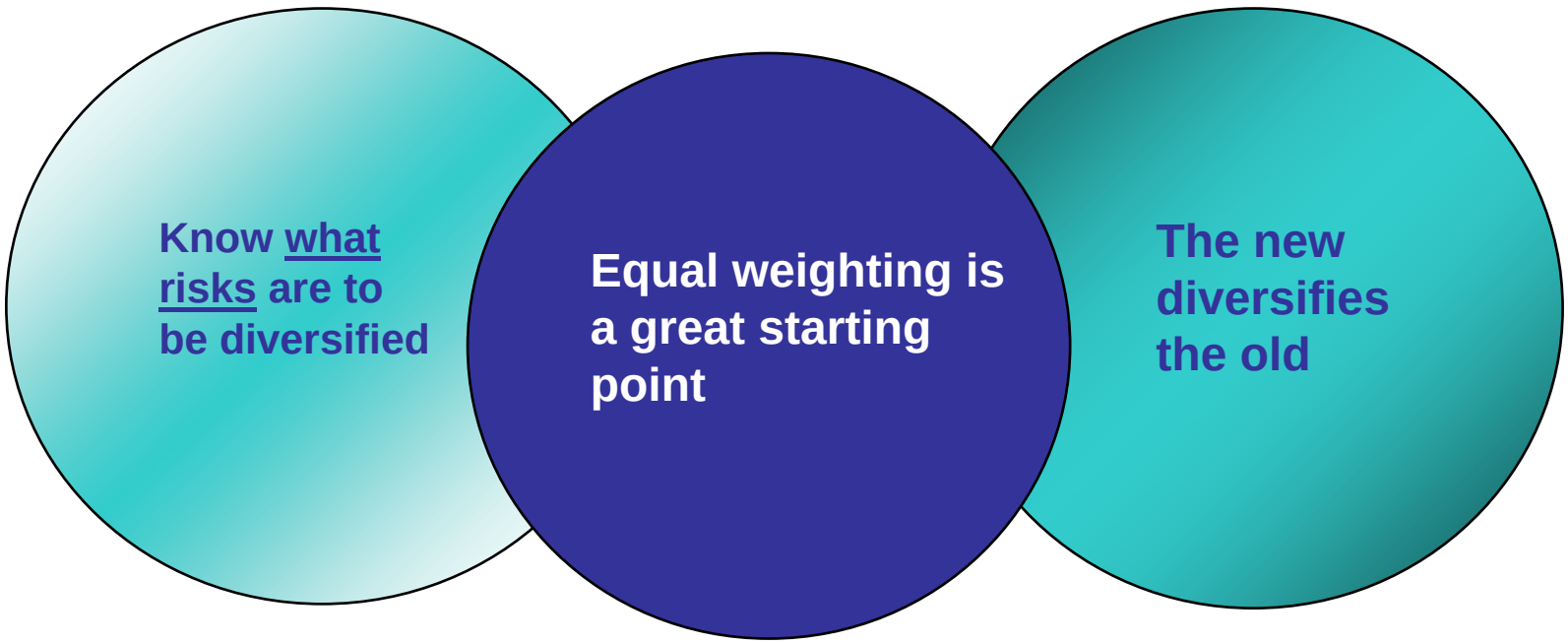
The search for diversity

Ronan Smith

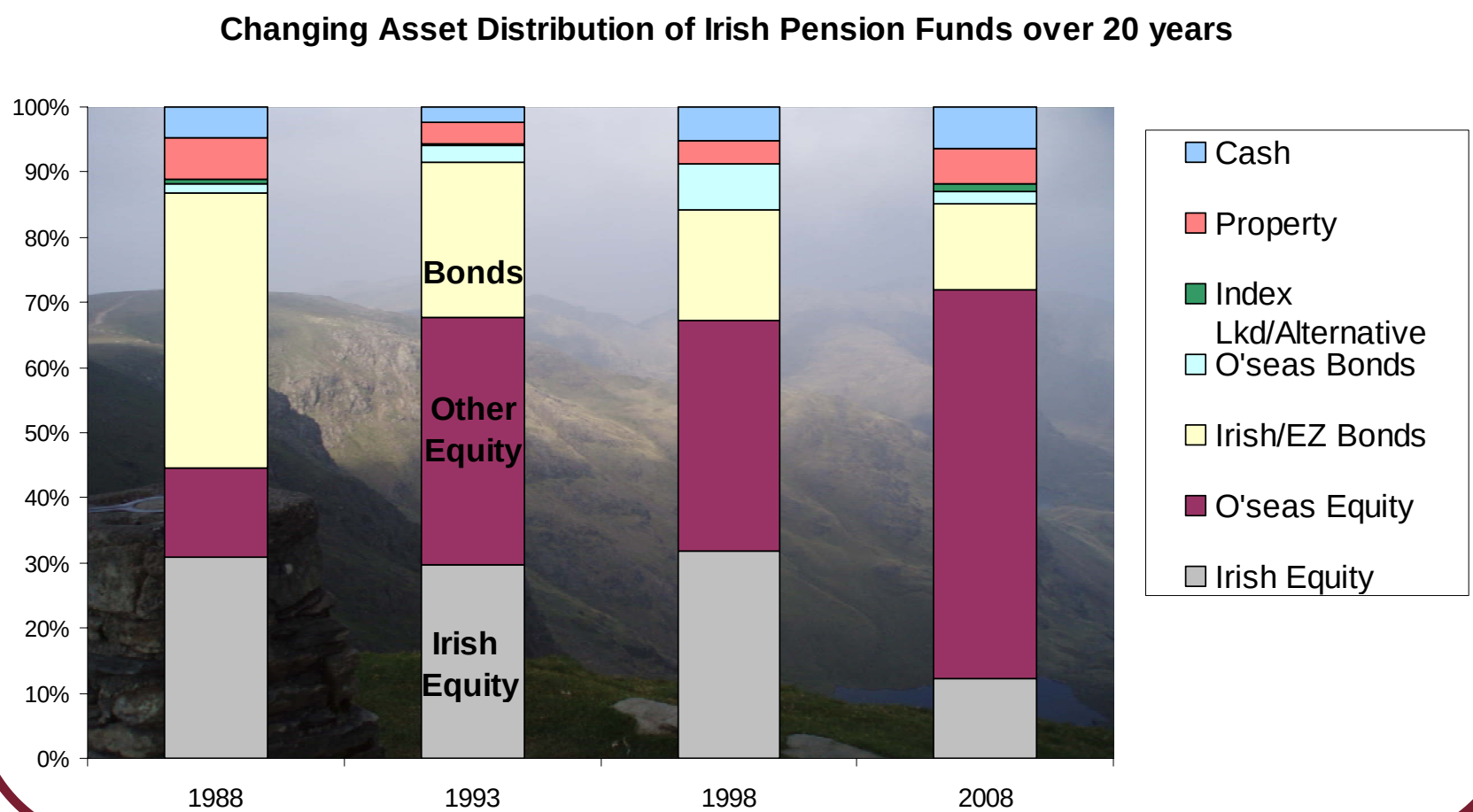
RSIC

5 November 2008

Three diversifying principles



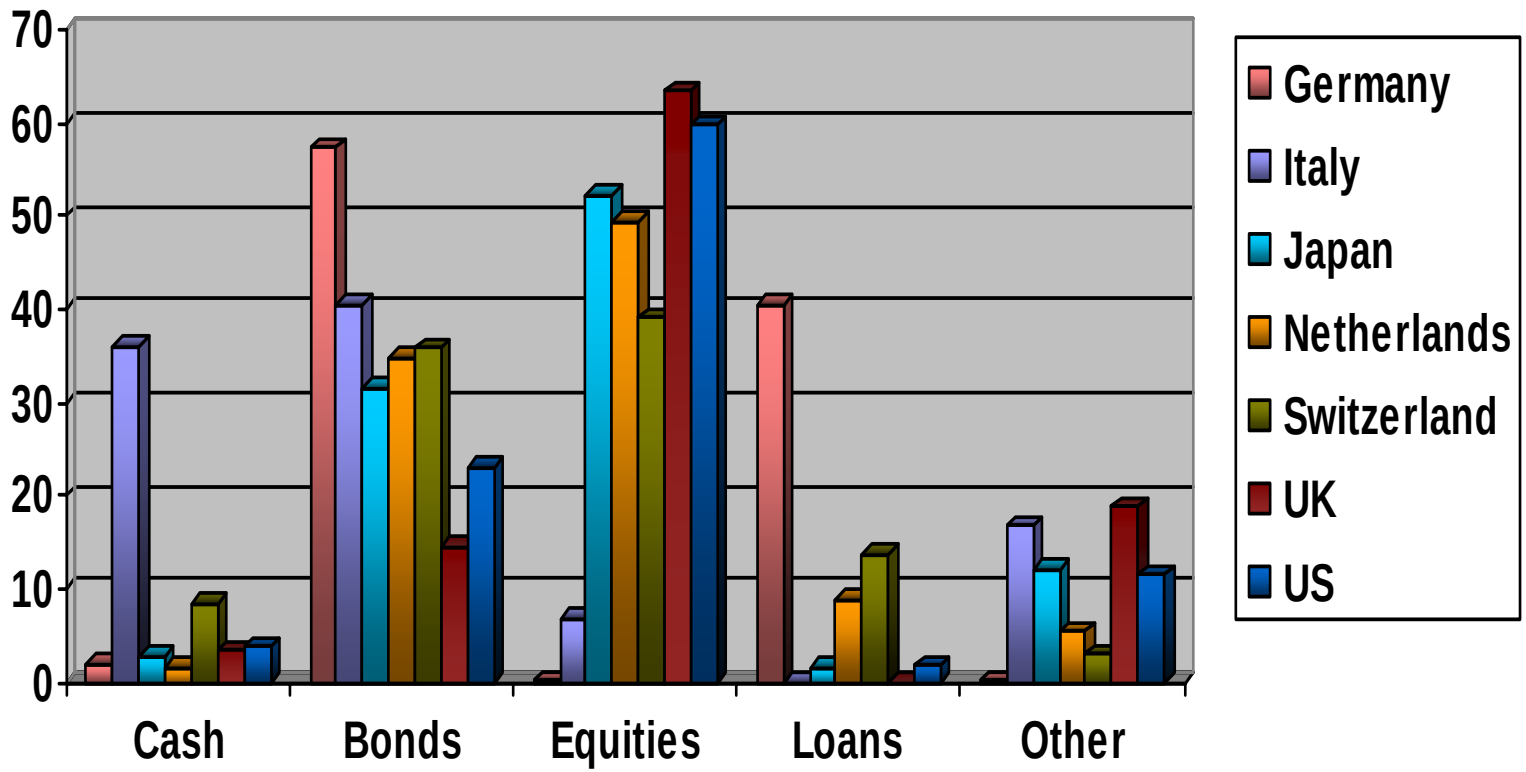
The Changing Landscape



A process of adaptation

- Exchange controls
- Concentration of Irish equities
- Minimum funding and accounting standards
- Evolution of DC
- Globalisation of markets
- New types of investment
- Indexation
- Euro
- Regulation

Other countries also heavily equity oriented



Source IMF

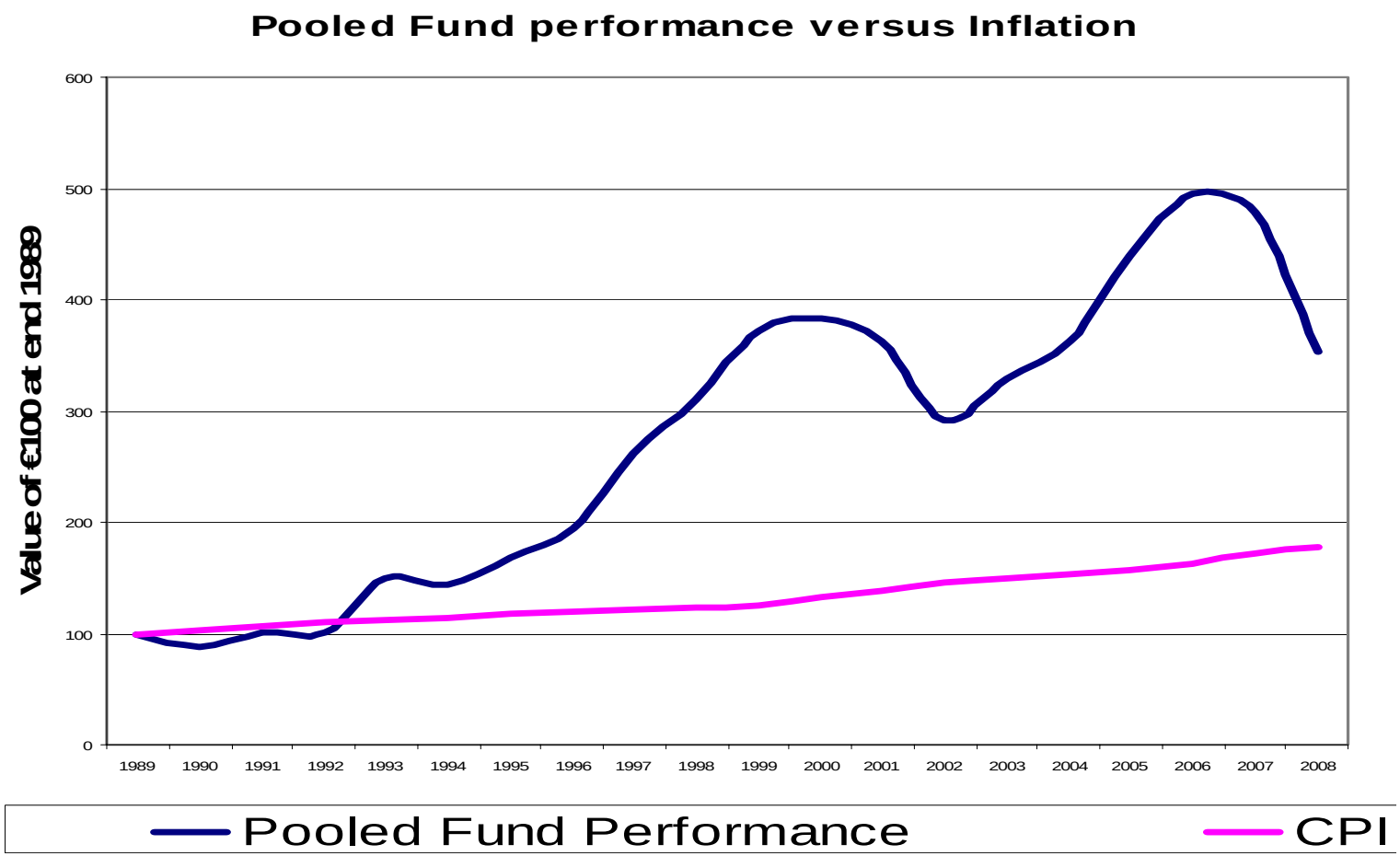
Largest holdings of Irish Pension Funds

Early 2007

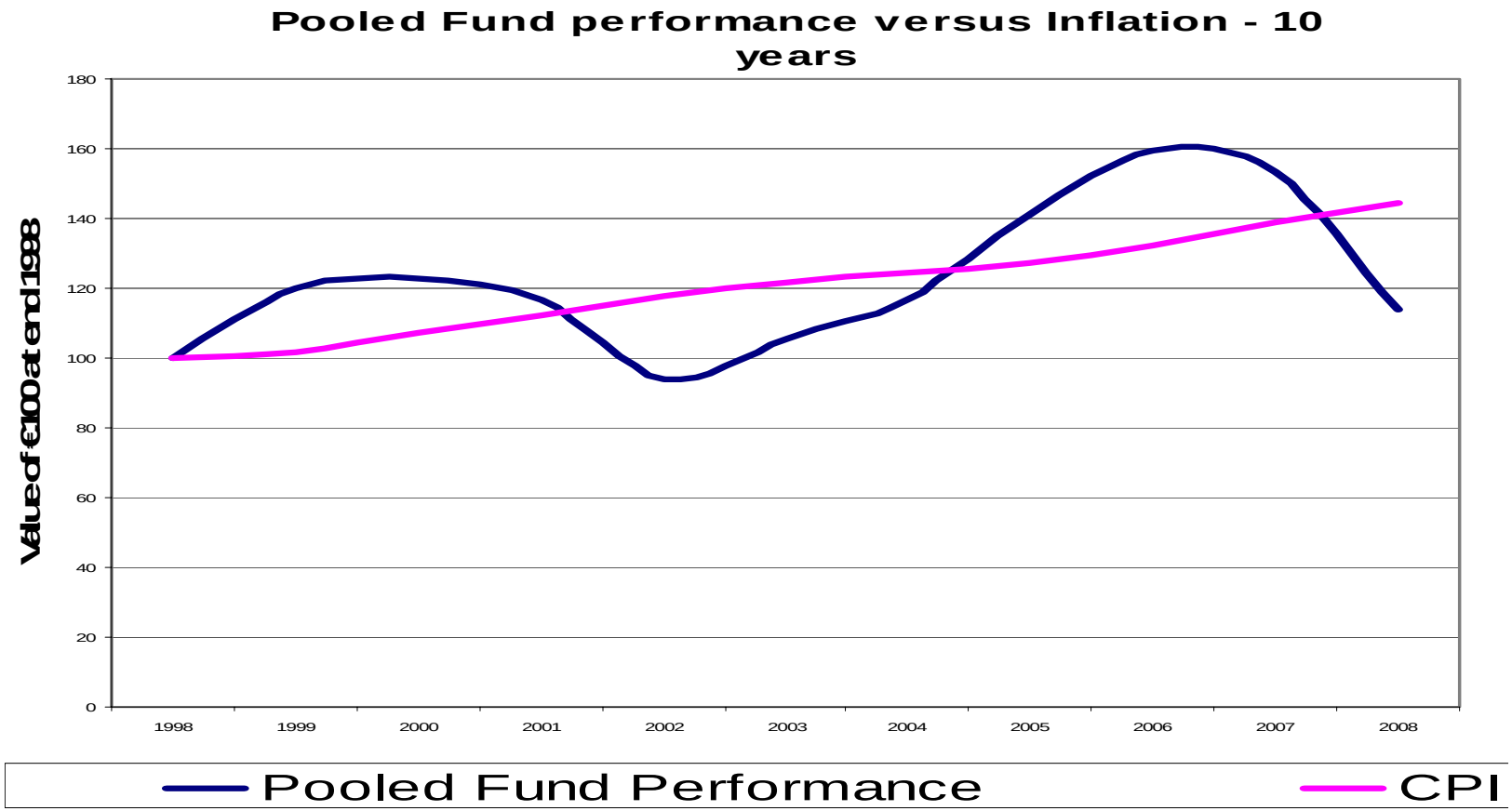
Bank of Ireland	3.7%
AIB	3.6%
CRH	3.5%
Royal Bank of Scotland	1.7%
BNP Paribas	1.5%
Johnson & Johnson	1.5%
…three more banks	4.2%

Source: Leading Irish fund manager

Performance history



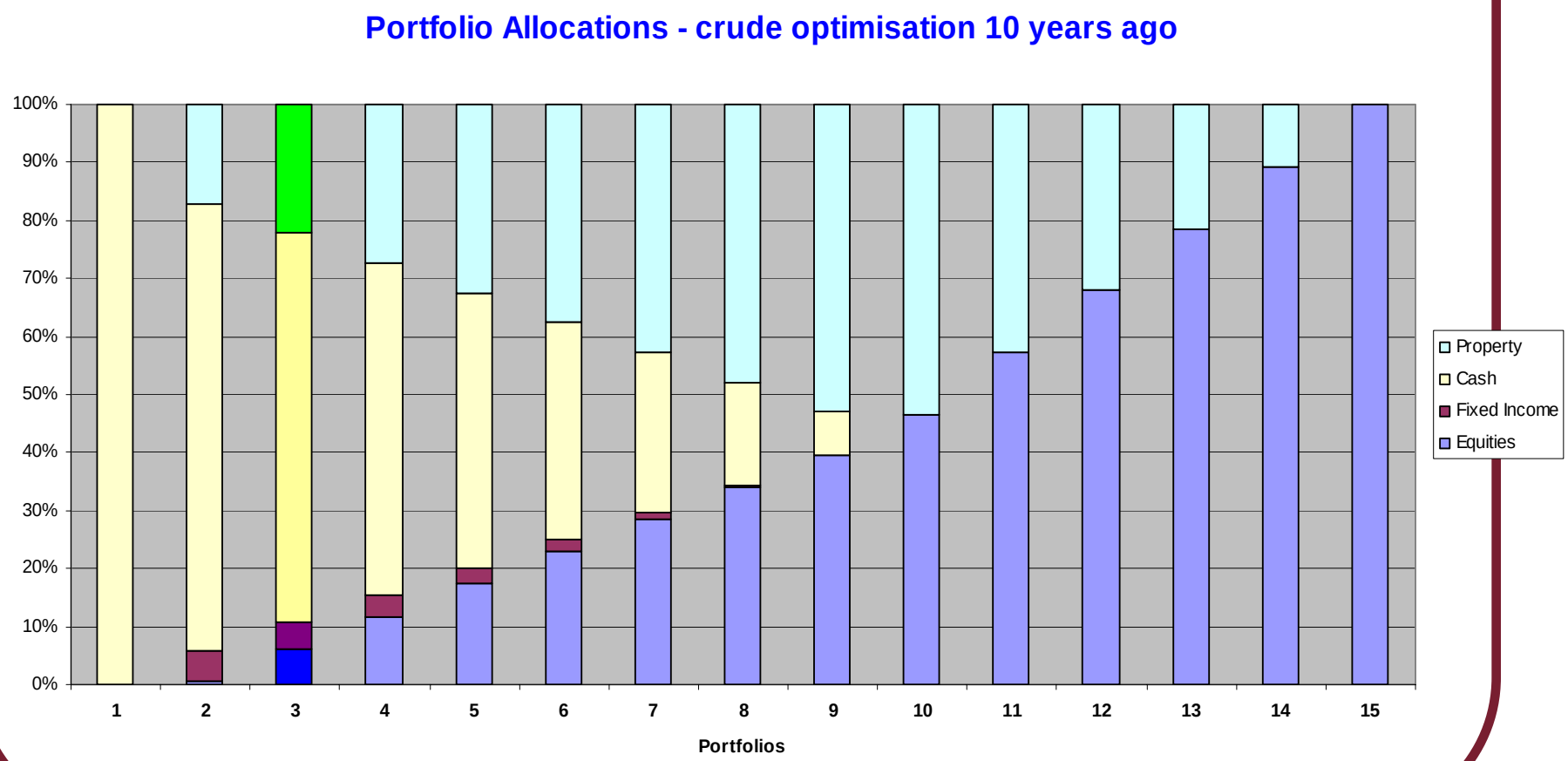
Performance history



A mirror on returns

		Annual Return to September 2008, %	
		15 Years	10 Years
1	Actual Return per annum	6.3	1.8
2.	Do nothing asset allocation	6.4	1.6
3.	Do nothing except Irish / other equities	7.2	2.1
4.	Equal weighted	8.5	5.1
5.	Equal weighted with rebalancing	8.2	5.0

If you had optimised 10 years ago…



Use of Alternatives

- Hedge Funds
- Private equity
- Commodities
- Currency
- Property / Infrastructure
- Emerging market securities
- Levered loans
- Asset backed securities

US Endowments- the frontier of investment thinking

How Yale Endowment Fund Views Asset classes

	Real Return	Volatility	Correlation
US Equities	6	20	1.00
Foreign Equities			
-Developed	6	20	High
-Emerging	8	25	High
Private Equity	11	29	High
Real Assets	6	15	Med/High
Absolute Return			
-Event Driven HF's	6	10	Very Low
-Value Driven HF's	6	15	Very Low
Fixed Interest	2	10	Moderate

US Endowments- the frontier of investment thinking

Harvard-Yale Endowment Funds

	Weight %
Listed equity	33
Fixed Income	13
Private Equity	13
Real Estate	10
Commodities	12
Hedge Funds	19
Cash	0

Source: Frontier

Modern asset allocation can overlook risks

- Variability is one risk, but is overshadowed by ….

- credit risk,
- risk of ruin,
- operational risks,
- policy risks,
- actuarial risks,
- economic risks, financial market risks, liquidity risks, expense risks, and governance risks

Asset Allocation practice the context for diversification

Discounted, market Values	Plan cash flows
Traditionally defined asset classes	Research what are your asset classes
Key risk is variability	Allocate across many risks
Strategy designed to lever returns	Asset allocation primarily for risk control
Strategy and tactics difficult to separate	Explicit role for current market tactics in strategy

Diversifying in the current environment