



Investment Issues for DC Schemes

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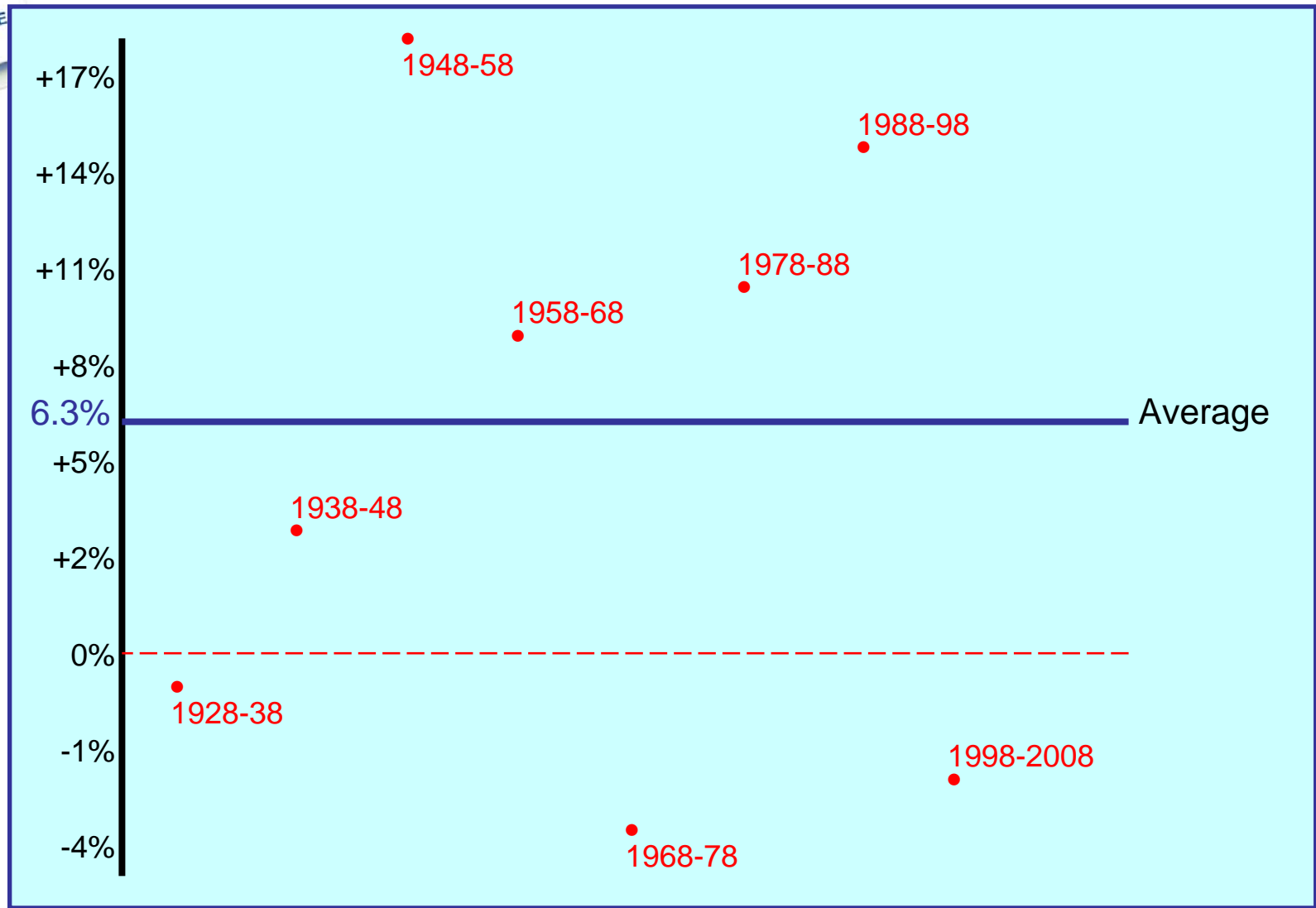
Introduction

- The Lost Decade
- Evolution of Irish Pension Funds
Equity Weighting
- Risk and Long Term Investment
- Equities to remain the dominant
asset class?
- DC Issues





Real Annual Investment Returns - Decades



Source of data: Barclays Capital



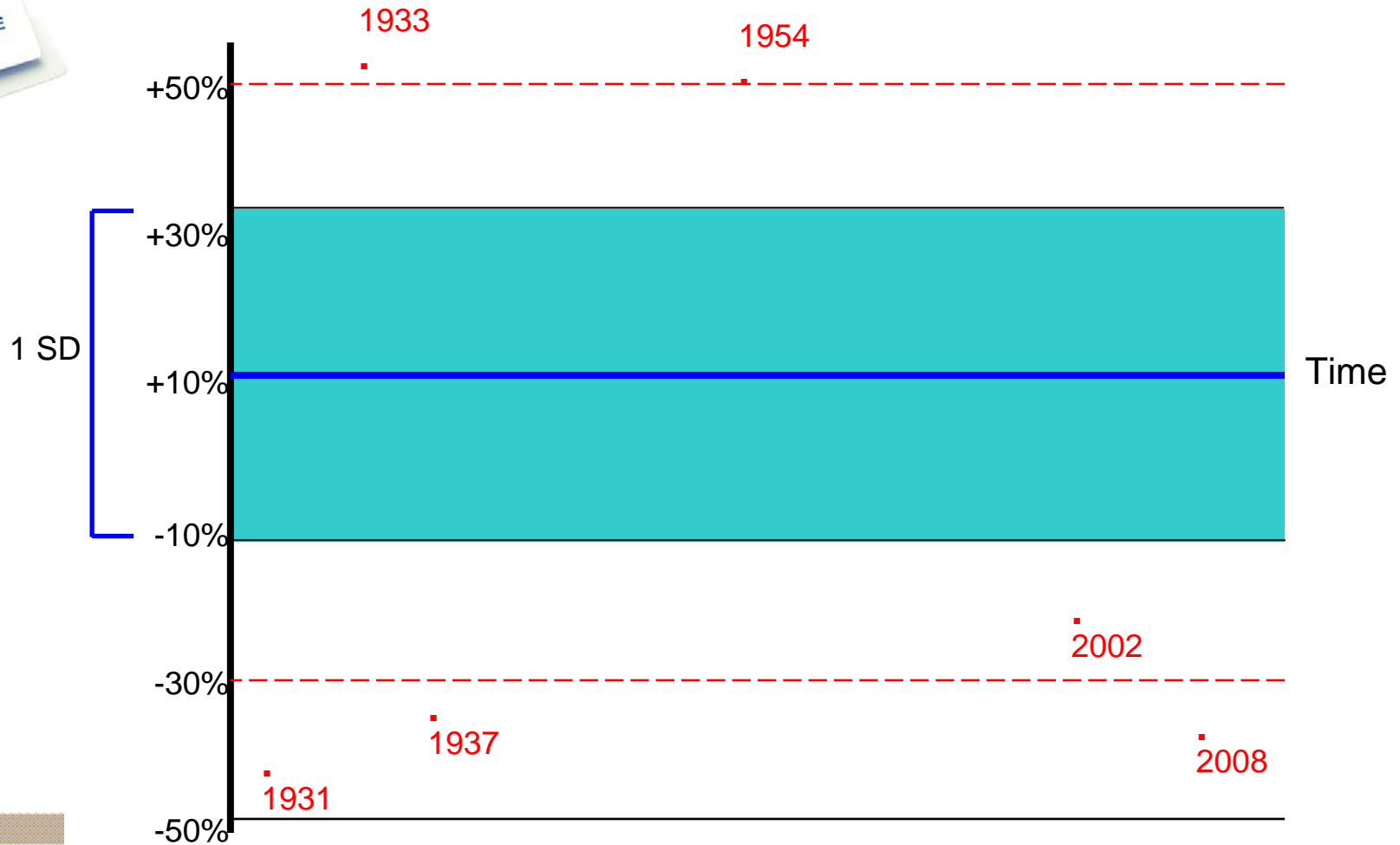
What Explains The Lost Decade?

- Madness of crowds?
- Broad decline in macro-economic volatility from mid-1980's led to the 'Great Moderation' in the volatility of corporate profits
- As the volatility of the 1970's faded the limited volatility of the 80's and 90's came to be seen as the norm





Extreme Years - 1930-2008





Irish Pension Funds Equity Weighting

YEAR	Equity Weighting
1988	47.1%
1993	56.5%
1997	58.6%
2001	65.0%
2002	58.0%
2003	65.0%
2007	66.3%
2008	47.8%

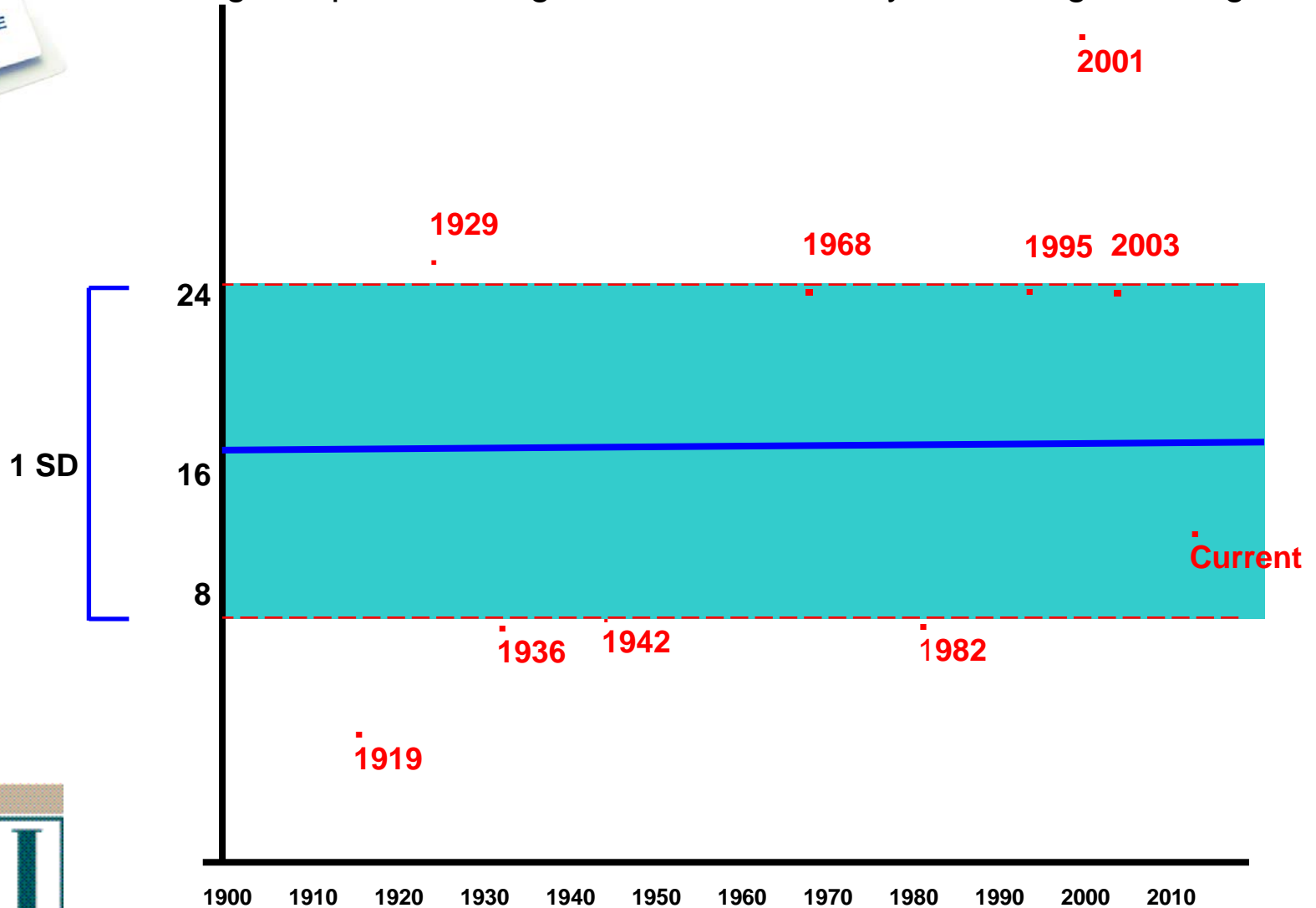
source of data: IAPF Asset Allocation Surveys, Whelan(2001)





Real Price Earnings Ratio

Trailing real price earnings ratio based on 10-year average earnings





The Lost Decade

- Weak equity returns over the past decade attributable to extreme overvaluation at the start of the decade
- 1997 – 2002 equities were extremely overvalued relative to earnings and net worth
- 2003 -2008 profits rose rapidly but equities rose by less than profits





The Lost Decade

- Over the long run equity valuations appear to be the primary driver of equity returns, with economic growth and profit trends contributing little
- Converse applies – valuations tend not to be able to explain shorter run fluctuations in the stock market (< 5 years)





Extrapolation of Lower Volatility

- Explains move higher in equity valuations
- Possibly explains accumulation in leverage
- But this increase in general leverage on the basis of low macro-economic volatility raised the sensitivity of the economic and financial system to small changes in the fundamentals
- Great Moderation was inherently unstable





Risk and Long Term Investment

- What are return objectives?
- How much downside can be tolerated?
- What is the trade-off between risk and return?
- How can a diversification policy be effectively executed?





Risk and Diversification

- Alternative Assets?
- Invest mainly in 'low risk' assets?
- What is return objective?
- Utilise long-run data for long-run investment strategy





DC - Risk and Return

- Default investment strategies
- Life-styling – a blunt instrument
- Asset allocation should be the result of:
 - minimising extreme downside
 - exploiting returns from risky assets on the basis of long run (10 years+) prospective returns

