

---

# **New Developments in Asset Management**

## **Amit Goyal**

**Spängler IQAM Research Center**  
**Investment Seminar**  
**26 Nov 2013**



# Agenda

---

- Current challenges
  - Demographics
  - Low yields
- Implications for investments
  - High-yield bonds
- Importance of asset allocation

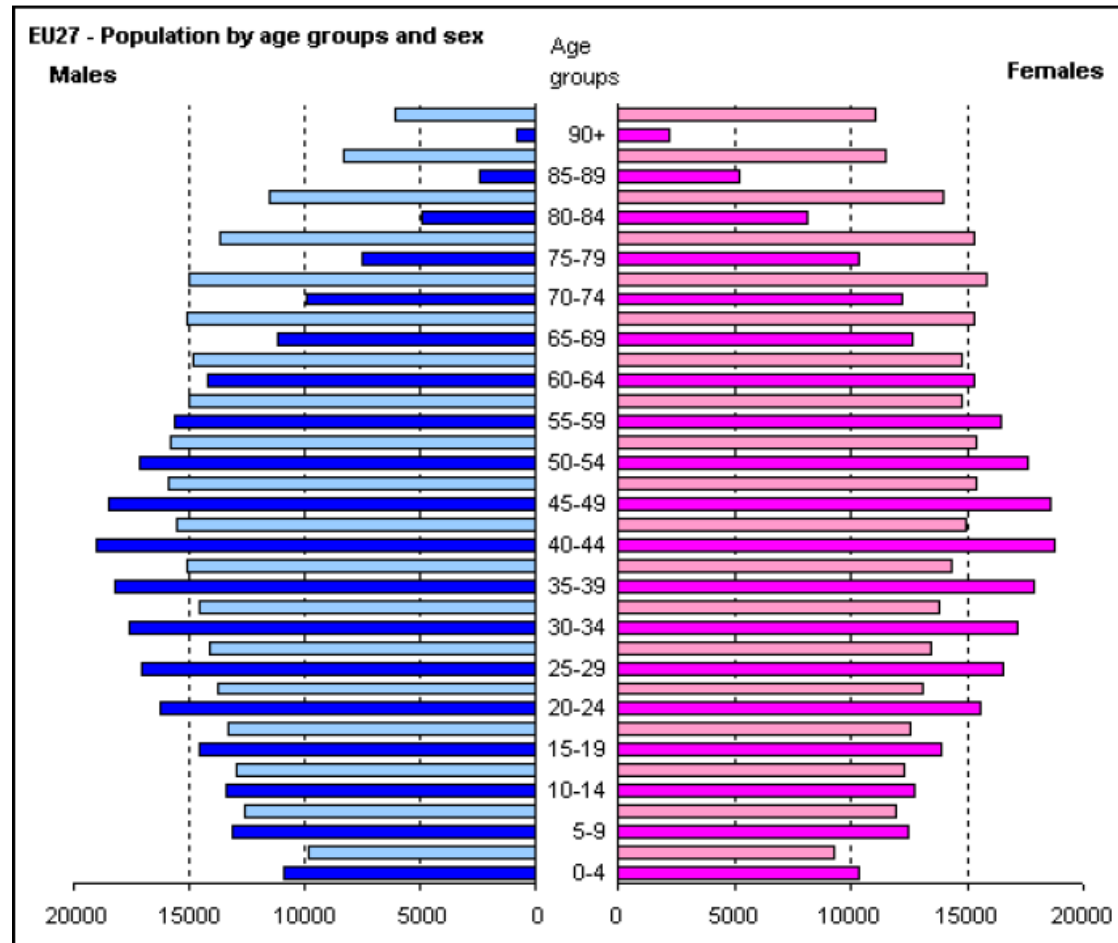
# Current situation

---

- Pension fund systems under stress worldwide
  - Demographic challenges
  - Funding gap challenges
  - Low yield challenges

# Population bomb

## Population pyramid 2010 and 2060



Source: European commission, 2012, "The 2012 Ageing Report."

# Impact on pension expenditure

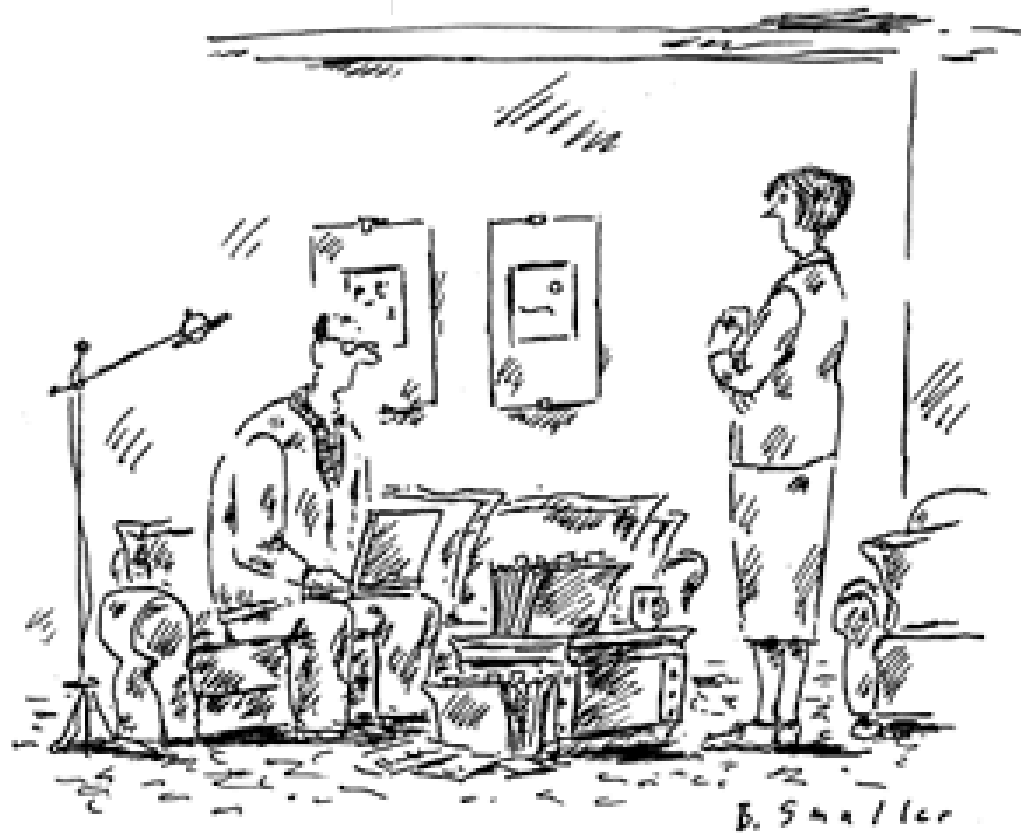
**Table 14: Comparison of Public Pension funds with projected deficits in age pension system**

	Size of public pension fund	Deficit in the public pension system						
	2009/2010	2007	2010	2020	2030	2040	2050	2060
		% of GDP						
Belgium	5	-	-	-	-	-	-	-
Bulgaria	-	-3.3	-1.5	-0.9	-1.2	-2.2	-3.5	-3.9
Czech Republic	3.4	0.5	1.2	1.4	1.2	-0.1	-1.9	-2.7
Germany	1.3	-3.2	-3.1	-3.6	-3.7	-3.8	-3.9	-4.2
Estonia	1	0.5	-0.3	0	0.1	0.2	0.3	0.7
Ireland	13.7	0.6	0.5	-0.1	-0.9	-1.9	-3.5	-4.1
Greece	-	-3.2	-2.8	-4.1	-7.7	-13.1	-15.7	-15.6
Spain	5.7	2.3	1.8	1.2	-0.1	-2.6	-5	-4.7
France	4.3	-0.4	-0.9	-0.9	-1.5	-1.7	-1.5	-1.3
Italy	-	-3.6	-3.4	-3.5	-4.2	-5.1	-4.1	-3
Cyprus	38.2	-2.1	-2.6	-4.4	-6.3	-8.2	-10.9	-13
Latvia	5.2	1.4	1.1	0.8	-0.1	-0.3	-0.1	0.7
Lithuania		-0.2	0.1	-0.4	-1.8	-2.7	-4.1	-5
Luxemburg	28	0.9	1	-0.1	-4.3	-8.6	-12.3	-14
Hungary	-	-2.3	-2.4	-2.4	-2.4	-3.5	-4.6	-5.2
Malta	-	-1.3	-2.5	-3.3	-3.3	-4.5	-6.1	-7.6
Austria	-	-3.8	-3.7	-4	-4.8	-4.8	-4.9	-4.5
Poland	0.5	-4.7	-5.2	-4.3	-4.3	-4.1	-4.1	-3.7
Portugal	5.7	-1.5	-1.6	-2.7	-3.6	-3.8	-4.7	-4.9
Romania	-	0.1	-2.1	-2.6	-4	-6	-7.9	-8.6
Slovenia	6.7	-1.2	-1.9	-2.6	-4.7	-7.5	-9.6	-10.1
Slovak Republic	-	-2.2	-1.9	-1.7	-2.8	-3.9	-5.1	-6
Finland	68	-0.7	-1.1	-2.1	-2.6	-2.2	-1.9	-1.9
Sweden	27.2	-3.2	-3.4	-3.3	-3.4	-3.4	-3	-3.4

Source: European Parliament's Committee on Economic and Monetary Affairs, 2011, "Pension Systems in the EU – Contingent Liabilities and Assets in the Public and Private Sector."

# Impact on pensioners

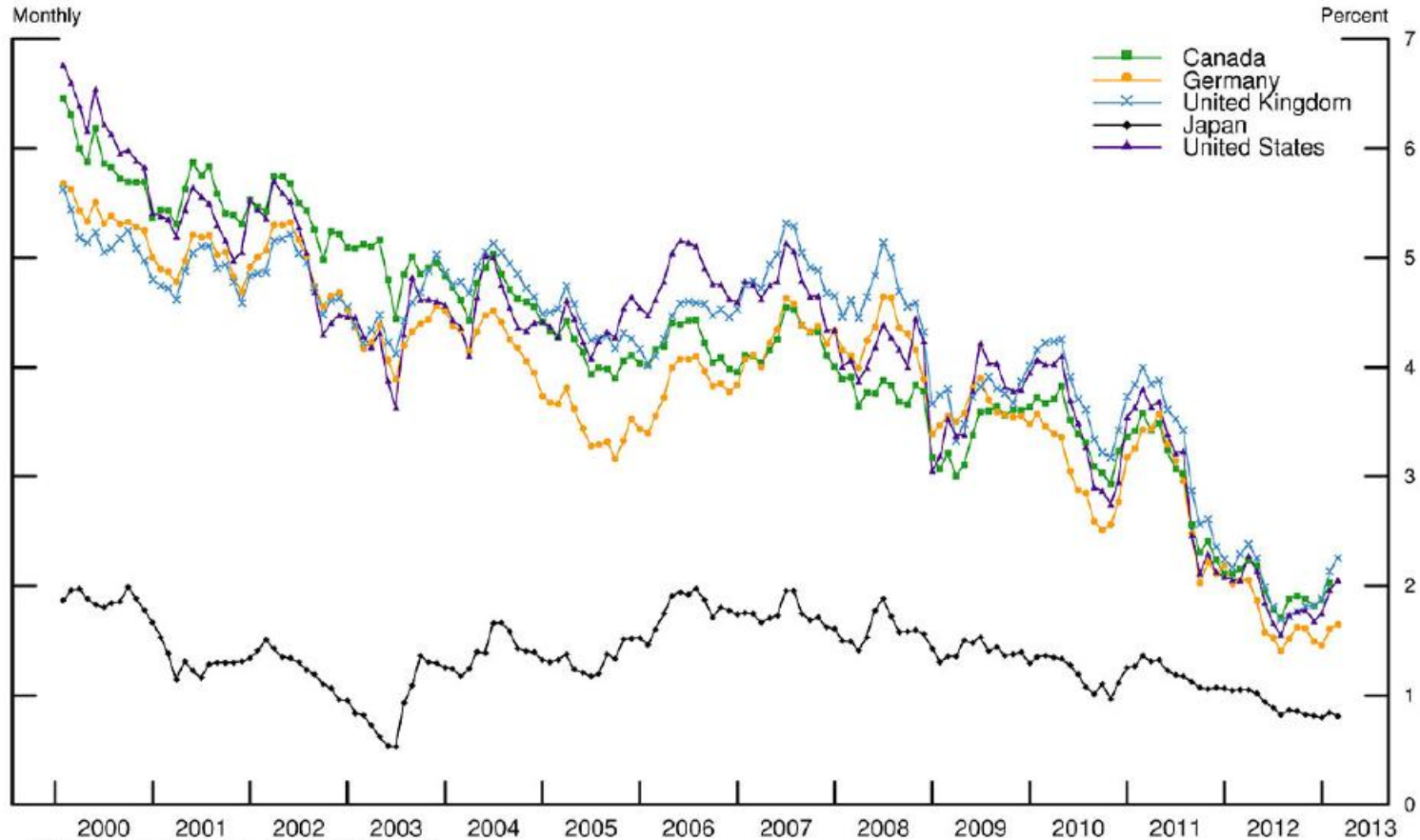
---



*"If we take a late retirement and an early death, we'll just squeak by."*

# Low yields

Chart 1. 10-Year Government Bond: Nominal Yield



Note: 10-year zero-coupon sovereign bond yields.

Source: Federal Reserve Board staff estimates.

Source: Ben S. Bernanke, 2013, "Long-term Interest Rates," Speech at SF Fed Conference.

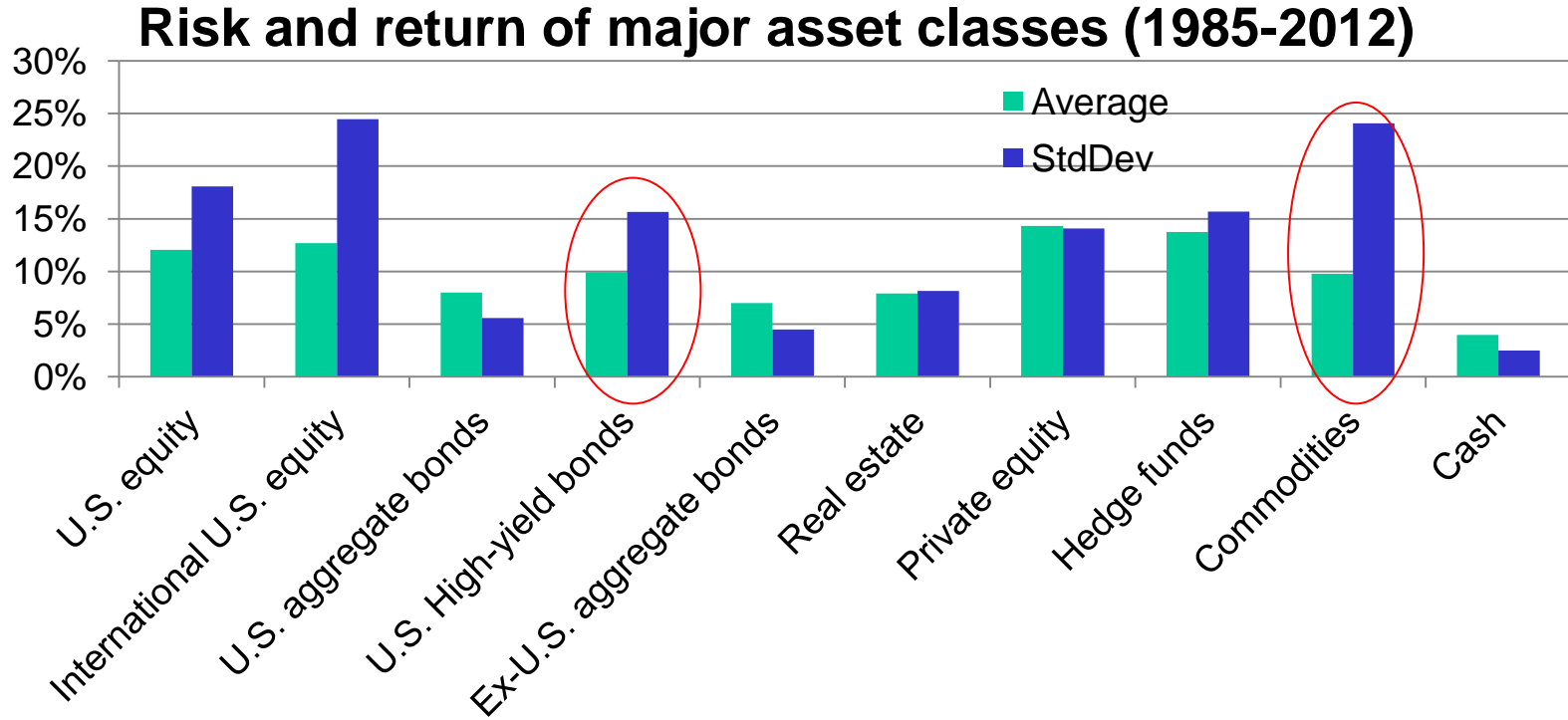
# Low yields' temptation

---

- Insurers and pension funds may seek higher yields via riskier investments
- For those under solvency pressure, this would mean “gambling for redemption”
- Risks for financial stability already noted under the BIS Annual Report of 2004



# What does the history tell us?



Source: Own calculations

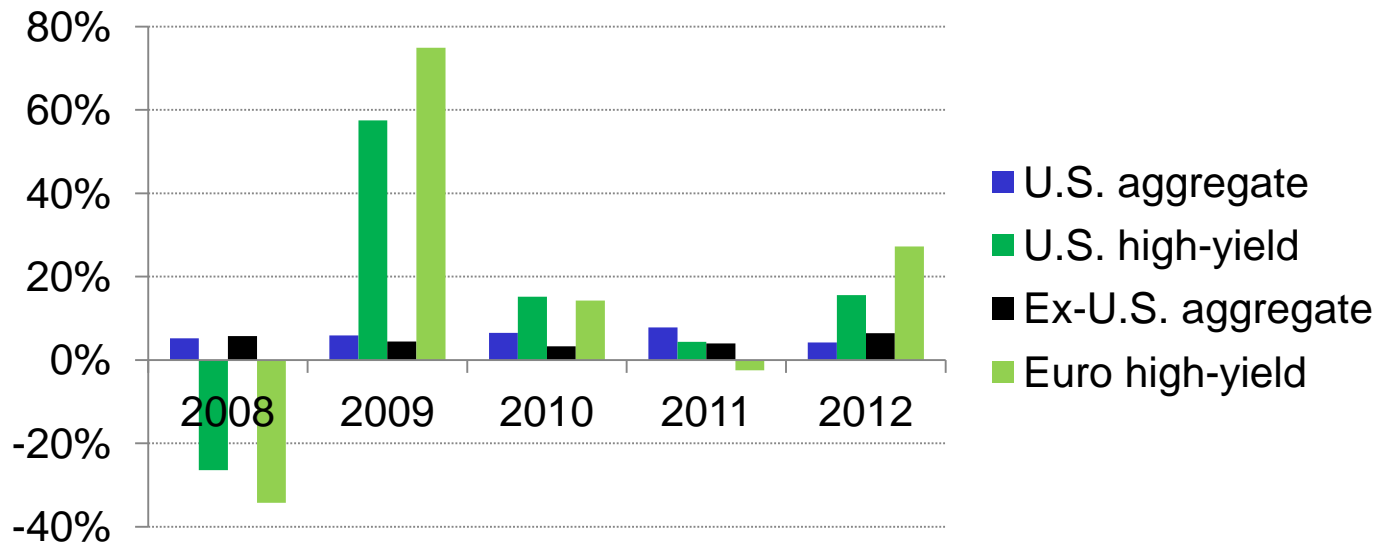
# High-yield bonds

## U.S. Hi-Yield (1998-2012)

- Average of 8.3%
- Volatility of 18.1%
- Correlation of only 0.22 with U.S. fixed income but 0.78 with U.S. equity

## Euro Hi-Yield (1998-2012)

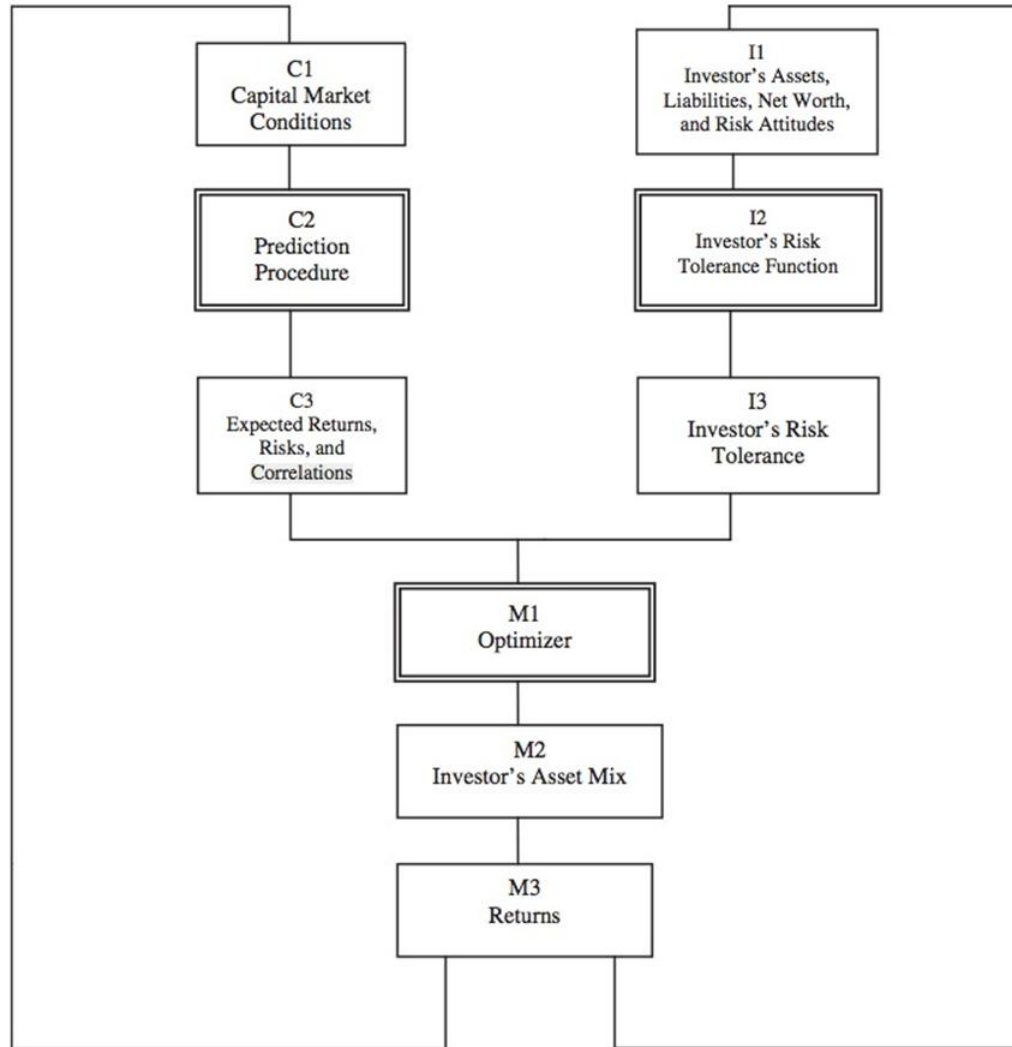
- Average of 7.7%
- Volatility of **25.0%**



Source: Own calculations

# So where does this leave us?

---



# Asset allocation

---

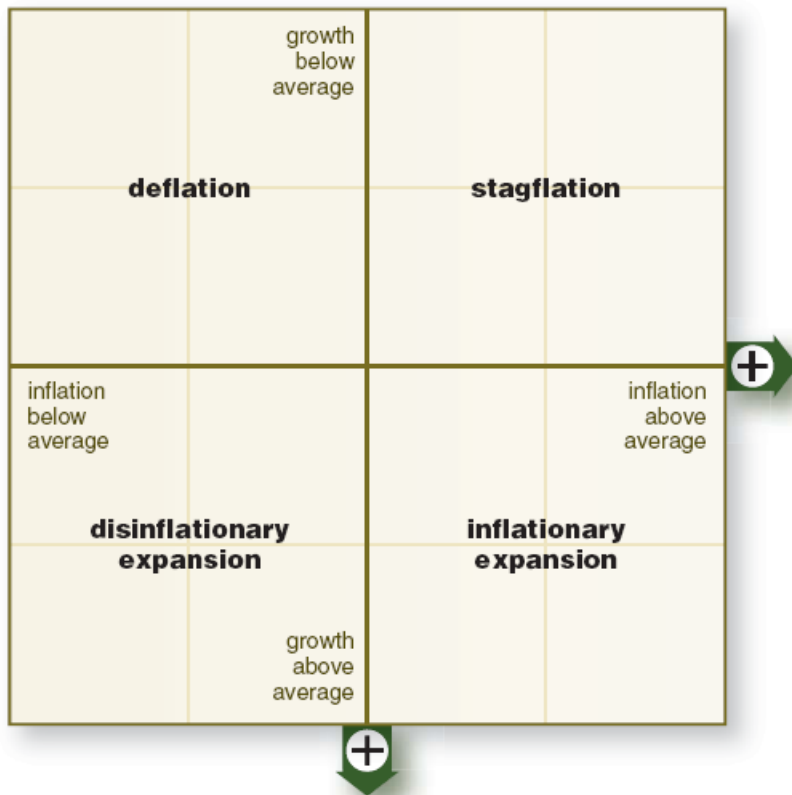
- What remains is asset allocation
- How does this take place?
  - In theory: Asset-liability management, with some dose of mean-variance optimization thrown in
  - In practice: Asset class return chasing



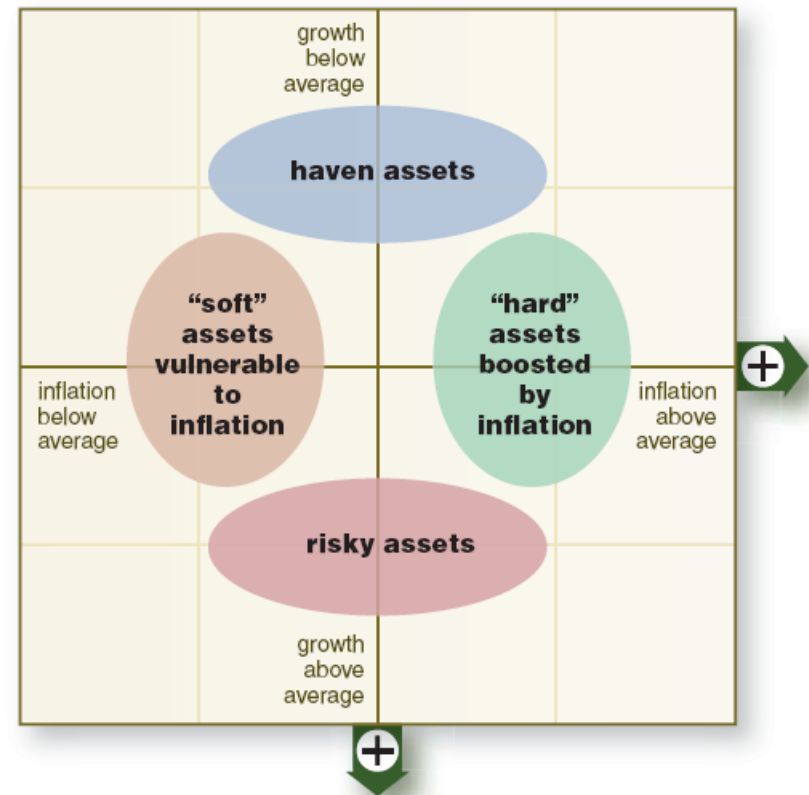
# Another approach to asset classes

- Risk budgeting

## Four Classifying Economic Scenarios



## Using Scenarios to Classify Asset Classes



# Key takeaways

- This time it's the same – The new normal is the same as the old normal
- Asset allocation is still the reigning champion of investment policy
- Search of alpha is a search for fool's gold
- Hi-Yield bonds are high yield for a reason
- Low yields/ageing population require thinking hard about asset allocation

