

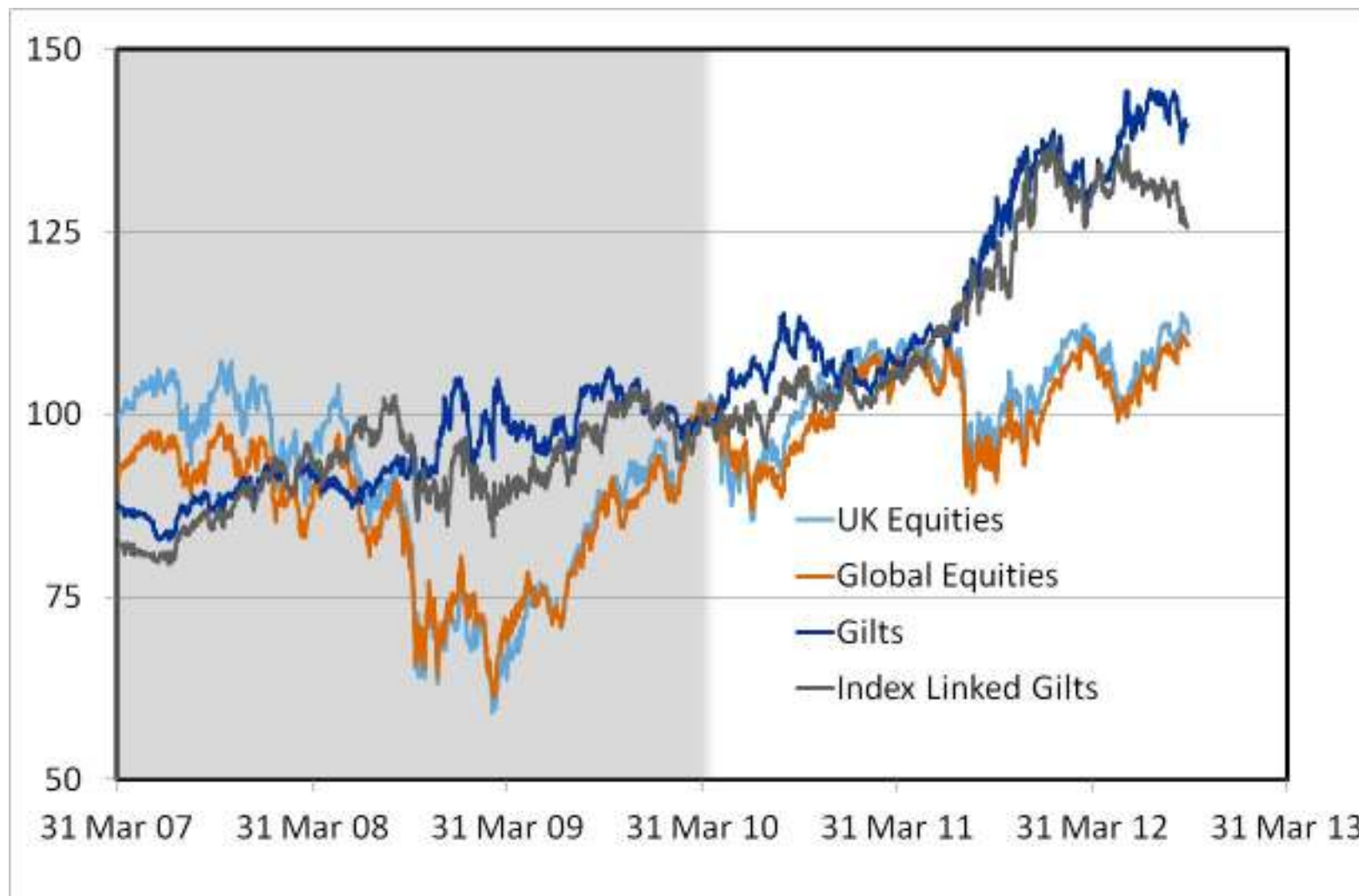
Economic themes impacting LGPS

CIPFA Pensions Network

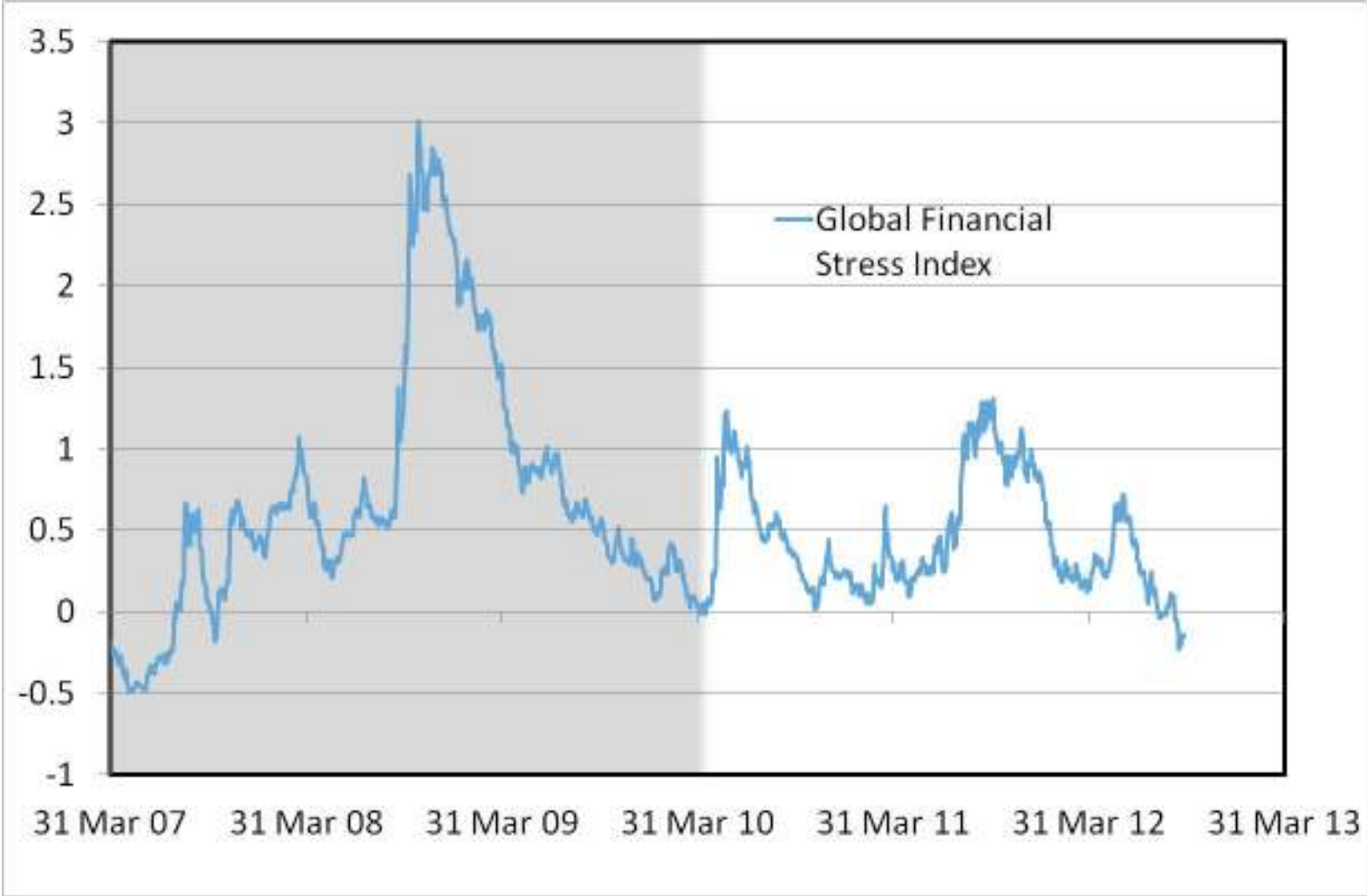
David Rae, CFA, ASIP, Head of Investment Solutions, EMEA

4 OCTOBER 2012

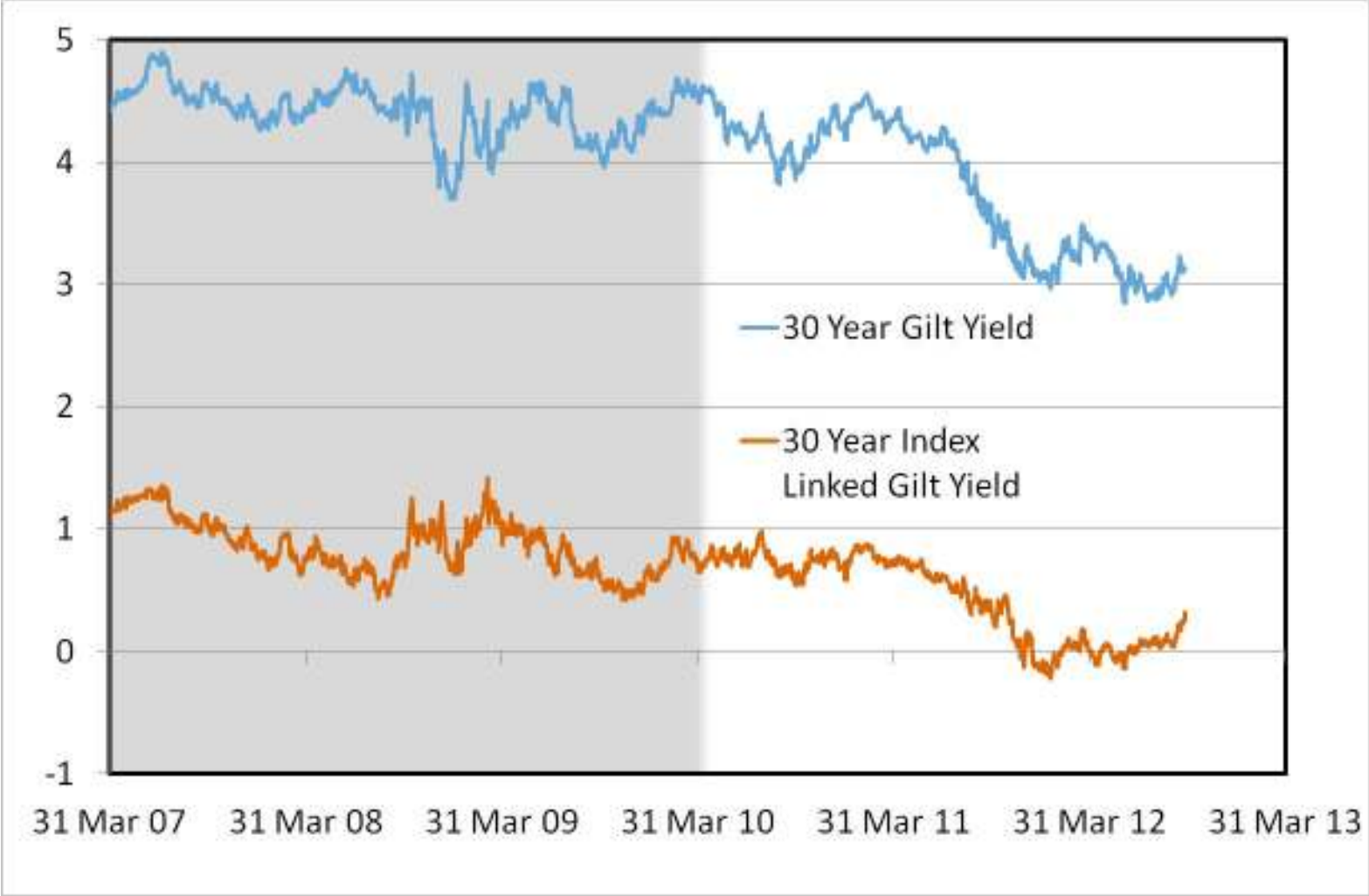
Asset Returns



Market Stress



Interest Rate Movements



Current thinking

What's ahead?

- › Risk-on/risk-off world to remain
- › US stuck in low but sustainable growth
- › China slowing but not collapsing
- › Equities to outperform government bonds

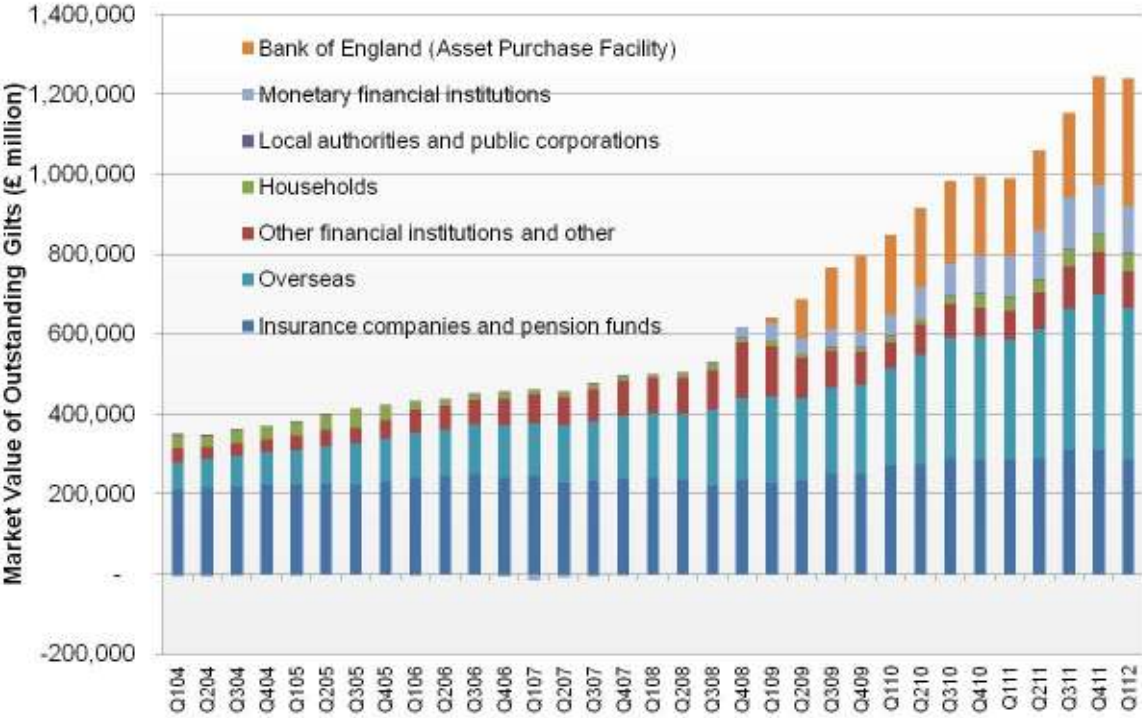
What's keeping us awake?

- › Asset Purchase Facility
- › Europe
- › China
- › Global GDP growth

Impact of Quantitative Easing

Saga: Bank of England's QE is 'permanently impoverishing pensioners'*

Bank of England: 'QE has not harmed pensioners'*



Source: DMO. Distribution of gilt holdings. . As at March 2012.

Bloomberg Businessweek

For Euro Crisis Relief



Instructions

- 1—Place magazine on a hard surface
- 2—Bang head
- 3—Repeat as necessary
- 4—If pain persists, turn to p9

Austria..... € 4.95	Denmark..... Dkr 44	Hungary..... Ft 1090	Lithuania..... LtP 6.000	Poland..... zPn 22.50	Spain..... € 4.95
Bahrain..... BHD 2.75	Egypt..... EGP 37.00	Israel..... NIS 29	Luxembourg..... € 4.95	Portugal..... € 4.95	Sweden..... SEK 45
Belgium..... € 4.95	Finland..... € 6.00	Italy..... € 4.95	Netherlands..... € 4.95	Qatar..... QAR 25	Switzerland..... SFR 9
Brazil..... R\$ 165.00	France..... € 4.95	Jordan..... JOD 4.25	Nigeria..... N20 350	Romania..... RON 25	Taiwan..... TWD 12.75
Cyprus..... € 4.95	Germany..... € 4.95	Korea..... ₩ 5.640	Norway..... NOK 45	Saudi Arabia..... SAR 25	UK..... £ 2.25
Czech Rep..... Czk 150	Greece..... € 4.95	Kazakhstan..... KWD 2.00	Oman..... OMR 2.75	South Africa..... ZAR 40	United Kingdom..... £ 2.25



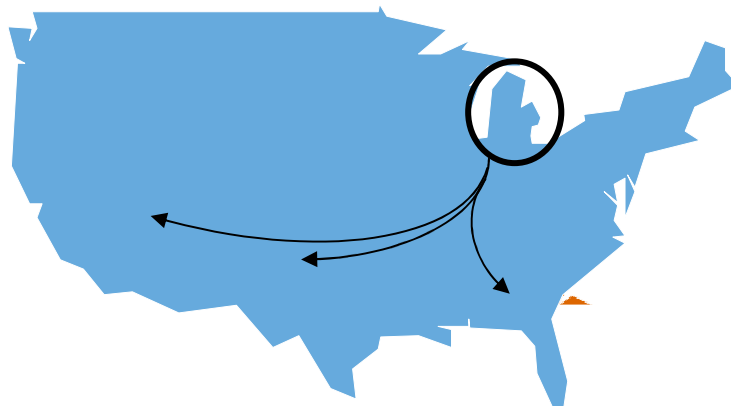
Source: Bloomberg Businessweek

Would the United States of Europe be in crisis?

% of 2012 GDP	Euro Area	United States	United Kingdom
Gross Government Debt	90	107	88
Fiscal Balance	-3.2	-8.1	-8.0
Primary Fiscal Balance	-0.5	-6.1	-5.3
Current Account	0.75	-3.3	-1.7

Source: IMF Economic Outlook, April 2012

Example – the difference between the US and Europe



An example of how monetary union with political union work

Assume a collapse of the Michigan economy

Michigan receives fiscal transfers and support from Washington (via revenues collected by the center from the 50 states)

People and business leave Michigan. Property values decline, factories go empty, wages fall. Governments don't build new roads, invest in schools, etc.

In short, Michigan adjusts via **deflation**.

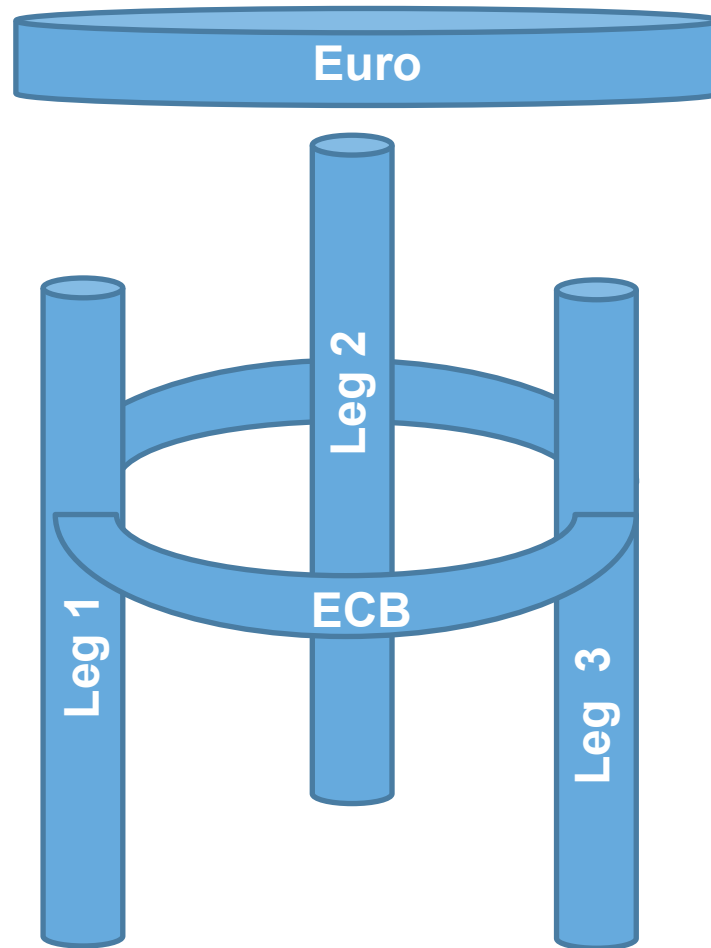
Eventually, Michigan attracts a new set of politicians and they embark on business friendly policies, lower local prices attract capital and eventually labour.

Greek citizens and firms don't leave Greece *en masse* to go to other parts of Europe. On the margin they may, but not sufficiently.

Greece, like Michigan has to deflate, cut spending, and see wages fall. This is politically painful for policy makers in Athens, and in the meantime, there is no provision for transfers from Brussels/Frankfurt/Strasbourg. The European Parliament has limited constitutional "power of the purse."



The 3-legged stool solution to save the Euro



Two years ago we described a “three-legged stool” solution to save the Euro

1: Increase size of bailout

- Recapitalise banks
- Provide liquidity

2: Restructure Debts of insolvent entities

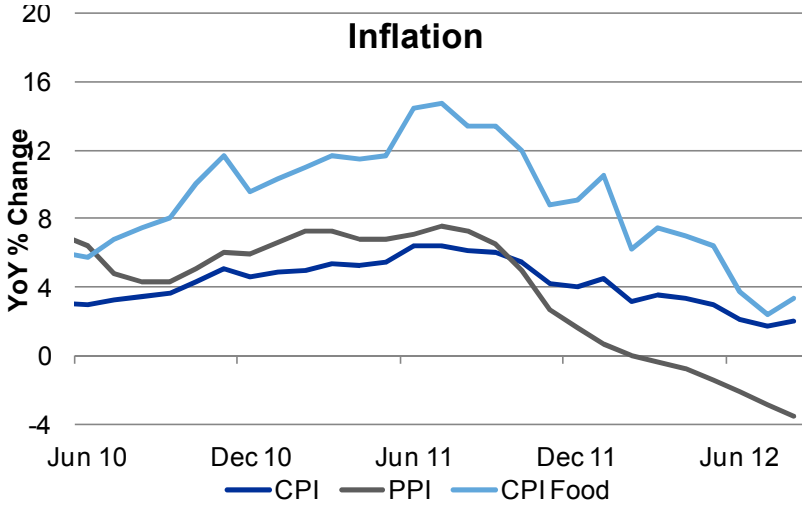
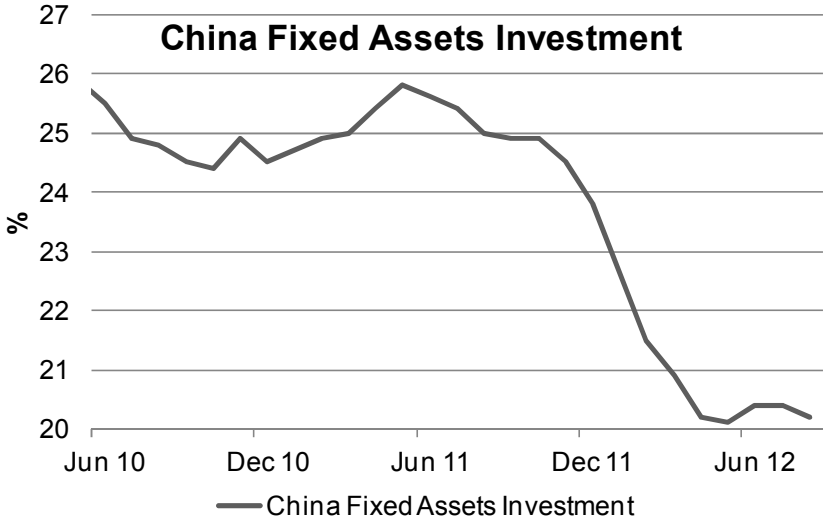
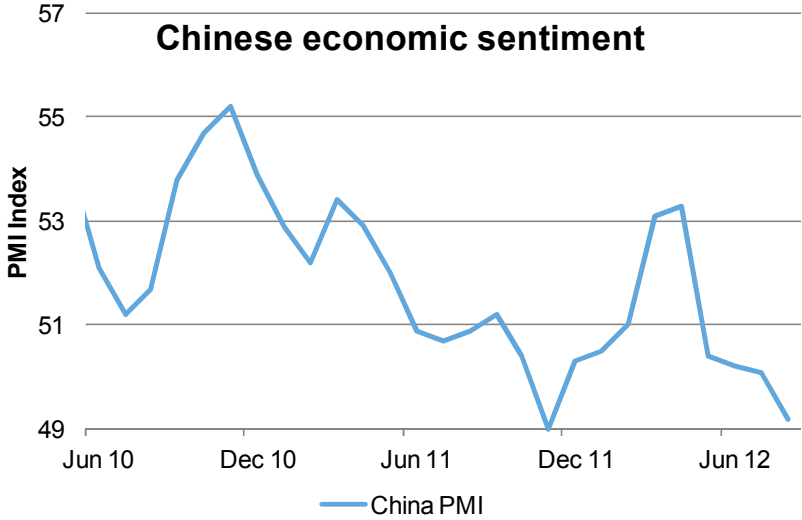
3: Ongoing convergence in periphery

Meanwhile: ECB provides liquidity

In the long run....

For illustrative purposes only.

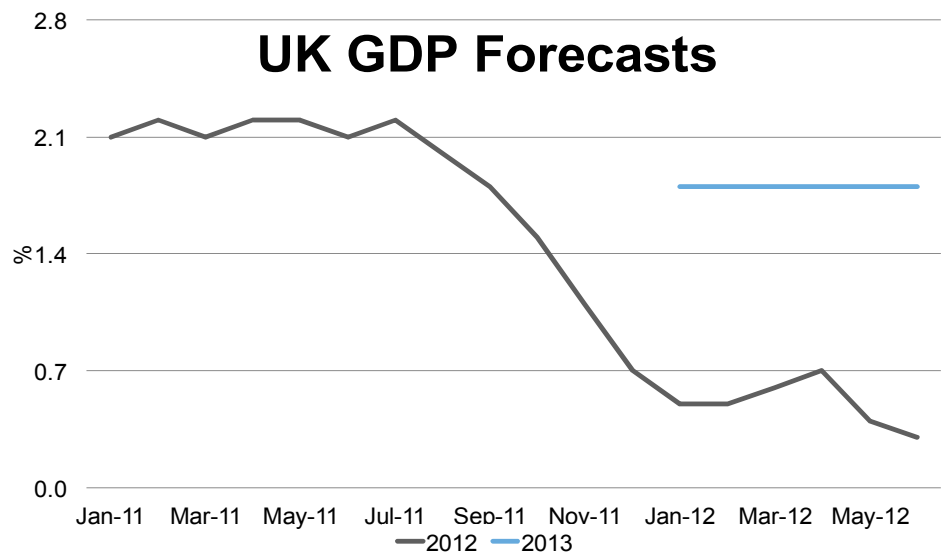
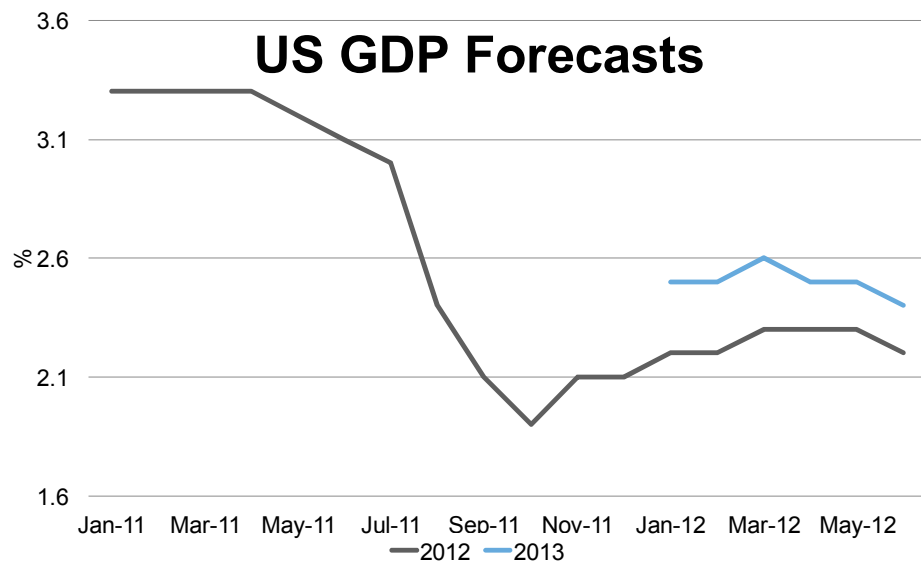
China risk getting worse



SOURCE: Bloomberg, Factset, 10 September 2012.

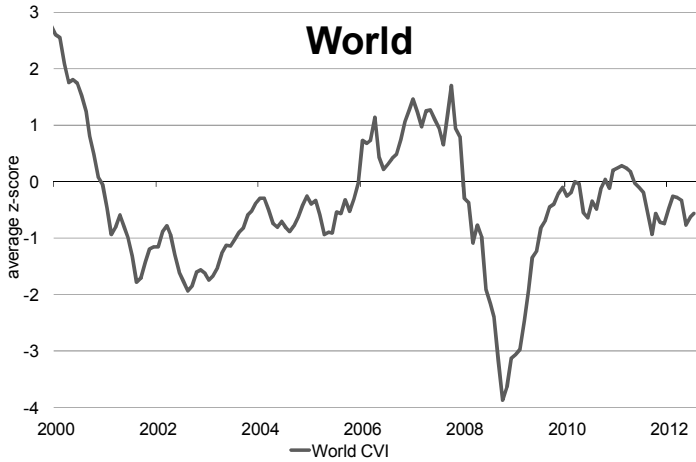
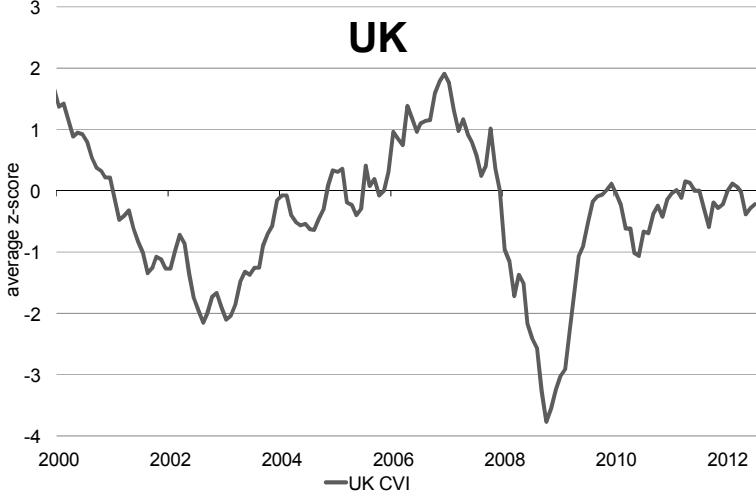
Consensus Economics GDP growth forecast

Weakening throughout this year, getting revised down for 2013



SOURCE: Consensus Economics, July 2012.

Composite Valuation Indicator - World



Navigating today's markets

Environment

- › US trying to recover
- › China trying not to collapse
- › Europe trying not to implode

Scenarios

- › Continued Market Volatility
- › Equity Markets – generally low returns
- › Bond Yields – no immediate relief for liabilities

Solutions

- › Diversify
- › Exploit opportunities when they present themselves

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