

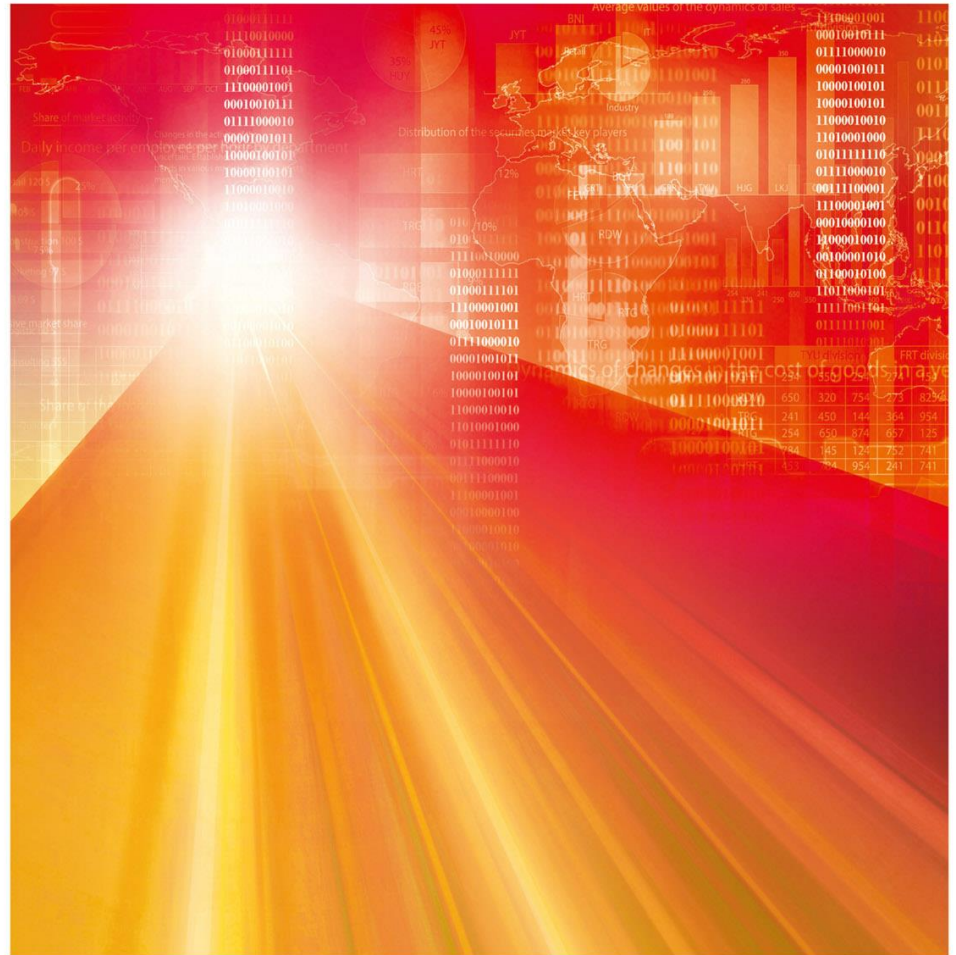
Enterprise Risk Management Seminar

Practical Risk Management



**Actuaries
Institute**

20 September 2016 • Sydney





Economic outlook

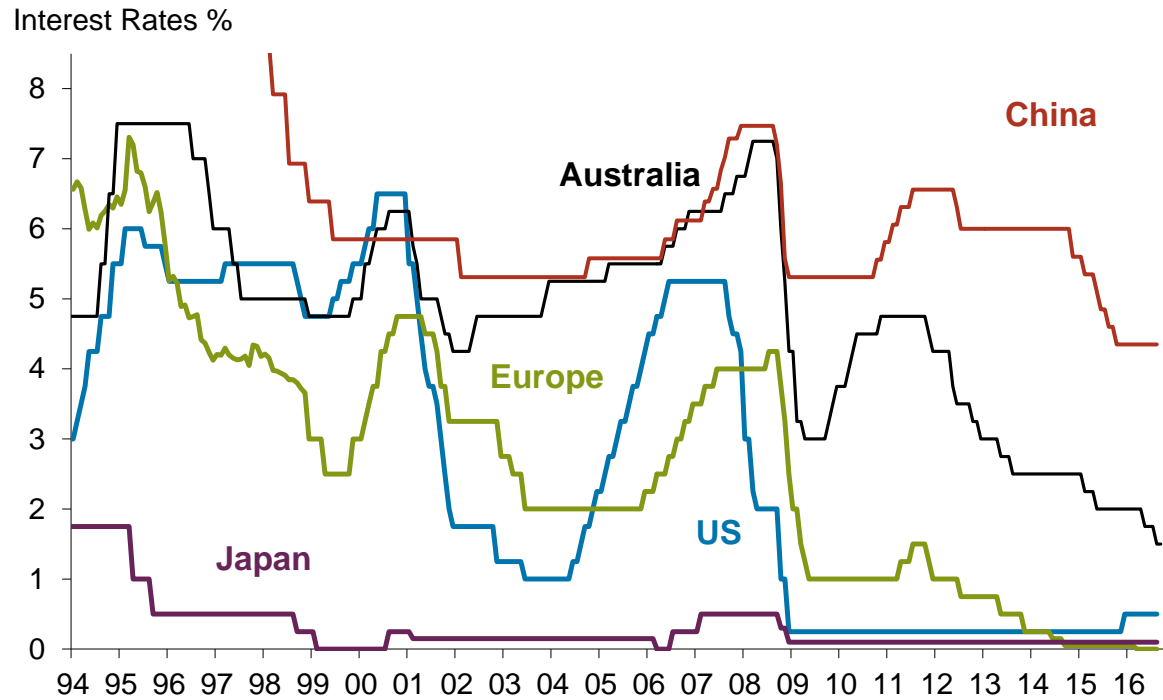
Simon Warner

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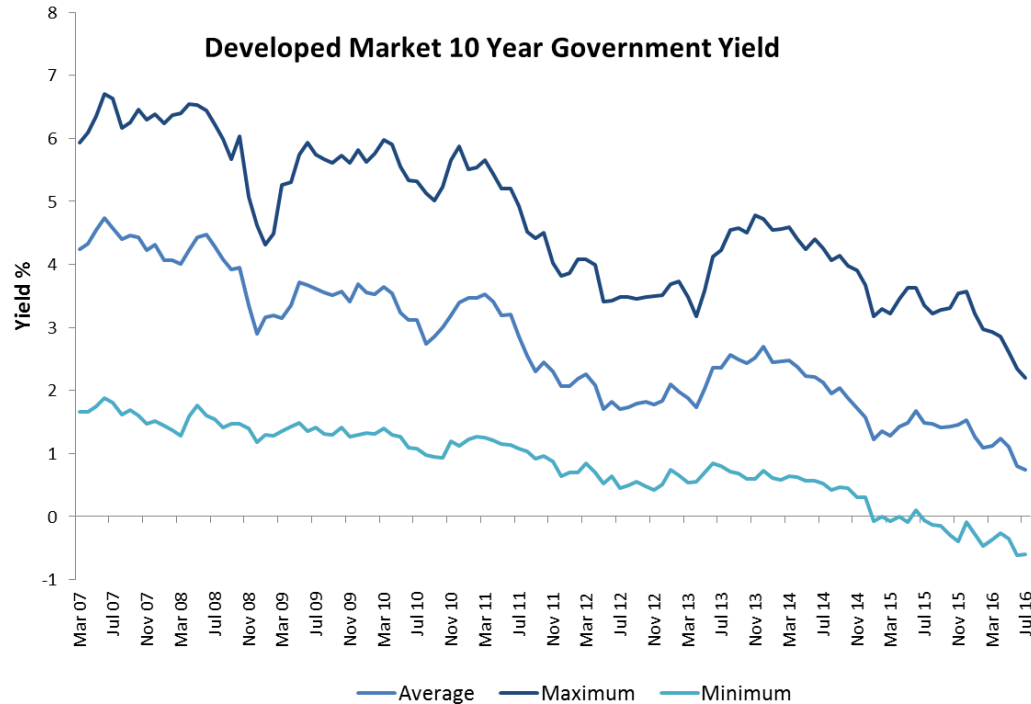


GLOBAL INTEREST RATES ARE VERY LOW

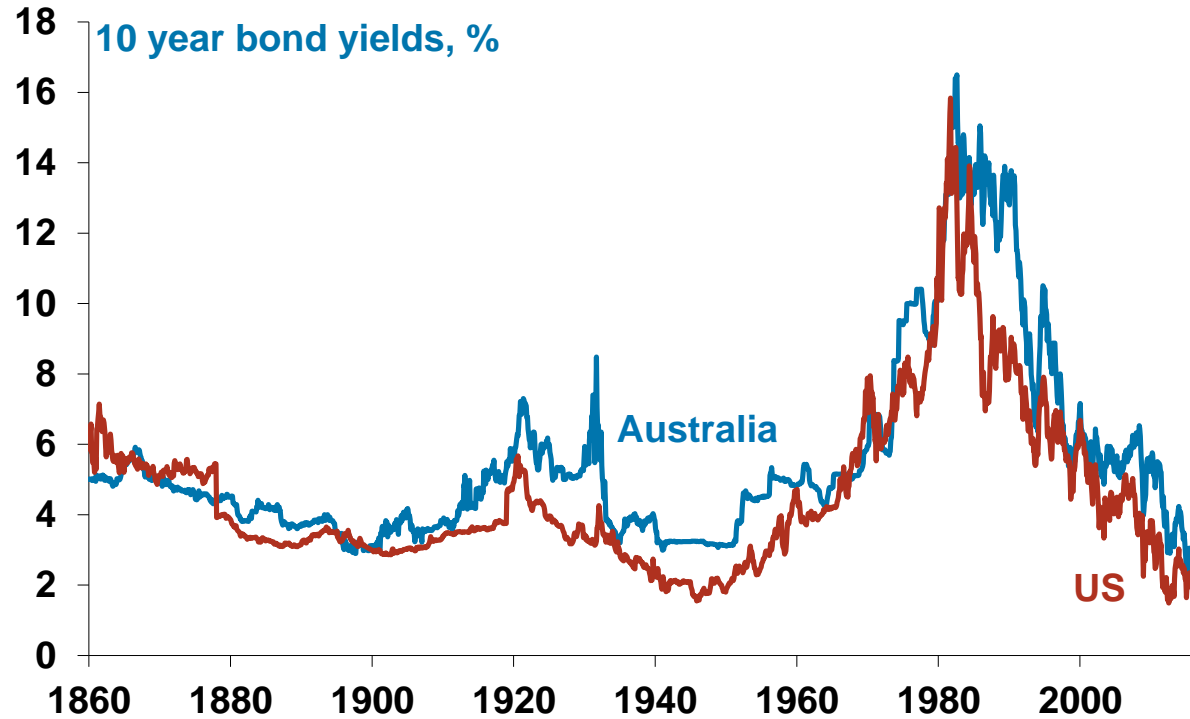




STATING THE OBVIOUS: BONDS YIELDS ARE LOW



Source: Bloomberg, AMP Capital

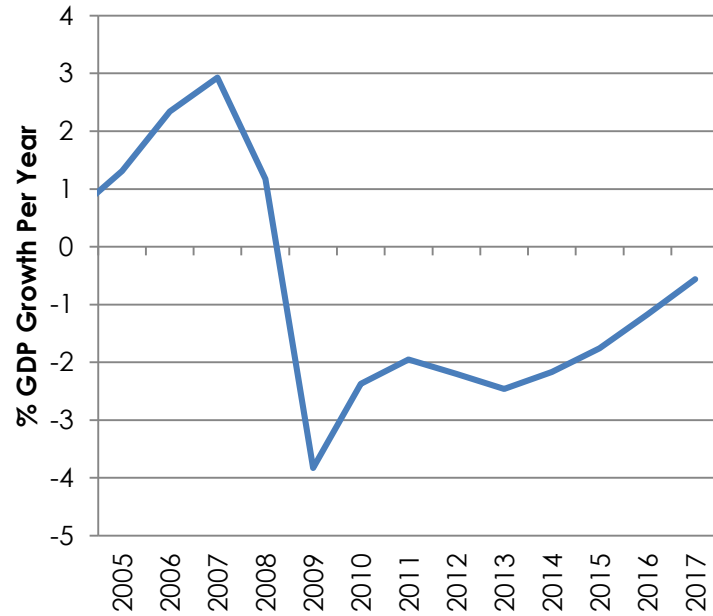




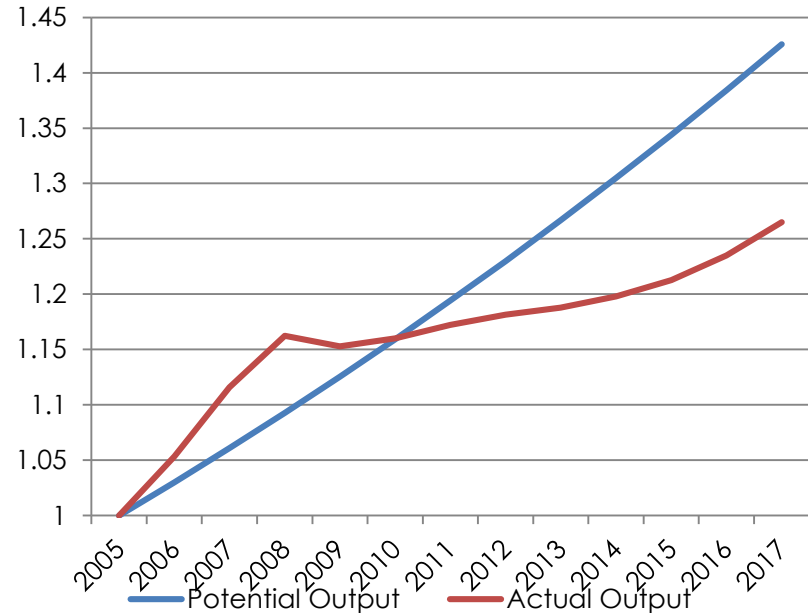
WHY ARE RATES VERY LOW?



OECD Output Gap

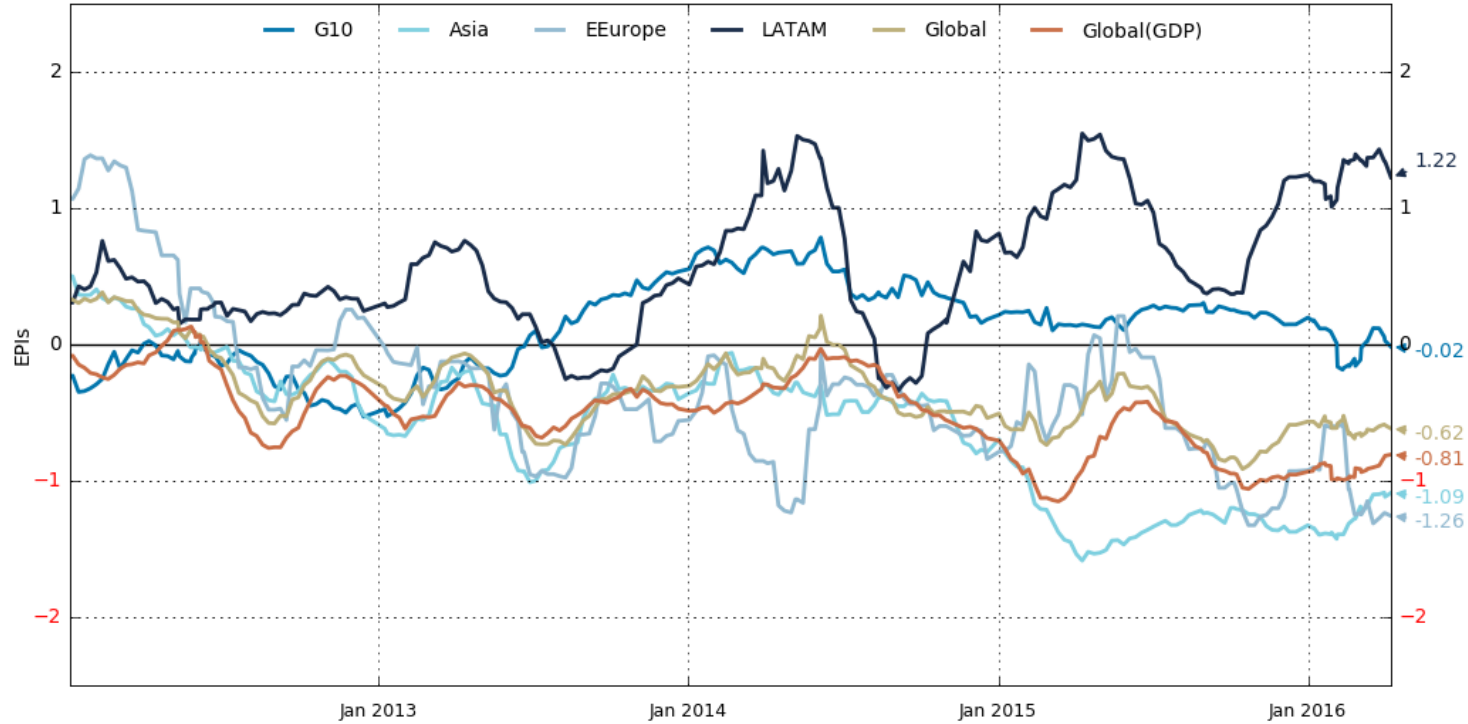


OECD Output Gap



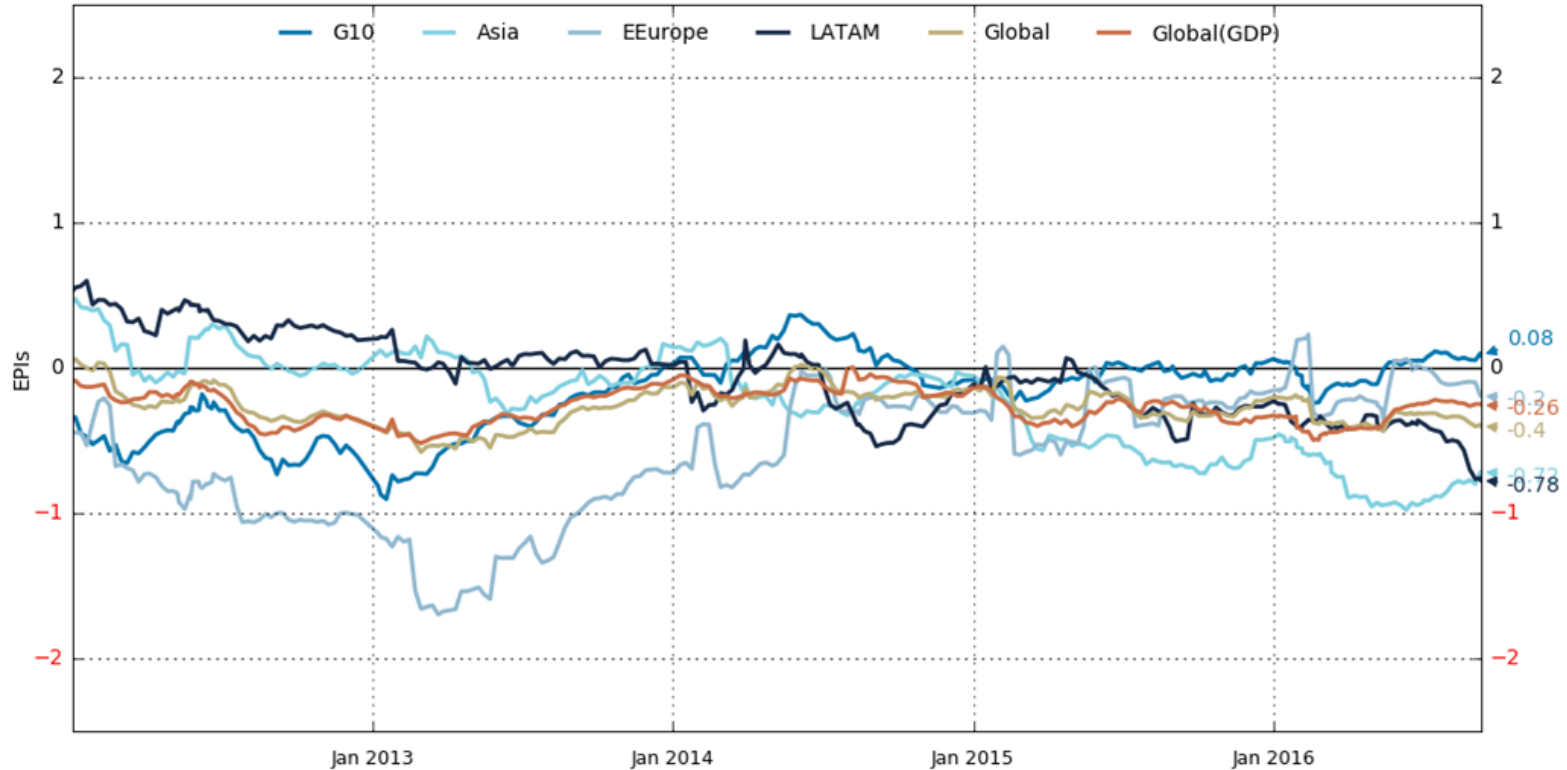


Inflation EPI by region





Headline EPI by region



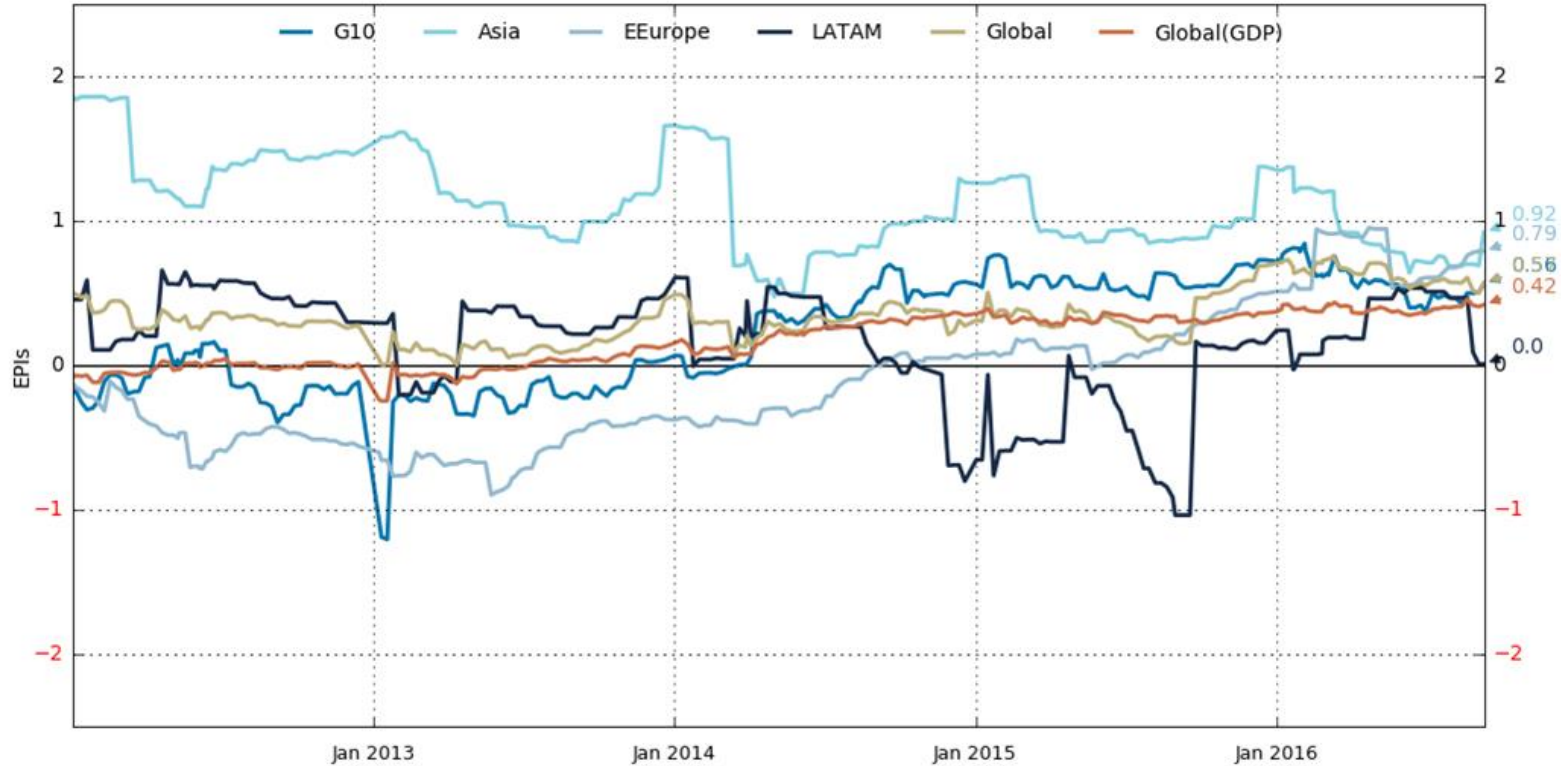


Business EPI by region





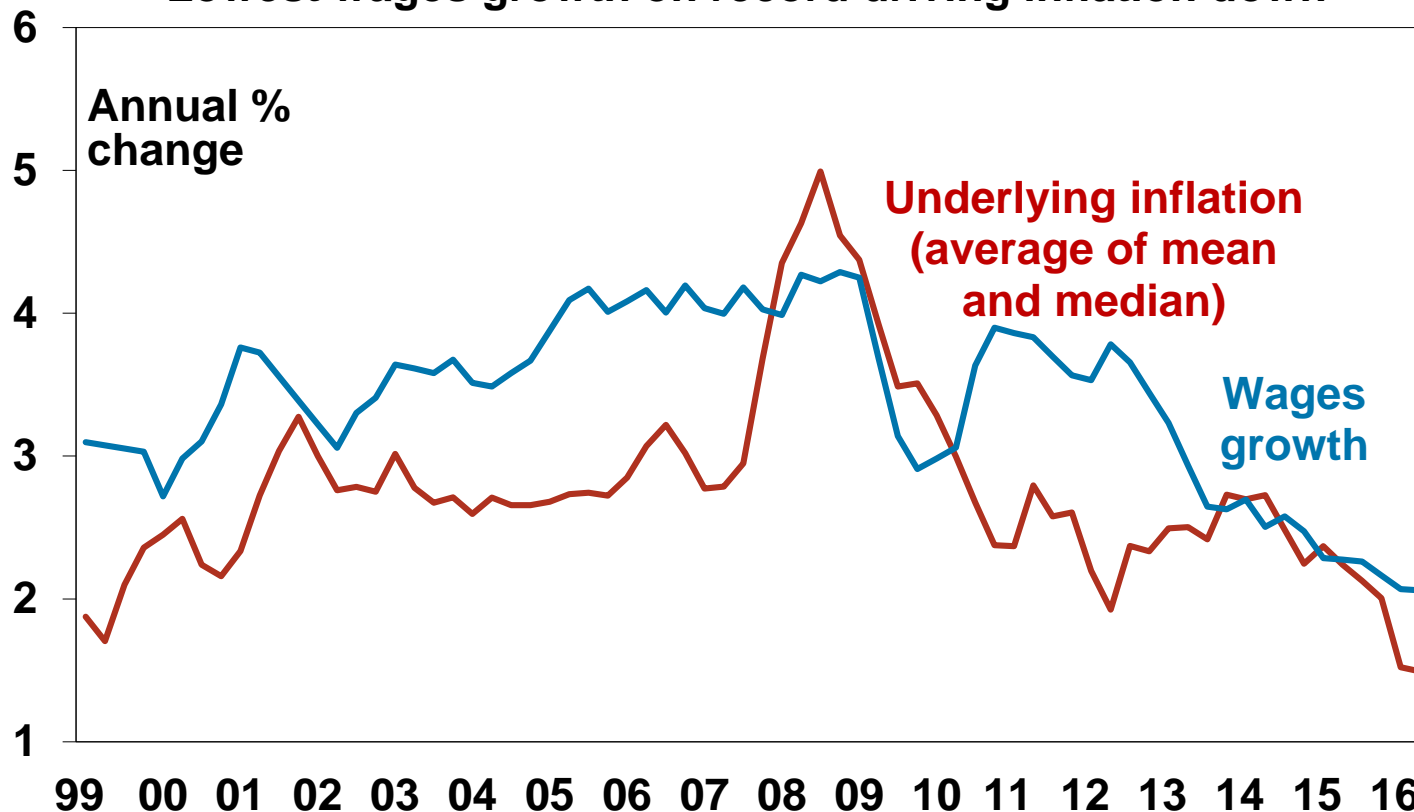
Employment EPI by region



SOURCE: AMP CAPITAL, BLOOMBERG



Lowest wages growth on record driving inflation down

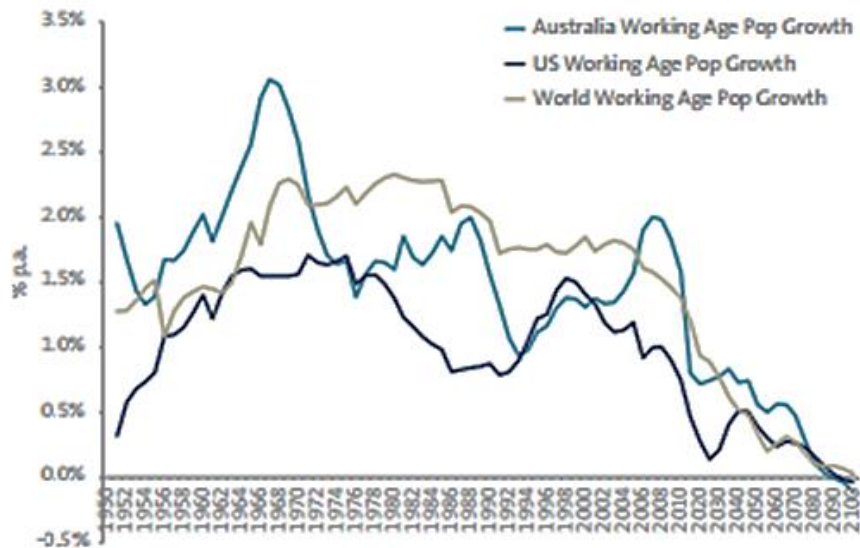




DRIVERS OF LOW YIELDS

DEMOGRAPHICS AND PRODUCTIVITY

Demographics are weighing on potential growth

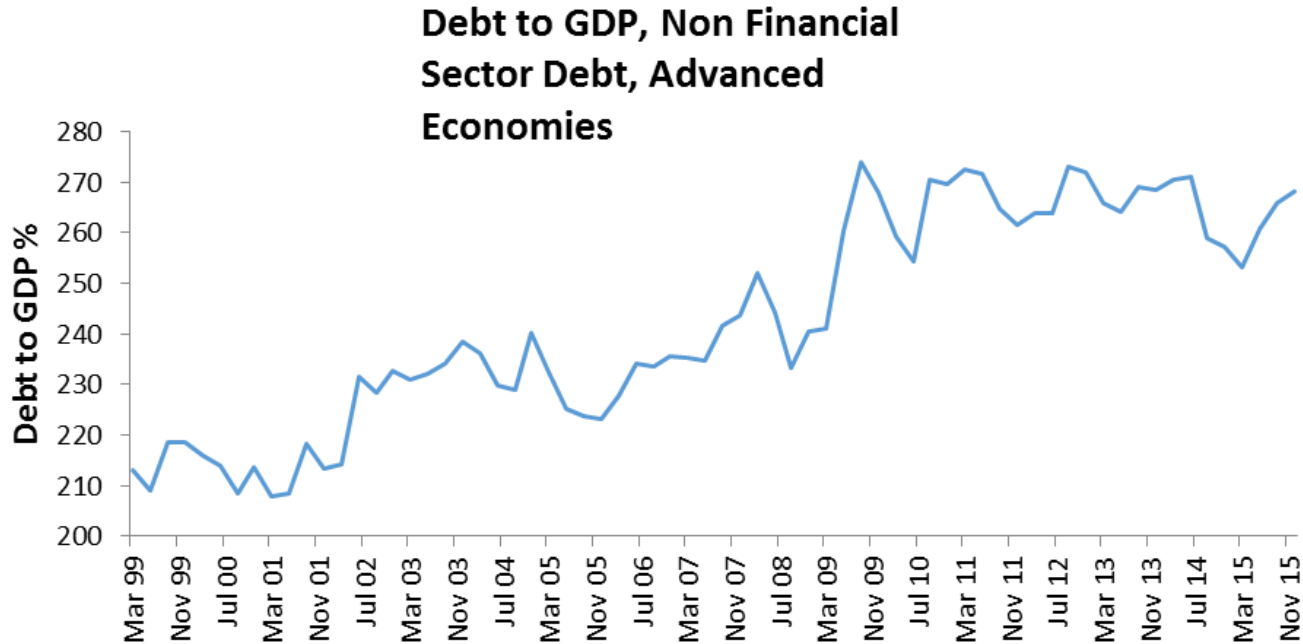


Source: United Nations, AMP Capital.



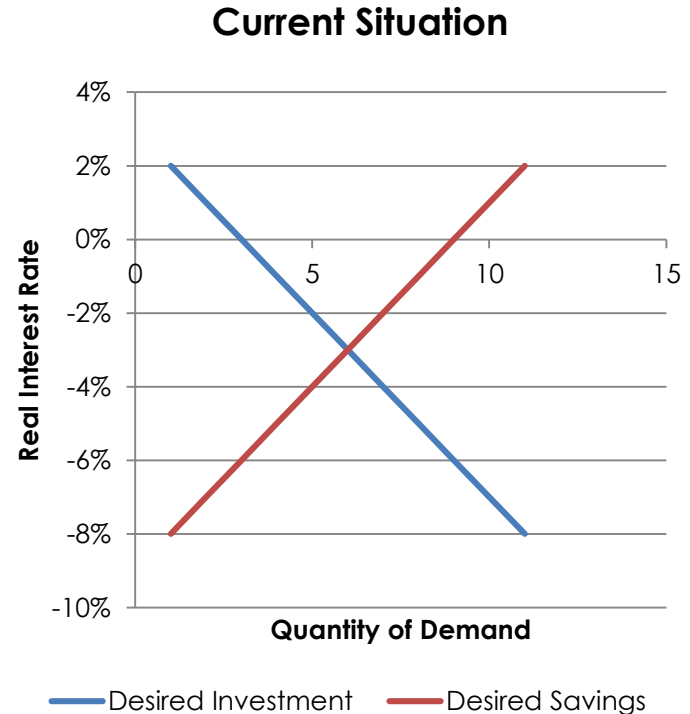
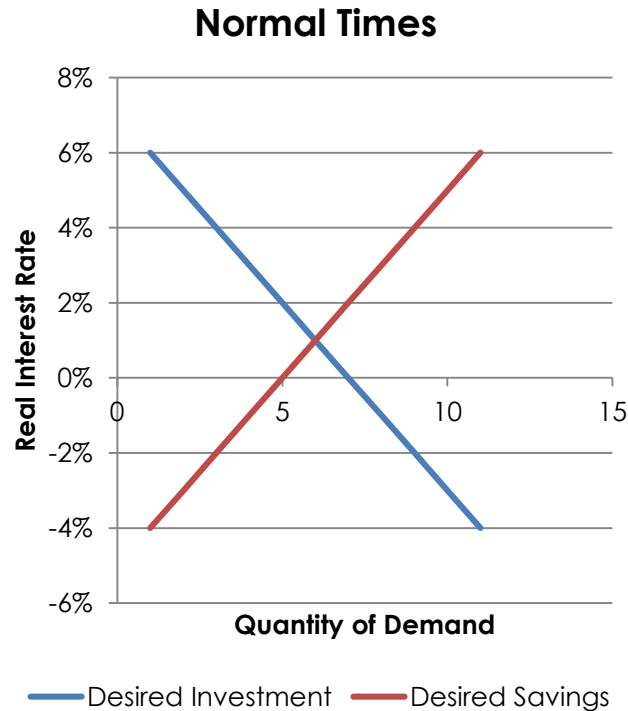
DRIVERS OF LOW YIELDS

DEBT SUSTAINABILITY AND LIQUIDITY TRAPS



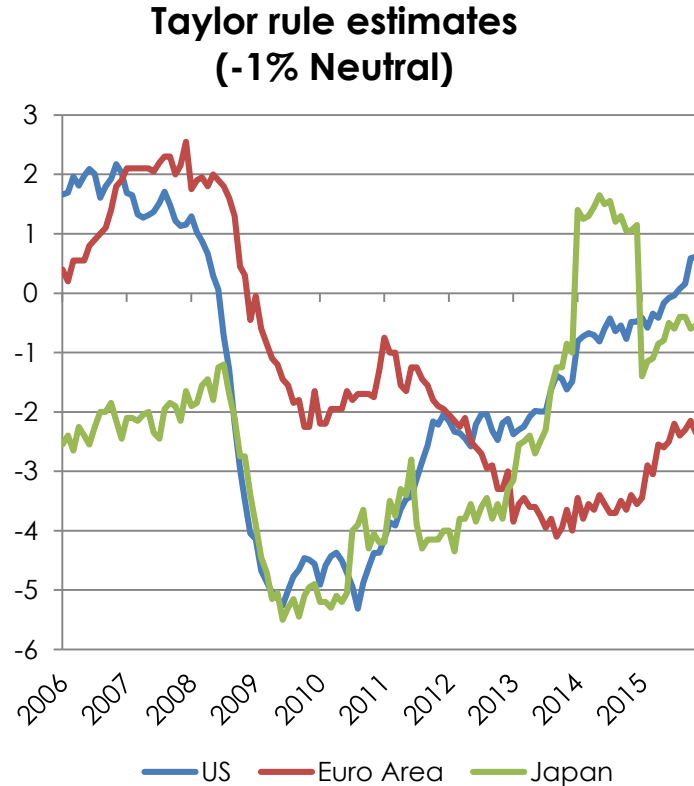


WHAT HAS GOT US HERE? ARE NEUTRAL RATES LOWER NOW?





WHAT HAS GOT US HERE? ARE NEUTRAL RATES LOWER NOW?

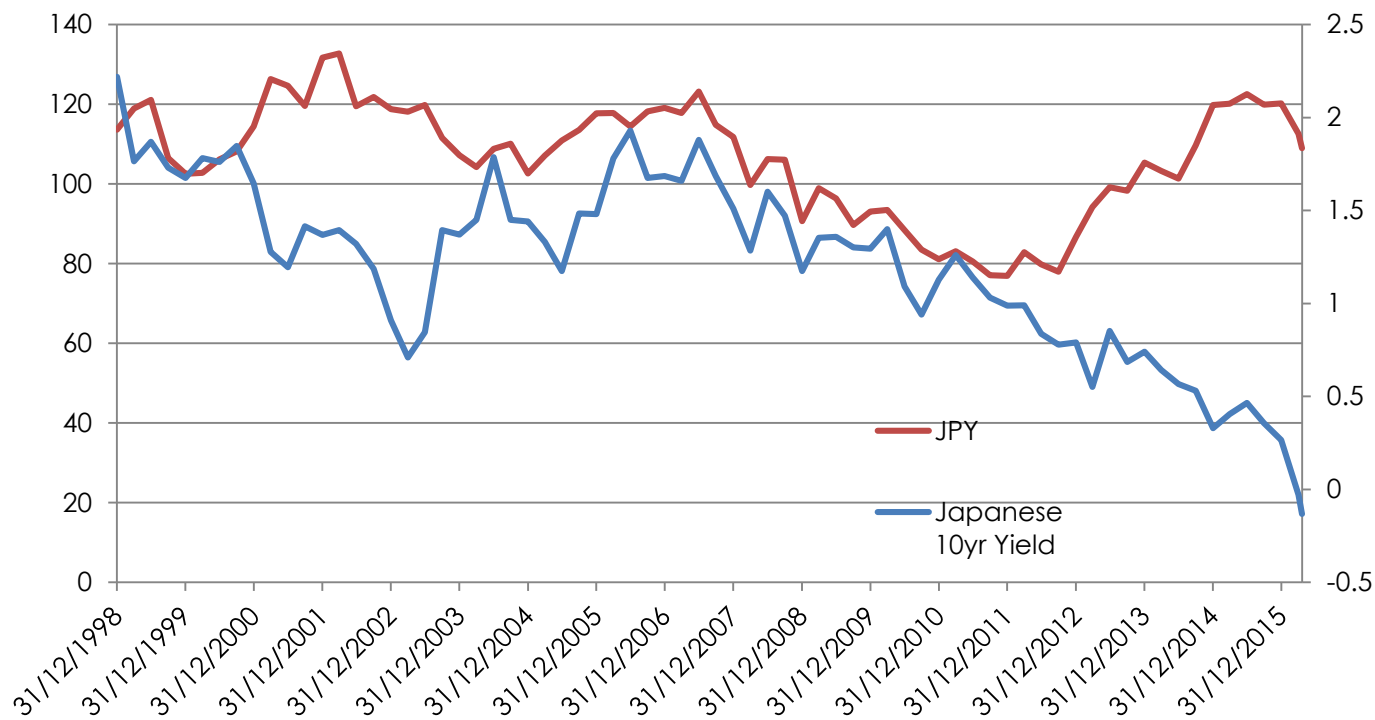




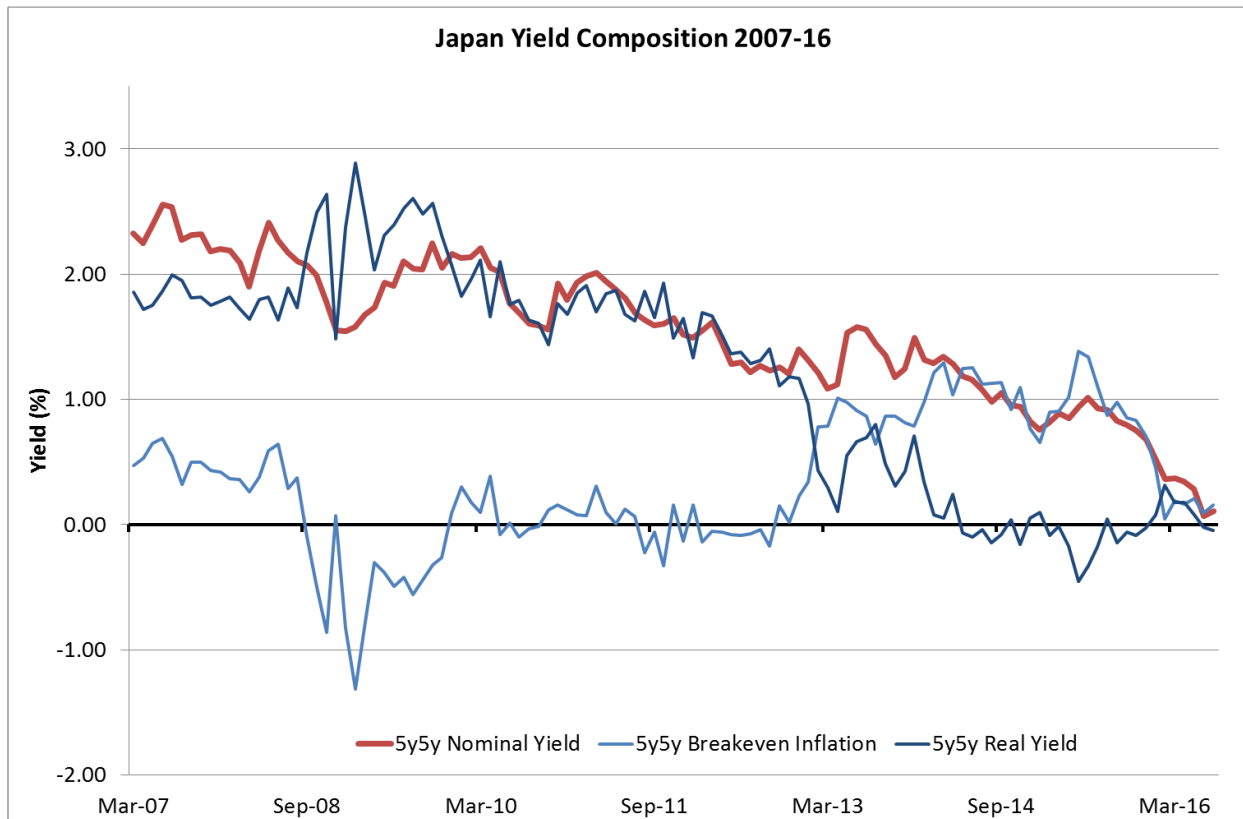
WHAT CAN WE LEARN FROM JAPAN?



THE JAPANESE CASE

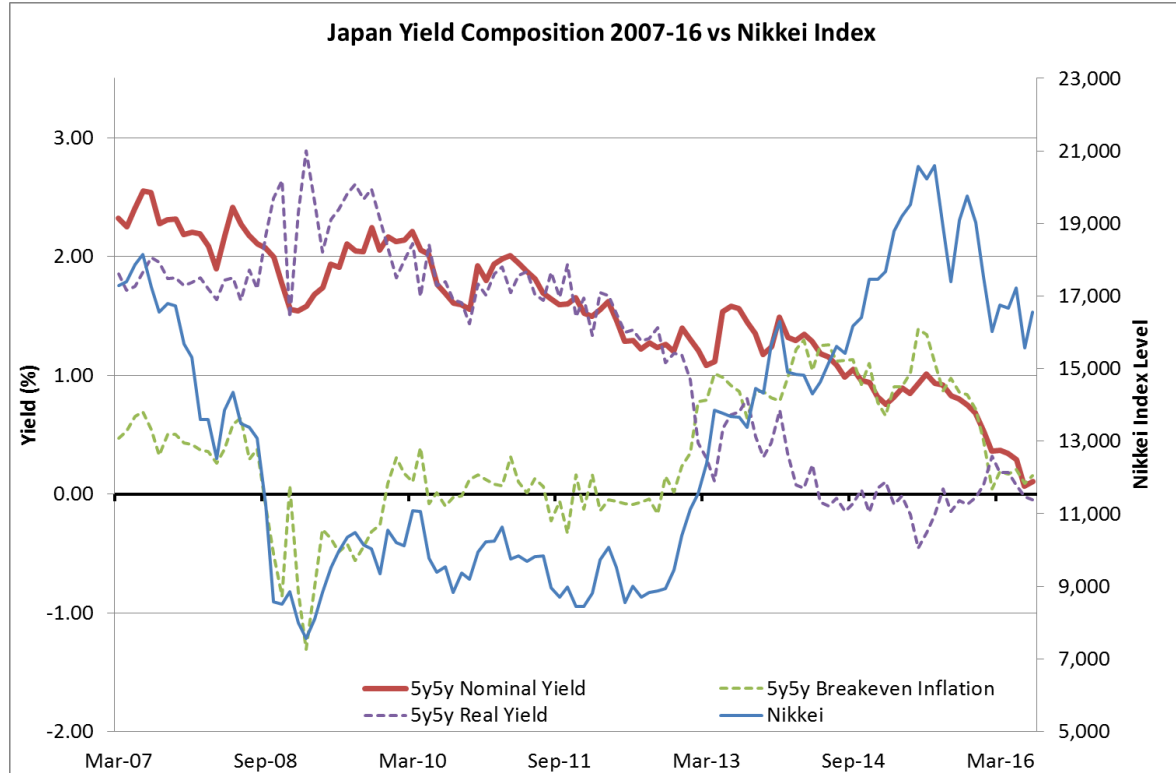


UNTIL NOW....





COMPOSITION OF NOMINAL YIELDS IS KEY THE BOJ – FAILING TO MANAGE EXPECTATIONS

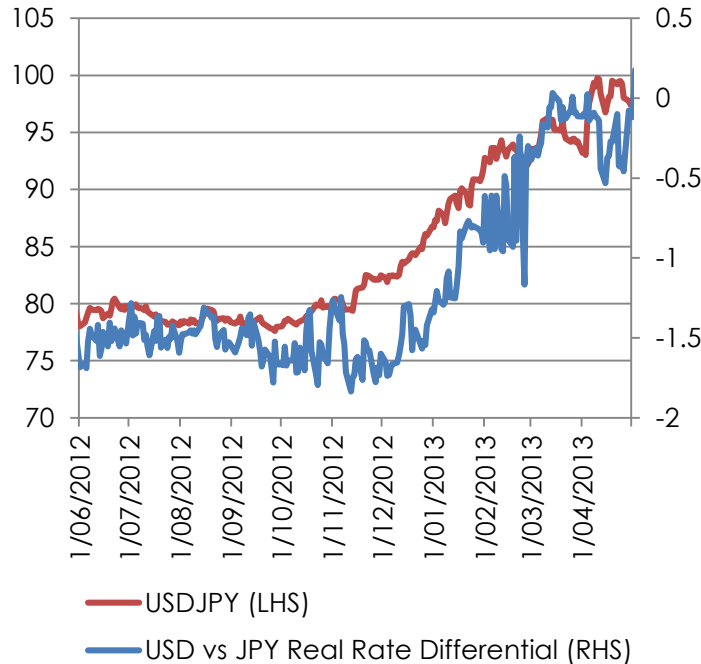




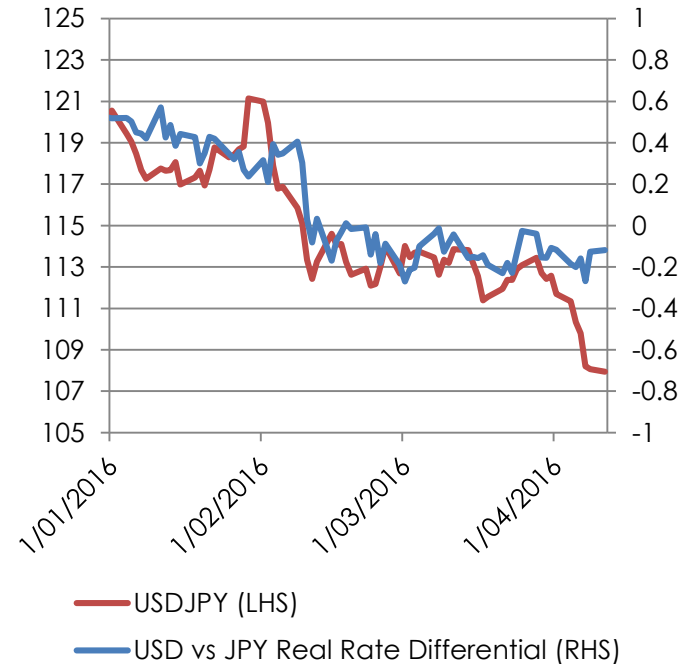
IMPACTS ON THE ECONOMY AND BOND YIELDS

THE JAPANESE EXPERIENCE

Reaction post-Abenomics



Reaction post-negative rates

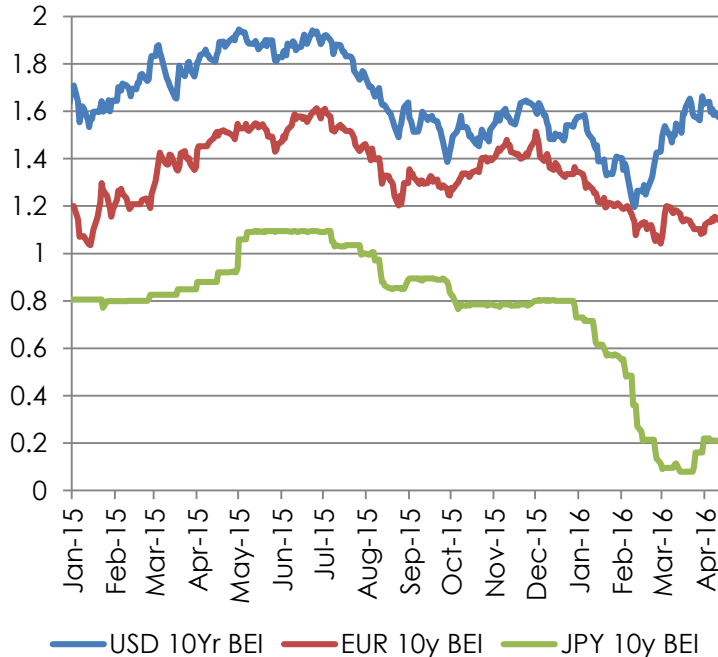




IMPACTS ON THE ECONOMY AND BOND YIELDS

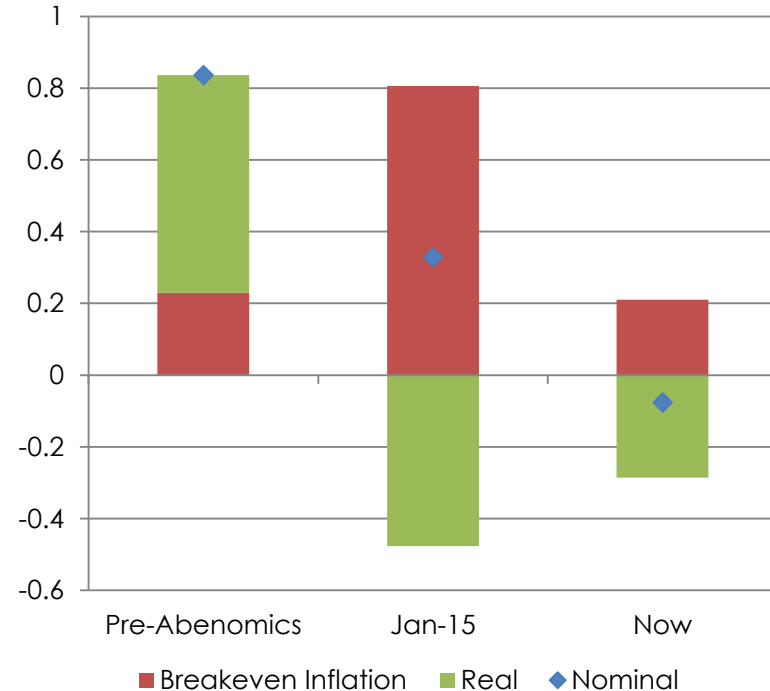
TWO KEY OUTCOMES

Europe is the next to 'Japanify'



SOURCE: BLOOMBERG

The time for Japan to reflate is now



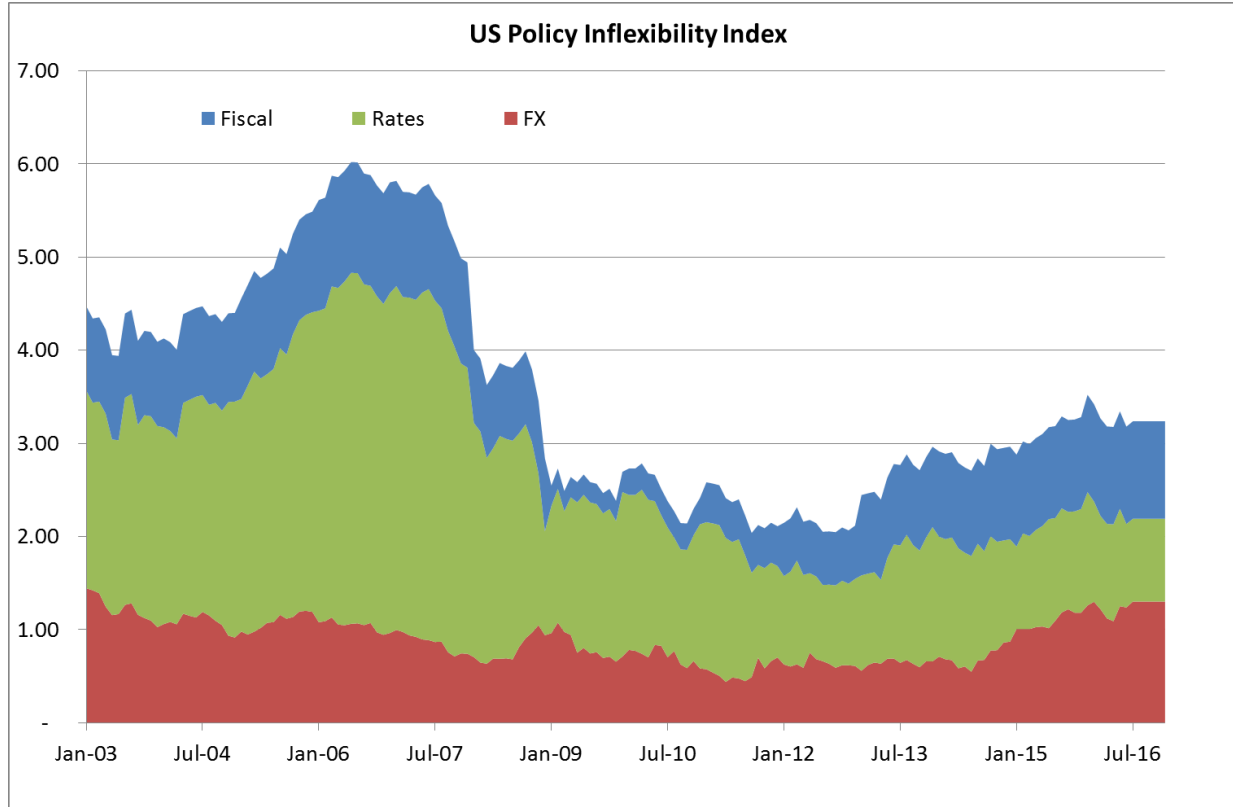


WHAT DOES THIS MEAN FOR THE FUTURE?



POLICY INFLEXIBILITY

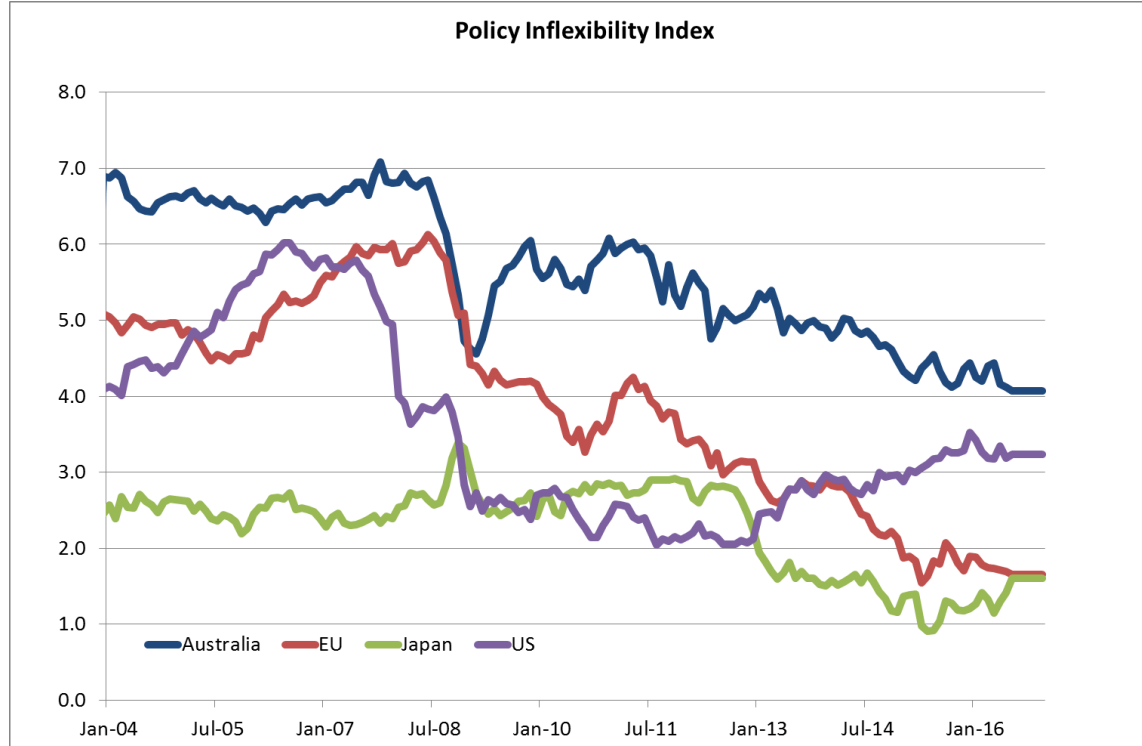
MEASURING THE LIMITS OF POLICY ACTION





POLICY INFLEXIBILITY

MEASURING THE LIMITS OF POLICY ACTION



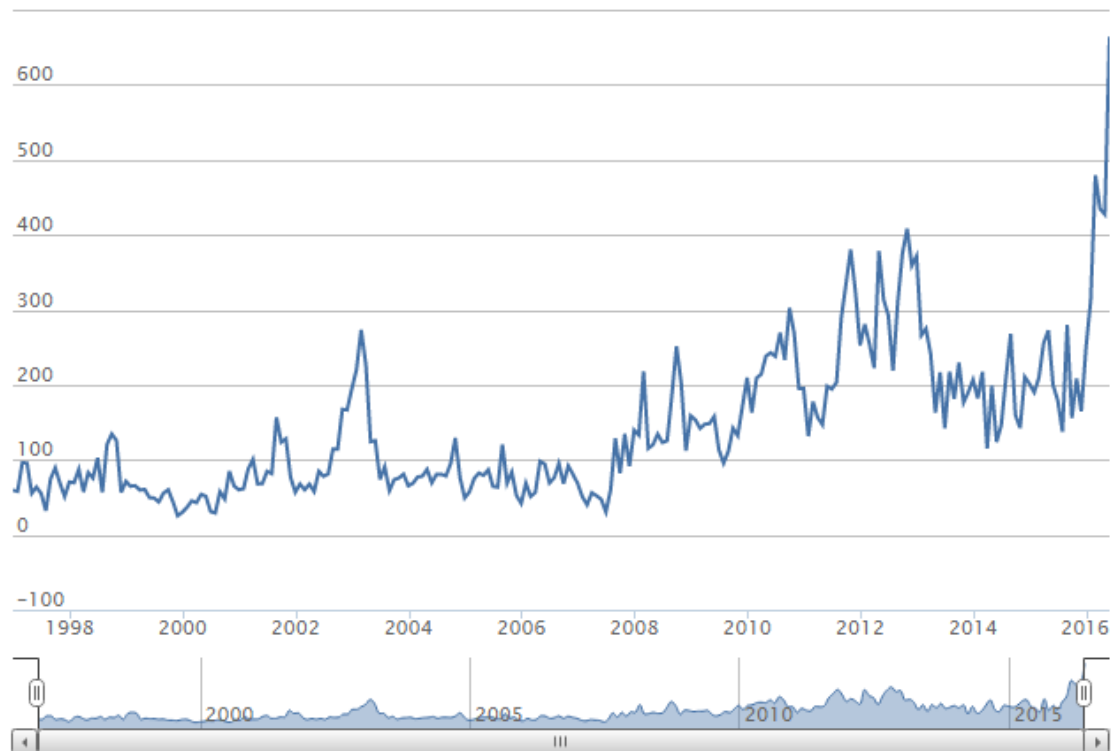
SOURCE: AMP CAPITAL



Monthly UK Economic Policy Uncertainty Index



Zoom 1m 3m 6m 1y 7y All



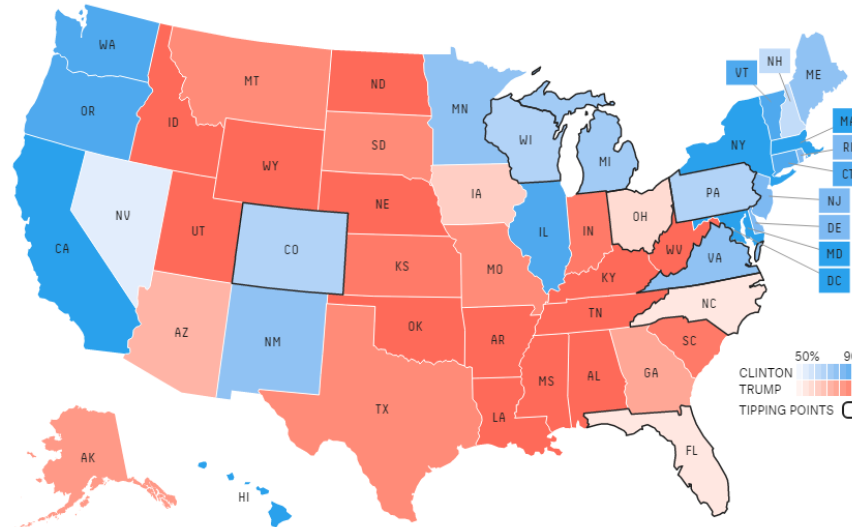


Chance of winning



Hillary Clinton
60.3%

Donald Trump
39.7%



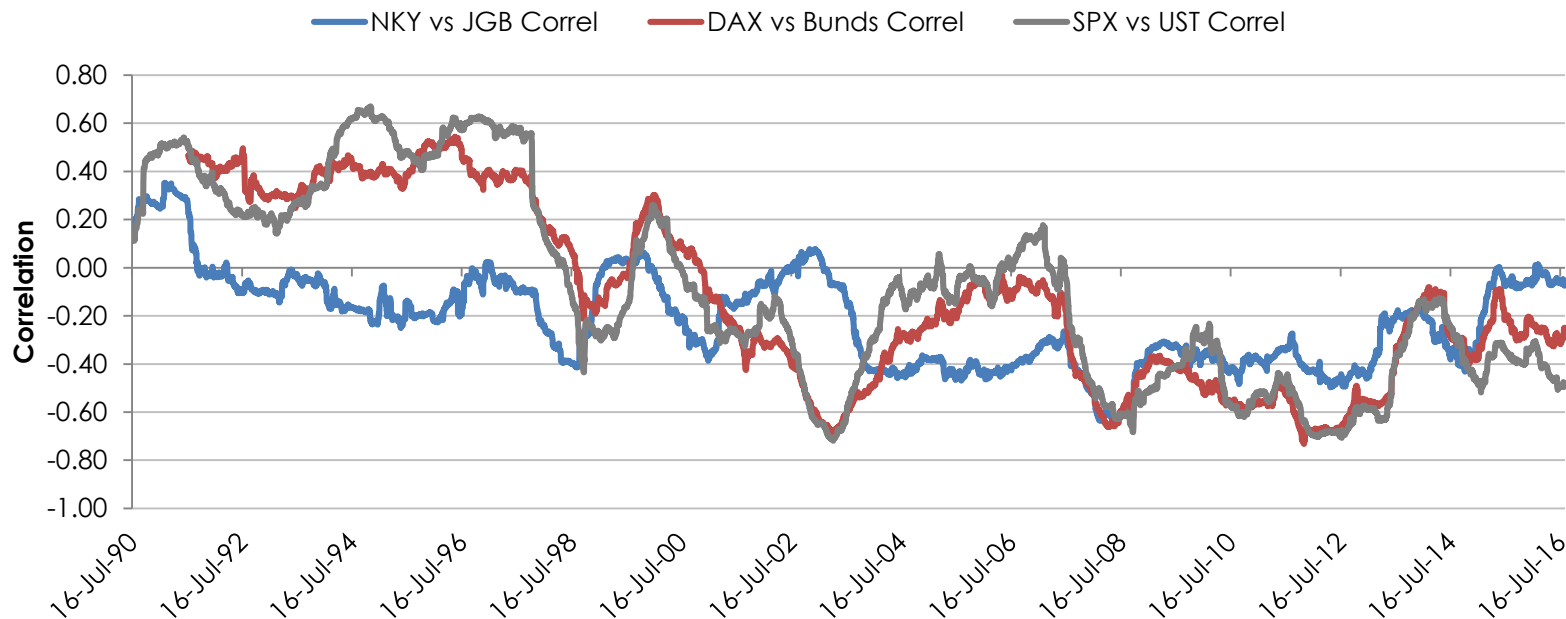


LOW RATES AND DIVERSIFICATION



REGIMES

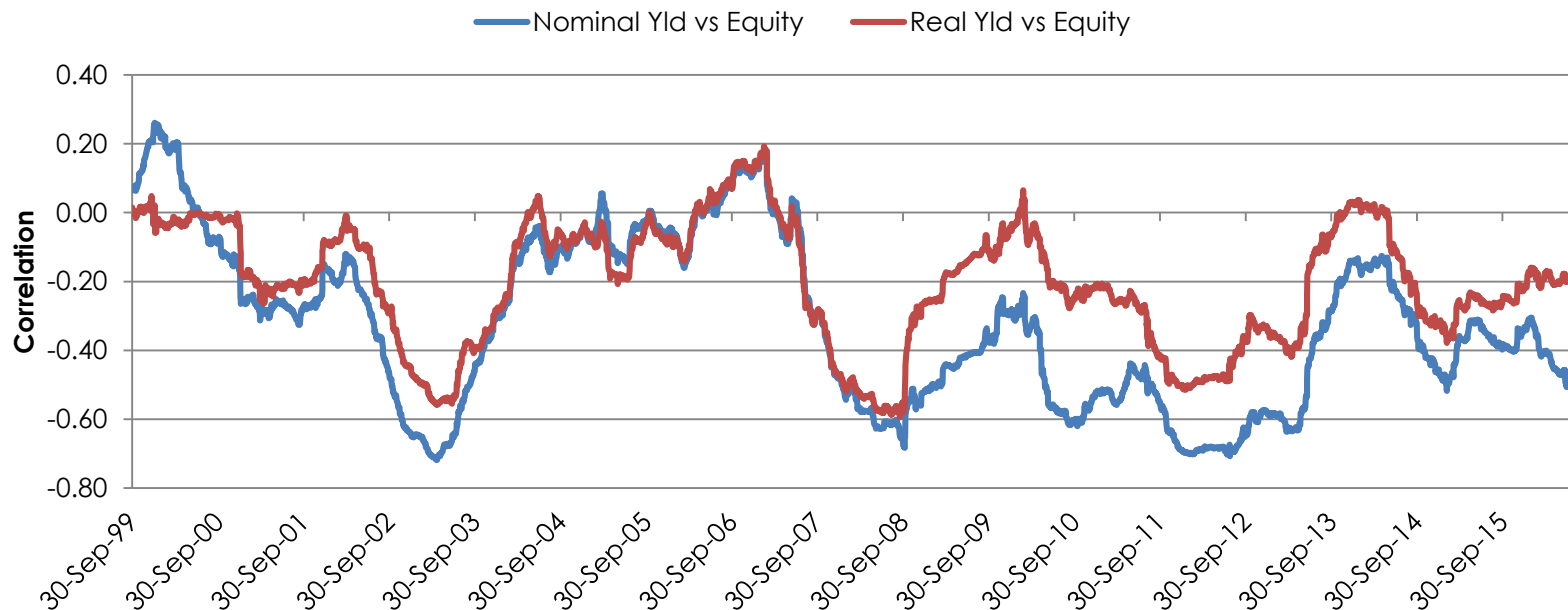
CORRELATIONS IN A CONSTRAINED NOMINAL WORLD





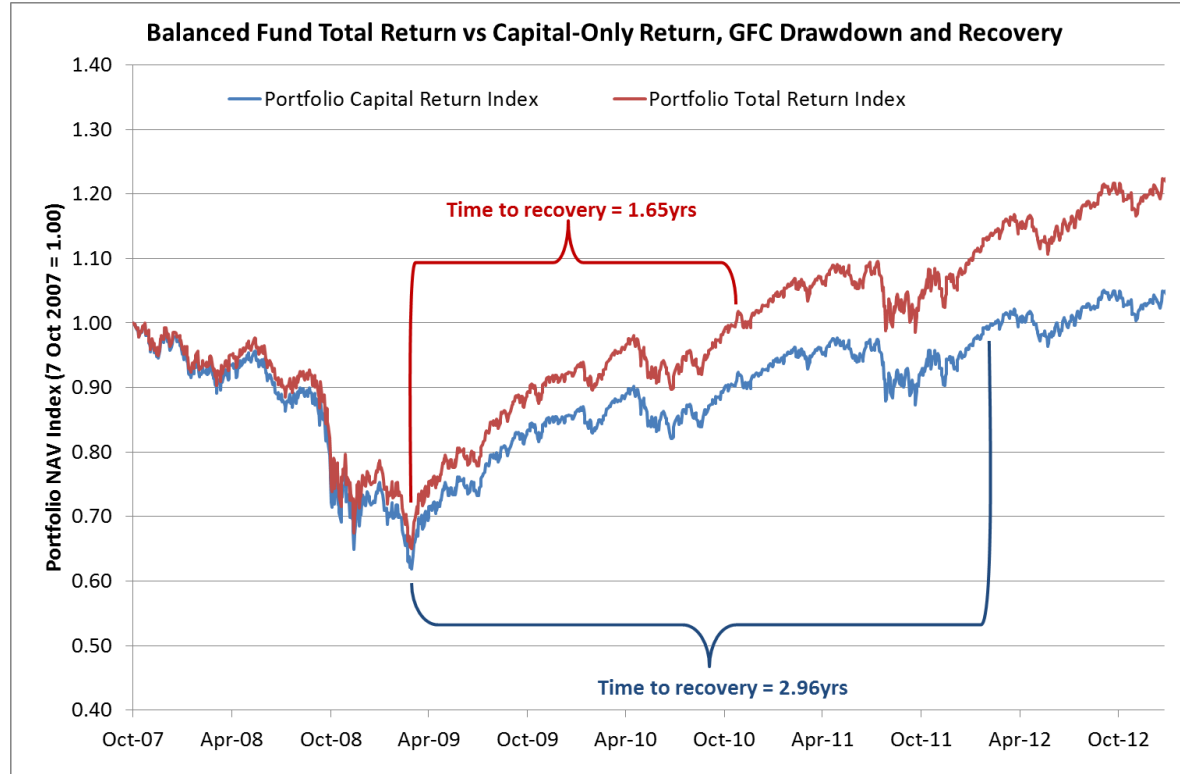
REGIMES

CORRELATIONS IN A CONSTRAINED NOMINAL WORLD



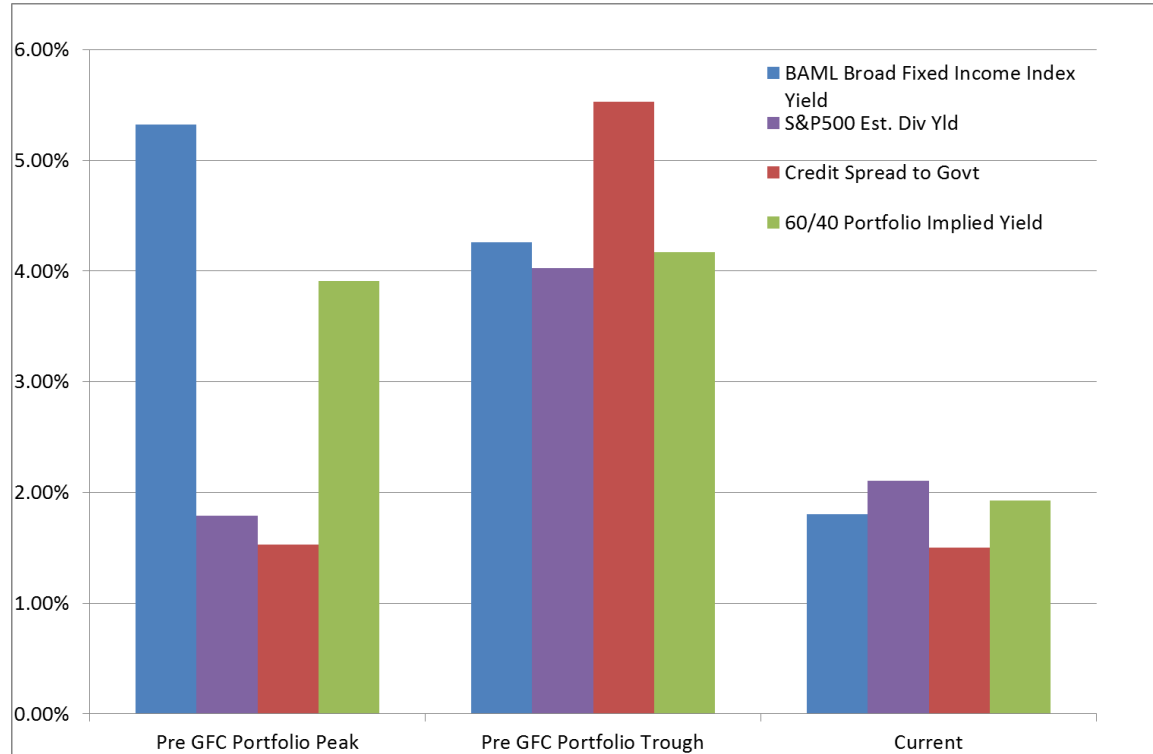


INCOME AS A DEFENSIVE FACTOR IT JUST MAKES CENTS





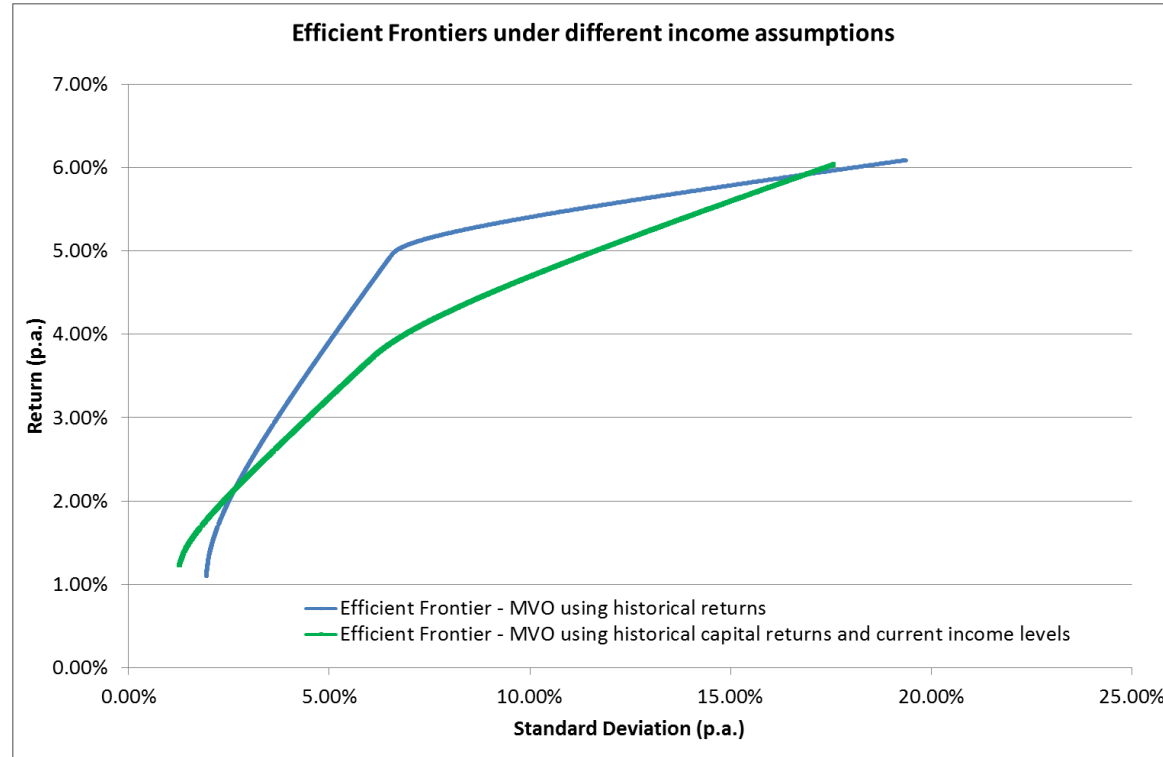
INCOME AS A DEFENSIVE FACTOR IT JUST MAKES CENTS



SOURCE: AMP CAPITAL, BLOOMBERG



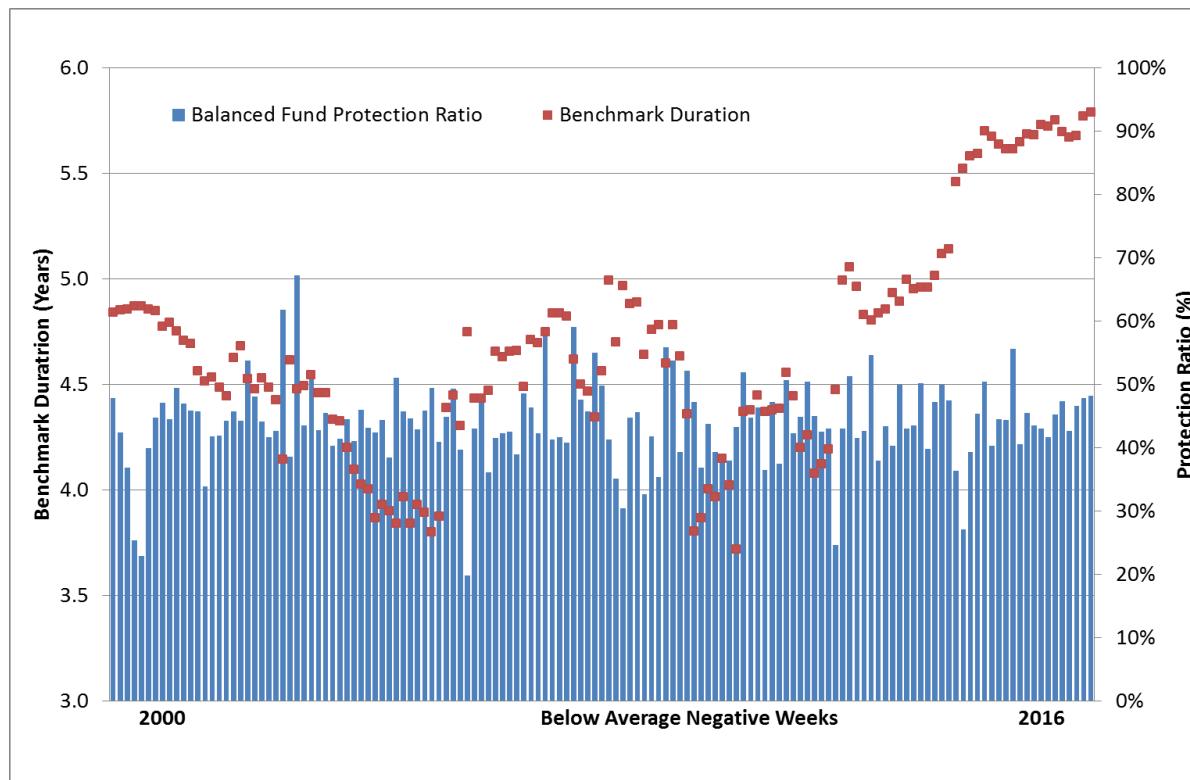
INCOME AS A DEFENSIVE FACTOR IT JUST MAKES CENTS





DEFENSIVE EFFECTIVENESS

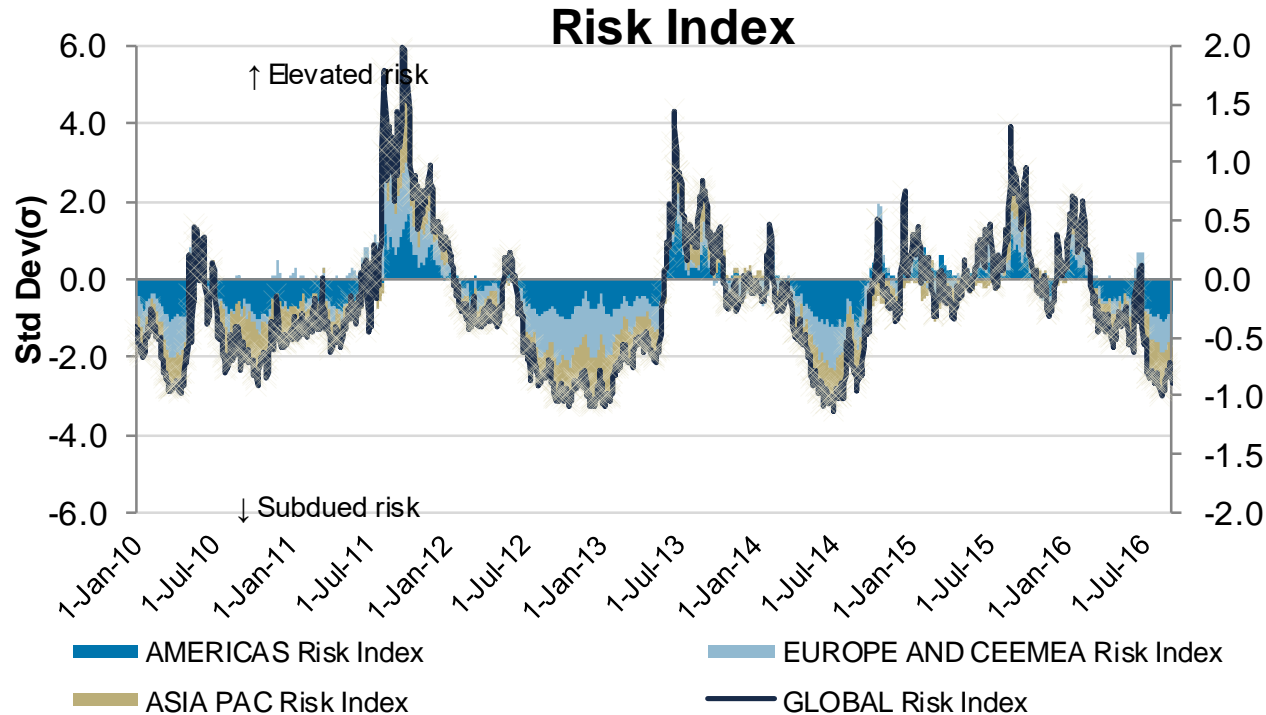
IT'S NOT WHAT IT USED TO BE...





THE ANATOMY OF RETURN AND RISK: BOND YIELDS IMPACT VALUATIONS FOR OTHER ASSETS

- Lower bond yields \neq lower real interest rates
- Therefore:
 - The nominal risk-free rate is no longer an adequate anchor for asset valuations
 - Historical relationships are no longer valid
- We need a new framework for constructing portfolios that incorporates:
 - The impact of lower bond yields on income and diversification
 - The impact of lower bond yields on defensiveness
 - Real interest rates and inflation





THE ROLE OF FIXED INCOME IN A ZERO YIELD WORLD: A SUMMARY

- The implications of low bond yields for investors goes deeper than what is implied by simply lower expected future returns.
- Income and capital components of returns have changed significantly, altering the role and relationships of assets in a portfolio. Recovery from drawdowns will be longer in a 60/40 balanced fund, demanding a greater focus on downside risks, particularly a fall in inflation expectations in a zero yield world.
- Assets can still benefit from further easing of policy in countries with policy flexibility and some countries may add new policy tools to expand the tool set.
- A framework accounting for real yields and inflation as discrete factors is required to understand future asset relationships. Implicit in this is the effective real yield duration that assets have. Low yields does not necessarily mean growth asset performance.
- This framework is useful for considering both country and asset allocations whilst also considering the impact of new policy tools.
- Understand the risk inherent in a given benchmark.
- Our analysis supports the view that allocations to credit premia should play a greater role in portfolios going forward.
- Other forms of premia and strategies that are likely to be supported by this analysis include currency, inflation, liquidity, protection strategies, and active management. This will form the basis for further research.