

# Asset Allocation by Institutional Investors after the Recent Financial Crisis

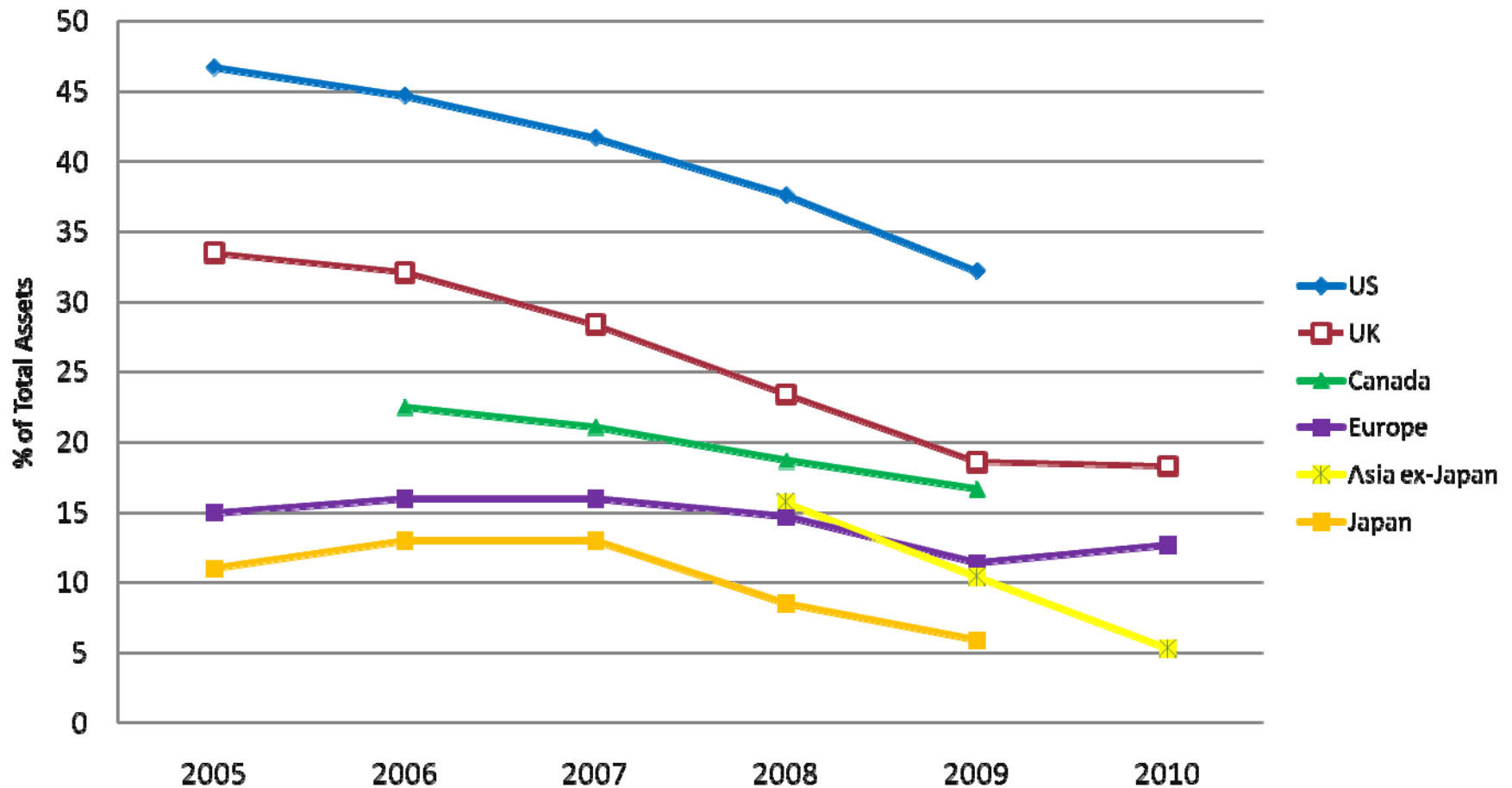
**Betsy Palmer**

Senior Managing Director

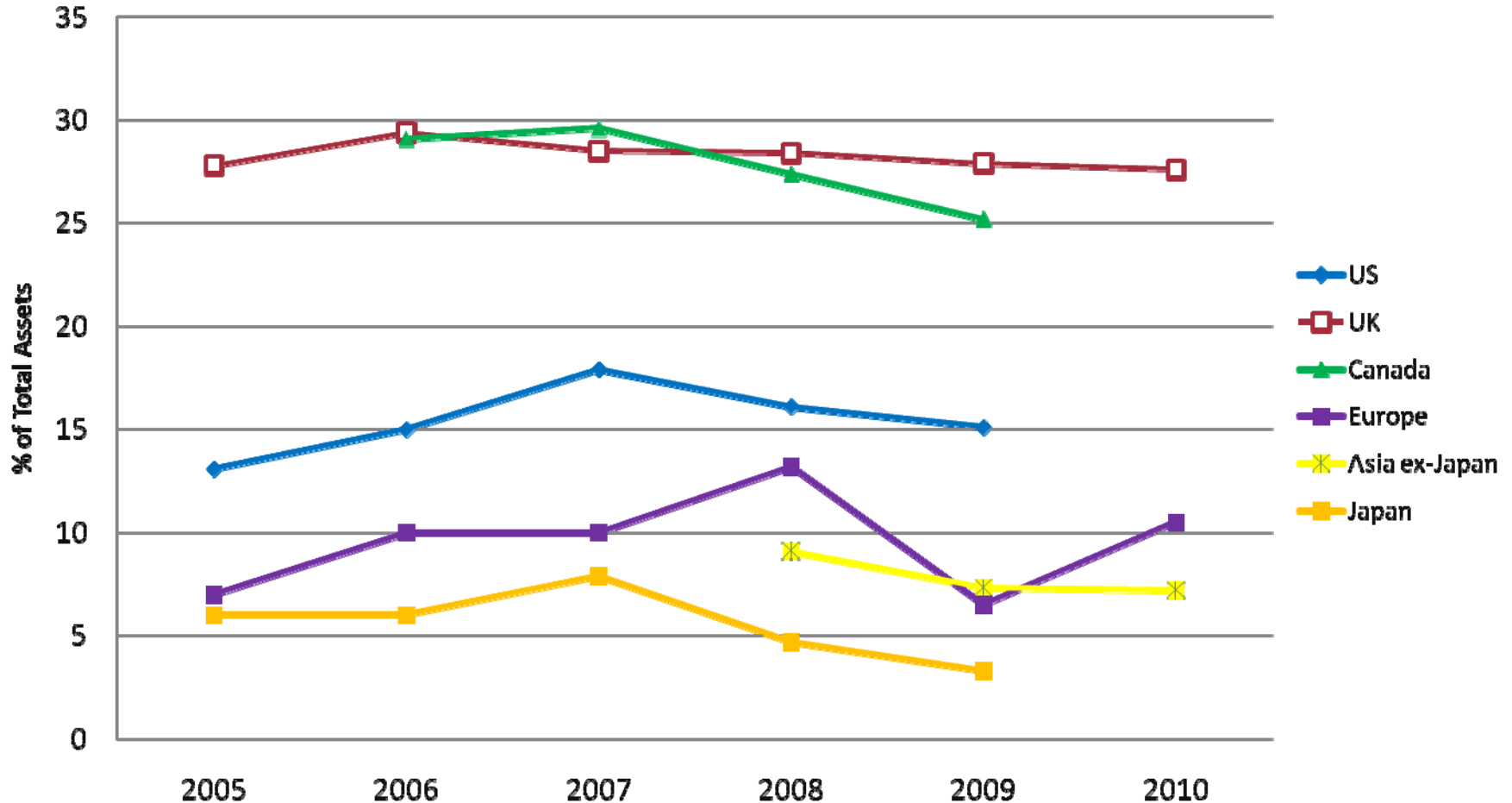
MFS Investment Management®

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# Domestic equity allocation trends across regions 2005 – 2010

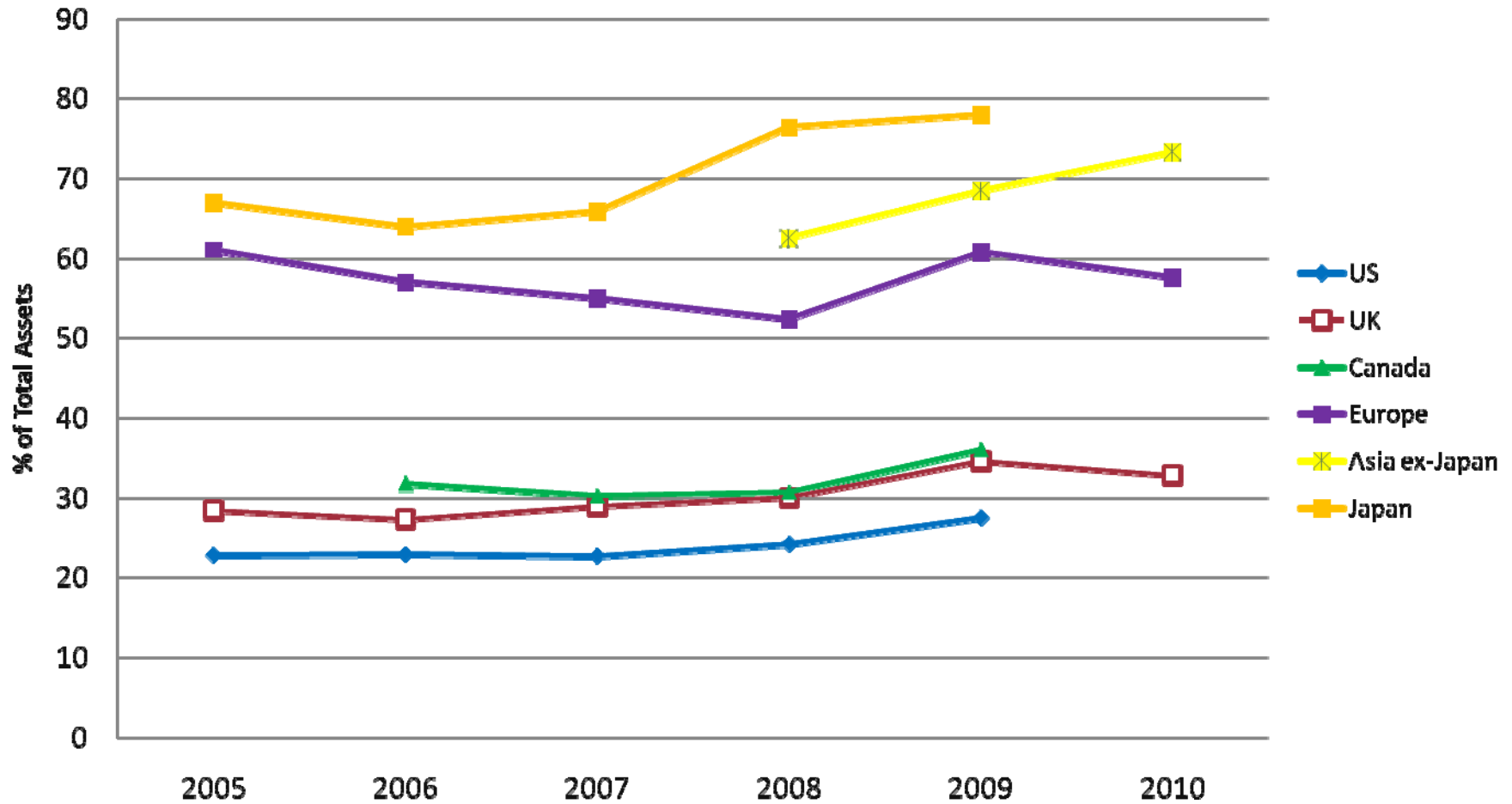


# Global/International equity allocation trends across regions 2005 – 2010

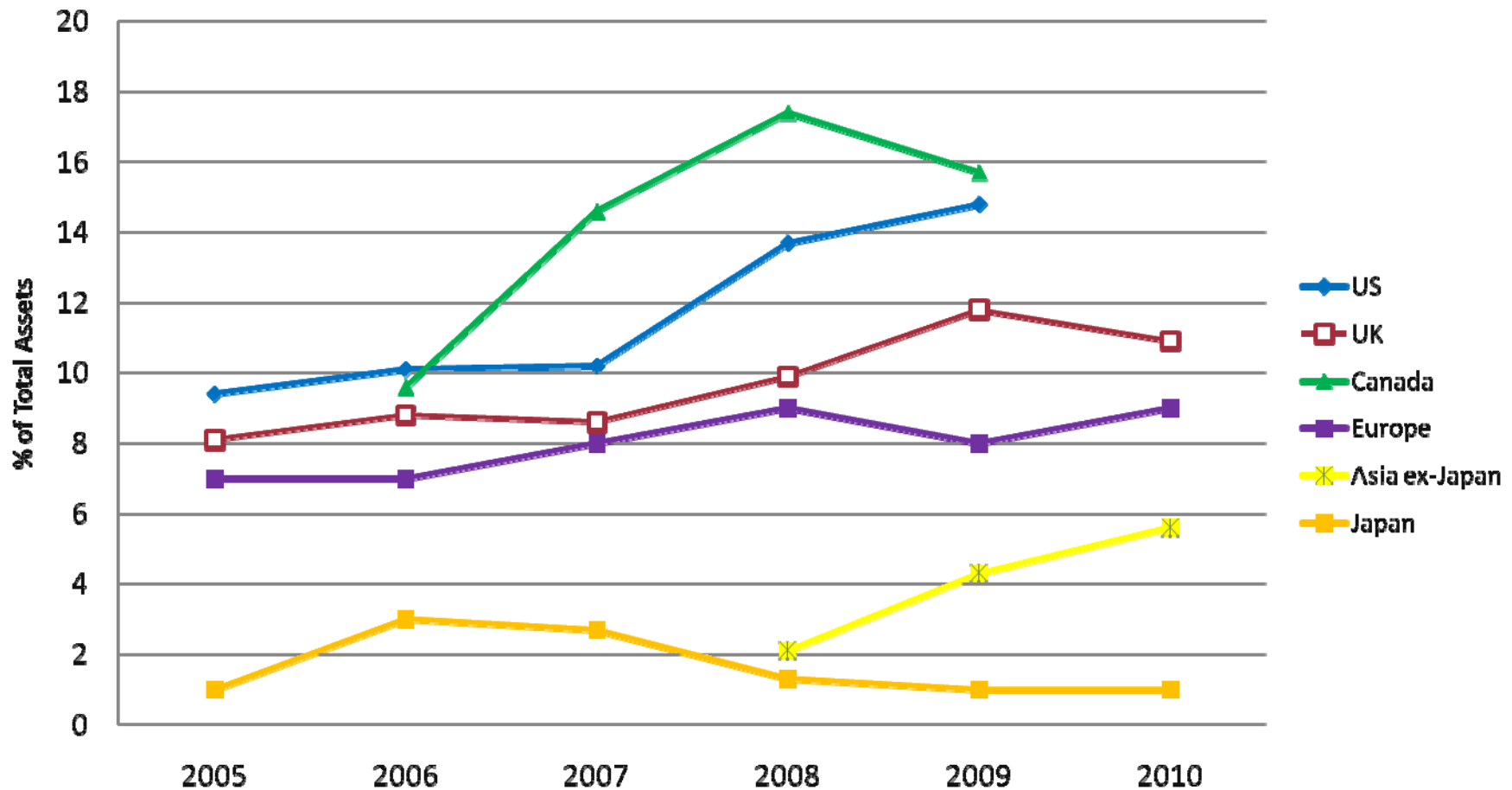


Source: Greenwich Associates data 2009 and 2010 (where available) surveys

# Fixed income allocation trends across regions 2005 – 2010



# Alternatives allocation trends across regions 2005 – 2010 (Private equity + Hedge funds + Real estate)



# Evaluation of the trends

## Declining equity exposure

- Decrease in overall equity allocation
  - More going to international/global
  - Less home country exposure
- Market crash accelerated decline in equity allocation
- Diversification did not help during the crash

**Correlation  
Matrix Ten  
Yrs. ending  
December  
2007**

	S&P 500	MSCI World ex U.S.	Emerging Market Equity	Barclays Aggregate	Barclays High Yield	Barclays 3-5 Yr Treasury	Barclays Long Treasury
S&P 500	1.00						
MSCI World ex. U.S.	0.83	1.00					
Emerging Market Equity	0.72	0.78	1.00				
Barclays Aggregate	-0.22	-0.19	-0.22	1.00			
Barclays High Yield	0.49	0.49	0.53	0.07	1.00		
Barclays 3-5 Yr Treasury	-0.34	-0.32	-0.33	0.93	-0.18	1.00	
Barclays Long Treasury	-0.29	-0.25	-0.28	0.94	-0.03	0.87	1.00

# Evaluation of the trends

## Declining equity exposure (Cont'd)

### Correlation Matrix April 2008 through March 2009

	S&P 500	MSCI World ex U.S.	Emerging Market Equity	Barclays Aggregate	Barclays High Yield	Barclays 3-5 Yr Treasury	Barclays Long Treasury
S&P 500	1.00						
MSCI World ex. U.S.	0.94	1.00					
Emerging Market Equity	0.89	0.96	1.00				
Barclays Aggregate	0.46	0.61	0.55	1.00			
Barclays High Yield	0.71	0.78	0.82	0.38	1.00		
Barclays 3-5 Yr Treasury	-0.20	-0.21	-0.28	0.50	-0.52	1.00	
Barclays Long Treasury	0.28	0.37	0.28	0.87	-0.05	0.75	1.00

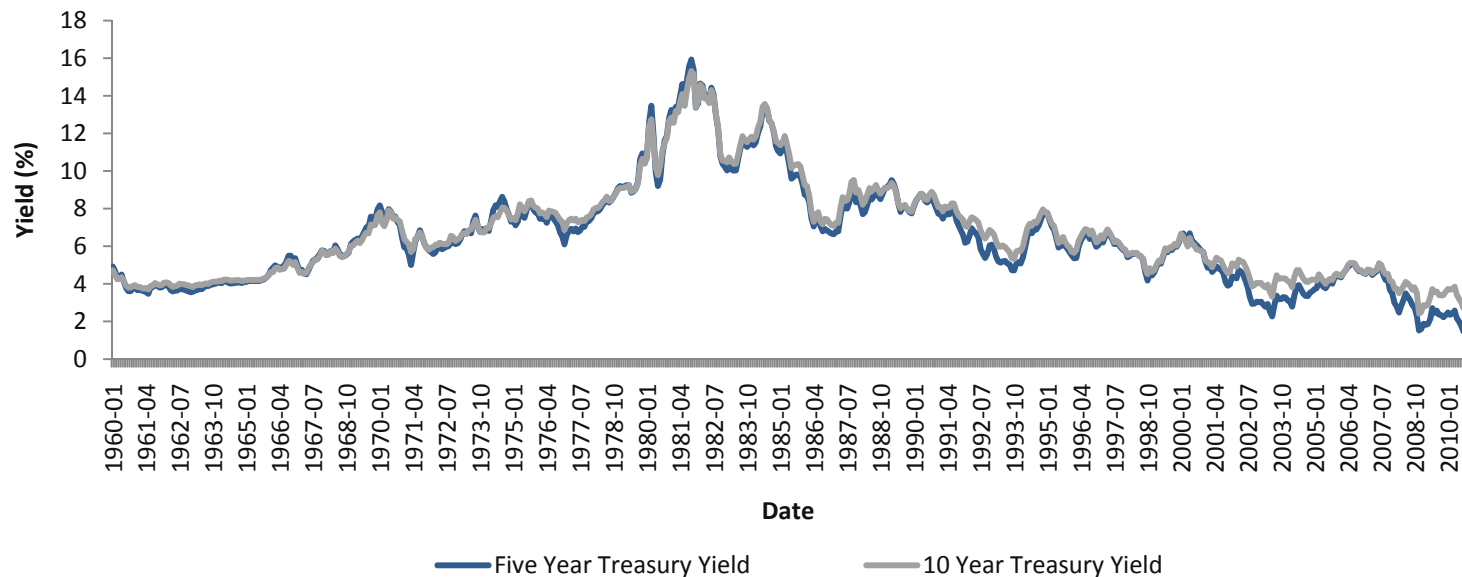
### Correlation Matrix April 2009 through March 2010

	S&P 500	MSCI World ex U.S.	Emerging Market Equity	Barclays Aggregate	Barclays High Yield	Barclays 3-5 Yr Treasury	Barclays Long Treasury
S&P 500	1.00						
MSCI World ex. U.S.	0.88	1.00					
Emerging Market Equity	0.83	0.94	1.00				
Barclays Aggregate	0.04	0.04	-0.04	1.00			
Barclays High Yield	0.65	0.81	0.84	0.00	1.00		
Barclays 3-5 Yr Treasury	-0.23	-0.36	-0.41	0.84	-0.45	1.00	
Barclays Long Treasury	-0.33	-0.46	-0.53	0.76	-0.54	0.88	1.00

# Evaluation of the trends

## Increases in fixed income

- Modest increases in fixed income exposure over the recent past
- “Flight to quality” in 2008
- Locking in deficits at low point in interest rate cycle – inconsistent with return assumptions
- Silver lining to black cloud of higher interest rates

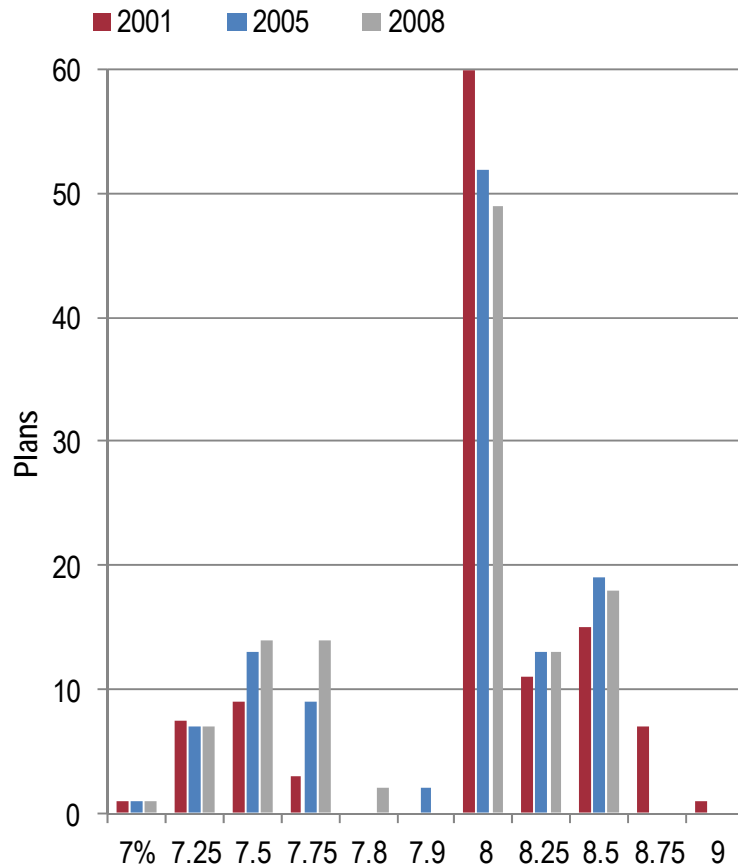




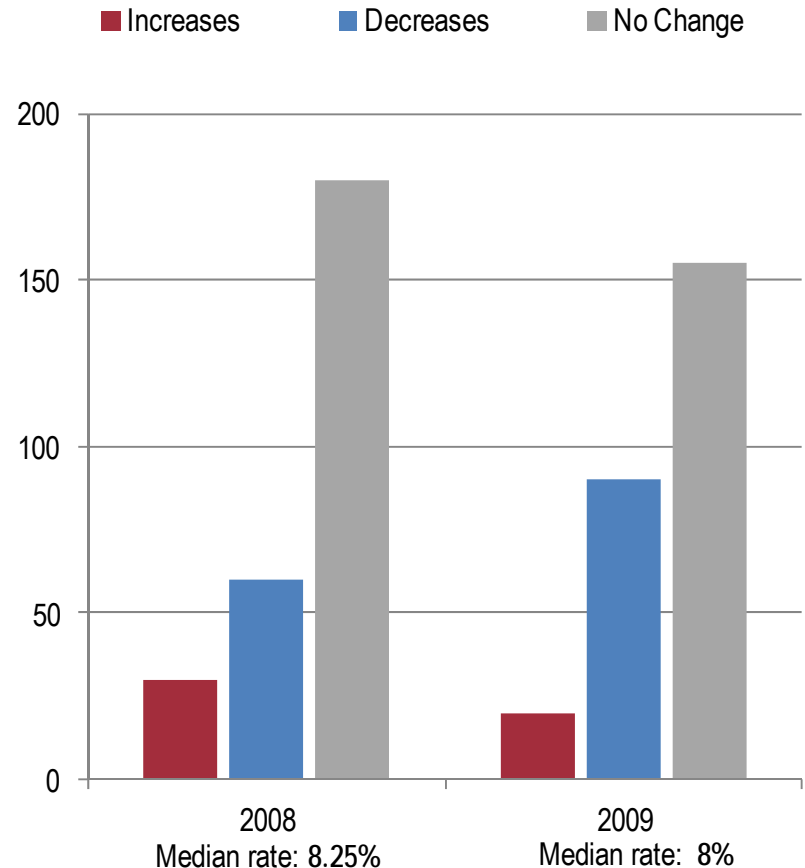
# Evaluation of the trends

## Increases in fixed income

Expected investment return rates for public pension plans, by number of plans reporting particular levels



Changes to return assumptions reported by S&P 500 companies with pension plans



# Evaluation of the trends

## Increases in alternatives

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Hedge fund return vs. other equity indices		
	2008	2009
Hedge Fund Index*	-19.03%	19.98%
S&P 500	-37.45%	25.55%
MSCI AC World	-42.19%	34.63%

- Performance
- Fees
- Liquidity
- Enduring appeal

\*Source: HFRI (Hedge Fund Research Index) returns are constructed from over 2,000 self-reported hedge fund manager returns. Returns are net of all fees and the index is equal weighted.

# Asset Allocation Trends by Type of Investor

## Corporate Pension

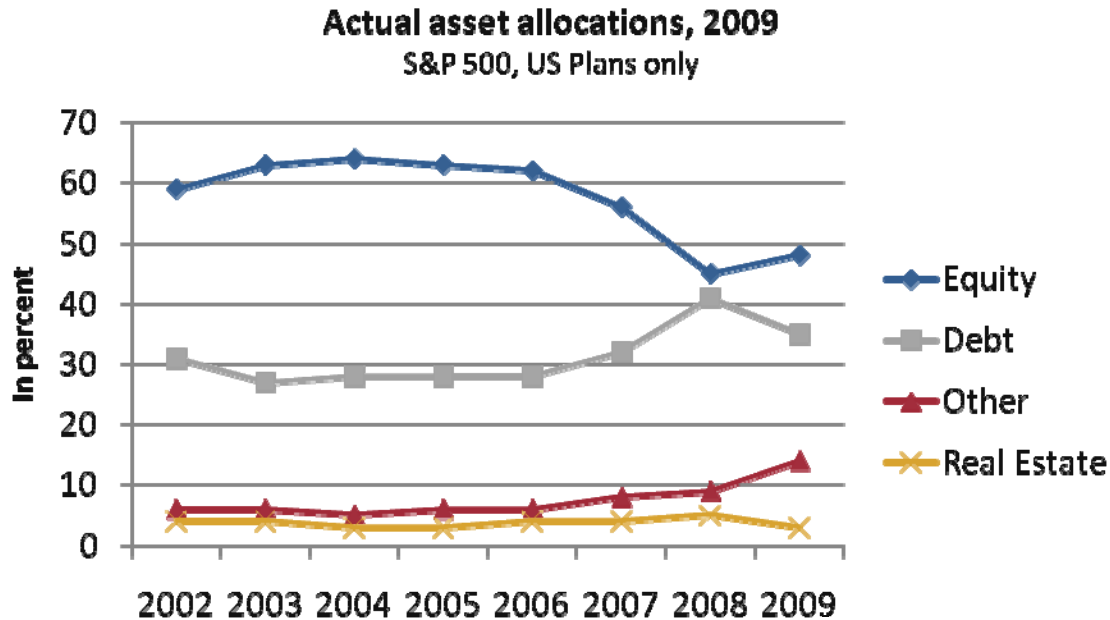
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- Many DB plans frozen/closed
- Shift from DB to DC
- Funded status impacted by declining equities and lower interest rates
  - 2007 – 107%, 2008 – 79%, 2009 – 82%, 2010(E) – 75%
- Current deficit for S&P 500 companies est. 2010 \$316 billion\*

\*Source: Goldman Sachs Global Markets Institute (*Pension review 2010: Pension palpitations refuse to dissipate for corporate plan sponsors*); Capital IQ; company reports

# Asset Allocation Trends by Type of Investor

## Corporate Pension



- Shift from equity to fixed income
- De-risking vs. interest rate risk
- Scenarios where shift to bonds make sense

# Asset Allocation Trends by Type

## Public Pension

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- Ongoing liability of states and municipalities
- Little DB to DC movement
- “The Trillion Dollar Gap” – Pew report
  - \$2.8 trillion liabilities
  - 82% funded
  - 8 states below 66%
- Understated funding shortfall
  - FY 2008 data
  - Accounting methodology

# Asset Allocation Trends by Type

## Public Pension

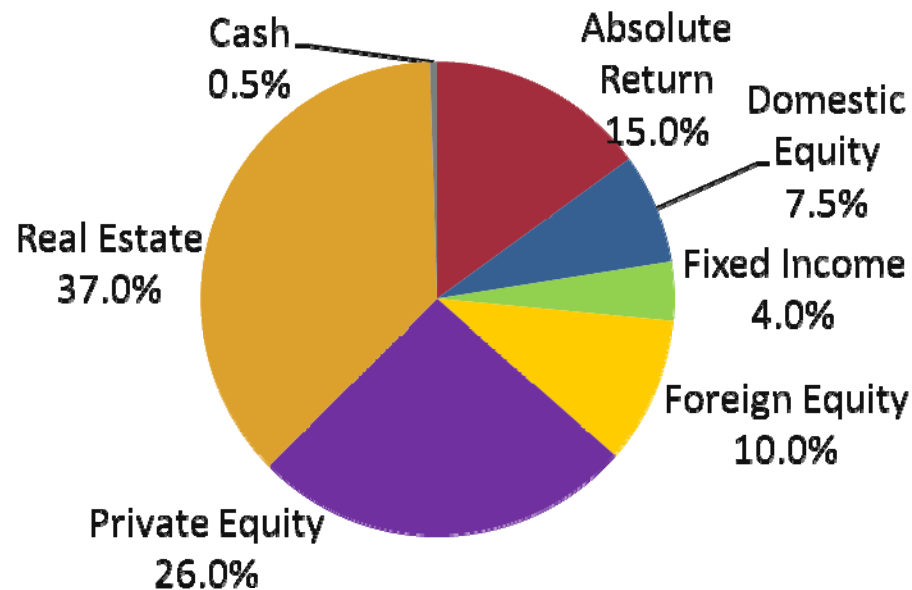
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- Shoot the Moon
  - Increase international/global
  - Increase alternatives
  - Decrease fixed income
- Aggressive alpha projections
  - 132 bp in 2008
  - 160 bp in 2009

# Asset Allocation Trends by Type Endowment and Foundation

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- Goal: to deliver return in perpetuity
- Greater use of alternatives, less to traditional stocks and bonds
- The Yale model, 2009 target asset allocation



# Asset Allocation Trends by Type Endowment and Foundation

- Heavy allocations to alternatives did not provide shelter during the crash
  - Endowment average return FY 2009 -19%
  - Foundation average return 2009 -26%
- Little reason to pursue LDI strategies
- Larger Endowment and Foundations → greater reliance on alternatives

Endowment and Foundations, Asset Allocation for key categories, June 30, 2009				
	Endowments Under \$1 billion	Endowments Over \$1 billion	Foundations Under \$1 billion	Foundations Over \$1 billion
US Equities	20.9%	14.1%	22.4%	18.8%
Global ex US	14.4%	9.9%	15.5%	10.6%
US Bonds	16.1%	8.4%	15.9%	9.1%
Hedge Funds	12.1%	15.9%	10.2%	12.7%



# Conclusions

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- Financial crisis did not lead to radical changes for most institutional investors' asset allocation policy
- Three trends already underway
  - Decreasing commitment to equity, with international/global becoming a larger part of overall allocation
  - Increasing fixed income allocation
  - Increasing use of alternatives
- Hope springs eternal!
  - Optimistic return assumptions
  - Can alternatives deliver?