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Financial Services Authority

# *Fixed Income Themes*

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# Pension Investors The Environment

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- Hit on Assets, as market prices decline
- Hit on Liabilities, as discount rate falls
- Funding ratio deteriorated by an estimated 20%-30% in the U.K.
- More complex situation in the U.S., due to flexible discount rate 'regimes'

# Pension Investors

## The Role of Fixed Income

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Focus on Domestic Fixed Income,

as liabilities denominated in domestic currency, sensitive to domestic discount rate

- LDI                      Execution, Liquidity, Counterparty, Libor  
                                Nominal yields unattractive, real yields average  
                                Why immunize, if Plan is far from 100% funding ratio?
  
- Towards Riskier Assets?      Equities (for rebalancing, for 'value'), Investment Grade Corporate Bonds, High Yield Bonds & Loans, Convertibles, Property

# Fixed Income Macro Environment



	U.S.	U.K.	Europe	Japan
Monetary	Zero Rates	Nearly Zero	Tight, relative to macro	Zero Rates
Fiscal	Massive Expansion	Massive Expansion	3% GDP Limit	Boring
Currency	Weaker in recent years	Recent collapse	Strong in recent years	Too strong
Demographics	Mature	Mature	Mature	Mature
Inflation Expectations	1.3% 10Y	2% 10Y	1.6% 10Y	-2.2% 10Y
Other Features	Reserve Currency	Finance & Oil	Ideologically blind	Locked
<b>BOND YIELDS ?</b>	UP	UP	STABLE	STABLE



# Attractive Strategies

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## PLAIN VANILLA STRATEGIES

- European fixed rate vs U.S./U.K.

## INFLATION STRATEGIES

- Inflation-protected fixed income, directional
- Breakeven trade, i.e. short nominal bond and long inflation bond (U.S. & Japan)

## IMMUNIZATION STRATEGIES

- LDI (inflation protected) or Long maturity benchmark (real money) for pension plans who are fully funded

## CREDIT STRATEGIES

- Investment Grade Credit
- High Yield Credit (beware!) or Loans
- EMU Periphery – Buy Italy and Spain risk

## FX STRATEGIES

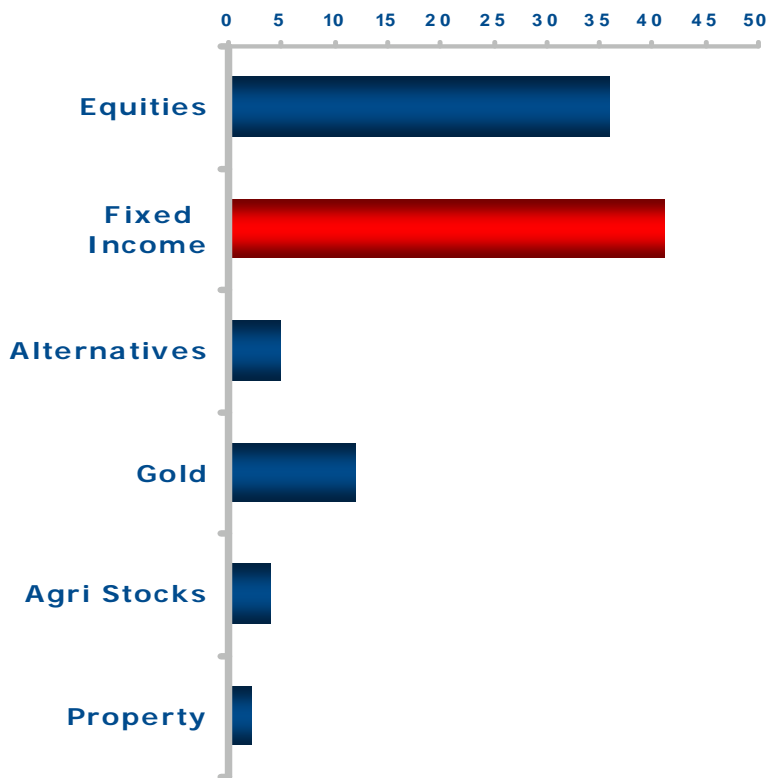
- Foreign Currency (i.e. non-US\$), see Bernanke 2002 speech



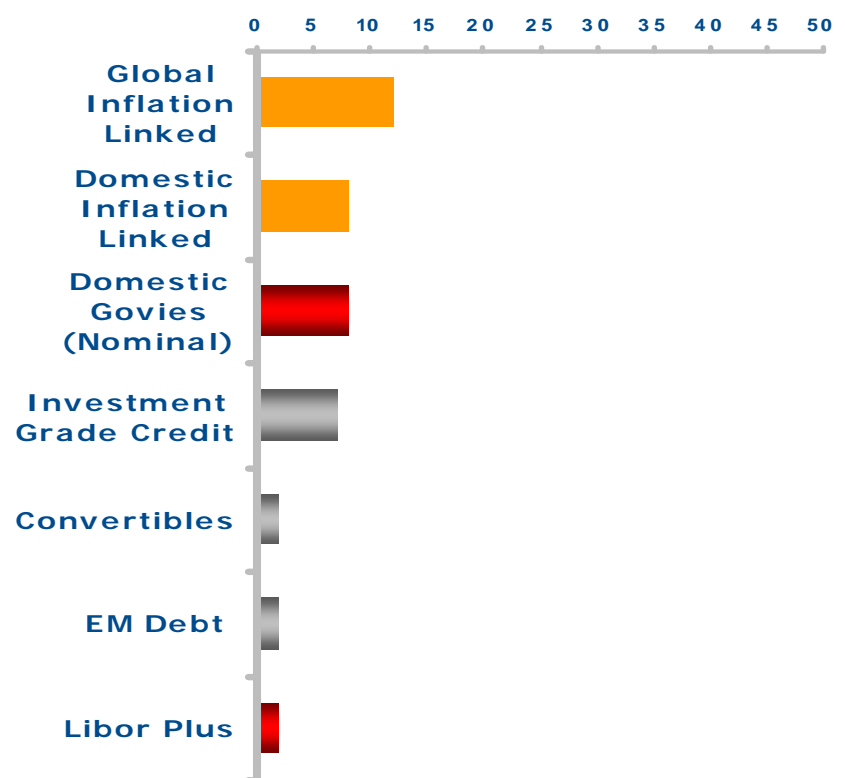
# Baring Asset Allocation Strategy

## Current Portfolio Positions, Absolute

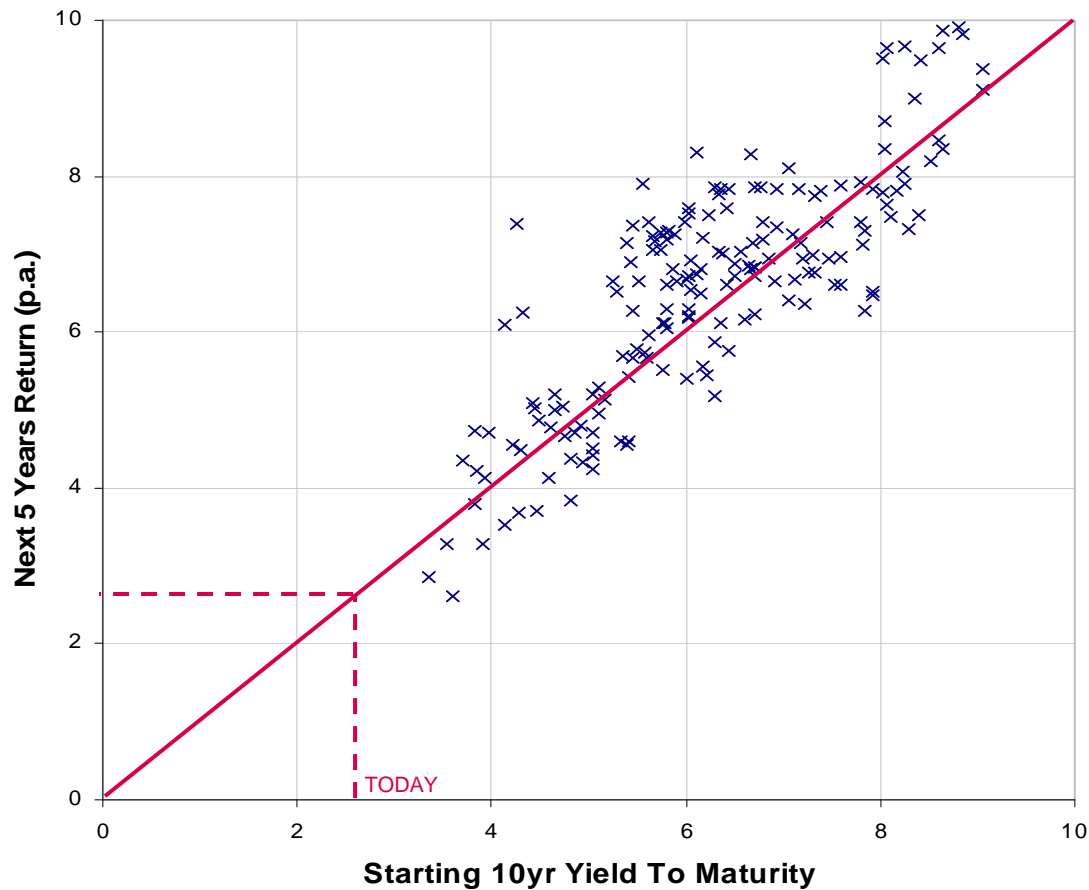
*Asset Allocation*  
in %



*Fixed Income - Detail*  
in %



# U.S. Treasuries The Historical Experience ...



# Looking Forward

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- Market making in fixed income – Where to go next ?
- CDS trading: centralized clearing and even exchange trading ?
- Tier 1 Bank Securities: What happens now ?
- Systemic implications from widely-held CDO reference entities



# Institutional Regulatory Disclosure

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