

The Prospect for Long Term Assets Returns

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Agenda

- Asset Cycles
- Economic Trends - Developed Economies
- Economic Trends - Emerging Economies
- The Shape of the Global Economy
- Inflation and Demographics
- Historic Returns
- Valuation
- Implication for Investment Policy
- Conclusion

Asset Cycle History

Chart 1: The chart shows the exceptional returns achieved during the second period

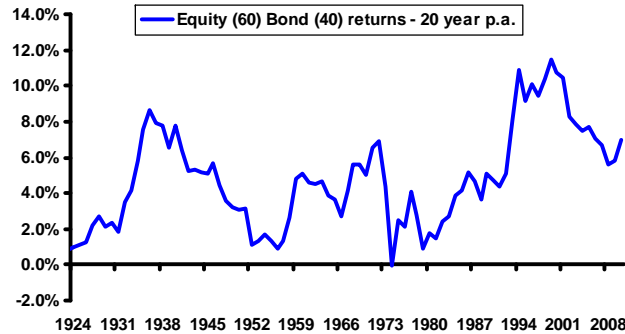
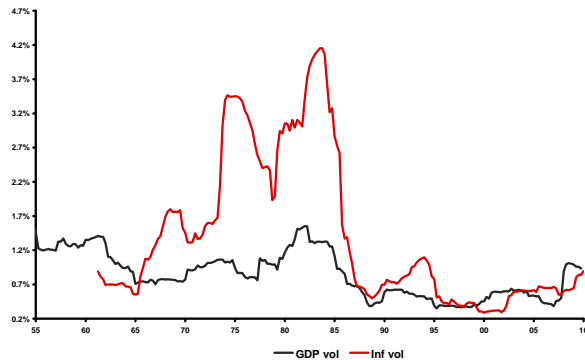


Chart 2: The chart shows the exceptionally low volatility of inflation and GDP growth in the decade before the start of the financial crisis

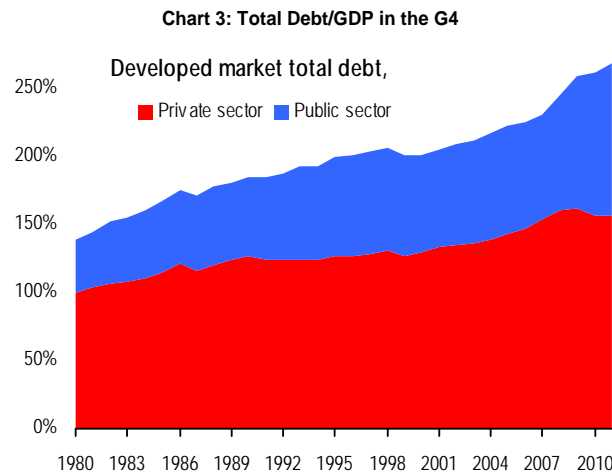


- The last sixty years has seen three main periods for asset returns.
- The eighties until 2007 saw strong returns from financial assets and a sharp fall in inflation and economic volatility.
- Globalisation allowed Western policy accommodation to prolong the economic cycle and for debt to build.
- This debt legacy means the strong returns generated ahead of the financial crisis are unlikely this decade.
- Since 2007 real equity returns have averaged -4% per annum.

Economics - These are Troubled Times

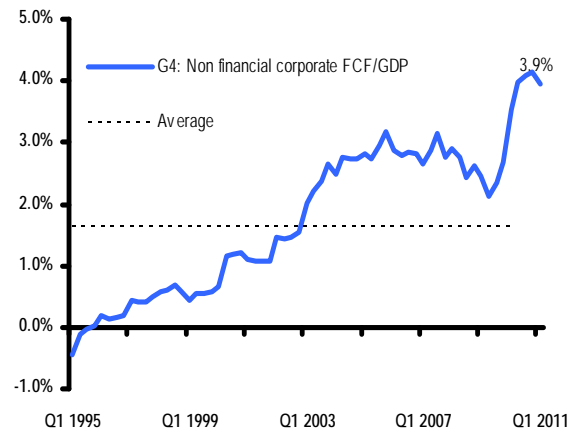
- “The crisis has reached a systemic dimension....over the last month” - Jean Claude Trichet, ECB President.
- “There is significant downside risk to the economic outlook” - Ben Bernanke Chairman of the US Federal Reserve.
- The country faces the “most serious financial crisis ever” - Mervyn King Governor of the Bank of England.

Economic Trends - Debt the Main Problem



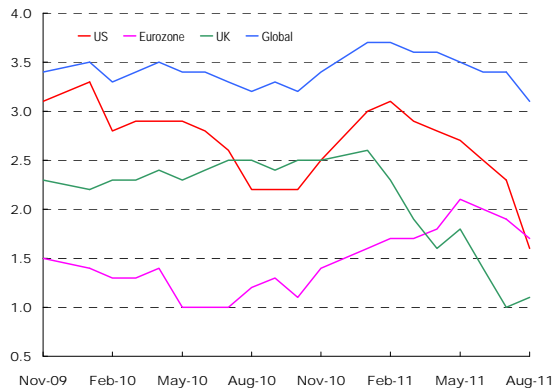
- High debt levels and deleveraging in the developed economies will impact on economic growth.
- Government debt has increased sharply, as a result of stimulus packages to offset weak domestic demand.
- Debate over where debt levels stabilise.
- Corporate sector is in strong position.

Chart 4: In the G4, the ratio of free cash flow to GDP is at record highs

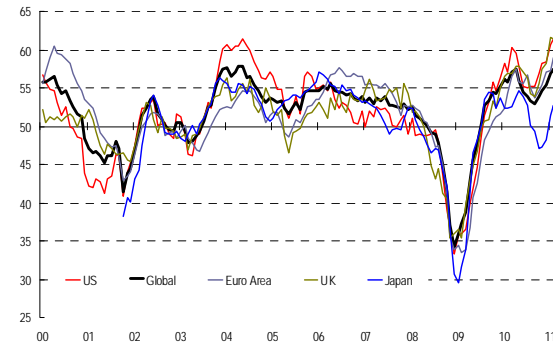


Developed Economy Growth is Slowing Sharply

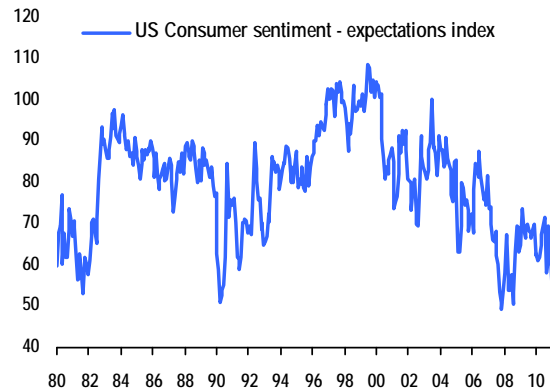
2011 GDP Growth Forecasts



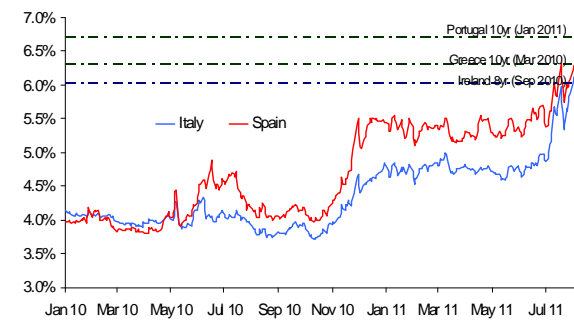
Business Confidence Surveys



Consumer Confidence



Spanish and Italian 10yr Bond Yields

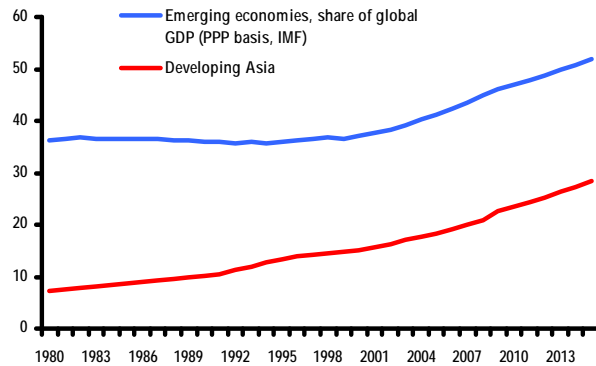


Growth Prospects are poor for Developed Economies

- Deleveraging continues to affect developed economy growth, and is likely to continue to do so for the medium term.
- Forecasts for economic growth are falling sharply.
- Political wrangling in the US and Europe is impacting on business and consumer confidence.
- Europe remains the main concern.

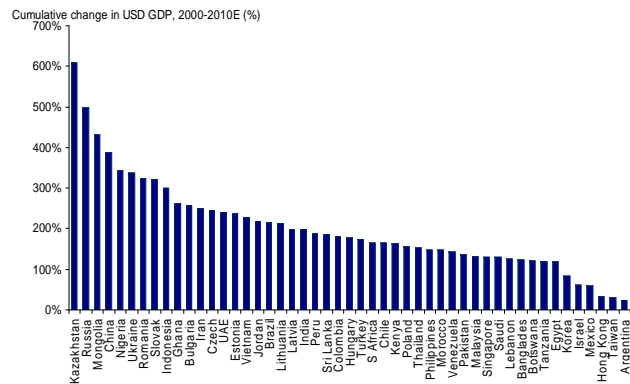
Emerging Market Economic Growth has been Supportive

Chart 5: Global Emerging Markets share of GDP is already close to 50% on PPP



- In the past 10 years, emerging markets have grown to 35% of world GDP in US\$ terms, and 50% in PPP terms.
- They have contributed hugely to global economic growth over last two decades.
- A number of the former communist economies in particular have grown strongly.

Chart 1: Change in \$GDP 2000 – 2010 (source UBS)



Convergence

Chart 2: Selected Countries Convergence in Real per Capita GDP
(Source Conference Board)

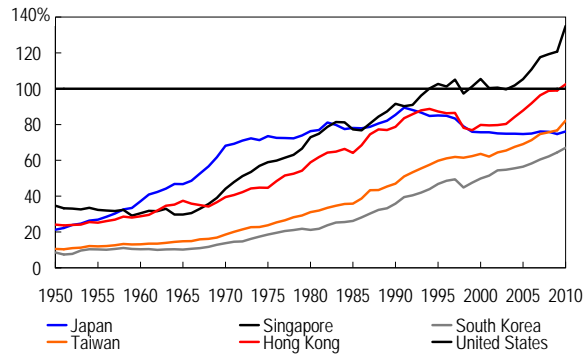
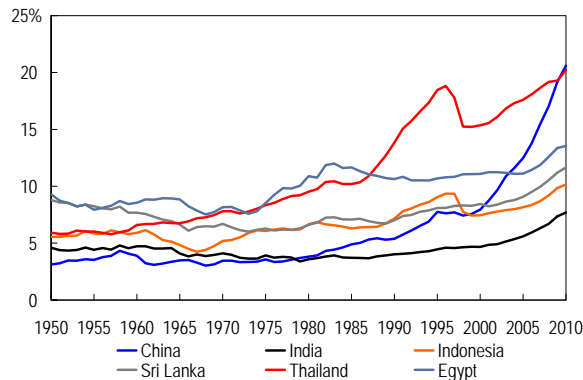


Chart 3: Selected Countries Convergence with US in Real per Capita GDP



- Emerging economies have started to close the gap in per capita income and living standards. We have seen the start of convergence.
- Not new, over the last sixty years Japan, South Korea, Hong Kong, Singapore and Taiwan all went through this process.
- What's new this time is the scale, both by population size and the number of countries involved.
- Convergence encompasses Asian, Latin American, and more recently African economies.
- Convergence of productivity and income levels only just started. China's real per capita GDP is barely 20% of US, India below 10%.

Convergence is likely to Continue

Chart 6: Number of Households (Millions) with Annual Income of at least \$10,000 Economist Intelligence Unit / Citi Investment Research

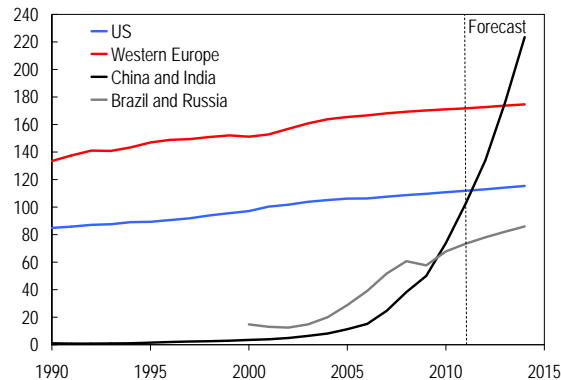
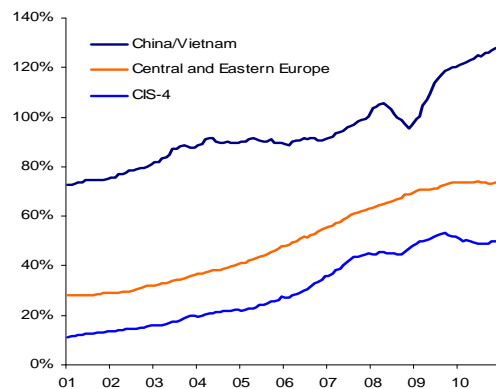


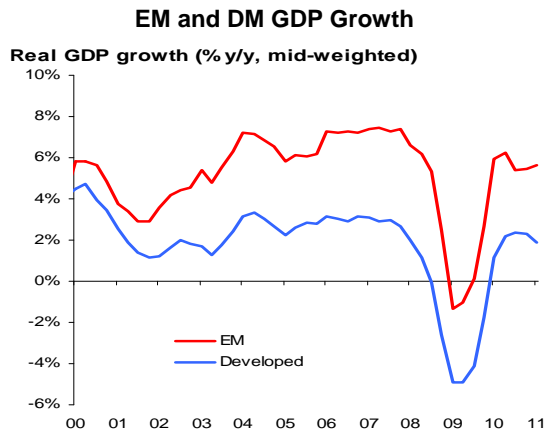
Chart 7: Change in Private Credit as Percentage of GDP (US 165%)

Cumulative change in private credit/GDP, 2000-2010 (pp)



- There are already well over 100 million households with incomes over \$10,000 in China and India.
- Convergence driven by globalisation and technology.
- More market orientated policies - driven by the fall of communism and the subsequent adoption of commercial and legal codes - are a driver.
- The post communist countries are strong in terms of enforcing contracts, registering property and access to credit.
- Growth is supported by solid balance sheets, high savings ratios, relatively low public sector debt and large cushions of foreign exchange reserves.

Outperformance in Good and Bad Times



- Global emerging market economies have outperformed developed market but are not immune to slow down.
- They benefit from relatively low debt levels, healthier financial systems, high investment and supportive demographics.
- China will continue to be a large driver - consumption and value added manufacturing the focus.
- These economies have conventional policy drivers at their disposal.

Emerging market investment spending versus developed market investment % GDP

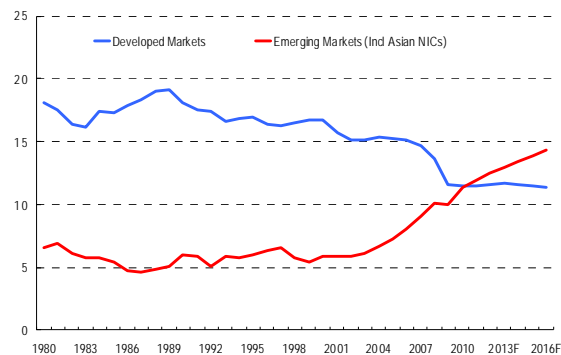


Table 1: FYP Chinese GDP Growth Targets have Always been Surpassed

Y-Y% p.a.	Target	Realised
7 th FYP (1986-90)	7.5	7.9
8 th FYP (1991-95)	8-9 (6 originally)	12.3
9 th FYP (1996-00)	8	8.6
10 th FYP (2001-05)	7	9.8
11 th FYP (2006-10)	7.5	11.1
12 th FYP (2011-15)	7 (expected)	?

Changing Composition of Global Growth

Chart 4: Composition of World Real GDP 2010 IMF World Outlook

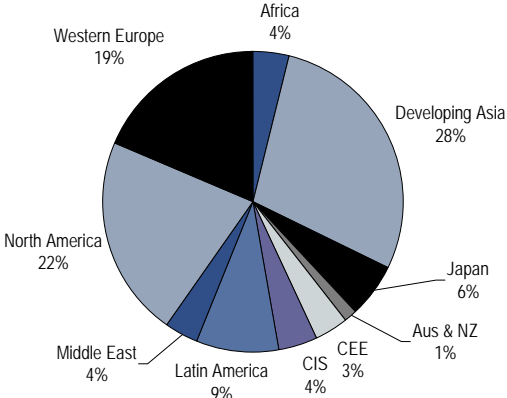
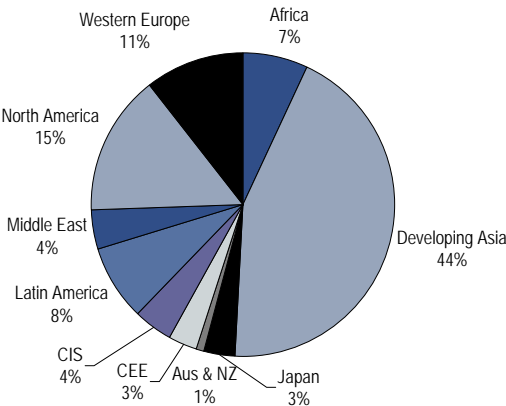
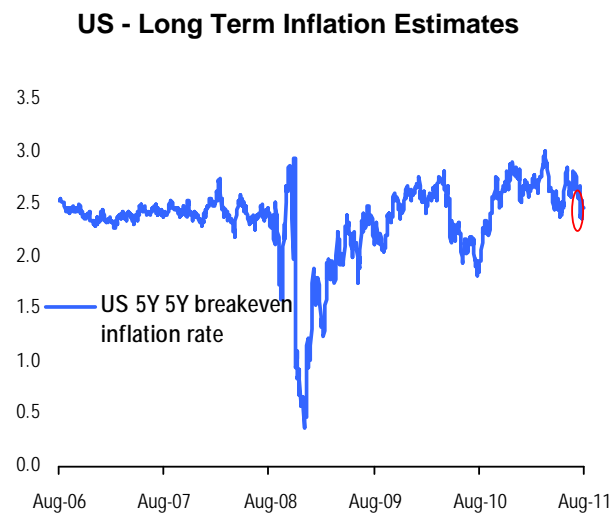


Chart 5: Composition of World Real GDP 2030 IMF World Outlook/Citi Investment Research



- Convergence will see the composition of world GDP change dramatically.
- Consensus growth forecasts point to 5-6% real EM economic growth rates over the next two years versus 1-2% for developed world.
- Emerging economies are likely to account for 60% of global growth over the next ten years.
- By 2030, China will be one and a half times the size of the US.

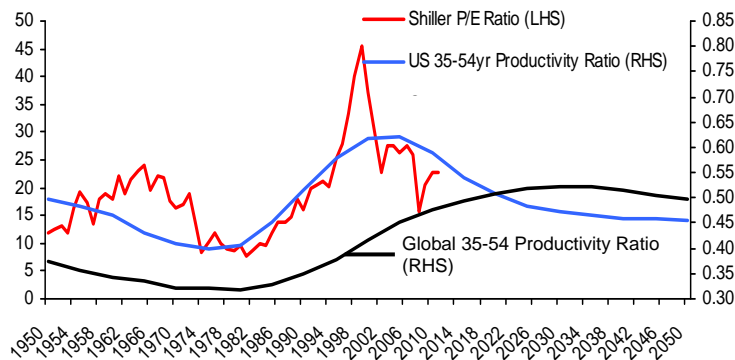
Inflation is Important for Asset Prices



- Longer term inflation expectations stable.
- Developed economy inflation picking up.
- Ultimately developed economy central banks will print money which will be inflationary.
- Longer term, Emerging Markets demand will lead to elevated commodity prices.
- Since 1900 average inflation in the US has been over 3%, and in the UK 4%.
- Since 1971 and the abolition of the Gold Standard inflation has averaged 5% in the US and about 7% in the UK.
- Higher inflation likely medium term.

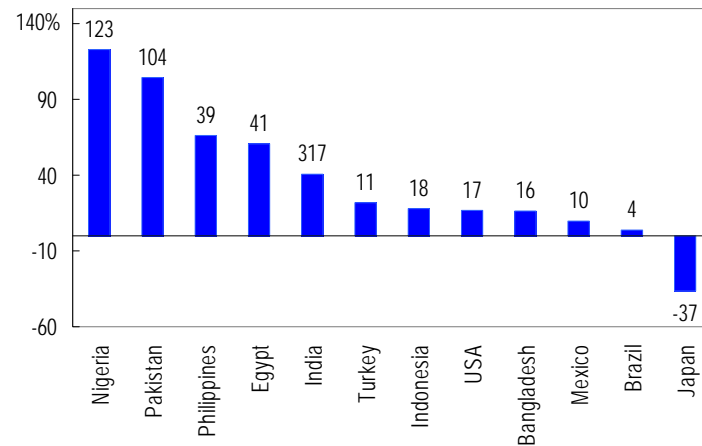
Demographics

The ratio of 35-54 year olds versus the over 65 and under 24 year olds and the Shiller PE



- Demographics are not supportive for developed economy markets, especially Japan and Europe.
- Emerging markets benefit from stronger demographics.
- Global demographics positive longer term.

Total % Change in Working Populations 2010-2050 (bars = total change in millions) UN Haves Analysis



Economies and Asset Returns

- Difficult time for developed economics as de-leveraging impacts on growth.
- The global economy will be more robust, supported by emerging market economic growth.
- Monetary policy is likely to be loose and inflation liable to pick up in the medium term.
- Demographics are challenging for developed economies, but supportive globally.
- The strong asset returns we saw in the decades leading up to 2007 are unlikely to be repeated this decade.

What does History tell us about Asset Returns?

Table 2: Long Term Real Returns: UK Assets (% pa)

Years to 2010	2010	10 years	20 years	50 years	111 years
Equities	8.9	0.6	6.0	5.4	5.1
Gilts	4.4	2.4	5.8	2.5	1.2
Corporate Bonds	3.9	2.1	n/a	n/a	n/a
Cash	-4.1	1.1	2.6	1.7	1.0

- Equities have delivered annualised real returns of over five percent.
- Outperformed bonds.
- Investors been rewarded for the higher risk.

Table 3: Real Returns on Major Asset Categories, 1900-2009

Country	Equities	Bonds	Cash
Australia	7.5	1.4	0.7
Canada	3.5	2	1.6
Denmark	4.9	3	2.3
France	3.1	-0.2	-2.8
Germany	3.0	-2	-2.4
Italy	2.1	-1.6	-3.7
Japan	3.8	-1.2	-1.9
Netherlands	4.9	1.4	0.7
Spain	3.8	1.4	0.4
Sweden	6.2	2.5	1.9
Switzerland	4.3	2.1	0.8
United Kingdom	5.3	1.3	1
United States	6.2	1.9	0.9
World (\$)	5.4	1.7	0.9

Historic Asset Returns

Table 4: Equity performance

Years	Number of consecutive years					
	2	3	4	5	10	18
Outperform Gilts	76	81	82	80	81	84
Underperform Gilts	34	28	26	27	21	10
Total number of years	110	109	108	107	102	94
Probability of Equity Outperformance	69%	74%	76%	75%	79%	89%

- Probability of equity out-performance high.
- Equity returns follow long cycles.
- Strong bond performance unlikely.

Table 5: Real returns by decade

Real returns, % p.a.	Equity	Gilt 10yr	Cash
Returns by decade			
1900-1910	4	-0.1	1.9
1910-1920	-7.9	-10.8	-6.3
1920-1930	12.8	13.1	9.8
1930-1940	2.3	4	-1.2
1940-1950	6.3	0.3	-1.1
1950-1960	12.1	-4.1	-0.6
1960-1970	3.3	-1.4	1.6
1970-1980	-0.4	-3.2	-3.1
1980-1990	11.7	6	5.2
1990-2000	11.8	9.4	4.2
2000-2010	0.6	2.4	1.1

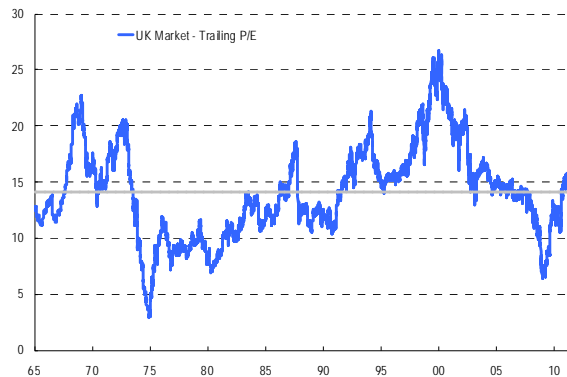
Valuation - Equities (1)

Table 6: Returns by PE

Highest av. PE	UK DataStream Total excl. Financials		Average 10-year future REAL growth:	
	Year groups	PE Band 35yrs 1966-2000	Annual Avg. PE	Mkt. ex.Finl. TRI
1-7	Above 17.4x	20.7	-0.1%	4.0%
8-14	15.0-17.4x	16.3	2.9%	6.6%
15-21	12.5-15.0x	13.7	5.5%	10.4%
22-28	9.8-12.5x	11.5	7.8%	12.4%
29-35	Below 9.8x	8.1	9.1%	14.7%

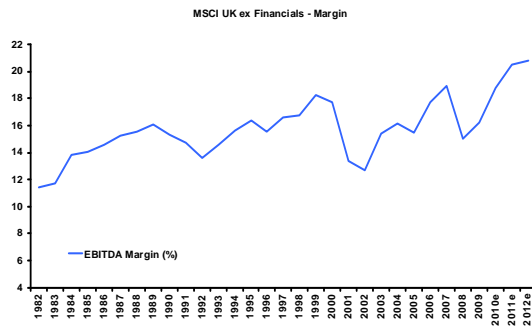
- Most important factor in terms of buying equities is value.
- PE values suggest strong returns.
- PE valuation low historically.

Chart 7: UK Equity Market PE History



Valuation - Equities (2)

Chart 8: UK Margins

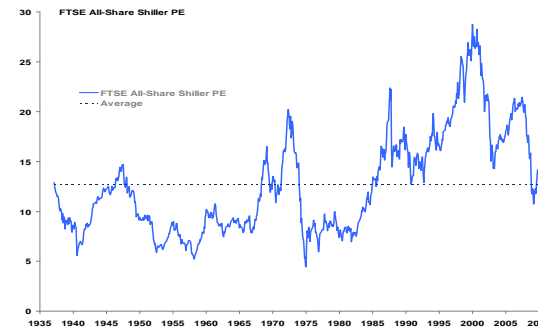


- Low PEs reflect high margins.
- Price/Book valuation reasonable.
- Shiller PE supportive.
- Return to more normal real returns likely.

Chart 9: UK Price/Book

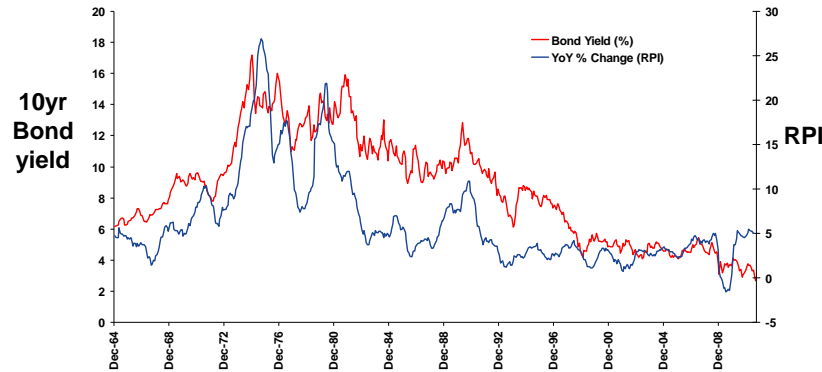


Chart 12: The Shiller PE



Valuation - Bonds

Chart 13: Bonds yield versus Inflation



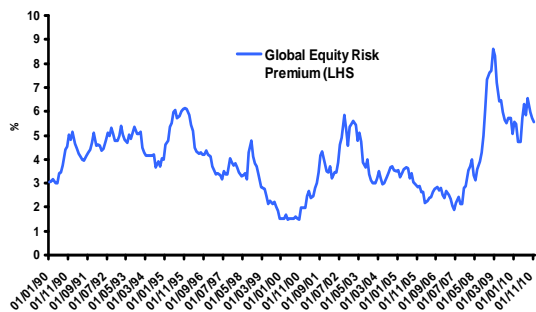
UK 10yr Breakeven Inflation



- UK bond yields below inflation rates for the first time in decades.
- Official (short term) interest rates, inflation and fiscal balances have strong influences on long term bond rates.
- Bond markets offer no longer term value
- Bond markets could see negative real returns from here.

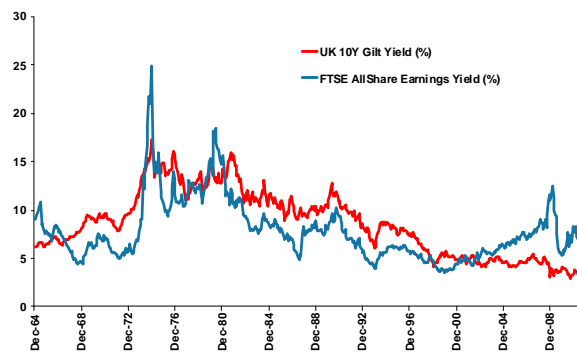
Investment Policy - Equities versus Bonds

Chart 16: Global Risk Premium

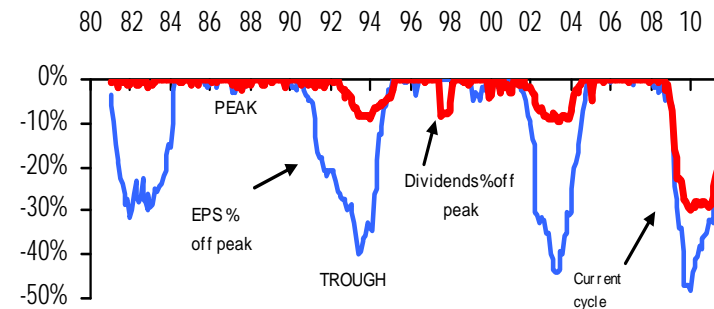


- Equity Risk premiums high.
- Earnings yield supportive for equities.
- Dividend yields have crossed over bond yields. Dividends look robust, payout ratios low
- Inflation supportive for relative out performance
- Equities likely to outperform bonds.

Chart 17: Earnings yield versus Government Bond



UK Dividends and Earnings versus Peak



Global Emerging Market Equities

Table 8: Emerging versus Developed Markets Valuation

	Wgt	P/E		P/B	ROE	Div Yld	EV/ EBITDA
	%	11E	12E	11E	11E	11E	10
Developed World	87.4	10.9	9.6	1.44	13.1	3.2	7.9
Emerging World	12.6	9.4	8.4	1.42	15.2	3.4	7.1

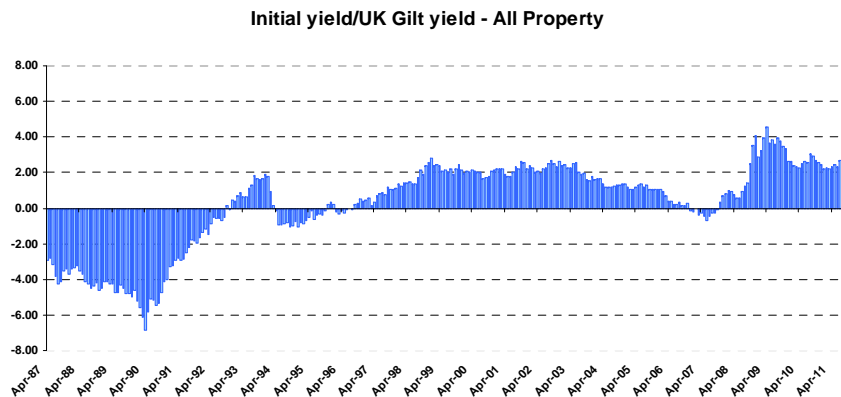
Drivers of Equity Price Performance 2000 - 2010

2000 – 2010	Emerging	Developed	Difference
Real Equity Price (\$)	6.8%	-3.6	10.4%
Price-earnings ratio	-2.2%	-4.6	2.4%
Real Earnings	6.7%	1.2%	5.5%
Real Exchange Rate	2.5%	---	2.5%

- GEM valuation metrics attractive.
- Strong historic returns, outperforming developed markets by 10% per year over the last 12 years, driven by stronger real earnings growth.
- Demographic are favourable (Demi – Ashton ratio).
- Growth of market capitalisation ratios supportive.
- Outperformance to continue.

Bonds versus Property

The difference between the Rental yield and the 10 year Gilt yield



- Property looks attractive in both absolute terms and against bonds.
- Over the last 40 years property has delivered total real returns of just over 4%.
- Property has historically proven to be a decent inflation hedge, as rents tend to rise with inflation.
- The risk of tenant default is mitigated through having a diversified portfolio of tenants.

Private Equity versus Public Equity

Table 10: The table shows a comparison of Pooled Mean End-to-End Returns of US Buyouts (%) Net to Limited Partners. Period Ended December 31, 2009.

Asset Class	5 years	10 years	15 years
US Buyouts	10.0	11.3	12.5
Top Quartile	22.7	24.4	28.8
S&P	2.9	2.7	6.5

- Private equity investments should outperform public equity investments.
- Persistency of performance larger than other asset classes.
- Confident can access top managers.
- Outperformance achieved.

Conclusion

- Deleveraging will hold back economic growth in the developed economies over the coming years.
- Emerging market economies will continue to drive global growth.
- Inflation is likely as policy makers continue with loose monetary policy.
- Overall asset returns are unlikely to match the sorts of returns seen in the period leading up to the financial crisis.
- Equities offer value relative to bonds, emerging market equities preferred.
- Private Equity and property offer value.