

Rising Equity Markets boost Pension Funds during Third Quarter of 2005

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In the early years of the 21st century, pension funds saw massive surpluses become large deficits over a few short months, as equity markets suffered a series of catastrophes. Beginning with the bursting of the technology bubble in March 2000, equities continued to fall as a number of large companies were revealed to have committed accountancy frauds. The terrorist attacks in New York, Washington and Pennsylvania in September 2001, and the consequent hostilities in Afghanistan and Iraq, led markets further downwards. It was only with the official announcement of the end of hostilities in Iraq in March 2003 that equity markets finally began to recover from the worst and longest bear market in recent history.

Since then, equities have regained much of the ground lost during this three-year downturn. The third quarter of 2005 was particularly strong. Group pension managed funds produced positive returns during the third quarter of 2005 with the average fund returning 5.8%. In the first nine months of the year, the average fund return was 15.8%, while over the past twelve months managed funds have returned 21.5% on average. Over the three years to 30th September 2005 the average fund return has been 13.7% per annum. In the five-year period ended 30th September pension managed funds have, on average, returned a disappointing 1.2% p.a. However, the ten year period to the end of September saw an average return of 9.9% per annum.

During the third quarter the best performing fund was that of Montgomery Oppenheim which returned 6.9%, while Bank of Ireland Asset Management (BIAM) propped up the table with a disappointing 2.8%. Over the first nine months of the year, Setanta Asset Management's managed fund returned 18.1%, while in the twelve months to 30th September Eagle Star's balanced fund tops the performance table. While BIAM have underperformed their peers over these periods, they have the best and second best performing fund over 5 and 10 years to the end of September 2005. This variation in performance highlights how difficult it is to find an investment manager that can consistently outperform in all market conditions. It also draws attention to the danger of focusing on short term performance when selecting an investment manager, as two years ago BIAM were top of the league table over almost all periods. When considering the performance of investment managers, it should be borne in mind that the investment horizon of most pension schemes is substantially more than five, ten or even twenty years.

During the third quarter of 2005, equity markets performed strongly. All of the major equity markets produced positive returns, with the weakening of the euro relative the dollar boosting the return on North American assets to Irish investors. Despite the terrorist attacks in London on the 7th, equity markets rose during July (compounding positive returns achieved in May and June) benefiting from optimism over economic growth, combined with a strong second quarter earnings results season. News that China had removed the Renminbi's dollar peg was welcomed by markets, even though the extent of the actual revaluation was just 2%. August saw markets fall back slightly, mainly due to concerns over the rising price of oil and the impact of Hurricane Katrina in the US. However, this negative sentiment was short lived, as markets rallied strongly in September.

Japan was by far the best performing market over the quarter. After parliament had blocked his plans to privatise Japan Post, Prime Minister Koizumi dissolved parliament and called snap elections, which his LDP party won by a larger-than-expected majority. The win effectively gives Koizumi a mandate to push forward with progressive economic reforms. The market reacted positively, reaching its highest levels since 2001. Tokyo land prices rose for the first time since 1990, and data showed that Japanese manufacturers have become more confident of business decisions.

The markets of the Pacific Basin region also fared well, despite some negative impact from rising oil prices and concerns over the impact on the US economy from Hurricanes Katrina and Rita. However, the positive economic news coming out of Japan and an announcement by the North Korean authorities pledging to end the country's nuclear programme provided a boost to the region. During the quarter the South Korean and Indian equity markets reached all-time highs.

While rising over 4%, the US equity market underperformed the other major bourses. The Federal Reserve raised interest rates twice during the quarter, two major airlines filed for bankruptcy, and the oil refining region of the Gulf Coast was hit by two of the worst hurricanes in recent history. However, corporate earnings were strong, takeover activity was lively, consumer confidence remains stable and the negative impact on the economy of the reduction in oil refining capacity appears to have been offset by the positive boost to the construction sector resulting from the destruction in the Gulf Coast.

European markets also had a strong quarter. In the UK, the Bank of England cut interest rates which boosted the market despite weak economic and consumer confidence data. The market was also helped by its heavy exposure towards commodities (in addition to rising oil prices, gold and copper prices reached record levels during the quarter). On the Continent, the inconclusive German election result and the impact on insurers of floods in Central Europe, combined with losses in the US Gulf Coast, were detrimental. However, strong company earnings, continued corporate activity and rising business confidence figures supported markets. In Ireland, the ISEQ rose 5.1% over the quarter, despite mixed earnings results.

While the improvement in equity markets over the past 2½ years has been beneficial for pension funds, continuing historically low bond yields are keeping pension fund liabilities at unprecedented highs. Therefore pension fund deficits remain a significant concern, especially following the introduction of new accounting standards which mean that companies need to show the pension fund deficit on their balance sheets. Although many economic indicators imply that bond yields should rise from current levels, other market factors appear to be overriding these and it is difficult to predict when and if bond yields will rise. Going forward, the trustees and sponsors of pension schemes must hope that equity markets and bond yields will rise significantly, if schemes are to return to the good old days when the biggest challenge was to avoid exceeding Revenue limits on the level of surplus maintained within a fund.

Tables
Group Pension Managed Fund Returns to 30th September 2005

	Investment Returns to 30th September 2005					
	3 Months	9 Months	1 Year	3 Years	5 Years	10 Years
	%	%	%	% p.a.	% p.a.	% p.a.
AIB Investment Managers	6.5%	16.0%	22.3%	13.2%	-0.5%	8.6%
Bank of Ireland Asset Management	2.8%	12.0%	17.4%	12.0%	3.5%	10.5%
Canada Life/Setanta	6.0%	18.1%	23.0%	14.2%	0.8%	9.0%
Eagle Star	6.6%	17.5%	24.0%	14.1%	1.9%	10.7%
Friends First/F&C	6.0%	15.9%	21.6%	13.8%	0.8%	10.2%
Hibernian	5.3%	13.7%	18.8%	13.4%	1.1%	10.1%
Irish Life	6.3%	16.8%	22.9%	15.5%	3.0%	10.1%
KBC Asset Management	5.1%	15.4%	21.0%	12.7%	-1.7%	8.7%
Montgomery Oppenheim	6.9%	16.1%	21.1%	13.5%	2.2%	12.7%
Standard Life Investments	6.5%	16.8%	22.7%	14.4%	1.0%	8.9%
Average	5.8%	15.8%	21.5%	13.7%	1.2%	9.9%

Equity Market Index Returns to 30th September 2005

Region	3 Months		9 Months	
	Local Ccy	Euro	Local Ccy	Euro
Ireland	5.1%	5.1%	12.5%	12.5%
UK	8.1%	7.1%	16.9%	21.5%
US	4.2%	5.0%	4.8%	18.4%
Euro	8.3%	8.3%	20.5%	20.5%
Rest of Europe	10.4%	10.7%	25.3%	24.3%
Japan	21.0%	18.8%	23.9%	26.3%
Pacific Basin	10.6%	10.0%	18.5%	30.8%