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Group Pension Managed Funds Update to 31st July 2007

Summary

Among the ten main managed fund providers, returns during July ranged from -3.3% (Oppenheim Investment Managers) to -2.1% (achieved by Setanta Asset Management). As a result, over the first seven months of the year funds have made disappointing progress, with the average fund rising just 1.9%. Over this period, Eagle Star were the best performing managers with a return of 3.4%, while Bank of Ireland Asset Management propped up the table with a disappointing -0.2%. Returns for the past twelve months were 13.1% on average, with individual returns ranging from 8.6% (Setanta Asset Management) to 15.7% (achieved by AIB Investment Managers). Over the past three years, the average managed fund has shown a gain of 14.2% per annum. The five year returns to the end of July remain strong, with the average managed fund delivering a return of 10.5% per annum over this period. Returns over the past ten years have been 7.4% per annum on average. When considering these returns it is important to remember that the investment horizon of most pension schemes is generally over 25 years, and that equities have historically provided significantly higher returns over the long-term than bonds, property or cash, although at the cost of greater volatility.

Market Review

Concerns over sub-prime mortgage lenders in the US escalated during July, with the announcement from Bear Stearns that two of its hedge funds exposed to this sector were now worthless. Federal Reserve Chairman Ben Bernanke warned that losses from such debt could be as much as $100 billion. The problem has arisen due to rising interest rates and a slowdown in the housing market. As a result of these problems, credit spreads on corporate bonds widened dramatically. This led to concerns over a slowdown in merger and acquisition activity, as such deals are often financed through the issue of new debt. For the past 18 months, M&A has been one of the main drivers of the rising equity prices, and the potential loss of this support further eroded investor sentiment. Although all sectors were affected, financial and construction stocks suffered the most.

Furthermore, the volatility in equity markets caused investors to seek out “safe-haven” assets – predominantly government bonds. This led to long-dated bond prices rising by over 2.5%. Movements in government bond prices can be seen as a proxy for the cost of purchasing annuities on retirement. Therefore, when asset values decline and pension prices rise, the ultimate retirement income that people can expect from their savings is doubly eroded.

The Irish stock market was the worst performing bourse, with a decline of 8% over the month. This was partly due to the fact that it is heavily exposed to the financial and construction sectors. Irish equities typically represent about 17% of pension managed funds. This is a serious source of concern, due to the high level of stock specific risk inherent in the Irish market. Irish pension funds took another hit as the euro reached an all-time high against the dollar, eroding dollar-denominated gains.

UK equities declined by 3.7% over the month. The Bank of England increased interest rates by 0.25% at the beginning of the month, bringing the base rate to 5.75%. Inflation figures for June came in at an annual rate of 2.4%, well ahead of the Bank’s target rate of 2%. These figures, combined with stronger than expected economic growth, make it likely that interest rates will increase to at least 6% by the end of 2007. House price surveys indicated that the housing market is slowing down, suggesting that rising interest rates are beginning to have an impact.

US equities declined by 2.9% in dollar terms during July. The strength of the euro reduced this to -4.2% for Irish investors. Several major indices reached all-time highs in the early part of the month, driven by stronger than expected economic growth. However, towards month-end concerns over the spreading impact of the sub-prime mortgage crisis, a slowdown in consumer spending, further weakness in the housing market, and disappointing results from several bellweather companies, led markets sharply downwards.

Eurozone equities fell 3.6% over the month, while the Rest of Europe performed little better with a decline of 2.5%. Positive corporate earnings combined with increased merger and acquisition activity led European markets to six-and-a-half year highs early in the month. However, the impact of the US sub-prime mortgage crisis weighed heavily on credit markets, which led to concerns over the ability of companies to issue debt to finance their corporate activity. Several bond issues, intended to finance deals already agreed, were delayed due to the volatility in credit markets. Mergers and acquisitions have supported European markets over the past 18 months, and a fall-off in such activity would not bode well.

Japanese equities fell 4.1% over the month (falling 1.8% in euro terms). As expected, the Bank of Japan kept interest rates on hold in July. The yen strengthened somewhat over the month, impacting negatively on exporters. Consumer price data indicated ongoing deflation. Disappointing earnings led technology stocks downwards, while insurers faced losses following an earthquake.

Rising commodity prices and strong economic growth supported Pacific Basin equity markets in the early part of the month. The Australian and Hong Kong indices reached all-time highs early in the month. Despite eventually succumbing to global nervousness, the region was the only one to deliver a positive return during July, rising 3.3% in local currency terms.

Tables

1. Group Pension Managed Fund Returns to 31st July 2007

	1 Month %	7 Months %	1 Year %	3 Years % p.a.	5 Years % p.a.	10 Years % p.a.
AIB Investment Managers	-2.6	3.2	15.7	15.6	10.7	6.6
Bank of Ireland Asset Management	-3.1	-0.2	10.5	11.2	8.8	7.5
Canada Life/Setanta	-2.1	1.4	8.6	12.1	9.4	6.3
Eagle Star	-2.2	3.4	15.2	16.1	11.5	7.7
Friends First/F&C	-2.7	1.4	13.3	14.2	10.8	7.2
Hibernian Investment Managers	-2.9	2.0	12.9	13.8	10.6	7.6
Irish Life Investment Managers	-3.0	2.8	14.7	15.1	11.7	7.8
KBC Asset Management	-2.8	1.3	13.3	14.2	9.8	6.5
Oppenheim Investment Managers	-3.3	1.7	12.5	13.6	10.2	9.5
Standard Life Investments	-3.0	2.2	14.5	15.6	11.6	6.8
Average	*-2.8*	*1.9*	*13.1*	*14.2*	*10.5*	*7.4*

2. Equity Market Index Returns to 31st July 2007

Region	1 Month %		7 Months %	
	Local Ccy	*Euro*	*Local Ccy*	*Euro*
Ireland	-8.0	-8.0	-7.8	-7.8
UK	-3.7	-3.7	4.3	4.3
North America	-2.9	-4.2	4.1	0.8
Eurozone	-3.6	-3.6	8.5	8.5
Rest of Europe	-2.5	-2.1	7.7	5.9
Japan	-4.1	-1.8	1.9	-1.8
Pacific Basin	3.3	2.4	18.8	18.3

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