

## Group Pension Managed Funds Update to 31<sup>st</sup> December 2007

### Summary

During December, pension funds compounded their earlier losses, with the average fund declining a further 1.0% over the month. Overall, Irish pension funds declined by 2.6% on average during 2007, the first time since 2002 that funds have ended the year in negative territory. AIB Investment Managers are the best performing manager over the year with a return of 1.3%, with Eagle Star the only other manager to end the year in positive territory, with a return of 0.6%. Bank of Ireland Asset Management prop up the table with a very disappointing -7.6%. Over the past three years, the average managed fund has shown a gain of 10.2% per annum. The five year returns to the end of December remain strong, with the average managed fund delivering a return of 10.7% per annum over this period. Returns over the past ten years have been 6.4% 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

2007 has been a tumultuous year for Irish pension funds. Up to May, the average group pension managed fund delivered a strong return of 5.9%. Subsequently, however, concerns over sub-prime mortgage lenders in the US came to dominate equity markets. The problem arose due to rising interest rates and a slowdown in the housing market. Several central banks were forced to inject liquidity into money-markets to ease investor concerns, while the US Federal Reserve reduced interest rates several times during 2007. As a consequence, the dollar weakened against most major currencies. Financial stocks were worst affected amid uncertainty regarding the extent to which many banks are exposed. Ultimately, the crisis in credit markets began to spill over into the broader global economy. Furthermore, the outlook for global economic growth weakened in the wake of record high oil prices and rising inflation.

Having been the best performing market (of the major markets in which Irish pension funds invest) in 2006, Ireland was the weakest in 2007, declining 24.5%. Irish equities were the worst performing asset class over the month of December, with a fall of 3.7%. The domestic bourse was also the worst over the fourth quarter with a return of -11.5%. Early in December, the market responded well to the Budget for 2008, while a reassuring trading update from AIB helped stabilize volatility in the Irish financials sector. However, the market resumed its downward trend due to the ongoing credit crisis and hawkish commentary by the ECB signalling that an interest rate cut in the Eurozone was not imminent. Irish group pension funds lost €5.5 billion over the last 7 months of 2007, as the US sub-prime mortgage crisis, the weakening dollar and the rising oil price depressed equity markets. Of this loss, exposure to Irish equities accounted for almost €3 billion, as the Irish stock market has declined 28.6% since the end of May. Irish pension funds continue to have an unnecessary bias towards domestic equities, a situation that had been beneficial up until this year. Recent events, however, have highlighted the risk inherent in this overweight position, particularly given the low level of diversification in the Irish market.

UK equities outperformed their global peers rising 0.5% in sterling terms during the month, bringing the return for the fourth quarter to 0.3%, and 7.1% for the year. However, Irish investors saw these returns eroded by the weakening of sterling, which fell 8.4% against the euro during 2007. As widely expected, the Bank of England cut interest rates by 0.25% to 5.5% during December, citing tight credit conditions and concerns that the economy is slowing faster than expected. Despite this leading to an uplift in the stock market early in the month, continued uncertainty regarding the full extent of the US sub-prime mortgage crisis and how it will affect the UK economy dampened markets as the month progressed.

US equities fell 0.5% during December and by 2.9% over the fourth quarter as a whole. However, returns for 2007 were positive at 6.3%. Unfortunately, Irish investors saw these returns eroded by the weakness of the dollar, which fell to record lows against the euro during the year. The US Federal Reserve reduced interest rates by a further 0.25% to 4.25% during December, leaving rates 1.0% lower than at the start of the year. However, this reduction was seen as disappointing by investors who had hoped for more. In an attempt to assist financial institutions in light of the current squeeze in credit markets, the Federal Reserve along with other Central Banks announced plans to make \$60 billion available to commercial banks. Furthermore, proposals were announced by the government to limit sub-prime mortgage defaults. These interventions, rather than calming fears, caused investors to worry that the impact and longevity of the credit crisis were, in fact, worse than previously thought. In addition, rising inflation and some positive economic data caused concerns that the Federal Reserve would not be in a position to reduce interest rates further over the coming months in order to help ward off a recession.

In Europe, returns were mixed. The Eurozone region returned -0.5% over the month. This brought the fourth quarter return to -0.6%, although for the year as a whole the region returned a healthy 8.7%. Meanwhile, the rest of Europe fell 2.7% during December, rising just 0.3% over 2007. The European Central Bank kept interest rates on hold at 4.0% in December. The decision was accompanied by hawkish commentary from the ECB warning about the "strong upward pressure" that remains on inflation, which dampened hopes of an interest rate cut over the coming months.

Japanese equities fell 3.5% during December, with a fall of 8.3% for the fourth quarter. Overall, Japanese equities were the second worst performing major bourse during 2007 with a return of -10.7%. During December, Japanese equities suffered due to disappointment at the size of the interest rate cut in the US, while continued uncertainty regarding the fallout from the US sub-prime mortgage crisis also hurt markets. Furthermore, the latest Tankan survey showed a larger drop in Japanese business confidence than had been expected, affecting banks and property shares.

During December, news of more sub-prime write-downs in the US, a pessimistic attitude over Central Banks' plans to help credit markets and speculation that China will increase its interest rates to combat inflation, saw Pacific Basin equities fall 1.1%. Over the fourth quarter, the region returned -1.6%. However, the region was the star performer of 2007 with a positive return of 26.1%.

On the positive side, long bond yields increased by just over 0.5% during 2007, which means that pension fund liabilities will have reduced by approximately 5% - 10% on average, more than offsetting the impact of the negative returns on assets.

## Tables

### 1. Group Pension Managed Fund Returns to 31<sup>st</sup> December 2007

	1 Month %	Quarter 4 %	1 Year %	3 Years % p.a.	5 Years % p.a.	10 Years % p.a.
AIB Investment Managers	-0.8	-2.9	1.3	12.3	11.8	5.9
Bank of Ireland Asset Management	-1.5	-5.3	-7.6	6.4	8.2	6.2
Canada Life/Setanta	-1.0	-3.4	-1.8	9.3	9.9	5.8
Eagle Star	-0.8	-2.8	0.6	12.3	12.1	6.9
Friends First/F&C	-1.3	-3.9	-3.3	10.3	10.9	6.1
Hibernian Investment Managers	-0.9	-3.8	-1.7	10.2	10.9	6.7
Irish Life Investment Managers	-0.9	-4.3	-2.9	10.4	11.7	6.7
KBC Asset Management	-1.4	-5.1	-5.3	9.6	9.6	5.1
Oppenheim Investment Managers	-0.3	-2.6	-1.6	10.3	10.8	8.5
Standard Life Investments	-1.3	-5.5	-3.9	10.7	11.0	5.6
<b>Average</b>	<b>-1.0</b>	<b>-4.0</b>	<b>-2.6</b>	<b>10.2</b>	<b>10.7</b>	<b>6.4</b>

### 2. Equity Market Index Returns to 31<sup>st</sup> December 2007

Region	1 Month %		Quarter 4 %		2007 %	
	Local Ccy	Euro	Local Ccy	Euro	Local Ccy	Euro
Ireland	-3.7	-3.7	-11.5	-11.5	-24.5	-24.5
UK	0.5	-2.4	0.3	-4.7	7.1	-1.7
North America	-0.5	-0.1	-2.9	-5.5	6.3	-3.1
Eurozone	-0.5	-0.5	-0.6	-0.6	8.7	8.7
Rest of Europe	-2.7	-2.6	-6.4	-7.0	0.3	-2.2
Japan	-3.5	-3.8	-8.3	-8.2	-10.7	-14.1
Pacific Basin	-1.1	-1.4	-1.6	-4.9	26.1	18.7

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