

# Pensions Bulletin

## Fact Sheet 1

Autumn 2008 Issue 3

### Recent market turbulence

#### I Background

I.1 Financial markets have been through turbulent and troubled times since the start of the 'credit crunch' back in the Summer of 2007. In particular, markets went through an extremely rocky period in September and October 2008.

I.2 Here are some of the key events in recent months:

- The US mortgage banks Freddie Mac and Fannie Mae (owners and guarantors of \$5 trillion of US home loans) were rescued by the US Government due to the systemic risk they posed to the US financial system.
- The investment bank Lehman Brothers collapsed and filed for Chapter 11 bankruptcy.
- The largest insurance group in the US, AIG, agreed to an \$85 billion rescue package from the US Federal Reserve.
- Bank of America decided to takeover the investment bank, Merrill Lynch.
- Morgan Stanley and Goldman Sachs became deposit taking banks.
- Washington Mutual (a US mortgage bank) was taken over by J P Morgan Chase.
- Lloyds TSB announced its takeover of the commercial bank HBOS, following pressure on its share price.
- Bradford & Bingley was nationalised.
- European financial institutions such as Fortis and Dexia also had to be rescued.

I.3 In response to this banking crisis, regulators across the globe have attempted to shore up the banking system, and to calm the markets, as follows:

- A temporary ban was imposed on the short selling of financial stocks.
- A '\$700 billion rescue plan' was proposed by the US Government. The idea being that the State takes on much of the risk associated with the troubled assets in the banking sector, most notably sub-prime mortgages.
- The UK Government announced a £50 billion package to prop up eight of the largest banks and building societies. In return, the Government is to receive shares in those institutions. A further £450 billion has been made available to provide liquidity to the money markets and loan guarantees for banks.
- A number of European countries decided to guarantee private bank deposits.

I.4 Financial stocks (especially banks) suffered the steepest falls in value as investors expressed their concerns about the weakness of their balance sheets; the ability of institutions to raise funds; the fear of more bad news; and the extent to which Governments would be prepared to act as 'lender of last resort' given the decision to allow Lehman Brothers to collapse.

1.5 In the month of September 2008, all major stock indices produced negative returns. In sterling terms, market returns were:

FTSE All Share	- 13.2%
FTSE W North America	- 7.0%
FTSE W Europe ex UK	- 13.0%
FTSE W Japan	- 8.9%
FTSE Developed Asia ex Japan	- 15.6%
MSCI Emerging Markets	- 15.6%

1.6 Markets fell further in October 2008. The returns for the month in sterling terms were:

FTSE All Share	- 11.9%
FTSE W North America	- 9.3%
FTSE W Europe ex UK	- 14.9%
FTSE W Japan	- 5.7%
FTSE Developed Asia ex Japan	- 16.5%
MSCI Emerging Markets	- 19.9%

## 2 Security of the Trust's assets

2.1 The Pensions Trust has a diversified investment portfolio which includes equities (company shares across the globe); bonds (issued by companies and the UK Government); property (UK and European) and money market instruments.

2.2 We have seen the failure of major institutions undermine the integrity of the financial system and this has led to problems for the global economy. Most UK pension schemes have also suffered losses as a result of these systemic issues.

2.3 Whilst the portfolio has lost value as equity, property and some bond markets have fallen, the Trust has focused on the safe-keeping of assets and is able to report that there have been no significant losses as result of the failure of the financial institutions mentioned above.

2.4 During September 2008 we have looked at:

- Counterparty Risk

This is the risk that a financial institution we are dealing should fail to honour its commitments:

- a. The Trust suspended its securities lending programme back in September 2007 and as a result there was a very small amount still out on loan in September 2008; none of this was with Lehman Brothers and our custodian (Northern Trust) has reported that no loss was suffered.
- b. Our custodian reported no failed trades resulting from the troubled institutions mentioned above.
- c. Our custodian and managers have reported no losses resulting from trading over-the-counter instruments such as swaps.

- **Global Equity Fund (GEF)**

Given that the Trust runs a diversified equity portfolio (in fact one of its managers is paid to track stock market indices) there is some exposure to banks and other financial institutions.

However, because of the diversified nature of the portfolio, in aggregate no single holding – relating to the troubled financial institutions – exceeds 0.1% of the value of the GEF.

- **Fixed Interest Fund (FIF)**

As you would expect from its size, the Trust has some holdings in the financial sector but again the individual holdings in the troubled financial institutions is small, i.e. in aggregate, no individual holding exceeds 0.1% of the value of the FIF.

The Trust is also satisfied that none of our bond managers has any direct exposure to the US sub-prime sector.

- **Money Market Fund**

This fund has no exposure to either US or Icelandic banks and we continue to monitor the exposure to European banks.

The purpose of this fund is to preserve capital values and liquidity, rather than to maximise returns. Our mandate requires that only minimal risk is taken.

- **Buy-in Policy**

The Trust has recently invested in a buy-in policy with Paternoster UK Ltd. Paternoster have advised that their investment portfolio underlying this policy has a minimal amount of exposure to troubled financial institutions. It has also not suffered any losses resulting from swaps agreements.

Paternoster UK Ltd itself is entirely funded through equity; its sole activity is writing annuity business and the company is debt-free. As a UK Financial Services Authority regulated life insurer, protection for scheme members is provided by the Financial Services Compensation Scheme ([www.fscs.gov.uk](http://www.fscs.gov.uk)).

### **3 Summary**

3.1 The Pensions Trust is a long-term investor and we have to accept that there will be periods when markets fall. The Trust also remains committed to monitoring the structure of its funds and its investment managers with the aim of delivering good performance over the longer-term.

*While every effort has been made to ensure the accuracy of the information contained in this fact sheet, it should not be treated or relied upon as a statement of law. Readers should contact their regular Account Manager at The Pensions Trust in relation to their own circumstances and/or refer to the original source material as appropriate.*