



Investment Solutions

Funding Level Index Quarter 4, 2011

Funding Level Changes: September to December 2011

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|---|-------|
| Starting position (30/09/2011) | 62.1% |
| Increase due to asset returns | 4.6% |
| Increase due to change in liability value | (6.3) |
| Ending position (31/12/2011) | 60.4% |

Commentary

Global stock markets experienced a sharp rebound in the final quarter of 2011, with Global equity markets rallying 7.4% (in Sterling terms) and the FTSE All Share Index rising by 8.4%. This was a recovery from the setback of Q3 when markets were very concerned that the US would not raise its debt ceiling and that various peripheral Eurozone countries may default and potentially leave the Euro.

The emerging economies have continued to see slowing growth, and China, in particular, has been using monetary policy actively to engineer a soft landing. The main concern in many global emerging economies is to balance inflationary pressures, with the need to ensure business cycle expansion for as long as possible, whilst encouraging internal demand.

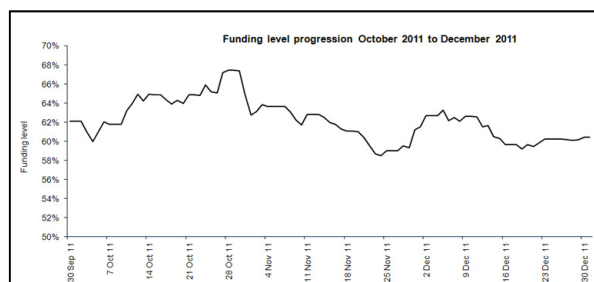
Fixed Interest markets experienced yet another positive return this quarter, as Gilts benefitted from the significant uncertainty in global sovereign bond markets. Corporate bonds lagged Gilts over the quarter; however, the sector still is, in our view, relatively attractive versus cash or Gilts.

Yields on UK Government bonds, both Index-linked and Fixed Interest fell through the quarter as investors continued to seek the safety of Gilts and the additional round of QE was brought to bear at the longer end of the curve. Despite the move toward riskier assets through the last 6 weeks of the quarter, bond yields held steady as investors continued to hold onto their Gilts.

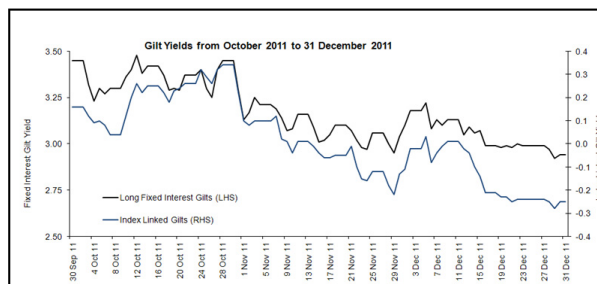
As Gilt yields have fallen dramatically over the course of 2011 so the typical pension schemes liabilities have risen, and as equity markets have remained weak so the typical funds funding level has declined by some 13.5%. Umar Ilyas, Senior Investment & Risk Actuary at Investment Solutions says:

“Q4 2011 continued to be a challenging environment for pension schemes. Despite the rebound in equity markets, significant long Gilt yield compression continued. Overall this resulted in funding levels for pension schemes to fall on average by -1.7% over the quarter (as measured by the IS Pension Funding Level Index).

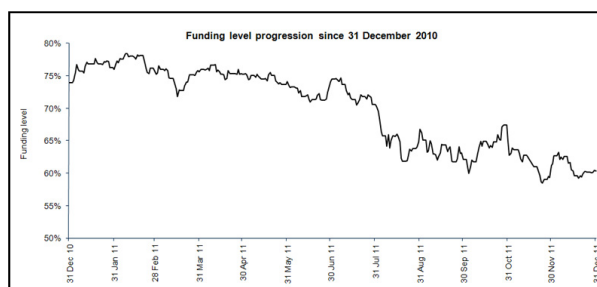
A confluence of weak economic growth, massive monetary expansion (that the ECB has recently added



to), fears of a breakdown in the global financial system along with uncertainty about the future of the euro and sovereign downgrades, all contributed to the continued heightened volatility across markets. Investors continued to pile into UK government debt, as investors continued to view Gilts as a safe haven, with yields falling over the quarter, resulting in a negative impact on pension scheme liabilities. This has been the overarching trend throughout 2011 with the result that the typical schemes funding level has declined significantly, with the largest contributor being the sharp increase in estimated liability values as bond yields fell dramatically. Over the year, the typical funding level has fallen by 13.5% .



Although headline inflation continues to remain well above target, both CPI and RPI numbers fell over the quarter. Broadly speaking gilt markets followed essentially the same pattern as swap markets, both nominal and real yields.”



Source for all graphs: Investment Solutions, Bloomberg

About the Funding Level Index

The Investment Solutions SME Pension Funding Level Index reports the health of the UK's small and medium sized pension schemes, which make up the majority of employer-sponsored defined benefit pension schemes in the UK.

Investment Solutions has been using the Index as an in-house tool since 2006 to illustrate the historical patterns of funding levels for a 'typical' small to medium sized pension scheme. The last time the Index showed 100% funding level was in July 2007.

Based on a typical scheme allocation of 70% in equities and 30% in bonds the index dramatically highlights the inflection point (circled) in July 2007.

Notes

The characteristics of the standard scheme modelled in the Index are set out opposite. The Index reflects the difference in movement of assets and liabilities, solely allowing for market movements. Deficit contributions, benefit payments and demographic changes are not included in the Index.

Standard Scheme behind the Funding Level Index

Nature of liabilities

Proportion related to index linked gilts = 70%
Proportion related to fixed interest gilts = 30%
Duration of liabilities = 20
Valuation return = 1.3% p.a. above gilts

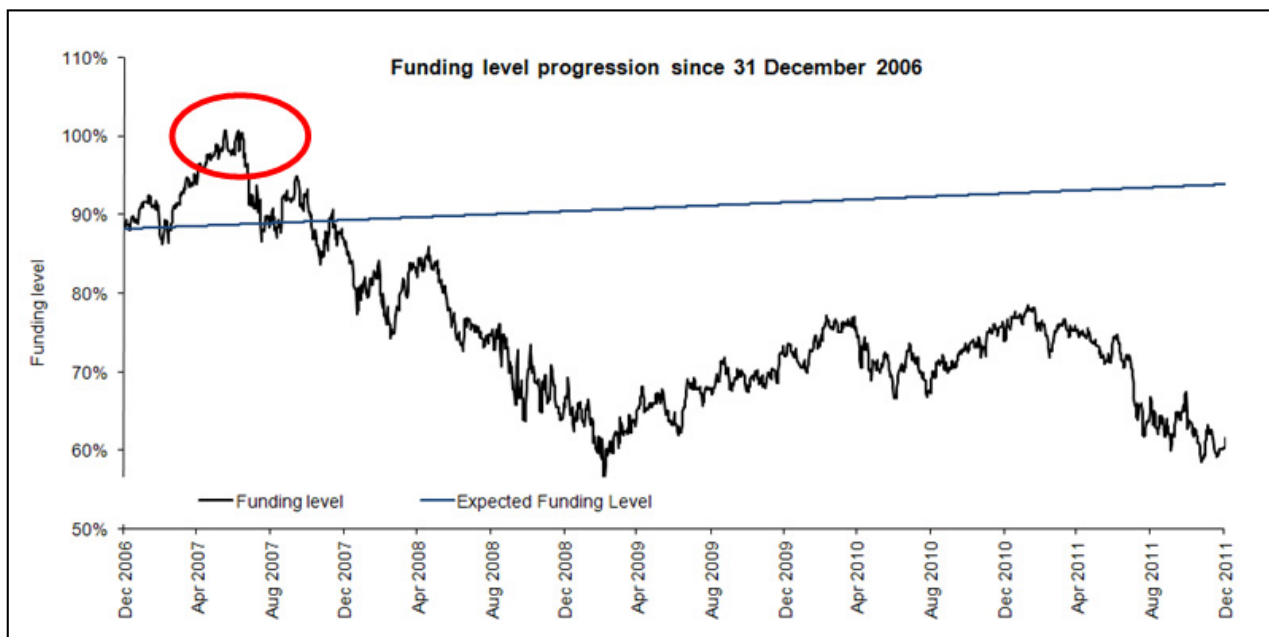
Nature of assets

Equity allocation = 70% (64% passive UK and 36% passive regional overseas)
Bond allocation = 30% (33.3% ILGs, 33.3% FIGs, and 33.3% UK corporate bonds)

Contact Us

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Source: Investment Solutions

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