

AHEAD OF THE CURVE

Ahead of the Curve covers developments that may impact the behavior and portfolio positioning of institutional investors. Take a closer look at events in the ever-changing regulatory, legislative and investment markets to determine how they may impact you.

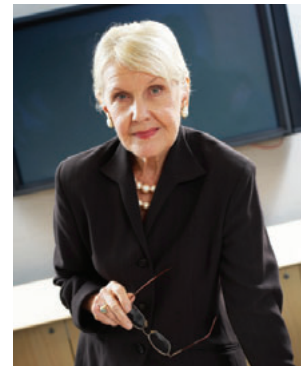
Long-Dated Bonds in High Demand

Demand by pension funds for long-dated government bonds is stronger than the supply of bonds, according to a recent study by the Paris-based Organisation for Economic Co-operation and Development (OECD).

The report predicted a large future gap between supply and demand but also noted a significant range where shortages would occur across currency and maturity segments. “G-10” countries were cited as the primary long-term bond hotspots. Meanwhile the largest gap in the U.S. market was forecast for bonds with maturities of 10 years or more.

Pent-up demand by pension funds could also be considerable, according to the report. Such demand will undoubtedly prompt policymakers to further debate the situation resulting from new regulations requiring that assets match liabilities. Long-bond pension fund demand has increased and, in turn, prompted governments to issue debt of longer maturities. France and the U.K. introduced 50-year bonds last year, and the U.S. Treasury re-launched a 30-year bond in February 2006.

The complete report can be found at oecd.org.



Global Marketplace Presents Risks, Opportunities



As the world’s stock exchanges consider merging into a global marketplace, it’s unclear what the economies of scale would mean for institutional investors.

In June, the New York Stock Exchange agreed to merge with Euronext, which owns stock markets in Paris, Brussels, Amsterdam and Lisbon, and a futures and options market in London. Meanwhile, the Nasdaq made a bid for the London Stock Exchange.

Larger exchanges would create better efficiencies for operators, which, in turn, could result in lower fees for investors. It would also expand the array of trading options. But some investors fear marketplace consolidation would create monopolies that reduce incentives for keeping fees low.

The mega-marketplaces also could allow companies to list stocks in the least regulated markets, some say.

U.S. Pension Reform Nears

As U.S. lawmakers complete an overhaul of pension funding rules this summer, some industry groups are calling for more time to adjust to the stricter rules. For pension funds with calendar year-ends, it would be difficult to adhere to new funding rules beginning in 2007, the ERISA Industry Committee says.

Proposed funding changes could require plan sponsors to use a different method of calculating the discount rate. Lawmakers are also expected to strengthen contribution requirements and to reduce the number of years to fully fund pension plans.

A complete list of the ERISA Industry Committee’s “Pension Pointers” can be found at eric.org.



Weighing Alternative Indexes

Alternatively weighted indexes are gaining in popularity, given that these vehicles may offer heftier returns than the current market. But buyers beware, says Northern Trust's global quantitative management team. Where are these indexes taking their bets? Traditional indexes weight securities by market capitalization, whereas alternatively weighted indexes use a subset of stocks or bonds. By doing so, alternatively weighted indexes show a different risk-and-return profile than the broader universe.

These vehicles should not be called enhanced indexes, however. Northern Trust's global quantitative management team prefers to call them quasi-active indexes for reasons laid out in their white paper on the topic. For an in-depth look at alternatively weighted indexes, go to northerntrust.com.

The China Question Mark

In a bid to sell institutional investors and others a piece of China's booming economy, the Bank of China began publicly trading its shares in June, raising \$11 billion. It was the world's largest public offering in six years. The Industrial and Commercial Bank of China, the largest of the state's "big four" banks, will likely top that later this fall with an offering of its own.

Despite a rough patch for emerging markets earlier this year, both the bank and

its investors can be encouraged by performance by other publicly traded banks. At the China Construction Bank, operating profits rose by 17%, and at the Bank of Communications, share prices have doubled, according to the *Economist*. Investors might be wary, however, of investing in banks that are being propped up by the government and more recently by foreign investors. That's despite the country's recent attempts at banking reform.

University Study Cites Need for Trustee Education



The average pension fund trustee in the United Kingdom requires more education and professional qualifications to "play the role of informed consumers of financial advice and decision-making (as suggested in the 2004 Pensions Act)," according to a recent study by Oxford University. Only a few trustees could be called experts in their field according to the standards applied in the study, authors found. In addition, some respondents were inconsistent in applying judgment across related problems.

For a copy of the report, "Consistency of decision-making: the effect of education, professional qualifications, and task-specific training on the probability judgments of pension fund trustee decision-making," go to geog.ox.ac.uk/research/wpapers/economic.

Housing Futures Fall Short

The Chicago Mercantile Exchange recently introduced futures contracts for housing price indexes, but the value for investors remains uncertain. The derivative would offer investors an opportunity to move with the economy as the housing market begins to flag. However, some critics say the new derivatives pose challenges for buyers because the indexes fail to recognize the differences in the underlying properties. More information can be found at cme.com.

