



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.

Asset Growth Mitigates Negative Demographic Impact

Strong asset growth is helping private pension plan sponsors worldwide overcome the adverse effects of rising dependency ratios, in which fewer workers are supporting more retirees.

The “Global Pension Assets Study 2008” from Watson Wyatt Worldwide found workforce pension fund assets in 11 countries grew 8.7% to US\$24.93 billion during 2007. During the previous 10 years, assets have grown at a compound annual rate of 7.1%.

The countries studied were Australia, Canada, France, Germany, Hong Kong, Ireland, Japan, Netherlands, Switzerland, the United Kingdom and the United States. The pension assets represented 82% of the gross domestic product for the 11 countries, up from 64% in 1997.

The global average asset allocation for the pension funds studied was 56% equities, 28% bonds and 16% other assets, estimated at 11% alternative assets and 5% cash. The study noted, however, the funds were underweighted in bonds relative to global capital market opportunities. Allocations to both bonds and alternative assets were expected to grow in coming years as plan sponsors assume more defensive postures because of improved funding positions and local regulatory and accounting changes.

The study also found that defined contribution plan assets have grown 13% annually during the past five years, compared with 11% for defined benefit plan assets.

The full study can be found at watsonwyatt.com/research.

Another Record Year of Growth On Tap for Gulf Nations



The economic report from the Institute of International Finance (IIF), Washington, D.C., reports total foreign assets of GCC countries could total more than \$2 trillion by the end of 2008. GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

“With oil prices likely to remain at robust levels, the GCC governments are set to sustain recent growth in capital spending and foreign investment,” says Charles Dallara, IIF managing director.

The outlook isn’t entirely rosy. There are concerns about rising inflation and a depreciating U.S. dollar, to which five of the six countries’ currencies are pegged.

The full report is available at iif.com.

Correction

The article entitled “The Dividend Puzzle” in the January 2008 issue of *Point of View* contained a misleading paragraph.

The passage stated that U.S. investors pay taxes on dividends at the normal income tax rate, whereas gains from stock repurchases were taxed at the lower capital-gains tax rate.

U.S. tax law changes enacted in 2003 effectively lowered the tax on individuals receiving qualified dividends from about 35% to 15% for the highest tax bracket. That change essentially made the tax treatment of dividends and long-term capital gains the same.

The revised article can be found in the *Point of View* archive at northerntrust.com.



Exploring Private Equity's Beta Characteristics

Research by Ibbotson Associates, a subsidiary of Morningstar, Inc., explores the notion that private equity, traditionally an alpha-generating strategy, is becoming more of a beta-oriented asset class.

In its research paper entitled "Private Equity and Strategic Asset Allocation," Ibbotson notes securitization is driving the development of private equity as an asset class. Ibbotson used two new indices — one for domestic private equity and one for international private equity — as proxies for the asset class.

From 1997 to 2006, U.S. and non-U.S. private equity were the top-performing asset classes in the firm's opportunity set. The performance of the private equity proxies, however, was highly sensitive to the weighting schemes of the indices. This sensitivity, Ibbotson's paper indicates, shows private equity still has a significant level of specific risk, but could be reduced through further securitization.

The full research paper can be found at corporate.morningstar.com/ib.

Target-Date Funds Meet Default Criteria

A research paper finds asset allocation funds, also known as target-date funds, meet the default investment option requirements for defined contribution (DC) plans from both the plan sponsor's and participant's perspective.

"Optimal Life-Cycle Strategies in the Presence of Interest Rate and Inflation Risk" is one of three 2008 working papers from The Pension Research Council of the Wharton School of the

University of Pennsylvania. According to the research, target-date funds give sponsors an option that appeals to a broad range of participants, are easy to administer and carry low costs. For participants, the funds are easy to understand, have transparent strategies and reduce the anxiety of investment decision-making.

The working paper can be found at pensionresearchcouncil.org.

DB Plans Still Dominant In the U.S. Public Sector

Two primary factors explain why defined benefit (DB) plans are the dominant retirement vehicle in the U.S. public sector: workforce demographics and the nature of employers.

A briefing paper from the Center for Retirement Research at Boston College — "Why Have Defined Benefit Plans Survived in the Public Sector?" — notes DB coverage has dropped for all U.S. workers. In 2005, 92% of state and local government employees

were covered by a DB plan, compared with 98% in 1975. By comparison, only 33% of private-sector employees were covered by a DB plan in 2005, down from 88% in 1975.

Public employees tend to be older, less mobile and more risk-averse than their private-sector counterparts, according to the paper. In addition, there is a higher degree of unionization in the public sector. Governments also are perpetual entities, unlike private companies, and are less



concerned about the financial volatility associated with DB plans.

A third factor, the regulatory environment, also plays a role. For example, the U.S. Employee Retirement Income Security Act of 1974 established standards for participation, vesting and funding for private plans. Government plans are not covered by the legislation.

To download a copy of the paper, go to crr.bc.edu.