



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.

IMF Researchers Examine Global Recessions

A study conducted by researchers at the International Monetary Fund (IMF) found recessions accompanied by financial difficulties last longer and are more costly. The study analyzed links between key macroeconomic and financial variables around business and financial cycles in 21 countries between 1960 and 2007. There were 122 recessions in the studied countries during that time period, lasting an average of four quarters and resulting in a 2% decline in economic output.

A recession's impact, however, was magnified if accompanied by financial difficulties, including credit crunches, house price busts and equity price busts. For example, recessions coupled with a credit crunch or house price bust on average lasted three months longer with two to three times the loss in economic output. Recessions associated with equity price busts also tended to be longer and deeper, but the differences were not statistically significant.

The researchers concluded at the time that although the impact of the current crisis already had been felt gradually throughout the world, historical evidence indicates the effects were likely to intensify as the crisis unfolded. They added, however, that recessions in a specific country "can be shaped" by many factors, and continued decisive action on the national and global levels could help meet the challenges of the current crisis.

Highlights from the study were published in an article, "When Crises Collide," in the December 2008 *Finance & Development*, a quarterly IMF publication. The study also will be the topic of an upcoming IMF working paper. A copy of the article is available at imf.org.



Interim Investment Solutions Paper

Institutional investors sometimes must make rapid adjustments to their portfolios in response to changes in the financial markets or one of their investment managers. During these transition periods, interim investment solutions can provide a temporary answer until an investor has sufficient time to identify and hire a new investment manager.

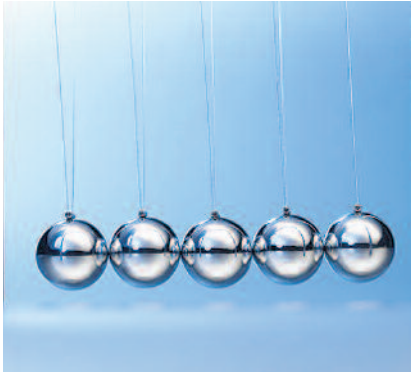
A new white paper from Northern Trust, "Transition Management: Understanding and Evaluating Interim Investment Management Solutions," examines temporary asset management solutions. In essence, these solutions, sometimes referred to as equitization, enable an investor to gain exposure to, or a hedge against, a particular class of investments or benchmark.

The paper identifies three situations in which interim solutions could prove beneficial – a change in market outlook or fundamentals, cash

needs to be invested or unexpected changes to a current investment manager. The paper also outlines several considerations when selecting an interim solution, including:

- **Timeframe:** How long does the investor expect to stay in the interim investment?
- **Flexibility:** Does the investor need readily accessible investments or a customized benchmark?
- **Benchmark:** What vehicle provides the best tracking to the benchmark?
- **Cost/Risk Trade-Off:** Will the cost of trading into the interim solution be offset by reduced risk?

To download the white paper, go to the "Insights & Research" section at northerntrust.com.



Foundations Holding Steady On Asset Allocations

A survey by the Association of Small Foundations found that although a majority of the respondents experienced investment losses last year, many do not anticipate changing their asset allocation policies.

The survey, conducted in January, found 79% of the foundations surveyed had losses of 10% or more in 2008. Still, 49% of the respondents are not considering a change in their investment mix. Another 15% of foundations were considering a shift in asset allocation, but weren't sure what it would be.

Among the asset classes likely to see increases, 28% of the foundations said they would increase their cash allocations, followed by investment-grade bonds, 25%, and U.S. large-cap stocks, 23%. Among the categories expected to see decreases in allocations were hedge funds, mentioned by 16% of respondents; international stocks, 14%; and U.S. small-cap stocks, 13%.

Almost 350 foundations responded to the survey.

For more survey findings, go to smallfoundations.org.

Freezing DB Plans Could Increase Costs

An issue brief from the National Institute on Retirement Security advises public employers to use caution when considering whether to abandon defined benefit (DB) pension plans in favor of defined contribution (DC) plans.

“Look Before You Leap: The Unintended Consequences of Pension Freezes” found freezing a DB plan and moving to a DC could increase costs to the employer/taxpayers. In addition, freezing a DB plan could worsen employees' retirement insecurity, thus hurting recruitment and retention efforts.

Specifically, the brief examines three reasons why freezing a DB could lead

to higher expenses:

- Maintaining two plans is more costly than operating just one
 - Employers that switch to DC plans forgo the built-in efficiencies inherent in DB plans, and freezing a DB plan actually undermines the economics of a frozen plan over time
 - The accounting rules that govern public pension plans can cause an acceleration of required pension contributions to cover unfunded liabilities in the wake of a plan freeze
- The complete issue brief can be found in the “Research” section at nirsonline.org.

Liability Driven Investing Implementation

As pension sponsors become more attuned to managing assets in line with plan liabilities, the question being asked more frequently is not whether to implement a liability driven investing (LDI) strategy, but how best to do so.

A recent Northern Trust white paper, “Liability Driven Investing Implementation,” outlines a five-step process that provides a framework for an implementation strategy:

- Develop objectives
- Characterize liabilities
- Quantify risks
- Develop and implement solution
- Monitor strategy

The paper also recommends including all parties – consultants, actuaries, asset managers and solution providers – in determining the best course of action for a plan sponsor considering LDI implementation. Once the strategy is



developed, options for optimizing the risk/return tradeoffs of the plan relative to its liabilities can be discussed.

The white paper is available in the “Insights & Research” section at northerntrust.com.