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Standard Life Investments Trigon Investment Seminar



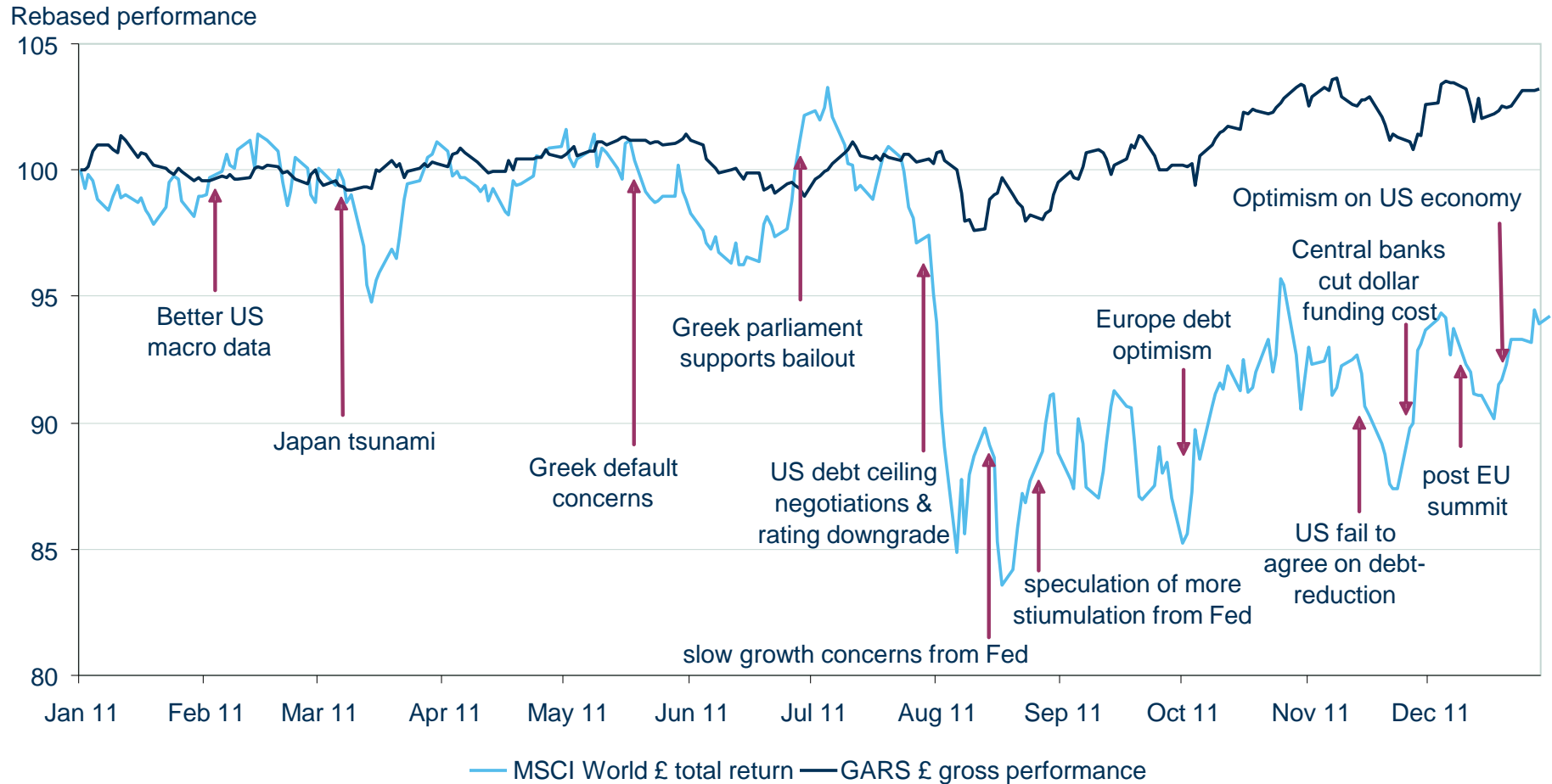
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January 2012



A glimmer of light

A look back at events influencing assets in 2011



The House View into 2012

- We expect considerable market volatility into 2012, reflecting the political and economic complexities of dealing with the financial crises
- Short-term economic prospects are a little better, medium term economic prospects remain muted
- The onus remains on central banks to support economies while they restructure
- We worry about unknown unknowns
- The House View favours credit, property and some equities, as long as recession and major financial shocks can be avoided

How can we navigate through this situation?

“Reports that say that something hasn't happened are always interesting to me, because as we know, there are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns – the ones we don't know we don't know.”

~Donald Rumsfeld

Positioning for unknown unknowns is a key consideration in this environment !

A. What do we know we know?

1. Economies will remain differentiated and volatile with excess capacity
2. Politics matter, regulation will expand
3. Interest rates will be low for the foreseeable future
4. Western companies are strong while governments and households are weak
5. Portfolio construction matters enormously when financial markets are volatile and highly correlated

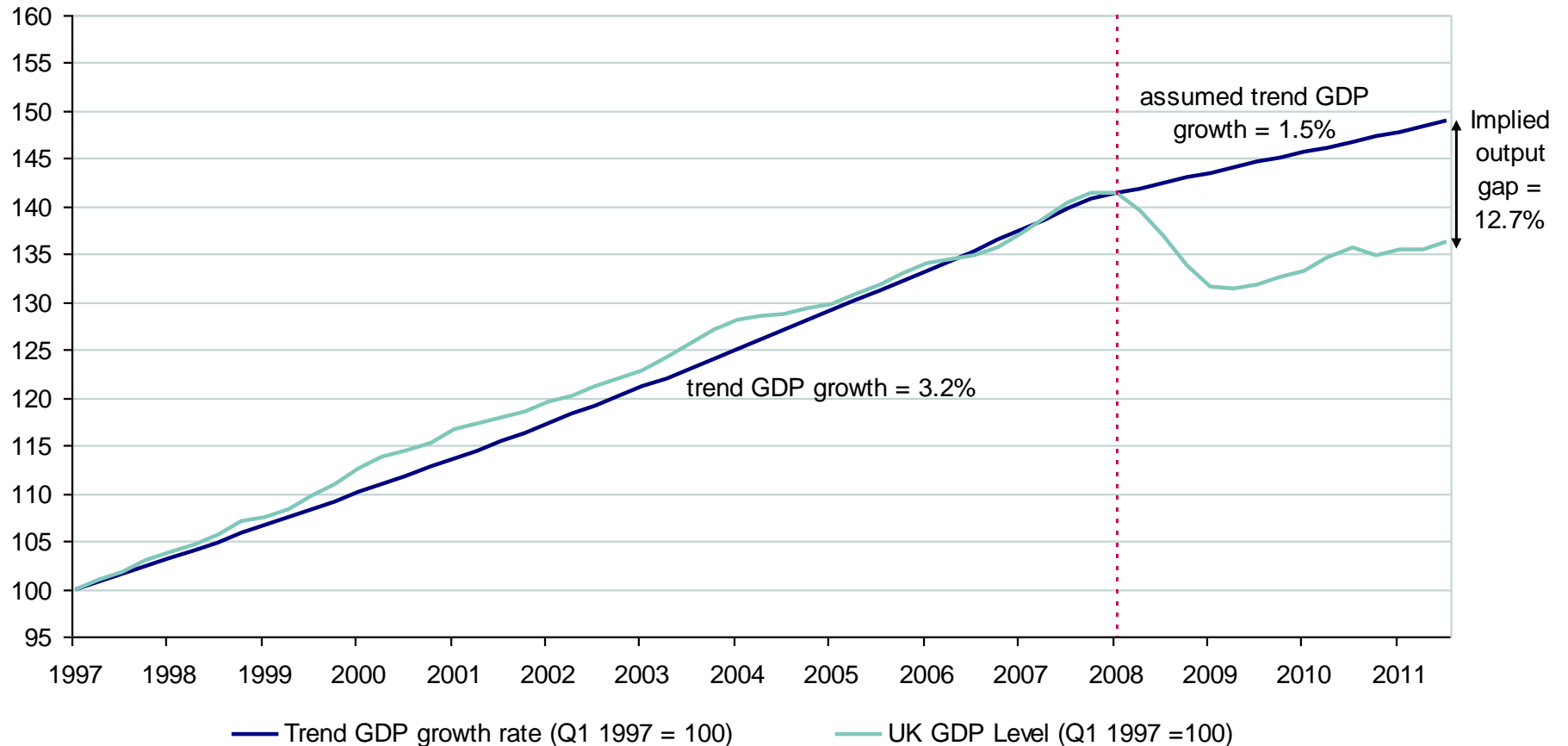
Investors are aware of the “new” environment

A.1.a. The global economic outlook

- Short term: activity improves reflecting lower oil prices, lower bond yields & mortgage rates, and Japan's recovery budget
- Medium term: threats from the EMU crisis on confidence, plus the weakened state of the banking sector and further fiscal tightening
- Longer term: deleveraging impacts on trend growth rates, creating a higher chance of more frequent recessions
- More positive on the outlook for the USA and China than Europe or Japan

Global growth 3-4% in 2012, 1-2% for OECD and 5-6% for GEM

A.1.b. Slack in the economy



Source: Datastream, Standard Life Investments

Disinflationary forces will remain high for some time

A.2. Politics: Europe tackling symptoms not cause

- Good news – European politicians have finally realised the need to stop “building fire walls’ and move towards a fiscal ‘compact’
- Bad news – EMU packages remain ‘necessary but not sufficient’, with little progress on boosting future economic growth
- The ECB’s role remains vital to control the situation and support the financial sector and key economies

Expect more European policy meetings in 2012

A.3. Interest rates set to be lower for longer



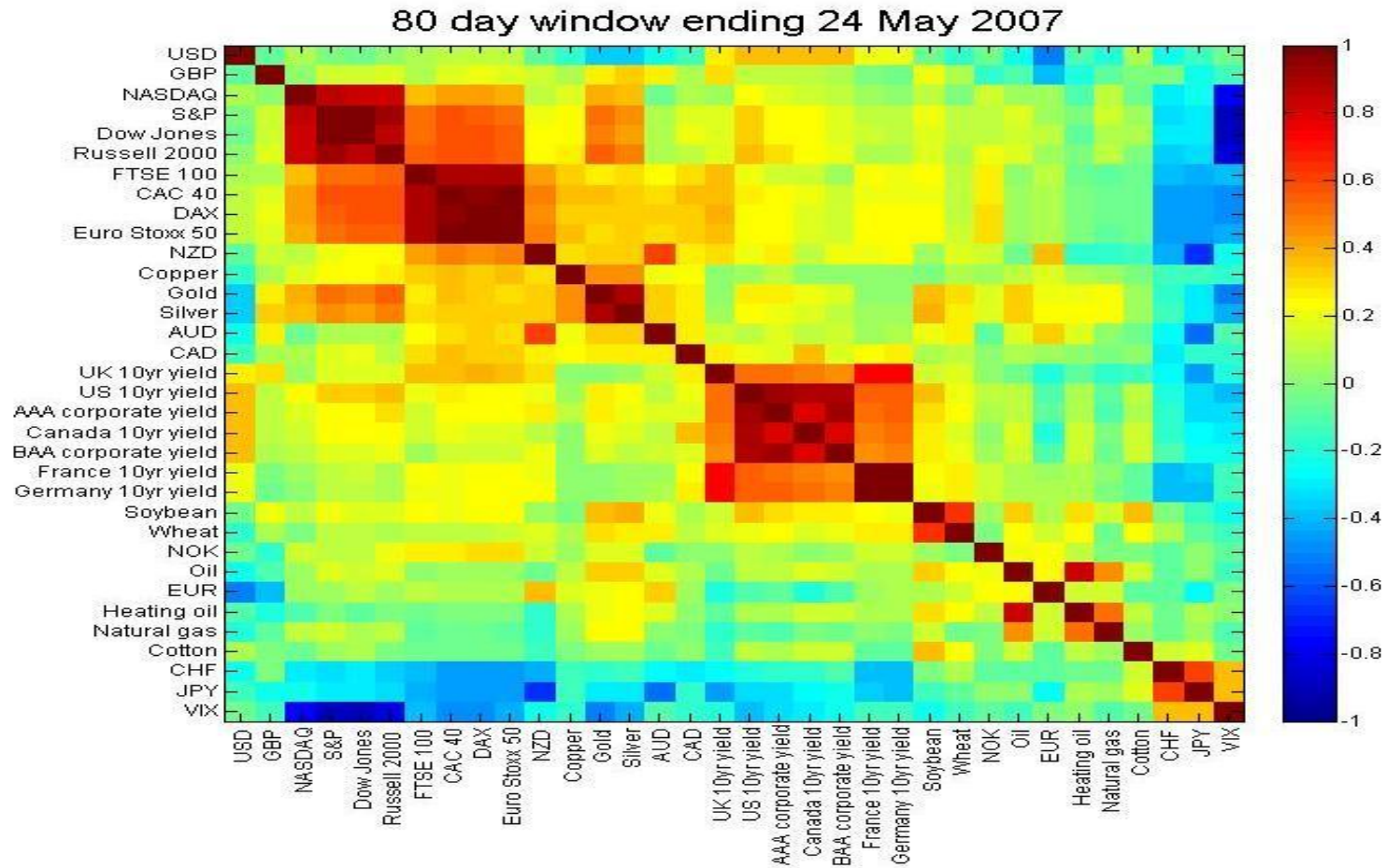
5yr Gilt yields to remain around the “new” average keeping corporate bond yields low ¹⁰

A.4. Corporate sector still expanding

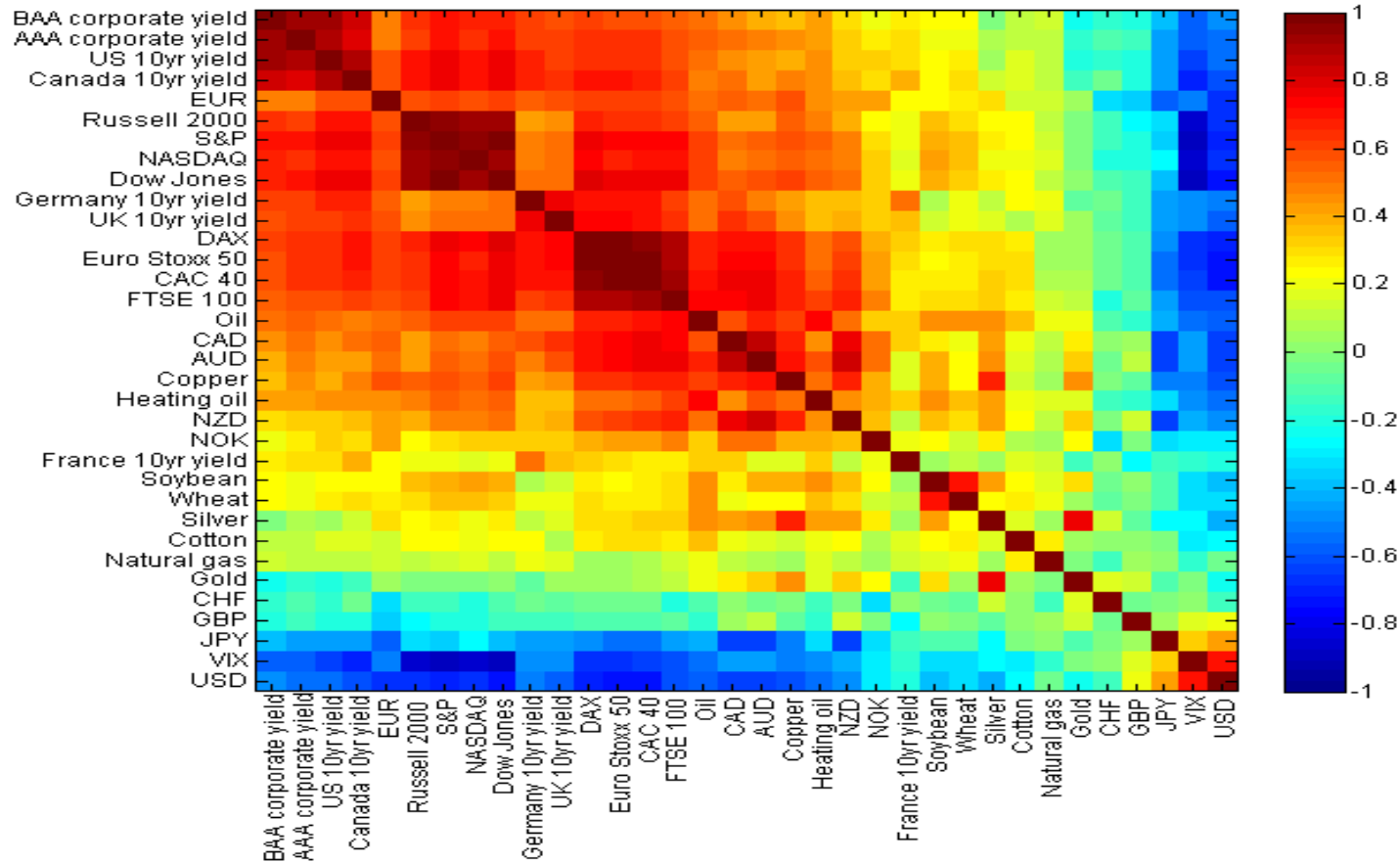
- Companies are generally in good shape, with cash rich balance sheets and the prospect of high single digit growth rates for global earnings in 2012
- Strong areas: business to business expenditure in the OECD - business to consumer & business to government in emerging economies
- Risks to corporate margins: higher costs, eg more expensive raw materials, or lower revenues, eg China forced to restrain growth, European recession

We forecast 6% global earnings growth in 2012

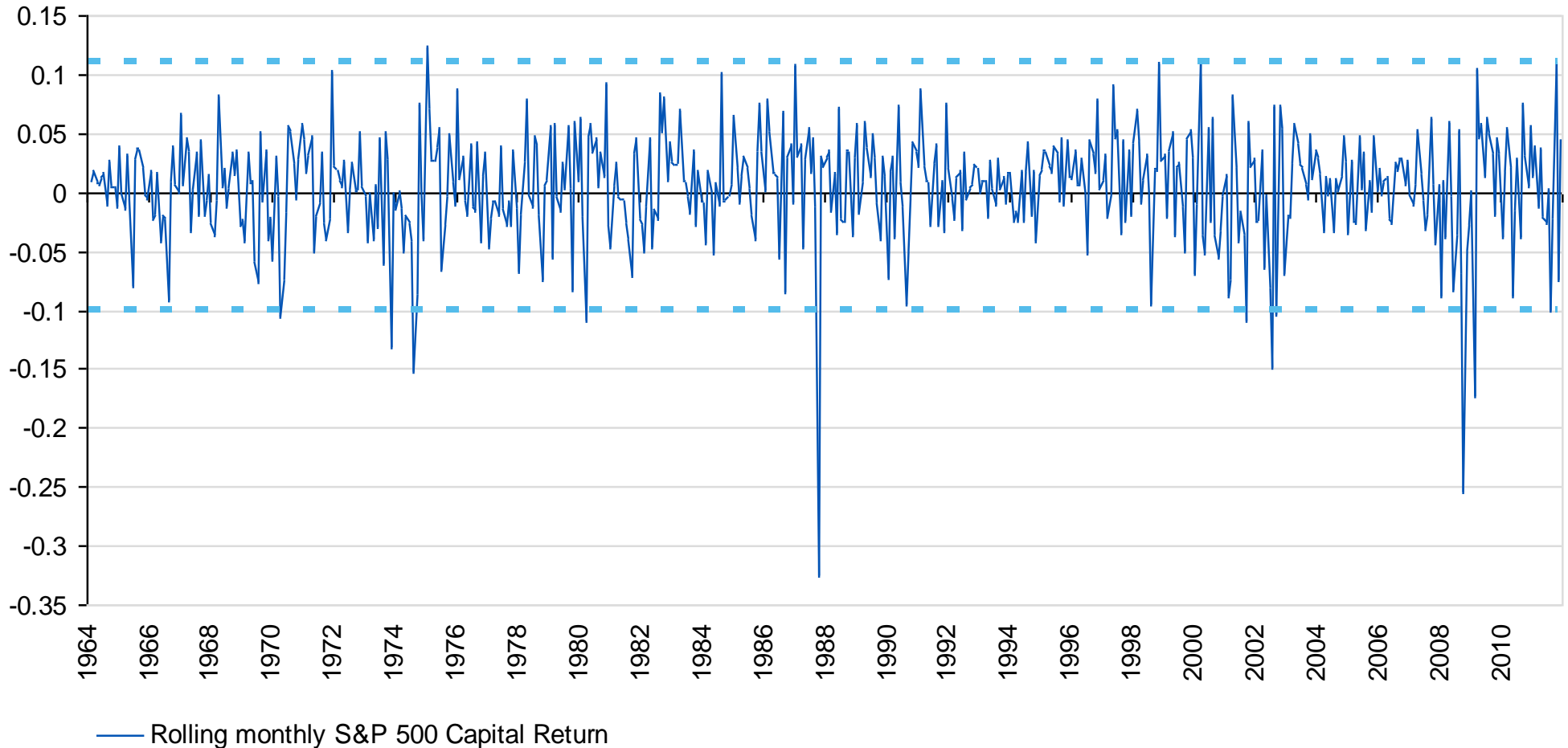
A.5.a. Correlations between assets low pre-crisis



A.5.b. Correlations between assets high recently



A.5.c. Living through volatile times



Source: Datastream, Standard Life Investments

August 2011: 11th largest monthly decline → October: 3rd largest monthly gain

B. What do we not know?

1. The impact of QE on growth or inflation
2. The impact of deleveraging on economic activity
3. The extent of China's complex economy
4. Policy responses

Lots of unknowns !

B.1.a. Quantitative easing explained!



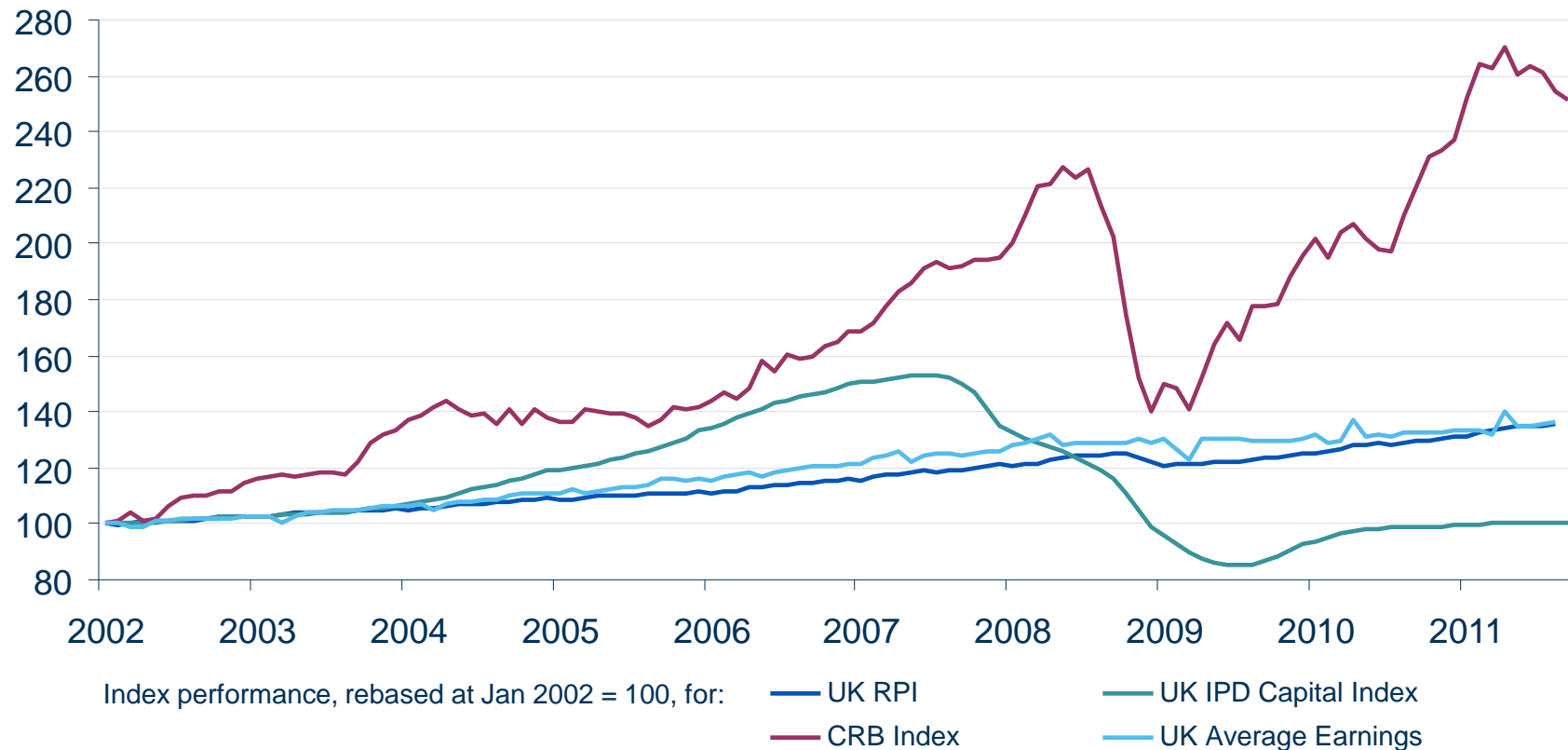
A bold step into uncharted territory

B.1.b. Deflation risks need to be mitigated

1. Cut interest rates
2. Introduce QE
3. Communication
4. Flatten the yield curve
5. Lower the currency
6. Helicopter money
7. Finance government spending

Bernanke has a checklist – we are at number five

B.1.c. What sort of inflation worries you?



Source: Datastream

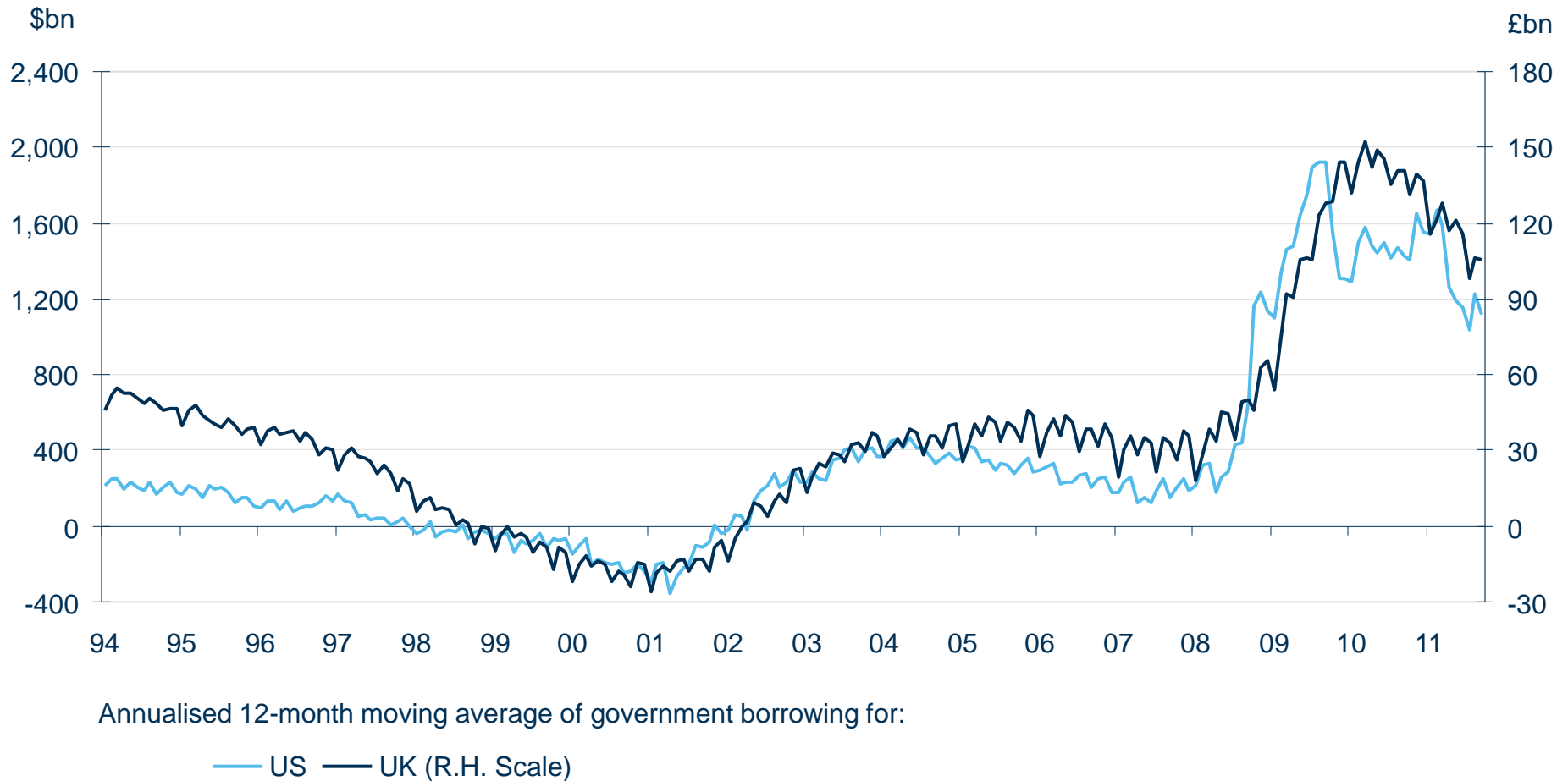
Different types of inflation matter

B.1.d. Inflation ahead?

We are one step closer to central banks creating inflation:

- The Fed is considering QE3
- The ECB is buying peripheral Eurozone bonds
- The UK could launch CE as well as QE
- China is slowing the RMB's appreciation

B.2.a. Debt burdens are too high



Source: Bloomberg, Standard Life Investments

Unfunded liabilities make the picture look even worse

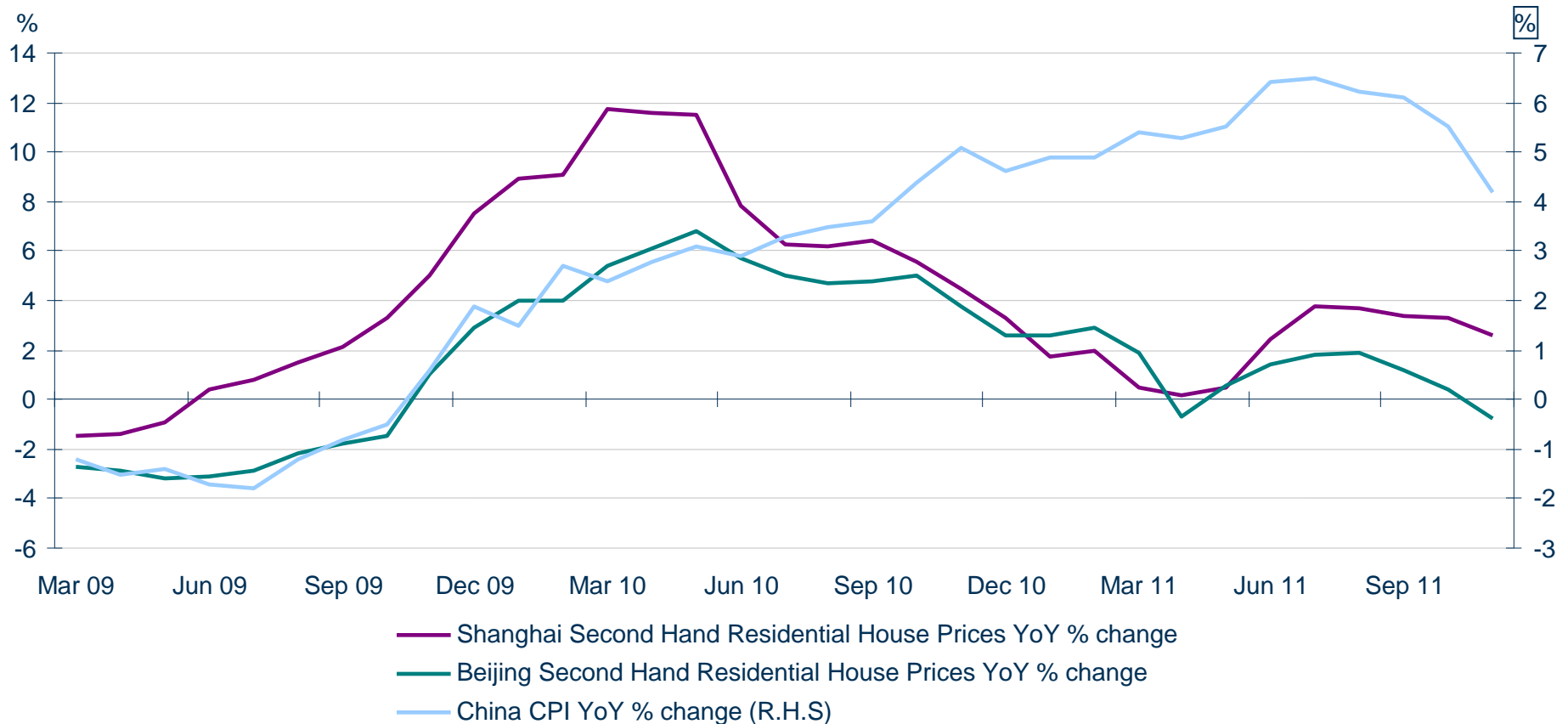
B.2.b. The policy responses are very difficult

OECD governments could:

- cut spending and raise taxes (eg the UK)
- enforced buying of government debt (eg Japan)
- grow their way out of the problem (eg the US is still trying)
- default or restructure (eg Greece.....and others.....)
- inflate the debt away – is this the long term answer?

The time for easy solutions is long past

B.3. The balancing act in China remains complex



Source: Bloomberg

Fine tuning to support certain sectors while capping inflation

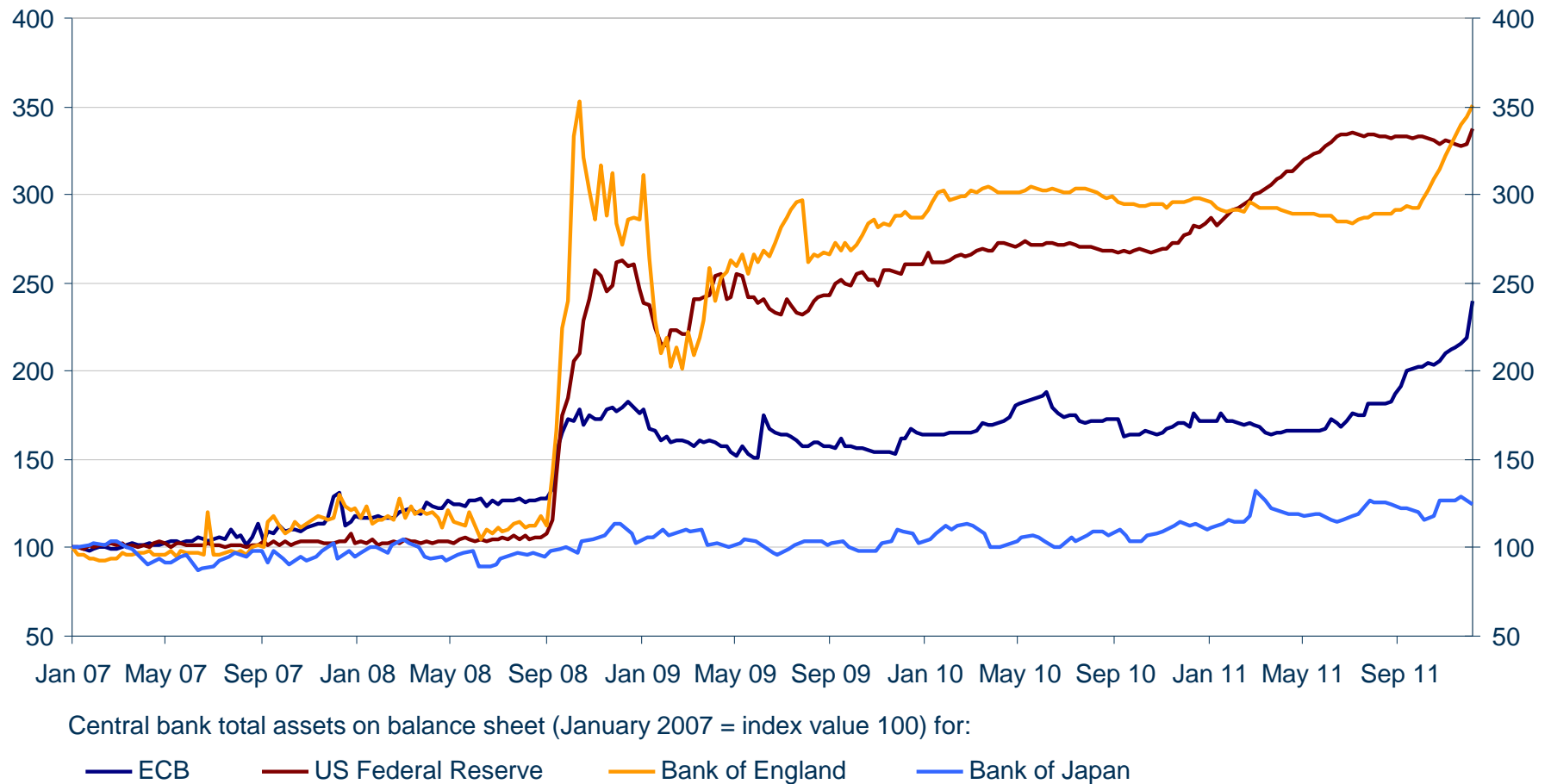
B.4.a. The onus remains on central banks ..

In recent months central banks have launched:

- USA – Operation Twist
- Japan – Yen intervention and expanded QE
- UK – New round of QE, potentially alongside credit easing
- Europe – expanded SMP, longer term loans for banks
- plus rate cuts in eg Australia and Brazil

How could QE turn into inflation?

B.4.b. .. but they are responding



Source: Bloomberg

Currencies reacting to monetary policy changes

The current House View

Medium term stance		Tactical funds
	Very Heavy	
Credit Property	Heavy	High Yield Corporate Bonds Investment Grade Corporate Bonds US Equities US Dollar FX UK Property US Property
Equities Government Bonds	Neutral	US Treasuries Japanese Bonds UK Inflation-linked debt UK Gilts European Equities UK Equities Emerging Market Equities European and Asian Property Global Commodities Sterling FX Yen FX
Cash	Light	Japanese Equities Developed Asian Equities European Bonds Euro FX Cash
	Very light	

Sustainable yield remains the preferred approach

Conclusion

- The aftermath to the global financial crisis will be a long and complicated one, for countries, their citizens and investors alike
- The corporate sector can still perform well, even in a slow growth world
- Investors should expect continued market volatility, due to risks of policy errors and political disturbances in a world of debt deleveraging
- Volatility in asset markets will create tactical opportunities for investors

Sustainable yield, rather than capital growth, remains the key contributor to returns

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