



NEPC, LLC

YOU DEMAND MORE. So do we.<sup>SM</sup>

## **NEPC Market Discussion**

---

### **Risks and Opportunities in a Challenging World**

October 6, 2011

One Main Street, Cambridge, MA 02142 | TEL: 617.374.1300 | FAX: 617.374.1313 | [www.nepc.com](http://www.nepc.com)

**CAMBRIDGE | ATLANTA | CHARLOTTE | CHICAGO | DETROIT | LAS VEGAS | SAN FRANCISCO**

## Today's Speakers



**Erik Knutzen, CFA, CAIA**

– Chief Investment Officer, Partner



**Tim McCusker, FSA, CFA, CAIA**

– Director of Traditional Research, Partner



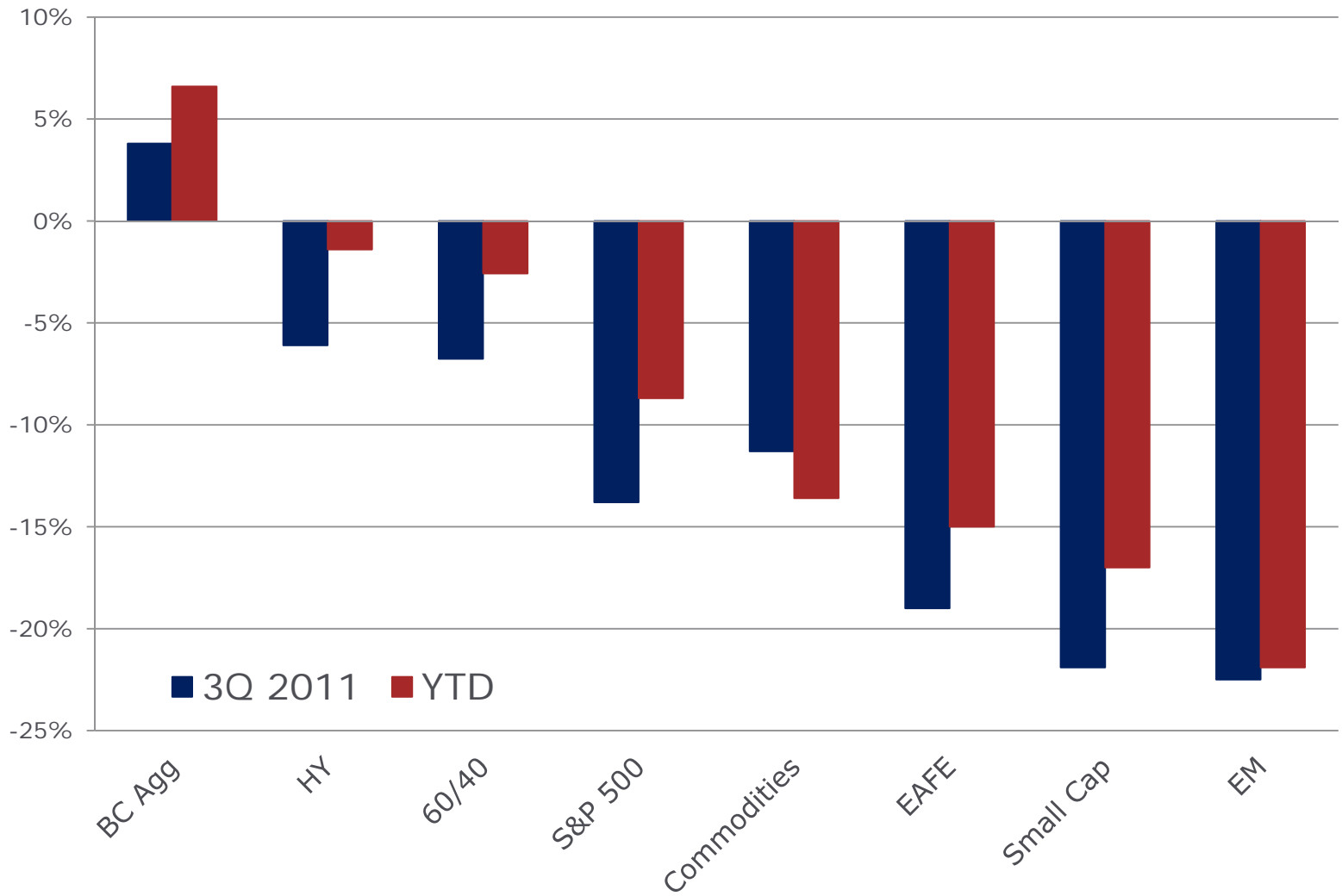
**Chris Levell, ASA, CFA, CAIA**

– Director of Corporate Practice Group, Partner

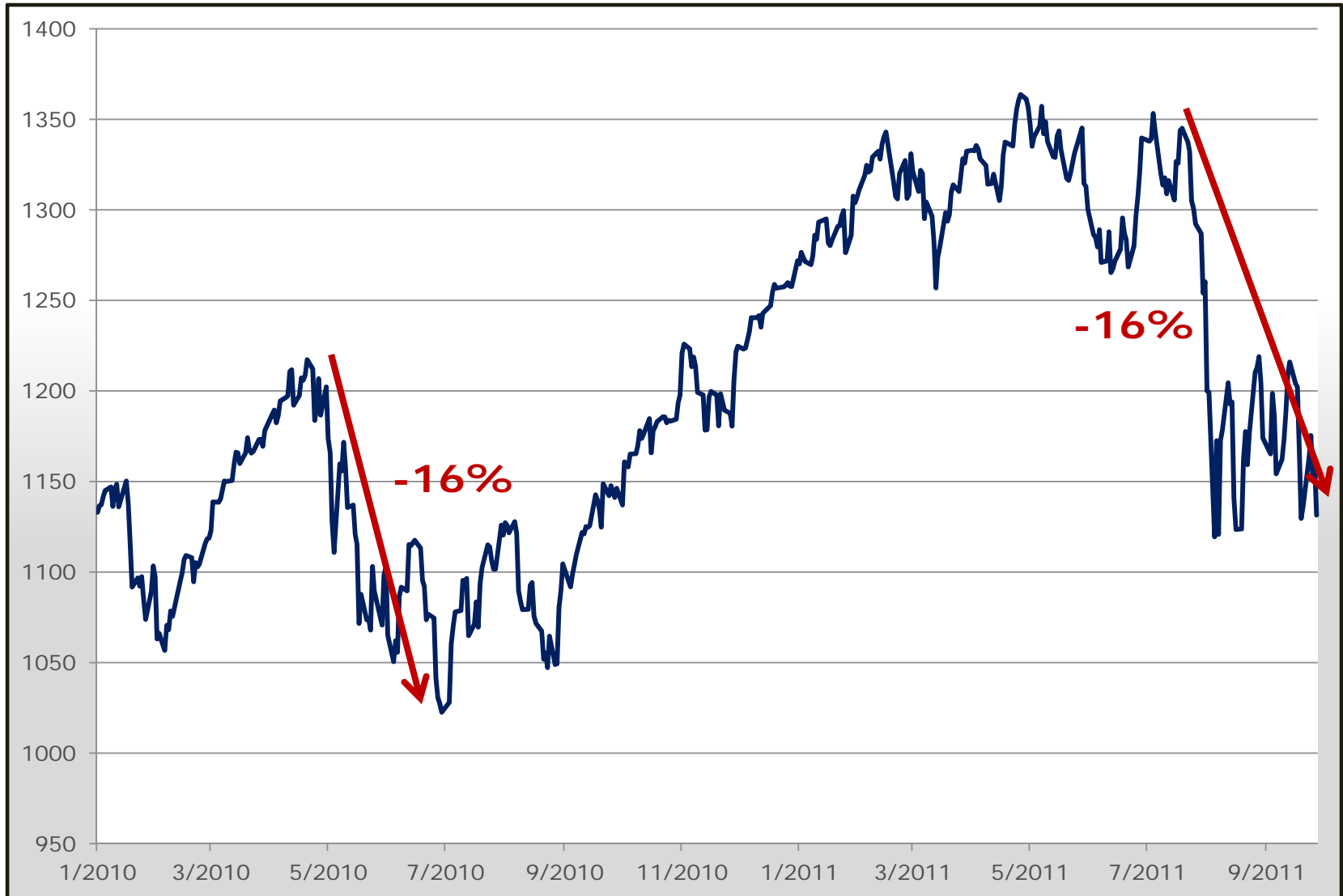
# Agenda

- **Markets through September 30, 2011**
- **Economic Challenges – the Euro, the US, and prospects for global growth**
- **Opportunities amidst the risks**
- **Your Questions**

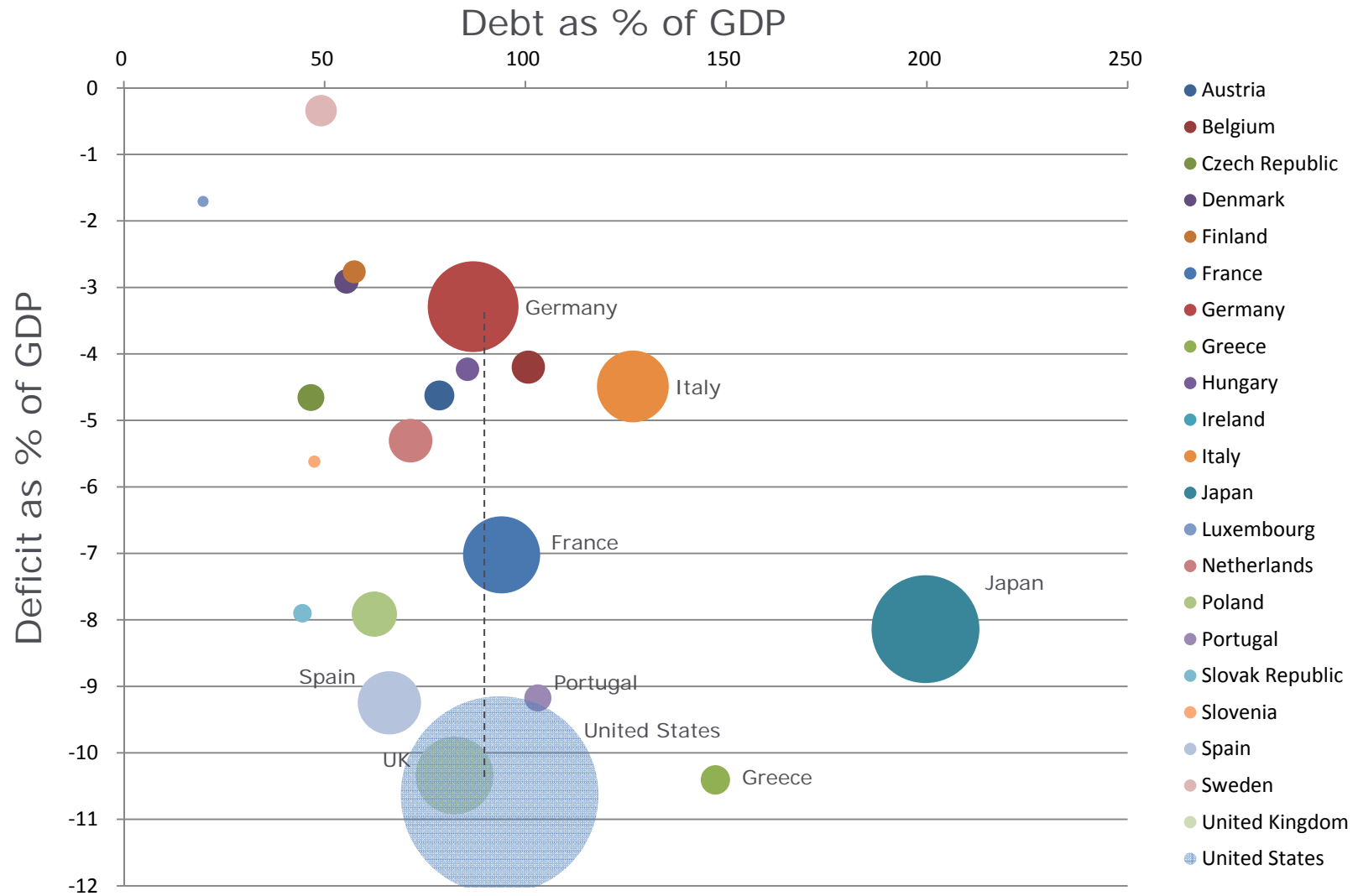
# Market Returns



# S&P 500 – January 2010 – September 2011



# Developed Markets– 2010 Financial Position

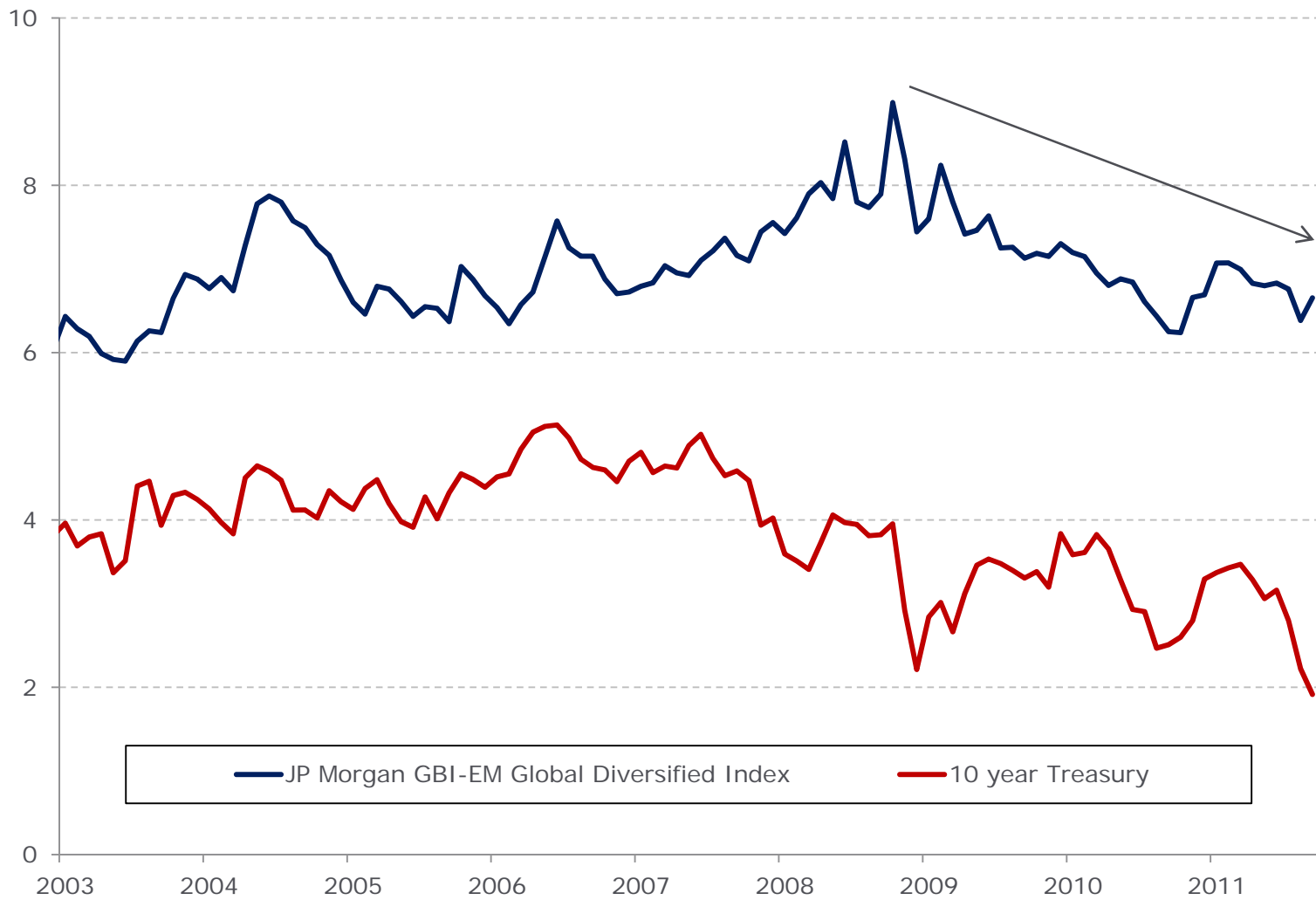


Bubbles illustrate relative sizes of GDP

Source: OECD, IMF



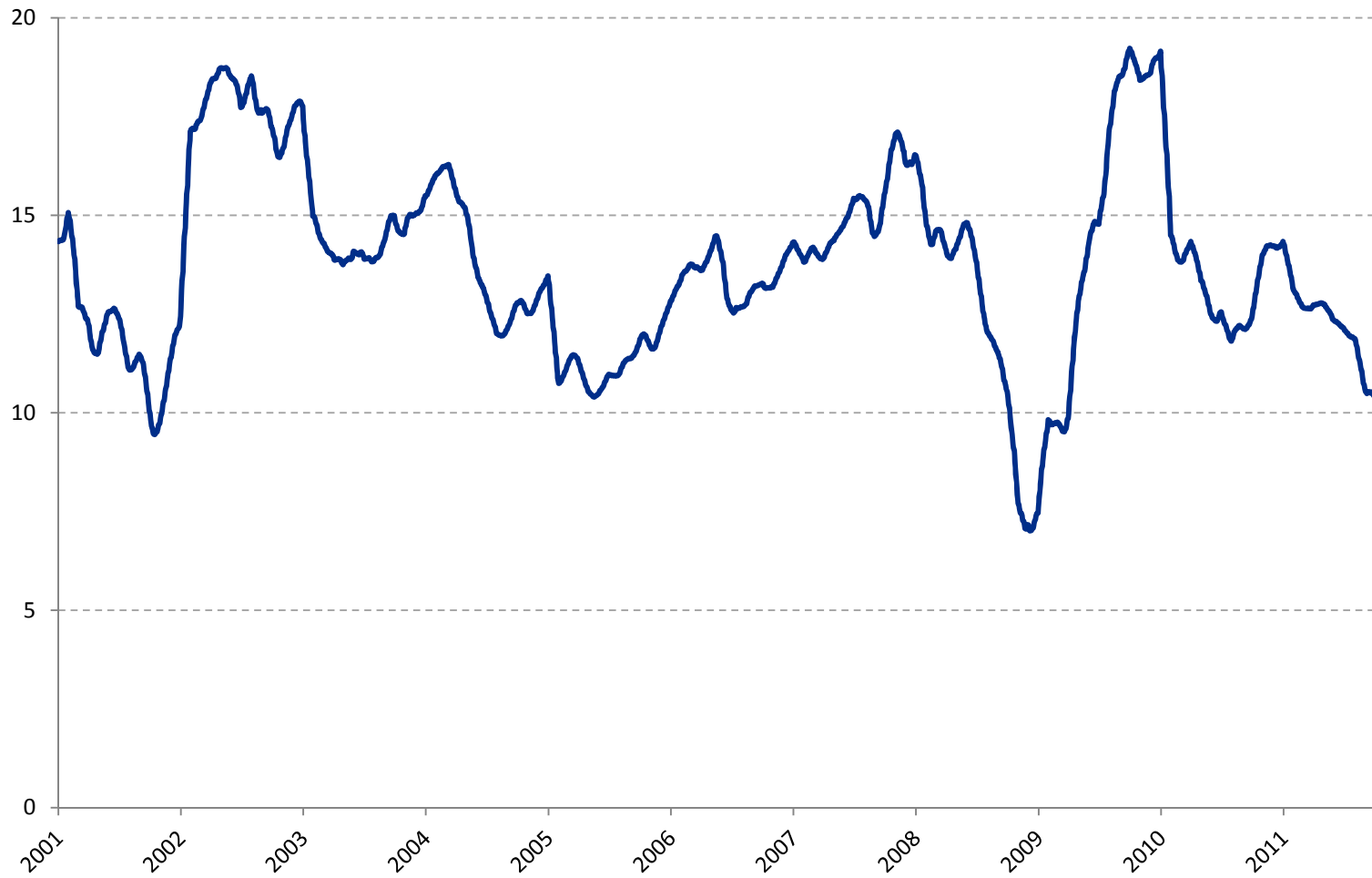
# Emerging Markets – Local Currency Debt Yield vs. US Treasury



Source: Bloomberg



# Emerging Markets – Trailing Price-Earnings Ratio

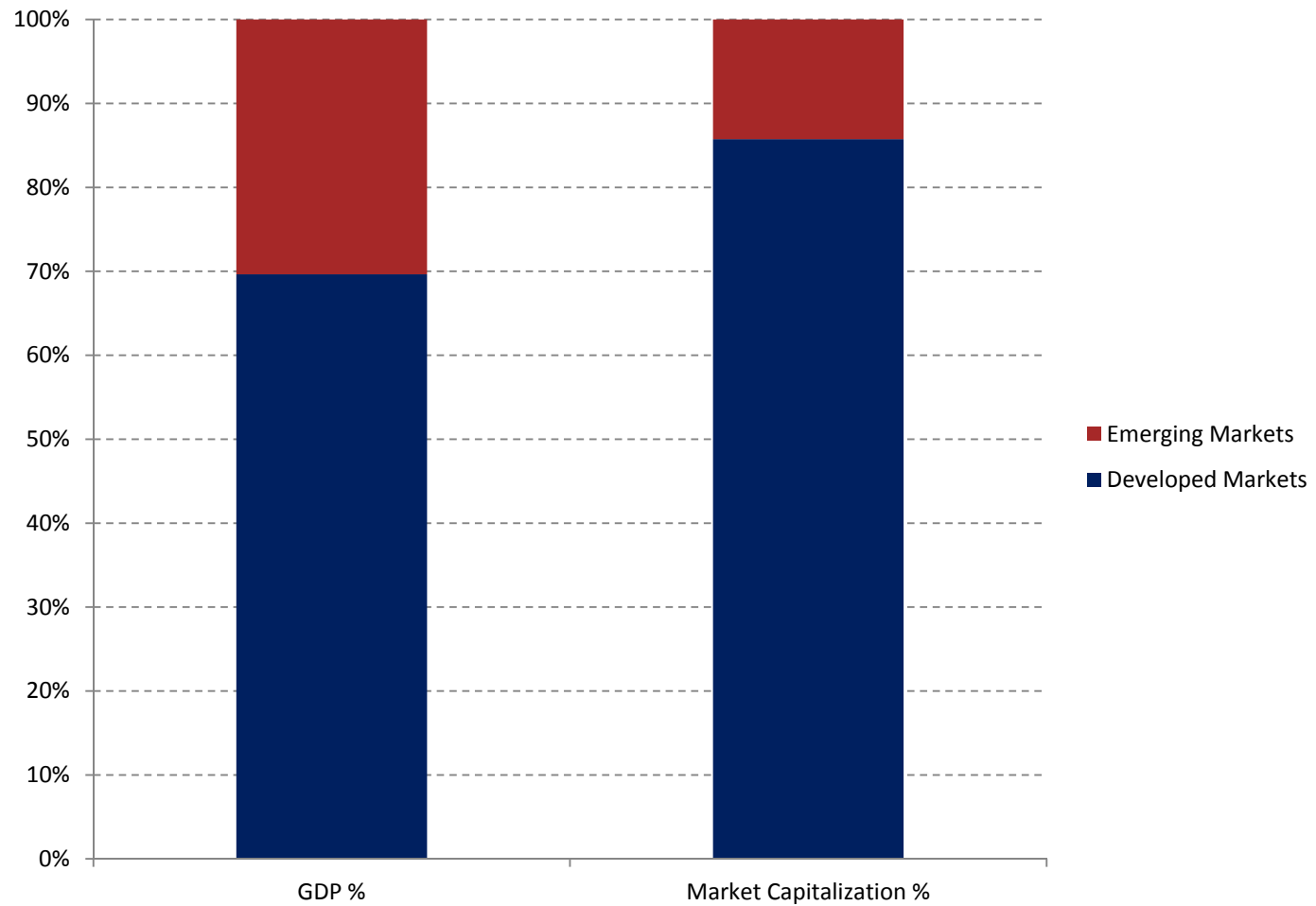


Source: Bloomberg



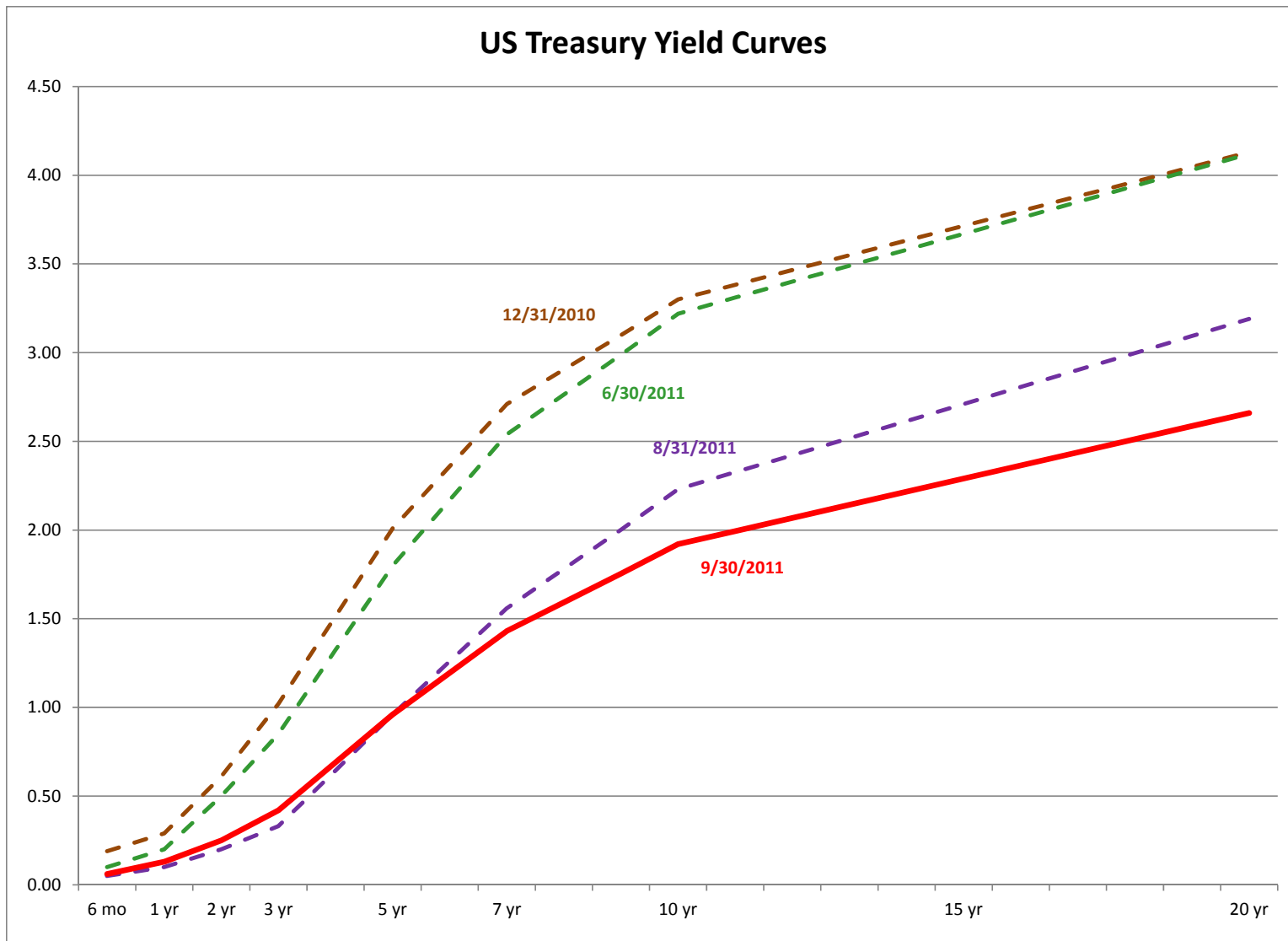


# Emerging Markets – Share of Global Economy and Markets

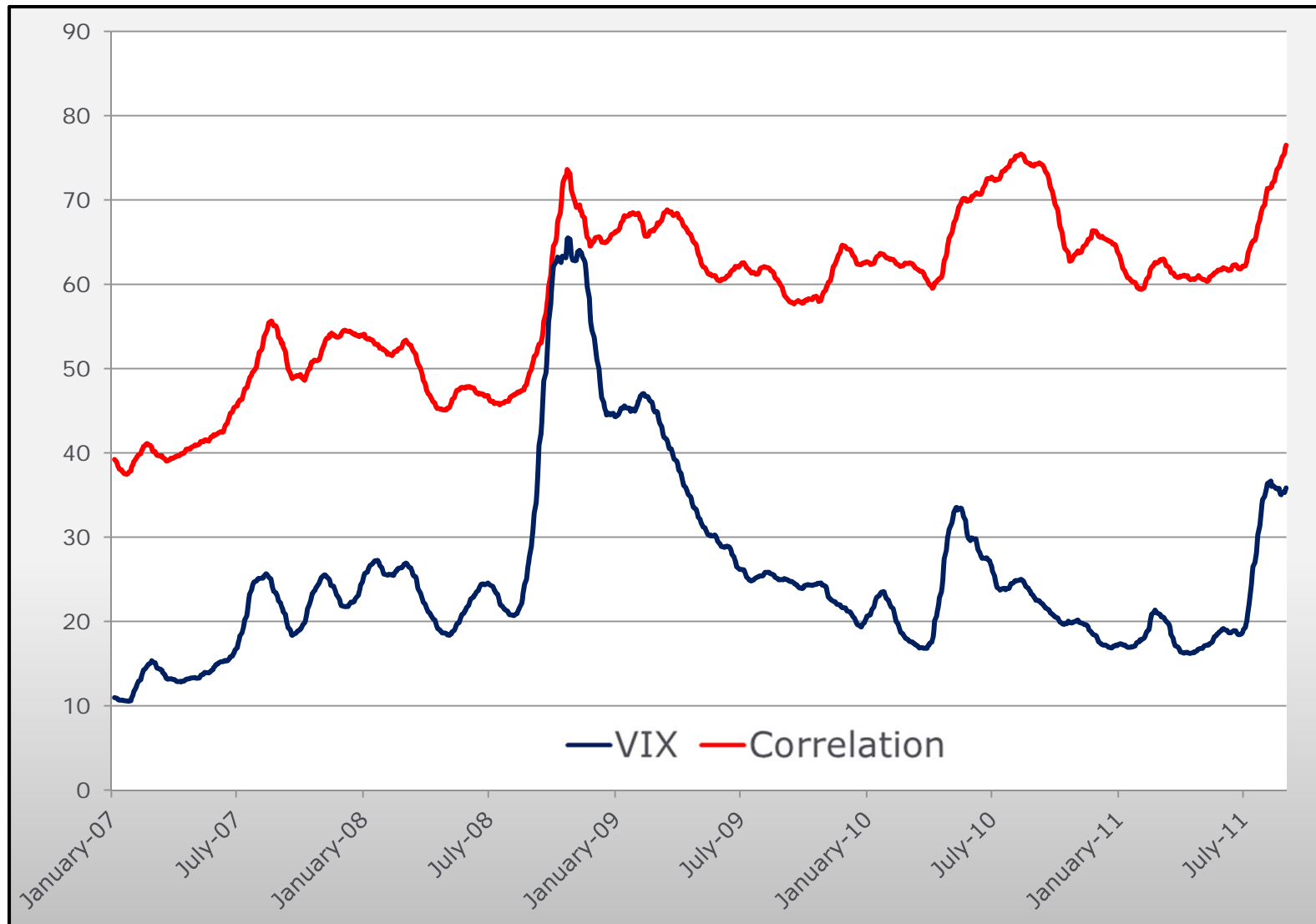


Source: Bloomberg

# "Operation Twist" Ready to Kick Off

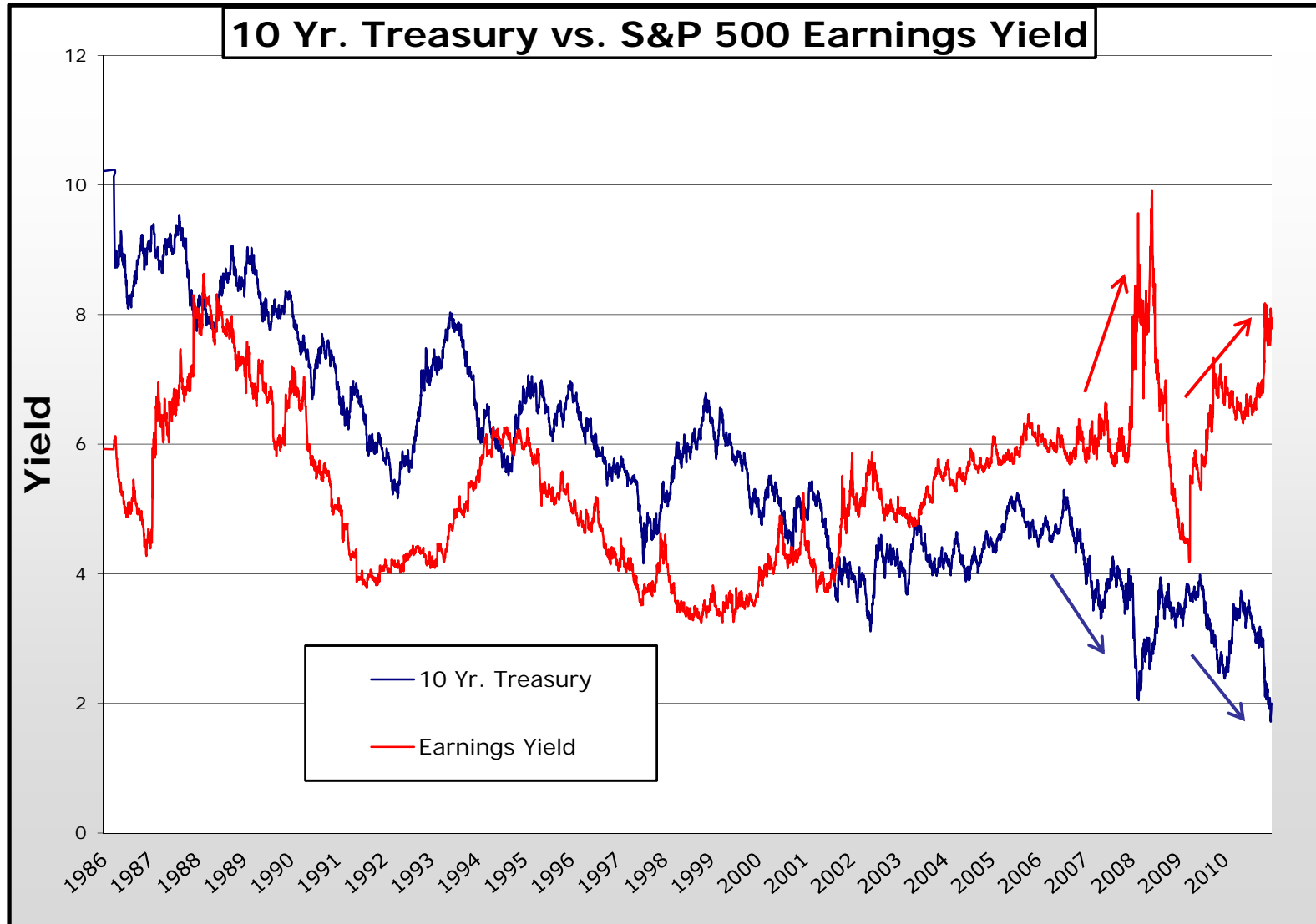


# US Stock Market Volatility and Dispersion



Source: OECD, Bloomberg

# Equity Risk Premium



## Evolving Crises: 2008 vs. Current Landscape

### 2008

- **Securitized/sub-prime credit crisis**
- **Major bank failure (Lehman) served as catalyst**
- **Major liquidity squeeze**
  - Over-leveraged financials/hedge funds
  - Short-term lending frozen (TED spread peaked at 467 bps)
  - Flight to quality = Treasuries
- **S&P 500 P-E (trailing) = 17.2**
  - VIX peaked at 80
- **Optimism priced in across markets leading into crisis**
- **Response to crisis – QE1 followed by QE2**

### 2011

- **Developed sovereign credit crisis**
- **Sovereign debt concerns and declining economic growth serve as catalysts**
- **Less leverage across system today**
  - Flight to quality = Treasuries and gold (?)
  - Reasonable liquidity and tighter money market standards
  - TED spread still low at 36 bps
- **S&P 500 P-E (trailing) = 12.4**
  - VIX at 40
- **Optimism priced into corporate earnings**
  - But growth and inflation expectations are tepid
- **Response to crisis – fewer fiscal and monetary tools available**

## Summary – A Challenging Market Environment

- **Key risks remain**
  - Slowing growth in US amidst political uncertainty
  - Evolving Euro-zone crisis
  - Threats to growth in developing world
- **Global challenges will likely lead to continued short-term market volatility**
- **Equity market declines and low bond yields are putting investors in a difficult position**
- **Nevertheless, the expected return premium for risky assets appears to be improving**

# Investor Actions and Opportunities

- **Maintain disciplined approach to investing**
  - Review the risks in your portfolios
  - Re-balance toward targets, essentially buying on the dips
- **Pursue opportunities in the current environment:**
  - Emerging markets debt and equity
  - Active strategies that can take advantage of macro-driven events
  - Less directional approaches to portfolio structuring, i.e. equity long short as an equity substitute
  - Distressed and event-driven strategies to take advantage of restructurings, particularly in Europe
- **Prepare to adjust asset allocation to reflect evolving relationships of risk and return**

# Your Questions