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1999 INVESTMENT CONFERENCE

5-7 MAY 1999

One hundred delegates attended the 1999 Investment Conference held at the Cameron House Hotel, Loch Lomond, between 5 and 7 May 1999. The Conference Committee, chaired by Mr George Henshilwood, had assembled a programme consisting of some 20 papers, many of which had been prepared by working parties set up at the September 1998 conference in Cambridge.

Following an opening introduction by Mr Fraser Low, President of the Faculty of Actuaries, a keynote address was given by Mr Keith Percy, Chief Executive of SG Asset Management, who considered the effects of the increasing concentration of fund management. He outlined the problems encountered by 'mega' managers, and explored the role of the more specialist management houses.

In the first plenary session of the conference, Mr Martin Cumberworth and the Portfolio Risk and Return Working Party demonstrated that there was no evidence of persistency in the levels of performance achieved by either institutional or retail United Kingdom equity fund managers over the period since 1988. A plot of relative performance of funds achieved in any 36-month period against the subsequent 36 months showed no evidence of correlation. Their conclusion was that the past gave no guide to the future, and was of no help in selecting investment funds.

The conference then split into two parallel sessions. In the first of these, papers were presented by Professor Robert Clarkson, by Mr Cumberworth and the Property Sub-Committee of the Investment Committee and by Mr Shane Whelan. In the first paper, Professor Clarkson outlined his trading model for equity stock selection and compared the performance of the selected stocks with the FTSE 100 Index during the 1998 bear market and the subsequent recovery. Analysis of the investor psychology underlying the observed differences in sector performance enabled him to propose a tentative index of 'market overconfidence', which might be used to predict imminent bear market reversals.

The property sub-committee considered the effect that adoption of International Accounting Standard 19 on the reporting of pension scheme funding costs might have on asset choice and, in particular, the prospects for property investment. They concluded that property was a valuable diversifying asset class that showed low correlations with equities and gilts. As a result of the new accounting standards, there would be an increased demand from pension funds for corporate bonds, and property shared many of the investment characteristics of this asset class.

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Mr Whelan's paper concentrated on the modelling of extreme returns, as demonstrated by a long-term study of the Irish stock market. This showed that standard Gaussian/random walk models did not adequately replicate the frequency of extreme movements in share prices, and that it was necessary to use other distributions, such as the *t* distribution, for this purpose.

The second parallel session considered three papers produced by the Financial Economics Working Party. Mr Andrew Smith looked at models used for valuing pension benefits linked to inflation by using analytical techniques for pricing caps and floors. Mr Shyam Mehta explored tax considerations when investing in a life company, and Mr Jon Exley considered the conflicting views that life and pensions actuaries took when pricing deferred annuity contracts. In each case, modern finance theory was applied in producing the results.

In the second plenary session of the conference, Mr Jeroen van Bezooyen briefly restated the conclusions reported by the Defined Contribution Pension Scheme Strategy Working Party in their September 1998 conference paper. Mr Smith presented a paper that applied agency theory to explain the approaches adopted by company managers in investing pension scheme assets. Mr Simon Jagger then presented a paper by Mr Ed Wilson that revisited the issue of active versus passive fund management to consider the costs and benefits of the alternative approaches.

In the final paper of the first day, Mr Gareth Derbyshire and the Institutional Investment Working Party looked at the performance of hedge funds, explaining the characteristics of the different types of funds and the results achieved by typical funds (both in terms of risk and return). Stochastic modelling suggested that U.K. trustees might wish to invest up to 10% of assets in a well-diversified portfolio of hedge funds.

The second day of the conference was opened by Mr Paul Seymour, Chairman of the Wider Fields Board. The keynote address was then given by Mr Tony Dye of PDFM, who analysed the performance of 'value' asset management strategies, and made the case for the adoption of such strategies in current market conditions. In the plenary session that followed, Mr Malcolm Kemp presented an updated standard on portfolio risk measurement and reporting that is being proposed for use by pension scheme trustees.

The conference then split into a second group of parallel sessions. In the first of these Mr Kemp and the Derivatives Cap and Collar Strategies Working Party presented a paper looking at suitable derivative-backed protection strategies for use by pension schemes. The Bond Portfolio Management Working Party then reported on supply and demand imbalances in the U.K. Government bond market and, in particular, how these contrasted with pricing evidence from swaps trading. The third paper in this session, from Mr Emmanuel Acar and Mr Pierre Lequeux,

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presented further evidence on the results achieved by active currency management.

The other parallel session focussed on 'wider fields' issues. Mr Iain Allen and Mr Seamus Creedon argued the pros and cons of financial services rationalisation between the banking and insurance industries. Dr Seth Armitage of Edinburgh University considered the effects of changes in United Kingdom taxation on the effective equity risk premium and hurdle rates of return for capital project assessment. Finally, Mr van Bezooyen presented an overview of agency theory.

In the final plenary session, Mr Mike Brooks introduced a review of behavioural finance theory being researched by the Faculty Investment Research Committee. The conference ended with a report from the Stochastic Investment Models Working Party, looking at the guidance that should be given to the actuarial profession in respect of the use and reporting of stochastic modelling techniques.

Copies of the papers presented will be published, and are also available on the profession's website. During the conference suggestions for further research were submitted by delegates, and working parties were set up to pursue these issues. The results of their investigations will be reported at the next Investment Conference, to be held in Bishops Stortford in June 2000.

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