

# Stress management

**Ashish Kapur** says trustees should use volatility as an opportunity



It is likely that volatility will dominate the markets in 2012 and it is important that trustees capitalise on the opportunities that this brings. This requires 'stress-testing' your portfolio to determine its sensitivity to different economic scenarios and identify the areas which trustees need to insure against, or at least have a plan of action for, should the circumstances arise. Markets move with such speed that improvisation after the event is simply not an option.

Taking bond yields as an example, the current yields on Over 15 Year Gilts are at their lowest for over a decade. Index-linked Gilts, which are often used to hedge the inflation exposure in pension schemes, are currently giving a negative yield. Will bond yields drop further... should we increase the hedge against further deterioration in liability values and when should we start buying bonds? No one can say for sure, but trustees of well-governed pension schemes will have rehearsed for such scenarios and will be armed with appropriate responses should they materialise. Stress-analysis on an average UK pension scheme's liabilities would show that if Gilt yields dropped a further 0.5%, the liabilities would increase by around 10%. Trustees not comfortable with this level of risk should look at hedging their liabilities. For those not wanting to lock into the current low bond yields, there are other ways of getting bond-like assets which have a higher yield such as infrastructure assets or timber land.

Other areas to consider setting triggers for include those around asset allocation such as timing the decision to move out of equities into bonds or alternatives. Portfolios should be positioned to exploit return enhancing or risk reducing opportunities. Accordingly, de-risking triggers can be set today based on future improvements in the funding level.

Whilst theoretically simple, the practice of undertaking scenario analysis and implementing its corresponding recommendations can be complicated. Many trustee boards meet infrequently; scheme valuations are undertaken intermittently and strategies are in some cases reviewed as little as every three years. This structure is ill at ease with the dynamic approach required to survive in today's fast-paced environment. Schemes faced with this dilemma may benefit from working with a strategic partner such as a fiduciary manager.

Ultimately, careful planning may provide for a smoother and more profitable journey across 2012. ■

*For more information about how your scheme could benefit from a Fiduciary Management approach please go to [www.seic.com/institutions](http://www.seic.com/institutions).*

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