

Outlook for Volatility in 2013 and beyond: What uncertainties should we look to hedge?

Volatility and Tail Risk Investment Conference

May 2013

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An audience question to start...

- Of the selection below, which do you believe is the greatest risk to global financial asset pricing for the next 6-12 months?
 - 1) **US QE** - a clear tapering of QE
 - 2) **Global Growth** - QE continues, but growth weakens to sub 1% in US and 2% globally
 - 3) **Eurozone** - growth fails to stabilise and banking union is delayed
 - 4) **China** - sees implied sub 7% growth print
 - 5) **Japan** - Abe/LDP fail to secure Upper House control and '3rd arrow' of reform hopes diminish

An audience question to start...

- Of the selection below, which do you believe is the greatest risk to global financial asset pricing for the next 6-12 months?

1 - US QE | 0%

2 - Global Growth | 0%

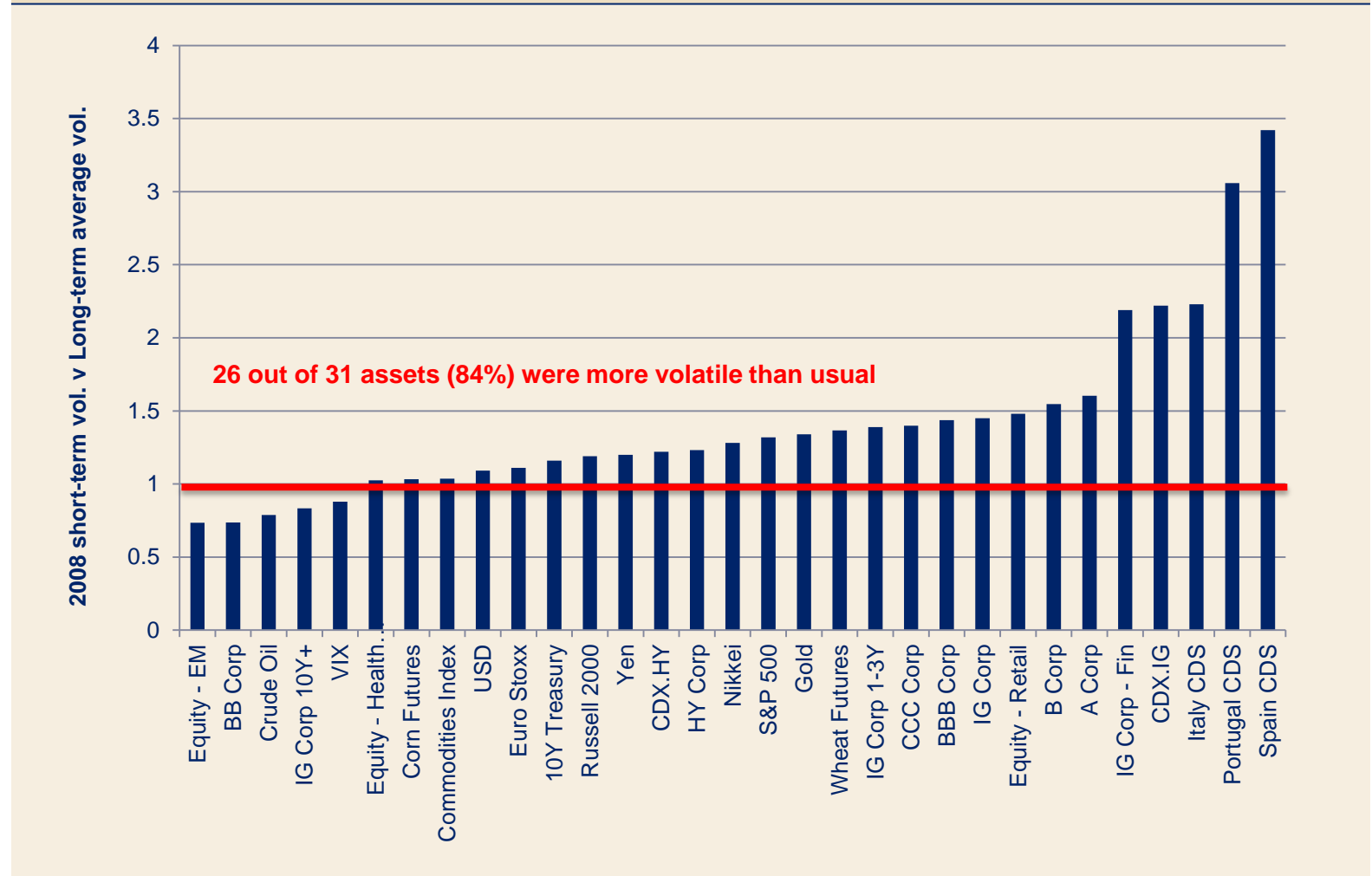
3 - Eurozone | 0%

4 - China | 0%

5 - Japan | 0%

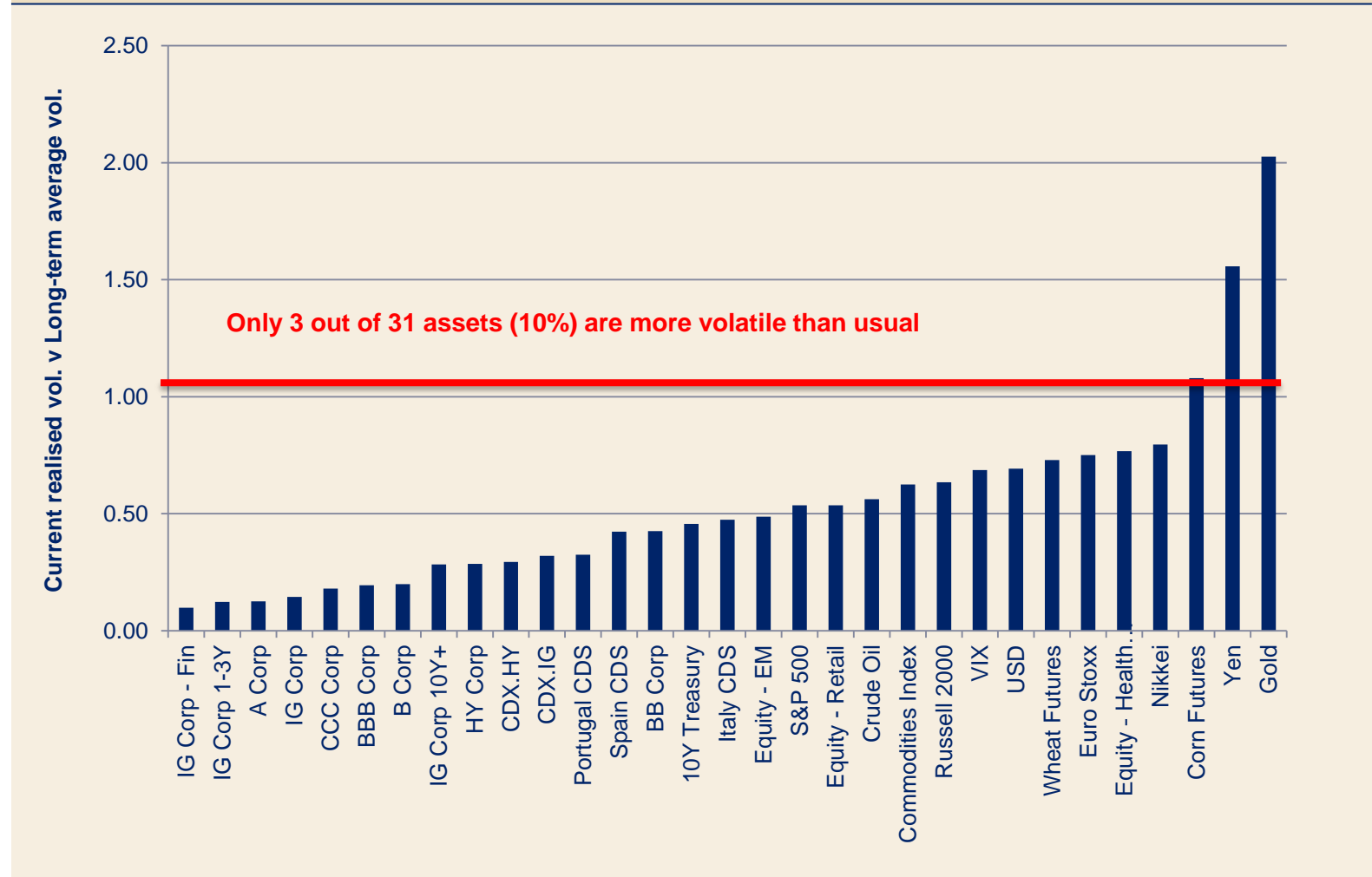
A brief snapshot on sentiment and pricing – then...

2008 – Ratio of short-term volatility to the long-term average vol.



A brief snapshot on sentiment and pricing – and now...

2013 – Ratio of current realised volatility to long-term average vol.



What is volatility potentially telling us?

- Non conventional monetary policy has been successful (to date)
- Yield curve manipulation is working
- That returns will be low
- A new breed of 'risk free' asset(s)

Which risks should we worry about in coming years?

- Economic
- Political
- Regulatory
- Corporate Taxation
- Counterparty
- Liquidity

The potential to create economic volatility for some time yet...

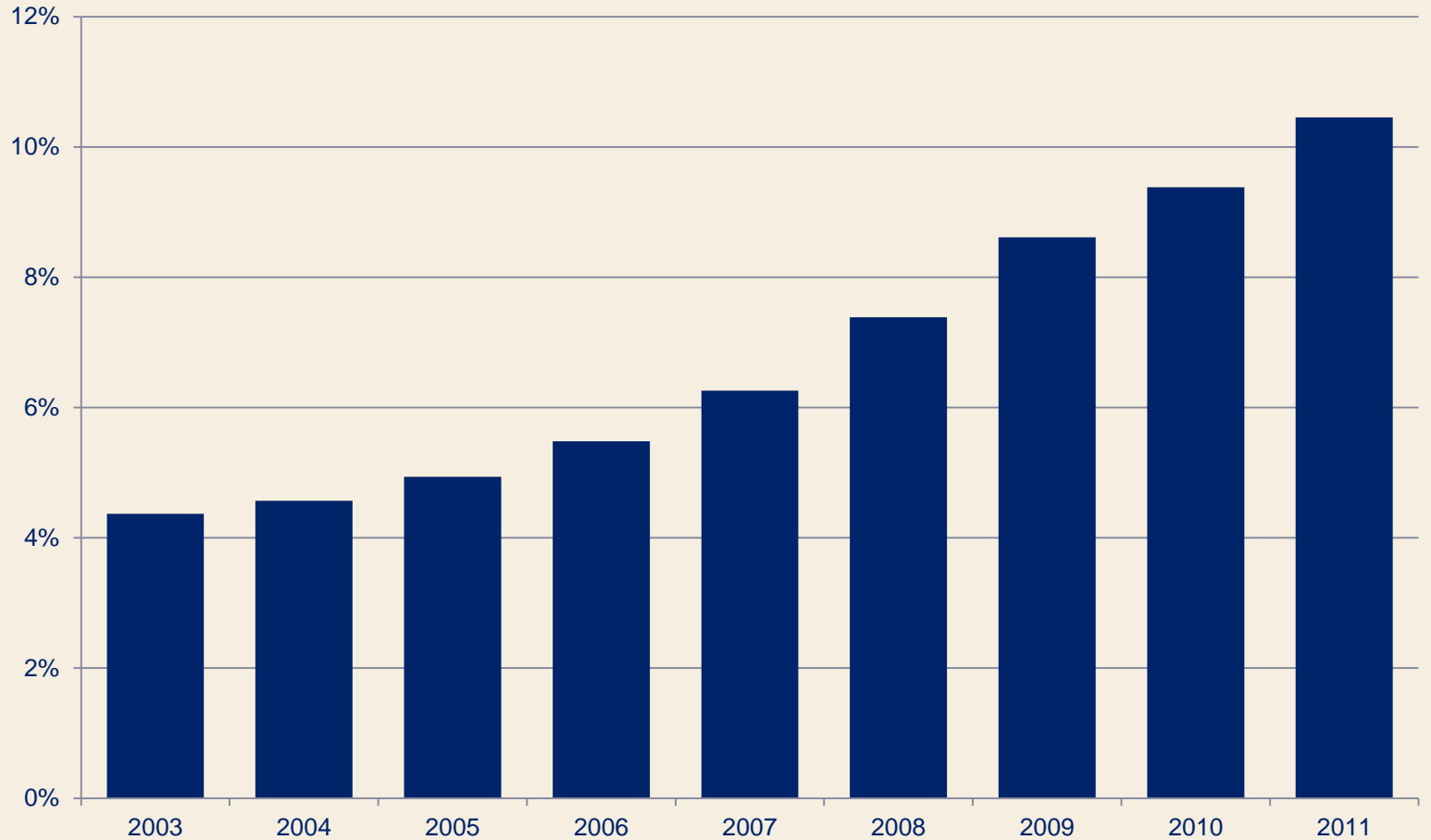
Economic risks

Economic in brief...

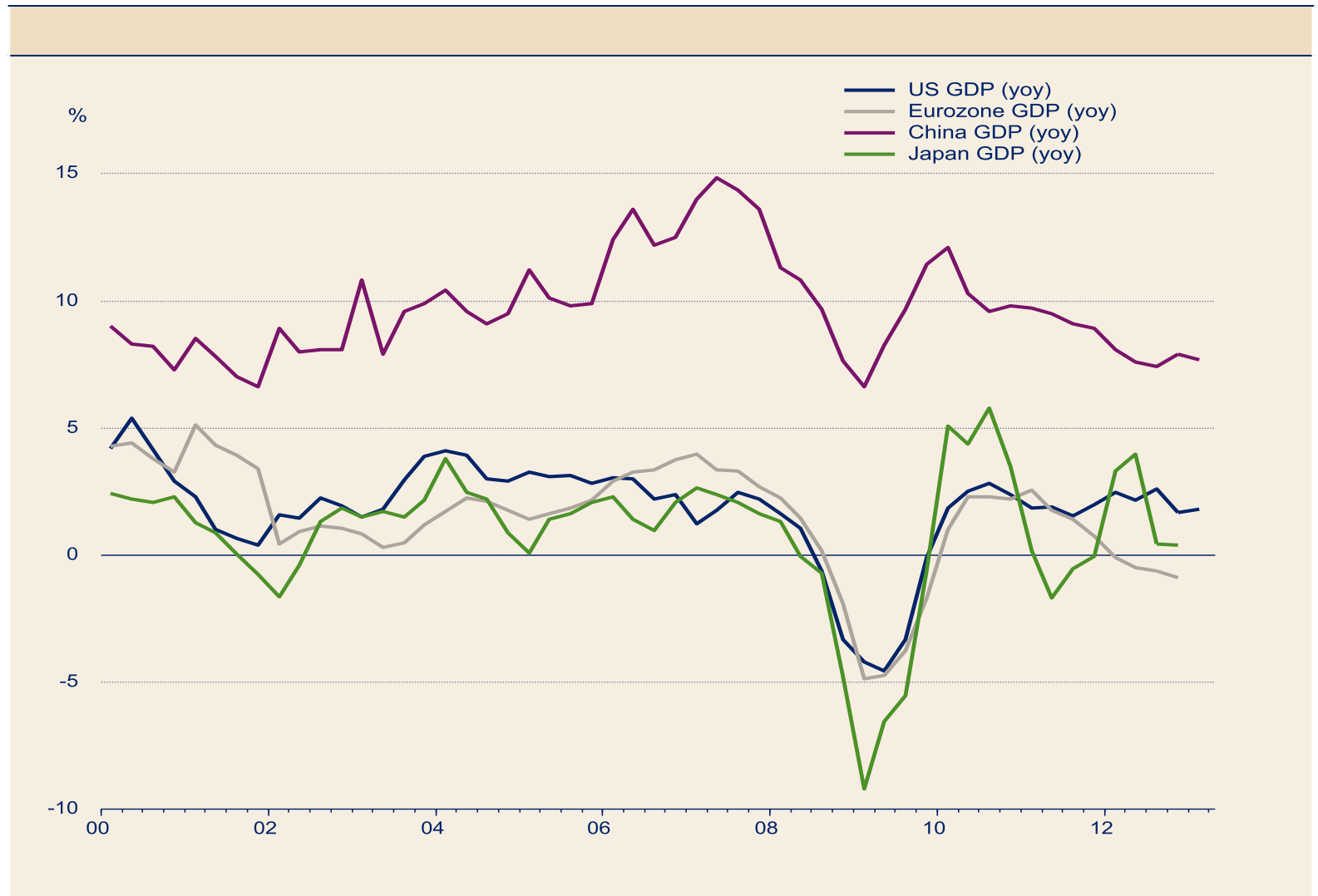
- China – too big to ignore for growth
- Global money supply – where is the velocity?
- US – the housing ‘engine’, stalling again...

China – ever more important

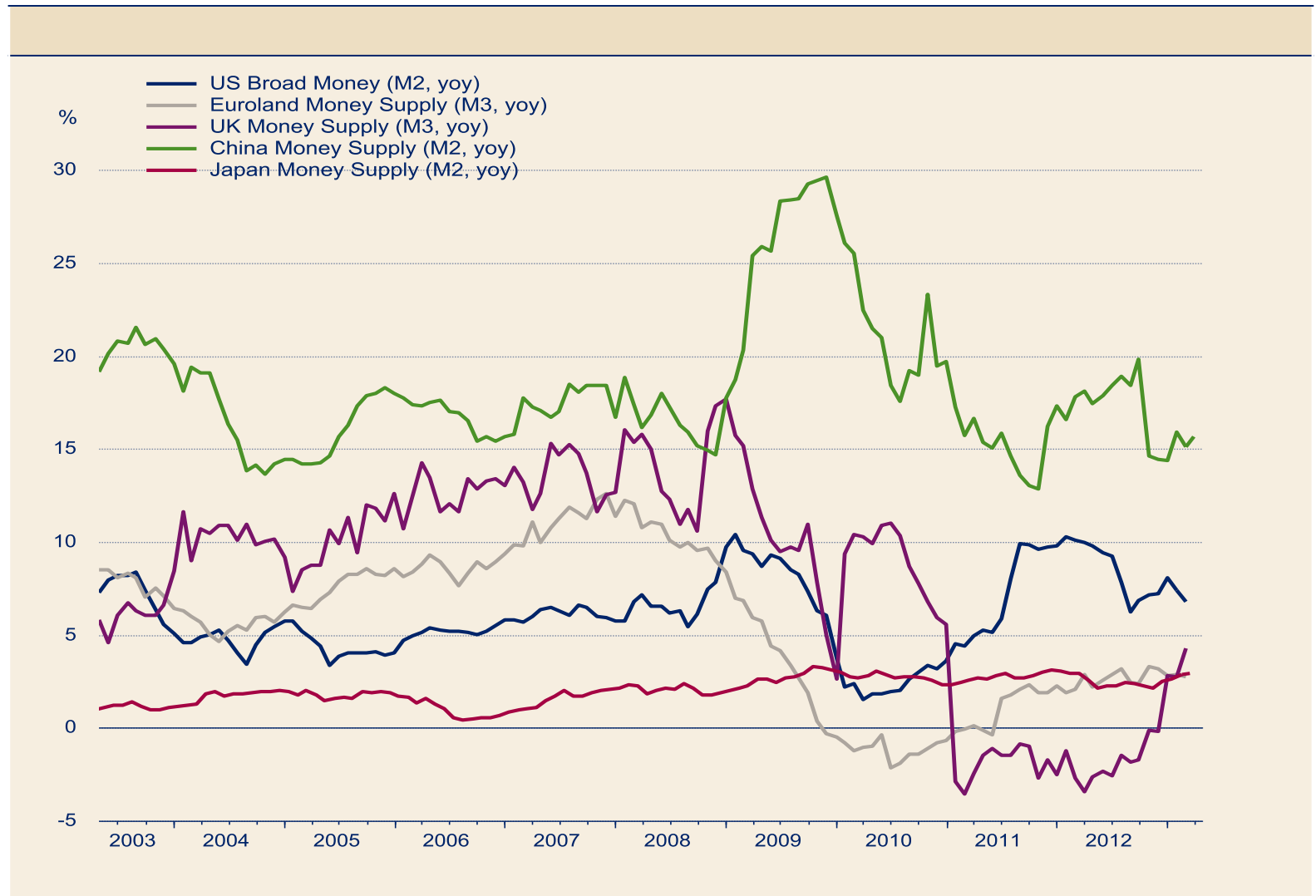
China as % of Global GDP



Global GDP Growth



Global Money Supply



Source: Datastream, Apr 13

The great hope for self-sustaining US growth...

National Association of Home Builders Traffic of Prospective Buyers SA



Source: Bloomberg, Apr 13

Lumber Price – a lead indicator turning down...

Lumber Price leads the US housing market activity



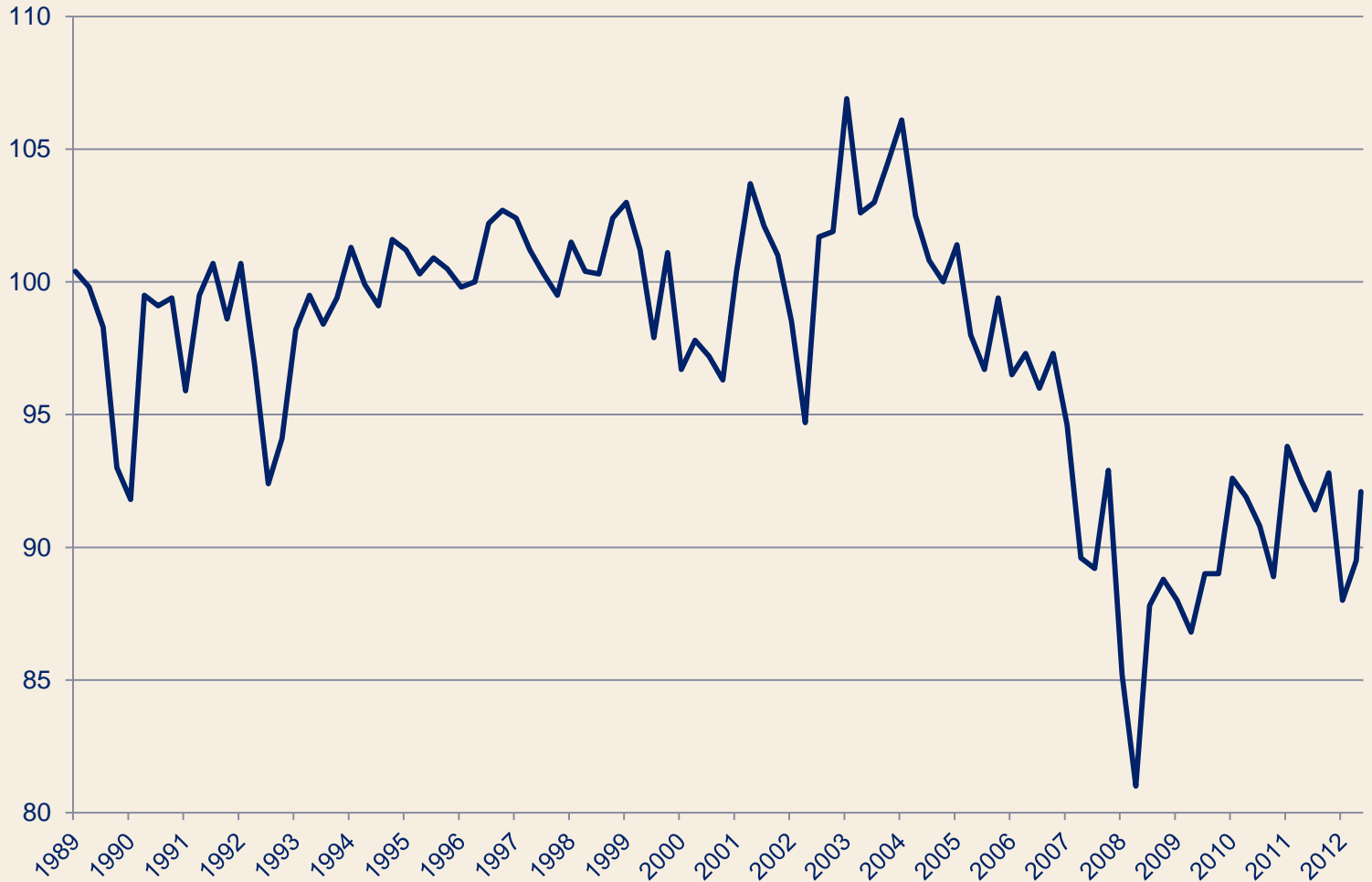
Political risks

Political in nature

- Elections
- Fragmentation of electorates - Italy just a start?
- Policy setting fragmentation (US/EZ)
- 'Affordable Healthcare Act'
- Relative risks rising, markets no longer pricing...

Small businesses are the lifeblood of any economy

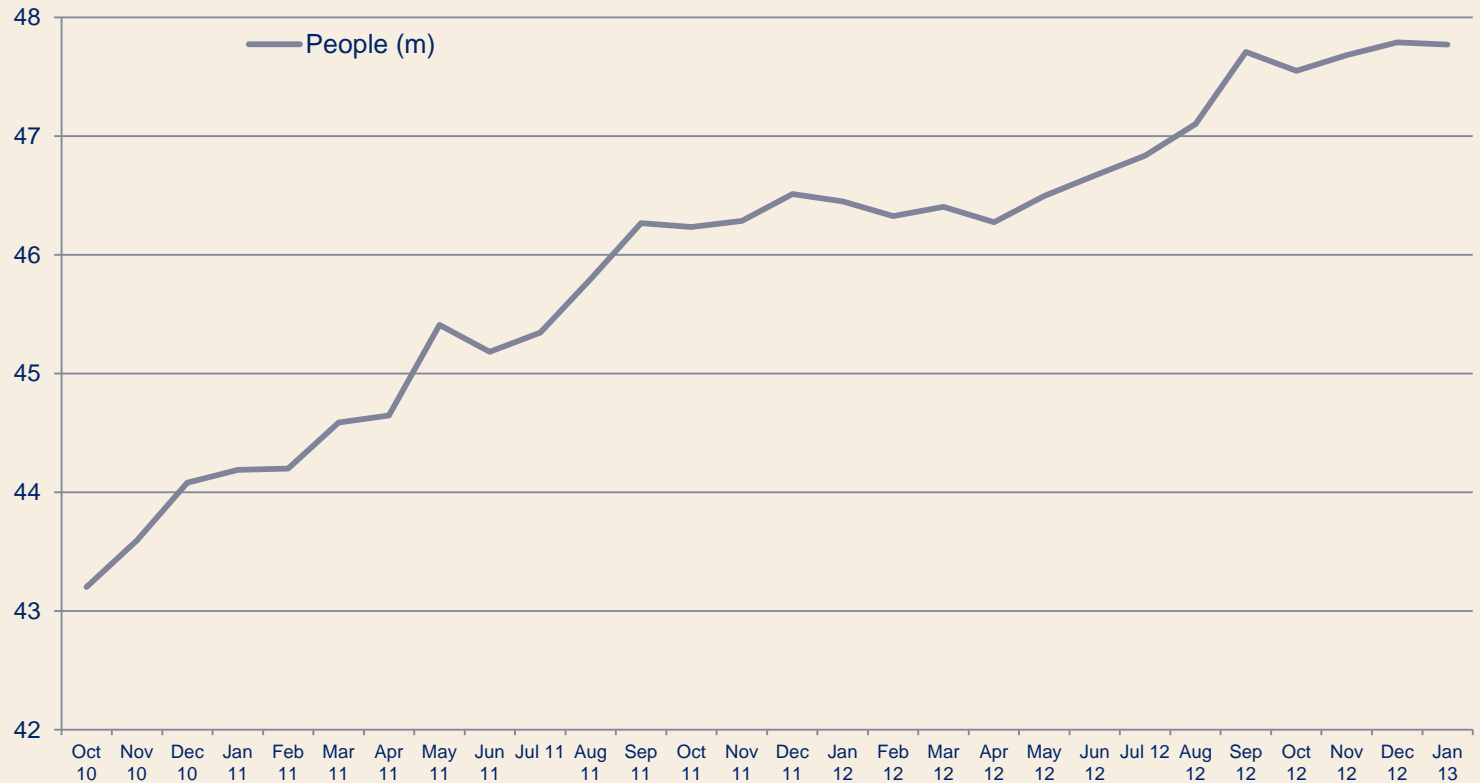
NFIB Small Business Optimism Index



Source: Bloomberg, May 13

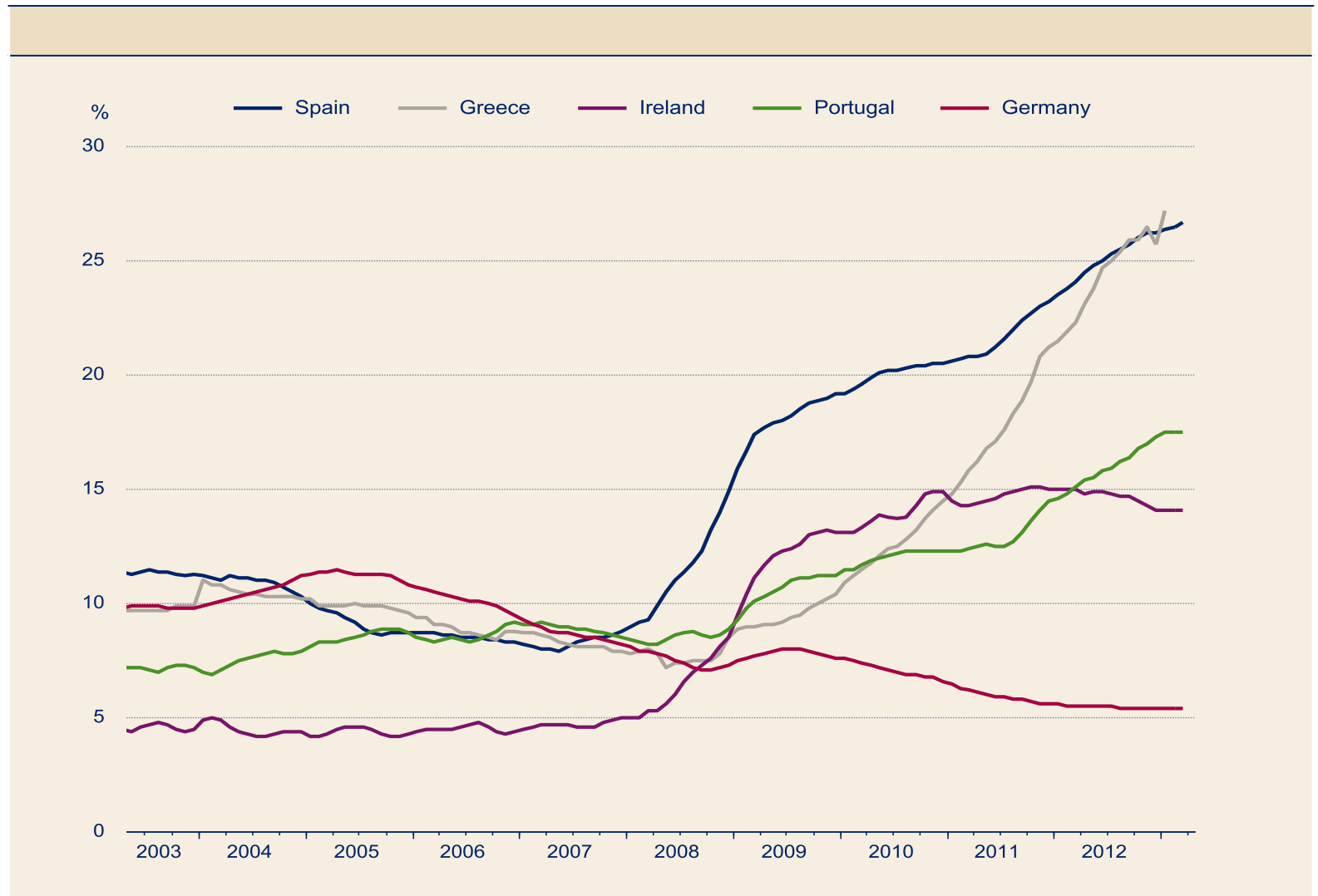
Welfare costs in US rising

No. of people in US receiving food stamps



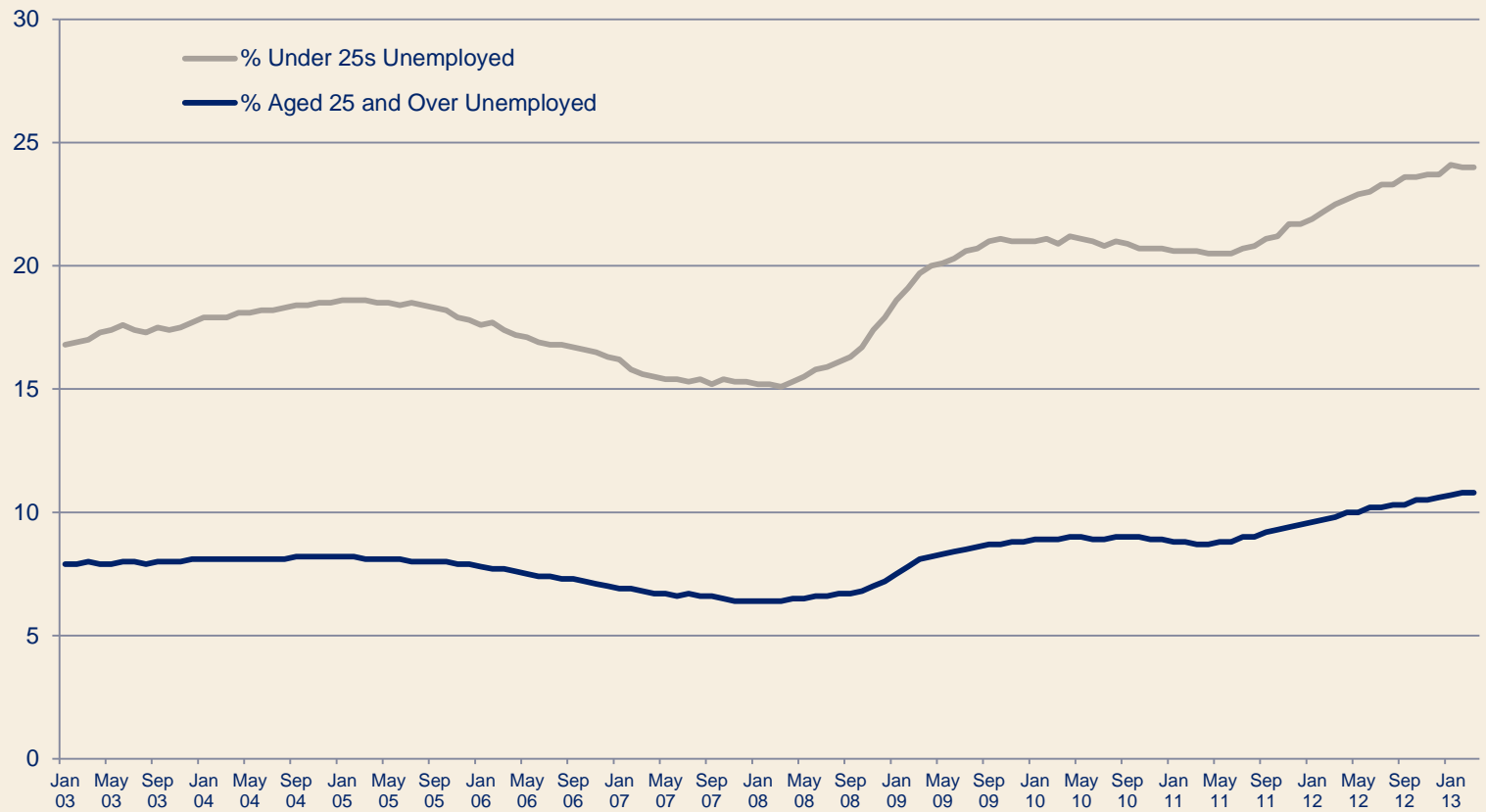
Source: USDA Food and Nutrition Service (Data as of 5 April 2013)

Eurozone Unemployment



Eurozone Demographic Issues

Unemployment a youthful problem



Does this reflect the real risk?

Spreads of 5Y Generic: BTPs/Bunds and Bonos/Bunds



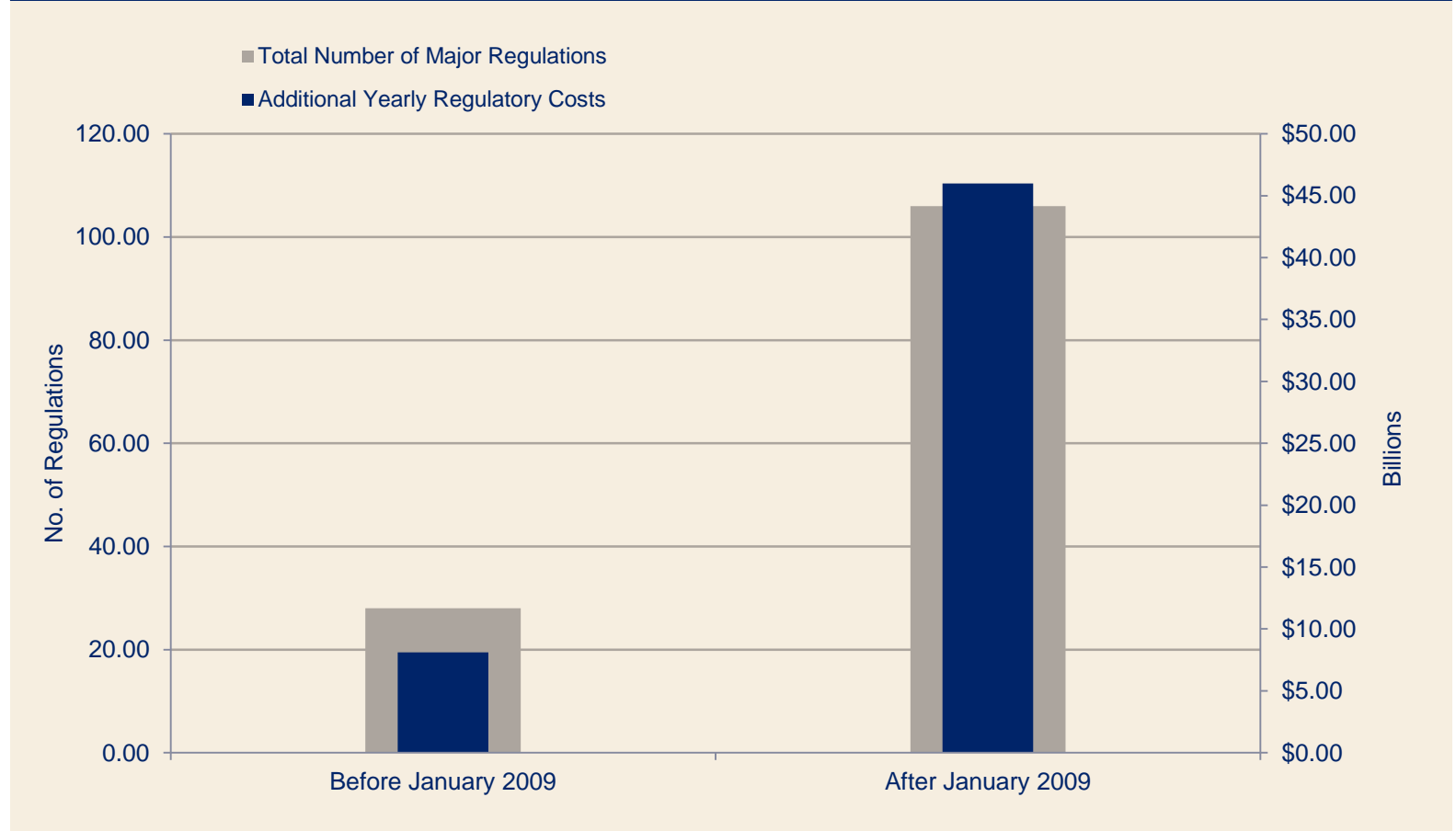
Regulatory risks

Regulatory environment still a 'bull' market

- Where is the greatest risk on implementation?
- Solvency II, Basel III, AIFMD, UCITS V/VI ad infinitum, Dodd/Frank, FTT
- US, Europe or Asia
- Costs and consequences

Regulatory costs increasing

Impact of increased US Regulation

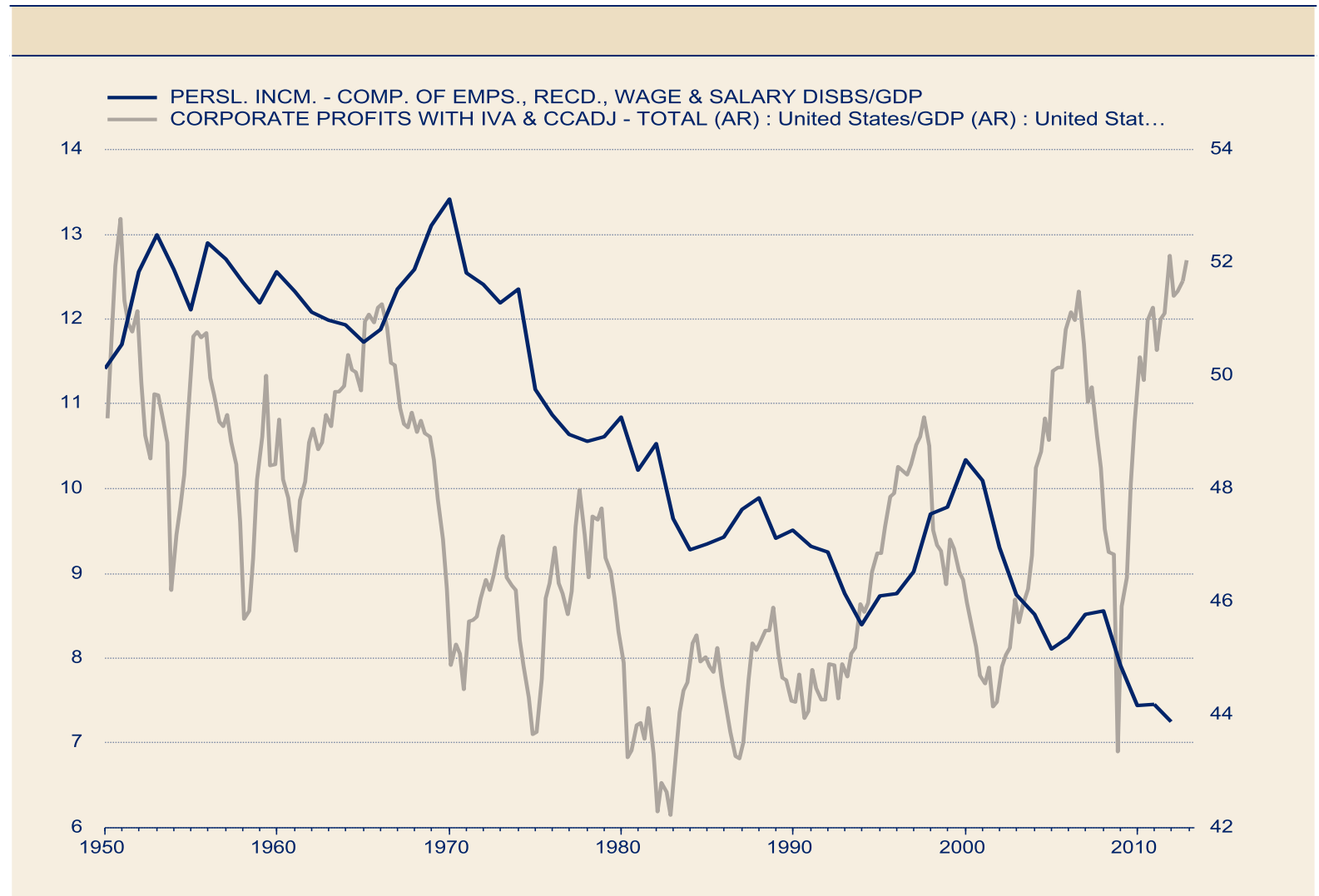


Corporate taxation

Corporate Taxation – the pot not yet raided...

- The next target for government coffers...
- Who are the next villains...?

Corporate profits as percentage of GDP



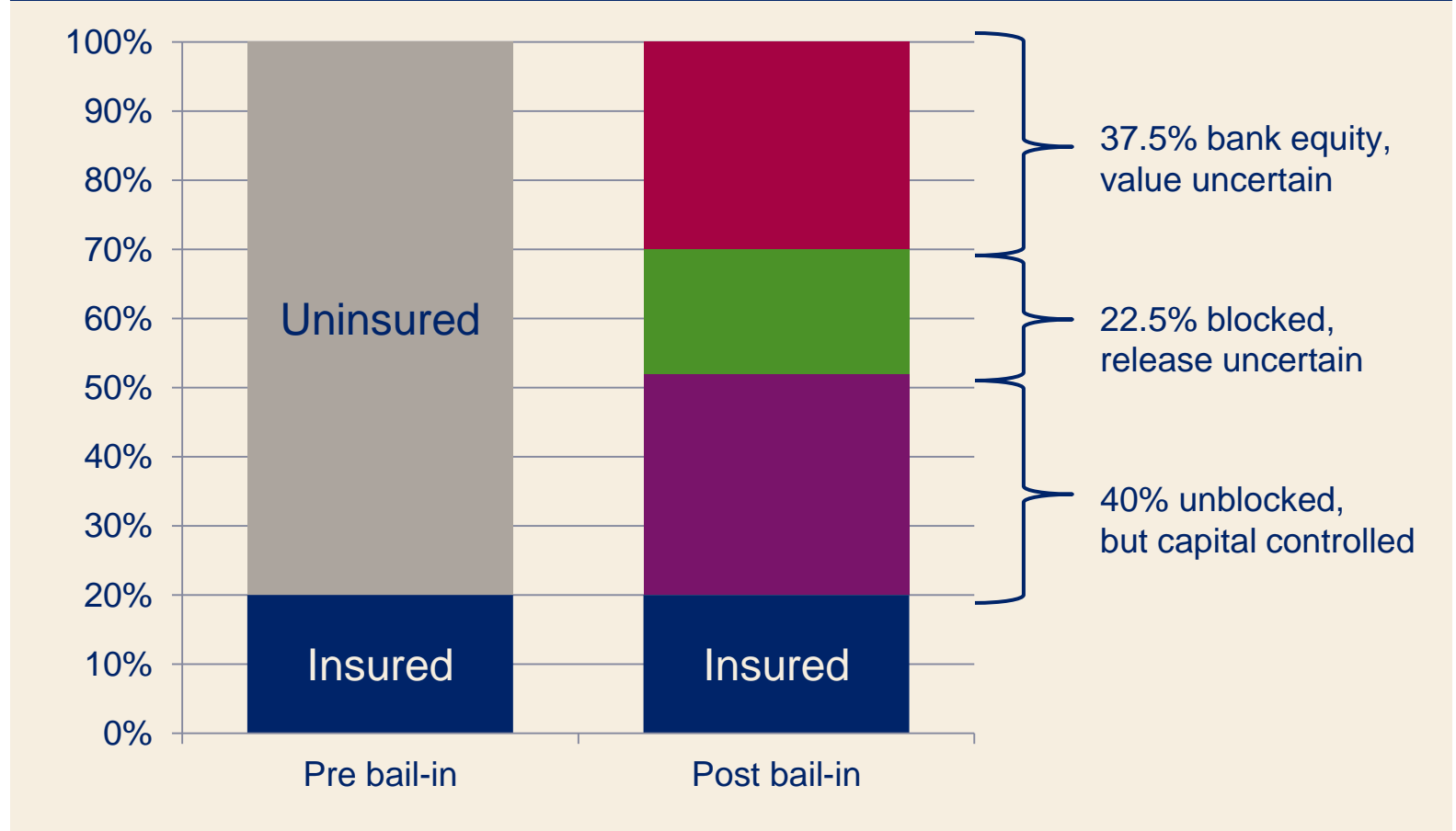
Counterparty risks

Counterparty concerns

- Cyprus has changed the playing field...
- Did someone mention the Co-Op, and what about the Spanish banks?
- Fed/IMF Collateral Reports – is the system functioning?
- Holding securities suddenly looks safer!

Cypriot bank deposits

Probable returns on a €500,000 deposit before and after bailout.



Liquidity risks

Liquidity

- Perceptions have improved, but how stable is liquidity provision...
- Collateral and margining
- Capital commitment
- 'High Frequency Trading' – ethereal liquidity?

In conclusion

- Volatility levels look low in a number of markets
- However, consider and identify what the real risks are to you and your investments
- Clarify what could lead you to a permanent loss of capital and minimise or avoid...
- If your assessment of the risks is inconsistent with market pricing, consider actively incorporating targeted tail risk protection



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A final question...

On reflection, do you feel:

- Optimistic - and want to embrace opportunity

Press 1: 

- Uncertain - and worried about the challenges ahead

Press 2: 

A final question...

On reflection, do you feel:

1 - Optimistic | 0%

2 - Uncertain | 0%

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