

I want to start with five simple observations about the inflection points of our industry. I am mostly using US data here for the simple reason that we have a sixty year history of statistical financial data from the US Federal Reserve, which we do not have for instance for the Euro.

1. Interest rates

In 1979, the Fed Funds rate peaked at 16%. As you know, it reached zero at the end of 2009. It took thirty years to go from the top to the bottom. On the other side, the last previous low had been reached in October 1941 – the month before Pearl Harbor – at 1%. So the Fed Funds rate went from 1% up to 16% and then down to zero, over a period of seventy years. Interest rates move in long cycles. They do not follow economic cycles, but social cycles.

In October 1979, Paul Volcker became chairman of the Fed. He started the interest rate downward trend. As we know, if interest rates go down, all asset classes go up. Indeed, from late 1979, they went up at accelerating speeds. We had a massive growth of financial assets, globally. Recently we all saw the bubbles burst in the highly leveraged housing market, not only in the US, but in Canada, Europe and Asia as well.

From 1950 to 1980, debt increased less than GDP. Then debt growth started to overtake GDP growth. In the 1980s it was two dollars of debt for one dollar of GDP, in the 1990s, it was three dollars of debt for every dollar of GDP, and in the last final blowout the ratio was 5:1. That is the first point to keep in mind: We are at one of those major turning points that are very rarely seen in the history of a human lifetime.

2. Inflation or deflation?

Are we heading towards inflation or deflation? Everyone is discussing this right now, and our two panelists will have interesting views on it, too. The statistical figures seem clear: There are predictions about an average annual inflation of 2% over the next thirty years. The ten year US Treasury Bond yield is right now at 3.2%. The German ten year Bund yield is at 2.6%. That does not look much like inflation.

But look at the dividend yields of Johnson & Johnson, or Coca Cola, or Nestlé, or similar cash-rich companies. They are all paying about 3% to 3.5% dividends. 2010 is the first year since 1958 where dividends of large cap corporates exceed government bond yields. Before 1958, we did not have the concept of "growth companies" that typically do not pay out dividends but invest all their profits into further growth. Today, the investor demand is such, that these companies pay very high dividend yields, relative to the government bonds. It was normal through most of financial history that equities were a risky asset class that had to pay more than a bond, not less than a bond, as was the case in the last years until now. So, the second point to note is that we are about to go into a different paradigm between equities and bonds.

3. Shifting locations of global economic growth

2009 was the first year in history where in key categories of demand (e.g. cars, mobile phones, steel, electric energy, coal) consumption was higher in the emerging markets than in Europe and the US. Economic growth is now strongest in the emerging markets. Western winners are companies like Coca Cola or Unilever that essentially grow with those emerging markets. They are the ones going to pay the high dividend yields. They are very cash-rich and, in principle, they do not need banks anymore. Keep that in mind when you want to invest!

Many people do not know that this year, we have 4% global growth, which is the 6th best year in human history. In the 1990s, 3% global growth was considered high. The reason for that was, even if China claimed that their growth rate was 8%, they were still a small economy. Today, the Chinese economy is bigger than Japan's and it overtook France and Germany several years ago. So, the third point to make is that the global growth dynamics and dimensions have changed dramatically. That of course must affect a fund manager's asset allocation.

4. Demographic changes and unfunded pension liabilities

In 2011, the first baby boomers (i.e. those born in 1946 and later) will turn 65. In the US, every year for the next 19 years, 4.5 million people will collect social security, and the US government is fully responsible for their health care. That is a 63 trillion dollar unfunded liability. The dependency ratio (working vs. retired people) keeps getting worse. Today, there are four working people for every retired citizen. Fifteen years from now, only two working people will have to support one retiree. And if we live ever longer, that unfunded liability goes up. Many corporate issuers today have better credit default swap rates than governments do. The principle reason for that is: Corporates do not have to pay for "Joe on the beach"! If you have to pay for "Joe on the beach" and your liabilities are unfunded, that is real debt and that will be reflected in the CDS rates.

5. Changing investment time horizons and investment dynamics

When people reach their retirement age, they don't worry so much about a long-term investment view anymore. Their personal time horizon is not 30 years anymore. They move from asset accumulation to income. An increasing percentage of their invested assets will change from long-term to relatively short-term durations. If you are seventy years old and you lose a lot of your savings, you will not be able to make it up anymore, nor is your pension fund able to do it, if it happens to it. So the buying behavior of a private investor or his pension fund is changing. The first change is the one from asset growth to income orientation. The second change is a restructuring of pension plans. Many pension plans are still based on assumed returns of 8% per year. What are those assumptions worth in the current reality, when the market delivers only 3%? If you raise the level of contributions to cover the difference, you have an unsustainable tax burden on the contributors. That must cause changes in investment product design, changes in what pension plans can do for you. It changes the way we think of performance. We think of performance as Alpha and Beta, with Beta being the index return. Exchange Traded Funds (ETFs) deliver cheap Beta; this is now cheaper than any passive investment product that fund managers offered a few years ago. There are surveys predicting that soon more than half of all market exposures will be through ETFs. If that is true, that will dramatically change the entire dynamics of the investment management business. Again: a clear sign that we have reached an inflection point.

Our two panelists have very different views on how to approach all of these observations. How do they approach their asset allocation challenge, in a world where nothing seems safe anymore?