Government Actuary's Department

INVESTMENT NEWS

*MONTHLY NEWS BULLETIN*
*FROM THE INVESTMENT AND RISK TEAM*

02

2 May 2014

# MONTHLY UPDATE

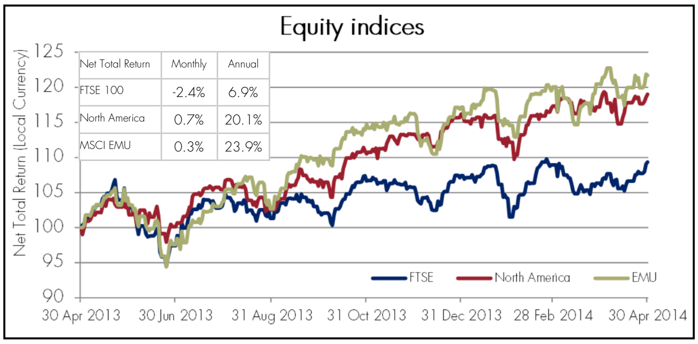
## Overview

The UK economy grew 0.8% in the first quarter of 2014 according to ONS - lower than the 0.9% predicted. The growth was largely driven by Britain's services sector, which accounts for more than three quarters of UK GDP. This development marks the fifth consecutive quarter of steady growth. Unemployment also fell below 7% in February this year for the first time since the recession.

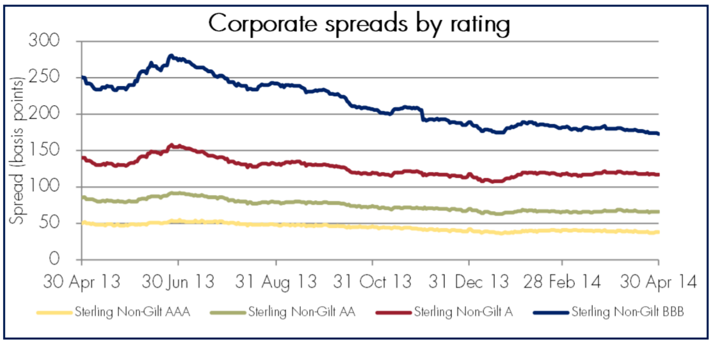
The news followed the announcement made earlier in the month by the ONS that rises in weekly earnings have finally caught up with inflation. Weekly wages, including bonuses, rose by 1.7% in the year to February which was also the rate of CPI over the same period. The headline rate of inflation for March came in at 1.6% which was the lowest rate in more than four years and below the Bank of England's 2% target.

Overseas developments include Tokyo's consumer prices rising at their fastest pace in 22 years, surging 2.7% from a year earlier. The data comes after Japan increased its sales tax to 8% from 5% from 1 April, pushing up prices.

### Equity markets saw mixed returns during the month




### Credit spreads were largely unchanged over the month

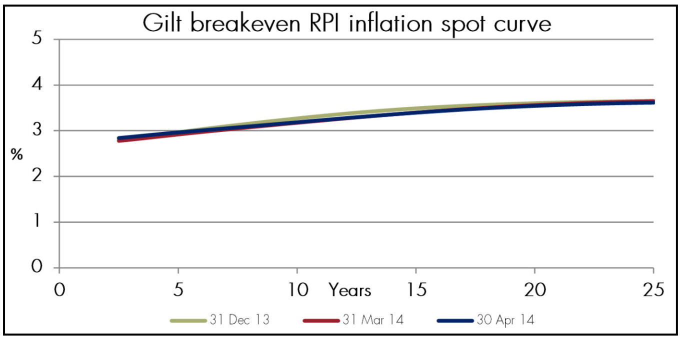



## LATEST ECONOMIC NUMBERS

| | |
|---|---|
| Current base rate | 0.5% |
| Quantitative easing level | £375bn |
| CPI increase March (%y/y) | 1.6% |
| Halifax house prices March (%m/m) | -1.1% |
| IPD TR property index March (%m/m) | 1.6% |
| PPF 7800 funding ratio | 94.3% |
| VIX (volatility) index | 13.41 |
| $/£ exchange rate | 1.69 |

Numbers as at the end of month unless stated

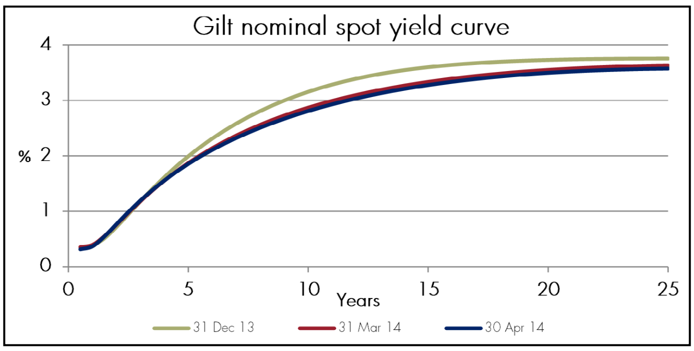
### Breakeven inflation was largely unchanged this month



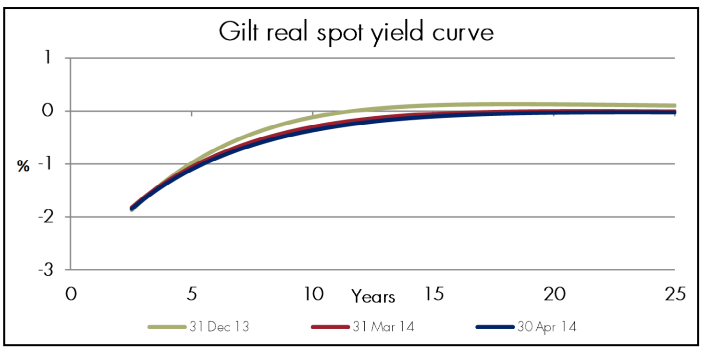

## CALENDAR OF EVENTS AND DATA RELEASES

| | |
|---|---|
| MPC interest rate announcement | 8th May |
| Inflation Report | 14th May |
| Producer Price Index | 14th May |
| Minutes of MPC meeting | 21st May |
| GDP Forecast | 21st May |

### Nominal yields are largely unchanged this month




### Real yields are largely unchanged this month




All chart data sourced to Bank of England, Merrill Lynch, Financial Times, MSCI & Standard and Poor.

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# Institutional Investments in Infrastructure

## What is infrastructure?

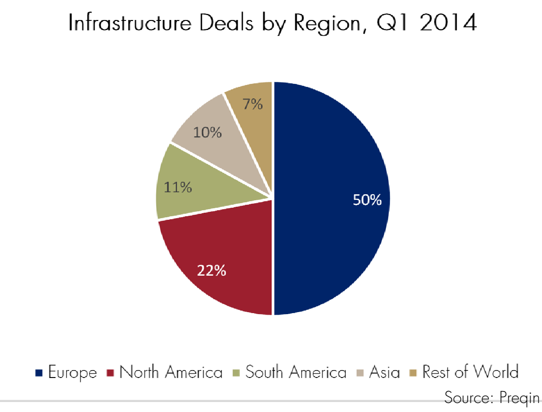
Infrastructure investing is a relatively new and fast growing sector within institutional investor portfolios. Generally speaking, infrastructure falls into two broad categories: economic infrastructure and social infrastructure. Economic infrastructure covers energy, utilities, transport and communications – so typically includes investments in toll roads, airports, energy distribution and cable networks. As its name suggests, social infrastructure covers investment in community facilities, services and networks such as schools, hospitals, prisons and even parks. Infrastructure projects are an integral part of our society and provide opportunities for investors.

## Methods of gaining exposure

Investment is either made into the debt or equity of an infrastructure project, with institutions commonly choosing to invest through professionally managed funds. This allows access to the returns of infrastructure investment with little in-house expertise, as well as increasing diversification and enabling access to larger projects. There is also the potential to benefit from further diversification by investing in funds consisting of a number of smaller funds. Alternatively, indirect exposure can be gained by buying shares in companies specialising in infrastructure. This allows access to the returns of infrastructure investment but also enables an exit route if required.

Direct investment in infrastructure projects is uncommon as it requires a high level of risk assessment as well as the need to help manage the project.

### Box 1 — Infrastructure Investments




Break down of infrastructure investments by region. Europe leads the way with 50%

## Investment characteristics

The characteristics of the infrastructure depend critically on whether the investment is through debt or equity, but are typically characterised as long term that provide inflation adjusted "real" returns. The cash flows are generally regarded as stable and so are usually preferred by long term investors. Investment in infrastructure may be appealing to investors as it offers returns uncorrelated with other market assets. The return may be dependent on the success of the project and so be based on factors the institution is not yet exposed to. The downside to investing into these unique projects is that there is limited secondary market, which can introduce potentially undesired levels of commitment.

## Issues with investing

The traits of infrastructural investment may suggest that it would be a popular choice for pension schemes and institutional investors. Perhaps surprisingly, this is often not the case with less than 1 percent of pension provision allocated towards it. There are likely to be several reasons for this, the first of which is the lack of capacity or expertise required to assess and quantify risks involved with infrastructure investments. As a result, schemes may prefer to invest in assets with an established income steam and so avoid the risk of funding an unsuccessful project. In addition to this, the absence of a clear benchmark may make it difficult for Trustees to monitor performance.

## Recent market developments and government encouragement

Despite these challenges, low yields on sovereign and corporate debt and equity market volatility can make infrastructure investments appear attractive to institutional investors. In addition, banks have reduced the level of funding they provide to infrastructure projects over the past few years as they look to deleverage their balance sheet and due to Basel III requirements to hold more capital against such loans.  As a result, institutional investment in infrastructure has increased dramatically in the last few years. Issuance of infrastructure bonds reached €7.51 billion in Europe last year compared to €1 billion in 2012 (source: Dealogic) with the market being boosted by significant demand from pension funds and insurance companies.

In the 2011 Autumn Statement the Government announced the intention to encourage up to £20 billion of private sector finance for UK infrastructure over the following decade.  As a result of this announcement the Pensions Infrastructure Platform (PIP) was introduced in 2012, supported by the NAPF and PPF, with the intention of providing an appropriate platform for pension schemes to access infrastructure investments.  The PIP has recently announced its first fund, the PPP Equity PIP Limited Partnership, which already has £260m of funds committed from various institutional investors and has purchased a stake in a holding company consisting of 13 infrastructure assets including schools, government accommodation and projects overseen by the Ministry of Defence.

The Organisation for Economic Cooperation and Development (OECD) estimates that there will be $53 trillion required to be invested in infrastructure over the next two decades. In the coming years this will allow substantial opportunities for investors across the globe.



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