



Public Employee Retirement System of Idaho

**Presentation to Economic Outlook and Revenue
Assessment Committee**

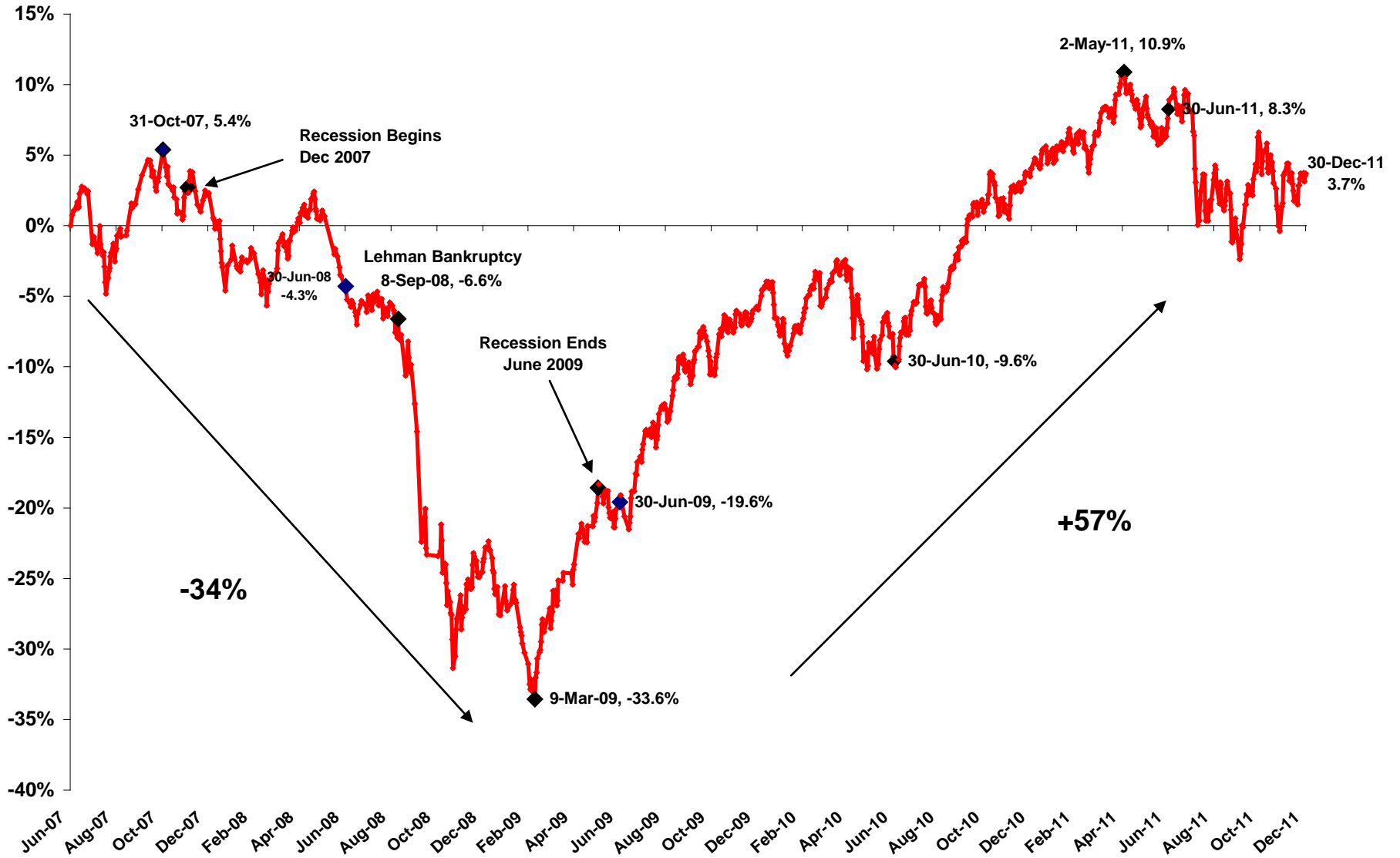
CAPITAL MARKET OUTLOOK

**Robert Maynard
Chief Investment Officer**

January 5, 2012

PERSI TOTAL FUND RETURNS STARTING FY 2008

June 30, 2007 through December 30, 2011



WORLD REBALANCING

- Great Deleveraging continues
 - World is Restructuring
 - US Debt reduction and consolidation
 - Europe fiscal integration
 - China and developing world rebalancing economies between exports and consumption
 - Process will take years, not months
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Expectations : Muddling Through

■ Economic Expectations

- US: 2.1% real growth, 1.8% inflation
- Europe: 0.25% real growth, 1.9% inflation
 - Euro Currency Zone expected to have mild recession: -0.2%
- China 8.5% real growth, 3.5% inflation

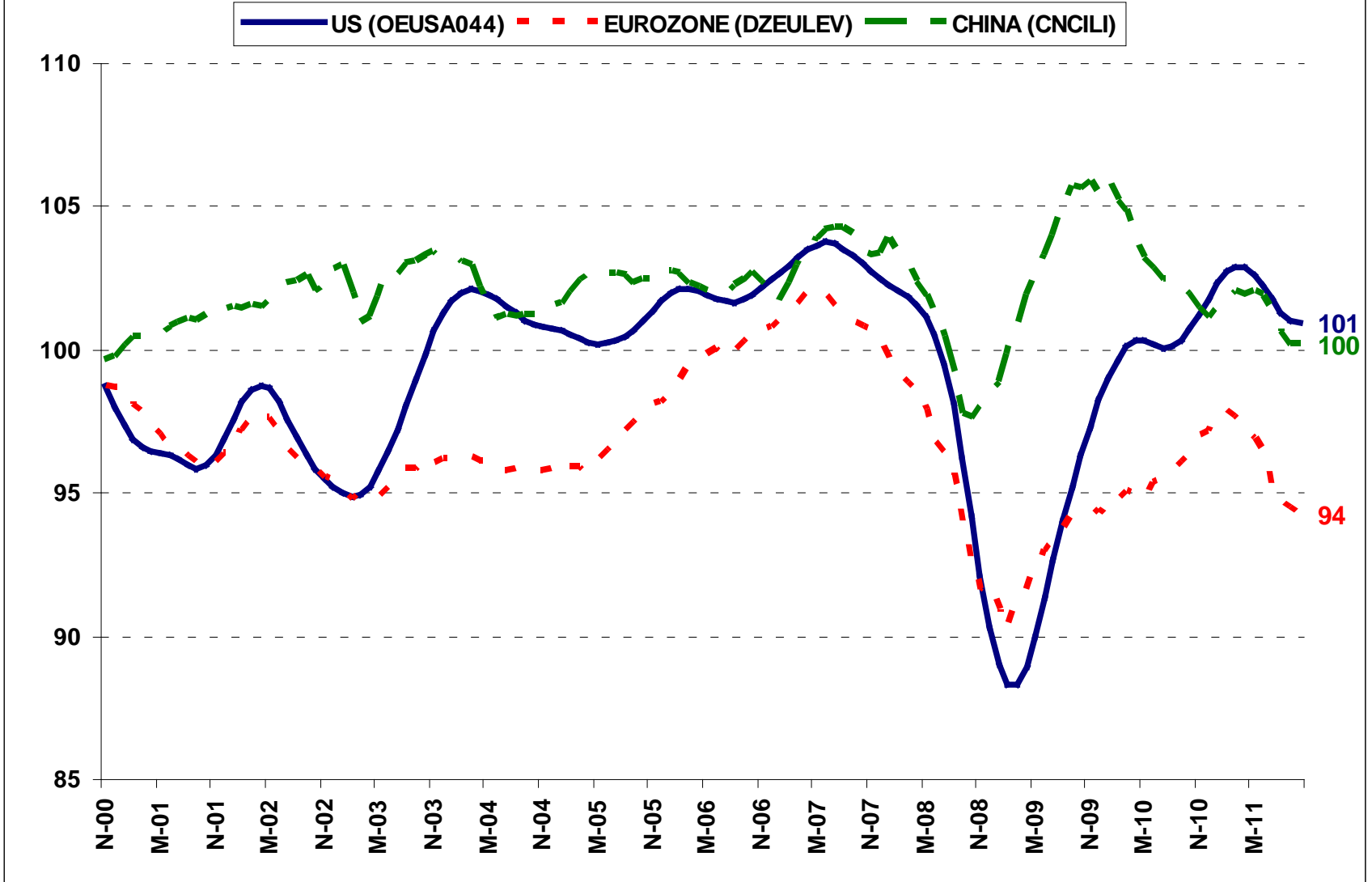
■ Capital Market Expectations

- Cash: Yields will rise from 0.3% to 0.8% for a +0.7% return
- TIPS: Yields will rise from 0.0% to 0.1%, for a +1.1% return
- 10Y Treasury: 1.9% Yield will go to 2.4%, for a -2.0% return
- 10Y Corporate "A": Yields from 3.3% to 3.6%, +0.2% return
- US Equities: +12.0%
 - International and Emerging Markets same or less
 - Corporations, particularly in US, incredibly profitable

ECONOMIC CONSENSUS

	Projected 2011	Actual 2011	Projected 2012
Real GDP	2.7%	1.8%	2.1%
Nominal GDP	4.1%	4.0%	3.9%
Real Consumption	2.5%	2.3%	1.9%
Real Business Spending	9.3%	9.0%	7.3%
Real Industrial Production	3.9%	4.0%	2.7%
Unemployment	9.4%	9.0%	8.7%
Housing Starts	690,000	685,000	680,000
Core CPI Inflation	1.5%	2.2%	2.1%
Europe Real GDP	1.5%	1.6%	0.25%
China Real GDP	9.1%	9.2%	8.5%

Leading Indicators (Smoothed)



U.S. STILL LOOKS TO EXPAND, CHINA SLOWING, EUROPE LOOKS DISMAL

BASIC CAPITAL MARKET CONCEPTS

■ EXPECTATIONS

- Not Current Conditions
- Current Expectations Moderate

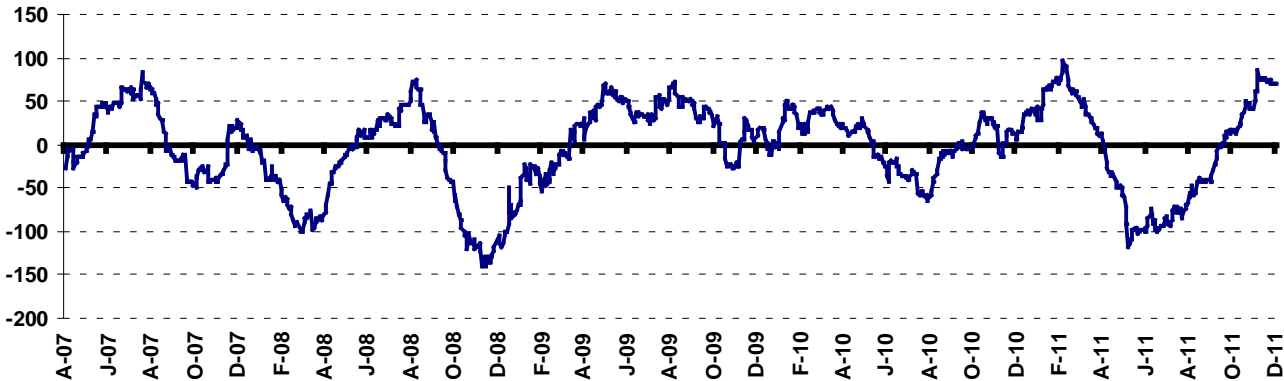
■ PROFITS

- Not general economy
- Good balance sheets, lean operating conditions, growth overseas (x Europe), little pressure on labor costs

■ RELATIVE VALUE

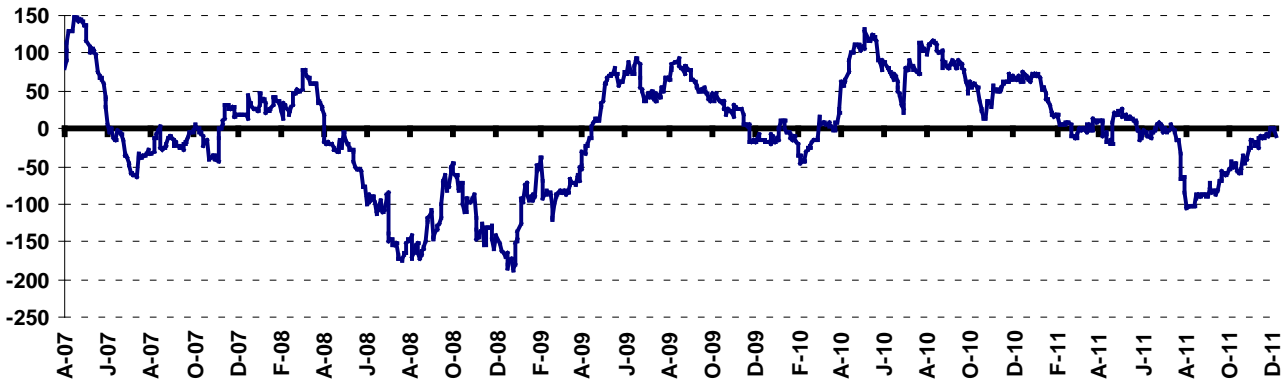
- Not absolute value in itself
 - What are people willing to pay for expected earnings
 - Current alternative – bonds -- unattractive
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US ECONOMIC SURPRISE (CESIUSD)



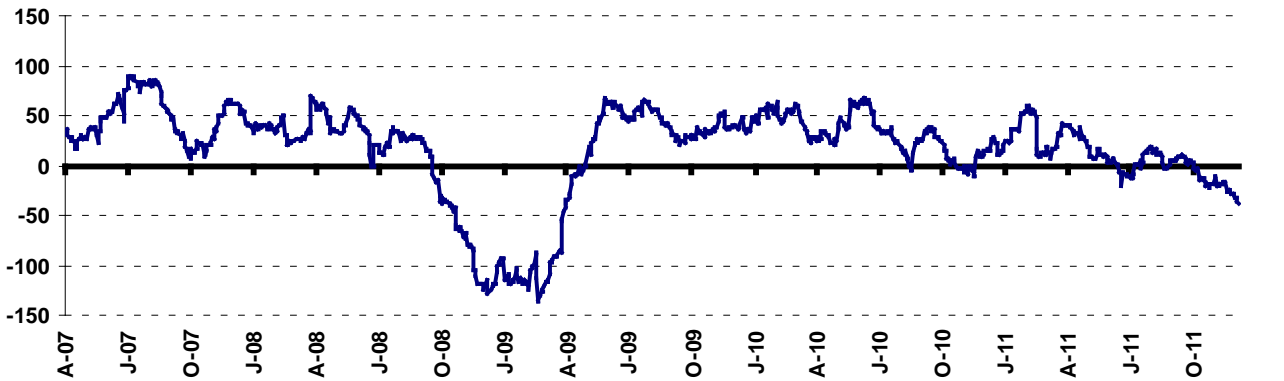
**U.S. Exceeding
Expectations**

EU ECONOMIC SURPRISE (CESIEUR)



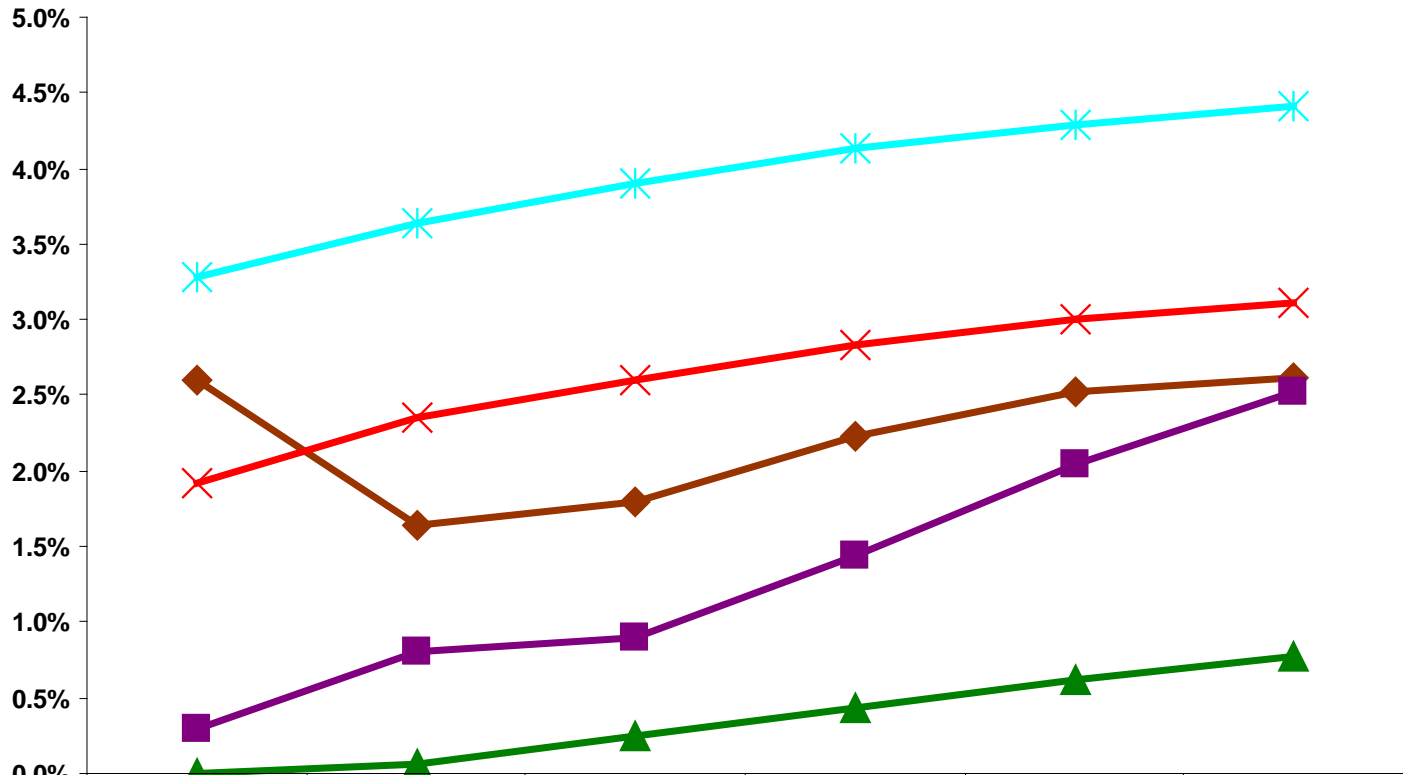
**Europe Sluggish
Expectations
starting to be met**

ASIA ECONOMIC SURPRISE (CESIAPAC)



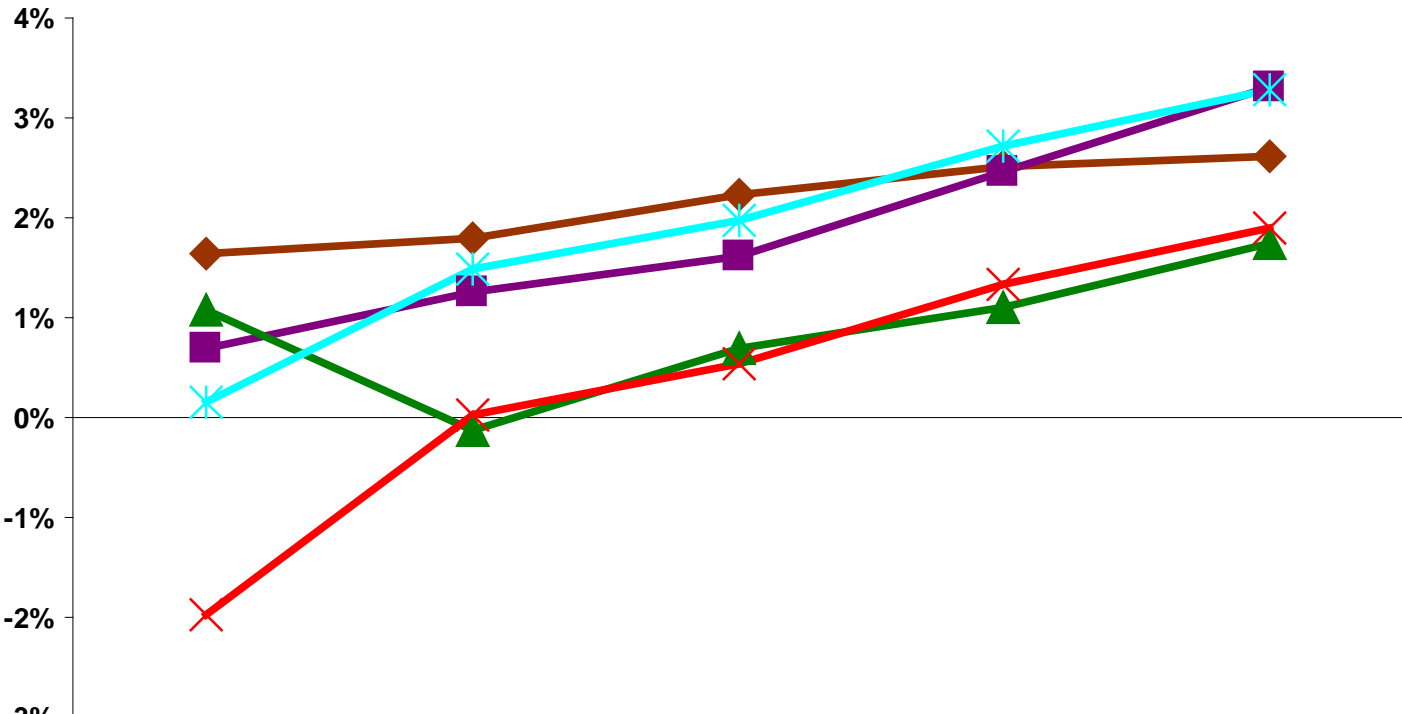
**Asia Starting to
Disappoint
after period of better
than expected growth**

Predicted Levels over next 5 Years



	Current	1 YR	2Yr	3Yr	4Yr	5Yr
Inflation	2.60%	1.65%	1.79%	2.23%	2.52%	2.62%
1M LIBOR	0.30%	0.80%	0.90%	1.44%	2.04%	2.52%
10 Y TIPS	0.00%	0.06%	0.25%	0.43%	0.62%	0.77%
10Y Gov	1.92%	2.35%	2.60%	2.83%	3.00%	3.12%
10Y "A "	3.28%	3.64%	3.90%	4.13%	4.29%	4.42%

Annual Returns over next 5 Years



	1 YR	2Yr	3Yr	4Yr	5Yr
Inflation	1.65%	1.79%	2.23%	2.52%	2.62%
Cash	0.70%	1.25%	1.61%	2.46%	3.31%
10 Year TIPS	1.09%	-0.14%	0.69%	1.11%	1.75%
10 Year Treasuries	-1.97%	0.04%	0.55%	1.32%	1.90%
10 Year "A"	0.16%	1.48%	1.98%	2.72%	3.27%

CAPITAL MARKETS - FIXED

	2010	2011	Projected 2012
Inflation Predicted	1.5% 1.8%	2.6%	1.7%
1M LIBOR – Level Predicted [Return]	0.3% 0.7%	0.3% 0.10%	0.8% 0.7%
10Y TIPS -- Level Predicted [Return]	1.0% 1.2%	0.0% 13.8%	0.1% 1.1%
10Y Treas Level Predicted [Return]	3.3% 3.9%	1.9% 9.2%	2.3% [-2.0%]
10Y Corp A - Level Predicted [Return]	4.4% 5.1%	3.3% 8.1%	3.6% 0.2%

CAPITAL MARKETS – EQUITY

12% for 2012

- **Current Dividend**
 - **2.1% dividend for S&P 500**

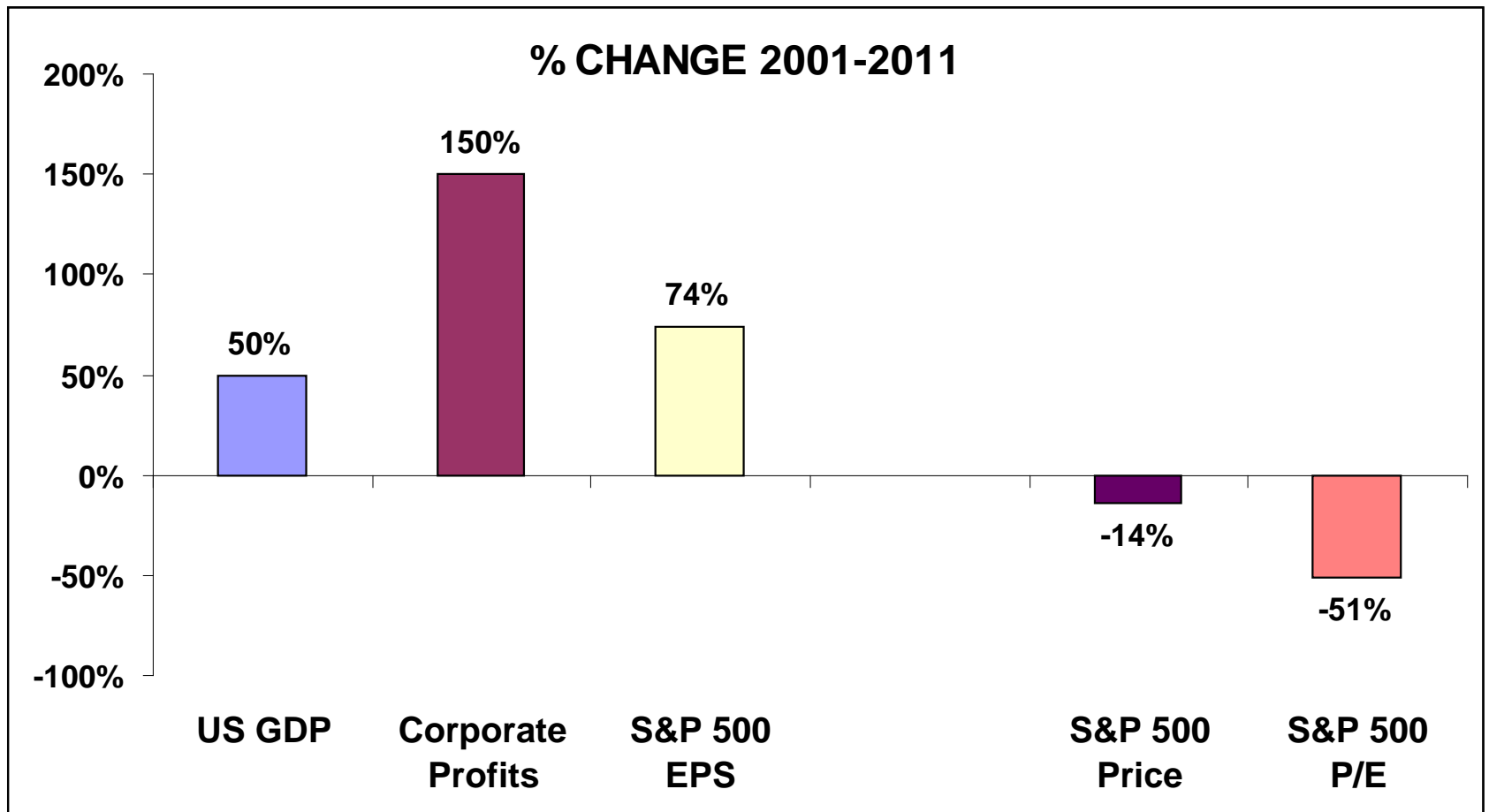
- **Expected Earnings Growth**
 - **Current median estimate – 9.6%**
 - **Includes share buyback – now 1.7%**

- **Price will pay for each \$ of earnings over the next year**
 - **Change in P/E ratio – Assume stays the same**

- **2.1% dividend plus 9.6% earnings growth = 11.7% Return**

- **KEY ISSUE NEXT YEAR IS PRICE/EARNINGS RATIO**

If Current P/E Drops to 11 then -1%, if rises to 14 then +22%



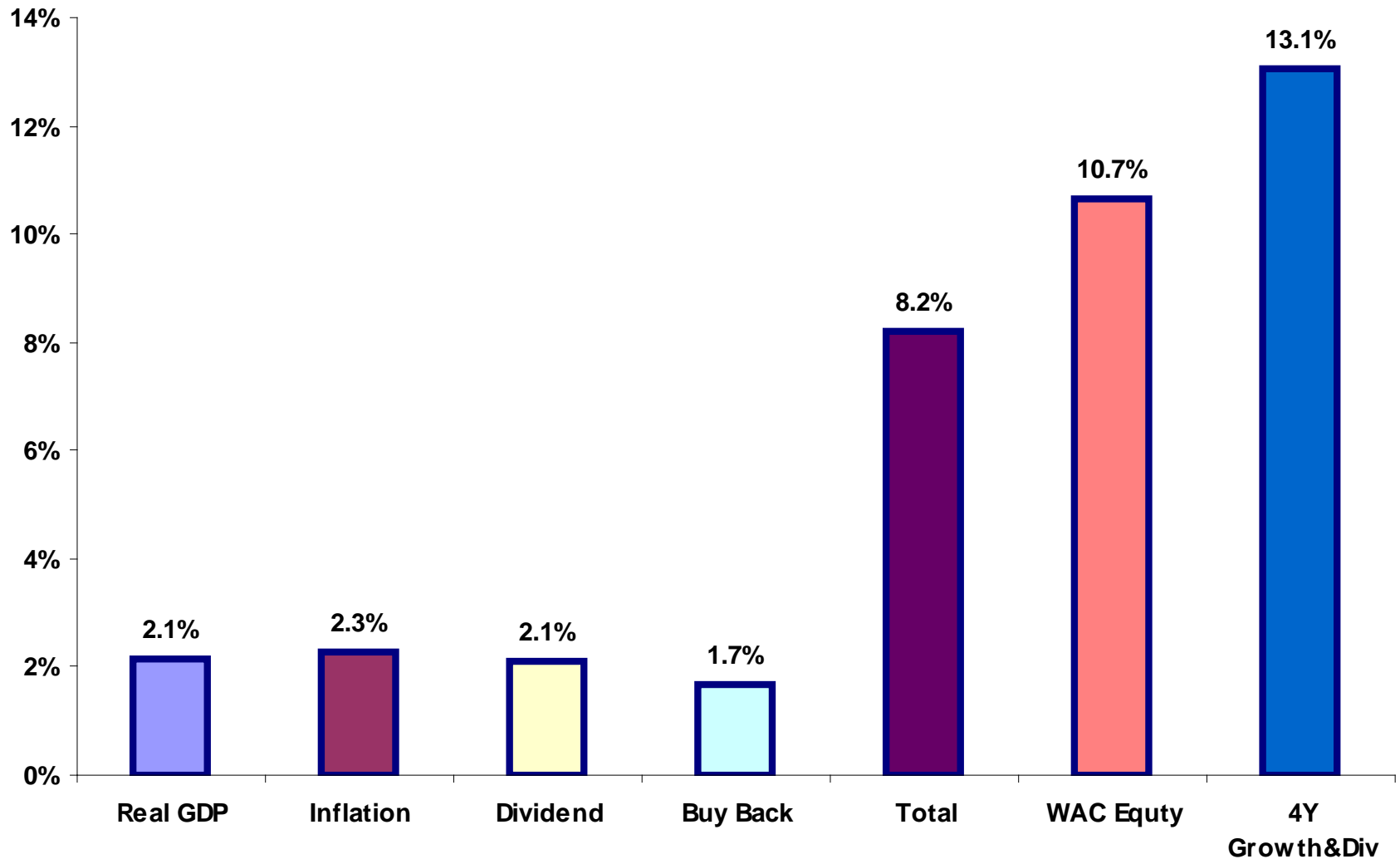
	US GDP (Billions)	Profits (Billions)	S&P 500 EPS		S&P 500 Price	P/E Ratio
2001 (1/1)	\$10,130	\$ 790	\$54.44		1320	24.3
2011 (9/30)	\$15,181	\$1,977	\$94.81		1131	11.9

EQUITY MARKET

ALL DEPENDS ON P/E

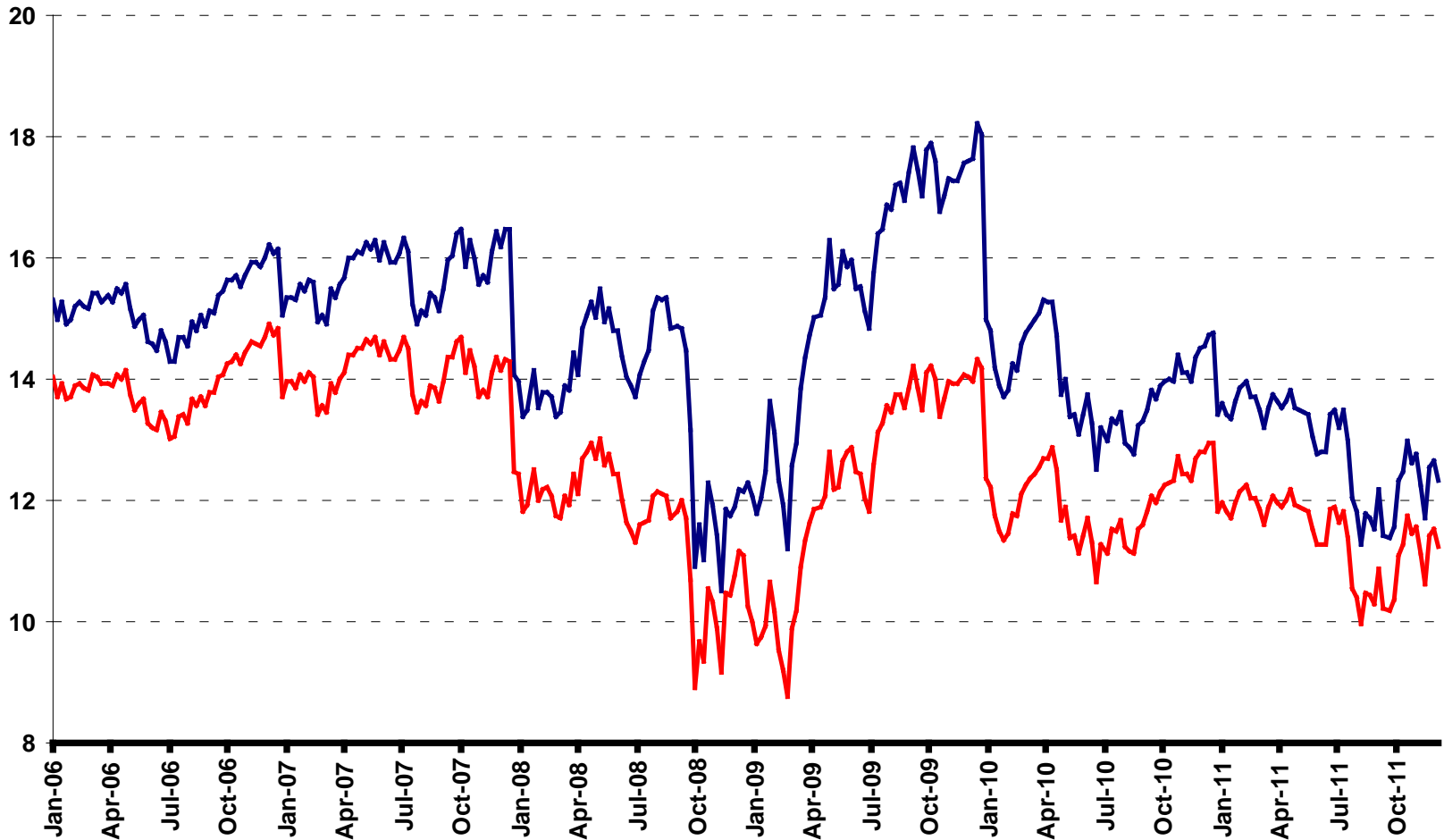
- Last Year Expected Equity Return 13%-15%
 - Earnings Growth + Dividend + Change in P/E
 - 13.7% + 1.8% + 0% = **15.5%**
- **Actual S&P 500 RETURN: 2%**
 - Earnings Growth + Dividend + Change in P/E
 - **15.9% + 1.8% - 15.7% = 2%**
- **P/E DROPPED FROM 15.3 TO 12.6**
 - **Optimism for future hurt by Europe and China difficulties**

Expected Long Term Stock Return and Sources (Assumes Current P/E and Corp Profit Share of GDP remains the same)



HISTORIC P/E RATIOS

— Current P/E — Expected



Since the Civil War, P/E has averaged between 15% - 16%

EUROPE – THE FLY IN THE OINTMENT

- **U.S. seems to have avoided double dip**
 - **If Europe doesn't infect US, likely to continue slow growth**
 - **Financial, not economic contagion seems to be issue**
 - **China appears to have contained inflation problem**
 - **Issue is hard landing**
 - **Europe is largest trading partner**
 - **China and Asia in hard landing will likely hurt US more**
 - **KEY IS THE BANKS AND ABILITY OF EU GOVERNMENTS TO SUPPORT**
 - **Europe depends more on banks and less on capital market financing than Anglo-Saxon system**
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TRANSMISSION OF CRISIS

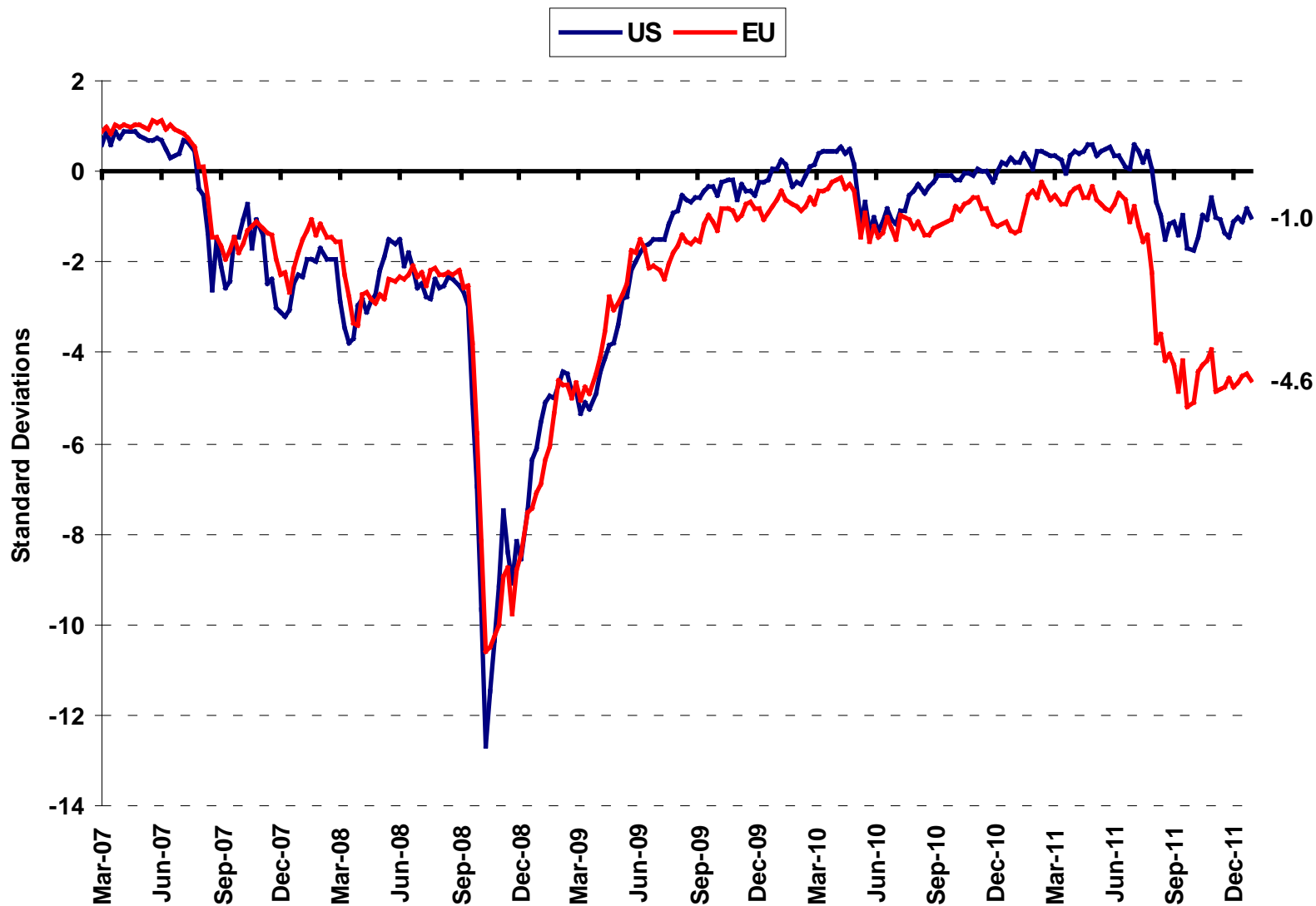
■ FINANCIAL

- ❑ European Liquidity and Financial Freeze infects US institutions
- ❑ More likely direct impact on US

■ ECONOMIC

- ❑ European Recession impacts other economies
 - ❑ US not particularly vulnerable directly
 - ❑ China and Asia more exposed
 - US would be impacted
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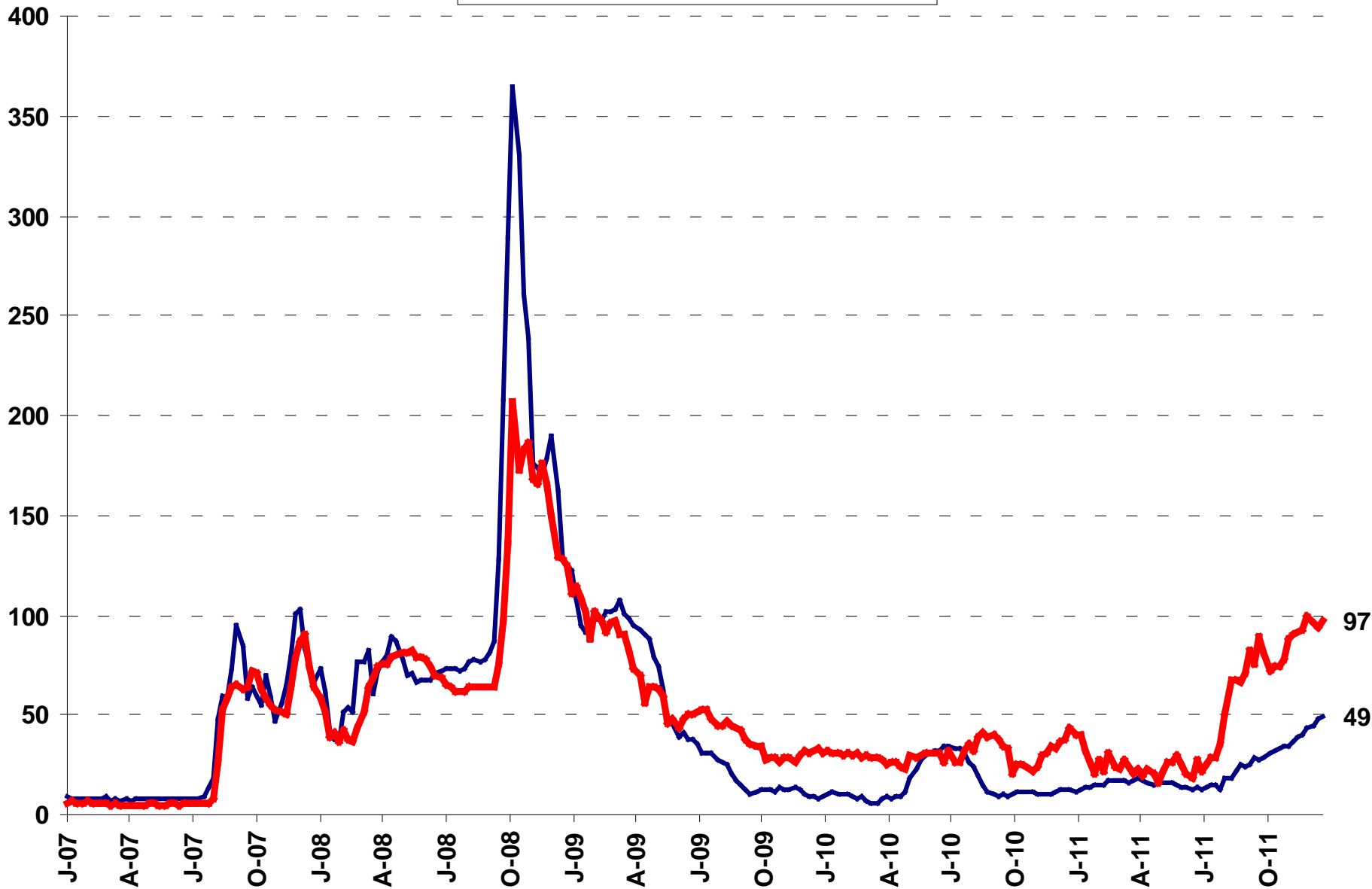
FINANCIAL CONDITION



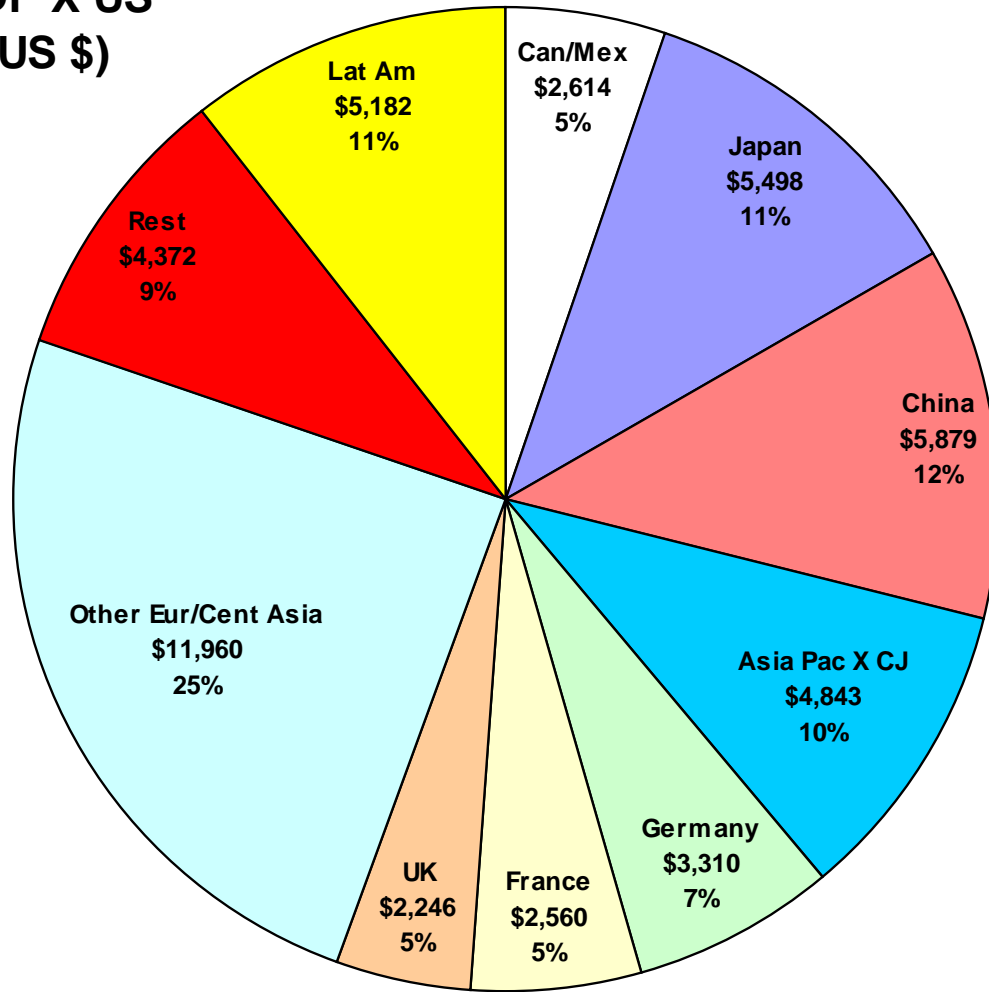
US Financial Conditions and Institutions holding up so far

HISTORIC LIBOR/OIS SPREAD

LIBOR/OIS EURIBOR/OIS

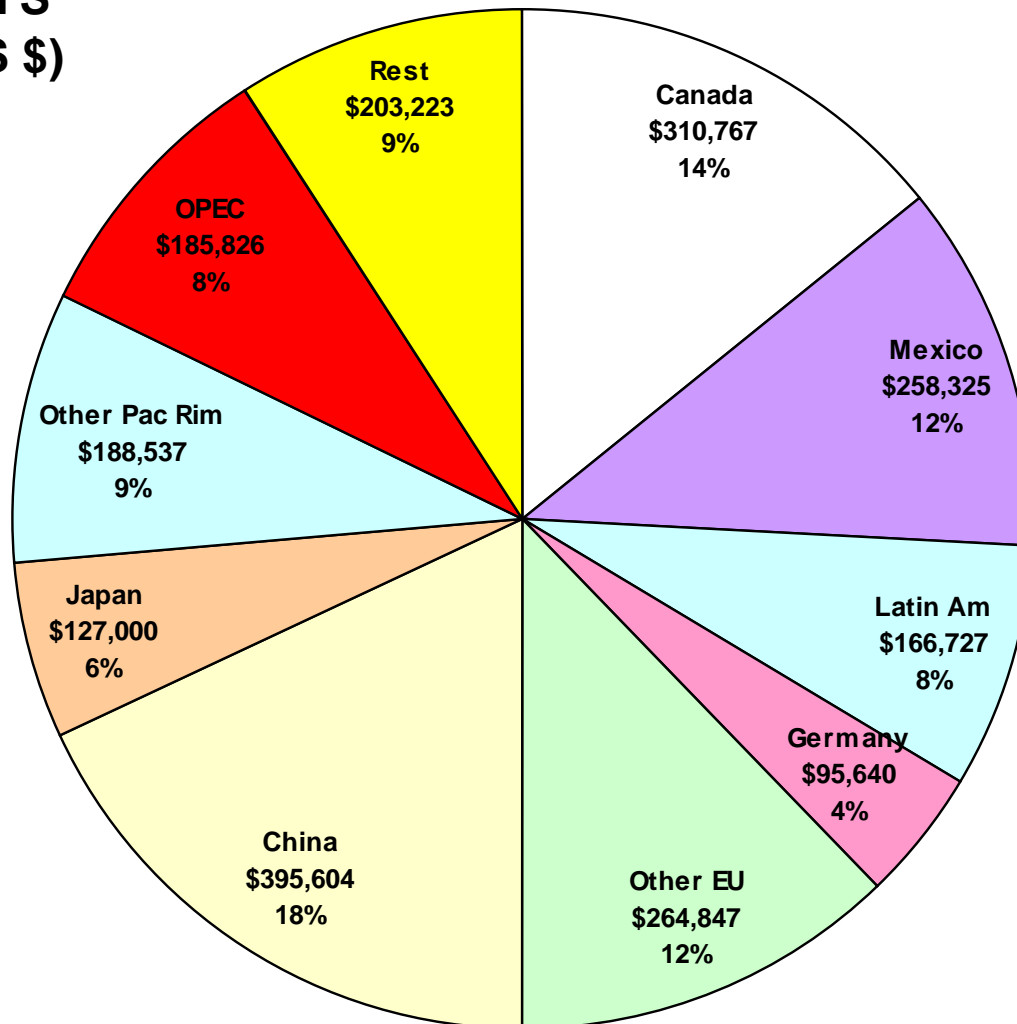


WORLD GDP X US (Billions US \$)



EUROPE OVER 40% OF WORLD GDP X US

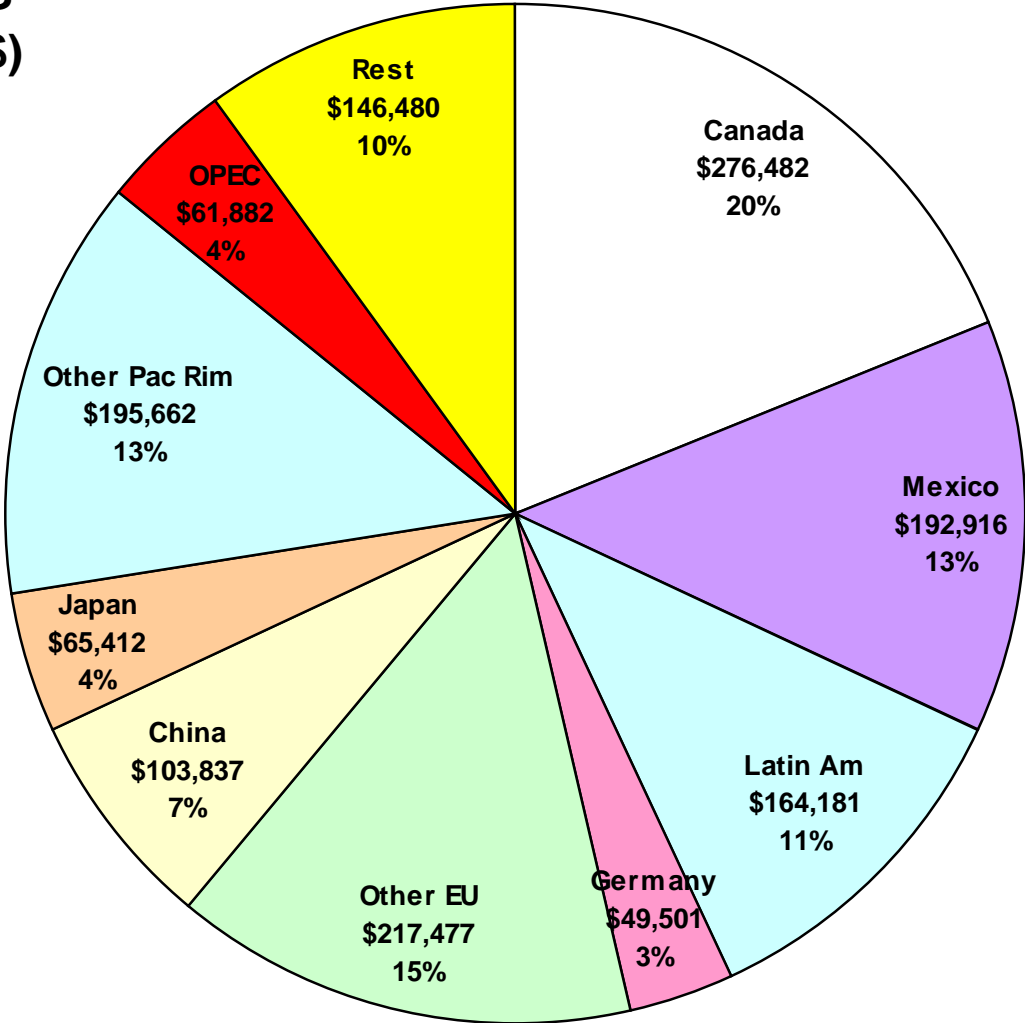
US IMPORTS (Millions US \$)



Cumulative last 12 months

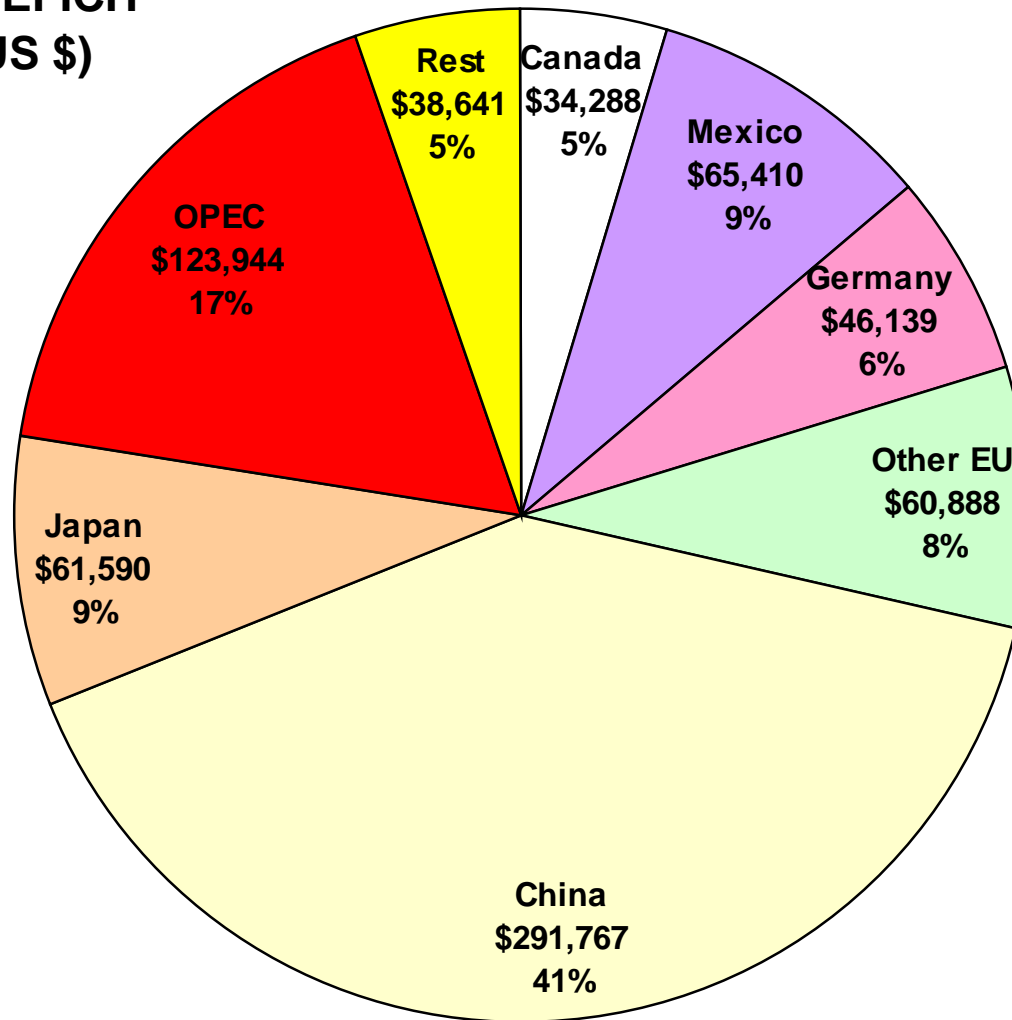
EUROPE ONLY 16% OF US IMPORTS (\$360 billion or 2.4% of GDP)

US EXPORTS (Millions US \$)



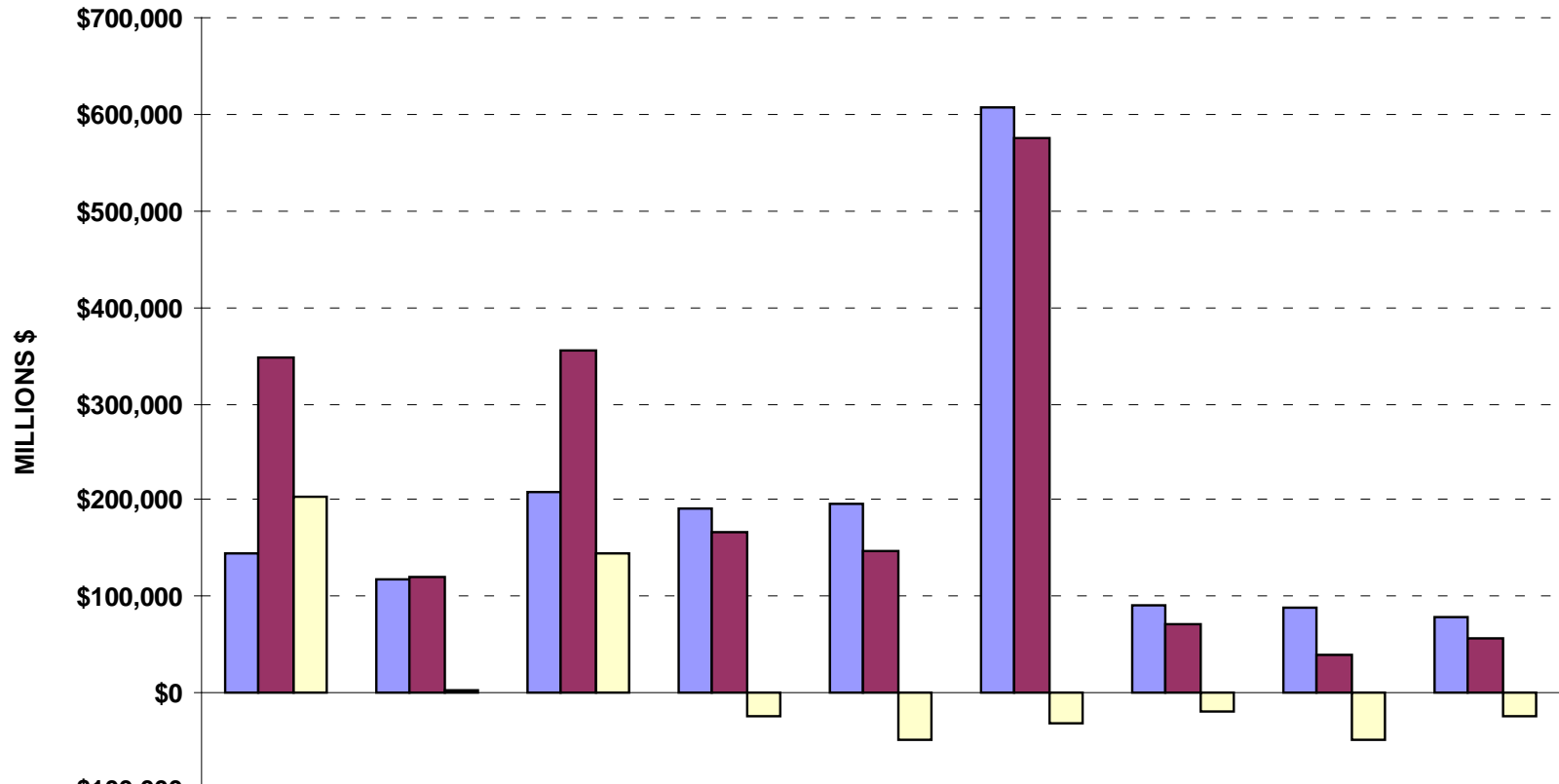
EUROPE 18% OF US EXPORTS (\$267 Billion or 1.8% of GDP)

US TRADE DEFICIT (Millions US \$)



TRBL OR USTB

CHINA TRADE BALANCES



	North America	South America	Europe	ASEAN	Japan	Other Asia	Africa	Ocean Pacific	Other
Imports	\$144,297	\$117,380	\$209,021	\$191,273	\$195,548	\$607,655	\$91,649	\$87,743	\$79,735
Exports	\$346,874	\$119,881	\$354,010	\$167,354	\$146,607	\$575,412	\$71,814	\$40,200	\$56,558
Balance	\$202,578	\$2,501	\$144,989	-\$23,919	-\$48,941	-\$32,243	-\$19,835	-\$47,544	-\$23,176

CHINA IS MORE EXPOSED TO EUROPE THAN TO NORTH AMERICA

CHINA NET TRADE SURPLUS OF \$150 BILLION ALMOST ALL DUE TO EUROPE

QUESTIONS?
