

Designing and Managing with Benchmarks

11th Annual Senior Level Policy Seminar
Caribbean Center for Monetary Studies Seminar

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Focus of talk

- ◆ Policy focus – key issues
- ◆ Public vs. Private
- ◆ Socratic approach

What are Benchmarks?

- ◆ Most challenging decision is selecting an appropriate institutional anchor.
 - Fiduciary
 - Moral Suasion
- ◆ Reflect institutional priorities with respect to risk taking
 - No decision is a de facto decision.

Defining Institutional Anchor

- ◆ What are investment objectives?
 - Maximizing liquidity?
 - Optimizing returns?
 - Mitigating downside risk?
- ◆ What is risk appetite?
- ◆ How do you determine Institutional Risk Profile?

Determining Risk Profile

- ◆ Several methodologies:
 - Questionnaire to Trustees
 - Looking at Peer Group
 - Defining Liabilities
 - Shortfall Risk Scenarios
- ◆ Each has Pros/Cons
- ◆ Search for Comfort Zone
 - Politically defensible
 - Institutionally beneficial

Tools evolve with time

1980s

Qualitative
Analysis:
Bonds vs. Stocks

1990s

Quantitative I:
Risk vs. Return
Wider universe

2000s

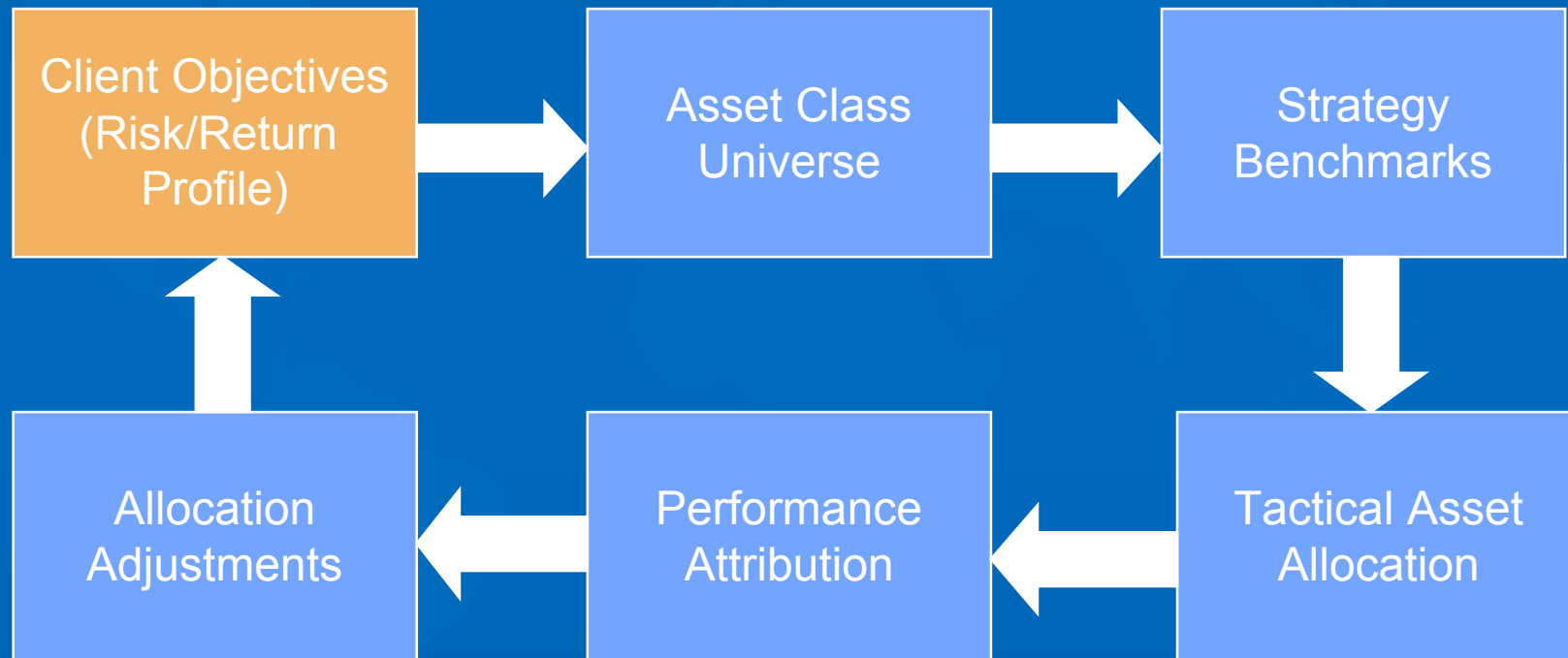
Quantitative II:
Asset-Liability
Management

- Investments increasingly more diverse
- Evolution of risk management technology
- More tailored institutional solutions

Risk Profile into Effect

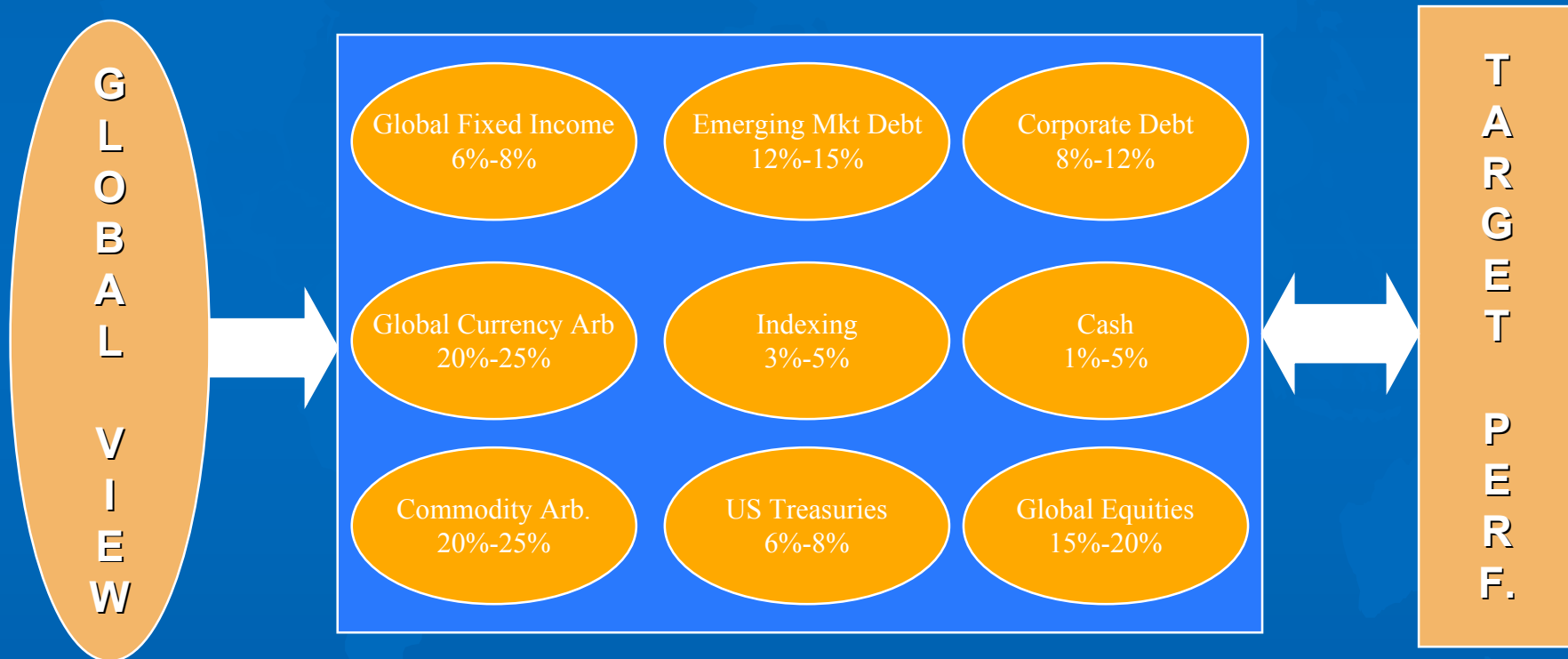
- ◆ The Policy Statement – Board level
 - Stocks: 25%; Bonds: 30%; Real Est.: 10%; Cash: 35%
- ◆ Selecting appropriate Benchmarks
 - Indices (S&P, JPM, SSB)
 - Policy Allocation (SAA) or Absolute Return Target
- ◆ Constructing Portfolios
- ◆ Replication vs. Deviation (Risk Budget)
- ◆ Performance Attribution and adjustments relative to benchmarks

Risk Management Process



Tactical Asset Allocation Process

Dynamic Strategy Allocation



Final Thoughts: Public Sector vs. Private Sector

- ◆ Central Banks
 - Moral Suasion vs. Budget Pressures
- ◆ Commercial Institutions
 - Shareholder returns vs. Going Concern

Takeaway...

- ◆ Benchmarks should reflect Institutional Risk Profiles
- ◆ There is a difference between Public and Private sector institutions – appropriate benchmarks
- ◆ Tools and thinking evolve but objectives should drive process.

Thank you.

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