Maximizing the Afore Investment Regime

Amafore X, Mérida

Viernes 22 de octubre de 2010

John Pirone, CFA
Managing Director
BlackRock Multi-Asset Client Solutions (BMACS)

Maximizing the investment regime

Mexican bond yields are not high by historical standards

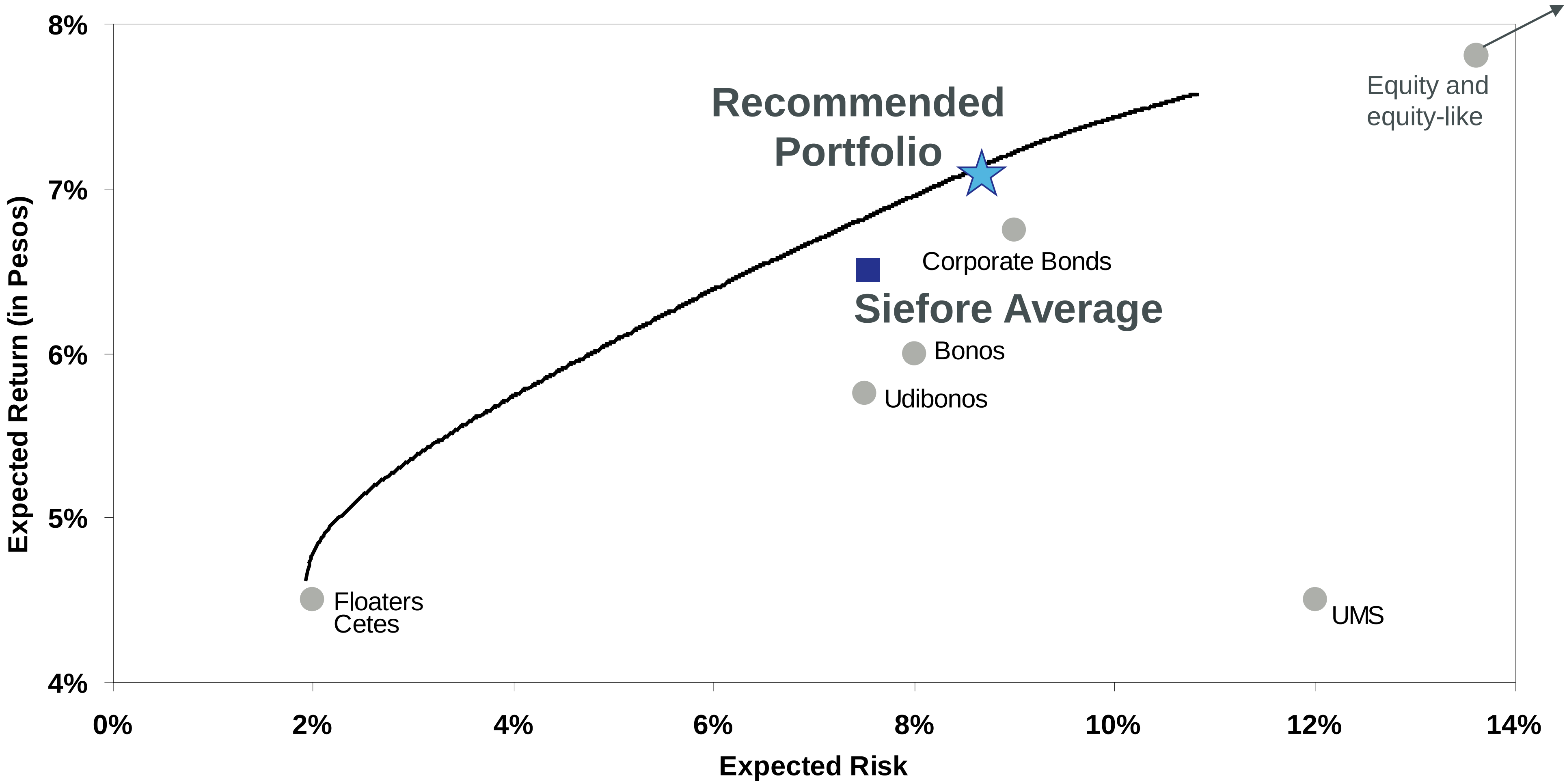
- Nominal 10 year yields at 6%
- Udi 10 year yields at 1.75% real

With over 80% of Afore system invested in fixed income, where will the long term growth of the system come from?

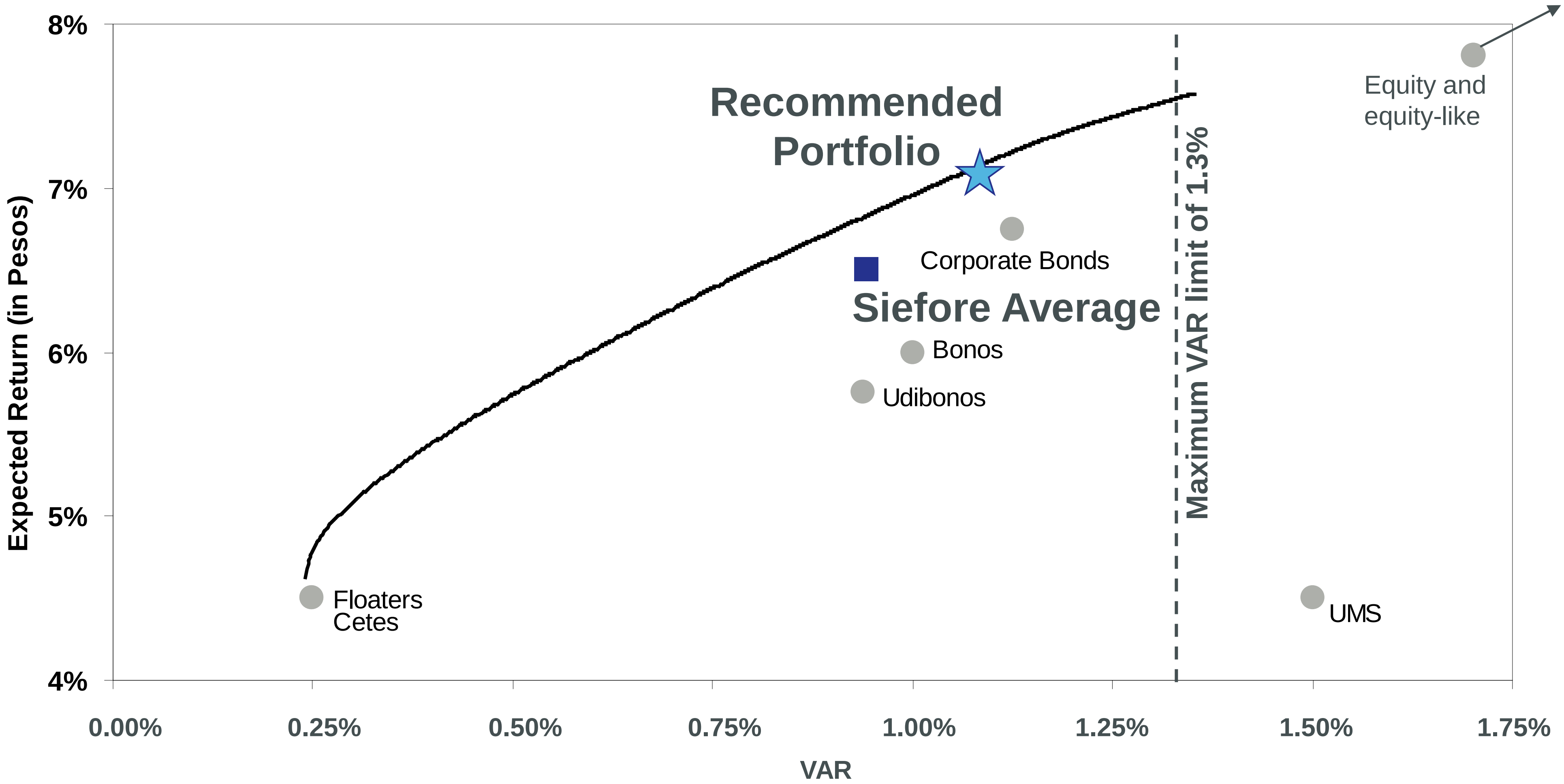
- By increasing allocations to equities and equity-like investments
- By making full use of the investment latitude provided by Consar

Let’s examine where the system is and where it could be…

Recommended portfolio invests in equity and international up to the guidelines



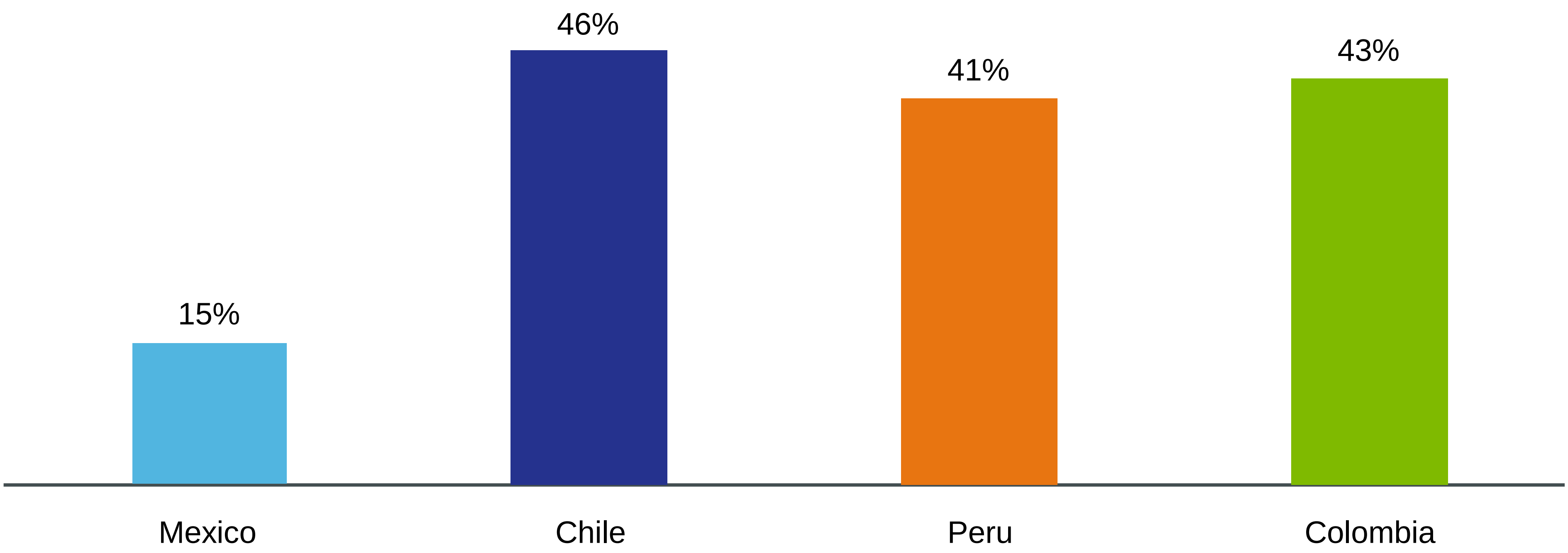
Recommended portfolio invests in equity and international up to the guidelines



1.00% VAR is modeled as 8.00% standard deviation.

Peers have higher system wide allocations to equity

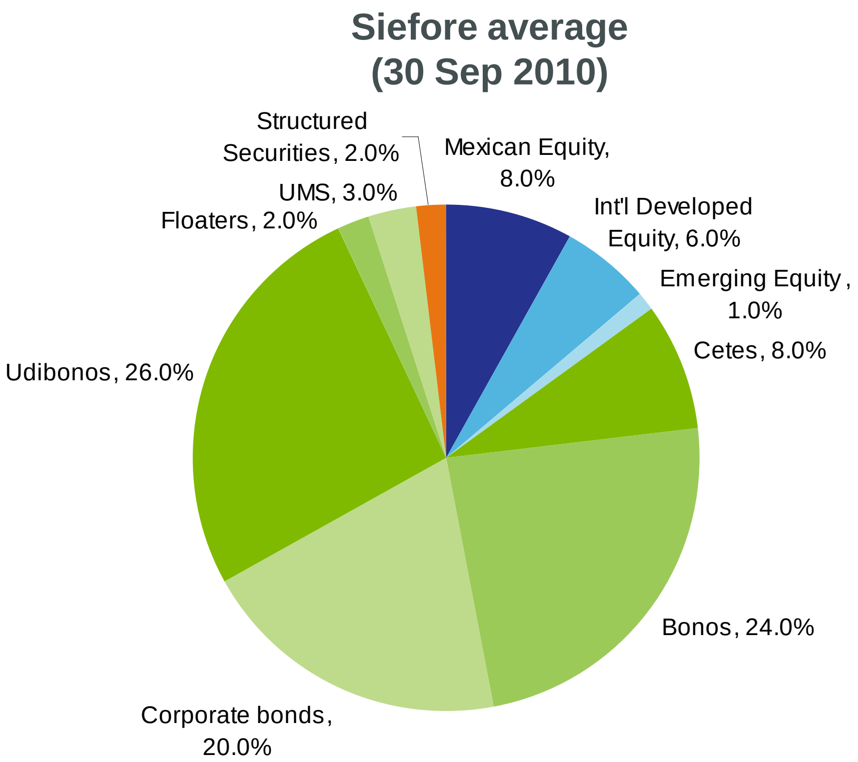
Equity allocation of Latin American pension systems



Peers average 43% equity

Sources:Superintendencia de AFPs Chile; Superintendencia de Banca, Seguros y AFPs Peru; Superintendencia Financiera de Colombia, Consar

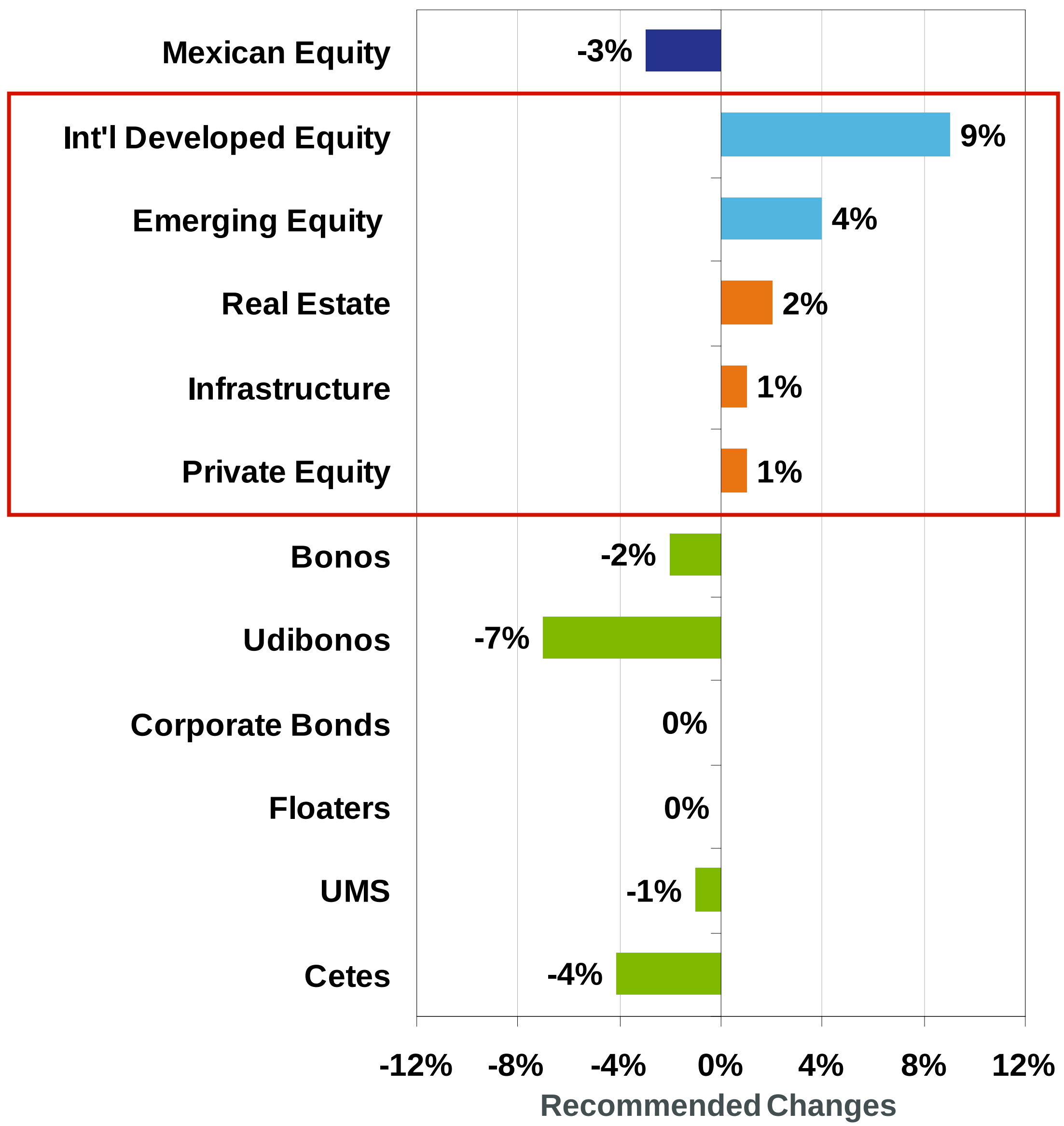
Recommended portfolio has higher absolute and risk-adjusted returns



	Siefore average	Recommended portfolio
Expected return	**6.53%**	**7.08%**
Expected risk	**7.48%**	**8.49%**
Estimated VAR	**0.91%**	**1.03%**
Sharpe Ratio	**0.27**	**0.30**

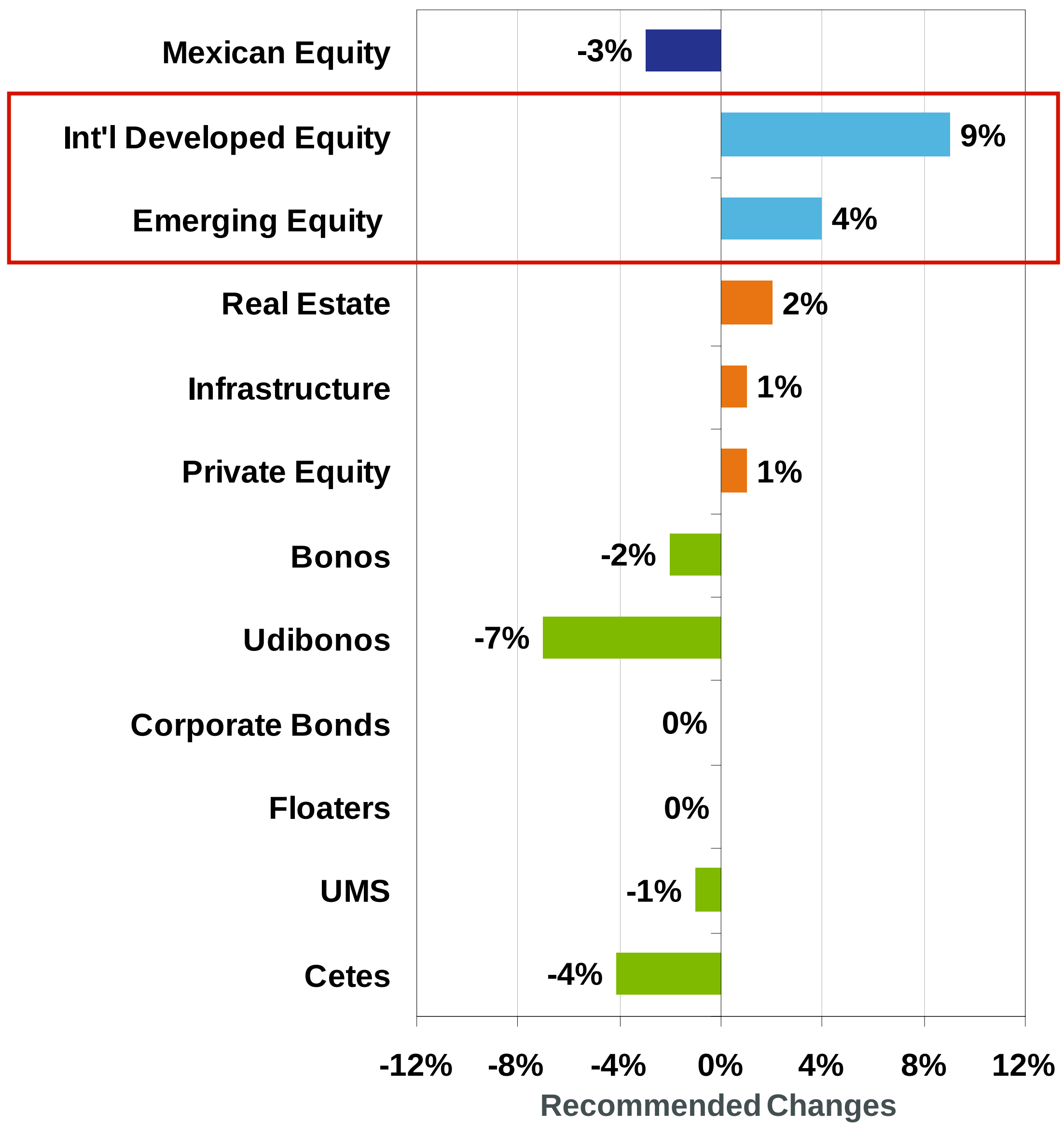
Sharpe ratio based on 4.5% Cetes rate.

Recommended portfolio has a higher allocation to foreign equity and equity-like



Increase in foreign equity and equity-like

Detail on foreign equity recommendations



Foreign Equity Recommended Allocations:

Developed Int'l Equity	≡	15%	
US		8%	✓
EMU/UK		3%	✗
Hong Kong		2%	✓
Japan		2%	✗

Emerging Equity	—	5%	✓
China		2%	✓
Brazil		3%	✓

Recommendations going forward

1. Continue to increase equity and equity-like allocation

- Make full use of existing investment latitude
- Allocation changes should be diversified to control risk
- Explore possibility of raising limits in future

2. Continue to increase international allocation

- Incorporate both developed and emerging investments
- Explore possibility of expanding emerging markets opportunity set
- Increasing breadth leads to portfolio flexibility and opportunity for manager insights

Asset Class Expected Returns and Risks

Asset Class	*Benchmark*	*Expected Return*	*Expected Risk*
Mexican Equity	IRT Index	10.50%	27.50%
Int'l Developed Equity	MSCI World (50% hedged)	8.50%	17.50%
Emerging Equity	Custom (50% Ibovespa, 50% MSCI China, unhedged)	11.00%	32.00%
Cetes	DJLATixx Govt Cetes	4.50%	2.00%
Bonos	DJLATixx Govt Bonos 5-10	6.00%	8.00%
Corporate bonds	DJLATixx Corp Custom Blend (50% 0-5Y, 50% 7+Y)	6.75%	9.00%
Udibonos	DJLATixx Udibonos	5.75%	7.50%
Floaters	PIP Floaters	4.50%	2.00%
UMS	DJLATixx Govt UMS	4.50%	12.00%
Structured Securities	Custom (Real estate, infrastructure, private equity)	10.00%	24.00%

All assumptions in Mexican pesos

Asset Class Correlations

Correlations	Mexican Equity	Int'l Dev'd Equity	Emerging Equity	Cetes	Bonos	Corporate bonds	Udibonos	Floaters	UMS	Structured Securities
Mexican Equity	1.00									
Int'l Developed Equity	0.70	1.00								
Emerging Equity	0.70	0.70	1.00							
Cetes	0.00	0.00	0.00	1.00						
Bonos	0.30	0.10	0.10	0.00	1.00					
Corporate bonds	0.30	0.10	0.10	0.00	0.90	1.00				
Udibonos	0.30	0.10	0.10	0.00	0.80	0.80	1.00			
Floaters	0.00	0.00	0.00	0.95	0.00	0.00	0.00	1.00		
UMS	0.30	0.30	0.30	0.00	0.60	0.60	0.60	0.00	1.00	
Structured Securities	0.70	0.40	0.50	0.00	0.30	0.50	0.30	0.00	0.20	1.00

Efficient frontier incorporates average system limits on equity investments (<=25.1%) and international securities (<=20%). Consistent with current practice, allocations on efficient frontier are constrained to have a maximum of 20% in Mexican corporate bonds and equal allocations to bonos and udibonos.