

2016 sees greatest annual volume of hedging activity, BMO Global Asset Management

Shifting paradigm within hedging mentality of Liability Driven Investment (LDI) marketplace

London, 23 February 2017 – The annual volume of hedging activity in 2016 was the highest seen since the inception of BMO Global Asset Management’s quarterly LDI survey. The survey began its record a full 9 years ago in Q1 2008.

Hedging levels were consistently high throughout 2016 in comparison to other years; however both interest rate and inflation hedging fell slightly in Q4. Total interest rate liability hedging activity decreased by 6%, to £27.9 billion, and inflation hedging decreased by 7%, to £23.9 billion during the quarter.

The fall in overall interest rate and inflation hedging is unusual as the fourth quarter of the year tends to see significant new hedging activity as schemes reassess their level of hedging prior to year-end. The net hedging activity number belies the substantial and increased new hedging activity recorded in the survey however relative value trading activity - switching between hedging instruments - fell meaningfully as gilt and swap interest rates traded in a tight range to one another. It is also possible that pension schemes prioritised an increase in outright hedging levels given the year-end rise in interest rates to pre-Brexit levels, and switches became of secondary importance.

The report indicates that market movements and hence trading activity in the fourth quarter of 2016 were linked to event-driven news-flow. This was particularly evident in the Foreign Exchange (FX) markets as sterling rose or fell with commentary on the type of Brexit that the government would be seeking or be able to achieve, whether it be a ‘hard’ or a ‘soft’ Brexit.

“2016 was a year that saw both a greater peak-to-trough move in 30-year gilt yields than in 2008 and the greatest annual volume of hedging activity since our survey began. This statistic points to a shifting paradigm within the hedging mentality of the LDI marketplace. More pension schemes are taking liability risk off the table and adopting both a systematic hedging approach to increase outright hedging levels and a dynamic hedging strategy that makes the most of short-lived market events. This was particularly evident in 2016’s final chapter of trading activity.” said **Rosa Fenwick, LDI Portfolio Manager at BMO Global Asset Management**. “Looking to 2017, the de-risking theme is likely to continue as funding ratios improve.”

The survey also shows there continued to be a bias in 2016 for hedging via bonds versus swaps. This is partially owing to the higher yield offered by gilts, but another key driver was an increased confidence in access to repo funding for leveraging bonds.

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The BMO Global Asset Management LDI survey is led by BMO Global Asset Management’s LDI team, a leading LDI manager, and respondents are polled on a quarterly basis.

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Notes to editors

The figures include other institutional investors as banks do not differentiate between pension scheme and non-pension scheme investors when aggregating the LDI hedging data. However, we would expect pension schemes to represent the large majority of the data given the overall make-up of the market.

With regards to the countries, the survey covers UK/GBP hedging.

About BMO Global Asset Management

BMO Global Asset Management is a global investment manager delivering service excellence from our four major investment centres in London, Toronto, Chicago and Hong Kong operating in over 25 cities in over 15 countries with more than £160 billion in assets under management (31 March 2016). It includes a network of world-class boutique managers: BMO Real Estate Partners, LGM Investments, Money Inc., Pyrford International Ltd., and Taplin, Canada & Habacht LLC.

BMO Global Asset Management is a signatory of the United Nations-supported Principles for Responsible Investment initiative (UN PRI).

It is part of BMO Financial Group (NYSE: BMO), founded in 1817 as the Bank of Montreal, a fully diversified financial services organisation and is one of the largest banks in North America by assets with C\$699 billion as of 31 January 2016 and more than 47,000 employees.