

# BBH Institutional Investment Management

## Inflation-Linked Strategy Performance Review and Outlook

*Prepared for:*

Employees' Retirement System of Rhode Island

February 25, 2015

This information has been prepared for sophisticated investors and their advisors. It is to be used in connection with a one-on-one presentation only.

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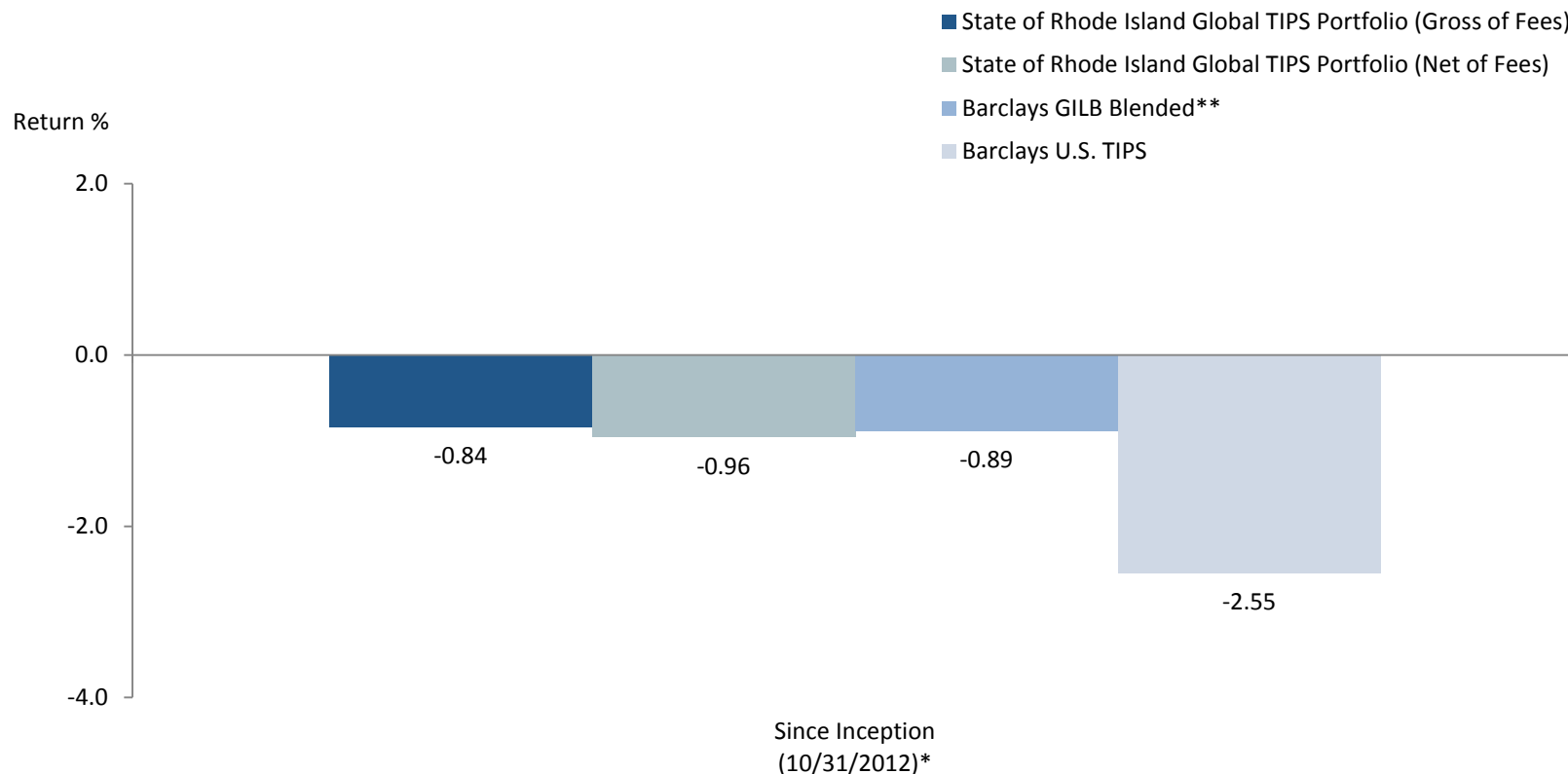
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- BBH has managed ERSRI's Inflation-Linked Strategy since its inception in 2004.
- In October of 2012, ERSRI's Inflation-Linked Strategy was changed from an all-U.S. mandate to a Global mandate.
- At that time, a decision was also made to fully hedge the Global mandate back to U.S. dollars.
- In August of 2013, the duration of the Global mandate was significantly reduced through a benchmark shift focused on bonds with maturities less than 10 years.
- The collective performance impact of these decisions is well ahead of the all-U.S. benchmark.

# Employees' Retirement System of Rhode Island Global TIPS Portfolio Comparative Performance Summary (December 31, 2014)



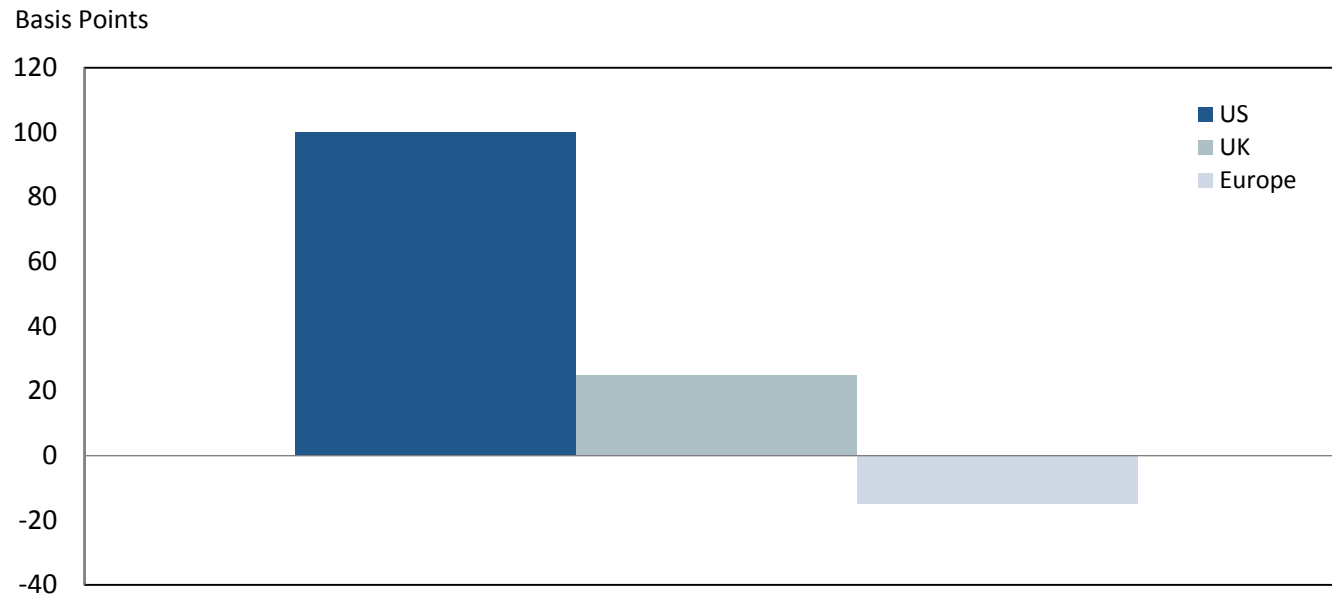
\* Annualized.

\*\* Blended Index = Barclays World Government Inflation-Linked - Hedged from inception through 08/31/13; Barclays Intermediate World Government Inflation-Linked-Hedged thereafter.

**Performance data quoted represents past performance which is no guarantee of future results. There can be no assurance that any strategy presented will meet its investment objective. This information has been prepared for sophisticated investors and their advisors. It is to be used in connection with a one-on-one presentation. If you are not the intended recipient, please alert IIM and disregard this presentation.**

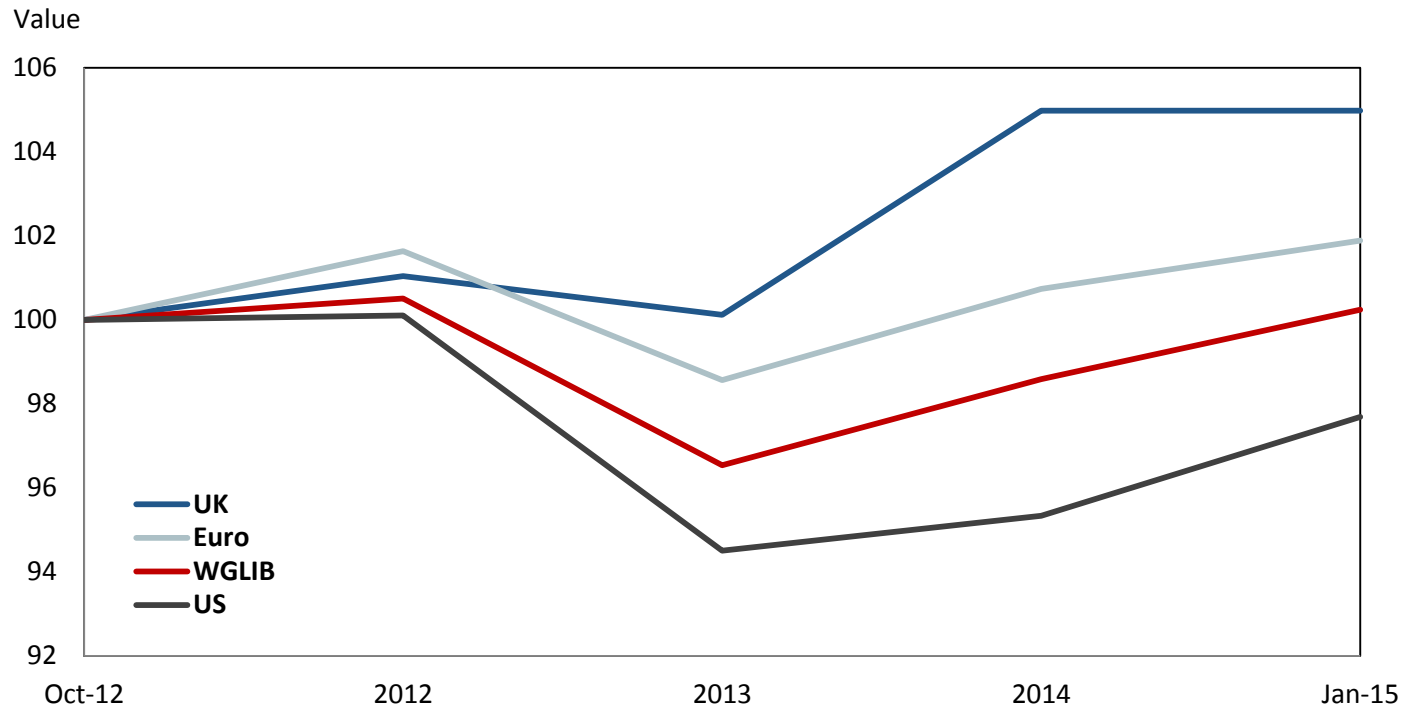
"Gross" of fee performance results do not reflect the deduction of investment advisory fees. Actual returns will be reduced by such fees. "Net" of fees performance results reflect the deduction of the maximum advisory fees. Performance calculated in U.S. dollars.

## Change in Intermediate Real Yields – Oct'12 – Jan'15



- Real yields in the U.S. were up sharply relative to real yields in Europe during the period...

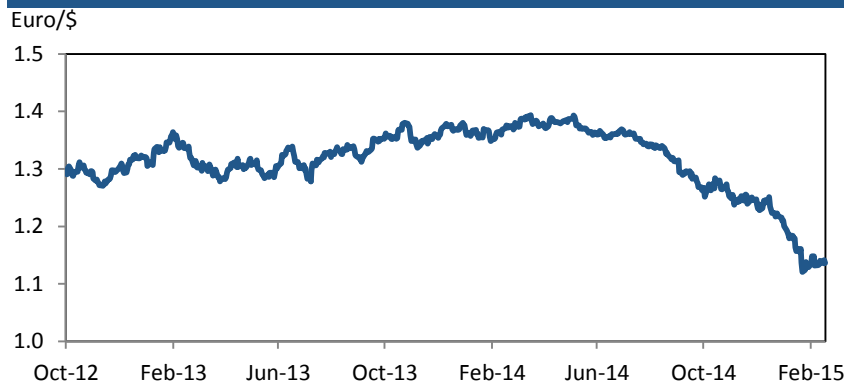
## Intermediate Inflation-Linked Bond Return



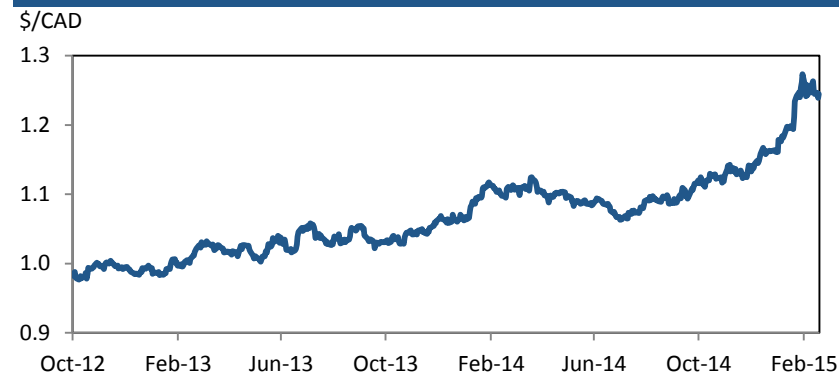
- ...Resulting in stronger returns for European inflation-linked debt.

# Employees' Retirement System of Rhode Island Global TIPS Portfolio Currency

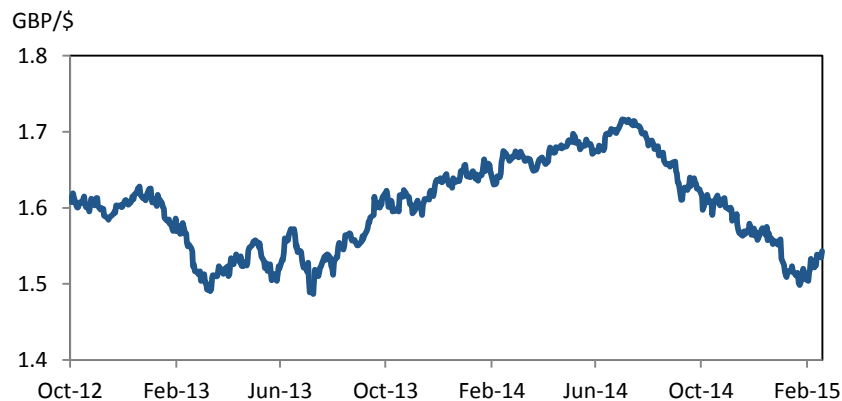
## Euro (European Economic & Monetary Union)



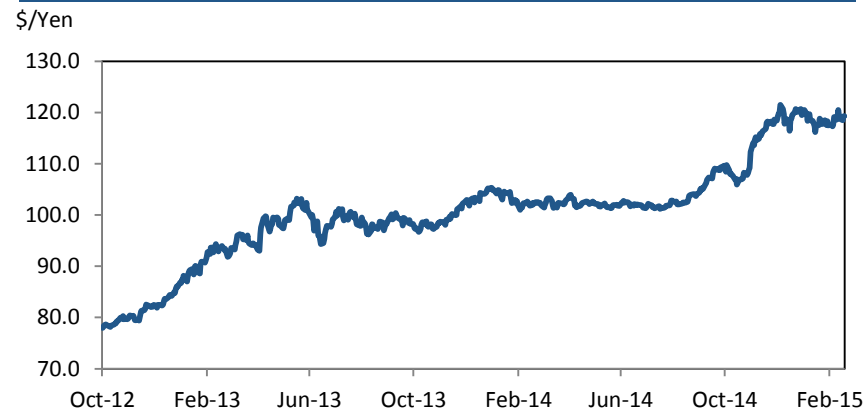
## Canadian Dollar



## British Pound Sterling



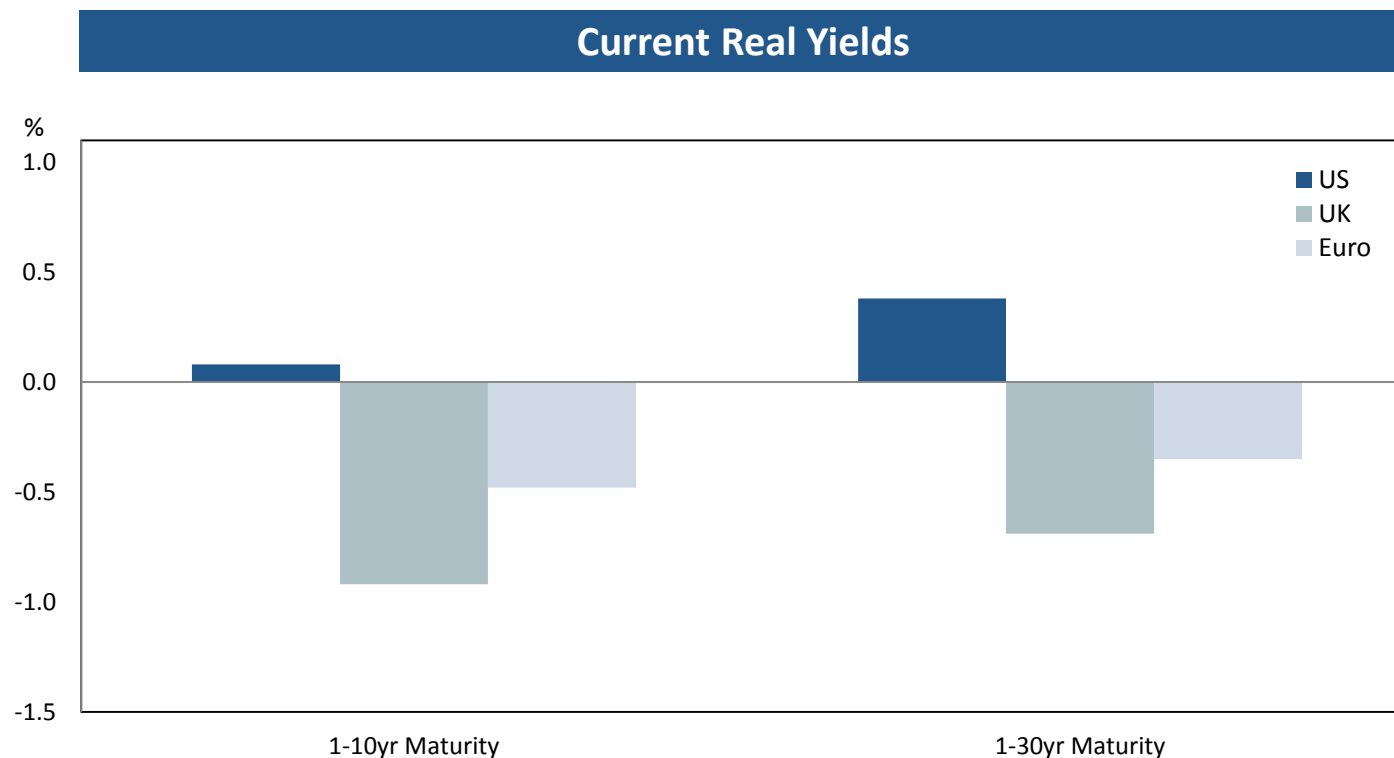
## Japanese Yen



- The U.S. dollar has appreciated relative to most of the currencies in the Global Index. As a result, fully hedging the portfolio contributed to meaningfully stronger performance.

# Employees' Retirement System of Rhode Island Global TIPS Portfolio

## Where to Go from Here?



- Real yields in Europe are historically low and negative. U.S. real yields are significantly higher and positive for maturities longer than 5-years.

# Employees' Retirement System of Rhode Island Global TIPS Portfolio

## Comparative Yield Table (as of January 31, 2015)

### 10-Year Hedged Real Yields

	U.S.	UK	France	Sweden	Canada	Japan
<b>Real Yields</b>	0.25%	-1.45%	-0.60%	-0.55%	-0.35%	-0.45%
<b>Expected Inflation</b>	1.75%	2.90%	0.95%	1.20%	2.00%	1.15%
<b>Hedging Costs</b>	N/A	-0.25%	0.20%	0.20%	-0.10%	0.10%
<b>All In Yield</b>	2.00%	1.20%	0.55%	0.85%	1.55%	0.77%

Sources: Bloomberg and BBH Analysis

- Accounting for current real yields, inflation expectations, and hedging costs, the U.S. appears to be the most attractive market to position inflation protection.

**Real Yield** – The real yield is the internal rate of return that will discount the coupon payments of an inflation-linked security to the current price. The real yield is often referred to as the market yield for sovereign debt that does not include an expected inflation premium.

**Expected Inflation** – An estimate for future inflation based on the expected inflation rate taken directly from market traded five-year inflation swaps.

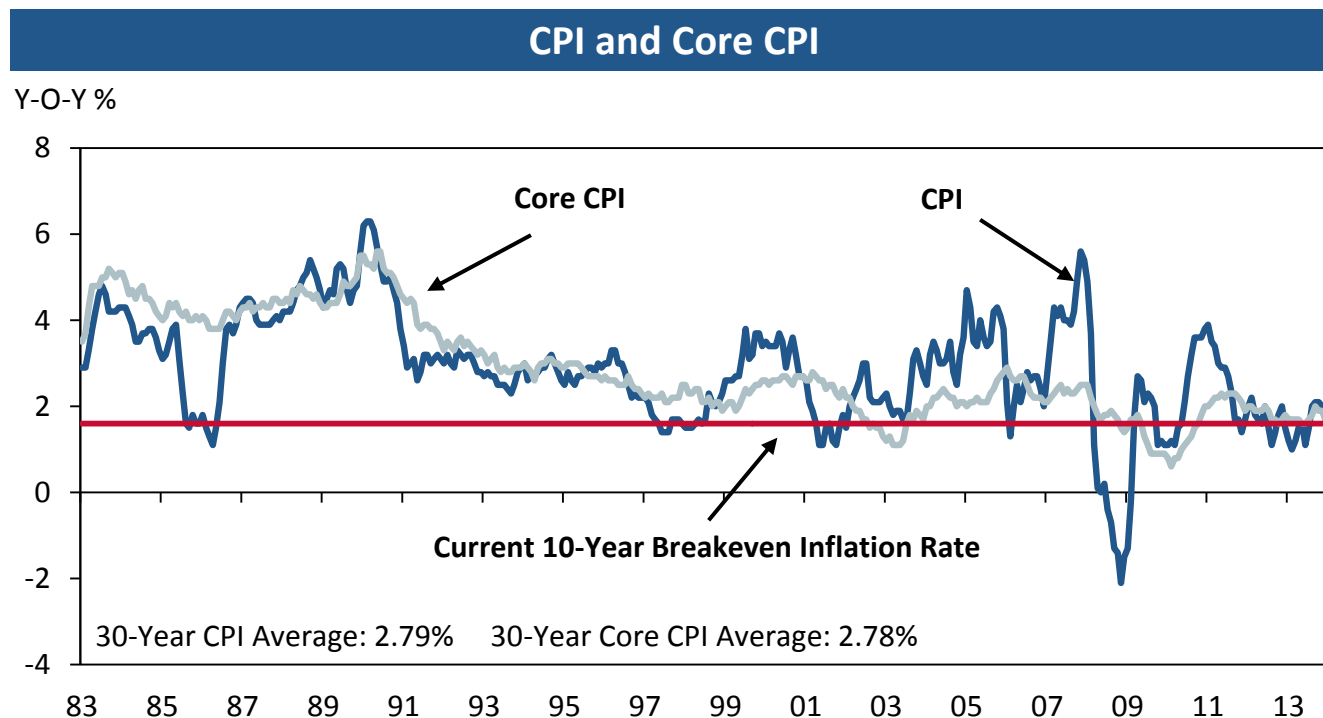
**Hedging Costs** – The estimated costs of hedging the currency exposure associated with a security denominated in a currency other than the U.S. dollar.

**All In Yield** – Net sum of the real yield, expected inflation, and hedging costs.



# Employees' Retirement System of Rhode Island Global TIPS Portfolio

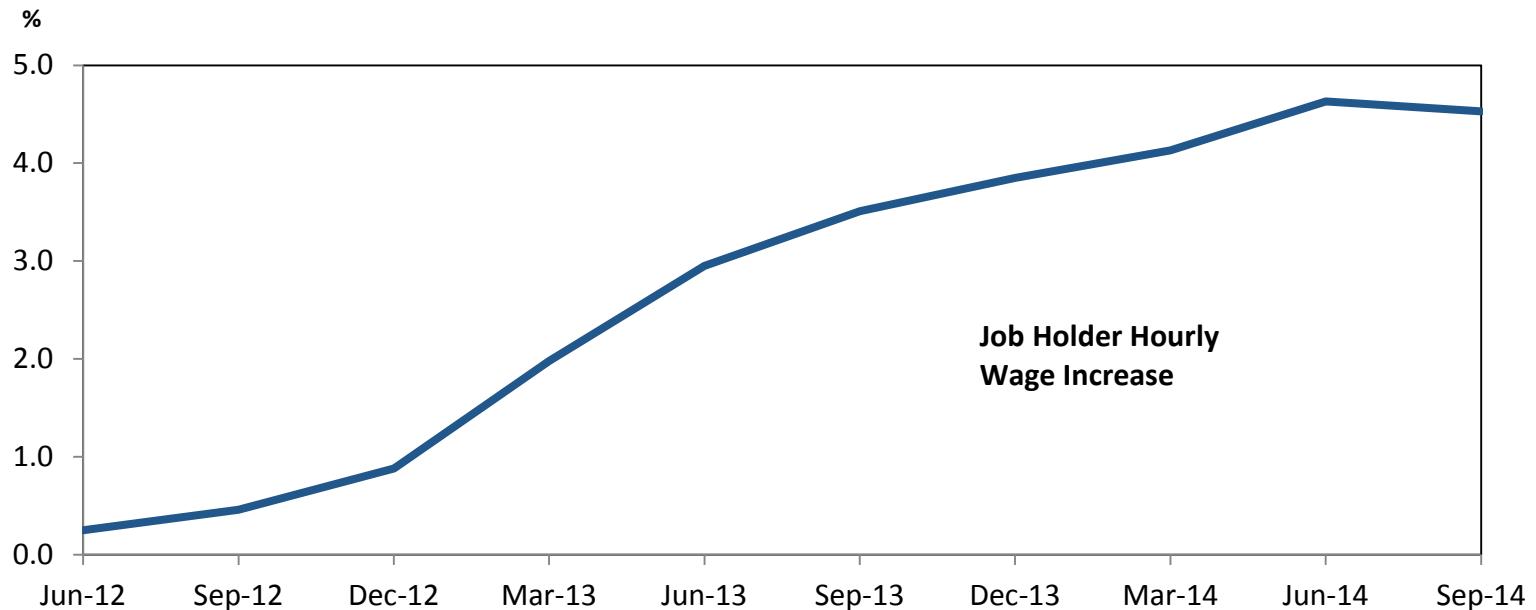
## Inflation More Likely in The U.S.



Sources: Bloomberg and BBH Analysis

- Economic fundamentals are more likely to drive inflation higher in the U.S. Several factors including stagnant wages, weak growth abroad, and the recent decline in gasoline prices have led to CPI readings persistently below historic norms in 2014. Sustained periods of inflation below 2% have not been common in the U.S., particularly during periods of economic growth. TIPS valuations at current breakeven inflation rates will prove compelling if CPI simply trends back toward historic norms, which we expect.

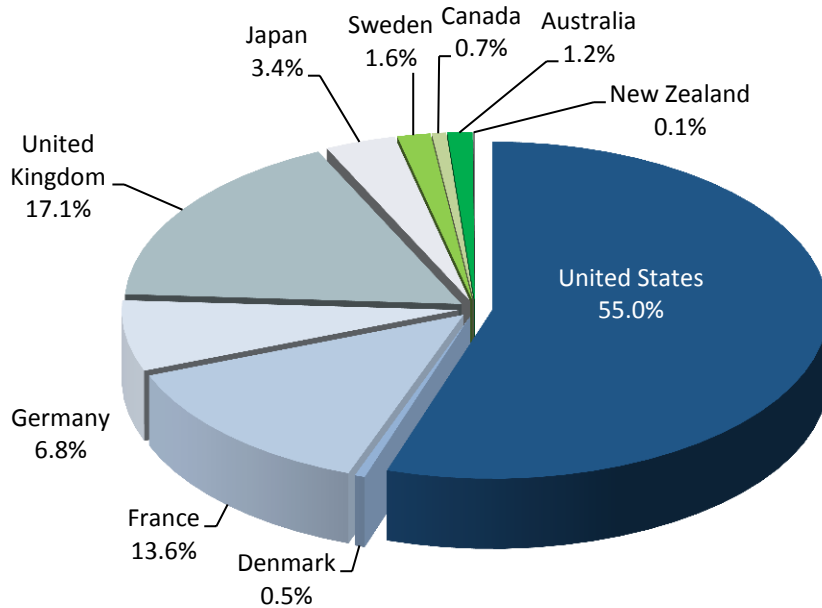
### ADP Payroll Clients Reporting Strong Compensation Gains



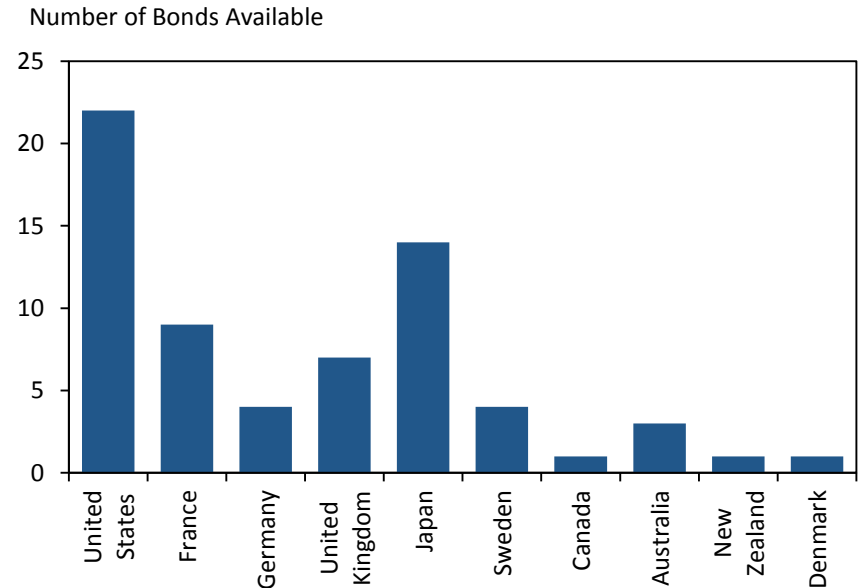
Data reported for full year. Data as of September 30, 2014  
Sources: Federal Reserve, Congressional Budget Office, and BBH Analysis

- Inflation risks are increasingly becoming skewed higher in the context of steady employment gains in the U.S.

### Current Government Index Constituents



### Government Bonds Issuance



Sources: Barclays and BBH Analysis

- By far, the U.S. maintains the largest and deepest inflation-linked securities market. Non-U.S inflation-linked securities can be tactically added when we see value.

The views expressed are as of January 2015 and are a general guide to the views of Brown Brothers Harriman ("BBH"). Commentary is at a macro or strategy level and this document does not replace portfolio and fund-specific materials.

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