

The Future of Financial Markets

Milken Institute Summit - London

Heron Tower

October 18, 2011

Today, our clients have an issue...

...the last thing State budgets need is another \$25 - \$50 billion liability...

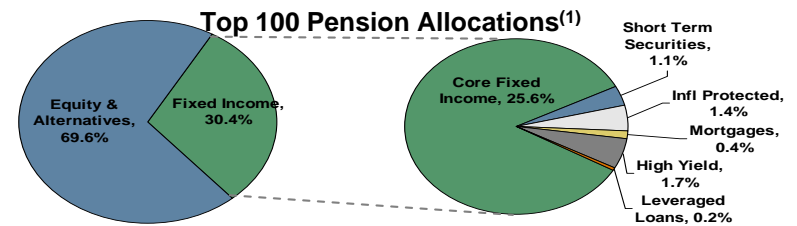
A Pension Plan's Need for Yield

\$200 Billion Asset Fund

Assuming a 40 Year Even Annuity

Discount Rate	Deficit
8%	\$0
7%	\$23.6 bn
6%	\$52.4 bn
5%	\$87.8 bn
4%	\$132.0 bn

Current Allocation Schemes do Not Work



	"Then" March 31, 2007	"Now" October 12, 2011	Change
CD Rate (1 year)	4.94%	0.78%	-84.2%
Money Market Rates	3.76%	0.54%	-85.6%
U.S. 5-Year Treasury	4.53%	1.07%	-76.4%
LIBOR (3 month)	5.35%	0.40%	-92.5%
Investment Grade	5.79%	4.40%	-24.0%
S&P 500 Total Return	2,200.12	2,062.22	-6.3%
S&P 500 Projected ⁽²⁾	N/A	N/A	+3-5%

Source: Bloomberg, JP Morgan.

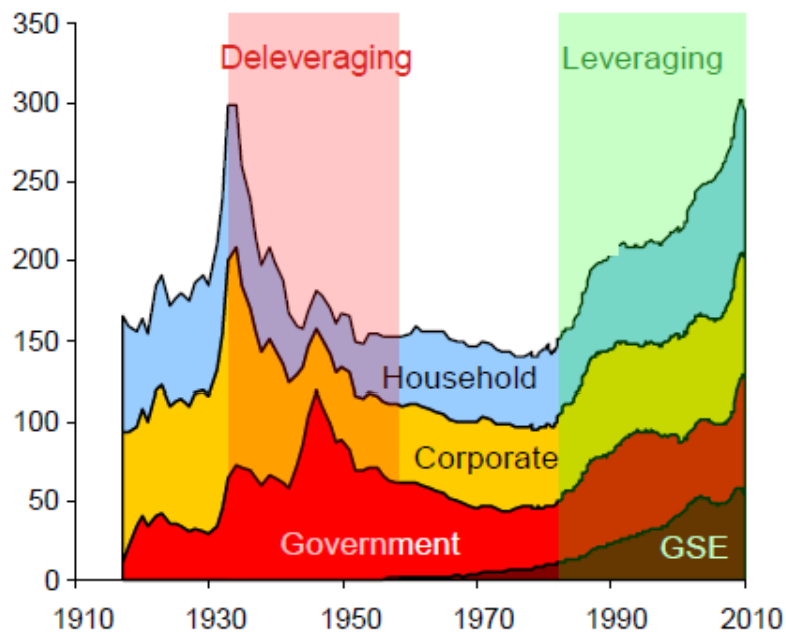
(1) Source: Pensions & Investments Online. Pension funds typically reference the Barclays Aggregate Index when constructing core fixed income allocations. Credit is a small allocation within the Barclays Aggregate Index.
 (2) Represents Apollo estimates for returns over next 3-5 years based on current market trading levels, interest rates and potential interest rate changes over time, inflation and expected inflation, third party research, comparable analysis, precedent transactions and current and expected underwriting levels. No assurances can be made that these projections will be met.

Equities: be suspicious of any valuation

metric post-1980 *Equities typically do poorly in periods of prolonged deleveraging. Most valuation metrics show them to be the cheapest since 1980 – but since that is when leverage really began to rise, this is not surprising.*

What goes up must come down

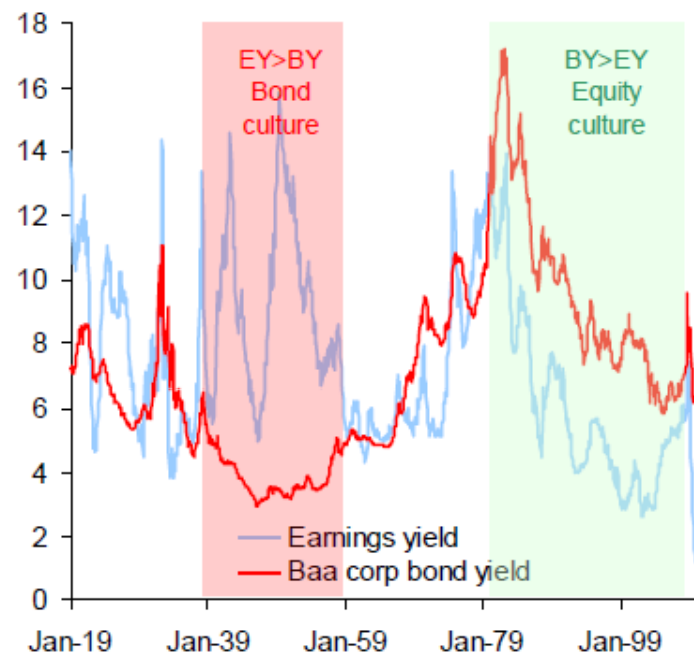
US non-financial debt/GDP by sector, % GDP



Source: Federal Reserve, Haver Analytics, CIRA, 'The Statistical History of the United States'...

Earnings yields vs bond yields

S&P500 12m trailing trend vs Baa bond yield



Source: Moodys, Federal Reserve, Datastream.

The \$55 Billion Misunderstanding

Investing in the Nifty Fifty

12/31/72 - 12/31/81

90% of the “Nifty Fifty” showed a negative return over nine years.
The average inflation-adjusted rate of return was -46%.



The \$55 Billion Misunderstanding

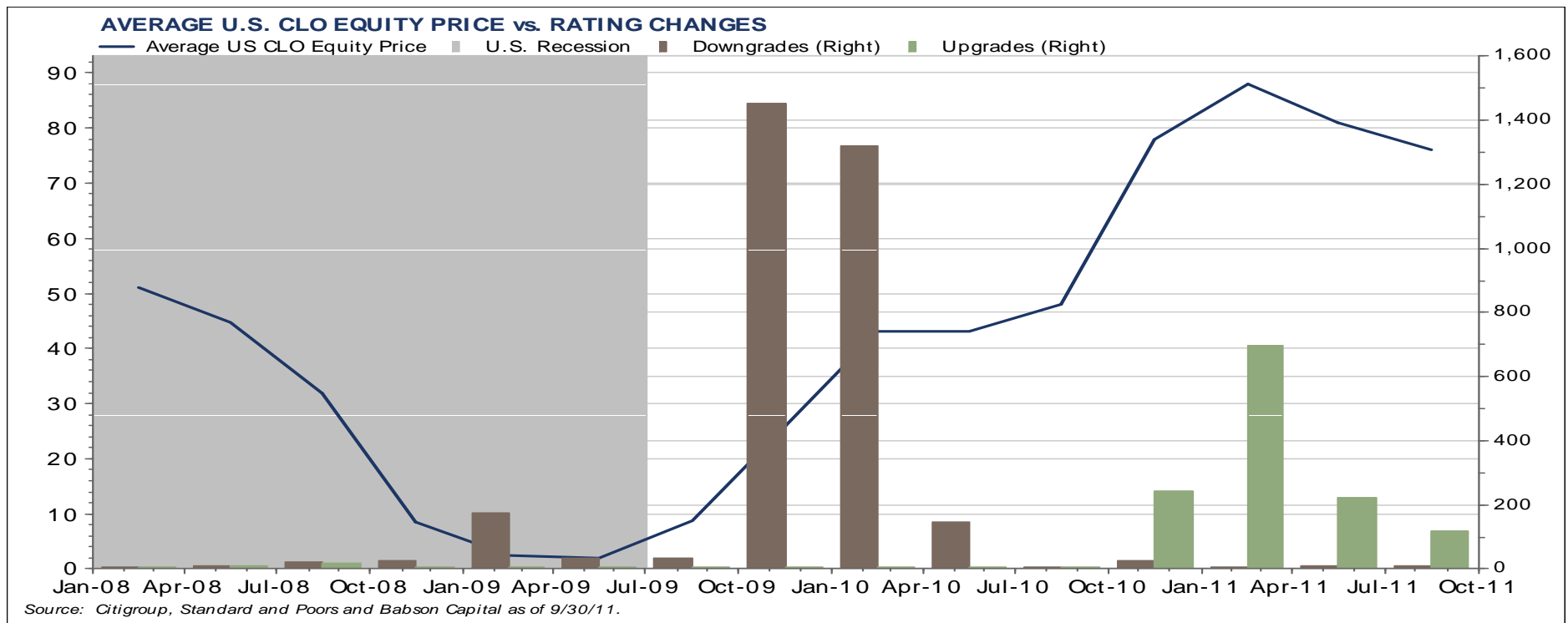
Investing in the Nifty Fifty

12/31/72 - 12/31/81

The average P/E ratio of these 16 companies dropped from 66 to 11.

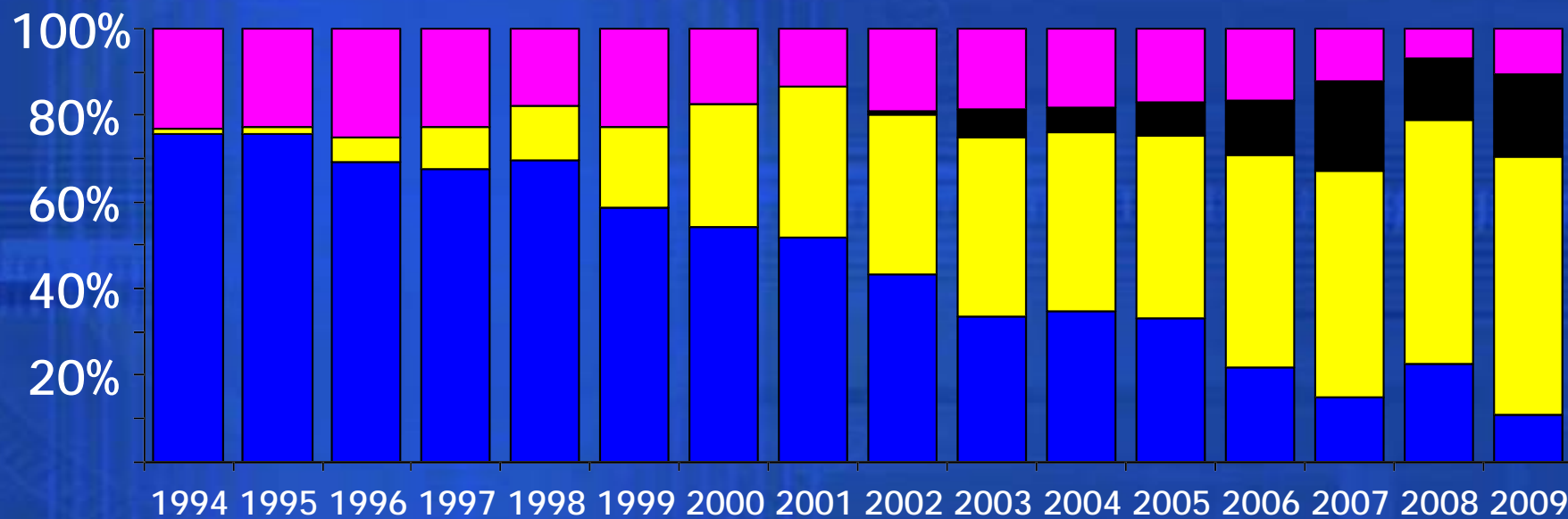
Avon	ADP	Coke	Disney
Dr. Pepper	Kodak	H-P	J&J
Eli Lilly	Marriott	McDonald's	Merck
Polaroid	Rite-Aid	Wal-Mart	Xerox

CLO equity investors were ahead of the ratings curve on the way down and on the way back up.



Institutional Investor Base for Non-investment Grade Loans

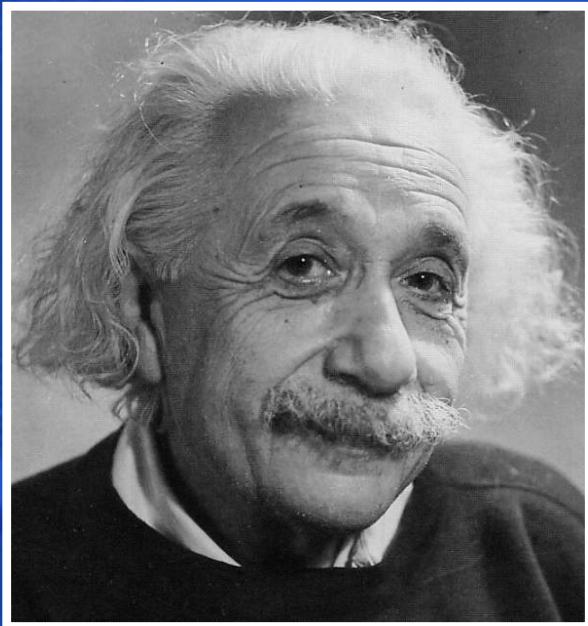
■ Banks
 ■ CLOs
 ■ Hedge, distressed and high-yield funds
 ■ Prime rate funds, financial and insurance companies



Sources: S&P LCD, JPMorgan (4/12/2010).



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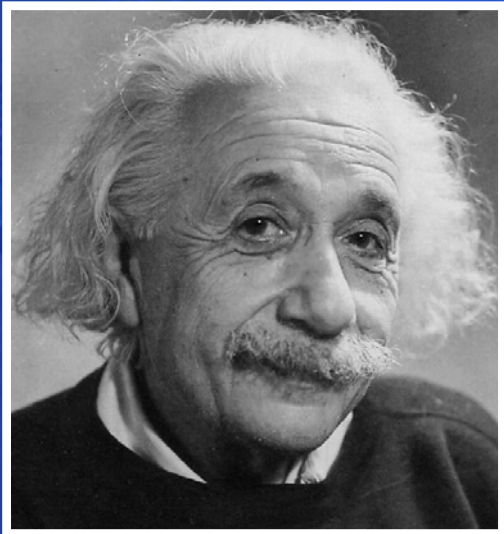


What is the most powerful force the world has ever produced?



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$$y = Ce^{kt}$$



#4 - "Compound interest."



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Rate of Return Concerns

How to Save \$1-Million in 40 Years

\$25,000-a-year @ 0%

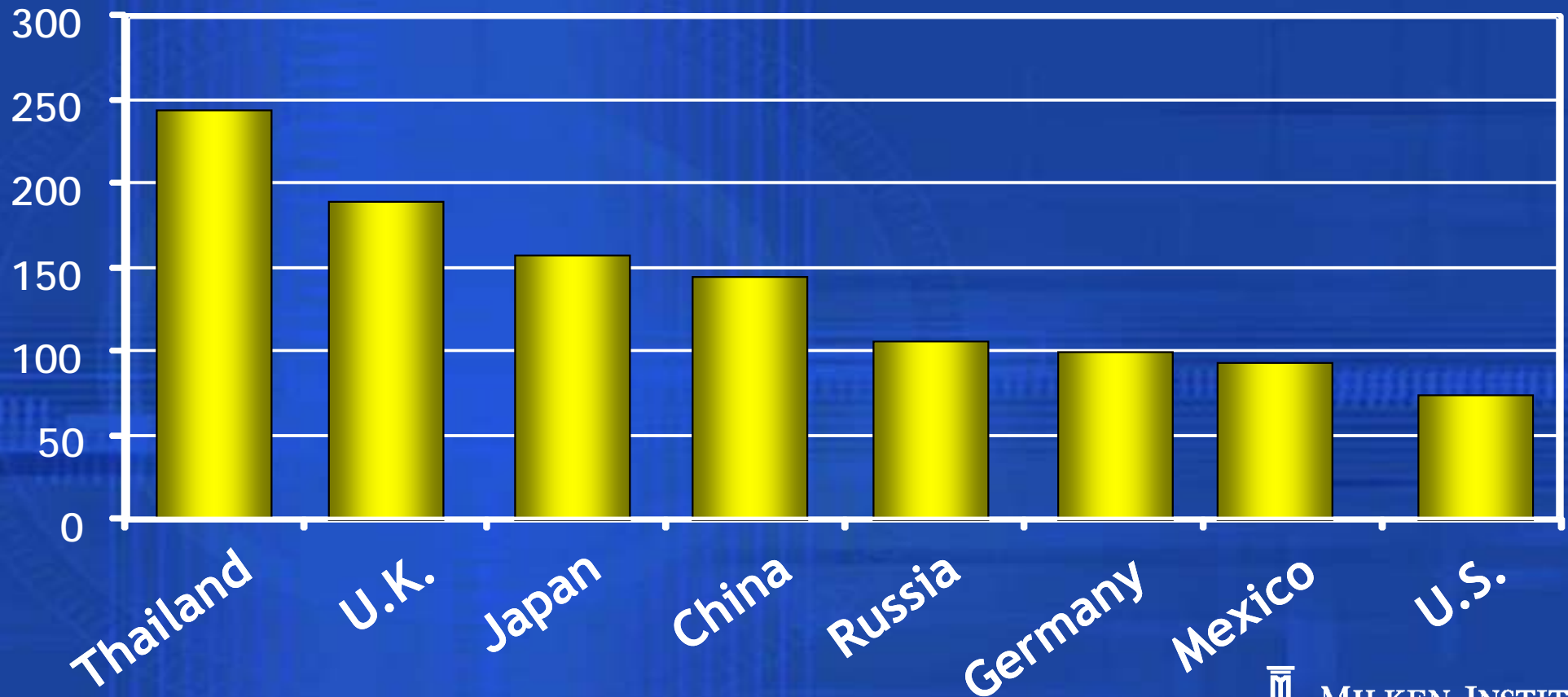
\$6,642-a-year @ 6%

\$1,304-a-year @ 12%

(or a one-time investment of \$10,747)



Bank Assets as Percent of Debt & Equity



Sources: IMF, BIS, S&P and Milken Institute - January 2010

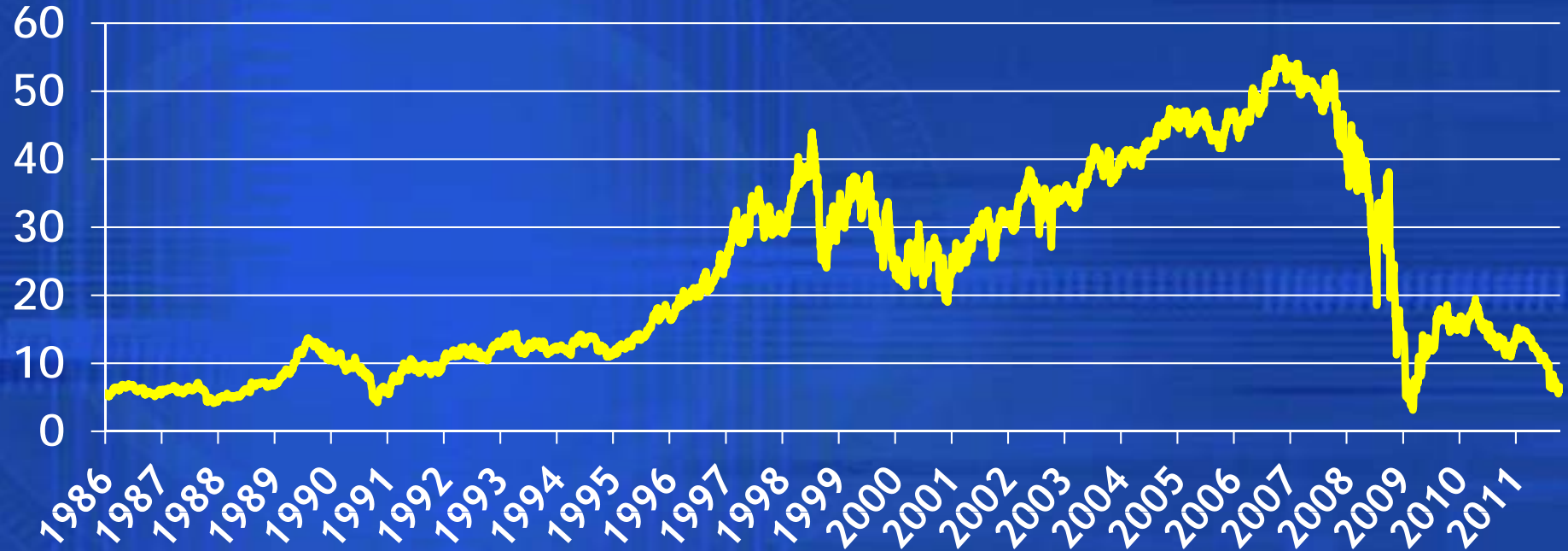


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Bank of America

Stock Performance - 25 years

Price



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Source: Bloomberg; 1/2/1986-10/14/2011.