Isio Reward and Benefits Blog

Still on course for retirement?

April 2022

Review of DC investment strategies over Q1 2022

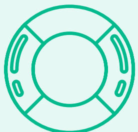
After several quarters of rising markets, the start of 2022 saw investors navigating tricky headwinds in response to Russia's invasion of Ukraine and inflationary pressures. Unlike Q1 2020, when the impact of the pandemic caused a much sharper equity sell-off and flight to "safe haven" assets, 2022 saw bonds also suffer in the market sell-off as concerns around rising rates unsettled investors. This created a challenging environment for both diversified and more equity-heavy strategies alike, and members close to retirement (who typically have a higher weighting to bonds) were more severely impacted.

Despite choppy waters initially, markets settled towards the end of Q1 with global equities in particular recovering most of their losses. It is also important to note that most asset classes have delivered very strong returns over the past few years, with equities returning 19.8%[1] p.a. in the 3 years to 31 December 2021. This should mean most DC pots have grown when taking a longer term view, particularly for members in the growth phase.

In this paper we explore the questions at the forefront of DC members' minds:

- How have the headwinds of 2022 impacted members in the growth and at-retirement phases?
- Which Providers breezed through choppy waters and who had a more turbulent journey?
- Should members be making any immediate changes to their DC investments in light of the stormy seas?

Don't jump overboard yet and remember our 3 Ds approach to DC investing...



Don't panic...
In the growth phase

Diversify appropriately...
In the retirement phase

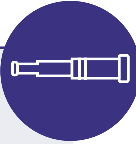
Dynamism...
Where it matters

Note: [1]MSCI World £ sterling terms (i.e. no currency hedging).
Source: Refinitv.

isio.

From choppy waters to calmer seas

The seas at the start of 2022 were difficult to navigate for members in both the growth and at-retirement phase...



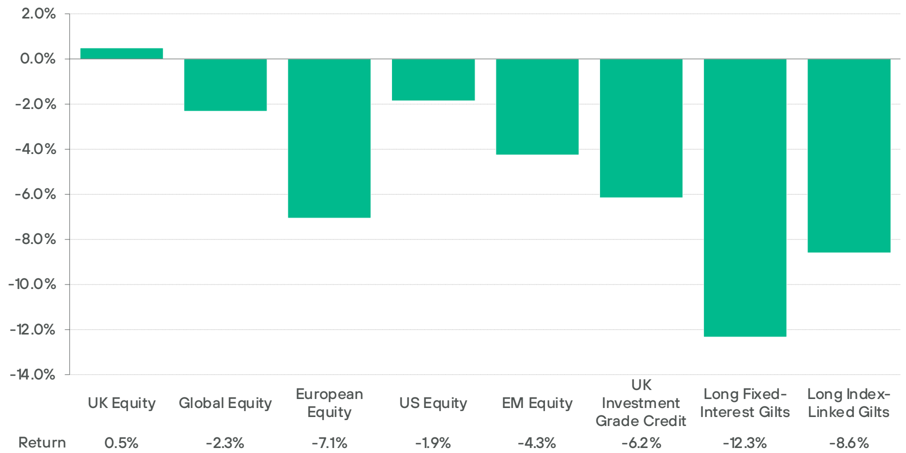
Market commentary...

Markets made waves at the start of 2022 in response to geopolitical tension and inflation concerns.

Despite recovering some losses in March, most equities were down at the end of Q1, with the UK an exception to this. European equities were most impacted due to their proximity to Ukraine / Russia.

We normally see bonds perform well in falling equity markets as investors abandon ship in favour of calmer waters, however, inflation concerns and increasing interest rates resulted in bonds performing even worse than equities.

Returns in Q1 2022 by asset class



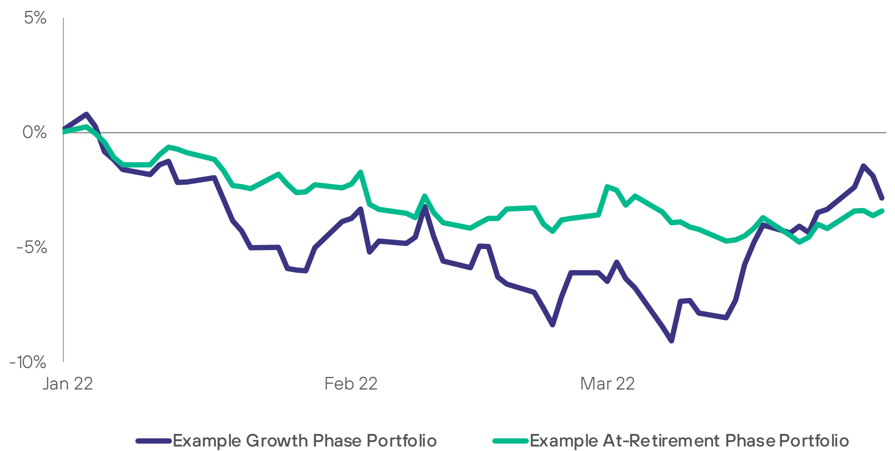
Growth phase...

Members in the growth phase will have likely seen drawdowns and increased volatility during Q1.

Investors that sat tight and didn't drop anchor to de-risk would have seen their pension pots recover to some degree by the end of Q1 as equities regained some of their losses. Investors that panicked and de-risked at the wrong time may have been left high and dry.

Diversified strategies are unlikely to have offered much protection, and may have performed worse than equity driven strategies, as bonds fell further by the end of the quarter.

Cumulative returns in Q1 2022 for example growth and at-retirement portfolios



Note: Example growth phase portfolio composed of: 80% Global Equities (FTSE World (£) Index) and 20% Corporate Bonds (FTSE Non-Gilts (All Maturities) Index). Example at-retirement phase portfolio composed of: 25% Global Equities (FTSE World (£) Index), 25% Corporate Bonds (FTSE Non-Gilts (All Maturities) Index), 25% Index-Linked Gilts (FTSE ILG (All Maturities) Index) and 25% Cash (SONIA). Assumes no rebalancing. Gross of fees. Equity returns shown in £ sterling terms (i.e. no currency hedging).
Source: Refinitv.

At-retirement phase...

Despite experiencing lower volatility, members in the at-retirement phase found themselves in deeper water as their strategy is more likely to have higher exposure to bonds which struggled in the rising inflationary environment.

More defensive strategies with higher corporate bond and gilt allocations are likely to have underperformed at-retirement strategies with a higher allocation to equities.

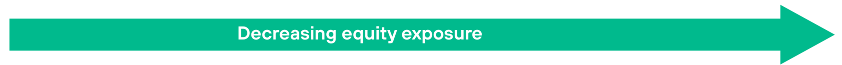
Impact on members

Growth phase...

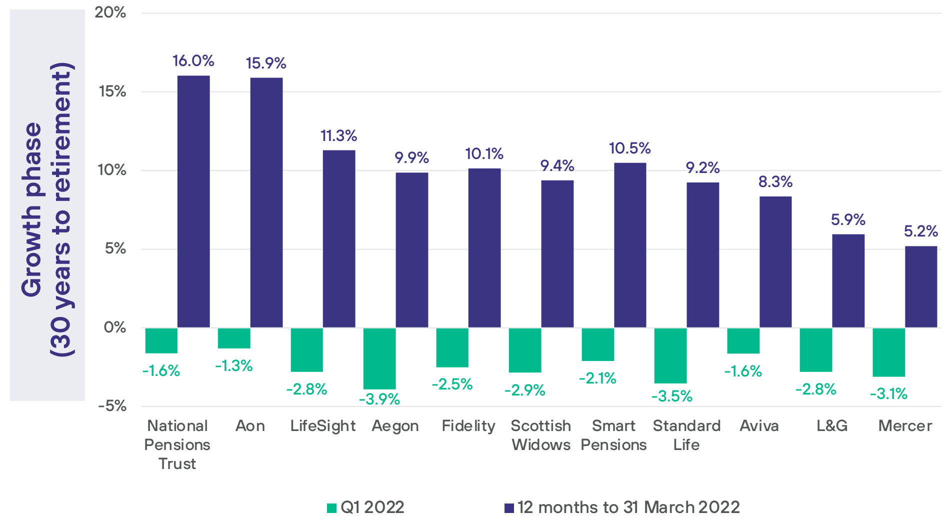
All Providers assessed produced negative returns as stormy seas proved tricky to navigate, however losses were recovered to some extent as equities partially improved over March.

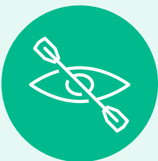
More diversified growth strategies failed to offer members much protection in a quarter where both equity and bond markets fell.

Despite a quarter of negative returns, members in the growth phase should stay calm and remember that they're invested for the long-term. Looking over the 12 month period, returns remain strong despite Q1's volatility.



Default growth phase performance to 31 March 2022





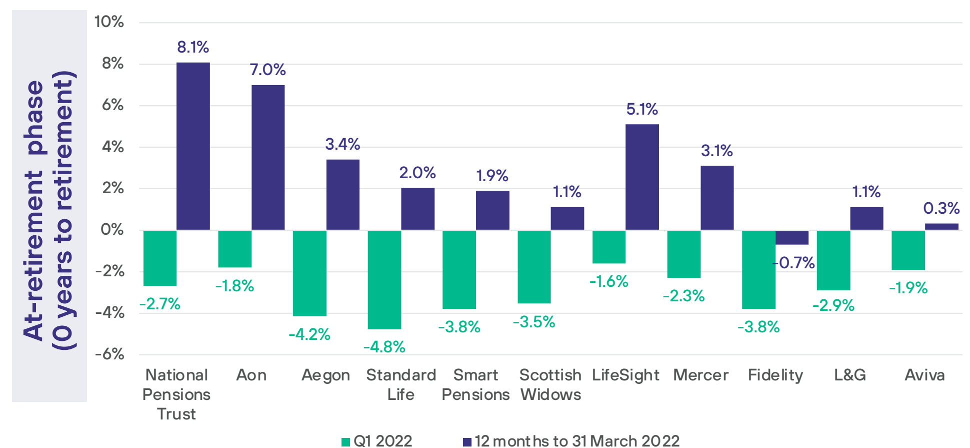
At-retirement phase...

Members approaching retirement would typically expect more protection in falling equity markets due to their more diversified approach and greater exposure to bonds. However rising rates presented a challenging backdrop for bonds and at-retirement strategies tended to underperform returns in the growth phase.

This is concerning for members who wish to retire soon and have a shorter time horizon than members in the growth phase. With few DC members buying annuities at retirement (and most defaults targeting flexible retirement or wealth preservation outcomes), members may need to re-evaluate their pension plans given many strategies failed to keep pace with inflation.

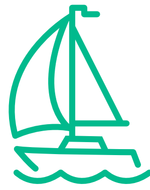
This could result in members needing to explore delaying retirement, adding additional contributions, or even assessing if their strategy remains suitable based on their individual circumstances.

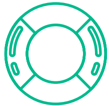
Default at-retirement phase performance to 31 March 2022



Note: Returns shown for some Providers are unaudited returns due to the close proximity to quarter end when first reporting the numbers above.
Source: Providers.

Don't jump overboard yet and remember our 3 Ds approach to DC investing...

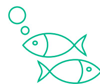


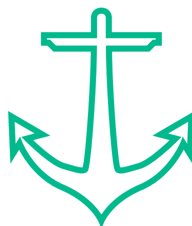


Don't panic
Whilst markets in Q1 were difficult to navigate, sit tight and don't make any knee jerk reactions. DC members, particularly in the growth phase, are invested for the long-term.

Diversify appropriately
Members at-retirement were hit hardest by market losses in Q1. Members should ensure their strategies diversify appropriately (and not just into bonds) to reduce the impact of market downturns on members.

Dynamism
We expect markets to continue to be volatile at least over the next few quarters which should present opportunities for your Provider to adjust their strategy and steer a different route to your retirement destination if required.





Don't jump overboard yet

The start of 2022 proved difficult to navigate, as investors had to sail through strong headwinds of increased geopolitical uncertainty and rising inflationary pressures. This challenging environment was particularly difficult for bonds, which had a greater impact on members approaching retirement. Our analysis has shown that most providers have failed to provide adequate protection against rising inflation for members in the later stages of their savings journey, which will likely have a meaningful impact on their income at retirement.

The forecast for 2022 continues to look choppy, with inflationary pressures, rising rates, and geopolitical tensions expected to remain on the horizon. Given this, we believe DC default strategies could look at non-traditional growth assets, such as private markets, to access genuine diversification for members in these turbulent times.

Our advice in 2020 when the market impact of COVID was unclear was to sit tight and wait for the storm to pass. Investors that did this were rewarded with the strong returns we witnessed in 2021. Today our advice remains the same – sit tight through market volatility, don't necessarily lower the anchor to de-risk in response to market volatility, and remember that younger members are invested for the long-term.

Sail with us

Mark Powley
Head of DC Investment
+44 (0)7795 644 573
mark.powley@isio.com

Jenny Roe
Senior Manager
+44 (0)7468 365 261
jenny.roe@isio.com

Tom Gurney
Assistant Manager
+44 (0)7468 359 479
tom.gurney@isio.com

Ahmed Ali
Analyst
+44 (0)1218 279 192
ahmed.ali@isio.com

Data sources:
DC Providers, Refinitiv, Isio calculations.
Returns shown gross of fees and may be estimated / based on unaudited values.
Past performance is not a guide to future returns.

We have used the following strategies and providers when compiling this report:
Aegon LifePath, Aon Managed Core Retirement Pathway, Aviva My Future Focus, Fidelity FutureWise, L&G Target Date Funds, LifeSight Medium Risk Target Drawdown, Mercer Smartpath Target Retirement Drawdown, Scottish Widows Balanced (Targeting Flexible Access), Smart Pensions Growth Moderate, XPS NPT Life Stage, Standard Life Sustainable Multi Asset

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© Isio Group Limited/Isio Services Limited 2022. All rights reserved