

DC default review: Weathering the storm

As at 31 March 2020

DC meteorologist's report



The pension pots of members close to retirement have on average fallen by 8.7% since the start of the year, despite the lower risk approach that is adopted.

This illustrates the need to understand how your strategy is diversified at the pre-retirement phase and independently benchmark performance, as getting this right has a massive impact on members' retirement outcomes.

Sunshine gives way to heavy spring showers

By the end of 2019, financial markets had experienced several years of positive returns despite a raft of trade wars and Brexit ultimatums.

COVID-19 has tipped markets over the edge, wreaking havoc across risk-based assets with volatility at its highest since 2008.

The following pages outline the experience of early-career and late-career members in a selection of Master Trust default strategies.

Action in view of highly uncertain weather forecast – carry your umbrella!

- Think about your investment strategy using our simple 3 Ds framework (see box on right), with a particular focus on pre-retirement.
- Undertake an independent performance review to benchmark your default on a regular basis.
- Consider your investments alongside the wider impact on your DC scheme using our COVID-19 action checklist.

Our view – the 3 Ds of DC investing



Don't panic... *in the growth phase*

Growth strategies have been hit hard recently. However, we would advise clients against overreacting to this and remember that for younger members, future contributions will have a bigger impact than recent investment returns.



Diversify appropriately... *in the retirement phase*

It is important to keep in mind risk levels for members approaching retirement, as too much focus on chasing return could result in disaster. Now the lightning has struck, the benefits of diversifying appropriately has been acutely highlighted at this vital time for members.

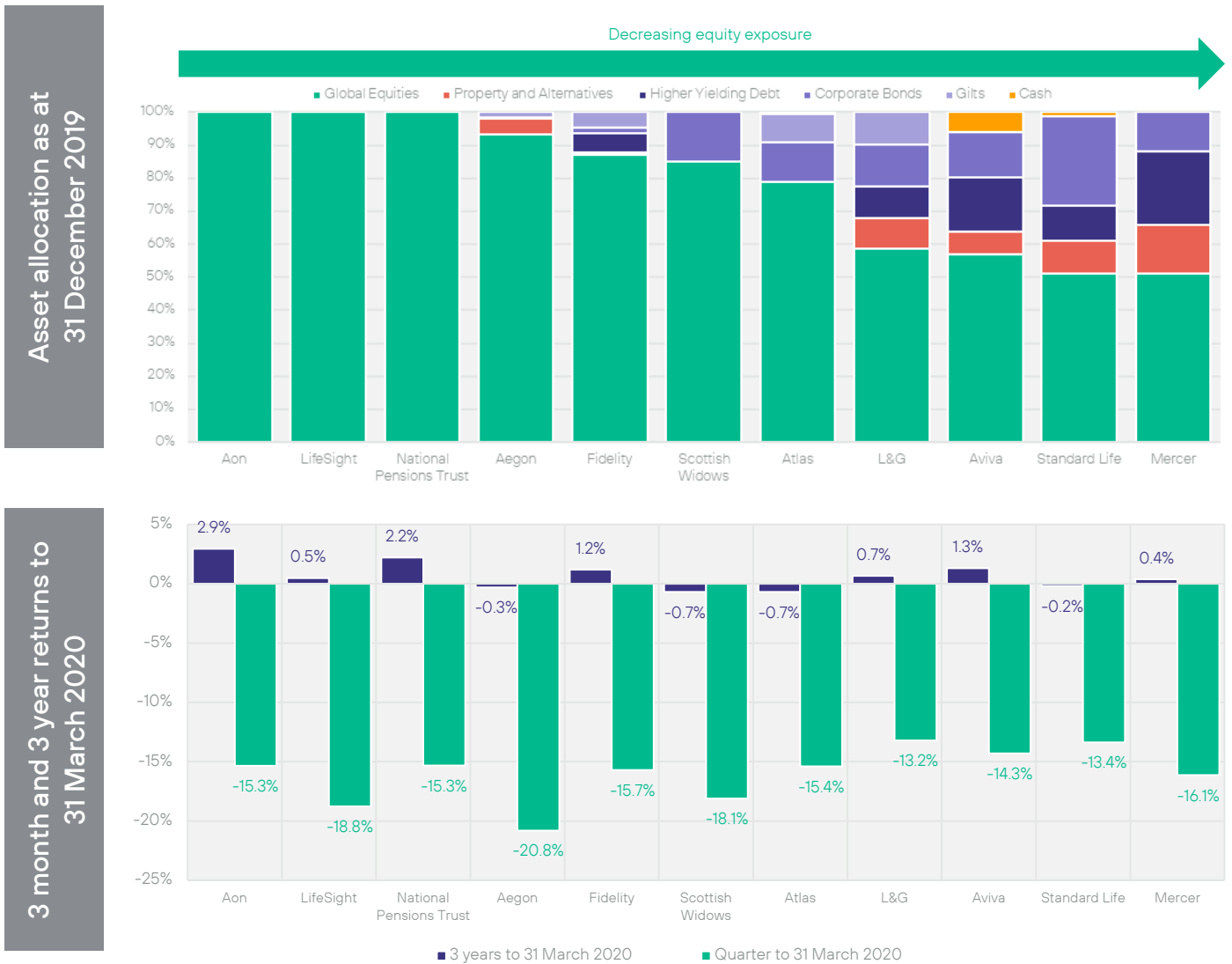


Dynamism... *where it matters*

Investors have the right to be cynical about the use of active management, as recently the only certainty this has provided is higher fees. However, at times of large dislocation, active management can provide opportunities for long-term investors to exploit. We believe Master Trusts with the governance structure to be nimble in response to current market conditions could add real value to members.

Gale force winds buffer younger members

Comparison of Master Trust strategies (30 years to retirement)



When it rains, it pours

- **Early-career members** in the growth phase of our sample Master Trust default strategies saw their pot sizes fall between 13.2% - 20.8% over the past few months.
- **Equity-driven strategies** were generally the worst hit as the extreme market sell-off eroded gains from the past few years. Other factors such as regional allocations (e.g. UK and emerging markets) and the impact of currency differentiated performance for providers with similar equity exposures.
- **Diversified strategies** generally weathered the storm better but finding positive returns has been challenging. How providers diversified was critically important as listed alternatives particularly suffered.



Don't panic... in the growth phase

Although equities have been battered by the storm over the past few months, returns over the longer term remain reasonable. Younger members also have time to rebuild their pots and current prices could prove attractive should markets begin to recover.

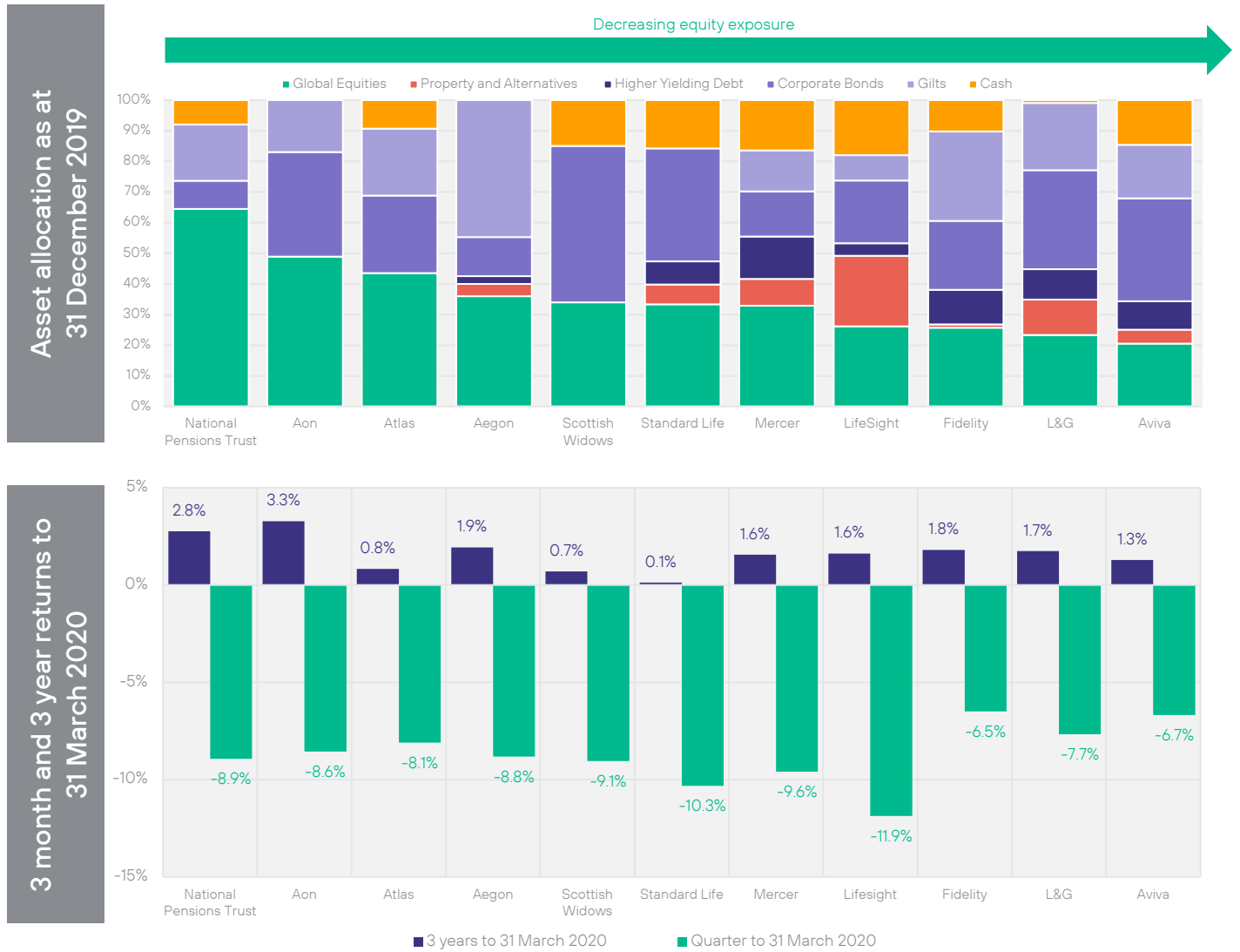


Dynamism... where it matters

Providers with the ability to make tactical decisions have offered downside protection in volatile markets. Going forwards providers with the skill to capitalise on market dislocations could add real value.

Meanwhile, older members take shelter

Comparison of Master Trust strategies (2 years to retirement)



Lower risk portfolios broadly staying dry

- **Late-career members** have been impacted by the recent market volatility to a lesser extent, but these members do not have the luxury of time to recoup any losses.
- **Defensive strategies** with higher gilt allocations have offered downside protection.
- **Exposure to listed alternatives**, such as REITs, has hurt performance due to their high correlation with equity markets. This illustrates that the way strategies diversify is more important than diversification for the sake of it.



Diversify appropriately... *in the retirement phase*

Recent sell-offs have illustrated the need to diversify in the right way and dial down risk as members approach retirement.



Dynamism... *where it matters*

Again providers and multi-asset fund managers with the ability to position the portfolio more defensively have provided downside protection over the past few months, and are better placed to add value should markets begin to recover.

Data sources: DC Providers, Financial Express Analytics, Isio calculations.

Returns shown gross of fees and may be estimated. 3-year returns have been annualised.

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
Atlas Higher Equity
Aviva My Future Focus
Fidelity FutureWise*
L&G Pathway
Lifesight Medium Risk Target Drawdown
Mercer Smartpath Target Retirement Drawdown
Scottish Widows Balanced (Targeting Flexible Access)
Standard Life Active Plus III Universal
XPS NPT Life Stage

*Fidelity performance for older members is based on the strategy 5 years to retirement due to availability of data.

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.

Contact us

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

George Fowler
Partner
george.fowler@isio.com
+44 (0)7920 722 541

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

Jacob Bowman
jacob.bowman@isio.com
+44 (0)7468 366 125

James Hawkins
james.hawkins@isio.com
+44 (0)7385 025 776

Umar Yaqoob
umar.yaqoob@isio.com
+44 (0)7769 741 360

<https://www.isio.com>
contact@isio.com