May 2024

DC market update: Equities still going strong – but for how long?

Q1 2024

Remember our 3 Ds approach to DC investing

Don't panic...
In the growth phase

Diversify appropriately...
In the retirement phase

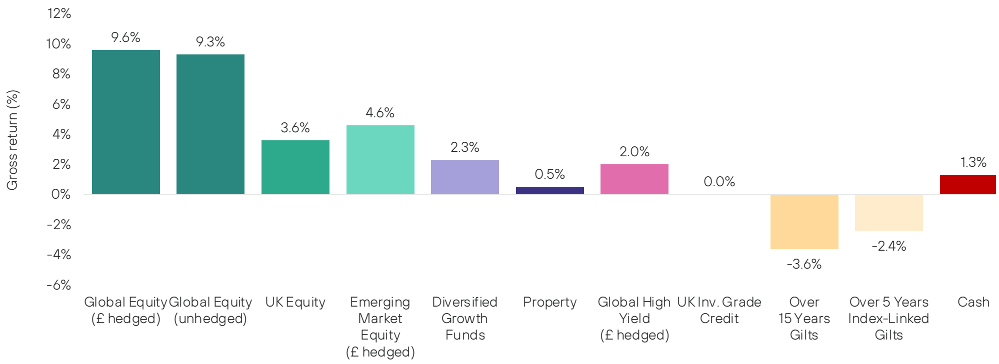
Dynamism...
Where it matters

Market Background – Quarter to 31 March 2024
Market expectations on interest rate cuts were heavily revised over Q1, as markets priced in fewer expected rate cuts for 2024 due to resilient growth, sticky inflation and low unemployment figures. This pointed to a stronger economic picture, especially in the US.

US and Japanese equities delivered strong returns – the former was supported by strong earnings growth, particularly from the 'magnificent seven' mega-cap tech stocks; and Japan was driven by an improving economic outlook as the BoJ began to normalise monetary policy.

In credit markets, with the expected pace of rate cuts slowing, gilts and index-linked gilt returns were negative. Corporate debt benefitted from the tightening credit spreads, as such, high yield bonds outperformed US and UK investment grade.

Looking forward, with the date now set for the UK's next General Election on 4 July, we'll be keeping a close eye on any changes in market sentiment around key economic factors (inflation, interest rates, and gilt yields) and potential new Government policy (e.g. Lifetime Allowance and the Mansion House Compact).



Source: Refinitiv, DGF investment managers, Isio calculations.

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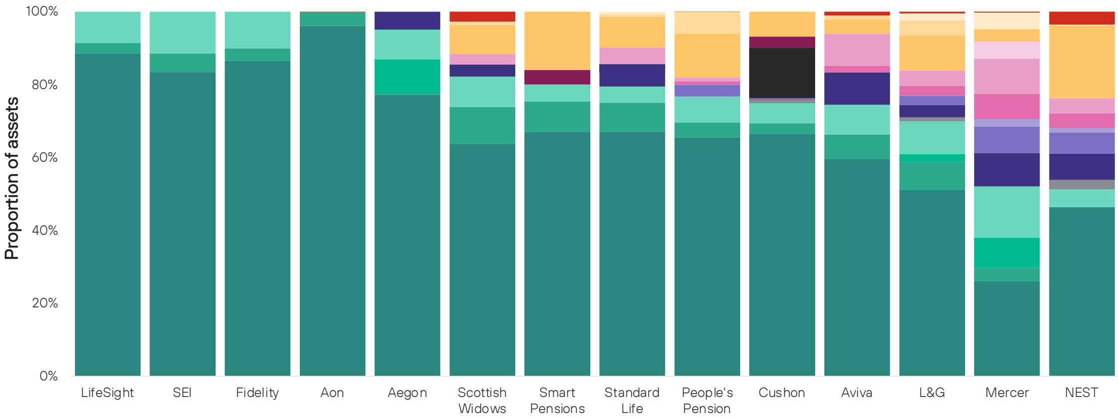
Growth Phase: The equity train keeps on rolling!

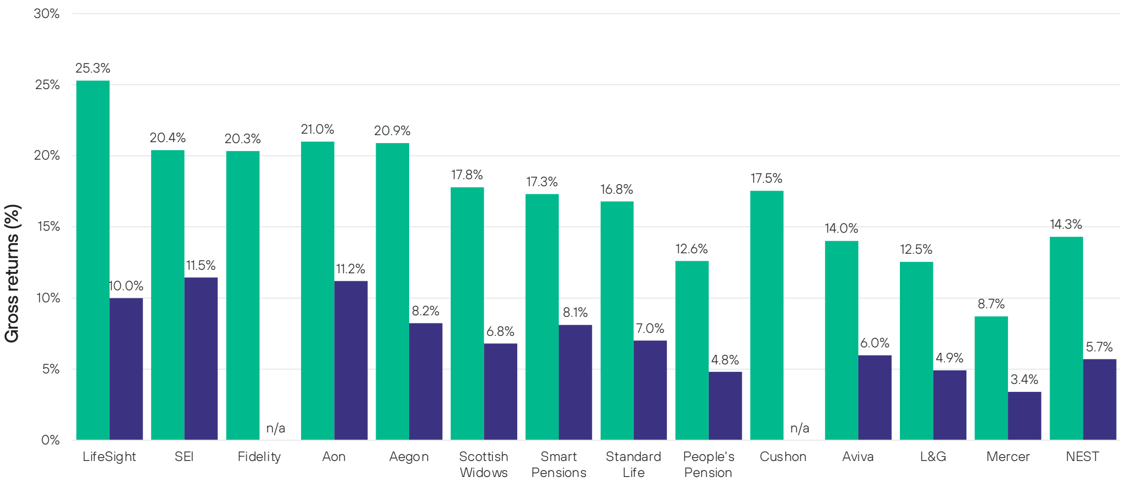
Decreasing equity exposure

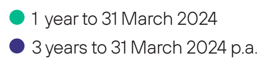
Growth Phase – Peer Group Asset Allocation (30 years to retirement)



Source: Providers, Isio calculations.

Performance to 31 March 2024 – Growth Phase (30 years to retirement)





Source: Providers, Isio calculations.

Wide range of member returns

There remains a wide spread of returns between those providers with an all-equity growth phase vs those who adopt a more diversified approach – with the latter falling materially short.

Over the last 12 months, the difference between the top and bottom performers has been a staggering 16.6%. Whilst over the 3-year period it is 8.1% per year.

Some of this is down to a strong equity bull market but some is down to diversifying into assets less appropriate for the growth phase (e.g. corporate bonds, gilts and cash). We would prefer to see either increased equity allocations or diversification into private market assets. Whilst the former is the easier (and cheaper!) option, we would caution providers from 'chasing equity returns' and overexposing themselves to concentration risk, particularly to the 'magnificent seven' US tech stocks.

Private markets – welcome to DC

We have seen a number of new Long-Term Asset Funds (LTAFs) receive FCA approval over the last few months and providers are gearing up to introduce illiquid allocations into their existing (or new) defaults.

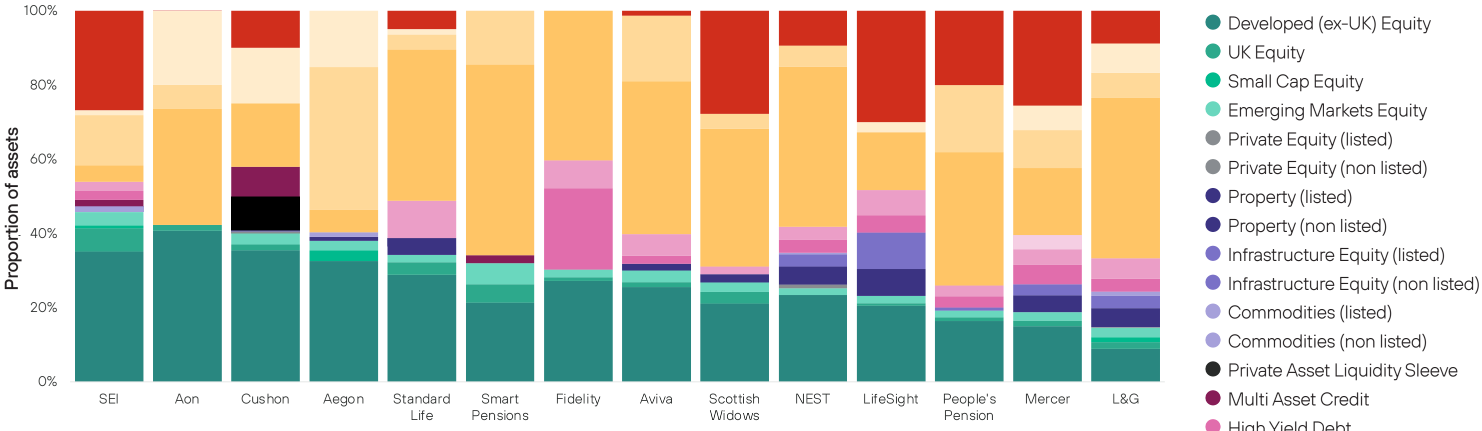
However, most of these private market solutions will have long 'ramp-up' periods as they identify appropriate deals and start to invest. We have therefore included a new asset class in the chart above ('Private Assets Liquidity Sleeve') which represents the short-term tactical cash holding to be used to fund private market investments.

p.s. please look out for our separate market survey on Illiquid Assets in DC – coming soon!

At-Retirement Phase: Getting back on track, but not out of the woods yet

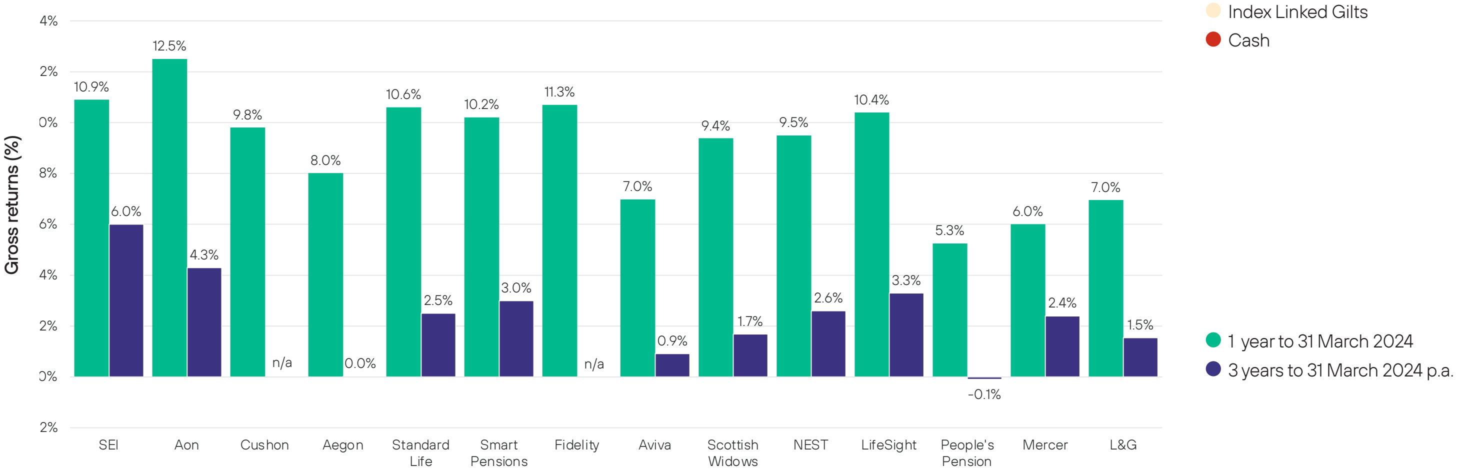
Decreasing equity exposure

At-Retirement Phase – Peer Group Asset Allocation (0 years to retirement)



Source: Providers, Isio calculations.

Performance to 31 March 2024 – At-Retirement (0 years to retirement)



Source: Providers, Isio calculations.

Gilts fall in Q1 but member returns remain positive

Whilst gilt markets were negative over Q1 all providers still delivered positive returns over Q1 and over the 1-year period.

Returns over 3-years have also improved, although are still feeling the effect of the 2021 gilts crisis. More concerning for older members will be how their pension pot has kept pace with inflation (or in most cases hasn't!). Although UK inflation recently fell to its lowest level in three years, economic and political risk will remain in the run-up to the UK General Election, exposing older members to short-term volatility at times when security and certainty are their greatest needs.

Cash or no cash – is that the question?

At-retirement strategies are increasingly split into two camps within the market. Those with higher cash allocations (typically 25%) and those with minimal to no levels of cash.

Strategically, we see little benefit of holding cash under normal market conditions, as they act as a drag on member returns. However, as a lot of DC members are still taking their maximum tax- free cash allowance at retirement (or as early as age 55) we are sympathetic with those providers who have positioned themselves more defensively.

In spite of this, we are now seeing more providers reduce their cash allocations and so we expect the chart above to look materially different by the end of the year.

Key market developments to look out for

- More LTAFs coming to market – watch out for our future thought-pieces
- Chair Statement asset allocation breakdown
- Run up to the UK election – see you on 4 July!

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 BlackRock LifePath Flexi
Aon Managed Core Retirement Pathway
Aviva My Future Focus
Cushon Sustainable Investment Strategy
Fidelity FutureWise
L&G Target Date Funds
LifeSight Medium Risk Target Drawdown
Mercer Smartpath Target Retirement Drawdown
NEST Retirement Fund
Scottish Widows Balanced (Targeting Flexible Access)
SEI Flexi Default Option
Smart Pensions Growth Moderate
Standard Life Sustainable Multi Asset Strategy
The People's Pension – Balanced Profile

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