DC market update:

Strong returns continue as providers consider private market allocations

Q2 2024

Remember our 3 Ds approach to DC investing

Don't panic...
In the growth phase

Diversify appropriately...
In the retirement phase

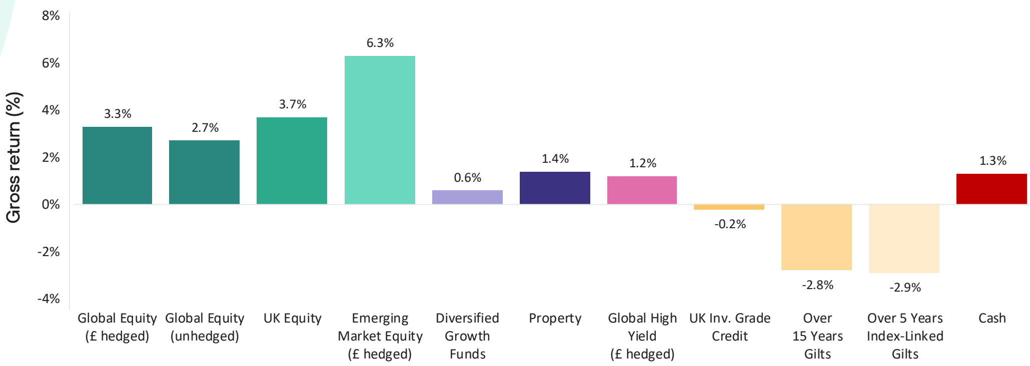
Dynamism...
Where it matters

Market Background – Quarter to 30 June 2024
Q2 2024 saw mixed returns across asset classes as economic data supported risk assets, but central bank messaging led to negative returns in some areas of bond markets. Whilst the ECB implemented a rate cut over the quarter, the US and UK maintained their current interest rates, noting any cuts would be data dependent. This rhetoric led to nominal and index-linked gilt yields rising over Q2, and consequently falls in long dated gilt valuations.

As such, investment grade bonds also experienced negative performance, following government bond yields higher amidst persistent services inflation. However, high yield bonds delivered positive returns as credit spreads remained stable.

Global equities delivered strong returns over Q2, underpinned by positive investor sentiment due to strong earnings growth and easing headline inflation figures.

Performance in the property sector was positive following an increase in consumer demand and activity. However, transaction volumes within the property market remain supressed as markets wait for interest rate cuts to materialise.

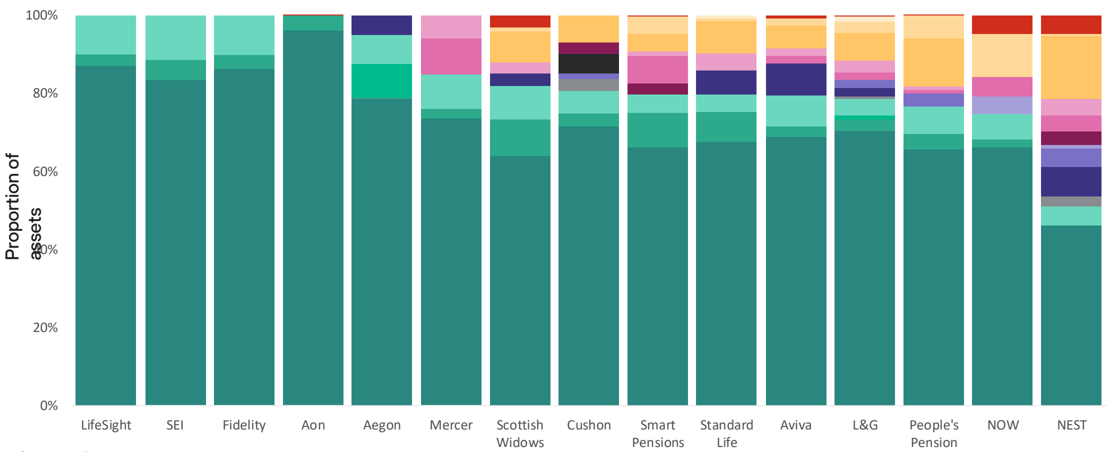


Source: Refinitiv, DGF investment managers, Isio calculations.

Growth Phase: Equities continue to rise...

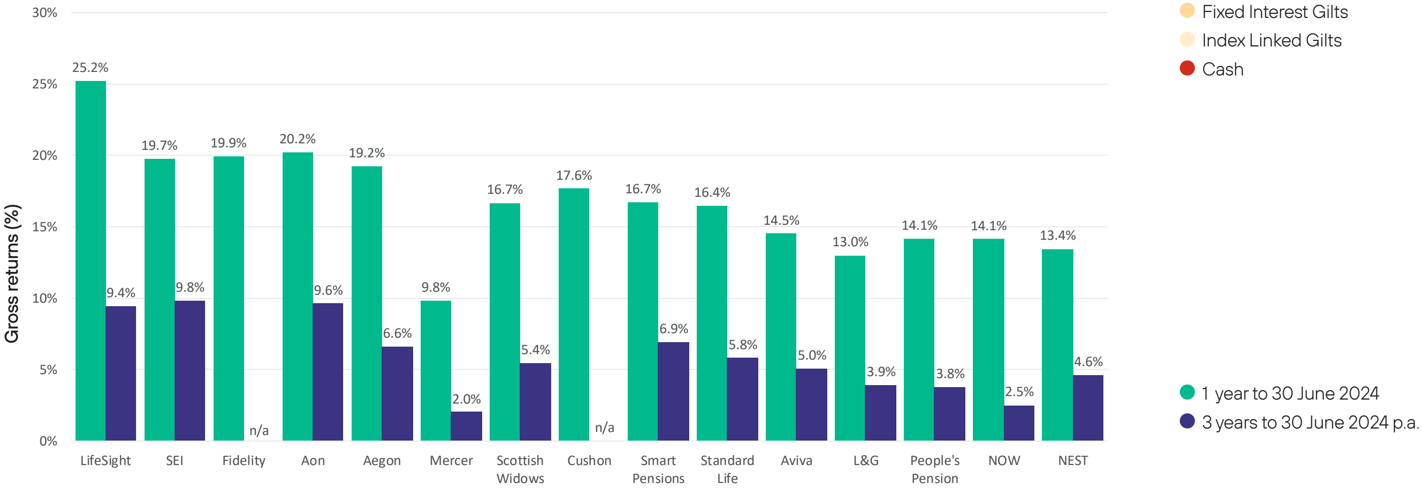
Decreasing equity exposure

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



Source: Providers, Isio calculations.

Performance to 30 June 2024 – Growth Phase (30 years to retirement)



Source: Providers, Isio calculations.

UK and EM stronger returns

Increasing investor confidence encouraged by positive signals in the macro economy has contributed to real growth in the UK, sparking a period of UK equity outperformance relative to global equities. For the first time in 3 quarters we have seen the UK equity market outperform global equities. In addition emerging market equity also performed strongly over the quarter, exceeding developed market returns.

Defaults that have retained a significant home bias have benefited over the quarter but remain below the peer group median over the longer term.

Over the last 12 months, the difference between the top and bottom performers has been 11.8%. Whilst over the 3-year period it is 7.8% p.a., continuing to highlight the importance of equity portfolio construction and overall risk.

Testing the waters of private markets

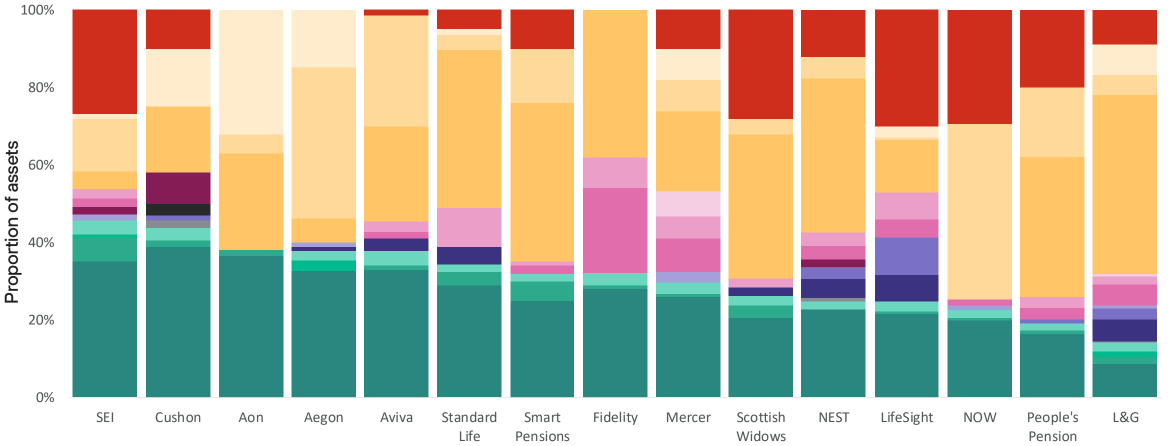
A number of providers are launching their new offerings which include meaningful allocations to private assets primarily through Long-Term Asset Funds (LTAFs). We expect that new default strategies will be launched with an allocation to private markets, although some existing defaults are able to integrate smaller exposures within the existing strategies. We understand this stems from a desire not to disrupt existing members in mainly passive solutions and the potential impact on existing fee structures which might not be palatable to current schemes invested.

Whilst it might make sense for the DC market to dip their toes into private assets rather than diving in headfirst, smaller commitments may not lead to the opportunities in this sector being fully realised.

At-Retirement Phase: Diversification within credit is key

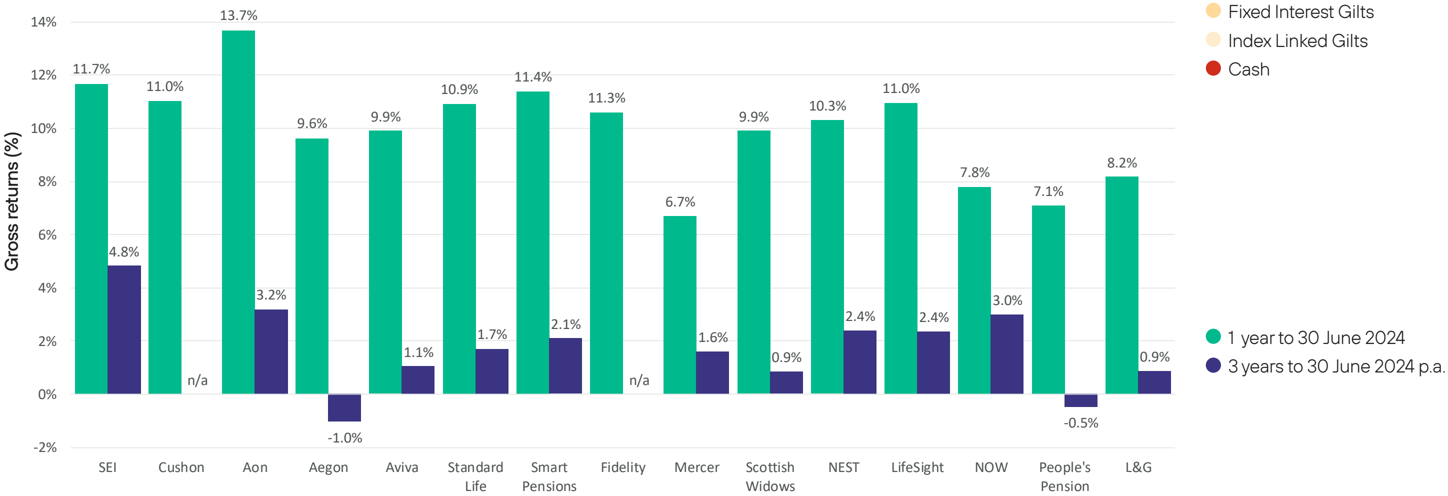
Decreasing equity exposure

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



Source: Providers, Isio calculations.

Performance to 30 June 2024 – At-Retirement (0 years to retirement)



Source: Providers, Isio calculations.

Positive outcomes from diversified strategies

Trends from Q1 continued as long dated gilts delivered negative returns, primarily due to market concerns that the decline in UK inflation might be temporary and high wage inflation is sustaining the elevated annual inflation rate in services. Despite this, all providers successfully delivered positive returns over the quarter and over the 1-year period.

This achievement was largely attributable to their diversified investment strategies, encompassing equities, property, and high yield debt, which performed well amidst market volatility. Equities benefited from strong corporate earnings and resilient consumer spending, while the additional spread from high yield debt more than compensated for falling prices, resulting in outperformance relative to government bonds and investment-grade corporates.

Pension Reform: Delivering Better Value for UK Savers

In the July King's Speech, a Pension Schemes Bill was announced, including a new value for money (VFM) framework aimed at enhancing pension outcomes for savers. This framework seeks to ensure that pension schemes deliver good investment returns and high-quality services at competitive prices.

By creating a consistent method for assessing and comparing both contract-based and trust-based DC schemes, the VFM framework aims to improve transparency, consistency, and competition across the pension landscape.

Also included in the Bill were measures aimed at automatically consolidating small DC pots of less than £1,000, helping savers in tracking their pensions while reducing the number of loss-making pots that providers need to manage.

This Bill is designed to transform pension savings for millions, ensuring that savers receive the best possible value for their retirement investments.

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Key market developments to look out for

- More information on the VFM framework in the Pension Schemes Bill
- Labour's Autumn budget
- Run up to the US elections in November
- Decumulation

Disclaimers
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
NOW: Pensions
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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