December 2024

DC market update:
Key announcements take centre stage

Q3 2024

Remember our 3 Ds approach to DC investing

Don't panic...
In the growth phase

Diversify appropriately...
In the retirement phase

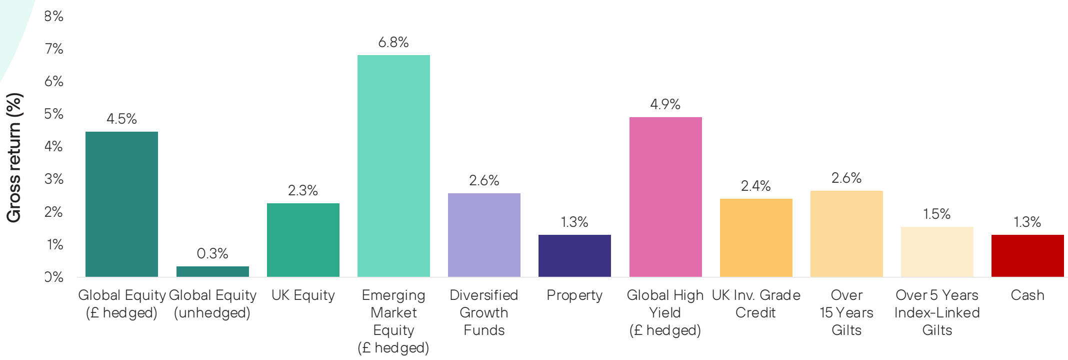
Dynamism...
Where it matters

Market Background – Quarter to 30 September 2024
Q3 2024 saw positive returns across most asset classes.

Global equities ended the quarter strongly, despite significant volatility at different times of the quarter, including a sell-off in August driven by weak US jobs data and an unanticipated interest rate rise in Japan. Central bank rhetoric quickly eased concerns, with the US recovering strongly. Emerging Markets delivered strong gains, outperforming developed markets. Thailand was a top performer and China showed strong growth resulting from monetary stimulus measures announced in September and expectation of fiscal stimulus to reverse the region's recent slowdown.

Fixed income markets benefitted from central banks beginning to cut interest rates, with risk-on sentiment further benefitting valuations, as credit spreads marginally tightened. UK Investment Grade Credit also rebounded from its flat performance in Q2. UK gilt yields fell over the period amid hopes of economic growth and stability under the new Labour government, coupled with the expectation of further near-term rate cuts.

UK commercial property continued to perform positively as deal flow appeared to have already bottomed out with liquidity picking up, albeit slowly.



Source: Refinitiv, DGF investment managers, Isio calculations.

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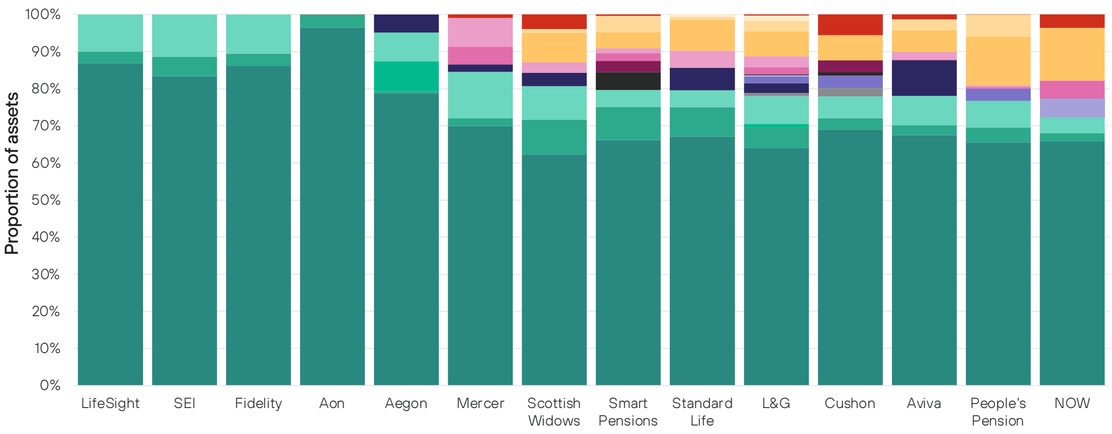
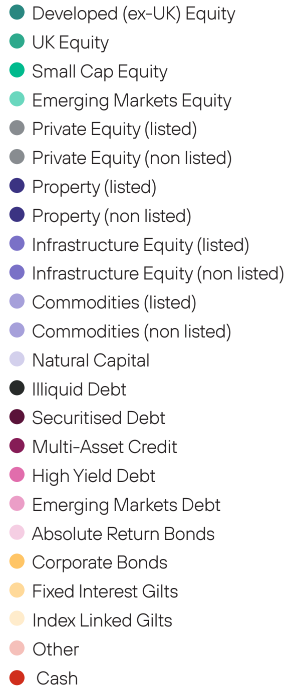
Growth Phase: Diversified strategies bounce back

Decreasing equity exposure

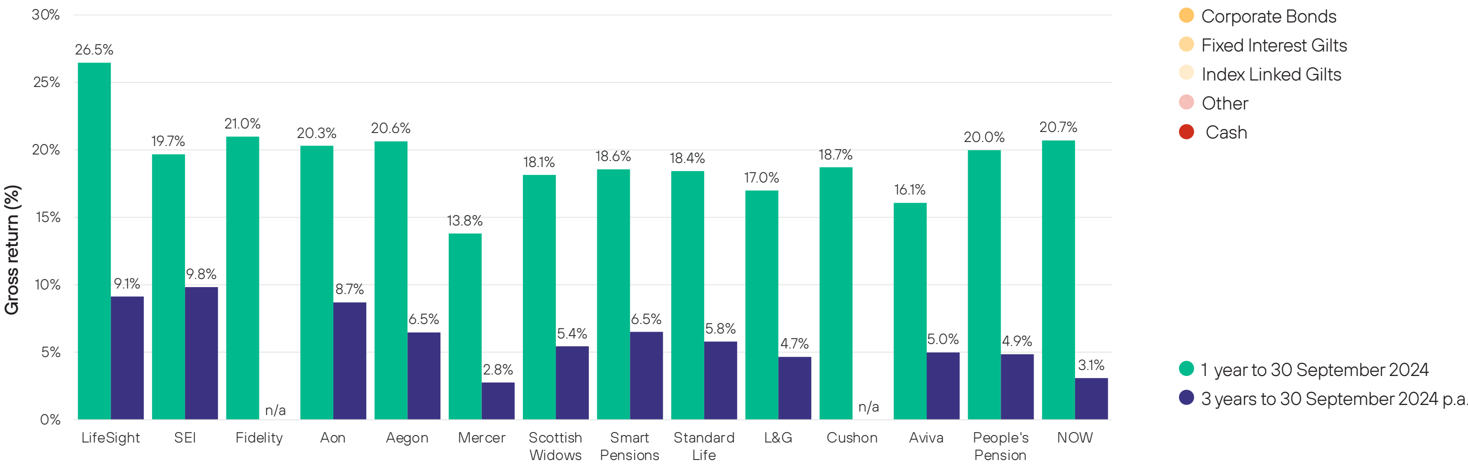
Growth Phase – Peer Group Asset Allocation (30 years to retirement)





Source: Providers, Isio calculations.

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



Source: Providers, Isio calculations.

Diversified growth strategies show their potential

Following a period of strong performance, equities experienced a sell-off in August but managed to recover, ending the quarter in positive territory. GBP-hedged equities outperformed their unhedged counterparts as the pound strengthened versus the dollar.

Despite this positive equity performance, diversified growth strategies outperformed their all-equity counterparts – driven largely by strong returns from High Yield credit. This resulted in diversified strategies performing roughly in line with their all-equity peers over the past year. However, over the 3-year period, all-equity strategies have outperformed diversified strategies by approximately 4% p.a.

The recent performance underscores the resilience of diversified strategies, especially in volatile markets, but also highlights the longer-term potential of all-equity strategies.

Differentiating within an all-equity approach

Within equity strategies, we observe diverse investment styles, typically market cap or smart beta/factor-based, and varying levels of currency hedging.

Factor investing targets specific stock characteristics such as value, quality, and momentum, while market cap investing focuses on company size. This year, a strong upward trend in US markets has enabled factor-based strategies to leverage momentum, delivering robust returns for investors.

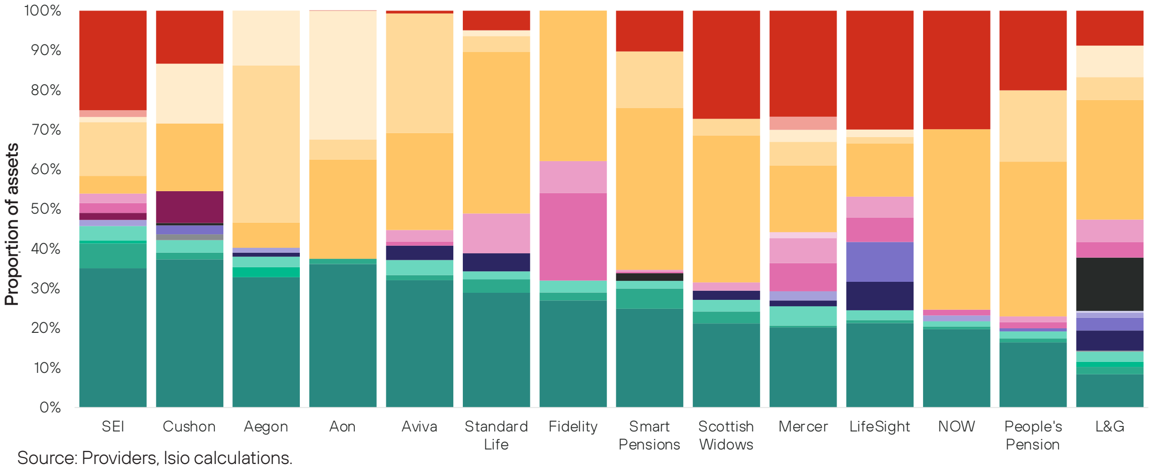
Currency hedging strategies often hedge none or half of the foreign exchange risk as it is typically believed that currencies mean revert over time. This approach has led to divergent returns, with GBP-hedged equities outperforming over the past year.

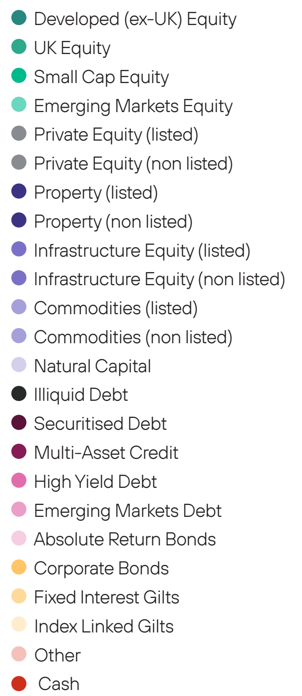
From a strategic investment perspective, we believe that leaving currency unhedged on equities is preferable in terms of providing diversification during extreme market environments. This approach also avoids the inherent cost, operational complexity and governance burden involved in introducing a hedging program.

At-Retirement Phase: Change is coming

Decreasing equity exposure

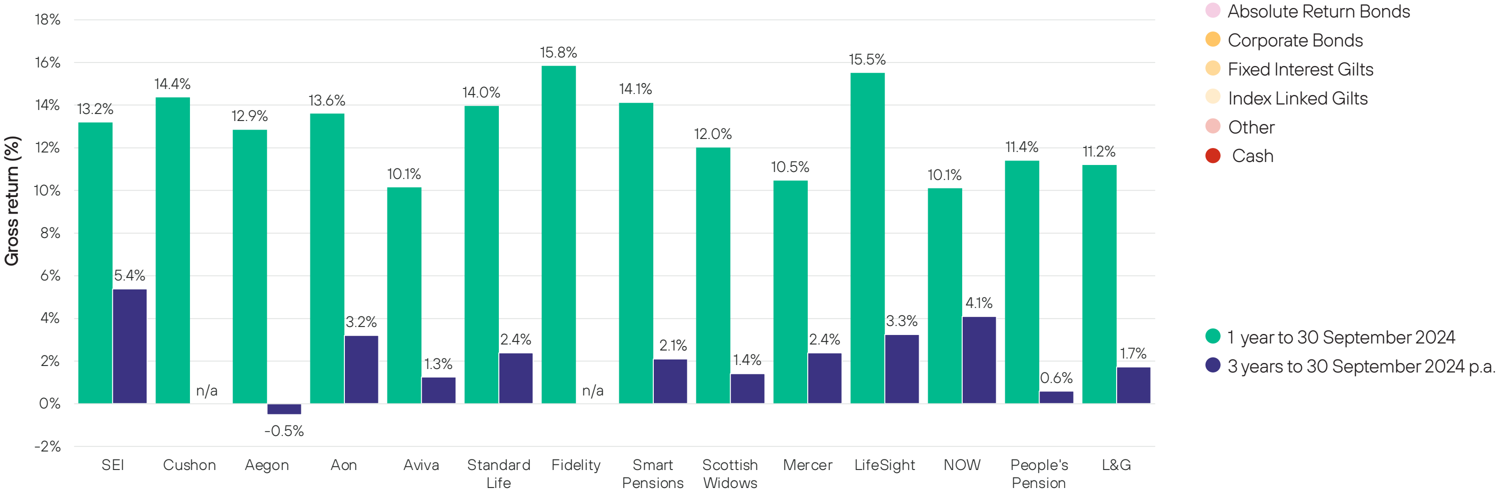
At-Retirement Phase – Peer Group Asset Allocation (0 years to retirement)





Source: Providers, Isio calculations.

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



Source: Providers, Isio calculations.

Positive gilt markets boost performance

At retirement returns have been strong over the past year as most asset classes have delivered positive performance.

During the quarter, the election of the new Labour government and the subsequent budget announcement led to significant fluctuations in gilt markets. Initially, there was a sharp sell-off in gilts as investors reacted to concerns over potential tax increases and increased government borrowing. However, the Budget's focus on infrastructure investment and green energy initiatives gradually restored confidence. By the end of the quarter, gilt yields stabilised, reflecting a cautious optimism about the government's strategic fiscal measures aimed at long-term growth.

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Mansion House – immediate reaction for DC savers

In her Mansion House speech, Rachel Reeves introduced key principles aimed at transforming the pensions industry, focusing on accelerating consolidation and prioritising value over cost.

Reeves argued that by consolidating smaller pension schemes into larger, more efficient entities, it would be possible to achieve economies of scale, enhance investment opportunities, and ultimately provide greater financial security for pensioners.

The speech launched a consultation for the 2025 Pensions Bill, outlining policies such as minimum size requirements for pension schemes and mechanisms to facilitate bulk transfers of assets. These changes aim to reduce fragmentation and improve fund performance. While the proposed timeline extends to 2030, the initiatives signal significant potential changes, encouraging increased transfer and merger activity within the industry.

Isio welcomes the opportunity to contribute to shaping these measures, recognising the importance of balancing competition, innovation, and member interests in a consolidated market.

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Key market developments to look out for

- The evolution of decumulation strategies
- Illiquid Assets – our follow-up research paper

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
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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