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2020 DC Default Review

When you walk through a storm...

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Hold your head up high...

- The backdrop to 2020 in the UK, was Sir Captain Tom's NHS charity walk, also achieving chart success with his version of "You'll Never Walk Alone", the lyrics of which bear a close similarity to describing the investment fortunes over the year.
- 2020 was one of the most challenging years for investors for a long time, with the impact of the global Covid-19 pandemic, drawn-out Brexit negotiations and a stormy US election giving fund managers plenty to consider.
- Global equity markets fell by over 15% in a week in March, but thereafter there was a remarkably quick turnaround of fortunes, with overseas equities in particular responding well to central government stimulus packages, quickly regaining the Q1 losses. Typically, in the UK, the miserable weather stuck around for longer, with UK equity returns lagging the wider market recovery.
- Despite the volatility, pension pots of younger members rose on average 8% during 2020, and just under 6% for members closer to retirement. Three year returns were 7% p.a. for younger members and 5% p.a. for older members.

Don't be afraid of the dark...

....days of equity market falls. Investors holding their nerve during the Q1 market sell off would have been rewarded with strong investment returns in 2020. Those who sought shelter by de-risking may have crystallised significant losses.

Providers able to take a dynamic asset allocation approach may have increased equity weightings at deflated values, thereby benefitting further from the subsequent rally, although providers with a UK equity bias will have fared less well.

December brought positive news of the COVID-19 vaccination programme and equity markets around the world, including the UK, ended the year on a high.

Walk on through the rain....

The early months of 2021 have still been a little stormy, with potential to further disrupt markets, including the threat of new covid variants, a slower than anticipated global recovery, rising interest rates and possible inflationary pressure.

The economic outlook for 2021 may look brighter as lockdown conditions ease and economies reopen, but there is continued uncertainty which could see another volatile year for markets.

Based on the 2020 experience, younger investors may benefit again by remaining calm and walking on through the wind and the rain. Older investors may find their retirement dreams are tossed and blown if market volatility materialises but the benefits from lifestyle de-risking should provide greater protection.

Our view – the 3 Ds of DC investing

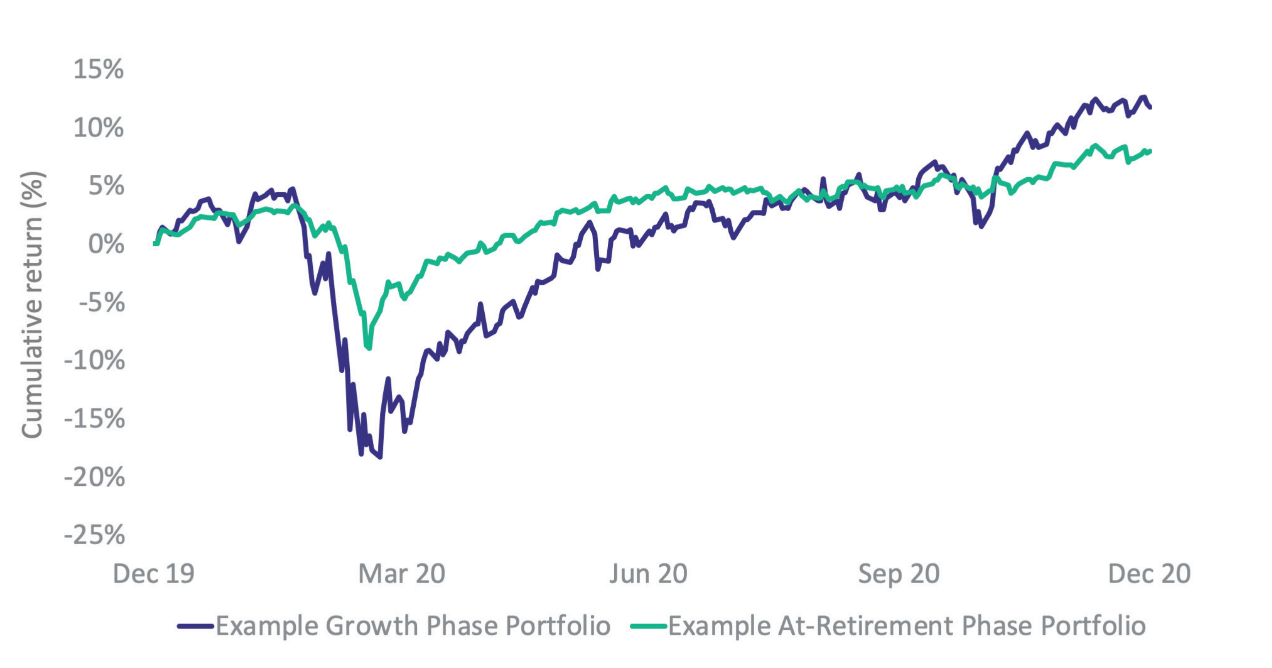
Don't panic...
in the growth phase

Diversify appropriately...
in the retirement phase

Dynamism...
where it matters

At the end of the storm....

Cumulative returns in 2020 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 (7 day LIBOR Index). Assumes no rebalancing. Gross of fees. Source: DataStream.

While the overall returns for 2020 look good for members, they mask the rollercoaster of a ride to get there.

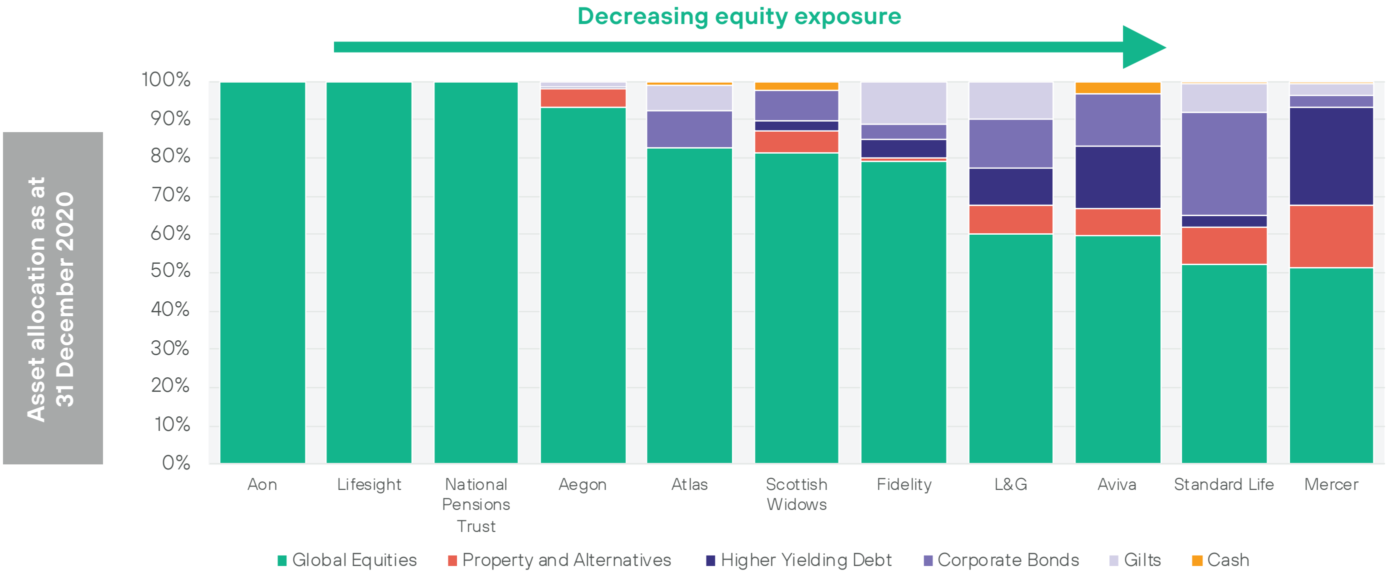
- **All members experienced significantly high levels of volatility in 2020**, with all major markets heavily impacted by the outbreak of COVID-19.

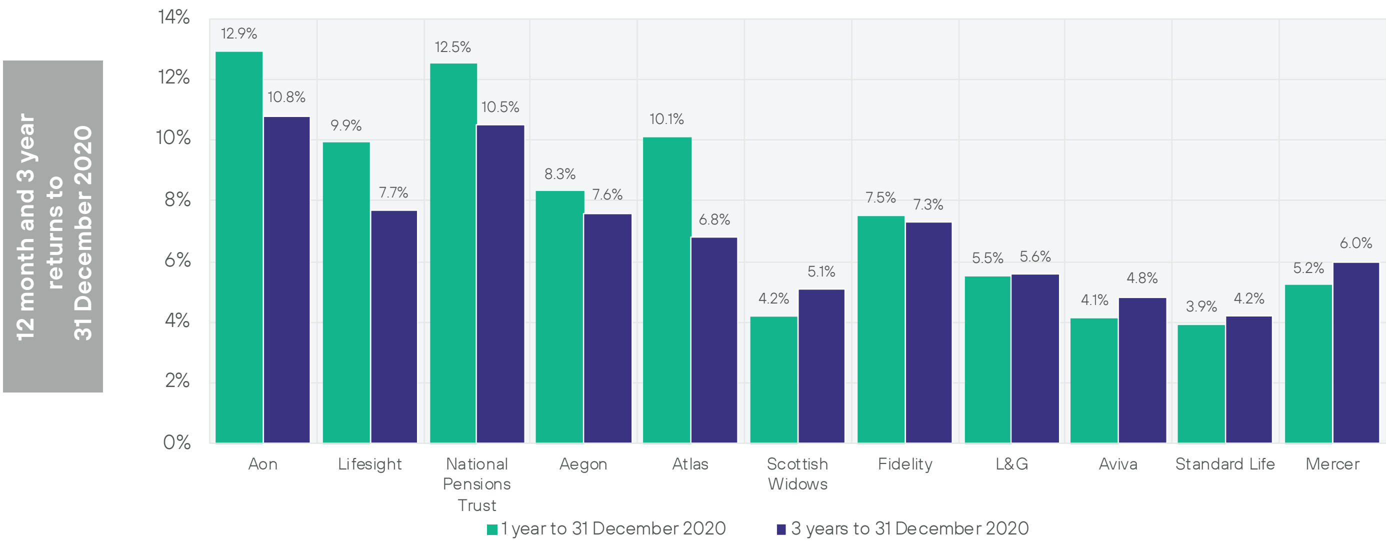
- **Growth phase members will have seen a bigger Q1 drawdown** than members closer to retirement as they were invested in riskier assets. This higher risk was rewarded with strong 12 month returns by the end of 2020.

- **Whilst older members have a lower tolerance to volatility due to their shorter investment horizon,** those members that sat tight and didn't sell any assets will have been rewarded with a quick market recovery and seen their pot sizes increase in value by the end of 2020.

There's a golden sky (for younger investors)...

Comparison of Master Trust strategies (30 years to retirement)





Note: 3 year performance returns are annualised

- **Despite an unprecedented market sell-off in March 2020,** early-career members in the growth phase of our sample Master Trust default strategies saw their pot sizes increase by up to 13% over 2020.
- **Equity-driven strategies benefitted the most,** especially those with a lower weighting to UK equity, as overseas equity markets responded well to central government stimulus following the Q1 2020 market sell-off.
- **Diversified strategies** did not fare quite as well given the equity-led rally, with alternative growth assets struggling to keep pace with strong equity market returns.

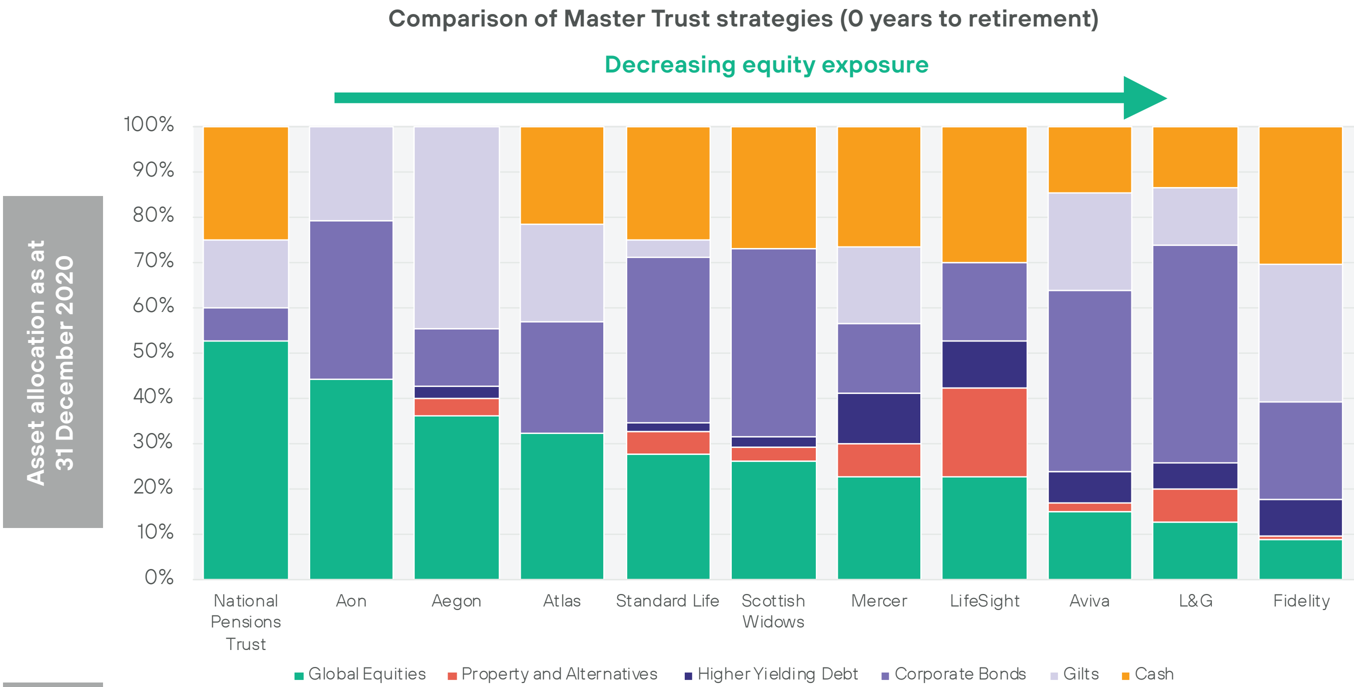
Don't panic... at any point

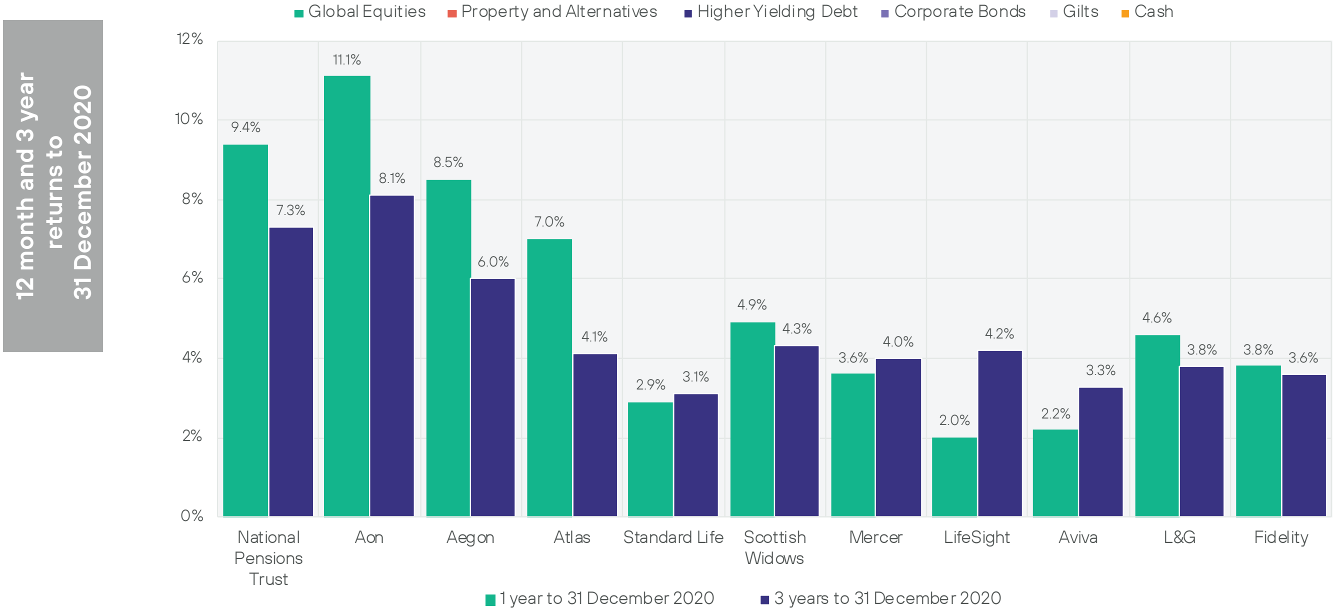
Playing a patient waiting game paid off for younger members as most quickly recovered the losses in March and enjoyed strong returns in the second half of 2020.

Dynamism... where it matters

Whilst we prefer providers whose approach allows them to adapt to market conditions and take tactical opportunities, having a high global equity allocation benefitted the Master Trust provider universe during 2020.

And the sweet silver song of a lark (older members)...





Note: 3 year performance returns are annualised

- **At-retirement members** recovered past the Q1 losses with longer term returns now averaging 4.8% p.a.
- **More defensive strategies** with higher gilt and cash allocations lagged riskier growth strategies but still delivered positive returns and will have experienced lower volatility in 2020.
- **The impact of automatic de-risking** in lifestyles and target dated funds helps preserve capital for older members whilst still generating positive absolute returns.

Don't panic... when the end is in sight

Whilst the market volatility in 2020 may have caused some nervousness, sitting tight into 2021 will have been beneficial for older members.

Diversify appropriately... in the retirement phase

Strategies should not rely on any one asset class in this phase, with a broad mix of assets providing reduced risk at a time investors have larger pots and less time to recover any losses.

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Data sources: DC Providers, Refinitiv, Isio calculations.

Returns shown gross of fees and may be estimated. 3 years 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 Target Date Funds
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