Pension fund investment returns

The importance of understanding the risk being taken

nestpensions.org.uk

Fund investment

Pension fund investment returns

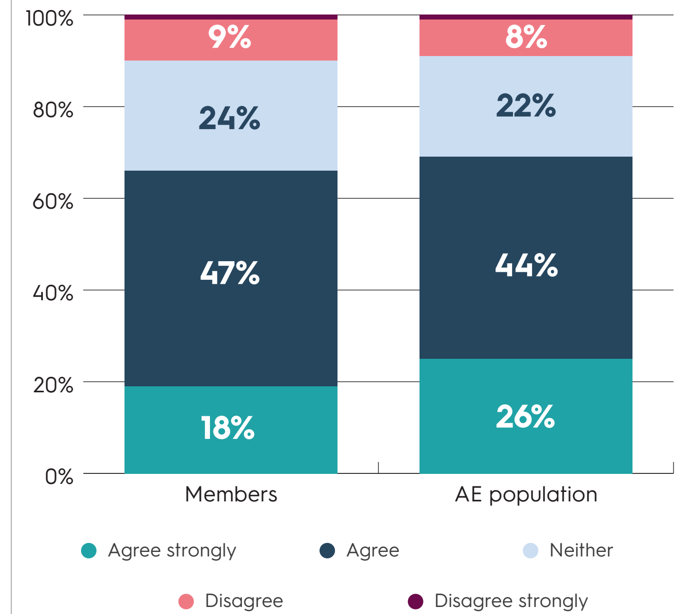
Rather than just look at short term investment returns, we believe employers and their advisers should judge pension schemes on their ability to deliver consistently good returns over the longer term, in all market conditions and without taking excessive risks with members' money. Understanding the level of risk being taken by the pension fund provider is key.

Scheme members

Pension scheme members expect to see growth in their savings. However, through extensive research we've found that most people are uncomfortable with the idea of investment volatility and stock market crashes. Most people have a strong desire for smoothness and stability in their pensions savings rather than chasing bigger but less likely returns.

As the chart opposite shows, these views are consistent across our membership and the wider working population eligible for auto enrolment.

Figure 1: It's better to play safe with your retirement savings, even if investing in higher risk investments could make you more money

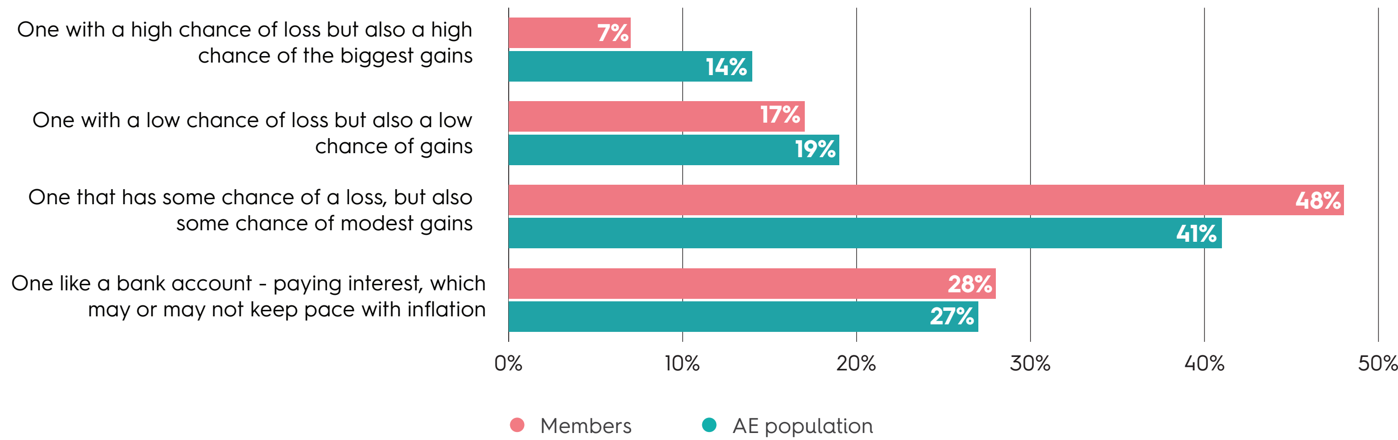


Figures may be affected by rounding.

Source: Nest member survey, 2017 Base: Nest members (3535); Consumer survey 2017, Base: workers eligible for auto enrolment (1030)

Savers' risk appetite was also explored in the surveys by asking participants to choose between four different types of pension fund. Most people chose the options they perceived to be lower risk. In fact, just over a quarter went for the pension fund option that was just like a bank account paying interest.

Figure 2: If you were offered four different types of pension fund and could only invest in one, which would you be most likely to pick?



Source: Nest member survey, 2017 Base: Nest members (3535); Consumer survey 2017, Base: workers eligible for auto enrolment (1030)

However, pension schemes need to take some risk and invest in company shares, property and other investments to make members' money grow faster than inflation. If we only invested in safe, interest paying accounts, after allowing for inflation the money members would get at retirement could be worth less than when they invested it. We believe it's important to deliver inflation beating returns for our members.

We recognise, understand and respond to people's views and concerns about investment risk, while at the same time knowing we need to take sufficient risk to deliver inflation beating returns. This is what has led to the innovative, diversified Nest investment approach.

We believe one of the big questions employers and their advisers should ask is how much investment risk do they think their employees want to take? How much will they be prepared to accept to keep ahead of inflation and will their chosen pension provider reflect this?

Pension scheme members expect to see growth in their savings. However, through extensive research we've found that most people are uncomfortable with the idea of investment volatility.

Default funds

Pension scheme default funds that invest heavily in just a few asset classes in a restricted geographic area or have a very high proportion invested in equities are likely to be more volatile and risky. Our approach is to invest more widely to spread risk. More narrowly invested funds may deliver good returns in one year but may not in other years. This fails to meet members' clear preference for security and stability. It also discriminates against members on the basis of when they contribute to the scheme and when they leave the scheme, with some winning and others losing, purely based on luck and timing.

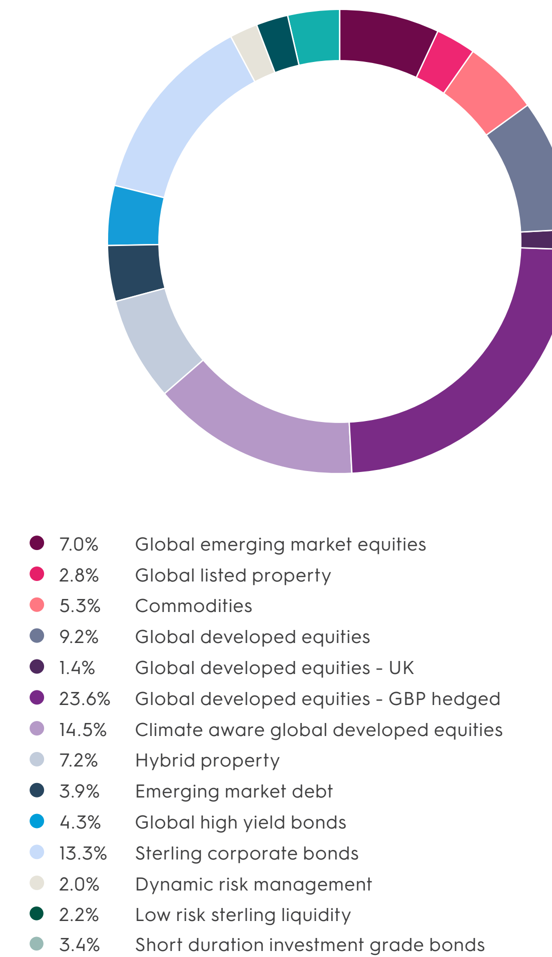
At Nest we have a well-diversified portfolio, invested across a range of regions and different types of investments and by experts in those different fields. We believe this is the best way to deliver good returns in all conditions, for all members regardless of when they contribute, at a lower level of risk.

We understand the correlations between the different types of investments and ensure that money is invested across a broad spread of investments. This is so that when one type of investment or geographical region isn't doing well, other investments in the fund should compensate for this.

Nest fund

These charts show how a typical Nest fund is invested in a range of assets and geographical regions to spread risk for our members.

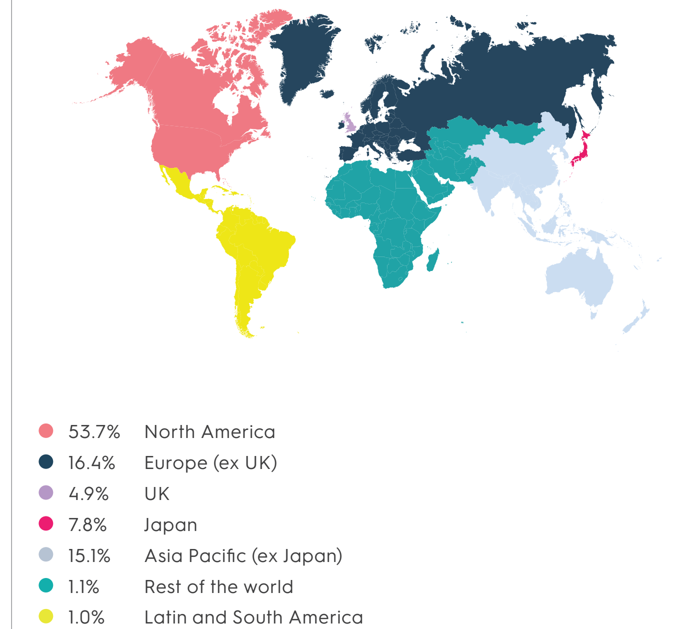
Figure 3: Nest 2040 Retirement Date Fund



Source: Nest 2040 Fund factsheet as at December 2018

At Nest we have a well diversified portfolio, invested across a range of regions and different types of investments and by experts in those different fields. We believe this is the best way to deliver good returns in all conditions, for all members regardless of when they contribute, at a lower level of risk.

Figure 4: Global breakdown of equity



Source: Nest 2040 Fund factsheet, as at December 2018

Global investment

Rather than be dependent on the returns from companies based only in the UK, we invest in companies globally. This enables us to spread risk for our members and give them a share in profits from around the world.

Investing in a carefully chosen, well spread range of investments means our members don't have all their eggs in one basket. This level of diversification helps reduce risk for our members while still aiming for good returns.

In July 2018 Corporate Adviser published an analysis of the default funds of the UK's main Master Trust pension schemes, known as the Corporate Adviser Pensions Average (CAPA) index. We believe this is important research as it stresses the need for employers and their advisers to look at pension fund performance in the context of the risk the pension provider is taking to generate those returns.

Pension fund investment return

Data from the CAPA index below shows the average annualised performance over five years for Nest and other pension providers. This is for members 30 years away from their retirement, to the end of 2018.

The top left quarter of the graph is the best place to be. This would mean a provider has produced high returns with no risk. However, in reality this isn't achievable. So instead look for the reward achieved for the risk taken. Higher risks should produce higher returns. Where funds produce broadly similar returns, the fund that is furthest to the left on the chart has taken the least amount of risk. Therefore, they have invested more effectively and efficiently.

As you can see below, Nest delivered excellent returns while taking a lot less risk than other providers.

When choosing a pension scheme for their employees we believe employers and their advisers should firstly look at the investment approach of different pension providers and the risk they're taking. They should then narrow their choice down to the pension providers whose approach to investing reflects a level of risk that the employer thinks their employees will be comfortable with.

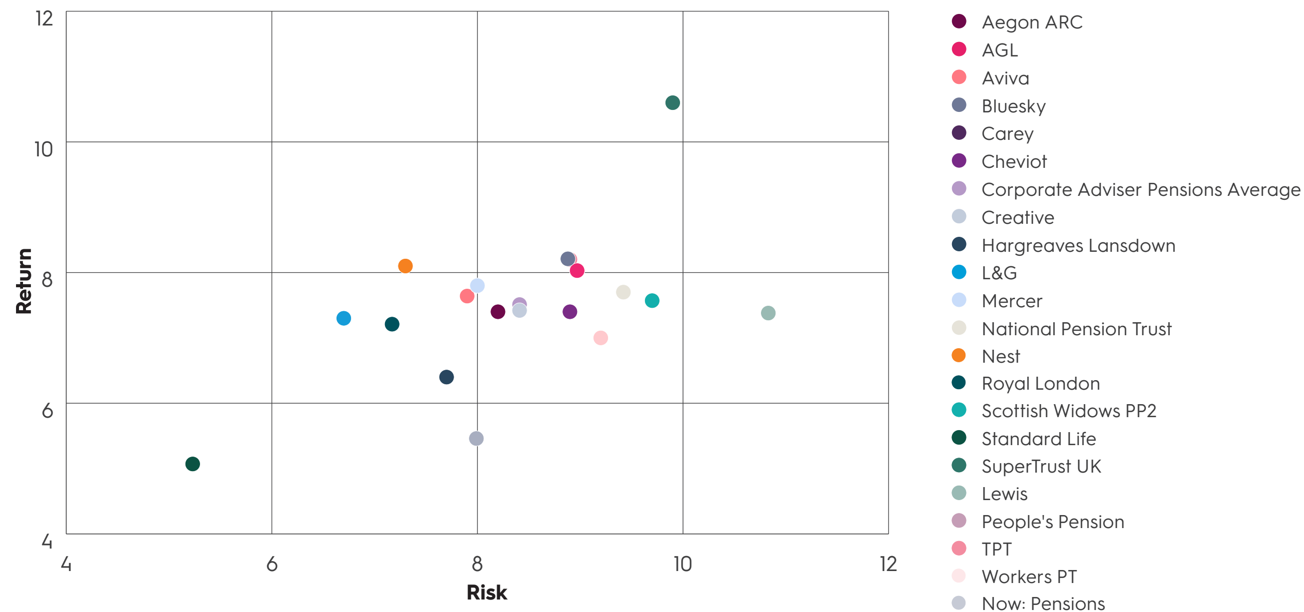
The employer and the adviser can then move on to choosing the pension provider within this group that they think will deliver good investment returns within the context of the risk being taken.

The success of the investment approach is crucial to the amount of retirement income members will receive. Nest continually assesses world investment markets and manages risk for our members.

We believe we understand the level of risk and volatility our members are comfortable with and the smooth, predictable returns they want. Our well-diversified approach invests across a range of regions, asset classes and fund managers, with an understanding of the correlation between each. We believe this is the best way to deliver good investment returns over the long term and with reduced levels of volatility along the way.

Figure 5: Risk/Return

Younger saver, 30 years from retirement, 5-year annualised



- Aegon ARC
- AGL
- Aviva
- Bluesky
- Carey
- Cheviot
- Corporate Adviser Pensions Average
- Creative
- Hargreaves Lansdown
- L&G
- Mercer
- National Pension Trust
- Nest
- Royal London
- Scottish Widows PP2
- Standard Life
- SuperTrust UK
- Lewis
- People's Pension
- TPT
- Workers PT
- Now: Pensions

Source: capa-data.com/risk-return-younger-saver-30-years-from-retirement-5-year-annualised

© Nest Corporation 2019.
All rights reserved. This information does not constitute financial, investment or professional advice and should not be relied on. Any form of reproduction of all or any part of this material is not allowed. We do not give any undertaking or make any representation or warranty that this material is complete or error free. We do not accept responsibility for any loss caused as a result of any error, inaccuracy or incompleteness. The Nest trade marks and trade names used above are owned by Nest Corporation and should not be used in any way without our permission.

Nest Corporation
10 South Colonnade
Canary Wharf
London, E14 4PU

nestpensions.org.uk

p31004-v1 30877 04/19