

Making the Case for UK Pension Fund Investment in Developing Country Assets

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1. Introduction

UK Pension Funds had estimated total assets of £683.5 billion at the end of 2001. The proportion of investment in overseas assets – both equities and bonds - has been steadily rising over the last twenty years as the benefits of diversification have been recognised. However, the share of UK Pension Fund investment going to developing countries remains low and has even decreased in the years following the Asian crisis and Russian default in 1997-98.

Developing countries need stable sources of foreign private capital and, as long-term investment vehicles, Pension Funds seem intuitively to be a potentially good source of such investment. At the same time, the well-documented crisis in UK pensions implies both that pension assets will have to continue to grow rapidly over the next ten years and that Pension Funds will be looking for investment opportunities that can provide above-average returns. Developing country (or Emerging Market) assets could now provide such opportunities, particularly in light of expected low returns in mature markets.

This paper shows the continued validity of the case for UK Pension Funds investing part of their portfolio in emerging markets in order to obtain an optimal risk/reward mix that will maximise return for any given level of risk. Having established the case, the paper will then look at the major factors that are preventing UK Pension Funds from investing more in Emerging Markets. Key among these is the strong preoccupation with short-term performance that not only acts to discourage investment in developing countries, but also fails to serve the long-term investment needs of pension savers. The paper will then put forward a range of policy options designed to address these problems, with the aim of encouraging UK Pension Funds to reach an optimal level of investment in Emerging Market assets.

2. UK Pension Funds and Asset Allocation

UK Pension Fund assets, which stood at an estimated £683.5 billion at the end of 2001, are projected to rise by around a third over the next ten years. With the continued increase in longevity in the UK population, and lower bond yields, it is widely acknowledged that Pension Fund assets will have to grow significantly in order to provide adequate retirement incomes.

Three major trends in asset allocation among UK Pension Funds are likely to impact on how this growing pot of funds is invested; and each of them has some bearing on the potential for investment in Emerging Markets.

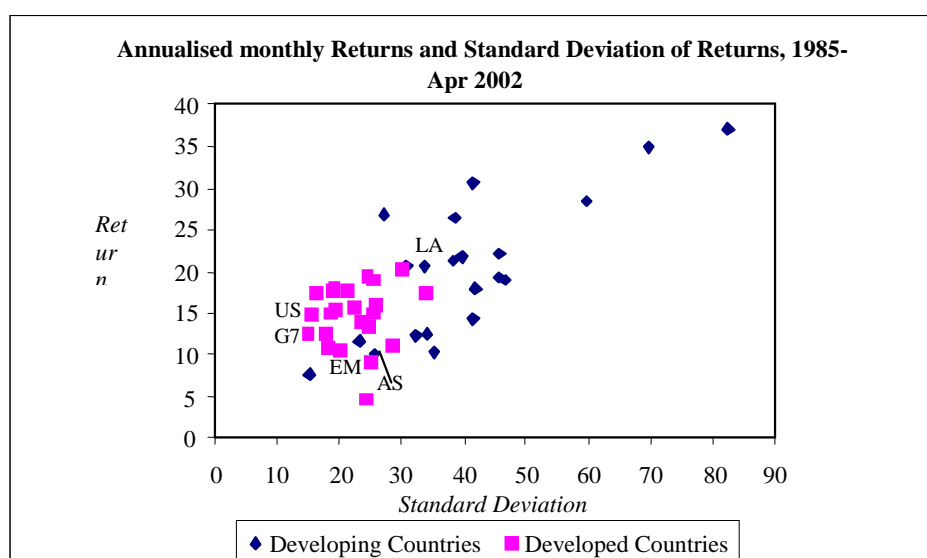
1. There has been a long-term rise in the proportion of Pension Fund assets invested in equity markets – in 2001, average Pension Fund equity holdings totalled 71%. In recent years, however, this trend has been slowly shifting as a reappraisal of the merits of bonds has taken place in light of pension scheme maturity and the introduction of new regulation (FRS17 and the MFR).
2. There has been a gradual, long-term increase in the proportion of investment in overseas assets (mainly equities) as the benefits of diversification have been recognised. In 2001, UK Pension Fund investment in overseas assets totalled 28%, compared with 10% in 1981.

- The proportion of UK Pension Fund assets invested passively has increased and is set to continue to do so. Passive investment is clearly less time-consuming, less costly, and greatly reduces the risks of under-performance.

3. The Benefits of Investing in Emerging Markets: The Empirical Case¹

Acquiring EM assets can be very rewarding for international investors in the long term. As regards equities, it can be seen in Chart 1 that historically asset returns of a number of EM countries have been higher than asset returns of developed countries. This despite the recent financial crises in emerging market countries that have affected returns on EM assets negatively and increased their volatility, thereby making investors less willing to invest in such assets.

Chart 1. Annualised Monthly Returns and Standard Deviation of Returns 1985-Apr 2002



Source: Authors' elaboration, based on data from the International Finance Corporation and Morgan Stanley Capital International. Emerging markets are composed of countries from Latin America (LA), Asia (AS), Europe (EU), and Middle East/Africa (ME&Africa). LA: Argentina, Brazil, Chile, Colombia, Mexico and Venezuela. AS: India, Korea, Malaysia, Pakistan, Philippines, Taiwan and Thailand. EU: Greece, Turkey. ME&Africa: Jordan, Zimbabwe and Nigeria. Data for Turkey are available from 1987. Developed countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, United Kingdom and United States. Data for Finland, Ireland and New Zealand are available from 1988. Regional indexes: Latin America, Asia and Emerging Markets Composite; EAFE and G7.

However, building a diversified international portfolio is important not just to maximise returns but mainly to reduce risks. Although volatility of EM assets has been higher than developed countries assets (see Chart 1), for the purpose of reducing portfolio risk correlation between returns of different assets matters more than the volatility of individual assets.

It can be seen from Table 1 that correlation of asset returns within developed countries is higher than between developed countries and emerging markets over the

¹ There is no single, official definition of an emerging market, but the EM universe covers a broad and highly heterogeneous group of countries at various stages of economic development. The most widely used emerging market equity indices, the S&P/IFC and the MSCI, both comprise around 30 countries (roughly half the number of developing countries that have a stock market).

period between 1985 and 2002. During this period, the correlation within developed countries was 0.53, while the correlation between developed and emerging market countries was significantly lower at 0.20. The table also shows that over the 1994-2002 time-period, when correlation between EM asset returns and developed countries' asset returns went up due to increased integration of emerging markets with the international capital markets, the correlation between developed and emerging market countries was still significantly lower.

Table 1. Pearson Correlation Coefficients

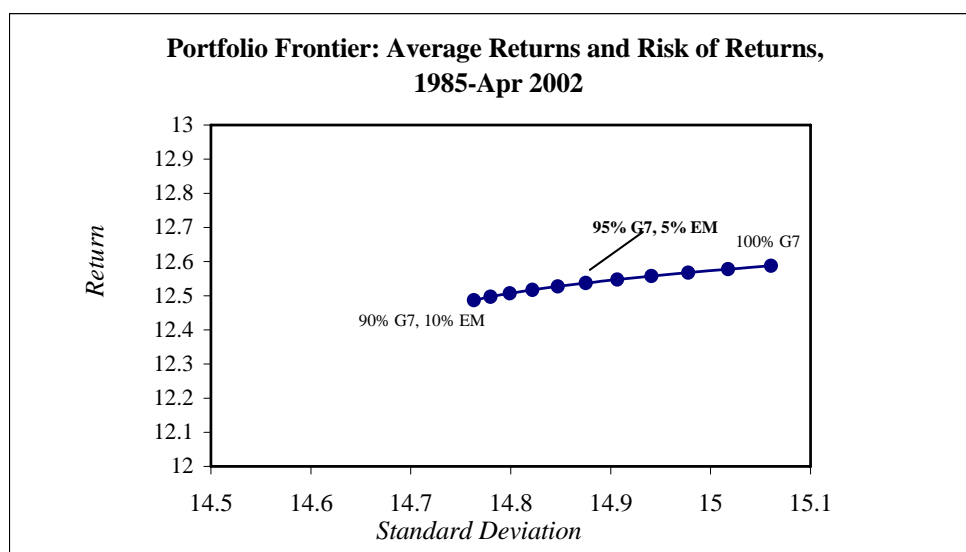
(based on monthly change in return index)

	Within developed countries	Between developed countries and EM
1985-Apr 2002	0.53	0.20
1994-Apr 2002¹	0.57	0.33

Source: Authors' elaboration, based on data from the International Finance Corporation and Morgan Stanley Capital International. 1. Composite regional indexes are used for EM.

The statistical evidence thus supports the claim that international investors can benefit from diversifying their portfolio through acquiring emerging markets assets, as this can reduce their portfolio risk and even increase returns.

Chart 2. Portfolio Frontier: Average Returns and Risk of Returns, 1985- April 2002

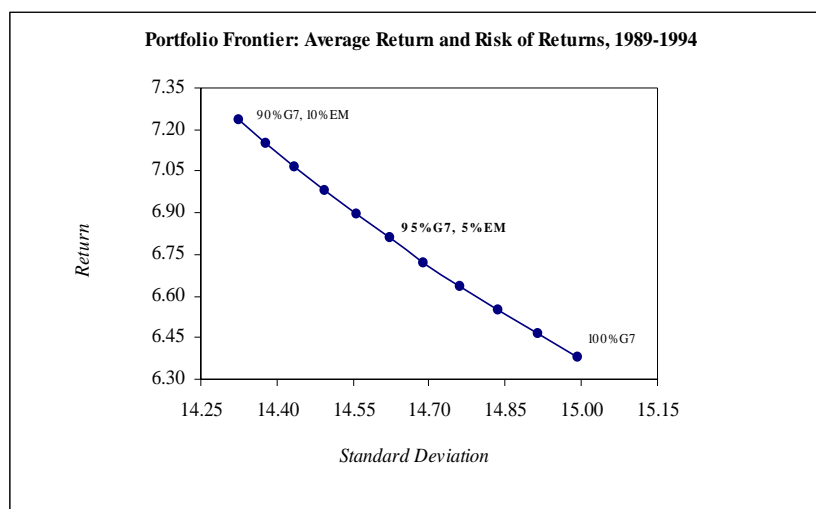


Source: authors' elaboration based data from the International Finance Corporation and Morgan Stanley Capital International.

Chart 2 displays a portfolio frontier along which the portfolio composition moves gradually from a 100% of G-7 countries assets holdings to another of a mix of 90% of G-7 countries assets and 10% of EM assets. The portfolio frontier shows that, as the portfolio of assets is diversified towards EM asset holdings (moving south-west along the line), portfolio risk falls significantly, together with a slight decline in returns.

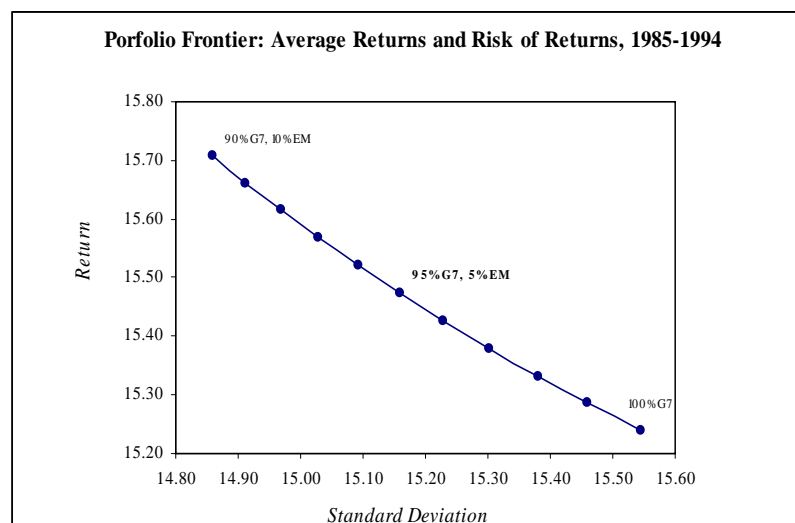
However, given that the line is formed by a combination of average returns and risk over the 1985-2002 period, a decline in returns is observed because it includes periods during which EM assets suffered from high instability in international financial markets. If appropriate international financial reforms were adopted, the international financial markets could become more stable, and EM countries would have fewer crises and as a consequence be able to generate long-term growth together with high returns on its assets. Indeed, economic theory and recent empirical evidence support the view that returns on capital of developing countries tend to be higher than that of developed countries. Charts 3 and 4, which concentrate on more stable time-periods – 1989-1994 and 1985-1994, clearly indicate what portfolio diversification towards EM assets can mean for investors, if a more stable future is attained: a portfolio of higher returns combined with lower volatility.

Chart 3. Portfolio Frontier: Average Return and Risk of Returns, 1989-1994



Source: authors' elaboration based data from the International Finance Corporation and Morgan Stanley Capital International.

Chart 4. Portfolio Frontier: Average Returns and Risks of Returns, 1985-1994



Source: authors' elaboration based data from the International Finance Corporation and Morgan Stanley Capital International.

Today, EM assets represent only around 2% to 3% of international investors' total assets. As the Charts displayed above show, there is an economic justification for holding EM assets at least up to 10%, even if one includes the most unstable time periods.

Therefore, investing in EM can be rewarding for cautious investors in search of reduced risk. Active investors, of course, have additional reasons for investing in EM assets, which is the prospect of outperforming through exploiting the inefficiencies of such markets (commonly associated with higher transaction costs, asymmetry of information, and so forth).

A further reason for investing in EM assets is that they are undervalued today, when measured in terms of their price to earning ratio and price to book value ratio, while developed countries' stocks are still overvalued despite the sharp decline in their returns in the recent past (see Global Financial Stability Report, Chapter 4, June 2002).

Finally, as with equities, investing in Emerging Market bonds can bring high rewards to international investors. Tables 2 and 3 show that average annual returns on EM bonds were 16% over the 1991-2000 period. This level of returns is extremely good, especially when compared with returns on bonds in mature markets. For Europe as a whole, for example, returns were around 5% over the same period, and in the United States returns were 7.7%.

The higher returns on EM bonds vis-à-vis developed country bonds can be clearly visualised in Chart 5. It is true that the chart also shows that the risk of holding EM bonds is much higher. However, the portfolio diversification argument presented earlier for equity assets can be equally applied to bonds. Diversifying a bond portfolio towards EM assets will be increasingly advantageous to the extent that international investors begin to differentiate between different emerging market countries; some analysis suggests that this has already started to happen more recently (see IMF Financial Stability Report, June 2002; Gottschalk, 2003).

Table 2. Returns in Emerging Bond Markets (1991-2000)*

	Annual Return (%)	Volatility (%)	Spread (bps)
1991	39	9	751
1992	7	6	635
1993	44	9	687
1994	-18	22	751
1995	26	17	1209
1996	35	12	724
1997	12	15	438
1998	-12	32	795
1999	24	12	861
2000	14	10	651
2001	1	10	792
Average 1991-2001	16	14	754

Source: UBS Global Asset Management, Pension Fund Indicators 2002. Calculations are based on an Emerging Market Debt Index using JP Morgan EMBI returns (1991-1993) and JP Morgan EMBI+ returns (1994-2001)

* Sovereign Spreads over US Treasury bonds.

Table 3. Returns in Developed Bond Markets (Average 1991-

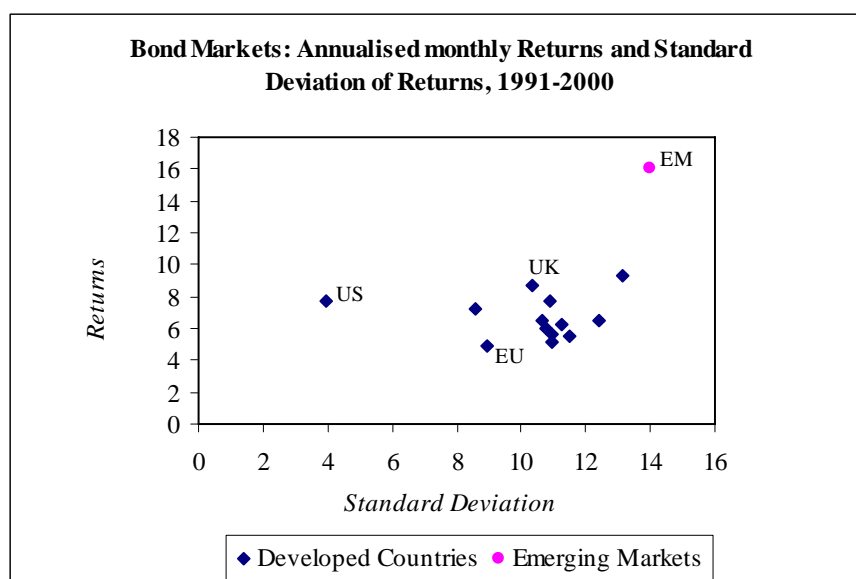
	Annualised Returns (%)	Annualised Standard Deviation (%)
Australia	7.7	10.9
Belgium	6.0	10.8
Canada	7.2	8.6
Denmark	6.5	10.6
France	6.3	11.3
Germany	5.2	10.9
Italy	6.5	12.4
Japan	9.3	13.1
Netherlands	5.6	10.9
Spain	5.5	11.5
United Kingdom	8.7	10.3
United States	7.7	4.0
<i>Europe**</i>	5.0	8.9

Source: Datastream, J. P. Morgan

* Calculations are based on monthly percentage changes in the J.P. Morgan Bond Index (Return Index in US dollar

** Data available from August

Chart 5. Bond Markets: Annualised Monthly Returns and Standard Deviation of Returns, 1991-2000.



4. The Barriers to Investing in Emerging Markets

The findings of Section 3 just confirm what the portfolio allocation theory predicts: international portfolio diversification is good as it reduces risk for a given level of return. If both theory and empirical evidence support international portfolio diversification, and if the evidence just provided shows that including EM assets in investors' portfolio of assets may be rewarding (even when investment in such assets includes periods of high volatility), why is there so little portfolio diversification, and why is the share of EM assets in total portfolio assets so low?

This part of the paper will look at some of the major factors that are inhibiting a greater degree of investment in Emerging Market assets by UK Pension Funds. The focus is on issues on the supply-side that impact on investment decision-making, but this is not to deny the importance of factors on the developing country side – problems of liquidity, corporate governance, and disclosure in developing countries, for example – which also clearly have an impact.²

The benefits of high returns and portfolio diversification from EM investment have been less evident in recent years.

² For an exhaustive list of the factors that may have been inhibiting investment in EM assets, see Gottschalk (2003).

While emerging market performance has been less impressive in the five-year period following 1997/98, the resulting reduction in investment in EM assets may reflect a failure to take a longer-term view. As we have seen in Section 3, historically asset returns in a number of developing countries have been higher than those of developed countries. It is also worth noting that the years following the Asian crisis represented a bubble period in the US market, while emerging markets were suffering the aftershock of financial crisis. Now that the outlook for US stocks is less positive, and given that emerging market stocks are under-valued, many industry experts believe that this is a good time to make strategic investments in emerging markets.

The diversification benefits of investment in emerging markets have also been questioned as correlation between emerging and mature markets has risen as global markets have become more integrated. However, as Section 3 of this paper has shown, there are still diversification benefits to be gained from investing part of a Pension Fund portfolio in emerging markets.

Increased risk aversion among investors generally, and Pension Funds specifically, have impacted on emerging market investment

The financial crises that have hit some emerging markets in recent years have resulted in a much more cautious attitude towards these markets from international investors. Pension Fund trustees, who may lack specific knowledge on investment opportunities, have become wary of investing in markets that they perceive as highly risky.

Risk-aversion among Pension Fund investment decision-makers may have been further encouraged by regulations introduced to strengthen Pension Funds, such as the Minimum Funding Requirement (MFR) and the new accounting standard FRS17. Both the MFR and the FRS17 encourage a closer matching of assets and liabilities for Pensions Funds. The MFR test has been widely criticised as it compares the assets and liabilities of Pension Funds at a given moment in time, rather than assessing whether the fund will be able to meet its pension liabilities in the future. These regulations may be encouraging Pension Funds to be excessively risk-averse; for example the recent shift away from equities towards bonds is partly put down to the introduction of the MFR and the FRS17.

Asset allocation methods employed by Pension Funds do not favour investment in emerging markets

In devising asset allocation strategies, Pension Fund investment decision-makers typically employ asset-liability modelling. This is a quantitative process that relies on the availability of long time series data on performance, and the division of assets into classes. As the Myners report³ recently highlighted, such a process necessarily discourages investment in asset classes that are under-researched and where there is limited availability of historical data. Emerging markets clearly suffer from being difficult to model; there is less historical data available on EMs than on more mature markets, they are often poorly researched, and the great diversity among emerging market economies means that they do not easily form a single asset class.

³ Institutional Investment in the United Kingdom: A Review. Usually referred to as the Myners Report.

Fund management styles and performance criteria encourage herding and short-termism

The two main styles of fund management for UK Pension Funds (the balanced mandate and the specialist mandate with a customised benchmark) both contain performance criteria that may prejudice investment in emerging markets and, more importantly, do not serve the best interests of the members of pension funds.⁴

Under the balanced mandate, which is declining in use, manager performance is measured with reference to a peer group benchmark. This provides incentives for the manager to focus on outperforming other fund managers and encourages herding. Such performance criteria can make it difficult for managers to invest in any asset class (for example, emerging markets) that others are not investing in, no matter how attractive it might be.

In the case of fund managers with specialist mandates, their performance is often measured by a customised benchmark, usually an index. The increasing importance of such benchmarks raises a number of problems for investment efficiency generally, and for investment in emerging markets specifically. First, there is the issue of which stocks get included in an index. Emerging market stocks feature in both global indices and specific EM indices, but even in the latter - such as the S&P/IFC and the MSCI – only stocks from around half the developing countries that have stock markets are included and, from those countries, only certain types of firms will feature. Second, the setting of tight limits on divergence from the index (tracking error) will result in less innovative stock selection and less opportunities for fund managers to add value.

The investment distortions caused by the performance criteria outlined above are further exacerbated by the time-scales over which the performance of managers is judged. While there is no set time period over which manager performance is evaluated, the quarterly appraisal of managers at the time of Pension Fund Trustees meetings, may be causing insecurity and provide further incentives for managers to focus on the short-term.

5. Corporate Governance and Socially Responsible Investment

In recent years the importance of corporate governance and socially responsible investment for institutional investors has increased significantly in both mature and emerging markets. There are a number of reasons for this. First, concerned stakeholders (investors, pension fund scheme members, etc) are exerting pressure on institutional investors to take these issues more seriously. Second, institutional investors have to respond to their fiduciary duty, and it is now widely believed that investing in companies with good corporate governance, and companies and countries with sound policies on social and environmental issues, makes financial sense.

⁴ Many of these issues were raised in the Myners report with reference to investment by UK Pension Funds in private equity.

Corporate governance is concerned with whether the company is run for the benefit of the shareholders, and encompasses issues such as accounting disclosure, shareholder equality and board accountability. Evidence suggests that good corporate governance practice is linked to improved financial performance and increased investor confidence. A recent study by McKinsey & Company shows that many investors put corporate governance concerns on a par with financial indicators when evaluating investment decisions, and that investors are willing to pay up to 30% more for the shares of well-governed companies. Conversely, concerns over poor governance can lead investors to avoid individual companies and certain countries. These concerns have increased even further with the recent corporate failures in the US.

These findings are important for developing countries, and the importance of corporate governance for investment in emerging markets is also borne out by further research carried out by McKinsey and Company. McKinsey tested the link between corporate governance practices and market valuation by looking at companies from six major emerging market economies.⁵ The study showed that investors do indeed pay a premium for shares in well-governed companies, sometimes a significant one.

The financial crises that hit many emerging markets in recent years have been, at least in part, attributed to poor corporate governance practices in those countries. As a result, corporate governance – along with areas such as transparency and financial sector stability – have become central components in the codes and standards that developing countries are advised to comply with. However, it is important to recognise that the perception that companies in developing countries compare badly in terms of corporate governance practices is often misleading. Helmut Reisen has shown that blue-chip Asian corporations have more transparent accounts than their US counterparts.⁶ Also, a recent survey published in Euromoney shows that many developing countries score highly in terms of corporate governance.⁷

Corporate social responsibility (CSR) is concerned with how companies address the social and environmental impact of their activities. More widely, Socially Responsible Investment (SRI) in relation to developing countries is concerned with issues such as human rights, labour standards and the environment. Companies and their institutional investors have come under increasing pressure to take these issues into account in their operations and when assessing investment decisions. Existing pressure from stakeholders was strengthened in UK by Government legislation introduced in 2000 that requires all occupational pension funds to report on the extent to which social, environmental or ethical considerations are taken into account in their investment decisions.

While Socially Responsible Investment has many positive elements, it is vital that it does not lead to decreased investment flows to developing countries. In early 2002, California's major public pension plan – CalPERS – adopted a new policy on investing in emerging markets. The new policy requires investors to analyse factors such as political stability, protection of civil liberties, and labour standards alongside more traditional factors such as market liquidity, investor protection, and openness to foreign investors. As a result, the pension plan has limited the number of emerging markets it can invest in to just 13 – and the list of 'permissible' countries excludes

⁵ India, Malaysia, Mexico, South Korea, Taiwan, and Turkey

⁶ Helmut Reisen 'Standards, Codes and Pension Flows' in *Wider Angle*.

⁷ Euromoney, July 2002

Indonesia, Malaysia, China, Thailand, Pakistan, and Russia. Although CalPERS itself does not invest huge amounts in emerging markets, as the largest public pension plan in the US, its lead could well be followed by other institutional investors and could therefore have a significant detrimental impact on investment flows to emerging markets.

The main problems with the CalPERS approach are, first, that it is based on 'screening' rather than 'engagement' and, second, that it is country-based rather than company-based. Under the CalPERS strategy, countries are effectively blacklisted, regardless of the quality of individual companies within those countries. This goes against the current received wisdom that corporates can rate more highly than the sovereign within which they are located, as is being increasingly recognised by ratings agencies. A strategy based on screening, and therefore exclusion, also undermines the positive role that SRI can play in engaging with companies and countries to exert pressure for improvement on social, environmental and ethical issues.

This approach has negative consequences for both investors and developing countries. For international investors, withdrawing from a number of emerging markets limits portfolio diversification. While from the point of view of developing countries, much needed foreign capital inflows are withheld – this, perversely, is quite likely to lead to a worsening of labour standards in those countries and other negative social and environmental consequences.⁸ Even if the level of foreign inflows does not decrease overall, the cost of capital is likely to rise and the composition of inflows will be altered. A strategy which excludes countries from investment interrupts the virtuous circle of portfolio inflows leading to financial (ie stock market) development and, as a consequence, more inflows.

It is very important, therefore, that Socially Responsible Investment acts a positive force with regards to investment in developing countries, rather than a negative one. Given the importance of foreign capital inflows for many developing countries, the encouragement of stable capital flows that can support pro-poor growth could become a major element of the SRI agenda. At the same time, the practice of 'positive engagement' (rather than 'screening' and the introduction of country black-lists) could play a useful role in encouraging positive changes in areas such as governance and transparency in emerging markets.

6. Policy Proposals to Encourage Pension Fund Investment in Emerging Markets

Asset Allocation and Performance Criteria

The systems used for asset allocation and the incentives provided to fund managers are clearly distorting investment outcomes and could be discouraging investment in emerging market assets. These issues have also been addressed in the Myners report on Institutional Investment in the UK, with specific reference to the barriers that limit investment in private equity. The Myners report made a number of

⁸ This point has been made by Helmut Reisen.

recommendations in that context that this paper would endorse. Further work is also needed on a number of issues: asset allocation, asset-liability modelling, the use of customised benchmarks and indices, the practice of index tracking, and the timeframes by which fund managers are evaluated.

Tax Incentives

UK pension funds are recipients of heavy tax breaks. This government support could be used to encourage funds to invest more in developing countries, given the benefits to investors outlined in Section 3 of this paper. Further research is necessary on the types of tax incentives that could be offered, the likely scale necessary to be effective, and briefly how tax incentives might be implemented. There may also be a case for a taper tax, similar to the one introduced for capital gains tax in the UK, under which the tax incentive grows as the term of the investment lengthens.

Investor Education

Clearly, lack of knowledge on developing countries and inexperience in analysing information from emerging markets is acting as a barrier to increased investment. This suggests that there could be some public policy role in providing analysis on developing country stock markets – at least until the market is big enough to support such a function in the private sector.

Additionally, the shift from Defined Benefit (DB) to Defined Contribution (DC) schemes will result in an increased role in investment decision-making for individual investors. Evidence from the United States suggests that individual investors may be more risk-averse than pensions professionals. As DC schemes become more important in the UK (at the moment, they account for less than 20% of occupational schemes) it is important that investors are presented with the option of investing in emerging markets and that they are properly advised of the risks and rewards of doing so. One issue at present is that no link in the pension fund decision-making chain has the mandate to advise individuals on their investments. Again, there may be a public policy role on investment advice pertaining to DC pension schemes, at least until the system is more established and the market can fill that role.

Socially Responsible Investment

As we have seen, it is important that SRI acts as a positive, rather than a negative, force for investment in developing countries. SRI could adopt the encouragement of stable capital flows to developing countries as part of its agenda. A useful first step might be a requirement that investors in mature markets should disclose their investments in emerging markets, and their behaviour in those markets. Increased transparency in this area would facilitate better analysis of which emerging markets are attracting stable portfolio flows, and also show which market actors are behaving irresponsibly in developing country markets (for example, during periods of crisis).

More ambitiously, Socially Responsible Investment could encompass a more active approach to encouraging portfolio flows to developing countries. Here, parallels can be drawn with policies introduced within the United Kingdom to encourage financial provision for the financially excluded and for small business start-ups. With regard to investment in developing countries, one idea put forward is that there could be an

obligatory minimum proportion of UK Pension Funds' total portfolio that has to be invested in emerging markets (for example, 0.25%). This would make sense according to portfolio diversification arguments, but would also serve to protect minimum levels of portfolio investment during periods when markets suffer from crises of confidence. Such a scheme could be introduced first in the public sector pension funds, where members are likely to be more sympathetic to SRI issues, and then widening if found to be successful.

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Pension funds have moved beyond traditional investments in bonds and stocks. The new order includes private equity and other alternative asset classes. Pension fund assets must be managed with the intent of ensuring that eligible retirees receive the benefits they were promised. Until relatively recently, pensions funds invested primarily in stocks and bonds, often using a liability-matching strategy. Today, they increasingly invest in a variety of asset classes including private equity, real estate, infrastructure, and securities like gold that can hedge inflation. Pension plans, also known as defined benefit plans, guarantee that employees receive a set payout regardless of how investments perform. Our research suggests that the investment case for UK PRS is backed by:

- Low correlations with commercial real estate, equities and bonds.
- Defensive characteristics with improved capital preservation.
- PRS is the fastest growing tenure type.

The rising demand for private rental in the UK contrasts with the situation in continental Europe, where in many countries the sector is now fully mature and has stopped growing or is even shrinking. Indeed, in a report by the London School of Economics and the University of Cambridge, the UK was the only European country out of 11 studied where the general trend pointed to ongoing PRS growth. Housing supply (England). 300. Pension Funds Insider brings the latest pensions news and industry insights; from investment and governance updates to new mandate appointments and pensions regulatory information. Pension Funds Insider search form. Search articles.

The Case for Hedged Equity. 21 January 2021. If any of the questions below are important to your pension scheme we think it is worth a few minutes of your time to read this post

The Cost Transparency Initiative (CTI) templates are helping pension funds to get a grip on their investment costs but how can funds make the data useful? There are three fundamental questions that pension fund Boards should expect answers on: 1. Are my costs reasonable? Pensions in the United Kingdom, whereby United Kingdom residents have some of their wages deducted to save for retirement, can be categorised into three major divisions - state, occupational and personal pensions. Automatic enrolment has been successful, but there are a number of myths remaining around the scheme, which professional bodies and companies are working to eradicate. Pensions are long term investments. You may get back less than you originally paid in because your capital is not guaranteed and charges may apply. 74 results found, sorted by affiliated products first.

A personal pension plan is when you appoint a pension company and they choose the funds you invest in. If you have a workplace pension, this is often how it'll work. The other option is a self-invested personal pension (SIPP).

The UK government encourages workers to save for retirement by offering pension tax relief. It essentially acts as a bonus, as money you would otherwise have paid in tax on your earnings goes into your pension pot instead. The tax relief you earn is equivalent to your highest rate of income tax.