Quarterly Pensions Investments Review

Expected Investment Performance - Q4 2023

Introduction

The Quarterly Pensions Investments Review is a comparison in expected risk and return investment.

Key Findings

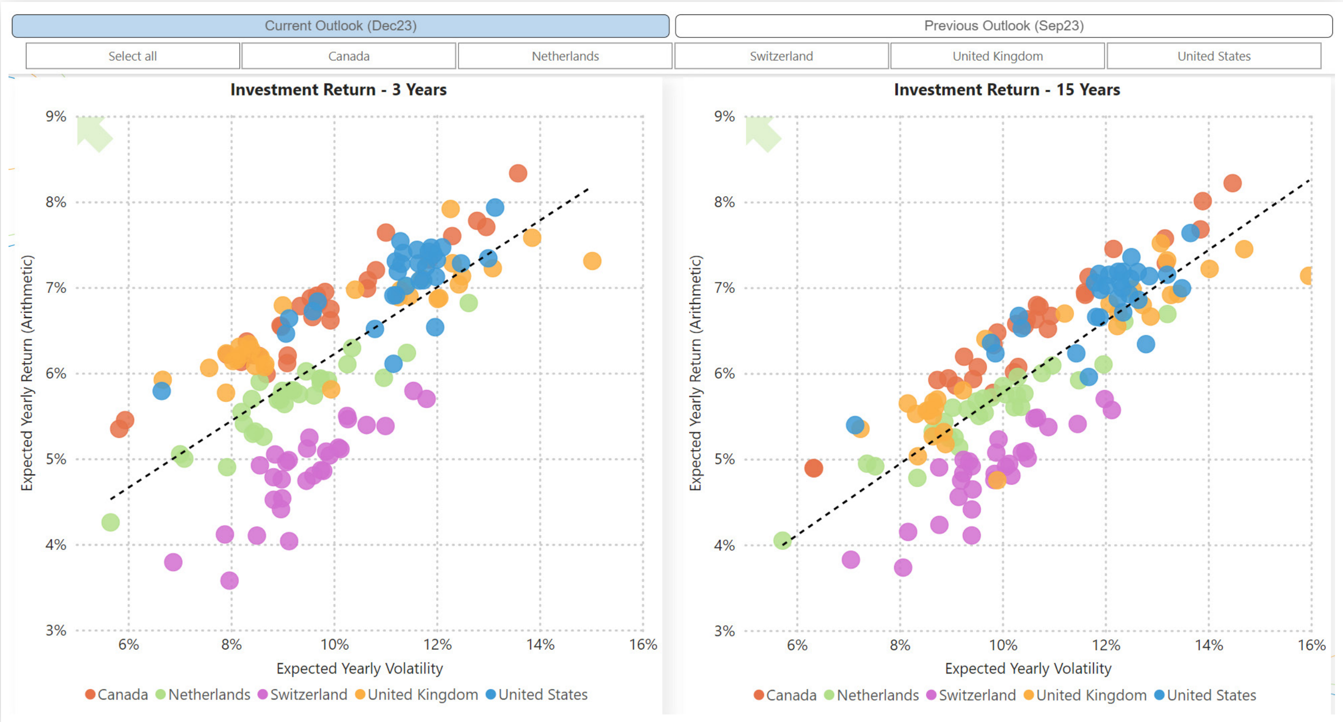
- **Comparing pension funds and regions:** North American pension plans show relatively high expected returns, compared to mainland Europe due, among other things, to differences in asset allocation.
- **Comparing quarter on quarter:** expected returns have significantly decreased overall, driven by realized returns and lower long rates.
- For details, please see below.

If you're interested in learning how your pension fund is performing relative to others, please contact us for more information.

Expected Investment Performance – Risk and Return Results

The charts below show the expected investment return vs. the expected investment risk - from the top 30 largest pension funds per region.

Comparing pension funds and regions



Looking at general trends, the difference in expected returns between regions is stark. Expected returns and volatility among pension plans in North America and the UK are relatively high, while pension plans in Switzerland and the Netherlands show more moderate expectations.

This quarter we focus our attention on North America.

The chart shows that most **US pension plans** are grouped around a relatively high expected return of around 7%. In the United States, many of the largest pension plans are public plans. These plans strategically allocate a major portion of their assets to riskier categories like Public Equities and Alternatives, in a search for yield. The resulting high expected returns are reflected in the discount rates.

Critics argue that this approach may increase solvency risks in the long-term. Hence, in recent years, there has been a trend among some public plans towards adopting more conservative market discount rates, such as the yield on high-quality corporate bonds, similar to the approach that US corporate pension plans already use. This aligns with new accounting standards, encouraging a focus on the risk-free rate or rates that reflect the duration of the pension liabilities . It is important to note that the 'market discount rate' approach serves as a complement to the fixed discount rate approach rather than a replacement.

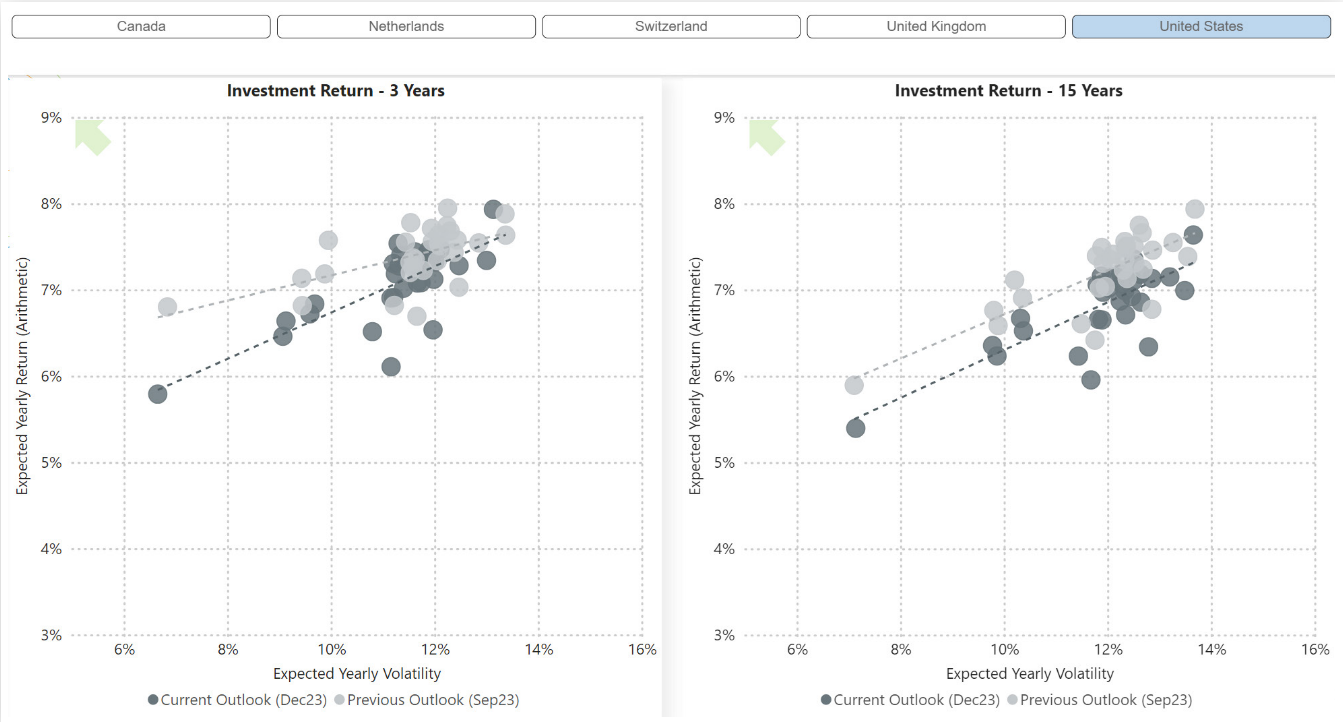
In general, **Canadian pension plans** show relatively high expected returns. Unlike many European plans that require large, fixed income exposures to hedge market discount rate risk, Canadian plans allocate a major amount (20-40%) of their assets to Alternatives, not in the least in an attempt to hedge inflation risks.

What is even more noticeable is the wide and quite equal distribution along the return axis, all the while keeping the risk/return ratio comparable. These risk/return ratios show Canadian pension plans to be relatively efficient compared to other regions. Key drivers may be relatively high leverage and relatively high exposure to private assets, which may boost diversification.

For Canada and the US, long-term return expectations generally exceed those of mainland Europe. This is driven by higher interest rates and GDP growth which, in turn, are linked to demographic changes and expectations for capital and productivity growth. Combined with a home bias, this may give Canadian and US pension plans an edge.

This Quarterly Pension Investment Review is based off an asset-only scenario analysis and does not assess the match with liabilities. With an Asset Liability Management (ALM) study, we can uncover the tradeoff between contributions, benefits, and investment risk; increasing the likelihood of meeting future obligations, while keeping the plan affordable. Our mission is to enable you to manage the complexity of strategic decision-making.

Comparing quarter on quarter



Comparing the outlook for the end of December to the end of September, we see a large drop in expected returns for all regions – both in the short- and long-term. This is driven by a deterioration in equity momentum outlook (after a strong quarter for equities) and lower long rates, which worsen the government bond return outlook.

During the fourth quarter, capital markets have rallied as inflation readings in several developed markets came in cooler than expected and major central banks signaled a stabilization of policy rates. As a result, long interest rates have retracted from their recent highs, decreasing over the quarter by roughly 65bps to 85bps for the US, the UK, and the Eurozone, leading to strong Q4 returns for high duration government bonds.

Equities have performed strongly for most developed market regions, while UK and Japan were lagging. The energy-heavy UK equity index underperformed due to lower oil prices and sterling strength. Japanese equities underperformed other developed markets due to prospects of future monetary tightening and yen strength.

The short-term outlook for equity worsens, compared to the end-of-September projection, reflecting the realized positive equity returns over the past quarter. Nonetheless, the equity momentum outlook is expected to remain slightly positive on the 12-month horizon on the back of decreasing interest rates. The outlook is clouded by elevated volatility and downside risk due to tight financial conditions and elevated geopolitical tensions.

Simultaneously, the lower long rates worsen the government bond return outlook as "higher for longer" fears receded after a series of softer than expected inflation readings in the US, the EU, and the UK. The High Yield and Investment Grade corporate credits return outlook also worsened following lower expected government bond returns.

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Methodology and assumptions

This analysis is based on publicly available data, such as investment policy statements and annual reports, from the top 30 largest pension funds in Canada, the Netherlands, Switzerland, the UK, and the US.

The projections are made with GLASS Ortec Finance's GLASS, a forward-looking Asset-Liability Management platform for institutional investors. Plan modeling is based on strategic asset allocations, mapped to public and private benchmarks, and rebalanced annually. For simplicity, active hedging strategies and derivatives are not included in the Quarterly Pension Review.

Returns shown are gross of management fees and expressed in the local currency of the relevant country.

The projections in this analysis are driven by the Ortec Finance Economic Scenario Generator.

Ortec Finance is a leading global provider of technology and solutions for risk and return management, enabling you to manage your investment decisions.

More information?

If you have any questions regarding this information please get in touch with Elwin Molenbroek or Drazen Pesjak via the contact details below.

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