

# Pension Recovery Service



## UK Pension Trustees Need Asset Allocation Advice

### The Problem

Evercore Pan-Asset have researched the problems facing employer-funded pension plans in the UK. We understand the pressures on these funds, with actuaries and other advisers urging companies to commit more to the annual payments into the funds to make up for the apparent deficits. The scale of the deficit depends on a range of interconnected variables. The deficit will rise if inflation increases, making it dearer to pay future pensions. It will go up if the underlying investment performance is poor. It rises when actuaries decide that the members of the scheme are likely to live longer, in line with the improving age expectancy of the population at large. It will even go up when interest rates fall, as actuaries use the long bond rate of interest to calculate how much money you need to buy future annuities when people retire, and you need more in an era of low interest rates.

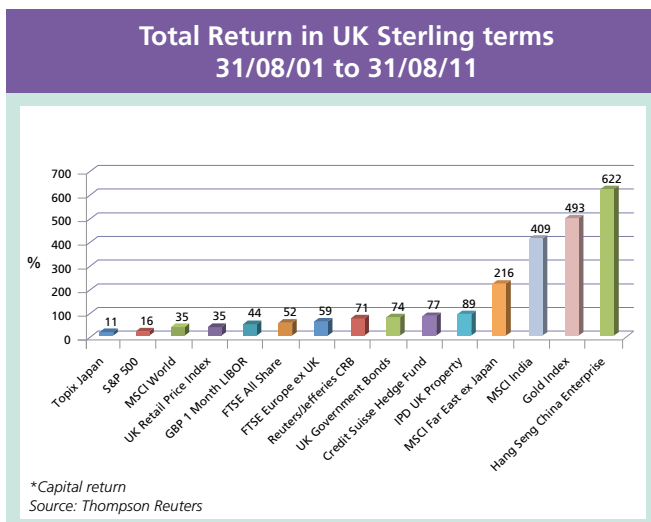
We appreciate that companies and trustees want two kinds of assurance. They need to know that the assets of their fund are being well invested, so that investment policy is contributing to paying future pensions, not making the task more difficult. They also wish to know that the combination of company cash flows into the pension fund and investment gains and income are realistic so that the pensions are payable in the future and the company can afford its contributions.

**Did you know there was a whole decade when investors made nothing on investing in US, Japanese and world shares? Is this reflected in your asset allocation?**

### What We Offer

We can come to talk to trustees and/or company executives responsible for the pension funding in a company about the state of the deficit and the role investment management can play in filling the gap. We can help you understand the deficit calculation and can then offer advice on what kind of investment strategy is likely to make the best contribution to cutting it. Whilst we are not actuaries we can help you ask the right questions of your actuarial advisers to ensure the sensible calculation of the balance between assets and liabilities to give a realistic figure.

However the numbers are calculated it is always right for trustees to aim to grow their fund value so that the assets of the fund make their contribution to paying the pensions. Even at the best of times a company does not want to have to keep putting extra money into a pension scheme to make up for investment losses. Some actuaries favour the idea that a pension fund can match its liabilities, removing its investment risk, by investing the cash into a series of government bonds. We agreed with them about the investment wisdom of bonds and cash in 2008, but would point out that it is not possible to match the future payments out of the fund by nominal income bonds. Most bonds have a fixed repayment value and a fixed income, whereas pension payments rise in line with wages. In normal conditions pension funds need some assets with growing income to make a bigger contribution to paying future pensions.

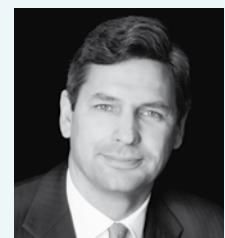


“You can’t avoid having an asset allocation so it makes sense for trustees to get continuous advice on it.”

*John Redwood*

“Making the right asset decisions helps both plan sponsors and pensioner beneficiaries.”

*Christopher Aldous*





## Running the Pension Assets Better

Many funds had a torrid 2008. Talking to pension trustees we find that many lost substantial money during the Credit Crunch collapse by remaining fully invested in equities, property and other claims on real assets. Many funds have also lost additional money through employing active managers to run their equity and other asset portfolios. In the extreme volatility of 2008 most active managers lost against the relevant index, in some cases losing substantial sums on top of the decline in the underlying asset class. In 2009 and 2010 some of the losses were removed by the rally in world shares.

Over the last ten years pension funds have made little or no return on US, UK and Japanese shares. Only by investing in Asia ex Japan and other emerging markets have trustees beaten inflation and cut their deficits.

Worse still, many trustees do not have access to asset allocation advice, and are usually told by their professional advisers not to meddle with the asset allocation even in situations where that means losing substantial sums of money. This naturally leaves trustees feeling worried about their responsibilities and the poor performance that results from all the expensive advice around the table. So often the investment managers claim they need their fees to manage the individual shares and bonds actively, but do not take responsibility for the overall allocation.

At Evercore Pan-Asset we have developed an approach to investing which can tackle these losses and give trustees greater security and control over the strategy of their fund.

We start from the proposition that the main determinant of how well a fund performs is the proportion it has invested in equities, bonds, cash and other assets. Independent academic studies show that at least 100% of the positive performance of the average fund comes from this decision about which assets to invest in, as most share selection subtracts value.\*

We offer trustees continuous advice on asset allocation, and can work on a discretionary or an advisory basis. In 2008 we favoured very high weightings in cash and short bonds. Trustees cannot avoid making these important decisions about asset allocation. In 2009 we recommended being fully invested, with the emphasis on Asian equities and property.

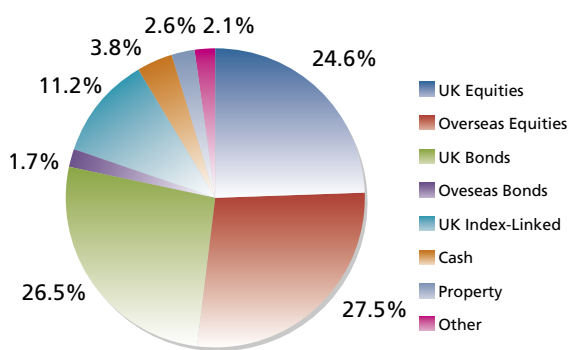
We also favour implementing the asset allocation decision by indexing the investments. We find Exchange Traded Funds give us the right balance of transparency, liquidity and low tracking difference which help us to improve fund performance. A typical ETF for UK or US equities can have a tracking difference as low as just 0.06% after all costs and expenses and some ETFs even have a positive tracking difference and beat the index by a small margin. This compares with 1% to 2% points of tracking difference after expenses for the typical active managed fund. Positive tracking differences cannot be relied upon, but even earning all but 0.06% of the equity index return, is much better than losing 1-2% of the return from average active management.

We would welcome the opportunity to talk to you about your pension scheme. At the very least we could probably save you money on the active management fees your fund is paying, and offer you the asset allocation advice you need for a lower total fee than you are currently paying. This is a way to raise performance that does not require superior judgement about which market will do best. We would also hope to offer advice which could help preserve fund assets in bad times, and offer some sensible growth in better times without entailing undue risk.

We recommend holding the bond portfolio in higher yielding prime corporate bonds rather than UK government debt, and having more emerging market and Asian equity exposure.

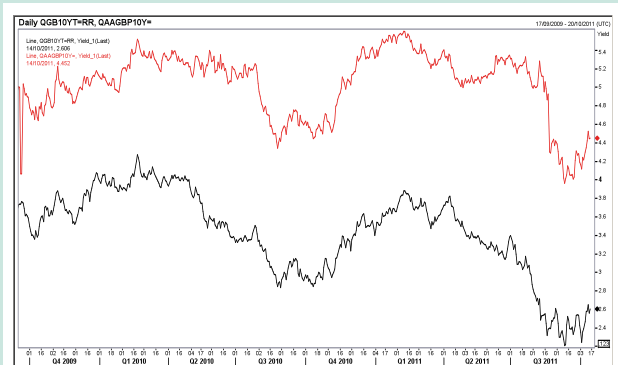
\*e.g. Ibbotson & Kaplan, 2000

### Current UK Pension Holdings\*



\*Data for 31st March 2009.  
Source: BNY Mellon Asset Servicing UK Pension Fund Analysis to 31st March 2009, Section B.

### Relationship between Corporate Bond Yield and Government Yield



Source: Thompson Reuters



**John Redwood** held senior investment roles at Robert Fleming and NM Rothschild in the 1970s and 1980s. Since, he has been a Pension Trustee, Investment Committee member for an Oxford College, Chairman of an investment company and a non-executive Director of a hedge fund and an Investment Trust. An early advocate of tracker funds, he has written extensively on economics and investment.



**Christopher Aldous** has been involved in wealth management since joining Cazenove in 1981. He has since been a Director of Barclays de Zoete Wedd, an Executive Director of UBS and a Managing Director of Robertson Stephens, the US technology investment bank. He co-founded Absolute Fund Management in 2001, where he managed a fund of hedge funds and was Chief Executive Officer until 2007.

# Evercore Pan Asset % Pension Recovery Service



## Our Investment Methodology

Our investment methodology is based on the following seven propositions:

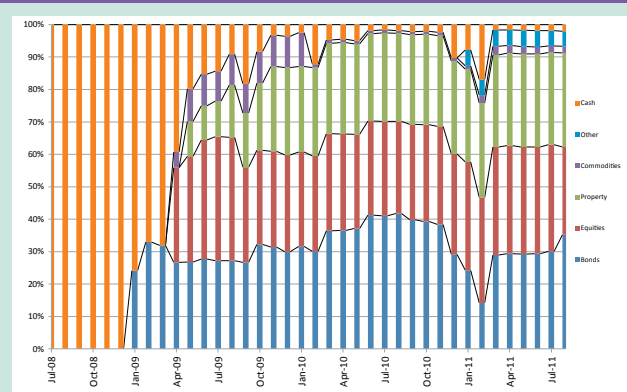
1. Successful **asset allocation** is the key to good investment performance.
2. Most **stock picking is a costly failure** – index tracking is much more effective.
3. Investment should be approached on a **global** basis. We are moving from an Atlantic-centric world to a more Pacific-centric world.
4. Asian equity investment is likely to produce better long-term returns, given the underlying **growth of Asian economics**.
5. **Real assets** like equities and property represent a stake in economic progress providing a rising income stream. They should produce significantly higher returns over time than monetary assets, such as bonds and cash, which are at the mercy of inflation.
6. **Alternative investments** have an important role to play.
7. **Cash** is an important and underrated asset class.

We have an investment approach which differs from most other UK investment managers, although it is widely adopted by endowment funds and family offices in the US. It aims to reduce the cost of investment management, reduce the risks presented by active management and thereby boost long-term performance. **For more detailed information please see back page.**

### The Benefits for You

- ☞ **Confidence** that you have an investment policy to match your particular circumstances.
- ☞ **No risk of poor stock selection** since Exchange Traded Funds are index trackers.
- ☞ **Cost Efficiency and Administrative Savings** from using ETFs as portfolio building blocks
- ☞ **Peace of mind:**
  - ☞ Your affairs are in safe and well-qualified hands
  - ☞ You are receiving genuinely independent advice
  - ☞ You are dealing with the principals in the firm who invest their own money in the same way as yours
  - ☞ You will always be kept closely in touch
  - ☞ You know exactly what you are being charged
  - ☞ Your investments are held to your order with one of the safest banks in the world

### Example Asset Allocation for a Pension Fund Client



### Cutting Risk. Cutting Cost. Keeping it Simple.

Evercore Pan-Asset believes in **Keeping it Simple**. We say, don't take the risk of individual stocks, buy the index. That way you can keep costs down and avoid taking too big a bet on a share which lets you down. Remember what you are trying to achieve and just pick the degree of risk and income you need. We can do the rest.

You cannot avoid having an asset allocation. Everyday markets trade a portfolio has to stand up to the market test. So why not have someone watching it every day, making changes when necessary? That's **Big Picture Investing** - concentrating on the decisions that make a real difference.



**Guy Davies** was until recently Head of Charities at Barclays Wealth in London. After a commission in the Army he began his career in investment management at Barclays Private Bank in 1994, followed by roles as private client and charities Director at UBS Warburg, Lazard and Barings. He is a Trustee and Investment Committee member of the Army Benevolent Fund and Army Central Fund.



**Jane Bransgrove** worked as an investment manager at Sarasin Chiswell (formerly Cantrade) for over 13 years with responsibility for private clients, charities and investment strategy implementation. She is an Associate member of the CFA Society of the UK and holds a degree in Accounting and Financial Management from Loughborough University.



**Lynn Hutchinson** joined Cantrade in 1992 which subsequently became Sarasin Chiswell. She was responsible for the investment administration of pension funds, corporate, private client and charity portfolios, including reporting, dealing and investment strategy implementation. She holds the Investment Management Certificate qualification.

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### Our Investment Approach

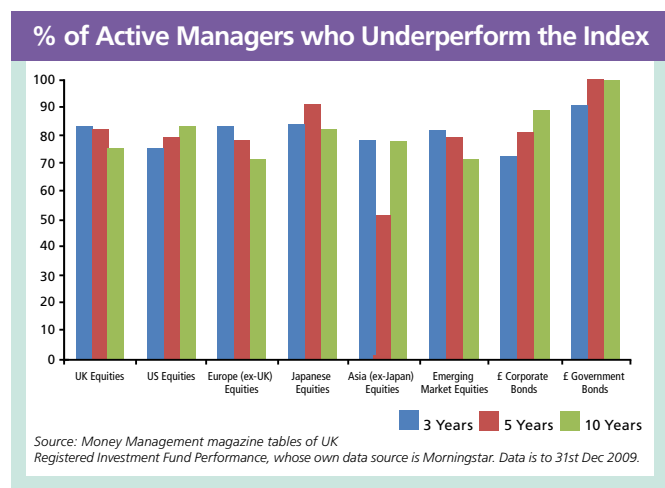
Getting the big decisions right determines how much your clients make on their money. We take asset allocation decisions to choose whether to be in cash or property, equities or government bonds, or in a mixture. So many asset managers charge investors for trying to choose the right shares but on average stock-picking managers do less well than just buying all the shares in the Index.

We concentrate on the big picture and take long-term views about the likely performance of an asset. We move more into cash if there is substantial economic and market disruption. If an asset class becomes unattractive we will sell it and if we cannot find enough attractive assets to buy because markets are difficult we will temporarily hold cash instead to avoid losses and preserve capital.

Our investment universe covers over 30 asset classes across all geographic regions. The asset allocation team constantly monitor each asset class to find the best investment opportunities around the world.

### The Case for Index Tracking rather than Active Stock Picking

-  An index represents the overall performance of all investors (active and passive) operating in a market.
-  On average, investors will achieve performance lower than the index due to trading expenses and other cost & fees.
-  Successful index managers track the index very closely before costs and charge substantially lower fees than active managers.
-  Therefore, index funds should outperform the average of all active managers, in both bull and bear markets.
-  For a majority of investors, active management is a triumph of hope over experience.



### About Evercore Pan Asset

Evercore Pan Asset was founded in 2007 with the aim of providing a new and different approach to investment management. Following a development capital partnership struck in 2008, the company is now 50% owned by Evercore Partners, a leading US-listed investment firm which manages over \$15bn of client assets. The team has extensive knowledge of dealing with the particular issues which face charities and have over 50 years aggregate experience in the investment industry. This transaction provides Evercore Pan-Asset with an extremely strong balance sheet and allows it to take full advantage of the major growth opportunity for its innovative investment management process.

We would be delighted to come to see you and discuss how we could help. We think we can provide you with the advice you need at a price the fund can afford, and can work with you to enhance returns and to reduce risks in periods of difficulty.

For further information please contact Christopher Aldous by email at [Christopher.Aldous@pan-asset.co.uk](mailto:Christopher.Aldous@pan-asset.co.uk) or on 020 7340 9290

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