Group Pension Managed Funds Update to 30th September 2008

Summary

Financial markets went into freefall during September, as the fallout from the credit crunch escalated. As a result, Irish pension managed funds fell by 8.3% on average, the worst monthly decline in over 10 years. Eagle Star was the best performing manager over the month with a return of -6.7%. Hibernian Investment Managers delivered the worst performance over the month, with a return of -9.5%. The third quarter of 2008 saw managed funds decline by 8.8% on average. So far this year, pension funds have declined a worrying 22.2% on average. Irish pension funds have now lost over a quarter of their value (25.3%) over the past twelve months.

The average managed fund has shown an extremely disappointing return of -3.6% per annum over the past three years. The five year returns to the end of September are little better, with the average managed fund delivering a return of just 4.0% per annum over this period. Irish group pension managed fund returns over the past ten years have been a disappointing 3.2% per annum on average, well below the Irish inflation rate of 3.8% per annum over the same time horizon. Indeed, of the managers surveyed, only Merrion Investment Managers (formerly Oppenheim) outperformed inflation over this period.

In spite of recent declines, it is important, when considering these returns, to remember that the investment horizon of most pension schemes is generally over 25 years, and that equities have historically provided significantly higher returns over the long-term than bonds, property or cash, although at the cost of greater volatility.

Defined Contribution Schemes and the Default Option

It is worth noting that members of defined benefit schemes and younger members of defined contribution schemes should not get overly worried about short or medium term declines in equity markets. However, older members of defined contribution schemes need to ensure that they adopt a lower risk investment strategy as they approach retirement age.

Many defined contribution pension schemes choose a managed fund (which may be actively or passively managed) as their default option. This can lead to an unwelcome level of volatility for older members as they approach retirement. We suggest that trustees of defined contribution schemes consider adopting a "lifestyle" strategy as their default option. Typically, with such a strategy, members in the default option are automatically moved out of equities, and into a combination of bonds and cash, on a gradual basis over the ten years before they retire. As a result, older members are insulated from equity market volatility as their investment horizon shortens.

To illustrate the impact that exposure to equity market volatility can have on a member's ultimate fund value, consider two members of a defined contribution scheme with identical savings histories; one who retires on 1 October 2007 and one who retires on 1 October 2008. If both members had been invested in the average managed fund over the ten years prior to their retirement, the first would have earned 7.1% per annum during this period, while the second would have earned just 3.2% per annum, a difference of 3.9% per annum. However, if both members had been following a typical lifestyle strategy, then the first member would have earned 5.4% per annum over the ten years prior to retirement, while the second would have earned 5.1% per annum, a difference of just 0.3% per annum. Furthermore, volatility over the ten years would have been between 13% and 17% for members investing in the average managed fund, but just 8% to 9% for those following a lifestyle strategy.

In monetary terms, if we assume that both members had €100,000 accumulated in their pension fund 10 years prior to retirement and each contributed a further €5,000 per annum over the next ten years, the outcomes that could be expected at 1 October 2007 and 1 October 2008 are shown in the table below:

Investment Strategy 10 Years prior to Retirement	Fund Value at Retirement		Difference
	Retiring 1 October 2007	Retiring 1 October 2008	
Average Managed Fund	€273,000	€190,000	€83,000
Lifestyle Strategy	€230,000	€225,000	€ 5,000

We can see from this table that members in a lifestyle strategy can expect to achieve fairly consistent fund values, regardless of when they retire. However, members invested in the average managed fund will find themselves exposed to a greater level of uncertainty regarding their fund values at retirement. While the average managed fund may deliver a higher value than the lifestyle strategy, as in the 2007 example, there is also a risk that the fund value will be lower, as in the 2008 example. While younger members can afford to wait out volatile equity markets, older members do not have this luxury as they must purchase a pension and/or take their tax-free cash lump sum on the date of their retirement, regardless of the state of investment markets at that time.

Tables

1. Group Pension Managed Fund Returns to 30th September 2008

	1 Month %	3 Months %	9 Months %	1 Year %	3 Years % p.a.	5 Years % p.a.	10 Years % p.a.
AIB Investment Managers	-8.0	-8.6	-22.2	-24.5	-1.7	5.0	2.7
Bank of Ireland Asset Management	-7.3	-7.5	-20.8	-25.0	-5.4	2.1	3.6
Canada Life/Setanta	-6.9	-5.0	-17.6	-20.4	-3.1	4.6	3.7
Eagle Star	-6.7	-6.7	-19.5	-21.8	-1.1	6.1	3.6
Friends First/F&C	-9.4	-9.9	-25.6	-28.5	-4.8	3.0	2.4
Hibernian Investment Managers	-9.5	-10.3	-24.8	-27.6	-4.0	3.6	2.8
Irish Life Investment Managers	-9.0	-10.7	-24.4	-27.7	-4.5	4.0	3.4
KBC Asset Management	-9.1	-10.2	-24.5	-28.3	-4.9	2.5	1.6
Merrion Investment Managers*	-9.2	-9.1	-20.7	-22.7	-2.8	4.4	5.2
Standard Life Investments	-8.4	-9.9	-22.2	-26.5	-3.3	4.3	2.5
Average	*-8.3*	*-8.8*	*-22.2*	*-25.3*	*-3.6*	*4.0*	*3.2*

(*Please note that with effect from 1 October 2008, Oppenheim Investment Managers has been renamed Merrion Investment Managers)

2. Equity Market Index Returns to 30th September 2008

Region	1 Month %		3 Months %		9 Months %	
	Local Ccy	*Euro*	*Local Ccy*	*Euro*	*Local Ccy*	*Euro*
Ireland	-20.7	-20.7	-31.2	-31.2	-47.2	-47.2
UK	-12.8	-10.6	-11.7	-11.3	-21.5	-26.8
North America	-9.1	-4.8	-8.8	1.9	-18.3	-15.5
Eurozone	-11.1	-11.1	-11.4	-11.4	-29.2	-29.2
Rest of Europe	-10.7	-10.2	-9.0	-8.8	-22.6	-21.0
Japan	-12.9	-6.7	-17.3	-7.3	-25.5	-18.4
Pacific Basin	-11.6	-12.3	-16.3	-16.0	-28.8	-32.1

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