Quarterly Investment Briefing
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First Actuarial LLP

Discussion topic – Investment Opportunities from Brexit

The only thing we can be certain about when it comes to the result of June's referendum that it is uncertain. However, uncertainty is not necessarily a bad thing. Indeed it may provide opportunities for pension schemes to lock into an improved funding position.

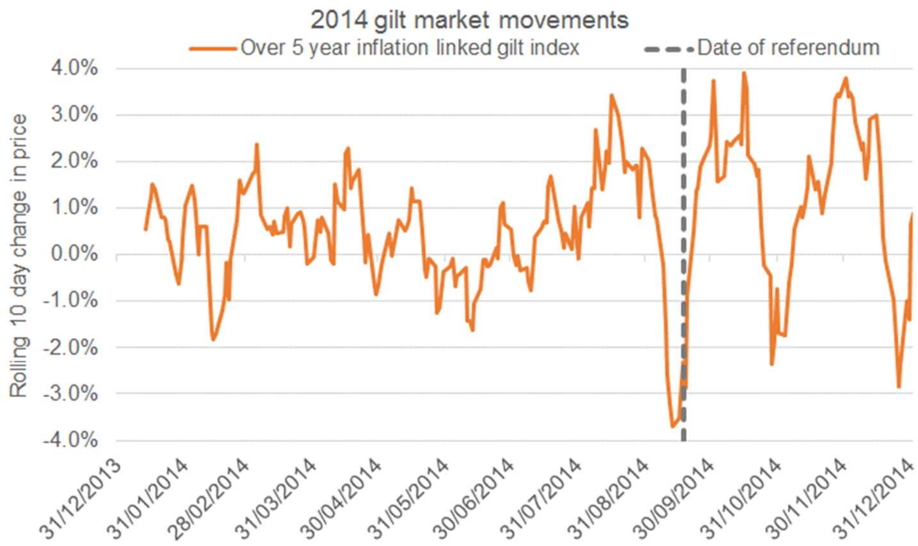
Particular areas to monitor are gilt and currency markets and we only have to look back to September 2014 to see why.

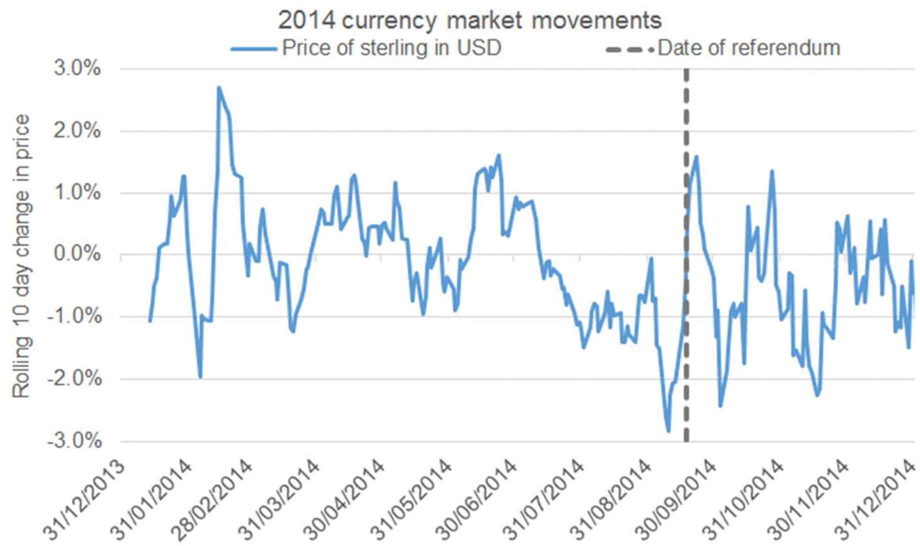
Lessons from the Scottish referendum

The Scottish referendum provided a clear opportunity to buy gilts at a lower price. This can be seen from the orange line on the chart opposite. With polling suggesting a very close result there was a great deal of uncertainty about the future of the UK in the run up to the referendum – something that could easily be repeated on a more dramatic scale in June.

The result was that the price of gilts fell significantly. The 4% fall in the fortnight running up the referendum was the largest fall in gilt pricing seen during 2014. Following the result, gilt prices quickly returned to their previous levels.

Sterling followed a similar pattern, as can be seen in the blue line in the chart opposite. Sterling weakened significantly relative to the US dollar during the period of uncertainty and, whilst this was bad news for a US investor in sterling denominated assets, it was good news for the UK investor with US denominated assets. The currency fluctuations associated with such periods of uncertainty could lead to material improvements in the funding positions of many UK pension schemes.





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How this might be relevant to your pension scheme?

Pension scheme investment should of course be a long term endeavour and trustees and sponsors shouldn't be overly concerned about short term volatility and positioning; where short term tactical positions are taken, these are best delegated to a fund manager*.

However, where pension schemes are closed to new accrual and/or entrants it is natural to think about the end-point. Whilst for some pension schemes it is appropriate to rely on the support of the sponsor until the last benefit has been paid, most trustees (and sponsors!) would consider it preferable not to do so. As such, many pension schemes have a long term plan in place to either "buy out" (pass their assets and liabilities to an insurer) or become "self-sufficient" (invest their assets in a low risk manner and thereby attempt to avoid additional funding being required).

It is likely that such a plan would include de-risking of the investment strategy over time (through currency risk being removed and interest rate or inflation protection being gained through purchasing gilts or LDI funds). ***The referendum, and the volatility it may cause in markets, could allow pension schemes to de-risk more quickly and lock in some short term funding gains relative to their long term plan.***

How this can be done?

Completion of the following four steps will allow a pension scheme to lock in future short term funding gains.

1. Consider what the long term funding objective is and over what timeframe this can be achieved; without this it is impossible to assess whether a pension scheme is ahead of its long term plan.

2. Consider how the investment strategy will be de-risked over time if things go broadly in line with expectations.

3. Put in place the building blocks of the future de-risked investment strategy: de-risking can then be achieved quickly by changing the weighting to the building blocks.

4. Regularly monitor progress against this plan and set-some triggers for de-risking more quickly if things go well.

Depending where your scheme is in relation to this process it may be possible to capture any funding gains that the referendum brings in June.

* *Your pension scheme may already delegate the ability to take asset allocation and currency positions to a fund manager through investment in a Diversified Growth or Absolute Return style fund.*

Small print

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