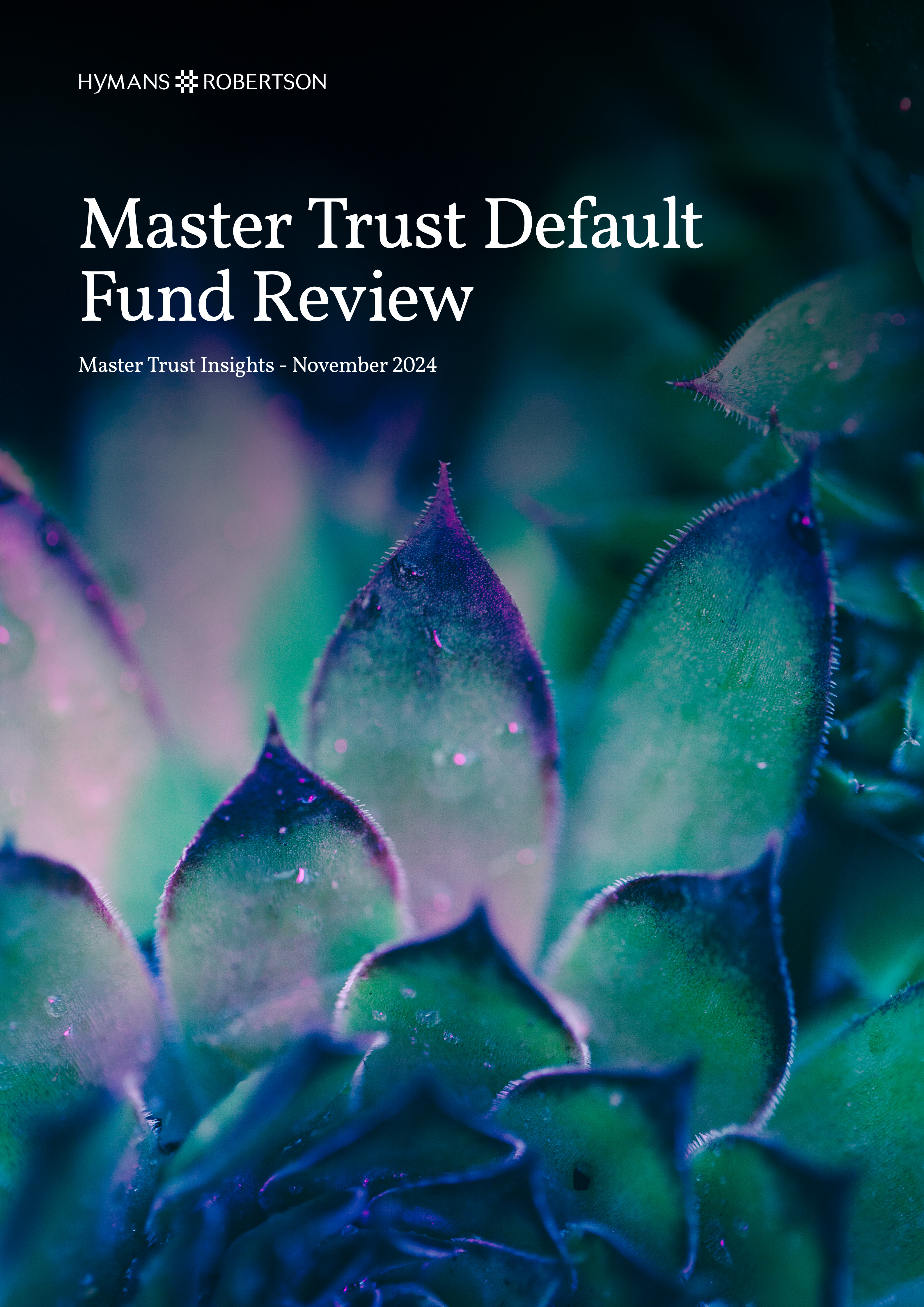

Master Trust Default Fund Review

Master Trust Insights - November 2024

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Focusing on member outcomes

Welcome to the latest edition of our Master Trust Insights, in which we assess the impact of Master Trust default fund performance on member outcomes.

We expect the trend of schemes switching to Master Trust to continue, and possibly at an increased pace, over the next few years. This will place even greater emphasis on the effective monitoring and comparison of providers. While recent fund performance is clearly an important factor in that endeavour, we believe it must be considered in the context of longer-term member outcomes.

Our Master Trust Insights report provides a forward-looking assessment by examining how recent market events and fund performance have impacted outcomes for different members. In simple terms, and from the perspective of most Master Trust members, who invest in the default fund, we answer the question: "What does this mean for me?"

Tracking outcomes

The following charts are from our Member Outcomes Tracker and show how the expected retirement fund value for three sample members has changed over the last five years since 30 June 2019.

We have used various assumptions to estimate the change in expected fund values for each sample member and therefore the changes shown are not guaranteed. Furthermore, the use of different assumptions is likely to lead to different results.

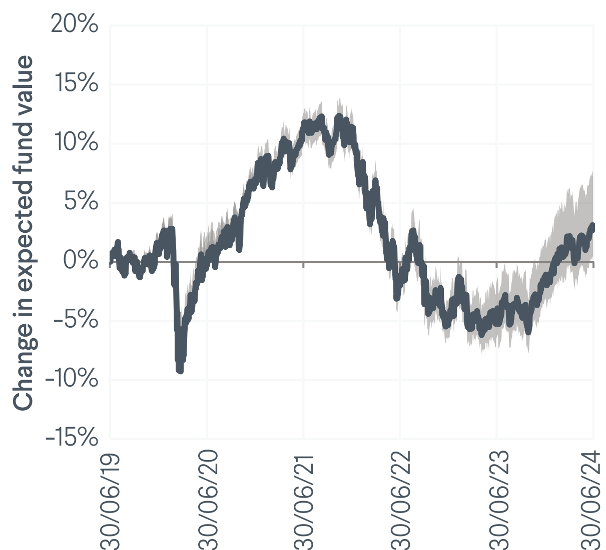
In each chart, the solid line is based on the average Master Trust investment strategy, which we've estimated based on the strategies of the providers sampled. The shaded regions show the potential range of changes to expected fund value for similar members invested in different provider default strategies.

Jasmine is currently 30 years from retirement, in the early part of her savings journey and has a modest level of savings. At this point, she is most concerned about making ends meet and does not view her pension as a significant priority.

Over the last year, Jasmine has seen a material improvement in her expected fund value at retirement, as a result of strong returns in equity markets, which will make up the majority of Jasmine's asset allocation at this stage of her investment journey.

Given Jasmine is a long way away from retirement, she has time on her side and is in a good position to recover from any future market downturns. However, it's important she maintains or aims to maximise her pension contributions to continue to grow her pot over the long term.

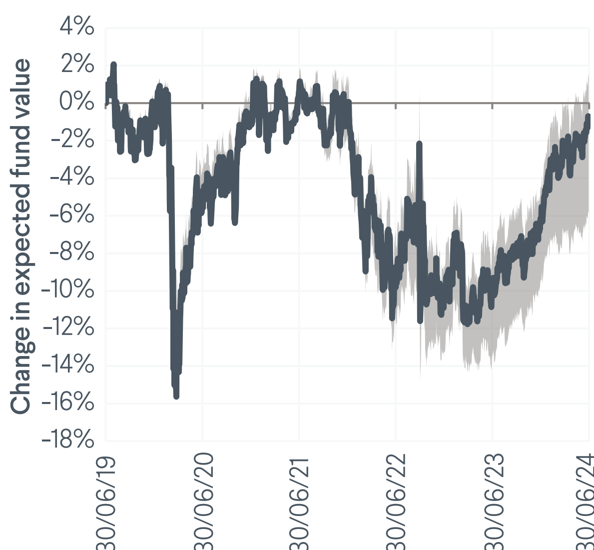
Our view is that during the growth phase, a strategy should maximise the return potential given how long members are invested until retirement.



Louise is 10 years from retirement. She has a reasonably sized fund and is starting to think about her retirement choices.

Members like Louise, who were negatively impacted by volatility within bond markets throughout 2022, have since experienced a recovery in their expected retirement outcomes. They've benefitted from strong returns in both equity markets and falling yields, which support positive returns for bonds.

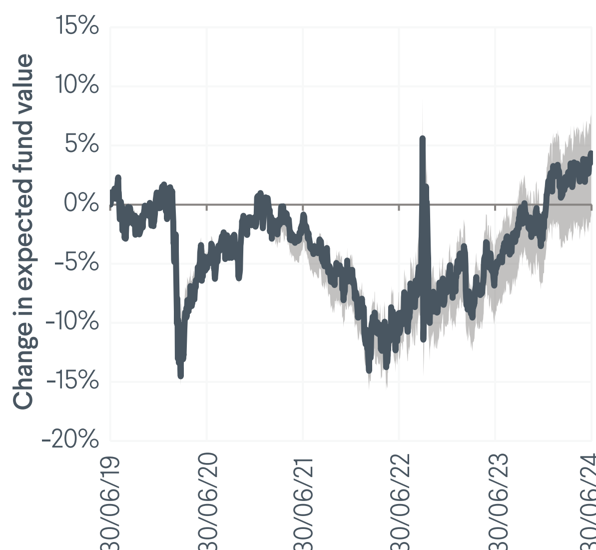
It's important Louise understands the risks associated with her current investment strategy; any subsequent market falls associated with a prolonged recession could have a significant impact on her pension and the amount of income she is likely to retire with. Over the next 10 years, Louise's investment strategy will shift in focus towards assets focused on downside protection, to de-risk towards retirement.



David is part of the "Baby Boomer" generation and plans to retire in 5 years. Certainty of his pension value is important as he plans to travel in the early years of his retirement.

Like Louise, David's expected fund value at retirement has risen in recent months due to strong returns within both equity and bond markets, having largely recovered from the bond market volatility throughout 2022. David's investment strategy will have a more defensive asset allocation and a greater focus on downside protection than Louise's, given he is 5 years closer to his retirement.

David must be invested in a manner that protects his pension while helping him meet his retirement goals.



What is appropriate at different stages of DC investing?

Growth
Take on more investment risk for the prospect of higher returns. Short term risk mitigation is of dubious value.

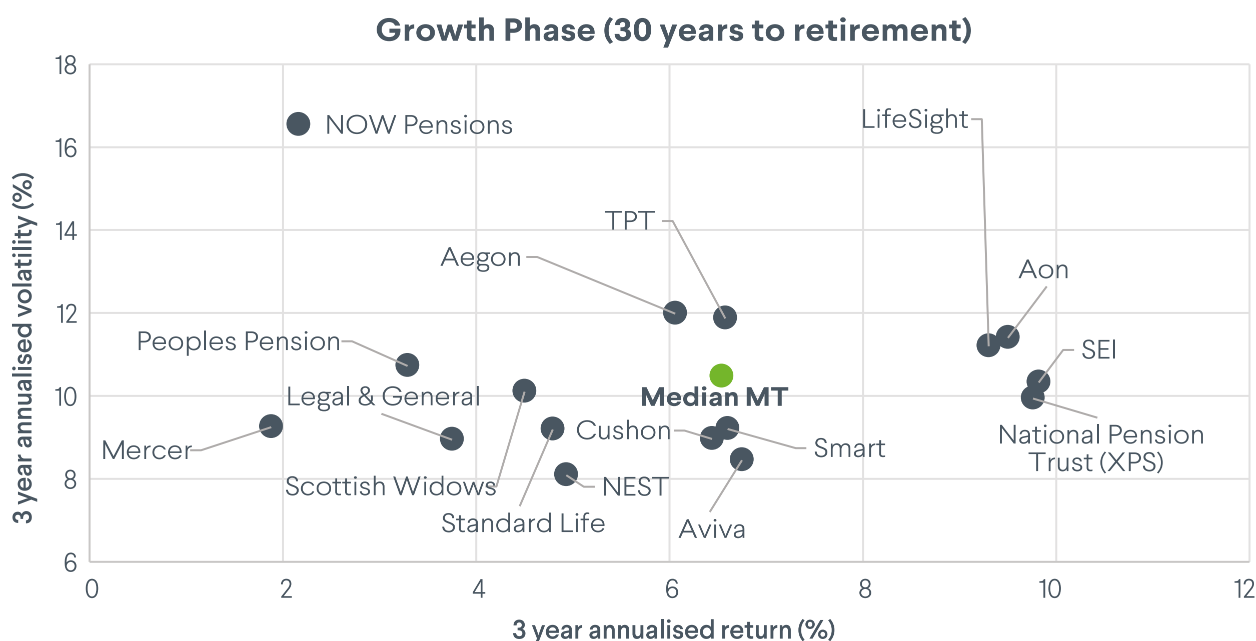
Consolidation
Balance risk reduction and aligning strategy with retirement goals.

Pre-retirement
There is a need to move away from "one size fits all" defaults and understand what members plan to do with their savings.

In the next section, we compare provider performance in the 3 years to 30 June 2024 and its impact on member outcomes in each phase.

Growth phase

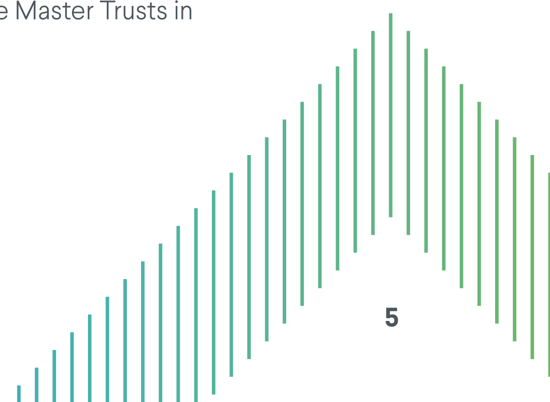
Over the last 3 years, members in the growth phase have experienced positive, but varying, levels of performance. Depending on their provider, otherwise similar members could have faced differences in return of up to 8% pa. In general, members in strategies with a higher allocation to equities during this stage have fared better due to stronger returns in equity markets over the period.



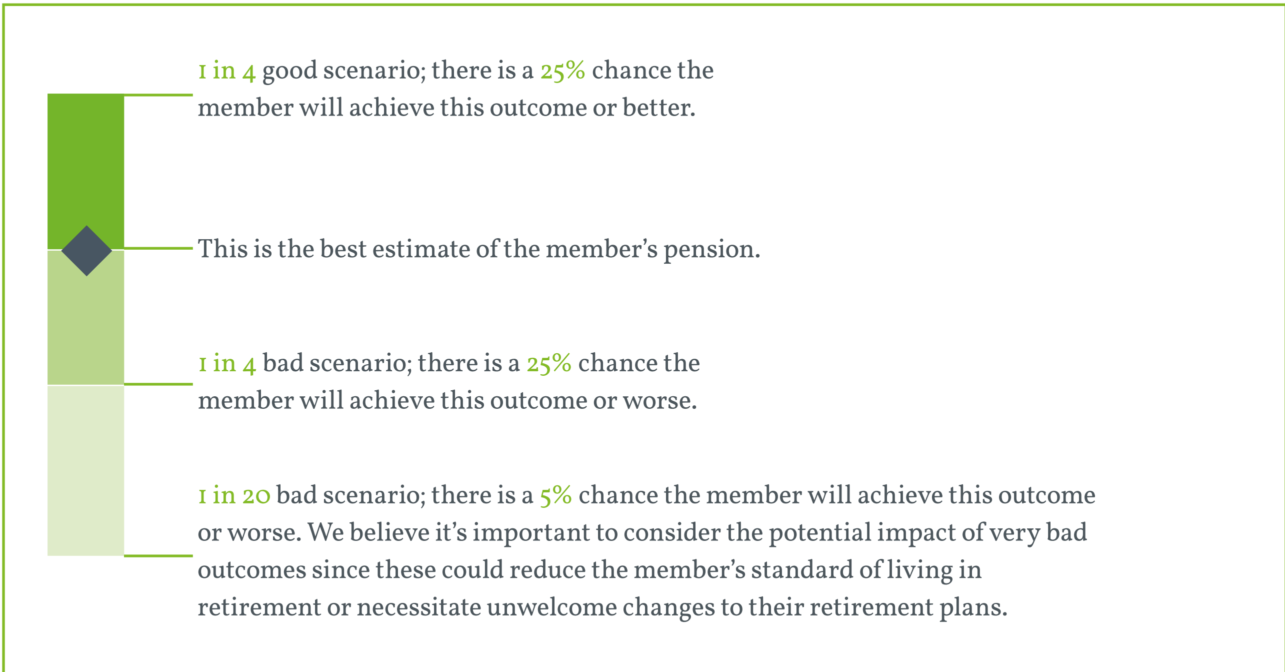
1. Chart is based on net performance and volatility to 30 June 2024, supplied by the providers and relates to their default lifestyle option. Please note that the performance figures are actual performance, except for those from Cushon which are based on a static allocation. Fidelity is not included in the performance charts due to their default lifestyle only recently having been launched.

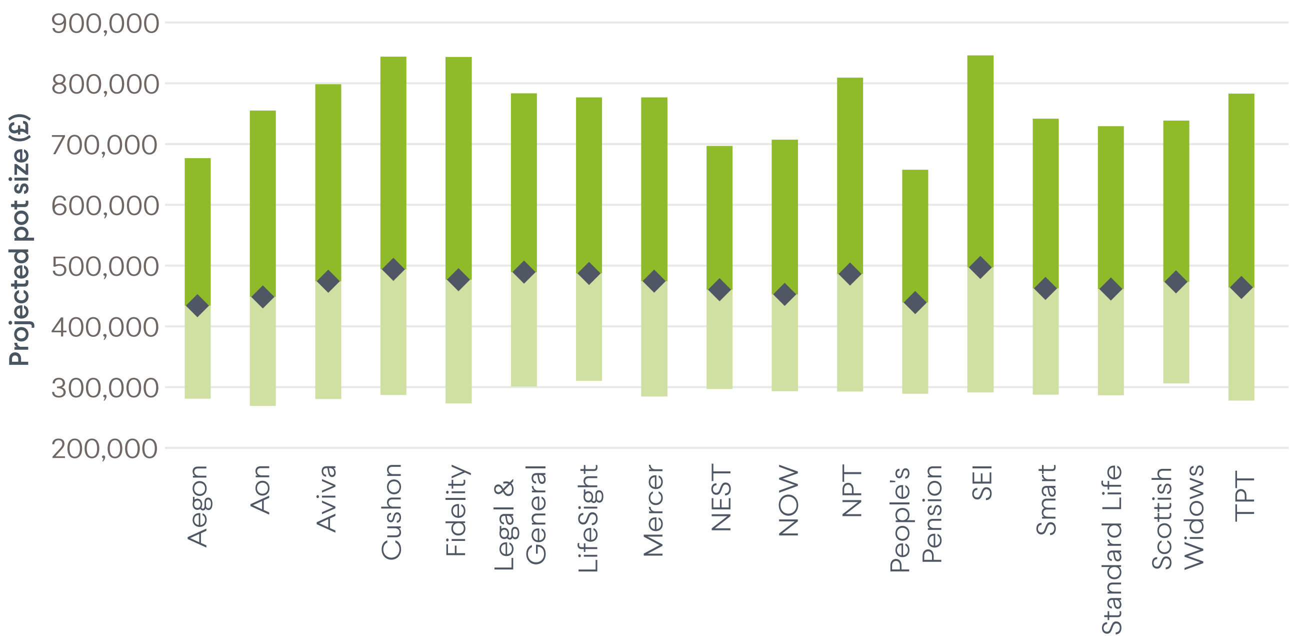
In the growth phase, members are a long way from retirement, and we believe short-term risk mitigation through diversification of asset classes or active asset allocation is of questionable value. Cautious investment strategies may show relative outperformance during periods of market stress, but it's unlikely such outperformance will persist and lead to better member outcomes (versus higher volatility approaches) over the longer term.

Also, lower volatility strategies are unlikely to achieve significantly better downside protection over longer time horizons. To illustrate this point, we've projected the range of potential pension outcomes for growth phase members of the Master Trusts in our sample.



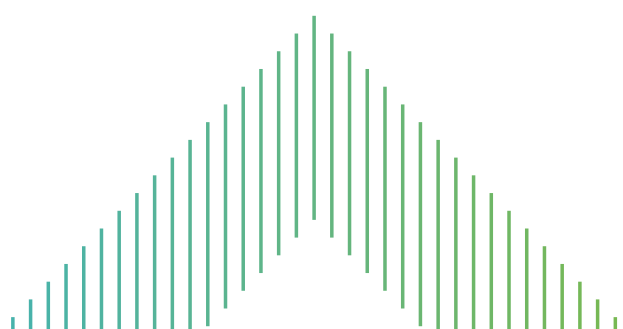
Illustrating uncertainty in outcomes





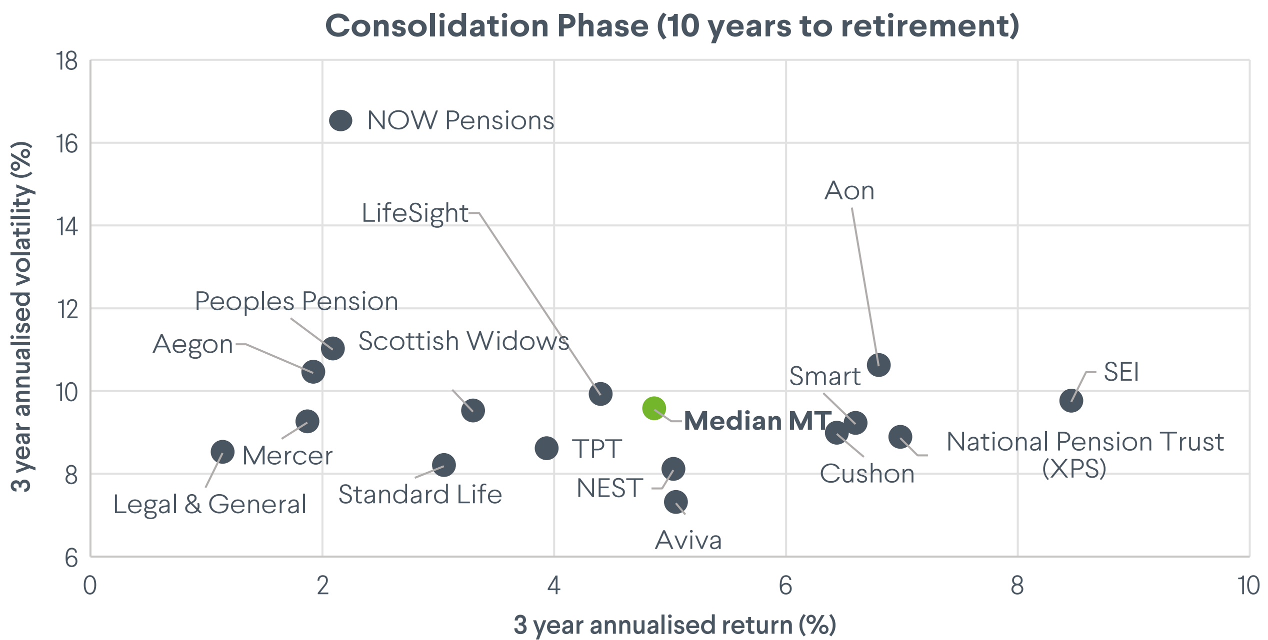
1. Projections are based on a member 30 years from retirement on 30 June 2024, with a starting fund value of £50k, earning £30k pa and with a total contribution rate of 10% pa.

The chart shows downside outcomes are similar across the providers, but there is greater upside potential for higher-risk strategies.

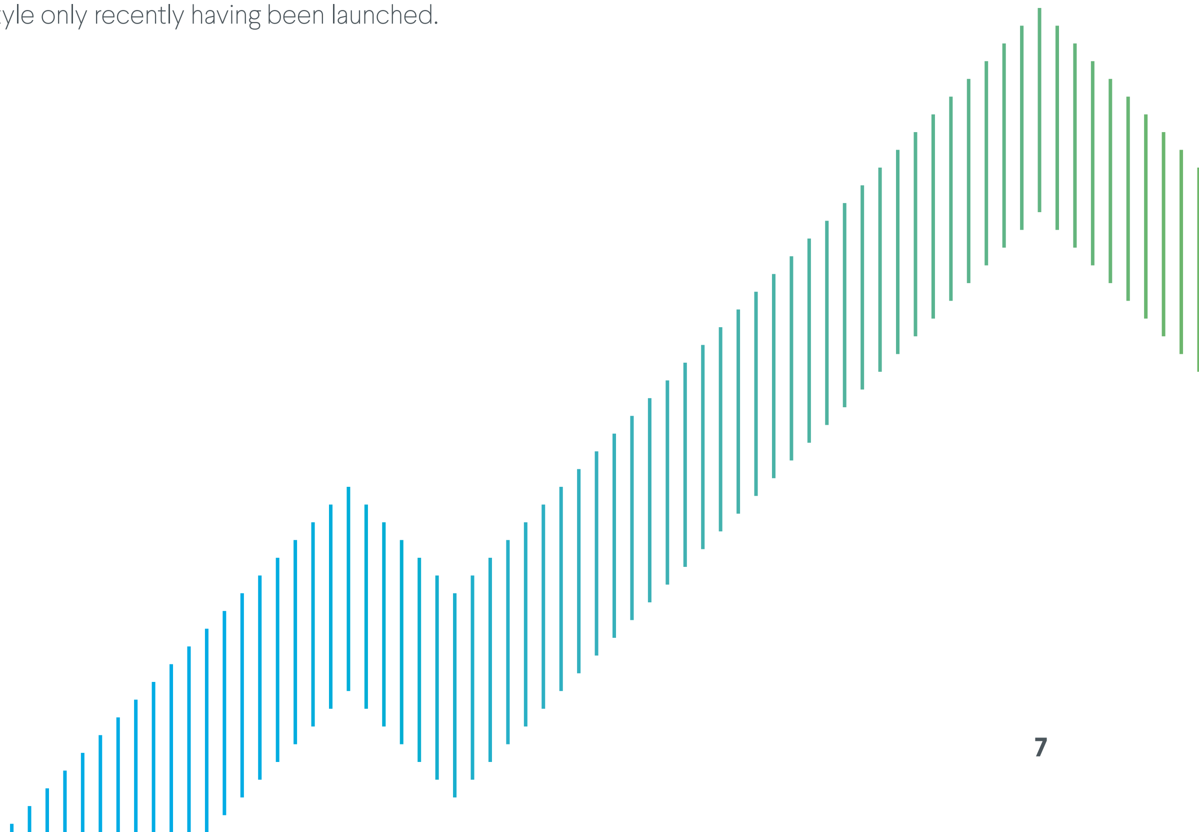


Consolidation phase

Most providers have returned in the region of 1-8% pa for consolidation phase members over the period shown. At this stage, providers invest in different levels of growth assets, as evidenced by the range of returns and volatilities in the chart.

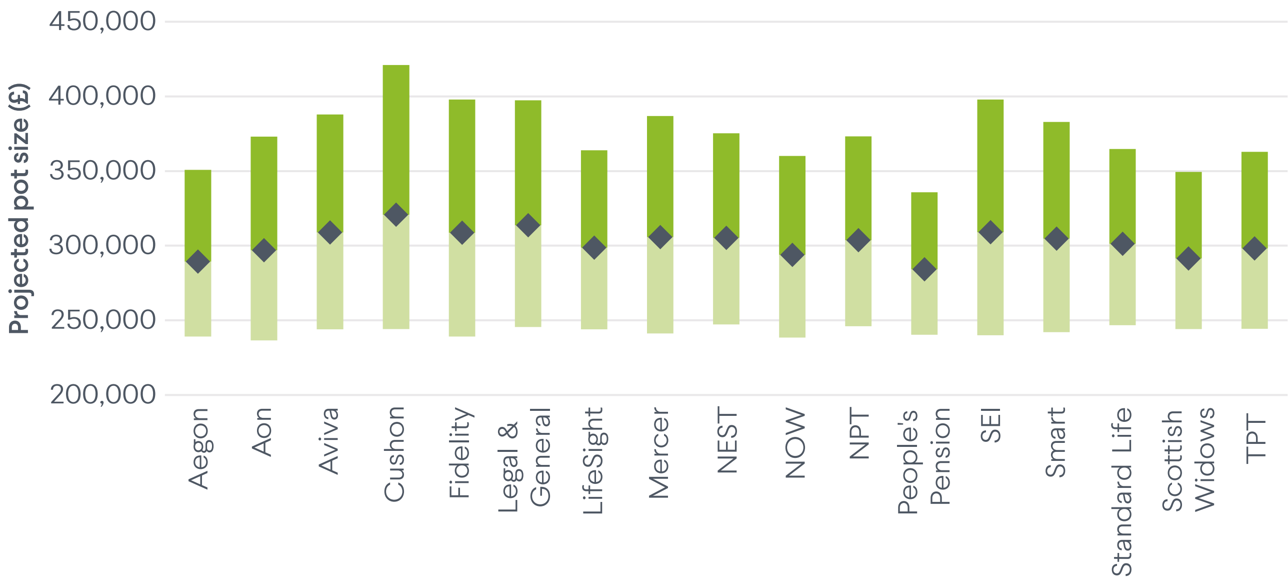


1. Chart is based on net performance and volatility to 30 June 2024, supplied by the providers and relates to their default lifestyle option. Please note that the performance figures are actual performance, except for those from Cushon which are based on a static allocation. Fidelity is not included in the performance charts due to their default lifestyle only recently having been launched.



At 10 years to retirement, there's likely to have been or begin to be a shift in focus towards downside protection as assets begin to de-risk towards retirement, although any change in strategy should be consistent with the member's plans for their DC pot. For members likely to take cash at retirement, risk reduction makes sense. However, those who can rely on other sources of income, such as a DB pension, may wish to maintain a higher-risk strategy for longer.

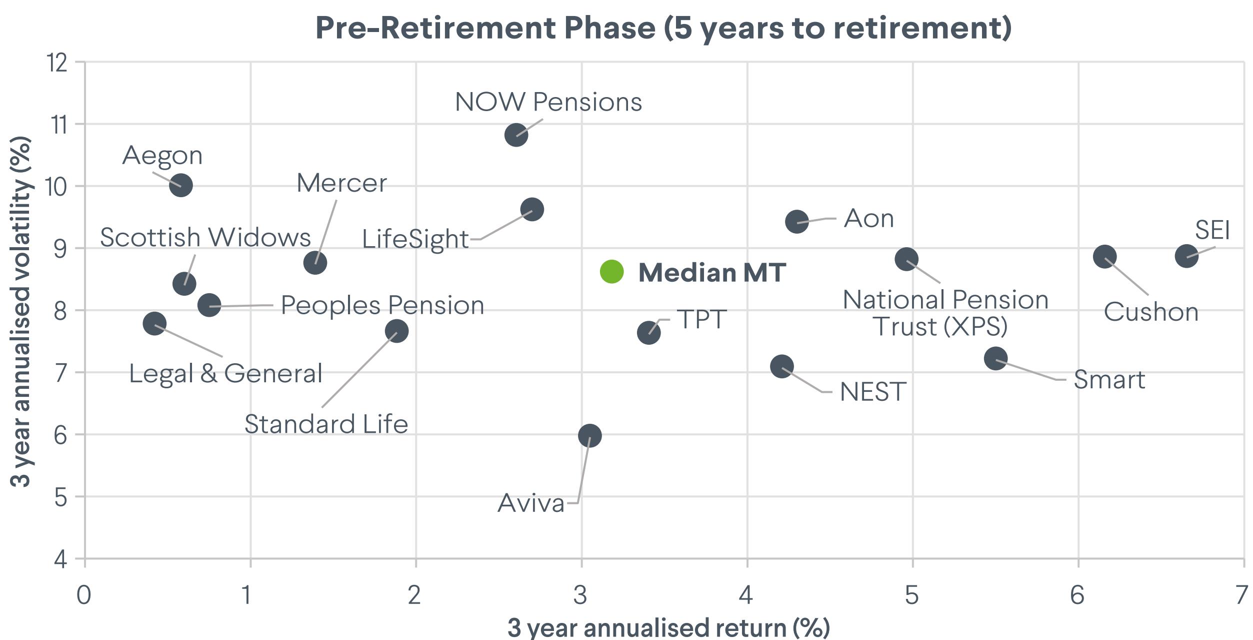
Our projections show the level of uncertainty in member outcomes (indicated by the length of each bar) varies significantly across providers during the consolidation phase. At this stage, while riskier strategies may offer higher expected returns, they could leave members vulnerable to market shocks in their run-up to retirement.



1. Projections are based on a member 10 years from retirement on 30 June 2024, with a starting fund value of £150k, earning £50k pa and with a total contribution rate of 10% pa.

Pre-retirement phase

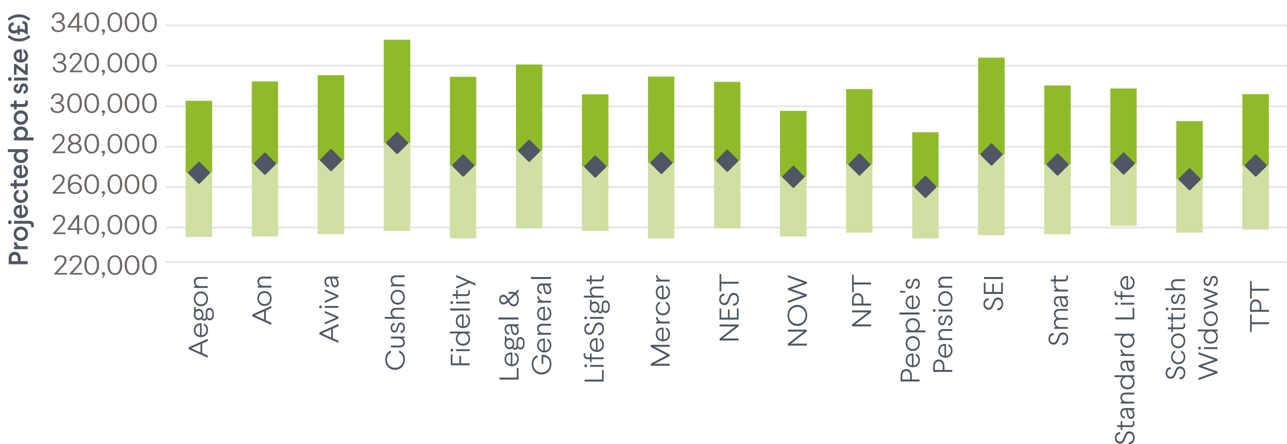
As with the consolidation phase, differences in investment strategies during the pre-retirement phase are evident, with a wide dispersion of default fund performance and risk across providers. Provider's return ranges from 0-7% pa, with different levels of investment in growth assets during this phase evidenced by the range of volatilities in the chart.



1. Chart is based on net performance and volatility to 30 June 2024, supplied by the providers and relates to their default lifestyle option. Please note that the performance figures are actual performance, except for those from Cushon which are based on a static allocation. Fidelity is not included in the performance charts due to their default lifestyle only recently having been launched.

Investment strategy in this phase should be aligned to members' likely decisions at retirement. In the short term, reducing risk will be the norm given most members withdraw their DC pot as cash. However, as DC pot sizes are expected to become larger over time, there will be a growing requirement for pre-retirement strategies with higher levels of risk as members opt for drawdown at retirement. Strategies targeting drawdown will still need to generate growth at retirement. They must address the need for income and certainty, given members' ability to earn additional income in retirement is diminished should markets fall.

Again, our projections illustrate a range of investment approaches being implemented by providers. While the shorter horizon and more conservative investment strategies mean the range of potential member outcomes is generally narrower than in other phases, there is evidence that members in this phase are assuming very different levels of risk.



1. Projections are based on a member 5 years from retirement on 30 June 2024, with a starting fund value of £200k, earning £55k pa and with a total contribution rate of 10% pa.

Post retirement glidepaths

Greater focus is being placed on decumulation strategies within DC schemes, with more sophistication of in-retirement investment strategies being developed to provide members with a true "to and through" investment solution. At present, there are a limited number of Master Trusts that automatically move members into post-retirement glidepaths, with the majority having static asset allocations upon reaching the point of retirement, relying on member engagement to make active decisions and opt into suitable retirement solutions. Where there is a need for members to engage and make choices, alternative investment strategies post-retirement are available to opt into eg investment pathways.

We've summarised the default post-retirement glidepaths for each provider in the table below to demonstrate the differences in approach. With a range of approaches out there, it's important to assess the post-retirement glidepaths of your provider and its suitability for your members.

Provider	Post Retirement Glidepath?
Aegon	Static TDF
Aon	TDF with Post-Retirement Glidepath
Aviva	Static Lifestyle
Cushon	Static Lifestyle
Fidelity	Static TDF
L&G	TDF with Post-Retirement Glidepath is dependent on a members' term to retirement.
LifeSight	Static Lifestyle
Mercer	Static TDF
NEST	Static TDF, eligible members are moved into Nest Guided Retirement Fund
NOW Pensions	Not available
NPT	Static Lifestyle
People's Pension	Static Lifestyle
Scottish Widows	Static Lifestyle
SEI	Lifestyle with Post-Retirement Glidepath
Smart	Static Lifestyle
Standard Life	Static Lifestyle
TPT	TDF with Post-Retirement Glidepath

What do these approaches mean?

Strategy	Static	Post Retirement Glidepath
Target Date Fund (TDF)	A TDF is a strategy where members are invested in a single investment fund designed with a specific retirement date in mind (ie the "target date"). The fund's asset allocation changes over time but becomes fixed at the target retirement date, with no further de-risking continuing beyond this point.	A TDF where the asset allocation continues to de-risk after the target retirement date, continuing to switch members' assets from riskier assets (ie equities) into more defensive assets (ie bonds).
Lifestyle	A lifestyle strategy follows a pre-set glidepath, gradually switching member's assets from riskier funds (ie equity funds) into more defensive funds (ie bond funds) as they approach their selected retirement age. Unlike TDFs, lifestyle strategies involve switching between several investment funds, as appose to being invested in one single fund. Once members reach retirement, the asset allocation remains fixed.	A lifestyle strategy where de-risking continues beyond a member's selected retirement age, continuing to switch members' assets from riskier funds (ie equity funds) into more defensive funds (ie bond funds).

Closing words

Overall, our analysis indicates that member outcomes have improved since 2022, particularly for older members affected by the gilt market volatility. Since the beginning of 2023, members across all stages of the glidepath have benefited from more favourable market conditions; amidst falling inflation, higher than expected global growth forecasts, and falling yields.

Returns have been particularly strong within equity markets, with the technology sector continuing to drive global performance. Stocks associated with AI have maintained their outperformance, benefiting younger members over the period due to their higher equity allocation.

Looking forward, we anticipate further developments in provider defaults with the introduction of private market assets in strategies. While some providers are looking to incorporate a modest (<5%) allocation to private assets within their main default, the broader trend we expect from providers is the launch of additional 'premium' defaults at a higher cost point. These options include a more material allocation to private assets (c.10-15%), for those employers that are willing to embrace the value over cost shift.

In addition, greater focus is also being placed on decumulation strategies within DC schemes, with more sophistication of in-retirement investment strategies looking to provide members with a true "to and through" investment solution.

Please contact us or your usual Hymans Robertson consultant for further information on this publication.

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The Member Outcomes Tracker is based on a number of assumptions. Pension outcomes for actual members may differ from the persona outcomes for a number of reasons, including but not limited to, differences between the persona profiles and actual member characteristics, differences between projected changes in markets and actual future changes in markets, changes in market indices being different to changes in the value of members' fund amounts, members choosing to convert their savings to income in different ways, and members changing contribution rates, retirement age or investment strategy between now and their retirement date.

Please note the value of investments, and income from them, may fall as well as rise. This includes but is not limited to equities, government or corporate bonds, derivatives and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets.

Exchange rates may also affect the value of investments. As a result, an investor may not get back the full amount of the original investment. Past performance is not necessarily a guide to future performance.